Letter n°141

Western Reindustrialisation Weakened by Chinese Deflation

"The essence of reflection is understanding that we did not understand."
— Gaston Bachelard

International leaders were mistaken in the year 2000 when they viewed China merely as an assembly workshop and a market to be conquered. The outcome is striking: on the eve of China's accession to the World Trade Organization, it accounted for 6% of global industrial production. Today, that figure stands at 32%—more than the United States, Japan, Germany, and South Korea combined—and continues to increase by approximately one percentage point each year.

This issue is of major importance, as it calls for caution before investing in Western industrial companies, which are facing competition from Chinese firms that are often burdened by overcapacity, firmly export-oriented to compensate for a sluggish domestic market, and sometimes operating at a loss despite state subsidies or tax incentives.

Admittedly, deindustrialisation—except in a few economies such as Switzerland, Sweden, and to some extent Italy—is occurring almost everywhere. Since 2013, 6% of industrial jobs worldwide, or about 20 million positions, have disappeared. This is primarily the result of productivity gains, advances in robotics, and the shift of economies toward services. Nevertheless, Chinese competition is amplifying and exacerbating this phenomenon.

The Chinese economy has yet to recover from the COVID crisis: GDP growth figures that struggle to reach 5% officially (with reality likely closer to 2%), compared with an average annual growth rate of 9% since the late 1970s; very high youth unemployment; producer-price deflation for three consecutive years; an unresolved property crisis; real estate prices down 17% since the pandemic according to the Bank for International Settlements; weak transaction volumes; massive overcapacity; and numerous property developers effectively bankrupt.

As Xi Jinping is unwilling or unable to stimulate domestic consumption, the country's growth relies on a single engine: exports. This explains the aggressiveness of Chinese companies in conquering international markets and the progressive closure of the domestic market to foreign firms.

These are the two dimensions examined in this Letter 141 to analyse some of the obstacles to the reindustrialisation of Western countries and the pressure on corporate margins. When China joined the WTO in 2001, it was primarily an assembly hub and a potential market for Western companies. That is no longer the case.

The Closure of the Domestic Market: Three Key Points:

- ***Closure in a Context of Fierce Competition:***

Of the 5,300 companies listed in China, one quarter reported losses over the first nine months of the year—nearly half in real estate and solar energy. Thirty percent posted declining profits, while only 40% saw profits increase.

The automotive sector is a prime example. China produces one-third of global vehicle output. There are 130 electric vehicle manufacturers, most of them loss-making, slow to exit the market, and cutting prices in the

meantime. BYD, the market leader, was forced in spring to cut prices by one-third and still saw its market share fall from 35% to 27% in one year. Consequently, foreign automakers' share of the Chinese market dropped from 60% in 2020 to less than 40% in 2025.

Xi Jinping aims to prioritise domestic players and combat overcapacity. Over an 11-month period, investment has declined by 3.6%. However, closing excess capacity risks rising unemployment and social unrest.

- ***Retaliatory Measures:***

China fully understands the leverage of a 1.4-billion-person domestic market and knows it can weaken many international companies by threatening closure. Against the EU, following measures on cognac in July 2025, European dairy products now face tariffs of up to 42%. Against the United States, China periodically wields the rare-earths weapon and, this year, halted soybean purchases.

- ***Weak Domestic Consumption:***

The population, impoverished by the loss of savings invested in real estate, is cutting back on consumption despite government stimulus measures. Consumption growth, at just +1.3% year-on-year, is the weakest since the COVID period, with automobile sales down 8% and household appliances down 20%.

Consumption remains constrained by limited social-protection spending—9% of GDP for healthcare and pensions, compared with 20–25% in Western countries. Urban disposable income is below USD 700 per month per capita, while in rural areas hundreds of millions survive on just a few dollars a day.

Local governments, deprived of land-sale revenues, face funding difficulties and a rapid rise in debt—from 62% of GDP in 2019 to 84% in 2024 (IMF). A USD 1.4 trillion debt-swap programmed by the central government has proved insufficient, and Beijing is now forcing local governments to sell assets to raise liquidity. This year, asset-backed securities issuance reached USD 2.3 trillion, still not enough.

The World Bank forecasts GDP growth of 4.4% in 2026—the lowest in 50 years. Public debt has doubled since 2019 to USD 23 trillion. Deflation increases the real burden of debt servicing, yet further rate cuts would squeeze bank margins.

The Conquest of International Markets:

Six points help explain this expansion:

- ***China's Ambition to Become the World's Factory:***

To strengthen strategic autonomy, China trains 3 million engineers per year, has increased R&D spending by 50% since 2020, and installs more robots than any other country. Although the US recently authorised Nvidia to sell certain chips to China, Beijing refuses and continues to pursue semiconductor self-sufficiency, targeting 70% by 2028.

China does not merely seek efficiency. It massively subsidises its companies to accelerate international expansion and crush foreign competitors. The IMF estimates government aid and tax relief at USD 800 billion in 2023.

As a result, over the first 11 months of 2025, China's trade surplus reached a record USD 1.076 trillion. Exports rose 5.4%, even though exports to the US fell 19%. In November alone, exports to the US plunged 29%, while those to Europe rose 15% and even more to Asia.

- ***The Conquest of European Markets:***

Between 2016 and 2025, the EU's trade deficit with China widened from EUR 145 billion to EUR 355 billion. In 2024, China invested only EUR 65 billion in Europe, while Europe invested EUR 240 billion in China.

Within three years, European manufacturing fell from 16% to 14.7% of GDP.

China has announced 13 automotive plant projects in Europe, seven already confirmed. Investments focus on electric vehicles and batteries (where China holds 60% of global market share), notably in Hungary and Spain, skillfully exploiting divisions within the EU. Key investors include CATL, Geely, and Tencent.

By 2030, these plants could produce 1.1 million vehicles—10% of the European market—with only 30% European components. The EU plans to demand technology transfers and push for 70% local content, especially in autos. Partnerships are already multiplying: Uber–Baidu (autonomous taxis), AstraZeneca (USD 2.5bn research centre in Beijing), Renault–Geely (Brazil), Nvidia–BYD (autonomous driving), Nvidia–Alibaba (humanoid robots).

- ***Germany's Difficulties:***

As a major industrial power, Germany is particularly vulnerable to Chinese competition amid US market closures and higher energy prices. Since 2019, exports to China have fallen 25%, imports have surged, and Germany's trade deficit with China is expected to reach EUR 88 billion this year.

Industrial employment has declined 5% since 2019. Automotive exports to China fell from EUR 20 billion in September 2022 to EUR 7 billion in September 2025. For the first time, Germany's automotive sector ran a deficit with China in 2025.

In steel, ThyssenKrupp is cutting capacity from 11 million tonnes to 9 million tonnes. Over the first nine months of 2025, exports to the US and China fell by 8% and 12% respectively.

- ***Chinese Factory Deployment Worldwide to Circumvent Tariffs:***

Southeast Asia is the main beneficiary of redirected foreign direct investment away from China. In 2023, Indonesia, Singapore, the Philippines, Thailand, Malaysia, and Vietnam attracted over USD 200 billion in investment—often Chinese—while China received only USD 43 billion.

Over the first nine months of the year, Chinese exports to Southeast Asia rose 23% to USD 407 billion, often serving as re-exports.

- ***Emerging Markets Struggling Against Chinese Competition:***

OECD countries are not alone. All emerging economies are affected.

India is emblematic. Despite Modi's nationalist push to industrialise, manufacturing remains stuck at 15% of GDP. India's trade deficit with China reached USD 100 billion in 2022 and USD 83 billion in 2024. In 2023–2024, India imported USD 100 billion from China—chemicals, machine tools, semiconductors, and telecom equipment. Barriers have proved ineffective, and renewable-energy expansion (especially solar) will increase dependence on China.

India exports little to China beyond refined products, cotton, and iron ore—USD 17 billion in 2023–2024. China actively protects itself against Indian pharmaceuticals and IT services, despite one in five generic medicines worldwide being produced in India.

- ***Recent Breakthroughs in Services:***

Beyond industrial dominance, China is becoming a major services player through firms such as TikTok, WeChat, Shein, and Temu—and has even become the world's leading caviar producer in the luxury sector.

Conclusion: ***"Remorse wants to forget; regret wants to perpetuate." — Vladimir Jankélévitch***

Allowing China into the WTO in 2001 under favourable conditions now inspires more regret than remorse. There is no obvious solution, and Chinese deflation is spreading its poison. Preventing global deindustrialisation outside China would ideally require a substantial yuan revaluation, a major dollar devaluation, or high tariff barriers.

Yuan revaluation is off the table. The currency is not convertible, and Xi Jinping does not want to repeat the Plaza Accord scenario of the early 1990s. China, already facing deflation (consumer prices +0.7% y/y; producer prices −2.2%), will not worsen the debt burden.

A sharp dollar depreciation, favoured by Donald Trump, would be disastrous for the eurozone. Fortunately, markets—not politicians—will decide the dollar's trajectory.

Tariffs may be the last line of defence. Trump, Biden, and the European Commission have used them, particularly in autos and steel. Yet consumers will eventually resist the loss of purchasing power. Tariffs failed to create jobs during Trump's first term and have not prevented rising unemployment this year. US manufacturing jobs fell by 58,000 over 11 months to 12.7 million. Tariffs have not reindustrialised economies, boosted GDP, or reduced trade deficits. Despite them, US imports rose 10% in 2025 and the trade deficit increased 17%. Meanwhile, Shein continues to penetrate markets despite regulatory resistance.

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