Global Macro Research

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China strikes back

China's retaliation to US tariffs was restrained but sets out a 'playbook' for how it could hit back more forcefully. We think China will find it difficult to offer concessions to remove the latest 10% increase, and in fact tariffs are likely to rise further. Additional easing will help to mitigate much, but not all, the damage to the economy.

Key Takeaways

- The initial good news that President Trump did not announce tariffs on China immediately didn't last long.
- Additional 10% tariffs and an end to de minimis exemptions – which allowed low-value items to be imported without any duty – went into effect after three weeks. The equivalent rise in the average bilateral tariff rate during the first trade war took over a year.
- The focus on fentanyl as a justification for tariffs makes any rollback unlikely. China will struggle to deliver strong political optics, such as Mexico's 10,000 troops on the border, while House Bill 747 – the 'Stop Chinese Fentanyl Act' – could spark sanctions on Chinese producers.
- Moreover, the US trade review will almost certainly conclude that China did not live up to the 'Phase 1' deal and that non-tariff barriers to trade, such as subsidies, remain high, leading to further tariff increases. While these could be used to create leverage to force through a new trade deal, another plan for China to purchase more US goods may struggle with credibility. All told, we continue to expect a large and lasting increase in US-China tariffs.
- There are few indicators of economic activity available at the moment – as is typical following the Lunar New Year. But abrdn's China Financial Conditions Index continues to suggest that recent easing will support 2025 growth.
- More support will be needed to mitigate the trade war impact, and our best guess is that around 1% is knocked off Chinese GDP, limiting 2025 growth to 4.6% and potentially pushing 2026 GDP growth down to 4.1%.

No reprieve

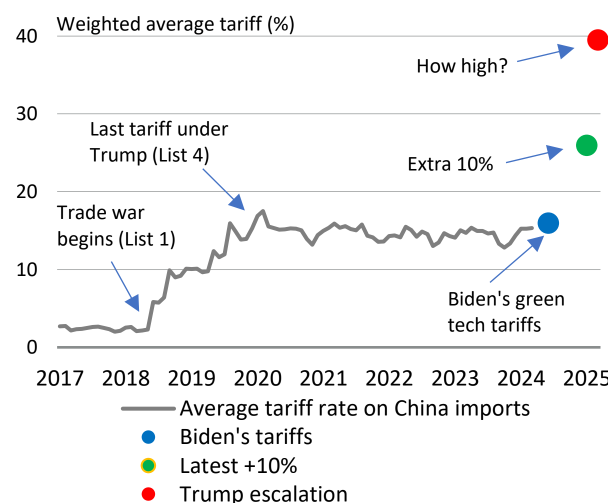
While Mexico and Canada managed to avoid US tariffs – helped by last minute phone calls – China did not.

Across-the-board 10% tariffs have gone into effect, while the end to *de minimis* duty free imports will be put into place soon, after US customs work out the practicalities.

While this tariff hike is, for now, smaller than the 60% President Donald Trump threatened on the campaign trail, it is striking in several regards.

First, it took over a year for the average bilateral tariff rate on US imports of Chinese goods to rise by 10 percentage points during the first trade war (see Figure 1).

Figure 1: Is +10% just the start?



Source: U.S. Census Bureau, USTR, WITS, abrdn, February 2025

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Second, the implementation of across-the-board tariffs suggests no inclination on the US' part to lessen the hit to consumers. This could have been achieved by pursuing a more targeted approach focused on intermediate products, which would have likely been partly absorbed across the supply chain.

Third, the addition of tariffs for security, as they have been framed by some members of the administration – for example those targeting fentanyl – could result in tariffs settling at a higher rate than we anticipate. For now, we judge these tariffs are a stepping-stone towards our base case for US-China average bilateral tariffs to increase to 40%. But there remains a risk they go higher still, particularly if the Commerce Department focuses on non-tariff barriers such as government subsidies and currency manipulation.

China's retaliation was measured, setting out a 'playbook' for where it can do more damage if pushed

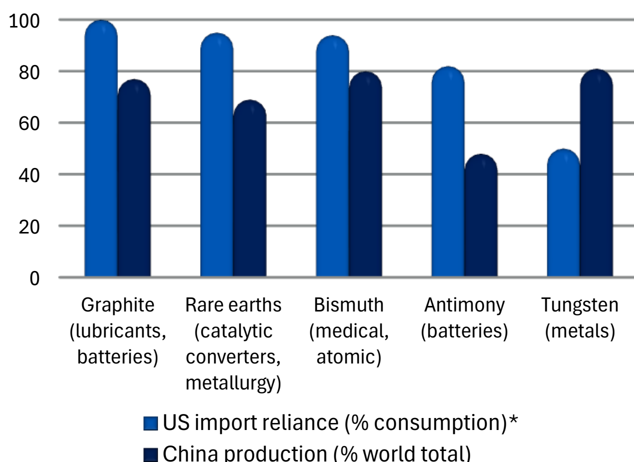
China hit back by announcing: i) 10-15% tariffs on US imports of LNG, coal, oil, farm equipment and some 'large engine' autos; ii) an antitrust investigation into Google; and iii) tighter export controls on a selection of critical minerals.

The three prongs are more of a warning about where China can strike back harder if provoked, rather than an attempt to inflict material damage on the US.

China's imports of US energy are a very small share of US exports. Google is a high-profile US company, but corporates with larger exposure to China could certainly have been found (Apple or Tesla, for example). And there are alternative minerals that are *more critical* to the US that could have been chosen.

Indeed, if we consider minerals where China is both the largest US supplier and the largest global producer, out of those now facing tighter controls only Tungsten meets these criteria. And, even then, US import reliance is notably lower than for other minerals (see Figure 2).

Figure 2: Critical minerals… not that critical (yet)



Source: abrdn, Mineral Commodity Summaries 2024, February 2025

The latest +10% tariffs will be hard to roll back…

China will struggle to deliver strong political optics that could help defuse tensions over fentanyl – like Mexico did by placing 10,000 troops on the border.

Even if China tightens up trade in the precursor chemicals necessary for illegal fentanyl production – introducing tough 'Know Your Customer' requirements, for example – it could still be vulnerable to accusations that it is not doing enough.

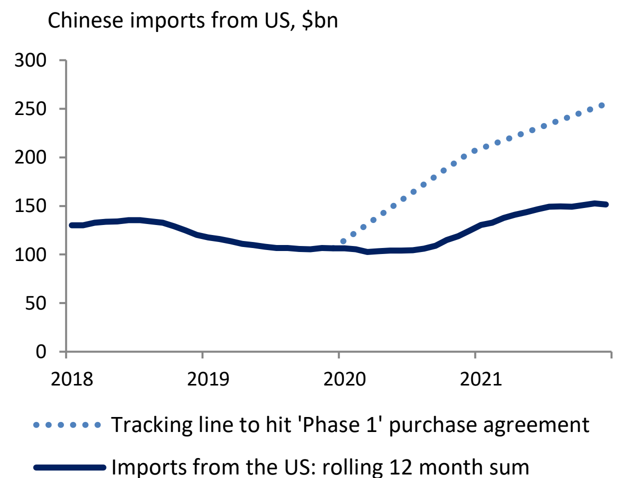
Indeed, with Bill 747 – the 'Stop Chinese Fentanyl Act' – currently moving through Congress, the US could impose sanctions on Chinese producers, stoking trade tensions further and raising the bar for tariffs to be removed.

… while the US trade review will lead to additional tariffs

The 'Act of God' clauses in the 'Phase 1' trade deal between the US and China signed shortly before the pandemic will not help China avoid additional trade-related tariffs when the US review reports on 1 April.

For a start, many US politicians (including Trump) have blamed China for the pandemic itself. China did increase its US purchases by around $20 billion after the initial pandemic shock unwound and global trade rebounded, but this is well short of the $200 billion agreed (see Figure 3). Moreover, even though there was little-to-no effort by either the US or China to pursue the 'Phase 1' deal after Trump was defeated by Biden in his first attempt at re-election – this is unlikely to change the conclusion.

Figure 3: A new purchase agreement is not impossible, but it may suffer from credibility issues



Source: abrdn, U.S. Census Bureau, February 2025

It would of course be harder for China to slow-walk purchases should 'Phase 1' be resuscitated, given we are at the start of Trump's term, rather than the end. And we cannot rule out that tariffs introduced after the trade review will be used as leverage for a new deal. But the credibility of any purchase agreement will remain a big hurdle to overcome. All told, we continue to expect a large and lasting increase in US-China tariffs.

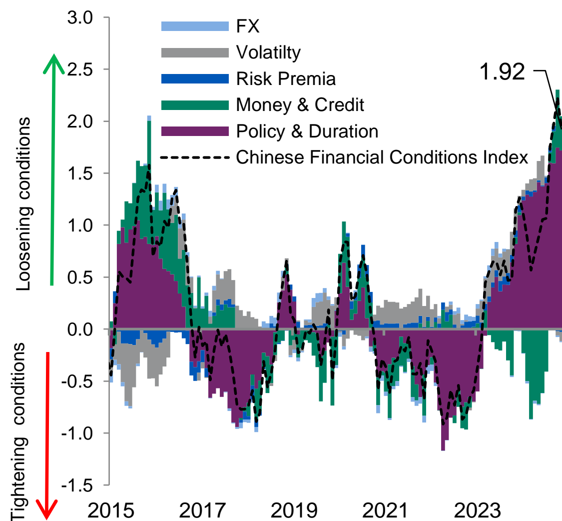
China's strong end to 2024 and continued easing of financial conditions should offset some of the trade war

The data black hole caused by the Lunar New Year means that there are fewer indicators of activity to help judge economic momentum.

The January PMIs did point to a potential slowdown at the start of the year, but travel and tourism figures for the Lunar New Year were fairly robust, with the number of visitors and total tourism revenue both up around 6% compared to a year ago. That said, revenue per head remains below pre-pandemic norms, suggesting a degree of lingering consumer caution.

Regardless, the loosening of financial conditions since the September policy pivot is unlikely to have filtered through to activity, given normal lags. This suggests that policy easing to date will help support growth in the face of headwinds from the second trade war.

Figure 4: Financial conditions remain loose heading into the Year of the Snake



Source: Haver, Bloomberg, abrdn, February 2025

Indeed, while our China Financial Conditions Index (CFCI) moderated slightly in January, it continued to signal accommodative financial conditions (see Figure 4).

This was reflected in Chinese credit data, which were strong in January. Total Social Financing (TSF) posted a seasonally adjusted flow of RMB 3.5 trillion, only marginally weaker than December's flow, putting the three-month moving average close to series highs.

This was driven by a strong rebound in medium- to long-term corporate borrowing and a tentative pickup in household borrowing.

Where financial conditions did appear to moderate most was in M2 money supply, which fell short of consensus expectations of 7.2% year-over-year growth, coming in at 7%.

Financial conditions should get further support from a likely announcement of fiscal loosening at the 'two sessions' in March. There is a risk of disappointment, but recent communications from the State Council have been encouraging. The latest statement highlights efforts to shore up foreign direct investment and support household income and consumption, for example.

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