

“The Donkey of Guizhou”

There were no donkeys in Guizhou until an eccentric took one there by boat; but finding no use for it he set it loose in the hills. A tiger who saw this monstrous-looking beast thought it must be divine. It first surveyed the donkey from under cover, then ventured a little nearer, still keeping a respectful distance.

One day the donkey brayed, and the tiger took flight and fled, for fear of being bitten. It was utterly terrified. But it came back for another look, and decided this creature was not so formidable after all. Then, growing used to the braying, it drew nearer, though it still dared not attack. Coming nearer still, it began to take liberties, shoving, jostling, and charging roughly, till the donkey lost its temper and kicked out.

“So that is all it can do!” thought the tiger, greatly pleased.

Then it leaped on the donkey and sank its teeth into it, severing its throat and devouring it before going on its way.

Poor donkey! Its size made it look powerful, and its bray made it sound redoubtable. Had it not shown all it could do, even the fierce tiger might not have dared to attack.

-- Liu Zongyuan (773-819 AD)

A quick email to follow up on last week's big note [“The Dude Abides: China in the Golden Age of Central Bankers.”](#) A number of readers asked if China's accumulation of physical gold played a significant role in China's current and forthcoming challenges to the Western monetary policy status quo. Absolutely! It has exactly the same *meaning* as the recently announced dollar-free natural gas trade agreement with Russia. It's a fang. It's a claw. It's a tool in the construction of an alternative monetary policy regime structure.

Gold has meaning to China in the same way that gold has meaning (or should have meaning) to Western investors. Not as an inherent store of value or some timeless monetary standard ... if you've gotten nothing else out of Epsilon Theory over the past year I hope it's a recognition that [there's nothing eternal or timeless about anything that the human animal does](#), particularly in social practices like trade or commerce ... but as a symbol of failed confidence in Western central bank control over market outcomes. To both investors and China, [gold is an insurance policy against Western central bankers losing control of their massive monetary policy experiment](#). The difference is that China has the power to do something about it.

What will China do and when will they do it? Other than pointing you to what China is already doing – weakening the renminbi, pushing against the dollar denomination of international trade in every possible venue, acquiring technology by any means necessary, claiming vast tracts of energy-rich territory – and suggesting that these behaviors will accelerate and expand ... I have no idea. But this is exactly why it's possible to find asymmetric risk/reward opportunities for trading on future Chinese-led challenges to the Narrative of Central Bank Omnipotence. If this were simply a matter of identifying the outcomes and odds of known policy initiatives, then we wouldn't be talking about the possibility of a Big Trade. Identifying that potential in an [environment of uncertainty as opposed to mere risk](#), whether it's a bet on gold or – my choice – a bet on the hard peg of the Hong Kong dollar and US dollar coming undone, is where game theory can really shine and what gets me up in the morning.

How should the US respond to the “shoving, jostling, and charging roughly” that the Chinese tiger is starting in the economic realm? Coolly, with no braying or kicking out in anger. So long as China perceives the US as another, larger tiger – as opposed to a donkey – this is not an inevitably apocalyptic Great Power confrontation. To switch metaphors from animals to poker, China will not put the US all-in unless it believes that it knows the cards everyone is holding. The careful use of intentional ambiguity is *extremely* useful in these situations, but [unfortunately that has not exactly been the US forte of late!](#) Understanding this sort of strategic interaction and communication [is what game theory is designed to do](#), and it's an analysis that I hope you'll look to [Epsilon Theory](#) to provide.

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