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Morning Briefing

On Japanese Bond Vigilantes, Trump's Method & Earnings Surprises

Check out the accompanying chart collection.

Executive Summary: Japanese bond yields have risen to their highest in decades as monetary policies and fiscal initiatives conflict at a time rife with uncertainties related to the nation's elections and US tariffs. William discusses the forces that are rousing the Bond Vigilantes of Japan. … Also: Melissa finds method in Trump's tariff madness, sharing six reasons that Trump's accelerated tariff aggressions might make sense for the United States—balanced by detractors' arguments. … And Joe's Q2 earnings revisions data suggest that estimate reductions may be overdone, so, he says, don't be surprised if Q2 reporting season brings big earnings surprises.

Japanese Debt I: Electioneering Jitters. Thanks to a weak yen, Japan is in the midst of the biggest *tourism boom* in the nation's history. Unfortunately for Tokyo policymakers, more and more Bond Vigilantes are heading this way, too.

The presence of activist debt-market players made global headlines again this week as 20-year Japanese government bond (JGB) yields rose to the *highest level since 1999* (*Fig. 1*). The turn of the millennium was a PTSD-triggering period for Tokyo, much as 2025 is shaping up to be. Between 1999 and 2001, the Bank of Japan became the first major central bank to *slash interest rates to zero* and *pioneered quantitative easing*. Now the Bank of Japan's (BOJ) efforts to normalize rates are colliding with those of government officials keen on adding new debt to the national balance sheet via tax cuts (*Fig. 2*). That's animating the Bond Vigilantes.

Let's explore why this is happening and where things may be heading:

(1) *Global tensions*. It's not just Japan, of course. Long-term debt yields in *Germany*, *France and the UK* are rising amid concerns over widening fiscal deficits. Japan, though, is arguably leading the charge, and just four days ahead of a national election.

The fiscal discussion ahead of the July 20 *upper house election* is unnerving the bears. Though few think Prime Minister Shigeru Ishiba's Liberal Democratic Party (LDP) will lose power, it's unlikely to win an outright majority. The LDP would have to forge a coalition with opposition parties that favor *cutting taxes*, particularly on consumption. Ishiba could also be shown the door.

(2) *Tax-cut fever*. Ishiba is deeply unpopular with voters, with *approval ratings* in the 20s. But since taking office last October, he's been more fiscally conservative than most predecessors. In mid-May, Ishiba *warned pro-tax-cut lawmakers* that "our country's fiscal situation is undoubtedly extremely poor, worse than Greece."

For the bond market, Ishiba has sometimes been a bulwark against Tokyo adding to the largest debt load in the developed world—about *260% of GDP*. Even so, the normally placid Japanese market has hit some rough patches this year. One came in May, when a 20-year bond auction saw the *weakest demand* since 2012 amid President Donald Trump's tariff onslaught. A 40-year sale later that month *flopped* too.

(3) *The Trump effect*. This latest surge in Japanese yields comes as concerns about election largess collide with Trump's Tariff Turmoil (TTT). As it turns out, bets that Trump would pivot from import taxes to negotiations aren't panning out.

Japan's bond market is as paradoxical as they come. With *about 90%* of outstanding JGBs held domestically, Japan doesn't face conventional capital-flight risks. For several years now, the BOJ has been the largest buyer of Tokyo's debt. Governor Kazuo Ueda could tame market volatility by throttling back more aggressively on *tapering moves*.

Japanese Debt II: Turbulence To Come. Still, like most developed nations, Japan's *1.32 quadrillion yen* ($8.97 trillion) worth of government debt doesn't matter—until it suddenly does.

Notably, not everyone is alarmed by Tokyo's current debt trajectory. "Despite fiscal hand-wringing in the ruling coalition and media, Japan's government finances are in their best shape in decades, thanks to inflation boosting revenues and shrinking debt," argues Stefan Angrick of Moody's Analytics.

Here are a few of the many reasons that Japan's debt market could be in for a turbulent second half of 2025:

(1) *Monetary tightening.* One reason is that the BOJ remains determined to continue hiking interest rates with consumer price inflation rising at a *3.5% y/y rate* in May. Though down from *4% in January*, prices are uncomfortably above the BOJ's 2.0% target.

(2) *Demographic blues*. Also, the gaping disconnect between Japan's debt load and demographics turns off many global investors. As Allianz *points out*, "in the long run, the Japanese economy's vulnerabilities mostly stem from a declining, aging population, with gains in productivity not enough to compensate and a strong resistance to immigration."

(3) *Tariff Man.* The markets are also worried about the inflationary fallout from Trump's latest tariff aggressions. HSBC strategists Paul Mackel and Joey Chew note that the *falling odds* of a US-Japan trade deal are "souring market sentiment on the yen." Some worry this might upend the "yen-carry trade," wherein investment funds *borrow cheaply* in yen to bet on higher-yielding assets around the globe.

(4) *Election wild card*. If a poor election result forces Ishiba to step down, Trump's patience might run even thinner as it takes time for Japan to pick a new leader. And assuming that the next leader is more open to a trade deal than Ishiba, it would take even longer to get a new team in place to engage in real talks with Trump World.

(5) *Potential profligacy.* Add in the high odds that the next Japanese government turns to tax cuts and increased spending in ways that trigger the Bond Vigilantes. This pivot could have a typically calm debt market sending turbulence around the globe.

Trump Tariffs: Carrot, Stick, or Showmanship? In Monday's *Morning Briefing*, we warned investors that TTT isn't over even though the financial markets' calm suggests expectations of more TACO (Trump Always Chickens Out) moments, and we warned the President against hubris. Trump is doubling down on tariffs with abandon despite all that is at stake economically and politically ahead of the midterms. How can he be so reckless?

Responses poured in as they always do when we try to decode Trump. Readers argued that Trump's actions aren't about the economy but about power, security, and leverage.

We don't disagree. But only one man truly knows why President Trump is handing out tariffs like Oprah handing out gifts. The rest of us are left to speculate.

Here are six plausible motives behind Trump's tariff blitz and why some detractors aren't buying the arguments:

(1) *To generate revenues*. Supporters say TTT isn't just political theater—tariffs are raising serious cash. From January 1 through July 10, tariffs have funneled $99.6 billion into the US Treasury, up 111% from a year ago, according to Politico's *tracker*.

Tariffs could help offset the yawning federal deficit, which will be exacerbated by the tax cuts in Trump's "One Big Beautiful Bill." The Congressional Budget Office estimates that tariff revenues could reach $3 trillion over the next decade under a 10% universal tariff plus a 60% China-specific rate. For context, federal individual income taxes brought in roughly $2.5 trillion in 2024, while corporate taxes contributed about $490 billion, just north of the $300 billion tariffs should contribute annually.

(2) *To encourage domestic reindustrialization.* Trump's "America First" policies prioritize rebuilding domestic industry. Trump's message: If you want to sell it in the US, build it in the US. Tariffs are designed to protect the domestic manufacturing base.

The administration argues that Trump's trade policies already are driving investment in the US. The White House has *announced* more than $5.0 trillion in investment commitments under Trump: $3.2 trillion in manufacturing and industry; $1.9 trillion in technology and AI; and $50 billion in pharmaceuticals manufacturing and biotechnology. That includes massive investments from the UAE ($1.4 trillion), Quatar ($1.2 trillion), and Saudi Arabia ($600 billion) in US technology, aerospace, energy, and manufacturing.

(3) *To lower US trade deficits*. Trump repeatedly has championed the idea of "free, fair, reciprocal trade," aiming to level the playing field in global trade. Supporters argue that trade deficits are harmful because they must be offset by foreign investment.

Trump's primary concern is "conquest by purchase," whereby large trade deficits allow foreign rivals to buy US farmland, companies, and technologies. This could affect national security if these entities control critical industries. China in particular is channeling its trade surpluses into its ambition to become the world's AI superpower—raising alarms about US technological competitiveness and security.

(4) *To weaken the dollar.* Another theory: Tariffs are a tool to push the dollar's value down. The dollar already has slid roughly 10% during the first half of 2025, its worst start to a year in decades—even as US interest rates remain elevated. The markets may be pricing in trade policy risks and geopolitical shifts rather than just monetary policy fundamentals.

(5) *To address national security.* Tariffs aren't just economic; they're strategic. Trump wants

the Western Hemisphere to function as a secure energy bloc, with steady oil from Canada and a cooperative Mexico.

Canada, the US's largest oil supplier, is a key partner. For Trump, tariffs on Canadian imports serve as leverage to force Canada into even closer economic proximity. As "the 51st state," as Trump has called Canada, it wouldn't pay any US tariffs.

Mexico faces *ongoing* pressure from Trump's tariff threats to control fentanyl trafficking from China and stem migrant flows across the southern border. China's use of Mexico as a tariff-evading gateway fuels Trump's frustration.

(6) *To flex America's power*. Finally, some see tariffs as a pure show of force. As one portfolio manager told us: "This isn't about trade policy; it's about flexing American economic muscle." Access to US consumers is a privilege, not a right. Whether deterring China, pressuring allies, or signaling dominance, the message is clear: America sets the rules—and plays to win.

(7) *But not everyone's buying it*. Detractors call tariffs a "stealth tax" on consumers, i.e., it raises revenue for the government like a tax and comes out of consumers' pockets like a tax, but it doesn't require raising tax rates. Others say the White House's foreign and corporate investment numbers are padded with announcements that predate Trump's return to the Oval Office. Some defend trade deficits as a magnet for foreign capital—fueling US growth, not undermining it. And critics warn that a weaker dollar might not boost competitiveness so much as dent the dollar's reputation as the world's anchor currency.

Trump's tariffs have created lots of confusion among global leaders and investors trying to understand Trump's tariff strategy and objectives. We conclude that Trump's tariffs are tools that serve multiple purposes.

US Strategy: Don't Be Surprised by a Big Q2 Earnings Surprise. Joe has been tracking the quarterly earnings forecast for S&P 500 companies collectively each week since the data series started in Q1-1994. Each reporting season brings a typical playbook: Industry analysts cut their estimates gradually until the quarter's last month, when some companies warn of weaker results. The combination of falling forecasts for companies that have underperformed earlier expectations, steady forecasts for those holding good news close to their vests, and insufficient estimate increases so close to reporting time to balance out the lowered expectations invariably creates an "earnings hook" pattern in the charted estimate/actual data as reported earnings exceed the latest estimates—i.e., a positive earnings surprise.

In short, estimate revisions activity in quarters' final month paves the way for better-than-expected earnings reports. Joe's revisions data for Q2-2025 suggest no exception—and indeed a big earnings surprise:

(1) *S&P 500 Q2-2025 estimate unusually steady heading into reporting season.* By the last week of June, the S&P 500's Q2-2025 EPS estimate of $62.64 was down 4.6% from $65.57 at the quarter's start (*Fig. 3*). What was unusual is that all of the decline in the Q2 EPS estimate occurred by late-May, after which point the forecast stabilized instead of falling further as typical (*Fig. 4*). While that 4.6% decline in the Q2 EPS estimate was the largest in six quarters, it remained close to the 3.9% average decline over the 125 quarters since consensus quarterly forecasts were first compiled 30 years ago.

(2) *S&P 500 earnings growth streak at eight quarters.* Analysts expect the S&P 500's earnings growth rate to be positive on a frozen actual basis for an eighth straight quarter following three y/y declines through Q2-2023. They expect 3.5% y/y growth in Q2-2025, compared to 11.5% in Q1-2025 (*Fig. 5*). On a pro forma basis, they expect an eighth straight quarter of positive y/y earnings growth, up 5.7% in Q2-2025 versus 13.7% in Q1-2025.

The lack of downward revisions activity during the quarter's final month suggests yet another strong earnings surprise. With the earnings hook, Q2's final earnings growth rate could reach 10% on both frozen actual and proforma bases.

(3) *Ten S&P 500 sectors could show y/y growth, not six as analysts expect.* Analysts think just six of the S&P 500's 11 sectors will record positive y/y percentage earnings growth in Q2-2025, down from eight sectors in Q1-2025 and the fewest since Q1-2023. Four are expected to post only low-single-digit percentage declines. We think the typical surprise hook will make y/y earnings growers of most of them yet, with the final count of earnings growers coming in at 10, up from nine in Q1-2025.

Two sectors are expected to record double-digit percentage gains in Q2-2025: Communication Services at 31.9% y/y and Information Technology (17.8%). Energy is the biggest laggard with a forecasted y/y earnings decline of 23.9%, well behind Consumer Discretionary (-3.4), Materials (-3.2), Consumer Staples (-2.7), Utilities (-0.6), Industrials (1.8), Real Estate (2.5), Health Care (2.6), and Financials (2.7).

(4) *Most MegaCaps still growing faster than the S&P 500.* The Magnificent-7 group of stocks is expected to record y/y earnings growth of only 14.1% in Q2-2025 ([Fig. 6](#)). That's down from 25.8% during Q1-2025 and a peak of 55.4% during Q3-2023. Nvidia is Q2's biggest expected earnings grower, rising 45.4% y/y, way ahead of Microsoft (14.0%), Meta (13.2), Alphabet (13.1), and Amazon (4.8). Two Magnificent-7 companies should see earnings fall y/y in Q2: Tesla (-17.3%) and Apple (-0.2).

(5) *S&P 493 earnings growth positive again without faster growing MegaCaps.* S&P 500 earnings ex the Magnificent-7—a.k.a. "the S&P 493"—are expected to rise 2.1% in Q2—way below the prior two quarters' double-digit rates (their best in three years)—and even a Q2 earnings hook won't hoist growth into the double digits.

(6) *Profit margins holding up well.* The S&P 500's quarterly profit margin is forecasted to drop to 12.9% in Q2 from four-year highs of 13.4% in Q1-2025 and Q4-2024 ([Fig. 7](#)). The earnings surprise hook could see Q2's margin challenge the 13.5%-13.8% readings during Q2- to Q4-2021, when companies enjoyed immense pricing power amid supply-chain shortages.

The S&P 493's collective profit margin is expected to edge down to 11.5% from a 10-quarter high of 11.8% in Q1. It still seems a stretch to expect the S&P 493's profit margin to beat its 12.9% record highs of H2-2021 during 2025. Higher oil and gas prices could see Energy sector earnings grow meaningfully in 2026 and boost the 493's profit margin as well. Analysts currently expect it to improve to 12.4% by Q1-2026.

The Magnificent-7's collective margin is expected to drop to 24.2% in Q2 from a record-high 26.5% in Q1. By company, here are the comparisons: Nvidia (54.0% in Q2-2025, 53.8% in Q1-2025), Meta (34.1, 39.4), Microsoft (34.1, 36.8), Alphabet (28.5, 30.9), Apple (24.1, 26.1), Amazon (8.7, 11.0), and Tesla (6.5, 4.9).

Calendars

US: Wed: Industrial Production 0.1%; Capacity Utilization 77.4%; Headline & Core PPI 0.3% & 0.2%; MBA Mortgage Applications; Beige Book; Williams; Barr; Barkin. **Thurs:** Retail Sales 0.2%; Business Inventories 0.0%; Philadelphia Fed Manufacturing Index 0.4; Initial Claims 234k; NAHB Housing Market Index 33; Atlanta Fed GDPNow 2.6%; Daly; Cook; Waller. (Source: FX Street)

Global: **Wed:** UK Headline & Core CPI 3.4% & 3.5%y/y; Italy CPI 0.2%m/m & 1.7%y/y; Germany Buba Monthly Report. **Thurs:** Eurozone Headline & Core CPI 0.3%m/m, 2.0%y/y & 0.4%m/m, 2.3%y/y; G20 Meeting; UK Average Earnings Index + Bonus 5.0%; UK Unemployment Rate 4.6%; UK Claimant Change 17.9k; Japan CPI 3.3%y/y. (Source: FX Street)

US Economic Indicators

Consumer Price Index (*link*): The *headline CPI* matched expectations, rising 0.3% last month, its largest monthly gain since January. The CPI averaged monthly gains of 0.1% from February through May. The *core CPI* edged up 0.2%, a tick below the consensus estimate of 0.3%, also averaging monthly gains of 0.1% from February through May. Looking at the *yearly rates*, the headline rate accelerated for the second month to 2.7% in June, after easing from 3.0% in January to a four-year low of 2.3% in April. The core rate ticked up to 2.9% y/y in June, from a steady 2.8% the prior three months. The *headline* rate peaked at 9.1% during June 2022, while the *core* rate peaked at 6.6% during September 2022. During June, shelter costs increased just 0.2%, though the BLS noted the category was still the largest contributor to the overall 0.3% gain in June's monthly CPI. Categories posting noticeable increases over the past year include motor vehicle insurance (6.1% y/y), household furnishings & operations (3.3), shelter (2.8), medical (2.8%), and recreation (2.1).

Regional M-PMI (*link*): The New York Fed, the first regional Fed bank to report on manufacturing activity for July, showed activity picked up, posting its first positive reading since February. The *headline general business conditions* index climbed 21.5 points (to 5.5 from -16.0). Both the shipments (to 11.5 from -7.2) and new orders (2.0 from -14.2) measures moved from contraction to expansion, with shipments moving deeper into expansion territory. Inventory (15.6 from 0.9) investment showed an impressive accumulation in inventories this month. Meanwhile, delivery times (8.3 from 1.8) lengthened, while supply availability (-11.0 from -8.3) continued to deteriorate. *Turning to the labor market*, *employment* (9.2 from 4.7) in the manufacturing sector moved higher again in July—after posting its first positive reading since January during June, while the average workweek (4.2 from -1.5) also rose in July—the first time both these measures have been positive since 2022. *As for pricing*, the *prices-paid* (56.0 from 46.8) measure accelerated this month, while the prices-received (25.7 from 26.6) measure held steady. *Looking ahead*, firms turned mildly optimistic in July, with business conditions edging up 2.9 points (to 24.1 from 21.2). The report noted: "New orders and shipments are expected to increase, and supply availability is expected to be little changed. Capital spending plans picked up."

Global Economic Indicators

Eurozone Industrial Production (*link*): Eurozone industrial production rebounded in May after contracting in April for the first time since the end of last year. *Industrial production* jumped 1.7% after slumping 2.2% in April; output had jumped 3.6% the first three months of this year. Nondurable consumer goods led May's increase in production, soaring 8.5% during the month, followed by energy (+3.7%) and capital goods (+2.7) output. Partially offsetting those gains was a slump in consumer durable goods (-1.9) and intermediate goods (-1.7) production. *Compared to a year ago*, production rose 3.7%, after slowing from 3.6% in March to 0.2% in April. Nondurable consumer goods (11.6% y/y) production posted a double-digit increase in May, with capital goods (4.5) and energy (2.6) output also in the plus column. Output of intermediate goods (-1.8% y/y) posted the largest yearly decline, while consumer durable goods (-0.1) production was basically flat with a year ago. Looking at the *largest Eurozone economies*, data are available for the top four and show production rose on a monthly and year-over-year basis in both Germany (2.2% m/m & 1.9 y/y) and Spain (0.6 & 1.7), while they fell in both Italy (-0.7% & -0.9%) and France (-0.5 & -1.0).

Contact us by *email* or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-241-6502
Melissa Tagg, Senior Global Investment Strategist, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
William Pesek, Contributing Editor, 516-277-2432
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-228-9102