China Policy

Signals for economic rebalancing

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In response to economic imbalance with overcapacity, deflation, confidence erosion and trade tensions, China's policymakers have signalled a strategic pivot recently, making "boosting domestic demand" the top economic priority for 2026. Demand-side policies will focus on stabilizing the property market by lowering mortgage rates and purchasing unsold property and stimulating consumption by increasing fiscal subsidies and strengthening the social safety net. On the supply side, a new round of structural reform aims to address overcapacity through reduced supply, stricter regulations on energy saving and environment, and encouraged M&A to boost industry concentration and profitability for leading firms. To mitigate trade tensions, China will employ a four-pronged approach: adjusting VAT rebates, allowing Outward Direct Investment (ODI), supporting strong RMB, and further opening domestic market. The rebalancing process, despite a potential GDP growth target reduction to 4.5%-5% in 2026, is structurally positive in our view. Investors should focus on globally competitive industry leaders, as these efforts are expected to improve their market shares and earnings prospects. China's economic rebalancing and global liquidity easing should support stocks, commodities, and EM currencies through 1H26. This momentum may face challenges in 2H26 if resurgent US inflation sparks liquidity fears and a stronger greenback.

- **Economic imbalance state and challenges.** China's economic imbalance is primarily characterized by a low consumption ratio, a high investment ratio, a massive trade surplus, and persistent deflationary pressure. Data indicates that Chinese household consumption as a percentage of GDP is significantly lower than the global average, fundamentally driven by an extremely high household savings rate. This high propensity to save, combined with local governments' long-standing pursuit of high GDP growth, has supported a disproportionately high level of fixed asset investment as a percentage of GDP. The continuous expansion of fixed asset investment has accumulated supply capacity that far exceeds domestic consumer demand. This mismatch between supply and demand not only leads to deflationary pressure but also compels enterprises to seek overseas markets, thereby generating a massive current account surplus. More critically, this imbalanced model has exacerbated debt accumulation: once investment surpasses the point of diminishing marginal returns, the efficiency of capital drops sharply. China must spend increasingly on investment to achieve the same unit of GDP growth, which has directly led to a massive buildup of corporate and local government debt. Furthermore, the overcapacity resulting from excessive investment has triggered cut-throat competition or involution across broad industries, severely eroding corporate profitability and business confidence. The reliance on exports to absorb this overcapacity has, in turn, fuelled trade tensions with major trading partners.
- **Policy signals for economic rebalancing.** From late 2025 to early 2026, China's top leadership has sent strong, concentrated signals of a strategic shift towards "demand-side management." The Central Economic Work Conference held in December 2025 explicitly designated "boosting domestic demand" as the top economic priority for 2026, with a commitment to "build a strong domestic market". The conference outlined five "New Musts", positioning the expansion of domestic demand as the core driver for unlocking the economy's full potential, and pledged to adopt a proactive fiscal stance and a moderately loose monetary policy. In January 2026, President Xi Jinping further stressed in a speech to provincial leaders that consumption must become the main engine of economic growth. He clarified specific policy pathways, including increasing urban and rural residents' income through multiple channels, strengthening the social safety net to reduce precautionary

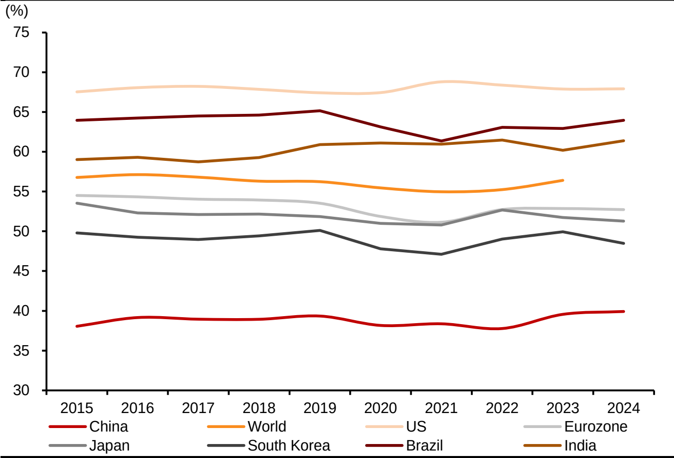
savings, and vigorously developing service consumption. Subsequently, at the Davos Forum, Vice Premier He Lifeng publicly stated that China would not deliberately pursue a trade surplus and was willing to transform from the "world's factory" into the "world's market," sharing its development dividends by expanding imports globally. These statements signify a clear strategic pivot from the traditional investment-driven model to a consumption-driven one.

- **Possible demand-side policies.** On the demand side, China is expected to launch a combination of stimulus policies targeting both the property market and consumer spending. To stabilize the property market, the central bank is likely to implement Loan Prime Rate (LPR) cuts by approximately 20 basis points, while the Ministry of Finance (MoF) may provide direct subsidies for new mortgage interest payments. These two measures are expected to lower the effective mortgage financing rate for homebuyers from the current 3.1% to around 2.4%. Furthermore, the MoF and policy banks may enhance cooperation to support local governments to purchase unsold property projects and idle land, transferring them into social housing supply. In the realm of consumption, the policy focus is shifting from simple durable goods subsidies to deeper investment in social development and stronger support to broad service consumption. In addition to extending the "trade-in" subsidy program for home appliances and automobiles, the government has introduced national subsidies for the disabled elderly and multi-child families. Future policy space includes higher tax credits for mortgage interest payments, subsidies for newly registered married couples and parents' spending on childcare services and kindergarten education and stronger support to the unemployed and low-income households. This transition from "investing in physical assets" to "investing in people" aims to alleviate residents' concerns about future expenses by strengthening the social safety net, which is a crucial step toward achieving economic rebalancing. Based on our forecast, total package of new demand-side stimulus may amount to RMB1.55trn or 1.1% of GDP in 2026.
- **Possible supply-side policies.** In response to overcapacity, the Chinese leadership has repeatedly called for the comprehensive rectification of irrational competition. This is widely seen as a prelude to a new round of supply-side structural reform, aimed at combating disorderly price wars. For industries with high overcapacity risks, such as steel, photovoltaics, and new energy vehicles, the central government requires strengthening industry self-discipline, reducing total supply through market-based and law-based means, and promoting staggered production to balance supply and demand. The release of the "Ten Major Cases" by the State Administration for Market Regulation (SAMR) in early 2026 signals a comprehensive escalation of regulatory intensity. Enforcement agencies have adopted a "zero-tolerance" stance, focusing on combating malicious competition achieved through quality reduction and intellectual property infringement. Concurrently, policymakers are encouraging mergers and acquisitions (M&A) within industries, aiming to increase industry concentration, thereby enhancing leading companies' pricing power and profitability prospects. While this "de-capacity and quality-improvement" strategy may temporarily curb economic growth, it is structurally beneficial for dominate corporates in the long run.
- **Policy pathways to alleviate trade imbalance.** To address the increasingly challenging international trade environment, China is adopting a four-pronged approach to alleviate its trade imbalance. Firstly, it comes with mechanized adjustment, which includes lowering VAT tax rebates for certain export products and reaching price commitment or export quota mechanisms with trading partners. For instance, China will gradually cancel the VAT rebate for exports of photovoltaic products and batteries within next 12 months. China and the EU have agreed on a price commitment framework for EV exports, setting a minimum price threshold to replace high anti-subsidy tariffs. Similarly, China and Canada have reached an export quota agreement, allowing an initial 49,000 Chinese electric vehicles to be imported annually at a lower tariff rate of 6.1%, with the quota planned to increase to 70,000

vehicles per year within five years. Secondly, China is allowing firms to make outward direct investment (ODI), effectively "rerouting" the trade surplus by shifting some production capacity overseas. The Ministry of Commerce has emphasized that China values not only the "economy within China" but also the "economic contribution of Chinese enterprises overseas." Thirdly, supporting a relatively strong RMB exchange rate to discourage exports and encourage imports. Given the significant price advantage of Chinese products, a moderate appreciation of the RMB is expected to have limited negative impacts on exports. Finally, China has pledged to further open its market, seeking more free trade deals with lower import tariffs and non-tariff barriers to expand the scale of imports.

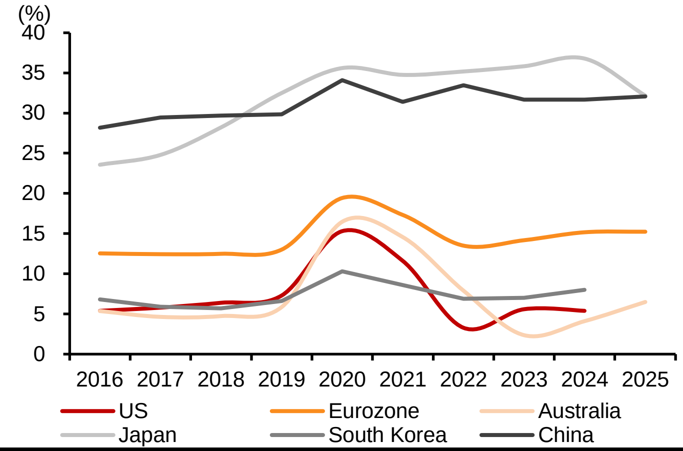
- **Implications for the market.** The convergence of China's economic rebalancing and global liquidity easing is poised to bolster risky assets—including equities, commodities, and emerging market currencies—throughout 1H26. To facilitate economic rebalancing and enhance data integrity, China may moderate its 2026 GDP growth target to a 4.5%-5% range, down from 5% in 2025. This adjustment should not be interpreted as a bearish signal for equity markets. On the contrary, "anti-involution" measures and capacity reduction initiatives, while temporarily weighing on fixed investment and industrial output, serve as a tailwind for industry leaders. These reforms are expected to consolidate market share, stabilize producer prices, and enhance earnings visibility for top-tier firms. While the global rally is expected to persist in 1H26 supported by stable US inflation as declining rental inflation may offset rising commodity prices, the outlook for 2H26 is more cautious, in our view. As the downward trend in US rental inflation bottoms out and commodity inflation continues to rise, a potential inflationary rebound could trigger a pivot toward liquidity tightening and a stronger US dollar. Such a shift would likely exert downward pressure on risky assets, particularly those with stretched valuations.

Figure 1: Household consumption as % of GDP



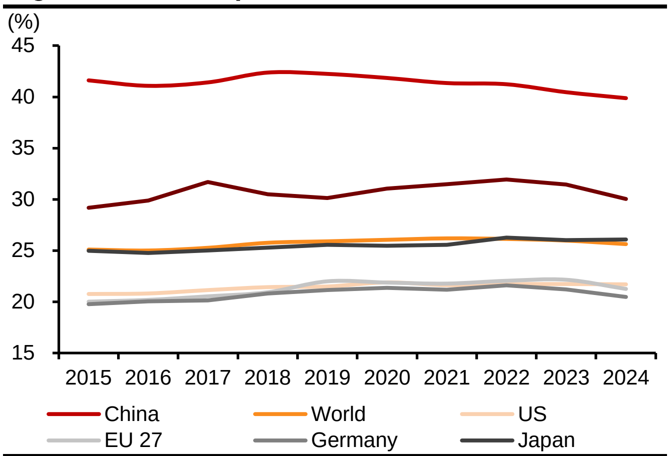
Source: Wind, CMBIGM

Figure 2: Household saving rate



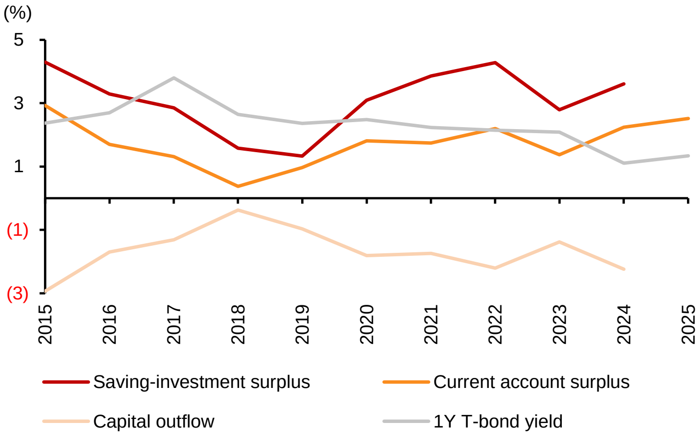
Source: Wind, CMBIGM

Figure 3: Fixed capital formation as % of GDP



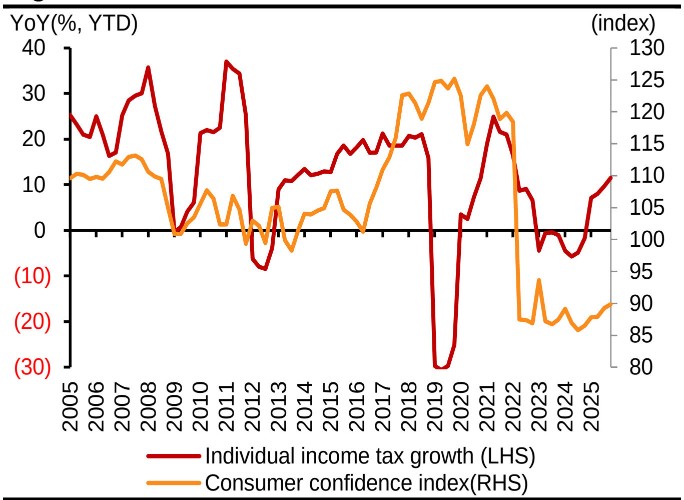
Source: Wind, CMBIGM

Figure 4: China's economic imbalance



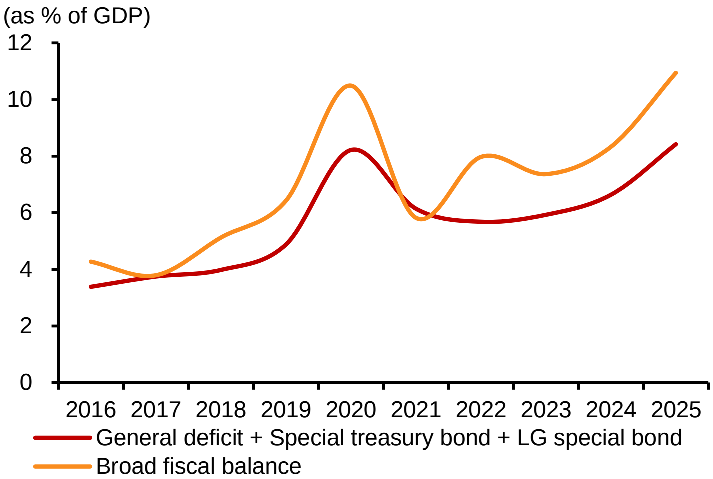
Source: Wind, CMBIGM

Figure 5: Consumer income and confidence



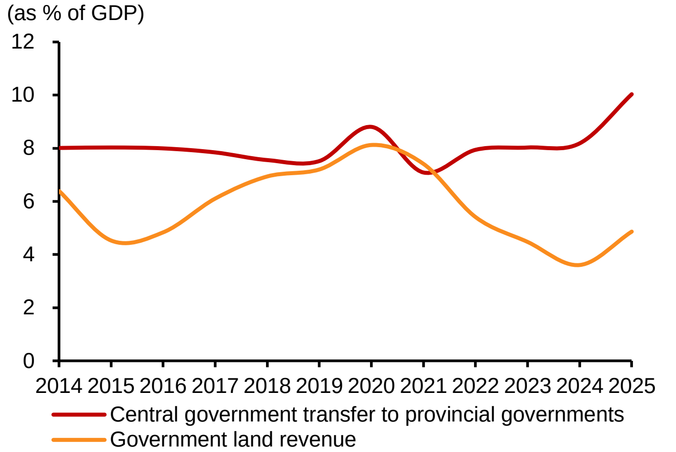
Source: Wind, CMBIGM

Figure 6: Broad fiscal deficit ratio



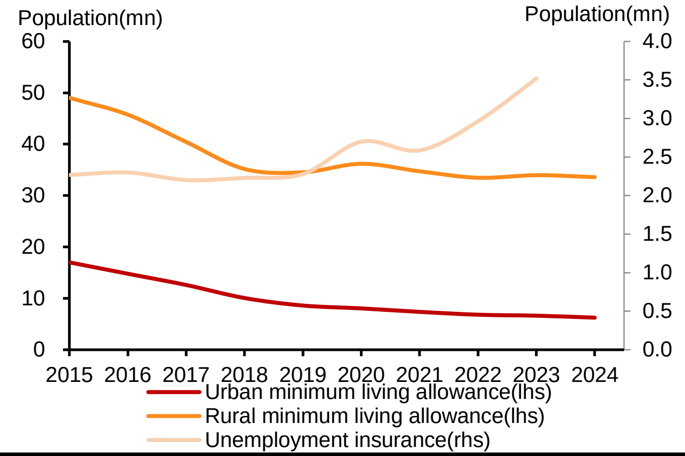
Source: Wind, CMBIGM

Figure 7: Central fiscal transfer & government land income



Source: Wind, CMBIGM

Figure 8: Minimum living allowance & unemployment insurance beneficiaries



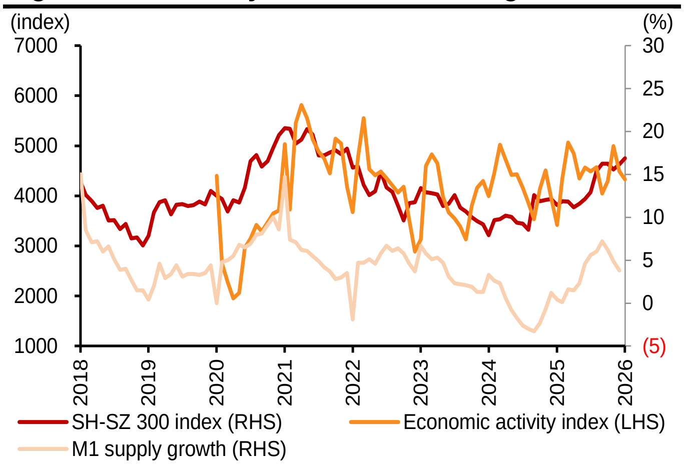
Source: Wind, CMBIGM

Figure 9: Expected demand-side stimulus in 2026

Policies	Estimated financing costs reductio or subsidy amount
LPR cuts by 20bps	RMB550bn or 0.37% of GDP
Loan interest subsidies for targeted consumers, SMEs, service businesses and equipment renewal	RMB200bn or 0.14% of GDP
Trade in program for durable consumption & equipment capex	RMB300bn or 0.2% of GDP
Interest subsidies for new mortgage loans (50bps) and higher tax credit for mortgage interest payments (RMB2,000 per month)	RMB100bn or 0.07% of GDP
Subsidies for the disabled elderly, newly registered married couples, childcare service and kindergarten education	RMB300bn or 0.2% of GDP
Increasing support to the unemployed and low-income households	RMB100bn or 0.07% of GDP
Total	RMB1.55trn or 1.1% of GDP

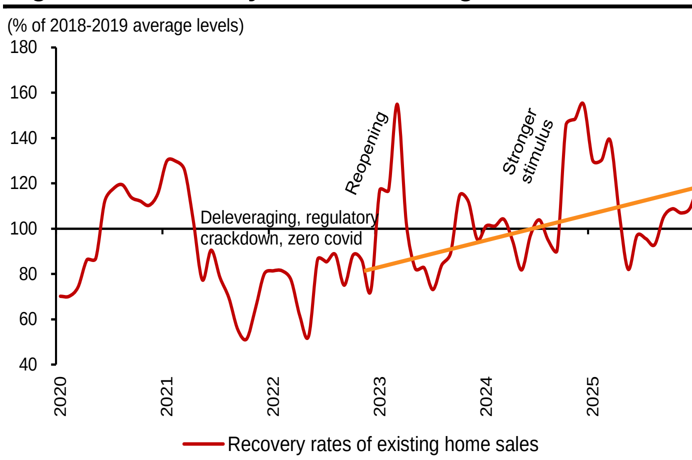
Source: Wind, CMBIGM

Figure 10: Economy, stock index & M1 growth



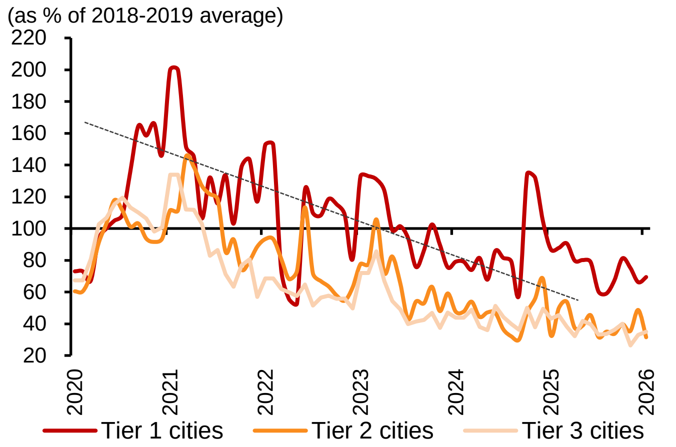
Source: Wind, CMBIGM

Figure 11: Recovery rates of existing home sales



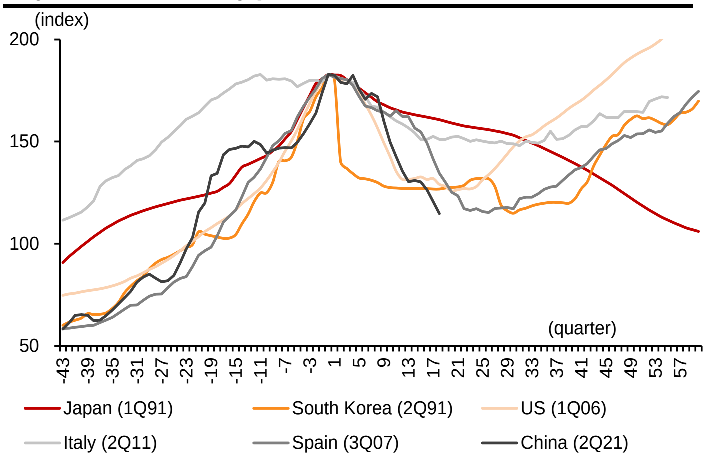
Source: Wind, CMBIGM

Figure 12: Recovery rates of new home sales



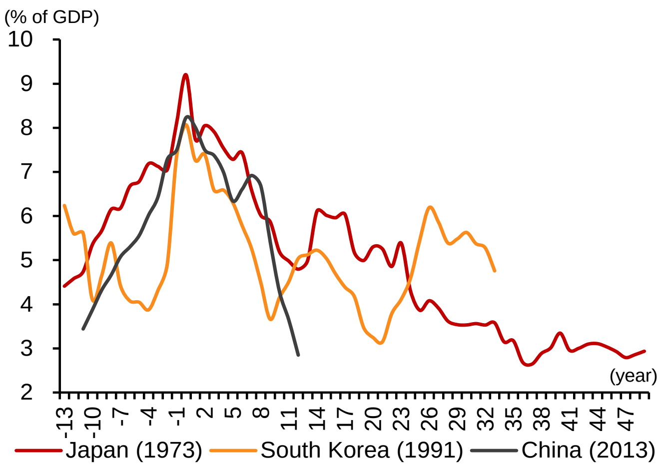
Source: Wind, CMBIGM

Figure 13: Housing price after bubble burst



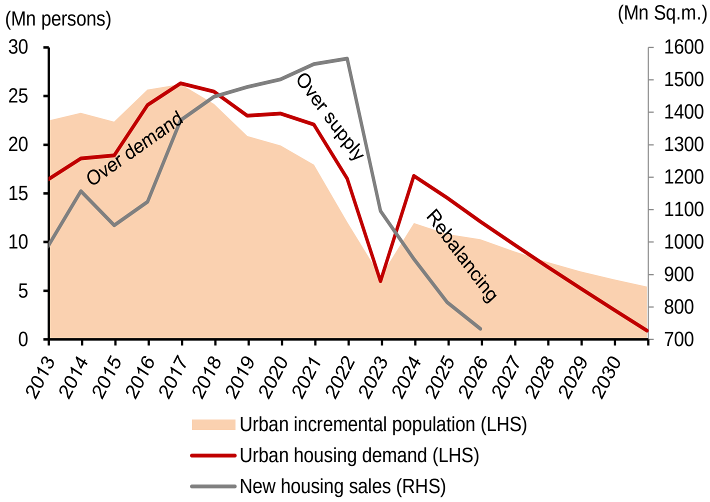
Source: Wind, CMBIGM

Figure 14: Real estate investment as % of GDP after bubble burst in East Asia



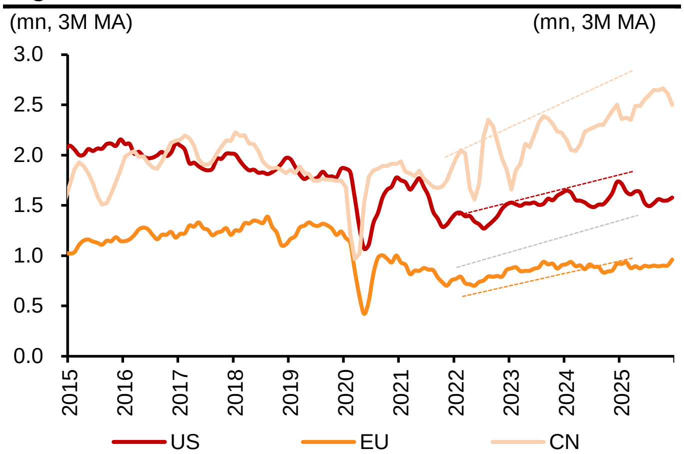
Source: Wind, CMBIGM

Figure 15: Housing market rebalancing in China



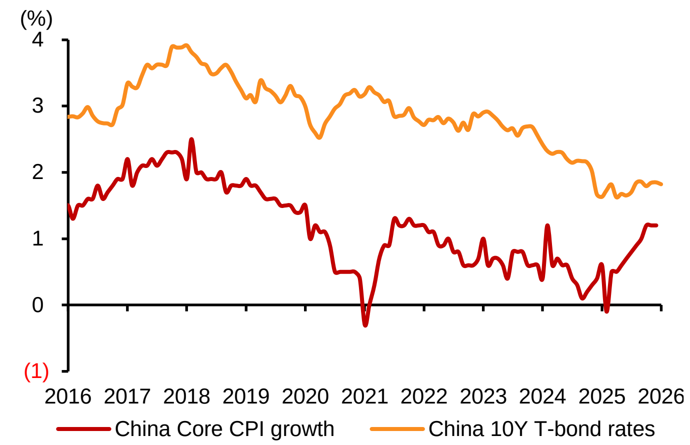
Source: Wind, CMBIGM

Figure 16: Vehicle sales in US, EU & China



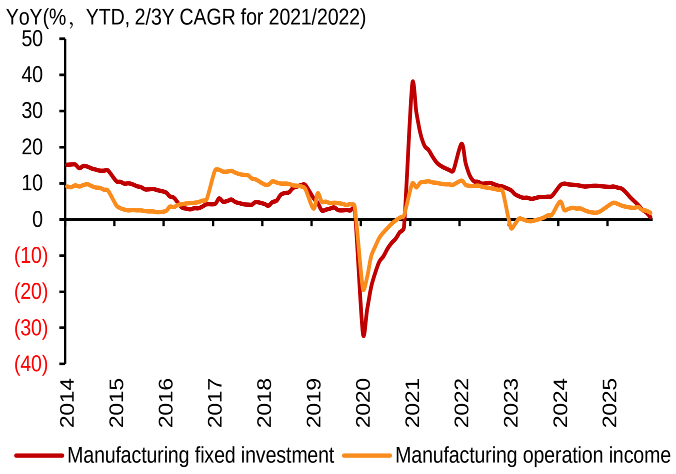
Source: Wind, CMBIGM

Figure 17: China core CPI growth & 10Y treasury rates



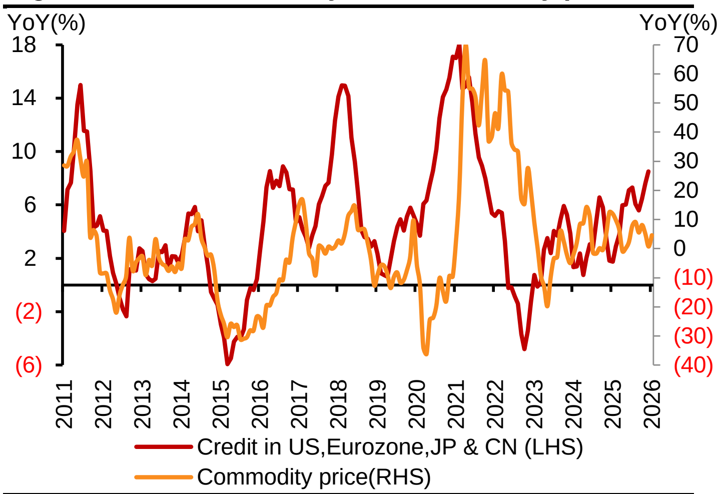
Source: Wind, CMBIGM

Figure 18: Manufacturing FAI & income growth



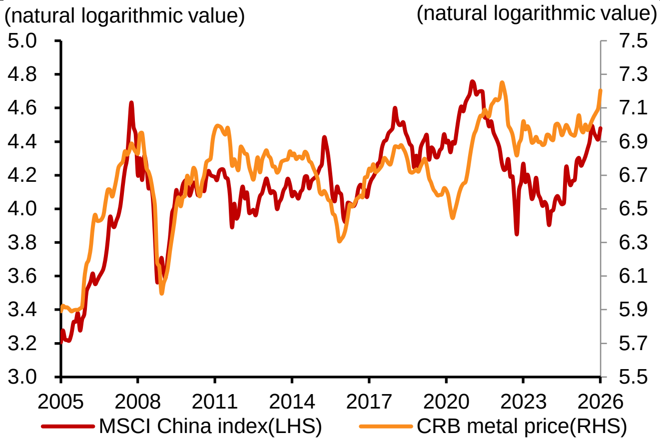
Source: Wind, CMBIGM

Figure 19: Global credit cycle & commodity price



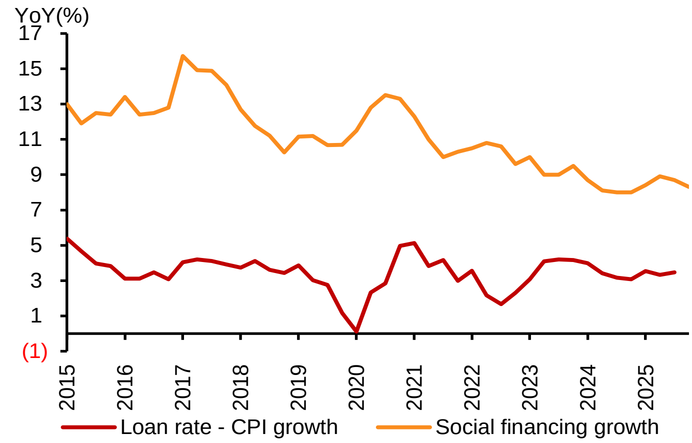
Source: Wind, CMBIGM

Figure 20: China's stock market & CRB metal price



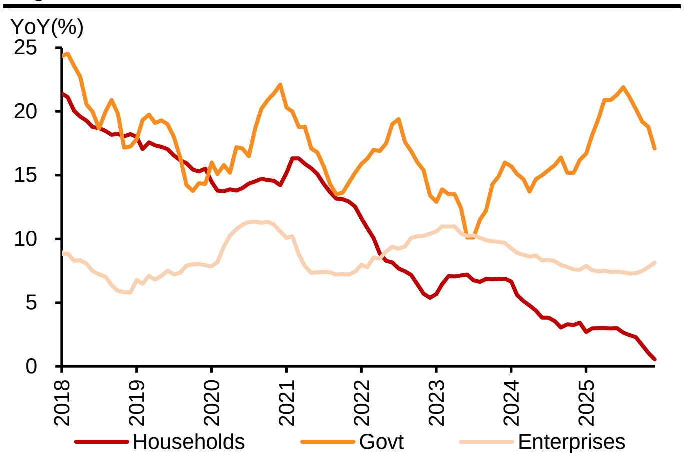
Source: Wind, CMBIGM

Figure 21: China's real interest rate & credit growth



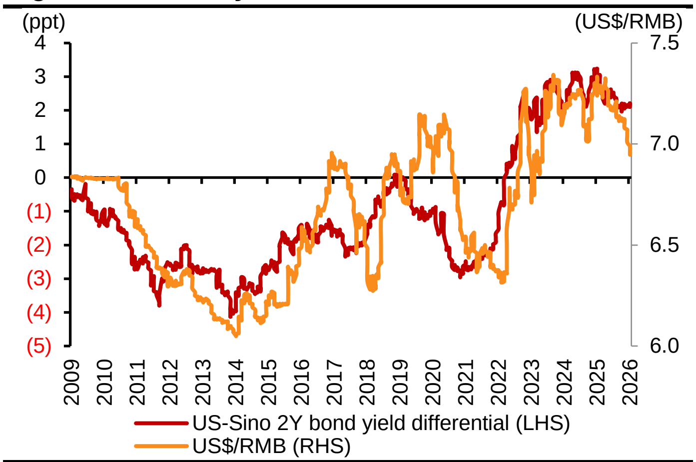
Source: Wind, CMBIGM

Figure 22: Growth of credit to real sectors in China



Source: Wind, CMBIGM

Figure 23: US-CN yield differential & US/RMB



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