China's Q2 2026 Business Sentiment Index and Outlook for H2

The Shock in Q1 Has Not Yet Fully Receded, but Production Lines Are Restarting

Gan Jie — Professor of Finance, Cheung Kong Graduate School of Business; Director, Research Department on Finance and Economic Growth
Li Xuenan — Professor of Finance, Cheung Kong Graduate School of Business; Director, Research Department on Industrial Policy
Wang Xiaolong — Senior Researcher, Cheung Kong Graduate School of Business

I. Overview: The Shocks Are Receding, and the Machines Are Roaring Back to Life

In the second quarter of 2026, Chinese companies recalibrated their pace of development after a period of intense external shocks.

In the first quarter, external tensions drove up energy and raw-material prices, sending the cost curve sharply higher. At the same time, China’s domestic prices began to recover: PPI returned to positive territory and CPI edged upward moderately. Companies finally saw a long-awaited window for passing higher costs through to prices.

By the second quarter, the international market was still experiencing aftershocks, and cost pressures remained elevated, but companies had absorbed the most severe part of the shock. Production lines began heating up again.

The Cheung Kong Graduate School of Business (CKGSB) Business Sentiment Index (BSI) shows that the Business Sentiment Index stood at **53 in Q2 2026**, down 1 point from the previous quarter but still above the expansion-contraction threshold (50). The Operating Conditions Index was **62**, down 1 point from Q1, while the Expected Operating Conditions Index was **50**, exactly at the expansion-contraction threshold (50). The Investment Timing Index remained at **48**.

On the surface, business sentiment had cooled slightly. But companies' actual behavior told a more telling story: the Production Volume Index surged from **45 to 53**, the share of firms making fixed-asset investments rose from **18.7% to 22.2%**, and the share of firms making expansionary investment increased from **16.8% to 19.8%**.

This is the most noteworthy development of the quarter: **companies did not continue to contract. Instead, they restarted their engines.**

China's macroeconomic environment is sending a similar signal. According to the National Bureau of Statistics, China's GDP grew **4.7% year on year in the first half of 2026**, while second-quarter GDP grew **0.9% quarter on quarter**, indicating that the economy remained within a reasonable operating range. CPI rose **1.0% year on year in June**, with average CPI growth of **1.0% from January to June**, while PPI rose **4.1% year on year**. The pricing environment is therefore markedly different from the subdued conditions of the past two years.

Externally, the China-U.S. economic and trade consultations have also provided some relief to corporate expectations. The Ministry of Commerce of China recently stated that China and the United States would continue implementing the outcomes of their previous economic and trade consultations, promote the extension of certain tariff and non-tariff arrangements, and aim to achieve a number of positive results in areas including agriculture, export controls, and aviation. For companies, this means that uncertainty surrounding external demand is at least becoming something that can be discussed and managed.

Key Indicators of the Business Sentiment Index, Q2 2026

Indicator	Q1 **2026**	Q2 **2026**	**QoQ**	Notes
Business Sentiment Index (BSI)	54	53	↓1	Business sentiment softened slightly but remained above the 50 expansion-contraction threshold.
Operating Conditions Index	63	62	↓1	Current business conditions weakened slightly, but the underlying fundamentals remained stable.
Expected Operating Conditions Index	51	50	↓1	Expected business conditions returned to the 50 expansion-contraction threshold as sentiment became more measured.
Investment Timing Index	48	48	0	Assessment of the investment environment remained cautious.

Supplementary Indicators, Business Sentiment Index, Q2 2026

Indicator	Q1 2026	Q2 2026	Note
Production Volume Index	45	53	Production lines restarted and output recovered sharply.
Price Index	56	52	Fell from a high level but remained above the 50 expansion-contraction threshold.
Unit Cost Index	72	64	Cost pressures eased significantly.
Raw-Material Cost Index	74	64	The raw-material shock receded.
Share of Firms Making Fixed-Asset Investments	18.7%	22.2%	Investment activity continued to rise.
Share of Firms Making Expansionary Investment	16.8%	19.8%	Investment in capacity and efficiency continued.
Share of Companies with New Loans	2.1%	2.0%	Companies remained reluctant to take on significant additional leverage.

The core picture of Q2 can be summed up in one sentence:

The shock in Q1 has not yet fully receded, but production lines are restarting.

The cost shock in Q1 forced companies to reassess their supply chains, price pass-through mechanisms, and efficiency tools. The recovery in production lines in Q2 shows that companies have begun turning external pressure into internal action.

II. Interpreting the Core Changes: From Tactical Retrenchment to Restarting the Production

In the first quarter of 2026, the Production Volume Index fell from **53 to 45**. Faced with sharply rising raw-material and energy costs, companies opted for tactical retrenchment.

It was a highly practical response: raw materials had become expensive, price pass-through was only beginning, and the outlook of external conflict remained unclear. Recklessly ramping up production could simply have transferred the pressure into inventories and cash flow.

By the second quarter, the Production Volume Index had returned to **53**, almost completely reversing the contraction of the previous quarter. The machines were roaring again. This meant that companies had moved beyond the initial shock and begun rearranging orders, capacity, and deliveries.

This was not simply a matter of improving sentiment. Rather, it reflected companies' **replanning of production after absorbing the cost shock**.

The Unit Cost Index fell from **72 to 64**, while the Raw-Material Cost Index declined from **74 to 64**, showing that cost pressures had begun to lift.

Although the Price Index declined from **56 to 52**, it remained above the expansion-contraction threshold. In other words, companies were still able to pass some higher costs on to customers, but the sharp cost-driven price increases seen in Q1 had eased into a more moderate recovery. Companies were finally no longer being pressured by rising costs. They could once again consider the balance among output, inventories, and orders.

These figures show that in Q2, prices did not continue to surge, while costs also didn't remain at extreme levels. Companies once again found room to balance between the two.

For many manufacturing companies, this is more important than price increases alone, as prices, if rising too quickly, can squeeze demand, while costs, if rising too quickly, can consume profits.

The investment side is even more intriguing.

The Investment Timing Index remained at **48**, indicating that companies remain conservative for the investment environment. Yet the share of companies making fixed-asset investments rose from **18.7% to 22.2%**, while the share of companies undertaking expansionary investment increased from **16.8% to 19.8%**.

In other words, **companies remained cautious in attitude, but their actions were anything but slow.**

This continues a recurring characteristic observed by BSI in the past few quarters: entrepreneurs tend to have **"low expectations but strong action."** When assessing the environment, entrepreneurs tend to fully account for the difficulties; when it comes to actually taking action, however, they often move one step ahead.

This is also a particularly characteristic state of Chinese companies. Faced with uncertainty, they are not quick to proclaim optimism. But once they see costs receding, prices remaining stable, policy support continuing, and room for external tensions to ease, production lines and investment move ahead first.

They do not wait for every signal to become clear before acting. Instead, amid ambiguity, they move forward with the equipment that needs to be replenished, the efficiency tools that need to be introduced, and the production processes that need to be upgraded.

III. Observations: Inventory Pressure is Emerging, While Borrowing Remains Subdued

Another set of second-quarter data reminds us not to focus solely on the recovery in production.

The share of companies holding finished-goods inventories fell from **63.1% to 61.2%**, suggesting that the overall inventory levels continued to decline. Yet the share of companies whose finished-goods inventories took **more than three months to clear** jumped from **5.7% to 15.7%**.

This is an interesting divergence: fewer companies had inventories, but among those that did, the time required to clear them had lengthened significantly.

After production lines restarted, **inventory pressure began to emerge**.

This also explains why the continued increase in investment activity did not translate into a corresponding surge in new lending. The share of companies taking out new loans was only **2.0%**, essentially maintaining the low level of the previous quarter. Meanwhile, the bank lending attitude diffusion index declined from **99 to 96**, but remained at a high level.

Money is not entirely unavailable, and companies are not entirely unwilling to invest. But they remain reluctant to use high leverage to achieve short-term expansion.

Investment is taking place, but companies are relying more on **internal cash flow, existing funding arrangements, and more cautious project selection**.

This point is particularly important.

In the past, whenever investment expansion was discussed, it was easy to associate it with “borrowing money to build out capacity.” But the BSI data over the past several quarters have repeatedly shown that companies are becoming more restrained.

They are willing to invest in fixed assets and undertake expansion-oriented investments, but they are unwilling to allow their balance sheets to expand too rapidly.

In a sense, this is healthier than a simple increase in lending.

Expansion that can truly withstand the cycle requires balancing **cash flow, equipment efficiency, and order structure**, while fully taking into account the impact of uncertain events.

Macroeconomic survey results also point to the same sense of caution.

The share of companies expecting the year-on-year growth rate of actual GDP to increase in the next quarter was **34.9% in Q2**, continuing its decline from Q1.

The share of companies believing that the China-U.S. trade war had a negative impact on the current quarter was **29.0% in Q2**, down from **31.1% in Q1**.

The share expecting a negative impact of the China-U.S. trade war over the next one to two years fell from **25.2% to 21.5%**.

Companies have not become significantly more optimistic about economic growth, but their immediate fear of trade friction has eased somewhat.

This combination closely reflects the current mindset among companies: **the broader trend still requires cautious judgment, but the most tense phase has already passed to some extent.**

IV. Outlook for H2 2026: From Restarting Production to Validating Orders

Looking ahead to the second half of 2026, there are three key indicators to watch.

First: Prices

The Price Index surged to **56 in Q1** and then fell back to **52 in Q2**, while remaining above the expansion-contraction threshold.

The fact that prices remain above 50 indicates that companies still retain some ability to pass costs through to prices. But the decline from 56 to 52 also indicates that price increases driven by cost shocks are unlikely to continue.

The key question for the second half is therefore **whether prices can stabilize, rather than whether they will surge again**.

If prices stabilize while costs no longer accelerate sharply, corporate income statements can gradually begin to recover.

Second: Inventories

The rise in the Production Volume Index from **45 to 53** is good news.

The increase in the share of companies taking more than three months to clear finished-goods inventories, from **5.7% to 15.7%**, is a warning sign.

The real determinant of the quality of the recovery in the second half will be **whether inventories can move**.

The recovery in production is only the first step. **The ability to secure orders is the key.**

If consumption, external demand, and orders for industrial goods can keep pace, the production-line restart seen in Q2 could develop into a more solid expansion.

If demand fails to follow, however, the recovery in production could once again turn into inventory pressure.

Third: Investment

Fixed-asset investment and expansionary investment continued to rise, indicating that companies have begun preparing for the next stage.

This includes investment in production capacity, but may also involve **equipment upgrades, automation, digital tools, and investment related to new quality productive forces**.

The U.S. Federal Reserve maintained its federal funds target range at **3.5%–3.75% in June**, while reiterating its ample-reserves framework. Global liquidity did not tighten suddenly, while the moderate recovery in domestic prices has also left room for corporate profits to recover.

The environment facing Chinese companies in the second half of the year will nevertheless remain challenging.

Developments in the Middle East, and their contraction and expansion, have already clearly begun to resonate with multiple variables. The **U.S. dollar index, AI capital expenditure, international energy prices, and China-U.S. economic and trade frictions** could all change companies' expectations for costs and orders at any time.

But the Q2 BSI data have already delivered an important signal:

Companies were not passive when facing the shocks.

They stepped back in Q1 to assess the shock, and in Q2 they restarted their production lines and pushed investment forward again.