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China's Rising Power and the Implications for US Hegemony

In a [recent report](#), we noted that the world is now transitioning away from its 30-year era of Globalization, when the United States mostly embraced its traditional role as global hegemon, i.e., the big, dominant country that provides international security, ensures relative order, and issues the reserve currency. Our previous report showed that the world is now entering a new era of Global Fracturing or, potentially, Chinese Hegemony. In this report, we take a deeper dive into the current US-China balance of power. We show that in all key aspects of power — military, diplomatic, technological, and economic — the balance appears to be shifting noticeably in favor of China. As this monumental shift in international relations becomes more obvious, US leaders and voters are increasingly struggling to decide whether they want to cede hegemony to the Chinese, defend it, or reform it into something that is more “America First.” Whatever they decide, the US role as global hegemon is changing as China’s relative strength increases. We conclude our report by discussing the investment implications of this change.

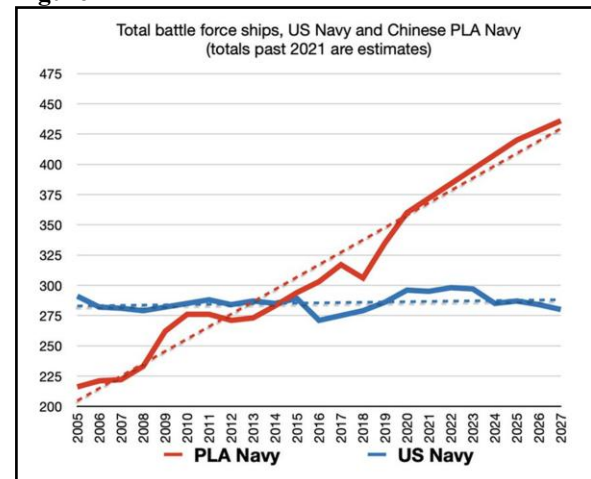
Military Power

Since 2021, we’ve been publishing detailed biennial studies on the military balance of power between the US and China, drawing largely from the [Defense Department’s annual report on the topic](#) but also reflecting

other relevant sources. The 2025 edition of this series can be found [here](#). Based on the trends we’ve discussed in these reports, we think some of the main changes favoring China are in the realms of naval power, missile arsenals, munitions production, and space and cyber warfare.

Naval Power. The most recognized change favoring China’s military is the continuing expansion of its navy. China’s total naval combat force continues to grow and now exceeds 370 ships, while a spate of ship retirements this year will cut the US force to just 287 vessels (see Figure 1).

Figure 1



(Source: *TheSoundingLine.com*)

China’s navy still falls short of the US fleet in total tonnage and technology. For example, each of its three aircraft carriers relies on diesel power, while all US carriers use nuclear propulsion. Still, China’s growing ship count is increasingly allowing it to saturate the western Pacific Ocean, where a potential US-China conflict would

most likely occur. Finally, the Chinese navy continues to ramp up its pace of operations, training, and provocative maneuvers in disputed waters. That effort probably helps offset new US naval programs in the region, such as a buildup of forces in Guam and small deployments of anti-ship missile batteries in allied countries.

Missile Arsenals. It's also widely known that China's massive arsenal of short-, intermediate-, medium-, and long-range conventional missiles can saturate the Western Pacific, putting US and allied forces at sea, on the ground, or in the air at risk. While the US has begun to deploy more anti-air and anti-ship missiles in the region, the numbers are small. China's conventional missile force has therefore already made the regional waters a high-risk area for US and allied forces of all types, but what's less recognized is that China also continues to expand its arsenal of nuclear-armed missiles that can strike the US.

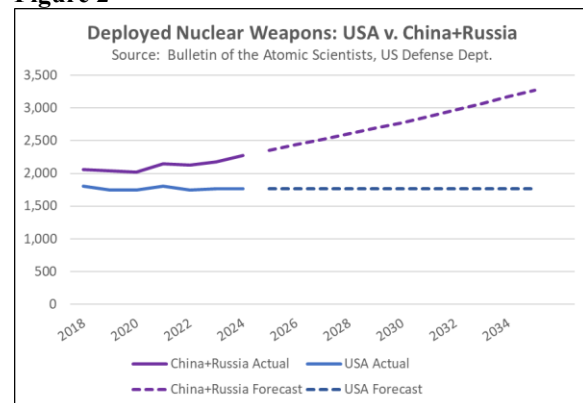
[Beijing is believed to be intent on matching the US's deployed nuclear force of about 1,700 warheads by the early 2030s.](#)

Meanwhile, the US arsenal is currently still capped by the New START treaty with Russia. The US is trying to modernize its decades-old nukes, but cost overruns and engineering issues have dramatically slowed the effort. If coordinated with Russia's enormous nuclear force, China's growing arsenal could potentially negate the US's nuclear deterrence and compel US leaders to back down in any geopolitical conflict with China (see Figure 2).

Arms and Munitions Production. As concerning as China's growing naval and missile forces are, the biggest problem may be that the US and allied defense industries are having trouble ramping up their arms and munitions production. [China's naval shipyard capacity is some 200x that of the](#)

[US, while reports indicate US missile producers are struggling to meaningfully accelerate their output despite strong Pentagon pressure to do so.](#) That's left US missile supplies at uncomfortably low levels after the aid provided to Ukraine and Israel this year. As discussed below, it's now also widely recognized that the US defense industry has become too reliant on foreign supplies — including rare earth minerals and computer chips from China.

Figure 2



Space and Cyber Warfare. [Finally, China continues to develop and operationalize space weapons aimed at neutralizing one of the US's key military advantages, even as it keeps probing US and allied cyber defenses through computer hacking, espionage, and pre-planted malware.](#) Of course, the US military and intelligence agencies also continue to fight a shadow cyber war against China in the same realms, but Beijing's massive effort constitutes a formidable and growing threat to the US all the same.

Diplomatic Power

In our initial study of the overall US-China balance of power in 2021, we did a detailed comparison of the two countries' diplomatic position around the world. As the reigning global hegemon, the US has traditionally had a large, strong, and well-regarded diplomatic effort. This diplomatic effort was buttressed by an emphasis on "soft power"

to draw in allies and influence their behavior. [Still, China has been rapidly building up its diplomatic infrastructure and has tried to bolster its image with its own soft-power programs such as its Belt and Road Initiative. What's new in 2025 is that the US has adopted a more populist America First approach, including dismantling public information sources such as the Voice of America and significantly reducing foreign aid programs.](#) China has attempted to fill the resulting perceived void, potentially earning it goodwill overseas.

Technological Power

Artificial intelligence has become the technology of the moment, with the US and China leading the way. [Importantly, while US-based OpenAI touched off the frenzy in November 2022 with the release of its ChatGPT model, which reportedly took billions of dollars to develop, the release of China's much cheaper DeepSeek model in January 2025 served notice that China would be a powerful competitor in the new industry.](#) Some analysts believe Chinese AI models have already surpassed the best US models. At the very least, Chinese AI is nipping at the US's heels.

Some proof of that threat is the US government's extraordinary efforts to constrain China's AI developments by restricting the export of the US's top-end AI computer chips and related equipment to China and China's strong retaliatory efforts in response. Less recognized is that Chinese firms' focus on open-source AI models that are customized to specific uses may be a cheaper and more productive strategy than the US's focus on comprehensive, generalized large language models.

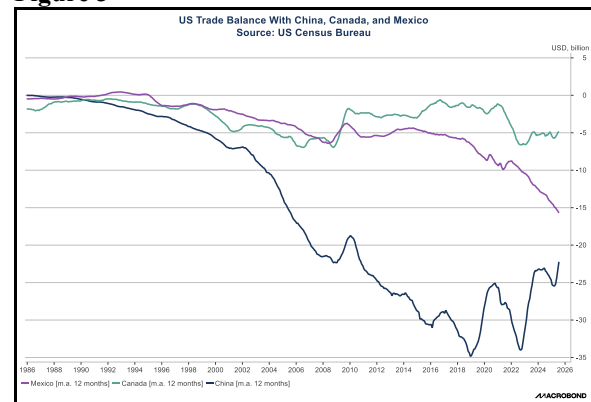
China's competitiveness in AI is only one success from its "Made in China 2025" initiative, in which it has invested huge

resources to gain market share and global dominance in a number of key technologies, from electric vehicles and batteries to solar power. China's technology success feeds into its growing military, diplomatic, and economic power.

Economic Power

Finally, we think one key development of 2025 has been a shift in perceptions about China's economic power versus that of the US. Reports indicate that President Trump and members of his administration came into office in January convinced that the enormous US trade deficit with China would give Washington overwhelming economic leverage against Beijing (see Figure 3).

Figure 3

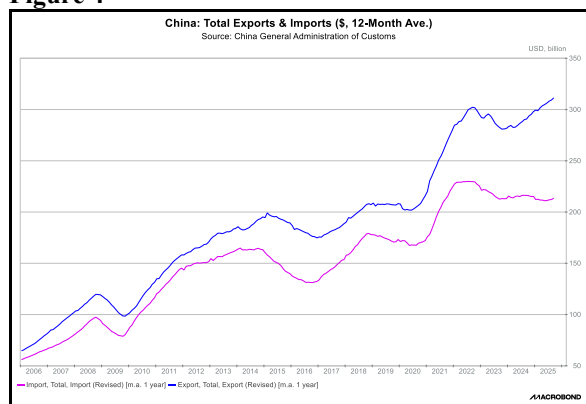


After all, the flipside of the US trade deficit is that China has an enormous trade surplus with the US, meaning much of its economic activity depends on exporting to the US. [However, when the White House attempted to impose massive import tariffs against China in April, it was quickly forced to back down by Beijing's clampdown on exports of rare earths and rare-earth products, which are essential to an array of modern products ranging from military goods to electric motors.](#)

The key learning has been that even though China depends much more on exports to the US than vice versa, it also has enormous

economic leverage from its near monopoly on producing and refining rare earths and other critical minerals that are essential to many of today's most important and lucrative technologies. After Beijing curbed exports of such supplies, manufacturers throughout the West quickly realized their production would soon have to stop. Frantic lobbying of the White House by those firms (along with a US clampdown on aircraft parts and software exports to China) prompted a trade truce. A similar flare-up occurred in October 2025, when Beijing extended its export licensing scheme to more critical minerals and to the technology and equipment to mine or process them, threatening the West's budding efforts to develop its own secure supplies. Finally, it's notable that China's total exports in 2025 have held up well, as many goods that would have normally gone to the US appear to have been shifted to other markets (see Figure 4).

Figure 4



To be sure, the US does have important points of economic leverage over China, even beyond its ability to crimp supplies of advanced semiconductors, software, and aircraft parts. Nevertheless, the great lesson of 2025 may be this: In the large and complex economic relationship between the US and China, each side has powerful ways to hurt the other's economy. However, the backdowns by the US in the face of

Beijing's stranglehold over critical mineral products suggests China has "escalation dominance" and can force the US to adopt more conciliatory trade policies. Unless and until either side decides to unleash economic weapons that have so far been held in reserve, it looks like the advantage may increasingly lie with China.

Conclusion and Implications

[According to Chinese insiders, General Secretary Xi is now leaning heavily on China's economic leverage against the US because he thinks President Trump is overly sensitive to the US financial markets.](#) In Xi's assessment, Trump will back down from his policies if they spur a sharp fall in equity prices. As potential evidence of that, the October flare-up in trade tensions only drove down US equity prices, while bond prices and the dollar were little changed. In contrast, the initial April flare-up drove down stocks, bonds, and the dollar. It appears that at least bond and currency investors have become complacent that any stock market disruption will prompt Trump to compromise. Nevertheless, this could well be a misreading of Trump and his administration. Treasury Secretary Bessent has signaled that he wouldn't be overly concerned about a stock market drop, and Trump could well take the same approach going forward.

Our analysis here suggests that if the US appears to be pulling its punches against China, it's not because of the personal, political, or financial calculations of President Trump, but because of a broader realization that Chinese power is starting to match or surpass that of the US in military, diplomatic, technological, and economic aspects, just as US voters over the last decade or more have tired of the social and economic costs of global hegemony. This gradual reassessment of US power and

obligations was evident as far back as the Obama administration, when the president famously set a “red line” against Syria using chemical weapons in its civil war, only to look the other way when Damascus did just that. Hesitation to use US power was also probably a reason why President Biden was reluctant to aggressively arm Ukraine against Russia’s invasion of it. In sum, China’s new comprehensive strength raises the likelihood that the US will have to back down and accept long-term compromises, such as acquiescence in a Chinese takeover of Taiwan and a cut in US import tariffs in exchange for more Chinese investment in the US.

Nevertheless, the developments we see today don’t *necessarily* signal future US isolationism or retrenchment. The US political class and voters could ultimately decide they don’t want to give up global leadership or the US’s ability to control its own destiny. They could rebel against the thought of living under Chinese dominance, especially if China overplays its hand and besmirches US honor or causes real damage to the US. In fact, even though many in Trump’s political coalition embrace isolationism, the president’s foreign policy to date is actually quite internationally engaged. It includes not just big tariff hikes to force better trade relationships, but also efforts to build up US forces in the Western Pacific, putting strong political and military pressure on Venezuela’s socialist leaders, and assisting Israel’s bombing of Iranian nuclear sites. Trump can be seen as using his extraordinary political strength not to end US hegemony and isolate the country, but to *reform* that hegemony and make it more America First, more focused on the interests of the US working class, and more reliant on hard power versus soft power.

At the extreme, if Chinese leaders press too hard against US interests, the “Jacksonian” values of Trump and the American people could ultimately even embrace something more like the traditional, activist US hegemony of the post-Cold War period. In any case, rising Chinese power coupled with Trump’s reformed version of US hegemony or a return to Cold War-style hegemony could result in a true multi-polar world, consistent with global fracturing and the formation of relatively separate geopolitical and economic blocs, which we at Confluence have long discussed.

For investors, all this presents several different possibilities. If US leaders and voters acquiesce to China’s increasing strength and back down when faced with Chinese power plays, like its restriction of critical minerals, the resulting decline in geopolitical risks could actually give a boost to both US and Chinese stock prices. Globalized US sectors such as technology and agriculture would probably enjoy outsized gains. As government intervention in the economy increases, favored industries and companies could perform especially well. US Treasury securities would also likely appreciate to some extent, helping to push down yields. Finally, the dollar would presumably appreciate, but gold would likely face selling pressure, driving down prices, as the safe-haven bid softens.

However, if the US settles on either a new, harder-edged America First hegemony or even something like its traditional hegemony, the result would likely be further geopolitical tensions from time to time. That, in turn, would create a risk of periodically pushing US and Chinese stock values lower, although industries and companies critical to US competitiveness could still perform well. The risk of a Chinese pullback from the US financial

markets would likely weigh on Treasury obligation and drive up interest rates. In this scenario, uncertainty about the success of the US would likely weigh on the dollar and buoy gold prices. Whether this scenario plays out will depend to a high degree on whether China overplays its hand in the

current US-China negotiations and how hard the US pushes back.

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