

US-China Trade Update

October 15, 2019

- Our conversations with trade folks in the last few days indicate that the “Phase I trade deal” the US and China alluded to on Friday remains precarious as final details have not been cemented and China is testing the contours of the deal to see whether existing tariffs can be rolled back on top of a suspension of the December 15 tariffs before any signing ceremony in November. **Enforcement** remains the key sticking point in negotiations, which we will discuss below.
- In order to get a Phase I deal inked, we believe China will at least need to see the List 4B tariffs suspended beyond December 15 and our conversations with those close to the US trade delegation indicate that there is growing willingness to suspend those tariffs if enough concessions and ag purchases are made in the next few weeks. **Our odds that those tariffs will go into effect have been 80% but based on the reduced willingness of the US side to escalate tariffs at this moment, we are reducing those odds to 70% today.**
- **Similarly, we are reducing our odds that the tariff rates on Lists 1-3 will be increased to 70% from 80%. Those tariffs were suspended last week when the Phase I deal was announced but remain a threat in the future, particularly as we look ahead to Phase II and/or a second term for the Trump administration.**
- Progress on other fronts – potentially as pressure on farmers eases or the USMCA looks like it might pass the House – could reinvigorate the Trump administration’s appetite for tariffs at any time.
- Lawmakers are back in D.C. after a two-week recess today and already there is a line to get an audience with USTR Lighthizer, particularly from agriculture-heavy Senate Republicans such as Senators Grassley (R-IA) and Roberts (R-KS). USTR Lighthizer will be spending time one-on-one with these lawmakers in person and over the phone throughout the week to once again “read them in” and secure their “buy in” on Phase I. We are expecting readouts of those meetings to emerge late this week. We are not expecting Republicans to come out *en masse* **against** the “Phase I” plan, but there is clearly a need for the administration to do damage control on Capitol Hill as US farmers and manufacturers have felt the pain of tariffs since March 2018 and will need more than a Chinese commitment to make agriculture purchases to show for it. Democrats and Republicans have panned the deal so far but USTR Lighthizer’s personal touch will determine whether President Trump is able to spin this deal as a “win” or accept a deal at all in 4Q19.
- One of the most significant problems we hear from farm state Senators is that one-time commitments to make purchases of US agriculture are not the main problem for US farmers – making up for two years of lost time and getting back on solid ground

with Chinese customers to stem the tide of trade between China, Brazil and Argentina, is a more desirable end which China has not conceded on. That go-forward commitment has not been agreed to and will depend on the enforcement terms the US insists upon, which remain far higher than China is willing to accept at this time.

- The Democratic debate tonight will (or should at any rate) provide a real-time guide to how Democrats plan to pan President Trump’s deal with China. A cohesive or consistent narrative from any of the leading candidates opposing this small scale deal could form the bounds of what the Trump administration can sell as a “win” to Rust Belt voters in the coming weeks and will be instructive to China’s US hawks and Vice Premier Liu He as they continue to speak with the US trade delegation.

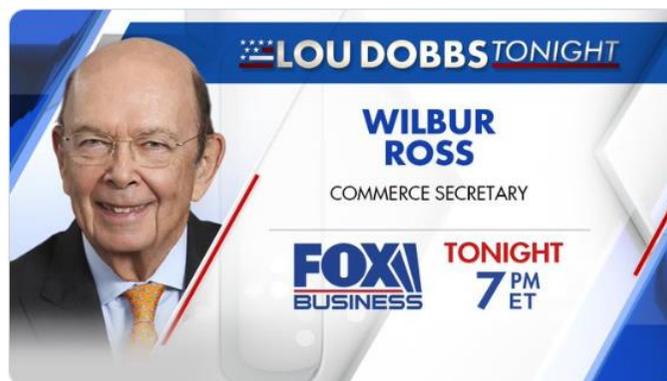
Enforcement

The biggest problem we’ve seen since the deal was announced dropped this morning when [Bloomberg](#) reported that China might need to see US tariffs removed before it would be able to make substantial agriculture purchases. Specifically, *Bloomberg* reported that China was telegraphing that reaching \$40-50B worth of agriculture purchases per year (something the US has said will be effective within two years) might be untenable for China without the US removing its existing tariffs on Chinese exports. **The subtext of this is remarkably consistent with China’s starting position in the trade war which is that they are willing to negotiate any number of issues with the United States, but they are unwilling to do so with the gun of tariffs to their head.**

Since that report this morning, China has [walked that sentiment back](#) and spokesmen for the party are sticking to their line that the US and China are “on the same page”. More clarity will likely be needed though in the coming weeks as that message hasn’t quite broken through:



China reneges again. Beijing refuses to buy \$50B of U.S. agriculture until @POTUS lifts all tariffs. @SecretaryRoss joins Lou 7PM/ET. #MAGA #AmericaFirst #Dobbs



3:23 PM · Oct 15, 2019 · Twitter Web App

Source: Twitter

Speaking with Senate Republican counsel this evening, investors should expect to hear more about this potential development as it made its way around the Capitol throughout today and is a major source of concern for members on both sides of the aisle..

Tariff Escalation Looking Less Likely but the Situation is Fluid

We believe the Trump administration is growing more open to not implementing the List 4B tariffs on December 15 and are lowering our odds from 80% to 70% today that they will ultimately go into effect. However, should China return to a position that it has held since the outset of the trade war, that the US needs to repeal all of its existing tariffs in order to secure a deal, there will be no deal – big or small and \$360B worth of US tariffs will remain in place and the threat of escalation will obviously remain.

Last Spring, when the US and China were closer to reaching a more comprehensive trade deal, US hawks in China stepped in to veto the parameters of the deal Vice Premier Liu He had negotiated. The main risk to a deal now is that US hawks in China will do so again and make it impossible for the US to even secure a Phase I-style deal this year (or next).

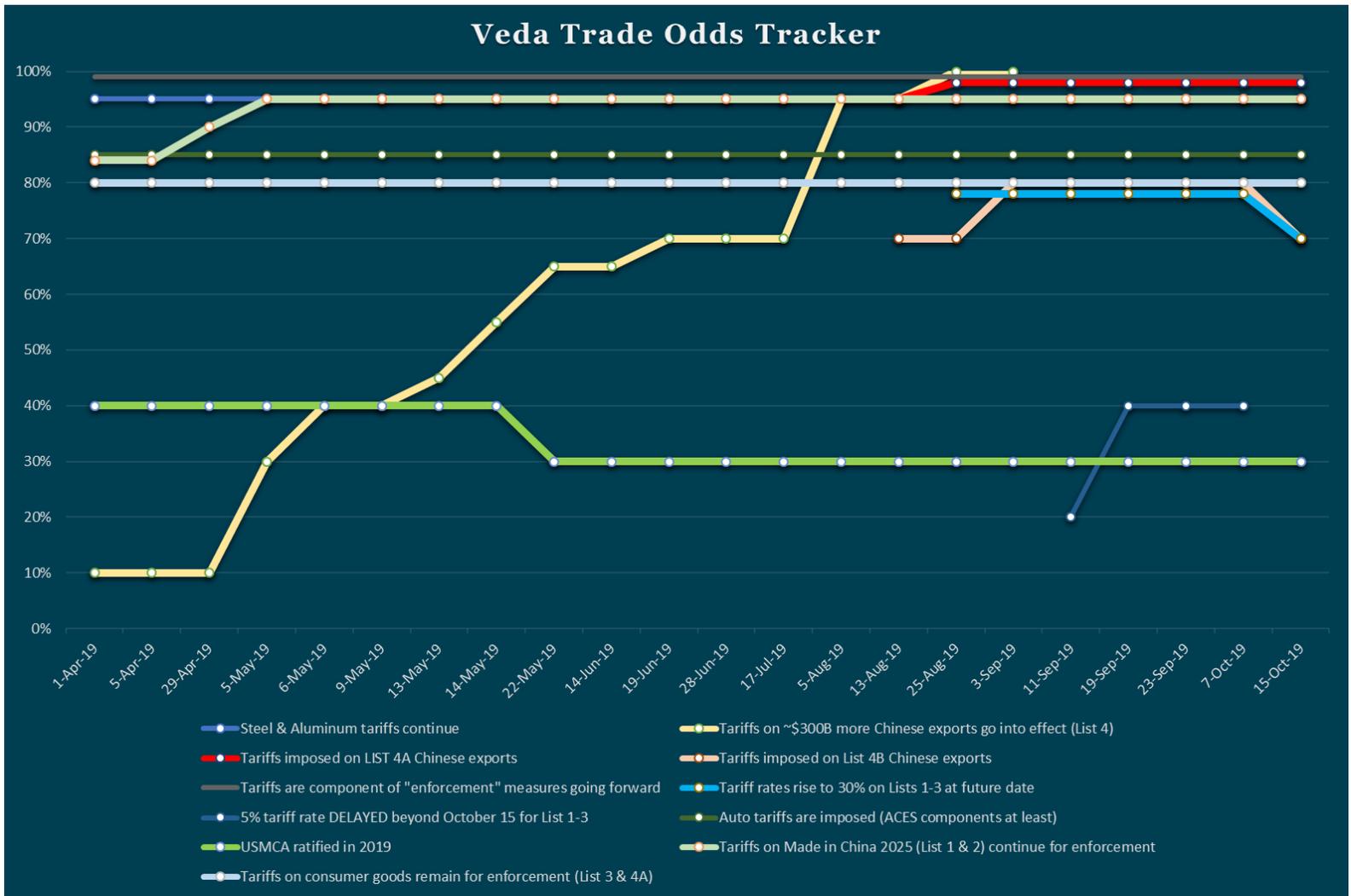
Enforcement mechanisms (i.e. tariffs) can and have singlehandedly brought down the potential for an agreement in the US-China trade war and lawmakers in the US have made it abundantly clear that no matter what deal USTR Lighthizer reaches, it **must be enforceable, i.e. that tariffs must continue**. Without tariffs, there is no enforcement, and “if there is no [enforceability](#), then our trade agreements are not really worth the paper that they are written on,” lawmakers stressed to USTR Lighthizer earlier in the year.

We highlight these developments and stress their import because the US and China remain at a fundamental impasse on enforcement, but problematically now even the détente option or the possibility of an off ramp for the US in this trade war, is at risk if China continues to stress the need for removal of any tariffs before concessions to US farmers will come. The catch-22 in the trade war continues to be the mutually exclusive requirement that China will not accept a deal that perpetuates tariffs and the US will not accept a deal that can’t be enforced. As USTR Lighthizer himself has stated, the Trump administration believes there is no other option to secure enforcement except for the continued implementation of tariffs.

President Trump and others on his trade team have gotten less enthusiastic about imposing new tariffs as we [noted](#) back in September, as US farmers and manufacturers have absorbed unendurable pain from the tariffs, but the Trump administration would have to admit the last 18 months of pain will result in no gain to domestic businesses, farmers and lawmakers if they take off enough existing tariffs to compel China to ink a deal with them in the future, because there will be no way to enforce a deal after it is signed.

China signaled very clearly this morning that the position of US hawks remains constant: they will not accept a deal with the US while tariffs remain in place and they are increasingly unwilling to even purchase US agriculture as stipulated by the "Phase I deal" if tariffs remain in place. President Trump could accede to that request but will have lost the trade war if he does so. At this juncture, we continue to believe that doing so would not be in President Trump's best interests and a continuation of the trade war is still more palatable than ending it in defeat.

Veda Trade Odds Tracker



Source: Veda Partners, LLC

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