

## China Up the Pressure

China's tightening of restrictions on exports of rare earth magnets and derivative products is an ominous development ahead of a potential Trump-XI meeting at APEC on October 31 (which Trump has outed via Truth Social but, interestingly, China has yet to confirm).

China's latest threatened restrictions look less incremental in nature than a signal that, on current trends in US-China relations, they will consider **turning the rare earth magnet spigot off** on December 1<sup>st</sup>.

### [China unveils sweeping rare-earth export controls to protect 'national security'](#)

*Under the new rules, foreign companies will need Beijing's approval to export magnets that contain even trace amounts of Chinese-sourced rare earth materials, or that were produced using the country's extraction methods, refining, or magnet-making technology.*

*The restrictions announced on Thursday by the commerce ministry will, for the first time, create a Chinese version of the US foreign direct product rule, a measure Washington has used to block semiconductor-related exports to China from third countries.*

*"If enforced, and the US doesn't respond strongly, Beijing could have complete control over the entire advanced semiconductor supply chain. Even US AI chips made in a US fab sent to a US AI lab would need Beijing's permission," said Jimmy Goodrich, an expert on semiconductor supply chains at the UC Institute on Global Conflict and Cooperation.*

The move follows the [recent tightening of US export controls](#) via extension of the entity list to subsidiaries of restricted entities, and China's order explicitly ties the issue of rare earths to semiconductors by saying that "exports to manufacturers of semiconductors and related equipment would be examined on a case-by-case basis."

As I alluded to in [last week's note](#), China might be trying to force Trump to a crossroads here. The consensus view that China is trying to "run out the clock" on Trump appears wrong because China's leverage with regard to both soybeans and rare earths will only diminish over time. With Trump facing difficult midterm elections in a little over a year, **China's leverage is never going to be higher** than it is right now.

The dynamic seems similar to late 2019, when, I contend, China told Trump his options were either a deal or an all-out economic war. Trump couldn't afford the latter in an election year. (Turns out that he couldn't afford a Chinese-originated pandemic either).

Instead, it is Trump who is trying to run the clock out on the midterm elections. China would be foolish to allow him to do that, only to allow Trump to bring down the "strategic decoupling" hammer at a time of his choosing.

This was always **the fly in the ointment of the strategic decoupling strategy**: we need to decouple because we have crippling dependencies on China, a perceived adversary. But once we move to begin alleviating those dependencies, China's leverage begins to degrade to the point where they may decide they need to "use it or lose it."

If this framing is correct, China's supposed [trillion-dollar investment offer](#) provides Trump with a face-saving off-ramp from strategic decoupling and locks him in an economic embrace with China from which he cannot extricate himself, or the country.

On offer for President Trump, aside from a big headline on investment (which is probably of negative political value), would be a return to Chinese buying of US soybeans, a renewed flow of rare earth magnets, some empty promises on fentanyl, and perhaps, reduced support for Russia.

All Trump must surrender in return is the foundational rationale for his entire trade strategy: the aim of reshoring US manufacturing for purposes of national security. That means abandoning the strategic decoupling policy by cutting tariffs, ignoring transshipments, and backing off from pressuring allies to "de-risk" their supply chains.

In other words, **it's either full coupling or full decoupling**. China isn't going to sit around with the status quo while the US figures out how to onshore rare earth magnet production, finds other markets for its agricultural products, builds domestic capacity in critical industries, and pressures allies to economically align with the US while de-risking from China.

Given that strategic decoupling, if successfully executed, would present an existential threat to Xi Jinping's long-term vision for China, we can't discount that veiled threats of military action might have been floated either. (This bizarre and unsolicited [comment from Trump](#) recently on Taiwan sticks with me.)

Handicapping what Trump will do is extraordinarily difficult and not just because he's famously unpredictable. We simply don't know how forcefully China is making its point. That said, the Chinese are acting with a confidence that suggests they know something we don't.

Presuming that Trump's primary motivation is babysitting an economy that [his team already fears might be rolling over](#), through the midterms, **a TACO of some variety is likely on order.**

The best option, from the perspective of balancing near-term risk with the longer-term objectives, might be for an interim deal involving reduced tariffs in return for soybean purchases and rare earth magnets, *without the entanglements of an investment deal*. This would leave open the option of returning to strategic decoupling in 2027, but at the risk of derailing allied trade deals, and the trade strategy more broadly.

Until we get further clarity, **the re-emergence of a rift in US-China relations is a notable risk for asset markets.**

The "debasement trade" and the "run it hot" narrative are both grossly over-extended. Any hint of a significant geopolitical disturbance will put the "debasement trade" to a test that it's destined to fail. If US-China relations go off the rails, you want to be holding Dollars. And it is impossible to "run it hot" while engaging in economic warfare with China.

There may well be a TACO at the end of this, but markets are ill-placed to absorb the interim uncertainty.

I shorted gold and S&P's today for a trade. So far, so good. Trades are subject to closure without notice, given the extreme counter-trend nature of the positions. (Views are updated in real-time via IB chat, available to all Macrolens subscribers at no additional charge).