Brian McCarthy
Chief Strategist
(o) 203-614-8600
brian.mccarthy@macrolens.com

MACROLENS
Markets in High Resolution

Osaka G20: Trump Captures Another Piece

- The deal: a continued temporary reprieve for Huawei in exchange for interim Chinese purchases of U.S. Agricultural products
- Trump gave up little to nothing:
  - Delaying the tariffs on the remaining $325bn is in his own interest
  - Huawei had already been granted a "Temporary General License" through Aug 19
- If China relents on its U.S. Ag boycott, Trump will have banked the latest iteration of tariffs without retaliation
- The outcome is in line with the base case of a jointly agreed **"time out" that does little to reduce the medium-term risks of decoupling**

Scanning the headlines, one would think President Xi came out of Osaka with an easy victory – avoiding further tariffs and "skating" on Huawei. The reality is quite the opposite: in the Osaka iteration of this decoupling chess match, Trump took another rook and maintains a dominant position on the board.

Trump appears to have parlayed a temporary Huawei reprieve (one which is *already in place* until Aug 19th) for a resumption of Chinese agricultural purchases, thereby unwinding the primary Chinese retaliation to the last round of tariff increase. Meanwhile, the sword of Damocles continues to hang over Huawei and the China-based supply chain.

Trump maintains control of the scope and timing of future actions. Xi remains the "frog in the pot"

Meanwhile, both sides jockey for position with Kim Jong-Un. President Xi's visit to Pyongyang can be seen as a veiled threat to withdraw support for sanctions in the event of a trade blow-up. In response, Trump agreed to a cooling of trade tensions within a framework that is politically favorable to him, and cobbled together a quick trip to the DMZ to get some face time of his own with the "Rocket Man." Quite the P.R. coup for Kim to have the leaders of the World's two dominant powers knocking on his doorstep within 10 days of each other, but indicative of his importance as a piece in the Trump-Xi game.

Let's run through some of the pertinent sound bites from President Trump's Osaka presser and Larry Kudlow's appearances on Fox News Sunday and Face the Nation:

MACROLENS
Markets in High Resolution

Brian McCarthy
Chief Strategist
(o) 203-614-8600
brian.mccarthy@macrolens.com

In his opening remarks in Osaka President Trump emphasized Chinese Ag purchases:

> *I promised that, for at least the time being, we're not going to be lifting tariffs on China. We won't be adding an additional tremendous amount of — we have, I guess, $350 billion left, which could be taxed or it could be tariffed. And we're not doing that. We're going to work with China on where we left off, to see if we can make a deal.*
>
> *China is going to start — they're going to be consulting with us, and they're going to start spending money, even during the negotiation, to our farmers, our great farmers in the Midwest. I call them the "great patriots" because that's what they are. They're patriots.* ***And China is going to be buying a tremendous amount of food and agricultural product, and they're going to start that very soon, almost immediately****. We're going to give them lists of things that we'd like them to buy.*

Then in response to a question about Huawei:

> *we sell to Huawei a tremendous amount of product that goes into the various things that they make. And I said that that's okay, that we will keep selling that product. These are American companies, John, that make product. And that's very complex, by the way. Highly scientific.*
>
> *And in some cases, we're the ones that do it and we're the only ones that do it. We're the only ones with the technology. What we've done in Silicon Valley is incredible actually. And nobody has been able to compete with it. And I've agreed — and pretty easily —* ***I've agreed to allow them to continue to sell that product so American companies will continue. And they were having a problem. The companies were not exactly happy that they couldn't sell because they had nothing to do with whatever was potentially happening with respect to Huawei. So I did do that.***

The comments seem to **refer to actions already taken** on May 20th to grant Huawei a "temporary general license" in response to complaints from U.S. tech companies that a broad ban with immediate effect would be highly disruptive to the industry both globally and in the U.S.

The exemptions granted (through August 19) apply to four categories:

- Continued operation of existing networks and equipment
- Support to existing handsets
- Provisions of notification of and patches for potential security vulnerabilities
- Engagement as necessary for development of 5G standards by a duly recognized standards body

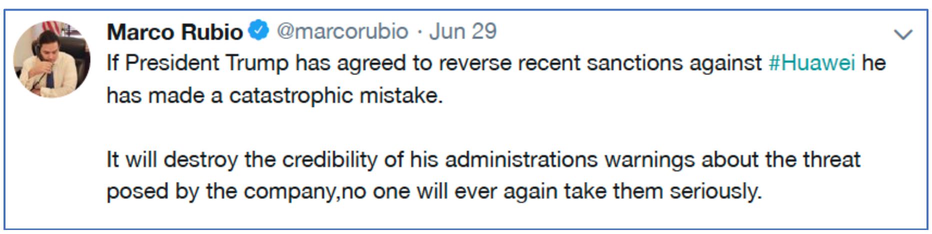
Brian McCarthy
Chief Strategist
(o) 203-614-8600
brian.mccarthy@macrolens.com

NEC Director Larry Kudlow on *Fox News Sunday* did allude to the possibility of some expansion of those exemptions:

> *So the commerce dept as you may know has already offered a number of sort of general service licenses for some sales to Huawei. On the other hand, I think Commerce will probably go back after the president's decisions and take another look at that, maybe open it up. You know there are a lot of technology services, telecom related services, that really you can find on general markets that don't have any national security implications, so I think there's a good chance commerce dept, secretary ross will open the door on that and grant new license.*

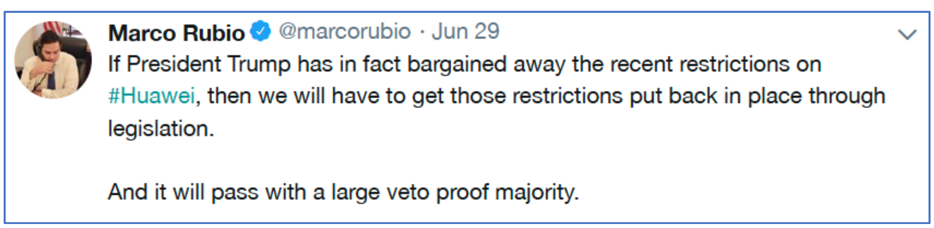
Trump suggests some willingness to deal accommodation of Huawei's non-security sensitive business lines for normalization of China's purchase of U.S. agricultural products. While hawks in Congress will undoubtedly rant about "trading national security for soybeans," one may question whether trashing Huawei's handset business by cutting it off from Google Android, for instance, furthers U.S. national security interests or merely fuels Chinese sentiment that the U.S. is out to blunt China's economic development.

A stream of reactive tweets from Senate uber-hawk Marco Rubio gives us some insight into the Congressional response to the Huawei exemptions:



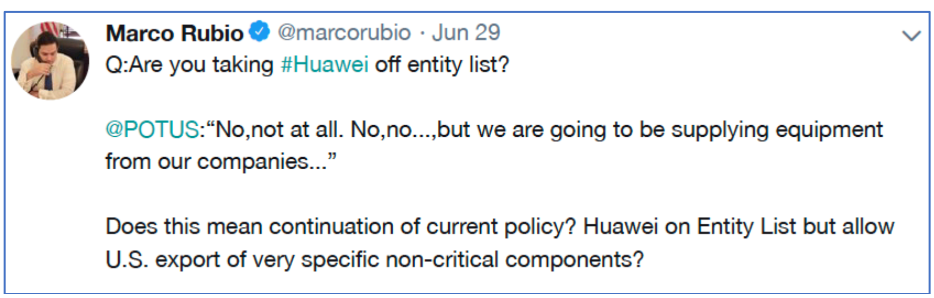
Marco Rubio @marcorubio · Jun 29
If President Trump has agreed to reverse recent sanctions against #Huawei he has made a catastrophic mistake.

It will destroy the credibility of his administrations warnings about the threat posed by the company,no one will ever again take them seriously.



Marco Rubio @marcorubio · Jun 29
If President Trump has in fact bargained away the recent restrictions on #Huawei, then we will have to get those restrictions put back in place through legislation.

And it will pass with a large veto proof majority.



Marco Rubio @marcorubio · Jun 29
Q:Are you taking #Huawei off entity list?

@POTUS:"No,not at all. No,no...,but we are going to be supplying equipment from our companies..."

Does this mean continuation of current policy? Huawei on Entity List but allow U.S. export of very specific non-critical components?

Brian McCarthy
Chief Strategist
(o) 203-614-8600
brian.mccarthy@macrolens.com

Congress is unlikely to undertake Huawei-killing legislation if the company remains on the "entity list" but is allowed a slightly expanded list of exemptions, particularly given that the politically sensitive agriculture sector will be the beneficiary.

Beyond the Huawei / Ag deal, neither side provided any detail regarding the basis for resumed talks, nor gave any indication that positions have softened. Kudlow again:

> *So, new talks, resume talks, no new tariffs, and agricultural purchases,* ***and the rest of it's going to go on for quite some time frankly.***

Trump's strategy seems clear: having banked the latest iteration of tariffs, use the current window of Huawei exemptions to see if he can coax China into stepped-up Ag purchases in order alleviate some of the politically resonant farm-belt stress. This creates event risk around the August 19th expiry of Huawei's "Temporary General License," but if China is in fact buying U.S. agricultural product at normal rates, there's no reason for President Trump not to extent the exemptions for a subsequent 3 months. A "time out" is in his economic and political interest.

The media response on the Chinese side has been restrained. This from a China Daily op-ed:

> *While avoiding the worst-case scenario and allowing more time, and thus a greater likelihood of maneuvering a deal, Saturday's agreement is no guarantee there will be one.*
>
> *Agreement on 90 percent of the issues has proved not to be enough, and with the remaining 10 percent where their fundamental differences reside, it is not going to be easy to reach a 100-percent consensus, since at this point, they remain widely apart even on the conceptual level.*

And from Xinhua:

> *If the U.S. side delivers no action that highlights the spirit of equality and mutual respect, and asks too much, the hard-won restart will produce no results.*

Whatever the opposite of "spiking the football" might be, this tweet from the editor of the ultra-nationalist *Global Times* would seem to be it:

Brian McCarthy
Chief Strategist
(o) 203-614-8600
brian.mccarthy@macrolens.com

Market Outlook

- The Osaka "time out" **does little to improve the odds of an ultimate trade deal.**

- Any short-term bounce in Chinese assets based on the impression that they have improved their position in the "decoupling game" is to be faded.

- Assuming China's stepped-up Ag purchases do in fact materialize, **U.S.-China trade issues could fade as a market driver** for several months.

- The **temporary truce increases the risks around the anticipated July rate cut** should U.S. economic statistics fail to provide negative news - of which the Fed "wants to see more" before sanctioning a rate cut.