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China Economy

Weak 2Q growth points to accommodative policy stance in 2H

China's economy lost momentum as real GDP growth slowed to 4.3% YoY in 2Q26, the weakest pace since 2022, while the GDP deflator turned positive at 1.5% after 12 negative quarters as deflation pressure eased. The increasingly K-shaped growth structure has not been sufficient to sustain overall resilience, as export strength and AI-related industrial production failed to offset weakening consumption and the continued property downturn. The weak 2Q print increases the odds of a pro-growth signal at the July Politburo meeting and more accommodative policy stance in 2H26 in our view, but the package will probably remain targeted, as GDP needs to grow by only 4.3% on average in 2H26 to meet the annual growth target's lower bound of 4.5%. We expect policymakers to continue prioritizing supply-side support, particularly AI development, technological self-reliance in strategic sectors and competitiveness in the global technology race, while providing moderate demand-side support through property stabilization, faster infrastructure execution and measures to strengthen household incomes. We expect the 2026 GDP to moderate to 4.6% (revised down from 4.7% previously) from 5% in 2025, dragged by demand payback following the trade-in subsidies, property-related fiscal stress at the local-government level, and persistently weak household income and employment expectations.

- **Growth slowed in 2Q, while the GDP deflator turned positive.** Real GDP growth eased to 4.3% YoY in 2Q26 from 5.0% in 1Q26, missing market expectations at 4.5%, while sequential growth slowed to 0.9% QoQ from 1.3%. The moderation was broad-based, as 2Q averages for industrial output, services and retail sales growth slowed to 4.6%, 4.5% and 0.2%, respectively, from 6.1%, 5.1% and 2.4% in 1Q26, while investment contracted sharply. The GDP deflator rose to 1.5% in 2Q26 from -0.1%, ending 12 quarters of economy-wide deflation, which should help revenue and debt servicing, but it is not broad reflation as consumer demand remained soft and the price impulse was concentrated in energy and upstream goods. As global commodities prices started their declining trends in June, we may see moderating price momentum in the 2H26 weighing on corporate profits and deflation pressure.
- **Property weakness extended while tier-1 cities rebounded.** Gross floor area sold fell 11.6% YTD in June from 10.8% in May, while new starts and completed area further declined 23.4% and 23.7% YTD, confirming that the improvement earlier in the year was not durable. The 30-city sales recovery rate dropped to 32.4% of the 2018-2019 average in the first half of July from 46.5% in June. Tier-1 cities saw a notable rebound in YoY sales in July at 29.7%, as wealth effect from the AI frenzy disproportionately benefited higher-income households. Lower-tier cities, however, saw bigger dips in July, at -14.4% and -21.6% in tier-2 and -3 cities. Second-hand transactions remained resilient, increasing by 10.5% YoY in the first half of July after rising 12.8% in June, yet existing-home prices fell 0.3% MoM. Tier-1 cities continued to see price rebounds in both new and second-hand housing while lower-tier cities continued to dip. Tier-1 stabilization masks lower-tier price declines that erode household wealth and local land revenue. We expect further policy support in 2H26 in completing projects, stabilizing liquidity by purchases of excess inventory, and fixing balance-sheet damages by stabilizing housing prices through mortgage easing and fee reduction.
- **Consumption remained soft despite a June bounce.** Retail sales rose 1.0% YoY in June after falling 0.6% in May, beating market expectations at 0.1%, but average 2Q growth was only 0.2% versus 2.4% in 1Q26. June

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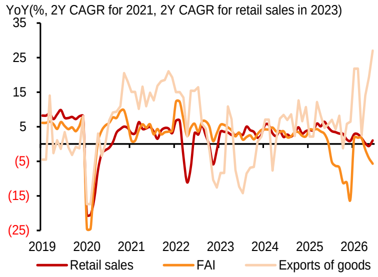
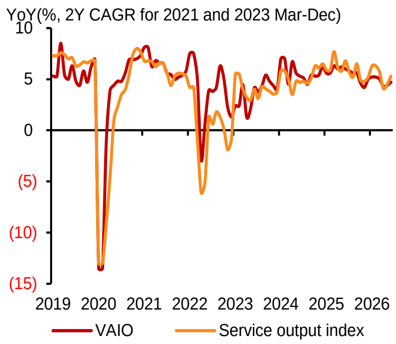


Source: Wind, CMBIGM



Source: Wind, CMBIGM

real retail growth was near zero using CPI as a rough deflator. Catering grew 1.2%, while home appliances, furniture, building materials and autos fell 8.7%, 6.6%, 10.5% and 16.1% as impacts of trade-in subsidies faded. Telecom and office equipment rebounded by 16.5% and 12.7%, but base effects and higher chip prices likely exaggerated the real-volume improvement. H1 real per-capita income rose 4.2%, versus only 2.7% growth in real consumption expenditure, while savings remained high and consumer confidence slipped to 89.5 in June. Looking forward, we expect consumption to remain muted as sustainable recovery requires household-income support, service-sector job creation and credible property stabilization rather than another temporary trade-in subsidy.

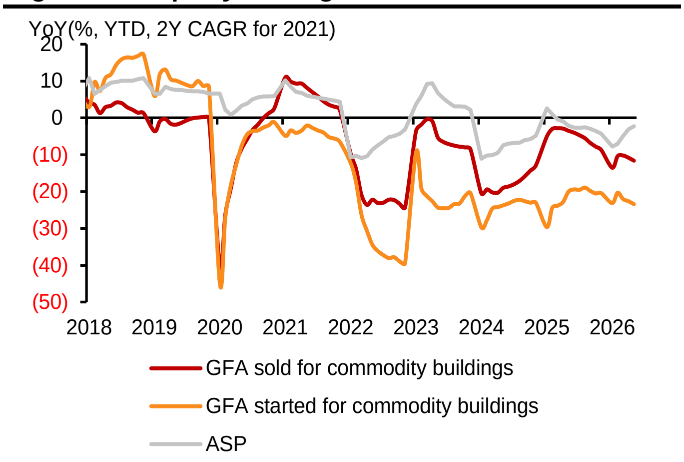
- **Investment contraction became the key downside drag.** Urban FAI fell 5.7% YTD in June after dropping 4.1% in May, while its monthly YoY remained at -10% in June. Manufacturing, infrastructure and property investment fell roughly 3.2%, 10.2% and 24.2% in June respectively. Weaknesses among both state-controlled and private firms show that both fiscal and market-led investment remained subdued. The manufacturing sectors showed divergence, as other transport equipment and computers/electronics rose 24.7% and 6.5% YTD, while autos, special equipment and food manufacturing fell 4.2%, 8.6% and 8.1%. Strong exports alongside contracting manufacturing capex suggest firms doubt the durability of external demand, while efforts to curb excess capacity may also restrain investment. Infrastructure weakness due to property-related local fiscal stress and moderating government debt financing may improve in 2H26 as government bond issuance picked up in June.
- **Industrial output regained momentum, led by export-facing manufacturing.** Value-added industrial output rose 5.3% YoY in June from 4.5% in May. Manufacturing accelerated to 6.0% and export delivery value rose to 14.8%, confirming that external demand remains the main anchor. Transport equipment excluding autos, computers/electronics, special equipment and general equipment grew 18.2%, 15.7%, 10.0% and 9.9%. Yet high-tech strength is narrower than it looks, as integrated-circuit output rose 18.8% while export volumes were broadly flat, and surging auto exports could not offset the larger domestic sales contraction. Construction-linked sectors remained weak, with non-metallic minerals down 2.3%, chemicals flat and non-ferrous metals down 3.8%. These showed a sectoral K-shape as AI-, equipment- and export-linked producers are outperforming property, consumer-facing and traditional industries. Looking forward, we estimate that industry output should continue to outperform, but exposure to trade friction, excess capacity and weaker global demand is rising.
- **Policy support is likely to build a floor instead of broad-based stimulus.** The weak 2Q print increases the odds of a pro-growth signal at the July Politburo meeting and more accommodative policy stance in 2H26, but the package will probably remain targeted, as GDP needs to grow by only 4.3% on average in 2H26 to meet the annual growth target's lower bound of 4.5%.The latest consumption plan under the 15th Five-Year Plan also points to limited policy scope on impactful demand-side stimulus, as its 2030 target of RMB60tn social retail sales implies a modest 3.7% annual growth rate, only slightly above the 3.3% post-pandemic pace. We expect policymakers to remain focused on supply-side support, particularly for AI development, technological self-reliance in strategic sectors and global technological competition, while providing moderate demand-side easing through property stabilization, faster infrastructure execution, and measures to support household incomes. We expect China's 2026 GDP growth to moderate to 4.6%, with a 4.4-4.7% range. Upside would require accelerated fiscal spending, property sector stabilization, and improving consumption while downside risks are renewed deflation pressure, lower-tier property sector weakness and export normalization.

Figure 1: China's economic indicators

YoY(%)	2020-2021 CAGR	2022-2023 CAGR	2024	2025	3Q25	4Q25	1Q26	2Q26	May	June
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	5.3
-Mining	2.9	4.8	3.1	5.6	5.5	5.4	6.0	1.3	2.3	(2.2)
-Manufacturing	6.6	4.0	6.1	6.4	6.4	5.1	6.4	4.8	4.4	6.0
-Public utility	6.6	4.6	5.3	2.3	2.1	3.5	4.3	6.8	7.6	7.4
Delivery value for exports	8.3	0.7	5.1	2.2	2.0	1.0	7.1	11.3	10.1	14.8
Service output index	6.3	3.9	5.2	5.5	5.7	4.6	5.1	4.5	4.4	4.7
Retail sales	4.0	3.4	3.5	3.7	3.4	1.7	2.4	0.2	(0.6)	1.0
Exports of goods	15.9	0.3	5.8	5.4	6.5	3.8	14.7	20.2	19.4	27.0
Imports of goods	13.7	(2.4)	1.0	0.2	4.7	3.6	23.2	29.5	27.4	36.0
Urban FAI (YTD)	3.9	4.0	3.2	(3.8)	(0.5)	(3.8)	1.7	(5.7)	(4.1)	(5.7)
-Property development	5.7	(9.8)	(10.6)	(17.2)	(13.9)	(17.2)	(11.2)	(18.0)	(16.2)	(18.0)
-Manufacturing	5.4	7.8	9.2	0.6	4.0	0.6	4.1	(1.2)	(0.4)	(1.2)
-Infrastructure	1.8	9.9	9.2	(1.5)	3.3	(1.5)	9.2	(2.4)	0.8	(2.4)
GFA sold for commodity building (YTD)	2.2	(16.8)	(12.9)	(8.7)	(5.5)	(8.7)	(10.4)	(11.6)	(10.8)	(11.6)
GFA started for commodity building (YTD)	(6.4)	(30.5)	(23.0)	(20.4)	(18.9)	(20.4)	(20.3)	(23.4)	(22.6)	(23.4)

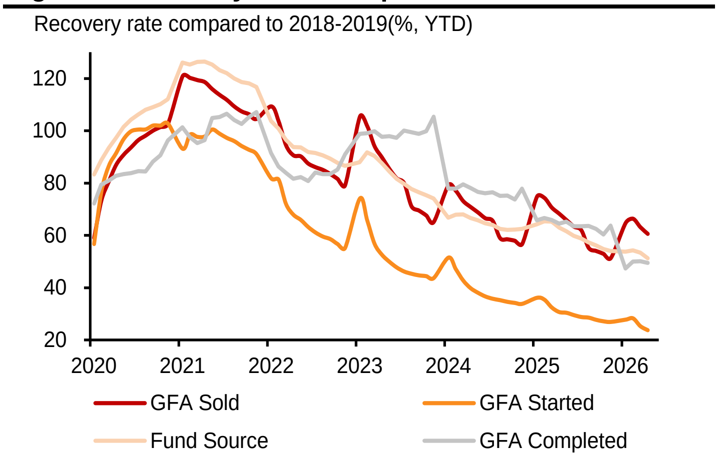
Source: Wind, CMBIGM

Figure 2: Property sales growth



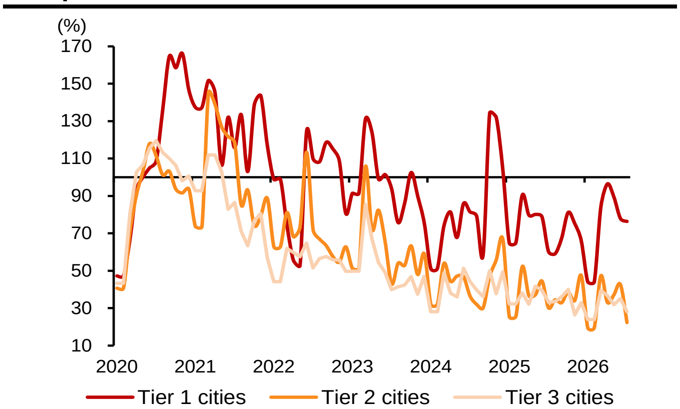
Source: Wind, CMBIGM

Figure 3: Recovery rates compared to 2018-2019



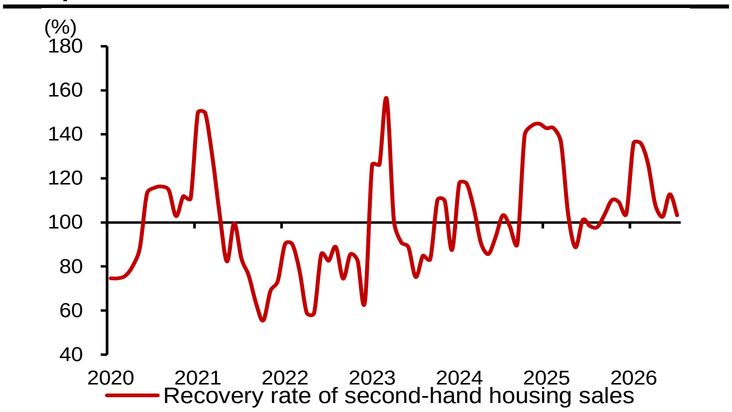
Source: Wind, CMBIGM

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



Source: Wind, CMBIGM

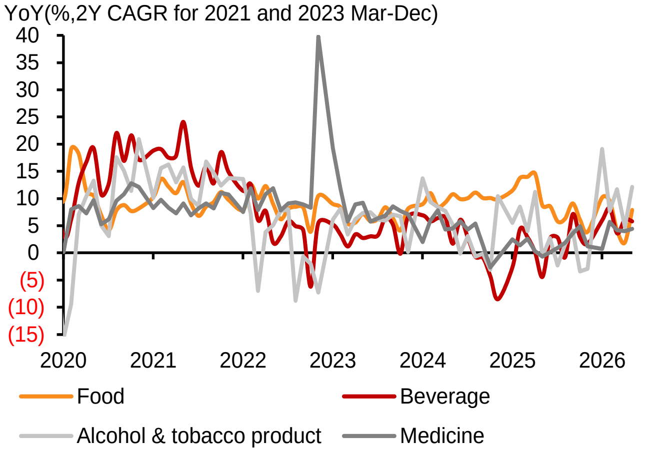
Figure 5: Recovery rate of second-hand housing sales compared to 2019 in 11 selective cities



Source: Wind, CMBIGM

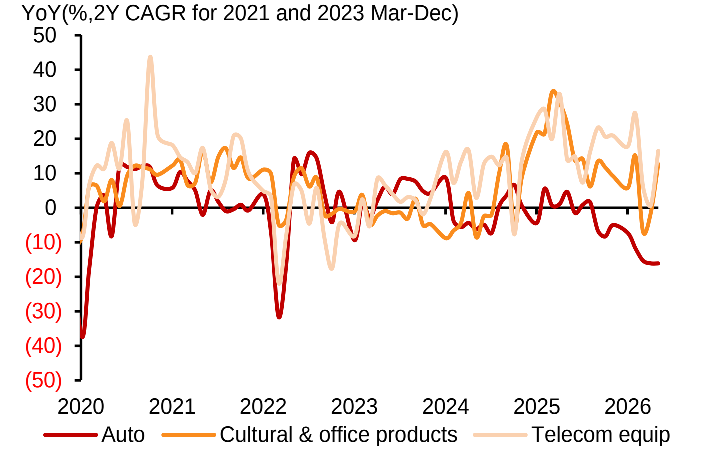
Note: The 11 cities include Beijing, Shenzhen, Hangzhou, Nanjing, Chengdu, Qingdao, Suzhou, Xiamen, Wuxi, Dongguan and Foshan

Figure 6: Retail sales of staples



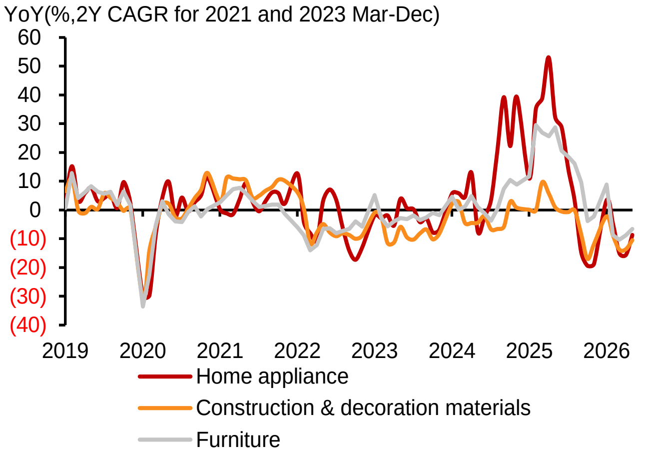
Source: Wind, CMBIGM

Figure 7: Retail sales of auto & electronics



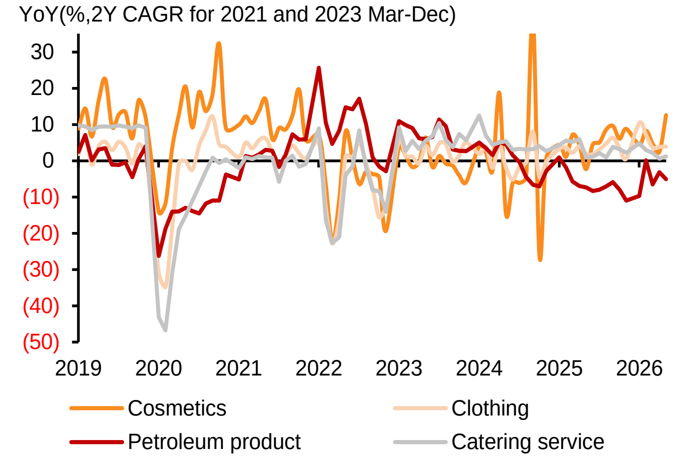
Source: Wind, CMBIGM

Figure 8: Home appliance & furniture retail sales



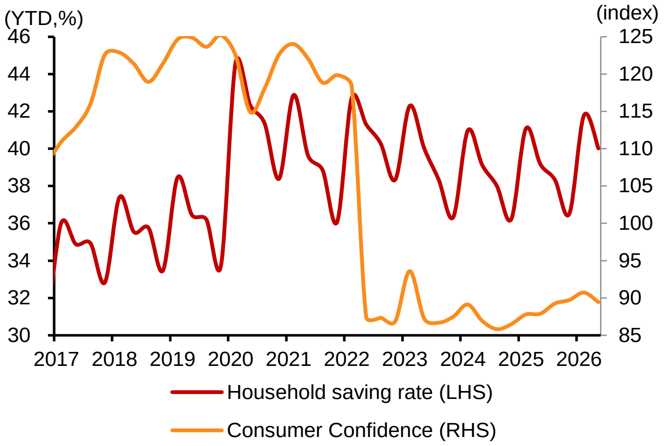
Source: Wind, CMBIGM

Figure 9: Retail sales related to outgoing activities



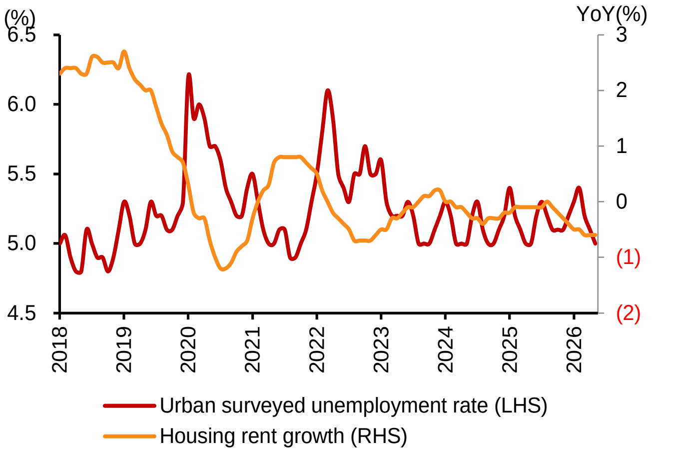
Source: Wind, CMBIGM

Figure 10: Consumer confidence



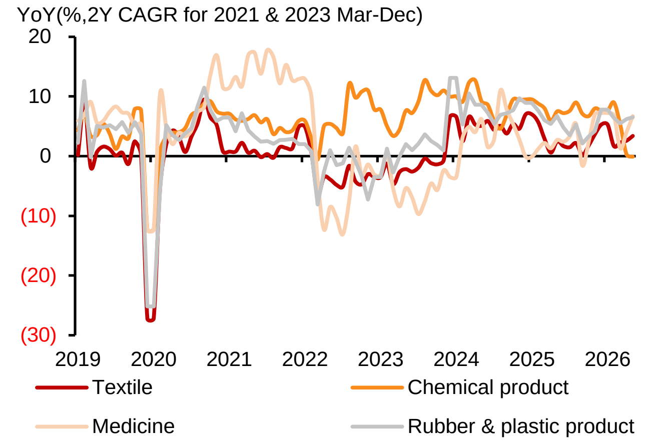
Source: Wind, CMBIGM

Figure 11: Urban unemployment rate & housing rent



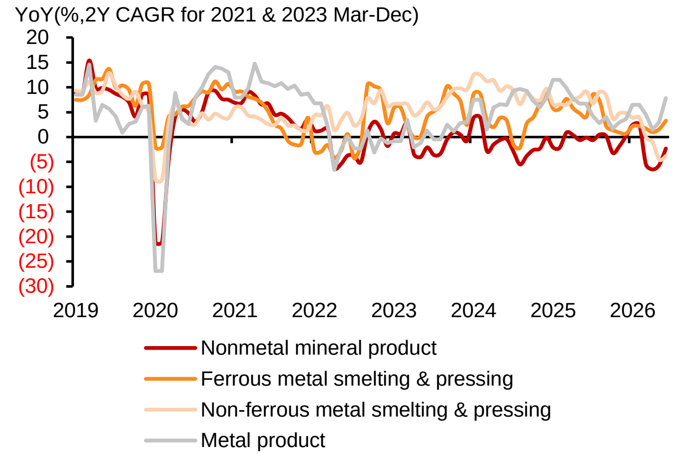
Source: Wind, CMBIGM

Figure 12: VAIO in textile & chemical products



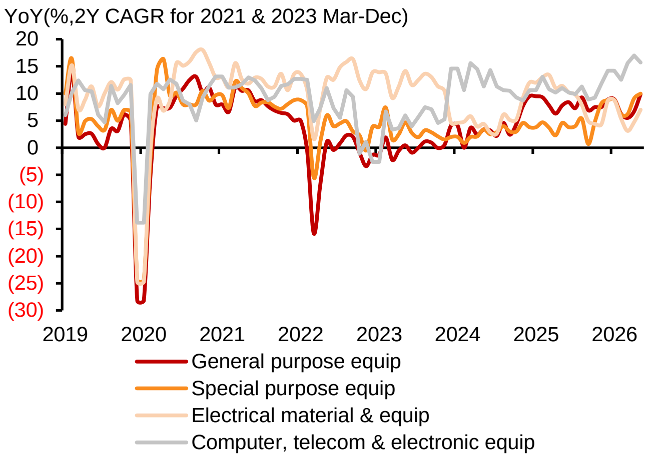
Source: Wind, CMBIGM

Figure 13:VAIO in mineral & metal products



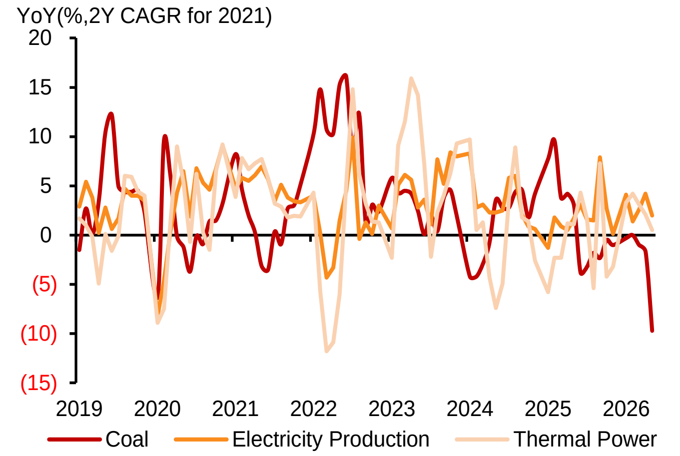
Source: Wind, CMBIGM

Figure 14: VAIO in equipment



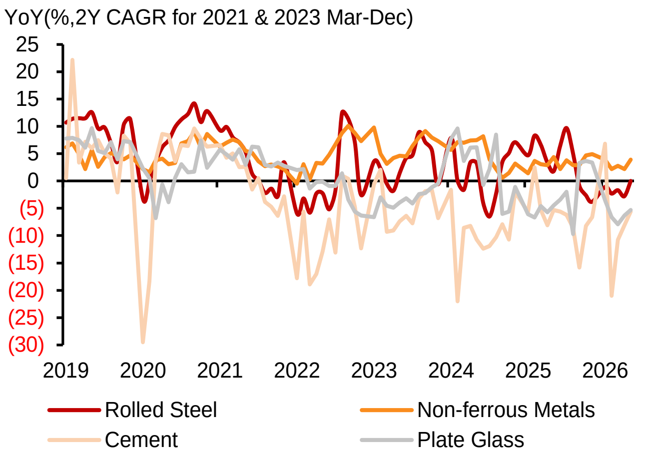
Source: Wind, CMBIGM

Figure 15: Output in energy and electricity



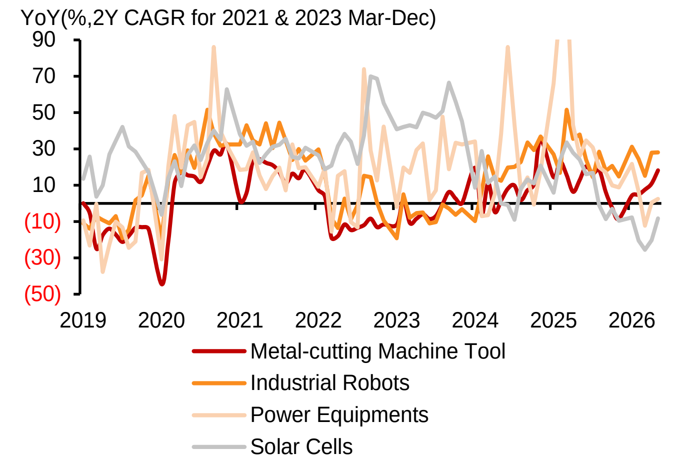
Source: Wind, CMBIGM

Figure 16: Output in steel & construction materials



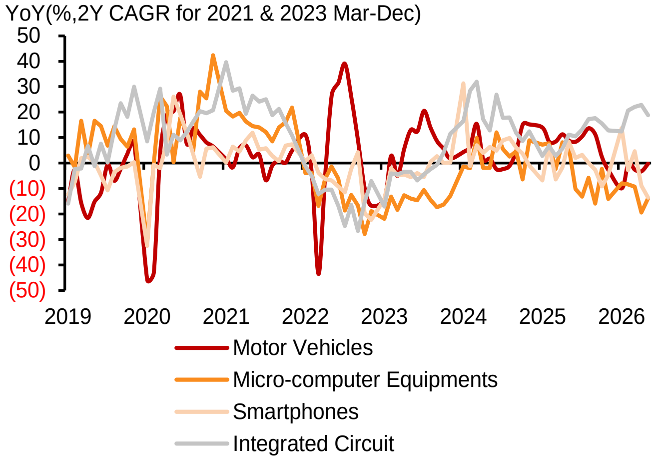
Source: Wind, CMBIGM

Figure 17: Output in capital goods



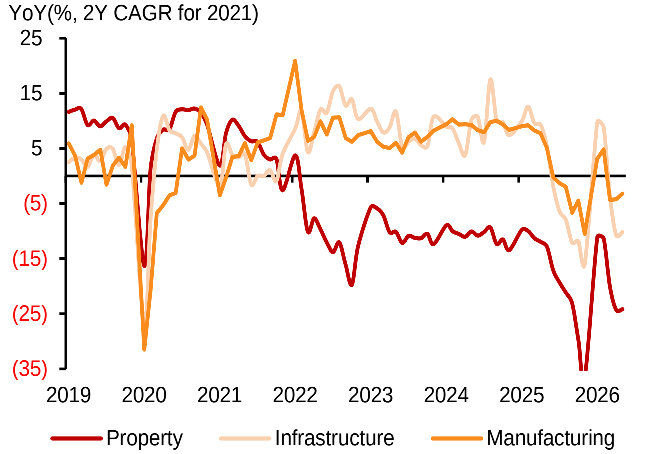
Source: Wind, CMBIGM

Figure 18:Output in auto, computer & smartphone



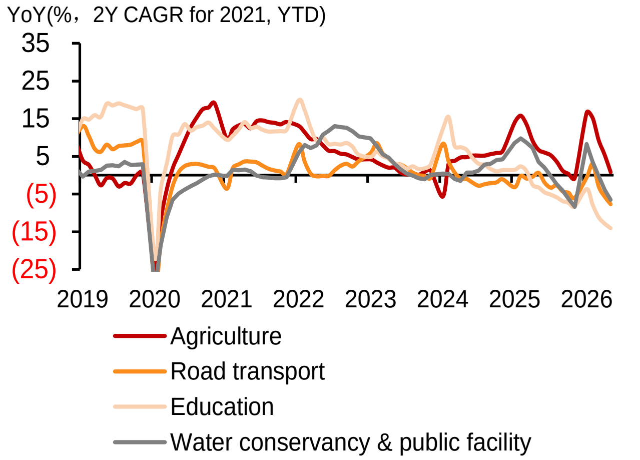
Source: Wind, CMBIGM

Figure 19: FAI by sector



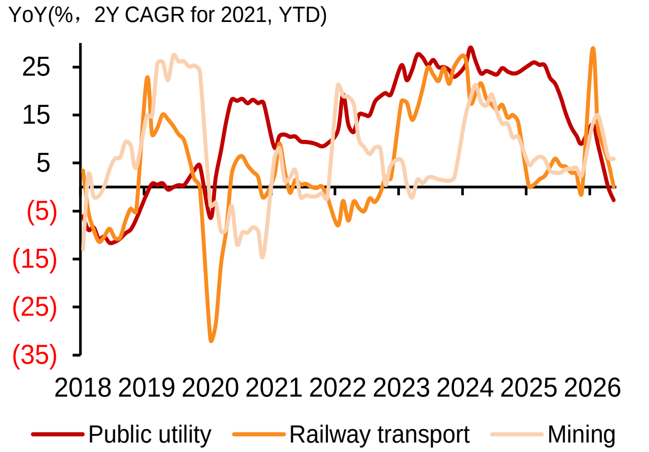
Source: Wind, CMBIGM

Figure 20: FAI in agriculture & local infrastructure



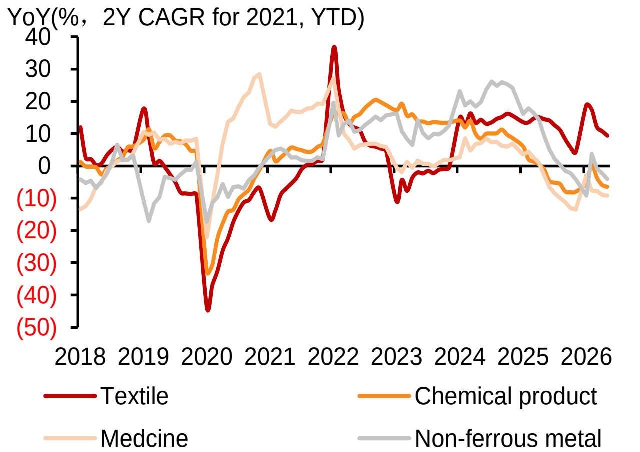
Source: Wind, CMBIGM

Figure 21: FAI in central infrastructure & mining



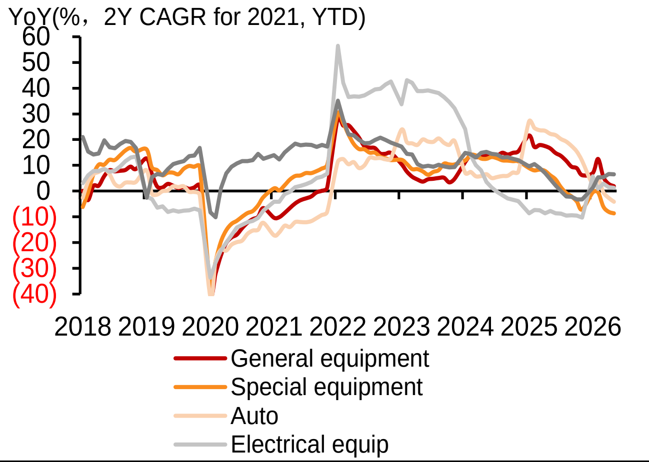
Source: Wind, CMBIGM

Figure 22: FAI in chemical products



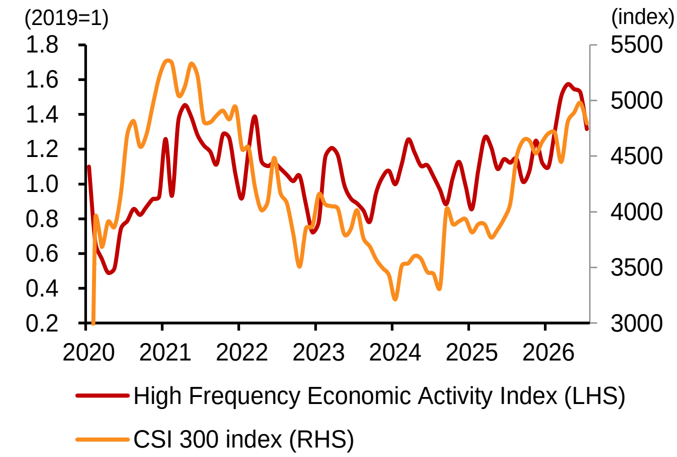
Source: Wind, CMBIGM

Figure 23: FAI in equipment



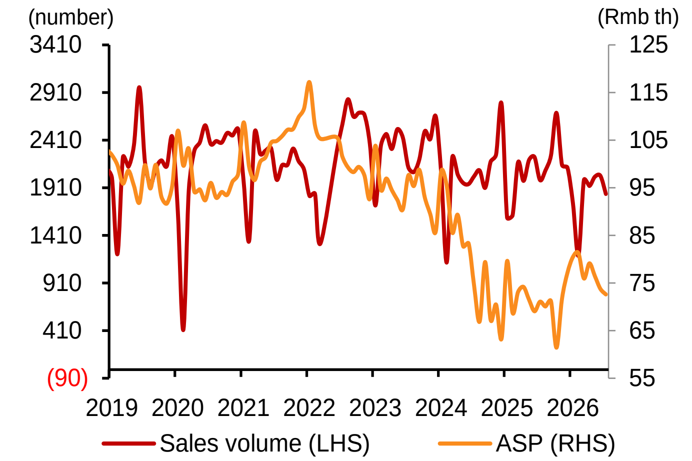
Source: Wind, CMBIGM

Figure 24: Economic activity & A-share index



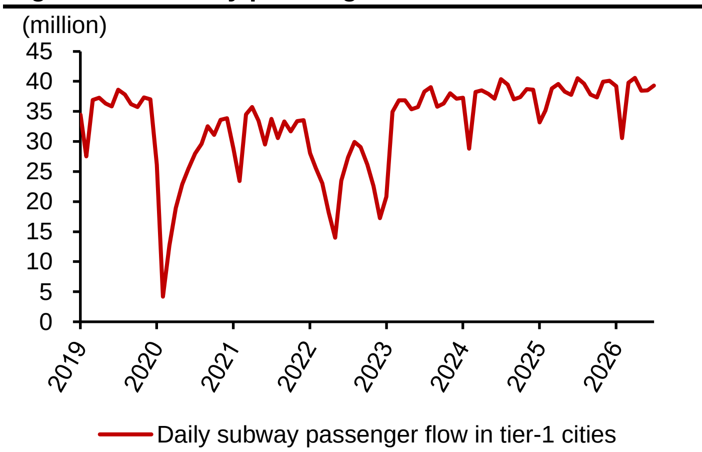
Source: Wind, CMBIGM

Figure 25: Used vehicle sales in Shanghai market



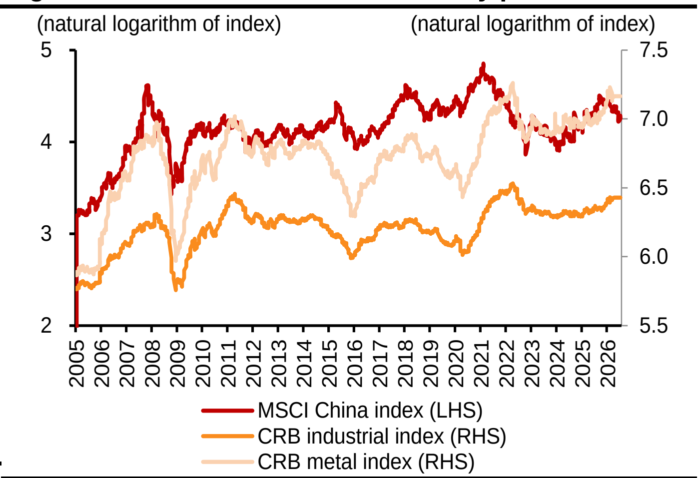
Source: Wind, CMBIGM

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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