16 Sep 2026

CMB International Global Markets | Macro Research | Economic Perspectives

China Economy

Uneven recovery awaiting fiscal support

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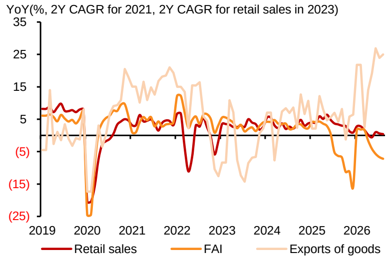
China's economy remained uneven in August, with stronger production and exports masking persistent weakness in domestic demand. Industrial output growth accelerated and beat market expectations, while retail sales, fixed asset investment and credit demand extended the decline. A deteriorating property sector continues to constrain household wealth and developer cash flow, despite tentative stabilization in top-tier cities and existing home sales. Under the circumstances, we expect incremental policy support in 4Q26 to focus on faster deployment of existing fiscal resources, policy-bank financing and targeted housing measures, while RRR and LPR cuts remain possible. With limited prospects for substantial additional support to household incomes, these measures are more likely to stabilize investment than generate a sustained consumption acceleration, in our view. We therefore retain 4.6% as our full-year GDP growth base case, and quarterly GDP growth forecasts of 4.5% and 4.6% for 3Q and 4Q 2026, respectively. For equity market, the implication is continued earnings divergence, as globally competitive exporters and AI-related equipment suppliers with visible orders, pricing power and cash generation, complemented by sustainable dividend payers may outperform, while domestic cyclicals may struggle.

- **New housing sales continued to slump, with developer cash flow still under pressure.** The property market showed two notable divergences: existing-home sales outperformed new-home sales, while tier-1 cities remained more resilient than tier-2&3 cities. New property sales by floor area fell 12.1% YTD in 8M26 from -11.8% in 7M26, with residential sales down 13.0%. Developer funding further contracted 21.0% YTD, including declines of 14.8% in deposits and advance payments and 22.4% in mortgage receipts. In the first half of Sep, new home sales further dropped 16.2% YoY from 10% in Aug, as tier-2&3 cities slumped 24% and 42.1% while tier-1 cities rebounded by 25.2%. Second-hand housing sales in 11 selective cities, on the other hand, picked up 13.2% YoY in the first half of Sep compared to 7.4% in Aug. Price performance was more differentiated: new and existing home prices in tier-1 cities each rose 0.1% MoM in August, while existing-home prices in tier-2 and tier-3 cities both fell 0.3%. The divergence suggests that housing demand is concentrated in existing homes and core cities, which leaves the national recovery subdued and uneven. The ongoing downturn should continue to weigh on durables consumption, while keeping credible delivery of unfinished homes and reducing excess inventory high on the policy agenda in 2H26.

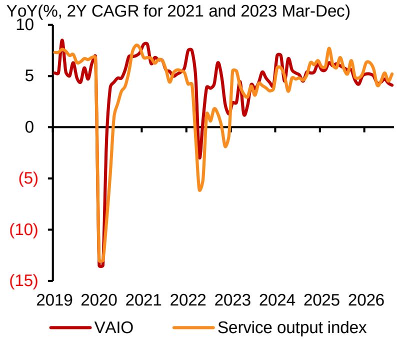
- **Retail sales weakened further as durable-goods demand remained depressed.** Retail sales growth slowed to 0.4% YoY in August from 0.6% in July, below market expectations at 0.7% while bringing YTD growth to 1.1%. Auto sales fell 18.5%, versus 17.0% in July, while furniture sales remained weak at -7.9%. Appliances improved to 2.3% from -1.9%, and telecom equipment accelerated to 27.3% from 20.4% as higher electronics prices contributed to the latter's nominal strength. Discretionary spending remained fragile as jewellery sales fell 17.5%, while catering growth eased to 1.1% from 1.4%. Clothing and cosmetics sales also moderated. Services offered some support, with service retail sales rising 4.9% YTD, compared with 1.0% for goods. The pattern is consistent with payback from earlier trade-in subsidies alongside weak household confidence. Further subsidies may support individual categories, but sustained consumption growth requires stronger income expectations and less pressure on household balance sheets. We see limited prospects for additional policy support in this area in 2H26.

YoY(%, 2Y CAGR for 2021, 2Y CAGR for retail sales in 2023)



Source: Wind, CMBIGM

YoY(%, 2Y CAGR for 2021 and 2023 Mar-Dec)



Source: Wind, CMBIGM

- **FAI further contracted, making fiscal execution the key near-term test.** FAI fell 7.2% YTD in 8M26, versus -6.7% in 7M26, in-line with market expectations. The estimated single-month decline narrowed to 10.6% from 12.8%, but investment remained deeply depressed. Property investment narrowed its contraction to -25.4% YoY in Aug from -27.5%, while manufacturing investment further fell 6.1%. Chemical products, non-ferrous metals, metal products and auto further declined while computer & electronics continued to accelerate. Infrastructure investment saw another decline at -14.7% YoY in Aug, as local fiscal conditions remained major constraints. Local government land sales revenue dropped 30.8% in 7M26. We should see a gradual recovery in infrastructure investment, as the RMB800bn policy-financing program offers an autumn catalyst, with China Development Bank making its first disbursements in early September. The program's effectiveness will depend on funds reaching viable projects and generating actual construction. We expect a selective improvement in investment, while weak private-sector appetite and local fiscal constraints limit the strength of the recovery.

- **Industrial output recovered, led by exports and advanced manufacturing.** Industrial value-added growth rose to 5.2% YoY in August from 4.5% in July, above market expectations at 4.7%, with manufacturing accelerating to 6.1% from 5.5%. Mining's contraction narrowed to -1.4% from -4.2%, while utilities growth edged down to 4.9% from 5.0%. High-tech manufacturing expanded 16.7%, while computer, telecom & electronic equipment, integrated-circuit and industrial-robot output rose 17.2%, 20.6% and 34.6%, respectively. Export delivery value increased 11.1%, up from 10.4%, reinforcing external demand's support for production. However, construction-related activity remained weak, with cement and crude-steel output falling 11.7% and 3.7%. Service-output growth also eased to 4.1% from 4.3%. The production recovery therefore remains concentrated. Strong technology output can sustain aggregate growth, but softer services and construction suggest that its benefits have yet to spread broadly through domestic employment, income and spending.

- **Credit momentum weakened further in August, with public financing cushioning continued household deleveraging.** New total social financing (TSF) reached RMB1.66trn, down 35% YoY, while outstanding TSF growth slowed to 7.2% from 7.4% in July. New bank lending amounted to just RMB60bn, down nearly 90% YoY versus RMB590bn a year earlier, with household loans contracting RMB203bn across both short- and longer-term borrowings. Government bonds accounted for approximately 61% of new TSF despite lower net issuance YoY, highlighting the importance of public-sector support. Corporate financing was more resilient than the headline loan figures suggested, as stronger bond issuance largely offset the decline in medium- and long-term corporate lending. Financing substitution therefore explains part of the loan slowdown, while persistent household deleveraging provides clearer evidence of weak domestic demand and property-related balance-sheet pressure. In our view, faster fiscal deployment and the RMB800bn policy-financing program could help stabilize credit growth later this year, but stronger headline TSF would not itself establish a recovery in private borrowing. Government issuance can lift financing aggregates before funds translate into spending. The decisive test is whether policy support generates sustained project activity and renewed household borrowing.

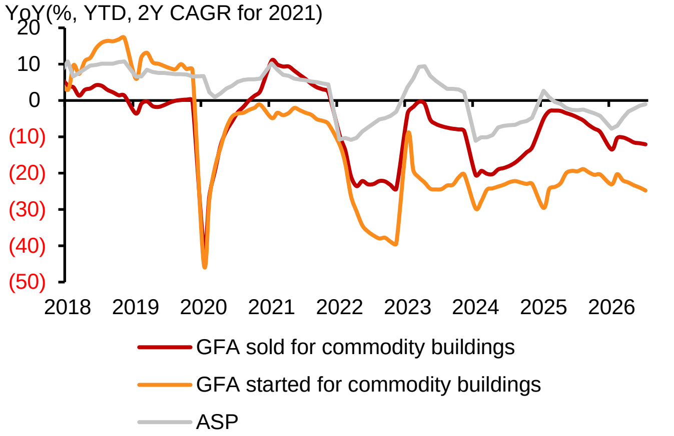
- **China's growth is becoming more dependent on industrial competitiveness and public-sector support, with limited transmission to household demand.** Technology investment and resilient exports continue to support output, but the property decline and household deleveraging constrain the spending recovery. This divergence allows headline GDP to remain relatively resilient while domestically exposed businesses face weak demand and limited pricing power. Rising upstream prices could further widen earnings differences by lifting producers' revenues while squeezing downstream margins. Under the circumstances, we expect incremental policy support to focus on faster deployment of existing fiscal resources, including spending of government-bond proceeds and implementation of the RMB800bn policy-financing program, alongside continued consumption-loan interest subsidies. The announced RMB300bn recapitalisation of central financial institutions should strengthen financing capacity, although its impact on activity will depend on borrowers' willingness to invest and spend. Targeted housing measures and additional liquidity provision, potentially including RRR and LPR cuts, remain possible in 4Q26. With limited prospects for substantial additional support to household incomes, these measures are more likely to stabilize investment than generate a sustained consumption acceleration. We therefore retain 4.6% as our full-year GDP growth base case, and quarterly GDP growth of 4.5% and 4.6% for 3Q and 4Q 2026, respectively. For investors, the implication is continued earnings divergence, as globally competitive exporters and AI-related equipment suppliers with visible orders, pricing power and cash generation, complemented by sustainable dividend payers may outperform, while domestic cyclicals may struggle. A broader market recovery would require fiscal spending to translate into stronger private investment, household income and corporate cash flow.

Figure 1: China's economic indicators

YoY(%)	2020-2021	2022-2023	2024	2025	3Q25	4Q25	1Q26	2Q26	July	August
GDP	5.3	4.1	5.0	5.0	4.8	4.5	5.0	4.3		
GDP Deflator	2.5	0.7	(0.8)	(1.0)	(1.0)	(0.6)	(0.1)	1.5		
VAIO	6.1	4.1	5.8	5.9	5.8	5.0	6.1	4.6	4.5	5.2
-Mining	2.9	4.8	3.1	5.6	5.5	5.4	5.7	1.3	(4.2)	(1.4)
-Manufacturing	6.6	4.0	6.1	6.4	6.4	5.1	6.0	4.8	5.5	6.1
-Public utility	6.6	4.6	5.3	2.3	2.1	3.5	3.5	6.8	5.0	4.9
Delivery value for exports	8.3	0.7	5.1	2.2	2.0	1.0	8.1	11.3	10.4	11.1
Service output index	6.3	3.9	5.2	5.5	5.7	4.6	5.0	4.5	4.3	4.1
Retail sales	4.0	3.4	3.5	3.7	3.4	1.7	2.3	0.2	0.6	0.4
Exports of goods	15.9	0.3	5.8	5.4	6.4	3.7	14.7	20.1	23.9	25.0
Imports of goods	13.7	(2.4)	1.0	0.3	4.7	3.7	23.5	29.4	27.6	28.2
Urban FAI (YTD)	3.9	4.0	3.2	(3.8)	(2.6)	1.8	(4.1)	(6.7)	(6.7)	(7.2)
-Property development	5.7	(9.8)	(10.6)	(17.2)	(15.9)	(11.1)	(16.2)	(19.2)	(19.2)	(19.9)
-Manufacturing	5.4	7.8	9.2	0.6	1.9	3.1	(0.4)	(1.7)	(1.7)	(2.3)
-Infrastructure	1.8	9.9	9.2	(1.5)	0.1	9.8	0.8	(4.1)	(4.1)	(5.4)
GFA sold for commodity building (YTD)	2.2	(16.8)	(12.9)	(8.7)	(7.8)	(13.5)	(10.8)	(11.8)	(11.8)	(12.1)
GFA started for commodity building (YTD)	(6.4)	(30.5)	(23.0)	(20.4)	(20.5)	(23.1)	(22.6)	(24.0)	(24.0)	(24.8)

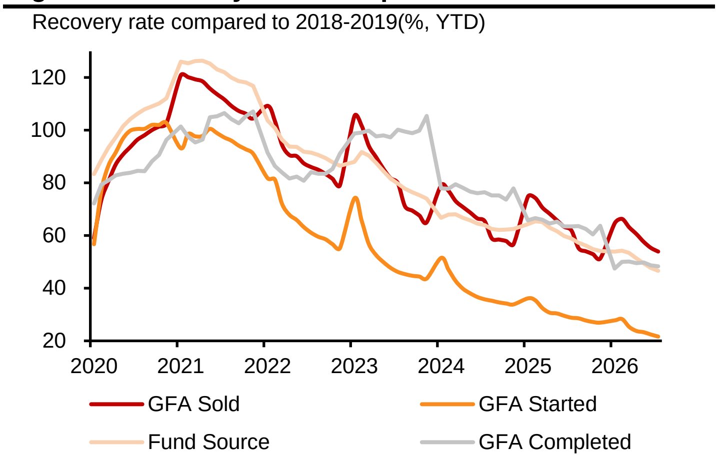
Source: Wind, CMBIGM

Figure 2: Property sales growth



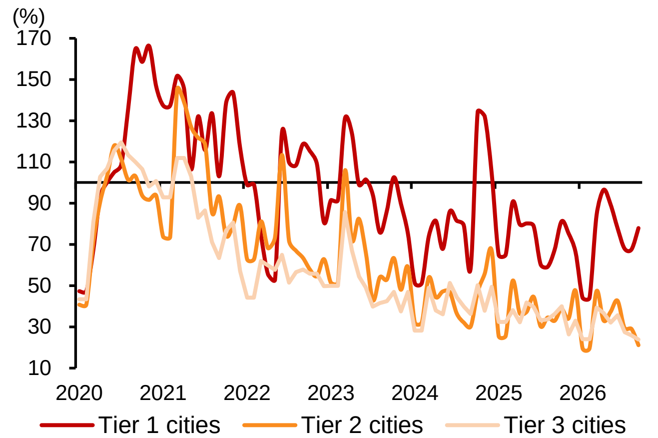
Source: Wind, CMBIGM

Figure 3: Recovery rates compared to 2018-2019



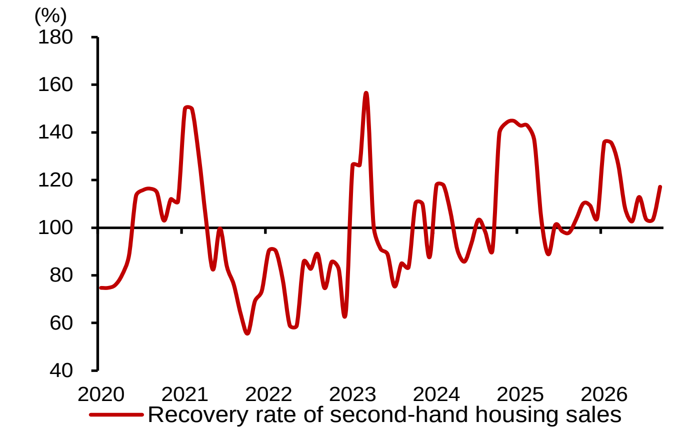
Source: Wind, CMBIGM

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



Source: Wind, CMBIGM

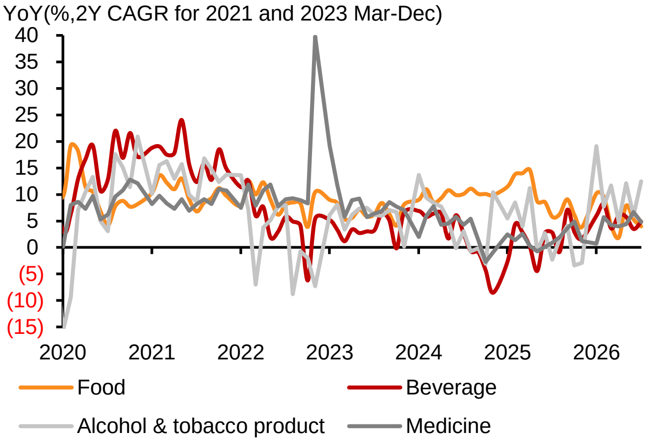
Figure 5: Recovery rate of second-hand housing sales compared to 2019 in 11 selective cities



Source: Wind, CMBIGM

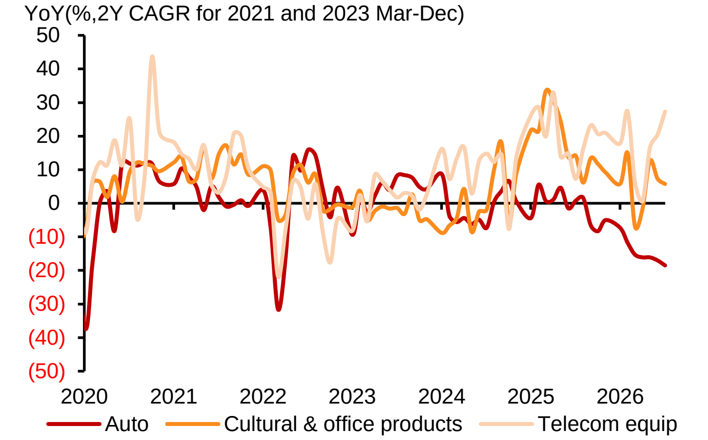
Note: The 11 cities include Beijing, Shenzhen, Hangzhou, Nanjing, Chengdu, Qingdao, Suzhou, Xiamen, Wuxi, Dongguan and Foshan

Figure 6: Retail sales of staples



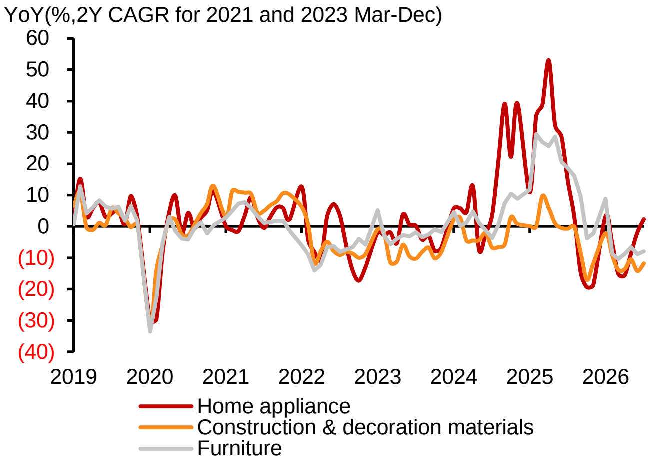
Source: Wind, CMBIGM

Figure 7: Retail sales of auto & electronics



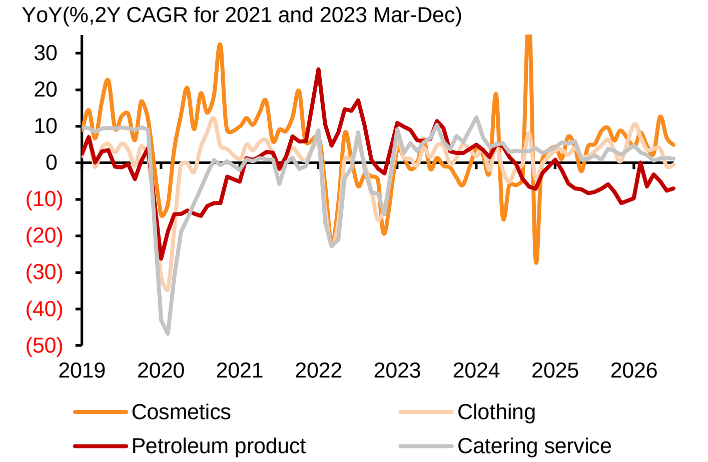
Source: Wind, CMBIGM

Figure 8: Home appliance & furniture retail sales



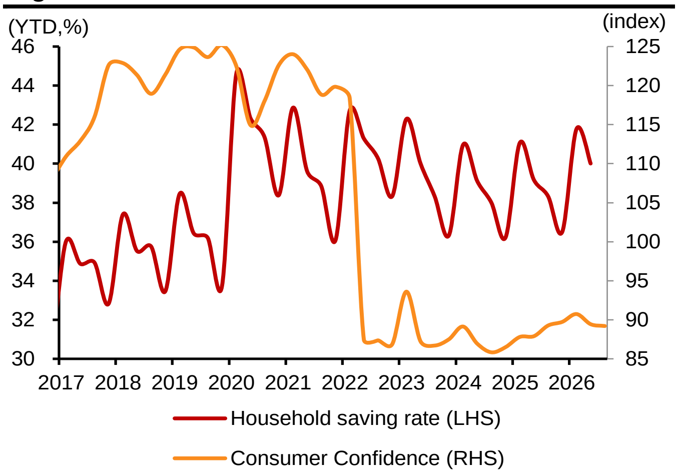
Source: Wind, CMBIGM

Figure 9: Retail sales related to outgoing activities



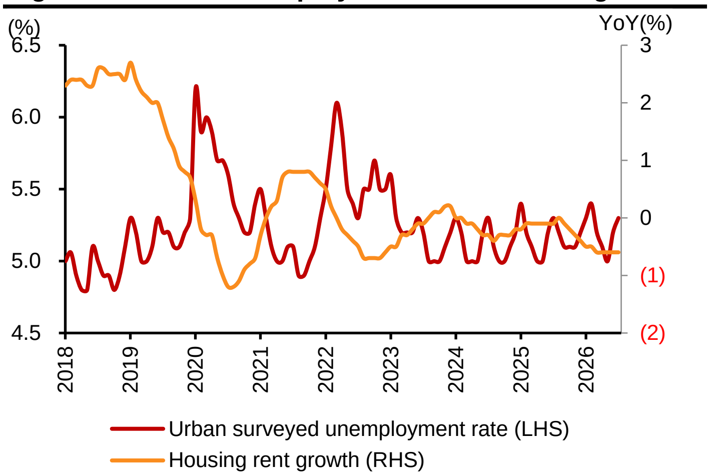
Source: Wind, CMBIGM

Figure 10: Consumer confidence



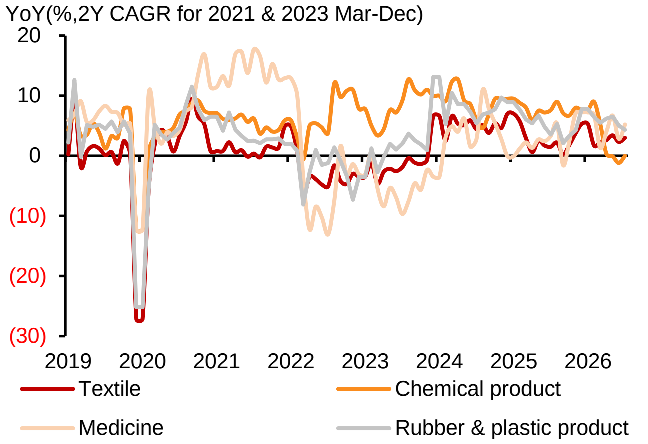
Source: Wind, CMBIGM

Figure 11: Urban unemployment rate & housing rent



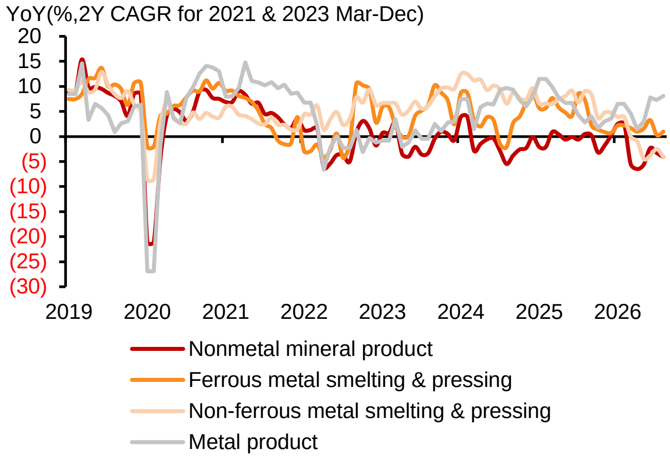
Source: Wind, CMBIGM

Figure 12: VAIO in textile & chemical products



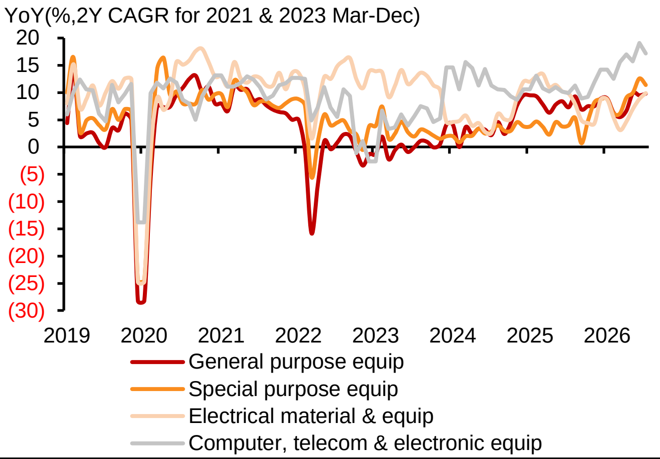
Source: Wind, CMBIGM

Figure 13:VAIO in mineral & metal products



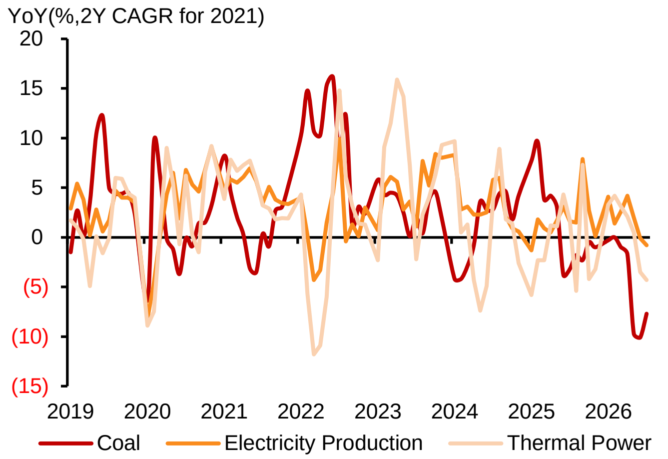
Source: Wind, CMBIGM

Figure 14: VAIO in equipment



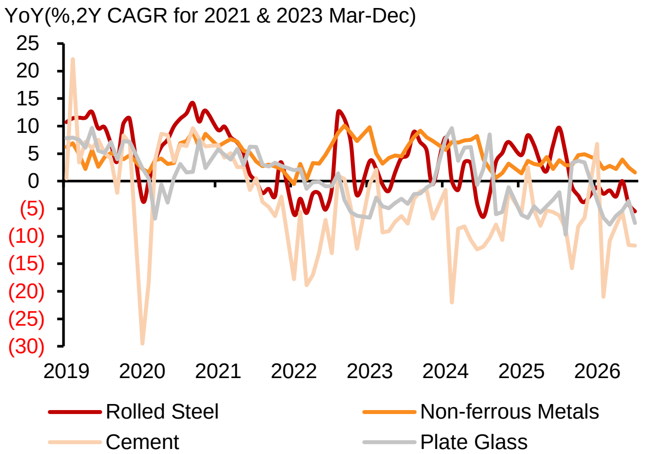
Source: Wind, CMBIGM

Figure 15: Output in energy and electricity



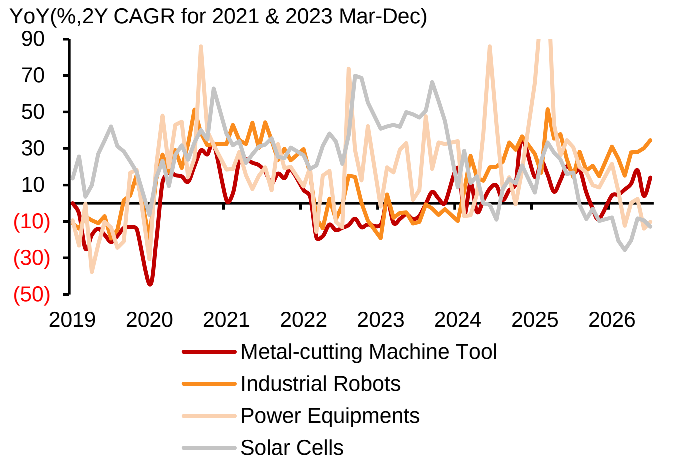
Source: Wind, CMBIGM

Figure 16: Output in steel & construction material



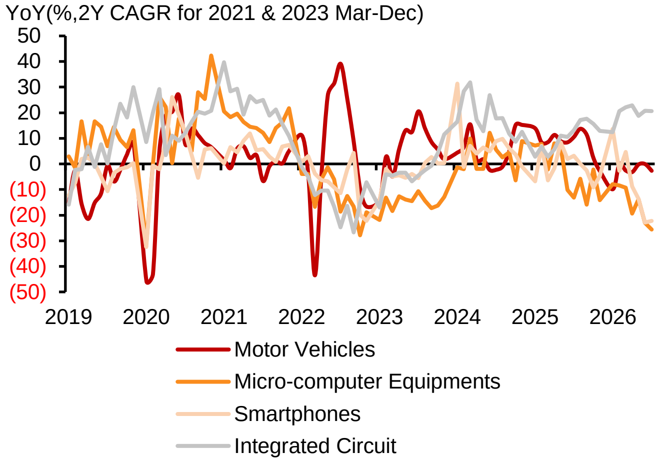
Source: Wind, CMBIGM

Figure 17: Output in capital goods



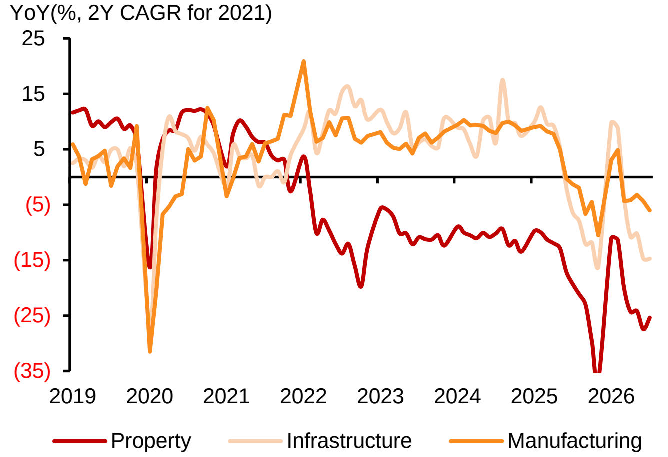
Source: Wind, CMBIGM

Figure 18:Output in auto, computer & smartphone



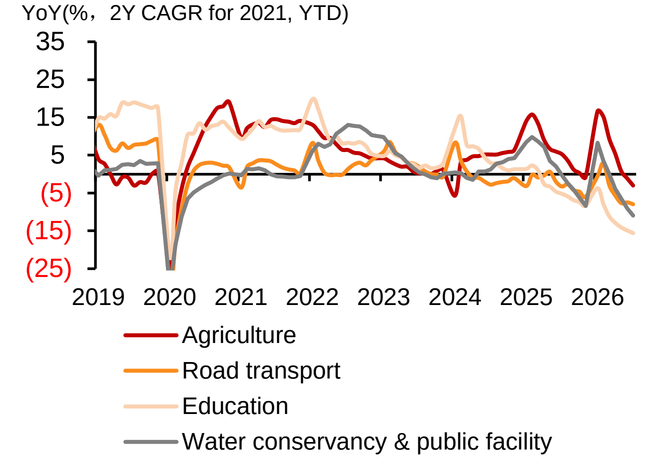
Source: Wind, CMBIGM

Figure 19: FAI by sector



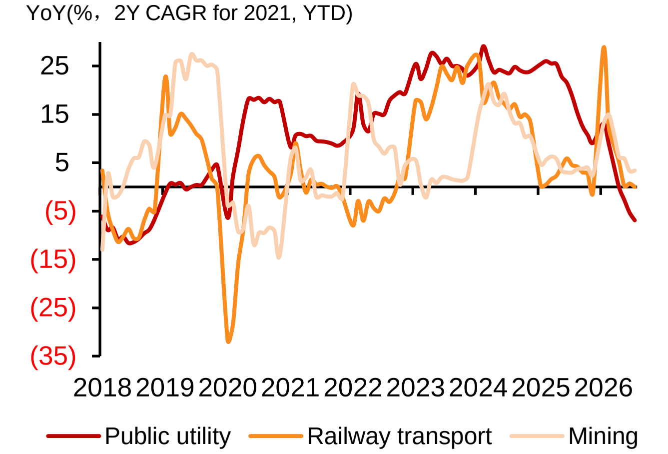
Source: Wind, CMBIGM

Figure 20: FAI in agriculture & local infrastructure



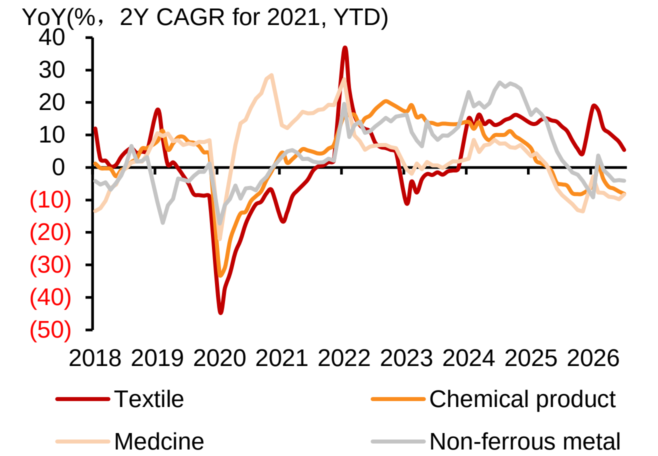
Source: Wind, CMBIGM

Figure 21: FAI in central infrastructure & mining



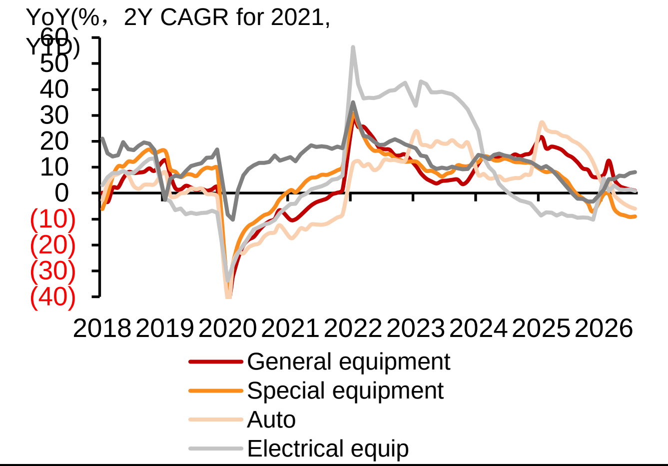
Source: Wind, CMBIGM

Figure 22: FAI in chemical products



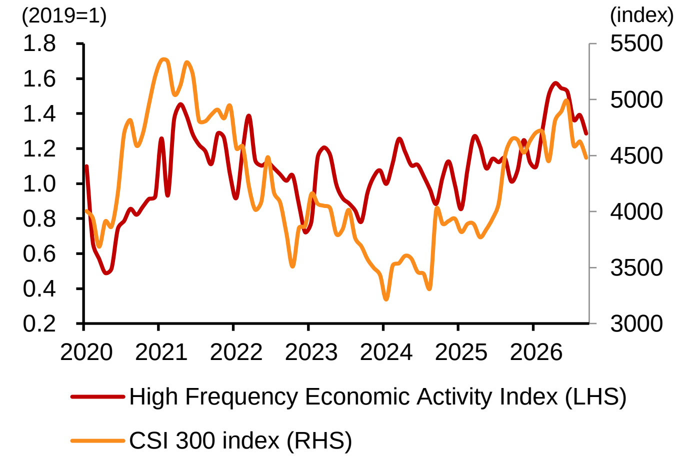
Source: Wind, CMBIGM

Figure 23: FAI in equipment



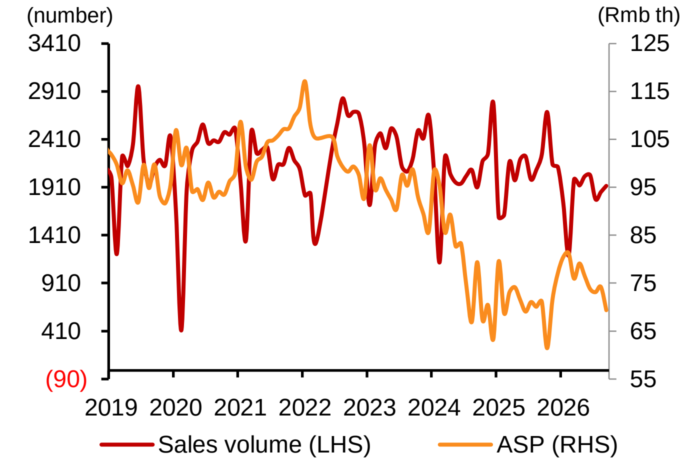
Source: Wind, CMBIGM

Figure 24: Economic activity & A-share index



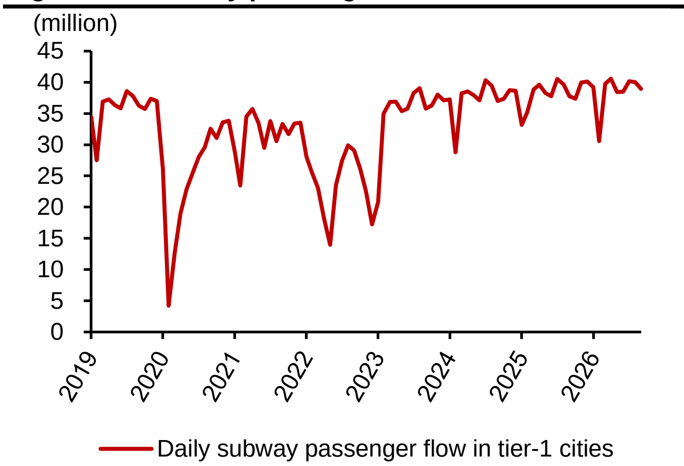
Source: Wind, CMBIGM

Figure 25: Used vehicle sales in Shanghai market



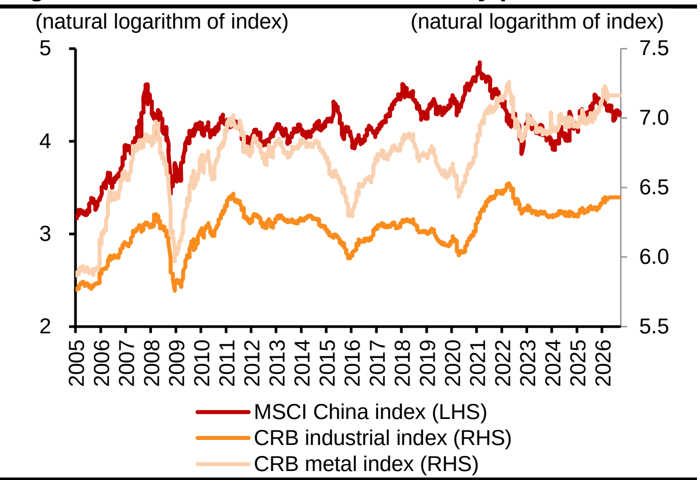
Source: Wind, CMBIGM

Figure 26: Subway passenger flow in tier-1 cities



Source: Wind, CMBIGM

Figure 27: MSCI China and commodity prices



Source: Wind, CMBIGM

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