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Focus on System Rivalry: Where Is China Heading?

When the winds of change blow, some people build walls while others build windmills.

Chinese Proverb

- Maintaining power as a key motive: Both the reform and opening-up policy under Deng Xiaoping and the centralized and nationalist policy under Xi Jinping are expressions of the CCP's consistent incentive structure to secure its power and legitimacy.
- First transformation (from 1978): Deng Xiaoping initiated the reform and opening-up policy, ushering in an era of economic liberalization that integrated China into the global economy and shaped the globalization of recent decades. This policy marked China's peaceful rise.
- Second transformation (from 2012): With Xi Jinping, a strategic realignment began prioritizing stronger ideological control, a return to Marxism-Leninism and the expansion of state control over key industries. Xi is also pursuing an increasingly rivalrous policy towards the West.
- Systemic competition: Xi Jinping is pursuing a policy that strengthens China's economic and technological independence and is redefining the global balance of power in trade and innovation.
- Parallel globalization: With initiatives such as the New Silk Road, aka Belt and Road Initiative, China is creating an alternative global network. This strategy aims to create economic dependencies and strengthen China's influence, particularly in the global South.
- Legitimacy of performance under pressure: China's financial stability is wavering in the face of the real estate crisis. Xi faces the challenge of putting the economy on a sustainable course without causing major shocks.
- Technological leadership and industrial strategy: China has achieved a leading global position in key industries such as e-mobility, renewable energies, and high-tech. Through smart industrial policy and strategic investment, it has become a driver of innovation in key areas and has overtaken the West in several fields of technology.
- Gold is booming among both private investors and the PBoC: Private investors are increasingly replacing real estate with gold, while the PBoC is expanding its holdings as protection against geopolitical risks and to reduce its dependence on the US dollar.

Introduction

History tells us that China and the US stand to gain from cooperation and lose from confrontation.
Mao Ning, spokesperson of the Chinese Foreign Ministry

It is January 17, 2025. Donald Trump, back at the threshold of power, dials the phone to Beijing just a few days before his second inauguration. The phone call was surprisingly friendly; Trump even praised the conversation as 'a very good one'. Two polar opposites – united, at least for the moment, in the lofty intention of 'making the world more peaceful and safe!' Are these mere conciliatory phrases, rhetorical whitecaps on the ocean of geopolitical currents?

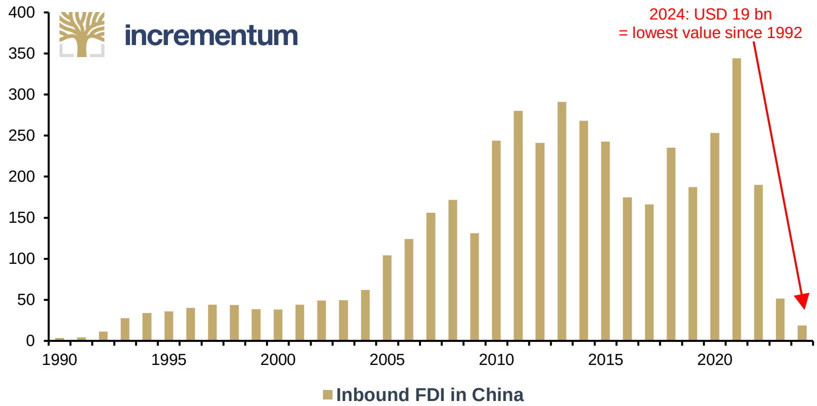
We've been ripped off by China for a long time.
Donald Trump

In any case, the tone here was different from Trump's in 2018. With a piece of economic improv theater, illuminated by the spotlight of a patriotic production, Donald Trump raised the curtain on the trade war with China in 2018, when erratic tariff increases and arbitrarily imposed trade barriers led to considerable irritation and imbalances in global trade. Companies were reluctant to invest in the face of uncertainty, as tariffs drove up production costs and disrupted global supply chains. Consumer goods became more expensive; and while the US dollar became the focal point of these uncertainties, its strengthening put additional pressure on the US export economy. Consequently, the Federal Reserve was forced to perform a hat trick of interest rate cuts in 2019 to lift the shadow from the economy.

Cold War II is worse. From a technological vantage point, it's also worse because we have the nuclear weapons of Cold War I […], but we also have a lot of things that they didn't have in Cold War I, from artificial intelligence to maybe quantum computing.
Niall Ferguson

Trump's impulsive volatility came up against a Chinese counterpart whose plans are not conceived in weekly or monthly cycles but in decades. Under Biden's direction, the conflict continued less erratically but no less implacably – because fundamental geopolitical tectonics had shifted noticeably when Xi Jinping took office in 2012. The intensive economic interdependence between China and the West was increasingly showing cracks in its structure. In light of comprehensive Chinese measures such as the strict regulation of technology companies, the dismantling of market monopolies, and the increased control of data flows, as well as US restrictions such as President Biden's ban on US investments in strategic Chinese technologies such as semiconductors, quantum computers and AI in 2023 to protect national security, more and more multinational companies are being forced to actively manage their China-specific risks.

Inbound FDI in China, in USD bn, 1990–2024



Source: Chinese State Administration of Foreign Exchanges (SAFE), Incrementum AG

There is an urgent need – from a political, entrepreneurial and investor perspective – for a deeper understanding of China under Xi Jinping. In the face of what is brewing in the Far East, Western narratives oscillate between appeasing hope and alarmism. But what factors actually determine China's course? What challenges threaten the country's stability? How solid is the power structure around Xi Jinping and the Chinese Communist Party (CCP)?

The Pillars of the CCP's Monopoly of Power

Ideas and ideologies matter, and institutions play a major role in determining just how much they matter. Ideas and ideologies shape the subjective mental constructs that individuals use to interpret the world around them and make choices.
Douglass C. North

Our approach focuses on the CCP and its party leader as a central actor with a clearly definable incentive structure. This approach is anchored in the tradition of political economy and at the same time closely related to Ludwig von Mises' concept of the *acting man*. China's geopolitical strategy and domestic political actions appear in a different light as soon as they are interpreted as an expression of the CCP's efforts to secure its hold on power. Legitimacy plays a decisive role in this and is based on several pillars:

- **Ideology**: On the one hand, it serves to "convey a unified and conscious worldview to the individual", which, among other things, justifies the necessity of the CCP's supremacy. On the other hand, it functions as organizational communication, which aims to create a clear and uniform orientation for action within the party and to translate the world view into consistent actions. (It should be noted that the CCP has 100 million members.)[48]
- **Performance legitimization:** The government justifies its rule through economic success and the improvement of living standards.
- **Social stability and security:** Tensions are controlled through stability policies, surveillance, and repressive measures in order to prevent chaos as in

[48] Marx and Engels argued in the Communist Manifesto that the dictatorship of the proletariat was necessary to overcome the bourgeoisie and create a classless society. Lenin took up this idea and developed the idea of the vanguard party, which, as the leading force, had to represent the revolutionary interests of the proletariat.
The distinction between pure and practical ideology (here: world view vs. organizational communication (Weltanschauung vs. Organisationskommunikation)) can be found in: Schurmann, Franz: Ideology and Organization in Communist China, 1966, p.22.

the Cultural Revolution. At the same time, social equality as a communist ideal remains central to limiting inequality and avoiding conflict.

– **Geopolitical legitimacy**: China's national rise and its role in world politics strengthen the legitimacy of the leadership.

稳定压倒一切。
(Stability is the top priority.)
Deng Xiaoping

The pillars of legitimacy do not work in isolation but are in tension with each other, which often creates conflicts of interest. The following sections are dedicated to analyzing China's two central transformations of the last 50 years against the backdrop of the aforementioned pillars of legitimacy and their reciprocal dynamics:

– The reform and opening-up policy from 1978
– The realignment under Xi Jinping from 2012

Strengthening the Basis of Legitimacy through Economic Reforms from 1978 and the Golden Age of Globalization

It doesn't matter whether a cat is black or white, as long as it catches mice.
Deng Xiaoping

After Mao Zedong's death in 1976, China found itself in a state of profound uncertainty in which society was balancing on the ruins of ideological excesses. The Great Leap Forward (1958–1961) and the Cultural Revolution (1966–1976) had proved to be furious self-demolitions, historical boomerangs that not only undermined the country's economic foundations but also corroded the social texture through a climate of generalized mistrust and systematic political paranoia. The following table shows the status quo of the basis of legitimacy at the time:

Pillar	Rating	Status quo
Ideology	weak	(Impending) loss of faith in Maoism and Marxism-Leninism (Impending) fragmentation within the CCP Doubts about one-party rule
Performance legitimization	weak	Economic stagnation and widespread poverty Inefficiency of the planned economy, production losses, and lack of technological development
Social stability and security	weak	Social trauma and fragmentation caused by the Cultural Revolution Deep mistrust between citizens and the government, and within society Widespread poverty Local unrest and protests
Geopolitical legitimization	weak	International isolation, especially after the split with the Soviet Union Little influence in global politics Regional rivalries and military backwardness

Source: Incrementum AG

Deng Xiaoping's assumption of power in 1978 came at a time when the CCP was characterized by internal tensions and uncertainties. Although there was no openly visible revolutionary counter-camp, the fear that even the smallest trigger event could turn the simmering unease into a conflagration kept the party leadership on constant alert. **The imperative was hanging over the country – and Deng recognized it – to generate economic momentum through reforms that seemed capable of halting the erosion of the legitimizing foundations and enabling forward momentum.**

Trial and error: Deng Xiaoping's pragmatic reform course

摸着石头过河。
(Crossing the river by touching the stones)
Deng Xiaoping / Chen Yun

In the years that followed, Deng Xiaoping introduced the economic and political innovations that became known as the reform and opening-up policy (改革開放, gǎigékāifàng). The focus was on a pragmatic trial-and-error approach: Special economic zones such as Shenzhen became laboratories of cautious market economy experiments and decentralized reform initiatives. Without jeopardizing the fragile political stability, Deng created islands of progress whose dynamic successes served as blueprints for the gradual opening up. It was a two-pronged reform practice that was based on a controlled interplay between central government authority and decentralized reform initiatives and that created room for competing approaches and adjustments in the event of undesirable developments.

[The Party] prescribes to its people, every few years, sometimes every few months – whenever necessary – forgetting, complete and total forgetting.
Kai Strittmacher

The introduction of non-planned, non-state economic sectors led to the formation of a dual structure, a coexistence of market-based, vibrant innovation spaces and central planning, whereby the share of the planned economy was gradually reduced ("growing out of the plan").[49] At the same time, the targeted expansion of exports, fueled by capital from Hong Kong and overseas, set in motion the mechanisms of global integration that gave China's economy ever new growth spurts.

But didn't this gradualist course of reform reveal with cutting clarity that the planned economy was failing while the market economy was proving to be functional? **Wasn't reaching for the tools of the ideological opponent a subtle capitulation to the methodology of the system rival?**

Checking the pillars of legitimacy

These questions show the fine line that was being walked. **The economy was booming, and the legitimacy of performance was strengthened.** But what about the other pillars of legitimacy?

We must integrate the universal truth of Marxism with the concrete realities of China, and blaze a path of our own and build a Socialism with Chinese Characteristics.
Deng Xiaoping

The CCP invested a great deal in ideology. It was a phase of ideological acrobatics that created a rhetorical hub with the guiding principle of the "initial stage of socialism", which reinterpreted contradictions as strategic necessities and brought the unorthodox reforms back into the fold of Marxism. A market economy and income inequality were rationalized as necessary stages and presented as "temporary", without explicitly rejecting the country's Marxist-Leninist foundation – the central justification of CCP rule. The establishment of a modern, industrialized state was declared to be an indispensable prerequisite for the long-term realization of communism.

The result was a *socialism with Chinese characteristics* that dialectically modulated the cognitive dissonance between the official party dogma and the course of reform. While some see Deng's course as a loss of ideological substance

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[49] Naughton, Barry: Growing Out of the Plan: Chinese Economic Reform, 1978–1993, 1995

and the communist vision degraded to lip service,[50] others argue that ideology played an important role by taking on a stabilizing function and a supporting role in the transformation.[51]

The basic rationale of socialism would be thrown into question if China had to pursue modernization at the expense of equality.
Feng Chen

In terms of social stability and security, the picture was ambivalent. The rise of hundreds of millions of Chinese out of extreme poverty strengthened the basis of the social fabric, but the downside of the reforms was growing social and regional inequalities. Formulas such as "Let some people and some regions get rich first" (Deng Xiaoping) or "Fundamental Interests of the People" (Jiang Zemin) or *Harmonious Society* (Hu Jintao) were used as ideological band-aids. But the focus on economic progress widened inequalities further and deepened the need for entrepreneurs, who were finally – against the Party's DNA as the vanguard of the working class – officially accepted into the CCP in 2002 as part of the *Three Representations* (Jiang Zemin).

You don't have individual incentives for any one member of the party to limit corruption [...] You yourself would like to steal as much as you can get away with.
Noah Feldman

While unleashed markets brought fabulous profits to entrepreneurs, the opaque, hermetically sealed power structure gave party functionaries access to lucrative backroom economies in which capital flows and privileges were discreetly diverted ("cadre capitalism"). It is obvious that this challenged the sense of social fairness. But while elsewhere protest would have flared up, in China cultural and psychosocial factors acted as fire extinguishers of indignation. Values such as harmony and authority ensured that the population often perceived inequality as a necessary phase or even as fair.[52]

韬光养晦。
(Hide your strength, bide your time.)
Deng Xiaoping

The economic successes of the opening-up policy not only strengthened the CCP at home but also China's position in the global order. As the *workbench of the world* and an integral part of the global economic mechanism, the country became a central hub in the structure of economic interdependencies, whose growing importance translated into geopolitical influence. Until 2012, there was a policy of peaceful rise, characterized by China's efforts to anchor itself as a cooperative player in the global community – symbolically crowned by the hosting of the 2008 Summer Olympics in Beijing.

Success breeds complacency. Complacency breeds failure. Only the paranoid survive.
Andy Grove

The following table provides an overview of the sustainability of the individual pillars of legitimacy of CCP rule during the reform and opening-up period. The reform policy strengthened the party, but at the same time confronted it with structural challenges that Xi Jinping later took up.

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[50] See e.g. Heilmann, Sebastian: Das politische System der Volksrepublik China (The politictal system of the People's Republic of China), 2002, p.71. Heilmann sees the reform policy as an intellectual sell-out of the ideological core, while the CCP carried out a pragmatic capitulation to the imperative of economic modernization and private enrichment.

[51] Holbig, Heike: "Ideological Reform and Political Legitimacy in China: Challenges in the Post-Jiang Era", GIGA Working Paper No. 18, German Institute of Global and Area Studies (GIGA), Hamburg, 2006

[52] Im, Dong-Kyun: "The legitimation of inequality: Psychosocial dispositions, education, and attitudes toward income inequality in China", in: Sociological Perspectives 57(4), 2014, pp. 506–525; Sun, Wanning: "Inequality and Culture: A new pathway to understanding social inequality", in: dies./Yingjie Guo (eds.): Unequal China: The political economy and cultural politics of inequality, London 2013, pp. 43–58

Pillar	Rating	Risks
Ideology	medium	Ideological erosion Generational conflicts Growing pressure from critical intellectuals
Performance legitimization	strong	Slowdown in growth Middle-income trap
Social stability and security	medium	Social tensions as a result of inequality Demographic challenges Loss of trust due to corruption
Geopolitical legitimization	medium to strong	External dependencies International criticism Resource conflicts Regional rivalries

Source: Incrementum AG

Realignment under Xi Jinping and Parallel Globalization

When Xi Jinping took over the leadership of the CCP in 2012, he ushered in a new phase of Chinese politics that marked a clear break with the reform era. To understand this, it is worth taking a look at the pillars of legitimacy during this period. **There are numerous indications that performance legitimacy lost its previous traction and that Xi was forced to reshape the economic model and strengthen other pillars of legitimacy to secure the CCP's authority.**

Challenges in performance legitimization

The growth during the reform era was based on favorable starting conditions: low wages, high returns on capital, and access to global markets favored rapid "catch-up growth". However, these factors had reached their limits:

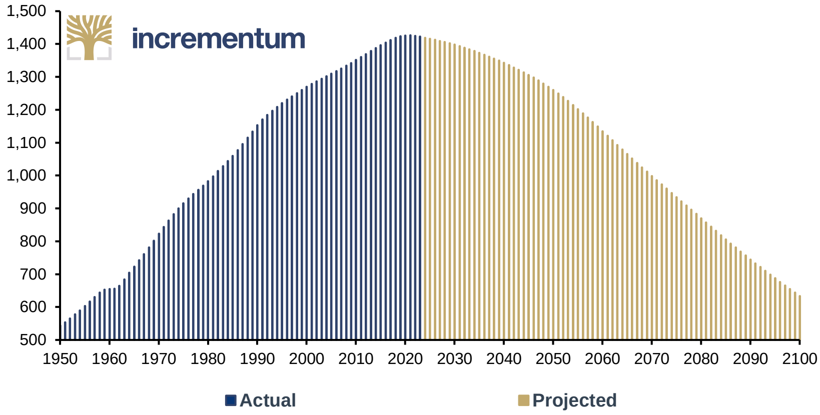
- **Falling returns on capital**: As the capital stock grew, the marginal returns on new investments fell.
- ***Middle-income trap***: Rising wages weakened China's role as the *workbench of the world*, causing production to migrate to cheaper countries.
- **Saturation of global markets**: It became more difficult to tap into new markets, as many had already been penetrated.

前人栽树，后人乘凉。
(Ancestors plant trees, descendants enjoy the shade.)
Chinese proverb

Demographic challenges were also weighing on growth.[53] The effects of the one-child policy have led to an ageing population and a shrinking workforce. Since 2013, the number of marriages in China has more than halved. By 2050, China's potential workforce will have declined sharply, which will both dampen economic growth and put a strain on the social security system.

[53] See "Global Demographics Turn Inflationary," In Gold We Trust report 2021

Population of China, in mn, 1950–2100e



Source: ourworldindata.org, UN, Incrementum AG

Xi's decision to promote the Two Integrations at the highest levels of party discourse suggests he is turning further toward emphasizing ideological and historical claims to legitimacy. This reflects a growing realization in Beijing that China's economy will no longer deliver significant levels of performance legitimacy.
Hongjia Yang

Financial risks in the Chinese real estate sector and the shadow banking system have been a further drag on performance legitimacy. The real estate sector, once a core element of the Chinese boom, has become the Achilles heel of the Chinese economy. Speculation-driven growth and increasingly weak demand, which is likely to worsen with demographic change, mean that the sector appears to be exhausted as a growth driver. The combination of excessive debt – local governments, for example, are also heavily indebted as they have long financed themselves through the sale of land – and the fact that loans are heavily secured by real estate has led to a sustained fall in prices that threatens to jeopardize financial stability. This risk is exacerbated by the closely interwoven, unregulated shadow banking sector, further increasing vulnerability to shocks.

Real Estate Climate Index (lhs), and Real Estate Development Investments (rhs), yoy, in %, 01/2000–03/2025

Source: LSEG, Incrementum AG

The elephant is metabolically more efficient than the mouse, but if an elephant falls just a little bit, it breaks a leg; it's gone.
Nassim Taleb

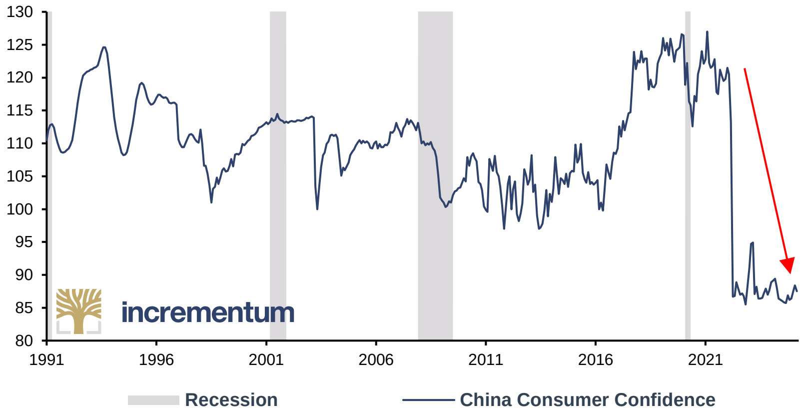
These weaknesses are the result of a long-term neglect of resilience in favor of rapid expansion. As Nassim Taleb explains in *Antifragility*, overoptimized efficiency – for example by prioritizing rapid, debt-driven growth and short-term profits – comes at the expense of resilience and leads to complex systems becoming more susceptible to crises.[54] **Structural risks of this kind are particularly serious for the CCP, as it commonly presents itself as a protective shield against crises and as a capable counterweight to Western systems, which it claims are inherently crisis-prone.**

[54] Taleb, Nassim: Antifragile: Things That Gain from Disorder, 2012

Also, during the Covid-19 pandemic, the CCP declared its technocratic model to be superior. After initial success with strict lockdowns, Beijing propagated the 'China model' as an example of efficient crisis management, while Western states struggled with uncoordinated measures. But as Western countries emerged from the pandemic, Beijing's insistence on zero-Covid led to massive protests and a hasty U-turn: As a result, at the end of 2022, an uncontrolled wave of infections hit an unprepared healthcare system – overcrowded hospitals and supply shortages characterised the chaotic reopening.

This turned the image of efficient crisis management propagated by the CCP into its opposite. At the beginning of 2022, consumer confidence fell to a historic low, lower than during the Asian crisis in 1998 or the global financial crisis in 2008. The German Economic Institute (IW) points out in a study that this slump was closely linked to the downturn in the real estate market that began at the end of 2021 and coincided with a comprehensive Covid lockdown in Shanghai.

China Consumer Confidence, 01/1991–03/2025



Source: LSEG, Incrementum AG

Change of strategy: sustainability, resilience, and technology leadership

The Chinese real estate bubble is a classic case of a capital structure distorted by false investment signals. With a contribution of 30% to GDP, considerable resources are tied up in an oversized industry whose golden age is probably over. Redirecting capital and labor to more productive sectors is not only expensive but also lengthy and associated with structural friction losses.

Xi Jinping's thought, at least as it applies to recessions, is basically the fusion of an Austrian diagnosis with a communist cure.
Noah Smith

Such a redirection is exactly what Xi Jinping is trying to achieve. His economic policy is geared towards a far-reaching transformation to develop more sustainable sources of growth and includes the following key decisions:

- reduce the Chinese economy's dependence on the real estate sector
- reduce over-indebtedness to make the economy more robust
- focus the economy on innovation and technological leadership

– strive for greater self-sufficiency and less dependence on the West (*Dual Circulation Strategy*, 2020)[55]

房子是用来住的，不是用来炒的 (Houses are for living in, not for speculation).
Xi Jinping

In this way, Xi Jinping intends to defuse the speculative bubble without provoking a drastic crisis. In 2020, he introduced the 'three red lines' policy to stabilise the debt limits, to financially stabilise the real estate sector, and reduce excessive debt, supplemented by regulation of the shadow banks.

Ironically, however, Beijing exacerbated the crisis as many developers lost their financing options and projects stalled. In tier 3 cities in particular, which account for 60% of GDP, a worrying price decline has been observed for years.

As loyal readers know, the choreography of modern financial crises calls for ever new rounds of monetary morphine. For a long time, however, Beijing deliberately refused to react to a crisis caused by excesses with new excesses. Similar to the Bundesbank in its stability-oriented tradition, Beijing focused on budgetary discipline, reducing economic risks, stabilizing the real estate market, and reducing the debt of local governments – an attempt to deflate the bubble slowly and in a controlled manner. China's Premier Li Qiang reaffirmed this line in his speech at the World Economic Forum 2024 in Davos:

> *In promoting economic development, we did not resort to a massive stimulus. We did not seek short-term growth or accumulate long-term risks. Rather, we focused on strengthening the internal drivers.*

All-in, buy China.
Louis-Vincent Gave

However, in view of the ongoing economic challenges and concerns about a downward economic spiral, Beijing was forced to take extensive stimulus measures at the end of 2024. It was a step that should not be underestimated in its scope: Louis-Vincent Gave draws parallels with Mario Draghi's "whatever it takes" moment, with which the ECB finally broke with the Bundesbank's stability-oriented principles during the euro crisis. The Chinese leadership resorted to the following monetary and fiscal measures, among others:

Stimulus measures by the PBoC:

– Reduction of the minimum reserve by 50 bp (USD 142bn released for additional loans)
– Key interest rate cuts (7-day repo rate from 1.7% to 1.5%, medium-term credit facility by 30 bp, loan prime rate (LPR) by 20–25 bp)
– Lowering interest rates on existing mortgages by 50 bp
– Lowering the minimum down payment to 15%
– Support for the equity markets (USD 71bn swap program to ensure better access to funding for funds, insurers, and brokers; up to USD 42.5bn in cheap PBoC loans for banks to facilitate share [re]purchases)

[55] See "Gold Mining in China," In Gold We Trust report 2021

Stimulus measures by the Chinese government:

- “substantial” increase in the issuance of government bonds – volume: USD 411bn for 2025 to overcome the real estate crisis, recapitalize banks, and strengthen the purchasing power of low-income households
- Permission for local governments to issue USD 839bn worth of bonds over three years to restructure hidden debt

The measures catapulted Chinese stock prices upwards, with the Shanghai Composite Index recording an increase of almost 30% between September and October 2024. The consumer spending figures for the Chinese New Year also sparked confidence again for the first time: Consumption of goods increased by 9.9%, while spending on services grew by 12.3%. According to the Ministry of Culture and Tourism, domestic trips rose by 5.9%, while tourism revenue increased by 7%. The number of cross-border trips also increased by 6.3%.

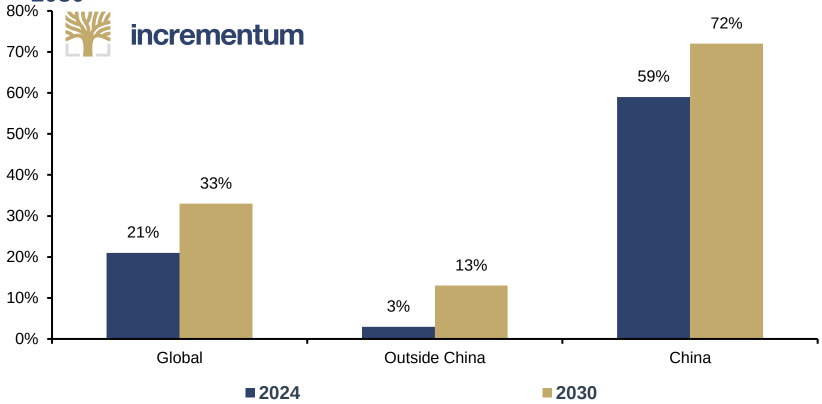
However, it remains to be seen whether this credit-financed upswing in sentiment will provide Beijing with the necessary leeway for structural reforms – or merely create an even more fragile starting point for the next slump. Unsurprisingly, these support measures are placing an enormous burden on the Chinese state budget. *Fitch* estimates that the consolidated budget deficit in 2025 could reach 8.8%, up from 6.5% last year and 5.7% in 2024. In 2025, the deficit would even exceed that of the first year of the cCovid-19 pandemic, 2020, for which Fitch calculates a shortfall of 8.4%. Accordingly, Fitch expects China’s public debt ratio to be well over 65% at the end of this year, more than 10 percentage points higher than in 2023. At the beginning of April, Fitch downgraded the long-term foreign currency-denominated debt to A from A+.

Meanwhile, Xi is focusing on another central goal: reducing China’s dependence on foreign technology and creating strategic independence in key industries such as semiconductors, cars, and green technologies. Programs such as *Made in China 2025* and a targeted industrial policy focus are intended to lead the country to technology leadership with the help of massive subsidies and center China’s role in the global value chain on high-value industries such as e-mobility and artificial intelligence.

Chinese EVs have benefited from massive industrial policy support, and their quality is improving, making them attractive to domestic and overseas consumers […] An effective response by the US, Europe, and others must take account of both facts.
Scott Kennedy

This policy marks the transition from resource-intensive, debt-based growth to a model that focuses on innovation, quality, and sustainability, and has left China’s status as a workshop *of the world* behind. **The number of engineers trained in China each year now exceeds the total number of all university graduates in the US, of which only one in five earns a degree in a STEM subject – a fact that is likely to strengthen China’s industrial and technological thrust for decades to come.** The AI bang from DeepSeek at the beginning of the year and the steep rise of Chinese car manufacturers – 21% global market share in 2024, forecast 33% in 2030 – speak for themselves: **China is already a high-tech giant**.

Market Share Forecasts for Chinese Car Manufacturers, 2024 vs. 2030



Source: Alix Partners, Incrementum AG

Change of strategy to strengthen the pillars of legitimacy

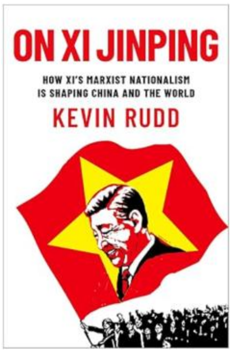
In his anti-corruption fight, Xi's main concern is to ensure that "the party never disintegrates" rather than to create a fair and transparent society.
Alexander Davey

Many ideological adjustments from the reform era were seen by Xi as an expression of "ideological decay". He also placed the widespread corruption within the party – so-called *cadre capitalism*, a system of political and corporate cronyism at all administrative levels – in this narrative. According to Xi's interpretation, it was a rampant decline in values as a result of capitalist thinking that made party officials corruptible and thus undermined the legitimacy of the CCP. In order to strengthen the party morally and emphasize its irreplaceability, Xi initiated an ideological realignment alongside a decisive anti-corruption campaign, which, according to Kevin Rudd , former Prime Minister of Australia and China expert, consists of a combination of three main directions:

- **Leninist left:** Strict party control and central leadership role
- **Marxist left:** State economic governance and "shared prosperity"
- **Nationalist rights:** National sovereignty and an active, confrontational foreign policy with a geopolitical claim to power

Opportunities lie in the place where the complaints are.
Jack Ma

Xi has moved away from the principle of collective leadership established by Deng and has concentrated all the levers of power in his hands. The cult of personality that has grown around him is not just a staged performance but the expression of a new ideological imperative: By canonizing the Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era, in short Xi Jinping Thought, he has not only carried out the most significant change of course in Chinese politics since 1978 – especially with regard to the concentration of power, ideological recentering, and party discipline – but has also committed the party to a unified ideological line and made unconditional loyalty the supreme duty.



With his Common Prosperity agenda, Xi is pursuing a much more uncompromising course than his predecessors in managing the conflict between economic growth and social stability. This is evident, for example, in the strict regulations against billionaires and large tech companies, including Alibaba and Tencent, as well as in the symbolic treatment of Jack Ma – who disappeared for a while after making statements critical of the government and finally returned, converted and loyal to the party line – show Xi's uncompromising course. **The message is clear: The party remains the untouchable center of power; and excesses, even indulged in by the economically successful, will not be tolerated.**

Every individual is scripted there as an actor or actress in the drama of the harmonious society. […] The electronic surveillance state becomes the total reviewer by sending every actor and actress into the purgatory of individual judgment.
Peter Sloterdijk

The CCP's technology-supported surveillance tools turn the boldest fantasies of communist control apparatuses into reality. With projects such as Operation Skynet and the social credit system, the population's behavior – both physical and digital – is comprehensively recorded, evaluated, and disciplined in the event of deviations. The Xuexi Qiangguo app, which offers compulsory reading and quiz formats on Xi Jinping Thought, also carries the ideology into people's everyday lives and measures their political loyalty; presumably, it also serves to monitor and evaluate users' ideological conformity. **A nightmare for libertarians, but at the same time, a factor of social stability in China.**

Geopolitical display of power through parallel globalisation

Xi uses a narrative of sacrifice that portrays the West as a former tormentor by referring to the *century of humiliation* (1839–1949) and presents the CCP as a protective shield against a repetition of such historical injuries. **He contrasts this with the slogan of the "Great Rejuvenation of the Chinese Nation", as part and parcel of the Chinese Dream, which serves as his central leitmotif. Under the aegis of the CCP, which holds the "historical helm", China will achieve its resurgence as a global power.**

China has forged fifteen free trade agreements (FTAs) with Global South countries […] to expand its economic influence in these countries and regions.
Xue Gong

With strategic brilliance, China is pursuing the development of a financial and economic architecture that acts as a parallel structure to the Western-dominated order and at the same time seeks to loosen its grip. The focus is on bilateral and multilateral trade strategies (e.g., RCEP, the world's largest free trade agreement), particularly with countries of the global South such as Brazil, Saudi Arabia, India, and the ASEAN states, which function independently of Western-dominated institutions such as the WTO.

Like the opium the British exported to China, the easy loans China offers are addictive.
Brahma Chellaney

The New Silk Road (Belt and Road Initiative, BRI), launched by Xi in 2013, is a core element of this global strategic realignment.[56] It manifests itself as a far-reaching infrastructure and development project that aims to fundamentally reorganize trade and logistics flows between Asia, Europe, Africa, and beyond by expanding railroads, ports, and roads . Countries along the routes will be more closely linked economically, with China playing a central role as a

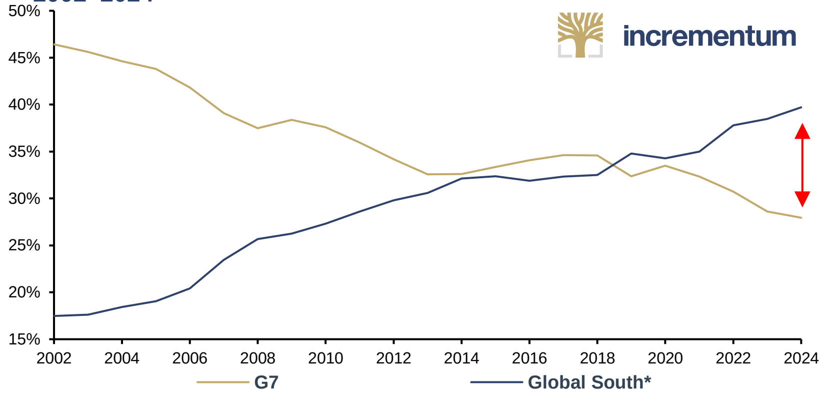
[56] See "Enter the Dragon: De-dollarization and the Eastern Push for Gold," In Gold We Trust report 2024, "Gold and the Dragon – China Stabilizes Its Ascent with Gold," In Gold We Trust report 2019

trading partner, investor, and financier. **Other countries often become strategically dependent,** as loans are often linked to the use of Chinese companies and workers. If those debts cannot be repaid, there are accusations that China is taking over strategic assets such as ports or raw materials, i.e. China is pursuing *debt-trap diplomacy*. In 2010, for example, Sri Lanka began building the port of Hambantota with Chinese loans amounting to USD 1.1bn, but this proved to be economically unviable. As the country was unable to service the debt, it entered into a 99-year lease agreement in 2017 with China Merchants Port Holdings, which led to accusations that China had taken strategic control of a geopolitically sensitive port in the Indian Ocean.

China's industrial overcapacity is reshaping regional and global trade patterns, and ASEAN finds itself increasingly exposed to the consequences.
Brendan Kelly

The following chart shows the extent to which China has reduced its dependence on the West and increased its exports to the Global South over the past two decades. While almost half of exports went to G7 countries in 2002, this figure has now fallen to less than 30%. At the same time, the proportion of exports to emerging and developing countries has risen from around 15% to almost 38%.

Share of China Exports to G7 Countries and Global South*, 2002–2024



Source: World Bank, General Administration of Customs China, Incrementum AG
*For 2023 and 2024, no data is available for the Middle East, Caribbean, and Pakistan; 2022 figures were used as proxies.

In the large-scale reorganization of its export geography, China is pursuing a logic of resilience-oriented decoupling: The gradual shift of trade to southern economies is forming as a **prophylactic buffer against attempts at economic blackmail through sanctions or an intensification of the trade war with the US under Donald Trump.**

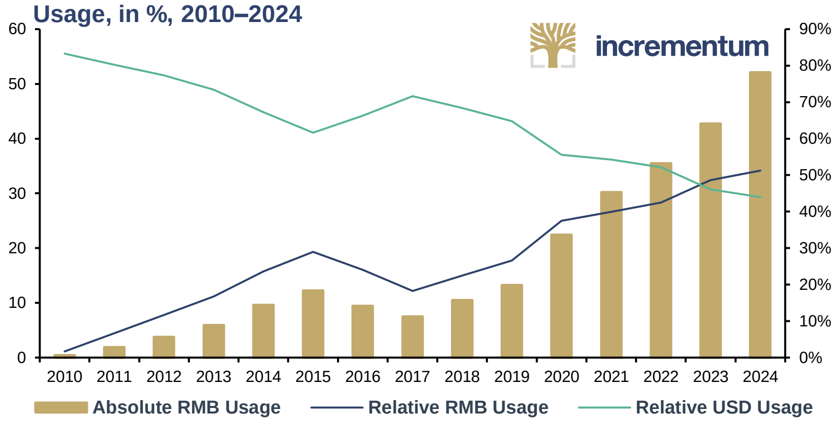
Access to cheaper goods is no longer a good 'trade' for the US, given the loss of economic security over production supply chains and technologies to a competing power.
Jim Reid

Despite the increased relocation of exports to the Global South, trade with the US – with an annual trade surplus of around USD 300bn – remains a mainstay of the Chinese economy. China thus remains vulnerable to the US, although this vulnerability has already been mitigated compared to Trump's first term in office. **The ongoing trade war is therefore another sword of Damocles that could pose a significant threat to China's growth and economic stability in the longer term.** However, it is also a catalyst for the alternative world that Beijing is pushing – beyond the Atlantic gravitation and along the trade arteries of the BRI.

As part of its de-dollarization strategy, which we discussed in detail in last year's edition, Beijing is promoting the use of the renminbi in global trade in order to reduce dependence on Western-controlled

financial systems.[57] As the following chart shows, China now conducts over 50% of its international trade in renminbi. This is a dramatic increase when you consider that this share was just 3.7% in 2012. In 2024, trade volumes amounted to RMB 52.1trn, the equivalent of around USD 7.3trn.

Absolute RMB Usage (lhs), in RMB trn, and Relative RMB and USD Usage, in %, 2010–2024



Source: Chinese State Administration of Foreign Exchanges (SAFE), Incrementum AG

Nevertheless, China is still far from shaking the supremacy of the US dollar as an international means of payment or as an international reserve currency. Beijing is pursuing a targeted strategy to establish the renminbi in the international financial system, e.g. by promoting it along the BRI and as part of the Regional Comprehensive Economic Partnership (RCEP) and the Cross-Border Interbank Payment System (CIPS) as an alternative to SWIFT, and through its inclusion in the SDR currency basket in 2016. However, even after temporary surges as a result of the war in Ukraine and the signal effect of frozen Russian reserves, the renminbi remains a marginal player, both as a means of payment and as a reserve currency, with a share of less than 5% in most cases.

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[57] See “Enter the Dragon: De-dollarization and the Eastern Push for Gold,” In Gold We Trust report 2024

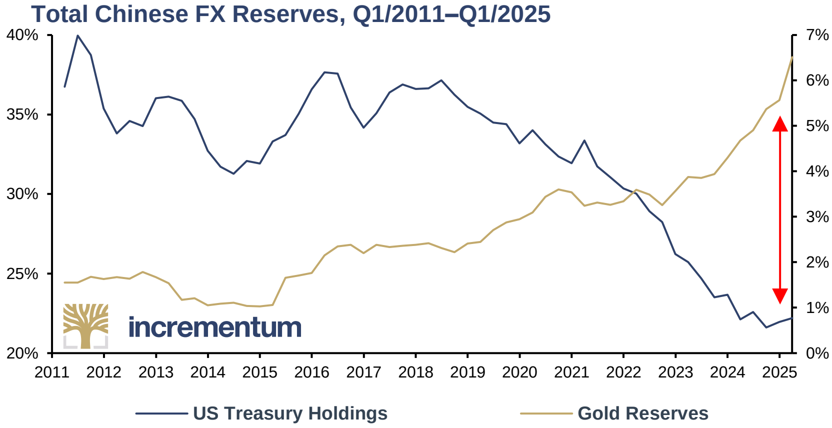
Gold and its importance in decoupling

Gold is playing an increasingly important role in the diversification strategy of the People's Bank of China (PBoC) and other central banks around the world, as a metallic bulwark against geopolitical risks and the dominance of the US dollar. As an apolitical reserve instrument, it is less subject to the arbitrariness of geopolitical sanctions and promises financial stability in a multipolar world.

The PBOC will likely continue to diversify its reserves in the longer term, given the rising geopolitical uncertainty.
David Qu

According to the IMF study "Geopolitics and its Impact on Global Trade and the Dollar" China and China-oriented countries have significantly increased the share of gold in their foreign exchange reserves from around 1% to around 7% since 2015. This study divides the world into three blocs: a US-oriented bloc, a China-oriented bloc, and a group of nonaligned countries. In the US-oriented bloc, this share has remained largely stable. According to the authors, these gold purchases "may have been driven by concerns about sanctions risk". The IMF study shows that the share of gold in China's reserves rose from below 2% (2015) to 4.3% (2023), while US government bonds as a reserve instrument fell from 44% to around 30%. This reflects both net purchases of gold and net sales of US government bonds as well as valuation changes.

US Treasury Holdings (lhs), and Gold Reserves (rhs), as % of Total Chinese FX Reserves, Q1/2011–Q1/2025

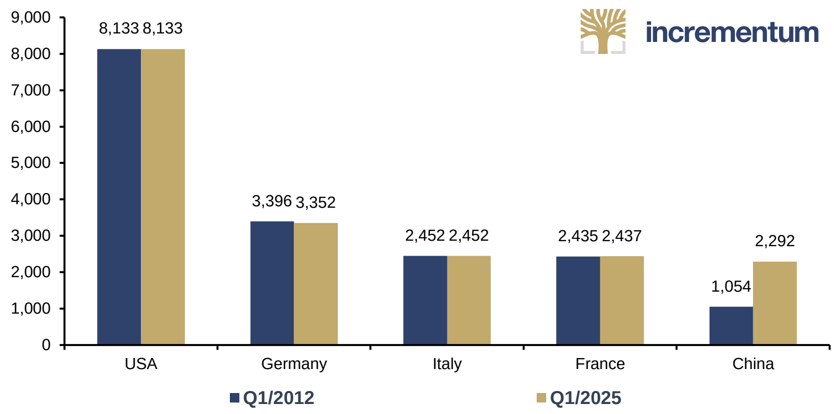


Source: LSEG, Incrementum AG

We're going to take a look, and if there's 27 tons of gold, we'll be very happy […] We want to see lots of nice, beautiful, shiny gold in Fort Knox.
Donald Trump

The following chart compares the official gold reserves of the largest holding countries (excluding Russia) and shows their development from Q1/2012 to Q1/2025 based on data from the World Gold Council. China's rise is striking: With a more than doubled reserve of 2,292 t, it has almost reached the level of leading European countries such as France, Italy, and Germany. Nevertheless, US dominance remains an unchallenged reality with 8,133 t.

Goldreserves, in Tonnes, Q1/2012 vs. Q1/2025

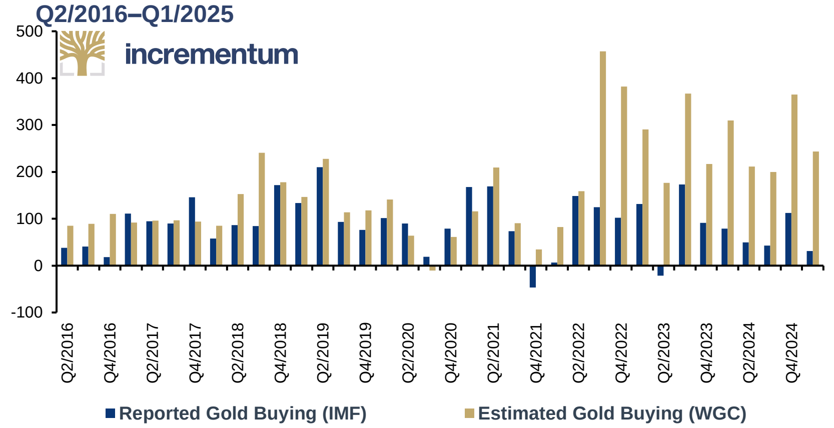


Source: World Gold Council, Incrementum AG

Observe calmly; secure our position; cope with affairs calmly; hide our capacities and bide our time; be good at maintaining a low profile; and never claim leadership.
Deng Xiaoping

However, it is known that the PBoC does not always disclose its gold purchases promptly or in full. **Since 2022, the discrepancy between the World Gold Council's estimates of global central bank purchases and the figures officially reported to the IMF has risen sharply – presumably due to covert purchases by the PBoC.**

Reported and Estimated Central Bank Gold Buying, in Tonnes, Q2/2016–Q1/2025



Source: World Gold Council, IMF, Incrementum AG

We are able to import 500-600 tons a year, or more, but we will also take into consideration a stable gold market.
Yi Gang

Analyst Jan Nieuwenhuijs hypothesizes that the PBoC buys at least three times more gold than it reports to the IMF. He sees evidence of this in the gold exports from the London Bullion Market, which consist almost exclusively of 400-ounce bars, a format preferred by central banks, while the Chinese private sector tends to demand 1 kg bars. Furthermore, since the Ukraine war began, gold supply in China has exceeded sales on the Shanghai Gold Exchange (SGE), suggesting that the PBoC is absorbing the surplus. Finally, British exports are not made via the SGE, but directly via bullion banks to the PBoC, which means that these purchases appear in the trade statistics but not as SGE transactions.

The PBoC keeps the "pedal to the metal" (pun intended).
Jan Nieuwenhuijs

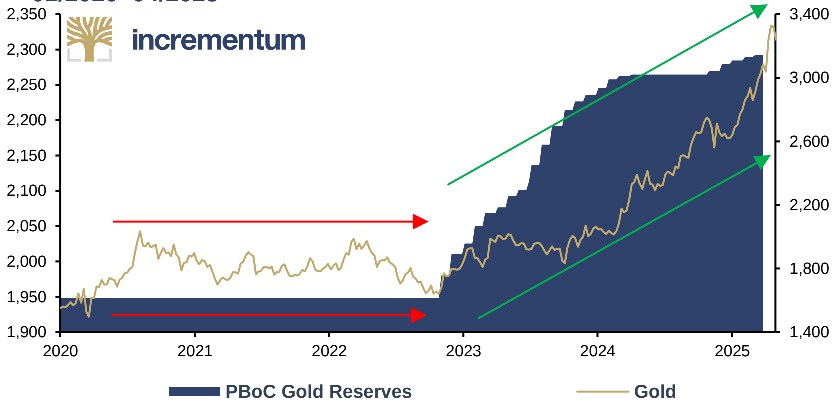
But if the flow size of gold purchases in recent years and beyond has been significantly higher than officially declared, then the stock size should also be far above the communicated level. **Jan Nieuwenhuijs estimates that China's actual gold reserves at the end of 2024 were approximately 5,000 t,**

which would put the country in second place among the world's gold holders.

Before long, this will go mainstream and gold could more than double in price this decade.
Jan Nieuwenhuijs

In any case, the global gold market is shuddering in the face of China's hunger for gold: Based on official figures, the PBoC became the largest buyer in 2023 and had a lasting impact on the price of gold. Added to this is the immense Chinese private demand, which, together with that from India, accounts for almost 40% of the global volume. However, the PBoC's covert purchases, in particular, reinforce this trend. **By increasingly absorbing gold from Western-dominated markets – far in excess of what is officially reported – China is tightening the available supply and increasing the structural upward pressure on the price.**

PBoC Gold Reserves (lhs), in Tonnes, and Gold (rhs), in USD, 01/2020–04/2025



Source: World Gold Council, LSEG, Incrementum AG

Gold as an indicator of dwindling CCP legitimacy?

Money is not everything... There is also gold and shares.
Karel Gott

For decades, real estate was the preferred way to accumulate wealth in China – around 59% of private assets are invested in residential property. However, the real estate crisis of recent years has caused prices to fall across the country and shaken confidence in this asset class. It is also to be expected that the real estate sector will suffer structurally in the long term as a result of the shrinking population. Many households are now faced with the problem of finding safe alternatives. Equities are considered risky in China, as they are characterized by market instability and government intervention.

一寸光阴一寸金。
(An inch of time is an inch of gold.)
Chinese proverb

Where gold once glitteringly symbolized social advancement in China, it now serves as a strategic reserve against economic decline as a result of inflation or real estate deflation. Demand for bars and coins rose by 20% to 345.7 t in 2024, while jewelry sales fell by almost a quarter due to rising prices.

Sturdy grass withstands high winds; genuine gold stands the test of fire.
Xi Jinping

The gold boom among Chinese private investors points to dwindling confidence in Beijing's economic policy management.[58] Many citizens see gold as the ultimate emergency metal – a hedge against crises, government intervention, and currency risks. How is the CCP dealing with this vote of no

[58] See "Introduction," In Gold We Trust report 2024

confidence? And how sovereign is a hoarder in a system that regards property as a potential compulsory resource? In the *In Gold We Trust* report 2023, "Showdown", we already noted that China holds its gold in the pockets of its citizens, because:

> *It is possible that the Chinese government could, if it deemed it necessary, exert control over China's huge private gold holdings, either asking that physical gold be transferred to the authorities for patriotic reasons and the greater economic good, or by even making it mandatory to do so. This would give the Chinese sovereign control over far greater gold holdings than just the monetary gold held by the PBoC and other Chinese government entities.*[59]

Outlook

China's successful development model resists the neoliberal Washington Consensus, and both the success and the resistance lend China soft power in the eyes of the Rest.
Sean Golden

While Western observers focus primarily on China's ailing real estate sector and the threat of financial instability, a profound economic transformation is taking place**. China's increasing technological competitiveness and its industrial leadership in key sectors are shifting the global balance of power.** Louis-Vincent Gave gets to the heart of these contrasts with a pointed rhetorical question:

> *Still, the fundamental question all investors should ask themselves is what matters more going forward: whether Shanghai real estate prices rise or fall by another 10%? Or whether the BYD Seagull becomes the default vehicle among new car buyers, not only across emerging markets but across the whole world?*

China must lead the reform of the global governance system with the concept of fairness and justice.
Xi Jinping

China's industrial and economic rise inevitably casts its shadow–or its light–beyond the horizon of its zones of influence. Beijing is acting as a catalyst for a multipolar global order in which the dominance of the US is being relativized. The Chinese model serves as a template: a centrally controlled, state-capitalist alternative that presents itself not only as a viable but also as a historically significant alternative to Western democracies. The aim is to create a new legitimacy for authoritarian systems worldwide and to position them at least as an equal form of government to the liberal-democratic model and its universal claims to validity.

The process of Western modernization has brought deep suffering to many developing countries.
Xi Jinping

In the Global South, China enters the stage as a moral agnostic. The memory of its own colonial wounds is discreetly shared in order to build a bridge of common pragmatism. Moral neutrality thus becomes an expression of the quiet politeness of geopolitical engagement. **Projects such as the Belt and Road Initiative and institutions such as the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank act as levers for the establishment of a multipolar world order.** Although it remains to be seen to what extent the Global South can be drawn into the Sinosphere as a whole – and whether China can assert its hegemonic role in this sphere in view of its economic

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[59] "The Rise of Eastern Gold Markets: An Impending Showdown with the West," In Gold We Trust report 2023

challenges – the global political structure is witnessing the striking self-assertion of those states that are striving for new independence away from the West.

What Mr. Xi is really promoting is something else: the idea that authoritarian political systems are not only legitimate but can outperform Western democracies.
Richard McGregor

The parallel globalization that China is orchestrating, which is likely to gain momentum in light of the looming trade war, is not only unfolding economically but also culturally and technologically. China is driving the development of independent digital ecosystems (WeChat instead of WhatsApp, Douyin instead of Meta, Alibaba instead of Amazon, Weibo instead of X, DeepSeek instead of ChatGPT), which function not only as technical counter-designs but also as political, cultural, and narrative alternatives to the Western-dominated technosphere and create completely different understandings of the world.

China is keeping us on our toes, and I think that's a good thing.
Sebastian Heilmann

Whether these parallel orders coexist peacefully or drift into confrontation will be determined by the ability of global players to formulate rules of engagement. **However, what appears to be a geopolitical challenge could also prove to be the driver of a new era of innovation.**

About Us

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Ronnie is managing partner of Incrementum AG and responsible for Research and Portfolio Management.

He studied business administration and finance in the USA and at the Vienna University of Economics and Business Administration, and also gained work experience at the trading desk of a bank during his studies. Upon graduation, he joined the research department of Erste Group, where in 2007 he published his first *In Gold We Trust* report. Over the years, the *In Gold We Trust* report has become one of the benchmark publications on gold, money, and inflation.

In 2014, Ronnie co-authored the international bestseller *Austrian School for Investors*, and in 2019 *The Zero Interest Trap*. He is a member of the board of directors at Tudor Gold Corp. (TUD), and Goldstorm Metals Corp. (GSTM). Moreover, he is an advisor to *Von Greyerz AG*, a global leader in wealth preservation in the form of physical gold stored outside the banking system. He is also a Member of the Advisory Board at *Monetary Metals*.

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