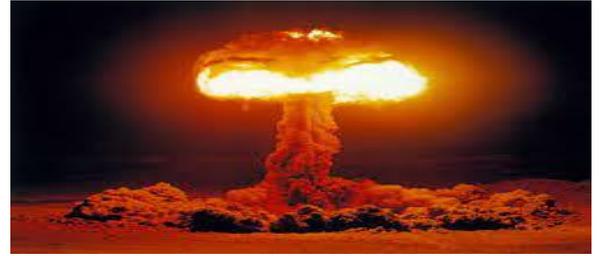




R&R Weekly Column
By Brunello Rosa



How Imminent Is a Nuclear Exchange Between Russia and the West?

Last week, Ukrainian [forces struck the Russian fleet in the Black Sea](#) with a massive drone attack in Sevastopol. [The Russians are accusing the British army and intelligence services](#) of having contributed to the planning of the attack. They have retaliated by [suspending the agreement on grains](#), which allowed Ukrainian crops to be distributed globally. So, tensions are clearly on the rise in the Russian-Ukraine war, and the risk of a further escalation exists.

Recently Russian [President Putin said that the use of nuclear weapons is not necessary](#) in the war in Ukraine, and that Russia is [now ready to negotiate](#). To which US President Biden responded that his Russian counterpart is only posturing. In effect, Russian foreign minister Sergej Lavrov recently repeated what he had already said already in April 2022, namely that [the current situation is as severe as the Cuban missile crisis of 1962](#), when the US and the Soviet Union got closest to a possible nuclear exchange during the entire Cold War.

The real question therefore is how close we are to a potential nuclear conflict in Ukraine, and which countries such a conflict would involve. The answer to this question is quite disturbing, in the sense that of course nobody can predict with any degree of certainty how close we really are to an actual nuclear attack. By definition of using nuclear bombs as a deterrent, one country needs to use the threat to the fullest possible extent to extract as many concessions as possible from its rival, even if the nuclear weapon is never actually deployed.

At the same time, the impression is that we may not be very far from an exchange that will include nuclear weapons. In particular, the more the [Ukrainian army regains control of the provinces that were illegally annexed](#) by Russia in recent weeks (especially in Kherson), the more likely it becomes that Putin will see no alternative other than using a nuclear device to defend the “territorial integrity of Russia.” This was the main motivation for Russia’s speeding up the annexation process of the four provinces.

The Russians are accusing the Ukrainians of wanting [to prepare the use of a “dirty” bomb](#), i.e. a conventional bomb with some nuclear component (e.g. uranium from nuclear power plants). If that were to happen, this would certainly constitute a pretext for the Russians to use their “tactical” nuclear devices. [As discussed in our previous column](#), these tactical devices would serve a double purpose. *First*, they would be intended to annihilate the morale of the Ukrainian army. *Second*, they would potentially inflict an irreparable wound to the continuity of the Ukrainian government.

How would the West then react? The US and NATO are not officially involved in the conflict, and certainly they are not directly involved, even though it is clear to all that the most recent advancements by the Ukrainian forces have been possible only because of the military technology provided by NATO, and especially by the US and the UK. Hence, the US cannot directly react with another nuclear strike: doing so would be the beginning of an escalation that would quickly bring to the beginning of World War III, and the end of the world as we currently know it.

So, the Americans may stage a brutal reaction which may involve weapons that may not be fully known to the Russians, or to other NATO allies, weapons that could be deployed as a one-off response to end the conflict with Russia, bringing it to a sort of perennial standstill. The questions within US policy circles are: should they keep these cards close to the chest, so to maximise the surprise effect if and when Putin has launched its nuclear attack? Or should they publicise to the fullest extent what reaction they are ready to stage in case of a Russian nuclear attack, so as to dissuade Putin from launching it in the first place?

A shared line has not yet emerged, but rather a sort of mixed approach, [with former CIA director and US general David Petraeus saying that the US would wipe out all Russian forces in Ukraine in case of a Russian nuclear attack](#), but without specifying how and over what time horizon doing so would be accomplished. Our hope is that Putin may in fact be dissuaded from launching a tactical nuclear attack by knowing that the US reaction would be ferocious. But our hope does not necessarily coincide entirely with our expectation.

Our Recent Publications

✳ [Review: ECB Delivers Another Jumbo Rate Hike, And Promises More Tightening Ahead](#), by Brunello Rosa and Nato Balavadze, 27 October 2022

✳ [The “New Space” Economy: A Politically Turbulent Ride Towards A Lucrative Horizon](#), by London Politica, 26-10-22

✳ [Central Banks Try To Chase Inflation Without Sinking The Real Economy](#), by Filippo Ramigni, 25 October 2022

✳ [Another Jumbo Rate Hike Is On The Table for October](#), by Brunello Rosa, Nouriel Roubini and Nato Balavadze, 24 October 2022



Looking Ahead

The Week Ahead: EZ Inflation To Surge; EZ QoQ GDP To Advance By Less; Final PMIs To Fall In DMs; CBs To Remain Hawkish

In the US, in October, manufacturing and services PMI is seen falling to 49.9 (*p*: 52) and 46.6 (*p*: 49.3). Composite PMI is likely to decline to 47.3 (*p*: 49.5).

In the EZ, in Q3, the economy is expected to slow down to 0.2% q-o-q (*p*: 0.8%) and 2.1% y-o-y (*p*: 4.1%). In October, the headline and core inflation are likely to surge by 10.2% y-o-y (*p*: 9.9%) and 4.9% y-o-y (*p*: 4.8%). In October, manufacturing and services PMI is seen falling to 46.6 (*p*: 48.4) and 48.2 (*p*: 48.8). Composite PMI is seen falling too to 47.1 (*p*: 48.1). September's unemployment rate is expected to stay unchanged at 6.6%.

In the UK, October's manufacturing and services PMI is seen falling to 45.8 (*p*: 48.4) and 47.5 (*p*: 50) respectively. Composite PMI is seen decreasing to 47.2 (*p*: 49.1).

CBs are expected to remain hawkish. In the US, the Fed is expected to raise its Fed funds range by 75 bps to 3.75% - 4.0%. In the UK, the BoE is also expected to increase its Bank Rate by 75bps to 3.0%.

The Quarter Ahead: Sunak Became UK PM; Musk Takes Over Twitter; Putin Says He Won't Use Nuclear Weapons; Brazil Elections

Rishi Sunak became the third Conservative PM in less than three months. Rishi Sunak delayed the release of an economic plan to fix the country's public finances until November 17. The government's fiscal statement was planned to be announced ahead of the Bank of England's meeting on November 3. As Sunak confirmed taming soaring inflation will be the most important task.

Musk takes over Twitter. After months of lawsuits, Musk seized the control of social media platform in a \$44 bn blockbuster deal. Musk said that Twitter will form a 'content moderation council'. As sources report, three top executives of Twitter were fired by Musk.

Putin said there is 'no need' to use nuclear weapons in Ukraine, while Biden expressed skepticism over Putin's remarks. Putin also claimed that Ukraine could be preparing a dirty bomb. Western leaders rejected it as 'transparently false' Russia's evidence-free claim.

In Brazil, the second round of voting for Brazil's president took place on 30 October between Jair Bolsonaro and Lula. The latter narrowly won (50.83% vs 49.17% of votes) the race to begin his third term in office.

Last Week's Review

Real Economy: US QoQ GDP Rose; EZ Economic Sentiment Declined; CBs Remained Hawkish

In the US, in Q3, GDP advanced by 2.6% q-o-q (*c*: 2.4%; *p*: -0.6%).

In the EZ, October's economic sentiment fell to 92.5 (*p*: 93.7) as expected, whereas consumer confidence recovered slightly to -27.6 (*c*: -27.6; *p*: -28.8).

Also in the EZ, ECB is raised its main policy rate by 75bps: *i*) interest rate on the 'main refinancing operations' to 2.0%; *ii*) interest rate on the 'marginal lending facility' to 2.25%; and *iii*) 'deposit facility' to 1.5%. It also revisited the conditions for TLTROIII auctions and the reserve remuneration policy.

Financial Markets: Stocks Were Up And Yields Fell; Dollar Is Down, Whereas Oil Is Up and Gold Is Down

Market Drivers: Investors eye the Fed meeting, in particular, there has been a pullback of expectations on Fed monetary tightening. Most market participants believe that the Fed will soften its tone after the November meeting. As a result, yields were seen falling and stocks rose. In Europe, shares increased on the hopes that the ECB might slow its pace of rate hikes.

Global Equities: Increased *w-o-w* (MSCI ACWI, +3.3%, to 588.95). The US S&P 500 index increased (+4.0% *w-o-w*, to 3,901.06). In the EZ, share prices were up (Eurostoxx 50, +3.9% *w-o-w*, to 3,613.02). In EMs, equity prices declined (MSCI EMs, -2.2%, to 845.58). Volatility rose to 26.2 (VIX S&P 500, 52w avg.: 25.5; 10y avg.: 18.2).

Fixed Income: *w-o-w*, the 10-year US treasury yields fell (-20 bps to 4.01%). The 2-year US Treasury yields fell (-7 bps to 4.41%). The German 10-year bund yield also declined (-34 bps to 2.10%).

FX: *w-o-w*, the US Dollar Index was down (DXY, -1.3%, to 110.55; EUR/USD +1.0%, to 1.0). In EMs, currencies rose (MSCI EM Currency Index, +0.2% *w-o-w*, to 1,581.36).

Commodities: *w-o-w*, oil prices rose (Brent, +3.2% to 94.22 USD/b), as US exports record high. Gold prices decreased *w-o-w* (-0.5% to 1,648.3 USD/Oz), on the Fed rate-hike bets.



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Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	Five Star Movement, Italy
ann.	annualized	m-o-m	Month-on-month
ARS	Argentinian Peso	mb	Million barrels
avg.	Average	mb/d	Million barrels per day
bn	Billion	MENA	Middle East and North Africa
BoC	Bank of Canada	MHP	Nationalist Movement Party, Turkey
BoE	Bank of England	mn	Million
BoJ	Bank of Japan	MPC	Monetary Policy Committee
bpd	Barrels per day	NAFTA	North-American Free Trade Agreement
bps	Basis points	NATO	North Atlantic Treaty Organization
BS	Balance sheet	OECD	Organization for Economic Cooperation and Development
c	Consensus	Opec	Organization of Petroleum Exporting Countries
C/A	Current account	p	Previous
CB	Central bank	P2P	Peer-to-peer
CBB	Central Bank of Bahrain	PBoC	People's Bank of China
CBK	Central Bank of Kuwait	PCE	Personal Consumption Expenditures
CBT	Central Bank of Turkey	PE	Price to earnings ratio
CDU	Christian Democratic Union, Germany	PM	Prime minister
CNY	Chinese Yuan	PMI	Purchasing managers' index
CPI	Consumer Price Index	pps	Percentage points
DJIA	Dow Jones Industrial Average Index	pw	Previous week
DJEM	Dow Jones Emerging Markets Index	QCB	Qatar Central Bank
d-o-d	Day-on-day	QAR	Qatari Riyal
DXY	US Dollar Index	QE	Quantitative easing
EC	European Commission	q-o-q	Quarter-on-quarter
ECB	European Central Bank	RE	Real estate
ECJ	European Court of Justice	RBA	Reserve Bank of Australia
EIA	US Energy Information Agency	RRR	Reserve Requirement Ratio
EM	Emerging Markets	RUB	Russian Rouble
EP	European Parliament	SWF	Sovereign Wealth Fund
EPS	Earnings per share	tn	Trillion
EU	European Union	TRY	Turkish Lira
EUR	Euro	UAE	United Arab Emirates
EZ	Eurozone	UK	United Kingdom
Fed	US Federal Reserve	US	United States
FOMC	US Federal Open Market Committee	USD	United States Dollar
FRB	US Federal Reserve Board	USD/b	USD per barrel
FX	Foreign exchange	UST	US Treasury bills/bonds
FY	Fiscal Year	VAT	Value added tax
GCC	Gulf Cooperation Council	VIX	Chicago Board Options Exchange Volatility Index
GBP	British pound	WTI	West Texas Intermediate
GDP	Gross domestic product	WTO	World Trade Organisation
IMF	International Monetary Fund	w	Week
INR	Indian Rupee	w-o-w	Week-on-week
IPO	Initial public offering	y	Year
IRR	Iranian Rial	y-o-y	Year-on-year
JPY	Japanese yen	y-t-d	Year-to-date
k	thousand	ZAR	South African Rand
KSA	Kingdom of Saudi Arabia	2y; 10y	2-year; 10-year