China–EU Trade: Buying Time, Managing Tensions

- **Last week's EU-China agreement must still be signed off by this week's European Council.**
- **Many details are still lacking, but the agreement sends a signal of reduced near-term disruption risks.**
- **It does not, however, resolve the structural imbalance, which suggests that some tensions will continue.**
- **The path ahead is recurring friction, selective bargains and gradual localization—not either a comprehensive settlement or rupture.**

Emerging Markets Asia, Economic and Policy Research

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The agreement reached in Beijing on October 8–9, 2026, between EU Trade Commissioner Maroš Šefčovič and China's Commerce Minister Wang Wentao is a stabilization package, not a strategic reset. The agreement lowers near-term disruption risks and creates a more structured process for managing disputes, but does not resolve the imbalance in EU–China trade. This imbalance reflects China's rapid industrial upgrading and weak domestic absorption, Europe's competitiveness deficit, and growing security and resilience concerns.

The clearest symptom is the EU's goods-trade deficit with China, now running at roughly €1 billion per day (Figure 1). The gap increasingly reflects competition in sectors central to Europe's industrial base—including vehicles, batteries, machinery and electrical equipment (Figure 2)—rather than mainly low-cost consumer imports. This raises both the economic stakes and the political salience of the dispute.

The 16-point outcome is concrete but light on implementation detail. The clearest result is a WTO-consistent understanding on hybrid and plug-in hybrid vehicles. The EU says the arrangement could reduce Chinese shipments by more than half, but the joint statement does not specify quotas, timing or the legal instrument. Those details will determine its commercial effect and WTO durability. A transparent, monitored and time-bound mechanism would preserve a negotiated route to market; a rigid restriction could instead accelerate Chinese localization in Europe.

Two other outcomes matter economically. The two sides will explore lower or zero most-favored-nation tariffs on selected goods covering almost €4 billion of current EU exports to China; the EU estimates annual duty savings of at least €225 million, including on car parts, olive oil and footwear. China will also facilitate EU-bound export licenses for rare earths and permanent magnets through a "green channel". The tariff initiative offers modest but measurable market access; the licensing channel could matter more for supply-chain continuity if approval times and rejection risks fall.

A further policy signal followed on October 12, 2026, when China's Ministry of Finance and State Taxation Administration announced that the export VAT rebate for new-energy vehicles—including battery-electric and plug-in hybrid passenger

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cars—will fall from 13% to 9% from April 1, 2027. The global measure modestly reduces fiscal support for EV exports and is directionally consistent with EU concerns over state-backed competition, although the Chinese announcement did not link the decision to the talks. Its delayed and partial implementation limits the near-term impact, but its timing reinforces the broader de-escalation signal.

The remaining provisions set a broader implementation agenda. The two sides kept price-undertaking and review procedures open in the EU's anti-subsidy case for battery electric vehicles; continued work on medical devices, animal-health restrictions, computer reservation systems, cosmetics and pharmaceuticals; opened a technical dialogue on the EU Foreign Subsidies Regulation; and strengthened export-control cooperation. China will seek faster treatment of eligible EU animal products and medical devices, while the EU will coordinate with member states on priority Chinese dual-use cases. More predictable licensing, advance notice of control-list changes, and clearer delisting procedures could prove to be the package's most durable gains.

For European businesses, the immediate benefit is greater operating visibility, rather than a decisive opening. Tariff relief and regulatory progress could support selected exports, while smoother critical-mineral licensing would reduce production-interruption risks. Diversified sourcing, inventory buffers and China-specific compliance remain necessary: the green channel facilitates licensing but does not guarantee supply. For Chinese firms, the hybrid understanding and continued EV procedures preserve a negotiated route into the EU, but scrutiny under trade-defense, foreign-subsidy, procurement and economic-security rules will persist. Local production, European suppliers, transparent financing and demonstrable local value creation will increasingly shape market access.

The package therefore channels broad friction into narrower workstreams, reducing near-term tail risks while leaving the central disputes intact. There is no quantified path to a more balanced trade relationship, no broad opening in services, procurement or investment, no settlement of existing battery-EV duties and no binding critical-mineral assurance. Intellectual-property and WTO-reform commitments remain process-heavy, while investment cooperation is exploratory. The structural tension persists: China's advanced capacity is expanding faster than domestic demand can absorb it, while Europe's supply side is adjusting too slowly.

The October 15–16, 2026, European Council is the first political checkpoint. Commissioner Šefčovič said the Commission President would assess the outcome with EU leaders, while the summit agenda also includes competitiveness and global macroeconomic imbalances. Leaders are likely to support continued engagement while preserving the option of stronger trade-defense, procurement and resilience measures. A ministerial China-EU video conference in January 2027 will test whether the hybrid arrangement is a workable legal form, whether tariff reductions have been translated into product lines and implementation dates, and whether the rare-earth green channel is delivering faster approvals. The third Trade and Investment Consultations meeting in March 2027 will assess whether sectoral talks have produced meaningful market access and whether EV price-undertaking negotiations have advanced. The EU has described the outcome as a "first step" and its initial results as a "proof of concept"; further de-escalation will depend on delivery.

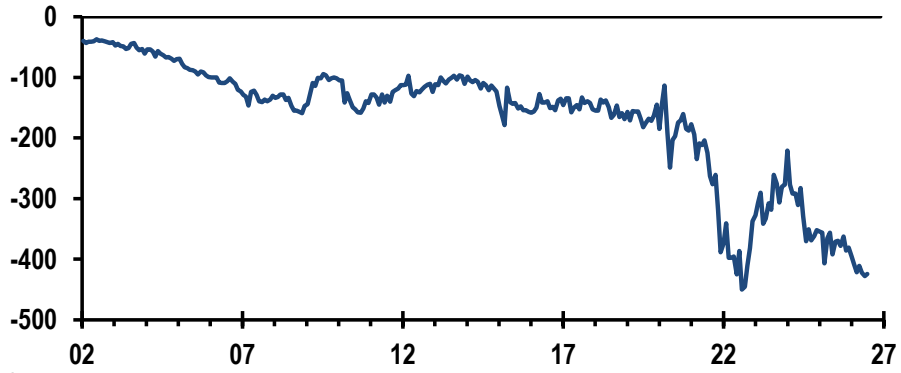
Our three-to-six-month base case is managed de-escalation alongside selective pressure. EU action is likely to remain targeted at politically and industrially sensitive products rather than broadening into across-the-board restrictions, while China may maintain calibrated investigations or sector-specific counter-pressure. Beijing's willingness to reach a limited deal confirms the strategic importance of the EU market; Europe's preference for a monitored settlement reflects the domestic costs of wider escalation. Mutual vulnerability should keep

retaliation bounded, not eliminate recurring disputes.

The result will be more managed and conditional integration, not normalization. Bilateral trade should remain large, but its composition and governance will change: Chinese firms will localize more production in Europe; European firms will diversify critical inputs while retaining exposure to China; and more commerce will be shaped by licensing, undertakings, subsidy reviews and local-value requirements. Credible implementation would lower disruption risks and expand selected EU exports; slippage on licensing or market access would invite wider EU remedies and Chinese retaliation. The path ahead is recurring friction, selective bargains and gradual localization—not either a comprehensive settlement or rupture.

Figure 1: EU trade balance with China

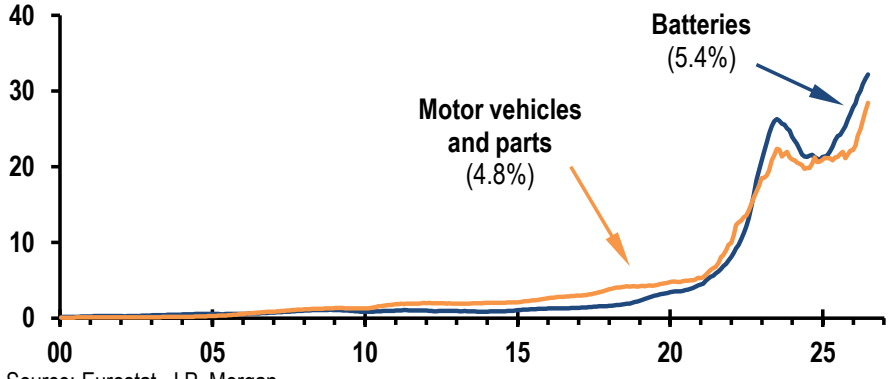
€bn ar, nominal, trade in goods



Source: Eurostat, J.P. Morgan

Figure 2: EU imports from China

€bn, 12-month sum, latest shares of total imports in brackets



Source: Eurostat, J.P. Morgan

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