



R&R Weekly Column
By Brunello Rosa



Are World Leaders Creating The Conditions For A Military Exchange Between The US And China?

We have discussed on several occasions that we believe there is an ongoing Cold War between the US and China, which is being fought on the fields of trade, technology, and supply chains. For example, on the tech side, the [Netherlands and Japan have recently joined the US in restricting chip exports to China](#). According to Harvard scholar Graham Allison, [there may be a chance that this Cold War will escalate into a “hot war”](#), with an open military exchange between the US and China taking place. In our [in-depth analysis of Nancy Pelosi’s visit to Taiwan](#), we also discussed how Taiwan may become the detonator of such a military exchange.

Today, the news emerged of a memo written by General Mike Minihan, head of US Air Mobility Command, in which the general said that he has a gut feeling that “the two military powers were likely to end up at war” by 2025, [according to the FT](#). In fact, in 2024 there will be the US presidential election, which will distract the US administration and population. [There will be also presidential elections in Taiwan](#). The uncertainty created by these two occurrences may favour a Chinese attempt to take over Taiwan.

The US had historically kept so-called “strategic ambiguity” as to whether they will intervene in defence of Taiwan, but recently Biden has been more vocal about the fact that the US will in fact intervene. This is supposed to deter China from taking that step. That is the reason why China is watching very closely the US position vis-à-vis the war in Ukraine. In [the joint declaration of 4th February 2022](#) between Chinese President Xi and Russian President Putin, the “Russian side reaffirm[ed] its support for the One-China principle, confirm[ed] that Taiwan is an inalienable part of China, and oppose[d] any forms of independence of Taiwan.”

So, how is the situation progressing in Ukraine? [Last week](#), we discussed the hesitation by Germany in sending its Leopard 2 tanks to Ukraine. Eventually, [the German Chancellor decided to send 14 tanks](#), and allow other European countries to do so. Also, the US approved another aid package for Ukraine, [which includes the possibility of sending 31 M1 Abram tanks](#). The US and Germany are the two largest providers of weapons to Ukraine, followed by the UK. Meanwhile, Lockheed Martin said [it is ready to provide F-16 fighter jets to Ukraine, if necessary](#).

On the back of this news, the FT wondered if Ukraine was getting ready to resist the likely assault by the Russian troops that is expected to take place in the spring. [Or rather, whether Ukraine is ready to launch its own offensive](#). Italian defence minister [Guido Crosetto said that, if Russian tanks come back to Kyiv, World War 3 would ensue](#). That cannot be taken for granted. But clearly a direct military exchange between US and China over Taiwan would likely lead to what will undoubtedly be labelled by future historians as the beginning of World War 3.

Is this scenario avoidable? In theory, yes, even if it seems to be that we are sleepwalking into it. On the positive side, after Pelosi’s provocative trip to Taiwan, there is the scheduled trip of US secretary of state Antony Blinken to China in a week’s time; Blinken will be the first cabinet secretary from President Joe Biden’s administration to visit China. [Additionally, President Xi will visit the US in November for the APEC meeting, which will be held in San Francisco](#). One hopes that these will be occasions for the two super-powers to clarify their respective positions and re-start a constructive dialogue, instead of being occasions on which ultimatums are launched.

Our Recent Publications

✦ [Flash Preview: BoE To Deliver a 50bps Rate Increase in February](#), by Brunello Rosa and Nato Balavadze, 27 January 2023

✦ [Top 3 Overlooked Political Risks For 2023](#), by London Politica, 25 January 2023

✦ [An Outlook On 2023’s Key Elections: What We Know So Far On This Year’s Most Significant Elections](#), by London Politica, 20 January 2023

✦ [Flash Review: BOJ Surprised The Market Again, And Left Its Policy Unchanged In January](#), by Brunello Rosa and Nato Balavadze, 18 January 2023

Looking Ahead

The Week Ahead: EZ QoQ GDP To Stall; Inflation To Fall In EZ; Composite PMIs To Rise In US And EZ And To Fall In the UK

In the US, in January, the unemployment rate is expected to edge up to 3.6% (*p*: 3.5%). NFPs are likely to increase by 185K (*p*: 223K). In January, S&P Global Services and Composite PMIs are likely to rise to 46.6 (*p*: 44.7) and 46.6 (*p*: 45.0)

In the EZ, in Q4, on a quarterly basis, GDP growth is expected to stall (*p*: 0.3%). The economy is likely to advance by 1.8% y-o-y (*p*: 2.3%). In January both headline and core inflation are expected to ease off to 9.1% y-o-y (*p*: 9.2%) and 5.1% y-o-y (*p*: 5.2%) respectively. In December, the unemployment rate is seen to stay unchanged at 6.5%. Still, in January, S&P Global Manufacturing and Services PMIs are seen increasing to 48.8 (*p*: 47.8) and 50.7 (*p*: 49.8) respectively. Composite PMI is expected to edge up to 50.2 (*p*: 49.3).

In the UK, in January, S&P Global Manufacturing PMI is seen rising to 46.7 (*p*: 45.3), whereas Services and Composite PMIs are expected to edge down to 48 (*p*: 49.9) and 47.8 (*p*: 49.0).

Major CBs to increase policy rates. In the US, the Fed is seen increasing its target Fed funds range by 25 bps to 4.5% - 4.75. In the EZ, the ECB is likely to increase all its policy rates by 50bps. In the UK, the BOE is expected to increase its Bank Rate by 50bps to 4.0%.

The Quarter Ahead: Allies Are Expected To Send Ukraine Tanks; Scholz's Tour in South America Begins; Tesla Stocks Rose

Ukraine War. US President Biden announced plans to send 31 Abrams tanks to Ukraine. In addition, Chancellor Scholz confirmed sending 14 Leopard 2 tanks. The decision followed weeks of international pressure from Kyiv to approve the export of the German-made tanks. Ukraine's president Zelensky hailed both announcements.

Scholz headed to the South American tour. Scholz is expected to visit Argentina, Chile and Brazil. German government seeks to reduce the country's economic dependence on China and create closer ties with democracies around the world. Berlin also wants to discuss commodities cooperation, as Europe is trying to reduce its reliance, especially on China for the important minerals key to the transition to a carbon-neutral economy.

Tesla had its best week since May 2013. Musk said that the company was on target to potentially produce 2 ml vehicles in 2023 and demand would boost sales of those cars. The fourth-quarter earnings report also aided Tesla's rally.

Last Week's Review

Real Economy: US QoQ GDP Slowed Down; US PCE And Core PCE Decreased; Consumer Sentiment Rose In US

In the US, in Q4, GDP slowed to 2.9% q-o-q (*c*: 2.6%; *p*: 3.2%). PCE and core PCE eased off to 5.0% (*p*: 5.5%) and 4.4% (*c*: 4.4%; *p*: 4.7%) respectively. In January, Michigan Consumer Sentiment surged to 64.9 (*c*: 64.6; *p*: 59.7).

In the EZ, in January, according to a flash estimate, consumer confidence recovered slightly to -20.9 (*c*: -20; *p*: -22.2).

Financial Markets: Stock Prices and Bond Yields Increased. Oil Prices Fell, While USD and Gold Prices Were Broadly Unchanged

Market Drivers: Investors remained optimistic about better-than-expected economic data. As the market digested fresh signals that US inflation is slowing, US stocks rose. Encouraging economic data in the Eurozone boosted shares in Europe. Yields are also up awaiting major CB meetings.

Global Equities: Increased w-o-w (MSCI ACWI, +2.1%, to 649.9). The US S&P 500 index edged up (+2.5% w-o-w, to 4,070.56). In the EZ, share prices were up (Eurostoxx 50, +1.4% w-o-w, to 4,178.01). In EMs, equity prices moved up (MSCI EMs, +1.4%, to 1,051.19). Volatility fell to 19.5 (VIX S&P 500, 52w avg.: 26.1; 10y avg.: 18.5).

Fixed Income: w-o-w, the 10-year US treasury yields were up (+3 bps to 3.51%). The 2-year US Treasury yields rose (+2 bps to 4.20%). The German 10-year bund yield increased (+5 bps to 2.22%).

FX: w-o-w, the US Dollar Index remained the same (DXY, +0.0%, to 101.7; EUR/USD +0.1%, to 1.09). In EMs, currencies rose (MSCI EM Currency Index, +0.2% w-o-w, to 1,701.00).

Commodities: w-o-w, oil prices decreased (Brent, -1.5% to 86.33 USD/b). Gold prices are virtually unchanged w-o-w (+0.0% to 1,928.00 USD/Oz).



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Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	M5S	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