ASIA MONTHLY

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Asia: Trump tariffs to weigh down Asian economies

As the Trump tariffs begin to bite, Asian economies are projected to slow down, particularly those highly dependent on external demand. Attention also needs to be paid to the risk of sharp downturns across the region if additional reciprocal tariffs are imposed.

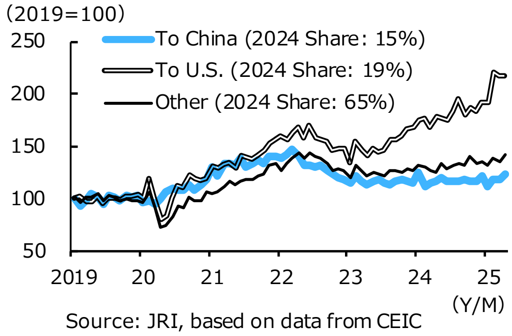
1. An economic slowdown from the latter half of 2025

(1) Exports drove economies in the first half of the year

Asian economies have picked up. The region's real GDP growth rate, calculated as the weighted average of individual countries and territories, was 5.5% year over year (YoY) in the first quarter of 2025 (January, February, and March). This exceeded the 5.1% figure recorded in the post-pandemic period (2022-24). Overall, exports to the U.S. surged as buyers rushed to complete purchases ahead of the implementation of the Trump tariffs. In China, more generous government subsidies for replacing durable consumer goods and equipment upgrades proved successful, with domestic demand showing signs of recovery too.

Asian economies have continued to bounce back since April too, driven by external demand. With the U.S. having delayed imposing its additional reciprocal tariffs for 90 days, the export rush from Taiwan and ASEAN countries to the U.S. has continued. Another key factor has been the related rise in raw material and component exports from China to these areas.

<Exports from Asia (excluding Japan and China) >
(USD, Seasonally Adjusted)

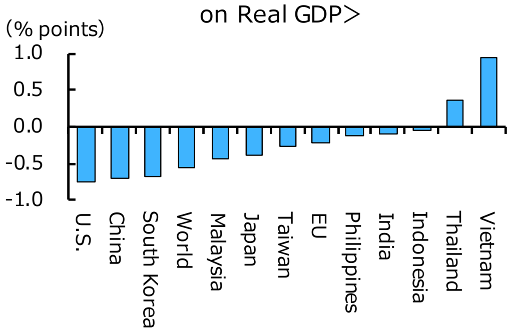


Source: JRI, based on data from CEIC

(2) The fallout from the Trump tariffs will weaken economic momentum

The Trump tariffs will begin to bite going forward as external demand falls. Asian economies look set to slow down as a result. Although the additional reciprocal tariffs are still expected to remain unimplemented, the ramifications of the 10% baseline tariff should become apparent as demand falls back following the pre-tariff surge. Additionally, product-specific tariffs are expected to put mounting pressure on Asian exports to the U.S., with a 25% duty to be applied to semiconductors, pharmaceuticals, copper, timber, aircraft, and smartphones soon. This is on top of existing levies on steel, aluminum, and automobiles, which have already been raised. Furthermore, economic slowdowns in the U.S. and China, due to their intensifying trade war, are expected to cause a slump in external demand worldwide.

<Impact of the Trump Tariffs on Real GDP>



Source: JRI, based on data from the US Department of Commerce, the IMF etc.
Note: Figures calculated based on the following U.S. tariffs: a baseline 30% tariff on China goods, 25% or 50% product-specific tariffs, and 10% reciprocal tariffs.

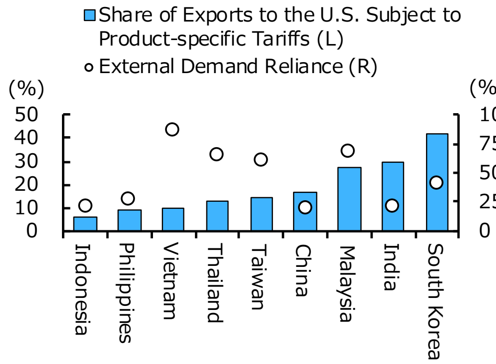
Still, the severity of the impact on each country or territory's economy is projected to vary depending on their economic structures. I will examine three key factors.

The first is differences in the degree of reliance on external demand. In countries and territories where exports account for a large share of GDP, a drop in overseas demand is likely to lead directly to slowdowns in the economy as a whole. The overall economic impact of exports falling due to the tariffs will be particularly serious for South Korea, Malaysia, and Taiwan. This is because their key exports, such as automobiles and semiconductors, will have higher tariffs slapped on them. In contrast, the domestic demand-driven economies of India, Indonesia, and the Philippines are only expected to see limited fallout.

The second factor is differences in leeway to use fiscal and monetary policy to support the economy. On the fiscal front, government debt has ballooned in most countries and territories due to their COVID-19 responses, so there is little room for further fiscal expansion. However, Vietnam and Taiwan, have made progress with fiscal consolidation thanks to high economic growth since the pandemic, so they are expected to be able to support their economies to some degree by boosting government spending.

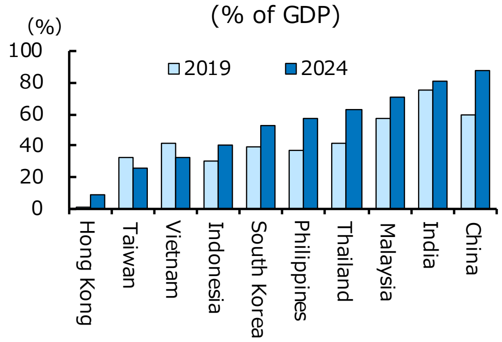
On the monetary front, all the countries and territories in the region have inflation rates that are at or below the targets set by their central banks, so interest rate cuts could be used to support consumption and investment. Six of the nine central banks in Asia have already cut rates since April. Notably, India's has done so at each of its three meetings since February. Financial markets expect interest rates to be lowered in Asia in response to the impending economic slowdown. Still, Indonesia is seen as having limited scope for rate cuts in light of concerns about the risk of further currency depreciation provoking financial instability.

<External Demand Reliance and Items Exported to the U.S.>



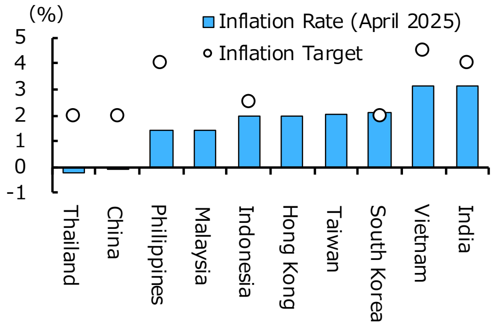
Source: JRI, based on data from the US Department of Commerce and CEIC
Note: Export reliance figures are for 2023 and export share figures are for 2024

<Outstanding Government Debt>
(% of GDP)



Source: JRI, based on data from the IMF

<Inflation Rates and Targets>

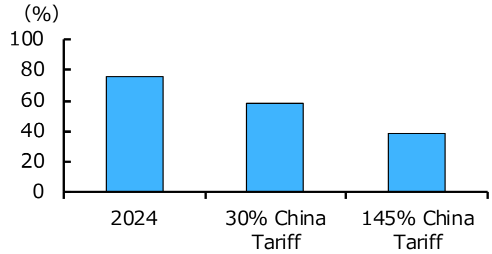


Source: JRI, based on data from CEIC

The third and final factor is differences in how able different countries and territories are to displace Chinese exports and benefit from production relocation from China. Some Asian countries and territories are expected to gain from replacing Chinese exports to the U.S. and attracting production facilities being relocated out of China in two product categories. The first is Chinese items that will lose their competitive edge in the U.S. market due to tariffs; the second is goods where concentrating production in China poses significant supply chain risks. I will examine both in more detail, starting with the first category.

By export value, the share of Chinese exports to the American market that were price competitive with similar goods from other countries stood at 80% in 2024, before the tariff hikes. But if the current 30% tariff rate agreed by the U.S. and China May this year remains in place, this figure will drop

<Share of Products Exported to U.S. Where China is Price Competitive>

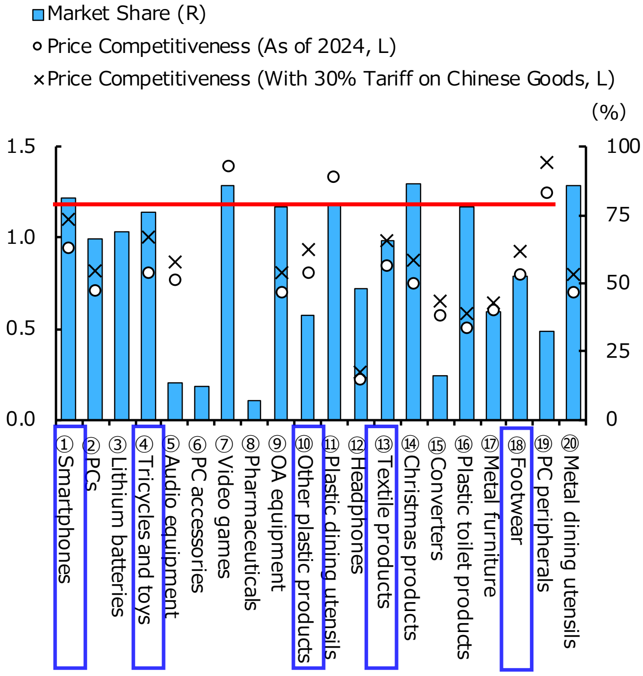


Source: JRI, based on data from the US Department of Commerce
Note: Price competitiveness = prices of Chinese exports to U.S. / prices of exports from rest of world to U.S. A value below 1 indicates that China is more price-competitive than other countries. Calculated based on 2024 export values.

to 60%. The fact that products such as smartphones and toys (including tricycles) – among China's top exports to the U.S. – are now relatively more expensive will have a notable impact. In addition, tariffs have narrowed the price gap between China and other countries for items such as textiles, plastic products, and shoes so much that China has practically lost its competitive edge. Vietnam and India, the next biggest exporters of these products, are therefore likely to see their exports to the U.S. rise as their offerings replace those from China.

As for the second category, among China's top exports to the U.S. by export value – specifically the products where it enjoys significant market share – global firms are expected to become more averse to concentrating output in China and instead relocate production to other Asian countries. Among the top twenty Chinese exports to the U.S., twelve boast a market share of more than 50%. There are likely to be significant production transfers to Vietnam, which has large shares for all of the products, and Thailand and Taiwan, which have large shares for nine of them, from now on. In addition, Chinese companies themselves have begun to diversify their production locations. Outward direct investment from China into ASEAN increased 1.7-fold between 2017 and 2023, with investment in Vietnam standing out with a 3.4-fold rise.

<Price Competitiveness and Market Share of China's Top 20 Exports to the U.S.>



Source: JRI, based on data from the US Department of Commerce
Note: Price competitiveness = prices of Chinese exports to U.S. / prices of exports from rest of world to U.S. A value below 1 indicates that China is more price-competitive than other countries. Values above 1.5 are omitted. Calculated based on 2024 export values.

These export displacement and production relocation effects are expected to be felt both in the short term, due to higher capacity utilization at existing production facilities, and in the medium to long term due to the need to relocate equipment and build new facilities.

In light of the above, the growth rate of Asia as a whole is expected to be just 4.8% in 2025, down from 2024 and the lowest growth rate seen in recent years. Although China will avoid a sharp slowdown due to the tariff cuts agreed with the U.S. and government stimulus measures, its growth looks unlikely to top 5%. Other Asian countries and territories are expected to see varying growth depending on economic structure. Those that are highly dependent on external demand, notably South Korea and Malaysia, look set for significantly lower growth. This is because products subject to product-specific tariffs make

<Projected Growth Rates for Asian Economies>

(%)

	2023 (Actual)	2024 (Actual)	2025 (Forecast)	2026 (Forecast)
Asia total	**5.8**	**5.2**	**4.8**	**4.8**
Northeast Asia	4.9	4.7	4.3	4.1
China	5.4	5.0	4.7	4.4
South Korea	1.6	2.0	0.6	2.1
Taiwan	1.1	4.8	3.1	2.4
Hong Kong	3.2	2.5	2.4	2.2
ASEAN 5	4.4	5.0	4.6	4.8
Indonesia	5.0	5.0	4.7	4.9
Malaysia	3.5	5.1	4.2	4.5
Philippines	5.5	5.7	5.3	5.6
Thailand	2.0	2.5	2.2	2.2
Vietnam	5.1	7.1	6.6	6.8
India (fiscal year)	9.2	6.5	6.3	6.7

Sources: Prepared by JRI based on data from IMF and national statistics and central bank data from each country up a large chunk of their exports, and they have limited room to expand fiscal spending. On the other hand, even though they are heavily reliant on external demand, some countries should maintain relatively stable, albeit slower, economic growth. These include Vietnam, where the impact of product-specific tariffs will be small and gains from export displacement and production relocation are expected, and India and the Philippines, whose economies are driven by domestic demand.

In 2026, China and other Asian economies' performance is expected to diverge. Projections are for Chinese growth to slow considerably as the fragility of domestic demand becomes apparent amid the fading effects of economic stimulus measures, whereas other Asian economies will enjoy a pick-up in external demand during the second half of the year as they adapt to the impact of tariffs and benefit from an economic recovery in the U.S.

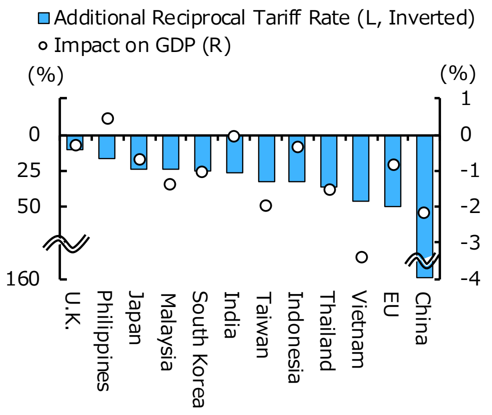
2. Key risks are the U.S. imposing additional reciprocal tariffs and the acceleration of China "exporting deflation"

(1) The U.S. imposing additional reciprocal tariffs would deal a blow to Asian economies

Of the threats that could cause further economic slowdowns, the most concerning is the re-imposition of additional reciprocal tariffs. Depending on the outcomes of negotiations with the U.S., high additional tariff rates may be re-imposed, potentially slashing exports from Asian countries and territories.

The impact of the Trump tariffs, including the additional tariff rates, would be enormous, with the Vietnamese, Chinese, and Taiwanese economies taking hits of -3.4%, -2.2%, and -1.9%, respectively. Drops in external demand would also have ripple effects on domestic demand, and Asian economies would likely contract significantly. However, some countries such as India and the Philippines would be largely shielded from much of the fallout as their economies are driven by domestic demand. Indeed, their relatively low additional tariff rates may enable them to benefit from export displacement and production relocation instead of Vietnam, Thailand, and Taiwan.

<Impact of Additional Reciprocal Tariffs on Real GDP>



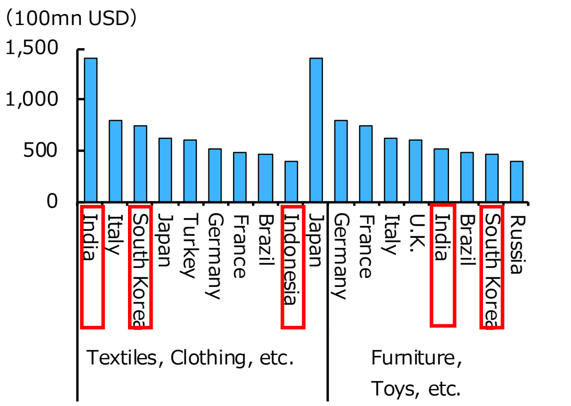
Source: JRI, based on data from the US Department of Commerce, the IMF etc

(2) The acceleration of China "exporting deflation"

If China is once again subjected to a 145% reciprocal tariff, around 60% of the products it exports to the U.S. market will no longer be price competitive, causing its exports to the U.S. to plunge by approximately 60%. Chinese products such as textiles, clothing, furniture and toys would have nowhere to go and turn into "deflationary exports" to other nations. This would damage other Asian economies through two channels.

The first is by intensifying domestic price competition, causing corporate earnings to suffer. Excluded from the U.S. market, Chinese products may flood countries with large markets. Specifically, in countries like India, South Korea, and Indonesia, an influx of cheap Chinese merchandise would expose domestic manufacturers to intense price competition, potentially threatening their business performance.

<Sizes of non-U.S. Markets for Products Subject to Reciprocal Tariffs>

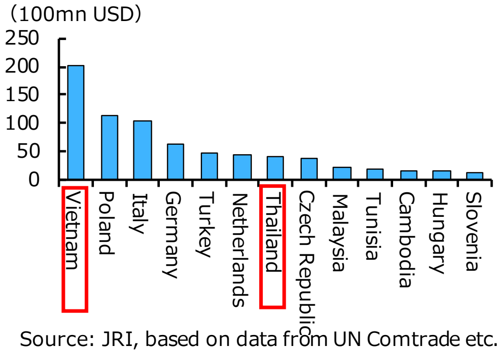


Source: JRI, based on data from the OECD, the UN etc.
Note: Based on the 2019 OECD Inter-Country Input-Output tables. Market size = production - exports + imports

The second is by intensifying price competition in export markets, which would also damage corporate earnings. Asian countries and territories that export to other markets the same products that China exports at competitive prices to the U.S. – such as textiles, clothing, furniture and toys – would face stiff competition from cheap Chinese goods now flowing into those markets. More specifically, Vietnam and Thailand, which export a great deal to non-U.S. markets, are likely to be suffer.

A drop in corporate earnings of this kind could push down employment and wages and weigh down domestic demand in many countries. So, they must also be vigilant of the danger of China increasingly "exporting deflation" to them and indirectly undermining their economies.

<Net Exports of Products Subject to Reciprocal Tariffs>
(Non-U.S. Export Destinations)



Source: JRI, based on data from UN Comtrade etc.
Note: Figures are for 2023.

(Tomohiro Hosoi)

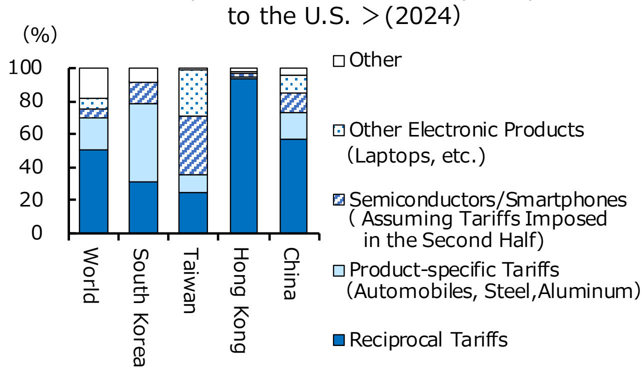
NIEs *Economies to slow down amid fallout from Trump tariffs*

■ Growth in 2025 will be the slowest since the pandemic

The real GDP growth rate of the Newly Industrialized Economies (NIEs) - South Korea, Taiwan, and Hong Kong - was 0.7% quarter over quarter in the first quarter of 2025 (January, February, and March). Overall, their economies have continued to expand moderately, though outcomes vary across each country/territory.

In Taiwan, the economy is expanding, supported by strong external demand from an upturn in the semiconductor cycle a rush of exports ahead of the Trump tariffs being imposed, and demand from people replacing their computers before Windows 10 support ends. Hong Kong is also benefiting from expanding external demand as China's economy picks up. In South Korea, however, both domestic and external demand have become increasingly sluggish, and real GDP growth in the first quarter slipped into negative territory. Although the rebound in global semiconductor demand has provided a tailwind, external demand dropped overall due to the high product-specific tariffs imposed by the U.S. on key South Korean exports such as steel and automobiles. In addition, domestic demand has sagged because of temporary factors such as political turmoil and large-scale wildfires, as well as the ongoing slump in the construction sector since last year.

<Composition of Each Country's Exports to the U.S. >(2024)



Source: JRI, based on data from U.S. Census Bureau, etc.
Note: Categories are based on U.S. executive orders. Semiconductors, smartphones, and other electronic products were subject to the April 9 executive order.

<Projected Growth Rates of NIEs (South Korea, Taiwan, and Hong Kong)>

(%)

	2022 (Actual)	2023 (Actual)	2024 (Actual)	2025 (Forecast)	2026 (Forecast)
NIEs	2.1	1.6	3.0	1.6	2.2
South Korea	2.7	1.6	2.0	0.6	2.1
Taiwan	2.7	1.1	4.8	3.1	2.4
Hong Kong	- 3.7	3.2	2.5	2.4	2.2

Source: JRI, based on data from the IMF and each country's national statistics bureau and central bank

Looking ahead, the NIEs are expected to see growth slow overall due to the fallout from the Trump tariffs. In South Korea, domestic demand is expected to bottom out as the political turmoil peters out and construction orders rebound. However, exports to the U.S. of products such as steel and automobiles will likely remain sluggish, and the U.S. government has warned that product-specific tariffs could be imposed on semiconductors and smartphones in the second half of the year. As a result, direct exports of semiconductors to the U.S. and exports of components for smartphones are predicted to slow, prolonging the economic downturn.

The Taiwanese and Hong Kong economies are also expected to slow. Taiwan's economy looks set to contract as external demand falls because of the pre-tariff export rush fading and the U.S. imposing new semiconductor and smartphone duties. The Hong Kong economy is also predicted to decelerate due to a slowdown in the Chinese economy as the full impact of the Trump tariffs is felt. As a result, the NIEs are expected to see real GDP growth of 1.6% YoY in 2025, the lowest growth rate since the pandemic.

Depending on what happens with the Trump tariffs, there is a risk of the NIEs getting dragged down even more. If the additional reciprocal tariffs are re-imposed, it will be difficult for Hong Kong in particular to export goods to the U.S., as it would be subject to a whopping tariff rate of over 100%, like China. Additionally, should steep duties be re-imposed on China, the NIEs would likely be impacted negatively by the ensuing Chinese economic downturn and acceleration of China’s "exporting deflation". Furthermore, if product-specific tariffs are expanded to cover electronic goods such as laptops, this can be expected to not only damage Taiwan, a major exporter of such goods, but also significantly reduce global semiconductor demand.

(Shota Muromoto)

ASEAN5 Economies to slow in H2 2025 as the demand rush fades

■ Economies will slow during the second half of 2025

In the first quarter of 2025, the ASEAN5 - Indonesia, Malaysia, Philippines, Thailand, and Vietnam – saw a weighted average real GDP growth of 4.9% YoY. While a slight reduction compared to the previous quarter's 5.1%, they maintained high growth. Their economies have held firm on the whole, with exports pushed up by buyers rushing to complete purchases ahead of the imposition of additional U.S. tariffs and capital investment expanding concomitantly. However, household consumption is weak in Thailand and Indonesia, and the pace of recovery is uneven across the region.

<Projected Growth Rates for ASEAN5>

(%)

	2022 (Actual)	2023 (Actual)	2024 (Actual)	2025 (Forecast)	2026 (Forecast)
ASEAN 5	6.1	4.4	5.0	4.6	4.8
Indonesia	5.3	5.0	5.0	4.7	4.9
Malaysia	9.0	3.5	5.1	4.2	4.5
Philippines	7.6	5.5	5.7	5.3	5.6
Thailand	2.6	2.0	2.5	2.2	2.2
Vietnam	8.5	5.1	7.1	6.6	6.8

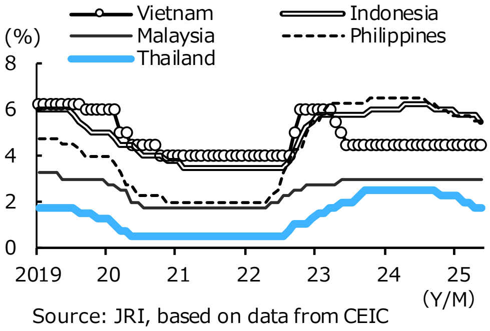
Source: Prepared by JRI based on national statistics from each country

The economies have continued to bounce back recently, with external demand the primary driver. Notably, the U.S. delaying the implementation of additional reciprocal tariffs has sustained the demand rush, and exports have remained solid.

But toward the second half of the year, the momentum is projected to further weaken. Full-year real GDP growth among the ASEAN5 is projected to decelerate from 5.0% in 2024 to 4.6% in 2025 because of weakening goods exports. This is expected because of the demand from the first half of the year fading as well as the phased imposition of additional tariffs on specific products by the U.S. and slowdowns in both the U.S. and Chinese economies. Malaysia, in particular, is likely to see a sharp drop in exports due to its heavy dependence on the semiconductor industry.

However, a sudden economic slowdown should be avoided. Given the ASEAN5 are seeing falling inflation rates, monetary easing is expected to support their economies. As of the end of June, interest rates had already been lowered twice in Thailand and Indonesia and once in the Philippines. In Thailand and Indonesia, domestic factors such as lower inflation and stagnant domestic demand led to the rate cuts. In the Philippines, the cut was a precautionary move taken amid uncertainty about the future due to U.S. trade policy.

<ASEAN5 Policy Interest Rates>



Source: JRI, based on data from CEIC

Looking ahead, with external demand expected to fall, there are likely to be one or two additional rate cuts in each of these countries before the end of this year. This should support domestic demand. However, the policy rate is already low in Thailand, meaning there is limited room for additional easing. I Indonesian monetary authorities will also need to be cautious about monetary easing given the persistent risk of rupiah depreciation.

Looking ahead, key risks include the U.S. re-imposing additional reciprocal tariffs and political instability both within and outside the region. Were the U.S. to re-introduce the higher tariffs, the rates would likely rise from the current 10% to 46% for Vietnam (the highest), 36% for Thailand, 32% for Indonesia, 24% for Malaysia, and 17% for the Philippines. There is a danger of this driving down each ASEAN5 country's exports significantly.

(Wu Zijing)

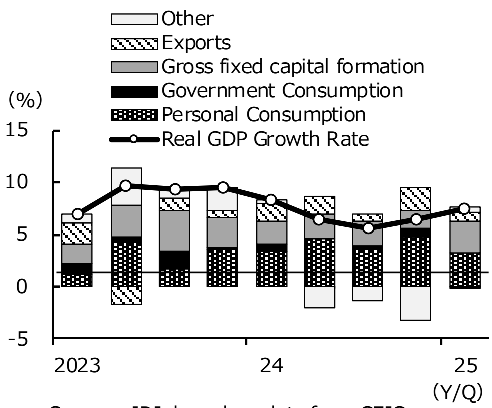
India   Stable growth led by domestic demand to continue

■ The rural economic recovery is driving domestic demand

The Indian economy is continuing its gradual recovery. The real GDP growth rate in the first quarter of 2025 was 7.4% YoY, up from 6.4% YoY in the previous quarter. By demand component, personal consumption climbed 6.0% YoY, maintaining the strong 8.1% YoY growth recorded in the previous quarter. The key reason was expanded consumption in rural areas amid steady wage increases in the agricultural, forestry, and fisheries industries, which employ about 40% of the working population. In addition, fixed capital formation accelerated to 9.4% YoY from the previous quarter's 5.2% YoY.

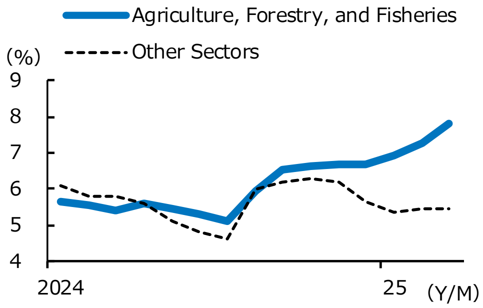
However, the external demand recovery paused, with export growth slowing to 3.9% YoY from 10.8% YoY in the previous quarter. Service exports increased 14.1% YoY, maintaining the rapid growth registered in the previous quarter (17.9% YoY), but goods exports declined 4.4% YoY, having seen 3.0% YoY growth in the previous quarter. Exports of petroleum products, which account for 20% of goods exports, fell sharply due to weaker global demand; this had a significant impact.

<Real GDP Growth Rate (YoY)>



Source: JRI, based on data from CEIC

<Rural Wage Growth Rate>



Source: JRI, based on data from CEIC

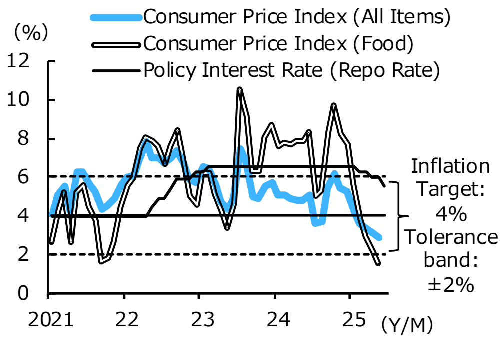
■ The domestic demand-driven recovery will continue, with policy effects adding to the momentum

The economy is expected to stay on a moderate recovery track led by domestic demand during the second half of the year. Slower inflation, particularly for food prices, and the effects of fiscal and monetary policy changes should boost domestic demand.

On the fiscal front, the minimum annual income qualifying for exemption from income tax was raised from 800,000 rupees to 1.2 million rupees in April this year, reducing the tax burden on low- and middle-income earners. In addition, government spending on infrastructure development in fields such as logistics, electricity, and water is expected to increase by about 10% from last financial year. The hope is that policies like these will stimulate consumption and spur capital investment.

On the monetary front, the Reserve Bank of India, the nation's central bank, has reduced its policy rate at three consecutive meetings since February. This aggressive monetary easing should also support domestic demand.

<Inflation Rate and Policy Interest Rate>



Source: JRI, based on data from CEIC

Meanwhile, though external demand is expected to dip due to the Trump administration's tariff policies, a slowdown should be avoided. Firstly, according to media reports, trade negotiations between the U.S. and India are progressing smoothly, and the additional reciprocal tariff rate (26%) may be reduced accordingly. But even if the 26% levy is implemented and goods exports are put under heavy downward pressure, service exports should continue to grow by about 10% YoY, offsetting the decline. Indeed, these have continued to grow rapidly since April, driven by increasing global demand for IT Business Process Outsourcing (BPO).

■ The key risk is a policy reversal by the Trump administration

However, attention needs to be paid to the risk of U.S. government altering its stance, which could adversely affect the IT-BPO sector, the driver of the Indian economy.

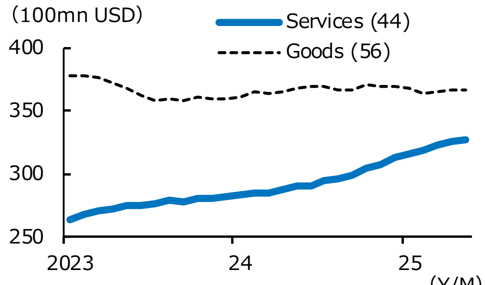
India's IT-BPO exports to the U.S. exceed $100 billion, and account for 20% of service exports. Therefore, a thriving American IT sector also serves to enhance the competitiveness of India's IT industry.

So far, the second Trump administration has pursued deregulation to energize the industry. For instance, immediately after taking office, President Trump rescinded the executive order on AI safety issued by the outgoing Biden administration and announced the withdrawal of the U.S. from the international digital taxation framework. This emphasis on IT was probably partly due to businessman Elon Musk's influence on the new administration’s decision-making.

However, disagreements with top officials over tariff policies and tax cuts led Mr. Musk to step down as a senior advisor to the president and leave the administration. Given these changes, there are fears that the Trump administration will stop prioritizing support for tech companies and shift to an approach that creates headwinds for Indian firms’ IT business expansions. For example, the administration might impose stricter requirements for issuance of H-1B visas, a temporary visa allowing professionals to work in the U.S. Indian IT companies have taken advantage of the visa to send many IT engineers to the U.S. and develop their IT-BPO businesses to span the two countries. Under the first Trump administration, the number of rejected applications for the visa rose. Since most of the applicants were Indian, this created obstacles to their travel to the U.S. and damaged the operating performance of Indian IT firms.

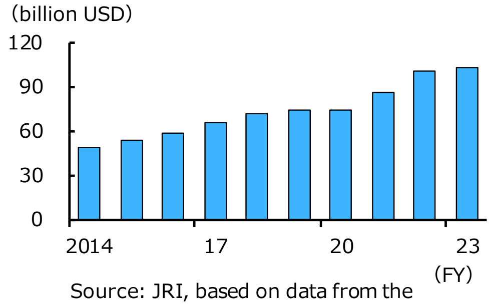
Since Mr. Musk left the administration, the influence of the anti-immigration faction within the administration has grown, increasing the risk of it again restricting visa issuance. If moves to restrict immigration intensify, the performance of Indian IT companies could be undermined and India's economic growth hampered.

<Goods and Services Exports>



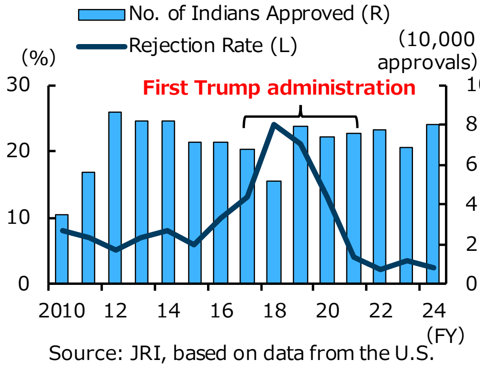
Source: JRI, based on data from CEIC
Note: 12-month moving averages. Figures in brackets are export shares in 2024.

<India's IT-BPO Exports to the U.S.>



Source: JRI, based on data from the Reserve Bank of India
Note: Figures until FY2021 include Canada.

<Rejection Rates and No. of Indians Approved for U.S. H-1B Visas>



Source: JRI, based on data from the U.S. Department of Homeland Security

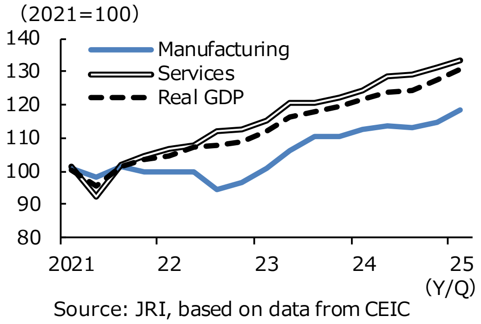
■ The urgent need to strengthen manufacturing competitiveness

For India's economy to sustain high growth over the medium to long term, it will be important to restructure it so that the manufacturing and service sectors can both grow in a balanced, healthy way. However, India's current economic growth is mainly being driven by services, and the manufacturing industry is stagnant apart from some areas such as smartphones. Breaking GDP down by industry, the service sector has grown by 33.4% since 2021. In contrast, manufacturing has only grown by 18.3% and its presence within the economy as a whole has diminished.

Furthermore, the international competitiveness of high value-added manufacturing, which the Modi government has sought to strengthen under the banner of "Make in India," has not improved. A look at trade specialization coefficients (measures of the degree of export competitiveness) reveals that in 2023, coefficients for both intermediate goods and final goods were below zero, except in some industries such as electrical machinery, including smartphones. This suggests low export competitiveness. Indeed, between 2013 and 2023, the trade specialization coefficient only markedly improved in a few categories, such as finished electrical machinery goods.

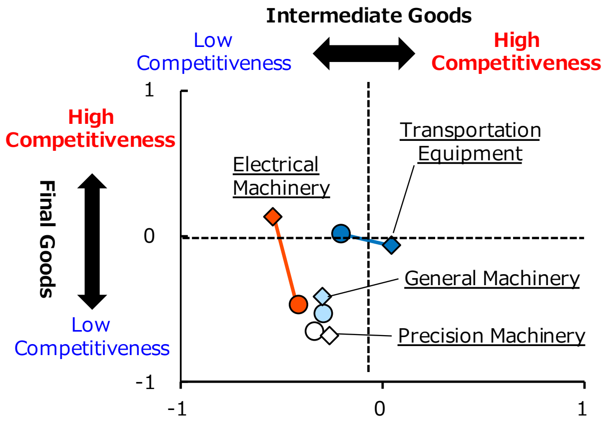
One of the reasons for manufacturing stagnating may be the sluggish growth of inward direct investment in the sector. Inward investment in non-manufacturing increased 25.3% from 2016 to 2024 but declined 13.1% for the manufacturing sector. There is a large disparity between the scale of investment in the manufacturing and non-manufacturing sectors.

<India's Real GDP by Sector (Seasonally Adjusted)>



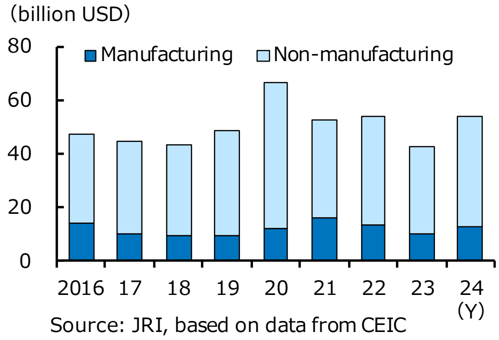
Source: JRI, based on data from CEIC

<India's Trade Specialization Coefficients from 2013 to 2023) >



Source: JRI, based on data from RIETI-TID
Note: Trade specialization coefficient = (exports - imports) / (exports + imports). Closer to +1: more export specialized, closer to -1: more import specialized.
○: 2013 figures, ◇: 2023 figures.

<Inward Direct Investment into India (Amounts Invested)>



Source: JRI, based on data from CEIC
Note: Figures are for equity investments only.

One likely reason for the low level of inward investment in manufacturing is that investment from China, with its massive financial firepower and strong technological capabilities, has stalled. Based on the rationale of safeguarding economic security, direct investments from neighboring countries have required prior approval by the Indian government since 2020. Direct investment from China and Hong Kong has been effectively halted as a result.

With India's relationship with China becoming increasingly uncertain following the recent deterioration in India-Pakistan relations, an expansion of investment from China in the near term is unlikely. However, with U.S. protectionism necessitating supply chain risk diversification, global companies from Japan, the U.S., and Europe are eyeing India as a potential manufacturing location, just behind Vietnam and Thailand. This is because India offers a vast supply of cheap labor and has a lower trade surplus with the U.S. than other Asian countries, meaning that its additional reciprocal tariff rate will be relatively low. But for India to leverage these advantages and strengthen its manufacturing industry, it will need to improve the investment environment. This means moving faster to remove obstacles to business such as an opaque legal system and delays in infrastructure development.

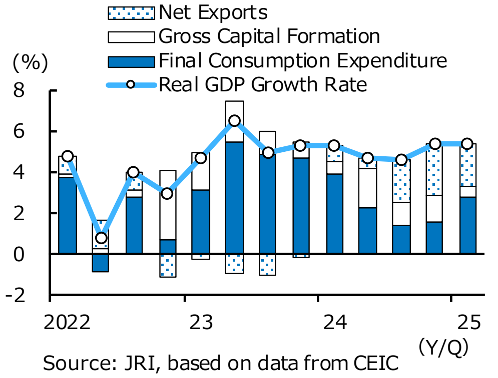
(Tomohiro Hosoi)

China Economy set to slow once more, but sharp decline to be avoided

■ The economy picked up in the first half of 2025

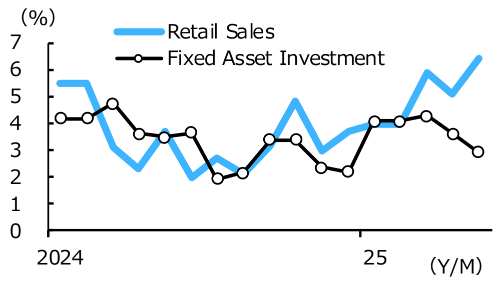
The Chinese economy picked up in the first half of 2025. With both domestic and external demand holding steady, the real GDP growth rate in the first quarter was 5.4% YoY, exceeding the government's 5% target for 2025. Domestic demand recovering because of policy factors was a big driver behind the growth. More generous government subsidies for the replacement of durable consumer goods proved successful, with sales of home appliances and automobiles rising. Higher subsidies for equipment upgrades and greater infrastructure investment also supported investment. External demand also rose with exports to the U.S. soaring as buyers rushed to complete purchases ahead of the Trump tariffs, and exports to ASEAN and other destinations increasing too.

<China's Real GDP Growth Rate (YoY)>



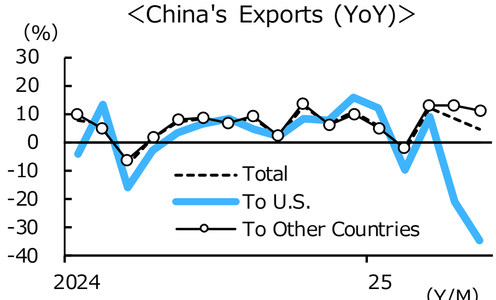
Source: JRI, based on data from CEIC

<Consumption- and Investment-related Indicators (YoY)>



Source: JRI, based on data from CEIC

<China's Exports (YoY)>



Source: JRI, based on data from CEIC

In the second quarter (April, May, and June), the growth rate is expected to have been slightly lower. Domestic demand likely rose at the same pace as in the first quarter, as the effect of policy support will have continued. Exports to the U.S. are expected to have slumped with the demand rush fading, but a serious downturn after June is expected to be avoided, as the U.S.-China agreement in May saw the additional U.S. tariff rate for China slashed from 145% to 30%. In addition, U.S. delaying the imposition of the additional reciprocal tariffs has allowed a rush of raw material and component exports from China to Taiwan and ASEAN countries to continue.

■ The economy will slow down going forward, but stimulus measures will provide support

In the second half of the year, the role of exports as a driving force will weaken, but the government's economic stimulus measures will support domestic demand, which should avert a significant decline in the growth rate.

First, regarding the outlook for the export environment, U.S. tariffs on goods imported from China are expected to remain in line with the terms of the U.S.-China tariff agreement reached in May. In short, the tariff on China is expected to stay at 30% in the second half of the year, and the rate for small packages with a value up to $800 should remain at 54%.

Under this scenario, exports to the U.S. will drop by 20%, in large part because smartphones and some toys will be more expensive than before the tariff hike. On the other hand, exports to countries and territories other than the U.S. should hold up overall, though they will rise at a slower pace. In recent years, the Chinese government has encouraged Chinese companies to reduce their dependence on exports to the U.S. and diversify their export markets. It has done this by improving the trade environment for them, such as signing new free trade agreements and upgrading others. In November 2024, soon after the U.S. presidential election, it announced fresh measures to support exports. These included broader export credit insurance coverage and more lending to businesses.

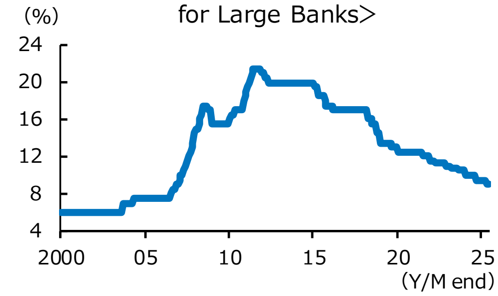
Furthermore, a wide range of Chinese products, including EVs, solar panels, household appliances, and textile products have improved in technological terms but are inexpensive for the performance they offer.

They are therefore highly competitive in export markets. For this reason, exports to regions such as the EU and Africa can be expected to expand in the future. Exports to ASEAN countries and Taiwan, however, will likely remain flat or fall slightly due to the substantial impact of the demand rush of the first half of the year fading. So, while export performance will vary depending on the destination, the steep decline in exports to the U.S. will be offset to some extent by moderate increases in exports to countries and territories other than the U.S. Exports are therefore expected to remain flat or dip slightly overall.

The pace of domestic demand is expected to slow slightly but should continue to support the economy in the second half of the year. Specifically, the following three economic stimulus measures from the government are projected to stimulate domestic demand.

The first is monetary easing. In May, the People's Bank of China (China's central bank) unveiled a 10-point monetary policy package that, in addition to monetary easing, included measures such as greater financial support for science and technology innovation. This resulted in reductions in a range of monetary policy metrics in the same month. Besides cuts in the policy rate (seven-day reverse repo rate) and the reserve requirement ratio, the one-year loan prime rate (the benchmark rate for loans to companies) and the five-year loan prime rate (the benchmark rate for mortgages) were also reduced. The monetary easing effects of these moves are expected to materialize gradually during the second half of the year. Since there is still plenty of room to reduce the reserve requirement ratio even further, it will likely continue to be lowered flexibly in line with the economic situation.

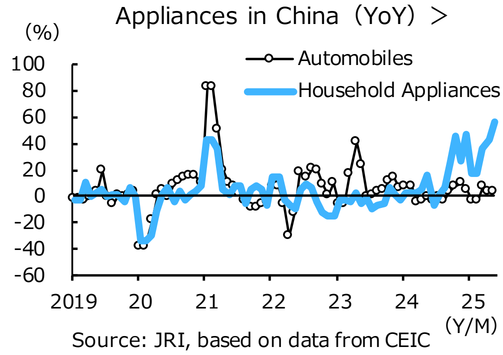
<Reserve Requirement Ratio for Large Banks>



Source: JRI, based on data from CEIC
Note: As of June 18 for June 2025.

The second measure is stimulating consumption. The prolonged real-estate slump has left the Chinese economy is facing challenges such as a lack of domestic demand resilience and weakening growth drivers. In addition, Donald Trump's return to the White House has elevated the risk of a tariff-induced drop in exports. Given these circumstances, the government has been redoubling efforts to stimulate consumption, and unveiled a "Plan on Special Initiatives to Boost Consumption" in March this year. It is an economic stimulus package comprising 30 measures in eight categories, and the measures include government subsidies for the replacement of durable consumer goods, expansion of social security, and action to stimulate services consumption. The effects of these measures are expected to result in consumption continuing to rise gradually in the second half of the year.

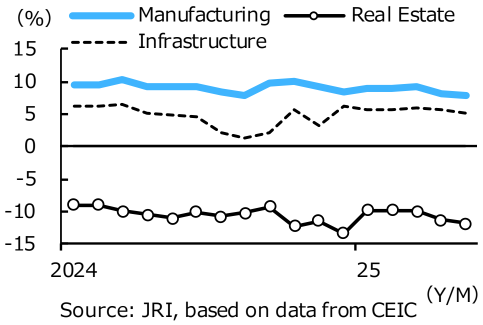
<Sales of Automobiles and Household Appliances in China (YoY) >



Source: JRI, based on data from CEIC

The third is stimulating investment. The government is using funds raised through the early issuance of local government special-purpose bonds to scale up infrastructure investment. It has also positioned manufacturing as a priority area for strengthening the nation, is expanding subsidies for equipment upgrades and is working to promote manufacturing investment. As a result of these efforts, capital investment in public works and manufacturing are expected to sustain a gradual recovery in overall investment during the second half of the year.

<Fixed Asset Investment (YoY)>



Source: JRI, based on data from CEIC

However, since the Chinese economy still faces structural dampeners, it is unlikely that the raft of measures will result in a sharp recovery. First, consumer sentiment is weak given households' persistent desire to curtail spending. The strict activity restrictions imposed during the pandemic caused households to curb purchases of high-priced items in favor of accumulating savings, and this behavior has continued, resulting in the consumer confidence index still being well below the pre-pandemic level. The employment and income environments are also tough, with the youth unemployment rate trending higher than it was a year ago. There is thus little hope of a strong rebound in consumption.

In addition, the protracted real-estate slump is also hindering economic recovery. Faced with a frigid housing market, developers are reluctant to embark on new projects, and investment in property development remains down more than 10% on the previous year's figures. With new development stalled, revenue from land sales, the main source of finance for local governments, has declined, and public works projects have been delayed.

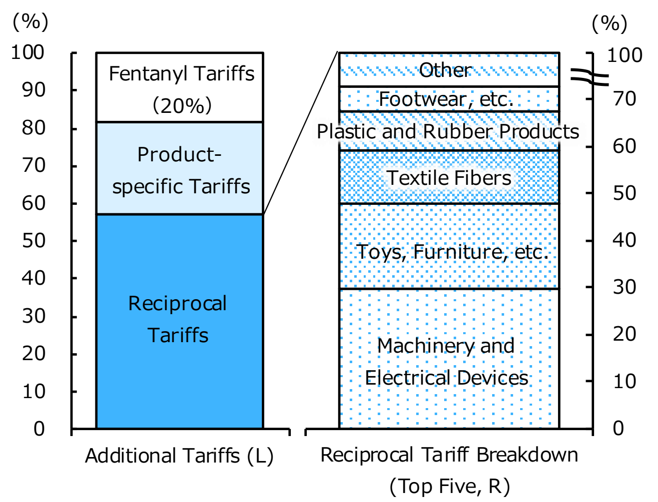
Thus, although external demand is expected to fall in the second half of the year, policy measures should prove successful in supporting domestic demand. Economic growth in the low-to-mid 4% range should therefore be maintained. As a result, China's growth rate is expected to be 4.7% for the full year, slightly below the government's 5% target. In 2026, full-year economic growth is forecast to be 4.4%, down from the previous year, with the drop being mainly due to the effects of the stimulus measures fading and the re-emergence of various unfavorable factors.

■ If the 145% tariff is brought back, the growth rate will drop below 4%

One risk scenario is that the U.S.-China tariff negotiations collapse and the U.S. re-imposes the 145% reciprocal tariff, causing exports to collapse.

Products covered by reciprocal tariffs account for 57.3% of China's total exports to the U.S. by export value. If the staggering 145% reciprocal tariff on these products is brought back, China's competitiveness will be significantly reduced, especially in low-priced consumer goods that can be easily replaced by items from other countries, such as toys, furniture, and clothing. China's exports to the U.S. would plummet 60% as a result. Furthermore, if additional tariffs are introduced for products that are currently only subject to the 20% fentanyl levy, the drop in exports to the U.S. would probably be even greater.

<Composition of China's Exports to the U.S. (2024) >



Sources: Prepared by JRI based on data from U.S. Census Bureau, White House, etc.
Note: The breakdown of additional tariffs could differ from U.S. government assumptions due to the effect of such factors as exemptions. Machinery and electrical devices do not include semiconductors, smartphones, laptops, etc.

Lower external demand would hit the financial performance of exporters, making companies less willing to make capital investments. There would also be downward pressure on employment and wages, which could cancel out the effect of the government's consumption stimulus measures, posing the danger of a sharp drop in consumption.

Estimates suggest that the re-imposition of the Trump tariffs, as outlined in the above scenario, would push down China's GDP by 1.1 percentage points in 2025, resulting in a sub-4% growth rate. The Chinese government believes that the massive economic stimulus measures deployed at the time of the global financial crisis of 2008 are the cause of structural problems that have continued to this day, such as huge government debt and overproduction, so it is cautious about significantly increasing fiscal expenditure. But if it were to maintain this stance even in the risk scenario above, the country’s economy would become more likely to slide into a deflationary spiral, with domestic and external demand falling rapidly.

(Junya Sano)