

China's Q1 2026 Business Sentiment Index and Outlook for Q2

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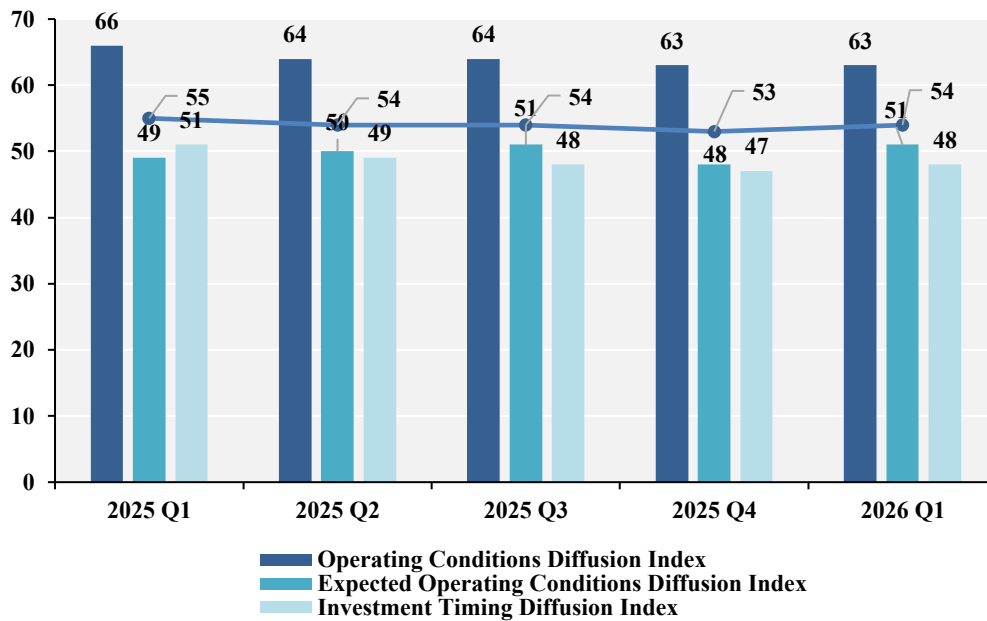
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I. Overview: A Turning Point Arrives Amid the Storm

China's companies entered a new macroeconomic regime in the first quarter of 2026, buffeted by sharp shocks abroad and a deep shift at home.

Abroad, the sudden outbreak of fighting involving the U.S., Israel and Iran upended a fragile global supply chain, sent crude prices soaring and quickly spread imported-inflation pressure. The conflict triggered extreme uncertainty in early March, whipsawing global equity and commodity markets. At home, the picture was very different: producer prices turned positive after 41 straight months of declines dating to October 2022; consumer prices firmed; and Chinese stocks rebounded sharply, with the ChiNext index hitting an 11-year high. A genuine recovery in domestic prices is reshaping how Chinese companies plan.



The latest CKGSB Business Sentiment Index, or BSI, captures it. Sentiment was broadly steady and mending — but on costs, prices and actual investment behavior, the index recorded some of the wildest swings in its history. Surging costs met rising prices in a rare resonance; firms quietly throttled output even as they unleashed a wave of capital spending. Confronted with external chaos and a clearer signal at home, China's companies cast their vote for the future the most concrete way they could: by writing checks for new capacity.

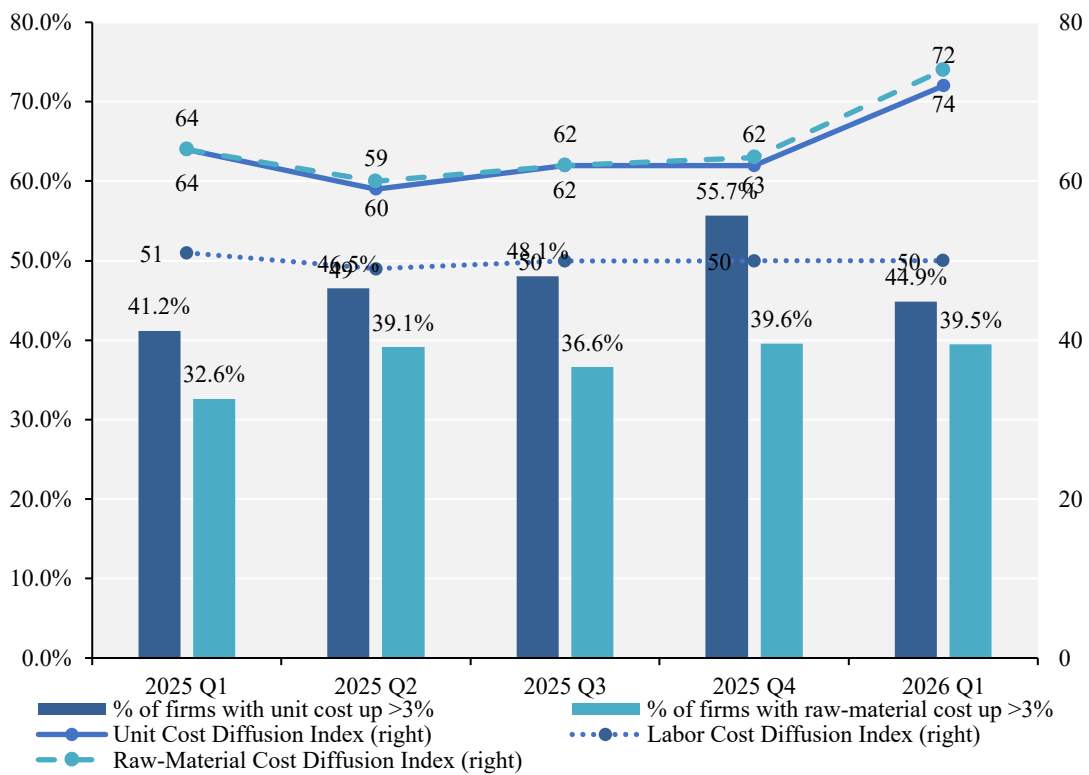
The price signal is real, but turning a single positive month into a full earnings recovery still requires demand, volumes and cost discipline to follow.

Q1 2026 BSI: Headline Indicators

Indicator	Q4 2025	Q1 2026	QoQ	Read
Business Sentiment Index (BSI)	53	54	↑1	Sentiment edges higher and stays above the 50 expansion line; the headline holds steady
Operating Conditions Index	63	63	0	Current operations remain resilient
Expected Operating Conditions Index	48	51	↑3	Confidence climbs back into expansion territory; corporate nerve returns

II. The Story Beneath the Numbers: Costs, Prices and an Investment Awakening

This quarter's portrait of corporate China is defined by a handful of explosive data points.



Costs are climbing — and for the first time in years, prices are climbing with them.

Energy bills, jolted higher by the U.S.-Israel-Iran conflict, hit companies' cost lines first: the unit-cost index jumped to 72 from 62, and the raw-materials index leapt to 74 from 63.

Hit by a powerful imported-cost shock, the price index leapt to 56 from 47 — clearing the 50 expansion threshold and reaching a multi-year high. With producer prices turning positive and consumer prices firming, the macro backdrop for passing those costs through is finally there.

And companies pushed back. They moved on offense, passing higher costs through to downstream customers. The operating logic of the economy has flipped: this is now a cost-driven, pass-through recovery. Smooth price transmission is the leading indicator that earnings can heal in earnest.

Gloomy forecasts, brighter fundamentals.

Faced with the conflict, executives turned starkly cautious about the macro outlook. The share expecting GDP to rise next quarter plunged to 37.5% from 57.6%; the share that sees the U.S.-China trade war hurting them over the next year or two climbed to 25.2%. We don't read this as outright pessimism. It is a reminder that, under extreme shocks, expectations themselves become unstable.

The dimmer macro view reflects geopolitics, plain and simple. Yet against that grain, the expected-operations index climbed to 51 from 48 — back in expansion territory. The weather outside is rough; the weather at home is warming. Producer prices turning positive and end-prices moving up have given executives tangible evidence that cash flow and margins are improving. External pressure is hardening, not breaking, their commitment to the real economy.

III. A Closer Look: How the Macro and the Micro Are Pulling Apart

Tracking the data quarter by quarter, a quiet shift is underway: Chinese executives are decoupling what they can't control — the macro picture — from what they can — their own businesses. The supplementary data shows it clearly.

Q1 2026 BSI: Supplementary Indicators

Indicator	Q4	Q1	Read
	2025	2026	
Unit / Raw-Material Cost Index	62 / 63	72 / 74	War and oil drive costs sharply higher
Price Index	47	56	Mild volume-price recovery gives way to cost-driven price hikes
Production Volume Index	53	45	Firms throttle current output to

absorb the raw-materials shock

Finished-Goods Inventory Index	50	47	Working through prior stock; trimming inventory
Share of firms making fixed-asset investments	11%	19%	Real money on the table — actual investment activity nearly doubles
Share of firms making expansionary investments	9%	17%	Companies start a capacity- and tech-upgrade push

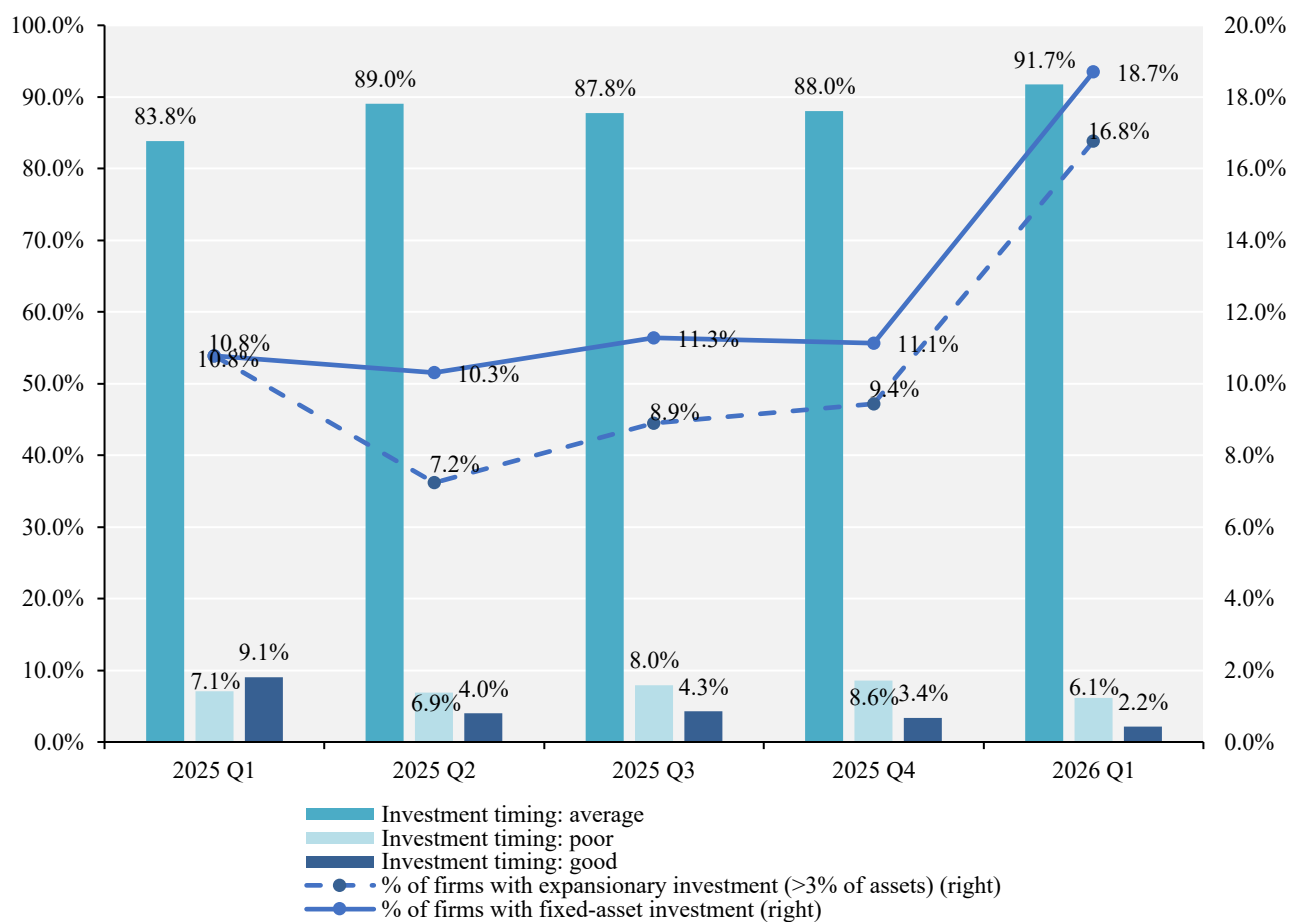
The production index dropped to 45 from 53; finished-goods inventories slipped to 47 from 50. Faced with short-term supply-chain dislocation and a raw-materials index leaping from 63 to 74, companies dodged sharply. Operating on a worst-case assumption, executives went hunting for the best route through: throttle current output, work down the cheaper inventory bought earlier, and protect cash on hand.

Capital spending breaks out.

In sharp contrast to the cooling production line, the investment side surged. The share of firms putting money into fixed assets jumped to 19% from 11%, and the share making expansionary investments climbed to 17% from 9%.

The recovery in fixed-asset and expansionary investment from such low bases shows that companies are starting to position for capacity, technology and efficiency ahead of demand. It doesn't necessarily mean a full-blown capex cycle has begun. But it does mean executives have stopped waiting.

Crisis is sharpening ambition. The conflict has injected both urgency and resolve, and money is moving — into hard tech, new productive capacity and efficiency tools that can withstand the next external shock. Executives have accepted that turbulence is now the baseline, and that the only response is to push forward, building a moat out of higher technology barriers, better productivity and stronger pricing power. A doubling-scale hard-tech capex cycle is getting underway.



IV. The Q2 Outlook: Chinese Manufacturing, Sailing Through the Eye of the Storm

The first quarter mattered. The U.S.-Israel-Iran conflict redrew the map of global energy and supply chains and lifted the world's inflation baseline.

Counterintuitively, that external shock looks like the catalyst China's industrial economy needed to break free of cyclical gravity — an unexpected push to shift gears. Call it providence if you like, but the old saw is right: outside forces work through internal ones, and opportunity favors the prepared. External energy shocks amplify price volatility; better domestic supply and demand provide steadier ground for prices to feed through.

Whether this price recovery turns into real earnings recovery hinges on three things: whether costs pass through cleanly, whether end-demand picks up, and whether overseas orders hold. Against this backdrop, we expect three deep shifts in the Chinese economy in 2026.

First, balance-sheet repair will flow through to earnings.

Q1's price moves mark the formal exit from a destocking cycle and the start of a cycle of active price increases and earnings recovery. Smooth pass-through, combined with the consumption-stimulus and stabilization measures already in place, is now translating into real cash-flow improvement. A recovery powered by company-level profits has staying power.

Second, China's bets on "new productive forces" begin to pay off.

The near-doubling of fixed-asset and expansionary investment in our data is an early vote of confidence by China's industrialists. With policy increasingly steering patient capital toward early-stage, smaller and harder-tech bets, frontier industries — high-tech manufacturing, artificial intelligence, commercial space — are now the dominant drivers of the sentiment recovery. In 2026, those earlier technology bets will harden into durable cost advantages and global competitive edges.

Third, the payoff from going global arrives at scale.

After a year of tariff fights and trade friction, Chinese firms have moved beyond simply exporting products. They now export capacity and, increasingly, standards. The Middle East turmoil only reinforces the case for diversified, localized supply chains. As overseas plants come online through 2026, Chinese manufacturing will embed itself more deeply — and more flexibly — in global value chains, smoothing out the systemic risk from any single geopolitical flashpoint.

Pessimists are usually right; optimists win the future. Faced with a storm overhead, China's executives have given the firmest answer they can — committing 17% of firms to expansionary investment. The quiet build-up phase is over. Chinese industry is entering a phase of real, breakout expansion. The great ship is at full power, breaking free of gravity, sailing steadily through the eye of the storm.