Yardeni Research

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Morning Briefing

On The Dollar,
The Debt & Earnings

Check out the accompanying chart collection.

Executive Summary: Investors can dismiss worries that the US dollar's weakness presages an emerging-market-style crisis. That's impossible for the US. Foreign investors need dollars to invest in US assets, which retain their clear advantage in attracting investment capital. We attribute the recent dollar weakness to the strong euro and devaluation of high-P/E Mag-7 stocks, which foreign investors shed amid Trump Tariff Turmoil. … Also: Melissa discusses expectations for the House's tax reconciliation package that should stop Trump 1.0's tax cuts from expiring this year—which won't come cheap. … And: Joe reports that tariff-related uncertainties are reflected in analysts' estimate revisions, skewed uncharacteristically downward despite strong Q1s.

Foreign Exchange: Dollar Down, Not Out. Dollar dominance is something that provides the US with a lot of privilege, and investors are worried that Trump 2.0's weaponization of that dominance will lead to its downfall. The US Dollar Index (DXY) is down 8.7% ytd, a stark decline for a G10 currency over just a few months (*Fig. 1*). Coalescing with higher long-term bond yields (lower bond prices) and stocks falling into correction territory, the US has shown symptoms of an emerging-market-style crisis.

An EM-like downward spiral is, for all intents and purposes, impossible for the US. That's because of the government's unlimited ability to print dollars and the generally unlimited demand for them and related assets (even if printing Treasuries would come at a slightly higher cost, or yield, to the government).

But this could very well be the early innings of a secular decline for the dollar. Trump 2.0's policies seem to prefer that course: Decoupling from the global trading system and reducing America's trade deficit would leave foreigners with fewer dollars to invest in dollar assets. Many investors haven't needed to hedge their US assets against foreign exchange (FX) movements because the dollar has climbed. Dual losses on dollar assets plus the dollar are a double whammy for foreign investors. And a relatively high federal funds rate (FFR) means hedging FX exposure is costly (*Fig. 2*).

To boot, the federal government's budget deficits seem on course to continue growing. So perhaps the dollar's reserve currency status will erode. Perhaps the US will mirror the post-Brexit UK: Over the past decade, the British pound has weakened, gilt yields have become relatively prohibitive for domestic financing, assets have underperformed, economic growth is slower, and inflation isn't tamed.

That's of course all possible, but we aren't counting the dollar out after its latest fall. Consider an alternative perspective:

(1) *Up, up, and away*. The DXY remains on an upward trend that started around 2010, when America's recovery from the Great Financial Crisis (GFC) outpaced other major economies' (*Fig. 3*). That case was clear once more following the pandemic, as much stronger productivity growth has helped US assets soar past comparative markets. US capital markets have a clear advantage in attracting capital, which will not change anytime soon.

(2) *European Rennaissance 2.0.* The euro makes up 57.6% of the DXY, followed by the yen (13.6%) and the British pound (11.9%). So the DXY is basically the EUR/USD. The trade-weighted US dollar index compiled by the Fed, meanwhile, is much broader. It's only down by 4.8% ytd, and it's also been on a steeper upward trend than the DXY since the GFC (*Fig. 4*). The Fed also breaks down its dollar index versus currencies of advanced economies and emerging market ones, which shows stark gains against EM currencies and ups and downs against advanced ones (*Fig. 5*). In essence, most of the current decline in the dollar is due to a strengthening euro, which is up more than 10% against the dollar this year (*Fig. 6*).

(3) *Mag-7 problem*. We chalk up the current dollar weakness to the selloff in the Magnificent-7 stocks (*Fig. 7*). Foreign investors plowed a record $475.0 billion into the US stock market over the 12 months through February (*Fig. 8*). Trump Tariff Turmoil (TTT) amid sky-high valuations—plus signs that European policymakers are finally willing to spend—encouraged foreigners to flee US stocks and the Mag-7. Since the start of the year, the Mag-7 have been revalued from a 30.0 forward P/E to 24.6 (after a drop to 21.7 in early April) (*Fig. 9*).

We believe the strength in the euro is a key reason for the dollar's decline. But we aren't sure it's sustainable. The European Central Bank is on course to continue lowering interest rates to combat TTT, while stagflation may keep the Federal Reserve on pause (*Fig. 10*). European economies are more dependent on exporters for growth, and they would suffer if the euro continued to climb.

US Fiscal Policy I: Preventing the Unthinkable. We're not enthused by the House GOP's forthcoming tax reconciliation package because it isn't a tax cut but an anticipated extension of existing tax breaks that will add to the US federal deficit. On the table are extensions of several provisions from Trump 1.0's Tax Cuts and Jobs Act (TCJA), many of which are set to expire at the end of 2025. The financial markets seem to assume that the most beneficial TCJA tax provisions won't expire. If they do, it could hit sentiment and stocks hard. Pay-fors could sting, too—especially for consumers and investors.

We don't expect any changes to the corporate tax rate. The TCJA set the rate permanently at a historically low 21.0%. Prior to that change, it had been as high as 35% for companies at the top end of a graduated structure. That said, any and all tax legislation technically is on the table.

Extending these TCJA provisions won't come cheap. The Joint Committee on Taxation *pegs* the cost at roughly $4.5 trillion. That could mean that reductions in federal programs such as SNAP and Medicaid could be coming—a politically fraught proposition, even among GOP hardliners. Many represent districts with heavy concentrations of these programs' beneficiaries. Meanwhile, President Trump is toying with the idea of a millionaire's tax, *The Hill* reported Monday.

Still, the President's Council of Economic Advisors (CEA) backed the extension of Trump-era tax cuts in an April *report*, stating: "The TCJA's extension will also prevent the unthinkable consequence of a more than $4 trillion tax hike on Americans."

Here's a closer look at the current tax policy landscape:

(1) *Countdown to Memorial Day*. Our friend Jim Lucier of *Capital Alpha Partners* recently offered insight into the House GOP's reconciliation timeline. He expects the bill to move before Memorial Day. The long-awaited Joint Committee on Taxation's macro and revenue estimates may arrive before the Ways and Means Committee begins markup—tentatively around Thursday, May 15.

The Rules Committee could clear the bill on Tuesday, May 20, with a full House vote expected by Thursday, May 22. Given the tight vote margins, Republicans are unlikely to let the measure hang before recess. A delay past Memorial Day would likely push action to just ahead of the July 4 break.

(2) *Slim margin to pass*. On April 10, the House narrowly passed, by a 216–214 vote, the fiscal 2025 budget resolution as amended and passed by the Senate. Budget resolutions set spending and revenue priorities and open the door for reconciliation bills to pass in the Senate with a simple majority. (For more on the process, see *here*.)

(3) *Dependent on spending cuts*. The budget resolution allows for a net deficit increase of at least $2 trillion over 10 years. Included in the budget, the Ways and Means Committee is given a $4.5 trillion reconciliation instruction to extend and expand the TCJA. However, this instruction is contingent upon other committees' identifying at least $2 trillion in mandatory spending cuts. If these spending cuts fall short, the Ways and Means instruction is reduced accordingly, *explained* the Bipartisan Policy Center on April 10.

(4) *Sunsetting TCJA provisions*. A number of taxpayer-friendly provisions from the TCJA will sunset in 2025 unless extended. These include: lower individual marginal tax rates; nearly doubled standard deduction; doubled unified estate and gift tax exemption; expanded child tax credit; and a 20% qualified business income deduction (a.k.a. QIBD) for pass-through entities, or PTEs, which primarily benefit small businesses. Also expiring: provisions meant to offset those benefits, such as the state and local taxes cap, limitations on excess business losses, and restrictions on net operating losses. (For more, see the Congressional Research Service's reference *table*.)

(5) *Promoting real GDP*. According to the President's CEA, extending the TCJA—along with other Trump-era policies like deregulation—would boost real GDP growth to 3.0% annually over the next decade.

While that's not exactly a growth bonanza, the alternative—letting the TCJA expire—might carry untenable public sentiment risks. That said, concerns about the sustainability of the federal deficit remain front and center.

US Fiscal Policy II: Getting Out of DOGE. The Federal Reserve's latest financial stability *report*, released Friday, reaffirmed growing concerns around US fiscal policy—particularly the trajectory of federal debt. Market participants remain uneasy, with debt sustainability now seen as a top financial risk, surpassing even inflation and geopolitical instability.

Rising deficits, upward pressure on Treasury yields, and limited policy traction all add up to a troubling fiscal picture. If yields continue climbing, equity markets could face downside pressure, as higher financing costs eat into corporate profits and slow earnings growth. Meanwhile, a rising debt burden would constrain future fiscal policy flexibility in the event of economic shocks.

Despite measures such as the creation of the Department of Government Efficiency (DOGE), structural obstacles to fiscal sustainability remain entrenched. Here's more:

(1) *Debt sustainability*. In the Fed' s latest survey, around 50% of respondents cited US fiscal sustainability as the most pressing risk to the financial system—only slightly down from 54% six months ago. Concerns center on the risk of government borrowing crowding out private investment and reducing headroom for stimulus in future downturns.

(2) *DOGE dead-on-arrival*. DOGE was set up to streamline federal spending and root out inefficiencies in government. So far, its impact has been limited. According to a recent *article* in *Business Insider*, initial projections suggested that DOGE would yield $2 trillion in savings within an elusive timeframe. In reality, it appears the actual savings are closer to $150 billion for 2026. Critics say real deficit reduction won't happen without tackling the politically sensitive heavyweights: defense, Medicare, and Medicaid.

Social Security is not up for cuts. According to a *Newsweek* *report*: "US law prohibits Congress from passing a reconciliation bill that contains recommendations to change programs under the Social Security Act."

As for Elon Musk's cameo at DOGE? It's wrapping up. Musk is expected to step back from his role in early June.

Strategy: Strong Q1 Surprises Aren't Lifting Analysts' Future Sights. With the S&P 500's Q1 earnings reporting season 44% complete through midday Tuesday, the results are better than expected. Aggregating the results of the S&P 500 sectors' reporting companies to date shows that nearly all 11 sectors beat analysts' consensus expectations on both top and bottom lines (*Fig. 11* and *Fig. 12*).

However, these strong results have been totally overshadowed by the uncertainty over tariffs. The unclear future has left corporate managements with little to offer analysts in the way of guidance, so analysts have been cutting estimates for upcoming quarters rather than raising them as one would expect after surprisingly good earnings reports. To better track and analyze the rapidly changing quarterly consensus expectations for the 11 sectors, Joe recently created a weekly publication titled *S&P 500 Sectors Quarterly Revenues/Earnings/Margins (REM)*.

Here's his compilation of the data on how analysts have been adjusting their Q2 revenues and earnings expectations for the various S&P 500 sectors and the S&P 500 itself:

(1) *Q2 revenues revisions lag for just four sectors.* While the S&P 500's Q2-2025 revenues forecast has dropped 0.6% in the four weeks since the March 31 week, just four of the 11 sectors are lagging the index (*Fig. 13*). Among the seven outperforming sectors, Utilities leads with its Q2 revenues forecast rising 0.3%, slightly ahead of the 0.1% gains for Health Care and Materials. Communication Services (-0.5%) and Information Technology (-0.4) were also ahead of the S&P 500's Q2 revenue forecast decline.

Among the worst performers, Energy's Q2 revenue forecast has tumbled 3.3%, followed by declines for the Consumer Discretionary (-1.1%), Industrials (-1.0), and Financials (-0.7) sectors.

(2) *Same four sectors lag on earnings too.* Analysts took a bigger hatchet to Q2 earnings forecasts than they did to Q2 revenues, with all 11 sectors posting declines since the March 31 week (*Fig. 14*). The aggregate earnings estimate for the S&P 500 companies has fallen 2.7%, steeper than the 0.6% revenues decline.

Q2 earnings estimates have dropped the least so far for the Materials (-0.2%) and Utilities (-0.3) sectors. Not coincidentally, the four sectors with the worst Q2 revenue forecast declines are also the worst in terms of Q2 earnings. Among them, Energy's Q2 earnings forecast has tumbled 12.4%, markedly worse than the declines for the Consumer Discretionary (-4.6), Industrials (-4.1), and Financials (-2.8) sectors.

(3) *Quarterly growth forecasts falling faster now.* Analysts now expect Q2 revenues growth of 3.6% y/y for the S&P 500, the slowest rate of the year (*Fig. 15*). That's down from their 4.7% forecast for Q2 growth at the year's start. For the back half of 2025, analysts think revenues growth will accelerate to 4.3% in Q3 and 5.0% in Q4—but both forecasts have tumbled about 1.5ppts since the year began.

On a proforma same-company basis, analysts now think S&P 500 earnings will rise 7.3% y/y in Q2, down from around 12% at the year's start and below Q1's current blended forecast of 9.7% (*Fig. 16*). Analysts are now forecasting single-digit percentage earnings gains in H2-2025, and their estimates have been on a declining trajectory that hasn't stabilized yet.

(4) *Quarterly profit margin forecasts edging lower too*. As earnings forecasts fall faster than

revenues, the implied profit margin falls (we calculate analysts' margin expectations from their consensus earnings and revenues forecasts). Analysts currently expect the S&P 500's profit margin to rise to 13.2% in Q2, down from the 13.7% forecasted when the year began and above the current Q1 forecast of 12.9% (*Fig. 17*). We still think that Q1's profit 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: Real GDP & GDP Price Index 0.4% & 4.1%; Personal Income & Spending 0.4% & 0.6%; PCED 0.0%m/m, 2.2%y/y; ADP Employment Change 108k; Employment Cost index 0.0%; MBA Mortgage Applications; Chicago PMI 45.9; Pending Home Sales -0.3%. **Thurs:** ISM M-PMI 48.0 & Price Index 70.2; Construction Spending 0.2%; Jobless Claims 225k; Continuing Jobless Claims 1.86m; Fed Balance Sheet. (FXStreet estimates)

Global: Wed: Eurozone GDP 0.2%q/q, 1.0%y/y; Germany GDP 0.2%q/q, -0.2%y/y; Germany 6.3%; GDP Retail Sales -0.4%; Germany Import Prices -0.7%; France CPI 0.3%m/m, 0.8%y/y; France GDP 0.2%; Italy GDP 0.2%q/q, 1.0%y/y; Italy CPI 0.2%m/m, 2.3%y/y; China NBS M-MI & NM-PMI 49.9 & 50.7; Montagner. **Thurs:** UK M-PMI 44.0; Japan Consumer Confidence 34.0; Japan Unemployment Rate 2.4%. (FXStreet estimates)

US Economic Indicators

Consumer Confidence (*link*): Consumer confidence fell for the fifth consecutive month in April, sinking to its lowest level in nearly five years. *Headline consumer confidence* sank 7.9 points in April and 26.8 points (to 86.0 from 112.8 in November) over the five-month period, with the *expectations* component plunging 39.3 points (to 54.4 from 93.7) and the *current conditions* component falling 7.9 points (133.5 from 141.4) over the comparable five-month period. The *expectations* component sank to its lowest level since October 2011, and was well below the threshold of 80 that usually signals a recession ahead. Of the five components of the index, only consumers' assessment of *current business conditions* were more positive in April, with 19.2% stating business conditions were good, up from March's 18.3%, while 16.1% said conditions were bad, down from 16.5% last month. *Consumers' assessment of present labor conditions* weakened this month, with 31.7% of consumers saying jobs were plentiful, down from 33.6% in March and 16.6% of consumers saying jobs were hard to get, up from 16.1% in March. Consumers' assessment of the *short-term labor* *market* deteriorated this month, with 32.1% of consumers anticipating fewer jobs, up from 28.8% during March, while only 13.7% expected more jobs to be available, down from 16.7% last month. Their outlook for *short-term business conditions* six months from now also deteriorated, with only 15.7% expecting conditions to improve, lower than March's 17.8%, while 34.8% expected conditions to worsen, up from 26.1% last month. Consumers were less optimistic about their *income prospects* this month, with 15.0% expecting their incomes to increase, down from 17.1% last month, while 18.2% expected their incomes to decrease, up from 14.9% last month. As for *inflation expectations*, the 12-month expected inflation rate jumped to 7% in April—the highest since November 2022, when the US was experiencing extremely high inflation. *Write-in responses* showed that tariffs were the top concern for consumers this month, reaching an all-time high, while inflation and high prices were also a major worry.

JOLTS (*link*): Job openings fell more than expected in March, sinking to a six-month low and near levels not seen since December 2020 (6.8 million). *Job openings* dropped 288,000 last month to 7.19 million (vs consensus estimate of 7.5 million), down from 7.48 million in February and 7.76 in January. *By industry*, March's decline was widespread, with the largest declines occurring in transportation, warehousing, and utilities (-59,000), accommodation & food services (-42,000), real estate and rental and leasing (-39,000), construction (-38,000), health care & social assistance (37,000), and federal government (-36,000). Meanwhile, job openings increased in finance & insurance (25,000), other services (20,000), state & local education (17,000), wholesale trade (10,000), and manufacturing (4,000). *Regionally*, job openings fell in the Northeast (-180,000), the West (-76,000), and the South (-69,000) and rose in the Midwest (36,000). There were 1.1 *available jobs for each unemployed* person; this ratio was at a recent high of 2.0 during July 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 increased recently, climbing to a six-month high of 3.33 million in March, after falling from a recent peak of 4.46 million during spring 2022 to a recent low of 3.03 million during November 2024.

Global Economic Indicators

Eurozone Economic Sentiment Indicators (*link*): The Economic Sentiment Indexes (ESIs) for both the EU and the Eurozone fell again in April, with both slipping by 1.4 points to 94.4 and 93.6, respectively. ESIs among the *six largest EU economies* declined in the Netherlands (-2.5 points to 97.7) and Italy (-1.8 to 95.6), while Germany (+0.5 to 89.9), Spain (+0.4 to 103.8), and France (+0.2 to 96.4) posted slight gains; Poland's ESI was unchanged at 101.0. *By sector*, for the overall EU, consumer (-2.1 points to -16.0) confidence posted the largest decline, followed by retail trade (-1.7 to –7.1), services (-1.0 point to 2.3), and industry (-0.3 to -10.1) confidence, while construction (0.0 to 6.0) confidence held steady.

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