

# MERICS

## Economic Indicators

Economy rebounds as geopolitical fallout is yet to come  
Q1/2026



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## MERICS Q1 ANALYSIS

### China's economy rebounds as geopolitical fallout is yet to come

By **Alexander Brown**

Amid global turbulence, China's GDP expanded by five percent according to the official statistics in the first three months of 2026, up from 4.5 percent in Q4 last year. It was stronger than the market consensus of 4.8 percent and at the top end of the leadership's target of 4.5-5 percent annual growth this year. Strong investment in infrastructure and manufacturing, led by state-owned enterprises, was crucial in returning fixed-asset investment (FAI) growth to positive territory. Yet the overall picture of the economy has not changed: growth continues to rely on strong manufacturing and exports, while consumption remains weak. The government's cautious approach to policy support may be tested in the coming months as global uncertainties increase.

#### Geopolitical turbulence had limited impact on China

China remained relatively insulated from the US war with Iran in Q1. While much of Asia faced energy disruptions and price spikes due to the closure of the Strait of Hormuz, China was cushioned by large fuel reserves. China sources roughly half of its crude oil from the Middle East, but its exposure is less acute than peers such as Japan, which relies on the region for the 95 percent its imports. A diversified energy mix - still anchored by coal - offers further insulation. While some Asian countries have already taken drastic steps to reduce energy demand, such as four-day working weeks or extended public holidays, China looks comparatively well placed.

China's government has been able to moderate oil price increases somewhat by using its substantial stockpiles and price ceilings for gasoline and diesel. In March, the producer price index (PPI) for the oil and gas extraction sector jumped by 15.8 percent, and headline PPI rose to 0.5 percent, its first increase in over three years. China's crude oil imports remained relatively steady in March, falling just 2.8 percent year-on-year from a high base, as these cargoes were loaded in January and February. Direct constraints on China's fuel supply will only begin to show in Q2.

So far, China's trade with the world has been barely affected by the conflict in the Middle East. China recorded a strong increase in trade volumes in Q1, with imports up 22.7 percent and exports up 14.7 percent, the largest quarterly growth figures for either since the start of 2022. Strong imports were driven by demand for commodities and high-tech components rather than consumer goods, showing that the increase does not reflect any improvements in household demand or a structural shift in the drivers of growth.

#### Moderate measures not enough to stimulate consumption

Household sentiment remains subdued by the protracted downturn in the property market and still-fragile labor market. Retail sales rose a mere 2.4 percent year-on-year in the first three months of the year (which included the Chinese New Year holiday), offering little sign of an imminent rebound. Consumption is unlikely to accelerate significantly

without more forceful policy action. So far, the government has opted for an incremental approach. Efforts have focused on stabilizing employment and nudging up incomes. Firms are being subsidized to retain workers and hire graduates and local governments have raised minimum wages. In the past year, 27 of China's 31 provincial-level jurisdictions have implemented minimum wage increases; half of these rises were in double-digits.

China's strategy before the US-Israeli attack on Iran appeared to hinge on patience: shore up the labor market, lift incomes gradually and allow confidence to recover in time. Given the relatively large role of consumption in China's GDP, even a modest improvement could offset weakness elsewhere. Yet the odds of success are diminishing. The lengthening conflict in the Middle East is likely to stoke inflation, squeezing both corporate margins and household purchasing power. In that case, gradualism may prove insufficient.

### **Leadership to remain calm as economy enters choppy waters**

The longer the US-Israeli war with Iran lasts, the more difficult it will be for China to keep economic growth within their target range for the year. The chief danger is that rising inflation, at home and abroad, could undermine efforts to revive consumption while dampening global demand for Chinese exports. China's cost advantages and relative energy stability may allow its firms to gain market share even as global demand softens. But this would be a consolation prize: the overall volume of exports might still decline.

Despite these risks, China's leaders may hold off on any major policy changes for the time being. A strong start to the year gives policymakers some breathing room. Experience suggests that, in times of stress, Beijing's instinct is not to unleash consumption-led stimulus but to double down on industrial policy, supply-chain resilience and technological self-sufficiency.

Ultimately, China's performance will be judged in relative terms. If it can maintain stability while other economies succumb to inflation - or worse, stagflation - the leadership may see little reason for alarm. In a troubled global economy, merely weathering the storm could be counted as success.

## China's 2026 budget prioritizes technology, reveals stretched public finances

By **Andreas Mischer**

China's public finances are hard to decipher. The Ministry of Finance's recent [2025/2026 budget report](#) gives insights into 2025 actual revenue and spending for the general public budget and announces the 2026 draft budget. However, priorities are obscured by multiple budgets operating at different administrative levels. Moreover, digging into the budget data reveals China's fiscal situation is more strained than it appears on the surface, questioning the feasibility of hefty spending hikes in the future.

Understanding the structure of China's budgets (see text box below) helps put into context the figures in the 2025/26 budget report. For example, spending targets shed light on priorities in the *central government budget*, but do not account for local budgets. If taken at face value, these targets show that, in 2026, China's leadership will 1) prioritize spending on science and technology (S&T) and national defense 2) neglect spending on social security 3) allow debt interest payments to rise more quickly (see exhibit 1). The picture becomes more nuanced if local government spending is included and we look at the *national general public budget*. Although the finance ministry does not publish spending targets by budget category for the national general budget, we can get perspective by looking at past trends (see exhibit 2) and more recent actual spending data for [January and February 2026](#).

### China's general public budget 101

- The "general public budget" (一般公共预算) is China's primary budget. It is mainly financed by tax revenue, whose sources include value-added tax, consumption tax, enterprise income tax, and individual income tax. Spending covers over 20 major budget categories, such as public administration, national defense, education, social security, science and technology (S&T) and industry.
- The general public budget consists of the central government budget (中央一般公共预算) and various local government budgets (地方一般公共预算). The consolidated budget integrating the central and local budgets is called the "national general public budget" (全国一般公共预算).
- The division of labor between central and local budgets varies by budget category. For some, like foreign affairs or national defense, the spending comes largely from the central budget. Local governments contribute a much larger share in other areas like S&T, social security, healthcare, education or industry.
- The remaining budgets are the "government funds budget", the "state capital operations budget", and the "social insurance fund budget".

## **S&T, national defense and industry are priorities**

National general public spending on S&T rose by a modest 27 percent over a six-year period between 2019 and [2025](#), broadly in line with the increase in S&T central government spending over that period. However, a planned ten percent increase in central government S&T spending during 2026 alone could signal S&T has risen up in the list of policy priorities. Reinforcing that impression, national general spending on S&T rose by eight percent in January and February 2026 year-on-year. This is consistent with technology's prominent position in China's recently-approved 15<sup>th</sup> Five-Year Plan (2026-2030).

National defense is a clear priority. Spending is mostly from the central government and rose by almost half from 2019 to 2025 and is projected to increase by seven percent in 2026. In comparison, total national general spending rose more slowly, by 20 percent from 2019 to 2025, with a planned increase of 4.4 percent in 2026. National general public spending on resource extraction and industry rose by a whopping 78 percent from 2019 to 2024. Unfortunately, data for 2025 and January and February 2026 is not yet available for this budget category.

## **Social security balloons though services remain limited**

Social security receives substantial public funds, even though the headline figure in the 2026 central government budget suggests otherwise. In the national general public budget, it got a respectable 51 percent spending increase between 2019 and 2025. In January and February 2026, spending rose 8.6 percent year-on-year, higher than for S&T. It is the largest budget category in the national general public budget, with a roughly 15 percent share in 2025.

However, more than one third of national general budget social security spending goes on pensions for public officials (行政事业单位养老支出) and close to a third goes into subsidizing the basic pension insurance fund for regular people. Only a trickle is spent on wider social welfare (社会福利), such as child welfare, elderly welfare, rehabilitation aid and elderly care.

Additionally, China's recent hefty increases in social security spending come from a very low base. Based on spending in the national general budget and social insurance fund budget, China's social expenditures still only amounted to an estimated 11 percent of GDP in 2025. For comparison, in [Germany](#) and [Bulgaria](#), two countries at different income levels, social expenditures respectively made up around 31 percent and 20 percent of GDP in 2024.

## **Public finances are strained**

China increasingly relies on borrowing to meet its spending needs. Its headline deficit target rose as a share of GDP from three to four percent in 2025 and remains unchanged for 2026. It has set the highest-ever projected national general public budget deficit of CNY 5.89 trillion for 2026, which is a six percent increase over 2025's actual deficit. Yet, this omits additional debt from the announced issuance of CNY 4.4 trillion special purpose bonds or of CNY 1.3 trillion ultra-long special treasury bonds, which fall under the government funds budget. If these were included, China's budget deficit would be far

higher. For reference, [France](#), which is sometimes seen as a fiscal laggard in Europe, had a 2025 budget deficit to GDP ratio of 5.1 percent.

On average, the deficit has risen by 14 percent annually since 2019, outpacing economic growth. Annual national debt interest payments have therefore surged, up by more than half since 2019. Although a moderate five percent of national general public spending went on debt interest payments in 2025, the burden was far higher for the central government budget, at almost one fifth of spending. But things could also worsen for the national general public budget, as its debt interest payments spending surged by 22 percent year-on-year in January and February 2026.

### **Future implications**

China's 2026 further increase in social security spending is in line with past trends and does not constitute a significant shift, based on the data available so far. Meanwhile, with large budget and spending increases that diverge from the previous trajectory, S&T seems to have been elevated in the government's list of priorities. This matches the 15<sup>th</sup> Five-Year Plan's prominent focus on innovation as well as technological leadership and autonomy. In these geopolitically volatile times, China would surely benefit from achieving breakthroughs in the technologies it desires. Yet, its strained fiscal situation with skyrocketing debt interest payments casts doubt on the sustainability of further spending increases.

Exhibit 1

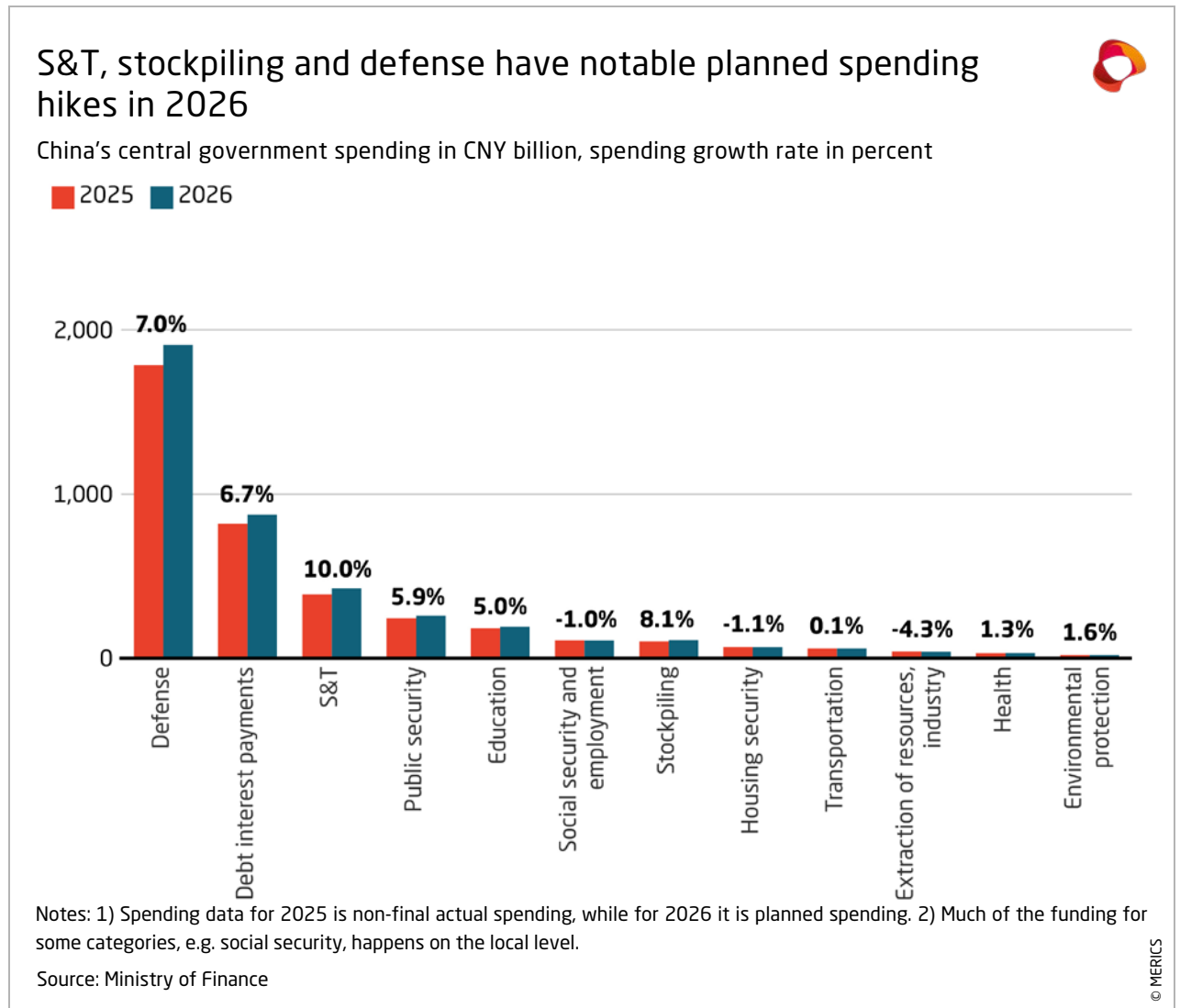
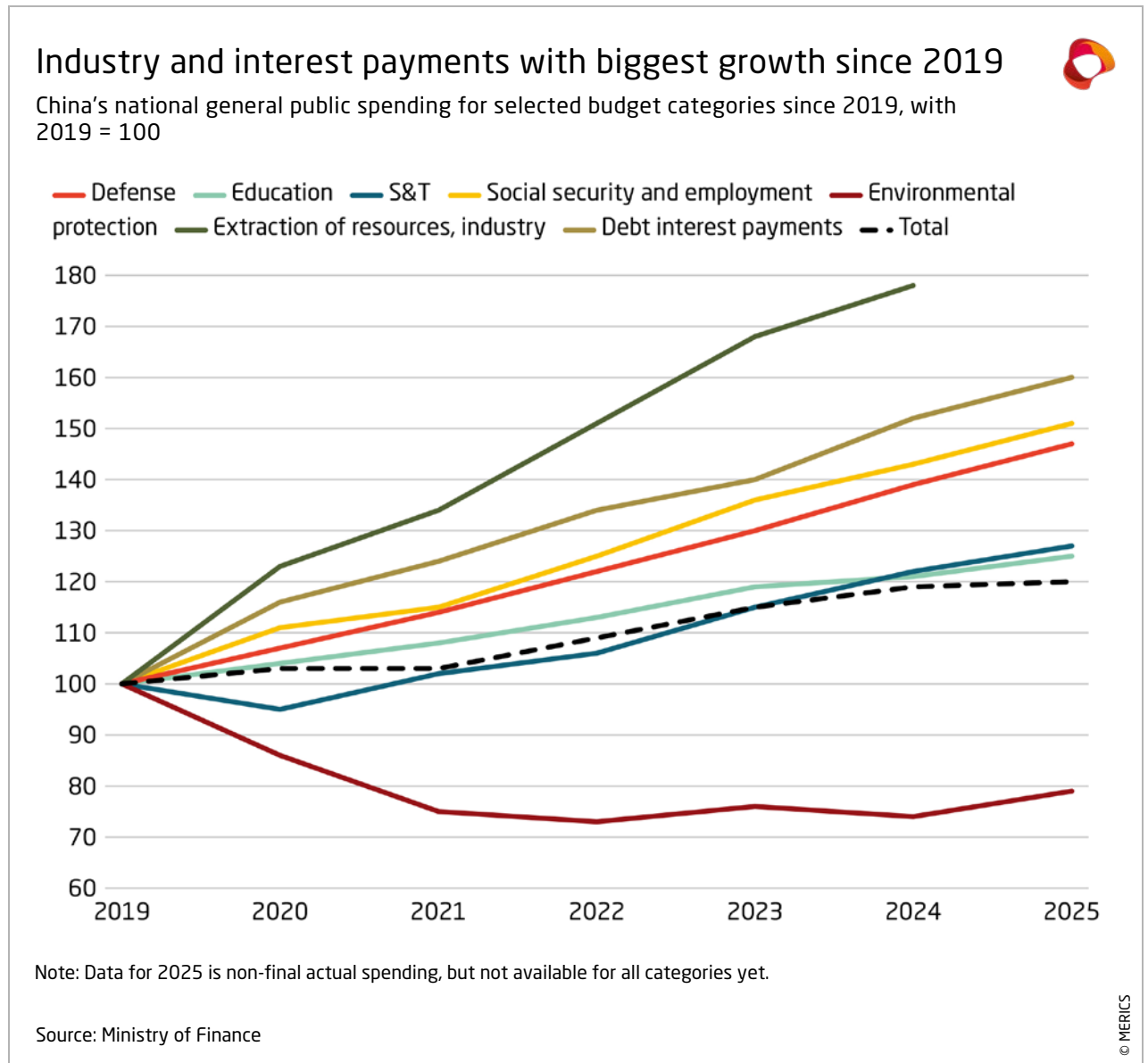
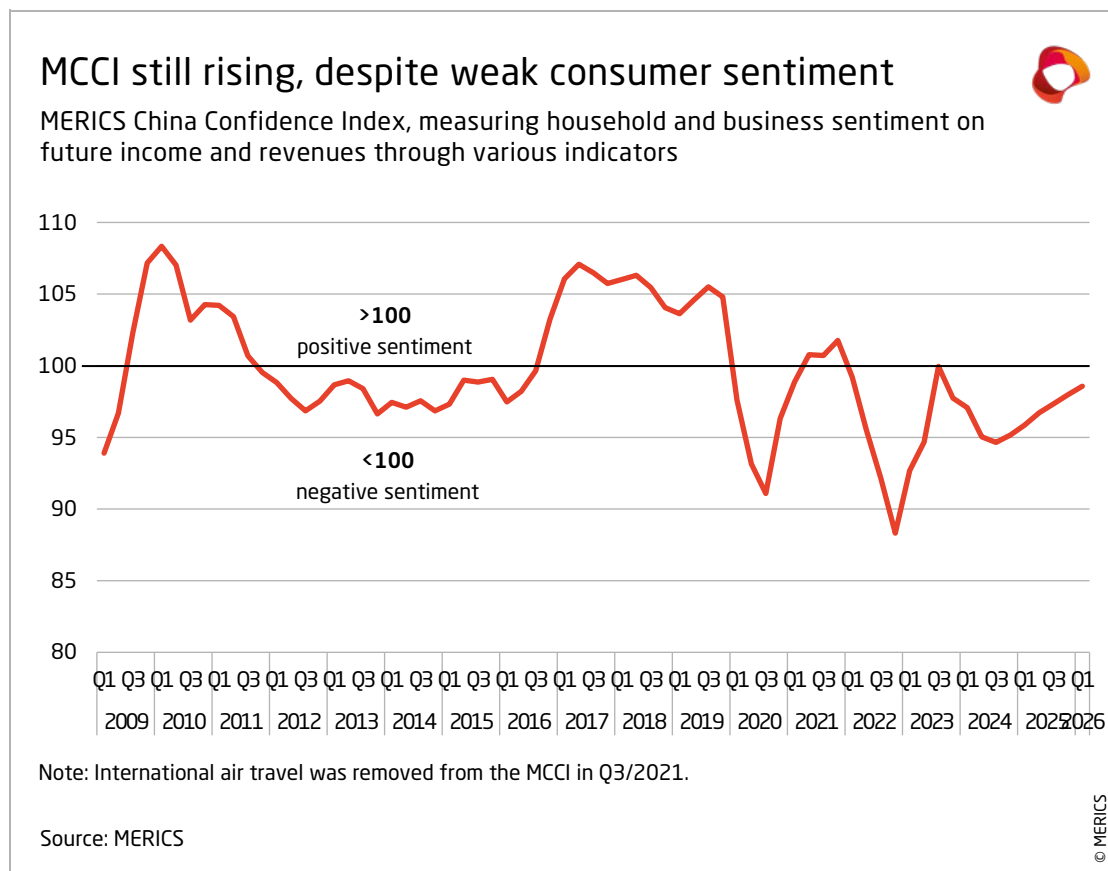


Exhibit 2



## MERICS CHINA CONFIDENCE INDEX (MCCI)

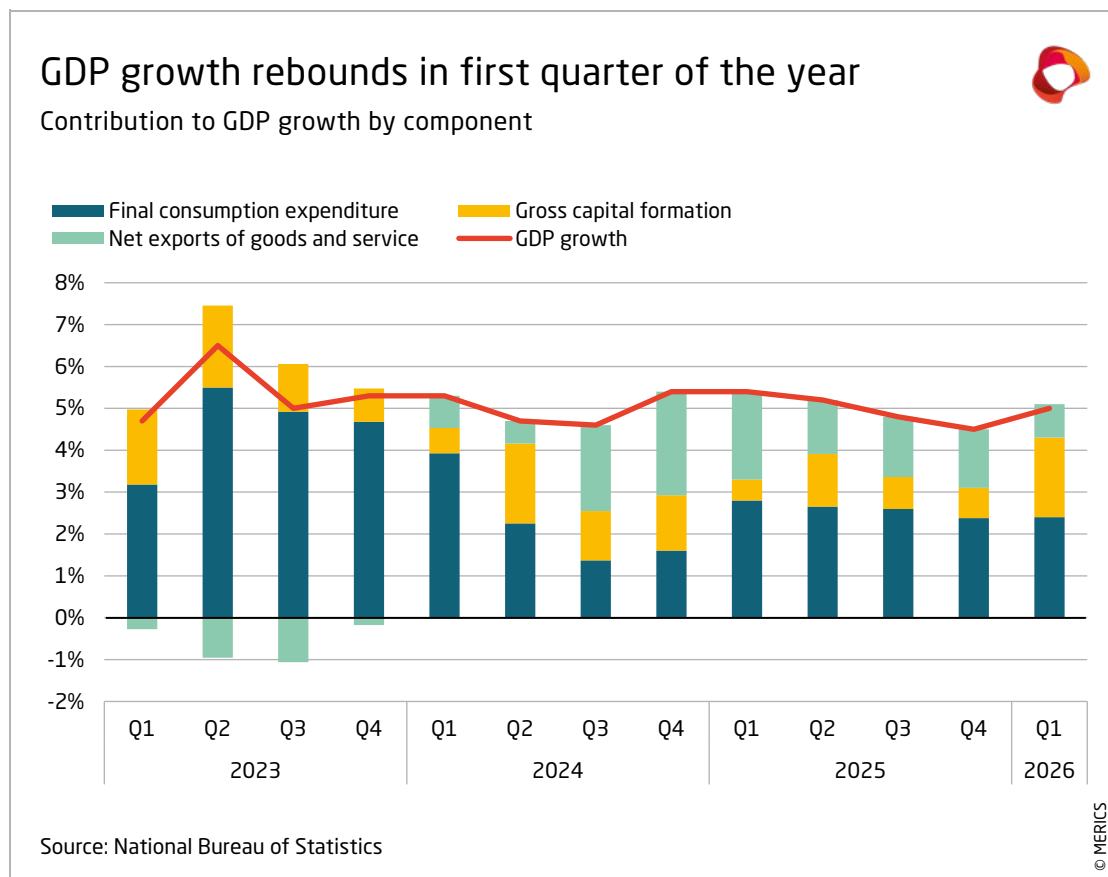


- **Two-year high:** The MERICS China Confidence Index rose from 98.0 to 98.6 in Q1 2026, reaching its highest level since Q3 2023, suggesting that sentiment is continuing to improve.
- **Clouds on the horizon:** The MCCI was lifted by turnover value at the Shanghai Stock Exchange as well as new orders in manufacturing, but most other indicators declined in Q1. For example, new business in the service sector, consumption expenditure per capita and international air travel all deteriorated, casting doubt on how sustainable the MCCI's recovery will be.

### The MERICS China Confidence Index (MCCI)

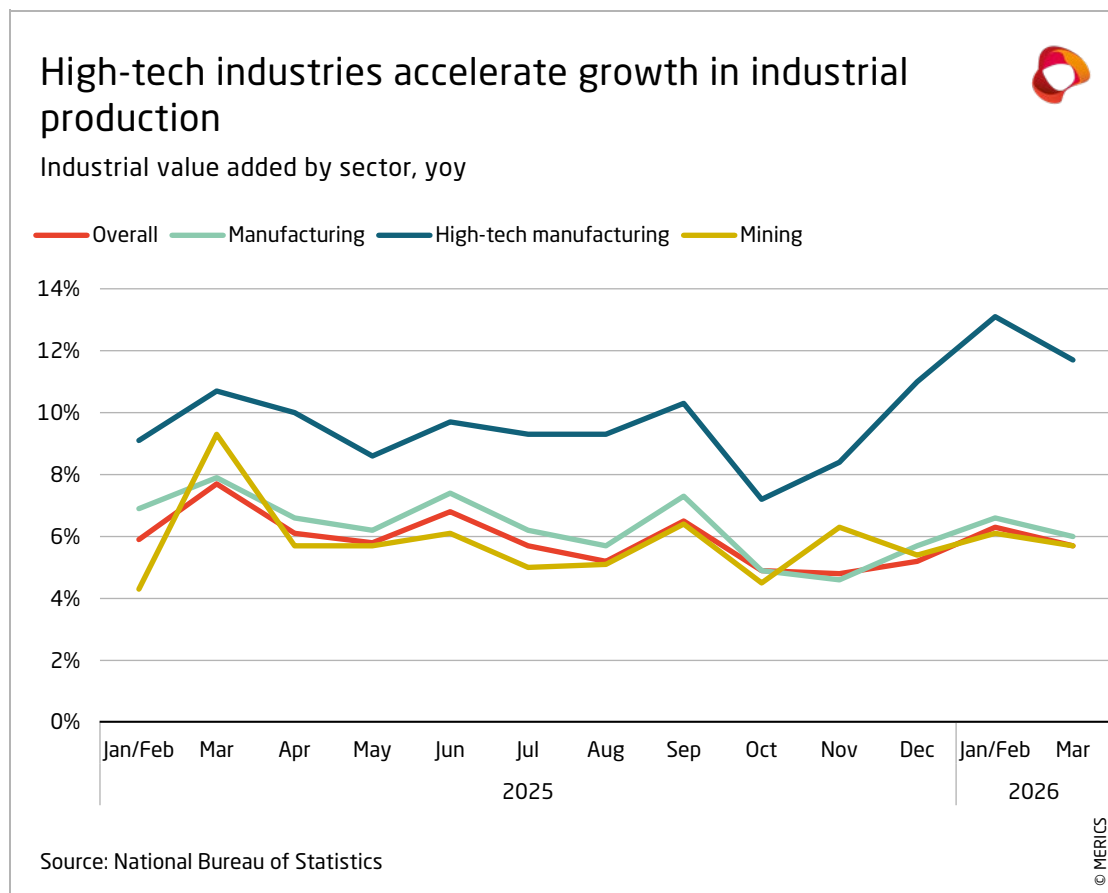
The MCCI – first developed in 2017 – includes the following indicators: stock market turnover, future income confidence, international air travel, new manufacturing orders, new business in the service sector, urban households' house purchase plans, venture capital investments, private fixed asset investments and disposable income as a share of household consumption. All components have been tested for trends and seasonality. The index is weighted between household and business indicators.

## MACROECONOMICS



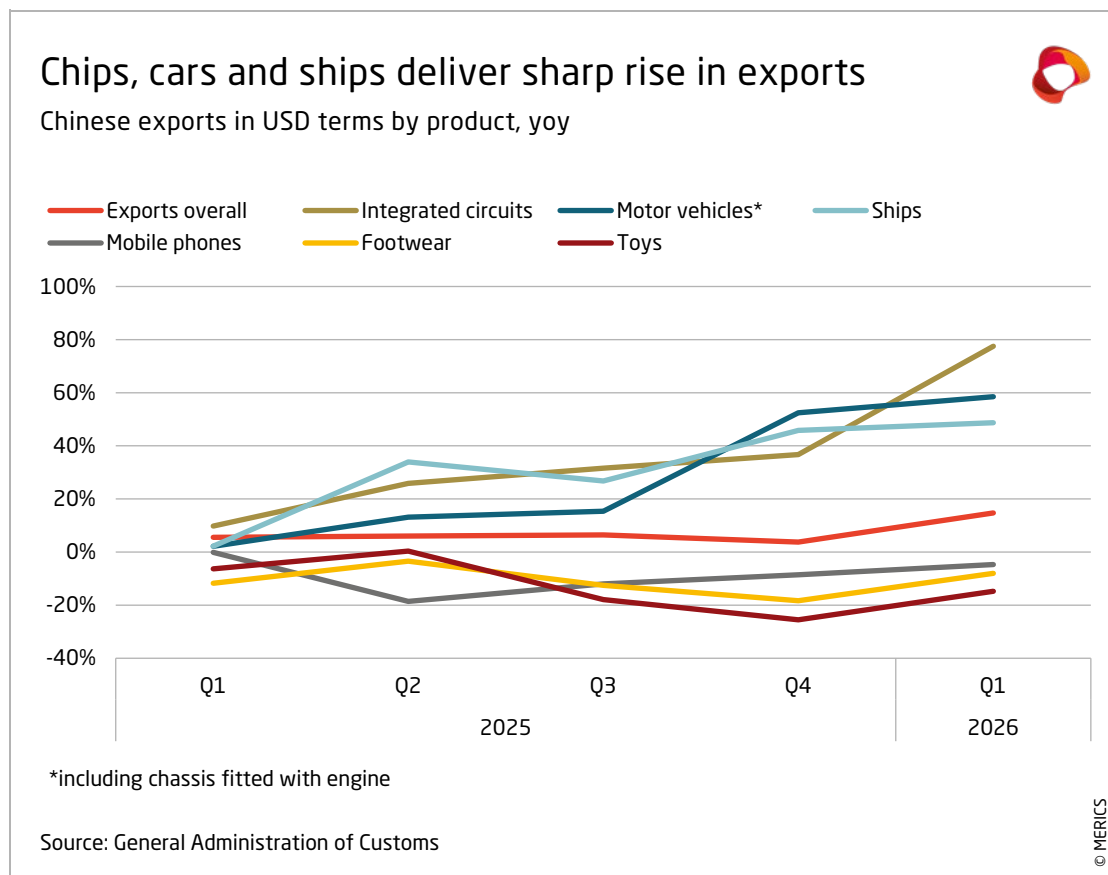
- Growth makes a strong start:** China recorded 5.0 percent GDP growth in Q1, up from 4.5 percent in the previous quarter. China's top leaders set a growth target of 4.5-5.0 percent for 2026 at the National People's Congress in March. The strong start to the year will permit policymakers some flexibility in responding to the economic impacts of the US-Israeli war with Iran, as they unfold over the coming months. The government has yet to announce any meaningful increase in fiscal support and appears content to await developments.
- Investment rebounds:** Gross capital formation accounted for 1.9 percentage points of growth in Q1, the highest level since Q3 2024. State-led investments in infrastructure and manufacturing generated a rebound in fixed-asset investment, which had contracted by 3.8 percent in 2025.
- Exports' share drops:** Meanwhile the contribution made by net exports to GDP growth fell to just 0.8 percentage points – the lowest level since Q3 2024 – as China's trade surplus declined by 16.0 percent compared to the previous quarter.

## INDUSTRY



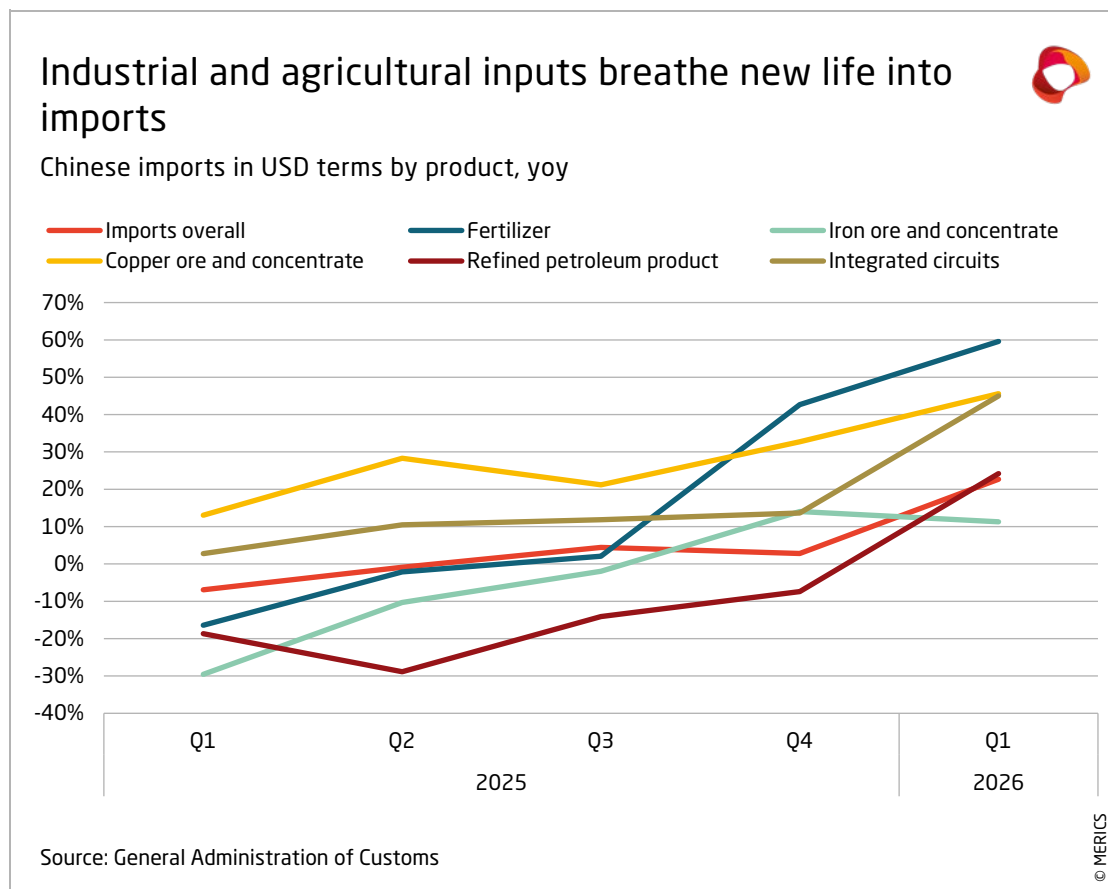
- Production recovers:** Value-added industrial output in Q1 rebounded from a dip in late 2025; it rose 5.7 percent in March year-on-year, up from 4.8 percent growth in November 2025. The manufacturing production managers' index (PMI) shot up to 50.4 in March from 49.0 in February, showing a sharp increase in factory activity.
- High-tech output a highlight:** High-tech goods production saw a noticeable uptick from its recent trendline. Strong contributors to Q1 growth included 3D printing devices (up 54.0 percent), lithium-ion batteries (up 40.8 percent) and industrial robots (up 33.2 percent).
- Profits rise:** Manufacturing operating profits grew by 20.1 percent across January and February, the strongest start to a year since 2022. In March, the producer price index (PPI) rose by 0.5 percent, the first gain since September 2022. At least to begin the year, domestic and external demand are provided robust conditions for industrial firms in China.

## EXPORTS



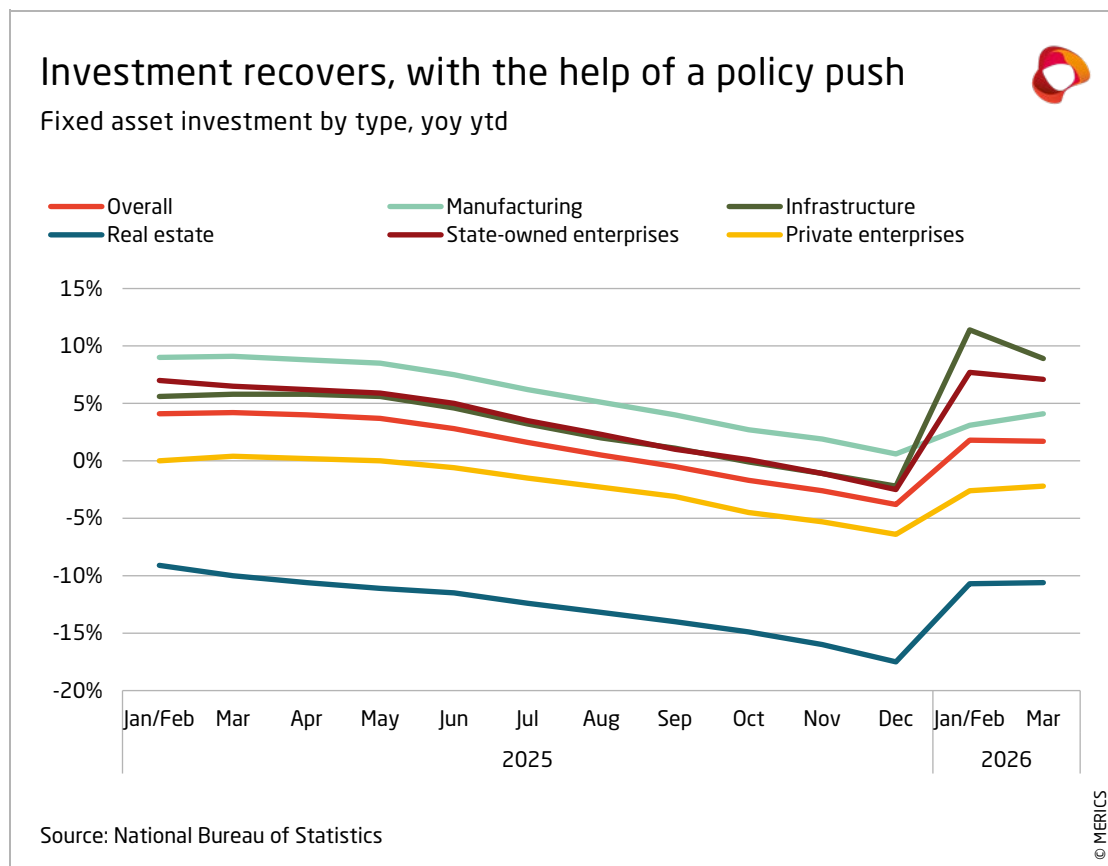
- Data seesaws:** After Chinese exports powered upwards by 39.6 percent in February, export growth slackened to 2.5 percent in March. However, the significant variation was largely due to base effects, as there does not seem to have been any impact from US-Israeli war with Iran in March.
- Exports shine:** Exports continue to lift China's economy. They grew by 14.7 percent year-on-year in Q1, including by 21.0 percent to EU markets and by 20.2 percent to ASEAN countries.
- Digital and green growth:** Exports of high-value goods such as integrated circuits and automobiles underpinned strong export growth. According to the China Association of Automobile Manufacturers, exports of electric and hybrid vehicles more than doubled in Q1 in unit terms. Robust global demand for such green technologies is likely to persist this year and aid Chinese exporters as oil prices are projected to remain high.

## IMPORTS



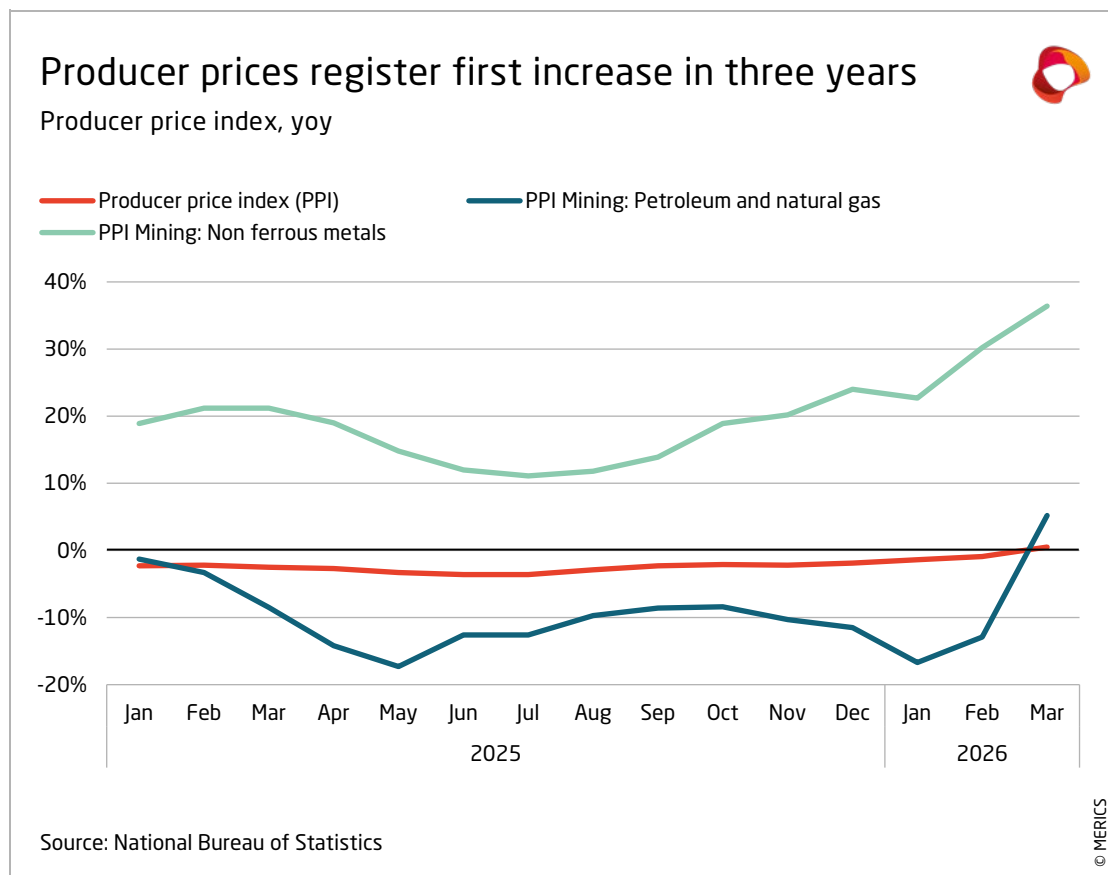
- Imports surge:** China's imports grew by their highest level in four years, up by 22.7 percent in Q1, thanks to strong demand for raw materials and advanced electronics. As a result, imports from Australia rose 50.7 percent, those from Brazil rose 36.7 percent and those from South Korea were up 44.3 percent. Imports from ASEAN grew 15.0 percent and the EU was up 10.5 percent.
- Consumer goods miss out:** Despite the strong uptick in imports overall, imports of consumer products did not get a boost. Q1 car imports (including chassis fitted with engine) fell 10.2 percent by value, while imports of household appliances dropped by 21.5 percent across January and February yoy.
- Ship traffic:** Oil tanker arrivals in 20 major Chinese ports were up 20.4 percent year-on-year in Q1 and 20.3 percent in March (based on the number of ships). Disruptions in the Strait of Hormuz are only beginning show up in Chinese port data in mid-April.

## INVESTMENT



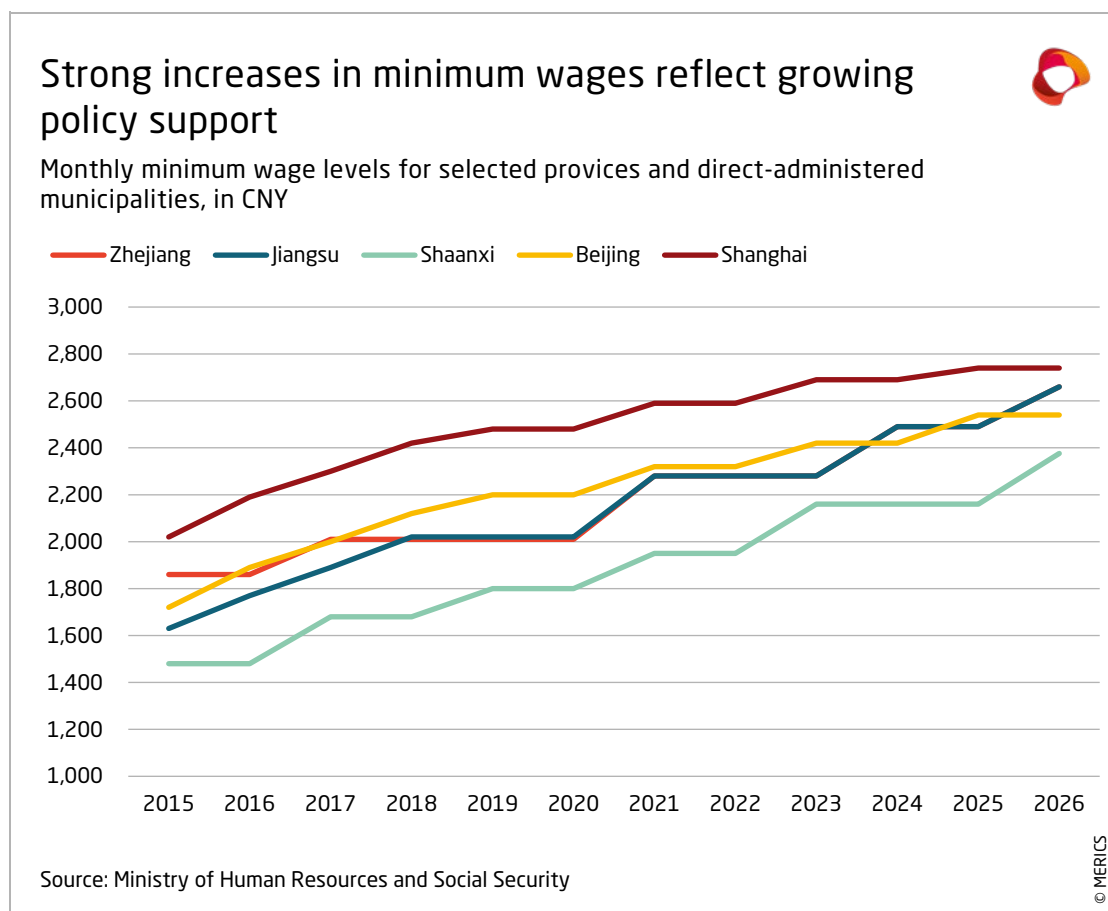
- FAI grows again:** Reversing its extraordinary decline in 2025, overall fixed-asset investment (FAI) turned positive again, increasing 1.7 percent in the January-March period year-on-year. Infrastructure spending, manufacturing investment, and construction all helped lift FAI. Real estate continued to contract, down 10.6 percent in Q1.
- FAI fueled by state push:** Additional funds released by the government towards the end of last year were put to use by state-owned enterprises, delivering the hefty growth in infrastructure investment in Q1. State Grid announced it would invest CNY 4 trillion (about EUR 500 billion) between 2026 and 2030 to upgrade the national power grid, lifting its spending 40 percent on the previous Five-year Plan period. Such activity could help put a floor under investment.
- Challenges remain:** Yet FAI will continue to face obstacles. These include local government's financial problems and the central government's policies to curb China's spiraling surplus in manufacturing capacity (its anti-involution push). Beijing will likely aim to keep FAI positive, while avoiding a spending spree on the scale of 2009.

## PRICES



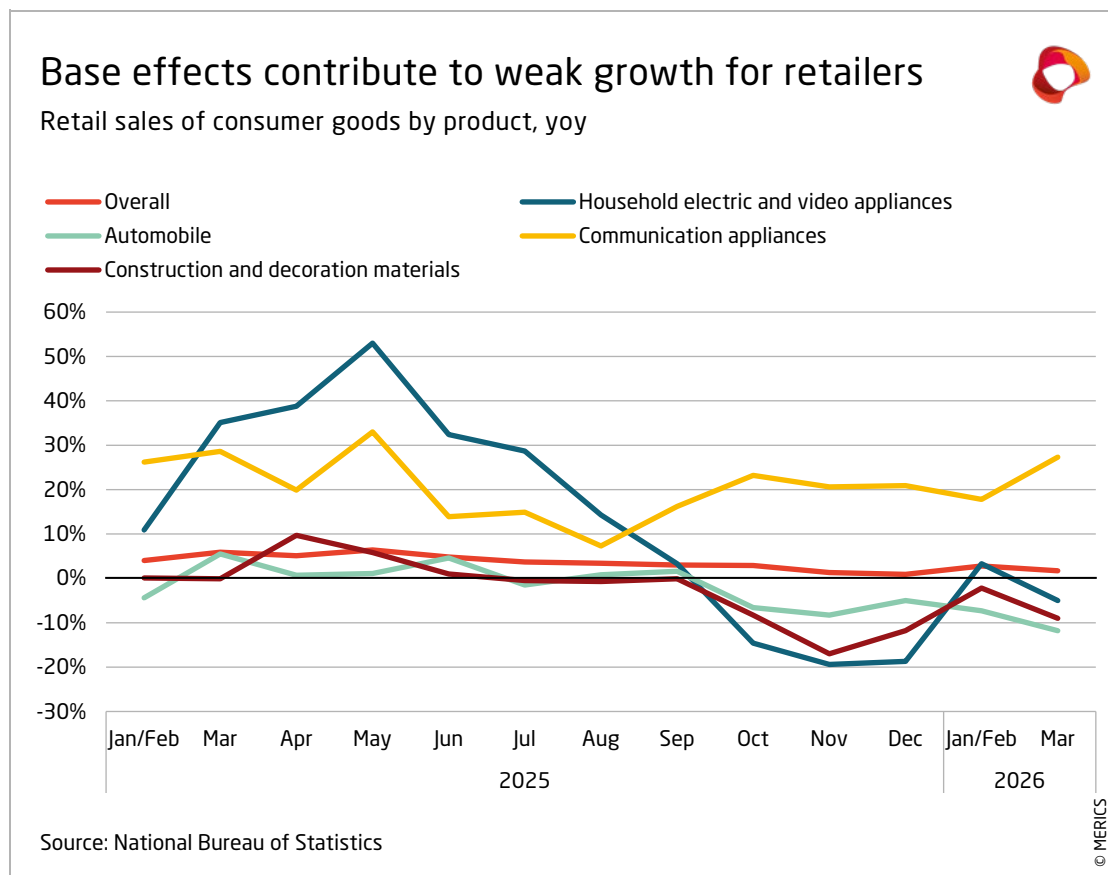
- PPI positive again:** After 41 months of decline, higher prices for oil and raw materials nudged the producer price index (PPI) into expansion territory again, up 0.5 percent. The price received by producers of non-ferrous metals, which covers aluminum and copper, climbed even higher on supply constraints and ongoing strong demand, due to global investments in digital and green technologies.
- CPI is also rising:** The consumer price index (CPI) continued the upward trajectory which began in Q4, rising by 1.3 percent year-on-year in February (the largest increase since January 2023) and 1.0 percent in March. Higher global oil prices delivered a 10.0 percent month-on-month jump in transport fuel prices in March. Inflation is likely to rise further, due to higher fuel costs. However, the government will have room to adopt more measures to provide support for households and businesses as long as inflation continues at moderate levels.

## LABOR MARKET



- **Strong minimum wage increases:** The provinces of Jiangsu, Zhejiang, and Shaanxi have announced minimum 2026 wage increases of 6.8 percent, 6.8 percent, and 10 percent, respectively, compared to 2025. With China's GDP growth target lowered to 4.5 to 5 percent this year, these minimum wage increases are unexpectedly strong and signal growing support from policymakers.
- **Labor market faces headwinds:** The surveyed urban unemployment rate rose to 5.4 percent in March, its highest level since February 2025. Youth unemployment also saw an increase to 16.9 percent, higher than the 16.5 percent reached in March last year.
- **Tackling unemployment:** The government is rolling out measures to increase employment, in further signs of policy support. The measures include social insurance subsidies and tax and fee reductions to encourage enterprises to hire fresh college graduates. The State-owned Assets Supervision and Administration Commission has urged SOEs to recruit more graduates.

## RETAIL



- Weakness persists:** Retail sales growth was lackluster in Q1, rising just 2.4 percent. Relatively strong year-on-year growth of 4.6 percent recorded in Q1 2025 partly explains the meagre increase, but weak consumer sentiment remains the key factor.
- Online sales lift:** Online sales of consumer goods and services grew by 9.2 percent year-on-year across January and February, and by 8.0 percent in Q1 overall. Online merchants benefitted from increased activity over the longer than usual nine-day break for Chinese New Year.
- Subsidy support wanes:** Domestic car sales dropped by 9.1 percent during Q1, mainly due to the reduction in subsidies for EVs and less aggressive price-cutting by automakers. Sales of household appliances also recorded zero growth in Q1. This suggests the government’s ongoing consumer-trade in program will not outstrip the spending push it generated in the first half of 2025.

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