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China runs up against the limits of growth

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Beijing is leaning ever more heavily on exports

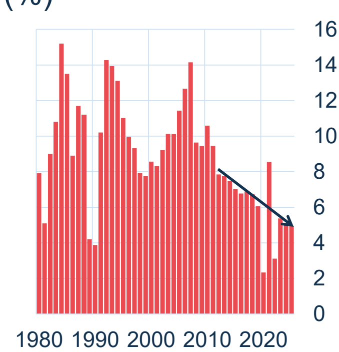
Credit where credit is due: few countries in modern economic history have grown as fast as China. Since 1980, China's economy has expanded by an average of nearly 9% a year. Yet the sources of its seemingly endless growth are beginning to run dry. The causes include grim demographics, overinvestment and heavy debt – public and private alike.

LBBW Research is especially skeptical about Chinese growth forecasts. We take some pride in that. Unlike many other forecasters, we put little faith in the official GDP figures. Under Xi Jinping in particular, the economy has looked strangely free of volatility – except during the pandemic years (see fig. 1). The growth target is usually met bang on, give or take a decimal here or there. That the growth estimates are already released in [January] and typically not revised does not instill me with a lot of confidence.

Diminishing returns on investment

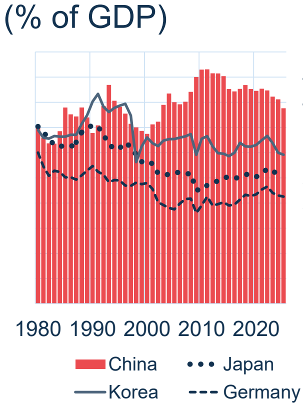
Let me explain why I suspect China is growing more slowly than Beijing claims. Since the global financial crisis, Chinese growth has rested on investment running at nearly 40% of GDP (see fig. 2). Anyone who visits China will see that much of the country is strikingly modern – not least its infrastructure. But it is equally clear that some of this was overdone: investment in homebuilding has proved excessive. The real estate sector has been in crisis for almost five years. Beyond housing, too, the signs point to saturation. China could of course still build a high-speed railway through Tibet. The growth impact of such an endeavor would be minimal, though. The low hanging investment fruits have been picked already.

Fig. 1: GDP growth China (%)



Source: IMF, LBBW Research

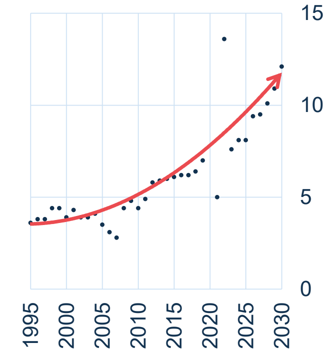
Fig. 2: Investment (% of GDP)



Source: IMF, LBBW Research

Fig. 3 shows how much China must invest, as a share of GDP, to generate one percentage point of growth. This is what economists call the incremental capital-output ratio, or ICOR. A low figure would be desirable: it would suggest that even relatively modest investment can lift the economy. In fact, the opposite is true. It now takes almost three times as much investment as it did 30 years ago to generate one percentage point of growth in China. The country's investment-driven model has reached its limits. Whether the money now pouring into AI can change that – and when – remains uncertain.

Fig. 3: Investment as a Share of GDP divided by GDP growth

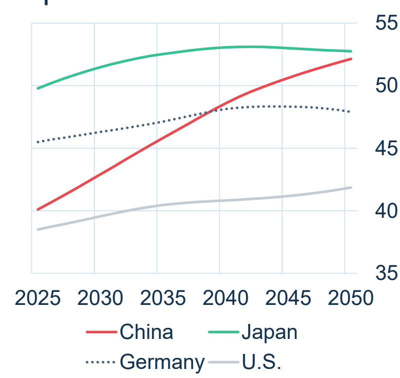


Source: IMF, LBBW Research

Consumer spending is faltering

Retail sales, too, stalled in the spring only to recover to a meagre yearly growth of 1 % in June. That is hardly surprising. Two generations of the "one-child policy" have left their mark. Nowhere in the developed world is the population aging as quickly as in China (see fig. 4). By comparison, Germany's demographic outlook looks almost benign. And because there is no reliable state pension system, the Chinese save prodigiously for retirement. The older the population becomes, the more people feel the need to hang on to their money. A consumer boom is unlikely to follow. China's retirement age is also much lower than in many developed economies: 60 for men and as low as 55 for women, with retirement ages due to rise gradually by a total of just three years over the next 15 years.

Fig. 4: Median Age Population



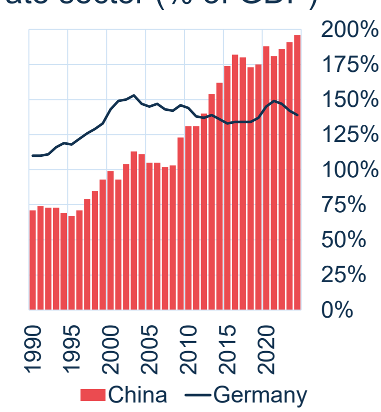
Source: UN, LBBW Research

Nor can Chinese savers simply put their money into a BlackRock ETF or one run by LBBW Asset Management. Their choices are largely confined to low-yielding bank deposits, a lackluster stock market or real estate. Real estate, meanwhile, has saddled many with losses. With youth unemployment at almost 16%, young people are hardly in a spending mood either.

Debt, debt, debt …

Debt financed much of China's investment boom. Successive rounds of fiscal stimulus have also been financed with borrowed money. Corporate debt in China, as a share of GDP (see fig. 5), has almost doubled since the financial crisis. Total debt – households, companies and the state – is around 300% of GDP. That, too, is close to double the level of 20 years ago. It is not sustainable. Yet China mostly owes the money to itself. Its net external debt position is essentially zero. That makes the problem easier to manage. A balance-of-payments crisis is not on the horizon.

Fig. 5: Indebtedness corporate sector (% of GDP)



Source: Federal Reserve Bank of St. Louis, IMF, LBBW Research

Exports as a last resort, at least for now

With investment and consumer spending stagnant, it is no surprise that Beijing is now leaning heavily on exports. China's trade surpluses speak for themselves. In 2024 and 2025, they rose by more than 20%. But importing countries – especially the U.S. and the EU – are pushing back against the tide of subsidized imports. So it is probably only a matter of time before even this last outlet for growth will considerably narrow, too.

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