Global Macro Research

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#China / #Fiscal policy / #Growth

China readies for Trump 2.0

Chinese policymakers will have to wait for more clarity on the Trump administration's trade policies. Encouragingly economic momentum picked up at the end of 2024, but it will still be hard to fully offset the drag from the upcoming trade war, even if policy is primed to deliver more stimulus.

Key Takeaways

- The good news is that President Trump did not announce tariffs on China on his first day back in the White House.
- Initial comments have not given much indication of his intentions, potentially reflecting a higher priority being given to border security and also disagreement among his economic team.
- Tariffs and other trade measures can still be expected, but we may have to wait until trade reviews are delivered in early April.
- China's economy seems to have found some momentum at the end of 2024, posting a strong Q4 GDP growth print.
- Unfortunately, one key driver of recent economic strength has been broad export growth married to subdued import demand. This will likely compound the tensions around China's trade imbalances going into any trade negotiations with the Trump administration.
- More positively, given lags between loosening financial conditions and their impact on the economy, Q4's additional momentum is unlikely to capture the recent policy easing. The 1.5 standard deviation loosening in abrdn's China Financial Conditions Index should therefore signal that policy loosening will support 2025 growth.
- Ultimately, more support will be needed to mitigate the impact of trade war disruptions, and our best guess is that around 1% is knocked off the level of Chinese GDP, which will limit 2025 growth to 4.6% and potentially push 2026 GDP growth down to 4.1%.
- Inflation is likely to remain subdued (0.6%), even if the authorities condone a sizeable FX depreciation.

New president, same threats

President Donald Trump did not announce new tariffs on China on his first day back in office, suggesting other priorities – such as its southern border – are higher on the administration's agenda.

That said, it is difficult to view this as anything other than temporary breathing space.

There is potentially some parallel to Trump's 2017 inauguration when he declined to label China a "currency manipulator" on his first day in office, but subsequently raised tariffs more aggressively than markets expected.

Trump's call for a review of the US's trade relationships and compliance with past trade deals by 1 April is likely to have only one outcome: China only raised its purchases on US goods by around $20 billion, rather than the $200 billion agreed as part of the Phase 1 trade deal.

Reducing or eliminating the de minimis threshold, which provides duty-free entry for low value goods, is effectively another way of increasing tariffs, which could affect some high-profile Chinese firms, such as Temu and Shein.

Overall, there appears to be quite a lot of disagreement among Trump's economic team on the path forward. It may simply take time to agree a plan while other priorities are seemingly reducing the urgency to act.

China had a very strong end to 2024

Chinese Q4 GDP was strong, beating consensus expectations and suggesting the economy could carry decent momentum into any trade war with the US.

Sequential growth registered 1.6% quarter over quarter – above the 1.4% we had pencilled in – while a downward revision to Q4 2023 (0.9%, -0.4ppts) and upward revisions to Q2 (0.9%, +0.4ppts) and Q3 2024 (1.3%, +0.4ppts) all helped to boost the year-over-year and annual growth rates.

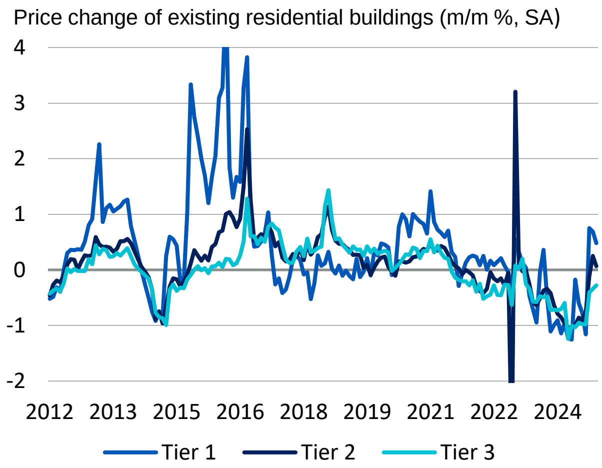
As it happens, this was enough to generate 5% annual growth, hitting the centre spot of the authorities' "around 5%" growth target.

While the upward revisions to Q2 and Q3 sit uneasily with the macro data released over those quarters, the monthly data for December did at least back up the picture of an improving economy through Q4.

Headline indices, such as industrial production and retail sales, generally improved and were above consensus expectations. And, while the sector remains fragile, the latest property data reinforce the picture of green shoots that have emerged over the last two months.

The proportion of cities reporting rising house prices has risen from close to zero in September to around 33% for new builds and 13% for existing properties. Tier-1 and tier-2 cities posted another month of price rises, while price declines have at least slowed in tier-3 cities (see Figure 1). This offers hope that the shock to household balance sheets could be reaching a turning point.

Figure 1: Continued house price rises could help support consumption



Source: abrdn, Haver, January 2025

External demand partly explains Q4 outperformance

Strong exports contributed to Q4's strong growth outturn both directly via net exports and indirectly via industry.

Taking a step back, it is clear that exports have been making steady gains since early 2023, with export volumes rising more than values, helped by the 14.5% fall in the deflator. In contrast, imports have been flat (see Figure 2).

Figure 2: Export volumes have been propped up by falling prices

Source: abrdn, Refinitiv, January 2025

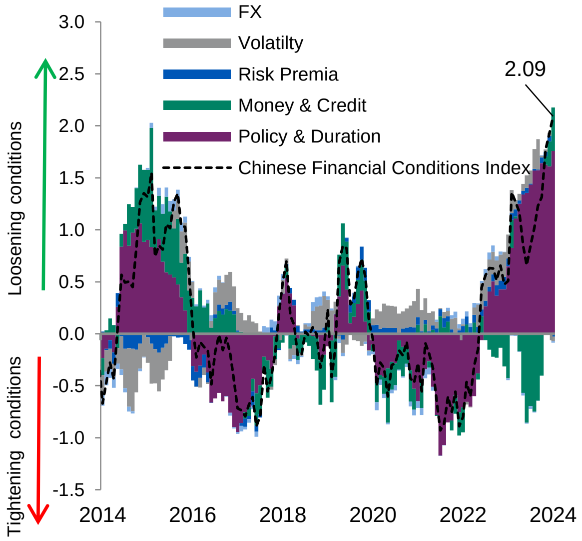
Exports to the US have picked up, which could be indicative of a degree of tariff front-running, but external demand seems fairly broad-based, which challenges the assertion that tariff front-running was a significant driver of Q4's export strength. For example, Chinese exports to ASEAN have also strengthened over the past three months.

Bond rally has further eased financial conditions

In contrast to the support from net trade, the policy pivot since the end of September is unlikely to explain much of the acceleration across Q4. Given lags between policy loosening and its impact on the economy, the bulk of the stimulus is likely still working its way through, suggesting that recent easing should buttress growth in H1.

Encouragingly, our China Financial Conditions Index (CFCI) rose higher in December, continuing the trend of easing financial conditions in motion since May (see Figure 3).

Figure 3: Financial conditions have been supported by falling long-dated yields



Source: Haver, Bloomberg, abrdn, January 2025

The chief driver of this easing remains the decline in rates, as reflected via the Policy & Duration sub-component, but Money & Credit has become supportive in recent months too.

Indeed, while demand for credit by corporates remains lacklustre, Total Social Financing (TSF) posted a strong seasonally adjusted flow of RMB 3.9 trillion in December, which is around 1 trillion more than the average of the past five months, and close to series highs.

This was in part evidence of the step-up in government bond issuance but also of a tentative recovery in household borrowing. Since August, households have begun to make use of the looser financial conditions, boding well for the beleaguered property sector. In time, looser financial conditions may well support corporate borrowing too, but firms may remain cautious until the contours of US trade policy become clearer.

Overall, the combination of People's Bank of China (PBOC) rate cuts and falling bond yields have loosened financial conditions to an extent not seen since China's response to the global financial crisis. This is still some way short of the 'bazooka' fired then, but looser policy – and the potential to do more now that the policy machinery is primed – should help offset much of the damage from another trade war, even if it will be difficult for the economy to escape unscathed.

The impact from the trade war is of course hard to gauge, reflecting both uncertainty about its scale and policy moves on both sides of the Pacific. Our best guess remains that the trade war will knock around 1% off the level of Chinese GDP, which will limit 2025 growth to 4.6% and potentially push 2026 GDP growth down to 4.1%.

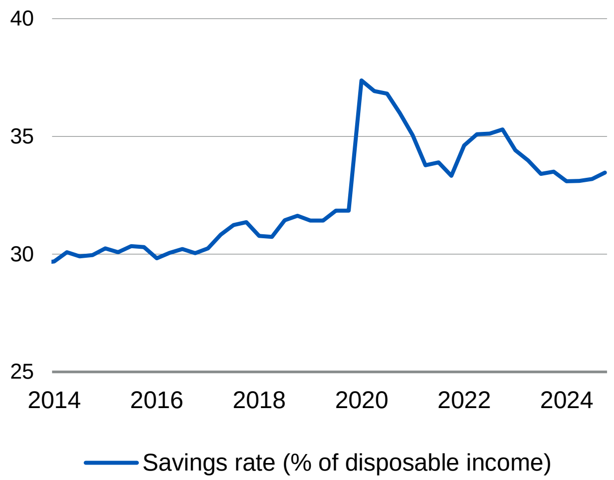
Will the authorities fire up the domestic consumption engine?

A key question is not just what the policy reaction is – for example in terms of PBOC rate cuts or the degree of fiscal easing that comes out of the 'Two Sessions'. How the trade war will interact with China's existing structural challenges, such as the weakness of domestic consumption, is just as important.

Ahead of the Lunar New Year, local governments announced a round of consumer vouchers and appliance trade-in schemes, which at the margin provide a temporary boost to spending. There have also been reports of wage hikes for millions of civil service workers ahead of the holiday but steep cuts for those working at the PBOC.

More forceful steps to boost household consumption could emerge from the 'Two Sessions', but it is hard to escape the conclusion that the equilibrium saving rate has pushed higher. Indeed, the latest data suggest the saving rate stabilised at 33% over 2024.

Figure 4: The household saving rate remained stubbornly high in Q4



Source: Haver, abrdn, January 2025

Rather than raising consumption up the list of policy priorities, there is some risk that the trade war reinforces the desire to achieve a greater degree of self-sufficiency, amplifying efforts to direct investment towards strategically important high-tech sectors. And of course, high savings support the current account, potentially aggravating relations with trading partners.

Deflation nation

Similarly, the negative demand shock from the trade war and potential policy reaction could reinforce the low inflation dynamics already prevalent in China.

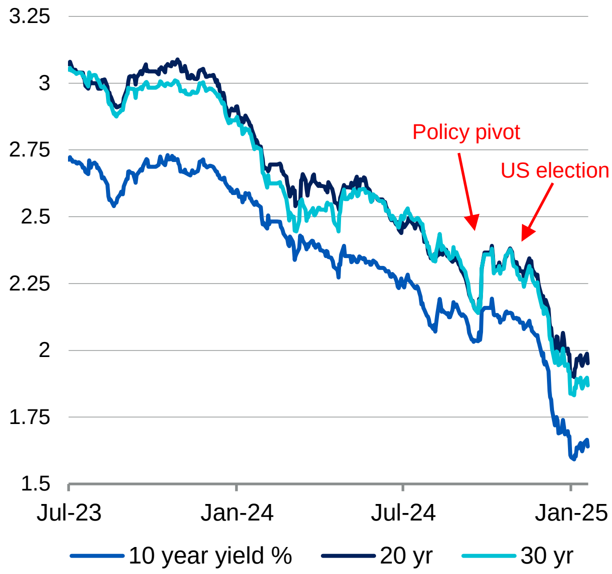
Headline CPI inflation averaged a paltry 0.2% through 2024, the second year of tepid CPI.

December's inflation release did at least show an improvement in month-over-month core inflation, which led us to nudge up our 2025 forecast to (a still below consensus) 0.6%. But, if correct, that would still leave the three-year rolling average at its weakest since 2003.

If low inflation expectations become entrenched, which is arguably being signalled by bond markets (see Figure 5), this risks reversing some of the recent easing of financial conditions as real rates climb higher.

Ultimately, such a low run rate of inflation leaves the economy vulnerable to external deflationary shocks and a doubling down of domestic supply-side policies.

Figure 5: Collapsing bond yields are less supportive if inflation expectations decline



Source: Haver, abrdn, January 2025

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