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POLITICAL PULSE

The Bloomberg Threat

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Bloomberg's emergence prolongs the trade war and risks repeal of corporate tax cuts.

The emergence late last week of Michael Bloomberg as a 2020 Democratic presidential contender changes the political calculus that drives this phase of the US/China trade war. We believe that, until now, the rise of Elizabeth Warren (R-MA) as the front-runner has moved China to prefer, and support with a "Phase 1" deal, President Donald J. Trump's re-election (see, initially, "The ("Phase 1") (Unpapered) (Unsigned) China Trade Deal" October 14, 2019 and "China Votes Trump 2020" November 7), because Warren would be a less friendly negotiation counterparty (see "Trump♥Muslims (In China)" October 9, 2019). *China may see Bloomberg as more electable than Warren in the 2020 general election, and far more China-friendly than either Warren or Trump. Such a view would cause China to slow down trade negotiations with the US and be less willing to make concessions. This would draw out the risk that all the existing tariffs will stay in place and that new ones will kick in, which in turn puts pressure on the Chinese currency and drives the Chinese economy closer to a disorderly first-ever recession. At the moment it's just a remote possibility with all kinds of embedded what-ifs – but it seems to us to be in the direction of risk-off.*

- It has been *de rigueur* this political season for all presidential aspirants to be "tough on China." The only way for Democratic hopefuls to challenge Trump on it has been to mock his style, while not disagreeing with his substance. Warren, uniquely, staked out an anti-China position to the right of Trump, which Trump has now mostly co-opted (again, see "Trump♥Muslims (In China)").
- We don't know yet how candidate Bloomberg will evolve on the subject to meet the demands of Dem primaries. But up to now, he has been the strongest possible friend of China, very much in the old school mode of "engagement" – in which it is believed that if McDonalds just opens enough franchises in China, freedom and democracy can't be far behind.
- The moment Trump announced tariffs against China in early April 2019, Bloomberg publicly opposed them and pledged to personally lobby to end them, treating them as nothing more than rank protectionism.
- A month later, Bloomberg announced he, Henry Kissinger and Henry Paulson would be spearheading development of the New Economy Forum, a global conclave of the Great and the Good intended to rival the famous World Economic Forum that meets in

Update to strategic view

US MACRO, US STOCKS, ASIA MACRO: The possibility of Bloomberg entering the Democratic presidential sweepstakes raises multiple risks. He is far softer on China than Trump or any other Democrat, especially Warren, so his presence in the mix lowers at the margin Chinese willingness to cut a deal with Trump and aid his re-election. This prolongs the risk of a disorderly first-ever recession in China, which would have global implications. Bloomberg's more moderate positions make him more electable, but those positives are still far-left, including opposing the 2018 corporate tax cut, the repeal of which would reduce S&P 500 earnings by 10%. Warren is more dangerous economically, but less electable for that reason, so Bloomberg may be the greater threat to markets.

[Strategy dashboard]

Davos, Switzerland – but this one will meet in Beijing. According to the Financial Times, it is "aimed at addressing a changed global order in which China's rise challenges the primacy of the US." Bloomberg, Kissinger and Paulson "partnered with the China Center for International Economic Exchanges, a self-described 'think-tank with Chinese characteristics', which is overseen by the central planning ministry and led by Zeng Peiyan, a former vice-premier."

- As recently as six weeks ago Bloomberg took heat from the Right for saying on PBS's "Firing Line" that Chinese president-for-life "Xi Jinping is not a dictator... the Communist Party…listen[s] to the public."
- *In a perfect world for China, Xi would love to have an American president with these attitudes. But if Bloomberg campaigns on these obsolete globalist visions, with no acknowledgment of the need for reform in Chinese trade and human rights policies, Trump will be able to vilify him in rust belt swing states as "soft on China."*
- From China's perspective, even if Bloomberg significantly toughens his views for campaign purposes, they will know that under the newly hard exterior lies the old soft core – which they would very much prefer to Trump.
- *So again, this development likely slows down trade negotiations while China recalibrates its calculus of relative advantage – given the highly dicey joint probability of Bloomberg (1) actually deciding to run, (2) then winning the primaries and (3) then winning the general. China doesn't have all that much time to do the math, with new tariffs set to kick in on December 15. So expect some tough talk on that subject from Trump designed to rub China's face in it.*

China isn't the only issue here. In our view, markets have been quite blasé about the severe anti-growth economic consequences of the policies being put forward by Warren and Bernie Sanders (D-VT). Perhaps markets are embedding the idea that the worse these candidates' policies, the less likely they will be elected. Or perhaps markets assume that even if elected, it would turn out that these policies were only hyperbole for the primaries, and they would never actually be followed through on, or couldn't get through Congress. *But to the extent that Bloomberg's policies are less extreme, by the same logic he should be more electable, and by the same logic more of his proposals would actually be implemented if elected. So the market's trade-off is: Bloomberg's policies are less anti-growth than those of Sanders or Warren, but less pro-growth than Trump's – and he is more likely to be elected; so on a probability-weighted basis does it matter which of them Trump loses to?*

- So markets need to be asking the same question Xi is asking. If Bloomberg really decides to run, could he go all the way?
- And markets need to be asking how anti-growth Bloomberg's policies actually are.
- *While Bloomberg is thought of, casually, as a centrist, that's only because he is being compared to hard-Left alternatives like Bernie Sanders and Warren. He is, in fact, very much to the left on most issues – and in some cases, he has thrown considerable funding*

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South China Morning Post
November 8, 2019

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and organizational efforts into his issue advocacy. Thinking at the margin, as markets must do, he is certainly far to the left of Trump in every way.

- Yes, he has said that Warren's wealth tax "probably is unconstitutional," and that attacking the basic institutions of capitalism leads to "starving to death – it's called Venezuela.
- *But it's easy to position one's self as more sane than the crazy stuff on the far Left. That doesn't make one pro-growth.*
- When it comes to the most significant pro-growth policy of the Trump years, Bloomberg opposed the 2018 corporate tax cut, saying in 2017 when the legislation was being debated. He called it a "trillion dollar blunder" because "We don't need the money" – "we" being corporations, which he says "are sitting on a record amount of cash reserves."
- *This is a scary misunderstanding of the effect of tax rates on incentives*. Lower tax rates don't nudge behavior toward growth by giving corporations more money when they are in need. Rather, they create incentives at the margin to make investments to earn, in the future, higher after-tax returns for shareholders.
- Oh, and according to Bloomberg the corporate tax cut was bad because it failed to deal with "inequality," too.
- It's not particularly controversial among Democrats to advocate the repeal of the 2018 corporate tax cut – to our knowledge, every 2020 aspirant raised his or her hand on this one. *Just don't forget that raising the corporate tax from 22% back to 35% would be to raise the single largest cost corporations face by 59%. It would shave 10% off after-tax S&P 500 earnings at the stroke of a pen, and that would just be the first-order effect, without considering the follow-on consequences of raising disincentives to investment. That's a risk you probably don't have to worry about with Warren because she is unelectable. But with Bloomberg… be afraid.*
- Bloomberg is devoted to gun control, funding a lobbying organization called Everytown for Gun Safety. It spent $2.5 million in last week's Virginia elections, outspending the National Rifle Association by eight to one, surely contributing to a Democratic sweep.
- He is devoted to fighting global warming, funding with $500 million a lobbying organization called Beyond Carbon. If advocates complete conversion to electric vehicles in the United States – and while not calling for the abolition of fracking directly, it supports the campaigns of politicians it calls "local climate champions" who do.
- Cutting the other way, Bloomberg has come out in opposition to what he calls "pie in the sky" health care proposals of other Democrats such as "Medicare for all." That said, he has actively opposed the Trump administration's attempts to scale back Obamacare. And his advocacy of "stop and frisk" police tactics while mayor of New York, and his recent defense of them, will make him unattractive to the most race-conscious voters – but may well endear him to "security moms" in the suburbs.
- *These are not all salient economic issues – but they do go to Bloomberg's electability. Because he's not taking ludicrous positions, he won't alienate centrist Democrats. But because he is*

nevertheless taking strongly left-leaning stances, he will give Trump and the Republicans something to position against – Trump versus Bloomberg would be a real race, not the turkey-shoot we think Trump versus Warren would be. So markets have to care about issues like gun control to the extent that they are determinative of the winner – who will determine tax policy – even if they are not economic issues inherently.

- *If Bloomberg runs, and becomes the candidate, the potential slow-down of negotiations with China, and the risk that he would be elected and repeal the corporate tax cuts, would make 2020 a difficult year.*

Bottom line

The possibility of Bloomberg entering the Democratic presidential sweepstakes raises multiple risks. He is far softer on China than Trump or any other Democrat, especially Warren, so his presence in the mix lowers at the margin Chinese willingness to cut a deal with Trump and aid his re-election. This prolongs the risk of a disorderly first-ever recession in China, which would have global implications. Bloomberg's more moderate positions make him more electable, but those positives are still far-left, including opposing the 2018 corporate tax cut, the repeal of which would reduce S&P 500 earnings by 10%. Warren is more dangerous economically, but less electable for that reason, so Bloomberg may be the greater threat to markets.