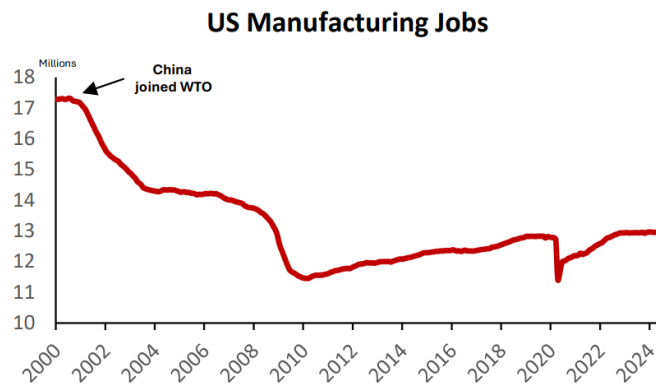


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## Our Summary of: “A User’s Guide to Restructuring the Global Trading System”

Donald Trump wants to re-shore manufacturing jobs to the US and has been very vocal about his intention to use tariffs as a way to achieve that objective. Stephen Miran’s “A User’s Guide to Restructuring the Global Trading System” offers a summary of the economic tools available for the Trump administration to “put American industry on fairer ground vis-à-vis the rest of the world,” according to the author.

To put those objectives into context, note that the number of manufacturing jobs in the US plunged by about five million in the decade after China joined the WTO – and essentially never recovered - despite a near three-fold increase in the size of the US economy since that time (to be clear, this specific points was not discussed in Mr. Miran’s policy paper, which we’ll abbreviate as the “User’s Guide” white paper from now on in this report).



The full 40-page “User’s Guide” report is fairly technical (Miran holds a PhD in Economics from Harvard) and can be found on the website of [Hudson Bay Capital](#), a USD 32bn AUM hedge fund, where the author is a Senior Strategist. We believe the “User’s Guide” should be viewed as a preview of the incoming administration’s likely tariff strategy, given that Miran was previously a Senior Advisor for Economic Policy at the US Department of Treasury and is reportedly close to appointed US Treasury Secretary Scott Bessent (recall that the Biden administration’s policy towards Vietnam/Southeast Asia<sup>1</sup> was similarly previewed in the “Longer Telegram” white paper published by The Atlantic Council).

### Summarizing the Strategy

The “User’s Guide” policy paper essentially proposes using tariffs as a negotiation tool to drive down the dollar’s value via a “Mar-a-Lago Accord.” In short, the overvaluation of the USD discourages manufacturing/production in the US, which in-turn is because an overly strong USD makes it cheaper for US consumers to buy imported products than to buy products that are produced domestically.<sup>2</sup> Most economists believe the USD is overvalued by about 25%, so a circa 20% depreciation in the USD is probably a prerequisite to achieving Trump’s goal of re-shoring jobs to the US (JD Vance has also, often repeatedly mentioned<sup>3</sup> that an over-valued USD inhibits re-shoring manufacturing jobs in the industrial “rust belt” of the US).

The dollar’s overvaluation stems from its role as the world’s reserve currency. Countries pay for most of their imports with US dollars (especially oil), necessitating their central banks to keep enough dollars on hand to pay for their imports. Central banks typically hold USD equivalent to at least three months’ worth of imports and most of those FX reserves that are put aside to pay for imports (in case the country’s sources of USD vanish for some reason) are usually held in the form of short-term T-Bills.

<sup>1</sup> [The Longer Telegram, Atlantic Council](#)

<sup>2</sup> Cheaper imports not only discourage domestic production but also make US exports less competitive in global markets, as foreign buyers opt for goods from countries with lower currency values and production costs.

<sup>3</sup> <https://nymag.com/intelligencer/article/why-jd-vance-wants-a-weak-dollar-is-that-a-good-idea.html>

T-Bills are very liquid, and the value of a T-Bill does not fluctuate much if-and-when there are significant changes in USD interest rates, so central banks can readily liquidate those financial instruments for cash that can be used to pay for import bills in a pinch. However, countries like Japan and China that have accumulated very large amounts of USD foreign exchange reserves typically hold a mixture of T-Bills and longer-dated US Treasury Bonds (UST), which usually earn higher interest rates but are subject to much bigger fluctuations in value if-and-when there are significant changes in USD interest rates.

The net result of all of the above is that demand for US dollar denominated “reserve assets” (i.e., short-term T-Bills and long-term T-Bonds), coupled with the dollar’s “safe haven” status, reinforces its overvaluation by sustaining global demand for U.S. assets.

### ***Tariffs as a Negotiation Tool Towards a “Mar A Lago Accord”***

Tariffs can be used to encourage countries/companies to set up factories in the US (which creates jobs in the US) in order for them to avoid having their exports to the US taxed – which is essentially how the US-Japan trade tensions were resolved in the 1980-90’s. However, the author also envisions tariffs also being used to compel the participation of trading partners into a “Mar-a-Lago Accord,” which can be characterized as a “Plaza Accord 2.0” and which is aimed at significantly depreciating the value of the US dollar.

The 1985 Plaza Accord led to a circa 50% drop in the value of the USD against the Japanese Yen and a 40% drop against the Deutsche Mark, which in-turn supported US industry and encouraged Japanese and German producers to shift some production to the US. One critical difference between 1985 and now is that the US was in a much better position to garner the cooperation of Japan and West Germany at that time than the Trump administration would be able to secure the cooperation of China/Japan/Germany/etc to join a Plaza Accord 2.0. This is where tariffs come in.

The strategy outlined in the “Users Guide” envisions three punitive measures the US could pursue to compel the cooperation of countries around the world in a Mar-a-Lago accord:

- 1) Tariffs on exports to the US that do not participate in the Mar-a-Lago Accord
- 2) Removing the US security umbrella for countries that do not participate (i.e., Europe)
- 3) Taxing the interest payments of US Treasury Securities held by central banks that do not participate (i.e., China)

Further to that last point, the People’s Bank of China directly holds nearly USD 800 billion of US Treasury Securities; countries that run large, persistent trade surpluses with the US accumulate a large pile of US dollars, and they typically deploy those USD into UST and other liquid investments.

Finally, participation in the Plaza Accord 2.0 / Mar-a-Lago Accord would entail the central banks of US trading partners (i.e., the People’s Bank of China, Bank of Japan, and European Central Bank) simply selling their “excess” US dollar FX reserves (i.e., reserves above-and-beyond 3-4 months’ worth of imports) and buying their own currencies on the open market. However, central banks holding a significant portion of their USD FX reserves in the form of long-dated US Treasury Bonds would put upward pressure on US dollar interest rates if-and-when they sold a significant portion of those bonds, which is discussed below (to be clear, central banks would sell their UST to raise USD cash which would then be sold into the FX markets).

### ***Mitigating the Negative Economic Impacts***

The two main risks of the strategy outlined above are: 1) tariffs are inherently inflationary to US consumers, and 2) central banks selling their US Treasuries would push up US interest rates.

Regarding #1 inflation, implementing tariffs *gradually* would avoid the inflation spikes entailed in the immediate imposition of large tariffs while also maintaining the threat of additional tariff increases gives potency to their use as a negotiation tool. For example, an initial 2% tariff could be imposed on a country with the threat of increasing those tariffs by 2% pts per month. In the case that the tariffed country does not cooperate with the administration’s objectives and tariffs do escalate to elevated levels, then Miran points out that a depreciation in that country’s currency (the Chinese Yuan, for example) would likely offset some (most?) of the inflationary impact of those tariffs on US consumers.

Next, a 20% devaluation of the dollar could raise US CPI inflation by as much as 1% pt due to higher import prices,<sup>4</sup> but incoming officials are planning structural reforms – such as the deregulation of domestic energy production (Trump’s “Drill Baby Drill” promise), which could cut US CPI by 0.5%pts (while boosting GDP by 1-2%), thus mitigating some of the inflationary impact.

<sup>4</sup> Gopinath, G. (2015). *The international price system* (No. w21646). National Bureau of Economic Research.

Finally, a depreciation of the Chinese Yuan / appreciation of the US dollar did help mitigate the inflationary impact of Trump's first round of tariffs on China, but a stronger USD would inhibit re-shoring of US jobs.

Regarding #2 interest rates, Miran advocates encouraging (compelling?) global central banks to switch from holding short-term T-Bills to holding very long-dated T-Bonds (with maturities potentially as long as 100 years) in order to prevent a spike in USD interest rates during a Mar-a-Lago Accord / Plaza Accord 2.0, if-and-when central banks liquidate some of their T-Bills. Here is a hypothetical example of how-and-why that would work: If a central bank (CB) previously held '100' worth of US FX reserves, all of which were held in the form of T-Bills, that central bank could sell half of all of those T-Bills in exchange for US dollar cash. Next, the foreign CB would sell '50' worth of US dollar cash into the global FX markets and buy back their own currency, which would depress the value of the USD and support the value of their home country currency.

Then, the foreign CB would use the '50' of USD cash remaining to buy 50-year US Treasury bonds. This combination of transactions would prevent US interest rates from rising because the "Duration" (aka "Modified Duration") of a 50-year bond is about 50 times greater than that of a 6-month T-Bill<sup>5</sup>. Consequently, even though the CB would have sold half of portfolio of US Treasury securities, they effectively "Bought Duration" which depresses interest rates.

### ***The BTFP-Solution***

The (major!) caveat to the long-dated bond scheme described above is that by selling short-dated T-Bills in favour of long-dated bonds, the foreign central bank has locked up their money into an illiquid investment for 50 years. More importantly, the value of long-dated bonds decreases dramatically when interest rates increase. For example, the value of Austria's famous 100-year government bond<sup>6</sup> has plunged by more than 50% since it was issued in June 2020. A dramatic drop in the value of FX reserves held by a central bank would cause major problems if the central bank in question needed US Dollars to pay for the country's imports.

An analogous situation caused the collapse of Silicon Valley Bank last year. That bank bought "safe" long-dated US government bonds with depositors' money, but the value of the high-duration bonds plunged when US interest rates rose, putting SVB in a position where it could not sell those bonds and raise enough cash to repay depositors. The solution to this problem was the so-called "Bank Term Funding Program (BTFP)" which essentially enabled banks to borrow against the "par value" of the long-term T-Bonds they hold.

In other words, if a bank owned long-dated T-Bonds for which the value dropped from '100' to '70' (which is more-or-less what happened to SVB and other banks last year), then the Federal Reserve offered to lend '100' to those banks (if the bank were to use those impaired bonds in the private sector as collateral, it would probably only be able to borrow 50-60 cents on the dollar). The BTFP program is essentially how the Fed solved the Silicon Valley Bank problem last year (which many banks besides SVB had), and the author envisions a comparable Fed swap-line facility for foreign banks that would own ultra-long dated US Treasury Bonds in the scheme described above.

<sup>5</sup> <https://www.investopedia.com/terms/m/modifiedduration.asp>

<sup>6</sup> <https://www.home.saxo/content/articles/bonds/the-most-infamous-bond-trade-18012024>