BIDEN BLUNDER RAISES STAKES

Risks are higher after the US ceded air supremacy

ROBERT GOTTLIEBSEN

When European markets closed for the weekend shares were up about 1 per cent. Institutions were comforted by the American and UK pronouncements that Ukraine was going to win and their optimistic sentiments were backed by others in Europe. This was great news for markets and the world.

But the markets did not understand that President Biden had made a dangerous decision that signalled to Russian dictator Vladimir Putin that he would be allowed to control the air in Ukraine.

As a result, Putin is now not only likely to "win" Ukraine but markets must brace for an emboldened Putin looking to seek more conquests, so creating widespread and prolonged fear in Europe.

I am not a defence expert so I spent long hours over the weekend with a number of my trusted defence advisers, including Air Power Australia and others.

They explained to me in the strongest possible terms that, as a result of Biden's decision to cede Ukrainian air control to the Russians, the danger of a European war leading to a world conflict is now greater than it has been since World War II.

Australia now has close connections with the US and its allies. We need to help mobilise those allies to explain to President Biden the likely consequences of his error. To explain, I need to take you back to the beginning of the conflict.

When Putin was detailing his plan to China's President Xi Jinping at the Beijing Winter Olympics, he believed that Russia's military might would quickly overrun Ukraine.

Putin did not realise the determination of the Ukraine people, their well-trained army and the fact that NATO would supply them with weapons.

Worse still, Putin sent to Ukraine a large number of poorly trained reservists and the Russian communications and food supply systems broke down.

The West supplied deadly anti-tank weapons, surface-to-air missiles and highly successful Turkish drones. These inflicted heavy casualties on the Russians, particularly the poorly trained reservists. And the captured Russian weapons enabled Ukraine's stock of arms to be possibly greater than it was at the at the start of the war.

China sensed that Putin was in trouble and President Xi had discussions with both the French and German leaders. China was moving towards a mediation role. Putin responded with the nuclear threat, gambling that Biden, under pressure, would cede air control. Putin knew that if he had control of the air he could, if necessary, bomb Ukraine back to the Stone Age and win.

Poland realised that if Putin won in Ukraine it was a potential target, so offered Ukraine some 55 MiG jets (provided the US replaced them) to prevent Russia controlling the air. But America vetoed the supply on the basis that it might provoke a much wider war. Poland realised that any sign of "Chamberlain-style" US weakness made Poland and Europe's position far more perilous – that's why it offered the planes.

The US has now effectively signalled to Putin that America is prepared let him win. The US signal also means that once Putin has finished with Ukraine, he will be able to use the Ukraine devastation and the US unreliability to invade other non-NATO countries, possibly without strong resistance. There are juicy non-NATO targets in the Baltic and countries like Moldova. And then it would be Poland's turn.

Defence experts around the world are stunned that America, having given Ukraine some of the most sophisticated ground-based and drone weapons in existence, would then not allow them air cover. Ukraine on its own does not have sufficient power. There was no point in giving those land weapons without air cover because in modern wars, no matter how strong the army is on the ground, it will almost certainly lose if its opponents control the air.

Many members of the US Congress realise that Biden has almost done "an Afghanistan" in supplying weapons to fight Russia but and then being too scared to stay the distance and allow Mig jets to be sent to Ukraine.

Regular readers will remember my March 1 commentary, when Russian-born Den Burkyin explained that ruthless Russian troops would surround the populations in many towns and begin a blockade that prevents food, water, power and another essentials from coming into such towns – exactly what the Germans did in the 1940s to Leningrad, now called St Petersburg. Putin is following the Nazi pattern in selected Ukraine towns. With air control he can now starve those towns because food can't be dropped.

Alternatively, once cities are destroyed via bombs Russia may send ruthless fighters from Syria and Chechnya to carve up the survivors. President Biden will be blamed.

Putin no longer needs a mediator, whether it be China or anyone else. And once Putin has won Ukraine he believes his mates in Germany and Hungary will be anxious to restore relations. Sanctions will fade. Air Power Australia, one of Australia's top defence analysts, has issued an extreme risk rating for a World War III-style battle ahead.

Meanwhile markets need to understand that there is now a much greater degree of risk than there was a few days ago.

BLOOMBERG

Poland offered MiG fighter jets to Ukraine but the US vetoed the idea, giving Russia air control

Markets brace as Russia heads for another default

JILL TREANOR

Bob Diamond knows exactly where he was in August 1998. The American was at his desk in the headquarters of Barclays Capital and, like bankers across London, had his eyes glued to trading screens as Russia defaulted on its debt in what was at the time the largest sovereign default in history.

As Russia stands days away from missing a $US117m ($160m) payment on its debt, the financial world is braced for the fallout.

For Diamond, the default of 98 could have been career-ending. The trading operation he ran blew a £250m ($447m) hole in the high street bank as a result of the Russian economic crisis. Recriminations flew. Diamond offered to resign. His boss at the time, Martin Taylor, refused, then lost his job instead.

Years later, Taylor asserted that the US banker's team had exceeded its Russian credit limits, which Diamond denied. But, as he reflected on those events almost a quarter of century later, Diamond admitted he had to move quickly, shutting down the trading desk that took bets with the bank's own money rather than for clients.

He recalled: "We made a decision to exit proprietary trading. That kind of risk-taking is not appropriate in a bank. It's more fitting in a hedge fund."

Diamond became CEO of Barclays in 2011 but was ousted a year later during the Libor rigging scandal.

The impact of the Russian debt default at Barclays was only part of a plot that had global ramifications. Other banks also lost millions. The Russian crisis came just a month before the US Federal Reserve orchestrated a $US3.6bn bailout of the Long Term Capital Management hedge fund, which had already been under pressure before the emerging markets crisis that had started in Asia reached Russia.

On Wednesday, markets will get a taste for what happens when Russia defaults on its debts again. While markets are braced for default, they have also been taken by surprise. Until Vladimir Putin invaded Ukraine, investors had regarded the Russian government as a good creditor, likely to pay its debts on time. The $US1.6 trillion economy has built up reserves of $US630bn. There had been few concerns about the state's ability to make interest payments.

Putin's aggression changed all that. Sanctions imposed by the West have impeded his ability to get hold of the dollars he needs for the interest payments. Fitch warned last week that a "sovereign default is imminent".

Putin has issued a decree forcing a re-denomination of foreign currency sovereign debt payments into local currency. But even if Russia does make payments on Wednesday in roubles it risks being deemed to be in default.

When Russia defaulted in 1998 it was on its domestic debt, not its international borrowings, which would be the case this time. The last time that happened was in 1917 after the Bolshevik revolution.

Mohamed El-Erian, the legendary bond investor, knows all too well the problems that can arise. He was in London as head of emerging markets at Salomon Smith Barney (now part of Citi) helping clients navigate the 1998 Russian default.

"You are going to see mounting arrears out of Russia," said El-Erian, who went on to forge his reputation at Pimco, where he helped it steer clear of Argentina's default in 2001. "It's going to be part of a massive financial dislocation."

This situation is altogether different from that in 1998, according to James Donald, head of emerging markets at Lazard Asset Management. Russia's economy then was only eight years into its transition from communism. The price of a barrel of oil was as low as $US10, putting pressure on a Russian economy that needs oil to finance its expenditure. Now there are forecasts oil could hit $US200 – but any benefit to Russia seems unlikely to reach the economy as sanctions bite.

In 1998, recalled Donald, the international community wanted to help Russia, with the IMF stepping in to help restructure the debt.

Now the Russian default is a function of the sanctions that have been imposed on Russia.

In the absence of the IMF, could China step in? John Lough, an associate fellow at Chatham House, who worked in Russia as the NATO representative in the 1990s, is not so sure. "What the Russians have done runs counter to Chinese interests. They've united the West," said Lough.

Banks have already raced to calculate their exposure to Russia. French and Italian banks each have about $US25bn of exposure and Austrian banks $US17.5bn. Updates have already been given to the market from the direct hits they could take.

Big defaults can impact markets in unthought-of ways. What might they be this time? A declaration of default is a technical issue for contracts written on complex financial instruments. There is a grace period of 30 days for payments so that would not start to be assessed until next month – and then will seem likely to drag on.

When it comes, it could have implications for credit default swaps (CDS) – a sort of insurance product that pays out in the event of a default. Bond manager Pimco, according to the Financial Times, has sold CDS in expectation Russia would not default. It means Pimco has already taken losses of hundreds of millions of dollars.

Vulture funds, which sweep up distressed debt, are likely to be on the prowl although they tend to be having less luck than in the past. "If you ever think that Russia is at some point going to be back as a member of good standing with the global community, then Russian debt looks extremely cheap now. But you would really not want to be in a hurry to see the money," said Paul McNamara, investment director at GAM Investments.

In the last default, Howard Davies was chair of the Financial Services Authority. He recalled that "last time the problem was Russia was borrowing too much, the economy was in deep trouble, was fundamentally unstable and unviable".

"Now the reason they will default is simply because they don't have access to foreign currency because the sanctions are essentially cutting them off from the financial system."

He added: "I don't think it's necessarily a kind of canary-in-the-coal mine moment where you have contagion effects."

Investors will hope he is right.

THE SUNDAY TIMES

'Fingerprint' start-up identifies the source for trade bans

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process can step in at any part of the supply chain to verify where a product is coming from.

"You need to be able to absolutely trust the claims that have been made, because if you don't then it's either going to be subject to fraud or there's a whole heap of greenwashing or whitewash or whatever you want to call it happening inside the supply chain," Scadding says.

To use gold as an example, as it becomes a solid metal over time it drags into it information, including elements and isotopes, about its environment.

"Those elements and isotopes are a direct reflection of that very specific location where it (came from). So what we've done is we've found a way, not just for gold but a whole range of other things, to determine what those elements, isotopes and molecules are – like markers – and build that into an elemental fingerprint.

"That elemental fingerprint is a direct representation of where it came from – just like our own fingerprint," he says.

The application can be applied to grains, seafood or beef. It can also be used for every mineral and to trace oil.

In agriculture this could relate to different prawn farms or wheat growing regions. And like Google Maps drilling down into finer detail, each farm carries its own fingerprint and it can be broken down to even smaller detail.

For example, Scadding says each pond on a barramundi farm has its own unique fingerprint, and on a chicken farm each shed could have its own markers.

"We found a way to determine those. You need to build this forensic provenance database – you need to know what those fingerprints are," he says.

Initially the demands for Source Certain came from agriculture, particularly the Australian seafood industry, which has taken a lead role in defining its products as being locally harvested. This has also helped to stop local producers being undercut by foreign imports claiming to be Australian products.

"We've had really good success with respect to making sure that stuff that's labelled 'Australian prawns' is actually Australian. The seafood industry, to their credit, took a really strong leadership position and said 'we're going to go for it'. And they positioned themselves really well, because of it," he says.

Proving goods are not from Russia is critical at a time of sanctions
PICTURE: AFP

Other demands are coming from diamond miners to verify a gem isn't a "blood diamond" mined in a war zone or an area where labour is being exploited.

A new area of growth is lithium, which is used in the production of electric vehicle batteries.

Scadding says Australia has a substantial opportunity here because it already supplies a significant volume of lithium.

"Because of our governance frameworks, our regulatory frameworks, it actually comes out of Australia in pretty good shape from an ethical and social perspective, and an environmental one, frankly, because of the regulations that are around it," he says. Global carmakers and component manufacturers are working with Source Certain, looking to build a "trusted supply chain" that remains a major selling point.

The tech player is eyeing an ASX listing, which will help fund its expansion on Australia's east coast as well as the US. While it has put in the groundwork for the process it hasn't yet settled on a time frame for an IPO.

Scadding says his long-term investors are patient and have already backed the construction of a bigger hi-tech lab facility which is almost finalised.

Despite the recent challenges of the WA border closures, Scadding says he is getting access to good tech talent, even to the point of looking at ways to accommodate additional applicants that have come in. He sees his company as helping to play a role in developing a technology industry in the west.

"WA is pretty good at minerals and it's pretty good at agriculture, but we are average at tech. And we sit across that real world versus technology space. For people that work here we're not just a lab processing samples – we are out in the real world in the field."

Myer comeback

This weekend has been shaping up as a key test for Myer boss John King. After being drained by Covid lockdowns, CBDs are starting to fill with students and workers, tourists are arriving and it was relatively rain-free in Sydney for the first time in weeks.

King was speaking as Myer resumed paying dividends for the first time since 2017, after delivering sales growth of 8.5 per cent during the December half to just over $1.5bn. The retailer posted a 21 per cent drop in interim profit to $32.3m, with the previous reporting period inflated by JobKeeper payments.

King for one remains a believer in Australia's CBDs, with plans to refurbish the retailer's Pitt Street Mall store in Sydney. He noted the refurbished Melbourne Bourke Street Mall store, which was often a symbol of an empty city during lockdown, is recovering quickly.

"We saw during the early stages of the pandemic, big swings out of CBDs to regional and suburban stores.

"We're starting to see the CBD return as people come back into the office, even if it's two or three days a week, and also students and tourists.

"Sydney is the one CBD store that we need to really refurbish and we're having conversations with the landlord about doing that. We've got big plans for Sydney," he says.

"Melbourne has recovered. It was probably the worst hit initially but now it is the quickest to recover."

Any refurbishment of Sydney will be in line with King's push for smaller stores, to make the existing store more productive in terms of sales per square metre.

Myer shares rallied on the release of its results last Thursday with its shares up 12 per cent so far this calendar year. This compares with the broader S&P/ASX 200 which is down nearly 7 per cent.