

CHINA

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STRENGTHS AND IMBALANCES

China's economic growth continues to be characterised by a significant disparity between the robust performance of the export sector and the fragility of sectors that rely on domestic demand. This gap has even widened this year, fuelling concerns about China's growth model and its imbalances with its trade partners. In recent months, China has once again demonstrated its resilience to external shocks. The impact of the energy crisis caused by the war in Iran on economic activity and inflation has been limited. Furthermore, exports have benefited from the surge in global demand for goods linked to AI and green technologies. This momentum is expected to continue in the short term.

CHINA IS MANAGING THE ENERGY SHOCK WITH RELATIVE EASE

The energy shock triggered by the war in Iran has produced various effects on the Chinese economy, yet its overall impact has been moderate. Firstly, the country, which is a major importer of hydrocarbons (accounting for 72% of its crude oil requirements), has not experienced any supply difficulties. It has strengthened its energy security in recent years by diversifying supply sources and increasing reserves, developed renewable energy (which constitutes around 20% of the energy mix), all the while maintaining a predominant reliance on coal (55% of the mix). China has also acted swiftly to cushion the blow: turning to suppliers outside the Gulf region, compensating for shortfalls with coal, domestic gas and green energy, drawing on commercial reserves, temporarily suspending exports of refined products and fertilisers, and, finally, reducing crude oil imports and the production of refined products to lessen the impact of rising prices.

Indeed, the surge in oil and gas prices has increased production costs, contributing to a slowdown in industrial production (+4.3% y/y in April-May, down from +6.1% in Q1). Moreover, the rise in petrol prices at the pump has undoubtedly impacted household consumption. However, the direct impact of the inflationary shock is expected to be limited, thanks to China's fuel price control mechanism.

Finally, the conflict in Iran has not held back exports. In fact, it could even improve their prospects in the green technology sector.

ECONOMIC GROWTH: THE IMBALANCE CONTINUES

Exports have been rising rapidly since the start of the year (+18.7% y/y in value terms in H1 2026 vs. +5.4% in 2025). This growth has been driven by higher volumes (+16% y/y in January-April vs. +8.7% in 2025) and, for the first time since 2022, by a positive price effect (Chart 1).

Exports have benefited from: i) the reduction in US tariffs since 24 February and the rebound in sales of Chinese goods to the United States (+23% y/y by value in April-May, following twelve months of decline), ii) the surge in global demand for AI-related goods (exports in this sector rose by +44% y/y in January-May, accounting for 22% of total Chinese exports), and iii) strong demand for green technologies, which may continue in the short term as various countries seek to bolster their energy security in response to the shock caused by the war in Iran. Total exports of goods linked to the low-carbon transition (notably batteries, electric vehicles and solar panels) have risen rapidly (+40% y/y by value in January-May, according to Ember data), particularly to Asia and Europe. These goods account for 7% of China's total exports. The short-term outlook for exports remains very positive, despite the potential for a correction in the tech sector.

Economic forecasts

	2022	2023	2024	2025	2026e	2027e
Real GDP growth, %	3.1	5.4	5.0	5.0	4.6	4.5
Inflation, CPI, year average, %	2.0	0.2	0.2	0.0	1.3	1.6
Official budget balance / GDP, %	-2.7	-3.8	-3.0	-4.0	-4.0	-4.0
Official general gov. debt / GDP, %	49.4	54.7	60.9	68.5	74.6	77.5
Current account balance / GDP, %	2.2	1.4	2.5	3.8	3.5	3.4
External debt / GDP, %	13.4	13.4	12.5	11.9	11.7	11.4
Forex reserves, USD bn	3 307	3 450	3 456	3 744	3 844	3 924
Forex reserves, in months of imports	12.5	13.0	12.5	13.6	13.4	13.2

TABLE 1

e: ESTIMATES & FORECASTS

SOURCE: BNP PARIBAS ECONOMIC RESEARCH

China's external trade: energy shock and IA boom

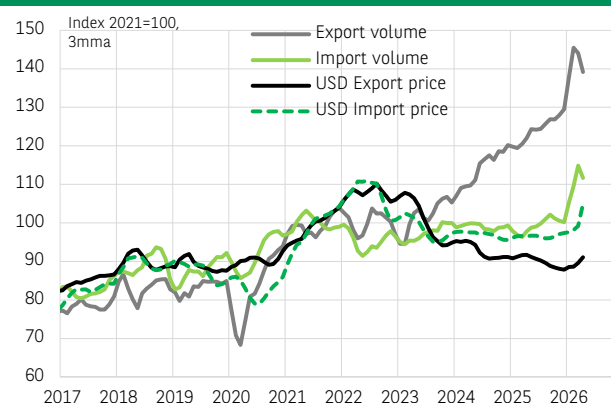


CHART 1

SOURCE: CPB, BNP PARIBAS

Domestic demand, meanwhile, has remained sluggish. It rebounded in January and February, but it has since significantly declined. In H1 2026, retail sales rose by only 1.3% y/y in value terms, vs. +3.7% in 2025. Investment saw a decline of 5.7% y/y in value terms in H1 2026, driven by a contraction in the property sector, manufacturing and infrastructure. The crisis in the property sector continues and household confidence remains low. Output in the services sector slowed to +4.5% y/y in Q2 2026, down from +5.1% in Q1 2026.



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INFLATION: THE ACCELERATION IS NOT ENTRENCHED

Consumer price inflation accelerated slightly due to the energy shock, rising from +0.8% y/y in January–February to +1.2% in April–May. It then fell to +1% in June (having not exceeded +1% since early 2023). In Q2, vehicle fuel prices rose by an average of 17.9% y/y after six consecutive quarters of decline, while food prices fell by 1.6% y/y. Producer prices rose by 3.6% y/y, following more than three years of decline (Chart 2).

This rebound in prices would be welcome if it facilitated a sustainable exit from deflation for China. However, the problem lies in the fact that it is not accompanied by a strengthening of domestic demand – quite the contrary. It is primarily driven by rising commodity prices (with two other contributing factors being anti-involution measures and rising prices for electronic goods). Core inflation slowed slightly in H1 (+1.1% y/y in June). Consequently, inflationary pressures are unlikely to intensify in the short term unless oil prices start to rise again.

ECONOMIC POLICY: ADDITIONAL FISCAL SUPPORT EXPECTED IN H2

A short-term recovery in domestic demand seems possible only if the authorities step up their support measures. While the implementation of the new five-year plan (2026–2030) is expected to encourage investment, particularly in innovation, technology and AI¹, the easing of monetary and fiscal policies aimed at stimulating private consumption will remain cautious.

On the monetary policy front, the moderately accommodative stance of recent months will be maintained in the short term. Further cuts to policy rates are no longer expected in 2026 (the last cut to the 7-day reverse repo rate, from 1.5% to 1.4%, took place in May 2025), but real interest rates on loans have been falling slightly. Furthermore, the authorities are urging banks to increase their loan supply. However, reversing the slowdown in credit growth, observed since 2023, will be difficult without a recovery in the property market. Growth in total social financing reached a low of +7.7% y/y in May (down from +9.8% at the end of 2023), largely held back by the decrease in property loans (-3.4% in March).

On the fiscal policy front, the stance became restrictive in Q2 2026, particularly as local governments cut their spending², constrained by a decline in their land sales proceeds and tighter fiscal management rules. However, in line with the budget announced last March for the entire year, public spending is expected to rise in H2 2026. The budget forecasts a 4.4% increase in total general government expenditure in 2026; therefore, following a 1% y/y decrease over the January–May period, spending is expected to rise by 6% y/y over the June–December period. Households may therefore benefit from slightly more fiscal support in the coming months.

TRADE SURPLUS DOWN SLIGHTLY, EXPORTS UP SHARPLY

China's trade surplus has narrowed slightly since the start of the year. Imports have rebounded even more strongly (+26.2% y/y in H1 2026, following a period of near stagnation in 2025) compared to exports. This trend may continue, leading to a modest reduction in the current account surplus this year (projected at 3.5% of GDP).

On the capital account side, China is expected to remain a major net external creditor. Foreign exchange reserves remained largely unchanged in the first half of 2026, amounting to USD 3,786 bn in June, and the current account surplus continued to be channelled

China: slightly higher inflation

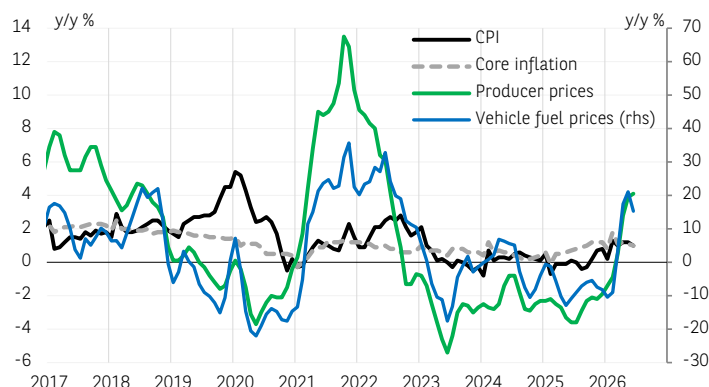


CHART 2

SOURCE: NBS, CEIC, BNP PARIBAS

primarily through residents' investments abroad. Total resident capital outflows fell in Q1 to USD 144 bn, consistent with the decline in the current account surplus and ongoing geopolitical uncertainties.

At the same time, China has seen its export base strengthen, leading to increasing imbalances with some of its trade partners. Exports have been buoyed by strong global demand and the sustained competitiveness of Chinese goods. Although the yuan appreciated in H1 2026 (by 3% against the USD and 2% in real effective terms), it remains nearly 10% lower than its end-2022 level in real effective terms. This situation is expected to continue to support exports for the rest of the year.

The trade surplus stood at USD 577 bn in H1 2026, compared with USD 583 bn in H1 2025. Firstly, the energy trade balance (oil and gas) is in deficit (-1.8% of GDP in 2025), and the shock caused by the war in Iran has had a negative impact, although this has been mitigated by the reduction in oil imports.

Secondly, the boom in trade in AI-related goods has not led to an increase in China's trade surplus. In fact, the trade balance in this sector is close to equilibrium: while China exports a wide range of goods, their production requires the import of microprocessors and other high value-added components (particularly from South Korea and Taiwan). Imports have therefore risen in tandem with exports, both in terms of volume and value. Over the first five months of 2026, imports and exports of AI-related goods were estimated at around USD 380 bn.

By contrast, in sectors linked to the low-carbon transition, China often controls the entire value chain. As a result, the robust growth in exports has a significant positive impact on its trade balance. An acceleration of the low-carbon transition in certain European and Asian countries could potentially exacerbate their trade imbalances with China. Over the January–April period, China's trade surplus with the Eurozone grew by nearly 10% y/y, driven in particular by its exports of green technologies.

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Christine Peltier

christine.peltier@bnpparibas.com

¹ BNP Paribas, 6 March 2026: [China: Innovation and AI driving economic development](#)

² Local governments account for over 80% of expenditure in the general government budget. See BNP Paribas, September 2021: [China's public finances, a tangled web](#)



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