RV Pro

Steno Signals

with Andreas Steno

Steno Research

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The biggest inflation divergence between the Eurozone and the U.S. in years

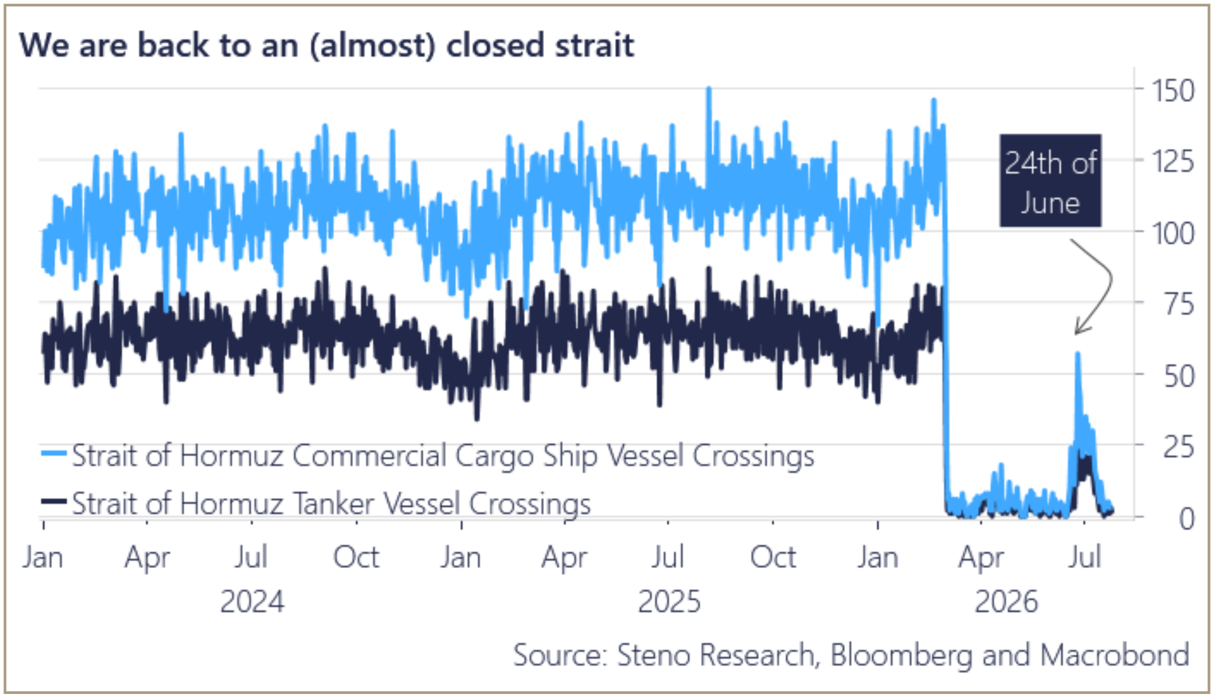
Our nowcasts show the U.S. decelerating on inflation while the rest of the world re-accelerates on the back of the Middle East. Meanwhile, the earnings "wall of worry" is built on the most mean-reverting consensus forecasts I have ever seen...

Happy Monday from Copenhagen, where I am back at a normal desk and no longer writing with a tiger staring at me through the glass.

Before we take a guided tour around the nowcasts, let's touch on the latest from Iran, which is obviously the elephant in the room for markets again. The weekend saw a complete halt in attacks from the U.S., reciprocated by an Iranian pause in attacks. The pause came as the U.S. leadership contemplated a more widespread bombing campaign against Iran to go after the "20% remaining targets". Why the pause, then? Well, one explanation is the depletion of U.S. stockpiles. We will dive further into this in Wednesday's The Drill and look at the implications for the defense industry. More importantly, it shows that Donald Trump is trying everything to limit and end the war. This has been the case since 1-2 weeks into the war and is still very evident. "When you find yourself in a hole, stop digging," as the saying goes. While Trump hasn't found a way out of the hole yet, he has indeed stopped digging. And this should give comfort to markets in the coming days.

It also opens the prospect of a quicker resolution and resumption of business as usual in the strait. The problem is that the Iranians now won't let go of their control of the Hormuz Strait, and the U.S. has no military means of forcing them to do so. So a return to the Memorandum of Understanding or a new one probably means 1) allowing Iran some control over the Strait — perhaps joint with Oman. 2) probably means no solution on nuclear weapons, proxy groups or other issues. I'm still not overly optimistic about this, but as mentioned, we shouldn't underestimate Donald Trump's desire to put this to bed.

Chart of the week #1: Not much activity in the Hormuz...

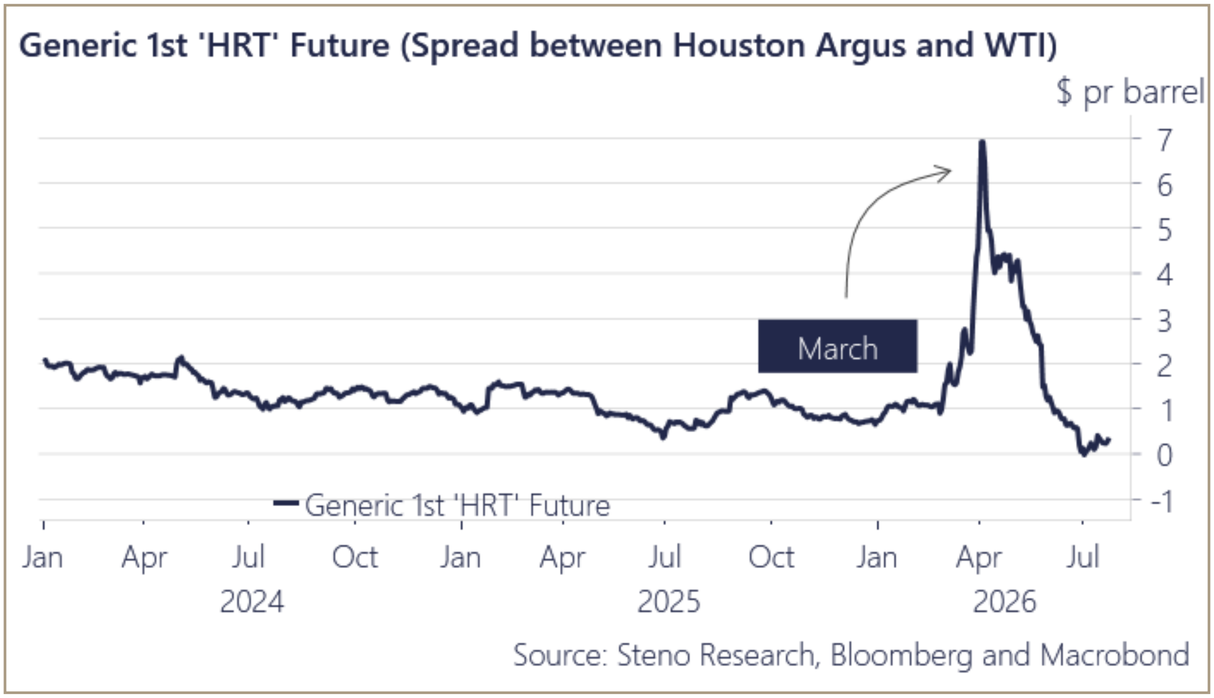


The market has quite clearly been trading off the rate of change (progress/regress) in Iran, which has been a drag on markets over the past few weeks. But as we rightly said when Round 2 of the Iran bombings started, the market rarely discounts the same event twice, at least not with the same intensity.

Yes, we have seen a material washout of the oil shorts (which we also warned against), but various gauges of how “panicky” the market is over oil are still in much calmer territory than they were in March/April. There is, for example, no international panic bid for U.S. oil exports, nor anything close to the same level of extremeness in prompt spreads as we saw in March/April.

We therefore reiterate that there is a clear limit to how much panic the Iran 2.0 situation will create, and we think we turned a page in equity momentum last week (despite an overall poor week for markets). Inflation is still printing soft in our U.S. nowcasts, and we are starting to see some of the same trends that emerged during April, which may bode well for what lies ahead, especially into the autumn. More on that below.

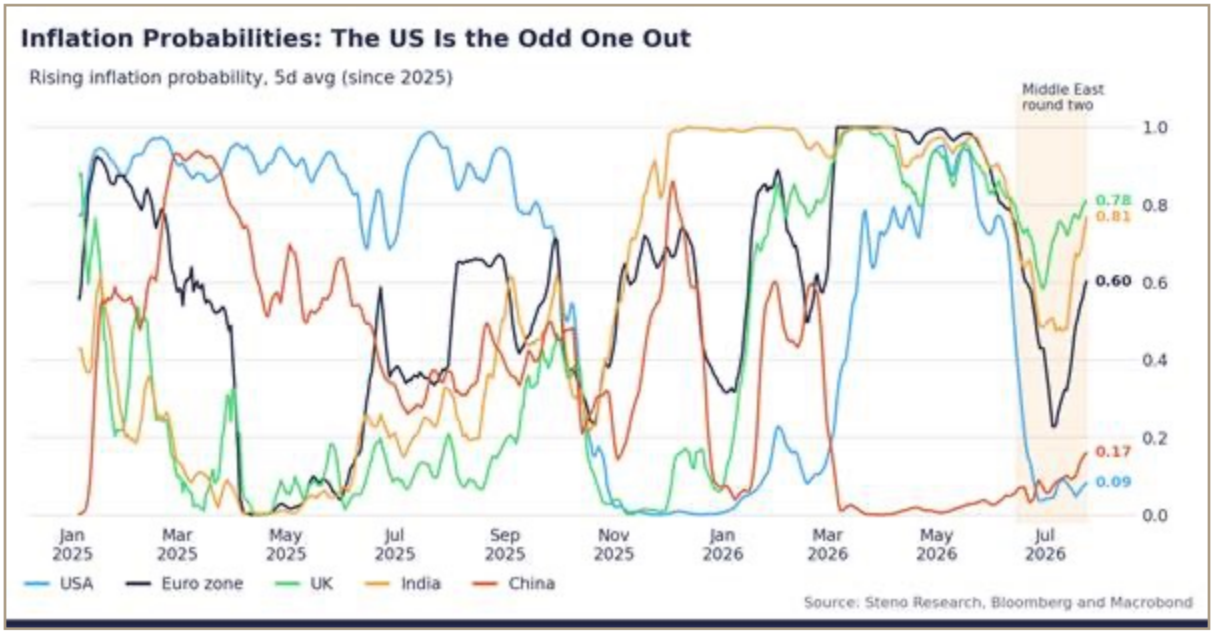
Chart of the week #2: The oil market is far less stressed than in March/April



A guided tour around our nowcasts: the U.S. is the odd one out

Let's start with the state of the art. Our rising-inflation probabilities have shot up across essentially every economy we track since the Middle East entered round two of the conflict. The Euro zone, the UK, Japan, the lot… Everyone is flashing amber-to-red on inflation momentum again. And then there is the U.S., sitting at the bottom of the scoreboard with a probability that looks like a typo. The biggest inflation divergence between the Euro zone and the U.S. in years, and it is happening WHILE oil is rising.

Chart 1: Rising-inflation probabilities are up everywhere in round two of the Middle East conflict ... except in the U.S.



Why is the U.S. the odd one out? Three reasons, in order of importance.

First, the U.S. is simply better equipped to deal with an energy shock than the rest of the world. It is a net energy exporter with domestic molecules priced in domestic currency, while Europe imports its marginal energy in USD at whatever price the two straits allow on a given morning. An oil-and-LNG scare is a terms-of-trade GIFT to the U.S. relative to Europe, not a symmetric shock.

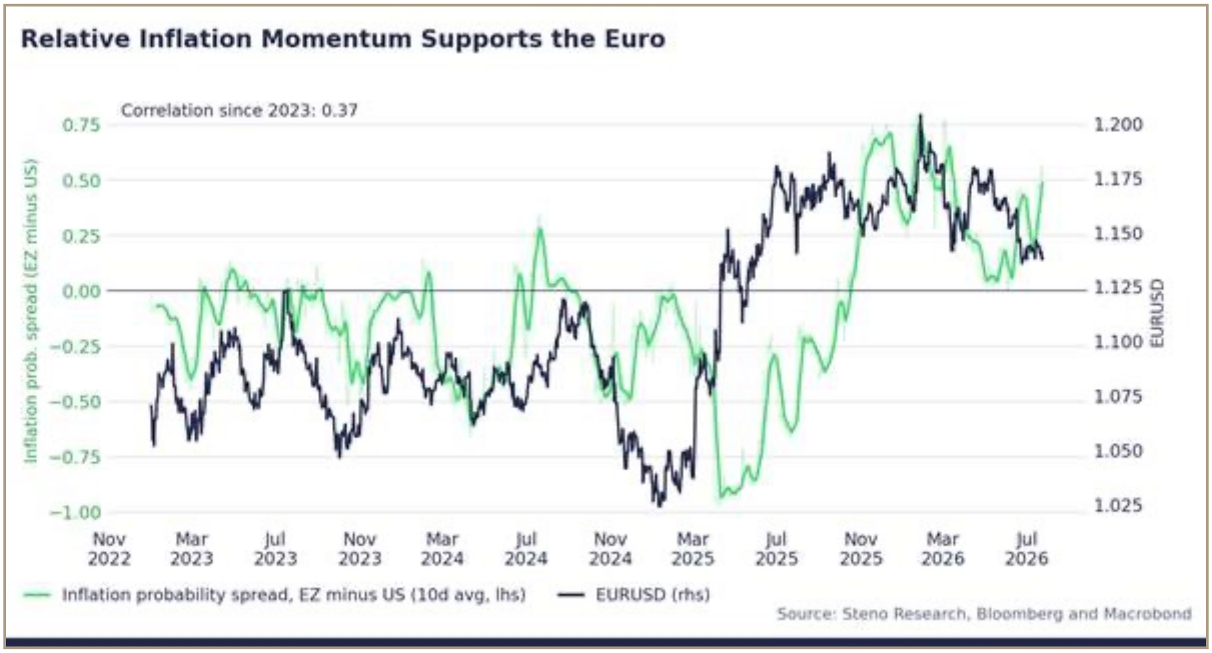
Second, we see genuine softness outside the energy basket in the U.S., partly because tariffs are now being paid back through goods prices (the great tariff pass-through is running in reverse, exactly as our nowcasts hinted it would in July).

And third, the post-World Cup blues. The services complex got a lovely one-off bump in April/May from the greatest show on earth being hosted on American soil, and hotels, airfares and recreation are now handing that bump straight back. One-offs cut both ways, even if the hawks only ever remember the first half.

The FX market has started to sniff this out. Relative inflation momentum (in our nowcasts) has been a decent EUR/USD compass since 2023 (correlation of 0.37, not a law of nature but not noise either), and right now it points towards a supported euro.

A hawkish-by-default ECB staring at re-accelerating energy inflation, against a Fed staring at soft underlying prints it has been handed every excuse to ignore, but the difficult part is just that the FX market also tends to look at the balance of trade, which in case of a very energy-uniform inflation spike tends to heavily move against the EUR. So currently, there is no clear-cut case to short the USD, even if our inflation data wholeheartedly supports such a position. Still, we are slowly but very cautiously leaning into the trade...

Chart 2: Relative inflation momentum supports the EUR...



Growth and liquidity: this looks VERY much like round one

On growth, the picture has flipped in the past couple of weeks. The U.S. is again gaining a little rate-of-change momentum while, again, the momentum is rolling over outside of the U.S.... If you overlay the current constellation with round one of the Iran war in March/April, the resemblance is almost embarrassing. Energy shock hits, Europe and Asia wobble on the growth nowcasts, the U.S. shrugs and quietly re-accelerates on relative terms. We have seen this movie, we know the ending, and the ending was USD equities outperforming until the dust settled.

Chart 3: Growth rolling over everywhere… while U.S. liquidity remains the outlier support

Which brings me to liquidity, where I disagree vehemently with most other pundits, including Michael Howell, whom I otherwise read with great interest. Our liquidity nowcasts for the U.S. are still solid and still **rising**, admittedly less convincingly than a few months back, but rising is rising. The doom-mongering about a liquidity cliff simply does not show up in our numbers.

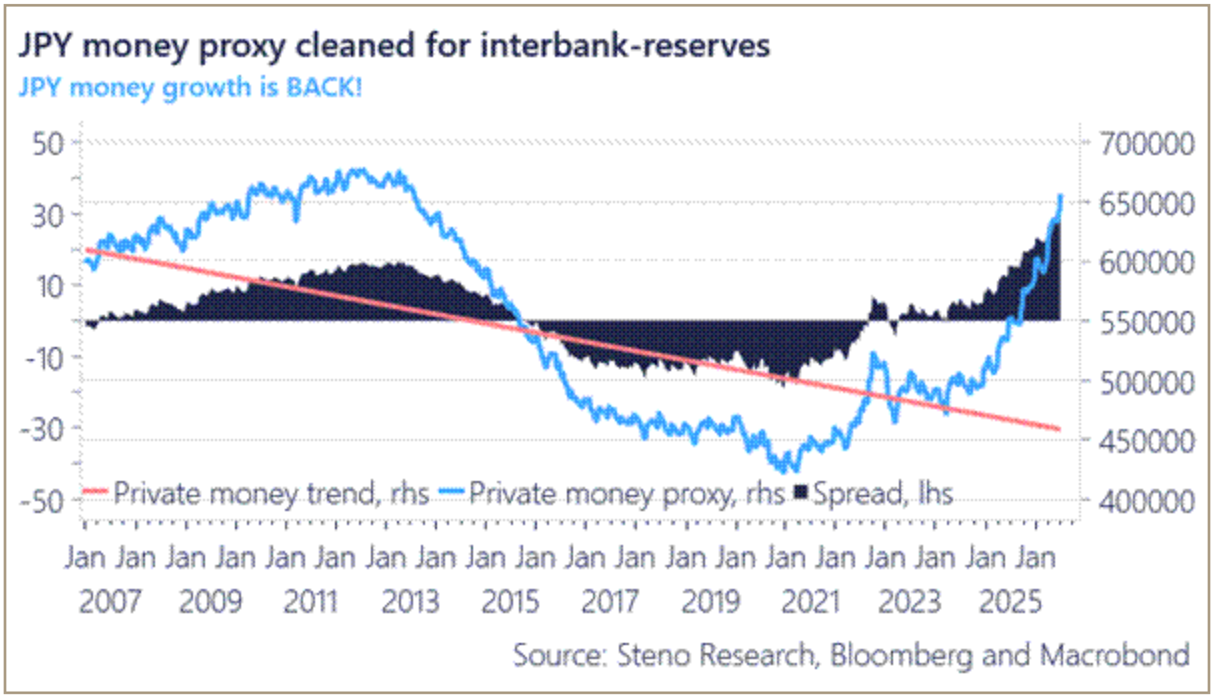
The core of my disagreement is how to factor in private credit creation, and this has proven extraordinarily important in this cycle. Private credit creation is actually very **positively** correlated with higher long bond yields, which sounds counterintuitive until you remember what a bank actually does for a living.

Take Japan as the cleanest case study on the planet. Private credit creation has **exploded** in Japan as the yield curve was finally allowed to function again after decades of yield curve control. Give a commercial bank a steep curve, and it will happily borrow short, lend long, and manufacture money for you. That is the business model in its essence, and it is actually amplified by higher long bond yields, as long as the curve slopes. Take the curve away, and it buys JGBs and sulks.

The Japanese private money numbers are back for the first time in a generation, and the long end going **up** is precisely why. This money creation has happened while bond yields have risen sharply and while the BoJ has hiked interest rates several times, even as it removed stimulus from bond markets. I am yet to hear a single good pushback on this observation, which is, by the way, going global, with private/commercial banks doing the heavy lifting on money creation in most economies today.

Had my liquidity models not included **both** money created by central banks and money created by private banks, I would have completely missed this... and I think Mike Howell does miss it.

Chart 4: JPY money growth is BACK.. private credit creation exploded once the curve was allowed to function



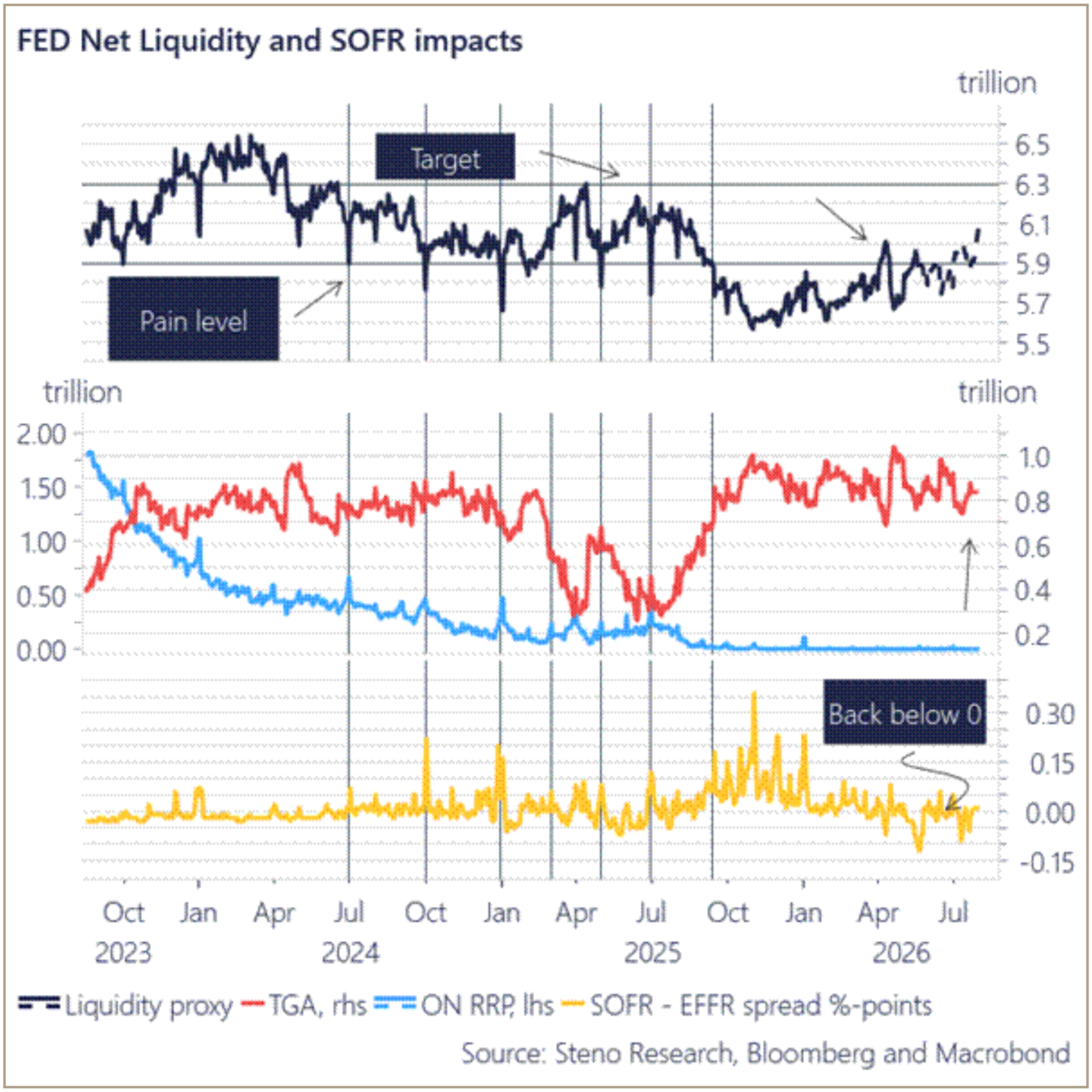
Mike Howell, to my understanding, uses a measure of long bond yields as an input in his daily liquidity score, on the logic that bonds are "collateral" to borrow against, and higher yields mean falling collateral values, which in turn means less liquidity. And that is obviously true in repo markets, no argument there. But it kind of discards the extremely positive effects a steeper curve has had on credit creation in the commercial banking system.

A higher long end **shifts** liquidity creation from the central bank/shadow/collateral channel to the commercial banking channel; it does not kill it. At least as long as the curve is steep and upward sloping, which it very much is. Punishing the liquidity score for the exact thing that is turbo-charging bank lending strikes me as a category error, and it is why our nowcasts and Mike Howell's collateral-based scores are telling such different stories right now.

On the U.S. specifically, we still have a decently benign forecast for liquidity, and we do **not** see a cliff edge when Bessent updates the Treasury's issuance projections in early August. The TGA has actually been running fairly in line with the UST's own expectations (and way higher than mine, credit where credit is due), which means there is simply no need to ramp up issuance materially in the refunding announcement, as I had otherwise feared. No issuance ramp, no reserve drain shock, no liquidity cliff.

The SOFR complex agrees with us, for what it is worth. Liquidity should be fine for now.

Chart 5: Fed net liquidity is holding up, and the TGA has behaved in line with the UST's own projections..

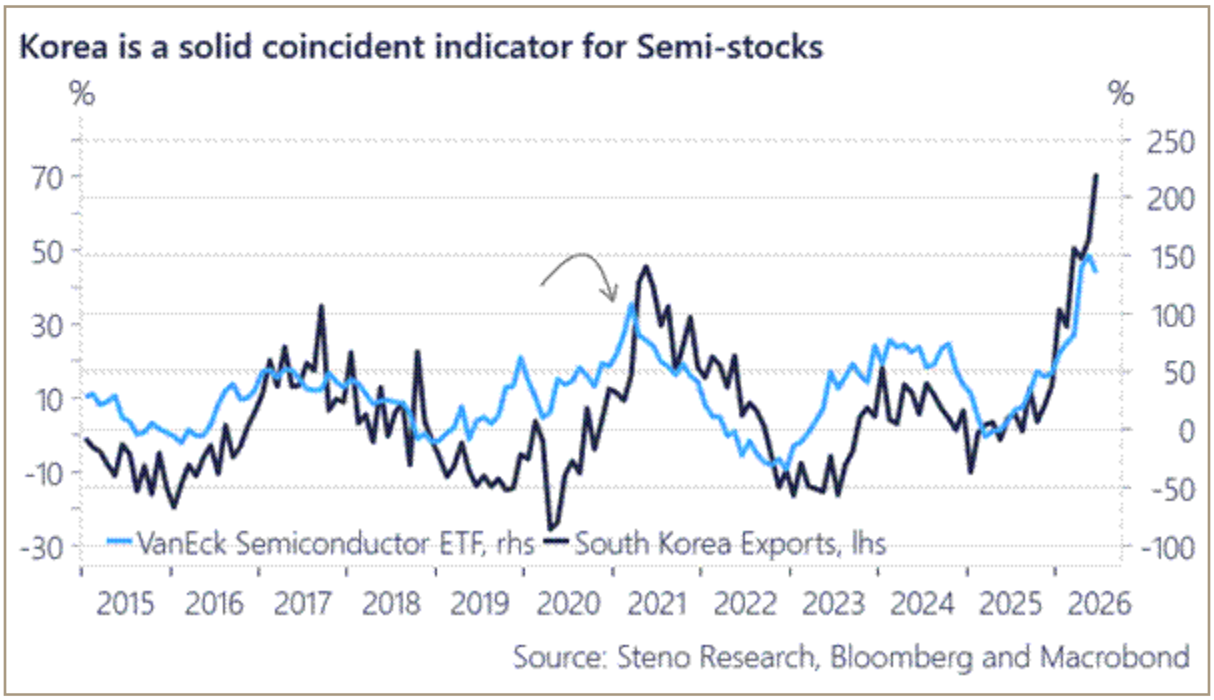


Market focus: The rate of change "wall of worry"... Is everything just going to be flat from 2027 and onwards?

Over to markets, where the wall of worry du jour is the RATE OF CHANGE of earnings in everything AI, CapEx and semiconductors. And let me concede the arithmetic upfront. Of course, the rate of change will drop.

We are many-x'ing revenues in parts of the semiconductor complex THIS year, and if you extrapolate triple-digit (or even four-digit in some cases) growth rates for another couple of years you get to numbers so outrageous that even I would blush. Nobody serious is arguing for that, and the second derivative turning lower is a mathematical certainty, not new information. Korea's export cycle, our favorite coincident indicator for the semi stocks, will roll over in rate-of-change terms at some point too (maybe it has already happened). That is what cycles in LEVELS look like when you chart them in CHANGES.

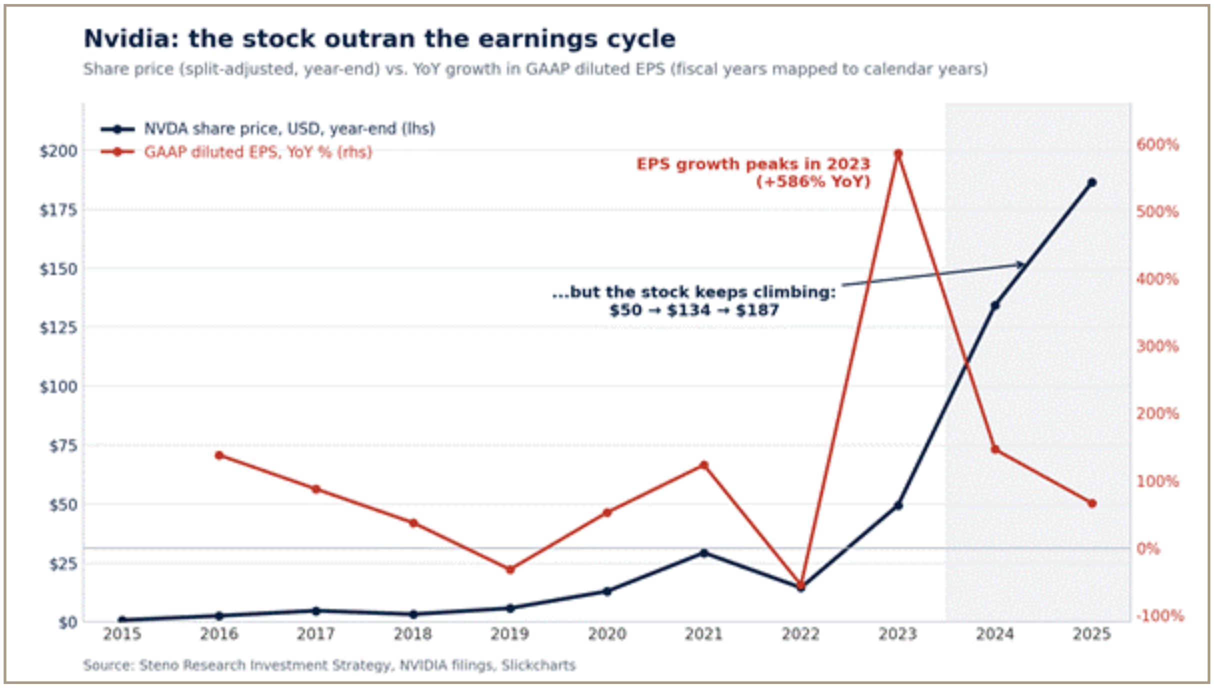
Chart 6: Korea exports remain a solid coincident indicator for semi stocks...



But we have run this exact experiment before, and recently.

Nvidia's EPS growth peaked in 2023 at +586% YoY. Peak rate of change, textbook wall of worry, and every mean-reversion model on the street screamed sell. The stock then went 50, 134, 187 over the following years. Peak GROWTH is not peak EARNINGS (and it is an especially dangerous assumption to make from incredibly high earnings growth levels), and it is certainly not peak stock price, as long as the level keeps compounding. We made this exact argument on Micron in the weekly, and it applies to large parts of the whole complex.

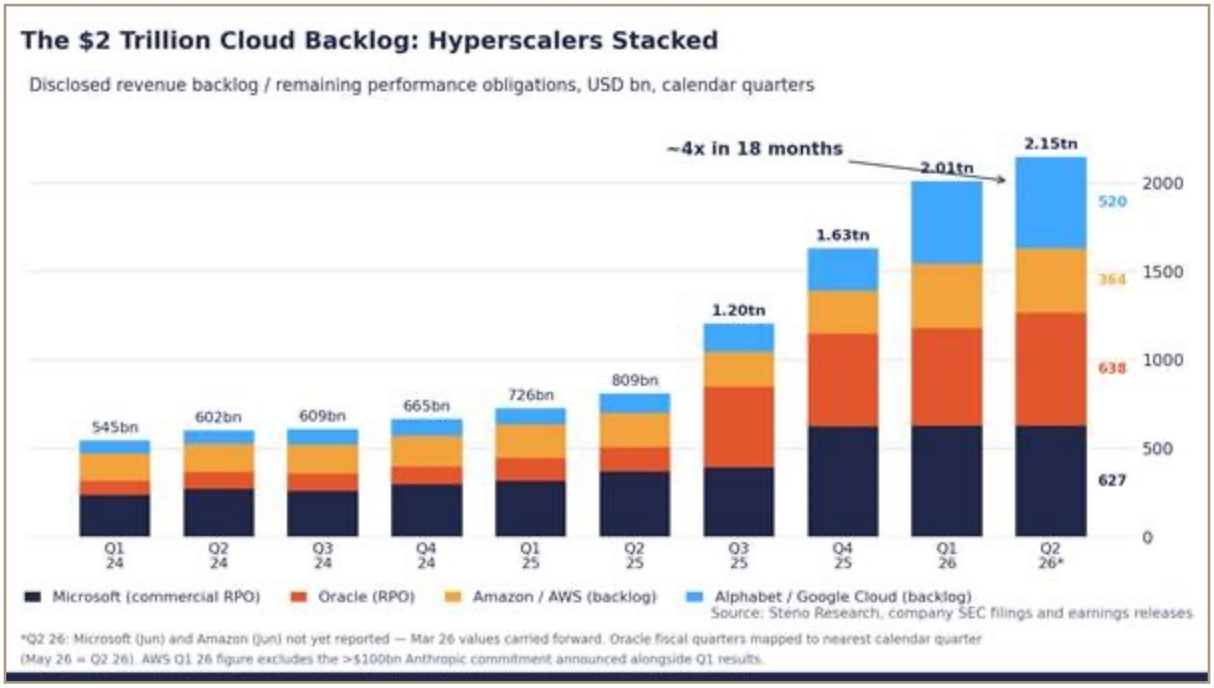
Chart 7: Nvidia 2023... EPS growth peaked, the stock tripled anyway



And here is the interesting thing: the (hyperscaler) backlog actually supports the spending. The disclosed cloud backlogs (remaining performance obligations) across the hyperscalers have gone up roughly 4x in 18 months to a combined 2.15 TRILLION dollars (we are still waiting for the last few quarterly reports this week). That is contracted, signed, we-owe-you-this-compute revenue, not a hope and a PowerPoint.

Every quarter of CapEx is being underwritten by a backlog that grows faster than the spending itself. This is the part the rate-of-change bears consistently skip past, presumably because it ruins the story.

Chart 8: The $2 trillion cloud backlog, up roughly 4x in 18 months



Now for the truly bizarre part. Look at what consensus actually has embedded for the out-years. The street has the spending continuing through 2027 with a decent year of growth, and then just FLATLINING in 2028-2029, roughly speaking.

Microsoft's consensus has CapEx marching higher through FY27 and then the model simply... stops. Micron's consensus is even better: revenue goes from 37bn to 130bn to 251bn, and then 278bn and 303bn, i.e. from doubling-plus to 9-10% growth, with operating income outright FLAT-to-down in 2028-2029. This is a bizarre set of expectations if you think about it for more than four seconds. Let me expand on why...

Chart 9: Microsoft consensus: CapEx keeps rising through 2027, and then the model simply stops

Microsoft Corp — Periodicity: Annuals — Source: Standard — Cur: USD — Broker: -------- — Guidance

More estimates are available | MODL »

1) Headline | 2) Headline Growth | 3) Company-Specific

12 Months Ending	FY 2025 Act 06/30/2025	FY 2026 Est 06/30/2026	#	FY 2027 Est 06/30/2027	#	FY 2028 Est 06/30/2028	#	FY 2029 Est 06/30/2029	#
21) Net Debt	17.619B	-47.169B	10	-27.939B	11	-25.395B	11	-49.770B	5
22) BPS	46.204	60.142	13	77.054	13	94.313	12	115.343	3
23) CPS	18.319	23.320	10	28.610	11	35.334	8	43.748	4
24) DPS	3.240	3.615	23	4.002	24	4.331	20	4.217	7
25) Return on Equity %	33.281	30.747	22	27.275	21	25.123	15	23.087	3
26) Return on Assets %	18.005	18.297	7	17.647	7	17.050	4		
27) Depreciation	22.000B	42.716B	42	56.888B	41	76.015B	33	100.976B	16
28) Amortization		5.063B	7	4.146B	7	3.570B	7	2.883B	4
29) Free Cash Flow	71.611B	62.796B	32	32.015B	35	51.116B	29	86.091B	13
30) CAPEX	-64.551B	-116.944B	44	-185.039B	44	-204.953B	36	-215.376B	20
31) Net Asset Value		439.251B	30	559.251B	31	691.173B	26	888.372B	13

Current Multiples — 5) Hide Multiples

Chart 10: Micron consensus: from doubling revenues to 9-10% growth and flat earnings by 2028-29. Sure.

Micron Technology Inc — Periodicity: Annuals — Source: Standard — Cur: USD — Broker: -------- — Guidance

More estimates are available | MODL »

1) Headline | 2) Headline Growth | 3) Company-Specific

12 Months Ending	FY 2025 Act 08/31/2025	FY 2026 Est 08/31/2026	#	FY 2027 Est 08/31/2027	#	FY 2028 Est 08/31/2028	#	FY 2029 Est 08/31/2029	#
13) Revenue	37.378B	129.826B	47	250.660B	49	278.073B	35	302.941B	8
14) Gross Margin %	40.900	80.625	40	86.082	40	83.095	27	76.518	7
15) Operating Income (EB...	10.846B	98.572B	39	207.286B	44	219.051B	31	206.046B	7
16) EBITDA	19.198B	107.677B	25	215.646B	28	247.172B	21	244.625B	5
17) Pre-Tax Profit	9.654B	98.605B	40	209.631B	40	224.399B	28	224.840B	6
18) Net Income Adj+	9.470B	83.317B	45	175.199B	45	191.092B	33	184.916B	6
19) Net Income, GAAP	8.539B	83.345B	33	177.378B	33	199.794B	22	179.784B	7
20) Net Debt	3.416B	-38.381B	13	-128.322B	13	-230.145B	11	-302.981B	4
21) BPS	48.275	118.882	21	258.198	21	415.474	11	609.460	2
22) CPS	15.703	75.695	10	167.547	10	198.596	7	20.368k	2
23) DPS	0.460	0.646	17	1.350	18	1.603	14	0.795	2

Current Multiples — 5) Hide Multiples

Do we really think the economy will just stay FLAT in a given year?

Economies and technology races do not do flat. Either it goes up, or it goes down, and flat is the single least likely outcome of the three, yet it is the one the entire street has penciled in as the base case. And given that this remains a RACE, between hyperscalers, the U.S. and China, and whoever blinks last on compute, the risk to those flat-lined out-years is more likely up than down. The mean reversion is SOOOO embedded in these forecasts that simply regular nominal growth in 2028 would count as an upside surprise. That is not a wall of worry. That is a market that hasn't made up its mind on 2027-2028. Either we go up, or we go down. Just moving forecasts sideways is simply not serious analysis, and if I am right on the Nvidia analogy from 2023, all of these base assumptions from analysts are simply dead wrong.

So while most currently trade the second derivative, I will keep owning the level on this AI trade. Same conclusion as last week, now with even more details and bitter observations.

Thanks for reading...

Andreas Steno

Andreas is the core macro consultant in Steno Research. Building on years of experience as Global Chief Strategist at Nordea Bank, he is one of the most quoted and sought-after macro analysts out there. Andreas' expertise is the FX/rates, energy, real estate and equity spaces, but doesn't shy away from hot takes on other topics if the underlying analysis is strong enough. Andreas anchors the weekly editorial 'Steno Signals'.

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