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Morning Briefing

On Europe's Declining Influence, China's Auto Glut & More Great US Earnings

Check out the accompanying [chart collection](#).

Executive Summary: Internal discord among the EU's member nations portends fragmentation and waning geopolitical influence, reports Melissa. ... China's EV industry, BYD in particular, had been booming until recently. Now it faces formidable headwinds from within the country and without; William discusses. ... Joe's data on consensus expectations for S&P 500 companies' aggregate Q3 earnings suggest that investors can look forward to a third straight quarter of above-trend, double-digit-percentage y/y growth.

Europe: Geopolitical Clout on the Wane? European locals may roll their eyes at the sight of snap-happy tourists posing in front of storied landmarks like Barcelona's Basilica holding their grandkids' Labubu toy. But Europe can't keep tourists away. In a [robust](#) summer for European tourism, with international arrivals up 3.3% y/y during Q2, US travelers [led](#) the surge (up 10.0% y/y).

Yet while all those tourists are enjoying sightseeing in Europe, officials in the seats of government aren't having much fun. Increasing discord among the European Union's (EU) member nations on key issues is shrinking Europe's geopolitical influence.

Here's more:

(1) *A warning from Draghi.* Former ECB chief Mario Draghi [warned](#) in an August 22 speech that the EU risks becoming a sidelined spectator on the world stage. He noted that that internal barriers to trade act like a 64% tariff on machinery and a 95% tariff on metals, driving up costs and pushing procurement abroad.

Draghi underscored how scale is lost to Europe's fragmentation, contrasting the size of Europe's national industrial tech projects (€2 billion to €3 billion) with America's investment in chip mega-factories (\$30 billion to \$65 billion). He warned that fragmented national

projects can't deliver scale—only common debt can. Yet despite over [€620 billion](#) in EU supranational bonds already issued, the bloc ranks only as the fifth-largest issuer in Europe, still far behind the firepower of major sovereign markets.

Calls to expand joint borrowing—whether for defense or tech—are growing louder, with Paris [pushing](#) to bolster the euro's global role through new common instruments. But this could get complicated, as debt trajectories in core European nations are muddying the outlook.

(2) *'Happy vassal.'* The August 11 *Financial Times* [discussed](#) how the European Commission (EC) has conceded key industrial and tariff ground in what critics call Europe's "happy vassal" (i.e., willing submission) complex. In one fell swoop, US President Donald Trump's trade negotiation tactics undermined Europe's single market, disregarded the region's core climate objectives, and exposed the inadequacy of its institutions.

The core of the US–EU trade deal [announced](#) in July remains largely [intact](#): Tariffs on most EU exports to the US are capped at 15%, and Europe has pledged major energy purchases and investments in the US. The trade deal still needs to move through EU legislation. But pushback is [growing](#): German industry groups are labeling the trade agreement with burdensome terms as "a difficult pill to swallow," and regulators fear the concessions could weaken Europe's economic sovereignty and digital rulemaking.

(3) *Fractures over Ukraine.* EC President Ursula von der Leyen has [unveiled](#) "precise plans" for deploying European troops to Ukraine—moves welcomed by Washington but branded premature by Germany's defense minister.

(4) *Sidelined over Gaza.* At an August 30 meeting in Copenhagen, EU foreign ministers [failed](#) to reach agree on approaches to the Gaza conflict—some calling for sanctions on Israel, others resisting—leaving the bloc sidelined on one of the world's most urgent crises.

China I: Auto Boom Hits Headwinds. Elon Musk could be excused for indulging in some *schadenfreude* as Chinese electric vehicle (EV) upstart BYD hits a serious pothole. It's been a tough 2025 for the Tesla CEO, in part thanks to BYD's global sales surge. The year started with the Shenzhen-based EV phenomenon surpassing Tesla in revenue. Some were tempted to write obituaries for Tesla.

News on Friday of a staggering [30% drop](#) in BYD's quarterly profit for the April-June period, the first decline in three years, sent its shares sharply lower. It plunged [as much as 8%](#)

Monday in Hong Kong trading. While probably delighting Tesla's investors, the stumble came as a shock to China EV market bulls.

Let's explore what BYD's stumble portends for China's EV ambitions:

(1) *BYD is a microcosm*. No single company represents China as a whole; it's an [\\$18 trillion economy](#) driven by 1.4 billion people. But the challenges confronting Warren Buffett-backed BYD are also straining rival industry leaders Geely Automobile Holdings, Stellantis-partner Leapmotor, Xpeng, and Xiaomi—which many had thought were above the fray. These challenges include China's deflationary dynamics and the competitors' cutthroat battles for market share.

All this suggests that China Inc.'s designs on dominating the global auto business won't be as easy as President Xi Jinping apparently believed when he established that goal in 2015.

(2) *International success*. Ironically, BYD's expansion overseas isn't the problem. Its ambitious foray into Australia, Brazil, Singapore, and parts of Europe helped revenue grow [14% y/y](#) in Q2. During the first six months of 2025, overseas revenue rose [50% y/y](#) excluding Hong Kong, Macau and Taiwan. Hence, BYD's nearly [43% one-year return](#).

Also, the scale and speed of China's EV revolution, one that caught Musk and peers by surprise, continues to upend the global market. Since 2023, China has held the title of largest vehicle exporter, one previously held by Japan. In 2024, domestic car sales surged to a record [31.4 million units](#), with new mainland EVs accounting for 41% of purchases.

(3) *Road to 36 million*. By 2030, Michael Dunne of Dunne Insights thinks China will be manufacturing 36 million vehicles annually. That would equate to four out of 10 cars produced globally! China is also on track to export 9 million vehicles per year, up from 1 million in 2020. China, Dunne [told CNBC](#), is solidifying its dominance in autos "just as it has done for solar panels, ship-building, drones and steel in recent years."

China II: Rough Road Ahead. Yet risks abound as Trump's tariffs create global headwinds, putting China's exporting overcapacity in the headlights. In the US, Europe, and Japan, there is growing alarm over the key role that Beijing's subsidies and tax incentives play in powering China's global growth. This is attracting scrutiny from regulators alleging anti-competitive strategies. The US and the European Union have responded with duties on made-in-China EVs.

Yet domestically, EV makers are confronting economic growing pains. Consider the following:

(1) *China's rat race*. BYD is at the vanguard of companies suffering from price wars that their own growth ambitions helped to generate.

Sanford C. Bernstein says the company that CEO Wang Chuanfu built is suffering from the "[*scars of competition*](#)." This is ironic considering that BYD is one of the household-name companies driving the race to the bottom on prices.

Earlier this year, Xi's Communist Party set out to tame extreme pricing using awkward slogans such as "rate-race competition" and "[*anti-involution*](#)" tactics. The worry is that overcapacity and how it affects the stability of supply chains, is marring the global reputation of "Made in China."

(2) *The AI factor*. One reason for investors not to bet against Chinese EVs is that automakers are making aggressive investments in research and development despite narrowing profit margins. BYD, for example, is investing heavily in cutting-edge batteries, electrification, and artificial intelligence.

In February, BYD [*unveiled*](#) a driver-assistance technology with AI upstart DeepSeek. This "DiPilot" program made BYD the first Chinese automaker to offer such capabilities in vehicles priced below 70,000 yuan (\$9,816).

(3) *Precarious road ahead*. Yet conflicting priorities are now creating roadblocks for BYD and its rivals. Unless they prioritize a strategic response to Xi's ambition to battle overcapacity and normalize pricing, they risk getting caught in Xi's dragnet. At the same time, they need to access global markets, but protectionism in the West makes that increasingly difficult. It's no understatement to say that the road ahead looks increasingly precarious for China's EV giants.

US Strategy I: Pockets of Q3 Earnings Strength. For the S&P 500 companies in aggregate, the current consensus Q3 estimate would represent a ninth straight quarter of y/y earnings growth, albeit at a "below-trend" rate. But we think companies could exceed forecasts at a well above-trend rate for a third straight quarter and deliver a third quarter of double-digit percentage earnings growth.

The consensus growth forecast for S&P 500 Q3 earnings ticked up 0.2ppt to 6.6% as of the

August 28 week from its lowest forecast of 6.4% at the beginning of the quarter on July 1. Still, that's down from 11.9% at the start of the year ([Fig. 1](#)). A steep decline is typical of quarters' final weeks, when bad earnings news tends to dominate estimate revisions activity. However, we think Q3 estimates may not have much further to fall.

That said, there are strong pockets of strong earnings growth within the S&P 500 sectors and fewer instances of tumbling earnings, as Joe shows below:

(1) *What's ahead for Q3 sector earnings growth?* Six of 11 sectors are expected to show positive y/y earnings growth, down from eight sectors doing so in Q2 and Q1 and 10 sectors in Q4-2024. However, the five sectors expected to see growth decline in Q3 are only expected to drop at a single-digit percentage rate. None have a forecasted double-digit EPS percentage decline now, which suggests nearly all sectors could report y/y earnings growth in Q3 when their positive surprise beats roll in.

(2) *Q3's earnings-growth leadership expanding.* Five of the six sectors expected to post earnings growth in Q3 are forecasted to rise at a double-digit percentage rate (versus three during Q2 and seven in Q4-2024).

Notable among the gainers, Materials is expected to grow earnings at a double-digit percentage rate in Q3 for the first time in 13 quarters, and Information Technology for a ninth straight quarter. Among the laggards, Consumer Discretionary's earnings is expected to fall y/y for the first time in 11 quarters, and Consumer Staples' for the second time in three quarters. Also, Energy's is expected to fall y/y for a fifth straight quarter and the 10th in the 11 quarters since Q2-2023.

Here are the consensus S&P 500 sectors' y/y proforma earnings growth rates for Q3: Information Technology (21.6%), Real Estate (18.7), Industrials (16.7), Materials (15.3), Financials (10.3), S&P 500 ex-Energy (9.2), S&P 500 (7.5), Communication Services (5.7), Health Care (-0.1), Consumer Discretionary (-1.3), Consumer Staples (-2.1), Utilities (-2.6), and Energy (-6.2).

Strategy II: Q2 in Review. Joe recently updated his analysis of Q2's revenue and earnings results for the S&P 500's sectors in our [S&P 500 Quarterly Metrics](#) publication. Here are highlights:

(1) *S&P 500 revenues in review.* During Q2, nine of the 11 S&P 500 sectors recorded positive y/y growth in revenues (up from seven in Q1): Information Technology (18.0%),

Health Care (12.7), Utilities (6.2), Communication Services (10.5), S&P 500 (5.1), Real Estate (5.2), Consumer Discretionary (3.4), Consumer Staples (2.9), Materials (2.5), Industrials (1.3), Financials (-0.5), and Energy (-5.9).

(2) *S&P 500 earnings in review.* On the earnings front, six of the 11 S&P 500 sectors posted positive y/y earnings growth in Q2 (down from seven in Q1-2025 and nine in Q4-2024).

Three sectors posted double-digit percentage y/y earnings growth in Q2 (down from four in Q1 and six in Q4). Here are the S&P 500 sectors' y/y earnings growth rates for Q2:

Communication Services (48.6%), Information Technology (21.0), Financials (11.0), S&P 500 (10.7), Health Care (5.2), Consumer Staples (2.5), Real Estate (2.0), Materials (-1.9), Utilities (-1.9), Consumer Discretionary (-11.7), Energy (-21.2), and Industrials (-22.0).

(3) *S&P 500 margins in review:* Profit margins improved q/q for five of the 11 sectors again in Q2 (down from seven in Q4). Q2's gainers: Consumer Staples, Financials, Information Technology, Materials, and Real Estate.

Here's how the sectors' profit margins ranked in Q2: Real Estate (29.1%), Information Technology (26.4, down from 27.4 record high in Q4-2024), Communication Services (21.2, second-highest on record since Q1's 22.3), Financials (16.3, 12-quarter high), Utilities (12.8, six-quarter low), S&P 500 (13.0, 12-quarter high), Industrials (8.0, 13-quarter low), Materials (10.6, four-quarter high), Health Care (7.7), Consumer Discretionary (8.0, six-quarter low), Energy (7.7, 16-quarter low), and Consumer Staples (7.0, up from Q1's seven-year low of 6.4).

Calendars

US: Wed: JOLTS Job Openings 7.4m; Factory Orders -1.4%; MBA Mortgage Applications; Musalem. **Thurs:** ADP Employment Change 68k; Initial Claims 230k; Nonfarm Productivity & Unit Labor Costs 2.7% & 1.2%; ISM NM-PMI 51.0; S&P Global C-PMI & NM-PMI 55.4 & 55.4; Trade Balance -\$75.3b; Fed Balance Sheet; Williams; Goolsbee. (Source: FX Street)

Global: Wed: Eurozone PPI 0.2%/m/m, 0.1%/y/y; Eurozone C-PMI & NM-PMI 51.1 & 50.7; Germany C-PMI & NM-PMI 50.9 & 50.1; France C-PMI & NM-PMI 49.8 & 49.7; UK C-PMI & NM-PMI 53.0 & 53.6; China Caixin NM/PMI 52.5. **Thurs:** Eurozone Retail Sales -0.2%/m/m, 2.4%/y/y; Cipollone. (Source: FX Street)

US Economic Indicators

Manufacturing PMI ([link](#)): The ISM M-PMI contracted for the sixth consecutive month in August, after a brief expansion during January and February. The M-PMI increased to 48.7 in August, declining at a slightly slower pace than during July (48.0). (The consensus estimate was 49.0.) According to ISM, the overall economy continued its expansion for the 64th month after a one-month contraction in April 2020. (A manufacturing PMI above 42.5 over a period of time generally indicates an expansion of the overall economy.) The new orders (to 51.4 from 47.1) measure expanded in August, following six months of falling orders, while the production (47.8 from 51.4) measure moved from expansion to contraction during the month. Inventories (49.4 from 48.9) continued to decline, though was just shy of the breakeven point of 50.0 last month. The suppliers' deliveries (51.3 from 49.3) gauge moved back above 50.0, indicating slower deliveries, after one month in "faster" territory—which was preceded by seven consecutive months in expansion (or "slower") territory. The employment (43.8 from 43.4) measure continued to show jobs cuts in the sector, with jobs in August falling at a steady pace compared to July. Meanwhile, prices (63.7 from 64.8) increased at a slightly slower pace, though remain elevated.

Construction Spending ([link](#)): Construction spending fell again in July, as higher mortgage rates continued to restrain the housing market. Total construction spending fell 0.1%, in line with consensus estimates, following an unrevised 0.4% drop during June. Year-to-date, investment is down 2.2%. Residential investment edged up 0.1% in July, while nonresidential investment slipped 0.2%. Private construction investment dipped 0.2% during the month, led by nonresidential (-0.5%) investment, while residential investment ticked up 0.1%. The shortfall in nonresidential construction was led by declines amusement & recreation (-1.0%), commercial (-0.9%), manufacturing (-0.7), and power (-0.7) structures, while transportation (+0.6%), lodging (+0.3), and health care facilities (+0.3) led the gains. The uptick in residential construction in July was led by an identical increase in new single-family building (+0.1), while multi-family construction fell 0.4%. Versus a year ago, total construction spending was 2.8% below a year ago, with private construction investment down 4.6%, reflecting declines in both residential (-5.3) and nonresidential (-3.7) building. Meanwhile, public construction spending increased 0.3% in July and was 3.4% above a year ago.

Global Economic Indicators

Global Manufacturing PMIs ([link](#)): The JP Morgan Global M-PMI climbed from 49.7 in July

to 50.9 in August, as output, new orders, and employment all returned to growth. Production rose for the second time in three months in August, to a 14-month high, as activity in the consumer, investment, and intermediate goods sectors all returned to growth, though intermediate goods output was the weakest of the three. Meanwhile, orders rose for only the second time in the past five months, recording only mild expansions over the three sectors, as tariff concerns continued to weigh on international trade flows. Worldwide manufacturing employment for the first time in 14 months, though job creation in both the intermediate and investment goods sectors was partially offset by cuts in the consumer goods sector. Regionally, 11 of the 32 countries for which manufacturing data were available reported rates of expansion in August, with India, Thailand, Spain, Colombia, and the US posting the strongest growth rates. Meanwhile, only five of the 32 nations recorded steep declines, Poland, Taiwan, Russia, Kazakhstan, and Brazil. The report notes the *outlook* for the global manufacturing sector remained downbeat: While business optimism edged higher, positive sentiment remained below its long-run average for the 17th straight month. Turning to prices, price pressures edged higher in August, with input costs and selling prices accelerating to six- and four-month highs, respectively. The US recorded the steepest rise in output charges and the second-fastest rise in input costs (behind Romania) of the nations covered.

Contact us by [email](#) or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-241-6502
Melissa Tagg, Senior Global Investment Strategist, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
William Pesek, Contributing Editor, 516-277-2432
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-228-9102

