

All quiet on the Eastern front: China's economy after a year of trade war

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In 2025, Donald Trump's aggressive tariff policy and new protectionist barriers worldwide failed to undermine the foundations on which China's GDP growth has rested since the outbreak of the COVID-19 pandemic. A record trade surplus once again enabled Beijing to maintain its existing economic policy course, directing resources towards industrial modernisation rather than addressing key macroeconomic challenges, including the relatively low level of domestic consumption. A notable new development, however, was the first-ever decline in investment in fixed assets, driven primarily by the authorities' political campaign against 'destructive competition'.

In the past year, the trade surplus once again made its largest contribution to China's GDP growth since 1997. Trump's tariff war did not halt China's economic expansion but instead led to a reconfiguration of supply chains. Direct sales to the United States fell sharply, but some goods continue to reach that market via third countries. There is also a real dimension to diversification., as record exports reflected global demand for competitive Chinese goods. Beijing has also become more willing to exploit dependencies on supplies from China in order to exert pressure on its trading partners.

The strength of exports and the production driving them contrasted with weak domestic demand, labour market difficulties, the property market crisis, destructive competition between companies, and deflationary pressure. Beijing recognises the risks stemming from dependence on external demand, but its trading partners have yet to compel a fundamental policy adjustment. It therefore tolerates a 'two-speed' economy, limiting itself to stabilisation measures while focusing on its priorities: strengthening China's security and seeking new sources of growth. The current difficulties are seen as a temporary cost of transformation and of building an economic 'fortress' in preparation for a potential escalation of the conflict with the United States.

In 2025, the pillar that had underpinned China's growth for decades – namely investment – began to falter. According to official statistics, investment in fixed assets declined for the first time on record. It is difficult to determine conclusively to what extent this resulted from the campaign against destructive competition (involution or *nèijǔǎn*); the financial problems of local authorities and efforts to restructure their debt; or the deepening property market crisis, and to what extent it reflected a correction of previously overstated data. This is all the more the case as other official macroeconomic indicators – namely gross capital formation data – did not confirm a decline in investment activity below the previous year's level.

Official GDP growth reached the level set by Beijing last year, but independent economists have challenged these figures. According to analysts at Rhodium Group, China's economy grew in real terms by 2.5–3% in 2025, rather than the 5% reported by the statistical office, as in the previous year.^[1] A model developed by the Bank of Finland, which questions only the level of the inflation indicator (the deflator), points to growth of just under 4%. The actual pace of GDP growth remains uncertain, but China's economy is clearly on a trajectory of markedly slower expansion than before the outbreak of the COVID-19 pandemic.

Owing to deflation, China's nominal GDP growth for the third consecutive year was lower than its real growth rate,^[2] and at the same time, the lowest since 1976. This indicator captures the current weaknesses and prospects of the Chinese economy more effectively than measures that account for price changes: it reflects the slowdown in income growth among households and businesses, as well as in central and local government revenues, with implications for debt-servicing capacity and the propensity to consume and invest.

A trading power

Donald Trump's aggressive, erratic, and unlawful tariff policy,^[3] led to a sharp decline in China's direct exports to the United States, but did not halt the growth of China's trade surplus. Last year, the goods trade surplus reached a record \$1.2 trillion. Amid the weakness of the other engines of economic growth – namely investment and consumption – China recorded the highest contribution of net exports to GDP growth since 1997. As in the previous year,^[4] well-founded doubts about the pace of economic activity suggest that the contribution of foreign trade may, in reality, have been even higher than the 33% reported by the statistical office.

Although more goods from China reach the United States than official data suggest, the geographical diversification of exports is a reality. Exporters and importers circumvent higher tariffs in several ways, including falsifying the country of origin, relocating final assembly outside China (for example, to ASEAN countries or Mexico), understating the declared value of goods, double invoicing, changing tariff classifications, or using shell entities acting as the importer responsible for paying duties.^[5] This does not mean, however, that export growth in other directions was solely an attempt to circumvent US tariffs or a search for new markets driven by Washington. Rather, it reflected an imbalance already evident between rising production and weak domestic sales in China, alongside growing global demand for Chinese goods. Last year, China's trade surplus in manufactured goods exceeded 2% of the rest of the world's GDP, more than Germany and Japan recorded combined at the height of their export strength in the 1970s and 1980s.

The increase in the trade surplus is supported by Beijing's undervaluation of the renminbi. ^[6] Although China exported over \$1.2 trillion more in goods than it imported, its currency weakened against the euro by nearly 8% in 2025. In real terms – taking into account differences in inflation – the scale of depreciation was even greater, leading to a marked improvement in the relative competitiveness of Chinese exports. Analysts estimate that the renminbi may be undervalued by 20–30%.^[7]

In 2025, Beijing demonstrated that it views its dominance over critical bottlenecks in global supply chains as a source of leverage in its economic confrontation with the West.

In response to the escalation of its dispute with the United States in the spring, it imposed export controls on seven categories of medium and heavy rare earth metals and related products. From the outset, these restrictions were global in scope rather than targeted solely at the United States. In the autumn, China went a step further: it expanded oversight to additional metals, the technologies used for their extraction and processing, and the production of magnets, with some of the new regulations taking on an extraterritorial character.^[8] The regulations particularly targeted strategic sectors – from defence to semiconductors – and were intended to hinder the development of alternative supply chains outside China. They stipulated that licences for foreign military end users would, as a rule, not be granted, and that exports for military purposes or those enhancing military capabilities would be prohibited. In practice, this amounted to an attempt to slow the expansion of Western defence capabilities. Following an agreement between Xi Jinping and Donald Trump, the implementation of the new rules was suspended for a year. The threat of cutting off trading partners from critical raw materials, however, remains an effective instrument of political pressure in Beijing's hands.

Concerns are growing worldwide not only about Beijing's use of supply-chain dependencies as an instrument of political pressure, but also about 'China shock 2.0',^[9] that is, the effects of China's industrial expansion on other countries' manufacturing bases. Amid domestic demand too weak to absorb rapidly expanding production capacity, Chinese firms are increasingly directing sales abroad in an aggressive manner, displacing production in other economies and hindering the development of advanced industries. This worsens growth prospects, destabilises labour markets, and deepens dependence on supplies from China. China already accounts for around 30% of global industrial output, and according to UN projections its share could rise to as much as 45% by the end of the decade.^[10] Unlike the first 'China shock', the current wave of expansion extends beyond traditional low value-added industries to include high-margin products and sectors that are critical for future growth, technological security, and the energy transition.

In response to China's export expansion, many countries continued to adopt protectionist barriers, although these were not strengthened with equal resolve everywhere. The short-term costs of a trade conflict with the United States and the risk of retaliation from Beijing began to offset longer-term concerns about Chinese production surplus. In 2025, 52 of the world's 70 largest economies resorted to trade defence instruments, but only some adopted a more assertive stance towards Beijing.^[11] India, Brazil, Turkey, and Mexico remained among the most resolute. An escalation of the tariff war leading to the formation of a broad 'anti-China' coalition could pose a significant threat to the stability of China's economy. For now, however, the world – dependent on fast and inexpensive supplies from China – remains unable to construct a watertight 'tariff wall' around it.

Strong supply

The growing goods trade surplus reflects a widening imbalance between domestic production capacity and domestic demand. The Chinese authorities' ambitious industrial policy is leading to an expansion of manufacturing capacity beyond the needs of domestic demand. Intense competition among companies is fuelling destructive price wars. Consequently, domestic supply is displacing imports, while the competitiveness of Chinese goods in foreign markets is increasing.

China remains the leading producer of many simple, low-margin goods, while at the same time building competitive advantages in advanced industry, which Beijing regards as the foundation of economic modernisation and a source of security and prosperity.^[12] The authorities boast that in 2025 output of industrial robots rose by 28% year on year, metal-cutting machine tools by 10%, integrated circuits by 27%, smart drones by 57%, in-vehicle smart devices by 26%, optoelectronic components by 19%, and 3D printing equipment by 53%, while the value added of digital product manufacturing increased by 9%.

This is particularly evident in the automotive sector, where cost advantages and technological progress have translated into increasing competitive pressure on foreign manufacturers both within China and abroad. Industry estimates suggest that in 2025 passenger car exports increased by 20%, reaching nearly 6 million vehicles,^[13] and China retained its position as the world's largest exporter. Official customs data point to an even sharper increase in exports – by 86%, to more than 7 million units – alongside a drop in imports of over 30%, to just under 500,000 units.

Supplies from China remained critical to the global energy transition. In 2025, exports of photovoltaic components rose by nearly 30%, to more than 450 GW, batteries by over 50%, to more than 300 GWh, and electric and hybrid passenger cars by over 70%, to 3.8 million vehicles.^[14] The value of foreign sales of these goods, the so-called 'new trio',^[15] increased by 23%, exceeding \$180 billion. In the short term, the rapid growth of supplies from China supports the 'green' energy transition by reducing its costs. However, over the longer term, it hampers the development of domestic production of low-emission technology components and equipment that is independent of the authorities in Beijing.^[16]

China's global expansion in the cleantech sector is a consequence of the government-driven energy transition, whose primary objectives are to increase self-sufficiency, modernise the country through the use of domestic technologies and sources of electricity, and stimulate economic activity. Access to cheap electricity on a large scale is intended to strengthen industrial competitiveness and reduce the country's dependence on imports of fossil fuels. At a time when traditional sources of growth are weakening and new sources of growth remain insufficiently developed, the green transition is helping to sustain economic activity and support employment. Analysts estimate that the broadly defined cleantech sector – encompassing renewable energy, nuclear power, electricity grids, energy storage, electromobility, and rail – accounted for more than 11% of the economy in 2025, with its contribution to GDP growth reaching 30%.^[17]

Weak demand

The Chinese authorities appear to recognise that increasing the role of consumption in the economy is necessary to reduce dependence on foreign markets. However, they continue to prioritise supply-side stimulus over structural reforms aimed at supporting domestic demand. In Beijing's view, the solution lies not in strengthening the social safety net or improving the position of workers in the labour market – as recommended by many Chinese and foreign economists – but in technological progress. This is expected to boost productivity and, in turn, raise wages and household spending, as well as increase the availability of goods and services.

A genuine shift towards consumption would either weaken support for industry or lead to a significant increase in public debt, which Beijing views as a threat to stability, as well as reduce the party's control over the economy. A decisive rise in consumption would require strengthening Chinese households' sense of economic security – something that, unlike further investment, cannot be decreed. The programme implemented last year to replace old cars and household appliances with new ones cost just 0.1% of GDP and primarily served to support manufacturers of these goods by bringing forward purchases that would otherwise have been postponed. Beyond this, the authorities limited themselves to modest measures: a minimal increase in the lowest pensions and subsidies for health insurance, as well as the introduction of a new benefit for children up to the age of three and an annual interest subsidy for selected consumer loans. The cost of each of these instruments was below 0.1% of GDP.[\[18\]](#)

The propensity of Chinese households to spend continued to be weakened by the deepening housing market crisis, despite signs of stabilisation at the end of 2024.[\[19\]](#) Sales of residential units fell by 9% in terms of floor space and by 13% in value. Consequently, they were less than half the level recorded in 2021. The floor space of new housing projects declined by 20%, to its lowest level since 2002. Investment spending declined by a further 16%. As in the previous year, the downturn in the real estate sector may have reduced GDP growth by as much as 2 percentage points.[\[20\]](#)

Weak demand amid intense market competition is leading to a further deterioration in companies' financial performance. Last year, the profits of large industrial enterprises rose for the first time since 2021, albeit by just 0.6%. At the same time, the share of loss-making firms increased to 24% at year-end, the highest level in the 21st century. Zombie firms – those whose operating profits are insufficient to cover interest costs – already accounted for more than 12% of all listed companies, more than double the share in 2018 and nearly twice the global average.[\[21\]](#) An inadequate level of consumption relative to production capacity is prompting companies to intensify their expansion abroad in order to improve their financial performance.

The fight against 'destructive competition'

The weak financial standing of enterprises is constraining wage growth and reducing budget revenues. At the same time – most importantly from Beijing's perspective – it is pushing businesses into destructive price competition at the expense of technological development. In response to strong market pressure, many companies prioritise cost-cutting, including reductions in spending on research and development. This runs counter to the Chinese Communist Party's vision of a 'technological leap forward', in which innovation is intended to strengthen the country's self-sufficiency and generate new sources of productivity.[\[22\]](#)

The growing imbalance prompted Beijing to intensify its campaign against 'involution' (nèijǔǎn), a term used to describe destructive competition. The term had appeared in official messaging since July 2024, including in statements following the July meeting of the Politburo of the Chinese Communist Party Central Committee and the December Central Economic Work Conference. However, it rose to become one of the main slogans of economic policy only after Premier Li Qiang presented the government work report in March of the following year, and after it was elevated at the highest level in June and July 2025,

including during meetings of the Central Financial and Economic Affairs Commission and the Politburo, as well as in publications of the Party journal *Qiushi*.^[23] Beyond political messaging, Beijing has also deployed softer, sector-specific administrative pressure: ranging from calls for 'rational competition' and oversight of prices, costs, and quality, to pressure on companies to curb new investment in industries with excess capacity (including automotive, photovoltaics, and batteries, as well as steel, cement, glass, and non-ferrous metals).

One consequence of the tougher rhetoric against destructive competition was the first-ever annual decline in reported investment in fixed assets. In 2025, it fell by 3.8%. Unlike in previous years, a negative result became not only acceptable to Beijing but also desirable from the perspective of local authorities and affiliated businesses, as it signalled their active participation in the political campaign directed by the central government. However, it is difficult to determine to what extent this reflected a genuine weakening of activity. It may also have resulted from curbing the long-standing practice of inflating investment statistics in order to improve officials' prospects for promotion within the party-state hierarchy. The decline in investment was not confined to sectors covered by the campaign against 'destructive competition'.

The reasons for the decline in investment in fixed assets also include the deepening property market crisis, the diminishing rationale for further investment in the face of excess production capacity, reduced infrastructure spending due to the saturation of such assets in China, and the diversion of funds towards repaying hidden liabilities of local authorities and their affiliated entities. Investment in the real estate sector contracted by as much as 17.5%, compared with 10.8% a year earlier and just under 9% in 2023 and 2022. In previous years, this weakness had still been offset by strong investment in industry and infrastructure, but in 2025 this mechanism ceased to function: the former grew by only 0.6%, while the latter declined by 2.2%.^[24]

At the same time, the campaign against destructive competition reflects an attempt to move away from a decentralised economic model based on regional rivalry towards stronger central coordination and greater control by Beijing over the allocation of resources. To meet the expectations of the central government, local authorities have for decades channelled funds into sectors regarded as priorities at a given time,^[25] leading to duplication of investment, excess production capacity, misallocation of capital, rising local protectionism, and intense price competition.^[26] From the perspective of the Chinese Communist Party leadership, this mechanism is now less conducive to technological development, which requires specialisation, complementarity, and the use of economies of scale. The priority is no longer rapid expansion but high-quality growth. Local authorities take a different view: for them, limiting mechanisms that sustain local businesses leads to higher unemployment and weaker economic activity, and therefore poses a threat to social stability. Consequently, they will resist pressure from the central government for as long as possible.

The hypothesis of an investment collapse is not confirmed by other indicators, above all data on gross capital formation. These suggest that in 2025 investment accounted for 15.3% of GDP growth, implying an increase in its real value of around 2% compared with 2024. If both datasets are considered equally reliable, the discrepancy would stem mainly

from differences in coverage: investment in fixed assets includes, among other things, land and used equipment, but excludes inventories and certain intangible assets, which are counted as part of capital formation in the national accounts. In addition, the former indicator reflects nominal changes, while the latter presents real figures adjusted for price effects, which in a deflationary environment further widens the gap between them. However, as there is no clear evidence of a marked intensification of these factors in 2025 compared with previous years, the divergence is likely due primarily to the aforementioned 'squeezing out water' from the data (*jǐ shuǐfèn*). There is also an alternative explanation: gross capital formation could not decline as sharply as investment in fixed assets because, as a component of GDP, it would have made it impossible to report the 5% growth target set by Beijing.

The authorities have already announced measures to stabilise and revive investment. At the same time, they are increasingly broadening the concept, linking spending on physical assets with 'investment in people' (in sectors such as education and healthcare), while shifting priorities away from traditional construction towards modern infrastructure supporting digitalisation, AI, and advanced industry. In the first two months of 2026, investment in fixed assets rose by 1.8%.

Consequences for the global economy

For the rest of the world, what matters more than the pace of China's economic growth is its direction. A slowdown does not mean that Chinese companies will become less competitive, nor that Beijing's political influence on the international stage will weaken. Well-founded debates about the true pace of GDP growth often divert attention from the risks stemming from China's industrial expansion.

The lack of decisive measures to stimulate consumption in China means that the global economy cannot expect stronger demand from that source. Even if it were to increase significantly, the benefits for advanced economies, including the EU, would be limited. It would translate only to a limited extent into higher imports of European cars or machinery, as Chinese industry is increasingly able to meet domestic demand itself, while any support for lower-income households would not materially boost purchases of foreign goods. From a Western perspective, a greater concern than the limited extent to which Chinese citizens share in the gains from growth is that Beijing seeks to change this by further supporting supply, thereby increasing pressure on industry in the United States and the EU.

If the ongoing campaign against 'involution' proves successful, companies emerging from this domestic war of attrition will be more innovative and better positioned for expansion abroad. These companies will combine technological advantages with strong cost discipline, the ability to operate on very thin margins, and the capacity to scale up rapidly. For trading partners, this signals even stronger and more persistent competitive pressure from China, especially as the effects of some investments launched in previous years are only now feeding through into production and exports.

[1] D.H. Rosen, L. Wright, O. Melton, J. Smith, '*China's Economy: Rightsizing 2025, Looking Ahead to 2026*', Rhodium Group, 22 December 2025, rhg.com.

- [2] As a primary measure of economic performance, this indicator has for years served the Chinese authorities as a tool of both domestic and external propaganda.
- [3] *'Learning Resources, Inc. v. Trump, 607 U.S. (2026)'*, US Supreme Court, supremecourt.gov.
- [4] See M. Kalwasiński, *'A two-speed economy. China on the eve of a trade war'*, OSW, 12 March 2025, osw.waw.pl.
- [5] C. Shepherd, L. Kuo, Pei-Lin Wu, *'Chinese exports, aided by tariff dodging, defy Trump's trade pressure'*, The Washington Post, 9 May 2025, washingtonpost.com.
- [6] B.W. Setser, *'The PBOC, The State Banks, and Backdoor Intervention'*, Council on Foreign Relations, 2 February 2026, cfr.org.
- [7] S. Sivabalan, *'China's Yuan Is 25% Undervalued on Trade Basis, Goldman Says'*, Bloomberg, 10 December 2025, bloomberg.com.
- [8] See M. Kalwasiński, M. Bogusz, *'A blow dealt to Europe's defence: China steps up control of strategic exports'*, OSW, 14 October 2025, osw.waw.pl.
- [9] The first 'China shock' occurred after China joined the World Trade Organization in 2001, when exports from China surged, weakening the competitiveness of industry in other countries and leading to localised job losses and social challenges.
- [10] *The future of industrialization. Building future-ready industries to turn challenges into sustainable solutions*, United Nations Industrial Development Organization, November 2024, unido.org.
- [11] J. Gunter, C. Soong, *'Many countries launch new trade measures – but China's exports just keep growing'*, Mercator Institute for China Studies, 19 February 2026, merics.org.
- [12] See M. Kalwasiński, *'The economy according to Xi Jinping: a technological 'leap forward''*, OSW Commentary, no. 621, 21 August 2024, osw.waw.pl.
- [13] *'2025年12月份全国乘用车市场分析'*, China Automobile Dealers Association, 9 January 2026, cada.cn.
- [14] Calculations based on data from China's customs authority.
- [15] The 'old trio', which once underpinned export strength, consists of clothing, furniture, and household electronics manufacturing.
- [16] See A. Łoskot-Strachota, M. Kalwasiński, *'The EU in the face of China's growing role in global and European climate policy'*, OSW Commentary, no. 695, 7 November 2025, osw.waw.pl.
- [17] L. Myllyvirta, B. Schaepe, *'Clean energy drove more than a third of China's GDP growth in 2025'*, Carbon Brief, 5 February 2026, carbonbrief.org.
- [18] *People's Republic of China: 2025 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for the People's Republic of China*, IMF, 13 February 2026, imf.org.
- [19] See M. Kalwasiński, *From boom to bubble. The real estate crisis in China*, OSW, Warsaw 2024, osw.waw.pl.
- [20] *'China's Economy is Expected to Grow 4.8% in 2026 Amid Surging Exports'*, Goldman Sachs, 8 January 2026, goldmansachs.com.

[21] A. García Herrero, '[NATIXIS China Corporate Monitor 2025 – Corporate health hurt by lower profit margin even if supported by cheaper funding](#)', EuroAsia and the World, 17 July 2025, [substack.com](#).

[22] See M. Kalwasiński, '[The economy according to Xi Jinping...](#)', *op. cit.*

[23] The official theoretical journal and news magazine of the Central Committee of the Communist Party of China.

[24] The scale of these investments was constrained by the fiscal difficulties of local authorities, which faced lower revenues amid the economic slowdown and a decline in income from the sale of land-use rights. In 2025, special bonds – issued in principle for specific public projects, traditionally concentrated in construction – were increasingly used to repay hidden debt and settle arrears to companies. Consequently, of the total 4.4 trillion yuan in new bond issuance, only around 3 trillion may have been allocated to infrastructure projects, representing the lowest level since 2019. Part of these funds was also used to purchase unsold land from developers rather than to finance new investment.

[25] Until recently, they were also directed towards the real estate sector.

[26] Xi Jinping publicly criticised this practice: “Some regions, disregarding actual conditions, blindly follow trends. If others invest in chip production, they do the same. If others develop the ‘new trio’, they do not want to be left behind either”. Quoted from: '[学习进行时 | 产业发展，总书记强调不能喜新厌旧](#)', Xinhua, 28 January 2026, [news.cn](#).