

China: caught between resilience, fragility and innovation

After a tense few months, China's Xi Jinping could be forgiven for feeling more positive. Having just hosted 'new world order' leaders, showcased China's military might to the world, and seen local stock markets rally strongly, the tariff dispute of the spring has been delayed and overshadowed. But is China – not long ago dubbed 'uninvestible' – really on the ascendant again, both domestically and diplomatically?

By Naomi Waistell

A recent trip to China revealed a country in transition, caught between resilience, fragility and innovation.

Two-tier economy

China was once the darling of the emerging world. High GDP growth and a burgeoning equity market were built on the foundation of a booming property market. But a return to these days feels unlikely. After the property market collapse, Xi's 'whatever it takes' moment in Autumn 2024 initially boosted sentiment,

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but the feed-through to the real economy has been slow. The central government remains cautious and reactive, while local governments, burdened with debt, struggle to implement directives fully. The economy, heavily reliant on exports, may even face a tougher end to the year as the surge in trade demands (to avoid tariffs) ebbs.

As a result, a two-speed economy is emerging. Exports and manufacturing support the economy, but domestic consumption remains a challenge. Income levels must rise, social protection needs strengthening, and productive employment should be promoted. Progress is slow, consumer confidence is weak, and an uneven recovery is taking shape.

The largest cities show signs

of vitality while lower-tier cities remain stagnant. Below the top 20-30 cities we are unlikely to see a recovery in the near term. In the cities we travelled to, the scale of the over-build and presence of buildings sitting empty, unfinished and deserted was inescapable. Anecdotally, when we ate in restaurants, we were often the only table, and the taxi drivers we spoke to were former Goldman Sachs and Intertek employees.

At 30% of global manufacturing capacity and 18% of global population, but just 13% of global consumption, the over-capacity remains striking.¹ Encouragingly, since returning from the trip, the government is showing the first signs of intent to rationalise the supply excesses, vowing to fight so-called 'involution'. We expect pressure for

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further stimulus to rise in the coming months.

Trump makes China great again

China’s story cannot be read in isolation. It is inextricably linked with the US, and with the world.

While the trade war is not yet resolved, we think the likelihood of a complete relationship breakdown is extremely remote. China has too many cards in its hand, and decades of diversification mean it’s less reliant on the US. The transformation in trade patterns has been remarkable. At the turn of the millennium, the US was the largest trade partner for 80% of emerging markets. Across the intervening 25 years this has almost completely reversed, and China is now the key trade partner for 65% of emerging markets.

Jokes that ‘Trump is making China great again’ are commonplace on the ground. Many see his trade war as a political gift, creating a scapegoat for China’s economic woes. Preference for domestic goods is rising among China’s youth – potentially signaling an internal confidence that could be important for the next phase of recovery.

Innovation nation

Despite the economic headwinds, there are encouraging signals.

China is sharpening its focus on science and technology. Low-end production has largely migrated to Southeast Asia, while China has moved up the value chain. It now dominates the renewable energy supply chain and produces most of the world’s electric vehicles.

The DeepSeek breakthrough earlier this year reminded the world of the country’s capacity to surprise. The US may still lead in artificial intelligence and humanoid robotics, but China is catching up quickly. There is something of an irony in the fact that China, long being dubbed ‘the factory of the world’, will have more applications for this kind of labour replacement and far greater installed capacity for training.

And with self-sufficiency top of mind, similar advancements are seen in healthcare and technology, while unproductive capacity in older industries is being closed. In this field China really can achieve global firsts and in certain niches carve out superior solutions. These are the kinds of opportunities we look for.

At the same time, the Hong Kong market is enjoying a renaissance. Restrictions on mainland Chinese IPOs remain, and an increasing ‘anything but America’ trade and improved liquidity has seen

international capital return. A wave of innovative IPOs has helped narrow the premium between the mainland ‘A’ share and Hong Kong ‘H’ share market to a level not seen in five years. This is in part owed to renewed foreign investor demand for quality Chinese companies, but more significantly due to exceptional strength in southbound connect flows as local Chinese investors diversify.

Selectivity is essential

For investors, this environment presents both challenges and opportunities.

Some of the market’s recent performances may have run too far, but long-term, structural opportunities remain.

Attractive themes include AI enablers, automation, the experience economy, wellness, and future mobility. But with valuations starting to look stretched, we are more cognisant than ever of being discerning about both quality and price paid.

Away from innovation, a second area offers appeal: mispriced, high-yield companies which can offer resilience in the face of economic headwinds. Dividends are attractive and buybacks in the Chinese market are at all-time highs.

With economic struggles and a still unresolved trade war, stability, rather than rapid growth, is set to define China’s trajectory. But for careful stock-pickers, this might just be enough. ■



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SUMMARY

Xi Jinping projects strength after recent tensions, yet China remains between resilience, fragility, and innovation.

Property slump lingers. Exports and manufacturing support growth, but consumption and lower-tier cities stagnate.

The US trade war offers China political cover. Global trade links now favour Beijing.

Innovation advances in EVs, renewables, AI, and healthcare, while Hong Kong regains momentum.

Investors should focus on selective opportunities – AI, automation, wellness, mobility, and resilient high-yield firms. Stability, not rapid growth, defines outlook.

¹ Sources: Bloomberg, EM Advisors Group, Goldman Sachs, CSLA, July 2025.