

China holds strong as trade war crescendos

With Donald Trump set to implement a 145% (and counting!) tariff and China ready to 'fight to the end,' tariffs have spiralled to the endgame, becoming a test of endurance. China will be relying on stimulating domestic demand to help offset the shock and achieve 'around 5%' growth again



China's President Xi Jinping at last month's National People's Congress in Beijing

Sharp tariff escalations quickly send Trade War 2.0 into full swing

President Trump shocked markets on 2 April with a stronger-than-anticipated "Liberation Day" tariff hike, which sparked a series of back-and-forth escalations and retaliations.

As of the time of writing, Chinese exports to the US are now subject to 145% tariffs, while US exports to China are subject to 125% tariffs. At these tariff levels, we expect the majority of trade with viable substitution products will effectively be phased out, leaving only products with no viable alternative suppliers. Further tariff escalations are more likely to hurt the importing country

at this point, and China has indicated that it would be ignoring further US tariff hikes. We have seen that China has indeed shifted toward non-tariff responses in tightening export controls and reducing Hollywood imports, and these sorts of non-tariff barriers could be the focus of any further escalation.

There are fears of a hard decoupling and an end to bilateral dialogue, but both sides have signalled that they are open to talk, only on their terms and from a position of strength. Our view is that this has become [a test of endurance](#). Whoever blinks first will likely come to the negotiating table in a weaker position. It's yet to be seen if the carveout of smartphones, computers, and semiconductor exports (which accounted for over a fifth of Chinese exports to the US in 2024) from the broad-based country tariffs will ultimately play out as "blinking first."

We expect talks to resume at the working level, though a top-level dialogue could remain elusive until a framework for a deal is broadly in place. A lack of clarity on what the Trump administration actually wants beyond narrowing the trade deficit and reshoring manufacturing acts as an impediment to negotiations.

As always, the tariff impact will be very difficult to gauge amid so many moving pieces. The faster-than-expected escalation, though, pushes the implications for growth toward the higher end of our 0.4-0.8pp range in terms of GDP impact. It's still uncertain how tariffs will affect the substitution effect for exports or China's own re-exports – a pause in tariffs on the rest of the world should keep re-export channels open at least through the second quarter. Early anecdotal reports indicate a sharp slowdown of orders and shipments, but official data could take another few weeks to trickle out.

Many Chinese exporters and US importers are likely in wait-and-see mode as well, given the front-loading of imports in previous months and the volatility of tariff news over the past several weeks. However, after inventories are cleaned out, a key question of who will ultimately bear the burden of the tariffs will be put to the test. As we saw in the first trade war, many Chinese exports to the US ended up quite sticky despite tariffs. There were no viable alternatives from other countries. The tariff hike to 145% will soon give us a conclusive look at just how much of trade ultimately cannot be substituted.

Policymakers signal confidence but have a huge task ahead of them

Chinese policymakers have been busy over the past month. The Two Sessions set this year's growth target at "around 5%" again, signalling confidence in growth stability despite tough external conditions. It also raised various fiscal targets, implying stronger policy support. Soon after, they announced a [special action plan](#) to boost consumption. President Xi said the government is intent on "fully unleashing" domestic demand. The early policy focus is on the equipment renewal scheme, as well as the trade-in policy to support domestic demand.

That workload isn't going to slacken any time soon; the People's Bank of China (PBoC) signalled it would further ease policy at a suitable time.

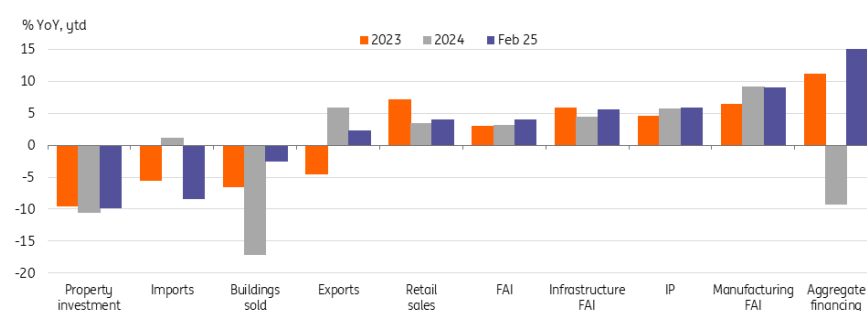
We think that the time has come and expect an interest rate cut and or a Reserve Requirement Ratio (RRR) reduction to be unveiled in the coming weeks. These moves could be bundled together to maximise the market impact of easing. Fiscal policy may take longer to roll out given the

complexities involved, but any early announcements on significant measures to shore up growth would be a welcome surprise.

We've also had hints of additional policy steps which are being held in reserve if necessary. A successful effort to revitalise domestic demand would support Chinese industry and also help fill some of the void in global trade.

As Trade War 2.0 erupts, policymakers have maintained calm for now. In the near term, maintaining market stability and supporting vulnerable exporters will likely be high on the agenda.

China's 5% growth objective will likely hinge on domestic demand



Source: CEIC, ING

Economy had been holding up well in 1Q but stronger headwinds are ahead

Surprisingly, a strong March brought export growth up to 5.8% year-on-year in the first quarter of the year, only down a hair from 5.9% in 2024. Assuming there is no quick reversal of tariffs, we expect the drag on exports to become more apparent in the second quarter.

We are revising downwards our 2025 GDP forecast by 0.2pp to 4.5%. We are also revising down our forecast for consumer price index (CPI) inflation to 0.0% (from 0.7%). This reflects heightened price competition and worsening overcapacity amid tariff shocks.

China's hard economic data from the first two months of the year generally beat cautious market expectations. Manufacturing and consumption both outperformed. Amid heightened uncertainties this year, trade-in policy beneficiaries – namely automobiles, home appliances, home renovation and decoration materials, and consumer electronics – will likely outperform.

Overall, the success or failure to achieve this year's growth objective will depend on the speed and effectiveness of China's policy response.

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