QUARTERLY ANALYSIS OF ECONOMIC TRENDS IN CHINA

MERICS China Economic Indicators

China's economy steadies as surging exports lift Q3 growth above forecasts

Q3/2026



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MERICS Q3 ANALYSIS

China's economy steadies as surging exports lift Q3 growth above forecasts

By **Andreas Mischer**

China's economy recovered slightly in the third quarter as GDP growth was 4.5 percent, bettering expectations and improving on 4.3 percent in Q2 - the lowest V growth in almost four years. China is therefore likely to reach its 2026 annual GDP growth target of 4.5-5 percent as overall growth over the first three quarters of 2026 was 4.6 percent. As a result, the leadership will probably continue to provide selective support to the economy, side-stepping any pressure to return to broad-based fiscal stimulus. For now, booming exports continue to deliver strong momentum, which helps to keep the economy humming overall.

Conditions are not tough enough to provoke a major stimulus

However, there is no shortage of challenges. Resilient headline growth concealed deepening imbalances within the economy. Sources of growth are narrowing, driven mainly by a few industries, as well as by exports. Overall industrial value added grew by a healthy 5.5 percent in September but, when examined by sector, the strong increases were delivered by the more advanced industries.

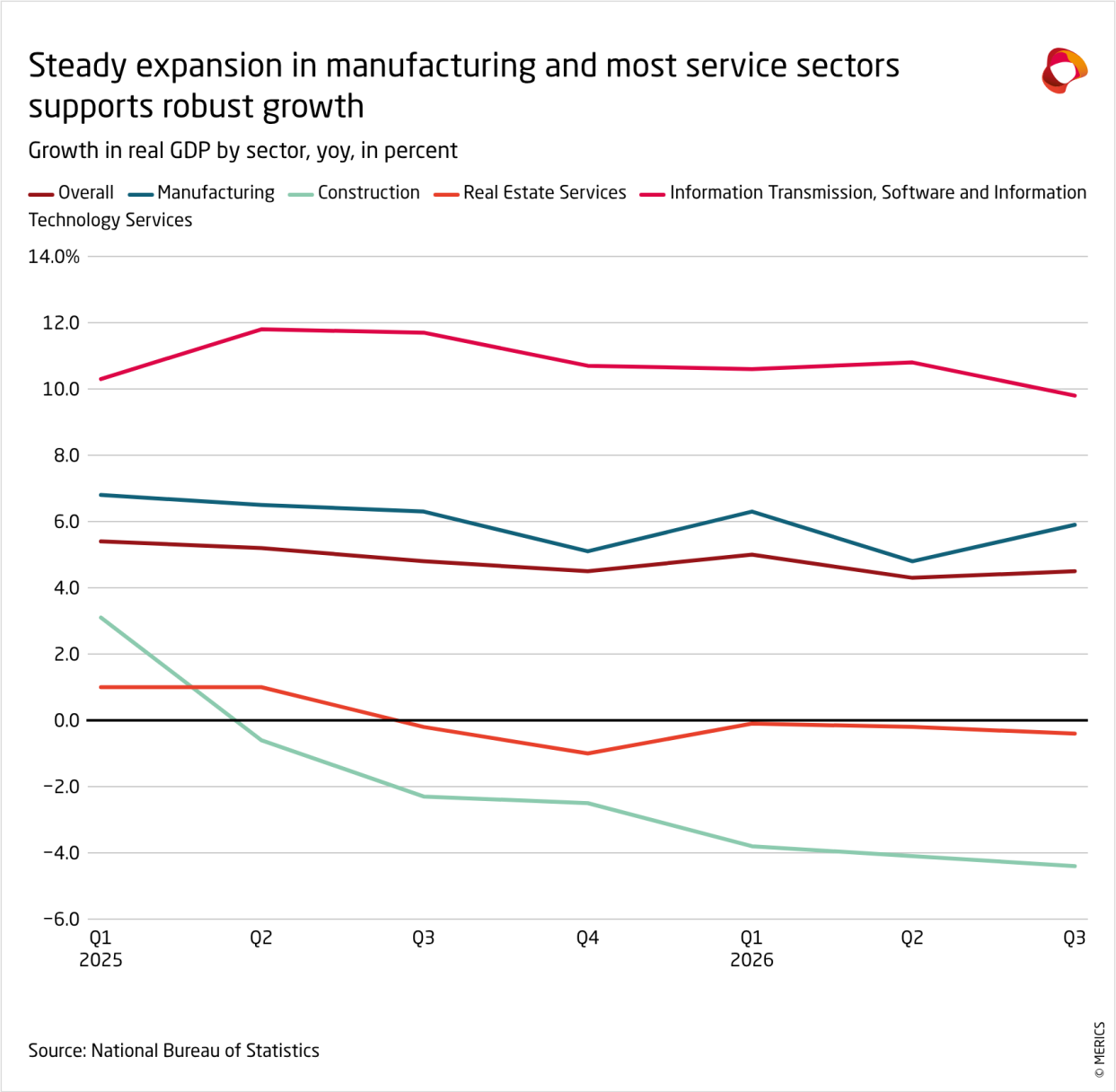
Value added in high-tech manufacturing surged by 15.3 percent and specialized equipment manufacturing jumped by 12.1 percent. By contrast, fixed-asset investment (FAI) fell by 7.2 percent from January to September compared to the same period in 2025. A state-led push for infrastructure investment briefly lifted FAI growth at the beginning of 2026, but it has steadily declined since. The worst-affected sector remains real estate, where investment has declined by 20.6 per cent so far this year, which is a new low. Weak consumption also continues to weigh down growth.

But any expectations of stronger fiscal support may be in vain. Pressures in other parts of the economy do not seem to be getting materially worse. Youth unemployment reached 18.9 percent in August (when new graduates enter the job market), which was the same peak level as last year. New job creation reached 10.5 million between January and September 2026, roughly the same as in 2025. The global energy supply shock pushed up producer prices by 5 percent in September, but consumers are not feeling the pinch yet, as consumer prices crept up by a mere 0.9 percent.

Additionally, weak retail sales growth of 1.1 percent in September reflected the government's ongoing struggle to boost consumption, but also its reluctance to take more forceful measures.

The measures taken mostly focus on the supply side, leaving underlying challenges like weak sentiment unaddressed. China's household goods trade-in scheme lifted sales of items such as communication equipment (up 31.1 percent). However, gains are typically short-term and not sustained as people may buy a large item sooner than otherwise, but overall demand for these products has not grown.

Exhibit 1



Exports keep momentum going in China's increasingly single-engine economy

Exports continued to lift the economy. In September, exports climbed by 36.3 percent in value terms, while imports rose by 31 percent. For most of this year, Chinese imports were growing faster than exports due to higher input prices. This trend has now reversed, pushing China's trade surplus to USD 133.5 billion in September. It was the highest trade surplus since January 2025, when Chinese firms frontloaded deliveries to get ahead of Trump's return to the White House, and the second highest monthly surplus on record. Once again, China's trade partners find themselves grappling with the fallout from an onslaught of Chinese goods in their home markets.

The automotive industry neatly encapsulates this dynamic of a weak domestic market and economic strength abroad. Industrial value-added in the automotive industry rose by 6.7

percent in September year-on-year. Although output of passenger vehicles dropped by 9.4 percent year-on-year in September (to 2.6 million cars), retail sales of passenger vehicles in China fell much more steeply, plunging 28.1 percent to 1.6 million cars. Most of these surplus cars go overseas. Already, China's monthly passenger vehicle exports have exceeded 900,000 units three times this year. And year-on-year export growth of passenger vehicles stood at 64.2 percent in September.

Beijing tackles financial risks from weak banks to protect against hazards ahead

As the 2026 GDP target is well within reach, Beijing is unlikely to start splurging on stimulus measures. Growth remains high in technologically advanced areas of the economy, which are central to the government's industrial policy goals. And the export engine, which compensates for lack of demand in the feeble domestic market, shows no sign of sputtering.

Stimulus measures announced in recent months have been modest in scope; those announced on September 29 did not indicate a shift towards broader support. The measures offered subsidies for some mortgages, and the central bank cut the pledged supplementary lending facility rate to encourage policy banks to step up lending. Other recent measures have included the release of unused bond quotas for local governments and the final tranche of this year's consumer trade-in program. New measures that might meaningfully increase household incomes are unlikely as long as global demand for China's exports stays high and the leadership's technological and industrial policy goals are achieved.

However, Beijing is not oblivious to the problems besetting China's economy. Policymakers have been consolidating the banking sector, closing or merging 82 village and township banks, 44 rural commercial banks and 38 county-level rural credit cooperatives between January and early May.

The government is also recapitalizing big state banks, and its financial stability draft law includes a rescue fund for strained financial institutions. This suggests Beijing is taking measures to stabilize its chosen economic model and ensure a more robust position if things worsen. Capital for state banks translates into more funding available to support high-tech industries.

And consolidating troubled rural banks into the big banks helps defuse risks – from local government debt or exposure to small local firms – that could otherwise precipitate a crisis with wider consequences. None of this suggests any changes to China's export-led growth model, so further tension with its trade partners is likely.

China pushes ahead with AI adoption and prepares for a possible jobs crisis

By **Alexander Brown** and **Elizabeth Ru-Tung Sun**

For fresh graduates and low-skilled workers, many already struggling to find steady employment, the government's aggressive promotion of AI poses yet another potential hurdle. China's rapid deployment of AI makes it an important case study for other countries when monitoring the impact on employment. China is not yet facing an AI-driven jobs crisis, but it is already preparing for the possible fallout.

Beijing's preference for high-tech industries has restricted overall jobs growth

China's push toward a growth model focused on high-tech industry has left its labor force in a difficult position. The youth unemployment rate has remained persistently high for years; in August it again hit 18.9 percent, a peak last seen a year earlier in August 2025. Among fresh graduates, competition for entry-level positions has become fierce as they join the ever-increasing pool of newly-minted, educated jobseekers. A university education and strong work ethic are no longer the ticket to a stable job and comfortable income. China's real estate crisis has also wiped away families' hard-won asset values, and left workers with no clear pathways to accumulate wealth.

Despite China's growing trade surplus and continued investment, the overall number of industrial sector jobs has remained basically flat since the end of the harsh zero-Covid policy of rolling lockdowns in December 2022. Strong job growth in sectors such as cars and equipment production has failed to compensate for losses in other sectors like textiles and coal mining (see exhibit 1). Employment opportunities in the service sector have been muted by weak consumption. Lower investment in the construction sector has also dampened job creation: the share of migrant workers employed in construction fell from 19 percent to 13.8 percent between 2021 and 2025.

As steady, full-time employment has become harder to obtain, workers are increasingly turning to "flexible employment" to make ends meet. According to the China New Employment Forms Research Center, the "flexible" workforce is set to reach 320 million this year, or about 40 percent of urban employment (see exhibit 2). With very limited prospects for career development and only basic social services coverage, the growth of this cohort is fueling inequality and undermining social stability.

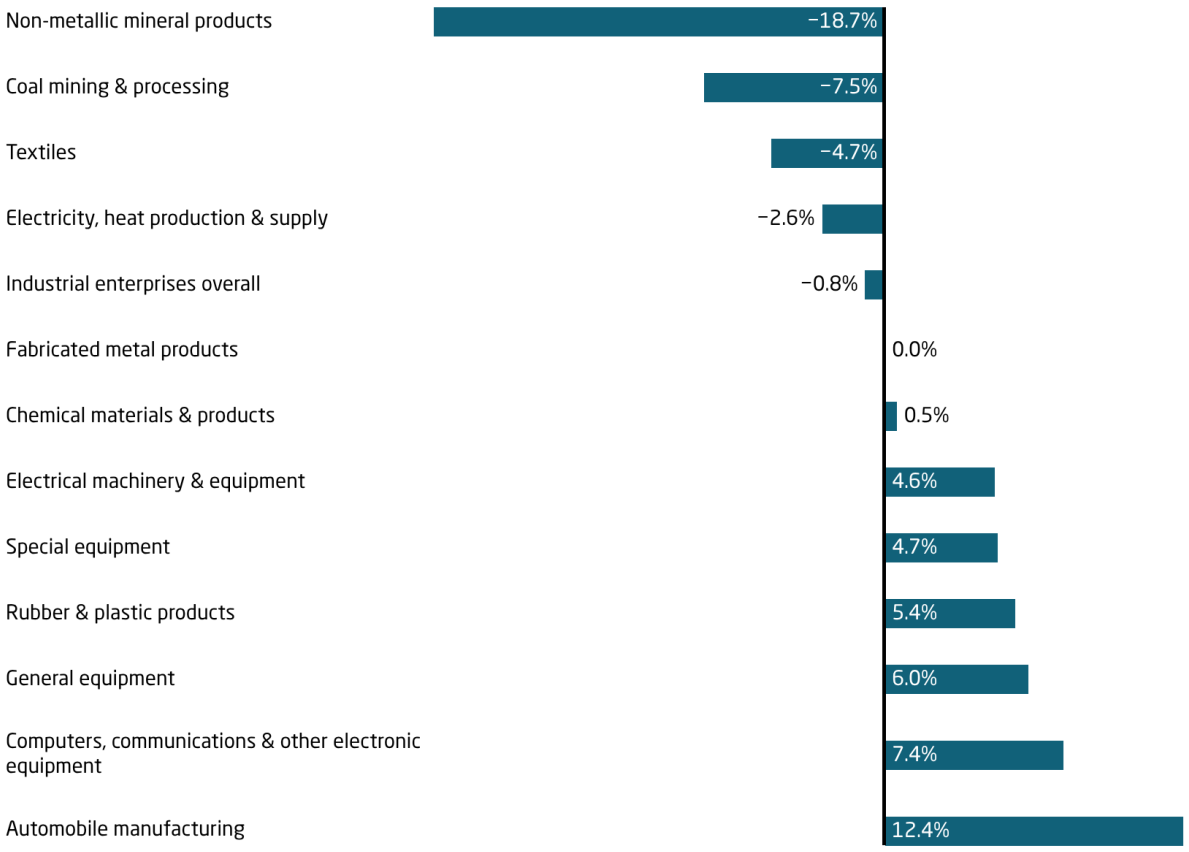
AI threatens further major disruption to job creation

China is accelerating AI adoption. Success in this endeavor could boost productivity and be beneficial, viewed from a policy-making level, as the now-abandoned One-child Policy has shrunk the working age population as a share of the total. However, widespread application of AI may also intensify the pain already being caused by shifts in China's labor market. It is too early to say how disruptive AI will be – so far there has been no collapse in jobs due to the technology. Although major tech companies such as Alibaba, Baidu and BYD made substantial cuts to their workforces in 2025, those layoffs were mainly attributed to broader economic pressures rather than any AI transformation.

Exhibit 1

Industrial job numbers are declining, despite expansion in some sectors

Change in the number of employees for industrial sectors, 2026 vs 2023, in percent



Based on average number of employees in the period Jan-Aug. Covers industrial enterprises overall and the top 12 sectors, ranked by average number of employees in 2026.

Source: National Bureau of Statistics

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Most policies and official statements focus on AI's positive implications for jobs, emphasizing new jobs and retraining. For example, the Implementation Plan for the Employment-First Strategy focuses on AI's potential to promote employment and entrepreneurship. The emergence of one-person companies (OPC), where AI agents perform functions that would traditionally be carried out by several employees, has received backing via supporting policies in more than 20 provinces.

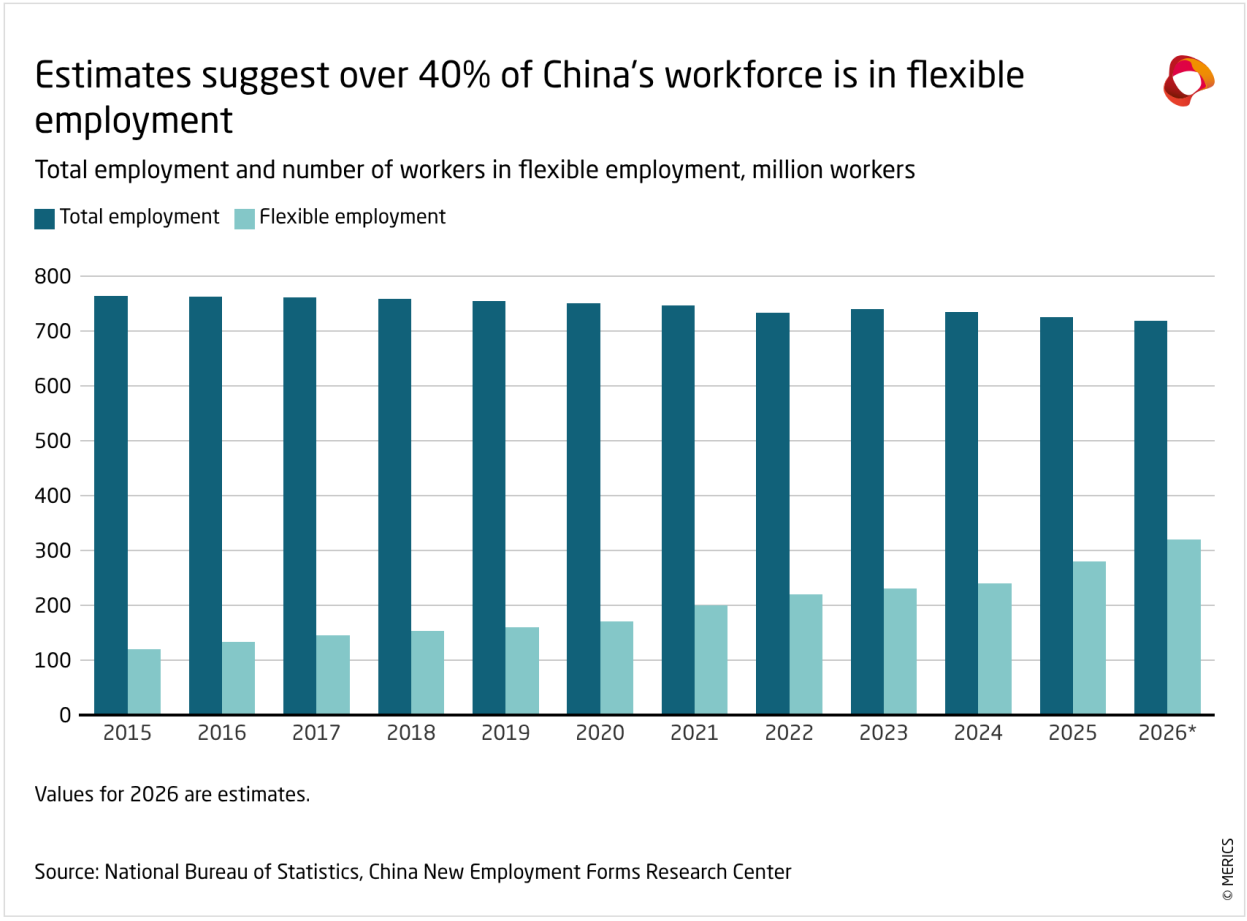
China's determination to fast track AI adoption means it may be headed for a difficult transition period. Major changes are inevitable to fulfill official targets of 70 percent AI tool adoption across key sectors by 2027 and 90 percent by 2030. According to Citibank, approximately 9.6 percent of jobs in China—equivalent to roughly 70 million positions—are at high risk from AI adoption, with younger workers facing greater impacts. As the younger generation is already

grappling with a difficult job market, AI adoption might diminish their employment prospects further and fuel social tensions.

The key question for China, as for all other countries confronting AI adoption, is what the net outcome will be for jobs, both lost and created. Greater efficiencies and reduced costs for providing goods and services could generate more demand and hence boost jobs in related sectors; this already appears to be true for some professions in the United States, such as AI engineers, software developers or data center construction workers.

Yet it is equally possible that AI may simply replace humans without creating new roles for them to take over. This is a clear danger in sectors like robotaxis and courier services. The deployment of Baidu's Apollo Go robotaxis in Wuhan has triggered protests by taxi drivers. Similar tensions may emerge in other sectors as more AI applications are introduced.

Exhibit 2



Beijing will respond if AI proves to be a job killer

China's leaders consider employment a key foundation for social stability so large-scale layoffs due to AI would demand their attention. Beijing has shown it wants to avoid this result. At the end of last year, a national standard was released on evaluating the social impact of generative AI technology, including employment. This year the Ministry of Human Resources and Social Security announced it was drawing up measures to address the impact of AI on employment. In April, the AI Plus Education Action Plan emphasized the need to align university majors and

academic programs with changing industrial structures and to establish new interdisciplinary programs that integrate AI.

Ironically, officials have even implied they could leverage AI to better mitigate the risks to employment caused by AI. A plan to integrate AI into human resources and social security services released in July aims to boost labor rights protection and enhance the monitoring of illegal employment behavior.

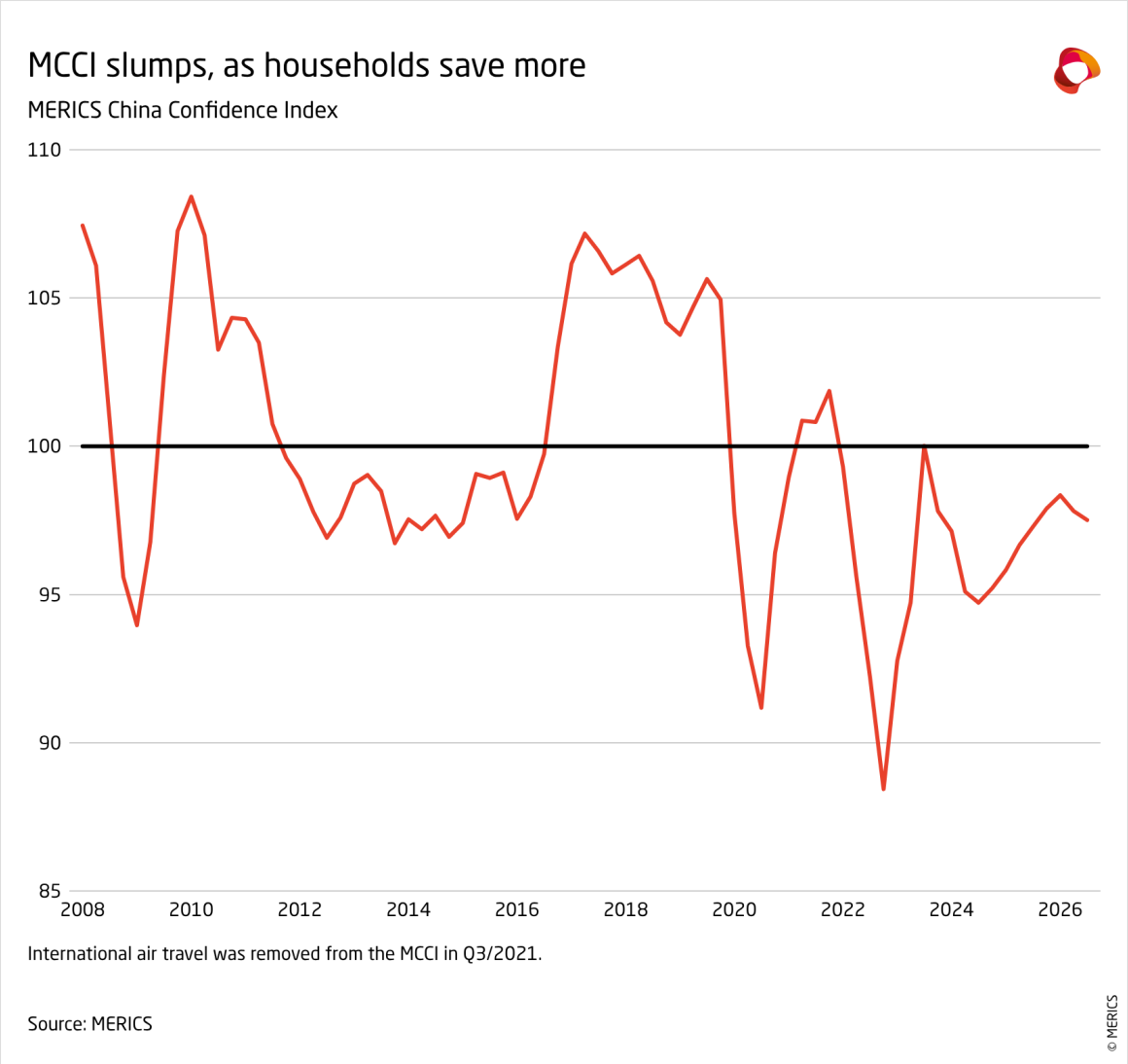
Together, these announcements point to greater government scrutiny of AI's impact on employment. If layoffs begin to snowball, then it is almost certain to intervene with more concrete action. Under China's labor contract law, the dismissal of 20 or more employees in one go must be reported to the local labor administration departments, allowing them to exert influence on the outcome.

In practice, most firms opt to terminate employment contracts by mutual agreement, to avoid the reporting requirement. Several court rulings have prevented firms from dismissing employees solely on the grounds that AI could perform their work more cost-effectively. In a recent case in Hangzhou, a fintech company demoted and dismissed an employee, claiming AI could replace their work. The Hangzhou Intermediate People's Court ruled that the dismissal violated the law and ordered the company to pay compensation.

Beyond such legal measures, another option for local and provincial governments would be to ramp up incentives to retain staff or use other methods to prevent companies from firing people. The government could also direct state-owned enterprises to increase hiring, while pressuring private firms to do the same as part of a renewed push for "Common Prosperity". Ultimately, new measures to strengthen protection for workers in the gig-economy may even be necessary.

This leaves Chinese firms confronting conflicting pressures, urged and incentivized to accelerate AI adoption, yet potentially admonished for cutting jobs. Small and medium-sized firms may be able to downsize their workforce without attracting attention, if they choose to. But larger firms, particularly listed companies, will not be able to avoid scrutiny. Their only choice, if they view AI adoption as key priority, may be slow-roll the pace of any restructuring.

MERICS CHINA CONFIDENCE INDEX (MCCI)



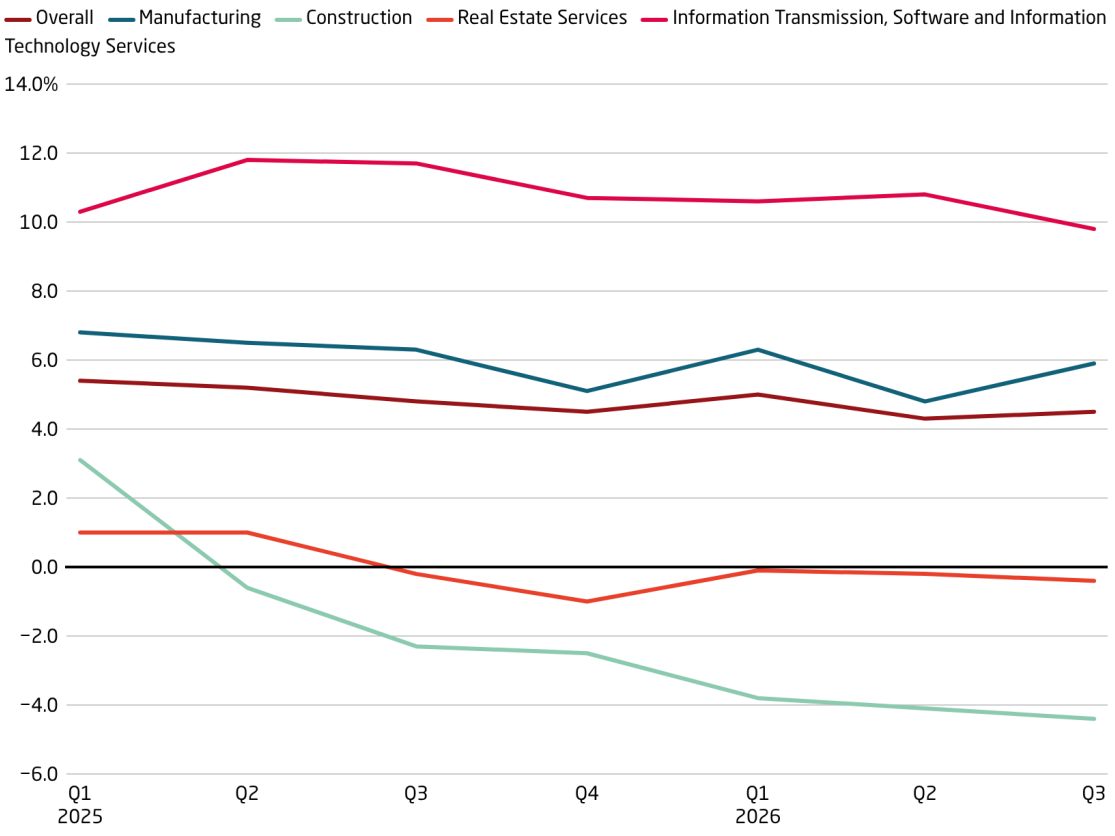
- **Sentiment crumbles:** After improvements at the start of the year, two consecutive quarters of decline in the MCCI point to fragile sentiment.
- **Savings trump consumption:** This decline was mainly driven by a deteriorating expenditure share of income, suggesting households favor savings over consumption in the face of China's ongoing real estate crisis. This is also reflected in low demand in the domestic economy.

The MERICS China Confidence Index (MCC) – 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

Steady expansion in manufacturing and most service sectors supports robust growth

Growth in real GDP by sector, yoy, in percent



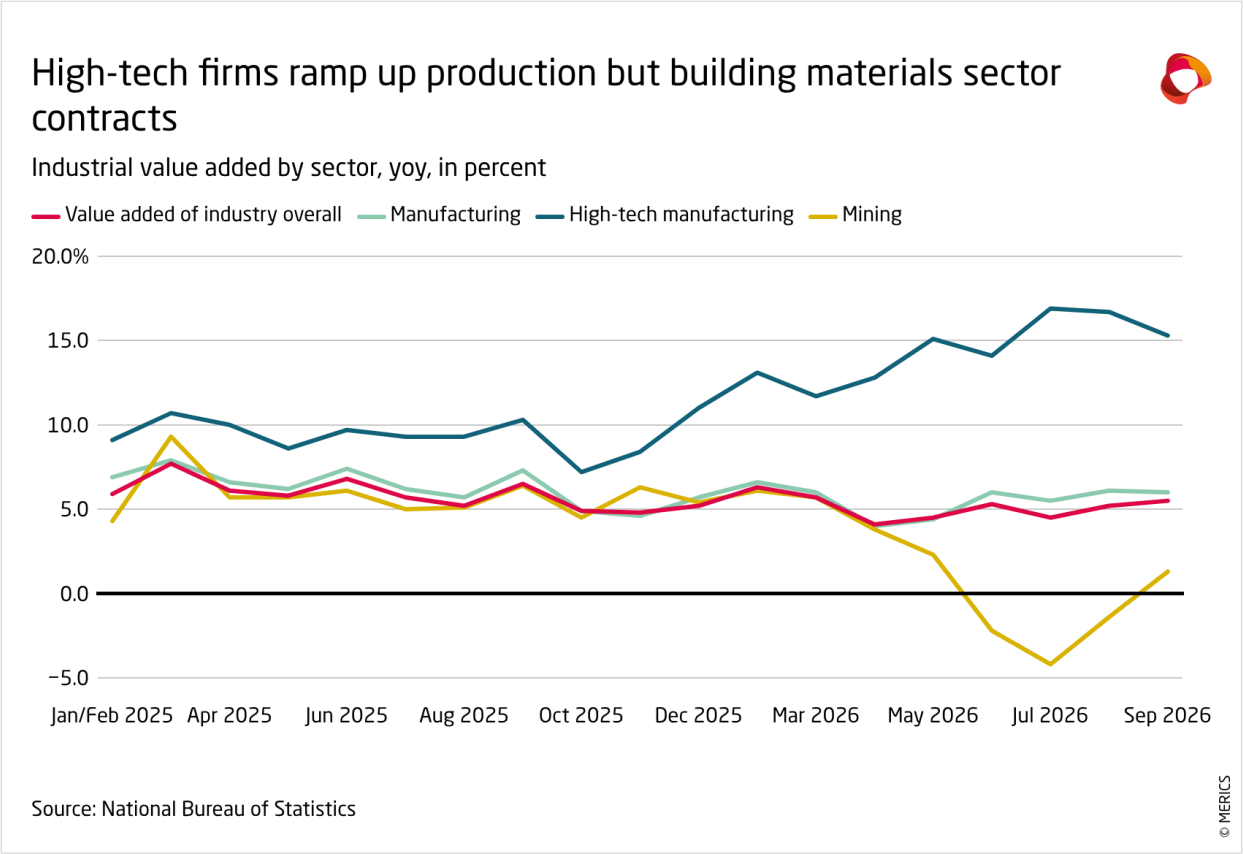
Source: National Bureau of Statistics

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- **Growth is on target:** In Q3, China's GDP grew by 4.5 percent, thanks to strong performances in the service and manufacturing sectors. With growth of 4.6 percent for the January-September period, China is on track to hit its full-year growth target of 4.5-5.0 percent.
- **Construction slows down:** Less building activity in the real estate sector continues to pose a drag on growth. The government has also limited new infrastructure investments as it focuses more on tackling financial risks. The result has been a long decline in construction. GDP growth in the sector has been negative and getting worse for six straight quarters, reaching negative 4.4 percent in Q3.

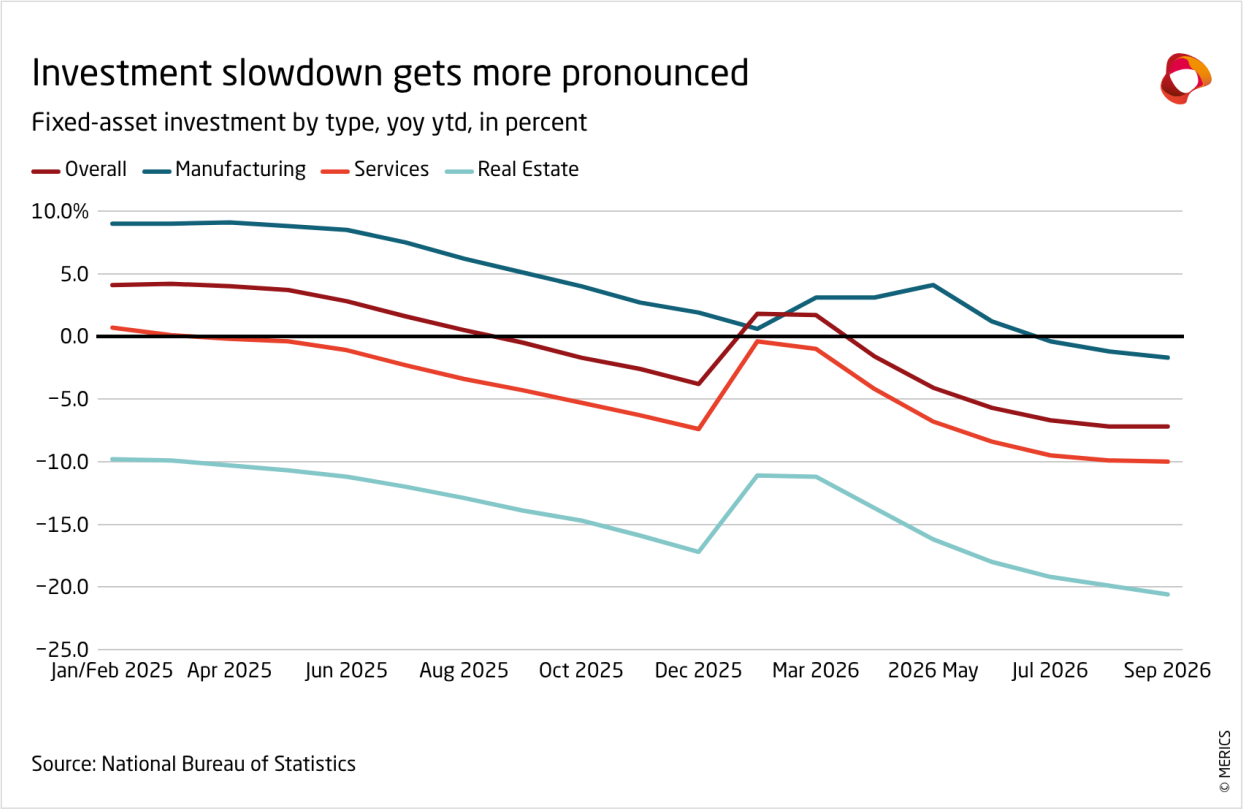
  Economic resilience may still be tested: China has managed to maintain moderate growth momentum this year, despite growing imbalances between different parts of the economy. Rising exports due to the AI boom have made weak domestic consumption and falling investment more tolerable, at least for now. Should this cycle end and global demand fall, the pressure on China's leadership to address these weaknesses will grow.

INDUSTRY



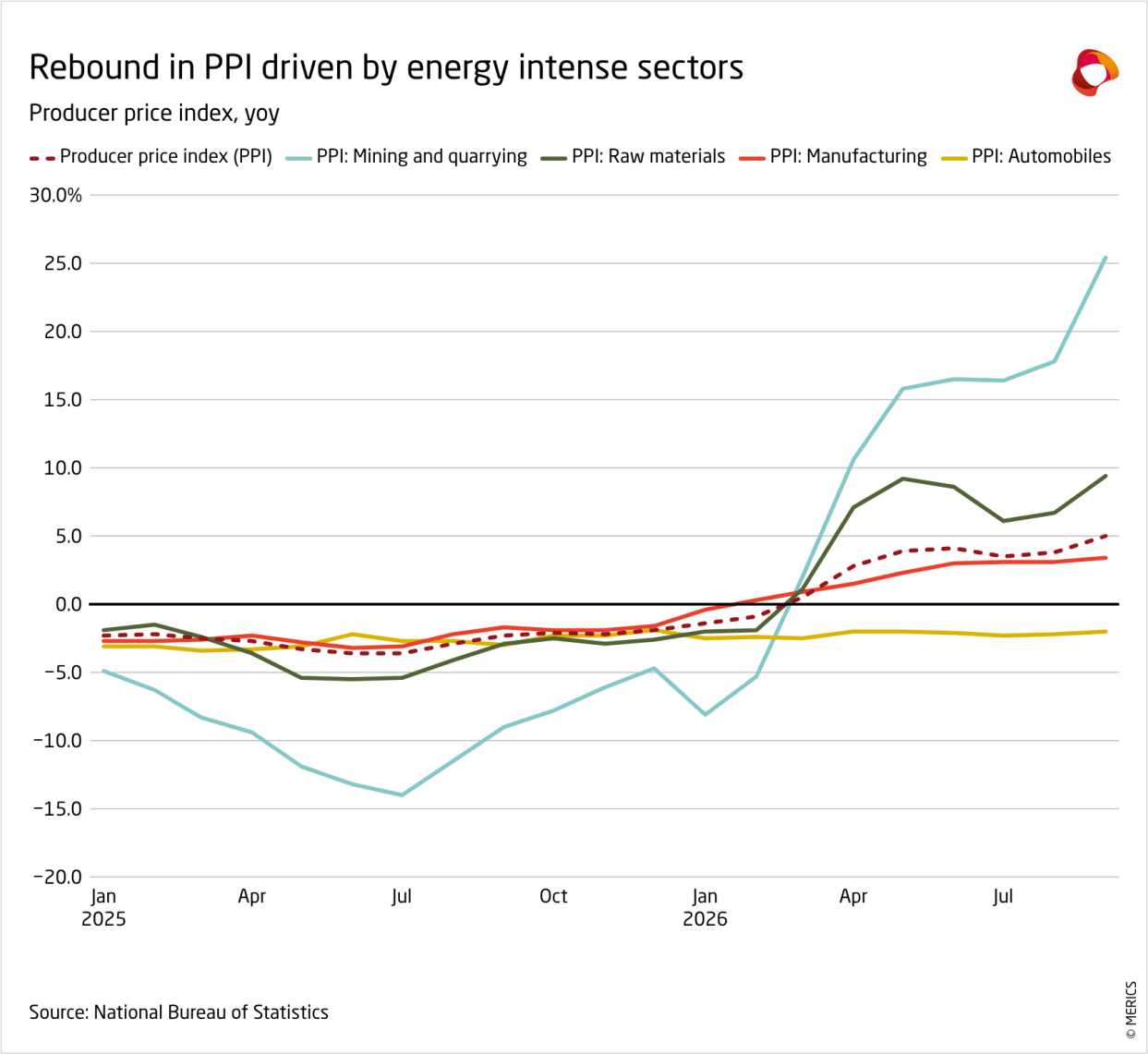
- **Push for high-tech products is paying off:** Growth in industrial value-added output for the manufacturing sector remained strong over Q3, finishing up 6.0 percent year-on-year in September. High-tech manufacturing grew by 15.3 percent, compensating for lackluster growth in the mining sector.
- **Foreign demand drives increased output:** Strong global demand for AI and green tech products is driving the rising production value of China's high-tech goods. In Q3, China's exports of integrated circuits in USD terms grew by 128 percent, while exports of new energy vehicles (primarily electric and hybrid vehicles) in unit terms rocketed up 146 percent.
- **Construction is still shrinking:** The years-long trend of rising output for high-tech goods and falling output for construction related products continues. In September, output in unit terms of industrial robots rose 18.9 percent, integrated circuits were up 18.4 percent and new energy vehicles grew by 16.9. By contrast, output of plated glass, cement and pig iron fell by 14.0 percent, 5.3 percent and 1.4 percent respectively.

INVESTMENT



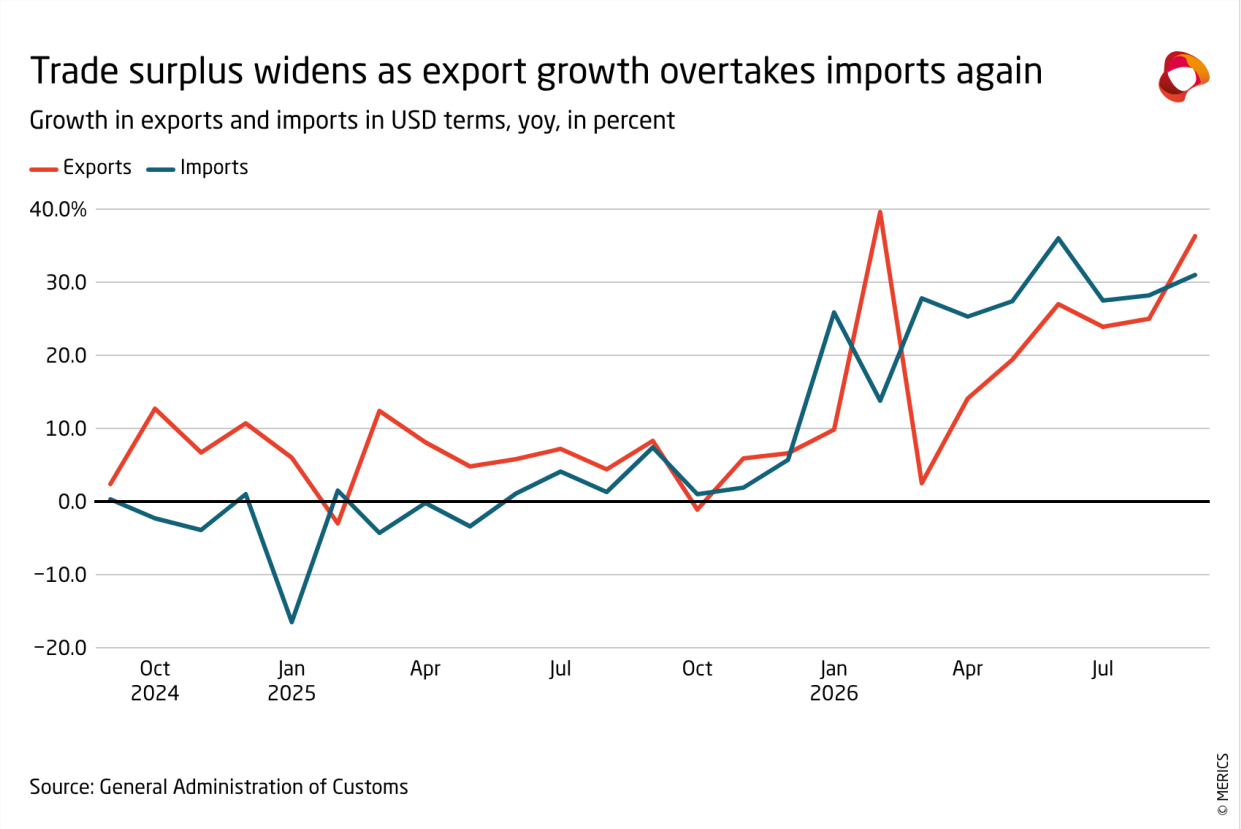
- **Investment is losing momentum:** After a brief rebound at the start of the year, growth in fixed asset investment saw deeper declines every month from April to August, before stabilizing at negative 7.2 percent year-on-year in September.
- **Manufacturing is no longer shielded:** Every major category of investment is now contracting. Manufacturing investment was still growing in 2025 but now it is down 2.1 percent as it has become limited to strategic industries. Investment in railway, shipbuilding and aerospace equipment manufacturing, for example, increased by 15.8 percent year-on-year, while electronics manufacturing investment rose by 9.6 percent.
- **The property downturn shows no sign of ending:** Real estate investment fell 20.6 percent, the steepest contraction on record, a reminder of how entrenched the crisis is. Beyond its direct impact on investment, the prolonged property crisis is impacting land-sale revenues, giving already heavily-indebted local governments less room to support companies' growth.

PRICES



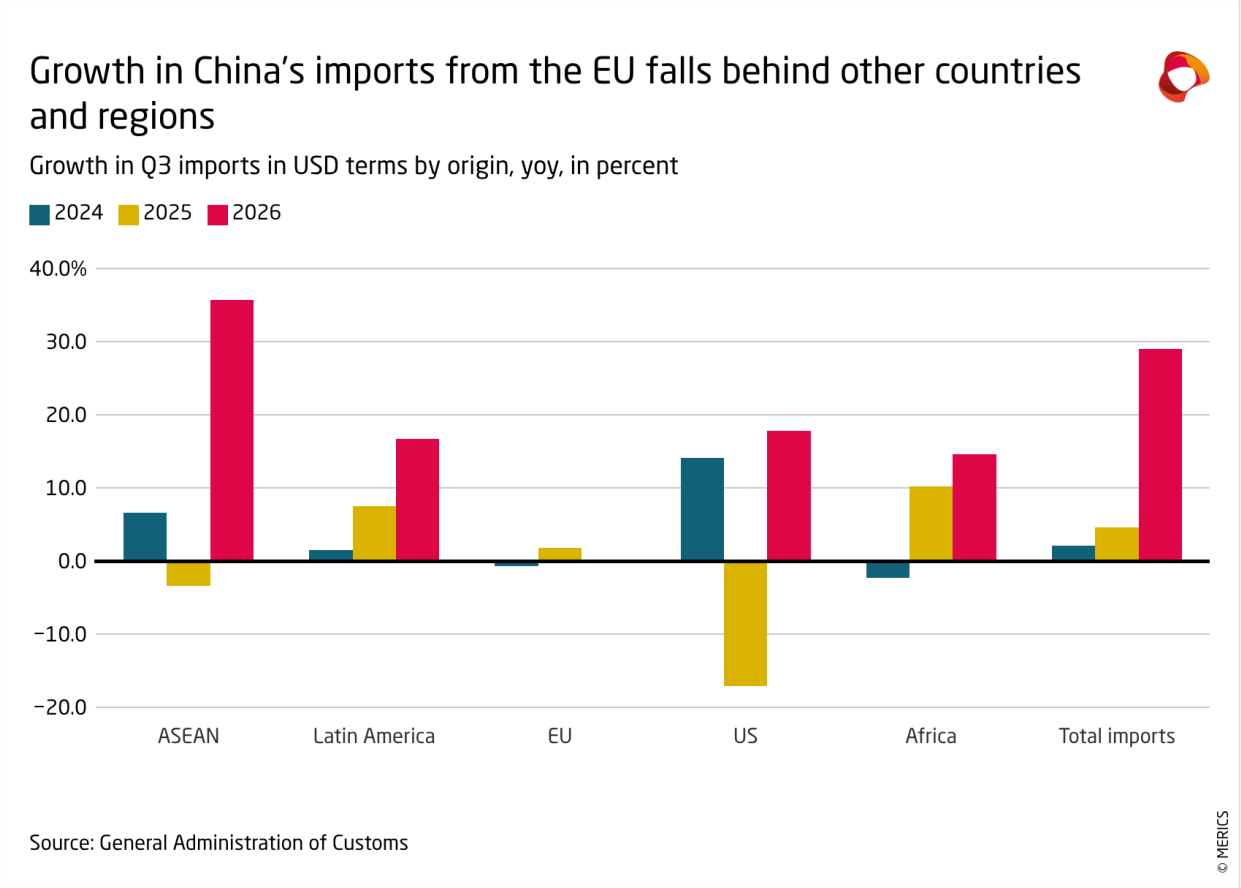
- **Increase in producer prices is driven by energy costs:** After more than three years of deflation, China's Producer Price Index (PPI) extended the rebound that began in Q2. The recovery was driven mainly by energy intense sectors, rather than any increase in companies' pricing power. Mining and quarrying prices jumped 25.4 percent, with oil and gas extraction up 24.5 percent and coal mining up 35 percent. Apart from disruptions in the Strait of Hormuz, China also faced declining coal shipments from Indonesia and a 10 percent fall in domestic coal output in June and July after a deadly mine collapse in Shanxi Province in May led to some temporary mine closures and widespread additional safety checks.
- **Prices keep falling in sectors that compete with European industry:** Deflationary trends persist in downstream sectors. While manufacturing prices rose 3.4 percent overall, general machinery prices fell by 0.4 percent and car prices by 2 percent. Weak domestic demand and intense competition continue to weigh on Chinese manufacturers and will encourage them to continue competing aggressively in export markets, putting pressure on European firms.

INTERNATIONAL TRADE (1)



- **AI and tech-related prices explain trade surge:** Rising prices for AI and high-tech goods continue to drive the value of China's trade, with semiconductor imports up 74.7 percent and computer part imports up 296.5 percent, in USD terms in Q3. These categories also boosted exports, particularly semiconductors (up 136 percent) and electronics and computer parts, as well as green tech.
- **Tech-trade volumes are down:** By contrast, in terms of quantity, China's trade in high-tech products was less strong. Semiconductor exports rose only 1.2 percent and imports 1.7 percent. Auto exports were an exception, higher in value and volume terms, with 1.18 million vehicles (including chassis) shipped in September.
- **No rebalancing in sight:** The balance of trade between Europe and China is increasingly skewed in China's favor, as trends are working against the EU in both imports and exports. China's trade surplus with the EU reached USD 277.4 billion (EUR 241.1 billion) for the year to September, a 26.2 percent increase year-on-year. China's trade surplus with the rest of the world grew by 7.8 percent over the same period.

INTERNATIONAL TRADE (2)

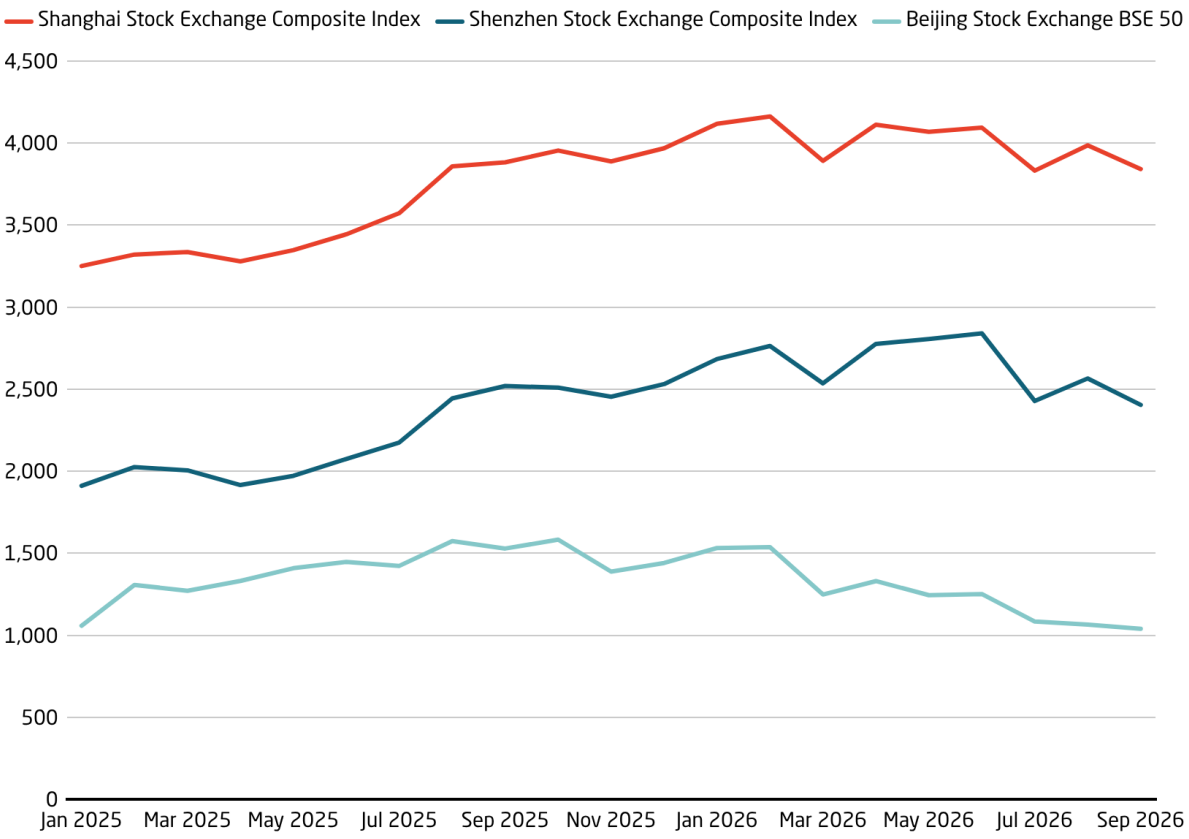


- **Imports from the EU are stagnant:** China's Q3 import growth surged by 29 percent year-on-year in USD terms, buoyed by the AI cycle and rising prices for related goods. However, imports from the EU stagnated, due to its position outside of high-volume AI-supply chains. In Q3, the EU accounted for 8.2 percent of China's total imports, ASEAN 15.4 percent and Latin America 9.1 percent.
- **EU sells China less autos, machinery and chemicals:** Amid the overall slump in EU-derived imports in Q3, imports of organic chemicals dropped 27.4 percent year-on-year, vehicle imports plunged by 32.5 percent, meat and offal fell 32.9 percent and imports of electrical machinery grew a slower rate of 13.4 percent.
- **Other regions are benefiting from supply chain links:** China's imports from Latin America and Africa rose strongly, likely due to increasing prices of tech-related metals, minerals and ores. Imports from ASEAN similarly received a substantial boost thanks to increased imports of intermediate goods such as parts, components and production inputs. The surge for the United States is primarily due to base effects, given imports decreased starkly in Q3 2025 during the trade war.

FINANCIAL MARKETS

The bull market on China's stock exchanges is over

Trend on China's stock market indices, index points



Source: Exchange Data International Limited, Beijing Stock Exchange

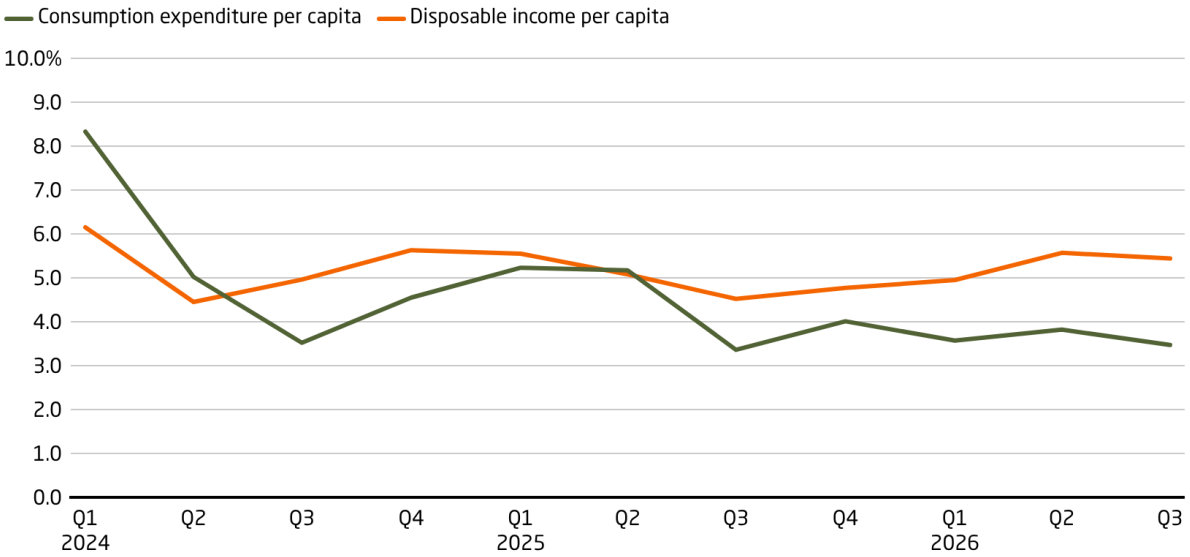
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- **Stock markets have peaked:** After enjoying long, and largely steady, gains throughout 2025, China's stock exchange indices seem to have peaked. As of September, the Shanghai, Shenzhen and Beijing stock exchanges were down 8 percent, 15 percent, and 34 percent, respectively, from their peaks.
- **The AI bubble is deflating:** Cooling investor enthusiasm towards tech companies has played a big role in the downturn. The STAR Market, a segment of the Shanghai Stock Exchange which tracks major technology companies, has dropped almost 40 percent so far in the second half of this year. Companies suffering significant declines in their valuations include GPU designer Moore Threads, semiconductor producer CXMT, and robotics firm Yushu Technology.
- **Another blow to confidence:** With real estate prices still falling and interest rates on deposits at Chinese banks traditionally repressed, the stock market declines threaten to erode the one remaining channel open to Chinese households to store and increase wealth. This is more bad news for consumer confidence and domestic demand.

CONSUMPTION

Consumption still in the doldrums despite steady income

Quarterly per capita disposable income and consumption expenditure, yoy, in percent



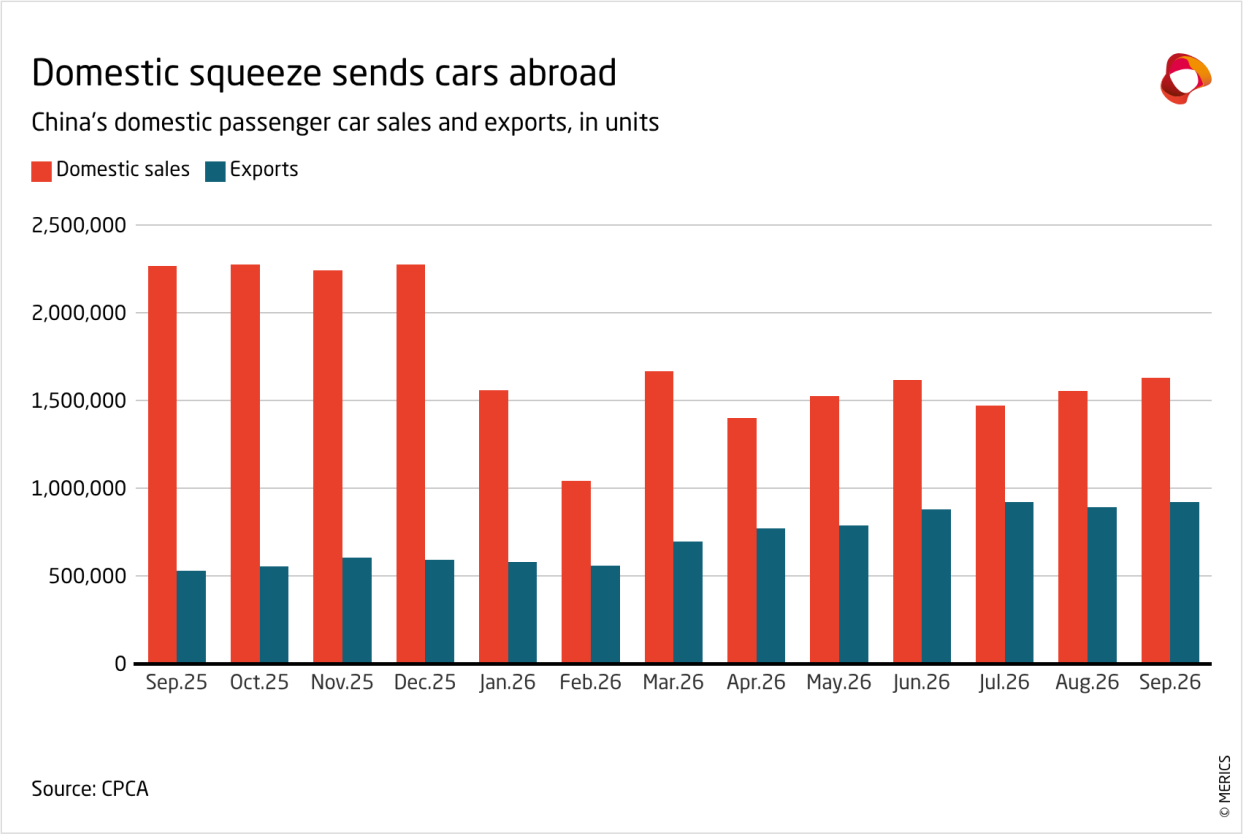
Figures based on national household survey.

Source: National Bureau of Statistics

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- **Save don't spend:** Over the past year, a large gap has opened up between growth in per capita consumption expenditure, which rose 3.5 percent in Q3, and growth in per capita disposable income (i.e. the amount left after people pay their taxes and basic needs), which rose 5.4 percent. Households will continue to prefer saving to spending.
- **Consumers are still pessimistic:** The trend for more saving than spending signals consumer confidence remains depressed; it crashed in 2022 and has yet to recover. The Consumer Confidence Index was only 89.2 points in August. It was even lower for employment, at 74.4 points (a reading below 100 indicates consumers are more willing to save than spend, or more pessimistic than optimistic about employment prospects).
- **Government support for demand is underwhelming:** The government has repeatedly signaled additional support for consumption and domestic demand, including a new Five-year Plan to expand consumption released in July. But actual measures focus on supply-side support and short-term subsidies instead of wage rises or the expansion of social services. So far, they have failed to meaningfully shore up retail sales, which rose only 1.1 percent the first three quarters of 2026.

AUTOMOTIVE INDUSTRY

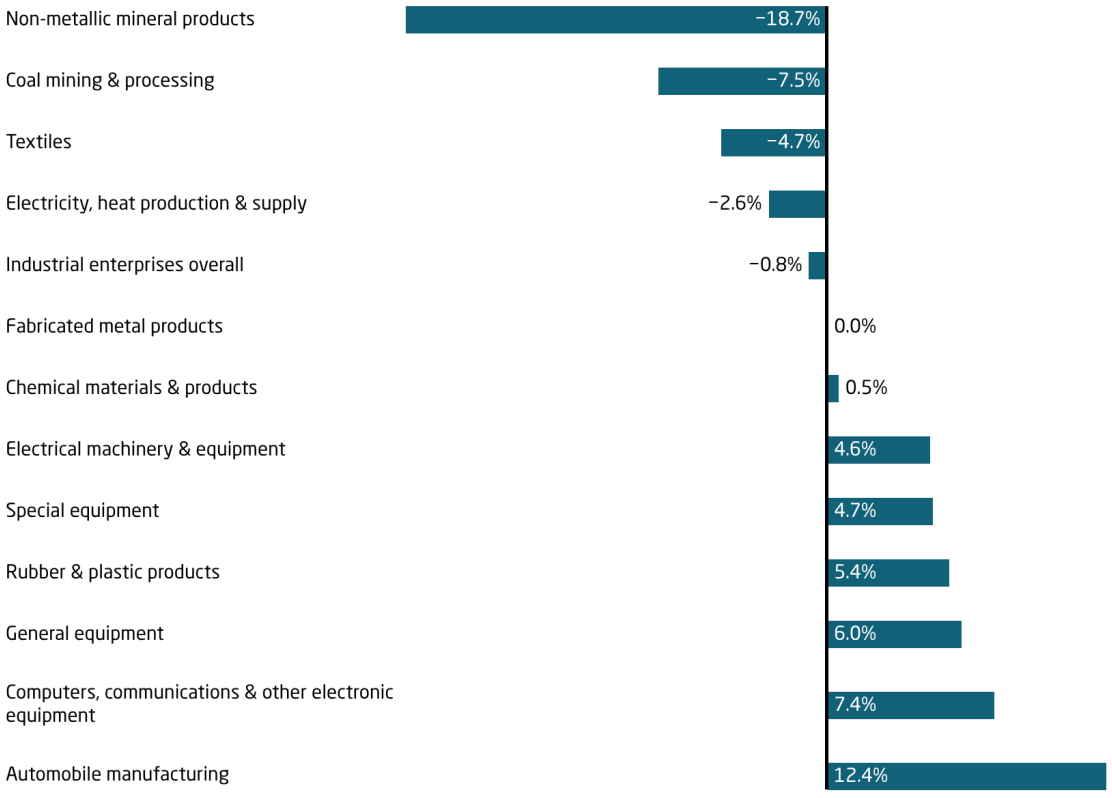


- **Sales are tumbling:** Domestic passenger car sales dropped from 2.27 million units sold in September 2025 to only 1.62 million units sold in September 2026, plunging by 28.1 percent. The downturn was triggered by cuts in policy support since January; tax exemptions on NEVs were reduced and trade-in subsidies on old cars became less generous. Aggressive incentives offered in 2024 and 2025 brought forward demand and have contributed to the subsequent slump in 2026.
- **Exports surge ahead:** Passenger car exports are increasingly filling the gap left by slowing domestic sales. Exports reached 923,000 units in September 2026, jumping 73.2 percent year-on-year.
- **Europe feels the squeeze:** Europe is a key export destination for Chinese passenger cars. From January to August, the EU imported around 1.1 million passenger cars from China. In September alone, China exported nearly 100,000 hybrid cars to the EU. As demand declines in China, and production does not, European car manufacturers will continue to face the fallout in their home market.

LABOR MARKET (1)

Industrial job numbers are declining, despite expansion in some sectors

Change in the number of employees for industrial sectors, 2026 vs 2023, in percent



Based on average number of employees in the period Jan-Aug. Covers industrial enterprises overall and the top 12 sectors, ranked by average number of employees in 2026.

Source: National Bureau of Statistics

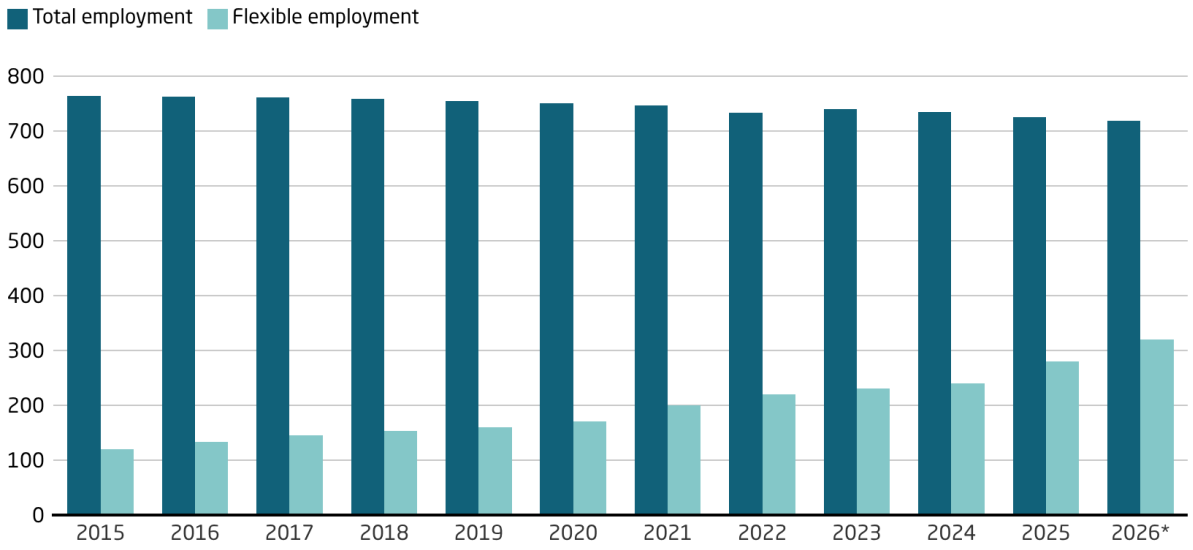
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- **In steady decline:** Industrial jobs are still a major source of employment, but the number of opportunities in Chinese industry has been shrinking for over a decade. According to official statistics, employment in China's secondary sector peaked in 2012 at 232 million jobs. By 2025, this number had fallen to 206 million.
- **Upgraded factories need less labor:** As China's industrial output and exports have risen dramatically over the last decade, manufacturers have been able to upgrade production processes and move into higher value-added goods which require less low-skilled and more high-skilled labor.
- **China's rising wages still lag behind OECD countries:** China's push into more high-tech sectors is reflected in rising pay. Average annual wages in the manufacturing sector doubled between 2015 and 2025, reaching 100,572 RMB (12,388 EUR) in 2025. Yet high-skilled labor is still significantly cheaper in China than in other advanced economies.

LABOR MARKET (2)

Estimates suggest over 40% of China's workforce is in flexible employment

Total employment and number of workers in flexible employment, million workers



Values for 2026 are estimates.

Source: National Bureau of Statistics, China New Employment Forms Research Center

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- **The gig economy is spreading:** It is estimated that over 300 million workers in China will be in flexible employment in 2026, which means they work part-time, temporary or project-based jobs. These jobs traditionally include writers, translators, and taxi drivers. Recently, newly emerging professions such as content creators have also joined this category.
- **Flexibility risks instability:** Flexible employment does not guarantee insurance coverage or participation in pension systems, creating potential instability. During low seasons, it might also be considered a form of unemployment.
- **AI impact:** Some jobs, such as taxi drivers and translators, could potentially be replaced by AI. At the same time, new forms of flexible employment might be created. The trend towards flexible employment has been growing since 2015, and is likely to accelerate alongside the widespread adoption of AI in the years ahead.

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