The path to avoid a more destructive US-China trade war is a narrow one

Donald Trump already has China in his sights as far as trade is concerned. There is some room for cooperation in the early days of China-US negotiations. But perhaps markets are overlooking the strength of China's response if it's pushed into a corner

Source: Shutterstock

Collision has been avoided... for now

Markets avoided what would've been a worst-case scenario for risk assets on Donald Trump's inauguration. The President indeed held back from enacting a national economic emergency and countrywide tariffs on China and the rest of the world. He also signed an executive order offering TikTok a 75-day grace period to continue operating in the US.

While this is welcome news for Chinese exporters ahead of the Lunar New Year, no one really thinks this will be the end of the story.

Our read on the first few days of Trump's term is that he indeed is operating in a transactional manner for now, seeking to leverage the threat of tariffs to obtain political victories and achieve other priorities. At the same time, a positive first call between Presidents Xi and Trump as well as various comments from Chinese officials indicate that China is also willing to expand cooperation.

This rational approach from both sides at the start of Trump's second term opens up the room for negotiations and avoids an immediate escalation of friction.

What does Trump want from China, and how have things changed since the first trade war? Is a collision course still inevitable, or is there room for cooperation?

These are key questions we're going to try to answer. We'll be looking at Trump's highlighted China priorities, examining the likelihood of both confrontation and cooperation in key categories. And let's not forget that the landscape in China has changed since the first trade war.

Phase One Trade Deal targets not met but it's all about the context

One of President Trump's first measures regarding US-China trade was directing an assessment of China's progress on the Phase One Trade Deal agreement.

As a refresher, the main terms of this agreement were for China to ramp up imports from the US by USD 200bn in the years 2020-2021, with 2017 used as a baseline. The targeted breakdown for increasing these imports was as follows:

- **Manufactured Goods:** USD 77.7 bn
- **Agricultural Products:** USD 32 bn
- **Energy Products:** USD 52.4 bn
- **Services:** USD 37.9 bn

The initial and obvious take on this is that it will be bad news for China on this front.

It should come as no surprise that China did not complete its targets in 2020-21. Our look at the headline and rough categories available from the US Census Bureau's data shows the following:

- **Total goods imports:** after falling in the trade war years and the pandemic outbreak year of 2020, China's total goods imports from the US were higher than in 2017 in each of the subsequent years.
- **Manufactured Goods:** imports fell USD 8.5bn and USD 0.1bn in 2020 and 2021 from 2017's baseline of USD 71.2bn.
- **Agricultural Products:** imports rose USD 5.6bn and USD 12.2bn in 2020 and 2021 from 2017's baseline of USD 19.3bn.
- **Energy Products:** imports rose USD 1.1bn and USD 6.9bn in 2020 and 2021 from 2017's baseline of USD 8.9bn.
- **Services:** imports fell USD 18.9bn and USD 2.4bn in 2020 and 2021 from 2017's baseline of USD 54.6bn.

The data will likely show that none of the purchase targets were met, and given the hawkish tone towards China, we expect to see this as the key takeaway for many. If Trump seeks to ramp up tariffs on China, the data will likely provide sufficient ammunition for him to do so.

However, context is important. Soon after the trade deal was signed on January 15th 2020, China was hit with the devastating Covid-19 pandemic, which upended the global economy, and the supply chain disruptions, as well as competing demands on resources, certainly threw off China's ability to ramp up its imports as agreed upon. Biden's election victory in 2020 also threw a wrench in the agreement as it was unclear whether or not these deals struck under Trump's administration still held any weight.

As a result, we think it is also worth monitoring how China's imports evolved after the pandemic-skewed years.

- Total imports of both goods and services began to recover in 2022.
- Manufactured goods imports have been lower than 2017 levels in every year from 2018 onward.
- Agricultural product imports have been higher than 2017 levels every single year since the Phase One Trade Deal was reached and was closest to completing the purchase targets.
- Energy product imports have also been higher than in 2017 levels every year since the Phase One Trade Deal.
- Services imports fell sharply during the toughest anti-pandemic measures in 2020 and 2021 but began recovering in 2022 and 2023.

What does this combination of data tell us?

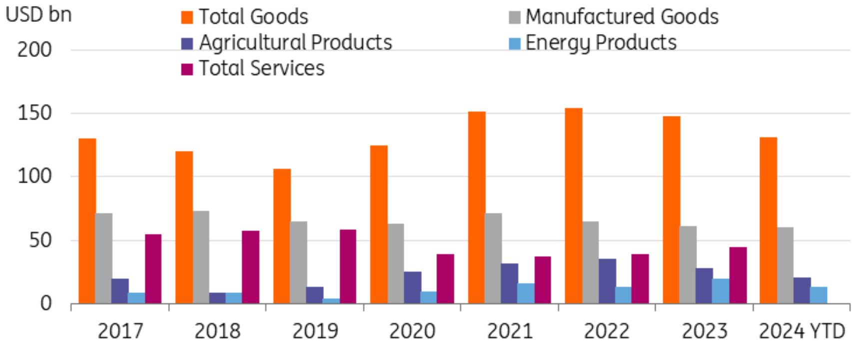
- Although the targets have not been reached, at least some progress has been made in three of the four categories.
- It is clear that the drop in manufactured goods imports is the main outlier. Why did this category drop so much? It is likely that, at least in part, this is due to the de-risking of supply chains. We saw the Biden administration begin implementing export controls blocking the export of semiconductors and semiconductor manufacturing equipment, among other hi-tech exports to China, starting in 2022 and further tightening these controls multiple times in subsequent years. These restrictions also impacted China's imports of US-manufactured products.

The question is, how much of the shortfall in terms of purchase targets will be attributed to China intentionally not living up to the agreement, and how much can be justified via extenuating circumstances and China's slowdown?

Will the backdrop behind the import performance and the progress seen in 2023 and 2024 be sufficient to renew the original agreement?

There is no easy answer to this, as there will likely be a great deal of subjectivity in the final judgment. It's possible that the US and China could resume this agreement. However, considering the data in a vacuum and adding the fact that many of Trump's cabinet are China hawks, this investigation feels likelier to set the stage for further tariffs ahead.

China has not met purchase targets but has ramped up imports of agriculture, energy, and services



Sources: CEIC, ING

Fentanyl crisis on paper seems like an easy area for cooperation

Trump has repeatedly mentioned the fentanyl crisis as one of his early priorities. After his inauguration, he noted that in addition to 25% tariffs on Mexico and Canada, China could also be subject to 10% tariffs for its alleged role as a provider of chemicals to those countries.

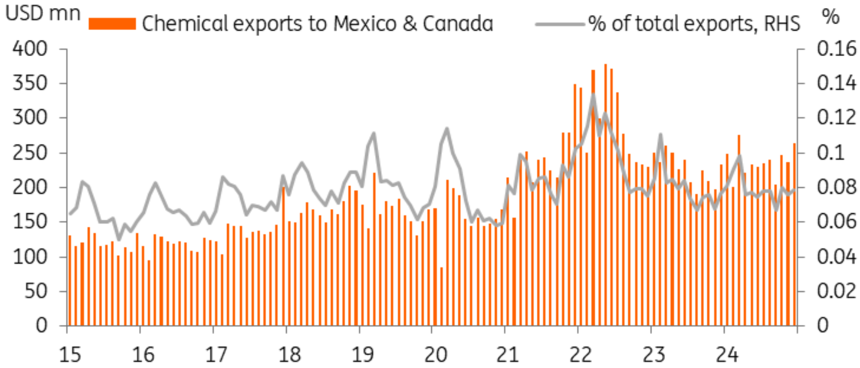
Room for cooperation

This is an area where there should be room for cooperation. First, looking at China's customs data, chemical exports to Mexico and Canada accounted for just USD 2.8bn in 2024, which is not even 0.1% of China's total exports. While a further detailed breakdown is unavailable, it stands to reason that export controls on fentanyl precursor chemicals to Mexico and Canada would have a negligible impact on China's economy.

Exports to the US, on the other hand, accounted for 14.6% of China's total exports in 2024; from a purely transactional perspective, it seems to make sense to restrict chemical exports to Mexico and Canada if that was a sufficient condition to avoid tariffs.

Chemical exports aside, Trump also expressed a desire for a stronger crackdown on drug dealers, which also should not be a major impediment.

China's chemical exports to Mexico and Canada are minimal



Sources: CEIC, ING

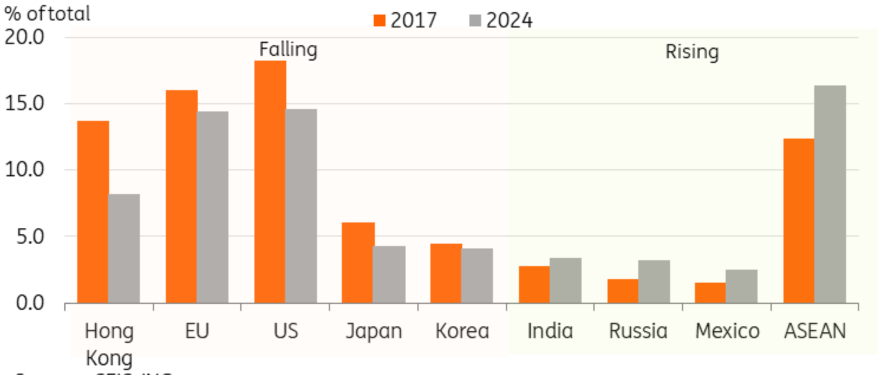
Could TikTok set the tone for US-China ties?

The TikTok saga has been ongoing for some time and could be approaching its final stages in the coming weeks.

Some market participants have speculated that China had been ready to approve a TikTok sale, but after Trump's high-profile involvement, there are now some concerns about optics and the precedent this could set for future companies. Others view Trump's involvement as positive and feel facilitating a TikTok sale sets up a path to further cooperation.

With a 75-day moratorium on TikTok's ban, how this ongoing discussion unfolds will likely play a role in how US-China relations progress this time around and could even impact the tariff picture as well. This sets up early April as a potentially important time window to watch if negotiations do not proceed smoothly.

China is less reliant on the US as an export destination



Sources: CEIC, ING

"China de-risking" works both ways

The world has changed a lot since the first trade war broke out in 2018. We have heard a lot about "China de-risking" in the US and Europe, and the lasting impact of tariffs and the pandemic has led to some permanent changes along global supply chains.

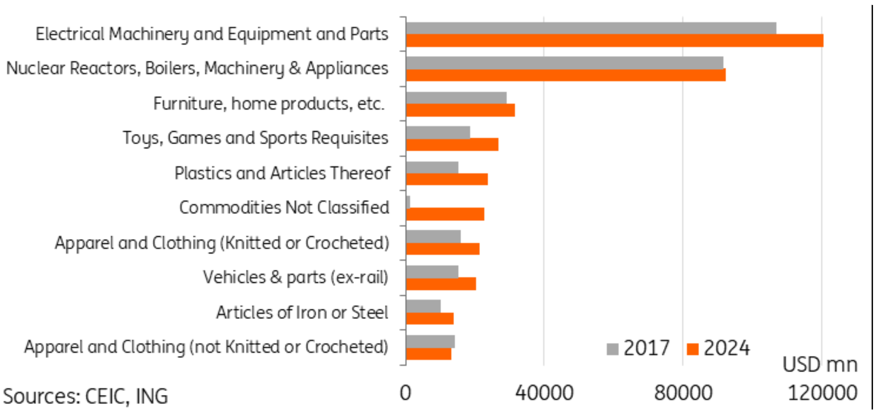
A less discussed angle is how these moves have impacted China. The first US-China trade war caught many economists by surprise, as most had been locked in a pro-globalisation mindset and one that the interconnectedness of the US and Chinese economies made such a prospect a double-edged sword and thus unpalatable. Many companies dismissed the threat and were caught unprepared when tariffs came into play and when export controls came into effect, with many still heavily reliant on US customers or suppliers. As a result, it could be argued that China's response to the first trade war was relatively measured.

China has improved its technological self-sufficiency

Since then, China has taken numerous steps to improve its technological self-sufficiency. While its proportion of exports to the US is still significant, it has also fallen from 18.2% in 2017 to 14.6% in 2025. Many of China's lower-end exports to the US have fallen, with categories such as footwear, leather, and non-knitted or crocheted apparel now below 2017's levels. However, most categories have seen exports rise since 2017, and many areas have no obvious substitute.

While China clearly would prefer to avoid trade conflicts, especially given recent economic sentiment, this decreased reliance on the US market and US suppliers does open up the possibility for more aggressive retaliation (such as export controls or more targeted tariffs on large US multinationals) from China if it is pushed into a corner, a risk that is probably a little overlooked by many in markets who may be expecting a 60% tariff on China with little real retaliation.

China's top exports to the US



Sources: CEIC, ING

China appears ready to ramp up imports and open up market access

On the other hand, it can easily be argued that China in 2025 may be more open to addressing some of the long-standing Western criticisms regarding its trade surplus and restrictions on market access.

2024's growth breakdown in China showed the importance of external demand to growth, with China reaching a record USD 992bn trade surplus in 2024. The boost from external demand also supported a stronger-than-expected growth of industrial activity throughout the year and helped China achieve its growth target despite disappointing investment and consumption activity domestically. It stands to reason that China would like to keep this external demand engine running as long as possible.

China may wish to expand imports

An important sign is that China has signalled a willingness to expand imports moving forward.

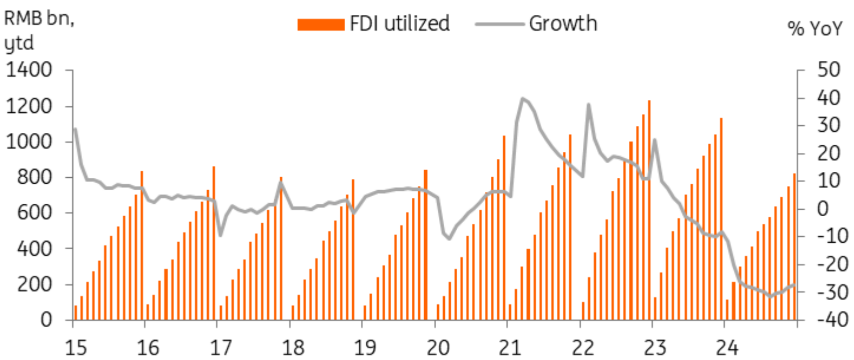
China's Vice Premier, Ding Xuexiang, mentioned at the Davos forum that China intended to expand its imports to promote more balanced trade. While sceptics may question whether these comments are lipservice or genuine, there is an economic case for ramping up imports; as China gradually transitions its economy toward a consumption-driven one, increasing imports could help expand the range and quality of consumer offerings and be a win-win for China and its trade partners.

In addition to expanding China's imports, the Vice Premier also discussed opening up China's market for foreign investment, which has actually been an ongoing process.

The most prominent step to pare back or remove restrictions on foreign investment was a 2023 piece entitled "Opinions on Further Optimizing the Foreign Investment Environment and Intensifying Efforts to Attract Foreign Investment." This piece set out 24 measures to improve the attractiveness for foreign investors, including reducing the "negative list" of sectors where foreign investment is restricted or banned.

With China's utilised FDI slumping by 27% YoY in 2024 and sentiment still downbeat, it could be a good window for China to take steps to try to attract foreign investment to return while, at the same time, addressing past criticisms.

China's FDI slump may also increase willingness to open up markets for foreign investment



Sources: China Ministry of Commerce, ING

Tariffs will be hard to avert but there's still a way to avoid a trade war

Early signs are that Trump will start off his second term with a transactional tariff stance, where tariffs are used as a bargaining tool to achieve various other objectives, rather than an ideologically driven stance, where tariffs are put into place without much discussion or negotiation with trade partners. China's stance has been relatively clear for months, in that it hoped for cooperation but would resolutely defend its interests if necessary.

We see some room for cooperation as far as Trump's early priorities go. Avoiding the worst-case scenario of an immediate 60% tariff hike and the subsequent retaliation from China at least ends the Year of the Dragon on a relatively positive note, though the coming weeks will no doubt feature high-stakes negotiations, and much could go wrong along what is almost certainly going to be difficult path ahead.

Given the prominent role of tariffs in Trump's economic philosophy, shown by his announcement of the creation of an External Revenue Service and by the repeated mentions of tariffs as a method of "taxing foreign countries to benefit the US," it remains unlikely that China will be able to avoid new tariffs altogether, especially considering the China hawks within Trump's cabinet. There is, however, a big difference between 60% country-wide tariffs and a full-on trade war and relatively more measured and targeted tariffs.

There are grounds for very cautious optimism given China's recent communications on expanding imports and opening up for foreign investment. At this point, Presidents Xi and Trump should have ample experience with each other and knowledge of their priorities and bottom lines. Trump's Art of the Deal called for thinking big, protecting against the downside, and keeping multiple options open; only time will tell if the US and China will find a smoother path forward.

Author

Lynn Song
Chief Economist, Greater China
lynn.song@asia.ing.com