GlobalData. TS Lombard

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Macro Picture

A MAR-A-LAGO TRADE ACCORD?

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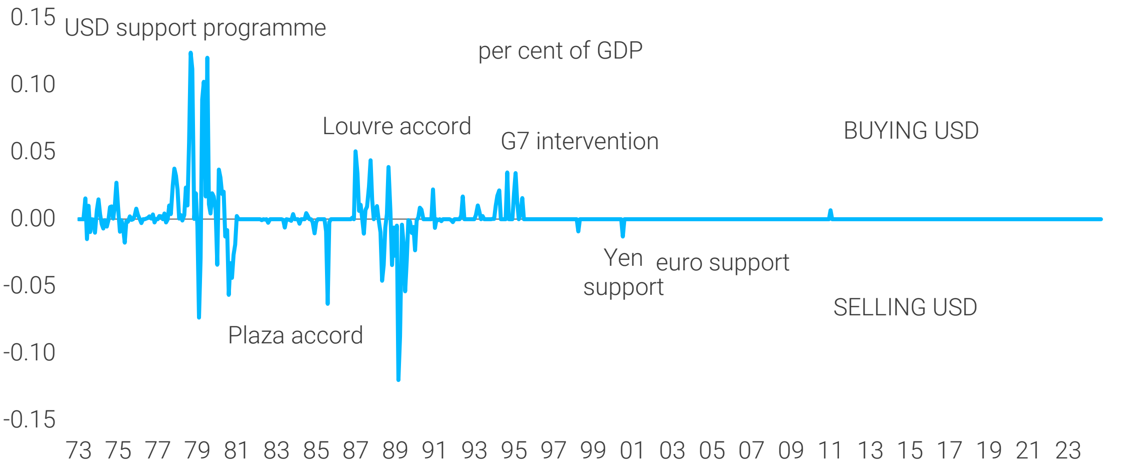
With the US administration determined to reduce the trade deficit, there is speculation about a Mar-A-Lago accord – a 1980s-style currency pact designed to rebalance global demand and devalue the dollar. While a formal deal seems impossible, Trump's tariff threats could ultimately have a similar effect by forcing expansionary policies on China and Europe.

Chart 1: No direct intervention but maybe an implicit currency accord (of sorts)



Source: FRED, TS Lombard

TRADE (NARRATIVE) WARS

There are a lot of flaws in the US administration's approach to international trade, particularly its obsession with bilateral current-account positions and its presumption that deficits are inherently "bad" or that running a trade surplus is a measure of "success". That said, the consensus on trade has shifted and – for the first time since the 1980s – there is an appetite to shake things up.

IDENTITIES POLITICS

All too often, international economics is just an argument about accounting identities. This has led to competing theories about who is to blame: US consumers who want to spend too much, an excessive desire to save in the rest of the world, dangerously "elastic" international capital flows or the burden of being the world's reserve currency. Such debates don't get us very far.

THE GREAT REBALANCING

Another 1980s-style Plaza Accord seems highly unlikely. Governments don't like to intervene in FX markets, central banks pride themselves on their independence, and China – which would have to adopt the role of 1980s Japan – will resist. But that doesn't mean global rebalancing is impossible, particularly if Trump's tariff threats force expansionary policy on China and Europe.

A NEW MAR-A-LAGO ACCORD?

Donald Trump's obsession with tariffs and the US current account deficit means that international trade is once again at the centre of investor discussions about the global outlook. Unfortunately, his administration's views are not always based on sound economics. Trump's advisors put a lot of weight on bilateral positions, which tell us nothing about the welfare implications of international trade; and they clearly regard America's overall current-account deficit as a sign that the US is "losing" or "being taken advantage of". You don't have to be an acolyte of David Ricardo to know that this zero-sum approach to international trade is flawed. But just because the US administration's thinking seems muddled, that doesn't mean the desire to reduce the US current-account deficit is totally without merit. The consensus around free trade has clearly broken down; and there are many private-sector economists – both in academia and in markets – who believe the current system is "unfair" and could be storing up problems for the future. This is not the first time we have heard complaints about "global imbalances", but it is the first time we have had policymakers who are determined to do something about them.

Too often, international economics is just an argument about accounting identities. The same identities can produce very different interpretations about what is "causing" the US current account deficit. One of the most popular theories focuses on international patterns of savings and investment. In these models, the US "spends too much" or is "forced to spend too much" because other countries are "saving too much". Michael Pettis is now the most influential proponent of this view, and there are many who credit him with providing the intellectual backing for Trump 2.0. But Pettis doesn't have a monopoly on invoking accounting identities to infer behavioural relationships and support their pet theories. We can also approach the question from the other side of those identities, focusing instead on capital flows and financial transactions. When we do that, the US current-account deficit starts to look like a "residual", the result of international capital mobility, and the desire of foreigners to gain exposure to superior US returns. And if we drill down further, we can even get into questions about the role of the US currency as the world's reserve asset. Does the dollar's unique status mean the US has "no choice" but to run persistent deficits? There are certainly some in the Trump administration who think so.

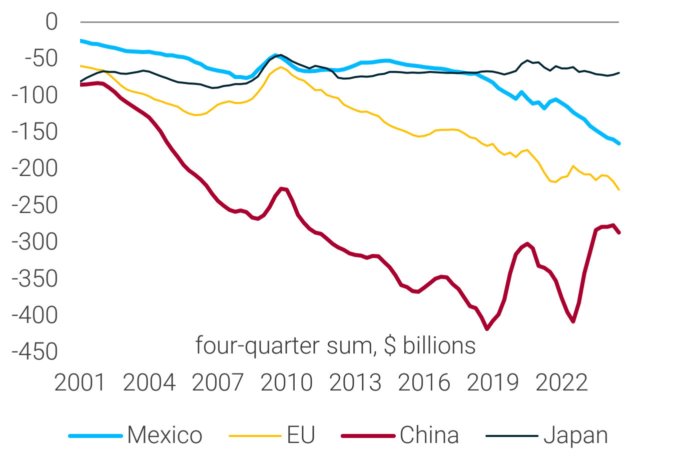
Back in the 1980s, the G7 countries faced a similar set of pressures – persistent US trade deficits, a strong dollar, and widespread calls for protectionism – and agreed a formal deal to devalue the US dollar. They intervened directly in FX markets and adopted a set of macro policies explicitly designed to rebalance international demand: US budget consolidation combined with fiscal expansion in Japan and Germany. In fact, the 1985 Plaza Accord worked so well that just a few years later, the authorities needed another accord to halt the dollar's descent. Could we see a similar currency pact today – perhaps a Mar-a-Lago Accord in which China adopts the role that Japan played in the 1980s? Unfortunately, the odds of a harmonious multilateral agreement are roughly zero. Today's governments do not like to intervene in FX markets, central banks pride themselves on their "independence" and the Chinese will be reluctant to play the role of Japan, especially given what happened to Japan's economy shortly after the Plaza Accord. (Plus, it's not obvious China could revalue RMB even if it wanted to.) And the Stephen Miran/Jim Bianco "debt swap for US protection" idea is a total non-starter. But do not despair. While a formal Mar-a-Lago accord seems out of reach, it is possible that Trump's tariffs – or, more precisely, the *threat* of tariffs – could still force a rebalancing in global demand even without a formal currency pact. Trump's bullying tactics will force China and governments in Europe to spend more, and that is our best bet to get the dollar down, rebalance the world economy and end US "exceptionalism".

1. TRADE NARRATIVE WARS

What is wrong with Trump's approach to trade?

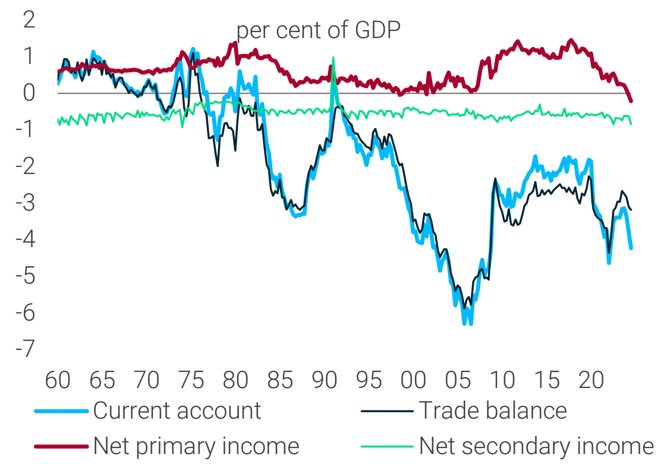
Trump approaches international trade from a zero-sum perspective. He talks about the current account deficit as if it were a subsidy to other countries ("why are we subsidizing Canada?") and he clearly regards deficits as inherently "bad" and surpluses as "good". If the US is running a deficit, it must be "losing" at international trade or being taken advantage of by its trading partners. This line of thinking is obviously flawed. I run a deficit with my local supermarket, but that doesn't mean my welfare would improve by growing my own vegetables. And it is certainly not true that current account surpluses are a sign of economic "success". Germany has been running surpluses for decades; but by focusing on international competitiveness, German companies have often done things that have actively damaged the domestic economy – such as wage restraint, which has squeezed households and delivered a persistently moribund consumer. (There are also questions about how Germany has used the proceeds from those trade surpluses, given its involvement in various speculative manias – e.g., Spanish and US property.)

Chart 2: Why is the US subsidizing the world?!



Source: Datastream, TS Lombard

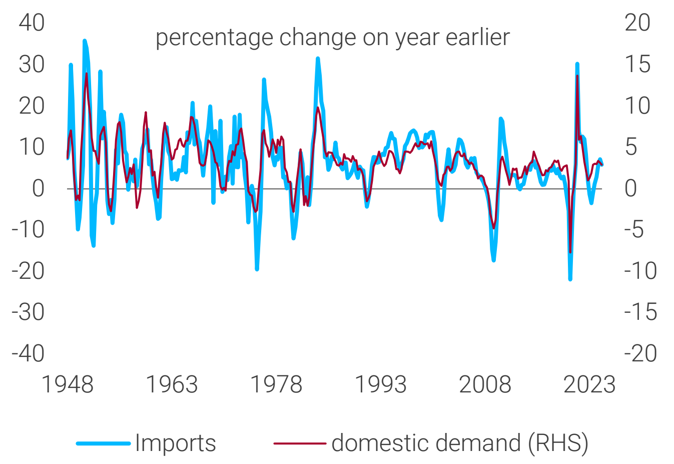
Chart 3: US current account deficit



Source: Datastream, TS Lombard

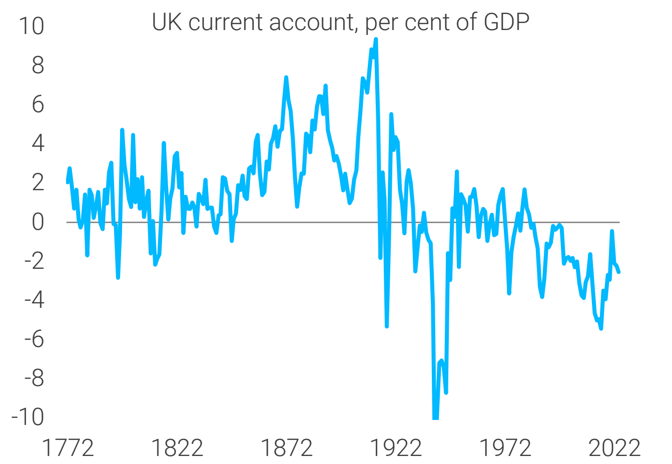
While Trump's zero-sum approach to international trade is questionable, his obsession with bilateral trade positions is particularly problematic – for two reasons. First, bilateral trade flows record only the total value of exports and imports. What really matters, particularly in an era of global supply chains, is the "value added" component of those trade flows. If, for example, China is importing components from other parts of Asia (which were previously exported directly to the US) and sending them as finished products to the US, America's overall deficit with China would swell but this wouldn't reflect an overall change in US import penetration. Second, it is natural for a country to run deficits with some countries and surpluses with others, even if the overall current account is balanced. Suppose, for example, the US sells $200bn of agriculture products to the Saudi Arabia, Saudia Arabia sells $200bn of oil to China, and China sells $200bn of consumer goods to the US. Each country would have a balanced current account, but the US would have a large bilateral deficit with China. Focusing solely on one trade flow doesn't make sense, particularly if you want to understand how international trade affects US welfare.

Chart 4: Domestic demand drives imports



Source: Datastream, TS Lombard

Chart 5: Balanced trade is not the norm



Source: Datastream, TS Lombard

What are the other popular misconceptions about trade?

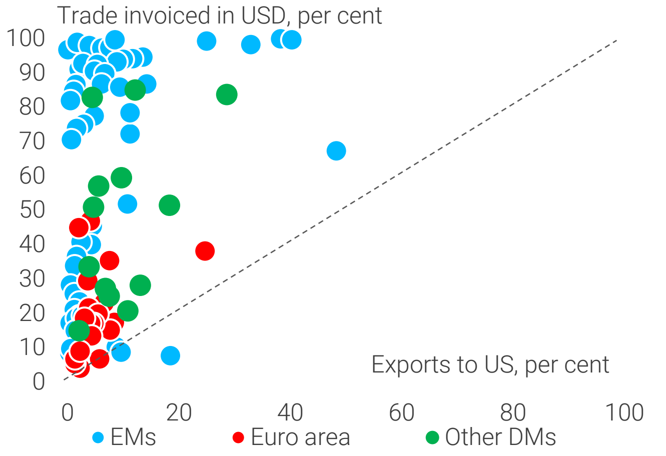
Seeing deficits as inherently bad (and surpluses as inherently good) is just one of the misconceptions that seem to be framing discussions about global trade. Here are some others:

(i) **Imports reduce GDP:** As we will see when we discuss the causes of global trade imbalances, a lot of faulty analysis is derived from trade identities – in this case, the identity that suggests imports cause a reduction in GDP. The only reason we subtract imports from GDP in the national accounts is because those same imports are already included in other components of GDP, such as consumption and investment. Chart 4 shows that any *causal* link between domestic output and imports runs in the opposite direction because it is a strong, fast-growing economy that tends to demand more products from overseas. (And if the rest of the world is growing slowly, capping exports, the current account deficit is likely to widen.)

(ii) **Exchange rates drive trade flows:** People who work in financial markets tend to put a lot of emphasis on currency movements as a driver of trade flows. But the evidence suggests exchange rates have become less important over time, both as an influence on inflation and as a determinant of trade imbalances. There are two reasons: cross-border supply chains and the dominance of the US dollar in global trade invoicing. With the former, the consequences of a given currency move depends not only on where imported inputs come from but also on the ultimate destination of final consumption. In some situations, a devaluation in the domestic currency can, in fact, be bad for exports, contrary to what it says in economics textbooks. And a similar issue arises with dollar invoicing: a lot of international trade is invoiced in dollars, even when there is no American counterpart to that trade. This makes trade flows less sensitive to domestic currency moves.

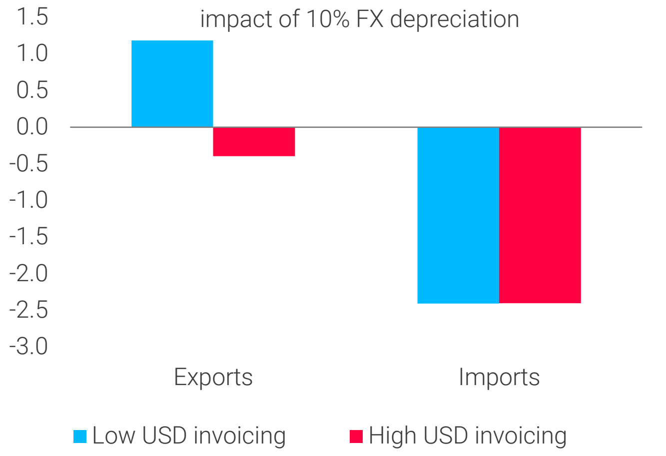
(iii) **Large deficits/surpluses are not 'abnormal:** In a lot of discussions about "global imbalances", there is an assumption that large current account deficits/surpluses are "unnatural" or the result of currency manipulation and/or trade distortions. But that assumption is questionable. Chart 5 shows long-term historical data for the UK, which has oscillated wildly between huge surpluses and deficits over the past 250 years; in fact, the only time the UK has run a broadly balanced current-account position was in the 1950s and 1960s, when governments deployed capital controls to restrict the movement of cross-border lending. As Paul Krugman points out, it is possible that freer trade naturally creates imbalances rather than the reverse proposition that those imbalances must be the result of government restrictions.

Chart 6: Global USD invoicing



Source: IMF, TS Lombard

Chart 7: Dollar invoicing damps FX impact



Source: IMF, TS Lombard

Is Trump right to worry about global imbalances?

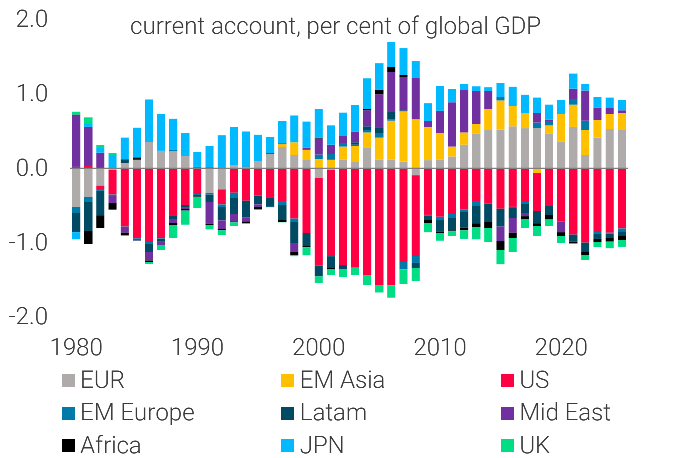
While Trump's thinking on trade is muddled, it is not just the US administration that is questioning the benefits of the current system. There is a growing consensus that mainstream economics has overstated the benefits of free trade and that it was a mistake to welcome China into the WTO in the early 2000s. Even if consumers have benefitted from decades of cheap consumer products, the China shock, as it is now called, has left permanent scars, hitting certain sectors and regions particularly hard (presumably the same people who have been voting for Trump and other populist leaders). And without intervention, there is a good chance the situation is about to get worse, with China again looking to escape its domestic slump by flooding global markets with cheap manufacturing goods (China shock 2.0). It is also true that US tariffs are generally lower than those of other countries, a legacy of previous administrations trying to incentivize free trade as a route to global peace (a legacy that Trump now wants to dismantle). While concern about "global imbalances" is not new – there was a lot of talk about these issues in the 2000s – this time we have a US administration that is determined to do something about them. So, perhaps it is better to focus on the impact of those policies rather than on whether they are justified. Will Trump's intervention work? That depends on what is causing global imbalances in the first place.

2. IDENTITIES POLITICS

What has caused global trade imbalances?

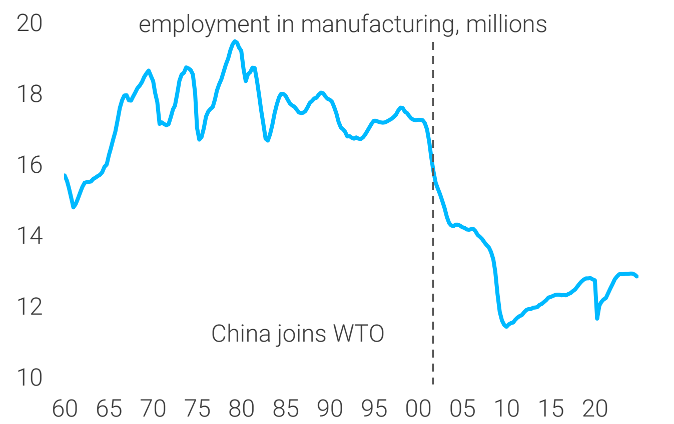
There is no consensus explanation for global imbalances. Noah Smith jokes that this is because "nobody really understands international economics". Macro is hard, and international economics is macro on steroids. Not only is it difficult to take account of multiple economies interacting at the same time, but it is impossible to isolate the precise impact of trade interventions – because they interact with domestic monetary and fiscal policies. This complexity creates the perfect environment for several competing pet theories about trade imbalances to thrive at the same time. In fact, ironically, these theories often start from the same place, which is the one thing all economists can agree on: namely, the simple accounting identity that the net flow of capital into a country, as measured by the financial and capital accounts, must balance the net flow of goods, services, transfer payments and income receipts out of the country, as measured by the current account. When the US current account is in deficit, that means foreigners are purchasing more US assets than US citizens are purchasing foreign assets. This is just a mundane truism, a relationship that is always true and is consistent with a range of economic outcomes. But pick your favourite side of this identity and you can infer a line of "causation", as follows:

Chart 8: Global trade imbalances



Source: IMF, TS Lombard

Chart 9: The China shock

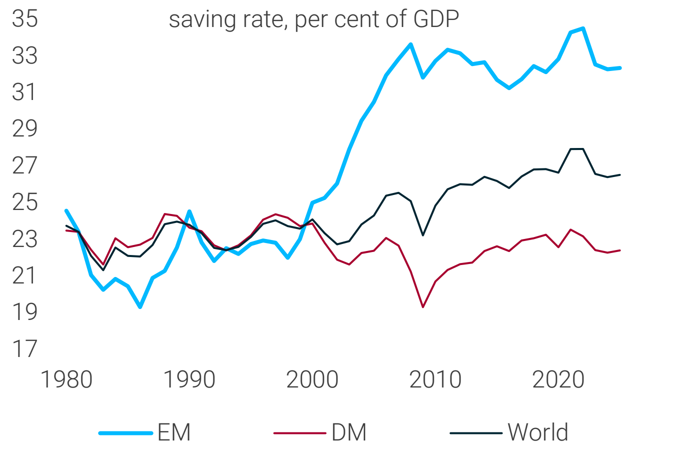


Source: BLS, TS Lombard

(i) **The Michael Pettis view:** While Pettis isn't exactly MAGA, Noah Smith calls him the "single most important and influential international economics theorist", and you certainly hear officials in the US administration express views that seem to be derived from Pettis-style thinking. Again, the basic thesis starts with an accounting identity – that the current account position must equal the difference between a country's savings and investment. When a country runs a deficit, it is investing more than it saves and borrowing from overseas to do so. When it runs a surplus, savings exceed investment and that country is lending to foreigners. In its most basic form, the Pettis thesis is that America's trading partners are "saving too much" (producing more than they want to consume). And they push this excess production onto the US, which has to absorb it by consuming more than it produces.

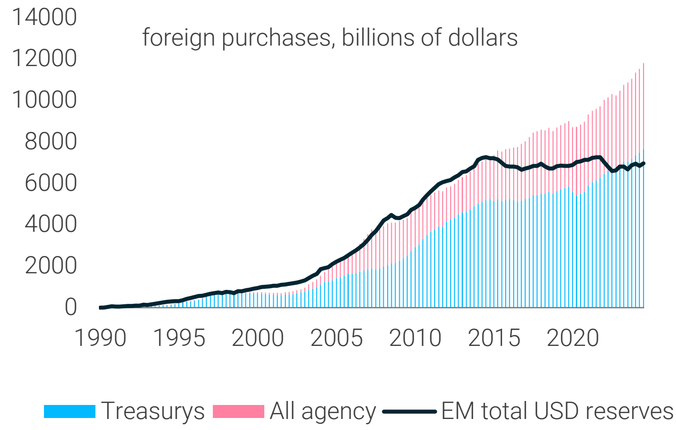
Pettis puts the blame for the US deficit squarely on America's trading partners. China and Germany, in particular, have been too obsessed with their international competitiveness and have deployed beggar-thy-neighbour policies designed to sustain large surpluses (fixed exchange rates, export subsidies, wage suppression and fiscal austerity). The Pettis theory is similar to the "saving glut" argument that Ben Bernanke popularized in the early 2000s. Back then, the focus was on Asian central banks: their determination to fix their exchange rates against the dollar and their willingness to accumulate large FX reserves. By investing the proceeds from their trade surpluses in Treasuries, the savings-glut countries kept their exchange rates "undervalued" and suppressed US interest rates, inflating a US credit bubble. But the Pettis argument is broader, focused on deeper imbalances in global consumption and production (Chart 17). This is important because EM reserve accumulation hasn't really been an issue since 2013, as Chart 11 illustrates.

Chart 10: The global saving glut



Source: IMF, TS Lombard

Chart 11: EM FX reserve accumulation until 2013

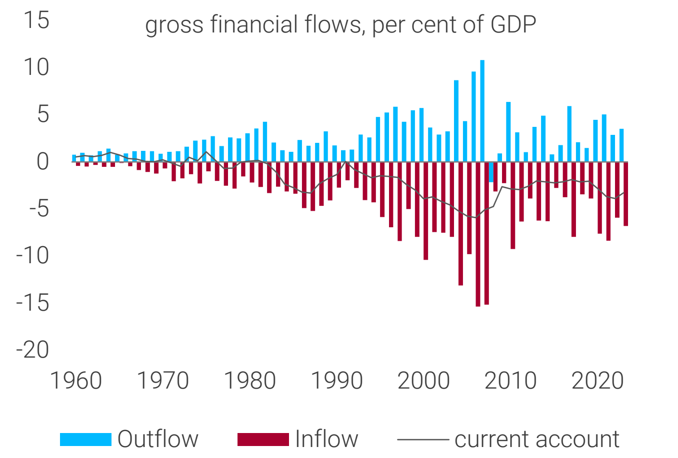


Source: Brad Setser

(ii) **The capital account view:** Paul Krugman, who knows a thing or two about international trade, is not a fan of the Pettis thesis. In fact, he describes it as "largely wrong" and "adulterated nonsense". Tyler Cowen goes further, saying "Pettis flat-out doesn't understand international economics". Rather than blame the beggar-thy-neighbour policies of China and Europe, Krugman sees the US current account deficit as a benign symptom of American economic strength. It is the result of superior US productivity and demographics, which creates a strong international bid for US financial assets. This is just another way of interpreting the same accounting identity. When foreigners invest in the US and Americans spend those funds on imports, the current-account deficit widens but the line of causation runs from the capital account to the trade account. Of course, there is nothing new in blaming current account deficits on foreign capital inflows. This line of argument has always been popular among policymakers in deficit countries, as successive UK finance ministers have shown. But Krugman's view – the prevailing mainstream thesis – is more general, because he believes current account deficits are simply the natural result of international capital mobility, a claim that has triggered a fascinating dispute with Matt Klein about the "causes" of UK trade surpluses during the Edwardian era.

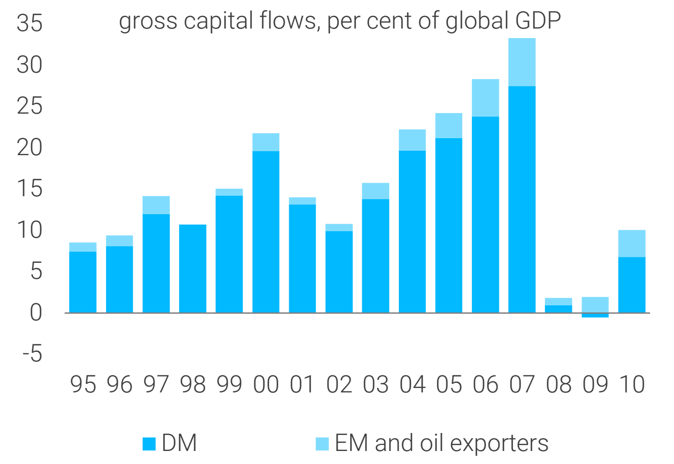
(iii) **Gross financial flows:** If we want to explain current account positions by reference to capital flows, we can take the analysis further and look at *gross* financial flows. Afterall, since the current account must equal *net* capital outflows, it is also the difference between two gross flows: domestic residents' holdings of foreign assets (gross outflows) and domestic residents' liabilities to non-residents (gross outflows). And these gross financial flows can be huge. Why does this matter? The BIS has made a compelling argument that we should look at global imbalances from the perspective of gross financial flows. It points out that these flows are more informative about how domestic investment is funded, which is what matters for financial sustainability. The best illustration is what happened in the early 2000s, when Europe played an outsized role in funding in the US subprime bubble and this didn't show up in the region's net-trade position. In fact, Europe's current account was in balance at that time. The BIS points out that rather than a global savings glut, the real problem was a European "investment banking glut". European banks were round-tripping, that is, borrowing funds in US money markets and investing them in US asset-backed securities. But there is another, more general point: even if a country's current account is in balance or is neither importing nor exporting, all its investment expenditures could still be financed from abroad. Looking at gross financial flows is the only way to understand what is going on below the surface.

Chart 12: Gross financial flows swap net flows



Source: Datastream, TS Lombard

Chart 13: DMs inflated the subprime bubble



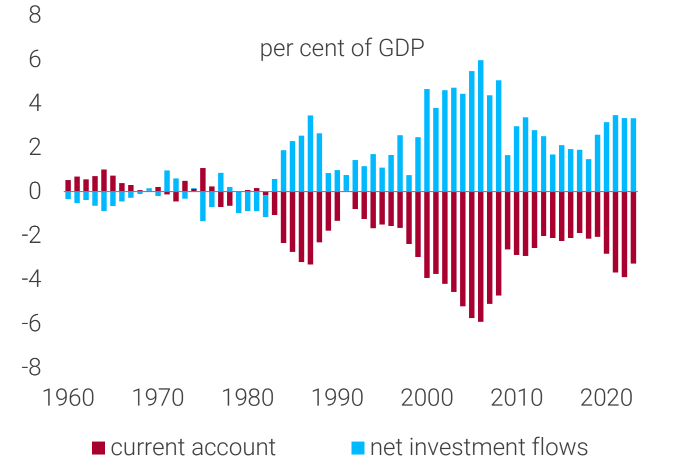
Source: BIS, TS Lombard

Is the dollar's reserve status to blame?

We didn't include this in the list above because it is a subset of those other arguments. When countries hold USD as reserves assets, they are, in effect, providing free loans to the US, which causes the capital account to widen. Since the dollar is the main numéraire for global trade, this creates a structural bid for US currency, which keeps the trade balance in deficit. In fact, there are some who regard this as a matter of simple arithmetic: the US must run perpetual deficits so the rest of the world can accumulate US assets. This is not a new idea. It dates back to at least the 1960s and the Triffin dilemma. But the theory is making a comeback because there are clearly some people in the new Trump administration who subscribe to the view. Stephan Miran, the nominee for chair of the CEA, is the most prominent example. Miran's "blueprint for restructuring the global trading system", published in November, argues that the US could be facing a "tipping point" where, absent a Trump-inspired policy realignment, international demand for dollars will overwhelm America's capacity to run twin deficits, eroding the creditworthiness of the Treasury and triggering a serious financial crisis. This tipping point comes from the fact that the US is shrinking as a share of global GDP, which means the "burden" from "exporting reserve assets" only gets bigger over time – until it becomes overwhelming.

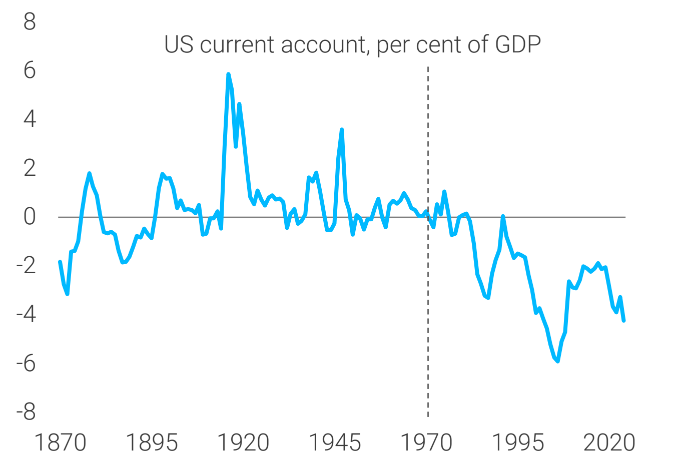
While it is true that the US dollar occupies a special role in global markets, there are several problems with the Miran thesis. First, contrary to popular belief, there is no direct relationship between the US current account deficit and the supply of USD reserve assets. As we noted in our discussion of gross financial flows, countries can trade dollar assets and liabilities in ways that have no bearing on international trade imbalances. For example, the US could meet the global demand for USD just by swapping assets with the rest of the world, perhaps for diversification reasons (without any new net US borrowing). And in the early years of the eurodollar system, banks found they could create dollars "at the stroke of a pen", to quote Milton Friedman, without needing the US to export capital. Second, it would be wrong to assume that US reserve status means the dollar will always be "overvalued" or appreciate indefinitely. There is still a business/monetary cycle; and if the US economy were to weaken or US financial assets suddenly become less attractive (perhaps because the Mag7 bubble bursts), the dollar could still decline, perhaps significantly. Dollar "centrality" is not the same as dollar "strength", and the modern dollar-centric system has seen periods of both USD strength (1981–85, 1995–2002, and 2014–present) and weakness (1970s, 1986–94, 2002–08). Finally, we should be careful not to mistake correlation with causation. There are other countries that run persistent deficits, even without reserve status.

Chart 14: Two sides of the same trade identity



Source: Datastream, TS Lombard

Chart 15: US deficit has widened since Nixon shock



Source: MacroHistory, TS Lombard

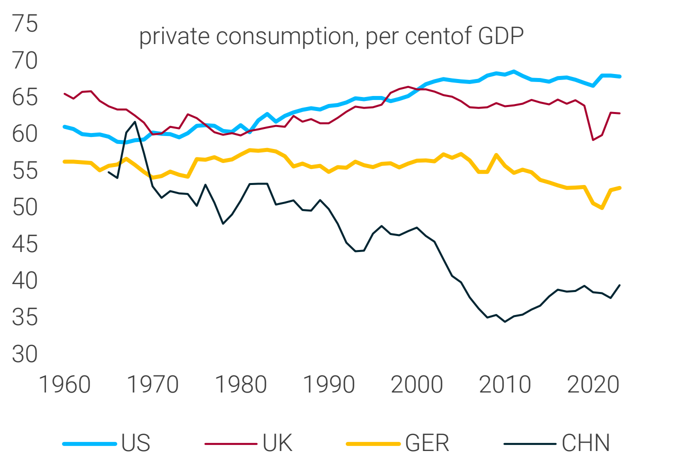
Does the world need a weaker dollar?

It is certainly true that dollar weakness is helpful for the global economy. Contrary to what you read in economics textbooks, dollar depreciation tends to boost world trade (even where there is no US counterpart in that trade), improve the balance sheets of international dollar debtors, ease cross-border lending conditions and make it easier to fund global supply chains. There is even evidence that dollar weakness provides a direct boost to stock markets and international property prices. Economic theory argues that exchange rates act as a shock absorber. If the US is growing strongly, the dollar should appreciate, and that will cause those growth differentials to narrow. But in the current system that doesn't happen; instead, dollar strength acts an amplifier, hurting the rest of the world more than it hurts the US, which makes growth differentials worse. (For more on these issues, see our previous analysis of the dollar's special role in global markets.)

What do we learn from these trade controversies?

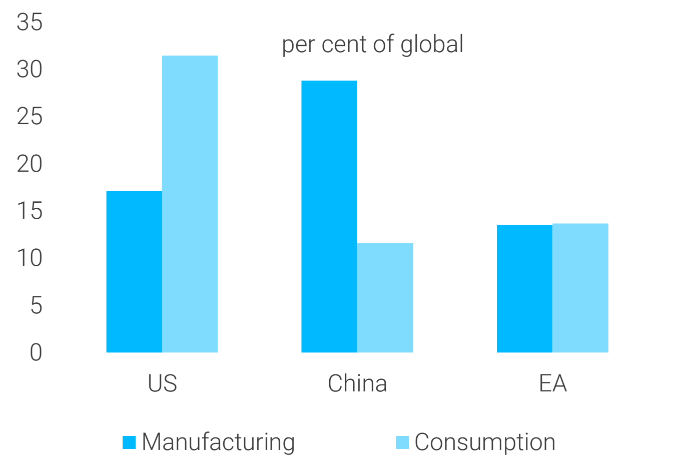
Arguing about accounting identities doesn't get us very far. Fast-growing economies will see their imports growing quicker than their exports and at the same time they will become a hot destination for foreign capital, particularly if that growth outperformance is expected to continue. Chart 21 shows a clear link between America's deficit and US domestic demand relative to the rest of the OECD. None of this is surprising; and if we want to understand the sustainability of trade imbalances, we need to look for underlying macro-financial imbalances (which, as the BIS explains, can show up in gross financial flows). It is also true, however, that countries have pursued policies that have made global imbalances worse. If China and Europe had focused on boosting domestic demand – rather than relying on exports – the result would have been a stronger, healthier global economy, and a smaller US current account deficit. And there are structural features that make these imbalances worse, such as the lack of unemployment insurance and public healthcare in China, which encourages high levels of precautionary savings. Meanwhile, exchanges rates have failed to act as a shock absorber. The important question is what happens next. Scott Bessent believes we are going to see a historic "Bretton Woods realignment of global trade policy". Is that a realistic outcome, especially with the available tools?

Chart 16: China needs to consume more



Source: IMF, TS Lombard

Chart 17: Pettis imbalances in the world economy



Source: United Nations, TS Lombard

3. THE GREAT REBALANCING

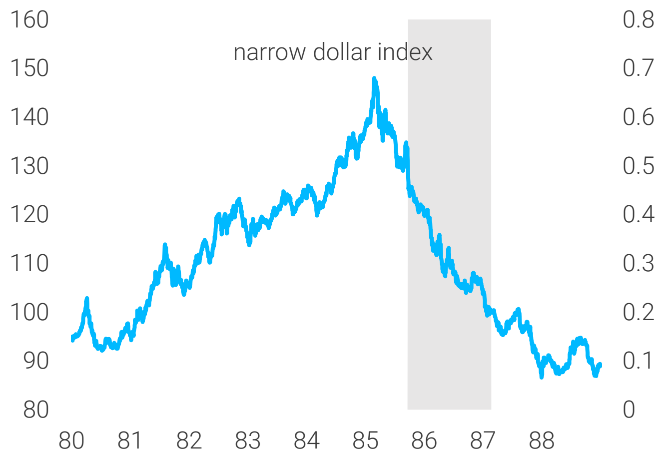
What were the currency accords of the 1980s?

The mid-1980s was the last time global policymakers showed a genuine determination to tackle international trade imbalances. In fact, the problems they faced back then are similar to those we have today: a persistently strong dollar, a large US current account deficit and a growing protectionist backlash. Of course, the protectionist angst of the 1980s was centred on Japan, whereas today it is China that stands accused of pursuing beggar-thy-neighbour policies (Germany played a prominent role in the 1980s and is doing so again today, with the rest of the world unhappy about its consistent failure to boost domestic demand). In the 1980s, the solution to global imbalances cane in the form of the 1985 Plaza Accord, with the G7 economies agreeing a combination of policies designed to force a realignment: namely (i) direct currency intervention to reduce the dollar; (ii) a clear signal that they wanted further USD depreciation; (iii) a US commitment to budget consolidation; (iii) easier fiscal policy in Germany and Japan; and (iv) a realignment of monetary policy, whereby all central banks lowered rates but the Fed cut interest rates most. The Plaza Accord was successful: US yields dropped sharply relative to the rest of the G7, the dollar plunged 30% in trade-weighted terms (with a 50% appreciation vs the yen) and the US current account deficit narrowed significantly. In fact, the Plaza Accord was so successful that the G7 had to agree another currency pact, the 1987 Louvre Accord, to halt the dollar's slide.

Could we get another currency accord today?

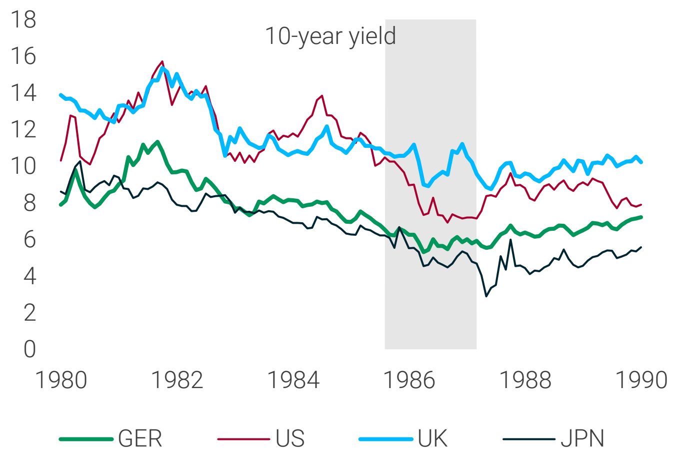
A formal Plaza-style accord seems incredibly unlikely, for several reasons. First, there is no real appetite to intervene directly in FX markets. These days, central banks only do this when there are immediate threats to financial stability (usually because an exchange rate is moving too quickly, not because the level is wrong). The reason is simple: the authorities have given up targeting exchange rates and are now targeting inflation instead. Attempting to realign FX markets would threaten central banks' independence, and that is now a much bigger deal that it was 40 years ago. China is the exception – the one major economy that routinely intervenes. But because of the weakness in China's domestic economy, it is not clear that the authorities could force RMB higher even if they tried (the pressure from markets is in the opposite direction). Second, it is not obvious another Plaza accord is in everyone's long-term interest. China would have to play the role of Japan in the 1980s and Japan's experience wasn't exactly great. Indeed, Chinese policymakers believe the Plaza accord contributed to Japan's bubble, which eventually burst and plunged the economy into a multi-decade balance-sheet recession. Third, the geopolitical situation is different today. Back then, Japan and the US were allies, global power was centred at the G7 level, and there was more appetite for multilateral agreements. None of that is true today.

Chart 18: 1985 Plaza Accord



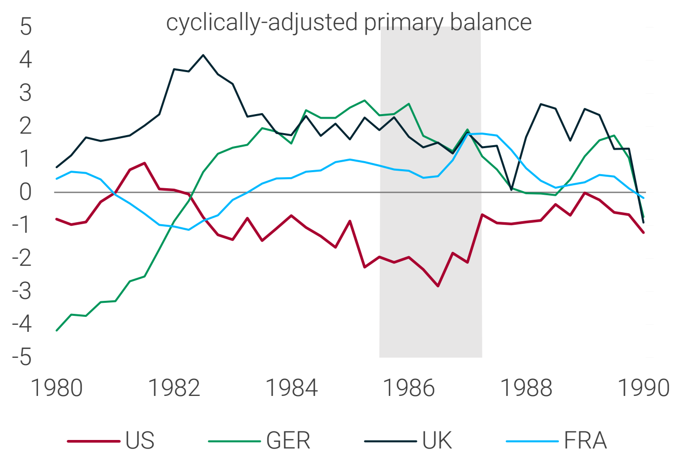
Source: Federal Reserve, TS Lombard

Chart 19: Big decline in US yields vs RoW



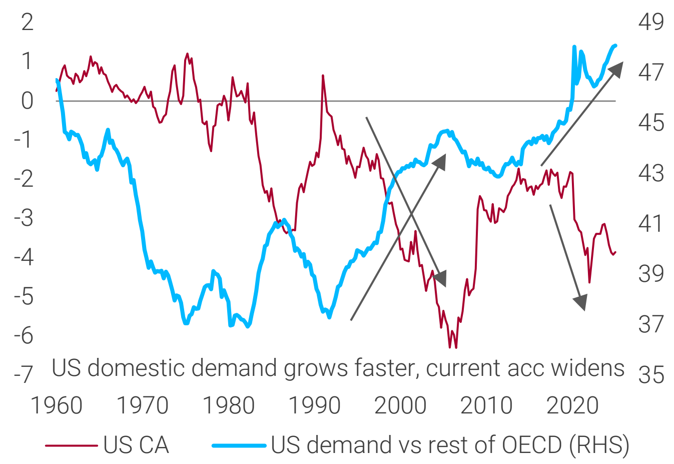
Source: Datastream, TS Lombard

Chart 20: Fiscal rebalancing after Plaza Accord



Source: OECD, TS Lombard

Chart 21: Growth differences drive US deficit

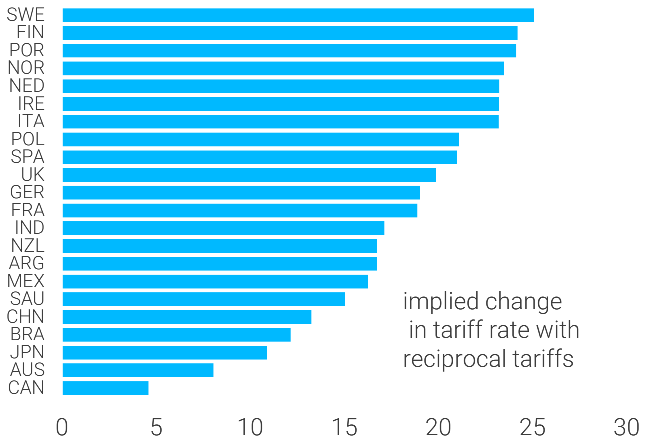


Source: OECD, TS Lombard

Could tariffs rebalance global demand?

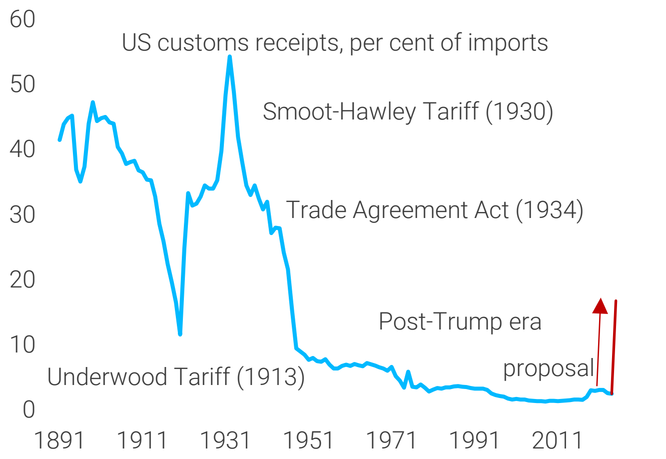
Instead of multilateral trade and FX agreements, the new administration is trying to use tariffs to force a rebalancing in global demand. Outside Trump's officials, Michael Pettis is the main proponent of this policy. Writing in Foreign Affairs, Pettis accuses the economics profession of being too pessimistic on the impact of tariffs and argues that the policy could improve global welfare. Tariffs are a tax on consumers combined with a subsidy to producers. If domestic producers can respond quickly, increasing the output of tariffed goods, they will create new jobs and incomes that could offset the tax on consumers. Overall GDP would rise, even with a higher savings rate and a lower current account deficit. Pettis thinks economists are too obsessed with what happened when tariffs were deployed during the Great Depression, in an economic environment that bears no resemblance to today's conditions. Back then, the US was suffering from excessively high savings, which meant there was no scope for domestic production to rise to offset the tax imposed on consumers. Today the US saving rate is too low. While it would be wrong to say Pettis believes tariffs are a panacea – in fact, he has recently diluted his support for Trump's policies – he still believes they can help rebalance the global economy.

Chart 22: Trump's plan for reciprocal tariffs



Source: the Budget Lab estimates

Chart 23: The impact of reciprocal tariffs



Source: TS Lombard based on the Budget Lab estimates

Several years ago, Pettis co-authored an influential book on global imbalances with Matt Klein. Interestingly, Klein's take on tariffs is very different: he thinks tariffs will be ineffective, and potentially damaging. Klein raises three objections. First, he doesn't believe the tariff subsidy on US production will raise domestic output quickly enough to offset the squeeze from the tax on consumers. While there are some goods where tariffs might be effective, because production can increase quickly, there are other goods where production is constrained. If producers are unable to respond, the tariffs are just a tax on consumption. Second, tariffs cause the dollar to appreciate. By making it more attractive to produce inside the US, US capital inflows will rise, which pushes the USD higher. And stronger dollar dilutes the impact of the tariffs. Third, there is the threat of retaliation. If other countries respond by implementing their own protectionist policies, any relative advantage to US producers is lost. Imports and exports decline together, leaving the net current-account position unchanged. Finally, we must also remember that the US imports a lot of commodities and intermediate goods from the rest of the world. Putting a tariff on these goods – as is likely with universal tariffs – makes it costlier to produce in the US. Again, this hurts the competitiveness of US exporters, dampening the initial boost from the tariff.

What about the 'debt swap for US military protection' idea?

Much of the recent talk about a formal Mar-a-Lago accord has been focused on the Stephen Miran paper we discussed in Section 2 (which has received a further boost recently thanks to Jim Bianco's various media appearances). The Miran idea is that the US could use tariffs to force other countries to restructure their holdings of US debt. In return for US military protection and to avoid the imposition of tariffs, other countries would need to swap their Treasury holdings for *non-marketable* zero-coupon century bonds. According to Miran and Bianco, this would reduce US interest expense, thereby preventing a "debt crisis", devalue the dollar and ensure that America's allies are no longer "free-riding" on the US military. Unfortunately, the whole concept is deeply flawed and totally unworkable – for two reasons. First, Miran and Bianco are taking the "reserve status" of the dollar too literally. They are assuming that America's exchange rate is being propped up artificially by official FX holdings in other parts of the world. This is not true. Although Asian central banks accumulated large reserves in the decade after the 1997 Asia crisis, that hasn't been the case since the GFC. Second, it is not obvious there is any deal to be struck as far as US military protection is concerned. China holds a large share of America's foreign debt and doesn't want or need US military protection, whereas NATO countries' holdings are largely in the *private* financial sector. There is no reason why European banks and asset managers would want to swap their US Treasurys for non-marketable zero-coupon bonds. Miran et al. are confusing the "reserve status" of USD with the use of dollar-denominated securities as a "safe asset" in the modern financial system. While it would be possible to erode those safe-haven properties – forcing a debt restructuring on private debt holders is a good place to start – it would not reduce the cost of US debt-servicing. In fact, it would be more likely to push the term premium up!

Is there no hope for global rebalancing?

Tariffs – with or without the Miran-style debt swap – are not a solution to global imbalances, not mechanically anyway. But that doesn't mean the US administration's efforts will be futile. We think the threat of tariffs could still be useful, particularly if it forces other parts of the world to adopt policies aimed at reviving their domestic economies rather than relying on exports. This sounds fanciful but it is already happening:

(i) **Fiscal policy** – China and Europe are both looking to adopt more expansionary policies, partly in response to Trump 2.0. Until recently, China seemed intent on exporting its way out of its current economic funk. The authorities were reluctant to stimulate consumption and were instead focusing their efforts on trying to boost manufacturing capacity, particularly in strategically important export sectors (EVs, solar panels, etc.). With Trump back in the White House, those incentives have changed. As exports no longer offer a route to an economic revival, the authorities now realize that they have no choice but to engineer a sizeable fiscal stimulus. And Europe is in a similar position. We see a European fiscal boost coming from two sources: a dilution of existing debt rules at the national level (including Germany's debt brake) and an expansion of pan-European fiscal capacity (with a focus on boosting defence spending and replacing the US NATO contribution). Bruegal estimates that Europe would need to spend an extra €250bn per year on defence and recruit an extra 300,000 troops. Conservative calculations from the Kiel Institute say this would add 1–1.5 percentage points to annual GDP growth.

(ii) **Monetary policy** – While the threat of tariffs and deportations has discouraged the Fed from further cutting interest rates, other central banks are focusing more on the potential growth risks from Trump 2.0, which should lead to a wider divergence in monetary policy between the US and other developed economies. On one level, this is bad for global imbalances because it means a strong dollar. But we suspect the growth effects will dominate. If monetary easing can stimulate a revival in European bank credit, the boost to European GDP should comfortably offset the FX effects. Indeed, by improving the relative attractiveness of European assets, capital outflows from Europe would slow, which would ease any upward pressure on USD.

(iii) **Regulatory policies** – we see potential for deregulation, particularly in Europe, in areas like environmental rules, M&A, digital technologies and banking. The Draghi report made strong recommendations; and while implementation has been slow, the new Trump administration could be a catalyst to speed up the process.

The original Plaza Accord involved direct FX intervention, a realignment in monetary policy and a shift in relative fiscal policies (US tightening, RoW easing). Clearly, we are not going to get a similar multilateral agreement today. There is not going to be a formal Mar-A-Lago Accord, and the debt-swap idea is a non-starter. But there is a possibility that the "Trump threat" will force other parts of the world – China and Europe – to do more to stimulate their economies. And that is surely our best bet for global rebalancing and a weaker dollar (particularly if DOGE is serious about reining in US government spending). Is this all part of Trump's plan? Is it in the Art of the Deal? That would be pushing things too far, but it could still set up a bullish environment for risks assets, especially non-US equities. Perhaps US exceptionalism is coming to an end.

Bottom line

Global imbalances are making headlines again and causing fierce arguments among economists (it doesn't take much…). International macro is complicated, and all too often these disputes come down to bickering over accounting identities. The basic issue is that the US economy keeps outperforming its peers, which creates a desire among foreigners to hold US assets – particularly when US outperformance is expected to continue (remember that "US exceptionalism" trade that was so consensus in January?) Other countries make the situation worse, particularly where they pursue policies designed to boost their export sectors at the detriment of their domestic economies. Now, however, we have a US administration that explicitly wants to rebalance the global economy. The new Treasury Secretary, Scott Bessent, has said we are on the brink of a "Bretton Woods realignment", and there is even talk of a new Plaza Accord (presumably thrashed out at Trump's Mar-a-Lago retreat). We see no real prospect of a formal currency pact, let alone direct FX intervention or the "debt swap for military protection" idea that is suddenly popular on macro podcasts. But it is possible that the threat of Trump's tariffs and the removal of US support for Ukraine will force governments in other parts of the world to pursue more expansionary fiscal policies. This is the best bet for global rebalancing and a weaker USD.

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