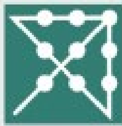

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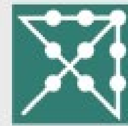

March 12, 2025

Morning Briefing

On Japan, Crude Oil & Earnings

Check out the accompanying chart collection.

Executive Summary: Yes, there's been upward pressure on Japanese interest rates and the yen at a time of downward pressure on US rates and the dollar. But no, Eric explains, we're not worried about a repeat of last year's carry-trade havoc in global markets. Resting our minds are recent Japanese and US economic data and signs that yen-funded carry trade positions aren't huge. … Also: Melissa explains why we expect the price of oil to remain in a narrow range as countervailing forces pressure it in both directions. … And: Joe reassures us that the recent plunge in S&P 500 companies' aggregate Q1 earnings growth expectations is typical as quarters wind down.

Global Strategy: Carry-Trade Calamity 2.0? Japanese government bond yields have surged on the back of stronger economic data. Hotter inflation data have also raised the odds of further Bank of Japan (BOJ) interest-rate hikes, boosting the yen. This has come while US Treasury yields have fallen, thus making the yen even stronger against the US dollar.

All of this is reminiscent of the carry-trade "blowup" last summer, when declining US interest rates and rising Japanese interest rates jeopardized the positions of traders who had borrowed cheaply in yen to fund trades abroad. Even if unwinding carry trades has put some pressure on global markets this time around, the latest Japanese data suggest it won't last for long. Consider the outlook for Japan and the BOJ:

(1) *Rates up*. The 10-year Japanese government bond yield traded as low as 0.80% last September, and since has climbed above 1.50% (*Fig. 1*). While the yen hasn't quite reached its peak of 140 to the dollar from last fall, it has strengthened from 158 in early January to around 147 today (*Fig. 2*).

(2) *Nikkei down*. The Japanese Nikkei has sold off alongside US tech stocks, now down 5.6% over the past month (*Fig. 3*). However, the rout hasn't reached the extremes of last

year, when Japanese stocks fell 25% in just two weeks.

(3) *Not-so-hot economic data.* Yesterday, Japan's Q4 real GDP growth was revised down from 2.8% to 2.2% (saar) (*Fig. 4*). Private consumption was revised down from 0.1% to unchanged, while residential investment flipped from up 0.1% to down 0.2%. Japanese government bond yields and the yen pared some of their recent rise.

(4) *BOJ is still a flock of doves*. Inflation is still sticky in Japan, with the BOJ's target rate rising to 2.5% in January—the highest since March 2024 (*Fig. 5*). We think the BOJ might stay on hold at its meeting next week after hiking to 0.5% in January—the highest since 2008 (*Fig. 6*).

(5) *Carried out*. There are plenty of signs that the carry trade is a fraction of its size last year. We think the most leveraged traders were already carried out by last year's volatility shock. For instance, leveraged shorts against the yen have already been washed out by the latest strength (*Fig. 7*). However, the buildup of net short-term foreign assets in Japanese banks—which we believe are parked there to fund carry trades—remain fairly close to last year's peak (*Fig. 8*).

In short, the latest Japanese data and our belief that the US economy remains resilient give us confidence that Carry Trade Calamity 2.0 isn't a worry. But rising fears of a recession in the US combined with anticipation of BOJ rate hikes could prompt more carry-trade unwinds and therefore pressure on global markets.

Global Oil: Why Oil Prices Should Stay Range-Bound. Despite President Trump's imposition of tariffs, including on Canadian oil, we expect global oil prices to remain within a historically low range for the foreseeable future. The tariffs may actually have a deflationary effect on oil, dampening global aggregate demand and suppressing prices, in our view.

On Monday, the price of a barrel of Brent crude oil hit below $70 for the first time in three years, at $68.33 (*Fig. 9*). It had traded mostly in a range of $75-$80 since September. The immediate trigger wasn't Trump's tariffs but OPEC+'s unexpected announcement of a supply expansion. Trump has been pressuring OPEC+ to lower oil prices, which tilted oil traders into a net bearish position.

A confluence of factors suggests to us that global oil prices will stay within a narrow, $65-$75 band through the end of this year. That's barring a severe global recession, which we are not expecting this year despite Trump's Tariff Turmoil 2.0. In most scenarios, we can't

see oil prices dropping into the $50s, as at least one forecaster *projects*. That's because geopolitical factors, such as tensions between the US and Iran and further meddling in the market by Trump and OPEC, likely will result in oil prices remaining around current levels.

Also supportive of oil demand would be the potential refilling of the US Strategic Petroleum Reserve, as the US energy secretary intends. On the other hand, the global addition of renewable energy sources to the energy mix should limit demand.

These countervailing influences support our case for a range-bound oil price. Let's examine these and related factors:

(1) *Demand-side factors.* Three demand-related factors should help keep a lid on global oil prices:

- *Weak demand from China*. The world's second-largest economy is slowing, and we aren't overly optimistic on the success of its recently announced stimulus plan (see yesterday's *Morning Briefing*). The country also is *shifting* away from fossil fuels and growing its reliance on renewable energy sources, which will contribute to a steady decline in its oil consumption growth rate. China now generates 31% of its electricity from renewables, including wind, solar, hydro, and geothermal. Despite its dependence on coal, solar is expected to surpass coal as the leading energy source by 2026. In 2024, China led global energy transition investment, according to BloombergNEF data.

- *Weak demand from Europe*. While our concerns about Europe's economic slowdown have eased with the potential *boost* from defense spending under the European Union's ReArm initiative (see yesterday's *Morning Briefing*), Europe is quickly shifting to cleaner energy. Reliance on renewable sources is a pillar of Europe's *commitment* to completely phase out Russian gas imports and to achieve energy independence. Last week, the European Commission (EC) replaced its Green New Deal with the Clean Industrial Deal, designed to support *dual goals* of decarbonization and economic growth.

- *Global shift toward renewables & mainstreaming EVs*. As renewable energy sources continue to gain ground, catalyzed by government policies, the long-term outlook for fossil fuels, especially oil, appears increasingly uncertain. Renewable energy technologies—including solar, wind, and electric vehicles (EVs)—are fast becoming mainstream. As the EV market expands, a major inflection point is *approaching*: The

sticker price will soon match that of a gas-powered car, perhaps as soon as this year. The rise of EVs is expected to dent demand for gasoline and diesel, pressuring oil prices downward.

(2) *Supply-side factors.* We see three major influences on oil supplies:

- *OPEC+ production increases should expand supply.* Oil prices sank last week after OPEC+ *agreed* to increase crude production for the first time since October 2022. Over the next year and a half, the group will pursue a “gradual and flexible return” of 2.2 million barrels a day. This followed a long-delayed hike in production by eight countries: Saudi Arabia, Russia, Iraq, the United Arab Emirates, Kuwait, Kazakhstan, Algeria and Oman. Even before the OPEC+ alliance announced additional supplies, the International Energy Agency was already forecasting a surplus, with supply growth expected from non-OPEC+ sources. We expect OPEC+ to maintain global oil prices within a manageable range that protects producers.

- *Geopolitical risks threaten oil supplies.* Geopolitical tensions in the Middle East consistently introduce uncertainty into oil pricing. Middle East tensions and Russia’s war in Ukraine are the two biggest known risk factors for energy in 2025, followed by trade-related disruptions. However, we note that supply disruptions from geopolitical causes are typically short-lived, causing oil price spikes but not rallies, as alternative oil sources usually step in to stabilize the market. Topping our list of geopolitical risks to oil prices are the tensions between the US and Iran over Iran’s *evasive* international shadow network that ships millions of barrels of Iranian oil to China amid US sanctions. Pressure on Iran could offset a global supply surplus, especially given the Trump administration’s aim to reduce the regime’s oil flows by 90%.

- *Shale backstops supply*. The US shale industry has become a key counterbalance to global supply disruptions. President Trump’s executive order to "unleash America’s energy" lifts restrictions on oil and gas extraction and reverses several climate-related policies enacted by the Biden administration. Despite his tariffs, Trump has pledged to lower US energy costs. Even with falling oil prices, US shale producers are able to reduce costs and maintain output, helping to stabilize oil prices within a set range. Shale producers may be able to remain profitable at oil prices as low as $50 per barrel, the US energy secretary recently stated. While shale production provides a buffer against supply shocks, major shale producers are unlikely to significantly increase production, *prioritizing* returns to shareholders over aggressive drilling.

US Strategy: Earnings Growth Scare in Q1? The earnings warning season is upon us. On Monday evening, Delta Air Lines warned analysts that their revenues and earnings forecasts for Q1 were too high. The company said corporate and consumer spending stalled in Q1, growing at a slower-than-expected rate y/y. However, the company did not foresee a recession ahead and actually left its 2025 guidance unchanged on expectations of lower energy prices.

For the S&P 500 companies in aggregate, consensus estimates call for earnings to rise y/y for an eighth straight quarter, albeit at a slower "back-to-trend" rate. The consensus growth forecast for S&P 500 Q1-2024 earnings has dropped to 6.8% as of the March 6 week from over 11% at the beginning of the quarter (*Fig. 10*). The steep decline in recent weeks is typical of quarters' final weeks, when bad earnings news tends to dominate estimate revisions activity.

However, there are still pockets of strong earnings growth within the S&P 500 sectors, as Joe shows below:

(1) *What's ahead for Q1 sector earnings growth?* Eight of 11 sectors are expected to show positive y/y earnings growth, down from 10 sectors in Q4. Among the three 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 is expected to fall for a third straight quarter. Among the six sectors expected to post single-digit earnings growth in Q1, for Consumer Discretionary and Utilities such a result would end their double-digit percentage growth streaks at eight and six quarters, respectively.

(2) *Health Care and Tech are Q1's and 2025's growth leaders.* Just two sectors are expected to post double-digit percentage earnings growth in Q1, Health Care and Information Technology. That would mark the lowest count of sectors with double-digit percentage earnings growth since Q4-2022, when only Energy and Industrials posted such growth. The Health Care and Information Technology sectors are expected to grow revenues and earnings faster than the S&P 500, not just in Q1 but for all of 2025's quarters (*Fig. 11* and *Fig. 12*).

(3) *Review: S&P 500 sectors' Q4 revenues growth.* Joe recently updated his analysis of Q4's revenue and earnings results for the S&P 500's sectors in our *S&P 500 Quarterly Metrics* publication. During Q4, eight of the 11 S&P 500 sectors recorded positive y/y growth in revenues, unchanged from Q3's count. Here's how the S&P 500 sectors' y/y revenues growth rates stacked up in Q4: Information Technology (12.1%), Health Care

(9.2), Real Estate (8.6), Communication Services (7.3), Financials (7.3), Consumer Discretionary (6.2), S&P 500 (5.2), Consumer Staples (1.4), Utilities (1.0), Materials (-1.8), Energy (-1.9), and Industrials (-3.0).

(4) *Review: S&P 500 sectors' Q4 earnings growth.* On the earnings front, ten of the 11 S&P 500 sectors posted positive y/y earnings growth in Q4. That was the broadest sector growth since Q4-2021. Seven sectors posted double-digit percentage y/y earnings growth, the highest count since 12 quarters in Q1-2022. Here are the S&P 500 sectors' y/y earnings growth rates for Q4: Financials (35.1%), Communication Services (31.5), Consumer Discretionary (27.2), Information Technology (19.8), S&P 500 (17.0), Real Estate (15.4), Health Care (14.3), Utilities (12.5), Industrials (8.0), Materials (2.0), Consumer Staples (1.5), and Energy (-29.1).

(5) *Review: S&P 500 sectors Q4 profit margin.* Profit margins improved q/q for just four of the 11 sectors in Q4: Financials, Industrials, Information Technology, and Real Estate. However, nine sectors, all but Energy and Materials, had higher Q4 margins y/y. Here's how the sectors' profit margins ranked in Q4: Real Estate (31.0%, six-quarter high), Information Technology (27.5, record high for the first time since Q4-2021), Communication Services (19.6), Financials (15.8, 10-quarter high), Utilities (13.1), S&P 500 (12.8, 10-quarter high), Industrials (11.0, six-quarter high), Materials (8.9, 18-quarter-low), Consumer Discretionary (8.9), Energy (7.8, 14-quarter low), Health Care (7.6), and Consumer Staples (6.5).

Calendars

US: Wed: CPI Headline & Core CPI 0.3%mm, 2.9%y/y & 0.3%m/m, 3.2%y/y; MBA Mortgage Applications; Monthly Budget Statement -$31.5b; 10-Year Note Auction. **Thurs:** Headline & Core PPI 0.3%m/m, 3.3%y/y & 0.3%m/m, 3.6%y/y; Initial Claims 225k; Fed Balance Sheet. (FXStreet estimates)

Global: Wed: BoC Interest Rate Decision 2.75%; Lagarde; Lane; Jones. **Thurs:** Eurozone Industrial Production 0.6%m/m, -1.0%y/y; De Guindos; Nagel. (FXStreet estimates)

US Economic Indicators

NFIB Small Business Optimism Index (*link*): "Uncertainty is high and rising on Main

Street and for many reasons," noted Bill Dunkelberg, NFIB's chief economist. "Those small business owners expecting better business conditions in the next six months dropped and the percent viewing the current period as a good time to expand fell, but remains well above where it was in the fall." The *Small Business Optimism Index (SBOI)* fell again in February, while the *Uncertainty Index* recorded its second-highest reading on record last month at 104. The SBOI dropped to 100.7 last month after reaching 105.1 in December—which was the second straight month above the 51-year average of 98.0 and the highest level since October 2018. In February, seven of the 10 *components of the SBOI* fell, while three rose. The biggest declines last month occurred in expect the economy to improve (-10ppts to 37%), sales expectations (-6 to 14), now is a good time to expand (-5 to 12), current inventory (-4 to -5), plans to increase employment (-3 to 15), and capital outlay plans and plans to increase inventories (both ticking down a percentage point to 19% and -1%, respectively). Quality of labor (19%) was the *single most important problem for small business owners* in February, followed by taxes and inflation both at 16%, while cost of labor was at 12%. The net percentage of owners *raising selling prices* climbed from 22% in January to 32% in February—the highest percentage since May 2023—while a net 29% plan price hikes in the next three months, the highest since last March. Turning to *compensation*, a net 33% reported raising compensation in both January and February, up from 29% in December, while a net 18% plans to raise compensation in the next three months, down 10ppts from November's recent peak of 28%.

JOLTS (*link*): Job openings rose 232,000 in January to 7.7 million—slightly above the consensus estimate of 7.6 million. *By industry*, the biggest gains in job openings in January were led by retail trade (143,000), finance & insurance (77,000), real estate and rental and leasing (46,000), wholesale trade (46,000), and health care & social assistance (58,000). The largest declines were recorded in professional & business services (-122,000), leisure & hospitality (-46,000), and transportation, warehousing, and utilities (-40,000). There were 7.1 million people unemployed in January, so there were 1.1 available jobs for each unemployed person for the eighth successive month. This ratio was at a recent high of 2.0 during March 2022. *Separations* include quits, which are generally voluntary separations initiated by employees—serving as a measure of workers' willingness or ability to leave jobs. *Total quits* have been on a downtrend since peaking at 4.5 million during spring 2022, falling to 3.3 million in January, little changed from its recent low of 3.0 million in November.

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