GLOBAL MARKETS RESEARCH

China

15 July 2025

Bottleneck to Reflate the Economy

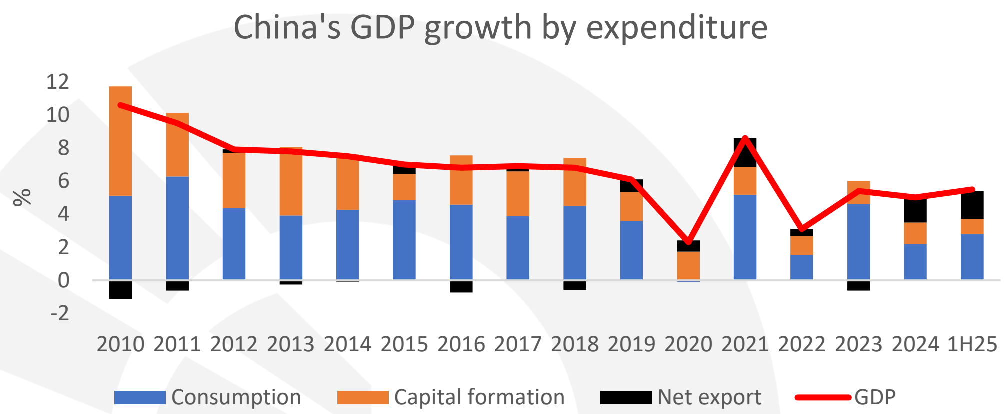
Tommy Xie
xied@ocbc.om

- The stronger-than-expected performance in the first half was underpinned by three key drivers: robust external demand, continued upgrade in high-tech industries, and policy support from the consumer trade-in program.
- China's efforts to reflate its economy hit the bottleneck. The persistent disinflationary trend was partially due to involution. The rollout of anti-involution measures is expected to be more gradual compared to previous supply-side reforms.
- Given the still-uncertain trade outlook and the sluggish recovery in the property sector, we think hurdle for China to reach its "around 5%" GDP target remains high. Nevertheless, we upgrade our full year GDP forecast to 4.8% from 4.6% to reflect the stronger than expected external demand.

China's economy grew by 5.2% YoY in the second quarter, bringing first-half 2025 GDP growth to 5.3%, above the government's annual target. The stronger-than-expected performance was underpinned by three key drivers: robust external demand, continued upgrade in high-tech industries, and policy support from the consumer trade-in program.

Net exports contributed 31.2% to GDP growth in the first half, surpassing the 30.3% contribution in 2024. Looking ahead, July trade data may remain resilient due to the deferred tariff implementation. However, the real test could emerge in August if new tariffs are implemented.

Chart1: External demand accounted for 31.2% to GDP growth in the first half.



Beyond external demand, investment in high-tech sectors remained solid. Fixed asset investment in high-tech services rose by 8.6% YoY in 1H 2025. On the consumption front, nominal retail sales increased by 5.0% YoY, outpacing the growth of nominal GDP—highlighting the impact of policy efforts to stimulate domestic demand.

Despite the strong data, headwinds are gathering. First, the uncertainty from the US-China trade tension despite the temporary truce remained elevated.

Second, sentiment turned sour again following the intensification of new wave of eight point regulation aiming at cutting government wastage and corruption from May.

Third, the recovery of property market stalled again due to still weak income growth and income expectations as well as limited wealth effect. The contraction of China's real estate investment worsened to 11.2% in the first half from 10.7% in the first five months.

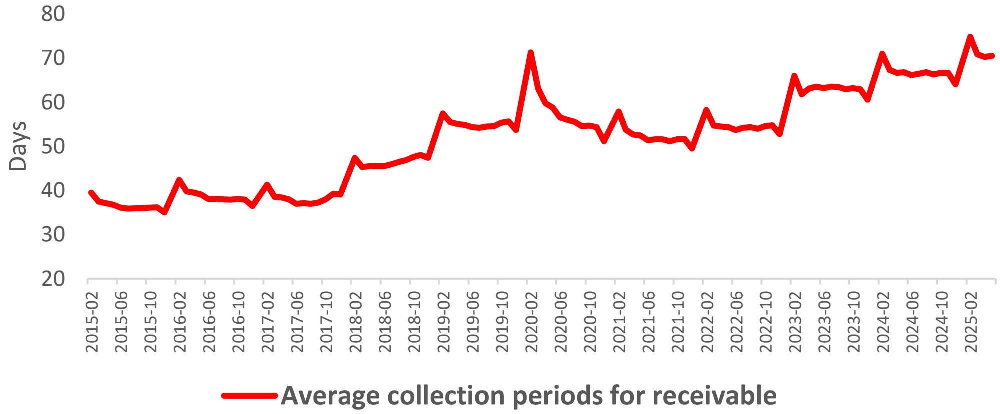
Fourth, China's efforts to reflate its economy hit the bottleneck. CPI for 1H 2025 remained in slight deflation at -0.1% YoY, with core inflation staying below 0.5%, underscoring the persistent challenges along China's reflation path. The prolonged downturn in the property sector—now entering its fourth year—continues to erode household wealth and dampen consumer confidence. PPI fell 2.8% YoY in the first half. The weakness was driven by a combination of lower global commodity prices and sustained domestic pressures, including the property downturn and lackluster consumer demand. As a result, China's GDP deflator has been in negative territory for nine consecutive quarters.

<u>**Chart2:**</u> China's GDP deflator has been in negative territory for nine consecutive quarters.

The weak nominal growth despite above target real growth may weigh down corporate profitability as well as income growth. The performance of durable goods sectors of industrial profit—particularly automobiles and furniture—acted as a drag. Despite robust car sales in volume terms, the ongoing price war significantly eroded profit margins.

The persistent disinflationary trend was partially due to involution. The involution also led to the lengthening of the accounts receivable cycle. The average collection period has now extended beyond 70 days, reflecting growing payment delays and rising financial strain within the corporate sector.

Chart3: As a result of involution, payment collection cycle increased sharply.



On June 29, 2025, the People's Daily published an article titled "Achieving High-Quality Development by Breaking 'Involution-Type' Competition", which emphasized that "multiple measures by government departments and coordinated efforts from relevant parties" will be key to advancing anti-involution governance. This marks a notable departure from the supply-side reforms in 2015-16, which were predominantly government-led. The current anti-involution campaign is positioned as a joint effort between the government and market participants.

Industries currently targeted under this governance framework fall into two broad categories. First are traditional sectors such as cement, steel, aluminum, petroleum, chemicals, and coal-fired power. Second are fast-growing emerging industries, including photovoltaics, lithium batteries, new energy storage, new energy vehicles, and e-commerce platforms.

Based on recent policies and regulatory meetings, the approach varies by industry structure. In sectors with a high concentration of state-owned enterprises—such as steel, coal, aluminum, and coal-fired power—administrative tools like production curbs and capacity reduction remain the primary instruments. In contrast, industries dominated by private enterprises, such as photovoltaics, new energy vehicles, energy storage, and cement, are more reliant on industry association-led self-regulation and market-based discipline.

Overall, the rollout of anti-involution measures is expected to be more gradual compared to previous supply-side reforms. As such, the short-term impact may be more catalytic in shaping sentiment than in delivering immediate fundamental improvements.

The key to restoring price momentum lies in expanding effective demand, resolving bottlenecks in the real economy, and improving the supply-demand circulation. This requires deepened structural reforms supported by coordinated fiscal, monetary, industrial, employment, and social security policies.

The property market is set to play a central role in efforts to boost domestic demand in 2025. As China transitions toward a new real estate development model, policymakers prioritize measures to prevent developer debt defaults, ensuring financial stability within the sector.

In addition, we expect PBoC to lower its benchmark interest rate by another 20bps this year although the room for more aggressive rate cuts may be limited given the bottleneck faced by the economy.

Beyond conventional fiscal and monetary support, we believe China retains ample policy tools to stabilize growth. Among them, new-type urbanization is likely to emerge as a key strategic focus in the coming year. This initiative seeks to address hukou-related barriers faced by migrant workers, enabling them to purchase homes and access public services in urban areas. If effectively implemented, these reforms could generate a “threefold benefit”: enhancing social equity, unlocking housing demand by absorbing excess inventory, and stimulating consumption as migrant workers integrate more fully into urban life.

That said, given the still-uncertain trade outlook and the sluggish recovery in the property sector, we think hurdle for China to reach its “around 5%” GDP target remains high. Nevertheless, we upgrade our full year GDP forecast to 4.8% from 4.6% to reflect the stronger than expected external demand.

Macro Research

Selena Ling
Head of Strategy & Research
LingSSSelena@ocbc.com

Tommy Xie Dongming
Head of Greater China Research
XieD@ocbc.com

Keung Ching (Cindy)
Hong Kong & Macau Economist
Cindyckeung@ocbc.com

Herbert Wong
Hong Kong & Macau Economist
HerbertWong@ocbc.com

Lavanya Venkateswaran
Senior ASEAN Economist
LavanyaVenkateswaran@ocbc.com

Ahmad A Enver
ASEAN Economist
Ahmad.Enver@ocbc.com

Jonathan Ng
ASEAN Economist
JonathanNg4@ocbc.com

Ong Shu Yi
ESG Analyst
ShuyiOng1@ocbc.com

FX/Rates Strategy

Frances Cheung, CFA
Rates Strategist
FrancesCheung@ocbc.com

Christopher Wong
FX Strategist
ChristopherWong@ocbc.com

Credit Research

Andrew Wong
Credit Research Analyst
WongVKAM@ocbc.com

Ezien Hoo, CFA
Credit Research Analyst
EzienHoo@ocbc.com

Wong Hong Wei, CFA
Credit Research Analyst
WongHongWei@ocbc.com

Chin Meng Tee, CFA
Credit Research Analyst
MengTeeChin@ocbc.com