



The Frog Stays In the Pot

I've been using the "frog in the pot" analogy to describe China's position in the U.S.-China trade brouhaha. The "Osaka deal" to provide relief to Huawei in return for renewed Chinese purchases of U.S. farm products was akin to Trump turning down the heat to a simmer.

The risk to the Osaka truce was that President Xi might decide to disrupt the game, in which Trump seems to be calling all the shots, by "jumping the pot" and taking measures to disrupt global markets and the U.S. economy in an effort to politically damage Trump. If the weekend's reporting is correct, **that risk is receding.**

The News

After an initial spate of [U.S. sorghum purchases late last week](#), Chinese press over the weekend reported that China's Custom's Tariff Commission is appointing a board of experts to evaluate tariff exclusion requests. [From China Daily:](#)

China and the United States are implementing the consensus reached by the two heads of state during the G20 Osaka summit.

The United States recently announced a move to exempt 110 items of Chinese industrial imports from additional tariffs and expressed willingness to encourage US businesses to continue providing supplies for Chinese enterprises.

In order to meet the needs of Chinese consumers, Chinese enterprises are willing to continue importing certain agricultural products from the United States that are marketable in China.

Relevant Chinese authorities have expressed hope that the United States will meet halfway with China and earnestly implement its commitments.

Today's SCMP reports that [US Trade War Negotiators Likely to Visit China Next Week:](#)

US negotiators led by trade representative Robert Lighthizer and Treasury Secretary Steven Mnuchin are likely to fly to China next week for the first face-to-face talks since President Xi Jinping and US counterpart Donald Trump agreed to a trade war ceasefire at the end of June, according to a source who is familiar with the matter.

The initial arrangements for the meeting in Beijing, according to the source who declined to be identified, came after the United States announced that it would offer exemptions to 110 Chinese products, including medical equipment and key electronic components, from import tariffs. In a goodwill gesture of their own, China also said that several companies would buy American agricultural products, having already applied for exemptions from the tariffs imposed by Beijing.

Today's Politico *Morning Trade* newsletter confirms (from U.S. sources) the likelihood of a meeting in Beijing next week, so presumably this should be hitting the wires in coming days.

Also, Mnuchin and Kudlow are [reportedly meeting in the White House today](#) with U.S. semiconductor and software executives to discuss economic matters which are expected to touch on Huawei:

The subject of Huawei was expected "to come up but that it is not the reason why they are convening the meeting," said the official, who spoke on condition of anonymity.

The Outlook

This is unlikely to prove a prelude to a broader deal, as by all indications [the sides are still not even close to agreement on the point from which talks would pick up](#) – i.e. pre or post China's alleged "reneging." Expect little to emerge from next week's talk in Beijing other than vague pleasantries and after that we should get several weeks of radio silence as [Chinese leadership heads to the resort town of Beidaihe](#) for the traditional Summer policy enclave.

There remains no path to solving the "Impossible Trade Trinity" ([U.S.-China Trade: Strategies and Roadmap](#), 5/15/19):



Without the requisite level of trust, the U.S. must continue to insist on either an "unbalanced" enforcement mechanism or a process of China "earning back" the current tariffs by displaying good behavior over time. China steadfastly refuses to accept either of those conditions. I don't see that changing any time soon.

Furthermore, while Trump will happily trade the supply of non-sensitive technologies to Huawei in return for renewed Chinese Ag purchases, he has no political leeway to provide broad relief to the Chinese telecom giant. [A bipartisan group of Senators has already introduced legislation](#) to prevent the Administration from removing Huawei from the "entity list" and to allow Congress to disapprove of any waivers provided by the Commerce Dept. While the bill is unlikely to be allowed to the floor for a vote, it's a warning to the Administration to limit any waivers to genuinely "non-security sensitive" technologies.



Trump's bandwidth on Huawei will be further limited by stories like this in today's Washington Post, "[Leaked Documents Reveal Huawei's Secret Operations to Build North Korea's Wireless Network:](#)"

Huawei Technologies Co., the Chinese tech giant embroiled in President Trump's trade war with China and blacklisted as a national security threat, secretly helped the North Korean government build and maintain the country's commercial wireless network, according to internal documents obtained by The Washington Post and people familiar with the arrangement.

Huawei partnered with a Chinese state-owned firm, Panda International Information Technology Co. Ltd., on a variety of projects there spanning at least eight years, according to [past work orders, contracts](#) and [detailed spreadsheets](#) taken from a database that charts the company's telecom operations worldwide. The arrangement made it difficult to discern Huawei's involvement.

the revelations raise questions about whether Huawei, which has used American technology in its components, violated U.S. export controls to furnish equipment to North Korea

If the Post's accusations are corroborated, they could scuttle the "Osaka truce" altogether. Watch this space...

The Strategies

Given Trump's limited bandwidth to provide Huawei relief, I'm somewhat surprised China would accept the Osaka deal. **Once China resumes purchases of US Ag products, Trump loses all incentive to make a deal** involving the removal of the current tariffs. Running in 2020 on a platform of "I hit China with \$250bn in tariffs and they hit us with nothing back" is certainly superior to "I had \$250bn in tariffs on China but I gave them back for a trade deal that everyone is trashing."

So why is China looking to make the Osaka deal? It must be some combination of weakness in their position, and misreading of Trump's intentions and perhaps a risky bet that November 2020 will bring a more favorable adversary.

China's economic vulnerability speaks for itself ("[China Stimulus: More Smoke & Mirrors](#)", 6/12/19), and events in Hong Kong took another turn for the worse over the weekend, with the mob's grievance morphing from the extradition issue into a broader push for independence. A China Daily editorial this morning was entitled "[No Tolerating Challenge to Bottom Line on HK:](#)"

The vandalizing of the Liaison Office of the Central People's Government in the Hong Kong Special Administrative Region following a demonstration against the extradition law amendment on Sunday was a blatant challenge to the central government's authority.

Scores of radical protesters who refused to stop at the police-designated destination for the march amassed outside the liaison office in Western District. They defaced the national emblem and sprayed anti-China slogans on the building's façade. Some even tried to break into the premises.

Since the liaison office represents the central government, the aim of such actions was crystal clear — to undermine the central government's authority in the SAR. The SAR government rightly and swiftly condemned the acts as "absolutely unacceptable", and the Hong Kong and Macao Affairs Office of the State Council expressed its firm support for the SAR government and police to bring the perpetrators to justice.

We've known **China's political and economic stability puts it in a weak position** in trade negotiations. Acceptance of the Osaka deal would confirm that China knows it too.

China's characterization of the Trump Administration's July 9 provision of [tariff exclusions on 110 products](#) as a "good will measure" is also a tell – a bit of superfluous spin to justify the show of weakness that a resumption of U.S. Ag purchases would entail.

James Rosen @JamesRosenTV · Jul 17
 EXCLUSIVE: In an interview w/ @WeAreSinclair, @larry_kudlow, economic adviser to @POTUS @realDonaldTrump, warns #China will wind up "on the wrong side of history" if Beijing rejects the trade deal being offered by @WhiteHouse. cc: @ChineseEmbinUS @AmbCuiTiankai @stevenmnuchin1



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EXCLUSIVE: 2/ @larry_kudlow, top adviser to @POTUS @realDonaldTrump, tells @WeAreSinclair if #China rejects U.S. trade deal: "They're not the Soviet Union; but this kind of government control, statism, never works for long."
 cc: @ChineseEmbinUS @AmbCuiTiankai @stevenmnuchin1

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Replying to @JamesRosenTV
 EXCLUSIVE: 3/ @larry_kudlow, top adviser to @POTUS @realDonaldTrump, tells @WeAreSinclair the prospect that #China could collapse like the Soviet Union did has "always been an undercurrent in" the talks to resolve the trade war, cc: @ChineseEmbinUS @AmbCuiTiankai @stevenmnuchin1

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As for U.S. intentions, they should be becoming clearer to the Chinese. The Trump Administration's ultimate objective is an economic decoupling that causes sufficient economic distress to force wholesale changes in China's behavior – either under the present regime or, preferably, another more liberal one.

This was alluded to in a sparsely broadcast interview Larry Kudlow gave to Sinclair Broadcasting last week. The "money line" in fact has not even been aired yet, but if this reporter's characterization is correct, Kudlow said that "China will end up on the wrong side of history" if Beijing rejects the trade deal being offered by the U.S.; that "they're not the Soviet Union, but this kind of government control – statism – never works for long;" and that **the prospect that China could collapse like the Soviet Union "has always been an undercurrent" in talks to resolve the trade war.**

(Heady stuff. I've been pestering @JamesRosenTV on twitter to post the full video, and he's promised to do so this week, but nothing yet.)



If the Trump Administration's strategy is in fact tilting "full Bannon" - decoupling as a means of fomenting instability in China - (as I believe is the case) then how should China respond? Their optimal strategy would be to ensure Trump does not get re-elected, regardless of the degree of self-inflicted pain in the short term. Buying U.S. farm products – putting a salve on the one political bruise they've inflicted on Trump – does not fit this strategy.

Ergo, either China still doesn't fully understand the political dynamic in the U.S. or they perceive their domestic position as so weak at present that they are unable to respond to the impending threat. Either way, the frog remains in the pot.

Conclusions

China's economy continues to weaken, the supply chain exodus continues, Huawei remains under existential threat, and easy answers in Hong Kong remain elusive.

In the meantime, China's adversary grows stronger, a petulant Federal Reserve now under control, \$250bn in tariffs in his pocket, and soon able to claim that's he's taken actions to support the farmers – a prized constituency.

Should China in fact consummate the "Huawei for Ag" deal, as seems likely, expect:

- 3-6 months of pro-forma "negotiations" that make little progress
- China's economy continues to weaken as credit market stresses become increasingly difficult to contain
- China continues to manage the RMB in a 6.8-7.0 range via strict FX market restrictions ([The Renminbi Regime](#), 6/25/19)
- The U.S. economy defies expectations of a second half growth recession
- U.S. equities continue to a series of new highs, **significantly outperforming Chinese shares**

At some point the frog will jump out of the pot and China will pivot to a strategy of financial, and perhaps geopolitical trouble-making. But such a volatility-inducing pivot appears to be nowhere on the investible horizon.