

THOUGHTS OF THE WEEK

Let's Talk China, But Don't Be Fooled by Its Propaganda Machine

After a week of traveling abroad to meet with clients and discuss our outlook for the US economy and financial markets, we returned feeling the need to address a growing misconception, both in the United States and overseas, regarding the differences between the US and Chinese economies.

That is not to say the United States is without challenges. It faces inflationary pressures, widening fiscal imbalances, an unsustainable trajectory for government debt, and weak employment growth, among other issues. However, China is not the economic paradise that many seem to believe it is.

Historically, dictatorial and totalitarian regimes have been highly effective at controlling information. In China's case, that responsibility falls to the Chinese Communist Party. In previous eras, such regimes maintained a near monopoly over domestic communications. Today, the landscape is different. Information is more decentralized, particularly outside China's borders. As a result, the strategy has evolved. Rather than controlling every channel, governments can shape perceptions by flooding the public sphere with selective information, exaggerations, half-truths, and carefully crafted narratives. This is what many observers refer to as a sophisticated and highly effective propaganda machine.

Democracies are certainly not immune to political messaging, but there is a fundamental distinction. Communist systems excel at controlling domestic media and projecting favorable narratives abroad, while democratic systems generally allow competing views to coexist and challenge one another.

With that said, politics is not our primary focus here. We discuss it only insofar as it helps explain the Chinese economy. It is important to remember that China largely presents to the world what it wants the world to see, which is typically an image of uninterrupted success. And to be fair, many of its achievements are impressive, particularly in technology, given the relatively short period over which they have occurred. Some of that success has been driven by genuine entrepreneurship. Some has been achieved through aggressive industrial policies. And some, critics would argue, has involved cutting corners or violating accepted competitive norms.

This brings us to the question of how China has become so advanced in key technological sectors. Part of the answer lies in the ability of centralized governments to direct vast amounts of capital toward targeted industries. That is considerably more difficult in market-oriented economies, where resources are allocated through price mechanisms, profit incentives, and what economists often call the 'invisible hand.'

At the same time, Chinese policymakers appear to have learned lessons from the collapse of the Soviet Union. While both systems relied on centralized control, the Soviet model ultimately became mired in inefficiency. China has sought to avoid that outcome but we contend that, in the long run, they are bound to fail.

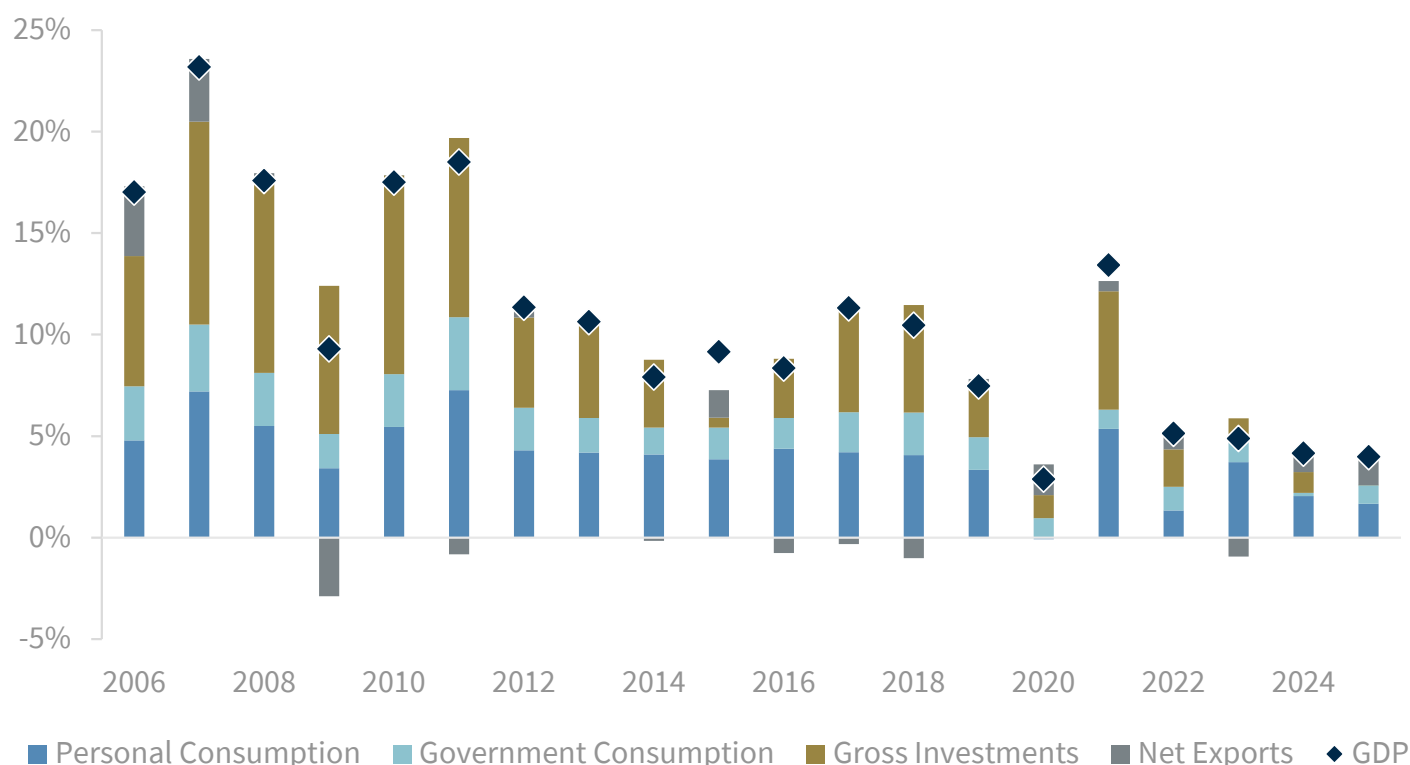
The Chinese system extracts significant resources from firms and workers while fostering intense competition among companies backed, directly or indirectly, by the state. Winners are rewarded, while losers are quickly pushed aside. The process resembles a state-sponsored version of survival of the fittest.

The electric vehicle industry provides a useful example. Some estimates suggest there were roughly 500 EV startups in China as recently as 2018. Today, the number of manufacturers has fallen to around 100, with approximately 40 companies accounting for the vast majority of production. Some analysts also argue that China's current EV production capacity is large enough to more than satisfy global demand.

As a result, Chinese automakers increasingly depend on foreign markets to absorb excess production. Their alternative is to export large volumes of low-cost vehicles. This helps explain why Chinese officials criticized the G20's recent concerns regarding excess capacity and cheap exports, characterizing such criticism as protectionist.

To sustain this model, China allocates an extraordinarily large share of national resources to investment. Real gross fixed investment accounts for roughly 40% of GDP in China, compared with about 18% in the United States. At the same time, personal consumption expenditures account for roughly 40% of GDP in China versus approximately 70% in the United States.

China: Contributions to GDP Growth Vs. A Year Ago



Source: RJ Economics, FactSet, data as of 9/4/2026

Excessive investment, however, comes with risks. The United States experienced those risks firsthand during the housing boom and subsequent Great Financial Crisis. China has faced similar consequences through the collapse of its own housing market.

Unlike in the United States, however, China's housing boom was heavily influenced by government-directed investment. The country has avoided a recession of the magnitude many expected largely because its capital account remains closed. To borrow from the Las Vegas slogan, what happens in China tends to stay in China.

Nevertheless, the damage has been severe. The effects of the housing collapse are likely to weigh on the Chinese economy for many decades. Having closed off one major investment outlet, policymakers have redirected resources toward advanced technologies and manufacturing. Those are the sectors being showcased today, leading some observers to question the long-term competitiveness of the US economy.

We believe that conclusion is mistaken.

The US economy remains capable of adapting, innovating, and growing through the ups and downs of an imperfect business cycle. China, by contrast, operates under a fundamentally different economic model, one in which political decisions play a dominant role in determining economic outcomes.

Chinese policymakers learned from the housing crisis that homes could not serve as an export outlet for excess production. Housing is not tradable and foreign ownership remains highly restricted. Electric vehicles, however, are different. They can be exported.

As a result, EVs have become one of China's primary channels for absorbing excess industrial capacity. The country is selling that capacity to the rest of the world through exports of low-cost vehicles. This remains China's pressure-release valve, and it is likely to remain in place for as long as foreign markets are willing to absorb the excess supply. If and when this export escape valve falters, the Chinese economy will falter.

Forecast Table

	Actual						Forecast						Actual		Forecast	
	1Q25	2Q25	3Q25	4Q25	1Q26	2Q26	3Q26	4Q26	1Q27	2Q27	3Q27	4Q27	2024	2025	2026	2027
Real Gross Domestic Product ¹	-0.7	3.8	4.4	0.5	2.1	1.5	3.5	2.3	2.0	2.0	2.0	2.2	2.8	2.1	2.3	2.2
Real Gross Domestic Product ²	2.0	2.1	2.3	2.0	2.7	2.1	1.9	2.3	2.3	2.4	2.1	2.0	2.5			
Consumer Price Index ²	2.7	2.4	2.9	2.8	2.7	3.9	3.3	3.2	3.0	1.9	2.5	2.8	3.0	2.7	3.3	2.5
Ex-food & energy ²	3.1	2.8	3.1	2.7	2.5	2.7	2.4	2.5	2.4	2.1	2.3	2.6	3.4	2.9	2.5	2.4
PCE Price Index ²	2.6	2.4	2.7	2.8	3.1	3.9	3.7	3.6	3.0	2.3	2.3	2.3	2.6	2.6	3.6	2.5
Ex-food & energy ²	2.8	2.7	2.9	2.9	3.1	3.4	3.3	3.3	2.8	2.4	2.3	2.2	2.9	2.8	3.3	2.4
Unemployment Rate	4.1	4.2	4.3	4.5	4.3	4.3	4.1	4.2	4.3	4.3	4.3	4.3	4.0	4.3	4.3	4.3
Fed Funds Rate ³	4.50	4.50	4.25	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.50	3.50	5.1	4.3	3.8	3.6

¹ Annualized Quarter-Over-Quarter Growth² Year-Over-Year SA Percentage Change³ Upper Bound of the Federal Funds Target Range

Economic Releases

ISM Manufacturing PMI: The ISM Manufacturing PMI for August came in below expectations but remained above the 50-demarcation line, marking the sector's eighth consecutive month of expansion. The overall report was strong, with all five subindices that directly factor in Manufacturing PMI in expansionary territory for the second month in a row. More importantly, the price subindex, while still elevated, has remained the same or declined over the past four months, while the employment subindex remained firmly in expansion for the second month in a row. August ISM Manufacturing PMI ticked lower to 54.6% but remained in expansion, according to the Institute for Supply Management. The New Orders Index fell to 53.7% compared to 56.7% in July and the Production Index was also slightly lower, at 58.3% compared to 58.5% in July. The Employment Index remained expansionary territory but declined from 52.8% in July to 51.2 in August, while the Supplier Deliveries Index strengthened to 59.3% compared to 58.9% in July. The Inventories Index weakened slightly, at 50.6% compared to 51.2%, and the Customers' Inventories Index, the only subindex in contraction, was higher, at 42.8% compared to 40.7% in July. The Prices Index was unchanged at 71.1% in August. The Backlog of Orders Index dropped sharply, at 51.8% from 55.0% in July. The New Export Orders Index was slightly higher, at 53.2% compared to 53.0% in July, and the Imports Index declined from 55.7% to 52.5%. Manufacturers most frequently cited rising input costs and supply chain disruptions—driven by tariffs, the Middle East conflict, AI-related demand, and broader trade uncertainty—as key challenges weighing on profitability and the outlook.”

Construction Spending: Despite the continued normalization in manufacturing construction following the investment surge of 2022 and 2023, construction spending weakness in July was broad-based, with spending declining across both the private and public sectors. Elevated interest rates continue to weigh on financing conditions and new project activity, reinforcing our view that the construction sector will remain subdued through the remainder of this year and likely into the first half of next year. Construction spending came out much lower than expected in July, down 0.5%, month-on-month, compared to FactSet expectations for a 0.15% increase. The seasonally adjusted rate of construction spending was \$2,157.6 billion compared to a revised rate of \$2,167.7 billion in June of this year. Compared to a year earlier, construction spending was down 3.5%, according to the release. The increase in construction spending in July was due to weakness in both private and public construction, which were down 0.5% and 0.2%, respectively. Furthermore, private residential construction spending was down by 1.3% during the month. Construction spending in manufacturing was down by 1.0% during the month of July, month-on-month, and also down strongly, by 22.2% compared to July of last year. Construction spending in manufacturing has continued to normalize after the strong increase after the passage of the CHIPS and IRA acts.

JOLTS: Job openings were 7.271 million in July, lower than the original June estimate of 7.359 million, but higher than the downwardly revised number of 7.182 million. Hiring and separations also showed little movement during the month, pointing to continued stability in labor market turnover. The modest increase in openings was supported by the durable goods manufacturing sector, while hiring declined notably in professional and business services. The job openings report for July showed openings at 7.271 million compared to a downwardly revised 7.182 million in June 2026, according to the Bureau of Labor Statistics. The job openings rate remained at 4.4%. The hires rate was unchanged at 3.2%, while the total separations rate also held steady at 3.2%. Quits were little unchanged at 3.1 million, while layoffs and discharges remained at 1.7 million. Overall, the July report points to a relatively stable labor market, with little movement across openings, hiring, or separations. However, subdued hiring and a low quits rate suggests employers and workers remain cautious, reinforcing our view that the labor market continues to soften despite relatively steady demand for workers.

ADP Employment Report: The ADP Employment survey was weaker than expected in August, up 38,000, while the original July print was revised slightly higher, from 44,000 to 46,000. The very small and very large employers created the largest number of jobs during the month of August—20,000 and 34,000, respectively. Once again, the education and health services sector was the strongest sector during the month, adding 45,000 while the manufacturing sector was the weakest, showing 17,000 fewer jobs during the month. This report tells us little of what the Friday nonfarm payroll number is going to be. We expect nonfarm payrolls to have increased by 70,000 in August. The ADP Employment Survey showed that private employers added 38,000 jobs during the month of August. Small (1-19 employees) businesses added 20,000 jobs during the month while those with between 20-49 employees subtracted 17,000 jobs. Mid-sized employers (between 50-249 employees) added another 2,000 but those with between 250-499 employees subtracted another 2,000 jobs. Finally, large employers, those with 500 or more employees added the largest number of workers during the month, up 34,000. If we segment the report by industry, the goods-producing sector showed a decrease of 17,000 in the manufacturing sector but a 12,000 addition in the construction sector. Meanwhile, the natural resources and mining sector subtracted 5,000 jobs during the month. The service-providing sector saw another strong month for the education and health services sector, up 45,000, while the leisure and hospitality sector added 16,000. The other services sector added 6,000 jobs during the month while

Economic Releases

ADP Employment Report (continued): the financial activities sector added another 6,000 jobs. The trade, transportation, and utilities sector saw jobs down by 5,000 while there were 4,000 jobs lost in the information sector. Finally, the professional and business sector showed a decline of 16,000 jobs. The ADP revised July's original increase of 44,000 to 46,000. The leisure and hospitality sector posted its largest increase this year, up 16,000, while the manufacturing sector showed its largest monthly decline in more than a year, down 17,000. "The ADP National Employment Report is an independent and high-frequency view of the private-sector labor market based on the aggregated and anonymized payroll data of more than 26 million US employees.

Trade Balance: The trade balance in goods and services was slightly lower than expected but still very high, as firms increased imports in order to once again avoid paying higher prices due to the incoming tariffs announced by the Trump administration. This increase in imports is also going to put downward pressure on the estimation of GDP during the third quarter. Imports of capital goods surged by \$14.4 billion during the month of July, as imports of computers, computer accessories, and semiconductors increased. This also reflects firms buying equipment for new factories constructed over the last several years, as well as for the ongoing surge in AI and data center construction. The US trade deficit in goods and services surged to -\$88.6 billion in July from a deficit of -\$71.2 billion in June or an increase of 24.4%, according to the US Census Bureau and the Bureau of Economic Analysis. Exports of goods and services were \$301.7 billion, down 2.1% compared to June while imports were \$399.3 billion, or up 2.8% compared to the previous month. Exports of goods on a census basis declined \$5.9 billion during the month of July as exports of industrial supplies and materials declined \$8.7 billion while exports of capital goods increased by \$1.9 billion. Exports of consumer goods increased \$1.7 billion. Imports of goods on a census basis increased \$12.0 billion in July as imports of capital goods increased \$14.4 billion. This increase in imports was due to a \$6.9 billion increase in imports of computers, a \$6.6 billion increase in imports of computer accessories and a \$1.2 billion increase in imports of semiconductors. Imports of industrial supplies and materials declined \$1.8 billion during the month. It is clear that firms are, once again, trying to move ahead of the new tariffs announced by the Trump administration and have been increasing imports to avoid these new tariffs.

ISM Services PMI: The ISM Services PMI was stronger than expected in August with almost all of the different indices showing strength during the month. The notable exceptions were the Employment index, which failed to come back to expansion territory for a second consecutive month while the Prices index was higher than in July, underscoring the negative effects of higher tariffs, higher oil prices, as well as the scarcity of workers. This means that the service sector's Employment index lack of expansion is more related to the inability of firms to find workers rather than the willingness to hire workers, which is an important distinction. The ISM Services PMI was stronger than expected in August, increasing to 55.4% compared to 54.1% in July, according to the Institute for Supply Management. The Business Activity/Production index increased to 61.7% FROM 59.1% in July while the New Orders index increased to 60.9% from 57.2%. The Employment index improved slightly but remained in contraction territory, at 47.8% compared to 47.4% in July. The Supplier Deliveries index was weaker in August, at 51.3% but remained in expansion territory while the Inventories index surged to 56.7% from 51.4% in July. The Prices index moved higher also, to 72.6% from a reading of 70.3% in July while the Backlog of Orders index increased to 55.6% compared to 50.9% in the previous month. The New Exports Orders index also increased, to 56.3% compared to 52.0% in July while the Imports index increased to 56.3% compared to a reading of 51.8% in July. Finally, the Inventory Sentiment index increased to 54.1% compared to 52.5% in July. The ISM Services PMI Employment index failed to cross into expansion territory in August with the report indicating that labor is in short supply. 12 industries in the services sector reported growth in August while five industries reported contraction during the month. Oil prices, higher interest rates and tariffs were mentioned conspicuously in the commentaries.

Employment Report: Employment was much stronger than expected in August, surging by 162,000 after an upwardly revised number of 21,000 in July. The rate of unemployment remained unchanged, at 4.1%. Both the goods-producing and the service-providing sectors were strong in August, but the strength came from very few sectors. The government sector recovered partially in August (+35,000) compared to the loss in July (-50,000). The recovery in government employment was due to an increase of 41,900 in local government education jobs in August. As we said in July and as was confirmed with the August release, July's original loss in jobs was bound to be revised due to seasonal noise. Although August's employment growth was very strong, there is a high probability that it will be revised lower in the months to come but remain positive. Employment in August was much stronger than expected, up 162,000, according to the Bureau of Labor Statistics, while the rate of unemployment remained at 4.1%, unchanged compared to July. Total private jobs were up 127,000 with the goods-producing sector adding 41,000 of those jobs. The strongest sectors in the goods-producing sectors were construction, up 22,000 and manufacturing, up 16,000.

Economic Releases

Employment Report (continued): The service-providing sector added another 86,000 with the bulk of jobs being added by the leisure and hospitality sector, up 62,000, while the private education and health services sector added another 29,000. Wholesale trade added 7,800; retail trade added another 1,400. Transportation and warehousing added 5,000 jobs while the utilities sector added another 2,500. The information sector saw jobs down by 23,000 while the financial activities sector reduced jobs by 11,000. The professional and business services sector saw jobs increase by 10,000 while the other services sector showed 35,000 more jobs during the month. Finally, the government sector saw an increase of 35,000 after losing 50,000 in July. Average weekly hours increased slightly, from 34.3 in July to 34.4 in August while average hourly earnings increased from \$37.65 to \$37.75. Average weekly earnings increased from \$1,291.40 to 1,298.60 in August. The Household Survey showed a relatively strong increase in the labor force, up 663,000, while the labor force participation rate increased from 61.4% to 61.6% in August. Employment, as measured by this survey, surged by 569,000 during the month of August. The net revision to June and July were positive, with 11,000 more jobs reported in June than originally and 44,000 more jobs in July. The 44,000 more jobs in July pushed the July employment creation from -23,000 to 21,000.

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Consumer Sentiment is a consumer confidence index published monthly by the University of Michigan. The index is normalized to have a value of 100 in the first quarter of 1966.

The S&P 500 Price Index is a market-capitalization-weighted index that measures the performance of 500 large-capitalization US companies. The index reflects price movements only and does not include dividends.

Indices and peer groups are not available for direct investment. Any investor who attempts to mimic the performance of an index or peer group would incur fees and expenses that would reduce returns. Investing involves risks including the possible loss of capital

Personal Consumption Expenditures Price Index (PCE): The PCE is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services.

The Consumer Confidence Index (CCI) is a survey, administered by The Conference Board, that measures how optimistic or pessimistic consumers are regarding their expected financial situation. The CCI is calculated from two primary sub-indices: the Present Situation Index and the Expectations Index

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GDP Price Index: A measure of inflation in the prices of goods and services produced in the United States. The gross domestic product price index includes the prices of US goods and services exported to other countries. The prices that Americans pay for imports aren't part of this index.

Employment Cost Index: The Employment Cost Index (ECI) measures the change in the hourly labor cost to employers over time. The ECI uses a fixed "basket" of labor to produce a pure cost change, free from the effects of workers moving between occupations and industries and includes both the cost of wages and salaries and the cost of benefits.

US Dollar Index: The US Dollar Index is an index of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of US trade partners' currencies. The FHFA HPI is a broad measure of the movement of single-family house prices. The FHFA HPI is a weighted, repeat-sales index, meaning that it measures average price changes in repeat sales or refinancings on the same properties.

The Pending Home Sales Index (PHS), a leading indicator of housing activity, measures housing contract activity, and is based on signed real estate contracts for existing single-family homes, condos, and co-ops.

Disclosures

Import Price Index: The import price index measures price changes in goods or services purchased from abroad by US residents (imports) and sold to foreign buyers (exports). The indexes are updated once a month by the Bureau of Labor Statistics (BLS) International Price Program (IPP).

ISM Services PMI Index: The Institute of Supply Management (ISM) Non-Manufacturing Purchasing Managers' Index (PMI) (also known as the ISM Services PMI) report on Business, a composite index is calculated as an indicator of the overall economic condition for the non-manufacturing sector.

The ISM Manufacturing Index: The Institute of Supply Management (ISM) Manufacturing Measures the health of the manufacturing sector by surveying purchasing managers at manufacturing firms. The survey asks about current business conditions and expectations for the future, including new orders, inventories, employment, and deliveries.

Consumer Price Index (CPI) A consumer price index is a price index, the price of a weighted average market basket of consumer goods and services purchased by households.

Producer Price Index: A producer price index (PPI) is a price index that measures the average changes in prices received by domestic producers for their output.

Industrial production: Industrial production is a measure of the output of the industrial sector of the economy. The industrial sector includes manufacturing, mining, and utilities. Although these sectors contribute only a small portion of gross domestic product, they are highly sensitive to interest rates and consumer demand.

The NAHB/Wells Fargo Housing Opportunity Index (HOI) for a given area is defined as the share of homes sold in that area that would have been affordable to a family earning the local median income, based on standard mortgage underwriting criteria.

Conference Board Coincident Economic Index: The Composite Index of Coincident Indicators is an index published by the Conference Board that provides a broad-based measurement of current economic conditions, helping economists, investors, and public policymakers to determine which phase of the business cycle the economy is currently experiencing.

Conference Board Lagging Economic Index: The Composite Index of Lagging Indicators is an index published monthly by the Conference Board, used to confirm and assess the direction of the economy's movements over recent months.

New Export Index: The PMI New export orders index allows us to track international demand for a country's goods and services on a timely, monthly, basis.

Gold is subject to the special risks associated with investing in precious metals, including but not limited to: price may be subject to wide fluctuation; the market is relatively limited; the sources are concentrated in countries that have the potential for instability; and the market is unregulated.

The Conference Board Leading Economic Index: Intended to forecast future economic activity, it is calculated from the values of ten key variables.

Source: FactSet, data as of 9/4/2026

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