Roland Berger

RBI Quarterly

No. 2/25

Navigating Disruption

JULY 2025

AUTHORS

DAVID BORN
Senior Manager

YU WANG
Senior Expert

STEFFEN GEERING
Senior Specialist

China's Economic Model in a World in Transition

From miracle to maturity - China's changing economic landscape

China's growth story, once defined by double-digit expansion and relentless urbanization, has been gradually losing steam for over a decade. After decades of breakneck industrialization and infrastructure build-out, the returns on capital investment have diminished, while the demographic dividend that once fueled factory-led expansion is fading. At the same time, rising geopolitical frictions and the weaponization of global trade have exposed the vulnerabilities of China's dependence on foreign markets and imported technologies. To sustain growth, Chinese policymakers are increasingly turning to domestic consumption and homegrown innovation as new engines of development. This rebalancing is also intended to create a more resilient economy – less exposed to external shocks and better aligned with the aspirations of an increasingly urban and sophisticated middle class. Yet the transition to a consumption-led economy is proving more difficult than policymakers had hoped.

Technologically, China has long demonstrated that it can rival – and in some areas surpass – other global superpowers. From artificial intelligence and automation to robotics and green technologies, China now leads the field not only in academic research but also in real-world applications. The recent release of DeepSeek underscored just how advanced Chinese technological capabilities have become. These gains are starting to feed through to productivity growth, potentially giving

Beijing an edge in the race for global economic leadership. However, the broader impact of China's transformation on its domestic economy and role in the global system remains uncertain. Key questions loom over the internationalization of the renminbi, China's growing alignment with Global South nations, and its ability to improve its position in global value chains amid mounting geopolitical tensions.

This Quarterly takes a closer look at these developments by examining China's evolving position in the world economy, particularly in light of the latest geo-economic rifts stemming from US trade policy.

Economic and geopolitical headwinds in the midst of a strategic pivot

China is undertaking a decisive pivot away from its long-standing export-driven, investment-heavy model toward one that focuses on domestic consumption and stabilization. This shift marks a broader geostrategic recalibration in the face of a polarized international environment and US-China rivalry. By fostering a consumption-led growth model, Beijing intends to reduce its reliance on volatile export markets and address economic imbalances.

In line with Chinas "dual circulation" strategy, policymakers are focusing on domestic demand as the growth engine, supported by selective engagement with the global market. The rising affluence of the country's middle class provides a foundation for this transformation. Additionally, the emphasis on self-reliance in critical sectors such as technology and energy, as exemplified by the "Made in China 2025" initiative, highlights the commitment to strengthening economic sovereignty.

Headwinds challenge Beijing's pivot toward a new growth model

China's rebalancing efforts, however, are facing stiff economic headwinds. Years of structural imbalances – masked by credit-fueled investment and export momentum – are now surfacing as sluggish domestic demand, a faltering property sector, and mounting industrial overcapacities that create persistent deflationary pressures.

Domestic consumption in China continues to be weighed down by the lingering effects of the weak real estate market - a primary result of the "three red lines" policy introduced to curb developer leverage. At its peak in 2021, real estate and related activities accounted for over 30 % of GDP. Regulatory tightening has triggered the risk of major property developer defaults and caused transaction volumes to plummet. New floor space started in March 2025 was 23 % lower than a year earlier and 62 % below March 2019 levels. The resulting decline in home values has eroded household balance sheets, undermining the wealth effect that typically supports consumer spending.

As a result, growth in domestic demand is expected to remain subdued for the foreseeable future. With consumer wealth under pressure, household sentiment remains fragile - a trend that has been exacerbated since April 2022, when confidence, already dampened by the pandemic, suffered another sharp decline following Shanghai's strict lockdowns. According to OECD data, consumer sentiment dropped to historical lows and has remained near these levels ever since, making a strong rebound in private consumption unlikely in the short term.

A glimmer of stabilization, however, can be seen in recent real estate data, suggesting the housing market may have bottomed out, with a broader stabilization anticipated by late 2025 or early 2026. Secondary sales in major cities have begun to recover, partly due to government support measures.

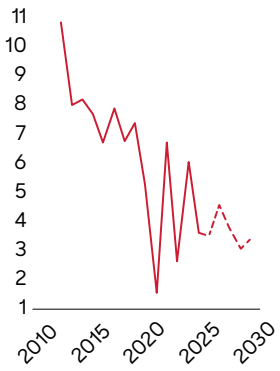
However, the Chinese consumer is not the only one under pressure. Mounting challenges in the export sector have led to overcapacity issues in the country's industrial base. The Trump administration's renewed trade war has hurt Chinese exporters with tariffs of up to 145 % on many Chinese imports. Beijing retaliated by imposing 125 % tariffs on selected US goods. Although both sides have since agreed to a 90-day truce[1], lowering the average effective US tariff rates to around 55 % and Chinese tariffs to 10 %, the dispute continues to jeopardize China's most critical export market, compounding pressure on an already strained industrial base. Even before the latest tariff salvo, China's inventory-to-sales ratios had been climbing, signaling that manufacturers were already struggling to shift goods. Consequently, the share of Chinese industrial firms operating at a loss has surged from around 15 % in 2018 to 29 % by March 2025.

1 The truce came into effect on May 14 and is set to remain in place for 90 days.

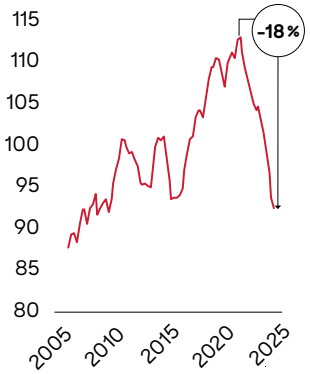
The combined impact of these headwinds is becoming increasingly evident in China's price indicators: while headline consumer prices have slipped into mild deflation in early 2025, the slide in factory-gate prices has been far more severe. The producer price index has been negative for 32 consecutive months until June 2025, suggesting China is facing the risk of resistance deflation.

Mounting domestic challenges are creating deflationary pressure

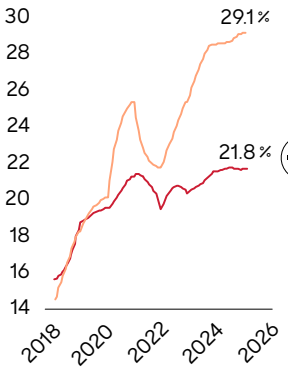
Growth in domestic demand[1] [%]



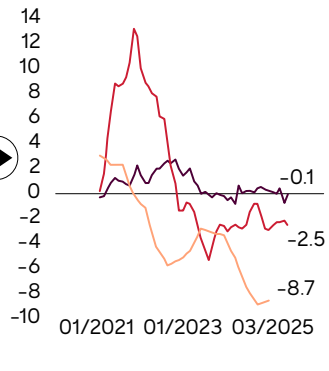
Residential property prices [Index, 2010 = 100]



Overcapacity in Chinese manufacturing



Price development of different categories in China [%]



1 Domestic demand is defined as the sum of private & public consumption, total fixed investment and stockbuilding
2 The inventory-to-sales ratio refers to the ratio between the end-of-month inventories and monthly operating income of Chinese industrial companies
Source Oxford Economics, National Bureau of Statistics China, Federal Reserve

Roland Berger

Heading for a balance sheet recession

Taken together, these trends suggest that China may be slipping into a balance sheet recession - a situation, in which private sector entities prioritize debt repayment over

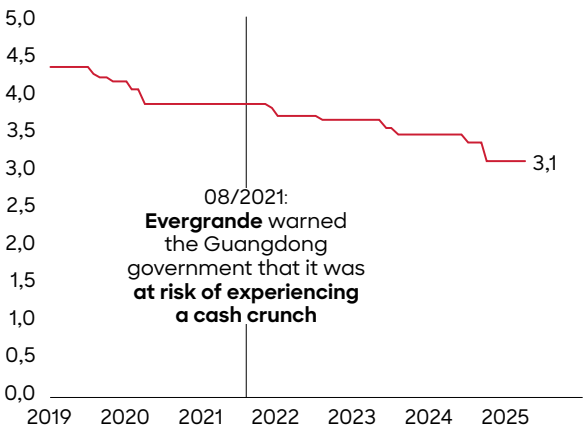
spending or investing, even when monetary policy is loose. First observed during Japan's " lost decades" beginning in the 1990s, this concept describes a cycle in which falling asset prices, weak domestic demand, and cautious private sector behavior reinforce each other. This makes traditional monetary policy stimulus measures less effective. In this environment, expansionary fiscal policy becomes the primary - and often the only - lever capable of reigniting growth.

As Beijing seeks to engineer a more sustainable growth model, the gap between policy ambition and economic reality becomes apparent. China's leadership recognizes these challenges. The policy shift, first unveiled in September 2024, gained further momentum during the March 2025 Two Sessions, when Beijing outlined a more assertive economic strategy. During the Two Sessions - the annual gathering of the countrys top political bodies - Beijing has signaled a decisive shift toward boosting domestic demand, stabilizing markets, and an deploying unprecedented fiscal stimulus package. A defining feature of this shift is its departure from the 3% fiscal deficit ceiling - once a symbol of fiscal discipline. Now, Beijing is embracing more active economic management by deepening state intervention in financial and real estate markets through regulatory relief, providing liquidity support, and offering selective bailouts.

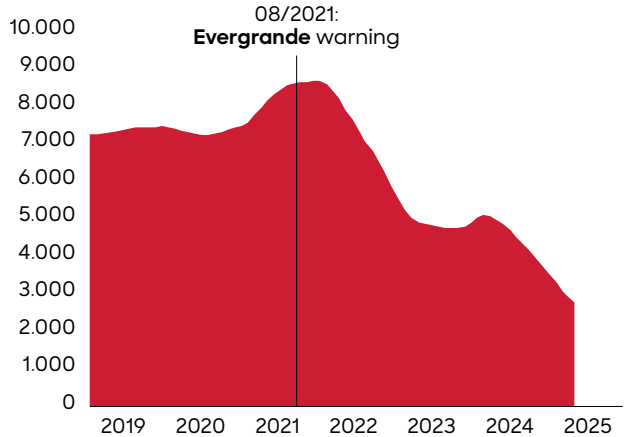
Beyond direct market intervention, Beijing's stimulus agenda focuses on broader economic and social development goals to revive domestic demand. Measures such as trade-in subsidies for cars, home appliances, and consumer goods aim to encourage household spending. Policymakers also intend to stimulate lasting demand by expanding social safety nets - pensions, healthcare subsidies, and unemployment support - to increase disposable income and reduce savings. The ultimate goal is to reorient China's growth model toward consumption-driven expansion and away from reliance on infrastructure and real estate.

Monetary easing has proven ineffective in reviving household appetite for borrowing

Chinese loan prime rate [%]



New household loans [RMB bn., 12m rolling avg.]



Source PBoC, Roland Berger

Roland Berger

However, rather than boosting demand, recent stimulus measures have struggled to break the current cycle of caution characterizing consumers and businesses. Rather than unleashing a wave of consumer and corporate spending, the measures have been met with restraint as households and businesses alike prioritize repairing their balance sheets - damaged in large part by losses in the property sector. As is typical in a balance sheet recession, sharply reduced interest rates have failed to revive demand; households are opting to deleverage rather than take on new debt.

Fiscal push against balance sheet recession

To avoid a full-blown balance sheet recession, China can act decisively on multiple fronts. Fiscal policy will need to take the lead, with government supporting demand through targeted spending. During a balance sheet recession, the private sector prioritizes paying off debt over borrowing, even when monetary policy is loose. If all sectors deleverage, the economy risks deflation and stagnation, similar to Japan in the 1990s. The government could become the "borrower of last resort." Sustained fiscal stimulus aimed at productivity-enhancing investments - such as infrastructure, green technologies, and social housing - can stabilize aggregate demand.

However, direct fiscal transfers to households – such as tax cuts or stimulus checks - are largely ineffective during a balance sheet recession because households are not constrained by a lack of income but rather by a damaged balance sheet. Their primary focus is on debt repayment and asset repair, not consumption. Thus, fiscal support is saved or used to pay down debt, failing to stimulate demand. This behavior undermines the multiplier effect typical of a normal recession.

Given China's strained public finances, deeper structural reforms are necessary to rebuild domestic momentum and shift toward consumption-driven growth. Compared to Japan, however, China still holds several trump cards. Beijing can draw lessons from Japan's missteps and avoid repeating the same policy errors. Moreover, Chinas urbanization potential far exceeds that of Japan in the 1990s and Chinese government has ample room to maneuver in strengthening its social safety net. Its political system also allows for the swift implementation of policy shifts. Crucially, with a nominal per capita GDP of USD 12,614, China has significant room for growth. Although growth rates are expected to slow in the coming years, expectations for absolute expansion remain steady.

The tech war ignites a "Cambrian explosion"

Despite the significant macroeconomic challenges China is facing, the country has performed remarkably well in innovation, from AI to chips to human-shaped androids. DeepSeek has even triggered a Sputnik moment for the Magnificent 7, those large technology companies, whose stocks have been trading exceptionally well in recent years. DeepSeek has achieved superior results at a fraction of the cost, prompting global capital markets to question the once unshakable Silicon Valley doctrine that massive investment in stacking chips is the only path to technological dominance.

Pushed by US-China tech war

Japan's experience serves as a cautionary tale of failed industrial transformation under the weight of deflation. In the 1990s, the US-Japan Semiconductor Agreement

imposed strict limits on Japanese chip exports just as a wave of global innovation was taking off. As a result, Japan's once-dominant consumer electronics and semiconductor sectors were unable to seize the opportunities of the subsequent digital revolution.

However, China is poised to avoid a similar fate. Although the "Made in China 2025" initiative encouraged significant localization in machinery, progress in semiconductors remained sluggish; expensive R&D and an abundance of comparatively cheap imported chips suppressed any real market-driven urgency to innovate at home. This situation changed fundamentally in 2018, when the US sharply expanded its export controls on dual-use technologies, including advanced chips, 5G, and AI, under President Trump, who was nicknamed "Comrade Trump" for galvanizing China's technological ambitions. Confronted with these restrictions, Chinese firms were compelled to dramatically accelerate local innovation. What followed was a true "Cambrian explosion" of technological advancement, evoking the evolutionary period in Earth's history when life diversified rapidly. In China's case, this meant a surge in homegrown breakthroughs and startups, particularly in the semiconductor sector and other strategically sensitive fields. Unlike Japan, China now benefits from the dual forces of external constraints and a vast domestic market. This creates a powerful engine for self-sufficiency, ensuring that China's ascent up the technological value chain remains firmly on track.

A critical moment came in 2019, after Huawei was added to the US Entity List and TSMC (Taiwan Semiconductor Manufacturing Company) cut off its supply of 7nm/5nm chips. Just as the world assumed Huawei's smartphone era was over, the company staged a dramatic comeback by unveiling the Mate 60 Pro during the visit of US Secretary of Commerce Gina Raimondo in August 2023. Powered by a fully domestic 7nm Kirin 9000S chip designed with homegrown EDA tools and manufactured by SMIC (Semiconductor Manufacturing International Corporation), the phone defied expectations. Despite SMIC's estimated 50%-60% process yield rate (far below TSMC's >90%[2]), the achievement sparked a national consumer movement and drove millions of sales.

2 TSMC's 3nm production process yield rate reportedly reaches 90%.

In response, the US escalated the tech blockade by banning NVIDIA's downgraded A800 chips, a stopgap measure created after the A100 ban. While this left AI firms like Baidu and Alibaba scrambling for computing power, Huawei swiftly rolled out its Ascend 910B, a chip with 80% of the A100s performance. Early adopters relied on workarounds, such as smuggling A100s or renting cloud access, but as the 910B proved itself, the era of "domestic AI power" truly began.

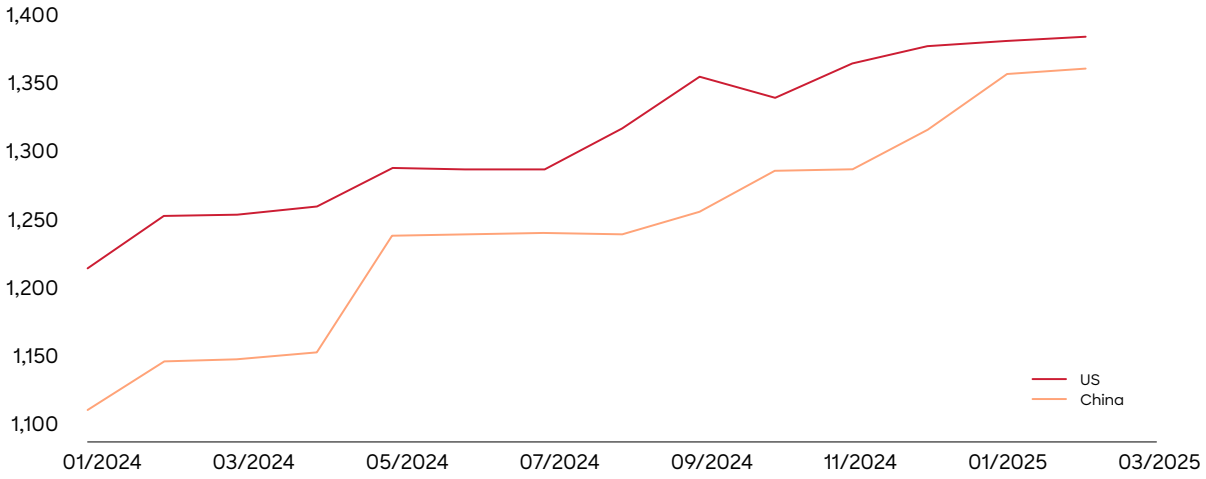
At the same time, Huawei wasn't alone. Across China, tech firms unveiled their own chips, their very names declarations of defiance: Cambricon, evoking life's great evolutionary leap, and Biren Tech, meaning "scaling the cliffs of tech suppression." While NVIDIA's China revenue plummeted from 30% in 2021 to below 15% in 2024, Cambricon's revenues exploded - matching all of 2024's earnings in Q1 2025 alone, with net profits decisively turning positive.

Moreover, China's AI landscape has flourished, with DeepSeek as its brightest star. According to Stanford's 2025 AI report, China is rapidly closing the gap with the US. When asked how China advanced so quickly and why others hadn't pursued

alternative tech paths, a local AI scientist would bluntly reply: "Others had unlimited computing power. We had none - so we relied on human capital."

Chinese AI chatbots narrow the gap with US rivals

Performance of top US vs Chinese models on LMSYS Chatbot Arena



Source Artificial Intelligence Index Report 2025

Roland Berger

In 2023, China graduated 5 million STEM students, dwarfing the combined 2 million of the EU and the US. Elite universities such as Tsinghua and Peking funnel 30 % of their 100,000 annual graduates into R&D, while the rest diffuse innovation into the economy. Trump's latest crackdown on US academia has only accelerated the reverse brain drain, with top talent staying or returning home.

Crucially, China's tech sector is forming a self-reinforcing loop. AI firms adopt domestic chips despite their initial limitations, providing chipmakers with the revenue necessary to refine their designs. This, in turn, boosts foundries like SMIC. It is only with this market-driven flywheel that state initiatives, such as the 2014 National IC Fund, the 14th Five-Year Plans focus on chips/AI/quantum, and local subsidies can gain real traction.

This virtuous cycle is spreading. According to a 2024 report by the Australian Strategic Policy Institute (ASPI) report, China has overtaken the US in 57 of 64 critical technologies, up from just 3 in 2003-07. Tech is also reshaping China's capital flows. While overall fixed-asset investment grew just 3.2 % in 2024, investment into high-tech manufacturing (+7 %), high-tech services (+10.2 %), and aerospace (+39.5 %) soared. Although the risk of overcapacity persists, notably in sectors such as solar PV, the awakening of grassroots R&D is fueling industrial upgrades and correcting previous resource misallocations.

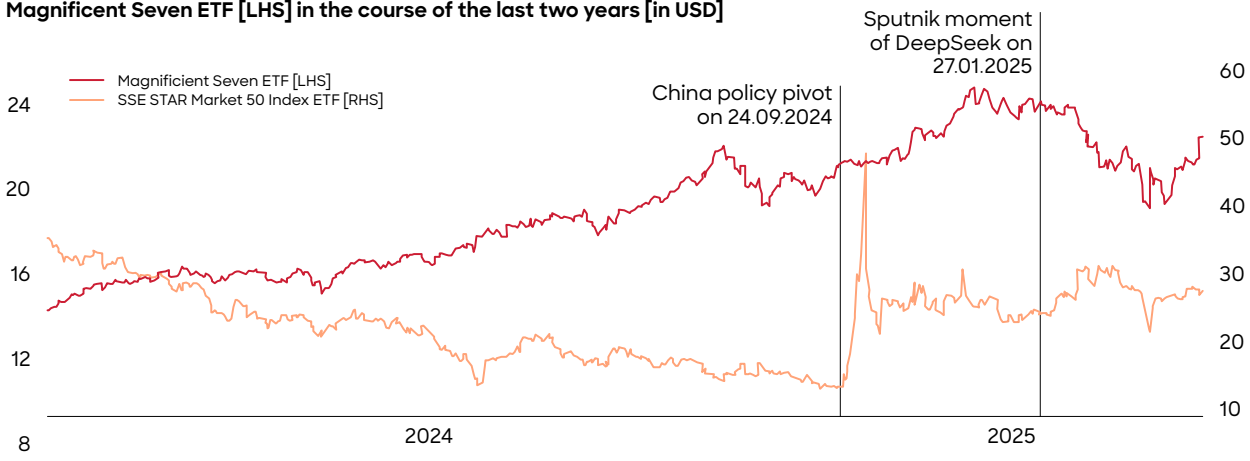
By 2024, China's top export was no longer the "New Three" (EVs, batteries, solar), but rather, chips - the very sector America had sought to cripple. Voices like Nvidia's

Jensen Huang have called for change, and US policymakers now recognize the blowback of their strategy. In 2025, Trump expanded the blockade by banning Huawei's Ascend chips globally, effectively drawing a tech Iron Curtain. While the Global North may comply, the Global South - as with 5G - will hardly refuse capable, inexpensive chips.

The global investment landscape is witnessing a dramatic revaluation of Chinese tech equities. As America's "Magnificent Seven" tech giants are facing their Sputnik moment as they are challenged by the rise of DeepSeek, their stocks underwent sharp corrections but have since rebounded to previous levels. Meanwhile, China's STAR Market 50 index, encompassing semiconductors, advanced manufacturing, and biotech, jumped after China's policy pivot in September 2024. This jump was fueled by Beijing's 2024 strategic policy shift and an accelerating wave of semiconductor localization, signaling a new phase in the global tech race.

Chinese tech stocks jumped following Beijing's policy pivot in September 2024

Share prices of the SSE STAR Market 50 Index ETF [RHS] and Magnificent Seven ETF [LHS] in the course of the last two years [in USD]



Source S&P Capital IQ

Roland Berger

Forging the second growth curve

During China's economic transition period, when new production capacity replaces the old, Chinese companies have not passively waited for profit margins to decline. A strong survival instinct has driven entrepreneurs to rally behind the industry consensus: "Sail out or sell out." However, in today's world, where economic sovereignty is emphasized more than ever, going global is not just about exporting goods anymore. Instead, it requires a comprehensive internationalization strategy that covers factories, supply chains, technology, services, brands, and capital - thereby creating a second growth curve.

Looking back at China's three decades as the "world's factory", its share of manufacturing exports in the global market surged from 2.4 % in 1992 to a peak of 20.3 % in 2021, falling slightly to 18.3 % in 2023. During that time, Chinese companies could focus solely on the manufacturing segment at the bottom of the "smile curve"[3], relying on capacity expansion to generate profits.

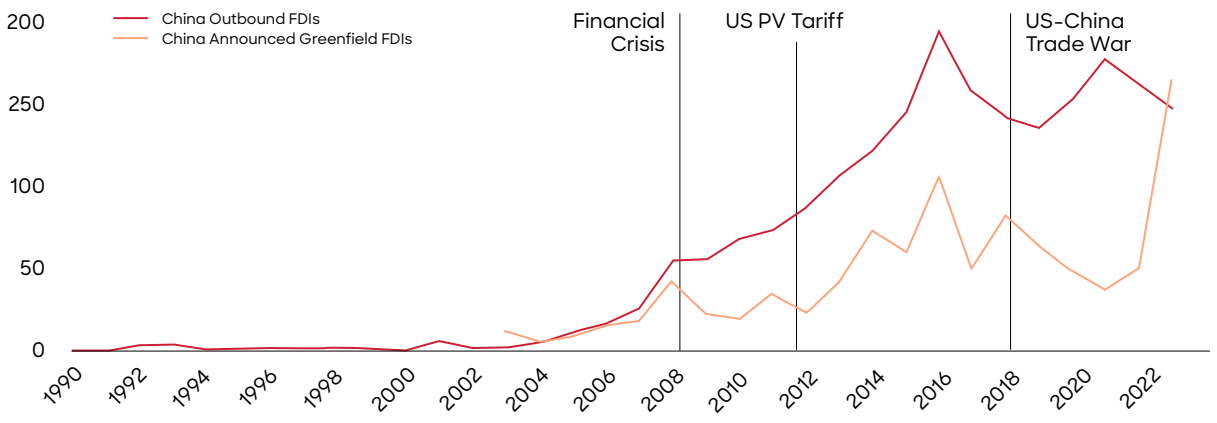
However, two major events in 2012 - one domestic and one international - marked a turning point for Chinese companies, accelerating their globalization. First, China entered a three-year period of PPI (producer price index) deflation starting in 2012. Second, the US imposed tariffs of up to 250 % on Chinese solar panel manufacturers that same year. As a result, Chinese companies realized that they had to seek overseas markets more aggressively to secure profits, relocate industries exposed to tariffs outside China, and move toward both ends of the "smile curve"[3],to capture higher value-added returns.

From then on, Chinese enterprises embarked on a process of genuine globalization, distinct from the financially driven investments seen after the 2008 financial crisis. As the chart below shows, the 2008 financial crisis marked the takeoff of China's M&A-dominated FDI, as Chinese firms seized opportunities to acquire distressed global assets. The 2012 PV anti-dumping tariffs sharply accelerated Chinas shift toward greenfield FDI to bypass trade barriers. The 2018 US-China trade war forced Chinese companies to rapidly globalize their supply chains.

3 Smile Curve is a business concept that illustrates how value is distributed along the stages of a value chain, particularly in manufacturing. It illustrates that the highest value in a product's value chain is created at the early (R&D, design) and late (marketing, branding, services) stages, while the middle stage (manufacturing or assembly) adds the least value.

Chinese investments have been shifting from M&A to greenfield

Chinese foreign investments [USD bn]



Source UNCTAD, Roland Berger

Roland Berger

Their international expansion exhibited five notable characteristics, shaped by industry-specific differences.

Traditional manufacturing (e.g., home appliances):

These companies primarily fill the market share vacated by Western and Japanese firms. Examples include Haier, Hisense, Midea, and TCL, which initially acquired foreign brands or factories from GE or Toshiba for OEM production[4] before gradually establishing their own brands overseas. These firms leveraged sports marketing, such as partnerships with FIFA and the NBA, to boost brand recognition and build global sales networks.

Electronics & machinery suppliers:

Pressured by the "China+1" supply chain strategy of Western multinational companies, these firms have relocated production overseas. Apple suppliers, for instance, such as Luxshare Precision, BOE, Goertek, and Sunny Optical, have set up factories in Vietnam, Malaysia, and India to produce key components, such as screens, cameras, and earphones, for iPhones. Similarly, Tesla required Chinese suppliers to move production to Mexico, prompting companies such as CATL, Sanhua Intelligent Controls, and Ganfeng Lithium to expand their battery, thermal management, and lithium processing operations in North America.

Automotive:

Responding to global localization policies, Chinese automakers have accelerated their overseas expansion. Although China has been the world's largest auto exporter for two consecutive years - shipping 5.86 million vehicles in 2024, or 18.9% of domestic production - companies like SAIC, Great Wall Motors, and BYD are rapidly investing in factories in Thailand, Indonesia, Hungary, and Brazil to meet rising localization demands from Western and Global South markets. For instance, BYD has established an EV production base in Hungary, and Great Wall Motors has launched EV production in Thailand to bypass trade barriers and cater to regional markets.

Clean Energy:

Due to tariffs, localization policies, and supply chain security measures, clean energy has become one of China's most globally oriented industries. Moreover, as this industry has evolved from China's well-established manufacturing ecosystem, its international expansion has exhibited a clear trend of vertical integration across the supply chain. For example: Ganfeng Lithium and Gotion High-Tech have established production facilities in Türkiye and Morocco, leveraging local phosphate resources to manufacture batteries for the European market. Trina Solar conducts R&D in China, produces polysilicon in the Middle East, and assembles components in Southeast Asia and the US, using economies of scale to mitigate the impact of tariffs.

Cross-border e-commerce platforms:

Leveraging China's mature e-commerce model, platforms such as Temu and Shein have achieved rapid global expansion. In Western markets, these platforms target budget-conscious consumers with aggressive marketing, for example Temu's Super Bowl advertisement, and localized logistics. In China, they have deeply integrated supply chains in the Yangtze and Pearl River Deltas, using AI-driven consumer data analysis for reverse product customization. Their "full-trust" model, in which the

4 OEM (Original Equipment Manufacturer) production in the home appliance industry refers to the practice where one company manufactures appliances, which are then branded and sold by another company under its own brand name. The OEM focuses on production efficiency and quality, while the purchasing company handles branding, marketing, and distribution to consumers.

platforms handle operations and logistics, has lowered the barrier of entry for SMEs looking to go global.

For Chinese companies, this may be just the beginning of their globalization journey. Since mid-2022, China has experienced nearly three consecutive years of PPI deflation. Unlike in 2015, the country can no longer rely on the real estate sector to escape deflationary pressures. At the same time, the global trade war initiated by Trump 2.0 has closed off the possibility of China accessing the US market through "friend-shoring." Against this backdrop, Chinese companies must proactively explore global markets and gain a deep understanding of global economic and industrial cycles, regional markets, and cultural differences. They must also build global organizational structures, supply chains, R&D systems, and financing strategies accordingly.

Notably, Chinese entrepreneurs are actively responding to these challenges. They understand how Japanese companies used internationalization strategies to overcome the " lost three decades" at home. They are very familiar with key data points, such as the fact that Japanese manufacturing overseas production accounts for one-third of the total, overseas net assets make up two-thirds of GDP, and annual overseas portfolio investment returns represent one-tenth of GDP. As a result, an increasing number of Chinese companies are adopting the strategy of rebuilding supply chains outside of China and actively expanding overseas to adapt to the ever-changing global environment.

Outlook: Navigating a complex transition

China's next phase of growth will be defined by its ability to rebalance toward domestic consumption, technology improvement, and the global expansion of its leading businesses. However, headwinds such as households balance sheet repairment, a struggling property sector, manufacturing industry overcapacity, and external trade frictions will continue to constrain the economy in the near term.

Continued government intervention and accelerating innovation, particularly in semiconductors and AI, will likely offset some of these pressures. At the same time, globalization of Chinese firms in sectors such as manufacturing, automotive, clean energy, and e-commerce will help diversify risk and tap new markets.

Long-term prospects hinge on deeper structural reforms, such as boosting household incomes, strengthening social safety nets, and fostering an open yet resilient business environment. If these reforms progress, China may avoid the fate of long-term stagnation and remain an engine of global growth, albeit at a more moderate pace and with different foundations than in past decades.

What do these developments mean for Western companies when the competition is becoming increasingly local ? Chinese firms in automotive and capital goods are gaining ground in Western markets through much faster product development and 20–30 % lower costs. To stay competitive, Western multinationals must analyze these strengths, accelerate their own innovation cycles, and streamline their operations to close the gap and defend their market position.

Further reading

- *FORESIGHT CHINA 2025*
- *A NEW PHASE OF GLOBALIZATION*
- *THE GLOBAL SOUTH - BEYOND BRICS*
- *BUSINESS SUCCESS IN THE NEW CHINA*

CONTACT:

DAVID BORN
Senior Manager
david.born@rolandberger.com

YU WANG
Senior Expert
yu.wang@rolandberger.com

STEFFEN GEERING
Senior Specialist
steffen.geering@rolandberger.com