

On the Margin: China's Scariest Fragility

Monday, August 6, 2018

Developing items of interest and deeper color on themes from our regular reports.

The Thin Red Line



We're told by people who know that POTUS liked our *Wall Street Journal* op-ed on the US/China trade war (see, most recently, "[China is Losing the Trade War with Trump](#)" July 29, 2018). And now the Trump administration has adopted our thought-model – it's calling it a contest to see [who can endure the most pain](#), with [markets acting as the score-keeper](#). Right now the game is pretty one-sided. Chinese

stocks remain in a deep bear market, and the Chinese currency just experienced back-to-back its two weakest months in history. [China said last week](#) that it would levy tariffs on \$60 billion of US imports – but that's not much of a response to [Trump's latest threat of higher tariffs on \\$200 billion](#), but given how little China imports from the US, it's the best they can do. Given how markets are reacting, probably more significant is the [People's Bank of China's appointment of two new deputy governors](#) "to shore up its in-house expertise on systemic financial risk."



We've said from the beginning, though, that the most salient pain-point for China will be social unrest in what is [effectively a police state](#), which can only increase as the Chinese economy weakens under the pressure of trade frictions (see "[Is Trump Really Bluffing on Tariffs?](#)" June 22, 2018, and "[Did China Just Run Up the White Flag in the Trade War?](#)" July 10, 2018).

Consider this potpourri of headlines from just the last week.

- [China's controversies create cracks in Xi's façade](#)
- [China's Summer of Discontent](#)

Update to strategic view

ASIA MACRO, ASIA STOCKS, FX: An outpouring of headlines the last week shows civil unrest and political repression in China rising. We think this is the most salient pressure-point in the what the Trump administration is increasingly seeing, as we have, as a game to see who can endure the most pain, with markets acting as the score-keeper. Xi is nominally "president for life," but he won't live long if social pressures in China break out as the economy weakens further. Repression helps Trump isolate China from US allies, and drives Xi to make a deal before the mid-terms, when success would be most valuable to Trump.

[\[Strategy dashboard\]](#)

- [Investors Protest Outside Headquarters of China's HNA Group](#)
- [Rare two-day protest over China vaccine scandal reveals public anger](#)
- [China appeals to military veterans not to protest, respect law](#)
- [Thirty people detained at factory worker protest must be released](#)
- [Chinese dissident in his 80s arrested at home during live TV interview](#)
- [Ai Weiwei Beijing studio demolished 'without warning'](#)

And finally...

- [Disney's 'Christopher Robin' Won't Get China Release Amid Pooh Crackdown](#)

As we discuss our China thesis with clients, we often hear the objection that Xi, having been [made "president for life" in March](#), can outlast the Trump administration that is only as enduring as the next election. We reply that "for life" is only as long as his life is – and if the little bit of fraying we see now in China's social fabric worsens into an outright coming apart at the seams, that might not be very long for Xi (remember how quickly the Soviet Union decomposed once the Berlin wall was breached – *no one* expected that).

Xi may end up envying the fact that Trump is pretty much guaranteed at least another two-and-a-quarter years. If anything, the upcoming US mid-terms serve as a time-focus for a resolution of the trade war – a week or two before election day will be the time when Trump will most want to have a deal to brag about, and surely China knows that the terms of surrender will never be as good again. In the meantime, the more the West hears stories of unrest and repression, the easier it will be for the Trump administration to line up allies against China – as we believe has already occurred with the nascent US/EU trade deal (see ["On the US/EU Trade Deal"](#) July 26, 2018). ▶

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