Trend Macrolytics, LLC
Donald Luskin, Chief Investment Officer
Thomas Demas, Managing Director
Michael Warren, Energy Strategist

# On the Margin: China Sees the Cliff

Friday, October 19, 2018

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

## Fear drives China to admit it is "currently in contact"

Last month China's vice-minister of commerce Wang Shouwen tried to sound tough, saying China won't negotiate on trade with the US while we hold "a knife at its throat." But we said that was a sign of weakness, because that's China admitting we hold "a knife at its throat" (see "Our Knife at China's Throat" October 8, 2018).

Looks like we were right. Yesterday – while Chinese stocks made new lows as China announced Q3 GDP growth at 6.5%, the lowest since the global financial crisis, and the second lowest in the history of the data – vice-premier Liu He admitted "China and the US are currently in contact."

Liu said on Chinese television, "The outlook is very bright" – though authorities have had to step in with backstops to prevent cascading stock market losses driven by forced liquidation of shares pledged against loans. Some claim Chinese authorities intervene directly in the stock market – they are called the "National Team" – and did so yesterday to turn around plunging stocks after the weak GDP figures were announced. At the same time, the yuan makes new lows against the dollar, even as the US Treasury showed the good grace not to name China a currency manipulator in its semi-annual FX report this week.

On the effect of US tariffs, Liu rationalized, "the psychological impact is greater than the actual impact." But that, too, is a sign of weakness. It is really only to wake up to what we've been saying all along, before most tariffs were even put in place: that markets anticipate that China will suffer far more from them than the US will (see "Did China Just Run Up the White Flag in the Trade War?" July 10, 2018).

Meanwhile, President Donald J. Trump has opened up a new line of attack in the US/China trade war – threatening to pull out of the Universal Postal Treaty, under which the US Postal Service subsidizes the delivery in the US of

**Update to strategic view**

**ASIA MACRO, ASIA STOCKS, FX:** Having refused to negotiate while the US holds "a knife to its throat," Chinese officials now admit "China and the US are currently in contact." As Q3 GDP is reported at the second lowest in the history of the data, the yuan weakens further, and stocks make new lows, authorities have had to step in to prevent forced selling of shares pledged against loans. Officials claim "the outlook is very bright" and say, of US tariffs, "the psychological impact is greater than the actual impact." It is a very positive development that China seems to be starting to come to grips with reality, rather than blindly stumbling off a cliff into recession.

[Strategy dashboard]

Chinese goods.

Apparently there is a lot of cognitive dissonance in China right now, and more than a little fear. That's a good thing – it's better than outright denial. It is the first step to China coming to grips with reality. The biggest risk facing markets is that China won't have the good sense to relax and enjoy the inevitable – to settle the trade war with Trump before it blindly stumbles off a cliff, and falls into recession – which could have unpredictable and dangerous consequences for internal social cohesion, and ultimately for global supply chains (see "One Sell-Off, So Many Causes" October 15, 2018).

**Contact TrendMacro**

On the web at
trendmacro.com

Follow us on Twitter at
twitter.com/TweetMacro

Donald Luskin
Chicago IL
312 273 6766
don@trendmacro.com

Thomas Demas
Charlotte NC
704 552 3625
tdemas@trendmacro.com

Michael Warren
Houston TX
713 893 1377
mike@trendmacro.energy

[About us]

**Recommended Reading**

**The Global Competitiveness Report** 2018
World Economic Forum
October 16, 2018

[Reading home]