Trend Macro™

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On the Margin: CREEP, the Sequel – China to Re-Elect the President

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

China tweets, too. It's signaling a more comprehensive deal than expected.

Many clients thought we were overoptimistic when we said the Oval Office photo-op in October announcing the "Phase 1" trade deal with China would, at long last, end the escalation of trade tensions between the world's two largest economies, and avoid the imposition of new US tariffs on Chinese exports of consumer goods that had been scheduled for last week (see "The ("Phase 1") (Unpapered) (Unsigned) China Trade Deal" October 14, 2019). But while the deal has yet to be signed, we now regard it as a sure thing (already, the December tariffs have been suspended). President Donald J. Trump tweeted Friday that he and Chinese President XI Jinping are talking directly – not just about getting the deal wrapped up, but also folding North Korea and Hong Kong into their conversation. If you must, you can take that as Trump hyperbole designed to goose the stock market into year-end. But it matches well against a statement by Xi the next day confirming that "the two countries have reached a phase-one agreement" that "benefits both sides and the whole world."

As we expected, we are approaching year-end on a high note for global equities (see "Can This Year Just Please Be Over?" December 4, 2019). Clients are shifting from a consensus of disbelief to wonderment as to what upside surprises could possibly still be in store. Look to this Friday tweet from Hu Xijin, the editor of China's state-controlled *Global Times*, an English language mouthpiece for the Communist Party – basically, this is the face of the CCP on Twitter. In a direct reply to Trump's tweet, Hu waves away the risk of Trump's impeachment, promises more good

Update to strategic view

US MACRO, ASIA MACRO: State-sponsored tweets from China make it clear that a "phase 1" trade deal is going to be signed, that it could be more comprehensive than expected, and that China is doing it to support Trump in 2020. This is an upside surprise to the extent that it re-ignites global trade and capital investment by reducing and deferring the risk that China will be forced into a disorderly first-ever recession. A greater likelihood of Trump's re-election reduces the risk that the 2018 reduction in the corporate income tax rate will be repealed, a goal of every Democratic candidate.

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news on trade, and notes that this "will help Trump to hold more initiatives in the election." That last phrase is key: you may have thought we were crazy when we first said it, but a trade deal only became possible when China decided it was in its interest to work for the re-election of President Trump – and that is exactly what is happening now (see "China Votes Trump 2020" November 7, 2019).

Here's another Hu tweet from the day before, basically siding with Trump's long-standing contention that the House impeachment process is nothing but a partisan ploy. Pandering to Trump? Probably, but it speaks volumes that China is trying to lift him up here, rather than kick him when he's down, and hoping he stays down.

The upside here is that, as we anticipated, the "Phase 1" deal could be more comprehensive than originally advertised – touching more than just agricultural purchases (see "Video: What you're not hearing about the US/China 'Phase 1' trade deal" December 16, 2019). *For that matter it could touch more than trade, including China's help in pacifying North Korea. It all adds up to China providing Trump with little victories that will help him get re-elected in 2020 – which, in turn, for markets, removes a great deal of policy risk from 2020, in which every Democratic candidate, including the centrists, wants to take back Trump's pro-growth 2018 cut in the corporate income tax rate.*

Why would China take such a position for a US president who has done so much to damage and discredit it? Earlier this year, China had walked away in anger from trade negotiations, willing to live with the damage already done to its economy from the 2018 tariffs, and ready to bet on the reasonable chance Trump would not be re-elected in 2020, and would be replaced by a China-friendly globalist Democrat (see "On China's Trade War 'White Paper'" June 2, 2019). But all that has changed. Trump's new tariff threat in August (see "On the New China Tariffs" August 1, 2019) , and the US Treasury's designation of China as a "currency manipulator" (see "China the Currency Manipulator, and So What?" August 6, 2019) put China into a currency crisis that substantially raised the risk of a disorderly first-ever recession (see "Never Let a Good Currency Crisis Go to Waste" August 14, 2019). At the same time, the Democratic candidate debates revealed that China-bashing has become a bi-partisan political litmus test in the US (see "Impeachment and China-Bashing 2020" September 30, 2019), and that some Democratic candidates – especially Elizabeth Warren (see "Trump ♥ Muslims (In

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China)" October 9, 2019)– were to the right of Trump on China. Together, China had to perceive the situation as one in which the risk of waiting had gone up, and the reward for waiting had gone down.

You can see this dynamic quite clearly in the Chinese boycott of US agricultural products. It began in 2018 as specific retaliation for the 2018 US tariffs, and was targeted specifically at farmers whom China believes are Trump's electoral base – in order to work actively against Trump's re-election. Withdrawing that boycott – even though the tariffs against which it was retaliation have not been withdrawn – reverses the political threat against Trump, turning it into a small victory Trump can tout, while still positioning himself as the commander in chief in an ongoing trade war conducted for the sake of America's middle class.

What does China get? Well, it gets US agricultural products, which it needs now more than ever thanks to the epidemic that has destroyed much of its massive pork industry. And it gets the suspension of the December tariffs and the reduction of the small September 2019 tariffs. But, more important, China gets the undying gratitude of a president re-elected with its cooperation.

And it gets some measure of economic stability back, or at least relief from the dangerous instability it experienced in August – when the yuan weakened by 4% in a single month, making August the worst week for China's currency in modern history. Politics aside – or, rather, treating political considerations as a side-constraint – it was always economic pressure that was going to drive China toward reform (see "China is Losing the Trade War with Trump" July 29, 2018). It should be no surprise to now see China lowering tariffs on US and non-US imports across the board, and announcing new measures to help private companies compete with state-owned ones.

Bottom line

State-sponsored tweets from China make it clear that a "phase 1" trade deal is going to be signed, that it could be more comprehensive than expected, and that China is doing it to support Trump in 2020. This is an upside surprise to the extent that it re-ignites global trade and capital investment by reducing and deferring the risk that China will be forced into a disorderly first-ever recession. A greater likelihood of Trump's re-election reduces the risk that the 2018 reduction in the corporate income tax rate will be repealed, a goal of every Democratic candidate.