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Morning Briefing

Trump Trade Turmoil, Again

Check out the accompanying chart collection.

Executive Summary: The latest US–China aggressions have the financial markets worried about the high stakes of a trade war between the globe's biggest trading nation and its largest economy. William observes that a disruption to global supply chains would have adverse consequences for earnings, economic growth, and central banks' pursuit of their mandates. But given the severity of the consequences, we expect a quick de-escalation of the tensions, with both sides willing to negotiate. … Also: The German economy is contracting, with weak industrial production, exports, employment, and consumer sentiment. Yet the government's stimulus measures do little to address the underlying structural causes.

YRI Weekly Webcast. Join Dr Ed's live webcast with Q&A on Mondays at 11 a.m., EST. You will receive an email with the link one hour before showtime. Replays of the weekly webcasts are available *here*. This week, William Pesek, our contributing editor, will join Dr Ed to discuss the latest developments in Trump Tariff Turmoil.

Trade War I: Trump Vs China, Game On (Again). A reboot of the US–China trade war is the last thing the global economy needs as 2025 staggers toward a close. But we think both sides are likely to blink given the dire risks to the global economy.

Wall Street was quick to express its displeasure over President Donald Trump's slapping another 100% tariff on Asia's biggest economy in response to China's curbing rare-earth mineral exports. Friday brought the S&P 500's biggest single-day drop in *six months*, to 6,552. "The reactions may say as much about recent market complacency as they do about the policy ramifications," notes *Steve Sosnick* at Interactive Brokers.

The *yen rallied* on news that Trump also plans export controls on "any and all critical software," just hours after he called the upcoming summit with China's leader Xi Jinping pointless. Sudden yen surges are Asia's version of a cry for help. Gold's surge toward *$5,000 per ounce* is a global one.

Excuse Federal Reserve Chair Jerome Powell if his head is spinning over which Fed mandate Trump's newest tariff—effective *November 1 or sooner*—affects more: The levy, coming just ahead of Christmas, might fan inflation and fast. Or it might sledgehammer the labor market.

But Trump's hitting China anew seemed inevitable given the speed bumps that his tariff deals are encountering in Asia. Let's look at how we got to this point and where things might go:

(1) *Speed bumps in Asia*. South Korea recently indicated that it can't pay Trump's *$350 billion* "signing bonus," equal to 18% of its annual GDP. Japan's probable next prime minister, Sanae Takaichi, wants to "*renegotiate*" the $550 billion "*blank check*" (as Trump adviser Peter Navarro calls it) Washington demands in return for just a 15% tariff rate.

And on Thursday, Chinese leader Xi Jinping slammed the door on the "grand bargain" pact of Trump's dreams by imposing new restrictions on the rare earth minerals that are vital to making cars, semiconductors, and electronics like laptops. Trump called it a "rather sinister and hostile move."

Unless cooler heads prevail, the rekindled trade war casts a big shadow over Q4 economic growth and corporate profits.

(2) *Supply-chain chaos.* If there's any marginal silver lining here, it's that *130%* isn't 145%. But the lowered 130% US tariff on Chinese imports is still hefty enough to effectively represent a trade embargo. The near severing of trade ties between the globe's biggest trading nation and its largest economy, which also prints the world's reserve currency, will upend supply chains everywhere.

For instance, China's rare earth curbs will disrupt electric vehicle (EV) production. Tesla and Volkswagen will have a harder time sourcing neodymium and dysprosium. Going without China's advanced memory and *sub-14 nm chips* will cause serious agita at Intel, Samsung, and Taiwan Semiconductor Manufacturing Company. Ditto for Lockheed Martin, Raytheon, and other *defense juggernauts* requiring China's minerals to make jet engines, missile guidance technology, and radar systems.

And good luck to General Electric and Siemens in building wind turbines and to Apple and Sony in trying to make smartphones or headphones.

Trade War II: Global Stakes Rising Fast. All this raises the stakes for Trump and Xi as they jostle for advantage in trade talks. To be sure, Trump's tariff threat could be a negotiating tactic designed to grab the Communist Party's full attention and bring Xi to the table.

Beyond Asia, Trump World is hitting *snags* in Europe. Since Trump shook hands with European Commission President Ursula von der Leyen in late July, the 15% tariff deal has come into question. At issue: the investments in US energy (*$750 billion* worth) and other US investments (*$600 billion* by 2028) that the European Union (EU) is expected to make.

Here's more:

(1) *Why EU is balking*. EU officials are telegraphing that these figures are aspirational, not binding. Offices in Brussels, Von der Leyen's team says, can't compel private companies to hoard American energy or invest if they can get better deals elsewhere.

The question, of course, is: What's next? Trump's trade war, remember, is all about China. Japan was patient zero for Trump's metastasizing Asia-is-stealing-from-us *worldview*. But China is both the economic nemesis of the moment and increasingly looking like the one that got away.

(2) *Trump needs a win*. Arguably, the only way Trump can convince his base and his billionaire donors that the tariffs, the market chaos, and the ruined vacations all were worth it is a big, beautiful *China trade deal*. The trouble for Trump is that Xi knows it, and he seems disinclined to give Trump a win.

Since the Trump 1.0 show, Xi recalibrated trade relationships toward the EU, Southeast Asia, and the broader "Global South" universe. That's given Beijing more confidence to slow-walk trade negotiations.

(3) *Xi's big gamble*. There's no telling whether leaving Trump at the economic altar might backfire on Xi.

China's *$18 trillion economy* is not exactly state-of-the-art going into the strongest headwinds of the Xi era. His government is grappling with deflation, a confidence-killing property crisis, high youth unemployment, and households still more keen to save than spend. And *Shanghai stocks* are flirting with the highest levels *since just before the market crash of 2015*.

(4) *The Fed's dilemma*. Renewed US-China rancor may dash the Bank of Japan Governor Kazuo Ueda's hopes of raising interest rates again this year.

Where this next episode of the Trump-versus-Xi show leaves the Fed is anyone's guess. Already, Powell & Co. was struggling to assess whether the artificial intelligence (AI) boom is in irrational exuberance territory as well as whether it explains why employment is weak when GDP growth is strong at *3.8% y/y* during Q2. Now, Powell must walk a tightrope between Trump's demands for lower interest rates and the potential inflationary implications of new taxes thrown at an already fractured *$582 billion* trade relationship.

Again, the odds favor Teams Trump and Xi stepping back from the brink and avoiding the deep global recession all this would likely cause.

In the meantime, if Powell's seatbelt isn't buckled, now is the time.

German Economy I: Recession Risks Abound. If France is the sick man in Europe, Germany is the immunocompromised neighbor worried about its own near-term prospects.

In August, German industrial production (IP) fell a larger-than-expected *4.3% m/m*, the sharpest drop since March 2022 after Russia's invasion of Ukraine. The German industrial production manufacturing index fell from a reading 94.4 in July to 89.2 in August (*Fig. 1*). This downshift matters globally for two reasons: 1) it suggests the frontloaded demand ahead of US tariffs is fast running its course; and 2) it raises the odds of recession in Europe's anchor economy at a moment when France is stumbling badly (good news perhaps only for short sellers betting on a tougher 2026).

Some have blamed the IP weakness on the effects of the summer holiday and changes in production facilities. But with IP down by *almost 4% y/y* and other data hinting at trouble ahead, it's hard to dismiss this as a blip. Though Trump's tariffs and Chinese overcapacity aren't helping, it's structural challenges facing German industry that are tripping up growth.

Let's look at how Germany's pre-existing conditions are flaring up again:

(1) *Industrial production in the doghouse.* More than six years after Covid-19 hit, German production is *15% below* pre-pandemic levels. With IP having "collapsed," *observes* Bank Syz CIO Charles-Henry Monchau, "Germany is headed for the third consecutive recession year."

Also, Germany's industrial capacity utilization is at lows last seen amid the 2008-09 financial crisis. With IP sliding, orders declining, and inventories rising amid trade war tensions and geopolitical upheaval, Berlin has been struggling to spark a rebound.

The external sector isn't helping. Exports *fell 0.5%* in August m/m. US-bound shipments are now down for five consecutive months.

Once, German was the country to beat in engineering and brand prestige. Now, luxury German automakers are losing mainland market share to Chinese rivals in EV adoption and related software innovation. Mercedes-Benz, for example, reported a *12% y/y plunge* in Q3 sales, with its US and China sales falling 17% y/y and 27% y/y, respectively. Porsche's Q3 China sales *dropped 21% y/y*. Meanwhile, Chinese EV giants BYD, Xiaomi, and others are gaining speed with high-feature, competitively priced models.

(2) *Headwinds abound*. Germany's economy *contracted 0.2% y/y* in 2024, dragged down by rising global competition, high energy costs, and extreme uncertainty (*Fig. 2*). On Wednesday, the German government said it expects Europe's biggest economy to *grow 0.2% y/y* this year and 1.3% in 2026.

Trouble is, the very same headwinds Germany faced in 2024 will continue to blow its way next year. New ones might too as the Trump trade war drags on, China's deflation persists, and Japan pivots toward expansionary policies that could upend currency and bond markets.

(3) *Unemployment woes*. Additionally, German consumer sentiment remains weak, while *energy-intensive sectors* like food production, mechanical engineering, and pharmaceuticals are flailing (*Fig. 3*). In August, the number of unemployed Germans *topped 3 million* for the first time in a decade. The government expects the *unemployment rate* to end this year where it sat as of July at 6.3% (*Fig. 4*). During this year's first half, business failures *surged to 11,900*, the highest in a decade.

(4) *Unaddressed structural challenges.* Growth boosting ideas coming from Chancellor Friedrich Merz's government include lower value-added and electricity taxes, increased commuter allowances, and higher infrastructure and military spending. Yet the government has proposed nothing to address structural weaknesses in the German economy, like reducing Germany's sensitivity to energy price volatility, rising to the challenge posed by China Inc., or reversing the chronic underinvestment in raising industrial productivity.

As German growth flatlines, Metz is trying to prepare Germany's *83 million people* for painful savings and "to work more" going forward. Last week, though, the country's stability council said national debt will likely jump to *80.3% of GDP* by 2029 from 62.5% in 2024, thanks to rising infrastructure and defense spending.

German Economy II: Headwinds from France to China. Metz's stimulus measures could be complicated by external factors such as the potential fallout from the US-China trade war, highlighted above, and the travails that neighboring France is encountering. Consider the following:

(1) *Upgrades in short supply*. Last week, France's political implosion amid vitally needed fiscal consolidation led to the resignation of its fifth prime minister in less than two years, Sébastien Lecornu. That's increasing *tensions in Brussels*, as France remains a chronic violator of the EU rule that member nations' budget deficits can't exceed 3% of GDP.

On October 6, as Paris was burning, European Central Bank President Christine Lagarde told EU lawmakers that the region "must *do its homework* and strengthen its foundations" if the single currency is going to rival the dollar.

(2) *French debt risks.* France is Exhibit A. As President Emmanuel Macron loses government after government, it becomes increasingly impossible to pass a budget. France's debt and budget deficit are roughly two times larger than EU stability rules allow.

This has Eurozone financial markets increasingly alarmed, raising the risk premiums on French debt. The turmoil could spill over into Germany, putting the DAX stock index's *21% rally* this year in jeopardy.

(3) *The Bond Vigilantes*. Increased borrowing would put Germany even further outside EU fiscal rules limiting government debt to 60% of GDP. In 2026, Berlin's deficit could rise to as much as *4.8% of GDP*, well beyond the EU's preferred 3.0%. Will the Bond Vigilantes take that in stride? Only time will tell. So far, the German 10-year government bond yield has risen from 2.18% during December 2024 to 2.69% as of September (*Fig. 5*).

Yet German Finance Minister Lars Klingbeil appears to understand the difficult balancing act Germany faces, having recently said: "Precisely in the interest of future generations, we must invest in future viability, economic strength, and security while at the same time ensuring sound public finances."

Curbing debt over the longer term may prove easier said than done as Germany skirts recession. In the short run, this has raised the stakes for the ECB. At its September 10-11 policy meeting, the ECB decided to take a wait-and-see approach toward easing, holding the key deposit rate at 2.0% (*Fig. 6*). With Europe's two biggest economies in varying degrees of distress, that may no longer be a luxury it can afford.

Calendars

US: Mon: CB Employment Trends; OPEC Monthly Report; IMF Meetings; Treasury Secretary Paulson. **Tues:** NFIB Small Business Optimism Index 100.5; IEA Monthly Report; Powell; Bowman; Waller; Collins. (Source: FX Street)

Global: Mon: Germany PPI 0.2%; UK BRC Retail Sales Monitor 2.5% y/y; IMF Meetings; Balz; Buch; Mann; RBA Meeting Minutes. **Tues:** Eurozone ZEW Economic Sentiment 30.2; Germany CPI 0.2%m/m, 2.4%y/y; Germany ZEW Economic Sentiment 41.7; UK Unemployment Rate 4.7%; China M2 8.5%y/y; China CPI 0.2%m/m, -0.2%y/y; China PPI -2.3%y/y, Bailey. (Source: FX Street)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): The US MSCI index fell 2.4% during the October 10 week to 3.0% below its record high on Wednesday. The AC World ex-US outperformed with a decline of 1.5% for the week to 1.7% below its record high on Monday. The AC World ex-US has been hitting new record highs since May 14--the first time it's had such a long streak of successive record highs since June 15, 2021. Despite its strength in recent weeks, the US MSCI outperformed the AC World ex-US in only 13 of the past 37 weeks. EMEA was the best performing region last week, with a decline of less than 0.1%, followed by EM Asia (-0.4%), EM (-0.6), and the AC World ex-US. EM Latin America was the worst regional performer, with a decline of 3.3%, followed by EMU (-3.1), Europe (-2.4), and EAFE (-1.9). The Korea MSCI index, with a gain of 1.6%, performed the best among country indexes, ahead of India (1.5), Taiwan (1.3), Hong Kong (-0.1), and South Africa (-0.5). The Brazil MSCI index was the worst performer w/w, with a decline of 4.0%, followed by France (-3.3), China (-3.3), Mexico (-2.6), and Canada (-2.6). In terms of ytd performance rankings, the 11.6% gain for the US MSCI index ranks as the second worst country performer and trails the 23.6% gain for the AC World ex-US. Among the regional indexes outperforming the AC World ex-US ytd, EM Latin America leads with a gain of 30.7%, followed by EMU (29.1), EM Asia (27.2), EM (27.0), Europe (24.2), and the AC World ex-US. EAFE is the worst ytd performer, albeit with a gain of 21.9%, followed by EMEA (23.6). Korea is the best ytd performer, with a gain of 64.7%, followed by Spain (55.1), South Africa (54.2), Mexico (38.1), and China (35.5). The worst performing countries ytd: India (1.1), Australia (12.0), Japan (18.0), France (19.9), and Switzerland (21.3).

US Stock Indexes (*link*): Just one of the 48 major US stock indexes that we follow rose during the week ended October 10, down from 46 rising a week earlier. The Dow Jones 15 Utilities index was the best performer for the week, rising 1.5%, ahead of Nasdaq Industrials (-1.8%), Russell MidCap Growth (-2.1), S&P 100 SuperCap (-2.1), and Russell 1000 Growth (-2.2). The S&P 600 Smallcap Pure Value index was the worst performer, with a decline of 6.8%, followed by S&P 400 MidCap Pure Value (-5.8), S&P 600 SmallCap Value (-5.8), S&P 600 SmallCap Equal Weighted (-5.3), S&P 600 SmallCap (-4.9), and Dow Jones 20 Transports (-4.9). All but four of the 48 indexes are higher ytd. With a gain of 16.5%, the S&P 500 LargeCap Growth index is in the top spot as the best performer so far in 2025, ahead of Dow Jones 15 Utilities (16.0), Nasdaq 100 (15.3), Nasdaq Composite (15.0), and Russell 1000 Growth (13.4). The worst performing major US stock indexes ytd: Dow Jones 20 Transports (-5.2), S&P 600 SmallCap Equal Weighted (-2.5), S&P 600 SmallCap Value (-2.5), S&P 600 SmallCap Growth (0.5), and S&P 400 MidCap Value (0.6).

S&P 500 Sectors Performance (*link*): Four of the 11 S&P 500 sectors rose during the week ended October 10, and nine were ahead of the S&P 500’s 2.4% decline. That compares to six S&P 500 sectors rising a week earlier, when four were ahead of the S&P 500’s 1.1% gain. The outperformers last week: Utilities (1.9%), Information Technology (1.5), Consumer Staples (0.3), Communication Services (0.1), Consumer Discretionary (0.0), Health Care (-0.4), Industrials (-0.7), Materials (-1.3), and Real Estate (-2.2). The underperformers last week: Energy (-4.0) and Financials (-3.0). The S&P 500 is now up 11.4% ytd, with 10 of the 11 sectors positive ytd and four are ahead of the index. During the June 20 week, Consumer Discretionary and Health Care were trailing so far behind ytd that they were the only sectors trailing the index. Information Technology wears the crown as the best ytd performer with a gain of 24.7%, followed by Communication Services (22.4), Utilities (19.5), and Industrials (16.3). These seven sectors are lagging the S&P 500 so far in 2025: Energy (-0.3), Real Estate (1.0), Consumer Staples (1.6), Consumer Discretionary (3.9), Health Care (4.8), Materials (6.4), and Financials (7.9).

US Economic Indicators

Consumer Sentiment Index (*link*): Consumer sentiment was little changed in mid-October, surpassing consumer's expectations of a slight decline. *Consumer sentiment* ticked down from 55.1 in September to 55.0 in mid-October, beating the consensus estimate of 54.1. It fell for the third straight month after climbing from 52.2 in April and May to 61.7 in July. The report notes, "Pocketbook issues like high prices and weakening job prospects remain at the forefront of consumers' minds," and at this time they don't expect any meaningful improvement in these factors. Meanwhile, interviews show little evidence that "the ongoing federal government shutdown has moved consumers' views of the economy thus far." *Current conditions* moved up to 61.0 this month after falling from 68.0 in July to 60.4 in September, while the *expectations* component fell for the fourth successive month from 58.1 in June to 51.2 in mid-October. *Turning to inflation*, year-ahead inflation expectations eased slightly again this month, from 4.7% in September to a still-high 4.6%, while long-run inflation expectations held steady at 3.7%. According to the report, "Inflation expectations for both time horizons are about midway between the readings seen a year ago and the highs seen this year in April and May in the wake of the initial announcements of major tariff charges."

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