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China: waiting for the shock

The latest economic data give President Xi little reason to back down. That said, as the impact of the trade war becomes visible on both sides of the Pacific, we expect China and the US to come to the negotiating table.

Key Takeaways

- Stronger-than-expected economic data show that China was carrying robust momentum into the beginning of the trade war.
- The combination of a stronger start to the year and revisions to the national accounts back data – which proved favourable to growth in the current year – pushes up our 2025 growth forecast to 4.3% (+0.1ppt).
- Even if policy easing is brought forward and expanded, we doubt that the authorities will be able to hit their "around 5%" growth target.
- Moreover, our forecast is conditioned on cooler heads prevailing, which lowers the average tariff rate on Chinese goods to around 60%. The current average is well above 100%, while we have also seen non-tariff actions escalate. China is reportedly considering halting deliveries of Boeing aircraft, while the US has placed new restrictions on the export of Nvidia's H20 chips to China.
- Complementing the robust set of monthly activity data for March, our in-house China Financial Conditions Index (CFCI) loosened modestly (+0.14pts), remaining squarely in accommodative territory. The CFCI should also get a boost in April following the sharp decline in bond yields since "liberation day", although that will be partly offset by falling equities.
- That said, lower yields also reflect a larger economic headwind. And there is also a risk that the authorities allow deflation to become embedded, blunting policy easing by pushing up on real rates. The GDP deflator is likely to extend its record-breaking run below zero, which may restrain fiscal easing.

Headline data beat expectations…

China's Q1 GDP expanded 5.4% year over year (versus consensus of 5.2%), while sequential growth expanded 1.2% quarter over quarter, above the 1.1% we had pencilled into our latest forecast.

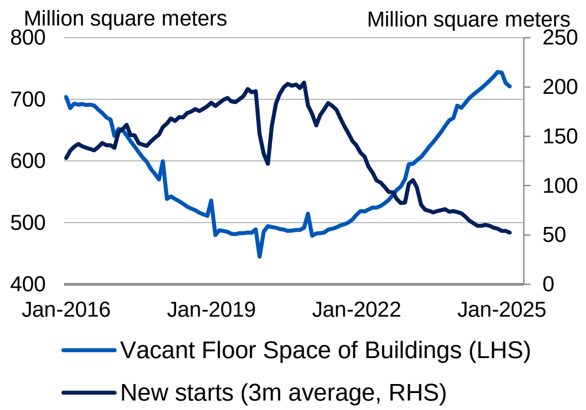
Monthly activity data for March also surprised on the upside, helping key metrics post robust quarterly growth rates.

Industrial production (IP) expanded by 7.7% year over year (versus consensus of 5.9%), while retail sales grew 5.9%, more than the 4.3% expected by consensus. This was enough to generate quarter-over-quarter growth rates of 1.3% and 1.1% respectively.

… but the property sector continues to struggle

Property data cast further shade on the tentative green shoots that emerged in Q4 2024, suggesting that a conclusive turnaround will be elusive.

Figure 1: The end point for real estate remains unclear



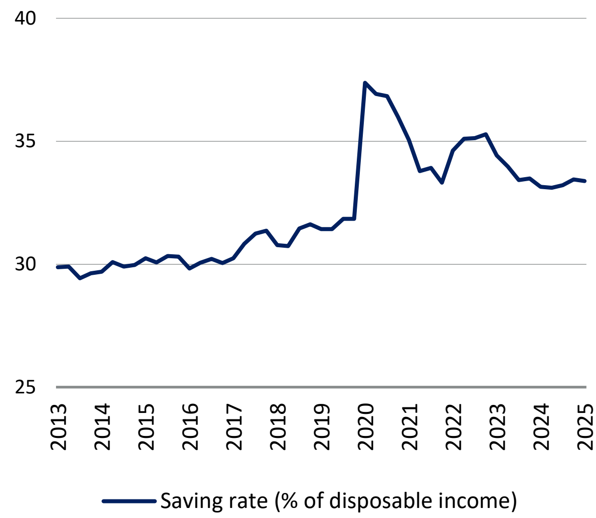
Source: Aberdeen, Haver, April 2025

Developer funding and the volume of buildings sold at least remain broadly stable, but new starts and fixed asset investment continue to drift lower. Our best guess remains that the drag from real estate could be getting close to complete, but the risk of a substantial inventory overhang could prolong the headwind to growth (see Figure 1).

Property prices are falling, suggesting that household balance sheets are under pressure once again. Prices of existing buildings continued to fall at a steady pace in March (-0.2% month over month), while prices in tier-1 cities fell for a second month, following on from four months of reasonable gains (averaging 0.5% month over month).

Damage to balance sheets appears to be mirrored in household savings rate, which has been stuck at elevated levels since Q3 2023 and could easily rise higher as the trade war unfolds (see Figure 2).

Figure 2: Policy is not doing enough to encourage households to spend more



Source: Aberdeen, Haver, April 2025

Policy at least remains primed to do more

Policymakers have at least been easing ahead of the trade war and look set to do more to support the economy.

Our China Financial Conditions Index (CFCI) indicates that policy has moved into highly accommodative territory since the September pivot. Indeed, this puts the starting level well above that seen in Q1 2018 – the equivalent stage of Donald Trump's first trade war – when Chinese policy was reasonably restrictive (see Figure 3).

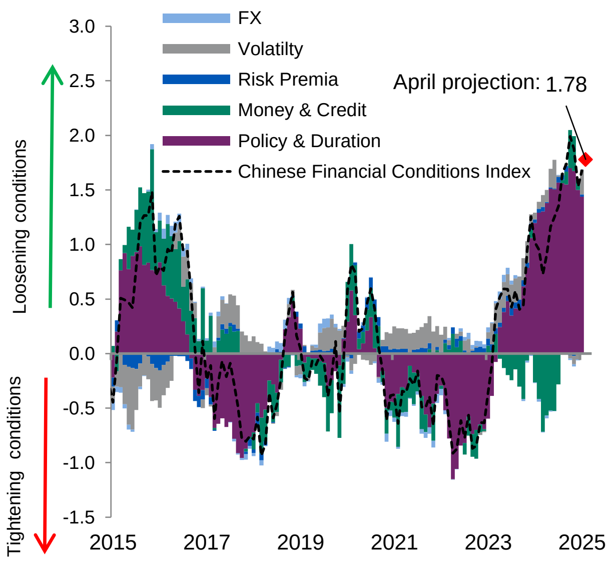
The index rose 0.14pts in March as market volatility cooled ahead of the tariff announcements on 2 April.

While this will reverse in April as equity prices swung sharply down, the drop in bond yields and policymakers' efforts to stimulate the economy over the month should more than offset this, resulting in a likely continued easing of financial conditions in the month (see Figure 3, red diamond).

We expect government bond issuance to be brought forward, while the reserve requirement ratio will be cut to ensure liquidity remains ample. Cuts to the seven-day reverse repo rate and other policy rates are also likely to support the economy as the trade shock unfolds.

Thus far, the renminbi's depreciation against the greenback has been modest: only ~0.7% month-to-date. A more notable trade-weighted depreciation is however implied when factoring in the Dollar Index dropping ~4.5% in the same period, which – alongside fears of capital flight – is likely contributing to the authorities' preference for relative FX stability. That said, as the trade war unfolds and the economic shock becomes clearer, we expect that a more substantial depreciation will be condoned to complement other policy easing.

Figure 3: Policy conditions are considerably looser than during Trump's first trade war



Source: Aberdeen, Haver, April 2025

Putting it all together, attentive policymakers, a slightly stronger start to the year, and revisions to the national accounts back data – which once again 'pivoted' the GDP profile and helped boost this year's annual growth – push up our 2025 growth forecast to 4.3% (+0.1ppt). Risks are however skewed to a much larger miss of the authorities' "around 5%" growth target.

A weak nominal environment risks blunting policy

Despite stronger-than-expected real GDP figures, there is little sign of a turnaround in whole-economy prices. The GDP deflator fell to -0.9% year over year, down from -0.6% in Q4 2024. We expect that the trade war and the continued bias towards the supply-side in policy settings will keep the GDP deflator in negative territory this year, expanding the record-breaking run below zero (see Figure 4).

Figure 4: Deflation will continue as the policy mix skews further towards 'resilience'

Source: Aberdeen, Haver, April 2025

The length of time that deflation has persisted suggests a risk that inflation expectations could be in the process of re-anchoring lower. If correct, this could blunt policy easing by pushing up on real rates and could mean that financial conditions are not as accommodative as our calculations imply. Similarly, damage to potential growth from the trade war could push down on equilibrium interest rates (r*), also reducing the degree of accommodation imparted. Put simply, there is a risk that loosening is insufficient relative to the challenges – both domestic and external – which China faces.

The scale of the shock remains hard to call

Real-rate dynamics are arguably a secondary concern. The most pressing issue is the risk of a much larger shock than we condition our forecast on.

We continue to pencil in a -2.25% shock to the level of Chinese GDP, consistent with the average tariff rate falling back to around 60%. As economic damage emerges, incentives to make a deal should rise.

However, this may be too optimistic. Tariffs got a partial reprieve recently (by exempting electronic goods), but non-tariff actions continue to escalate: China has tightened its restrictions on seven rare earth metals, effectively suspending their exports; Trump accused China of having "reneged" on its plans to buy Boeing aircraft, following Bloomberg reporting that China was halting deliveries and orders; and the US administration also placed new restrictions on the export of Nvidia's H20 chips to China.

Even if a deal is struck, unless it is done soon – or another more wide-ranging "pause" is introduced – a larger shock may be hard to avoid.

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