Letter n°65

Russian invasion, escalation and/or beginning of the end?

" A beast can never be as cruel as a human being"
Dostoevsky in The Brothers Karamazov.

How will this war end? In 1904, Russia's defeat of Japan sparked a revolution, in 1917 the war also led to the October Revolution. Between 1979 and 1989, the war in Afghanistan contributed to the fall of the Soviet regime by exposing some of its flaws.

The army had 100,000 men replaced each year, that is to say one million over the duration of the war, including 50,000 injured or killed. The death toll is clearly lower than today's after only 7 months of conflict. But, let us remember the shock of these human losses, a shock well captured by ***Svetlana Alexievich*** in her very good book ***"Boys in Zinc".***

From the beginning of the conflict, in Letter 51, we titled the first part "Ukraine is weak but unsinkable", we showed the irrationality of Putin's intervention, the illusion of his posture as guardian of civilization in the face of a West deemed decadent and a probable defeat of the country.

How could the 11^{th} world power overcome the Western determination to defend Ukraine? How could Russia, with a military budget of $60 billion, hold up in the face of the support shown by the United States and its $730 billion in arms spending? How could Russia, struggling with international sanctions and deprived of a number of components, not be caught in a trap of difficulty in replenishing its weapons stockpile?

The West, haunted by the memory of Munich and the question of Sudetenland which has a certain parallel with Russia in Ukraine, is determined to be firm. Putin stirs up the nuclear threat, protects the occupied regions and does not hesitate to lie by saying "those who want to blackmail us with nuclear weapons... " when no Western country has mentioned such a hypothesis. Russia presents itself as besieged when it is an aggressor. So many reasons for Putinophiles to open their eyes.

Where are we now? The escalation is the annexation of 20% of the territories, the imposition of the Russian language and the ruble in these oblasts, the enlistment of men in these territories to fight. The beginning of the end is the accumulation of setbacks, the largest number of exiles, estimated at 700,000, since the revolution of 1917, the rise of protest within the country and that of international disapproval.

In order to better understand the problems faced by Russia, let us focus on six themes: the difficulties on the ground, the impact of sanctions, the rise of resistance in the heart of Russia, international abandonment, the weakening of Russia's international positions and the malaise of the Putinophiles in the West.

1. **Difficulties on the ground**:

Difficult for Russia to hold a front line of 1000 km. Ukraine has a military budget five times less than Russia's, but it has 700,000 motivated men and US aid is substantial, estimated at between $25 billion and $40 billion. Putin may deny the existence of the Ukrainian nation, but he is suffering setbacks and the invasion has only strengthened Ukrainian national sentiment.

- ***A costly toll for Russia***:

Of the 200,000 people initially engaged on the ground, the Russian army would have lost about a quarter before accounting for reinforcements and, in fact, adding the injured and prisoners, we are probably closer to 80,000 unable to fight but reinforcements have arrived regularly.

In seven months of conflict, Russia lost nearly half of its tanks, 1250 according to Oryx, 40% of its infantry tanks, most of its cruise missiles because they were fired, a tenth of its air force, a small percentage because the planes, under the threat of effective anti-aircraft systems, do not leave the country. Only the fleet is really spared but it is little used.

The Russian army no longer has control of the skies or the Black Sea and is therefore on the defensive with less than 350,000 soldiers on the ground, a little demoralized by the recent defeats.

Proof of the effectiveness of sanctions, deprived of Western technology, Russia no longer uses its fleet and aircraft much, lacks precision weapons, focuses on artillery and is forced to buy Iranian drones and shells from North Korea.

- ***Annexation attempts***:

On the day of the referendums, the Russian army controlled only part of the annexed territories. 57% of Donetsk, 72% of Zaporizhzhia, 93% of Kherson and almost 100% of Luhansk. Russia, after the referendums on the annexation of the occupied regions, added 100,000 km^2 to the 25,000 km^2 of Crimea, but the international community did not recognize the outcome.

- ***Recent setbacks***:

Since then, positions have been eroded. In the northeast, the Ukrainians first recaptured 10,000 km^2 and then the cities of Izoum and Lyman, the latter being a strategic railway hub for the transport of weapons and goods. They also got their hands on tanks (according to Oryx, more than 460 battle tanks since the beginning of the conflict) and shell stocks. In Donetsk, the Ukrainians are still in control of the city of Siversk; in the south, the Ukrainians are still 100km from Kherson but the fighting is intense. Although the Russians have positioned their elite troops, they are retreating from the Ukrainian breakthrough. In three days, Ukrainian troops advanced about 30km towards Kherson and some 25km to the east.

The partial destruction by a truck bomb of the expensive Crimean bridge, $4 billion for nearly 20km, inaugurated by Putin in 2018, is a blow to Russian logistics for the delivery of equipment to Kherson and the general in chief of the Russian army has been replaced.

The mobilization of reservists up to 65 years of age will bring 300,000 men in reinforcement but it will take several weeks or up to two, three months of training because the men are poorly motivated, poorly trained and clearly under-equipped. This logistics is decried on social networks and even on television, and should lead to changes in the general staff. ***Dostoevsky*** said that ***"The military are the people in the world who ask the least questions"***, but that may not be the case today.

It is difficult to see Ukraine, with its dynamic of reconquest, giving up the 20% of the territory annexed by Russia, and it is difficult to see the Westerners not accelerating arms deliveries to help make major progress before the conflict freezes over the winter. It is hard to see Europe fracturing today in the fight against Russia. There is a risk of moving towards a non-solution, as in Cyprus, and therefore a continuation of sanctions.

From a military point of view, the annexed territories are certainly protected, but Putin has not yet set in stone the borders of these oblasts. So, he is not bounded by his words if the Ukrainians take back territory.

The situation will be more delicate for the Zaporizhzhia nuclear power plant that accounts for one-fifth of Ukraine's electricity generation capacity and capable of supplying four million homes. The Russians made it a property of Russia to better serve Crimea.

- ***Nuclear blackmail***:

This is a first since 1945, to which the Americans in Vietnam or the Russians in Afghanistan had not yielded. The use of a tactical nuclear weapon could have an impact on Russia's border regions. In any case, such an attack would not overcome the determination of the Ukrainians, would prompt the Americans to provide more offensive weapons and NATO to destroy all or part of the Russian military means on the ground in Ukraine and the Black Sea.

2. The impact of sanctions:

- ***Russia's assets***:

Russia is protected by its abundance of foreign exchange reserves (even half-blocked) and its hydrocarbon revenues. Moreover, it appears that only 50 of the $400 billion in overseas assets are blocked as many are in jurisdictions like Cayman. For the first time, however, with the fall in oil prices, the budget went into deficit in August and the fiscal situation will worsen in the coming months.

- ***The impact of sanctions*** :

It is not true that sanctions have no impact on Russia. This year, Russia's GDP will have fallen by 8% while Europe will be growing. Consumption in Russia is down by 10%, industrial production by 7%, car manufacturing has fallen by 90%, the pharmaceutical industry by 25%, 1200 foreign companies, accounting for 40% of GDP according to Yale University, have left the country and all this is already affecting employment and will get worse. Oil extraction in the Arctic could thus be curbed due to lack of access to Western technologies.

- ***The economic war waged by Russia against Europe is losing effectiveness***:

Energy prices, compared to 2019, remain very high but they are falling, gas by 50% to €162/MWH since the high of 26 August despite the closure of Nord Stream I, electricity by more than half, oil by 25% because European dependence is rapidly decreasing, underground storage in Europe is already at 85% of capacity.

As part of the 8th sanctions package, a price cap on Russian crude transported by ship has been decided and similar measures are being considered for gas.

It would be futile for the Russians to count on social conflicts in Europe against sanctions because tariff shields have been put in place.

In 2021, the EU had imported 341 billion m3 of which 167 billion m3 came from Russia out of a total of 240 billion m3 of Russian exports. With these figures, we measure the Russian dependence because, as the capacity of the gas pipeline to China is only 38 billion m3, the reorientation to Asia will take time and the new gas pipeline "Power of Siberia" will not open before 2030.

According to estimates, Russian export revenues from hydrocarbon sales are expected to be halved in 2023 from $340 billion to $170 billion. A decrease representing the equivalent of a little more than 2 years of their military budget.

3. An expression of opposition in the heart of Russia:

Traditionally, the Russian people have been quite passive but with this mobilization that potentially affects all families, anger is rumbling. The implicit social contract between Putin and the people is weakened for the third time. There were protests in 2011 against election rigging allowing Putin to regain power after Medvedev's departure. Then there were the 2018 protests against the pension reform.

For months, the population had heard not of a war but of a "special operation", a lightning intervention. Even before the announcement of the mobilization of the "reservists", 500,000 people had nevertheless left Russia. Since then, 300,000 according to official figures have done the same, a low figure compared to the country's population, but an important figure in view of the mobilization objective. Between the requisition of 300,000 soldiers and the departures for abroad, the economic activity of many companies is disrupted and will be more and more so.

This mobilization provokes a rejection among the student and urban youth, encourages some to find ways to exempt themselves from this enlistment, and leads to an increase in arrests.

This mobilization of poorly trained young people risks aggravating the losses on the ground and the disapproval of families. The mobilization is primarily in the occupied regions of Ukraine or among the Crimean Tatars (15% of the population of Crimea), thus difficult to imagine a strong motivation of these troops.

Certainly, Putin maintains propaganda and reinforces repression, especially against deserters, but public opinion protests and seven elected officials from St Petersburg, Putin's hometown, have dared to demand his resignation. A former deputy in the Duma dared to say on television "it is impossible to defeat Ukraine". Kadyrov recently refused to mobilize further in Chechnya.

14 oligarchs or dignitaries were found dead under strange circumstances. On the ground, the government is seeking to substantiate the idea that human losses are limited to 6,000 men but the reality is probably ten times higher, figures close to the losses recorded in ten years of conflict in Afghanistan.

In short, between the anger of public opinion, the difficulty to muzzle the protesters, the extension of the economic crisis, the loss of competence due to the emigration of qualified young people, everything is mobilized against Putin.

4. **A loss of international support**:

The Shanghai summit was supposed to show the world a united front against the West, but Putin appeared isolated because all countries are in favor of preserving borders.

From China to India, through Erdogan in Turkey and the regimes of Central Asia, there is a distancing from Russia, a growing concern.

Symptomatic was the vote at the UN in favor of an intervention by Mr. Zelenskyy through videoconference on the occasion of the annual session bringing together the heads of state of the world. Only a handful of weakened regimes, North Korea, Syria, Venezuela, Belarus, Nicaragua voted with Putin. All the others, including African countries, including China, have refrained from supporting Putin.

China, struggling with a deep real estate crisis, is concerned about its growth, eager to export, worried about an imminent recession of Western economies and, despite the "no limits friendship", would like the war to end. Chinese support is economic because China has become the first but not military partner and is limited to the purchase of Russian hydrocarbons at discounted prices. Xi recalled that " all countries deserve respect for their sovereignty and territorial integrity" and the foreign minister warned "against the use of weapons of mass destruction under any circumstances." The relationship with China is increasingly asymmetrical and Russia will not emerge victorious but vassalized.

India, Russia's largest buyer of military equipment, is worried that spare parts are no longer being delivered and Modi said that " today's era is not an era of war".

Erdogan, an autocrat, shares with Putin the anti-Western rhetoric, the same aversion to democracy, but he recalled that "no invasion can be justified", called the annexation referendums "illegitimate", said that "the lands which were invaded will be returned to Ukraine" and outlawed the use of Russian credit cards, Mir.

Even ***Belarus***, worried about being on the losing side, is more cautious in its support for Putin and has not sent any men to the field.

Six former Soviet republics, Uzbekistan, Kyrgyzstan Kazakhstan...have refused to send troops and threaten to prosecute their nationals in Russia who may go to fight.

Africans, Asians and Arabs keep their distance and do not feel very concerned because for them it is a war between Europeans. This bloc is not homogeneous, it presents itself more as a non-aligned bloc than as an anti-Western bloc, and many of these countries, especially Asian, have a tradition of not getting involved in the affairs of others.

The only small sign of support is OPEC+ and its decision to reduce supply by 2Mb/d, or 2% of world production, thus marking its opposition to a price cap decided by Western countries and wanting to take advantage of the windfall effect for their public finances presented by these high prices.

In Europe, the summit of the 44 members of the European Political Community allows for a show of unity in the face of an isolated Russia and this is all the more notable with the presence of Georgia, Armenia, Azerbaijan, countries formerly in the Soviet orbit but it is too early to know if this organization will be sustainable.

5. **A weakening of Russia's international positions**:

As a result of the war, the Russians had to repatriate soldiers from other fronts and this weakened the maintenance of their influence.

Due to the lack of Russian troops, unrest has resumed in the peripheral countries between Armenia and Azerbaijan, between Kyrgyzstan and Tajikistan, two poor countries with populations of 6 and 9 million respectively.

On the border with Armenia, Azerbaijan, supported by Turkey, is taking the opportunity to strengthen its positions while Russia had deployed a peacekeeping force in Nagorno-Karabakh.

On the border between Tajikistan and Kyrgyzstan, there was artillery fire.

Thus, Putin's desire to retain or regain control of the 15 former republics of the Soviet Union is undermined and, let us not forget, China is eager to strengthen its grip on Central Asia.

6. A malaise in the West wins over the "Putinophiles":

Putin, who has long claimed to want to fight against democracy, trumpets that he is at war with the West.

But many populists of the far right or the far left in Europe were sympathetic to Putin's regime, tinged with hostility towards the United States, supposedly taking advantage of the current disorder to strengthen their competitive position in relation to Europe, accused of letting Europe fall into recession and suspected of fuelling the conflict to better export its gas, shale oil or cereals at high prices.

Today, whatever the differences with the United States, the division of the Western camp, dissension should not be the case. In a fight presented by Putin as democracies against autocracies, everyone must choose sides.

So, notwithstanding the endless oppositions of Mr Orban in Hungary, Europe has been able to preserve an identity of views in favour of sanctions against Russia, even if they have to cost a few points of growth, even if they have to cause a brief recession in some countries such as Germany.

Within the different countries, European sentiment is reinforced, verifying the old principle of a Europe built on crises. In Latvia, the pro-Russian parties collapsed in the parliamentary elections and will no longer have deputies. In Italy, Salvini's percentage of the vote from one election to the next has fallen from 30% to 10% and he is increasingly criticized for his pro-Russian positions.

Conclusion: ***"What kind of loathing for your own people does it take to send them to something like that" Svetlana Alexievich in Boys in Zinc.***

Let's summarize some key points:

- ***From a diplomatic point of view,*** Putin’s ever-increasing demands are blocking the game and it is impossible for the West to give in to nuclear blackmail aimed at annexing territory.

- ***From a military point of view,*** China and India are against the possible use of nuclear weapons.

- ***From an economic perspective***, the OECD estimates the cost of war on global growth at $2.8 trillion by the end of 2023. But, we will remain cautious about the figures.

- ***From the point of view of sanctions***, if European imports have fallen by 35% in volume since the end of February, they have risen by 40% in value because of the rise in hydrocarbon prices, but the EU has decided on an 8th set of sanctions which will further reduce the number of spare parts supplied to Russian aeronautics and which will set a limit on the prices of oil purchased from Russia.

  Next year, the impact of sanctions will be aggravated for Russia as European dependence on Russian hydrocarbons is gradually decreasing, already from 40 % to 9% of gas imports, and gas pipelines to Asia have a capacity four times less than sales to Europe before the conflict.

  In the long term, the EU estimates Russia's loss of export revenue at €83 billion, half of its 2021 exports to the EU.

- ***In terms of hydrocarbons***, Norway is now EU’s leading supplier ahead of Russia. Russia may be thinking of developing LNG but countries like Qatar, the United States, Australia are much further ahead.

  The alternatives are however moderate with the only margin coming from Iran, 1.5Mb/d available immediately but a nuclear deal seems increasingly unlikely. Elsewhere, Venezuela is unable to increase production rapidly due to a lack of engineers and capital. European industry suffers from these high energy prices but just as banks were helped in 2008, governments, especially Germany, will help companies.

- ***On the grain side***, farmers are struggling with a sharp rise in fertilizer prices, but at the same time, grain prices have risen significantly. Wheat prices, which had fallen in recent weeks from €430/tonne to €310/tonne, have just risen to €345 after the decision to annex the Luhansk, Donetsk, Kherson and Zaporizhzhia oblasts, as they represent 20% of Ukrainian wheat and sunflower production and 17% of barley.

- ***From a stock market perspective***, the conflict does not have a direct determining impact. Equity markets are much more sensitive to rate hikes policies or recession risks than to the daily evolution of the conflict.

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