US Daily: The Economic Impact of the Delta Variant: Risks from Global Supply Chain Spillovers (Briggs/Mericle)

- We expect the direct impact of the Delta variant on the US economy to consist mainly of a delay in the final steps of reopening, rather than a major reversal. But many Asia Pacific economies have imposed tighter restrictions that in some cases have included factory closures, raising the risk of negative spillovers at a time when supply chain disruptions are already at record levels.
- Past increases in our Effective Lockdown Index for Asia Pacific countries have been associated with only modest increases in US supplier delivery times. However, larger downside risks are possible if new restrictions constrain semiconductor or auto production in the region, or if China adopts tighter restrictions that affect exports to the US of several currently constrained goods.
- Any setbacks in the Asia Pacific region could also pose upside inflation risk, especially for autos and other goods that require semiconductors. Port closures or stricter control measures at ports could also put further upward pressure on shipping costs, which are already very high.

Jan Hatzius
+1(212)902-0394 | jan.hatzius@gs.com
Goldman Sachs & Co. LLC

Alec Phillips
+1(202)637-3746 | alec.phillips@gs.com
Goldman Sachs & Co. LLC

David Mericle
+1(212)357-2619 |
david.mericle@gs.com
Goldman Sachs & Co. LLC

Spencer Hill, CFA
+1(212)357-7621 | spencer.hill@gs.com
Goldman Sachs & Co. LLC

Joseph Briggs
+1(212)902-2163 |
joseph.briggs@gs.com
Goldman Sachs & Co. LLC

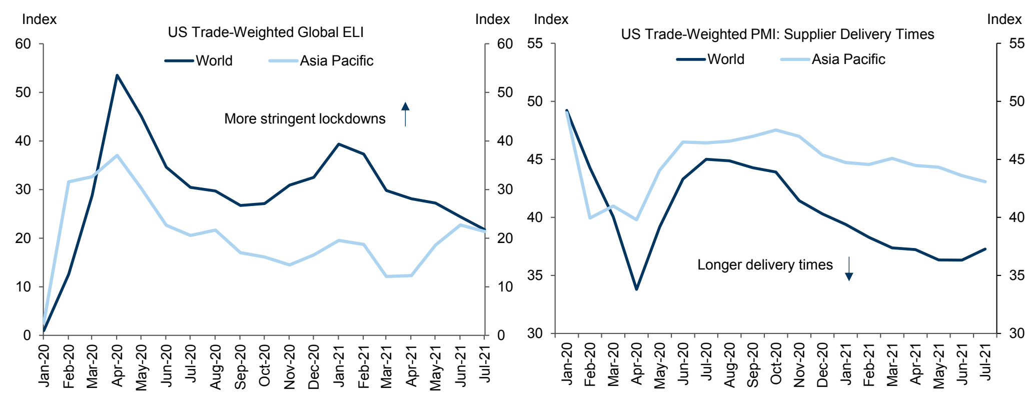
Ronnie Walker
+1(917)343-4543 |
ronnie.walker@gs.com
Goldman Sachs & Co. LLC

The Economic Impact of the Delta Variant: Risks from Global Supply Chain Spillovers

The spread of the Delta variant in the US has heightened some consumers' virus fears and has led some businesses and local governments to reinstate mask requirements and workers to delay plans to return to offices. But high-frequency data show little hit to consumer activity so far, and we continue to expect the direct impact of the Delta variant to consist mainly of a delay in the final steps of reopening, rather than a reversal of progress to date, mainly because we do not expect severe new restrictions in the US.

In contrast, some other countries—especially in the Asia Pacific region—have reacted with forceful new restrictions. Exhibit 1 shows that US import-weighted aggregates of both our Effective Lockdown Index (ELI)—which combines data on mobility and government restrictions—and the supplier delivery time components of purchasing managers' indexes have improved over the last couple of months, suggesting that the Delta variant has not been a major setback for US trading partners on average. But in the Asia Pacific region, the ELI has increased meaningfully and supplier delays have worsened.

Exhibit 1: Lockdowns and Supplier Delays Have Worsened in Asia as the Delta Variant Has Spread, but Less So in Other US Trading Partners

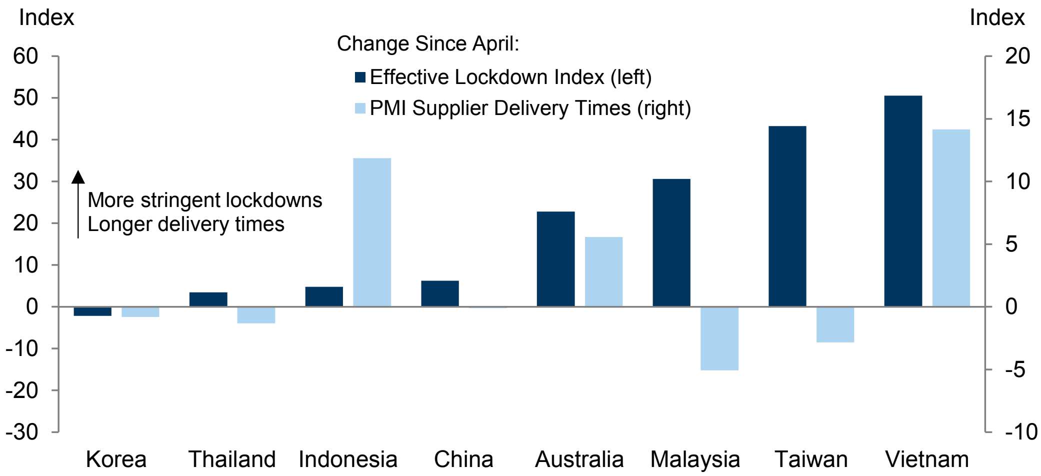


Source: Markit, Goldman Sachs Global Investment Research

Several countries in the Asia Pacific region are pursuing zero-Covid policies, and even those with less ambitious goals tend to have lower immunity levels than in other regions. As a result, several countries in the region have tightened restrictions forcefully (Exhibit 2). According to press reports and comments in the purchasing managers' indexes, restrictions have included temporary factory closures in Malaysia, Thailand, Indonesia, and Vietnam, as well as closures of ports where outbreaks occurred. Unfortunately, in most countries in the region the policy response to date has not been enough to stop virus spread from increasing.

While most countries found ways to operate factories and ports safely in earlier stages of the pandemic, it is not yet clear what measures will be needed to contain the far more infectious Delta variant. The risk is that a zero-Covid goal will require much tighter restrictions until the vaccine is available to the full population, which is still months away in most countries in the region.

Exhibit 2: Lockdowns and Supplier Delays Have Worsened in Asia as the Delta Variant Has Spread, but Less So in Other US Trading Partners

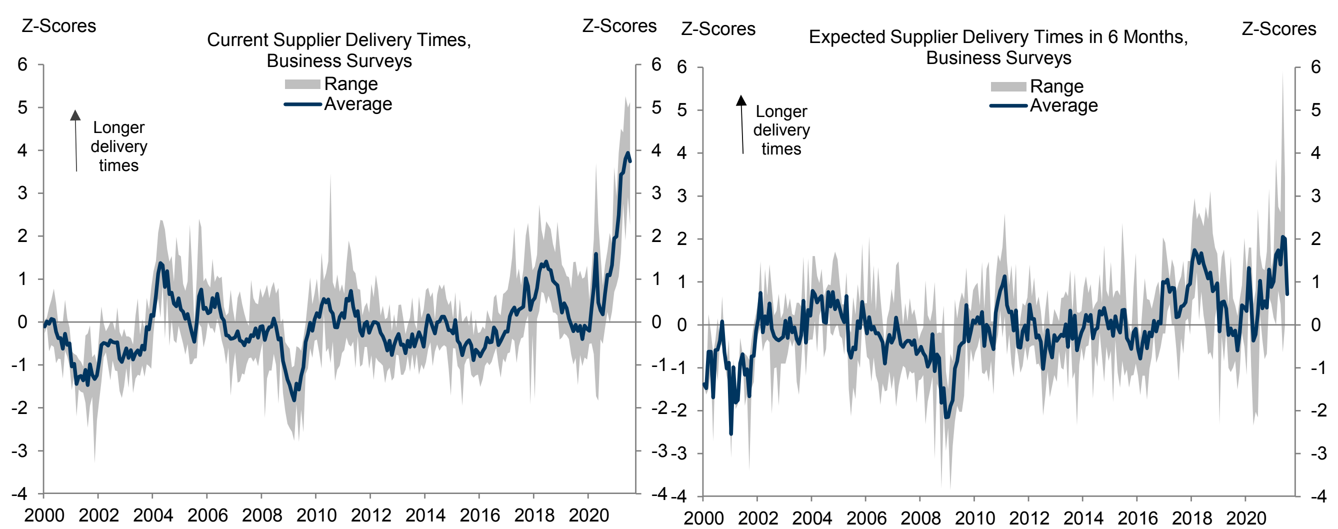


Note: We invert the PMI data so that larger values correspond to longer supplier delivery times.

Source: Markit, Goldman Sachs Global Investment Research

Any setbacks in Asia could spill over to the US at a time when supply chain disruptions are already the most severe and widespread in decades, as shown in Exhibit 3. These supply-side problems accounted for much of the disappointment to our initial Q2 GDP growth expectations and have lingered into Q3.

Exhibit 3: Any Setbacks to Production in Asia Could Prolong Record Supplier Delivery Delays in the US



Source: Goldman Sachs Global Investment Research

How large of an impact could new restrictions abroad have on US output? From a purely statistical perspective, we find that past increases in ELIs for Asia Pacific countries have been associated with notable increases in their own supplier delivery times, but only modest spillovers to US delivery times.

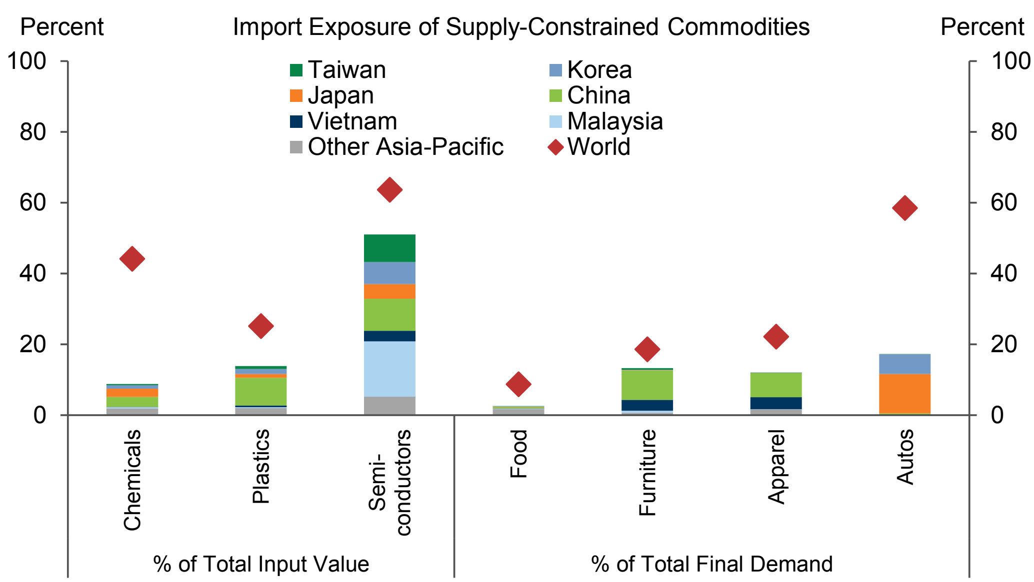
Of course, the effect of supply chain disruptions on production is often muted until inventories run out, a nonlinear dynamic currently visible in the impact of the semiconductor shortage on the auto industry. To narrow in on current vulnerabilities where Delta-related supply disruptions pose the greatest risk, Exhibit 4 shows the share of US imports from Asia Pacific economies for several intermediate inputs and consumer goods that have been in short supply recently. We highlight three key risks.

First, Asia Pacific countries account for about half of the semiconductors used in the US. Our sector analysts do not expect shutdowns of semiconductor plants themselves because cleanliness standards are exceptionally high even in normal times, but the plants rely on a long supply chain in the region that could be vulnerable to tighter restrictions. The final packaging and export steps also pose some risk.

Second, the US imports just under 20% of its autos from the Asia Pacific region. Our sector analysts see some risk that auto parts producers in Southeast Asian countries with especially stringent lockdowns could further reduce production in Japan, where Toyota has already announced a brief production halt. Any reduction in auto exports to the US would worsen already tight new auto inventories in the US.

Third, US imports from China account for 7-9% of domestic use of several vulnerable goods, including plastics, semiconductors, furniture, and apparel. If China—which is also experiencing supply chain challenges related to weather and flooding in July—needs to adopt tighter measures that hamper either production or exports, the US could also see moderate negative spillover effects in these areas.

Exhibit 4: The Semiconductor and Auto Industries Pose the Greatest Spillover Risks from Asia to the US



Source: Census Bureau, Goldman Sachs Global Investment Research

We also see several inflation risks from Delta-related restrictions in the Asia Pacific region. First, further delays in the rebuild of auto inventories would push back the timeline for new and used car price normalization. Second, any further hit to semiconductor output could raise prices on a range of consumer electronics that require them. Third, port closures or stricter virus control measures at ports could further increase shipping costs from East Asia to the US, which are already extremely high due to container shortages and remaining restrictions on international transport services.

Joseph Briggs

David Mericle

Disclosure Appendix

Reg AC

We, Jan Hatzius, Alec Phillips, David Mericle, Spencer Hill, CFA, Joseph Briggs and Ronnie Walker, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

Unless otherwise stated, the individuals listed on the cover page of this report are analysts in Goldman Sachs' Global Investment Research division.

Disclosures

Regulatory disclosures

Disclosures required by United States laws and regulations

See company-specific regulatory disclosures above for any of the following disclosures required as to companies referred to in this report: manager or co-manager in a pending transaction; 1% or other ownership; compensation for certain services; types of client relationships; managed/co-managed public offerings in prior periods; directorships; for equity securities, market making and/or specialist role. Goldman Sachs trades or may trade as a principal in debt securities (or in related derivatives) of issuers discussed in this report.

The following are additional required disclosures: **Ownership and material conflicts of interest:** Goldman Sachs policy prohibits its analysts, professionals reporting to analysts and members of their households from owning securities of any company in the analyst's area of coverage. **Analyst compensation:** Analysts are paid in part based on the profitability of Goldman Sachs, which includes investment banking revenues. **Analyst as officer or director:** Goldman Sachs policy generally prohibits its analysts, persons reporting to analysts or members of their households from serving as an officer, director or advisor of any company in the analyst's area of coverage. **Non-U.S. Analysts:** Non-U.S. analysts may not be associated persons of Goldman Sachs & Co. LLC and therefore may not be subject to FINRA Rule 2241 or FINRA Rule 2242 restrictions on communications with subject company, public appearances and trading securities held by the analysts.

Additional disclosures required under the laws and regulations of jurisdictions other than the United States

The following disclosures are those required by the jurisdiction indicated, except to the extent already made above pursuant to United States laws and regulations. **Australia:** Goldman Sachs Australia Pty Ltd and its affiliates are not authorised deposit-taking institutions (as that term is defined in the Banking Act 1959 (Cth)) in Australia and do not provide banking services, nor carry on a banking business, in Australia. This research, and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act, unless otherwise agreed by Goldman Sachs. In producing research reports, members of the Global Investment Research Division of Goldman Sachs Australia may attend site visits and other meetings hosted by the companies and other entities which are the subject of its research reports. In some instances the costs of such site visits or meetings may be met in part or in whole by the issuers concerned if Goldman Sachs Australia considers it is appropriate and reasonable in the specific circumstances relating to the site visit or meeting. To the extent that the contents of this document contains any financial product advice, it is general advice only and has been prepared by Goldman Sachs without taking into account a client's objectives, financial situation or needs. A client should, before acting on any such advice, consider the appropriateness of the advice having regard to the client's own objectives, financial situation and needs. A copy of certain Goldman Sachs Australia and New Zealand disclosure of interests and a copy of Goldman Sachs' Australian Sell-Side Research Independence Policy Statement are available at: https://www.goldmansachs.com/disclosures/australia-new-zealand/index.html. **Brazil:** Disclosure information in relation to CVM Resolution n. 20 is available at https://www.gs.com/worldwide/brazil/area/gir/index.html. Where applicable, the Brazil-registered analyst primarily responsible for the content of this research report, as defined in Article 20 of CVM Resolution n. 20, is the first author named at the beginning of this report, unless indicated otherwise at the end of the text. **Canada:** Goldman Sachs Canada Inc. is an affiliate of The Goldman Sachs Group Inc. and therefore is included in the company specific disclosures relating to Goldman Sachs (as defined above). Goldman Sachs Canada Inc. has approved of, and agreed to take responsibility for, this research report in Canada if and to the extent that Goldman Sachs Canada Inc. disseminates this research report to its clients. **Hong Kong:** Further information on the securities of covered companies referred to in this research may be obtained on request from Goldman Sachs (Asia) L.L.C. **India:** Further information on the subject company or companies referred to in this research may be obtained from Goldman Sachs (India) Securities Private Limited, Research Analyst - SEBI Registration Number INH000001493, 951-A, Rational House, Appasaheb Marathe Marg, Prabhadevi, Mumbai 400 025, India, Corporate Identity Number U74140MH2006FTC160634, Phone +91 22 6616 9000, Fax +91 22 6616 9001. Goldman Sachs may beneficially own 1% or more of the securities (as such term is defined in clause 2 (h) the Indian Securities Contracts (Regulation) Act, 1956) of the subject company or companies referred to in this research report. **Japan:** See below. **Korea:** This research, and any access to it, is intended only for "professional investors" within the meaning of the Financial Services and Capital Markets Act, unless otherwise agreed by Goldman Sachs. Further information on the subject company or companies referred to in this research may be obtained from Goldman Sachs (Asia) L.L.C., Seoul Branch. **New Zealand:** Goldman Sachs New Zealand Limited and its affiliates are neither "registered banks" nor "deposit takers" (as defined in the Reserve Bank of New Zealand Act 1989) in New Zealand. This research, and any access to it, is intended for "wholesale clients" (as defined in the Financial Advisers Act 2008) unless otherwise agreed by Goldman Sachs. A copy of certain Goldman Sachs Australia and New Zealand disclosure of interests is available at: https://www.goldmansachs.com/disclosures/australia-new-zealand/index.html. **Russia:** Research reports distributed in the Russian Federation are not advertising as defined in the Russian legislation, but are information and analysis not having product promotion as their main purpose and do not provide appraisal within the meaning of the Russian legislation on appraisal activity. Research reports do not constitute a personalized investment recommendation as defined in Russian laws and regulations, are not addressed to a specific client, and are prepared without analyzing the financial circumstances, investment profiles or risk profiles of clients. Goldman Sachs assumes no responsibility for any investment decisions that may be taken by a client or any other person based on this research report. **Singapore:** Goldman Sachs (Singapore) Pte. (Company Number: 198602165W), which is regulated by the Monetary Authority of Singapore, accepts legal responsibility for this research, and should be contacted with respect to any matters arising from, or in connection with, this research. **Taiwan:** This material is for reference only and must not be reprinted without permission. Investors should carefully consider their own investment risk. Investment results are the responsibility of the individual investor. **United Kingdom:** Persons who would be categorized as retail clients in the United Kingdom, as such term is defined in the rules of the Financial Conduct Authority, should read this research in conjunction with prior Goldman Sachs research on the covered companies referred to herein and should refer to the risk warnings that have been sent to them by Goldman Sachs International. A copy of these risks warnings, and a glossary of certain financial terms used in this report, are available from Goldman Sachs International on request.

European Union and United Kingdom: Disclosure information in relation to Article 6 (2) of the European Commission Delegated Regulation (EU) (2016/958) supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council (including as that Delegated Regulation is implemented into United Kingdom domestic law and regulation following the United Kingdom's departure from the European Union and the European Economic Area) with regard to regulatory technical standards for the technical arrangements for objective presentation of investment recommendations or other information recommending or suggesting an investment strategy and for disclosure of particular interests or indications of conflicts of interest is available at https://www.gs.com/disclosures/europeanpolicy.html which states the European Policy for Managing Conflicts of Interest in Connection with Investment Research.

Japan: Goldman Sachs Japan Co., Ltd. is a Financial Instrument Dealer registered with the Kanto Financial Bureau under registration number Kinsho

69, and a member of Japan Securities Dealers Association, Financial Futures Association of Japan and Type II Financial Instruments Firms Association. Sales and purchase of equities are subject to commission pre-determined with clients plus consumption tax. See company-specific disclosures as to any applicable disclosures required by Japanese stock exchanges, the Japanese Securities Dealers Association or the Japanese Securities Finance Company.

Global product; distributing entities

The Global Investment Research Division of Goldman Sachs produces and distributes research products for clients of Goldman Sachs on a global basis. Analysts based in Goldman Sachs offices around the world produce research on industries and companies, and research on macroeconomics, currencies, commodities and portfolio strategy. This research is disseminated in Australia by Goldman Sachs Australia Pty Ltd (ABN 21 006 797 897); in Brazil by Goldman Sachs do Brasil Corretora de Títulos e Valores Mobiliários S.A.; Public Communication Channel Goldman Sachs Brazil: 0800 727 5764 and / or contatogoldmanbrasil@gs.com. Available Weekdays (except holidays), from 9am to 6pm. Canal de Comunicação com o Público Goldman Sachs Brasil: 0800 727 5764 e/ou contatogoldmanbrasil@gs.com. Horário de funcionamento: segunda-feira à sexta-feira (exceto feriados), das 9h às 18h; in Canada by either Goldman Sachs Canada Inc. or Goldman Sachs & Co. LLC; in Hong Kong by Goldman Sachs (Asia) L.L.C.; in India by Goldman Sachs (India) Securities Private Ltd.; in Japan by Goldman Sachs Japan Co., Ltd.; in the Republic of Korea by Goldman Sachs (Asia) L.L.C., Seoul Branch; in New Zealand by Goldman Sachs New Zealand Limited; in Russia by OOO Goldman Sachs; in Singapore by Goldman Sachs (Singapore) Pte. (Company Number: 198602165W); and in the United States of America by Goldman Sachs & Co. LLC. Goldman Sachs International has approved this research in connection with its distribution in the United Kingdom.

Effective from the date of the United Kingdom's departure from the European Union and the European Economic Area ("Brexit Day") the following information with respect to distributing entities will apply:

Goldman Sachs International ("GSI"), authorised by the Prudential Regulation Authority ("PRA") and regulated by the Financial Conduct Authority ("FCA") and the PRA, has approved this research in connection with its distribution in the United Kingdom.

European Economic Area: GSI, authorised by the PRA and regulated by the FCA and the PRA, disseminates research in the following jurisdictions within the European Economic Area: the Grand Duchy of Luxembourg, Italy, the Kingdom of Belgium, the Kingdom of Denmark, the Kingdom of Norway, the Republic of Finland, Portugal, the Republic of Cyprus and the Republic of Ireland; GS -Succursale de Paris (Paris branch) which, from Brexit Day, will be authorised by the French Autorité de contrôle prudentiel et de resolution ("ACPR") and regulated by the Autorité de contrôle prudentiel et de resolution and the Autorité des marches financiers ("AMF") disseminates research in France; GSI - Sucursal en España (Madrid branch) authorized in Spain by the Comisión Nacional del Mercado de Valores disseminates research in the Kingdom of Spain; GSI - Sweden Bankfilial (Stockholm branch) is authorized by the SFSA as a "third country branch" in accordance with Chapter 4, Section 4 of the Swedish Securities and Market Act (Sw. lag (2007:528) om värdepappersmarknaden) disseminates research in the Kingdom of Sweden; Goldman Sachs Bank Europe SE ("GSBE") is a credit institution incorporated in Germany and, within the Single Supervisory Mechanism, subject to direct prudential supervision by the European Central Bank and in other respects supervised by German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin) and Deutsche Bundesbank and disseminates research in the Federal Republic of Germany and those jurisdictions within the European Economic Area where GSI is not authorised to disseminate research and additionally, GSBE, Copenhagen Branch filial af GSBE, Tyskland, supervised by the Danish Financial Authority disseminates research in the Kingdom of Denmark; GSBE - Sucursal en España (Madrid branch) subject (to a limited extent) to local supervision by the Bank of Spain disseminates research in the Kingdom of Spain; GSBE - Succursale Italia (Milan branch) to the relevant applicable extent, subject to local supervision by the Bank of Italy (Banca d'Italia) and the Italian Companies and Exchange Commission (Commissione Nazionale per le Società e la Borsa "Consob") disseminates research in Italy; GSBE - Succursale de Paris (Paris branch), supervised by the AMF and by the ACPR disseminates research in France; and GSBE - Sweden Bankfilial (Stockholm branch), to a limited extent, subject to local supervision by the Swedish Financial Supervisory Authority (Finansinpektionen) disseminates research in the Kingdom of Sweden.

General disclosures

This research is for our clients only. Other than disclosures relating to Goldman Sachs, this research is based on current public information that we consider reliable, but we do not represent it is accurate or complete, and it should not be relied on as such. The information, opinions, estimates and forecasts contained herein are as of the date hereof and are subject to change without prior notification. We seek to update our research as appropriate, but various regulations may prevent us from doing so. Other than certain industry reports published on a periodic basis, the large majority of reports are published at irregular intervals as appropriate in the analyst's judgment.

Goldman Sachs conducts a global full-service, integrated investment banking, investment management, and brokerage business. We have investment banking and other business relationships with a substantial percentage of the companies covered by our Global Investment Research Division. Goldman Sachs & Co. LLC, the United States broker dealer, is a member of SIPC (https://www.sipc.org).

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients and principal trading desks that reflect opinions that are contrary to the opinions expressed in this research. Our asset management area, principal trading desks and investing businesses may make investment decisions that are inconsistent with the recommendations or views expressed in this research.

We and our affiliates, officers, directors, and employees, will from time to time have long or short positions in, act as principal in, and buy or sell, the securities or derivatives, if any, referred to in this research, unless otherwise prohibited by regulation or Goldman Sachs policy.

The views attributed to third party presenters at Goldman Sachs arranged conferences, including individuals from other parts of Goldman Sachs, do not necessarily reflect those of Global Investment Research and are not an official view of Goldman Sachs.

Any third party referenced herein, including any salespeople, traders and other professionals or members of their household, may have positions in the products mentioned that are inconsistent with the views expressed by analysts named in this report.

This research is focused on investment themes across markets, industries and sectors. It does not attempt to distinguish between the prospects or performance of, or provide analysis of, individual companies within any industry or sector we describe.

Any trading recommendation in this research relating to an equity or credit security or securities within an industry or sector is reflective of the investment theme being discussed and is not a recommendation of any such security in isolation.

This research is not an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Clients should consider whether any advice or recommendation in this research is suitable for their particular circumstances and, if appropriate, seek professional advice, including tax advice. The price and value of investments referred to in this research and the income from them may fluctuate. Past performance is not a guide to future performance, future returns are not guaranteed, and a loss of original capital may occur. Fluctuations in exchange rates could have adverse effects on the value or price of, or income derived from, certain investments.

Certain transactions, including those involving futures, options, and other derivatives, give rise to substantial risk and are not suitable for all investors. Investors should review current options and futures disclosure documents which are available from Goldman Sachs sales representatives or at https://www.theocc.com/about/publications/character-risks.jsp and https://www.fiadocumentation.org/fia/regulatory-disclosures_1/fia-uniform-futures-and-options-on-futures-risk-disclosures-booklet-pdf-version-2018. Transaction costs may be significant in option strategies calling for multiple purchase and sales of options such as spreads. Supporting documentation will be supplied upon request.

Differing Levels of Service provided by Global Investment Research: The level and types of services provided to you by the Global Investment Research division of GS may vary as compared to that provided to internal and other external clients of GS, depending on various factors including your individual preferences as to the frequency and manner of receiving communication, your risk profile and investment focus and perspective (e.g., marketwide, sector specific, long term, short term), the size and scope of your overall client relationship with GS, and legal and regulatory constraints. As an example, certain clients may request to receive notifications when research on specific securities is published, and certain clients may request that specific data underlying analysts' fundamental analysis available on our internal client websites be delivered to them electronically through data feeds or otherwise. No change to an analyst's fundamental research views (e.g., ratings, price targets, or material changes to earnings estimates for equity securities), will be communicated to any client prior to inclusion of such information in a research report broadly disseminated through electronic publication to our internal client websites or through other means, as necessary, to all clients who are entitled to receive such reports.

All research reports are disseminated and available to all clients simultaneously through electronic publication to our internal client websites. Not all research content is redistributed to our clients or available to third-party aggregators, nor is Goldman Sachs responsible for the redistribution of our research by third party aggregators. For research, models or other data related to one or more securities, markets or asset classes (including related services) that may be available to you, please contact your GS representative or go to https://research.gs.com.

Disclosure information is also available at https://www.gs.com/research/hedge.html or from Research Compliance, 200 West Street, New York, NY 10282.