June 25, 2025

Morning Briefing

On Asia, US Budget Bill & Q2 Earnings

Check out the accompanying chart collection.

Executive Summary: Asian economies dodged a Strait of Hormuz closure after the US bombed Iran's three major nuke sites on Saturday, June 21. Most of the oil and gas passing through the Strait—which Iran won't be closing in retaliation for the US airstrikes—is bound for China, India, Japan, and South Korea. The close call was a wake-up call to strengthen their economies with structural reforms, William reports. … Also: Melissa compares and contrasts the Senate and House versions of Trump's "One Big Beautiful Bill," pointing out their best and worst aspects. … And: Joe shares industry analysts' Q2 growth expectations for S&P 500 companies—which suggest a ninth straight quarter of y/y earnings growth.

Asia's Big Reprieve I: Oil Shock Avoided. As economies everywhere braced for the fallout from war in the Middle East this week, Asia found itself directly on the frontlines.

Collateral-damage risks seemed to increase by the day for China, India, Japan, and South Korea following President Donald Trump's strategic gambit of ordering US airstrikes on Iranian nuclear sites last weekend. This sparked a mini-panic that Iran might close the Strait of Hormuz in retaliation. *Upwards of 80%* of the crude oil and liquified natural gas (LNG) passing through the waterway is destined for Asia.

Yet angst has been replaced by optimism that a major energy shock has been averted. Trump's announcement of a ceasefire in the "12-day war" between Israel and Iran sent Asian equities markets higher Tuesday. Bourses from Tokyo to Seoul to Hong Kong to Sydney posted solid gains as oil prices dropped.

Let's consider where all this leaves Asia in the second half of the year:

(1) *Cooler heads prevailing?* The unexpected truce leaves Asia less vulnerable to a *stagflationary shock* of the kind caused by Russia's Ukraine invasion in 2022. It also has Asia wondering whether Trump, thirsty for a nuclear deal with Tehran, might lift some

sanctions on Iranian oil and limits on who can purchase fuel from Ayatollah Ali Khamenei's economy. Lower oil prices would be a huge benefit for Asia's biggest importers of oil, especially *China and India*.

To be sure, ceasefires in the Middle East are often fragile and short lived. There's still reason for governments across the region to worry that either Israel and Iran or the US and Iran, if not all three, will come to blows again in the near future.

(2) *Asia's economic to-do list*. This week's reprieve is a moment for Asian governments to refocus on raising their games economically, as Trump's tariffs continue to wreak havoc, as well as battening down the hatches. As International Monetary Fund economist Thomas Helbling *pointed out* in an *April report*, the risks to the outlook are tilted to the downside. They include greater trade tensions, tighter financial market conditions, and increased uncertainty.

On the upside, new trade opportunities, through diversification of export markets and free-trade agreements and renewed structural reform momentum, could lift growth. Asia faces structural headwinds, including the vulnerability of its export-based growth model. This is in addition to pressures from *aging populations*, GDP growth declines in some countries in the region, and *declining productivity*.

Asia's Big Reprieve II: Time for Upgrades. The headwinds from heightened trade tensions "call for a more balanced growth model, led by stronger and structurally durable domestic demand in some countries, and greater diversification of exports and stronger regional economic ties more broadly," Helbling said.

Bold structural changes are needed to boost private consumption. Bigger social safety nets can reduce precautionary savings and foster confidence, especially in China. It's vital, too, to diversify export markets and accelerate *regional integration*; those measures could go a long way toward *insulating economies* from global shocks, notes Albert Park of the Asian Development Bank.

Consider the following:

(1) *Stealth stimulus time*. The specter of lower energy costs in Asia is a boon for consumer sentiment, companies' bottom-line growth, and inflation dynamics. "Falling oil prices are a *stealth stimulus*," argues Allen Sinai of Bottom Line Inc. He adds that "cheaper energy lowers costs for businesses and gives households some relief at the gas pumps and extra

income for spending."

Multiply this effect by a few billion people, and it's easy to see how lower oil and gas prices can alter Asian outcomes in the second half of 2025—if the Israel-Iran ceasefire holds, that is.

As Deutsche Bank analysts wrote on Monday, "[T]he situation in the Middle East is live and things can change quickly." On Tuesday, for example, Israel claimed that a missile fired its way *constituted a ceasefire breach*.

(2) *Risks abound*. Any resumption of tensions could put China at risk. Some estimates have China alone consuming roughly *90% of the oil Iran exports*. India gets *almost half of its oil* from tankers transiting through the Strait of Hormuz—and 60% of its LNG. Japan's vulnerability is even greater, considering that it gets almost *three-quarters* of its crude via the Strait. For Korea, it's 60%.

On June 20, the day before Trump joined forces with Israel to bomb Iranian nuclear sites, Asia was grappling with the effects of US tariffs. They range from weaker export demand to inflationary repercussions and extreme uncertainty about what's to come.

Asia's Big Reprieve III: Risks Abound. Since then, governments have been gaming out how to withstand a possible oil shock. Whether one does emerge could hinge on whether Trump can reassemble an Iran nuclear deal from the ashes of the Joint Comprehensive Plan of Action that former President Barack Obama signed and Trump 1.0 *disavowed in 2018*.

(1) *Iran's big choice*. All Asia can do is hope that Trump's bombing raid on Saturday was a one-and-done situation. But few Asian leaders believe that Iran will scrap its nuclear weapons program at this point. This would almost certainly anger Trump and Israeli Prime Minister Benjamin Netanyahu, putting *renewed military strikes* back in play.

If so, Asia would be looking at disruptions that increase the price of energy and the costs of production. It would come just as China, the region's top engine, is having to rely increasingly on exports and manufacturing to keep GDP growth *close to 5%* a year.

(2) *Fragile truce*. Roughly *20 million barrels* of oil pass through the Strait of Hormuz every day. That's one-fifth of global supply, most of it destined for China, Japan, and Korea.

The good news is that, for now, cooler heads from Tehran to Jerusalem to Washington appear to be prevailing. But risks abound for Asia's export- and imported-oil-addicted economies as this *fragile truce* plays out. It's not like Trump's Tariff Turmoil is going away anytime soon.

Fiscal Policy I: Senate's OBBB Creative Accounting. The House's version of the "One Big Beautiful Bill" (OBBB) is expected to add $3.7 trillion to the federal budget deficit over the next decade. Yet the Senate's version claims just a $441 billion budget impact. Enabling the difference is a creative accounting gimmick that masks the Senate bill's total deficit increase of $4.2 trillion, according to the Committee for a Responsible Federal Budget (CRFB). Apples aren't being compared to apples.

Let's take a deeper look and try to reconcile the differences between the House and Senate bills:

(1) *Senate's baseline budget gap*. The Senate's plan claims to have a much smaller impact on the deficit because it uses a "current policy" baseline. It assumes that the tax cuts in the 2017 Tax Cuts and Jobs Act (TCJA)—which are current policy but are due to expire in 2026—will be extended permanently, and it doesn't include the $3.6 trillion of deficits it will create over the next 10 years in its budget analysis.

In contrast, the House uses standard budgeting (current law), which recognizes that the Trump tax cuts are set to expire, making their extension a new cost. As a result, the House budget plan DOES include the $3.9 trillion of TCJA deficit spending in its budget plan.

CRFB warns that the Senate's budgetary maneuvering undermines transparency and deficit control, making the true fiscal impact harder for lawmakers and the public to assess. The bill, if passed as is under either the Senate or House, would significantly worsen America's long-term fiscal outlook. If we compare apples to apples and the TCJA is included in both the Senate and the House bill, the CRFB estimates the deficit would increase by $4.2 trillion in the Senate bill and $3.7 trillion under the House bill over the next decade.

(2) *The House plays games too.* Both the House and the Senate are introducing new tax cuts that they say will expire in 2028 or 2029. However, tax cuts are easy to give and hard to take away (as we are learning with the planned extension of the TCJA). So the CRFB ran the numbers assuming that all tax cuts were extended through the 10-year period they analyzed. Doing so increased the deficit under the Senate bill to $4.8 trillion and increased the deficit under the House bill to $5.2 trillion.

(For a comparison of the two versions of the bill, see the CRFB's Senate vs. House Reconciliation Tax Provisions *table*.)

Fiscal Policy II: The 411 on OBBB's Timing. Now that the Senate Finance Committee's first draft of the OBBB is *here*, what's next? When might the bill become law?

In a June 16 *report*, our friend Jim Lucier of *Capital Alpha* writes that Medicaid changes and state-and-local tax matters in this Senate Finance Committee draft are so controversial that it isn't a sure thing that the Senate itself will pass its version of the bill by July 4 as hoped.

After any further Senate amendments, Jim says, the House could stay in session through the week of July 1 and vote through the bill by midweek before adjourning in time for July 4. Alternatively, the House could request a conference, in which case Congress could spend July working on the bill before producing a final draft in August.

Consider the following:

(1) *Stricter Medicaid eligibility*. The Senate bill *requires* states to reassess the Affordable Care Act's Medicaid eligibility requirements every six months, caps provider taxes at 3.5% in "expansion states" (i.e., those that have elected to expand eligibility beyond the federal criteria) starting in 2027, and blocks non-expansion states from raising those taxes to supplement the contribution from federal funds. It also imposes Medicaid work requirements, mandating 80 hours per month of work, school, or service for the expansion population (i.e., recipients qualifying under Medicaid expansions), including for parents with children over 14—stricter than the House version.

(2) *SALT cap is an issue, too*. If the OBBB passes the Senate, the changes will need to be reviewed again by the House before they can be signed into law. The state and local tax (SALT) cap of $10,000 in the Senate's version (lower than the House's) likely won't be acceptable to the House, Jim's team notes.

Fiscal Policy III: OBBB's Good, Bad & Ugly. The Senate Republicans' proposed legislation to extend many provisions of the TCJA follow broadly similar legislation put forward by House Republicans, the Tax Foundation observed in a June 20 *analysis* titled "The Good, the Bad, and the Ugly in the One, Big, Beautiful Bill."

In our view, "the good" of both OBBB versions is that they extend the TCJA tax rates, so US taxpayers likely won't experience higher rates next year. "The bad": Both would worsen an already dire fiscal deficit situation.

Here's the Tax Foundation's take on the bills' key tax policy provisions:

(1) *The good: The tax policy changes would add stability to the tax code.* Both the Senate and House bills would:

- Permanently extend the rates and brackets of the 2017 individual tax cuts.
- Permanently extend some of the TCJA's limits on some itemized deductions like mortgage interest and limits itemized deductions for top earners.
- Institute a permanent, inflation-adjusted, estate and gift tax exemption level of $15 million.
- Provide a permanently higher threshold for expensing certain equipment for small businesses under Section 179.
- Raise revenue relative to current law by reducing some of the tax code's many tax credits, deductions, and other preferences; both bills reduce the cost of the green energy credits by about half.

The Senate bill:

- Permanently extends a larger standard deduction and a modified alternative minimum tax threshold—simplifying the tax code.
- Retains the $10,000 cap on the SALT deduction, which keeps the standard deduction preferable for many taxpayers (whereas the House raises the cap to $40,000 for taxpayers earning less than $500,000).
- Makes permanent the House bill's provision to allow expensing investment in short-lived assets and domestic research and development.
- Retains the House bill's temporary expensing for qualified structures.
- Makes permanent TCJA's less restrictive limitation on interest deductions
- Introduces new permanent international tax reforms that increase tax rates but reduce double taxation (the House's international tax reforms are less generous).

(2) *The bad: The tax policy changes would overspend on certain special interest groups.* Both bills:

- Provide tax exemptions for overtime pay and tips.
- Provide a deduction for auto loan interest.
- Include an additional standard deduction for some seniors.

- Make permanent the non-corporate "pass-through" deduction (at the current 20% in the Senate version and increased to 23% in the House bill).

(3) *The ugly: The tax policy changes would complicate the tax code.* Both bills:

- Place complex conditions on the rules for tipping, overtime, and car loan exemptions requiring lots of interpretation.
- Maintain complicated rules around the Inflation Reduction Act credits.
- Complicate incentives for saving; for example, the newly introduced "Trump Accounts" a.k.a. "baby bonus" create new red tape for taxpayers and the IRS that may outweigh the benefits.

Strategy: A Ninth Straight Quarter of Earnings Growth. Here we are in the final week of a quarter, when steep declines in industry analysts' estimates are typical. Yet the Q2 "earnings warning season" has been atypically quiet. Did analysts overdo their Q2 estimate cutting earlier in the quarter during Trump's Tariff Turmoil?

The consensus Q2 earnings growth forecast for S&P 500 companies in aggregate began the quarter at 8.5% y/y; it's been more than halved to 3.8% as of the June 19 week (*Fig. 1*). While 3.8% represents below-trend y/y growth, it's up from the week earlier's 3.4% y/y, and it suggests the Q2 is set to be the S&P 500's ninth straight quarter of y/y earnings rise.

Of course, there are pockets of weaker earnings growth and even y/y declines forecast for some of the S&P 500 sectors, but revenues growth prospects remain broad across sectors, Joe reports:

(1) *Broad sector revenue growth expected in Q2.* Ten of the 11 S&P 500 sectors' revenues should grow y/y in Q2, a slight improvement from nine sectors in Q1 and the highest count since Q3-2022 (*Fig. 2*). That's hardly indicative of a revenues recession.

Information Technology has been leading all sectors in revenues growth since Q1-2024; its Q2-2025 revenues should rise 12.4% y/y, a double-digit rate for a fifth straight quarter. Also notable: Materials' expected 5.2% y/y revenue gain would be its first gain in 11 quarters. Only Energy's revenues are forecast to drop y/y, tumbling 11.5% for the worst decline in two years.

Here are the sectors' proforma y/y revenues growth forecasts for Q2-2025: Information Technology (12.4%), Health Care (7.9), Utilities (6.9), Communication Services (6.0), Real

Estate (5.1), Materials (5.2), S&P 500 ex-Energy (5.0), S&P 500 (3.6), Consumer Discretionary (2.3), Industrials (1.8), Financials (1.3), Consumer Staples (1.3), and Energy (-11.5).

(2) *Earnings growth less broad for the 11 sectors.* Only six of the 11 S&P 500 sectors are expected to grow earnings y/y in Q2-2025, the fewest in over two years (since Q1-2023's five). Earnings growth was much broader among sectors the previous two quarters (eight in Q1-2025 and a whopping ten in Q4-2024, the most since Q1-2021).

Among the lagging sectors, Consumer Discretionary's earnings is expected to fall y/y in Q2 for the first time in ten quarters; Materials' is expected to fall again after rising for two straight quarters; and Energy's is expected to fall for a fourth straight quarter.

Among the six sectors expected to post earnings growth in Q2, just two, Communication Services and Information Technology, are expected to grow faster than the S&P 500.

Here's how the S&P 500 sectors' consensus earnings growth rates stack up for Q2-2025: Communication Services (31.2%), Information Technology (17.2), S&P 500 ex-Energy (7.6), S&P 500 (5.7), Health Care (4.6), Financials (3.1), Real Estate (2.7), Industrials (2.1), Utilities (-0.1), Consumer Staples (-2.7), Consumer Discretionary (-3.8), Materials (-4.4), and Energy (-25.5).

Here are their y/y revenues and earnings growth forecasts: Communication Services (6.0% revenues growth, 31.2% earnings growth), Consumer Discretionary (2.3, -3.8), Consumer Staples (1.3, -2.7), Energy (-11.5, -25.5), Financials (1.3, 3.1), Health Care (7.9, 4.6), Industrials (1.8, 2.1), Information Technology (12.4, 17.2), Materials (5.2, -4.4), Real Estate (5.1, 2.7), S&P 500 (3.6, 5.7), S&P 500 ex-Energy (5.0, 7.6), and Utilities (6.9, -0.1).

Calendars

US: Wed: MBA Mortgage Applications; New Home Sales 0.70mu; Powell Testimony. **Thurs:** GDP & Price Index -0.2% & 3.7%; PCED Headline & Core 3.6%q/q & 3.5%q/q; Initial Claims 247k; Kansas City Fed Manufacturing Index; Goods Trade Balance -$91.9b; Durable Goods Orders 0.1%; Chicago Fed National Activity Index; Barkin; Barr. (Source: FX Street)

Global: Wed: France Consumer Confidence 89; Spain Real GDP 0.6%q/q, 2.8%y/y;

Mauderer; Donnery. **Thurs:** Germany Gfk Consumer Confidence -19.3; EU Leaders Summit; Lagarde; De Guindos; Schnabel; Greene; Bailey; Breeden. (Source: FX Street)

US Economic Indicators

Consumer Confidence (*link*): Consumer confidence deteriorated in June, on widespread weakness. *Headline consumer confidence* sank from 98.4 in May to 93.0 this month, as both the current conditions (to 129.1 from 135.5) and expectations (69.0 from 73.6) components posted noticeable declines. Consumers' assessments of *current business conditions* were less positive in June, with 19.0% stating business conditions were good, down from May's 21.4%, while 15.3% said conditions were bad, up from 13.7% last month. *Consumers' assessment of present labor conditions* cooled this month, with 29.2% of consumers saying jobs were plentiful, down slightly from 31.1% in May, while 18.1% of consumers said jobs were hard to get, slightly below May's 18.4%. Consumers' assessment of the *short-term labor market* was more negative, with 15.4% of consumers anticipating more jobs to be available, down from 18.6% in May, while 25.9% anticipated fewer jobs, down slightly from 26.2% last month. Consumers' outlook for *short-term business conditions* six months from now were more pessimistic this month, with 16.7% expecting conditions to improve, down from May's 19.9%, while 24.0% expected conditions to slightly below May's 25.4%. Consumers' outlook for their *income prospects* were moderately less positive this month, with 16.3% expecting their incomes to increase, down from 18.6% last month, while only 12.4% expected their incomes to decrease, below last month's 13.5%. *Write-in responses* once again showed that tariffs were the top concern for consumers this month, while inflation and high prices were also among consumers' concerns—though there were more mentions of easing inflation compared to last month. This is consistent with a cooling in *consumers' average 12-month inflation expectations*, which eased to 6.0% this month, down from 6.4% in May and 7.0% in April. *Consumers' outlook on stock prices* continued to increase from April's 16-month low of 37.6%, climbing to 45.6% this month.

Global Economic Indicators

Germany Ifo Business Climate Index (*link*): "The German economy is slowly gaining confidence," noted Ifo President Clemens Fuest. The Ifo business climate index climbed for the sixth straight month, from 84.7 in December to 88.4 in January—the highest reading since last June, led by expectations. The *expectations* component climbed from 84.4 to 90.7

over the comparable period to its highest reading since April 2023, while the *current conditions* component has been in a relative flat trend in recent months, hovering around 86.0; it was at 86.2 this month. *By sector*, the *service sector* saw its business climate continue to improve, once again due to rising expectations, while current conditions were assessed only somewhat more positively. Meanwhile, *construction* saw its business climate index improve for the fifth successive month, as expectations rose to its highest-level February 2022—though "remain marked by skepticism," according to the report. Assessment of the current situation was unchanged this month. *Trade* saw its index improve as traders were more satisfied with their current conditions, while expectations were less pessimistic. The report notes that the improvement was driven by wholesale trade; retail trade fell slightly. The *manufacturing sector* improved marginally in June, with companies' expectations noticeably optimistic, while current conditions remained challenged—with companies remaining very disappointed with their order books.

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