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Investor Presentation | Asia Pacific

Macro Implications of China AI 2.0

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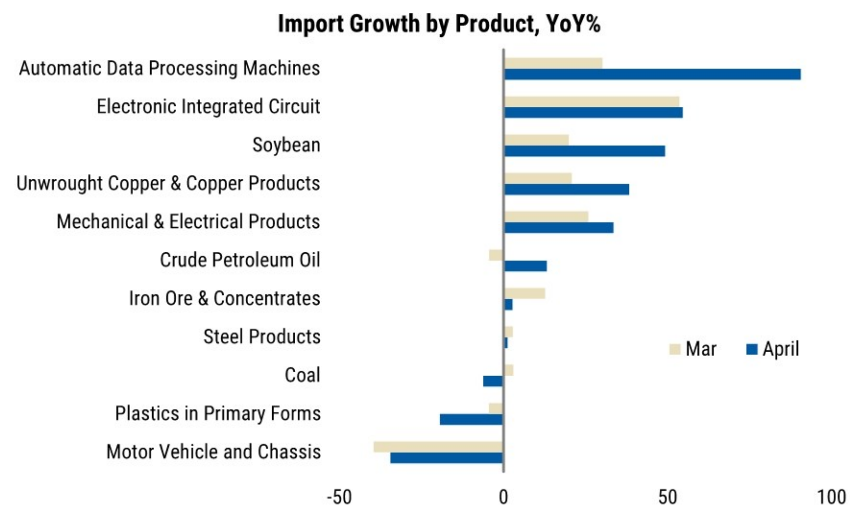
Tech-led Trade Strength

Tech-related demand drove the resilience in both export…

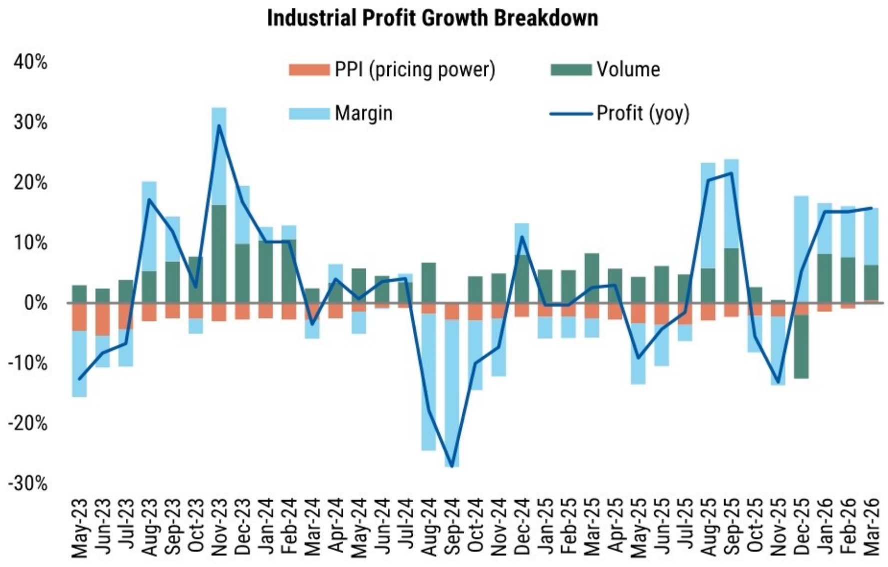
…and import growth in April



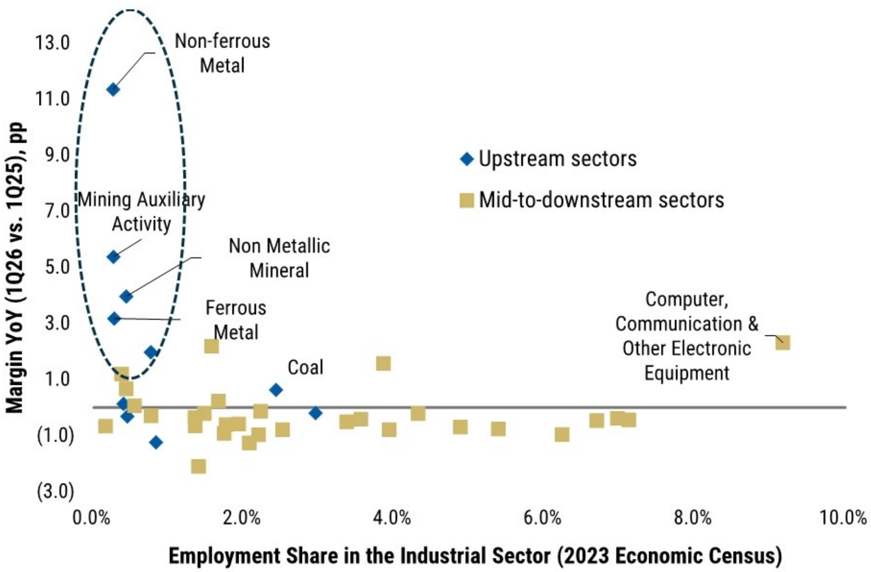
Source: CEIC, Morgan Stanley Research

Industrial Profits: Recovery Narrow and Upstream-Led

Industrial profit growth picked up, driven by volume…



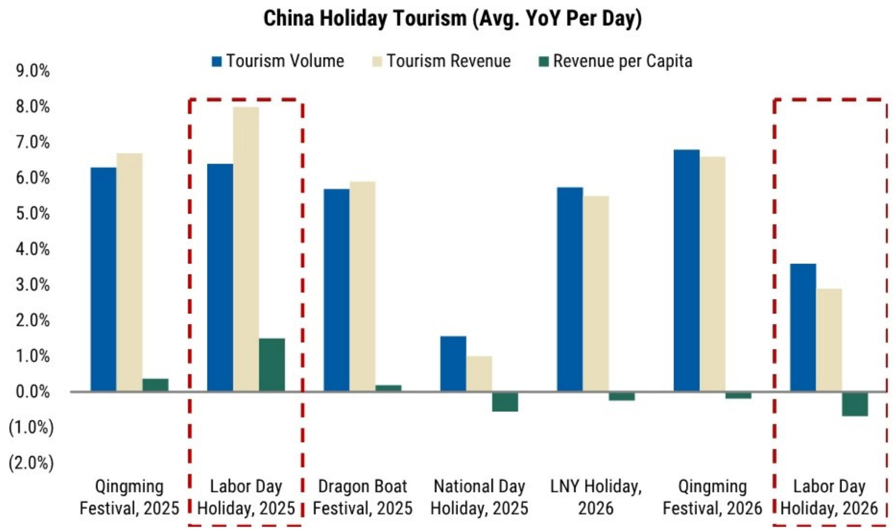
….and margin expansion, which is concentrated in the labor-light upstream sectors



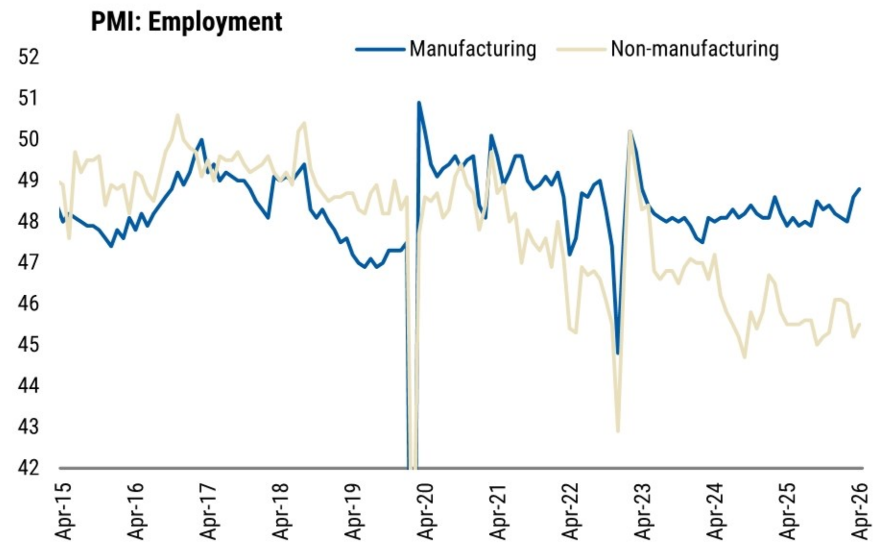
Source: CEIC, Morgan Stanley Research

Consumption Appetite Remains Subdued

Per capita spending softened during Labor Day Holiday, though partly due to a high base last year



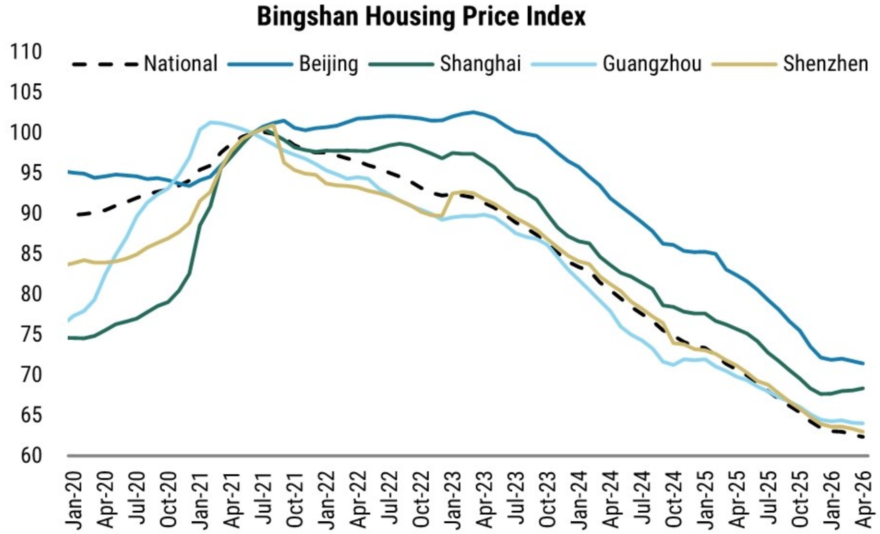
Persistent weakness in the labor market remains the key constraint



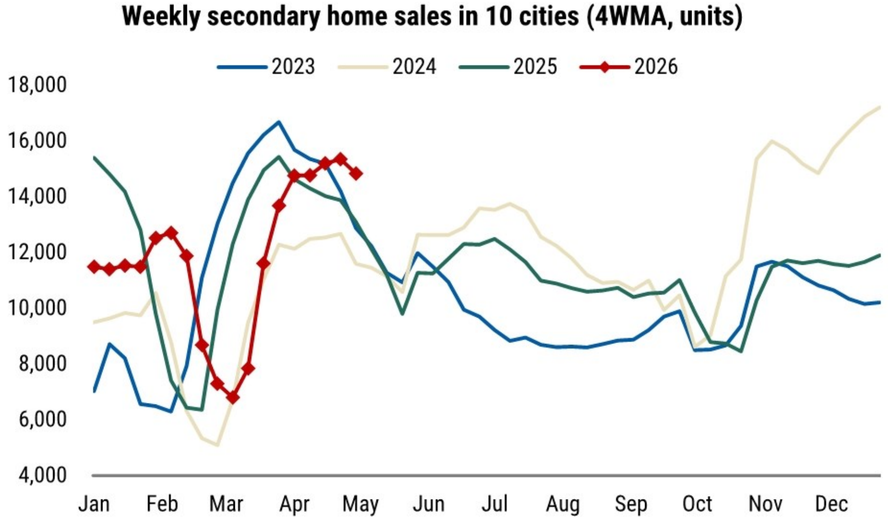
Source: CEIC, Ministry of Culture and Tourism, Morgan Stanley Research

A Sustained Housing Recovery Not In Sight Yet

Improvement in housing prices has concentrated in selected top-tier cities



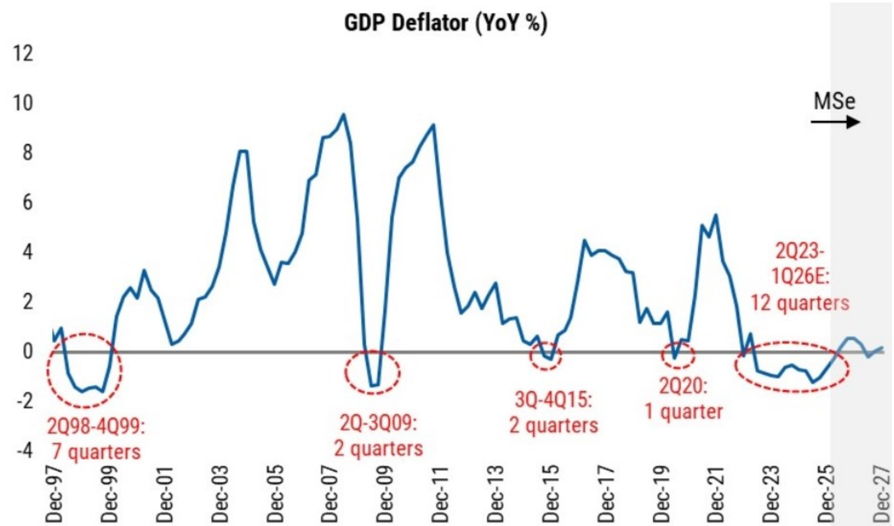
Sequential home sales in major cities has softened again post seasonal uptick



Source: Wind, Bingshan, Morgan Stanley Research

Durable Reflation Requires More Demand Stimulus

GDP deflator steps out of deflation but not out of the woods



China remains halfway in reflation journey, with demand the missing engine

Step 1
Slower investment in oversupplied sectors

(Investment slowed but not a slump)

Step 2
Cutting existing excess capacity

(Production curbs, but not durable capacity closures)

Step 3
Boosting final demand

(Still the missing piece)

Source: CEIC, Morgan Stanley Research estimates

AI Diffusion

China AI 2.0 – Entering a New Phase

AI: A Shift in the Center of Gravity over Past 12 Months

Infra -> Earnings

AI hits P&L

Rising earning expectations
Expanding margins
Efficiency gains

Compute -> Power

Shifting bottleneck

Storage
Grid flexibility
Real-time deployment

Models -> Physical AI

Embodied AI

Humanoids
Autonomous vehicles
Manufacturing data

China's Edge

- Speed of deployment
- Cost efficiency
- System integration
- Open-source platforms

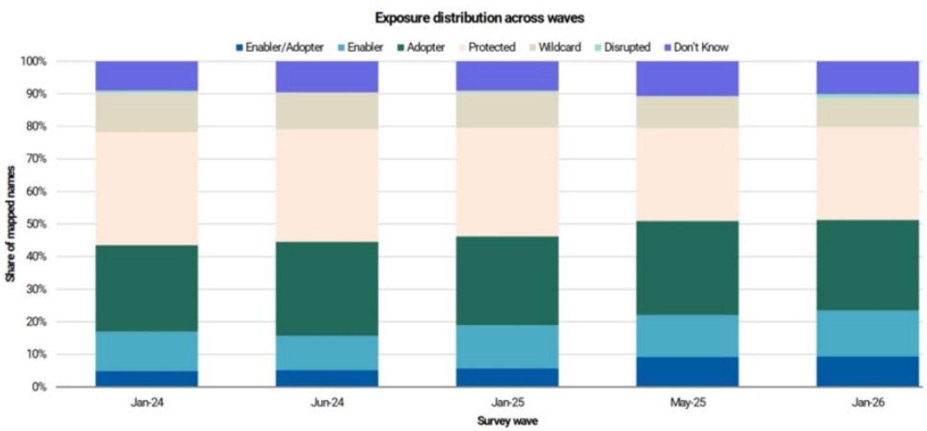
What changed	Commercialization at scale	AI cloud + data centers buildout	Rising domestic stack
Still developing	Advanced chips / EDA	2B monetization	Labor disruption risk

Source: Haver, NBS, UN, government website, Morgan Stanley Research.

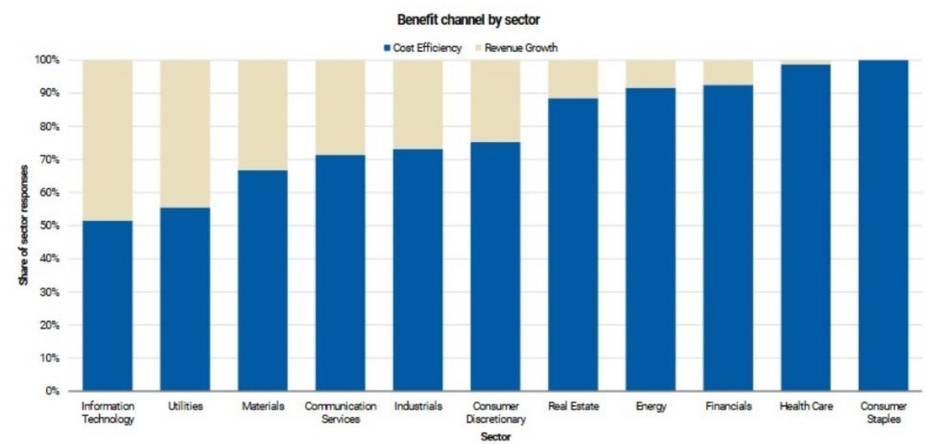
AI Diffusion

China AI Survey – AI Impact Broadening Out

AI adoption broadening – enabler/adopter increased from 43% to 51% in 2 years



IT, Utilities and Materials see the most significant revenue growth from AI

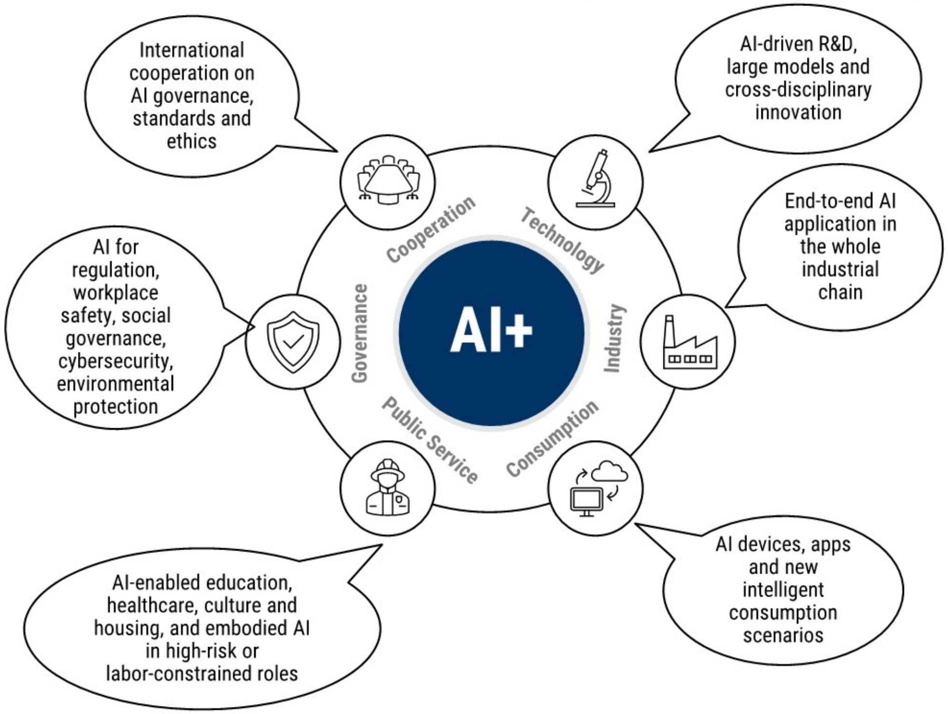


Source: Morgan Stanley Research

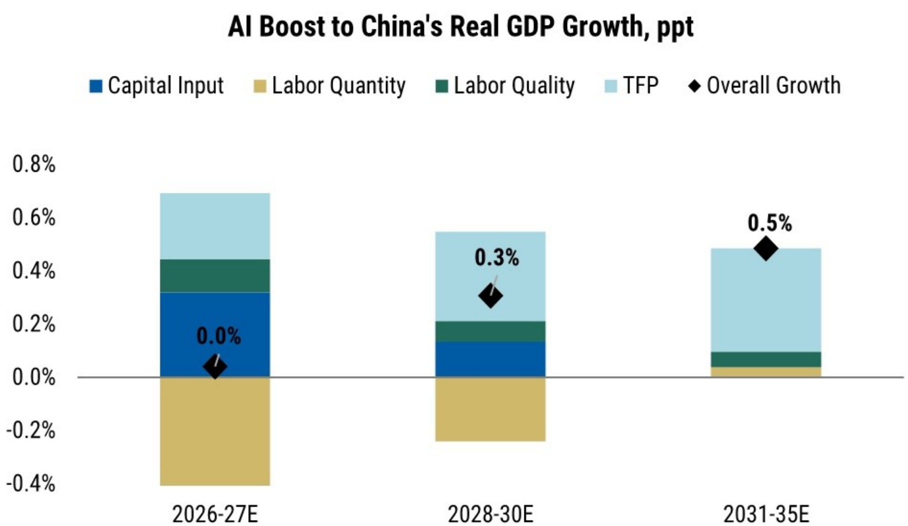
AI Diffusion

AI To Emerge As China's Medium-term Productivity Lever

The 15th FYP elevated "AI+" as a cross-cutting productivity strategy



AI to lift China's TFP by 3pp cumulatively in 2026-35, with gains skewed toward the latter 5 years

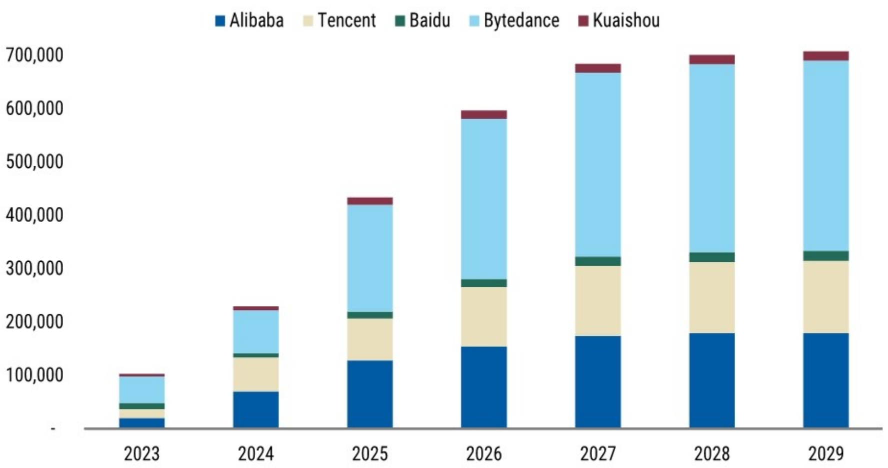


Source: Haver, NBS, UN, government website, Morgan Stanley Research.

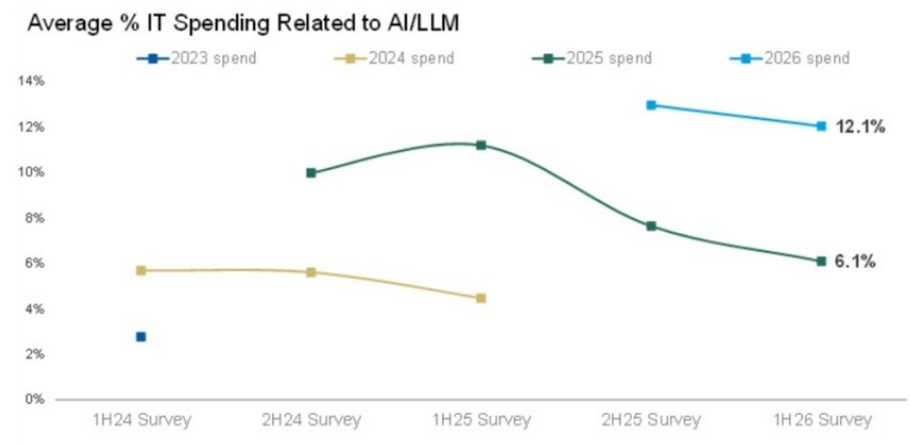
AI Diffusion

AI-driven Capex Boost to Lift GDP Growth by 20-30bps in 2026-27

Hyperscalers to step up AI-related capex spending significantly in next two years



1H26 China CIO Survey: AI share in IT spending budget to remained high at 12.1% this year



Why productivity lags:

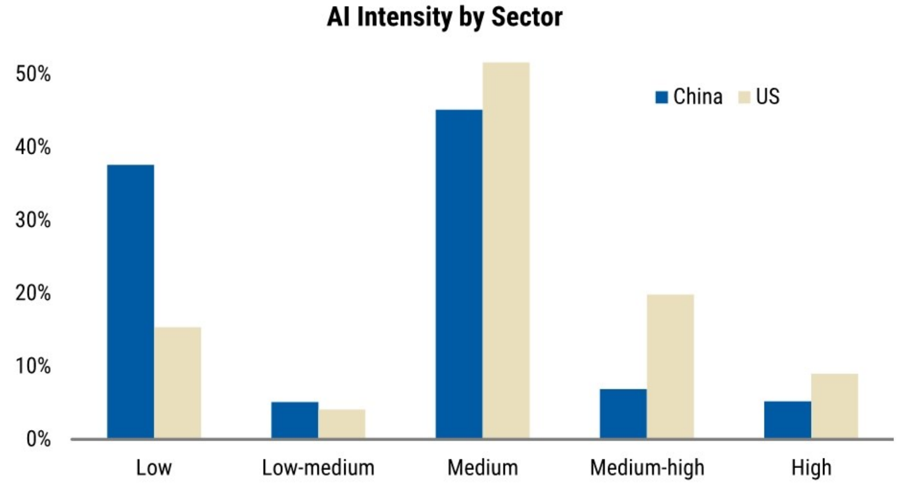
- Learning frictions
- Process disruption
- Investment in capital, skills and organizational change

Source: Company data, CEIC, AlphaWise, Morgan Stanley Research estimates

AI Diffusion

But Positives Could Be Offset By Near-term AI-induced Job Disruptions

China's job market is less exposed to AI diffusion than the US...



...but weaker corporate earnings in China means higher risk of AI-induced labor replacement

Why major technological breakthroughs tend to generate a J-curve in productivity

- Learning frictions
- Process disruption
- Investment in capital, skills and organizational change

Source: Company data, CEIC, AlphaWise, Morgan Stanley Research estimates

AI Diffusion

Broad-based AI Job Disruption Risk in China

TYPE OF AI	IMPACTED JOBS	MACRO CONTEXT	IMPLICATIONS
Generative AI	Displacing junior white-collar roles e.g., data entry, research support, content generation, basic analysis	China has elevated youth unemployment and rising numbers of university graduates towards 2030	More entrenched youth unemployment problems
Agentic AI	Encroaching on mid-level professional functions e.g., financial analysis, legal review, diagnostics, engineering design	Middle income has been under stress given job and wage pressures and housing downfall	Erosion of middle-income wage stability, hampering consumption
Physical AI	Threatens labor-intensive service sector e.g., delivery, transport, retail, warehousing, hospitality	Low-end service sectors have been the primary absorber of employment losses in recent years	Higher structural displacement risk in the blue-collar service jobs

Source: Morgan Stanley Research.

AI Diffusion

What to Expect on Policy Mitigation

1. GUIDING PRINCIPLE

Balance technological progress with labor-market stability

2. POLICY TILT

Higher-end, knowledge work

Greater labor flexibility to accelerate AI adoption

Labor-intensive service sectors

More cautious approach to protect employment

3. POSSIBLE MITIGATING MEASURES

- Upskilling & vocational training support
- New high-tech & service jobs creation
- Stronger social protection (unemployment, healthcare, pension for gig workers)
- More calibrated automation in labor-intensive services

Source: Morgan Stanley Research

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