Yardeni Research

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Morning Briefing

On Challenges Facing China & South Korea

Check out the accompanying chart collection.

Executive Summary: China has a shot at overshooting the government's 5% GDP growth target in coming years, William reports, if it keeps its exports flowing, as they have been, to developed nations other than the US. But this would risk geopolitical collision with President Trump's vision for US-China trade. … Also: South Korea's stock market is up dramatically so far this year, reflecting newfound political stability, faith in the government's reform plans, and exposure to the AI boom. Is the bull run sustainable? Several geopolitical, economic, and reform-related obstacles lie ahead.

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Chinese Economy I: Get Ready for 'China Shock 2.0.' Last week, Goldman Sachs released a surprisingly upbeat report on China's outlook that's both great news and terrible news for Xi Jinping's Communist Party.

It's great in that Goldman economists Andrew Tilton and Hui Shan argue that GDP growth in Asia's biggest economy could accelerate to 6% y/y for the "next few years." That's faster than the government's "around 5%" GDP target for this year and double the *2.0%-3.0% range* that many economists project for 2026 as US tariffs slam China's export engine (*Fig. 1*).

Turns out, shipping goods overseas has been the least of Xi's challenges. Tilton and Shan reckon that, despite a *47% US tariff*, mainland exports are tracking roughly 8% growth in 2025, "demonstrating the competitiveness of Chinese products across a wide range of industries relative to global peers."

External demand is helping China overcome a giant property crisis that's generating deflation, weak household demand, high youth unemployment, and onerous local government debt. This success owes to Xi's efforts since the Trump 1.0 era to reduce China's reliance on the US consumer. Today, Southwest Asia and Europe are the *main markets* that drive China Inc.

The terrible news in Goldman's report is that the good news comes with a qualifier: To keep GDP growth aloft, the analysts calculate, China will have to increase its exports or at least maintain current levels. Of course, what economists are calling "*China Shock 2.0*"—the idea that Beijing's policies are about to flood markets with exports and overcapacity in even more impactful ways than before—would increase the odds of geopolitical collision with President Trump's vision for US-China trade.

Let's consider why China's pursuit of export growth might further inflame global tensions:

(1) *Conflicting goals.* The government's priorities for 2026-30 are outlined in its "*15th Five-Year Plan*." They include high-quality development," a strategy of "high-level opening-up" that emphasizes "people-centered development," technological innovation, national self-reliance, and "accelerating the green transition to build a beautiful China" through "greater resolve, better future." (Xi's party is big on slogans.)

Lots to unpack here, clearly. But the overriding theme is that China wants to balance two conflicting aspirations: pivoting upmarket into tech-driven growth and recalibrating its economy to navigate an increasingly unpredictable world. The difficulty in reconciling them will become obvious in 2026.

Notably, this next five-year plan is really about 2035. That's because Xi's earlier "*Made in China 2025*" plan has largely run its course. Mentions of the strategy Xi launched in 2015 are now few and far between, partly to avoid triggering Trump World.

(2) *Triggering Trump*. In 2018, Trump derided Xi's plan to dominate the future of electric vehicles (EVs), artificial intelligence (AI), aerospace, semiconductors, renewable energy, batteries, biotechnology, green infrastructure, robotics, quantum computing, and self-driving vehicles as "*very insulting*." Trump complained China was "going to take over, economically, the world … that's not happening."

Clearly, it *hasn't* happened. But the global success of Chinese EV makers like BYD is now an *existential threat* to Elon Musk's Tesla. The "*DeepSeek shock*" from an unknown Hangzhou AI startup this year had Sam Altman's OpenAI and Jensen Huang's Nvidia looking over their shoulders.

The pivot to 2035 is a quiet one for Team Xi for fear of drawing unwelcome attention from the White House. At the moment, Xi's delay-delay-delay strategy on a "grand bargain" deal with Trump is going well for Beijing. In late October, Xi scored a *one-year truce*, likely pushing a bilateral trade agreement into 2027.

That is, unless Trump notices that Beijing is doing the economic equivalent of dancing while no one's watching.

(3) *Overcapacity isn't over*. The problem is that this unofficial "*Made in China 2035*" plan is primed to reignite global claims that Beijing is moving up the innovation ladder at the world's expense. There's nothing in Xi's new plan that suggests China is parting ways with the policies that have angered the West over the past decade, e.g., state subsidies, prioritizing of domestic champions, forced technological transfers tactics, and extreme overcapacity in China's manufacturing industries.

Also, for all the talk of increased domestic demand, investors have seen this movie before, and the ending never satisfies. The most important thing is getting *China's 1.4 billion people* to spend more and save less. In the decades leading up to 2020, China's retail sales growth trended around double what it is now (*Fig. 2*). There's no new strategy to build the huge, resilient social safety nets needed to get households to deploy their collective *$22 trillion* in savings, which is key to ending deflation.

(4) *Details scarce*. Ominously, Team Xi is doubling down on its "*dual circulation*" strategy. It speaks of boosting domestic consumption by expanding investment, improving income distribution, and strengthening the safety net—but offers no details on how it will do all this.

(5) *Consumers out in the cold*. Jeremy Mark at the Atlantic Council sees the Chinese consumer as the big "*loser*" in Xi's plan. Households' struggles have been mounting since the Covid-19 pandemic in 2020, when Xi's harsh lockdowns pulled the rug out from under the property market, wiping out considerable household wealth.

The problem with Xi's new blueprint, Mark says, is that "similar promises are included in most public statements from high-level meetings these days. The reality is that China's people increasingly find themselves left out in the cold when it comes to Beijing's spending priorities."

Moreover, Mark adds, “with local governments already under severe fiscal constraint after years of profligate borrowing and unpaid bills, many grassroots officials will undoubtedly see that the plenum document continues to give pride of place to Xi’s emphasis on industrial development—and not to the kinds of reforms that might improve the lives of China’s citizens in the near future.”

(6) *Bottom line.* This year’s 29.5% gain (in local currency) in the China MSCI equity index speaks to investors’ optimism that Team Xi will keep top-line growth booming, but the index has been looking a little toppy lately (*Fig. 3*). Yet keeping growth aloft may inflame global tensions in unpredictable ways for years to come.

South Korea I: Stock Bulls Running on Promised Reforms. Is the “Korea discount” phenomenon that has plagued Seoul stocks for decades suddenly over? With the Korea MSCI equity index up 74.5% (in local currency) so far in 2025, this question is making the rounds in investment circles (*Fig. 4*).

The gain has outpaced the equity price growth of other major Asian nations this year. And it suggests that President Lee Jae Myung is right on schedule with his pledge to propel the Kospi toward the *5,000 level*. Lee, in office since June 4, took a very rare step of making a political commitment to hit a particular stock market milestone.

So far, so spectacular. Lee’s inner circle argues that the stability Lee brought to Seoul is winning the attention of global investors. His predecessor, Yoon Suk Yeol, was impeached and removed last December for a bizarre move to declare martial law. The following six months were as chaotic as any period in Seoul in decades.

Team Lee also likes to say that investors are teeing off on its full-throated pledge to address the reasons that investors have undervalued Korean shares for the past two-plus decades. While on the campaign trail in April, *Lee wrote* on social media: “If we establish a fair and reasonable corporate governance mechanism and market order, our stock market will take a stunning leap forward. We will make the era of ‘Kospi 5,000’ come true with South Korea’s resilience and growth.”

Investors don’t just take Lee’s word for it, though. There’s an argument that long-undervalued Korea Inc. could offer some of the biggest AI gains in Asia. SK hynix, for example, trades at *10 times* forward earnings, roughly a quarter of Nvidia’s forward P/E. Also, as Jung In Yun at Fibonacci Asset Management Global Pte told Bloomberg: “Momentum in AI chip stocks is reviving as the Fed has started its easing cycle. Korean companies are expected to see continued inflows from foreign funds, as their valuations are cheaper than the US companies."

Yet a reality check is badly needed. For starters, AI is obviously playing an outsized role in fueling investor bullishness in Korea—as everywhere else. Also, Korea has benefited from a safe-haven dynamic this year.

Let's look at why Kospi bulls need to take a deep breath:

(1) *Geopolitics distraction*. As US President Donald Trump and Chinese leader Xi Jinping engaged in a tariff arms race, and as Xi and Japanese Prime Minister Sanae Takaichi have been mixing it up over Taiwan, Korea's sizable, open, and tech-obsessed economy has seemed a ready alternative for investors (*Fig. 5*).

The trouble is that the financial upgrades that Lee proposed are still on the drawing board. It's great that Lee's economic team understands that Korea's capital markets need greater transparency, stronger laws against manipulation, stronger anti-trust enforcement, and greater tolerance of short sellers. Yet Team Lee still needs to scrap outdated regulations, loosen limits on corporate ownership, and increase currency-trading hours.

(2) Chaebol *dilemma*. Then comes the really hard part: reining in the opaque family-owned conglomerates, or *chaebol*, that tower over the nation of *51 million people*. For 25 years now, each of Lee's predecessors pledged to reduce their dominance and to crack down on the rubber-stamp boards, cross-shareholding arrangements, and internal mergers that often benefit founding *chaebol* families more than average shareholders.

It's hardly surprising that *chaebols* are among the top beneficiaries of what Morgan Stanley calls a memory-chip "supercycle" amid the AI boom that's upending the financial landscape. *SK hynix Inc.*, for example, is harnessing its dominance in the high-bandwidth chips vital to AI applications. *Samsung Electronics Co.* has seen its shares *surge 89% ytd* on the belief that it's well positioned to catch up soon—and ride Nvidia's wave to greater heights.

(3) *Change is hard*. There will come a point when the Kospi's gains clearly outrun the reforms that Lee's government is able to put on the scoreboard. It took Japan several years to convince global investors that its corporate governance renaissance was real.

Lee also must act quickly to convince financial markets that Korea's *$1.7 trillion economy* is ready for global prime time. Two decades of presidents talking big about raising Korea's game and underdelivering are catching up with the place. Lee faces trust issues among global funds worried about cracks in the underlying economy.

(4) *Debt troubles*. For a decade now, successive governments set out to curb surging household debt. Instead, a recent Bank of Korea (BOK) report found that the household debt-to-GDP ratio *rose 13.8ppts* from 2014 to 2024, making it the world's third highest after China and Hong Kong.

As long as wage gains keep up with and support private consumption, a rising debt-to-GDP ratio can be manageable. Yet over the last decade, Korea's private consumption share declined by 1.3ppts.

(5) *Consumers on edge*. The imbalance is squeezing Koreans' consumption just as US tariff headwinds are intensifying. As the BOK puts it: "Rather than triggering a sudden crisis like a myocardial infarction, the *household debt problem* is constricting consumption gradually like arteriosclerosis." Lately, South Korea's retail sales index has been having trouble remaining as upbeat as it historically has been (*Fig. 6*).

As the trade war boosts global prices, Korea continues to suffer from weak worker efficiency. This is an added risk to the Kospi's bull run. The Korea Development Institute notes that *wage gains* since 2018 have been more than double the 1.7% productivity growth. As labor costs rise, they could erode corporate profits and impede investment.

(6) *Start me up*. Finally, Korea has a tech unicorn problem. The nation has loads of startups. But with the legacy *chaebol* giants still hogging the vast majority of the economic oxygen, it's hard for corporate upstarts to win market share. It will take bold regulatory changes to level the playing field.

Team Lee has demonstrated that it understands what Korea Inc. needs to win an MSCI upgrade and avoid disappointing the bulls charging Seoul's way. Now it's time to get on with the financial Big Bang on which Korea's stock market has been betting.

Calendars

US: Tues: Consumer Confidence 93.2; Retail Sales 0.3% (September); Business Inventories 0.0%; PPI Headline & Core 0.3%, 0.3%; Pending Home Sales 0.0%; Bowman. **Wed:** ADP Employment Change 19k; Industrial Production 0.1%; Capacity Utilization

77.3%; ISM NM-PMI 52.0; Import Price Index 0.1%; MBA Mortgage Applications. (Source: FX Street)

Global: **Tues:** Eurozone Headline & Core CPI 2.1%, 2.4% y/y; Eurozone Unemployment Rate 6.3%. **Wed:** Eurozone, Germany & France C-PMIs 52.4, 52.1 & 50.1; Eurozone, Germany & France NM-PMIs 53.1, 52.7 & 50.8; Eurozone PPI 0.2%; Lagarde; Lane. (Source: FX Street)

Strategy Indicators

S&P 500/400/600 Forward Earnings (*link*): During the November 28 week, forward earnings rose simultaneously for LargeCap and SmallCap for the 26th time in 28 weeks. LargeCap's forward earnings rose for a 28th straight week, its longest winning streak since it did so for 38 weeks through the September 13, 2024 week. MidCap's recovery has slow-walked at times, rising in 23 of the 28 weeks since it bottomed during the May 16 week. SmallCap's has risen in 26 of the 27 weeks since it bottomed during the May 23 week. LargeCap's forward earnings rose 0.2% w/w to its 26th straight weekly record high. MidCap's rose 0.3% and has recorded just 10 record highs this year, including eight during the last 13 weeks. SmallCap's rose 0.3% w/w to a 37-month high and improved to 5.8% below its June 2022 record. Forward earnings had bottomed in early 2023 for these three indexes following 2022's year of cost-cutting. Since then, LargeCap's forward earnings has soared 35.6% from its 54-week low during the week of February 1, 2023; MidCap's has slowly gained 11.5% from its 55-week low during the week of March 10, 2023; and SmallCap's has quickly rebounded 10.4% from a very recent 42-month low during the May 23 week. These three indexes' forward earnings downtrends from mid-2022 to early 2023 and again during Trump's Tariff Turmoil were relatively modest compared to their deep double-digit percentage declines during the Great Virus Crisis and the Great Financial Crisis. Here are the latest consensus earnings growth rates for 2024, 2025, and 2026: LargeCap (9.7%, 12.0%, 13.8%), MidCap (0.4, 1.4, 15.9), and SmallCap (-10.2, 6.1, 16.3).

S&P 500/400/600 Valuation (*link*): Valuations rose during the November 28 week for these three indices for the first time in three weeks. LargeCap's forward P/E rose 0.8pt w/w to 22.4 and is now just 0.4pt below its 25-year high of 22.8 during the October 31 week. It's up 5.4pts from a seven-month low of 17.0 during the October 27, 2023 week. That compares to a 30-month low of 15.1 at the end of September 2022 and an 11-year low of 11.1 during March 2020. MidCap's forward P/E rose 0.8pt w/w to 16.4 from a 22-week low of 15.6, and is now just 0.2pt below its 32-week high of 16.4 during the September 5 week. It's also just

0.7pt below its 40-month high of 17.1 during the November 29, 2024 week and 4.2pts above the 12-month low of 12.2 in October 2023. That compares to a record high of 22.9 in June 2020 when forward earnings was depressed and an 11-year low of 10.7 in March 2020. SmallCap's forward P/E rose 0.6pt w/w to 15.2 from a 26-week low of 14.6, and is now just 0.6pt below the nine-month high of 15.8 during the October 24 week. It's 2.3pts above its 17-month low of 12.9 during the April 4 week and 4.6pts above its 14-year low of 10.6 in September 2022, but remains 1.9pts below its 41-month high of 17.1 during the November 29, 2024 week. That compares to a record high of 26.7 in early June 2020 when forward earnings was depressed and a record low of 10.2 in November 2009 during the Great Financial Crisis. The forward P/Es for the SMidCaps have been mostly below LargeCap's since August 2018. MidCap's P/E improved w/w to a 28% discount to LargeCap's P/E, and is up from a 26-year low 30% discount during the October 31 week. That compares to a 19% discount during the March 2, 2023 week, which matched its best reading since October 14, 2021. SmallCap's P/E improved 2ppts w/w to a 32% discount to LargeCap's P/E, up from a 25-year-low 34% discount a week earlier. That compares to a 23% discount during the November 29, 2025 week, which was its best reading since the March 2, 2023 week. SmallCap's P/E improved to a 5% discount to MidCap's from an 18-month low 7% discount a week earlier, and remains above its 20-year-low 10% discount in late 2021. Prior to that, from 2003 to 2018, SmallCap's P/E had been mostly above MidCap's, and both were above LargeCap's.

US Economic Indicators

US Manufacturing PMI (*link*): The US manufacturing slump steepened in November. The ISM M-PMI contracted for the ninth successive month in November, following a brief expansion the first two months of this year. The *M-PMI* (to 48.2 from 48.7) contracted at a slightly faster pace in November, weaker than the consensus estimate of 49.0. According to ISM, the *overall economy* continued its expansion for the 67th month after a one-month contraction in April 2020. (A manufacturing PMI above 42.3, over a period of time, generally indicates an expansion of the overall economy.) The *new orders* (to 47.4 from 49.4 in October) measure contracted for the third month, falling further below the breakeven point of 50.0, while the *production* (51.2 from 48.2) measure moved from contraction to expansion. *Inventories* (48.9 from 45.8) continued to decline, though at a slower pace. The *suppliers' deliveries* (49.3 from 54.2) gauge indicated a faster delivery performance, after three consecutive months—and 14 of the previous 16 months—in slower territory. (Supplier deliveries is the only index that is inversed; a reading above 50 indicates slower deliveries, which is typical as the economy improves and customer demand increases.) The *employment* (44.0 from 46.0) gauge continued to contract in November, falling at a faster pace than during October. Meanwhile, the *prices* (58.5 from 58.0) measure increased at a slightly faster pace during the month.

Global Economic Indicators

Global Manufacturing PMIs (*link*): The global manufacturing sector showed a slowing of growth during November. The *JP Morgan Global M-PMI* ticked down to 50.5 in November from 50.9 in October—its lowest reading during the current four-month sequence of expansion. According to the report, "Three of the five PMI components (new orders, output, and suppliers' delivery times) were at levels consistent with improved operating conditions during November." *Regionally*, Thailand, India, Vietnam, Colombia, Pakistan, and the US were the top-ranked countries in terms of PMI Output Index readings, while the Eurozone (on average) and the UK also showed an increase in output. Meanwhile, growth contracted in Japan and stagnated in China. *Business optimism* rose to a five-month high in November, though remained below its long-run average for the 20th consecutive month. According to the report, Brazil, Russia, and Thailand were the most positive nations, while the UK (#5) and US (#10) finished in the top ten. *Turning to pricing*, average input costs and factory gate selling prices increased again during November, with price measures sharper (on average) in developed nations compared to emerging markets.

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