CHINA

FIRST EFFECTS OF THE TRADE WAR

The sharp increase in US tariffs on Chinese imports is a major blow to Chinese exports and economic growth. However, Beijing has prepared for this, and the impact will be partially offset by its response strategy. In the short term, this strategy consists of redirecting exports to other markets, continuing monetary and fiscal policy easing, and boosting private consumption. The redeployment of exports has begun, but it could quickly run into new protectionist barriers. Domestically, the challenge will be to restore household confidence while the labour market may suffer as a result of the slowdown in the manufacturing sector.

ECONOMIC GROWTH SLOWDOWN

Chinese economic growth stood at +5.4% year-on-year (y/y) in Q1 2025, unchanged from the previous quarter. After a stronger-than-expected start to the year, growth is expected to slow over the next three quarters. In our central scenario, it would reach 4.8% for 2025 as a whole: we are expecting a moderate growth slowdown despite the protectionist shock. The impact of this shock on exports and the manufacturing sector will be significant, but it will be partially offset by the positive effects of China's response. It should be noted that the authorities have set an economic growth target of 5% for 2025. The risks to our forecast are clearly on the downside.

Washington's declaration of a trade war on China since President Trump took office on 20 January 2025 has interrupted the momentum of growth recovery observed since last autumn. On the one hand, growth in goods exports slowed – less than expected – over the last two months. Measured in current dollars, exports rose by +8% y/y in April and +4.8% in May (after +5.1% in Q1 2025 and +10% in Q4 2024). They were first supported by intense activity among US importers in anticipation of tariff increases, and then by the beginning of a shift in Chinese goods flows toward third markets (*see below*). Exports are expected to continue slowing in the short term.

On the other hand, private-sector domestic demand lost the momentum that it had gained since the end of September 2024. The strengthening of retail sales in Q4 2024 and Q1 2025, mainly due to the government-subsidised consumer goods replacement programme, is fragile; it stalled in April before picking up again in May. Meanwhile, housing sales have not picked up despite the authorities' stimulus measures; they have continued to contract, albeit at a more moderate pace (-3.2% y/y in the first five months of 2025, after -14.1% in 2024). Indeed, households remain very cautious, against a backdrop of deflation, prospects of a slowdown in the manufacturing sector and, consequently, a deterioration in the labour market. In the first five months of 2025, the unemployment rate improved slightly (5.0% in May), but the weekly average number of hours worked fell slightly, while wage growth had already slowed sharply in 2024 (the average urban wage rose by +2.8% in 2024, after +5.8% in 2023).

Total investment growth began to slow slightly in April (reaching +3.7% y/y in value terms in the first five months of 2025), due to the slowdown in manufacturing investment (+8.5%) and the continued decline in real estate investment (-10.7%). On the other hand, infrastructure investment has strengthened since the beginning of the year (+5.6%).

Therefore, while the direct effects of the US tariff increases on exports are beginning to emerge, their spillover effects on other components of growth are already noticeable.

FORECASTS

	2022	2023	2024	2025e	2026e
Real GDP growth, %	3.1	5.4	5.0	4.8	4.5
Inflation, CPI, year average, %	2.0	0.2	0.2	0.0	1.0
Official budget balance / GDP, %	-2.7	-3.8	-3.0	-4.0	-3.8
Official general government debt / GDP, %	49.4	54.7	61.0	66.7	71.4
Current account balance / GDP, %	2.4	1.4	2.3	1.8	1.5
External debt / GDP, %	13.4	13.4	12.9	12.5	12.0
Forex reserves, USD bn	3 307	3 450	3 456	3 451	3 442
Forex reserves, in months of imports	12.6	13.3	12.7	12.7	12.0

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

DEFLATION

Deflationary pressures persist. They have been fuelled by excess production capacity, weak demand, falling house prices, slower wage growth and lower commodity prices. Consumer price inflation (CPI) remained slightly negative in the first five months of 2025 (-0.1% y/y). Core inflation has remained close to +0.5% since March, but food prices have been falling since December (-0.4% y/y in May) and fuel prices have been dropping since last summer (-12.9% in May). Producer prices have been falling continuously since Q4 2022 (-3.3% in May).

In the short term, the expected recovery in private consumption is likely to be moderate, the real estate market is expected to stabilise at best and the slowdown in goods exports will exacerbate production overcapacity. Therefore, we forecast zero CPI growth in 2025, compared with +0.2% in 2024. Deflationary pressures are weighing on nominal GDP growth (which remained below real growth in 2023-2024). They are damaging the financial health of enterprises, complicating monetary policy management and weighing on domestic demand.

CONTINUED MONETARY AND FISCAL POLICY EASING

The authorities have accelerated the easing of their fiscal and monetary policies in recent months and they have prepared to ease them further in the course of the year.

On the monetary front, the latest decisions date from May[1]. In addition, the large state-owned banks have received capital injections to strengthen their capacity to increase lending. However, for the time being, the monetary policy easing and loosening of the prudential rules for mortgage lending and house purchases has had very limited effects.

1 Lower reserve requirement ratios (-50 bp to 9% for large banks); 10 bp cut in policy rates; increase in bank refinancing facilities to encourage lending to targeted sectors (agricultural enterprises, SMEs, innovation, elderly care and other services); and strengthening of support measures for equity markets.

This is due to weak private-sector credit demand, banks' caution and the solvency or liquidity problems that real estate developers are still facing. In 2025, bank loan growth has continued to slow (+7% y/y in nominal terms in May) and housing loans have continued to contract slightly. Meanwhile, total financing to the economy has grown slightly faster (up 8.7% in May), driven by Treasury and local government bond issuance.

Therefore, the authorities will need to lower interest rates more significantly and/or strengthen fiscal stimulus measures. In fact, fiscal policy has taken a decidedly accommodative turn. The official budget deficit target has been set at 4% of GDP for 2025, the highest level in 30 years. In addition, measures have been implemented over the past few months to strengthen local government finances. These remain fragile but have nevertheless gained some leeway. Furthermore, the central government is expected to increase its role in support plans. Finally, the acceleration of government bond issuance since the beginning of the year reflects the increased stimulus efforts.

Increased public investment (particularly in strategic sectors and infrastructure projects), support for exporters weakened by US tariffs and a boost to private consumption are key objectives of the fiscal strategy for 2025. Strengthening private consumption in a durable manner requires the authorities to accelerate structural reforms aimed at improving the social protection system and reducing household savings[2]. In the short term, they will need to step up support measures to offset the effects of the slowdown in the manufacturing sector and revive the real estate market. Announcements are expected during the summer. Measures directly targeting incomes would be particularly welcome in order to reassure households.

RAPID REORIENTATION OF CHINESE EXPORTS

Following the announcements on "Liberation Day" on 2 April, escalating tensions between Washington and Beijing led to reciprocal tariffs reaching unprecedented levels within a few days (US tariffs on Chinese goods at 145%, Chinese tariffs on US goods at 125%). The start of negotiations then reduced the new tariffs to 10% on both sides as of 12 May. In addition to the US tariff of 10%, there is the 20% already applied to China by the Trump administration (the recent cancellation of which by the US International Trade Court is currently suspended).

As a result, the effective tariff rate (weighted average) applied by the US on Chinese imports rose from 10.7% at the end of 2024 (a 20% tariff was applied on nearly 60% of imports from China) to 34.2% in mid-June (+23.5 pp). This figure takes into account all exemptions and sector-specific measures (50% on steel and exemptions for pharmaceuticals, electronics and semiconductors).

Negotiations between Washington and Beijing have resumed but remain difficult to predict. The effective US tariff could rise again in the event of a disagreement or new sectoral tariffs. It would exceed 40% if 25% tariffs were introduced on semiconductors and electronic products (which account for around 20% of Chinese exports to the US). Our central scenario assumes that the effective tariff will remain at its current level in 2025.

Chinese exports to the US accounted for 14.6% of total exports in 2024, or only 2.6% of GDP. Assuming export price elasticity of -1, the loss of activity due to higher tariffs is estimated at 0.6 percentage points of GDP.

CHINA: GROWTH IN EXPORTS BY DESTINATION

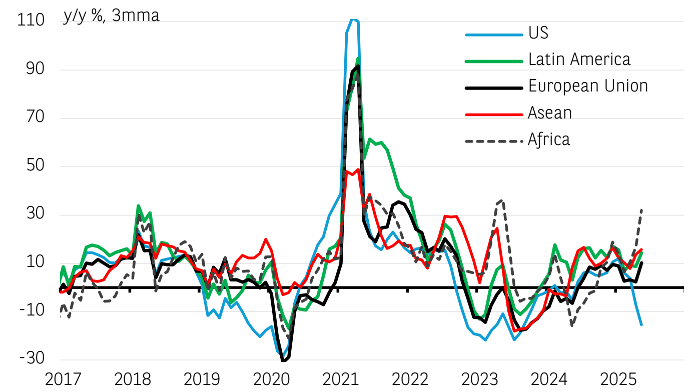

CHART 1 SOURCE: GENERAL ADMINISTRATION OF CUSTOMS, BNP PARIBAS

This direct impact excludes the indirect negative effects linked to the global economic slowdown and the positive effects of monetary and fiscal easing and China's strategies to offset the decline in its exports to the United States.

China will continue to reorganise its production chains in the coming years. In the short term, the reorientation of trade flows towards third countries will help to offset losses on the US market. Since April, the decline in exports to the US (-27.8% y/y on average in April-May) has been offset by a sharp increase in sales to the rest of the world (European Union: +10.2% y/y on average in April-May; ASEAN: +17.8%; Africa: +29.3%; Canada: +17.7%; and Latin America: +9.8%). This shows how quickly Chinese companies can redirect their exports (*see chart*).

This reorientation will continue, but it could become increasingly complex. First, it could be constrained by Beijing's efforts to develop its trade relations with its Asian and European partners. At the same time, countries facing increased competitive pressure from China could raise protectionist barriers. Then, Chinese exporters could find it increasingly difficult to lower their prices in order to gain market share. The evolution of the yuan will be decisive. After the depreciation episode in early April, the yuan appreciated against the US dollar and has remained fairly stable in recent days (the CNY/USD spot rate gained just over 1% between 1 April and 18 June). Its short-term evolution will depend in part on the outcome of negotiations with Washington. In real effective terms, the yuan depreciated by nearly 5% in March-April, which greatly helped Chinese exports to markets outside the US.

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2 See BNP Paribas EcoWeek (24 March 2025): China in 2025: temporary adjustment or structural rebalancing of economic growth drivers?