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China: Fiscal contraction remained in Q3

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The Ministry of Finance released September's fiscal data. Considering the volatility in monthly figures, we assess quarterly data to better capture the underlying trend. According to our estimates, broad revenue growth rose slightly to 2.4% y-o-y in Q3 from 2.1% in Q2, due mainly to steady tax revenue as a result of a more positive PPI inflation and enhanced tax enforcement on corporates and wealthy individuals. By contrast, broad expenditure growth remained negative, albeit increasing to -4.7% y-o-y in Q3 from -8.5% in Q2. Despite *faster* government bond issuance and the deployment of new policy financing tools (NPFT), fiscal spending has not picked up in September. We expect a more pronounced policy impact to materialize in Q4, while its magnitude should not be overstated. As local governments tap bond proceeds to meet basic spending needs, the fiscal multiplier effect could be largely muted. Meanwhile, the leverage effect of the NPFT could be constrained by eroding inter-firm trust amid *mounting arrears* .

Broad expenditure growth remained negative in Q3

Following the *fiscal contraction* in H1, the latest fiscal data pointed to little improvement in Q3, suggesting that government spending remained a growth drag despite the GDP growth rebound in Q3. Broad expenditure growth, which includes both on-budget and government-managed funds, remained negative in Q3, albeit up slightly to -4.7% y-o-y from -8.5% in Q2, with its year-to-date growth at -3.5% y-o-y (2025: 3.7%; Figure 1). The negative growth was once again driven by government-managed funds, for which the major source of revenue is from land sales. Although the NDRC and MOF vowed to speed up government spending in *late August* , following the *Politburo* meeting on 30 July, the pace has not picked up in September. With expenditure growth of on-budget and government-managed funds at 0.0% y-o-y and -12.1%, respectively, in September, broad expenditure growth increased only slightly to -3.6% y-o-y from -6.5% in August. In the first nine months, expenditure growth of on-budget and government-managed funds were at 1.0% y-o-y and -16.2%, respectively, well below their annual target of 4.4% and 5.1%.

Robust fiscal revenue in Q3, despite a sluggish economy

On-budget fiscal revenue growth turned negative in September, falling to -0.1% y-o-y from 4.7% in August. However, its quarterly growth only slowed modestly to 6.1% y-o-y in Q3 from 7.3% in Q2, taking its year-to-date growth to 5.1% y-o-y in September, which is still well above the annual target of 2.2%.

The revenue strength was mainly led by tax revenues, which grew 7.8% y-o-y in Q3, little changed from 8.6% in Q2, while nontax revenue growth fell to -1.8% from 1.6%. The steady tax revenue growth was driven by value-added tax (VAT), corporate income tax (CIT), and individual income taxes (IIT), with their Q3 growth at 6.0% y-o-y, 17.5% and 16.3%, respectively, compared to 7.4%, 11.3% and 16.4% in Q2. We believe the steady growth of VAT, CIT, and IIT were mainly a result of positive PPI inflation, enhanced tax enforcement on corporates and wealthy individuals, and rising capital gain tax collection amid the stock market rally earlier this year, rather than a broad recovery of the economy.

In fact, some tax categories have started to show some signs of weakness in September. CIT revenue growth dropped to -0.4% y-o-y in September from 11.6% in August, as profit margins of downstream companies could be eroded by rising raw material prices. Amid cooling stock markets and a high base, revenue growth of stamp duty tax on stock trading turned negative, falling to -11.5% y-o-y in September from 17.9% in August. Amid the perennial property bust and weak consumption, revenue growth of property-related tax and consumption tax both fell to -5.7% y-o-y in Q3 from their respective growth of -5.3% and -2.0% in Q2. For off-budget items, land revenue growth remained negative in September, albeit rising modestly to -12.1% from -20.9% in August, with its year-to-date growth at -27.9% y-o-y (2025: -14.7%; Figure 2). The sustained contraction in land revenue, a major revenue source of government-managed funds, has continued to

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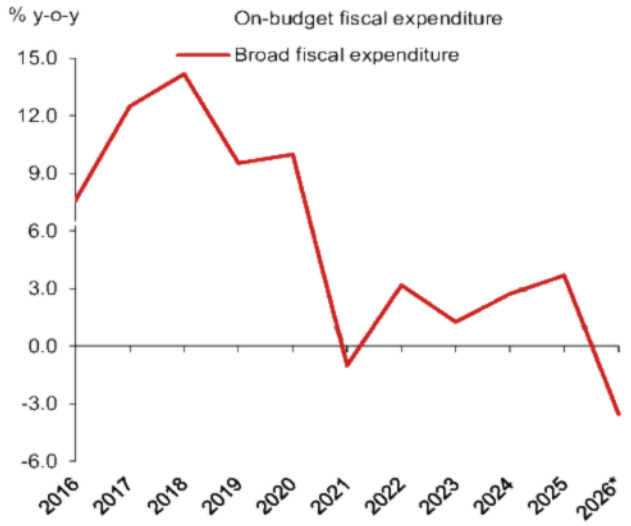
See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

pressure local fiscal conditions and constrain broad fiscal spending.

The backloaded government bond issuance in Q4

With the *RMB550bn* extra local government bond quota unveiled in early October, the annual quota for overall net government bond financing was raised to RMB14.44trn in 2026 from RMB14.36trn in 2025. We estimate net financing of government bonds, including both central and local governments, reached RMB10.4trn in the first nine months, which is around RMB1.1trn below a year ago's level. As a result, if all planned quotas are fulfilled, we estimate net financing of government bonds could reach about RMB4.0trn in Q4, above the RMB2.3trn a year earlier. In fact, early data have suggested a strong bond issuance month in October. In 1-23 October, net financing of government bonds already reached RMB1.0trn, well above the RMB528bn recorded in October 2025.

Fig. 1: Broad fiscal expenditure is on track for a contraction for 2026, first time in five years



Note: Data points for 2026 refer to year-on-year growth in the first nine months.
Source: MOF, Wind, Nomura Global Economics.

Fig. 2: Property-related revenues continue to decline



Note: Data points for 2026 refer to year-on-year growth in the first nine months.
Source: MOF, Wind, Nomura Global Economics.

Fig. 3: Major fiscal indicators

Major fiscal indicators	unit	Sep 26	Aug 26	Q3 26	Q2 26	2025	2024
On-budget revenue growth	% y-o-y	**-0.1**	**4.7**	**6.1**	**7.3**	**-1.7**	**1.3**
Tax revenue	% y-o-y	0.2	5.6	7.8	8.6	0.8	-3.4
Value-added tax (VAT)	% y-o-y	7.3	4.0	6.0	7.4	3.4	-3.8
Corporate income tax	% y-o-y	-0.4	11.6	17.5	11.3	1.0	-0.5
Property-related tax	% y-o-y	-14.6	-1.9	-5.7	-5.3	-4.4	0.0
Consumption tax	% y-o-y	-8.5	-14.0	-5.7	-2.0	2.0	2.6
Individual income tax	% y-o-y	10.5	11.8	16.3	16.4	11.5	-1.7
Stamp duty tax on stock trading	% y-o-y	-11.5	17.9	27.0	118.2	57.8	-29.1
Non-tax revenue	% y-o-y	-1.0	0.3	-1.8	1.6	-11.3	25.4
Revenue growth from government-managed funds	% y-o-y	**-16.1**	**-3.6**	**-13.4**	**-26.5**	**-7.0**	**-12.2**
Revenue from land sales	% y-o-y	-23.4	-12.3	-21.5	-38.0	-14.7	-16.0
On-budget expenditure growth	% y-o-y	**0.0**	**-0.1**	**0.1**	**0.2**	**1.0**	**3.6**
Infrastructure	% y-o-y	0.0	-2.4	-1.0	-7.9	-7.8	7.3
Healthcare	% y-o-y	-2.9	3.8	0.4	9.3	5.7	-9.1
Education	% y-o-y	3.5	1.3	2.3	1.6	3.2	2.0
Social security and employment	% y-o-y	-4.8	2.6	-0.5	5.9	6.7	5.6
Science & technology	% y-o-y	6.9	9.0	6.4	4.9	4.8	5.7
Environmental protection	% y-o-y	-13.7	-15.8	-16.8	-19.8	6.1	-1.4
Expenditure growth from government-managed funds	% y-o-y	**-12.1**	**-20.9**	**-15.9**	**-31.0**	**11.3**	**0.2**
Broad fiscal revenue	**% y-o-y**	**-3.5**	**2.9**	**2.4**	**2.1**	**-2.8**	**-2.0**
Broad fiscal expenditure	**% y-o-y**	**-3.6**	**-6.5**	**-4.7**	**-8.5**	**3.7**	**2.7**
Fiscal balance	RMB bn	**-1,309**	**-563**	**-1,563**	**-919**	**-2,333**	**-1,887**
Fiscal balance (12m rolling sum)	RMB bn	**-6,507**	**-6,504**	**-6,507**	**-6,793**	**-7,135**	**-6,491**

Source: Wind, Nomura Global Economics.

