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Morning Briefing

On The Fed, The ECB & Growing Earnings

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

Executive Summary: Fed officials presume that Trump 2.0's tariffs will lead to one-time price increases. But should the Fed look through "transitory" inflation effects, or are they underweighting the risks of sustained inflationary pressure? ... Melissa reports that Trump 2.0's policies toward Europe have spurred fiscal measures there that take the European Central Bank off the hook for supporting the economy; no one expects the ECB to ease further anymore. ... And: Joe reports that the S&P 500 companies should post "back-to-trend" y/y earnings growth this quarter.

Global Central Banks I: Transitory, Redux. The Federal Reserve, like all of us, is unsure what shape and form Trump 2.0's tariffs will ultimately take. One thing Fed officials do seem certain of is that tariffs will result in a one-shot increase in prices rather than a persistent inflationary shock. That's evident in the Federal Open Market Committee's (FOMC) [Summary of Economic Projections](#) (SEP), which was updated at last week's meeting. The FOMC's median projection for the core PCE rate this year was revised up from 2.5% to 2.8%, while those for 2026 and 2027 were left unchanged at 2.2% and 2.0%, respectively ([Fig. 1](#)).

The Fed's use of "transitory" to describe the surge of inflation in 2021 was a historic policy mistake that led to the highest inflation in four decades. Given the word's unfortunate baggage, we feel that Fed Chair Jerome Powell shouldn't have fallen back on using "transitory" in last week's [press conference](#). Frankly, it may have been a mistake to underscore the market's expectations for more rate cuts sometime this year as well. He would have been better off saying, "We are uncertain as to what tariffs that will be imposed and uncertain about whether their inflationary impact will be transitory or persistent. Therefore, we won't be lowering the fed funds rate until we get a better sense of these issues."

That begs the question: Should monetary policymakers be preparing to look past tariffs' one-time effects on prices? A recent [working paper](#) by the Minneapolis Fed suggests so: Its authors opine that the optimal monetary policy response to tariffs is to set expansionary policy to mitigate tariff's negative economic growth effects. But given the post-pandemic experience and lingering elevated inflation, that theory might not hold.

Let's discuss the risks of trying to predict tariffs' follow-through effects and how this could all go wrong for the Fed:

(1) *Inflation expectations*. From the Fed's perspective, the biggest risk is that a transitory price increase morphs into a persistent inflation shock. Primarily, the FOMC is watching market-based and survey-based inflation expectations to see whether price increases are becoming entrenched in business and consumer psychology. This would lead to an unanchoring of inflation expectations, which arguably is the cardinal sin of central banking.

While the University of Michigan's consumer inflation expectations have surged, our preferred gauge, from the New York Fed, remains okay relative to history ([Fig. 2](#)). Meanwhile, the difference between nominal and real Treasury yields (a.k.a. inflation breakevens) and long-term inflation swaps also aren't signaling concern ([Fig. 3](#)).

(2) *Retaliation*. A big question mark with respect to trade policy uncertainty is what retaliation entails. While Trump 1.0 and the Biden administration mostly targeted China with tariffs, this time around the "Dirty 15" comprises most of America's largest trading partners. Will those countries also raise trade barriers, or will negotiations bring down trade barriers reciprocally? Will non-tariff trade barriers, such as fines on US businesses in the EU or joint-venture sharing agreements with emerging markets, be removed or ratcheted up? Will there be an endpoint for the uncertainty, or will tariffs be raised and lowered persistently?

The scale, scope, and longevity of tariffs can only be speculated about at the present moment. However, sustained uncertainty may ultimately promote more "stag-" than "inflation," whereas lower trade barriers with select trading partners would promote economic growth even as import inflation from other countries raises prices. The end result on the US economy is extremely path dependent.

(3) *Supply chains*. Another possible result of retaliatory tariffs is that they foster a weaker version of the supply-chain shock during the pandemic. As companies reorder their supply chains to avoid producing in high-tariff countries (and also reshore back to the US generally), prices will rise and productivity will fall in the near term. Regional Fed M-PMI

price indexes all have been surging recently ([Fig. 4](#)). The ISM national M-PMI price index is already increasing, and the NM-PMI index would likely join it in this scenario, as wages and nonlabor costs rise in response to a higher cost of living ([Fig. 5](#)).

That said, supply chains are generally more resilient than they were pre-pandemic and have been in good shape for the past couple years ([Fig. 6](#)). Business owners and wholesalers are likely more adept and prepared for shifts this time around than they were during lockdowns—especially since lockdowns were accompanied by massive stimulus to aggregate demand.

(4) *China*. The property-led economic bust in China, and its export-led model to boost growth, helped lower prices across the world. We've argued that the recession in China may have been the recession many thought would be required here in the US in order to bring down US inflation. Given the deflationary backdrop in China, we aren't betting that consumer stimulus being pursued by Beijing will be enough to substantially lift pre-tariff export prices from China ([Fig. 7](#)).

(5) *Upshot*. Generally, uncertainty tends to keep business investment and some consumer spending at bay. So unless 25% tariffs are slapped on all major trading partners and sustained there—which Trump 2.0 has suggested will not be the case—it's hard to see a complete stagflationary scenario without a 1970s-style oil price shock.

It's too early to tell exactly what tariff and trade policy will look like. However, we do think that the odds that the Fed Put is on standby for longer are higher than the market appears to think. The Fed's dovish bias won't be able to kick in as long as inflation is travelling higher, which is highly likely in the near term.

Global Central Banks II: The ECB's Bad News Bear. With the benefit of hindsight, the modest interest-rate-cutting cycle by the European Central Bank (ECB) to “meaningfully less restrictive” may have been enough to support the region's flagging growth.

For years, ECB President Christine Lagarde has hammered home her refrain: “The central bank cannot be the jack of all trades”—i.e., it can't single-handedly fire up the economy in the absence of fiscal help. Now that help is here. After US President Donald Trump's warning that the US would no longer guarantee Europe's security in the event of war, Germany's lawmakers responded by greenlighting large-scale borrowing to fund defense spending and infrastructure projects. On Friday, new legislation passed its final hurdle, unlocking a 500-billion-euro fund and loosening austerity rules to fund defense expenditure.

Meanwhile, the European Commission's new growth strategy—dubbed the “Compass”—aims to revive Eurozone economic growth through additional fiscal aid.

With policymakers now bringing fiscal firepower to support the Eurozone, Lagarde can retire her refrain. The ECB is no longer on the hook for the full responsibility of stimulating the economy. Quite the opposite: Inflationary pressures may mount in the wake of the new fiscal support and the looming tariff conflict with the US, so maintaining rates in a neutral range, instead of lowering them into accommodative territory, is a better posture for the ECB.

Is there a risk that upward price pressures could compel the ECB to raise rates once again? Probably not. Most global central banks for developed economies (excluding Japan) are on pause with dovish leanings to ease if necessary.

Here's a breakdown of the latest ECB-related developments:

(1) *Rates neutralizing?* Since commencing its interest-rate cuts in June 2024, the ECB has reduced rates by 150bps ([Fig. 8](#)). Its January and March rate cuts of 25bps each have lowered the deposit rate to 2.50%. However, the bank isn't stimulating the economy yet, at least by its own standards. Its key rate remains at the top end of the ECB's identified “neutral” range of 1.75%-2.50%, i.e., neither restrictive nor stimulative. In other words, the ECB is more or less in a holding pattern.

(2) *Growth bearish?* On March 6, the ECB revised its real GDP growth projections to 0.9% for 2025, 1.2% for 2026, and 1.3% for 2027—primarily due to the ongoing trade policy uncertainty.

These projections were made before Trump issued his ultimatum asserting that Europe needs to defend itself, and the ECB's staff would not have had time to factor in the expected fiscal stimulus. During her March 6 press conference, Lagarde noted: “An increase in defense and infrastructure spending could also add to growth.” Last Thursday, however, she hedged in comments to the media that a possible escalation of the trade war with the US could further weigh on eurozone growth. For perspective, real GDP ended Q4-2024 at 0.9% y/y ([Fig. 9](#)).

(3) *Disinflation tracking?* Lagarde has reassured the financial markets that the “disinflation process is well on track.” She emphasized that wage growth has moderated as expected, with profits helping to buffer inflationary pressures.

And while she acknowledged the potential for some inflationary pressure from tariffs, she downplayed its significance, stating: “My suspicion is that markets are seeing it as a growth increase in the future financed over a long period of time ... Is there a little inflation anticipation associated with that? Probably, but not that significant.”

Eurozone annual inflation stood at 2.3% in February, down from 2.5% in January ([Fig. 10](#)). However, the ECB is concerned about wage inflation, as it has moderated but is still elevated.

The ECB's latest [projections](#) forecast inflation continuing to head toward the ECB's 2.0% target by 2027, with projections of 2.3% in 2025 and 1.9% in 2026. These projections were made in light of tariff threats but before the announcement of the massive fiscal spending spree.

(4) *Quantitative tightening?* Besides interest rates, also under the ECB's scrutiny is its balance sheet. Pandemic emergency assets were unwound as of December 14. As of Friday, the ECB's balance sheet stood at 6.3 trillion euros—well above the 4.7 trillion euros it held pre-2020 ([Fig. 11](#)). In line with its normalization process, the ECB plans to let billions of euros in debt mature in the coming years.

Lagarde has dismissed quantitative tightening (QT) as “not our key instrument,” claiming that it has “not been perceived as having a significant impact.” But we believe the ECB's balance-sheet reduction does exert at least some tightening effect on the economy, particularly if and when Germany and others start issuing debt to fund this new fiscal spree.

(5) *Equity markets rising.* Despite some bumps along the way, the MSCI EMU (European Economic and Monetary Union) index has surged recently, breaking well above its 200-day moving average. From January 1 to March 25, the index spiked 10.5%, buoyed by fading US exceptionalism and the promise of increased domestic fiscal stimulus ([Fig. 12](#)). However, the index pulled back after the ECB's second rate-cut announcement on March 6, the same day that Trump pulled the rug out under military aid to Europe.

(6) *Bond markets souring or soaring?* Germany's embrace of deficit spending—coupled with the likelihood that other more indebted nations may follow suit—has sent borrowing costs higher. Some have posited this is due to an erosion of confidence. We believe bund yields were too low due to lack of supply and weak growth—the projected increase in nominal growth from fiscal spending has helped them normalize.

German bund yields increased from 2.37% on January 2 to 2.81% as of Friday's close ([Fig. 13](#)). At one point, they reached 2.90% on March 11, coinciding with the ECB's March 6 rate cut along with Trump's announcement.

Strategy: Growth Forecasts Positive Nearing Q1 Finish Line. The industry analysts' consensus growth forecast for S&P 500 companies' Q1-2025 earnings began the quarter at over 11%. It is exiting the quarter much lower, having edged down to 6.5% as of the March 20 week from 6.7% a week earlier ([Fig. 14](#)). Such declines are typical in quarters' final weeks, when bad earnings news from a few major companies or industries tends to dominate estimate revisions activity. Also typical: The 6.5% y/y earnings growth rate is "back to trend" after stronger growth in prior quarters. At least Q1 earnings look set to post a y/y rise instead of the opposite, and for an eighth straight quarter.

The biggest downward revisions occurred earlier in the quarter for the steel industry in the Materials sector, followed by Consumer Discretionary (Telsa) and Industrials (Delta/Fedex) in recent weeks. While there are pockets of weak earnings growth or y/y declines within the S&P 500 sectors, revenues growth remains broad, as Joe shows below:

(1) *Broad sector revenue growth expected in Q1.* Nine of the 11 S&P 500 sectors' revenues should grow y/y in Q1, a slight improvement from eight sectors in Q4 ([Fig. 15](#)). Information Technology has been leading all sectors in revenues growth since Q1-2024; its Q1-2025 revenues should rise at a double-digit rate for a fourth straight quarter. Continuing to lag is the Materials sector, with its quarterly revenues expected to decline y/y for a 10th straight quarter.

Among the two revenue laggards, a decent revenue surprise in Energy could turn that sector's y/y growth rate positive, something we're not expecting for Materials. If 10 of the 11 S&P 500 sectors do report rising y/y quarterly revenues for Q1, as we expect, that would be the most doing so since Q3-2022—hardly indicative of a revenues recession!

Here are the sectors' proforma y/y revenues growth forecasts for Q1-2025: Information Technology (11.3%), Health Care (7.9), Utilities (6.0), Communication Services (5.3), S&P 500 (4.2), Real Estate (4.1), Consumer Discretionary (2.7), Consumer Staples (1.7), Industrials (1.5), Financials (1.2), Energy (-0.3), and Materials (-2.8).

(2) *Earnings growth less broad for the 11 sectors.* Seven of the 11 S&P 500 sectors are expected to show positive y/y earnings growth in Q1-2025, down from 10 in Q4 (which was the broadest growth among S&P 500 sectors since Q1-2021). Among the four lagging

sectors, Consumer Staples' earnings is expected to fall y/y in Q1 for the first time in ten quarters; Materials' is expected to fall after rising in Q4 for the first time in 10 quarters; and Energy's is expected to fall for a third straight quarter.

Among the five sectors expected to post single-digit earnings growth in Q1, for Utilities such a result would end its double-digit percentage growth streak at six quarters. We think Consumer Discretionary, at just 0.6% forecasted growth now, faces the possibility of falling y/y quarterly earnings for the first time since Q4-2022 because of the long list of challenges that Tesla has encountered so far.

Here's how the S&P 500 sectors' consensus earnings growth rates stack up for Q1-2025: Health Care (38.1%), Information Technology (15.9), Utilities (8.0), S&P 500 (7.7), Communication Services (6.1), Consumer Discretionary (0.6), Consumer Staples (-6.8), Industrials (4.2), Financials (2.0), Real Estate (-2.5), and Materials (-8.1), and Energy (-15.7).

Here are their y/y revenues and earnings growth forecasts: Communication Services (5.3% revenues growth, 6.1% earnings growth), Consumer Discretionary (2.7, 0.6), Consumer Staples (1.7, -6.8), Energy (-0.3, -15.7), Financials (1.2, 2.0), Health Care (7.9, 38.1), Industrials (1.5, 4.2), Information Technology (11.3, 15.9), Materials (-2.8, -8.1), Real Estate (4.1, -2.5), and Utilities (6.0, 8.0).

Calendars

US: Wed: Durable Goods Orders -1.0%; Nondefense Capital Goods Orders ex Air -0.2%; MBA Mortgage Applications Kashkari; Musalem. **Thurs:** Real GDP & GDP Price Index 2.3% & 2.4%; Real Consumer Spending 4.3%; Corporate Profits; Kansas City Fed Composite Index; Goods Trade Balance -\$134.6b; Jobless Claims 225k; Pending Home Sales 1.5%; Wholesale Inventories 0.4%; Fed Balance Sheet; Barkin. (FXStreet estimates)

Global: Wed: France Consumer Confidence 94; Spain GDP 0.8%q/q, 3.5%y/y; UK Headline & Core CPI -0.1%*m/m*, 3.0%*y/y* & 0.5%*m/m*, 3.6%*y/y*; Cipollone. **Thurs:** Spain Retail Sales 0.5%*m/m*, 1.0%*y/y*; ECB General Meeting; Lagarde; Schnabel; Guindos; Buch; Dhringa. (FXStreet estimates)

US Economic Indicators

Consumer Confidence ([link](#)): Consumer confidence fell for the fourth consecutive month in March, with the expectations component sinking to a 12-month low. Headline consumer confidence sank 7.2 points in March and 19.9 points (to 92.9 from 112.8 in November) over the four-month period, with the expectations component falling 28.5 points (to 65.2 from 93.7) and the current conditions (134.5 from 144.0) component sinking 9.5 points, respectively, over the comparable four-month periods. Of the five components of the index, only consumers' assessment of present labor conditions improved this month, with 33.6% of consumers saying jobs were plentiful, unchanged from February, while 15.7% of consumers said jobs were hard to get, down from 16.0% in February. Consumers' assessment of the short-term labor market deteriorated this month, with 28.5% of consumers anticipating fewer jobs, up from 26.6% during February, while 16.7% expected more jobs to be available, down from 18.8% last month. Consumers' assessment of current business conditions were significantly less positive, with 17.7% stating business conditions were good, below February's 19.1%, while 16.6% said conditions were bad, up from 14.8% last month. Their outlook for short-term business conditions six months from now also deteriorated, with only 17.1% expecting conditions to improve, lower than February's 20.8%, while 27.3% expected conditions to worsen, up from 25.5% last month. Consumers were less optimistic about their income prospects this month, with 16.3% expecting their incomes to increase, down from 18.8% last month, while 15.5% expected their incomes to decrease, up from 12.8% last month. As for inflation expectations, the 12-month expected inflation rate jumped from 5.8% in February to 6.2% this month, with consumers concerned about high prices on some key household staples, such as eggs, as well as the impact of tariffs.

New Home Sales ([link](#)): New home sales (counted at the signing of a contract) rose in February, following January's weather-related decline. New home sales climbed 1.8% to 676,000 units (saar), in line with expectations, after falling 6.9% in January to 664,000 units. Compared to a year ago, sales were up 5.1%. The estimate of new homes for sale was 500,000 units in February, representing a 8.9 months' supply at the current sales pace, down from 9.0 months in January. Regionally, the Midwest (20.6% to 76,000 units, saar) and the South (6.6 to 438,000) posted gains during February, while the Northeast (-21.4 to 22,000) and West (-13.6 to 140,000) saw double-digit declines. Of the 676,000 homes sold during February, 341,000 were completed, 252,000 were under construction, while 83,000 weren't started. Of the 500,000 homes for sale during February, 119,000 had been completed, 279,000 were under construction, and 102,000 hadn't yet broken ground.

Global Economic Indicators

Germany Ifo Business Climate Index ([link](#)): “German businesses are hoping for a recovery,” notes Clement Fuest, Ifo’s president. “Companies were more satisfied with their current business situation and their expectations rose noticeably.” Ifo’s business climate index rose 1.6% to an eight-month high of 86.7 in March, in line with expectations and up from February’s 85.3. March’s increase was led by a 2.5% jump in the expectations component to a nine-month high of 87.7, while the current conditions component rose 0.8% to 85.7. Activity in the manufacturing sector rose significantly in March, as expectations became noticeably less skeptical, while assessment of the current situation improved. The service sector saw its business climate pick up as expectations became clearly more optimistic, and companies rated their current situation somewhat more positively. Trade saw its index rise, as expectations among traders was much less pessimistic, and firms assessed their current business somewhat better. Construction saw its business climate brighten this month, as companies viewed their current situation somewhat more positively, though a lack of orders continues to be the greatest challenge. Meanwhile, expectations improved but remain highly skeptical.

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