

Discussion of:

Trade War and the Dollar Anchor

by Tarek Hassan, Thomas Mertens, Jingye Wang, and Tony Zhang

Jesse Schreger

Columbia Business School

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Trade War and the Dollar Anchor

- ▶ Macro implications of risk-based perspective on FX determination
 - ▶ Heterogeneous loading on global risk drives currency returns (Lustig-Verdelhan 2007), persistent interest rate differentials (Hassan-Mano 2019)
 - ▶ Sources of heterogeneity: country size (Hassan 2013), trade network centrality (Richmond 2019), rare disasters (Farhi-Gabaix 2016)...
- ▶ Hassan-Mertens-Zhang 2022: Pegging lets you adopt stochastic properties of anchor currency, changing your interest rate and capital accumulation dynamics
- ▶ **This paper:** Tariffs change risk properties of the USD, thereby changing the incentives of other countries to peg to it

The Key Mechanism

- ▶ Global SDF λ_t gives price of traded goods outside US

$$\lambda_t = -(\gamma - 1)(1 - \alpha) \sum_n \bar{\theta}^n y_N^n + (\gamma - 1) \sum_n \bar{\theta}^n \chi^n$$

$$\bar{\theta}^{USA} = \frac{(1 - \alpha) + \gamma\alpha}{(1 - \alpha) + \gamma\alpha + (1 - \theta^{USA})_{\tau}} \theta^{USA}$$

$$\bar{\theta}^n = \frac{(1 - \alpha) + \gamma\alpha + \tau}{(1 - \alpha) + \gamma\alpha + (1 - \theta^{USA})_{\tau}} \theta^n$$

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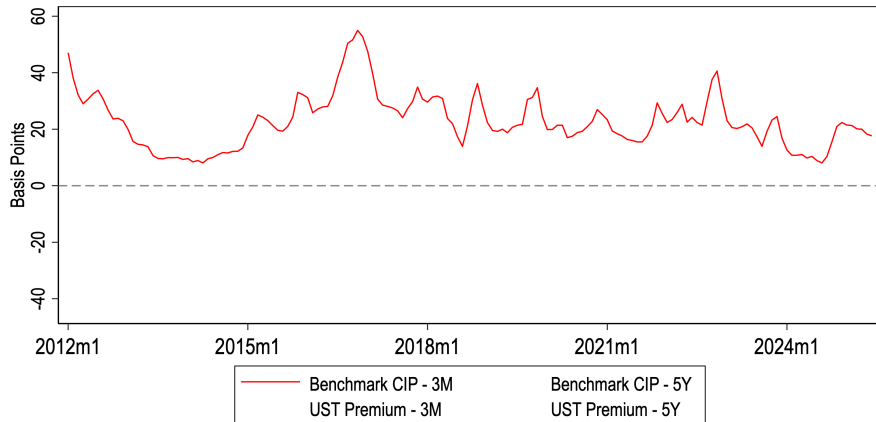
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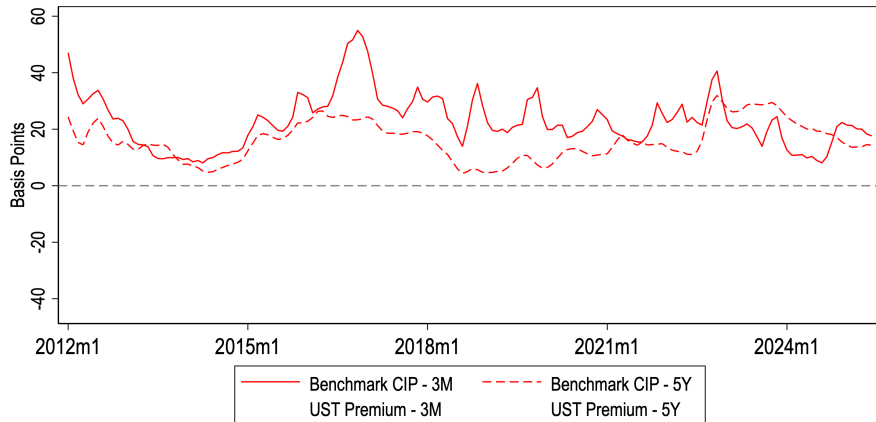
- ▶ No segmentation ($\psi = 1$), $\tau^{\text{crit}} \approx 200\%$. Segmentation ($\psi = 0.03$), $\tau^{\text{crit}} = 26\%$.

The Specialness of Dollar Assets



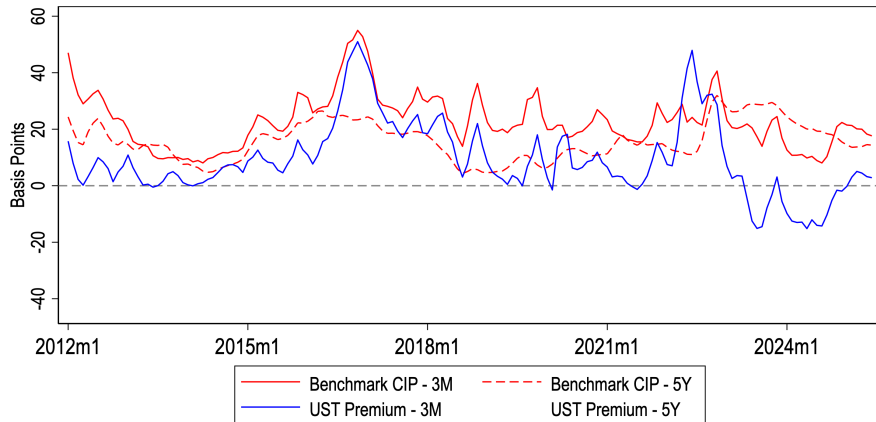
Source: Du, Keerati, and Schreger (2025)

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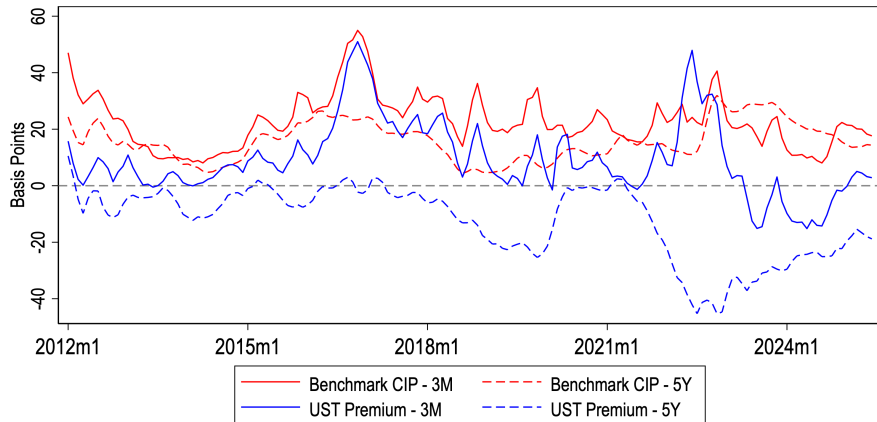
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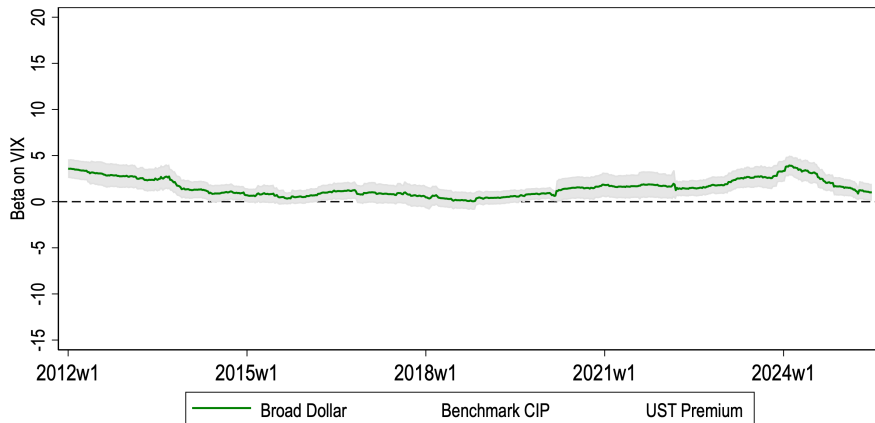
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Changing Risk Properties of USD Safe Assets?

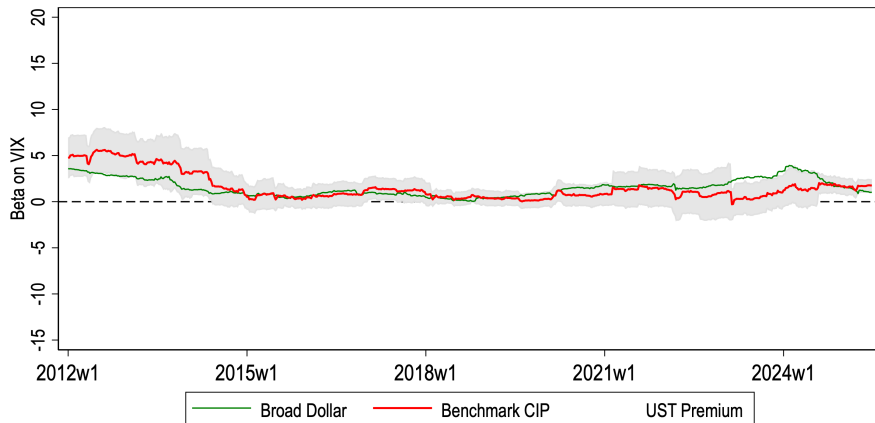
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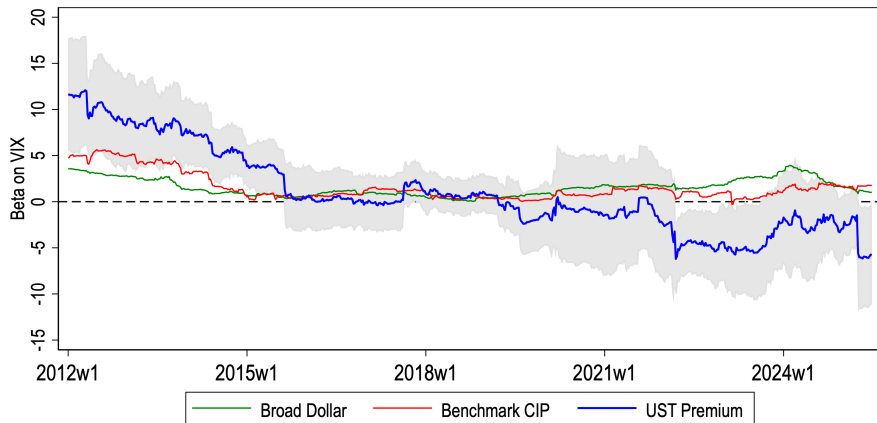
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Alternative to the Dollar: EUR or RMB?

- ▶ In model, only thing that determines anchor currency is effective country size
 - ▶ $\theta^{USA} = 27\%$, $\theta^{EUR} = 15\%$, and $\theta^{CHN} = 7\%$ in baseline 1984-2019
 - ▶ But in 2023 calculation, China is actually second at 17%
- ▶ If US tariffs destroy USD centrality, regime shift in global monetary system
- ▶ When system gets remade, would China be the more natural replacement as the rising challenger?
 - ▶ Dynamic model: growth rates + switching costs should affect choice of anchor

Applying Pressure to Support the Dollar



Donald J. Trump ✓

@realDonaldTrump

The idea that the BRICS Countries are trying to move away from the Dollar while we stand by and watch is OVER. We require a commitment from these Countries that they will neither create a new BRICS Currency, nor back any other Currency to replace the mighty U.S. Dollar or, they will face 100% Tariffs, and should expect to say goodbye to selling into the wonderful U.S. Economy. They can go find another "sucker!" There is no chance that the BRICS will replace the U.S. Dollar in International Trade, and any Country that tries should wave goodbye to America.

310 ReTruths **943** Likes Nov 30, 2024 at 12:40 PM

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- ▶ Does U.S. (still) want to be the anchor currency?

The Fiscal Side of Providing the Global Safe Asset

- ▶ In model, tariff revenue remitted lump-sum to households.
- ▶ In reality, tariff revenue may matter for global role of USD and Treasuries
- ▶ Could U.S. fiscal position begin to rely on this revenue?

S&P affirms US credit rating as Trump tariffs boost government revenues

Rating agency expects income from aggressive trade policy to offset tax and spending changes



Influential agency says it will keep its sovereign credit rating at AA+/A-1+ © AFP via Getty Images

Conclusion

- ▶ Important core idea: tariffs change stochastic properties of USD, affecting the incentives of the rest of the world to peg
- ▶ Same forces should affect decision to borrow/lend/invoice in USD
- ▶ Some questions looking ahead
 - ▶ Are we seeing a change in the specialness of the USD, UST, or both?
 - ▶ Is the natural rival to dollar supremacy the RMB or EUR?
 - ▶ How can the United States sustain the era of dollar dominance?
 - ▶ Does the United States even want that?