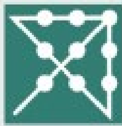
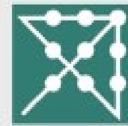
 Yardeni Research 

March 5, 2025

Morning Briefing

Trump Turmoil Raises Odds Of A Recession

Check out the accompanying chart collection.

Executive Summary: Trump 2.0's head-spinning barrage of executives orders, firings, and tariffs have rattled investors, shaken confidence in the economy, and inflamed inflation fears. The pain of these decisive actions is being felt now, while the benefits of his other policies are further off. As a result, we're revising our subjective odds of two of our three outlooks. We're not changing the 55% probably assigned to our base-case Roaring 2020s scenario, but we now see less chance of a stock-market meltup/meltdown scenario (10%) and higher odds of a recession and bear market (35%). … Also: Melissa examines why the copper price has been rallying notwithstanding stagnant global economic growth.

Strategy I: Trump Turmoil 2.0. We haven't had to change our subjective probabilities for our three alternative economic scenarios for quite some time. We are doing so today and may have to do so more frequently in coming months or even coming weeks in reaction to the volatile nature of policymaking under President Donald Trump. The initial animal spirits of Trump 2.0 have been trumped by the uncertainty unleashed by Trump Turmoil 2.0. The administration has been in office for less than two months. The whirlwind of tariffs imposed on America's major trading partners, federal job cuts implemented by the DOGE Boys, and the upending of the world order have been head spinning.

We held off changing our probabilities because we expected that the master of the art of the deal was going to get a deal with Canada and Mexico that would allow him to declare victory and bury his threat to impose 25% tariffs on America's only two neighbors and biggest trading partners. In fact, on February 28, US Treasury Secretary Scott Bessent said Mexico proposed matching Washington's tariffs on China and urged Canada to do the same—signaling a potential path for Mexico and Canada to avert levies on their own exports in the coming days.

"I do think one very interesting proposal that the Mexican government has made is perhaps matching the US on our China tariffs," Bessent told Bloomberg Television. "I think it would

be a nice gesture if the Canadians did it also, so in a way we could have ‘Fortress North America’ from the flood of Chinese imports,” he said.

Here is a quick timeline of related events since then:

(1) On Monday, March 3, Trump said that that there was “no room for delay,” and he implemented the tariffs on Canada and Mexico on Tuesday. Trump has said the tariffs are means to several ends: force the two US neighbors to step up their fight against fentanyl trafficking, stop illegal immigration, eliminate the Americas’ trade imbalances, and push more factories to relocate in the US.

(2) Trump had already put a 10% tariff on imports from China in February. The rate was doubled to 20% on Tuesday. Instead of rapid-fire trade deals, the US has triggered a trade war. Canada imposed retaliatory tariffs on the US on Tuesday. Mexico will announce similar measures on Sunday.

(3) On Tuesday, a foreign ministry spokesperson in Beijing warned, “China will fight to the bitter end of any trade war.” China is one of the biggest customers for US agricultural produce such as chicken, beef, pork, and soybeans, and now all those products will face a 10%-15% tax, which will take effect on March 10. Beijing’s relatively limited response suggests that the Chinese would like to negotiate with the US on trade issues.

Beijing is not ramping up the rhetoric or the tariffs in the same way as it did in 2018, during the last Trump administration. Back then, it imposed a tariff of 25% on US soybeans.

(4) Last weekend, Warren Buffett made a rare comment on Trump’s tariffs, warning of their negative effects on consumer spending. “[W]e’ve had a lot of experience with [tariffs]. They’re an act of war, to some degree,” said Buffett. “Over time, they are a tax on goods. I mean, the tooth fairy doesn’t pay ’em! … And then what?”

Strategy II: Recalibrating the Odds. Now that Trump has started a trade war, it could escalate. Or it could de-escalate. Either way, uncertainty has increased significantly, as evidenced by the sharp decline in stock prices on Monday and Tuesday (*Fig. 1* and *Fig. 2*). Interest rates have continued their recent decline, as the odds of more Fed rate cuts have increased—notwithstanding evidence that inflation remains stuck above the Fed’s 2.0% target and the likelihood that tariffs will boost inflation, at least initially (*Fig. 3* and *Fig. 4*).

In recent commentaries, we’ve downplayed the likelihood of a recession in 2025. Indeed, in

recent days, we've observed that the downward revision in the Atlanta Fed's *GDPNow* tracking model from 2.3% (q/q saar) on Thursday to an estimated -2.8% for Q1 reflects two temporary factors: a surge in January's imports, due to importers' frontrunning tariffs, and the coldest January since 1988, which depressed consumer spending (*Fig. 5*, *Fig. 6*, and *Fig. 7*). We expect that these big drags on GDP will be reversed in February and March. So we are projecting that real GDP will be up by at least 1.5% during Q1.

However, the negative consequences of Trump 2.0 policies are occurring before the positive ones. Tariffs, deportations, and federal government job cuts are weighing on the economy. An extension of the 2017 tax cuts has yet to occur. Business deregulation is unfolding slowly. Onshoring is underway, and more companies are committing to increase their capital spending in the US.

Considering the above, we are recalibrating our subjective probabilities for our three scenarios:

(1) *Roaring 2020s* (55%, unchanged). Our subjective probability of our base case remains the same at 55%. We are assuming that the trade war doesn't escalate. We are continuing to bet on the resilience of the economy and on a technology-driven boost in the growth rate of both productivity and real GDP.

In this scenario, the economy continues to grow, a tariff-related spike in inflation proves transitory, and the stock market remains choppy during the first half of the year, with the S&P 500 remaining below its February 19 record high. The index resumes its climb in record-high territory during the second half of the year, reaching 7000 by year-end (*Fig. 8*).

(2) *Meltup/meltdown* (10%, down from 25%). Arguably, there has already been a meltup in some areas of the stock market. They've been melting down since mid-February. Combining the odds of these two bullish scenarios reduces the odds that the bull market remains intact, without a correction or bear market in 2025, from 80% to 65%.

(3) *Bearish bucket* (35%, up from 20%). Over the past three years, we've assigned a 20% subjective probability to the various prospects that could go wrong for the economy, resulting in a recession and a bear market for stocks. We are raising it to 35%. During 2022 and 2023, our main concern was that geopolitical crises (including the war between Russia and Ukraine and the proxy war between Israel and Iran) would cause oil prices to soar, forcing the Fed to maintain a restrictive monetary stance and causing consumers to retrench. That seems less likely, as the oil price has remained weak.

Over the past couple of years, the risk of a federal government debt crisis also rose a few times along with bond yields. But now the 10-year US Treasury yield is down from a recent high of 4.79% on January 13 to 4.24% today. That's despite signs that Trump Tariffs 2.0 are already boosting expected and actual inflation. Bond investors are giving more weight to the "stag" than the "flation" components of a stagflation scenario. We are doing the same by raising the odds of a tariff-induced recession from 20% to 35%.

Trump's tariffs and DOGE-mandated job cuts are depressing consumer confidence. Trump delivered on his promise to stop illegal immigration. Oil prices are falling as he promised, though that may have more to do with weak demand than more supply. Mortgage rates are falling. However, he promised to lower consumer prices. Instead, his tariffs will drive these prices higher.

We are still betting on the resilience of consumers and the economy. However, Trump Turmoil 2.0 is significantly testing the resilience of both. That's why we've recalibrated our subjective probabilities.

Global Commodities: Dr Copper Goes Rogue. You may recall that we often call copper "the metal with the PhD in Economics." That's more than a quip: This malleable metal's price activity usually correlates with the currents of the global economy. But not lately. Is Dr Copper hanging up her economic forecasting hat?

Copper can be thought of as the lifeblood of progress. It's critical to industries that are critical to modern life including defense, infrastructure construction, and emerging technologies (e.g., electric vehicles, clean energy solutions). As the second most consumed material, copper is strategically important geopolitically. This deep integration into the word's essential systems suggests price action that's predictably tied to global economic fundamentals. Yet that hasn't been the case of late.

Copper has rallied 8.6% from the start of this year to $9,394 per metric ton (MT) as of March 3. The ascent has not mirrored the state of the global economy, which has been stagnating this year, according to our Yardeni Research Global Growth Barometer.

Why has the copper price disconnected from the forces that typically move it and commodity prices generally (*Fig. 9*)? Two factors stand out:

(1) *Metals tariffs revisited.* Investors are probably positioning themselves for the likely fallout of Trump's impending tariff regime. It's not a new story: Under both Trump 1.0 and Trump

2.0, tariffs on various metals were framed as measures to protect American industries, ostensibly on national security grounds. Next week, on March 12, 25% tariffs on steel and aluminum take effect; whether copper will be next must be on commodities traders' minds.

President Trump, on February 25, suggested as much in a social media *post*, referring to the "decimation" of the American copper industry and calling for an *investigation* by executive order into whether copper tariffs should be levied under the same Section 232 provisions that justified the steel and aluminum tariffs. We expect copper tariffs in the range of 10%-25% to become effective shortly after the investigation window closes in November.

For the administration, the inflationary consequences of such tariffs are seen as a necessary price to pay for the fortification of domestic production.

(2) *Refining China's copper production*. Meanwhile, the world's largest copper producer—China—made supply-altering moves in February. A regulatory shift aims to curb the overcapacity in China's refining sector. Construction of new copper smelters could be halted unless there is sufficient concentrate to support them in an attempt to rebalance an industry long plagued by excess production.

This is important because China is the world's largest producer of refined copper, controlling over half of global copper refining production; Chile and Peru dominate unrefined copper output (*Fig. 10* and *Fig. 11*). Notably, neither Chile nor Peru have ramped up production much in recent years (except for a restart in Chile after a temporary interruption in January owing to widespread power outages).

Besides producing the most refined copper, China is also the world's most voracious consumer of unrefined copper. In 2023, China mined a mere 1.7 million tons of unrefined copper while producing over seven times that amount in refined form.

To address this imbalance, China is not just slowing new construction of smelting facilities. Over the coming years, the country aims to boost its domestic copper mining efforts by as much as 10% to reduce its dependency on foreign copper concentrate. If it succeeds, China's copper refinery expansion may get a reboot, boosting global supply once again. However, it could be a long wait.

On the demand side, China's government is expected to unveil a large stimulus package at the National People's Congress on Wednesday. China has struggled to match the government's 5.0% growth target, under pressure from its property market slump. The

stimulus could revive domestic aggregate demand along with the demand for copper. However, the effects of China's stimulus efforts so far have been limited.

Looking ahead, we think the current copper price may already reflect these developments. Our gut sense is that copper won't rally much further in the near term toward the previous high of $10,800 per mt set on May 20. That assumes that the US will impose a probable 10% tariff on copper and that China's refined copper supply constraints are offset by continued weakness in global aggregate demand.

The global economy may continue to muddle along or weaken further, especially considering the recent trade developments. In other words, the divergence between the copper price and global economic indicators likely won't get much wider; but the neat correlation of the past might not return unless and until the global economy powers up again.

Calendars

US: Wed: ADP Employment Change 140k; Auto Sales; Factory Orders 1.6%; ISM NM-PM 52.9; MBA Mortgage Applications; Beige Book. **Thurs:** Jobless Claims 235k; Nonfarm Productivity & Unit Labor Costs 1.2% & 3.0%; Goods & Services Trade Balance -$96.4b. (FXStreet estimates)

Global: Wed: Eurozone, Germany, France, Italy & Spain NM-PMIs 50.7, 52.2, 44.5 & 55.1; Eurozone Industrial Output 0.4%; Eurozone PPI 0.3%; Italy GDP 0.0%q/q, 0.5%y/y; Japan NM-PMI 53.1; China Caixin NM-PMI 50.8; Ueda. **Thurs:** Eurozone Retail Sales 0.1%m/m, 1.9%y/y; ECB Main Refinancing Operations Rate 2.65%; ECB Monetary Policy Statement; Harker. (FXStreet estimates)

Strategy Indicators

S&P 500 Revenues, Earnings & Margins (Q4-2024) (*link*): With the Q4-2024 earnings season 97% complete, the near final actuals are now in. S&P 500 revenues per share rose to $509.25 in Q2, and was at a record high for a second straight quarter. The y/y revenues growth rate dropped to a four-year low of 3.9% from 7.0% y/y in Q3-2024, but was only 0.5ppt below its long-term average growth rate of 4.4%. Q4's multi-quarter low for revenues

growth was not unexpected since much of the growth since Q2-2022 was boosted by soaring and then lingering inflation. Turning to the bottom line, S&P 500 earnings per share rose to $65.11 in Q4-2024, and was at a record high for a third straight quarter. Earnings per share rose 14.0% y/y in Q4 for its fastest growth rate since Q4-2021. That was nearly double the 30-year average growth rate of 8.4%. The S&P's quarterly profit margin improved 0.2ppt q/q in Q4-2024 to a 10-quarter high of 12.8%. While Q4 marked a fourth straight quarter of improvement for the S&P 500's profit margin, the rate of gain is slowing. Q4's profit margin reading is just 0.9ppt below its record high of 13.7% during Q2-2021.

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