China Fiscal Watch

Holding fire on bigger stimulus

Demand indicators paint a much weaker picture than GDP growth. Fiscal policy is less expansionary than rhetoric suggests, while the PBoC is restrained. The reluctance to launch a bigger stimulus reflects tighter fiscal constraints and political incentives ahead of a leadership reshuffle.

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How weak is China, really?

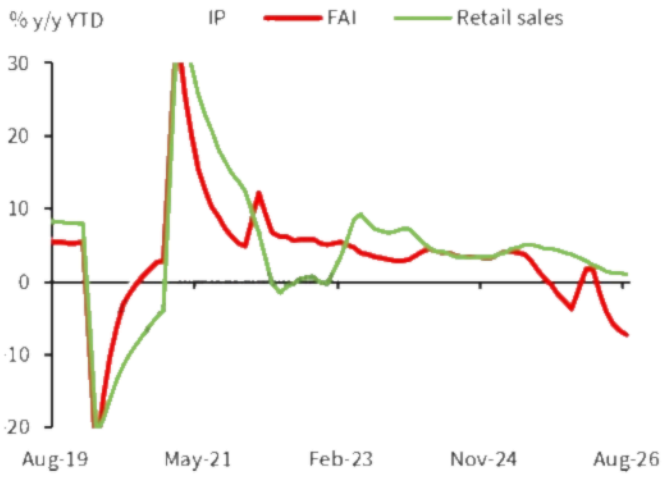
China's growth momentum has slowed sharply since Q2. While GDP growth remained at 4.7% y/y in H1, still within the government's 4.5-5.0% growth target range, underlying demand indicators paint a much weaker picture. Retail sales growth has slowed to just 1.1% y/y YTD in August, while fixed asset investment (FAI) contracted by 7.2%. The sole bright spot has been exports, supported by strong AI-related and green-technology shipments, which have risen 19% y/y YTD.

To gauge overall demand conditions, we estimate a weighted-average of retail sales, FAI and exports, deflated by core CPI. On this measure, aggregate demand contracted by 0.8% y/y in Q2 and 0.5% y/y in July-August, a sharp reversal from 2.9% growth in Q1. In our view, the large gap between GDP and demand indicators reflects: 1) China's GDP growth is production based; and 2) the slowdown in demand indicators is much faster than IP and services production.

We think the sharp slowdown in domestic demand reflects a combination of factors: a contracting credit impulse; reduced capital expenditure in traditional industries; overcapacity pressures in some high-tech sectors, such as solar panels and electric vehicles; a deteriorating labour market; more forceful household deleveraging; and significant negative wealth effects stemming from the renewed decline in home prices.

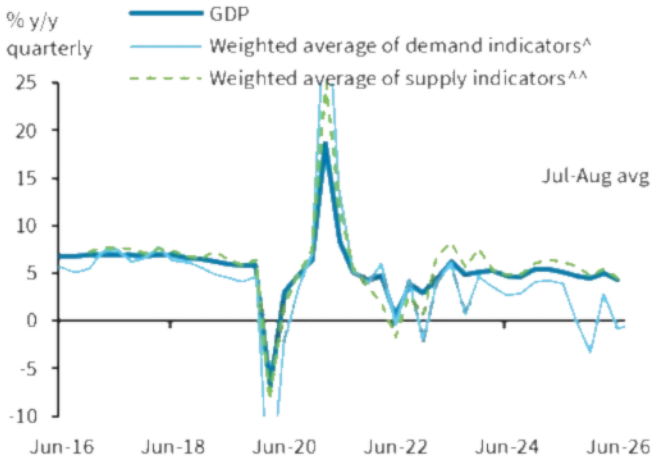


FIGURE 1. **Retail sales growth slowed to just 1.1% y/y YTD, while FAI contracted by 7.2% y/y YTD**



Source: Wind, Barclays Research

FIGURE 2. **Underlying demand indicators paint a much weaker picture than headline GDP**



Note: ^=0.55real retail sales+0.3real FAI+0.15real exports, deflated using core CPI; ^^=0.4IP+0.6*services production index
Source: Wind, Barclays Research

Is fiscal policy really expansionary?

We don't think so. Unlike the US, Japan and France, where high public debt has not been accompanied by meaningful fiscal consolidation, China has maintained relatively strong fiscal discipline. This year, policymakers have focused on boosting revenue collection through stricter tax enforcement while keeping fiscal spending growth relatively restrained. As a result, the effective fiscal impulse has been weaker than headline policy rhetoric might suggest.

- On the revenue side, the government has already introduced a number of measures this year to boost fiscal receipts, including raising the VAT on telecommunications services[1], reducing export tax rebates[2], tightening social security contribution enforcement[3], and closing offshore trust-related tax loopholes[4]. More importantly, personal income tax receipts have risen by 15% y/y YTD, partly reflecting stricter tax compliance and enforcement rather than a stronger labour market or faster wage growth. This effectively withdraws purchasing power from households and offsets part of the fiscal support provided elsewhere in the budget.

- On the spending side, fiscal expenditure growth has also slowed. While the budget remains expansionary on paper, the pace of fiscal spending has lagged expectations, with some local governments remaining cautious amid debt constraints and tighter oversight. Specifically, aggregate government expenditure has contracted by 3% y/y YTD, a sharp reversal from 3.7% growth in 2025. As a result, the transmission from budgeted stimulus to actual economic activity has been weaker than many expected.

Taken together, stronger revenue collection and subdued spending growth suggest that China's fiscal policy is, de facto, in austerity mode rather than expansionary.

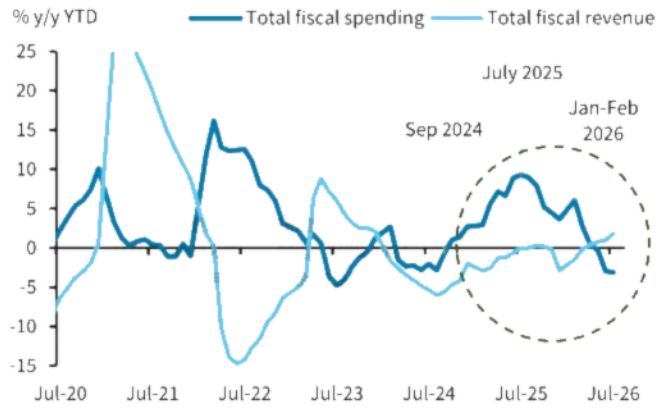
[1] "China's Top Three Telecoms Warn VAT Adjustment Will Impact Revenue and Profit", the Paper.cn, 1 February 2026

[2] "China to scrap export tax rebates for photovoltaic and battery products", Reuters, 9 January 2026; "China Abolishes VAT Refunds for a Wide Range of Exported Products", VAT Update, 8 Jan 2026

[3] "Tighter social security oversight to protect workers", China Daily, 20 May 2026

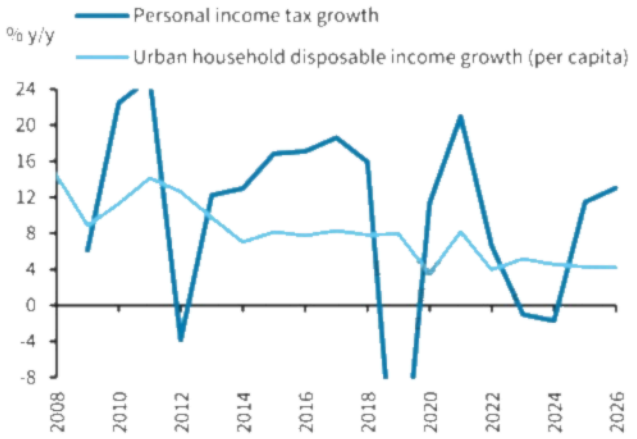
[4] "China to tax offshore trusts as Beijing targets overseas wealth", Reuters, 24 July 2026; China tax authority clarifies offshore insurance income subject to domestic tax, report say", Reuters, 7 August 2026

FIGURE 3. **De facto fiscal austerity**



Source: Wind, Barclays Research

FIGURE 4. **Stricter tax enforcement helped drive personal income tax revenue growth above the pace of household income growth**



Source: Wind, Barclays Research

Why no bigger stimulus?

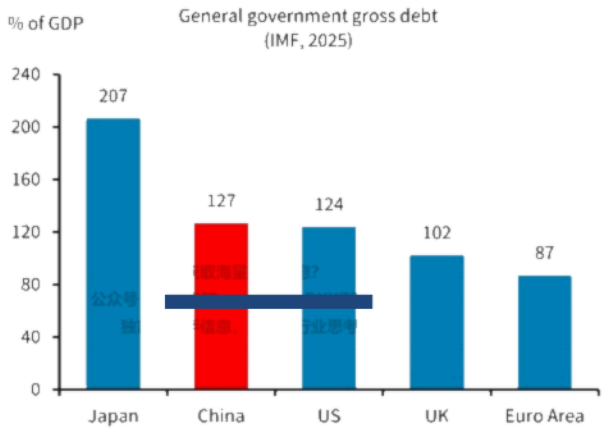
We see three main reasons for this policy restraint.

- **First, fiscal constraints are far tighter than the headline debt numbers suggest.** China's official government debt is around 75% of GDP, but that excludes the vast stock of off-balance-sheet borrowing by LGFVs. Including these liabilities, the IMF estimates government debt at roughly 127% of GDP in 2025, rising to 146% by 2028. Meanwhile, local governments have been hit by the collapse in land-sale revenue, once a major funding source. With fiscal buffers shrinking and pension liabilities mounting, China's priority has shifted from maximizing growth to preserving debt sustainability, leaving little appetite for another debt-driven stimulus binge.

- **Second, China is increasingly facing an infrastructure saturation problem.** After two decades of heavy investment, the country already has the world's largest high-speed rail, expressway, and port networks. The constraint is no longer supply, but demand and utilization. Many regional airports, rail routes, industrial parks, and new urban districts operate below capacity, pointing to diminishing returns from additional investment. For example, only 41 of China's 270 airports accounted for 84% of passenger traffic in 2025. As a result, another infrastructure-led stimulus is likely to generate far less economic bang for the buck than in previous cycles.

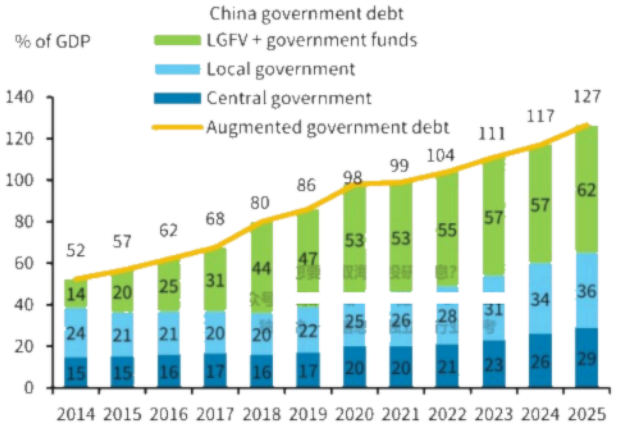
- **Third, a less discussed but increasingly important constraint is politics.** A new round of provincial leadership reshuffles is expected from late 2026 through 2027, with many governors, party secretaries, and senior officials likely to be rotated, promoted, or reassigned. Large infrastructure projects typically require two to three years for approval and initiation, and another 5-10 years before generating meaningful economic returns. For officials who expect to leave their posts within the next one or two years, launching major projects today can mean taking on additional debt and execution risks, while the economic benefits are realized by their successors. As a result, local governments may have stronger incentives to prioritize smaller, targeted investments and focus on completing existing projects rather than embarking on new large-scale stimulus programs.

FIGURE 5. **China's government debt is closer to the US than Japan...**



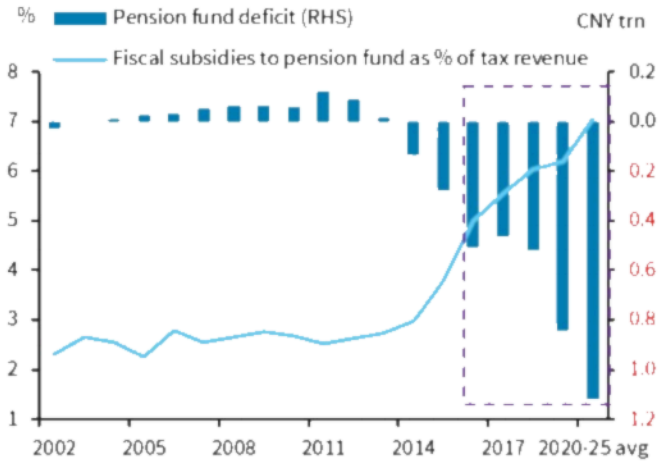
Source: IMF, Wind, Barclays Research

FIGURE 6. **... but deteriorating faster**



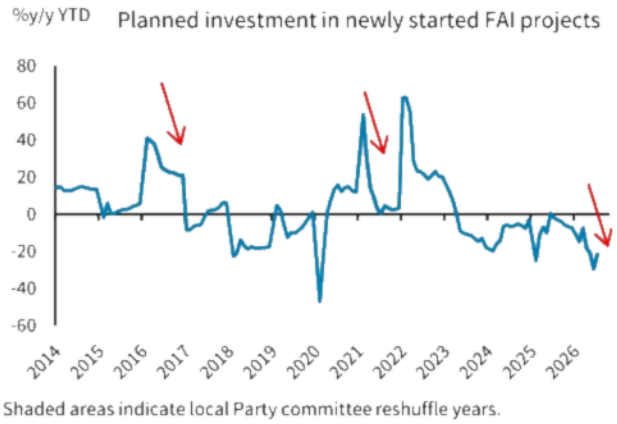
Source: IMF, Wind, Barclays Research

FIGURE 7. **Widening pension fund deficit**



Source: Wind, Barclays Research

FIGURE 8. **New project starts tend to slow during periods of leadership reshuffling**



Shaded areas indicate local Party committee reshuffle years.

Source: Wind, Barclays Research

Will the PBoC do the heavy lifting?

Again, we don't think so. The August PBoC Monetary Policy Report suggests the central bank is in no rush to roll out high-profile easing measures such as policy rate cuts or RRR reductions.

While CNY strength has eased some external constraints, record-low bank net interest margins (NIMs) leave limited room for further rate cuts. Historically, policy easing has compressed NIMs as lending rates linked to the LPR reprice lower quickly, while deposit rates adjust more slowly due to intense competition for deposits.

In our view, protecting NIMs has become a policy priority for two reasons. First, healthy profitability provides banks with a buffer against potential credit losses. Second, it preserves banks' willingness and capacity to lend, supporting the transmission of monetary policy to the real economy.

More broadly, policymakers appear increasingly concerned that excessively low rates could undermine financial stability and weaken monetary transmission. As a result, we expect the

PBoC to remain cautious, relying on targeted tools rather than aggressive, broad-based monetary easing.

What are the policy priorities?

Rather than relying on a large-scale demand stimulus, China is committed to the priorities outlined in the 15th Five-Year Plan (2026-30). The emphasis is on developing "new quality productive forces," strengthening technological self-reliance, accelerating the AI Plus strategy, upgrading advanced manufacturing, enhancing energy security, and improving supply-chain resilience. In other words, policymakers remain focused on the supply side rather than demand stimulus. The objective is not simply to boost growth in the short term, but to raise productivity and strengthen China's long-term competitiveness amid intensifying US-China strategic competition.

Policymakers have shifted toward targeted support for strategic sectors rather than broad-based stimulus. A notable recent example is the CNY800bn policy financing facility launched in September, a quasi-fiscal tool operated by policy banks to fund eligible projects. Priority sectors include advanced manufacturing, AI, technological innovation, green and low-carbon development, the low-altitude economy, and commercial aerospace.

Recent bank lending data provide a useful window into policymakers' priorities. While credit to the property and consumption sectors fell, loans to green industries grew 14.7% y/y and lending to high-tech sectors rose 14.6% y/y, led by ICT, pharmaceuticals, and aerospace. These trends highlight an ongoing reallocation of capital away from property and traditional industries toward sectors viewed as critical to China's long-term economic and technological ambitions.

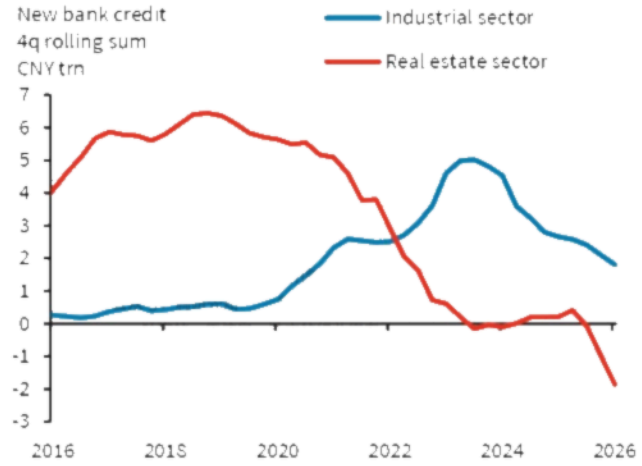
Why consumption stimulus is less prioritized?

China has introduced several pro-consumption measures in recent years, most notably a CNY150bn trade-in and subsidy program in 2024, which was expanded to CNY300bn in 2025 before being reduced to CNY250bn this year. However, the trade-in scheme was originally conceived as a temporary demand-support measure, with policymakers intending to withdraw it gradually rather than turn it into a permanent subsidy program.

Apart from fiscal constrains, we see two reasons that China has refrained from rolling out a big stimulus. First, policymakers have concerns about the effectiveness and distributional effects of pro- consumption support. Trade-in schemes and subsidies tend to favor selected sectors, such as autos, smartphones, and home appliances, creating winners and losers across the economy. Meanwhile, cautious households may save rather than spend additional income, diluting the impact of cash transfers.

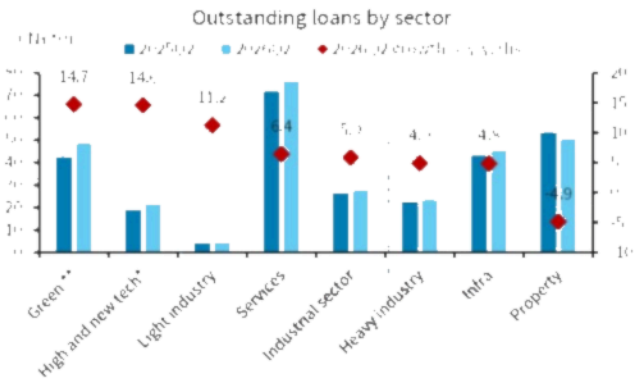
Second, there are political and ideological considerations. Policymakers have traditionally placed greater emphasis on production, investment, and supply-side upgrading than on direct household transfers. Large-scale cash handouts are often viewed as less consistent with China's long-standing policy approach, which prioritizes employment, investment, and productivity growth as the primary drivers of economic development.

FIGURE 9. **New bank loans to real-estate sector declined in 2026…**



Source: Wind, Barclays Research

FIGURE 10. **… while loans to high-tech sectors recorded double-digit growth**



Note: *NBS high-tech manufacturing industries include 1) pharmaceutical, 2) aerospace vehicles and equipment, 3) electronic and communication equipment, 4) computers and office equipment, 5) medical equipment, measuring instruments and meters, and 6) electronic chemicals.** PBoC green loans include loans to energy conservation and environment protection, clean production, clean energy, ecological environment, green upgrade for infrastructure and green services.
Source: Wind, Barclays Research

Appendix

FIGURE 11. **Official comments on government-debt control and debt discipline**

Comment date	Official / document	Official comments	Focus
23-Jun-26	Lan Fo'an, finance minister, presenting the State Council's 2025 central final-accounts report	**The report said described "not adding hidden debt" as an "iron discipline"; said authorities would quickly investigate and handle illegal borrowing and false debt resolution.**	Non-negotiable prohibition on new hidden debt
		For the remainder of 2026, the government would press localities to accelerate resolution of outstanding hidden debt,"resolutely prevent new hidden debt", improve full-coverage local-debt monitoring, and promote the classified and orderly reform and transformation of local-government financing platforms.	Monitoring, local responsibility and LGFV reform
23-Jun-26	Hou Kai, auditor general, presenting the State Council's annual audit report	**The report recommended stronger scrutiny of LGFV exits and stated localities that add hidden debt in defiance of the rules should face serious accountability in accordance with regulations.**	Explicit accountability for new hidden debt
		The audit called for stricter Budget Law compliance and stronger binding budget constraints. It also recommended holding both directly responsible officials and leaders accountable for financial-discipline violations, to avoid a "broken-windows effect".	Debt control as part of broader fiscal discipline
22-Jul-26	Zhao Zeyong, deputy director-general of the Ministry of Finance Debt Management Department	Zhao said authorities were strengthening full-chain management and making supervision stricter. Measures included look-through supervision of special-bond proceeds, "scanning-style" checks of their use, resolute investigation of violations, and asset registers for special-bond projects.	Look-through and end-to-end supervision
		The Ministry would strengthen the "borrow-use-manage-repay" closed loop. It would tighten project review from the planning stage, coordinate funding with construction, implement the negative list strictly, improve post-investment asset management, establish debt-service reserves, prepare principal-and-interest collection plans and collect project-operating revenue.	Full-lifecycle debt management
24 Jun meeting; published 19 Aug 2026	Members and attendees of the NPC Standing Committee's 23rd meeting	For the expanded "self-review and self-issuance" pilot, participating regions were required to define responsibilities for project selection, use of proceeds, fund supervision and debt repayment.	Delegated authority paired with local responsibility
		Participants recommended stronger coordination among budget, asset and debt management, with full-lifecycle management of assets created through government debt. They also called for better links among comprehensive government financial reports, state-asset reports and government-debt reports.	Integration of debt, asset and fiscal reporting
		Participants recommended special-bond projects and quotas be arranged scientifically on the basis of project-revenue and financing balance, to prevent repayment risks. They also called for stronger supervision and performance evaluation of government-investment funds.	Financing-return balance and repayment risk
25 Aug 2026; published 28 Aug	Lin Zechang, vice minister of finance, presenting the State Council report on budget implementation	The report said authorities would resolutely curb illegal additions to hidden debt, deepen cross-departmental regulatory coordination, severely investigate new hidden debt and false debt resolution, and impose heavier accountability.	Strongest late-summer enforcement statement
		The report said authorities were moving toward combined supervision of hidden and statutory debt and strengthening full-coverage monitoring of local debt.	Broader perimeter of debt supervision
		For the next stage, the government would press localities to bear primary responsibility for debt resolution, guard against false debt resolution and new hidden debt, and promote LGFV exits and market-oriented transformation.	Local accountability and LGFV transformation
		The report called for strengthened look-through fiscal supervision, strict investigation of financial-discipline violations and stronger action against financial fraud and accounting falsification.	Fiscal discipline beyond debt issuance

Source: Bloomberg, Caixin, Xinhua, Barclays Research