

**LBBW**

Bereit für Neues

To the point!

Cross-Asset- and Strategy-Research

„We are not in Kansas anymore”!

Trump is sawing off the branch on which the U.S. economy sits

Some might wonder about the title of today's editorial. The quote is from the film "The Wizard of Oz" (1938) and is nowadays a common saying in the U.S. "We're not in Kansas anymore", said the protagonist Dorothy to her dog Toto when she found herself in the magical land of Oz instead of the Midwestern United States. In other words, she was in a completely new, unfamiliar world. This is precisely how we feel now, as Donald Trump has brutally chased globalization away with his tariff spree. Or, as a blogger recently put it: Now we economists know how scientists felt when Trump recommended injecting bleach during the pandemic.

Concerning the U.S. tariffs and their absurd justification, essentially everything has been said. The same goes for the extreme volatility and sell-off in the stock markets. At this point, I will focus on the thought of how bizarre it is that Trump wants to tear down the system from which his country has benefited so greatly over the decades.

The exorbitant privilege of the world reserve currency

At the center stands the status of the dollar as the world reserve currency. The dollar is the globally preferred currency for international transactions or for maintaining financial assets' stability, such as currency reserves. This brings privileges. Firstly, the high global demand for a reserve currency makes borrowing in this currency cheaper, both for the government, companies, and households. Additionally, the reserve currency allows easy financing of current account deficits, giving the country significantly more room for consumption and investment than domestic production would justify. Furthermore, monetary policy flexibility

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Turning point
in global trade

The dollar
bestows the U.S.
with significant
advantages

is superior to that of other countries' central banks. This enables an effective response to financial and other crises. Recently, this flexibility was observed during the financial crisis and the pandemic: The Fed granted other central banks, including the ECB, dollar liquidity lines. It was once again clear who holds the power.

Valéry Giscard d'Estaing, former French finance minister and later president of France, coined the term "exorbitant privilege" for the U.S. in 1965 out of envy. He criticized that this privilege disadvantaged other countries. Donald Trump now sees this exactly the opposite way: He claims that all other countries have been looting, pillaging, raping, and plundering the U.S. over the decades (his words, not mine).

In my perception, Trump's litany about alleged trade barriers borders on paranoia. Apparently, all laws and decrees in Europe exist for the sole purpose to maliciously cheat on America.

Savings in the U.S. are too low

Fundamentally, the U.S. trade deficit reflects to a large extent a lack of willingness to bring domestic savings into line with domestic investment. America is living beyond its means and has done so for a long time. The savings of the more frugal rest of the world are supporting this lifestyle. Figure 1 shows that the savings rate in the U.S. has stagnated at a low level for decades. Countries that invest more than their own savings can finance inevitably record a deficit in foreign trade. It is a matter of an accounting identity. And, of course, the spendthrift behavior of the government itself is not exactly helpful. The humongous government deficit indicates massive dissaving by the government. Year after year, independent of the president's political affiliation (see Figure 2). Instead of raging so belligerently against the rest of the world, Trump should first clean up his own backyard.

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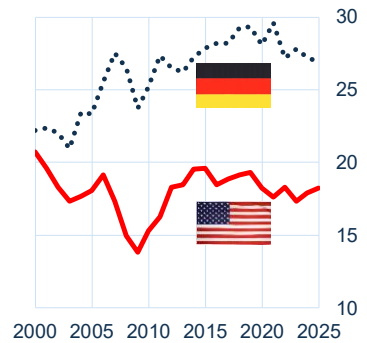
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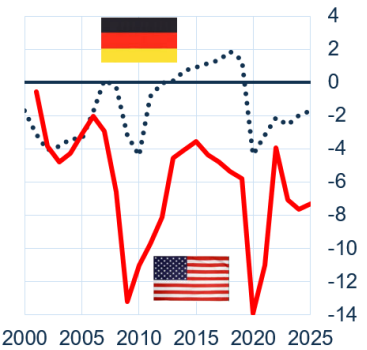
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Fig. 1: National savings rate (% of GDP)



Source: IMF, LBBW Research
NB: Global savings rate 2024 = 26.4%

Fig. 2: Budget balance (% of GDP)



Source: IMF, LBBW Research

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