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Morning Briefing

On Argentina's Woes & China's Policies

Executive Summary: Argentina's failing economy was buoyed by IMF intervention in April, but since August the floor has fallen out. President Milei's austerity plan is slamming consumer confidence, and foreign investors are rushing for the exits. Trump's controversial \$20 billion bailout won't help, William predicts. It simply buys more time for a (MAGA loving) president whose shock-therapy plan is failing spectacularly, and it could set off a 1980-style downward spiral. ... China's stock market has been riding high on the government's commitment to 5% annual GDP growth. But prioritizing the GDP targets warps economic incentives and comes at the expense of getting China's fiscal house in order.

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

Argentina Crisis I: Why \$20 Billion US Bailout Won't Work. On any list of chronically failing economies, Argentina is at the very top. This month's events in Buenos Aires encapsulate why. They also demonstrate why we view the Trump administration's \$20 billion lifeline as yet another example (of many historically) of throwing good money after bad.

On one level, US President Donald Trump's doling out a fat foreign aid package to a Latin American country is a head-scratcher, as he has seemed to want to disengage from the region ASAP. Perhaps it's a reward for Argentinian President Javier Milei's vocal support of all things "MAGA"?

Embattled Milei is a self-described hardline libertarian famous for brandishing a chainsaw at public events—a schtick copied by [Elon Musk](#) at a conservative conference in February (Milei actually [gifted a chainsaw](#) to Musk). Milei [took power](#) in December 2023 pledging to slash public spending and regulations. It's not going well.

Here's why a \$20 billion US bailout is unlikely to right Argentina's capsizing ship:

(1) *Argentina in turmoil—again.* The US bailout wasn't the first attempt to help the country.

In April, the International Monetary Fund (IMF) approved a [\\$20 billion extended fund facility](#). That is in addition to an earlier [\\$42 billion](#) package of IMF credits; Argentina is by far the IMF's biggest debtor.

Initially, the program appeared to be effective: Triple-digit y/y inflation declined to 33.6% y/y in August. That helped reduce Argentina's poverty rate to 31.6%, the lowest since 2018. Since August, though, the floor has been falling out of an economy whose top export is financial turmoil. Milei's austerity is slamming consumer confidence, and foreign investors are rushing for the exits.

(2) *Milei's election flop*. Increasing economic pain led to a wipeout for Milei's party in local [Buenos Aires elections](#) on September 7. That sent the peso and peso assets sharply lower. The central bank then burned through [\\$1 billion of reserves](#) to stabilize things, leaving net reserves of just [\\$6 billion](#), JPMorgan calculates.

Then came a flurry of phone calls to Trump World. On September 24, Treasury Secretary Scott Bessent unveiled a [giant swap line](#), exchanging dollars for pesos, to tame the markets. Argentina's foreign bonds [surged 22%](#) last week. Stocks [rallied 7%](#) last week.

(3) *Too MAGA to fail*. The motive behind the US's intervention seems less that Argentina is too big to fail than that Milei is too ideologically aligned with Trump for the US to let his government collapse. At a dinner honoring Milei in New York last week, Bessent praised him "for his tireless efforts" to "[Make Argentina Great Again](#)."

Bessent called the rescue of self-styled [anarcho-capitalist](#) Milei a "bridge to the election" next month, when his Libertarian Party hopes to fare better in mid-term congressional contests. If Milei's party does win back the majority, all that the US support essentially will have achieved is buying more time for a leader whose shock-therapy plan is already failing spectacularly. How that helps Latin America is unclear.

Moral hazard risks abound. Trump running cover for the latest inept leader of a chronically mismanaged economy—and with no conditions—could set off another 1980s-style downward spiral.

Argentina Crisis II: Past Catching Up With Economy. No doubt, Argentina's latest reckoning is a product of countless stumbles in recent decades. The pattern: The left-leaning populist Peronist Party takes power periodically and runs massive deficits. As inflation surges, a right-wing party rises with promises of austerity and a return to economic

sobriety.

Milei, though, isn't a natural fit in this rinse-and-repeat continuum. A crypto-heavy focus makes [Mileinomics](#) hard to define. Along with tens of thousands of job losses, financial markets in chaos, and pensioners fearing the worst, Milei's administration is engulfed in scandals—from [crypto scams](#) to his [chief-of-staff sister's](#) allegedly receiving pharmaceutical kickbacks.

Here's more:

(1) *Terrible timing.* Argentina's latest stumble could hardly be timed worse. Trump's tariffs are wreaking havoc with global growth trends and currency, bond, and stock markets. The punitive [50% levy](#) weighing on Brazil, the region's biggest economy by far, is an added headwind.

Another reason that propping up Milei is a big gamble for Trump: US farmers are [calling for bailouts](#) as tariffs bite. Yet even as Argentina clings to Washington's life-preserver, it's wooing China. Milei is [suspending duties](#) on several China-bound products, including soybeans (previously taxed at 26%).

(2) *The China angle.* This complicates the argument that backstopping Argentina would counter China's growing influence in Latin America. As Brazil shows, Chinese leader Xi Jinping can hit back hard, especially by leveraging his close ties with President Luiz Inácio Lula da Silva to exact pain on [MAGA states](#) like Iowa and Nebraska.

Less clear is why the latest Argentina incident is a systemic risk for Latin America. Alas, skepticism of the Trump-Bessent bailout is a rare area of agreement between Republicans and Democrats.

(3) *Farmers are collateral damage.* As MAGA supporting Senator Chuck Grassley (R-Iowa) wrote on social media: "Why would USA [help bail out Argentina](#) while they take American soybean producers' biggest market??? We shld use leverage at every turn to help hurting farm economy Family farmers shld be top of mind in negotiations by representatives of USA." He said farmers are "very upset" about Argentina "selling soybeans to China right after USA bail out."

Argentina, the American Soybean Association claims, sold [20 shiploads](#) of soybeans to China just as Bessent disclosed that the US was working up an aid package.

(4) *Bond Vigilantes*. Bessent, meanwhile, is testing bond traders as he tiptoes up to using the Treasury's Exchange Stabilization Fund to support Argentina. It hasn't been used in such a way since the 1990s, when President Bill Clinton's administration [approved a loan](#) to save Mexico.

Yet Argentina's [\\$646 billion economy](#) is nearly 2.8 times smaller than Mexico's [\\$1.79 trillion economy](#).

The bottom line: For a US administration to go out of its way to un-jam Milei's chainsaw is an extreme step indeed. Moreover, it won't work because chain-sawing an already fragile economy doesn't work. But a leader who's tight with the White House's current occupant gets to keep cutting anyway, to the detriment of most of Argentina's [45 million](#) people.

Chinese Economy I: It's Time Beijing Got Off Debt Treadmill. The trouble with China these days is that good economic news at home is increasingly bad news for the global financial system.

Obvious examples include China's sharing its overcapacity with a world economy that hardly needs another headwind. Look no further than how China Inc. is shaking up the [electric vehicle](#) universe. Despite Trump's tariffs, China's unstoppable export machine is heading toward a record [\\$1.2 trillion](#) trade surplus this year, topping 2024's record.

But a less recognized good-news-that's-actually-bad dynamic is worth considering: China's likely success in getting to, or very near, this year's "around 5%" GDP target. Let's explore why:

(1) *Warped incentives*. These arbitrary goals reveal a great deal about China's fiscal excesses, a problem that President Xi Jinping is attempting to conceal through creative policymaking. The Communist Party's need to meet its annual targets distorts all economic incentives.

The targets reward low-quality growth that delivers short-term sugar highs, not productive investments. That's why mainland households lack the purchasing power to share more of China's growth abroad. When GDP is more about optics than growing a vibrant middle class, most of its benefits stop at the water's edge.

In fact, the government's GDP targets are to blame for the credit-and-debt-fueled [housing bubble](#) that since has crashed, generating deflation.

(2) *Lehman's legacy.* Though China has long set annual targets, they became something of an obsession following the 2008 Lehman Brothers crisis. At the time, Beijing rolled out what was then a super-ambitious [4 trillion-yuan](#) (\$560 billion) infrastructure package. It worked, enabling China to navigate around the worst of the global financial crisis. In 2008, it [grew 9.6%](#), followed by [9.1% in 2009](#).

The lesson China Inc. learned: When in doubt, spread concrete. This explains why Asia's biggest economy is chock-a-block with six-lane highways to nowhere, a surplus of skyscrapers vying for the record books, sprawling international airports desperate for more routes, white elephant stadiums and shopping districts, cavernous museums devoid of masterpieces, and titanic apartment complexes that developers can't complete.

(3) *Recipe for disaster.* Incentive structures within Xi's party intensified this infrastructure arms race. Across China's [22 provinces](#), local government leaders craving national power are drawing up new GDP-boosting projects. The way you get Xi's attention is by routinely producing above-average GDP rates. It's easy to see why that's a recipe for fiscal disaster.

In 2010, hedge fund manager Jim Chanos warned that China was on a ["treadmill to Hell,"](#) one spinning faster with each passing year. Since then, each time China's GDP target looked dicey, Beijing and municipalities across the nation jumped back on the treadmill. It occurred in 2015, when [Shanghai's stock market](#) was experiencing a crash, and in 2020, amid the Covid-19 crisis.

In March, Xi's economic team raised the fiscal ceiling to ["around 4%"](#) from 3%, marking the widest deficit-to-GDP ratio since 2010. Raising this deficit target is a big deal—akin to hiking the US debt ceiling or the Eurozone's Maastricht Treaty criteria—and speaks to Xi's determination to make this year's numbers. This is cheering investors. China's CSI 300 stock benchmark has [risen 17.4%](#) ytd, as global funds have rethought ["uninvestable"](#) worries about China.

Chinese Economy II: Fixing the 'Hidden Debt' Problem. Yet raising the deficit target undermines the argument that Beijing is getting its fiscal house in order. Since transparency isn't China's thing, investors often turn to the IMF for a clearer picture. By the IMF's numbers, China's general government borrowings stood at 60.5% of GDP in 2024 versus 38.5% in 2019. But, worse, China's ["augmented debt"](#)—which includes local government financing vehicles—was 124% of GDP in 2024, up from 86.3% in 2019.

Herbert Poenisch at Zhejiang University [warns](#) that overall non-financial debt, which jumped

to 312% of GDP in 2024 from 245% in 2019, puts China “among the most indebted countries.” Consider the following:

(1) *Property woes*. Given Washington’s \$37 trillion national debt and Japan’s world-beating debt-to-GDP ratio, Xi can try to argue that China looks okay by comparison. Yet China’s [\\$18 trillion economy](#) has lost a [comparable amount](#) of household wealth amid its property crisis. When a sector that traditionally generates [30% of GDP](#) splutters, it’s best to repair it right away—preferably via a mechanism that takes bad assets off developers’ balance sheets to avoid fresh defaults.

(2) *Finding hidden debt*. Beijing has pledged to clamp down on “hidden debt” held by local governments. That might seem like good news, but the IMF estimates such debt at roughly [60 trillion yuan](#) (\$8.4 trillion), or about half of the country’s GDP. Given China’s transparency deficit, who really knows?

The plan is to utilize China’s national balance sheet to improve local government finances. Beijing would issue trillions of yuan worth of central government bonds to swap for municipalities’ hidden liabilities. That, in theory, might alleviate debt pressures, lower borrowing costs, and create fiscal space to stimulate local growth through increased investment.

The plan might work if municipal leaders weren’t scrambling to hit a 5% growth target. Michael Pettis of Carnegie Endowment [sees three problems](#) with the approach: 1) It perpetuates, rather than resolves, the non-productive investment dilemma; 2) it does “nothing to relieve the government’s overall debt burden from a systemic point of view,” and 3) it threatens to ravage the central government’s own balance sheet for years to come.

(3) *Japan’s lessons*. A similar plan didn’t work for Japan. In the early 1990s, before its bad-loan crisis and lost decades, Tokyo’s debt-to-GDP ratio was [just 40%](#). Today, it’s estimated by some to be [as high as 260%](#).

Trump’s trade war is an added risk. Even if China can grow 5% on paper, its underlying economy is struggling. Wages are stagnating as China Inc. engages in price wars that are exacerbating deflation.

Getting off the treadmill means dispensing with the GDP rat race. Unfortunately, the odds of that aren’t great.

Calendars

US: Tues: Consumer Confidence 95.3; JOLTS 7.15m; S&P/CS HPI Composite 2.3%/y/y; Chicago PMI 43.2; Goolsbee; Jefferson; Collins; Logan. **Wed:** ADP Employment Change 50k; MBA Mortgage Applications. (Source: FX Street)

Global: Tues: Germany Retail Sales 0.5%; Germany Unemployment Rate 6.3%; Germany CPI 0.1%/m/m, 2.3%/y/y; Germany Import Prices -0.2%; France Consumer Spending 0.3%; France CPI -0.9%/m/m, 1.3%/y/y; Italy CPI 0.2%/m/m, 1.7%/y/y; UK GDP 0.3%q/q, 1.2%/y/y; RBA Interest Rate Decision 3.60%; Japan Housing Starts -4.9%; Japan Large Manufacturing Index 14; Japan M-PMI 48.4; Elderson; Nagel; Mann; Ramsden; Breeden. **Wed:** Eurozone, Germany, France, Italy & Spain M-PMI 49.5, 48.5, 48.1, 50.0 & 54.0; UK M-PMI 46.2; Eurozone & Core Harmonized CPI 2.2% & 2.3%/y/y; UK House Prices 0.2%; De Guindos; Elderson. (Source: FX Street)

Strategy Indicators

S&P 500/400/600 Forward Earnings ([link](#)): During the September 26 week, forward earnings rose simultaneously for LargeCap and SmallCap for an 18th straight week. S&P's quarterly rebalancing and index changes on September 22 delivered what we believe will be a brief halt to MidCap's newest string of record high forward earnings. LargeCap's forward earnings rose for a 19th 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 three of the 19 weeks since it bottomed during the May 16 week. SmallCap's has risen for 18 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 gained a hair w/w to its 17th straight weekly record high. MidCap's dropped 0.8% w/w from a record high. SmallCap's rose 0.5% w/w to a 23-month high and is 9.0% below its June 2022 record. LargeCap's forward earnings has soared 30.6% from its 54-week low during the week of February 1, 2023; MidCap's is 9.7% above its 55-week low during the week of March 10, 2023; but SmallCap's has lagged considerably and is up just 6.6% 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%, 9.9%, 14.1%), MidCap

(0.4, 0.9, 17.8), and SmallCap (-10.2, 4.3, 17.4).

S&P 500/400/600 Valuation ([link](#)): Valuations were mostly higher for these three indexes during the September 26 week. LargeCap's forward P/E ticked down 0.1pt w/w to 22.5, from 22.6 a week earlier, which was its highest level since the January 8, 2021 week when forward earnings was still recovering from the Covid-19 shutdown. It's now 5.5pts 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 was steady for a third straight week at 16.2, down from a 32-week high of 16.4 the week before that. 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 dropped 0.2pt w/w to 15.5 from an eight-month high of 15.7. It's 2.6pts above its 17-month low of 12.9 during the April 4 week and 4.9pts above its 14-year low of 10.6 in September 2022, but remains 1.6pts 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 28% 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 32% discount the LargeCap's P/E, not much above its 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 2ppts 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

Regional M-PMIs ([link](#)): Five regional Fed banks have reported on manufacturing activity for September: New York, Philadelphia, Richmond, Kansas City, and Dallas. Activity in the Philadelphia, Kansas City, and Dallas regions expanded during the month, while the New York and Richmond regions contracted. [Philadelphia's headline general business activity index](#) rose 23.5 points (to 23.2 from -0.3) to its highest reading since January. The

shipments (to 26.1 from 4.5) and new orders (12.4 from -1.9) components rose 21.6 points and 14.3 points, respectively, in September, while employment (5.6 from 5.9) was little changed. The average workweek (14.9 from 4.7) component, meanwhile, rose 10.2 points. As for pricing, both the prices-paid (46.8 from 66.8) and prices-received (18.8 from 36.1) measures eased dramatically during the month. The Kansas City composite index (to 4 from 1) edged higher in September, with most indexes moving up during the month, with the exception of backlog of orders and the new orders for exports measures. Meanwhile, production (to 4 from 0) and volume of shipments (7 from 6) edged higher, while new orders (2 from 5) were less positive. Employment (7 from 0) improved during the month, while the average workweek remained flat at 3. Both prices paid for raw materials (58 from 61) and prices received for finished product (36 from 38) eased slightly during the month. Turning to the Dallas survey, the production index (to 5.2 from 15.3), a key measure of state manufacturing conditions, continued to expand, though at a slower rate, showing below-average output growth. New orders (-2.6 from 5.8) moved from expansion to contraction during the month, while shipments (6.7 from 14.2) slowed. The labor market showed a slight decline in employment (-3.4 from 8.8), to its lowest reading since April, while the hours worked index fell 11.6 points, though remained positive at 3.4. Price and wages pressures were largely unchanged during the month. New York's headline general business activity index declined in September, posting its first negative reading since June. The headline general business conditions index sank 20.6 points (to -8.7 from 11.9), with both the new orders (to -19.6 from 15.4) and shipments (-17.3 from 12.2) measures swinging from expansion to contraction, declining 35.0 points and 29.5 points, respectively. Meanwhile, delivery times (0.0 from 17.4) were steady, while supply availability (-8.8 from -5.5) worsened. Employment (-1.2 from 4.4) declined slightly, while the average workweek (-5.1 from 0.2) also fell during the month. As for pricing, prices-paid (46.1 from 54.1) eased slightly, though remained elevated, while the pace of prices received (21.6 from 22.9) remained moderate. Richmond's composite manufacturing index (to -17 from -7) softened again in September, with all three of its component indexes, shipments (to -20 from -5), new orders (-15 from -6), and employment (-15 from -11) all deep in contraction territory. As for pricing, the average growth rate of prices paid (7.22% from 7.24%) showed little change, while prices received (4.02 from 3.14) accelerated in September. (Richmond Fed measures current and expected changes as percent changes over the last and next 12 months.)

Global Economic Indicators

Eurozone Economic Sentiment Indicators ([link](#)): Europe's economic sentiment climbed slightly in September, with ESIs in both the EU (+0.6 points to 95.5) and Eurozone (+0.2

points to 95.5) rising, though both measures remained below their long-term average of 100. *ESIs among the six largest EU economies* were a mixed bag, with four moving higher and two moving lower. Moving higher were ESIs for Spain (+3.0 points to 104.7), Italy (+0.7 to 99.0), France (+0.3 to 93.0), and Poland (+0.1 to 100.0), while the Netherlands (-0.7 to 99.9) and Germany (-0.4 to 90.3) fell. *By sector*, ESIs moved higher for consumer (+0.5 to -14.3), services (+0.4 to 4.2), industry (+ 0.3 to -10.3), and construction (+0.1 to -5.6) and dipped for retail trade (-1.0 to -6.1).

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