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# China likely to tough out the tariff standoff

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**The Trump administration has of late been putting out suggestions that it is open to de-escalating the trade tensions with China. But Beijing has been giving the US the cold shoulder, and we expect it to hold this position and wait for the US to initiate a de-escalation. China does have a range of pressure tactics that it could deploy in the interim, especially not absorbing the tariff costs, which will likely boost imported inflation in the US. We remain Neutral on China equities and favor defensive SOE stocks.**

In the wake of the 2 April “Liberation Day” escalation in US-China trade tensions that saw the MSCI China (MXCN) fall 15% in three sessions, tensions have subsequently plateaued somewhat. Over the last week, the Trump administration has suggested that the current impasse cannot last indefinitely, and even President Trump has insisted to media that bilateral talks are already underway. Indeed, since the 7 April low, the MXCN has risen a total of 11%, including rising almost 5% from 16 April. Investors might well be tempted to position for a quick de-escalation in tensions.

But investors should note that the messages coming out from Beijing have been a lot more mixed. Chinese officials have disavowed the existence of any ongoing talks, and we think that China will only engage in talks when the US cuts tariffs to levels closer to those before 2 April. We interpret the Chinese stance as suggesting that China is in no hurry to seek a resolution with the US.

**China might reasonably feel no need to shift its current stance.** Both parties will be negatively affected by the extension of the trade war, and we suspect that the tariffs could end up hurting the US more than China. We expect US growth this year to slow to 1.5% from 2.8% in 2024. US Inflation may rise 1-2pps from the current around 3% if the proposed tariffs are maintained. For China, we expect around 200bps of lost GDP growth through 2025-26. The negative effects will extend beyond a slowdown in the growth rate of aggregate economic activity. The US is highly dependent on

imports of consumer goods from China, and constraints on these could lead to disruptions and higher imported inflation. This should complicate the US Federal Reserve's policy response, and we anticipate that it might hold off on rate cuts till 3Q25. Meanwhile, we expect Chinese government to enact stronger policy support to mitigate the loss of external demand. In particular, we expect RRR cuts of 100-200bps and policy rate cuts of 30-50bps in 12 months, likely starting in the coming weeks. This potential perception of greater pressure on the US might well lead Beijing to hold out and wait for a US climbdown.

**China has other tools in its toolbox.** To back up its negotiating position, Beijing has a collection of carrots and sticks it can deploy. The latter are likely to already be in use — the primary punitive measure looks set to be a refusal to absorb the tariff costs, whether by CNY depreciation or export tax rebates. If trade tensions escalate, China could tighten export controls on rare earths, which is likely to be impactful since China accounts for a large majority of global production. China also has additional leverage via services imports as it is the largest contributor to the US services trade surplus. Once talks begin, China may offer to buy more US energy and agricultural goods, as well as services (like movies). China could also agree to address the repatriation of illegal immigrants, control fentanyl exports, and cooperate on geopolitical flash points.

**Stay defensive on China equities.** We would advise remaining Neutral on Chinese equities in the near term on account of the ongoing volatility and uncertainty from the US-China trade tensions. Although current valuation remains attractive with the forward PE below 10x, we advise patience until there is clear progress on trade talks. Despite this cautious stance, there are some targeted opportunities. We prefer skewing our exposure toward defensive SOEs in financials, energy, telecom, and utilities, as well as e-commerce and consumer staples that benefit from consumption stimulus. Over the medium to long term, leading EV manufacturers appear attractive given their cost advantages and strong policy support, while sector trends in AI and EVs also remain compelling.

In the near term, we expect USDCNY to stay range-bound around 7.30 amid unresolved trade tensions and domestic growth uncertainties. Investors may consider gradually reducing hedges on CNY positions, as the environment should turn more constructive for the CNY. Taking account of the market concerns about medium-term policy uncertainty, we adjusted our USDCNY forecasts to 7.20 and 7.15 for December 2025 and March 2026, respectively, down from 7.30 for both.

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