RMB Plaza Accord Bullets

Some quick thoughts on Mnuchin's suggestion of a Plaza-like deal on the Yuan…

Treasury Secretary Mnuchin said yesterday regarding the Yuan that "currency has always been part of the discussion, it's on a list, it's one of the important issues, we've talked about it all the time, so it'll continue to be on it."

- No surprise: there was never any chance that Trump would make a deal that allowed China to devalue the yuan.
- Chinese leadership has closely studied Japan's experience heading into its "lost decades" and is aware of the dangers of a Plaza-like commitment.
- Chinese Ambassador to the U.S. Cui Tiankai said last August that "I wish to advise people to give up the illusion that another Plaza Accord could be imposed on China.
- Desperation: Faced with the prospect of blanket tariffs on exports to the U.S., China is likely to relent on FX if other contours of the deal are favorable.
- Flawed deal structure: China doesn't have a spare $1t in FX lying around. If China agrees to both maintain a strong Yuan and buy substantially more U.S. goods, those purchases will have to come at the expense of other trading partners (i.e. Brazilian soybean farmers, Russian LNG producers). Such a framework is not WTO compliant.
- Mnuchin pitching a "purchases and Plaza" deal is *not a great sign,* as President Trump is highly unlikely to settle for such thin gruel. Any deal without verifiable pledges on IP transfer, subsidization and market access will fall flat politically and may even result in Lighthizer's resignation, which would be devastating to the Administration.
- *We will need to see reports of substantive discussions on these structural issues coming out of the Liu He meetings in DC at month's end to retain a constructive outlook on the outcome of these talks.*
- Not so bullish: Any trade real requiring RMB stability will prove less bullish for global asset markets than many assume because *RMB stability precludes aggressive Chinese credit stimulus.*
- Fed Dominates: A re-pegged Yuan hands some responsibility for Chinese monetary policy to the Fed. Any Fed error in the direction of liquidity tightness will threaten the

Chinese credit bubble (and/or the peg) and quickly produce negative market feedback. *There is a restrictor plate on Fed tightening efforts*.

- DXY key to risk assets: If the Fed can somehow stumble into a Dollar-bearish policy stance (not my base case) global asset markets will scream. The ~14% DXY decline in 2017 allowed China to stimulate to the tune of 50%+ appreciation in most local real estate markets.

- Isolating China: Chinese "capital controls" work largely through quotas on FX availability. Only what comes in is allowed out. If the Dollar remains strong this noose will tighten. As export proceeds increasingly fail to "come home" to China, FX availability for imports and outbound M&A will shrink. **China will have to gradually retreat from global trade and finance. This plays right into U.S. objectives**.

A yuan-stability pledge is a terrible deal for China, but they may well agree to it as part of a trade deal that was otherwise favorable – i.e. "weak" from a U.S. perspective. But Trump can't sign a "weak" deal – he needs to show movement on structural issues to claim a political win. Liu He's visit to DC next week should provide important clues as to whether China is desperate enough to swallow that whole enchilada.