

MACROCOSM

Quick Thoughts on the Road to Osaka

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Donald Luskin

Trump and Xi come in maximum threat postures, but hints of compromises and off-ramps.

Various reported emanations from China and the US seem to suggest that Presidents Donald J. Trump and Xi Jinping will agree at their Osaka meeting on Saturday morning to resume trade negotiations. This is entirely in line with our long-held expectations, based on our model of the negotiating process as a converging sequence of alternating episodes of order and chaos – in which the negotiations are most likely to collapse in mutual recrimination just as a solution is near, and then come back together for more talks just when the two parties seem about to murder each other (see, among many, [“On the Margin: China Trade Talks at the Edge of Chaos”](#) February 19, 2019).

- The Trump-Xi meeting comes after several months of angry disengagement (see [“Video: What you’re not hearing about US/China trade talks”](#) May 9, 2019), much like the period just before the two presidents met productively last December at the G20 in Buenos Aires (see [“Our Knife at China’s Throat”](#) October 8, 2018).
- We think Xi comes to Osaka somewhat wounded by China’s having to back down in the face of mass protests in Hong Kong. One might argue that in the face of such a humiliation, Xi would need to avoid the further humiliation of conceding to Trump. Maybe – but *Trump demonstrated great regard for Xi’s dignity by staying silent during the Hong Kong incident, which signaled to him that Trump will be similarly helpful in saving face in the aftermath of a trade deal* (see [“Video: What you’re not hearing about the US/China trade war after Trump’s Mexico tariff gambit”](#) June 14, 2019).
- Xi has set himself up for face-saving, too, with a [“white paper”](#) recounting the sins of the US negotiating team and demanding “dignity” in any deal (see [“On China’s Trade War ‘White Paper’”](#) June 2, 2019). Look for Trump to use this a roadmap for structuring a deal with the right cosmetic attributes that will allow Xi to claim victory.
- Trump, for his part, is flush with the victory of having used a tariff threat to effectively get Mexico to “pay for the wall” (again, see [“Video: What you’re not hearing about the US/China trade war after Trump’s Mexico tariff gambit”](#)). And he now has the support – willing or not – of a more dovish Fed explicitly on alert to backstop the US economy from the risks of an ongoing trade war (see [“On the June FOMC”](#) June 19, 2019).

Update to strategic view

ASIA MACRO, US MACRO, US FED, ASIA STOCKS: Trump and Xi meet Saturday morning at the G20 in Osaka, arriving in maximum threat-postures but having offered hints of compromises and off-ramps. Xi is weakened by having backed down in Hong Kong, but grateful to Trump for having stayed silent – a token that Trump will help Xi save face when he does a trade deal. Xi has provided a roadmap to face-saving compromises that preserve China’s “dignity.” Trump comes flush with the victory of having used tariffs to effectively get Mexico to “pay for the wall,” and the support of a more dovish Fed. He is loaded with new tariffs in the pipeline, but delaying them was reportedly a precondition of the meeting. Chinese stocks are still the best-performing in the world in 2019, signaling a deal will get done. But their decline from the April highs shows that China’s economy is at risk with no deal. The Chinese Communist Party faces difficult trade-offs here, but public choice reasoning suggests it is better off with a deal than without one

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- [US media has mistakenly reported](#) that Trump has belligerently threatened new tariffs if Xi doesn't agree to resume talks. Neither the threat nor the tariffs are new at all. Trump is only talking about tariffs already ordered (but not yet implemented). Indeed, *threatening to implement these tariffs (if no talks) is logically equivalent to offering to not implement them (if there are talks).* *Reported as a threat, it is in fact a peace offering.* [Chinese media is reporting](#) that Xi demanded such an offering as a precondition to meeting in Osaka. Symmetrically, China [is reported](#) to be willing to hold off boycotting sales of rare earths to the US.
- *To be sure, Xi is coming to Osaka trying to look strong.* That was the whole point of disengaging for several months. It was the point of [his visit last month to the launch-point](#) of the Red Army's "[Long March](#)" of 1934, saying with chief trade negotiator Liu He at his side, "Now there is a new Long March, and we should make a new start." Strong indeed: if the US/China trade war works out like the Long March, 90% of the Chinese will either die or defect to the enemy.
- *It's always this way. The two negotiating parties assume their maximum threat-postures, while at the same time subtly offering little compromises and off-ramps. That's why it always looks like a deal is impossible just before a deal happens.*
- *And remember, most important of all in this matter, this deal is a "forced exchange" in which the US is attempting to coerce China into less protectionist policies, by threatening it with economic ruination if it does not comply. China's only counterthreat, really, is the reality that if the US pushes the Chinese economy into a sufficiently long and disorderly recession, the whole world will suffer. But that's why it's called a trade "war," not a trade "romp in the park."*
- The Chinese stock market is still the best-performing in the world this calendar year, up 20.1%. But it was up as much as 31% in April, before the negotiations with the US broke off. Sounds to us like Mr. Market is saying a deal is still likely to get done, but less likely now than in April. And therein lies a signal that even the Chinese Communist Party should be able to hear: China's economy will do better with a deal than without a deal.
- The question for the Party, then, is: *Shall we comply with US demands and give up a little of our control over the economy, but have a much larger economy to have a little less control over?*
- Or, to ask the same question in more personal terms for the Chinese decision-makers: *Shall we try to preserve our personal power by resisting US demands, but in doing so risk a potentially disorderly recession for which we'll be blamed – or shall we compromise a little and avoid getting assassinated?*
- We think the answers to these questions are rather obvious under standard [public choice](#) reasoning. China needs a deal.
- Let's rule out the possibility that Trump does *not* want a deal, and that he's only going through the motions of a trade war as a means of deliberately ruining the Chinese economy – conceiving himself to be in Winston Churchill's position in the 1930s, seeing that Hitler must be taken out before he gets too powerful. *Then Osaka on*

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Saturday morning will be the launch-pad for more negotiations that should lead, at this point fairly straightforwardly, to a deal.

Bottom line

Trump and Xi meet Saturday morning at the G20 in Osaka, arriving in maximum threat-postures but having offered hints of compromises and off-ramps. Xi is weakened by having backed down in Hong Kong, but grateful to Trump for having stayed silent – a token that Trump will help Xi save face when he does a trade deal. Xi has provided a roadmap to face-saving compromises that preserve China’s “dignity.” Trump comes flush with the victory of having used tariffs to effectively get Mexico to “pay for the wall,” and the support of a more dovish Fed. He is loaded with new tariffs in the pipeline, but delaying them was reportedly a precondition of the meeting. Chinese stocks are still the best-performing in the world in 2019, signaling a deal will get done. But their decline from the April highs shows that China’s economy is at risk with no deal. The Chinese Communist Party faces difficult trade-offs here, but public choice reasoning suggests it is better off with a deal than without one. ▶