Permutable

GMSI MACRO SENTIMENT · CHINA · Q2 2026

China's unfinished growth story: Q2 GDP lays bare the limits of industry-led expansion

Factories and exporters are still carrying China's economy, but Permutable's GMSI signals show domestic demand losing traction just as the external buffer begins to narrow. The 4.3% Q2 print describes an economy producing faster than it can absorb.

4.3%
Q2 GDP GROWTH
YEAR ON YEAR

-1.7σ	**5.3%**	**27%**	**-18.0%**
Expenditure sentiment by 16 July	Industrial output June, year on year	Exports June, USD terms	Property investment first half

Production has arrived. The broad-based recovery Beijing is seeking has not.

The Chinese idiom mǎ dào chéng gōng (马到成功) collapses the distance between momentum and victory: the horse arrives, and success follows. China's weaker-than-expected 4.3% Q2 print shows how far that distance has widened, and how uneven its model of dual circulation has become. Its industrial sector continues to gallop, carrying factory output and exports forward at formidable speed, yet the force of that advance falters at the domestic hurdle. The external loop remains powerful; the domestic loop is struggling to translate those gains into household confidence, consumption and a durable recovery in the property market. Production has arrived. The broad-based recovery Beijing is seeking has not.

The headline is not the story of an economy that broke between April and June. Much of the fragility was already on display in property, consumer spending and private investment, and June itself brought scraps of relief: retail spending returned to growth, the slide in new-home prices eased and exports surged. The relief, though, gathered in the parts of the economy least able to rebuild the domestic base. Factories produced more; overseas buyers bought more; Chinese families stayed cautious.

The second-quarter figures give that imbalance its shape. GDP growth slowed from 5.0% to 4.3% year on year, leaving first-half growth at 4.7%. Industrial output climbed 5.3% in June, and exports jumped 20.8% in renminbi terms and 27% in dollars. Set against that, retail sales crept up just 1.0%, fixed-asset investment shrank 5.7% across the half, private investment fell 8.5% and property investment slumped 18.0%.

Permutable's GMSI signals trace how the gap opened. They make no attempt to guess the number attached to any official release; they follow the tide of coverage around each economic topic, showing where pressure is building, where it is draining away and how weakness travels through the system.

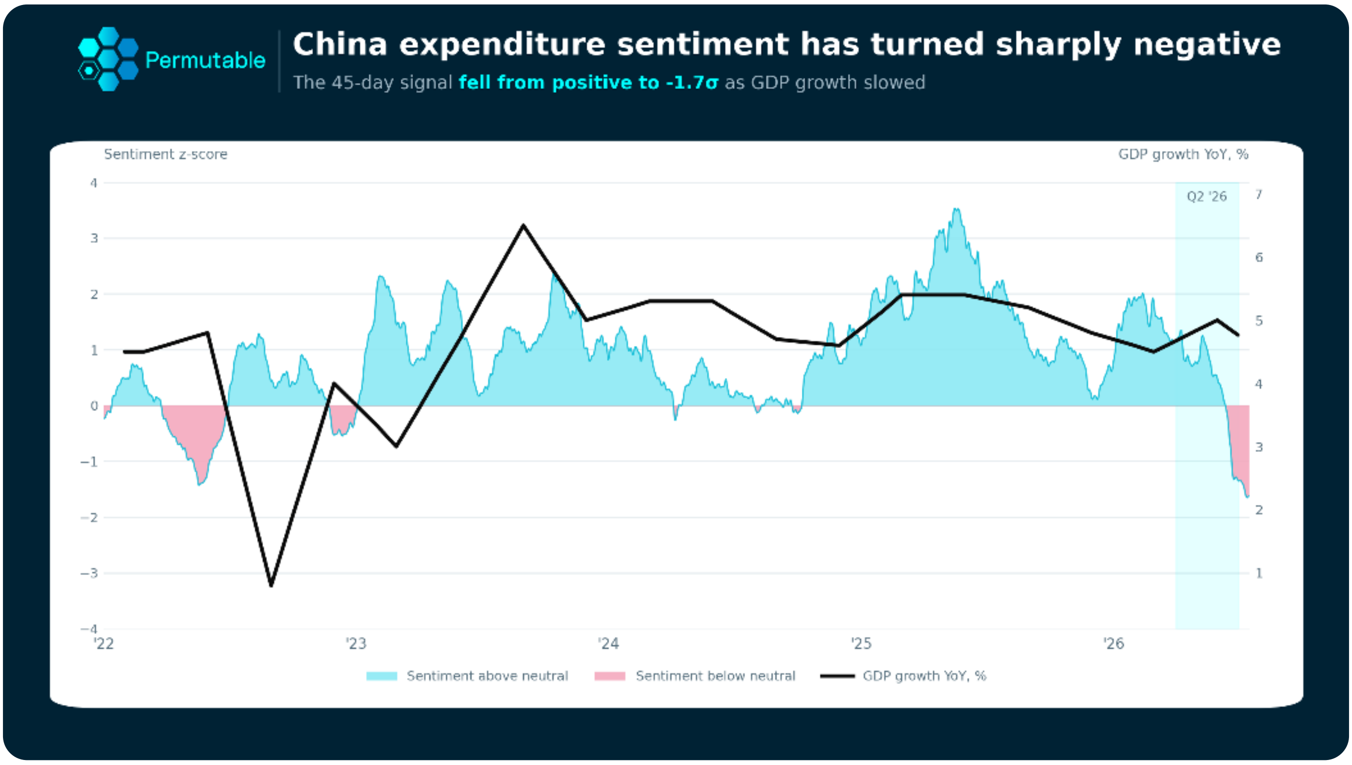
Read in sequence, the charts tell a single connected story. Expenditure gave way first. Housing failed to restore it. Prices exposed where the flow was breaking down. Exports offered an escape route. Industrial sentiment now shows that route narrowing.

4.3%	4.7%	1.0%	5.3%	27%	-18.0%
Q2 growth, year on year	First-half growth	Retail sales, June	Industrial output, June	Exports, USD terms	Property investment, H1

How to read the GMSI signals. Each signal aggregates GMSI L3 sentiment_sum for the relevant topic as a 45-day rolling sum, with a 90-day window for the slower-moving industrial topic, which reads more cleanly at lower frequency. Values are standardised with an expanding, no-look-ahead z-score using only observations available up to each date. A reading of +1σ or -1σ means sentiment stands one standard deviation above or below its own history to that point. The signals are used here for coincident monitoring, tracking co-movement and sequence against the hard data, not as a statistically identified lead.

01 / DOMESTIC DEMAND

Domestic demand lost its footing first



China has not run short of things to produce so much as of buyers willing, or able, to absorb them at the same pace.

Permutable's expenditure-growth sentiment held near two standard deviations above its norm at the beginning of 2026, then broke down through the second quarter, hitting -1.7σ by 16 July. The slide placed the damage squarely in spending and investment while industrial capacity stayed whole.

Output can keep an impressive rhythm even as the economy beneath it loses its balance. China can turn out more machinery, batteries and electronics without any matching rise in consumer spending or private investment; GDP counts the goods leaving the factory and reveals little about whether the income, confidence and purchasing power created along the way ever reach the people expected to buy them.

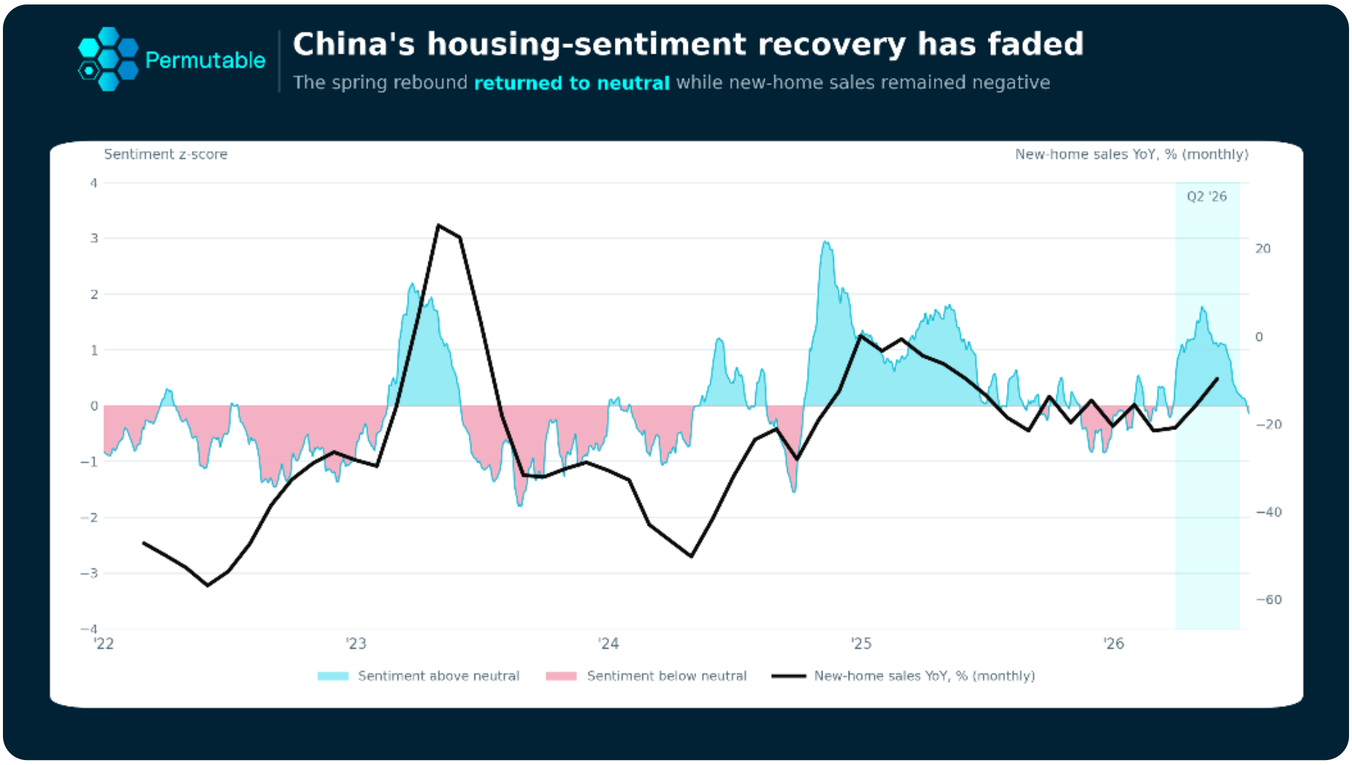
The official figures tell the same story. Retail sales recovered to 1.0% growth in June after shrinking in May, yet managed only 1.3% across the half. Private investment retreated faster than the aggregate. Industrial production, by contrast, expanded 5.4%.

June therefore softened the quarterly picture without altering its substance. One better month of spending does little to mend a consumer base hemmed in by falling property values, uncertain incomes and a powerful urge to save. An ever-narrower group of factories and exporters is shouldering more of the economy's weight while the foundations beneath them thin.

The expenditure signal shows where momentum first gave way. Housing explains why it has been so hard to rebuild.

02 / PROPERTY

The channel that has not reopened



Property was never merely one sector among many in China; it was the passage through which credit, income and confidence travelled. A new development meant land revenue for the local government, wages for builders, orders for steel and cement, sales for furniture and appliance makers, and an appreciating asset for the family that bought the home. Housing wired the banking system to the consumer and municipal finances to the wider economy, and that passage is still blocked.

Permutable's housing-activity gauge has staged several tentative revivals over the past three years. The most convincing ran through the first half of 2025; another flickered in the spring of 2026. Neither hardened into a lasting turn, and the latest has faded back towards neutral while new-home sales sit firmly in contraction.

New-home sales dropped 13.6% by value and 11.6% by floor space across the half, and property investment shrank 18.0%. Prices slipped again in June, though at a slower monthly pace. A gentler fall is not a recovery; it means the market is losing ground more slowly, not that buyers have found their conviction.

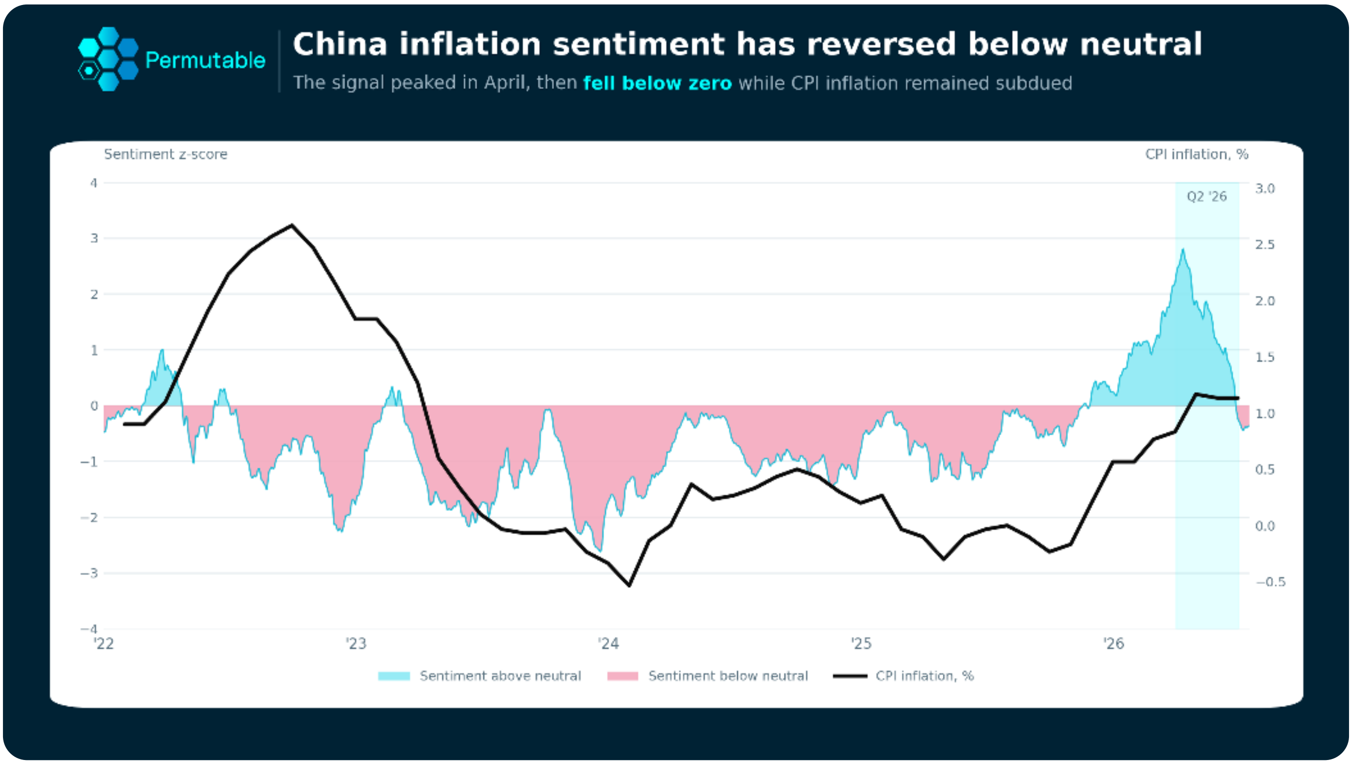
A handful of larger cities have posted firmer prices, but those pockets of resilience fall well short of a national revival. Across most of the country developers stay under strain, families expect further declines and unsold stock keeps pressing on the market.

The consequences run far beyond construction. A family unsure of the value of its largest asset saves rather than spends. A city collecting less land revenue has less room to invest. A bank staring at softer collateral and hesitant borrowers has little reason to turn cheaper policy into fresh credit.

Stabilisation can slow the descent. Recovery is what reopens the channel.

03 / PRICES

Cost pressure stalls at the factory gate



If the domestic channel is blocked, the obstruction has to surface somewhere. It surfaces in prices.

Consumer inflation stood at just 1.0% in June. Producer prices ran 4.1% above a year earlier, and the inputs industrial firms buy cost 6.4% more. Prices for the means of production climbed 5.5%; prices for consumer goods slipped 0.9%. The cost impulse enters the industrial system and dies before it reaches the shop shelf.

The pressure began outside China. The US–Iran conflict disrupted Gulf energy flows through the spring, driving up oil, freight and raw-material costs, and because China imports so much of its energy the shock passed swiftly into the cost base of refineries, hauliers and manufacturers. It travelled no further. Firms paid more for fuel and inputs while feeble domestic demand denied them the power to charge more at the till, turning an imported cost shock into a domestic margin squeeze.

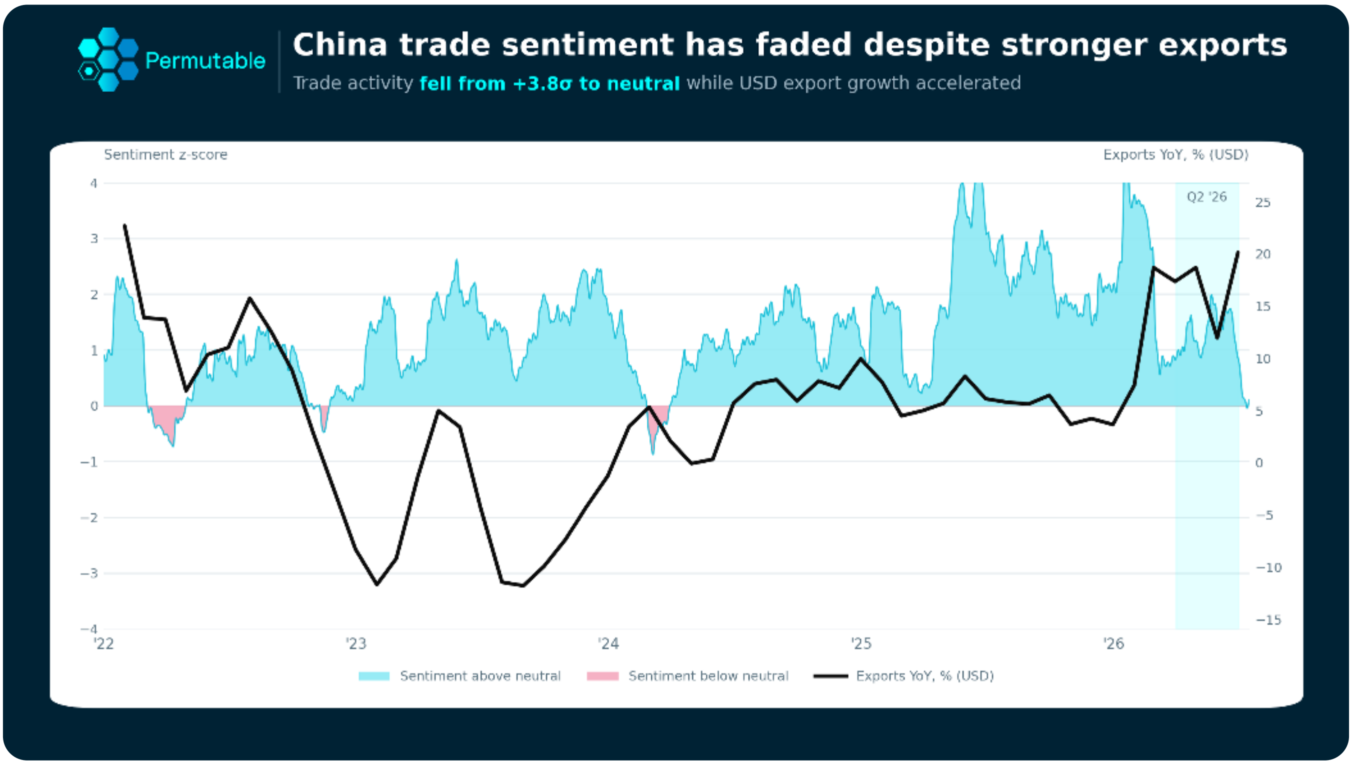
Permutable's inflation sentiment caught the first stage, climbing out of negative territory to a peak of +2.9σ in April as energy risk and producer-price pressure intensified. It has since sunk back to -0.4σ, even with producer inflation still elevated. The original shock was real; what never materialised was the broad reflation Beijing might have welcomed after years of falling prices. Consumers are too stretched to carry the higher costs, so margins swallow the difference.

That strain will land hardest on smaller private firms without the scale, pricing muscle or state backing to defend profitability. Big producers can ride out pressure for a while; small ones face a rawer choice between raising prices into thin demand and accepting leaner returns.

China is left with neither comfortable disinflation nor healthy reflation. The industrial economy runs hot enough to generate costs; the household economy stays too cold to accept them. The factory gate is bearing the pressure that the checkout cannot.

04 / TRADE

The external buffer is doing the work of domestic demand



A producer that cannot pass its costs to the Chinese household has one alternative: sell to someone else's. That is precisely what the trade data show.

Exports climbed 13.4% in renminbi terms across the half and accelerated sharply in June. Mechanical and electrical goods made up almost two-thirds of shipments, borne along by global appetite for semiconductors, computing equipment and advanced machinery.

Foreign buyers have soaked up production the home market could not, keeping advanced manufacturing at scale and stopping the weakness in housing and consumption from dragging headline growth lower still.

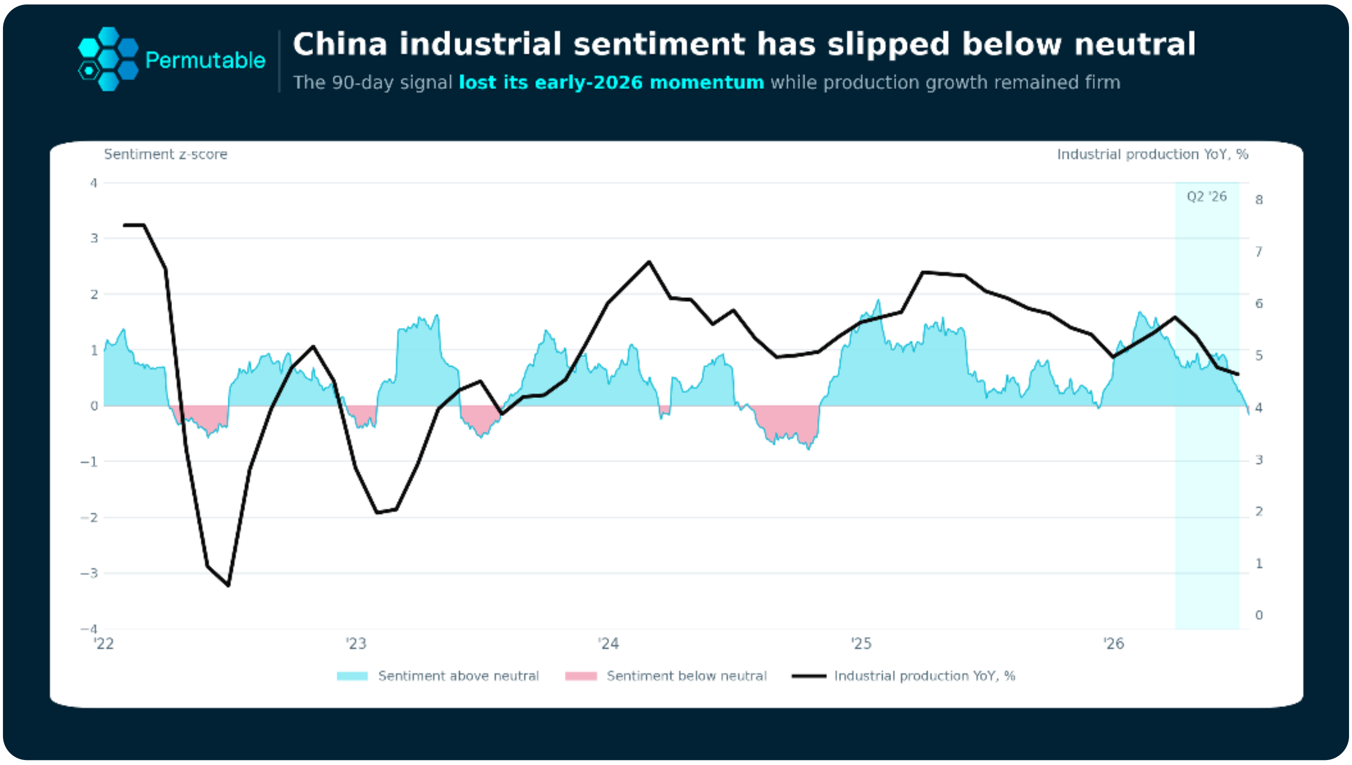
Yet Permutable's trade-activity sentiment cautions against reading the export surge as a safe road through the second half. The signal touched +3.8σ in January, then drifted steadily back to neutral even as the official numbers accelerated. Customs figures count goods already built, shipped and cleared; the sentiment signal tracks the climate around future orders, trading conditions and policy risk.

Global appetite for technology hardware may well persist, and Chinese manufacturers keep a formidable competitive edge. But the external sector sits exposed to tariffs, trade restrictions and the readiness of overseas markets to keep taking in swelling volumes of Chinese goods. Some orders may also have been pulled forward, flattering this quarter at the cost of the next. The more output the home market fails to digest, the more China leans on foreign demand and on decisions taken beyond its borders.

Exports are a release valve. They are not a repair.

05 / INDUSTRY

The last support line begins to bend



Industrial production remains the brightest patch in China's activity data. Output expanded 5.4% across the half; equipment manufacturing grew 9.3% and high-tech manufacturing 13.3%. Production of lithium-ion batteries leapt 39.3%, industrial robots 28.0% and 3D-printing equipment 48.5%. These are the numbers of an industrial complex still being built out at speed in the sectors Beijing prizes most.

The GMSI industrial signal, read over a 90-day window, firmed into early 2026 before slipping to -0.2σ by mid-July. Reported output stays strong; the news flow around future industrial conditions has turned less supportive.

June's data do not describe factories losing their footing. Output held up and the official manufacturing PMI sat just above the line dividing expansion from contraction. The risk is slower and larger: China's factories need not contract for the growth model to buckle. They need only lose enough pace that manufacturing and exports can no longer paper over the weakness already lodged in property, consumption and private investment.

For two years those sectors have fenced in the domestic slowdown. The fence thins if trade and industry soften together, and the sectors that concealed the weakness would begin to inherit it. The horse remains at pace, but it is carrying more weight with every stride.

06 / DUAL CIRCULATION

Dual circulation, out of balance

The vulnerability is not an accident of the quarter; it is written into the strategy itself.

Dual circulation was meant to put the domestic market at the heart of the economy, with international trade supplying scale, technology and resilience. Production would raise incomes and consumption at home; global demand would widen the market for Chinese firms. The present pattern sits a long way from that design. External demand is standing in for weak domestic absorption rather than reinforcing a healthy internal economy, and industrial success keeps building capacity and shipping exports without moving through housing, confidence and consumer spending strongly enough to close the loop.

That leaves Beijing with a choice that runs deeper than the size of the next stimulus package. More manufacturing capacity would lift output. More infrastructure would preserve activity. More credit would shelter chosen firms and local governments. Each risks piling further supply onto an economy already searching for demand.

China's constraint is no longer productive power. It is the route through which that power becomes household income, confidence and spending.

Repairing that route means working on the domestic base itself: finishing stalled housing projects, mending local-government finances, raising household incomes, widening social protection and easing the fears that drive precautionary saving.

Such measures would not resurrect the old property-led model; they would start building the household economy the new model was always meant to rest on.

07 / CONCLUSION

Speed without arrival

The diagnosis is settled; the second half will test it. What matters from here is not another recital of the imbalance but the order in which it either eases or spreads, and Permutable's signals will show that answer first.

Three readings carry the weight. If trade and industrial sentiment steady near neutral, the external buffer is holding and the economy can lean on it a little longer; if they follow expenditure below zero, the sectors that contained the slowdown have started to inherit it. In housing, the test is whether the next revival becomes the first in three years to hold above neutral rather than fading like its predecessors. And the surest sign of genuine repair would be expenditure sentiment climbing back through its norm, evidence that production is once again turning into spending.

WHAT THE SIGNALS WILL SHOW FIRST

01 **Trade and industrial sentiment** — steadying near neutral means the buffer holds; following expenditure below zero means the slowdown is spreading.

02 **Housing sentiment** — a third revival that holds above neutral, rather than fading like 2025 and this spring, would mark the channel beginning to reopen.

03 **Expenditure sentiment** — a durable move back through its norm is the first evidence that production is converting into spending again.

Policy gets its next word this month. The Politburo's mid-year economic meeting will show whether Beijing reaches once more for capacity and infrastructure or begins shifting resources towards households, and the composition of that answer will matter more than its size.

The bearish reading is not unassailable. Chinese families sit on an enormous stock of savings, confidence can turn faster than balance sheets suggest, and even a modest stabilisation in property would reopen part of the channel this report describes as blocked. Were that to happen, housing and expenditure sentiment would register it well before the quarterly accounts do.

Our base case is a further gradual loss of momentum, with growth drifting towards 4% by year-end unless the policy mix tilts decisively towards the household.

Mǎ dào chéng gōng promises that the arrival itself is the victory. China's second quarter read differently.

The horse keeps arriving, quarter after quarter, carrying more than the household can receive.

Data as of 16 July 2026.