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Strong Headline Growth Figure Masks Building Pressure in China's Economy

According to official figures, China registered 5.0 percent growth in Q1 2026. Closer examination reveals still-weak consumption, inconsistent data

reporting methodology, and headwinds from inflationary pressure brought on by the war in Iran.

- *Weak consumption:* China has repeatedly pledged to rebalance its economy toward consumer spending but has not followed through. Retail sales growth bottomed out in December 2025 (0.9 percent year-on-year), then rose slightly to 2.8 percent in early 2026 before slowing again in March to 1.7 percent.¹ A 9.1 percent drop in auto sales for Q1 dragged down retail spending for the quarter.² In an effort to stabilize prices, Beijing had subsidized

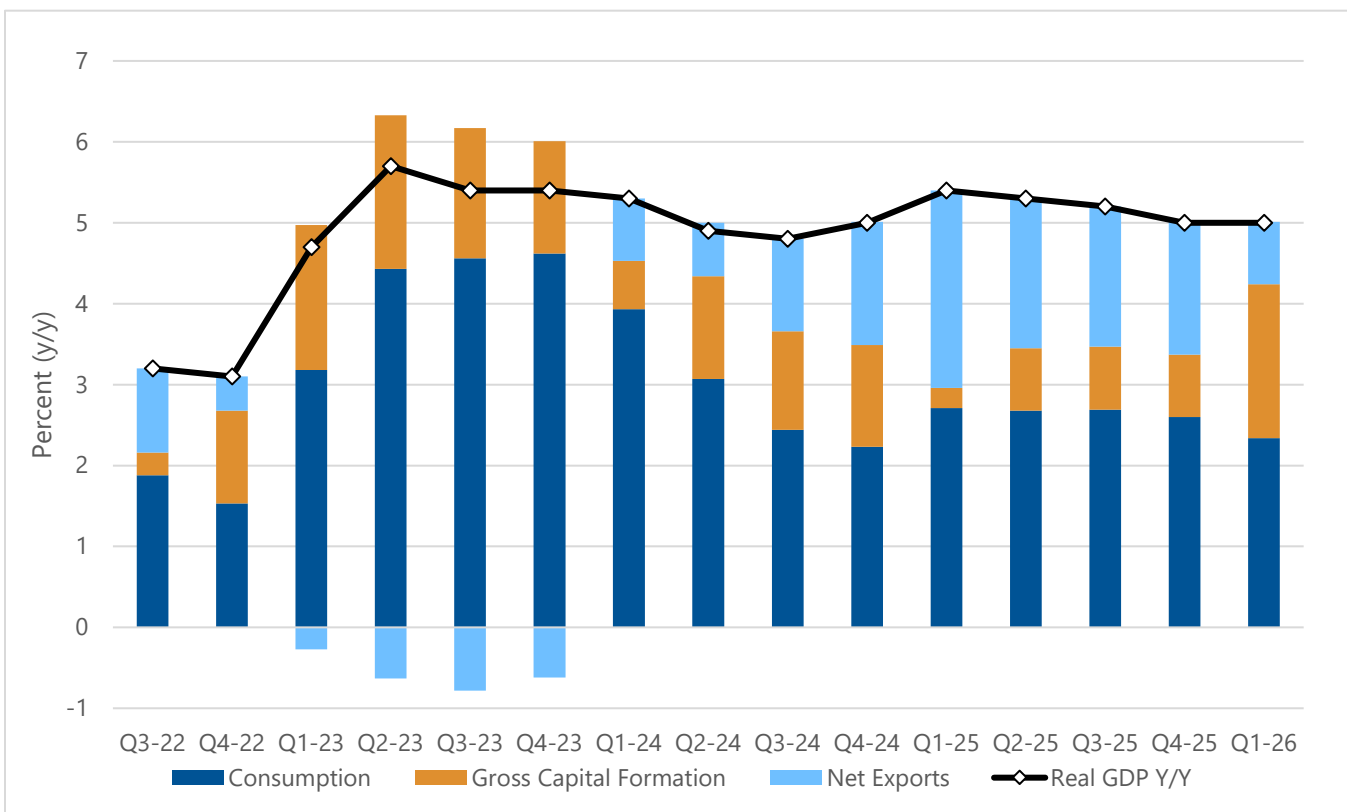
trade-ins of cheaper models in favor of higher-end models.³ Beijing’s “anti-involution” action led to an excess supply of lower-priced cars, fueling exports—China’s passenger car exports rose 60.6 percent year-on-year in Q1.⁴

- *Inconsistent data:* Higher-than-expected topline growth owes in part to downward revision of 2025 numbers.⁵ The National Bureau of Statistics (NBS) also reported a bounceback in fixed asset investment (FAI), an indicator closely watched by markets as a driver of demand for commodities. FAI dropped 3.8 percent last year but jumped 1.7 percent in Q1 2026.⁶ The infrastructure portion of FAI grew 8.9 percent year-on-year during Q1 2026 after

declining 2.2 percent in all of 2025.⁷ The sharp increase was driven partly by NBS adding power investment into the figure, which had previously been tracked separately by the National Energy Administration.⁸

- *Inflation:* China’s consumer and producer inflation both rose in March—1.0 and 0.5 percent, respectively—driven by higher fuel costs.⁹ As Trivium China analysts note, inflation from an external shock, rather than an organic rise in consumer confidence, puts China’s economy in a precarious position: it is harder for producers to pass price increases onto consumers without reducing demand, further compressing already razor-thin margins.¹⁰

Figure 1: Contributions to GDP Y/Y Growth (Quarterly, Not Seasonally Adjusted, YTD), Q3 2022–Q1 2026



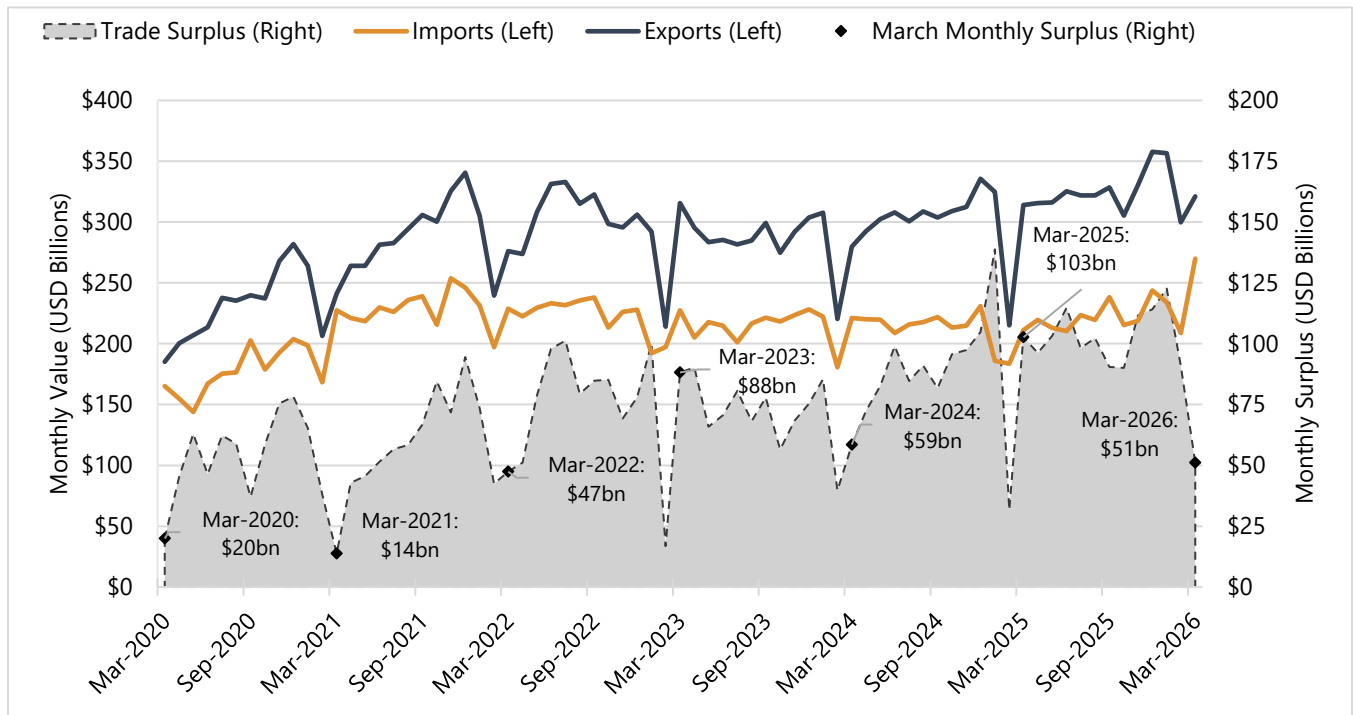
Source: China’s National Bureau of Statistics, via Haver Analytics.

China Shock 2.0 Deepens; Voracious Appetite for Advanced Semiconductors Helps Reduce Trade Surplus

Developing markets saw the brunt of a 14 percent surge in China Shock 2.0 as China’s market distortions continue to cause an export deluge to global markets. Meanwhile, China’s demand for high-end semiconductor imports surged on the back of rising AI investment.

- China’s export surge continued in Q1 2026, with double-digit growth in exports to developing markets and a shift in export composition to higher-value goods.¹¹ China’s exports in the first quarter of 2026 grew 14 percent year-on-year to \$977.6 billion, according to China’s General Administration of Customs.¹² China’s Q1 exports to countries in Southeast Asia and Africa grew 20 percent and 32 percent, respectively; the EU also recorded a 21 percent increase as Chinese exports rebounded from slower growth following EU tariffs on Chinese electric vehicles (EVs) in 2024.¹³ Conversely, exports to the United States fell 16 percent.¹⁴

Figure 2: China’s Trade Surplus in March 2026 Reaches Four-Year Low, March 2020–March 2026



Source: China’s General Administration of Customs, via Haver Analytics.

- Even with the continuing export surge, China’s trade surplus actually declined due in part to a record \$135 billion in semiconductor imports in the last quarter as demand for AI compute in China has skyrocketed.¹⁵ These numbers highlight China’s continued reliance on foreign-made advanced chips.

- More broadly, China saw a 27 percent increase in the value of imported electronics and high-technology products during Q1.¹⁶ Rising fuel costs in March have had less impact on China's trade balance so far, as crude oil imports were down 2.8 percent by volume and natural gas 10.7 percent compared to March 2025.¹⁷
- Export growth was driven by strong performance in China's higher-value-added exports such as EVs and lithium batteries.¹⁸ But exports of low-value-added goods like footwear and garments fell as input costs increased.¹⁹ Analysts expect China's exports of new energy goods to gain if the conflict in Iran drags on and hastens the energy transition in countries with high oil-import dependencies.²⁰ At the same time, export growth potential could diminish in the short run as emerging economies—China's fastest-growing customers—experience increasing inflationary pressures caused by the increase in oil prices.²¹
- Taken together, higher input prices and a weakening prognosis for emerging markets growth paints a difficult picture for China. In the near term, China is relatively insulated from energy shocks due to high EV adoption, substantial oil reserves, and heavy coal use. However, China's exporters have increasingly limited room to stay competitive by lowering their prices as margins are squeezed.²² Industrial value added in March grew just 0.3 percent on a month-to-month basis.²³ The deceleration in growth from January and February suggests pressure on profit margins and that weak demand may be weighing on output since the start of the conflict.²⁴
- The PLA Eastern Theater Command sent a task group through two sensitive Japanese waterways April 19–22 after a Japanese destroyer transited the Taiwan Strait on April 17 to join Balikatan—marking the first time Japan has participated in the exercise in a combat role.²⁵ The PLA's unusual routes passed by two Japanese islands hosting military garrisons and appeared intended to intimidate Tokyo.²⁶
- On April 24, the PLA Southern Theater Command (STC) announced the deployment of a task group to conduct live-fire drills in the waters east of the Philippines' Luzon Island and used language indicating the operations were a response to Balikatan.²⁷ Satellite imagery and regional reporting confirmed the deployment of at least 14 ships, including the *Liaoning* aircraft carrier and a submarine. The live-fire drills featured YJ-20 hypersonic anti-ship missiles, which China unveiled at a military parade in 2025.²⁸ On April 30, the STC conducted naval and air patrols around Scarborough Shoal and released a video of a fighter pilot locking on to what appears to be a Philippine patrol aircraft.²⁹
- These events likely signal Beijing's increasing willingness to use a show of force to respond to U.S.-allied security cooperation activities.

China Intensifying Sovereignty Claims Over Indian State of Arunachal Pradesh

Beijing refers to Arunachal Pradesh as “South Tibet” and considers it a “core interest”—placing it in the same category as Taiwan.

- On April 10, 2026, China's Ministry of Civil Affairs published a list of locations in Arunachal Pradesh that it had renamed with Mandarin titles.³⁰ India's Ministry of External Affairs immediately condemned the political maneuver, which is the latest Chinese attempt to undermine India's sovereignty over the border state.³¹

China's Aggressive Naval Activities Seek to Intimidate U.S. Allies

The People's Liberation Army (PLA) framed its operations as a response to the most expansive U.S.-Philippine-led Balikatan exercises to date.

- Arunachal Pradesh has long been considered a target for future PLA military operations, with China expanding dual-use facilities near the border, including an airbase 70 miles from the Tibetan Buddhist monastery in Tawang.³² Beijing is resettling Chinese citizens along the border in hundreds of villages, creating “permanent surveillance nodes and barracks” for acclimatized Chinese soldiers.³³ China also recently detained an Indian citizen from Arunachal Pradesh in a Chinese airport, calling her passport invalid and arguing that she was Chinese.³⁴
- These developments are heightening fears in India that a future confrontation over Tawang could be more severe than the December 2022 clash between Chinese and Indian soldiers.³⁵ In the Commission’s *Hearing on India, China, and the Balance of Power in the Indo-Pacific*, witness Sameer Lalwani warned that a military clash, even if it started small, might afford China the pretext to wrest control of Tawang and larger parts of Arunachal Pradesh from India.³⁶

China Creates New Tools for Technology Competition and Supply Chain Leverage

China is taking steps to strengthen its economic and national security toolkit. The State Council recently issued two new regulations targeted at industrial supply chain security and countering its interpretation of “extraterritorial jurisdiction” by foreign states.

- On April 7, the State Council issued the *Regulations on Industrial and Supply Chain Security* (Decree No. 834), expanding the PRC government’s authority to investigate and impose countermeasures on foreign companies deemed to be harming China’s supply chain security.³⁷ Articles 13 and 15 introduce new restrictions on entities conducting supply chain-related investigations within China, potentially targeting due diligence firms alongside companies looking to de-risk from China.³⁸ Previous frameworks were triggered by compliance with foreign legislative action rather than commercial behavior.³⁹ As is often the case for China’s national security-related laws, enforcement authorities have immense discretion to determine what constitutes a violation, creating further risk for foreign firms operating in China.⁴⁰
- Additionally, on April 13, the State Council released the *Regulations on Countering Foreign Improper Extraterritorial Jurisdiction* (Decree No. 835), which give China authority to exercise extraterritorial jurisdiction over acts with an “appropriate connection” to China to safeguard national security.⁴¹ The regulations introduce new mechanisms, such as the “Malicious Entity List,” designed to target individuals and companies that comply with U.S. and allied sanctions.⁴² They also contain what legal experts refer to as “piercing rules” that can be used to threaten parent companies and affiliated entities based on the actions of a subsidiary or affiliate, even if the activity occurs outside of China.⁴³ These measures are intended to deter compliance with U.S. sanctions and export controls.
- Beijing likely views both decrees as important new economic statecraft tools for U.S.-China technology and supply chain competition. In an April 20, 2026, *People’s Daily* article, National Development and Reform Commission (NDRC) Chairman Zheng Shanjie called for strengthening China’s economic security toolkit and emphasized countermeasures against sanctions and “long-arm jurisdiction,” reinforcing the policy direction behind the new regulations.⁴⁴
- USCC’s 2025 Supply Chain Leverage chapter previously analyzed Xi Jinping’s push to advance “rule by law” mechanisms to formalize and expand China’s economic coercion toolkit.⁴⁵ Amid a U.S.-China trade truce and an upcoming leadership summit, the regulations may signal Beijing’s intent to blunt U.S. tools and increase Chinese leverage over U.S. firms in future disputes.

China Flexes Its Muscles to Keep AI Innovations at Home: Tries to Block Meta's Acquisition of Manus

China's NDRC blocked Meta's acquisition of Manus, an AI agent startup with Chinese roots. This represents the first time the NDRC publicly used its foreign investment review to block investment in China's AI sector.

- On April 27, the Office of the Security Review Working Mechanism for Foreign Investment, under the NDRC, blocked Meta's \$2 billion acquisition of Manus and ordered both parties to cancel the transaction.⁴⁶ Since the investigation began in January 2026, as [the Commission noted in the February China Bulletin](#), Beijing has barred Manus's CEO Xiao Hong—who was appointed vice president of Meta following the acquisition—from leaving China.⁴⁷
- The NDRC bases its authority on the 2020 Measures for the Security Review of Foreign Investment, treating Manus's relocation to Singapore—including the transfer of its core team, research and development (R&D) capabilities, training data, and intellectual property—as a national security concern designed to circumvent Chinese oversight and attract U.S. investment.⁴⁸ This marks the first time Beijing has issued a public decision to block foreign investment in China's AI sector, emphasizing how it views AI as a critical technology with national security risks.⁴⁹
- While Beijing may have some leverage to enforce the decision, the extent to which it can fully unwind the deal remains uncertain. Despite its platforms being blocked in China, Meta's Chinese advertising business generated \$18 billion in 2024.⁵⁰ If Meta does not comply, the NDRC could impose penalties and even criminal charges.⁵¹ Enforcement would require Meta to terminate the transaction agreement; relinquish all de facto control of Manus; ensure Meta receives the full \$2 billion refund; and destroy all acquired data, technology, and documentation.⁵² Meta has already integrated Manus into some of its tools, making the disentanglement process complex, costly, and time-consuming.⁵³ Beijing raised concerns over the transfer of technology and knowhow, but the unwinding may also create a subtler impact for Meta. During the integration period, Manus's core team may have absorbed valuable technical knowledge from Meta, making the transfer of knowhow potentially a two-way street.
- More broadly, Beijing is sending signals to China's homegrown AI companies that they cannot sever ties with China to receive U.S. (if not all foreign) investment without government intervention.⁵⁴ Chinese AI firms have looked to U.S. investors to fund their capital-intensive operations, as domestic private-sector (i.e., non-state-backed) investment was stagnant in 2025, a sharp contrast to the massive surge in AI private investment in the United States last year.⁵⁵ Manus is not the first to follow this playbook: other firms with Chinese roots, including Tabcut and Wiz.ai (both relocated to Singapore) and HeyGen (moved to Los Angeles), pursued similar strategies.⁵⁶ Beijing recently ordered MiroMind not to relocate and issued similar warnings to AI labs Moonshot and Stepfun as they explore initial public offering options.⁵⁷

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