China Economic Update – May 2025

China's manufacturers need stronger domestic demand as trade with US is curtailed

NAB Economics

Summary

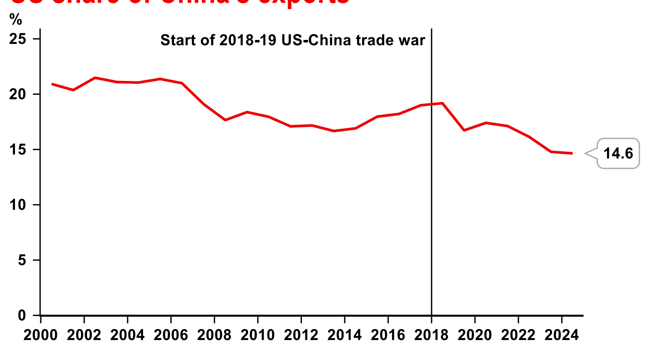
There remains considerable uncertainty around the global trade environment – particularly the US-China trade relationship – following the rapid escalation of tariffs post early April's "Liberation Day" announcements even allowing for subsequent exemptions (for consumer electronics and an easing of auto part tariffs). Commentary within China has suggested that there is little expectation of improvement in the relationship – with editorials in newspapers telling the public to prepare for a protracted trade war. Tariff rates at their current extreme levels will drastically reduce trade flows between the US and China – already seen in reduced bookings for global shipping – with the potential for this to have a sizeable impact on China's near term economic prospects.

US-China trade is set to be curtailed

China's economic growth was overly dependent on trade in 2024. While China's GDP by expenditure data is less comprehensive than the norm among advanced economies, official data suggests that net exports of goods and services accounted for over 30% of economic growth last year – its highest share since 1997.

The United States remained the largest single destination for China's goods exports in 2024 – at around 14.6% of China's total shipments. This share has steadily declined since the US-China trade war during the first Trump Administration, with the US accounting for 19.2% of China's exports in 2018.

US share of China's exports

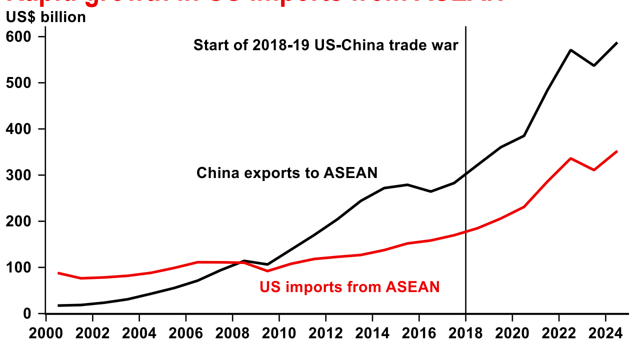


Source: Macrobond, NAB Economics

That said, this trade data likely underestimates the true share of trade as it excludes trans-shipments of Chinese goods through other countries. These trade flows could comprise finished goods where the origin of the product is hidden (likely to avoid the high tariff rates) or semi-finished goods, where a small amount of value add is performed in a second country, before being exported to its final destination (with this second country listed as the producer).

Given that a key purpose of trans-shipping is to disguise the true source of an exported good, it is not possible to have a firm measure of the scale of these flows. However, China's exports to ASEAN countries have rapidly increased since 2016 – more than doubling over this period to US$588 billion in 2024, while ASEAN's exports to the United States rose at an almost identical rate to US$352.3 billion last year.

Rapid growth in US imports from ASEAN



Source: Macrobond, NAB Economics

In particular, Vietnam is widely seen as a key market for trans-shipments – with 38% of its total imports coming from China in 2024. In response to the announced, although currently paused, reciprocal tariff of 46%, Vietnam's Trade Ministry issued a directive to crack down on trans-shipments. The directive stated there would be a strengthening in supervision and inspection of imported goods, as well as the countries factories to provide greater assurance over "Made in Vietnam" labelling.

The threat of punitive tariffs from the United States for accepting China's trans-shipments may be sufficient to limit (and possibly even reduce) this channel for Chinese exporters. However, the threats to China's exports extend beyond the US. Various countries and country groups – such as the European Union and Canada – raised tariffs on specific Chinese products in 2024 – including steel and aluminium and electric vehicles – while other countries commenced trade investigations or flagged potential tariff increases. The prospect of trade diversion – with goods previously targeted to the United States moving to other markets – could further increase trade tensions with the rest of the world – leading to a global increase in protectionism.

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How dependent are China's manufacturers on trade?

China's rapid industrialisation since the early 2000s has transformed its economy – making it the dominant force in global manufacturing – with the World Bank estimating that China accounted for around 29% of global manufacturing gross value added in 2023 (compared with 8.6% in 2004).

Based on the OECD's Trade in Value Added database, the majority of this manufacturing output was consumed domestically. As these data are only available up to 2020, we have estimated the subsequent years based on China's official trade and industrial production data.

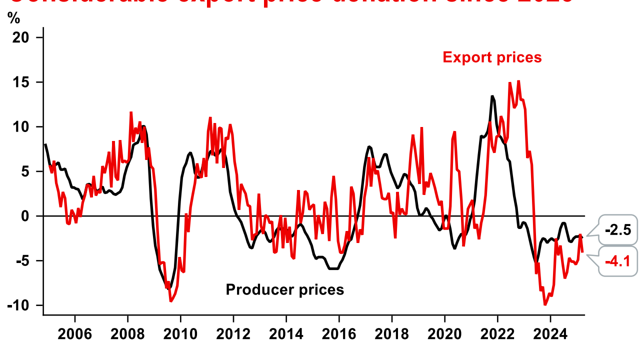
The export share of manufacturing rapidly increased from the late 1990s through to the mid-2000s – peaking at 58% of gross value added in 2006, before subsequently declining as growing wealth supported an increase in domestic consumption. In 2019, the export share dropped below 40%.

Export share of China's manufacturing

Source: OECD TiVA database, Macrobond, NAB Economics

Our estimates suggest that the export share of manufacturing rose during the pandemic and remained elevated (compared with pre-pandemic levels) in the subsequent recovery phase – as the zero-COVID policies, along with the downturn in the property sector, negatively impacted China's domestic demand. That said, the steep increase and subsequent decline may not present a fully accurate picture, as this period was not only impacted by disruptions associated with COVID-19 but also by substantial differences in price movements for manufactured products in domestic and export markets.

Considerable export price deflation since 2023



Source: Macrobond, NAB Economics

China's producer prices slowed rapidly across 2022 (and started to fall late in the year), while export prices remained comparatively strong over this period. Export prices then fell more rapidly than producer prices across most of 2023 and 2024 (which may tend to undervalue the export share over this period). Prior to the pandemic, these measures moved together with a relatively close correlation.

Overall, looking through this period our estimates suggest the China's manufacturers have become more export dependent since the COVID-19 pandemic – a view that is consistent with the rapid increase in export volumes since mid-2023 and relatively subdued domestic demand.

How is China responding?

Even ahead of the Liberation Day tariff announcement, Chinese authorities had identified the need to provide additional fiscal support – particularly given its annual growth target was left unchanged at the National People's Congress in early March and the persistent headwinds to growth from the property downturn and subdued domestic demand.

In mid-March, the State Council and Communist Party Central Committee jointly released the 30-point plan on "on special initiatives to increase consumption". As we noted last month, the plan was light on detail, but flagged measures to boost both the supply and demand sides of the economy and on its own was unlikely to be sufficient for China to hit its target.

Further proposals were flagged by Premier Li at April's State Council executive meeting. These included a series of supply side measures (such as direct support for exporters, incentivising multinational corporations to reinvest in China, stimulating private sector investment and expanding the supply of eldercare, childcare and tourism services) and some indirect demand measures (support for businesses to retain employees and continued efforts to stabilise equity and property markets). It is worth noting that the subsequent Politburo meeting at the end of April did not propose any increase in deficit spending.

To provide a sense of the importance of US trade to China's manufacturers, if exports to the US were to completely cease and there was no trade diversion to other countries, domestic sales of manufactured goods would need to increase by almost 8% just to offset the trade losses.

Conclusions

In the wake of the tariff escalation across April, we cut our forecasts for China's growth over the next two years – to 4.1% in 2025 and 3.9% in 2026. This forecast reflects an expectation that any fiscal stimulus that China implements this year will lag the negative impacts of US trade policy. As we have previously noted, the direction of policy measures is more important than the size of any fiscal package. An excessive focus on the supply side of the economy will likely worsen the imbalances that drove the recent surge in export volumes that fuelled trade tensions. This raises the possibility of other countries implementing protectionist policies against China. We argue that more needs to be done to sustainably improve household demand to reduce the reliance on exports to generate growth.

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