

# China Economy

## Demand side further deteriorated

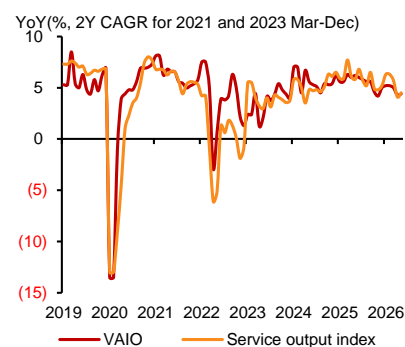
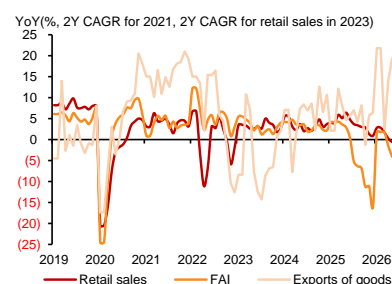
May's data pointed to a more pronounced K-shaped economy, with export- and AI-linked production still cushioning growth while domestic demand weakened further. Industrial production picked up modestly supported by export-delivered value and output in AI hardware. Retail sales retreated showing the first decline since Covid, while property sales and FAI contracted further. CPI came in below expectations, mainly driven by energy rather than demand-led pricing power, as core CPI softened. Credit growth also remained weak, as TSF growth slowed to a record low and new RMB lending was mainly supported by bill financing, while household and medium- to long-term corporate loans contracted. Looking ahead, policy support is likely to remain calibrated and largely structural to supply side in the near term, with room for policy easing preserved for 2H26 should momentum deteriorate further. We expect China's GDP growth to slow from 5.0% in 1Q26 to 4.6% in 2Q26 and full-year growth to moderate to 4.7%. We expect the K-shaped divergence to persist, which should also drive equity divergence, with AI infrastructure, competitive exporters and industrial champions benefiting from anti-involution campaign likely to outperform, while property-chain, low-end consumption and domestic cyclical sectors may continue to lag.

- Property downturn deepened despite earlier signs of stabilization.** New home sales fell by 13.1% in and 9.5% in value terms, both worse than April. Construction activity remained deeply depressed, with new starts down 24.6% in May, completions fell 19.9% and developer funding faded 21.5%, suggesting weak sales are still feeding back into developer cash flow and construction decisions. Home-price data also deteriorated, with new and existing home prices falling 0.20% and 0.26% MoM, respectively, although tier-1 cities remained resilient as existing home prices rose 0.35% MoM, in sharp contrast with widening declines in lower-tier cities. The key message is that China's property market is becoming increasingly bifurcated: top-tier cities may benefit from population inflows, better income prospects and AI-related wealth effects, but the national market remains constrained by excess supply, weak household expectations and developer balance-sheet stress. Policy therefore needs to move beyond broad easing toward faster inventory absorption, stronger completion financing and more effective local implementation; otherwise, property will continue to weigh on durable consumption, local fiscal revenue, construction demand and private-sector credit appetite.
- Consumption slipped into contraction in May.** Retail sales fell 0.6% YoY, the first negative reading since late-2022 reopening and below market expectations of 0.1%, while real retail sales likely declined by around 1.8% after adjusting for CPI. The weakness was broad-based but concentrated in discretionary and policy-sensitive categories: auto sales dropped 16.1%, home appliances fell 15.6%, furniture declined 8.7%, and communication appliances slowed sharply to 0.7%, reflecting the payback from earlier trade-in subsidies, weaker household confidence and higher prices for energy and electronics. Catering growth also moderated to 0.6% from 2.2%, suggesting services demand is not providing a strong offset to goods weakness. Overall, May's retail data suggest consumption remains constrained by the property downturn, weak income expectations and fading policy support. A durable recovery would likely require more income- and confidence-oriented stimulus, but we see limited scope for such a policy shift in the near term.
- FAI contraction deepened in May.** Fixed asset investment fell 10.7%, worsening from -8.0% in April, with YTD growth dropping to -4.1% versus consensus of -2.3%. The weakness was broad-based: property investment

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remained the largest drag at -24.3%, infrastructure investment unexpectedly plunged to -10.8% from -3.7%, while manufacturing investment stayed in contraction at -4.2%, showing limited support from strong exports. Within manufacturing, auto investment remained weak at -7.9% and electrical machinery investment fell back into contraction at -2.3%, likely reflecting the continued impact of anti-involution policies in EVs, batteries and solar, while transport equipment was the main bright spot, rising 21.4% on resilient shipbuilding and aerospace demand. The sharp infrastructure slowdown is consistent with fading fiscal support, as spending moderated across both the general budget and government funds. We see limited scope for a near-term inflection as government bond financing continued to disappoint.

- **Manufacturing output recovered mildly but remained uneven.** Industrial production rose to 4.5% YoY in May from 4.1% in April, beating market expectations of 4.4%. The rebound was supported by export-delivered value, which stayed elevated at 10.1%, and AI-related production, with integrated circuit output rising 22.9%. However, the recovery was narrow: construction-linked materials remained weak, with crude steel and cement output down 2.7% and 8.1%, while autos, PCs and smartphones contracted by 3.2%, 19.4% and 8.8%, respectively. Overall, May's production data suggest external demand and selected AI-related sectors are still cushioning manufacturing activities, but weak domestic demand, property drag and supply disruptions continue to limit a broader industrial recovery.
- **May's inflation data pointed to softening domestic demand.** CPI stayed flat at 1.2% YoY in May, below market expectations of 1.3–1.4%, as the headline was supported mainly by energy prices, while food remained a separate drag, with food CPI at -1.7% and pork prices down 16.1%. Core CPI edged down to 1.1% YoY from 1.2%, with services CPI also moderating to 0.8%, suggesting underlying consumer demand and pricing power remained soft. Durable goods remained tepid as autos and home appliances continued to drop despite some support from consumer electronics. By contrast, PPI rose sharply to 3.9% YoY from 2.8%, in line with consensus, but the acceleration was concentrated in upstream sectors, oil-related industries, non-ferrous metals and AI/electronics-related materials, while downstream consumer-goods PPI remained negative, implying margin pressure for mid- and downstream producers rather than healthy demand-led reflation.
- **Credit data reinforced the weak demand picture.** New TSF dropped 11.5% to RMB2.03trn in May, below consensus of RMB2.32trn. Government net financing further dropped 16.1% to RMB1.2trn, indicating weakening fiscal support. Outstanding TSF growth slowed to a record-low of 7.7% YoY; new RMB loans dropped 16.1% to RMB520bn, above market expectations of RMB450bn. More importantly, loan composition remained poor, as household loans contracted by RMB141bn in both short-term and medium- to long-term loans. The medium- to long-term corporate loans fell to -RMB20bn, while the headline corporate loan improvement was largely supported by RMB557bn of bill financing. Liquidity remained ample compared to weak credit demand, as M1 growth rose to 5.5% YoY from 5.0%, while M2 stayed at 8.6% YoY.
- **The recovery remains increasingly K-shaped.** On the positive side, export-oriented production and selected AI-linked sectors are still providing a floor to activity. However, the weaker side of the economy is broadening: retail sales fell into contraction, property investment and sales deteriorated further, infrastructure investment weakened sharply, and credit growth slowed to a record low despite ample liquidity. This divergence suggests China is not facing a classic cyclical recovery, but a segmented expansion led by external demand, upstream price effects and strategic manufacturing, while household demand, property-related activity and private-sector risk appetite remain impaired. Policy support will likely remain limited and largely structural on the supply side, as fiscal spending has moderated room for further monetary easing which appears limited, with more forceful easing

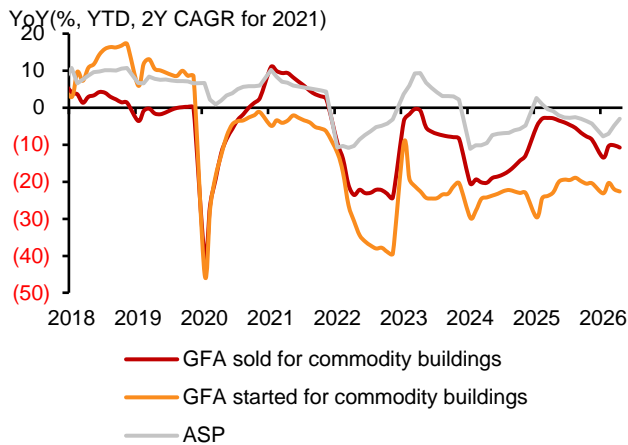
likely preserved for 2H26 should economy momentum weaken further. Looking ahead, we expect China's GDP growth to slow from 5.0% in 1Q26 to 4.6% in 2Q26, with full-year growth moderating to 4.7%. The same K-shaped pattern should also be reflected in equity performance, as sectors linked to AI infrastructure, competitive exporters and industrial leaders benefiting from the anti-involution campaign may continue to outperform, while property-chain, low-end consumption and domestically oriented cyclical sectors are likely to lag.

**Figure 1: China's economic indicators**

YoY(%)	2020-2021	2022-2023	2024	2025	2Q25	3Q25	4Q25	1Q26	Apr	May
GDP	5.3	4.1	5.0	5.0	5.2	4.8	4.5	5.0		
GDP Deflator	2.5	0.7	(0.8)	(1.0)	(1.2)	(1.0)	(0.6)	(0.1)		
VAIO	6.1	4.1	5.8	5.9	6.2	5.8	5.0	6.1	4.1	4.5
-Mining	2.9	4.8	3.1	5.6	5.8	5.5	5.4	6.0	3.8	2.3
-Manufacturing	6.6	4.0	6.1	6.4	6.7	6.4	5.1	6.4	4.0	4.4
-Public utility	6.6	4.6	5.3	2.3	2.0	2.1	3.5	4.3	5.3	7.6
Delivery value for exports	8.3	0.7	5.1	2.2	2.0	2.0	1.0	7.1	10.6	10.1
Service output index	6.3	3.9	5.2	5.5	6.1	5.7	4.6	5.1	4.3	4.4
Retail sales	4.0	3.4	3.5	3.7	5.4	3.4	1.7	2.4	0.2	(0.6)
Exports of goods	15.9	0.3	5.8	5.5	6.1	6.5	3.8	14.7	14.1	19.4
Imports of goods	13.7	(2.4)	1.0	0.2	(0.8)	4.6	3.4	23.0	25.3	27.4
Urban FAI (YTD)	3.9	4.0	3.2	(3.8)	2.8	(0.5)	(3.8)	1.7	(1.6)	(4.1)
-Property development	5.7	(9.8)	(10.6)	(17.2)	(11.2)	(13.9)	(17.2)	(11.2)	(13.7)	(16.2)
-Manufacturing	5.4	7.8	9.2	0.6	7.5	4.0	0.6	4.1	1.2	(0.4)
-Infrastructure	1.8	9.9	9.2	0.6	8.9	3.3	0.6	8.9	4.3	0.8
GFA sold for commodity building (YTD)	2.2	(16.8)	(12.9)	(8.7)	(3.5)	(5.5)	(8.7)	(10.4)	(10.2)	(10.8)
GFA started for commodity building (YTD)	(6.4)	(30.5)	(23.0)	(20.4)	(20.0)	(18.9)	(20.4)	(20.3)	(22.0)	(22.6)

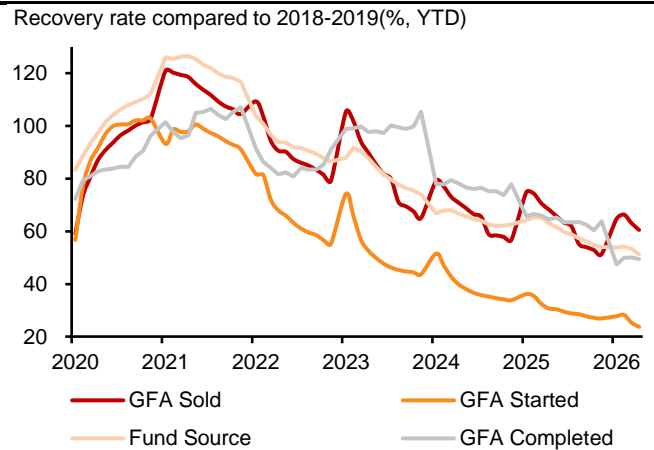
Source: Wind, CMBIGM estimates

**Figure 2: Property sales growth**



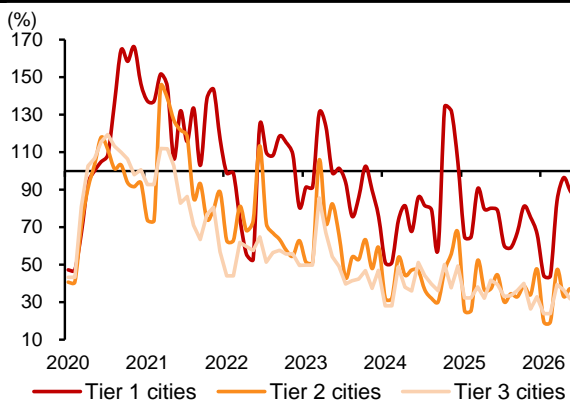
Source: Wind, CMBIGM

**Figure 3: Recovery rates compared to 2018-2019**



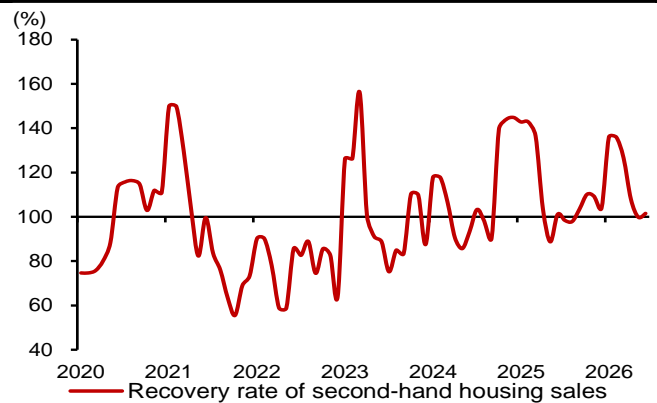
Source: Wind, CMBIGM

**Figure 4: New housing sales recovery rates compared to 2018-2019 in 30 cities**



Source: Wind, CMBIGM

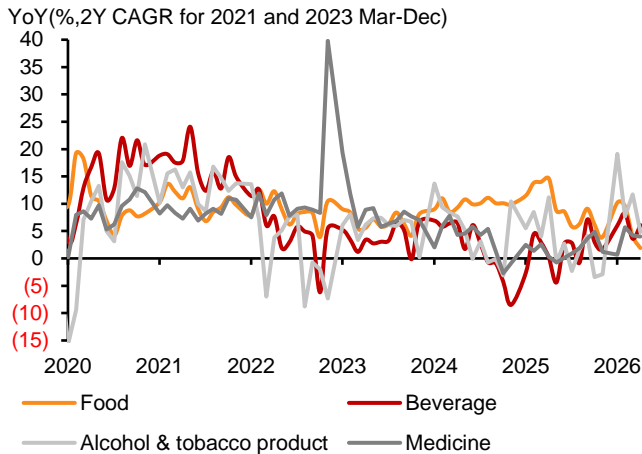
**Figure 5: Recovery rate of second-hand housing sales compared to 2019 in 11 selective cities**



Source: Wind, CMBIGM

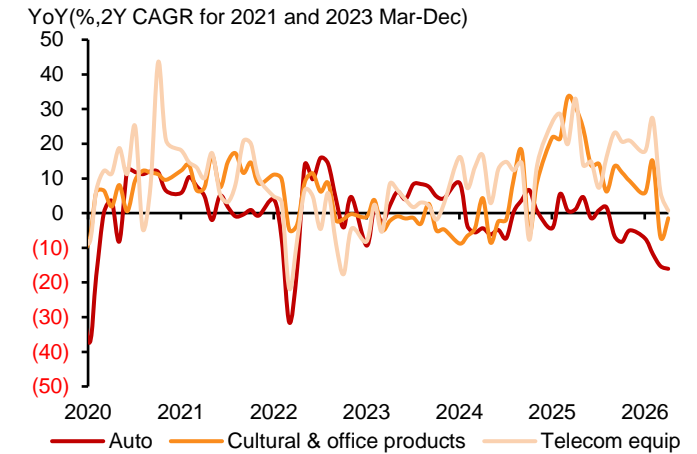
Note: The 11 cities include Beijing, Shenzhen, Hangzhou, Nanjing, Chengdu, Qingdao, Suzhou, Xiamen, Wuxi, Dongguan and Foshan

**Figure 6: Retail sales of staples**



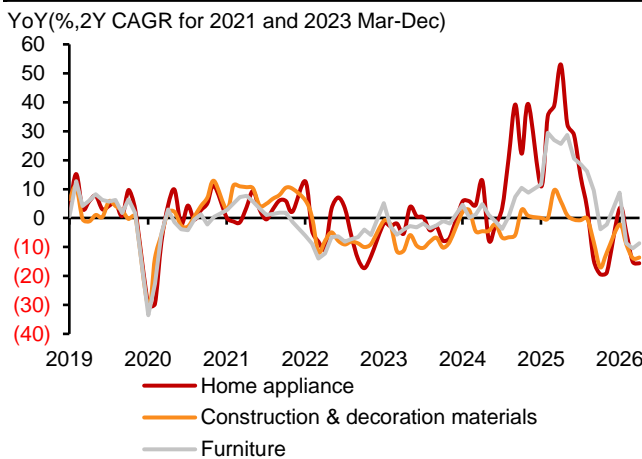
Source: Wind, CMBIGM

**Figure 7: Retail sales of auto & electronics**



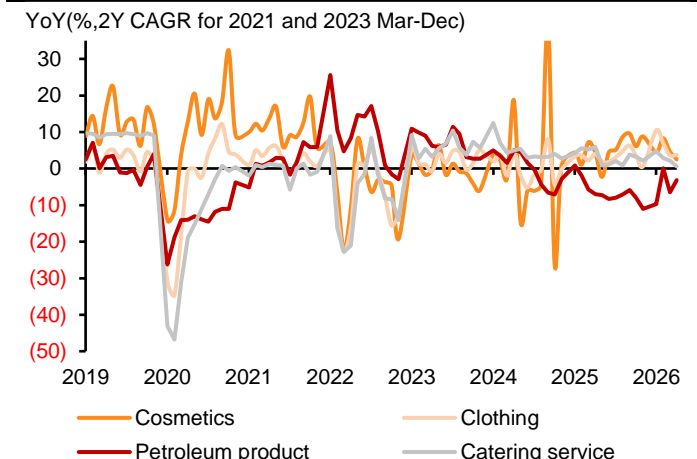
Source: Wind, CMBIGM

**Figure 8: Home appliance & furniture retail sales**



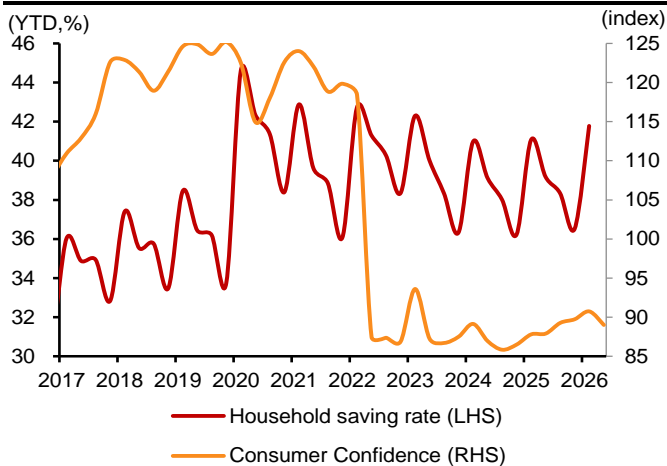
Source: Wind, CMBIGM

**Figure 9: Retail sales related to outgoing activities**



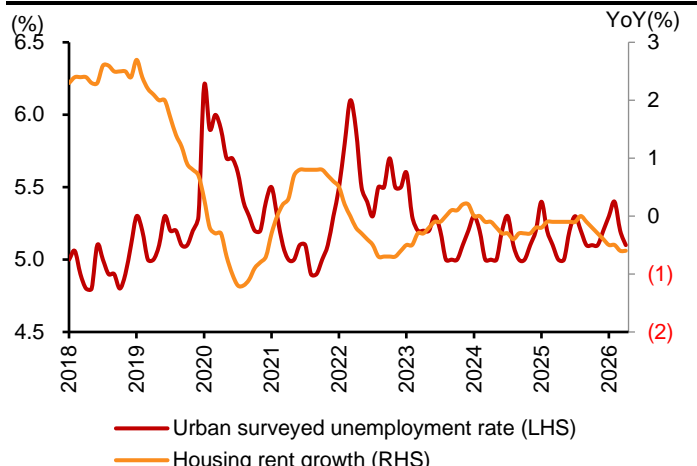
Source: Wind, CMBIGM

**Figure 10: Consumer confidence**



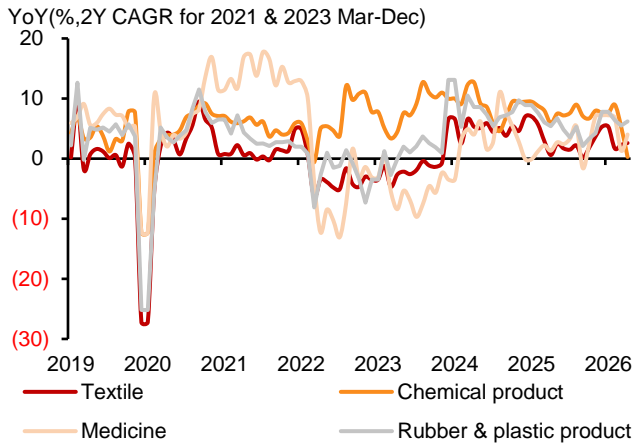
Source: Wind, CMBIGM

**Figure 11: Urban unemployment rate & housing rent**



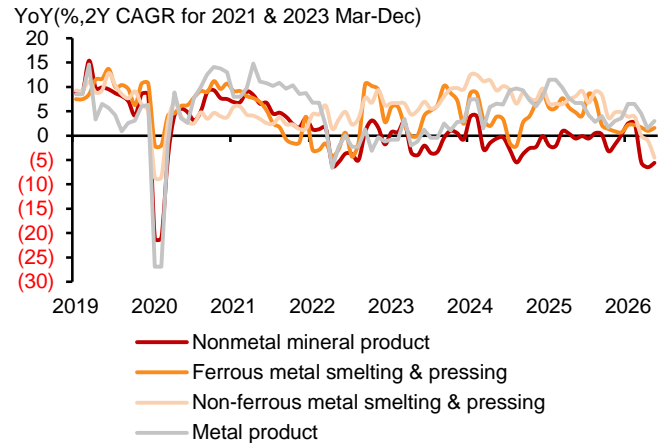
Source: Wind, CMBIGM

**Figure 12: VAIO in textile & chemical products**



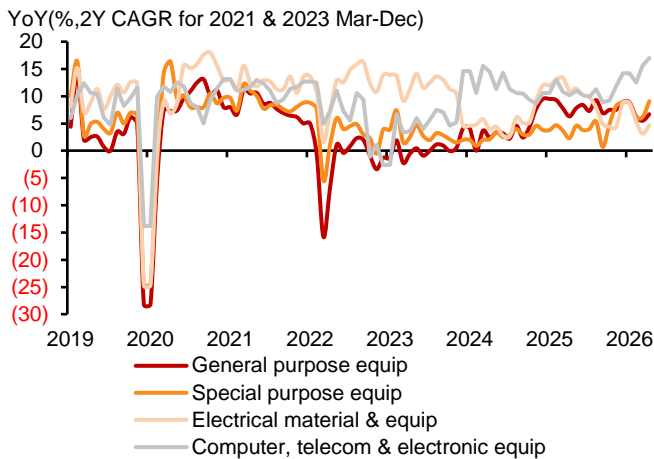
Source: Wind, CMBIGM

**Figure 13:VAIO in mineral & metal products**



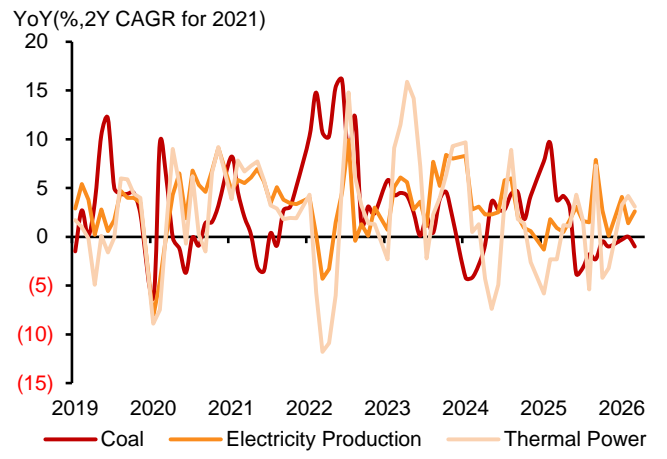
Source: Wind, CMBIGM

**Figure 14: VAIO in equipment**



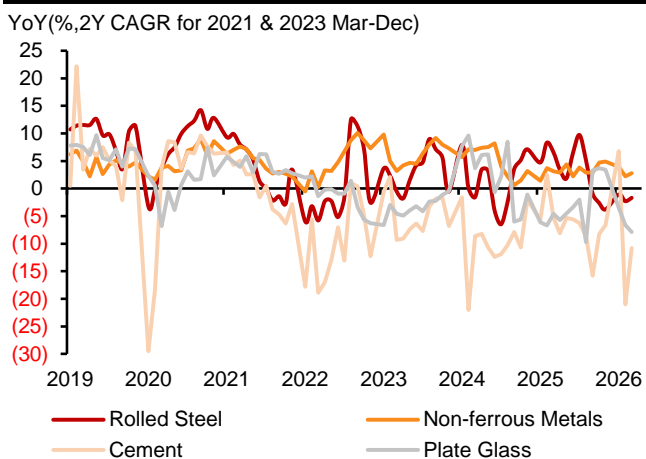
Source: Wind, CMBIGM

**Figure 15: Output in energy and electricity**



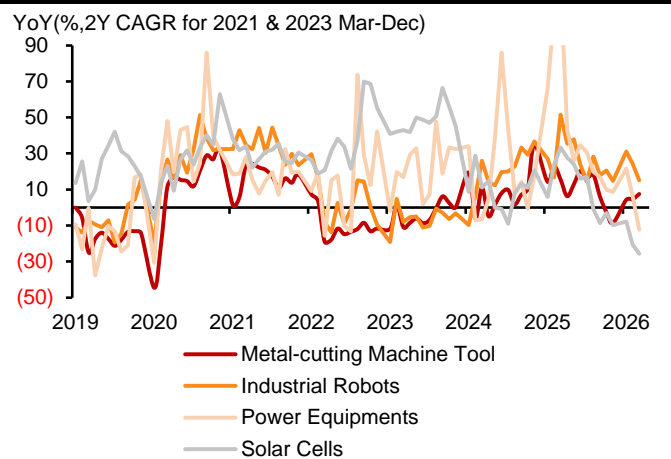
Source: Wind, CMBIGM

**Figure 16: Output in steel & construction material**



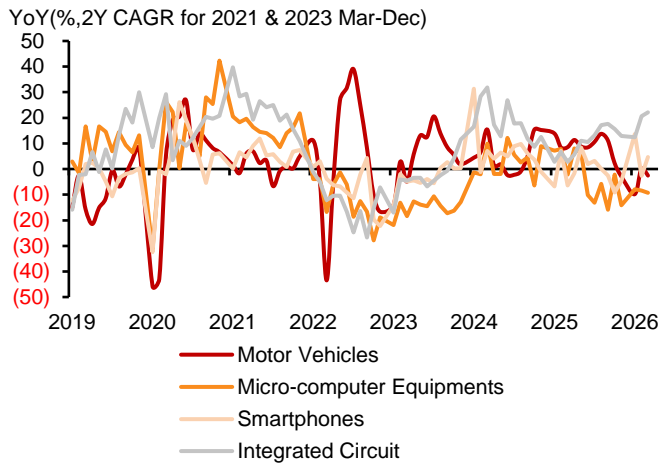
Source: Wind, CMBIGM

**Figure 17: Output in capital goods**



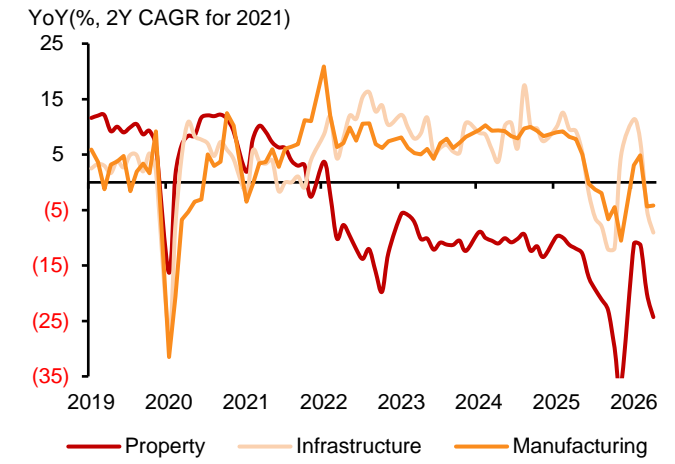
Source: Wind, CMBIGM

**Figure 18: Output in auto, computer & smartphone**



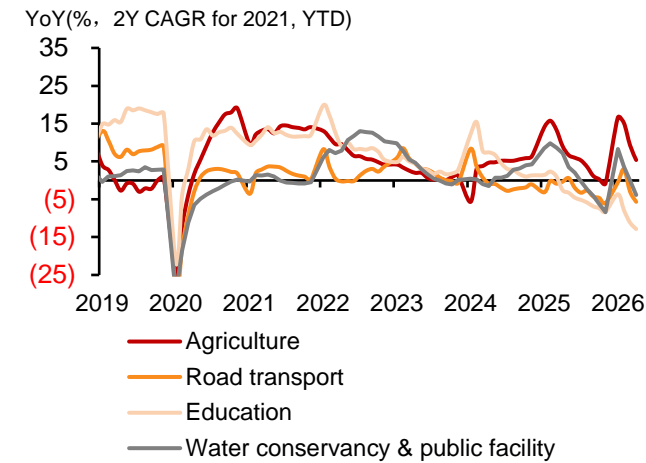
Source: Wind, CMBIGM

**Figure 19: FAI by sector**



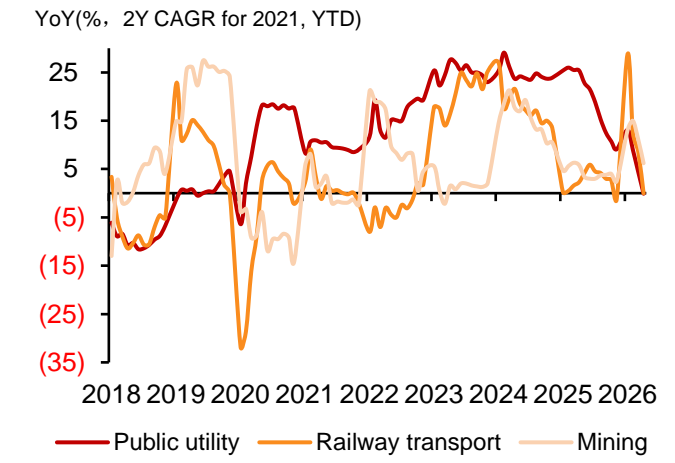
Source: Wind, CMBIGM

**Figure 20: FAI in agriculture & local infrastructure**



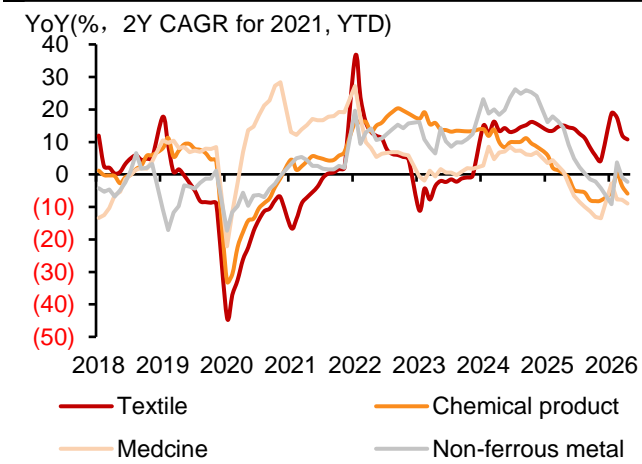
Source: Wind, CMBIGM

**Figure 21: FAI in central infrastructure & mining**



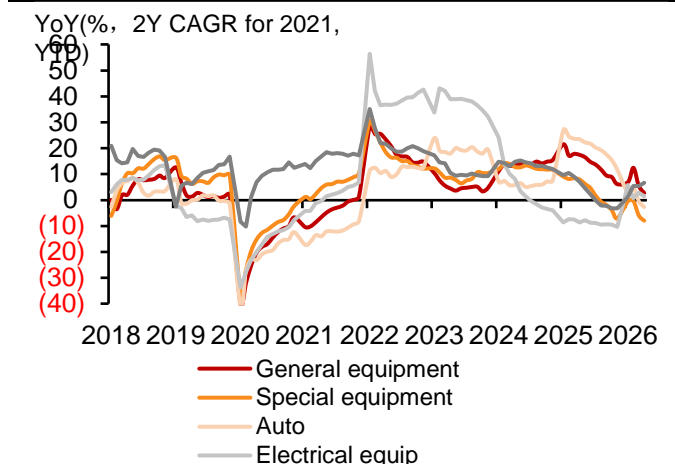
Source: Wind, CMBIGM

**Figure 22: FAI in chemical products**



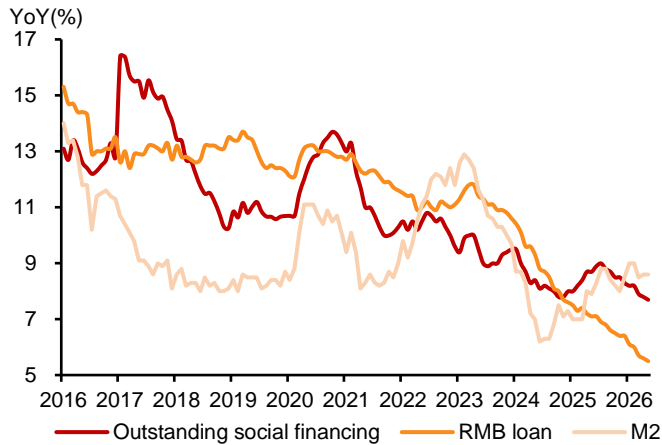
Source: Wind, CMBIGM

**Figure 23: FAI in equipment**



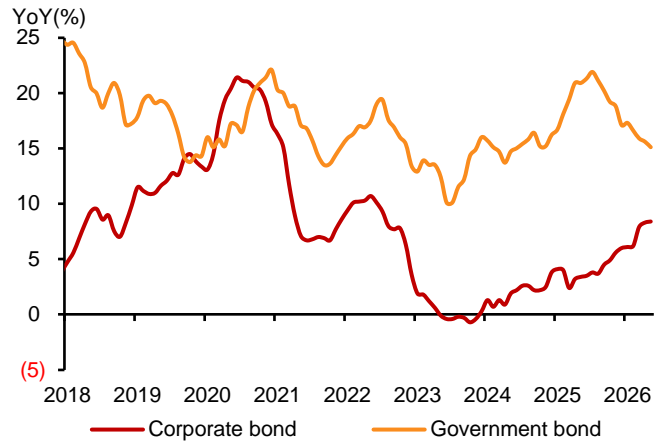
Source: Wind, CMBIGM

**Figure 24: Growth of outstanding social financing**



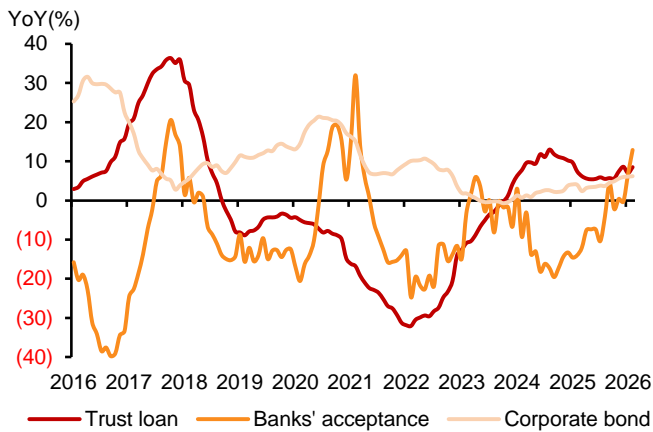
Source: Wind, CMBIGM

**Figure 25: Growth of outstanding bond financing**



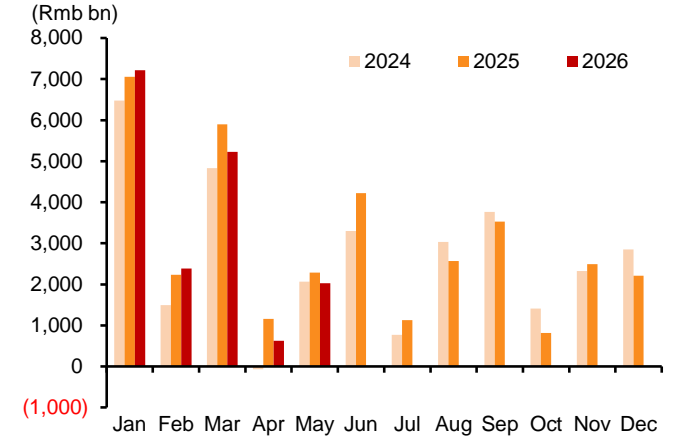
Source: Wind, CMBIGM

**Figure 26: Growth of outstanding OBS financing**



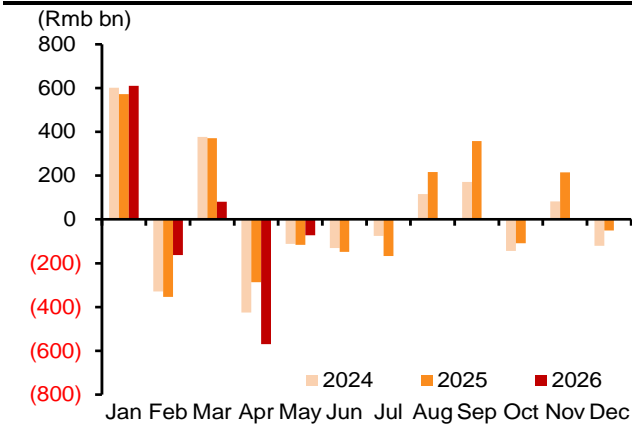
Source: MoF, CMBIGM

**Figure 27: Total social financing**



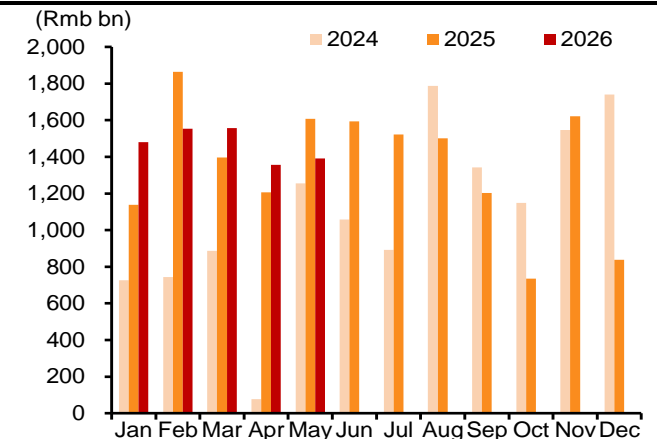
Source: MoF, CMBIGM

**Figure 28: OBS financing**



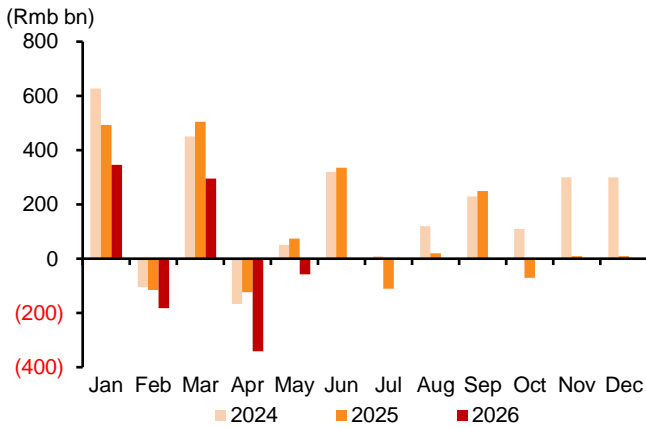
Source: Wind, CMBIGM

**Figure 29: Bond financing**



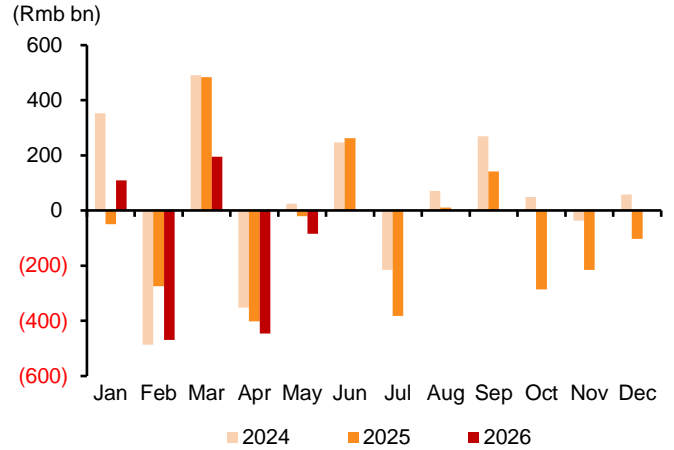
Source: Wind, CMBIGM

**Figure 30: New M&L term loans to households**



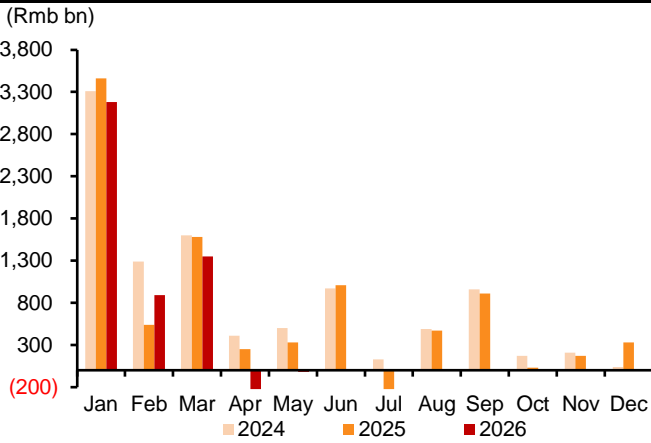
Source: Wind, CMBIGM

**Figure 31: New short-term loans to households**



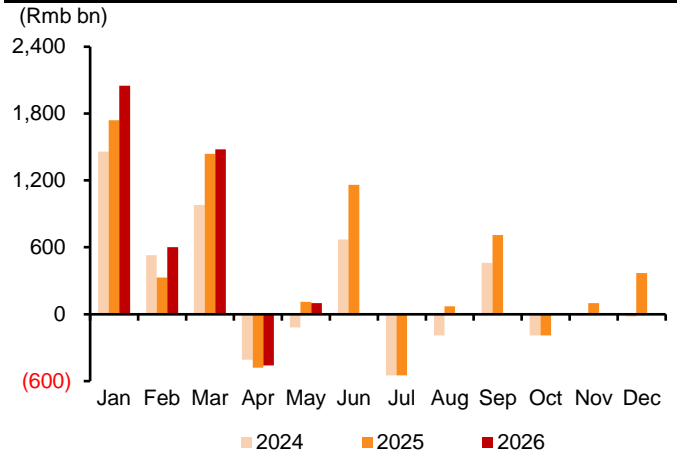
Source: Wind, CMBIGM

**Figure 32: New M&L term loans to enterprises**



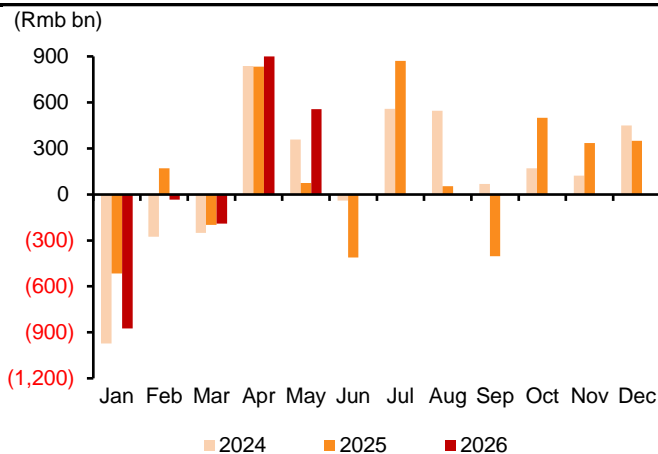
Source: Wind, CMBIGM

**Figure 33: New short-term loans to enterprises**



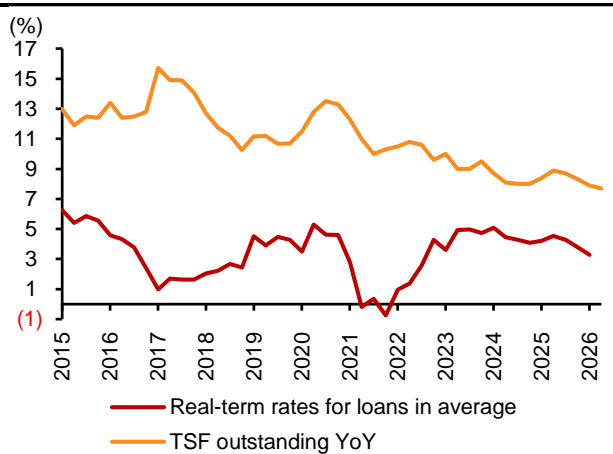
Source: Wind, CMBIGM

**Figure 34: Bill financing to enterprises**



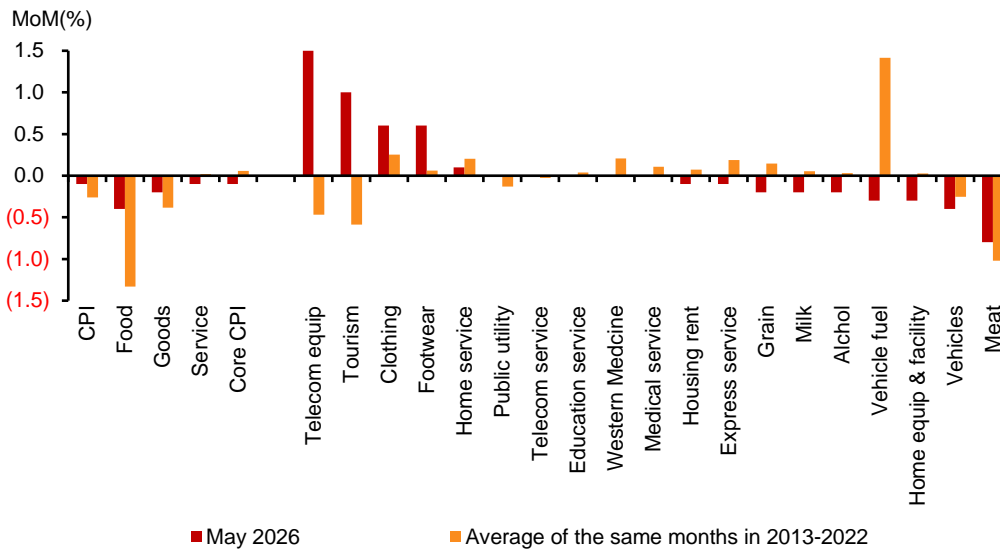
Source: Wind, CMBIGM

**Figure 35: Real-term loan rates & TSF growth**



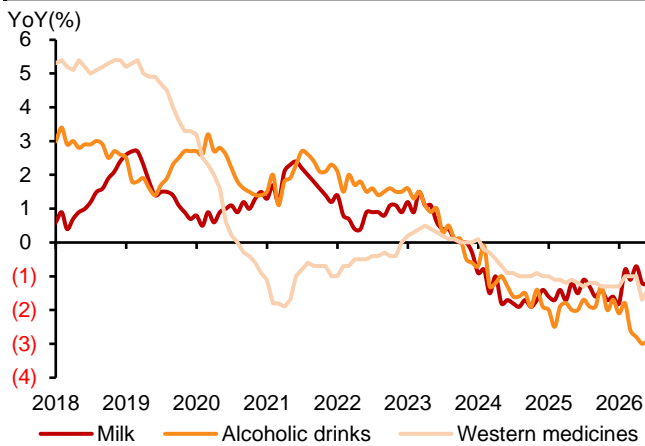
Source: Wind, CMBIGM

**Figure 36: MoM Changes of China CPI in May**



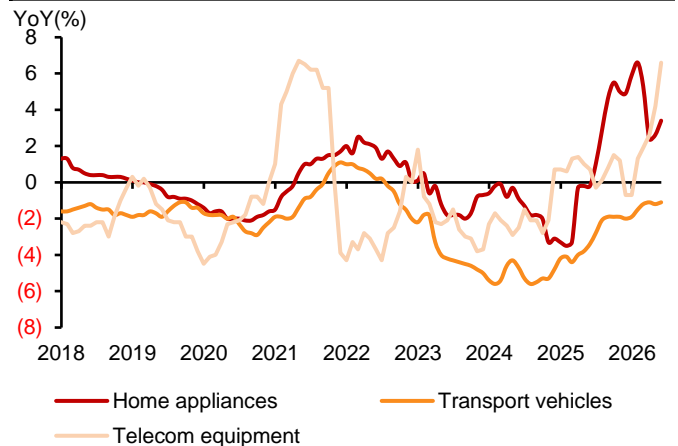
Source: Wind, CMBIGM

**Figure 37: China CPI growth in staples**



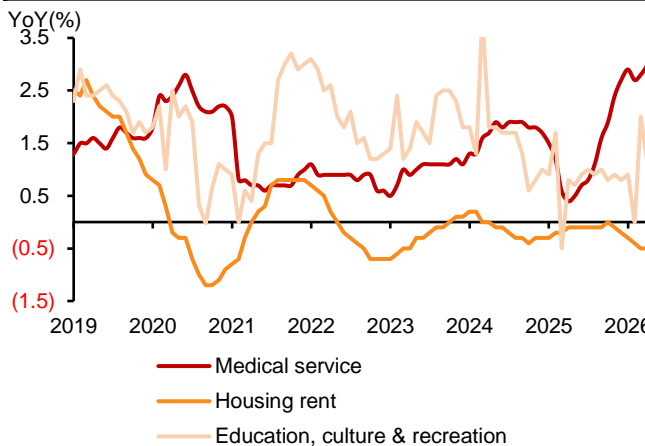
Source: Wind, CMBIGM

**Figure 38: China CPI growth in durables**



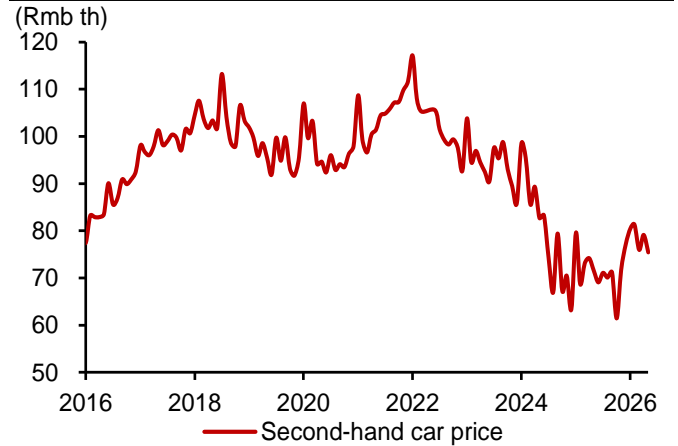
Source: Wind, CMBIGM

**Figure 39: China CPI growth in services**



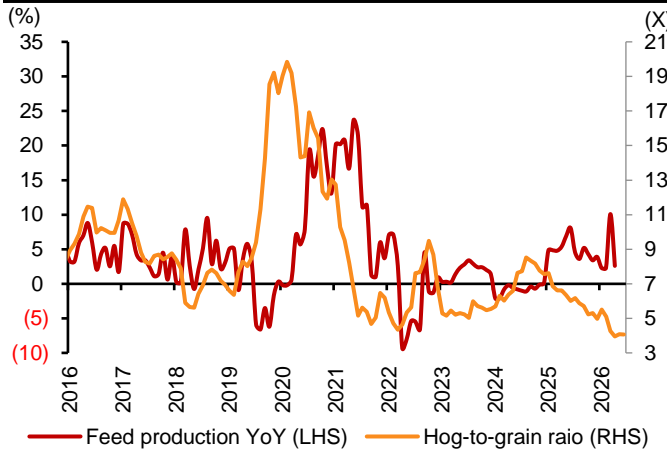
Source: Wind, CMBIGM

**Figure 40: Second-hand car price in Shanghai**



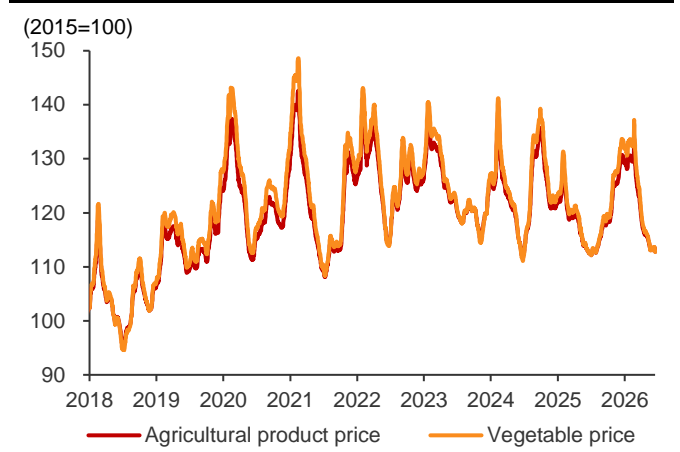
Source: Wind, CMBIGM

**Figure 41: Feed production & hog-to-grain ratio**



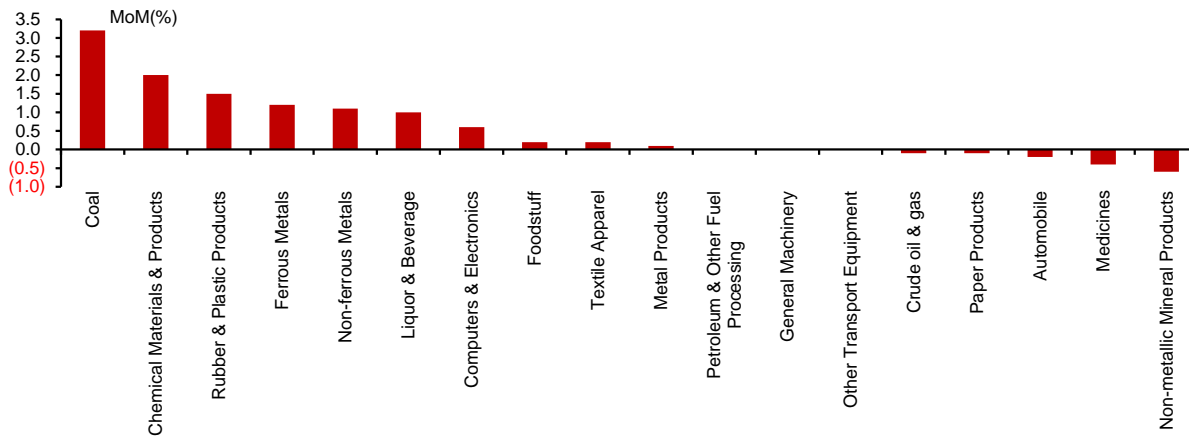
Source: Wind, CMBIGM

**Figure 42: Agricultural and vegetable price**



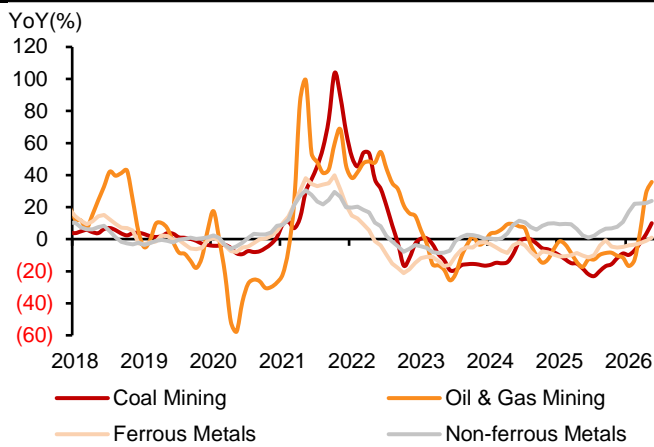
Source: Wind, CMBIGM

**Figure 43: MoM changes of China PPI in May**



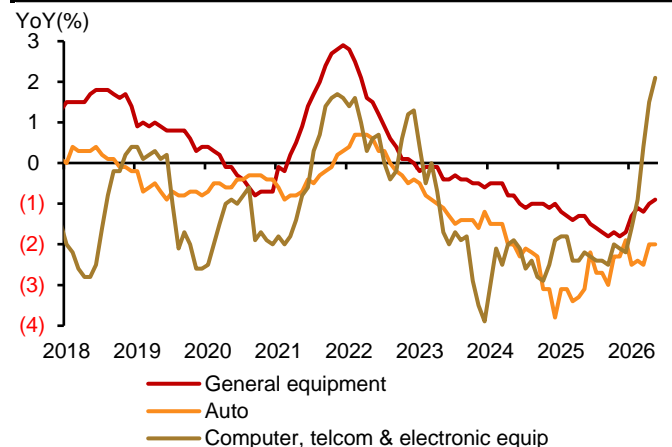
Source: Wind, CMBIGM

**Figure 44: China PPI in energy & metals**



Source: Wind, CMBIGM

**Figure 45: China PPI in equipment**



Source: Wind, CMBIGM

## Disclosures & Disclaimers

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**BUY** : Stock with potential return of over 15% over next 12 months  
**HOLD** : Stock with potential return of +15% to -10% over next 12 months  
**SELL** : Stock with potential loss of over 10% over next 12 months  
**NOT RATED** : Stock is not rated by CMBIGM

**OUTPERFORM** : Industry expected to outperform the relevant broad market benchmark over next 12 months  
**MARKET-PERFORM** : Industry expected to perform in-line with the relevant broad market benchmark over next 12 months  
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