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Trade war 2.0. China responds to Donald Trump's tariffs

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On 4 February, additional 10% tariffs, imposed by the US president on goods imported from China came into effect. In response, Beijing announced 15% tariffs on coal and LNG imported from the United States, along with a 10% rate on 72 categories of products, including oil, large-engine cars, and agricultural machines. These changes will take effect from 10 February. The Chinese authorities have also initiated an antitrust investigation into Google, placed two American companies on the 'unreliable entity list', and filed a complaint with the World Trade Organization regarding Washington's decision. Furthermore, they have expanded export controls to include additional critical minerals, such as tungsten.

The decision by the United States and China's response mark the beginning of a new phase in the trade war. The US tariffs stand at just 10%, but they are relatively impactful and leave open the possibility of further increases. This is an unfavourable development for China's economy, which has become more reliant on foreign sales in recent years, reaching its highest level in two decades. Beijing's response so far has been cautious and non-escalatory. However, China has demonstrated a broad range of tools that it could use if the situation intensifies. The stance of both sides suggests a willingness to negotiate a broader agreement, but the failure of talks could lead to the tariff conflict escalating further.

Commentary

- **China is not well-prepared for a trade war, but Trump's focus on restricting imports rather than American technology exports works in Beijing's favour.** In recent years, the Chinese authorities have prioritised reducing dependence on foreign supplies (such as technology and raw materials) rather than external demand, which has increased. Consequently, in 2024, net exports had the highest impact on economic activity since 1997, with the trade surplus contributing 1.5 percentage points to the officially reported 5% GDP growth. Well-founded doubts about the actual growth rate suggest that this impact may have been even greater. For China's leadership, tariffs at this level will be relatively less damaging than further US export restrictions, which could endanger the foundations of long-term prosperity. From Beijing's perspective, domestic technological advancement plays a crucial role (see '*The economy according to Xi Jinping: a technological 'leap forward'*").
- **The increase in US tariffs may seem moderate, but in reality, it is comparable in scale to those introduced during Trump's first term.** At that time, the effective tariff rate rose from around 2% to approximately 11%. Now, it could exceed 20% if the changes are implemented without exemptions for selected companies and without affecting the

structure of imports from China. Moreover, US authorities argue that the tariff hike aims to curb the influx of fentanyl into the country rather than reduce the trade deficit. However, it is likely that the president will also attempt to achieve the latter goal through tariffs. As a result, China faces the threat of even higher tariffs.

- **Trump's executive order also removes the duty-free import allowance for parcels from China valued under $800, previously covered by the *de minimis* exemption.** In the 2023 fiscal year, more than a billion such shipments entered the United States, the majority originating from China. Their estimated annual value amounts to tens of billions of dollars. This exemption not only allowed importers to bypass tariffs but also granted them access to a simplified customs procedure. Consequently, it contributed to the rapid expansion of Chinese e-commerce platforms such as Temu and Shein in the US market.
- **Beijing's response to Washington's decision has, so far, been measured.** The Chinese authorities could not afford to show weakness under US pressure, but the extent of that pressure has not required strong retaliation or sudden adjustments. However, they have demonstrated a wide range of tools that could be used if the conflict escalates, including tariff increases, measures against specific companies, and export restrictions. In the coming days, the exchange rate of the renminbi will be a key issue. The People's Bank of China may yield to market pressure and allow the renminbi to weaken. Such a move could offset the impact of tariff increases on the competitiveness of Chinese exports. However, it could also provoke further action from the United States. Additionally, it would influence the valuation of other currencies, particularly those of developing economies.