Weekly Commentary 48 – Dec 2022

Has Inflation Peaked?

Over the last month, the statistics released by economic agencies in the US showed that the steep inflation increases experienced by the economy seem to be moderating. After reaching just about 9% a couple of months ago, the CPI number slowed to 8 point something and then dropped to 7.7% in the most recent release. The Federal Reserve, while maintaining hawkish statements about how they will not tolerate inflation, started signalling that interest rate hikes will slow. The markets cheered. Stocks rallied from the lows to which they had fallen steeply from the record highs reached at the beginning of the year, bonds steadied and the US dollar started a retracement.

There is some confidence in the financial markets that at least in the US, inflation might have peaked. In our analysis for the past year, I have commented that inflation in the US did not just arise from the excessive demand that was created by money printing during the covid years, but also from the supply chain disruptions caused by a trade war with China and a proxy war with Russia.

The excesses in spending have been tampered by four hikes of 0.75 percent in less than a year. That is shock therapy. And it is beginning to work. CPI figures have not gone up further above 9 percent and seem to be just hovering. It is not over yet, and the Fed seems determined to increase interest rates until short term rates reach about 5%, which are at least another 1 percent from current levels.

The other factor that may be working to slow down inflation is expectations of a slowdown in the geopolitical contests around the world. These may not all help to moderate inflationary forces in the western economies but they will probably put the global economy back on a course of collaboration and gradually smoothen international trade. That will bring back the counter-inflationary forces, such as low-cost Chinese imports stacked on Walmart shelves, that were prevalent before Trump became the American president. Or energy prices $20 lower than they are now at.

What are these geopolitical factors that are changing in favour of the reestablishment of international trade and commerce?

I reckon the following to be important:

1) The Russo-Ukrainian war; and
2) The Sino-American contest;

Let's discuss each of these in turn and see if they would have an impact on the pressing economic problems in the west.

The Russo-Ukrainian War

This was launched as a proxy war between the west and Russia. How it started is very well known by now, and needs no repetition in this Commentary. Suffice it to say that given its ignominious beginnings, there are no obvious signs that it will end soon, by any process requiring negotiation.

As with all wars, both sides are using propaganda to gain the moral high ground and to advance their aims. This has created a fog of war, and most of us cannot see beyond what each side's media tell us. Of course, there is the objective way, and that is by assessing for ourselves by what is actually happening on the ground, benchmarking off both sides' claims.

On the Russian side, the information on the war is provided mostly by their Ministry of Defence. This information is matter-of-factly, with little exaggeration. But it is sketchy.

There is a lot more information describing in detail what is going on in the frontlines, from reporters embedded with Russian forces. These journalists publish what is going on in Russian social media which then gets transferred onto international platforms like Telegram. These are quite accurate in the sense that what has been described as upcoming events usually happen within the time frame expected. That provides a good view of the war from the Russian side.

On the Ukrainian side, the background of people in the Kyiv government has a strong influence on their narrative of the war. These officials have been mostly showbiz professionals, and their background influences how they provide news on the war. A lot of it is, in fact, public relations, publishing a story of achievement against the Russian war machine in order to keep the money flowing from the western countries who are sponsoring the war. And these narratives are supported by the American and British governments as well as the media of both countries that need to show that all the money and weapons that have been poured into the "Ukraine Project" have garnered some payoff.

That has developed into a sort of propaganda war, which on the one side (Russian), the protagonists try to impress upon its own population that the country's security had been compromised by an ever-expanding western effort to put NATO on the country's frontier with Ukraine, its historical Slavic brethren, which has become an accomplice of the west through the sponsorship of Nazi and other Russo-hating organizations that have come to infiltrate even its armed forces. As such, the propaganda on the Russian side have been to justify its "special military operation", to prevent attacks on Russian speaking people living in the Donbas and to demilitarize the Ukrainian armed forces, according to a global view of the world by its president, Vladimir Putin.

On the other side, the Kyiv government tends to exaggerate every action that has had some success, including the initial repulsion of the Russian attack on the capital, the recovery of some towns in the Kharkov region, and most recently the retaking of Kherson, a provincial capital that had been captured by the Russians. Some of the reports of Ukrainian military prowess turned out to be fairy-tales, such as the "ghost of Kyiv", a fictitious fighter pilot who was lionised as some hero who supposedly shot down two dozen Russian war planes; or the rape of women and children by an Ukrainian official who was ultimately sacked. This kind of reporting is still the style to this day of how the Kyiv government reports its battlefield achievements – mostly hype and in the best cases, stretching the truth as in the case of reporting Russian withdrawals from places they do not want to defend - as Ukrainian victories.

One of the biggest cover-ups is in the number of casualties taken by the Ukrainian Armed Forces. Holding of territory by the Russians is deemphasized by a country that already has too much land, and they focus more on demilitarizing Ukraine in a Clausewitz type operation to decimate its army. Kyiv therefore tries to understate its losses. Unfortunately for them, the EU President, Ursula von der Leyen, let slip out of the bag the number of Ukrainian casualties that have been incurred in the 10-month long war – 100,000 KIA. If we take the usual ratio of wounded to dead in the casualty count, we have to conclude that half of the original Ukrainian army at the start of the war (of about 600,000 men) have been incapacitated. On the other side, the Russian casualties are far lower, in one BBC estimate up to June, there were just a few thousand dead, in line with the few Russian MOD announcements that have been made up to September.

This Ukrainian way of reporting on the war has therefore become a narrative of Russian battle losses, war crimes, massive losses of equipment, missiles inventories running low, suicide attacks and a total embarrassment for Putin. The entire western media has the same story - Russian incompetence.

As a matter of fact, there are many in the west who are well informed of the developments in the battlefield, and they do speak up against this stretched Ukrainian/US/UK narrative. Here is an example.

"The national political and military leaders who committed America to wars of choice in Vietnam, the Balkans, Afghanistan, and Iraq, did so as a rule because they were convinced the fighting would be short and decisive. American presidents, presidential advisors, and senior military leaders never stopped to consider that national strategy, if it exists at all, consists of avoiding conflict unless the nation is attacked and compelled to fight.

The latest victim of this mentality is Ukraine. In the absence of a critical root-and-branch analysis of Russia's national power and strategic interests, American senior military leaders and their political *bosses viewed Russia through a narrowly focused lens that magnified U.S. and Ukrainian strengths but ignored Russia's strategic advantages—geographic depth, almost limitless natural resources, high social cohesion, and the military-industrial capacity to rapidly scale up its military power.*

Ukraine is now a war zone subject to the same treatment the U.S. armed forces inflicted on Germany and Japan during the Second World War, on Vietnam in the 1960s, and on Iraq over decades. Power grids, transportation networks, communications infrastructure, fuel production, and ammunition storage sites are being systematically destroyed. Millions of Ukrainians continue to flee the war zone in pursuit of safety, with ominous consequences for Europe's societies and economies.

Meanwhile, the Biden administration repeatedly commits the unpardonable sin in a democratic society of refusing to tell the American people the truth: contrary to the Western media's popular "Ukrainian victory" narrative, which blocks any information that contradicts it, Ukraine is not winning and will not win this war. Months of heavy Ukrainian casualties, resulting from an endless series of pointless attacks against Russian defenses in Southern Ukraine, have dangerously weakened Ukrainian forces.

Predictably, NATO's European members, which bear the brunt of the war's impact on their societies and economies, are growing more disenchanted with Washington's Ukrainian proxy war. European populations are openly questioning the veracity of claims in the press about the Russian state and American aims in Europe. The influx of millions of refugees from Ukraine, along with a combination of trade disputes, profiteering from U.S. arms sales, and high energy prices risks turning European public opinion against both Washington's war and NATO.

Russia has also undergone a transformation. In the opening years of President Putin's term of office, the Russian Armed Forces were organized, trained, and equipped for exclusively national territorial defence. But the conduct of the Special Military Operation (SMO) in Ukraine has demonstrated the inadequacy of this approach for Russia's National Security in the 21st century.

The opening phase of the SMO was a limited operation with a narrow purpose and restricted goals. The critical point is that Moscow never intended to do more than persuade Kiev and Washington that Moscow would fight to prevent Ukraine from joining NATO, as well as the further mistreatment of Russians in Ukraine. The SMO was, however, based on invalid assumptions and was terminated. As it turned out, the limited nature of the SMO achieved the opposite of the outcome that Moscow desired, conveying the impression of weakness, rather than strength.

After concluding that the underpinning assumptions regarding Washington's readiness to negotiate and compromise were invalid, Putin directed the STAVKA to develop new operational plans with new goals: first, to crush the Ukrainian enemy; second, to remove any doubt in Washington and European capitols that Russia will establish victory on its own terms; and, third, to create a new territorial status quo commensurate with Russia's national security needs.

Once the new plan was submitted and approved, President Putin agreed to an economy of force operation to defend Russian territorial gains with minimal forces until the required resources, capabilities, and manpower were assembled for decisive operations. Putin also appointed a new theater commander, General Sergei Surovikin, a senior officer who understands the mission and possesses the mindset to deliver success.

The coming offensive phase of the conflict will provide a glimpse of the new Russian force that is emerging and its future capabilities. At this writing, 540,000 Russian combat forces are assembled in Southern Ukraine, Western Russia, and Belarus. The numbers continue to grow, but the numbers already include 1,000 rocket artillery systems, thousands of tactical ballistic missiles, cruise missiles, *and drones, plus 5,000 armored fighting vehicles, including at least 1,500 tanks, hundreds of manned fixed-wing attack aircraft, helicopters, and bombers. This new force has little in common with the Russian army that intervened 9 months ago on February 24, 2022.*

It is now possible to project that the new Russian armed forces that will evolve from the crucible of war in Ukraine will be designed to execute strategically decisive operations. The resulting Russian force will likely take its inspiration from the force design and operational framework recommended in Colonel General Makhmut Gareev's work, If War Comes Tomorrow? The Contours of Future Armed Conflict. The new military establishment will consist of much larger forces-in-being that can conduct decisive operations on relatively short notice with minimal reinforcement and preparation.

Put differently, by the time the conflict ends, it appears Washington will have prompted the Russian State to build up its military power, the very opposite of the fatal weakening that Washington intended when it embarked on its course of military confrontation with Moscow.

But none of these developments should surprise anyone in Washington, D.C. Beginning with Biden's speech in Warsaw effectively demanding regime change in Moscow, the Biden administration refused to see foreign policy in terms of strategy. Like a stupid general who insists on defending every inch of ground to the last man, President Biden confirmed the United States's commitment to oppose Russia and, potentially, any nation state that fails to measure up to globalism's hypocritical democratic standards, regardless of the cost to the American people, whether in terms of their security or prosperity.

Biden's speech in Warsaw was hot with emotion and mired in the ideology of moralizing globalism that is popular in Washington, London, Paris, and Berlin. But for Moscow, the speech was tantamount to a Carthaginian Peace plan. Biden's "take no prisoners" conduct of U.S. foreign policy means the outcome of the next phase of the Ukrainian War will not only destroy the Ukrainian state. It will also demolish the last vestiges of the postwar liberal order and produce a dramatic shift in power and influence across Europe, especially in Berlin, away from Washington to Moscow and, to a limited extent, to Beijing.

ABOUT THE AUTHOR
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Douglas Macgregor, Col. (ret.) is a senior fellow with The American Conservative, the former advisor to the Secretary of Defense in the Trump administration, a decorated combat veteran, and the author of five books.

If Mr Macgregor's essay describes accurately the state of the "misunderstanding" in the west of how the Ukrainian war is going, then when the Russians do succeed in their new mission, there will be a huge shock that has its parallel in Vietnam in 1975 and Afghanistan in 2021. Disbelief and then anger will arise in America, but they will get over it. As a matter of fact, I interpret recent actions and statements by the American president to be seeking an off ramp for the Ukraine war. Biden seems to already know that the Ukraine war is unwinnable for the west. He was the first to tell the world that the missile that felled on Poland and killed two people was not Russian, hence directly contradicting the signal sent out by Zelensky that the act was a Russian effort to force a war between NATO and themselves. This was intended to tell the world that the US does not want to escalate in Ukraine and probably wants it to end sooner rather than later. With the takeover of the House of Representatives by the Republicans, which has already indicated they want a tighter audit of the arms and money sent to Kyiv, the US President does not seem he wants to lose control of the process in which he still has the moral high ground.

And last week, Biden had initially indicated that he wanted to talk to Putin, but in the end, it did not come to pass probably because the political vibes are still not ripe for that step. Still, if the Russians win decisively on the battlefield as Mr Macgregor predict they would, I have no doubt the Americans will seek to end this with some claim of victory and leave the burden of tying up the loose ends to the Europeans. The New York Times in a recent article has already proposed such an approach.

In Europe, there will likely be a sense of betrayal that a) they have been dragged into a war they did not want to fight but which they will end up finishing; b) an economic malaise that they will have trouble getting out of; and c) a foreign policy that they have no control over. And they will be left to carry the burden when things get rough in Ukraine. Now wouldn't that be a disaster?

Most importantly, the economics of Europe cannot go back to what it was. The economic dislocation of Europe that was initiated by the Americans cannot be solved by interest rate hikes by the ECB. It is not a matter of excessive demand that needs to be suppressed by monetary policy. It is going to be about the entire restructuring of a continent's economy that has to forego the abundance of cheap energy found in its eastern half. That is truly a ridiculous situation that has been created by politicians who sought the friendship of the Americans, and have, under a grand scheme of things that benefits only themselves, cut themselves off from an entire way of life that is actually natural and efficient. The impact of this breakup of two halves of a continent which should co-exist naturally will be similar to how the UK has suffered from the idiotic popularism of Brexit.

And unlike the west, the Russians will not be affected too much by this break up. They are not just contiguous with western Europe but also with the whole of Asia, especially China. All the abundance of natural resources and wealth that would have gone Europe's way will now go to China, India and a lot of other continental countries and will build up each other up into a new Eurasian superpower. This will have no parallel in the history of the world – the greatest industrial country in the world with the most well-trained population in STEM, now supplied with unlimited energy, food and other key resources. How can this combination not become the greatest economic power in the world?

This situation has long term consequences. If we can imagine how Brexit has dropped the UK into a deep black hole that is difficult to climb out off, reversing an 18 percent decline in trade with Europe and a GDP growth rate hovering around zero, plus a worsening public deficit, then the breakup with Russia by the EU is likely to bring about the same kind of economic outcome that the UK has experienced. We are not going to see a quick recovery from the economic sanctions, intended to destroy the Russian economy but which have backfired on the EU, and we can fully expect the EU to go the same way as the British economy – the inability to source the cheapest goods from its closest neighbours, the need to pay for expensive transportation costs for critical imports and the need to support a useless war that the Ukrainians cannot hope to win, once the USA gets Ukraine fatigue, as it always does.

Then there is the worsening problem of Ukrainian refugees swarming into Europe, now at 14 million and growing, as Ukrainian cities crumble under Russian air attack.   This problem is many times the scale of previous refugee crises and it has hardly got onto the radar of economic officials in the west.   And the outcomes are entirely predictable.   This refugee burden will soon become unbearable, both socially and economically.

The response of all these imminent problems cannot be to find the best solutions.   The best solutions have been ruled out – by politicians who have taken to believe they should never again work with Russia.   So they will go on buying gas at four times what Americans pay for their own gas.   How can the EU break out of the inflationary cycle if the obvious solution cannot be considered?

The Sino-West Contest

This has, in the last few weeks, appeared to have experienced a turnaround.   Firstly, Biden sought out Xi at the Bali G20 meetings to assure each other they don't want to fight a war, in fact, not even a cold war.   It felt almost like a truce is being called on the trade war that has been going on for four years.

This has been reinforced, last week, by statements from US Commerce Secretary, Raimondo, a policy hawk, that the US admits that it has not won the trade war.

U.S. Commerce secretary: Competing with China not 'easy'
By David Shepardson

WASHINGTON, Nov 30 (Reuters) - U.S. Commerce Secretary Gina Raimondo said on Wednesday Washington must do more to counter China while insisting the world's two largest economies should not isolate from each other.

Raimondo cited U.S. strengths like American universities, billions of dollars in government funding for semiconductors and research, and strong allies around the world as assets when competing with China.

"Despite all of these advantages -- and they are many -- competing effectively with China isn't going to be easy. It's going to take hard work and it's going to take the work of everyone, not just the government," Raimondo said at a speech at MIT.

She said the United States is "not seeking the decoupling in any way of our economy from that of China's."

She added that "cutting edge technology, that China wants to get its hands on to put into military capacity... We're not going to allow that."

The United States and China have sharply clashed in recent years. Raimondo laid out a detailed strategy to counter China in her speech.

"We are aiming to bolster our system of export controls, enhance our investment screening regimes, strengthen our supply chain resiliency, and develop innovative solutions to counter China's economic coercion and human rights abuses," Raimondo said.

In October, the Commerce Department published a sweeping set of export controls, including measures tightly restricting Chinese access to U.S. chipmaking technology, vastly expanding its reach in its bid to slow Beijing's technological and military advances.

She said for too long America's export control strategy "was quite reactive" and had "focused on preventing China from expanding its technological capabilities after it accessed American intellectual property."

China firmly opposes U.S. export controls on semiconductor chips, arguing they hurt Chinese companies and commercial interests of U.S. exporters.

Raimondo told reporters on Tuesday the United States is working with allies on semiconductor tooling restrictions and hopes they "will take steps similar to ours."

Concerns about China helped convince the U.S. Congress to approve hefty funding for semiconductor research and manufacturing and advanced science.

Raimondo in September 2021 said China was preventing its domestic airlines from buying "tens of billions of dollars" of U.S.-manufactured Boeing (BA.N) airplanes. In September, Boeing said it would begin to remarket some 737 MAX jets earmarked for Chinese customers citing ongoing geopolitical tensions.

Raimondo said on Tuesday "we need to continue to do business with China and trade with China supports American jobs."

Well, these comments are the most conciliatory we have seen in a very long time. Taking all that at face value, these are in the same vein as those that have been initiated by Biden himself at Bali. We have to take it that it is not all double talk and some degree of reconciliation is intended.

As for Raimondo's comments about America's strengths in the economic war, here are my comments:

1) America's universities, which are turning out 1/10th of the STEM graduates compared to China's universities lack sufficient output. The Chinese graduates have built the world's best infrastructure by far, have sent taikonauts into the sole remaining space station orbiting the planet and are now building a moon base, and they also have scientists discovering that graphine can be used as a more advanced material in semiconductors, instead of adhering to silicon. All these are signs that there is not much of an advantage in American universities over their Chinese counterparts.
2) Billions of dollars of US government grants to fund semi-conductor research is easily overtaken by those of the Chinese government which is putting more money at risk; and

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3) Its allies? Haven't they all followed Biden in Bali to get a meeting with Xi Jinping, always to discuss how to strengthen trade and commercial ties? As a matter of fact, Germany's Scholz pre-empted the whole American effort by visiting Beijing before Bali, and then the EU sent its chief foreign secretary, Josep Borell to represent the whole Union to find ways forward with the Chinese. What these allies said in China counters what Raimondo expect of them (to be assets on the American side), according to this report from the South China Morning Post:

EU will not follow US' China policy, top diplomat says in fiery debate with lawmakers

- *Josep Borrell distanced bloc from Washington's broad push to ban export of high-end chips seen as attempt to cripple Beijing's hi-tech sector*
- *But some lawmakers voiced disappointment in the EU's perceived softening approach, with one noting 'low ebb' in bilateral relations*

***Finbarr Bermingham** in Brussels*

EU and China leaders promise to keep talking amid 'multiple crises'

1 Dec 2022

The European Union will not follow the United States' toughest policies on China, its top diplomat insisted during a bruising debate on Tuesday in which he clashed with lawmakers calling for a more aggressive approach to Beijing.

EU foreign affairs chief Josep Borrell distanced the bloc from the US' broad push to ban the export of high-end chips, which is seen as an attempt to cripple China's hi-tech sector and has caused consternation among the EU's own semiconductor makers.

"Certainly, the United States are our most important ally, but, in some cases, we will not be in the same position or on the same approach towards China," Borrell said, adding that the US' "drastic reduction of China's access" to technology is a "decision that has to be taken into account".

His remarks echoed those of Dutch officials, who have pushed back against American efforts to build a common front blocking China's access to semiconductors. Dutch company ASML is one of Europe's few global players in the semiconductor manufacturing space.

While Brussels will "be engaged in a systemic rivalry" with China, Borrell's tone reflected a relative thawing in ties following a series of meetings between EU national political leaders and Xi Jinping, China's president.

Xi met with the elected leaders of France, Germany, Italy, the Netherlands, and Spain in recent weeks during a flurry of diplomatic activity in Beijing and Bali. Each stated a wish to maintain strong trade ties, even as they vowed to hold China to account for its human rights record. Leaders of EU institutions, however, found themselves watching from the sidelines.

When it comes to China, "differing models of governance and different visions of multilateralism … should not and are not stopping us from engaging with each other", Borrell said.

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He urged lawmakers to "take into account the reality of life, the complexity of this reality and the need for the European Parliament to contribute to it as well". Borrell's statement reflected frustration among EU diplomats that they pay the price for the body's pronouncements on China.

Whenever the European Parliament criticises China – which has been frequently in recent years – the EU's ambassador in Beijing is summoned or given formal diplomatic notice of China's displeasure. In August, the Post reported that the Chinese government views parliamentary statements as official EU policy.

"We cannot think that we can build a future without taking into account the enormous strength of a country that is called to play its rightful role in the world due to its size, due to its economic strength," Borrell said. "That is independent of the fact that our political system is not the same as yours. Of course it isn't."

A prickly Borrell engaged in a fiery back and forth with lawmakers led by Reinhard Buetikofer, the head of the parliament's China delegation, who said he was "very disappointed" with Borrell's perceived softening approach to Beijing.

"Mr Borrell, I'm disappointed. I heard from you a lot of generalities but very little indeed about the reality of EU-China relations. Maybe there isn't so much to report on what kind of relationship we have," the German MEP said.

"There is no point in putting lipstick on a pig. EU-China relations are at a very low ebb."

Belgian member Hilde Vautmans was one of several lawmakers to slam German Chancellor Olaf Scholz's decision to visit China last month, as well as his pushing through a sale of a stake in a Hamburg port terminal to a Chinese state-owned shipping giant.

"He couldn't understand why selling a part of the port of Hamburg to China would be such a problem," said Vautmans. "Is that really what he wanted after the Russian invasion of Ukraine? Is that really the lessons that we've learned?"

But Borrell said he could not understand what the fuss was all about.

"Isn't it normal that the German chancellor who exports 3 per cent or more of his products to China [goes]?" he asked. "How many times did Chancellor [Angela] Merkel go to China?"

Borrell's tone on China was markedly more muted than in April when he last addressed the European Parliament on the economic giant. At the time he described a recent EU-China summit as a "dialogue of the deaf" and noted China was not interested in discussing Russia's invasion of Ukraine.

On Tuesday, by comparison, Borrell said Beijing had shown "clear red lines" in its relations with Russia.

"China has not condemned yet the war of [aggression] of Russia against Ukraine – and the atrocities that are happening there, but it has set out clear red lines, and is increasingly concerned about the global consequences," he said.

The red lines, the Spaniard added, pertained to "the use of nuclear weapons", and he said Beijing at the G20 in Bali had sent "a clear message about the global consequences and the concern they have about [them]".

Nonetheless, Borrell warned that China was moving in a direction the EU did not like following the recent 20th National Congress of the Communist Party of China.

The concerns included "President Xi Jinping's personal hold on the Chinese [Communist] party, state and people, even a stronger hold of the party on the state, and, in particular, on public enterprises [and] the growing ideological nature of the Chinese political system with the development of both Chinese Marxist style – or Chinese way – and hyper-nationalistic rhetoric".

Then there is the very key development of the Democratic Progressive Party in the local Taiwanese elections last weekend. By now, everybody understands that the vast majority of Taiwan's population do not want a war with China, nor a government that will push for one. If that is so, the case for trade disruption in the Pacific region goes away.

If I were to critically put all these analyses together, the picture I get overall is that there is some reversal of the antagonism that has prevailed in west-China relations for some years now. That's an excellent sign. In addition, the war in Ukraine is not the Russian disaster that the western media put out for people to frame their expectations. And if what happens in the Donbas next makes the world more knowledgeable about why it is necessary to get everybody to the negotiating table, it would be a very good thing.

Hey, if Sino-American trade resumes to conditions before 2018 and similarly trade in Europe returns to the state before the war, then perhaps inflation in the world will settle down to 2% once again. It would be good if we get two for two, but then again, one out of two won't be so bad.

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Un-Influencer in a World full of Hubris