

Tariff Wars and Net Foreign Assets

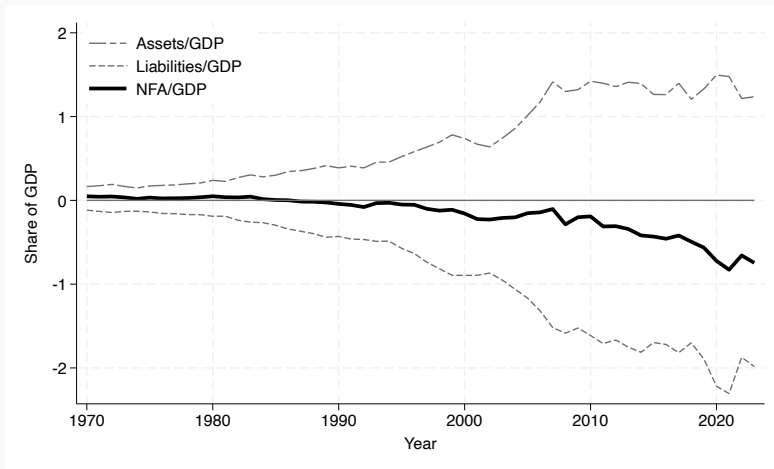
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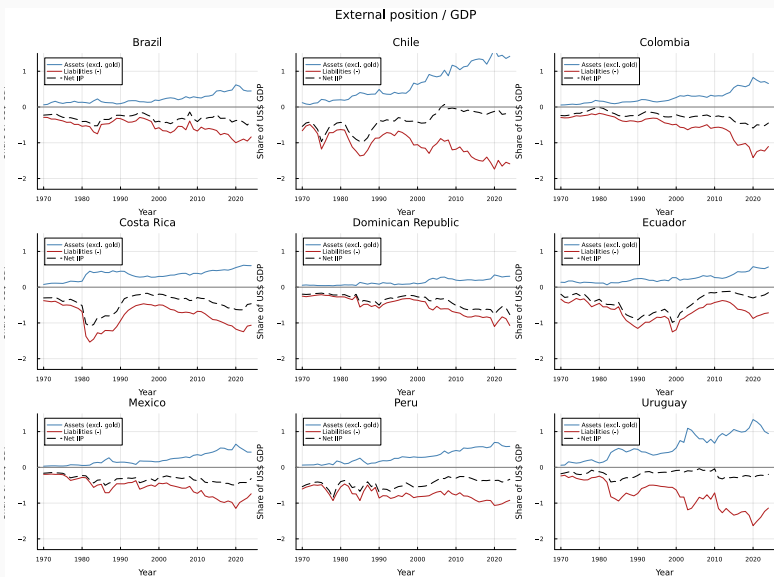
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US International Financial Position, 1970-2023



Source: External Wealth of Nations

International Financial Positions, 1970-2024



- 1 Asset positions represent international investment decisions:
 - Inter-temporal trade
- 2 Backed by the ability to move goods internationally:
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- Large tariff increases and other trade barriers
- When tariffs increase and the world fragments ...
 - What happens with the international financial investments?

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- Write down an exchange economy model – a la Samuelson
- Home country has ownership of Foreign assets and vice versa
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- Affect international relative prices (real exchange rate)

A Simple Example With Gross Positions

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- But Foreign owns Homes assets: $a^* > 0$
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Given that Home was a debtor, real exchange rate **depreciates**

- In a dynamic version, result holds:
 - Domestic interest rates align to domestic conditions
 - Exchange rate balances the financial side
 - Interest parity still holds
 - Distinction between the level of the exchange rate and the underlying rate of return
- Result extends to risk, non-traded goods, Ricardian trade, etc.

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- **Latent risk**: USD debt + trade direction
 - If USD *appreciates*, debt burden **rises**

- **Gross composition** of the external balance sheet, and not just net debt, determines the behavior of exchange rates in a tariff war.
- Liabilities in foreign units are a source of instability / vulnerability.
- Foreign Reserves as a hedging tool? When denominated in the same units as liabilities, they mitigate the impact of trade war on the external balance sheet.