

This week from Macrolens: [Down Goes China!](#)

Let's break down some film this week – first on the Fed, then on trade...

I wrote this on Wednesday to recap the FOMC:

- ***The 2019 dots point to another rate cut.** If things get worse they'll cut, and if things get better they won't. **But if things are broadly "as is" they will most likely cut** – which is dovish relative to my expectations for the meeting.*

*Recall the June dots which showed 7 @ 2 cuts, 1 @ 1 cut, 7 @ no cuts, and 1 @ one hike by year end. Neither the data, trade developments, nor market indicators have deteriorated materially since June, yet **the supposedly divided Fed has cut rates twice already.** The median dot mischaracterizes the direction of the committee. An **"authority-weighted" mean dot would point solidly to another cut.***

Perhaps that view made me susceptible to cognizant dissonance while watching [this morning's CNBC interview with Vice Chair Clarida](#), but I thought he clearly confirmed my assessment at the 3:00 minute mark:

*Sarah Eisen: "How likely is it that we just saw the final cut of the year."*

*Richard Clarida: "I don't want to put probabilities on it. Again, as the Summary of Economic Projections indicated, **seven participants indicated that under their baseline view that further adjustment would be appropriate policy.** But again that's not a commitment, we didn't vote on it, we'll take it on a case by case basis but again we're going to be very attentive to the data – not only the baseline data but the risk to the outlook.*

Yes, 7 participants indicated openness to a further cut. Ummm, **what about the 10 who didn't!?!** Quite a dis to the dissenters there. Furthermore, the reference to looking at "not only the baseline data but the risks" suggest that **the plan is to cut once more even if the coincident data continues to look decent.**

As for U.S.-China trade, we got news today of the cancellation of the Chinese delegation's "goodwill visits" to Montana and Nebraska in favor of an early return to Beijing, but no color as to why. The obvious ramification is a somewhat lesser amount of "goodwill" on the table than markets had anticipated. Cancellation of that diplomatic dog & pony show is not a good sign as to the outcome of this week's mid-level trade talks.

The cancellation reportedly came before these [comments from President Trump this morning \(17:30\)](#) in which he states a very clear lack of interest in an Ag-centric "interim deal." Despite my view ([Osaka Deal Do-Over?](#), 9/11/19) that the interim deal would be in Trump's political

interest, I have to acknowledge I have yet to pick up any sense from his public commentary that he sees it that way. Maybe he's bluffing in an attempt to extract something from the Chinese that can be sold as a "fundamental concession." Or perhaps he's genuinely less concerned about the recession narrative taking route than one might think he should be.

Keep in mind that if the economy does not roll over, **the politics of the China trade fight are decidedly positive for the President...**

### Trump's \$28 Billion Bet That Rural America Will Stick With Him

*...there's been no break in Trump's support in rural areas, where his poll numbers are consistently about 12 percentage points higher than they are nationally. In August, **52% of rural residents approved of Trump's job performance**, vs. 40% of Americans overall, according to Gallup polling including 1,258 self-identified rural respondents. **Support among farmers is even higher: 67% back Trump, up from 60% a year ago**, according to a Farm Futures survey taken from July 21 to Aug. 3.*

...and the scaremongering about elevated consumer prices for rubber floor mats and Christmas tree lights has failed to gain any traction:

### 'We were wrong': Koch network to change strategy in campaign against Trump's trade war

*Koch network leaders said Thursday that their digital and TV ad blitz that emphasized how Americans could experience financial pain from the tariff fight wasn't panning out the way they had hoped.*

*"The argument that, you know, the tariffs are adding a couple thousand dollars to the pickup truck that you're buying is not persuasive," a senior Koch official, who declined to be named, said during a briefing in New York. **"It doesn't penetrate with the people that are willing to go along with the argument that you have to punish China."***

*The official said the network came to this conclusion after conducting weekly focus groups on trade policies. Public polling also backs the conclusion. **A recent Harvard CAPS/ Harris poll shows that 63% of registered voters believe tariffs will ultimately hurt the United States more than China, but 67% of the electorate is convinced it's necessary to confront China over its trade practices.***

*Koch network officials said the organization will put out ads with a new message, although, according to one network leader **it is unclear what that message will be.***

All of which means that this is going nowhere...

### Lawmakers Make Long-Shot Bid to Check Presidential Tariff Powers

*Legislation reclaiming congressional trade authority isn't likely to get far, however, in part because most Republicans are loath to challenge the president and because Senate Majority Leader Mitch McConnell has refused to bring bills to the floor without some certainty that Mr. Trump would sign them.*

In other news, the market is taking solace from the fact that the FedEx pilot detained in Guangzhou was "released," but that just means he was remanded to house arrest in a hotel. I think we can rule out drug or espionage charges, and from the skimpy reporting we have thus far, it seems very much like petty BS designed to cause problems for FedEx...

[WSJ News Exclusive | China Detains Former U.S. Air Force Pilot Flying for FedEx](#)

*Mr. Hohn's last trip had been unexpectedly extended after he volunteered to take over the flight duties of another FedEx pilot whose wife had gone into labor and who was suddenly called away, one of the people familiar with the matter said.*

*That tacked on an additional flight from Tokyo's Narita airport. Mr. Hohn had completed that flight and was preparing to travel home when he was detained.*

*He had cleared security with the air gun pellets, which are often made of plastic, without any issues at both the airport in Japan and an exit-screening at the FedEx facility in Guangzhou, the people familiar with the matter said.*

That said, the people from FedEx and/or the State Dept. better bet cracking on getting this 15-year Air Force veteran released. Chinese law is amorphous and there is precedent it seems for irrationally severe sentences involving air guns...

[China confirms detention of American FedEx pilot suspected of smuggling ammunition](#)

*China has some of the world's strictest gun-control regulations and even many Chinese are not aware of draconian rules governing replica airsoft weapons, which fire pellets that can leave bruises but are seldom deadly. Chinese state media in 2016 covered the case of a man in Fujian province who was bewildered when he was given life imprisonment after ordering 24 replica guns from the Internet.*

I'll really be surprised if this story hasn't gone one way or the other – i.e. either to Col. Hohn's release or to full-blown international incident – by early next week.

[More on U.S.- China Relations](#)

Wilbur Ross confirms that there has as yet been very little work done towards any "interim deal:"

[U.S., Chinese trade deputies face off in Washington amid deep differences](#)

*U.S. Commerce Secretary Wilbur Ross, in an interview on Fox Business Network on Thursday, said **it remained unclear what China wanted** and that "we will find out very, very shortly in the next couple of weeks."*

*"What we need is to correct the big imbalances, not just the current trade deficit," Ross said. "It's more complicated than just buying a few more soybeans."*

Meanwhile, U.S. "Chinanoia"<sup>TM</sup> is really gaining steam. Economic interdependence has advanced far beyond the level of transnational trust will allow, unfortunately...

[FT: Trump is Serious About US Divorce from China](#)

*Barring commodities such as soybean or pork, the internet of things makes almost every product a potential dual-use technology in a future US-China conflict. They used to say ploughshares could be converted into swords and vice versa. How about refrigerators? Or children's toys? **Once you start down the road of excluding anything with Chinese-embedded chips, it is hard to know where to stop.***

[Fearing 'Spy Trains,' Congress May Ban a Chinese Maker of Subway Cars](#)

*Lawmakers — along with CRRC's competitors — say they are concerned that **subway cars made by a Chinese company might make it easier for Beijing to spy on Americans and could pose a sabotage threat to American infrastructure**, though CRRC says it surrenders control of all technology in the cars to its buyers. Nonetheless, critics speculate that the Chinese firm could incorporate technology into the cars that would allow CRRC — and the Chinese government — to track the faces, movement, conversations or phone calls of passengers through the train's cameras or Wi-Fi.*

[Lawmakers Seek Ban on Chinese Drone Purchases by Federal Agencies](#)

*The bill, the American Security Drone Act of 2019, would **ban federal departments and agencies from purchasing any commercial off-the-shelf drone or small unmanned aircraft system manufactured or assembled in China** or other countries identified for national-security concerns. Federal officials would have 180 days to stop using them.*

*The legislation, led by Sen. Rick Scott (R., Fla.), would also block local police forces and other law-enforcement agencies from using federal money to buy the banned drones.*

[Senators Urge F.C.C. to Review Licenses of 2 Chinese Telecom Companies](#)

*The Senate's top Democrat on Monday asked the Federal Communications Commission to consider whether two major Chinese telecommunications companies should be barred from operating in the United States.*

*Senator Chuck Schumer of New York, the Democratic leader, along with Senator Tom Cotton, an Arkansas Republican, cited national security concerns in a letter asking the commission to review the licenses that give the two companies, China Telecom and China Unicom, the right to use networks in the United States.*

*In the letter, they said that the two **Chinese government-linked telecom operators could use that access to "target" Americans' communications.** And they warned that the companies could reroute communications traveling on their networks through China.*

And once trade negotiations break down irreparably, the U.S. is preparing to use the Uighur issue as a cudgel to force the Europeans and other to join the decoupling effort...

[As China sway grows, U.S. to confront it on Uighur issue at U.N. gathering](#)

*A senior U.S. administration official, speaking on condition of anonymity, said **the White House was considering whether Trump might mention China's treatment of the Uighurs and possibly its broader human rights record in his speech to the 193-member U.N. General Assembly next Tuesday.***

*"The President will call on the international community to take concrete steps to prevent attacks against people on the basis of their religion or beliefs and to ensure the sanctity of houses of worship and all public spaces for all faiths," White House spokeswoman Stephanie Grisham in a statement on Tuesday.*

[Hong Kong](#)

The Hong Kong Human Rights and Democracy Act looks like it may pass as soon as October. While not materially different from existing legislation detailing Hong Kong's special status, it's an important symbolic and political statement to assure Hong Kong protestors that the U.S. will impose costs on China for any intrusion. China will not take kindly to passage.

[The U.S. Is About to Do Something Big on Hong Kong](#)

Rubio said he expects the Hong Kong Human Rights and Democracy Act to easily pass in Congress and be signed into law by the president. The legislation, which has bipartisan support in the Senate and the House of Representatives, has emerged as the primary vehicle through which the U.S. government is hoping to deter China from carrying out a Tiananmen Square–like crackdown against peaceful protesters and pressure it into upholding the city’s special status within China.

Rubio said he could envision the Senate passing the act, perhaps by unanimous consent, in mid-October when it returns from a break, and the House passing its version in short order as well.

Remarkable results of Hong Kong poll | The China Collection

- 75.7% of the respondents think the government has not done enough to defuse the crisis by withdrawing the extradition bill
- 71.7% of the respondents think police have used excessive force
- 39.4% of the respondents think the protesters have used excessive force
- 48.3% of the respondents give the police a trust score of 0 (compared with only 6.5% giving a 0 score last May)

Protesters are scarred and shaken but pressing on. Is an end in sight?

if the government’s strategy is to wear the protesters down, it is not working. The numbers may be thinning at some protests but Baptist University political scientist Dr Edmund Cheng Wai, who has been doing fieldwork on the protests, says **the longevity of the movement is historic.**

The psychological support offered to the protesters by the vast swathe of society, the moderate and middle-class ranks, is the political vitamin keeping the momentum going. Those who object to the violence and are tired of the disruptions mostly keep their sentiments in check in public, for fear of recriminations.

What explains this seeming unity and where is the protest movement headed?

At its core, it is more than just the five demands. Both sides know this even if they will not articulate it as eloquently as Cheng does when he says: **“It is a call to restore ‘one country, two systems’ and to defend their civil liberties and the way of life.”**

China Finance and Economics

I'm not going to let myself get excited about a crack in Chinese Real Estate, but these numbers for a key sales period are enticing...

No Mid-Autumn Festival pick up for China new home sales

*Only four new homes were sold in Beijing during the first two days of the festival, down from 180 units sold last year, according to brokerage Centaline Property Agency, in an indication the deteriorating economy was weighing on the sector.*

*In the financial centre of Shanghai, 136 new homes were sold during this period, a decline of 32% year on year.*

*In the technology hub of Shenzhen, across the border from Hong Kong, new home sales dropped by about half to 76 units.*

*"The usual September pick-up in activity in the housing market no longer exists, for sure," said Zhang Dawei, chief analyst at Centaline. "Market sentiment has cooled, and it is very difficult to see a sudden turnaround even in October."*

More perps... primarily an accounting scam. **If banks issue capital to other banks** (as will predominantly be the case) **the net systemic capital added is zero.**

FT: China Banks Surge into Perps Market to Bolster Capital

*China's banks are racing to issue domestic perpetual bonds as they seek to top up capital levels to meet tighter regulations, with about Rmb810bn (\$114bn) worth of debt issued or in the pipeline.*

*The embrace of "perps" - bonds with no maturity date, which qualify as loss-absorbing capital - " is part of an effort by Beijing to shore up the nation's financial system as the economy loses steam, and after a crackdown on the "shadow" banking sector, in which many banks had invested, put several under stress.*

Still massive: relative to GDP this is like the US spending \$90bn on rail, year in, year out...

China's railway spending plummets as Beijing struggles to sustain momentum

China's economic planning agency said on Wednesday that railway fixed-asset investment was 449.6 billion yuan (US\$63 billion) in the first eight months of this year, which marked a modest 2.5% fall from the same period last year.

China's Creeper story of the week...

[Journalists in Chinese state media to be tested on loyalty to Xi Jinping](#)

The media oversight office made clear that updated press cards, which are essential for those working in the industry, would only be issued to journalists who had passed the exam. Those who fail will have one chance to take the test again, according to the notice.

Non-China U.S. Trade

This new Trade Commissioner is going to be a huge problem. He makes his Trump-loathing predecessor Cecelia Malmstrom sound downright diplomatic...

[US envoy takes aim at EU's next trade chief](#)

Gordon Sondland, the U.S. ambassador to the EU, branded comments about Donald Trump from Commissioner Phil Hogan "unhelpful" and "very condescending." Speaking to POLITICO's EU Confidential podcast, **Sondland warned of the dangers of "someone handling the EU trade portfolio whose sole approach is belligerence."**

Hogan, the current European agriculture commissioner who is slated to take over the trade portfolio on November 1, told Ireland's RTE radio last week he would do everything he could "to get Mr. Trump to see the error of his ways" on trade. The veteran Irish politician said he hopes the U.S. president will "abandon some of the reckless behavior that we have seen from him in relation to his relationship with China and describing the European Union as a security risk."

Sondland said he expects any future EU trade commissioner to vigorously advocate on the bloc's behalf but added: "**I don't think you want someone handling the EU trade portfolio whose sole approach is belligerence**, because that just results in an impasse, a stalemate and then people start to do things that you don't want them to do."

[US and India on verge of trade agreement breakthrough, officials say](#)

U.S. and Indian officials are nearing a trade negotiation breakthrough, according to multiple administration officials and industry insiders familiar with the talks, **hoping to**



*unveil at least a preliminary agreement during Indian Prime Minister Narendra Modi's visit this week.*

## Central Banks

The best recap of repo market problems I saw all week here, in the form of an unrolled Twitter thread...

[Thread by @NathanTankus: "There was obviously a ton of discussion of liquidity this week after repo rates rose a lot and the Fed conducted the first large scale repur \[...\]"](#)

Dudley alludes to an announcement of a program to be gradually re-expanding sheet in October, which would undoubtedly trigger a crescendo of overwrought market commentary about "QE." This is not market-relevant other than to highlight how completely clueless the Fed – who until last month was still shrining the balance sheet – is about its own operating mechanism...

## [Get a Grip. The Fed Can Handle the Repo Market](#)

*One longer-term fix is for the Fed to boost its securities holdings more permanently, thereby increasing the supply of reserves to a level somewhat above the underlying demand from banks.*

*Chairman Jerome Powell hinted at this on Wednesday, and I expect the central bank to announce something in the near future. There probably wasn't sufficient time to prepare a detailed proposal this week.... And officials will have to communicate carefully, so the move won't be confused with quantitative easing.*

Lastly, an outside-the-box take on the ECB from Scott Sumner. I think he is correct – a better policy would have entailed a broader "exempt tier" (0% rate) and a deeper negative rate tail to serve as a sort of hyper-money hot potato...

## [The ECB cut its IOR to minus 0.5%; it should have been minus 50% - TheMoneyIllusion](#)

*The ECB should stop playing around with negative interest rates and simply put a prohibitive tax on excess reserves (something I proposed in 2009). If a small amount of excess reserves are needed to clear interbank balances, then exempt a modest amount of bank reserves from the negative 50% interest rate (aka 50% tax rate.)*

*It's time to abandon interest rate targeting and move to a monetarist approach to policy. In the short run, this heavy tax would lead banks to convert deposits at the ECB to currency.*