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Morning Briefing

On The Fed, The BOJ & S&P 500 Earnings

Check out the accompanying [chart collection](#).

Executive Summary: Fed Chair Powell came across as hawkishly dovish in his latest public remarks, observes Melissa. He noted risks to the labor market, the near completion of the Fed's quantitative tightening, and inflationary pressures that are only temporary—all dovish points. But he warned of risks in whatever action the Fed takes. Other Fed officials speaking recently echoed Powell's measured approach. ... Also: William discusses the risks posed by the yen carry trade, a strategy that gains appeal as the yen falls. If this speculative trade fails, it puts markets everywhere at risk. ... And: Joe analyzes S&P 500 companies' estimate revisions data, which he finds to be impressively strong for most sectors.

The Fed: Powell's Hawkish Dovishness. In Federal Reserve Chair Jerome Powell's latest [speech](#), on Tuesday in Philadelphia, he acknowledged that the labor market faces rising risks to employment. He also maintained that current monetary policy is restrictive, with the federal funds rate above its neutral level, restrictive enough to keep inflation on course to drop to the Fed's 2.0% y/y goal. Moreover, the balance-sheet runoff—a form of quantitative tightening—may be nearing completion, as reserves are approaching appropriately “ample” levels.

The Fed is navigating the “tension between our employment and inflation goals,” Powell said, with “no risk-free path” forward.

For perspective, the federal funds rate stands at 4.00%–4.25% following September's quarter-point cut, while the Fed's balance sheet holds about \$6.3 trillion in securities—about 30% below its 2022 peak ([Fig. 1](#) and [Fig. 2](#)). The financial markets are pricing in about two additional cuts over the next six months, consistent with Powell's speech and the Fed's rate path forecasts ([Fig. 3](#)).

Powell's latest remarks align with recent commentary from other Fed members, the FOMC's September Minutes, and the committee's latest forecasts. Current dissent is focused on

how much to cut and how fast, rather than whether to keep cutting at all. Powell is advocating for a paring knife instead of an axe.

Here's more about Powell's latest comments and the policy views of other Fed officials who've spoken recently:

(1) *Labor's warning label*. Powell observed that the labor market has become "less dynamic and somewhat softer," noting that "downside risks to employment appear to have risen." Payroll gains, he said, have slowed sharply, though the government shutdown has delayed data that normally guides the FOMC. Powell emphasized that the job market shows low hiring and low separations, evidence of cooling without collapse ([Fig. 4](#) and [Fig. 5](#)).

(2) *Inflation's temporary pressures*. Powell acknowledged that inflation remains above the Fed's 2.0% target, but he attributed this mostly to tariff pass-throughs that should diminish over the longer term ([Fig. 6](#)). The [September Minutes](#) similarly highlighted that the latest price pressures likely reflect temporary effects of tariff increases rather than sustained inflation.

(3) *Fed Speak somewhat echoes Powell*. Together, the latest chatter from Fed officials confirms that the Fed will be doing more cutting, but how much could still be on the table. The dispersion on the magnitude of the coming cuts lends credence to Powell's balancing act.

Supporting Powell's measured approach, Vice Governor Michael Barr [cautioned](#) that inflation risks still warrant patience. However, Vice Chair Philip Jefferson [suggested](#) that "tariff increases typically represent a one-time change in the price level." Meanwhile, New York Fed President [John Williams](#) and Fed Governor [Michelle Bowman](#) backed more rate cuts to support the fragile jobs market. Fed Governor Stephen Miran [defended](#) a faster move as absorbable given calm bond markets.

(4) *The Minutes in motion*. The Minutes of the FOMC's September meeting offered a preview of Powell's October message: a shift from signaling further policy easing to executing on it. Compared with June, the Committee's focus has clearly moved from fighting inflation to managing employment risk—a shift Powell underscored in Philadelphia. The internal disagreement in the Minutes continues to reflect the current debate that Powell is now guiding on the size and speed of the next cuts.

(5) *SEP: restrained optimism*. A look back at the September FOMC meeting participants'

[Summary of Economic Projections](#) also reinforces Powell's tone—cautious and with risks increasingly tilted to the downside. Participants' median expectation for inflation is a return to 2.1% y/y by 2027, suggesting confidence that price stability remains within reach while interest rates gently glide down. Economic projections were modest, including real GDP growth of 1.6% for 2026 and a slight rise in unemployment to 4.4% next year before stabilizing at 4.2% in the longer run.

The median federal funds rate forecast now sits at 3.60% for year-end 2025, anticipating about two quarter-point cuts from now. That is not too far from the longer-term projection of 3.00%, presumably the neutral rate in the Fed's view.

(6) *Waller and the rise of AI*. Powell avoided the elephant in the room—artificial intelligence (AI) and its impact on jobs. But Governor Waller on October 15 [discussed](#) AI's potential to transform productivity. When new technology arrives, he said, the first questions are about jobs: Will it replace human labor? Will it make workers more productive? He concluded that AI will bring productivity enhancements and new job creation in time, but job losses may happen up front.

Japanese Economy I: Yen Carry Trade's Untimely Return. Most of what currency traders thought they knew about 2025 earlier this year has gone awry: The dollar isn't tanking, the euro isn't basking in a reserve-currency glow, and the yen isn't skyrocketing.

In fact, the Japanese currency has been trending in the [opposite direction](#) for two reasons: (1) The fallout from President Trump's trade war forced the [Bank of Japan](#) (BOJ) to shelve its tightening plans; and (2) the two most likely candidates for next Japanese prime minister—Sanae Takaichi or Yuichiro Tamaki—favor a return to the fiscal and monetary expansion of old.

The down-trending yen enhances the allure of the yen carry trade, an investment strategy that involves borrowing yen and using it to purchase other financial assets around the world. This most crowded of strategies explains why sudden zigs in the yen can cause major zags in the S&P 500, Argentine debt, Indian real estate, the New Zealand dollar, South African commodities, cryptocurrencies, you name it. This is why Arif Husain at T. Rowe Price calls the "[San Andreas fault of finance](#)."

Let's look at why the yen's downward trajectory should worry financial markets everywhere:

(1) *Market blowups*. The most recent example of the trade blowing up was in [August 2024](#),

just after the BOJ hiked its key interest rate to 0.25% ([Fig. 7](#)). As the yen surged, the Nikkei 225 Stock Average had its worst day [since 1987](#). And hedge funds everywhere faced sizable margin calls. Around that time, the Bank for International Settlements [warned](#) that “hedge fund returns ... had become more sensitive to the proxies for returns on currency carry trades.”

Now, traders are looking at a different trajectory for the BOJ. Though Governor Kazuo Ueda and his fellow BOJ board members insist that more rate hikes are coming, the markets are not buying it. Even before Japan’s next prime minister is named, traders generally are expecting a weaker yen.

(2) *BOJ uncertainty*. Since January, when Ueda & Co. raised rates to a [17-year high](#) of 0.5%, Japan’s tightening cycle has been on ice. The economic chilling effect of Trump’s tariffs has the government expecting [0.7% y/y](#) growth this fiscal year, at best. The BOJ hardly wants to be blamed for tipping Japan into recession.

This changing of the political guard raises questions about whether the BOJ’s next move could be to ease. This prospect has put the [yen carry trade](#) back in vogue. Masayuki Nakajima at Mizuho Bank thinks the yen could fall toward [180 per euro](#) from 175 now. If the BOJ turns more dovish, Nakajima says, “the carry trade could resume, and the yen could weaken broadly.”

(3) *Risk-off time?* Yet risks abound. One is that the US and China aren’t bluffing as both Trump and Xi Jinping ratchet up tensions. The odds favor both leaders’ blinking and returning to negotiations. Neither Trump nor Xi wants a deep recession. On the off chance that the trade hostilities intensify, the yen might surge, a typical side effect of “risk-off” market shifts.

Japanese Economy II: Monetary & Fiscal Policy in Flux. Incongruous though it might seem, the world’s top creditor nation is also its most indebted major economy. In recent months, the inflationary fallout from the US tariffs had investors wondering how Japan can cap a debt-to-GDP ratio [as high as 260%](#) when its population is shrinking at a [record pace](#) and inflation exceeds GDP growth. In August, core CPI increased at a [2.7% y/y](#), well above the BOJ’s 2.0% inflation target ([Fig. 8](#)).

This is all disconcerting enough to bond investors. But recent political events portend fiscal and monetary policy changes that have the Bond Vigilantes up in arms. Let’s take a look:

(1) *Fiscal loosening likely.* The big worry for the bond market is that newly powerful opposition parties might realize their long held dream of cutting taxes, particularly on consumption. None of Japan's leading parties has a majority, so they're in horse-trading mode (we should know who will lead Japan next within 24-48 hours). The top contenders to replace Prime Minister Shigeru Ishiba: his Liberal Democratic Party mate Takaichi, 64, or Yuichiro Tamaki, 56, from the Democratic Party for the People.

Both candidates want to lower sales taxes. The Bond Vigilantes already have had a thing or two to say about that: Concerns about a budget-busting fiscal pivot recently sent 20-year Japanese government bond yields to the highest [since 1999](#) ([Fig. 9](#)).

(2) *Monetary tightening less likely.* A big source of [market friction](#) is the BOJ's effort to end the quantitative easing it pioneered in 2001. Yet with economic risks mounting, the BOJ's tightening cycle is in question. Both candidates would likely prod the BOJ to rethink its tightening strategy.

Additionally, the Fed now appears unlikely to ease as much as many investors have hoped. The prospects of the BOJ not tightening and the Fed not easing virtually assure a weaker yen—and, with it, another wave of yen borrowing to finance higher-yielding bets around the globe.

Yen liquidity adds fuel to any potential bubbles out there—be they in AI, gold, or crypto—which might complicate central banks' ability to tame assets markets at times of distress. The bigger an already crowded, highly leverage trade gets at a moment of maximum geopolitical peril, the greater the risks and volatility over the year ahead.

Strategy: Estimate Revisions Data Settling in Orbit. This week, LSEG released its October snapshot of the monthly consensus revenues and earnings estimate revision activity over the past month. In our [S&P 500 NRRI & NERI](#) report, we index this activity by the number of upward revisions less downward ones, expressed as a percentage of total forward estimates. A zero reading indicates that an equal number of estimates were raised as lowered over the past three months.

Our resulting Net Revenues Revisions Index (NRRI) and Net Earnings Revisions Index (NERI) reflect three months of activity, encompassing an entire quarterly reporting cycle (since analysts' tendency to revise their estimates differs at different points in the cycle).

Joe's review of the October data found that revisions activity remains impressively strong

among most of the S&P 500's 11 sectors, as it has since bottoming in May. More than a few sectors' data stand at or near multi-year highs. Some highlights:

(1) *S&P 500 NERI at 47-month high.* The S&P 500's NERI index rose 0.6ppt m/m to a 47-month high in October after turning positive in August for the first time in 11 months. It improved to 5.9% from 5.3% in September, having risen for five straight months from a 28-month low of -7.8% in May ([Fig. 10](#)).

October's 5.9% NERI reading ranks in the top 11% of the 486 monthly observations since March 1985, when the data were first calculated, and is well above the average reading of -1.9% seen since. More impressively, the 13.0ppts jump in NERI in the five months since May is its biggest improvement since December 2020 and ranks 15th overall, or among the top 3% of the five-month changes since 1985.

NERI finally has broken out of its moribund range since June 2022 and settled well above its average historical readings. Such speedy NERI reversals historically have preceded positive readings for at least the next 12 months. That supports the recent recovery to record-high stock prices and suggests further above-trend gains ahead.

(2) *Many sectors have positive NERI.* Seven S&P 500 sectors recorded positive NERI again in October, the most since August 2024 and up from five sectors in August. That's a notable improvement from May, when only Utilities' NERI was positive. Though there were no new sectors in the positive NERI club this month, these two continued to improved markedly m/m to multi-year highs: Consumer Discretionary and Utilities ([Fig. 11](#) and [Fig. 12](#)). Early-mover Financials has been in the positive club during 17 of the past 20 months, and its NERI remains near its highest level since early 2022 ([Fig. 13](#)).

Here are the October NERI readings for the S&P 500's 11 sectors: Information Technology (12.4%, 47-month high), Financials (11.4), Communication Services (11.2, 47-month high), S&P 500 (5.9, 47-month high), Health Care (5.6, 47-month high), Industrials (4.7), Utilities (4.4, 57-month high), Consumer Discretionary (3.9, 24-month high), Materials (-2.1, 15 months negative), Real Estate (-2.3, 10 months negative), Consumer Staples (-2.5, 16 months negative), and Energy (-4.8, 15 months negative).

Calendars

US: Thurs: Philadelphia Fed Manufacturing Index 9.1; NAHB Housing Market Index 33;

IMF Meetings; Barr; Barkin; Waller; Bowman. **Fri:** IMF Meetings. (Source: FX Street)

Global: Thurs: German Buba Monthly Report; UK GDP 0.1%*m/m*; UK Headline & Manufacturing Industrial Production 0.2%, 0.2%; UK BOE Credit Conditions Survey; Italy CPI -0.2% *m/m*, 1.6%*y/y*; Lagarde; Lane; Mann; Kashkari. **Fri:** Eurozone Headline & Core CPI 0.1%*m/m*, 2.2%*y/y* & 0.1%*m/m*, 2.3%*y/y*; Pill; Greene. (Source: FX Street)

US Economic Indicators

Empire State M-PMI ([link](#)): Business activity in the New York region moved from contraction to expansion in October, posting its third positive reading in the past four months. The headline general business conditions index climbed 19.4 points (to 10.7 from -8.7) as both new orders (to 3.7 from -19.6) and shipments (14.4 from -17.3) measures rose 23.3 and 31.7 points, respectively. *Turning to the labor market*, the *employment* (6.2 from -1.2) gauge moved from contraction to expansion, rising 7.4 points, while the average workweek (-4.1 from -5.1) continued to contract, though at a slightly slower pace. As for pricing, both the prices-paid (52.4 from 46.1) and prices-received (27.2 from 21.6) measures picked up. Looking ahead, future general business conditions (30.3 from 14.8) climbed to its highest level in several months, indicating firms expect conditions to improve in the months ahead, with new orders (34.9 from 16.6) and shipments (31.6 from 13.5) following suit. As for future pricing, the forward looking indicator for prices-paid (65.0 from 57.8) accelerated during the month, while the prices-received (43.7 to 43.1) gauge showed little change.

Global Economic Indicators

Eurozone Industrial Production ([link](#)): Production in August moved from expansion to contraction, despite a 9.8% surge in Ireland's industrial output—which tends to be notoriously volatile month-on-month. Headline production fell 1.2%, not as steep as the consensus estimate of a 1.6% drop and follows an upwardly revised 0.5% gain in July, first reported up 0.3%. Production of capital (-2.2%) and consumer durable (-1.6) goods posted the largest declines during the month, with energy (-0.6) and intermediate (-0.2) goods output fractionally lower; consumer nondurable goods production ticked up 0.1%. Compared to a year ago, production rose 1.1%, slowing from July's 2.0% gain, with consumer nondurable goods (+8.2%) output posting the largest gain. Consumer durable (-

2.6% y/y), intermediate (-1.7), energy (-0.7), and capital (-0.4) goods output were all below year-ago levels. Looking at the *largest Eurozone economies*: Production in Germany (-5.2% m/m & -4.6% y/y), Italy (-2.4 & -2.7), France (-0.7% & 0.5), and Spain (-0.1 & 3.2) all fell on a monthly basis, though only Germany and Italy posted marked declines. On a year-over-year basis, Germany and Italy were below year-ago levels, while Spain and France were above year-ago levels—with Spain posting the largest gain.

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