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Morning Briefing

On Trade & Earnings

Check out the accompanying chart collection.

Executive Summary: Today, we evaluate whether China or the US has more leverage in the trade war. China has a good hand but depends heavily on the US consumer to absorb its production. Whichever side "wins," the victory will come at the expense of global growth. … Also: Melissa summarizes the USTR's report on other countries' trade barriers that disadvantage US companies doing business abroad, with examples from China, the EU, and Canada. … And Joe notes unusual estimate revision behavior for the first weeks of a quarter: Analysts have been cutting their earnings and revenue expectations even before knowing Q1 results or getting new guidance from managements.

Global Trade I: US–China Trade War, Who Has the Leverage? There's considerable debate over whether the US or China will be able to dictate the direction of their trade war. Any definitive victory by either might be a pyrrhic one, as the complete economic decoupling of the world's two largest economies could very well plunge the global economy into a deep recession.

China has a decent hand: It is a major exporter of rare earth minerals used in high-tech production, and it controls a significant chunk of the supply chain related to US consumer and producer goods such as smartphones, solar panels, textiles, batteries, industrial machinery, etc. But the US may have the better hand: China doesn't have the consumer base to absorb all that production and also is extremely overleveraged after financing overcapacity building and poorly planned projects (the ailments of a centrally planned economy).

Ultimately, the US consumer is the endpoint for much of Chinese production. While national security is indeed an impetus for immediate change, America's "consumer of first and last resort" posture is why President Donald Trump believes that the US will not only benefit but win the ensuing trade war with China. The balance of trade, or how much China and the US import/export from each other, suggests that a trade war might not be too painful. The balance of payments, or the total trade surplus/deficit of each country, shows a much stronger relationship between China and the US.

(1) *Decoupling began years ago*. US merchandise imports from China (plus Hong Kong) peaked at $567.8 billion over the 12 months ended September 2022 and since has fallen to $452.5 billion (*Fig. 1*). Exports to China has slightly declined from a record high of $184.0 billion in April 2023; that puts the trade deficit with China at $285 billion, around the lowest in a decade. America's trading relationship with China has waned even as the overall US trade deficit has ballooned to an annual rate of $1.32 trillion and China's overall annual trade surplus has surged to $1.08 trillion (*Fig. 2* and *Fig. 3*).

The US trades more with the European Union ($976 billion in 2024), Canada ($762 billion), and Mexico ($840 billion) than with China ($582 billion). ASEAN, a bloc of ten Southeast Asian countries, accounts for another $477 billion of trade with the US. However, that stat may be obscuring actual trade between China and the US.

(2) *Perhaps the tight relationship was just rewired.* After Trump 1.0 and then the Biden administration ratcheted up tariffs and other barriers on China, it rerouted its US-bound trade through neighboring countries with better US relations. America's deficit with Vietnam, for instance, has grown from $56 billion in 2019 to $123 billion in 2024.

(3) *Balance of payments*. Bilateral trade deficits likewise don't tell the full story. For instance, China has increasingly sold goods to the EU, which has a trade deficit with China; the EU then sells to the US with which it has a trade surplus. EU exports to China have grown from only €203 billion in 2019 to €213 billion in 2023. Meanwhile, EU imports from China have increased from €385 billion to €518 billion (and reached as high as €626 billion in 2021). Moreover, the EU's surplus with the US has grown from €125 billion to €193 billion from 2019-23.

Globally, trade balances out. But ultimately, China still relies on US demand. This illustrates why China makes for a bad trading partner, which is why other countries are increasingly wary of relying on trade with China. China increasingly floods international markets with cheap goods but cannot afford to purchase foreign goods. It's not a free trading system that relies on comparative advantage.

That's the overarching issue that Trump 2.0 is looking to solve. Hopefully, the administration's methods are not all madness, and "Smoot-Hawley 2.0" does not drag us all into a depression.

Global Trade II: Dusty Trade Report Thrust in the Spotlight. Washington's trade warriors have found new inspiration in a 40-year-old annual publication. The *National Trade*

Estimate Report on Foreign Trade Barriers (a.k.a. "the *NTE*") is normally read by just policy wonks and trade lawyers. But it was showcased on President Trump's "Liberation Day" (April 2) as a blueprint for reversing America's trade deficits and reclaiming US "technological, economic, and military edge."

The administration views trade deficits as indicators of national vulnerability. The 2025 Trade Policy Agenda, released alongside the *NTE*, directs the US Trade Representative (USTR) to identify—and eliminate—foreign trade barriers that undermine the revenue potential of American exports and empower economic rivals. The administration views such trade barriers as unfair and as threats to US industrial strength and strategic independence.

At nearly 400 pages, the *NTE* is a compendium of protectionist practices around the world. It categorizes barriers to US exports across 14 industry areas—from agriculture and energy to digital services and financial regulation—and 60 key trading partners. While it contains grievances both familiar and obscure, it's clear which offending nation is most directly in the crosshairs: China.

Below, we summarize the USTR's trade concerns with China, the EU, and Canada—though we could go on and on, as the *NTE* indicts plenty of other nations too. Just perusing the report drives home the point that US trade is up against multitudinous barriers, tariff and non-tariff alike. Here are some highlights:

(1) *China strategically competes in industrial overdrive*. The *NTE*'s section on China is the report's most pointed and expansive, describing at length "state-directed distortions" from massive subsidies to sweeping digital controls.

The focal point is *Made in China 2025*, Beijing's ten-year blueprint to dominate strategic sectors like semiconductors, electric vehicles (EVs), and biotech. This policy plan increases China's support to favored industries to over $500 billion. Such scale, according to the USTR, skews global markets and sidelines foreign competition.

The Phase One trade deal, signed in 2020, was supposed to curb forced technology transfers and intellectual property theft. Yet five years on, many of the core grievances addressed by the deal remain. US companies still report pressure to localize data, still must hand over proprietary technology to the Chinese, and still have to partner with state-linked firms to gain market access.

Value-added taxes on US agricultural products create what the report calls "uncertainty and distortion." Meanwhile, selective enforcement of sanitary rules and shifting domestic standards act as regulatory minefields for American exporters.

Chinese regulators also maintain informal bans, burdensome licensing regimes, and restrictive capital thresholds that block US banks and service providers from scaling operations. China's 2024 data laws tightened government control over information flows, sparking fresh concerns about surveillance and the ability of foreign firms to compete fairly.

Finally, the issue of overcapacity looms large. China continues to flood global markets with subsidized steel, aluminum, solar panels, and—more recently—EVs and lithium-ion batteries. The result is persistent price depression and what the USTR calls "non-market excess capacity" that injures US industries and fragments global supply chains.

(2) *European Union regulates for a competitive edge*. Even among allies, frictions persist. The EU's average tariff on agricultural goods was 10.8% in 2023—modest by historical standards but still a sticking point. Passenger vehicles face a 10% duty; trucks, a steeper 22%.

But the EU's trade barriers aren't all tariffs. Many "technical barriers to trade" that the *NTE* cites stem from the EU's regulatory processes. US officials argue that Brussels often adopts rules without sufficient transparency or foreign stakeholder input, locking in standards that implicitly favor European producers.

A prime example: The EU insists on recognizing standards only from a select group of standards-setting bodies, none US-based. This de facto exclusion limits American firms' ability to certify products for European markets.

Sustainability requirements under the European Green Deal are also under scrutiny. The USTR contends that these rules inappropriately reclassify food safety standards to achieve environmental goals, effectively creating green barriers to trade.

Meanwhile, the regulatory perimeter continues to expand into digital territory. The Digital Services Act, Digital Markets Act, and the EU's nascent Artificial Intelligence Act have introduced new layers of compliance for US tech giants. While billed as consumer protections, the rules disproportionately impact non-EU firms, argues Washington—raising questions about competitive neutrality in the digital single market.

(3) *Canada is a friendly fortress***.** The US–Canada trading relationship is one of the world's

most integrated, but that hasn't dulled the edges of economic friction. The *NTE* highlights several "non-market" barriers in the Canadian system, particularly in agriculture and energy.

Take dairy: US exporters hoping to break through Canada's tariff-rate quotas face border taxes of 245% on cheese and nearly 300% on butter. The country's dairy and poultry supply management systems are structurally designed to cap imports and inflate domestic prices.

Bulk imports of fresh produce are also constrained, unless importers clear regulatory hurdles proving domestic supply shortfalls. Liquor sales are dominated by provincial monopolies—more roadblocks for US producers.

Then there's energy. US power producers face an uneven playing field, they argue, as Canadian operators prioritize domestic electricity sources even when American alternatives are price competitive.

And in agriculture inputs, the Seeds Act effectively bars unregistered US seed varieties from entering the market unless approved by and registered with Canada's Food Inspection Agency. That registration process is both lengthy and restrictive.

Strategy: Forward Earnings Peaking? Each week, we track consensus earnings expectations for the S&P 500 LargeCap, S&P 400 MidCap, and S&P 600 SmallCap indexes. During the week ended April 11, forward earnings fell simultaneously for all three indexes, toppling off record highs for LargeCap and MidCap. That's not normal: Typically, analysts stick with their estimates during a quarter's first weeks, awaiting guidance from the companies they follow. So we think the April 4 week may have marked the three indexes' forward earnings peak.

Let's take a look at what's been happening:

(1) *The forward earnings bull market has been a narrow one.* Through its peak a week earlier on April 4, LargeCap's forward earnings had soared 23.6%, to a record high, from its low 54 weeks prior (during the week of February 1, 2023) (*Fig. 4*). MidCap's rose to a record high too the April 4 week, but to just 9.2% above its 55-week low (March 10, 2023 week). SmallCap's forward earnings likewise rose but considerably less so, up just 1.3% from its 72-week low (March 17, 2023 week).

While LargeCap's forward earnings have hit new record highs steadily since September 2023, MidCap's didn't do so until mid-March. That was the first time they reached a record high since June 2022. SmallCap's earnings recovery never got off the ground; its forward earnings is languishing 12.5% below its last record high, in June 2022.

(2) *Pre-tariff results may matter more than usual.* In normal times, investors don't focus on past results as much as future expectations. But Q1-2025 may be an exception, as its "tariff-free" results will serve as a baseline from which to gauge how much a company's profitability is impacted by tariffs in subsequent quarters.

However, tariff anticipation generates impacts too, for some industries more than others. The S&P 500 Financials sector isn't directly impacted by tariffs, but banks eyeing emerging credit quality trends are firing warning shots about future earnings. JPMorgan pivoted during Q1 by increasing its reserves for future losses. That raises the possibility of more cockroaches in the Financials' sector.

(3) *Future quarterly forecasts have been falling earlier than usual.* Although the Q1 earnings reporting season is still less than 10% complete, some analysts are not waiting to hear the results before cutting estimates for future quarters. They're not likely to get much guidance anyway in these uncertain times. As a result, the S&P 500's Q2-2025 revenues forecast has dropped 0.2% since the March 31 week (*Fig. 5*).

Among the 11 S&P 500 sectors, Utilities leads with its Q2 revenues forecast rising 0.7%, slightly ahead of Materials' 0.5% gain. Among the six decliners, Energy's Q2 revenue forecast has dropped 0.7%, followed by 0.5% declines for Industrials and Consumer Discretionary.

Analysts took a bigger hatchet to Q2 earnings forecasts. Since the March 31 week, the aggregate earnings estimate for the S&P 500 companies has fallen 1.0%, steeper than the 0.2% revenues decline (*Fig. 6*). Only two sectors' Q2 earnings estimates rose: Materials and Utilities, by 1.1% and 0.3%, while forecasts were shaved the most for Energy (-3.3%) and Industrials (-2.4).

(4) *Quarterly growth and profit margin forecasts are falling now too.* Analysts now expect revenues growth of 4.1% y/y for the S&P 500 in Q2, flat with the current Q1 estimate (*Fig. 7*). That compares with 4.7% at the year's start. For the back half of 2025, analysts think revenues growth will accelerate to 4.8% in Q3 and 5.6% in Q4—but both forecasts have tumbled about 1 ppt since the year began.

On a proforma same-company basis, analysts think S&P 500 earnings will now rise 9.2%

y/y in Q2, down from around 12% at the year's start and above Q1's current forecast of 8.0%, which we think will be 11% by the end of the earnings reporting season (*Fig. 8*). After dipping into single-digit y/y earnings growth in Q2, analysts expect a return to double-digit growth in Q3 (11.5%) and Q4 (10.0%).

As earnings fall faster than revenues, the implied profit margin falls. Analysts currently expect the S&P 500's profit margin to rise to 13.3% in Q2, down from the 13.7% forecasted when the year began and above the current Q1 forecast of 12.8% (*Fig. 9*). We think Q1's margin will be 13.3% by the end of the reporting season and that Q2's forecast will fall below Q1's.

Calendars

US: Wed: Headline & Core Retail Sales 1.4% & 0.4%; Industrial Production -0.2%; Capacity Utilization 78.0%; Business Inventories 0.3%; NAHB Housing Market Index 38; Powell; Schmid; Hammack. **Thurs:** Housing Starts & Building Permits 1.42mu & 1.45mu; Initial Claims 225k; Philadelphia Fed Manufacturing Index 3.1; Atlanta GDPNow; Barr. (FXStreet estimates)

Global: Wed: Eurozone Final Headline & Core CPI 2.2% & 2.4%; UK Headline & Core CPI 2.7% & 3.4%y/y; BoC Press Conference. **Thurs:** ECB Interest Rate Decision & Deposit Facility Rate 2.40% & 2.25%; Germany PPI -0.1%; Germany Buba Monthly report; BoE Credit Conditions; Japan CPI. (FXStreet estimates)

US Economic Indicators

Regional M-PMI (*link*): The New York Fed, the first regional Fed bank to report on manufacturing activity for April, showed it continued to contract, though at a slower rate. The *headline general business conditions* rose 11.9 points (to -8.1 from -20.0), better than the consensus estimate of -14.5, with both the *new orders* (-8.8 from -14.9) and *shipments* (-2.9 from -8.5) measures rising 6.1 points and 5.6 points, respectively—the latter to close to expansion territory. Meanwhile, *delivery times* (0.0 from 1.0) held steady, while *supply availability* (-5.7 from -1.0) deteriorated. *Inventories* (7.4 from 13.3) continued to accumulate, though at a slower pace. Turning to the *labor market*, conditions showed *employment* (-2.6 from -4.1) moving closer to the breakeven point of 50.0, while the average workweek (-9.1 from -2.5) moved lower. *As for pricing*, both the *prices-paid* (50.8 from 44.9) and *prices-received* (28.7 from 22.4) measures climbed for the fourth successive month to their highest levels in more than two years. *Looking ahead*, firms are growing less optimistic about the outlook, with *general business conditions* (-7.4 from 12.7) sinking 20.1 points. The report noted: "[T]his level of pessimism has occurred only a handful of times in the history of the survey." Capital spending plans were flat, while input and selling price increases are expected to pick up, and supply availability is expected to deteriorate over the next six months.

Import Prices (*link*): Import prices fell in March for the first time since September (-0.4%), as lower prices for fuel imports more than offset higher prices for nonfuel imports. *Import prices* dipped 0.1% last month—slightly below the consensus estimate of unchanged—following February's downwardly revised 0.2% gain. Import prices were 0.9% above a year ago, down from its recent peak of 2.2% at the end of last year. *Imported fuel prices* fell 2.3% in March—led by lower prices for petroleum and natural gas—following gains of 1.6% and 2.7% the prior two months, while *food* prices ticked up 0.1% after no change in February. *Excluding fuels and food*, import prices edged up 0.1% for a second successive month and increased 1.1% versus a year ago. Prices for imported *capital goods* climbed 0.3% following February's 0.1% shortfall, while prices for imported *vehicles, parts & engines* slipped 0.1%. *Consumer goods ex autos* dipped 0.2% during the month.

Global Economic Indicators

Eurozone Industrial Production (*link*): Eurozone industrial production was a surprise on the upside for the second straight month in February, climbing to the highest level since December 2023, though is still only slightly above the sluggish activity levels experienced last year. February's gain was not broad-based: *consumer nondurable goods* production posted the largest gain, climbing two of the past three months, by 2.8% in February and 6.5% over the period, following a two-month slide of 2.7%, while *capital goods* production posted its first gain since November, advancing 0.8% following no growth in January and a 1.9% drop in December. *Intermediate goods* production edged up 0.3% following January's 1.4% rebound from December's 1.6% shortfall. Meanwhile, *energy* output contracted for the second month, by 0.2% m/m and 1.3% over the period, following gains of 1.4% and 2.0% during December and November, respectively. *Consumer durable goods* output also fell for the second month, by 0.3% in February and 1.8% over the period, after climbing 2.5% during the final two months of 2024. *Compared to a year ago*, *total production* rose 1.2%, following a string of negative readings, led by a 9.7% surge in consumer nondurable goods production, while energy output was up 1.4% over the 12-month period. Meanwhile, production of intermediate goods (-2.7% y/y), consumer durable goods (-2.3), and capital goods (-1.8) were all below year-ago levels. Looking at the *largest Eurozone economies*, data are available for the top four economies and show production in Spain (0.9% m/m & -1.7 y/y) and France (0.7 & -0.3) posted gains during the month, with France production nearly flat with the year-ago level. Meanwhile, Germany (-0.9 & -3.7) and Italy (-0.9 & -2.7) both posted declines on both a monthly and yearly basis.

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