

WHEN CAPACITY EXPANSION MEETS INSUFFICIENT DEMAND - CHINA'S EXCESS CAPACITY

*China's industrial overcapacity status and potential
impact on Swedish companies*



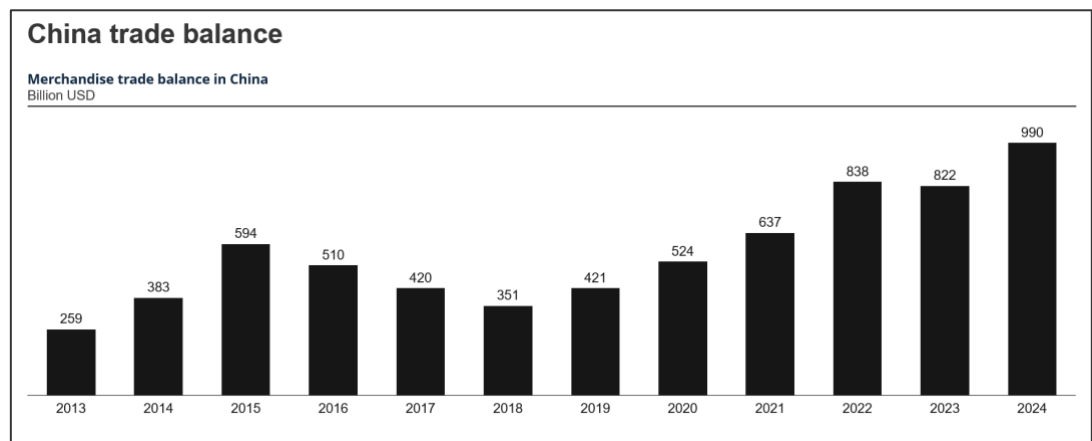
FOREWORD

Overcapacity has been a persistent issue in China’s economy since the start of its economic reforms over 40 years ago. Today, the vast scale of China’s export-driven economy means that excess capacity can no longer be absorbed through exports without triggering strong international reactions. In 2024, China’s record trade surplus of around USD 1 trillion, alongside a declining import share of GDP, underscores a growing disconnect between domestic demand and global trade, intensifying tensions with major trading partners.

Historically, Chinese policymakers have prioritised systemic support for producers over consumers, enabling enterprises to ramp up production despite shrinking profit margins. This directly leads to the recurrent overcapacity in China’s manufacturing sector. Unlike more market-oriented economies where unprofitable firms face bankruptcy and market exit, many loss-making enterprises in China — particularly state-owned ones — operate without such pressure, delaying necessary capacity adjustments.

At the Central Economic Work Conference in December 2023, the Communist Party of China officially recognised that “effective demand is insufficient, and some industries have overcapacity.” This marks the first mention of excess capacity by the highest decision-making body since 2018, signalling renewed urgency among policymakers to address the issue.

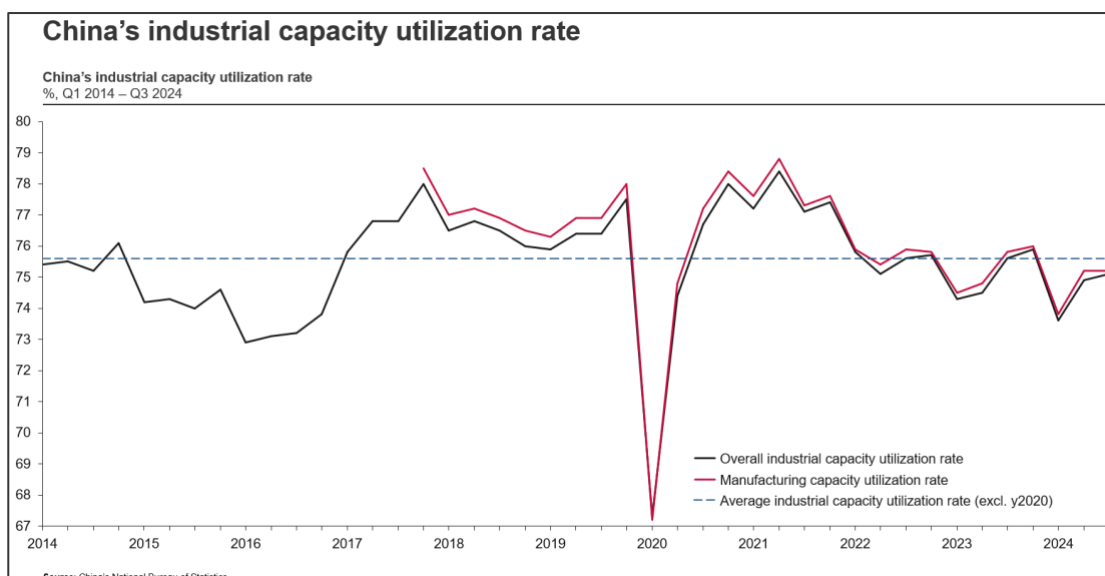
This report examines the current state of China’s industrial overcapacity, the government’s stance and policy responses, and the potential implications for Swedish companies operating in or with China.



EXCESS CAPACITY EXISTS IN ALMOST ALL SUB-SECTORS

The capacity utilisation rate of industrial enterprises is a crucial and direct indicator to measure whether capacity is excessive or insufficient within the economy. The Chinese government has consistently published the capacity utilisation rate of industrial enterprises above a certain scale quarterly since the fourth quarter of 2017. This data is further segmented into three major categories: mining, manufacturing, production and the supply of electricity, heat gas and water.

The past quarterly data of the capacity utilisation rate of China's manufacturing industry is as follows: illustrated in the graph below. Except from distortion from Covid in the beginning of 2020, the capacity manufacturing industry dropped to the lowest point since 2016 in the first quarter of 2024, reaching 73.8%. Although the rate slightly improved in Q2 and Q3, it remained below the historical average.



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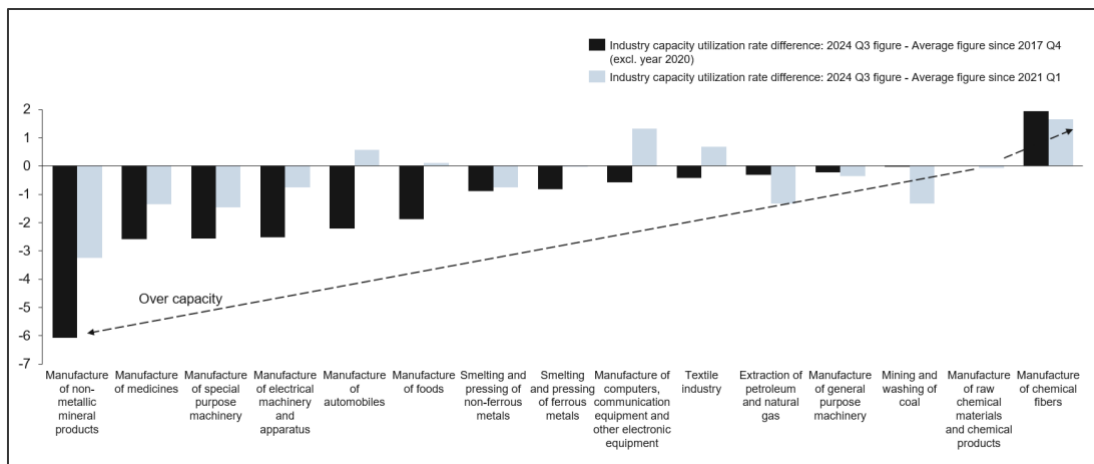


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Looking at more segmented industrial fields, as of the third quarter of 2024, excess capacity has emerged in most major industrial production sub-sectors, especially in some downstream manufacturing industries.



OVERCAPACITY IN “THE NEW THREE” – EV’S, LITHIUM BATTERIES AND PHOTOVOLTAIC PRODUCTS

Currently, China is the world’s largest producer, consumer, and exporter of the so-called the “new three” sectors – represented by new energy vehicles, lithium batteries, and photovoltaic (PV) products – key symbols of China’s shift towards high-end, intelligent, and green manufacturing. In 2023, the export of the “new three” exceeded one trillion yuan, with a growth rate of 29.9%, significantly higher than the overall export growth rate of 0.6%. Despite the world-leading market dominance and contribution to the Chinese GDP, overcapacity has emerged as a serious by-product.

Both domestic and international demand for the “new three” products can hardly digest the massive production. A Goldman Sachs report shows China’s EV production capacity was 2.1 times its domestic demand and 1.2 times global demand, with a capacity utilisation rate of just 54% in 2023. However, utilisation rates vary widely among manufacturers: BYD, a market leader, operated at 160% capacity, while many smaller EV producers ran below 50%.

Consequently, this overcapacity ripple effect extends upstream to the lithium battery sector. Gaogong Lithium Battery statistics show the industry’s overall capacity utilisation rate fell from approximately 76% in 2022 to around 50% in 2023, with effective utilisation remaining below 60% in 2024¹. Notably, the leading battery maker CATL’s utilisation dropped from 95% in 2021 to 65% by mid-2024. The bullwhip effects from battery enterprises also further impact upstream battery materials – including cathode, anode, electrolyte, and separator – with cathode material utilisation lingering around 40% in 2023.

The solar energy sector faces similar challenges. According to the “Advancing Clean Technology Manufacturing” report released by the International Energy Agency

¹CENEWS, <https://www.cenews.com.cn/news.html?aid=1199654>

(IEA), about 80% of the global PV manufacturing industry is concentrated in China, with India and the United States each accounting for 5% and Europe accounting for only 1%.

Zooming in on key PV components, China's silicon wafer production capacity accounts for about 95% of the global production capacity, polysilicon production capacity accounts for 96%, and module production capacity accounts for 83%. Currently, the global production capacity utilisation rate of solar cells and modules is about 50%, and China's rate is around 50 - 60%.

INTERNATIONAL TRADE FRICTIONS INTENSIFIED FROM A SPILLOVER OF CHINESE PRODUCTS AT LOW PRICES

Exports were crucial for Chinese enterprises to manage excess capacity and selling at below-market prices was an effective strategy for Chinese exporters. However, while cheaper products benefited consumers in many markets, they created market distortion and unfair competition for foreign companies.

For example, persistent oversupply in the solar energy sector caused prices to plummet: polysilicon and module prices fell over 50% in 2023, with further declines in 2024 — polysilicon dropped 35%, silicon wafers 45%, and battery wafers and modules over 25%. Countries with domestic production, especially net exporters, face intense competition from low-priced Chinese goods both at home and abroad. Sustained below-market pricing by Chinese firms could ultimately drive competitors out, posing serious long-term challenges for global companies to develop.

Previously, cheap Chinese exports had triggered a series of anti-dumping investigations, such as the EU's 2016 probe into Chinese steel — launched amid Beijing's efforts to curb excess production.

Lately, another round of trade conflicts has been provoked. In May 2024, the United States imposed tariffs targeting China's most emblematic oversupplied sectors: a 100% tariff on Chinese-made electric vehicles, 25% on lithium-ion batteries, and 50% on solar cells. Following suit, the European Union announced comparable measures against Chinese electric vehicles in July 2024, which came into effect in October 2024, with tariffs peaking at 45%.

Extending the tariffs introduced by the US government in 2024, Donald Trump further raised the actual and potential tariffs imposed on Chinese goods in 2025. By the beginning of June 2025, the actual tariff from the US on Chinese goods rose to almost 40%.

The high level of tariffs will further lead to reduced profits and investments, and exacerbate the already excessive industrial capacity and deflationary pressure in China. Looking for new export destinations and releasing more domestic demand will then be crucial to keep the economic resilience of China.

EXCESS INVESTMENT AND INSUFFICIENT CONSUMPTION LEAD TO EXCESS CAPACITY

The root causes of Chinese overcapacity are more complex and beyond simply having too many factories running day and night, seven days a week. Based on China's growth model, disproportional share of investment into supply expansion and under-stimulated consumption were outlined to be the key factors leading to overcapacity according to some Chinese economists.

China's long-term national strategies and policies have mainly focused on developing the economy through strengthening manufacturing that helped to grow export and GDP. Policies are tailor-made for industries as key GDP contributors and high-potential segments to develop with capital injections into equipment upgrading and structural optimisation. These developments are capital-intensive, but they have been backed up by massive investments. In the past decade, the share of investment of GDP in China has remained at a high level between roughly 42% and 44%².

As one of the major sources of government investments in manufacturing activities, the Chinese citizens have kept a high level of savings for decades compared to people from other countries. According to the International Monetary Fund, China's overall economic savings accounted for nearly 44% of GDP in 2024 which was significantly higher than that of South Korea (around 34%), Japan and Germany (slightly lower than 30%), and the United States (slightly lower than 17%).

In the past, people's large amount of savings used to be largely directed to the real estate market and infrastructure sector which are now struggling to maintain China's economic vitality. Nowadays, the country has been searching for new growth engines to maintain a high level of economic growth. When the "new three" segments started

²CEIC, [China Investment: % of GDP](#) | Economic Indicators | CEIC

to show potential, the state government has been highlighting the importance of cultivating their continuous growth. The dedication of cultivating new “pockets of growth” has been implemented across governments at different levels and regions to ensure successful implementation. As a result, the duplicated and overlapping investments, with or without government involvement, poured in all over China led to projected production capacity of the “new three” segments exceeding the actual market demand far beyond.

However, convincing the Chinese consumers to spend has not been an easy task. Due to the falling real estate prices and limited social welfare, many feel anxious about their shrinking wealth and prefer to save rather than spend, creating a buffer against uncertainties. This cautious sentiment is reflected in China’s consumer price index (CPI), which rose just 0.2% year-on-year in 2024 — far below the government’s 2% target — highlighting weak consumption confidence amid soaring supply in key sectors.

CHINA HAS EXPERIENCED OVERCAPACITY IN THE PAST FEW DECADES

Since China’s reform and opening up in the late 1970s, there have been approximately three rounds of notable excess capacity: the stage of excess consumer goods and light manufacturing in the 1990s, the stage of excess cyclical resources and traditional manufacturing from 2005 to 2017, and the stage of excess capacity in the technology manufacturing industry from 2022 to the present.

The Chinese government’s strategies for dealing with excess capacity vary regarding traditional industries (with low technological content) and advanced manufacturing industries (with high technological content):

Traditional industries

China’s solutions to deal with excess capacity mostly focus on the supply side, mainly using administrative means to reduce and limit production capacity. The government conducts governance through measures such as adjusting the industrial structure, eliminating backward production capacity, and strengthening industry management. The reason is that the entry threshold of traditional industries is low, it is difficult for the market to spontaneously reduce production capacity, and the majority of the supply side is dominated by central and state-owned enterprises. Administrative means can improve policy effectiveness and efficiency. Historically, the Chinese government has used this method to resolve overcapacity in many industries, including textiles, steel, coal, cement, electrolytic aluminium, and building materials.

Advanced manufacturing industries

China's solution to overcapacity in advanced manufacturing is different from that in traditional industries. Because the supply side is generally difficult to shrink due to high technology content, large capacity investment, and strong protectionist tendencies among local governments. The Chinese government tends to adopt more comprehensive and flexible measures to deal with overcapacity in advanced manufacturing, especially focusing on efforts on the demand side. For example, economic stimulus policies are introduced to boost domestic demand in related industries. This is very obvious in China's PV and automobile (especially new energy vehicles) fields.

Capacity relocation is also used by the government and enterprises to relieve the pressure of excess capacity. Since 2023, China's outbound foreign direct investment in industries such as electronics, machinery, and automobiles has increased significantly. The main countries to which China transfers its overseas production capacity are concentrated in developing countries or regions along the "Belt and Road".

POLICIES PROPOSED TO EXPAND DOMESTIC DEMAND TO DEAL WITH THIS ROUND OF EXCESS CAPACITY

In the government work report of the Two Sessions in China in early 2024, the government proposed to "strengthen the overall planning and investment guidance of key industries to prevent excess capacity and low-level redundant construction" in response to excess capacity. However, since then, the solutions adopted, such as eliminating backward production capacity and closing the least competitive enterprises while continuing to support the expansion, innovation, and export of production capacity in other industries, do not seem to have significantly improved the situation of excess capacity.

As a continuation, the Chinese Communist Party (CCP) Central Economic Work Conference in December 2024 set a clear agenda for 2025 to prioritise the expansion of domestic demand as the foremost task among nine key economic goals. This signals a strategic shift toward rebalancing China's economy by strengthening internal consumption.

Following this direction, the Two Sessions in March 2025 incorporated these priorities into the government's work plan, committing to a more proactive fiscal

policy with an increased budget deficit ratio and a moderately loose monetary policy to boost money supply.

China has set a 2025 economic growth target of around 5%, alongside a historic rise in the budget deficit ratio to 4% of GDP — up one percentage point from the previous year's 3%. This marks a significant departure from decades of maintaining a deficit near 3%, even during the severe economic disruptions of the 2020 pandemic when the deficit was only raised to 3.7%.

To stimulate consumption, the government will deploy RMB 300 billion (USD 41 billion) in special ultra-long-term bonds to support trade-in schemes, subsidising purchases of automobiles, home appliances, electric bicycles, and electronics such as smartphones and tablets. However, the ultimate impact of these measures remains uncertain amid persistent domestic and global challenges. Whether the measures proposed by China can effectively alleviate China's excess capacity problem remains to be seen.

“...Vigorously boost consumption, improve investment efficiency, expand domestic demand in all aspects, and implement special actions to boost consumption...”

CCP Central Economic Work Conference Announcement 2024

Key Takeaways

China's industrial overcapacity is likely to continue spilling over into global markets whether in already dominant sectors or emerging manufacturing segments. Given Sweden's strong manufacturing base, Swedish companies must closely monitor China's advancements in key industrial fields.

For sectors where Swedish firms compete directly with Chinese producers, it is critical to assess:

- The spillover effects of China's excess capacity – including potential price pressures and market distortions.
- Shifts in global competition – as Chinese overproduction may reshape trade flows, supply chains, and industry dynamics.

Swedish companies need to come up with proactive strategies to maintain competitiveness, such as innovative differentiation, supply chain resilience, and policy engagement.

Business Sweden can support Swedish companies in different ways, such as providing Swedish companies with monitoring and analysis of China's competitive situation in specific fields. By leveraging our knowledge and local network, Business Sweden can support you in updating your strategy for the Chinese market. For more information on how we can support your growth, please contact our China team [here](#).





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