Weekly Commentary 37 – September 2023

Halftime Scores in the Global Economic Contest

Last week was chock full of news. And whichever side you are on, you will have something to cheer about, and something to be disappointed about. On balance, I would think that the China fans have more good news to celebrate.

Event No 1

On the pro-west side, if a strong currency reflects the power of a country, then America surely won big last week. The US Dollar surged to new highs not seen in months, and for folks who saw de-dollarisation as the equivalent of a decline in the value of the dollar, they obviously did not see it coming. As a matter of fact, most people were thinking that the recent success of the BRICS summit in South Africa, just a couple of weeks ago, would definitely herald in an era of a weakening dollar as those countries in BRICS would try to arrange for bilateral settlements of trade, such as between China and Saudi Arabia in the oil trade. The notion is that if countries did not have to buy dollars to pay for their imports, then that fall in demand would lead to a falling dollar. In the end, if nobody uses the dollar in bilateral trade settlements, then the dollar would fall precipitously.

De-dollarization is supposed to reflect the eclipse of the American empire, the end of its position as global hegemon and the eventual decline in its ability to influence the global economy as its top dog. De-dollarization is supposed to be disastrous for America.

And since the major backers of BRICS are China and Russia, it is thought that de-dollarization would simultaneously result in a strengthening of the Chinese Yuan and the Russian ruble.

Therefore, if the dollar is rising strongly, as it did last week, de-dollarization would be off the table. That's how the logic flows.

What is the extent of the rise in the US Dollar during a week when most financial media called its movement as being very strong. Was it?

As a matter of fact, the US Dollar gained strength mostly against the Asian currencies, in particular, the Japanese Yen and the Chinese Yuan. The Yen is the weakest currency, as it fell towards the level reached in Sep 2022 when the BOJ intervened and reversed the trend. Now, it has reached the 148 level once again, and the BOJ is threatening to intervene one more time. In the case of the Chinese RMB, the currency has dropped to 7.34 and still sees no sign of stopping. Here are two one-year charts of the two currencies against the dollar:

The trends in the movements of these two currencies are broadly similar. While the Yuan has broken through one-year highs, the Yen has not exceeded 151 which was breached a year ago.

Is there a systematic similarity between these two currencies so that they are in fact moving in tandem with one another against the US dollar? In fact, there is, and we can summarise it simply as – government attitudes. In today's global economy, the US is the one country with the highest interest rates. Because of these high yields, the sharply lower yields of the Yen and the Yuan, more so in the case of the Yen, result in huge differentials in yields between dollar holdings and Yen/Yuan assets. On this basis alone, the US dollar has strengthened and will probably continue to remain strong. The two Asian governments could have raised their interest rates to match those in the US, just as European governments have done, which is why the Euro and the Sterling have not weakened significantly against the Dollar. Therefore, the question can be asked, is the maintenance of low yields in the Yen and Yuan deliberate?

In my last Daily Report at the beginning of September, I predicted the outcomes we have witnessed in the last ten days or so. US interest rates have returned to the 5.0 level in the US 2 year bond, and the 4.30 level for the US 10 year bond, the highest levels since 15 years

ago, and they are building a base to push upwards in due course. With these unrelenting rises in the risk free interest rates provided by US government bonds, the entire yield structure of US rates will bolster the strength of the dollar. I stated that view on the 1st of Sep and that turned out to be exactly what happened. I also said that the US government cannot allow the US dollar to weaken significantly, as it is so heavily indebted that it needs to refinance its debt by selling more treasuries, and a crash of the dollar due to de-dollarization is not going to help treasury bond sales. Therefore, besides the short term effects of a hawkish Fed fighting inflation, there is the unstated but obvious desire to keep the dollar strong to keep its funding of the debt feasible.

That's my view. To give you a different flavour on what other analysts say, here is an article by Erik Norland of the Chicago Merchantile Exchange Group:

Four Factors That Impact Yen-Dollar Exchange Rate

By Erik Norland 02 AUG 2023

When the Bank of Japan (BoJ) announced on July 28 that it was easing its 0.50% yield cap on 10Y Japanese Government Bonds (JGBs) to a target level, the currency market wasn't sure what to make of it. The yen (JPY) first fell by 1.4% versus the U.S. dollar (USD), then rallied by 2.5% before giving up most of those gains.

While the currency market was uncertain as to what to make of the BoJ adjusting its yield curve control policy, the global bond market reacted decisively. 10Y JGB yields rose by 11.6 basis points (bps) to 0.555%, the highest since 2014. Moreover, the bond sell-off wasn't limited to Japan. Long-term bond yields rose by 1bps to 14bps all around the world.

JPY has been no stranger to volatility in recent years. Between January 2021 and October 2022, JPY lost one third of its value versus the USD. JPY recovered about one third of its losses between October 2022 and January 2023 before selling off again. Several factors have weighed on the JPY over the past two and half years and how these variables evolve going forward may determine JPYUSD's future course. They include:

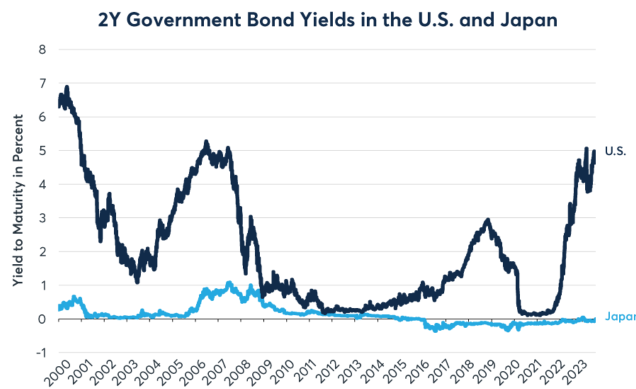
1. *Interest rate differentials*
2. *Quantitative easing*
3. *Economic growth rates*
4. *The relative size of trade balances*

Interest Rate Differentialsd

From 2008 to 2021, the difference between U.S. and Japanese rates was small, sometimes even close to zero. However, since the Federal Reserve (Fed) began raising rates in March 2022, the gap has expanded to its widest point since before the global

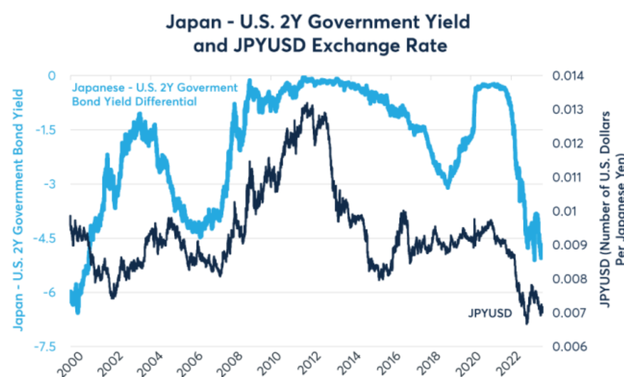
financial crisis (Figure 1). Thus far this century, JPYUSD has often followed the U.S.-Japan interest rate differential (Figure 2).

Figure 1: U.S. Japan rate differentials are at their widest point since before 2008



Source: Bloomberg Professional (GTJPY2Y and USGG2YR)

Figure 2: The differences between USD and JPY yields as a major driver of JPYUSD



Source: Bloomberg Professional (GTJPY2Y and USGG2YR, JPYUSD)

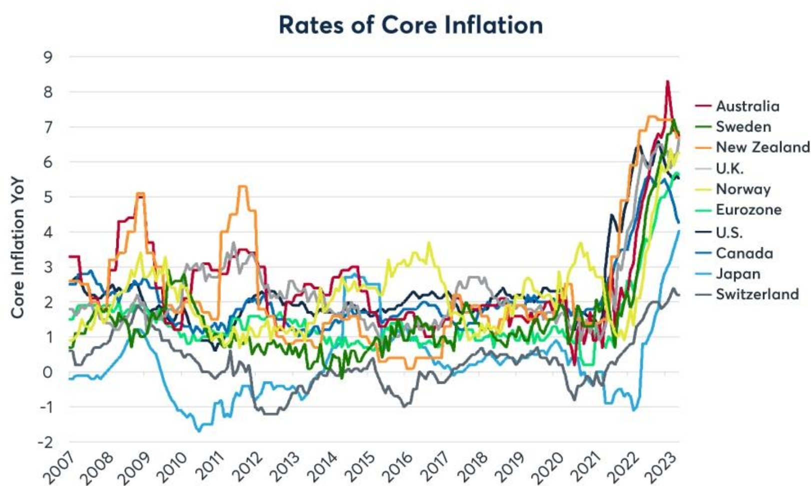
Pre-2008, JPY was often used as a funding currency. This is to say that because Japanese interest rates were much lower than rates in other countries, investors would borrow money in yen and deploy that capital in other currencies with higher rates. But such so-called carry trades, while sometimes profitable in the short-to-medium term, expose investors to enormous financial risks as the world discovered in October 1998 during the winddown of hedge fund Long-Term Capital Management. That month, JPY rallied by nearly 20% versus USD in 72 hours as carry trades were unwound as the Fed completed a 75bps policy easing while the BoJ kept its policy unchanged. To the extent that JPY is once again being used as a funding currency today, JPYUSD may once again contain an options-like risk.

The U.S.-Japan interest rate differential has been driven in part by large gaps in inflation. Japan's inflation, excluding the volatile food and energy sectors, has been

below that of the rest of the world for decades as the country oscillated in and out of deflation while Japan's peers typically had core inflation in the 1-3% range.

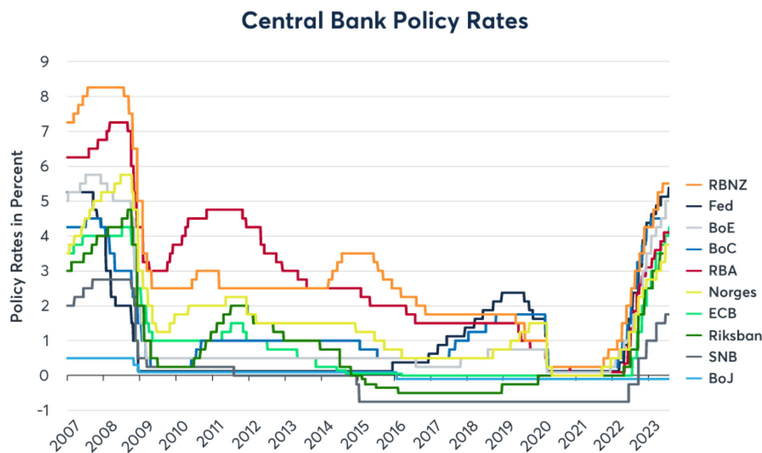
The post-pandemic inflation surge didn't spare Japan, but it hit much later and was seen from a different perspective (Figure 3). When inflation soared far above target in the U.S., Canada, Europe and Australia in 2021 and 2022, central banks reacted first with disbelief, and then with alarm. In Japan, the rise in inflation began about one year later and was greeted, at least initially, with relief: finally, Japan was exiting years of deflation and inflation was coming up to target. Rather than raising rates in tandem with other central banks, the BoJ appeared more concerned about returning to deflation than allowing inflation to increase further (Figure 4). Even so, core inflation in Japan has now far surpassed the BoJ's 2.5% target and might prompt further tightening action by the central bank.

Figure 3: Japan's wave of inflation started later and hasn't gone as high as other nations



Source: Bloomberg Professional (CPI XYOY, CACPTYOY, UKHCA9IC, CPIEXEMUY, JPCNEFEY, ACPMXVLY, NOCPULLY, CPEXSEYY, SZEXIYOY, NZCPIYOY)

Figure 4: The BoJ is one of the few central banks that hasn't tightened policy

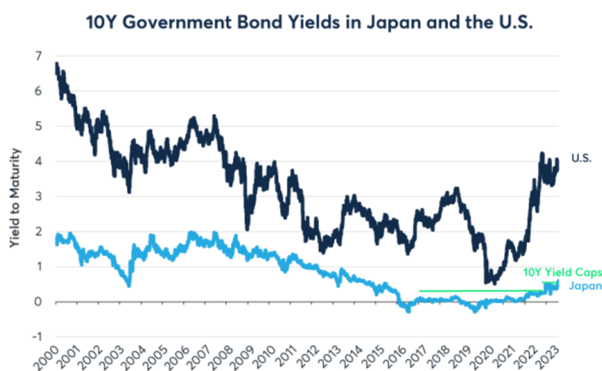


Source: Bloomberg Professional (FDTRMID, CBAROVER, UKBRBASE, EURR002W, BOJDPBAL, RBATCTR, NOBRDEP, SWRATEI, SZLTDEP, SZLTTR, NZOCR)

QE and Yield Curve Control

If the BoJ steps up actions against rising inflation, it might further loosen its yield curve controls. Up until late last year, Japan capped 10Y JGB yields at 0.25%. Since then, the *de facto* cap was first lifted to 50bps, then turned into a target rather than a hard limit (Figure 5).

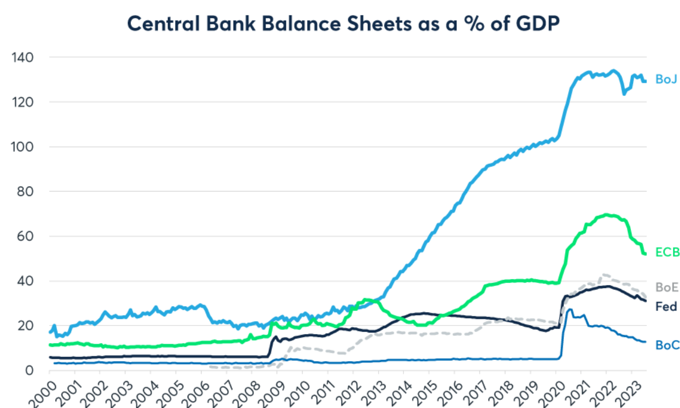
Figure 5: Easing the yield caps could cause the BoJ balance sheet losses



Source: Bloomberg Professional (GTJPY10Y and USGG10YR)

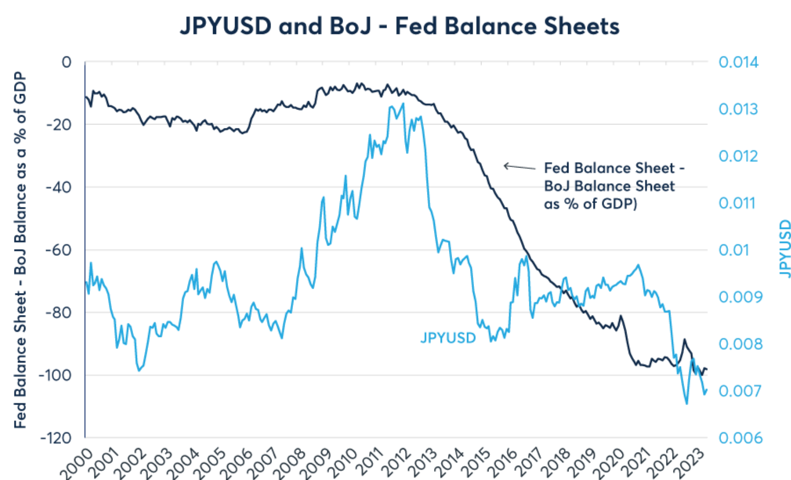
To prevent yields from rising beyond the 0.25% and 0.50% band, the BoJ was willing to create however much liquidity necessary to serve as the buyer of last resort for government bonds with maturities of less than 10Ys. This policy inflated the BoJ's balance sheet relative to the size of the Japanese economy and was much larger than the quantitative easing (QE) programs in the U.S. or Europe (Figure 6). As the BoJ's balance sheet expanded relative to that of the Fed, JPYUSD tended to weaken (Figure 7).

Figure 6: The BoJ QE was much larger than the Fed's or ECB's



Source: Bloomberg Professional (BSPGCPUS, BSPGCPEU, BSPGCPJP, BSPGCPGB)

Figure 7: More QE often translates into a weaker currency



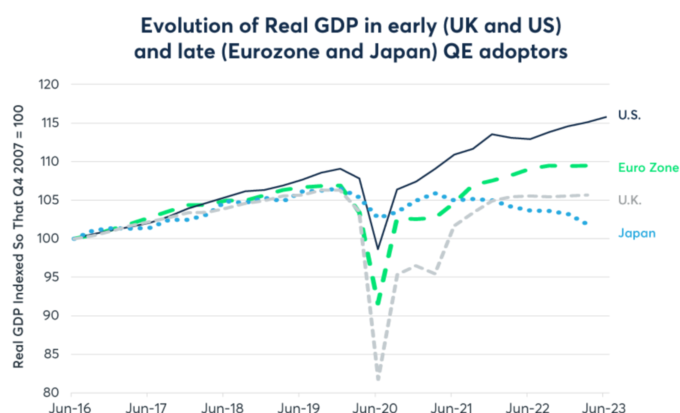
Source: Bloomberg Professional (BSPGCPUS, BSPGCPEU and JPYUSD)

Once 10Y JGB yields are uncapped, there is a possibility that the BoJ could start to raise short-term rates afterwards. With respect to the twin prospects of ending yield curve control and raising rates from -0.1% to positive levels, there appears to be a naïve assumption that doing so would slow Japanese growth. Underlying this assumption is a belief that yield caps and negative rates support growth. However, the evidence suggests otherwise. Yield caps may actually slow growth rather than support it by discouraging bank lending. Banks lend more profitably when yield curves are steep than flat as banks earn the spread between what they pay for short-term deposits at the bank and the banks' longer term loans to customers. Secondly, negative rates serve as a tax on the banking system and may cause hoarding of cash rather than expanding lending activity.

The Growth Differential

The idea that yield curve control and negative rates are burdening Japan's economy is supported to some extent by Japan's GDP data. While the U.S. economy has been slowly expanding and Europe's has been stagnating, Japan's economy has been shrinking (Figure 8). The shrinkage is driven in part by demographics: it's population growth is negative, whereas population growth in the U.S. remains positive. This has probably weighed on the yen as currency investors tend to prefer to be "long" in currencies with expanding economies.

Figure 8: The U.S. has been growing, Europe stagnating, Japan shrinking



Source: Bloomberg Professional (GDP CHWG, EUGNEMU, JGDPSCE, and UKGRABIQ)

As such, ending yield curve control might boost JPY for two reasons:

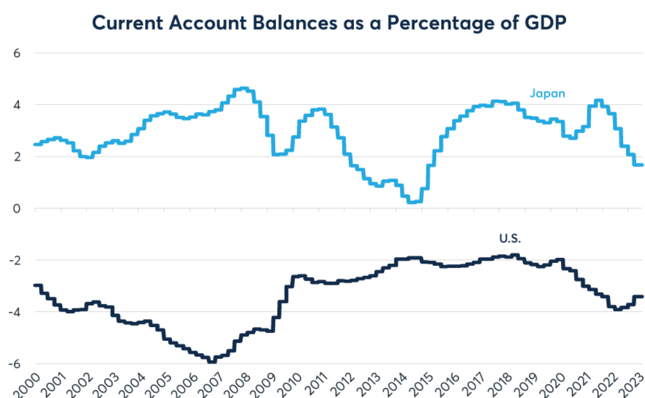
1. *It would allow the BoJ to shrink its balance sheet more quickly.*
2. *A steeper yield curve could boost economic growth by encouraging bank lending and thereby draw more capital into the yen.*

At some point the Fed's tightening might produce a slowdown in the U.S. while the weaker JPY might boost Japanese growth. If that happens, the growth gap could move in the opposite direction to the benefit of the JPY relative to USD.

The trade balance

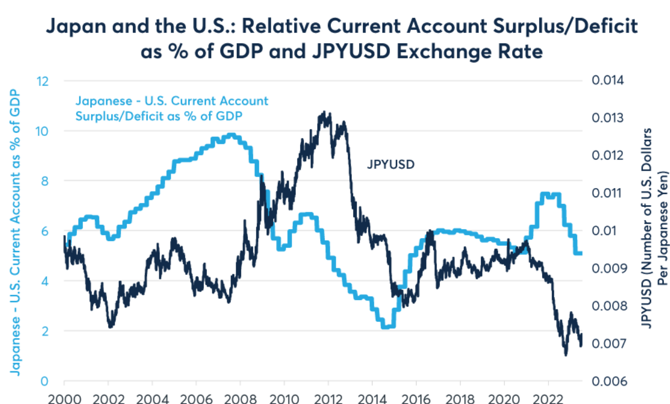
When it comes to trade balances, the U.S. runs consistent capital account surpluses and current account deficits owing largely to the USD's position as the global reserve currency. As such, because the U.S. runs trade deficits, the rest of the world tends to run trade surpluses and Japan is no exception. The relative size of the U.S. deficits and Japanese surpluses do, however, vary over time. Recently, U.S. deficits have shrunk modestly while the size of Japan's surplus has come down significantly (Figure 9). The relative size of Japan's surplus to the U.S. trade deficit has also been a major driver – and sometimes a leading indicator – of movements in JPYUSD (Figure 10).

Figure 9: Japan's trade surplus with the U.S. has shrunk



Source: Bloomberg Professional (EHCAJP and EHCAUS)

Figure 10: The Japan-U.S. relative trade surplus or deficit can also drive JPYUSD



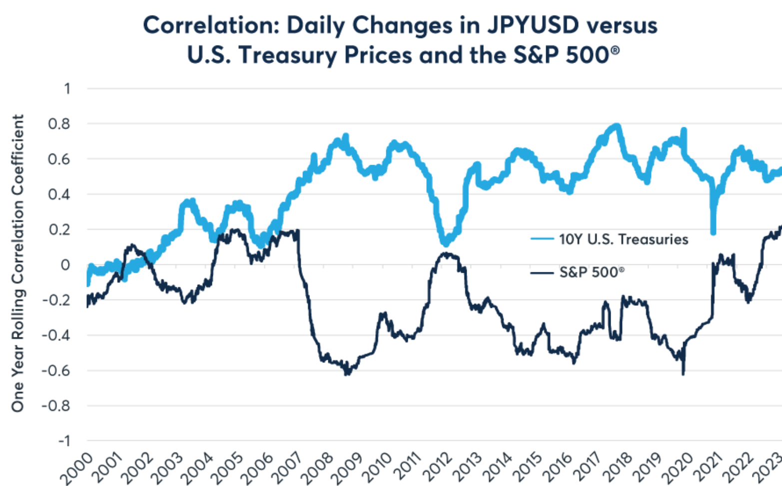
Source: Bloomberg Professional (EHCAJP and EHCAUS, USDJPY)

One of Japan's major vulnerabilities is that it produces almost none of its own crude oil, natural gas or coal, a weakness that has been exacerbated by the reduction in nuclear power following Fukushima. One of the reasons why Japan's trade surplus shrank in 2021 and 2022 was the soaring cost of imported energy. Crude oil prices soared as high as $110 per barrel. The Japan-Korea Marker (JKM) price of natural gas soared by 2,000%. Coal prices also rose, especially in 2021. All of these factors contributed to the yen's dive in 2021 and 2022 versus USD and most other currencies. The fact that JKM natural gas prices have now fallen by over 80% from their highs last year and the global moderation in crude oil and coal prices have also acted to support the yen in recent months. The combination of lower energy prices as well as the beneficial effects of a weaker yen on Japanese exports could give rise to an expansion of Japan's surpluses which could prove supportive for the yen.

One final note on JPYUSD: it has a lot of bond-like characteristics. Since 2006, JPYUSD has generally had a strong, positive, if not always stable correlation with the day-to-day price changes in U.S. Treasuries (Figure 11). Since bond prices and yields

move in opposite directions, that has meant that JPYUSD tended to fall when U.S. yield rise, and vice versa. As such, if the Fed's rate hikes tip the U.S. economy into a recession, that could provoke a steep fall in U.S. Treasury yields, which could prove to be very supportive for the yen. Moreover, any sudden reversal in monetary policy with the U.S. lowering rates as Japan tightens, has the potential to provoke an unwinding of carry trades that use the yen as a funding currency, which could, at some point, prompt a sudden strengthening of the yen.

Figure 11: JPY trends to correlate positive with Treasury prices/negatively with yields.



Source: Bloomberg Professional (JY1, TY1 and ES1)

Similarly, let me also bring in an external view, not written by me, to explain the weakness of the Chinese RMB. Let's see if this view coincides with mine.

Yuan Drops Toward Record Low as China Budges in Fight With Bears
Bloomberg News

Fri, September 8, 2023

Yuan Drops Toward Record Low as China Budges in Fight With Bears

(Bloomberg) -- The offshore yuan weakened toward its lowest on record against the dollar, as a cut to the daily reference rate for the managed currency stoked bets China is comfortable with a gradual depreciation.

China's currency declined as low as 7.3623 per dollar in overseas trading, beyond the psychologically important level of 7.35 and close to the weakest since the creation of the offshore yuan market in 2010. The move came after the People's Bank of China set its so-called fixing at a two-month low on Friday.

The PBOC is faced with a daunting task of maintaining the so-called impossible trinity, where it needs to stabilize the exchange rate and prevent capital outflows while keeping an independent monetary policy. But China's sluggish economy and dovish policy are heaping pressure on the yuan, especially as resilient US data and a high interest-rate differential there has traders favoring the dollar.

Such a trilemma is not new to Beijing, having occurred in the aftermath of the shock yuan devaluation in 2015 and during the height of the nation's trade war with the US five years ago. Past experience shows policymakers tend to prioritize growth and allow a controlled depreciation eventually, as a weaker yuan makes China's exports more competitive.

"The weaker fixing shows the PBOC is willing to accept a higher dollar-yuan rate as long as it is not an isolated case," said Kiyong Seong, lead Asia macro strategist at Societe Generale SA. "The yuan's future path largely depends on the general dollar movement which is hard to say at this juncture. But recent developments appear to support our year-end forecast of 7.60."

Key Level

The recent declines in the yuan have been so sharp that the currency is perilously close to the weak end of its 2% trading band with the greenback. On Thursday, the onshore yuan slid to a 16-year low.

The drop in the offshore market on Friday was notable because the yuan went through the 7.35 level that was one China's top leadership were playing close attention to last month, according to a Bloomberg report citing people familiar. The currency also weakened the most since mid-August against a basket of exchange rates, not just the dollar, a sign pessimism toward China was the biggest driver.

Yuan Traders Debate Whether or Not PBOC Has Drawn Line in Sand

"Sentiment is also affected by the lack of real improvement in the economy and corporate profits," said Gary Ng, a senior economist at Natixis in Hong Kong. "Until then, the yuan will likely face depreciation headwinds."

Of course the rebound in the dollar is not just causing trouble for China. In India, the rupee is also close to its weakest on record and Japan this week escalated its verbal warnings against yen bears with the currency back at more than a three-decade low.

Yuan Toolbox

Despite the gesture of a looser grip, China doesn't seem to be fully ready to let the currency go.

The offshore yuan pared losses in the afternoon to trade just 0.1% weaker at 7.3498. That came as state banks were seen selling large quantities of the dollar to prevent China's currency from sinking further, according to traders who asked not to be named as they aren't authorized to comment on the foreign-exchange market.

China can still dig deep in its toolbox to punish yuan bears. The central bank can opt to engineer a cash crunch in Hong Kong to burn speculators shorting the currency, or make it more expensive for traders to initiate bearish trades with forwards.

Policymakers have already sought to slow the yuan's decline by guiding state banks to sell dollars multiple times and boosting the supply of foreign exchange in the local market. Verbal support is also starting to appear, with a state-run newspaper saying in a front-page commentary on Friday that the yuan is only going through "intermittent depreciation" as the dollar index is strong.

Beijing has also announced a slew of other policy measures to help boost the economy, many targeted at the faltering property sector.

Still, while China's support measures are gradually coming through, investors are not likely to see a rapid rebound in the currency, according to economists at Goldman Sachs Group Inc.

"Although yuan liquidity management could be sustainable and effective to push back against one-way depreciation expectations, current conditions still suggest weakening pressures on the yuan, especially as the dollar strengthens," said a team including Xinquan Chen.

The two articles above, which explain the weakness of the Yen and the Yuan comprehensively, are completely in line with my assertions which I will repeat here:

1) Both these governments are not doing anything to seriously defend their currencies mainly because both have greater concerns over the performance of their domestic economies. To defend their currencies, a hike in interest rates would be necessary to match the US dollar's rising yields during a phase when the Fed is fighting inflation with monetary policy. Tokyo and Beijing are just not prepared to do that. They would rather have a bit more inflation, since they have no inflation at all, than to defend their currencies with higher rates that may hurt their economies. Therefore, my conclusion is that official government attitudes (rather than specific policies) in both countries are behind the weakness in their countries' currencies.

2) Given that the policy actions among the three countries are in one of two groups, with only the US actively tightening and the other two passive, the outlook for the Yen and the Yuan is therefore dependent on the outlook for US inflation. Over the last month, that outlook has turned to reflect the fact that US inflation has fallen from its highs of about 8.5% per year to the current 3% level. The market was thinking that the Fed is done raising rates. Then in the last week, oil prices rose sharply due to OPEC Plus acting to maintain cuts in supply till the end of this year. Brent crude shot up to $90 per barrel and the NY WTI is now at $87. Retail gasoline prices in the US are rising again. Food prices have hardly budged, with the failure of the collective west to meet the conditions of the grain deal with Russia, when they had agreed to relax the sanctions on the Russian agricultural bank but failed to do so. So that deal is off permanently. With food and fuel prices thus set in the short term, there is little hope that the US Fed will see its core inflation target of 2 percent met anytime soon. If we go with the Fed's own messaging, there will not be an end to high interest rates yet. As such, the Yen will likely weaken to 160 Yen to the dollar and the Yuan to 7.4.

3) While the two Asian governments are keen not to be perceived as fostering devaluation of their currencies to boost exports, I don't think they are averse to using cheaper export prices to add to the measures that boost their economies. They will

only act to reduce volatility on the road to a weaker level in their currencies, but they won't act to change the trend. There is no need to. There is no fear of imported inflation via weaker currencies, and a boost in exports is very much considered a good thing. As such, expect the current trends to continue.

4) As I have also said with regards to the de-dollarization, this is a long-term process. It has started but it won't take effect within ten to twenty years, if not longer. Most importantly, I have postulated that even if the world economy de-dollarizes, it may not mean a lower dollar. Yes, more bilateral trade flows will happen in non dollar currencies, but this does not necessarily lead to dollar devaluation. The remainder of the world using dollars is still humongous and there is no case to be made to argue that a smaller share of the world's trade will mean a lower dollar. Most importantly, trade flows are a minute part of the world's use of the dollar; there are far larger flows in foreign exchange investment and speculative flows, or so-called capital flows, and given that the Yuan is a controlled currency, there is no scope for a world based on the RMB to become the center of forex speculative activity. My contention is that even in the face of full de-dollarization, this is a different phenomenon from a broad devaluation in the dollar given that the loss of trade flows in the overall usage of dollars will be negligible.

Event No 2

Let's move on. How about the fall on the ruble? What happened? Well, if the dollar is appreciating with the rise in US interest rates, why should the Russian central bank be concerned about a weaker ruble against the American unit. Against the Yen or the Yuan, there is very little change in the value of the ruble. With the isolation of the Russian economy, there is also very little domestic damage in terms of imported inflation. It is not a Russian problem. For all the countries in the world with a weaker currency against the dollar, it is actually an American problem. They have inflation while the rest don't. Why should they worry about that?

Of course, the warmongers will say that the Russian sanctions are finally working and the ruble will soon become rubble. Not really. First of all, the war on the battlefront has been lost. Decisively. The Kyiv government basically announced the end of its current counteroffensive by sacking its defence minister in the last few days. Is there any other way to interpret this action? Blinken was visiting Kyiv for two days, and mumbled a speech that said that Russia had lost strategically, and if he believed his own words, he is a fool. And if he thought other intelligent people believed him, then he would be an even greater fool. You don't fire the man responsible for organizing victories, period.

Then there is this opinion piece in the Washington Post, written by Fareed Zakaria, CNN political analyst, just as Blinken announced another $1 billion as further aid to Ukraine.

Ukrainians are determined to persevere, but they worry that their allies aren't

By Fareed Zakaria

September 8, 2023

KYIV — The overnight train ride from Poland to Ukraine is a reminder of why this land has been so hotly contested over the last century: Ukraine's soil is among the most fertile on the planet. We passed vast fields of wheat and other crops dotted with small farmhouses; in some places farmers were still using horses to plow the fields. As we approached Kyiv, the landscape quickly shifted to urban.

Despite the war, Ukraine's railways continue to be clean, comfortable and efficient. My train rolled into Kyiv right on time. That says a lot about Ukraine. Despite the war, Kyiv feels almost normal. A year into the invasion, roughly half of Kyiv's population had fled, but many people have since returned. The city had about 3.9 million residents in 2021, before the fighting started, and it's back to around 3.6 million today (local sources tell me.)

The Yalta European Strategy annual meeting is also still being held as it has been for nearly 20 years (located originally in the Crimean city of Yalta and then, after the 2014 occupation of Crimea, in Kyiv). "The struggle for Ukraine is the most important struggle in the world right now, and we need to keep the world's attention focused on it," Viktor Pinchuk, the organizer, told me.

Stores and cafes in the city are bustling. Air raid sirens went off while I was having dinner at a friend's place, and no one even stopped eating. But there are constant reminders of the conflict. Billboards scattered around the city mourn Ukraine's lost "heroes," as the fallen soldiers are often called. Sandbags and roadblocks are common.

Everyone is exhausted and sober. Ukraine's losses have been terrible, measured both in cities destroyed and soldiers and civilians killed. As a German friend who has lived in Kyiv for years put it to me, "There is growing understanding of loss as part of normalcy. People are adjusting to the reality of knowing more and more people who have been killed or wounded. It's a tough, sad condition."

But exhaustion does not equal surrender. No one I spoke with believed that Ukraine should stop fighting to get back its territories. They were disappointed that the counteroffensive is not going better, but its difficulties only remind them that this will be a long struggle. Were they to make a premature peace, many said to me, this would only be a temporary pause. The Russians would come back, and they would have simply pushed the burdens of war onto the next generation.

When you speak with people at greater length, their views are more nuanced. "No surrender" is the mantra, but some said it was possible to imagine a cease-fire — with Ukraine never legally endorsing the legitimacy of Russian rule over parts of Donbas and Crimea — in

exchange for real security guarantees. As one Ukrainian politician (who wished to stay unnamed) told me, “It’s easy for all of us who have not been in the fighting to refuse to compromise. The real question is what are the attitudes of the soldiers in the field and those who have returned. They might have more nuanced positions. But they will have to articulate them.”

The dominant worry in Kyiv is not about Russia but the West. Ukrainians have reason to be worried. Support for their fight is waning in some European countries. An election in Slovakia later this month could bring into power a populist prime minister who is distinctly pro-Russian, which would give Hungary’s Viktor Orban a useful ally in trying to change Europe’s policies. Support for Ukraine is also slipping in the United States. Many observers believe that the Russians are determined to stay the course until the 2024 elections in the hope that Donald Trump would be elected and that he would quickly hang the Ukrainians out to dry as he searched for a deal with Vladimir Putin. That would be a disaster, legitimizing naked aggression and emboldening dictators such as Putin and China’s Xi Jinping who want to disregard norms and rewrite the rules of the international system. “The jungle,” as Robert Kagan calls it, would return to international life.

The West has often fought wars alongside allies who were not deeply committed to their own cause, let alone the larger cause of freedom — from Afghans and Iraqis to the South Vietnamese and even the South Koreans (who were defending a nasty dictatorship during the Korean War). The Ukrainians are different — utterly committed to their independence but also to the values the West holds most deeply.

Ukrainians understand that they are in for a long war of attrition. They understand that they are up against a formidable foe — Russia’s population is almost four times that of Ukraine’s and its economy is about 15 times larger. Ukrainians are determined to persevere, but they worry that their allies are not.

Given the timing of this article in a mouthpiece of the Washington elite (Wapo), by a member of that elite (Zakaria), it is a sign that the Americans are preparing to throw the Ukrainians under the bus. This article announces that there are alternatives to the collective west pursuing a course of action that must end in a Russian military defeat and a regime change in the Kremlin. These alternatives are now being considered because after 18 months of war, with the most recent 3 month-long counteroffensive failing miserably to even break through to the first line of Russian defence, while losing even more territory in the northeast to Russian attacks, Zakaria needs to speak to the sense of loss in the face of Ukraine’s allies wanting an off-ramp. The Zakaria article above is preparing the ground for alternative approaches.

What alternatives might there be?

1) There is obviously no room for surrender and I don’t mean the Russians. With the Americans so heavily invested in Project Ukraine, even if the last Ukrainian dies, it will not be enough to overcome the embarrassment (for the collective west) of a military loss

to the Russians whom their propaganda have called incompetent and basically, "losers". So that won't happen.

2) There is not even room to stop fighting, in the months before the Nov 24 elections in the US. Hence, a second alternative is to send more Ukrainians into the fray to be minced by Russian artillery. It's unconscionable and callous but that's exactly what the collective west has been doing, especially by giving them weapons which the Russians can easily blow up. This is what happens when Zelensky was suckered into this war, by the British and the Americans who promised NATO membership and all the money and weapons to beat the Russians. This alternative is actually actively being pursued right now. It's called "double down".

3) Now that it is known that Biden and Trump are running neck to neck in the polls, and that Trump is against the war, vowing that he will end it in a day, the neocons who sponsored this war are looking for alternatives in case Trump wins. A Trump win is of course a good alternative even if it is bad news for the neocons.

4) That could mean a sort of armistice, a Korean style truce, where there is no doubt both sides will refresh their armies for another go at it. But for the moment, the embarrassing silence of why 20% of Ukrainian territory is still in Russian hands, 400,000 Ukrainians have perished, most of the western equipment sent to the battle have been destroyed and most importantly, why Ukraine is a broken country with no viable economy to speak of, remains unbroken.

5) Prof John Mearsheimer, and other non-mainstream analysts, are of the view that the Russians are unlikely to negotiate now that it is obvious they are winning. As a matter of fact, the Russians may have enough momentum to keep the five oblasts now under their control permanently and then to extend that control to the next four oblasts further west until all the territory east of the Dneiper River have been captured. Should this happen, it does not matter what the ruble exchange rate is - the victory by the Russians over NATO will be considered so decisive, it will be unquestionable. No bullshit by Biden and Blinken will then be possible in those circumstances to convince even Joe-Six-Pack otherwise, just as it is already impossible to sell a "narrative" to those of us who are smart enough to know a lie when we see one.

Therefore, I wouldn't count the second event – a weaker ruble - as a pro-west victory. It could in fact be the beginning of the end in the NATO proxy war.

Event No 3

The third event that carried more headlines over the last week than anything else, was the news that Huawei has just released its latest phone. This is a phone that is estimated to generate 60 million orders in the coming year, and is pitched directly to compete with top-of-the-line Apple iPhone products. Its secret? The new Kirin 9000S chip – a 5G 7-nanometer chip designed and manufactured entirely in China.

This shocked the world.   Because the tech war which the Americans launched against China was supposed to cripple China's technology industry, especially Huawei, and it was thought by the US that China will NEVER be capable to breaking through the 14-nm barrier.   Of course, that was the view of morons in the American elite. More knowledgeable analysts, including myself, have always thought the US chip sanctions will hold back China for at most 2-3 years.   As such, all observers, including both neocon dumbfxxks and fans of China, were shocked to see this new Huawei Mate 60 Pro phone released just one year into Biden's announcement of his Chips Act last August.   It was a stunning breakthrough.   And the Chinese announced it in a remarkably sarcastic way – quietly without fanfare on the last day of Gina Raimondo's (one of the hawks advocating anti-China trade and tech policies) visit to Beijing.   Basically a well-placed slap on her face. And a middle finger to all those in the Biden Administration who were confident that they had cut the Chinese tech industry off at the proverbial pass.

As I said, the news made headlines everywhere.   Both in traditional media which seemed shocked and in non-traditional media which were mostly cheering the news. Here is an example:

Huawei Teardown Shows Chip Breakthrough in Blow to US Sanctions.

The company's Mate 60 Pro is powered by SMIC's 7nm chips, according to analysis that TechInsights conducted for Bloomberg News

By Vlad Savov and Debby Wu

4 September 2023 at 14:38 GMT+8

Huawei Technologies Co. and China's top chipmaker have built an advanced 7-nanometer processor to power its latest smartphone, a sign Beijing is making early progress in a nationwide push to circumvent US efforts to contain its ascent.

Huawei's Mate 60 Pro is powered by a new Kirin 9000s chip that was fabricated in China by Semiconductor Manufacturing International Corp., according to a teardown of the handset that TechInsights conducted for Bloomberg News. The processor is the first to utilize SMIC's most advanced 7nm technology and suggests the Chinese government is making some headway in attempts to build a domestic chip ecosystem, according to the research firm.

Much remains unknown about SMIC and Huawei's progress, including whether they can make chips in volume or at reasonable cost. But the Mate 60 silicon raises questions about the efficacy of a US-led global campaign to prevent China's access to cutting-edge technology, driven by fears it could be used to boost Chinese military capabilities.

With its export controls last year, the US administration tried to draw a line at preventing China from getting access to 14nm chips, or about eight years behind the most advanced technology. The US had also blacklisted both Huawei and SMIC. Now China has demonstrated it can produce at least limited quantities of chips five years behind the cutting-edge, inching closer to its objective of self-sufficiency in the critical area of semiconductors.

“It's a pretty important statement for China,” TechInsights Vice Chair Dan Hutcheson said. “SMIC’s technology advances are on an accelerated trajectory, and appear to have addressed yield-impacting issues in their 7nm technology.”

SMIC’s Hong Kong-traded shares rose 11% on Monday after publication of the report, in their biggest jump since January 2021. In Shanghai, its stock rose 6%.

The teardown by TechInsights — which has spent decades investigating the electronic innards of hundreds of devices for some of the world's biggest tech firms — represents the most authoritative analysis of the Mate 60 Pro's components since its abrupt introduction ignited a frenzy of speculation. Huawei quietly released the phone online last week without detailing key specifications, like the processor design or the wireless connection speeds. It came during a visit to China by US Commerce Secretary Gina Raimondo, whose agency imposed many of the key export controls on China.

The phone has sparked speculation because Huawei is at the center of Washington-Beijing tensions, the target of sanctions over allegations it aids China’s military. Once the world’s biggest telecommunications provider, it’s been pulling out the stops to research alternatives to American circuitry since the Trump administration added Huawei to its Entities List in 2019.

The Mate 60 advance could reset the dynamics of the tech clash, as it suggests Huawei is able to come close to, though not quite match, the fastest mobile devices using a chip that’s designed and produced in China. Testing by Bloomberg News showed the Mate 60 Pro capable of cellular speeds on a par with 5G devices like Apple Inc.’s latest iPhones.

“It’ll be a big boost for SMIC and the whole semiconductor industry in China. Their share rally could continue because it beats market expectations,” said Steven Leung, a UOB Kay Hian Hong Kong executive director. “Most people didn't foresee that China could catch up in this area so quickly.”

The move also raises questions about SMIC’s compliance with US rules stipulating that any company intending to supply Huawei using American technology — which is present throughout SMIC’s operations — must obtain Washington’s approval.

Representatives for Huawei and SMIC did not respond to requests for comments about the phone’s specs since its release last week. Huawei has said only that the Mate 60 Pro is the most powerful Mate device yet. The Commerce Department did not respond to queries about whether SMIC’s supply of 7nm chips to Huawei violates sanctions.

Chinese chipmaking still has a performance gap, as the main processor in the Mate 60 Pro is two generations behind the latest global technology, according to the teardown by

TechInsights, whose findings lent weight to unsubstantiated reports posted by amateur technicians, bloggers and influencers on Chinese social media.

Apple's current iPhones are built at 4nm and next week it will introduce a new flagship iPhone powered by a 3nm chip.

Shenzhen-based Huawei and Shanghai-based SMIC may already be approaching the ceiling of what they can achieve without more advanced chipmaking machinery. To move beyond 7nm, iPhone supplier Taiwan Semiconductor Manufacturing Co. utilizes extreme ultraviolet lithography, or EUV, machines from ASML Holding NV. China is completely prohibited from importing those machines.

It is unclear how many units of the new device Huawei intends to produce. The Mate 60 Pro sold out almost immediately and appears to have been available in limited quantities. It was welcomed with an outburst of patriotic fervor across Chinese social media, and national outlets like CCTV and the Global Times lauded it as a symbol of China's irrepressible spirit.

Huawei's consumer business took a heavy blow after the company was cut off from chipmakers like TSMC three years ago, when its smartphones were the clear growth driver for one of China's biggest tech manufacturers. Its consumer sales are now less than half the size they were before the sanctions took effect, and the company has shifted its focus to developing technology for enterprise, cloud and automotive applications.

Analysts at Jefferies, including Edison Lee, urged caution in interpreting what Huawei's Mate 60 says about China's progress in chips. They wrote that selling out of Huawei's phones in hours suggests limited inventory. They also said that Huawei may be powering some Mate 60s with chips from TSMC, which it had stockpiled before the US cut off such purchases. In a report entitled "Huawei Mate 60 Pro: More Myths Than Fact," the Jefferies team said it thinks China can produce only a "very small" volume of 7nm chips.

Analysts at Sanford C. Bernstein including Mark Li said teardowns suggest that Huawei's chip speeds were accomplished with advanced packaging and power consumption. China may not be able to make semiconductors as economically as global players, but it's taking steps toward building supply for its most critical sectors. "We find Huawei's and hence China's progress better than expected," they wrote.

And as usual, the US government is all arrogant. The first thing that comes to their mind is that there has been cheating. The next Bloomberg article published four days after the above one, says the following:

US Probes Huawei Mate Phone's Made-in-China Chip as Alarm in Washington Grows – Bloomberg

The US government has begun an official probe into an advanced made-in-China chip housed within Huawei Technologies Co.'s latest smartphone, as tensions flare between the two superpowers over technological prowess.

The Commerce Department, which enacted a series of restrictions against Huawei and China's chip industry over the past two years, said it's working to get more information on a "purported" 7-nanometer processor discovered within the Mate 60 Pro. The chip was made by China's Semiconductor Manufacturing International Corp., which like Huawei is blacklisted by the US and restricted from accessing American technology.

The discovery of the chip set off a debate in Washington about the efficacy of sanctions intended to contain a geopolitical rival and coincided with a move in China to expand a ban on the use of iPhones in government-backed agencies and state companies (there is no evidence of this ban and it has caused Apple shareholders $200 billion when the stock fell).

The US has been trying to throttle China's tech sector for years amid concerns in Washington that it will gain a military edge. China, which has bristled at the restrictions, has its own fears about the use of foreign technology in sensitive industries and has been seeking to reduce its reliance on American software and circuitry.

Clamping down on the iPhone threatens to erode Apple Inc.'s position in a market that yields about a fifth of its revenue and where it produces the majority of its star product. Apple has lost about $200 billion of market value in the past two days, adding to a litany of concerns over China weighing on major US indexes. The shares were little changed in premarket trading in New York on Friday.

Huawei's quiet reveal of a mobile phone utilizing technology the US has sought to keep out of Beijing's hands threatens to derail recent efforts of outreach by the Biden administration. The Huawei phone went on sale online while Commerce Secretary Gina Raimondo was on a trip to China last week, the latest in a series of high-level diplomatic visits to Beijing.

The debate now centers around whether it represents a failure of US efforts — led by Raimondo's department — and has raised questions about whether the main US mechanisms to rein in China, including controls on exports of key materials, tools and knowhow, need to be tightened.

"We are working to obtain more information on the character and composition of the purported 7nm chip," a Commerce spokesperson said in a statement. "Let's be clear: export controls are just one tool in the U.S. government's toolbox to address the national security threats presented by the PRC. The restrictions in place since 2019 have knocked Huawei down and forced it to reinvent itself — at a substantial cost to the PRC government." (Actually not true; Huawei never had a losing year)

Chinese semiconductor equipment makers soared as much as 20% after news of the US probe spurred bets that the sector will enjoy increased state support. That advance was mostly led by companies related to lithography gear — a weak link in China's chip supply chain and one Beijing is keen to develop. Shanghai Electric Group Co., whose controlling shareholder has a major stake in lithography specialist Shanghai Micro Electronics Equipment Group Co., rose by its 10% limit.

“We have always opposed politicizing trade and technology issues and overstretching and abusing the concept of national security,” Foreign Ministry spokeswoman Mao Ning told reporters at a regular briefing in Beijing Friday. “Sanctions will not stop China’s development, it will only strengthen China’s resolve and capability to seek self-reliance and technology innovation.”

The Mate 60 Pro smartphone employs an unusually high proportion of Chinese parts, in addition to its main processor, an ongoing teardown by TechInsights conducted for Bloomberg News revealed, a sign of the country’s progress in developing domestic tech capabilities.

US National Security Advisor Jake Sullivan has said he would withhold comment until the US gets more information.

“There’s a number of different methods to try to sort of come to an understanding of what exactly it is that we’re dealing with here,” Sullivan told reporters aboard Air Force One on Thursday. “I can’t give you an exact number of days but this is not going to be months down the road. We’re going to want to look at this carefully, consult with our partners, get a clearer sense of what we’re looking at, and then we’ll make decisions accordingly. “

In the meantime, Huawei’s new devices have spurred an outpouring of nationalist sentiment on Chinese social media, which portrayed them as a triumph in the face of US sanctions.

On Friday, Huawei debuted an even more powerful smartphone — the Mate 60 Pro+ — in an online video teaser.

The Pro+ adds a 1-terabyte maximum storage option and 4GB more memory than on the Pro model, which retails at 6,999 yuan. Shares of Huawei suppliers soared as much as their 10% daily limit on Chinese exchanges after that latest offering hit online stores.itu

From the looks of it, at half time, the Chinese tech industry has avoided a checkmate by the Biden White House. It is in fact gearing up to do its own checkmate on the Americans, the aggressor in all of this. ASML, a Dutch company, has already announced it received export licences from its government to sell lithography machines or chip fabricating technology to the Chinese, so that it will not miss out on a chip boom that is going on in China. In fact most of the American manufacturers are trying to get around government restrictions to sell to China. Nobody wants to give up the Chinese market just because Biden says so.

Thus, when Jake Sullivan wants to protect US technology by building a high fence in a small yard, he may face the problem of American companies not willing to stay in that confined space. The US fabs are unwilling to be caught in a “关门打狗“situation, when dogs are locked in an enclosed yard to get a thrashing…

My view is that Huawei has just demonstrated that the Biden sanctions are not worth the paper they are written on. They will probably fully catch up to the TSMC level of technology in 2-3 years, the time frame most analysts thought they would take to break through 14 nm. And after that, they will go at China speed, including attracting ethnic Chinese from across the Straits trained at TSMC to work for them to now break through where no man has ventured.

Bet on that. Chalk this one up to the Chinese.

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Un-Influencer in a World full of Hubris