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RMB: Postcard from China

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We hosted a three-day investor trip across Beijing and Shanghai, meeting policymakers, academics, market participants, think-tanks, business chambers, and tech industry practitioners. The single most important takeaway: China's geopolitical situation is stabilising faster than its domestic economy. While the US-China relationship is on a more stable footing, national confidence is being bolstered by advancements in AI, and the currency is strengthening, the domestic picture is more challenged. Consumption remains structurally impaired, the property sector is in a permanent retreat, and the labour market is weak. Consequently, the bull and bear cases for China are both clearly visible from the same set of conversations.

1. Warming US-China relations offer stability. The recent Presidential summit delivered its intended outcome: a crucial tone-setter rather than a transactional deal. Dialogue is set to continue, with three more high-level meetings planned for 2026 (APEC, G20, and a potential visit by President Xi to D.C. in Sep), where more substantive agreements are likely. Post-summit, interaction between both sides has notably improved, and congressional re-engagement is resuming—an underappreciated positive. The key near-term risk is the July 24 expiry of Section 301 tariffs. The US administration has signalled its intent to extend the regime, which could mean effective tariff rates on China rise again even as the diplomatic mood improves.

2. K-Shaped growth - New economy carries the old. China is experiencing a pronounced K-shaped recovery. The "new economy" (tradeable goods, AI-linked equipment, capital goods, new energy) is growing strongly, with AI-related equipment exports up nearly 100%YoY. Conversely, the "old economy" (consumption, property, services, domestic investment) remains structurally weak. April data confirmed this divergence. Crucially, the new economy's contribution to growth is currently offsetting the old economy's drag, limiting the risk of a sharp slowdown.

- Growth outlook. 1Q26 growth of ~5% is expected to be the peak for the year, with moderation in 2Q and beyond. Our speakers are confident China will hit its 4.5–5% growth target for 2026, and expect a managed deceleration to ~4% over the next decade as the country reaches high-income status.
- Policy response. Fiscal policy remains the dominant growth lever. Near-term easing will be targeted, not broad-based. Policy rates will likely only be

cut if growth falls meaningfully below the official target. The more impactful channel for stimulus will be quasi-fiscal, with policy bank lending serving as equity tranches for infrastructure projects.

3. The rebalancing dilemma, compounded by AI. The most consistent message from our meetings was that China's consumption problem stems from a lack of confidence and income. Households have accumulated an estimated RMB 50–60tn in deposits since 2021 but are reluctant to spend due to unemployment concerns, weak nominal wage growth, and severe wealth destruction from the property downturn. A decisive consumption rebound is contingent on nominal wage growth, but the structural barriers are deep. AI is compounding the problem, displacing service-sector workers at the exact moment traditional employment sectors have slowed their hiring. Until nominal incomes recover, consumption cannot.

4. Inflation - A welcome but still insufficient shift. A commonly shared view is that "bad/imported inflation is better than deflation". After 41 consecutive months of negative prints, PPI has finally turned positive. Can this shift household and business expectations away from deferring purchases? In a deflationary mindset, even a modest change in expectations could have an outsized effect on spending. However, for this to be sustained, government demand-side support is necessary—a prospect our speakers were not optimistic about. The turn in PPI is real, but its transmission to broader spending is yet to be realized.

5. Foreign business are not leaving. Our conversations suggest that while MNCs are still profitable in China, their margins are slimming. Yet, foreign firms are not actively looking to exit China. The reason is simple: as one veteran put it, "China is the world's fitness centre—if you can win here, you can win anywhere." The competitive intensity, manufacturing scale, and R&D speed that exist nowhere else keep companies anchored even as confidence slides. MNCs are increasingly treating China as a learning and innovation hub rather than a pure growth market.

6. Property sector - a permanent regime change. The conclusion from every meeting was similar: the government has no intention of using property as a primary growth lever again. Current policies are focused on risk control, not reflation. While the Tier-1 secondary market shows stabilisation in prices and improvement in sales, new home starts and sales remain low. An industry survey cited during our meetings found over 70% of developers and investors expect no market stabilisation before 2027. That said, in contrast to previous years, there is growing sentiment that the bottom is now visible, even if it remains distant.

7. US-China AI gap narrowing. China's advantage in AI is not in frontier models but in application and infrastructure. With 80% of transactions conducted via e-wallets, unified healthcare QR codes across cities, and fully agentic shopping and delivery apps already in consumers' hands, AI is being layered onto a digitalised economy that the US and Europe have not yet built. While the US remains the leader on frontier models, China is actively developing its own technology to close the gap.

8. Capital account: direction is open, pace is glacial. Opening measures are being gradually adopted, but a full capital account liberalization is not imminent—China does not have a target or a timeline for that. The 2015 capital outflow episode remains a warning. Hong Kong remains the key connector between offshore and onshore RMB — acting as a testing ground for internationalisation while capital controls onshore stay intact. The offshore market allows foreign investors to access

RMB exposure and Chinese assets without full onshore access, and Beijing is comfortable with this two-track structure as a long-term transition mechanism.

9. RMB the clearest bullish signal from the trip. Every speaker we met sees the CNY on a clear appreciation path, with a consensus year-end forecast of USD/CNY 6.50–6.70. This trend is driven by corporate settlement flows, as Chinese exporters convert a larger share of their trade surpluses into RMB. The catalysts for this shift include greater confidence in China's export competitiveness and domestic growth, rising volatility in USD-denominated financial assets, and geopolitical concerns about offshore capex. With sizable USD assets still held offshore by corporates, significant appreciation pressure remains. The PBoC appears comfortable with this direction, managing the pace, not the direction, of appreciation. The key risk to this view is a material slowdown in export growth, which would reduce corporate settlement flows and remove the main offset to a weak domestic economy.