

A two-speed economy. China on the eve of a trade war

Maciej Kalwasiński

In 2024, China's economy continued to struggle with persistent challenges, including slower growth, weak consumption, and deflationary pressures. However, Chinese leaders view these difficulties as an acceptable and temporary cost of its economic transition. The goal of this transition is to enhance China's security and identify new sources of growth through the modernisation of its economy.

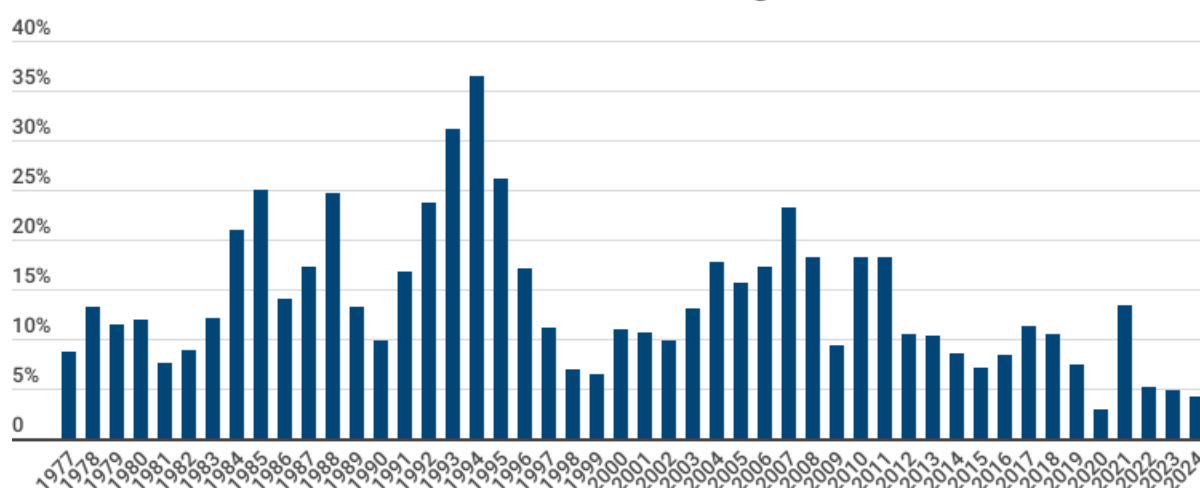
- The leadership of the Chinese Communist Party tolerates a 'two-speed' economy, accepting macro-level slowdown in exchange for progress in strategically important, high-tech industries. At the same time, it recognises that economic and social stability is essential for the long-term success of this strategy. The CCP has not yet deemed it necessary to introduce a large-scale stimulus package and has instead focused on less costly stabilisation measures to support the economy.
- Beijing has successfully redirected the flow of funds that had for years been channelled into the real estate sector towards industries aligned with the party's key priorities, including the development of a competitive and self-sufficient industrial base and the electrification of the economy using domestic energy sources. Consequently, market competition has intensified. On the one hand, this spurs technological progress and reduces China's dependence on imports. On the other hand, though, it exacerbates overcapacity and fuels destructive price wars.
- Last year was the first time in at least a decade when the trade surplus had such a significant impact on economic growth. On the eve of a potential trade war, China remains highly dependent on foreign demand, while the rest of the world relies on Chinese supplies to an unprecedented degree.
- Beijing may still choose to prioritise the activation of an alternative engine of growth, namely consumption, despite it being a less favourable option from the government's perspective. For the past two decades, the government has declared its intention to increase the role of household spending as a key driver of the economy. However, they have yet to abandon the development model primarily based on investment and exports. In recent months, the Chinese government has intensified efforts to lay the groundwork for a shift towards a consumption-driven economy, explicitly stating that weak domestic demand poses a threat to national security. This shift could ultimately be implemented to reduce China's dependence on foreign sales in the event of a severe escalation of the trade war.

The economic growth slowdown

The Chinese statistical office reported that GDP growth in 2024 met the target set by the government. However, independent economists challenge these figures. According to analysts from Rhodium Group, in 2024 China's economy grew by less than 3% in real terms, rather than the 5% claimed by Beijing.^[1] A model developed by researchers at the Bank of Finland, which challenges only the official inflation estimates, suggests a growth rate of just under 4%.^[2] Gao Shanwen, the chief economist at the state-owned SDIC Securities, publicly stated that actual growth over the past two to three years has been around 2%.^[3] Although the exact growth rate remains unclear, it is clear that China's economy is still expanding more slowly than before the COVID-19 pandemic.

Excluding the period of the COVID-19 pandemic, China's official real GDP growth last year was the lowest since 1990, while its nominal GDP growth was the lowest since 1976. Real GDP is widely considered as the primary indicator of economic health and has long served as a tool of both domestic and international propaganda for Beijing.^[4] Nominal GDP, on the other hand, is subject to less manipulation since it is measured at current prices. Moreover, it provides insight into household and corporate incomes which affect debt repayment capacity, as well as driving consumption and investment. In 2024, for the second consecutive year, China's nominal GDP growth was lower than its real GDP growth.

Chart 1. China nominal GDP growth



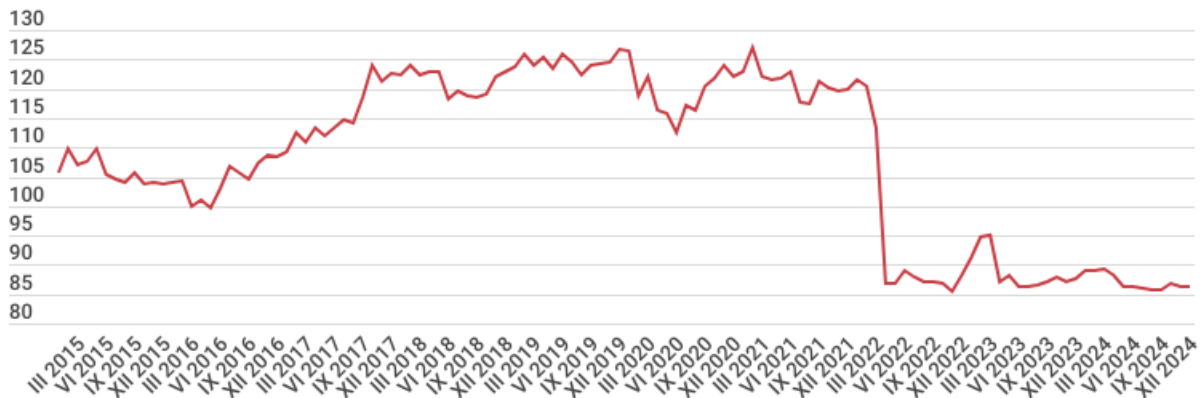
Source: National Bureau of Statistics of China.

Weak consumption

Although Beijing has expressed its intention to spur private consumption as a key driver of economic growth, in 2024 its contribution to GDP growth was the lowest since 2006, excluding the pandemic year of 2020. For many years, households have had access to a relatively small share of the country's total income while maintaining a strong tendency to save. The 'zero COVID' policy and the weak post-pandemic recovery have reinforced these trends. In 2024, the government launched a campaign to replace old cars, household appliances, and industrial equipment with new ones. However, despite repeated declarations and increasingly frequent recommendations from both domestic and foreign economists, it has still failed to introduce structural reforms that could significantly and sustainably boost consumer demand in China.^[5]

Consumer confidence remains significantly lower than before the mass lockdowns imposed in China in spring 2022. Facing intense competition and weak demand, some companies are cutting employee wages. Local governments, struggling with the burden of servicing massive debts, are reducing salaries and bonuses for civil servants and delaying payments to contractors. The real estate crisis, Beijing's lack of a strong response to the economic slowdown, and the looming risk of escalating tensions with the United States provide further motivation for the Chinese to exercise greater financial discipline.

Chart 2. Consumer sentiment index



Source: National Bureau of Statistics of China.

Hopes for a better future and the desire for wealth were fundamental to China's economic success during the so-called reform and opening-up period. In recent years, however, frustration and pessimism have been growing, particularly among young people entering a job market that does not align with their aspirations.^[6] Despite the national statistics bureau revising its calculation methods, youth unemployment for those under 25 still stands at over 15%. Increasing numbers of Chinese people attribute their professional struggles to an unfair 'system'. A long-term survey conducted by Professor Martin K. Whyte over the last two decades shows that between 2004 and 2014, respondents indicated talent, hard work, and a good education as the key factors for financial success in China. By 2023, however, survey answers were dominated by references to personal connections, privileged backgrounds and an unfair economic structure.^[7]

An attempt to stabilise the economy

Unlike in previous periods of economic downturn, in 2023–4 the government did not implement a large stimulus package, opting instead to focus on measures aimed at stabilising the economy and improving public sentiment. This marks a significant shift in China's economic policy paradigm, reflecting a change in Beijing's priorities. The government's efforts are no longer centred on boosting income growth at the expense of rapidly increasing debt but rather on reducing its dependence on foreign markets and fostering new sources of productivity.^[8] At the same time, policymakers recognise that, if their long-term strategy is to succeed, it will be essential to stabilise the current situation. They have thus gradually adjusted the course of their economic policy.

At the end of September 2024, over a short period, the government announced a series of decisions, creating the impression of a strong, comprehensive stimulus package. Despite

enthusiastic media commentary referring to it as a ‘bazooka’, most of its elements were minor adjustments that aligned with Beijing’s existing policy direction. The government continued its gradual reduction of interest rates and eased regulations on the housing market.^[9] Additionally, it pressured banks to accelerate the adjustment of interest rates on existing mortgages to reflect the more favourable current market situation.

The September stabilisation package is presented as the decisive factor that enabled the official fulfilment of the 5% GDP growth target in 2024. However, official statistics suggest that the acceleration in the fourth quarter of the year was primarily driven by an increase in the trade surplus. The gradual easing of monetary policy remains ineffective, as high borrowing costs are not the main obstacle to boosting consumption and investment. Changes to loan interest rates came into effect too late for their impact on the real economy to fully materialise in 2024. Their effect was also limited by the cautious approach of borrowers, who did not use the additional funds to significantly increase current spending. Government support for stock and real estate markets was reflected in rising stock valuations and increased home sales in major metropolitan areas. While this has temporarily improved investor sentiment, it has had little significant impact on broader economic activity.

Chart 3. Shanghai Composite Index

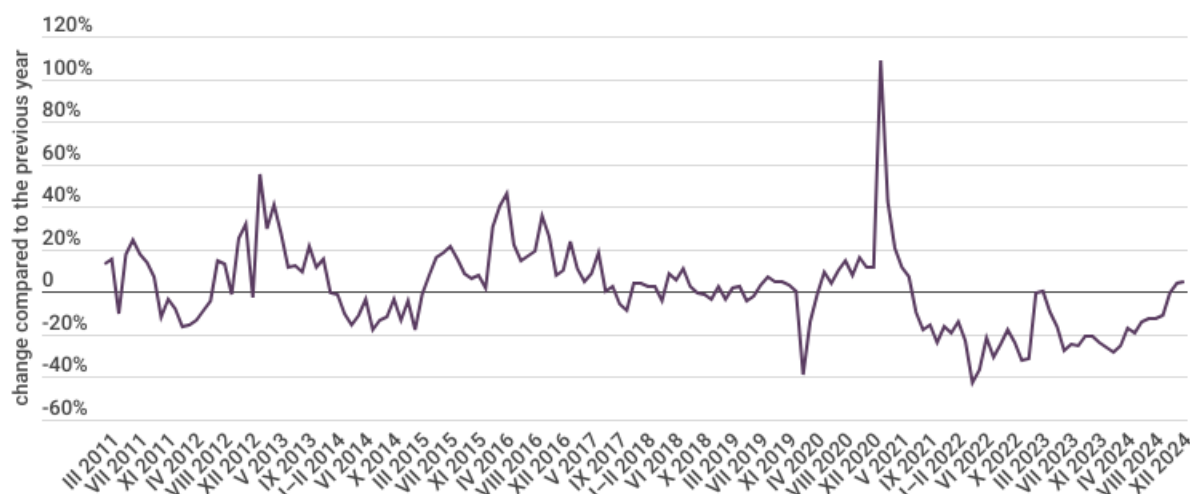


Source: Stooq.

Is the end of the real estate market crisis imminent?

The September package helped to stabilise the housing market and could become the catalyst that ends a crisis that has persisted for more than three years.^[10] For many months, the central government had been trying to curb the unexpectedly deep and prolonged downturn, which they themselves triggered in 2020 in an attempt to address structural problems in the real estate sector. In recent months, home sales in China have finally stopped falling, and in major metropolitan areas they have risen significantly. However, it remains unclear how long this effect will last and whether it will spread to smaller cities.

Chart 4. Home sales in China



Source: author's own calculation based on statistics on the floor area of sold homes, published by the National Bureau of Statistics of China.

It would be a positive development for China if it could bring an end to the real estate crisis before growing global protectionism weakens China's key economic driver, meaning international trade. In 2024, the downturn in the sector may have slowed GDP growth by as much as two percentage points. Investments in real estate fell by more than 10%. The amount of residential space started work on by developers is the lowest since 2004 and the amount of formally completed housing areas is the lowest since 2008. Home sales dropped by over 10% compared to the previous year and were nearly half the volume of the record-breaking year of 2021. According to official data, price drops on both the primary and secondary markets accelerated. Stabilising the housing market would not only directly impact activity in the sector but also contribute to a lasting improvement in consumer sentiment, which continues to be the main obstacle to boosting consumption and economic recovery.

If the crisis has indeed come to an end, Beijing may view its efforts to curb the negative trends on the real estate market as a success. Government actions have resulted in a reduction in the role this sector plays in the economy, a correction of inflated prices, a decline in speculation, a restructuring of the real estate development sector, and a strengthening of state-owned enterprises; all without triggering an economic, financial or social crisis. The authorities have managed to redirect more resources from a sector that posed an increasing risk to national stability towards industries aligned with Beijing's key priorities, namely an expansion and modernisation of the industrial base, and electrification of the economy using domestic energy sources.

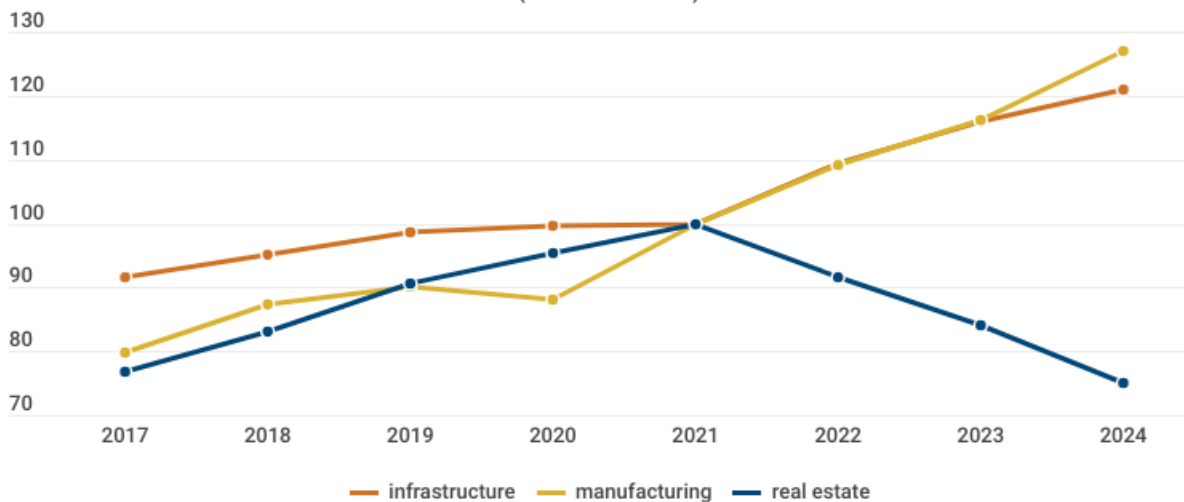
Investments aligned with the CCP's policy

The shift in China's economic priorities is visible in investment data. 2024 marked the third consecutive year in which spending in the manufacturing and infrastructure sectors grew rapidly, while investments in real estate declined significantly. Capital is flowing into industrial companies at a high rate, driven by government influence over bank lending policies. The government also supports corporate spending on machinery and tools by

providing subsidies for equipment upgrades. In 2024, investments in this area increased by more than 15%. In response to Beijing's policy push, local authorities are actively engaging in the development of priority industries and technologies.

Chart 5. Investments in fixed assets in China by sectors

(index: 2021=100)

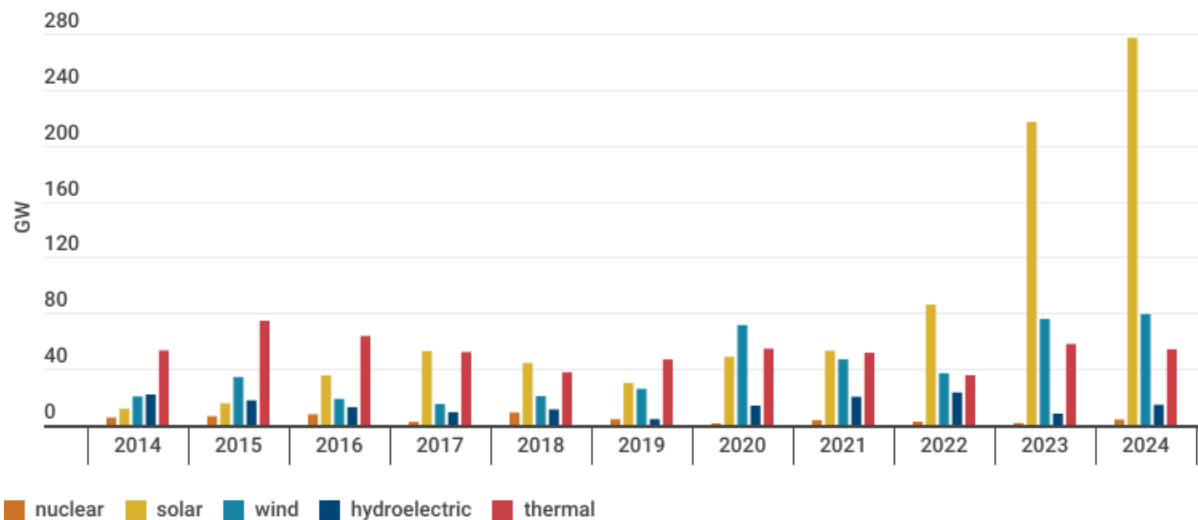


Source: National Bureau of Statistics of China.

Contrary to opinions suggesting that China is oversaturated with infrastructure after decades of massive investment, spending in this area does continue to grow. However, funds are now directed less towards constructing buildings and roads, and more towards electricity generation and distribution, water resource management and rail networks. These efforts align with the strategy of boosting national security and state development while also supporting economic growth amid the real estate market crisis. Beijing is focusing on increasing energy self-sufficiency, expanding green technologies, and enhancing the competitiveness of domestic industries through stable and affordable energy supplies.

China is the world's largest investor in renewable energy but continues to allocate significant resources to coal and nuclear energy generation. ^[12] In 2024, the country installed a record 429 GW of new capacity, with more than 86% coming from renewable sources. However, China's image as a global leader in the green transition is undermined by the simultaneous construction of more coal power plants than at any point in the past decade. ^[13] Due to legislative changes aimed at tying electricity prices to the market and also increasing challenges in integrating renewable energy into the grid, the pace of new solar power installations is expected to slow in the second half of the year. While the share of renewables in electricity generation is growing, it still accounts for just about a third of total production, whereas coal remains dominant at around 55%. This figure falls far short of the results achieved by the global leaders in the renewable energy transition.

Chart 6. Increase in installed electricity generation capacity



Source: author's own calculation based on statistics published by the National Energy Administration of China.

DeepSeek is a notable example of a private investment aligning with the Chinese Communist Party's vision. At the beginning of 2025, this small Chinese company, with significantly fewer resources than its American competitors, unexpectedly joined the ranks of the global leaders in the development of artificial intelligence. Beijing welcomed this achievement as proof of China's technological progress despite US sanctions and as a morale boost for the Chinese public. After DeepSeek's success gained widespread attention in the global media and financial markets, the Chinese government announced plans to increase support for the AI industry and the broader technology sector. As long as private companies adhere to Xi Jinping's strategy of 'leaping forward',^[14] they can continue to count on government favour.

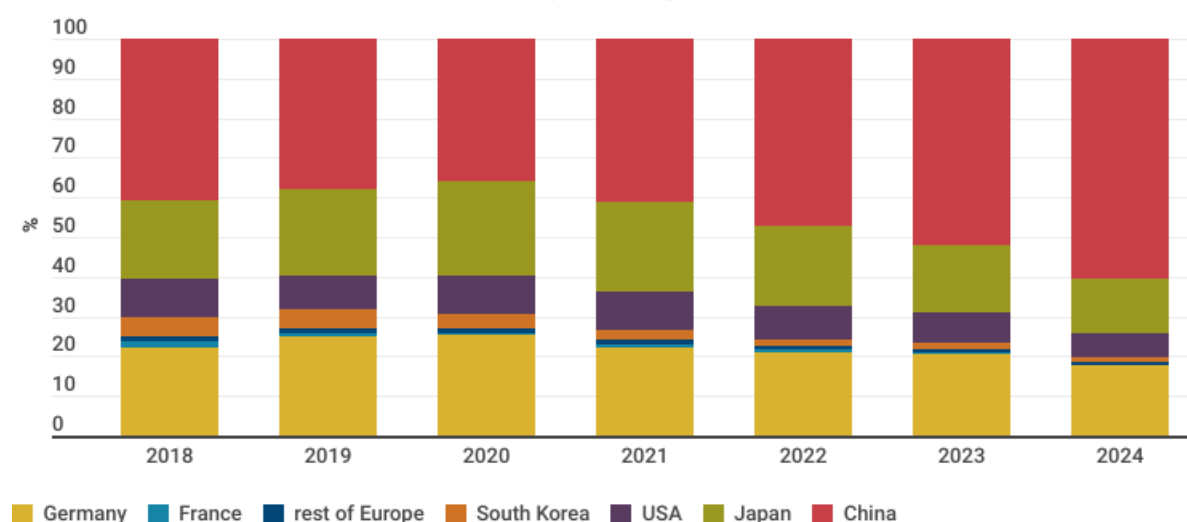
Business and the price wars

Intense competition among companies, fuelled by rivalry between local governments, stimulates economic growth and industrial production. However, it also exacerbates overcapacity and drives destructive price wars. According to the national statistics bureau, in 2024 production of passenger cars, both electric and hybrid, increased by 39%, semiconductors by 22%, photovoltaic cells by 16%, and lithium-ion batteries and industrial robots by 14%. Domestic supplies are increasingly replacing imports, and the competitiveness of Chinese-made goods on foreign markets is growing. Through this process, despite the short-term inefficiencies in resource allocation, Beijing is pursuing its long-term objectives: reducing its dependence on foreign supplies and 'forging' national champions through aggressive market competition.^[15]

The automotive market is a flagship example of this transformation, with the rapid rise of electric and hybrid vehicles, and Chinese brands steadily displacing foreign competitors. In 2024, the share of these vehicles in total car sales in China rose to 41%, up from 32% the previous year. Chinese consumers accounted for seven out of every ten electric and hybrid passenger cars sold worldwide.^[16] The expansion of EV production by around three million units may have contributed 0.5 percentage points to GDP growth, representing about 10% of

China's overall economic growth last year. The market share of Chinese brands in the domestic passenger car market surpassed 60%, compared to just under 52% in 2023 and around 36% in 2020. According to calculations by AlixPartners, the price war among manufacturers resulted in the elimination of 23 brands from the market and price reductions on 227 car models, up from 148 the previous year.^[17] The average price cut exceeded 10,000 yuan per vehicle. Despite a nearly 5% growth in car sales, financial difficulties forced the closure of one in ten of the country's 40,000 car dealerships.^[18] AlixPartners experts estimate that automotive manufacturers operating in China were utilising only about half of their available production capacity, meaning they could theoretically increase output by approximately 30 million vehicles. Currently, global car production stands at around 90 million units per year.

Chart 7. Share of car producers by country in China's passenger car market

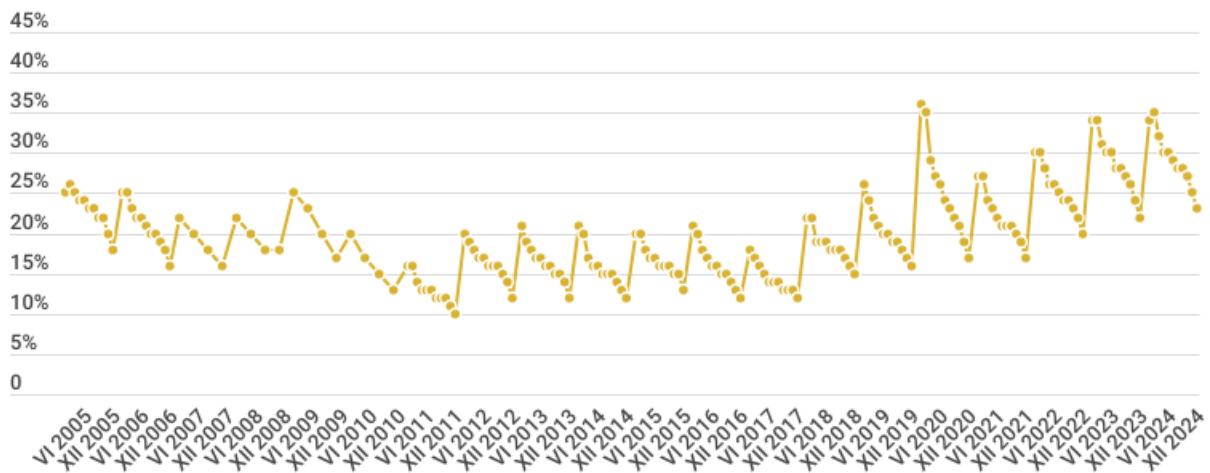


Source: China Passenger Car Association.

Against a backdrop of cautious consumer behaviour, the obvious consequences of state-supported production expansion include concerns among retailers about losing customers and an oversupply of many goods relative to domestic demand. This has resulted in lower prices for customers. As in 2023, in 2024 the Consumer Price Index (CPI), which tracks changes in prices of consumer goods, increased only marginally. Meanwhile, the equivalent measure for producer prices and the GDP deflator remained negative.

The relentless market competition has also led to a further deterioration in corporate financial performance. Profits at large industrial companies fell for the third consecutive year, and by the end of 2024, the share of companies reporting losses had risen to 23%, the highest level since 2001. A similar picture emerges from stock market reports and foreign direct investment data. Many businesses are only able to continue operating due to support from local governments and state-owned banks. Consequently, workers cannot expect pay rises or the traditionally high bonuses but instead face the risk of layoffs. This deepens negative public sentiment and reinforces the tendency to save rather than spend, ultimately worsening the financial standing of businesses.

Chart 8. Proportion of large industrial companies reporting losses



Source: author's own calculation based on statistics published by the National Bureau of Statistics of China.

The economy relies on exports

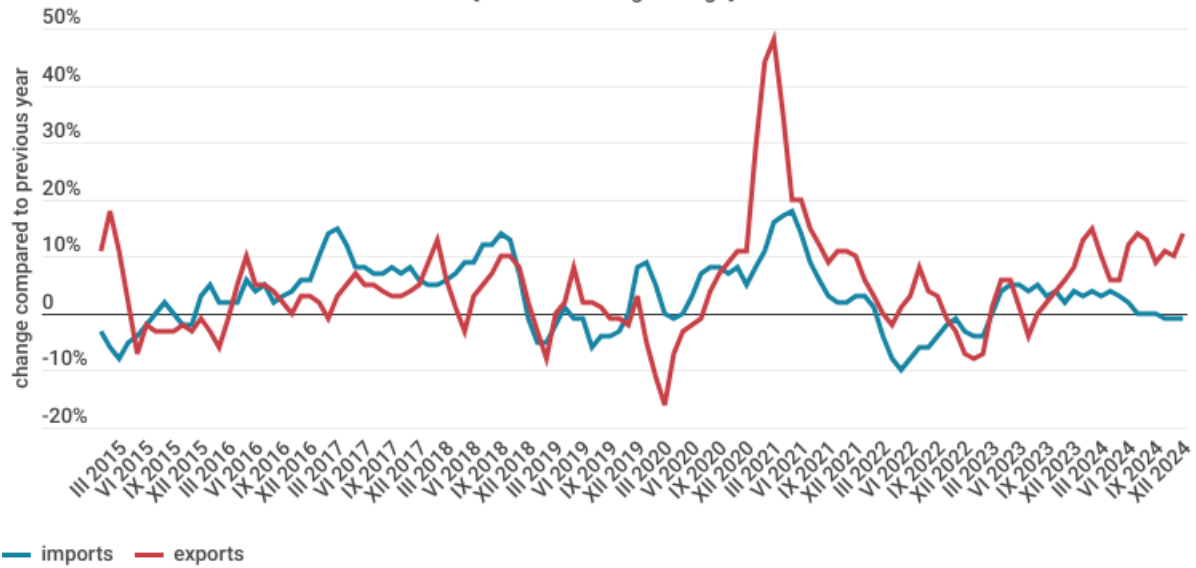
Faced with unsatisfactory domestic market performance, many Chinese companies are expanding abroad, where buyers are willing to pay higher prices and the competition is generally weaker. Consequently, Chinese production is displacing manufacturing in other countries or preventing the development of advanced industries. This has negative consequences for both the short- and long-term growth prospects of these economies, the stability of their labour markets, and it raises concerns about a dependence on Chinese supplies. China currently accounts for approximately 30% of global industrial production, and according to a UN forecast, this share could rise to as much as 45% by the end of the decade,^[19] a level comparable to that of the United States immediately after World War II. While these estimates may seem overly alarmist, they highlight the scale of the challenge that other governments must address if they want to prevent a rapid deindustrialisation of their economies.

In 2024, China saw a record surplus of nearly \$1 trillion dollars in commodity trade and almost \$2 trillion in the manufacturing sector.^[20] The positive balance on China's side is offset by an equivalent deficit for the rest of the world. Thus, from a purely arithmetic perspective, China is not a driver but rather a brake on economic growth in other countries. Instead of striving for balanced trade by boosting domestic demand, Beijing continues to stimulate the supply of goods and relies on foreign demand to soak up its production surpluses. Consequently, the rest of the world is forced to accommodate China's internal imbalances, which leads either to rising unemployment or increasing debt in the economies affected.

The rest of the world's dependence on Chinese supplies has increased even faster than is suggested in commonly cited international trade data. While the value of China's exports increased by 6%, the volume of goods sold abroad grew at a double-digit rate. No such discrepancy was recorded for imports. When compared to the growth rates of exports and nominal GDP, this suggests that Beijing's strategy is yielding results, and for the third consecutive year, China's economy has been relying less on foreign-made products.

Chart 9. China's foreign trade volume

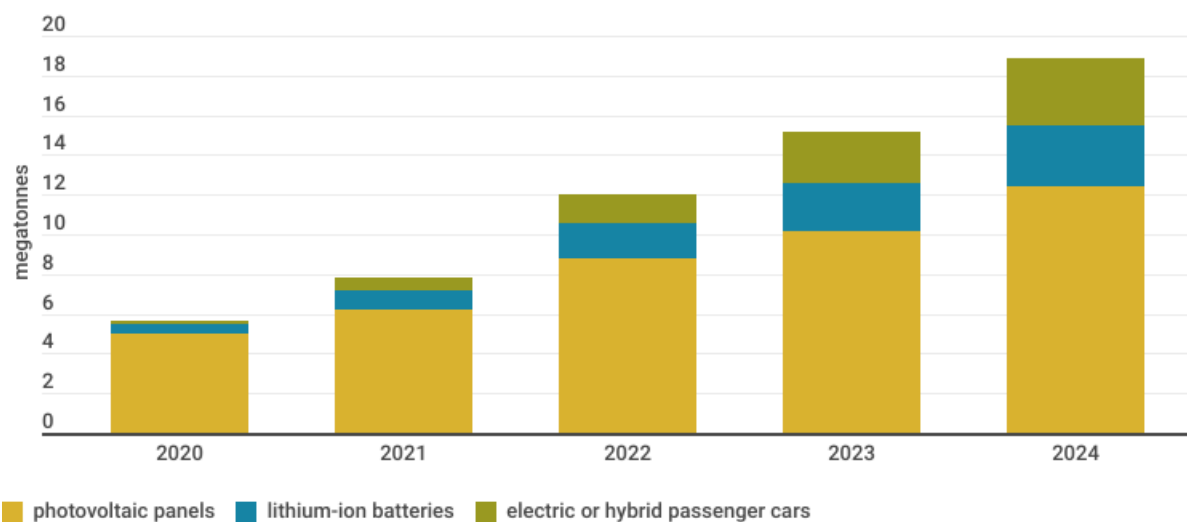
[12 month rolling average]



Source: author's own calculation based on statistics published by CPB World Trade Monitor.

Although the bulk of China's exports still consists of less advanced goods, in the context of the future of industry and the green transition, the trade in electric vehicles, photovoltaic panels, and lithium-ion batteries is particularly significant. Both Beijing and other governments worldwide view the energy and automotive sectors as strategic industries with high growth potential.^[21] In 2024, the value of China's exports of this 'new trio' declined, but this was due to falling prices rather than a drop in sales volume. In quantitative terms, exports of these goods continued to grow, albeit at a slower pace than in previous years.

Chart 10. Exports of China's 'new trio'



Source: General Administration of Customs of the People's Republic of China.

China maintained its position as the world's leading car exporter. Overseas sales increased by 23%, surpassing 6.4 million vehicles. Nearly 70% of these were cars equipped solely with internal combustion engines. Exports of passenger cars rose by 25% to 4.8 million units, with electric and hybrid vehicles accounting for just under 30% of the total.^[22] Approximately 22% of all electric and hybrid vehicles produced in China were sold abroad.

In response to China's trade expansion, governments worldwide are accelerating the introduction of protectionist measures to shield domestic producers from Chinese competition. These actions are being taken not only by developed economies like the United States and the European Union but also by emerging markets such as India, Brazil, Mexico and Thailand. With Donald Trump's policies and China's growing trade surplus, protectionist trends are expected to intensify globally.^[23] If the US president truly commits to reducing the American trade deficit, which he has long criticised, and imposes very high import tariffs, the move would deal a significant blow to China, despite its apparent recent efforts to diversify its export destinations. In reality, a large share of goods sent to third countries (including to Southeast Asia), ultimately ends up in the United States, which remains the consumer of last resort absorbing much of the world's surplus production.

China on the eve of trade wars

On the brink of a potential trade war 2.0, the world is more dependent on Chinese supplies than ever before, but China itself remains heavily reliant on foreign demand. Beijing has yet to find new, independent drivers of economic growth that could offset the negative effects of curbing the speculative boom in the real estate sector. In recent years, exports have gained importance. In 2024, their impact on economic activity was the highest since 1997, with the trade surplus making up 1.5 percentage points of the officially reported 5% GDP growth. Given the justified doubts about the accuracy of this figure, the actual share of exports in China's economic expansion may have been even greater, potentially accounting for 40–60% of real growth rather than the estimated 30%.

Chart 11. Share of net exports in China's GDP growth



Source: National Bureau of Statistics of China.

Without new drivers of economic activity, it will be difficult to prevent a slowdown in growth. Maintaining an export-driven model is unsustainable in the long run for an

economy of China's size. The rest of the world will neither be able nor willing to absorb China's rapidly growing production surpluses indefinitely. At the same time, the direct impact of the green transition on GDP growth is expected to weaken, as market saturation limits further expansion. The era when real estate sales served as the primary economic driver has definitively ended, and the two sectors that have taken over this role in recent years, namely foreign trade and the green transition, will inevitably lose momentum in the coming years.

A more favourable interpretation for Beijing is that China has not become dependent on foreign demand but has instead maximised its 'window of opportunity' before a global trade war erupts and the era of deep global imbalances comes to an end. Its record trade surplus, means that the government has been able to continue focusing on modernising the economy rather than stimulating domestic demand in response to the real estate market collapse. It has also retained the option of activating alternative, albeit less favourable, growth drivers from the Communist Party's perspective. In recent months, the government has been laying the groundwork for a shift towards consumer-driven growth, which could be leveraged in the event of a severe escalation of trade tensions with the United States to reduce China's dependence on exports. Furthermore, an open economic conflict with the West would give the Chinese leadership a stronger mandate to demand further sacrifices from the population and greater alignment from businesses with the party's strategic priorities, namely, strengthening national security and accelerating economic modernisation.

[1] D.H. Rosen, L. Wright, J. Smith, M. Mingey, R. Quinn, *'After the Fall: China's Economy in 2025'*, Rhodium Group, 31 December 2024, rhg.com.

[2] E. Kerola, *'Alternative indicators of China's economic growth'*, The Bank of Finland. Institute for Emerging Economies, bofit.fi.

[3] L. Wei, *'Xi Jinping muzzles Chinese economist who dared to doubt GDP numbers'*, The Wall Street Journal, 8 January 2025, wsj.com.

[4] M. Kalwasiński, *'Security trumps growth. China's economy heading into 2024'*, OSW, 5 March 2024, osw.waw.pl.

[5] *Idem*, *'The economy according to Xi Jinping: a technological 'leap forward''*, OSW Commentary, no. 621, 21 August 2024, osw.waw.pl.

[6] *Idem*, *'Youth unemployment in China hits record-high levels'*, OSW, 3 August 2023, osw.waw.pl.

[7] I. Mazzocco, S. Kennedy, *'Is It Me or the Economic System? Changing Evaluations of Inequality in China'*, Big Data China, 9 July 2024, bigdatachina.csis.org.

[8] M. Kalwasiński, *'The economy according to Xi Jinping...'*, *op. cit.*

[9] *Idem*, *'Strzelba, nie bazooka. Nowy pakiet stymulacyjny w Chinach'*, OSW, 1 October 2024, osw.waw.pl.

[10] *Idem*, *'From boom to bubble. The real estate crisis in China'*, OSW, Warszawa 2024, osw.waw.pl.

[11] P. Uznańska, *'A siege broken? China's processor sector under US sanctions'*, OSW Commentary, no. 614, 23 July 2024, osw.waw.pl.

- [12] M. Kalwasiński, *'China on the road to 'green' energy security'*, OSW Commentary, no. 605, 7 June 2024, osw.waw.pl.
- [13] A. Patel, *'China's construction of new coal-power plants reached 10-year high in 2024'*, Carbon Brief, 13 February 2025, carbonbrief.org.
- [14] M. Kalwasiński, *'The economy according to Xi Jinping...'*, *op. cit.*
- [15] *Ibid.*
- [16] *'月度分析』2025年1月份全国乘用车市场分析'*, China Passenger Car Association, 11 February 2025, cpcauto.com.
- [17] C. Leong, *'China Makes More Cars Than It Needs. Now, It's Shakeout Time'*, The Wall Street Journal, 9 January 2025, wsj.com.
- [18] D. Ren, *'A bleak 2025 awaits China's 30,000 car dealers as price war piles on US\$24 billion losses'*, The South China Morning Post, 5 January 2025, scmp.com.
- [19] *The future of industrialization: Building future-ready industries to turn challenges into sustainable solutions*, United Nations Industrial Development Organization, November 2024, unido.org.
- [20] B. Setser, *'Xi Is Making the World Pay for China's Mistakes'*, The New York Times, 18 February 2025, nytimes.com.
- [21] M. Kalwasiński, *'China on the road to 'green' energy security'*, *op. cit.*
- [22] *'2024年12月份全国乘用车市场分析'*, China Automobile Dealers Association, 8 January 2025, cada.cn.
- [23] M. Kalwasiński, *'Trade war 2.0. China responds to Donald Trump's tariffs'*, OSW, 4 February 2025, osw.waw.pl.