China: Macro CIO Tour Takeaways

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Following a week marked by rapid tariff escalations and heightened market volatility, we hosted our China Macro CIO Tour in Beijing on April 11th. Discussions were predominantly centered around US tariff-related topics. Our speakers also addressed issues including the property market's recovery, potential government strategies to offset the impact of tariffs, and the growth outlook for the year. Key takeaways are summarized below.

1. Size of US Tariffs a Surprise: The magnitude of the US tariff increases significantly surpassed policymakers' initial expectations. According to our speakers, despite extensive analyses and preparations undertaken by the Chinese government in anticipation of potential tariffs imposed by the Trump administration, a general consensus among policymakers was that tariffs would not exceed 60%. The fiscal expansion measures announced during the Two Sessions were designed to mitigate the impact of an approximate 20 percentage point increase in US tariffs. Although some policy flexibility was maintained to address unforeseen, more severe tariff shocks, a comprehensive macroeconomic policy plan remains to be formulated at this time.

2. Rationale for Matching Tariffs: Speakers offered differing perspectives on the Chinese government's decision to match US tariffs, but generally highlighted three key factors. First, policymakers believe that US tariffs are primarily targeted at China, and that decoupling may represent an irreversible trend. Second, a lack of mutual trust makes the Chinese leadership hesitant to engage in negotiations, as tariffs, even if temporarily lifted in exchange for Chinese cooperation on issues such as fentanyl controls and TikTok, may subsequently be reinstated. Third, some policymakers may believe that China possesses sufficient economic resilience to withstand the impact of the tariffs.

3. Shift in Policy Focus: With the substantial increase in US tariffs on Chinese goods, our speakers suggested that the government's "around 5%" real GDP growth target may no longer be attainable. Consequently, policy priorities may shift towards supporting employment stability. This potential shift mirrors the government's response in early 2020, following the initial outbreak of the COVID-19 pandemic in China. Specific measures could include large-scale retraining programs for workers displaced from export-oriented manufacturing, waivers on taxes and social security contributions for exporters to retain their workforce, and enhancements to unemployment insurance programs.

4. Complex Relations with Other Trading Partners: Our speakers concurred on the increasing importance of maintaining strong relationships with other trading partners, particularly the EU, given the anticipated significant decline in exports to the US. However, the Chinese government's ability to strengthen these relationships remains uncertain. Substantive efforts would be required to encourage the EU to enhance trade ties with China. These efforts could involve reducing tariff and non-tariff barriers, increasing Chinese imports from the EU, and promoting investment and technology transfer to the EU. Furthermore, the Chinese government would need to ensure that the surplus supply resulting from decreased exports to the US is not significantly redirected into the EU market.

5. FX Management and UST Holdings: Our clients have expressed concerns over the potential for trade tensions to extend into financial market tensions between the US and China. Our speakers generally believe that the Chinese government may permit a moderate depreciation of the Chinese Yuan (CNY). However, they doubt that policymakers would accept a significant depreciation. Regarding Chinese holdings of US Treasuries (UST), our speakers believe that large-scale UST selling is unlikely unless the objective is a deliberate escalation of US-China tensions. Nevertheless, they acknowledge that the rationale for China to maintain substantial UST holdings has diminished, given increasing geopolitical tensions between the two countries.

6. Strategies to Stimulate Consumption: Our speakers believe that policymakers differentiate between short-term and long-term consumption-boosting policies. Short-term measures should target middle-class households, whose consumption growth has decelerated the most in recent years, with stabilization of the stock and property markets as a key solution. Long-term measures should focus on low-income households, with a strengthening of the social safety net as the primary remedy. Given the abrupt increase in US tariffs and a weakening economy, our speakers anticipate that policymakers may prioritize short-term consumption-boosting measures. Furthermore, our speakers believe that there is less potential for growth in goods consumption in China compared to services consumption. Considering the ongoing government-subsidized consumer goods trade-in program targeting goods consumption, new policies may target services consumption.

7. Cash Handouts and Infrastructure Investment: Clients inquired about the potential for cash handouts to stimulate domestic growth, as well as other possible policy easing measures. Our speakers do not anticipate cash handouts, primarily because they view them as a temporary solution, whereas the impact of higher US tariffs may be more persistent. However, they believe that more targeted programs, such as childbirth subsidies, are probable. To facilitate a more timely response to support growth, our speakers expect an increase in government-led infrastructure investment.

8. Property Market Vulnerability: Our speakers noted early indications of price stabilization in top-tier cities during Q1. However, they believe that further price increases will be constrained by increased supply from the secondary market, which, in turn, would exert downward pressure on prices. Furthermore, our speakers expressed considerable concern that higher tariffs and declining exports could lead to renewed downward pressure on the property market in the coming months. In regions with a higher concentration of export activity, such as the Yangtze Delta and the Pearl River Delta, export-oriented SME owners may experience cash flow difficulties and be compelled to sell properties. Therefore, changes in property listings for sale warrant close monitoring.

Disclosure Appendix

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