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#China

/ #Politics

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Can China stay on target?

China delivered another year of 5% GDP growth, shrugging off Trump's "liberation day" shock and generating a record-high trade surplus. The PBOC now appears more comfortable allowing a currency appreciation, despite the risks of embedding deflation. Policy easing reduces the risk that growth slows materially in 2026.

Key Takeaways

- In 2025, for the second year in a row, net trade was the main driver of growth, helping to offset a weaker contribution to GDP from investment.
- While firms cut prices to support exports – and a potentially deeply negative investment deflator supported real GDP – household spending on services was the unsung hero.
- Household balance sheets continue to be hit by a wealth effect from falling property prices, which accelerated in December, while declining property income is also a drag. Larger transfers from the government have provided a small offset, but wages and salary growth and ample savings largely explain spending in the face of adversity.
- The record \$1.2 trillion trade surplus has made the People's Bank of China (PBOC) more comfortable about a stronger currency. But, as well as questions about the rest of the world's tolerance for China to further expand its share of global trade, there are risks that this embeds deflation, particularly while excess capacity remains.
- Reinforcing expectations of currency appreciation should at least encourage foreign investors to reconsider their China exposure, even if the authorities' preference for a "slow bull market" in equities may also temper enthusiasm.

Still an export powerhouse

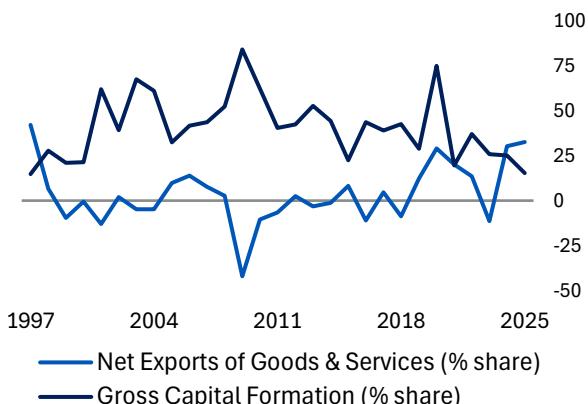
China posted 5% real GDP growth for 2025, matching the growth rate of 2024 and hitting the mid-point of the government's "around 5%" target.

Q4 growth was in line with consensus at 4.5% year on year, while sequential growth rose to an above-consensus 1.2% quarter on quarter, suggesting activity gained momentum through the second half of the year.

Despite higher tariffs and the uncertainty generated by the shock of "liberation day", the composition of Chinese growth has increasingly been skewed toward trade.

The share of GDP growth accounted for by net trade rose to almost 33% (+2.4ppts), while the contribution from capital formation slumped to only 15% (-10ppts). We have to go back more than 25 years to see growth being skewed in this way over a two-year period (see Figure 1).

Figure 1: 2025 and 2024 were both reliant on exports



Source: Aberdeen, Haver, January 2026

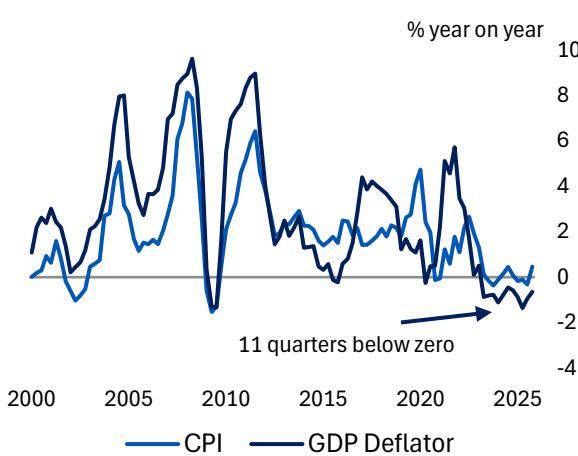


A softer contribution from capital formation within GDP growth is unsurprising given the ongoing contraction of fixed asset investment (FAI).

Indeed, while the two measures aim to capture somewhat different concepts of investment and the latter is not inflation-adjusted, the gap between FAI's 3.8% contraction and the 0.8 percentage points that capital formation contributed to 2025's 5% growth is remarkable.

The GDP deflator can help square the circle. While annual CPI inflation has been close to zero for the past three years, whole-economy price pressures have averaged -0.7% (see Figure 2). A sharply negative investment deflator that supports real GDP growth is part of the answer, although questions about the plausible magnitude of the (implied) fall in the investment deflator are hard to shake.

Figure 2: The GDP deflator has extended its record-breaking run in negative territory



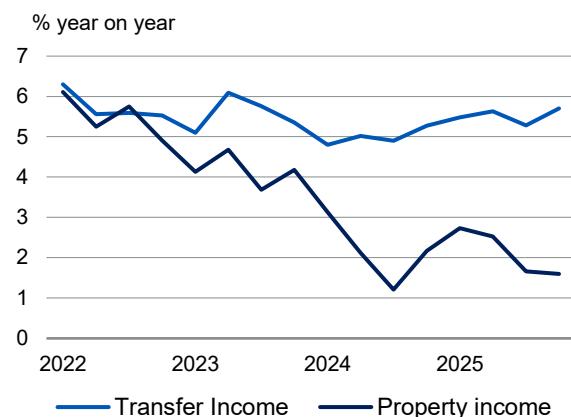
Source: Aberdeen, Haver, January 2026

At face value, the higher share of growth accounted for by consumption (+7.5ppts, 52%) contrasts with the weakness in retail sales, which eased to just 0.9% year on year in December. Base effects are exaggerating this weakness compared to the annual rate, but this data puzzle is more easily explained by the strength of the services output index (5.5%), which implies consumers have pivoted consumption away from goods.

A greater willingness to spend may seem somewhat at odds with continued falls in house prices – whose decline accelerated at the end of 2025 – and the still gloomy labour market for services indicated by the PMIs, but the NBS' consumer confidence index has been inching higher for more than a year now, even though it remains at a low level.

Disposable income growth also continues to outpace nominal GDP growth, helped by larger government transfers and despite the sharp moderation in property income (see Figure 3). Stronger stock markets may also be playing a role in boosting spirits, even if household exposure to equities is low.

Figure 3: Money from the government and robust wage growth has offset the hit from property



Source: Aberdeen, Haver, January 2026

The PBOC is getting comfy

Last week the People's Bank of China (PBOC) announced a raft of measures to support its lending programs, signalled that cuts to its main policy rates could be on the way and opened the door for further FX appreciation.

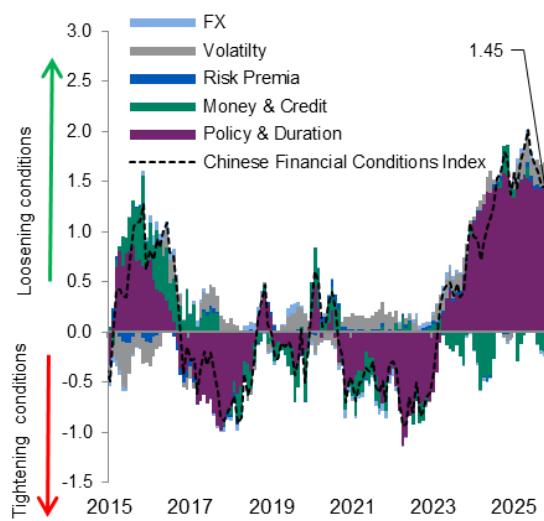
The one-year relending and pledged supplementary lending (PSL) rates have been cut by 25bps, while relending quotas are to be expanded by RMB 2.1 trillion. The downpayment ratio for commercial property will also be reduced by 20ppts to 30%.

Just as importantly, at the press conference officials noted that there was room to cut the reserve requirement ratio (RRR), which would inject liquidity into the banking system, while constraints on cutting the main policy rates emanating from banks' net interest margins (NIMs) and FX had dissipated.

A large stock of maturing time deposits will be rolling onto a lower rate this year, reducing the cost to banks. While the record \$1.2 trillion trade surplus and evidence of increased invoicing in RMB (rather than USD) have seemingly given the PBOC more confidence that corporates can cope with more "flexibility" in the exchange rate.

All of this should help support future credit growth and financial conditions (see Figure 4).

Figure 4: Financial conditions remain accommodative but were less so in H2 2025



Source: Aberdeen, Bloomberg, Haver, January 2026

Condoning a stronger currency won't help the weak inflationary backdrop, but it could boost foreign investor enthusiasm for Chinese assets.

It remains to be seen whether continued falls in house prices and time deposits rolling onto lower rates will encourage households to reallocate towards the stock market. Moves to raise margin requirements from 80% to 100% are however designed to take a bit of heat out of equities, with the authorities remaining wary of fast price moves that risk a speculative fervour.

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