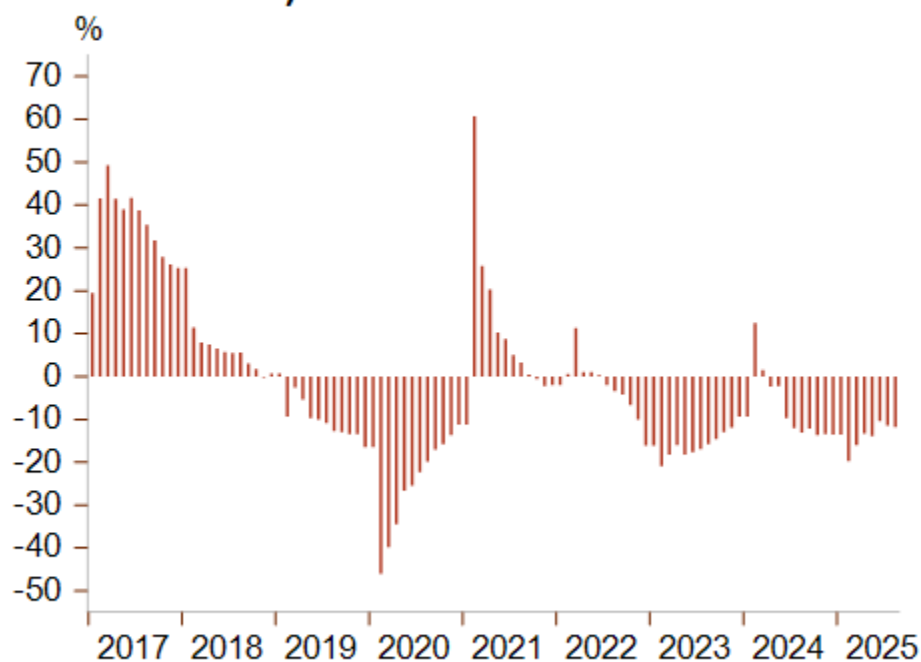


# China: Weak domestic demand, geopolitical tensions and an ongoing trade war expected to fuel economic slowdown | Credendo

## Export surge allows resilience amid weak domestic demand and deflationary forces

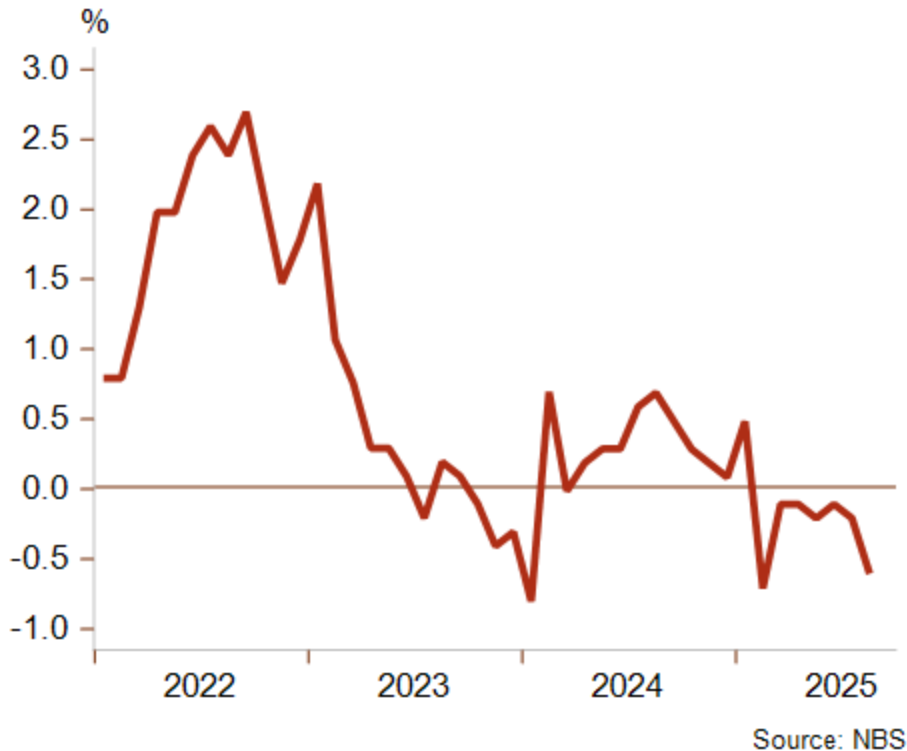
Persisting weak domestic demand continues to fuel the structural slowdown of the Chinese economy, with the uncertain world economic context an additional headwind as exports remain China's main GDP growth driver. Under the state goal of self-sufficiency and global leadership in high-tech, Chinese companies in those sectors have been overproducing goods (particularly in EVs, batteries and green technologies) well above the domestic demand and exporting this surplus to the rest of the world (outside the USA). Although industrial overcapacities bring benefits to China thanks to their competitive and technological strength, aggressive price competition has exacerbated the deflationary spiral in the country, turning this into a political issue. The country's other growth factors have been in crisis since 2022, with lingering property gloom (transactions and house prices are still on the downside), low business and consumer confidence (given that real estate used to be the dominant saving choice for households), and high youth unemployment that is harming private consumption and corporate investments, and ultimately domestic prices.

### China, real estate transactions (change YTD YoY in volume)



Source: NBS, BIS, Energy Institute

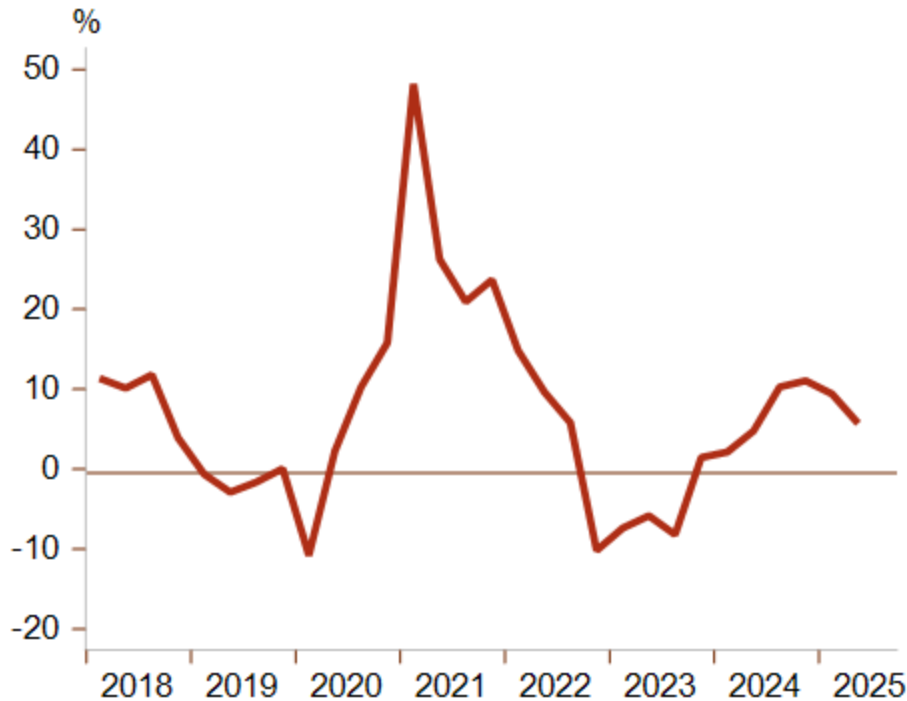
## China, consumer price index



With consumer prices stuck in negative or flat territory, there does not seem to be a way out from this deflationary spiral in the near term – unless Beijing launches a large stimulus, which is not on the cards for political, financial and fiscal stability reasons. So far, Beijing has opted for a supportive policy mix, with an accommodative monetary policy and some fiscal stimuli such as this year's consumption subsidies for household appliances, electronics items and cars. However, given the steadily deteriorating public finances – a wide fiscal deficit above 8% of GDP is expected in 2025, fuelling the upward trend in official government debt from less than 60% of GDP in the pre-Covid period to more than 100% forecast in 2026 – the government continues to limit its support to ensure fiscal sustainability and to mitigate the expansion of the heavy national debt burden (338% of GDP in Q2 2025). Among other things, the government has decided to invest more in infrastructure projects by means of very long-term bonds and to carry out various fiscal reforms, in particular to diversify revenues of embattled local governments. The government is also expected to take measures to reduce industrial overcapacities, with the associated risk of continuing the manufacturing sector's decline and weakening GDP growth. For the time being, Beijing will maintain its focus on exports and investments to drive GDP growth, which the IMF expects to be 4.8% in 2025 and 4.2% in 2026. The prospect of GDP growth nearing 5% this year, despite an expected deceleration in exports in the coming months, will not push the authorities to produce anything more than moderate stimuli to boost economic activity, especially as the USA and China may reach a trade deal within a few months.

Despite the US trade war and a threat of huge extra tariffs on Chinese imports – currently lowered to 30% during a transition period ending in November – exports have been performing strongly since the second half of 2024. The front-loading of goods exports along with exports redirected to non-US markets (first to South-East Asia, then to Europe), have kept the strong momentum going. The depreciation of the undervalued RMB vis-à-vis the EUR in particular, the currency of a major trading partner, and some other South-eastern currencies have also given Chinese exporters a competitive edge.

## China, exports of goods (YoY growth)



Source: SAFE

## A less upbeat outlook

The Communist Party's choice to not allow domestic consumption to drive the Chinese economic engine means that the nation will remain dependent on more volatile export markets in an uncertain global context. Chinese goods exports to the US fell by 15% between January and August, and not only will China find it difficult to find alternatives to compensate fully for the US consumer market, ranked number one globally, it will also have to withstand potential high US tariffs on "transhipped Chinese goods". In addition, it faces an increase in trade restrictions from a rising number of countries such as Thailand, Indonesia, India, Vietnam and Brazil, who, due to the impact of a wave of Chinese goods, are looking to protect their domestic industries. Moreover, the slowing global economy will also hit export prospects.

## Navigating through a weakened external environment

The US trade war launched this year has put global trade into turmoil, with particularly elevated import duties on China. Though significant additional tariffs on China have been put on hold in the face of China's significant powers of leverage regarding its critical minerals in particular, and to allow time for negotiations, an unstable trade relationship remains likely during Trump's rule. However, in the short term, a trade deal is still possible due to mutual interests and the need to mitigate the fallout from trade restrictions on both sides, but any agreement is expected to be highly volatile given their long-term strategic rivalry around economic and technological supremacy. Therefore, China will focus on further securing its supply chains (including those of critical minerals) through heightened market diversification, and will continue to accelerate its self-sufficiency goals, notably in the high-tech sector. In this regard, Beijing has again put its faith and support into the private sector and aims to attract FDI to help build up a self-sufficient economy. However, rising trade restrictions and political scrutiny on foreign companies operating in China amid heightened tensions with the USA and the West may impede a recovery in FDI inflows.

China's pivot to the Global South will bring more exports and investments as part of its ambitious Belt and Road Initiative. This is in line with the Chinese goal of leading a new world order and is also the result of US tariffs and a radical change in US foreign policy. As has been witnessed, Trump's aggressive and transactional foreign and trade policy and the sharp cuts in USAID have been quickly integrated into Beijing's soft power policy. China has been quick to court the victims of US trade and aid policy this year (South-East Asia, Brazil, Sub-Saharan Africa, etc.), promising them a more stable, predictable and mutually beneficial relationship that should support China's global economic network and influence and further strengthen its long-term access to critical minerals. As an alternative to more unpredictable US policies and a turbulent global economic climate, China's stock markets have been booming this year. Domestic and foreign investors have been showing increased interest in China's macroeconomic resilience – based on its large external liquidity, solid state banks, a comfortable current account surplus, political stability and policy continuity – which, along with its innovative economy and booming AI activity bring China closer to (and in some cases on a par with) US levels.

Looking ahead, no rating change is expected for the ST political risk, ranked in the best category at 1/7 thanks to ample liquidity, or the business environment risk that stands at a moderate D/G. As for the MLT political risk (2/7), despite its strong global financial, economic and trade weight, the world's second-largest economy faces many external headwinds and domestic challenges. China's regional assertiveness, which elevate conflict risks in Taiwan and the South China Sea, its rivalry for world leadership with the USA and China's overwhelming manufacturing sector have all been fuelling high geopolitical and trade tensions, primarily with the USA but also with the EU. On a domestic level, China's prospects will continue to be adversely affected by salient systemic issues dominated by a decreasing labour force, heavy debt and climate change.

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