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The Wind Beneath China's Wings: New Productive Forces

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SYNOPSIS

China is shifting from a real estate-driven economy to an innovation-based model under Xi Jinping. By channelling savings into stock markets, fostering competition, and investing in high-tech industries like AI and EVs, China aims for technological self-sufficiency, financial stability, and global leadership in an era of economic transformation and geopolitical competition.

COMMENTARY

A Strategic Pivot in China's Economic Model

China's economy is undergoing a profound transformation under President Xi Jinping's leadership, shifting away from an investment-driven growth model that relied heavily on real estate speculation toward a sustainable, high-tech, and innovation-based economy. This transition is a response to structural challenges such as an ageing population, geopolitical pressures, and economic resilience concerns. The goal is to position China as a global leader in key strategic industries, including electric vehicles (EVs), renewable energy, artificial intelligence (AI), and quantum computing.

At the core of this transformation is the redirection of China's massive savings into reformed stock markets and long-term industrial upgrading – what Xi calls "patient capital". The shift represents a significant evolution of China's social contract, moving beyond a simple growth-for-stability model toward self-sufficiency and technological advancement. By reforming China's financial system to fund high-tech growth, encouraging public-private collaboration to foster innovation, adopting market-driven competition to create globally competitive firms, and strengthening national self-reliance in critical technologies, Xi's vision marks a fundamental reorientation of China's economic trajectory.

The Real Estate Bubble and Its Aftermath

For decades, China's property market served as the primary engine of economic growth and household wealth accumulation. However, excessive speculation and overinvestment led to a property bubble that peaked in 2022, triggering a prolonged economic slowdown. China's economic overreliance on real estate resulted in local governments depending heavily on land sales for revenue, banks extending massive loans to developers and homebuyers, and households investing the majority of their savings in property. The bloated real estate sector absorbed excessive financial resources at the expense of more productive industries.

To break this cycle of real estate-fuelled booms and busts, the Chinese government is reforming its stock markets to become the primary funding source for economic development. This shift aims to channel household savings into productive investments, support high-tech enterprises and industrial innovation, and develop institutional investors to stabilise financial markets. Modelled after the financial systems of developed economies such as the United States, this stock market-driven approach fosters long-term, sustainable growth by moving investment from speculative assets to industries of strategic importance.

Public-Private Collaboration: Innovation Consortia and Industrial Growth

China's industrial strategy now focuses on state-guided, market-driven competition. This hybrid approach combines government support with fierce private-sector competition to create globally dominant firms. Industry-specific innovation consortia have been formed in key sectors such as EV production, battery technology, and renewable energy, enabling Chinese firms to become global leaders. Investments in quantum computing, semiconductor independence, and AI-driven automation are accelerating, while China's dominance in solar panel production, battery manufacturing, and wind energy is reshaping global energy markets.

President Xi has emphasised "high-quality development" as the guiding principle of China's future economic policy. The term was used 128 times in 2023 alone, double its frequency in previous years, reflecting a strategic shift toward technological excellence, sustainable growth, and global competitiveness. By aligning private sector dynamism with state-defined priorities, China is building an industrial ecosystem that fosters innovation and ensures long-term economic resilience.

Competitive Darwinism: Nurturing Global Champions

China's new industrial policy moves away from the old model of heavily subsidised state-owned enterprises toward a Silicon Valley-style approach that fosters competition and creative destruction. This approach, often referred to as the "Crouching Tiger" model, initially supports hundreds of companies in key sectors with state resources. As competition intensifies, weaker firms either fail or consolidate, leaving only the strongest survivors. The final winners emerge as global champions capable of competing on the world stage.

This Darwinian competition is already evident in China's EV sector. In 2019, China had over 500 EV companies; by 2024, only 50 remain, with further consolidation expected. Unlike previous industrial policies that selected winners in advance, this approach ensures that only the most innovative and competitive firms receive government backing for global expansion. The strategy is expected to be applied across various advanced manufacturing industries, further enhancing China's technological leadership.

China vs US: The Multi-Domain Tech Race

Between 2025 and 2050, the US-China technological competition will define economic, military, and geopolitical power. This strategic contest spans artificial intelligence (AI), semiconductors, quantum computing, 5G and 6G communications, biotechnology, genomics, autonomous systems such as drones and robotics, and space infrastructure.

China is already a global leader in telecommunications (Huawei), drones and unmanned aerial vehicles (DJI), solar panels and battery technology, and high-speed rail. By investing heavily in research and development (R&D), China aims to close the gap in pharmaceuticals, machine tools, and robotics. This multi-domain competition will shape global power dynamics for decades as both China and the US seek dominance in these transformative industries.

The Stock Market as a Pillar of Economic Strategy

Historically, China's households invested heavily in real estate. However, housing market instability prompted a shift toward equity investment as a more sustainable wealth accumulation method. To facilitate this transition, Beijing is implementing a series of financial reforms. Strengthening investor protection and market regulation is a key priority aimed at reducing market manipulation and speculative excess. Encouraging exchange-traded funds (ETFs) will help stabilise investment behaviour.

Institutional investment, often referred to as "patient capital", is also being promoted. Pension funds, insurance firms, and sovereign wealth funds are now encouraged to invest in China's stock markets to provide long-term financial stability. The government is also working toward developing a slow and steady bull market, avoiding the volatility of past boom-and-bust cycles. Additionally, China is addressing its pension system shortfall by expanding pension fund allocations to domestic equities. While pension funds in Canada and Japan allocate 50-60 per cent of their portfolios to equities, China's pension funds currently invest only 10-20 per cent. Increasing this allocation will provide stable, long-term capital to support high-tech and industrial development.

Beijing's Fiscal Stimulus and Global Financial Strategy

China's stimulus policies aim to balance short-term economic challenges with long-term sustainability. The government has initiated debt restructuring for local governments to reduce financial burdens, issued special bonds to revive the real estate sector without excessive speculation, and injected capital into state-owned banks to ensure credit expansion.

Despite global scepticism, China's relatively low central government debt provides significant fiscal flexibility compared to heavily indebted Western economies. This financial resilience allows China to implement targeted economic reforms and sustain long-term growth while adapting to shifting global economic conditions.

Conclusion: China's New Economic Trajectory

China's economic transformation represents a bold redefinition of its growth model. It is transitioning from speculation to innovation, from debt-fuelled property markets to equity-driven industrial expansion, and from state-subsidised enterprises to competitive global champions. By embracing financial reform, leveraging its vast domestic market, and harnessing technological advances, China is shaping a new model of economic resilience.

As China and the US engage in an intense technological rivalry, the real battleground will be innovation, competitiveness, and industrial leadership. The outcome of this contest will define global economic power for decades to come. Through strategic state-market collaboration and an emphasis on high-quality development, China is positioning itself to lead in the industries of the future, ensuring its long-term prosperity in an increasingly competitive world.

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