Lethame Capital Management

Technology : Research : Investing

China's Debt Is Not the World's Problem — Its Deceleration Is…

…The Standard Narrative Focuses on the Stock of Chinese Debt. The Risk to the Rest of the World Lies in the Flow — and in Where It Goes Next!

October 2026

Executive Summary

We were asked whether China's debt is a problem for the world economy. In our opinion China's debt, at over 300% of GDP, is not in itself the problem. The world's problem is that the debt is no longer growing fast enough to absorb what China produces.

The standard answers treat China's debt as a domestic balance-sheet question. *The Wall Street Journal* frames it as a debt spiral that is choking growth and spilling overseas.[1] Ray Dalio frames it as a question of whether Beijing can engineer a "*beautiful deleveraging*".[2,3] Both are right about the stock: it is mostly in renminbi, mostly held at home, and unlikely to produce a classic external crisis. Both miss the flow — what the debt paid for, and what replaces it as it slows.

> *China's debt was the world's solution after 2008. Its deceleration is the world's problem now*

Drawing on Pettis's income-distribution framework[4] and Keen's credit-flow analysis,[5] and on Bank for International Settlements data modelled in Steve Keen's Ravel software,[6, 32] we argue:

- **China's debt was a demand engine.** Chinese households receive too little of national income to buy what China produces. After 2008, debt-funded investment filled the gap at home. China's new private credit peaked at 39.5% of GDP in 2009Q4, just as US private credit fell to −5.0%. Chinese credit offset the US deleveraging and supported global demand.
- **The engine is slowing.** China's new private credit has fallen from a 2010–19 average of 21.9% of GDP to 10.6% in 2026Q1. Government borrowing has risen to 12.5% and has exceeded it since 2025Q3, but has replaced only half of the fall. The shortfall has shown up as twelve consecutive quarters of falling prices to Q1 2026 and a trade surplus of US$938bn in the first nine months of 2026, on track to beat 2025's record US$1.2 trillion.[7,8,9]

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- **The debt does not disappear; it relocates.** China's surplus must be matched by deficits elsewhere, and those deficits are financed by borrowing, increasingly by governments in the deficit countries.
- **The base case is Japan, not an external crisis.** China's private debt, at 204% of GDP, is close to Japan's 1993 peak, but China has not yet gone through Japan's private deleveraging. The 1930s risk comes not from China's banks but from the rest of the world refusing to absorb China's surplus.

We used Digital Ray https://www.digitalray.ai/home, an AI model of Ray Dalio's views, to answer five questions of our own (Section 7).[10] Pressed, it concedes that output households cannot buy goes abroad and that the cure is higher household consumption with a stronger renminbi. It still ranks a domestic debt crisis above the surplus as the bigger risk to the world, and we disagree.

The question to watch is not whether China deleverages. It is whether government borrowing raises household income — which would be rebalancing — or funds more production, — which would be the same imbalance with a sovereign borrower.

1. The Question and Two Standard Answers

There are two well-argued answers to the question, and both look at the stock of debt.

The Wall Street Journal view: a debt spiral that spills overseas. BIS data put China's credit to the non-financial sector above 300% of GDP, 60 percentage points higher than at end-2019 and larger than in the US. The IMF's broad measure of government debt, which includes local government financing vehicles (LGFVs), rose from 98% of GDP in 2020 to an estimated 127%. In the *Journal*'s account, firms that must service this debt overproduce and push the excess onto foreign markets, while Beijing "*kicks the can*" to protect its technology and military priorities. The *Journal* concedes that a crisis is unlikely because the debt is funded domestically, quoting Rhodium's expectation of a "*slow decay*".[1]

The Dalio view: a policy-execution problem. Asked whether China's debt poses a problem for the world economy, Digital Ray answered that the debt is "*about 300% of GDP*" but "*mostly in renminbi and held domestically*", and that the risk depends on whether China can engineer a "*beautiful deleveraging*" balancing debt restructuring, fiscal support and monetary easing: "*the outcome hinges on policy execution*".[3] In his own published commentary in October 2024, Dalio argued that China's position was "*at least as severe as the Japanese situation starting in 1990*", that Beijing faced a choice between a beautiful deleveraging and Japan-style malaise, and that a debt restructuring was needed.[2]

To test the Dalio view beyond this first answer, we put five follow-up questions to Digital Ray (Section 7). We agree with both views on the stock: renminbi debt, held at home by state-controlled creditors, does not produce a Brazil-1982 or Asia-1997 crisis. Where we differ is the mechanism by which China's debt affects everyone else. That mechanism runs through the flow of new credit and the trade balance, not through default.

2. What the Debt Paid For

China's debt is the financial footprint of a demand gap created by China's distribution of income. We developed the argument in *Mercantilism Revisited*,[11] following Pettis and Klein.[4] China's growth model has transferred income from households to producers, local governments and owners of capital — through wages growing more slowly than productivity, financial repression of household deposits, subsidised credit, land arrangements that favour local government, and an undervalued exchange

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rate. Households spend most of what they earn; firms and governments retain theirs. Total consumption was 53.4% of GDP in 2023 on Pettis's estimate, about ten points below what he considers a minimum sustainable level.[12]

The national income identity can be read two ways. As income, everything produced is paid out to someone — as wages and transfers to households, as profits retained by firms, or as revenue to the state. As spending, the same output must be bought:

$$Y = C + I + G + (X - M)$$

Households spend most of what they receive; firms and the state retain most of theirs. A low household share of income therefore means low household consumption (C) relative to output. For the identity to hold, the shortfall must be made up by some combination of three adjustments:

- **More investment or government spending** — in China, largely investment financed by new bank credit to firms, property developers and LGFVs.
- **More net exports**, so that foreigners buy the output.
- **Less output**, meaning unemployment and falling prices, so that Y falls until it matches what is bought.

The identity does not say which of these happens. It is accounting, not a causal theory, and we treat it that way. It does say that if one channel closes, the gap must appear in another. Since 2008 China has mainly used the first channel, and that is where the debt came from. In our framing the debt is not the disease; it is the treatment that kept the economy at full capacity while household income stayed suppressed.

The debt also has a cost the identity does not show. In *Trump's Tariffs*[13] we described how, each time one outlet saturated, Chinese credit was redirected to the next: from infrastructure to property, and from property to electric vehicles, solar and batteries. If an economy borrows 100 to build an asset whose economic value is closer to 80, someone has to pay the gap that the unproductive investment creates. In China the payer has been households, through financial repression and low deposit returns. That transfer suppresses consumption further, so the mechanism that sustains demand in the short run widens the demand gap in the long run. China's binding constraint is not external funding but domestic debt capacity.

3. 2009: When China's Debt Was the World's Solution

Keen's central point is that new credit adds to spending power in the period it is created.[5] When a bank lends, it creates a new deposit; it does not pass on existing savings. Total demand therefore depends on the *change* in private debt, not only on income. Our *Reconsidering Government Deficits*[14] states this as an identity: aggregate demand equals GDP plus the change in debt. There are only two sources of net new credit — the banks and the sovereign — and if one withdraws, the other must compensate. Figures 1 and 2 plot both flows.

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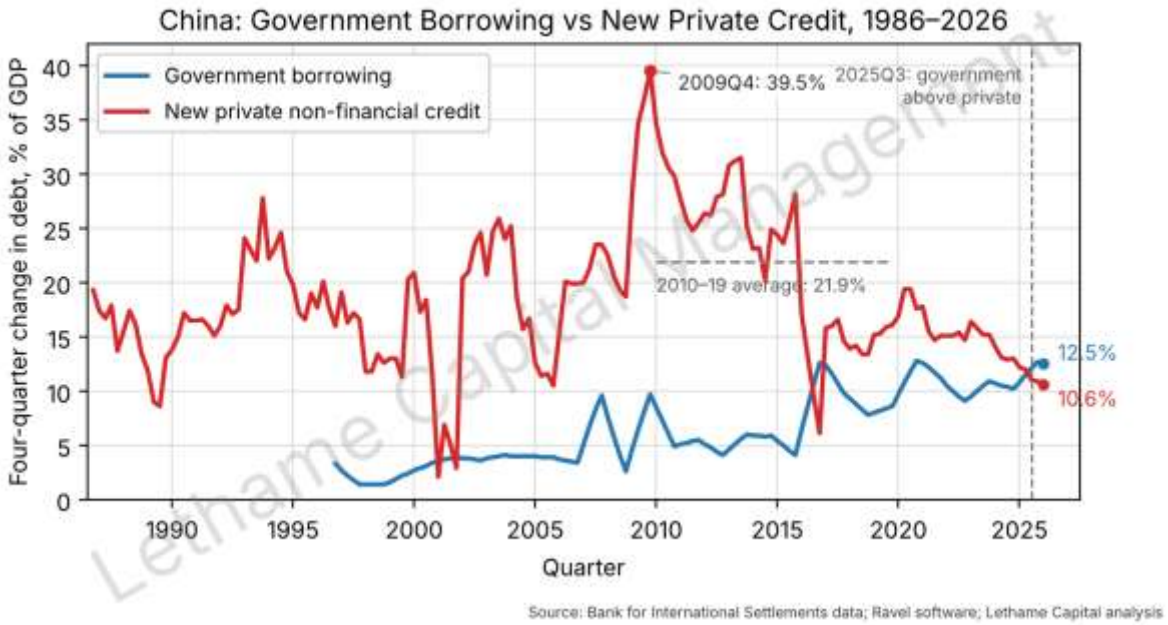


Figure 1: China – Government Borrowing vs New Private Credit (Four-Quarter Change in Debt, % of GDP)

Source: Bank for International Settlements data; Ravel software; Lethame Capital analysis.[6]

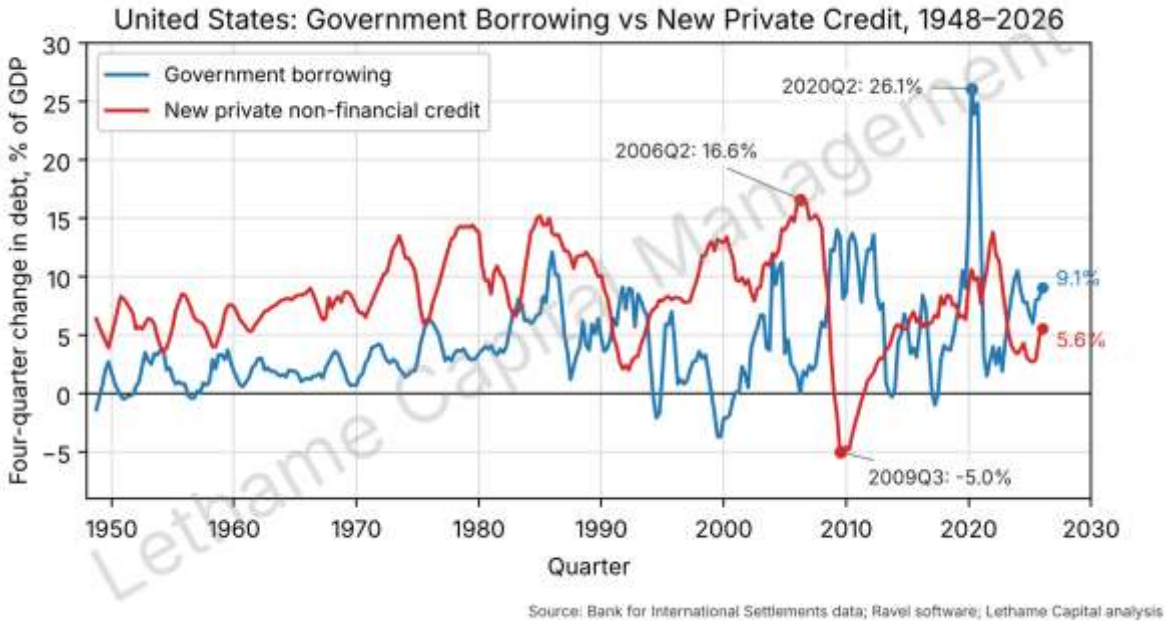


Figure 2: United States – Government Borrowing vs New Private Credit (Four-Quarter Change in Debt, % of GDP)

Source: Bank for International Settlements data; Ravel software; Lethame Capital analysis.[6]

In 2008–09 US households began repaying debt. The US private credit flow fell from 16.6% of GDP in 2006Q2 to −5.0% in 2009Q3, a swing of more than 21 points of GDP in credit-financed demand, and Washington offset part of it with fiscal deficits. Beijing's response took a different form. China's private credit flow, already 18.7% of GDP in 2008Q4, more than doubled to 39.5% within a year, routed through state banks to state-owned firms, property developers and LGFVs.

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Two things followed. Inside China, the investment share of GDP rose from 40.2% in 2007 to 46.3% in 2011 while the saving share barely moved, so the current-account surplus fell from 9.8% of GDP to 1.8%. Before 2008, foreigners had absorbed the output households could not buy; after it, credit-funded investment did. Outside China, commodity exporters — Australia among them — and capital-goods producers gained a large new source of demand just as US private demand was shrinking. Without China's credit expansion, the global recession would very likely have been deeper.

The debt the Journal now calls a problem was, for a decade, the main thing keeping China's surplus off everyone else's books

4. The Handoff: From Private Credit to Government Deficits

China's private credit flow has fallen from a 2010–19 average of 21.9% of GDP to 10.6% in 2026Q1, while government borrowing has risen to 12.5% and has exceeded it since 2025Q3 (Figure 1).

That convergence is the Japan signature. After 1990 Japanese firms paid down debt and the government ran the deficits — what Richard Koo later called a balance-sheet recession.[15] *Reconsidering Government Deficits*[14] sets out why the substitution matters. When a currency-issuing government runs a deficit, it adds net financial assets to the private sector; private borrowing adds a matching private liability for every asset. In Keen's terms, government debt is the safer form of demand support, and private debt that must be serviced from cash flow is the dangerous form. Three observations follow:

- **The handoff is incomplete.** China's private credit flow is 11.3 points of GDP below its 2010–19 average; government borrowing is 5.5 points above its own 2010–19 average of 7.0%. Net, about six points of GDP of credit-financed demand has gone, and it shows in prices: nominal GDP growth of 4.9% was below real growth of 5.0% in Q1 2026, the twelfth consecutive quarter of a negative GDP deflator.[7] Factory-gate prices have since turned up, with producer prices 5.0% higher year on year in September, but analysts attribute this to energy costs from the Middle East conflict rather than domestic demand: consumer prices rose only 0.9%, and real growth slowed to 4.3% in the second quarter.[9] Third-quarter GDP, due on 19 October, will show whether the GDP deflator has turned.
- **Part of the handoff may be relabelling.** In November 2024 Beijing launched a RMB 10 trillion programme to swap hidden LGFV debt into official local government bonds.[16] The BIS records LGFV debt in the non-financial corporate ("private") sector, so a swap lowers measured private credit and raises measured government debt without any new spending. We have not yet separated the two. The precedent supports caution: the only earlier time government borrowing exceeded private credit, in 2016Q3–Q4, coincided with the first local-debt swap programme of 2015–18.
- **"Private" in China is largely quasi-state.** Much of the private series is borrowing by state-owned firms and LGFVs, which cannot issue currency and service debt from land sales the property bust has cut. Moving their debt onto the central government's balance sheet is consistent with Keen's logic — it shifts debt from a borrower that can fail to one that issues the currency — but it only reduces risk. It does not by itself create household demand.

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5. The Debt Relocates

As the domestic credit channel narrows, the second channel — net exports — widens. China's goods surplus reached a record US$1.2 trillion in 2025, despite US tariffs.[8] Current accounts sum to zero across the world, so a Chinese surplus is someone else's deficit, and a deficit country spending more than its income means one of its sectors is adding debt: households, firms or, increasingly, the government. Figures 3 and 4 show the resulting stocks.

The latest trade data, published on 14 October, show the channel still widening. Exports rose 36.3% year on year in September and the surplus for the first nine months reached US$938bn, against US$875bn a year earlier.[9] Two qualifications matter. First, chips and data-processing equipment contributed 13 percentage points of September's export growth: part of the surge is pulled by foreign demand for AI hardware rather than pushed out by weak Chinese consumption. Second, imports also rose 31%, inflated by oil prices, so the surplus is growing far more slowly than exports. The direction is nonetheless clear, and so is the response: a week earlier Brussels and Beijing agreed a quota on imports of Chinese hybrid vehicles.

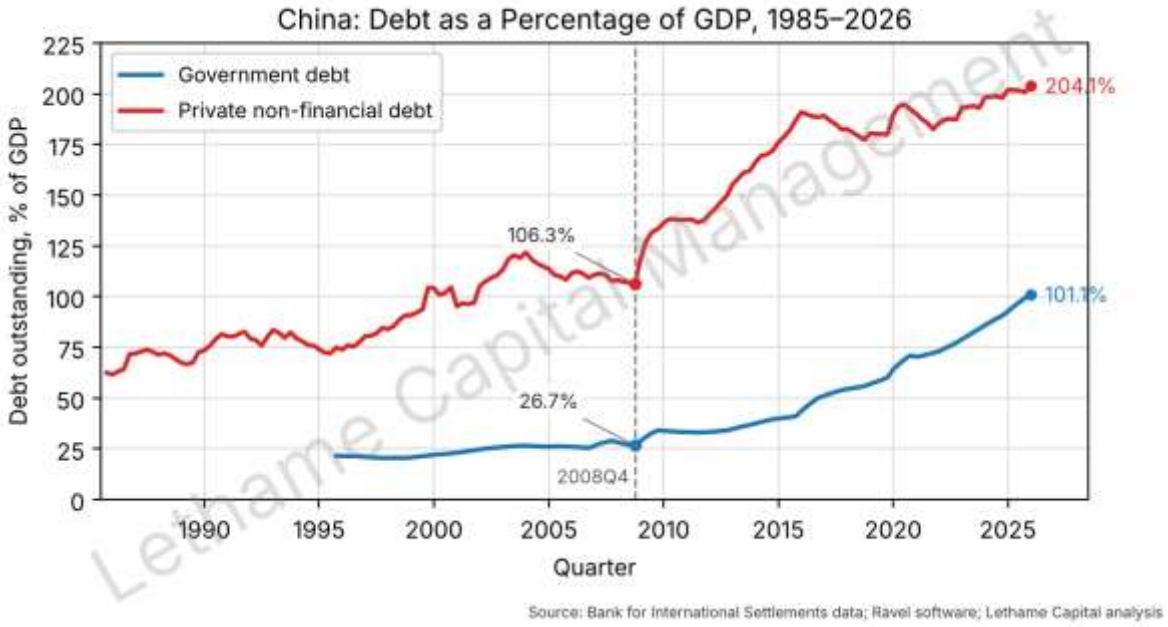


Figure 3: China – Government and Private Non-Financial Debt (% of GDP)
Source: Bank for International Settlements data; Ravel software; Lethame Capital analysis.[6]

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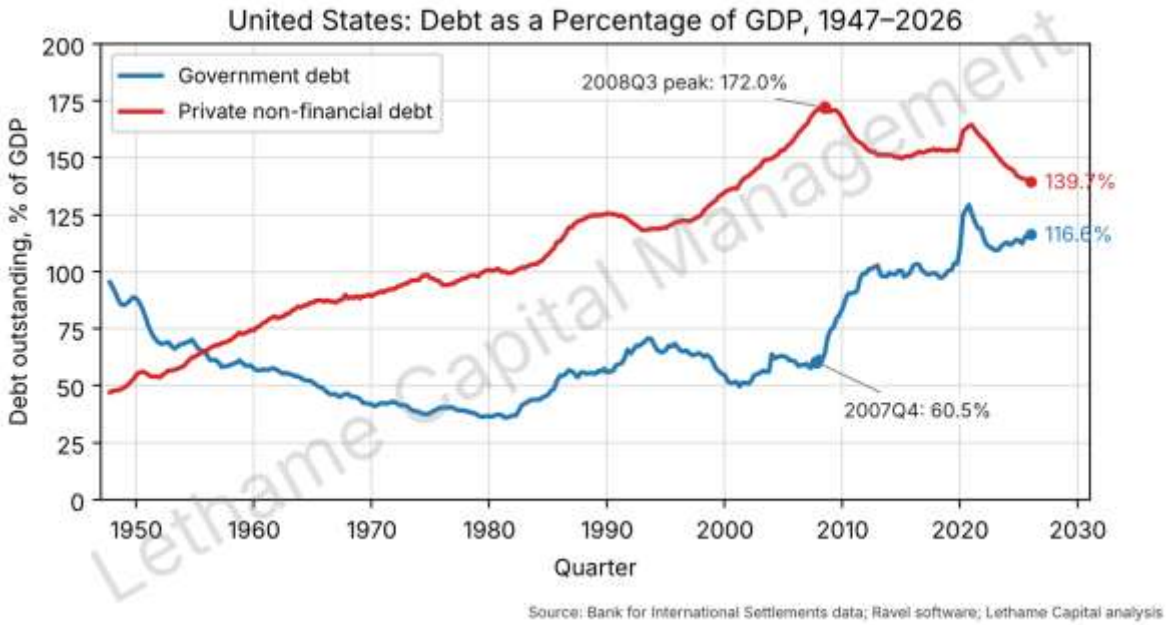


Figure 4: United States – Government and Private Non-Financial Debt (% of GDP)
Source: Bank for International Settlements data; Ravel software; Lethame Capital analysis.[6]

China's debt kept rising in both sectors: private debt from 106.3% of GDP in 2008Q4 to 204.1%, government debt from 26.7% to 101.1%. In the US, private debt fell from its 172.0% peak in 2008Q3 to 139.7%, while government debt rose from 60.5% in 2007Q4 to 116.6%.

Keynes saw this asymmetry at Bretton Woods, as we discussed in *Trump's Tariffs*.[13] His proposed International Clearing Union would have required persistent surplus countries to revalue or expand domestic demand. It was rejected by the United States, then the world's great surplus economy.[17] The resulting system puts the burden of adjustment on deficit countries — today the US and, increasingly, Europe. As President Macron put it in December 2025, the combination of US tariffs and subdued Chinese consumption means Chinese exports are now "*flooding into Europe*", which "*is not sustainable for Europe or China*".[18]

The debt does not disappear — it moves from Chinese balance sheets to foreign ones

This is where China's debt becomes the world's problem. The *Journal*'s claim that the debt is "*spilling overseas*" is right in outcome but wrong in mechanism: what spills over is the *slowdown* in Chinese borrowing, which sends the demand gap abroad for foreign borrowers to fill.

The Savings Glut in Reverse[19] adds a second layer. The surplus has not shrunk, but less of it now returns to US Treasuries through Chinese reserve buying, as China allows the renminbi to appreciate and diversifies into gold. The US still runs the deficit while its price-insensitive foreign buyer steps back, and the adjustment appears in the real term premium rather than in inflation expectations. Deficit countries are absorbing China's surplus on less favourable financing terms than in the 2000s.

A note on language: we avoid the phrase "*China exports its excess savings*", because it implies a fixed pool of savings looking for a home. Saving and lending are outcomes of income, spending and credit flows; the direction of cause runs from income distribution to spending to the trade balance.

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6. Japan or the 1930s?

Pettis identifies a recurring pattern in economies that grew rapidly on very high investment and suppressed household consumption — among them the United States in the 1920s, Brazil in the 1970s, Japan in the 1980s and, today, China.[4],[12] In the early stages the model delivers extraordinary growth, because the economy genuinely needs the infrastructure and capacity it is building. Once those needs are met, investment becomes increasingly unproductive, debt rises faster than income, and the economy must eventually rebalance. In Pettis's account that rebalancing has taken one of three forms: a sharp crisis in which debt is written down abruptly, as in the United States after 1929 and Brazil after 1982; a long period of very slow growth in which the debt is absorbed gradually, as in Japan after 1990; or, more rarely, an orderly transfer of income to households that lifts consumption fast enough to replace investment.

This last outcome is not the same as Dalio's "*beautiful deleveraging*", which manages the ratio of debt to income but is silent on who receives that income. China could deleverage "*beautifully*" in Dalio's sense while still exporting its adjustment through the trade surplus.

Our base case is Japan. The 1930s risk is real, but it would arrive through trade rather than through China's banks. Two features separate the historical outcomes: the monetary constraint on the over-indebted economy, and whether the rest of the world keeps absorbing its output (Figure 5).



Figure 5: How Over-Investment Episodes End – Monetary Constraint vs Access to Export Markets
Source: Pettis; Lethame Capital analysis.[4]

- **Brazil does not fit.** Brazil's 1980s collapse came from dollar debt and a dollar interest-rate shock. China's debt is in renminbi, owed to state-controlled banks, behind a closed capital account. A sovereign that borrows in its own currency cannot be forced to default; the UK's 1976 IMF loan and Argentina's repeated crises both arose under fixed exchange rates or foreign-currency debt.[21,14]
- **Japan fits the balance sheet.** Japan had own-currency debt, captive domestic creditors, private deleveraging offset by public deficits, and decades of weak growth without an external

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crisis — though not without a domestic banking crisis in 1997–98. Figure 1 already shows the same handoff. Dalio's "*Japan-style malaise*" and Rhodium's "*slow decay*" both describe this quadrant. Pettis notes that Japan's consumption share kept falling for five years after the turn and then took 17 years to rise by ten points.[20] Werner's account of the Bank of Japan's "*window guidance*", on which we drew in *QE, Money Creation and the Banking System*,[22,23] shows that Japan's bubble was itself directed credit — and China's state banks are a more direct version of the same arrangement.

- **The 1930s fits the trade position.** In 1929 the US was the world's surplus economy, over-invested and dependent on foreign demand. When the world turned protectionist, the surplus country took the largest fall in output; Pettis and Klein's point is that surplus economies lose trade wars. Joan Robinson warned that deficit countries do not absorb other countries' surpluses indefinitely,[24] and with US tariffs, EU measures against Chinese electric vehicles and a record surplus, China is moving up the chart. China has felt such a shock before: the 1934 US Silver Purchase Act drained silver from China, then on a silver standard, and caused the 1934–35 Shanghai credit crunch.[25,26]

Figure 6 puts the two episodes on the same clock, measuring time from the peak of each credit boom: Japan's in 1990Q1, when new private credit reached 28.5% of GDP, and China's in 2009Q4, at 39.5%.

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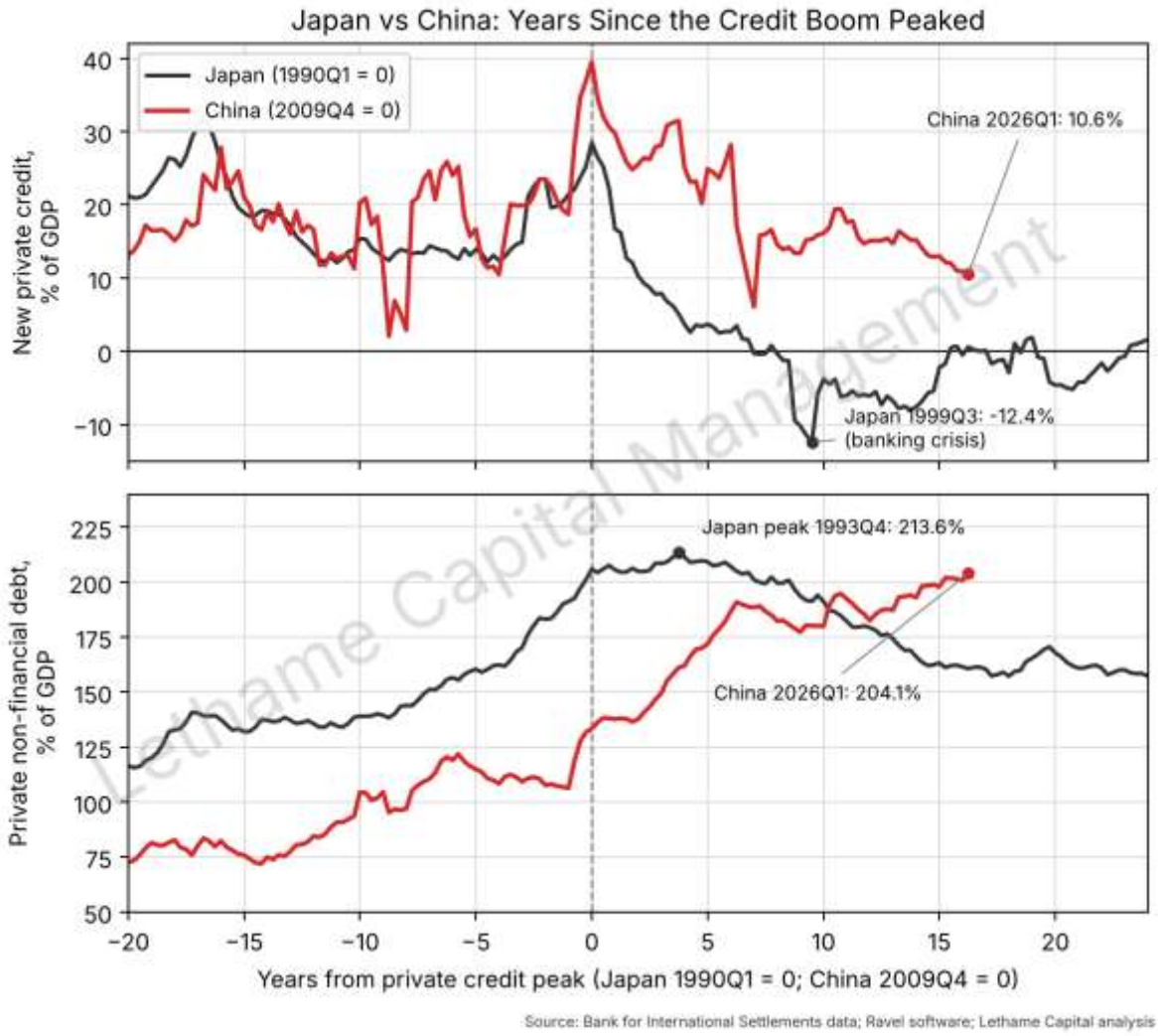


Figure 6: Japan vs China – New Private Credit and Private Debt, Years From the Credit Peak (% of GDP)

Source: Bank for International Settlements data; Ravel software; Lethame Capital analysis.[6]

Two differences stand out. First, China has decelerated far more slowly. Japan's private credit flow was down to 3.7% of GDP within four years, turned negative in 1997 and stayed at or below zero for most of the following sixteen years. Sixteen years after its own peak, China is still adding 10.6% of GDP a year. State banks have kept lending to state firms, LGFVs and favoured industries that Japanese banks were eventually forced to cut off.

Second, the stock has kept rising. China's private debt, at 204.1% of GDP, is now close to Japan's 1993Q4 peak of 213.6% and still climbing; sixteen years after its peak, Japan's had fallen to about 162%. China has followed the Japanese template on the government side (Figure 1) without yet going through the private deleveraging that defined Japan's 1990s.

If Japan is the base case, most of China's private-sector adjustment may still lie ahead

That is the uncomfortable reading of the comparison. Japan's version of slow decay included a domestic banking crisis — visible in Figure 6 as the collapse of private credit to −12.4% of GDP in

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1999Q3. Renminbi debt rules out a Brazil-type external crisis; it does not rule out a Japanese-type domestic one. Nor does it guarantee that China can postpone the private adjustment indefinitely by keeping state credit flowing, since every year of postponement adds to the stock that must eventually be worked down.

China also starts from a weaker position than Japan in 1990. It is poorer per head, ageing faster, and its consumption share is far lower. Japan's adjustment included a large currency appreciation after the 1985 Plaza Accord; the renminbi, on our estimate in *Mercantilism Revisited*, remains well below the CNY 4.5–5.0 per dollar that productivity catch-up alone would imply.[11]

7. Assessing the Two Standard Answers

Both answers get the stock of debt right and the mechanism of spillover wrong. Dalio's framework also understates how hard a "*beautiful*" outcome is under deflation.

Table 1: The Standard Claims and Our Assessment

Claim	Source	Our assessment
Debt is above 300% of GDP and larger than in the US	WSJ, Dalio	Correct, but it adds together debts that behave differently. Central government debt is owed by the currency issuer; LGFV and corporate debt must be serviced from cash flow (Section 4).
Renminbi, domestically held debt limits crisis risk	WSJ, Dalio	Agreed. It rules out a Brazil-type external crisis (Section 6).
Debt service forces overproduction, which spills into exports	WSJ	Partly right — indebted firms keep producing to cover interest, which feeds price wars — but secondary. The primary cause is the household income share.
The outcome hinges on policy execution: restructuring, fiscal support, monetary easing	Dalio	Necessary but not sufficient. All three levers act on the debt; none changes the income distribution that creates the demand gap.
A "beautiful deleveraging" is available	Dalio	It requires nominal growth above nominal rates. After twelve quarters of falling prices to Q1 2026, achieving it requires reflation — which means raising household income: the Pettis adjustment under another name.
China's debt is a world problem because it spills overseas	WSJ	Right in outcome, wrong in mechanism. The spillover comes from the slowing of Chinese credit, not its level (Section 5).

Sources: The Wall Street Journal; Digital Ray; Lethame Capital Management.

Dalio's framing is closed-economy: a debt cycle within one country, resolved by that country's policy mix. Pettis's framing is open-economy: any adjustment China avoids at home is exported. A deleveraging that is "*beautiful*" for Chinese balance sheets can be ugly for trading partners if it is achieved by holding domestic demand down and running a larger surplus — and that is the part of the question, a problem *for the world*, that the Dalio answer does not address.

This is not the first time we have taken issue with Dalio on categories. In *Is the Fed "Stimulating Into a Bubble"?*[27] we argued that his description of the Fed's balance-sheet decision conflated three different operations: quantitative easing swaps one asset for another, government deficits create net financial assets for the private sector, and private bank lending creates private debt. The same pattern recurs here. A "*beautiful deleveraging*" that treats central government, LGFV and household debt as one stock, managed with one policy mix, misses that only one of them is owed by the issuer of the currency. We say this with due modesty — Dalio's record as an investor is extraordinary — but on the

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nature of money, in our opinion, his framework repeatedly treats government and private debt as the same thing, and we treat its conclusions with corresponding scepticism.[28]

Five Questions Put to Digital Ray

To test whether the Dalio view survives these points, we used Digital Ray, an AI model of Ray Dalio's views and frameworks, to answer five questions of our own.[10] Table 2 summarises its answers and our assessment.

Table 2: Five Questions Put to Digital Ray

Our question	Digital Ray's answer (summarised)	Our assessment
1. If China deleverages "*beautifully*" but household consumption stays near 40% of GDP, where does the output go, and is a larger surplus good for trading partners?	Mostly into exports and investment, some into government spending. A larger surplus is a "*mixed blessing*" for partners. The ideal is a gradual shift to household consumption with modest, controlled renminbi appreciation.	Agreement on destination and cure: an unchanged consumption share sends the adjustment abroad, which is our central point. Calling cheap imports a benefit to partners overlooks that the counterpart is their borrowing (Section 5).
2. Is the "*beautiful*" condition (nominal growth above nominal rates) met, given twelve quarters of nominal growth below real growth and a 1.7% 10-year yield?	Yes: nominal growth is 5.5–7% (real 4.5–5% plus 1–2% inflation), well above 1.7%; but LGFVs and developers face higher effective rates. Levers: monetary easing, fiscal stimulus, structural reform, external demand, credit to consumers and SMEs.	The headline figures are wrong. With a negative deflator, nominal growth was 4.9% in Q1 2026. The condition is met at the sovereign level, but by much less; the answer rightly says the binding test is the LGFV and developer rate. Its "*external demand*" lever is the export of adjustment we describe.
3. Does moving LGFV debt onto the central balance sheet reduce risk, or relabel it?	Mainly relabelling: the risk does not disappear, and the central government's fiscal space shrinks, possibly requiring tax rises or spending cuts. Real restructuring and LGFV governance are needed.	Partly agree on relabelling (Section 4), but this is the conflation again. For a currency issuer the limit is inflation and real resources, not fiscal space, so the swap does reduce default risk. Its advice to "*encourage household savings*" is the opposite of what China needs.
4. Does a beautiful deleveraging require renminbi appreciation, as Japan's included the yen after 1985?	No consensus. Cites a Goldman Sachs estimate of about 25% undervaluation and fair-value estimates of 5.6–5.9 per dollar; favours gradual, controlled appreciation. Notes that the Plaza appreciation contributed to Japan's bubble.	Direction consistent with our CNY 4.5–5.0 counterfactual;[11] the figures it cites are its own and unverified by us. Japan's bubble owed more to Bank of Japan easing and credit guidance after Plaza than to the appreciation itself.[22]
5. Which is the bigger risk to the world: China failing to deleverage, or deleveraging through ever-larger surpluses?	Failure to deleverage: high impact, low probability, with possible 2008-style contagion. The surplus path is lower impact, higher probability. Most dangerous is a partial deleveraging relying on surpluses while hidden debt remains.	Its "*most dangerous combination*" is our base case. We rank the risks the other way: 2008-style external contagion belongs to the Brazil quadrant, which renminbi debt makes unlikely. The surplus path is already under way. A surplus "*bringing in foreign currency to pay down obligations*" does not apply to domestic debt.

Sources: Digital Ray, 14 October 2026; Lethame Capital Management.

When pressed, the Dalio framework concedes most of the open-economy argument: the output goes abroad, the cure is household consumption, and the renminbi should appreciate. It still treats the trade surplus as a cushion for China rather than as the channel through which China's adjustment becomes everyone else's debt. That is where we part company.

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8. Investment Implications

First: watch the credit flow, not the debt ratio. The signal is the gap between China's government borrowing and private credit flow (Figure 1): whether government borrowing fully replaces falling private credit, and whether it is aimed at households. If the gap stays open, deflation and the surplus persist.

Second: China exports deflation in manufactures. As long as the demand gap is closed through net exports, traded-goods prices abroad stay under pressure. Price-war sectors such as EVs, solar and steel, and producers competing with them, carry the cost. The energy-driven rise in Chinese producer prices this year does not change this: the pressure sits in the sectors where capacity exceeds domestic demand.

Third: deficit countries carry the debt, at a higher real price. The counterpart of China's surplus is borrowing by deficit-country governments. With less of the surplus recycled into Treasuries, that borrowing faces a higher real term premium; *The Savings Glut in Reverse* and *Paid to Wait* document the 2026 rise in yields as almost entirely a real-yield move, with the 10-year TIPS yield near 2.9% and breakevens broadly unchanged.[19,29]

Fourth: renminbi appreciation is the clean adjustment. A stronger renminbi raises household purchasing power and reduces the surplus at the same time. The asymmetric FX risk set out in *Mercantilism Revisited* still applies: the market prices renminbi depreciation more readily than a policy-driven appreciation.[11]

Fifth: for Australia, the China channel runs through the currency and commodities. In *Paid to Wait, Down Under* we found monthly changes in the Australian dollar correlating with the renminbi at around 0.7 since 2022, so the Australian dollar trades partly as a proxy for China's rebalancing.[30] A rebalancing toward households would be renminbi-positive but less steel-intensive than the 2009–20 credit boom, which is negative for iron ore. And as *Debt Dynamics Down Under* argued, Australian mortgage credit growth has been reinforced by the mercantilist surpluses of countries like China;[31] less recycling of China's surplus removes one of the forces behind it.

Conclusion

China's debt is mostly a domestic problem; the slowing of that debt is the world's problem. The debt was the price of keeping China's economy at full capacity while household income stayed suppressed, and for a decade after 2008 it also supported global demand. Now that private credit is slowing and government borrowing only partly replaces it, the gap is going abroad — as deflation in traded goods, a record surplus, and more borrowing by deficit countries.

Dalio is right that the debt is manageable and that the outcome depends on policy. But the policy that matters is not debt restructuring; it is whether Beijing moves income to households. Until it does, the most likely path is Japan's slow decay, with the surplus as the rest of the world's share of the cost. The risk is that the rest of the world refuses that share — which would move China toward the 1930s case.

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Data Notes

- Figures 1–4 and 6 use Bank for International Settlements quarterly data to 2026Q1, modelled in Steve Keen's Ravel software (Lethame Capital analysis).[6, 32] Debt is general government and private non-financial sector debt as a percentage of GDP.
- "*Government borrowing*" and "*new private credit*" are the four-quarter change in each sector's debt, in domestic currency, divided by GDP. They are not fiscal balances from budget statements.
- Ravel dates the four-quarter difference at the start of its window. We re-date each flow to the quarter in which the change ends, one year later than the Ravel default.
- BIS general government debt for Japan begins in 1997Q4, so Japan's early-1990s handoff to government borrowing cannot be shown on a like-for-like basis; Figure 6 therefore compares private sectors only. The sharp fall in Japanese private credit in 1998–99 coincides with the banking crisis and the resolution of bad loans.
- The BIS classifies LGFV debt as non-financial corporate ("private") debt; the IMF's augmented government debt measure reclassifies it.

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