Research @ Citi Podcast, Episode 74: China’s AI-Driven New Economy

Recorded: April 9, 2026

Published: April 16, 2026

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Transcript:

Erica Poon Werkun (0:00)

Welcome to the Research @ Citi podcast. I'm your host Erica Poon Werkun, Head of Research for JANA and Asia South here at Citi.

China has emerged as one of the global leaders in artificial-intelligence adoption, driven by a combination of ambitious national strategies, significant government investment, and a rapidly expanding technological ecosystem.

AI is a catalyst for new economic growth in China. It creates new sectors and business models in areas like autonomous driving, intelligent healthcare, and smart cities. While it fuels economic expansion and technological advancement, it also presents challenges related to workforce displacement.

To discuss China's AI development and the AI-driven new economy, I'm delighted to be joined by two of my colleagues: Xiangrong Yu, Citi's Chief China Economist, and Alicia Yap, Citi's Head of Pan-Asia Internet Research.

Xiangrong, Alicia, welcome to the show.

Let me first turn to Alicia with my question. Alicia, what are your thoughts on China's AI development over the past few years? How high is the country's AI adoption rate relative to its global peers?

Alicia Yap (1:22)

Thanks for having me, Erica. So in February, the China Internet Network Information Center released the latest industry report, noting that total numbers of internet users reached 1.12 billion by the end of 2025, with the internet penetration rate rising to 80%. Specifically, the report pointed out that the total number of users who have utilized generative AI reached 602 million by December 2025, representing a 142% year-over-year increase.

In comparison, a recent Federal Reserve report noted that the work-related Gen AI adoption rate in the U.S. was approximately 41%, and the non-work-related usage was at 50% of the population as of the latest survey in November 2025.

So with the proliferation of AI agents, such as the various clawbot agents emerging in China and globally, we believe the overall AI adoption rate in China and global markets has likely experienced a significant increase in the first three months of 2026.

Erica Poon Werkun (2:37)

Those are some impressive AI developments and figures. Xiangrong, on the macro level, does AI actually move the needle?

Xiangrong Yu (2:47)

Thanks, Erica. The short answer is yes, and I think this is still underappreciated by the market. Remember, before DeepSeek there was deep concern that China could be left behind in this round of the AI revolution, especially given U.S. export controls on AI chips and the key technologies. Now the gap between Chinese models and the global frontier has narrowed significantly.

But here's the bigger point: The AI-driven new economy is no longer just a compelling tech story, it's also macro relevant. And I want to make this case at three levels.

First, the capex. This is the most tangible channel. We estimate AI capex in China totaled around 400 billion RMB last year, roughly 0.3% of GDP. And we expect that to accumulate to over $3 trillion until 2030. That's the real money.

Second, direct GDP weight. IT services, for example, which is a subsector of the new economy, has grown from less than 2% of GDP a decade ago to now over 5%. Meanwhile, the property sector has declined to less than 6%. So, if these trends continue, IT services alone will outsize the property next year.

Third, the full picture. At its peak, property accounted for almost 30% of GDP, including both direct and indirect contributions. Today it's down to around 13%. On the other hand, the broader new economy as measured by the NBS is now over 18% of GDP. So, in a broader sense, the new economy can now fully offset the property's drag.

Erica, in the past few years, the markets actually have constantly underestimated China's headline growth. I think part of the reason is that the traditional framework centered around the property has missed how much the new economy has grown. The landscape has simply changed a lot.

Erica Poon Werkun (4:50)

AI certainly is a very important growth driver for China going forward. And the Chinese government clearly sees AI as a national priority. So Xiangrong, what are the policy roadmaps going forward?

Xiangrong Yu (5:01)

You know, AI is a defining theme for the 15th five-year plan. When I read through this long document, what strikes me is not just the emphasis, but also the level of details for the AI-plus economy. The sharp contrast was the underwhelming consumption push, despite all the talks on rebalancing.

So, clearly AI is where the real policy conviction lies, and the real question is, Can China keep catching up? I think yes, and the reasons go beyond policy.

The first is the talent: China produces more STEM graduates than any other country.

Second, the industrial ecosystem: China's manufacturing base gives it a unique advantage in deploying AI in the physical world — in factories, logistics, and the supply chain.

Third, infrastructure: As the world's largest power generator, China accounted for around one-third of global electricity production last year. For energy-intensive AI, this is a critical and often overlooked advantage.

Erica Poon Werkun (6:09)

Xiangrong, I think you brought up really important points on talent and also infrastructure power supply. But at the same time, we often hear about the hardware constraints facing China's AI development due to restrictions on advanced semiconductors. So, Alicia, is there a silver lining to the story here? Have these constraints actually led to a different and perhaps more efficient path of innovation?

Alicia Yap (6:37)

Yes indeed. So hardware limitations are challenging Chinese AI companies, but this also has sparked a wave of innovations focused on software-driven efficiency. So the industry is leveraging the strengths in software to overcome the hardware constraints.

So without unlimited access to the top-tier GPUs, Chinese firms are designing the leaner models using the sophisticated architectures, like the mixture of experts, called MOE. In these models, only the specific experts' parts of the network activate for a given task, making both the trainings and inference far more efficient.

This has also spurred innovations in the distributed training, where engineers orchestrate a large cluster of less powerful chips, efficiently splitting the model and data to maximize the computational output. So during the inference, efficiency is further boosted by removing data redundancy.

So, in short, hardware constraints have forced the Chinese AI industry to build deep expertise in efficiency. This focus on optimization has become a major competitive advantage, allowing the Chinese model to scale at a more affordable cost.

Erica Poon Werkun (8:01)

Got it. And China also is adopting a different AI model, it seems. In the West, many leading AI models are proprietary and closed, while in China, there seems to be a stronger trend towards releasing open-weight or open-source models. What is the strategy behind this and what does it tell us about China's approach to AI development?

Alicia Yap (8:24)

Yes, indeed. So we believe the trend in China is to use the openness as a tool to accelerate growth and drive adoptions. We believe this is related to companies also wanting to build a dominant ecosystem. So by releasing powerful open-weight models, Chinese companies encourage thousands of developers, start-ups, and even researchers to build applications on their platforms.

The goal is to become the go-to platform, which means developers will also use their other AI tools and computing services. Secondly, this also creates a powerful feedback loop. So when the community use the model, they test it, find flaws, and discover new use cases. This provides the company with invaluable data to improve their next versions of the model.

One important point to add is that most of the time, these companies are not releasing their most cutting-edge models to the public. They typically reserve their most advanced versions for their core enterprise customer. Once they develop an even better model, the previous best version is then released to the open-source community.

So, in the end, open-source strategy seems to be driven by the belief that owning the entire ecosystem is more valuable than just owning the single best model.

Erica Poon Werkun (9:50)

Staying with Alicia, let's chat about agentic AI, systems that can autonomously perform tasks and transactions like booking travel or managing schedules. So, Alicia, how easy or difficult will it be for China to implement?

Alicia Yap (10:06)

So ideally, China should be well positioned to implement agentic AI on a massive scale due to its existing infrastructure and the large data volume. However, we believe there are non-technical hurdles that complicate the deployment. The problem is surrounding the cross-platforms and also breaking down the walled gardens of the existing platform ecosystem.

On one hand, the super-app environment in China is ideal for transactional AI development. China's super-app ecosystem with its integrated digital payments, unified logins, makes it easy for an agent to complete tasks across different services within its own platform. If an agent is built into super app, it can handle transactions seamlessly. But these super apps are also walled gardens. While they centralize many services, they are closed off from their competitors. And AI agents built to work on one tech giant's ecosystem probably cannot interact with services in a rival's ecosystem.

So the challenge is that these tech giants are unlikely to open up their platforms to a competitor's AI. The real barriers to deploying a truly agentic AI in China isn't the technology itself, but the walled gardens created by the intense competition.

Erica Poon Werkun (11:30)

Thanks, Alicia. All these AI developments are certainly exciting, yet on the ground, consumer and business sentiment remains subdued. Xiangrong, why isn't the AI excitement translating into confidence?

Xiangrong Yu (11:44)

Consumer confidence remains low despite the exciting tech and macro stories. And I think there are two explanations, and they work together.

The obvious one is the balance sheet: The property downturn continues to drive a negative wealth effect.

The second is cash flow: Despite the robust GDP growth, household expectations on income growth and employment haven't improved much, according to the previous survey.

I worry that the AI-driven new economy may raise the risk of jobless growth in China. We estimate that around 30% of employment in China has high exposure to AI. Out of that, about 9.6% — or around 70 million jobs — could be subject to displacement risk. Services and the young workers are more exposed than others. This is actually a high-level challenge because the services used to absorb workers displaced from manufacturers and this pushing itself is now under pressure from AI.

Fortunately, our survey shows that AI displacement has been limited so far. Adoption is still largely personal, not yet formal workplace deployment. Also, the government is aware of this GDP-job disconnect. This year, they cut the GDP growth target for the first time in four years, but they didn't soften on jobs: They still aim to create 12 million new jobs this year.

Alicia Yap (13:22)

Let me also add a point here. So we recently collaborated with Citi Innovation Lab on a survey regarding the impact of AI. We found that in response to the questions of

whether AI will replace their current job, a higher percentage of respondents from the older age group, especially those over 35, indicated that they do not expect their jobs to be replaced.

We believe this may be because older individuals are more likely to hold senior positions with greater responsibilities. Therefore, they view AI as a tool that will benefit their work productivity and also help them generate a higher income, rather than as a threat that will replace their job.

Erica Poon Werkun (14:09)

It is certainly quite a balancing act for the country to, on the one hand, try to raise AI fluency for the technological advancement for the country, but also need to worry about managing or stabilizing the unemployment rate.

So, I have one last question, and that's for Xiangrong. Overall, what does all of this mean for policymakers and investors positioning in China's AI space?

Xiangrong Yu (14:35)

Erica, as you mentioned, policymakers will have to keep an eye on the socioeconomic impact while pushing for AI deployment. I see at least two major policy implications here.

First, augmentation over substitution. Take robotaxis as an example. Deploying them at scale could affect more than 10 million drivers in China. So this is not just a technical issue but also a social issue. As AI's social impact grows, I suspect policy will favor companies that use AI to empower workers, rather than just to replace them.

Second, a robust social safety net will be a precondition for larger-scale AI deployment. Strengthening job protection, unemployment benefits, and the retraining program has become more urgent than ever. Relatedly, we also anticipated some redistribution efforts going forward. I think investors should model a plausible future scenario where tax incentives for the new economy are phased out as it matures. The era of big tax cuts is simply behind us.

So what's the investment takeaway? In my opinion, AI governance is becoming a critical yet underappreciated variable in China AI investing. Just as regulation was once a key consideration for investing in Internet platforms, governance will need to be incorporated into the framework for AI investment.

Technological capability matters, but emerging policy and social constraints may matter just as much. In short, I think this year could mark a shift in focus from capex to governance.

Erica Poon Werkun (16:38)

A lot to look out for, for sure, for the AI space in China. It is fast-changing and highly relevant to our global audience. Alicia and Xiangrong, thank you both so much for sharing your insights.

Xiangrong Yu (16:40)

Thank you.

Alicia Yap (16:41)

Thank you.

Erica Poon Werkun (16:42)

This episode of Research @ Citi was recorded on Thursday, April 9, 2026. I'm your host, Erica Poon Werkun. Join us next time as we discuss AI, labor force and productivity with our U.S. Regional Director of Research, Rob Rowe.

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