Yardeni Research

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Morning Briefing

On China's CBDC, Europe & Earnings

Check out the accompanying chart collection.

Executive Summary: Digital currencies are coming, but the US and China are taking opposite stances on the form they'll take. Trump favors stablecoins issued by private-sector companies and forbids the US from pursuing a central bank digital currency (CBDC). Xi wants to take China's CBDC global, hoping the digital yuan (a.k.a. e-CNY) will give the dollar a run for its money. William discusses why China's initiative won't be the dollar-killer Xi hopes. … Melissa briefs us on how the EU's economy and markets are doing and the challenges facing ECB policymakers. … Joe reports that analysts' confidence in the outlook for S&P 500 companies is back; they've stopped their tariff-related estimate slashing.

Digital Yuan I: China's De-Dollarization Dream. Last month, during the same week that the US Senate passed landmark cryptocurrency legislation, China was pivoting in a very different direction. In Washington, the spotlight was on a regulatory framework for private stablecoins. In Shanghai, it was on the government's world-leading digital yuan project.

These diverging priorities make for a fascinating split-screen. On one screen, President Donald Trump's Republicans are putting *private-sector issuers* at the center of the digital asset boom. On the other, President Xi Jinping's Communist Party is placing all its chips on a top-down central bank digital currency (CBDC).

In January, Trump signed an *executive order* effectively banning the US from pursuing a CBDC, arguing that it would "threaten the stability of the financial system." China worries that stablecoins are a *boon for fraudsters*. Democrats, it's worth noting, want Trump's family *to divest* from its stablecoin venture.

It will be years until we know which of the globe's two biggest economies is making the better bet. But Trump and the Federal Reserve would be wise to pay close attention to Xi's "e-CNY" push, which China now views as a key tool to challenge the dollar's reserve currency status. And make no mistake, Beijing's efforts to cultivate a dollar alternative are intensifying in real time.

That said, the e-CNY isn't likely to be the dollar-killer that Xi hopes, for a number of reasons. Before we dive into those in the next section, let's look at what Beijing is doing on the CBDC front and why:

(1) *China leads the pack*. The digital yuan is "still the largest CBDC pilot in the world," according to the Atlantic Council, which runs the *CBDC tracker* website. And in Shanghai on June 18, People's Bank of China (PBOC) Governor Pan Gongsheng *detailed plans* not just to expand it domestically—to phase out inefficient paper money—but also to take the e-CNY global to hasten the emergence of a multi-polar currency system.

Last month, six foreign banks *officially joined* the yuan-based Cross-border Interbank Payment System (CIPS), China's fast-growing alternative to the Society for Worldwide Interbank Financial Telecommunication (SWIFT) system. The six: Singapore's United Overseas Bank, the African Export-Import Bank, First Abu Dhabi Bank, South Africa's Standard Bank, Kyrgyzstan's Eldik Bank, and Macau's Chongwa Financial Asset Exchange.

(2) *Growing yuan acceptance*. True, those recent CIPS joiners aren't financial services behemoths like Citibank, Deutsche Bank, or Mizuho. Still, their buy-in is a sign that the global financial community is warming to the yuan as a dollar alternative. And the timing is no coincidence, coming amid international tensions sparked by Trump's tariffs. Team Xi is wagering that Trump's Tariff Turmoil will have more nations getting on the de-dollarization bandwagon.

This has Xi's government accelerating the timeline for developing financial systems independent of Western institutions. The risk for the US Treasury Department, says Josh Lipsky, who heads Atlantic Council's CBDC tracker, is that "China can go to other countries and say the *US is not involved* in this technology you're interested in, but we are and we're leading."

Saudi Arabia's central bank, for example, recently began *pilot-testing* a wholesale CBDC. Officials in Beijing hope it will pave the way for oil sales using e-CNY and other digital currencies.

Digital Yuan II: Why It's No Dollar Killer. Yet it's worth separating the hype from the reality and calling out the hypocrisy problem hiding in plain sight.

True, Trump's trade war and attacks on the Fed's independence could all be dollar-negative. But the US currency has something much bigger going for it: the Xi era's glacial pace of economic and financial reform, a problem that's coming back to haunt China's *nearly $18 trillion economy*.

No doubt, the dollar benefits from historical inertia. The dollar is still the dominant global currency, *representing 58%* of global foreign exchange reserves, even though Beijing and the BRICS—Brazil, Russia, India, China, South Africa—are gunning for a less dollar-centric future. The yuan's share: *just 2.2%*.

Consider the following:

(1) *Privileged dollar*. The US isn't clinging to the "exorbitant privilege" of old because of Washington's policies but despite them. The euro's share of reserves is stuck *around 20%* because the *20 member countries* that use it have yet to craft the deep, resilient fiscal union that world dominance requires.

China's biggest problem is Xi's control-freak administration. The yuan punches far below its weight because, after *12-plus years* in power, the most powerful Chinese leader since Mao Zedong lacks the confidence to make the yuan fully convertible. That signals that the yuan isn't ready for global prime time.

(2) *Trust deficit*. Absent an independent monetary authority, why would global institutions trust the PBOC's e-CNY? Many global investors barely trust the veracity of *Beijing's GDP numbers*, never mind taking a leap of faith to conduct billion-dollar overseas transactions via a digital yuan.

These underlying "old economy" troubles limit Xi's "new economy" ambitions. A best-in-show CBDC doesn't paper over a debilitating property crisis and the crushing local government debt loads that are fueling deflation. Nor does an e-CNY offset China's *aging population*, *high youth unemployment*, or increasing number of *in-person protests*.

Yet there's an argument that a digital yuan could help solve the problem of China's weak household demand. Former Bank of England economist Andy Haldane argues that it could jolt demand by piercing the "*zero lower-bound barrier*." A CDBC might enable the PBOC to push deeper into negative interest-rate territory to incentivize consumption—if Xi dared to venture down that road.

(3) *Festering problems*. This, however, wouldn't fix the above-the-ground headwinds darkening household confidence. The longer Xi lets these challenges fester, the more China's economy might underperform in the long run.

Again, history will judge whether China's championing CBDCs or the US's favoring a stablecoins market with a total supply of *just $247 billion* is the wiser strategy. Notably, Europe favors CBDCs. Or is a middle ground best: create a CDBC and encourage stablecoin issuance simultaneously so that the former can benchmark and stabilize the latter?

Either way, China's designs on rivaling the dollar have a cart-before-the-horse problem. The nature of the digital asset a country chooses matters far less than the resilience of the economy that undergirds it.

Eurozone Economy I: Eurozone's Summer Status Check. It's July, so Europeans are beelining to the coastline to sip wine by the waves as their monetary and fiscal policymakers toil to keep inflation at bay and the economy afloat. European Union (EU) trade negotiators and their US counterparts are also hard at work trying to hammer out a trade deal that appeals to both President Trump and EU officials.

Cooling inflation has allowed the European Central Bank (ECB) to reduce its key interest rate eight times from 4.5% in June 2024 to 2.0% as of June 2025.

Investors betting on a Eurozone comeback have driven the EMU MSCI up 26.2% ytd (in US dollars) as of July 7 versus the US MSCI's 6.0% gain (*Fig. 1*). The Sentix, which rates investor and analysts' relative six-month economic outlook for the Eurozone, turned *positive* this July for the first time since July 2022. Sovereign Eurozone bond yield spreads reflect the market's calm (*Fig. 2*).

Will investors refocus on the region's challenges after the lazy days of summer? Possible threats include fewer cuts available in the ECB's easing cycle, a resurgence of inflation, a defense-fueled debt spiral, trade and geopolitical uncertainty, and deepening internal fractures within the bloc. Moreover, EMU MSCI valuations are looking toppy—the forward P/E, at 14.4, is back to 2019 levels, up from a low of 10.1 during the 2022 energy crisis.

For now, here's a breezy look at where Eurozone economies stand:

(1) *Macro data coast along*. Recent data suggest that the Eurozone is muddling along at

best.

Q1 real GDP grew 1.5% y/y, up from 1.2% in Q4 (*Fig. 3*). But retail sales suggest cautious spending: They rose just 1.8% y/y in May versus 2.7% in April. A note of cautious optimism comes from new manufacturing orders' *holding steady* in June for the first time in over three years, signaling a possible bottoming in this long struggling sector. And the inflation emergency is over: Flash *headline HICP* of 2.0% y/y in June was up only slightly from 1.9% in May (*Fig. 4*). Flash core inflation (excluding energy and food) held at 2.3% y/y, while services inflation remained sticky at 3.3% y/y, up from 3.2% in May.

(2) *Bankers scanning the horizon*. Might the ECB's easing cycle end soon? On June 5, the ECB *cut rates* by 25bps to 2.0% (*Fig. 5*). Financial markets are *pricing* in one more ECB rate cut to 1.75% by year-end, followed by a pause before potential hikes in late 2026.

Meanwhile, the bank's balance-sheet unwinding continues, as it no longer reinvests the principal from maturing securities.

Despite the current calm, the Eurozone's central bankers haven't packed their bags for summer break, instead preparing for the ECB's next policy meeting on July 24. But they and Europe's top economists did jet off to Portugal in June for a work trip: their annual policy review forum.

"[We] do think the last [inflationary] cycle is done," ECB Chief Economist Philip Lane *told* CNBC during the forum. But the ECB needs to continue monitoring the outlook, he added. That need was echoed by a former national bronze medalist in synchronized swimming at the forum: ECB President Christine Lagarde. "I'm not saying 'mission accomplished,' but I say 'target reached,'" she *emphasized*, warning that the bank must remain "extremely vigilant," as it faces "tormented waters."

(3) *EU-US trade deal treading water*. A decent golfer but no synchronized swimmer, President Trump has come out swinging—threatening tariff hikes on most global goods. He extended his previous July 9 deadline for "reciprocal" tariffs to August 1. If no deal is reached before then, the tariff rate for most goods imported into the US from the EU will rise from Trump's 10% global minimum tariff baseline to 20%.

In addition to Trump's broader aim of lowering the US trade deficit with the EU, the US is *negotiating* for lower tariff rates on EU imports of US goods (including agricultural products, cars, trucks, bicycles, fertilizers, and plastics). And he wants the EU to *eliminate* *administrative barriers* to trade by creating a cohesive EU single customs administration, harmonizing trade standards, and easing EU imposed chemical restrictions and environmental standards.

If Trump gets his way, the resulting deal would make US manufacturers more competitive in the EU market, lower prices on US goods sold in Europe, and support demand. If Trump doesn't get his way, he'll impose higher tariff rates on EU imports, which could force companies selling European goods to hike their prices and depress US consumer demand for them.

The EU still aims to reach a trade deal by Wednesday, July 9, a European Commission (EC) spokesperson *said*, after "a good exchange" between Trump and EC President Ursula von der Leyen.

Deal or no deal, Trump's 10% global tariff appears to be a non-negotiable pillar of his trade agenda. While discussions *reportedly* have included the possibility of sector-specific or product-level exemptions, it remains unclear whether existing tariffs of 25%–50% on global steel and aluminum would remain in place for EU exports.

For the EU, the deal risks deepening internal divisions. Germany—facing the greatest economic exposure to US tariffs—is pushing for a swift resolution, while France and Italy, with comparatively less at stake, seem more inclined to dig in for tougher negotiations with possible retaliatory measures.

(4) *Fiscal hawks armor up.* Under the ReArm Europe *initiative*, member states can toss the budget rulebook—temporarily—and spend big. A €650 billion defense spending surge is in motion, and a €150 billion *Security Action For Europe* (SAFE) fund will finance cross-border weapons procurement with a "buy European" protection clause. Altogether, EU-level spending on defense could top €800 billion by this decade's end, providing powerful fiscal stimulus to the region.

NATO just raised the bar again: Leaders meeting in the Netherlands *agreed* to target defense spending that equals 5% of GDP by 2035, up from actual *spending* of 2% in 2024 for most members. Euro area defense spending *reached* 1.8% of GDP in 2024. With national defense budgets ramping up and EU-level programs taking effect, an increase to 3.0% or more over the next few years appears feasible to us.

Increased defense spending can boost European economic growth and job creation in the short term. However, it often worsens budget deficits and can crowd out private investment in the long run. It may also fuel inflation.

Strategy: Analysts' Worries Wane. This week, LSEG released its July snapshot of the monthly consensus net earnings estimate revision (NERI) activity over the past month. The revenues and earnings forecasts are captured in our *S&P 500 NRRI & NERI* report, where we index the analysts' estimate revisions activity by the number of upward less downward revisions, expressed as a percentage of total estimates. Our past-three-months lens encompasses an entire quarterly reporting cycle, so it's moot that analysts' tendency to revise estimates differs throughout the cycle.

"Sweet!" was Joe's reaction to the July data: NERI has rebounded rapidly from its 28-month low in May, suggesting analysts have confidence in the economic environment despite global and domestic uncertainties. His takeaways:

(1) *S&P 500 NERI improves at fastest rate in 12 months.* The S&P 500's NERI index was negative in July for a tenth straight month (*Fig. 6*). That matches the 10-month negative NERI streak that ended May 2023 on the heels of the Magnificent-7's year of cost-cutting. The streak is likely to lengthen in coming months. However, NERI rebounded 2.0ppts m/m in July to a five-month high of -4.2%. That was up from a 28-month low of -7.8% in May and the strongest m/m improvement in 12 months. (A zero reading means an equal number of estimates were raised as lowered over the past three months.)

Also underscoring the breadth of improving revisions, nine of the 11 sectors rose m/m in July—the most in 13 months.

(2) *Positive NERI club less empty.* Back in May, Utilities was the only S&P 500 sector with a positive NERI reading—the emptiest that club had been for 15 months! By July, the club had two more members: Communication Services and Information Technology (*Fig. 7*, *Fig. 8*, and *Fig. 9*).

Information Technology's latest NERI reading was a 10-month high, topping the S&P 500's 11 sectors. Communication Services' was positive for the second straight month; it's been positive for 13 of the past 15 months. Utilities' was positive for a 14th straight month in July, but barely so at 0.8% (down from a two-year high of 2.6% in November).

Among the poorer performing sectors, Consumer Staples' NERI was negative for a 13th straight month in July, followed by Energy and Materials with 12 months of negative readings. However, Materials' NERI bested all sectors, improving for a third straight month to an eight-month high (*Fig. 10*).

Here's how the S&P 500 and its 11 sectors' NERIs ranked in July versus June: Information Technology (3.4% vs -1.1%), Communication Services (2.6, 3.0), Utilities (0.8, 0.6), Real Estate (-0.5, -4.0), Health Care (-2.1, -1.9), S&P 500 (-4.2, -6.2), Financials (-4.4, -5.8), Industrials (-5.6, -7.8), Materials (-7.1, -9.9), Consumer Staples (-10.9, -13.9), Consumer Discretionary (-11.8, -13.4), and Energy (-13.2, -15.6).

(3) *Forward earnings not as bad as NERI suggests and improving too.* While the downward estimate revisions are still relatively broad, they're recovering rapidly as the tariff fog clears. Estimates no longer are getting slashed deeply. Indeed, forward earnings remains close to record highs for the S&P 500 and nine of its 11 sectors (*Fig. 11*).

Calendars

US: Wed: Atlanta Fed GDPNow 2.6%; MBA Mortgage Applications; Wholesale Inventories -0.3%; FOMC Meeting Minutes. **Thurs:** Initial Claims 235k; FOMC Minutes; Daly; Waller. (Source: FX Street)

Global: Wed: BoE Financial Stability Report; Japan PPI -0.2%m/m, 2.9%y/y; Japan Machine Tool Orders 3.4y/y; De Guindos; Nagel; Lane. **Thurs:** Germany CPI 0.0%m/m, 2.0%y/y; Italy Industrial Production 0.1%; Breeden. (Source: FX Street)

US Economic Indicators

NFIB Small Business Optimism Index (*link*): "Small business optimism remained steady in June while uncertainty fell," noted Bill Dunkelberg, NFIB's chief economist. "Taxes remain the top issue on Main Street, but many others are still concerned about labor quality and high labor costs." The *Small Business Optimism Index (SBOI)* ticked down 0.2 point to 98.6 in June, after rising in May for the first time in five months, to a three-month high of 98.8; it had dropped sharply the first four months of this year, from December's recent high of 105.1 to 95.8 in April. June's 's reading was slightly above the 51-year average of 98.0. Meanwhile, the *Uncertainty Index* dropped for the fourth straight month, by five points in

June and 15 points from February's reading of 104—which was the second highest on record. In June, four of the 10 *components of the SBOI* rose, while four fell—with plans to increase inventories and expected credit conditions unchanged at -1% and -4%, respectively. Earnings trends (+4ppts to -22%) and current job openings (+2 to 36) were the largest positive contributors to the SBOI, followed by plans to increase employment (+1 to 13), and now is a good time to expand (+1 to 11). Meanwhile, current inventory (-6ppts to -5%), sales expectations (-3 to 7), and expect the economy to improve (-3 to 22) were the largest negative contributors to the index, with capital outlay plans (-1 to 21) only a small drain. Taxes (19%) was once again the *single most important problem for small business owners* in June, with quality of labor (16), inflation (11), cost of labor (10), and poor sales (10) rounding out the top five. The bottom five ranged from 3% to 9%. The net percentage of owners *raising selling prices* climbed to 29% in June from 25% in May and April, after increasing from 22% in January to 32% in February—which was the highest percentage since May 2023—while a net 32% of owners plan price hikes in the next three months, up from 31% in April and 28% in March. Turning to *compensation*, a net 33% reported raising compensation in June, up from 26% in May, while a net 19% plan to raise compensation in the next three months, a tick below May's 20%, which was up from 17%; it peaked recently at 28% in November.

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