

China Wins the Skirmish and Weekend Links

Well, that left a mark.

The deal, as I understand it, consists of cancellation of the Dec. 15th tariffs and a **halving of the September tranche on ~\$110bn from 15% to 7.5%**, leaving in place the 25% levy on \$250bn. In return, China offers a **vague promise on Ag purchases**, along the lines of a return to status-quo ante levels of \$25-30bn in 2020. Pledges on IP, market access and FX are most-likely **warmed-over nothingburgers**.

While the deal is not substantively different from the initial Phase One readout, the symbolic differences are critical. **Trump allowed himself to be “re-traded”** on both rollback and the firmness of the Ag commitment. The unambiguous message is that **Trump wanted the deal more than the Chinese did**.

The trade war is by no means over, but in this latest skirmish **China has prevailed in a rout**. As Trump waives the white flag, questions will remain as to whether this is a strategic retreat, or he simply lacks the stomach for the fight. (Or the brains – it really might be about nothing more to him than “balancing the accounts.” I covered the stupidity of a Soybean deal [HERE](#)).

While much remains unclear...



...concerns that this is an October re-run to be followed again by an interminable “papering” process **are misplaced**. Both sides have said **the text is largely agreed**. The cloudy messaging



likely just results from sensitivities on both sides to possible “loss of face.” **Phase one is done.**

There is a bit of a twist with Phase Two that bears consideration:

*TRUMP SAYS 25% CHINA TARIFFS WILL BE USED IN PHASE-TWO TALKS

*TRUMP SAYS HE WAS WILLING TO WAIT AFTER 2020 ON PHASE-TWO TALKS

So, who wanted to move up Phase Two? [Bloomberg’s recap](#) provides a clue:

*China and the U.S. agreed on the text of a phase one trade deal that includes the removal of tariffs on Chinese goods **in stages**, Vice Commerce Minister Wang Shouwen said, as President Donald Trump confirmed that some levies will be reduced and said the next round of talks will start immediately.*

China wants rollback “in stages” and Trump is telling us the 25% tariffs will be used for leverage in Phase Two. But Trump also told us **he didn’t want to do Phase Two!**

No, **it’s China that wants to move quickly to Phase Two** because they have their opponent on the run. **China will be looking to push that advantage** to achieve further tariff rollback in return for more vaguely-worded and easily skirted structural commitments.

As each day brings us closer to the U.S. elections, **China’s leverage in Phase Two talks will increase exponentially.** Should they halt purchase of U.S Ag products to bring pressure for further rollback concessions, President **Trump could face a “put up or shut up” moment** prior to the 2020 vote.

But that’s probably a story for Q2, not today. On a trading-relevant timeframe, Phase One is unambiguously **bullish for risky assets.**

To be clear, I expect this deal to have **no discernible effect on U.S. economic growth.** [The uncertainty narrative](#) has always been overblown, and this deal doesn’t dramatically reduce the uncertainty anyway.

What it does do is **reduce China-related tail risks** - namely the risk that China might respond to a breakdown in talks with a dramatic escalation of tensions. In fact, it is likely such a threat which earned them today’s concessions.

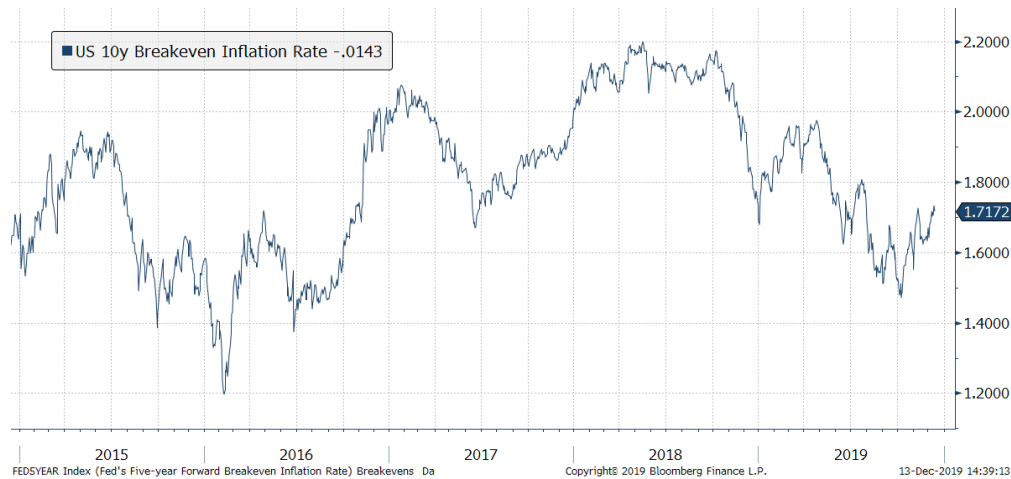
How bullish the removal of tails risk proves for global risk-assets depends on the degree to which liquidity has been subject to precautionary demand to guard against such tails. If demand for liquidity subsides, **monetary conditions could ease meaningfully even with the Fed firmly on hold.**



Some incipient weakness in the Dollar....



...and a visible uptick in breakeven inflation rates are quite positive on this score so far.



I'm a Dollar seller for choice in the weeks ahead, and am **running short USDCNH** into the weekend [dodges lightning bolt], having sold into Friday's rally based on misplaced deal-closure skepticism.

On to the links...

U.S. – China Relations

This is **exactly why China wanted rollback**: it will dramatically slow the supply-chain exodus.

[U.S. Business Plagued by Trade Confusion as New Tariffs Loom](#)



“He would consider moving more production out of China if he knew what to expect. Instead, he’s afraid to act because a deal to slash tariffs could come at any time.”

It’s unclear whether this uber-hawk’s departure is related to what looks like a capitulatory move on trade...

[Pentagon’s top official on Asia policy quits his post](#)

*Randall Schriver, the Pentagon’s leading Asia policy expert and **one of the administration’s most vocal critics of Beijing, has resigned**, the Department of Defence announced on Thursday.*

Schriver will leave his post as assistant secretary of defence for Indo-Pacific security affairs at the end of the month, citing the toll of his work on his family, department spokesman Jonathan Hoffman said.

Schriver’s nearly two-year tenure has been marked by his persistent critique of Beijing’s policies and behaviour in the military and security spheres and his view of strategic competition between the US and China as “the defining challenge of our generation”.

Tit for tat...

[Beijing orders state offices to replace foreign PCs and software](#)

[WSJ News Exclusive | Congress Wants to Ban Chinese Buses, Railcars in Defense Bill](#)

Another threat that China may have been dangling in the case of a breakdown in trade talks...

[China’s secret trade weapon: its tourists](#)

South Korean tourism researcher, Kim Han-gyu, estimates the number of Chinese tourists flocking to one of the world’s most reclusive states has this year pushed higher than the 1.2m he calculated last year, and up from 600,000 in 2017. A more conservative assessment from specialist North Korea-focused information service NK News puts the figure at 350,000 this year.

*Based on an average spend of \$300 to \$500 by each visitor — the range used by the different experts — that implies **a windfall of somewhere between \$105m and \$600m for Pyongyang.***



*This means that **tourism has provided a much-needed respite for Kim Jong Un**, just as economic growth is stymied by US-led sanctions aimed at convincing the North Korean leader to stop developing nuclear weapons.*

*There are clear signs that **this is no accident**. Tourism operators enjoy the highest possible level of endorsement; in June, Chinese president Xi Jinping included tourism as an area where China would extend its co-operation with North Korea.*

*Cheong Seong-chang, a North Korea expert at the Sejong Institute, a think-tank, told reporters in Seoul last week that **Kim Jong Un had been “successfully” adapting to sanctions, thanks to the support from Beijing**.*

Regardless of trade developments, decoupling to ensure access to critical inputs will continue apace...

[Exclusive: U.S. Army will fund rare earths plant for weapons development](#)

The U.S. Army plans to fund construction of rare earths processing facilities, part of an urgent push by Washington to secure domestic supply of the minerals used to make military weapons and electronics, according to a government document seen by Reuters.

The move would mark the first financial investment by the U.S. military into commercial-scale rare earths production since World War Two’s Manhattan Project built the first atomic bomb.

Chinese Foreign Relations

China is like a bull in the geopolitical China shop lately...

[China cancels trade visit to Sweden over bookseller’s free speech prize](#)

China has cancelled a trade visit to Stockholm as its threatened “bad consequences” start to emerge over a free speech literary prize awarded to detained bookseller Gui Minhai last month.

Gui’s case has deepened an ongoing crisis in bilateral relations between Sweden and China. On Monday, Sweden’s former ambassador to China Anna Lindstedt was [indicted over a meeting](#) arranged for the bookseller’s daughter to discuss his possible release and Lindstedt now faces trial in Stockholm.



Meanwhile, it has emerged that a trip to the country by a Chinese trade delegation scheduled for Tuesday was called off. Diplomatic sources confirmed to the South China Morning Post that it was cancelled because the Swedish culture minister presented the free speech award, given by Sweden's PEN International, to 55-year-old Gui, who is currently in detention in China

Last week, ambassador Gui Congyou told Göteborgs-Posten that China would "restrict cultural exchanges and cooperation on the economy and trade" with Sweden.

Trudeau may be losing control of China policy...

[Opposition parties vote to create China committee, handing Liberals first defeat of minority Parliament](#)

*The opposition parties won a significant victory in the minority Parliament on Tuesday when they voted overwhelming to set up a special parliamentary committee on China with a mandate to **review all aspects of Canada's strained bilateral relations** with the world's second largest economy.*

The Liberals opposed a special committee on China but were out-voted 171 to 148 in the first defeat for the government since it was returned to power with a minority.

Conservative Foreign Affairs critic Erin O'Toole tabled a motion to "appoint a special committee with the mandate to conduct hearings to examine and review all aspects of the Canada-China relationship including, but not limited to consular, economic, legal, security and diplomatic relations."

Hong Kong

[Foreign Panel Steps Down From Probe of Hong Kong Police](#)

A panel of foreign experts recruited to ensure the objectivity of an investigation into allegations of excessive force by Hong Kong police during recent protests said it was stepping down after their concerns about the probe went unresolved, a step likely to fuel criticism of the review.

The panel said the body tasked with the probe lacks the powers and investigative capabilities "necessary...to begin to meet the standards citizens of Hong Kong would likely require of a police watchdog operating in a society that values freedoms and rights."



This may be a one off, but its the kind of thing that will really try Beijing's patience should Hong Kong protests pick up again...

[Huawei critics in China inspired by Hong Kong protests](#)

*An online campaign against the alleged mistreatment of an ex-employee at Huawei in mainland China is **drawing inspiration from the Hong Kong protests** in a development that is likely to concern Beijing.*

After news of the alleged wrongful detention of a former employee of the telecoms equipment group went viral on social media in China last week, users published more than 20,000 posts drawing parallels between the Huawei situation and Hong Kong.

An online post titled "eight demands, not one less" began circulating on mainland Chinese social media, calling for among other things an independent investigation into the actions of Huawei and the Shenzhen police.

*"Its' extraordinary because it shows **there are chinks in the armour of China's propaganda machinery,**" said Chinese University's Mr. Lam of the posts.*

China Economy & Finance

[China Suffers Biggest Dollar Bond Default By State-Owned Company in Two Decades](#)

*A major Chinese commodities trader became **the biggest dollar bond defaulter** among the nation's state-owned companies **in two decades**, in a moment of reckoning for Beijing as it struggles to contain credit risk in a weakening economy.*

Tewoo Group Corp. announced results of its unprecedented debt restructuring, which saw a majority of its investors accepting heavy losses. This is expected to reshape investors' perceptions about government-owned borrowers whose identity has for years offered a relatively strong sense of security.

*The one-time Fortune Global 500 company from the northern port city of Tianjin said dollar bond investors representing 57% of the total \$1.25 billion have agreed to be paid just **37 to 67 cents on the dollar**, depending on the maturity of the debt. Bondholders representing 22.6% of these bonds voted to exchange their debt for new bonds with sharply lower coupons to be issued by Tewoo's offshore debt manager, a state asset manager from Tianjin.*



“Tewoo’s default is a landmark case, and demonstrates a growing tolerance for defaults by distressed SOEs,” Cindy Huang, an S&P Global Ratings credit analyst said in a note.

(See: [China: Where the Credit Risk Goes](#), 7/31/19, for an explanation for why China keeps have “landmark, first-since-whenever” default cases, yet panic never ensues).

This NYT piece touches on the issue – it’s all a **controlled process of “picking losers.”** As nominal growth slows and credit growth remains constrained, authorities will be forced into more and more difficult choices over time. It’s not “willingness,” as the Times argues. **It’s just math.**

[China’s Companies Binged on Debt. Now They Can’t Pay the Bill.](#)

*China now faces the difficult task of **figuring out which of these companies it will allow to fail.** The central government in Beijing keeps a tight grip on the Chinese financial system and often rescues companies to preserve jobs. But Beijing has shown a greater willingness to let companies go insolvent to teach them a lesson about borrowing too much, and many local governments now lack the funds to help their hometown champions.*

Ergo, yawn.....

[China Local Government Finance Vehicle’s Flop Raises New Concern](#)

***The latest bond failure by a Chinese local government investment arm has rekindled concerns** about a group of borrowers whose outlook is closely tied to Beijing’s shifting definition of its implicit backing.*

The debt woes faced by Hohhot Economic & Technological Development Zone Investment Development Group, a local government financing vehicle from Inner Mongolia, have sent chills among investors holding other such LGFV bonds, driving prices sharply lower for some.

Companies such as the LGFV from Hohhot have until now emerged as major beneficiaries of the surge in defaults as investors feared debt from ailing private businesses and on expectations that Beijing wouldn’t let these government-linked firms ever go bust.

“Hohhot government may be prompted to raise money with all efforts so as to prevent a single debt failure from becoming a financial crisis in the region,” according to a research note by Southwest Securities written by analysts including Yang Yewei. “If an actual default occurs, the incident may trigger a selloff on bonds sold by lower-rated LGFVs on the short run.”



China's "corporate social credit system" is rife for shakedowns, the creation of non-tariff barriers, and enforcing NBA-like adherence to China political demands – all codified.

[The Chinese Blacklist That Companies Pay \\$2,500-an-Hour to Avoid](#)

Those with good social credit will experience fewer and less frequent inspections, reducing their compliance costs and the burden on government resources, NDRC Vice Chairman Lian Weiliang said at a July briefing. Companies that endanger people's lives and property face "very severe" punishments, including expulsion from the market, he said.

*For foreign companies in China, the compilation invariably **raises the question of whether the system could be weaponized**, with multinationals getting caught in the crossfire of the U.S.-China trade war or being targeted so a domestic rival can reap a competitive advantage.*

"In some cases there is a lack of information on how blacklists will be implemented, which leads to uncertainty for many businesses," said Jacob Parker, vice president of China operations for the US-China Business Council.

*"Many companies are concerned that it offers too much leeway for local interpretation that **could be used to discriminate against foreign companies.**"*

Interesting piece on the broader fallout of the supply chain exodus...

[Chinese city a ghost town after Samsung closes its last smartphone factory](#)

*Samsung is the world's leading manufacturing enterprise. Its Huizhou factory had built an entire **ecosystem of supply chains** in Guangdong and nearby provinces in the past 20 years" said Liu Kaiming, head of the Institute of Contemporary Observation, which supervises working conditions in hundreds of factories in China.*

*"**At least 100 factories in Guangdong are going to close down.** They can't make it without the Samsung's Huizhou factory, let alone those small shops and restaurants in the surrounding area."*

The impact of the closure also stretches as far as the town of Changan in Dongguan city, some 100km (62 miles) west of Huizhou, where thousands of migrant workers and executives of a factory once owned by the Shenzhen-listed Janus Intelligent Group, a leading Chinese robotics company, have had their hours significantly reduced.



WTO

Those who agree to dispute resolution through years of litigation at an international appellate body can go that route and everyone - like the US - who wants to deal bilaterally or multilaterally outside that process can do so. It sounds like **an ex-US WTO** could be evolving...

[China May Back EU's Trade-Dispute 'Plan B' as Trump Hobbles WTO](#)

China's Ambassador to the WTO Zhang Xiangchen told Bloomberg News that Beijing is actively working to support the EU's vision of an appeal-arbitration model, which essentially replicates the work of the WTO's soon-to-be defunct appellate body.

Under the EU's appeal-arbitration approach, the WTO Director-General can select a panel of previously vetted former appellate body members who apply the same procedures of the appellate body to reach a final judgment.

As a practical matter, WTO members who sign on to such an approach will basically undergo the same process as the appellate body.

"If enough other countries sign up to the EU proposal, it could work as a stop-gap measure that would temporarily allow the WTO to arbitrate disputes between the other 163 members," said Chad Brown, a senior fellow at the Washington-based Peterson Institute for International Economics.