Could the Trump administration’s trade policy lead to the end of US global financial dominance?

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Overview

Three questions:

What underpins the role of the US dollar in the international economic system today?

How could the Trump economic policy shock change this?

What should advanced and emerging economies (other than the US and China) do to safeguard their interests?

Table 1: The Dollar's Role in Global Financial Markets (%)

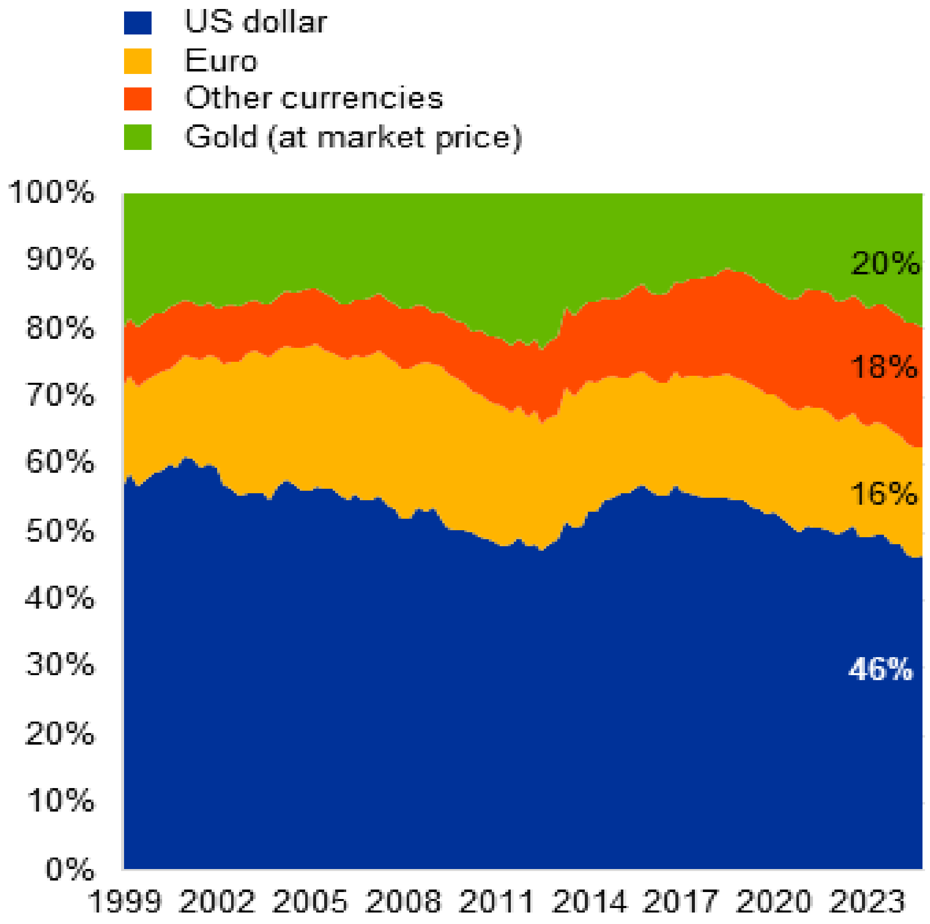
	USD	EUR	JPY	GBP	CNY
Trade invoice	63.50	16.80	1.30	0.97	5.55
FX reserves	58.4	19.9	5.7	4.9	2.3
Intl bank claims	57.36	19.24	5.52	5.51	-
Intl bonds	63.2	24	1.6	5	0.9
FX turnover	44	15.5	8.5	6.5	3.5

Table 2: Index of International Currency Usage

Year	USD	EUR	JPY	GBP	CNY
2000	56%	22%	10%	7%	0%
2021	53%	22%	7%	6%	3%
2024	53%	21%	7%	6%	4%

- Source: IMF External Sector Report, July 2025. 2025 External Sector Report: Global Imbalances in a Shifting World. The index is a simple average of each currency's share of global disclosed foreign exchange reserves (25 percent weight), trade invoicing (25 percent weight), foreign exchange turnover (25 percent) and global balance sheets (25 percent weight).

Chart 1: The share of gold in central bank reserves



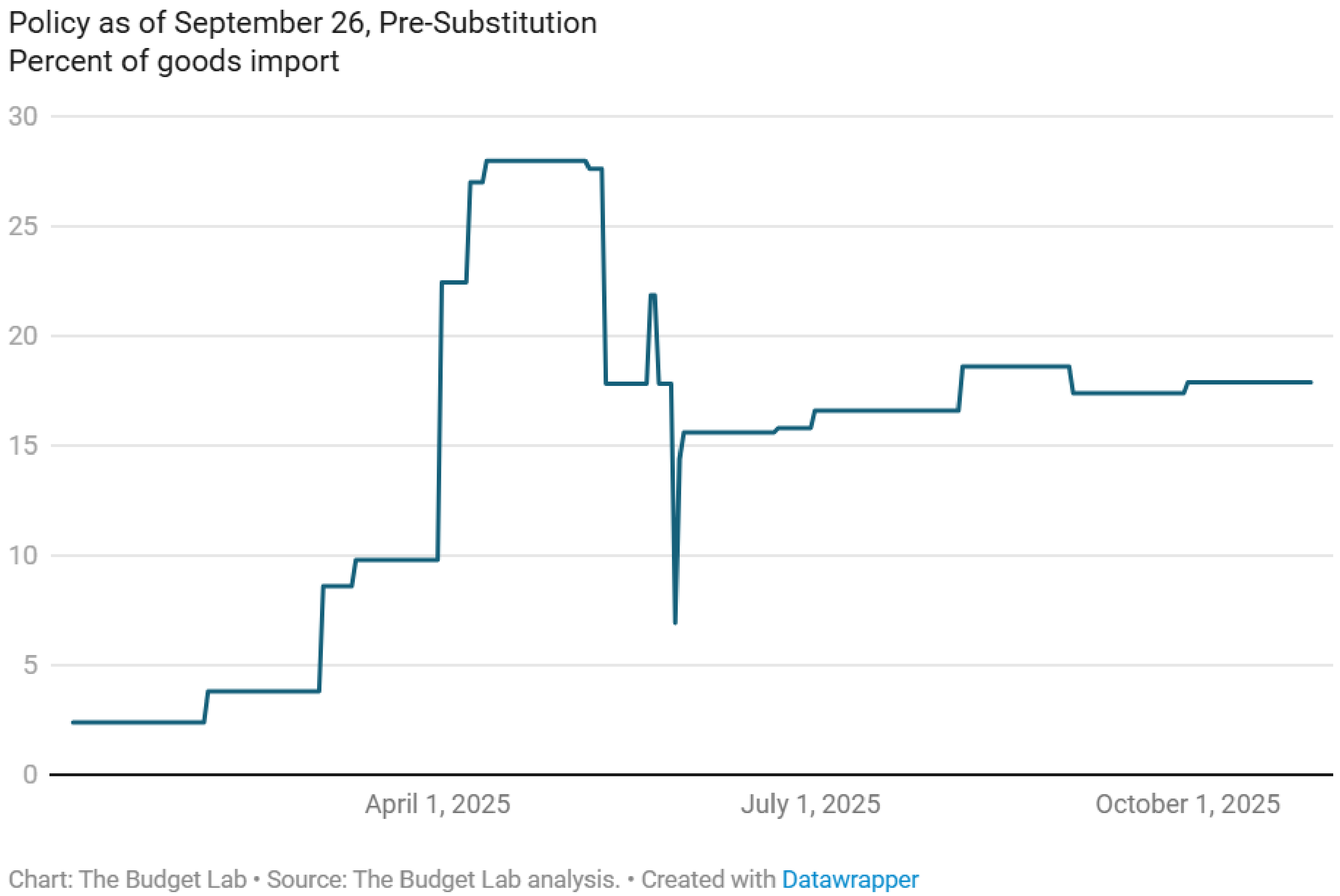
Five reasons for US dollar dominance

- Network externalities
- Complementarities among dollar-denominated instruments
- Availability of safe assets
- Depth and breadth of US financial markets
- US military power and alliances

Key features of the Trump trade policy shock

- Average effective tariff rate (pre-substitution) increased by more than 7 times to 18%, a level not seen since the 1930s
- Evolved in a chaotic and unpredictable way – enormous uncertainty remains
- Multiple steps and dependencies, some entirely new policy concepts introduced
- Focused very largely on merchandise trade, although the President has threatened to extend into regulation and taxation
- Completely unconstrained by WTO rules and bilateral trade treaties (except USMCA – for now)
- Trade "deals" signed so far are asymmetric, sketchy and vague, and may not stick

Chart 2: US average effective tariff rate since Jan. 1st, 2025



Main apparent motivations for Trump’s tariff campaign

- Reduce foreign trade protection against US (without changing US protection against foreigners)
- Leverage job-creating investments into the US
- Boost US economic security
- Increase federal revenues to offset costs of One Big Beautiful Bill
- Achieve foreign policy goals
- Support special interest groups in US

Will the new trade policy be sustained beyond Trump?

Possible checks on the policy

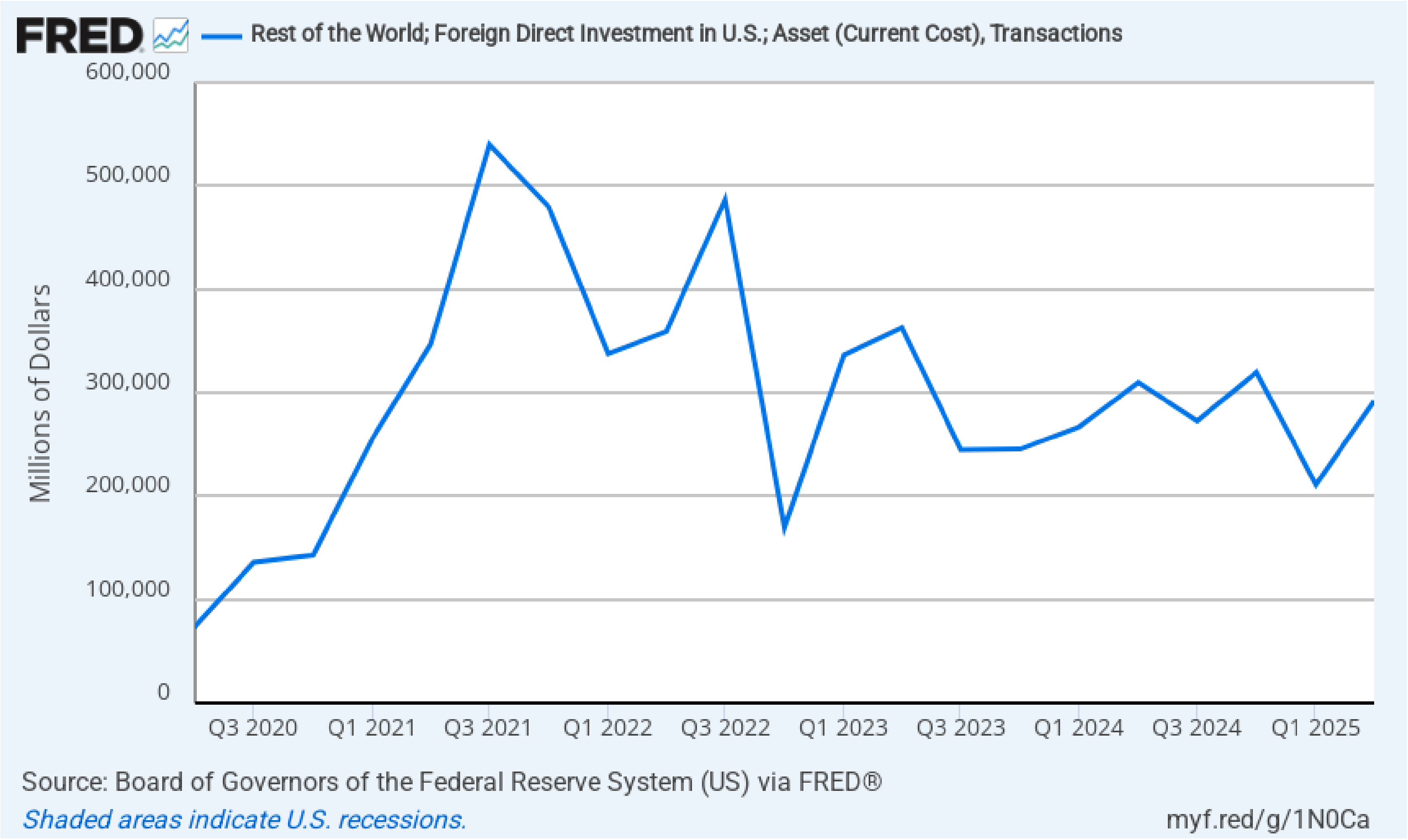
- Legal and political obstacles
- Deals can’t be implemented
- Trump overreach
- Evidence of growing economic costs

But, overall, a complete or even substantial reversal seems unlikely, and the longer current policies remain in place the harder they will be to change

Responses of main trading partners

- All countries focused initially on responding to Trump; a unified response was never a viable option
- Many advanced economies and several EMDEs have accepted asymmetric deals to minimise short-term economic cost
- Retaliation was arguably only a viable strategy for the EU and China; national security considerations have been decisive in both outcomes so far
- Outside trade with the US, countries have largely abided by WTO - 75% of global trade is on WTO terms - but situation is fragile
- Non-US countries are trying to lock in current arrangements through accelerating FTA negotiations

On FDI, MNCs saying one thing and doing another..



Other Trump policies that will amplify the impact of the trade policy shock

Policies which <u>constrain supply</u>

- Crackdown on inward migration
- Attempt to delay or reverse the US net zero transition
- Cuts to capabilities of US Federal government

Policies that <u>boost demand</u> (at least in the short term)

- Massive fiscal expansion through "One BBB" tax cuts (only partially offset by tariff revenue)
- Financial deregulation, particularly taking a light touch approach to stablecoins and crypto

How could Trump policies erode US financial dominance?

- By changing <u>fundamentally</u> the long-term growth path for the US economy
- By *directly* weakening the five factors that support US dollar dominance
- By helping to trigger (another) US-origin global financial crash which would accelerate the impact of the above two channels

Impact of trade policy shock on US long-term economic prospects

- Tariff hike won't *necessarily* reduce the US current account deficit, or boost domestic investment (as Trump Administration hopes)
- Equally there are some significant parallels with Peronism in Argentina from 1946-55 and Brazil's import substitution policies from the 1930s to mid-1980s
- Both involved high levels of protection, state direction of investment, political control of government agencies, etc.
- Resulted in some short-term employment gains, more rapid industrialisation but reduced competitiveness, lowered productivity, and increased inflation over the medium-long term.
- Will the shear size of US economy help reduce these costs?

Direct impact of Trump policies on drivers of US dollar dominance

- Reduced US participation in international trade will reduce network externalities
- Fiscal laxity and politicisation of Fed/other Federal agencies could reduce safe haven status of US Treasuries
- So could different approaches – between US and other advanced economies – to confiscation of sovereign state assets
- US financial markets could face more competition from deeper/broader euro markets if Draghi reforms accelerated
- Weakening in US military alliances may reduce allies' dollar holdings while global reserve status of euro may be boosted by higher European defence commitment

Trend away from dollar may speed up if there is a US-origin financial shock

Trump policies (e.g., net zero roll back, potentially excessive fiscal/monetary stimulus, erosion of independent Federal agencies and financial de-regulation/light touch regulation of crypto) are **increasing risk** in US financial system

Previous global financial shocks have had negligible long-term impact on dollar's role. But next time, it could be different. Why?

- traditional allies may feel empowered to hold back from assisting the US and/or demand unwinding of asymmetric tariffs in return for their help
- other countries may be more wary of engaging with the US and reluctant to accept US leadership
- In both cases, they may look for non-US led solutions through new coordination systems built to deal with Trump's withdrawal from global governance

How should non-US advanced countries and EMDEs (excl China) move forward?

- Step up efforts to create a **“rules group”** of countries (with EU as essential member) to act as **third pillar** of global economy *between* US and China.
- Begin with focus on preserving and improving the international trading system, but then expand into other areas where US has withdrawn or China is in some respects not trusted or may be overly dominant (development finance/MDB reform, global health, climate action, digital governance, anti-corruption, fiscal responsibility, etc.)
- Protect national financial systems from potential new US-origin financial stability risks
- EU to accelerate work on strengthening role for euro as second fully-convertible reserve currency along side dollar
- Urgently develop stable models for a 2-pole or 3-pole international currency system

What process is needed to take this forward?

- Need a new global summit mechanism (robust to US interference) to develop an action plan for the rules group, motivate, coordinate and direct relevant international organisations, and prepare consensus ground ahead of negotiations with US and China

- Cannot use G7 (as US would block the required agenda) or G20 (both US and China are members)

- Need a "G7-+" (minus US, plus other advanced and some EMDEs)

- This could be held ahead of, or back-to-back with, the normal G7

- France hosts G7 in 2026 and would normally be the ideal chair for such an effort, but needs domestic political stability first