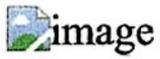


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# Trump's Trade Offensive Hits America's Financial Primacy

**Rising volatility and dollar weakness raise fears of a financial shift away from U. S.**

By Nick Timiraos, Jack Pitcher and Chelsey Dulaney

Financial markets have flashed an ominous message this month about President Trump's ambitious and improvisational bid to reshape global trade: Be careful what you wish for.

Volatility in Treasury markets and unexpected weakness in the dollar suggest that what began as a trade conflict could morph into a more dangerous "capital war." The clash threatens to raise U.S. borrowing costs by undermining Washington's financial primacy, which for years has drawn trillions of dollars of foreign funds into the country.

"This idea that you can break trade, and not break the capitalflow side, is a fantasy," said Steven Blitz, chief U.S. economist at GlobalData TS Lombard.

Market volatility spiked after the president unspooled his fluid and unpredictable trade policy on April 2. The White House paused tariff increases on some of the nation's largest trading partners hours after they took effect on April 9, but then ratcheted up tariffs on China.

A brutal bond-market selloff unfolded, with 30-year yields notching their largest weekly increase since 1987 despite decent bond auctions. The selloff occurred against the backdrop of a weakening dollar, which normally strengthens during bouts of stress. The abnormal combination prompted some analysts to warn about capital flight from the U.S.

Some of the market disloca-

tion reflected hedge funds and other large investors forced to unwind certain trades that became unprofitable. Treasury Secretary Scott Bessent has said the selloff largely reflected technical factors—how investors' risk-management strategies forced sudden and one-time liquidations as correlations between different assets changed unexpectedly.

Some analysts have warned against rushing to sweeping conclusions given how foreign investors began the year overly exuberant about U.S. growth prospects, or American "exceptionalism." Trump's trade policy, by threatening to push up costs while uncertainty over the policy execution chills growth, has demolished that narrative.

The market volatility in the days after Trump's trade announcements would have been more worrisome if they had occurred against the backdrop of a continued slide in stocks, said Richard Clarida, who served as the Fed's vice chair from 2018 until early 2022.

The dollar began the year looking potentially as over-valued as it had been since the 1980s, and Treasury yields remain in the middle of their trading range over the past two years, said Clarida, now a senior adviser at bond giant Pimco.

Bessent cautioned against rushing to judgment over one week's worth of market moves and reaffirmed Washington's support for a strong dollar. "We are still a global reserve currency," he said. "The dollar can go up and down."

But other analysts, economists, and former government officials warned that strained trading conditions might also reflect more-fundamental concerns. "The behavior of investors changed. Ordinarily they would've bought the dollar in this crisis time, and instead they sold the dollar," said Steven Kamin, a former senior Fed economist who is now at the American Enterprise Institute. "It suggests that maybe investors are getting 'hinky' about the safety of Treasuries or the desirability of dollar assets."

Trump administration officials have previously argued that consumers wouldn't bear the cost of tariff increases because the dollar would strengthen. A weaker dollar makes it more likely that U.S. importers and retailers will have to pass along price rises.

In addition to Trump's erratic trade war, global investors are digesting possible increases in budget deficits in the U.S. and Europe and a potential erosion of U.S. monetary-policy independence.

Hedge-fund investors said an increasingly popular trade in recent weeks has been to bet on a widening in the spread between short-term and long-term rates on Treasuries because of concerns about higher budget deficits, pressure on the Fed to cut interest rates, and foreign-investor wariness about U.S. debt.

Foreigners have said they are unsettled by the prospect of a far-more-transactional approach to trade and currency policy, together with a preference for lower interest rates and higher budget deficits.

"The tariffs are the tip of the iceberg," said Ludovic Sub-ran, chief economist and chief investment officer at Allianz, the German insurance giant. "If the dollar depreciates by 30%, what is the return on your investment in the U.S.? Everybody is doing the math."

In a call with analysts this month, BlackRock Chief Executive Larry Fink said the U.S. could face stiffer competition after benefiting from years of "over-allocation" and pointed to Europe as a potential better destination for foreign capital.

Ingo Mainert, a multi-asset chief investment officer at Allianz's asset-management arm, said the firm has been shifting to European assets from U.S. ones for the past month. He has fielded client calls over making more-significant reductions in U.S. exposure, including switching away from indices such as the MSCI World Index, which is more than 70% weighted to U.S. stocks.

That process could take six months to a year as clients complete formal reviews of their allocations, Mainert said. "We're now having a big discussion in the market—mainly outside the U.S.—about what would be better than these highly concentrated traditional benchmarks," he said.

Even if market conditions stabilize, a steady, gradual process that diminishes foreign appetites for U.S. assets could have serious ramifications for American households and businesses. Foreign demand for Treasuries has boosted U.S. asset prices and lowered interest rates, including for 30-year mortgages, over the past two decades.

Roughly 30% of nearly \$29 trillion in Treasury debt held by the public is owned by foreigners, though foreigners' share of Treasury holdings has steadily declined since the 2008 financial crisis.

Normally, Treasuries have served as a hedge against stock-market risks because bond prices typically rise (and yields fall) as stock prices decline. That property has made them far more attractive for investors to own than would otherwise be the case, and any breakdown in that hedging property could be worrisome for the U.S. because it would mean one reason fewer for investors to own Treasuries.

In a world where the U.S. isn't viewed as a dependable partner, it makes sense for foreign investors to gradually diversify their holdings toward Swiss francs, gold, Japanese yen or euros, some analysts said.

"The longer this goes on, the more likely it is that we become less of a reserve currency than we have been. And that could start being quite expensive," said Eric Rosengren, who served as president of the Boston Fed from 2007 to 2021.