Strategy Espresso: Europe and the China Dragon – a fiercer fight

- **Is China continuing to take share in Europe?** Yes, more than ever. China's exports to Europe have grown double-digit p.a. in recent months, and China has been increasing share in third markets. China now accounts for 23% of EU imports. Meanwhile, China's share of EU exports has fallen sharply since 2020.
- **What are the drivers?** China's companies are seeking growth outside given weak domestic demand and over-capacity in many industries. China also has huge cost advantages in labour, borrowing, energy and land use as well as a significantly undervalued currency. These, combined with Europe's own growth impediments—regulation, planning laws, lack of investment—have all meant China is rapidly gaining share in manufacturing.
- **Who is exposed?** Stocks in the China competition basket (GSXECHNX); mainly in Autos, Medtech, Chemicals and select Industrials. This basket has consistently underperformed both STOXX 600 and our Asia team's China Going Global basket (GSXACHGG); the underperformance tallies closely to the widening trade deficit with China.
- **Is it in the price?** Underperformance has largely been a function of EPS downgrades. Given the ongoing export share gains by China and continued weak earnings outlook for these exposed stocks we continue to expect earnings-driven under-performance rather than further valuation declines given the discount for these stocks is already steep.
- **Is Europe defending itself?** Less than 10% of Chinese imports into the EU currently face tariffs—a sharp contrast with the US approach. The EU is unlikely to copy the broad-based US approach but our economists do expect the EU to target reducing reliance on Chinese components and tariffs on specific sectors.
- **Does this matter for European indices?** Not as much as investors tend to think. Autos and Chemicals combined are smaller than Aerospace & Defence or Renewables. Tech Hardware and Autos had roughly the same market-cap just three years ago, now Tech Hardware is 4x the size of Autos.
- **What does this mean for global investors?** While China is clearly gaining market share, this does not necessarily translate into shareholder returns. Much of China's success has been driven by aggressive pricing, often resulting in subdued profitability. As a result, Chinese equities have not been the primary beneficiaries of China's export expansion. European equities have outperformed over most medium- and long-term horizons, supported by stronger earnings quality, higher returns on capital, and greater diversification by sector.

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Q&A on Europe Equity & the China Dragon – A fiercer fight

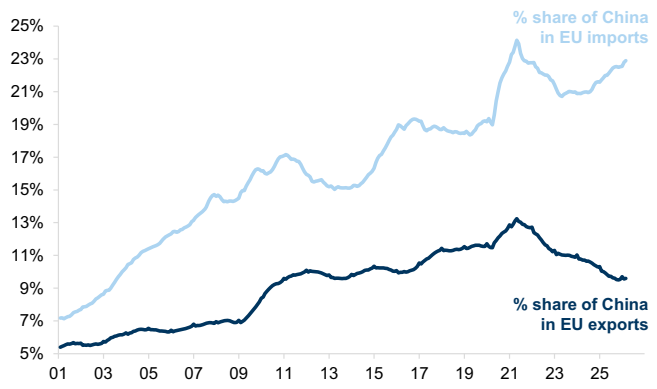
1. Is China continuing to take share in Europe, and in third markets? Yes, most certainly. China exports to Europe have been growing at a double digit annual pace in recent months, and China has been increasing share in third markets too. China now accounts for 23% of EU imports (Exhibit 1) and the share of China in Europe's exports has fallen sharply since 2020. In other words, China is buying less from Europe but selling more into Europe, representing a competitive threat to European manufacturing companies. We have seen several companies warn or lower guidance over China competition in recent weeks, including Signify and BMW.

- **Autos:** The figures are stark, our analysts report that Chinese domestic brands gained over 400 bps of Europe market share in the year to end May (their overall share of the European market is now 6-7%), corresponding to a roughly 400bps share loss from mass-market brands in Europe. They argue that this share gain trend appears to be accelerating, with every mass-market brand losing ground except Tesla. Relative to the mass market, the European premium brands have proven more resilient but even these are losing share.

- **Chemicals:** Our analyst recently downgraded several names arguing that China's export-oriented pivot over the course of the Middle East conflict has effectively extinguished any short-lived hopes of a revival in European competitiveness. With other Asian countries suffering feedstock supply issues and domestic Chinese demand remaining low, excess capacity is forcing product out of China with chemical exports from China to the rest of Asia rising 70% in March and April according to ICIS data. In addition, China is beginning to lead not only in commodities but increasingly in semi-specialty chemicals too.

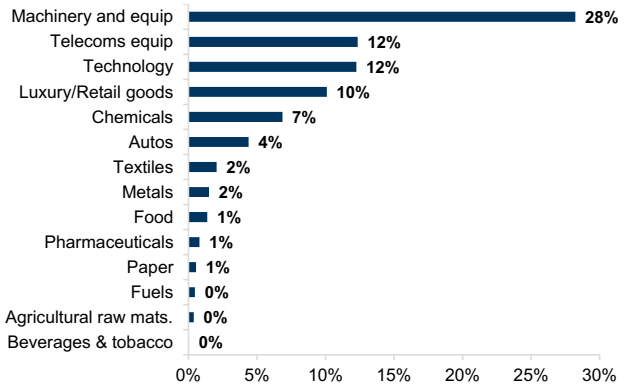
- **Capital goods:** In their machinery export tracker our Asia analysts talk about strong growth in Europe of +50%/+19% yoy in volume/value, mainly on accelerated China exports. And our European team argues that while Europe still leads in exports of capital goods within their tracked products, accounting for 43% of global volumes, its share has decreased from 54% in 2005. Meanwhile, China is steadily increasing its export presence in the global marketplace, gaining 17pp of market share, from 7% in 2005 to 24% in 2025. Chinese competition acceleration has been most noticeable in recent months for LED lighting, excavators, heat pumps, light commercial vehicles, heavy-duty trucks and tractors.

Exhibit 1: Europe imports more from China but exports less
% share of Greater China in EU trade - 1y rolling average



Source: Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 2: Machinery accounts for almost one third of EU imports from China
EU Imports from China (% of total import from China)

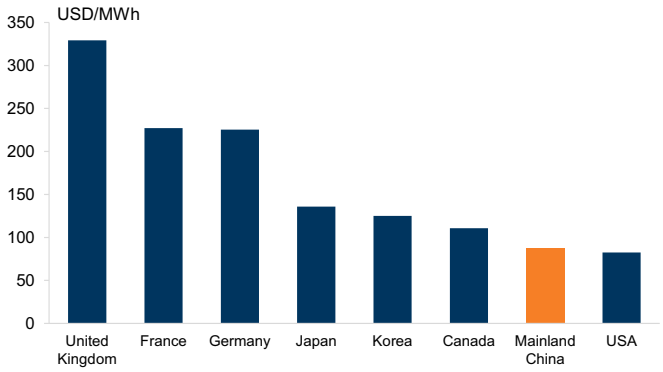


Source: UNCTADstat, Goldman Sachs Global Investment Research

2. What are the drivers? China's companies are looking for growth outside given weak domestic demand and over-capacity in many industries. Our Asia economists argue China has huge manufacturing cost advantages: (i) lower labour costs, (ii) borrowing costs are very low in targeted sectors facilitated by a state banking system with a large pool of low-yielding deposits, (iii) China has a large, low-cost (though high-pollution) energy source in coal while government policies have also encouraged rapid development of solar energy, as well as a broader shift away from reliance on imported energy (e.g. via development of the EV sector). China's manufacturing firms enjoy very competitive power costs, especially versus Europe (Exhibit 3), (iv) on land, top-down planning means households pay high residential property prices and in effect subsidize manufacturing land use, (v) currency weakness, despite China outpacing world growth over the past decade and an improvement in manufacturing productivity the renminbi has slid in recent years and while it is true that the currency has strengthened since the lows in early 2025, it remains significantly undervalued on our FX teams' currency frameworks (Exhibit 4).

The combination of all these, along with some of Europe's own impediments to growth – regulation, planning laws and lack of investment – have all meant China is rapidly gaining share in manufacturing.

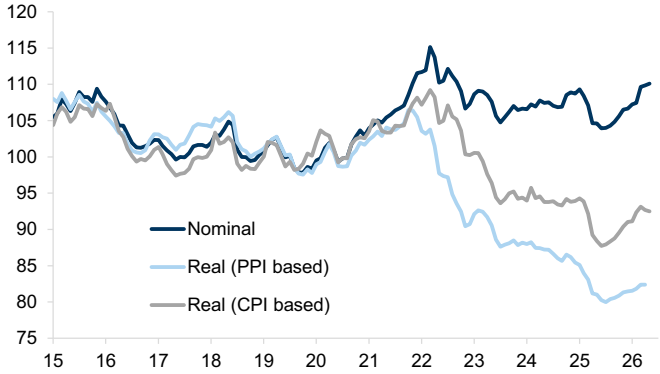
Exhibit 3: China's low power costs rival those in the United States
Power prices for industrial sectors



Industrial power prices including taxes in 2023 for all except for Japan, where data is only available for 2021, and for China, where data is only available for 2018 and average power prices for all sectors instead of the industrial sector only

Source: Penn World Table (PWT), Haver Analytics, Goldman Sachs Global Investment Research

Exhibit 4: CNY has appreciated since the 2025 lows but remains under-valued compared with China's strong economic and productivity growth in recent years
Index, 2019 = 100

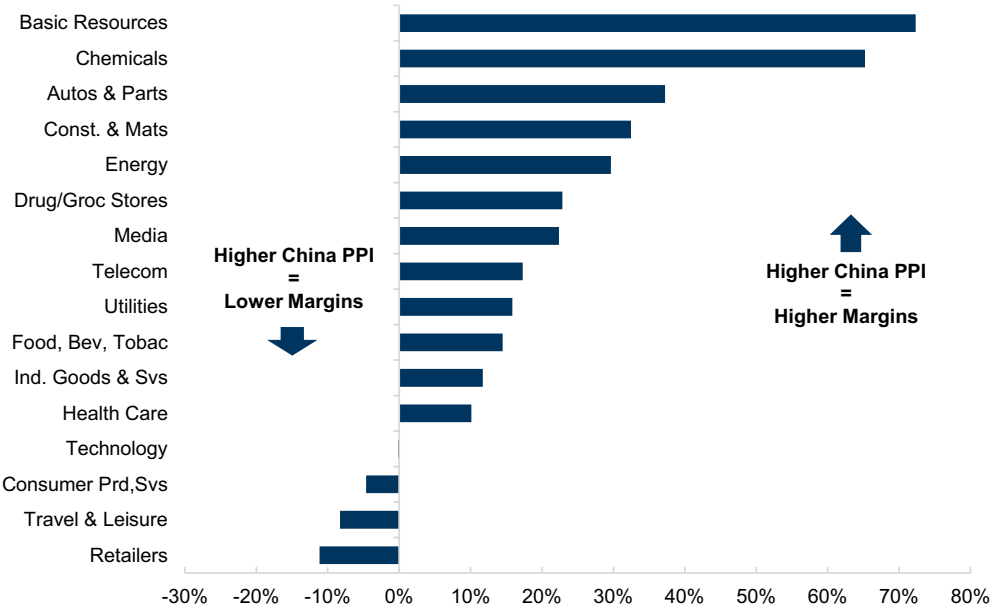


Source: Haver Analytics, Goldman Sachs Global Investment Research

3. Who is most exposed to China competition; how have they performed? Exhibit 5 shows the correlation of European sector EBITDA margins with China PPI inflation. The sectors with the highest sensitivity to this weak pricing dynamic, measured by the correlation of margins to China prices, have been Chemicals, Autos and Basic Resources (mining). On the flip-side, lower prices in China manufactured goods have been associated with better margins in some consumer and services sectors in Europe.

Of course there is always potential for these dynamics to shift either via Europe putting tariffs or other regulations on China goods, or by China making inroads into other previously insulated industries. Most recently internet retailing platform, JoyBuy, launched in the UK and users quickly rose to being 10% of those for Argos, owned by Sainsbury's.

Exhibit 5: Margins of Chemicals, Autos, and Mining are the most sensible to China pricing dynamics
Correlation between China PPI and EBITDA Margin across European sectors since 2005

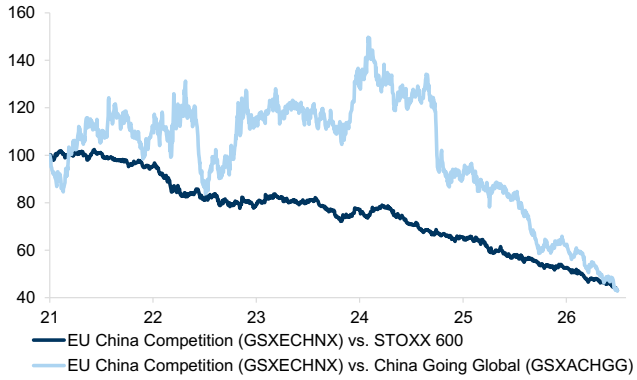


Source: Haver Analytics, Datastream, Goldman Sachs Global Investment Research

In terms of companies, in our original work on Fighting the China Dragon we screened for companies that mention China as a competitive threat or potential threat. We found that across the STOXX 600 index China has been mentioned almost 10,000 times by around 300 companies since Q1 2024, although mostly these mentions are positive mentions about growth/demand, they are increasingly also about risk and competition. We screened the companies for the more negative comments which concerned competition and our Global Banking and Markets (GBM) division created a basket optimising for liquidity - GSXECHNX.

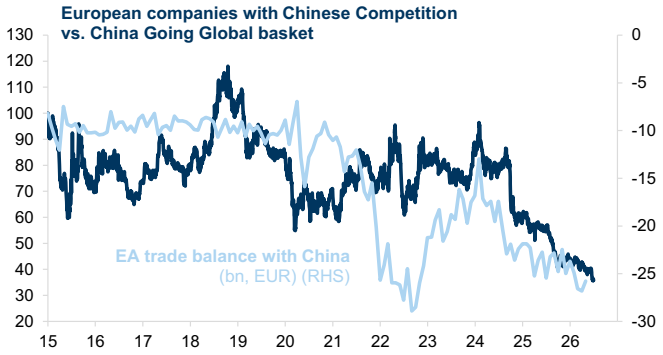
The companies are mainly in Autos, Medtech, Chemicals and select industrials. These companies have consistently underperformed both versus the STOXX 600 and versus our China Going Global companies from our Asia team, GSXACHGG (Exhibit 6).

Exhibit 6: European companies exposed to China competition have consistently underperformed the market
Relative price performance. Jan 2021 = 100



Source: Bloomberg, Datastream, Goldman Sachs Global Investment Research, Goldman Sachs FICC and Equities

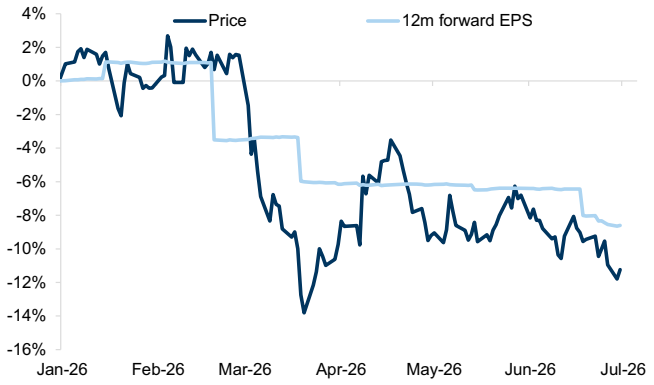
Exhibit 7: Europe's widening trade deficit with China
Price performance and trade balance between Euro Area and China (RHS)



Source: Datastream, Haver Analytics, Goldman Sachs Global Investment Research, Goldman Sachs FICC and Equities

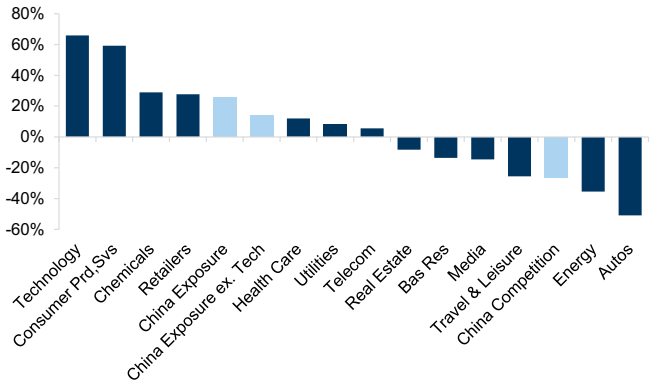
4. Is the weakness now well priced? We continue to argue for an under-weight in companies with high China-competition exposure, for example we recommend an underweight in Autos and Chemicals for this reason**.** The basket of China-competition exposed companies (GSXECHNX) has performed consistently poorly, both in terms of earnings and price performance (Exhibit 8). That said, these companies do trade on a substantial discount to the market c. 25-30%, a contrast to companies with high China sales exposure (GSSTCHNA) but not necessarily competition threat (Exhibit 9). Given the ongoing export share gains by China and continued weak earnings growth for these stocks we continue to expect earnings-driven under-performance (Exhibit 7) rather than further valuation declines given the discount for these stocks is already steep.

Exhibit 8: The basket of China-competition exposed companies has performed consistently poorly
EU China competition basket (GSXECHNX)



Source: Bloomberg, Goldman Sachs Global Investment Research, Goldman Sachs FICC and Equities

Exhibit 9: Companies exposed to China competition trade on a substantial discount to the market
12m fwd P/E Premium/Discount vs. STOXX 600. European sectors and baskets. China Exposure = GSSTCHNA; China Competition = GSXECHNX



Source: Datastream, Bloomberg, Goldman Sachs Global Investment Research, Goldman Sachs FICC and Equities

5. EU policy-makers are starting to focus on the threat posed by low-cost China manufacturing to Europe's industries. In its June meeting, the EU Council mandated the EU Commission with the task to propose the appropriate response to China, marking a shift in European policy. The EU has so far taken a relatively cautious stance toward

Chinese products. Although most EU trade-defence investigations have targeted China, less than 10% of Chinese imports into the EU currently face tariffs—a sharp contrast with the US approach (Exhibit 11). The main exceptions have been tariffs on battery electric vehicles, introduced in October 2024, and the abolition of the EUR 150 customs-duty exemption for small parcels from July 2026.

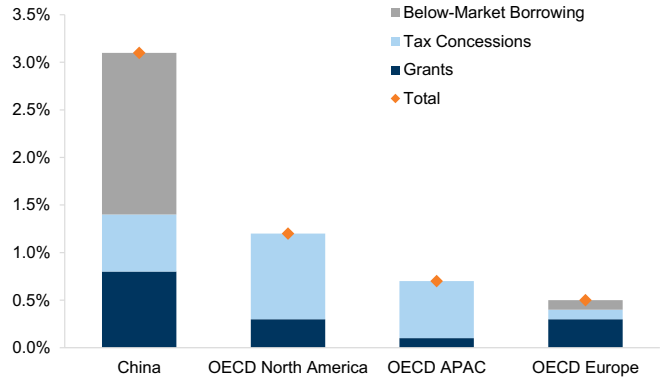
Our economists expect the Commission to continue to raise trade barriers, but in a targeted way consistent with the new trade-diversion monitoring framework:

- **Near-term measures are likely to focus on sectors** where evidence of diversion or injury is strongest, such as tightening steel safeguards to prevent Chinese steel from being rerouted through third countries.
- **Expect anti-subsidy duties to be extended** to hybrid vehicles, alongside faster anti-dumping investigations into machinery, wind-turbine components, and basic chemicals.
- **The EU is also discussing broader and more aggressive trade barriers** by forcing procurement of "made in Europe" goods, limiting foreign direct investment in strategic sectors (Industrial Accelerator Act), restricting access to European market for Chinese technologies (Cybersecurity Act), and forcing European companies to diversify their supplies ("Anti-Dependency" instrument). Talking to corporates, we find that supply-chain resilience is already an area in which most managements are focused.
- **This structural shift under discussion could allow the EU Commission to impose sweeping tariffs** and import quotas on sectors deemed critical to the bloc's "economic security". Benefitting from the WTO national security exceptions, the EU could target advanced manufacturing sectors—such as semiconductors, batteries, and robotics— where Chinese state subsidies are challenging the survival of Europe's industrial base.

Why does Europe not go further? Our economists expect the Commission to avoid US-style blanket tariffs for four reasons: (i) China retains leverage as a key supplier of refined rare earths, (ii) broad tariffs would do little to address the main source of the growth drag, which comes from lost market share in third countries, (iii) China still accounts for c. 8% of total EU goods exports with US tariffs still elevated, European policymakers have an incentive to preserve access to China, and (iv) China's cost advantage is sufficiently large that tariffs may not materially close price gaps in some sectors.

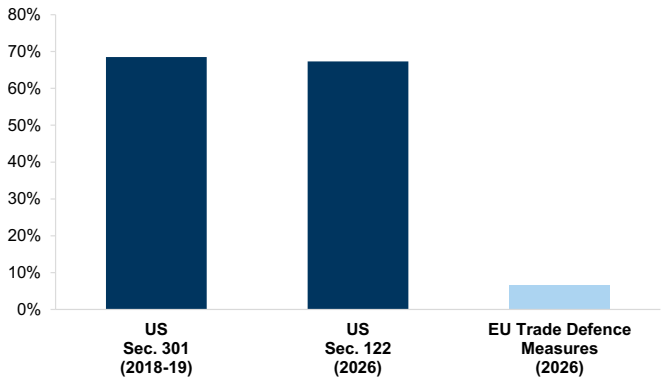
Given these barriers, our economists expect a dual-track strategy: a diversification instrument to reduce reliance on Chinese components, and a protective instrument to raise targeted tariffs and quotas after due process and sector-specific investigations.

Exhibit 10: Chinese Manufacturers Enjoy a Large Cost Advantage
Industrial subsidies in selected industrial sectors as a share of revenue (2024)



Source: OECD, Goldman Sachs Global Investment Research

Exhibit 11: Less than 10% of Chinese imports into the EU currently face tariffs
Share of imports from China covered by ad-hoc tariffs*



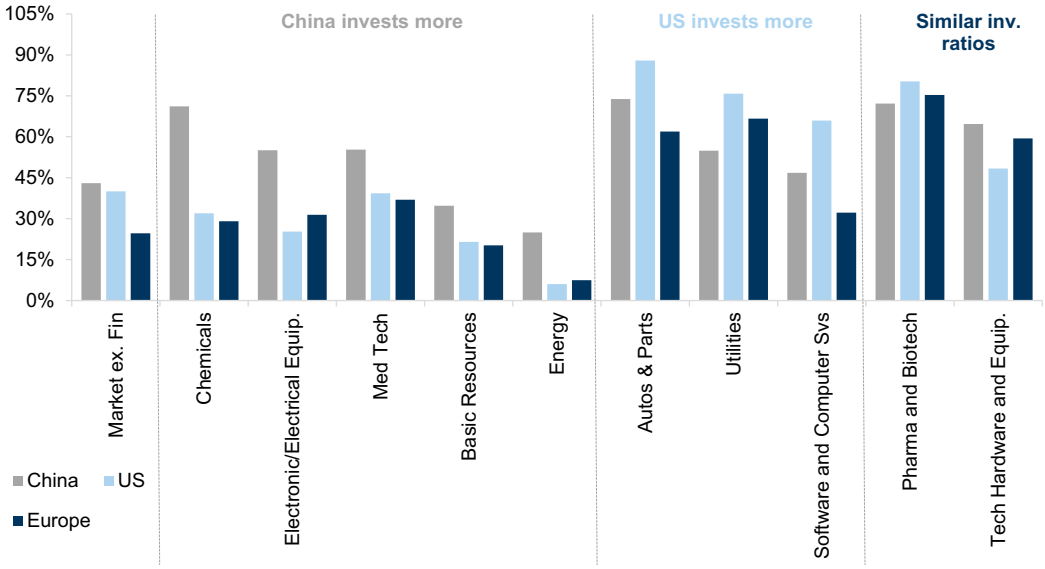
Tariffs imposed on top of MFN rates

Source: Haver Analytics, European Commission, Goldman Sachs Global Investment Research

6. How about innovation and investment? Europe has under-invested in recent years, at both the economy and corporate level, while in contrast China has been raising investment as part of the economic and political ambition to increase manufacturing and export share. For the market ex financials both US and China companies have spent in the last 5-years c.40-45% of their cash flow from operations (CFO) on growth investments, defined as R&D and capex over depreciation. In contrast, the European market share of growth-investment to CFOs is about 20%.

We show in Exhibit 12 the share of R&D and capex to CFO for tradable goods (ex food), technology and resources sectors. In almost all cases, Chinese companies have spent more in the last five years. For Chemicals the difference is especially large, but China also consistently spent more on growth-investment in Autos, Electronic/electrical equipment, Med tech, Software and computer services, Basic resources, Energy and Industrial transport.

Exhibit 12: Where do Chinese companies invest more?
Share of R&D and capex to CFO for tradable goods (ex food), technology and resources sectors (last 5-years)



Source: FactSet, Datastream, Goldman Sachs Global Investment Research

The only areas where Europe has spent to a similar degree as China are Pharmaceuticals, Tech hardware, and Utilities:

- **In Technology, ASML is considerably ahead** with China having neither EUV tools nor DUV immersion tools. Our analysts argue the ecosystem around EUV IE lenses and lasers and mirrors plus engineering know-how as well as feedback from leading edge customers will be challenging or even impossible to replicate. In a recent CEO visit note they contextualised Chinese efforts with stacking which validate that they do not have equivalent EUV technology. We continue to recommend an OW in Technology.

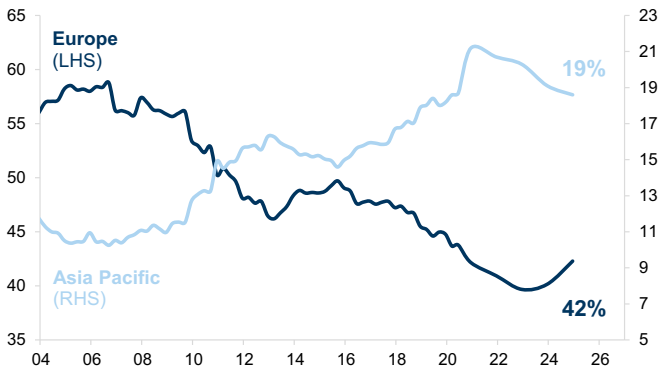
- **European utilities are investing heavily in renewables** and in electrification and power grids more broadly, which should improve Europe's aged power infrastructure, improve energy independence, and provide energy for the data centre roll out which will enable greater use of AI across industries. Our utilities analysts expect power-requirements to drive €3.5 trn of investment needs in power generation (largely renewables) and power grids over 2026-35, thus supporting a generational earnings super-cycle both for the utilities, and for the industrials in Europe which supply much of the equipment. See Utilities at the core of Europe's Electrification. We continue to recommend our Renewables basket (GSSBRNEW).

- **Pharma's long-term earnings largely depend on the sector's ability to offset patent expirations with innovation**. Our analysts continue to favour those companies seeing innovation momentum. Within their coverage, Argenx, AstraZeneca, Bayer, GSK, Novartis and UCB have seen the greatest success year to date in late-stage drug pipelines. M&A, to buy innovation, is also ramping up and about 25% of the 2026 YTD transactions are AI-driven, focusing on drug discovery,

protein engineering and digital pathology. Novo Nordisk and Sanofi announced strategic partnerships with OpenAI and Formation Bio, respectively, to build AI agents to automate and accelerate clinical trial enrolment and drug development workflows. That said China invests heavily here too and is increasingly launching more innovative drugs, capturing nearly half of all global oncology trials, and matching European technical capabilities in complex medical hardware like MRI and CT scanners.

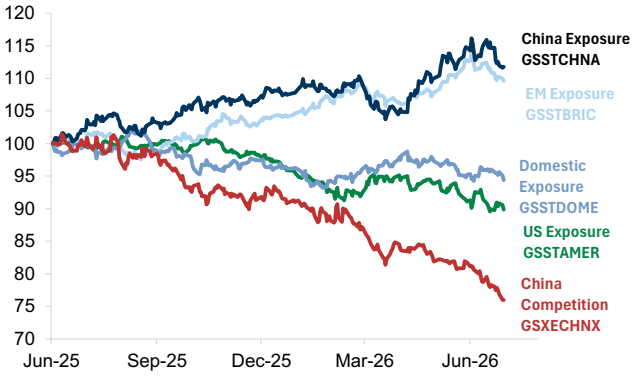
7. How about companies selling into China? China was a source of growth for European companies, and we saw a rise in investment spend going into Asia from 2000-14 to capture some of this growth. However, this has been in reverse for over a decade, and sales themselves into Asia peaked as a share of total European company sales and began to fall post the pandemic (Exhibit 13). We see this as a function of three things – (i) more regionalisation (more focus back on investing in Europe itself in defense, electrification etc, this is something we discuss in the Post Modern cycle), (ii) European businesses having already reached a high level of Asia exposure, and (iii) more competition of domestic players in China and/or other third-party Asian market making investment less worthwhile. As our Europe Med Tech analyst reports: while healthcare spend growth in China has accelerated from a 2022 trough and exceeded that of the U.S. in 2024 and 2025, much of that incremental growth has accrued to local market participants.

Exhibit 13: The expansion into Asia has recently stalled or even reversed
STOXX Europe 600 - Geographical Revenue Exposure



Source: FactSet, STOXX, Goldman Sachs Global Investment Research

Exhibit 14: Companies with China exposure have performed well year to date
Price Performance relative to the market, indexed to 100 in June 2025



Source: Bloomberg, Goldman Sachs Global Investment Research, Goldman Sachs FICC and Equities

Luxury goods exposure to China and Chinese-based travellers is high at around a third of European luxury sales. Previously these were seen as protected from Chinese competition by brands and heritage but even this barrier is being eroded. The global vintage or second-hand market has grown and Asian brands have also grown in prestige and influence. The lack of innovation/investment in brand and the significant price hikes for European luxury products over the pandemic recovery period have also reduced their allure.

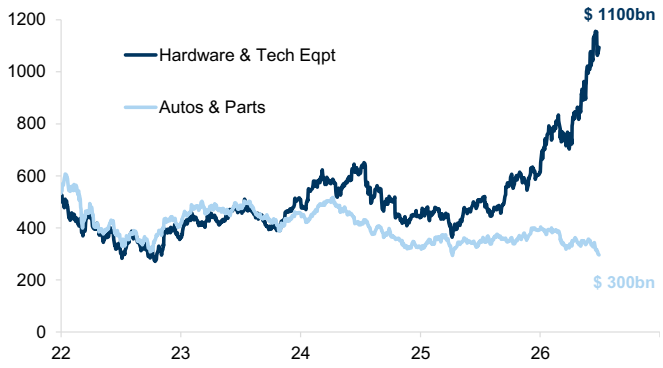
Of course the success of Europe selling into China in the last 20-years also provides a very real barrier to tariffs, quotas or other regulations against China-goods coming into Europe. China can always retaliate against European businesses and has done so, or

threatened this in the past. That all said, companies with China exposure have performed well year to date (Exhibit 14) and this has at least partly been driven by upward EPS revisions. A lot but not all of this performance has been in the Tech sector stocks in our China-exposure basket with both high China and global exposure. We think it has also been a function of the modest rise in the CNY.

8. How exposed are European equities? It is here we see some good news. European indices have performed well and this is largely a function of the shifting share of these indices towards growth areas. Talking to international investors, there is a perception that Europe can do little to defend itself and is very exposed to China taking manufacturing share. While that is to some extent true (albeit that defence-strategy from the EU is rising) it is also true that vast swaths of the European equity market are either unaffected, protected or are unlikely to be affected for some time, or are areas in which China's advantages are not obvious, such as in building materials which cannot be transported economically at distance.

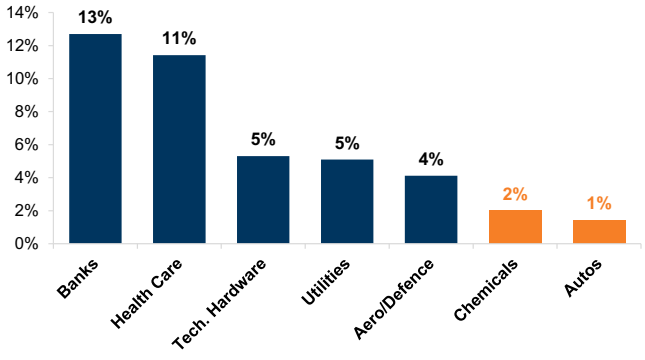
There tends to be a perception that Autos play a meaningful role in Europe. They do in share of the economy and certainly in the workforce in Germany, France and Italy, but they are increasingly a tiny fraction of the equity market (Exhibit 16). This reduction in the market cap of Autos has been ongoing but has accelerated in the last year just as there has been a sharp rise in the earnings and value of Tech Hardware, especially Semis. ASML is two-and-a-half times the size of the entire Autos market cap in Europe. As we show in Exhibit 15 tech hardware is now five times bigger than Autos. This transformation of European market cap has been fast and reflects significant growth in Semis and Equipment and suggests a deterioration in the competitiveness of European Autos.

Exhibit 15: In Europe, Tech Hardware is now 4 times bigger than Autos
Market cap of European sectors



Source: Datastream, Goldman Sachs Global Investment Research

Exhibit 16: Autos only constitute 1% of total European market cap
% of total European market cap



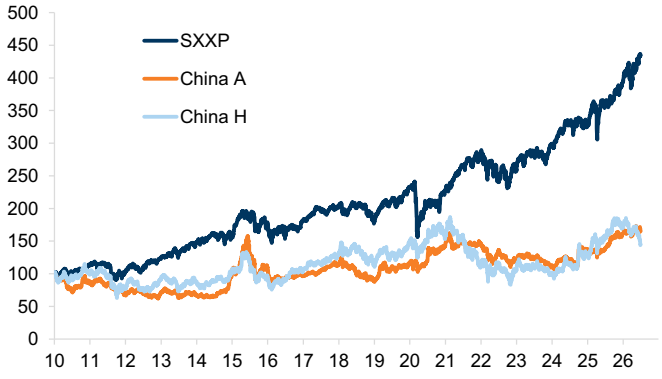
Source: Datastream, Goldman Sachs Global Investment Research

In addition, there are plenty of areas where Europe does not compete with China, or where there is demand for European products for reasons of security or ongoing servicing. In addition, the majority of sectors are not obviously vulnerable to China manufacturing pushing down prices: examples include Financials, Services companies (Business services, Media, Travel & Leisure), and domestic sectors like Real estate, Telecoms and Utilities. Moreover, the European consumer should benefit from lower prices and lower inflation than would otherwise be the case boosting real incomes and spending power elsewhere – on services, for example, which European companies tend

to supply – and also potentially reducing longer term inflationary risks and hence bond yields and borrowing costs.

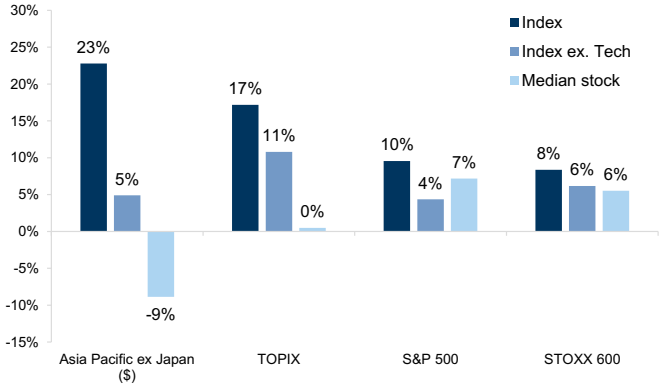
Finally, European equities have performed well versus China equities (Exhibit 17), as overcapacity and a relatively lower focus on returns to shareholders have hampered China returns for some time and, while there have been pockets of strong China performance (e.g., the more tech-heavy A-shares in the last year), Europe has outperformed significantly on most medium or long term horizons. Even year-to-date, in Asia, which has seen solid returns, performance has been driven by a few stocks, with the median stock lower (Exhibit 18). In contrast, year-to-date the median stock in the US and Europe is up.

Exhibit 17: The European equity market has been outperforming China
Total returns of STOXX 600 and China market in local currency (Euro and CNY). Indexed to 100 at the start of 2010



Source: Datastream, Goldman Sachs Global Investment Research

Exhibit 18: The performance of the median stock in Asia has been negative YTD, while returns have been positive in the US and Europe
Price return in 2026; local currency (APxJ in USD)



Source: Datastream, Goldman Sachs Global Investment Research

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