

## China Viewpoint

# Unravelling China's investment downturn: (1) the factory woes

### China's investment engine stalls

China's investment has hit an unexpected snag recently. Fixed-asset investment (FAI) fell 6.2% yoy in 3Q25, marking the sharpest quarterly decline since the pandemic shock of early 2020. For an economy where capital spending has underpinned growth for decades, this reversal raises concerns about domestic demand and sends ripple effects for global supply chains. This report kicks off a series examining the roots, implications, and future trajectory of China's investment downturn. In this first instalment, we focus on manufacturing—the sector that has defined China's role as the world's factory.

### “Anti-involution”: An accelerator, not the root cause

The headline FAI slump was the result of contraction in both manufacturing and infrastructure investment since June, while property remains mired in a fifth year of decline. What stands out is manufacturing: FAI contracted 1.2% yoy in 3Q25, a sharp contrast to the 7.5% increase in 1H25 and the 9.2% growth in 2024. Beijing's “anti-involution” campaign—intensified since June to curb destructive price wars in sectors such as solar panels, batteries, EVs, steel, and pharmaceuticals—has been widely cited as a trigger. In our view, the campaign acted more as an accelerator of restructuring in oversupplied industries than as the fundamental driver of the downturn.

### Demand weakness: the real culprit

The bigger drag, in our view, is insufficient demand for industrial goods amid trade tensions and a property market downturn. Investment in export-oriented sectors—particularly those reliant on US demand—has slowed amid persistent trade tensions. Domestically, weak performance in construction-related industries and consumer-sensitive sectors highlights ongoing demand fragility.

### Revisiting the overcapacity debate

Some argue that the investment slowdown is a healthy correction for the manufacturing sector, helping to address chronic overcapacity. We are less optimistic: many sectors with idle capacity suffer from persistent demand shortfalls or technological mismatches. For instance, autos and pharmaceuticals simultaneously seek advanced production capabilities and grapple with outdated ones.

### One step down for manufacturing capex growth

We expect manufacturing investment to gain modest support from reduced uncertainty in external demand, cyclical and strategic policy initiatives, and an incremental lift from AI-driven industrial demand. Nevertheless, growth will likely remain subdued, with only low single-digit expansion projected for 2026, constrained by weak domestic demand and an increasing tendency for firms to allocate capex overseas. Over the longer term, structural demand-supply imbalances are likely to continue to weigh on overall manufacturing FAI growth, and we expect capex to increasingly concentrate in a limited number of high value-added sectors.

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## China’s investment engine sputters

China’s investment—long the backbone of its growth model—has hit an unexpected snag.

Fixed-asset investment (FAI) fell 6.2% yoy in 3Q25, the sharpest quarterly decline since the pandemic shock of early 2020 (Exhibit 1). For an economy where capital spending has underpinned growth for decades, this reversal casts doubt on the strength of domestic demand and sends ripple effects for global supply chains.

This report kicks off a series examining China’s investment downturn. We seek to answer: What happened? What was the cause? What can we expect from here?. In this first instalment, we focus on manufacturing—the sector that has defined China’s role as the world’s factory.

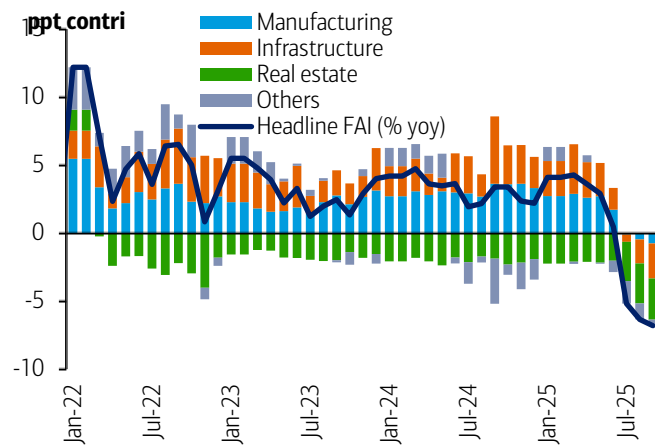
### Manufacturing Investment fell for first time since 2020

The headline FAI slump was due to contraction in both manufacturing and infrastructure investment since June, while property remains mired in a fifth year of decline (Exhibit 1).

What stands out is manufacturing: FAI contracted 1.2% yoy in 3Q25, a sharp contrast to the 7.5% surge in 1H25 and 9.2% growth in 2024. Over a longer horizon, the only comparable downturn occurred in 1H20 during the pandemic-induced shutdown, and the manufacturing investment growth has never seen a quarterly contraction during the 2017-19 trade tension (Exhibit 2). The contraction this time round was also broad-based, affecting sectors such as electronics, machinery, and pharmaceuticals alike (Exhibit 3).

**Exhibit 1: China’s investment engine stalls, with manufacturing and infrastructure investment both dipping into contraction in 3Q25**

Monthly China FAI growth by sector, % yoy

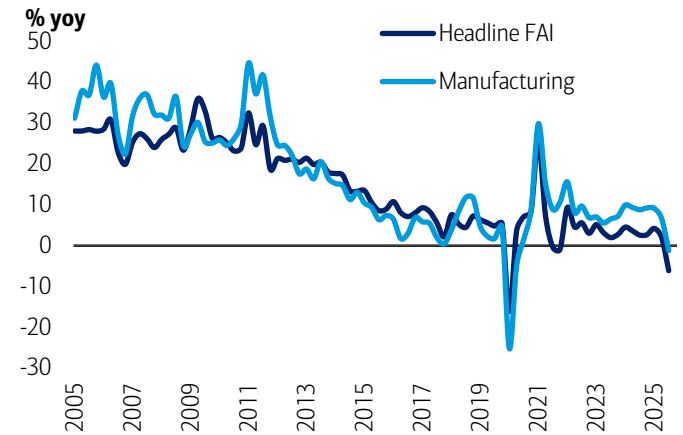


Source: BofA Global Research estimates, CEIC, NBS

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**Exhibit 2: Over a longer horizon, contraction in manufacturing investment was previously only seen during pandemic shutdowns**

Quarterly FAI growth, % yoy



Source: BofA Global Research estimates, CEIC, NBS

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### “Anti-involution”: An accelerator, not the root cause

The government’s intensified “anti-involution” campaign since July 2025—targeting destructive price competition in industries such as solar panels, batteries, electric vehicles (EVs), steel, and pharmaceuticals—has been widely cited as a cause of the downturn.

However, we view it more as an accelerator of restructuring in oversupplied sectors rather than the fundamental driver. The major targets of the campaign have been: (1) new-energy-related sectors such as EVs, lithium-ion batteries, and solar panels, which witnessed relentless capacity expansion and competition in recent years; (2) traditional sectors including steel, coal, cement, and glass; and (3) services sectors such as food delivery, which are outside the scope of this report.



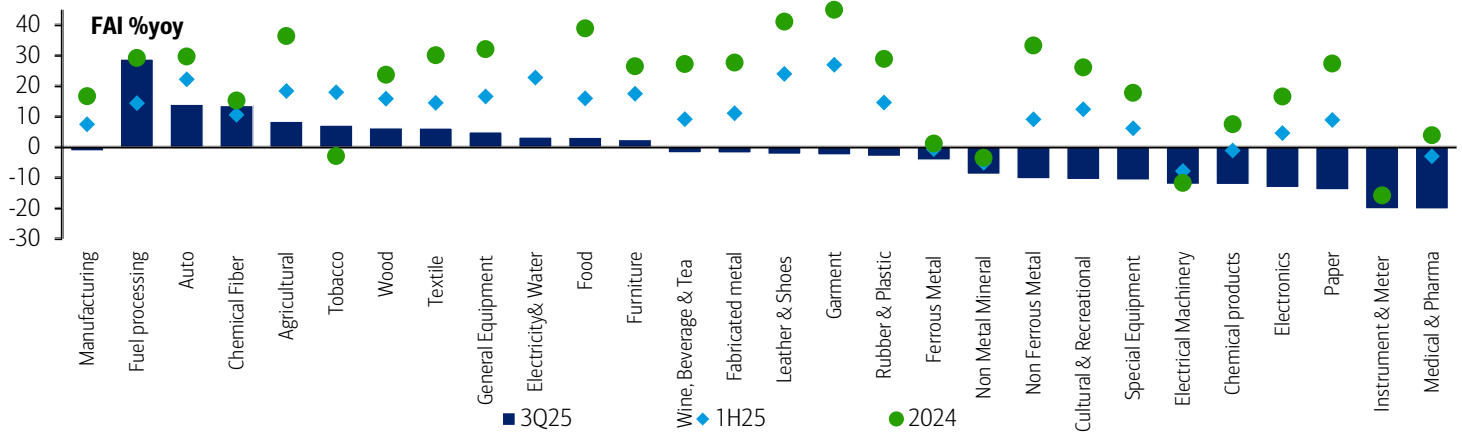
A direct—though perhaps simplified—way to assess the campaign’s impact is to compare investment trends in these sectors before and after the campaign’s ramp-up in early Jul’25, marked by the central Financial and Economic Commission meeting on Jul 1.

- **Traditional sectors**—primarily under “ferrous metals” and “non-metal minerals”—have seen muted investment since 2024 and into 1H25. In fact, production capacity for cement, crude steel, and coke (coal) had already fallen below 2015 levels by end-2024 (Exhibit 4), suggesting the ongoing downturn was neither due to the latest campaign nor a major drag on headline figures.
- **New-energy sectors**, often the focus of media coverage, fall under electrical machinery and auto industries. Investment in electrical machinery has contracted since 2024, while auto has seen a solid increase in recent months (Exhibit 3). This indicates that the campaign, despite intensifying since July, has not reversed existing trends. Our sector analysts highlight ongoing consolidation: lithium battery already saw improving capacity utilization in 2024-25 following market concentration; the auto industry is emphasizing improving internal practices (e.g., payment cycles, curbing price wars) rather than production restrictions; and solar module capacity exits are unlikely to materialize before 2026.

Moreover, the broader impact of the anti-involution drive remains uncertain due to implementation challenges, including conflicting local government incentives and the lack of clear quantitative targets (see our analysis in: [Muddling through without immediate help from policy stimulus](#)).

**Exhibit 3: Sectors such as electronics, non-ferrous metal, and special equipment reversed to contraction in 3Q25 vs. growth in 1H25**

Manufacturing fixed-asset investment growth by sector, % yoy



Source: BofA Global Research, CEIC, NBS (note: single-month/quarter growth in FAI was based on BofA estimates)

### Demand-side weakness: external and domestic pressures

We believe the primary factor behind cautious investment sentiment is concern about future demand. In fact, the sectors that saw the sharpest decline in 3Q compared to 1H25 and 2024 were either dependent on overseas demand or sensitive to domestic consumer and capex trends.

Although exports held up relatively well from Jan to Sep 2025, investment in export-oriented sectors—particularly those reliant on US demand—has slowed amid rising trade tensions. Electronics, non-ferrous metals, and chemicals, which are among the most externally exposed sectors based on value-added data (2022, Exhibit 5), recorded some of the steepest contraction or slowdowns. Traditional consumer goods—such as apparel, footwear, toys, and furniture—also appear to be affected by concerns about external demand.

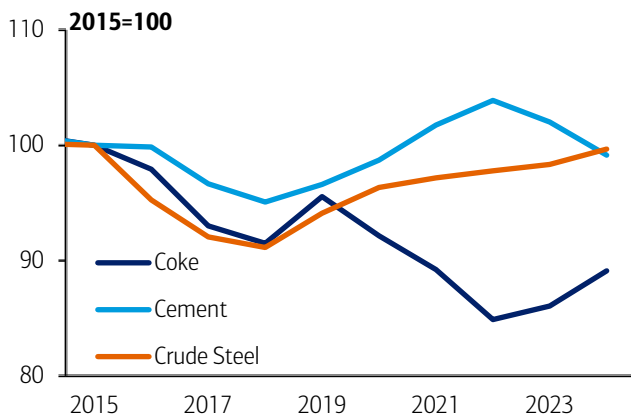


While concerns about external demand remain a key drag on future capex, it is worth noting that industrial production in electronics, non-ferrous metals, and chemicals has remained robust this year. This reinforces our view that supply may have outpaced demand, raising the risk of further capex weakness if these concerns materialize into softer orders.

Domestically, weak performance in construction-related industries (e.g., non-metal minerals, metals) and consumer-sensitive sectors (e.g., paper, beverage, recreational goods) underscores persistent demand fragility. In particular, restrictions on government and SOE dining have visibly weighed on dining-related retail sales, with a notable impact on the wine and beverage segment.

**Exhibit 4: Production capacity of cement/steel/coke has declined or seen no expansion in past decade**

Index of production capacity (2015 level=100)

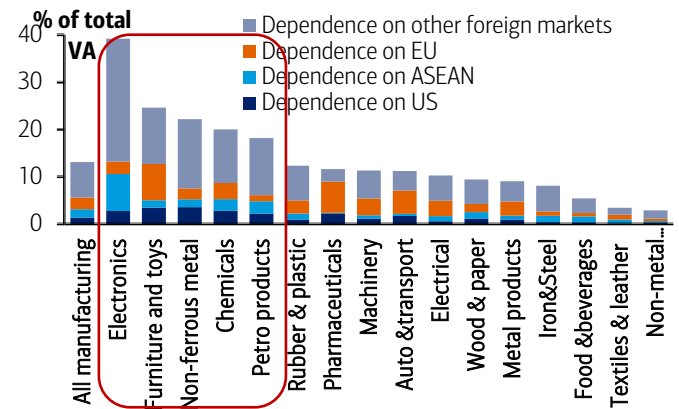


Source: BofA Global Research, CEIC, NBS

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**Exhibit 5: Sectors such as electronics, non-ferrous metals and chemicals are sensitive to external demand**

Dependence on external demand based on breakdown of value-added.



Source: BofA Global Research, OECD

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## Revisiting the overcapacity debate

Some argue that the recent investment slowdown represents a healthy correction for China’s manufacturing sector, helping to address chronic overcapacity. We believe this only solves part of the puzzle.

Indeed, reduced investment and “anti-involution” measures are curbing excessive capacity in certain areas—particularly those that faced overinvestment and competitive buildup in prior years, such as the new-energy sector. Structural overcapacity in new energy and cyclical overexpansion (e.g., the textile sector during the pandemic due to PPE demand) may gradually ease as investment slows and outdated capacity is retired.

However, overall capacity utilization remained low in 2Q–3Q25 (Exhibit 6), with sectors such as non-metal minerals, autos, and pharmaceuticals showing utilization rates well below pre-Covid levels (Exhibit 7). In our view, this reflects two key dynamics:

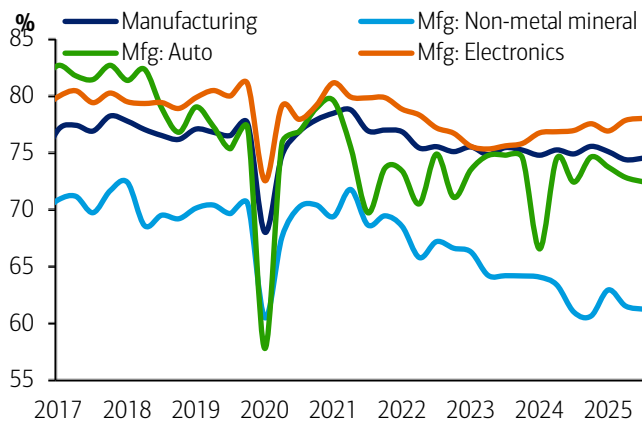
- **Chronic demand weakness:** Sectors like non-metal minerals are facing sustained downturn in demand, largely driven by the property market slump. Utilization continues to decline despite minimal new investment.
- **Dual-track capacity evolution:** Sectors such as autos and pharmaceuticals are simultaneously investing in advanced production capabilities while grappling with legacy capacity. For instance, auto sector FAI held up in recent quarters as new energy vehicle (NEV) manufacturers ramped up new product lines, yet traditional vehicle production capacity remains underutilized and may be permanently idle.

Notably, sectors like metals have seen utilization improve, thanks to years of disciplined capacity management. For other sectors, however, resolving overcapacity will likely require either a meaningful demand recovery or significant technological upgrades.



### Exhibit 6: Capacity utilization rate remained low in 2Q-3Q, indicating that falling investment has not yet lifted utilization

Capacity utilization rate, seasonally adjusted

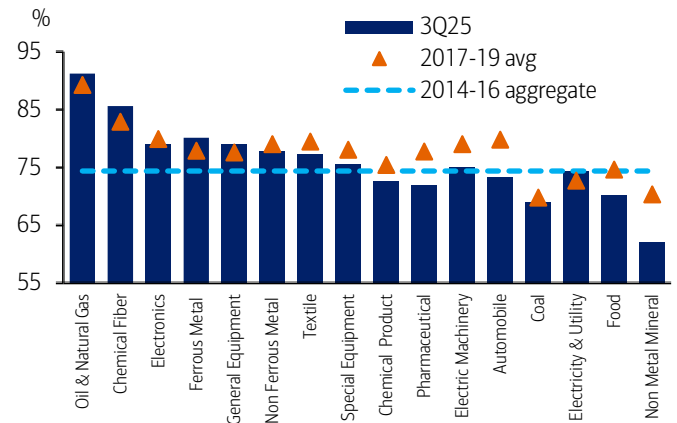


Source: CEIC, NBS

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### Exhibit 7: A few sectors see capacity utilization rate notably lower than pre-Covid levels due to weak demand, technology mismatch

Capacity utilization rate by sector



Source: BofA Global Research, CEIC, NBS

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## Long-term outlook: a step down for manufacturing capex

Looking ahead, we anticipate a modest recovery in manufacturing investment in 2026, supported by reduced uncertainty in external demand, policy initiatives aimed at strengthening strategic sectors and preserving manufacturing's role in the economy, and an incremental boost from AI-driven industrial demand.

- Brighter trade outlook:** The trade outlook appears brighter following a turbulent year of tariff disputes and intense negotiations. The recent summit between President Xi and President Trump resulted in a 10pp reduction in fentanyl tariffs, and the planned state visit could help narrow the gap between tariffs on Chinese goods and those applied elsewhere by early 2026. This development should stabilize and potentially revive US-China trade. At the same time, exports to non-US markets have provided a cushion for shipments this year, and that trend is likely to continue into 2026, supporting medium-term sentiment toward external demand.
- Policies to support manufacturing:** Policy efforts will also play a key role in sustaining manufacturing activity. In the near term, we expect structural monetary policy tools and fiscal measures to support manufacturing sector in 2026. Meanwhile, in proposals for the 15<sup>th</sup> Five-Year Plan, the leadership has pledged to maintain the sector's share in the economy (Exhibit 8), prevent de-industrialization, and upgrade traditional industries while strengthening strategic ones, indicating sustained policy support during the new FYP period (2026–2030).
- AI-driven industrial demand:** Another source of incremental demand comes from AI adoption. Although manufacturing accounted for only 2.6% of global private AI investment in 2024, we expect this sustained investment cycle to drive demand for industrial products and spur investment in electronics, electrical machinery, and related sectors. The deployment of AI-powered equipment on factory floors is also likely to contribute to capital expenditure growth.

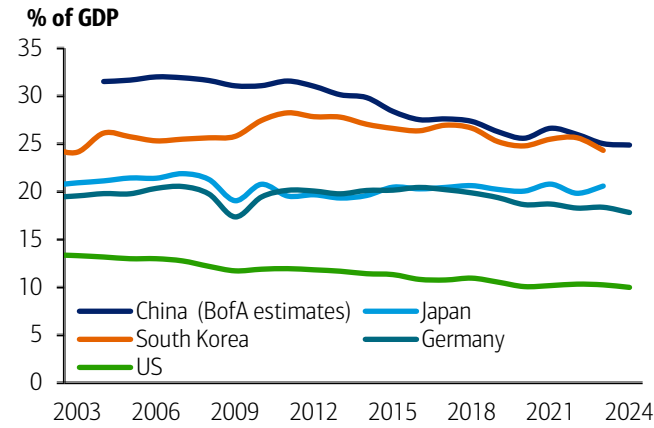
Despite these supportive factors, overall growth will remain subdued, with only low single-digit expansion projected for 2026, in our view. Weak domestic demand and an increasing tendency for firms to allocate capex overseas will constrain the recovery. China's rising outbound direct investment in ASEAN is increasingly concentrated in manufacturing (Exhibit 9), underscoring the shift of new capex to overseas destinations.

Over the longer term, structural demand-supply imbalances will continue to weigh on manufacturing FAI growth. The downturn in manufacturing investment this year will not

be sufficient to resolve persistent overcapacity, and the prolonged weakness in the property market will limit demand in related sectors. We expect remaining capex growth to become increasingly concentrated in a narrow set of high value-added and strategically important industries rather than across entire supply chains.

**Exhibit 8: China is seeking to maintain the role of manufacturing sector in its economy and avoid de-industrialization**

The value-added of manufacturing sector in GDP

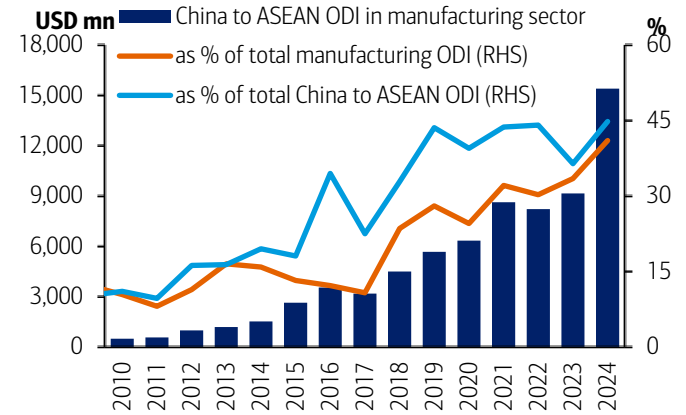


Source: CEIC

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**Exhibit 9: China's rising ODI to ASEAN is increasingly concentrated in the manufacturing sector**

China's ODI in ASEAN's manufacturing sector, relative to total manufacturing ODI and total ODI to ASEAN



Source: CEIC, Ministry of Commerce

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