RATHBONES

NEGOTIATING A TRADE WAR

REVIEW OF THE WEEK
28 **APRIL 2025**

Markets continue to recover as US President Donald Trump and his advisers whisper sweet nothings to investors. It's a brittle sort of recovery though: definitive de-escalation of the global trade war is needed to truly woo investors. Through it all, though, the dollar should still reign supreme.

Stocks and bonds reacted well to the US government's plans to negotiate trade deals with roughly 18 major partners over the next two months. The administration says that should allow agreements to come into force before 8 July – the date when Trump's 90-day pause on 'reciprocal' tariffs ends.

It's an unrealistically tight timeframe to discuss and agree 18 free trade agreements – if that's what these negotiations really are. They tend to take years of talks and then need ratification from both sides, generally requiring legislative approval. Still, the direction of travel has heartened most investors so far.

This process doesn't include China, however. Tariffs of more than 100% are already being levied on goods travelling between the two largest trading nations. Well, it's probably more accurate to say they ***would be*** levied if any goods actually make the trip across the Pacific. American ports report that virtually all major shipments from China to America have ceased. Which is what you would expect – it's incredibly hard to make make money on anything if you must pay more than its value in taxes just to cross the border.

Last week Trump assured reporters that officials were talking to Chinese counterparts daily about coming to a rapprochement, which buoyed market sentiment. There were a few wobbles when China disputed this statement and US Treasury Secretary Scott Bessent seemed to contradict his boss. Despite that, China has quietly started waiving tariffs on some imports of crucial parts, especially for medical devices, airplanes and computer chips. That mirrors a similar move by the US to allow semiconductors and other electronics to flow unheeded. It could be the start of a unified walk-back, or it could simply be both sides adjusting their footing as they prepare to dig in.

Unfortunately, it's a real wait and see situation. A game of chicken between two of the most important centres of production and economic activity in the world. Apart from a few public jabs thrown here and there, it will be resolved – if it's resolved – behind closed doors.

Meanwhile, Trump took a swipe at US Federal Reserve (Fed) Chair Jay Powell last week, calling him a "major loser" because the central bank declined to make an emergency interest rate cut to support the economy. The Fed meets next week to discuss monetary policy, so it may be that

Trump wants to try to rattle him into doing his bidding. Powell and the Fed seem unlikely to acquiesce. Interest rate markets suggest a 95% probability that the Fed's benchmark overnight rate will remain at the 4.25%-4.50% band until June. At first it sounded like Trump planned to try to oust Powell before his term ends early next year, but Trump clarified that wasn't the case. Just sprinkling a little more volatility on everyone, perhaps.

King dollar

All the confusion, unpredictability – chaos, really – has sent the dollar tumbling abruptly this year. In a matter of months, it's gone from a high seen only once before since the early 2000s to lows unseen for three years.

DOLLAR HAS FALLEN FAST, BUT STILL FAR FROM WEAK

Source: FactSet; DXY Dollar Index against major trading currencies, data to 25 Apr

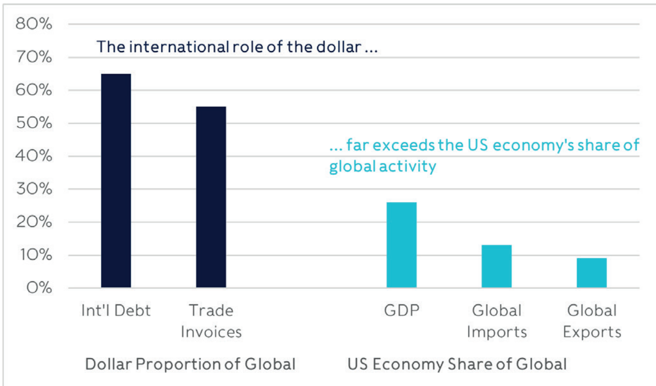
This big shift downwards has prompted many people to question whether the dollar is slipping from its throne atop the global economy. Big drops in the dollar always spark these discussions – of course, this is far from the first big slump in the dollar. We think this fall is no different to the others. The dollar will continue to be the preeminent currency, we believe, for years to come.

Why? Yes, the dollar has shed a lot of value, but it was arguably very overvalued. In fact, even after its big fall, it's still very strong relative to the past quarter century. And while the US administration could be considered kooky, its policies jarring and sometimes nonsensical, and foreign policy so spiky that it's encouraging global central bankers to swap some of their dollar-denominated assets for other nations' debt and even gold, that shouldn't make that much difference. The dollar (and therefore the US bond market) should continue to be the safe haven port of choice for most people in the world during times of stock market turbulence. Our reasoning? Because the world's debts remain overwhelmingly denominated in dollars. Bluntly, when things go pear-shaped, everyone tries to make sure they can cover their bills. And most of those bills can only be paid with dollars.

The dollar is the world's primary 'reserve' currency (the assets that central banks hold in their digital vaults), accounting for almost 60% of the total reported by the IMF for which currency composition is known. Yet we think the dollar's use in the real economy and commerce is more important and is what drives central bankers to think of the dollar as a reserve currency – not the other way round.

Most international debt obligations – whether mortgages, bonds, bank loans or trade invoices – have been issued in dollars. This means that they must be repaid in dollars. And the dollar's share of these debts is much greater than the US economy's share of global economic activity. Meanwhile, much trade and investment that's denominated in other currencies is routinely financed in dollars. As a result, when things go wrong in the global economy and firms or investors must meet their liabilities quickly, demand for dollars typically increases regardless of the cause of the problem. The global role of the dollar today is primarily a product of the liquidity and depth of US financial markets, rather than the economic weight of America.

PEOPLE NEED DOLLARS TO PAY THEIR DEBTS



Source: BIS, Brookings, LSEG, Rathbones

The US has been through many ups and downs, suffered through bad policies and economic shocks, and each time the death of the dollar has been foretold. Yet it has continued to live on. The dollar is not a haven because of the wisdom of US policymakers or the growth prospects of the US economy, but because of its embedded dominance in global funding markets.

This dominance is also supported by the structural flaws in its most credible alternatives: the fragmentation of Europe's bond markets into individual countries' issuance and China's capital controls. We think this explains why the dollar's safe haven behaviour is so persistent and why it can survive erratic and misguided economic policymaking – including the current tariff policy – so long as the core features supporting the international usage of the dollar as a funding currency are untouched.

*If you have any questions or comments, or if there's anything you would like to see covered here, please get in touch by emailing **review@rathbones.com**. We'd love to hear from you.*