

CHINA MATTERS

All About Tech

- China's May activity data continued to disappoint outside of exports and industrial production. With export growth contributing roughly 3pp to year-over-year real GDP growth, domestic demand appears to be growing at a sluggish pace of only 1-2% yoy in recent months based on official data.
- We nudge down our Q2 real GDP forecast from 4.0% qoq annualized to 3.5% on the back of weak April and May data, implying year-over-year growth of 4.5% (vs. 4.7% previously). Assuming lower oil prices, faster fiscal spending, and normalized weather conditions, we project Q3 real GDP growth to rebound to 5.0% qoq annualized (vs. 4.5% previously). Our full-year real GDP growth forecast remains unchanged at 4.7%.
- The Chinese government focuses on its long-term objective of transforming the economy into a tech-driven one. The divergence between high-tech/AI and property/consumption continues to widen in both industrial production and capital market data. Top leaders' domestic travel, recent policy communications, and our on-the-ground channel checks all suggest these trends will persist.
- While China's long-term planning has proved valuable in weathering external shocks such as the US-China trade war and energy price spikes, we believe cyclical policies are crucial to ensuring a smoother path toward China's strategic goals. We discuss three channels connecting near-term policies with long-term objectives.
- First, AI-related job displacement could amplify macroeconomic headwinds and delay, if not derail, the recovery in the property market and household consumption. Second, with export growth likely to remain strong over the next few years, targeting only headline GDP growth could cap domestic demand growth. Third, frequent quarter-to-quarter shifts in the policy stance to steer the economy toward the full-year target are not conducive to confidence-building. If not managed well, persistent cyclical weakness could impede China's goal of restructuring the economy into a virtuous cycle between tech-driven productivity gains and strong domestic demand growth.

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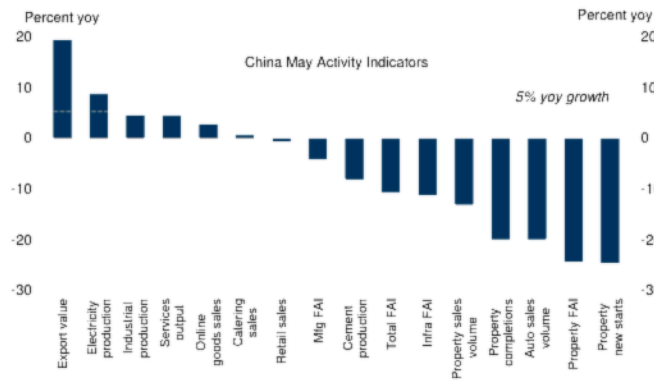
An even more divergent economy

China's May activity data disappointed again following weak April readings. Both retail sales and fixed asset investment (FAI) contracted: May retail sales declined 0.6% yoy, and January-May FAI dropped 4.1% yoy. In the history of official releases, this is only the second time on record that both retail sales and FAI have printed negative numbers—the first was in 2020 during Covid lockdowns.

Looking across major indicators, exports remain the best-performing sector, rising nearly 20% yoy in nominal USD terms. By contrast, domestic indicators such as property activity, auto sales, and infrastructure investment (on a single-month basis) showed double-digit year-over-year declines (Exhibit 1). Auto sales data best illustrate the significant divergence between exports and domestic demand: domestic sales dropped 22% yoy in May, while auto exports jumped 75% yoy (Exhibit 2).

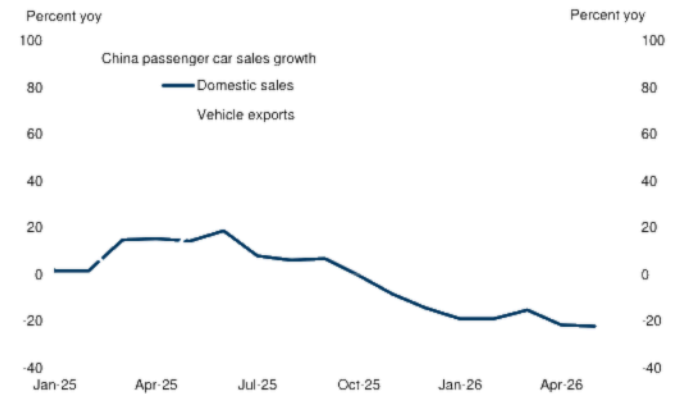
The April and May production data track roughly 4% yoy real GDP growth, about 1pp lower than the Q1 official real GDP growth of 5%. We calculate that the ongoing robust export growth likely contributes around 3pp to year-over-year real GDP growth, implying that domestic demand is growing at a very sluggish pace of only 1-2% yoy based on official statistics. This is also consistent with our import-implied domestic demand growth estimates.

Exhibit 1: Exports remain the best performing part of the economy



Source: CEIC, Goldman Sachs Global Investment Research

Exhibit 2: Domestic sales of autos dropped 22% yoy in May while exports jumped 75% yoy



Source: Haver Analytics, Goldman Sachs Global Investment research

A Slower Q2 and a Faster Q3

Given the April and May realized data, we nudge down our Q2 real GDP growth forecast from 4.0% to 3.5% in qoq annualized terms, or from 4.7% to 4.5% in year-over-year terms. The sequential slowdown from Q1 to April-May was likely driven by three factors.

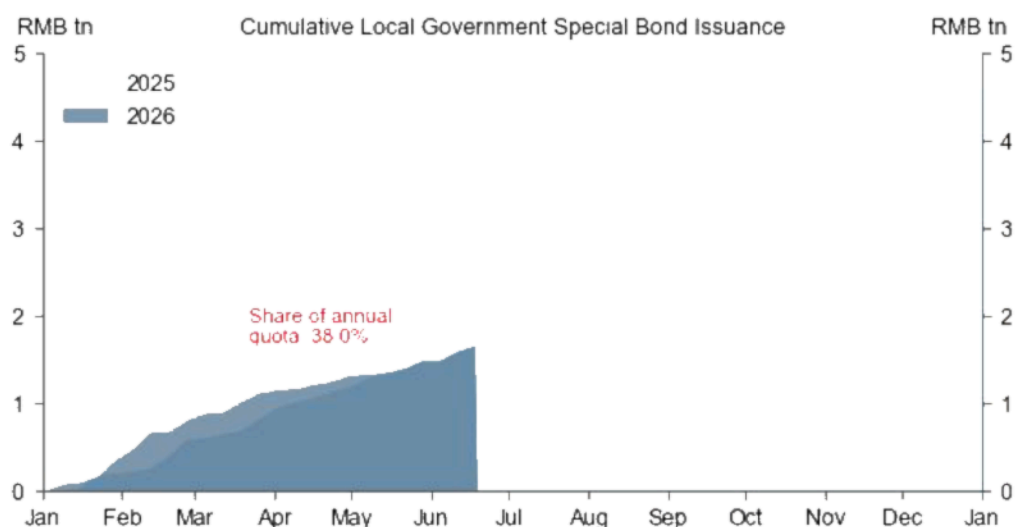
- 1. The negative impact of higher energy prices:** Notable declines in the production of refined oil and chemicals, as well as the sharp drop in domestic retail fuel sales, are clear signs that the Iran war and higher oil prices weighed on Chinese economic activity. With the interim deal to reopen the Strait of Hormuz and our commodity team's lower oil price projections reducing our 2026Q4 Brent forecast from \$90/bbl

to \$80/bbl, we expect the drag from elevated energy prices to gradually dissipate in the coming quarters.

2. **Slowdown in fiscal spending:** After January–February activity data beat expectations, the pace of fiscal spending slowed significantly in March and April. Combining the general public budget and government managed fund budget, total government expenditure growth dropped from +6.1% yoy in January–February to –7.3% yoy in April.¹ Other quasi-fiscal channels also showed tightening in recent months, with the PBOC’s Pledged Supplementary Lending (PSL) balance contracting and policy bank bond net issuance falling. Now that April and May activity data have disappointed, we expect the pace of government bond issuance and fiscal spending to accelerate in the coming months (Exhibit 3).
3. **Adverse weather conditions and residual seasonality:** The NBS noted that heatwaves and heavy rainfall impeded both consumption and investment in May. Adverse weather conditions continued into June, likely weighing on outdoor activities. That said, June industrial production may benefit from positive quarter-end residual seasonality, and Q3 sequential growth should rebound if weather conditions normalize.²

Taken together, we expect Q3 sequential growth to pick up to 5.0% qoq annualized (vs. 4.5% previously) from 3.5% in Q2 (Exhibit 4). Our full-year real GDP forecast remains unchanged at 4.7% for 2026.

Exhibit 3: Local government special bond issuance slowed after Q1



*Updated with issuance plan through Jun 18.

Source: Wind, Goldman Sachs Global Investment Research

¹ Spending out of the general public budget and government managed fund budget totaled RMB40tn in 2025 (29% of GDP) and accounts for almost all of China’s official government expenditure.

² According to the National Climate Center, the El Niño conditions may persist through the end of 2026, raising the odds of severe regional climate anomalies in Q3.

Exhibit 4: We nudge down Q2 sequential real GDP growth forecast while raising Q3 forecast

China real GDP growth forecast					
		New YoY%	Previous YoY%	New QoQ%, SAAR	Previous QoQ%, SAAR
2023		5.4	5.4		
2024		5.0	5.0		
2025		5.0	5.0		
2026		4.7	4.7		
2027		4.7	4.7		
2025	Q1	5.4	5.4	4.5	4.5
	Q2	5.2	5.2	4.5	4.5
	Q3	4.8	4.8	4.5	4.5
	Q4	4.5	4.5	4.9	4.9
2026	Q1	5.0	5.0	5.3	5.3
	Q2	4.5	4.7	3.5	4.0
	Q3	4.7	4.7	5.0	4.5
	Q4	4.6	4.6	4.5	4.5

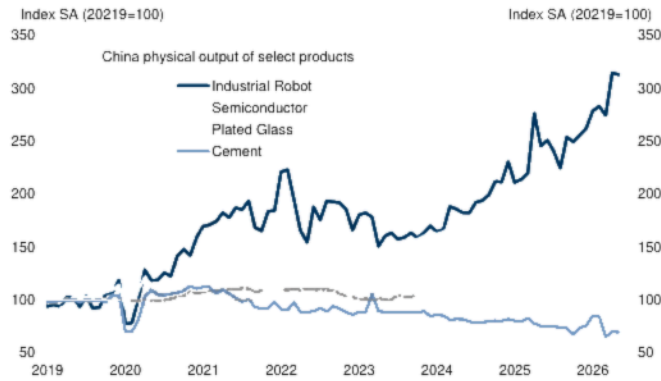
Source: NBS, Goldman Sachs Global Investment Research

Tech drives both the economy and the market

The Chinese government is restructuring the economy by shrinking the property sector and bolstering the technology sector. This transformation is clearly reflected in physical output data. Compared with 2019 levels, production of industrial robots has tripled, and semiconductor production has more than doubled, in sharp contrast to the decline in construction materials such as glass and cement ([Exhibit 5](#)). The divergence is also visible in equity market performance. The Shanghai Composite Index has been largely flat year-to-date, but beneath the stable aggregate index, the information technology sector index has rallied by over 50%, while the consumer discretionary sector index has slid by more than 25% ([Exhibit 6](#)).

Although policymakers have shown some concerns over the latest weakness in consumption growth, policy signals still point to unwavering support for tech and AI as China's structural transformation continues. During its press conference after the May data release, for example, the NBS touted China's technological advances in optical quantum computing and turbofan engine testing. According to NBS officials, high-tech manufacturing value-added grew 15.1% yoy, far outpacing overall IP growth of 4.5% yoy in May. In contrast to the 4.1% yoy decline in overall FAI in January-May, investment in the information transmission industry (which includes AI computing), R&D, and high-tech sectors increased 30.4% yoy, 9.3% yoy, and 4.5% yoy, respectively.

Exhibit 5: Physical output of industrial robots and semiconductors climbed while that of glass and cement fell



Source: CEIC, Goldman Sachs Global Investment Research

Exhibit 6: In the onshore equity market, tech index rallied while consumer index slid



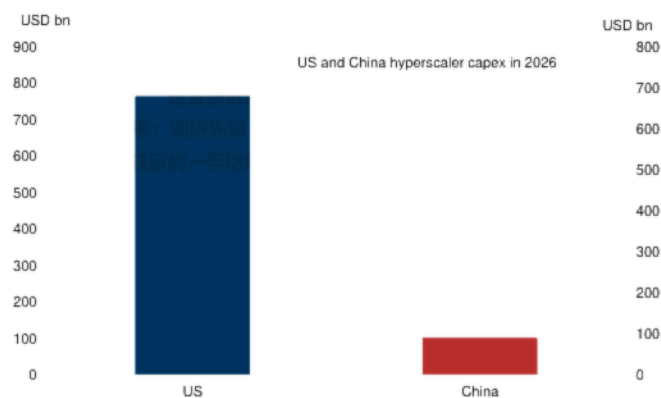
Source: Bloomberg, Goldman Sachs Global Investment Research

Racing for AI in a different way

On the surface, China’s AI capex appears to fall far short of that in the US. For example, while US hyperscalers Amazon, Meta, Google, Microsoft, and Oracle are estimated to increase capex to over \$750bn in 2026, Chinese hyperscalers Alibaba, Tencent, ByteDance, and Baidu are expected to reach only \$100bn in total capex this year (Exhibit 7). However, this does not mean China’s computing power is only a fraction of that in the US. As of mid-2025, installed data center capacity in China was already 60% of that in the US (Exhibit 8).

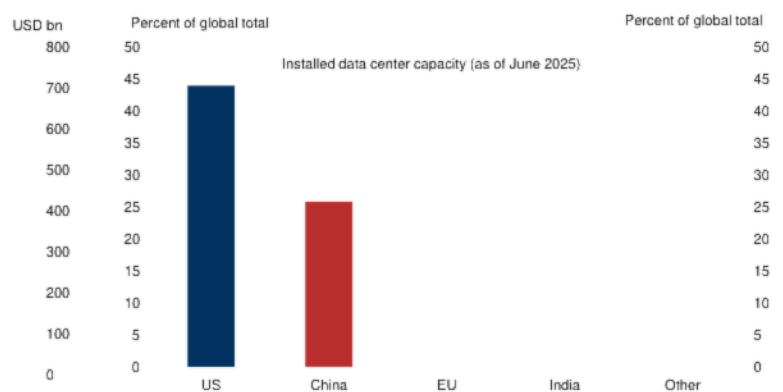
Two factors contributed to China’s low hyperscaler capex relative to its data center capacity. First, the cost of building data centers is much lower in China than in the US. Second, a significant share of China’s AI-related capex is conducted by the government. In the 15th Five-Year Plan (2026-30), for instance, policymakers plan to invest RMB2tn in computing power networks, including data centers. China’s push for AI development and adoption is real, even though the way it is financed and applied differs significantly from the US.

Exhibit 7: Hyperscaler capex is much lower in China than in the US



Source: FactSet, Goldman Sachs Global Investment Research

Exhibit 8: China’s installed data center capacity was 60% of that in the US as of June 2025



Source: IEA, Goldman Sachs Global Investment Research

As China continues to push aggressively on tech and AI advancement, investors are

increasingly asking what this means for China’s employment and consumption outlook. Regarding the pace at which AI adoption may replace labor, there are arguments on both sides. The case for slower AI adoption and less job displacement in China than in the US rests on relatively cheap labor and a government with more levers to discourage AI-related job losses in order to ensure social stability.

On the other hand, historical experience suggests that tech adoption to reduce labor costs accelerates during economic downturns, when profits erode and pressure on employers mounts. For example, our Global Economics team’s research shows that, historically, nearly all job losses from automation of routine occupations in the US have been concentrated in economic downturns (Exhibit 9). With fierce competition persisting and many companies facing low margins, Chinese employers may be more willing than their US counterparts to replace labor with AI to stay competitive.

Herein lies the risk that too rapid a spread of tech and AI applications puts additional pressure on China’s already weak labor market. After five years of decline, house prices are getting close to finding a bottom in the next year or two, based on the experience of historical international housing busts. However, if AI adoption were to lead to significant job losses, stagnant or even falling income would imply declining rents and further downward adjustment in house prices. In other words, with the domestic economy still weak and confidence fragile, another negative shock such as AI-related job displacement could amplify existing macro headwinds and delay the recovery in the property market and household consumption.

In June, the State Council released a document entitled “Implementation of the 15th Five-Year Plan for the Employment-First Strategy”, which tries to strike a balance between accelerating China’s AI development and ensuring labor market stability during 2026-30. However, it is unclear what concrete and effective measures could be introduced to create more jobs when the youth unemployment rate is already high and AI adoption threatens an increasing number of entry-level white-collar positions. Anecdotally, online job postings data suggest that growth in entry-level positions is underperforming the overall job market.

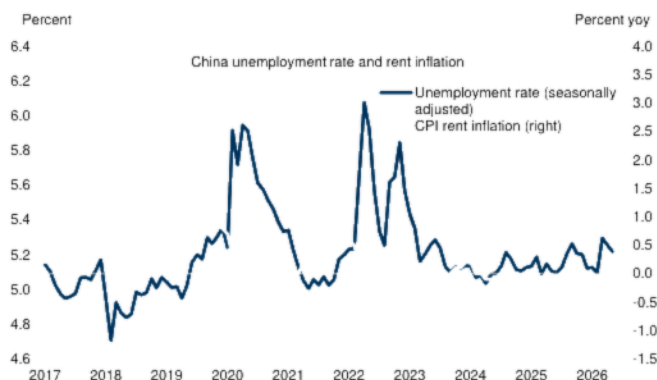
Exhibit 9: US experience shows that labor replacement tends to accelerate during economic downturns



Routine occupations include sales (e.g., clerks/telemarketers), office/administrative support (e.g., secretaries/typists), production (e.g., factory machine operators), construction/extraction (e.g., miners), and installation/maintenance/repair (e.g., mechanics).

Source: Jaimovich Siu 2018, Goldman Sachs Global Investment Research

Exhibit 10: Rising unemployment often precedes falling rents in China



Source: Haver Analytics, Goldman Sachs Global Investment Research

Policymakers focusing on the long-term

Recent policy news has focused on long-term strategies. The [State Council Decree 834](#), published in April, addressed supply chain security. The [State Council Decree 837](#), made public at the beginning of June, relates to monitoring and regulating tech transfers and cross-border investment amid US-China competition and Chinese companies' global expansion. The [Lujiazui Forum](#) in mid-June announced steps to build a price-based monetary policy framework and accelerate [RMB internationalization](#).

In contrast, near-term cyclical policies have attracted less attention. But the near term is the path to the long term. We think three aspects of cyclical economic management are important in this regard.

1. As discussed earlier, if rapid AI adoption were to lead to significant job replacement, it would disrupt China's pursuit of a self-sustaining, robust, tech-driven growth model. Therefore, concrete and effective policies to boost employment and income are crucial to creating a domestic environment conducive to continued tech development.
2. With Chinese exports [poised for strong growth](#) in the next few years, the current economic planning system, which targets only headline real GDP growth, effectively caps domestic demand growth. This runs contrary to the government's long-term goal of expanding domestic demand. Instead, domestically oriented targets such as employment and consumption growth would be more suitable for China's stated [long-term strategic objective](#) of expanding domestic demand.
3. Confidence-building takes time and persistence. Over the past few years, we have observed a repeated pattern in which a solid quarter of real GDP growth is followed by a slowdown in fiscal spending, and policy easing accelerates only after weak data put the full-year target at risk. Quarter-to-quarter shifts in the policy stance do not help boost sentiment and bolster confidence, which are important to households' propensity to consume and private businesses' propensity to invest, even if such shifts help the government land official GDP statistics exactly on the growth target laid out at the beginning of the year.

The experience of the past two years, including the US-China trade war of 2025 and the energy supply shock of 2026, has demonstrated the advantages of China's long-term planning and strategic thinking. However, if long-term planning becomes policymakers' sole focus, it could hinder progress toward achieving strategic goals. Fostering consistent and strong economic growth through cyclical tools should be an indispensable part of macro management. Robust growth, a strong labor market, and optimistic sentiment provide the cushion needed for the government to push through difficult structural changes and enable a virtuous cycle between tech-driven productivity gains and strong domestic demand growth.

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