Prospects

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The Point of view

China: The calm before the storm?

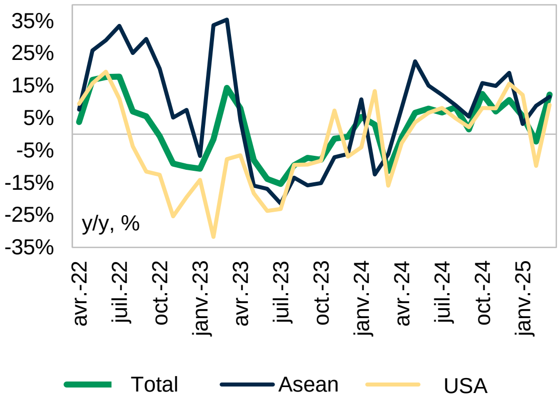
Economic activity data released by China this week for the first quarter of 2025 makes a mockery of Donald Trump and his administration. At a time when the United States and China are locked in an intense and multifaceted trade war and the Fed is warning that a US recession is becoming increasingly likely, China has released robust growth figures at odds with the mood of excitement that has reigned since Trump announced his trade tariffs.

A strong start to the year…

First-quarter growth came in at 5.4%, ahead of consensus expectations. This growth was driven by industrial production, which quickened sharply in March, up 7.7% (compared with 5.9% in the January-February period), buoyed in particular by the solar panel, electrical appliances and components, and transport equipment sectors.

However, the main positive surprise was retail sales, which were up 5.9% year on year in March, compared with 4% in January-February. Boosted by a programme of state subsidies that has been doubled from RMB 150 billion to RMB 300 billion (around $40 billion) for 2025, purchases of phones, TVs and household appliances experienced double-digit growth.

China: exports



Sources: Chinese customs, Crédit Agricole S.A./ECO

Rightly anticipating a deterioration in tariff conditions, **Chinese exporters increased their outbound shipments, particularly to the US.** Exports surged 12.4% in March and were buoyant across all geographical regions, particularly the ASEAN region (up 11.6%) and the US (up 9.1%). Unsurprisingly, the top exports were consumer goods (textiles, shoes, furniture, phones) and auto parts. China's trade surplus was in excess of $100 billion in March alone and is approaching $1.1 trillion over 12 months.

…but deeper concerns remain unresolved

Whatever happens next in its trade clash with the US, **this good news puts China slightly ahead of its 5% growth target for 2025. However, it masks a more nuanced structural picture**, with persistent deflationary pressures reflecting a lack of domestic momentum that the consumer goods subsidy programme alone will not be able to make up for.

The first thing to point out is that China is not out of the woods yet when it comes to deflation. The consumer price index was in negative territory in March for the second month running (down 0.7% in March after falling 0.1% in February). This trajectory reflects still constrained domestic demand and raises fears of a powerful deadweight effect on households which, while benefiting from state subsidies, have no intention of significantly changing their trade-offs between saving, spending and paying off debts.

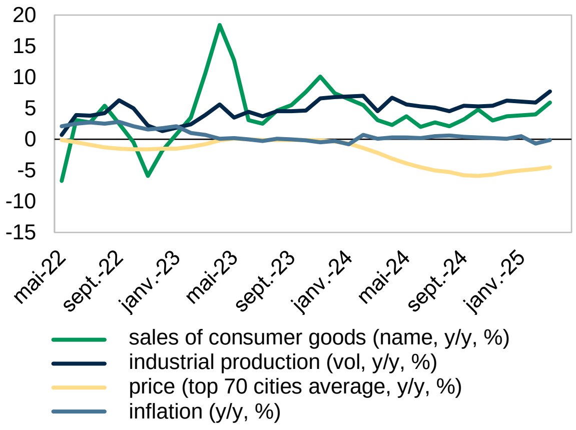
Meanwhile, producers continue to wage a ferocious price war to protect their domestic and foreign market share. The decline in commodity prices over the past week in the wake of Trump's tariff announcements could continue to support this trend while bringing some relief to businesses whose margins have fallen sharply over the past three years.

Secondly, the crisis in the real estate market is not yet over and the sector continues to give off mixed signals. Destocking appears to be ongoing and the difficulties faced by real estate developers mean the number of new projects getting off the ground (as measured by investment and building permits) is still well down. Although prices have begun to stabilise since the end of last year, they are still falling, and the situation continues to differ between major cities (Tier 1 and Tier 2) and those on the periphery (Tier 3 and below).

The situation in the real estate market is fuelling a deflationary environment in China. The authorities have now recognised this state of affairs.

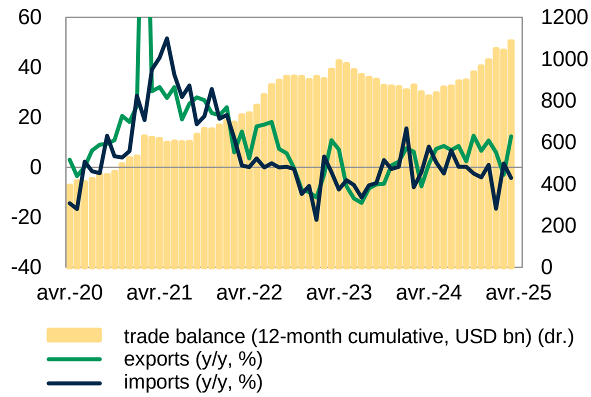
Lastly, while exports had an exceptional month, imports fell sharply in March (down 4.3% YoY) as a result of a commodity price effect but also because Chinese producers are anticipating a decline in demand. This is also the reason for the trade surplus seen in March.

China's ingredients for deflation



Sources : NBS, Crédit Agricole S.A./ECO

China: trade balance



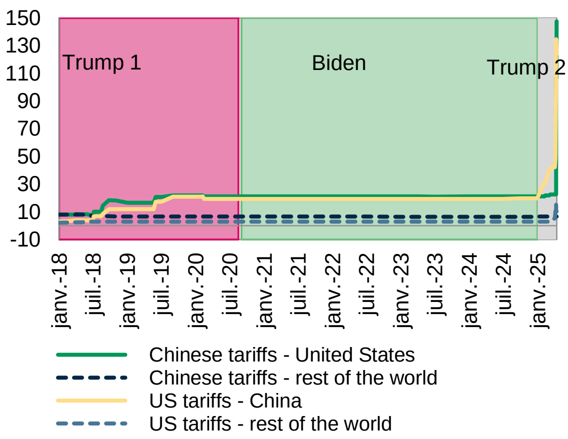
Source: General Customs Administration

Into the great unknown: the US-China trade war

Having tried the approach of appeasement and negotiation, but with the US showing no sign that it is interested in appeasement or openness, **China finally responded forcefully to US trade tariffs.**

For the time being, a 125% tariff applies to all imports from the US (compared with a minimum tariff of 145% on imports into the US from China). China has also announced fresh restrictions on exports of some critical metals and rare-earth elements (samarium, gadolinium, terbium, dysprosium, lutetium, scandium and yttrium), launched an anti-dumping investigation (medical CT tubes) and added more US companies to its Unreliable Entities List, severely limiting their scope to do business in China or with Chinese counterparties. China also appears to have withdrawn an order with Boeing and to have already begun diversifying its supplies of agricultural products (beef, soymeal and maize in particular) to include other suppliers such as Brazil and Austria.

Import tariffs: escalation



Sources: PIIE, Crédit Agricole S.A/ECO

With China the only country still targeted by import tariffs since Trump announced a 90-day suspension of his "reciprocal tariffs", **President Xi Jinping also embarked on a diplomatic tour, visiting partners and allies in the region** (Cambodia, Vietnam and Malaysia). All three countries – especially Vietnam, whose exports to the US make up 25% of its GDP – would be hit very hard if Trump's reciprocal tariffs were to come into force, with tariffs of 49%, 46% and 24% respectively.

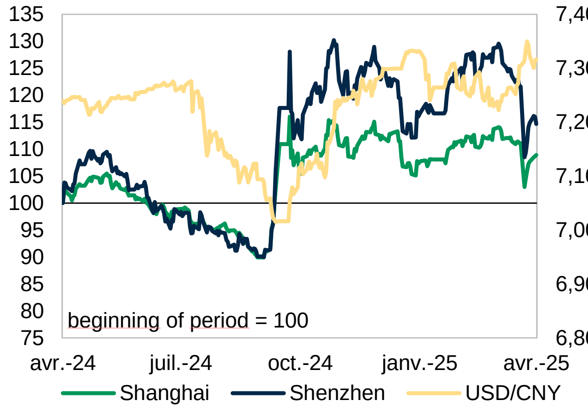
With that in mind, China is keen to convince them to join it in presenting a united front to the US. That puts these three countries in a tricky position: for the time being, they have positioned themselves as negotiators, proposing to lower their own import tariffs on US products and increase their imports from the US in some strategic sectors such as aerospace and liquefied natural gas.

China currently finds itself in the very uncomfortable position of being isolated and struggling to find other countries willing to stand up to the US. As each country pursues its own agenda, the worst-case scenario would be for Chinese products to be hit with very high import tariffs while goods from the rest of the world escaped such treatment. This scenario would force Chinese companies to work harder to circumvent tariffs, with far-reaching consequences for domestic employment and production. It would also prompt the rest of the world (apart from the US) to take action to protect itself against a tidal wave of surplus Chinese products as the US market closed to Chinese imports.

Try as it might try to position itself as a defender of the multilateral system and WTO rules, after two decades of China massively subsidising domestic industry and flouting intellectual property rights**, the rest of the world has learned not to trust it.** Being anti-American does not necessarily make you pro-China. And, with international firms finding it increasingly difficult to penetrate China's domestic market, the odds are that they – and their home countries – will continue to favour the US market.

Jittery markets have responded with relief to the few concessions made by the Trump administration, which, under pressure from American firms like Apple, has suspended import tariffs on tech products (computers, phones, tablets, etc.), which account for around 20% of Chinese exports to the US, worth $100 billion a year. The release of China's growth figures, on the other hand, has had no significant impact.

China: Stock markets



Sources: SSE, Crédit Agricole S.A/ECO

Another question will be how to understand the strategy pursued by China's central bank, which in recent weeks has allowed the yuan exchange rate to devalue slightly. With currency reserves in excess of $3.5 trillion, China could easily afford to defend its currency if necessary. **But allowing the yuan to depreciate sharply would surely be seen by the Trump administration** – which has regularly accused China of manipulating its currency by undervaluing it – as a further provocation. Other countries, including in particular emerging countries, which rely on price competitiveness (rather than competing on factors other than price) to boost their exports, would probably be quick to condemn such practices, making it harder for China to build a political alliance in opposition to US decisions. It is therefore likely that China will opt to allow the yuan to depreciate very slightly while making every effort to stabilise it at around the pivotal level of USD/CNY 7.3. After all, if US import tariffs were to remain very high (above the 60% originally announced by Trump during his election campaign, for which China undoubtedly prepared itself), devaluation would be a very inefficient way for China to try to maintain its US market share.

☑ **Notre opinion –** *Any good news is welcome in the current environment and, by maintaining its ambitious 5% growth trajectory, China has gained some ammunition for the trade war that lies ahead. However, we must not allow the March and Q1 data to blind us to problems – recent or otherwise – in the Chinese economy. Persistent deflation underscores just how much work China still has to do to revive consumer spending and suggests that the latter could fall again as soon as the subsidy programme expires. With the stock of vacant homes slowly declining, the real estate crisis that is fuelling this deflation appears to be far from over. Lastly, China is locked in a tug of war with the US, the outcome of which is highly uncertain. Whether it can succeed in rallying allies to stand with it will mainly depend on the US attitude towards the rest of the world. Its isolation – perhaps the Trump administration's primary goal – would be difficult to manage, though its dominance in logistics and its status as a major industrial power mean it still has some aces up its sleeve in this great game of trading poker.*

Sophie Wieviorka
sophie.wieviorka@credit-agricole-sa.fr

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12 place des Etats-Unis – 92127 Montrouge Cedex
Publication Manager and chief Editor: Isabelle Job-Bazille
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