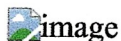


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Beauty Is in the Eye of the Bondholder

The "One Big Beautiful Bill Act" passed by the U.S. Senate on Tuesday used some creative budget math to make \$3.8 trillion equal zero.

If only congressional scoring could make actual costs vanish. The enlarged package of tax-and-spending measures looks a lot better to domestic investors who measure returns in dollars than to foreigners anxiously adding up Uncle Sam's tab.

The U.S. had a twin deficit problem—budget and current account—long before this year's beautiful bill and trade war. America was still the favorite destination for the world's savings, and official data show foreigners didn't dump U.S. stocks and bonds in the weeks after President Trump's "Liberation Day" tariffs.

Yet the U.S. Dollar Index fell nearly 11% in the six months through June—its worst start to a year since 1973.

There may be more where that came from, according to George Saravelos, head of foreign-exchange research at Deutsche Bank. He wrote this week that "foreigners don't need to sell U.S. assets to weaken the dollar but merely to say 'no thank you' to buying more," which they have done.

Saravelos estimates that narrowing the current-account deficit—America's balance of goods, services and capital—might require another 30% to 35% slide in the greenback. That would make U.S. products and investments attractive enough to entice foreigners.

If he is remotely right then the values of some stocks, such as multinationals and those exposed to commodities, could perform decently in dollar terms. More domestic ones like health insurers, retailers and utilities might lag. Almost all U.S. stocks would look worse to foreign investors in their own currencies.

Bonds would, too, and that is more concerning because America relies on the kindness of strangers.

Asian investors got rattled again recently when the Taiwan dollar spiked against the dollar, creating temporary paper losses for huge insurers there.

Even if they could cheaply protect themselves from currency losses, the riskiness of "risk-free" Treasury debt has grown with annual federal interest payments reaching \$1 trillion.

Adding another \$3.3 trillion or so to the primary budget deficit over a decade as a result of the beautiful bill makes that picture uglier.

How much it ultimately adds once federal interest costs are included depends on the market. With foreigners already owning so much Treasury debt, saying "no thank you" more often could push financing costs higher due to supply and demand.

Then there is the secondary effect of a weaker dollar on imports.

Analysts at Morgan Stanley estimate that each 10% of dollar depreciation adds about half a percent to consumer prices.

Higher inflation makes the Federal Reserve hesitant to cut the short-term interest rates it controls.

Budget arithmetic looks a lot different to financial markets than it does in Congress.

—*Spencer Jakab*

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