INSTITUT Montaigne

The Chinese Economy: Stalling—and in Export Overdrive

EXPLAINER - JULY 2026

Institut Montaigne is a leading independent think tank based in Paris. Our research and ideas aim to help governments, industry and societies to adapt to our complex world. Institut Montaigne's publications and events focus on major economic, societal, technological, environmental and geopolitical changes. We aim to serve the public interest through instructive analysis on French and European public policies and by providing an open and safe space for rigorous policy debates.

EXPLAINER - July 2026

The Chinese Economy: Stalling—and in Export Overdrive

Institut Montaigne's Explainers are analytical short-reads, setting out key facts and figures to make sense of the world we live in and how it is evolving.

Explainer
To understand the world in which we operate

Issue Paper
To break down the key challenges facing societies

Policy Paper
To provide practical recommendations

Exclusive Insights
Unique data-driven analyses and practical scenario exercises

Report
Deep-dive analyses and long-term policy solutions

Foreword

Institut Montaigne, under the care of François Godement, has launched this annual policy brief to track the trajectory of the Chinese economy using the most up-to-date data and delving into Chinese sources. While many economists argue that Beijing must expand its social safety net to navigate demographic headwinds and stimulate consumer spending, this year's analysis confirms that the government refuses to change path and more than ever depends on exports for its growth. There is a growing disconnect between China's official discourse that its policies are meant to foster domestic development and its actions that rather seek geoeconomical hegemony.

Indeed, China has deliberately doubled down on its export-led model, relying on a three-pronged strategy of currency undervaluation, export subsidies, and industrial overproduction. This approach is further reinforced by aggressive provincial competition and massive investments in emerging technologies—particularly artificial intelligence and robotics—designed to boost productivity and outpace global competitors.

The European Union cannot remain passive in the face of policies that threaten the very survival of its industrial base. With the EU-China trade deficit now exceeding $1 billion per day, a growing consensus is calling for more robust trade measures to safeguard European manufacturing. However, two critical dilemmas must first be addressed.

The first dilemma concerns the targeted versus systemic approach: should the EU intensify sector-by-sector investigations or adopt a comprehensive, systemic response to Chinese trade practices? A systemic approach may be needed to obtain a genuine negotiating stance, while a sector-by-sector fits the EU's need for painstaking justification but takes up too much time. An actual negotiation may resume the former approach after across the board safeguards have been decided. Strong, targeted-moves may imply escalation and a trade war from China. Conversely, sectoral, fully WTO-compliant decisions risk to be met with Chinese indifference and evasive actions.

The second dilemma addresses currency realignment: how can the EU advocate for a realignment of the renminbi without economically harming China's neighbors, who have depreciated their own currencies to remain competitive? Going into a devaluation spiral while enacting non-China specific protective measures leaves no way out. Our Asian trade partners need to be guaranteed easier terms of access than China to the single market, while they should simultaneously commit to avoid being third country importers of Chinese products and components. Currency realignment therefore requires a broader package of agreements with our partners of choice.

While this policy brief does not claim to offer simple answers, it underscores the urgent need for strategic decision-making and carefully weighs the implications of the above mentioned choices, from systemic and targeted protective measures to the actions necessary for a currency realignment.

Marie-Pierre de Bailliencourt,
Institut Montaigne's Managing Director

François Godement

Special Advisor and Resident Senior Fellow—US and Asia

François Godement is Institut Montaigne's Special Advisor and Resident Senior Fellow—Asia and America. He was also a Non-Resident Senior Fellow of the Carnegie Endowment for International Peace in Washington, DC and, until the summer of 2024, an external consultant for the Policy Planning Staff of the French Ministry for Europe and Foreign Affairs. He was the Director of ECFR's Asia & China Program and a Senior Policy Fellow before leaving in December 2018. A longtime professor at France's National Institute of Oriental Languages and Civilisations (INALCO) and Sciences Po, he created the Centre Asie at the Paris-based Institut français des relations internationales (1985–2005) and founded the Asia Centre in 2005. In 1995, he co-founded the European committee of the Council for Security Cooperation in the AsiaPacific (CSCAP), which he co-chaired until 2008.

He is a graduate of the École normale supérieure (Paris), where he majored in history, and was a postgraduate student at Harvard University. His last published books are *Les mots de Xi Jinping* (Dalloz, 2021) and *China at the Gates: A New Power Audit of EU-China Relations* (with Abigaël Vasselier) (Odile Jacob, 2018).

For Institut Montaigne, he recently authored the following policy papers: *Beyond Shein: Mapping the Global Ambition of China's E-Commerce* (March 2026), *The Incredible Resilience of the Chinese Economy* (July 2025), *[Scenarios] – China 2035: The Chances of Success* (January 2025, with Pierre Pinhas), *Europe Needs a Systemic Response to China's Car Offensive* (April 2024), *Making European Economic Security a Reality* (March 2024), *China's Disappointing Economic Figures and the Crisis of Confidence* (September 2023), *Cross-border Data Flows: the Choices for Europe* (April 2023, with Viviana Zhu).

Table of contents

If Beijing were to "rebalance" its own economy, this could induce a global rebalancing between big-spender America and thrifty China. However, this **is not on the agenda of the People's Republic of China** (PRC). This policy brief on the Chinese economy focuses less than its predecessors on immediate trends such as recent monthly or quarterly numbers. It also leaves aside the important issue of how China is managing its own oil consumption and stocks since the war with Iran started in February 2026—as this topic is addressed at length in the latest issue of Institut Montaigne's *China Trends*.[1]

Instead, it zooms in on the striking gap between China's stellar export economy and its persistent domestic slump. **For years, Institut Montaigne's papers on the Chinese economy have expressed the basic belief that**, contrary to the predictions of many economists, **China's maturing economy would not change its fundamentals or direction**. Those predictions were based on the precedent set by other countries as they reached middle- to high-income levels, but in the case of China, politics and societal culture trumped economics rather than the other way around. Financial repression—with forced savings and capital controls—a preference for supply-side support, and a low GDP share for household income are native features of the Chinese system.

Culture also plays an important role. From Singapore to Taiwan, the economies of all Chinese-speaking areas have been characterized by high savings rates, state-driven industrial and investment policies, and large export-driven current account surpluses. Taiwan now has a current account surplus of 20 to 25 percent of GDP,[2] ranking with oil-rich

[1] *"Energy Security First: What Hormuz and Chinese Sources Reveal about Beijing's Strategy," China Trends, Institut Montaigne, July 2026, https://www.institutmontaigne.org/en/expressions/china-trends-26-energy-security-first-what-hormuz-and-chinese-sources-reveal-about-beijings-strategy.*

[2] *This percentage is a quarterly figure: "Balance of Payments – Press Release," Central Bank of the Republic of China, May 20, 2026, https://www.cbc.gov.tw/en/cp-448-191280-dfadb-2.html; "Economy," Government Portal of the Republic of China, accessed on July 8, 2026, https://www.taiwan.gov.tw/content_7.php.*

Kuwait as the highest in the world. Even Republican China during the first half of the twentieth century—a basket case for economic policy by any measure—had a large savings base, which it failed to mobilize away from landowners and other rent seekers.

1 China's export economy: Growing to the sky

Politics has, of course, played an outsized role in the economy in the People's Republic of China. The bias toward forced savings—inherited from the PRC's first decades of uncertainties, shocks, and trauma—**and many associated factors all point the same way**. These factors include a rejection, for political reasons, of capital liberalization; the rise of an export economy created through the post-Mao "reform and opening up"; a reluctance to redistribute income, keeping instead both personal taxation and labor costs low; and, finally, an unending quest for self-sufficiency, rooted both in past sufferings and geopolitical strategy. The last trait is a signature feature of Xi Jinping's governance—but it has been there since Mao's days, apart from a short interval in the late 1970s.

These preferences all indicate that the **Chinese leadership will not underwrite a magical shift toward a balanced economy**, where high earnings and spending would result in a reorientation of the economy toward imports and services. Reformist factions within the establishment may have wished otherwise, and some prominent leaders have occasionally called for change. Former Prime Minister Wen Jiabao regularly called China's economic policies **"unstable, unbalanced, uncoordinated and unsustainable"**(不稳定, 不平衡, 不协调、不可持续).[3] In his yearly speeches to the National People's Congress, he promised that the large export surplus would end.

[3] *"Government Work Report," State Council Gazette, Issue No.13, No. 1228, March 5, 2007, https://english.www.gov.cn/archive/state_council_gazette/2015/06/08/content_281475123284782.htm;* "国务院总理温家宝中外记者招待会" *[Press Conference with Chinese and Foreign Journalists Hosted by Premier Wen Jiabao of the State Council], CCTV, March 16, 2007, https://news.cctv.com/china/20070316/100935_3.shtml.*

Were there really serious reform groups within the Chinese establishment? Or were those words intended to gain acceptance from an international audience for a long phase of high growth through the benefits of global free trade under asymmetric World Trade Organization (WTO) rules?[4] It is possible for both interpretations to coexist.

In any case, **Xi Jinping has restored complete Party rule and the primacy of the Party's interests beyond what any observer might have predicted**. Instead of demand-side stimuli, industrial policy driven by directed financial investment, innovation in the key sectors of the future, and supply-side support are his preferred tools. His predecessors consistently favored "big science" and had started moves toward self-sufficiency, but Xi has turned this into **techno-industrial messianism**.

Trees may not grow to the sky—but Xi seems to believe that there are no limits to China's growth. By pushing ever more Chinese supply onto global markets, he intends to reverse China's dependence on foreign investment and technologies while making the rest of the world more dependent on China.

In terms of China's political rhetoric, it is worth noting one overt change in recent times that has far-reaching consequences: This is the assertion of China's "right to development" as a core interest, alongside Taiwan and non-interference in China's political system. This concept is not new and was defined as a "universal right" in an official White Paper in 2016.[5] The new development is China's insistence on the need for others to "respect" its core interests, among which is China's "right to

[4] *Eleanor Butler & AP, "China Gives Up WTO Developing Country Status as Tariff Tensions Linger," Euronews, September 24, 2025, https://www.euronews.com/business/2025/09/24/china-gives-up-wto-developing-country-status-as-tariff-tensions-linger.*

[5] *"The Right to Development: China's Philosophy, Practice and Contribution (Full Text)," State Council Information Office of the People's Republic of China, December 2, 2016, http://www.scio.gov.cn/zfbps/ndhf/2016n/202207/t20220704_130515.html.*

development." Xi Jinping first expressed this idea to then-president Biden in November 2021.[6] He broached it again during his summit in Beijing with Donald Trump in May 2026.

Under the motto of "safeguarding national development interests," the right to development is being weaponized by new Chinese laws, from export controls and dual-use regulations to supply-chain protections and outward foreign direct investment (FDI) screening. These measures are often framed or implicitly adopted as tools that can be used for retaliation against foreign measures.

The first uses of China's new regulations against the "improper extra-territorial application of foreign laws and measures" have been against Europe in relation to the European Union's (EU) use of the Foreign Subsidies Regulation (FSR) in the investigation into Nuctech[7] and notably against the EU's envisioned protective measures, such as the Industrial Accelerator Act now being debated in Brussels. With the United States, **China pursues a cat-and-mouse game on technology export controls, resource monopolies, or outright export bans on an ever-expanding list of critical materials**. However, China has also made concessions to the United States in the form of a limited softening of its additional duties and export restrictions in return for a more significant American pullback on new additional duties.

Strikingly, **China has seemed determined to "go for broke" when it comes to the European Union**, perhaps calculating that a combination of threats and country-by-country lobbying will delay and weaken Europe's response to China's export drive and weaken imports from Europe. But China's trade trends with the European Union look no different from those of its trade with any other destination except

[6] *"Xi, Biden Pledge to Steer China-US Relations Back on Right Track," State Council of the People's Republic of China, November 17, 2021, https://english.www.gov.cn/news/topnews/202111/17/content_WS6193dc27c6d0df57f98e50ef.html.*

[7] *Peng Zhang, "Nuctech Case and a Clash between China's Anti-Extraterritorial Blocking Rules and the EU's FSR," Geopolitechs, May 16, 2026, https://www.geopolitechs.org/p/nuctech-case-and-a-clash-between.*

the United States: China's exports are climbing steeply.[8] Despite rising energy import prices and large imports of semiconductors, China's overall trade surplus in goods is still around $1,200 billion (€1,114 billion) per year. This figure is almost nine times the EU's own trade surplus in goods for 2025[9] and is equivalent to about half of Europe's exports or imports. Only the United States stands apart, with a lesser share of imports from China. This has a negative side consequence for Americans: rising consumer-goods inflation.

In other words, while China has heavily prioritized import substitution, self-sufficiency, national economic security, and a complete architecture of subsidies and industrial policies, it is now **asserting its own right to limitless exports**—eventually leaving zero room for competitors—**and forbidding its trade partners from using the tools that it itself used during its economic rise**.

[8] *"2026年6月全国进出口总值表(美元值)" [Table of Total National Imports and Exports for June 2026 (in U.S. dollars)], General Administration of Customs of the People's Republic of China, July 14, 2026, http://www.customs.gov.cn/customs/2026-06/09/article_2026060908295994113.html.*

[9] *"International Trade in Goods," Statistics Explained, Eurostat, accessed July 7, 2026, https://ec.europa.eu/eurostat/statistics-explained/index.php?title=International_trade_in_goods.*

2 Managing the contradiction with a disappointing domestic economy

China's export-led growth has opened up a major disconnect within its political economy. Its outward-facing sectors have grown from a small component of GDP to being the main and nearly sole engine of growth—even as the domestic economy slides toward stagnation. It is indeed a tsunami, and we identified the export surge behind it as early as 2020.[10] As we write, the waves are still getting larger and encompassing more sectors of the world's economy.

At the same time, China is experiencing the sharpest and quickest demographic downturn the world has ever seen. An unprecedented real estate crisis is still expanding after four years, weighing on the entire domestic economy,[11] which is persistently close to stagnation and undergoing deflation. The producer price index (PPI) declined for 41 continuous months until February 2026 and has since rebounded only on the back of energy prices.[12] The consumer-goods component of the PPI was flat in June of this year (+0.1 percent year-over-year). The consumer price index (CPI) has been broadly flat for more than three years, though with a 1 percent increase in June[13] that reflected higher energy prices. China's real effective exchange rate (REER, a

[10] *François Godement and Viviana Zhu, "China's Mercantilist Recovery after COVID-19," Institut Montaigne, December 2, 2020, https://www.institutmontaigne.org/en/expressions/chinas-mercantilist-recovery-after-covid-19.*

[11] *"2026年1—6月份全国房地产市场基本情况" [Overview of the National Real Estate Market for January–June 2026], National Bureau of Statistics of China, July 15, 2026, https://www.stats.gov.cn/sj/zxfb/202607/t20260715_1964126.html.*

[12] *"2026年6月份工业生产者出厂价格同比上涨4.1% 环比下降0.3%" [In June 2026, the Producer Price Index rose 4.1% year-over-year and fell 0.3% month-over-month], National Bureau of Statistics, July 9, 2026, https://www.stats.gov.cn/sj/zxfb/202607/t20260709_1964083.html.*

[13] *"2026年6月份居民消费价格同比上涨1.0%" [In June 2026, the Consumer Price Index rose 1.0% year-over-year], National Bureau of Statistics, July 9, 2026, https://www.stats.gov.cn/sj/zxfb/202607/t20260709_1964084.html.*

trade-weighted measure of a currency adjusted for inflation) peaked in March 2022 and has since declined by more than 15 percent.[14]

No other economy has ever combined exports and trade surpluses on this scale with persistently low domestic growth, price deflation, and a depreciating currency—an absurdity from a free-market perspective. The picture that emerges is contradictory to the point of incoherence. The contradiction does not lie in the numbers alone: It is political and social. Here, we would like to note the analysis by *Handelsblatt*'s Shanghai correspondent Martin Benninghoff, who recently expressed that contradiction so well.[15] The media and many analysts struggle with this duality—which is unsurprising given the tendency of social media to amplify voices that consistently offer a unilateral and radical view.

As early as China's accession to the WTO in 2001, we doubted that its economy was the locomotive of global growth that many took it to be. Far from pulling the world along, China has absorbed an ever-larger share of global growth—much like a black hole. **The concessions it made on entry proved to be not a floor but a ceiling**. And as exports have risen as a share of GDP, that view has only grown more apt.

Today, the consensus on China's economy has almost universally shifted toward the almost blind belief that its export drive will go on indefinitely in the absence of stronger safeguards, tariff barriers, or other man-made obstacles—whether emissions and environmental standards, measures against the products of forced labor, or against oligopolistic behavior from China's hybrid economy. Hopes of fostering change in China's

[14] *Bank for International Settlements, "Real Effective Exchange Rate, China / Broad Basket," BIS Data Portal, accessed July 7, 2026, https://data.bis.org/topics/EER/BIS,WS_EER,1.0/M.R.B.CN?filter=TIMESPAN%3D2016-06-11_2026-06-11.*

[15] *Martin Benninghoff, "So geht die China-Debatte nicht weiter! Ein Zwischenruf aus Shanghai" [This is no way to carry on the China debate! An interjection from Shanghai], Handelsblatt, June 5, 2026, https://www.handelsblatt.com/politik/international/essay-so-geht-die-china-debatte-nicht-weiter-zwischenruf-aus-shanghai/100229379.html.*

economic system are disappearing—and the Trump administration seems to have taken the lead in dealing with China as it is, using tariffs and some technology export denials.

The same consensus is forming, to a lesser degree, on the domestic economy but in the opposite direction. Too much savings and not enough income redistribution or consumption, the bias in public investment and subsidies toward supply rather than demand, the world's sharpest demographic downturn, deflation, and low interest rates all point toward low growth if one trusts official numbers—and toward outright stagnation if one does not.

Even after years of lower economic growth and much talk about invigorating the domestic economy, it is largely supply-side support rather than measures to increase purchasing power and demand that are under consideration. In the published report of a June 2026 debate with economists, the Chairman of the National Development and Reform Commission (NDRC) advocated many supply-side and essentially investment moves but only one demand-side initiative: To "continue implementing the consumer goods trade-in program."[16] By all accounts, this side policy is being implemented with little enthusiasm and is showing diminishing results.[17]

One potential game changer should be noted: the **recent decision to grant residents without a household registration permit *(hukou)*** some—but not all—of the same access to social services as formally registered residents with a *hukou*.[18] This potentially concerns more

[16] *"郑栅洁主任主持召开经济形势专家座谈会 围绕当前经济形势和做好下一步经济工作听取意见建议" [Director Zheng Shanjie chairs a symposium of economic experts to hear views and suggestions on the current economic situation and on doing the next stage of economic work well], China Society of Economic Reform, June 11, 2026, http://www.cser.org.cn/plus/view.php?aid=5335.*

[17] *Xinhua News Agency, "今年以来消费品以旧换新销售额突破5000亿元" [Since the start of this year, sales under the consumer-goods trade-in program have passed 500 billion yuan], State Council of the People's Republic of China, April 15, 2026, https://www.gov.cn/lianbo/202604/content_7065736.htm.*

[18] *"国务院关于推行常住地提供基本公共服务的实施意见" [State Council implementing opinions on providing basic public services at one's place of usual residence], Ministry of Ecology and Environment of the PRC, May 25, 2026, https://www.mee.gov.cn/zcwj/gwywj/202605/t20260525_1155865.shtml.*

than 250 million people. This decision is consistent with a thesis we developed in the past:[19] The fight against poverty, which started under Xi's predecessors but has been further emphasized under his rule, is real. This is so even if the goal is pragmatic: **replenishing the industrial workforce from an unproductive agricultural labor force**. Because the funding for this new policy is assigned to local authorities, implementation will most likely be patchy. This is consistent with the history of reforms in China and, in fact, with how systems of social protection have developed all over Asia—with the exception of Japan. Retirement allowances for elderly peasants, which have existed since the Hu–Wen leadership era, are still very low compared to urban pensions. Yet they exist.

[19] *François Godement and Viviana Zhu, "China's Mercantilist Recovery after COVID-19," Institut Montaigne, December 2, 2020, https://www.institutmontaigne.org/en/expressions/chinas-mercantilist-recovery-after-covid-19#:~:text=China's%20share%20of%20world%20exports,nearly%20every%20other%20major%20economy; François Godement, "China's Economic Rebound: Views from Beijing," Institut Montaigne, June 2021, https://institutmontaigne.org/ressources/pdfs/publications/chinas-economic-rebound-views-beijing-policy-paper.pdf; François Godement and Pierre Pinhas, "China 2035: The Chances of Success," Institut Montaigne, January 2025, https://institutmontaigne.org/ressources/pdfs/publications/explainer-scenarios-china-2035-chances-success.pdf.*

3 Nothing new on the horizon

This dual consensus—a stagnant economy and mushrooming exports—should not come as a surprise. We have repeatedly made these arguments in earlier publications. Of the eighty-one research notes and op-eds on China or China-related issues we have published or coauthored at Institut Montaigne, beginning in early 2019, thirty-one addressed China's trade and current account imbalances, along with the related accounting problems. Fifty-one publications, also starting in 2019, discussed China's efforts to increase other countries' dependence as a source of geoeconomic or geopolitical leverage. Twenty-two mentioned self-reliance, or "digital sovereignty"; eight highlighted the low household share of GDP; and three, published in 2019, 2022, and 2023, questioned official figures for China's foreign-currency reserves, suggesting that part of these reserves had been shifted through other state actors and intermediaries.

We had first raised this last issue in April 2011[20] in the context of China's holdings of European debt during the Eurozone crisis. We were puzzled back then by the massive but unattributed holdings of US Treasury bonds in places such as Luxembourg, the United Kingdom, and Thailand. We returned to this topic several times, including in a 2012 book.[21] Our analysis emerged independently from China's (positive) role in the Eurocrisis, but Brad W. Setser's earlier 2008 research at the Council on Foreign Relations on US Treasury International Capital statistics proved very useful. We shared his surprise at the International Monetary Fund's (IMF) long-standing silence on the matter—a silence that only began to fade in 2026.

[20] *François Godement, "Europe's Relations with China: Lost in Flight?" (Transatlantic Academy Paper Series), European Council on Foreign Relations, April 2011, https://ecfr.eu/archive/page/-/Godement_Flight_Apr11_web.pdf; François Godement, "Saving the Euro: What's China's Price?," European Council on Foreign Relations, November 1, 2011, https://ecfr.eu/wp-content/uploads/ECFR45_CHINA_MEMO_AW.pdf.*

[21] *François Godement, "Que veut la Chine ? De Mao au capitalisme" [What does China want? From Mao to capitalism], Paris: Odile Jacob, 2012; published in English as "Contemporary China: Between Mao and Market", Lanham, MD: Rowman & Littlefield, 2016.*

In our view, the IMF avoided describing how the People's Bank of China (PBoC) sterilized the foreign-currency reserves accumulated through trade surpluses because doing so would have legitimized the charge of Chinese "currency manipulation," and the Fund's ambition was to integrate China as a "responsible stakeholder," in Robert Zoellick's phrase. This reticence became even more pronounced after the Chinese yuan joined the IMF's Special Drawing Rights (SDR) currency basket—a decision taken in 2015 that became effective in October 2016. Overall, it is likely that China controls foreign-currency reserves, notably abroad—in state or public hands—of $7 trillion rather than the official $3.4 trillion figure given by its central bank. The difference is mostly in the reserves held abroad—and interestingly, this also makes China hugely vulnerable to financial sanctions of the type implemented against Russia.

4 Exports as an escape hatch and China's landlord dilemma

Why do these hidden currency reserves matter so much? Because they show that **China's leverage is far greater than the usually cited figures suggest**—even if it is still exercised through the US dollar, just as it was a decade ago. The paradox is that this puts China in the position of a landlord who depends on his tenants—here, its borrowers and its customers—remaining solvent enough to pay the rent and go on buying what he sells them. The model is the *latifundium*, the great estates of antiquity and of Latin America, whose tenants were kept permanently in the owner's debt and obliged to buy from his store. China is approaching the mirror image of the picture drawn by André Gunder Frank, in which a colonized periphery depends on the metropolitan core[22]—except that today, it is China that occupies the core.

In the end, **completely reversing dependence**, as Xi Jinping has called for, **is impossible. China needs to keep its clients alive and ready for more purchases and borrowing**. Still, **dealing with** tenants–in effect, **borrowers who are divided among themselves does help a lot**. Viewed from Beijing, that has never looked so good. Officially, China still rejects the idea of a "China Shock 2.0" that has been discussed elsewhere. Prime Minister Li Qiang prefers to use the catchword "China Opportunity 2.0," whereby "China's technological advances and emerging industries represent opportunities rather than shocks, and empowerment rather than threats for the rest of the world."[23]

[22] *André Gunder Frank, "The Development of Underdevelopment," Monthly Review, Issue No. 18, No. 4 (September 1966): 17–31, https://web.archive.org/web/20260330103407/https://doi.org/10.14452/MR-018-04-1966-08_3.*

[23] *"李强出席2026年夏季达沃斯论坛开幕式并致辞" [Li Qiang attends and addresses the opening ceremony of the 2026 Summer Davos Forum], State Council of the People's Republic of China, June 24, 2026, https://www.gov.cn/yaowen/liebiao/202606/content_7073191.htm.*

As is often the case with Chinese statistics, the numbers are fiercely debated. The long-term downward trend is clear, but China's actual domestic growth is not. GDP growth, excluding net exports, may range from zero—according to one informed rumor—to somewhere below 5 percent. The latter target is no longer formally upheld but was once more officially met in Q1 2026, although it was missed by a wide margin in Q2 as domestic stagnation returned. Weak household income growth better explains stagnant imports than the official claim that Chinese consumers "no longer care" about certain foreign products. Occasional import promotion efforts do exist but mainly in export zones, where they mostly encourage imports of advanced equipment and processes that help expand China's own exports.

Underlying this structural slowdown is an unprecedented decline in births. In 2024, China's fertility rate fell to 1,[24] a sharp drop compared to the 1970s fertility rate of 6. Given an aging population, this means that the actual birth rate will fall every year for two decades, even if overall fertility improves. In 2025, the drop in births was even more consequential: down to 5.63 per 1,000 people.[25] Both figures (fertility and birth rate) are close to those of Japan and South Korea. France has also seen a sharp recent drop in births—but the actual numbers in 2025 are still much higher (fertility rate of 1.56 and birth rate of 9.4 per 1,000). A UN projection puts China's population by 2100 as low as 500 million in a low fertility scenario,[26] a prediction based, of course, on the long-term continuation of recent trends. As we wrote earlier,[27] **the actual economic consequences of these demographic changes may be delayed—but they will be profound**.

[24] *Fertility Rate, Total (Births per Woman) — China," World Bank Open Data, accessed July 7, 2026, https://data.worldbank.org/indicator/SP.DYN.TFRT.IN?locations=CN.*

[25] *"2025年经济发展向新向优 预期目标圆满实现" [In 2025 economic development advanced toward the new and the better, and the expected targets were fully met], National Bureau of Statistics of China, January 19, 2026, https://www.stats.gov.cn/sj/zxfb/202601/t20260119_1962330.html.*

[26] *United Nations, Department of Economic and Social Affairs, Population Division, "China: Demographic Profiles," World Population Prospects 2024, accessed July 7, 2026, https://population.un.org/wpp/graphs?loc=156&type=Demographic%20Profiles&category=Line%20Charts.*

[27] *François Godement, "The Incredible Resilience of the Chinese Economy," Institut Montaigne, June 2025, https://www.institutmontaigne.org/en/publications/incredible-resilience-chinese-economy.*

Such a sudden drop cannot come from changing socioeconomics or attitudes—particularly when the Party-State has been encouraging childbearing for the past five years. A sad observation is that China now delivers roughly four times as many cars as babies. Among the suspects: the real estate crisis, the after-effects of COVID-era coercion, and the general reassertion of the Communist Party over the market.

Other political factors leading to low growth are recognized by Chinese economists, albeit discreetly. A recent publication[28] denies the large role of subsidies in fostering "new industries." But the authors casually drop the notion that most public subsidies and preferred lending actually go to the "old industries," often large state firms that are falling behind: "China's biggest resource-allocation challenge may not be excessive support for the new economy, but rather the continued flow of resources into low-return sectors. This may also help explain why Chinese firms are highly competitive at the micro level, while aggregate productivity growth remains relatively subdued." Indeed, this is another contradiction: While there are hugely competitive "new industries" and the total labor force remains at the same level, overall productivity lags behind.

The explanation is that **Xi Jinping and the Party, in their pronouncements on the economy, always insist on a balance between support for innovation and support for the mature sectors**. This is understandable given the employment at stake and the heavy state presence in these sectors. To quote Xi's words at the conclusion of a recent Politburo "study session": "Future industries, traditional industries, and emerging industries complement and promote each other; the traditional industries have a strong foundation, and the future and

[28] *Zhu He and Guo Kai, "为什么OECD'中国新兴产业发展靠补贴'是过时的错误叙事?" [Why the OECD's "China's emerging industries are subsidy-driven" narrative is flawed and outdated], China Finance 40 Forum (CF40), June 7, 2026, https://finance.sina.com.cn/stock/relnews/cn/2026-06-07/doc-iniaqpeq6376594.shtml; "China's Government Advisers Call for Fix to Two-Speed Economy," Bloomberg, June 27, 2026, https://www.bloomberg.com/news/articles/2026-06-27/china-government-advisers-call-for-fix-to-two-speed-economy.*

emerging industries have potential for development."[29] This is political language, of course—but the language itself reveals a real constraint: the Party must be seen as holding the balance between old sectors and new. This is why government support is still heavily leaning toward the supply side.

Does this domestic plateau and potential decline matter to China's partners, including the European Union? Less so, at least in the short term, than the causes and consequences of China's export drive. The former trend, however, may fuel a sense of urgency in the Chinese leadership that pushes them further along the latter path. We are not so far from Rudolf Hilferding's and Rosa Luxemburg's prediction of war resulting from an imperialist clash for resources.[30] Except today, **export outlets seem to matter more than resource imports**.

[29] *Xi Jinping, "前瞻布局和发展未来产业" [Xi Jinping's speech at the 24th collective study of the 20th Political Bureau], Qiushi, June 16, 2026, https://www.qstheory.cn/20260530/8fa0ec6956ee4bf2ade0e366ce29a722/c.html.*

[30] *Rudolf Hilferding, "Finance Capital: A Study of the Latest Phase of Capitalist Development," ed. Tom Bottomore, trans. Morris Watnick and Sam Gordon (Routledge & Kegan Paul, 1910); Rosa Luxemburg, "The Accumulation of Capital," translation by Agnes Schwarzschild (original work published 1913; republished by Routledge & Kegan Paul, 2003).*

5 Unpacking China’s industrial export tsunami to Europe

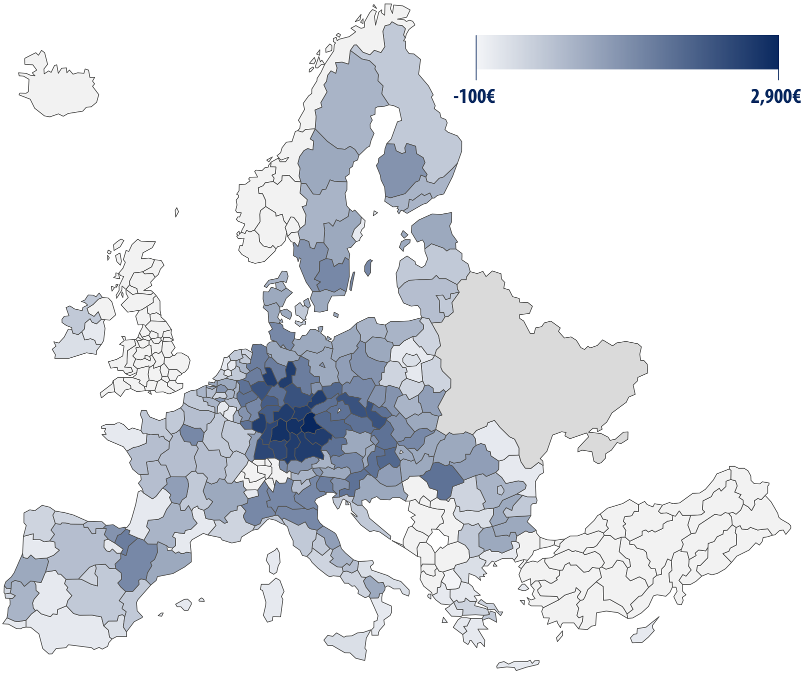
For Europeans to find solutions, it is necessary to understand and unpack both the directions of China’s outward push and the contributing factors. China’s export tsunami has had a changing impact on different target countries. **Whether the industrial structure of China’s partners overlaps with that of China—or is complementary or even has no industry to speak of, at least in certain sectors—makes a big difference**. It was long accepted that China’s industry competed with that of other developing economies or with the least advanced sectors of industrialized economies (e.g., low-tech and high-manpower sectors). This is no longer the case.

However, **even the mere recognition that China has moved upscale to the status of a mid-level industrial country and into many high-tech sectors misses a key point**. The share of electromechanical products in China’s exports has reached 63 percent.[31] China’s exports now hit the most developed industrial countries—especially those that are the most globalized and focused on export sectors—rather than economies that are less advanced or less focused on exports. The following graph depicting the ratio of China’s exports to industry jobs in the European Union is very telling:[32]

[31] *Zhang Yansheng, “1.2万亿美元贸易顺差下, 中国如何处理与世界的关系？” [With a US$1.2 trillion trade surplus, how should China handle its relations with the world?], Guancha, May 25, 2026, https://www.guancha.cn/ZhangYanSheng/2026_05_25_818285.shtml.*

[32] *Andrei Sterescu, “The Geography of Europe’s Manufacturing Exposure to Trade,” Out of Sample, March 5, 2026, https://outsample.substack.com/p/the-geography-of-europes-manufacturing.*

Figure 1 • Regional Exposure to Imports from China in Manufacturing (€ per worker, Manufacturing, 2016-2024)



Source: Andrei Sterescu, Eurostat SBS, LFS, Comext.

What the graph illustrates is a cross section between the recent concentration of China's exports in some industrial sectors and the geographically diverse number of manufacturing jobs in Europe for the same industry sectors. Again, in former times, one could assume that China's exports competed directly in low-tech, high-manpower sectors such as textiles, apparel, furniture, and basic household goods produced in second-tier industrial Europe. Today, **Germany and its**

Central European subcontractors' belt are directly in the sights of Chinese manufacturers. The "exposure is driven by industries such as electrical equipment, machinery, chemicals, motor vehicles, and electronics, which sit at the heart of the German export-led model."[33]

Denmark, Norway, Finland, Northern Italy, and Northern Spain are not spared either, with the auto industry playing a large role in the last two. The Netherlands has a different industry mix and currently faces less competition from Chinese goods. France is surprisingly absent, apart from the greater Paris area, largely because the economy is less concentrated in the same industries—or less concentrated on industry altogether, apart from transport equipment and machinery parts.

This analysis goes a long way toward explaining why a consensus should be reached among the core industrial Member States of the European Union and why there is an ongoing policy shift in Germany on the EU's Industrial Accelerator Act and safeguard measures designed to stem China's export onslaught.

[33] *Andrei Sterescu, ibid.*

6 Who and what to blame: The arguments behind unfair competition

To react with a suitable array of positive and negative policies, one must also understand the components of China's increased competitiveness and why it may have an edge. Undeniably, they increasingly include price, innovation, quality, and availability. Here, we focus on the **three main factors of unfair competition** that are usually cited in China's international competitiveness: subsidies, the undervaluation of the yuan, and overproduction.

6.1. SUBSIDIES

Any time a consensus about China becomes universal, it is time to worry about our shortsightedness. On the issue of subsidies, the consensus may be so overwhelming that we run the risk of exaggerating their role and neglecting other cost factors—such as human talent, hard work, and crafty planning—that are also major contributors. Although ruled with an iron fist, China is diverse: It is not a market economy, nor is it a state economy. Rather, it is a hybrid economy that combines the not-so-hidden hand of the state, a state-guided economy, and a "bird-cage" market economy. In international terms, the "win-win" catchphrase is often taken by Chinese policymakers to mean that "China wins twice." But on the domestic front or at least in frontier industries and innovation, China definitely allows for losers as well as winners—although in successive sequences. After initially wide and strong support, the plug may be pulled on underperforming entities.

Subsidies—whether direct or through pricing mechanisms—**have been a pillar of China's industry since the early '50s**. Under the planning system of the first decades of the PRC, agricultural prices were either undervalued or simply nonexistent as a result of mandatory deliveries to the state. Prices for industrial goods, especially consumer goods, were set artificially high. Household savings were entirely channeled by the state. Socialist industry may have been extremely inefficient, resulting in low capital and human productivity, but it could be compared to a steam engine: **Dissipating up to 90 percent of its energy along the way, a steam locomotive still moves forward quite reliably**. An IMF research note estimated the fiscal cost of industrial policy to be 4 percent of China's GDP. [34] However, this tally groups together cash subsidies, land grants, energy support, subsidized credit, and tax benefits. There are no comparable estimates for other large economies.

The subsidy issue remains at the core of China's industrial policies. In Xi Jinping's very own words:

"Since the cultivation of future industries involves long development cycles and significant market risks, strong policy support is essential… Fiscal, tax, and related policies should be improved… Efforts should be made to vigorously develop technology finance and build a financial services system that matches the financing needs of future industries throughout their entire life cycle. Long-term capital should be guided to invest early, invest in small enterprises, invest for the long term, and invest in hard technologies… Government procurement and related policies should be optimized."[35]

[34] *Daniel Garcia-Macia, Siddharth Kothari, and Yifan Tao, "Industrial Policy in China: Quantification and Impact on Misallocation," International Monetary Fund, August 2025, https://www.imf.org/en/publications/wp/issues/2025/08/07/industrial-policy-in-china-quantification-and-impact-on-misallocation-568888.*

[35] *Xi Jinping, "Xi Jinping Speech at the 24th Collective Study Session of the 20th Political Bureau.", January 30, 2026, Credit to Henry Gao for identifying the speech and source.*

A recent Organisation for Economic Co-operation and Development (OECD) paper has given new prominence to the use of subsidies in frontier technologies,[36] highlighting the intensity of China's practices in this area compared with other major economies. The findings of that paper should, however, be viewed with caution. Only 154 Chinese firms are included from 15 sectors, even if the data come from a large and unpublished OECD database and if the paper claims to use confidential information as opposed to declared subsidies. A superficial reading of the note may miss the fact that some figures (for example, a total of $108 billion in subsidies in 2024) include all OECD countries and emerging economies, not just China.[37]

Nonetheless, some results are striking. Between 2005 and 2024, these Chinese firms received, on average, three to eight times more government support than firms in the same sector based in OECD countries. This is considered a "conservative" estimate that in fact does not include the granting of land at preferential rates—estimated at 0.5 percent of GDP by an IMF study[38]—nor the equity injections that have become a key channel of support to innovation-intensive sectors in China in recent years. Even more telling is the mention, confirmed by other sources, that **it has now become more difficult to access Chinese companies' financial statements**—and impossible altogether for those in the aerospace industry. This is in line with a wider trend in China, which is to restrict economic reporting, including statistical data.[39] In this case, **the goal may not be to hide so-called negative views but to shield leapfrogging efforts and their costs in some sectors**.

[36] *"OECD MAGIC Database of Industrial Subsidies", Organisation for Economic Co-operation and Development, June 1, 2026, https://doi.org/10.1787/ce94f33b-en.*

[37] *Some of the figures have been misinterpreted by readers as concerning only China, for example a total of $108 billion of industry subsidies in 2024 for all of the 15 sectors. Additionally, this amount seems trivial when one becomes used to the numbers thrown about in the data and AI sector (not included in the OECD note except for semiconductors).*

[38] *Garcia-Macia, Kothari, and Tao, ibid.*

[39] *Tian Jian, "The Economic Downturn and China's Silent Press," China Media Project, June 12, 2026, https://chinamediaproject.org/2026/06/12/the-economic-downturn-and-chinas-silent-press/.*

The OECD note has immediately attracted official Chinese criticism, and there is at least one interesting rebuttal, with its own limits, from two prominent Chinese economists.[40] They consider the limited sample used by the OECD and counter it with the results of a study, unfortunately left unnamed, involving 5,300 Chinese firms. Noting that two-thirds of the subsidies previously described take the form of below-market-rate (BMR) loans, they explain that because of the real estate downturn, much lending in China has in fact taken place below the official market rate. This argument points us back to the deflation contributing to the international competitiveness of Chinese exports, and perhaps only compounds the issue.

They also explain that the bulk of these subsidies in the sectors picked by the OECD concern mature or “old” industries (steel and aluminum, transport sector, etc.), while “new industries” may have received an initial push in the form of subsidies but increasingly rely on equity financing and their own profits. They therefore dispute the contention that 60 percent of the Chinese cost advantage for exports in these sectors comes from government support. They further assert that if all subsidies were withdrawn, this would not lessen the competitiveness of these goods. However, the fact remains that much equity support in China is driven, directly or indirectly, by the state.

Their conclusion is, therefore, overreaching. **China has indeed taken a leaf out of the book of other state models of support for innovation**—notably the American model best illustrated by the Defense Advanced Research Projects Agency (DARPA). But the breadth of government support in China has no parallel. Banks, sovereign or quasi-state funds, and the markets themselves obey orders or signals from the top (“In China, the banks listen,” Nicholas Lardy famously wrote after decades of believing that China was going to market). Local governments—by now as big as many EU Member States but with more

[40] *Zhu He and Guo Kai, ibid.*

fiscal latitude at their disposal—compete among each other by supporting their local champions. Although the path of subsidies is used, they can also do so through share ownership in many companies, including some of the most prominent tech firms. This is even more so the case for dual-use technologies.[41]

However, **if policymakers draw the conclusion that they can counter China effectively solely by using negative measures, they will miss an essential point**. China has combined government action with competitive interplay among participants to greater effect than many systemic innovation policies adopted elsewhere—including recently with regulations on fast-tracked mergers.[42] What might be market competition in other countries is often led in China by local governments competing against one another. What happens at the end of every "blind development" (盲目发展) dance is that the losers either fall by the wayside or are merged with the winners to form market-dominating firms. The same pattern has been applied to several traditional sectors, from railway equipment to aerospace.

After Xi Jinping's early years in power, antimonopoly policies have begun to be applied. The state wants to see start-ups and new "small dragons" emerge. As was the case with Alibaba and Jack Ma, the state shows that it is able to prevent monopolies or near-monopolies from forming if they stifle competition and innovation. This goes together with a traditional Chinese propensity for betting, taking risks, and hoping that the wheel of fortune will swing in the right direction. Some of this ethos can be found in Silicon Valley or in frontier societies such as Israel, Singapore, and Taiwan—the comparison with the "precautionary principle" at work in most European societies is striking. This does, however,

[41] *The PLA's hidden hand through any number of vehicles, from investment funds to front companies to research centers and universities, is well documented: see Tai Ming Cheung, "Innovate to Dominate: The Rise of the Chinese Techno-Security State", Cornell University Press, 2022.*

[42] "市场监管总局部署开展经营者集中反垄断监管效能提升专项行动" *[The State Administration for Market Regulation has launched a special campaign to enhance the effectiveness of anti-monopoly supervision of business concentrations], People's Daily, June 30, 2026, http://finance.people.com.cn/n1/2026/0630/c1004-40751089.html.*

lead to dangerous shortcuts or experiments: to wit, the laboratory mishandling that most likely led to the emergence of the COVID-19 virus or the case of a scientist who used gene editing on human embryos to modify their characteristics.[43] China's leaders can apparently live with this.

6.2. CURRENCY UNDERVALUATION

The second factor underlying unequal competition is the undervaluation of the Chinese currency. The issue is complex. At one end, the US legislation has two acts (1988 and 2015)[44] allowing the United States to designate a particular country as a "currency manipulator." At the other end, the IMF recognizes whether a currency is "undervalued" or "overvalued" compared with its real effective exchange rate. However, the IMF has largely stopped applying this criterion to China since 2015. At that date, the People's Bank of China (PBoC) had indeed made a great deal of upward adjustments to the value of the yuan as it got ready to enter the IMF's Special Drawing Rights basket. Those were the years when financial institutions and many economists believed that China's current account surplus would continue to shrink. It was thought that China would move toward a consumer importing and service economy, solving the issue of international imbalances.

However, this was also a political decision that avoided confronting China head-on over a major currency issue while trying to negotiate more concrete outcomes sector by sector. The first **Trump administration returned briefly to the designation of China as a currency manipulator before relenting**. The IMF still does not formally recognize

[43] He Jiankui was indicted and sentenced in 2019, but the current enthusiasm for bioengineering may bring the issue to the fore again. He Jiankui himself recently reemerged in the news: "L'étrange retour du chercheur chinois qui modifiait génétiquement les bébés" [The strange return of the Chinese researcher who genetically modified babies], Le Monde, June 28, 2025, https://www.lemonde.fr/sciences/article/2025/06/28/l-etrange-retour-du-chercheur-chinois-qui-modifiait-genetiquement-les-bebes_6616297_1650684.html.

[44] By contrast with the first legislation from 1988, the 2015 Trade Facilitation and Trade Enforcement Act is more demanding in terms of proof.

a currency undervaluation by China. The IMF—as well as the European Central Bank and other EU authorities—has not raised the issue so far as a negotiating position.

There are two salient facts. First, the PBoC manages and even micromanages the yuan, although it does not acknowledge this officially. The yuan has, in practice, remained closely pegged to the US dollar even after the PBoC formally dropped the peg as an exchange rate policy anchor in 2010. The allowable margin is not formally defined, but it is sometimes called a "crawling peg." Overall, the outcome in terms of exchange rates is different for the US dollar and for other currencies (euro, yen), which have had swings in value relative to the US dollar over recent years *(see Appendix 1)*.

We should not assume that China has kept a lid on the value of its currency. Managing the yuan is like rafting over several strong currents. One such current is the relentless accumulation of foreign currency through foreign trade surpluses and because of differing interest rates: The European Union, for example, has long had ultra-low interest rates compared to China's. The prevailing interest rates set by the Fed were also lower than those set by the PBoC. Therefore, there was an argument for keeping profits and savings in China. This is no longer the case.

But a second fact is that, in the other direction, households and companies have a propensity to move their cash and savings abroad, escaping or hoping to escape Chinese jurisdiction. This is sometimes an illicit outflow of "hot money" and sometimes not. The overall tally often includes many "errors and omissions" columns. The extent of annual capital outflows from China—under what is, in principle, a capital control regime—is hard to assess with certainty.

Yet it is important to assess annual capital outflows because they are also a way to sterilize the massive inflows from foreign trade and to produce a current account balance that seems almost innocuous compared to

China's trade surplus.[45] Bloomberg and Singapore's Straits Times have circulated a figure for these outflows of $807 billion for 2025 from the Institute of International Finance (IIF)—though the figure is now unavailable on the IIF's website. It reportedly mixes legitimate FDI outflows, financial investment, and lending—but it does not include foreign-currency reserve assets, and it aggregates individuals and entities. It likely does not capture illegal outflows through other channels.

A reconstruction using the State Administration of Foreign Exchange's (SAFE) data for 2025,[46] again excluding the acquisition of reserve assets, yields a similar number. Additionally, a 2023 study on tax havens, excluding Hong Kong, found that by 2020, 60 percent of equities issued by entities resident in those havens whose nationality was not the tax haven were issued by Chinese individuals or entities.[47] By 2020, 20 percent of all corporate bonds issued in the same tax havens were issued by Chinese firms. To already considerable foreign currency reserves, Chinese players add overseas capital financing that is reminiscent of the role of the Eurodollars for US multinationals in the previous era.

The picture that emerges is complex. **As of mid-2026, the exchange rate between the yuan and the US dollar is literally the same as it was more than seven years ago**. This is with inflation all but nonexistent in China, while it has been strong in the United States. The yuan has depreciated against the euro, while EU inflation, although more limited than in the United States, still bears no comparison with China's price stability. If we had witnessed extraordinary progress in productivity per worker in China, this might justify the gap in pricing. However, this is not the case—**overall productivity has risen more in the United States and even in Europe**. This overall argument certainly

[45] *"Current Account Balance (BoP, Current US$) — China," World Bank Open Data, accessed July 7, 2026, https://data.worldbank.org/indicator/BN.CAB.XOKA.CD?locations=CN.*

[46] *"SAFE Releases China's Balance of Payments for the Fourth Quarter and for the Annual of 2025," State Administration of Foreign Exchange, March 27, 2026, https://www.safe.gov.cn/en/2026/0327/2406.html.*

[47] *Christopher Clayton, Antonio Coppola, Amanda Dos Santos, Matteo Maggiori, and Jesse Schreger, "China in Tax Havens", National Bureau of Economic Research, January 2023, https://www.nber.org/system/files/working_papers/w30865/w30865.pdf.*

has its limits: in manufacturing sectors working for exports, productivity has indeed vastly increased, thanks to automation and related developments. This is what the Chinese authorities demonstrate when they proudly organize visits to these factories.[48] It is also the exact definition of mercantilism in action!

On this count, it makes sense to speak of an underappreciation of the yuan, as Chancellor Merz,[49] following in the footsteps of Emmanuel Macron and several trade economists, has done. But there is a hitch that has political implications: If we look at the value of the Chinese yuan against the Japanese yen, the latter has undergone an even steeper devaluation, whether against the yuan, the US dollar, or the euro. In fact, **many East or South Asian countries and major emerging economies**—with the special case of Turkey—**have also undergone a deeper depreciation relative to the US dollar and the euro** *(see Appendix 2)*.

Not all cases point to the same systemic mercantilism that China exhibits, and **some of the trends may reflect a struggle to conserve existing export positions rather than to extend them further**. With the world's largest exporter and manufacturing producer running a sustainable massive current account surplus on the back of a managed undervaluation, we have entered a world of "competitive devaluation." There is also a risk that the current American administration might also engage in debasing the US dollar, as some quarters are advising.

The current account surpluses of Japan, Korea, and Taiwan are rising faster than China's *(see Appendix 3)*. It will be difficult to deal with Chinese underpricing of its currency independently of the current responses of other monetary authorities. This, for once, leads us to plead for a multilateral approach involving other East Asian economies. It should lead

[48] *DPCcars, "German Chancellor Friedrich Merz Visits Unitree Robotics," YouTube, 1:26, February 27, 2026, https://www.youtube.com/watch?v=2RheOxcKYTI.*

[49] *Finbarr Bermingham, "Germany Backs EU's Tough China Line with Call for 'Plaza Accord' Talks on Yuan," South China Morning Post, June 19, 2026, https://www.scmp.com/news/china/diplomacy/article/3357742/germany-hews-eus-tough-china-line-call-plaza-accord-talks-yuan.*

to **negotiation of a more general currency realignment**—if China is open to this, though. Most likely, this can only be obtained through threats of radically protective trade measures and direct or financial investment.

6.3. OVERPRODUCTION

The third factor is overproduction, or should we call it "blind development." This term was widely used in Maoist China, especially after the failure of the Great Leap Forward, and again in the early stages of the Reform era (sometimes described as a "blind advance"). **Overproduction is so evident that Chinese economists, if not the authorities, are beginning to admit it:** "If the surplus of trade in goods and services continues to expand, China can easily be regarded as a threat to competition by trading partners. Other countries will worry that their own development space is squeezed, which will lead to trade protectionism, anti-globalization, and conflict."[50]

Yet in his recent speech to a Politburo study session,[51] Xi Jinping dedicated only half a sentence to the need to "prevent blindly 'following the trend' on the project and 'burning money.'" Instead, his main argument details what he sums up as **taking "extraordinary measures to increase core technology research in key areas"** and to create a "vivid situation of a hundred flowers blooming and competing." Beyond the verbiage, what matters are the proportions in his speech: Cadres will understand that his command is 99 percent to forge ahead, with a 1 percent qualifier that is in fact not tied at all to international imbalances. For Xi, an investment stampede would be a useful way to foster new national champions and may be followed by a retreat. Has he ever broken completely from Mao's "Great Leap" mentality?

[50] *Zhang Yansheng, ibid.*
[51] *Xi Jinping, ibid.*

Europeans should confront China's mercantilism without caricaturing its economy. **Blaming China for unfair competition, mercantilist strategies, and market intervention at many levels should not go hand in hand with an inaccurate picture of China's economy and society, including its strong points**. Today, China is a rich and unequal society with pockets of poverty. It combines more and more social, health, and educational services with what could possibly be the last gasp of demography-induced dynamism. It has a heavy and authoritarian bureaucracy, but this is combined with very strong elements of competition and innovation. We had better stay alert to this.

This brings us back full circle to European policy issues. They go beyond the China policy angle, but the interconnection is deepening. Without pretending to have the exact formula for a solution, there are some choices that must be made:

- On **directly countering China's trade tsunami:** What balance is to be found between sweeping trade protection measures, with quasi-general tariffs, and followed by sector-by-sector or item-by-item bargaining chips in negotiations with China? Interesting, this sector-by-sector bargaining approach, involving purchases by China, may at last news be tentatively integrated in the renewed trade dialogue between the European Union and China.[52] This is also a **US approach**, and it is working, although with a great deal of American concessions. Or, conversely, should we stick to the **European case-by-case study of unfair competition** followed by specific tariffs? This eats up much time, during which China still remains on the front foot for exports. But there may be no other way.

[52] *Flagged by Finbarr Bermingham, see the testimony to EU Parliament by Denis Redonnet, "Committee on International Trade Ordinary meeting", European Parliament - Committee on International Trade, Video recording, July 14, 2026, https://multimedia.europarl.europa.eu/en/webstreaming/committee-on-international-trade-ordinary-meeting_20260714-0900-COMMITTEE-INTA.*

- On the scope to **choose with a package or sweeping approach:** Should it be agnostic or rather should it **single out China**—and eventually a short list of trade offenders? An **agnostic approach** to trade tariffs is consistent with the overall WTO-based European tradition and is less of a direct confrontation with China. But it is clear that neither China, nor in fact the United States, put much store in the WTO. We clearly have an issue with the other East Asian economies and their debased currencies. But who is going to place tariffs on absolutely vital TSMC semiconductors? So far, **other East Asian exporters prefer high profit margins through the pricing of their goods to China's steamroller approach**—but they do not represent the same threat to our national and economic security.

- On a **realignment of currencies**, an option now being publicly discussed: What is the chance that transatlantic partners will see eye to eye on this? **China reluctantly accepted the idea of such a realignment**, although never explicitly, **in the era when it sought more leverage in international financial organizations**. However, it held out to the world a potential liberalization of its capital account with full yuan convertibility. Our leverage is now more limited. How can we balance the interests of other Asians—who have had to adopt the path of competitive devaluation—to ensure that they too can regain some ground against competition from China? Except by mentioning it, we leave aside the choice of a competitive devaluation for the euro. Even with diminishing surpluses in goods for the Eurozone and a much-vaunted surplus in services that in fact relies heavily on tourism, it goes against the tenets of European Central Bank policy.

Nobody can fault the current approach inaugurated by the recent Maroš Šefčovič–Wang Wentao meeting, which introduced a trade and investment consultation mechanism between China and the European Union: "Dialogue is essential [but] dialogue has to deliver."[53] China's Ministry of Commerce has mentioned this as holding "one or two ministerial-level meetings each year."[54] The EU Trade Commissioner had earlier argued for intense consultations on par with the frequency of trade talks between Beijing and Washington.[55] What matters as much is that **the European Union and its Member States do not pause the implementation of defensive mechanisms and the crafting of new instruments, so long as China's export offensive goes on**.

[53] *Jorge Liboreiro, "EU Will Retaliate If China Misses October Trade Deadline, von der Leyen Says," Euronews, July 3, 2026, https://www.euronews.com/my-europe/2026/07/03/eu-will-retaliate-if-china-misses-october-trade-deadline-von-der-leyen-says.*

[54] *Xinhua, "China, EU to Hold Second Meeting of Trade, Investment Consultation Mechanism This Autumn," China Focus (China International Communications Group), July 3, 2026, https://en.chinadiplomacy.org.cn/2026-07/03/content_118580572.shtml.*

[55] *Xiaofei Xu, "EU Trade Chief Swipes at China's Overcapacity, but Seeks 'Meaningful' Talks with Beijing," South China Morning Post, June 4, 2026, https://www.scmp.com/economy/global-economy/article/3356007/eu-trade-chief-swipes-chinas-overcapacity-seeks-meaningful-talks-beijing.*

Annual average exchange rates, 2019-2026[56]

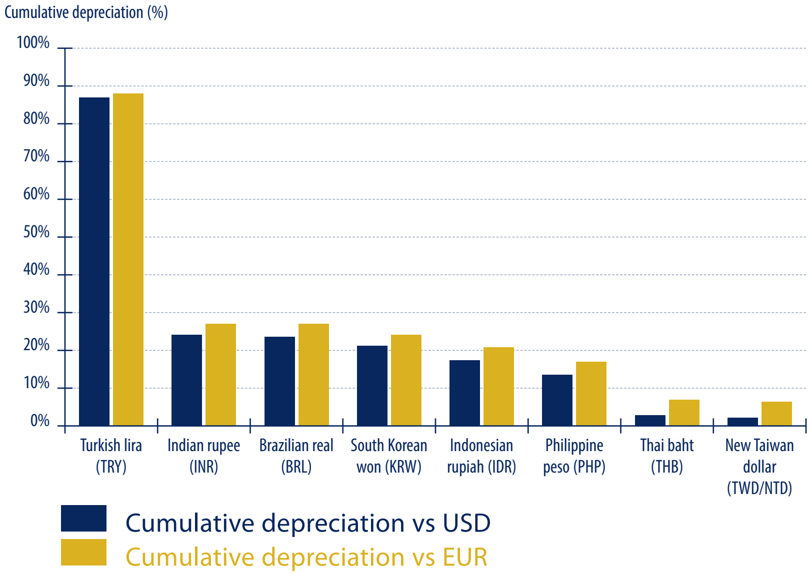
Appendix 1 • Five bilateral series with year-on-year changes (2026 is Jan-May YTD)

Year	CNY per USD	YoY (yuan +)	CNY per EUR	YoY (yuan +)	CNY per JPY	YoY (yuan +)	EUR per USD	YoY (euro +)	JPY per USD	YoY (yen +)
2019	6.9098	-4.51%	7.7355	+0.93%	0.06344	-5.88%	0.8933	+0.10%	108.92	+1.73%
2020	6.8943	+0.22%	7.8747	-1.80%	0.06463	-1.87%	0.8755	+1.99%	106.68	+2.06%
2021	6.4498	+6.45%	7.6282	+3.13%	0.05873	+9.12%	0.8455	+3.42%	109.82	-2.94%
2022	6.7225	-4.23%	7.0788	+7.20%	0.05128	+12.68%	0.9497	-12.32%	131.08	-19.37%
2023	7.0841	-5.38%	7.6600	-8.21%	0.05040	+1.73%	0.9248	+2.62%	140.56	-7.23%
2024	7.1947	-1.56%	7.7875	-1.66%	0.04753	+5.69%	0.9239	+0.10%	151.38	-7.69%
2025	7.1845	+0.14%	8.1185	-4.25%	0.04803	-1.05%	0.8850	+4.21%	149.59	+1.18%
2026*	6.8813	+4.22%	8.0510	+0.83%	0.04367	+9.06%	0.8547	+3.42%	157.56	-5.33%

[56] ***Methodology:*** *Quote convention: CNY per USD, CNY per EUR, CNY per JPY, EUR per USD, and JPY per USD. Every YoY column is expressed from the perspective of the first currency named in the corresponding pair. A positive (+) value indicates appreciation of that currency against the second currency; a negative (–) value indicates depreciation. The signs therefore run opposite to changes in the quoted rate, since a higher rate indicates a weaker first currency. Source series: Deutsche Bundesbank, Exchange rate statistics, II. Euro foreign exchange reference rates of the European Central Bank, annual and monthly averages. Annual averages are Bundesbank calculations based on the daily euro foreign exchange reference rates published by the ECB. Calculations: CNY/USD = (CNY/EUR)/(USD/EUR, quoted by ECB as USD per EUR); CNY/JPY = (CNY/EUR)/(JPY/EUR); EUR/USD = 1/(USD per EUR); JPY/USD = (JPY/EUR)/(USD/EUR). 2026 is not a full-year figure. It is a Jan-May 2026 average derived from the monthly averages available in the Bundesbank file dated 15 June 2026. European Central Bank, "Euro Foreign Exchange Reference Rates," 2026, https://www.ecb.europa.eu/stats/policy_and_exchange_rates/euro_reference_exchange_rates/html/index.en.html; "Euro foreign exchange reference rates of the European Central Bank," Deutsche Bundesbank, July 20, 2026, https://www.bundesbank.de/resource/blob/810486/a6f85aac3ac47b07ea32eae66e4b-fa82/mL/ii-euro-referenzkurse-der-ezb-data.pdf.*

Appendix 2 • Cumulative depreciation

(2019 average to January-May 2026 average)

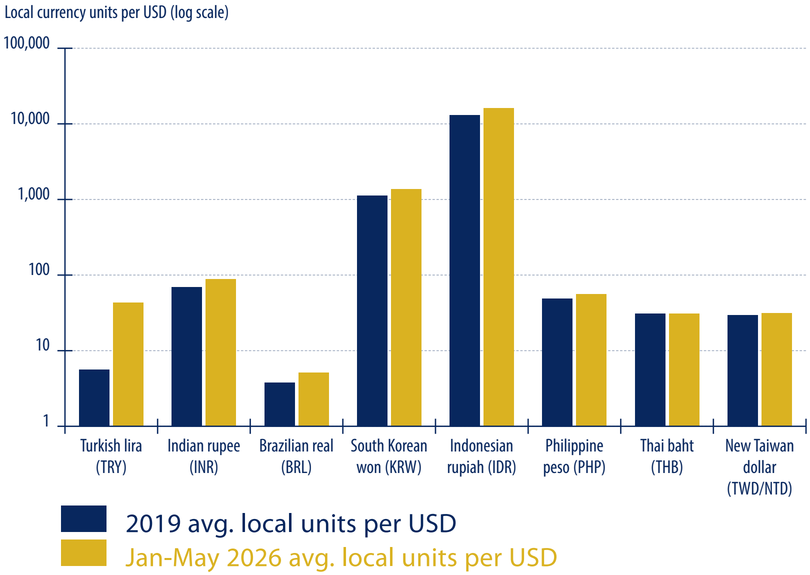


Source: Author's compilation of data from Deutsche Bundesbank, European Central Bank, and Central Bank of the Republic of China (Taiwan)[57]

[57] *Data compiled by author from "Exchange Rate Statistics", Deutsche Bundesbank, July 15, 2026, https://www.bundesbank.de/resource/blob/810480/17c37da84f6fe1ba834035b6c156211d/472B63F073F-071307366337C94F8C870/0-wechselkursstatistik-data.pdf; "Euro Foreign Exchange Reference Rates", European Central Bank, 2026, https://www.ecb.europa.eu/stats/policy_and_exchange_rates/euro_reference_exchange_rates/html/index.en.html; "Foreign Exchange Regime (annual)"/"Foreign Exchange Regime (monthly)", Central Bank of the Republic of China (Taiwan), 2026, https://www.cbc.gov.tw/en/cp-480-1879-66035-2.html & https://www.cbc.gov.tw/en/cp-480-58819-C8475-2.html.*

Appendix 3 • Local currency units per USD

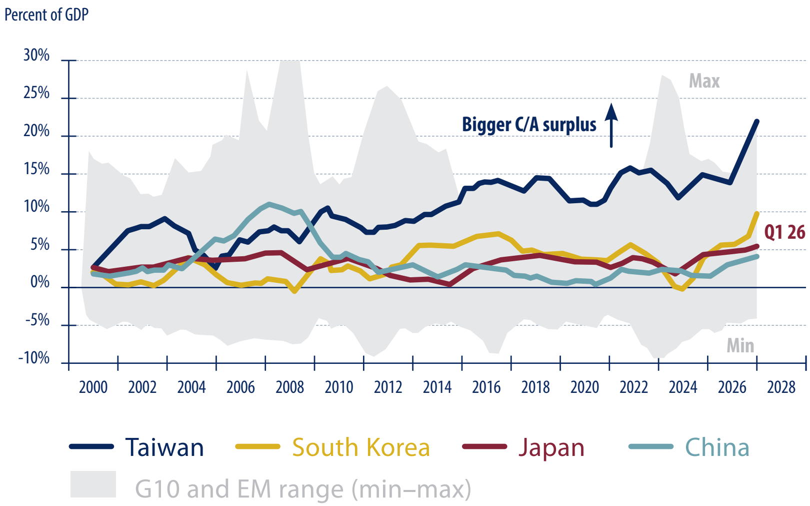
(2019 average and January-May 2026 average, logarithmic scale)



Source: Author's compilation of data from Deutsche Bundesbank, European Central Bank, and Central Bank of the Republic of China (Taiwan)[58]

[58] *Data compiled by author, ibid.*

Appendix 4 • Cross-section of G10 and EM current account positions (% of GDP, four-quarter moving average)



Source: Haver Analytics, cited in Robin J. Brooks, "Massively Undervalued Asian Currencies""[59]

[59] *Data from Haver analytics, cited in "Massively Undervalued Asian Currencies," Robin J Brooks, Substack, June 24, 2026, https://robinjbrooks.substack.com/p/massively-undervalued-asian-currencies.*

Acknowledgements

The author would like to especially express his gratitude to **Pierre Pinhas**, Policy and Research Officer within Institut Montaigne's Asia Program, for his assistance throughout the research and writing phases of this project. He would also like to thank **Mathieu Duchâtel**, Director of International Studies, **François Chimits**, Head of Europe Program, as well as the Asia Program team, **Rosalie Klein**, **Manon Anderson**, and **Valerio Castellini** for their comments and advice. Finally, he would like to thank the members of the communications team who made the publication of this note possible, **David Mulrooney** for his thorough editing, and **Matthieu Mercier** for his precious work on the layout and visuals of this publication.

Institut Montaigne welcomes thoughts and ideas on how to address these issues collectively and put forward recommendations which serve the public interest.

Institut Montaigne
59 rue La Boétie, 75008 Paris
Tél. +33 (0)1 53 89 05 60
institutmontaigne.org/en

Printed in France
Legal filing: July 2026
ISSN: 1771-6756

Corporate Members

INSTITUT Montaigne

ABB France
AbbVie
Accenture
Accor
Accuracy
Adeo
ADIT
Air Liquide
Airbus
Allianz
Amazon
Amir Aslani
Amundi
Antidox
Antin Infrastructure Partners
ArchiMed
Ardian
Arthur D. Little
August Debouzy
AXA
Bain & Company France
BearingPoint
Bessé
BNP Paribas
Bolloré
Bouygues
Brunswick
Capgemini
Capital Group
CAREIT
Carrefour
CEO2CEO Consulting
Chubb
CIS
Clariane
Clifford Chance
CNP Assurances
Conseil supérieur du notariat
Coopérative U
D'Angelin & Co.Ltd
Dassault Systèmes
Delair
Deloitte
Domia Group
Edenred
EDF
EDHEC Business School
Edmond de Rothschild
Ekimetrics France
Engie
EQT
ESL Rivington
Eurogroup Consulting
Everest Insurance International
FGS Global
FIVES
Forvis Mazars
Gide Loyrette Nouel
Gigalis
Google
Groupama
Groupe Bel
Groupe Berkem
Groupe BPCE
Groupe Brousse
Groupe Garcia
Groupe M6
Groupe Martin Belaysoud
Groupe Orange
Hameur et Cie
Helsing France
Hitachi Energy France
Hogan Lovells
Howden
HSBC Continental Europe
IBM France
IFPASS
Incyte Biosciences France
Institut Mérieux
International SOS
Interparfums
Ionis Education Group
iQo
ISRP
Jeantet Associés
Johnson & Johnson
Jolt Capital
Kairos
Katalyse
KPMG S.A.
Kyndryl
La Banque Postale
Lazard
LCH SA
Lenovo ISG
Les Jardins de la Testa
Limagrain
Linedata Services
Lloyds Europe
L'Oréal
LVMH
M.Charraire
Média-Participations
Mediobanca
Mercer
Meridiam
Meta
Microsoft France
Mistertemp'
Mitsubishi France S.A.S
Moody's France
Morgan Stanley
Natural Grass
Naval Group
Nestlé
OCIRP
ODDO BHF
Orano
o9 Solutions
PAI Partners
Pergamon
Polytane
Publicis
PwC France & Maghreb
Qualisocial
Raise
Renault
Ricol Lasteyrie
Rivolier
Roche
Roche Diagnostics
Rokos Capital Management
Rothschild & Co
RTE
Safran
Sanofi
SAP France
Schneider Electric
Septeo
SERB Pharmaceuticals
Servier
SIER Constructeur
SNCF
SNCF Réseau
Synergie
Teneo
The Boston Consulting Group
Tilder
Tofane
TotalEnergies
TP ICAP
Transformation Factory
Unicancer
Veolia
Verian
Verlingue
VINCI
Vivendi
Vodafone Group
Wavestone
White & Case
Willis Towers Watson France
Zurich

Much as the G7 countries might wish it were otherwise, "rebalancing the economy" is still not on the agenda for the People's Republic of China. In order to assist European decision-makers in shaping policy toward China, this policy brief seeks to analyze the key drivers shaping the country's economic trajectory. China's economic outlook is defined by two core dynamics: surging exports and a slow domestic economy. In the context of surging exports, a shift toward a balanced economy is unlikely any time soon, and with a slow domestic economy, there is little hope of reforming the economic system. This policy brief unpacks the forces underlying China's current heightened competitiveness: subsidies, currency undervaluation, and overproduction. As Chinese exports to Europe continue to surge, Brussels must navigate complex trade-offs to safeguard the European economy and decide whether to respond to this challenge in a targeted and systemic fashion or by taking a WTO-compliant neutral approach. It will also be necessary to conduct a currency realignment—but without alienating Europe's other partners in Asia in the process.

10 €
ISSN: 1771-6756
NCL2607-01