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Special Coverage:

US-China tariff pause supports de-escalation of trade tensions

Key takeaways

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- The temporary rollback of US tariffs on Chinese imports from 145% to 30% and China tariffs on US goods from 125% to 10% represented a substantial de-escalation of trade tensions.
- We estimate the 30% additional US tariffs will translate into 0.9ppt drag on China's GDP and expect the 90-day tariff reprieve will likely boost the front-loading of Chinese exports further in the next three months. However, the tariff pause is only a preliminary deal while the upcoming trade talks will likely be a lengthy and bumpy process. Hence, we don't expect Chinese policymakers to slow down the policy support for domestic consumption and structural reforms to bolster home-grown demand.
- Navigating persistent global trade uncertainty, we stay focused on domestically oriented China's AI innovation champions, including AI enablers and adopters in the ecommerce, social media, online gaming, software, smartphones, autonomous driving, and robotics sectors. We expect the Chinese market rally to broaden out to the consumption, financial and industrial sectors in the next phase of market re-rating. We remain overweight on Chinese equities, including quality SOEs paying high dividends and remain positive on Chinese hard currency bonds.

What happened?

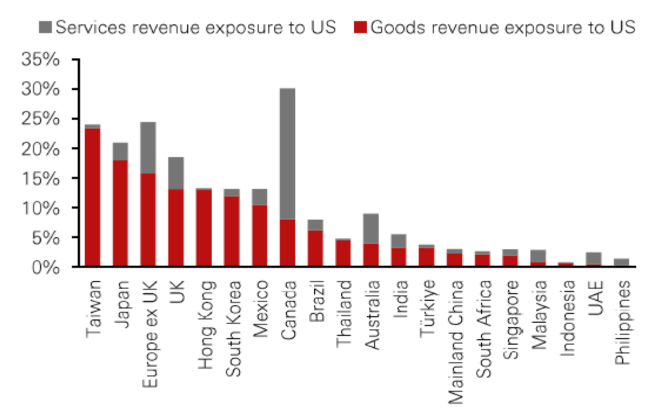
- Global equity markets staged a sharp relief rally in response to a positive surprise from the speedy and better-than-expected agreement reached by the US and China to temporarily slash tariffs after the first round of high-level negotiations on 10-11 May.
- According to their joint statement released in Geneva on 12 May, the two sides achieved a breakthrough as the US agreed to lower its 145% tariffs on Chinese imports to 30% for 90 days. The 30% tariffs, which include the earlier 20% tariff imposed on Chinese goods for the fentanyl issue, came in at much lower than the 80% tariffs suggested by President Trump on Truth Social before the weekend trade talks started.
- In a reciprocal manner, China agreed to roll back its 125% retaliatory tariffs imposed on US imports to 10% for 90 days. China also agreed to lift non-tariff countermeasures imposed on the US since the "Liberation Day" on 2 April. According to a Reuters report, China's lifting of non-tariff countermeasures will include accelerated approvals for export permits of rare earths for US companies.
- The 90-day US-China tariff pause will take effect on 14 May. However, it will not apply to sectoral tariffs imposed on all US trading partners while previous tariffs applied on China during Trump's first presidency remain unchanged.
- Looking ahead, we expect the upcoming negotiations between Washington and Beijing to cover broader bilateral economic and security matters. As President Trump highlighted after the announcement of the tariff reprieve, he noted the most important outcome of the trade talks was China's agreement to "open up" the market to US businesses although no specific details was provided.

- For China, we estimate the 30% additional US tariffs will translate into 0.9ppt drag on GDP. We caution that there are still many uncertainties surrounding the trajectory and final outcome of upcoming trade talks due to significant differences between the two sides on trade conflicts, market access disputes and technology export restrictions.
- Should the eventual US tariff levels stay at 30% rather than our base case assumption of 50%, this would represent upside risks for China's growth as compared to our recent downgrade of China's GDP growth forecasts of 4.3% for 2025 and 4.0% for 2026.
- Notably, we expect the 90-day tariff reprieve will likely boost the front-loading of Chinese exports further in the next three months. China's recently released April trade data revealed the significant impact of punitive US tariffs, with Chinese exports to the US recording a sharp decline by 21% y-o-y in April. By contrast, Chinese exports to ASEAN and Latin America were up 20.8% and 17.3% y-o-y, respectively, showing accelerated front-loading by importers and re-routing of China-US trade through third markets to mitigate the tariff impact.
- The 90-day tariff pause will likely trigger a new wave of Chinese exports front-loading in the coming months, potentially leading to export growth exceeding market expectations. Thus, ironically, we may see a boost in external demand to avoid potentially higher tariffs after the 90-day pause and the "above-seasonal-normal" export growth could boost economic activity in China.
- However, we don't expect Chinese policymakers to slow down the policy support for domestic consumption and structural reforms to bolster home-grown demand. The tariff reprieve is only a temporary and preliminary deal and does not change the overall strategic outlook of the US-China economic competition and technology rivalry. Considering the rapid policy twists and turns under the Trump administration, China is expected to stay focused on its own economic rebalancing through bolstering domestic demand, especially through supporting household consumption, improving social security reforms and enhancing productivity gains.

Investment implications

- The temporary US-China tariff reprieve has substantially boosted risk-on sentiment across global equity markets, but past history of trade talks reminds us that it could take a long time to reach a full trade agreement and there will likely be many twists and bumps in the negotiation process. Even if the eventual US tariffs on Chinese imports can hold at 30%, the tariff rate remains more prohibitive than before the "Liberation Day". Hence, we retain our preference for domestically oriented sectors and quality domestic leaders to mitigate global trade uncertainty.
- MSCI China is now trading at only 11.4x 12-month forward P/E based on consensus estimates, representing steep valuation discounts to the 22.1x and 13.5x 12-month forward P/E of the S&P 500 and MSCI Asia ex-Japan, respectively.

Mainland China has very limited exposure to goods sales from exports to the US



Source: WITS, HSBC Global Private Banking and Wealth as at 13 May 2025.

- Looking ahead, we expect continued strong investor interest in the technology self-sufficient leaders and select domestic consumer counters amid global trade uncertainty. There have been sustained mainland Chinese mutual fund inflows into self-sufficient tech names, both software and hardware plays. The DeepSeek-driven AI innovation and investment boom should continue to bring structural growth opportunities from AI enablers and adopters in the ecommerce, social media, online gaming, software, smartphones, autonomous driving, and robotics sectors.
- Under the policy priorities to boost domestic consumption and private sector growth, we expect the China market rally to broaden out to the consumption, financial and industrial sectors in the next phase of market re-rating. We remain overweight on Chinese equities and further enhance resilience of our equity exposure to quality SOEs paying high dividends in the telecom and financial sectors and expect the PBoC's monetary easing stance to underpin the low-for-longer rate environment to persist. We favour Chinese hard currency bonds in the technology, financials, SOEs, and Macau gaming sectors.

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