

Opinion | The China Shock 2.0 May Already Be Here

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Across Europe, Latin America, and large parts of the developing world, governments are confronting a new economic dilemma. Chinese electric vehicles are flooding export markets despite tariffs. Solar manufacturers outside China are collapsing under impossible price competition. Steel, batteries, industrial chemicals, and clean-energy components are all beginning to exhibit the same pattern: excess Chinese supply meeting a world economy increasingly unable, and unwilling, to absorb it.

At first glance, this resembles a conventional trade conflict. But it is something deeper. What is now surfacing across global markets is the outward spillover of structural pressures building within the Chinese economy for years.

For decades, China's growth model rested on a simple but extraordinarily powerful arrangement. Household consumption remained suppressed, while investment and exports carried the burden of economic expansion. That formula delivered one of the fastest industrial transformations in modern history. It built ports, factories, highways, supply chains, and manufacturing ecosystems at a scale no economy had previously achieved.

An Unresolved Problem

But the same model also produced an imbalance that China never fully resolved. Household consumption in China remains stuck at roughly 35 to 40% of GDP, extraordinarily low for an economy of its size. By comparison, household consumption accounts for roughly 68% of GDP in the United States, close to 60% in India, and 50-55% in mature East Asian economies such as Japan and South Korea. Even when government consumption is included, total consumption in China accounts for only around 54% of GDP. Investment alone still contributes roughly 43%.

These are not ordinary macroeconomic ratios. They describe an economy structurally dependent on capital formation rather than household demand.

For years, the imbalance remained manageable because investment itself generated rapid growth. Infrastructure expansion, urbanisation, and property development created employment, rising incomes, and local-government revenues simultaneously. Exports, meanwhile, absorbed excess industrial production externally.

Drowning In Debt

That arrangement is now weakening on multiple fronts at once. According to the IMF's 2025 Article IV consultation, China's total non-financial sector debt has climbed to roughly 313% of GDP and is projected to reach 323% by 2026. More revealingly, the IMF's broader measure of "augmented debt", which includes Local Government Financing Vehicles and off-balance-sheet liabilities, is projected to rise to 135.3% of GDP by 2026.

The problem is no longer merely the scale of debt. It is the declining efficiency of debt itself.

In the early 2000s, China's Incremental Capital Output Ratio remained relatively healthy, meaning investment still generated strong returns in growth. That relationship has deteriorated sharply. The economy now requires vastly larger injections of credit to produce the same unit of output. More investment is generating progressively less demand.

Real estate once concealed many of these contradictions. At its peak, the property sector accounted for nearly a quarter of China's GDP when upstream and downstream sectors were included. More importantly, real estate became the primary store of household wealth, accounting for roughly 70% of household assets.

The Growing Property Crisis

This is what makes China's property slowdown so economically dangerous. Falling property values are not simply weakening construction activity. They are eroding household balance sheets themselves. The result increasingly resembles the dynamics of a balance-sheet recession where households, firms, and local governments simultaneously become more cautious, indebted, and reluctant to spend.

The collapse in land sales has intensified the problem further. For years, local governments relied heavily on land transfers to finance infrastructure spending and service debt linked to Local Government Financing Vehicles. That mechanism has now weakened dramatically, severing one of the central feedback loops that sustained China's investment-heavy growth model.

The broader macroeconomic signals are becoming increasingly difficult to ignore. Core inflation averaged just 0.5% in 2024, while the IMF estimates China continues to operate with a negative output gap of roughly -1%. Producer-price deflation has persisted through prolonged periods, revealing the extent of excess industrial capacity.

At the same time, the demographic foundations of the old model are deteriorating rapidly. China's fertility rate now hovers near 1.0, far below replacement levels. The working-age population peaked nearly a decade ago and has been declining steadily since.

What Japan Did Differently

This is where the comparison with Japan becomes especially unsettling.

When Japan's debt and property bubble collapsed in the early 1990s, it had already become a wealthy society. Its per capita income had reached levels comparable to the United States. China, by contrast, is confronting demographic decline, debt saturation, and property stagnation at a per capita income level of roughly \$13,000.

In effect, China is ageing before fully becoming a high-income consumption economy.

That distinction matters enormously because the obvious solution to China's imbalance, stronger household consumption, is politically and institutionally difficult to achieve. Rebalancing towards consumption would require redistributing income away from state-linked investment sectors, local governments, and industrial producers toward households themselves. It would mean accepting slower investment growth and weaker industrial expansion.

Doing Business Elsewhere

Instead, China appears increasingly reliant on industrial expansion once again, only this time through newer sectors tied to green transition.

This is where the "New Three" sectors - electric vehicles, batteries, and solar manufacturing - become central to understanding the next phase of the global economy.

On the surface, these sectors are often presented as evidence of China's technological success. In reality, they also reflect the survival logic of an economy still attempting to compensate for weak domestic demand through industrial expansion. The numbers themselves are staggering. According to Bruegel's 2026 estimates, Chinese solar manufacturing capacity has now reached roughly 1,200 gigawatts, enough to meet domestic demand four times over and exceed total global demand by more than double. The International Energy Agency's 2026 Global EV Outlook similarly confirms that China produced roughly 16 million electric vehicles in 2025, exceeding domestic demand by roughly 20%.

That surplus inevitably seeks external markets.

The EV Boom

Chinese EV exports doubled to roughly 2.5 million units in 2025. Even after the European Union imposed tariffs of up to 35%, Chinese firms adapted by aggressively expanding hybrid vehicle exports, capturing roughly 9.5% of the European market by late 2025.

Historically, industrial development followed a relatively sequential ladder. Wealthier economies gradually moved upward into higher-value production, allowing poorer economies to absorb labour-intensive manufacturing underneath. Japan moved upward, then South Korea, then China. That ladder now appears increasingly congested.

China is not simply dominating advanced manufacturing sectors such as batteries and EVs. It continues to dominate lower and mid-level manufacturing simultaneously through subsidies, scale advantages, state-backed finance, and persistent overcapacity. Many developing economies now face the world's largest industrial state occupying multiple layers of the manufacturing ladder at once.

For countries such as India, Indonesia, Vietnam, or large parts of Africa, this creates a far more difficult developmental environment than the one China itself encountered during its rise.

The emerging tensions around tariffs, industrial subsidies, supply-chain diversification, and trade fragmentation are increasingly tied to a deeper reality within the Chinese economy itself: an investment-heavy growth model struggling to generate sufficient domestic demand, and consequently leaning more heavily on external markets to absorb its industrial surplus.

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