CHINA MACRO MONITOR

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China: persistent structural challenges, partly cushioned by strong exports

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As the contributions of consumption and investment erode, resilient external trade partly offsets the slowdown. Domestic demand stays weak, but the external constraint has eased: the US-China tariff truce, the move up the value chain and outbound FDI extend the reprieve. The 2026 inflation rebound owes mainly to the Middle East war, though 'anti-involution' measures have eased price wars and overcapacity; deflationary pressures nonetheless remain entrenched. Property weakness still compounds soft consumption. The question is no longer whether external support will hold, but whether China will use it to fund a genuine demand reform, or merely to defer it.

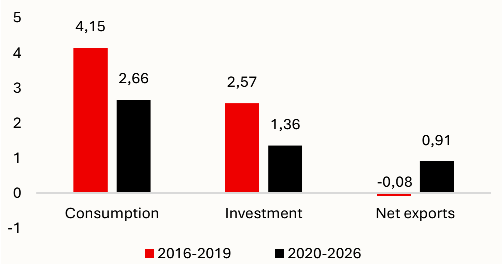
REAL GDP YoY	CPI YoY	PPI YoY	MFG PMI	PBoC LPR 1Y
+4.3%	**+0.5%**	**+3.5%**	**49.2**	**3.00%**
2026-Q2	JUL 2026	JUL 2026	JUL 2026	JUL 2026

1. A structurally more moderate growth regime

Chinese growth now runs at a structurally slower pace than in past decades. The old engines: a young and abundant workforce, rapid urbanisation, heavy investment and integration into world markets, have faded. The working-age population is shrinking, rural migration is slowing and high debt limits investment capacity.

Rather than a genuine pivot to consumption, Beijing accelerates the move up the value chain, while defending a large trade surplus. Exports thus offset part of the domestic weakness: net exports now add to growth but do not recover the points lost on consumption and investment (Graph 1). Should the external engine falter, nothing internal can currently take over.

Graph 1: Exports partially offset domestic weaknesses
% points contribution to growth

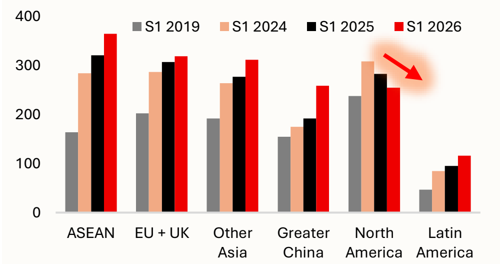


Source : NBS

2. External trade: from exporting to investing abroad

In 2026, the US-China truce brought tariffs back down from their April 2025 peaks, easing the external constraint. Exports proved resilient: their geographic reorientation more than offsets the drop in US-bound sales (Graph 2), and the mix keeps shifting toward higher value-added goods (electricals and electronics, shipbuilding, nuclear, cars).

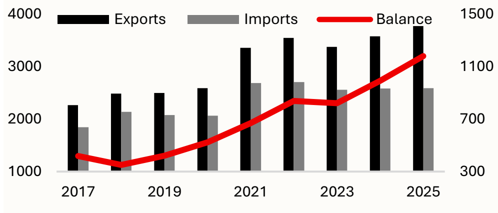
Graph 2: China shifts away from the US
Bn USD Exports



Source : GACC

Yet the record surplus is also high because imports are flat (Graph 3). Consequently, the external balance measures the weakness of Chinese demand as much as the strength of its supply. Moreover, in H1 2026 import values rose faster than exports (+26.6% vs +17.6% YoY) on the Middle East war, even as crude volumes imports fell. China pays more to import less, and Q2 2026 growth slowed to 4.3%, a three-year low.

Graph 3: A record surplus built on flat imports
bn USD, Exports & Imports LHS and Balance RHS



Source : GACC

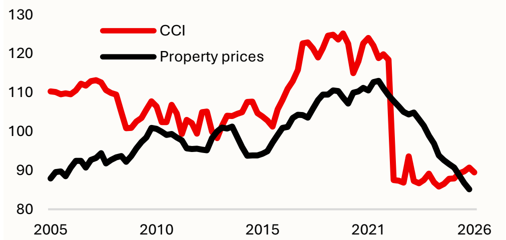
The model still looks fragile. As Chinese goods flood world markets, partners tighten barriers, and the rerouting channel is narrowing as US duties cover almost all origins. Faced with these barriers, the most durable adaptation runs through outbound FDI. Chinese groups increasingly produce in host countries, bypassing tariffs and offloading excess capacity. This prolongs the supply-side model without solving the domestic-demand deficit.

3. Property and domestic demand: why has nothing taken over?

The contraction in property market deepened in 2026. The hit passes into local finances. Indeed, collapsing land-sale revenues cut governments' main resources and their capacity to support demand. Households also feel negative wealth effects, with property at 50-60% of their assets.

These pressures compound heavy structural constraints. Household consumption has stalled near 40% of GDP for almost two decades. A thin safety net, limited public transfers, and high precautionary saving explain why rebalancing has not materialised.

Graph 4: Property drags on consumer confidence
Indexes



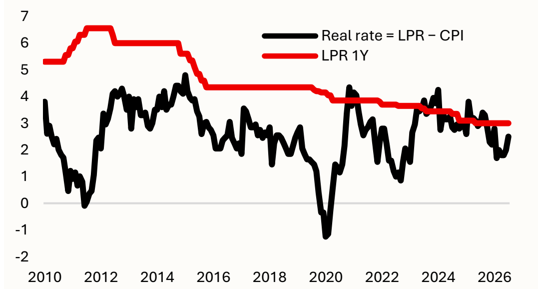
Source : FRED

4. Policy response: financing the transition or deferring it?

For now Beijing favours external markets. Indeed, global demand on the price-quality trade-off is real, and overcapacity has to be cleared. The 15th Five-Year Plan endorses this, centering technological self-reliance (integrated circuits, aerospace, biomedicine, low-altitude economy, quantum, 6G); consumption measures feature but are small next to the problem.

Fiscal stance is nominally expansionary but the land-revenue constraint holds back local spending. The PBoC stays moderately accommodative: the 1Y LPR has sat at 3.0% for over a year, a historical low, and the bank holds back as the price rebound cuts urgency and yuan stability remains a goal.

Graph 5: Policy rate held at historical low
%



Source : BIS

With poorly remunerated deposits, low real incomes and Hukou-gated public services, one-off transfers feed saving and debt repayment more than consumption. But despite the apparent urgency, a deep reform of demand would have damaging side effects. A rise in wages would squeeze the margins of exporting manufacturers, a higher return on savings would raise the cost of credit, and opening the Hukou would saddle cities with social spending at the very moment their land revenues have vanished.

IN CONCLUSION *China manages its imbalances through supply and externalisation. These buffers hold but do not replace a real reform of domestic demand: will Beijing use them to fund the transition, or merely defer it?*