

Trump's Games

Trump is playing games with Xi Jinping. With Jay Powell, not so much.

U.S. – China Trade Talks



- It is in President Trump's interest to drag out the imposition of the remaining \$300bn in tariffs as long as possible.
- He boxed himself in with brash talk about enacting those tariffs should Xi not show up at G20.
- China made clear that **the U.S. initiated today's call.**
- It may currently be in Xi's interest to avoid the next \$300bn in tariffs, but not indefinitely. At some point China may instigate that action in a way that is destabilizing for the U.S. economy and markets, rather than continuing to let President Trump dictate events.

The two sides gave **dramatically different read-outs** of today's call. Here's the U.S. read out:

President Donald J. Trump spoke with President Xi Jinping of China this morning. The two leaders discussed the importance of levelling the playing field for U.S. farmers, workers, and businesses through a fair and reciprocal economic relationship. This includes addressing structural barriers to trade with China and achieving meaningful reforms that are enforceable and verifiable. The leaders also discussed regional security issues. The two presidents look forward to meeting again in Osaka, Japan at the G20 Summit.

Compare and contrast to China's readout (via CCTV through Google Translate):

On the 18th, President Xi Jinping should have an ordinary telephone call with US President Trump.

Trump said that I look forward to meeting with President Xi Jinping again during the G20 leaders' Osaka Summit and in-depth communication on bilateral relations and issues of common concern. The US attaches importance to US-China economic and trade



cooperation and hopes that the working teams of both sides can communicate and find a solution to the current differences as soon as possible. I believe the whole world wants to see an agreement between the United States and China.

Xi Jinping pointed out that in recent times, Sino-US relations have encountered some difficulties, which is not in the interest of both sides. The combination of China and the United States is both good and bad. The two sides should, in accordance with the consensus reached by us, promote Sino-US relations based on coordination, cooperation and stability on the basis of mutual respect and mutual benefit. As the world's two largest economies, China and the United States must jointly play a leading role in promoting the G20 Osaka Summit to achieve positive results and inject confidence and vitality into the global market. I am willing to hold a meeting with the President during the G20 leaders' Osaka Summit to exchange views on fundamental issues concerning the development of Sino-US relations.

Xi Jinping emphasized that on economic and trade issues, the two sides should solve problems through equal dialogue. The key is to take care of each other's legitimate concerns. We also hope that the US will treat Chinese companies fairly. I agree that the economic and trade teams of the two countries will maintain communication on how to resolve differences.

President Xi may be playing a long-shot gambit of isolating Trump by lining up G20 globalists against him in support of the “rules-based global order.” Such a strategy is doomed to failure.

While there is widespread apprehension regarding Trump’s approach, G20 leaders could never stand behind the Communist authoritarians in Beijing with sufficient resolve to prevent them getting picked off one by one with tariff attacks such as Trump recently executed on Mexico. “Divide and conquer” is Trump’s game. Xi isn’t going to beat him at it.

As for Trump’s strategy, **the politics of the tough approach on China are too compelling for Trump to make a deal** on any basis short of Chinese capitulation.

Trump has the Democrats in a corner on China. They can acknowledge the dominant narrative that China poses an existential problem to U.S. economic security, in which case they have little hope of positioning themselves as “tougher” than Trump on China. Or they can take Biden’s approach of downplaying the issue, which has little hope of success. Any deal with China would have to be highly attractive for Trump to forego this degree of political leverage.

The trick for the Administration is to roll out the tariffs gradually to give supply chains time to move, and to spread out any residual effect on import prices so as to minimize the economic dislocation.



Hence, it's in the Administration's interest to "keep hope alive" for a trade deal to draw out the decoupling process. When [Larry Kudlow asked by Fox News](#) whether today's stock market optimism regarding a Trump-Xi meeting was warranted, he responded:

Well I don't want to judge. All I'll say is I think a lot of market investors think it's a good thing that talk is better than no talk. There are other things going on in the market, the economy is still pretty good and interest rates are coming down etc etc. But China trade is a key topic so it's alive and I guess folks want to keep hope alive... you know if I could just put in one plug for another trade deal - Ambassador Lighthizer on the hill today - Canada Mexico US - NAFTA 2.0, that's a terrific trade deal helping throughout our economy. In fact, in the shorter run - the next few years - it's more important than China trade.

That's a pretty dramatic downplaying of expectations from Kudlow, and a quick pivot to USMCA, where the news in coming months is likely to be much more economically positive than that regarding China.

The best case out of G20 remains a vague commitment to continued dialogue, but I'm not at all sure that Xi Jinping will want to play that game.

Fed Bashing

While President Trump is most likely playing Xi Jinping, when it comes to Jay Powell he's deadly serious. [Bloomberg reports today](#), in a story that's gone unchallenged by the White House, that

"The White House counsel's office (in February) weighed the legal implications of stripping Powell of his chairmanship and leaving him as a Fed governor," and that "Trump's team conducted the legal analysis and came to a conclusion that has remained closely held within the White House."

Forget about the legalities of what constitutes "cause" when it comes to removal of a Fed Chair (although logically, setting the economy on a recession course while wildly undershooting the inflation target should qualify). If the President asks the Fed chair to step aside, both democratic accountability and self-respect require that he do so.

As I wrote back in December ([Powell on Thin Ice](#), 12/27/18) a Powell firing in 2019 is not far-fetched. The Chairman improved his standing with a dovish pivot in January and March, but reverted to "tone-deafness" in May with his "transitory" mantra. He's one big mistake away from returning to the hot seat. Leaving rates on hold this week could be such a mistake.

With the sharp decline in the U Mich 5-10y inflation expectations measure from 2.6% to 2.2% on Friday, we now have both survey and market-based measures of inflation expectations

suggesting that **the Fed is nowhere close to hitting its inflation target**. And if the yield curve's signal of increasing recession risk is accurate (as it almost always is), the Fed could be headed into a heated election campaign having slowed the economy for no good reason.

Powell is damned if he does, damned if he doesn't tomorrow. But with near universal acknowledgement that the December rate hike was a mistake, why not just fix it and let the political chips fall where they may?

A delay to July only draws out the market angst and the Fed's political agony. They might as well just get on with it tomorrow.