03 April 2025

Research China

Trump's tariff hammer to hit Chinese growth, stocks and CNY lower

What a 'Liberation Day'. Trump's tariff announcement was clearly harsher than expected and not least China felt the heat. Below I try to answer five key questions but obviously a lot of uncertainty has emerged and more questions than answers are flying in the air.

How high will tariffs on China go?

There is some confusion over this. Before the announcement yesterday, Chinese tariffs were above 30% coming from the 20% increase related to Fentanyl in the past two months and the more than 10% tariff in place before Donald Trump took over as US President again. The reciprocal rate *announced* yesterday is described as "*an additional ad valorem duty"* so comes on top of existing rates. With the reciprocal rate for China set at 34% it lifts the rate to above 64%. On top of this a removal of the so-called 'de minimis' exemption for tariffs on packages below USD800 will add further to this rate. **So, China could be facing 65-70% US tariffs on average**. A lot of different numbers are floating around as it is not totally clear how much of the different tariffs are on top of each other. So, you may see numbers from anything between 54% and above 70%.

How will this affect the economic outlook for China?

Regardless of what the true average rate becomes, there is little **doubt it will be a quite big blow to China's economy in the short term** coming from different channels:

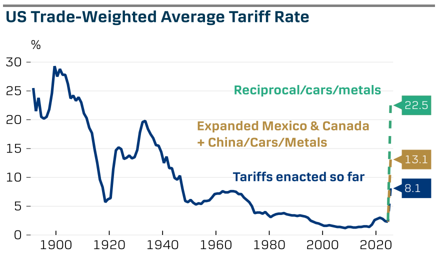
- **First, exports will obviously take a hit**. The tariffs work as a sharp fiscal tightening in the US, which will hit consumption growth and investments. When it comes to Chinese competitiveness, it is a mitigating factor that other low-cost countries in Asia are also hit with high tariffs (Vietnam for example 49%). But that also means that *their* economies will be hurt and thus their imports from China weaken. The rest of the world, such as Europe, will likely also see weaker growth and imports.
- **Second, investments are likely to be affected** as exporters are set to put some investments on hold due to weaker demand expectations. The sheer rise in uncertainty will add to this. There is a risk of even further escalation when China retaliates and although US and China may eventually make a deal, it could take a long time.
- **Third, private consumption growth could see a new set-back** due to more uncertainty over unemployment and weaker sentiment potentially spilling into housing.

Next week I will be in China where I will put the ear to the ground and talk to companies, officials, analysts and friends to get a temperature check of the economy, the latest on tech – and not least reactions to the sharp escalation of the trade war. I will also give presentations in the DCCC in Beijing (Monday) and Shanghai (Thursday) so feel free to join if you happen to be there, link to events here. The focus will be on the outlook for Chinese consumption.

Stocks continue correction after US tariff hit

Source: Macrobond Financial, Bloomberg.
Note: Past performance is not a reliable indicator of current or future results.

US tariffs to get higher than in 1930's



Source: Macrobond Financial, Yale Budget Lab, Danske Bank

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No doubt, China will increase stimulus on the back of the surprisingly big tariff hike and policy makers probably feel a sense of urgency to limit the negative sentiment effect as much as possible. PBOC is now likely to cut rates soon. Still the net effect is likely to be weaker growth this year than our current baseline of 4.7%. When I'm back from my China trip I will take a closer look at this, but a preliminary estimate would be shaving off ½% points with the biggest impact in Q2 and Q3.

How will China respond?

In line with previous responses, China's foreign ministry spokesperson stated that China opposes the US reciprocal tariffs and will "*resolutely adopt countermeasures to safeguard its rights and interests*". Judging from the first two rounds of US tariff hikes this year, China will announce the retaliation when US tariffs take effect, which is on 5 April (at least the first 10%). **China also tends to hit back with more targeted tariffs on much fewer goods relative to the US but they may add other measures** such as putting more US companies on the foreign entity list and potentially adding more restrictions on exports of critical minerals. China will aim not to escalate, which is why we tend to see a milder punch back than the one they receive. The tariffs also sharpen their focus on doing their own home work in making reforms and stimulate domestic demand. It is doubtful that we will have a meeting between Xi and Trump anytime soon as sharp escalation by Trump will sour the mood between the two nations for a while and China does not want to be bullied into negotiations.

Will the Chinese start to boycott American goods? I think that is indeed a risk that is getting bigger and which could start to hurt US companies as well. A larger part of young Chinese have become more nationalistic in recent years and buying Chinese would be a way to support the country when under 'economic attack' by the US.

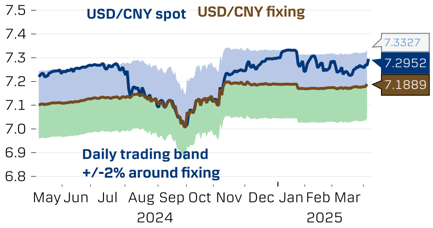
Where does it all end?

This is the big question. It can go in many directions from here. One possible scenario is further escalation and then eventually negotiations. But the Trump team will be busy negotiating with many countries at the same time, which is likely to drag out the process. **Our baseline scenario has been that US tariffs on China would eventually end at around 40% by mid-2026. I still see this as a likely scenario** as a deal could be struck by then that involves China buying more US goods and Trump lowering tariff rates again from current elevated levels. Ahead of mid-term elections in 2026, Trump is going to want some improvement in the domestic economic situation as well as easing concerns from unhappy farmers whose votes are important for the Republicans to keep the majority in both the House and the Senate. **China knows his hand in this poker game will weaken as time passes** and are unlikely to bow to his bullying strategy. China's economy will of course also be challenged but policy makers can be more patient as they don't face election and can put blame for new economic pain on Trump.

What are the market implications?

Stocks lower: After a good run, Chinese stocks corrected lower as we got closer to 2 April. After the news yesterday, stocks dropped further by 1.3%. Given the risks to the global economy as well as the Chinese, this is actually a moderate decline and there is a clear risk, in my view, that equities decline further from here. Eventually, China could come out stronger because Trump's aggressive trade war adds a lot of pressure on China to push through implementation of reforms and stimulus to the domestic economy. As well as an even sharper focus on technology and innovation. In the long run, I thus still see value in the Chinese stock market.

USD/CNY weakening, fixing moved slightly higher



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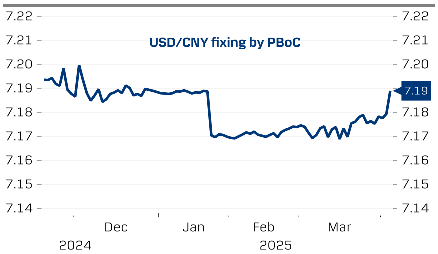
Close-up on USD/CNY fixing



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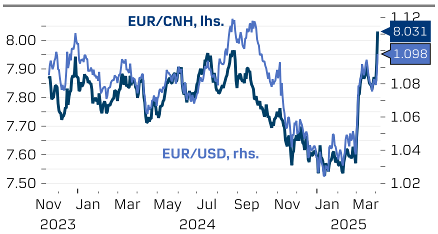
EUR/CNH continue higher



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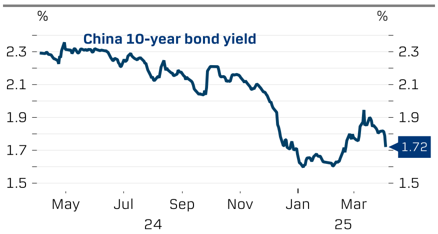
Bond yields lower as tariffs dent optimism



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CNY weaker: USD/CNY jumped higher to above 7.30 from below 7.27 after the tariff announcement and this was despite an overall weakening of the USD, which normally would push USD/CNY lower. Interestingly, PBOC today moved the daily fixing a bit higher from 7.1793 to 7.1889, which was the biggest rise since December. PBOC has kept it broadly flat for a long time and communicated a preference for stability. But with the increase in the fixing today they signal a willingness to let the USD/CNY move gradually higher. This would make sense to at least partly compensate for the higher tariff rate. They are unlikely to devalue and change the fixing a lot but there is a rising likelihood we see them let it move gradually higher from here paving way for an increase in spot USD/CNY as well. I see more upside risk to the cross in the short term and to our 12M forecast of 7.30, which was based on less aggressive tariff hikes by Trump.

The rise in EUR/USD topped up with a rise in USD/CNY has led to a further increase in EUR/CNY as well – and more than normally expected from the sheer move in EUR/USD (see chart of EUR/CNH on page 2). The risk is skewed towards a further rise in this cross and hedging CNY income is a good idea in my view

Bond yields lower: As expected the tariff surprise has fuelled new expectations of a rate cut soon and pushed bond yields lower again with the 10-year yield falling to 1.73% moving closer to the recent bottom of 1.60%. Downward pressure is here to stay in the short term.

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