



Economics

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THE WEEK AHEAD

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The Fog Will Not Clear

by Benjamin Tal

We really don't want to write another piece about the China-US trade dispute...but we have to. And the last thing we want to do is get into Trump's head, but again we have to. We have to because it's all about trade. Take trade out of the equation and nobody would be talking about the Fed easing, and the 10 year-rate would be at least 50 bps higher.

Simply put, if you're in the market, you must have a working assumption regarding the situation. The more we think about it, the more we realize that this trade dispute is going to be with us for a long time. The fog is not going to clear, because Trump doesn't want it to clear. The uncertainty is not a means to an end, it's the goal. Rightly or wrongly (and we believe wrongly), the President believes that the fog is, in fact, helpful to corporate America.

As we suggested in previous publications, the Chinese game plan is to stall and buy time until the 2020 elections. Trump's decision to levy tariffs on the remaining \$300 billion of Chinese exports is aimed at preventing them from doing so. As we expected, the Chinese are responding by allowing the yuan to fall to its weakest levels in more than a decade.

Both sides need a win. Trump for obvious reasons. As time passes and the trade dispute drags on, the damage to the US economy is becoming more evident. More and more studies using empirical data debunk Trump's claim that Chinese companies are bearing the brunt of the tariff payments, showing that in fact, corporate America and, to a lesser extent, consumers have absorbed the bulk of the damage. And

that's before the latest wave of tariffs has even taken effect, which will mostly be felt by the average American.

As for President Xi, sure, he doesn't have to face voters, but one should not underestimate the pressure he faces within the Communist party's elite to save face.

So, what is the endgame? What is a victory here? It's not about soybeans. It's slowing China's technological advance, full access to the Chinese market, and a protection of intellectual property. More specifically, the Administration would like a situation in which US companies aren't required to transfer their secrets in order to operate in China, as well as a more equitable tariff structure, and the ability, without government interference, to expand.

Now, it's not totally unreasonable to assume that Chinese authorities will agree to prohibit officials from demanding technological transfers as part of the licensing agreement and joint venture. They can because, in reality, the pressure on US companies to share information comes from behind the scenes and will not be affected by legal requirements. Furthermore, the likelihood that the Chinese will allow the US to verify compliance is basically zero. So even if there is an official agreement, in reality, very little will change.

That's why we believe we will have to live with the fog of a trade war for a while. Trump is comfortable in that environment, and even if we get an agreement, it will be full of holes, therefore shortening the duration of any relief rally.