

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

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Section 1: Introduction – the source of current US financial dominance

The US remains the world's leading economic power, accounting for 22.8% of global GDP, against 14.7% for China and 12.9% for the Euro Area. Its share of world trade (exports plus imports) in goods and services, at 14.0 %, now lags behind China (16.1%) and the Euro Area (15.3%), although it remains the world's largest exporter of services by a wide margin and this has typically grown much faster than trade in goods. It also leads the world in key areas of technological innovation, including the digital economy, health/bioscience and defence.

But the US's dominance of global finance is much greater than can be explained simply by its role in the real economy. As Table 1 below shows, the US dollar accounts for more than 50% of trade invoices, foreign exchange reserves, international bank claims, and international bonds. It also accounts for 44% of FX turnover and more than 50% of messages through SWIFT.

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

Source: IMF External Sector Report, July 2025. [2025 External Sector Report: Global Imbalances in a Shifting World](#)

US dollar dominance has also been remarkably stable over time. Table 2 shows some key dates for an index of international currency usage calculated by the IMF. Both the dollar and the euro were used to about the same extent in 2024 as they were in 2000; and there has been minimal change even in response to exceptional events, such as the freezing of Russian state assets by the G7 which followed Russia's invasion of Ukraine in 2022.

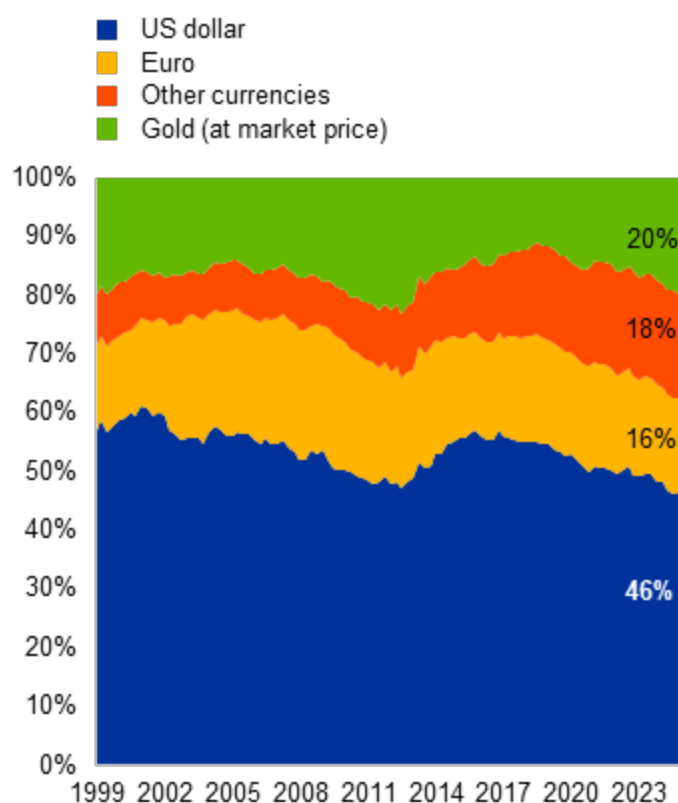
Table 2: Index of International Currency Usage

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).

One caveat on this general picture of stability is the growing role of gold. Table 1 shows that with respect to *total* reserve assets (not just foreign exchange), the dollar has lost significant ground to gold since 2018. This partly reflects the inevitable consequence of the rise in the gold price (since some central banks only adjust their gold holdings infrequently, if at all). But it also reflects new central bank purchases of gold.

Chart 1: The Share of Gold in Central Bank Reserves

Source: ECB, The International Role of the Euro, June 2025 [The international role of the euro](#)

Multiple factors have underpinned the US dollar's sustained dominance to date. These include: the **size and dynamism** of the US economy; **network externalities**, i.e. the benefit in terms of cost and convenience an individual economic agent gains from using the same currency as their counterparties in cross-border transactions; **complementarities** between the many different activities and instruments in which the dollar has a dominant role; the availability of abundant **safe assets** denominated in US dollars in the form of US Treasury securities; and the **depth and breadth of US financial markets** (particularly when compared with the euro's nationally fragmented markets and the restrictions on use of Chinese domestic markets arising from capital controls).

The US's **superpower status** and position at the heart of a comprehensive set of military alliances and defence treaties has probably also played a significant role in underpinning the dollar's dominant role. According to one argument¹ military strength reassures potential investors that a country will not suffer the economic chaos of defeat. There is also a feedback effect insofar that a country benefitting from exorbitant privilege is able to raise cheaper finance with which to sustain its military dominance. US allies also tend to rely on US weapons and may choose to hold liquid dollar assets in order to purchase more supplies at short notice. They may also see holding a large proportion of their reserve assets in the currency of their closest military ally as the most secure option as well as being helpful in reinforcing the underlying alliance.

However, the paradigm shift in US economic policies since President Trump took office for the second time at the start of 2025, raises fundamental questions about the future course of the US economy, whether it will continue to play as dominant a role in the global economy and finance in the future as it has in the past, and the future role of the US dollar.

At the core of the US policy shift is the **increase in the US average effective tariff rate** (pre-substitution effects) from 2.4% at the start of 2025 to 17.9% as of 31st October 2025 (before the new tariffs against China announced on 10 October take effect)². This is the highest average tariff rate the US has experienced since the 1930s and has been combined with an enormous increase in the uncertainty and complexity of the US tariff regime taking it to a level not seen since the second world war.

Alongside this tariff policy, the new administration has instituted a number of economic policies which may exacerbate its effects.

These include making a concerted effort to delay (and even reverse) the US economy's net zero transition; to restrict inward migration; to cut back federal government staffing and capabilities; to reduce the independence of key domestic economic institutions (notably financial regulators and the Federal Reserve); and to scale back regulation, including easing

¹ [US military strength secures financial dominance | CEPR](#)

² [State of U.S. Tariffs: September 26, 2025 | The Budget Lab at Yale](#)

regulations on banks introduced after the global financial crisis and adopting a light touch approach to the regulation of stable coins and other crypto assets.

In addition, the administration's approach to national security has weakened ties with America's traditional allies, including through threats by the President against the sovereign territory of Canada and the EU (Greenland). Trump has also introduced significant doubts around the extent of US support for NATO and sharply cut back military and economic support for Ukraine's fight to remain independent from Russia.

A key difference between President Trump's first administration (Trump 1) and his second (Trump 2) is that, under Trump 1, the President was constrained by a lack of political experience, by appointees from the conservative establishment and by the institutions and norms in the Federal government. He was also held back by Democratic Party control of the House of Representatives for part of the time he was in office. In this context, the President typically chose to opt out of international agreements he did not like (such as the Trans-Pacific Partnership Agreement) but did not proactively seek to frustrate other countries' from pursuing them.

Today, by contrast, the US is much more likely to try and force other countries to align with the new direction of policy in the US and to oppose and even retaliate against any efforts at international coordination which it believes are not in line with its interests.

The Trump administration argues that its new policy direction will strengthen the US economy domestically and internationally. It also argues that there is no conflict between the US remaining at the heart of the global economy and the range of steps it has taken to bring jobs back to the US.

Against the backdrop of a stock market reaching all-time highs (despite the tariff hikes) and the administration's apparent success in forcing trading partners such as the EU, UK and Japan to accept asymmetric trade deal outcomes, some might argue that Trump is on track to meet his objectives, at least in the short term.

However, there is also a strong case to be made that the Trump policy shift (if sustained) will fundamentally weaken the US economy over the medium to long term and this in turn will undermine its current dominance of global finance. In addition, some of Trump's new policies may directly impact on the US's financial role. It is also possible that the combined effect of Trump's actions (in the context of other trends in the US economy) could trigger another US-focussed global financial crisis which, in contrast to previous such shocks, could accelerate the move away from dollar dominance.

There are numerous internal inconsistencies in the current US policy mix. How these are resolved, as they eventually will have to be, will be critical to the eventual outcome.

The extent of the US decline will also depend crucially on how other countries react over time. Most important is the question of whether they choose to - and are able to - find a

way to coordinate their responses to the Trump shock and cooperate to achieve mutual benefit, without US leadership, and possibly in the face of US opposition.

The relatively short period that President Trump has been in office (just 9 months), the extraordinarily erratic nature of his policy making, and the continuing uncertainty over how other countries will react in the medium term mean that it remains very hard to draw clear cut conclusions about the likely implications of Trump's policies for the broader macroeconomic outlook. However, we are increasingly able to determine the most likely scenarios - both for the US and other economic blocks - and also the key decision points and milestones ahead.

Section 2 of this paper looks in further detail at the **main features so far of the Trump trade policy shock**, the underlying rationale presented for it, and the likelihood that it will be sustained.

Section 3 considers how the **main economic actors** - notably the US's main trading partners, but also multinational companies - have responded to date and the variety of reasons that have underpinned these responses.

Section 4 looks at the **other key elements** of the Trump economic paradigm shift and considers how these policies may re-enforce some aspects of the trade policy shock's impact on the on US economy.

Section 5 discusses the likely **overall consequences** of Trump's economic policy shock for US financial dominance and the role of the dollar.

Section 6 reviews the main **options facing policy makers in other advanced countries**, including the EU, UK and Japan, and the non-China global south and makes **recommendations** on what the latter group of countries should do.

Section 7 concludes.

Section 2: Key Features of Trump's trade policy shock

This section looks in further detail at the main features so far of the Trump trade policy shock, the underlying rationale presented for it, and the likelihood that it will be sustained.

Key features of trade policy shock

President Trump announced his initial set of tariffs against Canada, Mexico and China on February 1st justifying them on the base of national security concerns over cross border flows of Fentanyl and illegal migration.

There have been an **enormous number of twists and turns** since then, as the US has first raised tariffs against groups of countries for a variety of reasons, then paused them temporarily, and then either reached a settlement or re-imposed tariffs, sometimes at the

pervious level, but sometimes higher. Chart 2 below shows the overall impact of this strategy on the US average tariff rate (before substitution effects) since the start of the year.

But it is also clear that the process still has a **long way to go** before a stable US (and hence to a large extent, global) tariff regime is put in place. This is partly because a number of key negotiations are yet to conclude (notably with China), but it also reflects the President's direct oversight of the strategy and his personal approach. For example, he appears ready to re-open agreements at any point even though partner countries may believe they have settled all outstanding issues. He also appears to attach very little weight to the costs incurred by domestic or foreign business from constantly changing tariff levels. For these reasons we may not see a stable US tariff regime while Trump is in office.

Some features of the campaign so far may not be sustained. This includes the highly simplistic formula used to determine so called "reciprocal" tariffs, linking the US tariff rate almost entirely to a country's bilateral trade balance with the US regardless of the circumstances that led to it. Other features, such as the deals the Trump administration has done with US tech companies to share the revenues from chip sales to China in return for allowing them to continue exporting, may become part of a more common pattern in US trade policy. In this case US tariffs would not only be country or sector specific but are also in some cases targeted to benefit or punish individual US or foreign companies. It is also becoming clearer that some of the most important long-term economic effects from Trump's tariff campaign could be in the area of investment flows and the location of scarce capabilities for innovation.

Chart 2: US Average Effective Tariff Rate Since January 1st 2025

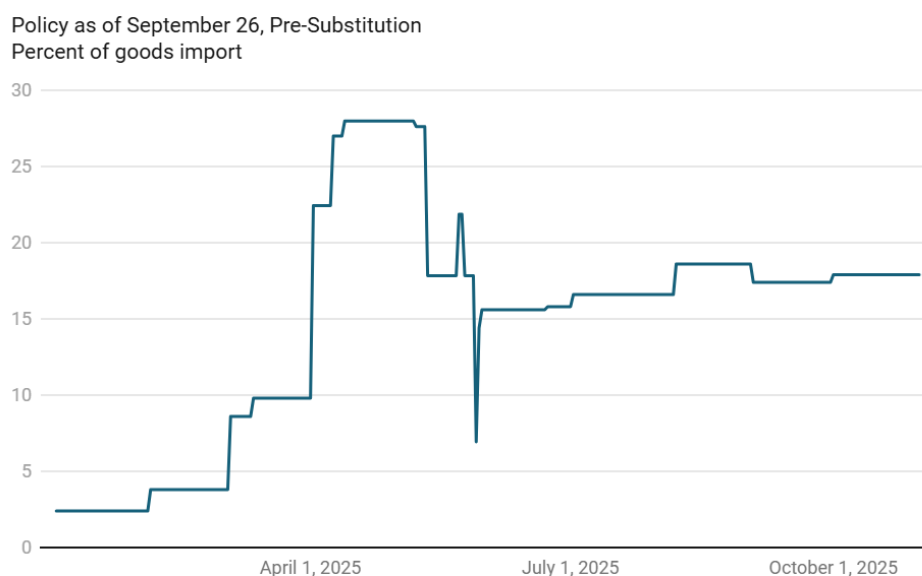


Chart: The Budget Lab • Source: The Budget Lab analysis. • Created with [Datawrapper](#)

Further key features of Trump's tariff regime include:

First, that tariff action has so far largely focused **on trade in goods** and not trade in services. This presumably reflects the very large surplus the US currently enjoys in services trade, and the political priority Trump sees in expanding manufacturing jobs. But this may not continue. In part this is because the services issues Trump is currently raising (such as digital services taxes and sustainability disclosure requirements) go to the heart of domestic policy sovereignty in partner countries. In addition, if other countries turn to retaliation, service sectors where the US has a surplus could appear an attractive target.

Second, Trump's approach has so far been completely **unconstrained by either WTO rules** or the US's 20 bilateral free trade treaties that pre-date the current administration. After initially breaching the USMCA, current U.S. tariffs on Mexico and Canada are structured to comply with the USMCA, as they exempt goods that meet the agreement's origin and documentation requirements. However, non-compliant goods are subject to significant tariffs.

Third, in many cases "deals" that have been signed are **sketchy and vague** and partner countries are finding them hard to implement. For example, the UK-US trade deal signed in May removed Section 232 tariffs on UK exports of steel and aluminium products. But this has still not been implemented, and the UK will have to satisfy a vague requirement on security of supply. Similarly, the EU's deal signed in July includes a clause capping future US tariffs on European pharma products at 15% (including any that might arise from the on-going Section 232 investigation). However, subsequent statements by the administration have raised questions about whether there could yet be additional tariffs as a result of the 232 investigation. While both the UK and EU deals did not mention US action against national digital services taxes, the EU did agree (in parallel) to withdraw proposals for an EU-wide digital services tax, and there is no guarantee that the US will not re-open this issue in future.

Fourth, the administration has presented a very **wide range of motivations** for the imposition of tariffs. In some cases, the rationale appears to be entirely one of foreign policy, in other cases it is linked to a domestic economic priority. This complexity, and the fact that some of the justifications used by the administration are extremely hard to sustain (such as the logic of tariffing Canada for failing to restrict flows of Fentanyl to the US), may reflect the need to find an existing legal justification for the tariff. But it also seems to reflect the underlying perception of tariffs as an all-purpose instrument.

Trump's rationale for the new US trade policy

There appear to be at least **six distinct motivations** for Trump's trade policies (largely, but not solely tariffs).

The **first** motivation is to force other countries **to reduce tariff and non-tariff protection vis-à-vis the US**. However, while this may on the face of it appear a laudable objective, it has been accompanied by the clear goal of maintaining existing US protection (tariff and non-

tariff) against other countries' exports. This contrasts with the approach taken by the first Trump administration in re-negotiating NAFTA and, as a result, the EU's initial approach to Trump's demands of seeking a tariff-free free trade area with the US in industrial goods failed.

In addition, the US administration has made clear that it will define for itself what constitutes foreign protection (rather than allowing for any independent or external adjudication). As a result, tax and regulation policies that affect US companies operating in overseas markets may be defined as discriminatory simply because US companies lobby against them, or appear to be disproportionately affected, or because there is no parallel regulation in the US domestic market.

The metric of success for this strand of US trade policy is the size of the **overall US deficit and bilateral deficits** in trade in goods. Hence the latter is at core of the "reciprocal tariffs" formula. But the approach takes no account of the complex underlying economic mechanism under which changes in the US current account as a result of the imposition of tariffs will ultimately be determined by the US savings and investment imbalance³, nor the principle of comparative advantage⁴. Nor does it take account of trade in services where the US has a large and growing surplus vs the rest of the world. As a result, if the US policy makers continue to pursue a balanced trade in goods objective using tariffs as their principal tool the outcome is likely to be both unstable and ultimately unsuccessful.

The **second** motivation is **to leverage more job-creating investment into the US**. This is partly intended to happen through the tariff policies themselves - making it more expensive to serve the US market from abroad. It is also partly to be achieved by **seeking investment commitments** as part of trade deals. But it is unclear what the latter commitments will mean in practice, particularly in the case of market economies, where investment is in the hands of private firms and individuals. In Japan's case a US-Japan \$550bn fund is to be established, largely controlled by the US government, which will invest in US strategic industries. But the initial terms of the deal did not specify how Japan would finance the investment, who would administer the funds, or how the profit retention mechanism (initially agreed to be 90 percent to the US and 10 percent to Japan) would operate in practice.⁵ Another approach being developed by Switzerland in order to reduce the current US tariff level of 39% is for the government to coordinate a set of investment pledges in the US by private Swiss companies.

The **third** motivation is to boost **US economic security**. This has been cited as an additional rationale for reducing the overall US trade deficit. It is also being used to justify very high tariffs on Chinese EVs, effectively closing the market to this source of supply, and the

³ Under the equivalence $(X-M) = (T-G) + (S-I)$.

⁴ Although the administration did eventually exempt from reciprocal tariffs goods that the US cannot produce domestically.

⁵ [Investing in Security and Success: Analysis of the US-Japan \\$550 Billion Strategic Investment Fund | Hudson Institute](#)

protection of steel and aluminium industries, as well as initiatives to develop domestic sources of critical minerals and lock in foreign supplies. The economic security justification has been applied almost as freely vs the US's close allies as it has been to its strategic competitors, raising the question of whether a strategy in which the US strengthens its own economic security without contributing to the security of allies is viable in the long-term.

The **fourth** motivation has been to **raise additional revenue for the Federal government** in part to offset the extension of tax cuts in the "One Big Beautiful Bill" (BBB) Act. Latest estimates suggest that tariffs imposed to date could raise a net \$2tn over the period 2026-35 in additional revenue (taking account of the gross revenue raised and the offsetting reductions in taxes elsewhere due to income effects etc)⁶. However, while a substantial amount, this would only amount to less than half the \$5tn total cost of the BBB act. The combination of the two policies would also be highly regressive as the BBB's extended tax cuts mainly benefit the rich, while tariffs impact disproportionately on spending by the poor.

The **fifth** motivation is to achieve **political and foreign policy goals**. For example, the Trump administration has placed an additional 25% tariff on India (making 50% in total) in part in response to Indian purchases of Russian oil. Here the aim is to block overall sales of Russian oil, in contrast to the "oil price cap" which is meant to reduce the earnings Russia makes from oil sales but avoid restricting global supply. President Trump has justified the effort to constrain Russian oil exports as a way of putting pressure on President Putin to reach a peace settlement in Ukraine. But it is also possible that he favours a total ban in part to boost demand for US oil.

In the case of Brazil, an additional 25% tariff (making 50% in total) has the objective of forcing the Brazilian authorities to release former President Bolsonaro following his conviction of an attempted coup. In both cases there are significant exemptions. However, the approach reflects an overall strategy of using tariffs along-side, or instead of, conventional economic security tools (sanctions, export controls and investment screening) to force countries to change behaviour.

The Trump administration's **sixth** motivation is to achieve wider **domestic economic policy goals** that benefit certain groups. These are highly diverse and may include raising demand for US oil through secondary sanctions on India as described above. It also includes the demand that US pharma companies cut retail drug prices in the US to the level charged abroad. Rather than reduce domestic prices, this is leading the industry to resist public pressure for lower prices in the UK and to threaten to withdraw investment so as to apply leverage on the UK government. Meanwhile Trump is threatening tariffs on foreign drugs companies, over and above those already levied through reciprocal tariffs, designed to drive investment into the US.

⁶ [State of U.S. Tariffs: September 26, 2025 | The Budget Lab at Yale](#)

These objectives have several apparent **internal contradictions**.

Arguably, the most important is the contradiction between wishing to strengthen the US economy and seeking to isolate it from global trade.

For example, even if investors are forced to switch investment from overseas locations to the US in order to avoid tariffs, the facilities they construct in the US may well be less productive than those overseas, which in turn will damage other US industries that, as a result of tariffs, have to rely on them for inputs. Similarly, some tariffs are being applied to deter imports of products that US workers may generally be too highly paid (and skilled) to make (such as trainers and other footwear) or do not have the skills and culture for (e.g. TSMC's⁷ advanced chips). Either way, workers will be diverted from areas where they are more productive to areas where they are less productive.

A further contradiction lies in the desire to boost capital inflows to the US, while at the same time reducing trade deficit. If nothing else changes, a fall in the trade deficit means a fall in current account deficit, whereas higher capital inflows require a rise in the current account deficit.

Will the new trade policy be sustained?

These contradictions combined with other factors raise the question of whether the current US trade strategy will actually be continued despite the President's current commitment and the short-term signs of success in some areas. If it is likely to be short-lived, the best strategy for the US's trading partners and multinational firms may simply be to wait it out.

The most immediate route through which the strategy may be checked or diluted is if the Supreme Court rules in the coming weeks that the IEEPA⁸ justification for the April 2nd reciprocal tariffs is illegal. If this happens, the administration will no doubt look for alternative (and possibly more tenable) legal justifications which may be sustained against further legal challenges. But in the short-term such an outcome could provide some temporary relief for companies and trading partners. Further ahead, it is also possible, though unlikely, that the Republicans could lose *both* Houses of Congress in the 2027 mid-term elections, enabling the Democratic party to pass legislation reclaiming Congressional authority over US tariff policies.

Another scenario is that the recent set of trade deals with the UK, EU, Japan etc prove impossible to implement. Or that additional demands from the Trump Administration, e.g. in relation to digital services taxes or climate regulation prove to be redline for the target countries (as an infringement on domestic sovereignty). Trump may also retaliate in response to future tariff policies adopted by foreign trade partners, such as the EU's Carbon

⁷ Taiwan Semiconductor Manufacturing Co Ltd

⁸ International Emergency Economic Powers Act

Border Adjustment Mechanism (CBAM) which is due to come into force from the start of 2026.

A further unlikely scenario is that under which growing evidence of the adverse economic effects of the tariff policy (or a sharp financial market reaction linked to such evidence) persuades Trump to moderate or even reverse some key elements in his approach.

However, the most likely scenario seems to be for the US's existing trade policy framework to continue for the foreseeable future. Moreover, the more it becomes embedded in US economics and politics, with the Federal government relying on tariffs for revenues, or specific industries relying on continuing protection to stay profitable, the harder it will be for a future administration or democratic-controlled Congress to reverse course, even if that would be their preference. What is possible after President Trump leaves office is that the current extreme level of uncertainty over future tariffs and trade restrictions is reduced.

Section 3. The response of US trading partners and companies to the Trump shock.

This section considers how the how the main economic actors - notably the US's main trading partners, but also multinational companies - have responded to date and the reasons that have underpinned these responses.

Overview

Not surprisingly, the US's main trading partners have put most effort since the start of the year into trying to manage their bilateral trading relationship with the US and minimise the domestic economic, political and security costs of Trump's policy shock.

While a coordinated response, including the threat of retaliation, from the US's main trading partners might *in theory* have forced a change of course by the US, this was never a practical possibility, partly because, in the absence of the US itself, there was no leader among the advanced economies willing or capable of stepping forward at short notice, and partly because of the different circumstances and sharp divisions among the US's major trading partners.

For the US's traditional western allies, an essential requirement was maintaining the US security umbrella at least in the short term. At the same, many advanced and some emerging economies shared US concerns about the manner of China's participation in the international trading system including its use of state subsidies, economic coercion and to a lesser degree, its perceived status as a long-term strategic threat. While this has not led them to the same conclusion as the US on how to respond (i.e. by abandoning existing bilateral agreements and WTO rules and procedures), it did make cooperation with China in response to the US tariff shock a non-starter at least in the short term.

The prospects of a unified approach vis-à-vis the US were also reduced by important differences among advanced countries in the extent to which they depended on trade with the US overall and the extent to which they were in deficit or surplus. In addition, Mexico and Canada have benefited from the US's current approach of respecting (uniquely among its trade agreements) the terms of the USMCA which covers some 80-90% of total trade in goods and services by the two countries with the US. However, the agreement is due for review on 1st July 2026, at which point the US may no longer accept the current, essentially balanced, arrangement.

The net result is that the US trading partners which have signed deals with the US have agreed an asymmetric outcome. They have accepted higher US tariffs while keeping their own tariffs vis-a-vis the US unchanged, or in some cases reducing them.

However, they have also typically maintained their non-US trading relationships on WTO terms as far as possible and accelerated their efforts to reach free trade agreements with other countries, seeing this as a way to lock in existing trade terms and diversify trade relationships over the longer term.

The WTO has estimated that 75% of world trade continues to be on WTO-consistent terms⁹ although this figure is likely to decline when some of the outstanding US deals (such as that with the EU) are formally confirmed. The WTO is also forecasting continued growth in world merchandise trade of 2.4% in 2025, partly due to stockpiling ahead of the imposition of US tariffs in H1 but also reflecting strong growth in AI-related goods. Meanwhile services trade is also expected to continue growing at 4.6% in 2025, although at a slower rate than would otherwise have been the case without the imposition of US tariffs on merchandise goods.¹⁰

A further consequence of the Trump shock has been a renewed focus in countries or blocks with significant internal trade barriers (such as India, Canada and the EU) on removing those barriers.

We now look in more detail at the decisions taken by the EU and China and the independent choices made by multinational companies.

European Union

The EU is the US's largest trading partner (with total trade amounting to \$1tn in 2024) and is one of only two US trading partners (the other being China) with sufficient economic weight seriously to consider forcing the US to accept a symmetric outcome in tariff negotiations through a strategy of retaliation against tariff hikes and a sustained trade war.¹¹

⁹ [Despite US tariffs, WTO says world trade rose sharply in H1](#)

¹⁰ WTO Global Trade Outlook and Statistics: Update October 2025 [stat_07oct25_e.pdf](#)

¹¹ Arguably Canada and Mexico whose trade with the US amounted to approximately \$800bn each in 2024 also have the capacity to mount a successful trade war vi-a-vis the US, particularly if they were to coordinate their efforts (and Canada did retaliate against the initial wave of US tariffs). However, both countries are

Reflecting this, the European Commission prepared a series of merchandise trade retaliation measures in response to President Trump's initial announcements. Consideration was also given to retaliating on trade in services (where the US enjoys a substantial bilateral surplus) and to deploying the EU's anti-coercion instrument which grants wide-ranging powers to impose restrictions on trade, finance and investment.

However, in the event the EU decided not to take the retaliation route and settled in July for an asymmetric negotiated outcome the terms of which allowed the US to impose a 15% tariff on most imports of EU goods (with some "strategic" goods kept at zero tariffs and steel, aluminium and copper at 50%). At the same time the EU eliminated all existing tariffs on US industrial goods imports, granted preferential access to some agricultural commodities, and committed to make substantial US investments and purchases of energy from the US.

When announced, this agreement was deeply unpopular in the EU. However, four factors are likely to have played a part in the outcome.

First, were the internal divisions among member states as well as some stark inconsistencies. For example, France argued for a tough approach towards the US in public but also sought to carve out sensitive sectors for the French economy from the EU's planned retaliatory response. Second, member states may have placed some weight on the possibility that the Trump tariffs would be reversed either as a result of a legal challenge or as the consequence of the Congressional mid-term elections. Third, the EU may have decided to prioritise the *certain* short-term economic gains from avoiding disruption and a trade war over *possible* longer-term economic benefits from resistance. But most importantly, it is likely that the EU decided to prioritise its security relationship with the US and the need to secure continued US military and political support for Ukraine.

In commenting on the settlement, EU officials also emphasised the importance of preserving the block's freedom of action on domestic policies, including financial regulation, digital governance and climate mitigation policies, none of which were included in the formal final agreement (although the EU did make a side agreement to withdraw a proposal for an EU-wide digital services tax).

One could read the EU's strategy as one of buying time to achieve greater capabilities and hence independence in defence. Preserving freedom of action in domestic regulation and taxation are also essential to achieving greater economic independence from the US and to strengthening the EU through internal reforms and renewed efforts at market integration, particularly in financial services.

However, it is unclear how far this approach will work in avoiding further intense trade frictions, given that establishing such independence is likely to take several years, while

substantially smaller than the EU and China in economic terms and much more dependent on trade and other relations with the US.

there are a number of flashpoints coming up vis-à-vis the US in the next few months, including the start date for CBAMs on 1st Jan 2026.

Separately, from the bilateral negotiations with the US, the EU has accelerated its efforts to complete long-standing free-trade negotiations and initiate new ones. The EU–Mercosur Free Trade Agreement (FTA) was formally signed on December 6, 2024, after 25 years of negotiations, with entry into force expected in 2026 provided all member states ratify it. The EU has also signed a new Comprehensive Economic Partnership Agreement (CEPA) with Indonesia and a wide-ranging agreement with the UK to enhance the existing Trade Cooperation Agreement in such areas as SPS¹², emissions trading, fisheries and youth mobility. At the same time the EU has stepped up efforts to modernise existing agreements with Mexico and Chile and achieve FTAs with India and the UAE. It has also proposed deeper cooperation with (although not membership of) the CPTPP¹³.

Other advanced countries, such as Japan and the UK, have followed a broadly similar approach to the EU. In both cases, the preservation of security ties with US is likely to have been the top priority in their decision to settle with the US on the best terms available. Neither country has the economic size on its own to make retaliation a credible strategy.

China

China is the US's fourth largest trading partner with total trade of nearly \$600bn in 2024 and is the only other country with sufficient economic weight to make retaliation against US tariff hikes a plausible strategy. In contrast to the EU, China *did* impose retaliatory tariffs on imports of US goods at the outset and escalated these in response to escalation by the US to the point where US tariffs on China (145 %) and Chinese tariffs on the US (125%) were sufficient to end all merchandise trade between the two countries. Both sides then agreed a truce, pending further negotiations, with the US reducing its tariffs on Chinese goods to 30% while Chinese tariffs on the US were cut to 10%.

However, in the past few days, Trump has announced an additional 100% tariff on imports of Chinese goods in response to a Chinese announcement of large-scale restrictions on exports of rare earth metals and related products.

China has adopted a strategy of retaliation against the US tariff hikes despite weakness in its domestic economy, including a continuing slump in property prices and high youth unemployment. Given the fragility of the Chinese economy, a strategy of trying to minimise economic disruption would have been understandable.

However, in making the choice to resist Trump, China will have been influenced by recognition of the Trump administration's long-term and openly stated strategic goal of restraining Chinese economic progress - a conciliatory approach might simply have

¹² Sanitary and Phytosanitary measures

¹³ Comprehensive and Progressive Agreement for Trans-Pacific Partnership

encouraged further demands. It may also have been influenced by its highly cost competitive manufacturing industry which would allow it to remain competitive despite significant tariffs of as much as 30% and the leverage provided by its strength in rare earth minerals processing. It may also have believed that it could re-route significant trade to the US via third countries, although this could prove more difficult than in the past given the way the US is framing trade agreements with such countries as Vietnam and Mexico. It is also likely to be keen over the long-term to diversify its trade away from reliance on US demand for strategic reasons.

Multinational companies

Intracompany transfers by multinationals account for between a third and a half of all global trade. Consequently, multinationals have a critical role as well as considerable agency in how they respond to the US's new tariffs.

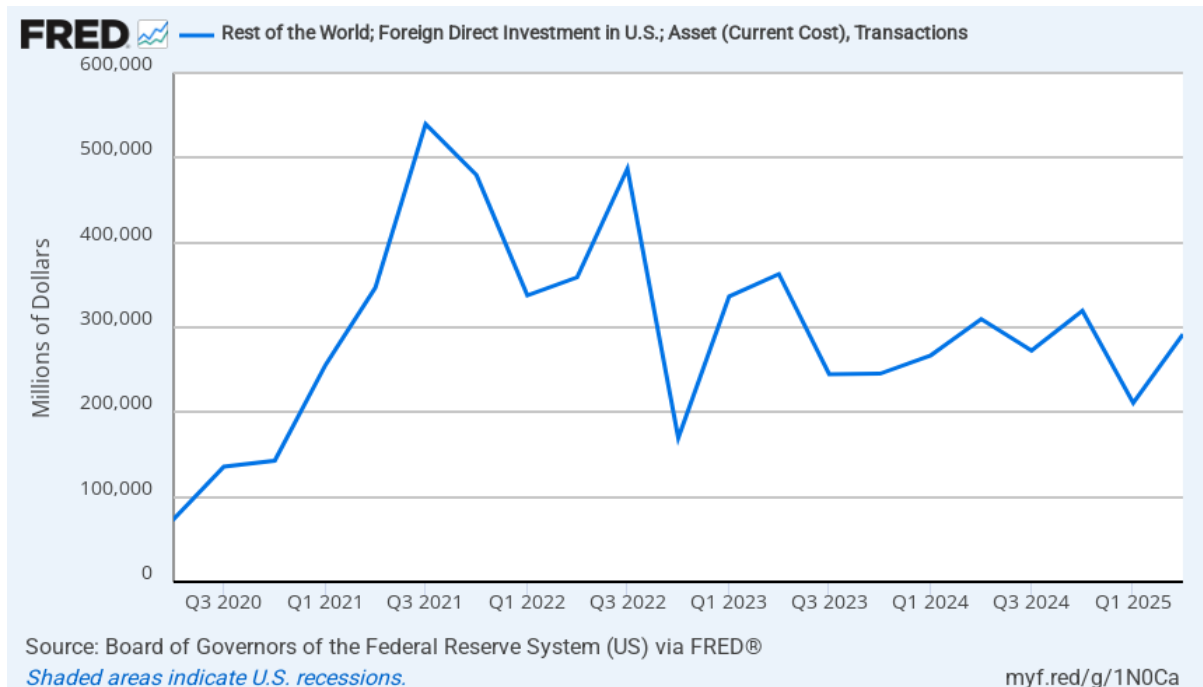
They must, for example, decide how far and how quickly to pass through tariff increases to US customers and what steps to take in redesigning supply chains to deal with US tariff uncertainty. They must also make key decisions on where to locate future FDI and whether to lobby the US government for assistance in pushing back against specific policies in other countries.

So far US and foreign multinationals have generally tried to avoid the limelight. Both foreign and US multinationals' private views on US tariff policies are likely to be strongly negative, but they are unwilling to voice these in public, given the fear of retaliation by the administration, or the kind of intervention Walmart experienced from President Trump when commenting on the need to pass through the costs of tariff increases to customers.

In some cases US and foreign multinationals have lobbied the Trump Administration for tariff exemptions and some US-based companies (notably in digital services) appear to have sought help - through US trade policy - in pushing back against actions by countries in which they operate (e.g. the EU's climate and digital regulations or Brazil's digital policies). Non-US multinationals have been willing to play a part in their home country's commitments to invest in the US as part of trade deals (although it is not clear that the commitments made go beyond what they would have been willing to do in any case).

There already appears to be substantial gap between companies' public statements and their underlying actions. This is illustrated by Chart 3 below which shows that FDI in the US in H1 2025 was running more than 10% below the level in H1 2024 despite the wide range of investment commitments made in response to Trump's tariff shock.

Chart 3



Section 4: How will US trade policy interact with other Trump economic policies?

This section considers how other features of the Trump administration's economic policies may amplify or offset the expected impact of the tariff shock.

Supply side effects

Overall the net effect of the US administration imposing tariffs is **to reduce overall supply** in the economy. This is because the reduction in the overall investment rate due to lower efficiency and higher costs offsets the substitution effect as some imports are replaced by domestic production.

This negative supply shock on the US economy will therefore be amplified by at least three other features of Trump's new policy paradigm.

First is **much stricter migration enforcement**. Net migration to the US has been projected to fall from 2.6mn in 2024 to only 1mn or less in 2025. Moreover, the resulting reduction in labour force may be particularly concentrated in certain low wage sectors already affected by the new tariffs. At the other end of the spectrum, the administration's \$100,000 fee for

H1B visas will slow intake of science and technology expertise restricting innovation and hence further harming supply.

Second is the administration's policy of delaying and in some cases trying to **reverse the US's net zero transition** by cancelling EV subsidies and restricting renewable infrastructure investments such as Orsted's 80% complete Revolution Wind Project (serving 350,000 homes). This will slow US productivity growth and increase policy risk in the financial system, threatening to keep the US further behind China and the EU in the development of green tech.

Third, is the **reduction in capabilities of the US government** arising from the administration's chaotic downsizing. Approximately 200,000 jobs have been cut already out of a Federal work force of 2.3mn since the start of 2025, through layoffs, buyouts and voluntary departures under pressure. While percentage reductions of this scale in central government staffing are not unprecedented in advanced economies, the way it is being done (with politically-motivated targeting of, for example, those undertaking climate-related research or working in the Internal Revenue Service) is likely to be particularly damaging to the supply side of the economy.

Demand effects

At the same time as restricting supply, the administration is also implementing policies that will boost demand.

First is the **expansion in the fiscal deficit** following the passage of the One BBB Act. This has been estimated to cost some \$5tn over ten years, and would be only be partially offset by the revenue from indefinite maintenance of current tariff rates (forecast to raise 2\$ over 10 years).

Second, is the possibility that the administration will **compromise the independence of the Federal Reserve** and engineer a faster reduction in interest rates than may be warranted by the evidence.

Third is the introduction of **light touch regulation of stablecoins and other crypto assets** under the Genius Act and related legislation. This has the potential rapidly to boost the role of crypto assets and related services in the US economy. A recent survey suggested 21% of US adults already use crypto assets. And while the crypto share of US personal wealth is probably still small - the value of *all* crypto assets at \$4tn is less than 3% of total US household wealth - this could change rapidly, increasing demand, but also risk in the US economy.

The combined effects of these policies therefore is to add additional supply side pressures to those created by the tariff shock, while at the same time boosting demand. This creates not only the risk of overheating and a resurgence in inflation but also increases the underlying financial stability risks in the economy.

Section 5: What are the implications for US global financial dominance?

This section considers how the combination of the Trump tariff shock with other administration economic policies could undermine US global financial dominance.

There are three main routes through which this could happen. First, by changing fundamentally the **long-term growth path** for the US economy. Second, by *directly* weakening the **other factors that support US dollar dominance** described in section 1. And thirdly, by helping to trigger a further **US-origin global financial crash** which would accelerate the impact of the above two channels

Impact on the US long-term growth path

A full assessment by the IMF of the impact of the Trump tariff shock¹⁴ indicates that after all the effects have worked through investment in the US will fall rather than rise while the impact on the current account will be positive in the short term, but in the medium term will revert to zero. Therefore, the administration's claim that the shock will boost the strength of the US economy by boosting investment and reducing dependence on foreign supply cannot be relied on.

Another way to try and assess the implications for the US long-term performance of Trump's policy paradigm is to look for examples in history where similar policies have been adopted. There are no direct parallels. But the examples that do exist support the view that, while there may be some short-term benefits, the long-term effects on the economy imposing tariffs are strongly negative.

For example, the **Peronist policies** adopted in Argentina from 1946-55, were focused on import substitution, national self-sufficiency and political control over economic institutions. Initially there was a boost to domestic industry and employment, but this subsequently evolved into reduced productivity, inflation and long-term stagnation. Arguably, Argentina continues to suffer from the fallout from the Peronist period.

Similarly, Brazil's **import substitution policies** of the 1930s to mid 1980s involved high tariffs and state-led industrial policy aimed at reducing foreign dependency. The latter has some similarities with Trump's incentives for domestic investment and a growing number of strategic US government stakes in critical minerals and tech. But once again, while the Brazilian model boosted industrial growth, it also embedded poor productivity growth in the economy, and contributed to inflation and ultimately to debt crises.

¹⁴ See Box 1.3 in [2025 External Sector Report: Global Imbalances in a Shifting World](#).

There has also been a lot of focus on the **Smoot-Hawley Tariff Act of 1930**, because of its role in triggering a subsequent crash in global trade. However, the parallels with today look more limited. This is because today's global macroeconomic conditions are more benign, the US is less central to global trade, and most countries have so far chosen not to retaliate against US tariffs.

Direct effect on factors supporting the dollar's role

There are a number of channels through which Trump's policies may directly weaken other factors that currently underpin the use of the dollar in international transactions.

First, by reducing the US's participation in the international trading system, the tariff shock may be expected to reduce the extent to which the dollar's role is re-enforced by network externalities linked to trade.

Second, "ultraloose" fiscal policy and politicisation of the Fed/other Federal agencies may be expected to erode the perception of US Treasuries as the ultimate safe asset. On the other hand, the Trump administration has argued that rapidly rising outstanding stock of US dollar-backed stablecoins (which reached \$300bn in October) will boost demand for US Treasuries. However, it remains to be seen how much additional demand there will actually be (particularly given that stablecoins will need to keep paying zero return in order to maintain their status as money in some jurisdictions)¹⁵. And while they will face no competition from a US dollar central bank digital currency (since the Fed has been legally banned from issuing one), this will not be the case for euro, sterling and yen.

Third, there is a critically important difference between the perception of the US dollar under the Biden Administration and under the Trump administration. Under Biden all issuers of western convertible currencies acted together on unprecedented steps such as freezing Russian state assets following Russia's invasion of Ukraine. However, under Trump it seems much more plausible that the US will take radical action of this kind on its own, increasing the benefit of diversifying across convertible currencies.

Fourth the shift in the ECB's view from being "neutral" to being "in favour" of deepening the euro's use as an international reserve asset, combined with a further push by the European Commission on the Savings and Investment Union, could result in US dollar assets facing enhanced competition from the euro area.

¹⁵ Although in the US some crypto firms have developed a way to pay a positive return on stable coins through a system of "rewards". <https://www.brookings.edu/articles/interest-by-any-other-name-should-be-regulated-as-sweetly/>

At the same time, the apparent ambivalence of some (though not all) Trump administration officials, such as Stephen Miran¹⁶, towards the dollar's reserve currency role is likely to have the opposite effect on perceptions of the dollar.

Fifth, the doubts that President Trump has introduced into US military alliances may reduce allies' dollar holdings while the global reserve status of the euro may be boosted by higher European defence spending under the revised NATO spending targets.

Impact of a further US-origin financial shock

The factors described above point to there being some gradual erosion in the dollar's reserve status over time. But there is nothing to suggest a sudden acceleration in the pace of the shift. What could change that is if the build up in risk in the US financial system caused by multiple factors under the Trump Presidency were to trigger a further US-origin financial crash.

The dollar's role has survived several previous crises in the post war period – from the Nixon shock to the LTCM¹⁷ crisis to the global financial crisis – without there being any long-term effect on the dollar's international status.

But in the event of a further shock today, it is possible that countries would react very differently as a result of their experience to date under the Trump 2 administration. For example, traditional US allies may be more likely hold back from assisting the US when they have doubts about proposed actions and/or demand the unwinding of asymmetric tariffs in return for their help. Other non-allied countries may be more wary of engaging with the US and reluctant to accept US leadership in responding to a crisis. In both cases, countries may look for non-US led solutions through new coordination systems built to deal with Trump's withdrawal from global governance

Section 6: How should non-US policy makers respond?

President Trump's economic paradigm shift has created a highly uncertain global economic environment which seems set to continue for the foreseeable future. The prospect of a gradual (or under certain circumstances rapid) erosion of US global financial dominance and the role of the US dollar is symptomatic of this.

¹⁶ Miran initially served as Chairman of the Council of Economic Advisers, but since September 2025 has been a member of the Board of Governors of the Federal Reserve system. Before joining the administration he set out his views on the role of the dollar in

[638199 A Users Guide to Restructuring the Global Trading System.pdf](#)

¹⁷ Long-Term Capital Management

In this context other advanced and emerging economies who wish to preserve the existing mutually beneficial and legally binding mechanism for reaching agreements between countries need to shift their focus at least in part from day-to-day responses to Trump's policy announcements to developing a new mechanism which would operate "around" the US and work with China on a case-by-case basis.

A starting point for this action would be preserving as far as possible the use of existing WTO rules to govern trade not involving the US. But beyond that are a wide range of other trade-related reforms needed to safeguard existing norms and principles and improve the system for the future.

To do this non-US advanced economies and a number of emerging economies who share this goal should establish a **"rules group"** of countries to act as **third pillar** in the global economy *between* the US and China.

The EU would necessarily need to be a core member of this group, along, ideally, with other members of the "G6" including the UK and Japan, other advanced economies (such as Australia, Korea and Switzerland) and leading emerging economies (notably Brazil, South Africa, Mexico and Indonesia). The EU uniquely within the non-US/non-China group of countries has the required economic weight and capabilities (including the euro reserve asset) to give the new group critical mass and credibility.

The "rules group" should begin with a focus on international trade, but then expand into other areas of global governance and global public good provision where the US has withdrawn and/or China is in some respects not a viable core member (either because of its previous actions e.g. in using economic coercion for political objectives or where it would be overly dominant).

Focus areas might include development finance/MDB reform, global health, climate action, digital governance, anti-corruption, fiscal responsibility etc.

In addition to establishing the "rules group", the other advanced and emerging economies should prioritise two further actions (in the context of this paper's analysis):

First, they should ensure that they are **protecting their financial systems from growing financial stability risk in the US**. This means, for example, maintaining progress to net zero despite push back from the US and taking a cautious approach to aligning with the US approach to regulating stablecoins and crypto assets, despite pressure from the private sector.

Secondly, they should develop as far as possible a collective approach to the **potential scenario** in which the international monetary system moved quite rapidly away from US dollar dominance to a bipolar or multipolar system. This would include both collective and national actions.

To take forward this agenda, and provide the necessary political leadership, there seems to be no way round engineering the establishment of a **new global summit mechanism** with the goal of setting up the “rules group” and situating it in the international architecture.

The G7 is not a viable option because the US would block the required agenda. Similarly the G20 has both the US and China as members and the US will hold the Presidency in 2026.

France hosts the G7 in 2026 and while the G7 itself (with the US as a member) could not be a vehicle for providing leadership to a rules group, the G7 role could give France a locus among the G6 and other like-minded countries to establish a complementary Summit mechanism distinct from the G7.

France would normally be well suited as chair for such an exercise, given its position as a leading member of the EU, the distance it has traditionally maintained vis-à-vis the US within the western alliance, its links to the global south, and the separation of responsibilities between President and Prime Minister under the French constitution (which gives the President more time to focus on foreign affairs). However, the recent political chaos in France would first need to be definitively addressed in order for this to be a viable option.

Section 7: Conclusion

As with any radical shift in direction, some of Trump’s policies may conceivably prove beneficial, simply by shaking things up. Arguably, for example, he has inadvertently created new momentum for WTO reform focused on accelerating work on plurilateral trade agreements within the WTO.

Also, not everything that weakens the US economy necessarily reduces US financial dominance. The UK continued for a long time as major reserve currency issuer despite economic weakness.

But the major part of the Trump policy package is likely to weaken US financial dominance over time.

What makes today really different compared with previous periods of history is (a) the lack of economic logic in many aspects of the current US approach – policies are internally inconsistent and don’t serve even the US interest – amplified by fear of speaking out; (b) the fundamental uncertainty about US policy and the possibility that it will continue indefinitely – this reflects President’s political approach and dominance of decision making in the executive, but also the nature of the MAGA movement he has created; (c) the way actions on trade are combined with other equally radical/disruptive policies, notably on financial deregulation, inward migration, climate, and development finance; and (d) the “America First” narrative and implementation – focused on extracting concessions from other countries (including the closest allies) rather than mutual benefit and deploying security assistance to increase negotiating pressure. This is more than a “transactional” approach, as

Trump's policies are often described, rather it reflects a desire to use current US power to extract the maximum benefit from allies and non-allies alike.

The eventual outcome will inevitably depend on what happens politically in the US over the next few years. But it will also depend crucially on how other countries and economic blocks respond today.

It is to be hoped that, after the initial period of disruption, there will now be a more concerted effort by countries that strongly support and benefit from a rules-based approach to international economic relations to re-establish their way of managing international relations on a broad range of economic policy issues and in a substantial economic space (even if this does not at least initially include the US).