China’s tariff pain is likely to permeate April data ahead of trade talks

April is likely to be the month when the full impact of US tariffs on China’s economy begins to come into view. Key indicators to watch include trade and manufacturing, while consumption offers insight on whether domestic demand can pick up the slack

We think the US and China will come back to the table soon to negotiate on tariffs

China and US talks set to begin as test of endurance continues

After several weeks of jostling for a better negotiating position, China and the US are set to begin trade talks this week. Both China and the US had been waiting for the other party to make a first conciliatory move. In the end, it looks like some softening from both sides will allow for talks to begin. Given the high level of urgency, we think initial talks to de-escalate things could see relatively faster progress. But tariff levels are likely to remain high even if some early de-escalation is agreed upon, and the overall process will likely be lengthy and difficult.

Most encouraging, the start of dialogue should reduce risks of further escalation of frictions, which might have spilled over into non-tariff measures if the standoff worsened.

The negotiating process could take weeks or months, and high tariffs will continue to hurt both parties in the meantime. This is what we’ve characterised it as a test of endurance. So far, market reactions and strong public backlash have appeared to be Trump's key pain points. For China, we believe it's the health of the job market, which is key for economic stability.

Policy response has been restrained in the early stages

Despite the sharp escalation of tariffs, Chinese policymakers have refrained from splashy announcements. On top of prior commitments to boost domestic demand via the trade-in policy and the equipment renewal scheme, April's Politburo meeting emphasised supporting exporters. Other priorities include stabilising employment and increasing debt issuance to provide economic support.

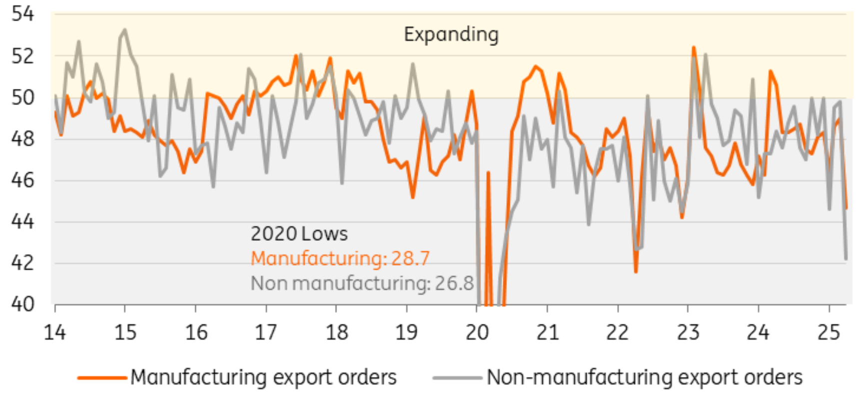
The People's Bank of China (PBoC) announced another monetary policy easing on 7 May, featuring a 10bp rate cut and 50bp reserve-requirement-ratio (RRR) cut. A host of supplementary measures were also announced, including steps to increase lending to boost consumption and the tech sector. These measures will help support the domestic economy.

Moving forward, we anticipate another 20bp of rate cuts and 50bp of RRR cuts this year, with the next move likely to come after the US Federal Reseve resumes its rate cuts.

First look at tariff impact suggests a noticeable hit, but no knockout blow

China's April purchasing managers' index (PMI) data was our first look at the tariff impact. As expected, the trade war sent the manufacturing PMI back into contraction. New export orders subindices in both the manufacturing and non-manufacturing PMI also took quite a blow. This is likely to translate to weaker real activity data out later this month.

Export demand has taken a hit after tariff spike



Source: CEIC, ING

We anticipate that April data will show the biggest hit yet to China's US-bound exports. US importers frontloaded imports in the first quarter and likely spent much of April in a wait-and-see mode, hoping for tariff de-escalation. If tariffs remain in place, inventories will eventually drop. Importers will be faced with a choice to either pay tariffs or cease operations. Estimates of when this may occur vary, but we should see clear signs in the coming months.

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