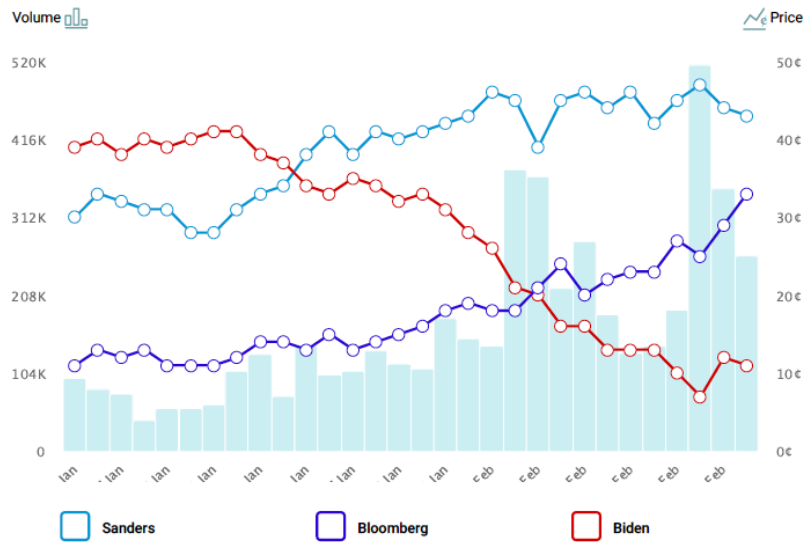




U.S. Politics and Weekend Links

Election season is in full swing now, and the improving odds of a market-friendly outcome have been a key driver of asset market performance in recent weeks. The implosion of the Biden candidacy and the Bernie surge leaves the Democrats in a real pickle.

PREDICTIT.COM Odds of Winning Dem Nomination



Michael Bloomberg – surging himself in recent weeks - would undoubtedly be a formidable general election candidate, considered in the abstract. The problem for the Democrat Party establishment is there appears no way to get from where we are today to a Bloomberg nomination without alienating a significant portion of the base.

This piece from last week’s note is worth closer consideration:

[NYT Opinion | The Center Cannot Hold](#)

Part of Mr. Sanders’s resilience against centrist attacks stems from his grass-roots movement of small donors, organizers and vocal supporters. If party leaders openly assail him, they risk alienating Sanders loyalists, only 53% of whom say they will certainly support the Democratic nominee if it isn’t him. The problems at the Iowa caucus have instilled even more rancor and suspicion regarding Democratic institutions among his base. Establishment attacks on Sanders — especially if effective — could result in Mr. Sanders’s base simply staying home in the general election.



Yet if Mr. Sanders's rise continues unimpeded, the party may risk demoralizing fiscally conservative Democrats, though those voters may be more likely to support a Democrat in the general election no matter what than Mr. Sanders's passionate backers.

If they attack Mr. Sanders, "they're going to get a massive backlash, but if they don't, then they're going to lose the center of the party," Jefferson Cowie, a historian of American class politics at Vanderbilt University, told me recently. "It's a very volatile moment, I think, in the party's history."

For a deeper analysis of the history of damaging splits in the Democratic Party and the potential for yet another very damaging one, I'd recommend this recent [blog post from an old high school buddy](#) of mine:

Previous primary cycles have seen the party divide along lines of outsider vs. insider (which could also be described as anti-establishment vs. establishment, or new vs. old) and/or center vs. left, both with varying degrees of severity and subsequent damage to the party's unity and prospects in the general.

But some back-and-forth this week over a Bernie Sanders surrogate calling Joe Biden "corrupt" reveals a newer, more serious rift that threatens the party's prospects in November — and beyond.

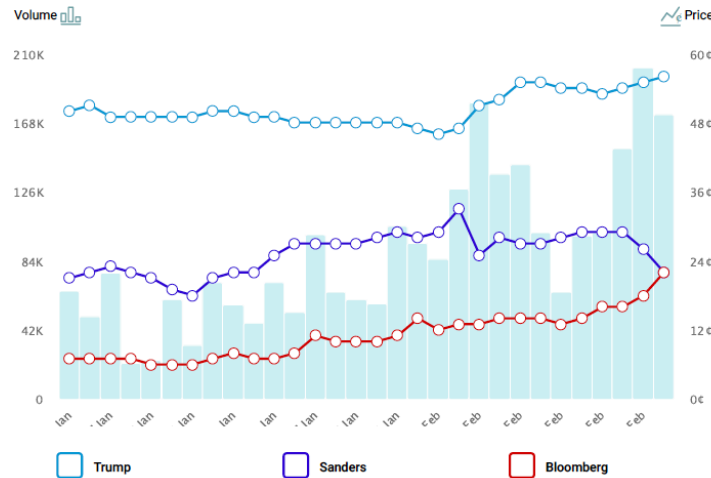
*...the divides on the Democratic side are reshaping into something new, different and potentially more damaging to the party's prospects in November — **Reformers vs. The Corrupt.***

...the type of split developing within the party now threatens to be deeper and more lasting than anything since 1968. Sanders and Warren both have built their campaigns around fighting a corrupt system, so the logical conclusion for their followers is that any nominee not named Sanders or Warren would be the product of that corrupt system — and, by definition, corrupt themselves.

I'd reiterate the bolding from the NYT piece above: **only 53% (of Sanders supporters) say they will certainly support the Democratic nominee if it isn't him.** This is a mind-boggling stat, suggesting that vehement anti-Trumpism may be more of an establishment phenomenon than a left vs right phenomenon. A Bloomberg candidacy is a dream for the upper-middle class urban and suburban Democrats and #neverTrump Republicans who largely control the media narrative. But it is far from assured that such a coalition could command an electoral college majority.

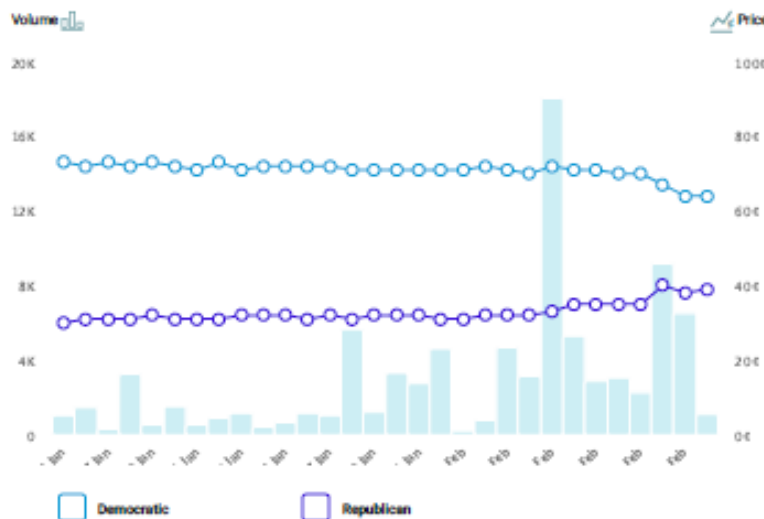
The failed impeachment effort ([Trump's approval ratings](#) rose to 2-year highs) and an economy that continues to defy forecasts of a slowdown (despite the dour signals emanating from the bond market) have helped to push President Trump's odds of re-election up by 10 points in recent weeks:

PREDICTIT.COM Odds of Winning The Presidency



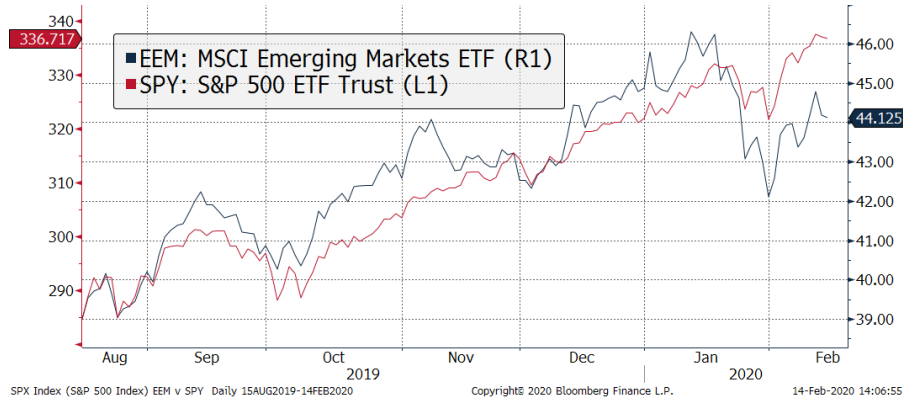
But the real rocket-fuel for financial markets would be the House coming into play. Recent weeks have seen a noticeable tightening in prospects for a change of control in the House, a move that could gather steam if the Dem primary process generates a party rift that threatens base enthusiasm and voter turnout.

PREDICTIT.COM Odds of Winning the House of Representatives





That domestic politics have been a bullish driver of US equity markets, rather than “easy liquidity” is evidence by the underperformance of EM equities, which actually peaked in mid-January:

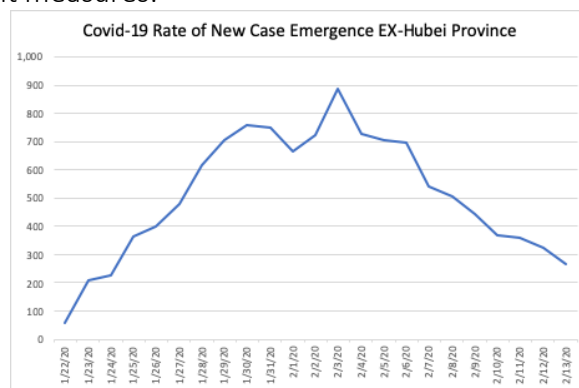


DM equities may also be seen as slightly less vulnerable to Coronavirus risks than EM assets although it seems that investors are genuinely downplaying the risks of China descending into a degree of crisis that could have material second order effects.

I think there’s a “boy who cried wolf” phenomenon at work here. Believe me, I get it – many Investors are just tired of hearing that China’s going to blow up. Of course, the observable fact that China did not “blow up” yesterday does not necessarily mean it won’t “blow up” tomorrow.

(The focus on a “blow up” which has yet to occur has also obscured the fact that the RMB has in fact been under persistent pressure for going on 5 years now, and outside a handful of dominant tech names Chinese equities have been a chronic underperformer.)

At any rate, markets seem unlikely to react dramatically to events in China until they get hit in the face with the extant risk. The most **likely catalyst would be a re-acceleration of viral cases outside of Hubei province**, which to this point appear to indicate a high degree of success in nation-wide containment measures:





I can't confidently predict whether or not that's going to happen. I can only suggest that there's a decent likelihood that it will happen, and that if it does happen, the resulting economic damage presents a non-negligible risk of tipping China into an existential crisis.

If that's crying wolf, well then.... WOLF! On to the links...

Here's a [5-minute discussion](#) of these issues I had with Cheddar news yesterday.

Wuhan

Expect more "upward revisions" to [the data in Hubei Province](#)

*2020-02-13 Chen Yixin, deputy leader of the Central Steering Group, said that we must be aware of the uncertainty of the Wuhan epidemic. Compared with the input area, the base number of infected people in Wuhan has not been fully figured out, and **the scale of spread has not been estimated accurately**. According to calculations by relevant parties, the potentially infected base in Wuhan may still be relatively large. (Chairman of the Central Committee of Political Science and Law)*

And the round-ups are just beginning. Sneeze in Wuhan and you risk getting sent to a death camp...

[China Expands Chaotic Dragnet in Coronavirus Crackdown](#)

China's leaders expanded a mass roundup of people possibly sickened with the coronavirus on Thursday, widening their dragnet well beyond the epicenter of the outbreak to at least two more cities in what the government has called a "wartime" campaign to stamp out the epidemic.

But the campaign, first announced last week in the city of Wuhan, already has been marred by chaotic conditions that have isolated vulnerable patients without adequate care and, in some cases, left them alone to die.

The expansion of the decree to "round up everyone who should be rounded up" in the Wuhan area of central China has deepened the nation's sense of anxiety.

In their zeal to execute the edict, officials in Wuhan, a metropolis of 11 million, have haphazardly seized patients who have not yet tested positive for the coronavirus, in some cases herding them onto buses with no protective measures where they risked infection from others, their relatives said.



On a more optimistic note, we may only be days or weeks away from word on effective medications...

[Results from Chinese drug trials for coronavirus due in weeks: expert](#)

Chinese scientists are testing two antiviral drugs against the new coronavirus and preliminary clinical trial results are weeks away, the co-chair of a World Health Organization (WHO) meeting said on Wednesday.

Kieny said quite a number of patients have already been dosed with a combination of the antiviral drugs ritonavir and lopinavir, but she did not have an exact count.

It "would be excellent if it would work because this drug is available in particular as a generic formulation for the treatment of HIV, so this would clearly be a drug that would be available," Kieny said.

It remains to be seen whether the treatment will prove effective against the new virus, she said. "We don't know the result, and we still have to wait for a few days, or a few weeks to have a result."

Economic Damage and the Policy Response

Clearly, the economic damage is widespread. Here are some snippets:

[China's fear of job losses looms large as coronavirus takes toll on economy](#)

Recruitment site Zhaopin said this week that around 10% of firms they surveyed were "on the verge of death", with around 30% planning job cuts and another 30% saying they could not pay their employees on time.

[In Depth: Epidemic Poses Existential Threat to Small Businesses](#)

Even before the outbreak, many small businesses were already grappling with shrinking sales as China's economy logged some of its slowest growth in decades. With business now at a standstill during the outbreak, many are facing existential liquidity crises. Large numbers say they are having difficulties just paying salaries, adding they can only survive for a matter of months using their current resources, even if Beijing provides support.



While most economists believe the epidemic's effects will be short-lived, it could still provide a knockout blow to many small and medium-sized business that were already struggling before the crisis. Such a wave of failures could create a ripple effect throughout the economy, causing the epidemic's economic effects to linger for longer, said Xu Gao, chief economist at BOC International China Co. Ltd.

[In Depth: China's Services Sector Pulls Out All the Stops to Survive the Coronavirus](#)

Plummeting demand during the holiday season has left many private companies with cash flow problems that will last three months at most, leaving the country's services sector scrambling to find a way out of bankruptcy even as business looks bleak. Measures like seeking financial assistance, closing branches and transforming businesses from offline to online are seen as the only way for virus-stricken domestic companies to keep running.

*How the services sector survives this unforeseen crisis will be a good indicator of how hard the Chinese economy, which was already growing at its slowest pace in 30 years, will be hit. The **services sector made up 54% of China's GDP in 2019**, according to preliminary data from National Bureau of Statistics.*

[Coronavirus could bring China's property investment market back to earth](#)

*The double whammy of Beijing's deleveraging campaign and the trade war has led to a **collapse in demand in the office sector**. Last year, net absorption of office space in Tier 1 cities plunged 25% year-on-year, data from CBRE show.*

*The sharp fall in leasing activity has been exacerbated by oversupply, especially in Shanghai. In a report released last month, Savills noted that in 16 major mainland cities, a further 6.7 million square metres of Grade A office space was added last year, an increase of more than 40%. This **has pushed vacancy rates up to levels last seen during the global financial crisis**, causing prime rents to decline.*

Even in the more resilient retail sector, shopping centre rents fell in most major cities last year due to a combination of acute supply pressures and retailers' more cautious expansion.

Investors in Chinese commercial property must now contend with a severe disruption to economic activity that could last a lot longer than most analysts anticipate, particularly



given the all-encompassing nature of the shock, with domestic demand, trade and travel all affected.

China Home Sales Plunged 90% in First Week of February

New apartment sales dropped 90% from the same period of 2019, according to preliminary data on 36 cities compiled by China Merchants Securities Co. Sales of existing homes plummeted 91% in eight cities where data is available.

“The sector is bracing for a worse impact than the 2003 SARS pandemic,” said Bai Yanjun, an analyst at property-consulting firm China Index Holdings Ltd. “

Once the virus dissipates, it's a sure bet the govt will lift any home purchase restrictions and embrace the property bubble.

Buy a House Online During the Epidemic? So Far, No Takers

In response to the central government's call to maintain economic stability, many local governments have introduced measures to help property companies. The Guangdong and Chengdu governments Wednesday allowed developers to reopen sales offices with conditions, including limiting the number of visitors.

I think we really do need to consider the risk that Xi Jinping is unbalanced. Emphasizing the need to reach arbitrary economic targets in equal importance with the need to prevent the possible death of untold thousands is Mao-level crazy...

奋力夺取疫情防控和实现经济社会发展目标双胜利

*On February 10, when General Secretary Xi Jinping surveyed and guided the prevention and control of new-type coronavirus pneumonia in Beijing, he stressed the need to coordinate and advance various tasks of economic and social development. **Work to minimize the impact of the epidemic on the economy, and strive to complete the various tasks of economic and social development this year.** Party committees and governments at all levels must unify their thinking and actions into the spirit of General Secretary Xi Jinping's important speech, seize the key points, make overall plans, and resolutely win the double victory of epidemic prevention and control and the realization of this year's economic and social development goals.*



This really is absurd...

[China's Top Leaders Vow to Meet Growth Targets Despite Virus](#)

The Chinese Communist Party's top decision body urged the nation to meet its economic targets this year even amid the downward pressure from the coronavirus shutdowns.

The goals will be met by keeping the prudent monetary policy flexible and appropriate, making greater use of fiscal policy, boosting domestic consumption, and promoting large foreign-investment projects, top leaders concluded at the Standing Committee of the Politburo meeting, according to reports by state media late Wednesday.

So far as reality goes, these Street forecasts are delusional – we can forget about positive year-on-year GDP in Q1...

[China's Stimulus Strategy Faces New Test in Coronavirus](#)

Daily industrial output figures tracked by China International Capital Corp. illustrate the slow return to business. The firm said steel transaction volume one day this week was 23% lower than the same day last year, though improved from 59% down on the previous day.

Coal consumption by power producers, an indication of industrial activity, was 39.6% below the year-earlier level on the same day, even worse than the previous day's year-to-year amount of down 37.1%, CICC found.

The overall pause in business activity has prompted economists to repeatedly mark down their expectations for Chinese growth. The gross domestic product may contract in the first quarter from last year's fourth quarter, more economists say, and sag toward 2% on a year-on-year basis—a rate that just two weeks ago appeared overly pessimistic to many.

Assuming lockdowns in central China are lifted in April, most economists expect the damage to Chinese growth to be limited, with GDP growth falling to around 3% to 4% from a year earlier in the first quarter, from earlier forecasts for above 5% growth.

The banks are going to have to do their national duty...



[China Sees Second Straight Jump in Coronavirus Infections](#)

*Peng Lifeng, an official at the People's Bank of China, said Friday **that the country's banks must increase lending and lower borrowing rates.** Mr. Peng said banks must also increase longer-term credit and loans to small businesses, while clearing red tape to do so quickly.*

[Coronavirus outbreak spells trouble for China's banks](#)

"The resilience of China's banking system may be tested," wrote S&P Global analyst Ming Tan in a report.

A surge in bad debt would weaken banks considerably. Lenders' average provisions coverage — the capital held in reserve to cover bad debt — would drop to a dangerously low level of about 55% from 188%, according to S&P. That in turn would lower lenders' tier one capital adequacy ratios by about 3.8%, depleting the capital they have on hand to defend against a crisis.

Codifying "extend and pretend" ...

[China banks to allow more bad debt as coronavirus hits economy](#)

*China's banking regulator **will allow the country's lenders to raise their tolerance for bad debt** during the coronavirus outbreak, in the latest bid by the authorities to keep the world's second-biggest economy from shuddering to a halt.*

Li Junfeng, an official with the China Banking and Insurance Regulatory Commission, said on Friday that some new bad loans created during the crisis should not be counted as non-performing loans, according to state media.

He added that lenders could increase their tolerance for bad debt connected to small and medium-sized companies, especially in areas hit hard by the outbreak but did not provide specifics.

The decision comes more than two years into an aggressive campaign by Guo Shuqing, the country's top banking regulator, to reduce bad debt levels and discipline lenders into better controlling risks.

So ok, widespread rollover and a surge in credit issuance re likely. Still, even if Beijing pumps



huge sums of credit into the system, there is still an almost impossible-to-solve coordination problem in getting the right amount of emergency funding into the right hands at the right time. Do they expect SME's to take on more credit, or will there be some measure of loan forgiveness? And if so, who foots the bill for that? And how does such a program get coordinated without massive inefficiency and corruption?

There is yet no indication that Beijing has any plan for coordinating the economic policy response. And actually, the numbers aren't even all that impressive yet. For reference, RMB 1.4T of these instruments were issued in 1Q19. Meh...

[Nation ups ante in front-loaded quota for local govt bonds amid NCP](#)

The ministry has front-loaded 848 billion yuan in the 2020 local government bond quota, with 558 billion yuan in general bonds and 290 billion yuan in special bonds, according to a statement posted on its website.

This adds to the recent announcement of 1 trillion yuan in special bonds, bringing the amount of the new local government quota for 2020 to 1.85 trillion yuan, the ministry said.

[Huawei](#)

The U.S. is getting rolled by Huawei in Europe...

[Merkel's conservatives stop short of Huawei 5G ban in Germany](#)

Lawmakers from German Chancellor Angela Merkel's ruling conservatives have backed a position paper on 5G mobile networks that recommends tougher rules on foreign vendors while stopping short of banning China's Huawei], sources said.

in this illustration taken January 29, 2020. REUTERS/Dado Ruvic/Illustration/File Photo The document was drafted by Christian Democrat leaders to address the concerns of party rebels who see Huawei as a threat to national security. It is intended to lay the ground for Merkel's coalition government to adopt a common position on 5G after months of divisive debate.

The move rebuffs U.S. President Donald Trump's calls on Washington's allies to bar the Chinese telecoms giant from next-generation networks after Britain stopped short of an outright ban and the European Union backed a rules-based approach.



[U.S. Relents in U.K. Feud on Huawei, Keeps Sharing Intelligence](#)

Robert B. Blair, Trump's special envoy for international telecommunications policy, said that the U.K. will continue to be one of Washington's "closest partners."

"We'll have to take a hard look at how the implementation of this new policy -- and it's still a policy at this point -- will affect our ability to take care of information with them, but there will be no erosion of our overall intelligence sharing operation with the Brits," Blair told reporters Friday at the Munich Security Conference.

This however was a critical win for the hawks. Perhaps if Europe refuses to cooperate, the U.S. will endeavor all the more seriously to impair Huawei's ability to compete...

[Pentagon set to back Huawei restrictions](#)

The Pentagon is poised to reverse its opposition to a proposal that would further crack down on U.S. exports to blacklisted Chinese telecommunications firm Huawei, according to five people familiar with internal deliberations.

The change in position would allow a rule first proposed by the Commerce Department to advance, making it harder for U.S. companies to get around an effective export ban that already applies to Huawei.