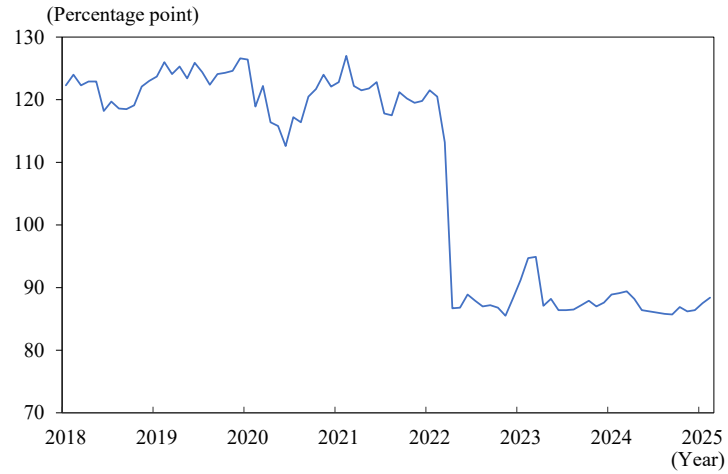
Section 2 China's economic downturn and underconsumption structure

While the United States has been leading the global economy, a change in the global economic picture is occurring: China, the second largest economy in the world,[2] is starting to lose its strength as a growth engine of the global economy. In China, even after the strict containment policy against COVID-19 ("zero-COVID 19 policy") was removed, the economic downturn continued. The negative asset effect[3] due to the real estate market slump, the heightening uncertainty over the Chinese authorities' economic policies, and the geopolitical confrontation with the United States and Europe gave rise to headwinds against China. As a result, expectations for growth have shown a downward shift in the medium to long term, as evidenced by the fact that the level of consumer sentiment continued to crawl along the bottom for three consecutive years (Figure I-1-2-1).

Figure I-1-2-1. Consumer confidence indices of China



Note: This figure shows the consumer sentiment indices based on survey data, in which the satisfaction indices reflecting households' views on the conditions of employment and income and the timing of purchasing durable goods are combined with the expectations indices indicating their forecasts for employment and income six months ahead.

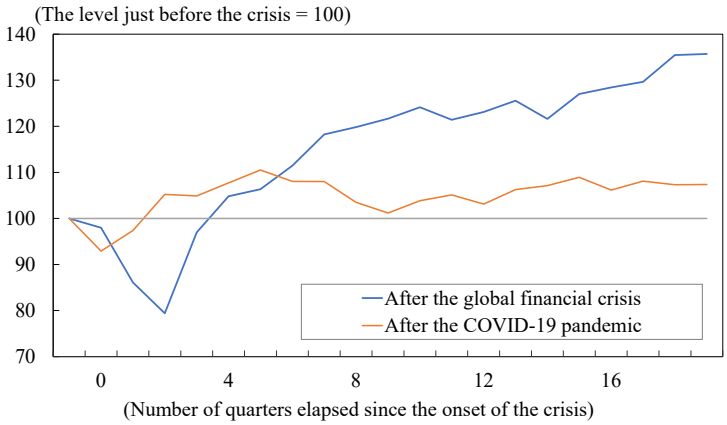
Sources: National Bureau of Statistics of China, CEIC.

Against the backdrop of this structural stagnancy of demand, the Chinese economy is facing growing deflationary pressures.[4] However, at least until the second half of 2024, it was understood that the Chinese authorities still remained cautious about resorting to the kind of large-scale fiscal pump-priming that had been implemented after the global financial crisis in 2008 as they attached importance to fiscal discipline, including among regional governments and state-owned enterprises. Amid the continued slowdown of the growth rate, the sluggishness of growth in imports by China in the post-pandemic

[2] In nominal terms and on a dollar basis.
[3] The effect of asset price declines causing households to curb consumption due to the erosion of the value of their asset holdings.
[4] See Part I, Chapter 5, Section 3.

period has been conspicuous, providing a contrast to the situation that followed the global financial crisis (Figure I-1-2-2). That has put an additional downward pressure on Asia and some European countries, many of whose exports go to China, through the weakening of external demand.

Figure I-1-2-2. China's import quantities

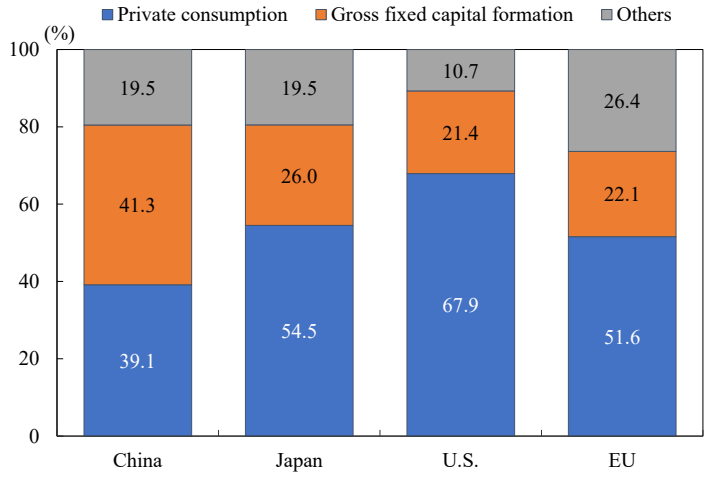


Note: China's import quantities were normalized to a baseline of 100, using the level of the period from April to June in 2008 as 100 for the quantities "after the global financial crisis" and that from October to December in 2019 as 100 for those "after the global financial crisis," and the subsequent trends were illustrated.

Sources: *World Trade Monitor* (CPB Netherlands Bureau for Economic Policy Analysis), CEIC.

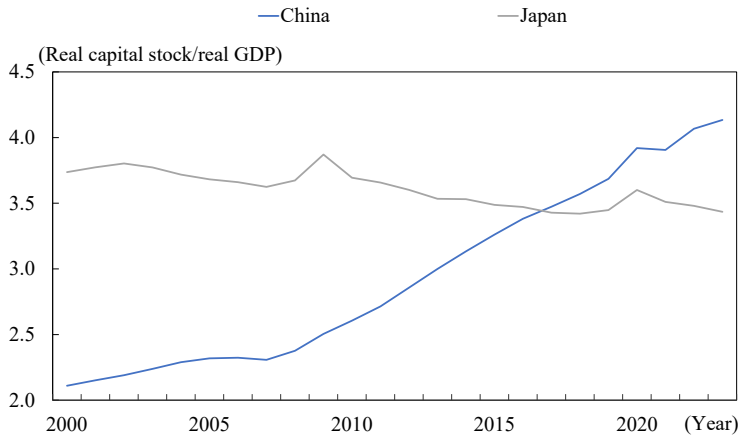
Behind the growing deflationary pressures on the Chinese economy is the fact that investment on the supply side has not been adjusted despite the downtrend in demand. In the case of the Chinese economy, fixed capital investment accounts for a larger portion of GDP compared with the U.S., EU and Japanese economies. In 2023, fixed capital formation accounted for 41% of Chinese GDP, meaning that the Chinese economy depends more on investment than on consumption (Figure I-1-2-3). The capital coefficient, which represents the ratio of capital stock to GDP, has basically stayed on an uptrend except during the pandemic period (Figure I-1-2-4). The fact that the capital coefficient for China, which is higher than the one for Japan, is continuing to rise indicates the possibility that the capital stock amount is overly large relative to economic size and that production efficiency is deteriorating.

Figure I-1-2-3. Breakdown of GDP demand components by major country and region (2023)



Sources: *World Development Indicators* (World Bank), *National Accounts of Japan* (Cabinet Office).

Figure I-1-2-4. Changes in capital coefficients in Japan and China



Note: The data on China up to 2016 is based on Herd (2020). The data from 2017 onwards is estimated using the formula: "Capital stock = capital stock at the end of the previous period × (1 - capital depletion rate) + real fixed capital investment." The capital depletion rate is assumed to remain constant from 2016 onwards. The growth rate of real fixed capital investment is calculated based on the growth rate obtained by subtracting the growth rate of the corporate goods price index (investment goods) from the growth rate of the nominal fixed capital investment.

Sources: Herd (2020), National Bureau of Statistics of China, Cabinet Office, CEIC.

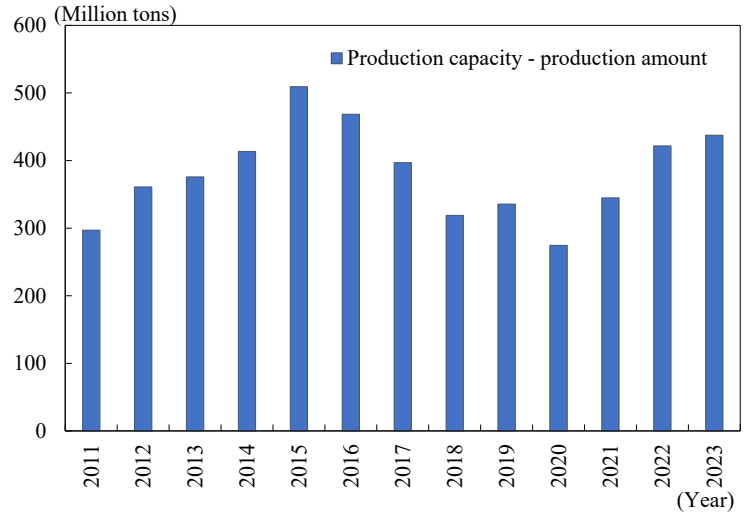
Because active investments led by the government and the accumulation of supply capacity continued despite the downtrend in domestic demand, the trend of deflationary exports, which refers to rapidly increasing exports accompanied by falling export prices, has been observed, drawing voices of concern from many export destination countries and regions around the world. In particular, the United States and European countries have expressed concerns not only about a steel supply glut, which already emerged as a problem in the past, but also about the international impact of "overcapacity," including

in advanced industry sectors to which the Chinese government has devoted particular efforts in recent years, associating these problems with China's market-distorting measures.

Indeed, in the most recent several years, as steel overcapacity in China has expanded once again (Figure I-1-2-5), the overall export value and export prices of products such as steel and solar cells have declined steeply (Figure I-1-2-6). In addition, recently, there has been a shift in export destination to emerging and developing countries, mainly neighboring countries in Asia, which is considered to be an attempt to skirt over the U.S.-China trade conflict (Figure I-1-2-7). In some cases, new trade conflicts are already starting to arise and are developing into a destabilizing factor of the global economy.

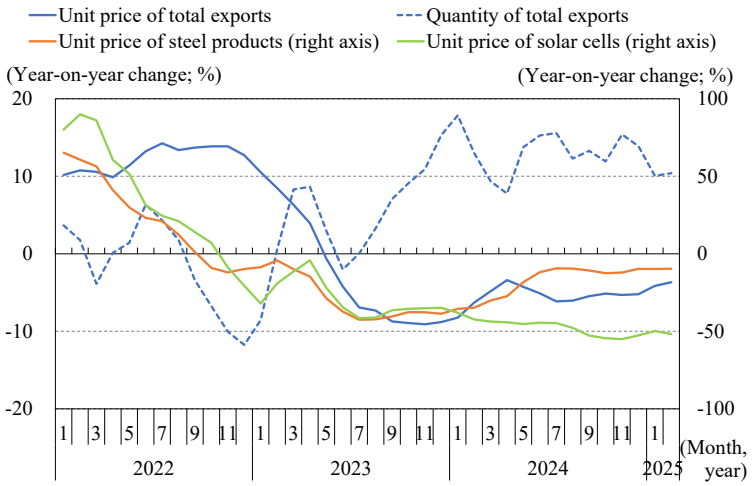
The abovementioned structural problem of underconsumption, stagnant imports, and the expansionary trend in deflationary exports are also reflected in a decrease in the contribution of final consumption to China's real GDP growth rate and a rise in the share of net exports (Figure I-5-3-1). Presumably, it takes some time before industrial and consumption structures change, but it is important to shift emphasis in economic policy from investment to consumption and curb excessive investment and excessive competition on the supply side. Furthermore, it is important not only to strengthen measures to expand domestic demand but also to ease tensions over trade by taking predictable and fair trade measures, including the reduction or abolition of import barriers, and by developing a predictable and fair trade environment (these matters will be discussed in detail in Part II, Chapter 2, Section 4).

Figure I-1-2-5. Changes in the differences between steel production capacity and production amount in China



Source: National Bureau of Statistics of China, CEIC.

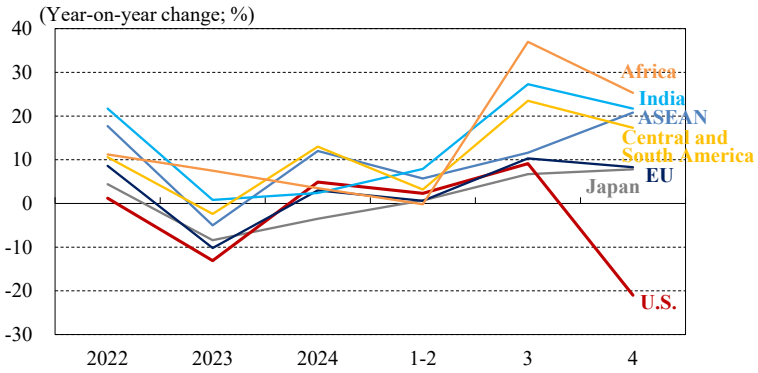
Figure I-1-2-6. Changes in export prices and quantities in China



Note: The data on total exports show the comprehensive indices published by the General Administration of Customs of China. The data on steel products and solar cells represent the average export unit price calculated from monthly export value and volume (tons and units). All data are calculated from a three-month moving average to derive year-on-year changes.

Source: CEIC.

Figure I-1-2-7. Changes in growth rates of export values in China by country and region



Note: The export values are in dollar terms. The data were reported on an annual basis through 2024 and on a monthly basis in 2025 (since the timing of China's Spring Festival holiday varies each year, the figures for January and February are published as a cumulative total to smooth out the holiday effect).

Sources: General Administration of Custom of China, CEIC.