MACRO Voices
with hosts Erik Townsend and Patrick Ceresna

Louis-Vincent Gave: What Comes Next After The Trade War Dust Settles

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Erik: Joining me now is Gavekal co-founder, Louis-Vincent Gave. Louis, it's great to get you back on the show. Let's start with the burning topic on everybody's mind, Trump tariffs, China-US. Okay, first we thought it was this great big tariff build up. Then it seemed like we had really high tariffs. Then all of a sudden, there's a weekend deal. I think everybody's head is spinning, kind of feeling like, Okay, where are we in this story? When do the weekend deals end? When do we get to stability? Are we almost there yet? Are we just in the first of several rounds of negotiation? How is this all going to wind up, and how close are we now in terms of the latest revision to the trade deal?

Louis: My head is spinning for sure. Anyway, thanks for having me, Erik. It's great to be back. Good to catch up with you. It's been too long since we caught up. I'm delighted to be here. So, thanks a bunch for having me. And yeah, it's probably a good time to catch up as to where we are in the world. It's been, obviously, a pretty roller coaster two months, you know, a lot of facts changing on the ground, a lot of policy shifts. China moving towards more stimulus, Europe moving towards more stimulus. Now, you mentioned this weekend, we have the Geneva deal between the Chinese and the US, we also have, yesterday, we had the US government dropping in a budget that's pretty stimulative. When you think that just a month ago, the discussion out of the Trump administration was all about DOGE and cutting spending and tightening belts, etc., that seems to have gone out of the window almost as fast as the tariffs against the penguins.

So, to your point, where do we stand now? I think we stand where we're probably going to end up, which essentially is 10% on pretty much everybody, and then China somewhere between 25% and 40%. And out of all of this, you could say we could have started here and foregone all the drama, foregone all the other headaches. Of course, that would have made it less exciting, that would have meant less time in the media for the for President Trump and for the various members of his administration. How does the world look with 10% on everybody? I think 10% on everybody really doesn't move the needle all that much. It does end up, I think, still being a little bit inflationary for the US, especially since, contrary to a lot of people's expectations, turns out that tariffs do not strengthen your currency, it probably weakens it. And so instead of going up on this news, the US dollar had a tendency to sort of pull back. So, if you think, okay, we have 10% on everybody. We have tariffs that bring up some of the cost, even if perhaps some are eaten by a little bit by the producers. The bigger question mark is, where does China end

up? Is it going to be 25%? 30%? 40%? If you end up at 40% for most of the Chinese goods, I think that could still lead to some supply chain dislocations, that could still lead to some issues. Now, granted, perhaps the big difference is, if you'd said, okay, we're putting China at 40% and we're leaving it there. Maybe you get a different outcome than where we're now. What we've just experienced, where you start up saying, oh, we're going to put China at 130%, everybody freaks out. Everybody is very worried the impact on growth, the impact on supply chains. Then you turn around, you say, actually, forget it. We're not going to do 130%, we're just going to do 40%. 40%, but we're just going to do it for those 90 days, and then we'll see afterwards. And now, if you're Walmart or if you're Costco or Home Depot, you think, hmm, okay, 40%, I don't like it, but I can live with it. So, I'm just going to load up now, make sure the shelves stay stacked for the summer. Load up on everything I can. I think this is essentially where we are, which perhaps we wouldn't have been if we'd started at 40%. Bottom line, here we are, 10% on everyone, 40% on China, probably an inflationary impact for the United States, especially if at the same time you get an easing of fiscal policy. I guess that's where we stand.

Erik: Let's talk about how that's translated for markets. In the last couple of days, or first two days of this week, we saw two nice big green up candles on the S&P, presumably a reaction to the trade deal. Can that be sustained? I mean, we've been kind of ignoring some recession signals for a while here.

Louis: Yeah, the recession call look is the super important one, right? Because, to your point, if you look at all the soft data, your ISM surveys, your consumer confidence, or basically any survey that you have, all the soft data does point to a slowdown in US, does point to a recession. And this is not yet being confirmed by the hard data. And in that regards, that the coming weeks' worth of data will be super important, and it'll be fascinating. Usually, hard data tends to follow soft data. It didn't happen, of course, in 2022, 2023, you might remember that back then, a lot of people were arguing for a US recession and a US recession that never came. Because at that time, if you go back to 2022, 2023, the US government basically followed a massively pro cyclical fiscal policy. You had Biden's Inflation Reduction Act, and the government essentially stepped on the gas and added another, whatever it was, trillion dollars, trillion and a half to the US government debt. And when you have that kind of stimulus, it's pretty tough to move into a recession.

Fast forward to today, and I think, obviously, up until 48 hours ago, everybody had every right to be massively concerned about supply chain dislocations, number one, and everybody had every right to be concerned about potential fiscal tightening in the United States. You had DOGE going around saying, oh, we're going to cut government spending by a trillion, a trillion and a half, maybe $2 trillion and then you turn around and say, well, actually, it's not going to be a trillion. It's more like $150 billion. And then out of the $150 billion, you have, like only $27 billion of confirmed cuts. And then you come to the budget that was just released yesterday, which seems to show pretty big fiscal expansion. And that leaves you with, indeed, the quandary of, is this '22 all over again? Where you had the softening of the soft data, and then you got the fiscal stimulus. And as a result, the recession never came. I think one difference today, between today and 2022, is that 2022-2023, in 2022-2023 there was still the perception that the US was the

only game in town, that the only place you could invest was the United States and the US essentially kept sucking in savings from everywhere around the world. And I don't know if that's true anymore. You know, I look around and it seems that most foreigners are now looking, at least from all the conversations I've had, in Europe, in Asia, in Latin America. Most foreigners are looking more to divest from the US than invest in the US. And here, an important point is, when you look around the world, you're actually seeing proper bull markets in a lot of places. If you look at Latin America, you and I have discussed this before—and I've been a big believer in the Latin American debt story—you look at Latin American debt, Brazil, Chile, Colombia, Mexico, Latin American debt indices are up, depending on which one you pick, anywhere from 11% to 15% for the year. And Latin American equity markets are typically up 25% for the year, whether you look at your Chiles, your Colombias, your Brazils, your Mexicos. So, you have bull markets there in Asia. Hong Kong, Korea, are up 15%. In Europe, your typical European index is up 20% or more. So everywhere around the world, all of a sudden, a situation where the S&P is doing nothing. It's even with the rally of the past, the past few weeks. It's essentially flat for the year, and I think it just turned green as we're speaking. It's now up 15 basis points for the year. But if you're a foreigner, all of a sudden, it's it feels like the US dollar is not going up. US Treasuries are definitely underperforming every bond market out there, and US equities are no longer the "end-all, be-all." So, the big difference today relative to '22-'23 is, you remember the old mantra that the US is the cleanest dirty shirt, that it's the only sharp knife in the knife drawer, etc. I'm not sure that's true anymore. And so you're now in a situation where maybe the US doesn't have a recession, maybe the supply chain dislocation aren't that bad. But still, you're still left in a situation where the US runs twin deficits of 12% of GDP, and for the show to stay on the road, the US needs to keep attracting capital from abroad, and that's easy to do when everybody is essentially sucking wind. But now the rest of the world is not sucking wind. The rest of the world has stealth bull markets everywhere. And there's perhaps better stories everywhere. And I think we just saw that 10 days ago, when you started to see the Taiwanese dollar suddenly break out to the upside, and you start to see the Korean won break out to the upside, and Malaysian ringgit and the Singapore dollar. All of this is a sign of capital coming home, which for me is really the big trend of this year, is just, it's just capital comes home. In the face of policy uncertainty in the US, in the face of economic uncertainty in the US, the first reaction of a European pension fund, a Taiwanese insurance company is to say, look, you know what? I'm going to bring my money home, and I'll figure out later what I do with it. This is, I think, what's happening. And it's leading to all these stealth bull markets everywhere except the US.

Erik: Louis, this idea of stealth bull markets other than the US is very intriguing to me, because I think it invites the question as to whether we're seeing the beginning of a permanent change. In other words, if you were to say, okay, look, the US is aggressively negotiating tariffs with China and other nations. That's leading to lots of volatility, the US markets are underperforming Europe and other markets while this is going on. Okay, that makes perfect sense. It's just cyclical markets. That's how they are. On the other hand, if what we're saying is that the long forecast, and I would say, in many ways, long overdue conclusion, a lot of people have looked and said, boy, is the US always going to be the cleanest dirty shirt? Is it always going to have that special favor of being everyone's favorite market to invest in? Or, is it likely to become the case that changing trade policies and foreign policy are going to erode that

premium of US assets so that they never have that luster again? I know it's probably an impossible question to answer on a podcast, but are we seeing the beginning of something permanent, Louis, where this is not just a current trend in in market settlements, but it's actually a structural change that the US is not going to be the de facto market for everyone to invest in internationally anymore.

Louis: I don't know, permanence is a long time and a lot of things can happen in between. I know that that's what's happening right now, and I don't see that changing in the near term. And near term, I mean the next two to five years, and maybe that's what you mean by permanent. But let me share with you an anecdote. You know, when I started my Gavekal with my father, back in the late 90s, my father would use a rugby analogy, and he would say, look, in life, there are those who move the pianos and there are those who play the piano, and you need both to have a good concert. And then he would say, helpfully, he would say, you move the piano and I play the piano. And people typically come and pay up the top dollar to see the piano player. They don't really care who's moved the piano in the concert hall. You pay to see the piano player. Now, there is no doubt that for the past 15 years, the US has been the piano player. The US has been the attraction. It's been where the show was. It's been all the excitement. And that corresponded, I think, to two super important trends that both unfolded around 2007, 2008, 2009. The first super important trend was the shale revolution. The US essentially added 8 million barrels per day over the course of eight to nine years, which is, yeah, just in terms of productivity gains, it meant that the US had a cheaper cost of energy than anybody else, meant a dramatic improvement in the US trade balance. I mean, the US added almost to Saudi Arabia in less than 10 years. It's kind of mind blowing to think of it that way.

The second thing I think that occurred in the US, starting also in 2007, 2008, 2009, was the birth of the smartphone. And, the US completely controlled the broader smartphone ecosystem, maybe not the manufacturing of them, but everything else. Whether Apple, whether Alphabet, whether Facebook, Microsoft, they were instrumental in that smartphone ecosystem, and that drove the US bull market, I think, from roughly 2008 to 2022, and you had a typical bull market formation when you look back on it, sort of grinding, grinding higher. And then the last two years, you get fiscal stimulus, you get monetary policy stimulus, and the thing goes absolutely bananas. And this is when you had complete stupid behavior in markets, you know, the monkey JPEGs trading for millions of dollars, the Gamestop and AMC and all that stuff. It was very reminiscent, for people our generation, Erik, it was very reminiscent of the whole dot-com thing of the late 90s, right? It felt very much like that. So then 2022, it hits the skids, and you think, okay, well, that's over. And then in ’23-’24, you get a huge second wind again, thanks to AI. It's like, oh, okay, there's a new third pillar to this US exceptionalism story. This great piano player has come out with yet a new album which is even better than the previous ones. It's called Artificial Intelligence, and it's going to change the world as we know it. And for two years, this drives the market up until the start of this year, where DeepSeek comes out and essentially says, look, with a piece of string and two pieces of bubble gum, I've built this. And it can compete with ChatGPT, it can compete with Gemini. And then all of a sudden, everybody realizes that this hope and belief that AI was going to be the new golden goose, that it was going to lead to outsized profit, just like smartphones did, that is actually not going to happen,

because the story of the past 20 years is that the last thing you want to do in life is compete with China. You know my old saying that when China enters a room, profits walk out. Well, this is what happened this year. China entered the AI room and essentially blew up any hopes and ambitions that AI was either going to be both an American monopoly, like the smartphones had been, and that it was going to lead to outsized profits. Instead, it just looked like AI was just going to lead to outsized CapEx that now would probably need to be written off. Now, that was the first sort of shaking to the story of the US exceptionalism. I think the sick and shaking, of course, comes with President Trump and the constant changing of rules. You know, most investors, most entrepreneurs, most business people, just want to know what the rules are. They want to know what the rules are. Then they choose to invest or not, and they get on with it. An environment where rules change on a whim, is reminiscent of emerging markets. It's reminiscent of, frankly, just bad times, and leads to the assets' derating. So, I think this explains the sort of first five months of this year, and it's led to this situation where, based with the policy uncertainty of the US, based with the fact that the US exceptionalism story doesn't really have a new growth driver anymore. Investors are just bringing money home and deciding, I'm bringing money home and I'll figure it out later. And that's, I think, that's where we are right now in this cycle.

And then you have to wonder, to your question, is it permanent? Well, I think to revive the whole US exceptionalism story, to revive the whole "I'm going go see the US pianist, because all the other ones are no good," you need one of three things to happen. The first possible thing to happen is for Europe to implode and everybody to panic. And all this money that has started to come back, all the European savings have started to come back into Europe to say, oh, I knew it. These guys are hapless. I shouldn't be invested here, etc. Now, look, I'm the first one to beat up on Europe. You know, as a Frenchman, 10 people always tend to be bearish on their own countries. But I look at Europe today, and given the low energy costs on the one hand, given the fact that bank loans are accelerating, given the fact that bank shares are outperforming everything, given the fact that we're having fiscal stimulus now across Europe, this doesn't seem to me like the kind of bad backdrop where Europe is going to implode. Usually, Europe struggles when energy prices are very high. This is not the case today. So that's not going to happen. The second thing that could happen to revive the "oh my god, I got to put all my money in the US trade," is for China to implode. But here again, you have a situation not that dissimilar to Europe, where bank loans are expanding, where you get fiscal stimulus in China, where energy prices are low. And you know, China is obviously the biggest energy importer in the world, so none of this seems to point towards China hitting the skids. So then you're left with third possibility to revive the excitement around the United States, which is that the US comes up with a new invention, something new to get excited about, and something as big as either the smartphones or the shale revolution, or the launch of AI back in '23. And that's why I said permanent is a long time when you ask the question, because I don't think you can ever write off the US' capacity to do this. The US has capacity to come up with something new, cool and exciting. Right now, I don't see what it is. I'll be honest, I struggle to see what it is. But it doesn't mean it can't happen. It might just be me lacking imagination.

Erik: It seems to me that energy is going to have to enter this equation sooner or later. Something Dr. Anas Alhajji told me last week is, although right now is a time of low and perhaps headed lower oil prices, Anas thinks that the US shale revolution has pretty much played out in terms of its ability to offset declining production elsewhere in the world, and that that's going to change things going forward. It seems to me like, that plus the fact that everybody, as you just said, has already figured out that AI is a really big, important part of the future, it feels like we may be headed toward a moment of reckoning where everybody kind of picks up those pieces. You talked about bringing the capital home and figuring out what to do with it after you get it there. At some point, are we headed toward a moment of reckoning where everybody says, oh, now that I'm home, I got to figure out what the energy situation looks like in my country compared to every place else, because that's going to be the next big squeeze.

Louis: I 100% agree, and I think so. Now, first, before I go there, let me just say that amongst all your regular guests, and you have terrific guests, when you invite Anas to speak, I always listen to it almost immediately. He's a fountain of wisdom on such an important part of the economy, as I never tire pointing out, most economic activity is energy transformed, which is one of the reasons why right now I struggle to be too bearish. You know, with their low price of energy, what it is that is going to be supportive of growth in most countries? Especially in countries that import a lot of energy, which is the case, of course, of China, of India, of most of the Asian countries, of most of Europe. Right now, the reality is, if you're a central banker in most emerging market countries, imagine you're the central banker of South Africa, of Chile, you're in a situation where you look at the world and you think, okay, I've got low energy prices, I have low food prices. I have a weakening US dollar, and I have China and Europe stimulating. You know, for most of these guys, that's Christmas come early, right? Like, what else could you ask for? This is about as good as it gets. And which is why, historically, the cure to low energy prices is low energy prices, just like the cure to high energy prices is high energy prices. I think we're now, when I look at most emerging markets, we're now in a situation where, almost everywhere you're getting fiscal and monetary policy stimulus. And yes, to your point, that is not bearish energy. And yes, I think the very important point you make is a lot of countries are going to be looking at what they've been doing over the past years, how they've managed their reserves, and what they should do going forward. I think that for decades, for basically your entire career, in my entire career, if you were Indonesia or Thailand or China, Korea, or anybody, then you earned US dollar, almost by default, you tended to buy US Treasuries, right? It was sort of, yeah, that's what the guy before me at the Central Bank did, so I'll just keep doing that. And as you and I discussed in the past, that changed in ’22. It changed for two reasons. First, and very obviously, we seized — we, being the Western world—
seized the Russian assets. And when we did that, all of a sudden, we increased the risk for a lot of countries of running US Treasuries. The feeling became, well, if the US can just grab my US Treasuries whenever they want, then these assets aren't the safe assets I thought they were. I think the second thing that happened in 2022 that I've already mentioned is that the US went on a massive pro cyclical fiscal vendor where nominal GDP growth in the US was running at 8%, 9%, 10%. Unemployment was below 4% and the Biden administration decided, you know what, let's step on the gas. Let's increase the budget deficits. And that made a lot of bond holders feel like a mug. It's like, okay, I understand that you might do fiscal stimulus in a downturn, but doing

it in an upturn, why am I stuck here holding these bonds? And so, they turned around, and I think countries did one of two things. If you were a non-democracy, if you are Saudi Arabia, if you are China, you start to buy gold and buy gold in size. You know, Saudi Arabia bought like, 170 billion over two years. So that was one way to recycle your excess dollars.

The other way, which is what the Swiss National Bank did, or Norges pension fund did and others, is to say, well, I don't want US Treasuries anymore. But tell you what, Microsoft and Apple and Amazon, they're just like US Treasuries. They're massive, they're liquid, and they're better than US Treasuries, because they actually have the ability to increase prices as inflation accelerates. So, everybody, well, not everybody, but a lot of people turn to US mega-cap stocks as a proxy for the money that used to be recycled in US Treasuries. And these mega-cap stocks, well, the total US market cap in three years moved from 40 trillion to 60 trillion US dollars, you know, absolutely mind blowing. You’ve never seen in three years, 20 trillion added to the global market cap, let alone in just one market, the United States. So as the excess dollar recycling all started to focus on the top 30 market caps in the US, valuations went berserk. So, this brings you to today, where that trend is ending, where the excess dollars are still going into gold. But you have to wonder to the very point you made, where, whether you're going to reach the point where countries like France, or, again, Thailand or China will say, you know what, instead of gold, maybe I should just stockpile copper. Maybe I should stockpile oil. Maybe I should stockpile soybeans. Or do like China and have a frozen pork reserve. You know, gold has, it's outperformed every commodity by so much. I think, one ounce of gold now buys 55 barrels of oil, which is about as extreme as it's ever been. Does it not make sense to just to store your excess dollars in these other commodities. Now, granted, these other commodities, there's a cost to storing them. But that brings me to the last point, which is that another super important development of 2025 is how the US turned to the rest of the world, but especially to Europe, and said, look, we're done securing your national security, and don't count on us and don't count on our Navy to deliver oil to you in a crisis like you counted in the past. Or, if you're going to rely on us, then be ready to pay up for it. Essentially, that was the tenure of J.D. Vance's speech at Munich, right? J.D. Vance came to Munich to break up with Europe. Now, usually when you break up with someone, you have the courtesy of saying, it's not you, it's me, I'm going through things right now, or whatever. J.D. Vance, no pretense, he came out and said, I'm breaking up with you because you're fat, you're lazy and you're stupid, and laid it into Europe. But if you're Europe, from there, what's the conclusion? The conclusion is, not only can I no longer rely on the US security umbrella, I also can't rely on the US delivering commodities to me at a time of crisis. So, the logical conclusion is, the one you just drew, all these guys should be building up commodity stockpiles for oil, for copper, and perhaps the first step was to say, okay, I'll buy gold. Instead of buying US Treasuries, I'll now buy gold. But given the price differentials, I think we're going to start moving to a world in which you are going to start to see stockpiling everywhere happen.

Erik: Let's talk a little bit more about that and what it means for the price of gold. Because, as you just said, we've reached a gold-oil ratio, which is at historic extremes. If we get to other ratios, gold to other assets at those extremes, it really suggests that the gold market is overdone and maybe overdue for a retrace to some extent. On the other hand, it's likewise pretty easy to

make the argument that, boy, everybody seems like they're walking away from US dollars in favor of gold. So, should I be bullish speculatively, the gold is headed up another few 1000 from here? Or should I be worried that the blow off top is overdue and that it's time to get out of gold?

Louis: It's a very tough one. Now, to your point on gold relative to other assets, I think we're there. You know, you look at the gold-copper ratio, is at all-time highs. If you look at gold, at the price of a median house in the United States, in terms of gold ounces, that's also at a low, right? So that's the extreme. If you look at the average weekly earnings of US employees, historically, on average, it takes about 1.2 weeks for the average weekly earnings of US employees to buy an ounce of gold. Today, we're at over three times. So, on all the sort of historical matrix, gold is expensive. But then we get to the argument you just made, which is that essentially, it's different this time. We're not in the usual cycle, and that given the de-dollarization trend, given that you now have China openly advocating around the world for moving trade away from being settled in US dollars to being settled in local currency, and the settlement to happen in gold, with China saying, look, we're going to open Shanghai metals exchange branches in Saudi Arabia and in Dubai and in Zurich and in Singapore, and so we can settle our trade over there for gold. Given that you're now looking at a world where not only are central banks buying, but ETFs have started to buy. For the past few years, ETFs were actually net sellers of gold as retail was getting rid of it, but that now seems to be over, and you're left scratching your head with who's going to be the marginal seller of gold from here on out. So, the bottom line is, is the problem you've just highlighted, which is that, yes, gold is expensive, and yes, it's different this time. But then, you know, you and I have been around a few cycles, when things get expensive, it's always what you hear at the top of cycles, right? You always hear it's different this time, whether it be tech stocks in 1999, whether it be pictures of JPEGs of monkeys in 2022, people will argue with a lot of passion and a lot of credibility that it is different this time. Now, I do believe it is different this time for gold. So, I would definitely not short it, and I still own some personally. What I personally have been doing in the past couple of months, as gold has continued to shoot up, is sell some of my gold for other assets, for other commodities, specifically for both energy and for copper. I think that if we're now entering a world in which global trade does continue to expand, thanks in part to the world moving away from the US dollar, I think this will be essentially bullish energy. It'll be essentially bullish copper. So, I remain decently optimistic, and the way I'd express this optimism at this point is perhaps more through the other commodities than with gold. But I still own some, because I think when you reach these blow off phases where we are now, it can go very high. You know, a lot of people were arguing on back in 1999, NASDAQ at 2500 is too expensive. And then it went, within six months, it went to 5000. I wouldn't be surprised if we see something like that for gold. Yes, at 3500 or 3400 it starts to get expensive. I still think the odds that we see 5000 in the next 12 months are actually decently high.

Erik: You said that you're starting to rotate out of gold into both base metals like copper and also into energy, or are you buying oil? Are you buying uranium on the energy side?

Louis: I've been buying more oil, to be honest. I do have, you know, you and I discussed this last time, I do have a little bit of uranium positions, and I'm a long term structural bull. But I think

that the value on offer today in a lot of the energy names, a lot of the energy companies, is really quite compelling. Now, granted, you could say, at 60 bucks, few of these guys make money. But you get back to 75 and a lot of these guys, after tightening their belt, after really constraining a CapEx, etc., a lot of these guys, at 75 bucks will start spitting out money. So in recent weeks, I've been buying, to be honest, I've been buying copper miners and energy producers.

Erik: Louis, let's come back to China, because that's so near and dear to your interests with Gavekal and you've got really good exposure to it. Tell me a little bit more about how we should be interpreting the situation in China, independent of the part of this everybody's focused on, which is obviously the Trump trade negotiations. We've been hearing China's economy is strong. We've been hearing China is headed toward an absolute real estate disaster, bust situation. Which is it? What should we be looking at, independent of the tariff negotiations, to understand where China's economy is headed next, and what it's going to mean for the rest of the world?

Louis: Tough one in a few minutes, but I'll give it a shot. To answer your point, is there a real estate bust? Is the Chinese economy booming? The answer is, it's actually both. Obviously, the Chinese economy is massive. It's the second biggest in the world. So, when you're that big, you could point to many different trends, and you can point to lots of contradictions, and you can prove whatever point you want to prove. For me, personally, the way to understand where you are today is you have to go back to 2018. In 2018, the US launched its semiconductor embargo against China. And to be honest, I think that the Chinese leadership essentially freaked out. They panicked. They thought, if they can embargo semiconductors today, tomorrow, it could be auto parts. It could be petrochemical products. Clearly, the US is trying to stifle our growth. They're trying to crush us, so we have no choice but to become independent, resilient, self-sufficient in every single industrial vertical. And so, in 2018, the order was given to the banks, normal loans to real estate, from now on, you only lend money to industry. And so, you saw a massive real estate bust, and if you picked up during that time, your Wall Street Journal, your FT, wherever you get your news, more often than not, if it was an article on China, it was about the unfolding real estate bust, which was very real. More than 70 property developers defaulted on their debt. Real estate prices went down by 30% in most big cities. It really constrained consumer spending, because a lot of people took big balance sheet hits, so on and so forth. But at the same time, money was pouring into industry. And I think, as everybody was running around saying, China's doomed, China's doomed, they forgot that bit, and now suddenly we wake up to a world in which China has leapfrogged the West in industry after industry. It's leapfrogged the West in auto production and in petrochemicals, and in power plants, turbines, industrial robots, you name it, China is now producing not only at a cheaper level than the West. That was always the case, but very often at a higher quality level, which I think is something that most western investors still have a hard time getting their head around, because it goes against all the prejudices that most people have about China, that it's just a low cost producer. But I think, you know, Jim Farley, the Ford CEO, gave a two page interview to the Wall Street Journal following his China visit back in September, where he stated very clearly that the challenge for

Ford and other Western producers, auto producers, was now to produce to the same quality levels as the Chinese, which is kind of a mind blowing statement when you think of it.

So, this goes back to your point, is it real estate implosion? Is it a booming economy? The answer is, it's both. Having said that, I think in the past 9-12 months, you started to see a paradigm shift in China, where, well, for 6, 7, 8 years, policy was all about, how do we cushion our economy against US attacks. Now that essentially the trade war is full on, the focus of policy has shifted to, okay, how do we stimulate our economy and get things going again for the man in the street? Because if seven years ago, the problem was the US embargo, now the new problem is collapsing marriage rates, collapsing birth rates, and essentially, millennials that are failing to launch because of lack of job prospects, because their balance sheet is being blown up. And so, if you look in 2018, China had 18 million births. Last year, China had 9.5 million births. So, you've had the birth rate effectively halved in less than a decade. This isn't an epic collapse. You've had epic collapses like this before, you had an epic collapse at the birth rate halved during the Great Leap Forward. But back then, people were literally starving. You had a collapse again, like that during the Cultural Revolution. But this is one that is happening without a massive crisis like Cultural Revolution and Great Leap Forward. And it's a real problem for the government, because if it continues to collapse, that means that in 20 years, 50 years, you really don't have much of a country. So, the policy focus is very, very visibly shifted, and the rhetoric you get from the government is now no longer, "let's cushion our economy against US attacks, but let's get consumption going again. Let's get birth rate going again." Now, on this, I think there's massive frustration amongst Western investors because they hear the government say, consumption is now our focus. And Western investors think, Oh, terrific. Great news, perfect. Let's get behind that. We like it. Then Western investors turn around and say, so, what are you doing about it? And the Chinese government says, we want consumption to go higher. Western investors say, yeah, sure, we heard you the first time. What are you doing about it? But I think the misperception here is, really, how policy happens in China. The way policy happens in China is that the central government points to a direction and then it's up to the local authorities and very often the banks, to do all the hard work and to get you there.

Take electric vehicles as an example. You know, six, seven years ago, Xi Jinping says we need to be number one in electric vehicles. Now, this doesn't mean that the Ministry of Industry wrote a huge subsidy check to BYD. Instead, it's meant that if I was the mayor of Shanghai or the provincial governor of Guangzhou or the party secretary in Zhejiang Province, I would pick up my phone and I would say, hey, Agricultural Bank of China or ICBC or whoever else, lend money to my local car producer, because he needs to transform himself into an EV producer. And before you know it, you got 130 EV makers in China. You have all competing with each other, and that means that for the end consumer, it's a good deal. They get cheap cars and better quality. And this is how policy happens in China. Was the same in 2008 when the government said, okay, you know what, there's a big slowdown globally, we're going to boost infrastructure spending. It was really up to the local authorities to load up their balance sheet with debt and fund local ports and local airports and local motorways and whatever else, and subways and all the infrastructure that happened. Then today, you're seeing the same thing, but you're seeing it on consumption. So, every municipality is now out there giving coupons to their

local consumers. You know, Wuhan is doing cash for clunkers. Guangdong is doing coupons to buy home appliances. Everybody tries different things. The end result is, does it work? Well, it's still pretty recent to say, but one of my favorite data points in China, one that we monitor carefully is all the tourism data. And we monitor it because you actually get really good numbers on train journeys and on airplane journeys and a number of hotel rooms booked, because all these things are official data and you get it pretty quickly. And here, the good news is, if you look at the latest, you know, Golden week around May Day holiday, so that the first week of May, you had a 6.9 increase, 6.9% increase in tourism spending, which came in better than expected. And, it's perhaps an indication that things are on demand. Tourism is one of these things that is highly discretionary. You know, you don't need to go do some tourism. You do it because you've got some money left over. So, I do think that the combination of real estate prices that are no longer falling, to be honest, the affordability ratio that has improved dramatically in China as mortgage rates have gone from six to three. As real estate prices have fallen, combination of all the vouchers they're receiving, combination of low energy, low food, you put all that into the brew and yeah, the consumer is starting to feel a little bit better in China after, frankly, a pretty hellish seven or eight years.

Erik: You talked about how Westerners and others around the world, for that matter, are going to have to get used to the idea that competing with China means competing with a high quality manufacturer. China has gotten really good at doing high quality, quality control, high precision manufacturing, things that we used to stereotypically think they were not good at, they've become very good at. I'm going to make the prediction that over the next 20 years, something else that they're going to be incredibly good at, on a relative basis, is energy policy. I think China is going to have a, just as they've enjoyed a much lower cost of labor in the past, they're going to enjoy a much lower cost of energy for manufacturing in the future, because they're just being smarter than the rest of the world is about their nuclear energy policy and about energy policy generally. If I'm right about that, the rest of the world is not going to just cheer and celebrate and say, oh, it's wonderful that China has been so successful with these things. They're going to say, it's unfair, it's not right. We should impose tariffs. We should do something. How would you see that playing out? What would the consequences be for the global economy if, as I predict, China is just set to have better energy economics than other countries in the future?

Louis: In some regions, we're kind of there already. Maybe not 100%, but you look at like during the summer months, a province like Shandong has put in so much solar power that in the summer months, during the daytime, you essentially get free electricity because they just have too much of it and they don't know what to do with it. So, we're not quite 100% there, but we will get there. Look, the reality is, all this as a country becomes as competitive as China, and today it is crazy competitive. You know, you have a trade surplus of 1.1, 1.2 trillion US dollars. Which to put things in perspective, the surplus of China, not China's trade, the surplus is roughly 4% of global trade, which is stupid. Like, that's so far out of whack relative to whatever we've seen through history. Logically, what should happen is, the currency should bear the brunt of that adjustment. You know, as China gets more and more competitive, whether because of the efficiencies that you get from massive supply chains, whether because of the low cost of

energy, whether because of the low cost of capital or the low cost of labor, it does seem that, most of China's input prices are lower than most other countries, which just comes down to the fact that the renminbi is just stupidly cheap. That's the big anomaly in our system. And I always tell everyone, you know, when people tell me, oh, the renminbi has got to devalue, I always say, when was the last time you were in China? Because if you've been in China in recent years, and especially since after the COVID reopening, I mean, you can't spend money if you try. Like, right now, you go to Beijing, you go to Shanghai, you can stay at the Four Seasons for, like 200 bucks. You know, our own office in Beijing is in Sanlitun, which is the sort of fancy neighborhood of Beijing. It's where all the embassies are, etc. And where we're sort of, our building is in a complex where there's the Intercontinental. So that's where I usually stay when I'm there. And last time I was there, my hotel room was like 90 US dollars at the Intercontinental. Now, try finding a room for 90 US dollars in any major Western city that's not a complete hovel. And even the hovels probably go for more than $90 at this point in cities like London or New York City.

So, the bottom line is, either the renminbi is going to have to go up, or, to your point, countries are going to impose tariffs on China to rebalance things, because things are too out of whack. And I, to be honest, that's my frustration with this whole trade war thing, is that I think there was an opportunity to put Japan, Korea, Taiwan, China, in a room. I think that's what Scott Bessent wanted to do. That's why he talked about the Mar-a-Lago Accords. I think there was an opportunity to put everybody in the room and say, guys, your currencies are way out of whack. Your currencies are way too undervalued. You have to bring them back up. And if you don't, we'll put on tariffs. But if you did, there's a nice way to do this and an evil, mean way to do this. Let's go for the nice way. And you know, it's the old story, you don't catch flies with vinegar. And I think, that opportunity that was there was sort of spoiled by the whole "we're going to use a formula from ChatGPT and punish everybody and their penguins." And so, it's a shame, because it's an opportunity, but that's where we eventually need to go. The renminbi needs to go up. The Asian currencies need to go up. Now, this may have started, you've seen the Taiwanese dollar move. You've seen the Korean won move, the ringgits, the Singdollar. The renminbi is now sort of pushing higher. And if that's the case, then where the next big trend for the markets will probably be an Asian triple merit scenario of rising exchange rate, falling real interest rates, which is a very powerful combo for asset prices. So, asset prices tend to go up. Maybe that's what we're starting in Asia. And if we are, then there's a lot to be optimistic about. But if we end up down the path of, "let's just punish China with a lot of tariffs," I'm not sure that will work. I'm not sure that'll do much good, because it'll always be countries out there that will be very happy to have a cheap Chinese car or a cheap Chinese nuclear power plant, or a cheap Chinese industrial robot. Most emerging market countries are very happy to have these things and are still doing these things. You know, Chinese exports for the month of April, we're up 8% year on year, with 20% year on year gains in India, 28% year on year gains in Indonesia. In those countries, China is essentially helping these countries industrialize on the cheap and on credit. And I don't think they'll stop because the US doesn't like it. So, hopefully, the good path would be for China to revalue. If it doesn't, we end up with a global economy that's completely out of whack.

Erik: Well, Louis, I can't thank you enough, as always, for a terrific interview. But before I let you go, please tell our listeners a little bit more about what you do at Gavekal, what services are on offer for institutional investors and where people can follow your work and the books that you've written.

Louis: Well, how much time do you have? Thanks a bunch for having me. The best place to find out about what we do is on our website. It's gavekal.com. We started off as an institutional, as a firm publishing research for institutional investors and that is still very much part of our DNA. We still publish a ton every day, and we moved into different directions, yes, and sorry, out of this publishing of research, we will write books every now and then, I'm probably overdue. My last one came out in 2021, so I'm probably overdue a book. I've got one in my head that I need to put on paper. I'm hoping to do this over the course of the summer. We also manage money for we have an asset management arm. We have a different Chinese fixed income strategy from, high yield to government bonds. We have a Latin American debt fixed income strategy. We have an Asian equity fund. So, we do different things on the fixed income front. And then finally, we have investments in two private wealth businesses, one based in the US and one based in Mauritius. So, if you go to our website, you can find all that information, and depending who you are and what you're looking for, hopefully the website is designed well enough that you can find it.

Erik: Patrick Ceresna and I will be back as MacroVoices continues right here at macrovoices.com.