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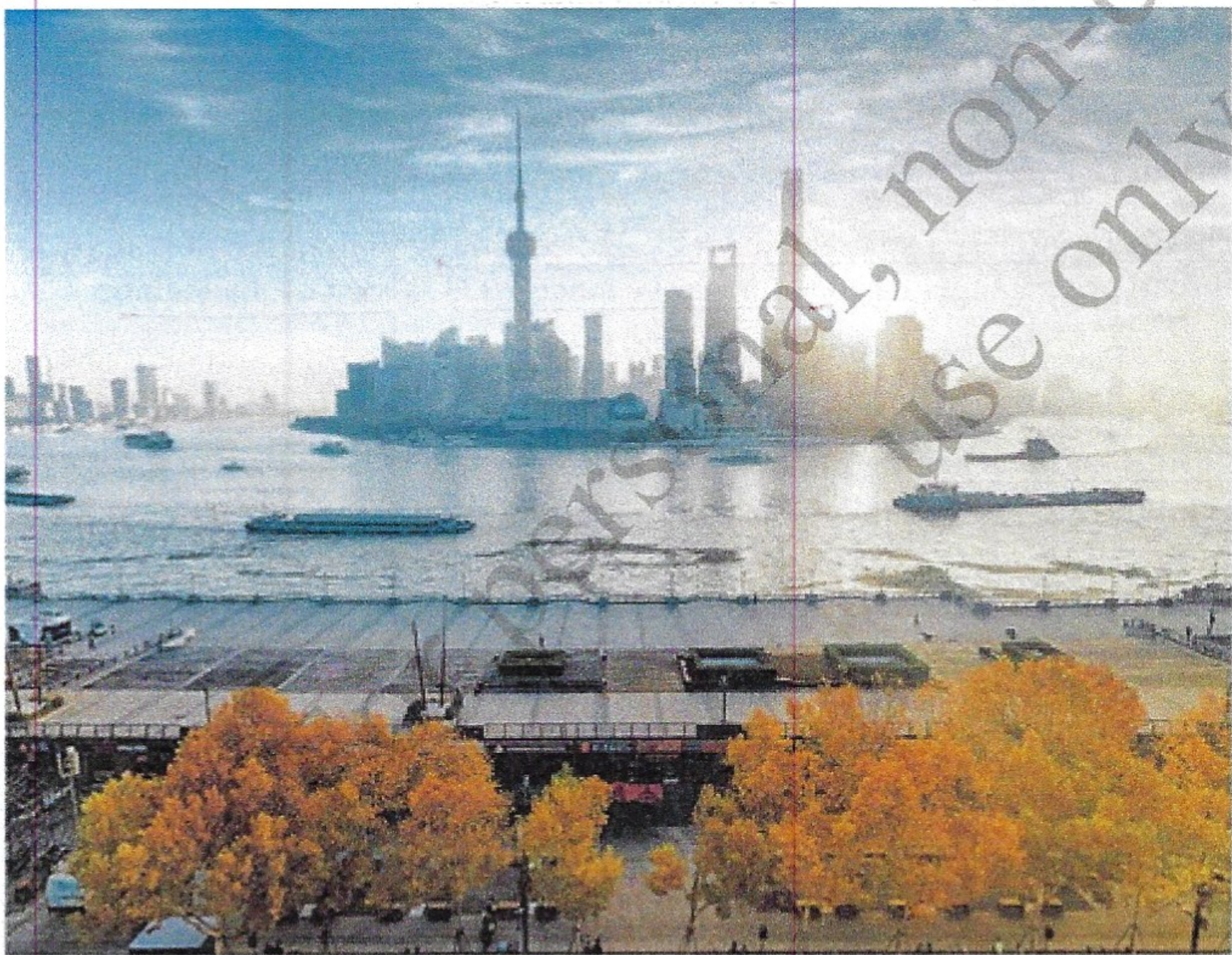

Cargo ships in Shanghai in November. Across China's economy, consumers don't spend enough and producers make too much. ALEX PLAVEVSKI/ EPA/ SHUTTERSTOCK

A Doom Loop Of Deflation Traps China's Economy

Exports drive growth while competition from overproduction hits prices

BY HANNAH MIAO

SHANGHAI—Hundreds of vendors at Shanghai's largest clothing market were busy. But they weren't making sales. They were processing returns.

At Qipu Road Wholesale Clothing Market, wholesalers send shipments of sweaters, dresses and pants to retailers all over the country. Stores pay for what they sell, and send back what they don't.

Lately, vendors say, little sells. On a recent weekday, delivery men dragged trolleys stacked with returned clothing through the halls. Vendors tallied the piles.

Wang Jingjing, a womenswear wholesaler, estimated her 2025 revenue was about half what she made the prior year. Before the pandemic, business was strong enough to hire four employees. Now she has only one, and even that feels like too many. The 40year-old mother of two teenagers said she no longer splurges on the occasional luxury bag, and instead lives frugally, ordering cheap takeout from food delivery apps.

"Ordinary people have no money in their pockets, including us," she said.

Note

Across China's economy, consumers aren't spending enough and producers are making too much. That leaves companies all along the supply chain earning less. Many feel they have no choice but to lower prices to unload inventory, eating into profits.

Note

With less money on hand, businesses are limiting wage growth, pausing hiring and shedding employees, which means workers have less to spend, continuing the cycle.

Notes

China managed to keep overall economic growth steady at 5% last year thanks to robust exports. The country is making extraordinary leaps in cutting-edge technology, from artificial intelligence to

robotics. Its ability to produce everything from rare-earth minerals to commercial ships is giving it a leg up in its trade war with the U.S.

Note Note

But its relentless pursuit of growth through manufacturing has also created a lopsided economy, with much of it stuck in a deflationary spiral. China's GDP deflator, a broad price gauge, has been negative since 2023, a sign of inadequate demand at home.

Corporate filings show profits shrinking at companies in a wide range of industries, including steel, concrete, electric vehicles, robotics, condiments and cosmetics. Profit margins among publicly traded companies in China are at their lowest levels since 2009, according to a FactSet index of 5,000 mainland- domiciled firms.

Note

Fixed-asset investment— which tracks spending on assets such as homes, factories and roads—fell in 2025 for the first time on record.

The risk is that China could get stuck in a prolonged period of stagnation similar to what Japan experienced during the 1990s and early 2000s—a mindset that becomes ingrained over time and even harder to shift.

Note

Deflation is increasingly a geopolitical liability. Squeezed in China, manufacturers are exporting more, notching a record $1.2 trillion trade surplus in 2025. Governments around the world are complaining about an influx of cheap Chinese goods.

Chinese policymakers have made boosting domestic demand their top priority and vowed to crack down on "involution," a buzzword for price wars and excessive competition.

But involution is also the price to pay for Chinese leader Xi Jinping's goal of industrial self-reliance and global leadership in advanced technologies, which has largely come at the expense of supporting consumers. Xi has indicated over the years that he has deep-rooted philosophical objections to Western-style consumerism, seeing it as wasteful. Note

In recommendations for the next five-year plan, China's policymakers aimed to boost household spending but again prioritized technology, manufacturing and industrial self-sufficiency— likely reinforcing the pattern of overproduction.

"Old habits die hard," said Robin Xing, Morgan Stanley's chief China economist, who expects deflation in the country to continue at least through this year.

Nation of savers

China's industrial rat race helped power the country's economic miracle. When Beijing sets economic goals, provinces and municipalities compete for glory. Local governments pour money into industries, creating a flood of companies all fighting to come out on top.

The system has made local governments and the financial system more incentivized to boost production than consumer spending. Businesses get cheap loans from Chinese banks, as well as investments and tax breaks from local governments.

Meanwhile, many everyday Chinese get by with bare-bones health insurance or small pensions, sometimes as low as around $30 a month. While the government has worked to strengthen the social safety net over the years, China's spending on such programs still lags behind many large economies.

Note

As a result, people tend to save for emergencies rather than spend. The average Chinese household stashes about one-third of its income, while Americans save less than 5%.

Note

Household spending made up only 40% of China's gross domestic product in 2024, compared with a world average of around 55%—and a U.S. average of about 68%, according to the World Bank.

Song Tianying, a 20-year-old cellphone saleswoman in Beijing, earns around $1,000 a month and saves about $400 of it. She started ramping up her savings around a year ago, when her father fell ill and her family had to borrow for his treatment.

She also wants to save money for a down payment to buy a home someday. A splurge is treating a friend to a good cup of coffee. "I want to save as much as I can," Song said.

The multiyear property-market slump—another example of overcapacity in China—is weighing further on spending.

Note

Zou Zhimin saved enough money as a jewelry wholesaler to buy a small two- bedroom apartment in Shanghai to live with his wife and two sons. But he bought at the peak of the real-estate market, around 2021. Prices have fallen some 20% to 40% since then, and Beijing has only taken modest steps to try to revive demand. Note

"It feels like my total net worth has shrunk by 20%," Zou, 35, said. His customers feel it too, he said. Lately, he has had to sell his earrings for about 60% off to maintain sales.

Note

In the auto sector, China has more than 100 EV makers. Local governments rushed to invest in the industry about a decade ago after Beijing identified EVs as a strategic sector. Now they want to keep production going to avoid layoffs and bring in tax revenue, instead of letting companies fail.

Note

"The problem now is that the rate of closures is too slow," said David Zhang, an auto analyst and the secretary-general for the International Intelligent Vehicle Engineering Association in China. "It isn't a purely marketdriven competition."

Prices in China for EVs have dropped for about three years. A survey by the China Automobile Dealers Association said just 30% of car dealers were profitable in the first half of 2025 and almost three-quarters sold at least some cars below cost.

At AVIC Lantian, a car dealer in Shanghai, business used to be pretty evenly split between selling imports to Chinese buyers, and selling Chinese cars abroad. But now it is mostly exports, as demand in China has weakened.

Zhang Leibin, general manager, said the dealer's car prices were about 30% lower in 2025 than in 2024. Profits were down about 50% from a good year. He is searching for new customers in the Middle East, Central Asia and Africa. The humanoid robotics sector— one of Beijing's newer favored industries—may already be falling into the pattern of overinvestment and excess competition. China's top economicplanning agency last year warned of the risk of a bubble, with more than 150 companies in the industry.

Nontech sectors are also struggling. China's paper industry was supported by significant government subsidies in the 2000s and has continued to suffer from overcapacity on and off for years. In the first 11 months of 2025, profits among large paper makers fell about 11% year over year, according to government data.

Shandong Chenming Paper, one of China's biggest paper manufacturers, cut prices. Its profits shrank, then turned into losses. As of June, it had racked up more than $500 million in overdue debt, had hundreds of bank accounts frozen and was forced to shut production lines, according to a filing.

Rising pet ownership in China has sparked a rush of companies into making items such as dog food, leashes and toys. Eric Yan, a manager at Petstar, a pet product maker in Hangzhou, said the industry has become extremely competitive, with rivals cutting prices and rolling out new designs.

Honworld Group, the holding company for cooking wine and soy sauce maker Lao Heng He in Zhejiang province, said household spending was weaker than expected, leading other brands to unload inventory at low prices. To cope, Honworld increased sales of its lower-end products that were more popular, but less profitable, the company said in a filing. That helped Honworld keep last year's first-half revenue in line with the previous year's period, but gross profits fell 11% to around $6 million.

In the online food-delivery business, the three major players— Meituan, Alibaba and JD.com—have burned cash by showering customers with aggressive discounts amid soft consumer demand, making ultrafast delivery of things such as milk tea and takeout often cheaper than eating out or cooking at home. Some Chinese media dubbed it the "summer of free lunch."

Meituan, the market leader, reported a net loss equivalent to $2.6 billion for the third quarter, its first quarterly loss since 2022, which it attributed to intense competition. Alibaba and JD.com reported profits roughly halving in their latest quarters, partly because of heavy spending on food delivery.

Working overtime

Note

With businesses struggling to make money, employees are having to do more work for less while companies avoid making new hires. Wage growth has stalled. Surveys by the People's Bank of China show widespread anxiety about job prospects.

Tian Yi, a 24-year-old in Beijing, started working as a graphic designer in 2024. But the startup she works at wasn't doing well, so she was also assigned to do livestreaming, promoting products on video platforms like Douyin, the Chinese version of TikTok. Most days, she works overtime, typically clocking in from 10 a.m. to 10 p.m. "I'm doing two jobs," she said, but her pay has stayed the same at around $1,100 a month. "I'm so tired."

Lu You, 32, feels pressured to watch his spending and save money for retirement, even though he has a relatively wellpaid job at a semiconductor company in Shanghai. "It isn't necessarily that your salary has decreased...But you might hear others around you say that theirs has, which creates a sense of urgency," he said.

China's major initiative so far is a program rolled out in 2024 that pays shoppers to trade in old vehicles or appliances for new ones. While the subsidies helped raise spending temporarily, the payoff has stalled now that many shoppers have already used them. Retail sales growth recently fell to the lowest level in several years.

Huang Hai, who runs a small toy shop in Shanghai, said he still feels he has no choice but to cut prices to make some sales.

He sells a set of nine blind boxes—collectible toys with the exact design a mystery to the buyer—for around $34, heavily discounted from the toymaker's suggested retail price of about $50. Online sellers on e-commerce platforms offer the same product for around $24.

Huang, 44, said that if his business is no longer feasible in Shanghai, he'll move back to his hometown of Nantong, a smaller city in nearby Jiangsu province. If he can't make a living in Nantong either, he said, "I'll just have to live off my parents." —*Zhao Yueling and Grace Zhu contributed to this article.*