Business Sentiment Index, Q3 2026[1]

Production Lines Gather Pace as Inventories Await Clearance in China

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I. Overview: China's Business Sentiment Improves Slightly, but Operating Pressures Persist

In the third quarter of 2026, China's economy gradually regained its production momentum after the external shocks of the first half of the year.

The Purchasing Managers' Index (PMI) of China's manufacturing industry fell to 49.2% in July, recovered to 49.8% in August, and rose further to 50.1% in September, returning to expansionary territory. At the end of September, as China and the United States reached a consensus on a trade council and a framework for reciprocal tariff reductions during their eighth round of economic and trade consultations, the trade uncertainty that has persistently troubled exporters somewhat eased. As third-quarter data of China's economy were released in October, the country's GDP growth reached 4.5% year on year, up 0.2 percentage points from the second quarter, while industrial production continued to recover.

China's macroeconomic picture offered some positive signals, but its companies' own experience of business conditions was more complex.

Based on valid company questionnaires collected in Q3 through late October, Cheung Kong Graduate School of Business (CKGSB)'s Business Sentiment Index (BSI) stood at an estimated **54**, up 1 point from the second quarter.

[1] About the Business Sentiment Index: Cheung Kong Graduate School of Business' Research Department on Finance and Economic Growth surveys more than 2,000 Chinese companies that have sales of over five million RMB from within the industrial sector every quarter to provide the most comprehensive set of independent data currently available.

Led by CKGSB Professors of Finance Gan Jie and Erica Xuenan Li, the Business Sentiment Index, a large-scale, micro-level quarterly company survey on China's industrial economy, which began in 2014 Q2, sheds light on how the sector is coping and what types of reforms are needed—based not on opinion, but on a painstaking, fact-gathering process. The survey has around 2,000 responding firms each time. To learn more about the index, visit CKGSB's webpage: https://english.ckgsb.edu.cn/knowledge/business-sentiment-index/

Among its sub-indices, the Operating Conditions Index was **61**, down 1 point; the Expected Operating Conditions Index rose 2 points to **52**; and the Investment Timing Index remained at **48**.

Key Indicators of the Business Sentiment Index, Q3 2026

Indicator	Q1 2026	Q2 2026	Q3 2026	Q3 QoQ	Notes
Business Sentiment Index (BSI)	54	53	54	+1	Sentiment improved slightly.

Indicator	Q1 2026	Q2 2026	Q3 2026	Q3 QoQ	Notes
Operating Conditions Index	63	62	61	−1	Current operating conditions continued to weaken.
Expected Operating Conditions Index	51	50	52	+2	Expectations for next quarter improved.
Investment Timing Index	48	48	48	0	Investment assessments remained unchanged.

Note: Third-quarter figures are calculated from valid company questionnaires collected by the BSI project in Q3 through late October.

These four indicators present a noteworthy combination for those who watch China's economy: overall sentiment improved, and companies' confidence in next quarter's operations recovered, but current operating conditions did not improve in tandem, while assessments of the investment environment remained cautious.

The Business Sentiment Index also looks at other aspects of China's industrial economy.

The Production Volume Index rose from **45** in the first quarter to **53** in the second and then to **55** in the third. Although the share of firms making fixed-asset investments edged down from **22.2%** to **20.9%**, it remained well above the level a year earlier. Yet as production recovered, the challenges of clearing inventories and balancing raw-material costs against product prices became more pronounced.

Whereas the main development in the second quarter was the restarting of production lines, the focus in the third quarter shifted to the business results of that recovery: **whether products could be sold promptly, higher costs could be passed through smoothly, and investment could secure sustained support from orders.**

II. Core Changes: Production Continues to Recover, but Inventory Clearance Slows

The clearest positive signal in the third quarter came from production.

As explained above, the BSI Production Volume Index rose for two consecutive quarters, from **45** in the first quarter to **55** in the third, exceeding the reading of **51** a year earlier. This was broadly consistent with the PMI of China's manufacturing industry returning above the expansion-contraction threshold (50) in September, suggesting that Chinese industrial companies gradually restored production and deliveries after the cost shock early in the year and the adjustments of the second quarter.

The recovery in production, however, did not eliminate the pressure from the imbalance between supply and demand.

This quarter, the BSI Domestic Oversupply Index remained elevated at **96**, with **92.6%** of respondents reporting that supply exceeded demand in the domestic market. The share of companies reporting excess capacity of more than 20% rose from **9.1%** in the second quarter to **10.0%** in the third. Despite the overall improvement in production activity, some companies still faced considerable difficulty absorbing excess capacity.

An even more noteworthy change occurred in inventories.

Key Production and Inventory Indicators, Q3 2026

Indicator	Q1 2026	Q2 2026	Q3 2026	Q3 QoQ
Production Volume Index	45	53	55	+2
Finished-Goods Inventory Index	47	49	48	−1
Share of Companies Holding Finished-Goods Inventories	63.1%	61.2%	59.6%	−1.6 pp
Share of Companies Reporting Rising Finished-Goods Inventories	10.3%	7.8%	5.9%	−1.9 pp
Share of Companies Taking More Than Three Months to Clear Finished-Goods Inventories	5.7%	15.7%	21.0%	+5.3 pp

The survey showed that among surveyed industrial companies, the share of companies holding finished-goods inventories declined from **63.1%** in the first quarter to **59.6%** in the third, while the share reporting further increases in finished-goods inventories fell from **10.3%** to **5.9%**. This suggests that China's industrial companies continued to contain inventory growth. At the same time, however, the share of surveyed industrial companies taking more than three months to clear finished-goods inventories rose

sharply from **5.7%** in the first quarter to **15.7%** in the second, and then to **21.0%** in the third, far above the **6.0%** recorded a year earlier. As production gradually recovered, fewer companies continued to accumulate inventories, yet significantly more faced lengthy sales cycles. Inventory conditions may therefore be diverging across companies.

This divergence was also reflected in operating performance across companies of different sizes. In the third quarter, the Operating Conditions Index for surveyed large and medium-sized industrial companies rose from **67** and **60** in the second quarter to **68** and **62**, respectively, while the index for small companies fell from **58** to **54**, widening the gap between large and small industrial companies from **9** points to **14**. Although the Production Volume Index rose for two consecutive quarters, operating conditions did not improve across all company sizes. Taken together with the inventory data, this suggests that some industrial companies may have adapted relatively well to market conditions, while others still faced lengthy inventory clearance cycles and operating pressures, showing some signs of a "K-shaped divergence."

This changing relationship between production and sales has direct implications for industrial business operations. When production recovers relatively quickly while sales and cash collection lag, balancing raw-material procurement, equipment utilization, funds tied up in inventories, and cash flow becomes more important. Particularly in highly competitive industries with standardized products, maintaining high output can help spread fixed costs, but slower product turnover can also tie up more capital.

China's third-quarter industrial capacity utilization rate, released in October, was 73.1%, only 0.1 percentage points higher than in the second quarter, also indicating that there is room for further improvement in overall industrial production.

From restarting production lines in the second quarter to sustaining the recovery in the third, China's industrial companies have moved beyond the most intense adjustment phase of early 2026. Order growth and inventory turnover will increasingly determine how long the production recovery lasts and how the current cycle develops.

III. Supplementary Observations: Costs Rise Again, but Investment Remains Resilient

Beyond production, another third-quarter change concerned prices and costs.

The BSI Raw-Material Cost Index rose from **64** to **67**, and the Unit Cost Index increased from **64** to **66**, while the Price Index remained at **52**. Signals of rising costs strengthened, but increases in selling prices did not become more widespread in tandem.

China's industrial price data released in October corroborated this development of these indices. In September, industrial producer selling prices rose 5.0% year on year in China, while purchasing prices

increased 6.9%. Upstream raw-material and energy prices rose more sharply, leaving some industrial companies under pressure from the gap between procurement costs and selling prices.

For companies, whether higher raw-material costs can translate into higher product prices depends on the composition of orders, customer relationships, market competition, and their own bargaining power. Companies enjoying stronger demand may have more room to adjust prices, while those facing intense competition need to absorb costs by improving efficiency, optimizing procurement, and adjusting their product mix.

Beyond cost developments, the investment data also revealed a pattern worth examining.

In the third quarter, the Investment Timing Index remained at **48**. The share of surveyed industrial companies rating current investment timing as average reached **94.0%**, while only **0.7%** considered it good. These subjective assessments show that surveyed companies remained quite cautious about the investment environment.

Actual investment activity, however, did not weaken to the same extent. The share of surveyed firms making fixed-asset investments was **20.9%**, while the share making expansionary investment reached **18.2%**. These figures were down approximately **1.4** and **1.6 percentage points**, respectively, from the second quarter, but remained well above the **11.3%** and **8.9%** recorded in the third quarter of 2025.

BSI Cost, Price, Investment and Credit Indicators, Q3 2026

Indicator	Q1 2026	Q2 2026	Q3 2026	Q3 QoQ
Raw-Material Cost Index	74	64	67	+3
Unit Cost Index	72	64	66	+2
Price Index	56	52	52	0
Share of Firms Making Fixed-Asset Investments	18.7%	22.2%	20.9%	−1.4 pp
Share of Firms Making Expansionary Investment	16.8%	19.8%	18.2%	−1.6 pp
Bank Lending Attitude Diffusion Index	99	96	99	+3
Share of Companies with New Loans	2.1%	2.0%	2.7%	+0.7 pp

This continues a pattern repeatedly recorded by the BSI over recent quarters: China’s industrial companies are cautious in their assessments of the overall investment environment, yet often more active in their actual spending. The divergence has been particularly evident in 2026. Following the external shocks of the first half, the share of surveyed industrial firms making fixed-asset investments was significantly higher than a year earlier. Although it eased in the third quarter, it remained relatively high.

China's national investment data released by the country in October also revealed structural differences: nationwide fixed-asset investment fell 7.2% year on year in the first three quarters, while investment in equipment, tools and instruments rose 9.7%. Even as overall investment remained under pressure, equipment upgrades and some industrial upgrading projects remained active.

Companies clearly need to assess future demand, funding arrangements and project returns more carefully when making investment decisions.

The BSI credit data provide an additional perspective. In the third quarter, the Bank Lending Attitude Diffusion Index rose from **96** to **99**, while the share of surveyed industrial companies with new loans increased from **2.0%** to **2.7%**. Assessments of financing conditions remained accommodative, and more companies obtained new loans, although the overall share remained low.

Taken together, these data show that companies in China have not abandoned investment and expansion, but continue to prioritize financial security and investment returns. Particularly as cost pressures reemerge and inventory turnover slows for some products, companies need to strike a more careful balance between expanding operations and maintaining financial flexibility.

IV. Outlook for Q4: Expectations Recover as Companies Await Orders in China

Entering the fourth quarter, companies' assessments of future operations improved in China. The BSI Expected Operating Conditions Index rose from **50** in the second quarter to **52** in the third, returning above the expansion-contraction threshold (50). After the cost shock early in the year and production adjustments over the following two quarters, companies held relatively positive expectations for next quarter's orders, production schedules and operating performance.

There were also some favorable changes in the external environment. The BSI survey showed that **29.7%** of companies surveyed believed the China-U.S. trade war had negatively affected their business in the current quarter, slightly above the **29.0%** recorded in the second quarter. Yet the share expecting negative effects over the next one to two years fell from **21.5%** to **19.3%**. New progress in China-U.S. economic and trade consultations at the end of September strengthened expectations of an easing in trade relations. Exporters now need to watch whether the relevant policies are implemented and whether overseas customers adjust their purchasing plans accordingly.

BSI Survey of Business Expectations and the Impact of Trade Frictions, Q3 2026

Indicator	Q1 2026	Q2 2026	Q3 2026	Notes
Expected Operating Conditions Index	51	50	52	Expectations for next quarter's operations improved.

Indicator	Q1 2026	Q2 2026	Q3 2026	Notes
Share of Companies Reporting a Negative Impact from the China-U.S. Trade War in the Current Quarter	31.1%	29.0%	29.7%	Negative short-term effects persisted.
Share of Companies Expecting a Negative Impact from the China-U.S. Trade War over the Next One to Two Years	25.2%	21.5%	19.3%	Medium- and long-term concerns continued to ease.

China's domestic market faces a different issue.

The Production Volume Index rose to **55** in the third quarter, but the share of surveyed industrial companies taking more than three months to clear inventories also increased to **21.0%**. As sales and deliveries become concentrated toward the year end, whether order growth and inventory turnover improve together will influence companies' production plans for the following year. Particularly when raw-material costs are rising and product price adjustments are limited, companies need to consider how much actual profit sales growth can generate.

On investment, although the share of firms making fixed-asset investments edged down in the third quarter, it remained well above the level a year earlier. As companies begin planning capital expenditure for 2027 in the fourth quarter, projects such as equipment upgrades, automation and AI applications will face more specific assessments of costs and returns. For companies that have already launched such projects, improvements in production efficiency, product quality and delivery capability will influence the scale and pace of subsequent investment.

Looking back over the first three quarters, Chinese companies gradually adapted to the external shocks early in the year, production activity continued to recover, and operating expectations improved. As the year end approaches, changes in the trade environment, a recovery in domestic demand and technological upgrading will continue to create opportunities, while inventories, costs and working-capital turnover will also shape operating decisions.

Toward year-end, companies need to focus more attention on order fulfillment, inventory turnover and investment returns. The continued recovery in third-quarter production has already provided a positive signal. As external economic and trade conditions evolve and domestic demand adjusts, companies' ability to improve the relationship between sales, costs and cash flow will further shape their operating and investment plans for 2027.

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