

## Reassessing China's Economic Outlook Amid Trade Uncertainty

### In a Nutshell:

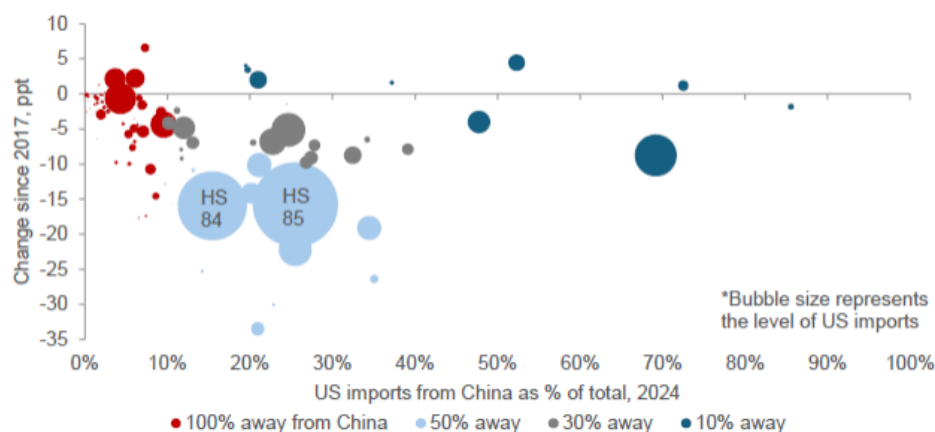
- Given the ongoing China-US trade uncertainty, we outline different tariff impacts on China's economic growth based on three sets of assumptions.
- Base case: we assume no resolution to the China-US trade confrontation by year-end but continued trade talks.
- By categorizing US imports into five groups based their reliance on China manufacturing, we estimate China's exports to the US to decline by 40-50% annualized, reducing this year's GDP growth by c.0.8 percentage points. With additional fiscal stimulus introduced around mid-year, China is likely to stabilize its full-year growth at 4.5% in 2025.
- Two tail risks: We also identify two tail risks to our base case, one to the upside and one to the downside. The upside one assumes significantly reduced US tariffs within the next few months as both parties make substantial concessions, allowing China's GDP growth to hold steady at 4.8% this year.
- The downside one assumes that economies with strong ties to China agree to impose additional tariffs on Chinese goods in exchange for lower US tariffs, which can reduce China's GDP growth by over 2 percentage points a year. However, we consider the likelihood of these two risks to be very low, especially the downside one.

Fig 1 Our assumptions on changes in US imports from China under current tariff rates

Type	% of US imports from China	Change since 2017	% of exports diverted away from China	Examples
1	<10%	n/a	100%	Vehicle parts, rubber products, etc.
2	10%<x<40%	Decline by more than 10ppt	50%	Garments, furniture, semiconductors, etc.
3	10%<x<40%	Decline by less than 10ppt	30%	Plastic and iron articles, etc
4	10%<x<40%	Increase	10%	Special import provisions, etc
5	x>40%	n/a	10%	Toys, games, etc.

Source: Mizuho

Fig 2 US imports from China by HS category



Source: CEIC, Mizuho

**Likely impacts.** We estimate that China's exports to the US will decline by 40-50% due to hefty tariffs. Approximately 50% of the US demand for Chinese goods will be diverted under our assumptions. However, this estimate may overstate the impact, as it does not account for current tariff exemptions on smartphones and computers, FOB exports where tariffs are paid by US importers, and exports rerouted to other countries like Vietnam and Thailand during 90-day tariff exemptions.

With strong Q1 results this year, China's exports to the US are expected to decline by around 35% YoY in 2025. This decline will reduce China's industrial value added by about RMB 1.1 trillion in 2025<sup>1</sup>, equivalent to 0.8% of GDP in 2024. Beyond the direct impact, suspended trade activity is expected to reduce income, if not unemployment, for workers in both manufacturing and service sectors related to international trade, affecting household consumption.

Meanwhile, it should be relatively easy for China to increase its fiscal deficit by another RMB 1 trillion around mid-year, or 0.7% of GDP, to stabilize domestic demand amid trade uncertainty, though part of the fiscal support may not be reflected in this year's growth. Consequently, **we expect China's annual GDP growth to slow only moderately to 4.5% in 2025, down from our previous estimate of 4.8%.**

**Flaws in our assumptions.** That said, trade confrontation on this scale is unprecedented and may lead to unexpected consequences. For instance, could it foster closer trade and investment ties between China and the EU, creating new business opportunities? Might broad-based US tariffs trigger an economic recession, further reducing US import demand? Could China-US trade decoupling heighten geopolitical tensions, destabilizing global financial markets and leading to a self-fulfilling financial crisis? These potential impacts are difficult to quantify at this stage and are not included in our GDP estimates.

**Potential future developments.** The deadlock in China-US trade confrontation is expected to persist for the foreseeable future. The situation may worsen before either party is willing to make sufficient concessions to resume high-level trade talks, and both parties will be seeking more leverage in the meantime. For example, the Trump administration extended the TikTok sale ban by another 75 days, while Beijing banned rare earth exports, suspended imports of US Boeing planes and agricultural products, and halted the transfer of the Panama Canal operation license.

### **Tail risk to the upside**

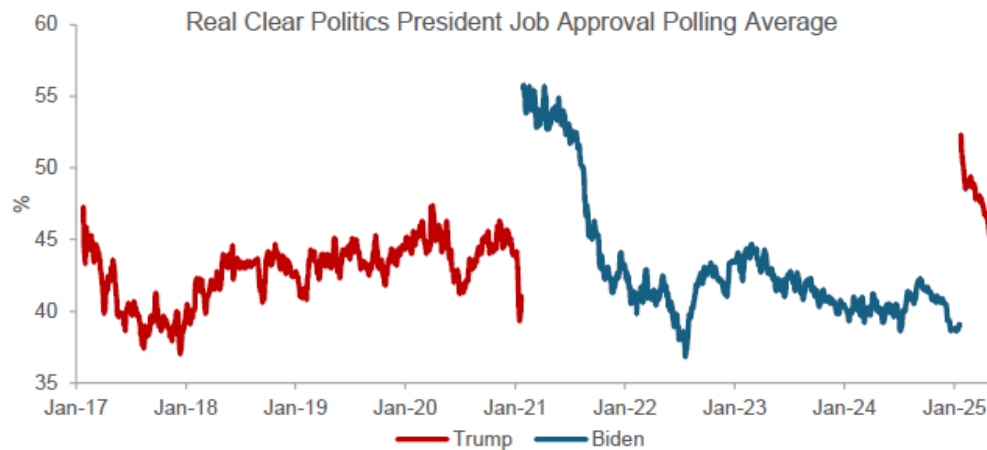
**Assumptions.** The Trump administration is poised to significantly reduce import tariffs within the next few months to avert a prolonged supply shock that could hinder the Federal Reserve's decision to cut rates amid impaired purchasing power domestically. Mid-term elections expected next year may also pressure the administration to soften its tariff stance in order to support domestic growth and employment. **In this scenario, we expect China's growth outlook to remain stable, with this year's GDP forecast holding steady at 4.8%.**

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<sup>1</sup> "China's domestic value added in exports reached 83% in 2016.", cited from Ping Hua, January 2022. How did China rise its manufacturing domestic value added in exports through GVC moving up?

**Low likelihood.** However, we suspected that Trump may be less concerned about an economic recession, given his preference for a weaker dollar and lower UST yields. Trump's current job approval ratings, which are higher than the average during his first term and ex-President Biden's ratings of around 40% in 1H24, suggest limited political headwinds in the near term. Furthermore, it has become less and less likely for China to make significant concessions for a short-term trade deal with the US, after recognizing the enduring nature of their conflicts.

Fig 3 Trump's job approval rates are still higher than the average of his first term



Source: Bloomberg, Mizuho

#### Tail risk to the downside

**Assumptions.** Should economies with strong ties to China, such as Japan and Vietnam, agree to impose additional tariffs on China in exchange for lower US tariffs, China could face a significant loss in global trade share. This would likely lead to a surge in domestic bankruptcies and unemployment, **potentially reducing China's GDP growth by over 2ppt and severely impacting market sentiment.**

**Extremely low likelihood.** The close economic and geographic ties these economies have with China suggest that additional tariffs could disrupt their domestic supply chains and cost them access to China's market and investments. Moreover, China would likely retaliate with measures ranging from tariffs to bans on imports and investments, making the trade-off for lower US tariffs unappealing. President Xi's recent visits to Southeast Asian countries, including Vietnam and Malaysia, are also expected to mitigate this risk.

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