



Who's Playin' Who and Weekend Links

More one-dimensional chess from China in the trade war...

What purpose does a “phase one” deal serve for China? The supply chain is already infected with decoupling risk. Phase one doesn't change that.

Furthermore, the December tariffs, deferral of which is seemingly on offer in phase one, are slated to be the most painful yet for U.S. consumers and therefore the riskiest yet for the President, who seems anxious to gain sufficient political cover to back out of the threat he's committed to.

Why does China want to help him out with that, and solve his Ag problem for him, all while absorbing economic hits and diplomatic embarrassment on Huawei, Xinjiang, and Hong Kong?

No one thinks there's any realistic chance of things progressing to a phase two, so the risk overhang threatening the Chinese economy will not be alleviated. China is getting nothing of practical value in Phase one. What's their motivation?

It looks like they've once again formulated a strategy based on an assessment of President Trump garnered from intelligence sources embedded deeply within CNN and MSNBC.

Another strategy based on #fakenews. Another strategy doomed to failure.

I won't belabor the impeachment stuff as I [covered it in this space three weeks ago](#). Suffice it to say that Trump is not feeling threatened by impeachment, else he wouldn't have taken such a politically risky decision in Syria. Impeachment will go nowhere in the Senate, and Trump is unlikely to sustain any electoral damage in the process.

Nonetheless, I'm sure the Chinese buy the media narrative that impeachment and recession risk make Trump “desperate for a deal.” Ergo, the transparently amateurish game they seem to be playing:

[BBG: China Says its Working on trade Agreement text with U.S.](#)

*Beijing needs further talks before it is ready to sign an agreement first made verbally last week, which would see China increase agricultural purchases from the U.S. in exchange for a limited reprieve on tariffs. The U.S. claimed China agreed to gradually increase buys of soybeans, pork and other farm goods to \$40 billion to \$50 billion annually at the most recent talks, but **China hasn't confirmed that**. Commerce Ministry spokesman Gao Feng declined to comment when asked about that number.*

*“Chinese companies are still increasing their purchases of American agricultural products according to the needs of the domestic market,” he said. “The Chinese market is huge. Ending the trade war as soon as possible **and abolishing the imposition of tariffs** will be conducive to the expansion of bilateral cooperation in a broader economic and trade field, including agriculture.”*

A lesser official was more succinct, [according to CNBC](#):

***The phased aspect of the deal is encouraging to the Chinese side**, said He Weiwen, executive council member of the China Association of International Trade, which comes under the leadership of the Ministry of Commerce.*

He said the Chinese will show their sincerity by increasing purchases of American agricultural products.

However, there’s a catch. It’s become increasingly clear that [Beijing would like to push the U.S. to remove the tariffs](#) it’s applied on billions of dollars’ worth of Chinese goods.

***“If China has promised to buy agricultural products, but the U.S. only delays the additional tariffs instead of lifting them, then it doesn’t make much sense to China,”** He said. “This is the crucial point.”*

This seems to be China’s thinking: Trump is desperate for a deal - let’s dangle a huge number for Ag in front of him, get U.S. farmers all ginned up about the piles of cash they’ll make (recall the cancelled trip to Ag country a few weeks back), get the deal negotiation process going and then we’ll have Trump over a barrel. As we move into an election year, Trump will give us everything we want so he doesn’t lose his Ag purchases again.

Yup, its more one-dimensional chess from the Chinese.

I’m guessing the Chinese policymakers haven’t noticed that President Trump doesn’t just call them farmers anymore. They are always our “Great Patriot Farmers.” Every time it comes up: “Great Patriots.”

Of course, the President wants to help out these great Americans. And he sure is trying. He got the Chinese to promise to buy \$50bn a year! But what is it we know about Chinese promises?

They tend not to be worth the paper they’re written on. And this one isn’t even “papered” yet.



It's already apparent what's going to happen. China is going to "renege" again. And the "Great Patriots Farmers" are going to again be called upon to take one for the team (with the salve of "adjustment assistance" that is order of magnitudes larger than the losses sustained as a result of China exiting the market).

The bad guy to those Great Patriot farmers in Nebraska, Kansas and is not going to be Donald Trump. It's going to be Xi Jinping. After all, you just can't trust that guy...

In the meantime, China is in the process of normalizing U.S. soybean inventories and helping to clear the Autumn harvest.

This from a [CNBC piece in August](#):

To manage the collapse of Chinese buying, American soybean farmers have been working alternative markets, said Sutter. Fast-growing markets that have absorbed half of the remaining stocks include Europe, emerging regions in [Southeast Asia](#), [Egypt](#), [Bangladesh](#) and [Pakistan](#).

While the U.S. soybean trade has been working to sell what would have otherwise gone to China, "unfortunately it doesn't look like we'll quite get there this year," said Sutter.

So American farmers are expected to be left with a record high level of ending stocks of over 1 billion bushels in this marketing year that ends on Aug. 31, as [estimated by the U.S. Department of Agriculture](#). That will be more than double the 438 million bushes in the previous marketing year.

1bn bushels of soybeans is about 27m tons. Since that was written, [China has purchased ~5m tons](#) of beans since September first as a "goodwill gesture." A few more weeks of heavy Chinese bean purchase continuation of heavy Chinese purchases could bring inventories to more normal levels, and help to solve Trump's "bean problem" even if "Phase One" eventually falls apart at the mid-November APEC meeting.

It's not clear whether or not Phase one breaks down in November (although I lean that way), or whether President Trump really wants to defer the December tariffs and string the Chinese Ag orgy out into early 2020 to help those "Great Patriot Farmers."

In handicapping outcomes, it's important to understand who's getting played here. It's not Donald Trump.

On to the Links...

Hong Kong

Lam's focus on "bread & butter" issues in her "state of the union" address is straight out of Xi Jinping's obtuse playbook:

[Lam Moves to Ease Hong Kong Housing Woes, Says City Is in Recession](#)

In an annual policy speech on Wednesday delivered via video after pro-democracy lawmakers disrupted her attempt to speak in the legislature, Lam said the economy entered a recession in the third quarter. She announced policies aimed at the 20% of Hong Kongers who live below the poverty line, from more compulsory land purchases for housing to cash for students to increased subsidies for low-income families.

"Housing is the toughest livelihood issue facing Hong Kong society," Lam said. "It is also a source of public grievances. I have never taken this matter lightly."

The announcements came on top of a \$2.4 billion stimulus package announced by Financial Secretary Paul Chan in August to help bolster the economy.

Still, Lam's bigger problem is her own legitimacy among protesters who view her as a stooge of the government in Beijing. Instead of economic issues they are demanding an investigation into incidents of police brutality and calling for the ability to pick a leader who will stand up to Beijing -- areas where Lam had no new proposals on Wednesday.

"When this government has lost all merit and all legitimacy, there's no way Carrie Lam can govern Hong Kong any more," said pro-democracy lawmaker Alvin Yeung. "This is the end of it."

[Hong Kong Policy Address 2019: Democrats blast Lam's 'irrelevant' speech as pro-Beijing camp offer lukewarm welcome | Hong Kong Free Press HKFP](#)

Chief Executive Carrie Lam's policy address on Wednesday was met with scorn from Hong Kong's pro-democracy lawmakers, who said she failed to tackle the political crisis at its root.

The policy address highlighted four main areas: housing, land supply, livelihood issues and economic development. Lam delivered her speech via a televised message, after democrats twice interrupted her from reading it aloud at the legislature.



Tanya Chan, Civic Party lawmaker and convenor of the pro-democracy camp, called on Lam to resign as she had become the “common enemy of the Hong Kong people.”

“Lam’s approval rating is at a record low... it is the wish of most Hongkongers that she resign,” Chan said. “In the hearts and minds of Hongkongers, Carrie Lam exists in the past tense. Nobody even bothers to surround her [in protest] anymore.”

Reports of citizen displeasure with elevated levels of violence are belied by a turnout of 130,000 at Tuesday’s march in support of passage of the Hong Kong Human Rights and Democracy act...

[Hong Kong Protests Show Early Signs of a Split on Using Violence](#)

Despite press reports of a split among protestors over the use of violence, Monday’s permitted march in support of the Hong Kong Human Rights and Democracy Act still drew over 100,000 reportedly...

*Ben Reilly, a professor at the University of Western Australia, said **governments often attempt to split hardliners from more moderate groups in protest movements.***

“The fact that it hasn’t worked so far emphasises the depth of support for the [Hong Kong] reform movement,” Prof Reilly said.

[China Finance & Economy](#)

The line between where the state ends and “private” business begins is getting ever-blurrier...

[China to Place Govt Officials Inside 100 Private Companies, Including Alibaba](#)

Despite claiming that the move in Hangzhou is no more than an “innovative” economic strategy, inserting government officials inside private firms further raises concerns about state influence at Chinese companies.

Under Chinese law, organizations can be forced to hand over data to the state if requested to do so.

The economy continues to suck wind. Admonitions from senior leadership are no substitute for cash flow...

China's economy cause of growing concern in Beijing amid trade war

Chinese premier Li Keqiang has urged local government officials to do everything possible to keep economic growth on track, sending a strong signal that Beijing is increasingly concerned about a deeper-than-expected economic slowdown amid a trade war with the United States.

Li told five provincial governors on Monday that local officials must “enhance the sense of urgency and responsibility” to ensure stable economic growth and “must put growth in a more prominent position” on their work agenda, according to a statement on the Chinese government’s website.

“The downward pressure on the economy is increasing continuously, and many real economic entities are struggling amid weak domestic demand,” Li said. He added local authorities must do everything they can to “make sure targets for this year are achieved.”

Li also told the governors from Shaanxi, Jiangsu, Henan, Hubei and Guangdong provinces that officials must strengthen their “bottom line thinking” – Communist Party jargon that describes the need to consider the worst-case scenario and take steps to avoid it.

Believe me, concerns about economic viability of a project never stopped an LGFV before. **They're not running short of “nowheres” to build bridges to.** They're short on financing...

FT: Chinese LGFV's Run Out of Projects to Back

Sichuan Development Guidance Fund has a problem. The company, based in the southwestern city of Chengdu, is running out of profitable infrastructure projects to fund — and that contributes to China’s wider economic woes.

“There are not many economically viable projects for us to take on,” an official at Sichuan Development told the FT. “We have plenty of bridges and roads already.”

Large errors & omissions in China’s BoOP are generally a sign of a high proportion of capital flight hidden in purportedly trade-related FX flows. In the new quota-based FX regime ([The Renminbi Regime](#), 6/25/19) they’re allowing the banks to decide to whom to allocate the supply of FX that comes in. If this data does, in fact, indicate a high proportion of available FX



supply going to satisfy demand for capital exodus, then we can presume import business is being impaired.

[China's Hidden Capital Flight Surges to Record High](#)

China's hidden capital flight surged to a record high in the first half of this year, suggesting that residents wanting to move money abroad are using unrecorded transactions to evade tight capital controls.

That's according to the Washington-based Institute of International Finance, which said the "net errors & omissions" in China's balance of payments, widely seen as an indicator of concealed capital flight, rose to a record high of \$131 billion in the first six months of this year. That was larger than the average \$80 billion recorded during the same period in 2015 and 2016, when outflow pressures intensified, it said.

The key to reserve currency status is not transactions but the **willingness of investors worldwide to hold and fund assets** denominated in the currency. Funding requires some semblance of stability in liquidity and asset & currency markets that are open and free from official manipulation.

[Why the renminbi's challenge to the dollar has faded](#)

A decade ago, China launched a high-profile challenge to the dominance of the US dollar, projecting a greater role for the renminbi in the global financial system. But the would-be challenger is struggling.

*The dollar is still used on one side of 88% of all foreign exchange trades, according to the latest triennial survey by the Bank for International Settlements, while the renminbi's share is just 4%, with a rise in turnover "only slightly faster" than the overall market. **The currency amounts for about 2% of total foreign exchange reserves, according to the IMF.***

*In Hong Kong, **renminbi deposits tracked by the Hong Kong Monetary Authority have dropped more than a third from their 2014 peak.** And the value of offshore renminbi bonds was \$53bn at the end of the first quarter of this year, down more than half from the 2015 peak, according to the Asia Securities Industry & Financial Markets Association.*

Market participants say internationalising the renminbi would require Beijing to let the currency trade more flexibly and to open up the country's capital account. "Right now it

isn't safe to do either," said Brad Setser, an economist at the Council on Foreign Relations, a US think-tank.

This sounds ugly...

[China Office Vacancies Reach Decade High on Slowing Economy](#)

The vacancy rate in 17 major cities climbed to 21.5% in the third quarter, according to CBRE Group Inc. The "spike" in vacancies this year is the worst since the depths of the global financial crisis a decade ago

I've given up on China ever kicking the moral hazard habit...

[In Depth: Recent Court Case Could Leave Banks on Hook for Customers' Losses - Caixin Global](#)

China's banks will now have to think twice when selling wealth management products to individual investors, after one branch was told to compensate a customer for all the losses she suffered when a product she bought tanked.

*In late August, the Beijing High People's Court upheld rulings by lower courts which said **a local branch of China Construction Bank Corp.** — one of the country's major commercial banks — **must pay a customer nearly 600,000 yuan (\$84,600) after a stock index fund product she bought from the bank was hit hard by the 2015 stock market crash.***

The court ruling has perplexed some in the financial industry, as China's regulators [released rules in April 2018](#) to ban financial institutions from issuing asset management products with an implicit guarantee of repayment. This implicit guarantee is considered to be a source of financial risk.

[General Interest](#)

[Kim Jong Un May Be Hiding a Hog Apocalypse From the World](#)

"Pork accounts for about 80% of North Korea's protein consumption and with global sanctions taking place, it's going to be hard for the country to find an alternative protein source,"

I don't know how long Pelosi can stonewall this without getting tagged with putting political grievance ahead of the nation's workers and farmers. I expect USMCA to pass this Fall...

[Mexico president urges USMCA ratification, vowing to implement labor reform](#)

Decent thought piece on the U.S. role in the Middle East from Peter Zeihan...

[Goodbye to the Middle East](#)

And some useful background on the strategic imperatives behind the atrocities in Xinjiang...

[China's Final Solution In Xinjiang](#)