# China’s growth faces pressure from reflation and a narrowing trade surplus

China's economy appears to be absorbing the early impact of the Iran war, with inflation trending higher, strong export and import growth in the first quarter, and the CNY emerging as a surprising winner. That said, if the conflict drags on, boosting domestic demand will become increasingly important


Inflation is trending higher for shoppers like these in Beijing

## Iran war will give China’s reflation story a nudge in the right direction

China’s reflation story is picking up steam. After years of struggling with deflationary pressure, China’s inflation looks like it’ll be solidly in positive territory this year. PPI inflation returned to positive levels in March, the first time since 2022, while CPI inflation has stayed above 1% for two consecutive months. Upward price pressures will likely persist, as higher energy prices are already showing in the data.

The factors behind reflation are less encouraging; higher inflation stemming from energy and food prices isn’t the typical, healthy demand-driven inflation that central bankers tend to look for. However, it could be the push in the right direction needed to restore inflation expectations and avoid a deflationary spiral. With FAI hitting a record low last year and retail sales sluggish, restoring inflation expectations could encourage companies and households to open their wallets.

## Can the external demand story hold up another year?

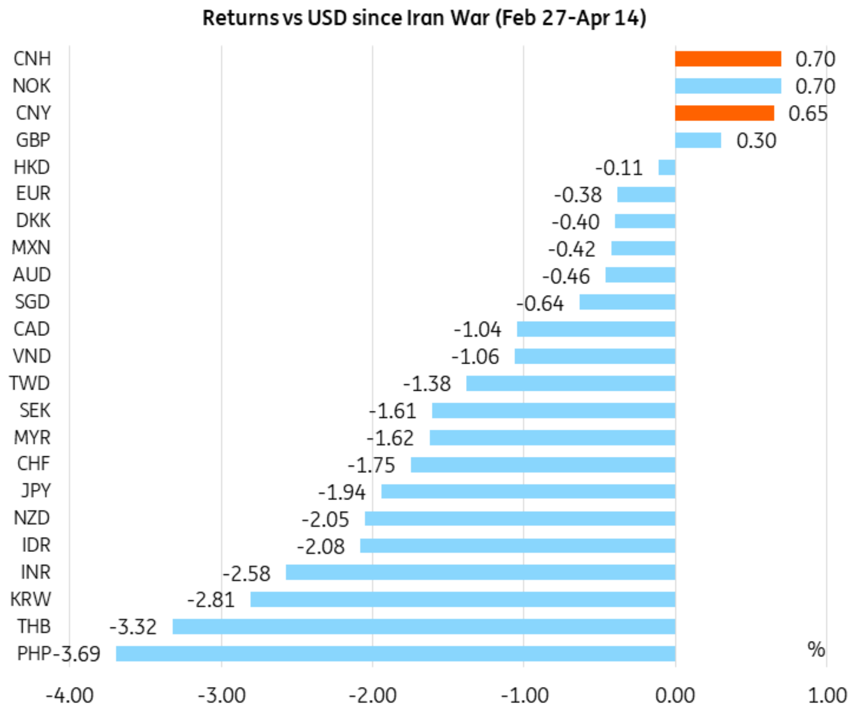
In the first quarter of the year, China's exports rose 14.7% YoY as strong demand from the rest of the world continued to offset the drag from the US.

However, the strong start to exports has been offset by an even sharper acceleration of imports, up 22.7% YoY in 1Q26. Higher tech product prices can be seen impacting both export and import growth. A stronger CNY may also be contributing to this.

In net, China's first quarter trade surplus of US$264.3bn is down -2.5% YoY compared to 1Q25. A smaller trade surplus may be welcome news for China's trade partners seeking a more balanced trade relationship, but it will come at the cost of this year's growth, which already looks to face more pressure from higher energy prices and the general reflation trend.

If the external demand driver begins to weaken, we'll likely need to see stimulus ramp up to keep growth on track this year.

## CNY has outperformed since the start of the Iran war




Source: Bloomberg, ING

## CNY emerges as a surprising outperformer post-Iran war

With all the focus on the negative impact of the Iran War on China's oil imports, the CNY stood out as a surprise winner. Amid the broader strong USD environment, the currency was one of the top performers.

This came despite widening US-China yield spreads. The main factor in the near term is likely the

People's Bank of China signalling tolerance for further appreciation after briefly pushing back on it before the Iran war. Sentiment may also have been buoyed by renewed talk of a potential “petroyuan” emergence after reports that Iran wished to collect tolls on passage through the Strait of Hormuz in CNY.

In any case, bullish sentiment on the CNY continued to prevail. We are adjusting our USD/CNY fluctuation band forecast to 6.70-7.05, down from 6.85-7.2, and risks are now broadly balanced to this forecast.

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