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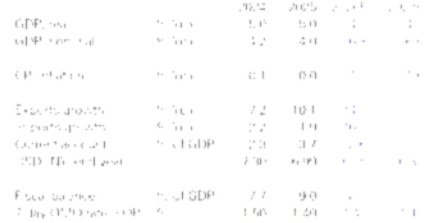
2026 H2 Outlook: Balancing a Two-Speed Economy

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- **After a strong start in Q1, a deepening K-shaped divergence has led to a growth slowdown in Q2**. Strong exports have been offset by weaker domestic demand, with consumption softening due to the diminishing impact of subsidies, weaker consumer confidence, and the pass-through of higher prices. Fiscal impulse also weakened significantly in the second quarter, with overall spending growth turning negative in March and April.
- **Looking into H2, we think strong external demand will continue to drive growth...** Exports are forecast to grow 14% for the full year, supported by the "AHEAD" factors: Agentic AI, heavy assets, energy cost advantages, accelerating green transition, and diversification.
- **...while increased fiscal spending and property market positive signals will help stabilize domestic demand.** A rebound in fiscal spending is likely in H2 as policymakers respond to the Q2 slowdown, with projects under the 15th Five-Year Plan expected to ramp up. Concurrently, the property market is showing early signs of stabilization in top-tier cities, with rising secondary home sales and declining inventories, though a broad-based recovery is not yet evident.
- **Reflation is expected to continue, though the pace of price hikes will likely become less steep in H2.** While imported inflation from oil has likely run its course, PPI is still expected to continue its reflation trend, driven by strong AI demand and price pass-throughs from upstream to downstream. CPI rebound will likely be more modest and slower than previously expected, partly due to fuel price drops and a delayed recovery in pork prices.
- **The PBOC will likely hold its policy rate unchanged.** Given growth target remains on track, a sharp rebound in PPI, and ample liquidity in the banking system from exporter FX conversions, the central bank is unlikely to pursue further broad-based easing. No policy rate changes are anticipated, with the PBOC likely to rely on targeted structural tools instead to channel lending into priority sectors such as AI, new infrastructure, and services.
- **RMB internationalization will gain pace as the currency continues to appreciate steadily.** RMB remains undervalued based on REER analysis. Stability of the RMB during recent market volatility accelerated its use in cross-border payments and financing. Sustained appreciation, driven by strong exports and political impetus, is expected to continue, supporting the currency's growing international role.
- **Key forecasts:** we forecast GDP growth will slow to 4.4% YoY in Q2 before rebounding to 4.6% in Q3 and 4.7% in Q4. CPI and PPI are expected to rise at a modest pace in H2 to 4.5% and 1.5%, respectively (from 3.9% and 1.2%

Figure 1: China economic forecasts



Source : Deutsche Bank Research

IMPORTANT RESEARCH DISCLOSURES AND ANALYST CERTIFICATIONS LOCATED IN APPENDIX 1. UNTIL 19th MARCH 2021 INCOMPLETE DISCLOSURE INFORMATION MAY HAVE BEEN DISPLAYED, PLEASE SEE APPENDIX 1 FOR FURTHER DETAILS.

in May). RMB is expected to appreciate to 6.55/USD by end-2026.

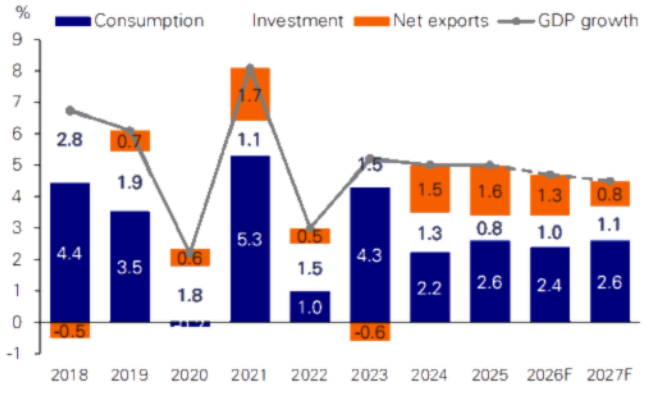
Growth outlook

We forecast China's GDP growth at 4.7% in 2026. This is a minor downward revision of 0.2 percentage points from our April forecast, reflecting softer-than-expected domestic activity since the start of the second quarter. But it remains higher than the 4.5% forecast in our 2026 Outlook at year beginning, as we anticipate continued trade outperformance and a persistent reflationary trend.

We expect growth to regain momentum in the second half of the year following a temporary slowdown in Q2. We project Q2 GDP growth will moderate to 4.4% YoY, weighed down by the impact of higher oil prices and slower government spending. As oil prices have since fallen back to Q1 levels and fiscal stimulus is expected to re-accelerate after the summer, we forecast GDP growth will rebound to 4.6% in Q3 and 4.7% in Q4.

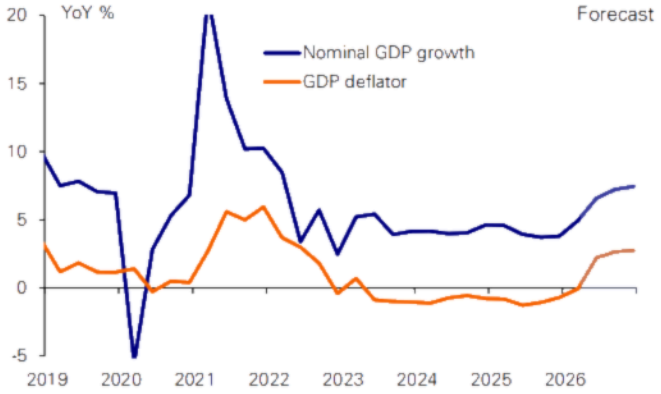
Reflation will be a powerful driver of China's nominal GDP growth. As identified in our 2026 Outlook: Path to Reflation, a price-driven nominal recovery is a key theme for the year. After reaching a three-year high of 4.9% in Q1, we now forecast nominal growth will accelerate to 6.6% in Q2 and exceed 7% in H2—significantly higher than the sub-5% rates of the past four years. This rise in RMB-denominated growth should bolster corporate profits, with potential positive knock-on effects expected for household income and asset prices.

Figure 2: We forecast 4.7% real GDP growth in 2026



Source : Deutsche Bank Research

Figure 3: Nominal GDP growth will likely rise to 5-year high in H2 2026



Source :Deutsche Bank Research

Exports: the Key Growth Engine

Exports are poised to remain a primary driver of growth in H2, supported by what we term the "AHEAD" factors. In March, we identified five pillars underpinning China's export strength: Agentic AI, HALO assets, Energy cost advantages, Accelerating green transition, and Diversification of export markets. These drivers intensified through April and May, particularly the demand for AI-related products; combined imports and exports for this category surged by over 80% YoY in May, exceeding our expectations. With these tailwinds likely to persist, we are raising our full-year export growth forecast to 14%.

Imports are also expected to demonstrate strong growth, potentially outpacing

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exports. This strength is largely attributable to surging domestic investment in AI, which is fueling higher imports of semiconductors, computers, and related components. Higher energy prices and the imports of input materials for future exports also supported the strength in imports.

The normalization of trade relations with the United States presents an upside risk. Following the reduction of reciprocal tariffs and the recent US-China leaders' meeting, we anticipate a meaningful recovery in bilateral trade flows. In May, China's exports to the US climbed to a one-year high, running 10% above the 2025 average. Trade talks between US and China could potentially lead to further reduction in tariffs and restrictions, paving the way for further increases in two-way trade flows.

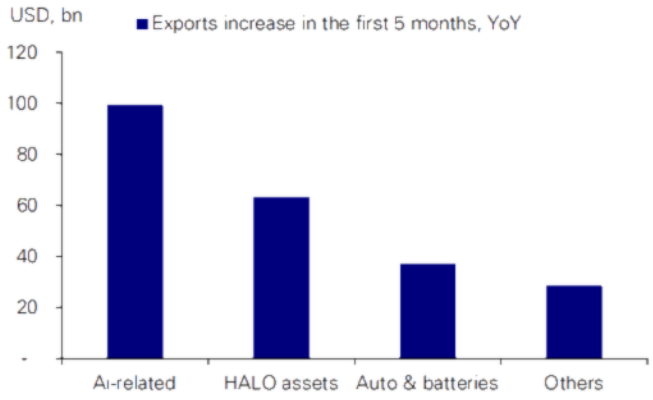
Strong exports should support industrial activities. Although industrial production growth has slowed over the past three months, we think this was mainly driven by drag from fossil fuels and chemicals. By contrast, the rest of the manufacturing sector has remained broadly stable, as also suggested by steady growth in power generation.

Figure 4: China's exports surged further in the past few months…



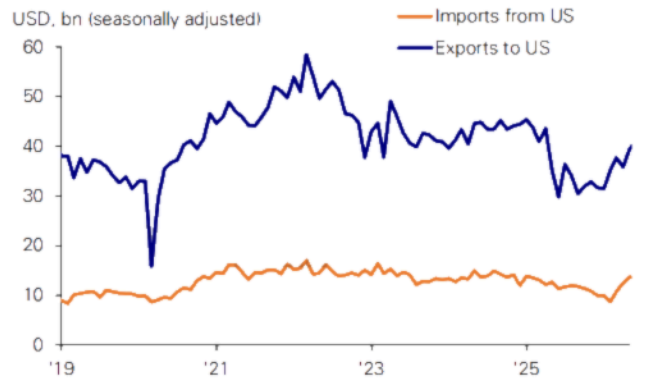
Source : Deutsche Bank Research, Haver Analytics

Figure 5: … driven by "AHEAD" factors



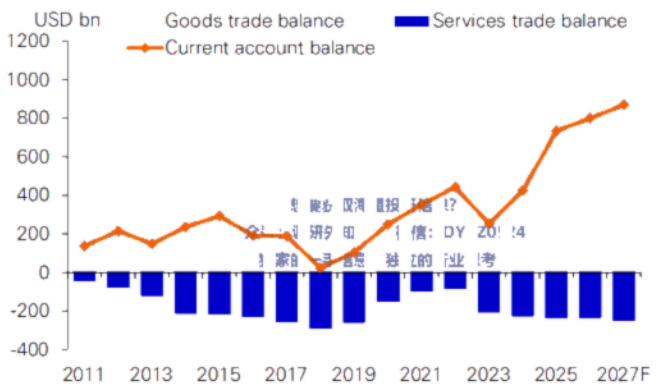
Source : Deutsche Bank Research, Wind
Note. AI-related products include semis and communication devices. HALO assets include metals and machinery outside autos and batteries

Figure 6: Trade flow with the US has recovered



Source : Deutsche Bank Research, Wind

Figure 7: We raise our full-year export growth forecast to 14%



Source : Deutsche Bank Research, Wind

Consumption: Navigating Headwinds

Consumption has softened in 2Q. Entering its third year, the marginal impact of consumer goods trade-in subsidies is diminishing. Since 2H25, sales of subsidized product categories have already started to decline. Stimulus of comparable scale targeting other consumer goods or services consumption has yet to take shape, leaving the gap unfilled and weighing on total consumption.

This policy vacuum has been compounded by softer consumer confidence. Our latest proprietary dbDIG survey shows a slight deterioration in sentiment in Q2, likely reflecting the sequential slowdown in economic activity and financial market volatility. The share of respondents reporting an improvement in their financial conditions or expecting future income growth fell by 6ppt and 2ppt, respectively. Consequently, willingness to spend on discretionary items has also weakened, with the proportion of consumers planning to increase such spending dropping to 46%, a one-year low.

Furthermore, price hikes linked to higher oil costs have dampened real demand. Our survey indicates that consumers have perceived notable price increases in categories like fuel, travel, and apparel. This is corroborated by official data: passenger air traffic, for instance, declined for two consecutive months in April and May, underperforming seasonal norms. This trend not only curtails transport-related spending but also has negative spillover effects on catering, accommodation, and the broader travel industry.

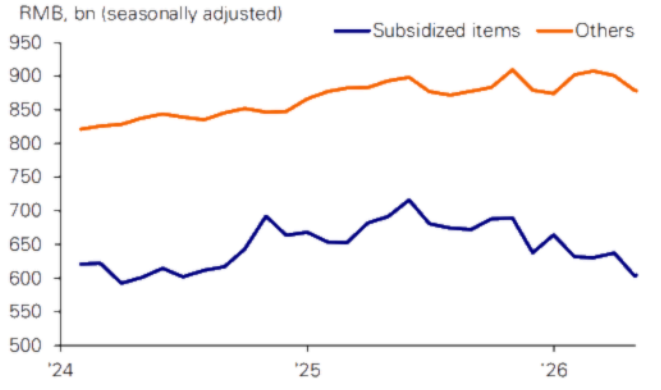
Looking forward, we expect consumption to improve modestly in the second half of 2026.

- The most direct effect is lower transportation fuel costs, and since late May we have already seen airlines reduce related charges. This should provide strong support for travel-related services consumption. In addition, price pressures for chemical and metal products are also likely to ease.
- Second, fiscal spending is likely to re-accelerate, supporting the labor market and household income, and ultimately helping improve consumer

confidence. In particular, faster infrastructure project implementation would not only directly generate substantial employment, but also create spillover demand for catering and entertainment consumption.

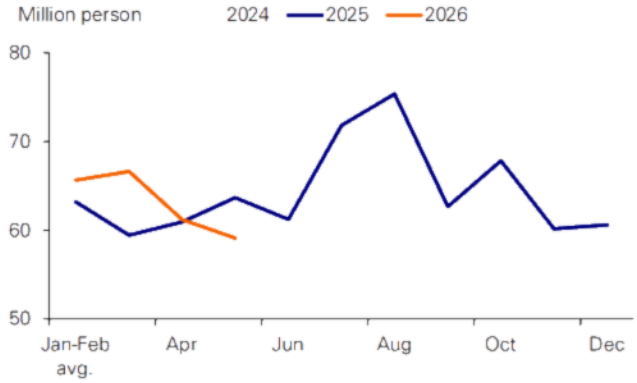
- Third, we expect additional policy measures to support consumption, especially services consumption. Domestically, we expect policy support to focus on fiscal subsidies, credit support, and supply-side quality upgrades. It is also worth noting that foreign visitors' spending in China could become a new growth driver as visa policies continue to be relaxed. Inbound foreign tourist flows have surged since last year, with travel service exports rising by 50% and reaching 1.6 times the 2019 level.

Figure 8: Marginal impact of consumer goods trade-in subsidies is diminishing



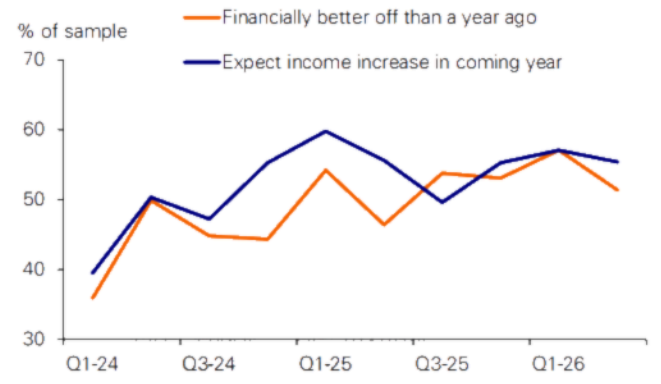
Source : Deutsche Bank Research, Wind

Figure 9: Passenger air traffic declined for two consecutive months



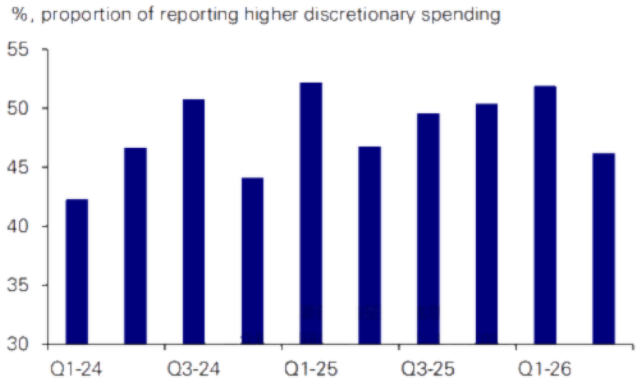
Source : Deutsche Bank Research, CEIC

Figure 10: Consumer confidence weakened in 2Q



Source : Deutsche Bank Research, dbDIG survey

Figure 11: Less proportion of surveyed consumer reported higher discretionary spending



Source : Deutsche Bank Research, dbDIG survey

Property: Stabilization in Sight, But Recovery Will Be Gradual

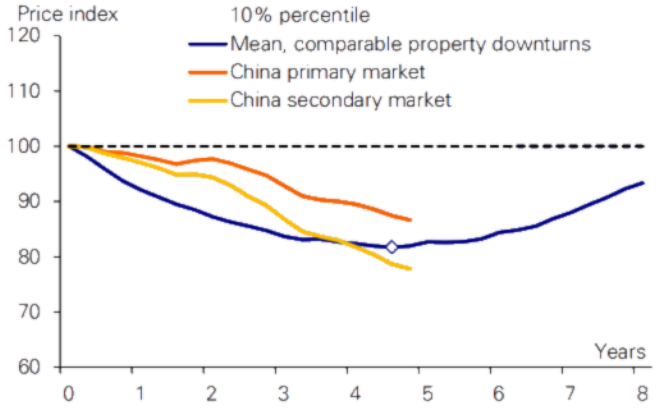
China's prolonged property downcycle may be approaching its end. The correction, now in its fifth year, has seen secondary-home prices fall by over 20%. In terms of both duration and depth, this aligns with major historical downturns observed in other countries, increasing the probability of a cyclical bottom emerging within the next one to two years.

Positive signals are already appearing in top-tier cities, where secondary-home transaction volumes have reached a one-year high. Unlike previous false starts, this rebound appears more durable for two reasons. First, inventories are declining as transactions rise, suggesting the market is finally absorbing excess supply. Second, rents are stabilizing, which can bolster homebuyer confidence in asset values.

However, any recovery will likely be gradual and uneven. The property sector now amplifies economic trends rather than acting as a counter-cyclical stabilizer, meaning a housing recovery will be a consequence of a broader economic upswing, not its cause. The rebound will be geographically specific, emerging first in economically vibrant Tier-1 and Tier-2 cities.

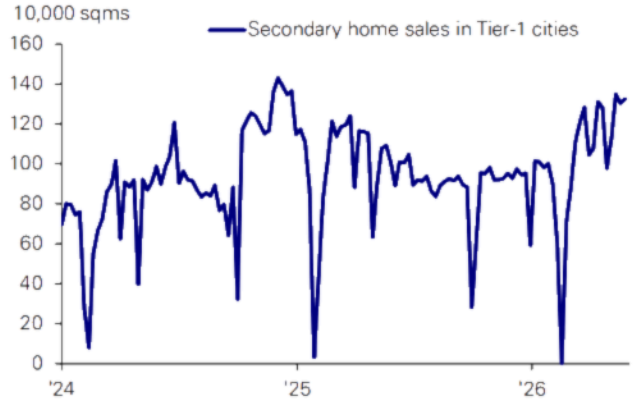
The transmission to the macro economy will also likely be slow. An improvement in the secondary market will take time to filter through to new-home sales, land revenues, and overall investment. As a result, the drag from property on growth may gradually narrow, but it will still take time before the sector turns into a positive contributor.

Figure 12: China's property correction has broadly moved into the range of major housing downturns



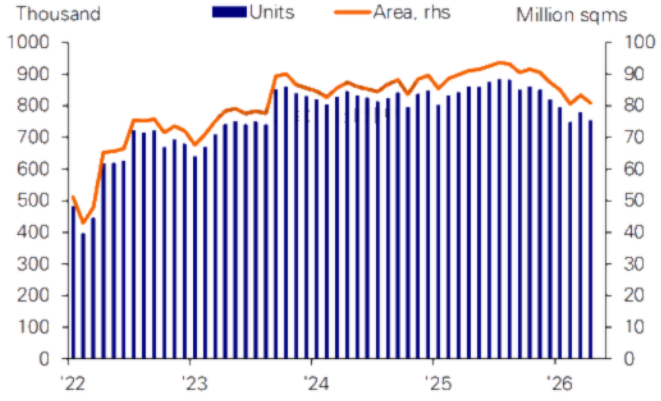
Source: Deutsche Bank Research, BIS, CEIC

Figure 13: Secondary home sales in top tier cities have rebounded



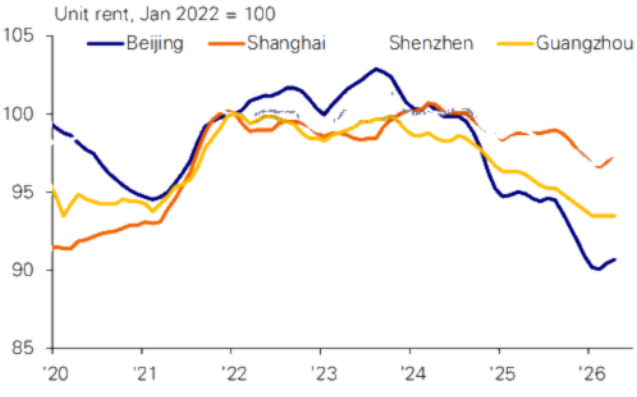
Source: Deutsche Bank Research, CREIS

Figure 14: Secondary listings declined in 4 top tier cities



Source: Deutsche Bank Research, CREIS

Figure 15: Rents have also stabilized



Source: Deutsche Bank Research, CREIS

Continued Reflation at a Slower Pace

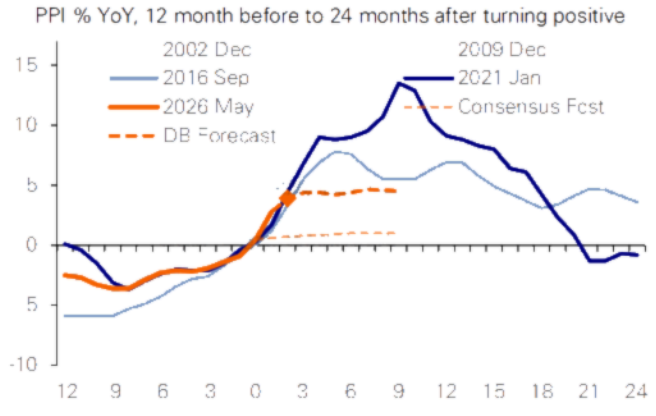
The reflationary trend in China remains a key theme, though the outlook has moderated following the recent drop in international oil prices. While the shock from imported inflation has likely run its course, we believe domestic factors will continue to drive producer prices higher. This will stand in contrast to a more muted recovery in consumer prices, which are being held back by soft domestic demand.

The Producer Price Index is expected to remain on a clear reflationary path. Although lower oil prices remove a key source of upside pressure, we believe a meaningful share of prior cost hikes will be retained due to price stickiness and strong external demand. Going forward, the primary drivers of PPI will be domestic. "Anti-involution" policies, designed to curb excessive price competition in sectors like autos and solar, will provide structural support. Furthermore, the inflationary effects of the AI investment boom are strengthening, generating price pressures for components such as non-ferrous metals and optical fiber cables. We now forecast full-year PPI inflation at 3.0% and year-end PPI at 4.5%.

This PPI rebound should continue to bolster industrial profits. In the first 5 months of the year, industrial profit growth reached an impressive 18.8%, a four-year high. While this improvement is currently concentrated in export, AI, and energy-related sectors, we expect it to gradually broaden to midstream and downstream industries as price increases pass through the supply chain.

In contrast, we now expect a slower pace of recovery for the Consumer Price Index. The slowdown in May's data suggests that consumption demand is softening, reflecting weaker consumer confidence and the impact of earlier price hikes on real demand. The key component of pork prices will also be slow to recover. Although the hog cycle is bottoming, the transmission to CPI is historically slow, and we do not expect pork prices to return to positive growth until year-end or even early 2027. We forecast full-year CPI inflation at 1.3%, rising to about 1.6% by year-end.

Figure 16: PPI will likely continue its reflation trend



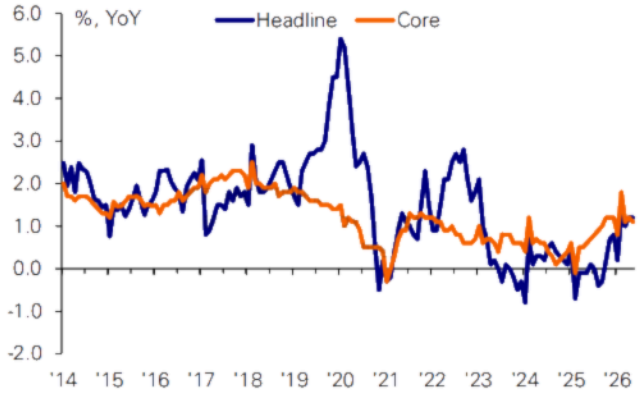
Source : Deutsche Bank Research, Wind

Figure 17: The PPI rebound should support an improvement in industrial profits



Source : Deutsche Bank Research, Wind

Figure 18: CPI inflation slowed in May



Source : Deutsche Bank Research, Wind

Figure 19: Pork prices will likely remain low in the short run



Source : Deutsche Bank Research, Wind

Policy: Fiscal to Take the Lead

The policy mix is set to shift in the second half of 2026, with fiscal policy poised to take the lead in supporting growth while monetary policy remains on a steady course.

Monetary policy is likely to remain supportive, but we see little scope for further broad-based easing. While weak domestic loan and investment demand argues for accommodative conditions, several factors constrain the PBOC. The banking system already has ample liquidity, which has been further boosted by recent FX conversion inflows from strong exports. In addition, banks' net interest margins (NIMs) continue to fall to a new low of 1.40% in Q1. In this context, the PBOC is unlikely to deliver additional policy rate cuts. Instead, we expect the central bank to rely on targeted structural tools to stimulate specific sectors like AI and energy infrastructure, and services activities such as travel and elderly care.

In contrast, fiscal policy is set to re-accelerate in H2. Fiscal momentum slowed significantly in Q2, with expenditure growth falling 7ppt below revenue growth—the first such gap since 2024. This slowdown was driven by a desire to preserve policy ammunition after a strong Q1, underperforming land-sale revenues, and local government caution in launching new projects. Following the Q2 growth moderation, we expect policymakers to pivot back toward stimulus. The upcoming July Politburo meeting will be a key event to watch for this shift.

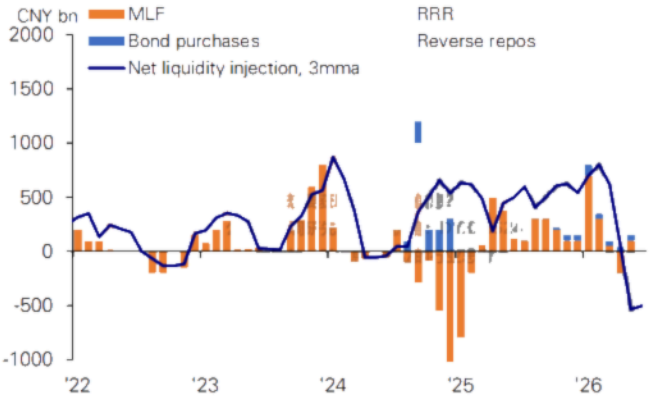
This renewed fiscal support will likely be anchored by major projects under the 15th Five-Year Plan. As 2026 is the first year of this new cycle, we expect the rollout of key initiatives in areas like urban renewal and infrastructure to ramp up in H2, supporting a gradual rebound in investment and overall domestic demand.

Figure 20: Ample liquidity in the banking system relative to credit demand



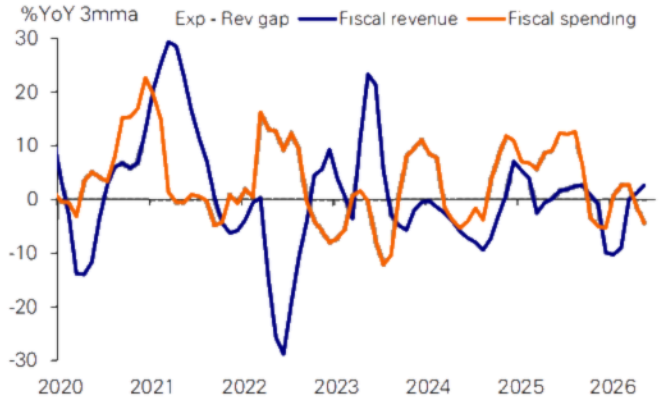
Source :Deutsche Bank Research, Haver Analytics

Figure 21: PBOC has withdrawn substantial liquidity in Q2



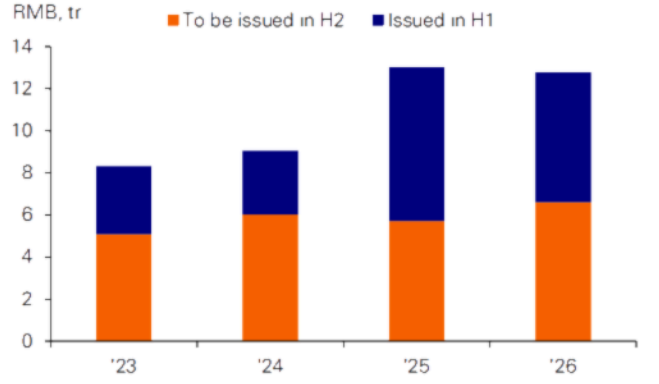
Source : Deutsche Bank Research, Wind

Figure 22: Fiscal spending growth was lower than revenue growth, the first time since 2024



Source : Deutsche Bank Research, Wind

Figure 23: Government bond issuance in H2 will likely increase by 15% YoY, compared to the -16% decline in H1



Source : Deutsche Bank Research, Wind

RMB: Steady Appreciation for Internationalization

The Renminbi is poised to continue its appreciation, supported by strong economic fundamentals, sustained export performance, and a shifting geopolitical landscape.

The currency's strength is fundamentally rooted in China's enhanced competitiveness and strong trade flows. Over the past year, the CNY has already appreciated 7% against a trade-weighted basket from its mid-2025 low. However, from a real effective exchange rate (REER) perspective, the RMB remains approximately 10% undervalued relative to its 2015-2020 average. This undervaluation is particularly salient given the significant productivity gains in China's manufacturing sector, suggesting ample room for further appreciation. The continued strength in exports, coupled with an increased propensity for exporters to convert foreign earnings, should maintain this upward pressure on the currency.

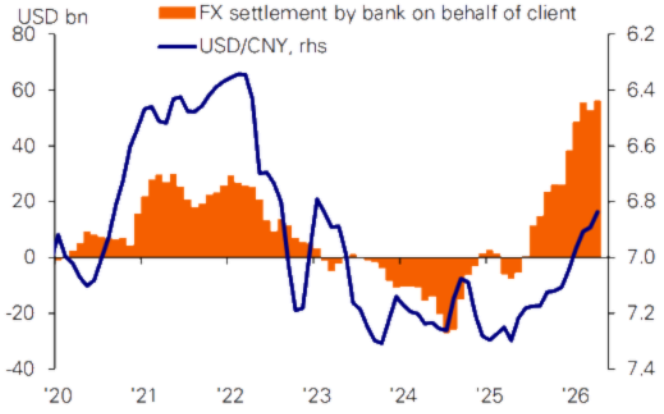
From an international relations standpoint, political impetus for a stronger CNY is likely to intensify in H2. As geopolitical tensions de-escalate, international focus

will likely pivot back toward global trade imbalances. Europe is already heightening its scrutiny of its trade deficit with China. A steady appreciation of the Renminbi thus serves as a strategic response to these external pressures.

Policy will be supportive to sustained RMB strength. Renminbi internationalization has become a key theme for Chinese policymakers. Since year beginning, we have observed notable progress in the use of RMB for international payments and financing. A stable, steadily appreciating RMB will be optimal for further promoting RMB's use by foreign central banks and businesses. Another interesting development is China is becoming an exporter of capital, recycling a part of its trade surplus inflows as cross-border RMB lending to the rest of the world.

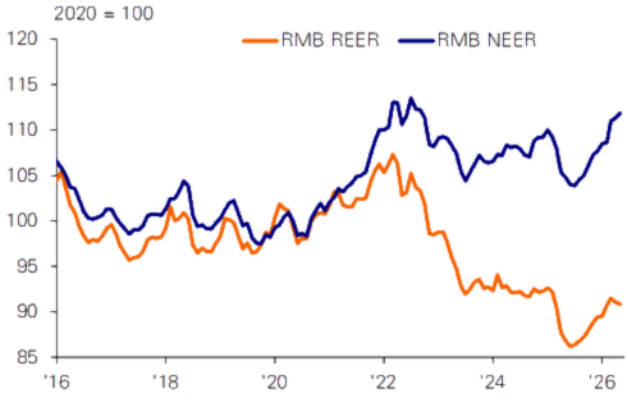
We forecast the Renminbi will strengthen to 6.55/USD by end-2026 and 6.3/USD by end-2027. The primary risk to this forecast is broad-based US dollar strength. In such a scenario, the RMB's appreciation against the dollar could stall, though its appreciation against the broader currency basket would likely continue.

Figure 24: FX settlement by exporters will likely support further RMB strength in H2



Source: Deutsche Bank Research, Wind

Figure 25: RMB REER is still well below historical levels, suggesting further room for appreciation



Source: Deutsche Bank Research, Wind

Figure 26: Chine economic forecast: 2026-27

		2024	2025	2026F	2027F
Activities					
GDP, real	% YoY	5.0	5.0	4.7	4.5
GDP, nominal	% YoY	4.2	4.0	6.8	6.6
CPI inflation, p.a.	% YoY	-0.1	0.0	1.3	1.6
Retail sales	% YoY	3.5	3.7	2.0	4.0
Fixed asset investment	% YoY	3.2	-3.8	1.0	3.0
Industrial production	% YoY	5.8	5.9	5.0	5.0
Fiscal					
Budgetary balance	% of GDP	-3.0	-4.0	-4.0	-3.5
Total fiscal balance	% of GDP	-7.7	-9.0	-8.5	-8.0
Central government debt	% of GDP	25.6	29.3	31.3	32.9
Augmented public debt	% of GDP	99.3	106.3	109.0	111.3
External					
Exports growth	% YoY	7.2	10.1	14.0	8.0
Imports growth	% YoY	2.2	1.9	16.0	8.0
Goods balance	% of GDP	4.1	5.4	5.2	5.0
Current account balance	% of GDP	2.3	3.7	3.6	3.5
USDCNY, eop		7.30	6.99	6.55	6.30
FX reserves	USD bn	3,202	3,358	3,458	3,558
Monetary					
TSF growth, eop	% YoY	8.0	8.3	8.0	7.8
RRR	%	9.5	9.0	8.5	8.5
7-day OMO rate, end-year	%	1.50	1.40	1.40	1.40

Source : Deutsche Bank Research