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TOP *of* MIND

WILL CHINA'S POLICY STIMULUS BE ENOUGH?

Chinese policymakers doubled down this week in signaling a strong policy response to China's internal and external economic challenges. But after months of policy disappointments, just how effective will the stimulus be? China watchers Michael Pettis, David Li, and GS' Hui Shan agree that domestic challenges pose a bigger problem for China's economy than the risk arguably most in focus—potential Trump tariffs—but disagree on the effectiveness of the latest stimulus measures in addressing two key domestic challenges: high debt and weak domestic demand. We explore the implications for growth in China—with Pettis, Li, and Shan expressing varying levels of optimism and pessimism on longer-term growth—and beyond, with GS' Joseph Briggs arguing that foreign spillovers from China's economic and policy developments could look different next year than in past cycles. And we assess the China growth expectations priced into markets today, which imply potential room for modest further upside in China-exposed assets.

"China doesn't just need more absolute consumption. It needs more consumption *relative to production*... attempting to increase consumption by continuing to subsidize the supply side of the economy will only worsen the current imbalance in the economy.

\- Michael Pettis

I am confident that policymakers will make the necessary changes to support growth... But... these adjustments won't be one and done; policymakers will gradually jack up stimulus, like replacing the tire of a car.

\- David Li

The RMB10 trillion local government debt swap plan... is the most important easing measure announced so far in terms of addressing the most urgent economic risk today, and is arguably the most underappreciated.

\- Hui Shan"

WHAT'S INSIDE

Allison Nathan | allison.nathan@gs.com

Jenny Grimberg | jenny.grimberg@gs.com

Ashley Rhodes | ashley.rhodes@gs.com

Macro news and views

We provide a brief snapshot on the most important economies for the global markets

US

Latest GS proprietary datapoints/major changes in views

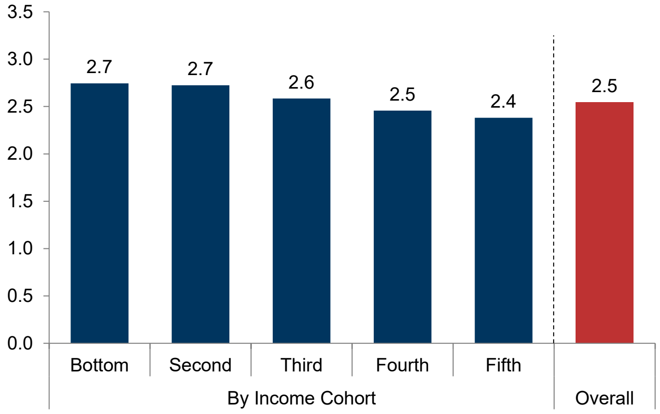
- We now expect the Fed's quantitative tightening to end in 2Q25 (vs. 1Q25 before) as we expect the FOMC to further slow the pace of runoff at its January meeting in order to move more cautiously as it approaches the stopping point.

Datapoints/trends we're focused on

- Inflation, which we expect to cool further as catch-up effects continue fading and shelter inflation normalizes, for core PCE of 2.4% by Dec 2025, barring a broad trade war.
- Real income growth, which we expect to be solidly positive and more evenly distributed across income groups in 2025.
- Broad North American tariffs, which, while not our baseline, would likely have significant economic impacts.

A still-healthy US consumer

GS 2025 US real income growth forecasts, Q4/Q4, % change



Source: Goldman Sachs GIR.

Japan

Latest GS proprietary datapoints/major changes in views

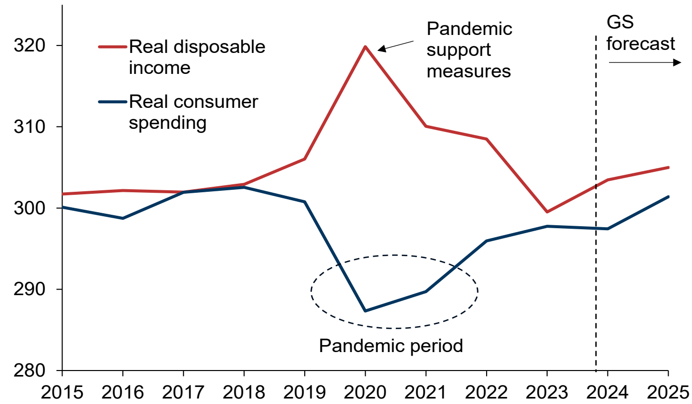
- No major changes in views.

Datapoints/trends we're focused on

- BoJ policy; we expect the BoJ to continue hiking rates at a pace of roughly two hikes/year, with the next hike in Jan.
- Japan inflation; we expect average new core CPI to fall in 2025 but remain above target at 2.1% yoy (vs. 2.4% in 2024).
- Japan consumption, which we expect to continue rising on the back of improving real wages and permanent income tax cuts, for real private consumption growth of 1.4% in 2025.
- Japan capex, which we expect to maintain its upward trend next year, supported by continued high corporate profits.

Japan: more money, more spending

Real private consumption vs. real disposable income, ¥tn, SAAR



Source: Cabinet Office, Goldman Sachs GIR.

Europe

Latest GS proprietary datapoints/major changes in views

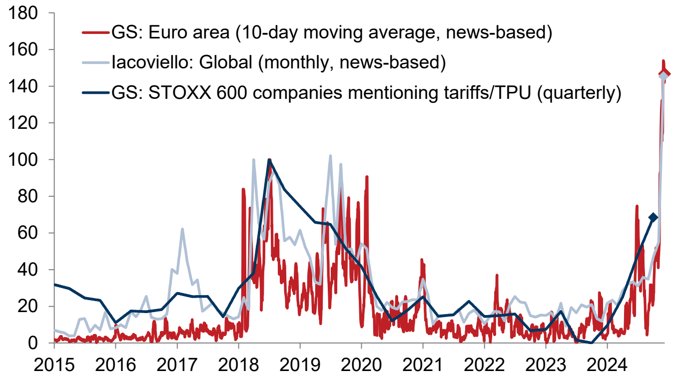
- No major changes in views.

Datapoints/trends we're focused on

- ECB policy; we expect the ECB to continue delivering sequential 25bp cuts to a terminal rate of 1.75% in July.
- Trade policy uncertainty, which has spiked following the US election, pointing to a potentially meaningful headwind to European growth in 2025, especially for economies heavily exposed to capital goods demand.
- EA inflation; we expect core inflation to gradually converge to 2% over the course of 2025, reaching target in 4Q25.
- French politics; we believe the recent ousting of Barnier's government will have material economic implications.

Trade policy uncertainty: starting to bite in Europe

Measures of trade policy uncertainty (TPU), % of 2018 peak



Note: Indices normalized so that 0 corresponds to sample minimum and 100 to the 2018 peak.

Source: Bloomberg, Iacoviello, Haver Analytics, Goldman Sachs GIR.

Emerging Markets (EM)

Latest GS proprietary datapoints/major changes in views

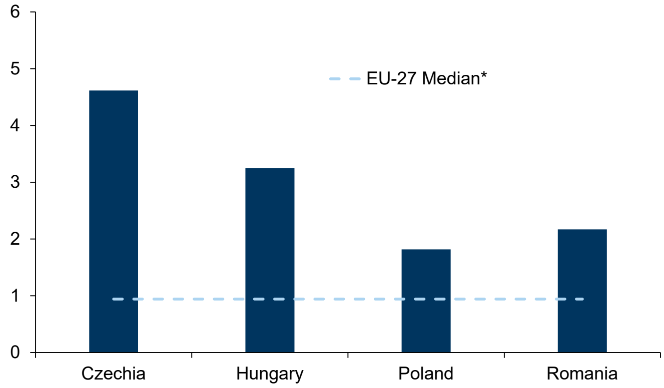
- No major changes in views.

Datapoints/trends we're focused on

- China macro policy; we expect more easing ahead, but the magnitude will likely be smaller than prior major easing cycles.
- LatAm growth; we expect real GDP for the LA7 economies to slow to a modest 2% in 2025 given still-tight financial conditions, limited economic slack, global trade policy uncertainty, and domestic political and policy uncertainty.
- CEE growth; which would likely be especially affected by higher US tariffs given the focus on auto tariffs, as auto manufacturing is a key sector for the CEE-4 economies, as well as CEE-4s' exposure to Euro area activity.

CEE economies: auto reliance

Share of economic output (GVA) for auto sector, % of total GVA



**The EU-27 sample excludes Luxembourg due to data availability.*

Source: Eurostat, Haver Analytics, Goldman Sachs GIR.

Will China's policy stimulus be enough?

After months of policy easing that generally disappointed investors, China-exposed assets rose again this week as policymakers doubled down in signaling a strong policy response to China's ongoing domestic economic challenges—owing largely to a years-long property crisis and weak domestic demand—as well as to heightened trade threats following the US election. But, especially given the recent pattern of dashed investor hopes, just how meaningful and effective the domestic policy stimulus will be in addressing China's internal and external challenges, and the implications for global growth and markets, is Top of Mind.

We first speak to three China watchers—Tsinghua University's David Li, Peking University Guanghua School of Management's Michael Pettis, and GS Chief China Economist Hui Shan—and begin by asking them about the economic risk arguably most in focus today: potential Trump tariffs. Shan argues that China could likely weather even a complete severing of Chinese exports to the US if the growth impact is contained to just lower exports, but she worries about the potential drag on investment from tariff uncertainty. Li goes a step further, making the case that Trump could actually benefit China's economy by accelerating necessary domestic reforms. But Pettis is more concerned, arguing that if Trump is serious about reversing the relative decline of the US manufacturing sector, that would conflict with China's desire to double down on manufacturing growth, as the world won't tolerate both manufacturing giants pursuing such strategies simultaneously.

However, Shan, Li, and Pettis agree that domestic challenges are a bigger issue for China's economy than US tariffs. We first explore the magnitude of two key challenges: high debt owing to the country's longer-term infrastructure- and property-related investment cycle and weak domestic demand. GS Chief Asia Credit Strategist Kenneth Ho notes that China has substantially relevered in recent years on the back of the property downturn, with non-financial debt estimated to rise to over 300% of GDP by end-2024. While Ho argues that this high debt doesn't pose a systemic financial risk, Pettis warns that correcting the fiscal imbalance will be painful. GS economists Andrew Tilton, Xinquan Chen, and Jonathan Sequeria then dig into China's domestic demand problem, finding that domestic demand is currently growing at around 2.5% yoy, sharply below the average pace of the last 20 years.

So, how effective will the latest stimulus measures be in addressing these challenges? GS senior China economist Lisheng Wang first lays out the recent easing measures, arguing that these and likely upcoming stimulus measures are not a "bazooka" and will likely pale in comparison to past major easing cycles given policymakers' changed reaction function (see pg. 16 for a comparative list of easing measures).

But among the various easing measures, Shan points to one whose importance she believes is being underappreciated: the recently-approved RMB10 trillion local government debt swap plan. While not nearly large enough to pay off all local government debt, Shan says that the plan will create crucial fiscal breathing room for local governments to provide services vital for their citizens' wellbeing, and that without such a plan, local economies across the country would face enormous pressure in the coming years.

Li, however, is less enthusiastic about the debt swap plan, arguing that it is "too little, too late" and does not resolve local governments' crippling debt burden, which, in his view, can only be achieved by swapping a large amount of local debt for central government debt. And Pettis, for his part, believes the plan "won't be effective at all" because, he says, it just shifts debt from one pocket to another, with the cost savings associated with doing so tiny and coming at the expense of much-needed banking system revenues.

The even more crucial question, though, is whether policymakers will be successful in boosting consumption—an important component of domestic demand—which Li, Shan, and Pettis all believe will be key for China's economic trajectory as the country seeks a new engine of sustainable growth. Li is optimistic that policymakers will implement, if only gradually, the necessary changes to boost growth in order to support the needs of China's young and highly-educated population. And Shan, for her part, is fairly confident about China's direction of travel toward consumption-led growth, but less confident about the timetable for this necessary shift.

But Pettis is less confident because, he says, Chinese policymakers have yet to embrace the fundamental problem: China doesn't just need more consumption, it needs more consumption *relative to production*. Until policymakers accept that and pursue a strategy that aggressively boosts the growth rate of household consumption and income, Pettis argues that China will struggle to deliver sustained high-quality growth.

So, what will all this mean for the global economy? GS senior global economist Joseph Briggs identifies several channels through which the economic and policy developments impacting China could spill over to the rest of the world, arguing that such spillovers could look different next year than in past cycles given China's evolving economic and policy backdrop as well as the shifting composition of its growth.

And what about for markets? GS senior market strategist Vickie Chang assesses the China growth expectations priced into markets today, finding that the market may now be pricing slightly too much pessimism around China's cyclical outlook, which leaves potential room for modest upside ahead. And GS market strategists opine on the implications for China, regional, and global assets in more detail on pgs. 23-25, finding that what happens in China could have wide-ranging impacts for everything from regional equities to commodities to the Dollar.

Allison Nathan, Editor

Email: allison.nathan@gs.com
Tel: 212-357-7504
Goldman Sachs & Co. LLC

Interview with Hui Shan

Hui Shan is Chief China Economist at Goldman Sachs. Below, she argues that the likely benefits of China's debt swap program are underappreciated, but that more policy support is needed.

Jenny Grimberg: How has China's growth evolved over the past couple of years?

Hui Shan: China's growth has disappointed in recent years. Based on every other country's experience, China's economy should have rebounded strongly following its post-pandemic reopening early last year, yet real GDP growth printed at only 5.2% in 2023 compared to 3.0% in 2022. 2024 has been another surprising year as exports performed strongly but domestic demand continued to weaken, especially around midyear, with the contribution of final consumption expenditure to headline GDP growth slowing materially from around 50% in Q2 to just under 30% in Q3, leading to a deceleration in year-over-year GDP growth in Q3 relative to Q2. This slowdown prompted policymakers to announce a slew of easing measures in late September. That said, the magnitude and timing of policymakers' reaction function surprised many China-watchers, with policymakers seemingly willing to tolerate more pain than many people expected before embracing stimulus measures.

Jenny Grimberg: With the benefit of hindsight, why do you believe these disappointments occurred?

Hui Shan: Looking back, it's clear that China's economy was in a near-perfect storm. The three-year-long pandemic lockdown shattered consumer confidence. The government embarked upon a regulatory tightening cycle in 2021 that spanned many industries—education, gaming, healthcare, finance, etc.—and weighed on growth. The housing bust that began in 2021 proved longer lasting and more severe than many people, including policymakers, expected. Then, in 2024, the economy experienced another big shock as the central government forced local governments to intensify their deleveraging campaigns. While in isolation that may have seemed warranted as local governments' debt issues were raising the risk of financial stress, asking local governments to reduce their debt loads while the economy was suffering from a housing downturn and downbeat sentiment was simply too much. It forced local governments to embark on extreme measures like raising fines and fees and delaying payments to workers and suppliers, which further worsened the already-challenging economic situation. That shock was the straw that broke the camel's back in terms of triggering more forceful and coordinated stimulus measures in September.

Jenny Grimberg: How effective will the latest stimulus measures be in addressing China's economic challenges?

Hui Shan: The RMB10 trillion local government debt swap plan approved by the National People's Congress standing committee in early November is the most important easing measure announced so far in terms of addressing the most urgent economic risk today, and is arguably the most underappreciated. The plan increases the amount of debt local governments are allowed to raise, with the additional debt to be swapped for "hidden debt" held by local government financing vehicles (LGFV), a mechanism by which local governments in China borrow money. Many people seem to view the plan as akin to a typical Western debt swap, which just exchanges one form of debt for another and doesn't fundamentally alter balance sheets, so they don't see the plan as very useful. The numbers also don't look that impressive. The new debt is to be issued over five years—RMB2.8 trillion annually from 2024 to 2026 and RMB800 billion annually in 2027 and 2028—which isn't nearly enough to pay off the over RMB60 trillion of LGFV total interest-bearing liabilities. But RMB2.8 trillion *is* roughly enough to cover local governments' fiscal shortfall this year. And in writing them a check for that amount, the central government has essentially ensured that local governments don't use fiscal revenues to pay off their debts, but rather to conduct regular operations vital for their citizens' wellbeing, including paying civil servants' salaries, funding school lunches, and covering hospital bills. Without the fiscal breathing room afforded by the plan, local governments would likely continue delaying these payables, which would be extremely contractionary. So, the debt swap plan is crucial.

Jenny Grimberg: What—if any—other policy developments could also move the needle on China's economic outlook?

Hui Shan: I would emphasize two other developments. One, the equity market measures that were part of the September stimulus package, which are new ground for policymakers. These measures include a RMB500 billion central bank swap facility for financial institutions to swap equities for government bonds which could then be used as collateral to obtain relatively cheap funding for more equity purchases as well as a RMB300 billion central bank relending program that would allow companies to borrow money to buy back their arguably undervalued shares. It is not entirely clear what policymakers are ultimately hoping to achieve by boosting the equity market—to lift confidence, to create wealth effects, or to engineer inflation—and whether they will succeed is an open question, but the intention and focus on the stock market is a notable development.

Two, Chinese policymakers' new-found recognition that property and infrastructure investment, which historically served as the main levers for stimulus, are no longer viable ones. So, policymakers are shifting their focus toward consumption and experimenting with policies to boost it, such as this year's "cash for clunkers"-style program, which provides consumers a subsidy for trading in their old cars and home appliances for new ones. That program has taken off in recent months as the government has increased the size of the subsidies, and policymakers have discussed continuing and expanding it next year.

Jenny Grimberg: Amid China's economic challenges, how concerning is the prospect of steeper US tariffs on Chinese goods following Donald Trump's reelection?

Hui Shan: The direct effects of new tariffs likely would not be *that* significant. Exports account for around 20% of China's GDP, and 15% of Chinese exports are US-bound. So, even an extreme scenario in which the Trump Administration levies a tariff so high that China stops exporting to the US completely would only amount to a loss of around RMB4 trillion—3% of GDP—which China could likely weather if it were the only impact of tariffs given that the country has its own central bank and a low central government debt load. And some Chinese exports to the US are likely to continue given that the US can't source everything from other countries, while some exports will find homes in alternative markets. However, the threat of tariffs creates significant investment uncertainty—determining the best place to build factories is difficult when it's not clear which country the US will impose tariffs on next. So, the tariff story is really about the uncertainty and second-round effects, which will undoubtedly have a larger impact on the Chinese economy than the tariffs themselves.

Jenny Grimberg: What impacts could this new external risk have on Chinese policymakers' mindsets and actions?

Hui Shan: Policymakers will probably deploy new policy measures in response to US tariffs, but their reaction function will likely look different from the 2018-19 trade war. Back then, policymakers initially didn't take Trump's tariffs very seriously, which led the Administration to consistently ratchet up tariffs over two years. Chinese policymakers have learned from that experience and are taking Trump's tariff threats more seriously now, recently cutting the VAT rebate on aluminum and copper to signal that they will not subsidize their exporters as aggressively, arguably as a measure of goodwill to see if they can avoid an escalating trade war. The reaction function may also differ in terms of the policy toolkit. Given the limited effectiveness of retaliatory tariffs during the last trade war, Chinese policymakers could rely more on their supply chain to retaliate this time around—for example, by cutting off the US' access to critical parts and materials, as they have begun to do. Policymakers are also likely to rely less on currency depreciation as a retaliatory tool, partly owing to higher capital outflow pressures today than in 2018-19, which is why we are forecasting only a moderate depreciation in CNY against the Dollar from 7.26 currently to 7.50 next year.

Conversely, tariff risks will probably *reinforce* two policy trends already in train: the importance of looking inward for sustainable growth, and the need for China to rely on a broader set of countries to support the still-large trade and investment parts of its economy. As we've discussed, policymakers are thinking about and experimenting with how to increase domestic consumption. And China has increasingly turned its eye to other EM countries and Belt and Road economies as a means of offsetting weakening trade links with DM countries. The more trade frictions flare up, the more convinced Chinese policymakers will be of the necessity of these actions.

Jenny Grimberg: What else might policymakers do to stabilize the economy, and given your policy expectations, what is your outlook for China growth next year?

Hui Shan: Historically, Chinese policymakers haven't cut the growth target by more than 50bp from one year to the next, and they then implement a range of policies to ensure they meet the target. So, 4.5% real GDP growth next year seems reasonable as a modal forecast. To achieve that, policymakers will need to put in place policies that boost consumption since this year's strong export growth will likely slow sharply next year. The debt swap plan we've discussed can boost local government consumption and investment, which have been very depressed this year. The goods trade-in and equipment upgrade program will also likely be expanded, perhaps by increasing the subsidies or categories covered, which should support household consumption and business investment. Cash handouts, which policymakers doled out in small scale earlier this year, will also likely continue, possibly expanding to households with multiple children—which would encourage both fertility and consumption—and rural retirees, whose government-sponsored pensions are very low. So, consumption stimulus experiments will likely be part of next year's economic planning process. Policymakers have also indicated a plan to recapitalize large banks to preserve their ability to make loans—a lesson learned from Japan's banking crisis. So, bank recapitalization will likely also be an important feature of next year's policy package.

Jenny Grimberg: The shift from export-led growth to consumption-led growth has failed to materialize in recent years. So, how confident are you that it will succeed now?

Hui Shan: I'm fairly confident in the direction of travel. Recognizing that the old playbook of property or infrastructure stimulus no longer works, policymakers started to address the current bout of cyclical weakness with consumption measures, which are unfamiliar territory and much more complicated to execute. That suggests policymakers are serious about finding a new engine of sustainable growth as the property and infrastructure roads to growth have ended and the export road may be ending soon. But I am less confident in how much policymakers will ultimately be able to do, and how fast. While policymakers are well-versed in how to undertake large-scale infrastructure projects, stimulating consumption is totally out of their comfort zone and will therefore require significant experimentation. And Chinese households' big savings culture may mitigate the effectiveness of any consumption experiment. So, the timetable for this necessary growth shift is unclear.

Jenny Grimberg: Longer term, how concerned are you about China's structural outlook?

Hui Shan: Policymakers seem to recognize that China is facing several structural issues—fertility rates have fallen, the debt buildup over the past two decades could spell financial trouble if left unaddressed, and the world may be headed toward deglobalization. But policymakers haven't figured out how to *tackle* these issues, which are incredibly challenging in isolation, let alone in combination. So, over the next decade, we expect real GDP growth to average 3.5% and nominal GDP growth to average 5% annually, a far cry from the 9% average annual real GDP growth and double-digit nominal growth that China experienced in the first two decades of this century. This will have important implications for businesses, households, and, of course, investors. While animal spirits are still very much a feature in parts of China's economy and extreme pessimism is not warranted, investors in China will need to be more selective going forward as China undergoes a significant economic transition and policymakers continue down the long road of figuring out how to execute that.

Interview with Michael Pettis

Michael Pettis is Professor at Peking University's Guanghua School of Management. Below, he argues that China's latest policy measures may not be effective in driving high-quality growth.

The views stated herein are those of the interviewee and do not necessarily reflect those of Goldman Sachs.

Allison Nathan: What's surprised you the most about how China's growth has evolved since we last spoke a decade ago?

Michael Pettis: When we last spoke, I argued that the very high GDP growth targets that China set were much higher than the real economy could productively deliver, so that the only way China would be able to achieve the growth targets would be to significantly increase investment, mostly in the property sector but also in infrastructure. And because so much of that investment would be non-productive—buildings that remain empty and railroads to nowhere—China's overall debt burden would rise rapidly. All of that has generally played out. But what has been surprising is how long policymakers have allowed this process to run and how much they have allowed debt to rise. According to official statistics from the National Institution for Finance and Development, China's debt officially totaled around 298% of GDP at the end of the third quarter, vs. 216% ten years earlier. So, making the adjustments necessary to correct this imbalance will be that much more difficult because a lot more bad investment will have to be written down.

Allison Nathan: Who will bear the losses of this adjustment?

Michael Pettis: Technically, most of China's debt resides at the local government level. But the distinction between central government debt, local government debt, and even corporate and household debt doesn't make as much sense in the case of China as it does in many other countries. That's because Beijing has viewed debt generation—both at the local government and household level—as a way to sustain higher GDP growth than the economy could otherwise manage. So, debt is ultimately accumulated in the economy to meet the growth targets set by the central government, which implicitly guarantees all debt. And almost all debt is issued by commercial banks, which are all basically insolvent, with Beijing or local governments having to recapitalize them. So, the central government, directly or indirectly, is on the hook for all debt within the system.

Allison Nathan: If the central government is ultimately on the hook, what is Beijing hoping to achieve with its recent efforts to intensify local government deleveraging?

Michael Pettis: The main purpose seems to be to move all the hidden, off-balance sheet local government debt onto the formal balance sheet so that it can be dealt with directly. How it will be dealt with is still an open question. Local governments argue that the only way they could have achieved Beijing's high growth targets was by borrowing and investing in infrastructure projects, which ultimately generated less growth than they cost, leaving local governments no choice but to let their debt burdens rise. That's why they believe that the central government should cover these debts. But Beijing wants to keep the central government balance sheet as clean as possible, and so is pressuring local governments to resolve their debts locally.

I suspect that underlying this dispute is a politically contentious struggle between the central government and the local governments about allocating the cost of all this bad investment. Many people argue that local governments are bankrupt, so cannot repay their debt. But that's technically not true. Local governments do have serious cashflow problems given that their revenues are down significantly, their expenses are up, and they are not allowed to borrow. But they also own substantial and varied assets. Beijing may be trying to put pressure on local governments to pay down these debts by liquidating or transferring these assets. This is a very political process because, contrary to what many people may believe, a real division of power exists between the central government and the local governments today. Given that Beijing would clearly prefer a greater centralization of power, one way to achieve this would be to weaken the economic power of local governments. So, by forcing the allocation of losses to local governments, who will then pay for them by liquidating assets, Beijing can kill two birds with one stone.

Allison Nathan: How effective will the new debt swap plan be in alleviating local government financing pressures?

Michael Pettis: This plan won't be effective at all, because it only moves debt from one pocket, off-balance sheet, to another pocket, on-balance sheet. Some argue that shift benefits local governments because off-balance sheet debt incurs a higher interest charge than on-balance sheet debt. So, they argue, even if this shift doesn't reduce the amount of debt, it reduces the *cost* of the debt, which in turn frees up cash flows that local governments desperately need to pay for workers, service providers, and transfers. But that argument has two big flaws. First, the actual savings from the reduced interest cost are tiny, less than RMB80 billion annually in a RMB123 trillion economy.

Second, lower interest rates don't come free; lenders, i.e. the banks, collect less revenue. So, lowering local governments' debt servicing costs lowers banking system revenues. If the banks were independently capitalized, that would represent a real transfer from the banking system to local governments. But, again, even China's top banks need to be recapitalized. So, on the one hand, local governments are saving money. But, on the other hand, those savings are matched almost dollar-for-dollar by the banking system's increased recapitalization costs. So, nothing is fundamentally changing in the economy.

Allison Nathan: Policymakers have begun to roll out other policies to support growth. Will any of those be effective?

Michael Pettis: I count four other major policies that the government is pursuing, all of them problematic. One is to continue subsidizing manufacturing. I was shocked to hear a very influential Chinese economist recently argue that while China needs to boost consumption, there is a good way and a bad way to do so. The bad way, he said, is to transfer income to households, and the good way is to transfer income to businesses so that they expand, hire more workers, and raise wages, which will, in turn, drive up consumption. But China doesn't just need more absolute consumption. It needs more consumption *relative to production*. So, his argument gets it completely backward; attempting to increase consumption by continuing to subsidize the supply side of the economy will only worsen the current imbalance in the economy.

Another policy is to stabilize the housing market to improve confidence in the household sector, which is heavily exposed to declining house prices. But making progress on this goal will be difficult because China still has too much housing for a shrinking population, and this is especially the case in provinces that are not among the six or seven rich coastal provinces. A third and related policy is to boost the stock market to raise consumer confidence and boost consumption through a wealth effect. But the float within the stock market is quite small, most speculators are already relatively wealthy, and the market is very volatile, so I doubt this will change much.

The last policy is to boost consumption directly through transfers, such as consumer coupons and spending more money on students, very poor retirees, etc. But money doled out through these programs has so far been very small because they are being implemented by provinces and municipalities, which, again, have real cash flow constraints.

Allison Nathan: Are any policies likely to materially improve China's economic situation?

Michael Pettis: In the short term, policymakers will likely try to expand the policies targeting the demand side of the economy—perhaps with greater support from the central government—which would be positive for growth. But these programs are only a short-term solution. Economists agree that the only sustainable way to rebalance the economy and raise the consumption share of GDP is to raise the household share of GDP. But, by definition, if the household share of GDP rises, either the business share of GDP or the government share of GDP must decline, which is hard to do. Reducing the business share of GDP would undermine the competitiveness of the Chinese manufacturing sector. And reducing the government share of GDP would require significant changes in the institutions that underpin local political, financial, and business elites and, for that reason, will be strongly resisted.

Meanwhile, policymakers appear convinced that the way to achieve growth is to double down on the policies of the last 10-15 years and continue subsidizing the supply side of the economy. But as long as supply-side growth outpaces demand-side growth, the only way to reconcile the two is through either more investment, which will only worsen China's debt problem, or a larger trade surplus, which the rest of the world may not be willing to absorb.

Allison Nathan: China is also facing the risk of steeper US tariffs on Chinese imports. How problematic will that be?

Michael Pettis: China is very worried about the impending tariffs, as is the rest of the world. China comprises roughly 17% of global GDP, but accounts for around 30% of global manufacturing. As if this weren't enough of a problem for manufacturing in the rest of the world, China's strategy of doubling down on manufacturing growth means that its share of global manufacturing must grow twice as quickly as its share of global GDP. In the past, the US absorbed most of China's rising manufacturing share, with the US share of global manufacturing declining steadily since the beginning of the century and the US currently comprising around 23% of global GDP and only 17% of global manufacturing. But if the US is serious about reversing the relative decline of its manufacturing sector, that creates a huge problem for China and the world. If the world's largest manufacturing power is trying to increase its share of global manufacturing, and the world's second-largest manufacturing power is trying to reverse its decline, this requires a sharp decline in the manufacturing share of the rest of the world. And nobody—not Europe, not large developing economies—wants that. So, something has to break.

Allison Nathan: Are Chinese policymakers likely to allow the RMB to weaken further to offset higher tariffs?

Michael Pettis: The RMB has been depreciating in real terms for a while now owing to the inflation differential between China and most of the rest of the world. But employing currency depreciation to counter tariff impacts has two major problems. First, a depreciating currency worsens China's major imbalance because it penalizes importers—the household sector—and subsidizes exporters—the tradable goods sector—which is the exact opposite of what China needs. Second, depreciating the RMB in response to US tariffs punishes all of China's trading partners, and it's not clear that the rest of the world would agree to absorb this. If they retaliate, trade conflict would spread even more rapidly throughout the rest of the world. As the world's biggest surplus country, China depends crucially on the rest of the world to balance its weak domestic demand, and so it is especially vulnerable to trade conflict.

Allison Nathan: So, how is China growth likely to evolve?

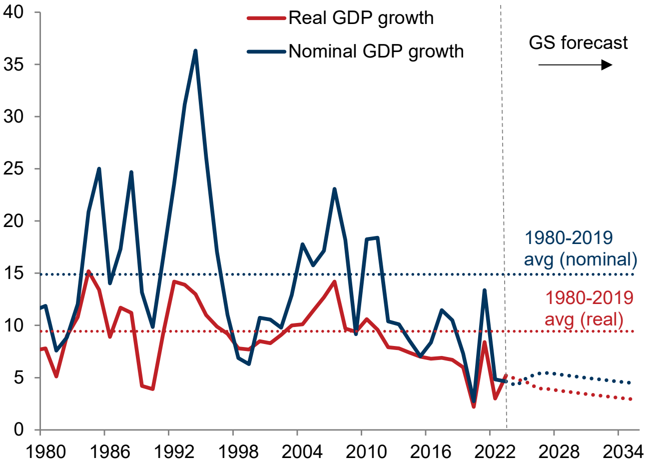
Michael Pettis: Policymakers will probably set next year's real GDP growth target in the 4.5-5% range, probably closer to 5%. But because they can achieve any growth level they want as long as they can continue to fund investment, whether that investment is productive or non-productive, the real question in China is not the extent of GDP growth but rather its quality. Given that so much of current growth has been driven by non-productive investment, the lower they set the GDP growth target, the better for Chinese growth in the medium term. That's because it will involve fewer wasted resources and less debt. However, a 4.5% GDP growth target is probably the lowest politically acceptable GDP growth target, which is why I am hoping, albeit without much confidence, that they set a GDP growth target for 2025 much closer to 4.5% than to 5%.

All told, the economy is in a more difficult position today than it was 10 years ago given this reliance on non-productive investment in property and infrastructure, and increasingly in the high-tech sectors, with the associated losses being capitalized as assets on balance sheets. This much-higher level of losses must ultimately be recognized and allocated, with all the attendant consequences for growth. This means growth has to eventually slow sharply unless Chinese policymakers are able to design and implement a strategy that aggressively boosts the growth rate of household income and consumption.

China's economic challenges...

China's growth has disappointed in recent years and remains well below its average pace in the four decades leading up to Covid...

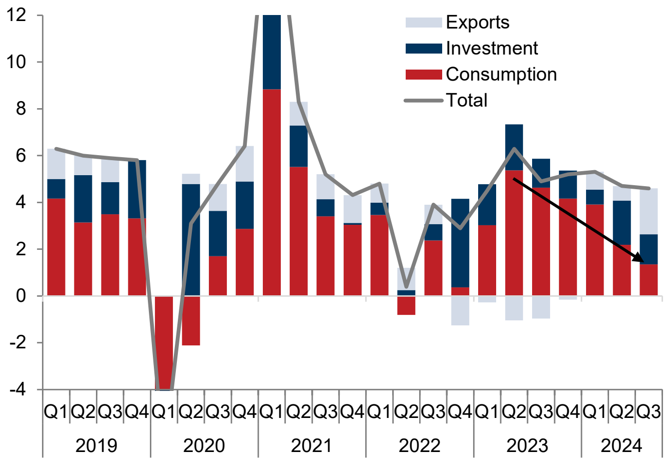
China GDP growth, % change, yoy



Source: NBS, Goldman Sachs GIR.

...and household consumption remains weak after slowing considerably this year...

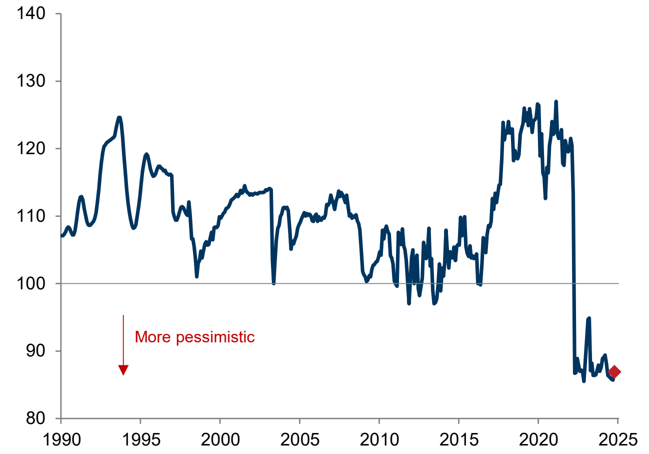
Contribution to real GDP growth, % change, yoy



Source: NBS, Goldman Sachs GIR.

...with China's consumer confidence falling to all-time lows in recent months...

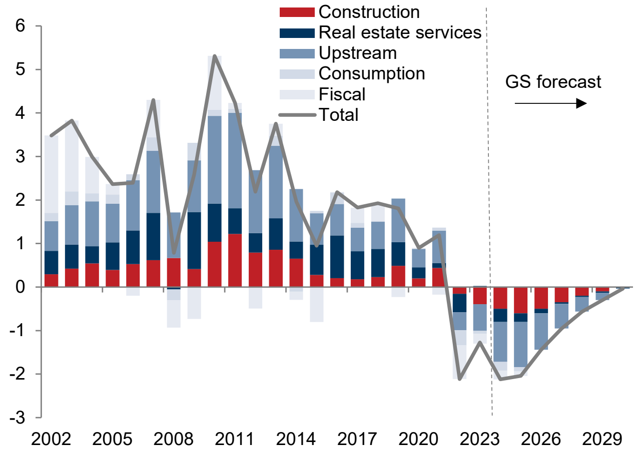
China consumer confidence, index



Source: Haver Analytics, Goldman Sachs GIR.

...as the property market remains a prolonged and significant drag on the economy

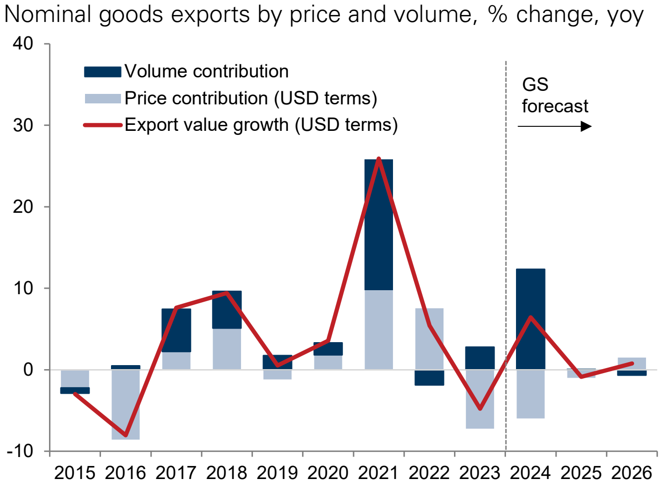
Housing contribution to yoy GDP growth, pp



Source: Haver Analytics, Goldman Sachs GIR.

While exports have been a bright spot in China's economy this year, export growth is likely to fall amid potential US tariff hikes under the second Trump Administration

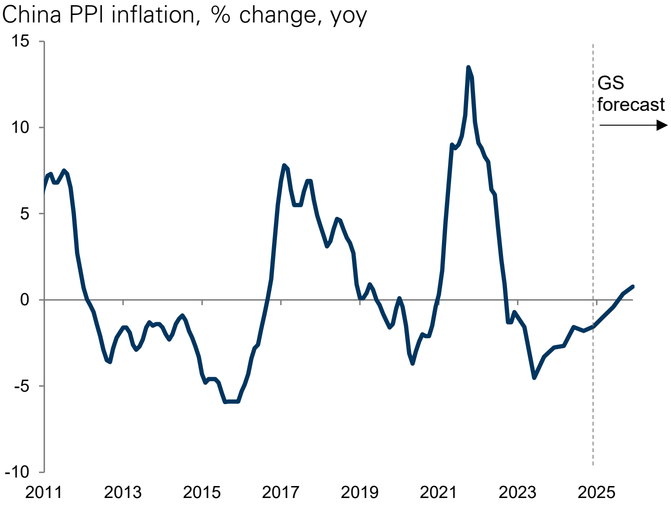
Nominal goods exports by price and volume, % change, yoy



Source: Haver Analytics, Goldman Sachs GIR.

China also continues to grapple with deflation, though we expect deflation to end in 3Q25 with zero full-year PPI inflation

China PPI inflation, % change, yoy

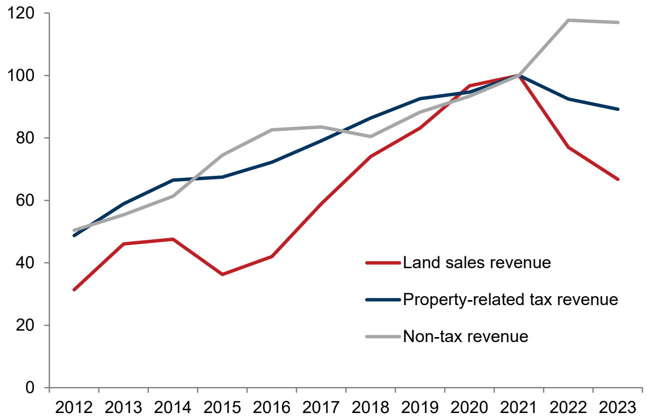


Source: CEIC, Goldman Sachs GIR.

...in pics

Chinese local governments face significant fiscal challenges as tax and land sales revenues have declined amid the property downturn and persistent PPI deflation

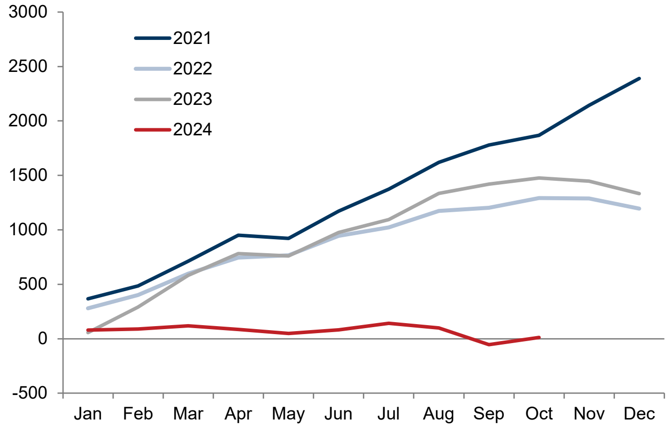
Local government fiscal revenues, index, 2021=100



Note: Non-tax revenue mainly covers fees/fine collection as well as revenues from local state-owned enterprises (SOEs) and state-owned assets.
Source: Wind, Goldman Sachs GIR.

Local government finances have deteriorated further amid restricted local government financing vehicle (LGFV) borrowing under the central government's focus on deleveraging...

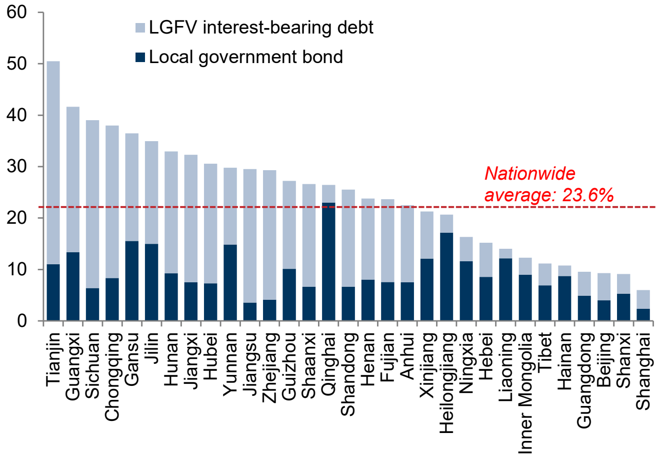
Cumulative net issuance of LGFV bonds, RMB billions



Source: Wind, Goldman Sachs GIR.

...and many Chinese provinces face significant interest payment pressures

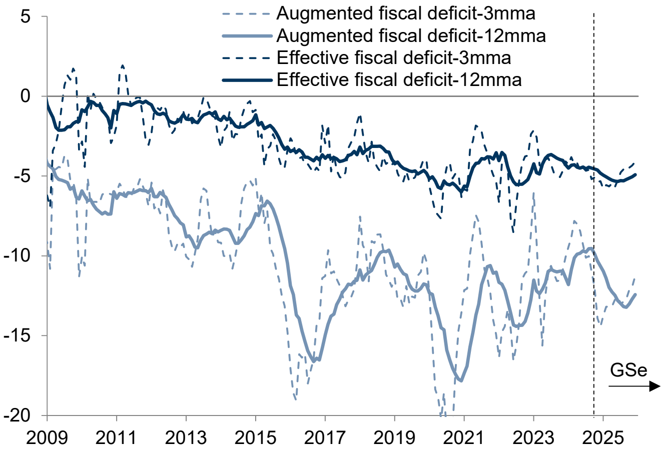
Interest payment of local government debt, % of local government revenue



Note: Data as of 2023.
Source: Wind, Goldman Sachs GIR.

China has seen material fiscal tightening this year that has weighed on growth, though we expect that to reverse in coming quarters owing to the significant step-up in easing measures

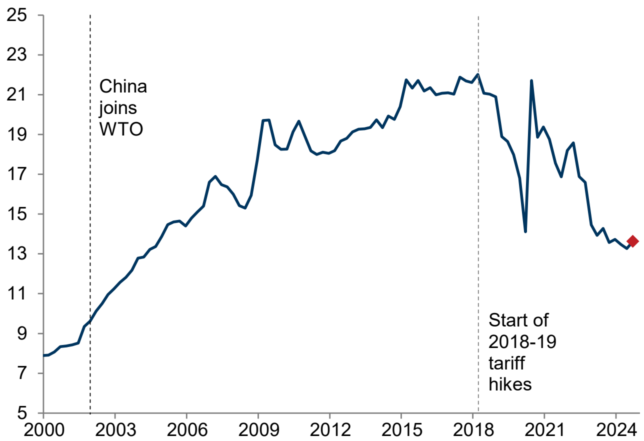
China fiscal deficit, % of GDP



Source: Wind, Goldman Sachs GIR.

Global supply chain de-risking has also weighed on China, with China's share of US imports declining in recent years

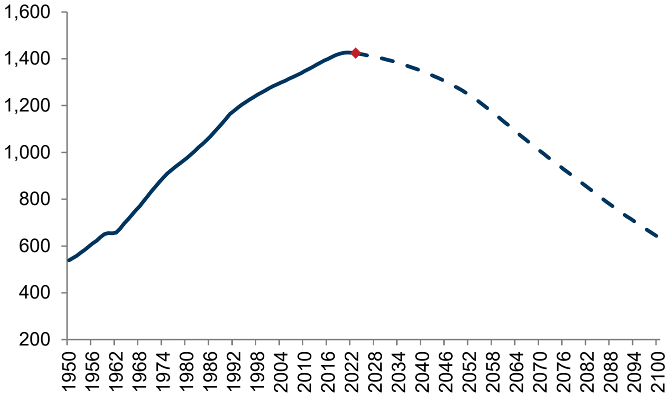
US share of imports from China, %



Source: Haver Analytics, Goldman Sachs GIR.

China also faces an unfavorable demographic outlook, with its population projected to decline sharply in the decades ahead

China population, millions of people



Note: Dashed line shows UN medium-variant projections. See here for details.
Source: United Nations, compiled by Goldman Sachs GIR.

Special thanks to China Economics team for charts.

Interview with David Daokui Li

David Daokui Li is Professor of Economics and Founding Dean of the Schwarzman College at Tsinghua University. He is a former member of the Monetary Policy Committee of the People's Bank of China and the National Committee of the Chinese People's Political Consultative Conference. Below, he argues that while China's recent policy measures are too little too late, policymakers will continue to jack up stimulus, so, growth in 2025 should outperform vs. 2024.

The views stated herein are those of the interviewee and do not necessarily reflect those of Goldman Sachs.

Allison Nathan: Given the recent trajectory of the Chinese economy, are you concerned that China may miss the government's "around 5%" growth target for 2024?

David Li: With the exception of exports, all sectors—investment, manufacturing, and consumption—have undeniably underperformed expectations. But the government will still achieve its growth target because the target is measured in real terms, meaning that the government will calculate nominal GDP growth—the total output of the economy measured at current prices—and then divide that by the GDP deflator, which is currently less than one given China's deflationary environment. So, real GDP growth will probably print at around 4.7-4.8% for the year.

But that reasonably solid real GDP masks disappointing nominal GDP, which official statistics suggest has only grown at a 4.02% pace through September—the slowest pace since the beginning of the "Reform and Opening Up" era over four decades ago, except for the first year of the pandemic in 2020. Nominal GDP growth matters because people don't feel deflation; they feel how much money is in their bank account. Chinese consumers, investors, and entrepreneurs are not accustomed to such low nominal GDP growth. So, this is a rare and difficult situation for most Chinese people.

Allison Nathan: What might explain the disappointing performance of the Chinese economy this year?

David Li: The most important economic reason for this disappointment is the boom/bust cycle of infrastructure investment, which is not unique to China. The US experienced two such cycles in the 1800s—one around the building of the Erie Canal and the other around the building of the railroad system—both of which were financed by short-term debt that couldn't quickly be repaid given the long-term nature of infrastructure projects and returns, ultimately leading to major recessions.

Similarly, the infrastructure boom that transformed Chinese cities over the last two decades has come to an end, and this year the central government stepped up pressure on local governments to repay the enormous amounts of short-term debt they used to finance this boom, which we've calculated totals around 100% of GDP. Intensified efforts to reduce this debt burden are squeezing local governments to the point that they have delayed payments to employees and other service providers to the tune of 8% of GDP. The situation is so crazy that some local governments have even attempted to squeeze payments from enterprises registered in other cities, detaining their senior executives until payment to the local government for so-called violations of local operating rules is made.

Allison Nathan: But the government seems to have begun addressing this problem. Are policymakers doing enough?

David Li: Around two months ago, the Chinese Politburo—the highest decision-making body of the Chinese Communist Party (CCP)—met and issued a statement that acknowledged China's economic challenges and pledged to address them. The National People's Congress (NPC) then met in early November and approved higher ceilings for local governments to issue new debt to cover their old debt. But these steps are too little, too late. The amount of new debt approved by the NPC is only RMB10 trillion, which is roughly 8% of GDP—too small compared to the 100% of GDP of local government debt outstanding. And this new debt was approved to be issued over five years, which is too slow.

Even more importantly, issuing new debt from already-indebted local governments rather than from the central government is not ideal. The Chinese central government is the wealthiest central government in the world; it holds shares of China's major commercial banks, three mobile phone operators, major oil companies, and two of the world's most profitable conglomerates, China Resources and China Merchants Group. Yet, outstanding Chinese treasury bonds issued by the central government currently total only 25% of GDP. The economies of China and the US are mirror images of each other: China has too little central government debt, too high savings, and not enough consumption while the US has too much federal debt, not enough savings, and booming consumption.

Allison Nathan: Why are Chinese policymakers so reluctant to increase central government debt?

David Li: Chinese leaders are trained engineers whereas US leaders are typically businesspeople or lawyers. And engineers view debt as a sign of weakness; they don't want to owe anybody anything. So, they think the high US debt load is something to avoid. And they believe that local governments are to blame for their debt problems and should therefore bear the onus of fixing them. The mentality is that debt is death, and China's top decision-makers want no part of it.

Allison Nathan: Amid these economic challenges, how concerning is the reelection of Donald Trump, who has promised to impose steeper tariffs on China?

David Li: Impending US tariffs are a concern, but they aren't the biggest concern for China. The Chinese economy is much less dependent on the US economy than it was five to seven years ago given that many firms have already moved away from China—to Mexico, Vietnam, Thailand, etc.—to manufacture for the US economy. So, the wolf that many economy-watchers have been worrying about for years has finally arrived, but Chinese policymakers are fully prepared for higher tariffs and Trump's well-known tough negotiating tactics, so the wolf's bite won't be that painful.

The bigger issue for the Chinese economy is weak domestic consumption. Boosting domestic consumption is the key to not only offsetting Trump's tariffs, but also ensuring a healthy trajectory for the Chinese economy over the medium-to-longer term. So, policy adjustments to support domestic consumption would have been critical regardless of the US election outcome. Policymakers have already begun to roll out such policies this year, such as trade-in programs for consumer goods. But the reelection of Trump will likely accelerate these necessary policy shifts. So, ironically, Trump has a nickname in Chinese that translates to "nation builder" or "patriot" because he is actually helping rather than harming the country by accelerating necessary reforms.

Allison Nathan: What might further reforms look like, and when will we have more specifics on them?

David Li: This week, the Central Economic Work Conference (CEWC) will issue a report that will likely announce a package of economic policies to address China's worsening international economic situation amid its current domestic challenges. This announcement may not mention specific numbers, or even specific programs, but will provide a clear indication of the economic policies to come. Policymakers will then likely start to announce specific policies and programs to implement the CEWC's report early in the new year. But new policies won't be announced and implemented all at once; they will be rolled out gradually over the course of several months, with most policies likely implemented by the middle or early third quarter of next year. So, the first half of 2025 will be crucial for new measures.

Such measures could include additional policies that support consumption, the implementation of which will be important. Policies that provide cash to households likely won't be effective given China's savings culture. So, I expect policies that instead subsidize consumer purchases, for example, via government-funded discounts or co-payments. Such policies shouldn't be viewed as stimulus but rather as necessary policy adjustments in the face of the economy's challenges.

Policymakers have also begun to experiment in new areas, such as implementing measures to support the equity market, which they view not only as a measure of confidence but also as an important factor *affecting* confidence. So, the equity market's poor performance in the first nine months of the year was a source of concern. But the 25% rally in China A-shares within a handful of trading days following the September policy announcements eased those concerns. All told, policymakers aren't particularly concerned about the stock market today.

Allison Nathan: Investors were disappointed by the lack of policy detail at the November NPC press conference. Why didn't policymakers announce more measures more quickly to avoid such disappointment?

David Li: What some may fail to understand or appreciate is that China's decision-making process is more centralized than it was 10 years ago, with major policy decisions coming directly from the Chinese president/leader of the CCP, who takes a very measured and thoughtful approach to decision-making, not the NPC. At this month's CEWC, the top decision-maker himself will deliver a long and important speech. So, investors should read that speech.

Allison Nathan: Given your policy expectations, what is your outlook for China growth next year?

David Li: If policymakers implement the two major policies we've discussed—swapping a large amount of local government debt for central government debt and subsidizing consumption—I would be very optimistic that growth in 2025 would outperform this year's disappointing growth, despite the likely imposition of Trump tariffs next year. Conversely, if policymakers fail to implement these policies and local governments remain constrained by their debt burden and consumption doesn't improve, I would be less optimistic about the growth outlook.

But I am confident that policymakers will make the necessary changes to support growth. 11 million college students graduate every year in China, and they need jobs, and not just any job, but good, well-paying jobs. Policymakers may not understand economists like me, but they do listen to these young people when they become anxious or frustrated about their future prospects. So, social pressures will push decision-makers to make the adjustments necessary to revitalize the economy. But again, these adjustments won't be one and done; policymakers will gradually jack up stimulus, like replacing the tire of a car.

Allison Nathan: Longer term, how concerned are you about China's structural issues, and will any of the steps you expect policymakers to take address them?

David Li: The key to addressing China's structural issues is speeding up urbanization, which will require the government, and especially local governments, to shift from spending money on infrastructure to spending money on people by, for example, providing basic housing, medical care, pensions, unemployment insurance, etc., so that the large swath of migrant workers that work in cities but are not entitled to cities' social services can do so. Urbanizing a meaningful portion of the roughly 350 million migrant workers not fully assimilated into cities today will help resolve China's ongoing property downturn as well as provide the jolt to domestic consumption that the economy so desperately needs. These people will work hard, bring their families, and consume.

While Chinese policymakers have not yet taken concrete steps to this end, I observe consensus among them shifting in this direction. 2025 marks the last year of the 14th 5-year plan. In anticipation of the 15th 5-year plan, economy-watchers are already looking back at the disappointing economic performance of the last four years and noting that the lack of consumption, which owes to the slow pace of urbanization, is largely to blame. So, I strongly believe that this shift in mentality will shape the next 5-year plan, which will heavily focus on consumption and urbanization. And we'll have Trump to at least partly thank for this crucial shift in China's economic development.

A history of the US-China trade war

Denotes tariff-related action

T **February 7, 2018** – US imposes Section 201 tariffs on solar panels and washing machines; China among countries included.

T **March 23, 2018** – US imposes Section 232 tariffs on steel and aluminum; China among countries included.

T **April 2, 2018** – China retaliates to US steel and aluminum tariffs by imposing tariffs on several US products, including aluminum waste and scrap and pork.

T **July 6, 2018** – US imposes Section 301 tariffs of 25% on $34bn of Chinese goods (List 1 products).

T **July 6, 2018** – China retaliates by imposing tariffs of 25% on $34bn of US goods.

July 13, 2018 – US lifts ban on Chinese telecoms firm ZTE.

T **August 23, 2018** – US imposes Section 301 tariffs of 25% on $16bn of Chinese goods (List 2 products).

T **August 23, 2018** – China retaliates by imposing 25% tariffs on $16bn of US goods.

T **September 24, 2018** – US imposes Section 301 tariffs of 10% on $200bn of Chinese goods (List 3 products).

T **September 24, 2018** – China retaliates by imposing 5-10% tariffs on $60bn of US goods.

T **January 1, 2019** – China suspends retaliatory tariffs on US auto goods.

T **February 7, 2019** – US reduces the Section 201 tariffs on solar panels and washing machines imposed one year ago.

T **May 10, 2019** – US imposes a step-up in the Section 301 tariffs on $200bn of Chinese goods from 10% to 25% (List 3 products).

May 15, 2019 – Trump signs Executive Order 13873, putting Huawei, a Chinese telecoms firm, on the Commerce Department's Entity List. As a result, Huawei is barred from buying components from US firms without special approval.

T **June 1, 2019** – China imposes a step-up in the tariff rate on the $60bn of US goods tariffed in Sept 2018.

June 29, 2019 – Following the G20 Summit, Trump announces that he and Xi Jinping have agreed to a "truce", under which the US and China will restart trade negotiations.

August 5, 2019 – US Treasury officially designates China as a currency manipulator.

August 5, 2019 – China allows the Yuan to weaken to above the 7 symbolic threshold against the Dollar.

September 1, 2019 – US imposes Section 301 tariffs of 15% on $120bn of Chinese goods (List 4A products).

September 1, 2019 – China retaliates by imposing 5% or 10% tariffs on $75bn of US goods.

December 13, 2019 – US and China reach "Phase One" trade deal, under which the US agrees to significantly modify its Section 301 tariff actions and China commits to substantial additional purchases of US goods and services in coming years.

January 15, 2020 – Trump and China Vice Premier Liu He sign the US-China Phase One trade deal.

February 7, 2020 – US further reduces the Section 201 tariffs on solar panels and washing machines imposed in 2018.

February 8, 2020 – US extends Section 232 tariffs to imports that use steel and aluminum.

February 14, 2020 – US reduces the Section 301 tariffs it imposed in Sept 2019 from 15% to 7.5% (List 4A products).

February 14, 2020 – China also reduces the retaliatory tariffs it imposed in Sept 2019 by half.

February 17, 2020 – China announces that it will grant tariff exemptions on 696 US goods.

May 12, 2020 – China announces tariff exemptions on additional 79 US goods.

September 26, 2020 – Commerce Department imposes restrictions on exports to SMIC, China's largest chipmaker.

January 6, 2021 – NYSE announces that it will delist US-traded shares of China Mobile, China Telecom, and China Unicom.

January 13, 2021 – Trump announces import ban on cotton and tomato products from Xinjiang over forced labor allegations.

February 7, 2021 – US further reduces the Section 201 tariffs on solar panels and washing machines imposed in 2018.

February 22, 2021 – China Foreign Minister Wang Yi calls for Biden to remove US tariffs and sanctions on Chinese companies.

May-June 2021 – Trade negotiations take place between China and US Biden Administration officials.

February 7, 2022 and 2023 – US further reduces the Section 201 tariffs on solar panels and washing machines imposed in 2018; washing machine tariffs expire in 2023.

October 7, 2022– The Bureau of Industry and Security issues set of export controls to restrict China's ability to purchase advanced computing chips and manufacture advanced chips critical for military advantage. Updated rules are released on **October 17, 2023**.

February 17, 2023 – China's Ministry of Commerce adds Lockheed Martin and Raytheon, two US defense companies, to its Unreliable Entity List. Under this designation, the entities are not permitted to purchase items from or make new investments in China, among other restrictions.

May 14, 2024 – Biden Administration announces that it will impose a 100% tariff on Chinese EVs, a 50% tariff on Chinese solar cells, and a 25% tariff on some Chinese steel and aluminum imports; tariff increases are to be phased in over three years.

November 25, 2024 – Trump posts on Truth Social that he will impose an additional 10% tariff on all Chinese imports to the US and that the tariffs will remain in place "until such time as [the drugs that are pouring into our country] stop".

November 26, 2024 – China state media warns that such action could drag the US and China into a tariff war, in which "there are no winners".

Note: List of actions is not exhaustive.
Source: USTR, Peterson Institute for International Economics, US Bureau of Industry and Security, various news sources, Goldman Sachs GIR.

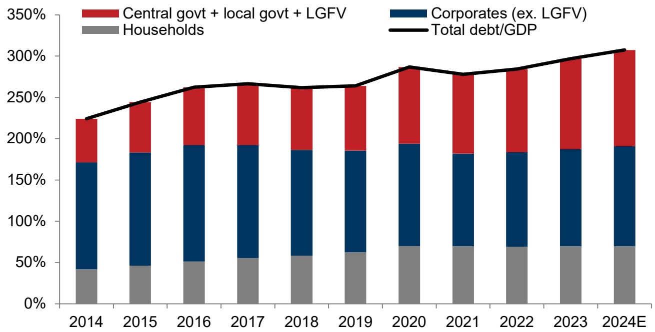
China releveraging: not systemic

Kenneth Ho details the magnitude of China's debt problems, arguing that they don't pose a systemic financial risk

In the eight years following the Global Financial Crisis (GFC), China experienced one of the largest credit booms on record, with the country's non-financial debt-to-GDP ratio rising by over 100pp to 262% by end-2016. Considerable efforts to rein in credit growth followed, with the leverage ratio remaining relatively unchanged from 2016 and 2019 and appearing to be back on a stable path in 2021 and 2022 following a pandemic-driven spike to 287% in 2020. But the last two years have witnessed a renewed rise in the leverage ratio as nominal growth slowed and government borrowing rose, with China's non-financial debt-to-GDP ratio increasing to 297% in 2023 and to an estimated 307%—RMB404.1 trillion—by end-2024.

Government borrowing on the back of the real estate downturn has driven leverage higher

Estimated total debt-to-GDP breakdown by borrower, %



Source: PBOC, Wind, Bloomberg, China Trustee Association, Asset Management Association of China, BIS, Chinabond, China Central Depository & Clearing, China Securities Finance Corporation, NFRA, company data, Goldman Sachs GIR.

Releveraging, courtesy of the real estate downturn

The years-long downturn in China's real estate sector has been a large driver of the recent rise in leverage, in several ways. One, property is the largest sector within China's economy, and the slowdown in real estate-related activity levels acted as a large drag on the economy, with nominal GDP growth slowing from 4.6% in 2023 to 4.2% in 2024. Two, local governments have heavily relied on land sales to generate revenues. The significant decline in land sales over the past two years has made local governments' borrowing needs more acute. And three, the real estate downturn accelerated the deleveraging trend among property developers and homeowners, adding pressure on the government to offset the negative growth impact with policy easing. As a result, government borrowing as a share of GDP has risen from 100% in 2022 to an estimated 116% by end-2024.

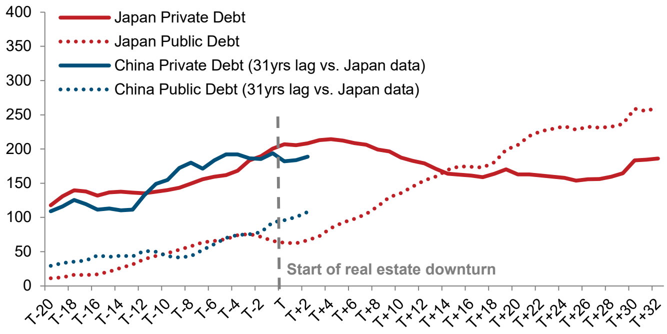
A not unusual situation

The historical paths of private and public leverage in China, Japan, the US, and the UK indicate that increases in government borrowing and private sector deleveraging are by no means unusual in the aftermath of a real estate downturn. In all these countries, the private sector delevered while public sector leverage increased following the downturns. The most notable example of this is Japan, where public sector leverage surpassed private sector leverage in 2004, with the gap showing no signs of closing even two decades later. We believe that Chinese policymakers can learn from Japan's experience and avoid a similar fate.

In China, the country's minimal reliance on external debt, sizable FX reserves, and only moderate banking sector leverage prevented the historic credit boom in the years following the GFC from becoming a financial crisis. Although releveraging has occurred over the past two years, we expect policymakers to remain focused on preventing the emergence of systemic concerns. We expect policymakers will continue to rein in "gray rhino" risks in the financial system—obvious risks that may lead to large credit problems. Although government borrowing has increased, shadow bank lending is substantially lower now compared with five years ago, and policymakers are focused on managing the deleveraging process in the property sector and on local government debt cleanup.

Increased government borrowing and private sector deleveraging tend to follow real estate downturns

Debt-to-GDP around real estate downturns (T-/+x indicates years removed from downturn), %



Source: IMF, Goldman Sachs GIR.

Systemic concerns remain in check

Despite these past experiences of debt buildups that resulted in crises, we believe systemic risk around China's current releveraging remains relatively low for many of the same reasons that prevented greater harm to the economy during its last major releveraging cycle. The recent rise in leverage is also much smaller in magnitude relative to the post-GFC credit boom, when the non-financial debt-to-GDP ratio rose by ~20pp per annum compared to ~10pp per annum over the past two years.

That said, our China economists expect debt in China to continue to rise in 2025, with the stock of total social financing—which includes all forms of financing within the economy—increasing by 9% in 2025 (compared to 8.2% this year). Looking further ahead, whether China's leverage growth will slow will likely depend on whether the property sector will stabilize and whether policy measures—much of which center on "new industrialization", i.e. increasing the country's global share of goods production and moving up the value chain to higher-tech manufacturing—will deliver stronger growth. Should these fail to materialize, the recent trend of rising leverage would likely continue.

Kenneth Ho, Chief Asia Credit Strategist

Email: kenneth.ho@gs.com *Goldman Sachs (Asia) L.L.C.*
Tel: 852-2978-7468

China's upcoming growth rotation

Andrew Tilton, Xinquan Chen, and Jonathan Sequeira argue that China's growth will likely rotate toward domestic demand in 2025

With the export environment looking more challenging heading into 2025, China will need more domestic demand next year to keep overall GDP growth near policymakers' target. China's economy suffered from weak domestic demand in 2024, as the services-oriented post-pandemic reopening boost faded and the years-long housing downturn continued to weigh on activity—directly via a fall in residential construction, and indirectly via its impact on household sentiment and consumer spending. While the property downturn will likely remain a headwind to consumer confidence, we expect a growth rotation toward domestic activity (ex-housing) in 2025 supported by policy stimulus, with the composition of consumption likely to tilt toward durable goods.

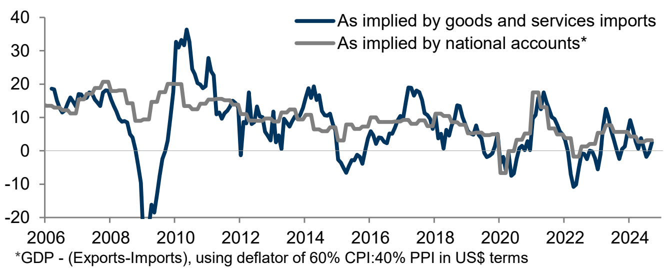
Gauging the weakness in domestic demand

China's domestic activity is hard to gauge confidently on a high-frequency basis because China (unusually among major economies) does not publish quarterly real expenditure-side GDP data. For consumption, only retail sales data—not total consumption—are available on a monthly basis. The monthly fixed asset investment data have a different definition than national accounts investment and are only available in nominal terms. To the extent that it can be inferred from national accounts, domestic demand seems implausibly smooth over periods such as the Global Financial Crisis.

Using a novel estimate of domestic demand based on detailed sectoral import flows, which serve as a kind of x-ray of the underlying economy from which we can infer the strength of consumption and investment, we find that China's real domestic demand declined during the pandemic lockdowns in mid-2022 and is currently growing in the neighborhood of 2.5% yoy, significantly below the average pace of the last 20 years.

Weak domestic demand over recent years

Chinese real US$ domestic demand, % yoy, 3m moving average



Source: Haver Analytics, Goldman Sachs GIR.

A growth rotation toward domestic demand...

As frontloading of exports to the US ahead of the likely rise in US tariffs fades—and exports slow sharply from their double-digit 2024 pace—domestic demand will need to rise to ensure that China's economy grows anywhere near policymakers' aspirations. We expect this to be the case next year.

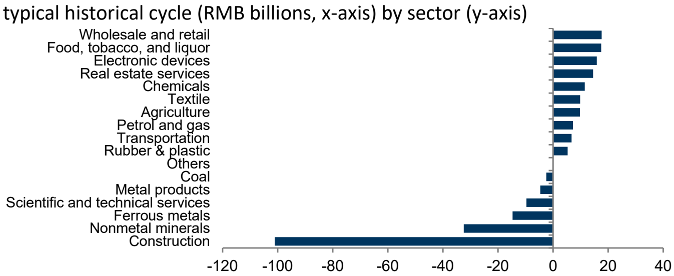
...that spurs a new growth pattern

This growth rotation toward domestic demand, combined with our expectation of softer (but still relatively healthy) export growth, continued housing drag, and policy support for selected components of investment in 2025, should produce a growth pattern distinct from past cycles along four dimensions[1]:

1. **A further pivot from construction to manufacturing.** In this cycle, the "big losers" from a sector perspective—construction and some related raw material inputs—are more obvious than the diffuse set of winners. The ongoing housing downturn means construction activity and materials that are heavily used in that sector (nonmetal minerals, ferrous metals) should weaken further. Conversely, wholesale/retail trade and a range of manufacturing sectors, including food and beverage, electronics, chemicals, and textiles, should modestly improve on the back of consumption subsidies.
2. **Goods consumption to play a larger role in growth.** Policy incentives such as the consumer goods trade-in program, likely to be scaled up next year (see pgs. 4-5), should support durable goods consumption in 2025. So, we expect goods consumption to play a larger role in growth next year than in past cycles, contributing just over 25% of the 4.5% real GDP growth we forecast (vs. ~10% in the typical pre-Covid cycle).
3. **A stronger import multiplier than during the Covid reopening cycle.** Services consumption dominated growth in 2023, with very limited spillovers to China's imports. We find that the "import multiplier"—the increased amount of imports per unit increase in final demand for a particular sector—is much lower for services consumption. With a more balanced mix of exports, goods consumption, and investment likely in 2025, the import intensity of China's growth should moderately improve.
4. **A rotation of imports from construction commodities to electronics, energy, and chemicals.** The shift from residential construction demand to consumer goods (notably, durable goods) should also shift the composition of imports somewhat toward electronics, energy, and chemicals.

A different sectoral growth composition likely ahead

Changes to gross value added per 1pp of GDP in current cycle relative to typical historical cycle (RMB billions, x-axis) by sector (y-axis)



Source: NBS, Goldman Sachs GIR.

Andrew Tilton, Chief Asia Pacific Economist

Email: *andrew.tilton@gs.com* *Goldman Sachs (Asia) LLC*
Tel: *852-2978-1802*

Xinquan Chen, Senior China Economist

Email: *xinquan.chen@gs.com* *Goldman Sachs (Asia) LLC*
Tel: *852-2978-2418*

Jonathan Sequeira, Senior ASEAN Economist

Email: *jonathan.sequeira@gs.com* *Goldman Sachs (Singapore) Pte*
Tel: *65-6889-2472*

[1] We map the shifts we expect in demand next year to industries using China's input-output tables to estimate the likely shifts in the composition of sector-level activity. Note that our analysis looks at a modest shift toward consumption overall; in practice, the composition of consumption might tilt slightly more toward durable goods.

China policy easing cycles, compared

Policy easing cycles	Background	Money, credit and tax			Demand-side stimulus		
		Monetary	Credit	Tax	Property	Infrastructure	Consumption
2008-09	Global Financial Crisis and Wenchuan earthquake in 2008	3 RRR cuts (totaling 200bp) for large banks; 4 RRR cuts (totaling 400bp) for small and medium-sized banks; 5 policy rate cuts (totaling 216bp)	Boosting the financing of local government financing vehicles (LGFVs)	N.A.	Cutting taxes on property purchase and transactions, lowering mortgage loan rates and downpayment ratios, supporting financing needs from developers, and launching housing construction programs for low-income groups in 2008-10	RMB4tn stimulus package to boost infrastructure investment, especially on nationwide high-speed railway network	Auto purchase tax cuts (to 5% in 2009 from 10%, before reversing to 7.5% in 2010 and 10% in 2011), "go rural" program for home appliances, and fiscal subsidies for auto and home appliance replacement
2015-16	Stock market crash in 2015, RMB market turmoil in 2015-16, high housing inventory in lower-tier cities, a deterioration in Greek debt crisis in 2015, Brexit in 2016	5 RRR cuts (totaling 300bp), 6 policy rate cuts (totaling 165bp), targeted RRR cuts, PSL, MLF cuts	Boosting the financing via corporate bonds, peer-to-peer (P2P) lending, share pledge financing	Replacing the business tax with VAT	PSL-backed shantytown renovation program (SRP) in lower-tier cities, cutting mortgage loan rates and downpayment ratios, cutting taxes on property transactions, removing/easing home purchase restrictions in Tier-2/3 cities, and facilitating developer offshore dollar bond financing	Launching public-private partnership (PPP) programs in 2015, boosting local government special bond issuance, and lowering capital requirement for investment projects	Auto purchase tax cuts (to 5% in 2016 from 10%, before reversing to 7.5% in 2017 and 10% in 2018)
2018-19	Deleveraging campaign in 2017-18, an escalation of US-China trade conflicts in 2018-19	6 RRR cuts (totaling 400bp broad-based, plus targeted cuts), criteria easing for targeted RRR cuts, TMLF	Adjusting key parameters in the PBOC's Macroprudential Assessment (MPA) framework, increasing bank loan quota, introducing central bank bill swap program for bank perpetual bond issuance	Cutting VAT rate, raising the threshold for individual income tax (IIT) exemption from RMB3.5k/month to RMB5k/month or RMB60k/year, and introducing IIT reduction items	N.A.	Intensively launching infrastructure investment projects, especially on rail and urban transit systems, allowing local government special bonds (LGSB) proceeds to be used as equity capital for projects in select investment areas	Fiscal subsidies for the purchase and replacement of qualifying home appliances, auto replacement in rural areas, relaxation of car plate restrictions in large cities
2020	Global Covid-19 pandemic	3 RRR cuts (totaling 50bp, plus targeted cuts), relending and rediscounting, 2 policy rate cuts (totaling 30bp)	Supporting the financing of SMEs and Covid-hit sectors, increasing credit support from policy banks, using some LGSB proceeds to replenish the equity capital for small banks	Tax cuts (mainly VAT cut for small taxpayers), waivers of social security fees, lowering utilities costs for SMEs	N.A. (instead, policymakers enacted some property tightening measures beginning in summer 2020, including the "Three Red Lines" to curb property developer debt)	Boosting infrastructure investment, supporting the financing of LGFVs, rolling out central government special bonds (CGSB) to counteract Covid pandemic, increasing transfer payments from the central to local governments	Small-scale consumption coupons in some large cities
Sep 2024 untill now (as of Nov)	Prolonged property downturn, increased fiscal funding challenges, weak domestic confidence, heightened geopolitical uncertainties	1 RRR cut (50bp) + PBOC forward guidance for another 25-50bp RRR cut by year-end, 1 policy rate cut (20bp), a 20-25bp cut to deposit rates, RMB800bn PBOC funding support for the equity market, continued PBOC purchases of CGBs	A 25bp LPR cut to lower the financing costs for the real economy	Tax cuts to facilitate property purchases and transactions	Cutting nationwide minimum downpayment ratio to 15%, removing home purchase restrictions in most cities, a 50bp cut to existing mortgage rates, allowing LGSB to be used for purchasing raw lands and housing inventory, cash-backed settlement of 1mn unit urban village renovation	A RMB10tn local govt debt resolution for 2024-28, pledging for ultra-long-term CGSB issuance to help large banks replenish equity capital, and more central govt debt financing in future; frontloading RMB200bn-worth of investment projects from 2025 for early start in late 2024	Subsidized consumer goods trade-in and equipment upgrade program, small subsidies to targeted groups and students; pledging to increase policy support for auto, home appliance, and electronics products

Source: Government websites, compiled by Goldman Sachs GIR.

Special thanks to China Economist Lisheng Wang for the table.

More stimulus, but no bazooka

Lisheng Wang expects more policy easing ahead, but argues the magnitude will likely remain smaller than prior major easing cycles

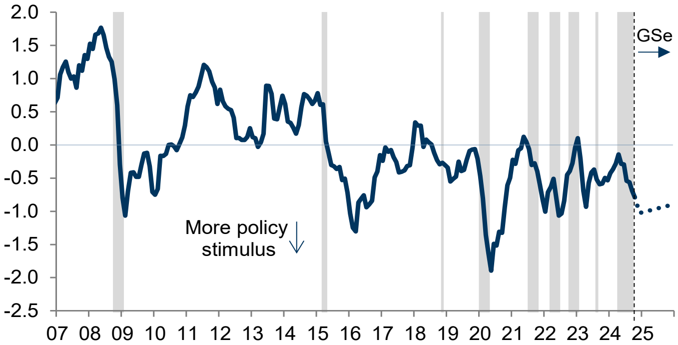
Despite persistent weakness in business and household confidence as well as deteriorating domestic demand, Chinese policymakers have only recently stepped up much-needed policy support amid rising concern that this year's "around 5%" real GDP growth target may be slipping out of reach. This delayed response stands in stark contrast to policymakers' prior willingness to deliver forceful countercyclical measures amid growth slowdowns, indicating a significant shift in their reaction function. As such, while we expect further policy easing in 2025 and beyond, the magnitude of easing will likely remain smaller than prior major easing cycles in the last two decades.

Less appetite for bazooka stimulus

Several reasons explain policymakers' changed reaction function. First, policymakers now view prior stimulus packages as excessive. Indeed, while the 2008-09 RMB4 trillion stimulus package during the Global Financial Crisis and the nationwide cash-backed shantytown redevelopment program during 2015-18 led to rapid growth recoveries, policymakers recognized that these measures have triggered significant structural problems, including the accumulation of local government implicit debt and unaffordable property prices. Second, current easing measures aim to put a floor under economic growth rather than engineer a dramatic growth rebound, which policymakers instead hope to achieve through technological innovation and greater self-reliance. And third, policymakers may wish to preserve policy space in the event of even greater economic pressure from renewed trade tensions during the upcoming second Trump Administration. As such, while we continue to expect further policy easing in 2025 and beyond, the magnitude will likely be smaller than the stimulus packages delivered in 2008-09, 2015-16, and 2020.

China's policy easing may continue in 2025 and even beyond

China domestic macro policy proxy, z-score



Note: Shaded areas indicate China CAI 3mma growth below 5%.
Source: Goldman Sachs GIR.

Significant, but smaller, stimulus

Similar to past major easing cycles, we expect **fiscal easing** will do the heavy lifting to stabilize growth, but the composition of this easing will likely differ substantially from past cycles, with more focus on consumption (e.g., the government-subsidized consumer goods trade-in program), high-tech manufacturing, and risk containment rather than traditional infrastructure and property investment. Specifically, we expect policymakers to raise the official fiscal deficit and expand the quota for central and local government special bond issuance in 2025, contributing to a 1.8pp of GDP widening in China's augmented fiscal deficit (AFD). But this widening pales in comparison to the over 5pp widening in AFD that took place in 2008-09, 2014-16, and 2020. And we expect total government bond issuance to rise from RMB9 trillion in 2024 to RMB12 trillion in 2025—a net increase of RMB3 trillion, or 2.5% of GDP—much lower than the 2008-09 RMB4 trillion fiscal package, which was equivalent to 12% of GDP. Given the size of China's economy today, an equivalent stimulus package would total over RMB15 trillion.

That said, the benefits of the recently-unveiled local government debt swap plan—RMB10 trillion issuance quota for debt swaps over 2024-28—extend beyond interest savings. Given that part of the refinancing bond proceeds can be allocated toward repaying arrears to corporates as well as delayed salaries to civil servants, we estimate that the plan could boost China's real GDP level by over half a percent, which investors appear to be underappreciating (see pgs. 4-5).

Following larger-than-expected **monetary easing** in recent months, we also expect further PBOC support, including two 20bp policy rate cuts and two 25bp RRR cuts as well as increased central government bond (CGB) purchases next year. The 40bp policy rate cut that we expect for 2025 would be the largest single-year cut since 2015.

We also expect more **property easing**, including further mortgage rate reductions and greater funding for local government purchases of housing inventory, though property market support will remain more muted than in previous cycles when the property market served as the key lever for policymakers to boost growth.

Lastly, policymakers are experimenting with new policy areas to boost consumer confidence and spending, such as the PBOC's recently announced direct funding support for the **equity market** in the form of a RMB500 billion swap facility to encourage non-bank financial institutions' stock purchases and a RMB300 billion relending program for listed companies to conduct share buybacks.

Structural reforms needed to address China's challenges

Overall, we believe recent and upcoming policy stimulus will be meaningful, if not as large as in past easing cycles. But policy transmission could be less efficient than in prior easing cycles amid the prolonged property downturn and weak consumer confidence. And, importantly, the RMB4 trillion government spending in 2008-09 led to substantially more bank lending and credit creation that further fueled economic growth. Such a transmission mechanism no longer exists as banks prioritize risk containment and the private sector leans toward reducing debt in today's environment. So, a more sustained positive shift in China's economic outlook will require policymakers to implement structural reforms that increase household income, strengthen the social safety net, and bolster business confidence to drive private consumption and investment higher.

Lisheng Wang, Senior China Economist

Email: lisheng.wang@gs.com *Goldman Sachs (Asia) LLC*
Tel: 852-3966-4004

Different growth, different spillovers

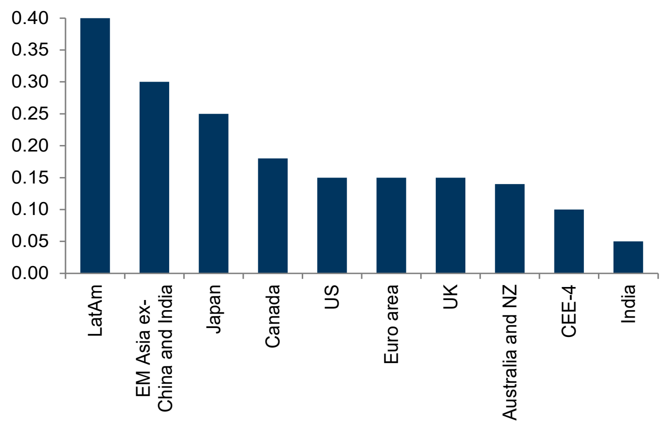
Joseph Briggs argues that spillovers from China to the rest of the world could look different next year than in past cycles

China's economy will face an unusual set of growth impulses in 2025, most prominently, a drag from likely higher US tariffs on Chinese imports that we expect will slow real GDP growth by 0.7pp (largely by slowing real export growth to zero following double-digit growth in 2024) and a sizable boost from increased domestic fiscal support as policymakers lean against the wind to support growth in the face of this new external risk and ongoing internal challenges.

These growth impulses will not only affect China's growth outlook next year—our China economists expect real GDP growth of 4.5% in 2025—but also other economies given the large size of China's economy. While our standard rules of thumb assume that each 1% increase in China GDP raises GDP elsewhere by 0.1-0.4%, the economic and policy backdrop and composition of China growth in 2025 should look very different than in typical economic cycles, suggesting that spillovers to other major economies could also diverge from historical patterns. We see three ways in which foreign spillovers from China could prove unusual next year.

Our standard rules of thumb imply moderate foreign spillovers from a China growth acceleration

GS estimates of the effect of a 1pp cyclical China growth acceleration on GDP over the next 1-2 years, % of GDP



Source: Haver Analytics, Goldman Sachs GIR.

Smaller spillovers from China GDP

First, we expect that the direct spillovers from China activity to other economies will be smaller than our historical rules of thumb suggest. The composition of China's GDP growth will likely be more skewed toward domestic consumption than industrial activity and investment. Given that domestic consumption is, on average, less dependent on foreign inputs, we anticipate that the composition of Chinese growth in 2025 will lead to smaller downstream impacts on foreign economies.

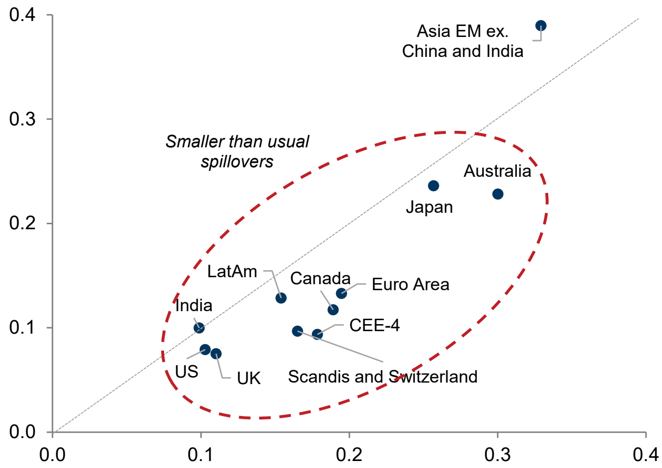
Investment in China (particularly housing investment) has also accounted for a meaningful share of global commodities demand in recent cycles, which affects the global economy via its impact on metals and, to a lesser extent, oil prices. While stronger Chinese growth would likely put some upward pressure on global commodity prices, the shift away from housing investment could dampen this channel's impact, particularly for countries that produce commodities typically used in construction (e.g., nonmetal minerals, ferrous metals).

Finally, although we expect softer (but not negative) Chinese real export growth in 2025 relative to 2024, the export impulse should remain larger than most other recent cycles given strong export momentum. So, we assume that more resilient than normal Chinese exports will raise growth spillovers to regional economies that provide intermediate production inputs but lower them for trade competitors like Europe relative to past cycles.

Taken together, we estimate that each 1% increase in China GDP will, on average, only raise GDP elsewhere by 0.13% compared to 0.16% historically. Our spillover estimates are also smaller than normal in most economies—particularly commodity exporters (e.g., Canada and Australia) and trade competitors (e.g., Europe)—but slightly larger than normal for regional Asian economies more exposed to Chinese spending and export-related production.

China growth spillovers will likely be smaller than normal in most economies

Effect of a 1pp growth acceleration in China growth: typical vs. current cycle, pp (grey line is a 45-degree line)



Source: Haver Analytics, Goldman Sachs GIR.

These relatively small spillover estimates, combined with the relatively modest change to our China GDP forecast (to 4.5% from 4.7% after embedding announced and expected policy developments), leads us to expect that China activity will have fairly small spillovers to other economies in 2025, particularly when benchmarked against the large amount of domestic growth news received over the last several months.

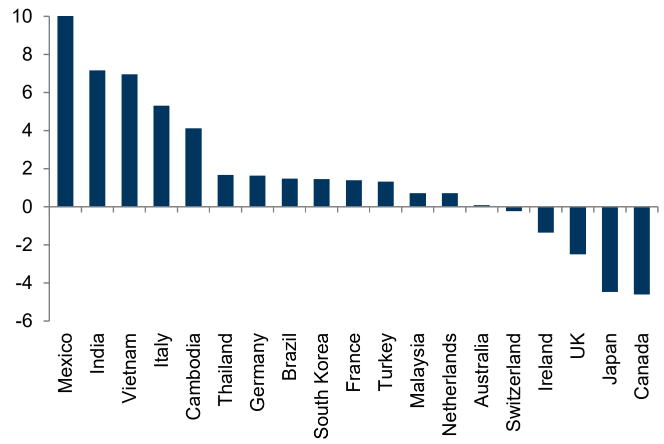
Tariff-driven trade reallocation could create winners

Second, we expect that higher US tariffs could lower demand for Chinese products and increase demand for foreign substitutes. These patterns could accelerate "supply chain de-risking" trends already underway and provide a positive growth impulse for countries that benefit from the reallocation of Chinese production.

Utilizing product-level changes in US-China tariff rates and export growth from third-party countries, we have found that US tariffs on China explained just under half of the shift in US trade away from China during the 2018-2019 trade war, with Cambodia, Vietnam, Mexico, and India benefiting meaningfully from a tariff-induced boost to exports.

Cambodia, Vietnam, Mexico, and India increased trade in tariffed goods with the US during the last trade war

Reallocation of exports to the US, 2017-19, $bn



Source: Haver Analytics, Goldman Sachs GIR.

The extent to which other countries will benefit from the reallocation of Chinese trade this time around will depend on whether trade gains reflect actual shifts in production or the superficial re-export of Chinese-made goods for tariff avoidance purposes. We find that production shifts that had real economic effects on bystander economies largely drove the trade reallocation of the 2018-2019 trade war. The re-export of Chinese goods can explain only around a third of the total tariff-driven trade reallocation, with value-added production in bystander economies accounting for the balance[1]. And several countries (particularly Vietnam and Mexico) that experienced the largest post-tariff gains in US trade also significantly increased their exports to other trade partners[2]. This suggests that the trade shock from US-China tariffs prompted bystander countries to expand production capacity or pursue new trade agreements that became more cost-effective following an increase in US demand for their products.

Production and trade reallocation could look very different in 2025 than in 2018-2019, particularly since the tariff shock could be much bigger and shifts in global value chains could be more advanced. But our analysis highlights that tariff-driven trade reallocation would likely generate some winners in the short-run—with Mexico and other Southeast Asian economies most likely to benefit—and help offset the drag on global investment that we expect from elevated trade policy uncertainty.

Tariff-driven supply increases could put downward pressure on DM inflation

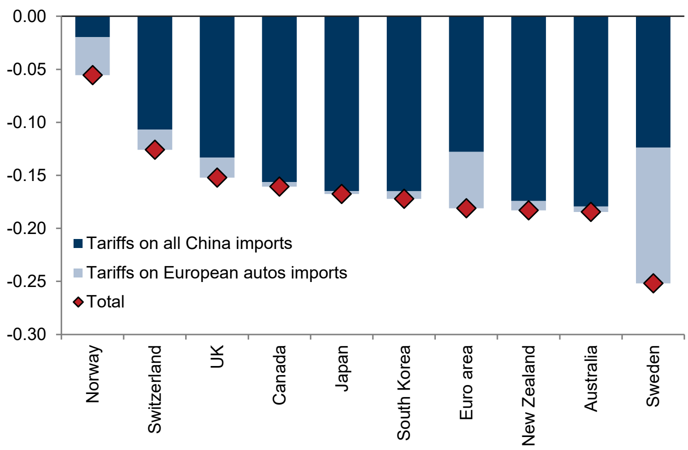
Third, we expect that lower US demand for Chinese-made goods, combined with efforts by Chinese companies to sustain current production levels, could lead to increases in the supply of Chinese goods to other major economies, putting modest downward pressure on ex-US core prices. Several central bank officials—including ECB President Lagarde and RBA Governor Bullock—have raised this point to emphasize that a global trade war would not necessarily be inflationary and that the net inflation impact would depend on how countries retaliate.

Specifically, we have estimated that each 1pp increase in product-level tariffs lowered US import demand for Chinese products by 1-2% during the last trade war. If this pattern repeats, lower US import demand could lead to around $100bn in goods being reallocated to other economies under our baseline tariff expectations.

The overall inflation impact will depend on how trade is reallocated, but product-level trade patterns suggest that this reallocation will increase goods supply in non-US DMs by 0.2-0.7%. Combined with estimates that each 1pp increase in domestic goods supply from low-wage countries lowers consumer prices by around 0.8%, we estimate a 0.1-0.2% hit to overall core prices in ex. US DMs. We also see scope for downward inflation pressures in major EM economies that saw a larger supply response to US tariffs during the last trade war.

Tariff-induced reallocations of Chinese goods could lower prices in non-US DMs by 0.1-0.2%

Combined supply reallocation impact on core inflation, pp



Source: United Nations Comtrade Database, Goldman Sachs GIR.

Offsets to a trade drag

As discussed in our 2025 macro outlook, we estimate that US trade policy shifts will subtract 0.4% from global GDP, with the potential impact 2-3x larger if the US were to impose a 10% across-the-board tariff on all trade partners. This headwind and the potential for escalation suggests a riskier macro outlook next year, but we view (albeit smaller than normal) foreign spillovers from policy-driven China GDP growth, the potential reallocation of Chinese production to other EMs, and downward pressure on core goods prices from tariff-induced increases in goods supply as potential offsets that may help blunt the impact on global ex-China growth.

Joseph Briggs, Senior Global Economist

Email: *joseph.briggs@gs.com* *Goldman Sachs & Co. LLC*
Tel: *212-902-2163*

[1] We find this by extending our analysis to consider the product-level relationship between US tariffs on China and Chinese exports to third-party countries.
[2] We find this by extending our analysis to consider the product-level relationship between US tariffs on China and bystander economy exports to rest of world ex. US.

Trump on China

"I've read hundreds of books about China over the decades. I know the Chinese. I've made a lot of money with the Chinese. I understand the Chinese mind."

- The Art of the Deal, 1987

"The most important difference in America's new approach on trade concerns our relationship with China. In 2001, China was admitted to the World Trade Organization. Our leaders then argued that this decision would compel China to liberalize its economy and strengthen protections to provide things that were unacceptable to us, and for private property and for the rule of law. Two decades later, this theory has been tested and proven completely wrong. Not only has China declined to adopt promised reforms, it has embraced an economic model dependent on massive market barriers, heavy state subsidies, currency manipulation, product dumping, forced technology transfers, and the theft of intellectual property and also trade secrets on a grand scale."

- UN General Assembly remarks, September 2019

"China's pattern of misconduct is well known. For decades, they have ripped off the United States like no one has ever done before. Hundreds of billions of dollars a year were lost dealing with China, especially over the years during the prior administration. China raided our factories, offshored our jobs, gutted our industries, stole our intellectual property, and violated their commitments under the World Trade Organization. To make matters worse, they are considered a developing nation getting all sorts of benefits that others, including the United States, are not entitled to."

- Remarks on the Administration's actions against China, May 2020

"President Trump will also REVOKE China's Most Favored Nation trade status. It is long past time China stops getting preferential treatment as they undermine American national security interests around the world."

- Trump-Vance Campaign Platform, June 2023

"Think of President Xi. Central casting. Brilliant guy. You know, when I say he's brilliant, everyone says, 'oh, that's terrible'. Well, he runs 1.4 billion people with an iron fist. Smart, brilliant, everything perfect. There's nobody in Hollywood like this guy. "

- Remarks at a Fox News town hall, July 2023

"I think there is no greater critic of China than me. But I respected China and I respected President Xi and I had a great relationship with them. They took advantage of us. And why shouldn't they? I mean, if we were stupid enough to let them do it, they made hundreds of billions of dollars a year, $507 billion, most years over that and now it's more, and I had them down to a much smaller. And I put massive tariffs on them. Nobody got any money from China, but I got hundreds of billions of dollars from China. I think that we will have a good relationship. I'd rather have a good relationship with China."

- Interview with Fox News Host Mark Levin, August 2024

"Oh, very easy. I had a very strong relationship with him. He was actually a really good, I don't want to say friend—I don't want to act foolish, 'he was my friend'—but I got along with him great. He stayed at Mar-a-Lago with me, so we got to know each other great. He's a very fierce person."

- Response to a Wall Street Journal interview question on how he would persuade Xi to stand down from a blockade of Taiwan, October 2024

"I have had many talks with China about the massive amounts of drugs, in particular Fentanyl, being sent into the United States – But to no avail. Representatives of China told me that they would institute their maximum penalty, that of death, for any drug dealers caught doing this but, unfortunately, they never followed through, and drugs are pouring into our Country, mostly through Mexico, at levels never seen before. Until such time as they stop, we will be charging China an additional 10% Tariff, above any additional Tariffs, on all of their many products coming into the United States of America."

- Truth Social post, November 2024

Source: The White House, WSJ, The Art of the Deal, Fox News, campaign platforms, Truth Social, compiled by Goldman Sachs GIR.

The China growth trade

Vickie Chang sees potential for markets to price modestly more China growth upside

Following a sharp rise in the market's China growth expectations around the significant step-up in policy easing in late September, markets have now largely retraced amid slow-to-materialize policy details and renewed US-China trade risks. The key question now is whether this reversal has gone too far and what the skew of risks is going forward. We ultimately see modest room for markets to price more China growth upside from here, but see risks in both directions. The wide range of possible outcomes, in China and elsewhere, suggests that any declines in volatility across assets in 2025 are likely to provide the best opportunities to add exposure.

Markets digesting opposing growth forces

Market expectations for China growth began to rise ahead of the government stimulus announcements that kicked off in late September. We estimate that the market upgraded its 1y-ahead China growth expectations by roughly 1.5pp from the September lows to the peak in early October. However, much of that optimism has now retraced as slow-to-materialize details on the fiscal stimulus package disappointed investors and Trump's reelection sparked renewed growth risks.

Directionally, these shifts in market pricing make sense. Our economists upgraded their own China growth forecasts on the back of the more forceful and coordinated stimulus in September, but subsequently lowered them following the US election given likely higher tariffs in Trump's second term. On net, their 2025 China GDP growth forecast at 4.5% (see pgs. 4-5) remains marginally higher than their 4.3% forecast prior to the stimulus announcements but 20bp lower than their peak (4.7%) expectations before the election.

The market priced China growth sharply higher from September to October, but has now reversed much of that optimism

Estimated country growth factors, index

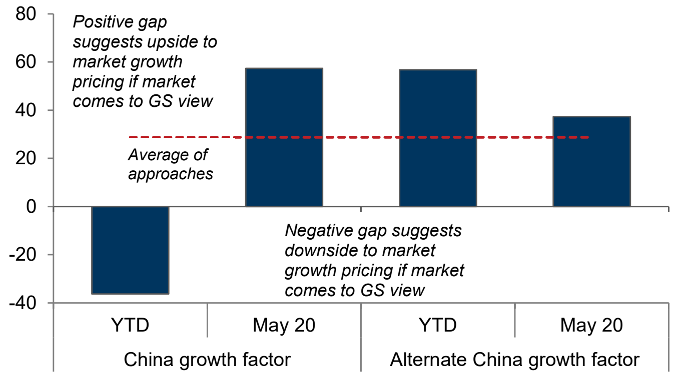
Source: Goldman Sachs GIR.

Room for upside

To assess if market pricing has now become too optimistic or pessimistic relative to these shifts in fundamentals, we turn to two versions of our China growth factor, which is a market-based measure of how market expectations of Chinese growth are evolving. We compare the evolution in our growth factors to the change in consensus growth forecasts since the start of the year as well as since the late May peak in China growth sentiment[1]. This analysis suggests that at the October peak, market pricing of China growth had potentially overshot even our growth forecasts, which were above-consensus at the time. But market growth pricing is now closer to fair, and while the conclusions depend somewhat on the approach, averaging across approaches suggests some modest upside risk to market pricing if the market moves toward our growth view[2].

Room for modest upside exists if market pricing moves toward our baseline forecast

Est. gap between GS China 1y-ahead GDP forecast and market pricing, bp



Source: Goldman Sachs GIR.

Two-sided risks

That said, material downside and upside risks to China's cyclical outlook exist. US tariffs could be greater than the 20pp increase in the effective US tariff rate our economists currently expect, and implementation of the announced stimulus could be disappointing. But it is also possible that Chinese exports prove more resilient than expected or that policymakers deliver more aggressive stimulus than we are currently assuming. Chinese policymakers have again signaled a stronger willingness to support domestic growth into next year, but policy implementation will ultimately be key for the effectiveness of any stimulus. All told, while our frameworks suggest that room for modest upside may now exist if market pricing moves toward our baseline forecast, if the market pulls back further without a material shift in details around tariff or stimulus policy, it will become clearer that the balance of risks to market pricing skews to the upside.

This outlook is more balanced than it is for many other markets, including for Europe, where we think tariffs are less widely expected and less reflected in asset prices. So, the risks around trade policy skew more firmly to the downside there. The wide range of potential market outcomes, including in China, also suggests that any declines in volatility across assets next year are likely to provide the best opportunities to add exposure.

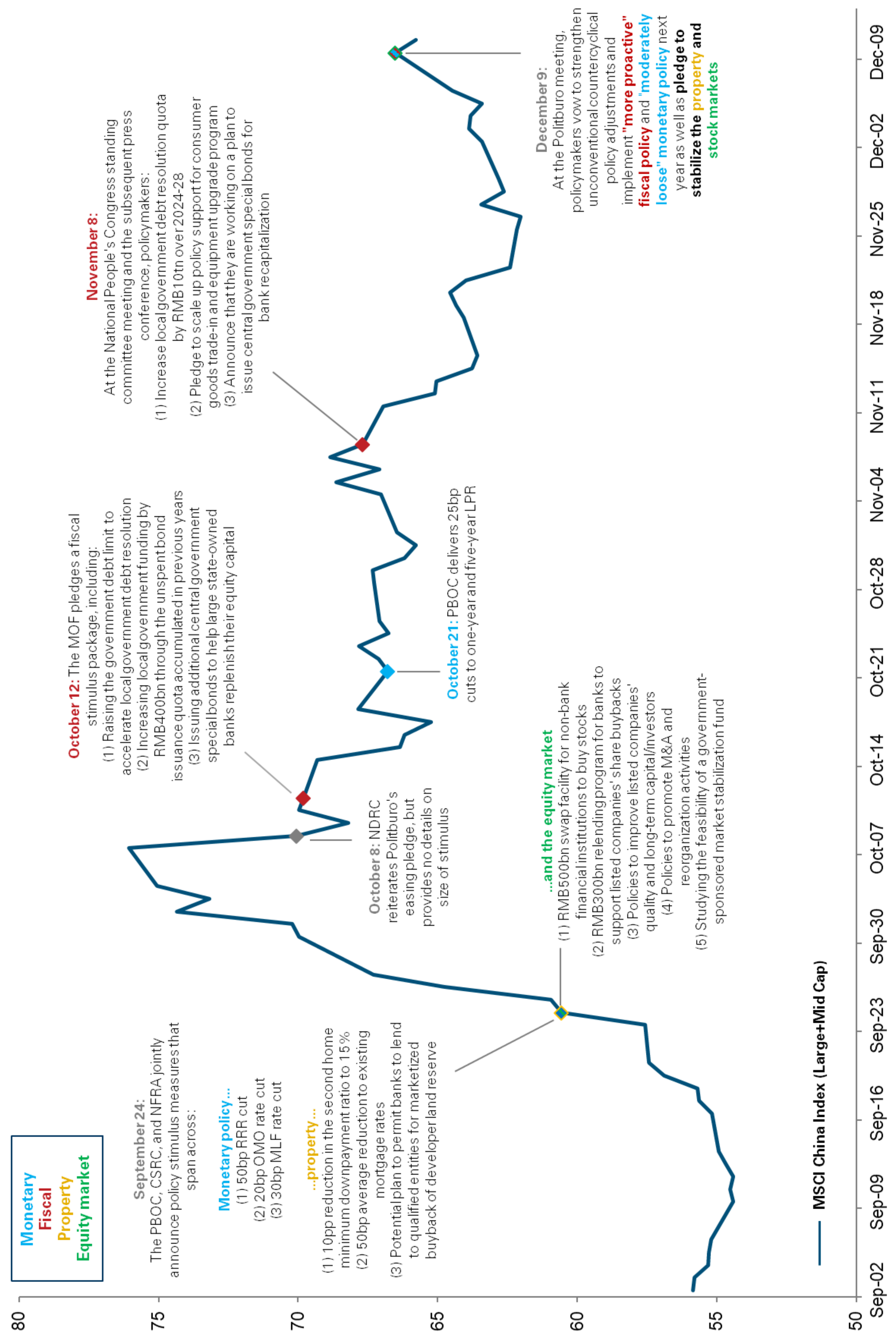
Vickie Chang, Senior Global Markets Strategist

Email: *vickie.chang@gs.com* *Goldman Sachs & Co. LLC*
Tel: *212-902-6915*

[1] Our primary approach calculates a China growth factor as the common component of changes in on and offshore Chinese equities, the trade-weighted AUD, and copper prices. We also consider an "alternate" China growth factor that tracks moves in Chinese equities as well as short- and long-term Chinese rates. We use the relationship between changes in our growth factors and changes in consensus forecast revisions to translate growth factor changes into changes in 1y-ahead GDP views.

[2] Based on the change between our view now and the consensus growth forecast at the starting point, averaged across our various approaches.

The ups and downs of China stimulus



Data as of December 10, 2024.
Source: MSCI, Goldman Sachs GIR.

A snapshot of our China asset views

What is the outlook for your asset class?

CNY

Danny Suwanapruti

- We see room for further CNY depreciation ahead and expect USD/CNY to rise to 7.4/7.5/7.5 on a 3/6/12m horizon (from 7.26 currently) reflecting broad US strength, lackluster Chinese growth, still-wide rate differentials between the US and China, and, notably, US tariff risk.
- We expect Chinese policymakers to allow some FX depreciation to offset the growth drag from higher US tariffs (alongside further monetary and fiscal easing) with CNY depreciation likely to materialize even before tariffs are implemented. The sharpest moves in USD/CNY during the 2018-2019 trade war occurred after the announcement of tariffs rather than around implementation and CNY has already depreciated by over 2% against the Dollar since the US election outcome.
- However, given the costs associated with excessive FX weakness—including potentially fueling further depreciation expectations and capital outflows—the PBOC will likely be proactive in managing the pace of CNY depreciation.

CHINA RATES

Xinquan Chen

- Given our expectations for the PBOC to intensify monetary policy easing next year, CNY interest rates will likely trend lower in 2025. The two 20bp policy rate cuts we expect next year as well as the PBOC's pledge to guide short-term money market rates closer to policy rates, should lower the 7-day repo rate from 1.5% to 1.1% by end-2025.
- While we expect long-term rates—including 10-year Chinese Government Bond (CGB) yields—to fall in sync, the decline will likely be smaller given likely higher long-term government bond supply next year and the PBOC's efforts to steepen the CGB yield curve.
- While the path of interest rate declines could be bumpy given potential funding shortages amid the large volume of government bond issuance, we expect the PBOC to inject liquidity, including through CGB purchases, outright reverse repos, and RRR rate cuts.

CHINA CREDIT

Kenneth Ho

- While China USD bond defaults have reached record-high levels in recent years amid the policy tightening in the property sector that began in late 2020, we believe the worst is now behind us. We expect the China property HY default rate to drop to 19.2% next year from around 48% in 2022 through 2024. And with over 90% of China property HY bonds having either defaulted or conducted bond exchanges already, the impact of further defaults is likely to be muted.
- Outside of the property sector, we expect credit stresses to remain benign as policy easing continues to curb tail risk in China (including measures such as the RMB10 trillion local government debt swap, plans for bank recapitalization, and further demand stimulus). We also expect robust credit growth ahead, with our China economists forecasting Total Social Financing stock growth of 9% yoy in 2025 (versus 8.2% yoy in 2024).
- Given that, we prefer China BBB credits, particularly those that carry the widest spreads. And within the HY space, we prefer China BB. For China property HY, given the difficulties of identifying which issuers will remain current and which will engage in bond exchanges or will default, we believe an up-in-quality approach is appropriate.

CHINA EQUITIES

Kinger Lau

- We expect MSCI China/CSI300 to appreciate 15%-20% in 2025, driven by our 7%/10% EPS growth forecasts and moderate valuation gains. While the recent step-up in Chinese stimulus has curtailed the extreme left-tail scenarios, our forecasts remain lower than prior to Trump's reelection and consensus estimates as policy stimulus will likely only partially offset US tariff drags.
- The policy-induced shifts in capital flows could accelerate in 2025, with corporate, onshore retail, Southbound, and quasi-government investors likely ratcheting up their stock ownership. However, global hedge fund investors will probably continue to approach China equity opportunistically until the longer-term growth and policy outlooks become clearer.
- Generally low investor positioning points to a favorable risk/reward for Chinese equities, underpinning our continued Overweight recommendation for both China A- and H-shares in our regional allocation framework. We maintain a tactical bias for China A-shares given their more favorable exposures to policy easing, lower sensitivity to DM tariffs and RMB depreciation risks, and a more supportive domestic liquidity backdrop.
- Sectorally, we prefer a broad consumption-tilt, and have upgraded Healthcare and Brokers to Overweight, driven by select Old-Economy Cyclicals. We see themes of government consumption proxies, EM exporters/RMB depreciation beneficiaries, New Tech/Infrastructure proxies, and income strategies as ways to capitalize on potential policy dividends.

A snapshot of our global asset views

How will developments in China impact your asset class?

REGIONAL EQUITIES

Timothy Moe

- Developments in China can spill over to the Asia Pacific region through three core channels. First, regional economies are sensitive to changes in China's economic growth through the impact it has on China's final demand given that China's imports account for close to a quarter of the region's exports. Changes to China's growth also impact its outbound capital flows, roughly a quarter of which go to regional economies.
- Second, regional equity markets have material sales exposure to China—the Asia Pacific ex-Japan region (excluding Mainland China/HK markets) has aggregate sales exposure of 9% to Mainland China, with added indirect exposure through second-order effects. As such, any change in China demand could impact the region's corporate revenues.
- Third, regional equity market share prices correlate with China growth and equity prices to varying degrees, reflecting the level of fundamental exposure, different betas, and exposure to foreign and domestic portfolio flows. Taking an average of regional sensitivities to Mainland China along these channels, Hong Kong and Taiwan have the highest composite sensitivity; Australia, Thailand, Malaysia, Korea, and Japan are in the middle tier; and much of ASEAN (Singapore, Philippines, Indonesia) as well as India have the lowest exposure.
- Given all that, Mainland China's less favorable macro backdrop will likely weigh more heavily on Hong Kong and Taiwan. Accordingly, we now expect lower EPS growth in both regions next year (5% for Hong Kong and 18% for Taiwan vs. 10% and 20%, respectively, prior to the US election) although solid AI demand could offset some of the Mainland China-driven drag in Taiwan. However, India's economy and equity markets should remain relatively insulated from China macro risks, with domestic factors continuing to act as the dominant driver.

REGIONAL BONDS

Danny Suwanapruti

- The economic slowdown in China that we expect in 2025 relative to 2024 can spill over to Asia's local currency bond markets through two key channels. First, regional economies are sensitive to changes in China demand, as China is a large export destination for most Asian economies. In 2023, exports to Mainland China represented around 14% of Vietnam's GDP, followed by 13% for Singapore and Taiwan, 11% for Malaysia, and 7% for Korea. And around a quarter of Thailand's tourist arrivals come from China, with international tourism representing around 12% of Thailand's GDP. So, downward shocks to China's growth—whether from US tariffs or from a slowdown in domestic consumption—would likely lower its demand for Asian exports, which could steer monetary policy in a more dovish direction and drive local bond yields lower.
- Second, China's exports to the region could rise as China looks to offset likely lower US demand amid higher tariffs, which could have disinflationary effects on the region. A greater supply of cheaper Chinese goods should nudge domestic inflation lower in regional economies and, at the margin, allow for a more dovish central bank stance.
- Taken together, slowing Chinese growth and dovish PBOC policy should, at the margin, be bullish for regional bond markets. South Korea, Thailand, and possibly Malaysia's bond markets are likely most sensitive to slowing growth given their greater exposure to Chinese growth and the CNY. Meanwhile, India and the Philippines are less exposed to China's economy and currency, so their bond markets will likely be the least sensitive to any such shifts.

COMMODITIES

Daan Struyven, Samantha Dart, Aurelia Waltham, and Lavinia Forcellese

- **Base metals:** Trade tensions pose two-sided risks to ex-China base metal prices, with downside risks from higher US tariffs on China's goods exports (via the negative growth impact), but upside risks from China's policy measures discouraging metal exports. These policy measures should especially support ex-China aluminum prices in particular, given China's aluminum product exports' large share of global demand. As such, we continue to expect modestly higher aluminum prices and maintain our $2,700/t aluminum price forecast for 2025. China's domestic policy stimulus measures should also support copper prices. Indeed, rising China sales growth for electric vehicles (+50% y/y in October) and home appliances suggests that the consumer goods trade-in program is already boosting copper demand, with more upside possible from any power grid capex stimulus. However, further Dollar appreciation poses downside risks to our bullish $10,160/t copper price forecast for 2025 given China's position as a net copper importer.

- **Steel:** We expect internal and external policy developments to have only limited impacts on steel markets. On the internal policy front, China's easing measures provide limited upside for domestic steel demand, as the housing inventory drawdown and the move away from 'traditional' infrastructure projects continue to weigh on steel demand, which is more heavily exposed to the construction sector than is base metals demand. On the external policy front, although China exports very little direct steel to the US, we expect US tariffs to act as a drag to exports of steel-containing goods such as appliances and machinery, therefore weighing on Chinese steel demand. As such, we expect iron ore prices to average $95/t in 2025 (-10% vs. spot).
- **Energy:** We also expect only limited impacts on oil and LNG markets from these external and internal developments given our base case expectation of only limited tariff implementation (20% effective tariff on China plus automotive sector tariffs). And, on the domestic policy front, the stimulus boost to energy prices would likely be modest relative to bigger drivers such as supply from the Middle East for oil and winter weather for natural gas. However, an escalation of US tariff policy beyond what we current expect would weigh more significantly on China's economic growth, posing further downside risk to oil and LNG demand. In a broad tariff scenario that reduces global GDP and oil demand by 1% vs. our baseline, we estimate that Brent crude oil prices would decline to $64/bbl by end-2026 (vs. our $71/bbl base case).

G10 AND EM CURRENCIES

Kamakshya Trivedi, Teresa Alves, and Karen Reichgott Fishman

- Changes in Chinese growth sentiment can spill over to currencies through their impact on copper prices, Chinese equities, and the RMB. Past China easing cycles have involved infrastructure spending measures that had large commodity demand spillovers (namely to copper and iron ore prices), which is the key channel through which the currencies of commodity-exporter economies respond to China growth expectations, especially AUD, ZAR, CLP, as well as other LatAm currencies. But, this time around, China stimulus is more focused on domestic consumption and capital markets, and so commodity demand spillovers will likely be smaller than in prior easing cycles, limiting the upside to these crosses.
- Moves in Chinese equities have a more direct impact on Asia low-yielder currencies, including KRW, THB, and MYR. So, to the extent that policy easing measures support Chinese equities, these currencies could benefit. However, these currencies are also among the most sensitive to moves in the RMB, together with SGD, TWD, and JPY (although the dominant driver for Yen should be US macro developments). As such, they are unlikely to find much reprieve from a resilient Chinese equity market if CNY weakens at the same time, as we expect (see pg. 23).
- For other G10 currencies outside the region, CNH and copper price moves are typically more important and the exposure to Chinese equity moves is limited. For the Scandinavian and CEE currencies, the impact of Chinese growth re-ratings tends to be largely driven by the Euro response. Finally, the high-yielder currencies in Asia—INR, PHP, IDR—are relatively more insulated from Chinese growth pricing across most channels due to a varying combination of tighter currency management and limited direct exposure to Chinese demand.

US DOLLAR

Michael Cahill

- Changes in Chinese growth could affect the broad Dollar and FX markets through three main channels. First, direct growth spillovers could have a strong influence on the rest of the world, with activity in China tending to lead non-Asia DM economies by a few months. Second, China is a large global trading partner—of the 36 other currencies we track, China is a top-3 trade partner in all but the Scandis. So, the value of the RMB can influence the relative competitiveness of other currencies and any policymaker adjustments to the value of CNY can have broad repercussions. Third, CNY is a managed currency as well as a policy tool, so policymakers' willingness to allow the currency to adjust to market forces can influence broader market volatility.
- Given these channels and the fact that FX is a relative asset class, the attractiveness of the RMB is an important input to the Dollar outlook. For the Dollar to fall, the RMB (and Euro) has to rise, almost mechanically. However, we continue to believe that weakness in key Dollar "challengers" raises an important hurdle for the Dollar to fall from its lofty levels. While that was not always the case—in 2016, China's positive growth impulse helped propel both CNY and the Euro stronger in 2017, which was the weakest year for the Dollar in recent memory—for now, we expect continued Dollar strength.
- That said, uncertainty around the degree and composition of China's economic stimulus, including the currency's role, is the biggest risk to our central forecast for a "stronger for longer" Dollar.

Summary of our key forecasts

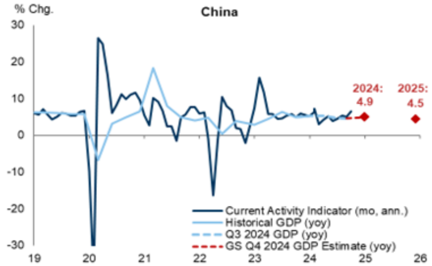
GS GIR: Macro at a glance

Watching

- **Globally,** we expect solid real GDP growth of 2.7% yoy in 2025, reflecting tailwinds from real disposable household income growth and easing financial conditions amid continued rate cuts, with US growth likely to continue outpacing its DM peers given its significantly stronger productivity growth. We expect core inflation to converge to target across DMs by end-2025 on the back of subdued core goods inflation, a further decline in shelter inflation, and steady wage disinflation.
- **In the US,** we expect above-consensus real GDP growth of 2.5% yoy in 2025, reflecting robust real income growth, easing financial conditions, and strong productivity growth. We expect core PCE inflation to slow to 2.4% by December 2025, reflecting further cooling in shelter inflation and easing wage pressures but a moderate boost from higher tariffs. We expect the unemployment rate to decline gradually to 3.9% by end-2025.
- **We expect the Fed** to deliver consecutive 25bp cuts in December, January, and March before slowing the pace of cuts to every other meeting, for two final 25bp cuts in June and September 2025 to a terminal rate range of 3.25-3.5%, although we see some risk that the FOMC could slow the pace sooner. On balance sheet policy, we expect the Fed to slow the pace of balance sheet runoff further in January 2025 and to end runoff in 2Q2025.
- **In the Euro area,** we expect below-consensus real GDP growth of 0.8% yoy in 2025, reflecting continued structural headwinds in the manufacturing sector—including high energy prices and competitive pressures from China—higher trade policy uncertainty, and ongoing fiscal consolidation. We expect headline and core inflation to return to 2% sustainably by end-2025, driven by a further cooling in services inflation.
- **We expect the ECB** to deliver a 25bp cut in December, followed by continued sequential 25bp cuts until the policy rate reaches 1.75% in July 2025. We continue to see risks towards faster and deeper cuts if growth and inflation turn out weaker than we project.
- **In China,** we expect real GDP growth to slow to 4.5% yoy in 2025 as the recent significant step-up in policy easing measures only partially offsets weak domestic consumption, the ongoing property market downturn, and likely higher US tariffs. Over the longer term, we remain cautious on China's growth outlook given several structural challenges, including deteriorating demographics, a multi-year debt deleveraging trend, and global supply chain de-risking.
- **WATCH US POLICY AND GEOPOLITICAL DEVELOPMENTS.** Trump's second term will likely bring important policy shifts, including higher China and auto tariffs, lower immigration, some fresh tax cuts, and regulatory easing. In the US, we expect the growth boost from lower taxes to be roughly offset by the drag from higher tariffs, but we expect larger growth drags from tariffs in Europe and China, especially in the case of an across-the-board tariff. Geopolitical developments also remain important to watch as the situation in the Middle East remains highly uncertain, the Russia-Ukraine war drags on, and US-China relations continue to be fraught.

Goldman Sachs Global Investment Research.

Growth



Source: Haver Analytics, Goldman Sachs Global Investment Research.
Note: GS CAI is a measure of current growth. For more information on the methodology of the CAI please see "Improving Our Within-Month CAI Forecasts," Global Economics Comment, Mar. 06, 2023.

Forecasts

Economics

GDP growth (%)	2024 GS (Q4/Q4)	2024 Cons. (Q4/Q4)	2024 GS (CY)	2024 Cons. (CY)	2025 GS (CY)	2025 Cons. (CY)
Global	2.7	--	2.6	2.6	2.7	2.6
US	2.5	2.4	2.8	2.7	2.5	2.1
China	4.9	4.9	4.9	4.8	4.5	4.5
Euro area	1.1	1.0	0.8	0.8	0.8	1.1

Policy rates (%)	2024 GS	2024 Mkt.	2025 GS	2025 Mkt.
US	4.38	4.38	3.38	3.70
Euro area	3.00	2.90	1.75	1.66
China	1.50	1.09	1.10	–
Japan	0.25	0.29	0.75	0.71

Markets

Interest rates 10Yr (%)	Last	E2024	E2025
US	4.22	4.30	4.25
Germany	2.13	2.20	1.90
Japan	1.06	1.10	1.60
UK	4.25	4.25	4.00

FX	Last	3m	12m
EUR/$	1.05	1.06	1.03
GBP/$	1.28	1.32	1.30
$/JPY	152	155	159
$/CNY	7.23	7.40	7.50

Commodities	Last	3m	12m
Crude Oil, Brent ($/bbl)	72	75	74
Nat Gas, NYMEX ($/mmBtu)	3.16	3.00	3.25
Nat Gas, TTF (EUR/MWh)	45.50	42	38
Copper ($/mt)	9,101	9,600	10,650
Gold ($/troy oz)	2,690	2,750	3,000

Credit (bp)		Last	2Q25	4Q25
USD	IG	76	83	85
	HY	263	290	300
EUR	IG	109	121	125
	HY	305	338	350

Equities

S&P 500	E2024 GS	E2024 Cons.	E2025 GS	E2025 Cons.
Price	6,000		6,500	
EPS	$241	$242	$268	$274
Growth	8%	9%	11%	13%

Returns (%)	12m	YTD	E2024 P/E
S&P 500	8	27	25.5x
MXAPJ	7	11	15.1x
Topix	13	16	16.1x
STOXX 600	2	8	14.4x

Consumer	2024 CPI (%, yoy)	2024 Unemp. Rate	2025 CPI (%, yoy)	2025 Unemp. Rate
US	2.9	4.1	2.5	3.9
Euro area	2.4	6.5	2.3	6.7
China	0.4	--	0.8	–

Wage Tracker 2024 (%)	Q1	Q2	Q3	Q4
US	4.5	4.5	4.3	4.2
Euro area	--	–	–	--
China	--	–	–	--

Source: Bloomberg, Goldman Sachs Global Investment Research. For important disclosures, see the Disclosure Appendix or go to www.gs.com/research/hedge.html.

Market pricing as of December 10, 2024

Glossary of GS proprietary indices

Current Activity Indicator (CAI)

GS CAIs measure the growth signal in a broad range of weekly and monthly indicators, offering an alternative to Gross Domestic Product (GDP). GDP is an imperfect guide to current activity: In most countries, it is only available quarterly and is released with a substantial delay, and its initial estimates are often heavily revised. GDP also ignores important measures of real activity, such as employment and the purchasing managers' indexes (PMIs). All of these problems reduce the effectiveness of GDP for investment and policy decisions. Our CAIs aim to address GDP's shortcomings and provide a timelier read on the pace of growth.

For more, see our CAI page and Global Economics Analyst: Trackin' All Over the World – Our New Global CAI, 25 February 2017.

Dynamic Equilibrium Exchange Rates (DEER)

The GSDEER framework establishes an equilibrium (or "fair") value of the real exchange rate based on relative productivity and terms-of-trade differentials.

For more, see our GSDEER page, Global Economics Paper No. 227: Finding Fair Value in EM FX, 26 January 2016, and Global Markets Analyst: A Look at Valuation Across G10 FX, 29 June 2017.

Financial Conditions Index (FCI)

GS FCIs gauge the "looseness" or "tightness" of financial conditions across the world's major economies, incorporating variables that directly affect spending on domestically produced goods and services. FCIs can provide valuable information about the economic growth outlook and the direct and indirect effects of monetary policy on real economic activity.

FCIs for the G10 economies are calculated as a weighted average of a policy rate, a long-term risk-free bond yield, a corporate credit spread, an equity price variable, and a trade-weighted exchange rate; the Euro area FCI also includes a sovereign credit spread. The weights mirror the effects of the financial variables on real GDP growth in our models over a one-year horizon. FCIs for emerging markets are calculated as a weighted average of a short-term interest rate, a long-term swap rate, a CDS spread, an equity price variable, a trade-weighted exchange rate, and—in economies with large foreign-currency-denominated debt stocks—a debt-weighted exchange rate index.

For more, see our FCI page, Global Economics Analyst: Our New G10 Financial Conditions Indices, 20 April 2017, and Global Economics Analyst: Tracking EM Financial Conditions – Our New FCIs, 6 October 2017.

Goldman Sachs Analyst Index (GSAI)

The US GSAI is based on a monthly survey of GS equity analysts to obtain their assessments of business conditions in the industries they follow. The results provide timely "bottom-up" information about US economic activity to supplement and cross-check our analysis of "top-down" data. Based on analysts' responses, we create a diffusion index for economic activity comparable to the ISM's indexes for activity in the manufacturing and nonmanufacturing sectors.

Macro-Data Assessment Platform (MAP)

GS MAP scores facilitate rapid interpretation of new data releases for economic indicators worldwide. MAP summarizes the importance of a specific data release (i.e., its historical correlation with GDP) and the degree of surprise relative to the consensus forecast. The sign on the degree of surprise characterizes underperformance with a negative number and outperformance with a positive number. Each of these two components is ranked on a scale from 0 to 5, with the MAP score being the product of the two, i.e., from -25 to +25. For example, a MAP score of +20 (5;+4) would indicate that the data has a very high correlation to GDP (5) and that it came out well above consensus expectations (+4), for a total MAP value of +20.

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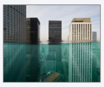

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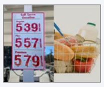

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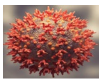

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Reg AC

We, Allison Nathan, Jenny Grimberg, Ashley Rhodes, Andrew Tilton, Joseph Briggs, Kenneth Ho, Hui Shan, Vickie Chang, Xinquan Chen, Jonathan Sequeira, and Lisheng Wang, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

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