



More on Trade: “Reneging”

Here is a quick follow-up to yesterday’s Trading Trade...

- 1) I’m surprised Liu He is making the trip
- 2) “Reneging” is a loaded term

I’m surprised China has decided to send the Liu He to Washington (albeit a day later than anticipated). China’s diplomatic reactions have generally been of the tit-for-tat variety, predicated more on a need to placate domestic hard-liners than on reasoned strategy. Notable examples are the snatching of the two Canadians, and the strong retaliation to the very first set of U.S. tariffs – without which we would likely still be at only \$50bn in U.S. tariffs (lacking pretext for more) and not in this mess.

Is President Xi is chastened by Trump’s tariff threat and about to start acting out of enlightened self-interest instead of political self-defense? I’m afraid it’s more likely that the hard-liners have already been placated by a lack of negotiating flexibility which created the present kerfuffle.

Liu He is not flying to DC with his tail between his legs. More likely he’s arriving in order to keep lines of communications open and in the faint hope that President Trump just might blink at the last minute. In light of yesterday’s events, **the Liu He visit doesn’t meaningfully reduce the likelihood of tariffs going into effect on Friday**, although it considerably reduces the risk of a worst-case scenario in which both sides go “straight to DEFCON 1.”

The chances that Liu He is going to Washington to finalize a deal are greatly reduced by U.S. Trade Rep. Lighthizer’s use of the word “reneging” yesterday.

What is the biggest impediment to making a trade deal with China? It’s the U.S. perception that China fails to live up to their commitments – i.e they “renege.” **If Lighthizer were trying to put up a hurdle to a last-minute deal he could not have picked a more effective term** with which to describe China’s behavior.

Here’s Lighthizer (via the Washington Post):

“Over the course of the last week or so, we have seen an erosion in commitments by China. I would say retreating from specific commitments that had already been made,” Lighthizer told reporters in Washington. “That, in our view, is unacceptable.” The Chinese sought to make “substantial” changes in the agreed text of a voluminous, seven-chapter pact, he said, adding, “Really, I would use the word ‘reneging’ on prior commitments



The WSJ details some points of contention:

According to White House officials, the dispute revolves in part around how a final deal would be presented to the public. The U.S. wants to publish full details of the pact, while China just wants to release a summary of the terms, one of the officials said.

Along with the transparency and legal force of the deal, another sore spot continues to be China's goal of seeing tariffs U.S. lifted, according to one of the White House officials. "There is a real desire on our end to keep the tariffs on," this person said. "That is a sticking point."

Now that the most credible actor on the U.S. side has told us China could not even stick to its commitments through the end of the negotiations, **a deal that doesn't include all of these U.S. asks – as well as an air-tight enforcement mechanism - is politically impossible.**

The "reneging" framing also makes another deadline delay unlikely. How can they once again delay based on nothing more than rhetorical promises from Liu He, who Lighthizer has suggested is unable to get the hard asks over the line in Beijing?

No, a deal this week would require overt and near-total capitulation from the Chinese. I don't see that happening.

Lastly, the politics on the U.S. side are much more complex than the "Trump needs a win" narrative that has gripped Wall Street. The S&P 500 is not driving the swing states in 2020.

Here is a clip of Steve Bannon on Lou Dobbs last night (1:45 mark) that sums up the political calculus very nicely. Bannon calls yesterday "the most important day of Donald Trump's Presidency." <https://video.foxbusiness.com/v/6033556991001/#sp=show-clips>

I've felt all along that making a deal with China is bad politics for Trump. Trump's opponents hate the bluster, the hyperbole, the constant showmanship. Here's the thing: his supporters don't much like it either. If Trump is going to pursue the same policy as Joe Biden on one of the biggest issues facing his "deplorable" base, then who needs him?

Conclusion

I see a tariff increase on Friday morning as an 85 delta.

If China and the U.S. can frame things as "agreeing to disagree," leaving avenues for discussion open, the increase in tariffs on Friday will create a nice "buyable dip" next week.

This week, risk-asset shorts remain in order into the Thursday / Friday news.