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Morning Briefing

Indonesia Is Cautionary Tale For Emerging Markets

Executive Summary: For many emerging markets around the world, Trump's tariffs on their exports to the US are stressing economies that already were facing formidable challenges, William reports. The President of Indonesia has been making moves that undermine Bank Indonesia's independence—shaking investors' confidence, roiling the country's financial markets, and risking destabilizing capital flight. Economic mismanagement in Indonesia also has triggered civil unrest. Other vulnerable economies, made more so by the US tariffs, include Brazil, India, South Africa, Turkey, Argentina, South Africa, and Thailand. Each is battling its own set of headwinds, but all seem to be in the same boat in a turbulent sea.

Weekly Webcast. If you missed Monday's live webcast, you can view a replay [here](#).

Emerging Markets I: Indonesia's Troubles Tell Bigger Story. There's a whiff of 1997-like paranoia in the air in Southeast Asia's largest economy as investors brace for a massive capital flight. The outflows may not be as chaotic and virulent as those that toppled the administration of then-President Suharto, but they're potentially destabilizing nonetheless.

The recent return of violent protests, currency volatility, and sudden high-level cabinet departures in Indonesia come with a sense of déjà vu. So do concerns about the nation's fiscal outlook, as evidenced by a [steepening yield curve](#). The gap between yields of short- and long-dated bonds is now the biggest since 2023, and it looks set to widen.

The stakes rose last week when President Prabowo Subianto fired his globally respected finance minister Sri Mulyani Indrawati. She's viewed as a vital guardian of fiscal discipline, having served in the role [under three presidents](#) since 2016. Prabowo kept her in the job after he took the helm in October 2024 following a landslide election victory.

Over time, Prabowo came to believe that she was stymying his ambitions to ramp up fiscal spending to boost economic growth. The abruptness of [Sri Mulyani's departure](#) is already shaking up the Indonesian financial markets. The loss of one of the very few checks on

Prabowo's spending plans and the strong market reaction are unnerving investors who recall Indonesia's central role in the 1997 Asian financial crisis.

Yet Indonesia is foremost among emerging market economies increasingly debilitated as fallout from US President Donald Trump's tariffs collides with a slowing Chinese economy exporting overcapacity. Financial markets from [Argentina](#) to [Lesotho](#) to [Laos](#) are gyrating disconcertingly to various degrees. Meanwhile, Trump's 50% tariffs on India and Brazil—whose fortunes matter greatly to their regions—are pushing these developing giants to the brink.

Let's consider the decidedly rocky year Indonesia is having and what it says more broadly about emerging-market economies:

(1) *Indonesia living dangerously—again.* Prabowo rapidly replaced Sri Mulyani with Purbaya Yudhi Sadewa, an outspoken proponent of aggressive fiscal and monetary policies. Two days into his gig as finance minister, Purbaya acted with similar speed in [announcing](#) a \$12 billion cash injection. He's also transferring half of the 400 trillion rupiah (\$24 billion) in cash reserves that the Ministry of Finance holds with the central bank to state-owned lenders.

Hence, the steepening of the yield curve as banks put much of that liquidity into shorter-dated bonds. Purbaya's hope is that banks channel the money into loans rather than sovereign debt. Even after recent rate cuts by Bank Indonesia (BI), Purbaya argues that the [financial system](#) suffers from a "drought" of funds. The move did little to calm nervous markets, though, as it raises thorny questions about central bank independence.

(2) *Central bank meddling.* At a moment when Trump is pressuring the Federal Reserve to lower US interest rates, officials in Jakarta are defending their own government's assault on BI's independence.

President Prabowo isn't known for his economic reform skills. He's the third former military officer to lead Indonesia—and former President Suharto's ex-son-in-law. So far, 330 days into his administration, his handling of the [\\$371 billion](#) economy prioritizes control over reforms to increase competitiveness.

(3) *Budgetary fallout.* Prabowo is now forging an unusual partnership between the government and BI to finance costly housing and infrastructure projects. This [burden-sharing](#) gambit is taking precedence as Prabowo seeks to mask the budgetary implications of his spending plans.

Last week, the finance ministry and BI assured global investors that the arrangement will be concluded “transparently, accountably and with strong governance.” In a joint statement, they claimed that the “synergy continues to refer to the principles of prudent fiscal and monetary policies, while maintaining market discipline and integrity.”

(4) *Erosion of trust.* Many economists argue that a fiscal stimulus initiative executed jointly by a government and its central bank is a dangerous experiment that has little precedent among major economies. The scheme has “the potential to damage BI’s reputation as an independent institution,” Wijayanto Samirin of Paramadina University [*told Reuters*](#). “Several things BI is doing are odd,” Wijayanto said. “They get too deep and detailed into fiscal matters and this disrupts our monetary policy ecosystem.”

With BI independence at risk, Capital Economics wrote on September 9, “the experience from other emerging markets shows that an erosion of central bank [*independence*](#) typically leads to higher inflation and inflation expectations. A prolonged period of high real interest rates would, eventually, be needed to get inflation back down.”

Emerging Markets II: ‘Fragile Five’ Are Fragile Again. Indonesia is hardly alone as US tariffs slam global economies: The economies once dubbed the “[*Fragile Five*](#)” (by Morgan Stanley in 2013 amid the Fed’s “[*taper tantrum*](#)”)—i.e., Brazil, India, Indonesia, South Africa, and Turkey—all are fragile again as Trump’s tariffs upend the global financial system.

Let’s take a look at where these economies find themselves as 2026 approaches:

(1) *Brazil.* President Luiz Inacio Lula da Silva’s economy is slowing under the weight of 50% US tariffs, China’s slowdown, elevated inflation, and high interest rates. The trade war is imperiling exporters of beef, coffee, seafood, soybeans, and the gamut of manufactured goods. Brazil’s efforts to diversify its trade are hitting a wall as China, Brazil’s latest export market, slows and experiences deflation. Brazil’s central bank is set to keep its key rate [*unchanged at 15%*](#) on September 17 amid persistently strong price pressures.

On September 8, Lula said Brazil is pushing for accelerated trade and financial integration efforts among the BRICS—Brazil, Russia, India, China, South Africa—to limit the damage from protectionism. “Tariff blackmail is being normalized as a tool for conquering markets and interfering in domestic issues,” Lula said. The BRICS countries, he added, have become “victims of unjustified and illegal trade practices.”

(2) *India.* Prime Minister Narendra Modi’s economy also faces a 50% Trump import tax.

This is complicating India's need to grow 8% per year to reach the ruling Bharatiya Janata Party's goal of achieving developed nation status by 2047. It's also undermining Modi's "Make in India" strategy to become a major manufacturing power, which puts further from reach India's goal of creating enough good-paying jobs to reduce the 19% unemployment rate among urban youths. On September 11, Reuters reported that Indian exporters are seeking a lower rupee exchange rate and a moratorium on loan repayments.

Modi hasn't shied away from pressuring the Reserve Bank of India (RBI) to ease monetary policy. In 2018, RBI Governor Urjit Patel resigned suddenly after Modi removed board members to appoint loyalists in their place—something that may sound familiar to Fed watchers. Modi tried to pressure the RBI to give him greater access to reserves to finance his priorities. This over-reliance on loose monetary policy is now coming back to haunt Modi's government.

(3) *South Africa*. Although South Africa fared better than Brazil and India in US tariff negotiations, its 30% tariff rate is the highest in sub-Saharan Africa. Nigeria, Ghana, and Zimbabwe face just 15% US tariffs. Levies are doing serious damage to key sectors including autos and components, wine, agricultural products like citrus and nuts, and metals like steel and aluminum. Job losses are mounting, costs are rising, and the competitiveness of South African goods is waning in real time. All this had President Cyril Ramaphosa's government scrambling to diversify export markets toward Asia, the Middle East, and other African nations.

The South African rand is extending losses against the dollar. One catalyst is a widening current account deficit. The current account gap—the broadest measure of trade in goods and services—expanded to 1.1% of GDP in the three months through June.

(4) *Turkey*. President Recep Tayyip Erdoğan's economy escaped with just a 15% US tariff. But the nation is reeling from an inflation rate of nearly 33.0% y/y in August. Though way down from its recent peak at 85.5% y/y in late 2022, the rate is still shaking up the \$1.3 trillion economy. A major reason why inflation surged was Erdoğan's disastrous pressure campaign against the central bank's authority. Between 2019 and 2023, he fired or replaced five central bank governors. By mid-2023, cooler heads prevailed. That allowed for interest-rate hikes, bringing inflation down.

Even if Turkey seemed to get off easy tariff-wise, the economy is feeling pain from the higher tariffs of others owing to the intermediate goods it supplies to countries or entities that export to the US, says Can Selcuki of Istanbul Economics Research. This includes the

European Union, which is subject to a 20% tariff.

Emerging Markets III: Developing World Limping Toward 2016. In Argentina, it didn't take long for Javier Milei's 646-day-old presidency to morph from reformist exemplar to cautionary tale. After loading up on Argentina's hard-currency bonds and stocks last year as inflation moderated, foreign investors now can't decide which to dump first.

The peso, meantime, has plunged to an all-time low as policy missteps, a [corruption scandal](#) involving Milei's sister Karina—who's also his chief of staff—and a [dismal showing](#) by his party in local elections imperil his latitude for implementing reforms. As of Monday, the peso is [down 41%](#) versus the dollar ytd. As for stocks, the S&P Merval Index is down [more than 30%](#) ytd. Earlier this month, Fragile Five arbiter Morgan Stanley abandoned its [bullish call](#) on Argentina.

Here's more:

(1) *Africa hit hard.* Over in Africa, the tariffs—and global turmoil since then—are hammering several economies. The southern nation of Lesotho, in particular, was severely impacted by Trump's initial 50% tariffs, which struck the textile industry particularly hard, as it provides nearly 90% of the jobs (Trump has since [lowered the levy](#) to 15%). Market volatility is [also hitting](#) Angola, Cameroon, Chad, Democratic Republic of Congo, Equatorial Guinea, Ghana, Nigeria, and Uganda.

In Asia, US tariffs and the resulting currency market chaos are hitting the economies of Laos, Cambodia, Sri Lanka, and Vietnam. Malaysia and the Philippines are battling ill-timed headwinds. So is Thailand, given its growing roles globally in sectors from autos to electronics to industrial machinery.

(2) *Thai paralysis.* Thailand is back in the news for political volatility once again. On August 29, the nation's top court removed Prime Minister Paetongtarn Shinawatra for an ethics violation. She's the sixth Thai prime minister from, or backed by, the billionaire Shinawatra family to be removed by the military or judiciary over the last two decades. The return to [political paralysis](#) in Bangkok is poorly timed as the global outlook darkens.

This situation has geopolitical watchers once again worried about the “[revolving-door](#)” leadership that too often afflicts Asia. In recent weeks, analysts have seen Japanese Prime Minister Shigeru Ishiba bow out after less than one year in power. In Nepal, the [worst public unrest](#) in decades recently forced Prime Minister KP Sharma Oli to resign.

(3) *Supply-chain risk*. Concerns about Indonesia are of greater global concern, though. It's a vital and fast-growing player in global supply chains thanks to its significant nickel reserves needed for electric vehicle batteries. Indonesia boasts a bevy of mineral resources like palm oil and tin.

The Indonesian government is in crisis management mode once again as the nation's [286 million people](#) "become a casualty of the [economic mismanagement](#) wrought by the Prabowo administration," said Priyanka Kishore at Asia Decoded.

Recent "protests," Kishore explained, "highlighted the tension between the narrative of a stable economy anchored around 5% annual GDP growth, and the reality of a shrinking Indonesian middle class with limited employment prospects, which has been evident in the bottom-up data for a while."

(4) *The Bond Vigilantes*. Prabowo's plan to address these and other problems is a return to budget-busting public spending. This is triggering the Bond Vigilantes. Stock investors, not so much, considering that the Jakarta Stock Exchange Composite Index is up [12% ytd](#). Yet increasing debt to paper over the structural problems undermining investment and job creation—including corruption—is why Indonesia crashed back in 1997.

Indonesia has come a very long way since the dark days of 1997 and 1998. That was when it required a [\\$43 billion](#) International Monetary Fund bailout and massive protests ended the 32-year reign of Prabowo's former father-in-law Suharto. But between the tariffs and China's slowdown, many are now questioning whether the Southeast Asian [growth model](#) is kaput. That should worry emerging market investors everywhere.

Calendars

US: Tues: Headline & Core Retail Sales 0.2% & 0.4%; Industrial Production 0.0%; Capacity Utilization Rate 77.4%; Business Inventories 0.2%; Atlanta Fed GDPNow 3.1%; NAHB Housing Market Index 33; Import Price Index -0.2%. **Wed:** Fed Interest Rate Decision 4.25%; FOMC Projections; Housing Starts & Building Permits 1.36mu & 1.37mu; Mortgage Applications. (Source: FX Street)

Global: Tues: Eurozone Industrial Production 0.5%; Eurozone ZEW Economic Sentiment 20.3; Germany ZEW Survey 25; Germany Buba Monthly Report; Italy CPI

0.1% m/m, 1.6% y/y; UK Average Earnings Including & Excluding Bonus 3.8% & 4.8%; UK Unemployment Rate 4.7%; Canada CPI 2.6% y/y; Buch. **Wed:** Eurozone Headline & Core CPI 2.1% & 2.3% y/y; UK Headline & Core CPI 3.9% & 3.6% y/y; Lagarde; Escriva; Cipollone. (Source: FX Street)

Strategy Indicators

S&P 500/400/600 Forward Earnings ([link](#)): During the September 12 week, forward earnings rose simultaneously for all three indexes for the 14th time in 16 weeks. LargeCap's forward earnings rose for a 17th straight week, its longest winning streak since it did so for 38 weeks through the September 13, 2024 week. MidCap's has dropped in just two of the 17 weeks since it bottomed during the May 16 week. SmallCap's has risen for 16 straight weeks since it bottomed during the May 23 week, its longest winning streak since it did so just over four years ago for 25 weeks through the August 27, 2021 week. LargeCap's forward earnings rose 0.4% w/w to its 15th straight weekly record high. MidCap's gained 0.5% w/w to its second straight weekly record high, after last hitting that mark five months earlier during the April 4 week. SmallCap's rose 0.2% w/w to a 58-week high and is 9.7% below its June 2022 record. LargeCap's forward earnings has soared 30.1% from its 54-week low during the week of February 1, 2023; MidCap's is 10.2% above its 55-week low during the week of March 10, 2023; but SmallCap's has lagged considerably and is up just 5.8% 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%, 10.3%, 13.8%), MidCap (0.4, 2.3, 17.4), and SmallCap (-10.2, 3.3, 18.5).

S&P 500/400/600 Valuation ([link](#)): Valuations were mixed for these three indexes during the September 12 week. LargeCap's forward P/E rose 0.3pt w/w to 22.4, matching its four-year high during the July 25 week. It's now 5.4pts above the 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 fell 0.2pt w/w to 16.2 from a 32-week high of 16.4. It's now 0.9pts below its 40-month high of 17.1 during the November 29 week and 4.0pts 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 edged down 0.1pt w/w to 15.6 from a 29-week high of 15.7. It's 2.7pts above its 17-month low of 12.9

during the April 4 week and 5.0pts above its 14-year low of 10.6 in September 2022, but remains 1.5pts below its 41-month high of 17.1 during the November 29 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 is at a 27% discount to LargeCap's P/E, up from a 26-year low 29% discount during the April 10 week which matched its similar 29% discount during the July 5, 2024 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 is at a 30% discount the LargeCap's P/E, up from a 13-month-low 33% discount during the August 7 week. That compares to a 23% discount during the November 29 week, which was its best reading since the March 2, 2023 week. It's now just 4ppts above its 24-year-low 34% discount during the July 5, 2024 week. SmallCap's P/E is at a 4% discount to MidCap's, up from a 13-month low 6% discount at the end of July and a 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

Empire State M-PMI ([link](#)): Business activity in the New York region unexpectedly contracted in September, posting its first negative reading since June. The headline general business conditions index (to -8.7 from 11.9) plunged 20.6 points, as both orders and shipments tumbled. The new orders (-19.6 from 15.4) measure tumbled 35.0 points, while shipments (-17.3 from 12.2) dropped 29.5 points—with both sinking to their lowest readings April 2024. Turning to the labor market, the employment (-1.2 from 4.4) gauge moved from expansion to contraction, falling 5.6 points, after three successive months of gains, while the average workweek (-5.1 from 0.2) also contracted. As for pricing, the prices-paid (46.1 from 54.1) measure eased this month but remained elevated, while the prices-received (21.6 from 22.9) gauge was little changed. Looking ahead, future general business conditions (14.8 from 16.0) held fairly steady—expecting conditions to improve somewhat in the months ahead. As for pricing, the forward looking indicators for prices-paid (57.8 from 64.2) and prices-received (43.1 to 41.3) showed a similar pattern to the current price measures.

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