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Asia Views: 2025 Outlook – Positioning for Trade War Two

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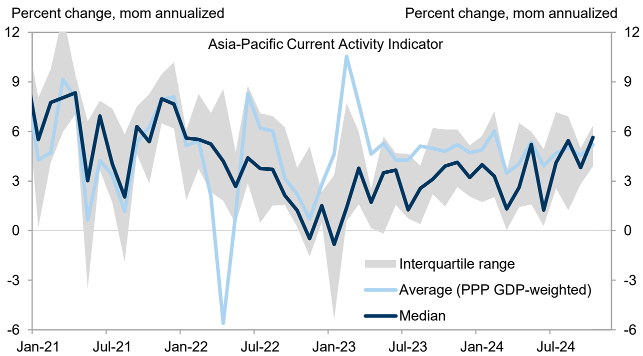
1. In last year's Asia outlook we noted that "Historically, Asian economies and markets benefited when China's growth was strong and Fed policy loose". Neither has been the case in 2024. Still, the year has featured a broad and strong export performance from China, a surge in tech/semiconductor exports via Korea, Taiwan, Malaysia, and Vietnam, and healthy domestic demand growth in several EM Asia economies. Recent high-frequency data have looked a little stronger (Exhibit 1) as China starts to roll out policy support and the Fed easing cycle is underway; lower oil prices have also been a plus for most economies. While more fiscal easing from China and more Fed cuts are likely in store for 2025, there are also obvious headwinds: trade/tariff uncertainty has surged following the election of Donald Trump to a second presidential term in the United States, and prolonged US dollar strength could constrain EM Asia monetary easing.

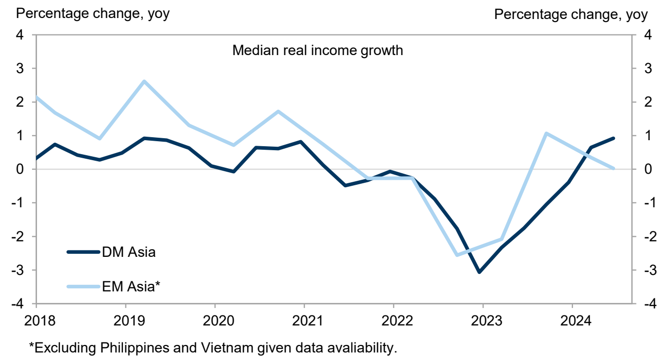
2. In 2025, we expect modestly slower growth in EM Asia and a shift towards domestic demand in China, but pickups in a few developed markets. Export growth could slow across the region – particularly from China, given we expect the Trump administration to increase the average tariff on Chinese goods by 20pp. India, notwithstanding its solid long-term growth prospects, is in the midst of a material fiscal tightening. ASEAN should be steadier, with economies like Vietnam potentially bucking the slowdown trend if they can benefit from trade reallocation without facing US tariffs themselves. Domestically, shifts in real incomes are an important driver of our growth forecasts: the 2022 spike in inflation came down earlier in regional EMs (particularly China) than in DMs, but the lack of stimulus left EMs with more spare capacity and generally weaker wage growth. The result has been that real income growth in the median DM Asia-Pacific economy has recently overtaken that in the median EM (Exhibit 2). Key developed markets that posted slow growth in part or all of 2024 (Japan, Australia, New Zealand) are likely to see improving domestic demand and GDP growth in 2025 as inflation decelerates further and real wage growth and consumption rise.

Exhibit 1: Regional growth data have picked up in recent months



Source: Goldman Sachs Global Investment Research

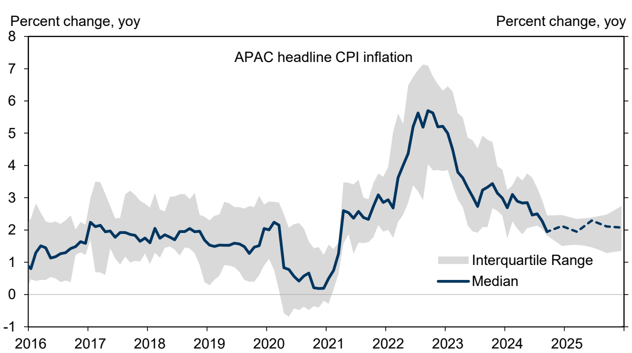
Exhibit 2: Real wage growth has accelerated recently in the median Asian DM economy, but slowed in the median EM



Source: CEIC, Haver Analytics, Goldman Sachs Global Investment Research

3. Inflation pressures have declined and should remain low (Exhibit 3). Oil prices have approached the lower end of our commodity strategists' forecast range ($70-85/bbl), though there are significant risks on both sides (short-term upside related to possible Iran supply disruption, medium-term downside given still-significant spare capacity elsewhere). Food prices have been notably higher in recent months in some countries, but we think the spike is likely temporary – some recent price increases may relate to poor weather, the favorable "La Nina" phase of the Pacific climate cycle appears to be approaching, and India recently resumed rice exports after a 15-month ban. As for core inflation, we see a risk of excess China goods capacity being reallocated to regional markets in the event of tariffs, while in higher-income economies, service prices are still decelerating from elevated Covid-era levels. The obvious exception is Japan (discussed below), where policymakers have stoked wage and service price inflation pressures intentionally.

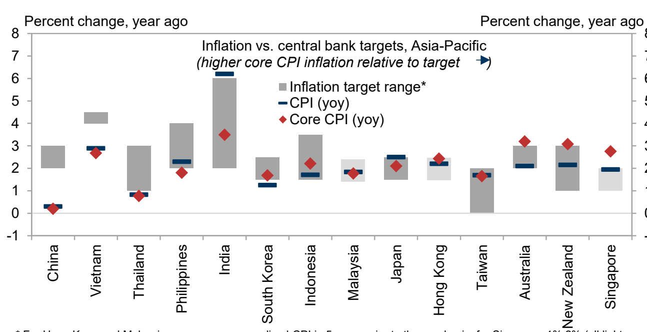
Exhibit 3: Inflation pressure continues to ebb in Asia…



Dotted line denotes GS forecast

Source: Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 4: …and key inflation metrics have generally returned to or below targets

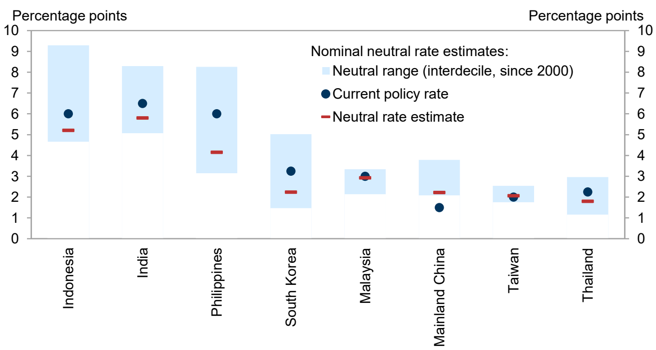


* For Hong Kong and Malaysia, we use avg. annualized CPI in 5 years prior to the pandemic; for Singapore 1%-2% (all light shading). For point targets, a +0.5/-0.5 range is displayed for clarity. We treat China's target as a ceiling.

Source: CEIC, Haver Analytics, Goldman Sachs Global Investment Research

4. Monetary easing is likely to proceed cautiously (ex-Japan). Inflation has come down to or below targets in most of the region (Exhibit 4), and is falling in the rest. Most countries' policy rates are still above neutral on estimates from our proprietary machine learning model (Exhibit 5). External balances are generally in good shape and the Fed has begun cutting, which opened the door for broader rate cuts around the region. However, a strong USD — likely to be supported by US tariff increases in early 2025 — complicates the picture for countries targeting stable exchange rates. We expect a broad but relatively shallow and gradual easing cycle around the region (Exhibit 6). Relative to prior forecasts, we have taken out 25bp of cuts in Taiwan/Indonesia and 50bp in Philippines; we also recently pushed back our forecast for cuts in India to early 2025 due to still-elevated food inflation there.

Exhibit 5: Policy rates still above neutral in most of EM Asia



Source: Goldman Sachs Global Investment Research

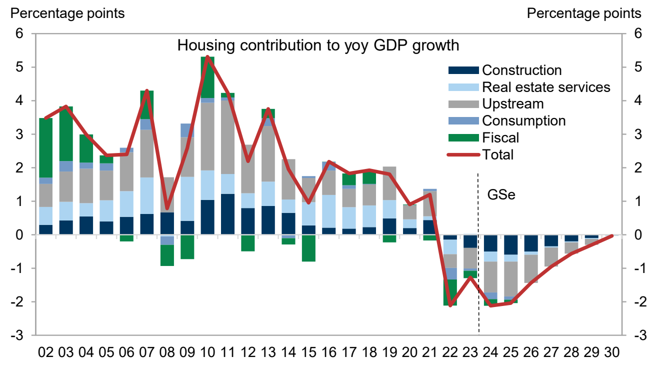
Exhibit 6: We expect a broad but relatively shallow rate cut cycle in Asia

Policy rates - actual and forecast	2024				2025			
	Q1	Q2	Q3	Q4F	Q1F	Q2F	Q3F	Q4F
US			-50bp	-50bp	-50bp	-25bp	-25bp	
Euro area		-25bp	-25bp	-50bp	-50bp	-50bp	-25bp	
Japan	+10bp		+15bp		+25bp		+25bp	
China			-30bp			-20bp		-20bp
India					-25bp	-25bp		
Indonesia		+25bp	-25bp	-25bp	-25bp			
Malaysia								
Philippines			-25bp	-50bp	-25bp	-25bp	-25bp	
Korea				-25bp	-25bp	-25bp	-25bp	-25bp
Taiwan	+12.5bp				-12.5bp		-12.5bp	
Thailand				-25bp	-25bp			
Australia					-25bp	-25bp	-25bp	-35bp
New Zealand			-25bp	-100bp	-50bp	-50bp	-25bp	

Source: Goldman Sachs Global Investment Research

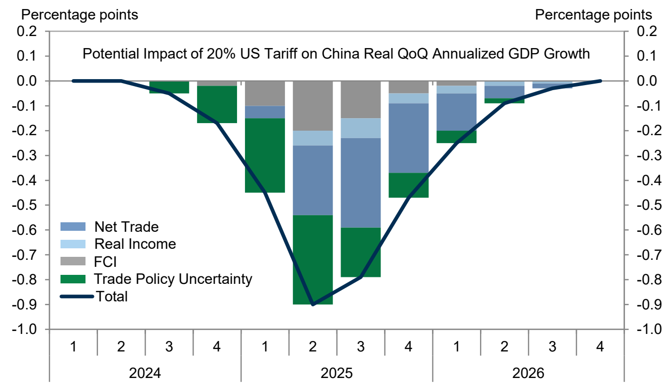
5. The combination of tariffs and policy support will rotate China's growth towards domestic demand (ex-housing) in 2025. The drag on activity from the housing downturn remains large, but should gradually diminish in coming years (Exhibit 7). Deceleration in real exports from the current double-digit growth pace seems assured, though strength could persist over the next couple of months as firms attempt to front-load shipments ahead of higher US tariffs. We estimate that a 20pp increase in the average US tariff on Chinese goods (our baseline assumption) would reduce Chinese GDP by about 70bp (Exhibit 8). A small part of this could be offset by RMB depreciation (we assume USDCNY moves to 7.40-7.50 following the imposition of tariffs), but policymakers' tolerance for further RMB depreciation may be lower than in 2018-19, given the weaker starting point. Fiscal policy should provide an additional (partial) offset: we expect China's "augmented fiscal deficit" to rise to 13% of GDP in 2025 (Exhibit 9), which we think will be critical for real GDP growth to plausibly approach the target (even presuming the target is lowered a little from this year's 5%). Collectively, these forces should shift the composition of China's economic activity materially (Exhibit 10). Long-term, China's top leadership still appear focused on technological advancement and manufacturing upgrading, and appear to view support to local governments (and potentially households) as a means to alleviate short-term social and economic pressures rather than an end in itself.

Exhibit 7: Housing downturn still a large drag on Chinese growth in 2025



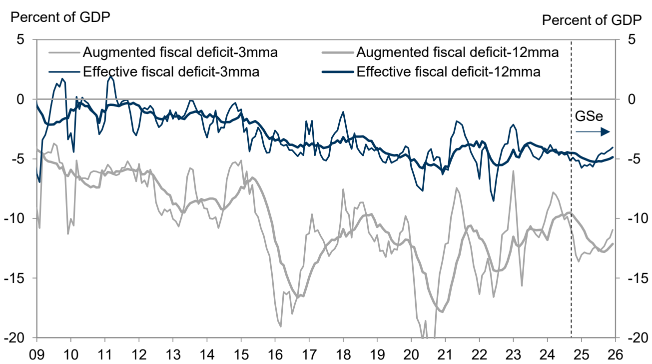
Source: Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 8: Tariffs and trade uncertainty a headwind in 2025



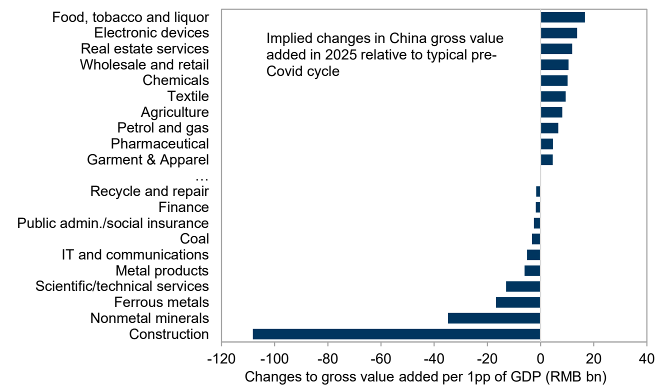
Source: Goldman Sachs Global Investment Research

Exhibit 9: Beijing to step up fiscal support in 2025



Source: CEIC, Wind, Goldman Sachs Global Investment Research

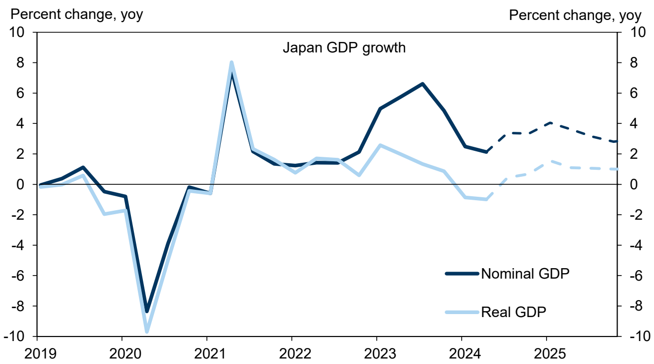
Exhibit 10: Shifting composition of Chinese growth



Source: Goldman Sachs Global Investment Research

6. Japan's economy is at a critical stage in its reflation experiment. Real economic growth should surpass 1% in 2025 as real wages are now rising faster than prices. (As elsewhere, US tariffs are a risk — we estimate that a 10% tariff on vehicles would reduce Japan's auto exports to the US by about 10%, lowering GDP by around 0.1-0.2pp.) Policy remains stimulative: monetary conditions are still loose, and the ruling LDP's poor performance in recent elections limits the scope for fiscal consolidation (potential pressure from the new US administration to increase defense spending could also be a factor). The feedback loop between domestic wages and service prices is key for reflation to be sustained (as import price pressures, which kick-started the inflationary process in 2021-22, are fading). Japan's long-term consumption growth has averaged around 0.5-0.7%, but we expect 2025 consumption growth of more than 1% as real income growth improves. We expect gradual BOJ normalization to continue at a pace of two 25bp hikes per year, with the next hike in January.

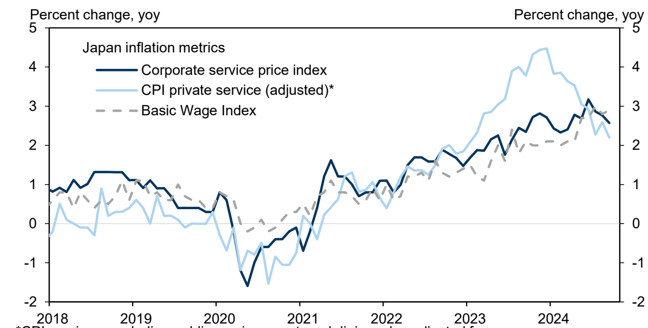
Exhibit 11: Modestly positive growth ahead in Japan



Dotted lines denote GS forecasts

Source: Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 12: Wage/service price feedback loop must be sustained near current pace

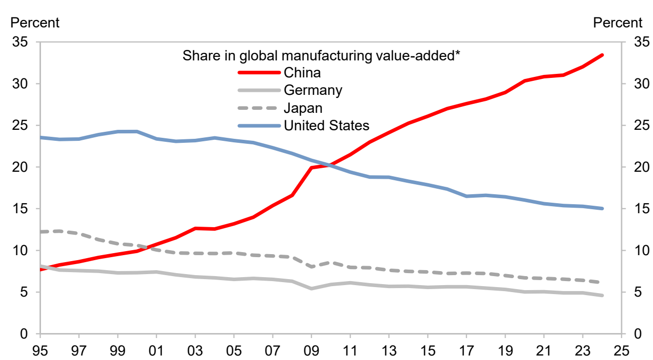


*CPI services, excluding public services, rent, and dining; also adjusted for

Source: Haver Analytics, Goldman Sachs Global Investment Research

7. Smaller export-oriented economies around the region have posted widely varying performances this year (our Current Activity Indicators have ranged between 0-10%). Policymakers frequently cite increasing imports from China (and export competition with China) as a challenge — China has steadily taken global manufacturing share over the past two decades (Exhibit 13) and remains the lowest-cost producer in many sectors. While US tariffs could provide new opportunities for some of China's regional export rivals to sell into the US, they could also put more downward pressure on goods prices in ex-US markets. We see relatively better prospects for exporters differentiated from China (Exhibit 14), either via their role as significant commodity exporters (e.g., Australia) or specialization in higher-tech products (e.g., Korea/Taiwan). Those with more overlap in lower/mid-tech manufacturing goods (Vietnam, Philippines, and to some extent Thailand, Malaysia) face a balancing act – they conceivably could benefit from trade reallocation away from China, but could also be hurt by intensifying deflationary goods pressures from Chinese exports. They could also be at risk of facing US tariffs themselves, especially if bilateral trade surpluses with the US grow further.

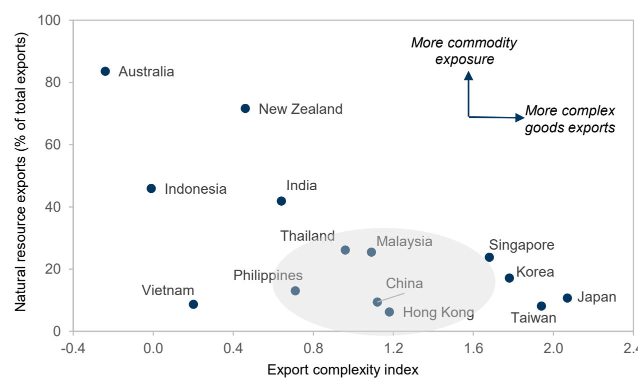
Exhibit 13: China manufactures about a third of all goods globally



* USD, 2015 prices. Extrapolated with real mfg GVA for 2023, monthly mfg production for 2024.

Source: United Nations, Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 14: Low- to mid-tech manufacturing exporters have faced most overlap with China

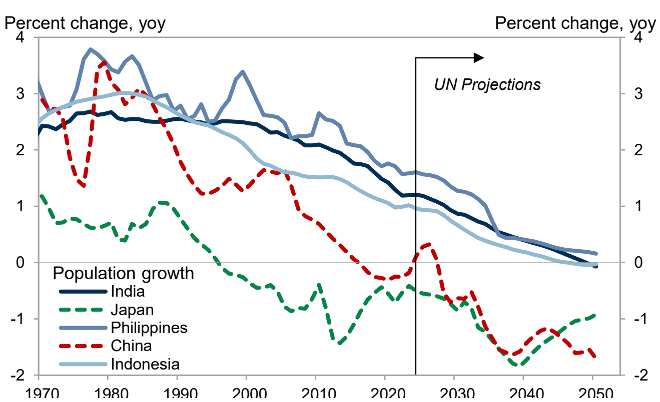


Source: UNCTAD, OEC, Goldman Sachs Global Investment Research

8. India, Indonesia, and the Philippines have the strongest growth prospects (5-6.5% over the next several years) on favorable demographics (Exhibit 15) and

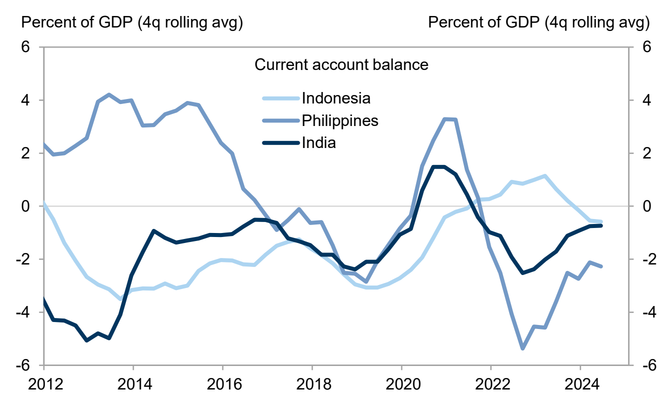
more catch-up potential (lower per-capita income levels). India, in particular, also has more insulation against global shocks than it did even a few years ago. Its economy is now nearly the size of Japan's ($3.6tn GDP at current exchange rates), its current account deficit mild (about 1% of GDP, in comparison with 4-5% prior to 2014's "taper tantrum"), its foreign reserves ample (>$600bn), and it stands to benefit from structural FDI inflows from supply chain relocation. Indonesia has some of these characteristics (a $1.4 tn economy, a similarly low current account deficit, and in addition low debt thanks to a strict fiscal rule) but not others (e.g., more limited reserves). The Philippines economy is smaller and its external position has gone from surplus to deficit over the past decade (Exhibit 16), so it could be somewhat more sensitive to global shifts than previously. Despite its greater domestic policy flexibility, India is hunkering down with continued fiscal consolidation and decelerating credit growth (partly due to proactive RBI regulation) – we expect below-consensus growth of 6.3% in the coming year. In contrast, Indonesia's new administration has ambitions to push growth well above 5% via increased "downstreaming" (onshore refining/processing of Indonesia's vast natural resources) and potentially a larger fiscal deficit. Philippines growth should benefit from falling inflation and a modest acceleration in real incomes in 2025.

Exhibit 15: India, Indonesia, Philippines have favorable demographics



Source: United Nations, Goldman Sachs Global Investment Research

Exhibit 16: ..and relatively modest external defiicts



Source: Haver Analytics, Goldman Sachs Global Investment Research

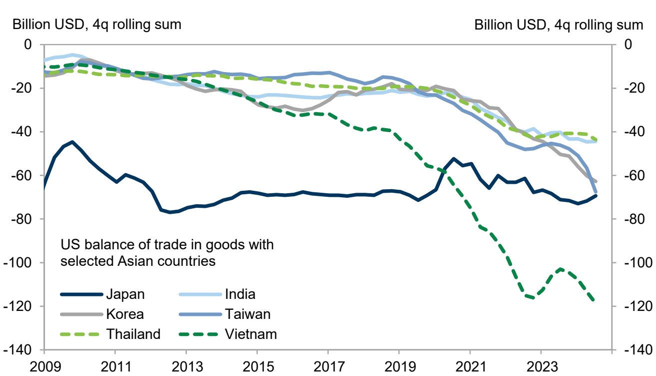
9. US tariffs—when, how much, and on what countries—represent the most important "known unknown" for Asia in 2025. Our baseline forecast assumes an average 20% additional tariff on US imports from China, but it's easy to envision other possible scenarios:

- **A China-US negotiated "deal".** While China ultimately did not purchase the full set of US goods envisioned in 2020's "phase one" trade deal, another agreement is still possible. A détente could be precipitated by some combination of renewed Chinese purchase pledges (though US tariffs would probably remain high pending compliance), more RMB appreciation, or Chinese cooperation in resolving geopolitical challenges (e.g., Ukraine), for example. The likely result would be an earlier/faster decline in the USD, easier regional monetary policy, and upside growth risks from reduced tariffs/trade uncertainty. But we would put a low probability on this outcome in 2025.
- **An escalating trade conflict.** Conversely, the China-US bilateral trade conflict could

intensify and become more damaging for both sides if the US imposes larger tariffs than we anticipate up front and/or China chooses to retaliate aggressively (for example, by significantly restricting exports of rare earths, or imposing large costs on US firms operating in China). In either case, the result would be weaker regional and global growth. Presumably, Chinese policymakers' incentives would be to retaliate in a manner that discourages escalation, but there is always room for miscalculation.

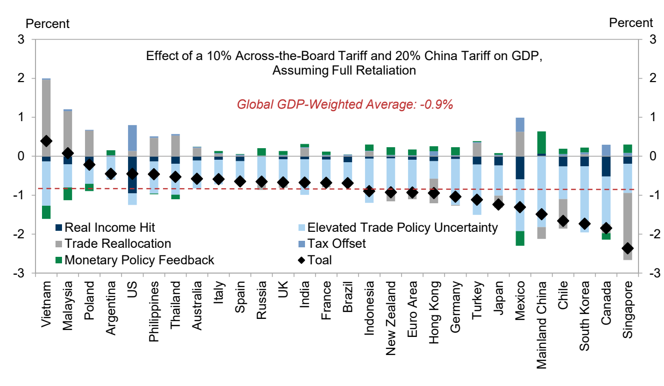
- **Broader regional or global tariffs.** The new US administration might decide to go after other big US bilateral trade deficits, many of which are with Asian economies. Vietnam, Korea, and Taiwan have seen the biggest trade gains vis-a-vis the US in recent years (Exhibit 17). Tariff threats could weigh on equities and FX in targeted economies, while tariff imposition would, of course, hit exports and growth. Smaller, export-oriented Asian economies are much more sensitive to tariffs than China, as their exports overall (and to the US in particular) typically represent two to three times the GDP share that they do in China. Of course, rather than a "whack-a-mole" approach, the Trump administration could just impose an across-the-board tariff on all other economies — our US and global economists have laid out the potential adverse growth and inflation impacts in recent analysis (Exhibit 18). We view global tariffs as a major risk (40% probability) but not our baseline assumption; in any case, these would likely take longer to implement procedurally than would a China-specific escalation.

Exhibit 17: Rising US trade deficits across EM Asia



Source: Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 18: Significant regional growth hits from broader US tariffs



Source: Goldman Sachs Global Investment Research

10. Our baseline market views envision modestly lower short-term interest rates, but higher long-term rates, in most Asian economies. (Japan is the exception where we see both short- and long-term rates moving higher as monetary policy normalization continues.) Asian local currency bonds should face a challenging year given the backdrop of shallow easing cycles, a stronger US dollar and a heavy bond supply pipeline. Credit spreads are tight, but we broadly expect them to stay "lower for longer" – while US tariffs could have idiosyncratic effects on particular firms, most firms in China (and likely Asia) USD credit indices do not have large US revenue exposure. In equities, our strategists continue to see some upside in China given undemanding valuations and policymakers' shift towards overt policy support for markets. In FX, we think tariffs (and the threat thereof) are likely to prolong USD strength, with USDCNY to move higher in early 2025 and other Asian FX to move in sympathy, particularly low-yielding exporters. That said, a combination of high USD valuation, large government borrowing requirements, a move towards neutral rates in the US, and less central bank tolerance for further depreciation (particularly in north Asia) should limit the scale of the moves and allow regional currencies to recover somewhat in subsequent years. Our colleagues will publish more detail on our 2025 market views over the coming week.

Disclosure Appendix

Reg AC

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