March 31, 2025

Morning Briefing

Trump's Reign Of Tariffs: Stagflation Odds Up, S&P 500 Target Down

Check out the accompanying chart collection.

Executive Summary: The expected fallout from Trump 2.0's Reign of Tariffs undercuts our former bullishness and dims the prospects of our base-case Roaring 2020s scenario for now. It has also drained confidence in the US economy on the parts of everyone from CEOs to consumers to investors. Recent data showing manufacturing faltering and purchasing managers paying higher prices suggest stagflation is already taking root. We're dropping the odds we assign to our Roaring 2020s scenario from 65% to 55% and upping the odds of a stagflation scenario, which may include a recession, from 35% to 45%. That 45% is also the probability we see that the stock market's correction will deepen into a bear market in coming months. Yet we still expect an up year, with the S&P 500 rising above 6000 by year-end. ... Also: Dr Ed recommends skipping "Eileen" (- - -).

YRI Bulletin Board. Our colleague Eric Wallerstein is taking a leave of absence. He has accepted a position on the President's Council of Economic Advisers. We wish him all the best.

YRI Weekly Webcast. Join Dr Ed's live webcast with Q&A on Mondays at 11 a.m., EST. You will receive an email with the link one hour before showtime. Replays of the weekly webcasts are available *here*.

Reign Of Tariffs I: Losing Confidence. Does President Donald Trump want a recession? He is going to get one if he continues to pursue his chaotic tariff policies. Consider the following:

(1) *CFOs & CEOs*. According to a recent small *survey* of chief financial officers conducted by CNBC and discussed in a March 25 CNBC *post*: "In a word, the 'pessimism' has crept back in where the animal spirits had been after Trump's election. That's one way to sum up the results from the latest CNBC CFO Council quarterly survey for Q1 2025."

Ninety percent of the surveyed CFOs say tariffs will cause "resurgent inflation." The majority of the CFOs expect a recession in the second half of 2025. They should know: The CFO Council survey is a sampling of views from CFOs at large organizations across sectors of the US economy. The Q1 survey covered replies from 20 respondents and was conducted between March 10 and March 21.

The Business Roundtable CEO Economic Outlook Index dipped modestly during Q1 (*Fig. 1*). In a special question posed this quarter, chief executive officers were asked to identify policies and actions that are important for strengthening domestic manufacturing. Seventy percent of respondents selected keeping tariffs low on intermediate inputs and raw materials, particularly those that cannot be sourced in the US.

This quarter's survey, conducted from February 19 through March 7, 2025, was completed by 150 CEOs. More than three-quarters of responses were submitted before the 25% US tariffs on Canada and Mexico were announced on March 3, 2025. Odds are that the Q2 survey will show a big drop in the CEO index, which could weigh on capital spending.

(2) *Small business owners.* The Uncertainty Index, compiled by the National Federation of Independent Business from a monthly survey of small business owners, was 104 in February, the second highest on record (*Fig. 2*). The highest was 110 during October 2024.

(3) *Consumers*. Also losing their confidence in Trump 2.0 are consumers. Debbie and I track the Consumer Optimism Index (COI), which is the average of the Consumer Sentiment Index (CSI) and the Consumer Confidence Index (CCI). It fell to 75.4 during March, which is the lowest since July 2022 (*Fig. 3*). In March 2017, during Trump 1.0, the COI was 111.3. Leading the way down has been the COI expectations component at 58.9 in March, the lowest since July 2022 (*Fig. 4*).

According to the CSI survey, consumers are depressed because their inflationary expectations soared in March to 5.0% over the next 12 months, up from 3.3% in January (*Fig. 5*). Their five-years-ahead inflationary expectations also jumped, to 4.1% in March from 3.2% in January. According to the CCI survey, more consumers are expecting fewer jobs will be available in six months (*Fig. 6*).

(5) *Credit investors*. The yield spread between the high-yield corporate bond composite and the 10-year Treasury bond yield has risen from a recent low of 239bps on January 24 to 320bps on Thursday (*Fig. 7*). That's still a relatively narrow spread. Starting to show more signs of stress is the Invesco Senior Loan ETF (BKLN). It is down 1.7% so far this year (*Fig. 8*).

(6) *US stock investors*. On Saturday, March 22, President Trump said that he would be "flexible" on reciprocal tariffs. The S&P 500, which had fallen to a 2025 low of 5521.52 on March 13 (a 10.6% correction), peaked at 5776.65 on March 25 (*Fig. 9*). At Friday's close, it was back down to 5580.94 as investors realized that Trump was actually turning less flexible on tariffs. Indeed, on Monday, March 24, Trump threatened that countries that purchased oil and gas from Venezuela would face a 25% tariff on trade with the US. The S&P 500 is now down 9.2% from its record high on February 19. The Nasdaq is back in correction territory, with a 14.1% decline (*Fig. 10*).

To be fair, the stock market's woes aren't all attributable to Trump 2.0. Investors have been questioning the sustainability and credibility of the AI story, with more concerns that it might be a bubble that is starting to burst. The Magnificent-7 have been at the forefront of this story. The Roundhill Magnificent-7 ETF (MAGS) is down 15.4% so far this year, while the Defiance Large Cap ex-Mag 7 ETF (XMAG) is down only 0.6% over this same period (*Fig. 11*). The S&P 500 Data Center REIT has dropped 21.8% since it peaked at a record high on November 29, 2024 (*Fig. 12*).

(7) *Global stock investors.* Even overseas stock markets are weakening as investors realize that Trump's tariffs are bad news not only for the US economy but for plenty of other economies around the world. Indeed, many economies might be more vulnerable to the tariffs than the US if their exports to the US are greater than are their imports from the US. Trade is more important to many economies than it is to the US economy.

The outperformance of overseas stock markets relative to the US stock market, which started at the beginning of this year, might be over already, as the ratio of the US MSCI stock price index to the All Country World ex-US MSCI stock price index appears to be bouncing off its long-term uptrend line (*Fig. 13*). In addition, the China AI rally also seems to be over. The Invesco China Technology ETF (CQQQ) has declined 11.1% since it peaked this year on March 17 (*Fig. 14*). Over this same period, the Nasdaq 100 (QQQ) is down only 2.7%.

Reign of Tariffs II: Stagflationary Consequences. Along with CEOs, CFOs, small business owners, consumers, and investors, we are losing our confidence in Trump 2.0. Trump's Reign of Tariffs is tariff-y-ing:

(1) In a March 18 Fox Business Network *interview*, Treasury Secretary Scott Bessent said, "We are going to go to them [our trading partners] and say, 'Look, here is where we think the tariff levels are, nontariff barriers, currency manipulation, unfair funding, labor

suppression, and if you will stop this, we will not put up the tariff wall.'" If a country doesn't change those policies, he continued, "then we will put up the tariff wall to protect our economy, protect our workers, and protect our industries." That sounds like a reasonable way to force other countries to lower their trade barriers.

(2) Trump's "flexible" *comment* a few days ago reflected his realization that estimating the impact of nontrade barriers was an impossible feat. So the reciprocal tariffs that he will be announced on April 2 will be based on estimates of average tariffs imposed by each trading partner with a trade deficit with the US.

In his Fox interview, Bessent said, "I'm optimistic that, April 2, some of the tariffs may not have to go on because a deal is pre-negotiated," he added, "or that once countries receive their reciprocal tariff number, that, right after that, they will come to us and want to negotiate it down."

(3) However, some tariffs will be permanent, according to Trump. On March 12, he imposed 25% tariffs on all steel and aluminum coming into the US; on March 26, he announced 25% tariffs on all motor vehicles and parts imported into the US. These will be even more prohibitive if they are stacked on top of the average reciprocal tariffs.

The permanent tariffs on autos and parts, along with the permanent tariffs on aluminum and steel and possibly copper, are already boosting the prices of the metals and may soon increase both new and used car prices (*Fig. 15*). Would-be auto buyers might respond to higher prices by continuing to drive their current vehicles. If so, then the auto industry will be hit with stagflation.

Initially, auto sales might boom in the next month or two as buyers scramble to buy autos before prices are raised to reflect the higher costs of producing a car in the US. Meanwhile, Trump warned automakers on Thursday not to raise their prices; yet not doing so would kill their profit margins. On Saturday, Trump told NBC News in an interview that he "couldn't care less" if automakers raised prices.

For now, dealers have stockpiled a two- to three-month supply of new cars, so the impact of the tariffs might not start to be felt until June. At that point, vehicle prices could rise by more than 10% to offset the tariffs. That would push up auto insurance fees and the costs of maintenance and repair (*Fig. 16*).

(4) The collective impact of all these tariffs is increasingly likely to be stagflationary. The

tariffs will be paid either by foreign exporters to the US, US importers, and/or US consumers. The result will be higher prices and narrower profit margins than otherwise.

Economists generally agree that tariffs are a tax on imported goods that are normally paid by the importing company, which in turn passes on some or most of the cost of the tariffs to consumers in the form of higher prices.

Reign of Tariffs III: Stagflationary Readings. It's really a shame that Trump is so willing to take a wrecking ball to the economy. It has been very resilient over the past three years in the face of the tightening of monetary policy. We are losing our confidence that it can remain resilient in the face of Trump's Reign of Tariffs. The latest batch of data suggests that stagflation is already eroding the stellar performance of the economy, which hasn't been in a recession since the pandemic lockdown in early 2020:

(1) *Personal income, consumption, and saving*. Colder-than-normal weather during January and February undoubtedly depressed consumer spending those two months. Industrial production of utilities rose to record highs in both months (*Fig. 17*). The Atlanta Fed's *GDPNow* tracking model is showing that real consumer spending rose only 0.3% (saar) during Q1. We expect to see strong rebounds in March and April consumer spending as the weather improves and consumers scramble to buy autos and other goods before their prices go higher. That could set up the economy to be quite weak during Q3 and Q4 if consumers retrench when they are hit by higher prices attributable to Trump's tariffs. Capital spending is also likely to get hit during the second half of this year.

For now, the labor market remains strong, as reflected by low initial unemployment claims. February's real personal income rose 0.4% m/m, and the nominal personal saving rate increased from 3.3% in December to 4.6% in February because the cold weather held down consumer spending.

(2) *PCED inflation*. We no longer expect that the PCED inflation rate will range between 2.0%-3.0%, as it has since early 2024 (*Fig 18*). Instead, we expect to see it range between 3.0%-4.0% over the rest of this year before it settles back down to 2.0%-3.0% next year, maybe. The PCED services inflation rate should continue to moderate (*Fig. 19*). However, the PCED goods inflation rate is likely to rise faster along with tariffs in coming months (*Fig. 20*).

(3) *Regional business surveys.* The ISM manufacturing PMI was showing signs of recovering during January and February (*Fig. 21*). The same can be said about the regional

business surveys conducted by five of the 12 Federal Reserve district banks. However, the regional surveys suggest that the manufacturing recovery faltered in March in reaction to Trump Tariff Turmoil 2.0.

Just as disturbing is that the regional prices-paid and prices-received indexes jumped higher since the start of the year through March (*Fig. 22* and *Fig. 23*). The surveys suggest that stagflation is seeping into the economy. The obvious source of the problem is Trump's tariffs.

Reign of Tariffs IV: Recalibrating Our Forecasts Again. We've alerted you before that we might have to change our minds more often because Trump changes his mind so often. Here we go:

(1) *Raising stagflation odds*. We are reducing the subjective odds of our optimistic Roaring 2020s scenario from 65% to 55% and raising the odds of a pessimistic stagflation scenario from 35% to 45%. The former worked out great for us during the first half of the current decade. We still expect it to prevail over the remainder of the decade. But Trump's Reign of Tariffs is likely to get in its way this year. The stagflation scenario includes the possibility of a shallow recession during the second half of this year. The higher inflation part of stagflation is almost a certainty.

(2) *Real GDP.* We had been expecting 2.5%-3.0% real GDP growth this year, similar to the pace of the past year (*Fig. 24*). We are lowering that to 1.5%. Here are our forecasts for the four quarters of 2025: Q1 (1.0%), Q2 (3.5%), Q3 (0.5%), and Q4 (1.0%). The last two quarters could have negative signs. The surge in Q2's real GDP reflects a buy-in-advance rush by consumers during April and May before tariffs jack up prices in June.

(3) *Inflation.* As discussed above, we are raising our PCED inflation forecast range to between 3.0%-4.0% over the rest of this year and then lowering it back down to 2.0%-3.0% in 2026. That assumes that there won't be a trade war with tit-for-tariff retaliation. If there is, there will be a recession that will bring inflation down.

(4) *Interest rates.* We've been predicting none-and-done for Fed rate-cutting this year because of better-than-expected GDP growth. Now we are predicting that the Fed won't be able to ease even if the economy stagnates because higher inflation will force the Fed to stay put. The Fed Put will remain on hold. As a result, we aren't changing our forecast for the 10-year Treasury bond yield to remain in the 4.25%-4.75% range this year.

(5) *Stock market*. We've previously written that we couldn't rule out a bear market under the circumstances, which have continued to deteriorate under Trump's Reign of Tariffs. Our increased stagflation odds—to 45%—is also the odds that the current stock market correction will turn into a full-blown bear market. In other words, if we have stagflation in the economy, we can expect to have a bear market in stocks.

So we are lowering our S&P 500 year-end target (again) from 6400 to 6100, which would be up 4% from the end of last year. In this scenario, the current correction could turn into a bear market in coming months before turning into a bull market again later this year on expectations of a resumption of the Roaring 2020s in 2026 and beyond. In addition, later this year, investors might begin to anticipate that the Fed will start lowering interest rates early in 2026 to clean up the mess from Trump's Reign of Tariffs.

(6) *Politics.* The Stock Market Vigilantes are also losing their confidence in Trump 2.0. The risk is that they cause a bear market, resulting in a consumer-led recession as the negative wealth effect depresses consumer spending (especially by retiring Baby Boomers). This time, the Fed won't come to the rescue so quickly if inflation is heading higher again. We are hoping that the Republicans will realize that the odds are increasing that they will lose their majorities in both houses of Congress if the White House continues to pursue stagflationary trade policies.

(7) *Personal note.* Admittedly, it's getting harder to be optimistic, but we are doing the best we can under the circumstances.

Movie. "Eileen" (- - -) is a boring 2023 movie about a deranged young lady who works at a boys' corrections facility. She becomes infatuated with a new female psychologist played by Anne Hathaway. The relationship leads to a crime. Watch the first 30 minutes and the last 15 minutes. Everything in between is a waste of time. (See our movie reviews *archive*.)

Calendars

US: **Mon:** Dallas Fed Manufacturing Index -12; Chicago Purchasing Index 45.4. **Tues:** ISM M-PMI & Price Index 50.3 & 65.0; JOLTS Job Openings 7.68m; Construction Spending 0.2%. (FXStreet estimates)

Global: **Mon:** Germany CPI 0.3%; Italy CPI 0.3%; Japan Tankan Large Manufacturing Index 12; China NBS M-PMI & NM-PMI 50.5 & 50.5. **Tues:** Eurozone Headline & Core CPI

2.2% & 2.5%y/y; Eurozone, Germany & France M-PMIs 48.7, 48.7 & 48.9; UK M-PMI 48.7; Italy Unemployment Rate 6.3%; UK M-PMI 44.6; China Caixin M-PMI 51.1; Australia Retail Sales 0.3%; RBA Interest Rate Decision 4.1%; Cipollone; Greene. (FXStreet estimates)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): The US MSCI index fell 1.6% last week, behind the 1.2% drop for the AC World ex-US index, which it has trailed in nine of the past 10 weeks. The US MSCI has risen 1.1% from March 13's six-month low to 9.5% below its January 23 record high. The AC World ex-US has lagged since March 13 with a gain of 0.8%, but is just 3.5% below its June 15, 2021 record high. EMEA was the best performing region last week, with a gain of 1.0%, followed by EM (-0.9%) and the AC World ex-US. EM Latin America was the worst regional performer, with a decline of 1.8%, followed by EMU (-1.5), EAFE (-1.4), Europe (-1.3) and EM Asia (-1.2). The Australia MSCI index performed the best among country indexes last week, with a gain of 1.5%, followed by India (0.9), the UK (0.5), Mexico (-0.2), and Spain (-0.3). The Korea MSCI index was the week's worst country performer, falling 3.5%, followed by the Taiwan (-2.8), Japan (-2.6), Sweden (-2.4), and Brazil (-2.3). On a ytd basis, the US MSCI index is the second-worst country performer, with a decline of 5.3% and trails the 6.5% gain for the AC World ex-US. Among regional indexes, EMU is ahead of the pack ytd, leading with a gain of 13.8%, followed by EM Latin America (12.4), Europe (11.7), EAFE (8.4), EMEA (7.8), and the AC World ex-US. The worst performing regions so far in 2025: EM Asia (3.0) and EM (4.2). Looking at the major selected country markets that we follow, Spain is the best ytd performer, with a gain of 23.7%, followed by Germany (17.0), China (16.4), Sweden (14.6), and South Africa (14.0). The worst performing countries ytd: Taiwan (-8.9), the US (-5.3), India (-3.1), Australia (-1.0), and Canada (0.6).

US Stock Indexes (*link*): Just three of the 48 major US stock indexes that we follow rose for the week. That compares to 46 of the 48 indexes rising in the prior week, and one and none in the two weeks before that. The Dow Jones 15 Utilities index was the best performer, with a gain of 0.2%, ahead of S&P 500 LargeCap Pure Value (0.1%), Nasdaq Industrials (0.1), Dow Jones 20 Transports (-0.1), and S&P 400 MidCap Pure Value (-0.2). The S&P 500 LargeCap Pure Growth index, with a decline of 2.6%, was the worst performer, followed by Russell MidCap Growth (-2.6), Russell 1000 Growth (-2.6), Nasdaq Composite (-2.6), Russell 2000 Growth (-2.6), and S&P 500 LargeCap Growth (-2.5). Just six of the 48 indexes are still positive so far in 2025, down from 47 of 48 rising ytd in mid-February and 46 rising in 2024. The Dow Jones 15 Utilities is in the top spot as the best performer so far in 2025, with a gain of 2.7%, ahead of Russell 1000 Value (1.3), S&P 500 LargeCap Pure Value (1.3), S&P 100 Equal Weighted (1.0), and Russell 3000 Value (0.9). The worst performing major US stock indexes ytd: S&P 600 SmallCap Pure Value (-10.4), Nasdaq Industrials (-9.5), S&P 600 SmallCap Value (-9.0), Russell 1000 Growth (-8.7), Russell 3000 Growth (-8.7), and S&P 600 SmallCap Equal Weighted (-8.7).

S&P 500 Sectors Performance (*link*): Three of the 11 S&P 500 sectors rose during the week ending March 28, and nine sectors beat the S&P 500's 1.5% decline. The outperformers last week: Consumer Staples (1.6%), Energy (0.8), Real Estate (0.4), Consumer Discretionary (0.0), Financials (-0.2), Utilities (-0.2), Materials (-0.3), Health Care (-1.0), and Industrials (-1.3). The underperformers last week: Information Technology (-3.7) and Communication Services (-3.2). The S&P 500 is now down 5.1% ytd, yet eight of the 11 sectors are ahead of the index and seven are in positive territory. Energy wears the crown as the best ytd performer, with a gain of 8.1%, ahead of Health Care (5.1), Utilities (3.0), Consumer Staples (2.9), Financials (1.8), Real Estate (1.8), Materials (1.2), and Industrials (-1.7). These three sectors are lagging the S&P 500 so far in 2025: Consumer Discretionary (-13.8), Information Technology (-12.8), and Communication Services (-6.6).

US Economic Indicators

Personal Income & Consumption (*link*): Personal income in February was stronger than expected, while spending was below expectations. *Personal income* accelerated 0.8%, double consensus expectations of a 0.4% gain, and follows January's 0.7% increase. Income averaged monthly gains of 0.3% during the second half of last year. *Disposable income* increased 0.9% last month—its largest increase in a year—and follows January's 0.7% gain; this measure also posted average monthly gains of 0.3% the final six months of 2024. *Personal consumption expenditures* climbed 0.4% last month, after falling 0.3% in January—which was the first decline in nearly two years. *Goods consumption* advanced 0.9%, following January's 1.7% drop, with *durable goods* consumption rising 1.4% following January's 4.3% drop and *nondurable goods* spending rising 0.6% from January's 0.2% downtick. Meanwhile, *services* consumption ticked up 0.2%, slowing from gains of 0.4% and 0.6% the prior two months. *Adjusted for inflation*, real PCE was little changed in February, ticking up 0.1% after falling 0.6% in January. *Goods consumption* advanced 0.7% from January's 2.1% shortfall, while services consumption showed little change for the second month, ticking down 0.1% in February following January's 0.1% uptick. Within goods consumption, *durable goods* spending rose 1.0% after slumping 4.6% in January and *nondurable goods* spending increased 0.5% from January's 0.8% setback. *Personal* *saving* jumped $295.7 billion during the two months ending February to $1.02 trillion, with the *personal saving rate* jumping from 3.3% at the end of 2024 to 4.6% in February. *Turning to pricing*, Both the headline and core PCEDs were basically in line with expectations in February, climbing 0.3% and 0.4%, respectively, though inflation remains elevated. The *yearly rate* for the headline PCED remained at 2.5% y/y in February, a tick below December's 2.6%, while the core rate ticked up to 2.8% last month from 2.7% in January.

Global Economic Indicators

Eurozone Economic Sentiment Indicators (*link*): The Economic Sentiment Indexes (ESIs) for both the EU and the Eurozone fell in March, with the EU measure slipping by 0.9 points to 96.0 and the Eurozone by 1.1 points to 95.2. ESIs among the *six largest EU economies:* France (-2.1 points to 96.4) and Italy (-2.0 to 97.6) posted sizeable declines during the month, while Spain (+1.1 to 103.4) posted the biggest gain; Germany (+0.3 to 89.4) and Poland (+0.2 to 101.1) posted small upticks in their measures. *By sector*, for the overall EU, services (-2.0 to 3.7) confidence posted the largest decline, followed by retail trade (-1.8 to -5.2) and consumer (-1.0 to -13.9) confidence. Industry (+0.2 to -9.8) confidence showed a slight uptick, while construction (0.0 to -5.9) confidence held steady.

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