Global Macro Research

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#China / #Politics / #Growth

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China: Industry does the heavy lifting

Chinese GDP growth was stronger than expected in Q3, helped by industrial production. In contrast, household demand remains soft, and investment is dragging on growth, which should at least spur further policy easing.

Key Takeaways

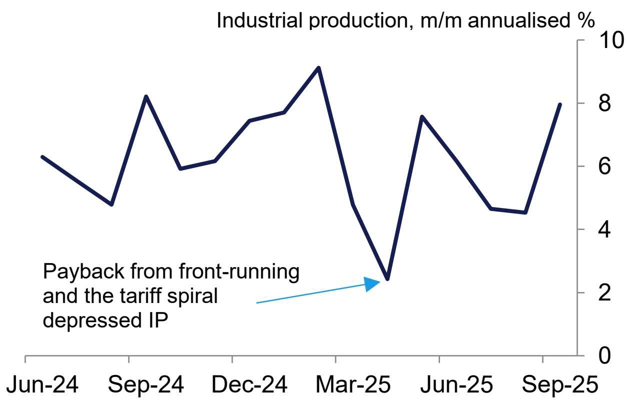
- The authorities' "around 5%" growth target for 2025 should be easily reached, but questions remain about momentum heading into 2026 and whether the nominal environment will recover.
- An acceleration of industrial production – which the NBS estimates expanded by 8% on a month-on-month annualised basis – appears to have helped confound expectations for a sequential slowdown in growth.
- It is however difficult to be confident in the other drivers that supported official GDP growth.
- Retail sales growth was unchanged (3% year on year) in September – consistent with only a moderate contribution from consumption and the tertiary sector.
- Headline fixed asset investment (FAI) growth has dropped to -0.5% year to date year on year – the only contraction outside of the pandemic shock. Sequential estimates can be volatile, but it is hard to conclude investment did not drag on the quarter.
- Financial conditions have tightened modestly through Q3 (-0.14 standard deviations), reflecting higher yields and a fading effect from the front-loading of government bond issuance.
- A silver lining from these weak strands of growth and another below-consensus CPI print has been the recent rally in 10-year bond yields in October, which have dropped around 10bps. This should help loosen our China Financial Conditions Index (CFCI) in October, while recent steps to increase and bring forward local governments bond quotas should help support financial conditions.

Official GDP growth remains robust…

China's economy grew faster than expected in Q3: GDP expanded 4.8% year on year, beating both consensus expectations (4.7%) and our forecast (4.6%). Sequential growth also accelerated to 1.1% quarter on quarter (from a downwardly revised 1% in Q2), confounding expectations for a slowdown. Even a soft Q4 GDP print would mean that the authorities can claim to have met their "around 5%" growth target.

It is somewhat challenging to explain the resilience of Q3 sequential growth, but industrial production (IP) – which rose to 6.5% year on year despite expectations for a small slowdown to 5% – played a key role. The NBS estimates that IP expanded by 8% on a month-on-month annualised basis (see Figure 1).

Figure 1: Industry has recovered from the tariff front-running slump and 'Liberation Day' surprise



Source: Aberdeen, Haver, October 2025

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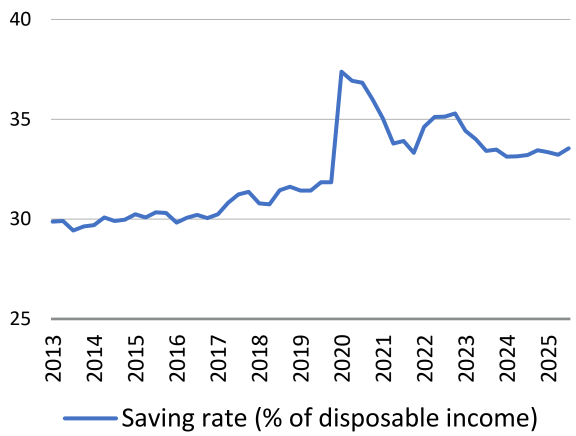
…but it is not all roses

Other key indicators paint a weaker picture.

The services output index was unchanged at 5.6% year on year and may have expanded around 0.6% on the quarter, despite lacklustre retail sales volumes, which we estimate fell by around 1.5%.

Given ongoing price falls in real estate, which continues to exert a negative wealth effect on households, tepid consumption growth, negative net borrowing, and a still elevated saving rate are unsurprising (see Figure 2).

Figure 2: Consumption continues to be held back by falling house prices and high savings



Source: Aberdeen, Haver, October 2025

Investment remains the most concerning aspect of the macro data.

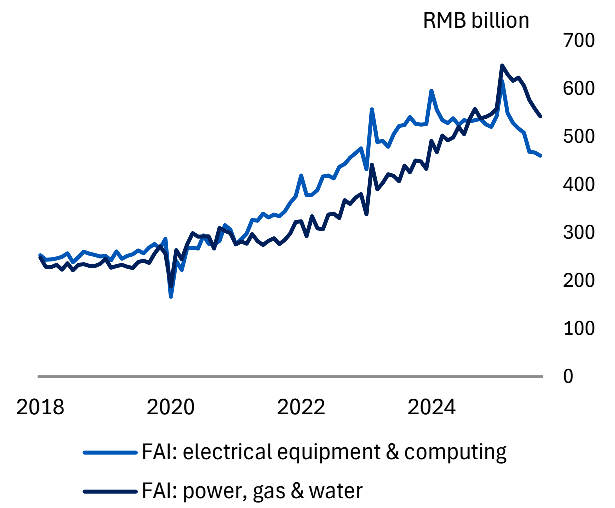
Fixed asset investment (FAI) data can be volatile and a lack of deflators makes it more difficult to judge sequential moves in real terms. But, even with another contraction in the GDP deflator (implying the investment deflator also remained in negative territory), it is hard to conclude investment did not drag on the quarter.

Headline FAI fell short of expectations for the fourth month in a row in September, dropping to -0.5% year to date year on year – the weakest growth rate recorded outside of the pandemic.

And, while further falls in real estate and a payback effect from a particularly rapid solar power rollout in H1 explain some of the FAI weakness in Q3, there is further evidence that the tariff shock is weighing too. Investment in electrical equipment and computing declined again, taking FAI down to levels not seen since Q4 2022 (see Figure 3).

The nascent 'anti-involution' campaign will see investment curtailed in excess capacity sectors such as autos, solar, and battery manufacturing, suggesting that new headwinds will emerge, which will motivate additional easing.

Figure 3: 'Anti-involution' could lead to new drags on investment



Source: Aberdeen, Haver, October 2025

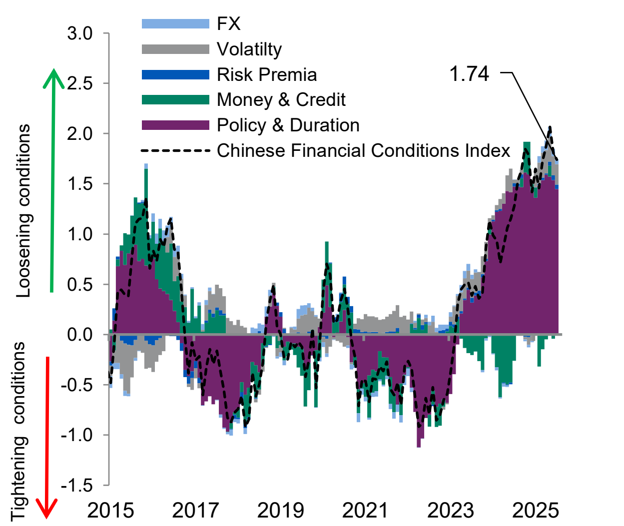
Policymakers to double down on support measures

A silver lining from these weak strands of growth and another below-consensus CPI print has been the recent rally in 10-year bond yields in October, which have dropped around 10bps.

This should help to offset some of the tightening of financial conditions through Q3, which had been partly driven by higher yields as domestic investors pivoted towards equities, and optimism around the effectiveness of the 'anti-involution' campaign grew.

Credit conditions also became less favourable due to the fading effect from the front-loading of bond issuance at the turn of the year. As such, our China Financial Conditions Index (CFCI) moved 0.14 standard deviations lower through Q3 (see Figure 4).

Figure 4: Financial conditions have retreated, but remain accommodative overall



Source: Aberdeen, Bloomberg, Haver, October 2025

Recent policy easing should also help to maintain accommodative financial conditions.

The Ministry of Finance (MoF) recently announced that local governments will be able to issue another RMB 500 billion in bonds (0.4% GDP), while also bringing forward issuance originally planned for 2026.

This adds to the announcement at the end of September of a new RMB 500 billion fund to provide equity for investment projects.

Funding is expected to be channelled through the three state-owned policy banks, and could potentially be augmented by interest rate subsidies from MoF. The focus on equity capital should (in theory) leverage the funding, perhaps to ~ 2.5 trillion, but this is likely to substitute some investment that would have taken place anyway.

Further announcements to support domestic demand are highly likely, particularly if trade negotiations with the US go badly, although we continue to expect that stimulus will be measured and implemented gradually.

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