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Politburo Preview: A Calm Reply to Mounting Downside Pressures

The upcoming Politburo meeting may disappoint investors hoping for an all-out stimulus package. The combination of acceptable headline growth and widening sectoral divergence argues against a broad-based stimulus. Instead, this meeting will probably acknowledge mounting downside risks and call for stronger countercyclical adjustment, faster implementation of existing measures, and advance preparation of incremental support.

In the near term, Beijing's priority is to convert already-announced fiscal and quasi-fiscal resources, including the RMB800bn policy-based finance instrument, into actual spending, credit creation and physical investment. More than RMB3tn of unused capacity under the local government debt ceiling provides an additional buffer if needed. Meanwhile, the PBoC is likely to rely primarily on liquidity management tools to stabilise market rates as government bond issuance accelerates in Q3, leaving further policy-rate and RRR cuts as contingency options. This policy mix should favour infrastructure tied to urban renewal and AI development, particularly power grids, computing networks and related digital infrastructure.

Beyond direct stimulus, Beijing is likely to intensify efforts to curb "involution-style," or cut-throat, competition and break the vicious cycle of from destructive price wars to subdued domestic demand. Additionally, a further stabilisation in China-US trade relations could provide a modest tailwind to China's growth later this year. We retained our full-year GDP growth forecast of 4.6% for 2026.

No All-Out Stimulus

Investor attention is firmly focused on China's Politburo meeting, expected to take place this week. However, we caution against expecting a broad-based stimulus package for two reasons:

- First, headline growth has not weakened enough to warrant an aggressive policy response. Despite a sharp slowdown in Q2 growth, real GDP rose 4.7% YoY in the first half of the year, consistent with the official target range of 4.5-5.0%. With a growth rate of 4.4% YoY or higher in the second half, the annual target should remain achievable. In fact, we retained our full-year GDP growth forecast of 4.6% for 2026.
- Second, increasing divergence has been seen in sectoral performance. High-tech manufacturing has maintained strong momentum, recording double-digit growth year to date, while related exports have risen by almost 40% YoY. By contrast, monthly fixed asset investment has registered double-digit declines since May, and retail sales of goods have remained subdued amid persistent declines in home prices.

In our view, the combination of acceptable headline growth and widening sectoral divergence argues against an all-out stimulus response. Instead, we expect the Politburo meeting to acknowledge intensifying downside pressures and call for **more forceful countercyclical adjustment, faster implementation of existing policies, and advance preparation of incremental policy support.**

Fiscal Support: Acceleration, Not Expansion

On the fiscal front, the absence of an all-out stimulus package suggests that an increase in the headline deficit is unlikely. Instead, Beijing is expected to press local governments to accelerate bond issuance and fiscal expenditure and, more crucially, translate financing proceeds into actual expenditure and project activity.

As of 24 July, the YTD issuance of new special local government bonds (LGBs), used primarily to fund infrastructure projects, has reached RMB2.35 trillion, equivalent to 53% of the RMB4.4 trillion annual quota. This compares with 63% at the same time in 2025 (Fig. 1).

The remaining quota is therefore likely to be front-loaded into 3Q26, alongside faster fund allocation and project execution. Urban renewal and AI-related infrastructure should be key beneficiaries, particularly the “six networks”: water, power, computing, communications, underground pipelines and logistics.

Beyond special LGBs, policy-based financial instruments and unused capacity under the statutory local government debt ceiling could provide supplementary support:

- **New Policy-Based Financial Instruments.** Beijing has introduced an RMB800 billion quota for policy-based financial instruments in 2026, up from RMB500 billion in 2025. This quasi-fiscal tool provides low-cost funding for major infrastructure projects and new growth drivers, including AI and the digital economy. Although the tool has yet to be deployed, implementation is likely to accelerate in 3Q26, unlocking additional project funding.
- **Untapped Debt Capacity.** Beijing may also allow selected local governments facing acute hidden-debt pressures to issue additional bonds. The RMB3.2 trillion of unused capacity under the statutory local-government debt ceiling provides a potential buffer if government fund revenue weakens further (Fig. 2). Any support, however, is likely to be targeted and conditional rather than signalling a return to disorderly expansion in local borrowing.

Fig 1 Special LGB issuance started to moderate in May

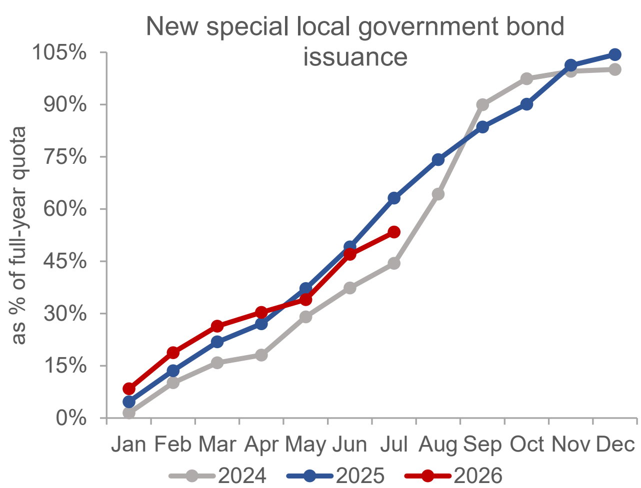
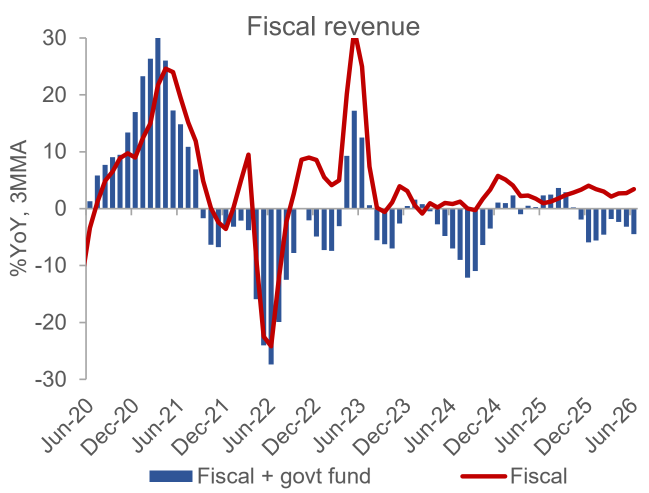


Fig 2 Local governments suffer from persistent revenue declines



Source: Wind, Mizuho

Monetary Support: Targeted and Measured

Rather than broad-based monetary easing, the PBoC is more likely to rely on liquidity management tools, such as 3M and 6M outright reverse repos, to stabilise market rates amid heavier government bond issuance in Q3 (Fig. 3). Additionally, targeted credit measures, including preferential policy lending, should also be deployed to support technology innovation and small and medium-sized enterprises.

However, ample liquidity does not necessarily translate into stronger credit demand. Persistent property-sector weakness, household deleveraging and local government debt resolution are expected to continue constraining broad credit growth (Fig. 4), despite solid performance in the high-tech sector.

Fig 3 Overnight reverse repos to better contain seasonal volatility

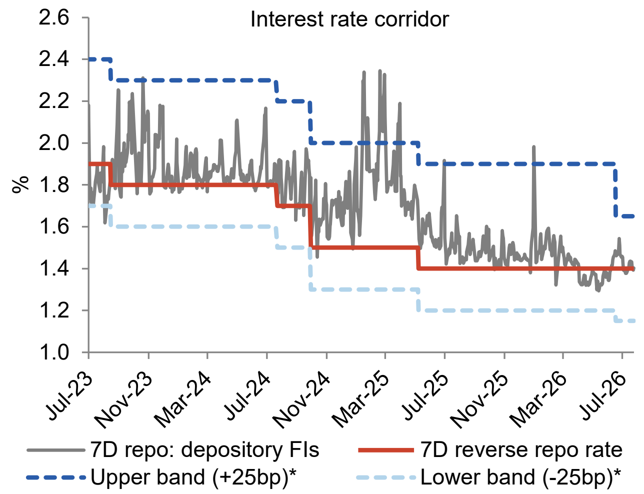
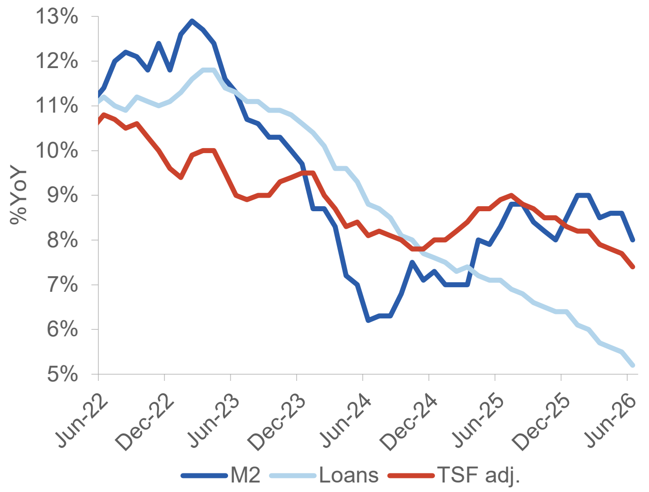


Fig 4 The persistent decline in loan growth since 2023



Source: CEIC, Mizuho

In this sense, we do not rule out further cuts to policy rates or the reserve requirement ratio (RRR) later this year, but believe such moves likely remain a last resort after largely exhausted fiscal room. We maintain our forecast for a 10bp policy rate cut and a 25bp RRR reduction in 4Q26. That said, any reference at the Politburo meeting to “cutting interest rates and the RRR at an appropriate time” would be a positive surprise for markets, given elevated oil prices and the rise in US Treasury yields since mid-July.

Tackling “Involution-Style” Competition

Beyond direct stimulus, Beijing is likely to place greater emphasis on curbing “involution-style,” or cut-throat, competition. The aim is to break the self-reinforcing cycle linking weak demand, destructive price wars (Fig. 5), margin compression (Fig. 6), subdued wage growth and subdued consumer confidence.

Fig 5 A lack of passthrough of higher input costs to consumers

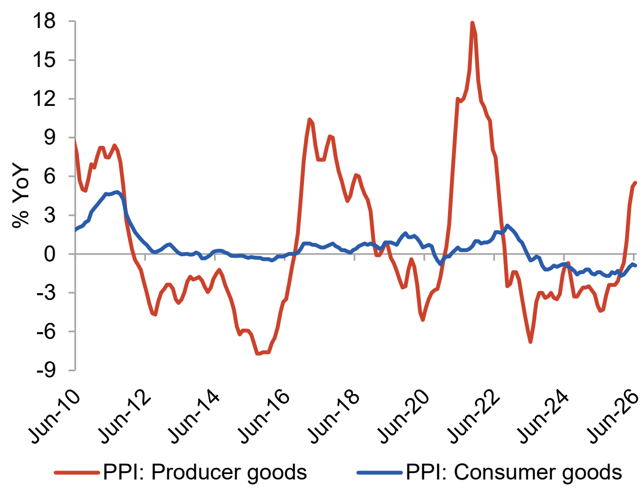
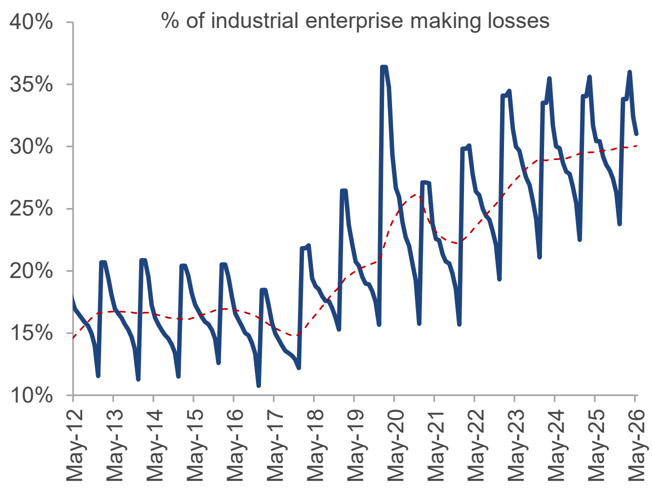


Fig 6 An elevated share of factory making losses since 2023



Source: CEIC, Mizuho

In the near term, the policy response is likely to be largely administrative. Potential measures include tighter controls on local government subsidies, tax rebates and investment incentives that distort market competition and contribute to structural overcapacity. Beijing may also step up scrutiny of below-cost pricing and strengthen enforcement of product quality and safety standards, and accelerate reform efforts to dismantle local protectionism and build a unified national market over the medium term.

Effective implementation should help stabilise prices, restore corporate margins and, over time, support wage growth and household confidence. However, these reforms are not a panacea. Stricter environmental, energy-efficiency and product-quality standards could facilitate a gradual and orderly exit of outdated and inefficient capacity, but may also weigh on employment and local government tax revenue during the transition period.

Lower Tariffs: A Potential Tailwind

President Xi's planned state visit to the US in September could pave the way for an extended period of relatively stable relations with the US. Following last year's near trade embargo, both sides have agreed to establish guardrails around their strategic competition and are exploring targeted tariff reductions on selected products. Any easing of trade barriers would provide an additional tailwind for foreign direct investment to and exports from China toward the year-end.

Meanwhile, China-US trade have remained remarkably resilient despite elevated tariffs. China's exports to and imports from the US have posted double-digit YoY growth for several consecutive months (Fig. 7), while its trade surplus with the US has reached a new high since last year's trade conflict. Additionally, China's rare-earth exports to the US have remained robust at around 500 tonnes per month recently (Fig. 8), more than double the level recorded during last year's trade tensions, underscoring the relatively stable bilateral trade relationship now.

Fig 7 The notably rebound in China-US trade growth

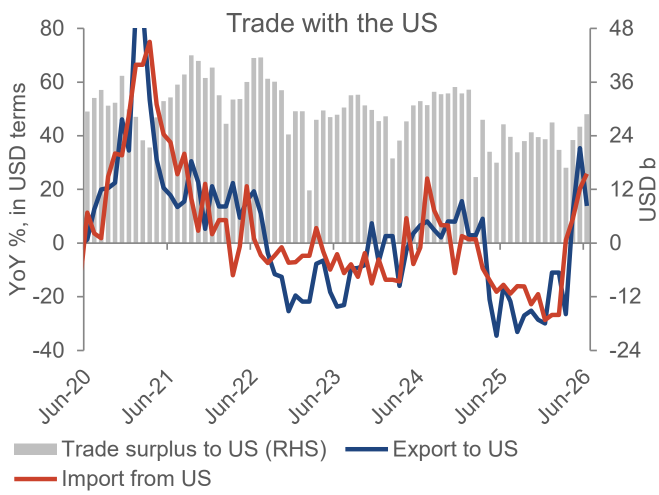
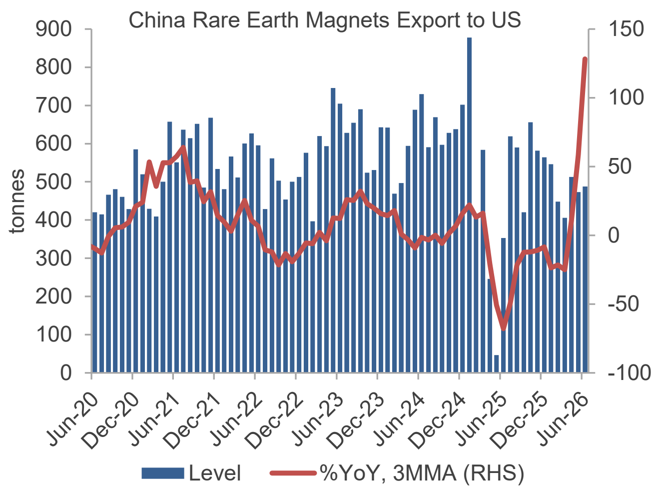


Fig 8 Stable Chinese exports of rare earther minerals to the US



Source: CEIC, Bloomberg, Mizuho

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