

Weekly Commentary 41 – Oct 2022

What's Next for the British Empire of the 21st Century?

Kwasi Kwarteng – sacked. Many of us in the financial industry saw it coming... It was an easy call.

To predict three weeks ago that Kwasi Kwarteng cannot survive the massive failure of his “mini-budget” and get it correct, is no big deal. Right on that very same day, the financial markets had already voted down the headline feature in that intended policy – a tax cut for the highest income bracket in British society. It led immediately to a crippling crash of the British bond market and simultaneously the Pound. He was sacked just three weeks later. This is the shortest term for a Chancellor of the Exchequer in 200 years, except for another one who died soon after assuming the post.

By any criteria, that's a bloody fxxk-up.

For somebody who wants to be the top guy in government responsible for economic policy, Kwarteng did not even demonstrate the skills needed to read the political winds right. What doomed him was his intellectual arrogance, thinking that those who opposed him, including the most senior civil servant in his ministry, are not smart enough to understand his ideological affinity for lower taxes and fewer regulations to drive growth.

And he was incapable of understanding the immediate criticisms that were levelled at his policies, including from the IMF. Never admitting that he was wrong, and only thinking he needed to communicate his plan better, he was never really repentant. The final signal that he was too obstinate to be saved was his attempt to put the blame for the turmoil in the markets on Andrew Bailey, head of the Bank of England who put a band-aid on the fatal wound he slashed on the national wrist.

The second indication of how a political team have no clue how the real world works, and were only concerned with abstract ideology, was the fact that they did not even know that the execution of the mini-budget would trigger a collapse of the pension industry which is highly leveraged in the gilt market. Unfunded public expenditures would require huge amounts of borrowing and which would have increased the cost of borrowing ie fall in gilt prices, and that would have caused massive margin calls, which if unmet, would cause the pension industry to buckle and break. Imagine what a crisis that would have been. That didn't happen only because the BoE, which saw through the stupidity of the mini-budget and knew it was the same as national suicide by wrist-slashing, rushed in to stem the haemorrhage. If not for the stalwarts there, it would not be just Kwarteng and Truss who would be in trouble. The whole country would have sunk. This is the state of the British Empire in the 21st Century

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I mean, for people in such high positions of power, getting ready to embark on an economic crusade which would obviously have a big impact on government budgeting and higher borrowing costs, NOT knowing that there would be these structural issues which must be taken care of first before they launch the mini-budget, is an abominable dereliction of duty. If you ask me, sacking Kwarteng is not sufficient. The man should have been put in jail (as

many have advocated for the perpetrators of the 2008 Lehman crisis) or banished forever into political oblivion.

Kwarteng, in other words, is just an academic who has no grounding in the actual economic affairs of state, and had the pompous attitude that since he's the finance minister, the permanent secretary of his ministry, Tom Scholar, and the governor of the central bank, Andrew Bailey, are underlings who should be ignored or cowed into submission, when they bring up critical matters like the leverage in the pension funds. They are the ones, whose advice should have been regarded as valuable, even as a matter of check and balance on matters of national significance. In the case of Bailey, he actually saved Kwarteng's ass when he pivoted on BoE QT policy instantly back to inflationary QE, by buying bonds on an unlimited basis. That negligence of sound advice from his economic advisors alone should have been enough to get the Finance Minister fired.

Then there is the Chancellor's partner in arms, Liz Truss, who to save her own skin, fired him on Friday. Kwarteng was not alone in trying to lead the UK into a regime of borrowed money financing profligate public spending; the PM was an accomplice. But while Kwarteng was an academic madman (and just a historian rather than a practitioner), without any knowledge of how the real world works, Liz is not much better. Not only is she totally inane about how the mini-budget would have worked (just listen to her press conferences and interviews), she has a long record of being a dimwit. The first instance in which she came into the limelight was when she was Foreign Secretary and was eaten alive when negotiating with her Russian counterpart, Sergei Lavrov. She left all and sundry dumbfounded, including this writer, when she blurted out that the Russians should not be in Voronezh and Rostov, thinking these were cities in Ukraine. That's a blunder of equivalent proportions as supporting a Keynesian style fiscal policy in the midst of a raging inflation. Frankly, from that point on, I never thought she would ever be a serious leader. Then in a press conference months later, she tripped over herself to prove she was ready to press the nuclear button, when she could have just dodged the question. With those two events, it proved that Liz Truss does not have enough brains to be Prime Minister.

But the Tories did not care. And favoured her over a more sensible man, Rishi Sunak. There is now hell to pay.

Together, the Truss-Kwarteng team continued to commit more errors in their one month in the highest echelons of the British government. When they announced the mini-budget, it was just a statement of policy, without an actual budget being set up so that they could avoid the scrutiny of the financial experts in the City who are justifiably concerned how the

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government would make ends meet. Because if they could not, the budget would be unsustainable. And the fact that they did not, probably meant that Truss and Kwarteng did not want opposition to their plans. I mean, how stupid did they think the City financiers were?

London has some of the best brains in the global financial industry and they act like activist shareholders in a company when they trade in the gilt and cable (Pound vs USD) markets. These sharks scrutinise government budgets and spending plans with the intensity of gnomes in Middle Earth and when they see something amiss, they will shoot to kill. In this case, the City traders realised that the unfunded public expenditures were much bigger than the Truss

Kwarteng team were willing to publicise. They stepped back from buying bonds and also shorted the Pound.

The rest is history.

My point in recounting the above execution errors by the Truss government is not so much to criticise the entire philosophy of deficit financing to boost growth, but that they obviously knew their policies were not likely to be well received and they tried to gaslight the markets and electorate by under-declaring the magnitude of the actual deficits they wanted to pursue (a total of about one-quarter of a Trillion pounds over several years and they kept saying it was just 45 billion pounds (actually, that was “per year” and they were notably silent on the annual recurrence). When it became public perception that they were being deceptive, they got hammered.

How stupid can you get? Gaslight the financial industry on matters of finance??

With Kwarteng dismissed, the question is how long can Truss herself last as PM?

By cutting loose Kwarteng, Liz Truss is desperately trying to show she is acting decisively to restore economic stability by dismantling the proposal to kill the previously planned increase in corporation tax. “The way we are delivering our mission right now has to change,” she blurted on Friday, while trying to shift direct responsibility for the financial turmoil of recent weeks to the former Chancellor.

In less than 40 days in power, she has gone from promising a new radical, tax-cutting Conservative government to whatever can save her from devastating political ruin. Her signature economic policy has been jettisoned by the financial markets, her voters and most MPs in her own Party. Truss has now been rated to be as unpopular as former premier John Major was in 1992 following a previous currency crisis. The Tories worked for 18 years after that debacle to win another election. This time, they may never come back in a generation.

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As Truss begins dismantling the “mini” Budget, Conservative MPs, the City and the wider public are asking, how long can her government survive? Truss wanted to launch her premiership with a distinctive program with significant tax cuts and deregulation to shake up a moribund British economy out of its torpor. She and her former number 2, launched their plan obviously without much feedback from the people it would affect, steeped as they were with ideological arrogance that nobody else knows better. Instead of a fan club receiving their plan with enthusiasm, the mini budget immediately sent interest rates soaring, the currency plunging and poll ratings going to hell. The Tories are now between 20-30 points behind the Labour opposition. And she has found that her much heralded growth strategy is a bridge too far even for the stalwarts in her own party.

“It seems like the anti-growth coalition is everyone except the right wing of the Conservative party,” commented one aghast Tory MP cited in the FT.

A former cabinet minister was even more brutal: “She has fucked the party, fucked the country and fucked our prospects at the next general election.” That language was published in the austere Financial Times, word for colourful word...

There were apparently many meetings within the party that tried to salvage the mini budget disaster. At one such meeting between Truss and party members midweek, the message put starkly to her was that the housing market has stalled, loans rates have soared and the very cost of living crisis she was supposed to solve have in fact worsened. The unprecedented sell-off in UK government gilts is also creating massive political damage. A decade of work by successive Conservative leaders to win over working-class voters has gone down the tubes. At first obstinate, she soon realised that her stance was untenable, that party discipline had shattered and if she stuck to her guns, the pressure to sack her could spiral out of control.

Not that the spiral has not already begun.

Even though the mini-budget was hardly implemented, expectations of its effects were already tearing markets apart. The politicians were being sent an unmistakeable message. Unless the government chopped the tax cuts, the markets will tank. There was no alternative, but for a complete unravelling of the controversial growth plans.

Within 24 hours of that Wed meeting, Truss, to save her own hide, got rid of Kwarteng, essentially thrown out into the street, without any chance to protest the treatment. If happened faster than a City trader caught doing a rogue trade...and this is the finance minister of the sixth largest economy in the world.

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The PM was herself wobbling. In the overhaul of the proposed budget, they managed to keep the expenditures to contain energy bills, but tax cuts, an outdated benchmark in her view of the world, were sent to the trash can.

She persisted that it was a communications problem, but as one critic quoted by FT put it, "When facile statements meet real life — boom!" One minister further lamented in the same FT article, "We're giving people a load of tax cuts that they didn't ask for and having to do a load of unpopular things (like crippling mortgage rates or cutting the benefits of the country's poorest) to pay for them." That basically sums up the ideological arrogance of politicians out of touch with the people they govern.

The U turn on sticking with the Chancellor, the mini budget, and the growth plan based on lower taxes will be an albatross on her shoulder. She cannot win in the battle against the highly critical financial markets, which are treating all her economic policies to be dead on arrival; but if she backs down completely, she will be found wanting on the virtue of steadfastness. What then does she have to go forward on as PM? As a matter of fact, she will be lambasted for her lack of brains, lack of experience in dealing with the economy and also lack of resolve.

Truss is finished as prime minister.

The remaining question is how long will her party let her cling on.

Her only hope to stay in her job a little longer than she deserves is that a change of leadership by the Tory establishment would really look absurd. That dilemma for the ruling party is stark.

“Don’t forgive, don’t forget!” Keir Starmer, leader of the Opposition, urged the nation, firing a broadside to launch Labour’s attack. Although Truss has sacked her chancellor and announced a reversal of key parts of her economic policy, nearly all analysts believe she can survive as PM only as long as her party can work out a way of replacing her that does not plunge it into another chaotic leadership contest.

I am one of those who think that she will be dumped next week, even though she is supposed to be protected by internal party rules that would not allow a leadership change for 12 months. But this is politics, and the Tories can change the rules anytime they wish, when there is still political damage to contain.

Why do I think so? I based my assessment on how the financial markets have reacted to Kwarteng’s dismissal. The gilt market and the currency market did not even budge. This is

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an indication that the markets do not accept the lame excuse that the fault lies entirely with Kwarteng. They are declaring that Truss is equally responsible for the fiscal planning blunder. Until she is gone, with all the evidence that the mini budget is completely binned, they would not let up the pressure on the Conservative brass to sack the PM.

This is politics by economic blackmail of course, and there is no way for the ruling party not to comply. Or they themselves will be gone when an early election will bring in a Labour government. Which I also think will happen...

The British media seems to agree with the above assessment. “It’s a question of what is less embarrassing for us (the Tories) now: the pain of getting rid of her, or the pain of keeping her,” he added. “The U-turn has changed that calculation towards the former.”

“The mood is already shifting from anger at the sheer stupidity of the prime minister and chancellor to one of sadness,” said one well-connected Tory MP quoted by FT, before Kwarteng was fired. “We face annihilation at the next election.”

Whether there is an obvious successor may no longer buy Truss any time. The knives are out, and there is rumour that a new dream team is forming under Rishi Sunak, the former chancellor and the other contender for the PMship before the entire Tory party lost their senses and chose the one who came across as a Ukraine supporter but disastrously forgot about her lack of economic policy making skills that would put a hole below the waterline. Sunak was a successful hedge fund manager, and had warned during the PM selection debates that everything about Truss’ plans would crash the markets. He was right and some quarters remember him for that. Let’s see if the Tories can reconcile it with the fact that it was during Sunak’s term at the Exchequer when the cost of living crisis erupted.

The NYT have noted the debacle across the Atlantic and are circumspect about it. Here is their view on the unfolding crisis:

By Patricia Cohen

Reporting from London Oct. 14, 2022

Government leaders in the West are struggling with rising inflation, slowing growth, and anxious electorates worried about winter and high energy bills. But Liz Truss, Britain's prime minister, is the

In U.K. Fallout, Lessons for a World Facing Harsh Economic Realities

"The sharp policy U-turn by Liz Truss, Britain's prime minister, reveals the perils of taking the wrong path in the fight against scalding inflation.

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only one who devised an economic plan that unnerved financial markets, drew the ire of global leaders and the public and undermined her political standing.

*On Friday, battered by savage criticism, she retreated. **Ms. Truss fired her top finance official, Kwasi Kwarteng, for creating precisely the package of unfunded tax cuts, billion-dollar spending programs and deregulation that she had asked for.***

She reinstated a scheduled increase in corporate taxes to 25 percent from 19 percent, a rise she had previously opposed. That announcement came on top of backtracking last week on her proposal to eliminate the top 45 percent income tax on the highest earners. The prime minister, in office a little over five weeks, also promised that spending would grow less rapidly than proposed, although no specifics were offered.

The drama is still playing out, and it's unclear if the Truss government will survive.

In the United States, President Biden, while waging his own political battles over gas prices and inflation, has not proposed anything like the kind of policies that Ms. Truss's government attempted, nor have any other leaders in Europe.

Still, for European governments whose economies are suffering greatly from shocks and energy price surges caused by Russia's war in Ukraine, there are timely lessons from the debacle playing out in London.

One of the strongest was delivered early on by the International Monetary Fund: Don't undermine your own central bankers. The I.M.F., which usually reserves such scoldings for developing nations, on Thursday doubled down on its message. "Don't prolong the pain," Kristalina Georgieva, the managing director, admonished.

How to blunt the impact of inflation on the most vulnerable without further stoking inflation is the dilemma that every government is confronting.

"That is the question of the hour," said Eswar Prasad, an economist at Cornell University who was attending the annual meetings of the World Bank and I.M.F. in Washington this week.

Tension between the fiscal spending policies proposed by a government and the monetary policies controlled by central banks is not unusual. At the moment, though, central bankers are engaged in delicate policy manoeuvres in the fight against a level of inflation not seen in decades. With the rate in Britain nearing 10 percent, the Bank of England has moved aggressively to slow down climbing prices through a series of interest rate increases aimed at crimping consumer and business spending.

Any expansion of government spending is going to interfere with that aim to some degree, but Ms. Truss's plan was far too big and too ill defined, Mr. Prasad said.

“Measures to help households hit hard by energy increases, by themselves, would not have created that much of a stir,” he said. Many other countries have proposed exactly that. And the European Union has proposed a windfall tax on energy profits to help finance those subsidies.

Ms. Truss, instead of coming up with a way to pay for energy assistance, pushed to eliminate a corporate tax increase and cut income taxes for the wealthiest segment of the population. The result was a reduction in government revenue and a ballooning of Britain’s debt.

“Overall, the package did not have much clarity in terms of how it would support the economy in the short run without raising inflation,” Mr. Prasad said.

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By contrast, Claus Vistesén, chief eurozone economist at Pantheon Macroeconomics, cited the way governments and central banks worked in tandem when the pandemic struck in 2020 to keep economies from collapsing, issuing vast amounts of public debt.

“Central banks printed every single dollar, euro and pound that governments spent” to support households and businesses because of the Covid crisis, Mr. Vistesén said. But now the circumstances have changed, and inflation is setting economies aflame.

The actions of the Federal Reserve in the United States illustrate the switch central banks have made: In the harrowing early weeks of the global outbreak of the coronavirus, the Fed embarked on an extraordinary program to stimulate the economy and stabilize markets. This year, the Fed has been swiftly raising interest rates in a bid to slow growth.

Both the United States and eurozone countries have somewhat more wiggle room than Britain, because the dollar and the euro are much more widely used around the world as currencies held in reserve than the British pound.

Even so, European governments can help households and businesses get through an energy crisis, Mr. Vistesén said, but they can’t embark on an open-ended spending spree.

They also need to take account of what is happening in other economies. The richest countries that make up the Group of 7 are essentially part of the same “monetary and fiscal convoy,” said Will Hutton, president of the Academy of Social Sciences. By championing a Thatcher-era blend of steep tax cuts and deregulation, he said, the Truss government strayed too far from the rest of the flotilla and the economic mainstream.

The adherence to 1980s-era trickle-down verities also revealed the risks of sticking with outdated policies in the face of changing circumstances, said Diane Coyle, a public policy professor at the University of Cambridge.

“The situation in 1979 was very different,” Ms. Coyle said. “There were sclerotic high taxes and an overregulated economy, but not anymore.” Today, taxes in Britain are lower, and the economy is less regulated than the average member of the Organization for Economic Cooperation and Development, a club of 38 major economies.

“The character of the economy has changed,” she said. “Public investment in research and skills are more important.”

In that sense, what was missing from Ms. Truss’s economic plan was as important as what was included. And what Britain is lacking, said Mariana Mazzucato, an economist at University College

London, is a visionary public investment program like the trillion-dollar climate and digitalization plans adopted by the European Union or the climate and infrastructure program in the United States.

“If you don’t have a growth plan, an industrial strategy innovation policy,” Ms. Mazzucato said, “then your economy won’t expand.”

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Both Ms. Mazzucato and Ms. Coyle emphasized that Britain had some specific economic handicaps that predated the Truss administration, including the 2016 vote to exit the European Union, a stubborn lack of productivity, anemic business investment, and lagging research and development.

Still, Ms. Coyle offered some advice that referred pointedly to Ms. Truss. “I think the main lesson is: Don’t shoot yourself in the foot.”

Well, if it is put that way, then the Brits are not the only ones mortally wounded. Across the EU, every country that has joined in the economic sanctions against Russia are now limping with that same foot injury...

And on the other side, the machine-guns of economic rage have all missed the Russian target. There was a torrent of sanctions against Russia that at one time led many to believe that the Russian economy would collapse (not this writer though, if you all remember my Weekly Commentaries all the way back to March this year). As a matter of fact, it was just announced by the Russian government that their reserves are almost back at the level before half of them were appropriated by the collective west, or US\$300 billion out of a total of US\$600 billion. The Russians, in just about six months, have brought the level of their reserves back to US\$540 billion. You don’t believe that? That’s Russian propaganda?? Well, here is a read of an The Economist article, hardly a fan of the country ruled by Putin:

Russia’s economy is back on its feet

There’s a reason for its resilience

In early April we pointed to preliminary evidence that the Russian economy was defying predictions of

collapse, even as Western countries introduced unprecedented sanctions. Recent data further support this

view. Helped along by capital controls and high interest rates, the rouble is now as valuable as it was before

Russia’s invasion of Ukraine in late February (see top chart). Russia appears to be keeping up with payments

of its foreign-currency bonds.

The real economy is surprisingly resilient too. True, Russian consumer prices have risen by more than 10%

since the beginning of the year, as the rouble's initial depreciation made imports more expensive and many

Western companies pulled out, reducing supply. The number of firms late on their wage payments seems to

be growing.

But "real-time" measures of Russian economic activity are largely holding up. Total electricity consumption

has fallen only a smidge. After a lull in March, Russians seem to be spending fairly freely on cafés, bars and

restaurants, according to a spending tracker run by Sberbank, Russia's largest bank. On April 29th the

central bank lowered its key interest rate from 17% to 14%, a sign that a financial panic which began in

February has eased slightly. The Russian economy is undoubtedly shrinking (see bottom chart), but some

economists' predictions of a gdp decline of up to 15% this year are starting to look pessimistic.

Even before the invasion Russia was a fairly closed economy, limiting sanctions' bite. But the biggest reason

for the economy's resilience relates to fossil fuels. Since the invasion Russia has exported at least \$65bn-

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worth of fossil fuels via shipments and pipelines, suggests the Centre for Research on Energy and Clean Air,

a think-tank in Finland. In the first quarter of 2022 the government's revenues from hydrocarbons rose by

over 80% year on year. On May 4th the European Commission proposed a ban on imports of all Russian oil

that would come into full force by the end of the year. Until then, expect the Russian economy to continue to

trundle along.”

Huh? I thought that the collective west took great comfort in a Yale study just a couple of months

ago, by some Prof Jeffrey Sonnenfeld and a Steven Tian, who published a long report that the

Russian economy was going down the tubes, due to the west's sanctions. At that time, there were

many high-fives from the haters of the Russian bear – the report was well publicised in the western

media like gospel truth.

This latest Economist article is in direct contradiction of the Yale study.

Who to believe?

Well, I have always held the view that the sanctions on Russia do not work, have not worked and

will never work. I have written extensively on that point of view in this blog. As such, I take it

Given its animosity towards Russia, and that it would not say anything complimentary about the

country, we can surmise that what The Economist has to say about a “good” economy under

Putin's management, must be true.

that The Economist article is a grudging admission that the Sonnenfeld/Tian report is all hype.

Their Editorial board must have come around to the inevitable conclusion that the sanctions have

instead created that crippling wound in the collective west's foot, while Russia trudges forward on

both feet.

This is an irony. As well as a bloody disaster. And in the context of this week's Commentary, the

worst affected must be the British economy. While all the major EU economies are deeply

traumatised by the energy crisis wrought by the lack of Russian oil and gas, the UK economy is the

one which took on the Ukrainian war as a central pillar of their foreign policy, led by Boris Johnson

and more recently by Liz Truss. Worse still, the ineptitude in the new British government is so

great that regime change plotted on Putin is happening not once, but TWICE, in the UK. And the

British economy is almost at the point of total collapse, if its gilt market and the Pound break,

bringing with it its entire pension industry. It is that serious. And likely intractable as well.

own citizens... The richest three countries of the EU!!! Add the UK, Hungary, Turkiye, Serbia,

Austria, Bulgaria and a host of smaller countries to that list of European countries in serious cost of

living problems, and we have a disintegrating European Union in the making.

In the meantime, major civil unrest has broken out in three of the leading EU countries – France,

Germany and Italy. All three of the biggest. They are ongoing in France and Italy, even as the
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German government is preparing to bring out its military not to fight in Ukraine but to police its
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European leaders have in recent days accused Berlin of undermining solidarity by introducing a cap

on gas prices at home while opposing an EU-wide price cap scheme. Polish prime minister, Mateusz Morawiecki, had this complaint against Germany – “The richest country, the most powerful EU country is trying to use this crisis to gain a competitive edge for their businesses on the single market. This is not fair, this is not how the single market should work.” Infighting? WTF?

And at the same time, not only has the west lost its sanctions war (is there any other way to assess

it?) against Russia, that war will bring untold misery over the winter to its industries and the vast

majority of its middle and lower classes (yes, the rich political elites are completely out of touch

since high energy bills don't hurt them).

The military war is also not going well. Our Commander-in-Chief of the Planet, Elon Musk, came

close to cutting the use of the Starlink system by the Ukrainians, which provides them a satellite

based internet system used to provide targeting of Russian military assets. Apparently, the

Commander in Chief took offence at the vulgarities lashed out at him for suggesting a peace negotiation, on his notion that Russia will eventually win the war.

Here is the story on this altercation:

Elon Musk promises to fund Starlink in Ukraine ‘indefinitely’

Billionaire has been in talks with Pentagon over how to finance the internet service to frontline troops By Hannah Murphy and Richard Waters in San Francisco, 15 Oct 2022

“Elon Musk has said he will continue to fund the Starlink mobile internet system in Ukraine for free “indefinitely” following discussions with the Pentagon.

The billionaire entrepreneur had complained this week that the service was costing his private space company SpaceX “approaching \$20mn a month” and had written to the defence department requesting financial support.

The Pentagon on Friday confirmed that it had been discussing payments with Musk's company to ensure connectivity for Ukrainian forces, adding that it was also exploring alternatives.

But in a sudden about turn on Saturday, Musk wrote on Twitter: "The hell with it . . . Even though Starlink is still losing money & other companies are getting billions of taxpayer \$, we'll just keep funding Ukraine govt for free."

When contacted by the Financial Times, Musk confirmed that he would keep paying for the service in Ukraine "indefinitely".

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Musk won acclaim earlier this year after intervening to bring internet services to Ukraine during the Russian invasion. However, he became embroiled in a spat with Ukrainian leaders last week after calling publicly for a negotiated settlement to end the war in the country, which would include allowing Russia to keep Crimea.

In response to a tweet quoting a Ukrainian diplomat who told Musk last week to "fuck off" following his proposed peace settlement, the US-based entrepreneur appeared to threaten to pull the service in the country, writing earlier this week: "We're just following his recommendation".

Musk had complained that his company was spending millions to "create, launch, maintain & replenish satellites & ground stations & pay telcos for access to internet via gateways." He added that the company had also "had to defend against cyber attacks & jamming, which are getting harder."

On Saturday, he responded to a comment on Twitter saying that "no good deed goes unpunished", writing:

"Even so, we should still do good deeds".

The Pentagon declined to comment on the news.

The Financial Times previously revealed that some Starlink terminals used by Ukraine's military had stopped working in areas recently liberated from Russian occupation, raising questions about whether the company was blocking the service to some parts of the front lines."

Additional reporting by Felicia Schwartz

The point of it all is that Musk is obviously pissed with the vulgarities piled on him when he

offered the wisdom that peace is not such a bad thing. When he was told by prominent Ukrainians

to fxxk off, he said fine. He seems to have relented. Let's see when another U turn (in this age of

U turns) will come.

There are also reports that Biden has told Zelensky he should not sound ungrateful for the aid he

has been receiving by his rude badgering of his hosts that he needed more and more of everything.

At the end of the day, the inevitable must happen – wrecked economies in the west with their governments continuously changed away cannot provide that military and financial support for a country without any resources of its own. That's not how the world works.

As our Commander-in-Chief Musk has said, the Russians won't lose this war. Can they win it?

That depends on how the "win" is defined. If destroying 100,000 Ukrainians troops and sustaining

only 20 percent of that number in their own army is considered a Clausewitzian success, then yes,

Russia has already won the war. Or if we consider they have captured and annexed 20 percent of

Ukrainian territory, in classic realpolitik, then again, they have won the war. If on the other hand,

we consider that they have not broken the will of the Ukrainian army to fight on, and that army is

still being supported by the collective west, however much pain it is causing, then no, Russia has

not had its victory. As things are, the war has not yet won by the Russians. But to say that Ukraine, or the west, have won is just as inaccurate an assessment.

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Can the real objective of Russia be the economic destruction of the EU? Whatever one wants to

say about the resilience of the Ukrainians in this war, their war materiel have been destroyed, and

without the west fighting a proxy war, the fighting would have been over a long time ago. But

without putting boots on the ground, which does not guarantee that the west would win against

Russia, the outcome of the actual war is indeterminate. Assuming Putin knows this, he is simply

waging the war on the economic front for as long as he can; and if this is indeed his intention, then

one can only say that Russia is winning the economic confrontation and bringing about regime

change throughout Europe, and may eventually cause the entire Union to cave.

I honestly think that will happen.

This may be hindering the US' main contest against China halfway around the world. Until there

is a resolution on the battlefield in Ukraine, it is unlikely the US will want to wage a two-front war,

cares?

The only worrisome thing that is happening is the technology war that has been started by Biden.

industry, China is not far behind and can indeed catch up quite quickly, but in the highest end chips,

now, these facilities are dominated by the US, the Netherlands and Japan.

one in Europe and the other across the Taiwan Straits. As such, there are many reasons that there

won't be a war any time soon in East Asia. But both sides are visibly gearing up to ensure that

there can be no first strike by the other side. If it stays that way, all talk and no action, who really

He has launched a total ban on exports of chips to China. His fears are not entirely without basis; if

the Chinese continue to expand their capabilities on supercomputing, it gives them the research

capability, I am told, to expand their nuclear arsenal. For all the falsehoods that the Biden

Administration has been circulating about Beijing, this one is closest to the truth.

Will the Chinese keel over and die because they are being barred from the chips market? Yes, it is

true that the US has a lead over China in this market. In some sectors of this highly sophisticated

China is still 2 to 3 tech nodes behind. The Chinese government is throwing money and talent at

the problem, but it will not catch up immediately. Besides the actual chip technology, the

manufacturing and testing facilities, in what they call the foundries, are also very IP intense. Right

This contest will however cut both ways. Because China is the largest market for these chips, restricting exports to the country will crash some of the chip makers' businesses. This is actually

quite deleterious for the R&D capabilities in the American semiconductor industry – lower profits

simply means less resources for exploration of the unknown. This is a lose-lose proposition but

the Americans are apparently prepared to grit their teeth and bear it, accepting loss of business and

slower growth, if it can throw a spanner into the inexorable Chinese advance. Well, NVIDIA and

Intel are apparently already going down the tubes...

In the longer term, what the Americans are doing now will make no difference. Because it is science, physics, math, engineering and technology in which the laws of nature will manifest

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themselves, and which enough research will lead to breakthroughs. It is not like poetry or art. As a

matter of fact, the Chinese are already having breakthroughs in basic science that will make a

difference at some time in the future. The Chinese have the human talent, the money and all the

basic capabilities to catch up with the leaders in the industry, which in the case of Japan and the

Netherlands cannot be said to have resources which the Chinese do not have.

So it is only a matter of time. As in the case of the Beidou system, the equivalent of the GPS, or

the Chinese space accomplishments, it can eventually all be done.

Or they may even break the mould in which existing technologies are built and create an entirely

different route to change the world.

Here is another well-researched opinion in the Asia Times, a reputable HK publication, on how the

Biden bans will impact on China:

NEW YORK

“The Biden administration’s unprecedented package of bans on chip and chip equipment sales to China announced on October 7 could not have come at a worse moment for the global semiconductor industry.

The damage to capital investment and R&D in the Western semiconductor industry will exceed Washington’s modest subsidies for the chip industry by a factor of five or more.

The US measures won’t affect China’s sensors, satellite surveillance, military guidance and other strategic systems because the vast majority of military applications use older chips that China can produce at home. But it may postpone autonomous driving, cloud computing and other efforts to digitize China’s economy.

It will also elicit an all-out Chinese effort to replace American chip-making and design technology. CapEx and R&D will shrink drastically in the US semiconductor industry while China allocates a massive budget to the sector.

On a five- or ten-year horizon, America’s technological edge in semiconductor design and fabrication is likely to vanish. As capital budgets collapse in the Western semiconductor industry, the damage to the US and other Western economies is likely to be greater than the harm inflicted on China.

The Biden administration meanwhile proposed a 14% budget cut for the Defense Advanced Research Projects Agency (DARPA), which is a much larger cut after inflation. Starving US high-tech industry of public as well as private funds is a strange way to conduct a strategic rivalry with China.

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The incipient global recession turned the chip shortage of 2021 into a glut, reflected in a collapse of the Philadelphia index of semiconductor stocks (PHLX) by nearly half during 2022. NVIDIA, the leading US chip designer, has lost 68% of its market capitalization so far this year.

The industry had already cut capital investment plans from about US\$200 billion to \$160 billion for 2022. US restrictions on exports of semiconductor equipment, design tools and high-end chips to China will shrink revenues further, putting an air pocket into R&D and capital expansion. The world's dominant chip fabricator, Taiwan's TSMC, planned \$44 billion in CapEx just six months ago but on Wednesday announced a cut to \$36 billion.

The Biden administration's \$50 billion, five-year subsidy for onshore chip fabrication will help firms that use older technology to supply the US defence industry, which mainly buys chips five to seven generations behind the cutting-edge semiconductors targeted by the new round of US sanctions.

Smaller American fabricators like GlobalFoundries and SkyWater Technology, who make chips for the US military several generations behind the present state of the art, will benefit from the Biden subsidies. But companies with the most advanced technology have the most to lose, including American manufacturers of chipmaking equipment.

It's still unclear what loopholes will be left in Washington's chip bans, or how damaging they will ultimately be. Reuters headlined an October 12 report, "US scrambles to prevent export curbs on China chips from disrupting supply chain," noting that the leading South Korean fabricators, Samsung and SK hynix obtained a 12-month reprieve for investment in their mainland chip plants, while TSMC obtained a one-year license to ship US chipmaking equipment to its expanding plants in China.

Few military applications of chip technology will be affected. According to a 2022 RAND Corporation study, the vast majority of chips used by the US military use so-called mature nodes with wider transistor gate width than the latest 3 to 7-nanometer (nm) chips that only TSMC and Samsung can produce. RAND published the chart below showing the node size of chips employed for key military applications:

Application

Artificial Intelligence

Edge Computing

Radio-Frequency Communications Integrated Silicon Photonics Space-Based Applications Laser-based sensing

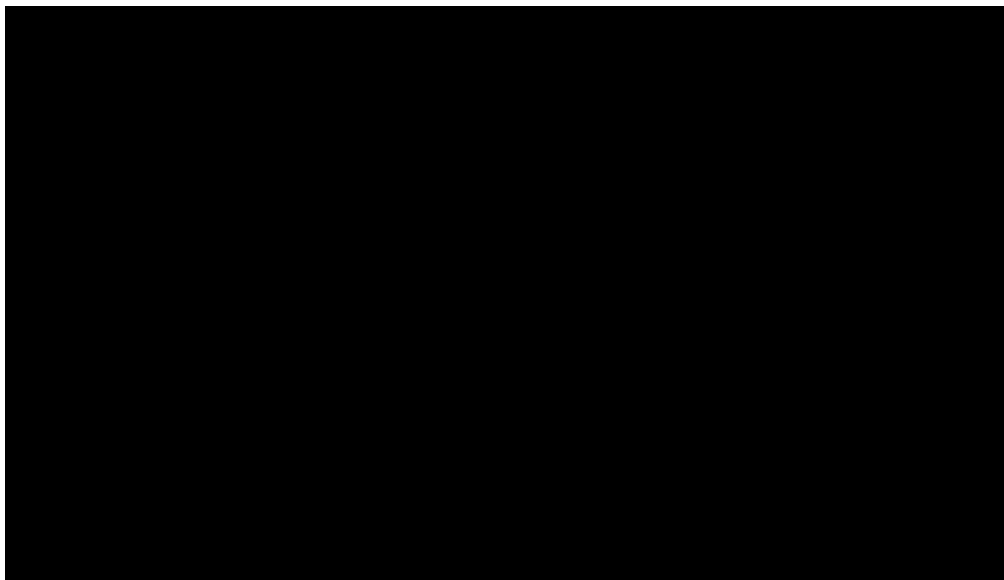
Node Size

<10nm

14nm

22nm

90nm 90-180nm 100nm-1000nm





The new US restrictions won't stop China's 2,000 surface-to-ship and surface-to-surface missiles from targeting US aircraft carriers in the Western Pacific, or US air bases in Guam and Okinawa, and they won't prevent China's more than 1,000 interceptors from aiming long-range air-to-air

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missiles at US planes. But they are likely to delay the rollout of key digital applications in China's civilian economy, such as autonomous vehicles.

The US is "doing everything in our power to protect our national security and prevent sensitive technologies with military applications from being acquired by the People's Republic of China's military, intelligence, and security services," US Commerce Department official Alan Estevez said in an October 7 release.

*The best that might be said about the Biden policy is that it came ten years too late to make a dent in the military balance in the Pacific. But **the Biden administration estimates that it will spend \$30 billion a year in student loan forgiveness over the next ten years, but less than \$10 billion a year in subsidies to the US semiconductor industry.***

Federal subsidies will cover a small fraction of the reduction in CapEx and R&D due to the economic downturn and restrictions on semiconductor sales to China.

China is by far the world's largest consumer of semiconductors, with 53% of the global total. The US manufactures just 12% of the world's chips, but it leads in some areas of chip technology, including some chip-making equipment.

LAM Research, a top producer of etching and other hardware, earned 30% of its sales revenues from China in 2022. KLA, its top competitor, also sells to China. Cadence, a top producer of Electronic Design Automation (EDA) software, obtained 45% of its total revenue from China in the second quarter of 2022.

Two years ago, a Boston Consulting Group study warned that an all-out US ban on chip sales to China would eliminate 37% of the revenue of US semiconductor companies, lead to severe cuts in R&D and capital expenditures, and the loss of 15,000 to 40,000 highly skilled direct jobs in the US semiconductor industry.”

China can't match American EDA tools yet. It would take China five to ten years to catch up, using software it already had purchased, or pirated copies without manufacturer support. It also can't match the lithography machines that burn impossibly small transistors with a gate width of 7nm or less, with Extreme Ultraviolet (EUV) technology.

That's available only from Holland's ASML, and the US has banned sales of the newest machines to China because they contain a significant amount of US intellectual property.

Hardest to gauge is China's ability to work around US technological restrictions. Mainland China has 20 of the world's 50 highest-ranked engineering schools – and more if Hong Kong is counted – and graduates seven times the American count of engineers each year. China can't buy some American technology, but it can hire anyone it wants.

At worst, the damage to China's economy is likely to be temporary, and the impact on its military capacity is likely to be minimal. But the impact of the incipient depression in the Western semiconductor industry may well do permanent harm.

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If I were a betting man, I would say that this Biden initiative is yet another desperate exercise by a

hegemon to cling on to its past glory. Let's see if Xi Jinping will address this semiconductor war in

his party congress this weekend.

But that is another story for another day.

By:

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Fintech Entrepreneur, Money Manager and Blogger Un-Influencer in a World full of Hubris

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