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CMB International Global Markets | Macro Research | Economic Perspectives

China Economy

Q1 beat but recovery remained uneven

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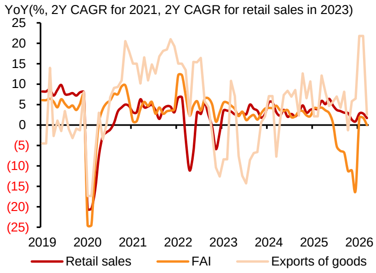
Q1 GDP growth rebounded and came in better than market expected, while a recovering GDP deflator points to a possible first positive reading in 2Q26 after more than three years of deflation. Industrial output and fixed asset investment were robust, supported by exports and fiscal expansion, while retail sales, especially durable goods, and service output moderated in Mar, as growth of household real disposable income dropped to 3 years' low. The property sector remained in contraction, despite showing limited signs of recovery as sales and prices among tier-1 cities bounced up. Higher energy prices may help narrow deflation through upstream cost pass-through, but this is still cost-push rather than demand-led and may squeeze downstream margins and household purchasing power, in our view. On the other hand, the Middle East tensions may push policymakers to prioritize security over growth again, potentially slowing China's economic rebalancing process. Looking ahead, we expect a 50bp RRR cut and a 10bp LPR cut by end-3Q26, and full-year GDP growth to slow from 5.0% in 2025 to 4.7% in 2026.

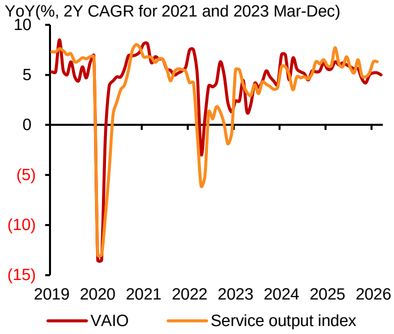
- **GDP rebounded in 1Q26 while GDP deflator recovered.** China's GDP growth in YoY terms (all on a YoY basis unless otherwise specified) rose to 5.0% in 1Q26 from 4.5% in 4Q25, while nominal GDP growth improved to 4.9%, implying the GDP deflator has notably improved to -0.1% from -0.6% in 4Q25. We may finally see a positive deflator in 2Q26 after 14 quarters of deflation cycle due to the rising commodities prices in upper-stream sectors. However, the stronger Q1 reading was mainly supported by robust exports, a firmer industrial cycle and stabilizing fixed asset investment, rather than a broad domestic demand recovery. We expect GDP growth to slow from 5.0% in 2025 to 4.7% in 2026, with 2Q GDP slowing to 4.6% due to narrowing trade surplus and still-weak domestic consumption.

- **Property sector showed improving signs.** The contraction of gross floor area (GFA) sold for commodity buildings narrowed to -10.4% YTD in 3M26 from -13.5% in 2M26. New starts stayed weak at -20.3% and total funding sources fell 17.3%, dragged by a 20.1% drop in advance receipts and a 34.6% decline in mortgage loans. New housing sales in the first half of Apr notably rebounded to 13.5% from -6% in Mar by GFA due to a lower base last year, as tier-1 cities surged by 35.5%. The recovery ratio of 30 major cities compared to 2018-2019, however, fell to 46% in Apr from 52% in Mar. Second-hand housing sales of 11 selective cities moderately rebounded in early Apr, with YoY GFA growth picking up to 9.63% from -4.2% in Mar, while the recovery ratio dropped to 114% from 127%. New and second-hand housing prices moderated on its MoM decline in Mar, as tier-1 cities rebounded by 0.2% and 0.4% respectively, while lower-tier cities further declined. Listing prices of second-hand properties continued to drop in Apr, though the pace of decline moderated. The ongoing downturn should continue to weigh on durables consumption and keep housing support high on the policy agenda in 1H26, as the limited signs of recovery is not enough to repair developers' cash flow or reverse the drag on household confidence.

- **Retail sales moderated after the holiday lift faded.** Retail sales growth slowed to 1.7% in Mar from 2.8% in 2M26, lower than market expectations at 2.5%. Catering growth moderated to 2.9% in Mar from 4.8% in 2M26, while food, beverage, apparel and jewelry still held up relatively well at 9.5%, 8.2%, 7.0% and 11.7%, respectively. By contrast, policy-sensitive and housing-related categories weakened again, with home appliances, furniture, building materials and autos at -5.0%, -8.7%, -9.0% and -11.8% in Mar. Telecom equipment remained strong at 27.3%, but the broader retail mix suggests the March slowdown was driven by weaker big-ticket spending after the holiday



Source: Wind, CMBIGM



Source: Wind, CMBIGM

boost and subsidy pull-forward. Moreover, growth of per capita disposable real income of households dropped to 4% in 1Q26, the slowest in 3 years. Looking ahead, we still expect consumption growth to stay muted in 2026, with softer goods consumption partly offset by a gradual recovery in services. Retail sales growth may slow from 3.7% in 2025 to 3.4% in 2026.

- **FAI edged down.** Fixed asset investment dropped 1.4% YoY in Mar after rising 1.8% in 2M26, in line with market expectations. Property investment was still the main drag at -11.3% in Mar, reflecting continued oversupply, weak sales and tight funding conditions. Manufacturing investment improved to 4.9% in Mar from 3.1% in 2M26, supported by general equipment, autos, transport equipment and computer, communication and electronic equipment, while high-tech industry investment rose 7.4%. Infrastructure investment eased to 7.2% in Mar from 11.4% in 2M26, but remained solid, with transportation, utilities and public facility spending still supported by early fiscal funding. Looking forward, investment should continue to rely on fiscal support, policy-bank funding and selected industrial upgrading themes, especially in power infrastructure, data centers, semiconductors and networking equipment, while housing investment should remain weak, in our view. FAI growth may recover from -3.8% in 2025 to 1.1% in 2026 as the CEWC (Central Economic Work Conference) vowed to stabilize investment, with FAI in property, infrastructure and manufacturing rebounding from -17%, -1.5% and 0.6% in 2025 to -9%, 1.5% and 4% in 2026.

- **Industrial output stayed resilient thanks to robust export delivery value.** VAIO growth edged down to 5.7% in Mar from 6.3% in 2M26, still higher than market expectations at 5.4%. 1Q26 cumulative growth picked up to 6.1%, still above the 2025 full-year pace of 5.9%. Manufacturing remained the main anchor, with cumulative growth at 6.1% in 1Q26 from 5% in 4Q25, as export delivery value accelerated to 8.7% in Mar from 6.3% in 2M26, showing that external demand was still providing support. Chemicals, transport equipment and electronics stayed relatively strong, while non-metallic mineral products remained weak, indicating domestic construction demand was still soft. Service output growth slowed to 5.0% in Mar from 5.2% in 2M26, also pointing to some moderation in domestic activity. Looking ahead, industrial growth should stay more resilient than consumption and property in the near term, but it is still likely to slow as exports normalize.

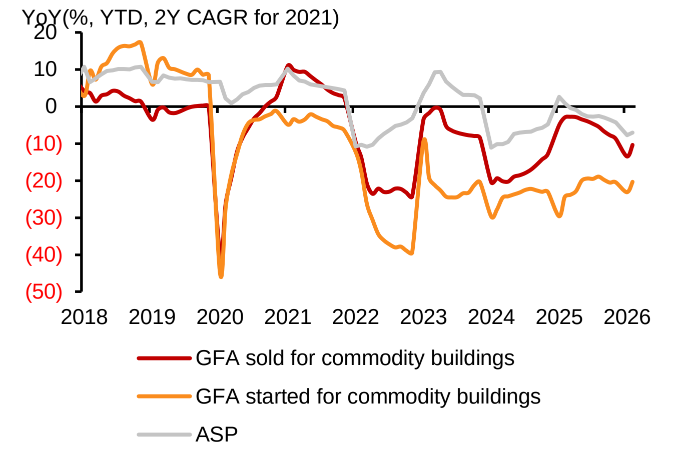
- **The March data argue for a more cautious reading of the Q1 rebound.** Activity in Q1 was better than feared, but the composition still looks driven by exports, manufacturing and fiscal-driven FAI rather than a self-sustaining rise in household and property demand. The slowdown in Mar big-ticket retail sales and services suggests the economy has not yet built a durable domestic-demand cycle. Higher energy and commodity prices may reduce deflation pressure at the margin, but the benefit is likely to be partly offset by weaker real purchasing power and margin pressure downstream. Middle East tensions may push policymakers to prioritize security over growth again, potentially slowing China's economic rebalancing process. Looking ahead, we expect a 50bp RRR cut and a 10bp LPR cut by end-3Q26, and full-year GDP growth to slow from 5.0% in 2025 to 4.7% in 2026.

Figure 1: China's economic indicators

YoY(%)	2020-2021	2022-2023	2024	2025	2Q25	3Q25	4Q25	1Q26	Jan-Feb	Mar
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	6.3	5.7
-Mining	2.9	4.8	3.1	5.6	5.8	5.5	5.4	6.0	6.1	5.7
-Manufacturing	6.6	4.0	6.1	6.4	6.7	6.4	5.1	6.4	6.6	6.0
-Public utility	6.6	4.6	5.3	2.3	2.0	2.1	3.5	4.3	4.7	3.5
Delivery value for exports	8.3	0.7	5.1	2.2	2.0	2.0	1.0	7.1	6.3	8.7
Service output index	6.3	3.9	5.2	5.5	6.1	5.7	4.6	5.1	5.2	5.0
Retail sales	4.0	3.4	3.5	3.7	5.4	3.4	1.7	2.4	2.8	1.7
Exports of goods	15.9	0.3	5.8	5.4	6.1	6.5	3.8	14.7	39.6	2.5
Imports of goods	13.7	(2.4)	1.0	0.0	(0.8)	4.5	2.9	22.7	13.8	27.8
Urban FAI (YTD)	3.9	4.0	3.2	(3.8)	2.8	(0.5)	(3.8)	1.7	1.8	1.7
-Property development	5.7	(9.8)	(10.6)	(17.2)	(11.2)	(13.9)	(17.2)	(11.2)	(11.1)	(11.2)
-Manufacturing	5.4	7.8	9.2	0.6	7.5	4.0	0.6	4.1	3.1	4.1
-Infrastructure	1.8	9.9	9.2	(1.5)	8.9	3.3	(1.5)	8.9	11.4	8.9
GFA sold for commodity building (YTD)	2.2	(16.8)	(12.9)	(8.7)	(3.5)	(5.5)	(8.7)	(10.4)	(13.5)	(10.4)
GFA started for commodity building (YTD)	(6.4)	(30.5)	(23.0)	(20.4)	(20.0)	(18.9)	(20.4)	(20.3)	(23.1)	(20.3)

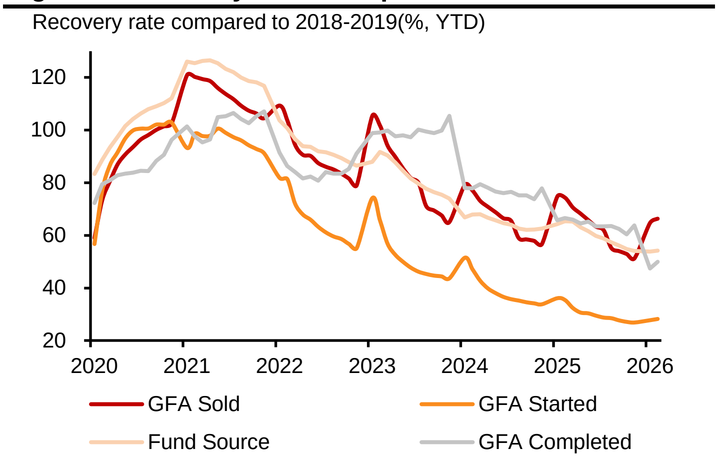
Source: Wind, CMBIGM estimates

Figure 2: Property sales growth



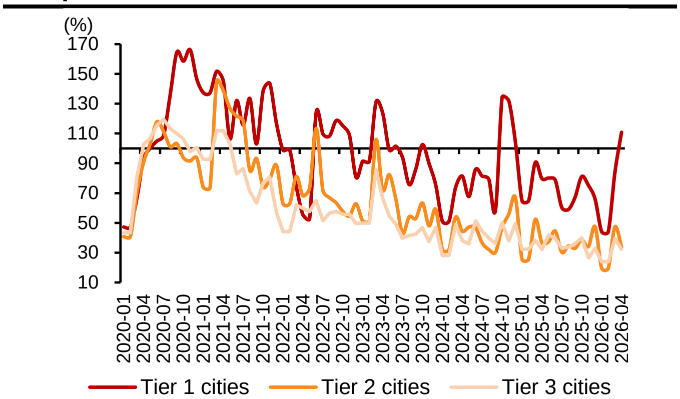
Source: Wind, CMBIGM

Figure 3: Recovery rates compared to 2018-2019



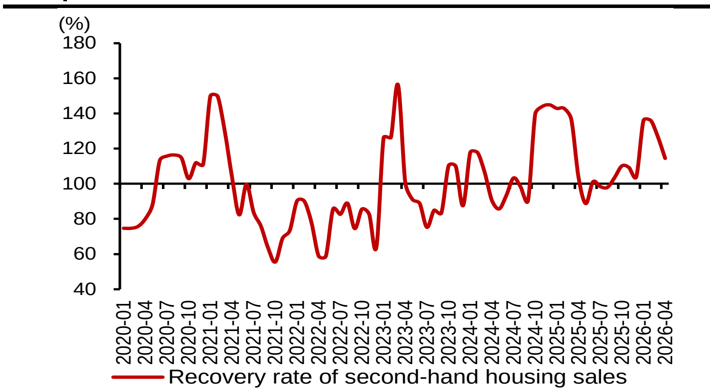
Source: Wind, CMBIGM

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



Source: Wind, CMBIGM

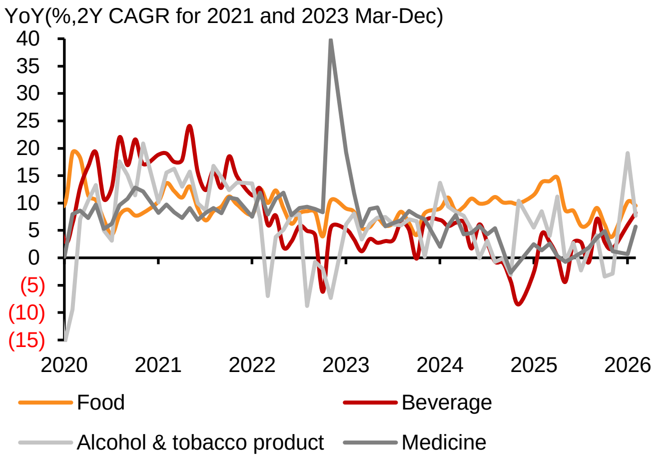
Figure 5: Recovery rate of second-hand housing sales compared to 2019 in 11 selective cities



Source: Wind, CMBIGM

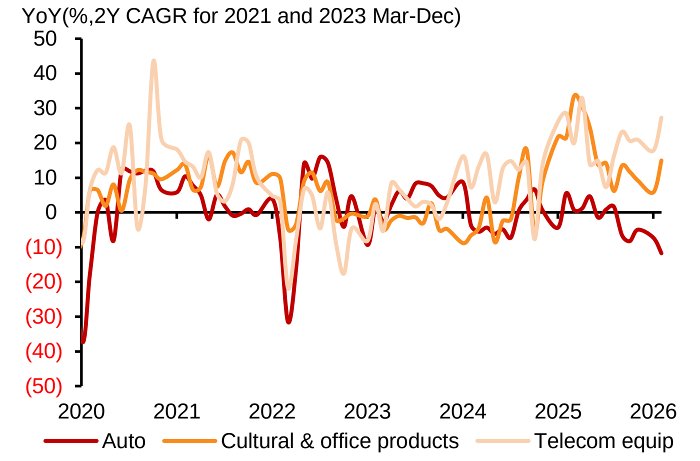
Note: The 11 cities include Beijing, Shenzhen, Hangzhou, Nanjing, Chengdu, Qingdao, Suzhou, Xiamen, Wuxi, Dongguan and Foshan

Figure 6: Retail sales of staples



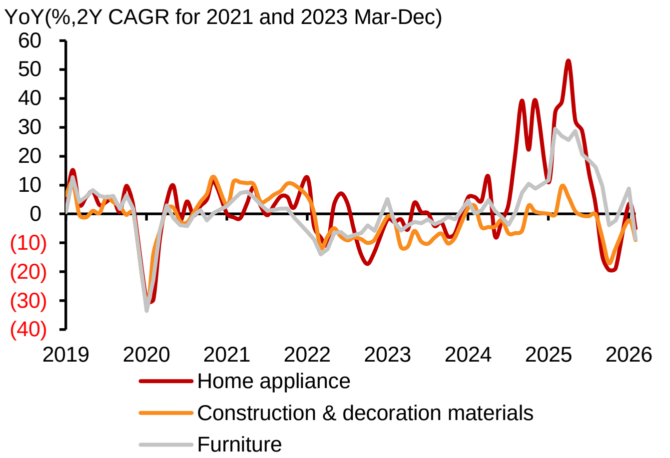
Source: Wind, CMBIGM

Figure 7: Retail sales of autos & electronics



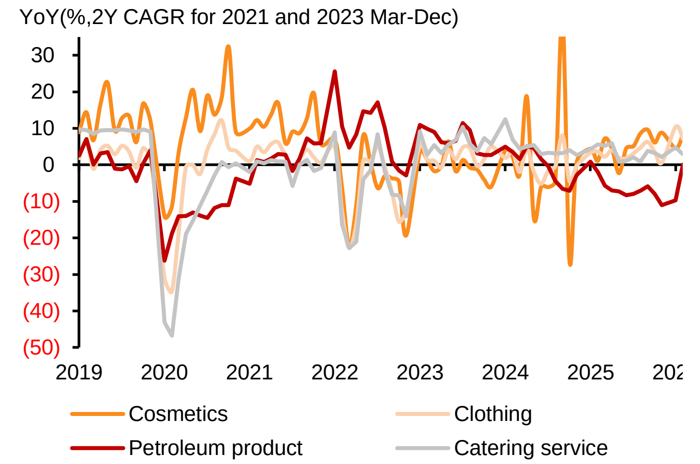
Source: Wind, CMBIGM

Figure 8: Home appliance & furniture retail sales



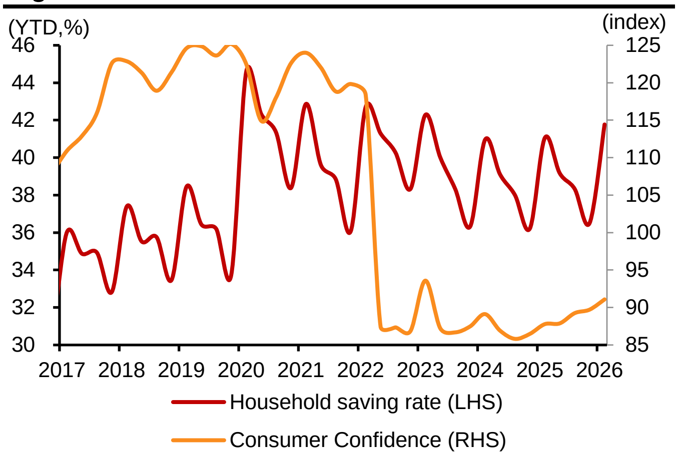
Source: Wind, CMBIGM

Figure 9: Retail sales related to outgoing activities



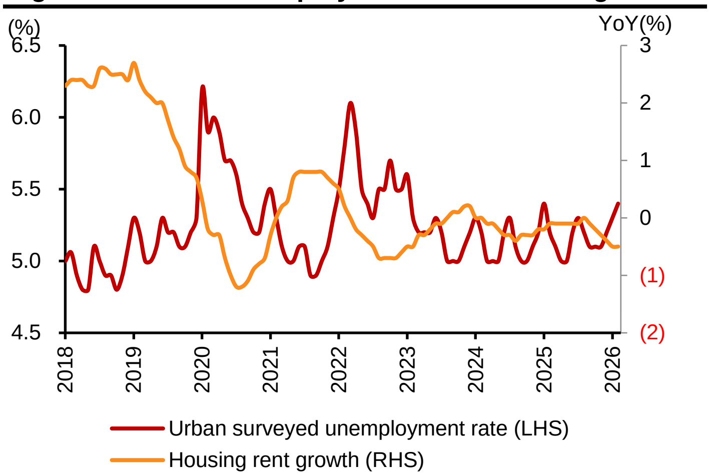
Source: Wind, CMBIGM

Figure 10: Consumer confidence



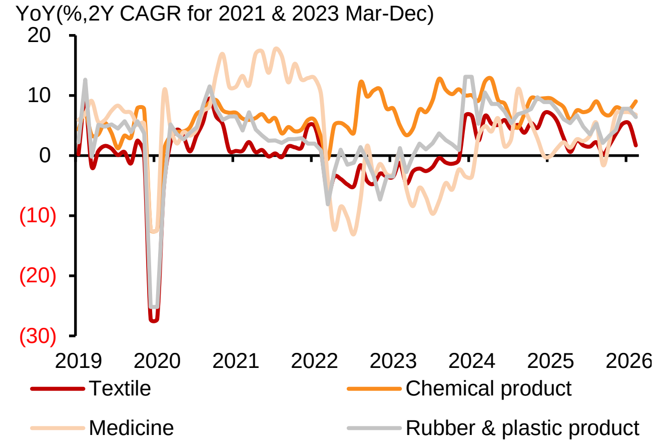
Source: Wind, CMBIGM

Figure 11: Urban unemployment rate & housing rent



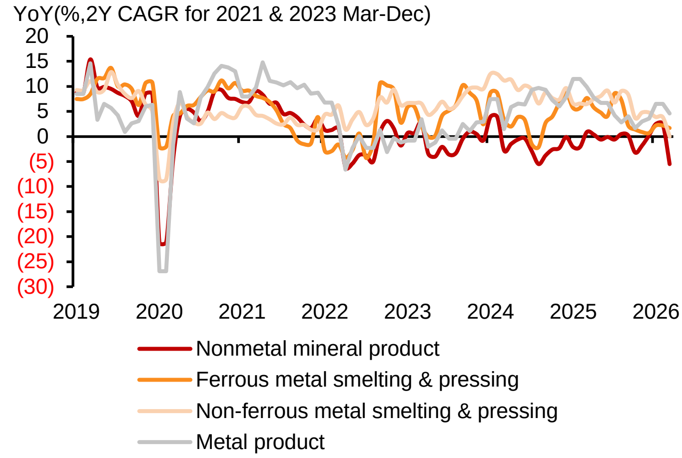
Source: Wind, CMBIGM

Figure 12: VAIO in textile & chemical products



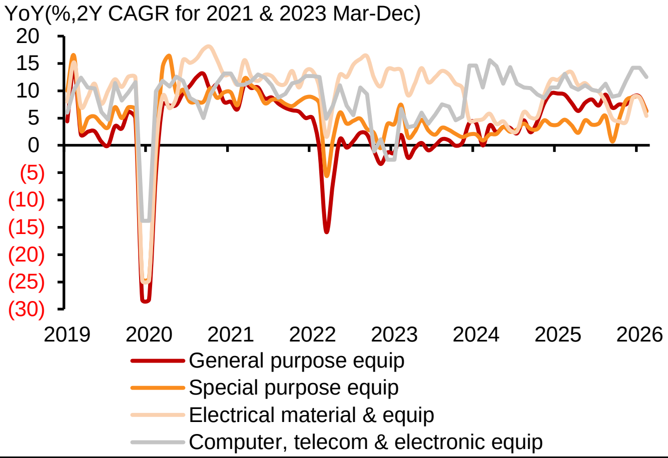
Source: Wind, CMBIGM

Figure 13:VAIO in mineral & metal products



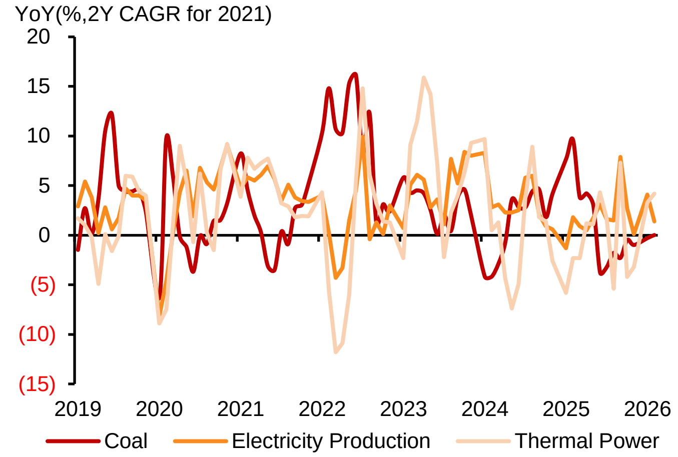
Source: Wind, CMBIGM

Figure 14: VAIO in equipment



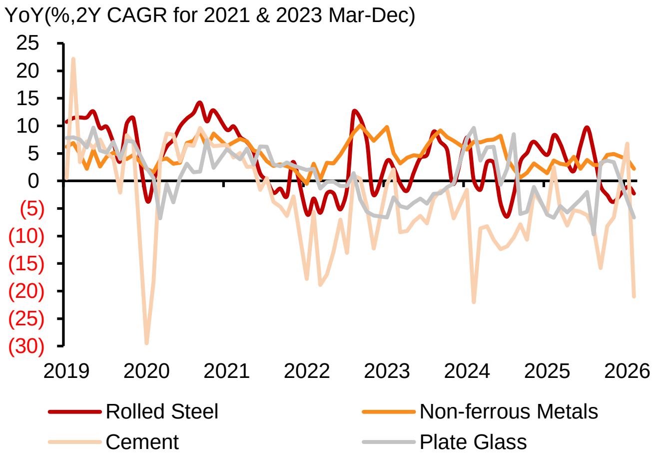
Source: Wind, CMBIGM

Figure 15: Output in energy and electricity



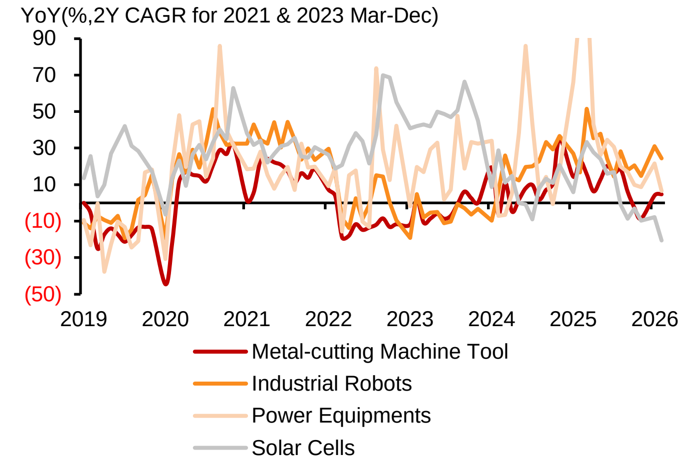
Source: Wind, CMBIGM

Figure 16: Output in steel & construction materials



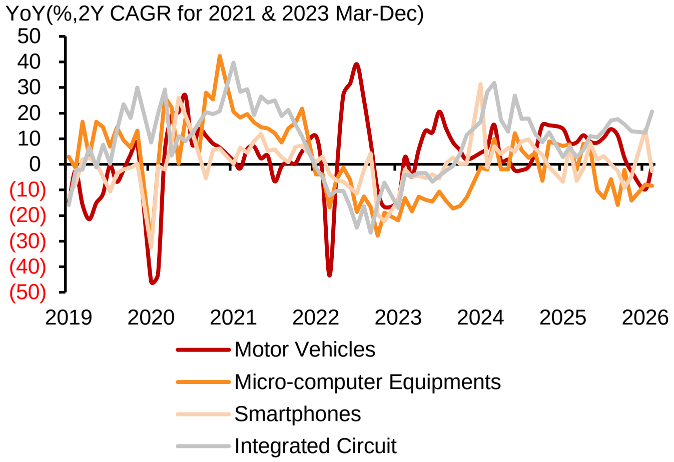
Source: Wind, CMBIGM

Figure 17: Output in capital goods



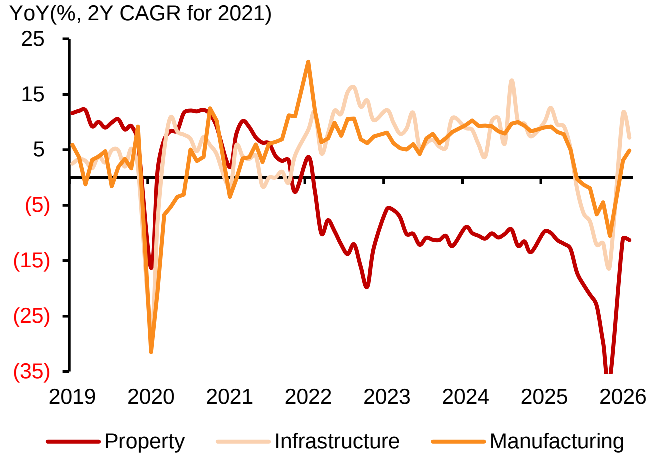
Source: Wind, CMBIGM

Figure 18:Output in auto, computer & smartphone



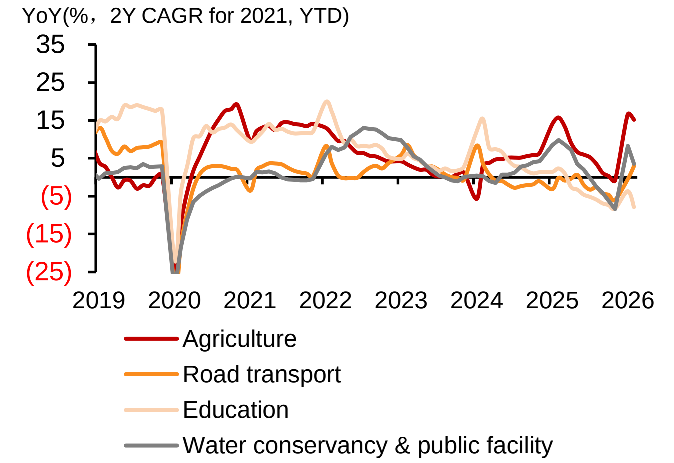
Source: Wind, CMBIGM

Figure 19: FAI by sector



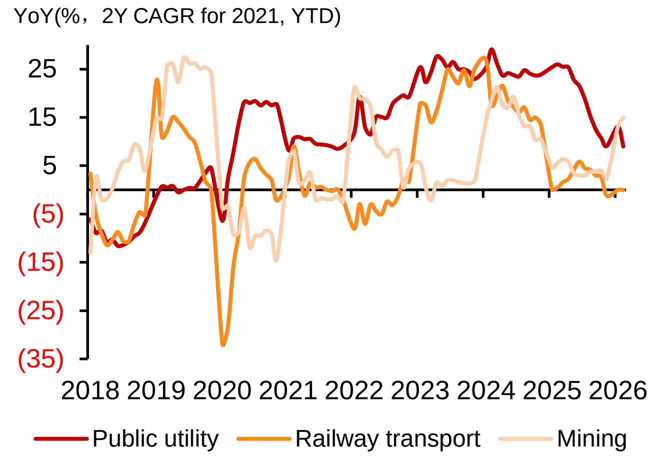
Source: Wind, CMBIGM

Figure 20: FAI in agriculture & local infrastructure



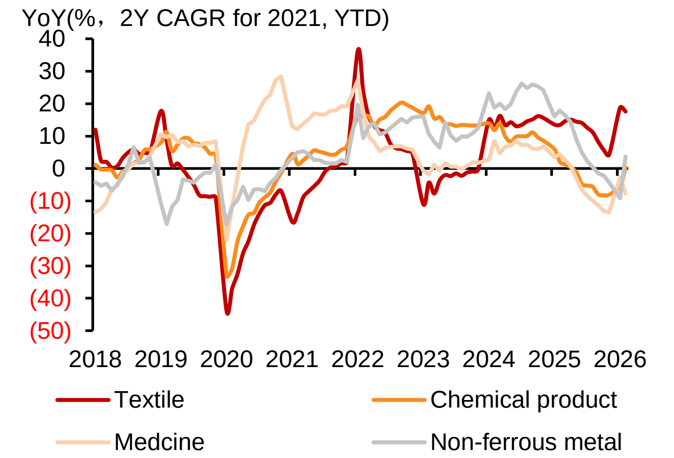
Source: Wind, CMBIGM

Figure 21: FAI in central infrastructure & mining



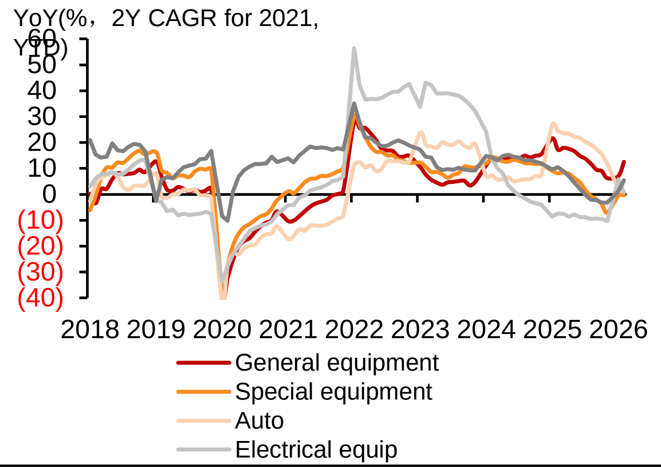
Source: Wind, CMBIGM

Figure 22: FAI in chemical products



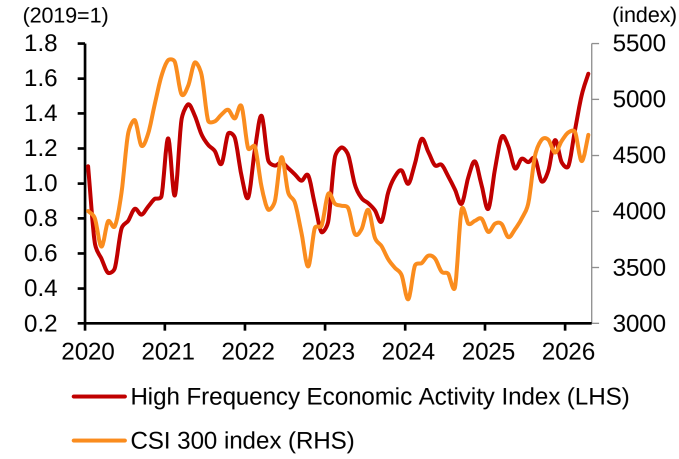
Source: Wind, CMBIGM

Figure 23: FAI in equipment



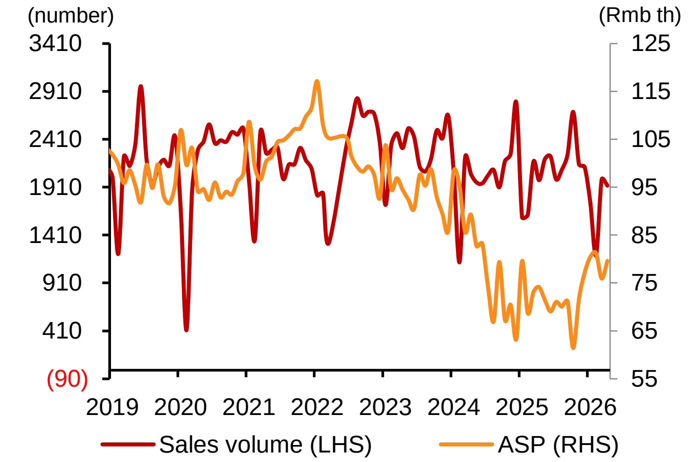
Source: Wind, CMBIGM

Figure 24: Economic activity & A-share index



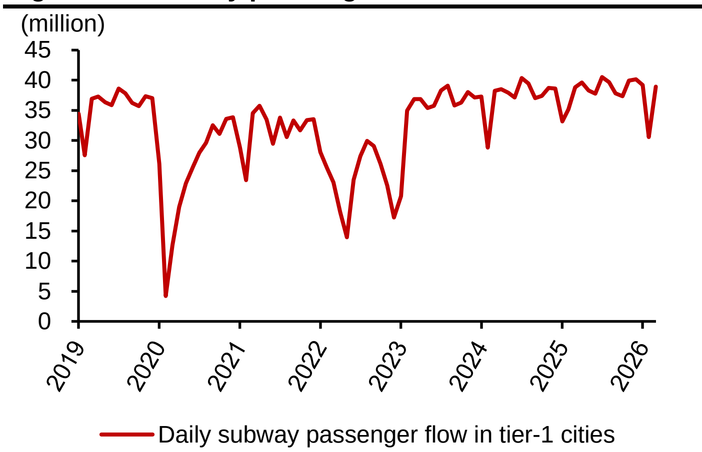
Source: Wind, CMBIGM

Figure 25: Used vehicle sales in Shanghai market



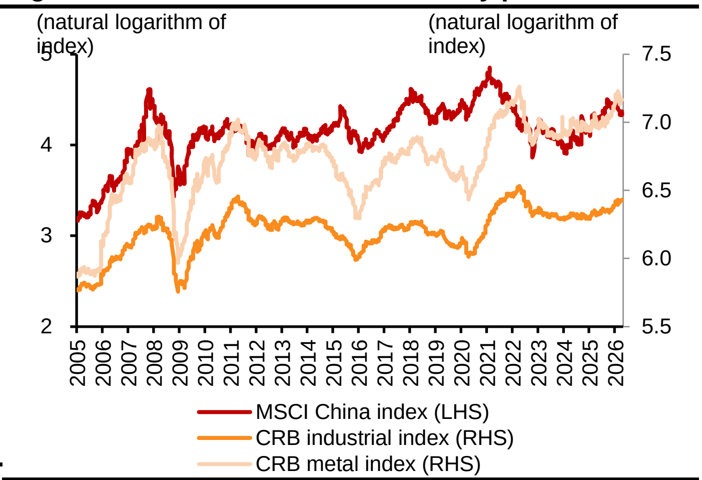
Source: Wind, CMBIGM

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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