

## The Pence Speech and Weekend Links



Vice President Mike Pence ✓  
@VP

Thank you to @TheWilsonCenter for welcoming me this morning. America is reaching out our hand to China. And we hope that, soon, Beijing will reach back, this time with deeds, not words, and with renewed respect for America.



2:36 PM · Oct 24, 2019 · Twitter for iPhone

The media-inspired consensus has quickly settled on a “good-cop, bad-cop” reading of yesterday’s speech on China by Vice President Pence. That’s far too simplistic.

Administration policy (and what the ticket will be judged on next November) is 100% what President Trump does, 0% what Mike Pence says. There is no sense in sending a mixed diplomatic message to the Chinese in a useless attempt to create political cover for a weak deal.

If Trump makes a weak “phase one” deal he’s going to get killed for politically. It makes not a whit of difference how tough Mike Pence sounds.

No, I believe the speech is meant as official communication to the CCP ahead of next week’s Fourth Plenum meetings:

[Amid crises, Xi seems set to uphold Party's rule at secretive China conclave](#)

*China’s Communist Party leaders will on Monday start their most important meeting this year, with **President Xi Jinping expected to champion the Chinese model of governance while fighting protracted economic and political crises at home and abroad.***



*It is key for Beijing to use the occasion to cast the Chinese political system as meritocratic, unchallengeable and **superior to Western democracy**, said Wang Jianguy, director of the Asian Law Institute at the National University of Singapore.*

*Party leaders have repeatedly warned that without Communist rule, China would descend into chaos and fall prey to hostile Western powers. In September, Xi said China was entering a period of “concentrated risks” - economic, political and diplomatic - and the country must be ready to fight.*

*“China’s Party-state wants to show that its political system is more attractive overseas, and others should stop their finger-pointing,” Wang said.*

To the extent that the existence of ‘reformers’ at high levels of the CCP is anything more than a myth at this point, the Pence speech provides them the fodder to push for a change in China’s path.

The first message is that China’s tactic of bringing pressure to bear via moneyed interests in the U.S. while offering nothing in the way of behavioral changes is doomed to fail;

*In response to America’s actions and resolve, **some multinational corporations say our economic policies are too tough** and that advancing our interests and our values runs contrary to better relations with China.*

*Needless to say, **we see it very differently**. Despite the great power competition that is underway, and America’s growing strength, we want better for China. That’s why, for the first time in decades, under President Donald Trump’s leadership, the United States is treating China’s leaders exactly how the leaders of any great world power should be treated — with respect, yes, but also with **consistency and candor**.*

*And in that spirit of candor, I must tell you that **in the year since my Hudson speech, Beijing has still not taken significant action to improve our economic relationship. And on many other issues we’ve raised, Beijing’s behavior has become even more aggressive and destabilizing.***

That couldn’t be more clear: we’ve gone backwards. Of course:

*President Trump still believes Beijing wants to make a deal. And we welcome the support for American agriculture in the new phase one agreement and hope it can be signed as soon as the APEC Summit in Chile this week (sic). But China knows there’s a whole range of structural and significant issues between our two countries that also must be addressed*



All signs point to Trump wanting to punt the December tariffs and see the Chinese solve his Ag problem for a few months. But if phase one does get signed, China should be under no illusions that it indicates a broad retreat from U.S. demands for fundamental changes in Chinese behavior.

The speech was broadly an updated, rehashed version of Pence's October 2018 speech on the same topic. Some additions were notable however:

*Despite China's promises to crack down on Chinese fentanyl and other synthetic opioids, the truth is, those deadly drugs also continue to flood across our borders, claiming the lives of thousands of Americans every month*

I don't see how the U.S. can make any deal of substance with a regime it is accusing of peddling deadly drugs to U.S. citizens.

Obviously, the updated speech had to address the issue of Hong Kong:

*We respect the sovereignty of nations. But America expects Beijing to honor its commitments, and President Trump has repeatedly made it clear it would be **much harder for us to make a trade deal if the authorities resort to the use of violence against protestors in Hong Kong.***

*Since then, I'm pleased to observe that Hong Kong authorities have withdrawn the extradition bill that sparked the protests in the first place, and Beijing has shown some restraint.*

*In the days ahead, I can assure you, the United States will continue to urge China to show restraint, to honor its commitments, and respect the people of Hong Kong. And to the millions in Hong Kong who have been **peacefully demonstrating** to protect your rights these past months, we stand with you. We are inspired by you, and **we urge you to stay on the path of nonviolent protest.** But know that **you have the prayers and the admiration of millions of Americans.***

Some have spun those comments as soft, but we shouldn't be surprised that the U.S. government is making an appeal against violence. This is treacherous diplomatic ground on which the Administration continues to tread carefully.

Also added to the speech were comments on the brewing culture wars surrounding business interest and China:



*Nike promotes itself as a so called “social justice champion,” but when it comes to Hong Kong, it prefers checking its social conscience at the door...*

*...the NBA is acting like a wholly owned subsidiary of the authoritarian regime. A progressive corporate culture that willfully ignores the abuse of human rights is not progressive; it is repressive*

A bit harsh for the NBA, but the corporate America has itself in an intractable bind here. Aside from playing up a newfound domestic wedge issue, Pence is signaling to China that the U.S. can fire up nationalism as well, should China want to go that route.

Lastly, the comments on decoupling seem to have been half-reported. They need to be read in their entirety for context:

*people sometimes ask whether the Trump administration seeks to “de-couple” from China. The answer is a resounding “no.” The United States seeks engagement with China and China’s engagement with the wider world, but engagement in a manner consistent with fairness, mutual respect, and the international rules of commerce.*

*But, so far, it appears the Chinese Communist Party continues to resist a true opening or a convergence with global norms.*

*All that Beijing is doing today, from the Party’s great firewall in cyberspace or to that great wall of sand in the South China Sea, from their distrust of Hong Kong’s autonomy, or their repression of people of faith all **demonstrate that it’s the Chinese Communist Party that has been “de-coupling” from the wider world for decades.***

The message here is clear, and different from the media portrayal: of course we don’t want to decouple from China, **but that is what’s happening if they don’t change their behavior.**

In sum, I don’t see the speech as having clear ramifications for the likelihood of a “phase one” deal getting done. But it’s a clear message to China, ahead if it’s important political conclave, that “phase one” or not, we are on a path of decoupling if China does not change its behavior.

## Phase One Update

As for phase one, here was the brief readout after this morning’s call between the principals:

*(Bloomberg) -- The U.S. and China are close to finishing some sections of phase one of the trade agreement, according to statement from USTR Robert Lighthizer and Treasury Sec. Steven*



*Mnuchin.*

*\* Mnuchin, Lighthizer spoke on phone call with China Vice Premier Liu He Friday*

*\* "They made headway on specific issues and the two sides are close to finalizing some sections of the agreement. Discussions will go on continuously at the deputy level, and the principals will have another call in the near future"*

Hmmm, OK but I thought all that was left was to “paper the deal?” They’re close to finishing “some sections.” The deal doesn’t have many sections, and they were all supposed to be largely agreed, we’ve been told.

As I wrote last week, enforcement will remain the bugaboo. I’ll be surprised if either side relents on that issue, but I suppose they could punt it to “phase two,” which would drop the odds of phase two ever getting completed to close to zero.

I’m still skeptical a deal gets done, but am surprised that virtually ALL my contacts in the MAGA-land (and readers may be surprised to hear that I have a few) believe that Trump has decided to “put the China ball down” in favor of babysitting the economy and goosing the stock market. I still think it’s a game to get some cash into the farm belt, but “we’ll see what happens,” as the President likes to say.

It doesn’t help prospects for a “phase one” deal that China seems to be moving the goal posts aggressively already:

### [China to ask U.S. to remove tariffs in exchange for ag buys in talks Friday: sources](#)

*So far, Trump has only agreed to cancel an Oct. 15 increase in tariffs on \$250 billion in Chinese goods as part of understandings reached on agricultural purchases, increased access to China’s financial services markets, improved protections for intellectual property rights and a currency pact.*

*But to seal the deal, Beijing is expected to ask Washington to drop its plan to impose tariffs on \$156 billion worth of Chinese goods, including cell phones, laptop computers and toys, on Dec. 15, two U.S.-based sources told Reuters.*

*Beijing also is likely to seek removal of 15% tariffs imposed on Sept. 1 on about \$125 billion of Chinese goods, one of the sources said*

One “section” that seems to have been agreed is on the currency pact, although there is less here than meets the eye. In the absence of further tariffs, “basic stability” was going to be



Beijing's policy anyway. A policy of keeping the RMB "basically stable at an equilibrium level" hasn't prevented the sizeable swings in both USDCNY and the basket in recent years (CNY is currently 4.6% off this year's high against the basket). Nonetheless, it would rule out a significant devaluation for as long as the truce holds, constraining China's ability to undertake aggressive credit stimulus...

### [China, US agree to keep yuan exchange rate stable as part of trade deal, Beijing confirms](#)

*The trade truce that China and the United States are expected to finalise next month will include a currency clause in which Beijing will promise to keep the yuan's exchange rate "basically stable" in relation to a basket of currencies, a Chinese foreign exchange official said Friday.*

*Wang Chunying, a spokeswoman for the State Administration of Foreign Exchange, said at a press conference in Beijing that China will stick to its "floating exchange rate system with adjustments and management," indicating there will be no major depreciation or appreciation of the yuan in the near future.*

China is also playing up changes to IP regulations (that will be meaningless without a U.S.-led enforcement regime)...

### [Global Times: China continues to further strengthen IPR protection](#)

*China has already done plenty and will continue to strengthen legal enforcement in the area of intellectual property rights (IPR) in a bid to create a better business environment and convenience for foreign companies operating in China, a senior official told a press conference on Wednesday.*

*The remarks came after China and the US have achieved substantial progress in multiple areas after holding a new round of high-level economic and trade consultations earlier this month in Washington. During the talks, IPR protection was a main topic.*

*"IPR protection is an important aspect of the business environment. We must improve the business environment and provide convenience for all types of enterprises investing in China, while the other side should also do that for Chinese enterprises overseas," Ning Jizhe, deputy head of China's National Development and Reform Commission (NDRC), said on Wednesday.*

*Ning said that China has strengthened IPR law enforcement in several aspects in recent days. These include tightening the crackdown on IPR violations, perfecting the penalty*



*system in the IPR sector, improving the efficiency of IPR reviews, strengthening international cooperation in IPR protection, and supporting enterprises to attain and protect IPR overseas.*

Oh look – they’re going to “level the playing field, too!”

### [China unveils major policies to improve biz climate](#)

*Premier Li Keqiang signed a decree for the release of **the regulation on improving the business environment**, set to take effect on January 1, 2020, the Xinhua News Agency reported on Wednesday.*

*The new regulation clearly stipulates that **the government will equally protect "all types" of businesses**, ensure they use factors of production and take advantage of policy support legally and fairly, Xinhua reported.*

*China will also push for the establishment of a national platform for market entities to streamline administrative applications and the approval process, and standardize intermediary services, Xinhua said. The State Council also stipulated equal market access and maintaining a fair market order, the report said.*

*To continually improve the business climate, "it was necessary to form special administrative regulations to provide guarantee and support for optimizing business environment on the institutional level," Xinhua said.*

Blah, blah, blah, blah blah blah blah. Enforcement anyone?!?

In other news...

Rubio is not going to let this go. Market participants continue to underestimate the risk that public pressure, if not legislation, will soon hinder the flow of U.S. capital to China. MSCI says there’s no law that prohibits them from adding China. Yes, but **Rubio has the power to make law...**

### [Rubio Duels With MSCI Over Investors' Money in Chinese Stocks](#)

*Global index provider MSCI Inc. is pushing back against criticism by U.S. Senator Marco Rubio that it’s helping funnel billions of Americans’ investment dollars into Chinese companies linked to human rights abuses and national security threats.*

*“Currently there is no U.S. law or regulation that prohibits an index company from creating an index containing China A securities or U.S. investors from trading in the China A market,” MSCI’s Chief Executive Officer Henry Fernandez said in a letter seen by Bloomberg*

## Hong Kong

HSI was doing the classic Chinese “bad news = stimulus = good news” routine this week. But an announced economic aid package is little more than a band aid in light of retail sales at -23% and tourist arrivals falling off a cliff. I look for another leg down in HSI after China’s Plenum (which I suspect is generating some “support” for both mainland and HK markets).

### Hong Kong Announces Fresh Relief Measures to Boost Economy

*Hong Kong Financial Secretary Paul Chan unveiled a range of relief measures worth about HK\$2 billion (\$255 million) targeting tourism and the transportation industry in a renewed effort to help businesses grappling with the economic fallout of ongoing political turmoil.*

Such sharp drops in retail and tourism will not be long sustainable in what might be the world’s most expensive city. Cutting rents to keep tenants in business makes sense in the hope that things blow over. But if they don’t? Interesting point here re: Christmas...

### Bargain Hunters Revel as Hong Kong Businesses See Life or Death

*So far, G.O.D.’s Young has been able to get about a 20% discount from talks with landlords, with some more generous while others have refused to budge. But business is so bad that even if the landlords charged no rent, “we’ll still be in trouble” due to overhead costs such as wages and electricity, Young said.*

*The retailer is trying a combination of unpaid leave, voluntary holidays and other ways to cut costs and avoid laying off workers as far as possible.*

*“The best thing is for the conflict to end,” Young said. “The bulk of our profits come in Christmas and we’re getting frighteningly close to it.”*

Again, I like buying HIS puts funded with the sale of puts on a U.S. index...

### Hong Kong Markets Are Calm as Protests Linger and a Recession Looms



*The economy is heading for a recession, violent protests show no sign of easing and yet Hong Kong's financial markets are enjoying an unusual period of calm.*

*A gauge of Hang Seng Index volatility has fallen 20% this month to the lowest level since mid-July, while the local dollar has barely moved in weeks. Even U.S. speculators are giving up, after their bearish bets in August sent short interest on a Hong Kong stocks fund to a six-year high. The city's interbank borrowing costs have also eased, a sign of looser liquidity.*

*Optimism over trade relations between China and the U.S. has recently outweighed concerns about a weak yuan eroding corporate earnings. **Mainland investors are buying Hong Kong stocks**, while initial public offerings are once again luring capital.*

Hong Kong's "special status" is key to China's already dwindling access to Dollar liquidity...

### [All About the Money: Why Hong Kong Matters So Much to China](#)

*since the Hong Kong dollar is pegged to its U.S. equivalent, and the city has no capital controls, a listing there can generate hard currency for foreign takeovers and investments. It would be harder to use a Shanghai stock sale for the same goal.*

*For global investors, Shanghai and Shenzhen have become more accessible. But investors typically prefer Hong Kong's legal protections, and they have other concerns about mainland markets, including the difficulties of moving money out.*

*Chinese entities also borrow liberally through Hong Kong, both via bank loans and through bond issues. Hong Kong is by far the largest offshore center for bond sales by Chinese firms. Companies can borrow for longer than they can onshore and, crucially, can raise funds in hard currency*

The downside to Xi of letting the protests run their course...

### [Taiwanese Opposition to Political Union With China Surges](#)

*Nearly 90% of Taiwan's public opposes unification with China under the "one country, two systems" model adopted by Hong Kong when it returned to Beijing's rule in 1997, according to a survey published by Taiwan's Mainland Affairs Council Thursday. That's an increase of 13.9% percentage points since January*

*The months-long protests in the city not only raised concerns among Taiwanese people about Hong Kong-style rule, but also gave Taiwan President Tsai Ing-wen a noticeable boost in public support. Tsai, who is seeking a second term in January, refuses to endorse Beijing's bottom line that both sides belong to "one China."*

## China Economy & Finance

I believe this to be a huge problem for Chinese policymaking in the economic sphere and in U.S.-China trade:

### China's Xi Jinping has more to worry about than slowing economic growth

*the authoritarian system that Mr. Xi inherited seven years ago – and has made far more rigid during his time in office — may be great at building infrastructure, repressing dissent and censoring the internet, but it is often **hopeless when it comes to passing bad news up the chain.***

***One senior US official, who has spent almost 30 years dealing with Chinese Communist party cadres across the country, said he was shocked during a recent visit to Beijing at how badly briefed even politburo-level officials appeared to be.***

*"They appeared to have been given very bad information," the US official said. "They kept saying things that were flat-out false."*

*Even in private settings, Chinese officials cling to their official narrative that American and British "black hands" sparked the unrest in Hong Kong. It is a narrative that conveniently absolves everyone, from Beijing's representative office in the semi-autonomous territory to Mr Xi himself, of the **failure to appreciate the potentially destabilising consequences of Hong Kong's unrepresentative political system, the chronic incompetence of its coddled civil servants-turned-politicians and its soaring economic inequality.***

If Xi believes that affordable housing is at the root of the HK protests, then you better believe he means it when he says "houses are for living in, not speculation." The problem, of course, is that the entire economy is dependent on continuation of the real estate bubble to sustain itself... price flooring?

### One of China's most expensive cities turns its back on Hong Kong housing model

*A new government plan will cap the price of land sold for subsidized housing at 30 to 40 per cent of the benchmark rate as it seeks to build 1 million units by 2035*

**Infrastructure approvals: ignore these announcement.** They make these announcements all the time, yet infrastructure spending remains in a multi-year downtrend. Project approvals is not the binding constraint - its financing...

### [China doubles infrastructure approvals to stave off economic slowdown](#)

*The Chinese government has doubled the value of large-scale infrastructure projects it has approved so far this year compared with last year, as it steps up efforts to steady the flagging economy amid a bruising trade war with the United States.*

*The National Development and Reform Commission (NDRC) has approved 21 projects, worth at least 764.3 billion yuan (US\$107.8 billion), according to South China Morning Post calculations based on the state planner's approval statements released between January and October this year.*

*The amount is more than double the size of last year's 374.3 billion yuan (US\$52.8 billion) in approvals recorded over the same period, which included 11 projects such as railways, roads and airports.*

Dollar shortage...

### [China Is Struggling to Offload Foreign Acquisitions, From Yachts to Pizza](#)

*Chinese firms started selling off assets two years ago when the government tightened curbs on capital outflows and stepped up scrutiny on foreign acquisitions. Geopolitical factors from the U.S.-China trade war to Brexit and protests in Hong Kong and Chile are hurting sentiment in dealmaking on uncertain outlook.*

*"It's a big process of adjustment," Mark Webster, a managing director at investment banking adviser BDA Partners in Shanghai, said in a phone interview. "Some Chinese companies made overseas acquisitions at the top of the cycle and ended up overpaying for assets that did not make a lot of strategic sense. They are now finding it challenging to offload those businesses at fair values."*

### [Chinese Conglomerate Said to Weigh Sale of Nasdaq-Listed Trophy Asset](#)



*A once-highflying Chinese conglomerate has earmarked for sale its controlling stake in Nasdaq-listed [Sirius International Insurance Group](#), according to people familiar with the matter, as pressure mounts from shareholders and creditors for a solution to its debt crisis.*

*A sale of the global property-and-casualty insurer that China Minsheng Investment Group bought in 2016 for \$2.6bn would dismantle a key piece of an overseas empire that the privately held Chinese conglomerate tried to build before [running into financial difficulties this year](#).*

I know an 8% coupon is pretty juicy in today's world, but there must be better options than highly-levered players in a sector that's clearly credit-inflated – so much so that even the government has called a halt to further inflation. The sector is also rife with shoddy accounting practices. Not to mention the fact that they're borrowing in USD in a country in which USD are becoming increasingly hard to come by, and there's a non-zero chance the nation gets frozen out of the USD payment systems at some point. **In a world where these bonds work out, isn't most everything else working out too?**

### [China Developers' Need to Refinance Boosts High-Yield Bonds](#)

*At \$51.8bn, the value of high-yield dollar bonds issued offshore during the year to date represents an increase of 116 per cent compared with the same period last year, and a gain of more than 60 per cent on the full total for 2018, according to data from Dealogic. More than 90 per cent of that issuance is from heavily indebted developers such as Evergrande, Country Garden and Dalian Wanda, whose high leverage usually limits them to issuing high-yield debt in international markets. This has helped boost developers' total offshore dollar debt sales to a record \$67.2bn this year.*

Samsung has been moving its supply chain out of China for a decade...

### [Samsung's departure is new blow to Chinese manufacturing](#)

*As it moved capacity elsewhere, Samsung kept its Chinese production to serve the China market. But it has seen its share evaporate to 1.1 per cent in the first quarter from about 20 per cent in 2013, according to Strategy Analytics, removing the final barrier to closing its factories there.*

*"Samsung did not pay enough attention to the particularity of the Chinese market," said Yanhui Wang, secretary-general of the Mobile China Alliance.*

*“Our market share in China has dropped so much... We used Chinese production for overseas sales as well in the past but its competitiveness as a global manufacturing base has decreased,” said the Samsung executive.*

## U.S. – EU Trade

It’s unclear whether Trump can again postpone the deadline for the EU auto tariff decision. Ross seem to think so. Odds of Trump dropping tariffs on Europe at this point must be very low...

### [FT: Wilbur Ross Looks to Negotiations to Ease Trade Dispute with EU](#)

*In May, Mr Trump offered carmakers a six-month reprieve from the levies, setting up a new deadline for a decision in mid-November. A strict interpretation of US trade law would present the president with a binary choice between ploughing ahead with tariffs or dropping the threat entirely, but Mr Ross suggested a new deferral might be possible.*

*“One [option] would be to say, ‘I’m just not going to do anything’, the second would be to impose tariffs on some or all [countries]...the third might be some other form of negotiation,” he said.*

*Mr Trump “has quite a lot of alternatives as to what he can decide to do, and I don’t think we should prejudge what the conclusion will be”, Mr Ross added.*

## Monetary Policy

An interesting perspective here that triggered the following thought: If the Fed massively mis-guesstimated the level of reserves at which we’d hit scarcity, doesn’t that imply they have failed to understand actual demand for reserves all along? If so, there was actually much less true “excess” than they thought. The implication would be that **we may have all overestimated the stimulative effects of QE** by dint of overestimating the level of reserves that were actually “excess.” This may also explain why the taper had such surprisingly strong effects on Dollar liquidity and XY in 2014-15.

### [New World Economics | Basel III and Demand for Bank Reserves](#)

*I have characterized the increase in bank reserves since 2008 as a matter of banks wanting to hold more reserves. This is why this very large increase in supply was not met with a very large decline in the value of the currency*

Zing...

### Strange respect for central banks

*The Economist recently did a long article on the mystery of low inflation. Overall it's a good article, well worth reading. But there are a few problem areas. Here's one:*

*Later in the decade, amid low unemployment rates, monetary policymakers became more attuned to the risk of overheating. It would be odd, however, to explain low inflation by appealing solely to deliberate choices on the part of central banks, when they themselves profess to be confused by inflation's quiescence.*

*A bus is driving from Los Angeles to Vegas. At some point the bus goes off course, and ends up in the Mojave Desert, 20 miles from I-15. The bus driver's labor union points out that this is a skilled driver. "It would be odd to attribute the location of the bus to choices made by the bus driver. More likely, an electromagnetic pulse from outer space affected the bus's navigation system." How would that excuse work?*