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

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Trade Update & 4D Chess

In Tuesday's Band in China I suggested the odds were 85/15 against any delay in U.S. tariffs. update that in light of new information which has raised the possibility of a middle-ground scenario.

Two new pieces of information:

- China appears much more desperate than I anticipated
- Acknowledgement of a 2:30 Liu He meeting at the White house

Given that the U.S. has been beating China like a rented mule in recent weeks, I'm frankly surprised they showed up in DC at all.

That they have, and have secured an audience with the president, suggests the possibility of a **"halfway house" deal** in which the U.S. delays next week's tariff increase (which is more symbolically important than practically so) **but leaves the question of the December tariffs open** pending further talks.

I still discount the possibility of the December tariffs being cancelled. **It's a terrible move for Trump politically**.

Updated scenarios and odds

- Breakdown: 30%
- Oct delay / Dec left open: 50%
- All new tariffs deferred: 15%
- Bigger deal w/ rollback: 5%

China Appears Desperate

If the only thing on the table for China aside from some very limited relief for Huawei is a deferral of the October 15 tariffs – which are of no practical significance - and the December 15th tariffs – which cover the most "inelastic" goods for which the incidence of the tariff should fall most heavily on the U.S. – then **why does China want to make a deal?**

- They're desperate to slow the supply-chain exodus
- To buy time in the hopes the political environment turns more favorable in 2021
- They fear U.S.-China relations are spinning out of control and want a time out at any cost
- To put U.S. relations on as sound a footing as possible ahead of possible intrusion on Hong Kong?

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What are the downsides for China?

- They remove a political thorn from Trump's side with Ag purchases

4D Chess

The key reality framing the 4D Chess analysis is that **there is no credible rationale for continued talks on "structural issues."** Everyone knows that China is not going to budge on its red lines, and therefore **an "interim deal" is a bridge to nowhere**. It's political and economic short-termism and **we're still 13 months from election day**.

Why would Trump want to make this deal?

- China takes down the Autumn soybean harvest
- Equity markets will rally for a few days
- Avoid a risk to the economy (overstated in my view) from the December "consumer tariffs"

What are the downsides for Trump?

- The voting public is in an anti-China lather, much of it of Trump's own making. The media will kill him for "going soft" on China
- He takes air out of an issue with "rally round the flag" potential – always good for a sitting President
- An interim deal does little to undercut the "economic uncertainty" narrative
- A cease-fire risks derailing the Fed easing campaign
- He shows political fear at a time when doing so could prove lethal domestically
- If China intrudes on Hong Kong, he gets tagged with Chamberlainesque appeasement
- The "interim deal" will not put U.S.-China relations on a footing that is sustainable through November 2020 - **it's only postponing the inevitable volatility event until closer to the election**

Donald Trump has been in the vanguard of arguing that the rise of an authoritarian Communist China presented an existential threat to economic and national security that the governing elite was failing to address. Now, with NBA kerfuffle, **the "China issue" has gone mainstream**, with a cross-spectrum level of public agreement unheard of in this day and age.

China will be a key issue in the 2020 campaign. It's an issue on which Donald Trump – whatever you may think of him – has a more established branding than any Democrat contender. It is **the only issue on which he is both in sync with a majority of the voting public and has some modicum of policy credibility**.

"Letting China off the hook," even if temporarily, simply to offload some soybeans will inevitably **tarnish the President's political brand** on the issue. Even Donald Trump's legendary marketing skills will not prevent an "interim deal" from being branded as "trading national security for soybean sales."

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As for the economy, it has already absorbed the bulk of the tariff hit. One more iteration and the "tariff wall" is built. Don't stop now - keep the pressure on the Fed and get the potential economic hit digested. With any luck the economy will be in a moderate upturn by spring in a lagged response to rate cuts.

Even if the economy slows further, **there is one political climate that is even a more supportive of Presidential popular support that economic recovery**: **war.** It doesn't need to be a hot war, or even a full-blown cold one. A "generational geopolitical challenge" will suffice. **Countering authoritarian Communism in China is a powerfully coalescing issue**.

It's the right thing to do. **The 4D chess move is to just get on with it**.

Postscript: Currency Accord

Wait - **we're going curb US capital flows to China AND have them commit to a strong currency?** I don't think that's going to work…

There are two options for a "currency accord":

- One that is not based on a commitment to USDCNY stability, but instead modeled after USMCA Chapter 33 which "affirms the three countries' commitment to market-determined exchange rates and adherence to the International Monetary Fund's (IMF) Articles of Agreement to "avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage."

- One that is based on a commitment to USDCNY stability that will either prove unsustainable, or force China to so completely close its capital account that it would amount to voluntary decoupling.

Format one is unlikely to much satisfy President Trump, as its completely toothless.

Format two is unlikely to satisfy President Xi in that it's a surrender of sovereignty akin to economic asphyxiation (currency pegs are fine, *but not at the peak of a multi-decade credit orgy*).

I don't expect to see anything on exchange rates today which would have a sustained market influence.