Yardeni Research

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Morning Briefing

China, Tariffs & Quantum Computing

Check out the accompanying chart collection.

Executive Summary: China's response to the US's tariffs on Chinese imports was muted, Jackie reports, involving limited new restrictions and tariffs on certain US goods. China has too weak an economy to risk a bolder retaliation. But the country did announce new economic goals that suggest bold new stimulus spending to help pull its economy up by its bootstraps. … Also: What a few American CEOs in tariff-affected industries have said about the impacts on their companies. … And: Development of ever better quantum computing capabilities is turning out to be a game changer for the big guys—Amazon, Google, and Microsoft—while most startups in the space remain unprofitable.

China: Putting on a Brave Face. In a trade war with President Trump, China won't win if it fights fire with fire. The US runs a trade deficit of $1.5 trillion, and the vast majority of US imports comes from either the EU, China, Mexico, or Canada (*Fig. 1* and *Fig. 2*). China, on the other hand, has far more exports than it has imports, resulting in a trade surplus of $1.0 trillion, using a 12-month sum (*Fig. 3*).

More specifically, the US imports $273.5 billion more from China than it exports to China. Due to that imbalance, China will never be able to match the US's 20% tariffs dollar for dollar. Nor would it want to risk angering the current resident in the Oval Office because China needs US exports to bolster its weak economy.

After meeting on Tuesday, Chinese leaders announced a GDP target of 5.0% for 2025, the same target it had last year and a touch slower than its Q4 GDP of 5.4% (*Fig. 4*). The 2025 target is a tall order given the economic headwinds the economy faced last year, which will be amplified by the US tariffs this year. Last year, exports represented nearly a third of China's 5% GDP growth, a March 5 *WSJ* article noted.

China also announced targeted import restrictions on US goods and tariffs on certain US imports. But the moves aren't considered excessive, indicating the country's desire to avoid escalating the already delicate trade situation. If the country did decide to get more aggressive, sharply raising prices on its exports sold in the US, it would inflict more pain on US companies and consumers. Imagine the howls if the country doubled or tripled the prices of China-made goods that US consumers are accustomed to having, like gaming consols, smartphones, or pharmaceutical ingredients.

China announced on Tuesday several measures it will be taking to help achieve its economic growth target and gave some details on how it would counter Trump's tariffs. Let's have a look:

(1) *Spend more money.* The Chinese government set a budget deficit target of around 4.0% of GDP, up from 3.0% last year and the highest level in years. It's an indication that the government plans to open its purse strings and spend to boost economic growth, the March 4 *WSJ* reported.

(2) *Impose tariffs.* In response to the latest round of Trump tariffs, China announced targeted tariffs on US imports that will begin on March 10. It'll place a 15% tariff on US chicken, wheat, corn, and cotton products and a 10% tariff on sorghum, soybeans, pork, beef, seafood, fruits, vegetables, and dairy products. In addition, the Commerce Ministry added more than 24 American companies to export control and corporate blacklists. The country also said it was suspending imports of US wood and US soybeans from three companies.

US farmers no doubt aren't happy; China was the third largest importer of US agricultural products last year.

(3) *Keep expectations low.* Chinese leaders set a target of 2.0% for consumer inflation, down from last year's goal of 3.0%. The Chinese economy's sluggishness has weighed on inflation, which came in at 0.5% y/y in January, or 0.2% excluding food and energy (*Fig. 5*). The country's producer price index registered deflation, coming in at -2.3% y/y in January (*Fig. 6*). China's economic woes and dance with deflation are reflected in its 10-year government bond yield of 1.76% and tepid demand for bank loans (*Fig. 7*).

Conversely, investors have received two good pieces of economic news recently. China's official manufacturing purchasing managers index (PMI) indicated that the industrial sector entered expansion territory above 50.0 in February, rising to 50.2 from January's 49.1 (which may have been weakened by the Lunar New Year holiday). New orders in February also rose, to 51.1, but new export orders registered at only 48.6. The non-manufacturing

PMI edged higher as well, to 50.4 from 50.2 in January (*Fig. 8*). However, some of this activity may have been artificially inflated by US companies racing to import goods before the Trump tariffs hit.

The excess capacity and excessive debt in China's residential real estate market have been drags on the general economy in recent years. Data remain mixed, with new home sales from China's 100 biggest property developers climbing 1.2% y/y in February after a 3.2% decline in January.

The Shenzhen Real Estate stock price index has popped up 27.8% from its 17-year low on August 28, but remains depressed and is down 1.1% ytd (*Fig. 9*). Likewise, the CSI 300 has dropped 1.3% ytd through Tuesday's close, but the China MSCI has jumped 12.7% (*Fig. 10*).

Strategy: CEOs Do the Tariff Tap Dance. Companies have been preparing for US tariffs and the expected responses from targeted countries for months. From moving production to cutting costs, here's a quick look at what some executives in the retailing, refining, and farming industries are saying about their companies' tariff-readiness:

(1) *Tariffs create uncertainty.* Given the uncertainty created by tariffs, Target aims to maintain a "larger-than-normal cushion" on its balance sheet, said CFO Jim Lee on Tuesday on the company's earnings *conference call*. The company has been pulling production out of China and moving it to other countries in Asia and Latin America. The increased diversity of production locations gives them more flexibility.

The uncertainty surrounding the tariffs and its impacts on consumer demand contributed to Target's decision to eliminate its quarterly earnings guidance and its extremely wide 2025 earnings guidance. The company now forecasts net sales growth of around 1% this year and adjusted EPS of $8.80-$9.80 compared to last year's adjusted EPS of $8.86. Granted, Target had operating issues last year before tariffs were even an issue. So it's certainly possible that the retailer is using tariffs as an excuse that buys it more time to turn around operations.

(2) *Tariffs hit refiners.* Trump's tariffs will impact US imports of Mexican and Canadian crude oil, much of which is of the "heavy" variety that US refiners use. Valero executives discussing tariffs noted that the company's operations on the US Gulf Coast could limit the impact by importing crude from other countries in the world. But if the tariffs are extended, they could reduce the refiner's throughput by 10%, said an executive on the company's

January 30 *conference call*.

(3) *China retaliation hurts crops.* The folks at ADM were well aware that tariffs wouldn't be a problem for ADM. Rather, it was the retaliation in response to the tariffs that would potentially cause the problem. "[W]e saw in 2018 how the corn imports from China were reduced by almost like 9 million tons from the U.S. Whether that's going to be something that's going to happen again or not, we'll have to see," said ADM CEO Juan Luciano during the company's February 4 earnings *conference call*.

And as we noted above, China did announce on Tuesday that it will impose additional tariffs of up to 15% on certain US farm products, including soy, wheat, and corn. The company plans to cut up to 700 jobs globally this year after reporting a 16% decline in adjusted EPS in Q4 due to falling crop prices and reduced trade flows.

Disruptive Technologies: Big Guys Elbow into Quantum Computing. Recently, tech giants Amazon, Google, and Microsoft all have announced breakthroughs they've made in quantum computing. Conversely, small startup quantum computing companies have watched their stocks tumble ytd, as they are racking up losses. In this David vs Goliath tale, it looks like Goliath may win.

Here's some of the recent news out of the quantum computing industry:

(1) *Lots of new chips.* Amazon, Google, and Microsoft each has developed new chips that can be used in quantum computers. Some aim to reduce computing errors; others hope to increase the number of qubits a chip can hold.

Amazon's quantum computing chip, dubbed "Ocelot," will lower the cost of reducing quantum computing errors by up to 90%. "It's designed to test our ability to perform quantum error correction, and once we have that building block, then we can scale it up to a much larger size," said Oskar Painter, head of quantum hardware for Amazon Web Services, as quoted in a February 27 *WSJ* *article*.

Microsoft has developed a new state of matter—one that's not a solid, liquid, or gas—and uses it in its new quantum chip called "Majorana 1." If successful, the quantum processing unit, or QPU, will ultimately hold a million quantum bits.

Google's new chip, Willow, helps to reduce errors "exponentially." It performed a computation in under five minutes that would have taken one of today's fastest super computers 10 septillion years to calculate, the company's December 9 *blog* stated. The more qubits Google added to its computer, the fewer errors it experienced. The system, which uses 105 qubits, was also able to fix errors in real time.

(2) *China & others in the mix, too.* Chinese scientists at the University of Science and Technology introduced a quantum computer prototype called "Zuchongzhi 3.0," with 105 qubits, reported a March 4 *article* in *Global Times*, a publication controlled by the Chinese Communist Party. The scientists claim that the quantum computer can process quantum random circuit sampling tasks one million times faster than Google's Sycamore processor. This news follows news of a Chinese prototype quantum computer named "Wukong," which has 72 qubits and can be accessed in the cloud.

Finnish company IQM Quantum Computers launched Europe's first 50-qubit quantum computer located at the facility of its partner, VTT Technical Research Centre of Finland. Companies and researchers will have access to the computer through the VTT QX quantum computing service. The 50-qubit computers follow earlier models that had five and 20 quibits, a March 4 *article* in HPC Wire reported.

Meanwhile, Dutch startup QuantWare has developed a 3D quantum chip architecture it calls "vertical integration and optimization," or "VIO." This 3D architecture should allow for more qubits on one chip. A single chip may ultimately be able to hold one million qubits, making it much faster than current chips linked together with fewer qubits. QuantWare is currently accepting orders for its first QPU, Contralto-A, for quantum-error correction. It aims to be the quantum equivalent of what TSMC is to Apple or to Microsoft in traditional computing, a March 4 *article* in The Next Web reported.

(3) *US startups slump.* Quantum startups rallied sharply in late 2024 on a batch of good news. Google announced the strong performance of Willow, its quantum chip. IonQ shipped its first quantum computer to a European customer. And Quantum Computing and D-Wave took advantage of the market's rally to sell stock and raise cash. The industry was also hopeful that the Trump administration would provide support because during Trump's first term he signed the 2018 National Quantum Initiative Act, which bolstered government research in the area.

In 2024, shares of quantum startups soared: Quantum Computing (up 1,606.2%), Rigetti Computing (1396.1%), D-Wave Quantum (800.8%), and IonQ (215.7%). Then in January, Nvidia CEO Jensen Huang said in response to a question that practical quantum computers are still roughly 20 years away. A few days later, Meta Platforms CEO Mark Zuckerberg shared a similar opinion, stating that quantum computers are “still quite a ways off from being a very useful paradigm” and that many people think it’s a “decade plus out.”

January’s CEO comments cooled investors’ enthusiasm, and they began to focus on the large losses that the quantum startups were racking up, as well as their need to raise additional cash to continue operations. IonQ, for example, doesn’t expect to be profitable until 2030. And D-Wave recently sold $150 million of stock to boost its cash balance to around $320 million. The deal gives D-Wave the necessary capital and ability to get to sustained profitability and positive cash flow, said its CEO.

In short, the quantum stars of last year have fallen to Earth this year. Here are their ytd performances through Tuesday’s close: Quantum Computing (-68.2%), Rigetti Computing (-48.5), IonQ (-46.5), and D-Wave (-36.7).

Calendars

US: Thurs: Jobless Claims 235k; Nonfarm Productivity & Unit Labor Costs 1.2% & 3.0%; Goods & Services Trade Balance -$96.4b. **Fri:** Nonfarm Payrolls 160k; Average Hourly Earnings 0.3%m/m, 4.1%y/y; Unemployment Rate 4.0%; Consumer Credit $14.5b; Powell; Williams; Bowman. (FXStreet estimates)

Global: Thurs: Eurozone Retail Sales 0.1%m/m, 1.9%y/y; ECB Main Refinancing Operations Rate 2.65%; ECB Monetary Policy Statement; Harker. **Fri:** Eurozone GDP 0.1%q/q, 0.9%y/y; Eurozone Employment Change 0.1%q/q, 0.6%y/y; Germany Factory Orders -2.8%; Lagarde; Nagel. (FXStreet estimates)

Strategy Indicators

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500’s forward revenues ticked down a hair again w/w during the February 27 week to less than 0.1% below its record high during the February 6 week. Forward earnings dropped a hair w/w as well, to 0.3% below its February 6 record high. The forward profit margin was unchanged w/w at 13.5%, down 0.1ppt from a record high of 13.6%. It is now 3.2ppts above its seven-year low of 10.3% during April 2020. The consensus expectations for forward revenues growth was steady for a fourth straight week at 5.5%, down just 0.3ppt from its 23-month high of 5.8% during the August 1 week. It has gained 3.2ppts from its 33-month low of 2.3% during the February 23, 2023 week. That's down from a record high of 9.6% growth at the end of May 2021 and compares to 0.2% forward revenues growth during April 2020, which was the lowest reading since June 2009. The forward earnings growth forecast fell 0.3ppt w/w to a 43-week low of 12.1%, and is now 2.2ppts below its 38-month high of 14.3% during the December 12 week and 8.8ppts above its 31-month low of 3.3% during the February 16, 2023 week. That's down from its 23.9% reading at the end of April 2021, which was boosted by the recovery from the pandemic to its highest reading since June 2010 and up substantially from its record low of -5.6% at the end of April 2020. Analysts expect revenues to rise 5.2% in 2025 (unchanged w/w) and 6.3% in 2026 (unchanged w/w), an acceleration from 2024's nearly finalized 4.9% (unchanged w/w). They expect an earnings gain of 11.6% in 2025 (down 0.4ppt w/w) and a 14.3% rise in 2025 (up 0.1ppt w/w) compared to 2024's forecasted earnings gain of 11.2% (up 0.3ppt w/w). Analysts expect the profit margin to rise 0.8ppt y/y to 13.3% in 2025 (unchanged w/w) and 1.0ppt y/y in 2026 to 14.3% (unchanged w/w), compared to 2024's forecasted 12.5% (unchanged w/w). The S&P 500's weekly reading of its forward P/E fell 0.7pt w/w to six-week low of 21.7 from a four-year high of 22.4. It's up 2.0pts from a 14-week low of 19.7 during the August 8 week and 6.4pts from a 30-month low of 15.3 in October of 2022. It also compares to 23.1 in early September 2020, which was the highest level since July 2000, and to a 77-month low of 14.0 in March 2020. The S&P 500 weekly price-to-sales ratio fell 0.09pt w/w to 2.94 from a record high 3.03. That's up from a six-month low of 2.22 during the October 26, 2023 week and compares to a 49-month low of 1.65 in March 2020.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins (*link*): During the February 27 week, forward revenues rose for four of the 11 S&P 500 sectors and forward earnings rose for three. This led to rising forward profit margins for three of the 11 sectors. Utilities was the only sector to post record-high forward revenues this week. These seven sectors are less than 0.4% from their recent record highs: Communication Services, Consumer Discretionary, Consumer Staples, Financials, Health Care, Information Technology, and Real Estate. Industrials' forward revenues has weakened to 3.4% below its early September record. Materials and Energy are struggling to improve, and remain the biggest laggards at 6.4% and 15.1% below, respectively. Communication Services and Information Technology are the only sectors with record-high forward earnings this week. These two sectors are less than 0.4% from their recent record highs: Financials, and Utilities. These three sectors are down as much as 1.8% from their respective record highs in January and February: Consumer Discretionary, Consumer Staples, and Industrials. Falling again now is Real Estate at 1.3% below its record high in August 2022, but Health Care has improved to just 0.7% below its February 2022 record. Among the remaining two sectors, forward earnings remains depressed for Energy and Materials, which are 34.7% and 27.4% below their respective highs during 2022. Looking at the record-high forward profit margin club, Financials' was steady w/w after entering the club during the January 16 week for the first time since August 2021. Also at a record high this week is Communication Services. In recent weeks, the Consumer Discretionary, Industrials, and Information Technology sectors were in that club. Among the laggards, Energy's forward margin is at a three-year low of 9.3%; Consumer Staples' 6.7% is approaching its seven-year low in March 2023; Health Care's 8.6% is only 0.1ppt above its record low in April; and Real Estate's 16.7% is up from a low of 12.4% in December 2020. Here's how the S&P 500 and its 11 sectors rank based on their current forward profit margin forecasts along with their record highs: Information Technology (27.1%, up 0.1ppt w/w and down from its 27.6% record high in September prior to low-margin Dell's index addition, which lowered the margin 1.3ppts then to 26.3%), Financials (20.0, a record high for a seventh week, the first since August 2021), Communication Services (18.6, a record high this week), Real Estate (16.7, down 0.2ppt w/w and from its 19.2 record high in 2016), Utilities (14.4, down 0.1ppt w/w and from its 14.8 record high in April 2021), S&P 500 (13.5, down 0.1ppt from its 13.6 record high in January), Materials (10.5, a four-year low and down from a 20-month high of 11.6 in July 2023 and a 13.6 record high in June 2022), Energy (9.3, down to a 36-month low and from its 12.8 record high in November 2022), Industrials (11.1, down from its 11.3 record high in early January), Consumer Discretionary (9.3, down 0.1ppt w/w from its 9.4 record high a week earlier), Health Care (8.6, only 0.1ppt above its 8.5 record low at the end of April and down from its 11.5 record high in February 2022), and Consumer Staples (6.7, down 0.1ppt w/w to a 19-month low and from its 7.7 record high in June 2020).

US Economic Indicators

ADP Employment (*link*): "Policy uncertainty and a slowdown in consumer spending might have led to layoffs or a slowdown in hiring last month. Our data, combined with other recent indicators, suggests a hiring hesitancy among employers as they assess the economic climate ahead," noted Nela Richardson, chief economist of ADP. *Private payroll* added just 77,000 jobs in February, well below the 148,000 consensus estimate and January's upwardly revised 186,000 gain. *Goods-producing* employment rose 42,000 during February, led by a 26,000 jump in construction jobs and an 18,000 increase in manufacturing employment, while natural resources/mining jobs posted a 2,000 loss. The *service sector* showed a 36,000 increase last month, though was a mixture of positives and negatives. Leisure & hospitality (41,000) posted the largest monthly gain, followed by professional & business services (27,000), financial activities (26,000), and other services (17,000), while trade, transportation & utilities (-33,000) recorded the largest decline, followed by education & health services (-28,000), and information services (-14,000). *By size*, medium-sized companies added 46,000 to payrolls, while large establishments were a close second adding 37,000 to payrolls. Meanwhile, small establishments cut employment by 12,000. According to the report, the yearly pay increase for *job-changers* slowed slightly to 6.7% in February from 6.8% in January, while pay gains for *job-stayers* was unchanged at 4.7%.

US Non-Manufacturing PMI (*link*): The US service sector continued to expand in February. The *ISM N-PMI* climbed to 53.5 in February from 52.8 in January, expanding for the 54th time in 57 months. The *business activity/production* index was little changed in February, dipping to 54.4 from 54.5 in January—the index's 57th consecutive month of expansion, while the new orders (to 52.2 from 51.3) measure increased at a slightly faster pace than in January. Meanwhile, inventories (50.6 from 47.5) moved from liquidation to accumulation last month. The employment index (53.9 from 52.3) was in expansion territory for the fifth straight month, adding to payrolls at a slightly faster pace. The *supplier deliveries* (53.4 from 53.0) measure remained in expansionary territory for the third straight month—indicating "slower" supplier deliveries. (Supplier deliveries is the only ISM component that is inversed—with a reading above 50.0 indicating slower deliveries.) On the *inflation* front, the price index (to 62.6 from 60.4) accelerated during February—posting its third straight reading above 60.0 for the first time since March 2023.

Global Economic Indicators

Global Manufacturing PMIs (*link*): "Global economic growth is at a 14-month low as uncertainty hits demand and employment," is the headline of the February report. The Global *C-PMI* Output Index sank for the second month to 51.5 in February from 52.6 at the end of 2024—with the headline index holding above the neutral level of 50.0 for the 25th consecutive month. While the global service sector outperformed its manufacturing counterpart again in February, it was by the smallest margin since the services sector first overtook manufacturing in 2023. *Services business activity* eased to a 14-month low in February, mainly due to a further slowdown in growth in both the business and consumer services categories, though the financial services industry showed an acceleration in growth. Meanwhile, *manufacturing* production rose at the fastest pace since June 2024, led by consumer and intermediate goods, while investment goods stabilized after contracting for eight straight months—partly reflecting the front loading of output and new orders ahead of tariffs. *Regionally*, PMI data indicated the US lost momentum, bumped from the fastest growing of the major developed economies in February, replaced by Japan. Growth was weak in Europe and Australia, while Canada's decline accelerated. Meanwhile, India outpaced the other emerging economies, while growth in mainland China was once again only moderate. Levels of *new business* in February rose for the sixteenth straight month; however, the rate of expansion eased to its slowest pace since September 2024. Even so, "the latest increase was more broad-based," the survey noted, "with all six of the sub-sectors covered by the survey (business, consumer and financial services and consumer, intermediate, and investment goods manufacturing) seeing concurrent growth for the first time since May 2024." *Turning to pricing*, average prices charged for goods and services rose at a slower rate in February, mainly reflecting a weaker increase in the service sector, while manufacturing cost inflation moved higher globally, most notably in the US, with some companies citing suppliers raising prices in advance of potential tariffs. The report noted that input costs accelerated at the fastest pace in seven months—with input cost inflation at factories at a 25-month high.

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