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The Chinese Economy: Stimulus without rebalancing

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Abstract

China continues to rely heavily on fiscal and monetary stimulus to sustain economic growth, yet these measures have not resulted in a meaningful shift from investment- and export-driven expansion toward domestic consumption. Despite policy efforts to boost domestic demand, persistent overcapacity in industrial sectors and continued dependence on external markets highlight the limitations of stimulus without structural reform. The economy's ongoing reliance on traditional growth drivers raises concerns about efficiency, long-term sustainability, and vulnerability to external shocks. Without a comprehensive rebalancing toward consumption-led growth, China risks perpetuating structural imbalances that could constrain its future development.

Key findings

- Economic growth continues to be driven by industrial production and external demand rather than domestic consumption. This reliance exacerbates structural imbalances and sustains the problem of excess capacity.
- Chinese exports expanded by 6.1% in the first seven months of 2025. Robust demand from markets outside the United States largely offset the effects of elevated U.S. tariffs.
- Industrial output growth has outpaced demand, resulting in persistent overcapacity. This has been accompanied by declining prices and a reduction in capacity utilisation.
- Policy stimulus has been directed primarily toward maintaining financial stability, particularly through local government debt restructuring. Measures to strengthen domestic consumption have been limited.
- Authorities have refrained from using currency appreciation as an adjustment tool. This cautious approach reflects both external pressures and concerns about repeating Japan's experience following the Plaza Accord.

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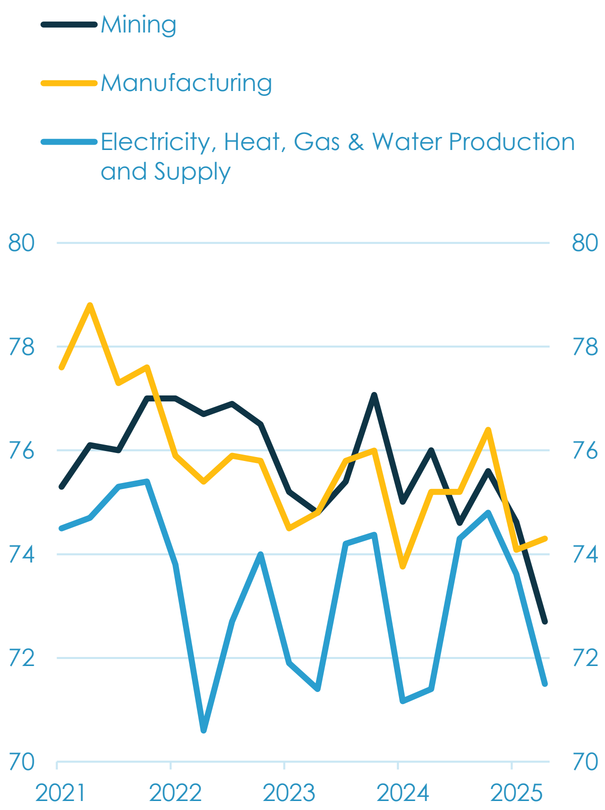
China's growth model has continued to rely on expanding industrial capacity and exporting to the world, rather than on domestic consumption. This has led to a significant increase in China's global share of manufactured exports and has raised concerns about overcapacity (Figure 1; Xu, 2025). The imbalance arises because China's expanding production capacity is outpacing domestic demand.

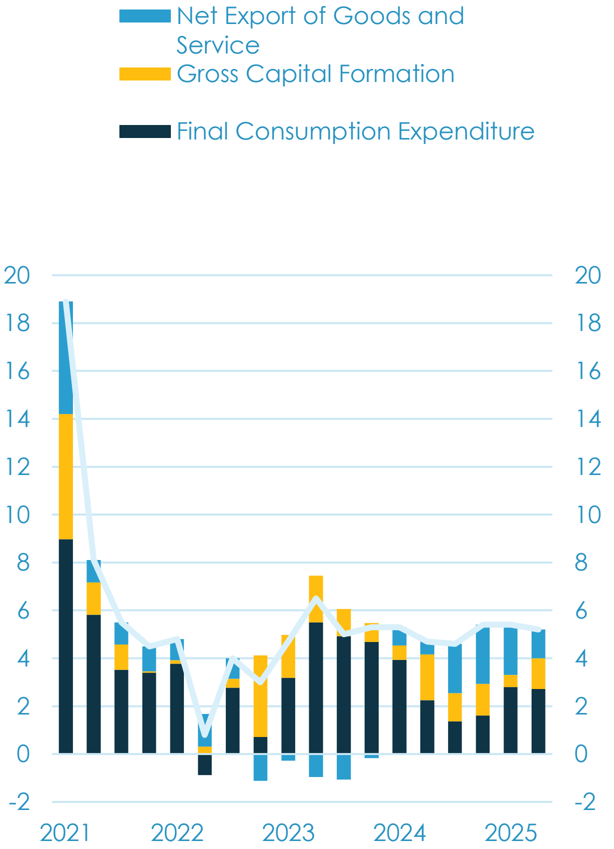
The United States and European Union have for years urged China to shift its economic focus away from manufacturing and exports, and towards greater reliance on domestic consumption, in order to address its structural saving-investment imbalance[1]. However, rebalancing towards a more consumption-driven growth model in China has yet to take hold in a significant way. On the contrary, the contribution of external demand to China's economic growth has remained strong, especially since the second half of 2024 (Figure 2).

Figure 1: China, capacity utilisation rate by industry (%)



Source: Bruegel based on Natixis and CEIC. Note: Capacity utilisation is a measure of how efficiently a company or economy is using its total potential productive resources, calculated as a percentage of actual output compared to maximum possible output.

Figure 2: China, GDP (%YoY)



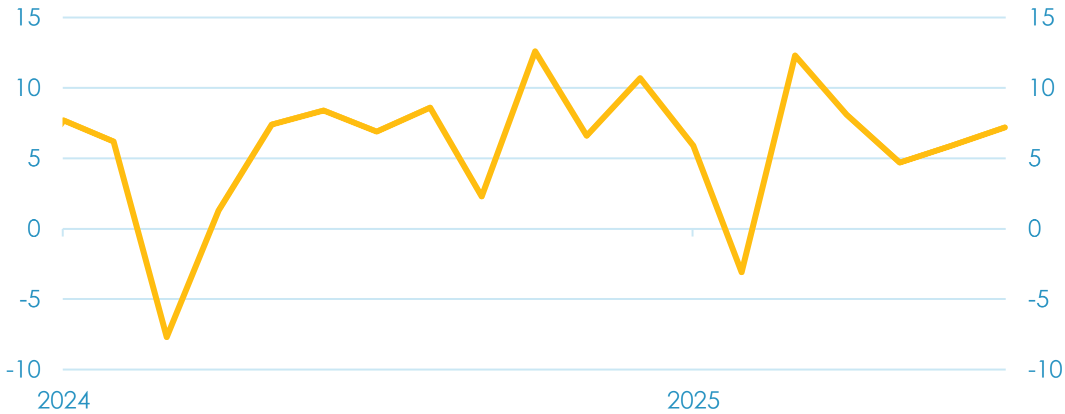
Source: Bruegel based on Natixis, China National Bureau of Statistics and CEIC. Note: Data as of June 2025.

[1] Andrea Shalal, 'White House warns China using overproduction for global dominance', *Reuters*, 18 October 18, https://www.reuters.com/markets/us-says-china-making-far-more-goods-than-it-needs-overtake-global-markets-2024-10-17/. See also European Commission news of 12 December 2024, 'EU Commission imposes countervailing duties on imports of battery electric vehicles (BEVs) from China', https://trade.ec.europa.eu/access-to-markets/en/news/eu-commission-imposes-countervailing-duties-imports-battery-electric-vehicles-bevs-china.

Since returning to office at the start of 2025, US President Donald Trump has adopted an especially forceful approach to compel China to rebalance its economy. US tariffs on Chinese imports were raised to as high as 145 percent, before being scaled back in May to 30 percent (including a 10 percent baseline and a 20 percent fentanyl-related surcharge)[2], on top of the already high tariffs piled up by the first Trump administration and the Biden administration.

Such steep tariffs can be expected to suppress Chinese exports. Shipments to the US declined sharply after April 2025, with a double-digit year-on-year contraction[3]. However, robust demand from other markets (some of which may be rerouting their exports towards the US) has more than offset the loss. In fact, Chinese exports grew by 6.1 percent year-on-year in the first seven months of 2025 (Figure 3), outpacing GDP growth, making external demand a major contribution to China's growth.

Figure 3: Chinese export growth (%YoY)



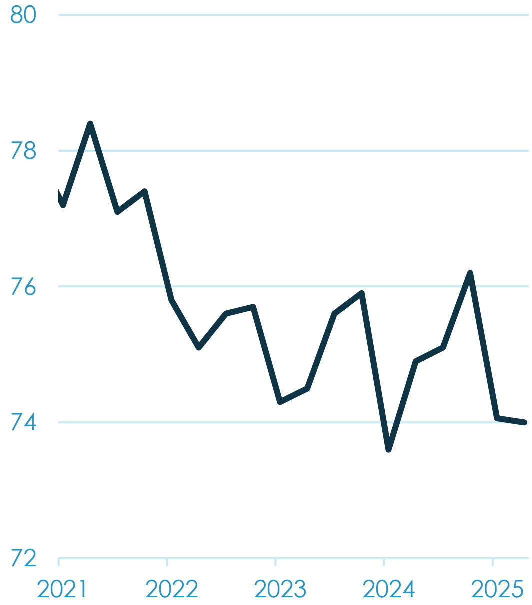
Source: Bruegel based on Natixis, China General Administration of Customs and Bloomberg. Note: Data as of July 2025.

Chinese industrial production has grown so much that not even very strong exports have been able to absorb it all, resulting in overcapacity. Meanwhile, capacity utilisation, which measures how efficiently resources are used to produce, has declined, pointing to a lack of demand for all the industrial capacity China has accumulated (Figure 4). Moreover, producer and export prices have dropped in most months since the start of 2025 (Figure 5).

[2] The White House, 'Joint Statement on U.S.-China Economic and Trade Meeting in Geneva', 12 May 2025, https://www.whitehouse.gov/briefings-statements/2025/05/joint-statement-on-u-s-china-economic-and-trade-meeting-in-geneva/.

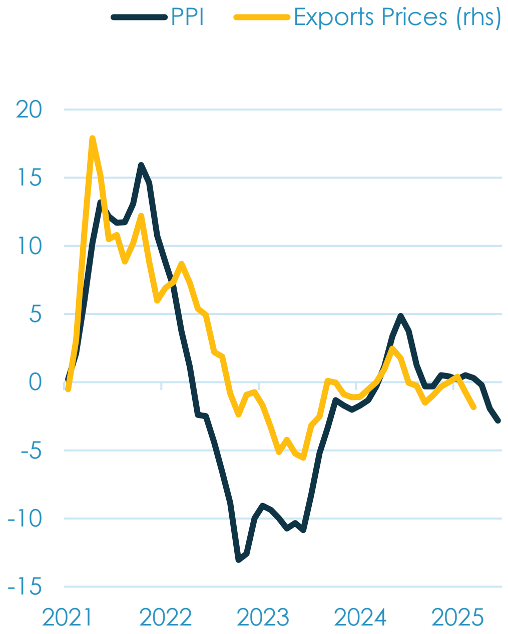
[3] *Bloomberg News*, 'Chinese Exports to US Slump 21% But Soar to Asia and Europe', 9 May 2025, https://www.bloomberg.com/news/articles/2025-05-09/china-s-april-exports-rise-even-as-tariffs-undercut-us-shipments.

Figure 4: Chinese industrial capacity utilisation (%)



Source: Bruegel based on Natixis and CEIC. Note: Data as of June 2025.

Figure 5: China, PPI and export prices (% YoY)



Source: Bruegel based on Natixis and CEIC. Note: Data as of June 2025.

China's stimulus and its impact on consumption

China's cyclical response to slowing growth, coupled with pressure from the Trump administration, has included fiscal and monetary stimulus. However, there has been limited action on the exchange rate, specifically in relation to renmimbi appreciation. This is partly because international financial markets have been seeking higher returns in the West, particularly the US[4]. It also reflects China's concerns about repeating Japan's negative experience with the sudden strong yen appreciation forced by the US in the 1980s under the so-called Plaza Accord, which contributed to a prolonged period of economic slowdown (García-Herrero and Xu, 2025; Liu, 2024).

Laxer fiscal policies have taken hold with a clear focus on infrastructure

In fact, since its zero-COVID policies ended, China has maintained a relatively cautious fiscal stance, largely because of significant fiscal deterioration at local-government level. However, in November 2024, this stance shifted notably towards a more proactive approach after an

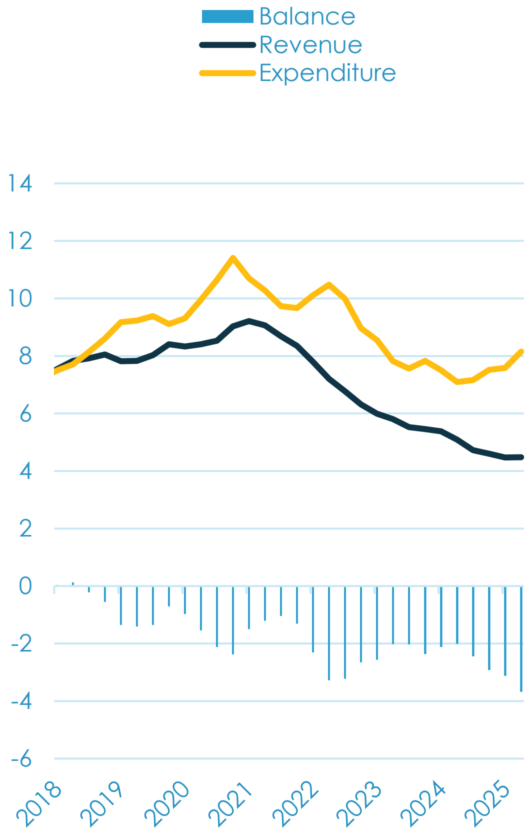
[4] Jason Ma, 'The S&P 500 has retaken all-time highs. Here's how much European and Chinese stocks raced ahead while U.S. markets regained lost ground', *Fortune*, 27 June 2025, https://fortune.com/2025/06/27/stock-market-all-time-high-europe-china-trade/.

announcement in September by the People's Bank of China governor[5], later confirmed by the State Council. A 6 trillion renminbi local-government bond-swap programme was announced[6] to deal with local government off-balance-sheet hidden debt. In other words, China's fiscal effort was refocused on ensuring financial stability, by helping local governments to repay their debts, rather than stimulating consumption. This was quite different from the market expectation of a consumption-led stimulus[7].

In March 2025, perhaps concerned by the looming risks arising from President Trump's threats, the Chinese leadership announced an increase in the general budget deficit to 4 percent of GDP, with the issuance of 1.3 trillion renminbi of ultra-long special treasury bonds, on top of 4.4 trillion renminbi of local special-purpose bonds (National Development and Reform Commission, 2025)[8]. The special bonds have been issued to finance the government fund, which is earmarked to finance infrastructure[9]. The government-fund deficit has already widened to more than 3 percent of GDP, marking the second largest shortfall on record since the COVID-19 shock in 2020 (Figure 6). Figure 7 shows how special bond issuance by local governments has climbed steadily since mid 2024.

[5] Ryan Woo and Liangping Gao, 'China's central bank unveils most aggressive stimulus since pandemic', *Reuters*, 25 September 2024, https://www.reuters.com/world/china/china-unveils-broad-stimulus-measures-revive-economy-2024-09-24/.
[6] *Xinhua*, 'China's top legislature approves bill to raise local gov't debt ceiling', 8 November 2024, https://english.www.gov.cn/news/202411/08/content_WS672dfefec6d0868f4e8ecbdf.html.
[7] Samuel Shen, Ankur Banerjee and Tom Westbrook, 'China's stimulus message leaves investors wanting', *Reuters*, 13 October 2024, https://www.reuters.com/world/china/chinas-stimulus-message-leaves-investors-wanting-though-hanging-onto-hope-2024-10-12/.
[8] See also Alicia García-Herrero, 'China's "two sessions" point to determination to rebuff Trump', First Glance, 11 March 2025, Bruegel, https://www.bruegel.org/first-glance/chinas-two-sessions-points-determination-rebuff-trump.
[9] *Xinhua*, 'China to issue more local government special-purpose bonds in 2025', 5 March 2025, https://english.www.gov.cn/news/202503/05/content_WS67c7b057c6d0868f4e8f0586.html; *Xinhua*, 'China finalizes 800-billion-yuan funding for key national projects in 2025', 3 July 2025, https://english.www.gov.cn/news/202507/03/content_WS6865bc0ec6d0868f4e8f3ce2.html.

Figure 6: China's government fund revenue/expenditure/balance (% GDP, 12-month moving average)



N.B. Data as of Q2 2025
Source: Natixis, CEIC

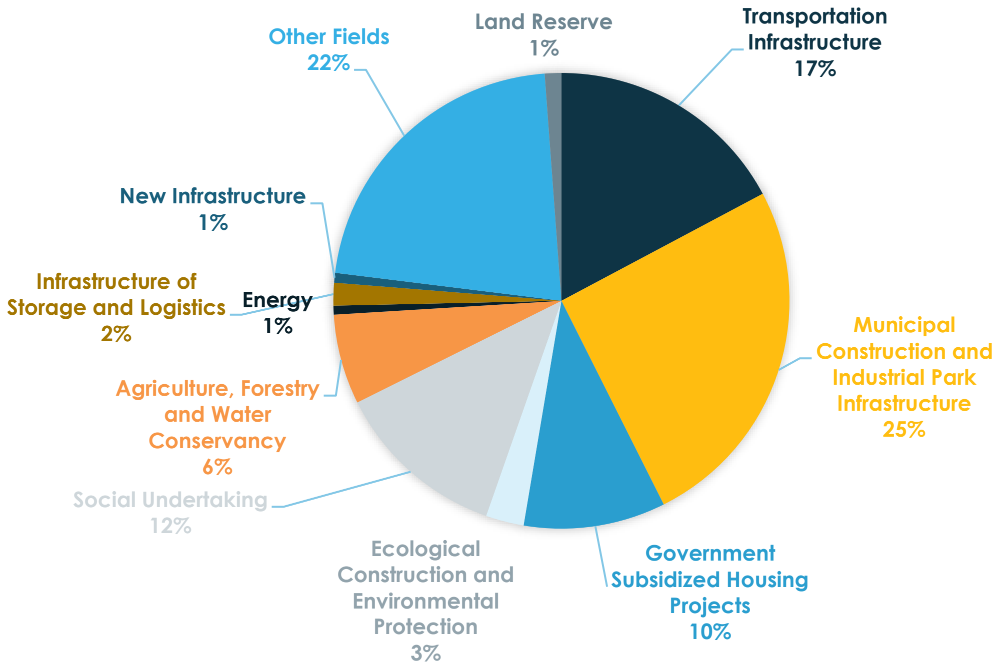
Figure 7: Local government special bond issuance (billion renminbi)

Source: Bruegel based on Natixis and CEIC. Note: Data as of June 2025. Data is based on 12-month moving average.

A breakdown of issued local government special bonds by purpose shows that most went into municipal construction, industrial park infrastructure, transportation projects and public housing (Figure 8). In addition, China will be under increased pressure to issue more infrastructure bonds beyond typical local government bonds to pay for a huge hydropower project in Tibet costing about $170 billion[10].

[10] Farah Master and Samuel Shen, 'China embarks on world's largest hydropower dam, capital markets cheer', *Reuters*, 21 July 2025, https://www.reuters.com/sustainability/climate-energy/china-embarks-worlds-largest-hydropower-dam-capital-markets-cheer-2025-07-21/.

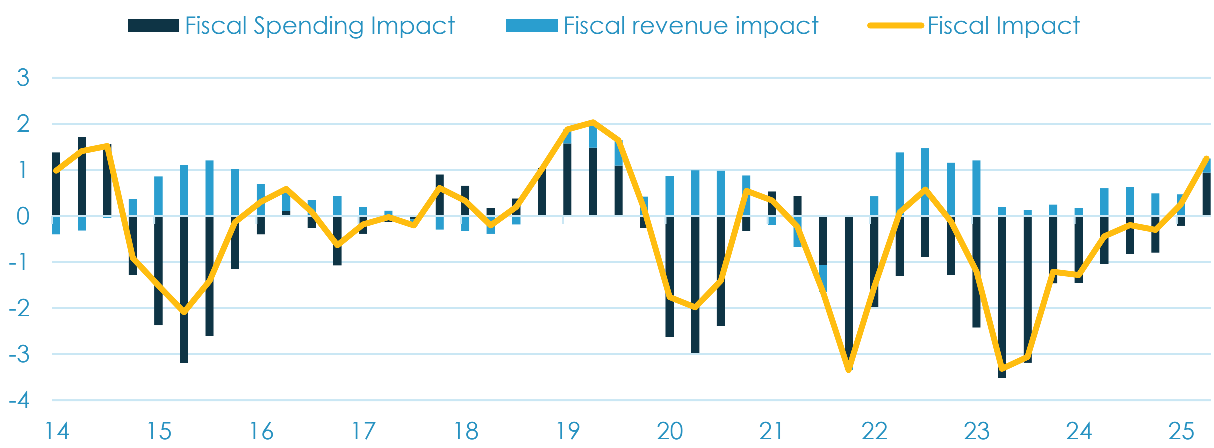
Figure 8: Breakdown of announced targets for special bonds



Source: Bruegel based on Natixis and CEIC. Note: Data as of 2025.

Another important question is to what degree debt swaps and infrastructure projects have resulted in a more supportive fiscal stance in China. We estimate the impact of China's fiscal policy on GDP growth (i.e. the fiscal stance) and conclude that the fiscal impulse has turned positive, from a highly negative starting point in mid-2023 (Figure 9). In other words, fiscal policy has indeed been supportive of growth in 2025. It's just that the focus is still on infrastructure projects.

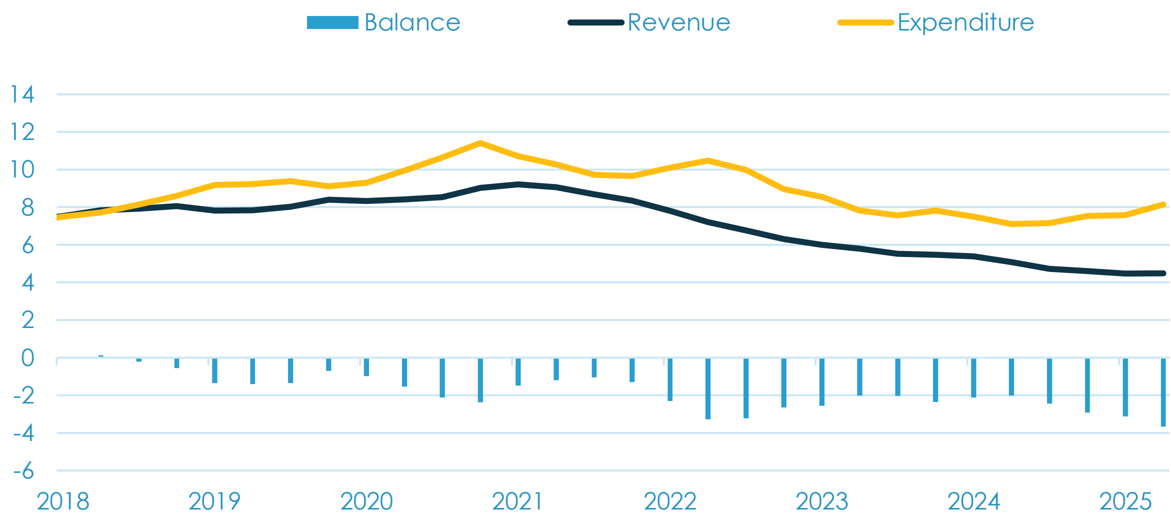
Figure 9: China's fiscal impact



Source: Bruegel based on Natixis and CEIC. Note: Data as of Q2 2025

Beyond the rise in infrastructure-related fiscal spending, China's general budget deficit – used to finance routine expenditures including education, healthcare and public-sector wages – has remained largely stable, hovering around 4.85 percent of GDP in the first quarter of 2025, similar to the fourth quarter of 2023 (Figure 10). While such spending could support consumption indirectly by easing pressure on household disposable income, its growth has been only moderate and is unlikely to generate a significant demand boost.

Figure 10: China's public revenue/expenditure/balance (% GDP, 12-month moving average)



Source: Bruegel based on Natixis and CEIC. Note: Data as of Q2 2025

Special targeted measures to boost consumption have largely focused on a subsidised consumer goods trade-in programme, which has been scaled up aggressively since the onset of the COVID-19 pandemic[11]. The government accelerated the trade-in programme in 2024, allocating 150 billion renminbi ($21 billion) through the issuance of ultra-long special treasury bonds[12]. In 2025, this amount was further increased to 300 billion renminbi (approximately $42 billion)[13]. However, despite doubling year-over-year, this figure remains small compared to infrastructure-driven spending. It is unlikely to address the fundamental cause of weak consumption: slowing income growth.

[11] *China Daily*, 'Renewals, trade-ins unlock investment, consumption', 28 October 2024, https://english.www.gov.cn/policies/policywatch/202410/28/content_WS671ef3a1c6d0868f4e8ec5d0.html.
[12] *China Daily*, 'Consumption drive pays off', 26 June 2025, https://www.chinadailyhk.com/hk/article/614796.
[13] *Xinhua*, 'China to allocate more funds in October to support trade-in program', 1 August 2025, https://english.www.gov.cn/news/202508/01/content_WS688c5330c6d0868f4e8f49a4.html.

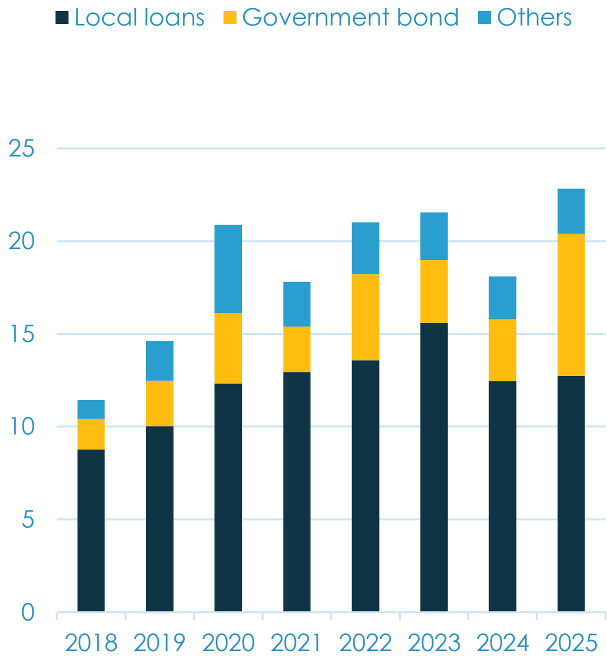
Monetary policy as a complement to fiscal expansion

Monetary policy was the first component of the stimulus previewed by the People's Bank of China governor in September 2024[14]. So far, this has led to a 50-basis-point cut in the reserve requirement ratio[15], a 20-basis-point reduction in the seven-day reverse repo rate (from 1.7 percent to 1.5 percent) and a 30-basis-point cut in the one-year medium-term lending facility rate[16]. However, most of the liquidity injected since then has been used to finance the surge in local-government bond issuance, rather than to significantly lower overall funding costs.

As Figure 11 shows, government bonds issued mainly by local governments were a major contributor to the rise in total social financing during the first four months of 2025. In other words, the laxer monetary conditions have mainly been used by local governments to fund boosts in infrastructure spending through the issuance of bonds with lower funding costs. This can be seen from the rapid growth in credit to the public sector, while credit to the private sector (corporates and households) has declined (Figure 12). Moreover, the risk that the public sector crowds out the private sector could become a reality[17].

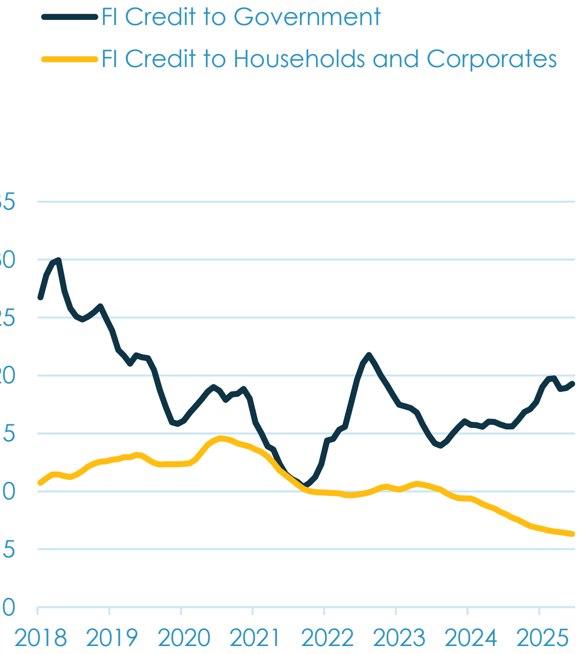
[14] Ryan Woo and Liangping Gao, 'China's central bank unveils most aggressive stimulus since pandemic', *Reuters*, 25 September 2024, https://www.reuters.com/world/china/china-unveils-broad-stimulus-measures-revive-economy-2024-09-24/.
[15] The percentage of customer deposits that a bank must hold in liquid assets. Alongside interest rates, this remains an important monetary policy tool for the People's Bank of China, to free or lock up liquidity.
[16] *Xinhua*, 'China unveils fresh stimulus to boost high-quality economic development', 25 September 2024, https://english.www.gov.cn/news/202409/25/content_WS66f3602ec6d0868f4e8eb3c0.html.
[17] See People's Bank of China, 'Announcement on Open Market Outright Reverse Repo Tender No.1', 5 June 2025, http://www.pbc.gov.cn/en/3688229/3688335/3730267/5734608/index.html.

Figure 11: Breakdown of China's total social financing (new increase, Jan to May)



Source: Bruegel based on Natixis and CEIC. Note: Data as of June 2025.

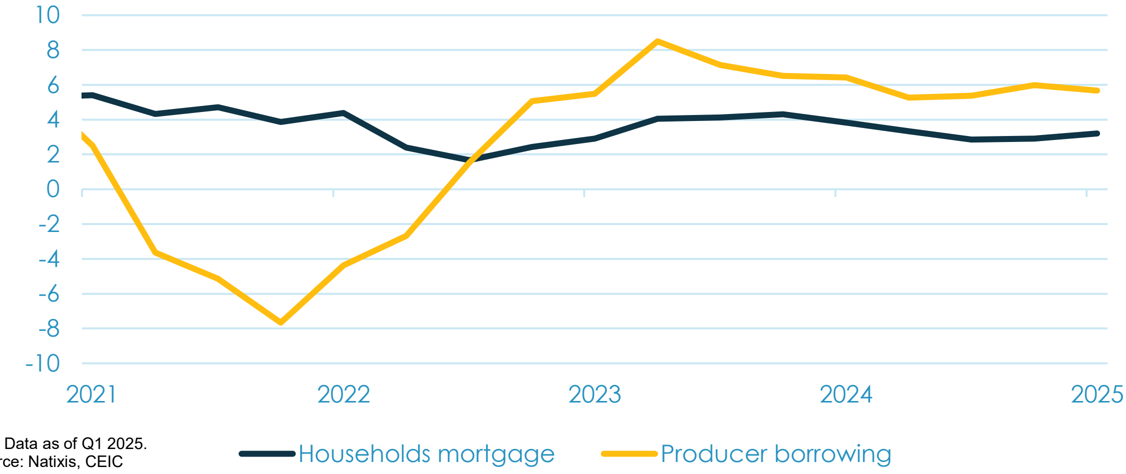
Figure 12: Financial institutions,credit to government, households and corporates (YoY %)



Source: Bruegel based on Natixis and CEIC. Note: Data as of June 2025.

All in all, the overall flow of funds from monetary expansion has favoured government bond purchases, while actual loan growth has been more muted. The overall monetary stance remains tight, as reflected in the stubbornly high real interest rates both for households (mortgages) and corporates (corporate loans) (Figure 13).

Figure 13: China's real interest rate



N.B. Data as of Q1 2025.
Source: Natixis, CEIC

No near-term global rebalancing

Faced with growth challenges compounded by domestic issues and pressure from the Trump administration, China has responded with largely traditional expansionary measures, with a particular focus on fiscal stimulus. This fiscal stance has shifted from tight to supportive during 2025. However, contrary to expectations that measures would be taken to foster consumption, the fiscal expansion has prioritised infrastructure investment. Meanwhile, a more relaxed monetary policy has primarily facilitated financing for government spending, rather than boosting household or corporate credit.

This raises the question of why China is hesitant about rebalancing its growth model towards greater consumption, especially given the potential of such a strategy to alleviate trade tensions with the US and EU. Khundrakpam and Pattanaik (2010), for example, argued that consumption-driven stimulus risks higher inflation, but this concern is arguably misplaced for China currently, given its low inflation environment. Another argument is that prioritising consumption may conflict with China's focus on technological upgrading and innovation[18]. However, stronger domestic demand would in fact benefit the Chinese economy and create more favorable conditions for technological development.

All in all, the Chinese government seems convinced that the current growth model, which moves away from the debt-driven reliance on the real-estate sector and focuses on increasing China's global market share of industrial production and exports, remains the right one. In other words, the need for rebalancing towards consumption does not seem to be a real priority. The ongoing stimulus is directed mainly towards infrastructure, meaning that no significant near-term surge should be expected in global demand resulting from increased Chinese consumption. In other words, the global rebalancing the US and the EU are expecting from China will not happen soon.

[18] Jayan Jose Thomas, 'Is consumption enough to drive growth?', *The Hindu*, 21 February 2025, https://www.thehindu.com/news/national/is-consumption-enough-to-drive-growth/article69244344.ece.

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