



ROSA & ROUBINI
ASSOCIATES

MACRO PICTURE

**China Shock 2.0:
Drivers, Industrial Ascendancy
and Global Conflict**

By
Nato Balavadze



2 September 2026

Nato Balavadze

China Shock 2.0: Drivers, Industrial Ascendancy and Global Conflict

2 September 2026

Table of Contents

	Page	Page 2
Executive Summary	3	
Introduction.....	4	
What Is Driving China Shock 2.0?.....	4	
China Shock 1.0 vs China Shock 2.0.....	5	
Germany at the Centre of China Shock 2.0.....	6	
Overcapacity or Industrial Competitiveness?	6	
The US and Federal Reserve View of China Shock 2.0.....	7	
Conclusion.....	8	



Rosa & Roubini Associates Ltd is a private limited company registered in England and Wales (Registration number: 10975116) with registered office at 75 King William Street, London EC4N 7BE, United Kingdom.

For information about Rosa&Roubini Associates, please send an email to info@rosa-roubini-associates.com or call +44 (0)20 7101 0718.

Analyst Certification: I, Nato Balavadze, hereby certify that all the views expressed in this report reflect my personal opinion, which has not been influenced by considerations of Rosa & Roubini Associates' business, nor by personal or client relationships. I also certify that no part of my compensation was, is or will be, directly or indirectly, related to the views expressed in this report.

Disclaimer: All material presented in this report is provided by Rosa & Roubini Associates-Limited for informational purposes only and is not to be used or considered as an offer or a solicitation to sell or to buy, or subscribe for securities, investment products or other financial instruments. Rosa & Roubini Associates Limited does not conduct "investment research" as defined in the FCA Conduct of Business Sourcebook (COBS) section 12 nor does it provide "advice about securities" as defined in the Regulation of Investment Advisors by the US SEC. Rosa & Roubini Associates Limited is not regulated by the FCA, SEC or by any other regulatory body. Nothing in this report shall be deemed to constitute financial or other professional advice in any way, and under no circumstances shall we be liable for any direct or indirect losses, costs or expenses nor for any loss of profit that results from the content of this report or any material in it or website links or references embedded within it. The price and value of financial instruments, securities and investment products referred to in this research and the income from them may fluctuate. Past performance and forecasts should not be treated as a reliable guide of future performance or results; future returns are not guaranteed; and a loss of original capital may occur. This research is based on current public information that Rosa & Roubini Associates considers reliable, but we do not represent it is accurate or complete, and it should not be relied on as such. Rosa & Roubini Associates, its contributors, partners and employees make no representation about the completeness or accuracy of the data, calculations, information or opinions contained in this report. Rosa & Roubini Associates has an internal policy designed to minimize the risk of receiving or misusing confidential or potentially material non-public information. We seek to update our research as appropriate, but the large majority of reports are published at irregular intervals as appropriate in the author's judgment. The information, opinions, estimates and forecasts contained herein are as of the date hereof and may be changed without prior notification. This research is for our clients only and is disseminated and available to all clients simultaneously through electronic publication. Rosa & Roubini Associates is not responsible for the redistribution of our research by third party aggregators. This report is not directed to you if Rosa & Roubini Associates is barred from doing so in your jurisdiction. This report and its content cannot be copied, redistributed or reproduced in part or whole without Rosa & Roubini Associates' written permission.

Nato Balavadze

China Shock 2.0: Drivers, Industrial Ascendancy and Global Conflict

2 September 2026

Page | 3

Executive Summary

China Shock 2.0: Drivers and Growing Trade Tensions

- ✦ China is increasingly relying on exports to offset weak domestic demand, with export volumes up over 40% since the pandemic and another trillion-dollar-plus surplus expected in 2026.
- ✦ The surge reflects weak consumption, high savings and manufacturing-focused industrial policy, while the role of renminbi undervaluation remains contested.
- ✦ China Shock 2.0 combines macroeconomic imbalances with genuine industrial upgrading, intensifying competition and protectionist responses abroad.

China Shock 1.0 vs China Shock 2.0

- ✦ China Shock 1.0 reflected China's rise as a low-cost manufacturing hub, disrupting Western labour-intensive industries while creating growing Chinese demand for advanced manufactured goods and capital equipment.
- ✦ China Shock 2.0 reflects China's move into EVs, batteries, green technologies and advanced manufacturing while replacing more imports with domestic production, shifting the shock from the US towards Europe's advanced industrial base, particularly Germany.

Germany, Overcapacity and Industrial Competitiveness

- ✦ Germany benefited from the first China shock through strong Chinese demand for its cars, machinery and capital goods, but China is now competing directly in these industries, displacing German producers at home, in China and in third markets.
- ✦ The impact is already significant, with declining net exports dragging German GDP by around 3% since late 2023 and autos particularly exposed, while Germany now imports more capital goods from China than it exports there.
- ✦ China's export surge reflects not only excess capacity but also genuine industrial and technological upgrading, while European weaknesses such as high energy costs, slower adaptation and underinvestment have contributed to declining competitiveness.
- ✦ China Shock 2.0 therefore combines a demand shock from China's consumption-light, investment-heavy model with a competitiveness shock from China's industrial upgrading, suggesting Europe needs investment and capability-building alongside trade protection.

The US and Federal Reserve View

- ✦ The Fed sees China Shock 2.0 as a larger and more asymmetric shock, with rapidly expanding exports, limited import growth and greater technological self-sufficiency creating stronger adjustment pressures for trading partners.
- ✦ US authorities increasingly view state-supported excess capacity as a threat to the US industrial base, driving a shift towards tariffs, industrial policy, technological restrictions and supply-chain diversification.

Introduction

China is increasingly relying on exports to offset weak domestic demand, fuelling what Western policymakers describe as a second “China shock.” Since the pandemic, [Chinese export volumes have risen by more than 40%](#), while imports have barely increased. China is therefore increasingly contributing to its own growth through net exports while absorbing comparatively little demand from the rest of the world. The divergence has become particularly stark: [exports rose 24% year-on-year in July](#), pushing the trade surplus to \$113 billion and putting China on course for another trillion-dollar-plus surplus in 2026, while [GDP growth slowed to 4.3% in the second quarter](#) and retail sales remained subdued.

Page | 4

This imbalance reflects both weaknesses in China’s domestic growth model and Beijing’s long-standing emphasis on advanced manufacturing. Over the past decade, China has built dominant positions in sectors such as electric vehicles, batteries and solar technology. The resulting surge in manufactured exports, often described in the US and Europe as the product of subsidized excess capacity, has given rise to the concept of “China Shock 2.0,” intensifying concerns that Chinese competition is undercutting domestic producers and threatening industrial employment.

However, the new China shock cannot be understood simply as excess Chinese production being dumped onto foreign markets. It also reflects China’s rapid technological and industrial upgrading and the declining competitiveness of parts of Western manufacturing, particularly in Europe. China Shock 2.0 therefore combines a macroeconomic imbalance, weak domestic consumption alongside exceptionally strong manufacturing investment, with a profound shift in global industrial competitiveness.

What Is Driving China Shock 2.0?

Usual three structural factors are brought to explain China’s growing reliance on manufacturing and exports. First, China’s [exceptionally high savings](#) and weak household consumption constrain domestic demand. Previously, the property boom absorbed much of the country’s excess savings through investment. With the property sector now depressed, this mechanism has weakened, while precautionary household savings remain high. The result is an economy capable of producing substantially more manufactured goods than domestic consumption can readily absorb.

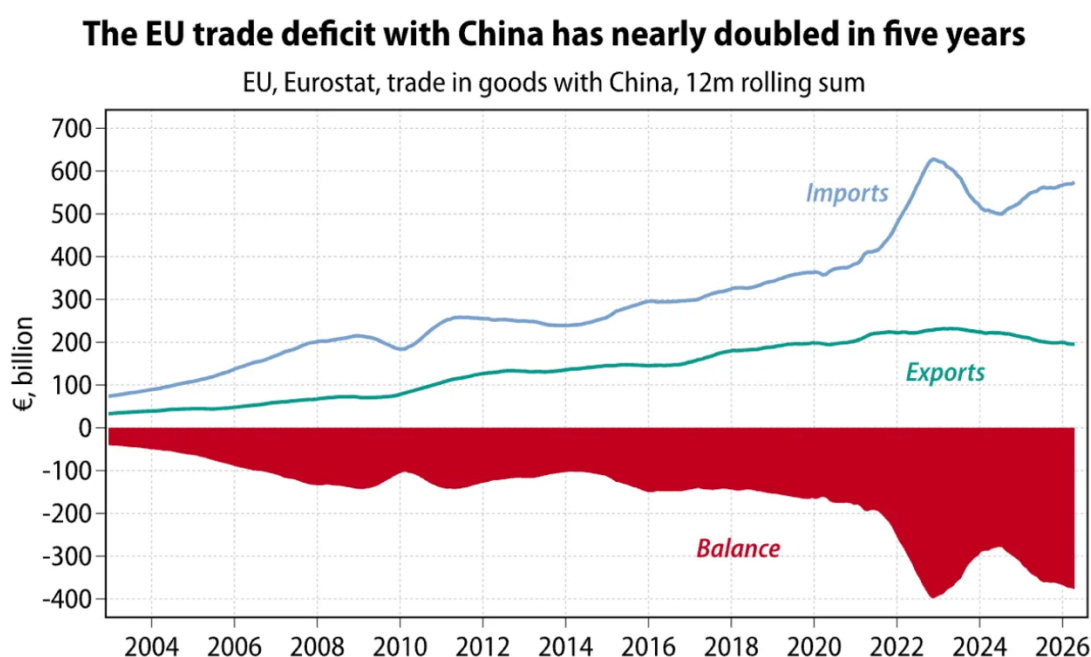
Second, rather than responding to this imbalance through a decisive shift towards consumption, Beijing has intensified its industrial policy. Subsidies, cheap credit, preferential access to land and other forms of state support have expanded productive capacity across strategic sectors, including semiconductors, machinery, cars and aircraft. [One IMF estimate cited by Tordoir and Setser](#) puts Chinese industrial subsidies at around 4.4% of GDP, or roughly \$800 billion annually. Competition among provincial and local governments to develop strategically important industries further reinforces investment and the expansion of productive capacity. On the other hand, industrial policy matters, but subsidies alone do not explain China’s success. China has developed technological, engineering and production capabilities at enormous scale.

A third potential driver is the exchange rate, although its importance is contested as well. In textbook terms, a persistent external surplus should generate currency appreciation, making exports more expensive and imports cheaper and thereby contributing to rebalancing. [Tordoir and Setser argue](#) that intervention by Chinese state banks has prevented this adjustment, citing an IMF estimate that the renminbi is undervalued by around 16% and suggesting that the true figure could be larger. China’s low inflation relative to Western economies has also contributed to real exchange-rate depreciation, potentially strengthening export competitiveness. However, this interpretation is disputed. [Guo Kai and Wang Jiankun find](#) little evidence that the sharp increase in China’s surplus with the EU reflects exchange-rate-driven price dumping: Chinese export unit values have been rising

and have broadly tracked those of Japan and South Korea. This suggests that the bilateral imbalance may owe more to shifts in sectoral competitiveness and European demand than to currency-driven price advantages.

Trade tensions have consequently intensified. Europe has responded with targeted tariffs and tighter regulatory requirements, while the US has increasingly resorted to protectionist measures. At home, however, Beijing has taken only modest steps to stimulate consumption or curb destructive price competition. Chinese firms are also adapting to the more protectionist external environment by expanding production abroad, allowing them to bypass trade barriers, maintain access to major consumer markets and reduce their exposure to geopolitical fragmentation.

Figure 1: The EU Trade Deficit with China



Source: [Economics Help](#)

China Shock 1.0 vs China Shock 2.0

China Shock 2.0 differs fundamentally from the original China shock. The first was largely a story of China's integration into the global economy as a low-cost manufacturing power. Chinese competition placed considerable pressure on Western producers in labour-intensive and relatively lower-technology industries, while China itself became an increasingly important market for sophisticated manufactured goods and capital equipment.

The second shock is different because China has moved substantially up the value chain. Its export expansion increasingly encompasses EVs, batteries, green technologies, chemicals, machinery and other advanced manufactured products. At the same time, China is increasingly replacing foreign manufactured imports with domestic production. The result is a more asymmetric relationship: China is becoming a larger competitor in sectors historically dominated by advanced economies while becoming less dependent on their manufactured exports.

This also changes the geographical distribution of the shock. China Shock 1.0 was felt particularly strongly in the United States. China Shock 2.0 is potentially more disruptive for Europe, and especially Germany, because it

increasingly targets the advanced manufacturing sectors at the centre of the European industrial model. It is therefore not simply a repetition of the American experience of the 2000s transplanted into 2026. The centre of gravity has shifted towards Europe's advanced industrial base.

Germany at the Centre of China Shock 2.0

Page | 6

Germany illustrates this transformation particularly clearly. The country actually benefited considerably from the first China shock. China's rapid industrialization generated enormous demand for German cars, chemicals, machinery and capital equipment, allowing German manufacturers to participate in and benefit from China's industrial expansion.

China Shock 2.0 reverses this relationship. [Germany specialized precisely in the industries into which China is now moving](#): cars, machinery, chemicals, electrical equipment, aircraft and clean technologies. German companies are therefore increasingly being displaced simultaneously inside the Chinese market, in third-country export markets and within Europe itself.

The deterioration is already visible in Germany's external position. [Tordoir and Setser estimate](#) that declining net exports have imposed a cumulative drag of around 3% of German GDP since late 2023, with industries most exposed to Chinese competition experiencing larger declines in production. [Vehicles have been particularly important](#): they accounted for around 60% of the \$27 billion deterioration in Germany's trade balance with China between 2021 and 2025.

Cars provide perhaps the clearest illustration of the emerging imbalance. [China has production capacity for around 55 million vehicles annually](#), equivalent to roughly 65% of global demand. This includes capacity for at least 25 million EVs, despite a domestic EV market only around half that size. At the same time, the US market remains largely closed to Chinese vehicles, while imports account for only around 2% of China's own car market. Chinese and European manufacturers are therefore competing intensely for much of the remaining global market.

The transformation extends well beyond automobiles. Since mid-2025, Germany has been buying more capital goods from China than China buys from Germany, a symbolic reversal of the economic relationship that characterized the first China shock. China is increasingly becoming a competitor in precisely the sophisticated capital goods that previously underpinned Germany's export relationship with the country.

Overcapacity or Industrial Competitiveness?

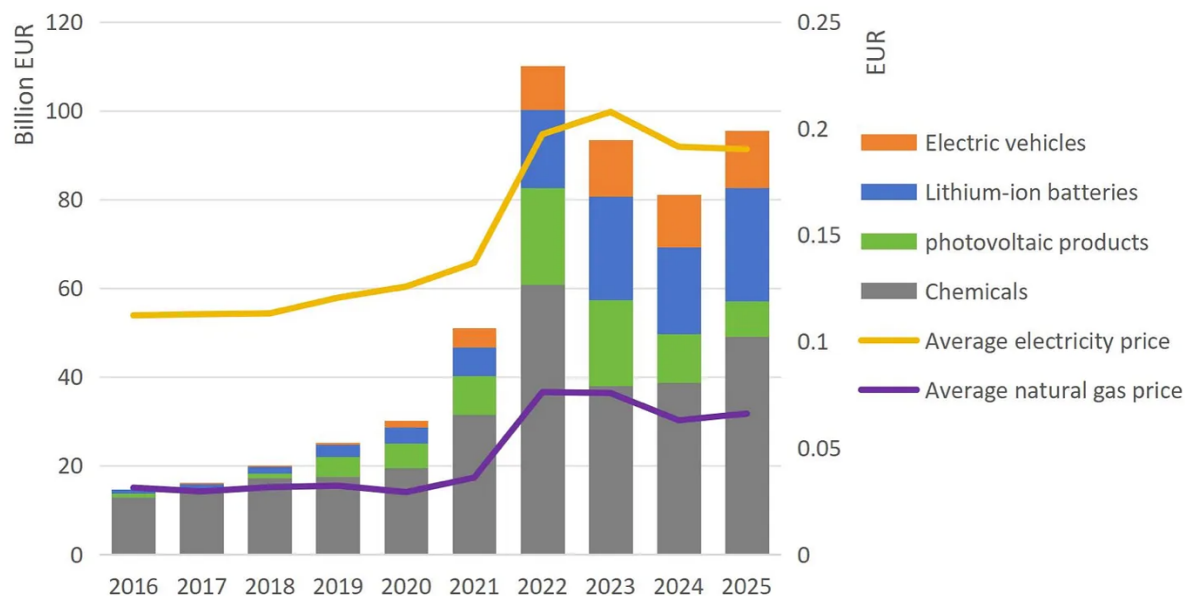
Yet attributing this transformation entirely to Chinese overcapacity risks overlooking an important part of the story. China's domestic imbalance undoubtedly contributes to its export orientation, but the sectoral export surge also reflects genuine improvements in Chinese industrial and technological capabilities, as well as weaknesses within European industry.

The sectors driving China's growing European surplus are not necessarily those experiencing collapsing domestic demand in China. Green-energy exports, for example, partly reflect strong European demand associated with the energy transition. Similarly, the expansion of Chinese chemical exports has coincided with a significant deterioration in the competitiveness of European chemical producers following the rise in European energy and particularly gas prices.

The automotive sector provides an even clearer example of the interaction between Chinese industrial upgrading and European weakness. Chinese industrial policy has undoubtedly played an important role in the

development of its EV industry. Yet state support alone does not fully explain the resulting competitive advantage. China has developed technological, engineering and manufacturing capabilities at enormous scale, while European producers have been slower to adapt.

Figure 2: China's Exports to the EU and Energy Prices



Source: [Eurostat](#), [CF40 Institute](#)

German corporate behaviour illustrates this contrast. [Even as Chinese EV competition intensified, Germany's three largest automakers distributed around €31 billion in dividends in 2023.](#) The contrast between sustained Chinese investment in productive and technological capabilities and large shareholder distributions by incumbent German producers suggests that European—and particularly German—industrial complacency is also part of the explanation.

China Shock 2.0 therefore tells us as much about Europe's industrial stagnation as it does about China's industrial rise. The distinction matters because the policy implications differ. If the problem is understood purely as subsidized Chinese overcapacity, tariffs and other trade defences appear to be the natural response. If the shock also reflects a genuine shift in industrial competitiveness, protection alone cannot restore Europe's position. It must be accompanied by investment, technological upgrading and the rebuilding of productive capabilities.

The two explanations are not mutually exclusive. China's consumption-light, investment-heavy economic model can generate substantial excess manufacturing capacity while its industrial policies simultaneously produce genuine technological and productive advantages. Europe can therefore face both a demand shock generated by China's macroeconomic imbalance and a competitiveness shock arising from China's industrial upgrading and Europe's own weaknesses. This interaction is what makes China Shock 2.0 substantially different from its predecessor.

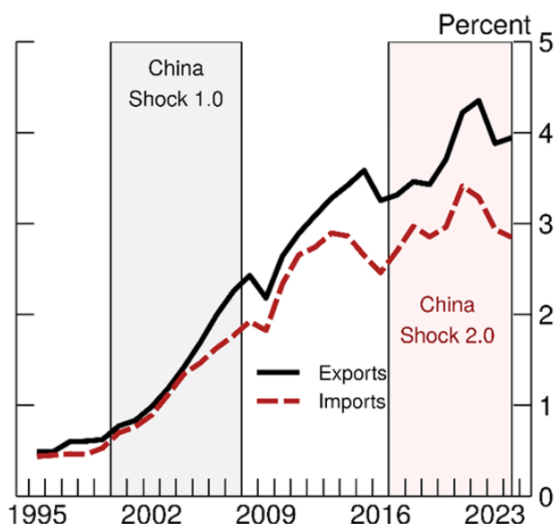
The US and Federal Reserve View of China Shock 2.0

[From the US perspective](#), "China Shock 2.0" differs significantly from the export surge following China's accession to the WTO. The first shock reflected China's integration into global production networks, with rising exports accompanied by growing imports of intermediate goods. Today, export expansion coincides with greater

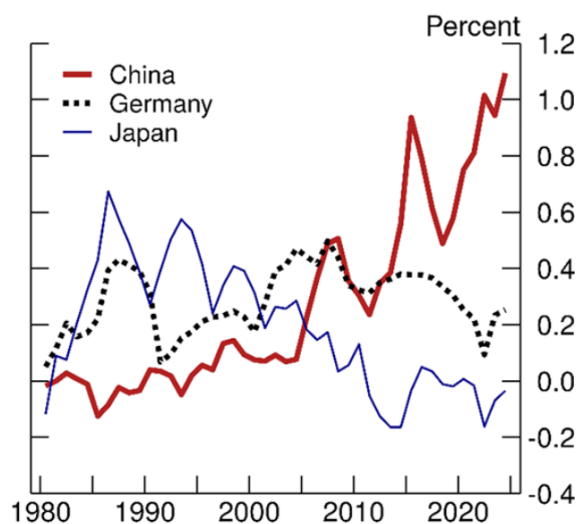
technological self-sufficiency and reliance on domestic supply chains. Federal Reserve researchers therefore describe the current episode as an “asymmetric” or “trade-surplus-driven” shock, in which exports expand much faster than imports.

Figure 3: China's unprecedented trade surplus as a share of the rest-of-the-world GDP

Chinese Trade Over World GDP ex. China



Trade Surplus as a Share of Rest-of-World GDP



Page | 8

Source: [US Federal Reserve](#)

The scale of the imbalance is also much larger. China’s trade surplus has risen above 1% of rest-of-world GDP, compared with around 0.5% during the first shock, exceeding the peak surpluses of Germany and Japan. China is also expanding from an already dominant position: its share of global exports rose from 13.1% in 2018 to 16.3% in 2024, while its import share increased only modestly. Even relatively small additional gains can therefore generate significant adjustment pressures for trading partners.

[The broader US government interpretation goes further than the Fed analysis.](#) US trade authorities attribute much of the export surge to state-supported excess capacity, arguing that subsidies and other forms of support encourage production beyond domestic demand. Combined with weak consumption, this pushes production into foreign markets, potentially undermining competing manufacturers and strengthening the case for protecting the US industrial base.

The policy response therefore differs markedly from the first China shock, which unfolded during an era of falling trade barriers and expanding globalization. China Shock 2.0 is occurring amid tariffs, export controls, investment screening, industrial policy and geopolitical fragmentation. Washington increasingly views it not simply as another influx of inexpensive Chinese goods, but as a challenge to the resilience and competitiveness of the US industrial base, helping explain the shift towards tariffs, industrial policy, technological restrictions and supply-chain diversification.

Conclusion

China Shock 2.0 represents a genuine challenge for the global economy. China’s growing dominance in advanced manufacturing, combined with weak domestic demand and a large external surplus, is intensifying competitive pressures not only in the US and Europe but across other emerging and industrial economies. Countries therefore have legitimate reasons to protect productive capabilities and pursue industrial strategies of their own.

Yet the China Shock narrative can also obscure an important part of the story. Western economies benefited substantially from China's integration into global production when it supplied inexpensive consumer goods and intermediate inputs; tensions intensified as China moved up the value chain and began competing directly in industries previously dominated by advanced economies. At the same time, Chinese imports continue to provide consumer and disinflationary benefits, while China's scale in batteries, solar, wind and EVs has helped reduce the cost of the global energy transition.

The US and Europe have strong reasons to rebuild industrial capacity, technological capabilities and supply-chain resilience, but industrial policy does not necessarily require economic disengagement. Chinese investment, competition and joint ventures can also contribute to capability-building if managed strategically. The challenge posed by China Shock 2.0 is ultimately not only how to constrain China's industrial rise, but how other economies can strengthen their own capacity to compete with it.