

Germany's "China Shock" Revisited

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Noah Barkin (nbarkin@rhg.com), Gregor Williams (gwilliams@rhg.com)

In February 2024, we published [a note](#) pointing to a major shift in the economic relationship between Germany and China. Bilateral ties, we argued, would increasingly be defined by an intense industrial competition, with major implications for German prosperity and the direction of policy in Berlin and Brussels. Two years later, before Chancellor Friedrich Merz's first trip to China, we examine how the competitive dynamics between the world's second and third largest economies have shifted since then, and how this has influenced the German debate on China. Over the past year, German political leaders, central bankers, business associations and unions have begun talking openly about the risks of a "China shock." The rhetoric, however, has not been matched by decisive policy action.

It's the economy, stupid

In our 2024 note, "[Tipping Point? Germany and China in an Era of Zero-Sum Competition](#)," we argued that the high degree of complementarity that had defined Germany's economic relationship with China in the first two decades of the 21st century was at an end, and that the two economies had entered a period of intense industrial competition. We suggested that this would push Germany toward a "tipping point," where the political and corporate forces advocating for deeper engagement with China would be drowned out by those supporting defensive trade measures, robust industrial policies, and more aggressive EU measures to level the economic playing field with China.

We pointed to three trends that were likely to fuel this shift: a structural decline in German exports to China, shrinking margins and market share for German firms in China, and rising competition with China in global markets. Below, we explore briefly how each of these trends has developed since we first examined them. We then turn our attention to three new economic drivers that are compounding Germany's industrial woes. Lastly, we explore how the China policy debate in Germany has evolved and where it may be headed.

German exports to China

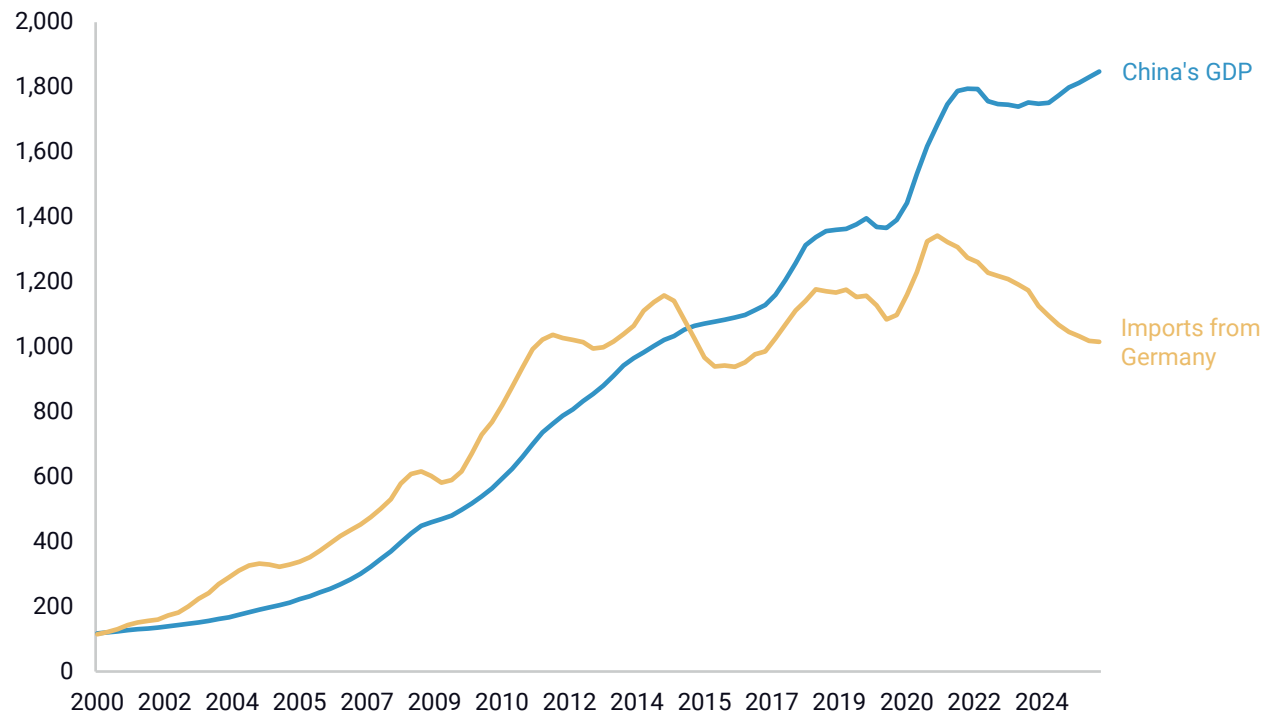
In the two decades leading up to the outbreak of the COVID-19 pandemic in 2020, German exports to China increased steadily, mirroring the expansion of the Chinese economy over the same period. Since 2020, however, Chinese growth rates and German exports have

essentially decoupled due to rising Chinese competitiveness in core German manufacturing sectors, the localization of production in China by large German firms and import substitution policies from Beijing (Figure 1). These factors have ushered in a new era for German exports to China: structural decline. This decline is eroding the link between Germany-based production and China-based sales. While German manufacturers have grown more dependent on inputs from China, the importance of the Chinese market for German jobs and prosperity is declining.

FIGURE 1

China no longer wants German goods

China's nominal GDP and imports from Germany in RMB, Q1 2000 = 100, twelve-month trailing average



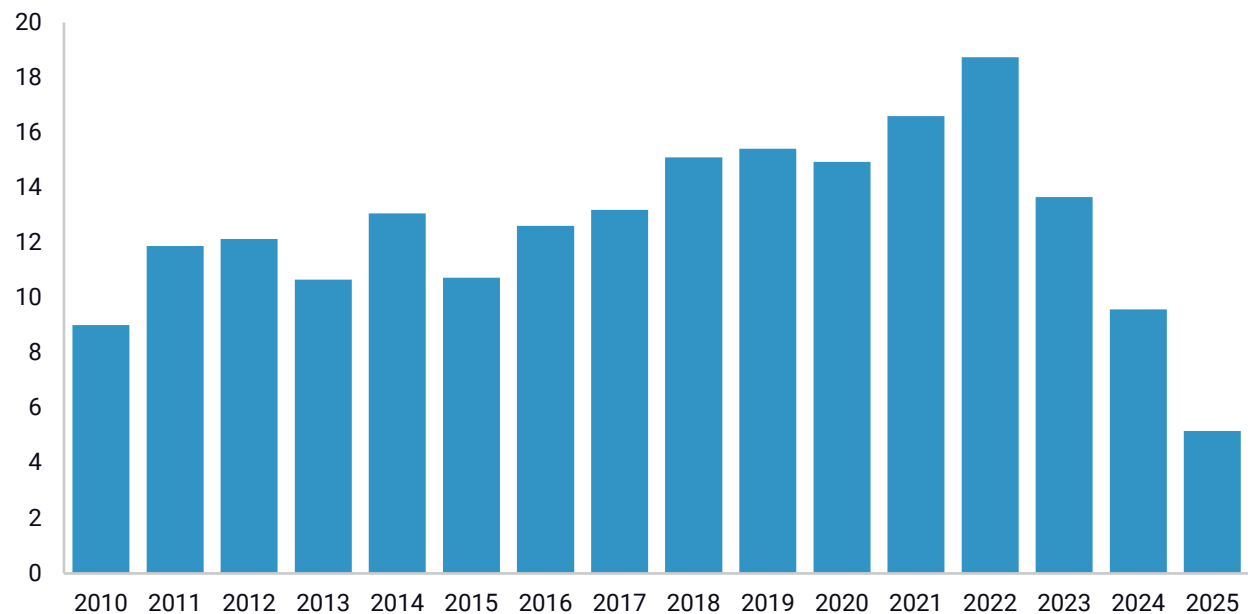
Source: CEIC

This trend has accelerated since we last examined it two years ago. In 2025, German goods exports to China fell by 9.3% to €81.8 billion, their lowest level in a decade. This amounts to a decline of 23% compared to the peak reached in 2022. The drop has been led by a sharp decline in German car exports to China, which tumbled by 66% between 2022 and 2025, reaching their lowest level since 2009 (Figure 2).

FIGURE 2

German car exports to China plummet

German passenger car trade surplus with China in EUR billion



Source: Eurostat. Note: 2025 is extrapolated based on Jan-Nov data

To put the overall export decline in perspective, if the average annual drop of the past three years were to continue for another three, German exports to China would sink to roughly €63 billion by 2028, well below the level of German exports to Austria or Switzerland, countries with populations that are just 0.6% the size of China's. The drop of the past years poses a major threat to German manufacturers. Unless they find alternative export markets, a wave of German bankruptcies and job cuts is likely to accelerate.

Market share and margins in China

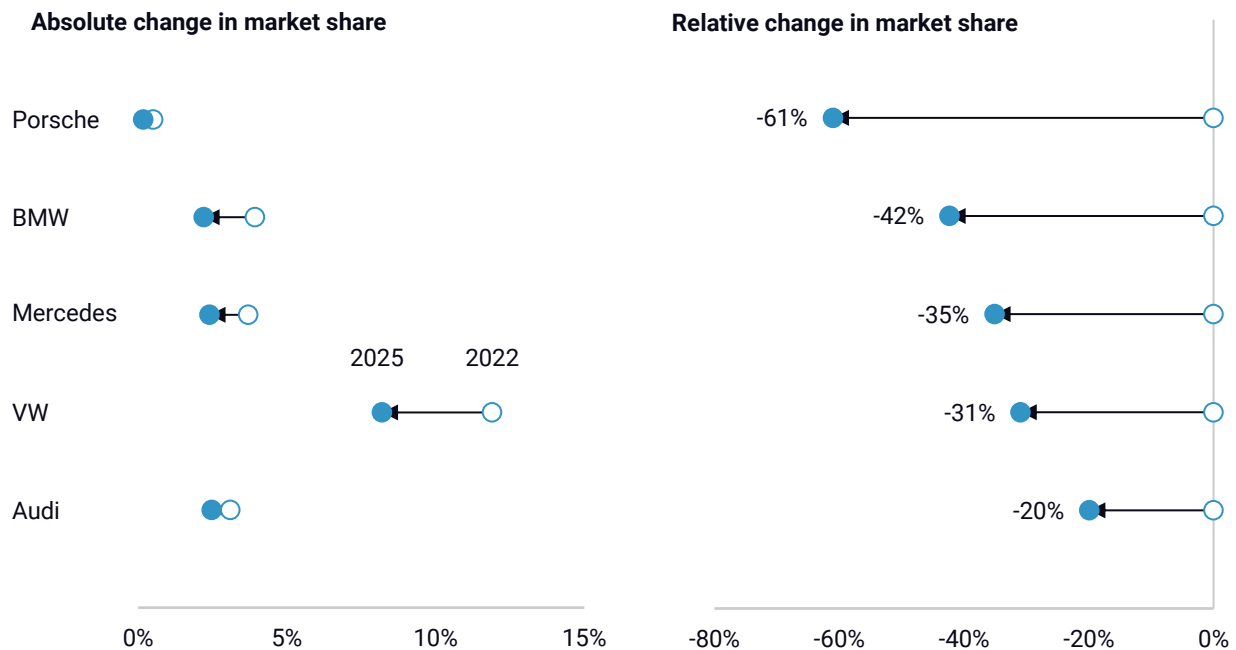
The Chinese market was a gold mine for German companies for decades. But that mine is looking depleted for many firms amid a slowdown in the Chinese economy, brutal local competition that has eviscerated pricing power, and a shift in consumer preferences toward home-grown firms—a trend that has been encouraged by authorities in Beijing.

This has led to a flurry of profit warnings from German companies over the past few years, notably in the car industry, and to sharp declines in market share. The market share of German carmakers in China collapsed by 33%, on average, between 2020 and 2025 (Figure 3) and profitability has deteriorated even more markedly for some firms. Volkswagen's profits from its Chinese joint ventures, for example, tumbled 60% in the Q1-Q3 2025 period, compared to the same period in 2022. China-based profits are also under acute pressure in other core German industries, such as chemicals.

FIGURE 3

German carmakers see sharp market share declines in China

Market share in percent



Source: Rhodium Group based on Marklines

There are some important caveats to mention. German companies are not alone in facing profit pressures in China. Many Chinese firms are also under severe strain, as overcapacities and weak consumption push down prices. (See [“China’s Subsidies are Fueling ‘Involuntary’ Competition in the Auto Sector”](#)). In the German car sector, moreover, there is an expectation that new product offensives in 2026 and 2027 will help stabilize lost market share (see [“The Hangover: Foreign carmakers’ China Strategies”](#)).

But even if these efforts succeed, the relationship between German headquarters and China operations has fundamentally shifted. Carmakers are transferring an increasing share of R&D capabilities to China in pursuit of a turnaround, and profits generated in the market now need to be reinvested locally rather than repatriated. This means that even if the turnaround is successful, it will primarily benefit jobs and value creation in China, rather than Germany.

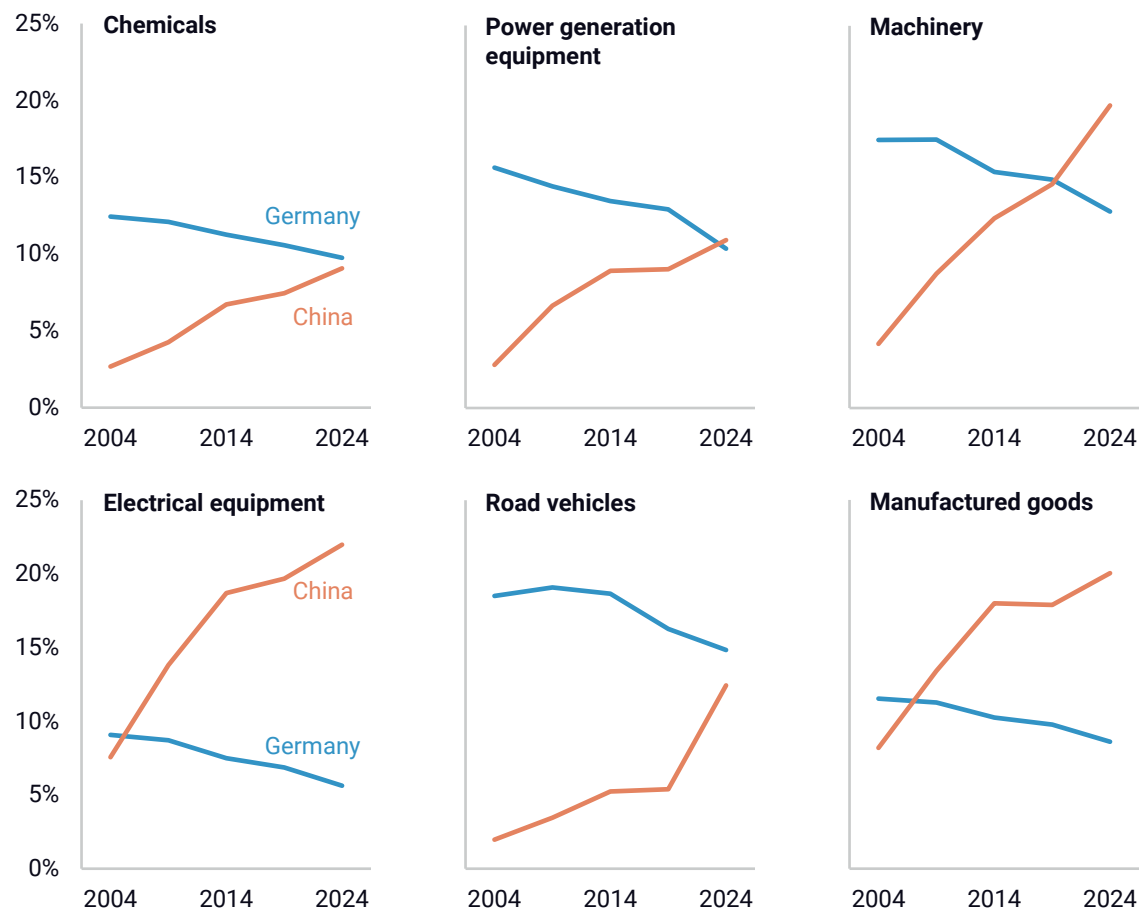
Competition from China in third markets

The third trend that we identified in our 2024 note was fierce competition from Chinese competitors in third markets. One way to measure this is to look at UNCTAD data on global export market shares in specific industries (Figure 4). This data shows that Chinese firms have seized market share from their German rivals at an accelerating pace in recent years, moving ahead in sectors like machinery and power generation equipment, and poised to overtake them in road vehicles and chemicals.

FIGURE 4

China takes export market share from Germany

Export market share in percent



Source: UNCTAD

China's export competitiveness has been driven by several factors, including a natural process of technological catch-up. But recent weakness in China's economy and growing production overcapacities have pushed down prices and profits at home in the past few years, forcing Chinese firms to look abroad and supercharging the competitive challenge for German manufacturers. This has led to growing calls, notably in the chemicals and machinery sectors, for the EU to raise trade barriers and introduce local content requirements. These calls reflect a deepening sense of panic over Chinese competition that has become especially acute over the past year.

Another way to look at how this trend has developed is to look at the breakdown of imports across key emerging markets. In Brazil and Indonesia, Chinese exporters have gained 3 pp and 7.2 pp of import market share, respectively, over the past three years. By contrast, in markets like the EU, UK, and Turkey—where German exporters have benefited from proximity, customs unions, and preferential trade agreements—Chinese market share gains have been more limited. Still, unless substantial trade barriers to Chinese goods are erected in these markets, there is a risk that Chinese producers gain the upper hand over German competitors in the coming years.

Of the three trends that we have discussed, this is the one that should worry Germany's export-oriented companies the most. It is painful for them to watch their exports to China shrink, but these exports made up just over 5% of total German exports in 2025. If exports to a wide range of other large markets, including to fellow EU member states, also decline because of intensifying Chinese competition, the impact will be far more serious. The EU can choose to raise trade barriers to protect its industry. But if other markets remain open to Chinese manufactured goods, the German export machine will continue to sputter, with far-reaching implications for the economy.

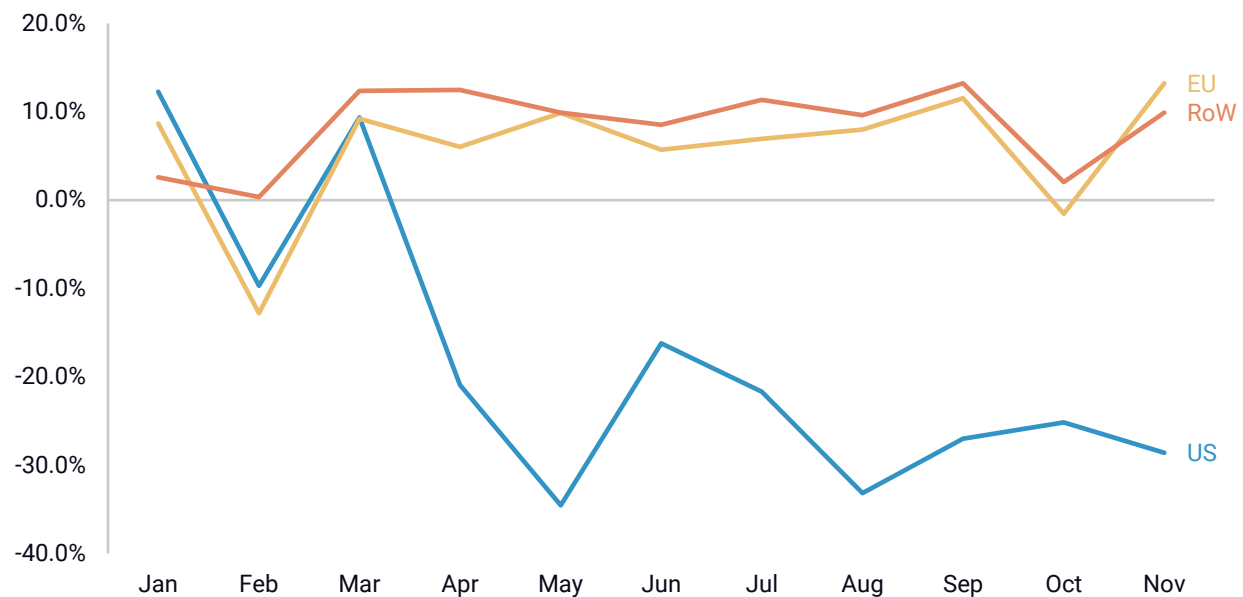
Three new developments

In addition to the trends identified above, three new developments have emerged over the past year which promise to deepen the competitive woes of Germany companies in relation to their Chinese rivals.

Trade diversion

On April 2, 2025, the Trump administration imposed tariffs on many US trading partners, including China. In the months that followed, US tariff levels on China fluctuated wildly in recurring cycles of escalation and de-escalation, culminating in the trade truce reached between Trump and Chinese president Xi Jinping in Busan, South Korea last October. According to Rhodium Group calculations, US average trade-weighted tariff levels against China are now hovering at 31%, well below the peak of last spring, but still high enough for some Chinese firms to divert exports from the US into other markets, including Europe. Measuring trade diversion is an inexact science, but the data shows that Chinese exports to the US fell by 19% from January to November 2025, while exports to Europe (and other markets) continued to rise. (Figure 5).

FIGURE 5
Chinese exports to the US decline, while those to the EU increase
 Chinese exports by region by value y/y change (%)

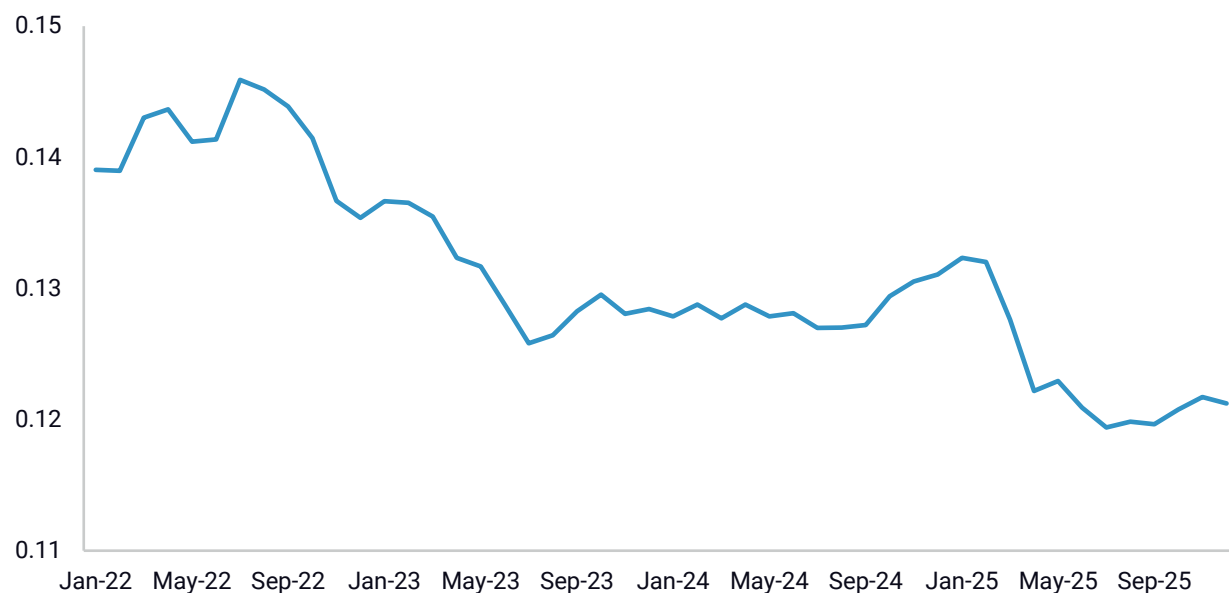


Source: ITC

Currency depreciation

In our December 2025 note "[Malign Indifference: China's Currency and the Threat to Europe](#)" we highlighted the risks to European industry from the Chinese yuan's depreciation against the euro. The yuan has lost nearly 20% of its value against the euro in nominal terms since mid-2022 and roughly 8% in the past year alone (Figure 6). In real terms (adjusted for inflation) the decline is more pronounced. This has compounded the trade imbalance between the EU and China and eroded the effectiveness of the bloc's trade defense instruments. It also disincentivizes Chinese companies from investing in European production facilities, a stated goal of the EU, by bolstering the business case for exports. There is a not insignificant risk that China's currency will continue to depreciate against the euro in the months and years ahead, given the deflationary dynamic in the Chinese economy and the prospect of continued US dollar weakness. This represents a significant additional risk for German exporters and the broader economy.

FIGURE 6
Weaker RMB contributes to China's EU trade surplus
 EUR to CNY monthly average exchange rate



Source: ECB

The weaponization of dependencies

One of the biggest threats to the competitiveness of German companies versus their Chinese rivals is their access to the minerals, chips, and other critical inputs that they source from China. Beijing's April 2025 export controls on rare earth elements and magnets and its October 2025 clampdown on sales of Nexperia chips laid bare the risks of dependencies on China in a wide range of sectors, from cars and medical devices to defense. While German companies have not been forced to halt production as [firms](#) in other countries have, the threat of production stoppages will linger, particularly for small- and medium-sized [Mittelstand](#) firms that do not have a large presence and network in China.

Going forward, the risks to the German economy and industry can be broken down into several categories. First, there is the very real risk that Chinese companies—and possibly non-German foreign firms—get preferential access to critical raw materials. Second, there is a risk that German and other western firms are forced to pay a premium for these inputs as they seek to make their supply chains more resilient and governments contemplate price floors to force diversification. Third, there is a risk that German and other foreign firms shift more production to China out of concern about the security of supply chains that rely on Chinese exports.

The German debate

When we wrote our note in early 2024, the economic risks to Germany from Chinese competition and the need for a more forceful policy response were not widely acknowledged or accepted in the German political, corporate, or financial establishments. This has changed over the past two years, as the German economy has stagnated and the country's industrial champions have begun shedding jobs at a record pace (Figure 7).

FIGURE 7

German auto worker layoffs are worse than during the global financial crisis or pandemic
Year-on-year growth in number of German auto workers



Source: DESTATIS

At the start of 2026, there is a sense of panic across German industry as more and more companies are squeezed by cheaper Chinese rivals. Over the past year, German and European business associations including the [VDMA](#) (machinery) and [CLEPA](#) (auto suppliers) have backed the idea of local content requirements in Europe to respond to the competitive onslaught from Chinese firms. In a September 2025 position paper, CLEPA estimated that European suppliers faced a cost disadvantage of up to 35% compared to Chinese competitors and warned that 350,000 jobs in Europe were at risk over the next five years. In recent months, even the CEO of German chemicals giant BASF, which is

investing billions of euros in China, has [urged the EU](#) to “intervene and send strong signals to protect its own industry,” arguing that trade cases needed to “go faster.”

“ Without decisive political countermeasures, Germany faces the risk of deindustrialization, job losses, and a weakening of its global competitiveness.

German unions, which in years past viewed booming China sales as a guarantor of German jobs, are also changing their tune. In June 2025, at a closed-door conference in Frankfurt, IG Metall officials discussed an in-house paper entitled “Is Germany Facing a China Shock?” The paper notes that while the “first China shock” primarily affected simpler consumer goods and the US industrial sector, the second one is hitting key German industries such as automobile manufacturing, environmental technologies, and chemicals—intensified by state subsidies and a technologically ambitious industrial policy. “The problem is not only the increase in imports from China, but also the growing competitive pressure in international markets,” it reads. “Without decisive political countermeasures, Germany faces the risk of deindustrialization, job losses, and a weakening of its global competitiveness.” This a radically new message from IG Metall, one of Germany’s biggest and most influential unions.

Institutions of the German economic and financial establishment are also weighing in. In their [annual report](#) on the German economy, presented in November 2025, the German Council of Economic Experts warned that Chinese firms were emerging as increasingly potent competitors to German industry. A month earlier, Bundesbank President Joachim Nagel urged Europe to respond to the economic challenges emanating from China in a “more offensive way,” including through punitive trade measures.

Importantly, the shift has also been evident in Berlin. German Chancellor Friedrich Merz, in office since May 2025, has struck a very different tone on China than his predecessors Olaf Scholz and Angela Merkel. Merz has spoken openly about the risks from Chinese overcapacities and acknowledged the need for [trade barriers](#), local content rules, and more restrictive [cybersecurity](#) policies to shield German industry and infrastructure.

Still, it is unclear how far his government is prepared to go in backing up its de-risking talk with concrete policy measures. In his first half year in office, Merz and his entourage were consumed by Ukraine and transatlantic diplomacy. In recent months, he has pivoted to the struggling German economy, with a single-minded focus on boosting competitiveness through cuts in regulations and greater integration of the EU’s single market. China, arguably the biggest long-term threat to German prosperity, has gotten lost in the shuffle.

Beijing’s weaponization of rare earths last spring, which sent shockwaves through the car industry and threatened Germany’s military build-up plans, produced barely a whimper from the German government. Only now, nearly a year later, is the government finalizing a diversification strategy for critical minerals. Work on a national economic security strategy, initially promised for 2025, has not begun. And President Donald Trump’s belligerent attitude toward European allies, including threats to seize Greenland, has triggered a debate on de-risking from the United States, further muddying the focus on China.

Merz heads to China

It is against this backdrop that Chancellor Merz will make his first trip to China in late February. He will travel with a two-dozen strong delegation of German CEOs, but no business deals or investment announcements are anticipated. German officials expect Merz to adopt a more sober approach than Canada's Mark Carney or Britain's Keir Starmer, whose visits in January were feel-good "resets" after years of diplomatic tension and no high-level engagement with Beijing. Chinese competition poses a far bigger threat to Germany's manufacturing-based economy than it does to Britain's or Canada's. At the same time, German companies are more exposed to the Chinese market and dependent on industrial inputs from China. Merz, therefore, faces a delicate balancing act: he must redefine an economic relationship that, as we have laid out in this note, is increasingly detrimental to German interests while taking care not to accelerate the downward spiral.

The messages that Merz sends on trade will be particularly interesting. Both French President Emmanuel Macron and European Commission President Ursula von der Leyen have warned China's leadership over the past half year that the European market risks closing down to Chinese goods unless Beijing takes steps to address its overcapacity problem and widening trade surplus. Merz, by contrast, has emphasized the "promote" and "partner" elements of Europe's economic security strategy—reducing regulatory burdens on companies, completing the single market and diversifying trade through new partnerships—over the "protect" pillar championed by Macron.

It will be important for Merz to bridge these approaches when he is in Beijing and present a united European front. Without a credible threat to restrict access to the European market, China will have little incentive to rein in its exports. Backing targeted "protect" measures is also in Germany's vital interests. Without some degree of protection, German industry is likely to continue to struggle against a much larger competitor who is not playing by the same rules. While Merz backed EU efforts to shield the steel industry, his government has been reluctant to embed restrictions favoring local production in its new electric vehicle subsidies scheme, as countries like France and Britain have done. The German answer to China cannot only be to "run faster".

At the heart of Germany's struggle to respond to China is a stubborn adherence to ordoliberal principles that set hard limits on the state's role in the economy. In an era where China and the United States, but also countries like Japan, are using the levers of government to reshape economic incentives, Germany risks being sidelined without a more pro-active approach. For decades, Germany's economic relationship with China ran on autopilot. Today, in more turbulent times, the government needs to seize the controls, defining long-term industrial and technological priorities, in close coordination with industry, and putting the policies in place to deliver on them. That will come with risks of its own. But betting on the old, hands-off approach is far riskier.

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