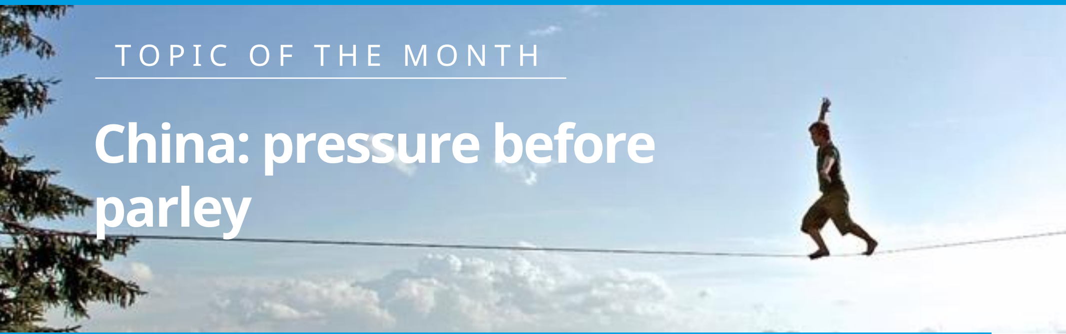

TOPIC OF THE MONTH

China: pressure before parley

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KEY TAKEAWAYS

Beijing's approach to the trade war has shifted dramatically; where it once favoured restraint and dialogue in Trump's first term, it now responds with decisive retaliation.

Washington's drumbeat of 'strategic decoupling' has strained trust, leading Beijing to adopt a more guarded and hesitant stance toward engagement, lowering the odds of meaningful negotiation.

Facing multiple contingencies, Beijing will likely lean towards an all-weather strategy: calibrating domestic economic buffers, expanding Global South partnerships, and selectively engaging with U.S. allies—while deprioritizing deals with Washington.

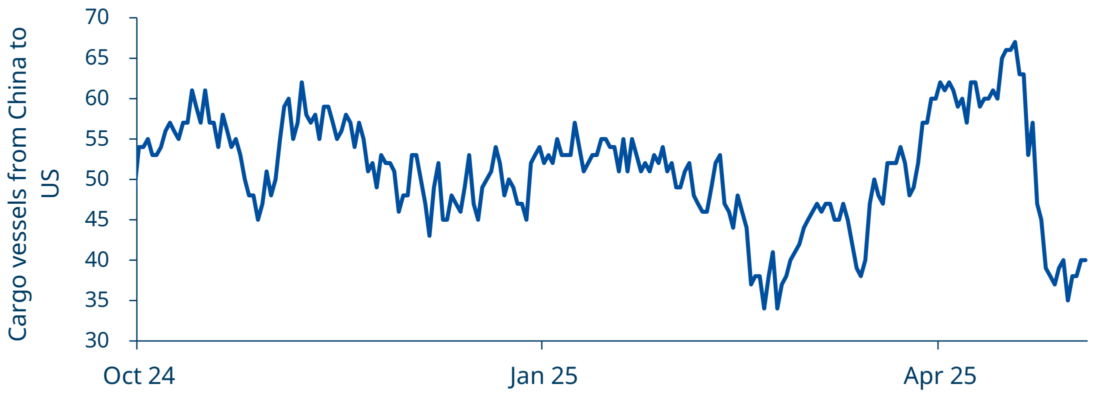
While mitigation plans may work for 30% tariffs, rates exceeding 100% are impossible to mitigate—even for businesses with high margins and strong pricing power. By imposing a high punitive tariff rate of 145%, Washington is dangerously flirting with the idea of economic decoupling. Even temporary adherence to this unsustainable rate has significant consequences.

The impacts are three-fold:

- **First, a supply shock as transpacific shipments halt and orders are cancelled;** this, however, is borne more by the US than by China. While the number of vessels carrying containers to the US is expected to decline sharply, China's port throughput has increased in both sequential and annual terms since 9 April. Reported increases in shipping demand in Vietnam, Thailand, and Cambodia, and rising traffic to Europe are not coincidences, indicating rerouting by Chinese exporters.

"Impacts of the trade war are just about to unfold, and some are not erasable by whimsical policy changes. It is complacent to assume there will be no structural consequence."

The volume of cargo from China to the US is down 40% from this year's peak



Source: Amundi Investment Institute and Bloomberg, as of 5 May 2025.
Shows 15-day rolling average of dry cargo vessels leaving China with US as destination

- **Second, a demand shock, as punitive tariffs start to take a toll on consumers and corporate profits**, in both the US and China. The costs of tariffs will be borne by Chinese exporters, US importers (such as Walmart, Home Depot, and Target), and US consumers. Approximately a quarter to a third of US imports from China are difficult to substitute. This is due to the heavy reliance on Chinese supplies in the US, the complexity of certain products, and China's position as the sole or one of the few producers. Among the top 100 products that are hardest to substitute, China accounts for an average of 57% of the world's total exports (see table below).
- **Finally, a structural shock, as companies adjust supply chains to accommodate increased protectionism**, exchanging efficiency for policy security. Since US retailers sourcing from China have experienced considerable damage from supply shortages, these risks are no longer economically justifiable.

"Among the top 100 products that are hardest to substitute, China on average accounts for 57% of the world's total exports."

Mutual de-escalation happened quickly, allowing tariffs to fall from the highly-punitive 145% to 30%. Together with the initial tariffs under Trump's first term, the effective US tariffs on Chinese imports are close to 40% - which are much higher vs Trum 1.0 and still prohibitive. Chinese exporters, on average operating with relatively low margins, have no effective way to mitigate the impacts on their own.

Mitigating amid multiple contingencies: amid the evolving tariff landscape, the bar for resuming monetary policy easing is lower compared to other measures. Rate cuts were already needed before Trump took office, to assist the fragile recovery in domestic demand. Restrictive US trade policies will act as a disinflationary demand shock to China's economy, further worsening the existing deflation issue.

Can US easily substitute made-in-China products?

Breakdown of US imports from China, by reliance and product complexity (% of total)

China's share in US imports on specific products	Product complexity (PCI): < -1	-1 to 0	0 to 1	>1
0-25%	Apparel; Fruit; Fish 3.2%	Wire, cable 4.6%	Medicine; Refrigerators; AC Unites 19.1%	Machinery; Electrical machines 11.2%
25-50%	Headgear; Underwear 0.9%	Leather shoes; Bed linen; Paper 3.3%	PC; Smartphones; Iron or steel articles 29.1%	Motor hand tools; Vacuum cleaners 3.1%
50-75%	Textiles; Wigs; Gloves 1.4%	Cutlery; Sports shoes; Stoves 3.3%	Electric water heaters, hand dryers, irons; Lamps 5.4%	Electric accumulators 4.2%
>75%	Blankets and travelling rugs 1.5%	Kitchenware and household articles of plastics, iron, and steel 3.2%	Wheeled toys; Video game consoles 6.2%	Vacuum flasks 0.4%

less reliance on China ↑ / ↓ *higher reliance on China*

→ *more complex products + less easy to substitute*

Source: UN Comtrade, Amundi Investment Institute. Data as of 7 May.

On 7 May, the PBoC cut the RRR by 50bp and the policy rate by 10bp. We expect two more cuts of 10bp each in July and September, respectively.

For fiscal policy, however, Chinese policymakers might prefer to wait and assess how damaging the trade war is before taking decisive action. It has only been two months since the fiscal stimulus package (approximately 2% of GDP) was introduced by the National People's Congress.

Q3 will provide a good opportunity to evaluate the need for a supplementary budget, with May and June data available for a better assessment of the impacts.

Playing the long game, China has no time constraints in this fight, unlike Trump with the upcoming mid-term elections, allowing Beijing to adopt a strategic approach.

China's economic warfare arsenal comprises three arrays of tools:

1. **Offensive measures:** these aim to retaliate and inflict pain on the rival, such as restricting access to critical Chinese supplies like rare earths (i.e., through its own export control), and gatekeeping access to China's market (punitive retaliatory tariffs, regulatory investigations, and government procurement rules). Selling US Treasury holdings would be ineffective as an offensive market measure. Even if all of China's FX reserves ($3.2 trillion) were invested in US Treasuries, the sheer size of the Treasury market— with daily trading volume exceeding $900bn—means China's rapid liquidation would be absorbed within 3-4 days, limiting any lasting market impact. Not to mention that the Fed has multiple liquidity tools to mitigate Chinese selling pressures.
2. **Defensive measures:** these are designed to mitigate the negative effects of potential attacks, particularly in the financial market, where the US holds a clear advantage in blocking China's access to the dollar-dominated global financial system. FX reserve divestments, cross-border payment arrangements, RMB settlement infrastructure, and central bank swap lines will progress further and faster.
3. **Remedial measures:** these involve concessions and positive moves, such as re-engaging in negotiations with the US, deepening trade ties with US allies through multilateral agreements like the CPTPP and strengthening partnerships with the Global South.

In this context, traditional tactical tools that could hurt strategic goals— export subsidies and currency devaluation—will likely be set aside.

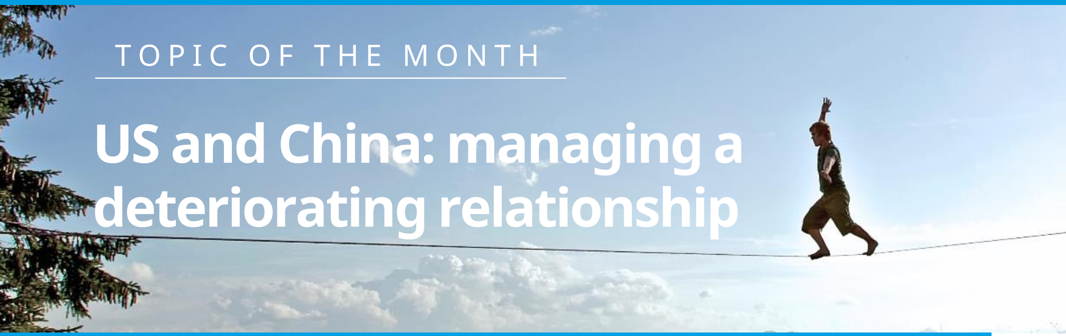
Key take-aways on China's equity market from the desk

We maintain a long-term positive view on China, considering the recent significant shift to supportive fiscal policies. However, given the extreme uncertainty on the tariff side, we are more cautious in the short term, and we think it's time to pivot towards more domestic and defensive areas that are less impacted by tariffs.

As such, we favour the onshore market (China A-shares) over offshore market (China H-shares) and domestic demand and dividend yield over export-oriented exposure, given the more geopolitically resilient risk premia in the onshore market and the government's focus on stimulating domestic demand.

In China, we are seeing positive momentum in earnings within the tech sector, particularly with the rise of AI applications and consumer technology. Nonetheless, we remain cautious about the risks of increasing overcapacity in China and the potential dumping or displacement of existing products in global markets, which would pose challenges for both domestic and international players.

NICHOLAS MCCONWAY, HEAD OF ASIA EX-JAPAN EQUITY, AMUNDI



TOPIC OF THE MONTH

US and China: managing a deteriorating relationship

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KEY TAKEAWAYS

The relationship between the US and China will likely continue to deteriorate, as the US security establishment considers 2027 as the key date for China to be able to take on the US.

However, the US and China have little interest in allowing their relationship to completely spiral, preferring instead to achieve an economic divorce that allows both countries to survive. Recent tariff reductions reflect these dynamic.

Although trade tensions between the US and China have now eased, it is important to understand the broader dynamic between the two countries. Over the next few years, the US-China relationship will continue to deteriorate, with 2027 seen as a key date on the horizon. This is the year the US security establishment believes China could be in a position to militarily challenge the US. Whether or not this is accurate, these fears are driving US policy towards China as well as US efforts to re-industrialise. To wage and win wars, a country must have a solid industrial base to build and repair military equipment. Trump's steel, aluminium and China tariffs must be seen from this perspective; they also aim at weakening China's industrial capacity.

That being said, in 2025, the US and China have little interest in allowing their relationship to spiral out of control: it is about achieving a divorce that still allows both parties to remain economically afloat. We are now seeing both sides walk back on tariffs. The scenarios outlined below show how the relationship has evolved from the 'escalation scenario' to our basecase, the 'tense understanding scenario', in which we expected US-China tariffs to fall significantly from the previous 145% level. While further talks are possible, we do not expect a 'grand bargain' anytime soon. During Trump's first term, US-China trade negotiations proved difficult and took years to complete.

> *"In 2025, the US and China have little interest in allowing their relationship to spiral out of control: it is more about achieving a divorce that still allows both parties to remain economically afloat."*

US-China economic scenarios

Scenario:	Escalation	Tense understanding	Grand bargain
Likelihood:	25%	55%	20%

Source: Amundi Investment Institute, as of 12 May 2025. These scenarios are not exhaustive.

Scenario 1: Escalation

Scenario	The US-China relationship escalates, with neither country backing down; tariffs go back above 100%, and full economic and security decoupling plays out.
Signposts to watch	The relationship deteriorates further if the US begins to limit China's access to US financial markets, or forces third countries to reduce their ties to China as part of trade deal negotiations, leading China to conclude that the US seeks to permanently harm China's economic prospects. China steps up retaliatory measures, drastically restricts rare earth and pharmaceutical exports, increases the intimidation of US businesses, and tries to force countries in its vicinity that are sitting on the fence to choose sides.
Implications	A cold war unfolds in which both sides seek to limit interactions, forcing a bipolar world. This scenario would increase geopolitical risks, both in Asia and beyond. While risks in the South China Sea would increase, so would tensions in other parts of the world, with China likely stepping up military support to Russia (depending on the China-Europe relationship and developments in Ukraine) and aligning more with Russia in space and the Arctic.

Scenario 2: Tense understanding (Basecase)

Scenario	The US and China reach an agreement whereby tariffs in the US will be lowered from current levels but remain elevated. China also reduces retaliatory actions. The US does not force all other countries it is negotiating with to choose sides against China, allowing China to re-route some trade to the US without choking it economically. There is some economic decoupling in sensitive sectors, but both countries continue to compete and do business.
Signposts to watch	The US and China lower tariffs, and talks occur between senior officials, along with promises of future negotiations. The US does not enforce taking sides against China in trade deals with other countries. Hostile rhetoric dials down, and a possible meeting between Xi and Trump emerges. A deal regarding TikTok is also possible in exchange for more tariff concessions.
Implications	There is a re-routing of supply chains and a reduction in Chinese exports to the US, with separation extending beyond just sensitive sectors, but falling short of a full economic decoupling. US-China relations would continue to focus on diversifying away from each other. Risks in the South China sea would remain elevated but not rise in the short term. China would continue to try and lure countries away from close ties with the US, both in Asia and Europe.

Scenario 3: Grand bargain

Scenario	The US and China work towards achieving a Phase Two trade agreement, implementing tariffs on some Chinese imports but not all sectors. China agrees to rebalance its economy towards consumption and buy more US products. The US does not force other countries to choose sides against China, allowing China to re-route some trade towards the US. China steps back from retaliatory measures. There is some economic decoupling in strategically sensitive sectors, but both countries continue to compete and do business. The US agrees not to change the status quo around Taiwan and acknowledges China's regional interests.
Signposts to watch	US-China lower tariffs simultaneously. Negotiations resume regarding TikTok and the CATL-Ford joint venture. Announcement of Xi-Trump meeting, resumption of trade talks follows.
Implications	Some market relief occurs, along with the re-routing of supply chains, a reduction in Chinese exports to the US, and separation in some sectors, but not a full economic divorce. Geopolitical tensions would ease, including in the South China sea. There could also be an increase in Chinese FDI in the US or more joint ventures involving technology transfers.

Source: Amundi Investment Institute, as of 12 May 2025. These scenarios are not exhaustive.

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