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Attachments: Jim_China.pdf

From Jim O'Neill...

I spent the latter 3 days working, after having travelled around some parts of the country with my wife for 8 days.

GS CHINA CONFERENCE.

The timing of my trip was determined by our annual China conference, which has become a really big event. It was Monday and today, and I believe involved around 1,000 people, including many investors from China and all over the world. I spoke early Monday, and some of the key slides I used in my presentation, "China in the modern World", are attached.

In my speech, I said that according to our latest long term BRIC projections, it is "just" 18 years until China might become the biggest economy in the world. This month is in fact, the 8th year anniversary of when I first wrote about BRICs, and in those 8 years, the C has been much more important than the others. To put it in perspective, I said that the increase in China's \$ GDP has been effectively the same as creating 2 new India's, a new Italy, nearly a new France or the UK. In fact, checking the numbers more closely, China's GDP has risen by about \$3 trillion since 2001. If you look at the \$ value of GDP of these other countries back then, in fact China has created another 7 India's (of the 01 size), nearly 3 Italy's, more than 2 France's, and even close to 1/3 of the size of the US back then.

In the next year of course, they will overtake Japan to be the world's number 2.

To become the world's largest \$ economy by 2027, around \$21 trillion, China needs to increase in \$ terms by around 10pct pa. This does not require 10pct real growth, and could occur through strong real growth and currency appreciation. As you can see in my slides, our growth assumptions for the next 2 decades are quite modest, between 6-7pct. China does not need miracles to get there.

I told the audience that the global credit crisis has been good for China as it has taken them off the "drug" of exporting, especially to the US, and discovered domestic demand. As I said, I saw plenty of strong evidence of this on my travels.

In terms of our above consensus forecast of 11.9pct for 2010, I can see why it might be a touch softer than this, but I really cannot understand why the consensus is so much softer. I have returned just as mystified as I was when I went, as given the current momentum, the consensus view implies quite a bit of sequential slowing. Monday's very strong PMI reading of 55.2 simply adds to this mystification.

MEETINGS WITH CLIENTS, POLICYMAKERS AND THE MEDIA.

I met with a large number of clients, a group of policymakers and regulators, and together with Helen Qiao and Yu Song, presented to a large group of journalists, which I believe led to quite a lot of coverage.

Amongst the clients, domestic and from many parts of the world, I met just as many dubious about China as those who were bulls. This included-as it did 4 weeks earlier when I was there- quite a lot of domestic clients. This seems quite healthy to me. Before a very entertaining dinner Monday evening for primarily international clients, I did a large session with a group of domestic only clients. On the way out 2 of them, who were quite bearish, told me that I knew nothing about China. I told them they might indeed be right!

Amongst the policy and regulatory crowd, I also detected a quite cautious mood, with the main doubt being China's ability to survive without very strong exports. It is also clear to me that there is quite a bit of -understandable -concern about too strong a rise in house prices again in some major urban areas. This latter issue makes me think that financial conditions could be deliberately tightened again in coming weeks (as we indeed forecast) which might be a hurdle for markets at the time.

MY TRAVEL ANECDOTES.

In another life I want to be a travel writer.....Anyhow, we went to Shanghai, Yangshuo, the Great Wall and Beijing.

SHANGHAI.

We marvelled at the airport, just as I did Beijing a few weeks earlier. I used Beijing twice again on this trip, and both of them really are fantastic. They are a shining example to many other major metropolitan airports around the world, especially Heathrow and JFK. They even have voting buttons at passport control asking you to comment on the service. I wonder whether we should have one of those at Heathrow??

Shanghai itself has to approach on the Maglev, the fastest train in the world. 430 km per hour, and 31 k in 8 minutes..incredible. From the destination in Pudong you can travel with the subway, as we did to our hotel downtown Puxi, as the widespread use of English signs makes it easy.

We were not bowled over by Shanghai. It might have been simply due to watching United lose to Liverpool there....., or something else. While the staggering architecture in Pudong is just as amazing as all you read, as with other many cities in China, it isn't exactly Rome.....What makes it especially tough at the moment is they are preparing for Expo 2010, so the place is even more like a building site than usual. As a result, the dust and pollution are remarkable.The Bund, while quite striking from the river , was especially disrupted and as I remarked to my wife, it reminded me a bit of Liverpool near the LiverBuilding.

We walked for miles and miles around the city for a couple of days, and it was great to witness the explosion of urban wealth , and it is not hard to feel the dramatic change. Except for using cabs, we had no problems at all without a guide as English is apparent in signs all over the place, and many are eager to try it out..this was contrary to what we had been told.

For market punters, there was an interesting piece in the Shanghai Daily when we were there, where the Shanghai Financial Services Office was proposing a trial period of an open market between the CNY and Taiwan Dollar as a " test" for a more permanent move. I expected to have seen this get some email and newswire coverage given all the stuff about internationalisation of the CNY.

GUILIN AND YANGSHUO.

We then went to the beautiful karst mountain area around the Li and Yulong River. We had been warned about the problems of not having a guide with likely difficulties of few speaking English and being hassled/ripped off. We were most pleasantly surprised, and had not problems at all either in transit or during our brief stay.

In fact one of the strongest memories from the whole trip stuck with me from here. I had get a mobile signal everywhere here, including rafting down the rivers on a bamboo raft. (cant manage that at our home 2 hours from London on the Isle of Purbeck....). Moreover, the desire to speak English was remarkable. In one village we cycled through, there was this big billboard " speak English, enjoy life"... Fantastic. We saw it in other villages also. (something Japan should have done a long time ago). In this globalised English speaking world, how important is this? We also saw an internet cafe on the river! I think our Growth Environment Scores for technology are in for an upgrading.....

2 other things stick with us from this area, throughout the villages, there was widespread evidence of building also, and on a less pleasant note, there was a lot of rubbish in the rivers, which slightly reduced the beauty of them.

One last relevant anecdote from here. It turns out that the toll road from Guilin airport to Yangshuo is possibly a product of last November's Yuan 4 trillion stimulus! If so, money well spent, it was fantastic.

THE GREAT WALL.

We spent a couple of days there over the weekend just passed. On Friday, we went to the nearest bit to Beijing, Badaling, and stayed at the luxurious Commune. Saturday when we woke, we went further afield to Jinshanling and walked on the wall for 4 hours to Simatai. I first visited the Wall 19 years ago at Badaling and the difference in the infrastructure, especially the road getting there is mind boggling. I literally felt as though I was at an entirely different place. I have memories of a dirt track , full of bicycles, and other odd things, with the biggest risk of a crash being the driver knocking over stray walkers or misplaced cartons , fruit or general farm produce. Not any more, the road was just first class. The road out to Simatai and back , was even better. If you read the guide books, it will tell you 4 hours each way. Nonsense. We did it in just less than 2 hours. America, Britain, eat your hearts out.....We also happened to be really lucky with the weather and had a beautiful walk (quite a challenge for those not used to anything other than a walk to the shops by the way)

BEIJING.

I spent the best part of 5 days in the capital including of course the last 3 days working.We were sick when we woke the first morning we arrived (something from Li River area possibly) but it didn't stop us too much. We did most of the Beijing things, many of which I had done before. A few things that may be of interest though;

1/ Chairman Mao's tomb. I queued one am literally with thousands of others to visit his body on the edge of Tiananmen Square (or the wax equivalent which I believe is rolled out occasionally when they clean up the real one). It was fascinating. Most of the people there seemed to be rural types and seemed quite poor. This did not stop them spending 3 " kwai" to get a small bunch of flowers that they could leave on the edge of the room outside the one with his body. I have never seen so many flowers building up so quickly. According to my companion, they are probably taken back to the shop and simply resold, as the speed at which the area fills up is incredible. Clearly the respect for his influence, and the "party" appears to be just as strong as ever. Having read more on this trip than in the past about his era, in many ways, his revered following still is a bit odd, but there you go.....Anyhow, for those of you that constantly don't believe the China consumer story still, go and see this. And if you are a Dutch flower producer, maybe a new market for you??

2/ I went straight from there to the new Park Hyatt hotel and the shopping mall there, which houses amongst others, Qeelin, a Chinese luxury jewellery company that I own a stake in. Rather pleasingly, just as I arrived, 3 young women had bought some stuff and they were still browsing with their nice red bags full of jewellery. I was most impressed as you can imagine. I think the fact that Maggie Chung models for them, helps.....

Walking around central Beijing, you can see loads of evidence of the high end consumer with all sorts of brand names. Again, having first gone there 19 years ago, it is a truly stunning experience to see the degree of change unfolding.

3/ I read some extremely interesting pieces in the China Daily while I was there, including;

a/ It seems as though the authorities might announce that they will reach their 15th 5 year Plan target for 20pct improvement in energy efficiency , soon. If they do, it will be a year before the end of the 5 years. I also get the distinct impression that energy efficiency and alternative energies might feature a lot in the forthcoming 16th 5 year plan.

b/ as well as smart new airports, China is going gangbusters for new high speed trains. According to one story, by 2020, 50pct of the world's high speed trains will be operating in China, at a speed of 250k with 18,000 km of track.

c/ The lottery! Somebody won CNY 360 million (\$52.7mn) and apparently took 19 days to build up the courage to get his money. When he did, he arrived wearing a mask and dark sun glasses to avoid being all over the media. The article spent most of the time discussing his supposed plans to give CNY10 mn away to charity and what this would do for his tax reduction. It was like reading something in the States!

d/ weather influence! as many unfortunate participants in our conference suffered, Sunday saw a big sudden snow fall. What I hadn't realised until today, is that the authorities were doing an " Olympics", they deliberately tried to bring on rain in order to help reduce drought by dropping stuff in the sky. What they hadn't planned for, was a sudden collapse of temperatures which caused a massive snow fall, which I believe was the first in October for nearly 20 years.....They don't get every right then!

I could go on and on, but I am going to stop there...See a selection of my slides earlier. Something eventually might go wrong in China, but after this diverse trip, it is not at all obvious to me what it will be, and I doubt it is the stuff that most of the sceptics often talk about. The first time I ever went in 1990 (less than a year after Tiananmen), I got the impression that people seemed very happy. I have felt that every time I have gone back since, and it certainly seemed to be the case again this time. I once believed that they might not be able to keep the exact same political and social structure and become the largest economy in the world. Having been on this trip, I think they just might.....

Quite simply as I said at the start, this remains the most interesting and important economic story of our times. Re markets, I am not sure despite all the above that you just buy China for ever, as they are likely to tighten financial conditions, butwhen we break out of 2,600 -3,400 on the A share market, it is going to be on the upside.....

I have actually returned from this trip, even more obsessed about another topic and it is the Yen...Indeed at our conference, quite a few old hands were full of the same idea.....It might be time to bring back some famous names of the late 1990's as this Yen is heading for the kind of fall that I always said had no chance to them back then.....

Onwards and upwards.....

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