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MACRO PICTURE

China's Growth Slowdown in Perspective

By

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13 August 2026

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Executive Summary

China's Slowdown in Perspective

- Despite renewed concerns following weaker Q2 GDP growth, repeated predictions of China's economic decline have not materialized, with the country continuing to strengthen its position in advanced manufacturing, artificial intelligence, semiconductors, and high-tech exports.
- China's slowdown reflects an uneven economic transition rather than broad-based decline, with persistent weakness in domestic demand and the property sector offset by continued resilience in manufacturing, technological upgrading, and exports as the economy seeks to rebalance toward a more sustainable growth model.

China's Growth Slowdown in Perspective

- China's GDP growth slowed to 4.3% in Q2 2026 amid weak domestic demand, subdued private investment, and the prolonged property downturn. However, first-half growth remained within the government's target range at 4.7%, supporting expectations of additional fiscal policy support rather than large-scale stimulus.
- Despite the recent slowdown, China's economic performance remains strong by international standards. Since 2014, its average annual GDP growth has exceeded the G7 average by more than four percentage points, while PPP-based measures suggest China's global economic weight has continued to increase despite exchange rate depreciation and domestic deflation.
- Industrial production continues to demonstrate the resilience of China's supply side. High-tech manufacturing, semiconductors, electronics, aerospace, and other strategic industries maintained robust growth, reinforcing the view that the current slowdown is concentrated in domestic demand and the property sector rather than reflecting a broad deterioration in productive capacity.

The Property Sector Remains the Main Drag

- The prolonged property downturn remains the principal drag on China's economy, weighing on domestic demand, private investment, and local government finances. Although housing prices have begun to stabilize in some cities, the sector continues to constrain broader economic activity.
- While Beijing continues to direct credit toward advanced manufacturing, semiconductors, clean energy, and other strategic industries, high levels of local government debt and weak private investment are limiting the broader investment recovery and slowing the economy's rebalancing process.

Outlook and Policy Implications

- Policymakers are expected to provide additional fiscal support in the second half of the year, but any stimulus is likely to remain targeted rather than broad-based as Beijing seeks to stabilize growth while avoiding another debt-driven investment cycle.
- China's recent slowdown reflects the challenges of rebalancing the economy toward stronger domestic demand and higher-value production rather than signs of imminent economic collapse. The long-term outlook will depend on whether Beijing can sustain industrial upgrading while implementing structural reforms that strengthen household consumption and productivity.

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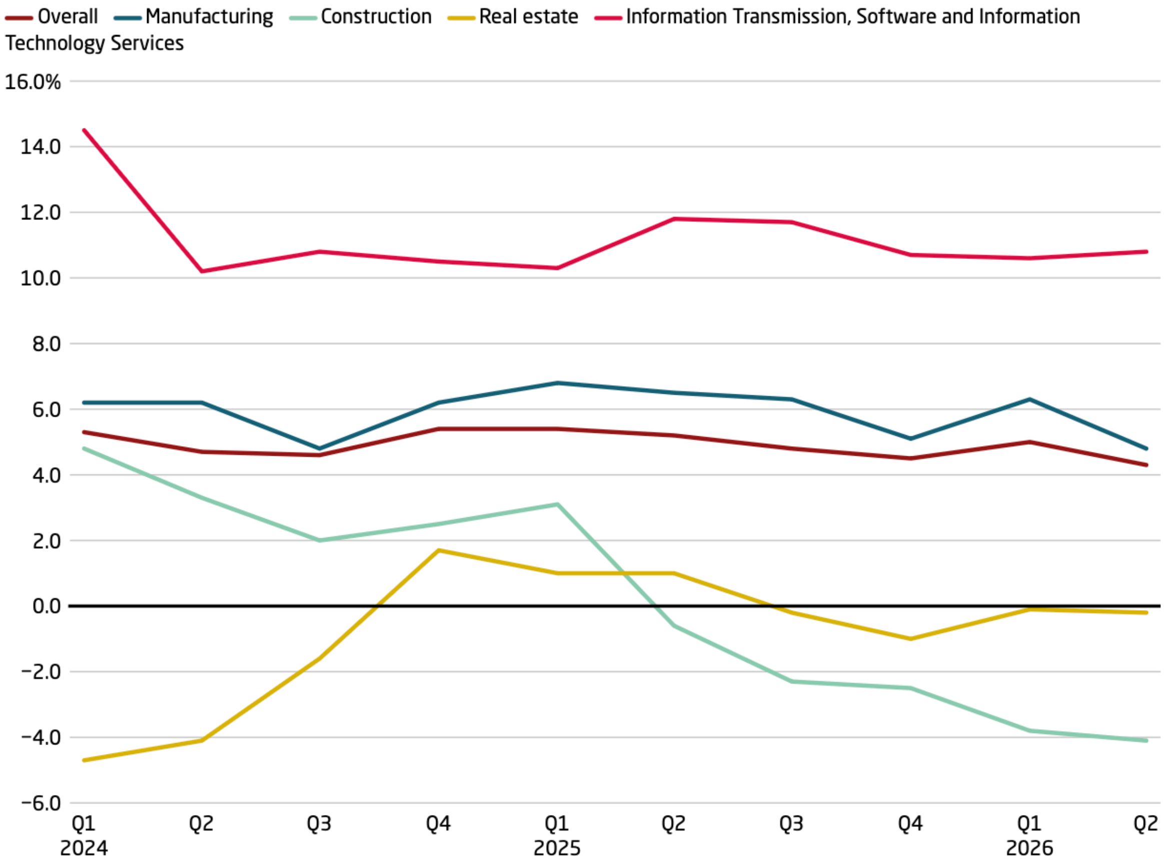
Key Picture: GDP Growth by Sector, Real YoY



Source: Merics

Understanding China's Economic Slowdown

China's economic slowdown, and at times even the prospect of economic collapse, has been repeatedly forecast over the past decades by prominent commentators and major publications. Instead, China has continued to strengthen its position in several strategically important industries. Its technology sector is increasingly challenging US leadership through rapid advances in low-cost open-source AI models, expanding domestic semiconductor manufacturing capabilities, and dominance across critical hardware supply chains, even as US firms retain an advantage at the frontier of computational capacity. Moreover, despite successive rounds of US tariffs and export controls China's high-tech exports have continued to expand.

Recent macroeconomic data, however, have revived concerns over the sustainability of China's growth model. Annual GDP growth slowed to 4.3% in Q2, down from 5.0% in the previous quarter and below market expectations, marking the weakest quarterly expansion since the pandemic-related disruptions of 2022. The slowdown has renewed debated over whether Beijing's traditional policy instruments are losing their effectiveness in sustaining economic growth. Some commentators have gone further, arguing that the US no longer faces a credible long-term economic challenger and that China's strategic position has weakened considerably.

Such conclusions are premature. China's slowdown is real, but it is highly uneven. While domestic demand remains constrained by the prolonged property correction and subdued private investment, manufacturing, technological upgrading, and exports continue to perform remarkably well. The central question is therefore not whether China's economy is collapsing, but whether it can successfully rebalance from a property- and

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investment-driven model toward one centered on advanced manufacturing, innovation, and, eventually, stronger household consumption.

China's Growth Slowdown in Perspective

China's economy grew 4.3% year-on-year in Q2 2026, slowing from 5.0% in Q1 and missing expectations of 4.5%. It marked the weakest annual growth since Q4 2022, as soft domestic demand, subdued private investment, and the prolonged property downturn outweighed resilient AI-related exports. The outcome also fell below the lower end of Beijing's 4.5%-5.0% growth target, reinforcing expectations of further policy support. The National Bureau of Statistics (NBS) said external uncertainties remained elevated and that the economy continued to face an imbalance between robust supply and weak demand. GDP expanded 4.7% in the first half of 2026, with Deputy NBS head Mao Shengyong emphasizing the economy's resilience, supported by high-tech manufacturing and steady services activity.

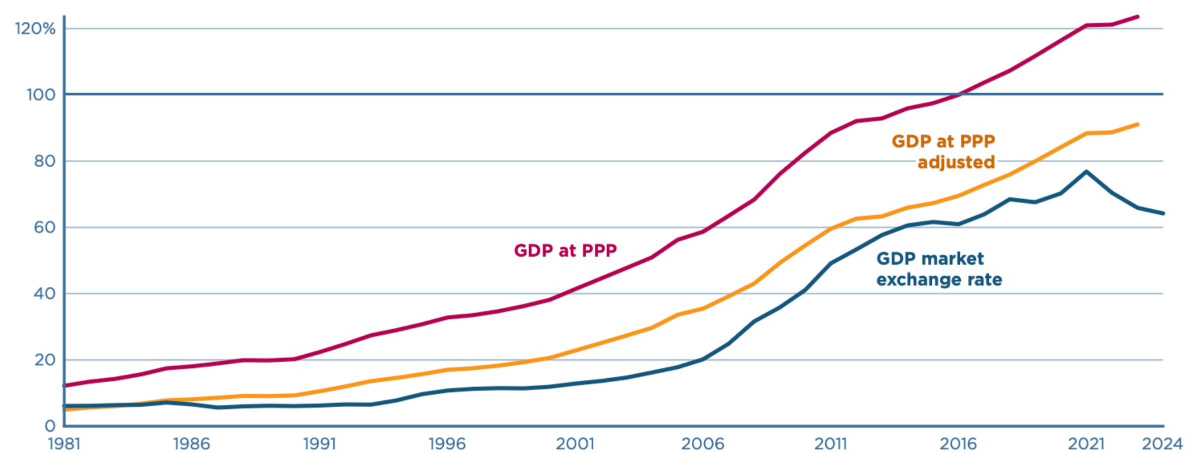
On a quarterly basis, GDP rose 0.9% in Q2, down from 1.3% in Q1 but in line with expectations. It was the weakest quarterly expansion since Q2 2024, as weak domestic demand and the Iran war-related oil shock offset resilient exports. The data reinforced expectations that Beijing will step up fiscal support following the upcoming Politburo meeting, as policymakers have limited room for aggressive monetary easing despite easing oil prices. Premier Li Qiang has called for stronger counter-cyclical policies to stabilize growth.

However, even with the Q2 slowdown, China's first-half GDP growth remained within the government's target range at 4.7% y-o-y. Additionally, since 2014, China's average annual GDP growth has exceeded the G7 average by more than four percentage points.

Placed in international perspective, China's performance remains comparatively strong. Since 2014, China's average annual growth rate has exceeded the G7 average by more than four percentage points. Although growth has slowed relative to the double-digit expansion of previous decades, it continues to outpace virtually every major advanced economy.

One reason perceptions of China's economy often diverge from underlying performance is the widespread reliance on nominal GDP measured in US dollars. China's apparent decline in global economic weight over recent years has been driven largely by renminbi depreciation and domestic deflation rather than falling real output. Measured in purchasing power parity (PPP) terms, which adjust for exchange-rate and price effects, China's share of global GDP has continued to increase. Exchange rates matter for financial markets, but they are a poor measure of changes in productive capacity.

Figure 1: China's GDP-based measures of relative economic power, as a % of US GDP, 1981–2024



Source: PIIE

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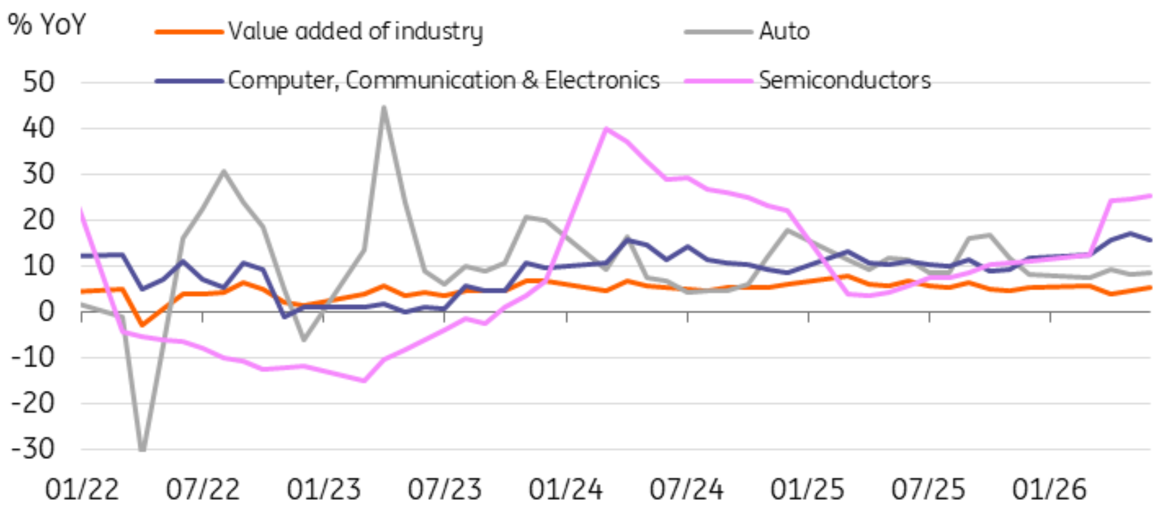
The composition of recent growth reinforces this interpretation. June activity data were mixed but showed some stabilization. The broader production data does not point to an economy in structural decline. Industrial production remained a bright spot, rising 5.3% year-on-year in June from 4.5% in May and exceeding market expectations. This brought first-half industrial output growth to 5.4%, making it one of China's strongest domestic activity indicators. Manufacturing expanded 6.0%, while high-tech manufacturing continued to outperform, growing 14.1%, reflecting Beijing's continued push toward industrial upgrading and semiconductor production surging 25.4% year-on-year, its fastest pace in 17 months.

The strongest-performing sectors were those benefiting from robust external demand and industrial policy, including rail, ships and aerospace (18.2%), computers, communications and electronic equipment (15.7%), and automobiles (8.7%), despite weaker domestic vehicle sales. Semiconductor production surged 25.4% year-on-year, its fastest pace in 17 months.

Figure 2: Industrial Production



Source: ING

Property Remains the Main Drag

This is not to dismiss the weakness elsewhere in the economy. Fixed-asset investment fell 5.7% year-on-year in the first half of 2026, the weakest reading since May 2020. Private investment contracted 8.5%, while growth in state-owned investment slowed to just 2.3%, suggesting that both private firms and state enterprises have become increasingly cautious about capital spending.

The main drag remains the prolonged property downturn and the debt overhang accumulated by local governments during the real estate boom. Although property prices continue to decline at a much slower pace—and have begun to stabilize in some cities—the sector continues to weigh heavily on domestic demand. Even excluding real estate, fixed-asset investment fell 2.7% in the six months to June, worsening from a 1.2% decline in the first five months of the year.

The property bust has also left many local governments burdened with debt incurred through financing developers during the boom years, limiting their ability to undertake new investment. While the central government and state-owned banks continue to channel credit toward Beijing's "new productive forces," particularly advanced manufacturing, semiconductors, and clean energy, many local governments lack the fiscal capacity to follow.

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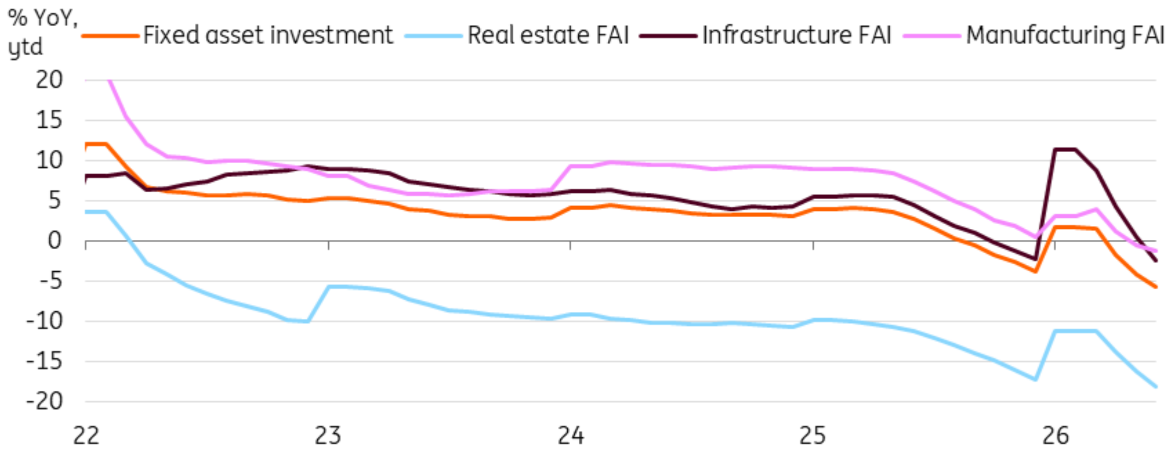
Figure 3: Broad Spread Weakness Of Investment



Source: [ING]

The External Sector Remains Resilient

The result is an economy characterized by two contrasting realities. On one side stands a globally competitive industrial sector supported by targeted industrial policy, technological upgrading, and resilient exports. On the other stands a domestic economy constrained by weak consumption, subdued investment, and the ongoing adjustment of the property market. Understanding China's current trajectory requires recognizing both realities simultaneously.

The external sector has become an increasingly important source of support. Despite continued geopolitical tensions, China's exports have remained resilient, particularly in higher value-added manufactured goods. Strong performance in electric vehicles, electronics, machinery, and other advanced manufacturing sectors reflects both sustained external demand and improvements in China's technological capabilities.

Recent geopolitical developments have also modestly improved China's external environment. The easing of US-China trade tensions following the Trump-Xi meeting reduced immediate uncertainty for exporters, while China's diversified energy procurement strategy and strategic stockpiles helped cushion the effects of disruptions in the Middle East. Nevertheless, renewed geopolitical tensions and higher energy prices remain important downside risks for both Chinese exports and global demand.

Strong exports, however, cannot permanently compensate for weak domestic demand. Net exports made an unusually large contribution to recent growth, but a development model that relies excessively on external demand becomes increasingly difficult to sustain amid rising protectionism. Beijing has repeatedly emphasized the need to strengthen household consumption, yet meaningful progress would require structural reforms, including higher household incomes, expanded social protection, and a reduced reliance on investment-led growth, that will take years rather than months to implement.

Policy Support and the Outlook

Against this backdrop, policymakers are expected to provide additional support during the second half of the year. Markets anticipate further fiscal measures following the Politburo meeting, particularly through infrastructure investment, local government bond issuance, and targeted support for strategic industries. Some additional monetary easing also remains possible. However, a large-scale stimulus comparable to previous downturns appears unlikely. With growth still broadly within the government's target range, policymakers appear determined to support activity while avoiding another debt-fueled investment cycle.

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Recent weakness in consumption and investment should therefore be understood as part of a broader structural transition rather than evidence of broad-based economic decline. While retail sales and fixed-asset investment have softened, growth continues to shift toward services, high-value manufacturing, advanced technologies, and other strategic industries. The investment slowdown remains concentrated in the property sector, whereas investment in semiconductors, artificial intelligence, advanced manufacturing, and digital infrastructure continues to expand.

China's economy nevertheless faces significant structural challenges. The property downturn, subdued household consumption, demographic headwinds, and rising local government debt all point to a more difficult growth environment than in previous decades. The central challenge is no longer simply sustaining high GDP growth, but successfully rebalancing the economy toward stronger domestic demand while preserving the industrial and technological dynamism that has underpinned China's competitiveness. Achieving that balance will likely require deeper structural reforms—including measures to strengthen household incomes and confidence—rather than relying primarily on investment and exports.

China therefore appears to be entering a new phase of development rather than an era of economic collapse. Growth is likely to be slower and more uneven than in the past, but the country's expanding technological capabilities, industrial upgrading, and continued policy support suggest that the more important question is not whether China's economy is failing, but whether it can successfully transition to a more sustainable growth model.

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