



China Facing Domestic Economic Challenges and Trade War with the U.S.

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A session of China's parliament in March confirmed that the main source of the country's economic growth in 2025 is to be state-supported industrial production, including the development of the high-tech sector, along with increasing domestic consumption and exports. The shape of China's economic policy will be influenced by, among other things, the course of the trade conflict with the United States. For the EU, China's economic plans imply the need to further protect the single market and increase competitiveness.

The Chinese authorities have been grappling for several years with the slowdown in their economy and the need to [seek new sources of growth](#). Plans formulated at the [Third Plenum of the CCP Central Committee](#) in July 2024 and in a following session of the Chinese parliament ([NPC](#)) in March this year were aimed at addressing this need.

Economic and Social Policy. Premier Li Qiang, in a report on the government's work in 2024, announced the achievement of China's GDP growth target of 5% that year and confirmed the same goal for 2025. Nominal GDP was just over \$19 trillion, positioning China as the second-largest economy in the world, after the United States (about \$30 trillion). However, the GDP growth rate is a political factor, achieved through statistical and accounting manipulation. Some Chinese economists (cited anonymously by the Rhodium Group) estimate that China's nominal GDP has been overestimated for at least the last three years and could be up to 10% lower (\$1.7 trillion), with the economic growth rate in 2024 actually at 2.4% to 2.8%. Goldman Sachs Bank estimates that, among other things, as a result of the trade war with the U.S., the growth rate will be 4% in 2025 and 3.5% in 2026.

The Chinese solution to its problems is to stimulate industrial production, including through tax breaks, lower borrowing costs, and subsidies, such as reduced rents. The 2025 budget allocates more than \$1.5 trillion for these expenditures, an increase of more than 14% year on year. The high-tech

sector is key, including robotics, telecommunications, quantum computing, and [artificial intelligence](#). China's advantage in these areas is expected to be decisive in its rivalry with the U.S. According to China, the U.S. government may be reducing its involvement in R&D and other areas amid the Trump administration's ideological disputes with scientific institutions.

The development of technological and manufacturing capabilities is expected not only to increase China's self-sufficiency but also to develop the domestic market, creating jobs and increasing budget revenues. In the optics of the authorities, this could lead to a decline in unemployment, especially among young people. According to official data, in February this year urban unemployment stood at 16.9% in the 16-24 age bracket (up from 16.1% in January), 7.3% in the 25-29 age bracket (up from 6.9%), and 4.3% in the 30-59 age bracket (up from 4%). The resulting overproduction is expected to be exported, helped by measures to lower producers' costs. Some of the production that will not go to the U.S. due to [high tariffs](#) is to be redirected to the domestic market and other markets, including [the EU](#) and developing countries. Support for Chinese companies in the domestic market is to be offered, for example, by e-commerce funds facilitating sales through digital platforms (e.g., the creation of a fund of more than \$27 billion was announced by JD.com, a company in this sector). One possible solution is also for the authorities to support the devaluation of the yuan, which

is favourable to exporters. Cooperation with foreign countries is primarily expected to increase the dependence of manufacturers, including European ones, on Chinese sub-suppliers, such as those in the automotive sector. It is also supposed to attract capital to China, including through investment in the high-tech and drug industries.

The Chinese authorities are paying a lot of attention to boosting domestic consumption. Its importance, however, depends on the U.S. maintaining high tariffs for an extended period. The Chinese authorities in their 2025 plans and budget propose, for example, to continue to support with public funds the purchase of new home appliances and phones made in China. Funding is to come from the issuance of long-term bonds worth more than \$41 billion. The authorities also pledge to reduce the price of public services and energy, as well as increase social spending, including on pensions to narrow the gap between urban and rural residents, and on healthcare. The proposed programmes could partially increase the Chinese public's purchasing power and have a positive impact on business sales. However, the level of funding is too low to lead to a significant increase in the share of consumption in GDP (in 2023, according to the World Bank, it was 39%, while the average for OECD countries is 60%). The authorities envision it will lead to an increase in the official budget deficit from 3% to 4%, but according to Fitch Ratings it could actually reach 8.8% of GDP.

Security and the CCP. China's budgeted increase of 7.2% in [defence spending for 2025](#) compared to 2024 to more than \$245 billion confirms the continued development of capabilities and reform of [China's armed forces](#). While the amount does not exceed 1.5% of China's GDP, this is not the total state spending on defence—other categories include intelligence, the internal security apparatus (the so-called People's Armed Police), and naval militias, among others. The U.S. Department of Defence estimates that, in total, China's defence budget could be as much as 40% larger than the official one.

There are also continual [personnel changes](#) in the army. Unofficial information indicates that disciplinary proceedings have been initiated against Gen. He Weidong, vice chairman of the Central Military Commission, which may be a reason for his absence from the Politburo meeting in April. Tensions over the development of the armed forces, including [the difficult relationship](#) between the generals and the Chinese Communist Party (CCP) leadership, were illustrated by the course and composition of Xi's meeting with army and security forces delegations at the NPC. Most of the attendees were representatives of line units, involved in military industrial production development, equipment testing, and logistical support rather than high-level officers. Xi admonished the military to increase the army's efficiency and improve inter-unit coordination and management.

The CCP's disciplinary authorities have also opened additional corruption cases against party officials (including

former ones) and their relatives. Unofficial information indicates that Liu Tianrun, son of Liu He, former vice premier for economic affairs, has been investigated. Meanwhile, the disciplinary committee's investigation of Yang Chao, the former chairman (retired for 14 years) of state-owned China Life Insurance, the largest in terms of insurance market share in China, has been officially confirmed. These cases are for show—their purpose is to discipline the party apparatus and demonstrate that kinship or retirement (after public activities completed and approved by the party) do not protect one from the consequences of actions that deviate from the CCP line.

Conclusions and Outlook. The plans for 2025 announced at the NPC do not indicate a change in China's economic and social policies. What is apparent is the Chinese authorities' belief in the seriousness of the challenges in the economy and foreign policy compounded by the trade war with the U.S. Measures aimed at boosting consumption are intended not so much to stimulate the economy but to convince citizens that the authorities are spending more money and thus improve public sentiment resulting from possible economic problems. The CCP believes this will mitigate the negative effects of the trade disputes with the U.S.

The Chinese authorities are convinced that it will be the U.S. economy that will feel the effects of high tariffs more quickly, so the need to increase domestic consumption will not be long-lasting. This belief is supported by signals from the U.S. administration about a possible reduction in tariffs, on top of the earlier exemptions for certain electronic products. China maintains strong public support for its economy, including through subsidies, which is expected to facilitate the survival of companies, as well as spur innovation and the development of the domestic market, and later the entry of companies into foreign markets and effective competition with U.S. entities, among others. The expanded industry and large amounts of funds allocated to research and development are expected to increase China's independence from cooperation with the West. In a situation of possible military conflict with the U.S, this would allow China to more easily shift its economy into war mode.

The crucial importance of industrial production to the Chinese economy and the uncertainty over U.S. trade policy will increase the importance of exports of China-producing companies to other markets, including the EU. This means [Chinese overproduction will be shifted to the EU](#), including by third countries. Such a situation will require the expansion and further active use by the EU of instruments to protect the single market from state-backed competition from China. However, it may also be an opportunity for the EU to obtain concessions from China, such as a positive response to expectations of access to [Chinese electromobility technologies for investment in the Union](#).