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Morning Briefing

China's Autos, Russia's Gas & US Earnings Review

Check out the accompanying chart collection.

Executive Summary: Chinese automaker BYD's rapid cornering of the global EV market is shifting into high gear with a 34% price cut. That's bound to present tough choices for automakers everywhere. The situation is mirrored on the economic level, William observes, as China continues to export deflation to other countries. … Also: Melissa examines who's funding Putin's war. It's not the Russian taxpayer but international actors including the EU, which is funneling more money to Russia via gas imports than to Ukraine in aid. … And: Joe observes that fewer S&P 500 sectors are projected to grow earnings in Q2 than in recent quarters.

Weekly Webcast. If you missed Tuesday's live webcast, you can view a replay *here*.

Chinese Autos I: Deflation Hits. China's deflation drama just kicked into higher gear as the nation's hottest electric vehicle (EV) makers launch a price war sure to reverberate globally. The first shot came from Shenzhen-based giant BYD, EV market disruptor extraordinaire.

In 2024, BYD's global revenues *rose 29%*, *beating* Tesla, despite having been building EVs only since *2009* and only in the Netherland and Norway until *late 2022*. "Enormous" is what auto research firm JATO Dynamics has called the implications of that feat.

Now, fresh off making 2024 a year Elon Musk would like to forget, BYD has unveiled sweeping *price cuts* of up to 34%. The move was quickly *followed by rivals* Geely Automobile and Zhejiang Leapmotor. Even faster, though, it has provoked a vocal backlash unprecedented in Chinese political and business circles: The Communist Party has accused BYD founder Wang Chuan-Fu of "rat-race competition"—which long had been China Inc.'s *raison d'être*—and Great Wall Motor Chairman Wei Jianjun says BYD might have precipitated the auto industry's "*Evergrande moment*," China's version of the *Lehman moment*.

Looked at dispassionately, BYD's sharp price downshift is a microcosm of both China's deflation troubles and the ways its EVs are coming for auto giants everywhere—from Tesla to Toyota to Volkswagen to Hyundai.

Chinese Autos II: Europe's Rough Year. The European piece of this tale is particularly jarring. In April alone, BYD's Europe volumes surged *359% y/y* despite European Union (EU) tariffs as high as *45.3%* on made-in-China battery EVs. JATO Dynamics, which compiled these figures, calls it a "watershed moment" for China upending Europe.

Consider the following:

(1) *EV price war*. BYD could wreck Europe's 2025. German behemoths Volkswagen, Mercedes, and BMW are already watching BYD hoover up sales. As tariffs fail to slow China Inc., Europe's EV makers face an unpalatable choice between cutting prices aggressively or ceding more market share.

In China, this could be the beginning of the end for many of smaller EV startups. At the start of the year, there were roughly *100 mainland brands*. It's not clear how many of them can survive BYD's advantage in price, scale, quality, and association with Warren Buffett. His Berkshire Hathaway began investing in BYD *in 2008*. And what a bet it turned out to be—at least for now.

(2) *Economic parallels*. Yet the reason that BYD is pushing back so hard against the Evergrande jab is that many worry about the EV giant's *70% asset-liability ratio*. It carries more than 580 billion yuan ($80 billion) of debt. BYD counters that Apple, Boeing, Ford, and General Motors all carry comparable ratios.

Then again, those companies are unlikely to be targeted by US President Donald Trump's next wave of tariffs as BYD might be. The President's claim that Beijing "violated "the US-China trade truce could be a harbinger of new import taxes. Already, Trump's *25% auto tax* is hitting legacy giants and startups alike—and fanning auto industry deflation risks. Not to be forgotten: The EU might up import taxes, too.

(3) *Reflation woes*. Morgan Stanley's Robin Xing notes that the latest car price competition underscores how the supply-demand imbalance continues to fuel deflation." Thus, he notes, "reflation is likely to remain elusive."

These are not unlike the challenges facing China's broader *$18 trillion economy*. Chinese leader Xi Jinping is grappling with a supply-demand imbalance driven by households' saving far more than they spend. This has China Inc. venturing overseas with even greater gusto and urgency, sharing the nation's deflation with a world economy that could do without it.

Geopolitics: Who Is Funding Putin's War? Ukraine's weekend drone strike on Russian military assets is unlikely to shift the trajectory of the war, in our view. Still, the scale was striking: 117 Ukrainian drones targeted deep inside Russian territory, destroying an estimated $7 billion worth of bombers, radar aircraft, and other strategic assets.

Some observers see the strike as a symbolic blow to Russian President Vladimir Putin's war narrative. For now, he won't get what he wants: Ukraine won't forswear seeking NATO membership nor will it recognize Russia's claim to the 20% of occupied Ukrainian territory.

But Putin is unlikely to back down—he'll continue pursuing his aims on the battlefield as long as he has the means. Ukrainian President Volodymyr Zelenskyy remains equally committed to defending Ukraine's sovereignty. The most probable outcome remains a grinding stalemate.

But if you want to know how this might ultimately end, follow the money. This is already a global conflict, bankrolled—directly and indirectly—by international actors. China, India, and Turkey have become key energy importing lifelines for the Kremlin, especially as EU purchases of Russian gas has declined. These countries are unlikely to change course anytime soon without being forced to do so.

That's why an EU halt would still matter. It wouldn't stop the war overnight, but it would cause Russia to feel the pain of finally losing Western financial support. Since Russia invaded Ukraine in 2022, the EU has been slow to completely disengage from Russian fossil fuels, aiming to do so completely by 2027. Officials fear that pulling out too quickly could trigger another energy crisis—escalating into another regional recession, or worse, a direct military attack from a desperate Putin.

But if the US Senate moves forward with a Trump-backed plan to impose *secondary tariffs* on countries buying Russian energy, the EU and the other Russian energy importers may have no choice but to act sooner. That could bring the war to a close—but also end the era of cheap energy in Europe.

Consider the following:

(1) *Brussels fuels both fronts*. Despite sanctions, speeches, and summits, the EU remains a top financier of Russia's war effort. Since February 2022, EU countries have *purchased* an estimated €209 billion in Russian fossil fuels—roughly 25% of all Russian energy exports. That sum overshadows the EU's military and economic aid to Ukraine of €147.9 billion, *according* to the European Commission, as *The Week* recently *observed*.

This isn't just an accounting glitch—it's a geopolitical contradiction. Russia's economy, heavily dependent on export revenues, continues to hum along. Moscow reported real GDP growth of 4.3% in 2024, up from 3.6% in 2023, reflecting the performance of a war economy that's still getting paid despite global sanctions.

True, the gains are driven almost entirely by surging defense spending, not private-sector vitality. But Putin isn't managing an economy; he's financing a war machine. Lowering the central bank's 20%-plus interest rate isn't on Putin's priority list. So long as oil and arms are flowing, the Kremlin seems content to trade household stability for battlefield leverage.

(2) *Brussels strategic ambitions with tactical limitations*. The EU's May 2022 REPowerEU *initiative* aimed to slash Russian energy imports. Officials pointed to a drop in Russian gas dependence as proof of success. But a backslide has begun.

The bloc is no longer the second-largest financier of Moscow's fossil fuel revenues. It's now in fourth position behind China, India, and Turkey. But according to CREA's Russian Fossil Tracker, the EU still hasn't closed the spigot entirely. As of May 2025, the EU still ranks as the fourth-largest buyer of Russian fossil fuels.

While the EU has banned Russian coal and seaborne crude oil, Russian liquid natural gas (LNG) still flows into Turkey via Gazprom's TurkStream pipeline. Its May 2025 volumes rose *10.3% m/m* and were just shy of May 2024's flow. Russian LNG accounted for nearly 20% of EU LNG imports as of spring 2024, up from 11% in late 2022, *reported* *Clean Energy Wire*. Russian LNG volumes rebounded more than 30% from their September 2022 lows.

Why the reversal from the 2022 resolve to break energy ties with Russia? Infrastructure constraints, cost concerns, and a mild winter dulled the urgency of energy diversification. Some member states, including Hungary and Slovakia, are walking back plans to pivot away from Russian supplies.

(3) *Washington's big stick—500% sanctions?* A bipartisan bill in the US Senate *proposes* a 500% tariff on any nation that continues to purchase Russian fossil fuels, including uranium

and petrochemical imports. For now, the bill remains in limbo. Trump has yet to officially endorse the bill, but he has backed secondary tariffs on Russian energy importers. If enacted, it would force the EU (and other Russian energy importers) to choose cheap Russian energy or access US markets.

(4) *Peace talks are nothing but Putin's delay tactic*. We view Putin's engagement in the ongoing peace talks—with the US mediating—as a delay tactic. Moscow is buying time to consolidate control over more Ukrainian territory and uninterested in a peace agreement.

Between February and June, diplomatic efforts floundered amid entrenched disputes over territory and sovereignty, NPR's *timeline* shows. US proposals were rejected by both sides. The war escalated, with Russia launching its largest drone strike in May and Ukraine rejecting any recognition of Crimea's annexation. Political flashpoints—including Trump's public criticism of Zelenskyy and fluctuating US aid—highlighted the conflict's unresolved and volatile nature.

This week's so-called *peace talks* echoed familiar themes: Russia demanded international recognition of Crimea and four other occupied regions along with a full Ukrainian troop withdrawal and insisted that Ukraine abandon any ambitions of NATO membership.

(5) *US targets Putin's energy lifeline, China*. Europe isn't the only one bankrolling Russia's war. China has become the Kremlin's economic backstop—still the largest buyer of Russian crude since before the war. On paper, the war may appear bilateral, but it's underwritten by the world's second-largest economy.

That's why the US Senate's proposed 500% tariff could hit two targets with one shot: pressure Putin and shore up the legal case for Trump's broader tariff agenda. India and Turkey, major importers of discounted Russian crude, would *take big hits*.

(6) *Putin keeps the nuclear option in play*. While Western leaders debate tariffs and LNG contracts, Putin plays the long game—and flirts with existential threats. In a May propaganda film, he *mused* that there had been "no need to use [nuclear weapons] ... and I hope they will not be required."

While Putin hasn't seen the need yet, might he if his war chest dries up? As sanctions tighten and drone strikes intensify, the nuclear card remains in Putin's deck.

US Strategy I: Earnings Growth Scare in Q2? As we begin the final month of the June quarter, it won’t be long before earnings warnings hits the newswires. Companies typically warn investors during the closing weeks of a quarter if their anticipated results are likely to miss consensus expectations.

For the S&P 500 companies in aggregate, the current Q2 consensus estimate implies y/y earnings growth for what would be a ninth straight quarter, albeit at a “below-trend” rate. The consensus growth forecast for S&P 500 Q2-2025 earnings has dropped to 3.6% as of the May 29 week—from 8.6% at the quarter’s April 1 start and from 10.9% at the start of the year (*Fig. 1*). The steep decline is typical of quarters’ final weeks, when bad earnings news tends to dominate estimate revisions activity. So Q2 estimates may not have much further to fall.

More concerning is that Q2 estimates suggest fewer pockets of strong earnings growers among the S&P 500 sectors than in recent quarters, as Joe shows below:

(1) *What’s ahead for Q2 sector earnings growth?* Seven of 11 sectors are expected to show positive y/y earnings growth, down from eight sectors in Q1 and 10 sectors in Q4.

Among the four lagging sectors, Consumer Discretionary’s earnings is expected to fall y/y in Q2 for the first time in 10 quarters; Consumer Staples’ earnings is expected to fall y/y for a second straight quarter; Materials’ is expected to fall after rising in Q1 for a second quarter following nine straight declines; and Energy’s is expected to fall for a fourth straight quarter.

Among the seven sectors expected to post earnings growth in Q2, just two are forecasted to rise at a double-digit percentage rate. That’s down from four sectors in Q1-2025 and seven in Q4-2024.

(2) *Q2’s earnings growth leaders becoming fewer and fewer.* Just two sectors are expected to post double-digit percentage earnings growth in Q2, Communication Services 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 hit that mark).

Here are the consensus S&P 500 sectors’ y/y proforma earnings growth rates for Q2: Communication Services (31.1%), Information Technology (17.0), S&P 500 (5.5), Health Care (5.0), Real Estate (2.8), Industrials (2.0), Financials (1.7), Utilities (0.3), Consumer Staples (-2.3), Consumer Discretionary (-3.6), Materials (-4.5), and Energy (-25.3).

US Strategy II: Q1 in Review. Joe recently updated his analysis of Q1's revenue and earnings results for the S&P 500's sectors in our *S&P 500 Quarterly Metrics* publication.

During Q1, seven of the 11 S&P 500 sectors recorded positive y/y growth in revenues, down from nine sectors in Q4. Likewise, seven sectors posted positive y/y earnings growth in Q1, also down from nine in Q4; four of them grew earnings in the double digits, down from six in Q4. Q1 profit margins improved q/q for five of the sectors: Communication Services, Energy, Health Care, Materials, and Utilities. That's down from seven in Q4.

Here's how the S&P 500 sectors' y/y revenues growth rates stacked up in Q1: Information Technology (15.0%), Health Care (11.1), Utilities (10.7), Communication Services (7.9), S&P 500 (3.5), Real Estate (2.8), Consumer Discretionary (1.0), Consumer Staples (0.8), Industrials (-1.5), Materials (-1.5), Financials (-2.0), and Energy (-2.1).

Here are their Q1 y/y earnings growth rates: Health Care (46.3%), Communication Services (30.7), Information Technology (16.8), Industrials (14.8), S&P 500 (11.6), Consumer Discretionary (6.0), Financials (4.7), Utilities (3.6), Materials (-2.4), Consumer Staples (-5.7), Real Estate (-8.0), and Energy (-19.3).

The sectors' Q1 profit margins: Real Estate (27.4%), Information Technology (26.3), Communication Services (22.4, record high), Financials (15.5), Utilities (14.0), S&P 500 (12.9, 11-quarter high), Industrials (10.2), Materials (9.3), Health Care (8.7), Consumer Discretionary (8.5), Energy (8.1), and Consumer Staples (6.4, seven-year low).

Calendars

US: Wed: ADP Employment Change 115k; MBA Mortgage Applications; Beige Book; Cook; Bostic. **Thurs: I**nitial Claims 235k; Nonfarm Productivity & Unit Labor Costs -0.7%/5,7%; Balance of Trade -$94.0b; Kugler; Harker. (FXStreet estimates)

Global: Wed: Eurozone, Germany & France C-PMIs 49.5, 48.6 & 48.0; Eurozone, Germany & France NM-PMIs 48.9, 47.2 & 47.4; UK C-PMI & NM-PMI 49.4 & 50.2; China Caixin NM-PMI 51.1; Lagarde. **Thurs:** Eurozone PPI -1.8%m/m/1.2%y/y; ECB Monetary Policy Statement; Germany Factory Orders -1.0%; Italy Retail Sales 0.2%; China Caixin NM-PMI 51.1; Greene. (FXStreet estimates)

US Economic Indicators

JOLTS (*link*): Job openings rose 191,000 in April to 7.39 million. *By industry*, April's increase was led by professional & business services (171,000), health care & social assistance (102,000), retail trade (46,000), arts, entertainment, and recreation (43,000), and information services (27,000). Meanwhile, the biggest declines in job openings occurred in accommodation & food services (-135,000), other services (-60,000), durable goods manufacturing (-16,000), finance & insurance (-12,000) and wholesale trade (-11,000). *Regionally*, job openings rose in the South (127,000) Northeast (116,000), and West (33,000), and fell in the Midwest (-85,000). There were 1.0 *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* slipped recently to 3.19 million, after climbing to an eight-month high of 3.33 million in March. Quits were at a recent peak of 4.46 million during spring 2022, falling to a recent low of 3.03 million during November 2024.

Global Economic Indicators

Global Manufacturing PMIs (*link*): "Global manufacturing output falls back into contraction, but confidence lifts from April low" was the headline of the May report. The *JP Morgan Global M-PMI* sank to a five-month low of 49.6 last month, signaling a deterioration in overall operating performance for the second straight month. *By country*, India once again recorded the fastest output growth of the nations covered by the survey, while the recovery in the Eurozone was extended for the third consecutive month. China, the US, Japan, and the UK saw production volumes contract. *By sector*, consumer goods output continued to expand, for the 22nd straight month, while output in both the intermediate and investment goods sectors fell following modest gains in April. *New business* declined for the second straight month, with the rate of contraction accelerating, though the US posted solid gains. Meanwhile, *business confidence* rose from April's two-and-a-half-year low. Of the 32 countries for which data were available, only six—India, Malaysia, Pakistan, Poland, Romania, and Russia—saw their level of optimism decline. *Turning to prices*, May saw the rate in input costs ease to a seven-month low, while selling prices eased to a four-month low.

Eurozone CPI (*link*): The *Eurozone's CPI* eased to 1.9% in May, below the ECB's target rate of 2.0% for the first time since September, according to the flash estimate. That's down from 2.2% the prior two months and 2.5% at the start of this year. It was at 1.7% last September—which was the lowest yearly rate since April 2021. The *core rate* eased to 2.3%, the lowest since January 2022, from 2.7% in March. The headline and core CPIs are down sharply from their recent peaks of 10.6% in October 2022 and 5.7% in March 2023. Looking at the components, the flash estimate shows the *services* rate easing to 3.2% in May from 4.0% in April. The rate for *energy* prices in May is expected to remain at -3.6%, after turning negative in March (-1.0%) and falling deeper into negative territory in April (-3.6% y/y); it had climbed from a recent low of -6.1% last September to 1.9% by January. Meanwhile, the rate for *food, alcohol & tobacco* is expected to accelerate for the fourth month to 3.3% in May, after easing from 2.9% in October to 2.3% at the start of this year. The rate for *non-energy industrial goods* held at 0.6% again in May, fluctuating in a narrow band between 0.5% and 0.6% since last October. May's yearly inflation rates are expected to ease from April among *all four of the largest Eurozone countries*: Germany (2.1 from 2.2), France (0.6 from 0.9), Italy (1.9 from 2.0), and Spain (1.9 from 2.2).

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