

The China-U.S. AI race: Who is leading?

Jasmine Duan – Hong Kong

China's AI models now rival leading U.S. alternatives yet face mounting semiconductor constraints. We examine the latest developments in Chinese AI and explore what these advances mean for the competitive landscape ahead.

Investors may still remember the “DeepSeek Moment” in January 2025, when a small Chinese AI startup launched an open-source reasoning model that matched the performance of leading U.S. AI models. Since then, China has rapidly narrowed the gap in AI development with the U.S., intensifying debate about who will lead this technology race.

Chinese AI models reach tier-1 performance

Despite facing intensifying hardware constraints, Chinese AI models are demonstrating rapid improvements in coding and reasoning capabilities. A recent example is Chinese startup Moonshot's Kimi K3 model, whose overall performance nearly matches that of advanced U.S. models at a fraction of the cost.

Chinese companies now account for the largest share of generative model downloads on Hugging Face, the primary hosting platform for AI models. Rather than isolated breakthroughs, Chinese developers are releasing high-performing models at a weekly cadence. New releases consistently rank among the platform's most downloaded each week, which is a sign of both quality and developer productivity, in our view.

Not all Chinese AI models adopt a low-price strategy

Chinese models have gained popularity partly because they are open source, allowing developers to customize and train them on proprietary data, and partly because they are significantly less expensive than closed-source alternatives. This has led many investors to assume Chinese firms could only compete on price. However, we argue that this assumption is being tested.

Chinese AI companies are now pursuing differentiated strategies. Moonshot's Kimi focuses on offering higher-intelligence models at premium prices. General language models from Qwen and Z.AI adopt two-tier approaches, pairing advanced, expensive models with efficient, cost-effective options. DeepSeek, meanwhile, sticks to a low-cost strategy.

At the same time, U.S. providers are responding with their own price cuts, particularly for lower and mid-tier models. We view this as a healthy market strategy for AI companies: lower-cost models expand accessibility, while premium options serve enterprises' most complex needs.

China's biggest constraint: semiconductors

As AI demand surges globally, Chinese companies face mounting supply constraints on semiconductors. While

For perspectives on the week from our regional analysts, please see [pages 3–4](#).

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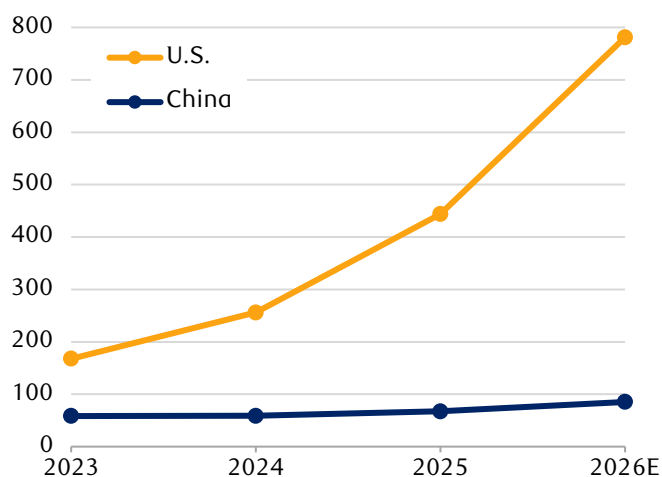
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previously reliant on stockpiles, legacy chips, and gray-market purchases to train models, these workarounds are no longer sufficient as compute needs have accelerated.

We believe the divergence in investment capacity reveals the severity of the constraint. According to Bloomberg, the eight largest U.S. hyperscalers are projected to increase capital expenditure by 76 percent in 2026, reaching over US\$780 billion. By contrast, China's three major internet companies and three telecom carriers combined plan only roughly US\$85 billion in data center capex this year, which is roughly one-tenth of the U.S. total. Even this amount represents a stretch, as memory chip prices have quintupled over the past half-year, further eroding purchasing power.

AI spending in China is a fraction of the U.S. total

Chinese companies' capex vs U.S. hyperscalers (USD billions)



Note: 2026 figures represent estimates.

Source - RBC Wealth Management, Bloomberg

More concerning for Chinese AI firms, in our view, is that U.S. export controls prevent China from accessing advanced manufacturing equipment, particularly extreme ultraviolet (EUV) lithography machines needed for cutting-edge chip production. This creates a potential structural disadvantage. While reports periodically surface of Chinese breakthroughs in developing EUV lithography, we doubt these will have meaningful near-term impact given their prototype status and the challenge of reaching mass production.

Chinese chipmakers are responding by stacking multiple chips in smaller spaces, improving interconnects, and pursuing system-level optimization to narrow the performance gap. We believe these efforts may not fully offset supply constraints, but they represent the most viable path forward in the near term.

Where will AI competition go next?

For many people, what matters most is how AI will affect their livelihoods, not which country will win or lead the AI competition. Public perception of AI diverges sharply between China and the United States. According to Stanford University's AI Index Report in 2025, 84 percent of Chinese respondents reported excitement about AI, compared to just 38 percent of Americans. Meanwhile, American concerns center on job displacement, while Chinese concerns are more varied.

We think this divergence partly reflects structural economic differences. The U.S. Bureau of Labor Statistics reports that more than 70 percent of American workers are in service sectors—which are more vulnerable to AI disruption—compared with approximately 50 percent in China, according to Chinese government data sources. AI's immediate workforce impact therefore seems smaller in China, explaining why Chinese people view it as a practical tool to increase productivity rather than an existential threat. Furthermore, a recent Chinese court ruling protecting a worker in an AI-related labor dispute signaled the country's regulatory commitment to labor-rights protections.

Beyond cultural attitudes, the divergence also reflects differing levels of trust in government policymakers and in big technology companies, and belief in personal benefit from the technology—with Chinese attitudes ranking higher than Americans' views. We believe these perceptual differences could help shape each country's AI development trajectory.

The China-U.S. AI competition's outcome remains uncertain, with the competitive landscape shifting rapidly as new models emerge. We think a few factors will be critical differentiators for China's long-term AI development relative to the U.S., including abundant engineering talent, reliable and affordable energy supplies, and capacity for large-scale industry applications.

With the contribution of Leo Shao.

UNITED STATES

Phil d'Entremont, CFA – Minneapolis

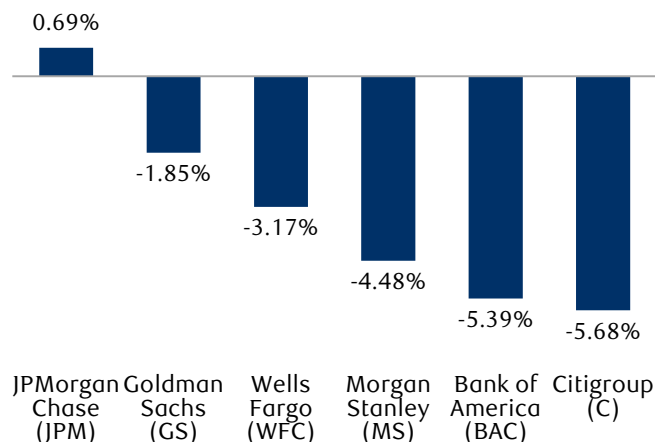
■ **Inflation remains stickier than anticipated.** Heading into the week, we viewed inflation primarily as an energy shock atop otherwise improving core measures (excluding food and energy). Wednesday's Consumer Price Index (CPI) report shifted the narrative, as the energy shock now shows signs of leaking into the broader goods and services inflation. U.S. Treasury yields initially responded with a strong lurch higher, as markets saw a greater likelihood of a rate hike at the October Federal Open Market Committee meeting, before Federal Reserve speakers urged the importance of patience. Yields then settled into pre-announcement levels and drifted lower Thursday despite a hot Producer Price Index report.

■ **Earnings season kicked off this week, led by large money-center and investment banks.** The initial slate of reports was underwhelming, as a flattening yield curve and delayed capital markets activities (initial public offerings, debt offerings, mergers and acquisitions, etc.) affected the banks and hampered expectations for the coming quarters. While the banks are setting the pace for a slow start to earnings season, it is still early, with many more sectors and industries to report.

■ **AI-sensitive tech stocks feel jittery.** This week witnessed a correction in semiconductor and tech hardware stocks as investors focused on AI infrastructure's return on investment in a higher interest rate environment. ChangXin Memory Technologies, a Chinese memory manufacturer, announced progress in a new DRAM cell architecture designed to increase memory density and storage, leading to concerns about a viable fourth player emerging to challenge Micron, SK Hynix, and Samsung. After the CPI report, there was a sharp

Bank stocks mostly lower following earnings reports this week

Week-to-date stock returns through Wednesday, Oct. 14



Source - RBC Wealth Management, FactSet

spike in AI and tech corporate borrowing costs, pressuring leveraged cloud providers and their server rack providers. Meanwhile, supportive commentary from Broadcom, ASML, and Taiwan Semiconductor throughout the week was unable to halt the weakness. While demand persists for AI and related compute, investors may be resetting their expectations.

CANADA

Claudia Humbert, CFA & Zachariah Muhn – Toronto

■ **The Canadian labour market lost 68,000 jobs in September, falling short of consensus expectations for a gain of 9,200.** This brought the combined decline over the past two months to 110,000 and left employment down 41,000 year to date. Losses were concentrated in the public sector, particularly education and health care, while private-sector employment was broadly unchanged. Canadians aged 15 to 24 accounted for roughly 70% of the net employment decline. Regionally, Quebec lost 49,000 jobs, British Columbia and Ontario both lost 20,000, while Alberta added 23,000. The unemployment rate rose to 6.5% from 6.4%, with a decline in the number of Canadians actively seeking work helping to limit the increase. Population aging continues to weigh on labour-market participation, while lower immigration has slowed the arrival of new workers. **RBC Economics remains cautiously optimistic that economic conditions will gradually improve. It points to job postings as an indication that hiring demand has remained relatively resilient following the latest U.S. tariffs and continues to expect unemployment to decrease through year's end.**

■ **The Canadian stock market has delivered solid returns to investors this year, though momentum has tapered somewhat lately.** The S&P/TSX Composite Index has rallied 15% year to date on a total return basis in Canadian dollars, generally keeping pace with U.S. and global equity markets. Energy, Materials, and Financials—which together account for just under 70% of the index—have led the charge so far in 2026 as strong bank earnings and higher commodity prices have lifted profitability. Over the last quarter, however, S&P/TSX Composite returns have lagged broader equity markets as trade-related flashpoints have renewed macroeconomic uncertainty and elevated global bond yields have weighed on rate-sensitive sectors. We expect trade-related overhangs to persist over the coming quarters, while resilient global growth and lingering supply chain pressures from ongoing geopolitical conflicts could maintain some upward pressure on bond yields. **With markets anticipating roughly 20% y/y earnings growth in Canada in Q3, corporate guidance and earnings delivery will likely play a greater role in shaping the near-term outlook for Canadian stocks, in our opinion.**

UK & EUROPE

Frédérique Carrier & Thomas McGarrity, CFA – London

- **Ireland hosted an international AI summit in Dublin on Oct. 14.** As the current holder of the presidency of the Council of the European Union (EU), Ireland seeks to help shape Europe's approach to AI. The event brought together policymakers and senior technology executives including Microsoft President Brad Smith and Demis Hassabis, chair of Google DeepMind.
- **The country has long been a magnet for global technology companies.** A low corporate tax regime and an English-speaking workforce have helped draw 16 of the top 20 global technology firms, which have their main EU bases there. Irish regulators have also recently clarified grid connection rules for data centers, which could support additional capacity. AI adoption is strong too, as the country ranked third globally in Q2 2026 according to the Microsoft AI Economy Institute report.
- **The consensus of analysts expects Q3 eurozone earnings to grow 17% y/y.** Energy is the main driver, helped by elevated prices and stronger refining margins. Excluding the sector, the consensus earnings forecast is still for solid 10% growth. This rests on mid-single-digit revenue growth consistent with buoyant economic data. A weak euro may also have helped exporters and companies with a strong presence abroad.
- **The consensus expectation is for margins to widen in many sectors.** Strong demand has enabled companies to pass higher prices on to clients, while operating leverage and restructuring have also helped. Car makers and parts suppliers, facing stiffer Chinese competition, are a notable exception.
- **Semiconductor manufacturing equipment firm ASML, Europe's largest company by market capitalization at**

AI diffusion: Six of the top 10 countries in Q2 2026 were European

Rank	Country	AI diffusion
1	United Arab Emirates (UAE)	73.3%
2	Singapore	64.3%
3	Ireland	49.9%
4	France	49.6%
5	Norway	49.4%
6	Spain	45.1%
7	New Zealand	44.1%
8	United Kingdom	43.7%
9	Netherlands	43.5%
10	Qatar	43.5%
16	Canada	38.5%
19	Taiwan	33.8%
21	United States	33.0%

Note: Microsoft defines AI diffusion as the share of people between the ages of 15 and 64 who have used a generative AI product during the reported period.

Source - RBC Wealth Management, Microsoft AI Economy Institute

€593 billion (US\$662 billion), reported Q3 results above consensus expectations alongside raising its FY2026 guidance. ASML's CEO stated that demand visibility for its lithography equipment continues to expand, driven by AI-related investments, with customers discussing orders as far out as 2029 and 2030. This growing order-book momentum suggests that ASML's planned supply for 2027–2028 will not meet customer demand, according to management. Accordingly, ASML is looking at ways to increase capacity for 2028. RBC Capital Markets projects double-digit growth for the Wafer Fab Equipment (WFE) industry to 2028.

ASIA-PACIFIC

Belmen Woo – Singapore

- **South Korean equities experienced a sharp selloff this week, with the benchmark KOSPI Index declining approximately 16% since Oct. 8 amid growing concerns over U.S. monetary tightening and the sustainability of AI investment spending.** The downturn has been particularly pronounced for semiconductor heavyweights Samsung Electronics and SK Hynix as investors reassess elevated technology valuations and the potential impact of higher borrowing costs on AI infrastructure investments.
- **Nevertheless, we believe the recent correction largely reflects bearish investor sentiment and an unwinding of leveraged positions rather than a fundamental weakening in Korea's semiconductor industry.** Samsung Electronics recently projected a nearly nine-fold increase in quarterly operating profit; the company posted a preliminary operating profit of 107.4 trillion won (US\$80.1 billion) for the September quarter after revenue more than doubled. However, its shares still declined as the results failed to meet elevated market expectations. Similarly, SK Hynix reported a 557% increase in Q2 operating profit to KRW 60.5 trillion, although its shares also fell sharply due to an earnings miss. However, these results highlight sustained demand for high-bandwidth memory chips and continued AI infrastructure investments, reinforcing our view that the structural growth narrative remains intact.
- **The sharp market correction has also brought valuations to what we view as increasingly attractive levels, with the KOSPI's 12-month forward price-to-earnings ratio falling below 5x, among its lowest historical levels.** We believe this valuation reset, coupled with resilient corporate earnings and a favorable structural growth outlook, may present compelling entry opportunities for medium- to longer-term investors—especially as Korean equities may continue to face further near-term volatility amid macroeconomic uncertainties, persistent foreign selling, and cautious investor sentiment. Overall, we maintain our constructive stance on the market, favoring a selective and gradual approach to building exposure.

MARKET Scorecard

Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Tuesday's close. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing.

Examples of how to interpret currency data: CAD/USD 0.70 means 1 Canadian dollar will buy 0.70 U.S. dollar. CAD/USD -3.6% return means the Canadian dollar has fallen 3.6% vs. the U.S. dollar year to date. USD/JPY 158.33 means 1 U.S. dollar will buy 158.33 yen. USD/JPY 1.0% return means the U.S. dollar has risen 1.0% vs. the yen year to date.

Source - Bloomberg; data as of 10/14/26

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	7,718.94	0.9%	12.8%	16.2%	31.7%
Dow Industrials (DJIA)	51,621.48	1.4%	7.4%	11.6%	19.9%
Nasdaq	26,692.87	-0.6%	14.8%	18.5%	44.3%
Russell 2000	2,729.53	-2.4%	10.0%	9.4%	21.4%
S&P/TSX Comp	35,584.46	1.0%	12.2%	17.2%	45.4%
FTSE All-Share	5,780.46	0.9%	8.0%	13.1%	27.6%
STOXX Europe 600	637.75	0.5%	7.7%	13.0%	21.5%
EURO STOXX 50	6,190.37	-1.3%	6.9%	11.5%	22.8%
Hang Seng	24,314.17	-1.2%	-5.1%	-4.4%	15.3%
Shanghai Comp	3,767.23	-2.0%	-5.1%	-2.5%	14.7%
Nikkei 225	67,744.29	1.5%	34.6%	44.6%	71.0%
India Sensex	72,781.89	0.4%	-14.6%	-11.3%	-11.2%
Singapore Straits Times	5,423.33	-4.4%	16.7%	24.5%	50.8%
Brazil Ibovespa	206,505.98	10.8%	28.2%	45.8%	57.6%
Mexican Bolsa IPC	66,795.17	4.0%	3.9%	9.9%	28.5%
Gov't bonds (bps change)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Treasury	5.190%	-9.5	102.3	115.8	108.9
Canada 10-Yr	3.877%	-11.7	44.4	72.6	65.7
UK 10-Yr	5.424%	0.0	94.5	83.4	118.6
Germany 10-Yr	3.466%	-12.0	61.1	85.6	119.1
Fixed income (returns)	Yield	MTD	YTD	1 yr	2 yr
U.S. Aggregate	5.50%	0.6%	-2.3%	-2.1%	3.1%
U.S. Investment-Grade Corp	5.99%	0.6%	-2.5%	-2.5%	3.2%
U.S. High-Yield Corp	8.30%	0.2%	0.3%	2.0%	9.6%
Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot \$/oz)	4,100.19	-1.4%	-5.1%	-1.0%	54.8%
Silver (spot \$/oz)	55.56	-8.1%	-22.5%	8.0%	78.1%
Copper (\$/metric ton)	14,694.20	1.7%	18.0%	38.2%	54.2%
Oil (WTI spot \$/bbl)	95.00	5.1%	65.4%	61.8%	28.7%
Oil (Brent spot \$/bbl)	105.92	2.3%	74.1%	69.8%	36.7%
Natural Gas (\$/mmBtu)	3.28	8.3%	-11.1%	8.3%	31.4%
Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	102.5330	1.1%	4.3%	3.5%	-0.7%
CAD/USD	0.7023	-0.1%	-3.6%	-1.4%	-3.1%
USD/CAD	1.4238	0.0%	3.7%	1.4%	3.2%
EUR/USD	1.1155	-1.5%	-5.0%	-3.9%	2.3%
GBP/USD	1.3189	-0.6%	-2.1%	-1.0%	1.0%
AUD/USD	0.6971	0.3%	4.5%	7.5%	3.6%
USD/JPY	158.3300	0.6%	1.0%	4.3%	5.7%
EUR/JPY	176.6100	-1.0%	-4.0%	0.2%	8.1%
EUR/GBP	0.8458	-1.0%	-3.0%	-2.9%	1.2%
EUR/CHF	0.9314	-1.6%	0.1%	0.2%	-1.0%
USD/SGD	1.2849	0.6%	0.0%	-1.0%	-1.8%
USD/CNY	6.6983	-0.1%	-4.1%	-6.1%	-5.5%
USD/MXN	18.4976	2.4%	2.7%	0.0%	-4.6%
USD/BRL	5.0308	-2.8%	-8.1%	-8.3%	-10.1%

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