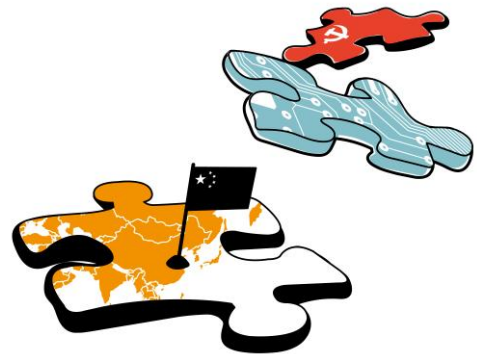


NOVEMBER 27, 2025

# MERICS China Essentials

## Special Issue: China in 2026



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## ECONOMY AND INDUSTRY

### China's economy: Confidence abroad, but trouble brewing at home

China is set to project economic confidence globally in 2026, having beaten back US tariffs since “Liberation Day,” but domestically, recent investment data suggest economic troubles ahead.

China was functionally the only country to put up a successful fight against US trade measures after Donald Trump took office in January. Beijing went tit-for-tat and also escalated, using its chokehold on the global supply of rare earth elements (REEs), needed for producing most electronics from TVs and smartphones to fighter jets and radar systems. This forced the US to the negotiating table to strike a deal that provided exactly what China needs – time for its efforts to become self-reliant from foreign technology.

Moreover, China saw its export volumes grow despite the trade war, with other global markets absorbing its production. This ability to withstand external pressure even from Washington has bolstered Beijing's confidence on the international stage, and China is likely to wave its new rare earth controls anytime someone threatens its economic interests – such as the EU derisking agenda. It will project that confidence globally in 2026.

But domestically, the economic outlook is not nearly as positive. Fixed asset investment (FAI) – a key engine of growth in China's economic model – started blinking red in the second half of 2025, slumping 12 percent year on year through October. The decline in infrastructure and manufacturing fixed asset investment (FAI) is especially troubling as both have been central to China's economic miracle. And, excluding the pandemic years, both have plummeted to historic two-decade lows.

There are several possible explanations for this. Officials may have slashed FAI, or purposely underreported it, in alignment with party directives to reduce industrial overproduction. But this account has a major contradiction: Areas that were meant to see less investment, such as the automotive sector, have seen increases, while signs of slowing FAI in other areas were already present before the policy shift.

The other – and potentially more concerning – explanation is the crisis brewing in local public finances. Historically, local officials have played a central role in driving investment, as well as in steering private finance. But due to the property crisis, banking sector issues, and declining manufacturing profits – all traditional sources of revenue – local finances have come under strain. This is most clearly visible in the debt data. Most bonds issued by local governments in 2025 have been for refinancing purposes, rather than investment. At the same time, borrowing costs have skyrocketed. Without further debt relief, this means that investment will continue to slow, and growth will cool.

“Overseas, Beijing has a lot to brag about as its confident outplaying of the US tariffs left China in a globally unique position to have fended off Washington, while wielding its rare earth export controls to deter anyone else from acting against China's

*interests. But at home, economic trouble is brewing as China's investment collapse signals that headwinds are taking their toll."*

**Jacob Gunter**, Head of Program – Economy and Industry

**Media coverage and sources:**

- The Economist: [Why China is winning the trade war](#)
- Financial Times: [Fall in Chinese investment suggests Xi Jinping's 'anti-involution' drive is biting](#)
- Yahoo finance: [Taking a deeper look at China's investment downturn](#)

## INTERNATIONAL RELATIONS

### Brussels likely to find itself sidelined in 2026 in face of "G2" truce

Donald Trump's impulsiveness makes US-China relations difficult to predict, putting Europe in a tough spot. If the conflict flares up again, Europe will be stuck in the middle of what the US President calls the "G2". If the truce holds and Xi and Trump broker further deals, Brussels will again find itself on the sidelines while decisions affecting European interests are negotiated by others.

Europe's declining relevance in Chinese foreign-policy thinking means Brussels should prepare for a China unwilling to offer meaningful concessions. Nowhere is this clearer than in the China-Russia partnership, a relationship of critical importance for Europe in the context of Russia's war on Ukraine. China will continue to stand by Moscow and be reluctant to apply pressure to facilitate a just peace. On Taiwan, Beijing will continue on its chosen path of military pressure and intimidation with little regard for other countries' apprehensions, emboldened by its global leverage over critical mineral supply chains.

At the same time, China will increase its global activism. Exploiting gaps created by the Trump administration, such as the US absence from the G20 summit in Johannesburg, China will try to cement its image as a responsible and reliable great power, in contrast to Washington. In 2025, Beijing already celebrated several major diplomatic wins, from a new round of BRICS expansion to holding the largest and most ostentatious Shanghai Cooperation Organization summit to date.

Europe, meanwhile, has been busy with its own problems such as the war in Ukraine, sluggish growth, and political fragmentation. Its alignment with Washington is widely seen as constraining its China relations. Barring decisive action, in 2026, Europe will struggle to assert its global relevance while Beijing attracts an expanding circle of partners interested in deepening their engagement with this pivotal actor – for reasons such as geopolitical alignment, economic interests, opportunism, or simply dissatisfaction with other major powers.

“Europe must prepare itself for a demanding year ahead. It should deepen and diversify international partnerships beyond the transatlantic relationship, defend its

*economic security, and build the resilience needed to withstand pressure from all major powers. Only through a unified effort can European countries push back against China's rising assertiveness and safeguard their interests vis-à-vis Beijing and other international actors."*

**Eva Seiwert**, Senior Analyst at MERICS

**Media coverage and sources:**

- Nikkei Asia: [Trump's 'G2' revival sparks anxiety in Washington and Asia](#)
- MERICS: [MERICS Europe-China Resilience Audit](#)
- The Shanghai Cooperation Organisation: [25th Council of Heads of SCO Member States and the SCO plus in Tianjin](#)
- Carnegie Endowment for International Peace: [BRICS Expansion and the Future of World Order: Perspectives from Member States, Partners, and Aspirants](#)

## SCIENCE, TECHNOLOGY AND INNOVATION

### China bets on AI to drive its economy, but tech exports may meet resistance

China has placed high hopes on AI technology to boost its export-driven economy, and in 2026 will be counting on its companies to sell more high-end goods overseas – even as a backlash begins to form. Beijing's sweeping "AI+" initiative aims to integrate AI across its economy, so that areas like manufacturing, energy, finance, healthcare, governance can offer more advanced, higher quality and even entirely new products or services. The recently launched initiative is supported not only by government policy and state funding, but also by private sector, which is betting big on domestic companies in response to Beijing's directives promoting home-grown technological solutions.

China has for many years successfully moved up the value chain, transitioning from low-cost manufacturing to higher value-added exports like electric vehicles, solar equipment, and lithium-ion batteries. While it continues to compete with the US in AI development, its growing presence in open-source AI models and robots suggests new export drivers.

But Europe is showing growing resistance to China's ambitions to export ever more high-tech products. China's dominant 5G network-equipment makers have once again come under the scrutiny of European governments. Finland and Germany are both looking to tighten restrictions on equipment used in critical infrastructure – and German Chancellor Friedrich Merz has said Chinese components will not be allowed in the country's 6G networks. Cybersecurity concerns are also casting a shadow over connected vehicles, one of China's flagship export products. Norwegian authorities flagged that their fleet of Chinese-made busses can be vulnerable to digital deactivation and hacking.

European governments are becoming more vigilant about protecting key technology companies. The Dutch government briefly took control of Netherlands-based Nexperia over concerns that its Chinese corporate owner was planning to move production and key

intellectual property to China – a move that would have threatened chip supplies vital to European industry. The EU is now pushing for Chinese companies looking to invest in European countries to bring technology and meet local content requirements, rather than simply assembling Chinese-made parts.

“China is moving full force on AI diffusion across its economy, with the goal of upgrading manufacturing and creating new AI-driven products it can sell abroad. But this export-based model is meeting resistance from Europe, which is increasingly focused on its digital sovereignty and protecting European businesses from Chinese competition. Growing scrutiny of cybersecurity and competitive practices will make exporting AI an increasingly uphill battle.”

**Wendy Chang**, Senior Analyst at MERICS

#### Media coverage and sources:

- MERICS: [China's "AI+" drive aims for integration across sectors: a wake-up call for Europe](#)
- Gov.cn (CN): [国务院关于深入实施“人工智能+”行动的意见](#) (Opinions of the State Council on deepening implementation of the “Artificial Intelligence+” action)
- Heise: [Chancellor Merz: "Will not allow components from China in 6G network"](#)
- BBC: [Dutch government suspends intervention into chipmaker Nexperia](#)

## POLITICS AND SOCIETY

### Citizens face growing hardship as Beijing's industrial priorities trump welfare

The Chinese state's rhetorical balancing act between boosting welfare and supporting industry will in practice once again tip heavily in favor of industry in 2026. The draft outline of the 15<sup>th</sup> five-year plan (5YP), which the National People's Congress is set to vote on next March, will reference socio-economic issues such as slowing growth and a difficult job market, and pledge to “put the people first” as a guiding principle for government. But instead of prioritizing steps to increase household incomes or bolster the welfare system, the government's policy focus will remain on supporting strategic industries, hand-picked technologies and domestic industrial capacity to achieve self-reliance and supply-chain dominance – seemingly at any cost to its citizens.

For ordinary Chinese, the picture in 2026 looks challenging as a result. As economic growth slows and public finances become more strained, the Chinese Communist Party's promise of common prosperity hinges on the success of industrial policies. The real estate slump has steadily eroded middle-class wealth since 2021, as many urban families tied up significant savings in apartments that have now lost value. At the same time, youth unemployment remains high at around 17 percent – and more than 12 million new graduates are expected to enter the employment market in the summer of 2026 in an economy that has recently created fewer than 11 million new positions a year.

Dissatisfaction among young people is mounting, and the precarious gig economy – which already employs over 200 million urban workers, or 40% of the urban labor force – offers workers little stability or security. In this environment, Beijing's intense focus on technology and industrial capacity means taking away resources from welfare programs that are meant to support a large and growing precariat, including among China's urban middle class. If the party's bet on industry-driven growth fails to generate sufficient economic growth to boost personal wealth, it risks undermining its own ambition of serving the people and leaving many Chinese to shoulder the costs.

“Despite its socialist roots and rhetoric, the CCP's focus on strategic industries prevents it from redistributing wealth in any meaningful way. The promise of common prosperity hinges on the success of China's industrial modernization and technological innovation to create enough jobs.”

**Nis Grünberg**, Lead Analyst at MERICS

#### Media coverage and sources:

- Reuters: [China's new home prices fall at fastest pace in 11 months](#)
- SCMP: [China braces for record 12.7 million graduates entering tight job market in 2026](#)
- The Strait Times: [China can't afford to ignore its army of gig workers](#)

## METRIX

# 12 vs. 15

This is the number of Five-Year Plans (FYPs) the Soviet Union implemented before its demise in 1991, compared with the number the People's Republic of China (PRC) will soon have embarked upon. The USSR collapsed before it could draft a 13<sup>th</sup> economic and social development blueprint, while China's National People's Congress is scheduled to adopt the 15<sup>th</sup> round of multi-year national policy priorities in March. Xi Jinping became leader of the Chinese Communist Party in 2012, one year into the country's 12<sup>th</sup> FYP, a historical milestone of which he seemed keenly aware. In some of his earliest speeches he emphasized the need to avoid the fate of the USSR, which had succumbed to “ideological chaos” through “historical nihilism” – “the complete denial” of Soviet history and that of its Communist Party. While the USSR ended just under a year after the end of its 12<sup>th</sup> FYP, the PRC will soon have outlived its dozenth by a decade. (Source: [Yibao](#))

## MERICS CHINA DIGEST

### [Xi and Trump hold phone call and agree to meet in Beijing in April \(NY Times\)](#)

President Trump said on Monday that he had accepted an invitation from president Xi Jinping to visit Beijing in April. Both leaders discussed several major issues, including Taiwan, the Ukraine war and trade issues, according to separate official accounts of their call. In an unusual move, the call was initiated by Xi, reports the New York Times. (25/11/24)

### [Japan and China send letters to UN chief in diplomatic spat \(Kyodo Times\)](#)

Japan's Ambassador to the UN, Kazuyuki Yamazaki, sent a letter to Secretary General Antonio Guterres on Monday rebutting a Chinese request that Prime Minister Sanae Takaichi retract remarks on a Taiwan contingency. Takaichi had answered to parliamentary questions that a military attack on Taiwan could present a "survival-threatening situation" for Japan, which was met with protests from China including warnings against travel and studying in Japan. (25/11/25)

### [German foreign minister might travel to China before the end of the year \(Reuters\)](#)

After the visit of vice-chancellor and finance minister Lars Klingbeil to Beijing on November 17 and 18, foreign minister Johann Wadephul might follow before the end of the year, he said at a policy forum in Berlin on Tuesday. Wadephul was originally due in the Chinese capital in late October, but he cancelled at the last minute after the Chinese agreed to just one of his meeting requests. The rescheduled trip might also be used to prepare a planned trip by chancellor Merz to China in the first weeks of 2026. (25/11/25)

### [China warns citizens risk becoming 'mining slaves' in CAR gold rush \(Reuters\)](#)

China's embassy in the Central African Republic (CAR) has warned its citizens risk becoming "mining slaves" in the politically unstable nation's gold trade, as Chinese workers look to sub-Saharan Africa as jobs in China's gig economy dry up. Chinese nationals have been killed or kidnapped by armed groups and even their supposed business partners, while others were scammed out of large sums of money and deported for illegally mining, the embassy said in a statement on Thursday. (25/11/21)

### [Taiwan to distribute security handbook to all households as China threat rises \(Straits Times\)](#)

The handbook, unveiled in September, provides guidance on locating bomb shelters and preparing emergency kits. It also includes, for the first time, instructions on what to do if citizens encounter enemy soldiers, and stresses that any claims of Taiwan's surrender should be considered false. (25/11/17)

### [European Commission ramps up pressure on Shein \(Reuters\)](#)

The Commission ramped up pressure on China's Shein on Wednesday, saying the online platform might pose a "systemic risk" for consumers and demanding more information from the company after illegal items, including childlike sex dolls and banned weapons, were found for sale on its marketplace. The development taints the launch of Shein's first permanent shop within Paris department store BHV. (25/11/26)

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