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# China Insights

## AI resilience meets domestic headwinds

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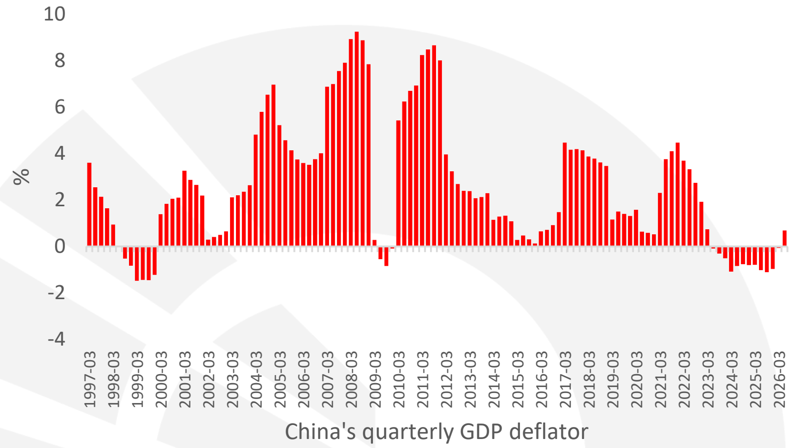
- **Growth slowed, but reflation continued.** GDP moderated to 4.3% YoY in 2Q, while nominal GDP accelerated to 5.9% YoY and the GDP deflator turned positive for the first time since March 2023, signalling improving pricing power despite softer activity.
- **AI exports remained the key growth engine.** Robust AI-related exports, led by semiconductors and computing hardware, continued to offset weak domestic demand. Strong growth in both IC exports and imports suggests China's AI supply chain remains a structural pillar supporting exports.
- **Policy focus shifts to consumption.** Weak investment and sluggish household spending warrant further policy support. We expect the July Politburo meeting to unveil additional measures targeting both goods and services consumption, supporting our view that 2Q likely marks the cyclical trough.

China's economy slowed more than expected to 4.3% YoY (0.9% QoQ SA) in 2Q26 from 5.0% in 1Q26. Nevertheless, GDP growth averaged 4.7% YoY in the first half of 2026, remaining within the government's 4.5–5.0% growth target.

One encouraging development was the continued reflation of the economy. Nominal GDP growth accelerated to 5.9% YoY in 2Q from 4.9% in 1Q, while China's GDP deflator turned positive for the first time since March 2023, signalling that deflationary pressures are gradually easing.

**Chart 1:** China's GDP deflator returned to positive for the first time in 13 quarters in 2Q




Source: Wind, OCBC

**Limited impact from the Iran war**

There is little evidence that the second-quarter slowdown was primarily driven by the Iran conflict. According to the National Bureau of Statistics (NBS), most sectors continued to operate normally, with disruptions largely confined to the petrochemical industry.

In fact, China may have benefited indirectly from the conflict. Elevated energy prices accelerated the global energy transition and reinforced demand for China's renewable energy products. Automobile exports surged 69.6% YoY in June, highlighting China's strengthening competitiveness in advanced manufacturing, particularly electric vehicles.

**Investment remained the main drag**

Although the NBS has yet to publish the expenditure breakdown of GDP, our estimates suggest that capital formation was the largest contributor to the downside surprise, while net exports remained supportive.

Fixed asset investment contracted 5.7% YoY in the first half of 2026, reflecting weakness across both property and infrastructure investment.

The property sector remained the biggest headwind, with real estate investment declining 18.0% YoY. The prolonged property downturn continued to weigh on construction-related industries, including cement, steel, furniture and other upstream manufacturing sectors.

Infrastructure investment also lost momentum. Growth slowed to -2.4% YoY in the first half from 4.3% during January–April, suggesting that the boost from front-loaded fiscal funding and concentrated project launches in the first quarter has gradually faded. More importantly, physical construction activity appears to have slowed meaningfully since the beginning of the second quarter.

**AI remains the structural growth engine**

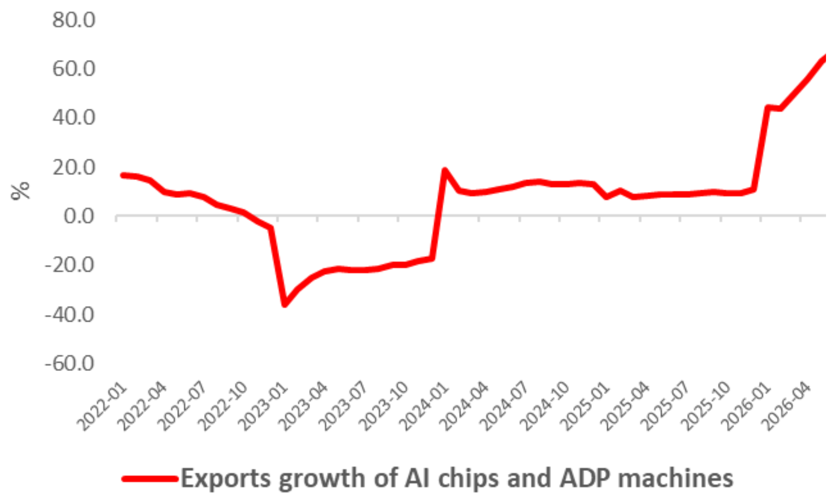
Exports continued to be the brightest spot in the economy. June exports rose 27.0% YoY, accelerating from 19.4% in May. For the first half of the year, cumulative exports expanded 17.6% YoY, far exceeding market expectations at the start of the year and marking the fastest pace of growth since the post-pandemic rebound in 2021.

Imports also strengthened, with growth accelerating to 36.0% YoY from 27.4% previously. Consequently, China's merchandise trade surplus narrowed only marginally to USD577.3 billion in the first half from USD583.4 billion a year earlier, while remaining historically elevated. Against the backdrop of subdued domestic demand, exports continued to serve as the primary engine of economic growth.

AI-related products remained one of the key drivers of export performance. China's AI exports are concentrated mainly in intermediate goods, particularly semiconductors and computing hardware. Integrated circuit (IC) exports surged 121.9% YoY in June, extending this year's record-breaking momentum. During the first half, integrated circuits and automatic data processing (ADP) equipment together accounted for 14.8% of total exports (chart 3), up from 10.7% in 2025, while their combined exports grew 67.5% YoY (chart 2).

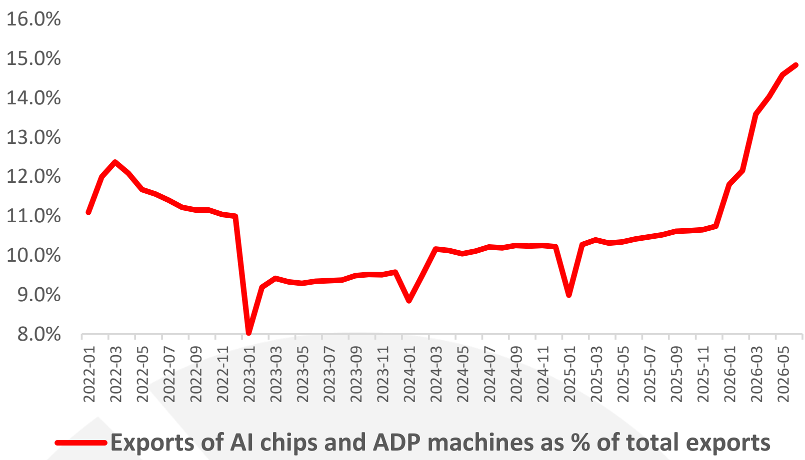
On the import side, IC imports also reached another monthly record, rising 72.3% YoY, highlighting strong upstream semiconductor demand. Robust growth in both IC exports and imports suggests continued expansion across China's AI supply chain, reinforcing our view that AI-related exports will remain an important pillar supporting China's external sector over the coming quarters.

**Chart 2:** Strong growth of China's exports of chips and Automatic data processing machines.




Source: Wind, OCBC

**Chart 3:** Share of AI related exports increased sharply this year




Source: Wind, OCBC

**More policy support for consumption is likely**

Household consumption remained the weakest component of domestic demand. Retail sales of consumer goods grew only 1.3% YoY in the first half of the year.

Against this backdrop, the State Council officially approved the 15th Five-Year Plan for Expanding Consumption, which targets total retail sales of consumer goods reaching RMB60 trillion by 2030.

The target implies average nominal retail sales growth of around 3.7% per year over the next five years—a relatively modest objective. It is below this year's implied nominal GDP growth and also below our expectation for nominal GDP growth over the medium term.

In our view, Beijing deliberately adopted a conservative target. Unlike infrastructure investment or industrial production, household consumption cannot be directly engineered through administrative measures. Ageing demographics, elevated precautionary savings, the lingering property wealth effect and an incomplete social safety net continue to constrain household spending. The decision is consistent with Beijing's broader preference for setting achievable policy targets, similar to its removal of the five-year cumulative urban employment target from the latest Five-Year Plan.

Nevertheless, with retail sales growth still substantially below the implied medium-term target, we expect policymakers to announce additional consumption-support measures at the July Politburo meeting, particularly to stimulate durable goods consumption.

At the same time, policymakers are placing increasing emphasis on services consumption, which is not fully captured by traditional retail sales data.

According to the NBS, retail sales of services grew 5.3% YoY in the first half, 4.2 percentage points faster than goods retail sales. Tourism and leisure-related spending remained particularly strong, with tourism consultation and rental services, and culture, sports and leisure services expanding 11.3% and 10.4% YoY, respectively. Separately, official tax data showed tourism and entertainment service revenues increased 12.3% YoY.

The composition of household spending is also shifting. Per capita services expenditure accounted for a larger share of total household consumption, increasing by 0.2 percentage points from a year earlier.

The new Five-Year Plan explicitly identifies services consumption as a separate policy priority. Since household final consumption in the national accounts tends to grow faster than goods retail sales alone, the July Politburo meeting may also unveil further initiatives aimed at boosting services consumption.

**Outlook: 2Q may mark the cyclical trough**

Looking ahead, infrastructure investment is likely to remain the government's primary policy lever for stabilising growth. The key question is whether fiscal resources can be translated into sustained physical construction activity and whether new initiatives, including the "Six Networks" strategy, can gradually offset the structural slowdown in traditional property- and municipal-related infrastructure investment.

While AI-related manufacturing and exports continue to provide an important structural tailwind, persistent weakness in household consumption, property, manufacturing investment and infrastructure spending suggests that domestic demand remains fragile.

That said, we believe 2Q26 is likely to mark the cyclical trough. With additional policy easing and consumption-support measures expected following the July Politburo meeting, growth should improve gradually during the second half of the year. We therefore continue to expect China to achieve its official growth target, although full-year GDP growth is likely to finish toward the lower end of the 4.5–5.0% target range, rather than the midpoint. We downgraded China's growth forecast this year to 4.6% from 4.7% previously.

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