

Tap the opportunities in Europe as secular and structural trends taking shape

The global economic and political landscape is shifting rapidly, marked by a broad reordering of trade relations and political alliances around the globe. In response, uncertainty measures across global markets soared in the first half of 2025.

There could be uncertainties on the precise estimates of where tariff rates will settle, the exact timing of interest rate changes and detailed inflation and growth forecasts. These estimates, among others, are heavily dependent on a more consistent sense of US policy direction.

The base case remains that investors continue to be in an environment punctuated by escalating and de-escalating tariff measures.

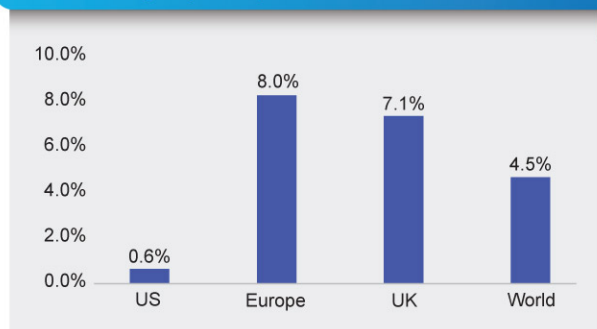
Outside the US, the macro environment appears to be turning favourable. European markets could potentially benefit from greater fiscal spending, an improving consumer backdrop and further rate cuts from the European Central Bank (ECB).

Could Europe escape a hit to growth from the trade war?

Direct European exports to the US equate to around 3% of European GDP,¹ suggesting that tariffs pose a limited headwind to exports. Auto manufacturing capacity is being repurposed for defence.

It's believed that investors seem to be optimistic on the economic and earnings prospects in both Europe and the UK – year to date, European and UK stocks outperformed both the US and the World.

Chart 1: Equity Market performance Year-to-Date (as of May 31, 2025)



Source: Bloomberg, as of May 30, 2025. US: MSCI USA Index; Europe: MSCI Europe Index; UK: MSCI UK Index, World: MSCI AC World Index. **Past performance is not indicative of future performance.** Investors could not invest directly in an index.

Boost in defence and infrastructure spending a key driver for economic growth

On March 3, Germany's new Chancellor, Friedrich Merz said that Germany would "do whatever it takes" to ensure the defence of Europe.

Shortly after, restrictions on the German debt brake were lifted, and Merz committed to greater defence and infrastructure spending, amounting to nearly 2.5% of German 2024 GDP.

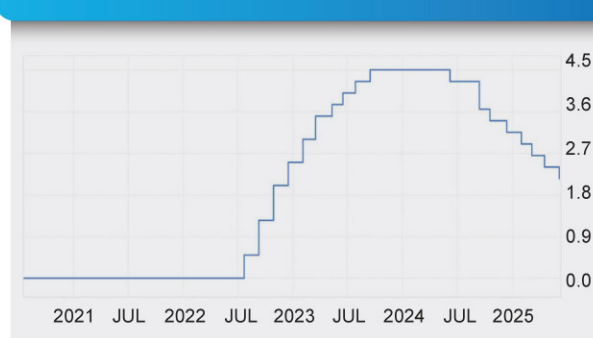
European firms are better placed to supply this equipment, suggesting the fiscal multipliers should be positive for Europe in the coming years.

The ECB set to cut interest rates further

It's believed that the ECB is likely to cut policy rates more quickly than previously expected as lower oil prices and the stronger euro lead to growing disinflationary pressures in the eurozone.

Further, while US tariffs will put upward pressure on prices in the US, European goods prices may see disinflationary pressure as excess supply from China and other regions is diverted from the US to Europe.

Chart 2: Euro Area Interest Rate



Sources: Bloomberg L.P., as of June 9, 2025.

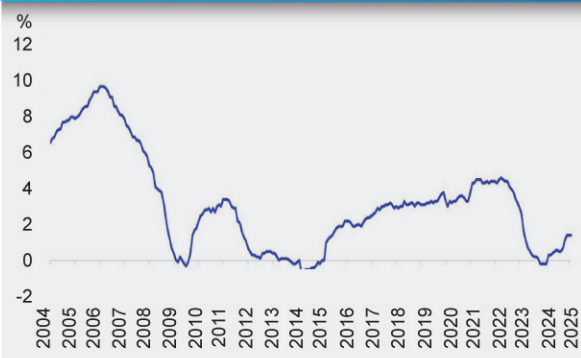
European consumer may spend more as household loans have picked up

Europe is a more rate-sensitive market than the US, and the ECB has led this cutting cycle, pushing borrowing costs lower and helping raise demand for household loans. This implies that European consumer may spend more and save less.

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Chart 3: Eurozone loans to households y/y %, (Monthly data, from January 2004 to April 2025)



Sources: Invesco and Bloomberg L.P., as of April 30, 2025.

In conclusion, it's believed that European growth will likely experience a hit from US tariffs, but investors think increased German infrastructure and European defense spending generally, coupled with a consumer recovery, may enable Europe to weather this storm.

Source

1. European Commission, as of Feb 14, 2025.

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Navigating China's Market in 2025: Resilience Amid Volatility

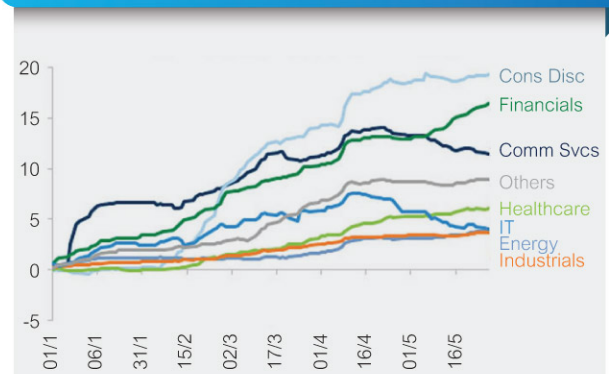
Volatility in financial markets has remained elevated in the wake of President Trump's tariff announcements and the implications they have for company profits and economic growth. For China, it's anticipated a divergence between market performance and macroeconomic readings in 2025. The Chinese stock market presents a landscape that differs from what macroeconomic readings tell people about the shape of the broader economy. While issues around tariffs, consumer and business confidence cloud the economic outlook, macro data will no longer be the key driver for the stock market in 2025. Instead, investors see multiple factors that could drive the market this year:

1. Domestic and Global Capital Flows Bolster Market Stability
2. Pro-Growth Policies to Counter Tariff Headwinds and Boost Domestic Demand
3. Unlocking the Potential of Chinese Enterprises Amid Global Challenges

Domestic and Global Capital Flows Bolster Market Stability

- Technically, domestic capital (including the national team and southbound buyers) has been the dominant buying force in the Chinese market this year, and it's expected such flows to persist. Meanwhile, policymakers have vowed to keep clearing bottlenecks to allow more long-term funds to enter the stock market. Since the tariff announcements, Beijing has made considerable efforts to stabilise its domestic financial markets and counter the shock. China's stabilisation funds – known as the “national teams” – supported by the People's Bank of China (PBoC), have intervened substantially in the domestic stock market. The National Financial Regulatory Administration also issued a new directive, guiding insurance companies to increase their exposure to equity markets. Moreover, numerous listed state-owned enterprises (SOEs) have announced share buybacks, suggesting a clearly coordinated effort to stabilise the stock markets. The strong inflows from domestic investors may provide a cushion over the long term.

Chat 1: Cumulative Southbound Flows YTD (US\$bn)



Source: Wind, Goldman Sachs Global Investment Research. Data as of 30 May 2025.

- Moreover, global investors are looking to diversify away from US equities and the dollar. A possible peak in the “US exceptionalism” theme, along with the US administration's erratic trade policy moves, have been prompting many global investors to seek shelter. China, with its enhanced strategic appeal, could be one of the beneficiaries.

Pro-Growth Policies to Counter Tariff Headwinds and Boost Domestic Demand

- Since September 2024, Beijing's policy tone has been clearer and more forceful: a pro-growth policy stance is now clearly the top priority. In particular, boosting domestic consumption has been elevated to be the top policy task. The tariff headwinds raise downside risk for China's growth this year and next, thus increasing pressure on Beijing to roll out more stimulative policies to boost the domestic sector and offset the growth drag from the external sector. Looking ahead, additional monetary and fiscal policy support initiatives, together with structural reforms (a “1-2-3 punch”), will be key to building the “next China story”.
- In terms of tariffs, it's believed there will be no winner in the global trade war, as global supply chains will be extremely difficult and painful to decouple. The 1930 Great Depression served as a perfect example after the introduction of the Smoot-Hawley Tariff by the US government to protect its domestic economy. Beijing's responses to the tariffs are not aimed at winning the trade war; instead, China is playing a bigger game, which is to defend its role in the global system. Therefore, neither aggressive renminbi depreciation nor dumping all its goods on the rest of the world would be meaningful ways for China to win the ultimate game. China

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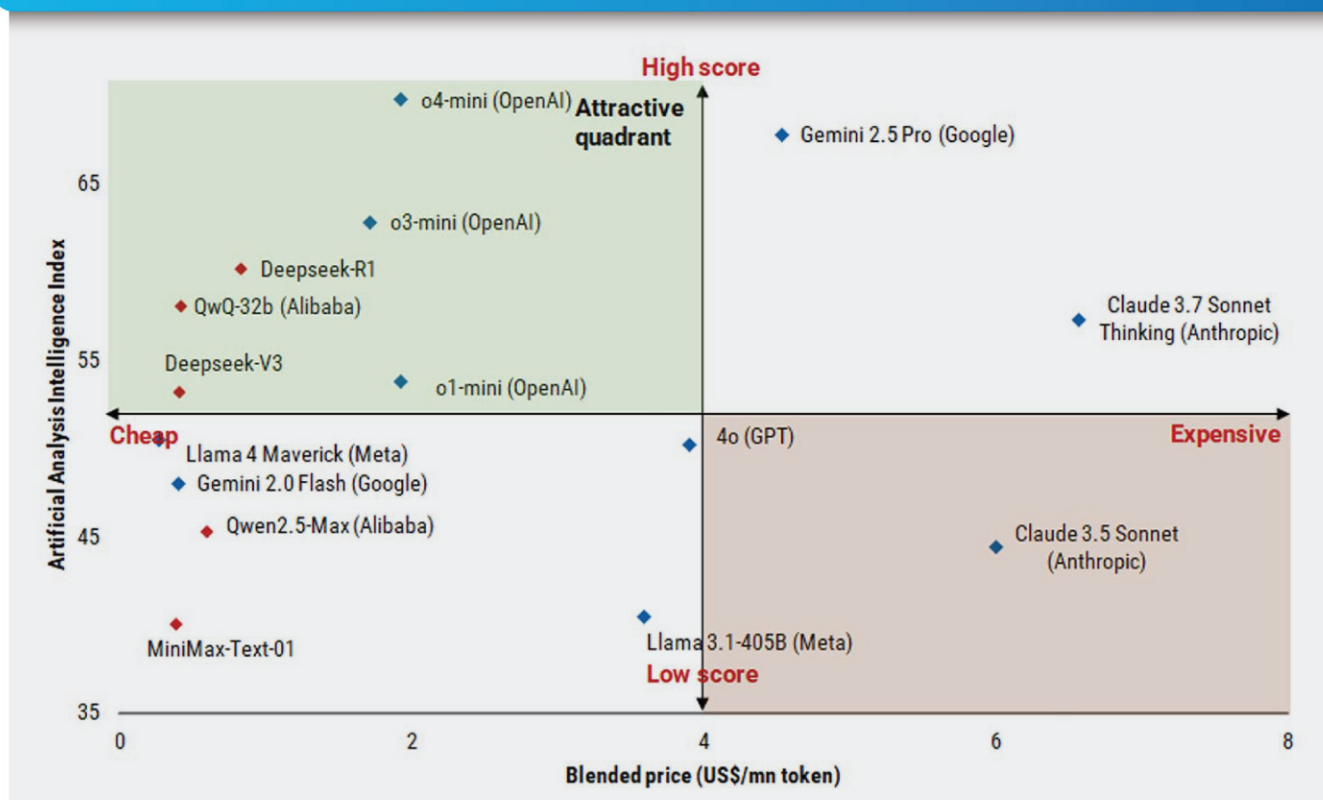
needs to show the rest of world that it can grow its domestic demand to partially offset the decline in demand from the US. To achieve this, Beijing needs to revive the 'animal spirits' of private enterprises (POEs) – the engine of China's economy growth, to strengthen the social safety net and further stabilise the property market.

Unlocking the Potential of Chinese Enterprises Amid Global Challenges

- Beneath the tariff and macroeconomic headwinds, an important aspect that global investors have ignored or underestimated over the last few years is the potential of Chinese enterprises. The success of DeepSeek and Unitree has shown that a group of privately owned enterprises (POEs) in China has the potential to break out in downstream AI application, robotic and automation development, despite the blockage on tech infrastructure. The gap between China and the US in the AI campaign may not be as large as the market initially estimated: Despite US restrictions,

initially estimated: Despite US restrictions, China has achieved cutting-edge AI capabilities with significantly less hardware, defying conventional expectations of computing power requirements. Similar to what investors saw in the mobile internet era, China may be a latecomer in smartphone or 4G internet hardware development, but once it breaks out, it can progress rapidly in application and tech usage (e.g., the big e-commerce and internet services companies in China have been game-changers and have become world leaders). China has developed a real edge in disseminating, commercialising and manufacturing technology. With a vast talent pool and POEs' confidence in rebuilding (on the back of policy support), more emerging champions and innovators are likely to break out in the Chinese market. Notably, such innovation and technology breakthroughs are not only happening in AI large language models (LLMs), but also span a wide range of industries such as electric vehicles (EVs - smart driving), humanoid robots, biotech and drones. The Greater China Equities team is actively looking for more opportunities in these areas.

Chat 2: AI model intelligence vs. price



Source: Artificial Analysis, Morgan Stanley. The index is a combination metric of MMLU-Pro, GPQA Diamond, Humanity's Last Exam, LiveCodeBench, SciCode, AIME, MATH-500; price blended with input and output prices (3:1), updated by May 2025

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Capitalizing on Structural Reforms, Stimulus, and Long-Term Growth Themes

- From an investment perspective, it's anticipated stronger consumption and property-related fiscal stimulus in the face of larger external challenges, as the economy progresses towards a firmer transition to domestic consumption and structural reform. Given the external headwinds, China will need more stimulus to support employment and investment, and structural reforms to strengthen the social safety net, stabilise the property market, reduce overcapacity, and create a more policy-friendly environment for high value-added service sectors and private enterprises.
- Undemanding valuations, light investor positioning, good fundamentals and long-term structural growth opportunities should help Chinese assets withstand near-term volatility. Looking ahead, domestic consumption, privately-owned enterprises (POEs), innovation and industrial upgrading companies are favoured under Beijing's structural reform tactics.

Lastly, themes that are well-positioned to benefit from China's long-term structural changes include

1. innovation;
2. industrial upgrade;
3. lifestyle change; and
4. consolidation.

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