



Zanetti Monday Missive 2023.08.21

Russian and Chinese Woes

“Russia is a riddle wrapped in a mystery inside an enigma.”

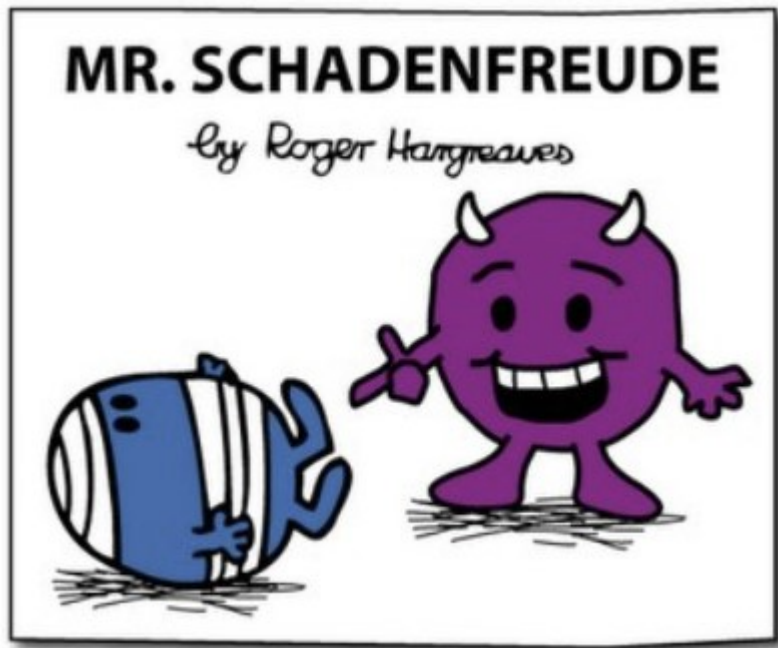
~ Winston Churchill

“Let China sleep, for when she wakes, she will shake the world.”

~ Napoleon Bonaparte

Hello Everyone,

Have you ever heard the term Schadenfreude? It is a German word that roughly translates as “taking pleasure from someone else’s misery.”



Today's missive may tip a little that way as we look at what is going on in Russia and China. While we in the US have our issues, things are not particularly rosy overseas.

So, to add some broader perspective, let's start in Russia.



As most of you know, I believe Russia is winning the war in Ukraine. That does not mean I want them to. I am just trying to dismiss the propaganda (both sides) and see the battlefield in an objective way.

Simultaneously, there is a financial/currency war being prosecuted as well. That war is bigger than the localized Ukrainian war. And that war is not going so well in Putin's paradise.

The ruble is now trading near decade lows vs. the dollar and inflation is soaring in Mother Russia. The reported 7.6% inflation rate is likely much higher. (Yes, they game their statistics, too.)

The Central Bank of Russia has been forced to hike interest rates from 8% to 12% (yikes!) in a belated effort to reign in higher prices.

So, why is the ruble tumbling down?

- Russia is selling less overseas.
- The sanctions matter---and Europe was a key buyer. India and China are not making up for the slack in European and western demand.
- Oil prices fell early this year...and Russia must sell at even a steeper discount just to keep cash flow going.
- Thus, oil revenues are down 23%. That is significant.
- Despite this, Russia is still running a trade surplus. Just not nearly as big as it used to be.

Now Russia is trying to put a brave face on this by saying a weaker ruble helps exports. That is true. But only to a point. And the Russian Central Bank's dramatic rate hike tells you the stress in the system was getting to be too much.

That is not to say Russia's economy is collapsing. It's not. But the old axiom that "wars are inflationary" is playing out yet again.

So back to schadenfreude.

While this may feel good to cheer some misery in Russia, domestic discontent is putting pressure on Putin to "end this thing" in Ukraine. The troops (and many generals) want to go on the offensive and push toward Kiev. The public is tired of Putin's "incrementalism" in his prosecution of the war. The population asks, "Why give

the west time to rearm Ukraine yet again?!”

A broader---and more lethal---Russian attack westward has the potential for rapid escalation involving a much broader coalition of players. That is very dangerous. It can lead to horrible miscalculations. And I will leave it at that.

Moving on to China...



Bloomberg’s Garfield Reynolds wrote a very detailed and well researched piece on [Zero Hedge](#) last week dissecting the woes of China’s economy.

In short, China's economic problems are severe:

- The property sector (Greg note: the Chinese invest and speculate far more in real estate than stocks) is in dramatic decline.
- Banks are on the hook for these bad loans. And major banks are now either missing payments or defaulting on obligations.
- Industrial production and retail sales are falling.
- Demographically, China's birthrate collapsed years ago; and a rapidly aging population is baked into the pie.
- Meanwhile, today's Chinese youth are so discouraged, they have adopted the old Soviet saying, "Let it rot."

I could go on, but you get the idea. Communist corruption has taken its toll.

Therefore, Chinese Central bankers are now advocating "helicopter money" to spark growth. Here is the quote:

"The most urgent goal now is to stimulate household consumption, and it is necessary to use all reasonable, legally compliant and economic channels to put money in residents' pockets," said Cai, 66, one of the most well-known economists in China to focus on demography and labor economics.

He also said, ... **"direct stimulus of 4 trillion yuan (\$551 billion) paid directly to Chinese households is an option to spur a recovery in consumer spending that has been slowed by weak wage growth during the pandemic."**

Translation: *“That darn pandemic. Here you go! We might even drop money from helicopters. Free money! Go buy something.”*

Of course, this drives up government debt. But why worry? We can always print more whenever we need it. (Sarc.)

Circling back to schadenfreude.

Yes, it feels good to know China has issues. Big issues. Their population is growing restless. That is always the biggest concern of a communist government. But civil and economic unrest in communist countries usually takes a dangerous turn.

The way dictatorial governments react to populist uprisings is to “blame the foreign devils!” You can hear the speeches already. “We must fight the oppressors! We must rally as a nation—a people---to save China for our children. Let’s take Taiwan!”

Divert and deflect. Old tricks.



You and I have no control over these things. But we can adjust our thinking and our investments.

Chances are the war cycle (discussed here before) is ramping up. Wars are energy intensive. Thus, oil, gas, coal, and uranium prices will see upward pressure. That is bad for consumers but good for investors. You want to invest in things where prices of your product are going up...and people need the product.

Supply chains also come under stress—as we are seeing with grain shipments out of Ukraine. As food chains get severed, prices rise. Same logic. Bad for consumers. Good for investors.

The same thing happens with commodities. For example, China is cutting exports of rare earth elements to the west. Prices rise. Commodities like copper are also stockpiled for the war effort. Prices rise again.

Finally, and to repeat, wars are inflationary. Always.

Egypt. Greece. Rome. China. Mongolia. France.
Germany. Great Britain. There are no exceptions.
Precious metals do well when the world isn't doing well.

Therefore, be right. Sit tight. The tide will turn. I believe soon.

Signed, Your How-Come-People-Who-Lie-Are-Not-Punished-But-People-Who-Tell-The-Truth-Are? Financial Advisor,

Greg

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