Letter n°154

The structural weakness of China's growth.

"Demand much of yourself and expect little from others" Confucius.

This quote from Confucius is particularly relevant today, as China's economic growth now depends heavily on others – namely, its exports.

To be sure, China has deployed an unparalleled strategy to establish dominant positions across almost every industrial sector, from traditional industries such as cement and steel to the industries of the future, including renewable energy, electric vehicles, batteries, and nuclear power. According to the World Bank, its GDP has reached $18.5 trillion.

However, this expansion, while orchestrated by the central government, is undermined by the intensity of domestic competition. A second weakness is that China, constrained by high levels of debt and a demographic decline with few parallels globally, has either been unable or unwilling to stimulate domestic consumption. A third weakness, resulting from the first two, is an economic growth model that has become dangerously dependent on exports.

We will examine these three points:

The strengths and weaknesses of the industrial sector:

Within just a few decades, since the rise of Deng Xiaoping, China's share of global industrial production has increased from 5% in the late 1990s to more than 30%, with market shares exceeding 50% in many industries. It accounts for 80% of battery and solar panel production, more than 70% of wind turbines, and nearly 40% of heat pumps…

An orchestrated industrial expansion:

Orchestrated it undoubtedly is, as plans such as "Made in China 2025" that was launched in 2015, have, with considerable foresight, made virtually every industry of the future a national priority. Apart from aerospace and, to a lesser extent, artificial intelligence, China has experienced very few relative failures.

It is orchestrated because state-owned banks finance these future-oriented projects at preferential interest rates, because subsidies for these industries are abundant, and because short-term profitability is not the primary objective.

As an example of preferential financing, let us consider the nuclear sector. As is well known, the pursuit of energy independence ranks among China's highest national priorities. Reducing dependence on coal and lowering its carbon footprint come next. China plans to increase its nuclear capacity by more than 40% by 2030, thereby surpassing the United States' nuclear fleet. Such a rate of growth has no equivalent in either the United States or France, two leading nuclear nations that are also seeking to expand their capacity. In a recent report, the IEA analysed China's cost advantage in nuclear construction. Nuclear power plants are built by state-owned enterprises financed with debt covering 70% of project costs at preferential interest rates below 1.4%, whereas in Western countries, companies are often privately owned and debt financing rarely exceeds 30% of total funding requirements.

Subsidised industries constitute China's second competitive advantage after preferential financing. The conclusions of a recent OECD report are illuminating and are corroborated by other studies. According to the report, Chinese industrial subsidies are, depending on the sector, three to seven times higher than those of the European Union. In strategic industries, they amount to 3% of annual revenue. The Chinese authorities refuse to acknowledge this, but the evidence is undeniable.

To these subsidies must be added the benefit of a currency that is clearly undervalued by 20% to 30%, providing a significant export advantage.

Finally, after preferential financing, subsidies, and an undervalued currency, the fourth advantage is the ability of these state-owned enterprises to operate at a loss. This is one of the European Commission's principal grievances, as one-quarter of Chinese companies operating in Europe are loss-making. Such an option is impossible for Western companies listed on the stock exchange. The IMF has therefore called on China to halve its subsidies, but this has had no effect.

An industrial expansion distorted by local competition:

China has 22 provinces, and these provinces often compete with one another to attract investors, offer incentives for business establishment, and position themselves in the industries of the future. The risk for the country is excess capacity, and this is evident across many sectors.

- ***The example of the electric and hybrid vehicle industry***:

According to Rhodium, China's automotive production capacity, including both internal combustion and electric vehicles, is approaching 50 million units, while sales in 2025 did not exceed 24 million. The excess capacity is therefore obvious, helping to explain both intense price competition and pressure on profit margins.

Within the automotive industry, the electric and hybrid vehicle segment is particularly emblematic because, in 2025, three-quarters of all electric vehicles sold worldwide were produced in China. According to AlixPartners, 143 companies sold electric vehicles last year, but only 46 sold more than 1,000 vehicles. Consolidation is not taking place, as 23 new companies were established in 2025 while only 9 ceased operations. Admittedly, many of these companies are sub-brands of larger groups. Admittedly, 10 companies sell more than 1 million vehicles each and account for 85% of the market. Nevertheless, these groups operate in a market that, in April, was down 20% year-on-year and in which excess capacity is widespread.

As a consequence, even major players in the sector are operating at a loss. XPeng reported losses in the first quarter, along with a 13% decline in revenue. During the same quarter, Li Auto also reported losses and an 11% decline in revenue. BYD, the global leader in a sector driven by consumers' desire to reduce dependence on petrol-powered vehicles, has seen its margins decline, while its share price has fallen by 4% this year and 13% over the past year. In 2025, as a result of intense competition among these numerous companies, net profit fell by 19% and net margin dropped to 4.1%. The first quarter of 2026 was even worse, with net profit declining by 55%.

The only escape is exports. In 2020, China's vehicle exports did not exceed 1 million units; by 2025, they had reached 7 million, and this year they are expected to total between 10 and 12 million. An entire global industry is being squeezed by this competition. One need to only look at Volkswagen's plan to cut 100,000 jobs!

- ***The example of the solar industry***:

Let us consider another example, equally revealing, namely the solar industry, a sector experiencing strong growth. In 2024, companies in the solar sector collectively lost $40 billion and laid off 30% of their workforce.

China's production capacity of 1,200 GW is equivalent to twice the global demand for solar panels, which stands at 640 GW. Unsurprisingly, Longi Silicon Materials, despite being the world's leading producer of solar modules, is losing money – reporting a loss of $280 million in the first quarter of 2026, compared with a loss of $210 million in the first quarter of 2025. Other major Chinese players, including Jinko Solar, the world's largest manufacturer of photovoltaic solar panels, as well as Trina Solar, are also reporting losses. The share prices of these companies, despite operating in high-growth industries, have fallen sharply: Longi is down 35% this year and 81% over the past five years; Jinko Solar is down 42% this year and 72% over the past five years;

Trina Solar is down 28% this year and 66% over the past five years. And yet, exports of solar panels doubled in March compared with February!

Weak consumer spending and accelerating demographic decline:

- ***Weak consumer spending***:

China presents itself as a communist regime, yet paradoxically, President Xi opposes the development of a welfare state. Household consumption remains at 40% of GDP, compared with 54% in France and 67% in the United States, largely due to a high household savings rate of 35% of income.

In 2020, the Chinese Premier pointed out that 600 million Chinese citizens were still living on $140 per month, and unfortunately, this figure has changed very little.

Recently published data confirm the weakness of consumer spending, with a year-on-year decline in May and growth of only 1% in June. Sector-specific data also show significant declines, with car sales down 20% in the first half of the year and, according to the latest available figures, down 23% in June. Another example is the 40% decline in pork prices over the past year, as excess production capacity (some farms have as many as 600,000 pigs) coexists with weak demand.

- ***The impact of the persistent property crisis on consumption***:

Property investment has always been the preferred investment for Chinese households. The scale of excess capacity, with more than 80 million vacant homes according to some estimates, has shattered expectations that property could continue generating wealth, not least because the rapid population decline will add even more vacant housing. As a result, Chinese households are increasing their savings deposits, which in turn weighs on consumption.

According to the Rhodium Group, construction activity has fallen since 2023 from 16% of GDP to 11%. Property investment during the first four months of the year was down 14% compared with the same period in 2024, while the value of property sales declined by 15% over the same period.

Admittedly, prices are stabilising in the major cities, particularly in Shanghai, but this can be explained in part by discouraged homeowners choosing to withdraw their properties from the market rather than sell them.

In a recent report, the IMF recommended that China spend 5.5% of its GDP over four years to resolve the property sector crisis, but the state of China's public finances remains a major constrain.

- ***Demographic decline***:

For the past few years, China has no longer been the world's most populous nation, having been overtaken by India. But this is not the most important issue. The one-child policy, imposed for many years, has profoundly altered the country's demographic structure, and today, despite President Xi's repeated calls to boost birth rates, the inability to revive fertility is leading to an accelerated pace of population ageing unmatched anywhere in the world. It is well known that the number of children per woman is even lower in South Korea, Taiwan, and Japan, but their demographic decline is expected to be less rapid.

In 2025, there were 11.3 million deaths but only 7.9 million births, equivalent to 0.9 children per woman. According to Yi Fuxian, this number of births is comparable to that of the year 1738, when China's population was only 150 million. As recently as 2015, the country still recorded 16.5 million births.

According to United Nations estimates, China's population is expected to decline by 35% over the next 50 years, a steeper decline than that projected for Italy (-30%) and Japan (-28%). By 2100, again according to the United Nations, China's population could fall to 633 million.

- ***The scale of indebtedness as a constraint on stimulus measure***:

China's actual budget deficit, as measured by the IMF, has averaged close to 15% of GDP over the past five years, increasing public debt to 135% of GDP, while the country's total debt has reached 3.5 times GDP – a very high level for a country that still retains some characteristics of an emerging economy.

In this context, it is difficult for the government to provide meaningful support to a property sector that has been in crisis since 2019. For many years, this sector was the main engine of China's economic growth, accounting for as much as 25% of GDP when public infrastructure projects are included.

Dependence on exports, now the only engine of growth:

The current account surplus reached 3.7% of GDP in 2025, compared with just 0.2% in 2018. The trade surplus alone ($1.2 trillion in 2025) represents, according to the IMF, 6% of GDP. This has resulted in a growing accumulation of savings.

The latest figures are revealing. In June, exports increased by 27% year-on-year, significantly faster than expected. The two main drivers were AI-related components, particularly semiconductors benefiting from sharp price increases, as well as rare earths and renewable energy products. Vehicle exports, many of them electric or hybrid, rose by 60% during the first five months of the year to reach 4 million units.

In May, the trade surplus reached $105 billion in a single month. Both developed countries (Canada, Japan, etc.) and emerging economies (Thailand, Indonesia, Mexico, etc.) are complaining about this influx of Chinese products.

The European Union's trade deficit with China now stands at €1 billion per day. Entire industries are threatened by what is viewed as unfair competition. The EU has therefore raised tariffs on Chinese steel to 50% beyond a specified quota. It also wants to require China to transfer technology, manufacture more products in Europe using local workers, and source a greater proportion of components from European suppliers.

Conclusion: ***"A journey of a thousand miles begins with a single step" Lao Tzu***.

The journey of a thousand miles could well represent overtaking the United States and establishing China as the world's leading power. But while the progress achieved has been immense, many obstacles remain:

- ***Admittedly, China appears to be the winner of the conflict in Iran***:

Leaving aside the damage to the United States' credibility resulting from its military campaign in Iran and the erosion of American soft power since President Trump's return, three developments have clearly worked in China's favour: increased use of the yuan, increasingly viewed alongside the euro and gold as an alternative to the US dollar; greater reliance on renewable energy, a range of industries, from wind and solar to batteries and electric vehicles, in which China holds dominant positions; and growing influence across many countries of the Global South as China continues to expand the Belt and Road Initiative. As an illustration, one may recall the recent opening of a 5,400-kilometre railway line to Turkmenistan.

- ***… But the primacy of politics over economics***:

In Xi's China, ideology and politics take precedence, with one overriding objective: independence. Energy independence, now achieved at around 85%, has been driven by the expansion of renewable energy, coal production, which accounts for more than half of global output, and refining capacity. The same ambition applies to food security, despite the country's limited arable land and freshwater resources. For now, however, China still records a $140 billion deficit in food products.

At the same time, China is erecting increased barriers to prevent technology transfers and overseas investment by foreign companies. Dozens of American firms are finding the Chinese market closed to them. One example is the prohibition on Meta's proposed $2 billion acquisition of Manus, an AI agent developed by a Chinese start-up.

- ***… contributes to the structural slowdown in growth***:

For decades, following Mao's death and the reforms introduced by Deng Xiaoping, China's annual economic growth averaged or exceeded 10%. That era is now over.

Since its peak in 2021, China's share of global GDP has declined from 18% to 16.5%, while the United States' share has increased to 26%. In the second quarter, China recorded its weakest growth since 2022, at 4.3%. The country's true economic growth may not be 4.5% but considerably lower – perhaps even only marginally above zero – and this growth is driven primarily by exports related to renewable energy and artificial intelligence. According to Capital Economics, China's 2025 growth figure may have been overstated by 1.5 percentage points. FactSet, having analysed the margins of 5,000 Chinese companies, found them to be at their lowest level since 2009.

Geneva, 17 July 2026

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