



October 21, 2025

Morning Briefing

On Reckonings For China & The UK

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

Executive Summary: US/China trade-war brinkmanship has reached the brink: China's President Xi hasn't budged on the rare-earth-minerals export controls that will severely curtail the world's ability to produce electronics. Numerous nations think China has gone too far this time, William reports, and are joining forces to formulate a solution. But China's trade strategy may backfire on it if a reputation for petulant law-making drives away foreign companies. ... Also: The UK economy is struggling with high inflation, weak domestic demand, and rising risks of a hard landing. Some fear a debt reckoning as the UK bond market reacts to mounting signs of distress in credit markets.

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

Trade War I: China's Rare-Earths Move Might Backfire. As China's leader Xi Jinping stands firm on implementing sweeping export controls on rare-earths and other critical minerals, signs are mounting that Asia's biggest economy has gone too far this time.

Officials from Washington to Tokyo to Brussels last week, in a rare moment of unanimity, all chided Beijing's intransigent misstep. Making it more difficult to manufacture cars, semiconductors, and electronics like laptops, said US Trade Representative Jamieson Greer, amounts to a "[global supply chain power grab](#)."

What Trump called a "rather sinister and hostile move," Treasury Secretary Scott Bessent said makes China "an unreliable partner to the world," upping the likelihood that nations of the world will have to "decouple" from the biggest trading nation.

Japanese Finance Minister Katsunobu Kato warned that China isn't taking into account "the risk that escalating retaliation could [adversely affect](#) the global economy and financial markets." European Union (EU) bigwigs are making similar noises.

What a difference a week makes. Until last week, Xi's Communist Party was riding the biggest wave of skepticism toward the US since the Iraq invasion of the early 2000s. So great is the anger over Trump's tariffs that the leaders of arch-rivals Japan, China, and South Korea are having summit meetings again and jointly expanding the Southeast Asia emergency [currency swap arrangement](#) to support regional financial stability.

Let's look at what Xi's misstep may be costing China:

(1) *Trust is in short supply.* In his effort to build relationships on the world stage, Xi has been making nice with Indian Prime Minister Narendra Modi, positioning China as an alternative to fellow democracy the US. And China is helping to boost Argentina's exports (even as Bessent's Treasury team looks to double Argentina's lifeline to [\\$40 billion](#)). It's doing the same in Brazil.

Now, Xi's divide-and-conquer strategy to increase its dominance over global supply chains is very much in question. Last week, the Group of Seven finance ministers agreed to [coordinate their responses](#) to China's export controls on rare earths. It was the rare multilateral communique onto which the Trump administration was happy to sign.

In short, trust between Beijing and Washington is in short supply. So is a sense of proportion. While Trump World is calling China's top trade negotiators "[unhinged](#)," many in Beijing feel the same about Trump's threat of a 130% tariff.

(2) *Hard to unring this bell.* Could China even rewind the situation if it wanted to? "I think the PRC side is feeling a bit of pressure from the [reaction of other countries](#), not just from the US," said China expert Bill Bishop, who writes the Sinocism newsletter. "But I still don't see how they will walk them back. Or, if they even would consider doing that, and even if they do 'suspend' them, they have still created an expanded regime [of trade war weapons] that can be switched on at any time."

Trade War II: Trump's Chance To Regain Momentum. China is giving foes and allies alike the impression that it's inflicting pain on a wide swath of countries for no justifiable reason. That's given Bessent reason to, in his words, huddle "with Australia, with Canada, with India and the Asian democracies" to form a concerted response to China.

Kato urged the G7 to "unite and respond" to China's actions, an emotion [seconded](#) by his German counterpart. Australian Prime Minister Anthony Albanese is in Washington this week to [strategize](#) on all things China.

That's not to say Trump's White House is sitting still. Earlier this month, it said it's taking a 10% stake in Canadian firm [Trilogy Metals Inc.](#) In July, it engaged in a \$400 million equity investment in [MP Materials Corp.](#) to finance a rare-earth-magnet plant.

With so many major nations of the world linking arms against China, Xi must tread carefully.

A few more observations:

(1) *Hitting the whole world.* "There's a part where you make magnets, and we want to be able to reshore as much of that as possible," Greer said. "The Chinese are hitting the whole world, and so our partners and allies are also looking at doing this, and they're taking their own steps, and we're trying to align with them."

(2) *Death by paperwork.* China's rare-earths ban is essentially a bet on extreme bureaucracy. Overseas firms must now [obtain Beijing's approval](#) before exporting products containing even trace amounts of certain rare earths originating in China.

This death-by-paperwork gambit cuts both ways. How Chinese officials could handle the overwhelming volume of requests inherent to such a system is anyone's guess. The rules will probably be enforced selectively and strategically.

(3) *China risking 'ultimate' loss.* This strategy could boomerang, hitting China hard, if major trading partners pivot supply chains away from other Chinese industries, too, fearing similar economic blackmail attempts. It follows that the "[ultimate loss](#)", if this happens, is very, very large for China," warns Alicia Garcia Herrero at Natixis.

Exhibit A: The EU may demand mainland firms share their technology with companies in order to operate locally. This could be a nightmare for Chinese electric vehicle giants like BYD. Also, the move by the Netherlands to grab control of [Nexperia](#) shows China could be on the losing end when companies are forced to choose between the US and China. This was in response to worries that the chipmaker's Chinese CEO might put the company on a US blacklist—or move its manufacturing operations to China.

(4) *Weaponizing pressure points.* The more Beijing tries to weaponize economic pressure points, the more it might turn off nations currently predisposed to working with China.

For Xi, the easiest way to limit the damage is to negotiate a trade deal with the Trump administration. Until now, China has slow-walked talks, betting that Trump is desperate

enough for a “grand bargain” pact that Team Xi need give up very little and buying time to woo some major economies away from the US into China’s orbit. At this, China has met with some real success. Southeast Asia is now China’s top market, followed by the EU. That’s limiting the damage from US tariffs. Even though US-bound shipments from China fell 27% y/y in September, China’s overall exports rose 8.3% y/y ([Fig. 1](#)).

Yet Xi’s latest trade war tactic may be tipping the geostrategic balance back toward the US as companies around the world think better of doing business in China generally.

UK Economy I: Hard-Landing Risks Abound. After three-plus years of financial turbulence, the UK economy may be coming in for a hard landing—one that’s worse than many feared.

The International Monetary Fund (IMF), for example, predicts the UK will have the highest inflation rate and weakest growth in living standards among the Group of Seven nations this year and next. Domestic demand is weak, fueling recession talk. Real GDP expanded just 1.4% y/y during Q3-2025 ([Fig. 2](#)). The jobless rate jumped to 4.8% in the three months through August, the highest since May 2021 amid Covid-19 quarantines. The monthly unemployment rate for September stood at 4.4% y/y ([Fig. 3](#)).

What’s worse, the Bank of England (BOE) “may have braked too hard” to cap post-pandemic inflation and price risks following Russia’s invasion of Ukraine, said central bank policymaker Alan Taylor. Last week, Taylor reiterated his view that the BOE should pick up the pace on rate cuts. The UK headline CPI rose 3.8% during August ([Fig. 4](#)).

Here’s more:

(1) *Intensifying headwinds.* As Taylor said in an October 14 speech, a hard landing “was a remote and low probability event a year ago, but the risk is rising. The probability of this outcome is now not trivial.”

Nor are the steadily intensifying headwinds zooming Britain’s way from all directions. Across the English Channel, France faces dueling debt and political crises, while Germany is skirting recession. Across the Atlantic, the US economic trajectory is a source of heated debate.

China’s economy is losing altitude as weak household spending collides with Trump’s tariffs, which could soon hit 130%. Though the UK isn’t on the frontlines of US-versus-China

hostilities the way Japan is, global trade tensions are hardly Prime Minister Keir Starmer's preferred backdrop as 2026 approaches.

(2) *London's baggage*. Then there's the baggage London carried into this global moment. Three-plus years on, the trauma from the [Liz Truss crisis](#) remains. In late 2022, then Prime Minister Truss' fiscal loosening plan triggered an epic surge in bond yields.

The markets fear that, fiscally speaking, the UK still risks a debt reckoning. Hence, chatter in recent months that the UK might require assistance from the IMF. On September 9, Conservative leader Kemi Badenoch became the latest senior UK official to say she's "[really worried](#)" that the nation might have to, "cap in hand," seek a 1976-style bailout.

(3) *Doom loop*. Badenoch said her party is keen to work with Starmer's Labor Party to slash welfare spending to avoid a "doom loop" of rising taxes to stabilize public finances.

Jagjit Chadh at the University of Cambridge [warned](#) that the UK's public finances "are in a precarious position" as the ratio of public debt to GDP "is persistently hovering at around 100% and the costs of servicing that debt rising to just under 4% of GDP in the fiscal year 2025/26." UK government debt to GDP has fallen from a post-pandemic peak above 140% but has remained elevated historically, at 96.4% during Q3-2025 ([Fig. 5](#)).

(4) *Elevated borrowing costs*. Chadh argued that parliament should take steps to get the ratio closer to 90%, pointing to a [July report](#) from the Office for Budget Responsibility (OBR). It warned of a "sudden stop" in London's ability to access the bond market. "Debt," OBR said, has "continued to rise and borrowing remained elevated because governments have reversed plans to consolidate the public finances. Planned tax rises have been reversed, and, more significantly, planned spending reductions have been abandoned."

UK Economy II: Signs of Financial Distress Growing. While the UK's debt situation is far from warranting an IMF bailout, signs of distress in credit markets have been growing, and the financial markets are reacting.

Here's more:

(1) *No debt reckoning is imminent*. Last month, Chancellor of the Exchequer Rachel Reeves hit back at Conservative Party claims, calling talk of IMF packages "[irresponsible](#)." Many private economists agree that fears of debt reckoning are overblown.

“The IMF is not called into countries that can finance themselves in their own currency and retain the confidence of investors,” said Neil Shearing at Capital Economics. The IMF “is usually summoned when chronic fiscal and balance of payments deficits have built up unserviceable foreign currency liabilities, or when banking systems buckle under the weight of external debt. Britain, for all its fiscal shortcomings, is not in that category.”

(2) *But signs of distress are growing.* Yet the markets are punishing UK bonds amid volatility in global markets—and putting at risk this year’s ___% gain in the UK MSCI index (in local currency) (Fig. 6).

Last week, IMF head Kristalina Georgieva said signs of distress in private credit markets around the globe are a growing concern for her institution. Her comments came in response to questions about the failures of the subprime auto lender Tricolor and car parts supplier First Brands.

The IMF, she said, is worried about the “very significant shift of financing” from the banking sector to non-bank financial institutions (NBFIs). Global markets could end up in “a difficult place” if the largely unregulated private credit sector increases significantly as the global economy weakens, Georgieva said.

“This is why we are urging more attention to the non-bank financial institutions,” Georgieva said. “You are asking the question that keeps me awake every so often at night.”

The BOE is stress-testing its NBFIs. This potential trigger point is a growing threat at the same time that the US and China are coming to blows over tariffs and access to rare-earth minerals.

(3) *Self-inflicted wounds.* If turmoil in global markets heats up, the UK economy isn’t in the best of shape to weather the storm. In August, the G7’s fourth-biggest economy grew just 0.1% m/m. Aside from global strains, the UK is still coming to grips with the self-inflicted wounds from its 2016 decision to leave the EU.

On Saturday, BOE Governor Andrew Bailey said Brexit remains a cautionary tale about the damage caused by erecting trade barriers. “Make an economy less open and it will restrict growth, though over a longer time trade will adjust and rebuild,” he said.

Yet, as Taylor’s concerns remind us, hard-landing risks abound as global headwinds zoom the UK’s way.

Calendars

US: Tues: Waller. **Wed:** MBA Mortgage Applications; Barr. (Source: FX Street)

Global: Tues: Canada CPI -0.1%; Lagarde; Nagel; Balz; Lane; Escriva; Kocher. **Wed:** UK Headline & Core CPI 4.0%,3.7% y/y; UK PPI; UK Retail Price Index 4.7%/y/y; De Guindos. (Source: FX Street)

Strategy Indicators

S&P 500/400/600 Forward Earnings ([link](#)): During the October 17 week, forward earnings rose simultaneously for LargeCap and SmallCap for a 21st straight week and MidCaps moved higher too. LargeCap's forward earnings rose for a 22nd straight week, its longest winning streak since it did so for 38 weeks through the September 13, 2024 week. MidCap's recovery has slow-walked at times, dropping in four of the 22 weeks since it bottomed during the May 16 week. SmallCap's has risen for 21 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 20th straight weekly record high. MidCap's rose 0.2% w/w to 0.4% below its record high during the September 19 week, which was just before index changes caused its forward earnings to tumble 1.7% w/w then. SmallCap's rose 0.1% w/w to a 23-month high and is 8.5% below its June 2022 record. Forward earnings had bottomed in early 2023 for these three indexes following 2022's year of cost-cutting. Since then, LargeCap's forward earnings has soared 31.6% from its 54-week low during the week of February 1, 2023; MidCap's has slowly gained 10.2% from its 55-week low during the week of March 10, 2023; and SmallCap's has jumped 7.3% 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%, 14.2%), MidCap (0.4, 0.6, 17.6), and SmallCap (-10.2, 4.4, 17.0).

S&P 500/400/600 Valuation ([link](#)): Valuations rose for all three of these indexes during the October 17 week. LargeCap's forward P/E rose 0.3pt w/w to 22.4 from a five-week low of 22.1, but remains down from 22.7 the week before that, 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 5.4pts 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 rose 0.2pt w/w to 15.9 from a nine-week low of 15.7, but is down 0.5pt from a 32-week high of 16.4 during the September 5 week. It's now 1.2pts below its 40-month high of 17.1 during the November 29 week and 3.7pts 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 rose 0.4pt w/w to 15.3 from 14.9, but remains 0.4pt below its 33-week high of 15.7 the week before that. It's 2.4pts above its 17-month low of 12.9 during the April 4 week and 4.4pts above its 14-year low of 10.6 in September 2022, but remains 1.8pts 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 29% discount to LargeCap's P/E, matching its 26-year low 29% discount during the April 10 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 31% discount to 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 1ppt 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.

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