KPMG

China Economic Monitor

Issue: 2026 Q2

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Key takeaways

- China's economy made a strong start to 2026, supported by front-loaded policy easing and resilient external demand. Real GDP grew 5.0% year-on-year (YoY) in Q1, accelerating by 0.5 percentage points from Q4 2025 and reaching the upper bound of the official '4.5%–5.0%' growth target range set at the annual "Two Sessions." Two structural developments stood out at the start of the year. First, improving domestic supply-demand conditions contributed to a recovery in nominal growth. Second, the transition from traditional to new growth drivers accelerated further.
- On the consumption side, retail sales of consumer goods grew 2.4% YoY in Q1, up 0.8 percentage points from the previous quarter. Consumption recovered gradually, supported by a combination of policy measures, including holiday consumption vouchers issued by local governments, cultural and tourism promotion campaigns, and a new round of trade-in programs. Both goods and services consumption showed signs of improvement.
- Supported by resilient global manufacturing activity, exports grew 14.7% YoY in Q1, 10.9 percentage points higher than the previous quarter. Export growth strengthened across both emerging markets and traditional trading partners. Strong global demand related to the AI supply chain and the energy transition boosted exports of related products. However, the external environment remains challenging. A further escalation of tensions in the Middle East could keep energy prices elevated, weighing on global growth and creating headwinds for China's exports.
- Industrial production maintained solid momentum, and grew 6.1% YoY in Q1, slightly above the 5.9% growth recorded in Q4 2025. Strong exports supported production in sectors such as integrated circuits, while high-tech manufacturing output rose 12.5% amid faster development of new growth drivers. Holiday-related demand also boosted consumer goods production, and geopolitical tensions in the Middle East contributed to faster domestic oil and gas output.
- Investment activity showed signs of stabilisation. Fixed asset investment grew 1.7% YoY in Q1, recovering from a 12.8% contraction in Q4 2025 and outperforming the 3.8% decline recorded for 2025 as a whole. Front-loaded fiscal support accelerated infrastructure project launches and equipment investment. Infrastructure and manufacturing investment growth rose to 8.9% and 4.1%, respectively, helping overall investment stabilise and supporting the broader recovery. Real estate investment remained weak, declining 11.2% YoY, although the pace of contraction narrowed significantly from Q4 2025.
- Looking ahead, geopolitical volatility will continue to pose uncertainties for China's growth outlook. The April Politburo meeting called for stronger confidence and more supportive policy to address external shocks. Going forward, policymakers are expected to make full use of existing policy measures, strengthen domestic demand, optimise supply structures, and better balance development and security.

Growth strengthens as domestic rebalancing and new growth drivers gain traction

Growth rate of major economic indicators, YoY, %

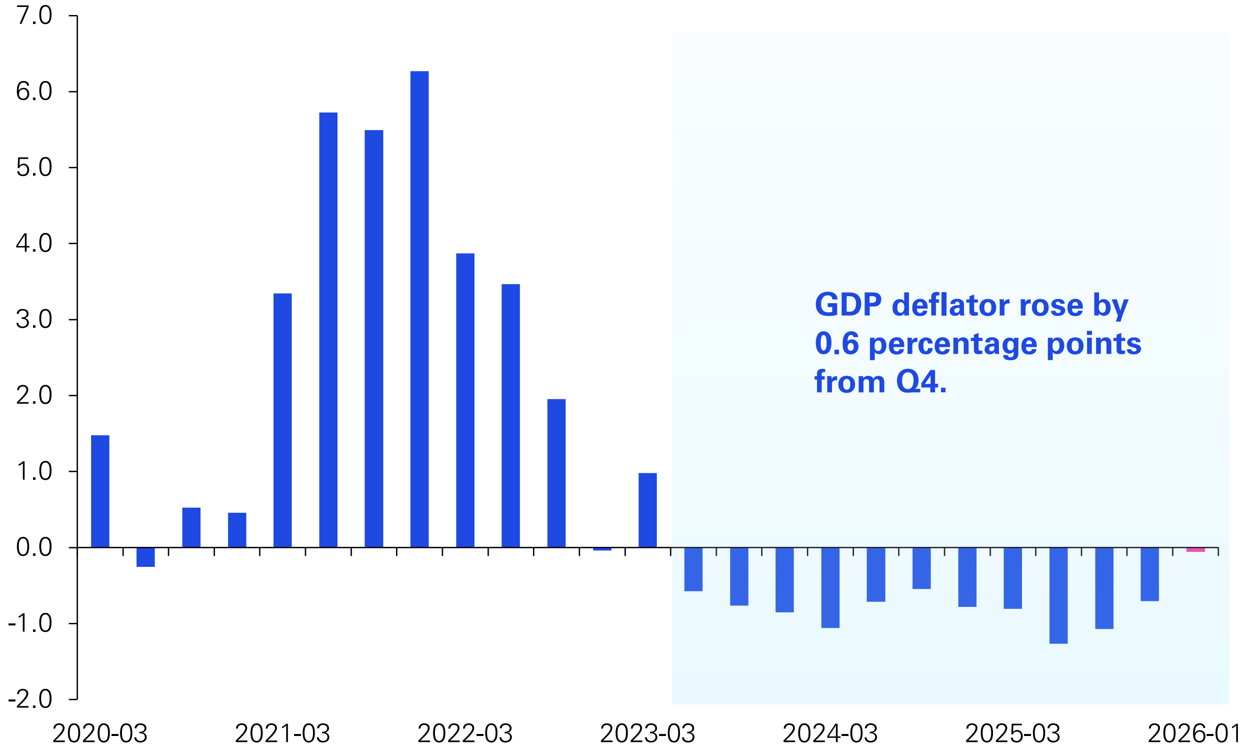
	2020-23 Average	2024 Q4	2025 Q1	2025 Q2	2025 Q3	2025 Q4	2026 Q1
GDP	4.8%	5.4%	5.4%	5.2%	4.8%	4.5%	5.0%
Industrial production	5.1%	5.7%	6.5%	6.4%	6.2%	5.9%	6.1%
Retail sales	3.7%	4.0%	4.6%	5.4%	3.5%	1.6%	2.4%
Fixed asset investment	4.0%	2.6%	4.2%	2.1%	-6.2%	-12.8%	1.7%
Exports	7.8%	9.9%	5.7%	6.2%	6.5%	3.8%	14.7%
Imports	5.3%	-1.8%	-7.0%	-0.8%	4.6%	3.1%	22.7%
Income per capita	4.8%	5.3%	5.6%	5.3%	5.1%	5.0%	4.9%
Fiscal revenue	4.6%	13.1%	-1.1%	0.6%	2.5%	-7.9%	2.4%
Fiscal expenditures	3.7%	8.0%	4.2%	2.6%	2.4%	-4.2%	2.6%

Source: Wind, KPMG analysis
Note: GDP growth, industrial production, and income per capita are in real terms, other indicators are in nominal terms.

- China's economy made a solid start to the year. Two structural trends stood out in Q1 2026. First, improving domestic supply-demand dynamics supported a recovery in nominal growth. Nominal GDP growth accelerated from 3.8% in Q4 2025 to 4.9%, while the GDP deflator approached zero growth for the first time in 12 quarters. Externally, rising global oil prices amid tensions in the Middle East contributed to a moderate pickup in domestic inflation, with PPI turning positive in March for the first time in 41 months.
- Second, the shift toward new growth drivers accelerated. High-tech industries outperformed the broader economy in both investment and production growth, with the artificial intelligence, aerospace, and biopharmaceuticals sectors showing strong momentum.
- Overall, Q1 growth improved in both pace and quality, with domestic rebalancing and the expansion of new growth drivers laying a firm foundation for high-quality growth.

Nominal growth improves despite persistent downside risks

GDP deflator, YoY, %

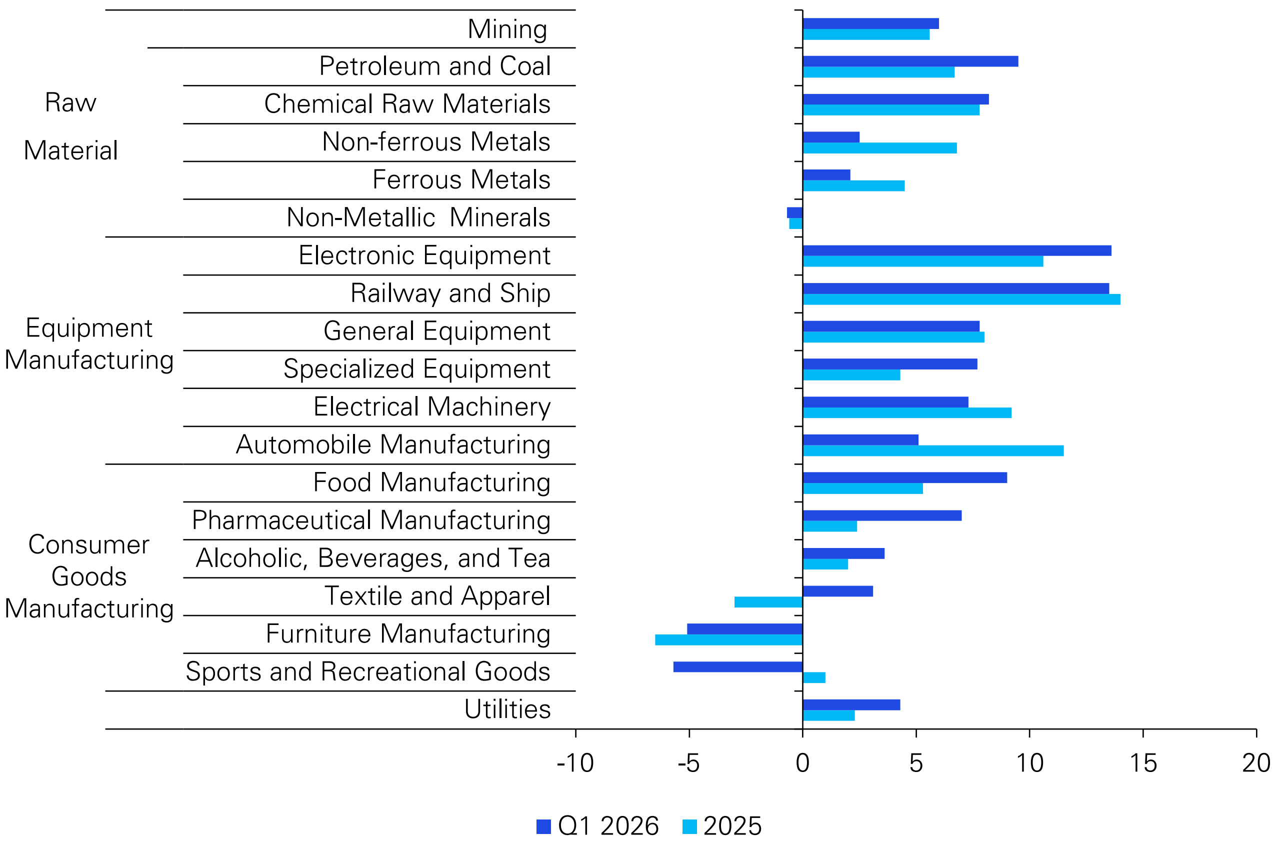


Source: Wind, KPMG analysis

- Major economic indicators outperformed expectations in Q1, while nominal growth recovered rapidly. The GDP deflator improved to -0.06% in Q1 2026, up 0.6 percentage points from Q4 2025.
- However, growth still faces several headwinds. Escalating tensions in the Middle East could drive energy prices higher, weighing on global growth, slowing exports, and increasing imported inflation pressures. Domestically, elevated youth unemployment, weak income expectations, and geopolitical uncertainty may continue to weigh on consumption and investment sentiment.
- In response, the April Politburo meeting introduced additional measures to stabilise investment and support consumption. Policymakers emphasised the need to unlock domestic demand potential by expanding the supply of high-quality goods and services, and accelerating upgrades in the services sector, which is expected to support both consumption growth and employment stabilisation.

Exports and high-tech manufacturing support industrial growth momentum

Growth rates of industrial production, by sector, cumulative YoY, %

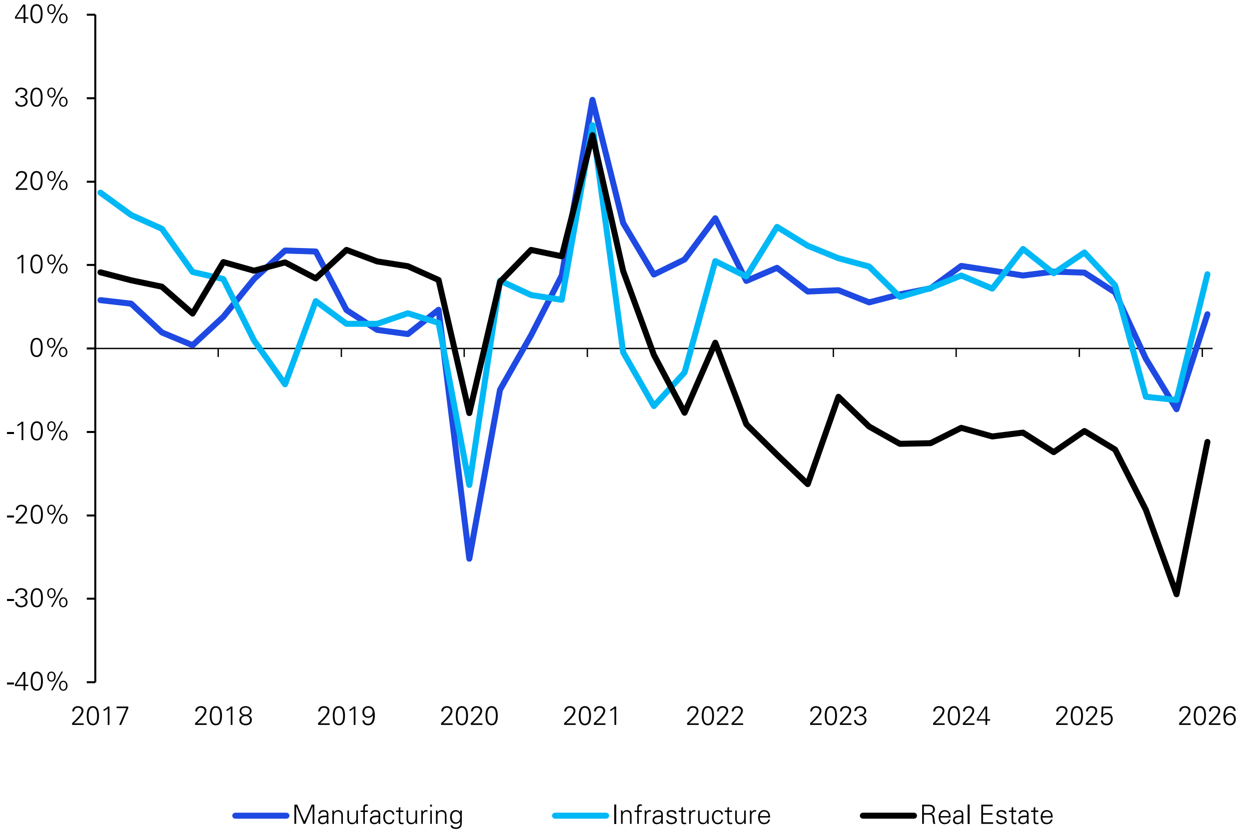


Source: Wind, KPMG analysis

- Industrial production remained resilient in Q1, rising 6.1% YoY, slightly above the 5.9% growth in Q4 2025. The improvement was driven by four factors. First, strong external demand supported production of integrated circuits, smartphones, ships, and automobiles. Second, accelerated development of new growth drivers boosted high-tech manufacturing, with electronic equipment, railway and ship, and pharmaceutical manufacturing rising 13.6%, 13.5%, and 7.0%, respectively. Third, holiday effects supported food, beverage, and textile production. Finally, tensions in the Middle East disrupted global energy and chemical supply chains, lifting domestic output of oil, gas, coal, and chemicals.
- Looking ahead, industrial activity is expected to remain resilient. Export demand should stay supportive amid geopolitical uncertainty and precautionary inventory building, while policy support will continue to underpin high-tech manufacturing. Efforts to strengthen energy security and develop a new energy system may also provide additional growth momentum.

Investment stabilises amid front-loaded policy support

Growth rate of fixed asset investment by sector, quarterly YoY, %

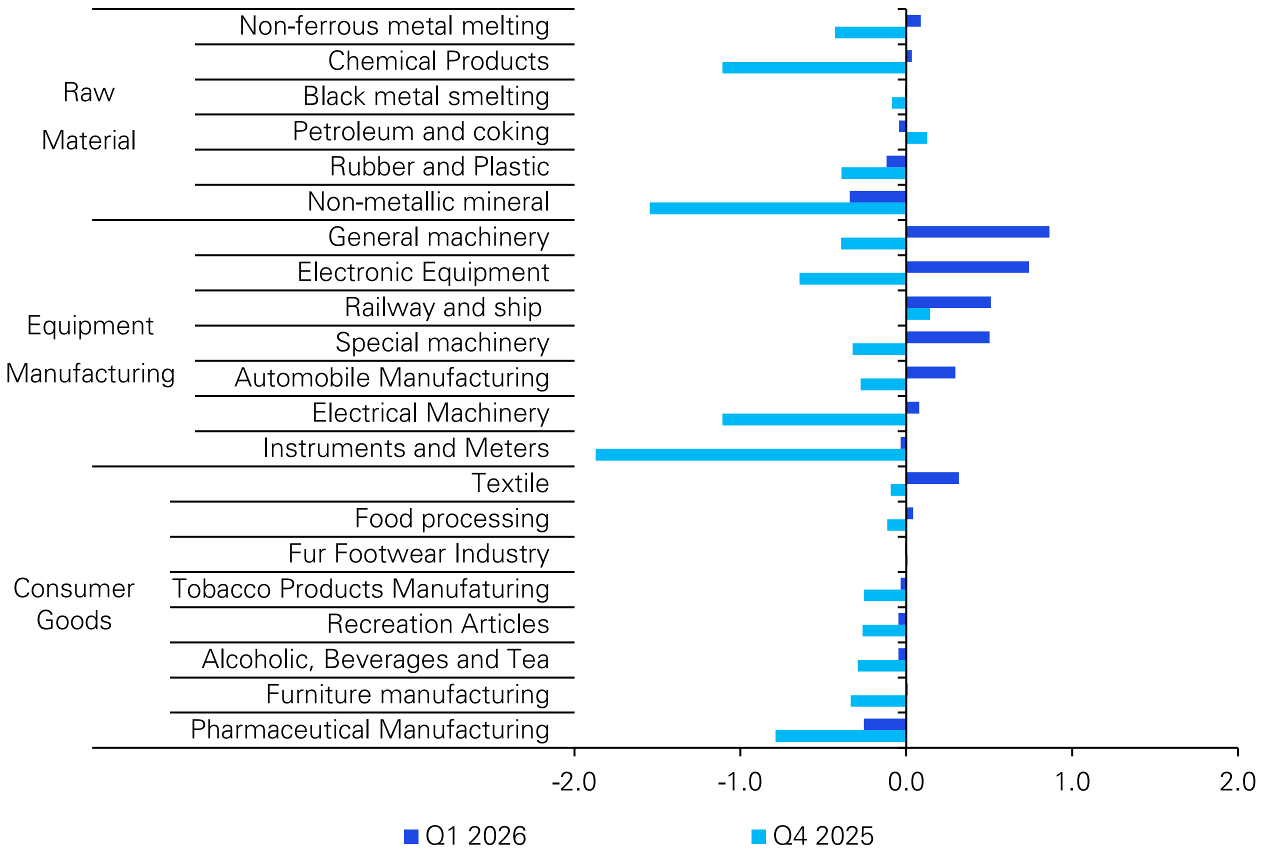


Source: Wind, KPMG analysis

- Fixed asset investment rose 1.7% YoY in Q1, rebounding from -12.8% in Q4 and -3.8% for 2025 as a whole. Three features stand out:
- First, infrastructure investment improved most markedly, rising from -6.2% in Q4 2025 to 8.9% in Q1 2026, outperforming manufacturing (4.1%) and real estate (-11.2%), and providing the main support to overall investment.
- Second, high-tech investment remained strong, up 7.4%, with high-tech services accelerating from 3.5% in 2025 to 12.3%, driven by AI-related expansion.
- Third, private investment remained weak, down 2.2%, while investment by state-owned enterprises increased 23.5%. This divergence reflects financing constraints in private real estate and weaker participation by private firms in major projects and emerging industries, as also indicated by softer manufacturing PMI readings for smaller private firms compared with larger state-owned enterprises.

Manufacturing investment rebounds on equipment upgrades and emerging industries

Contributions to manufacturing investment growth by sector, percentage points

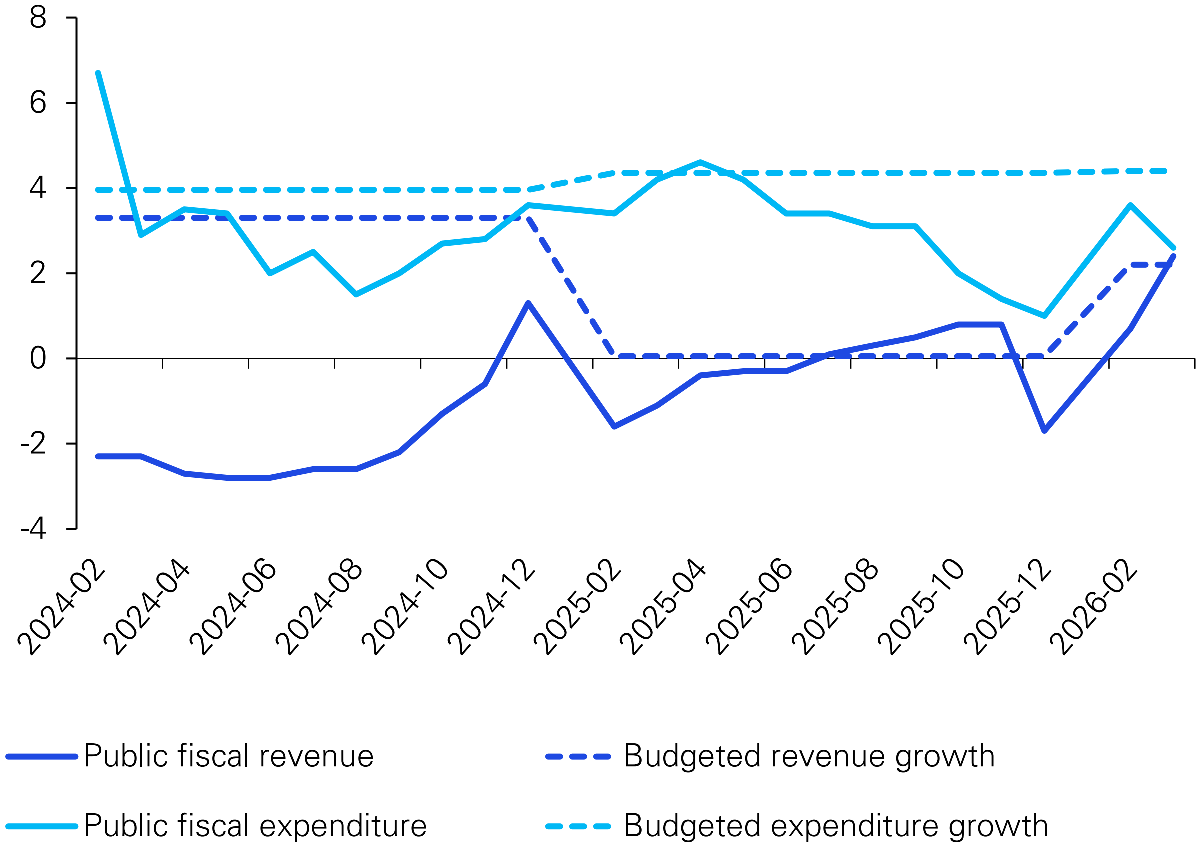


Source: Wind, KPMG analysis

- Manufacturing investment grew 4.1% YoY in Q1 2026, rebounding 11 percentage points from Q4 last year, supported by four factors.
- First, earlier disbursement of equipment renewal funds lifted machinery and equipment investment by 13.9%, driving a recovery in general and specialised equipment investment. Second, policy support and accelerated development of new growth drivers boosted emerging-sector investment. High-tech manufacturing investment rose 5.2%, with electrical machinery, electronic equipment, and railway and ship providing key support. Third, holiday effects strengthened activity in food processing and textiles. Fourth, improved profitability in upstream industries, such as non-ferrous metal and chemical products, supported a recovery in investment sentiment.
- Looking ahead, continued policy support for equipment upgrades and the expansion of emerging industries should help sustain manufacturing investment growth.

Infrastructure investment rebounds as major projects accelerate

Growth of public fiscal revenue and expenditure, cumulative YoY, %

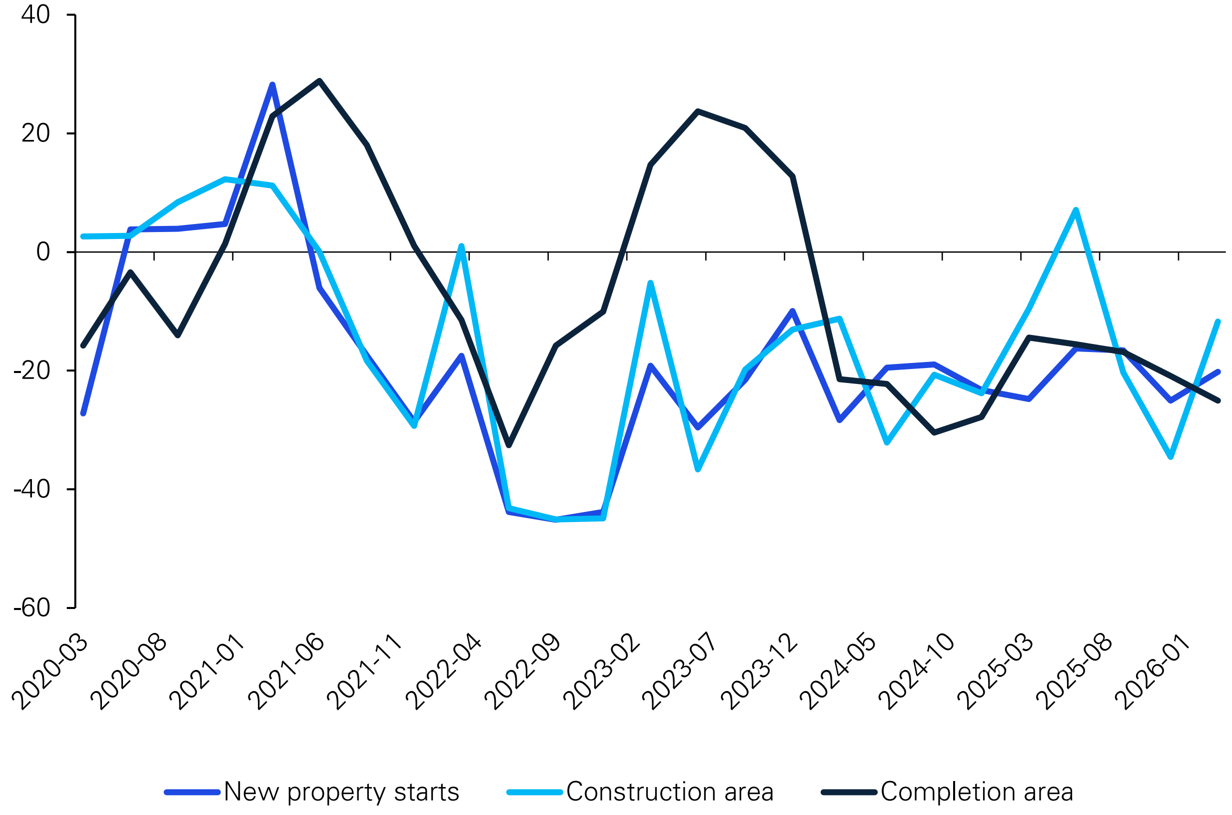


Source: Wind, KPMG analysis

- Infrastructure investment grew 8.9% YoY in Q1, rebounding sharply from -6.3% in Q4 2025, as major projects under the 15th Five-Year Plan accelerated.
- Fiscal conditions also improved notably. Public fiscal revenue returned to positive growth in Q1, supported by stronger economic activity, improved tax collection, resilient imports, and more active capital markets. Fiscal expenditure also accelerated, with spending frontloaded at the start of the year and continuing to prioritise social welfare and public services.
- Looking ahead, infrastructure investment is likely to remain resilient. As a key anchor for domestic demand and investment expectations, infrastructure spending is expected to receive continued policy support through accelerated implementation of major national projects, expanded local government investment capacity, and measures to encourage greater private-sector participation.

Real estate destocking progresses as core housing markets show signs of stabilisation

Real Estate Development Investment by Project Stage, quarterly YoY, %



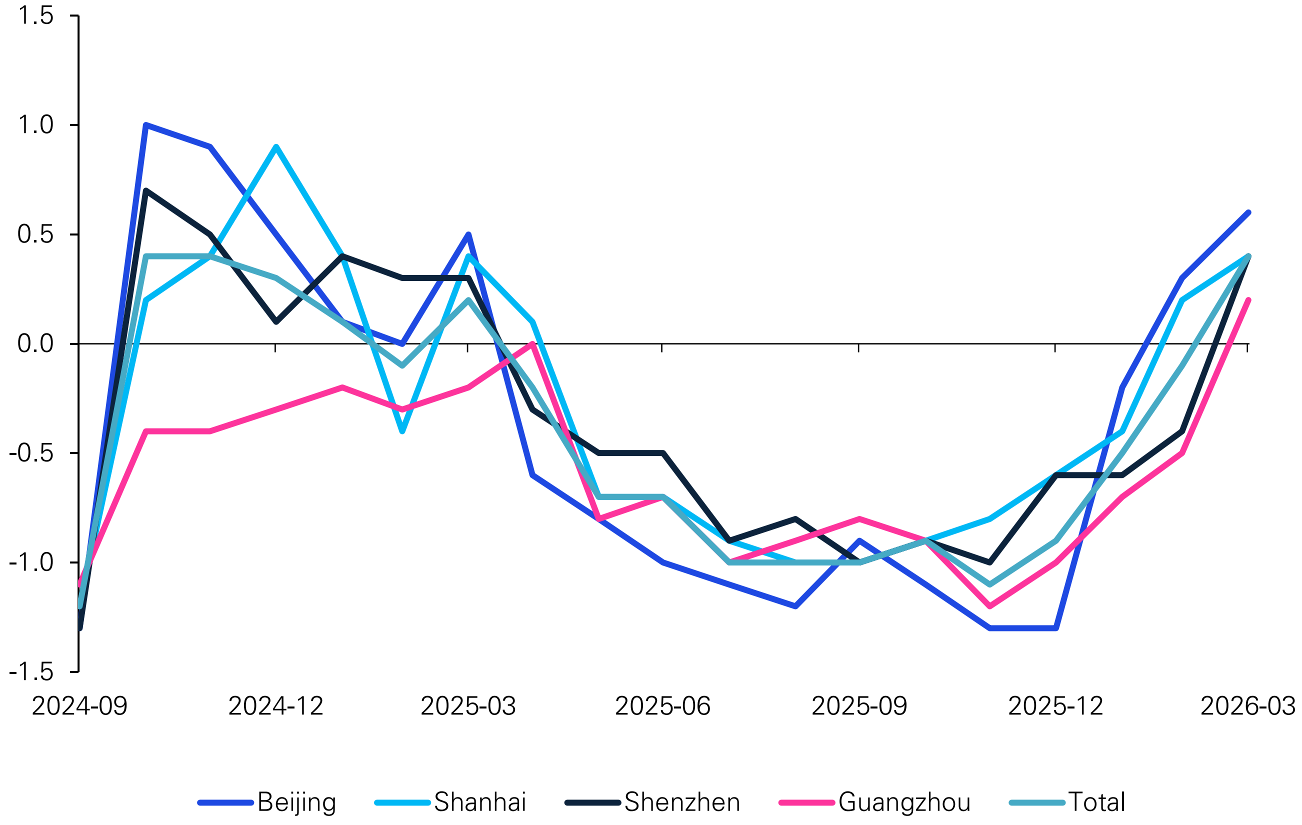
Source: Wind, KPMG analysis

- Real estate investment declined 11.2% YoY in Q1, narrowing significantly from -29.5% in Q4 2025, though remaining below the -9.9% recorded a year earlier. This marked the 16th consecutive quarter of contraction since mid-2022.
- The narrowing decline in real estate investment in Q1 was mainly driven by improving demand conditions. Commercial housing sales area fell 10.4% YoY, improving from -16.9% in Q4 2025. Supported by recovering demand, declines in housing starts and construction activity also narrowed, with new property starts and construction area falling 20% and 12%, respectively.
- Although the property market remained subdued, destocking[1] made further progress. By the end of March, YoY growth in unsold housing inventory had turned negative, indicating that new housing supply had fallen below underlying demand and that developers had entered a phase of inventory reduction.

1 Developers' inventory includes land reserves, projects under construction, and completed but unsold housing units.

Existing home markets in core cities show signs of stabilisation

Existing housing prices in tier-1 cities, MoM, %

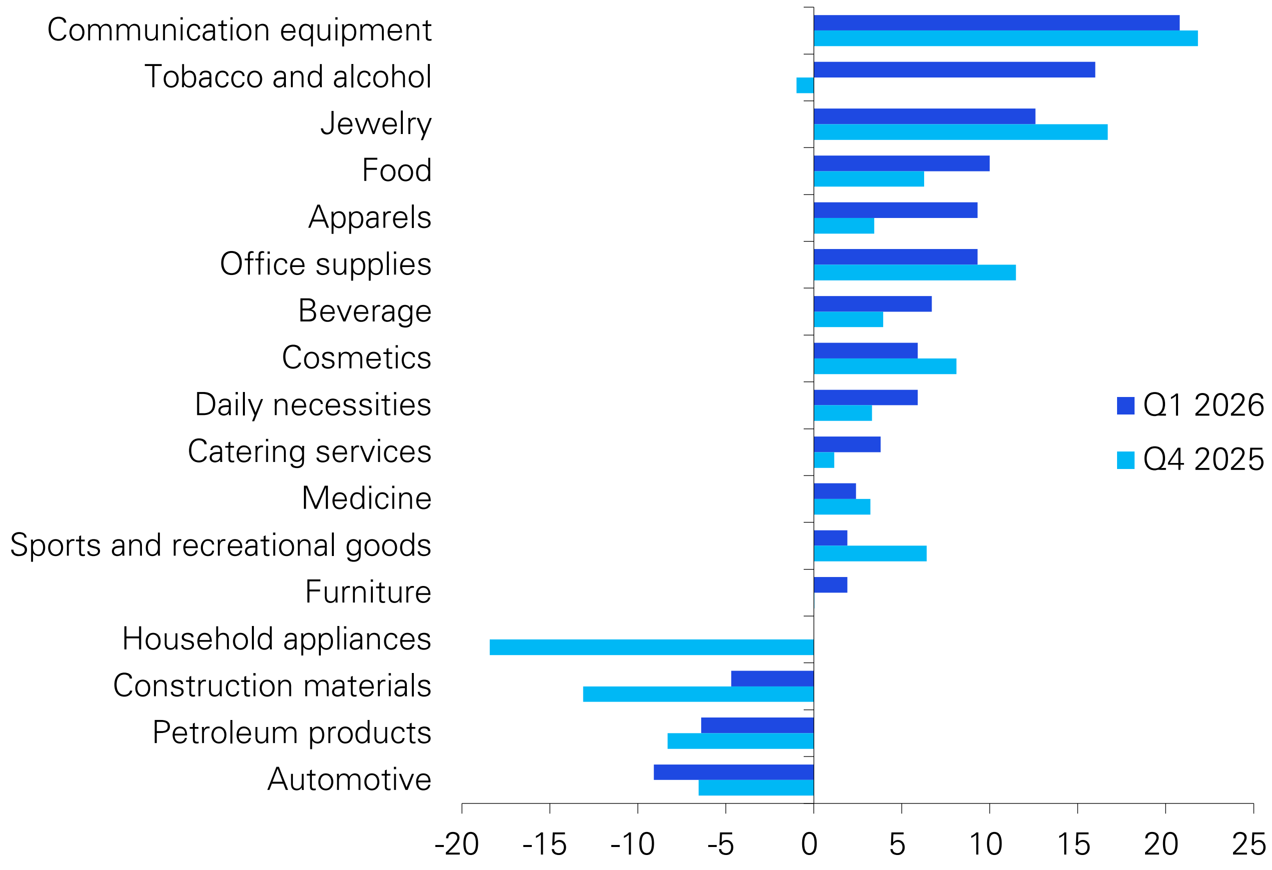


Source: Wind, KPMG analysis

- Since late last year, major cities have continued to ease home purchase restrictions, supporting a recovery in existing home markets. In Q1, existing home transaction volumes in Beijing, Shanghai, Guangzhou, and Shenzhen improved from Q4 levels, while price changes in tier-one cities turned positive MoM in March, with all four cities recording gains. This also helped stabilise new home prices, with tier-one city new home prices rising 0.2% MoM in March.
- Looking ahead, The April Politburo meeting emphasised continued efforts to stabilise the property market. On the supply side, reduced land supply and local government efforts to absorb idle land inventory are likely to keep new housing supply constrained, easing inventory pressures, and lifting developers' investment sentiment. Recent policy guidance suggests the sector is shifting from an expansion-driven model toward one focused on inventory optimisation and urban services, accelerating developers' transition toward integrated urban service providers.

Holiday effects support consumption while underlying recovery remains gradual

Growth rate of goods sales by category, quarterly YoY, %

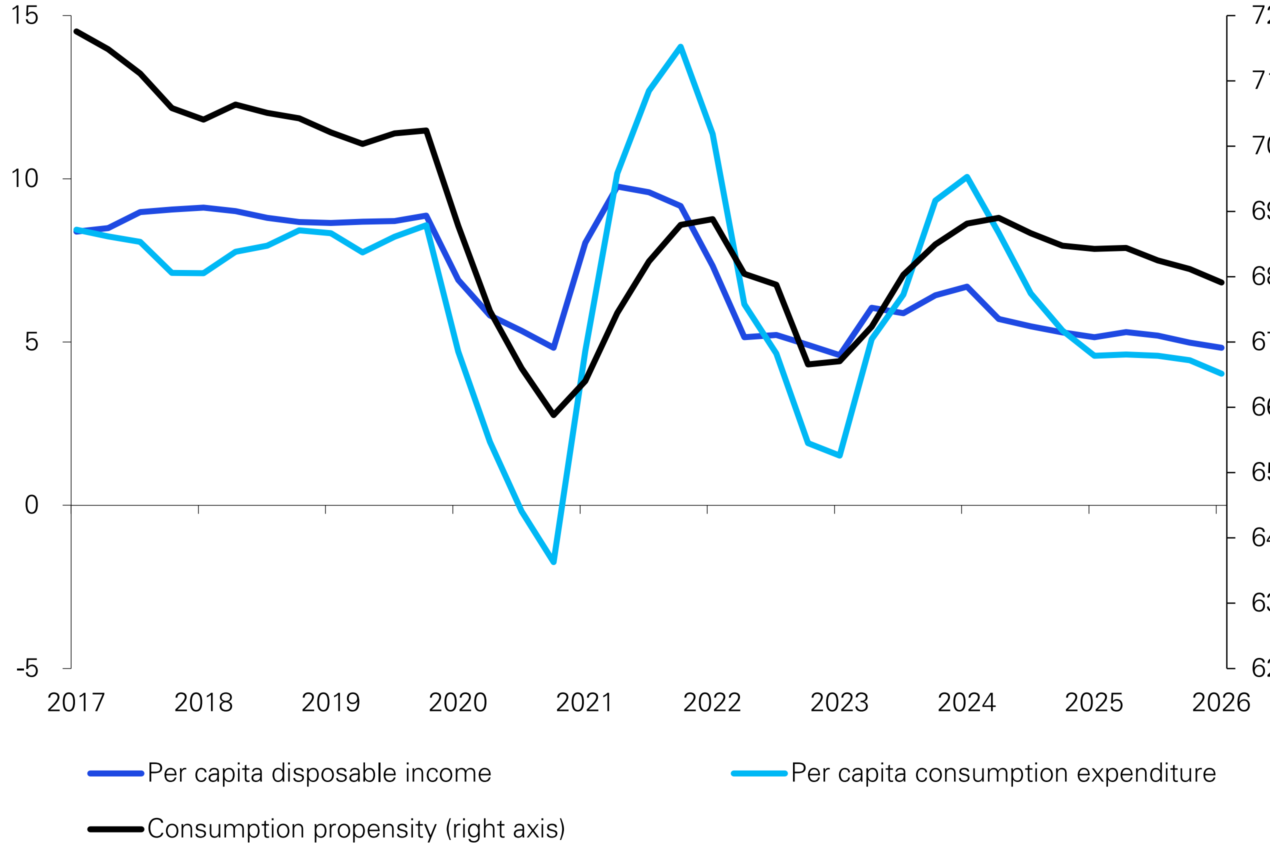


Source: Wind, KPMG analysis.
Note: Goods sales data are for above-size retail enterprises

- Total retail sales of consumer goods rose 2.4% YoY, up 0.8 percentage points from Q4, largely supported by holiday-related spending. Services consumption expanded rapidly, with services retail sales up 5.5%, reflecting both structural upgrading in consumption and the expansion of localised service supply.
- Goods consumption showed mixed trends. It rose 2.2% YoY, supported by steady recovery in non-discretionary consumption and continued upgrading demand, including growth in green consumption. However, the boost from trade-in policies is fading, with sales of automobiles, household appliances, telecom equipment, office supplies, and furniture down 4.4% YoY, dragging retail goods sales growth down by 1.7 percentage points.
- Looking ahead to Q2, the temporary boost from holidays is expected to fade, and consumption recovery will increasingly depend on improvements in employment and income expectations.

Slowing income growth amid labour market pressures

Growth rate of per capita disposable income and consumption expenditure, 4QMA, %

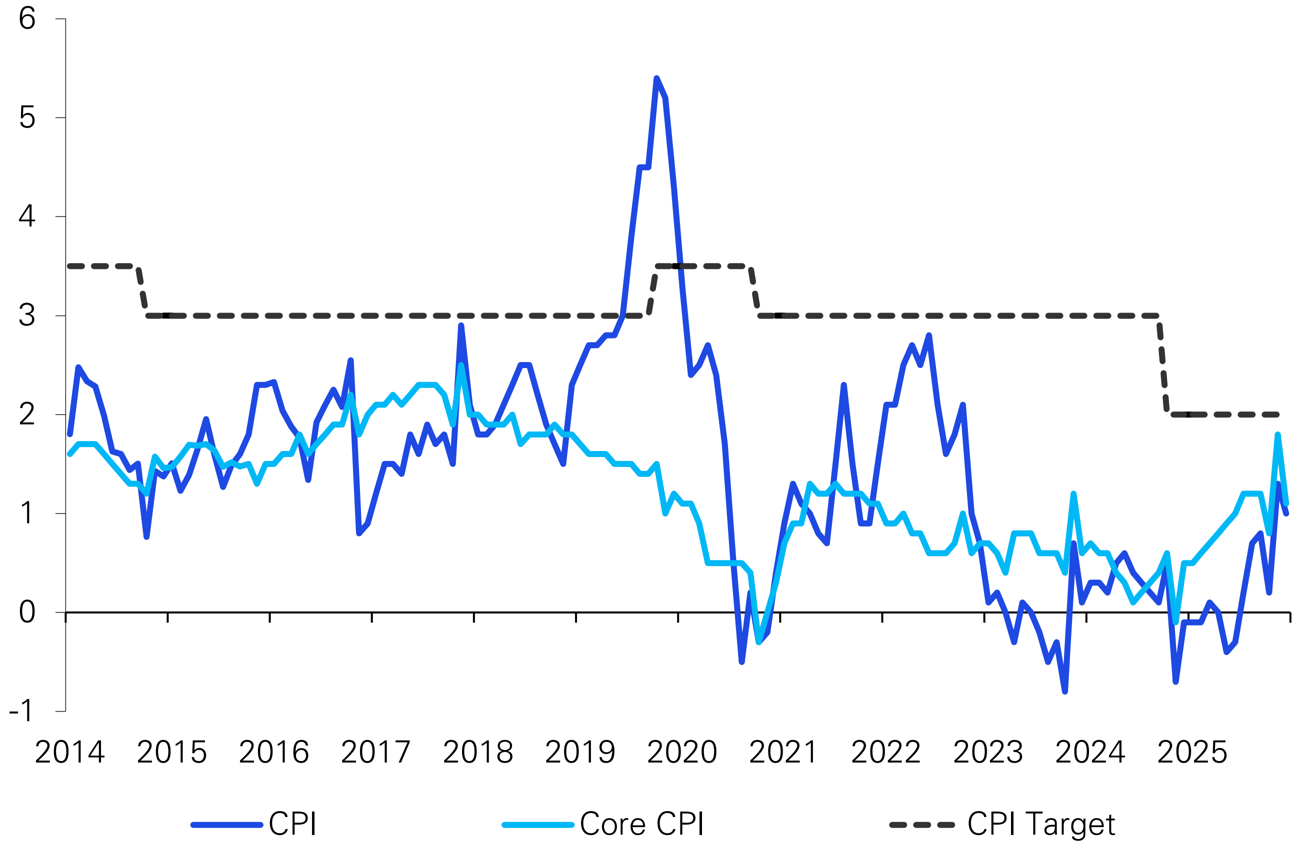


Source: Wind, KPMG analysis
Note: Consumption propensity = per capita disposable income / per capita consumption expenditure

- In Q1, per capita disposable income rose 4.0% in real terms, the lowest level in nearly three years. Labour market pressures persisted, with the unemployment rate rising to 5.4%, a 13-month high, and structural mismatches in employment—particularly for younger workers—becoming more pronounced.
- Against this backdrop, the average propensity to consume fell to 62.2%. Per capita consumption expenditure rose 2.6% in real terms, the weakest since 2023.
- In response, the April Politburo meeting emphasised deepening efforts to unlock domestic demand potential and prioritised the implementation of initiatives to upgrade and expand the services sector. Services sector expansion is seen as both a key driver of consumption and an effective channel to alleviate structural employment pressures.

Inflation rises moderately as supply and demand conditions improve

China consumer price index (CPI), YoY, %

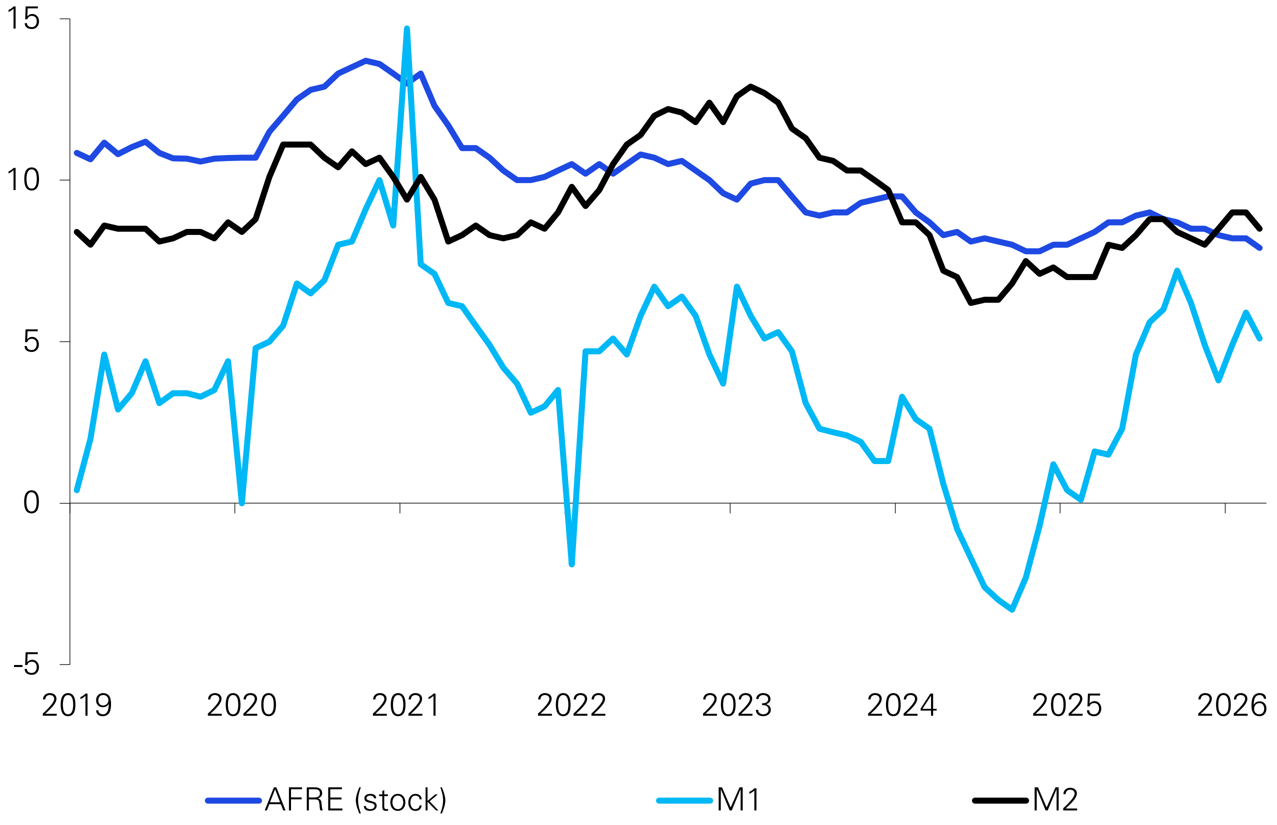


Source: Wind, KPMG analysis

- In Q1 2026, CPI rose 0.9% YoY. The recovery was driven by seasonal consumption during the Chinese New Year, domestic supply-demand adjustments, and external factors including fluctuations in global commodity prices. Core CPI rose 1.2% YoY. In March, CPI increased 1.0% YoY, easing slightly from February, while core CPI remained stable at 1.1%. Food inflation moderated, while energy prices rose on higher international oil prices.
- PPI declined 0.6% YoY in Q1 2026, and turned positive at 0.5% in March, ending a prolonged decline. The rebound was driven mainly by higher global prices for oil and non-ferrous metals, as well as demand from AI-related industries and green transition. However, the recovery remains largely cost-driven, with limited support from domestic demand. Upstream profitability improved, while downstream sectors remained under pressure from weak final demand and incomplete pass-through costs. The outlook remains sensitive to external geopolitical conditions and the pace of domestic recovery.

Monetary-fiscal coordination supports steady financial expansion and real economy financing

Growth rate of AFRE (stock), M1, and M2, YoY, %



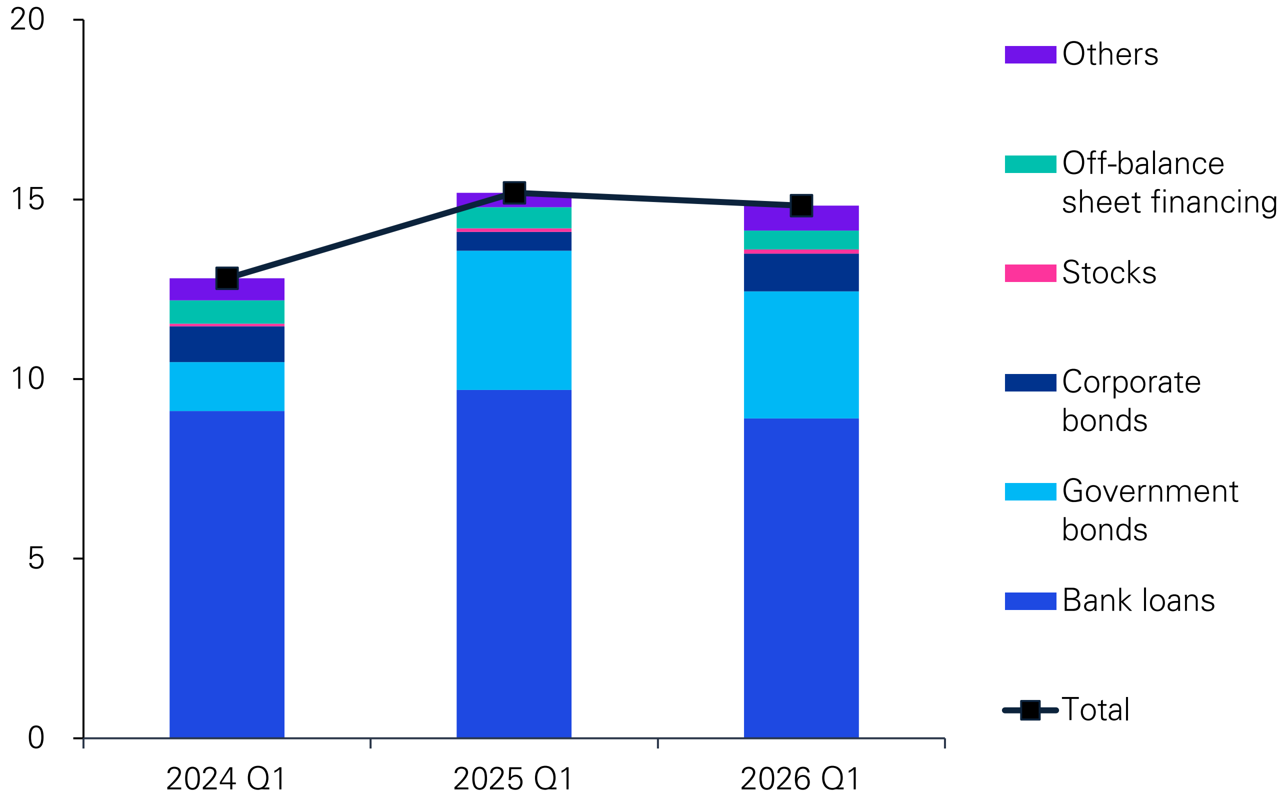
Source: Wind, KPMG analysis

- Aggregate financing reached RMB 14.8 trillion, remaining at a high historical level and grew 7.9% YoY, down 0.4 percentage points from end-2025. In March, M2 and M1 rose YoY by 8.5% and 5.1% respectively, narrowing the M1–M2 gap to 3.4 percentage points, indicating improved business activity and higher fund turnover efficiency, with liquidity conditions in the real economy continuing to improve.

- The 2026 Government Work Report emphasised aligning monetary aggregates with growth and inflation objectives, with GDP growth targeted at 4.5–5.0% and CPI around 2%. Overall, Q1 growth in social financing and M2 remained above the implied nominal GDP growth range of 6.5–7.0 %, maintaining a reasonable 1–2 percentage point premium. This supports growth and price recovery while avoiding excessive liquidity expansion, reflecting a moderately accommodative monetary stance.

Government bonds support social financing growth

Growth of total social financing (TSF) by sector, RMB trillion

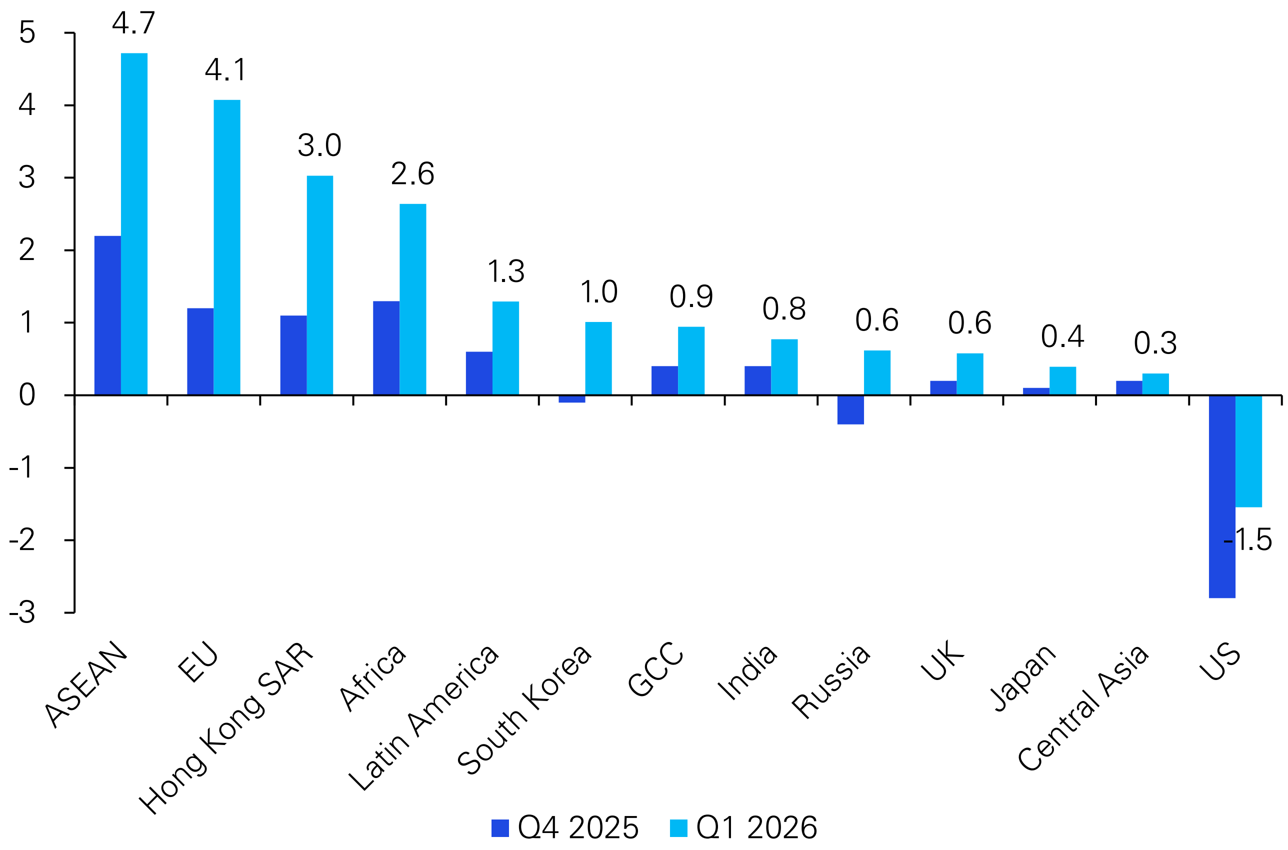


Source: Wind, KPMG analysis

- In Q1 2026, total social financing (TSF) continued to reflect frontloaded fiscal expansion, with government bonds remaining a key driver of growth. Issuance remained strong, aligned with the implementation of "Two New" and "Two Major" initiatives. Net government bond financing reached RMB 3.5 trillion in Q1.
- Bank loans increased by RMB 8.9 trillion, down RMB 796 billion YoY. Its share in TSF fell by 3.8 percentage points to 60.0%, reflecting still-weak credit demand from the real economy as well as a greater diversification of financing channels, with direct financing partially substituting for bank lending.
- Against a low-interest rate environment, bond financing costs remained favourable. Corporate bond rose to RMB 1.0 trillion, up 3.6 percentage points YoY to RMB 521.4 billion, and accounting for 7.1% of TSF.

Exports strengthen amid improving trade structure

Contributions to China's exports growth, by major trading partners, percentage points

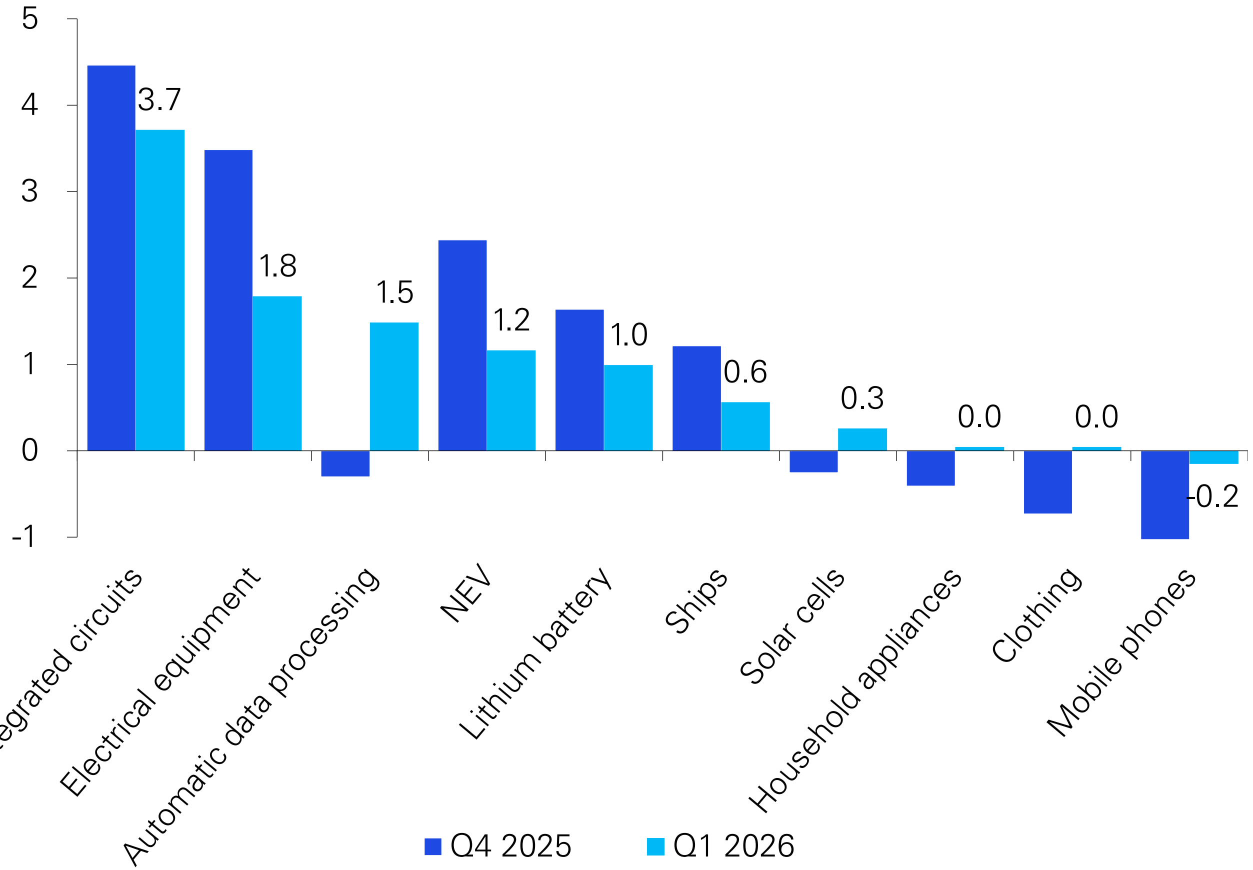


- In Q1 2026, exports rose 14.7% YoY, up 10.9 percentage points from Q4 2025 and 8.9 percentage points from a year earlier. Imports increased 22.7%, supported by a low base and signs of domestic demand recovery. The trade surplus narrowed slightly to USD 264.33 billion, mainly due to stronger imports.
- By trading partners, diversification continued to improve. Exports to emerging markets—including Africa, Latin America, the Middle East, India, and Central Asia—contributed 7.6 percentage points to total growth, up 4.8 percentage points from Q4 2025. ASEAN contributed 4.7 percentage points, while Hong Kong SAR added 3.0 percentage points. Exports to the United States stabilised, narrowing by 1.3 percentage points.
- Looking ahead, China retains competitiveness in high-end manufacturing and green products. With stabilising US-China trade relations and recovering external demand, exports to the US are expected to gradually stabilise in Q2, supporting overall external sector resilience.

Source: Wind, KPMG analysis
Note: The GCC economies include the United Arab Emirates, Saudi Arabia, Oman, Kuwait, Qatar, and Bahrain; the Central Asia economies include Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan.

High-tech and new energy products drive trade growth

Contributions to export growth by category, percentage points

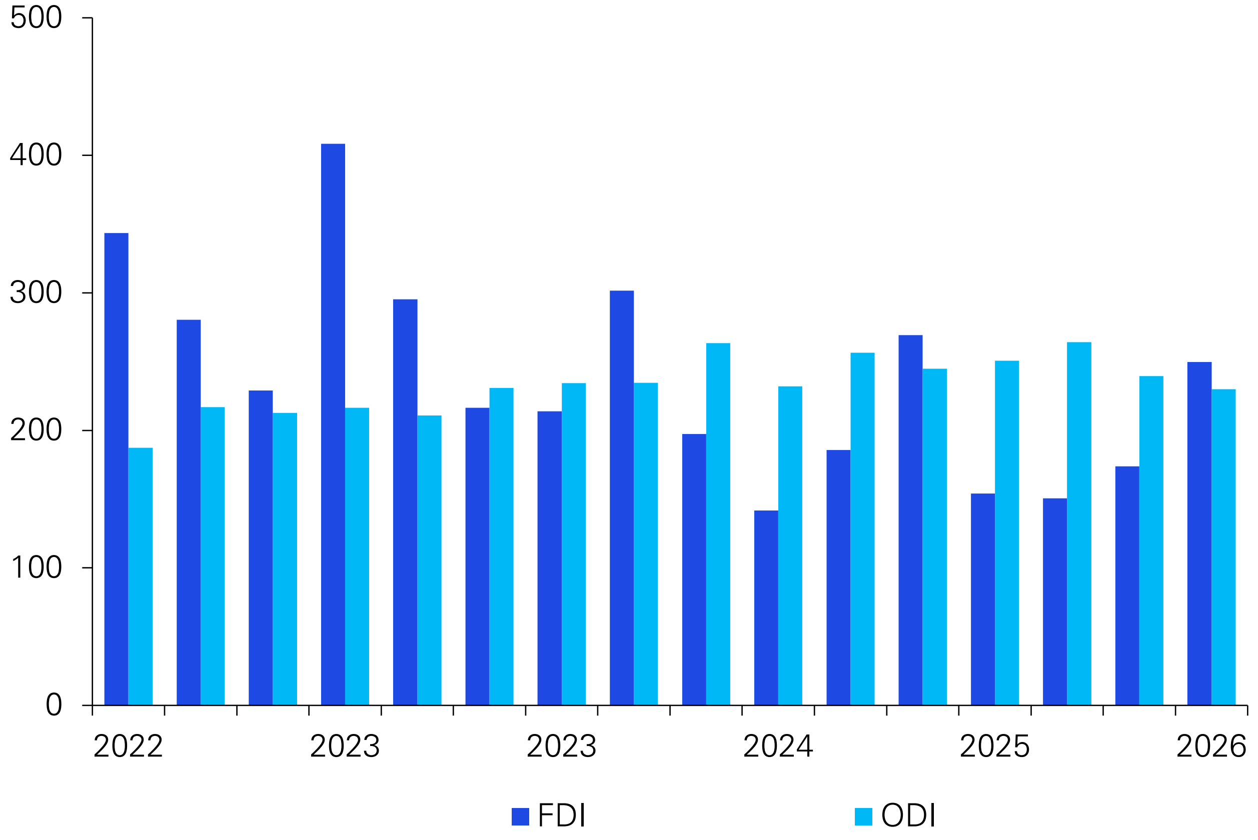


Source: Wind, KPMG analysis

- In Q1 2026, exports of mechanical and electrical products rose 21.4% YoY, contributing 12.8 percentage points to total export growth. Supported by strong global AI industry momentum, integrated circuit exports surged 77.5%, contributing 3.7 percentage points, while automatic data processing equipment contributed 1.5 percentage points.
- Rising AI computing demand and a new global upcycle in power investment, combined with heightened energy security concerns amid tensions in the Middle East , boosted exports of electrical equipment and new energy products. Electrical equipment exports rose 33.2%. "New three" products (NEVs, lithium batteries, solar cells) also performed strongly.
- Looking ahead, geopolitical tensions may increase imported inflation and supply chain volatility, while weaker global demand and trade uncertainty pose external headwinds. However, China's diversified export markets, product upgrading, gradual import recovery, and firm activity support strong external sector resilience.

China remains a key destination for global capital

China's foreign direct investment (FDI) and outbound direct investment (ODI), RMB billion

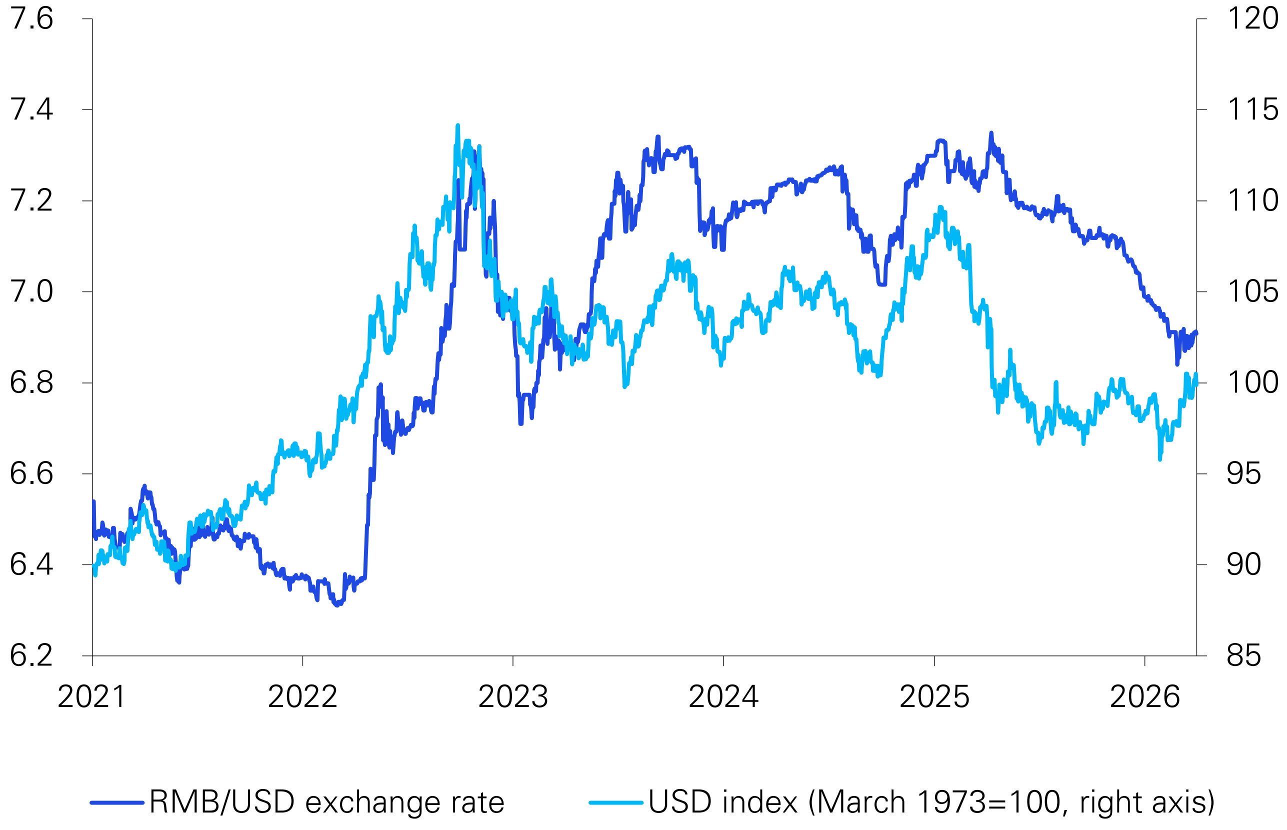


Source: Wind, KPMG analysis

- FDI into China reached RMB 249.6 billion, down 7.3% YoY, but the rate of decline slowed down significantly. At the same time, newly established foreign-invested enterprises rose 11% YoY, suggesting stabilising investor confidence. The divergence between inflows and new firm formation indicates a shift toward long-term positioning and higher-quality investment, with China's large market continuing to act as a key anchor for global capital.
- By sector, services accounted for around 70% of total FDI, while high-tech industries accounted for 41.2%, up 12 percentage points YoY. This underscores a continued structural upgrade in FDI composition, with capital accelerating into technology-intensive and high value-added sectors, supported by China's innovation ecosystem, industrial base, and expanding services market.

RMB appreciates with increased two-way flexibility

USD index and RMB/USD exchange rate

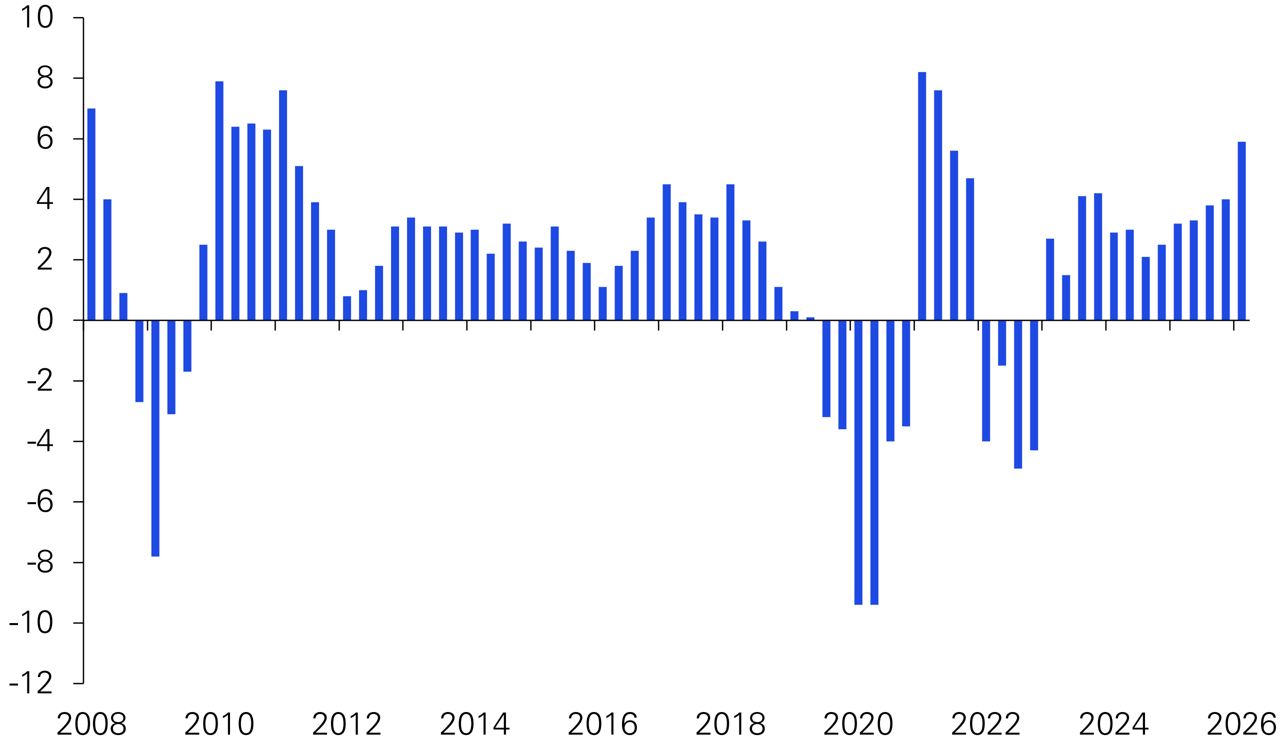


Source: Wind, KPMG analysis

- Against a backdrop of a moderately stronger US dollar, the RMB appreciated by 1.2% against the USD to 6.9, outperforming most major global currencies. Against a basket of currencies, the RMB remained competitive, with the CFETS RMB Index rising to 100.9 at end-Q1, up 2.9% from end-2025. This strength was supported by robust exports, seasonal foreign exchange conversion flows, and a strong start to the domestic economy.
- Looking ahead, near-term depreciation pressure is likely to stem from US dollar safe-haven demand and shifting rate expectations, reflecting external volatility rather than domestic fundamentals. The RMB is expected to move from a unilateral appreciation trend to a wider range of two-way fluctuations in Q2. The PBOC is likely to continue using counter-cyclical policy tools to curb excessive volatility, guiding expectations and maintaining stability around a reasonable equilibrium level.

Hong Kong SAR's economy strengthens

Hong Kong SAR's real GDP growth rate, quarterly YoY, %



- In Q1 2026, Hong Kong SAR's GDP grew 5.9% YoY, up 1.9 percentage points from Q4 2025, indicating a continued consolidation of recovery.
- External demand was a key driver. Goods exports surged 23.8% YoY, accelerating from 15.4% in Q4, driven by strong global demand for AI-related electronics and rising trade flows with ASEAN and Mainland China amid supply chain reconfiguration. Services exports grew 3.5% YoY, supported by a continued tourism recovery and active cross-border financial activity.
- Domestic demand also strengthened. Private consumption rose 5.0% YoY, reflecting improving consumer confidence, supported by asset price recovery and wealth effects from property and equity markets. Investment was particularly strong, with gross fixed capital formation surging 17.7% YoY, driven by improving business sentiment and inflows of external capital, including Middle Eastern investors, family offices, and real-economy projects.

Source: Wind, KPMG analysis

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