

MACROCOSM

Fail in Hanoi, Win in Beijing

Monday, March 4, 2019

Donald Luskin

Trump walked away from a Chinese trap, making a trade deal more likely and better.

WSJ WSJ

Breaking News

The U.S. and China are close to nailing down a trade deal, with Beijing offering to lower tariffs on American farm, auto and other products

Sunday afternoon the *Wall Street Journal* pushed an alert pointing to [a story that a US/China trade deal is imminent](#) – according to “people briefed on the matter on both sides.” None named, as usual.

Bloomberg pushed an alert moments later, as is its wont, [linking to its retelling](#) of the *Journal* story as established fact. Later the *New York Times* chimed in with its own [substantially identical version](#), no doubt having riffled through its Rolodex of sources to confirm the *Journal* story, all of whom did so, as is their wont, lest they seem unquotably out of the loop, allowing the *Times* to pretend it had an original story, as is its wont. We belabor the point to make you see the way the media echo chamber works. There’s actually nothing new in any version of the story, at least nothing we haven’t been saying to expect for a while now (see, most recently, [“Extending the Tariff Deadline, Moving the Goalposts”](#) February 25, 2019).

Indeed, the *Journal* story was mostly a hit-piece quoting a cavalcade of “experts” (including Steve Bannon!) on how the imminent deal (the details of which they admit they don’t know) isn’t good enough (one even called it a “total fraud”), and how it will meet [stiff political resistance at home in the US and China](#). That’s the important new development: as a likely deal has come increasingly into focus over the last several weeks, the media and the investment strategy community have had to come up with something new and exciting to replace the prior narrative that there can’t possibly be an agreement in the first place (see, among many, [“On the Margin: In the Beginning was the Word ‘Framework’”](#) November 16, 2018).

- *But a deal is indeed imminent. We’ll know it’s a sure thing when Trump and Xi announce a date to meet in Mar-a-Lago. And no one should worry about any home opposition either in the US or China.*
- *If there was any doubt that we’re entering the end-game, Trump’s walk-away from negotiations in Hanoi with Kim Jung-un should make it obvious.*
- We have our own “people briefed on the matter,” and we know that Trump headed to Hanoi having been led to expect by Chinese president Xi Jinping that the fix was in, that Supreme Leader Kim would be especially cooperative. It was seemingly a Chinese diplomatic assist – as [Trump himself tweeted](#). It seemed to be

Update to strategic view

US MACRO, ASIA MACRO, US STOCKS, ASIA STOCKS, FX: Media stories Sunday claim a US/China trade deal is imminent, that its terms will not be especially favorable to the US, and that it will face stiff resistance at home in both nations. If a deal is any more imminent than before, it is because Trump escaped a Chinese diplomatic trap in Hanoi, by walking away from negotiations with Kim. Such resolve suggests China would have to make more concessions to get a deal, not fewer. Xi faces no public nor hierarchical resistance to a deal, because the Communist Party has no choice but to make one. Because a deal would be a settlement of a Section 301 action, Trump does not need Congressional approval – and he needn’t worry about public opinion, because he will be vilified anyway no matter what the deal looks like. China has the most to gain in a post-deal relief rally, and long-term by becoming less protectionist. Short term, a deal will lift confidence globally, and long-term even an imperfect deal will lift global growth.

[\[Strategy dashboard\]](#)

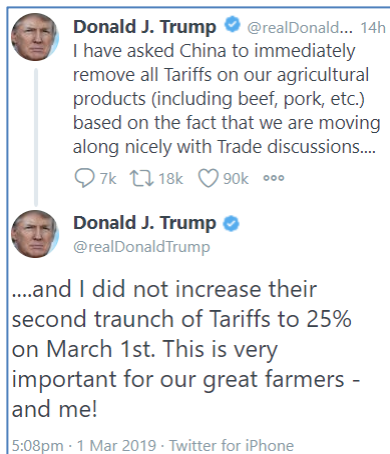
offered, as we had predicted, as a non-economic sweetener in the trade negotiations (again, see [“Extending the Tariff Deadline, Moving the Goalposts”](#)).

But it was a trap – Kim was not cooperative at all. And it was a test, to see how eager Trump was to make a deal, even a bad one. Trump passed the test and walked away in Hanoi – even knowing he would face the inevitable cat-calls in the US media that the whole thing was a colossal failure.

• No one should be surprised that Trump stood his ground. [The “second key element”](#) in Trump’s *The Art of the Deal* is “Protect the Downside and the Upside Will Take Care of Itself.” According to Trump’s playbook, you

protect the downside by having a well-defined walk-away point.

- *Walking out on Kim was less a message to North Korea’s supreme leader and more a message to China’s president for life. The message to Xi is clear: if Trump can walk away from a deal with North Korea, he can walk away from a deal with China, too.*
- *So if Sunday’s stories are correct that a trade deal is now more imminent than ever, that is likely the result of China’s having witnessed Trump’s resolve – which would suggest that China is likely to have to concede to more US demands, not fewer as the stories imply.*



• Indeed, upon Trump’s return, apparently confident that the message was received in Beijing, [he tweeted](#) a bold new impromptu demand that China immediately remove all agricultural tariffs – piling on, in the wake of last week’s [World Trade Organization ruling in favor of the US](#) on China’s grain subsidies. [In return Trump offered nothing](#), except to cite the *deferral of an increase of existing US tariffs which he had already granted* the prior Sunday. No specific period of deferral has been officially promulgated, so an additional 15% increase on tariffs on \$200 billion of trade still hangs

over the negotiations like the Sword of Damocles (again, see [“Extending the Tariff Deadline, Moving the Goalposts”](#)).

- As of this writing we don’t know how China will react to Trump’s latest demand. The *Journal* story suggests they’ve already conceded, at least to the extent that elimination of ag tariffs will be part of the final deal. The way the Chinese have been negotiating against themselves all along, though, it wouldn’t surprise us one bit to see them give it beforehand as they already have so much else.
- When a deal does come, we have no doubt that Xi can sell it at home. The mass of the Chinese people will only know what the Communist Party wants them to know. And as to the hierarchy itself, long gone are the days when his government could [haughtily say](#) it wouldn’t negotiate with the US while our tariffs represented “a knife at its throat” (see [“Our Knife at China’s Throat”](#) October 8,

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Recommended Reading

[Draining the Swamp](#)

Michael Anton
Claremont Review of Books
February 20, 2019

[Is Wage Growth Higher than We Think?](#)

Michael Morris, Robert Rich and Joseph Tracy
Federal Reserve Bank of Dallas
February 26, 2019

[U.S.-China Negotiations Risk Shutting Out the Rest of the World](#)

Shawn Donnan
Bloomberg Business Week
February 28, 2019

[How Huawei tried to sell itself to Motorola for \\$7.5bn](#)

Henny Sender
Financial Times
February 28, 2019

[Top Chinese officials plagiarised doctoral dissertations](#)

Tom Hancock and Nicolle Liu
Financial Times
February 27, 2019

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2018). China knows that our tariffs are pushing it toward an [economic cliff of unknown dimension](#), at an unknown distance, holding body and soul together with a hodge-podge of [tax cuts](#) and [stimulus](#) (see [“On the Margin: China Sees the Cliff”](#) October 19, 2018) – so it had to negotiate after all – with officials openly pleading to end the matter [“the sooner the better”](#) and to [“meet half-way.”](#) It has had to stand by meekly while Canada arrested Huawei’s Meng Wanzhou at the US’s behest, the equivalent of China seizing Facebook’s Sheryl Sandberg (see [“On the Margin: Well, We Said ‘Brace Yourself’”](#) December 5, 2018). The Communist Party has had to tell its own cadres, [amidst increasing social unrest, in Xi’s words](#), that “points of risk are multiplying” in this year of anniversaries, the 70th since Mao founded the People’s Republic, and the 30th since the Tiananmen Square uprising.

- *[For Trump, he has the extremely liberating blessing \(and curse\) of knowing that whatever he does or doesn’t do with China he will be vilified by Democrats, the media, and opportunists within his own party – so he faces no disincentives against just doing whatever he thinks is best to do, and ultimately the US economy will be his judge.](#)*
- *[And most significantly, he has the blessing of not having to secure Congressional approval for any China deal.](#) It will not be a treaty subject to advice-and-consent in the Senate. It will not be a free trade agreement subject to vote by the entire Congress. Instead, as US Trade Representative Robert Lighthizer [explained in House testimony last week](#) – much to the shocked disbelief of representatives of both parties – [any agreement will be a settlement of claims brought by the president with his statutory authority under Section 301 of the Trade Act of 1974.](#) [So the nature of the settlement is entirely up to the president.](#)*

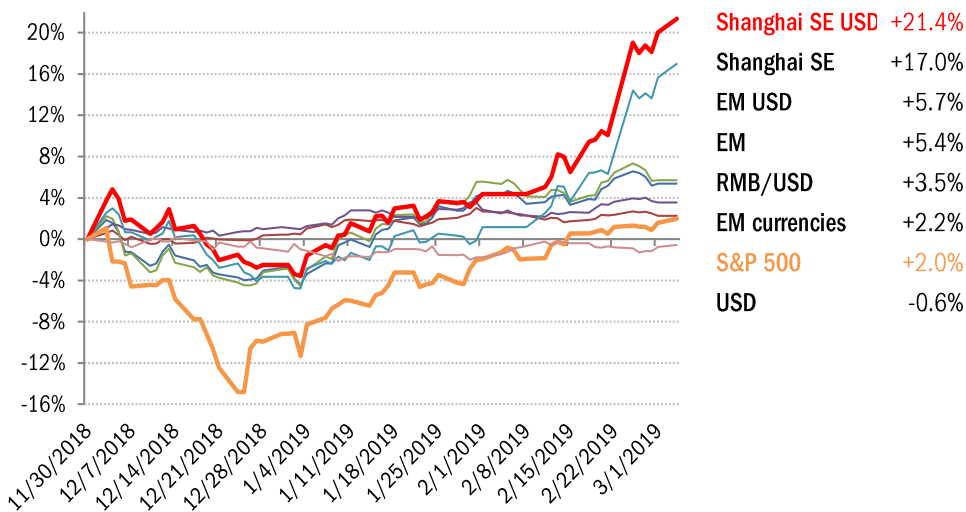
In terms of restoring confidence in markets, which became so dangerously eroded in the fourth quarter of last year (see [“2019 Outlook: Confidence Rots from the Head Down”](#) December 31, 2018), we find ourselves in a great position – worrying less about whether a deal with China can be done and more about whether it will be just perfect.

- We’ve said all along a deal would be done (see [“Did China Just Run Up the White Flag in the Trade War?”](#) July 10, 2018). Just to be clear, though, a deal isn’t done yet. As we move into the end-game, demands on both sides will accelerate toward the [edge of chaos](#) (see [“On the Margin: China Trade Talks at the Edge of Chaos”](#) February 19, 2019). *[We’ve warned for months that walk-aways, like the one with North Korea, will be part of the theatrics, and before this is over there may be another](#)* (see [“On the US/China Trade Breakthrough”](#) December 2, 2018).
- *[When the deal comes, will it be good enough? Well, good enough for what?](#)*
- This whole matter has been going on now for about a year (see, first, [“On the China Tariffs”](#) March 22, 2018). Most observers initially saw only downside, many regarding it as nothing more than the onset of a new age of global protectionism. Since then, Trump

has gradually changed the narrative, just as we said he would (see [“Is Trump Really Bluffing on Tariffs?”](#) June 22, 2018) – moving opinion away from the idea that US tariffs were a protectionist end in themselves, and toward the view that they are in fact weapons with which to force China off its own unfair and destructive trade practices. So now, if a deal ends up with Trump removing the tariffs and China just takes some steps toward more fairness, won't everyone come out well ahead, even if the very highest goals were not achieved?

- The *Journal* article Sunday treats China’s “speeding up the timetable for removing foreign-ownership limitations on car ventures and reducing tariffs on imported vehicles to below the current auto tariff of 15%... Beijing would also step up purchases of U.S. goods” as a given baseline for agreement. Is that a bad deal? The story then goes on to cite many more elements still being negotiated, such as protection for intellectual property. Is that still a bad deal? Treasury Secretary Steven Mnuchin has already stated definitively that [he has an agreement on currency manipulation](#) – a goal we had thought an unattainable Holy of Holies – something the story doesn’t even mention. At some point, will anyone admits this is a good deal?
- Maybe we’ve just missed it, but we haven’t seen any cynical commentary arguing that the strong relative performance of Chinese stocks, since negotiations with the US began in earnest, prove that China is getting the better of the deal, at the expense of the US (please see the chart below).

Cumulative performance from before Trump-Xi Buenos Aires summit



Source: Bloomberg, TrendMacro calculations

- In fact, this pattern of performance, which we predicted all along (see [“Did China Just Run Up the White Flag in the Trade War?”](#) July 10, 2018), primarily demonstrates that China has had the worst short-term losses from the trade war, so it naturally has the most to gain from a relief-rally. And longer term, as the world’s

most protectionist large economy, it has the most to gain from liberating itself from its own protectionism.

- Critics will make a “relative performance” argument when Trump’s deal inevitably allows China to surpass the US as the world’s largest economy. But that was going to happen anyway. The right way to look at it is in “absolute performance” terms – a faster growing China will enable the US to achieve growth it could never have had otherwise.

Bottom line

Media stories Sunday claim a US/China trade deal is imminent, that its terms will not be especially favorable to the US, and that it will face stiff resistance at home in both nations. If a deal is any more imminent than before, it is because Trump escaped a Chinese diplomatic trap in Hanoi, by walking away from negotiations with Kim. Such resolve suggests China would have to make more concessions to get a deal, not fewer. Xi faces no public nor hierarchical resistance to a deal, because the Communist Party has no choice but to make one. Because a deal would be a settlement of a Section 301 action, Trump does not need Congressional approval – and he needn’t worry about public opinion, because he will be vilified anyway no matter what the deal looks like. China has the most to gain in a post-deal relief rally, and long-term by becoming less protectionist. Short term, a deal will lift confidence globally, and long-term even an imperfect deal will lift global growth. ▶