PIMCO

US Trade, Current Account, Currency, Outlook

May 2025

Summary

Background

- **Last half century have been characterized by increased globalization, and persistent trade imbalances. The US's persistent trade deficits, have largely mirrored surpluses in China.**
- **The Trump administration believes their political mandate is to rebalance global trade, and importantly US current account deficit.**

Key Secular Question: US current account adjustment? If so, how?

- **Drawing lessons from 32 industrial economy current account adjustment episodes since the 1970s, three conclusions:**

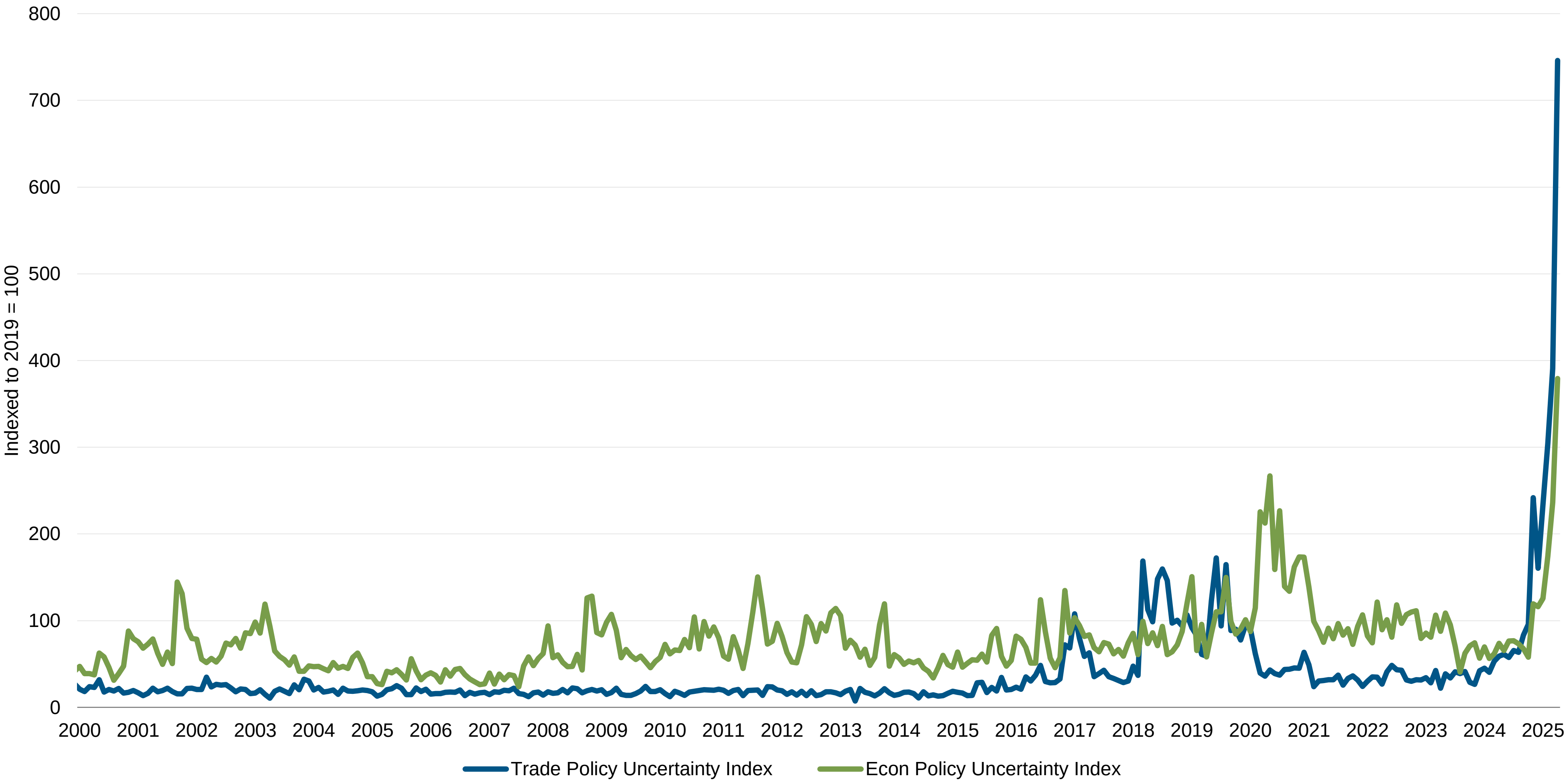
1. A smooth current account adjustment likely requires US fiscal consolidation, lower rates and dollar depreciation
2. If the US can't complete fiscal consolidation, then any current account adjustment would likely be characterized by a reduction in private consumption *and investment*.
3. Significant dollar deprecation without fiscal adjustment, would likely be inflationary, coincide with higher rates and a larger recession (i.e. A disorderly adjustment).

Each type of adjustment faces important economic, political and legal constraints. With meaningful US fiscal consolidation unlikely, a current account adjustment would likely to be characterized by lower consumption *and investment* to GDP, and a period of lower average growth rates.

Source: PIMCO.

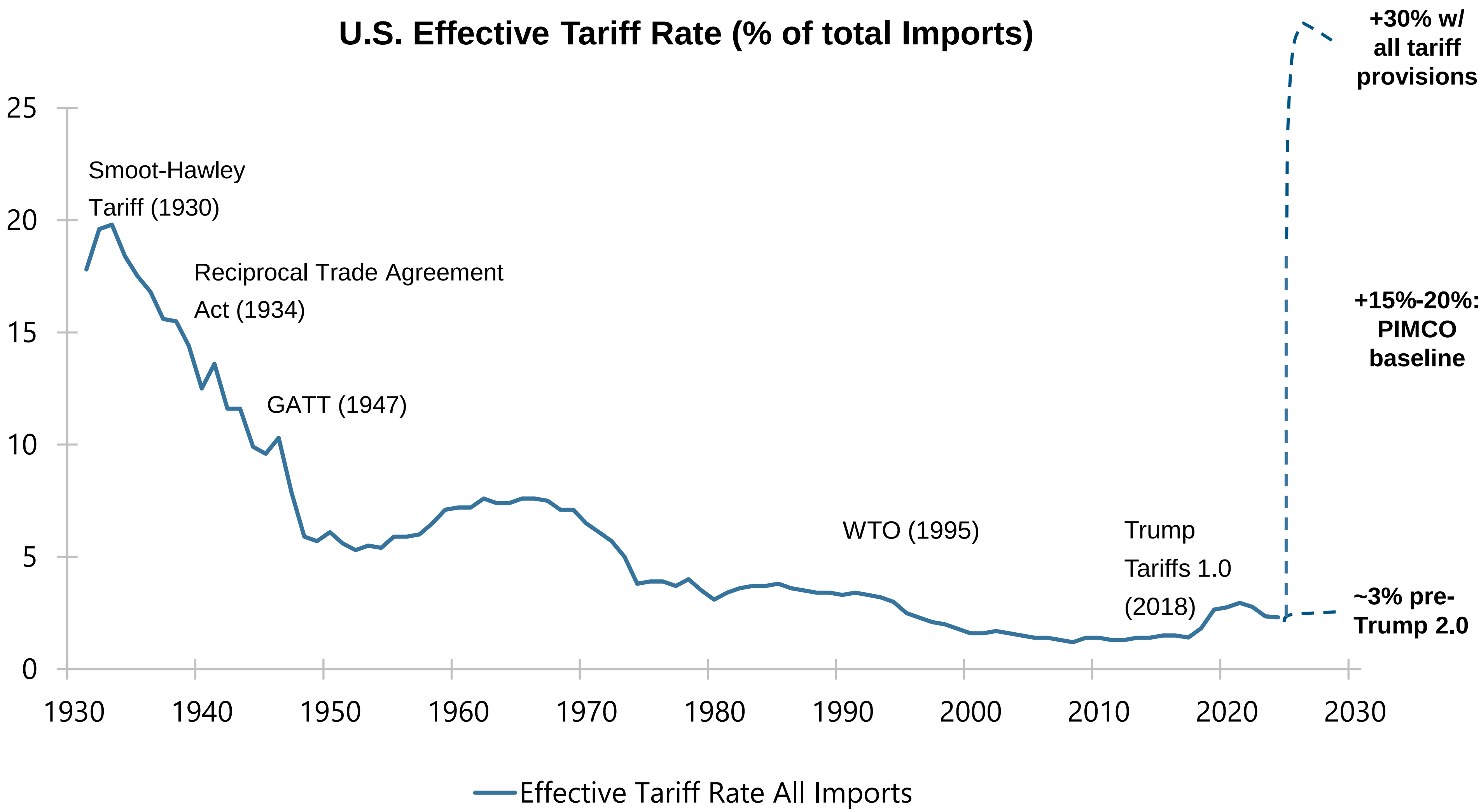
How did we get here?

News Based Policy Uncertainty Index



As of May 2025. Source: Haver, PIMCO, Caldara Dario, Matteo Iacoviello, Patrick Molligo, Andrea Prestipino, and Andrea Raffo, "The Economic Effects of Trade Policy Uncertainty."
TPU is constructed by staff in the International Finance Division of the Federal Reserve Board and measures media attention to news related to trade policy uncertainty. The index reflects automated text-search results of the electronic archives of 7 leading newspapers discussing trade policy uncertainty: Boston Globe, Chicago Tribune, Guardian, Los Angeles Times, New York Times, Wall Street Journal, and Washington Post (accessed through ProQuest Historical Newspapers and ProQuest Newsstream).
The index is scaled so that 100 indicates that 1% of news articles contain references to TPU.
Refer to Appendix for additional index and risk information.

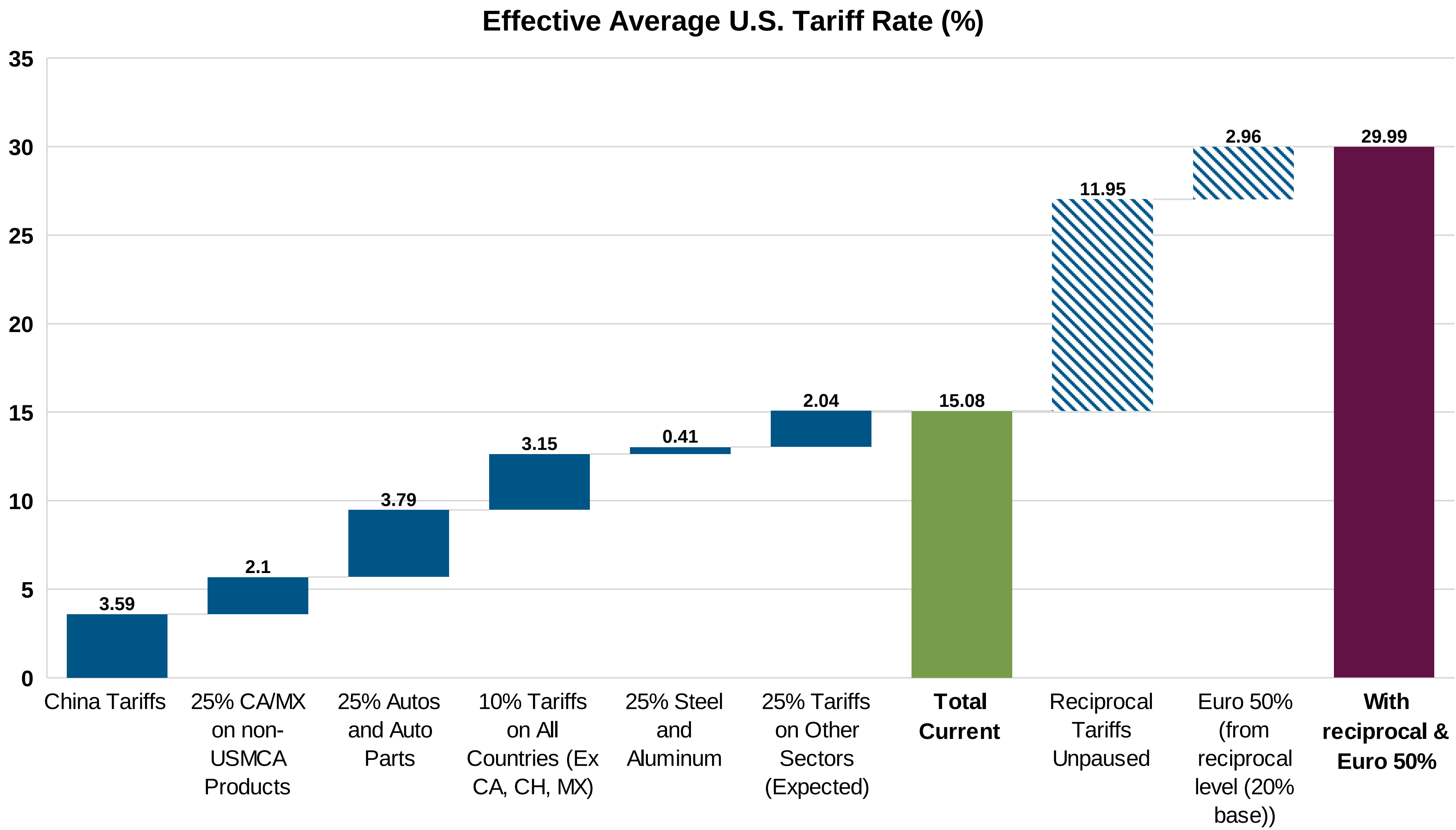
How did we get here?



Effective tariff rate data is annual as of 2023. PIMCO estimates as of May 2025

Source: USITC, PIMCO Calculations

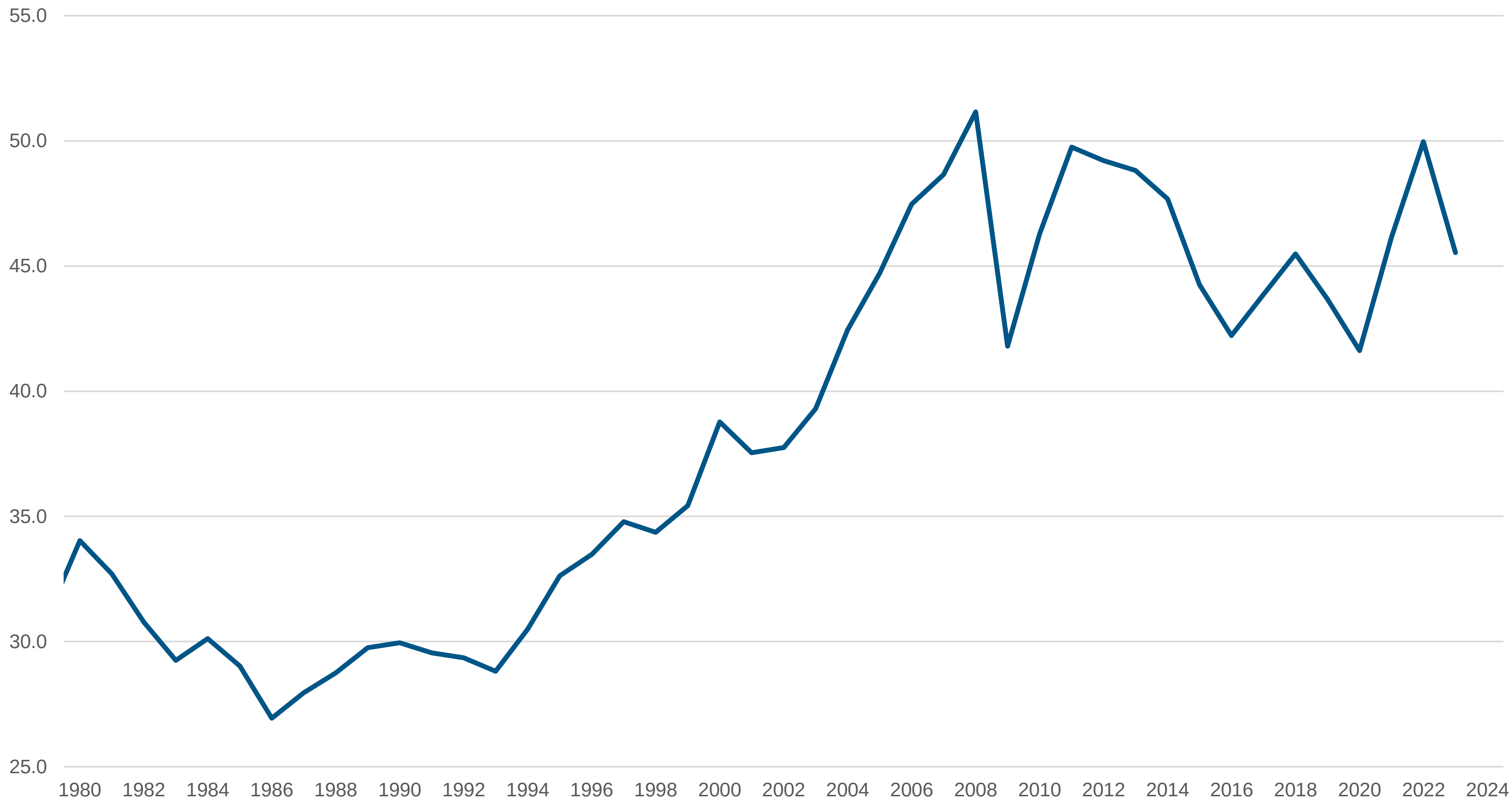
How did we get here?



PIMCO estimates as of May 23rd 2025.
Source: USITC, PIMCO Calculations.

Last half century have been characterized by accelerated globalization…

Global Goods Trade (% of Global GDP)

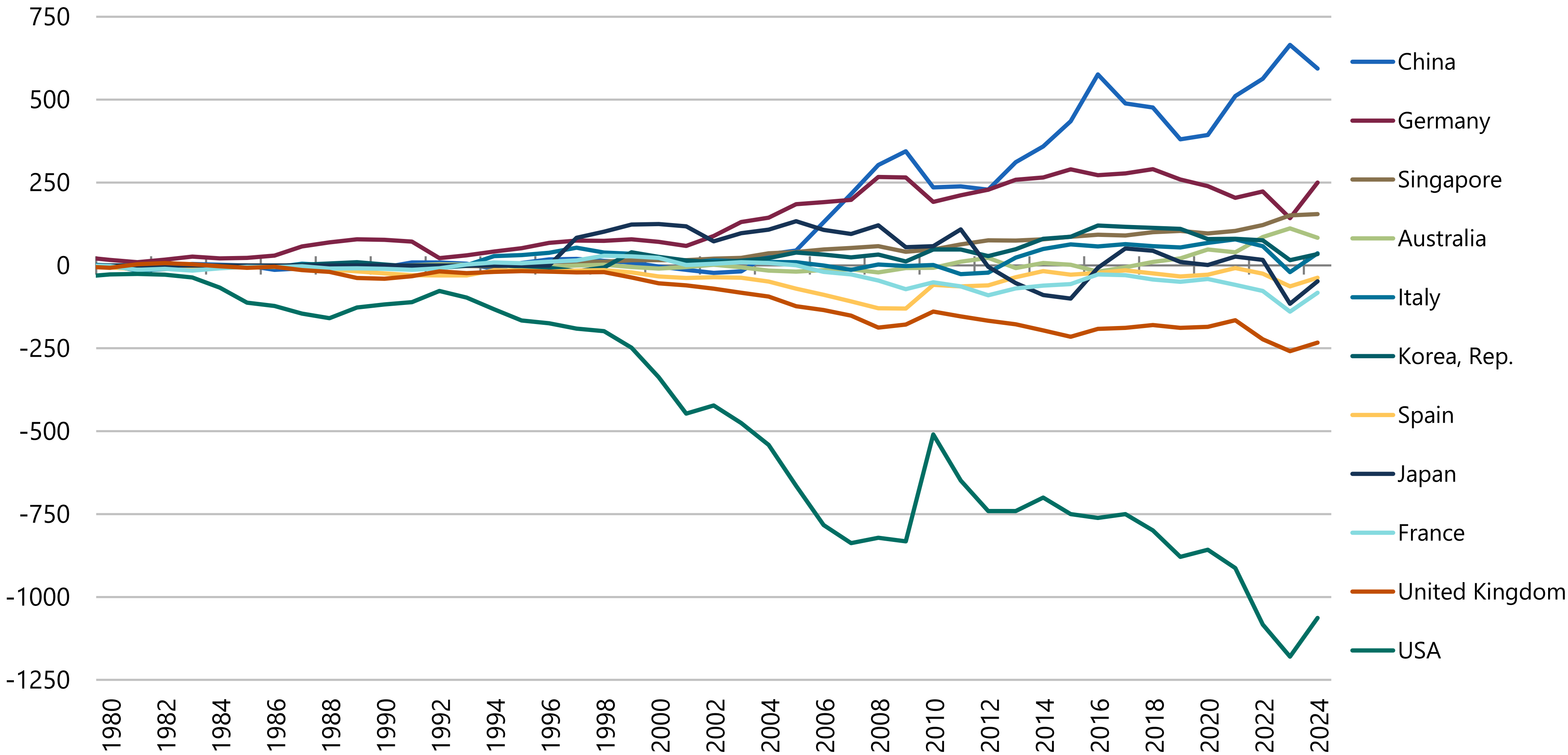


As of: December 2024. Source: World Bank, OECD Haver, PIMCO, CBO

…and persistent trade imbalances

Trade surpluses of China, Germany, Vietnam, and others exist against persistent deficits in the US, UK, and France.

Net Trade by Country (BOP $bls)

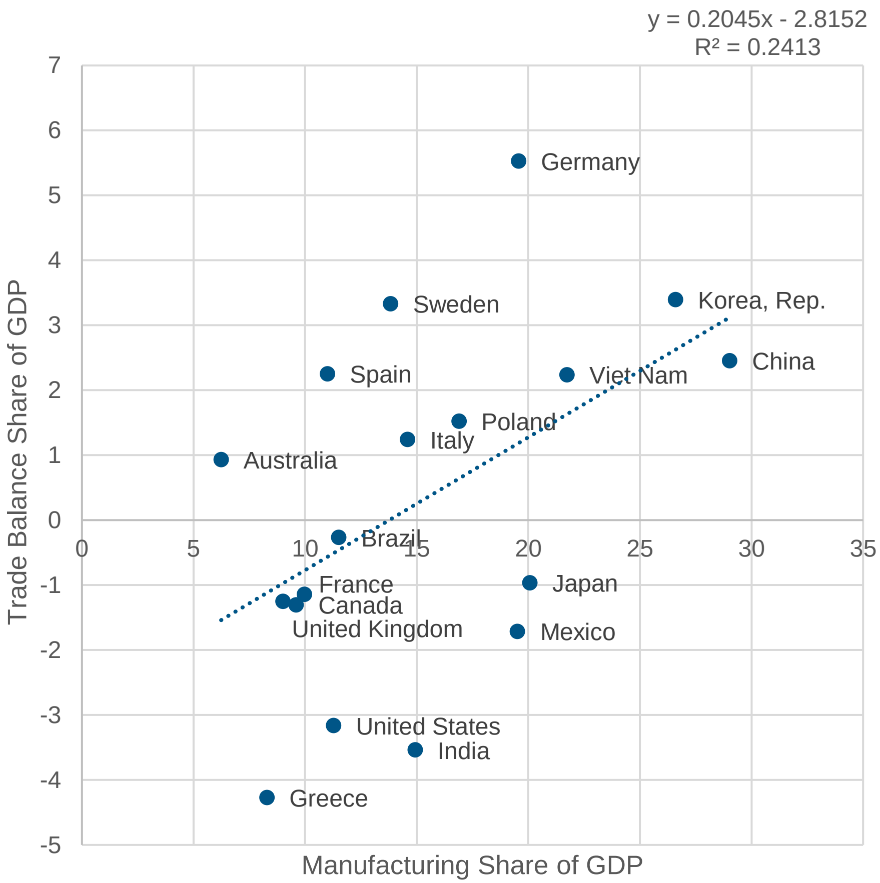


As of December 2024. Source: World Bank, Haver, PIMCO, CBO

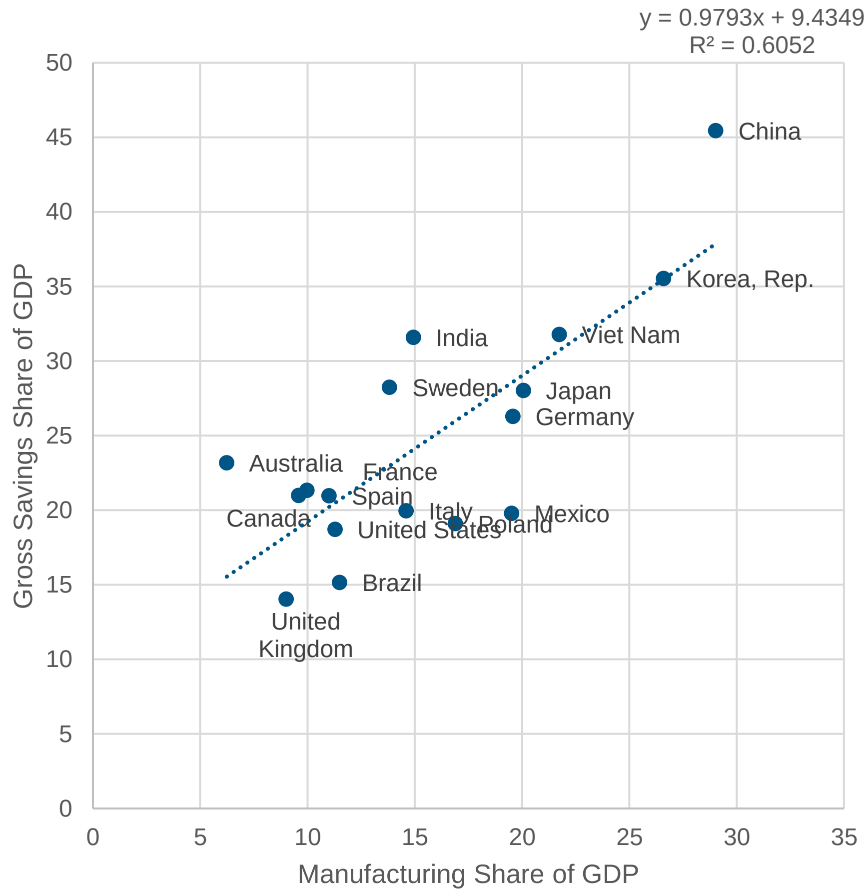
Countries with the highest manufacturing share, tend to have largest trade surpluses and savings rates

These countries consume less than they produce. The excess savings from these countries have accumulated in the US.

Trade Balance vs Manufacturing (% of GDP)



Gross savings vs Manufacturing (% of GDP)

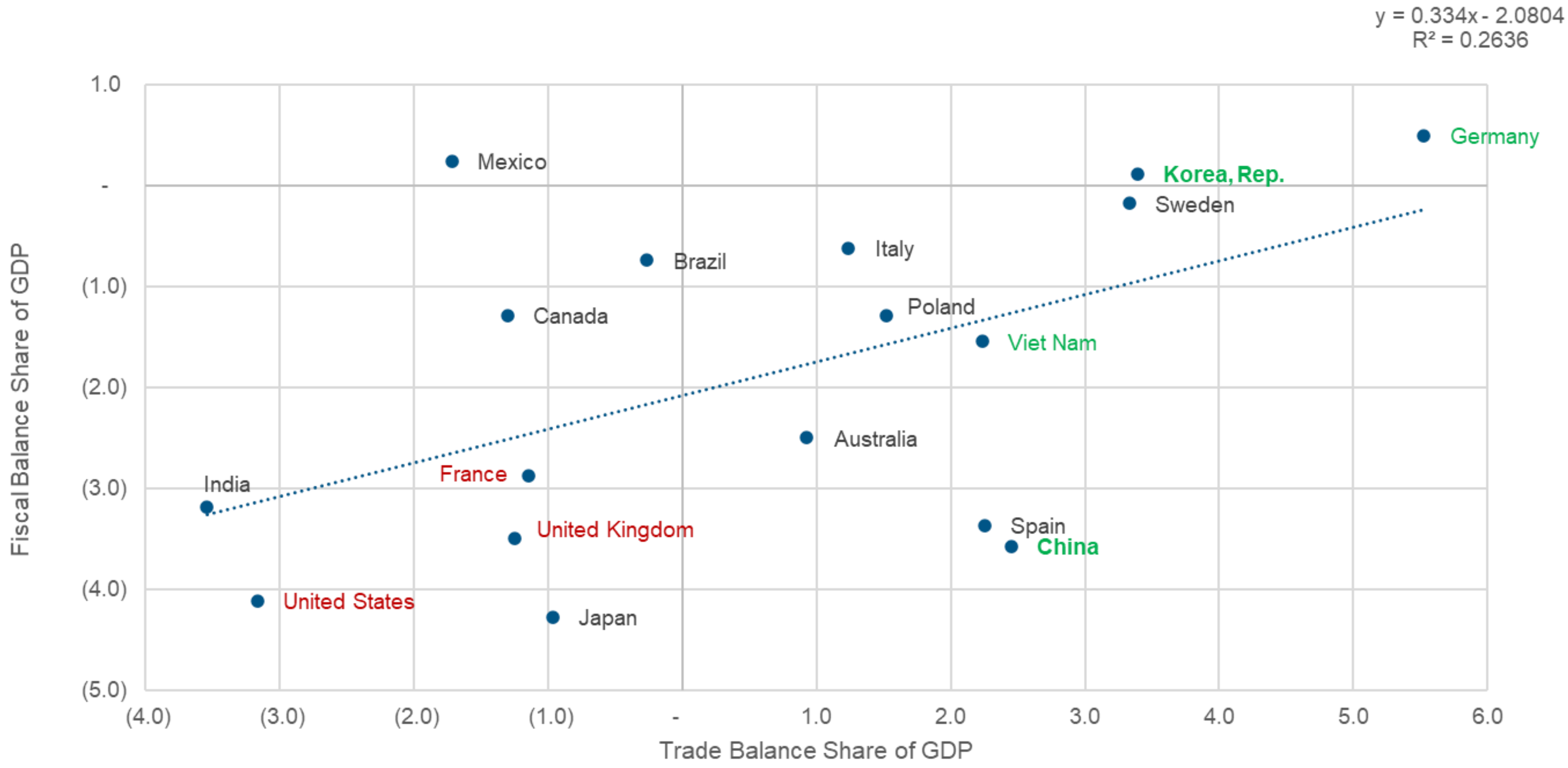


As of: December 2024. Source: World Bank, IMF, Haver, PIMCO
All figures in the plot represent annual averages over the 2012-2023 period.

Trade positions have a positive relationship with fiscal positions

…These countries include U.S., U.K. and France. Countries with the highest savings rates (although not necessarily the largest government surpluses) tend to fund fiscal deficit countries.

Trade Balance vs. Fiscal Balance (% of GDP)



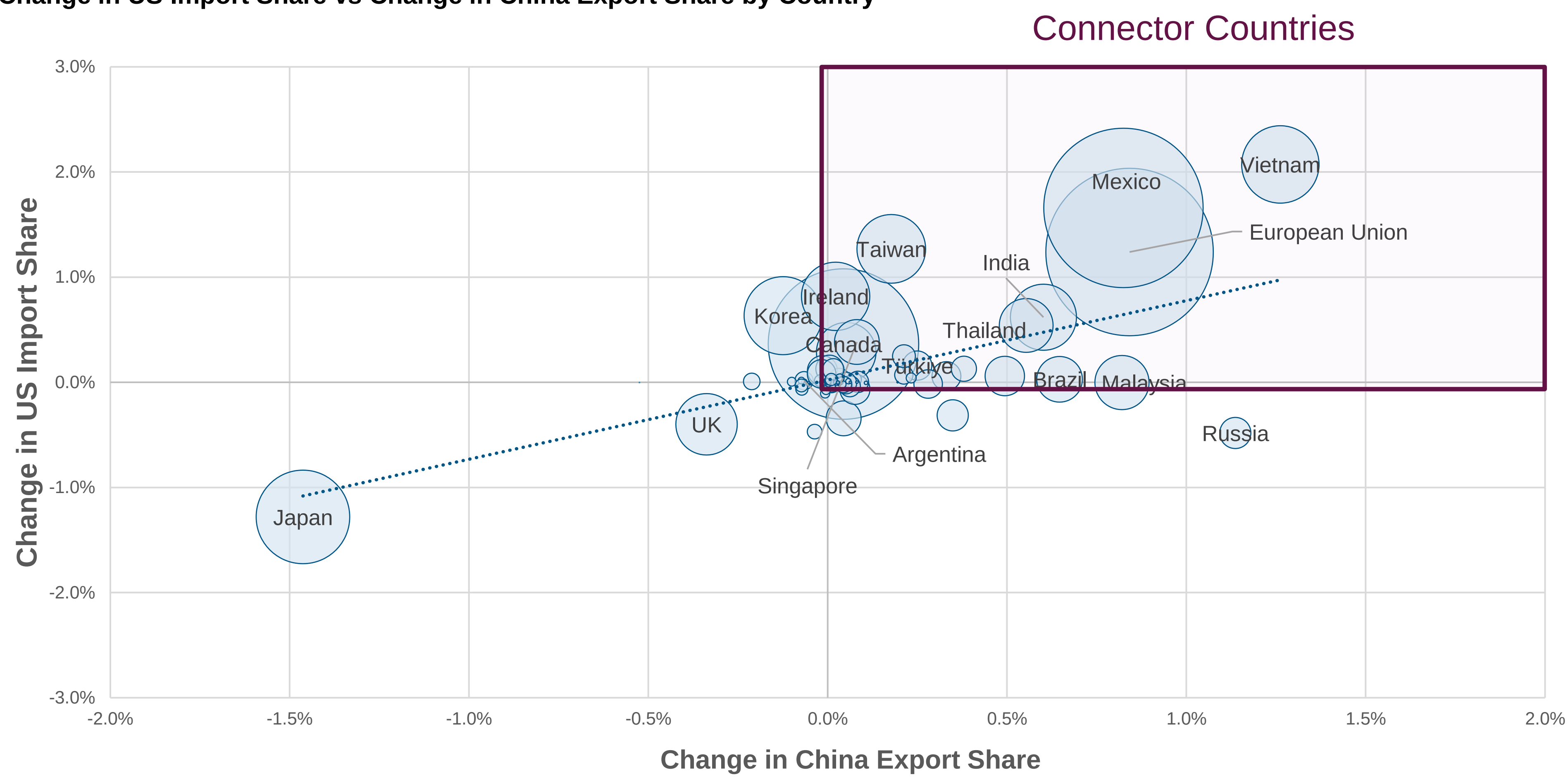
As of December 2024. Source: World Bank, IMF, Haver, PIMCO.

All figures in the plot represent annual averages over the 2012-2023 period.

Since Trump’s First term: Emergence in “Connector Countries” between US and China have smoothed decoupling

A reduction in Chinese share of US imports has been offset by higher import shares in Mexico, EA, Vietnam, India, Thailand, among others

Change in US Import Share vs Change in China Export Share by Country



As of December 2024. Source: World Bank, IMF, Haver, PIMCO.

All figures in the plot represent changes in average US import and Chinese export shares from **2022-2024 vs 2015 - 2017**

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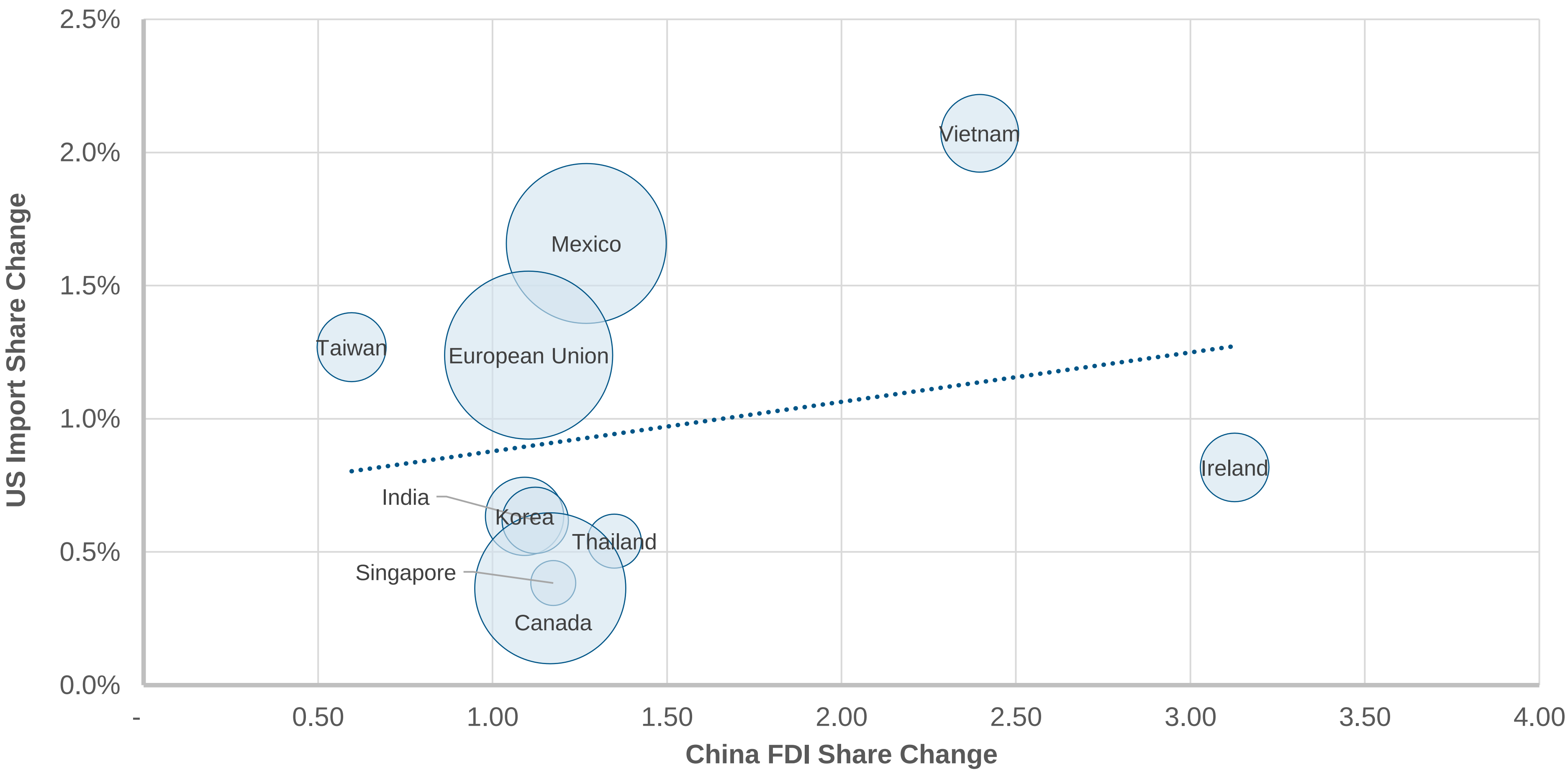
Increase in China FDI in these connector countries has coincided with US import share gains… can we really call it decoupling?

…Despite Trump 1.0 trade policies against China, the US/China trade linkages still very firm.

Change in China FDI Share vs Change US Import Share; Bubble size: Total US Import ($)



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Policy solutions vs. potential constraints

Potential Solutions?

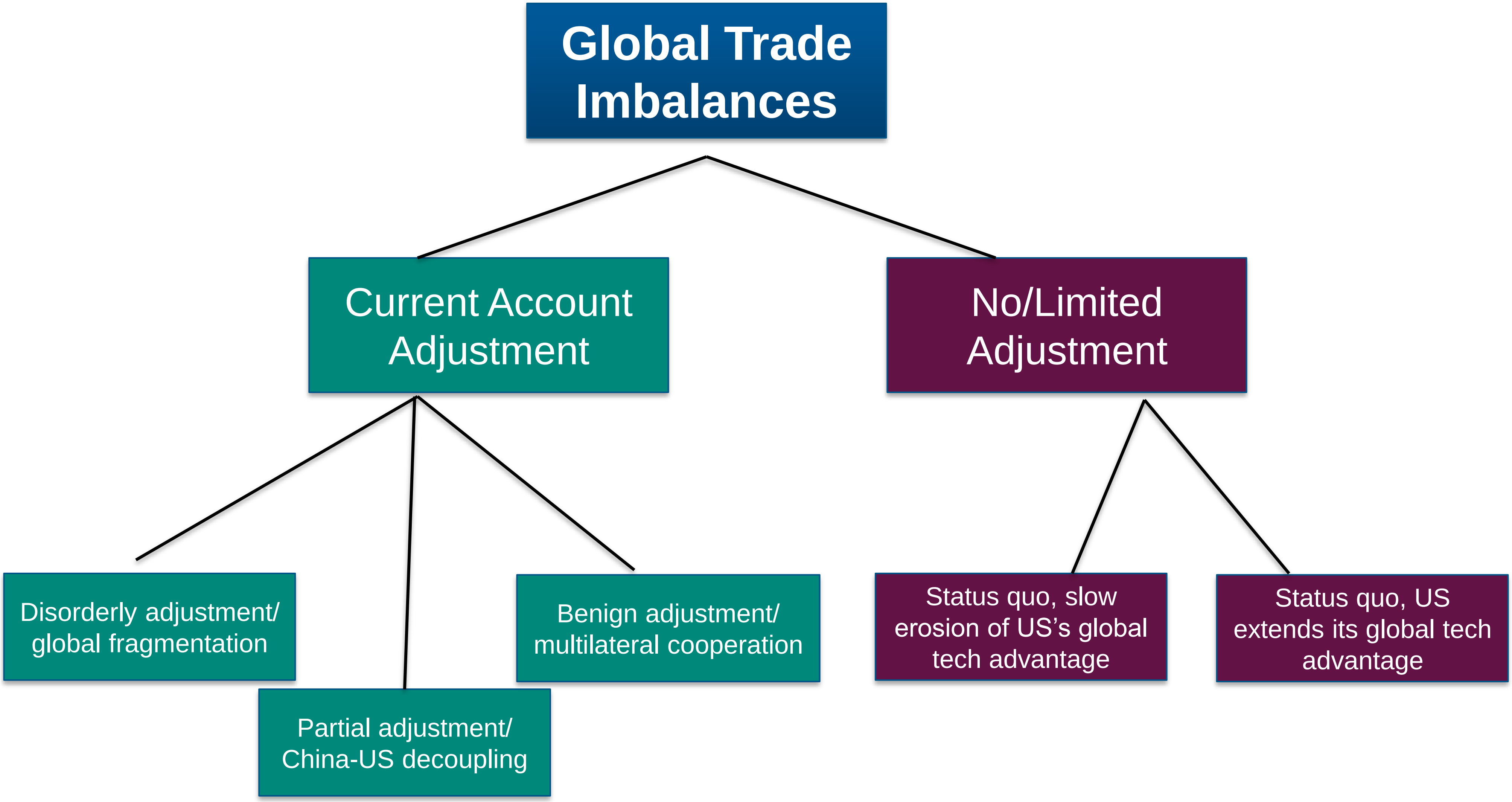
- Structural reforms in U.S. government spending, which reduce U.S. consumption share of GDP
- Structural reforms in trade surplus countries to reduce excess savings (and raise domestic demand)
- Dollar devaluation, which would reduce the value of excess savings in foreign currency terms and make it less expensive to produce the U.S. vs. elsewhere

Potential Constraints?

- U.S. political and economic constraints of US government deficit reduction
- Political and economic constraints structural policy changes in China, Germany, Korea, Vietnam and others?
- Can the US achieve a coordinated multilateral strategy against China?
- Can Trump negotiate a “Mar-a-Lago” Currency accord?
- Inflation: Rising inflation to constrain the Fed’s ability to cut rates? Will U.S. consumers tolerate higher prices?
- Market constraints: Will U.S. capital holders tolerate a rise in labor share? How much market volatility is too much?

Source: PIMCO.

US Secular Scenarios



Source: PIMCO.

US Current Account Adjustment: Benign or Disorderly?

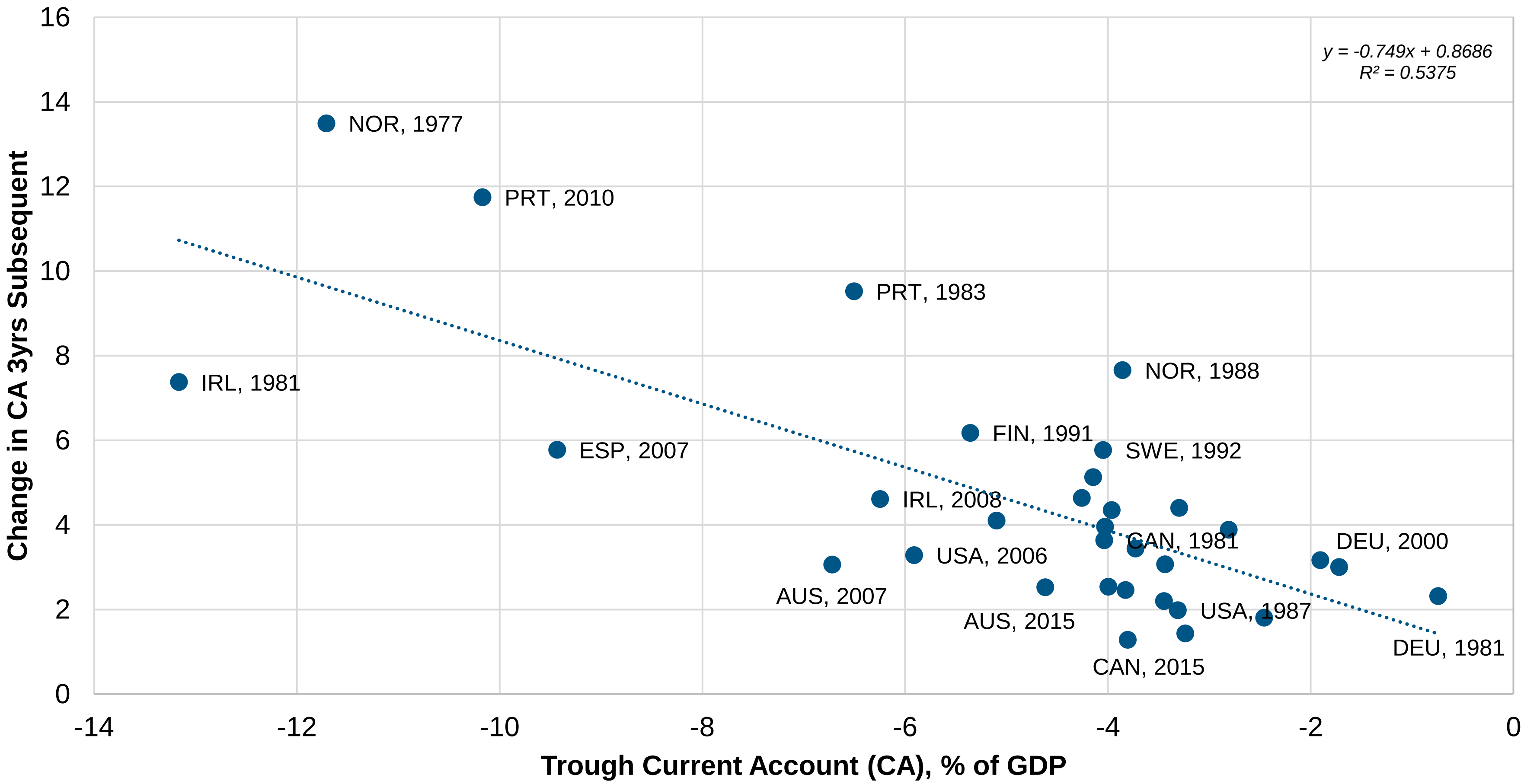
If you want to scare yourself, contemplate the following. The dollar begins to fall...Foreigners with massive investments in U.S. stocks and bonds begin to sell their holdings. They fear currency losses on their American investments because a depreciated dollar would fetch less of their own money. The selling then feeds on itself. The stock market swoons. American consumer confidence withers. The recession resumes and spreads to the rest of the world through lower U.S. imports. Wham! Is this horror story likely? Probably not. Is it possible? Well, yes.

Robert Samuelson, *The Washington Post*, May 29, 2002.

Current Account Adjustments Historical Context

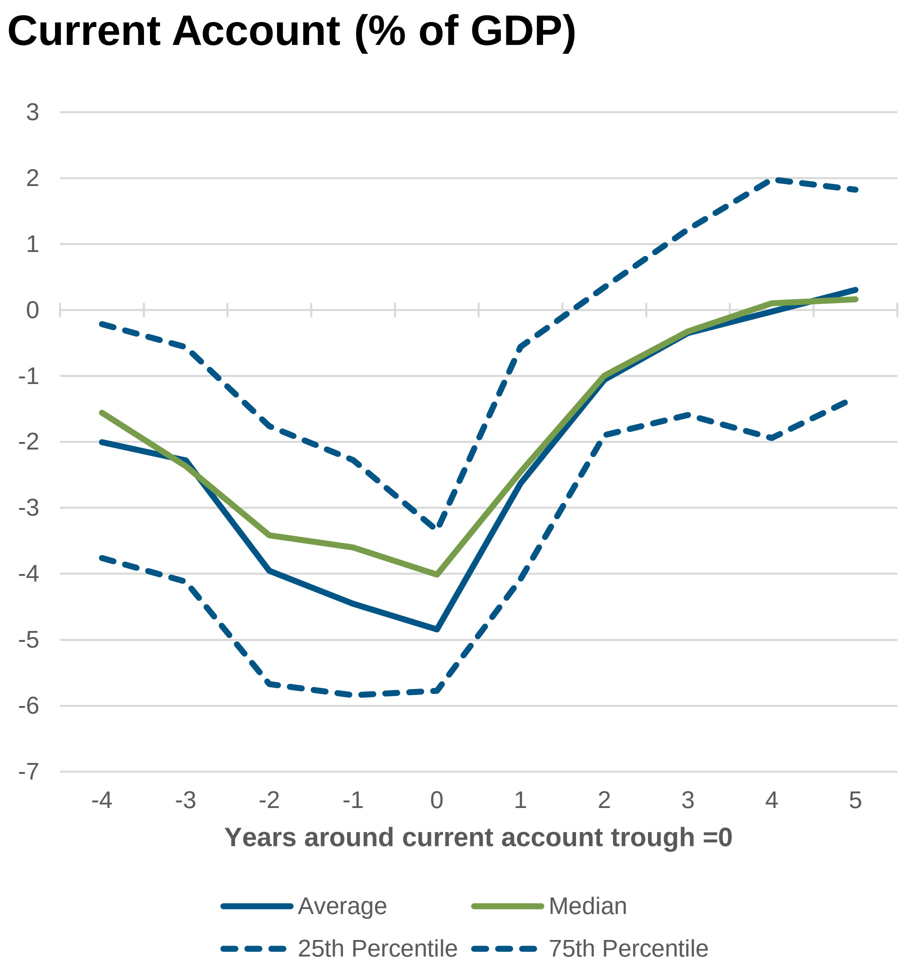
We analyzed macro and market impact of 32 current account correction episodes. Each episode included an initial current account deficit, with a 1% of GDP or greater adjustment, which was sustained over the subsequent 3-years.

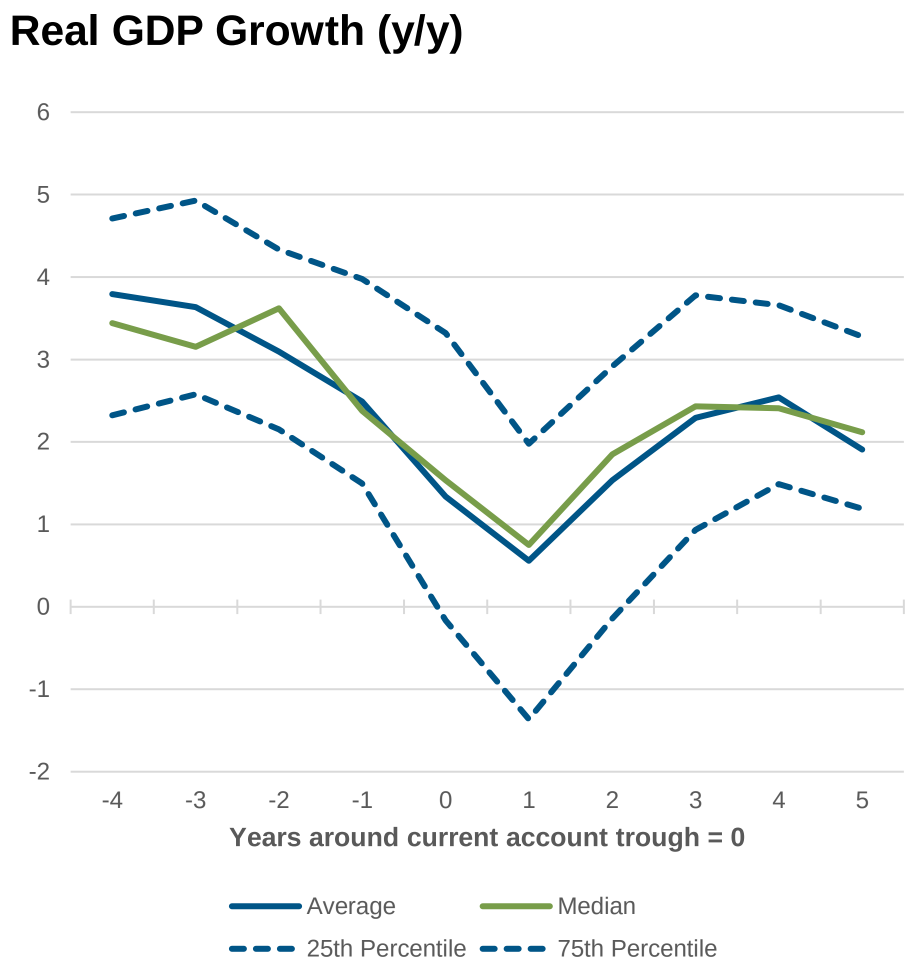
Historical Industrialized Economy Current Account Adjustments



Source: IMF Data, Jordà-Schularick-Taylor Macrohistory Database, PIMCO Calculations
Countries Included, AUS, AUS, BEL, CAN, DEU, DNK, ESP, FIN, GBR, IRL, ITA, NOR, PRT, SWE, USA
Current account corrections were screened loosely based on criteria from Freund and Warnock (2007). Our sample, includes 32 instances, across 15 industrialized economies, from a sample period between 1975-today,

Stylized Fact 1) Real Growth Rates Fall After Current Account Adjustment





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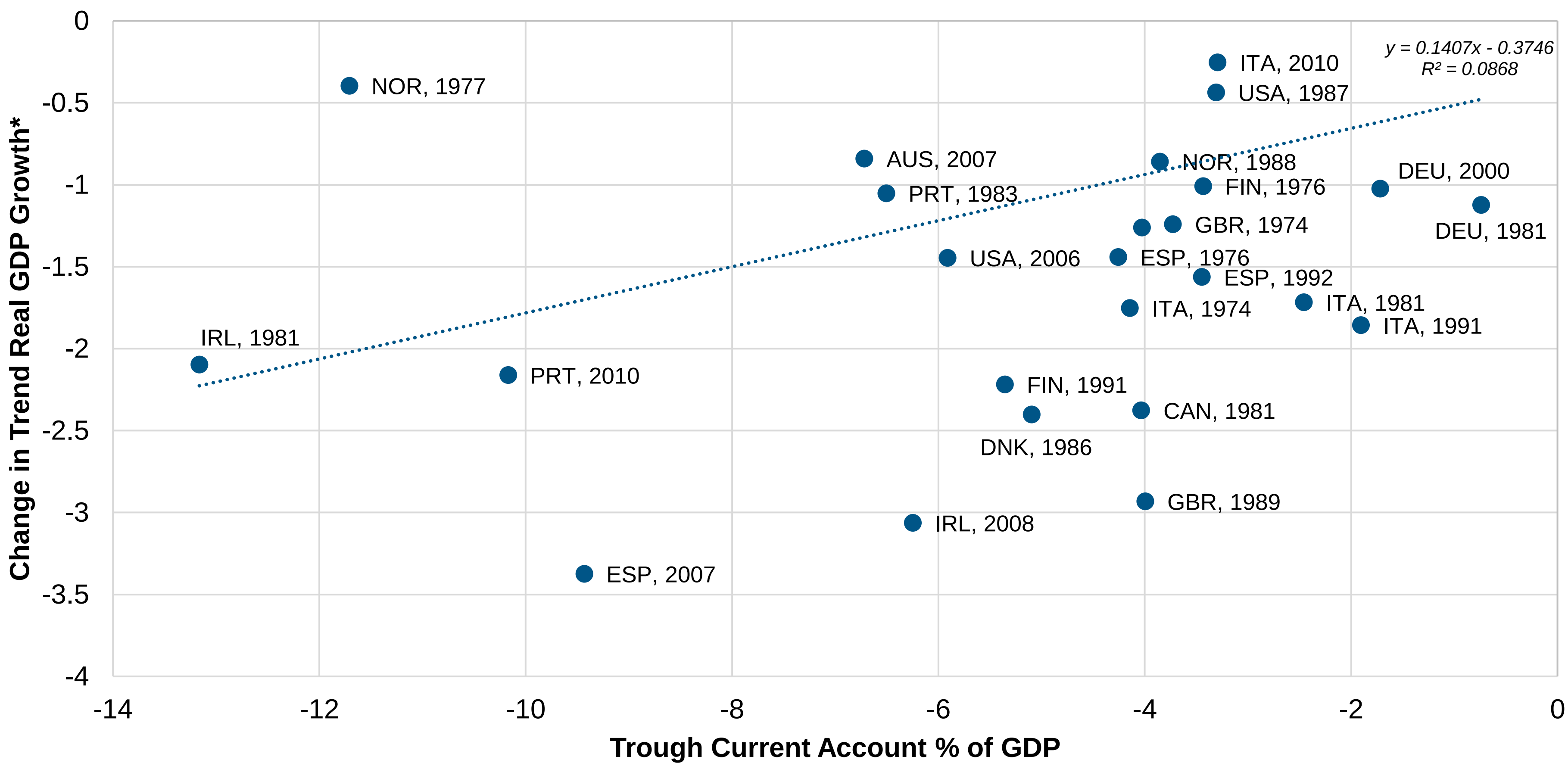
Stylized Fact 2) Bigger they are, the harder they fall

Larger current account deficits have coincided with larger declines in average real GDP growth, in the 3-years after the correction.

Historical Industrialized Economy Real GDP Growth Change vs Current Account Deficit



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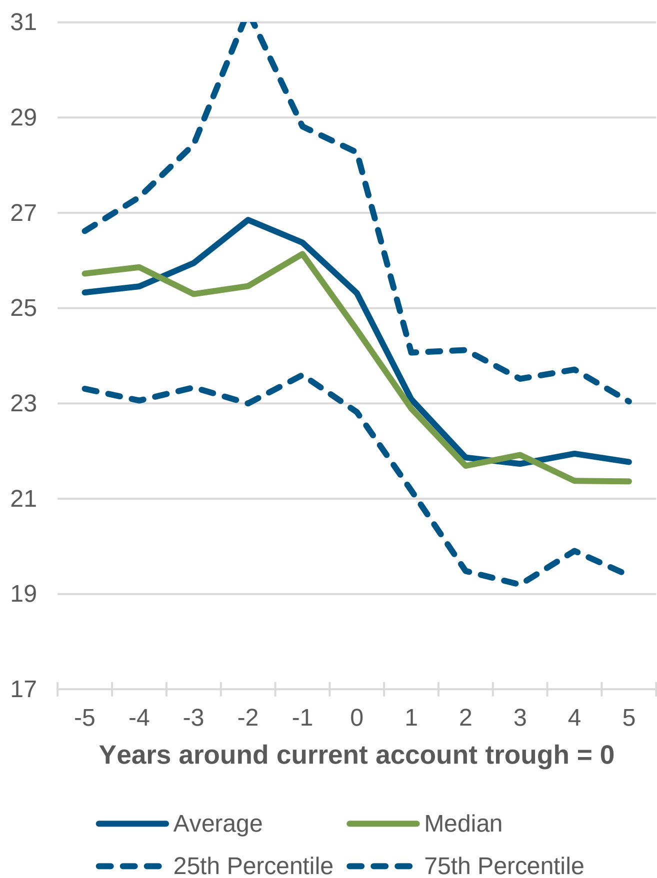
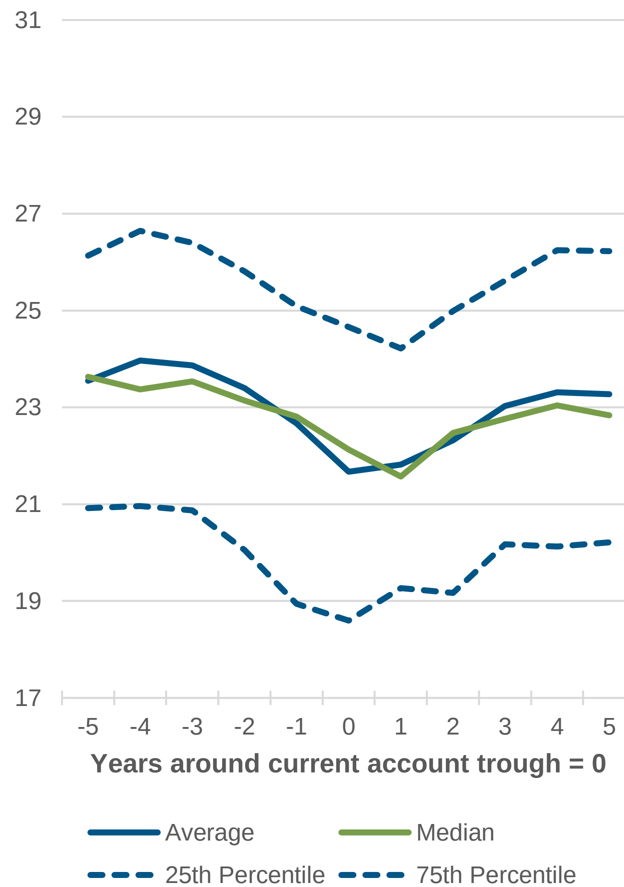
Stylized Fact 3) Investment *and* savings fall, investment falls by more

Small decline in savings rate is driven by a similar sized deterioration in the fiscal balance. The private savings rate rises.

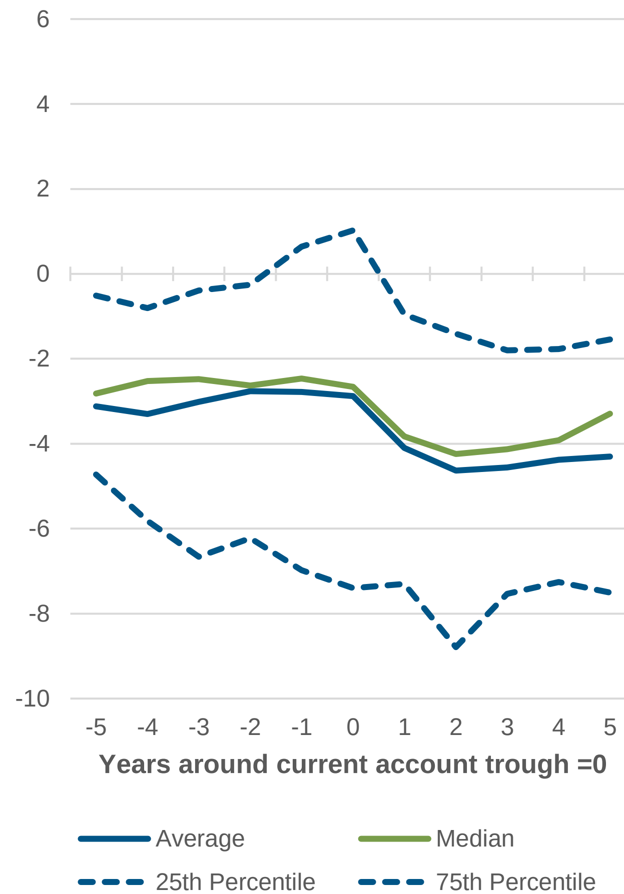
Investment (% of GDP)



Public and Private Sector Savings (% of GDP)



Fiscal Deficit (% of GDP)



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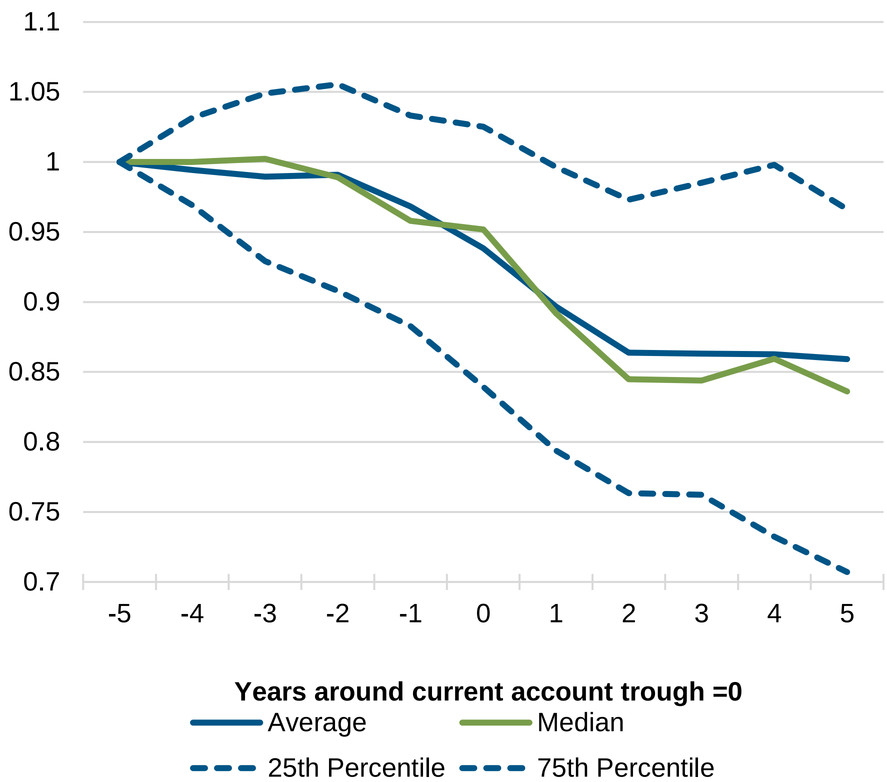
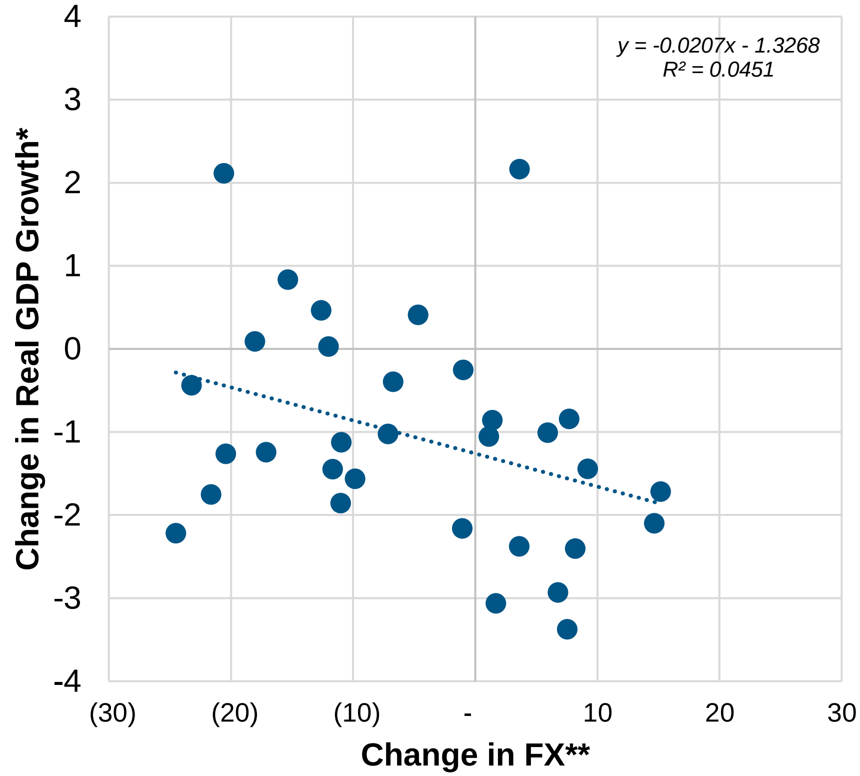
Stylized Fact 4) Current account adjustment coincides with a currency depreciation … which, in turn, buffers the growth drag

Larger FX deprecations are associated with small growth drags

Nominal FX Performance (1 = 5yr prior adjustment)



FX Change vs Real GDP Growth Change Around CA Adjustments



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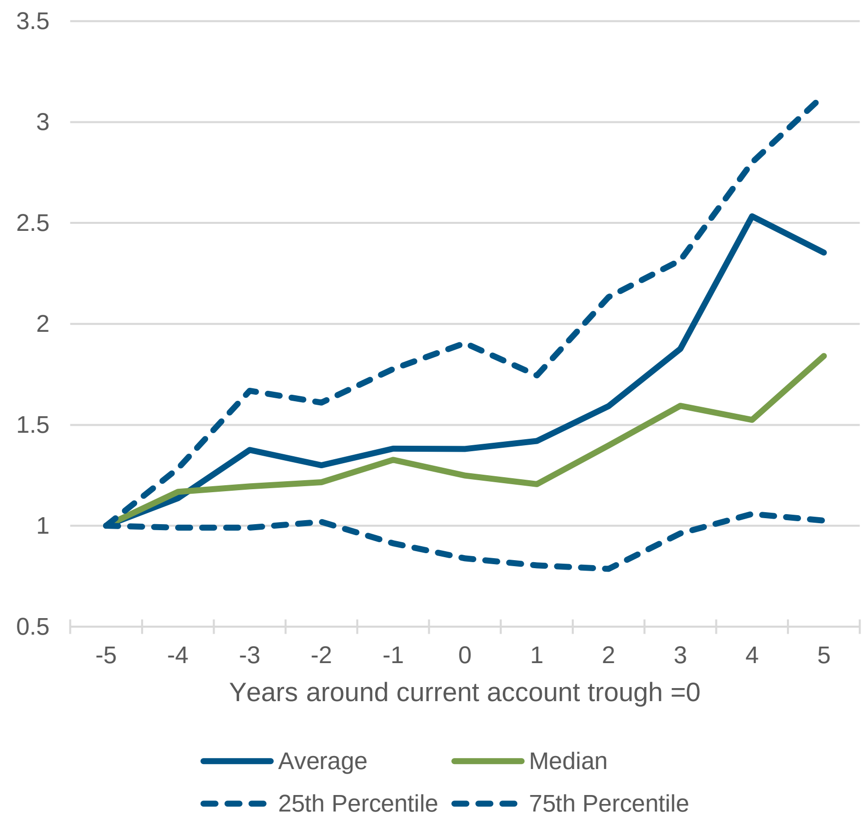
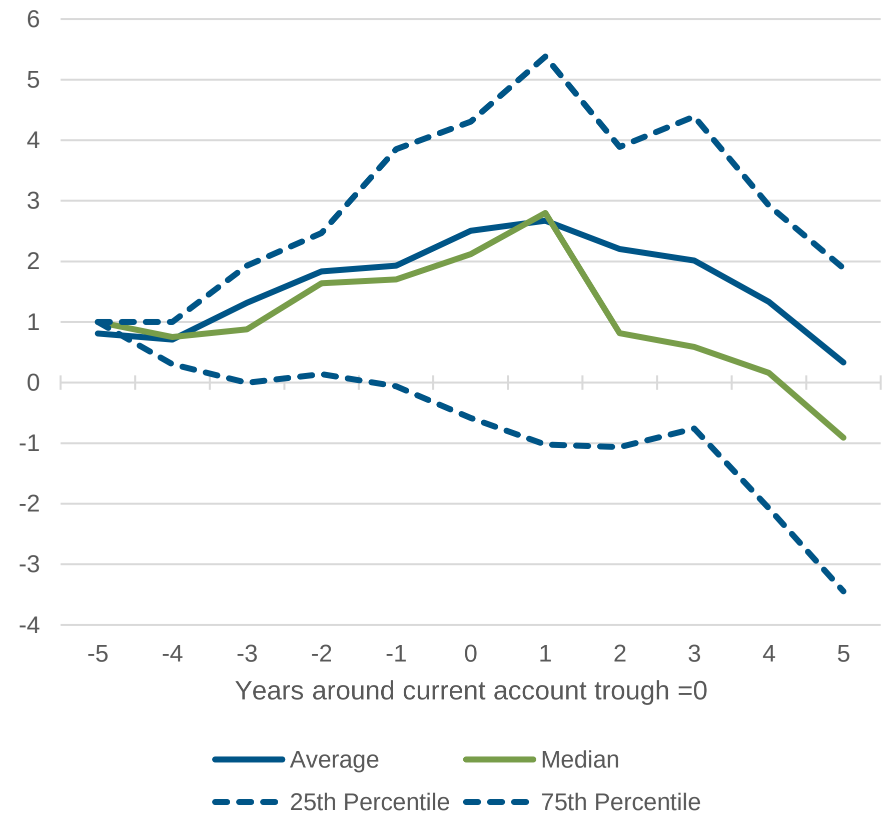
*Change in real GDP growth = Average of real GDP growth during the 3-year prior to adjustment vs average GDP growth in the three years subsequent
** Change in Real Trade Weighted FX, 3yrs prior to 3yr subsequent

Stylized Fact 5) Most industrial economy adjustments are *not* ‘disorderly’…

Equity Performance (1 = 5yr prior adjustment)



Long Rates Performance (1 = 5yr prior adjustment)



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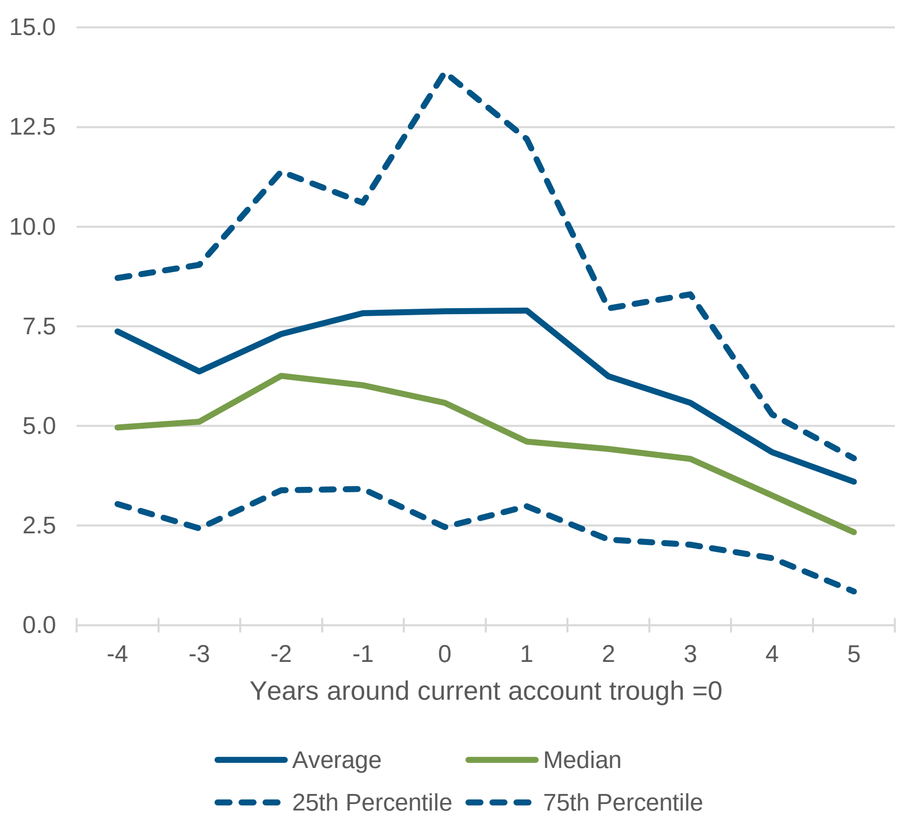
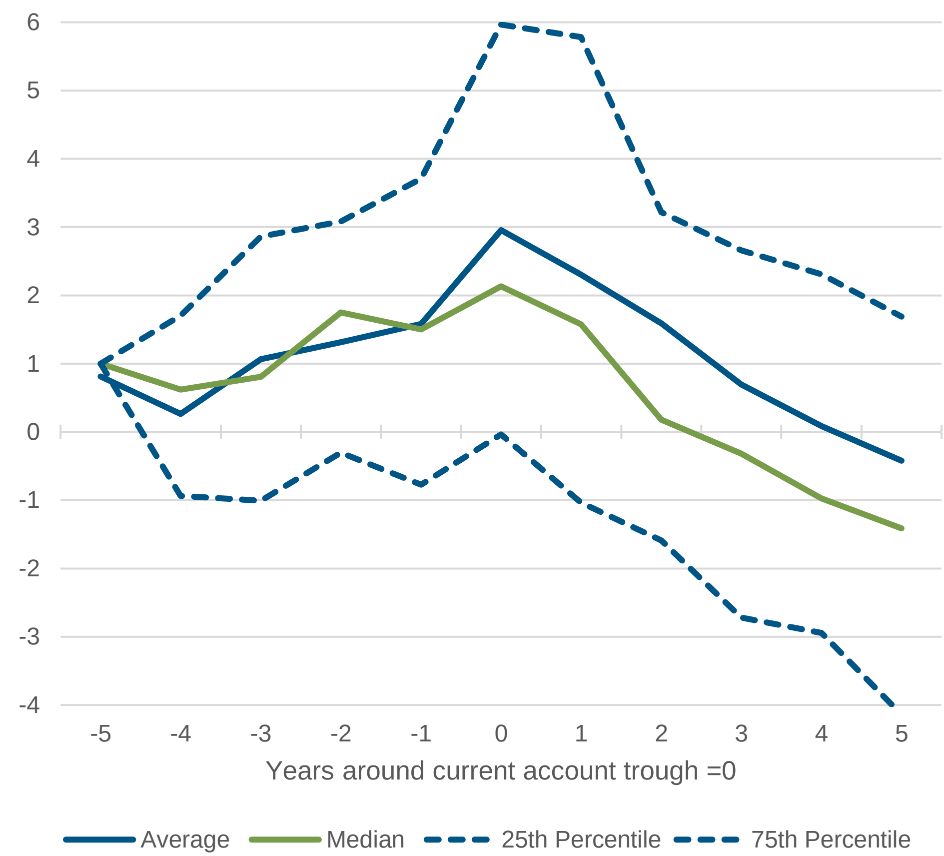
…Rather inflation and policy rate peaks tend to coincide with CA troughs

Monetary policy easing (after a period of tight policy), and associated currency depreciations are key drivers of the correction

Inflation (y/y)



Short Rates Performance (1 = 5yr prior adjustment)



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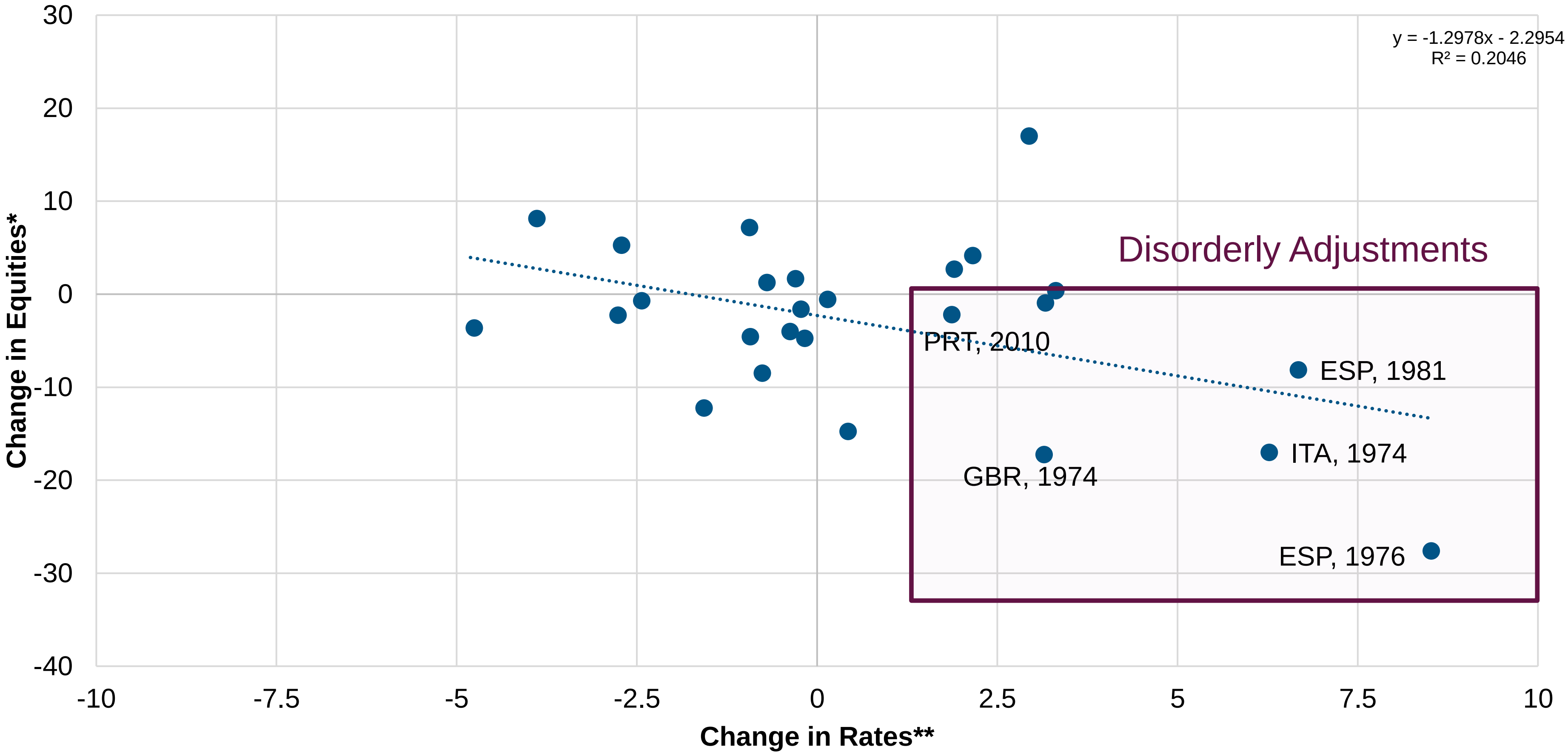
There are a handful of industrial economy adjustments that have been more disorderly

A disorderly adjustment is defined as an episode with weaker currency, higher rates, lower equities and at least 1-year of real GDP contraction during and after the adjustment.

Changes in Long-Term Yields vs Change in Equities around CA Adjustments



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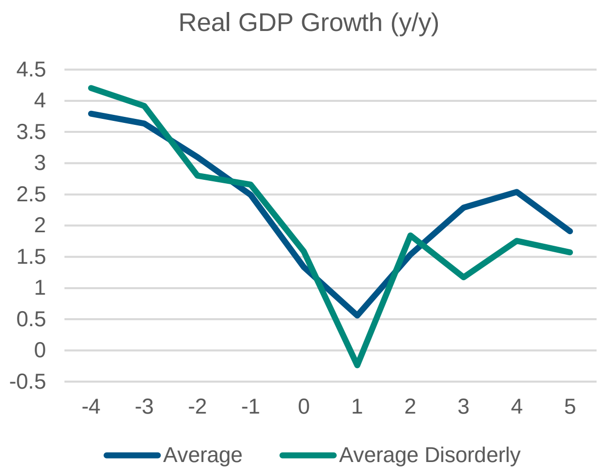
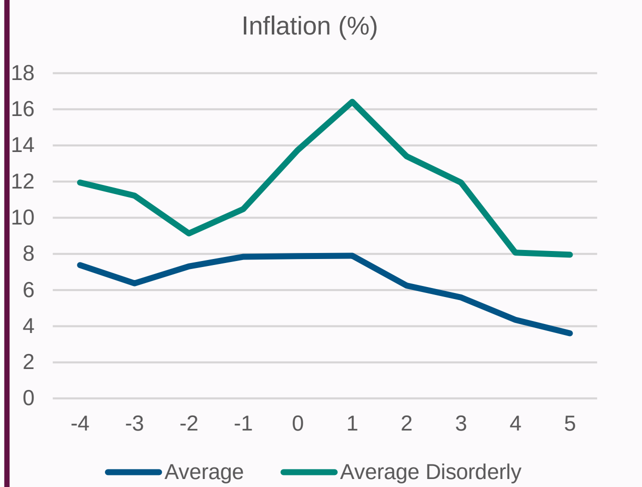
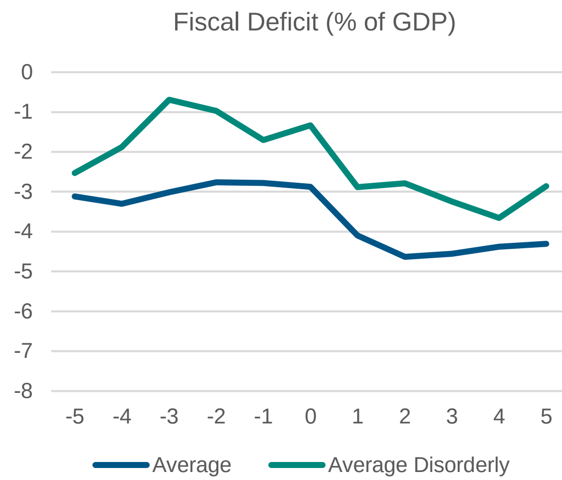
*Change in Equity = Cumulative annualized change in the real price of equity from 2-year prior to adjustment to two years subsequent
**Change in Rates = Cumulative change in yield of a longer-term maturity government bond from 2-year prior to adjustment to two years subsequent
Disorderly adjustments includes those with real FX deprecations, negative equity returns, and higher rates based 3yr prior vs 3-year subsequent.
See slide 13 for the sample of currency account adjustment episodes, including country and year of the current account trough. The plot also includes the initial current account trough, and the subsequent 3-year change.

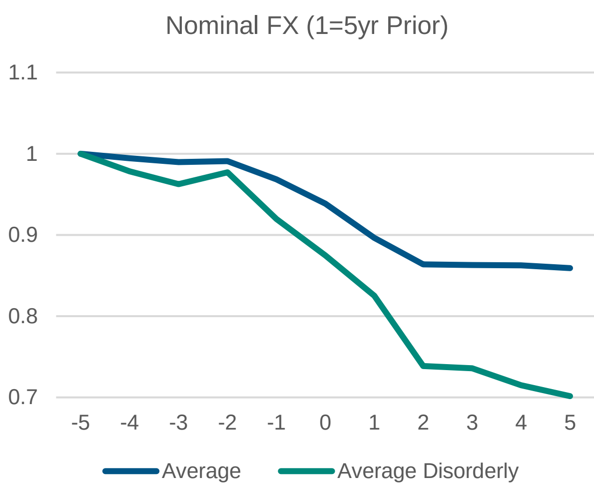
Disorderly adjustments tend to be characterized by larger FX depreciations, high/accelerating inflation, rising rates

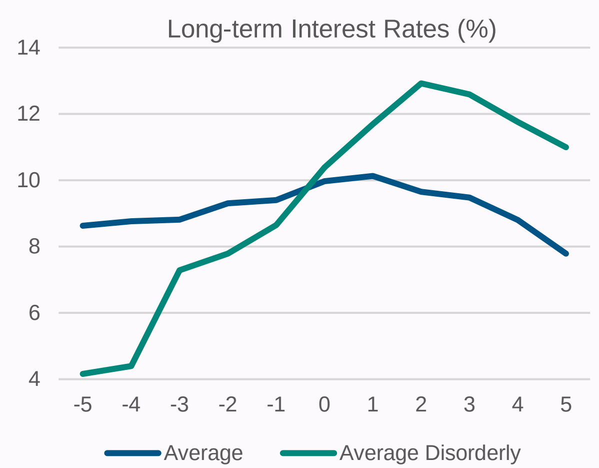
Average path of economic and market variables around all disorderly adjustments

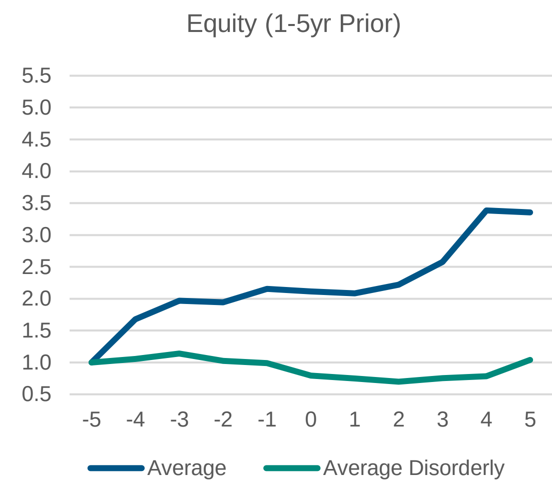












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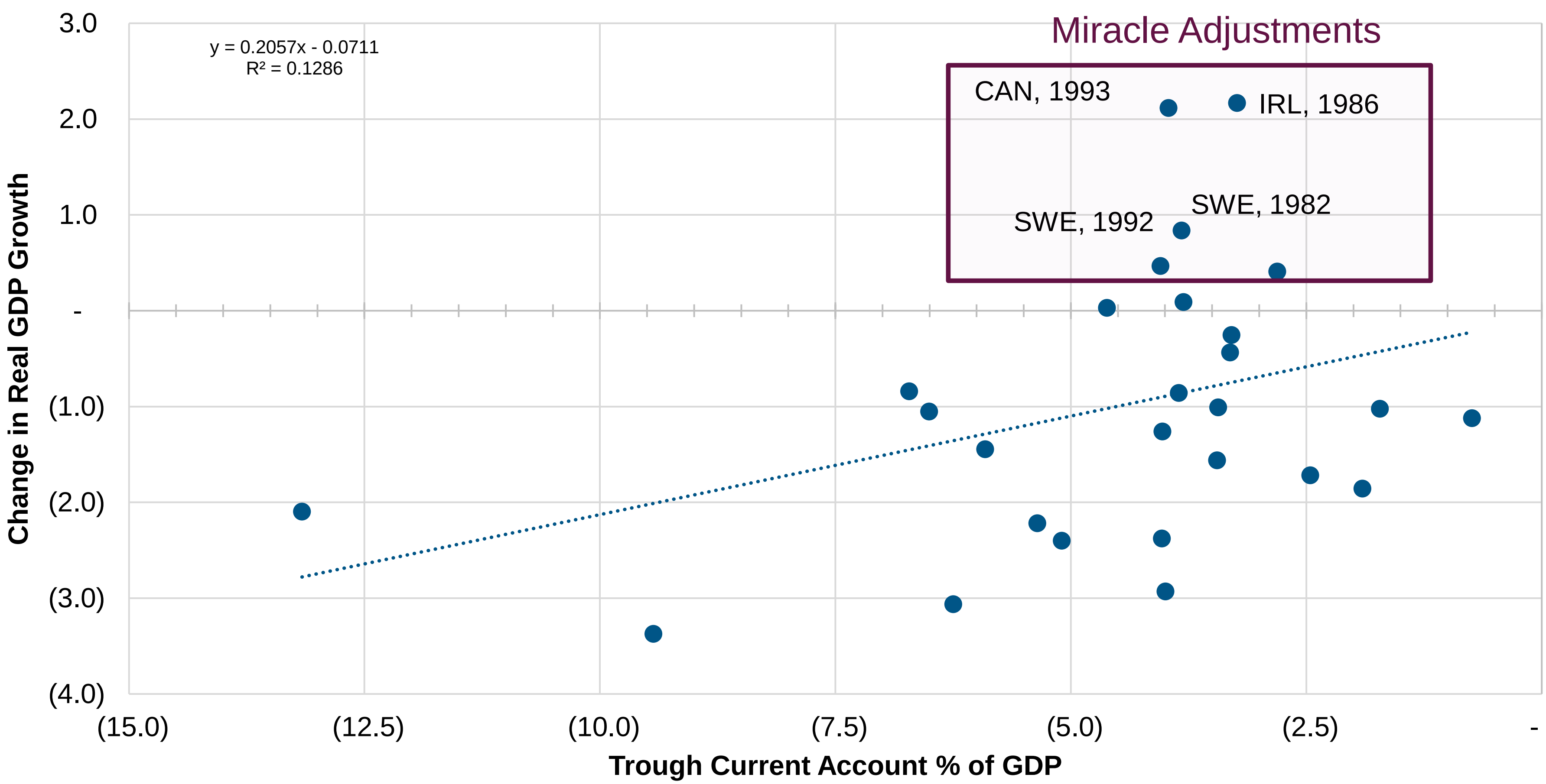
There also handful of episodes with *miraculous* post-adjustment real GDP growth accelerations

"Miracle" adjustments includes those where real GDP growth was higher on average in the 3-years after the adjustment than before, and real equity performance was positive.

Change in Real GDP Growth vs Current Account Trough



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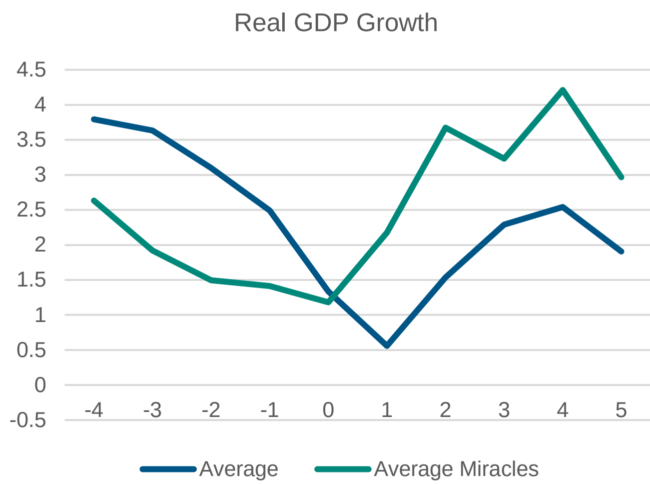
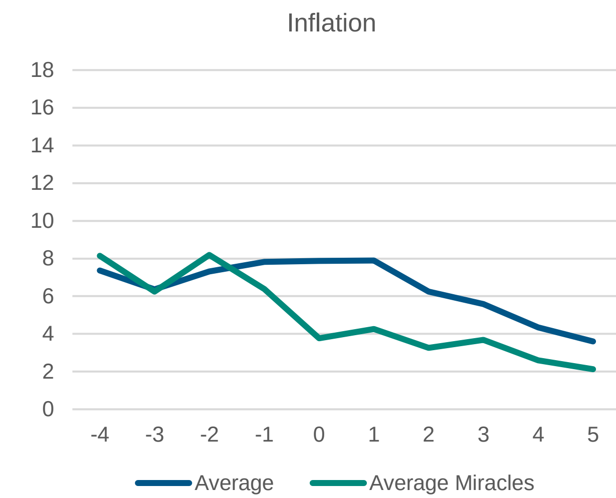
Change in real GDP growth = Average of real GDP growth during the 3-year prior to adjustment vs average GDP growth in the three years subsequent
Miracles defined as episodes where the 3-year average growth rate of real GDP after an adjustment was higher than the 3-year average growth rate below, and real equity returns were positive across this period.

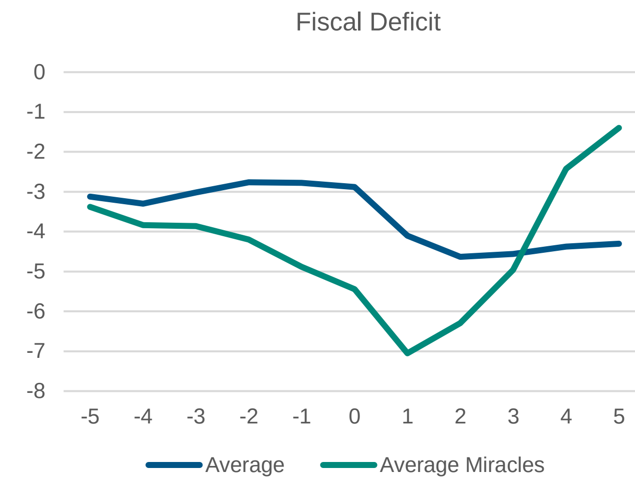
Current account adjustment miracles include fiscal consolidation, lower inflation, rates and FX, which boosts growth and equities

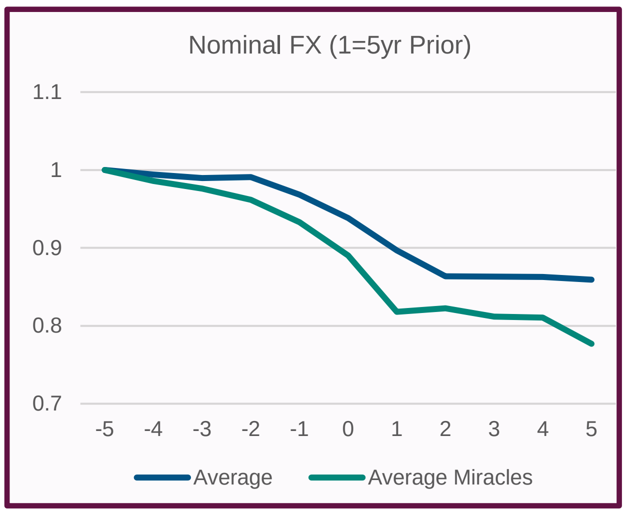
Miracle or "beggar thy neighbor" adjustments were characterized by low growth, or even recession before the adjustment, followed by large FX devaluations and growth acceleration

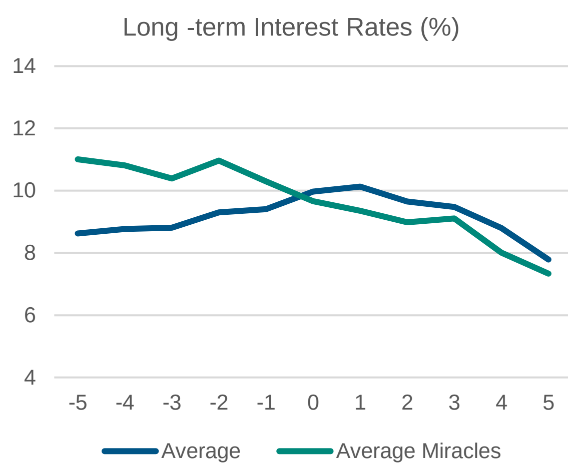
Average path of economic and market variables around the 'miracle' adjustments

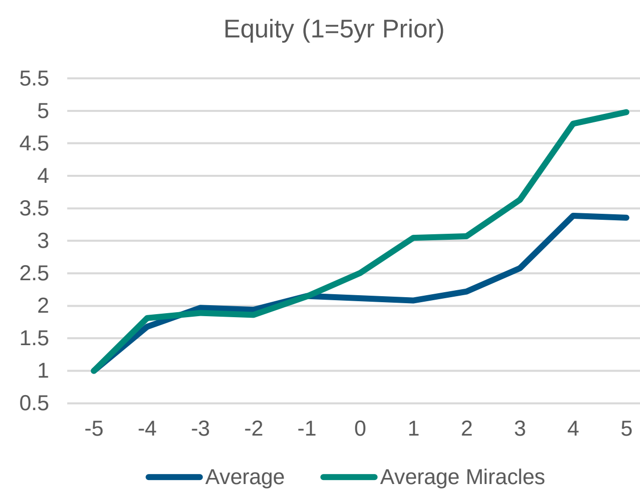












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Other Commonality of Miracle Adjustments: Fiscal Consolidation

Fiscal Deficit to GDP, Miracle Adjustment Episodes

Source: Jordà-Schularick-Taylor Macrohistory Database, PIMCO Calculations

Disclosures

OUTLOOK

Statements concerning financial market trends or portfolio strategies are based on current market conditions, which will fluctuate. There is no guarantee that these investment strategies will work under all market conditions or are appropriate for all investors and each investor should evaluate their ability to invest for the long term, especially during periods of downturn in the market. Outlook and strategies are subject to change without notice.

RISK

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