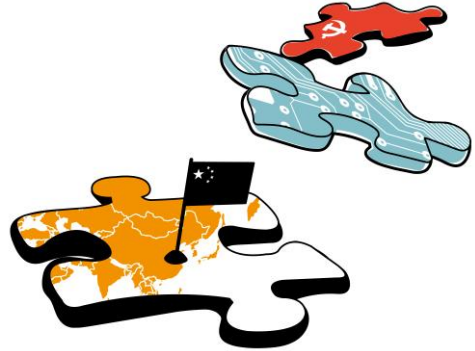


JANUARY 30, 2025

MERICS China Essentials



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TOP STORY

DeepSeek model revs up US-China AI race

The Nasdaq plummeted three percent Monday as a privately backed Chinese startup shocked the tech world with an open-sourced AI model that outperforms Western competitors at a fraction of the cost – revving up the fierce race for AI superiority between the US and China. Developed by a team of fresh graduates at DeepSeek (深度求素 in Mandarin), the model outdoes the industry’s best models, like OpenAI’s proprietary o1, on several reasoning, coding and math benchmarks.

Faced with restricted access to cutting-edge hardware due to US export controls, DeepSeek says it trained its R1 model using only about 2,000 Nvidia H800 chips, which are less advanced than Nvidia’s top-performing chips. The breakthrough was so significant that the world’s leading AI chipmaker lost USD 589 billion in market capitalization, the single greatest one-day loss of any company in history.

The reaction shows just how central the US-China race for artificial general intelligence (AGI), which is supposed to be close to or even better than human intelligence, has become in both geopolitical and economic terms. Just last week, both countries saw the creation of new AI investment funds, with China’s new state-backed fund committing an initial capital of CNY 60 billion (USD 8.2 billion) and new US president Donald Trump a USD 500 billion private sector investment to build AI infrastructure.

Speaking at the World Economic Forum, Chinese vice-premier Ding Xuexiang, who chairs the powerful Communist Party commission in charge of science and technology, said that in AI China “will not blindly follow the trend or engage in unrestrained international competition.”

What will China’s path look like? Ironically, US export controls may be forcing China’s traditionally wasteful innovation system to pursue efficiency amid scarcity. Chinese researchers are exploring a variety of approaches to achieving AGI, including less resource-intensive alternatives to the current scaling of large language models (LLMs).

DeepSeek, whose 40-year-old founder Liang Wenfeng (梁文锋) recently participated in a high-profile meeting with premier Li Qiang, just made those approaches more popular. The success also strengthens advocates of open-source AI in China and beyond: DeepSeek has published R1’s so-called weights (the parameters that define the behavior of a model), so developers worldwide can run the model locally. This is a huge challenge to the dominant players like OpenAI, which has since accused DeepSeek of using their work without permission.

Yet China’s ability to sustain this momentum is far from guaranteed. DeepSeek accomplished the R1 model before US restrictions could show their full impact. Those controls and the latest expanded limits to the global diffusion of advanced AI chips, plus new restrictions around exports of certain unpublished model weights (assuming that they are enforced) will only bite later.

Moreover, the involvement of state capital through the new AI fund might introduce some inefficiencies, as it typically comes with strings attached such as a say in strategic decisions. Stronger party-state intervention could hamper the kind of private sector-driven entrepreneurship that Liang and his team embody.

MERICS analysis: “DeepSeek’s breakthrough is not a lesson on the failure of export controls. Measures take a while to make an impact and Chinese AI companies could stockpile a lot of Nvidia GPUs before the October 2023 update to the controls expanded the parameters,” says **Rebecca Arcesati**, Lead Analyst at MERICS. “But it does pose a broader dilemma: Is Silicon Valley’s resource-hungry approach to frontier AI development sustainable, and is it even necessary?”

Media coverage and sources:

- Chinese government website (CN): [Ding Xuexiang on promoting Artificial Intelligence and other scientific and technological innovations for the betterment of all mankind](#) (丁薛祥谈促进人工智能等科技创新更好造福全人类)
- Interconnect: [DeepSeeks three idiosyncratic advantages](#)
- Lennart Heim: [The rise of DeepSeek: What the headlines miss](#)
- Center for Security and Emerging Technology: [Chinese critiques of Large Language Models](#)
- Bureau of Industry and Security: [Biden-Harris Administration Announces Regulatory Framework for the Responsible Diffusion of Advanced Artificial Intelligence Technology](#)
- Bureau of Industry and Security: [Framework for Artificial Intelligence](#)
- Financial Times: [OpenAI says it has evidence China’s DeepSeek used its model to train competitor](#)
- TEDAI San Francisco: [What are Weights in AI?](#)

METRIX

49.1

Any number under 50 in China’s national purchasing managers’ index signals that manufacturing contracted that month – as was unexpectedly the case in January. National Bureau of Statistics said its index fell to 49.1 at the start of the year from 50.1 in December 2024, the first time since September that manufacturing activity – including production, new orders, employment, supplier deliveries and inventories – shrank. The number suggests that businesses are not benefiting much from recent economic stimulus measures and that more government support may be needed soon. (Source: [AP](#))

TOPICS

Trump's China stance signals challenge for transatlantic coordination

The facts: Within days of Donald Trump's inauguration as US president, signs were mounting that his China policy will prioritize a unilateral, nationalist agenda with limited regard for Europe. In a call between Marco Rubio and China's Foreign Minister Wang Yi, the new US Secretary of State emphasized the administration's commitment to Indo-Pacific allies, but also that it would "advance US interests and put the American people first" in relations with Beijing. Trump's early moves have underlined this approach: delaying a ban on TikTok to allow a sale to US companies, threatening tariffs on China as of February 1 or on chips and semiconductors that would hit Taiwan and other US allies, justifying his claims to the Panama Canal and Greenland with competition from China.

What to watch: None of Trump's moves bode well for transatlantic cooperation. The European Commission has prepared proposals for EU-US co-operation, including joint action on market disruption from China, but the Trump administration is yet to show interest. The issues high on the EU's China agenda –protecting the rules-based international order, green initiatives, combating disinformation, – seem set to have little importance for Trump, given his withdrawal from international agreements and projects. Instead, he is playing up personal and transactional diplomacy, to which the 27-member EU is less suited. Trump praised his recent call with Xi Jinping, calling for Beijing to help end Russia's war against Ukraine.

MERICs analysis: "A transatlantic agenda on China will likely narrow in scope but remains crucial" says **Grzegorz Stec**, Head of the MERICs Brussels office. "As Trump's China priorities take shape, the EU will need to readjust what constitutes viable coordination. But boosting working-level engagement with the US – especially on issues like market distortions and export controls– should remain the immediate focus."

Media coverage and sources:

- Rhodium Group: [Trump and the Europe-US-China triangle](#)
- Reuters: [Trump tariffs on chips and drugs would hit US allies in Asia](#)
- Politico: [Trump's secretary of state finally calls Europe back after skipped meeting](#)
- POLITICO: [EU, seeking to woo Trump, offers to team up with US on China](#)

Vanke turmoil shows property sector not out of the woods yet

The facts: Rising debt concerns at China's fourth largest real estate developer – China Vanke – are pouring cold water over hopes for a gradual recovery in the property sector. This could further dampen consumption in 2025, potential bad news for European exporters and investors. On Monday, Vanke said it anticipated a net loss of approximately CNY 45 billion (EUR 5.8 billion) last year, its first ever annual loss and more than double analyst projections. The company Chairman, Yu Liang, and CEO,

Zhu Jiusheng, have both resigned from their posts. In mid-January, state media reported that Zhu had been detained by police.

What to watch: The worse-than-expected figures indicate that Vanke's financial position deteriorated further in the final quarter of last year, despite the government providing trillions of yuan in additional lending support to "high-quality" developers. Land and apartment sales remained suppressed across the real estate sector. If needed, the Shenzhen government could step in to bail out Vanke, so a default is unlikely. Yet its liquidity problems will put pressure on officials to announce new measures in the coming months to stabilize the property market.

MERICS analysis: "Vanke's debt troubles are a strong indicator that China's property downturn has not reached the bottom and remains a drag on consumer demand," says Senior Analyst **Alexander Brown**. "European firms ought to factor this into their expectations for 2025."

Media coverage and source:

- The New York Times: [China Vanke forecasts USD 6.2 billion loss, replaces top Executives](#)
- The Economic Times: [China Vanke flags record loss as Chairman, CEO resign amid woes](#)
- 21st Century Business: [多方积极支持，万科发展迎来重大转机，深圳国资](#)

China discovers the side-effects of volume-based drug procurement

The facts: China appears to be running into problems with its efforts to make healthcare more accessible by lowering drug prices. The National Healthcare Security Administration (NHSA) announced late January that it was seeking the views of medical experts on the country's centralized pharmaceuticals procurement program in response to concerns about the efficacy of some drugs. Members of Shanghai's political advisory body and doctors shortly before had flagged possible risks associated with some Chinese-made generic drugs – such as laxatives, blood pressure medicine and anesthetic drugs – procured cheaply in bulk. They also proposed that patients should be given the choice to pay more for alternatives.

What to watch: China's government is striving to make healthcare more affordable, since the nation faces the challenge of "getting old before getting rich," as a popular saying puts it. Reforms like volume-based procurement to lower costs are crucial for this ambition, so Beijing will be keen to solve any problems quickly. Launched in 2018, the program requires pharma companies to bid to supply large volumes of medicines. It unleashed fierce competition between Chinese manufacturers and drastically lowered drug prices – so much so that China's huge market has become increasingly unprofitable for Western branded-drug manufacturers.

MERICS analysis: "China's efforts to make essential drugs available has come with unintended side effects," says MERICS Analyst, **Alexander Davey**. "Until public

confidence is regained, efficacy issues with government-procured drugs for the National Medical Insurance Scheme is likely to encourage patients who can afford it to choose pricier, but more reliable foreign-made branded drugs.”

Media coverage and source:

- CCTV (CN): [The National Medical Insurance Administration and other departments will go to Shanghai to listen to opinions on centralized drug procurement in person](#)
- NYT: [In China, government data on drugs blocked from public after backlash](#)
- SCMP: [40,000 punished in China's medical corruption crackdown, including over 350 top figures](#)

MERICS CHINA DIGEST

[US overtakes China as Germany's most important trading partner \(GTAI\)](#)

The US overtook China in 2024 to become Germany's largest trading partner for the first time since 2016, according to Germany Trade & Invest, the country's international business promotion agency. US-German trade reached 255 billion EUR last year, while trade with China fell to 247 billion EUR. Germany imports more from China than any other country but in 2024 exported the most goods to the US. (25/01/20)

[Relatives plead with Thailand not send Uyghurs to China \(The Guardian\)](#)

Relatives of 48 Uyghur men detained in Thailand for a decade have asked authorities to drop what they fear are plans for imminent deportation back to China. UN experts have also urged Thailand to halt the transfer, saying the men face a “real risk of torture or other cruel, inhuman or degrading treatment or punishment.” (25/01/25)

[EU to resume WTO case against China over alleged economic coercion of Lithuania \(South China Morning Post\)](#)

Brussels has renewed its World Trade Organization complaint against China for alleged economic coercion of Lithuania, the European Commission said. The EU first launched the case in 2022, accusing Beijing of orchestrating a trade embargo against the Baltic state after allowing Taiwan to open a “Representative Office” in Vilnius. (25/01/24)

[Covid-19: CIA says lab leak most likely source of outbreak \(BBC\)](#)

Five years after the beginning of the COVID-19 pandemic, the CIA released a new assessment of its origins. The US intelligence agency said the virus was “more likely” to have leaked from a Chinese lab than to have come from animals on market in Wuhan. However, the agency warned that it had “low confidence” in this finding. (25/01/26)

OUR LATEST PODCASTS

[China's economy in 2025, with Max Zenglein](#)

China's economy ended 2024 on a stronger-than-expected note. GDP expanded by 5.4 percent in the fourth quarter, bringing full-year growth to five percent – exactly as

forecasted by the Chinese leadership. This momentum gives the leadership a good position to face an uncertain 2025, but significant challenges remain. MERICS Chief Economist **Max Zenglein** shares his takes on the state of China's economy.

EU-China relations in 2025, with Abigaël Vasselier

Abigaël Vasselier, Director Policy & European Affairs at MERICS, just returned from a trip to Washington, D.C. where she discussed transatlantic China policies with US counterparts. On the MERICS Podcast, she talks about the challenges that lie ahead for the EU in the coming months in managing its relations with China and the United States under President Donald Trump.

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