

MACROCOSM

Thoughts on North Korea, Fire and Fury Edition

Friday, August 11, 2017

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It started as fake news. Now two master persuaders are in a vicious cycle of belligerency.

As of this writing we're not there yet, but we're flirting with achieving only the second 3%-plus stock market correction since Donald J. Trump became president. Stocks were at all-time highs on Tuesday morning, and then Trump said – [apparently off the cuff](#), answering a question at the very end of [a press conference on an entirely unrelated subject](#) – “North Korea best not make any more threats to the United States. They will be met with fire and fury like the world has never seen.”

To be sure, the subject matter of Trump's words here – as opposed to, say, [Mika Brzezinski's plastic surgery](#) – is inherently very serious. [I mean after all, well let's face it we... we don't want to start a nuclear war unless we really have to, do we?](#) Yet we think this event actually bears the hallmarks of the fake news cycle typical of what we call the [Trump Infamy Ecosystem](#), and will probably end in the same forgettable way.

Yes, markets are taking it seriously. But we've been saying, with so long since a correction and the VIX Volatility Index at all-time lows below 9 just two weeks ago, a correction could set in at any moment for any reason or no reason (see ["Drop the BAT and Run"](#) July 31, 2017). And for all the [existential angst](#), markets aren't really taking it *all that* seriously – so far. At yesterday's close VIX had risen only to a mere 16 – it was at 53 two years ago after China devalued its currency (see ["On the RMB Devaluation"](#) August 11, 2015), and at 31 three years ago when a couple Americans came down with Ebola (see ["Something You Probably Didn't Know about Ebola"](#) October 14, 2014).

- The situation began with literally fake news.
- Trump's provocative “fire and fury” remark was instantly amplified throughout the media echo chamber (he makes such remarks precisely because he likes having his remarks amplified, and the media like amplifying them). This case was no doubt a particular pleasure for the media, which had probably been waiting 274 days (that is, ever since the election) to prove Hillary Clinton right when [she said](#) “A man you can bait with a tweet is not a man we can trust with nuclear weapons.”
- How perfect, then, soon afterward the Strategic Force of the Korean People's Army [released a statement](#) threatening Guam. The media [made it seem that the statement had been provoked by Trump](#). In reality [it had not been](#). It didn't refer to Trump or his “fire

Update to strategic view

US STOCKS, EMERGING MARKETS MACRO, ASIA MACRO, US MACRO:

The North Korean crisis began as fake news, but has taken on a real life of its own as Trump and Kim, two master persuaders, play a game of escalating belligerency and threat of war. Neither wants war. Neither is mad. The threat of war, then, is a necessary precondition for the negotiations that both of them are subtly signaling they want. The present correction, which was inevitable and overdue anyway, will end the moment decisive action is taken. Trump could come out of it with a renewal of political capital that will help him achieve his pro-growth economic agenda.

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and fury” warning in any way. It focused exclusively on the [fly-overs by US bombers](#) stationed in Guam – or in the [crackpot broken English](#) typical of North Korean press releases, how “In the morning of August 8 the air pirates of Guam again appeared in the sky above south Korea to stage a mad-cap drill simulating an actual war.”

- And it wasn’t even close to [the first time](#) North Korea had threatened Guam.
- So up to that point it was just an example of [Carpenter’s Law](#): the consequence of the images is the image of the consequences.
- *What is potentially new and dangerous here is that the initial fake news firestorm has elicited a second round of responses from both North Korea and Trump. There is some risk here that it is taking on a life of its own, and may be difficult to bring under control. All the more so because, in Kim Jong-un, it seems that Trump may finally be up against a [master persuader](#) of his own fearsome caliber.*
- Yesterday, the People’s Army released [a new statement](#) very much in response to Trump, saying in English more broken than usual, “the US president at a gold link again let out a load of nonsense about ‘fire and fury,’ failing to grasp the on-going grave situation. This is extremely difficult to obtain.”
- The statement seemed to be trying to match the disturbing physicality of Trump’s “fire and fury” imagery with the frightening tangibility of a detailed description of the logistics of an attack on Guam: “Hwasong-12 rockets...will fly 3 356.7 [sic] km for 1 065 [sic] seconds and hit the waters 30 to 40 km away from Guam.”
- The tangibility was underscored with a deadline of sorts: “The KPA Strategic Force will finally complete the plan until [sic] mid August.”
- Even if this threat in all its seeming specificity is actually no more feasible than [a Democrat congressman’s claim in 2010 that the island of Guam will capsize](#), it’s effective persuasion.
- Later yesterday Trump’s countermove was [to say in a brief statement](#) that his “fire and fury” warning “maybe wasn’t tough enough” – and later [in a press conference](#) surrounded by generals, Trump said, “If he [Kim] does something in Guam, it will be an event the likes of which nobody’s seen before, what will happen to North Korea.”



Donald J. Trump @realDonaldTrump 1h
 Military solutions are now fully in place,locked and loaded,should North Korea act unwisely. Hopefully Kim Jong Un will find another path!



- This morning Trump took the battle to Twitter, saying “Military solutions are now fully in place, locked and loaded, should North Korea act unwisely. Hopefully Kim Jong Un will find another path!”

- Before we saw

the tweet itself, we were alarmed when major media outlets immediately sent “news alerts” to every smartphone in the land, omitting the conciliatory second sentence.

- Remarkably, and emblematic of the amped-up partisanship of the moment, the *New York Times* –

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 Lubos Pastor and Pietro Veronesi
 VoxEu
 May 25, 2017

[New York Times guilty of large screw-up on climate-change story](#)
 Erik Wemple
 Washington Post
 August 9, 2017

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America's "newspaper of record" – didn't mention the conciliatory second sentence in [its full story](#), either. *This is the risk of the moment – that the Trump Infamy Ecosystem makes impossible the communications essential to a diplomatic solution.*

- *Markets will continue to correct so long as this exchange of escalating threats operates as a self-reinforcing vicious cycle, stoked by the media. The moment it damps down – or better yet, if some form of stable solution looks like it could emerge – this correction will be over. It's only an exogenous shock to an otherwise healthy situation.*

Will it damp down? Is reconciliation possible? Some observations.

- As disturbing as all this is, we continue believe that it lives four-square within conventional game theoretic notions of deterrence (see ["Some Thoughts on North Korea's Nukes"](#) July 10, 2017). [Deterrence is the art of producing in the mind of the enemy the fear to attack.](#)
- That "art" involves appearing to be enough of a madman to actually launch a retaliatory nuclear second strike (hence the [characterization by H. R. Haldeman](#) of Richard Nixon's nuclear strategy as "the madman theory"). We've seen these last two days both Trump and Kim establishing their madman credentials. As master persuaders, they are both very good at it.
- But unless one of them is *actually* mad, it is highly unlikely that there will be a nuclear encounter that neither of them wants. We think neither of them is mad (again, see ["Some Thoughts on North Korea's Nukes"](#)).
- Don't be overly frightened by a nostalgic bias that might make you think that this situation is uniquely unstable, and that prior similar events such as the Cuban missile crisis were [handled by the steady hands of sober and wise gentlemen](#). They were not. Now as always, [be careful Mr. President. I think he's drunk](#).
- *Heightened risk of war usually precedes the onset of negotiating*, and indeed may be a necessary precondition for it, especially for two master persuaders who will want to begin with maximum leverage. Yes, it seems chaotic and dangerous, and we suppose it is, but it is an efficient competitive equilibrium. In human affairs, it reflects the physics principle that [the computational power of a system is maximized](#) at the [edge of chaos](#). The trick is to keep from slipping over the edge into a [phase transition](#) that nobody really wants.
- *The present heightened risk also serves to draw China into the solution.* Trump has already demonstrated that this can be done. China's cooperation in the United Nations sanctions on North Korea was obtained by the Trump administration's [using protectionist Commerce Secretary Wilbur Ross](#) to threaten [trade penalties against China](#), and then [withdrawing the threat](#). Trump is perfectly capable of standing down on threats once they've worked.
- *North Korea already hinted at a willingness to talk in its second statement.* When it sniped at Trump by saying "Sound dialogue is

not possible with such a bereft of reason [sic]" it was implicitly asking for dialog. And in Trump's press conference, he channeled Ronald Reagan by saying, "I'd like to denuke the world. I would like Russia and the United States and China and Pakistan and many other countries that have nuclear weapons, get rid of them."

- Again, in this morning's tweet, while we admit Trump used provocative slang – "locked and loaded" – he really only indicated, as a president must, that America is militarily ready. But the important part is that he did another thing a president must – point to "another path."
- Kim knows what Trump wants – for North Korea to take "another path" and "get rid of them." Trump knows what Kim wants – to perpetuate his regime. It's not hard to imagine a set of mutually satisfactory guarantees.
- Trump would like to [perpetuate his regime](#) too, and a diplomatic victory here would go a long way – especially as his much-maligned tough rhetoric will be seen in retrospect as having catalyzed it.
- The pattern for markets in moments of military threat – such as the two Gulf wars and the Cuban missile crisis – is that risk-assets decline while the threat builds, and then rally strongly once decisive action begins (again, see "[Some Thoughts on North Korea's Nukes](#)"). We think that pattern will repeat here, all the more so if it endows Trump with political capital that he can use to take the next steps in his pro-growth tax-cutting and regulation-cutting agenda.

Bottom line

The North Korean crisis began as fake news, but has taken on a real life of its own as Trump and Kim, two master persuaders, play a game of escalating belligerency and threat of war. Neither wants war. Neither is mad. The threat of war, then, is a necessary precondition for the negotiations that both of them are subtly signaling they want. The present correction, which was inevitable and overdue anyway, will end the moment decisive action is taken. Trump could come out of it with a renewal of political capital that will help him achieve his pro-growth economic agenda.

