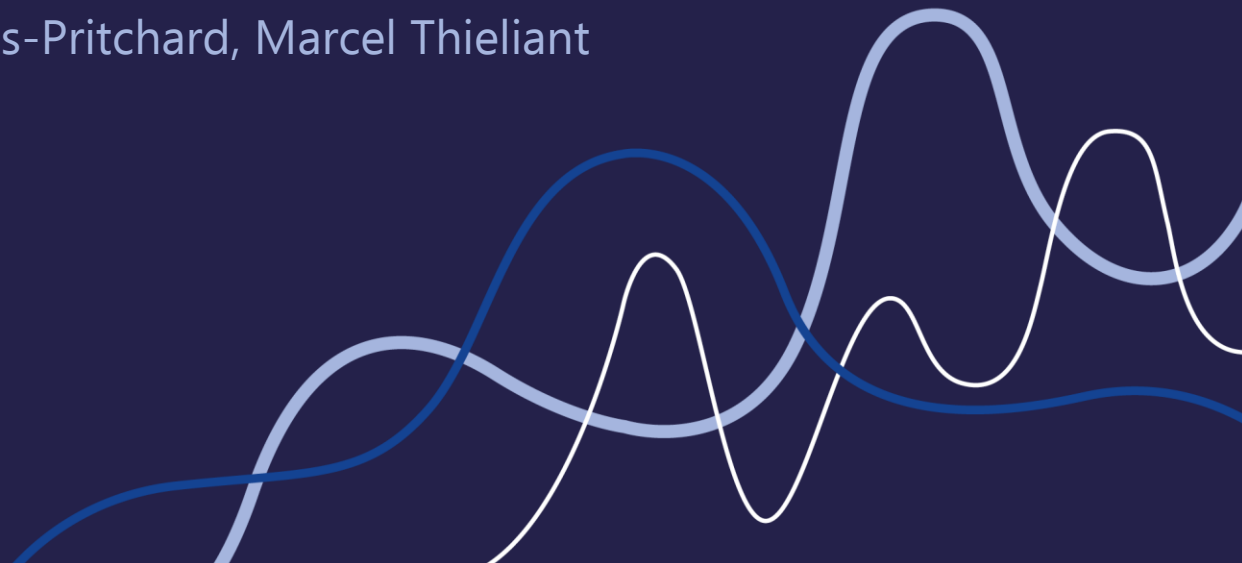


JANUARY 2026

China in Transition: Implications for the global economy

Mark Williams, Julian Evans-Pritchard, Marcel Thieliant



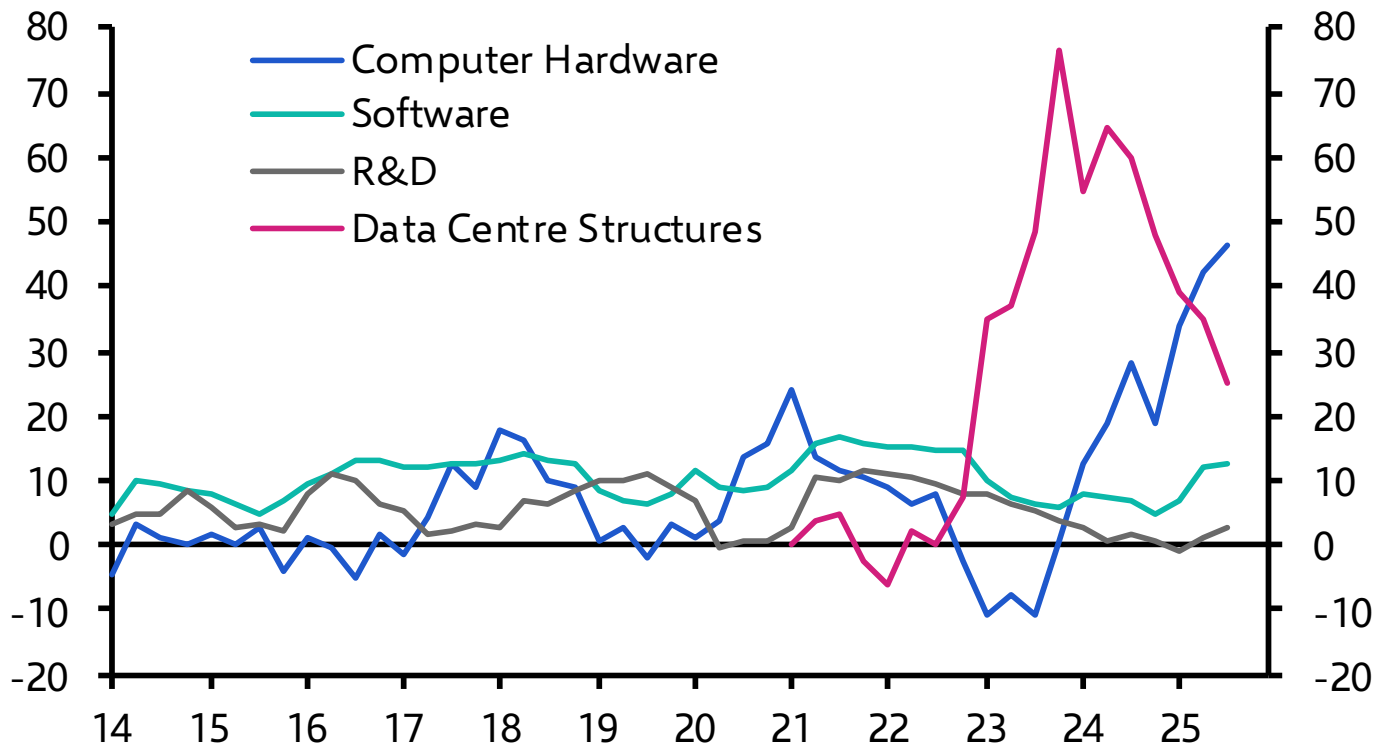
Agenda

- The outlook for the US and other developed economies (Mark Williams).
- China in transition (Julian Evans-Pritchard).
- The implications for the rest of Asia (Marcel Thieliant).
- China and the rest of the world (Mark Williams).
- Q&A

The Outlook for the US and other DMs

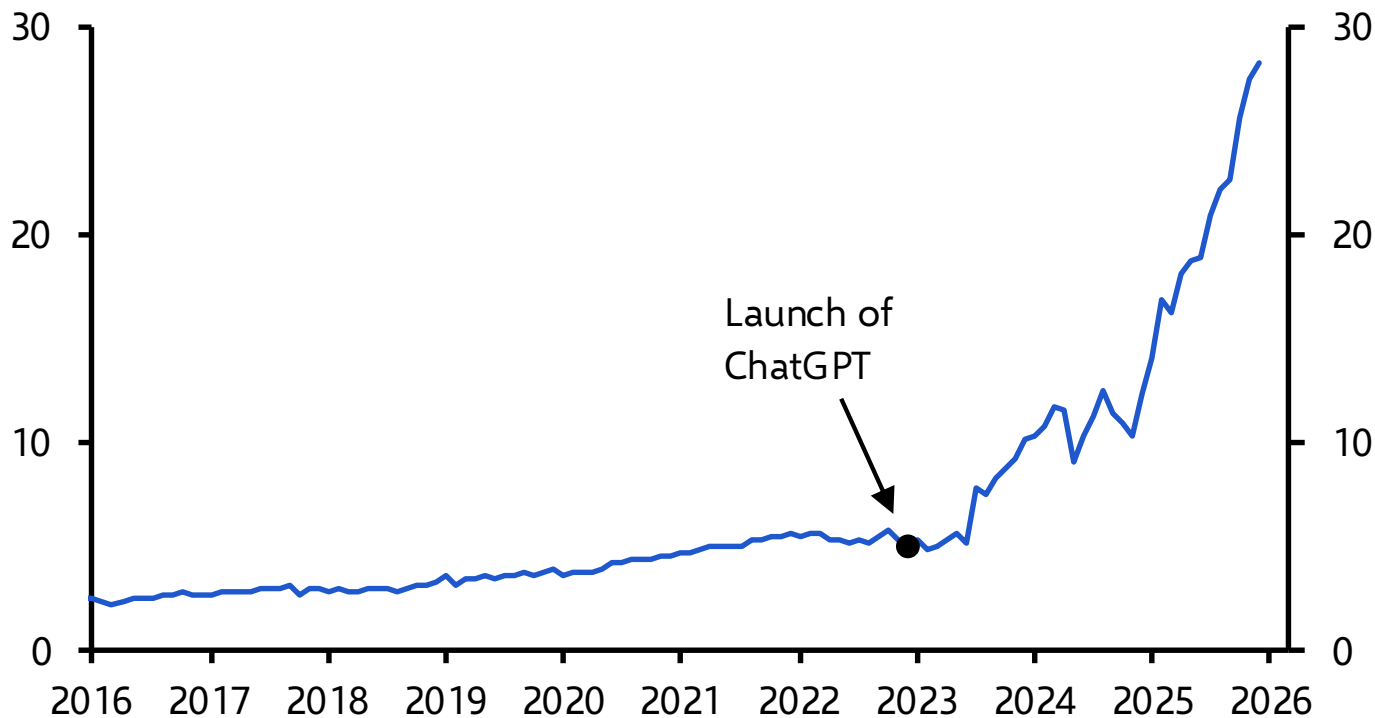
- Can the AI investment boom continue?
- Is the US on the brink of a major labour market downturn?
- Has inflation been vanquished?
- How will the Fed and other major central banks respond?

US Hi-tech Investment (% y/y)



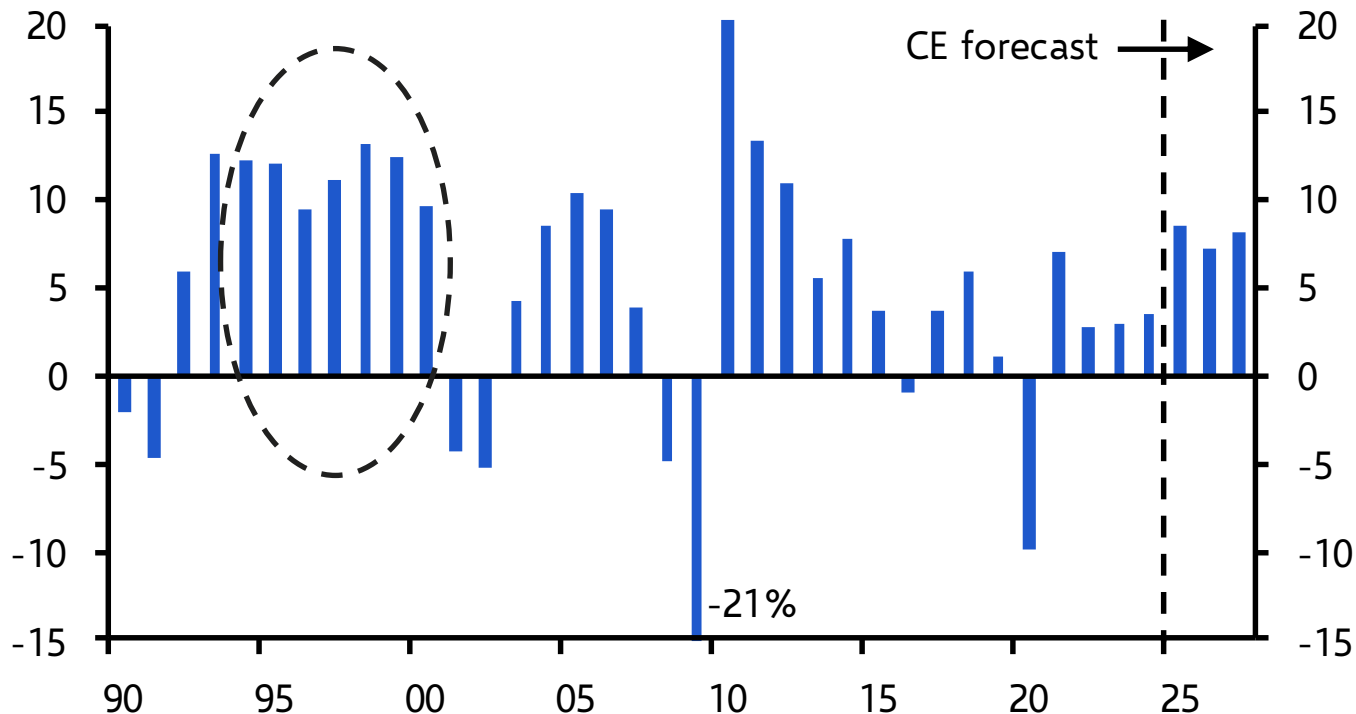
Sources: BEA, Capital Economics

Taiwan's exports of IT products (\$, seasonally-adjusted)



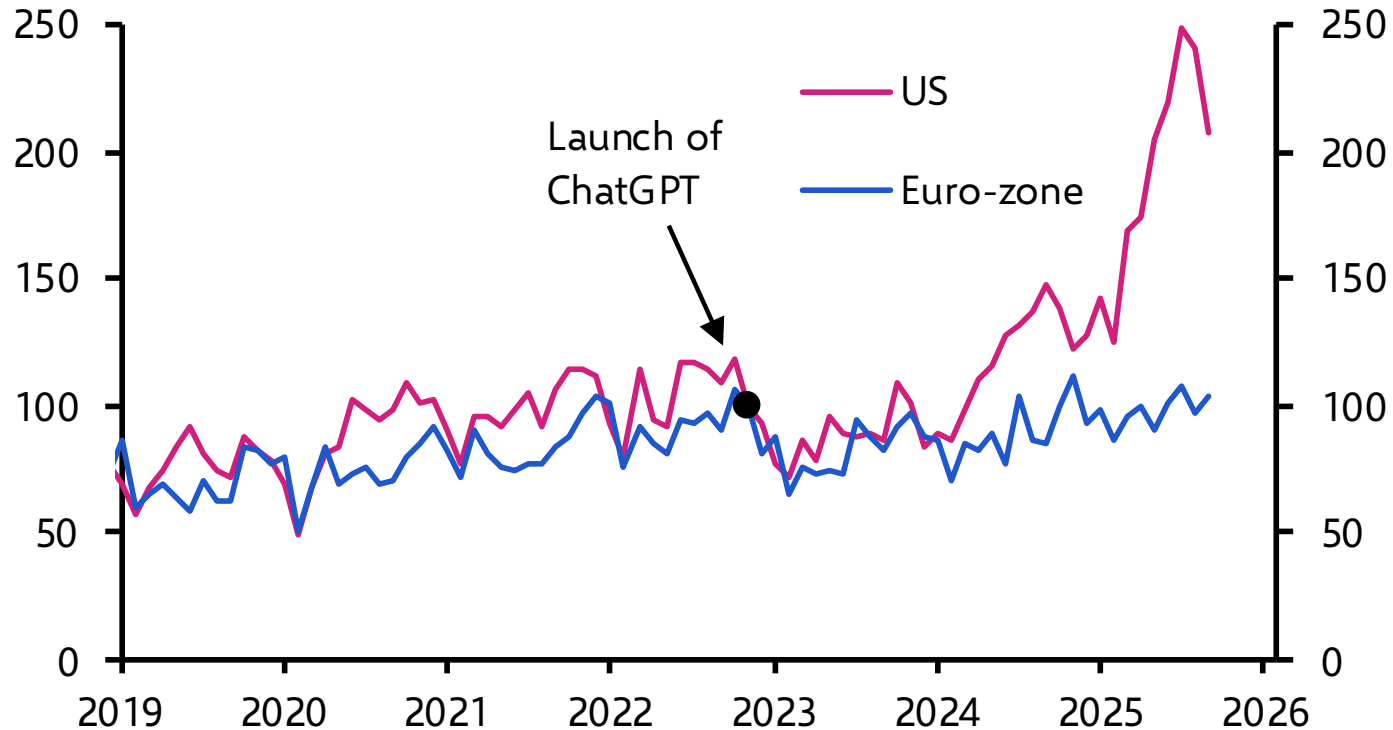
Sources: CEIC, Capital Economics

US Business Investment (% y/y)



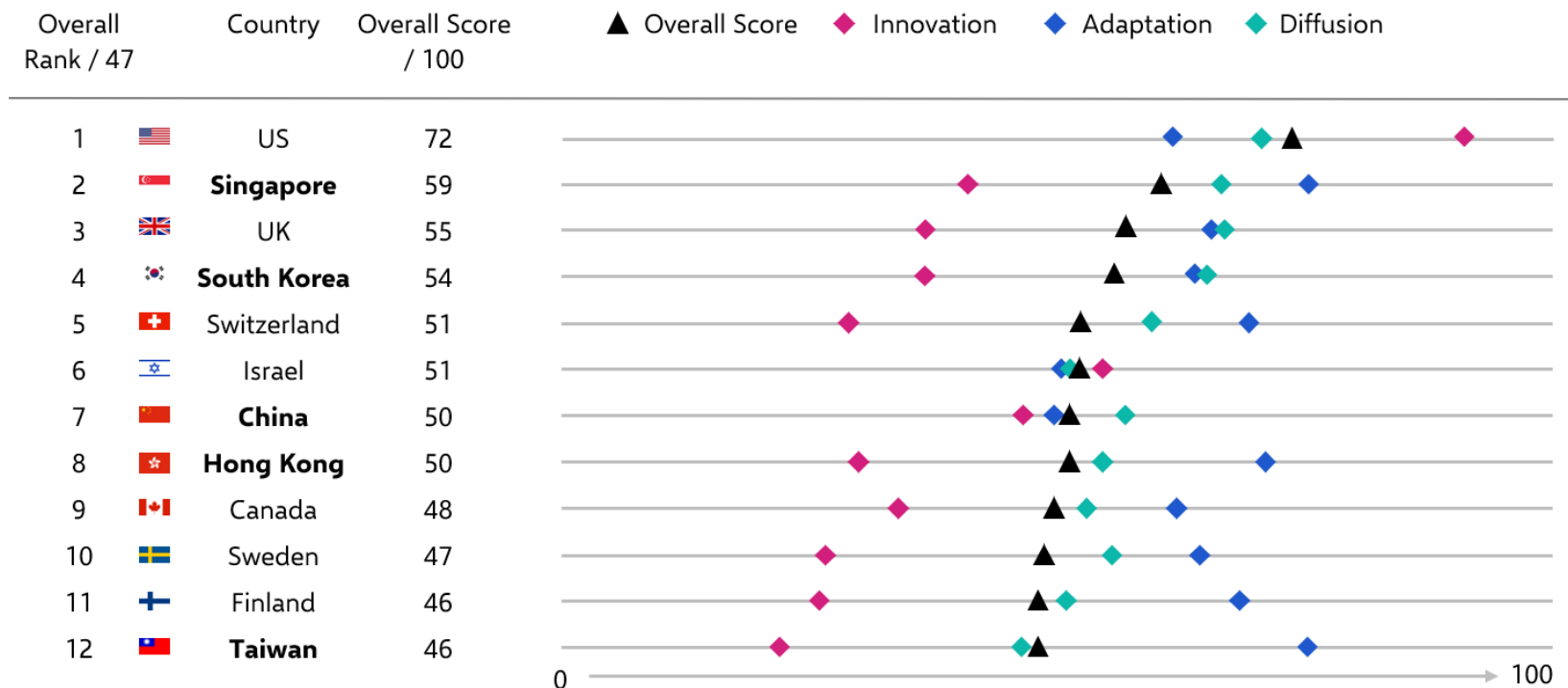
Sources: Census Bureau, Capital Economics

Imports of AI Components (Nov. 2022 = 100)



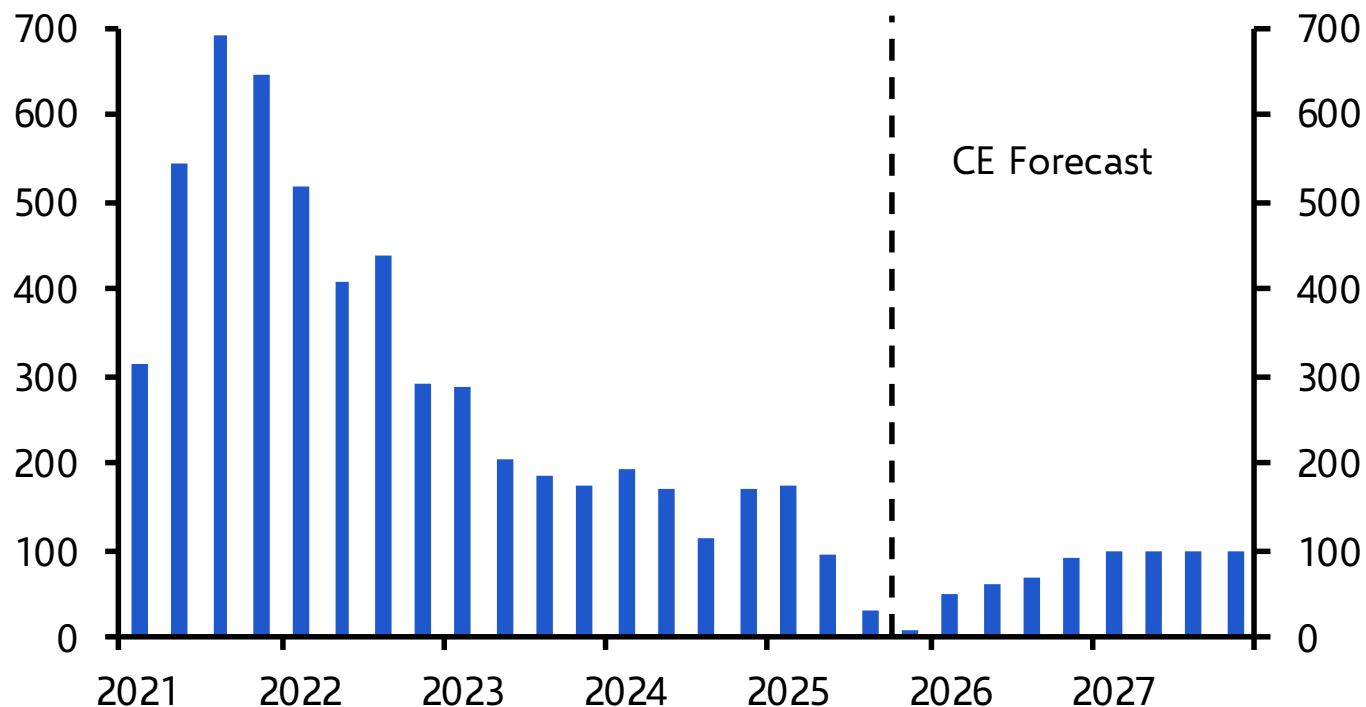
Sources: Eurostat, US ITC, Capital Economics

Capital Economics AI Economic Impact Index



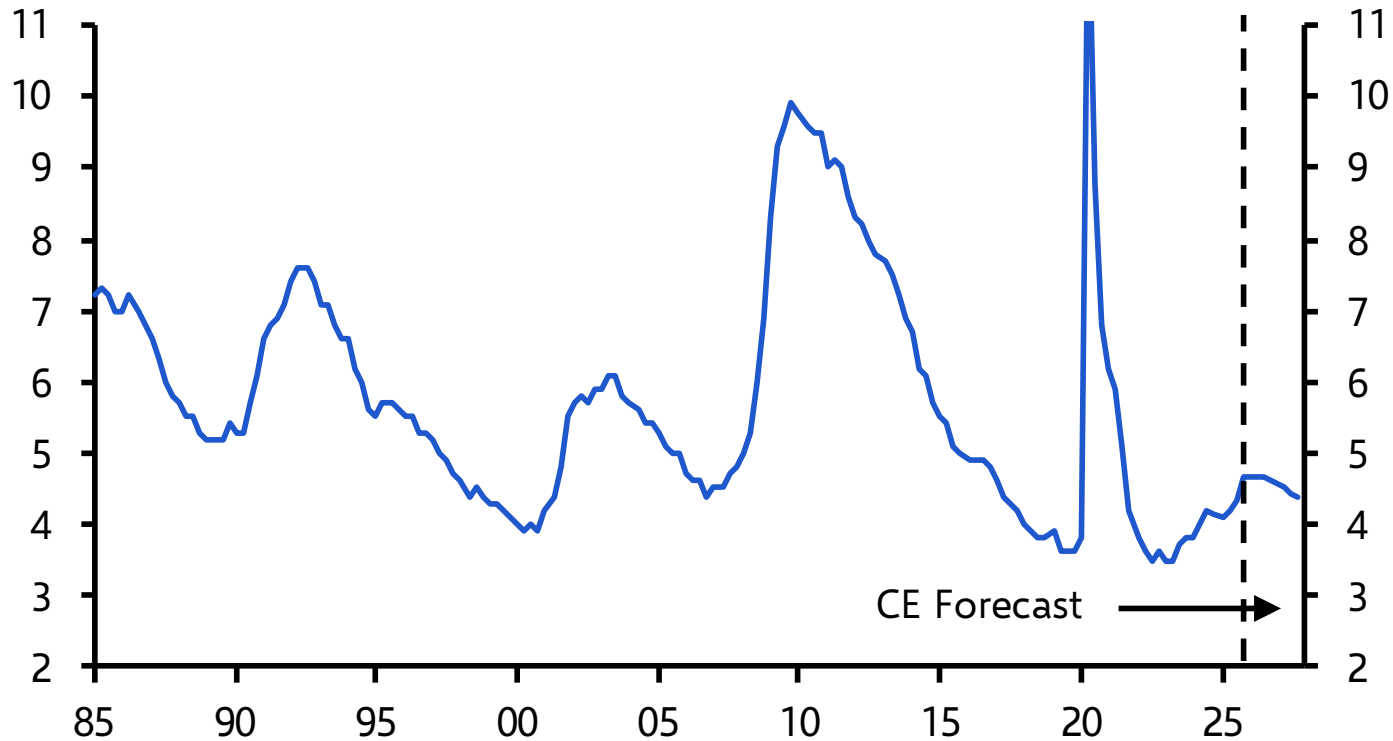
Sources: Capital Economics

US Monthly Change in Payrolls (000s, quarterly average)



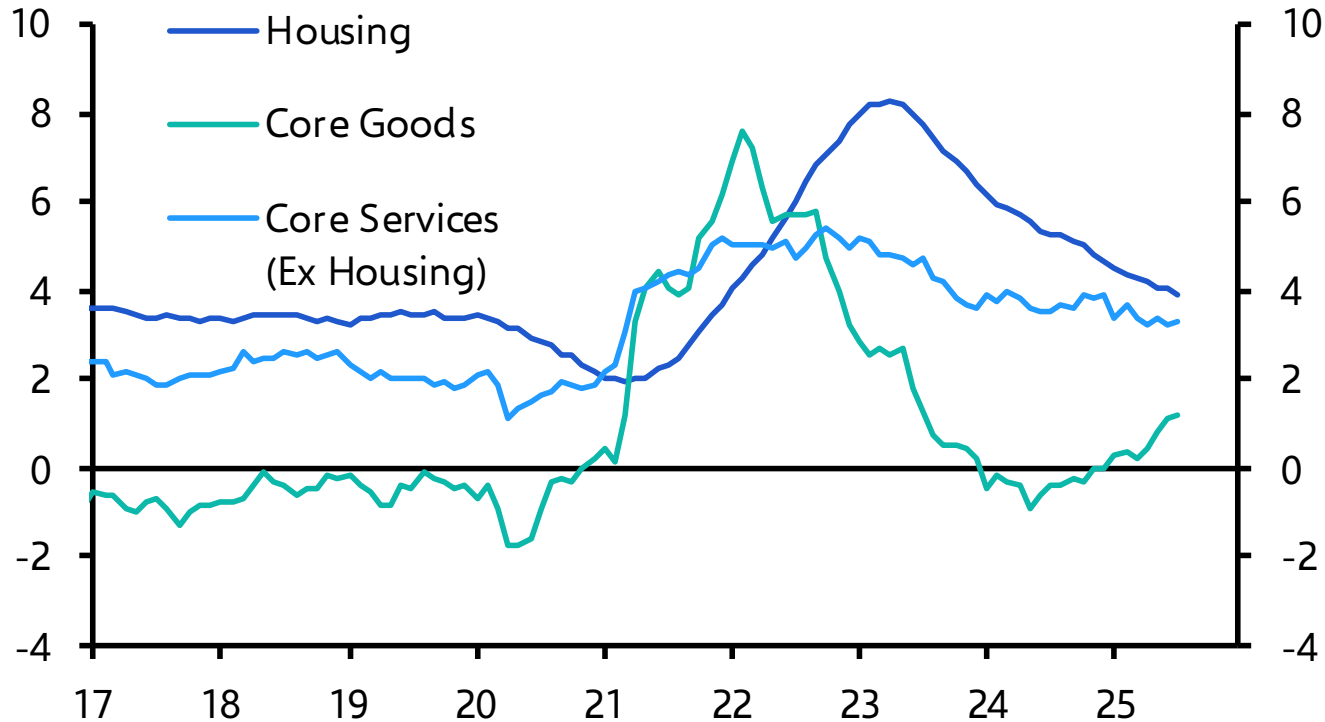
Sources: LSEG, Capital Economics

US Unemployment Rate (%)



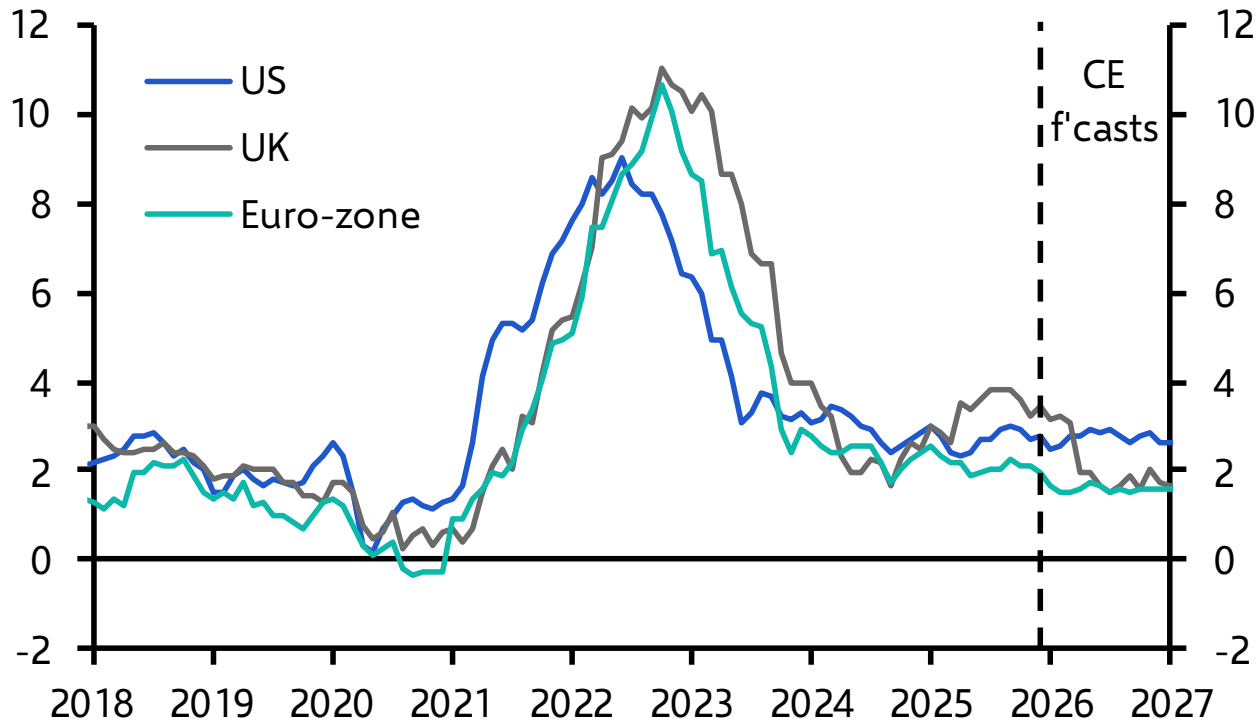
Sources: LSEG, Capital Economics

US Core PCE Inflation (%)



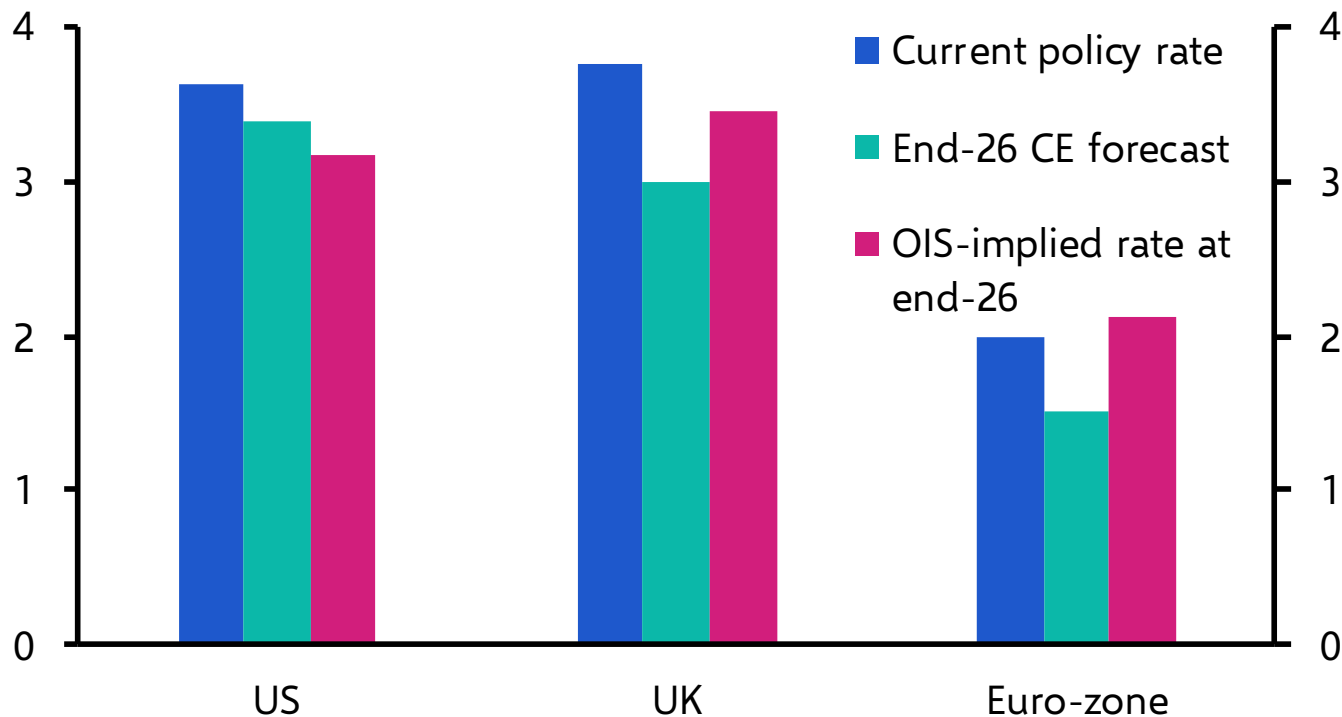
Sources: LSEG, Capital Economics

Advanced Economy Headline Inflation (%)



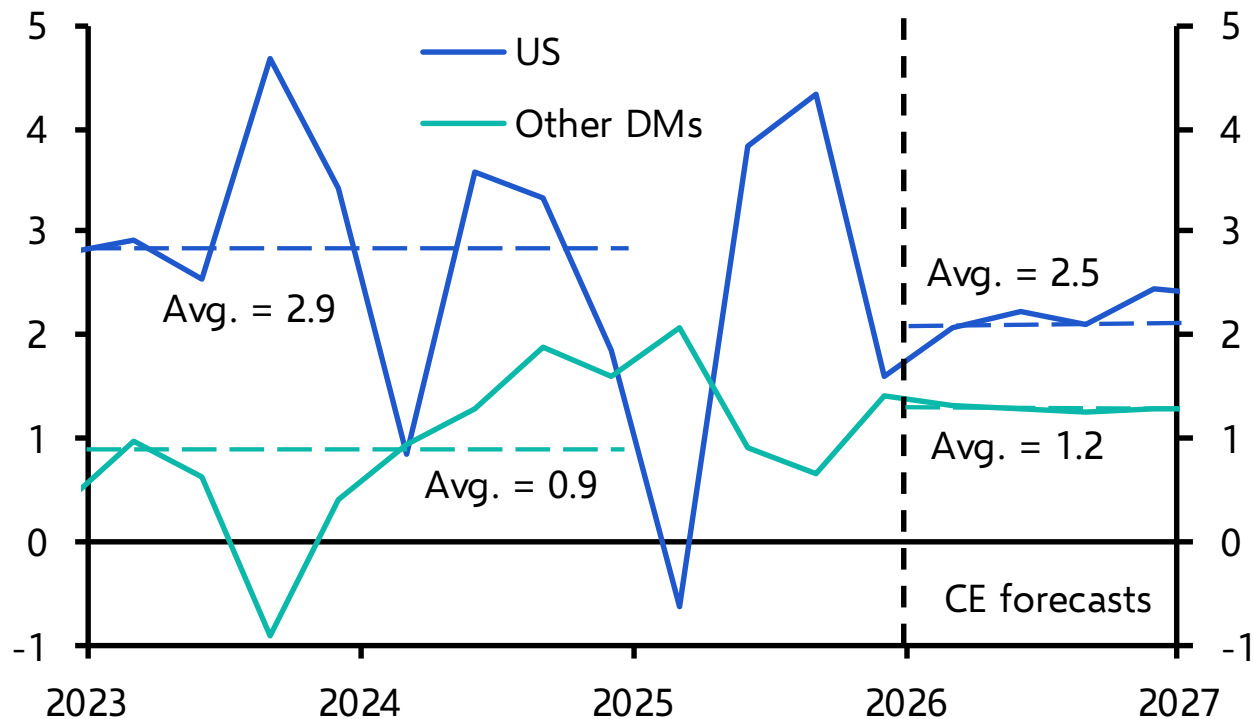
Sources: LSEG, Capital Economics

Policy Interest Rates (%)



Sources: LSEG, Capital Economics

US & other Developed Economy GDP (% q/q annualised)



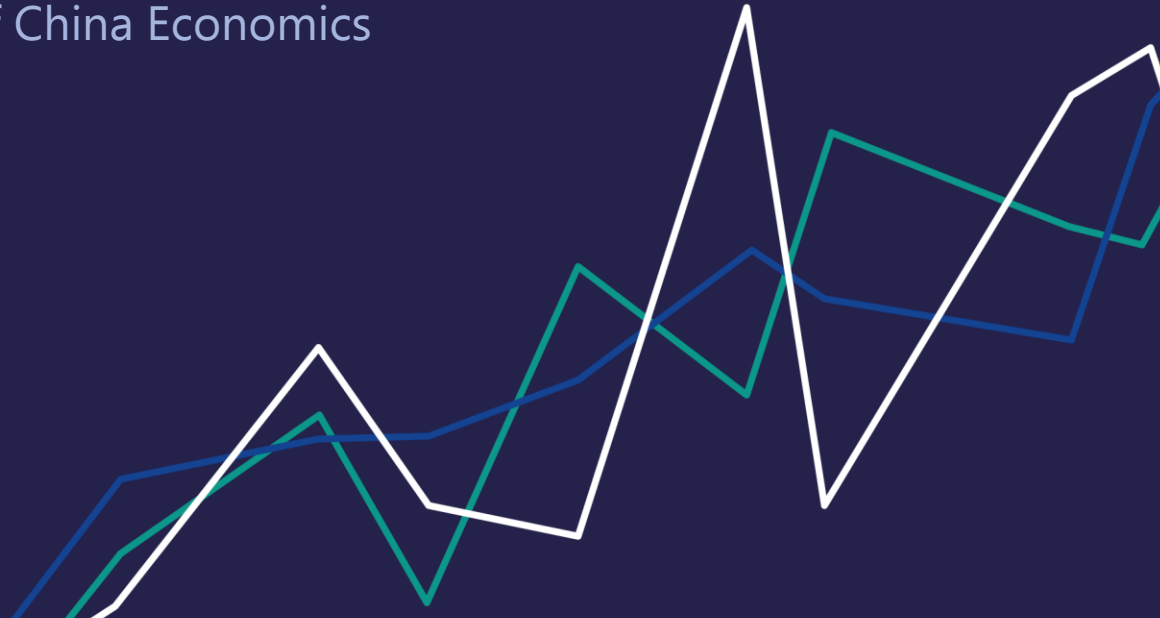
Sources: LSEG, Capital Economics

Conclusions

- Global growth will be a little slow and uneven, but no recessions.
- The US will continue to outperform other DMs – underpinned by a continuation of the boom in AI investment.
- The US labour market is cooling but unemployment won't surge.
- Most central banks will loosen policy further but Trump won't get the major cuts that he wants.

China in transition

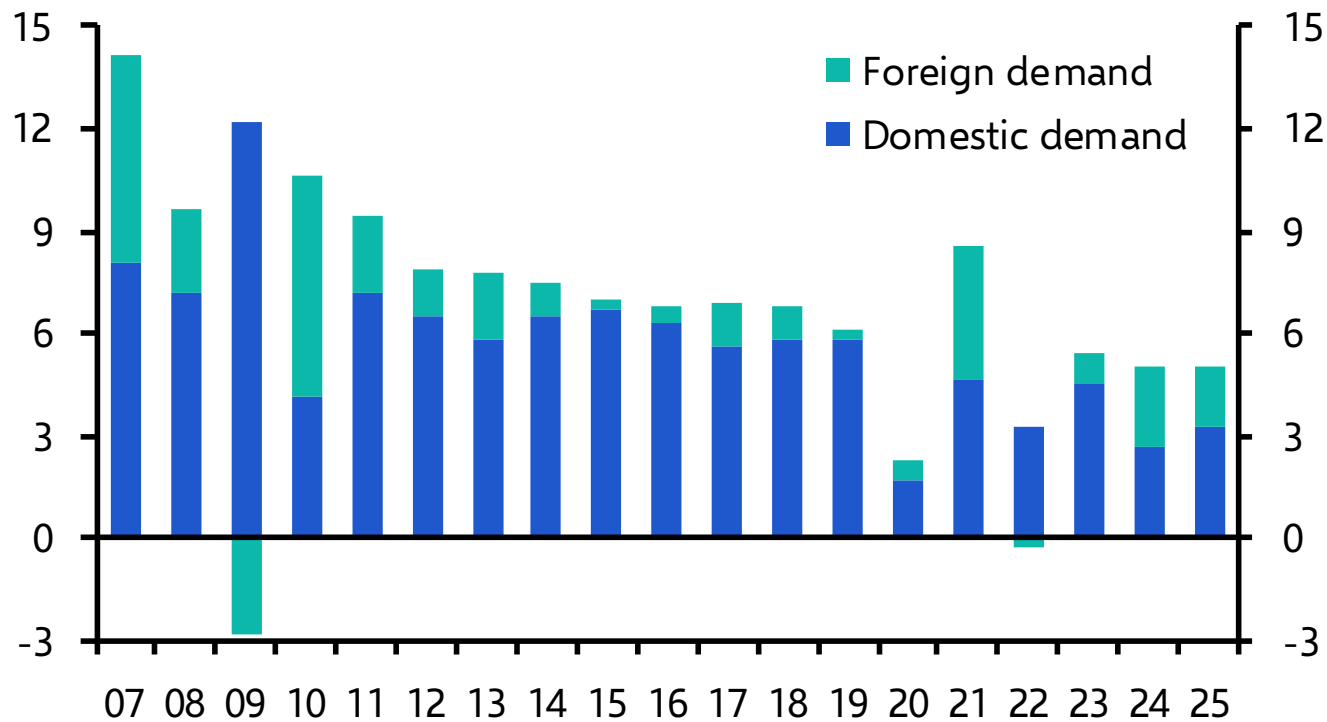
Julian Evans-Pritchard, Head of China Economics



Agenda

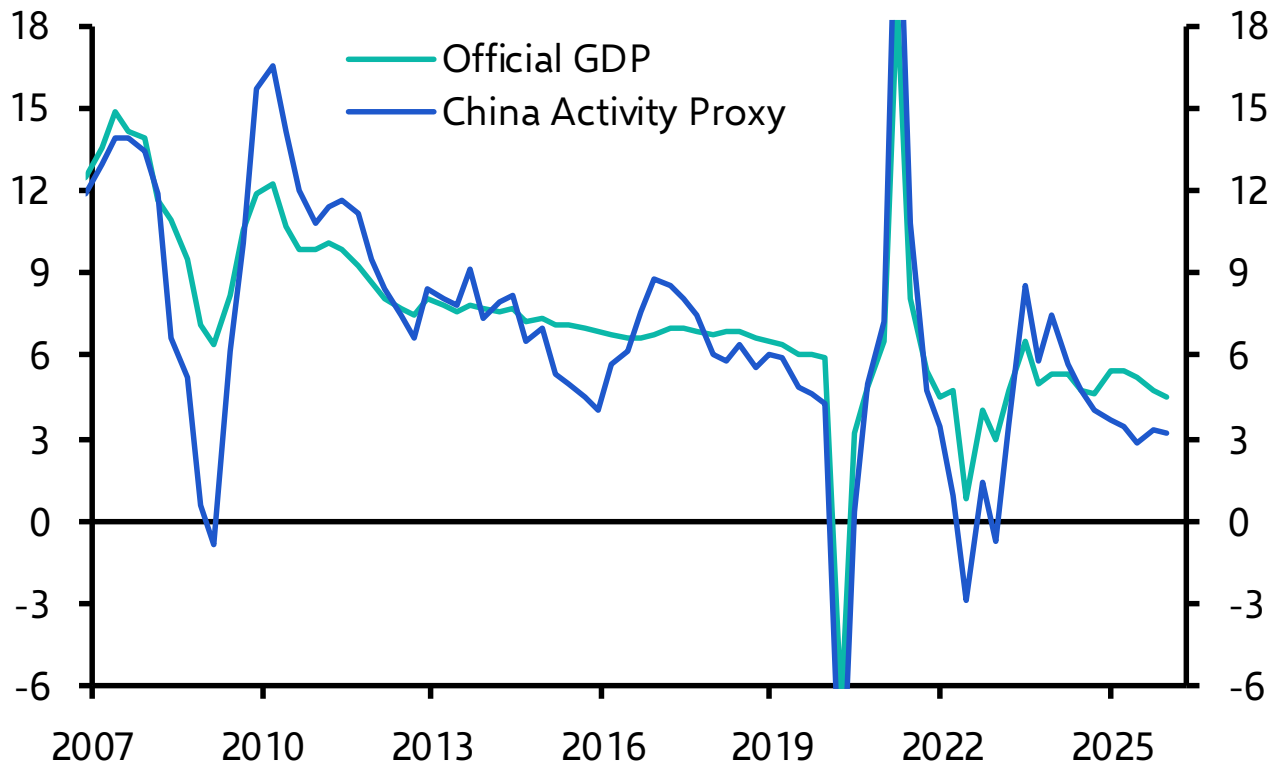
- China's AI catch-up and diffusion
- Plans to rebalance toward consumption
- Why overcapacity & deflation will linger
- The implications for China's trade surplus

China GDP Growth by Source of Demand (real, % y/y)



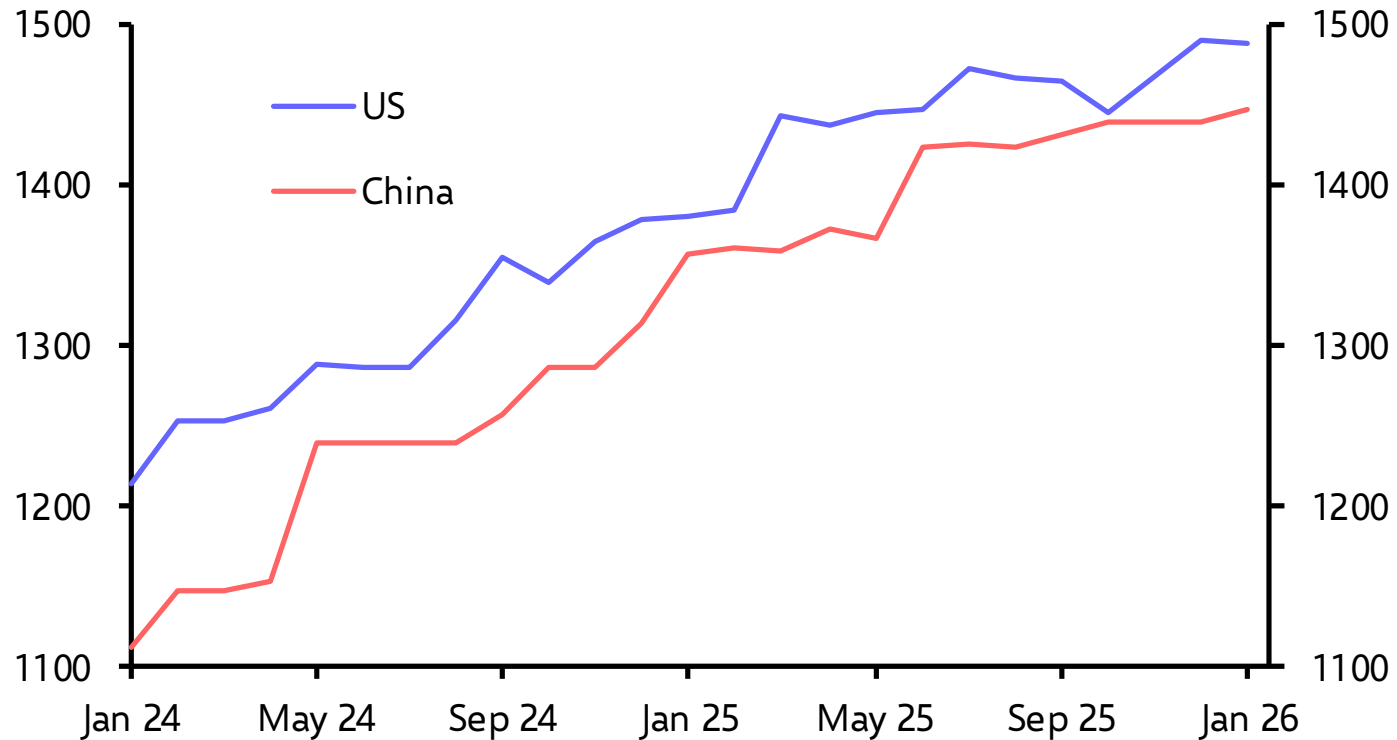
Sources: CEIC, WIND, Capital Economics

CE China Activity Proxy (CAP) & Official GDP (real, % y/y)



Sources: CEIC, WIND, Capital Economics

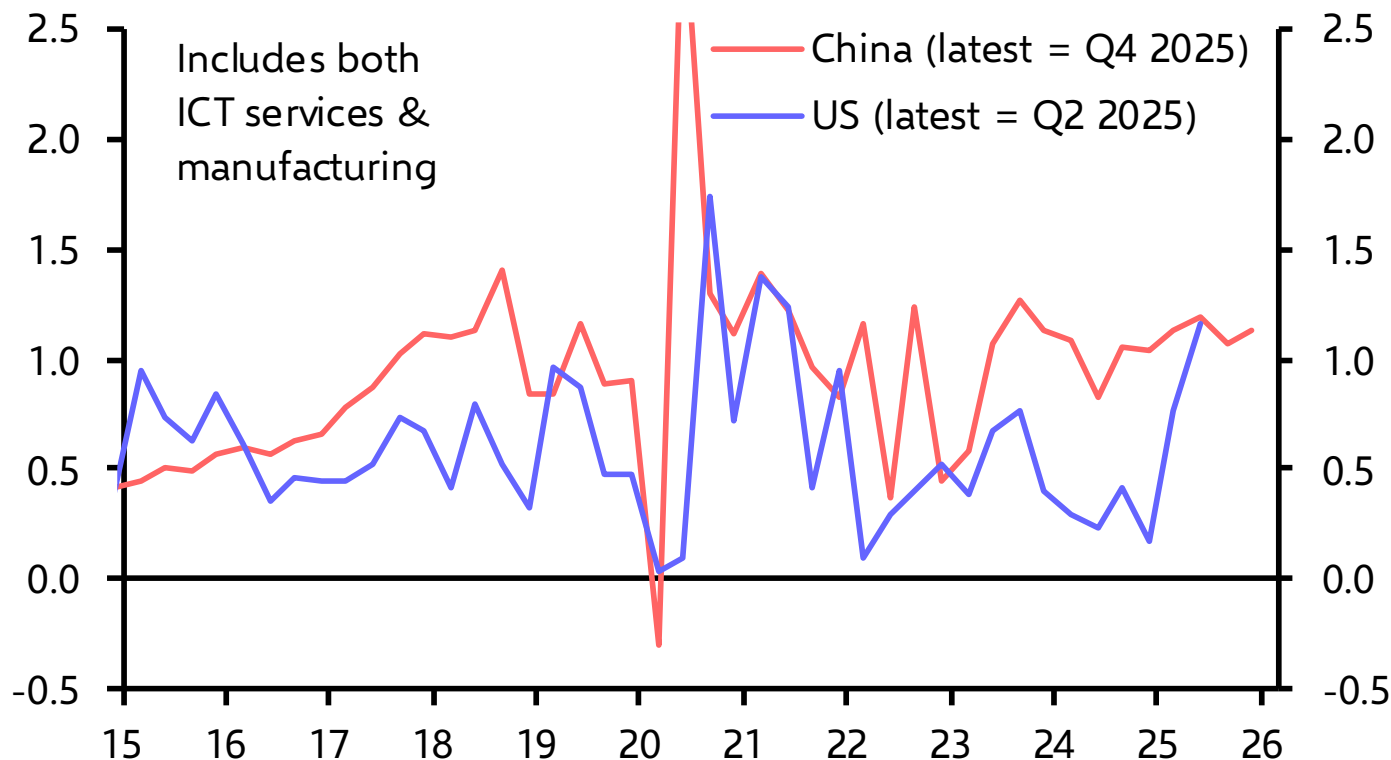
Performance of Top Large Language Models*



*Chatbot Arena Elo points

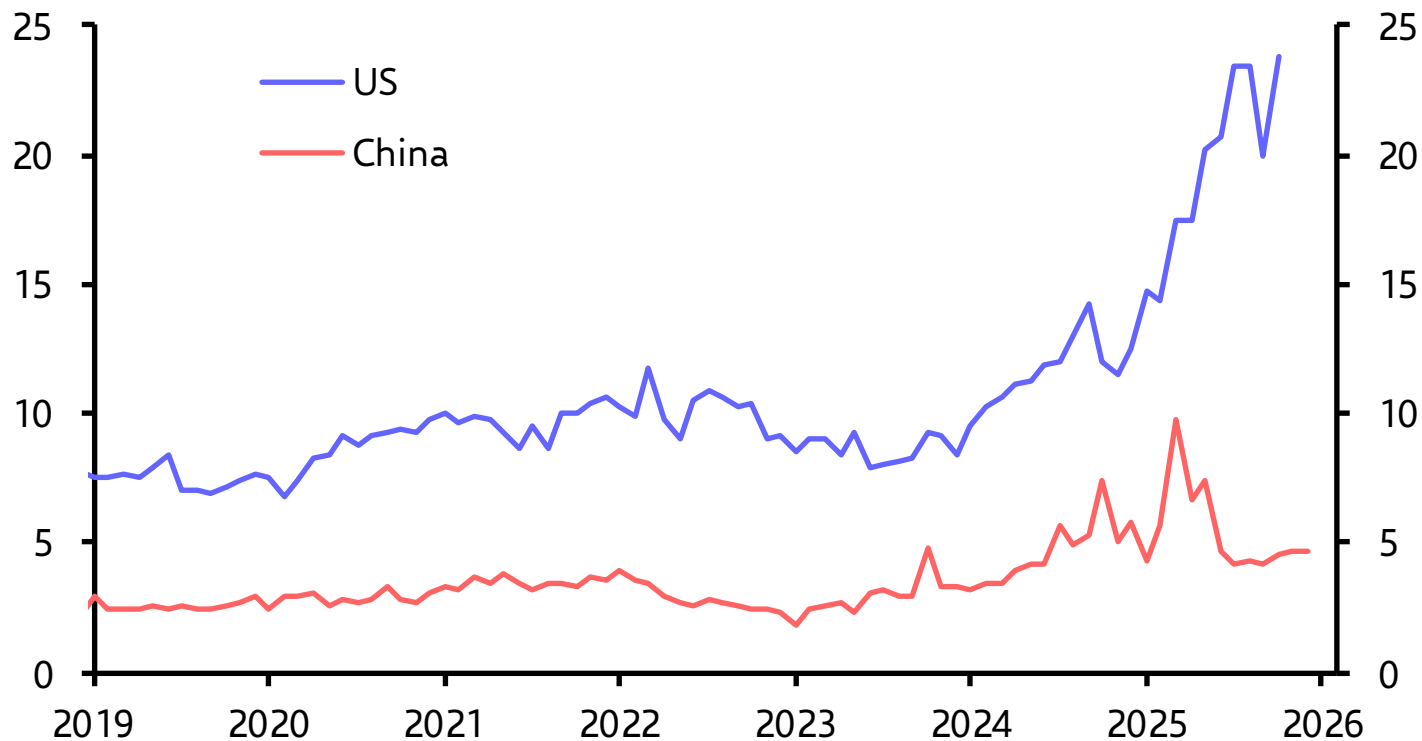
Sources: Stanford AI Index 2025 Annual Report, Internet Archive, OpenLM AI, Capital Economics

ICT Contributions to Real GDP Growth (annualised % pt)



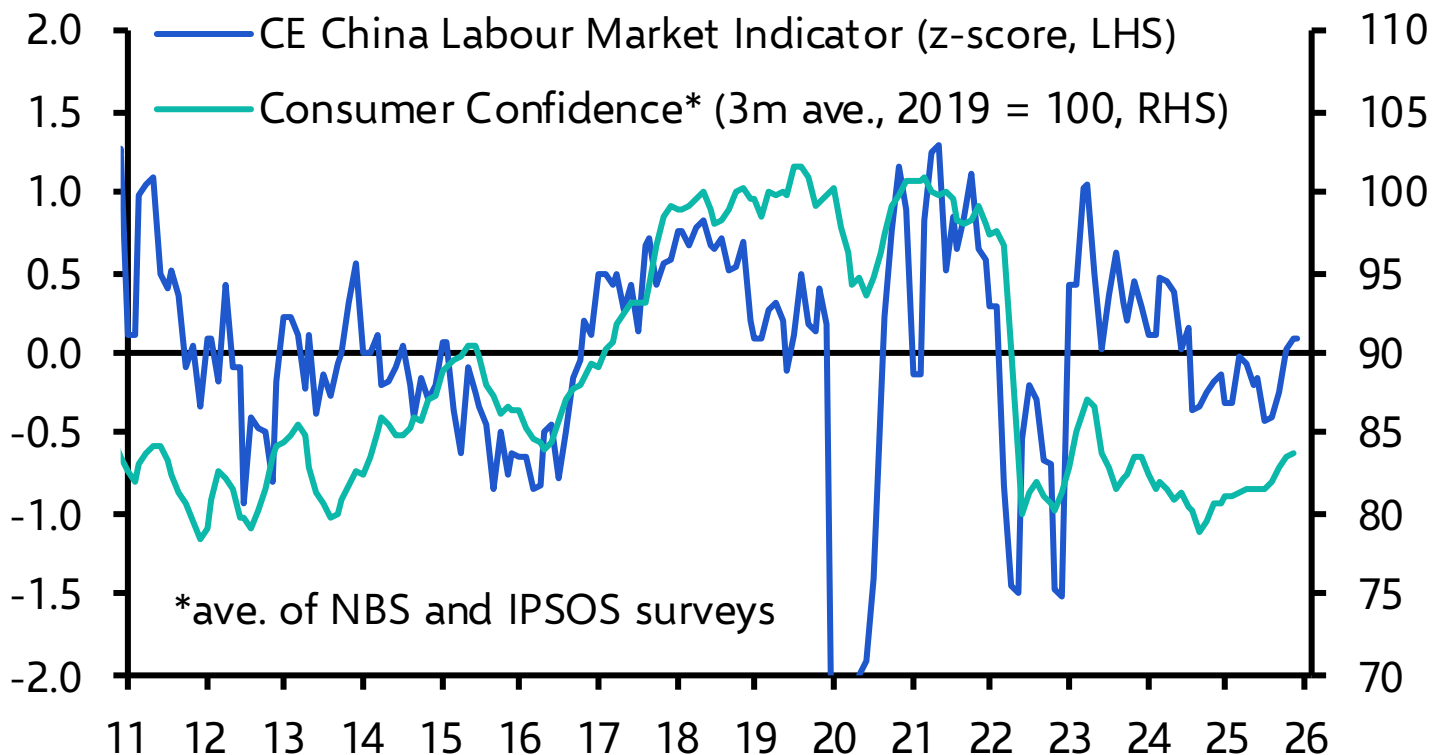
Sources: CEIC, BEA, Capital Economics

Imports of Computing Equipment & Parts (\$bn, seas. adj.)



Sources: CEIC, Comtrade, Capital Economics

China Labour Market Indicator & Consumer Confidence

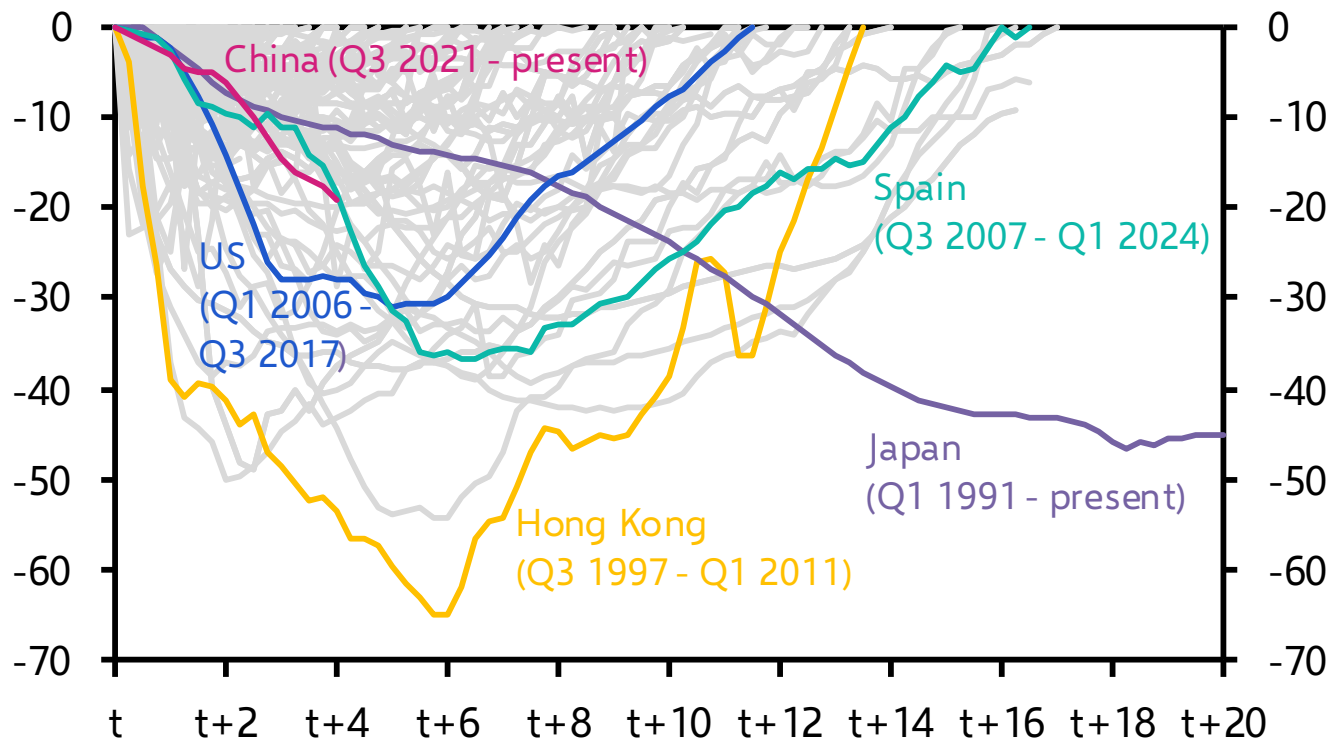


Sources: CEIC, LSEG, Capital Economics

China's Five-Year Plan Proposals

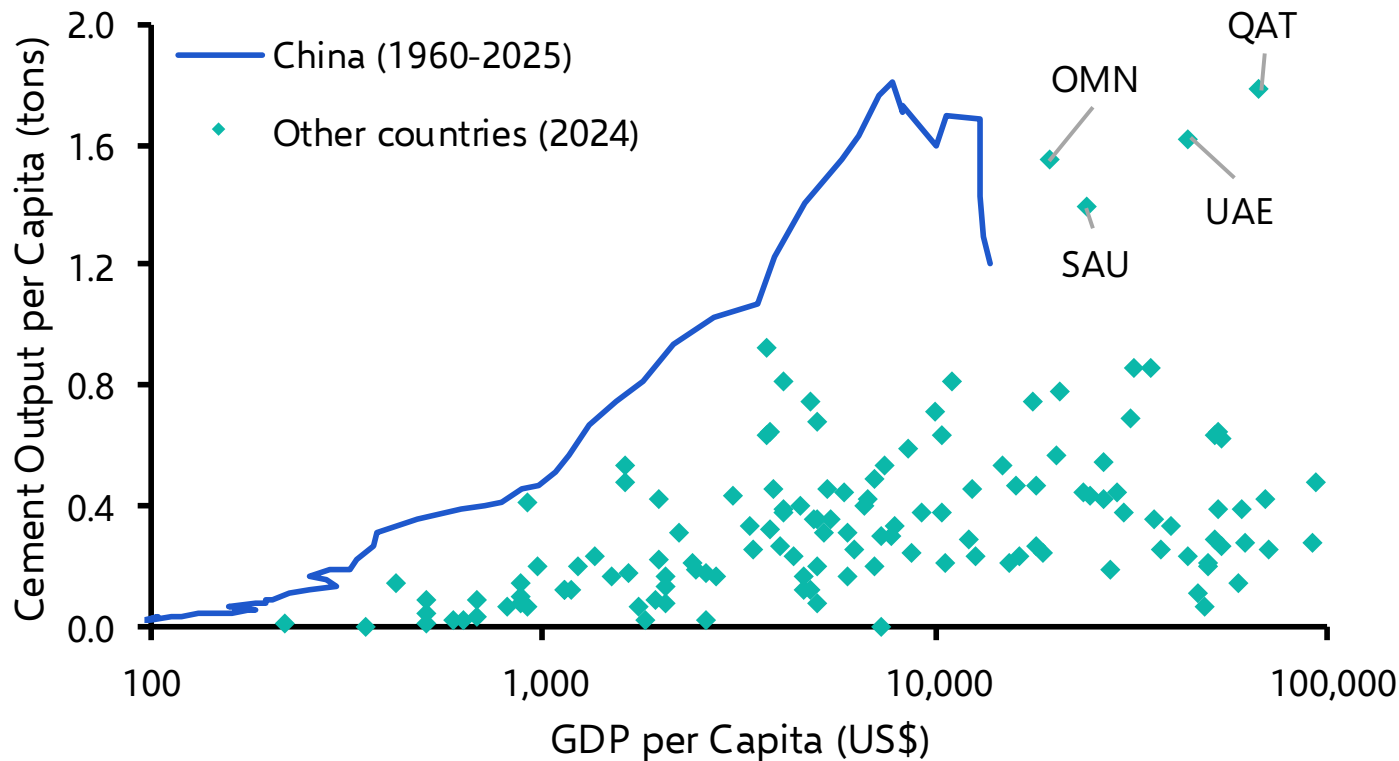
- Floated a goal of increasing the consumption share of GDP.
- Pledged to allocate a higher share of fiscal spending to social welfare.
- Proposed an expansion of free education, public healthcare, and a gradual increase in pensions and unemployment support.
- But rebalancing away from investment to be gradual.
- Economic security agenda means government will continue to support high-tech manufacturing.

Global House Price Drawdowns (% nominal)



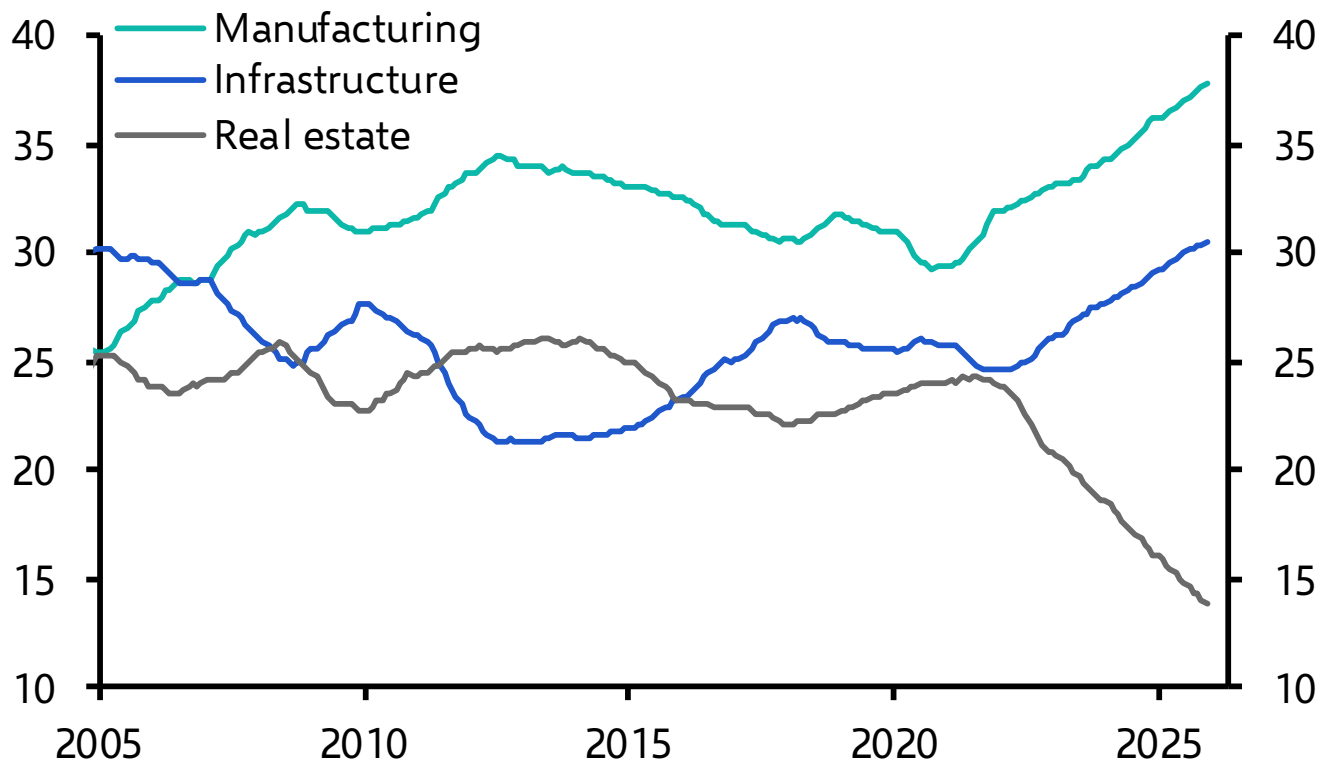
Note: $t+2$ indicates 2 years since prices started falling
Sources: CEIC, BIS, Capital Economics

Cement Output vs Income Level



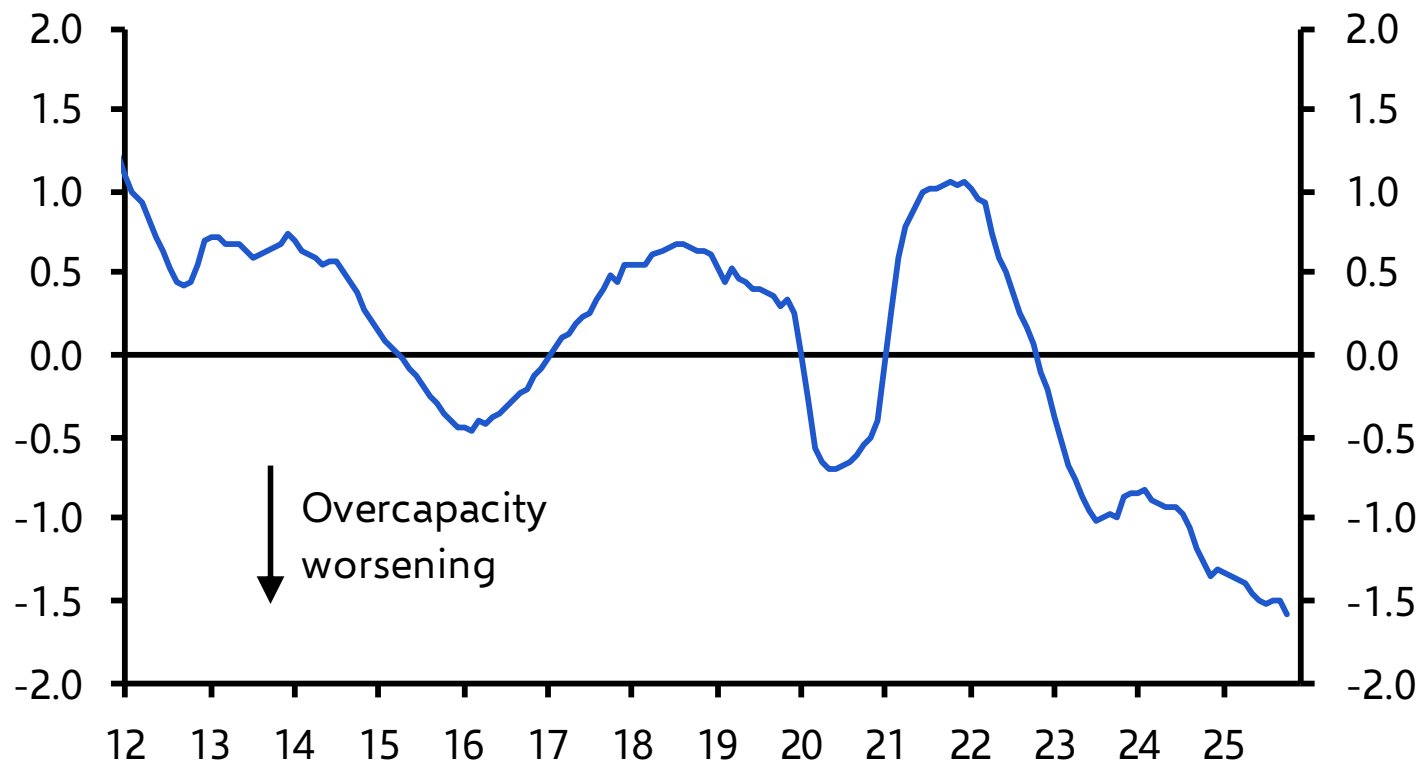
Sources: CEIC, The Global Carbon Project, Capital Economics

Fixed Investment (% of total, 12m ave.)



Sources: CEIC, Capital Economics

CE China Overcapacity Index (z-score, 12m ave.)

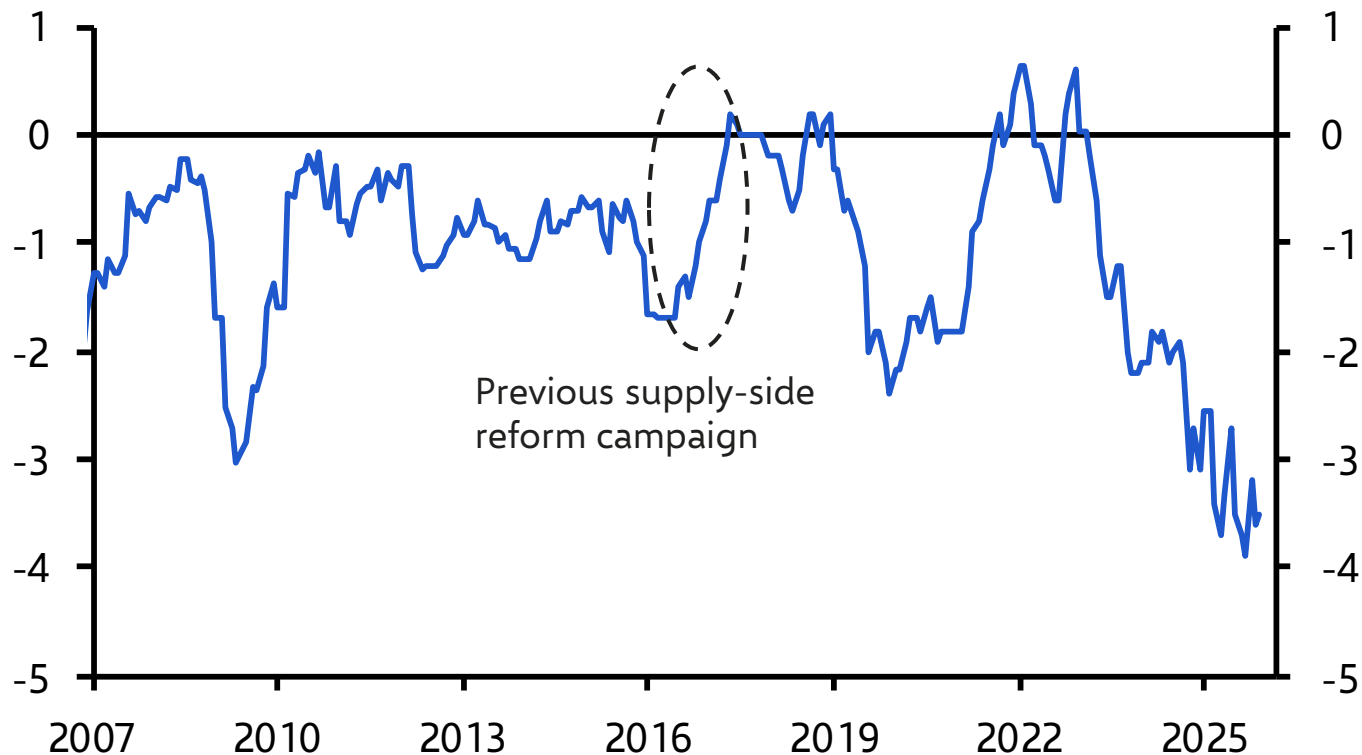


Sources: CEIC, Capital Economics

The Consequences of Rebalancing

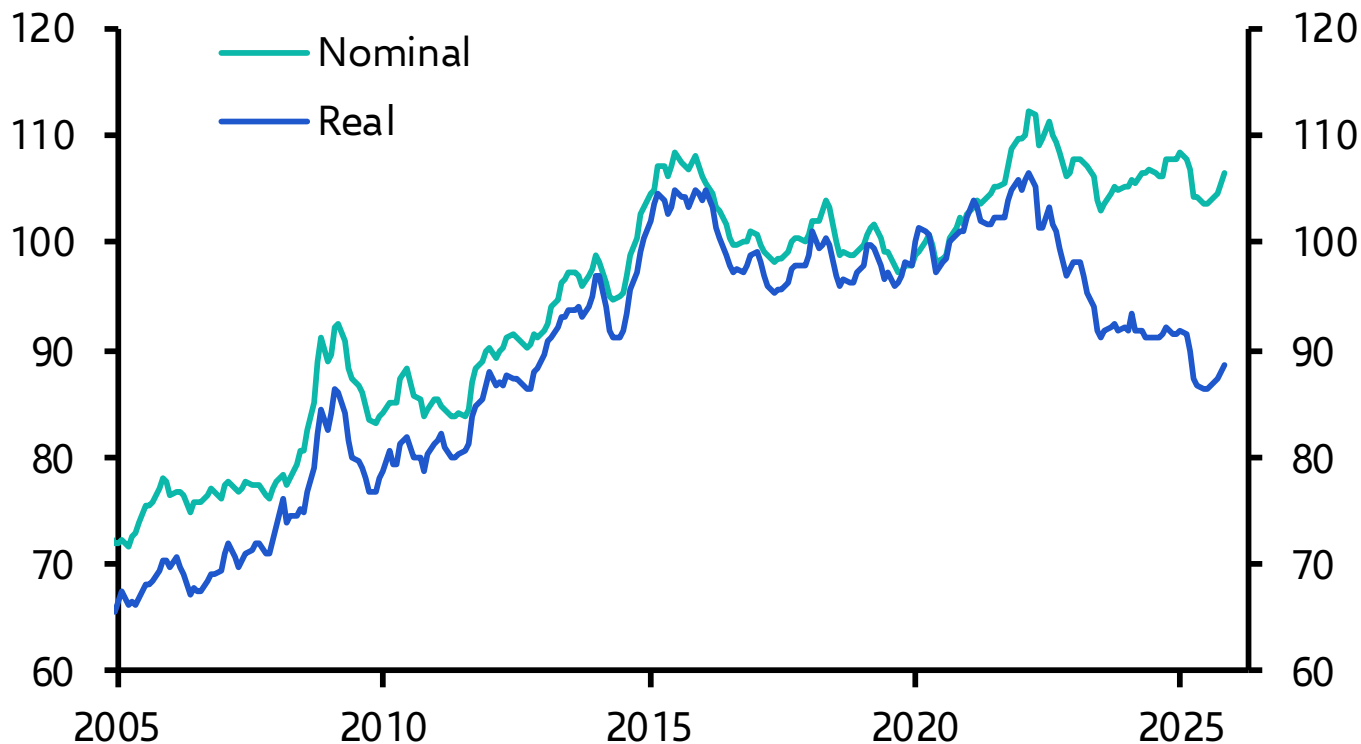
- The consumption share of GDP is set to rise, investment share to fall.
- Will this fix overcapacity and pull China out of deflation?
- Will this reduce external imbalances and rein in China's trade surplus?
- In both cases the answer is yes over the long-run, but probably not in the near-term.

PPI – Consumer Durables (% y/y)



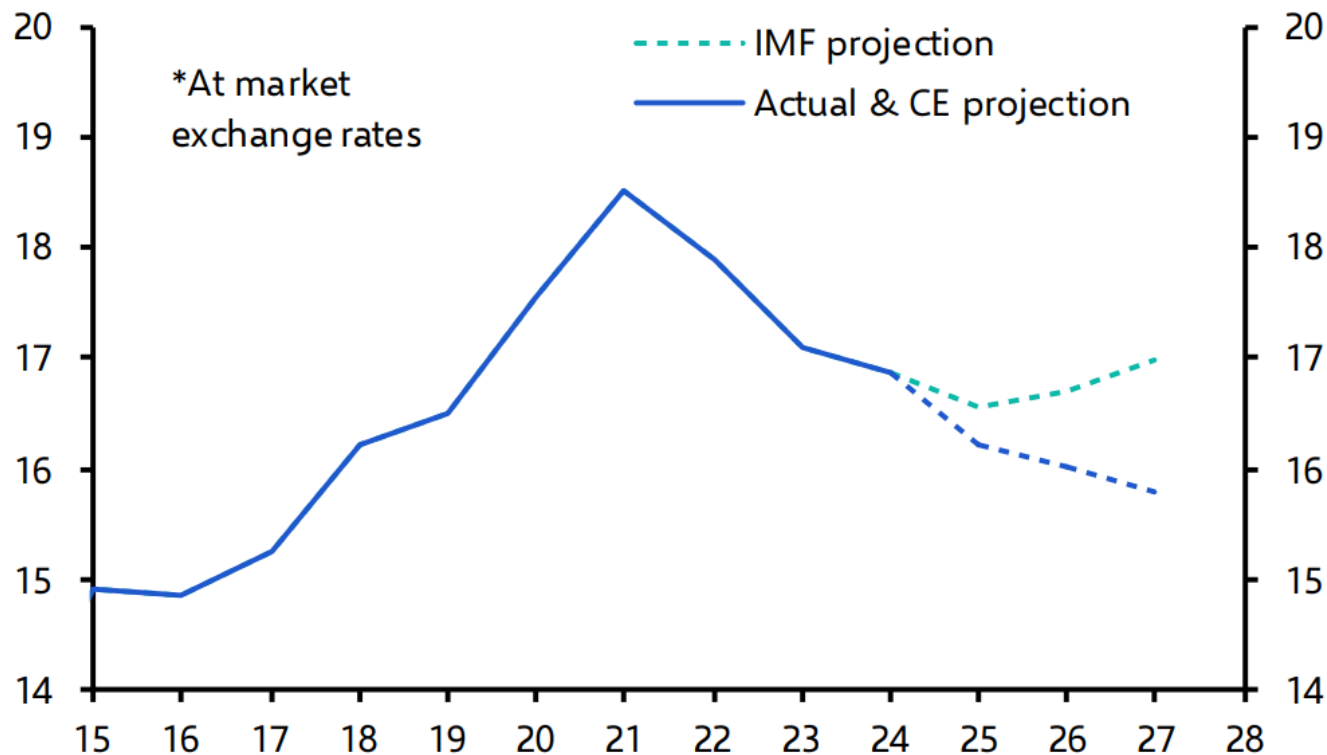
Sources: CEIC, Capital Economics

China's Effective Exchange Rate (2020 = 100)



Sources: CEIC, Capital Economics

China's Share of World GDP* (%)

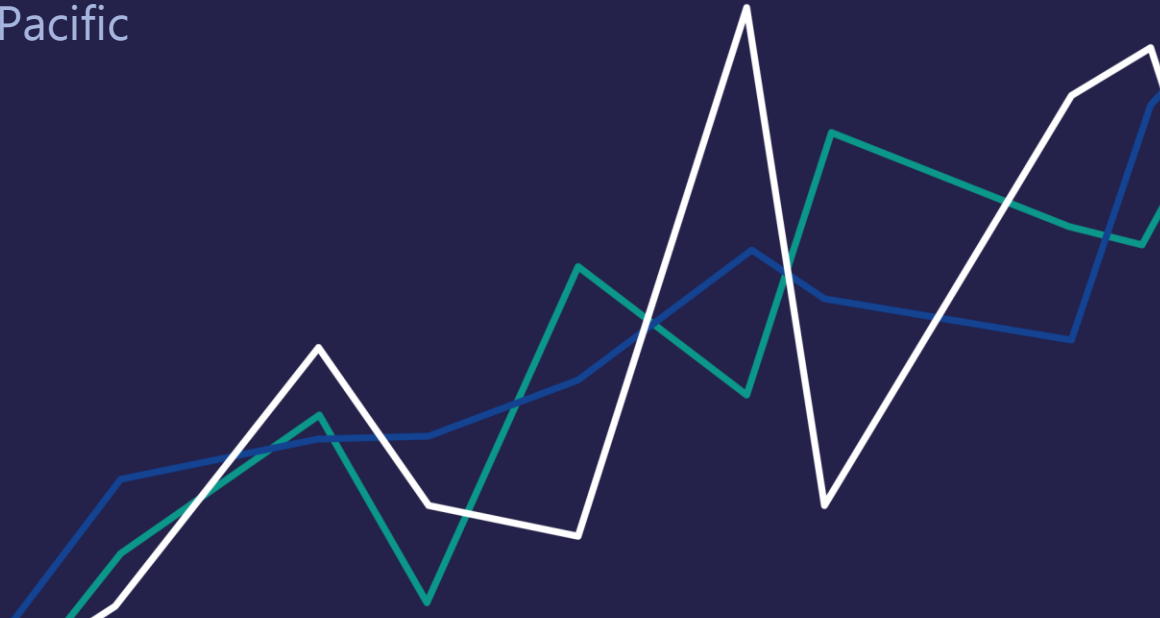


Conclusions

- AI rollout and consumption recovery will support activity.
- But will be offset by weaker investment spending.
- Rebalancing should benefit China over the medium-term...
- ...but won't fix overcapacity and deflation in the near-term.
- GDP growth to edge down in 2026, remain weak in nominal terms.
- Domestic weakness will continue to fuel China's trade surplus.

The implications for the rest of Asia

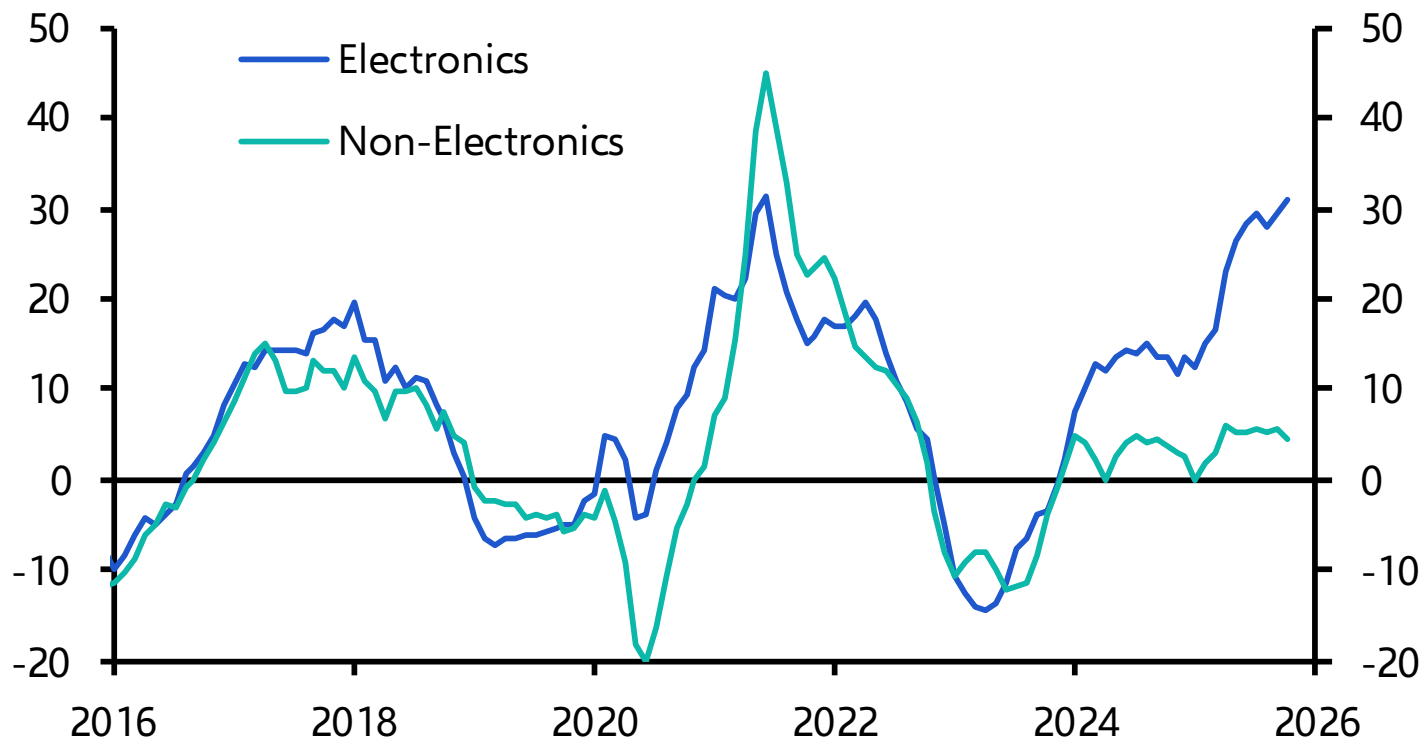
Marcel Thieliant, Head of Asia-Pacific



Agenda

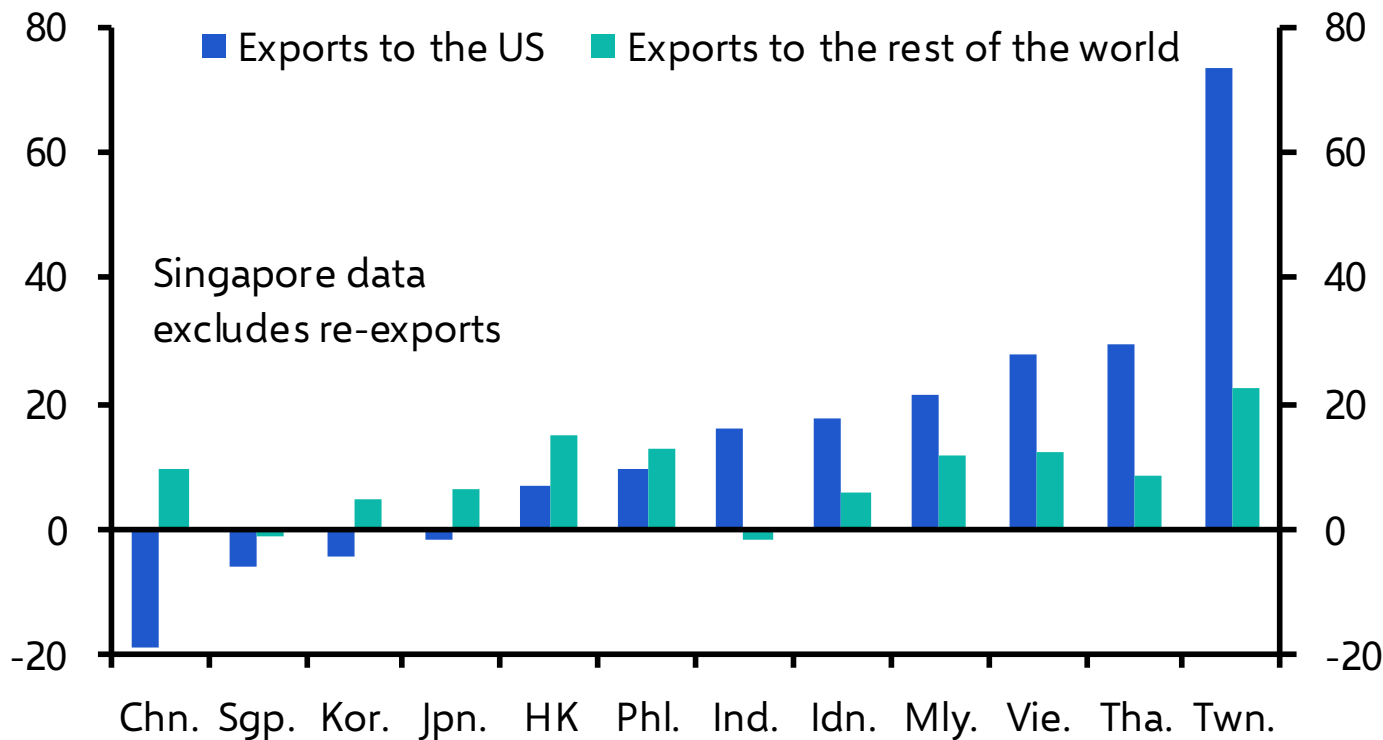
- How are the AI investment boom and US tariffs affecting Asian economies?
- Is China's export dominance harming the rest of the region?
- Is Japan facing a fiscal crisis?

Exports from Asia Excluding China (\$, % y/y)



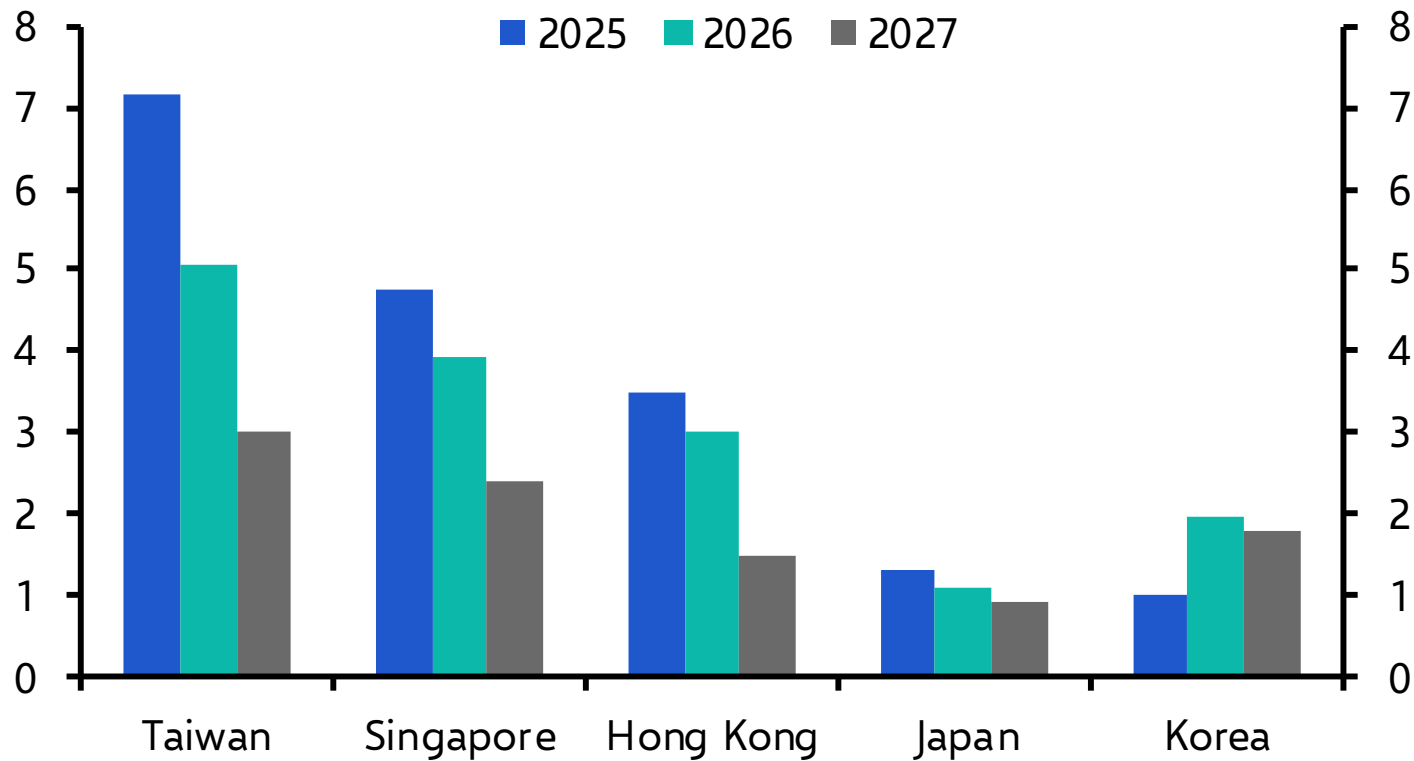
Sources: LSEG, Capital Economics

Exports from Asia (Jan. – Nov. 2025, \$, % y/y)



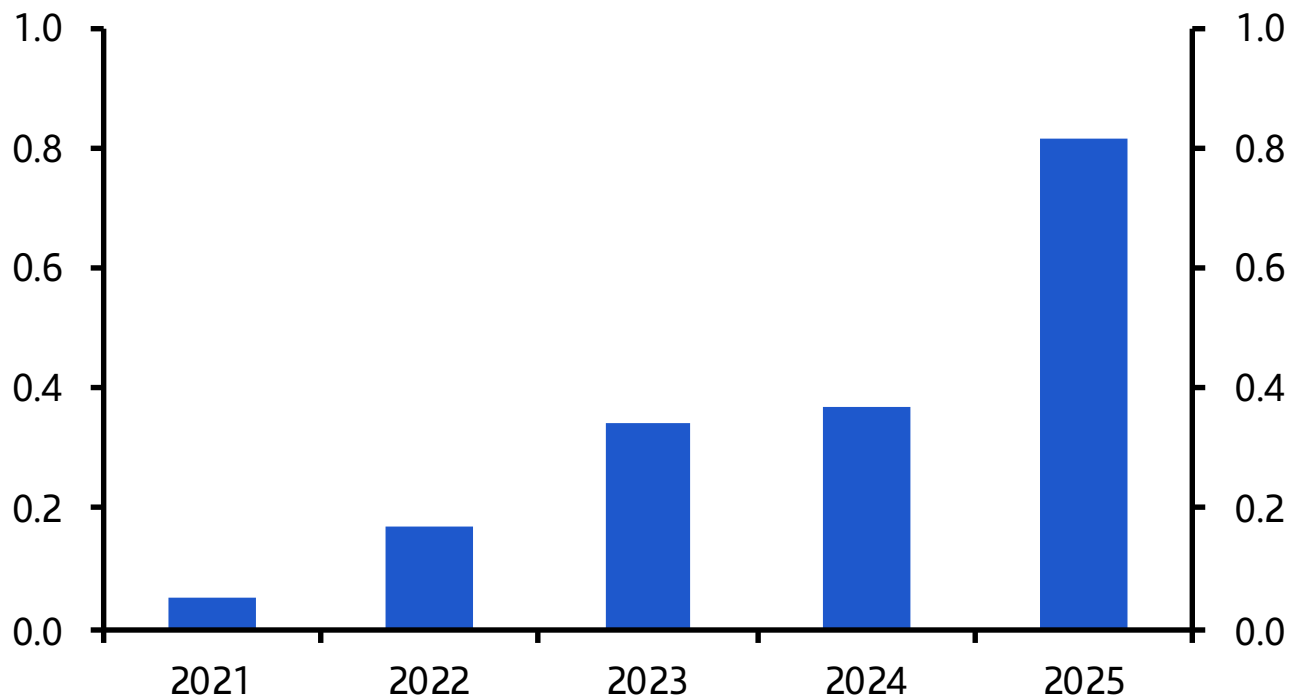
Sources: LSEG, CEIC, Capital Economics

Real GDP (% y/y)



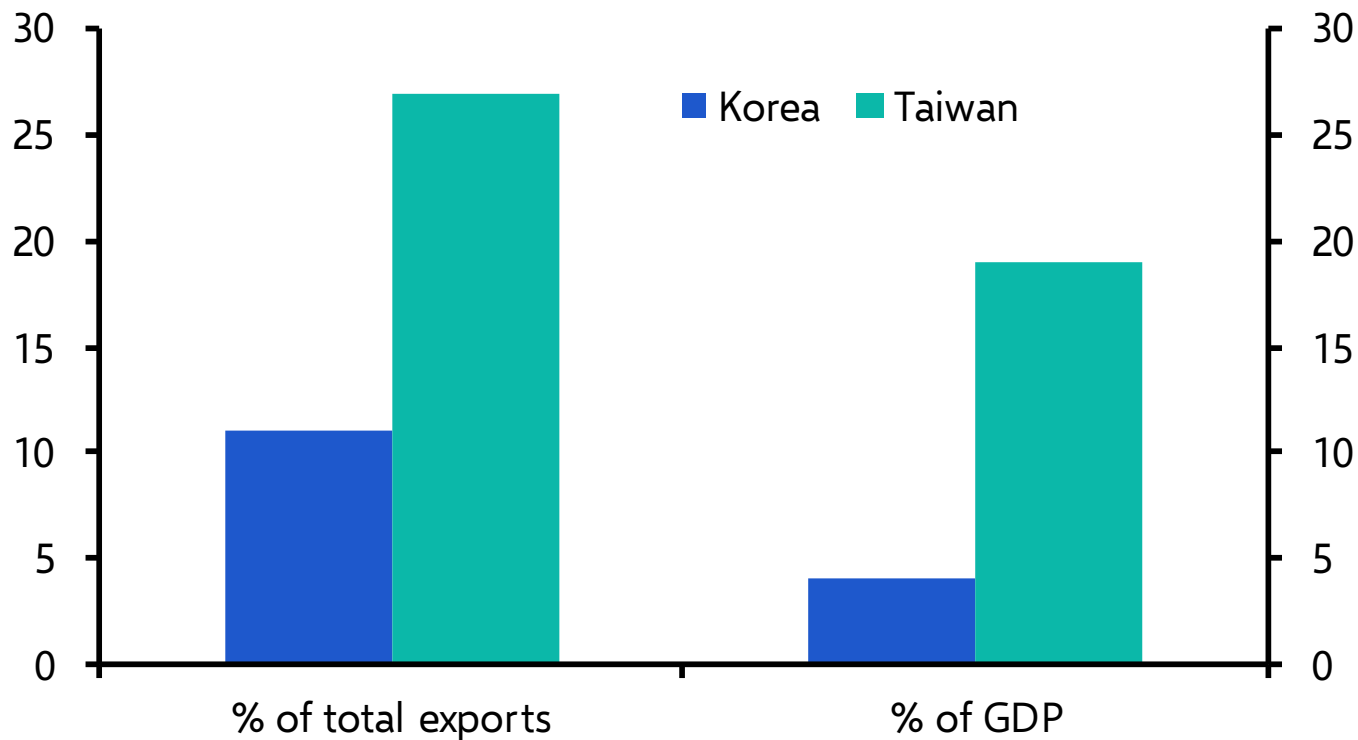
Sources: LSEG, Capital Economics

Malaysia Data Centre Construction (% of Real GDP)



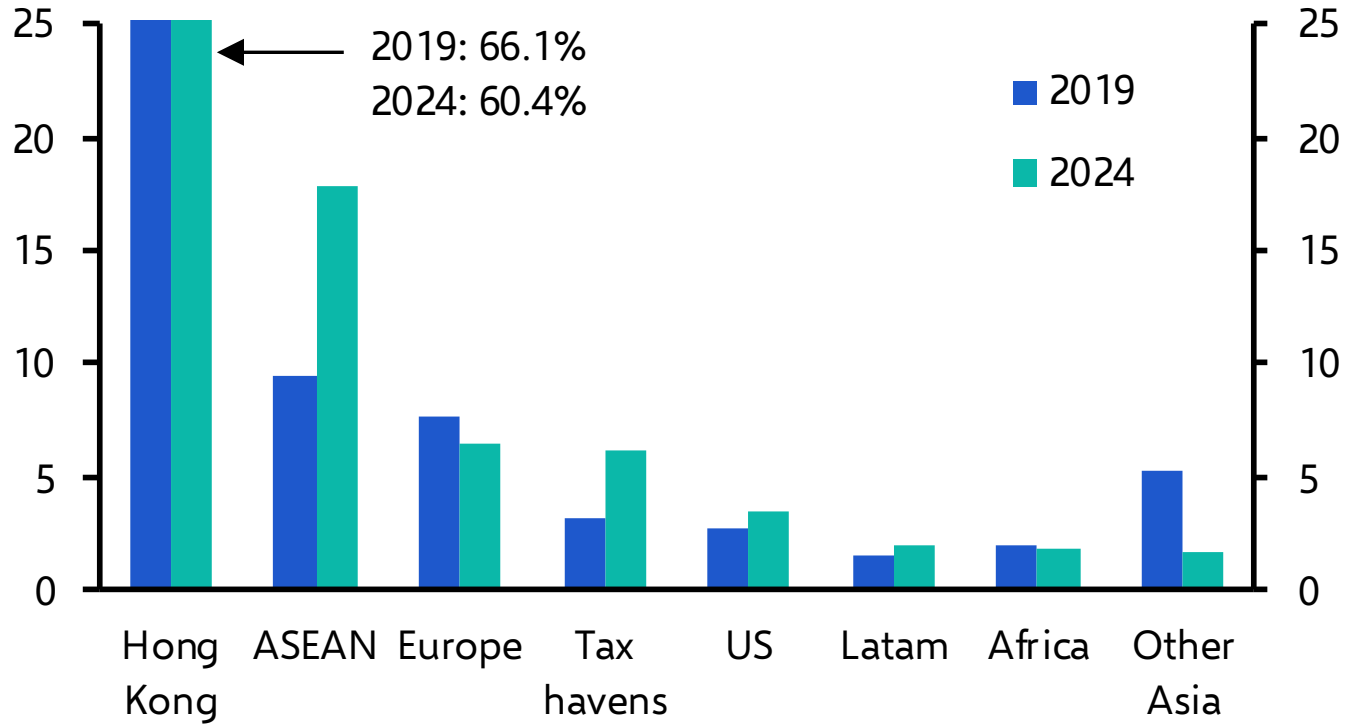
Sources: Bank Negara, LSEG, Capital Economics

Exports of AI Products



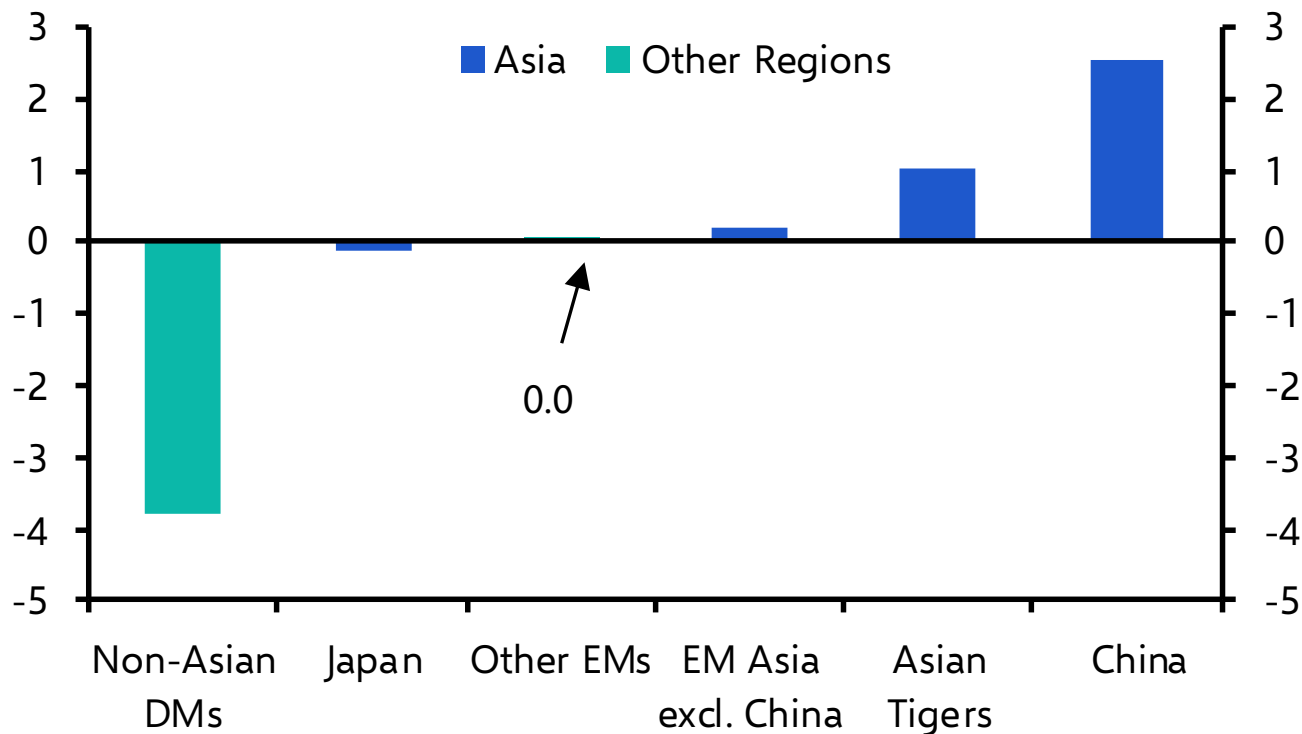
Sources: LSEG, Capital Economics

China's Outbound Direct Investment by Region (% of total)



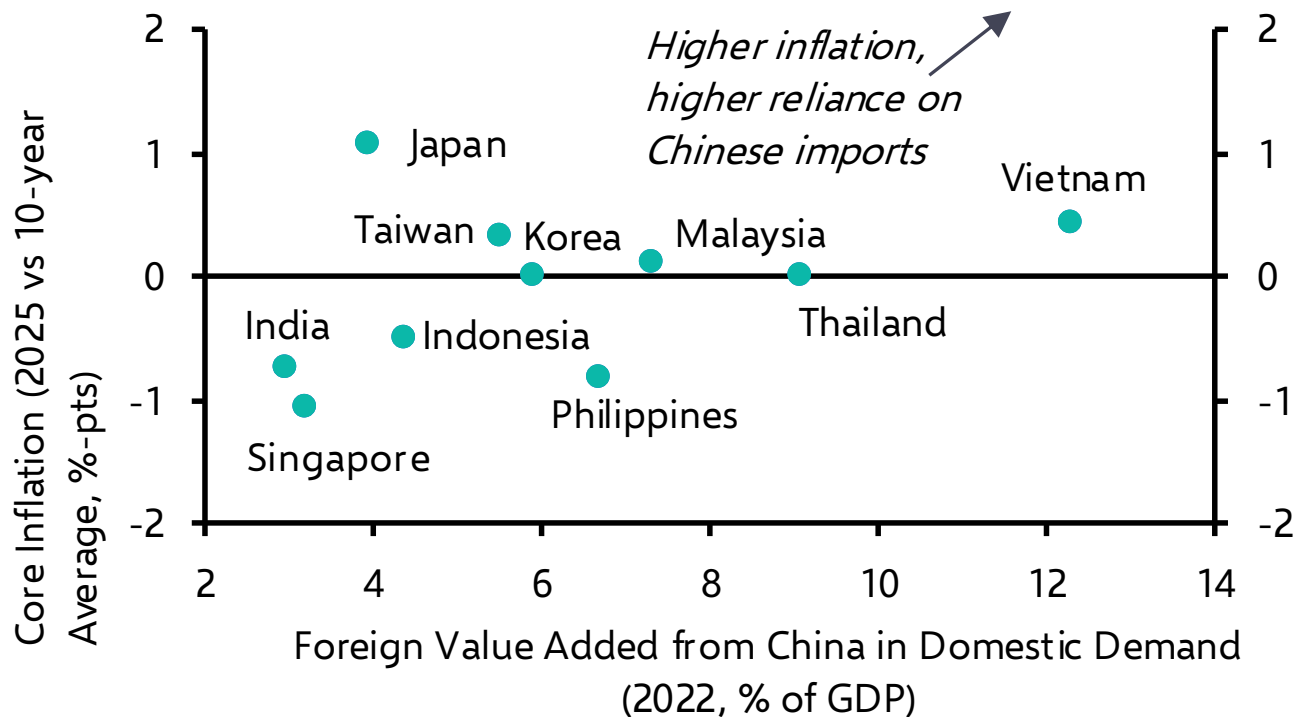
Sources: CEIC, Capital Economics

Global Export Market Share (Volumes, %-pt change since 2022)



Sources: LSEG, CPB, Capital Economics

Asian Countries' Reliance on Imports from China & Inflation

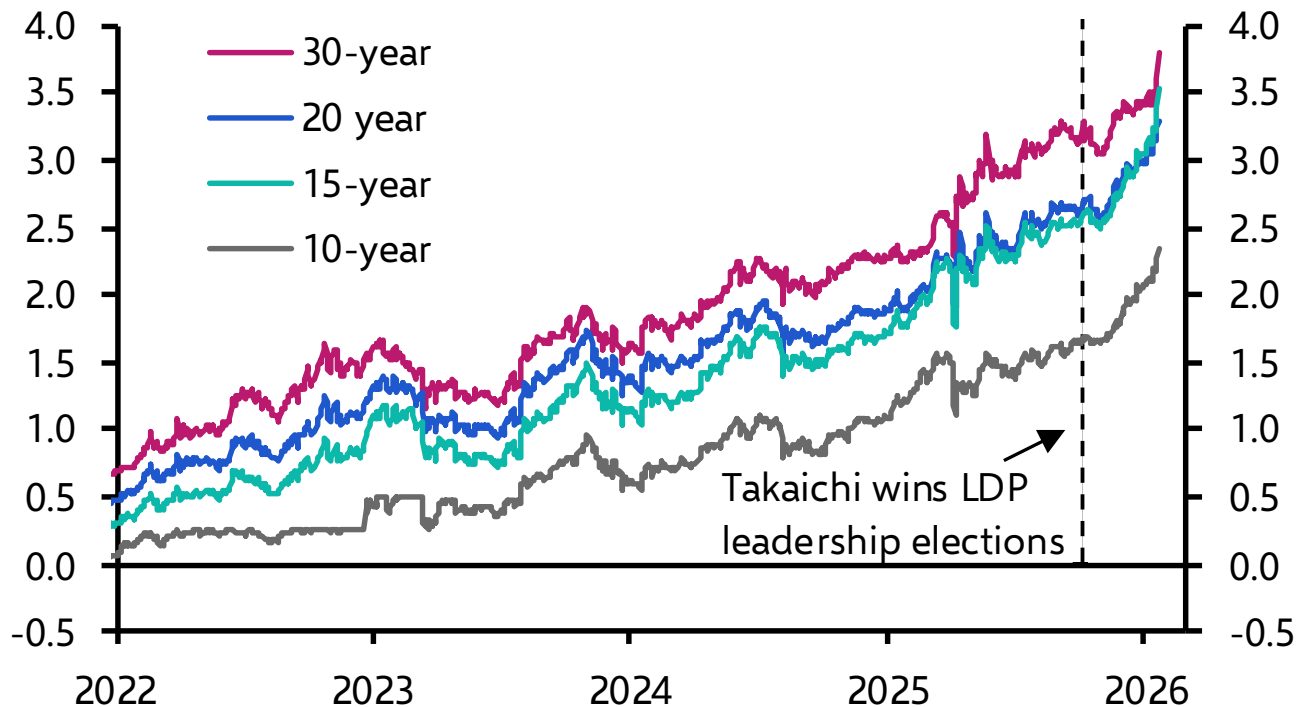


Sources: LSEG, OECD, Capital Economics

Conclusions

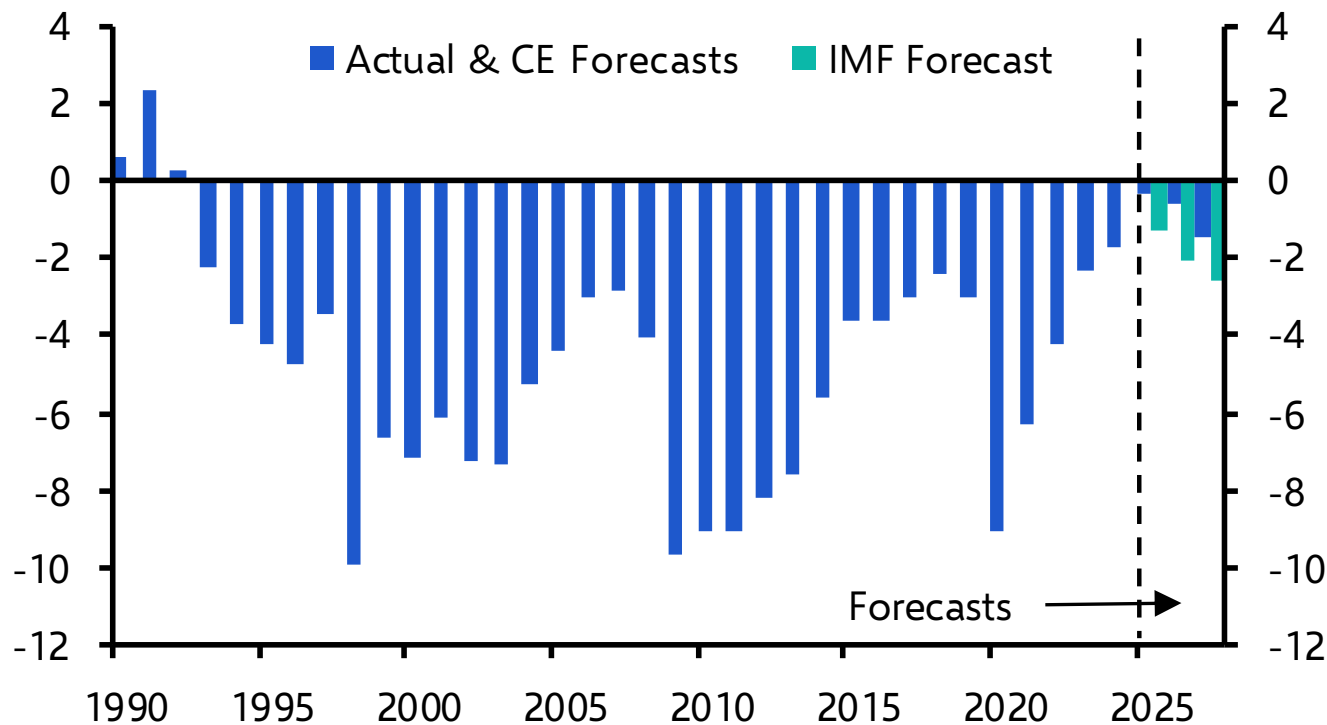
- Taiwan is benefitting from the AI investment boom, but electronics exports rising across the region.
- Lower-income countries are benefitting from US demand shifting away from China.
- China's mounting export dominance isn't doing much harm elsewhere in the region.

Japan Government Bond Yields (%)



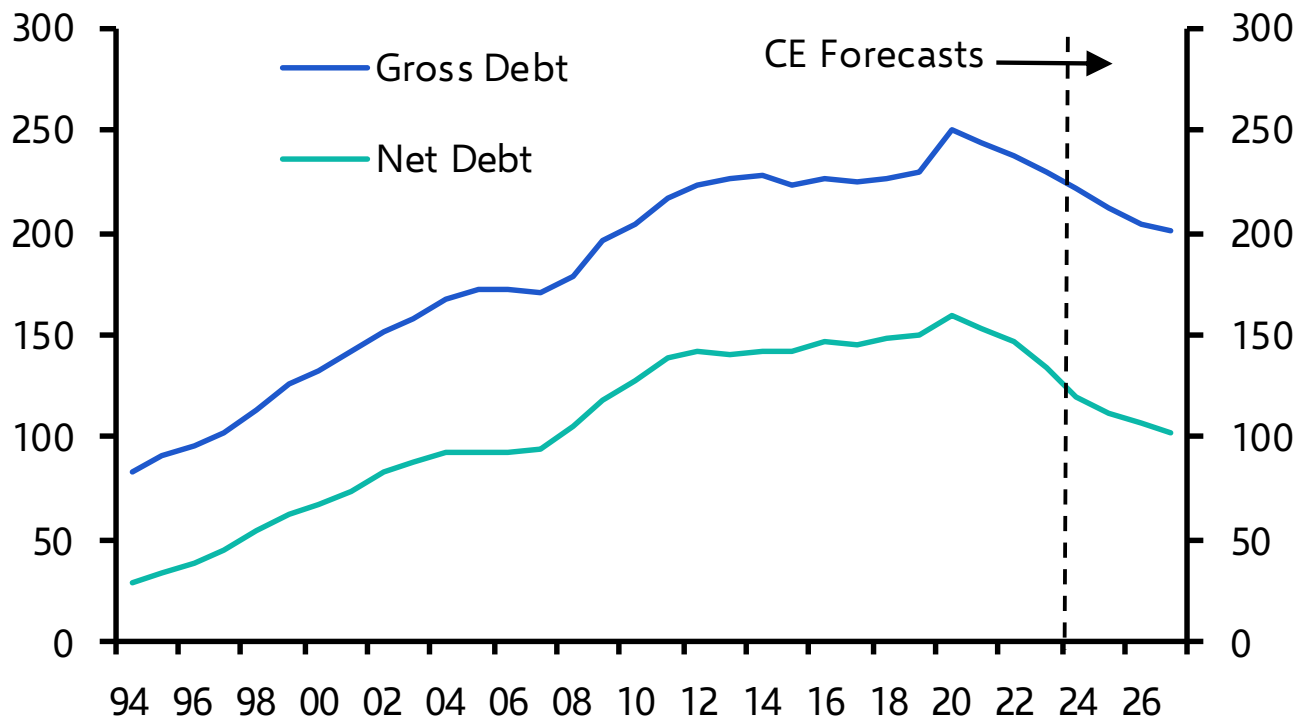
Sources: LSEG, Capital Economics

Japan General Government Budget Balance (% of GDP)



Sources: Cabinet Office, LSEG, Capital Economics

Japan General Government Debt (% of GDP)



Sources: Cabinet Office, LSEG, Capital Economics

Policy options should yields continue to surge

- Offset tax cuts with tightening elsewhere.
- Shorten maturity of bond issuance.
- BoJ could tilt purchases towards long-end or increase purchases.

China and the rest of the world

Mark Williams, Chief Asia Economist

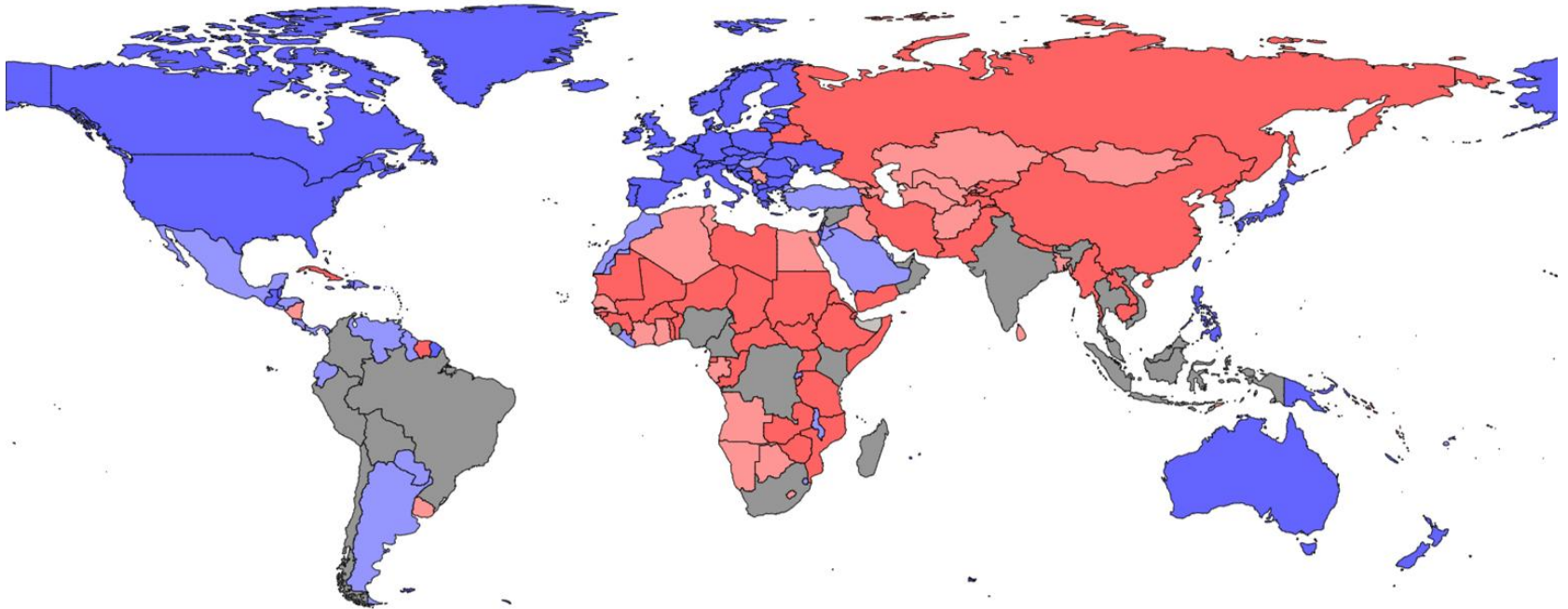


Key points

- China is running the biggest trade surplus of any economy in modern times.
- It will probably get bigger. Deflation will persist too.
- China will face mounting pressure from trade partners to adjust – and more countries will try to protect their markets.
- The flipside of a large trade surplus is large outward investment. The major beneficiary now is SE Asia.

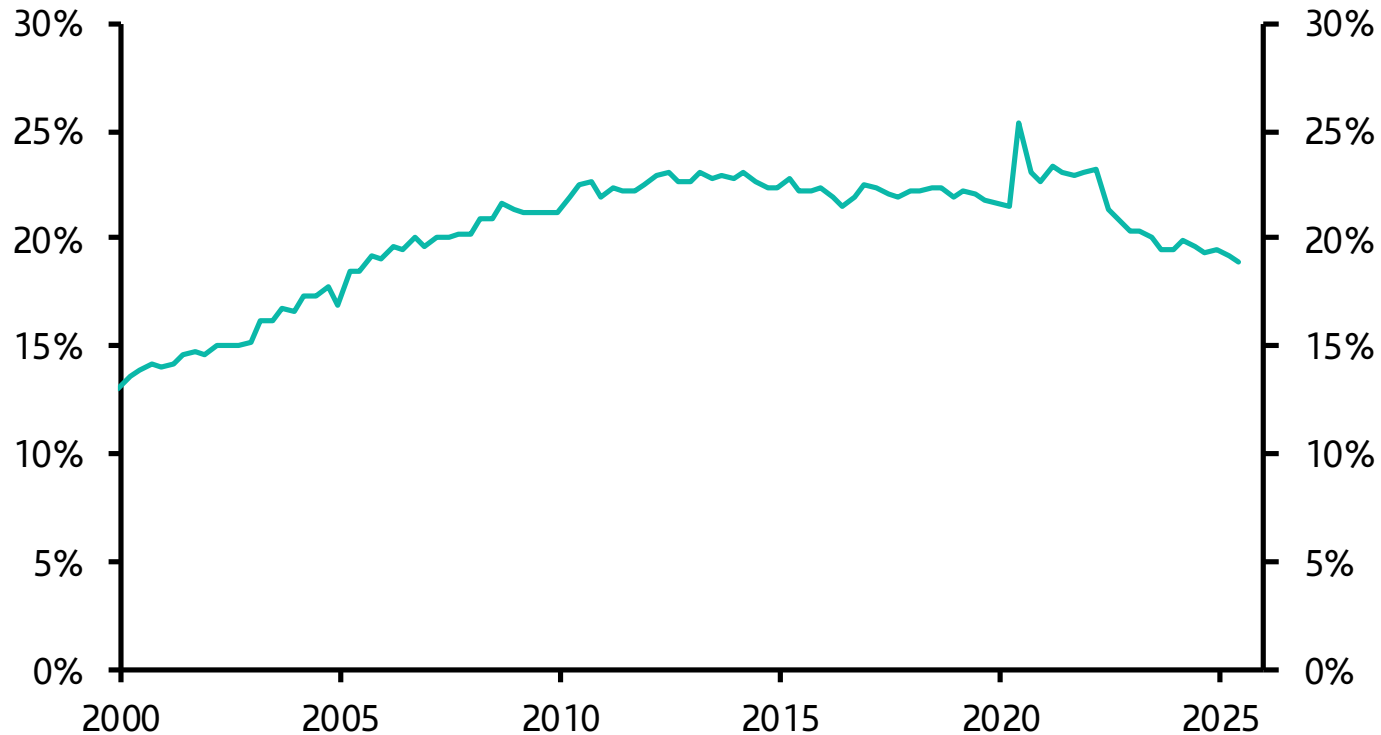
Capital Economics Classification of Global Alignment in 2026

● US & allies ● Leans US ● Unaligned ● Leans China ● China & allies



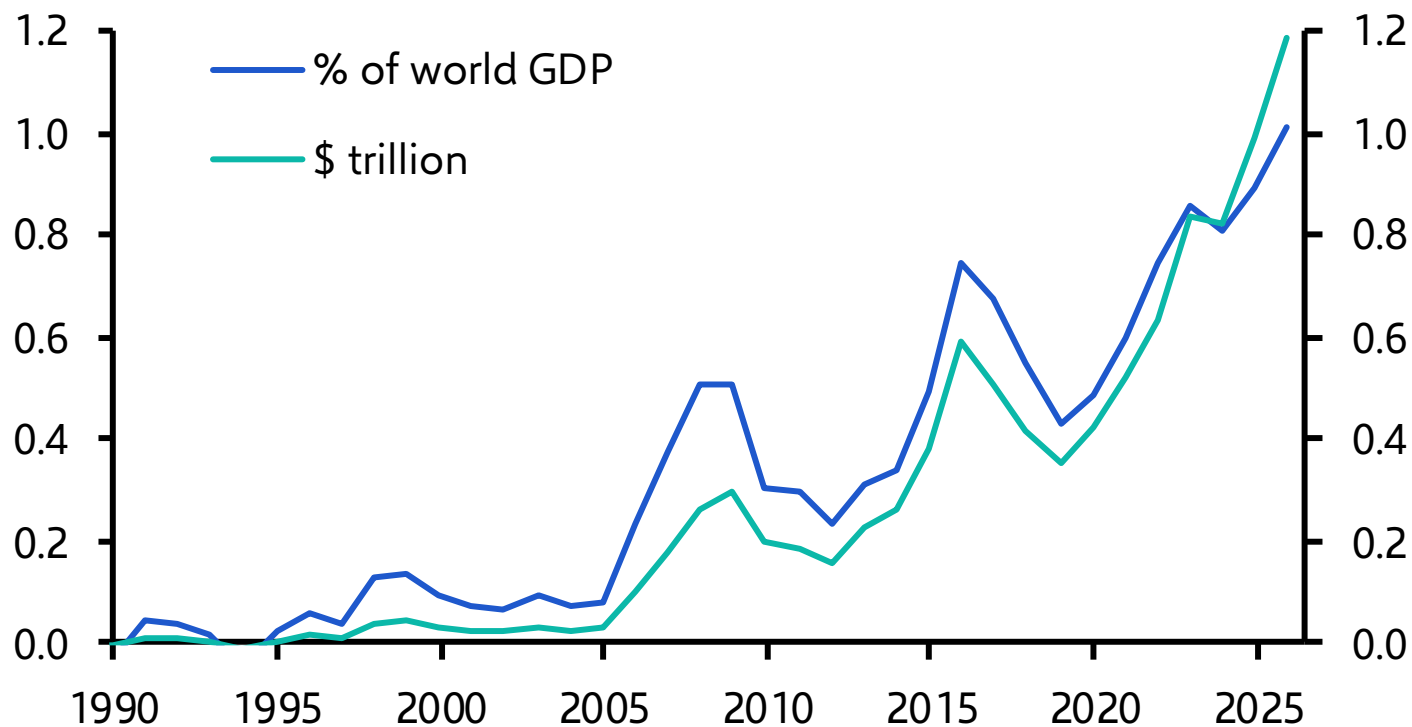
Sources: World Bank, Capital Economics

Share of Global Goods Trade between US & China Blocs



Sources: IMF, Capital Economics

China's Good Trade Surplus



Sources: CEIC, Capital Economics

Conclusions

- No country in modern times has had a goods surplus as large as China's. Goods manufacturers worldwide are under pressure as a result.
- Western governments have additional concerns:
 - About supply chain security
 - And about losing their advanced manufacturing bases
- That points to a more antagonistic economic relationship.
- Despite Trump, other major developed economies will be wary of drawing too close to China.

Key Forecasts

Geography	Indicator	2025	2026	2027
US	GDP (% y/y)	2.2	2.5	2.5
	Inflation (%)	2.7	2.8	2.5
	Policy Rate (%)	3.63	3.38	3.38
Euro-zone	GDP (% y/y)	1.5	1.1	1.2
	Inflation (%)	2.1	1.5	1.5
	Policy Rate (%)	2.00	1.50	1.50
UK	GDP (% y/y)	1.4	1.0	1.2
	Inflation (%)	3.4	2.1	1.8
	Policy Rate (%)	3.75	3.00	3.00

Sources: Capital Economics

GDP (% y/y)

Geography	2023	2024	2025	2026	2027
China (Official)	6.5	5.0	5.0	4.8	4.5
China (CAP)	6.3	4.5	3.1	3.0	2.8
Hong Kong	3.2	2.5	3.5	3.0	2.0
South Korea	1.6	2.0	1.0	2.0	1.8
Singapore	1.8	4.4	4.7	3.8	2.1
Taiwan	1.1	2.0	7.2	5.0	3.0
Japan	0.7	-0.2	1.3	1.1	0.9
India	8.8	6.7	7.5	6.5	6.5
Indonesia	5.0	5.0	5.0	5.0	5.0
Malaysia	3.7	5.1	4.9	4.9	5.0
Philippines	5.5	5.7	4.0	4.5	5.0
Thailand	2.0	2.5	2.1	1.8	2.5
Vietnam	5.1	7.1	8.0	8.0	7.5
Asia	5.6	4.6	4.9	4.3	4.1

Sources: LSEG, Capital Economics

Headline CPI (% y/y)

Geography	2023	2024	2025	2026	2027
China	0.2	0.2	0.0	-0.1	-0.1
Hong Kong	2.1	1.7	1.5	1.0	1.5
South Korea	3.6	2.3	1.8	1.5	1.9
Singapore	4.8	2.4	0.9	1.4	1.5
Taiwan	2.5	2.2	1.8	1.3	1.5
Japan	3.3	2.7	3.2	1.4	1.6
India	5.7	4.9	2.1	3.1	4.7
Indonesia	3.7	2.3	1.9	2.5	2.8
Malaysia	2.5	1.8	1.4	1.9	2.1
Philippines	6.0	3.2	1.6	2.3	3.0
Thailand	1.2	0.4	0.2	1.0	1.1
Vietnam	3.3	3.6	3.3	3.3	3.5
Asia	2.9	2.1	1.0	1.3	1.7

Sources: LSEG, Capital Economics

Policy Interest Rate (%)

Geography	2025	2026	2027
China	1.40	1.20	1.00
South Korea	2.50	2.00	2.00
Taiwan	2.00	2.00	2.00
Japan	0.75	1.25	1.75
India	5.25	5.00	5.50
Indonesia	4.75	4.00	4.50
Malaysia	2.75	2.75	4.75
Philippines	4.50	4.00	4.00
Thailand	1.25	0.75	0.75
Vietnam	4.50	4.50	4.50

Sources: LSEG, Capital Economics

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