

# The Economist

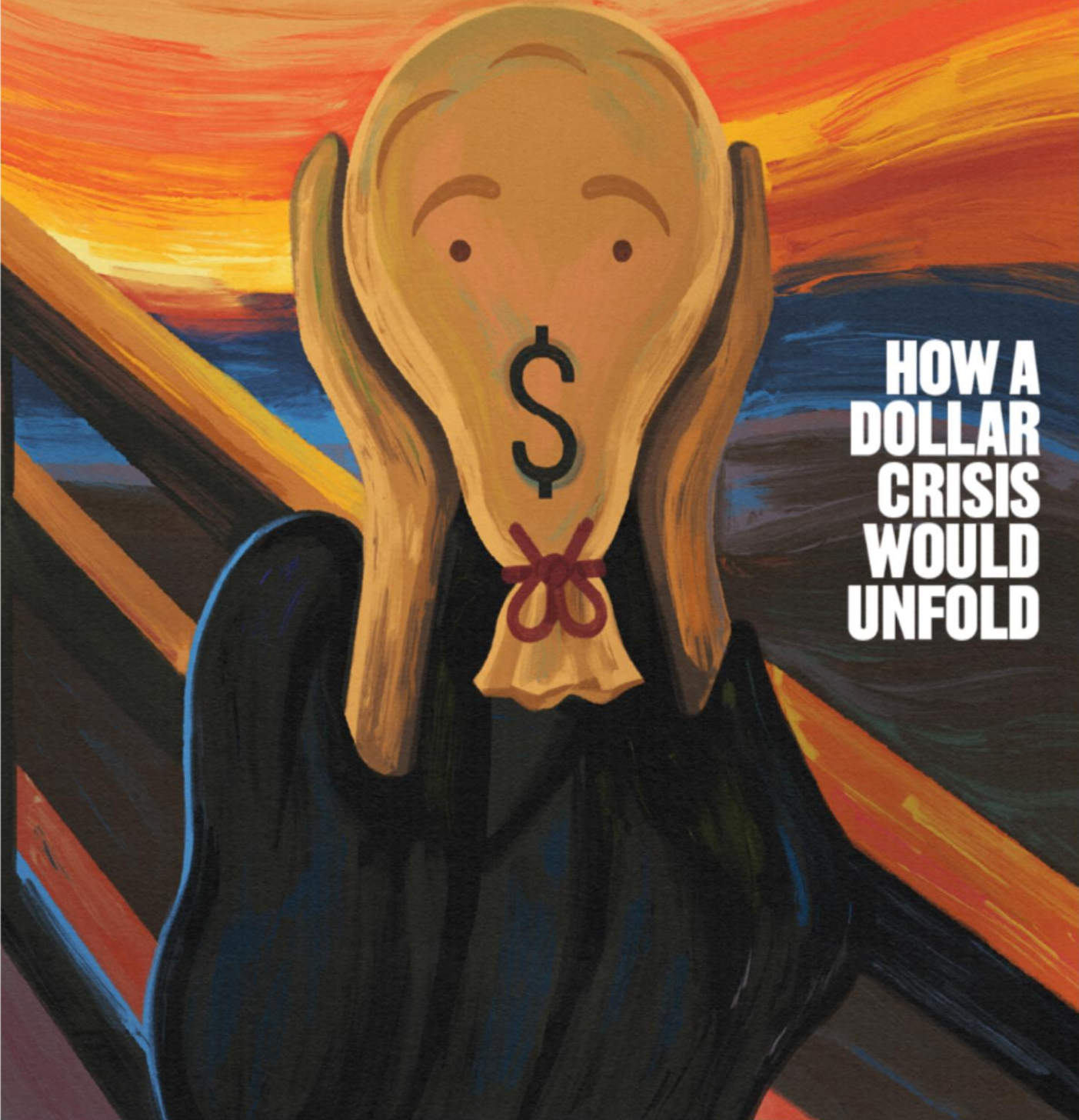
China's hold over America

Why Meta deserves to win

In praise of plastics

Mario Vargas Llosa, a passionate liberal

APRIL 19TH-25TH 2025



**HOW A  
DOLLAR  
CRISIS  
WOULD  
UNFOLD**

## Business



Photograph: Getty Images

The Trump administration’s [chaotic pronouncements on tariffs](#) caused more uncertainty among investors. America’s customs agency said that smartphones, computers and chips, among other things, would be exempt from Donald Trump’s punitive levies, only for the president to say later that the exemptions would be temporary, as nobody is getting “off the hook”. Tech products will be exempt from reciprocal tariffs for a time but included in other duties on the chip industry that may be two months away, said Howard Lutnick, the commerce secretary, sowing more confusion. Mr Trump also said he was looking to help car companies, though without saying how.

In a regulatory filing **Nvidia** warned that it expects to book a \$5.5bn charge as it will now have to obtain special licences to sell its H20 chip in China. America’s Commerce Department issued new export restrictions to China on the H20 and AMD’s MI308 chip to “safeguard our national and economic security”. Both chips are used in artificial-intelligence applications.

China continued its retaliations in the trade war. It emerged that the country’s shipments of a range of rare-earth metals critical to the production of electric vehicles have come to a halt after they were

subjected to export controls. The government also reportedly told Chinese airlines not to accept deliveries of Boeing aircraft. Meanwhile, China's exports rose sharply in March, an indication that companies rushed to fulfil orders before tariffs took full effect. That helped GDP grow by a robust 5.4% in the first quarter, year on year.

Bank of America, Citigroup, Goldman Sachs, JPMorgan Chase and Morgan Stanley reported a surge in revenues from trading stocks in the first three months of the year, boosted by the volatility in the markets. Goldman's equity traders had their best quarter ever. Revenues from market trading at JPMorgan Chase were up by 21%, year on year.

Britain's annual inflation rate fell in March to 2.6%. Inflation is widely expected to pick up again later this year in part because of a steep rise in utility bills for households.

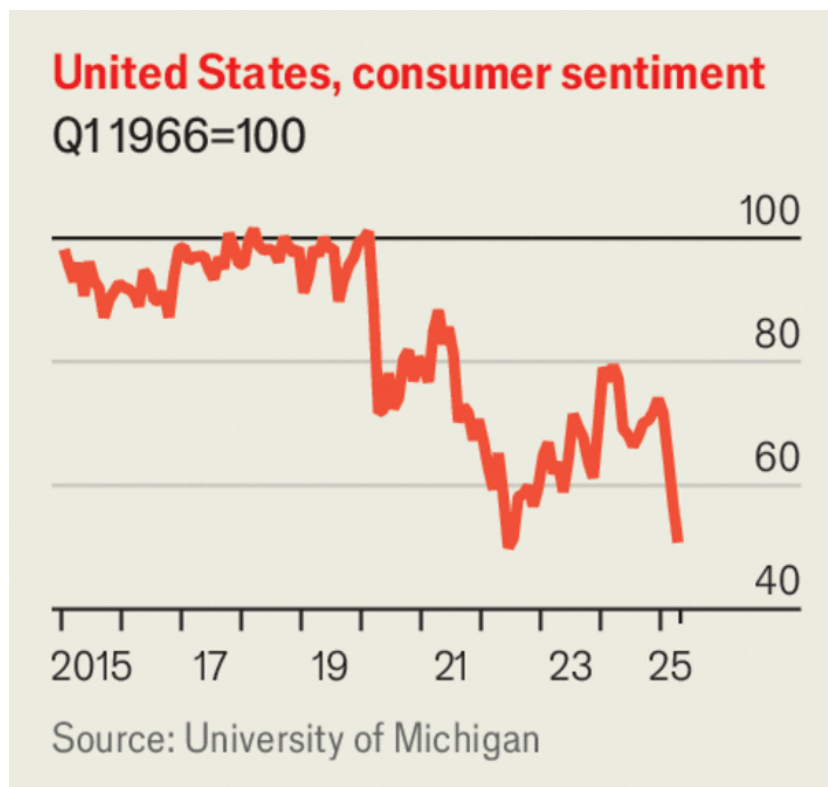


Chart: The Economist

A survey of American consumer sentiment published by the University of Michigan showed a sharp fall in April. The index registered a reading of 50.8. That was the second-lowest score since the survey began in 1952, though it was taken before Mr Trump announced some relief from his tariffs.

Expectations of higher inflation rose sharply. The decline in sentiment is “pervasive and unanimous across age, income, education, geographic region and political affiliation”, said the survey’s director.

The Federal Trade Commission’s antitrust trial against Meta got under way in Washington. The regulator argues that the acquisitions of Instagram in 2012 and WhatsApp in 2014 by Facebook, as it was then, were intended to hobble competition and that Meta has since built “monopoly power” in personal social-networking, a narrow definition that excludes the likes of X and LinkedIn. If the FTC wins its case Meta could be forced to break up its social-media empire.

Intel struck a deal to sell a 51% stake in its Altera business to Silver Lake, a private-equity firm, for \$4.5bn. It is Intel’s first big sale of a non-core asset since Lip-Bu Tan became chief executive in March. The deal values Altera at \$8.75bn. Intel paid nearly \$17bn for it in 2015.

The Chinese owner of British Steel, Jingye Group, said that it was on the brink of closing Britain’s last blast furnaces in Scunthorpe, warning that the plant was losing £700,000 (\$925,000) a day. The closure would have left the country as the only G7 member without primary steel production. The government recalled Parliament to pass emergency legislation to keep the facility going and give the government direct control over British Steel. A £2.5bn fund will help maintain production.

NATO announced that it had recently procured Palantir’s Maven Smart System, which provides AI military capabilities to the alliance’s operations and “data-enabled warfighting”. It was one of NATO’s quickest ever procurements, taking only six months from outlining the requirements to obtaining the system.

## **Handbags at dawn**

LVMH’s share price slumped after it announced a steep decline in sales of fashion and leather products. Demand remained subdued in China, which used to be a big source of growth for the luxury-goods industry. In a bad week for LVMH its stock fell so far after its announcement that its market capitalisation was overtaken by Hermès, a rival Parisian luxury house that it had once tried to buy.

Leaders | Biting the hand that funds

## How a dollar crisis would unfold

If investors keep selling American assets, a grim fate awaits the world economy

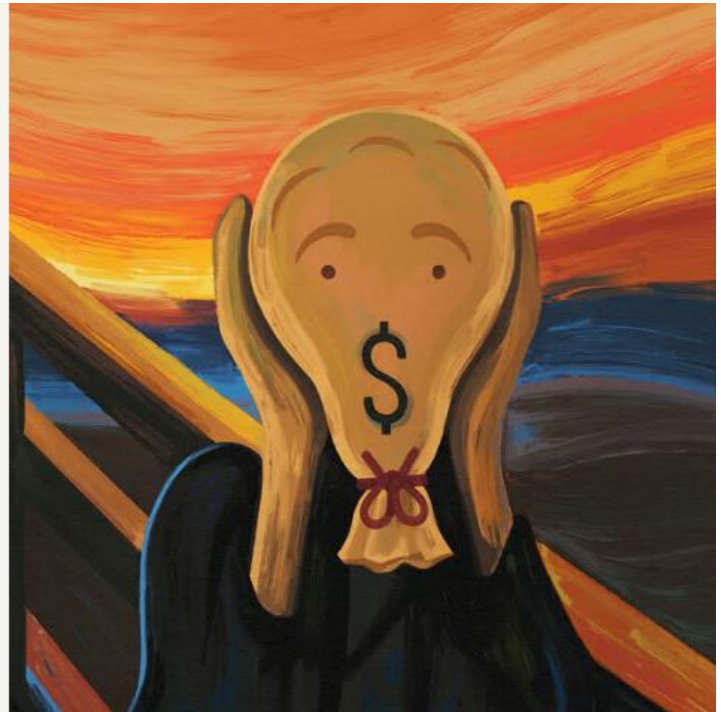


Image: Pete Ryan

THE DOLLAR is meant to be a source of safety. Lately, however, it has been a cause of fear. Since its peak in mid-January the greenback has fallen by over 9% against a basket of major currencies. Two-fifths of that fall has happened since April 1st, even as the yield on ten-year Treasuries has crept up by 0.2 percentage points. That mix of rising yields and a falling currency is a warning sign: if investors are fleeing even though returns are up, it must be because they think America has become more risky. Rumours are rife that big foreign asset managers are dumping greenbacks.

For decades investors have counted on the stability of American assets, making them the keystones of global finance. The depth of a \$27trn market helps make Treasuries a haven; the dollar dominates trade in everything from goods and commodities to derivatives. The system is buttressed by the Federal Reserve, which promises low inflation, and by America's sturdy governance, under which foreigners and their money have been welcome and secure. In just a few weeks President Donald Trump has replaced these ironclad assumptions with stomach-churning doubts.

This crisis-in-the-making was created in the White House. Mr Trump's reckless trade war has raised tariffs by roughly a factor of ten and created economic uncertainty. Once the envy of the world, America's economy is now courting recession, as tariffs rupture supply chains, boost inflation and punish consumers.

This comes as America's historically bad fiscal position is becoming even worse. Net debts stand at about 100% of GDP; the budget deficit over the past year, of 7%, was astonishingly high for a healthy economy. Yet in its quest to renew and extend tax cuts from Mr Trump's first term, Congress wants to borrow still more. On April 10th it approved a budget blueprint that could add \$5.8trn in deficits over the next decade, according to the Committee for a Responsible Federal Budget, a think-tank. That would boost the deficit by another 2 percentage points and exceeds the combined total value of Mr Trump's first-term tax cuts, the extra spending in the covid-19 pandemic and Joe Biden's stimulus and infrastructure bills. It could double the pace at which the debt-to-GDP ratio rises in the coming years.

What makes this economic downturn and the loss of fiscal discipline so explosive is the fact that markets are starting to doubt whether Mr Trump can govern America competently or consistently. The shambolic, incoherent way the tariffs were calculated, unveiled and delayed was a mockery of policymaking. On-again, off-again exemptions and sectoral tariffs promote lobbying. For decades America has carefully signalled its dedication to a strong dollar. Today some White House advisers are talking about the reserve currency as if it were a burden to be shared—using coercion if necessary.

Inevitably, this puts the Federal Reserve under strain. Mr Trump is pressing the central bank to cut interest rates. The courts are likely to stop him sacking Fed governors at will, but he will be able to nominate a pliant new Fed chair in 2026. Meanwhile, the president's other policies—such as shipping undocumented migrants to El Salvador without a hearing, or harassing law firms that displease him—make it possible to think that foreign creditors' rights could suffer.

All this has created a risk premium for American assets. The shocking thing is that a full-blown bond-market crisis is also easy to imagine. Foreigners own \$8.5trn of government debt, a bit under a third of the total; more than half of that is held by private investors, who cannot be cajoled by diplomacy or threatened with tariffs. America must refinance \$9trn of debt over the next year. If demand for Treasuries weakens, the impact will quickly feed through to the budget, which, owing to high debts and short maturities, is sensitive to interest rates.

What would Congress do then? When markets collapsed during the global financial crisis and the pandemic, it acted forcefully. But those crises required it to spend, not to impose cuts. This time it would need to take an axe to entitlements and raise taxes quickly. You need only consider the make-up of Congress and the White House to see that the markets might have to impose a lot of pain before the government could agree on what to do. As America dithered, the shock could spread from Treasuries to the rest of the financial system, bringing defaults and hedge-fund blow-ups. That is the sort of behaviour you would expect in an emerging market.

The Fed, for its part, would face a painful dilemma. It could buy assets to steady the ship. But it would not want to appear to be monetising the debt of an uncreditworthy government—an especially risky move when inflation is high. Could it strike the balance between emergency lending and monetary financing? And if it was not bailing out Mr Trump, would he approve of it lending dollars to foreign central banks that lack liquidity, as it usually does in a crisis?

A currency is only as good as the government that backs it. The longer America's political system fails to grapple with its deficits or flirts with chaotic or discriminatory rules, the more likely will be a once-in-a-generation upheaval that pushes the global financial system into the unknown. Wherever things settled, the greenback's diminished role would be a tragedy for America. True, some exporters would benefit from a weaker currency. But the dollar's primacy reduces the cost of capital for everyone, from first-time homebuyers to blue-chip firms.

### **Biting the hand that funds**

The world would suffer because the dollar has no equal—just pale imitations. The euro is backed by a big economy, but the euro zone does not produce enough safe assets. Switzerland is safe but small. Japan is big, but has its own vast debts. Gold and cryptocurrencies lack state backing. As investors tried one asset and then another, the hunt for safety could bring about destabilising booms and busts. The dollar system is not perfect, but it provides the stable ground on which today's globalised economy is built. When investors doubt America's creditworthiness, those foundations are in danger of cracking.

## Finance & economics

# How Trump might topple the dollar

For the first time in many decades, the greenback looks vulnerable

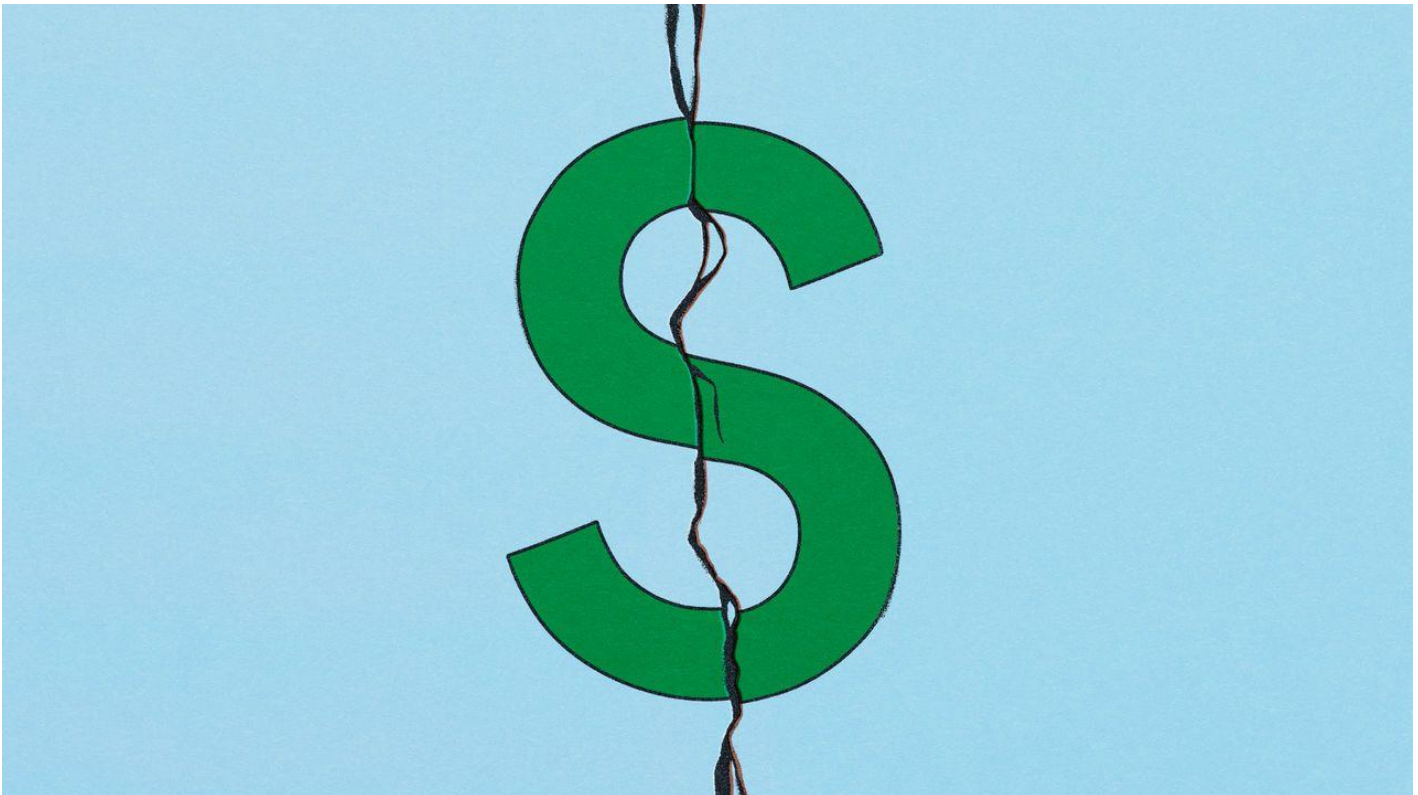


Illustration: Alberto Miranda

Stocks down, yields down, dollar up. A reliable relationship between America's listed companies, government bonds and the value of the currency has held, in moments of panic, for most of modern financial history. Until now.

The turmoil in financial markets over the past month, driven by an extraordinary rise in American tariffs, has been unsettlingly different. During the stockmarket slumps of 2008 and 2020, for instance, the dollar rose. When investors are fearful, they normally rush to the safety of American debt, bidding up the greenback in the process. This time round, investors are eschewing Treasuries. Yields on American ten-year government bonds, which rise when prices fall, have increased from 4.2% to as



high as 4.5% over the past month. Meanwhile, the dollar has fallen by over 9% against a basket of other currencies since its peak in mid-January.

The breakdown of the once-solid relationship reflects the impulsiveness of the current American government. President Donald Trump’s belligerent trade policy, his administration’s incompetent policymaking and some of his advisers’ suspicion about the dollar’s global role have shaken foreign investors. Since they hold some \$32trn-worth of American stocks and bonds, their opinion matters. Overseas demand not only lifts American stockmarkets, it pushes down interest rates on the government’s vast debts, making them manageable—a feature of dollar dominance known as “exorbitant privilege”.

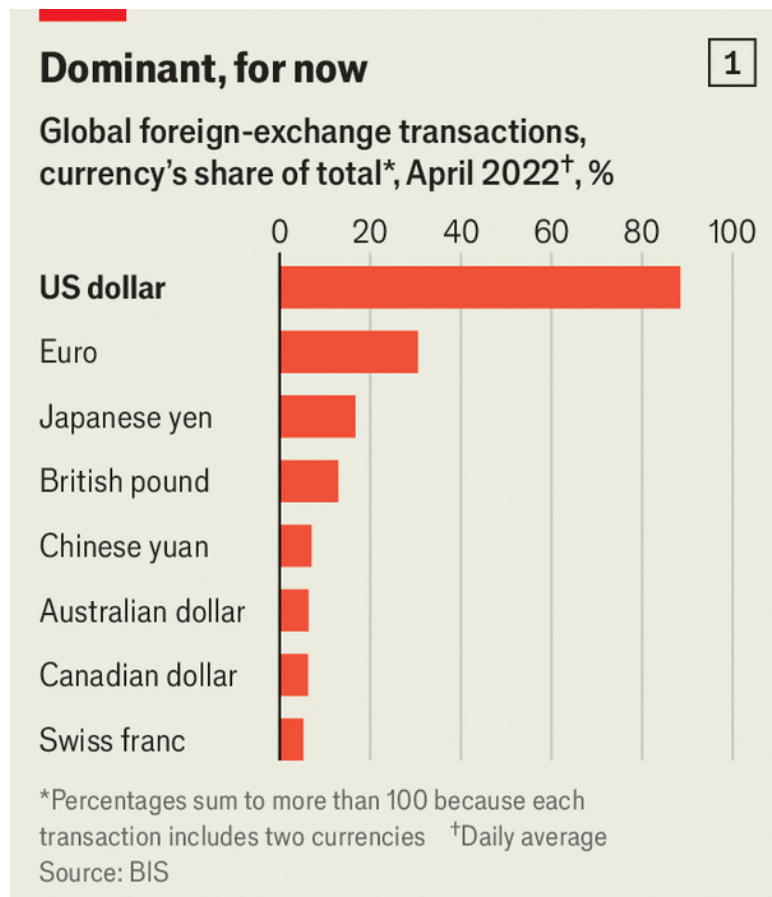


Chart: The Economist

Policymakers and investors everywhere once rolled their eyes at the idea of the dollar being dethroned. America’s economic heft, deep and profitable markets, openness to capital flows and reliable rule of law all helped make its position formidable. But in recent weeks, they have had to take the notion more

seriously. Even imagining what might come next is hard. For eight decades, America’s currency has been the linchpin of trade and finance. About half of all lending across borders is in dollars, and the currency is involved in 88% of foreign-exchange transactions (see chart 1). The modern world has been built on the greenback.

Some members of the Trump administration would cheer if the dollar lost its crown. During his time as a senator, J.D. Vance, now the vice-president, was critical of the currency’s international role, arguing that the accumulation of American securities by foreigners had artificially lifted its value, damaging American industry. In November Stephen Miran, now head of the White House’s council of economic advisers, published a briefing suggesting the president could unilaterally tax Treasuries held as reserves overseas, so as to discourage investors from purchasing them. Rarely has a single paper so spooked central bankers around the world.

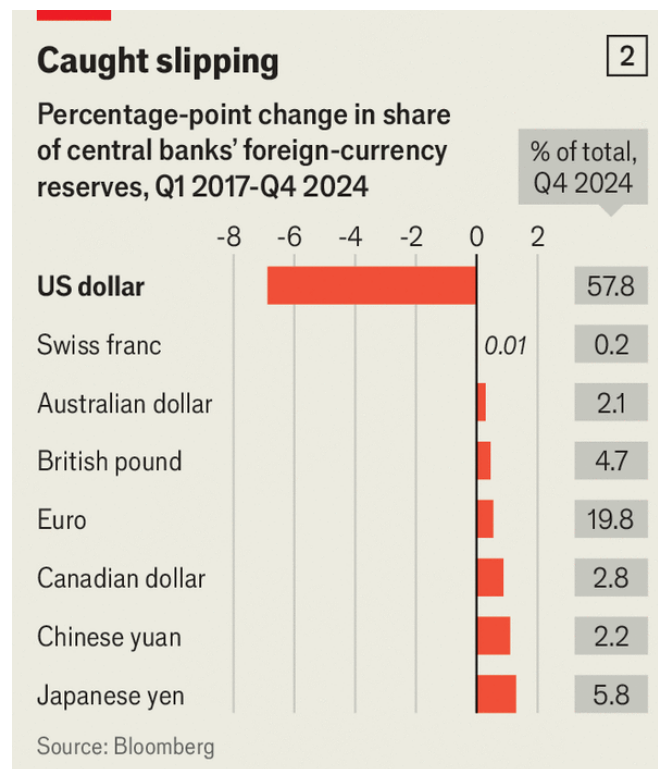


Chart: The Economist

Policymakers overseeing foreign-exchange reserves had begun to diversify well before Mr Trump won re-election (see chart 2). Some fear America’s Treasury, and its ability to impose sanctions; others simply want to ensure their eggs are not all in one basket. The dollar’s share of global reserves has declined from 73% in 2001 to 58% today. Over the same period, a wide variety of currencies—

including the Australian and Canadian dollars, the Swedish kroner and the Swiss franc—have seen their share rise. Central banks have diversified out of currencies, too, buying more than 1,000 tonnes of gold in each of the past three years, an increase of more than 140% on the three before that.

Such diversification will only accelerate, reckons Gary Smith of Columbia Threadneedle Investments, who works with central banks and sovereign-wealth funds. Before America’s tariff barrage got under way, Mr Smith had expected that the dollar’s share of reserves would decline by another ten percentage points over the forthcoming decade. It is now clear that was a sizeable underestimate, he says.

### Looking a little green

Over the past decade, international demand for dollar assets has mostly come from sources other than central banks, particularly giant government pension funds and life-insurance companies, many in Asia (see chart 3). These often have investments that run into the hundreds of billions of dollars, which are directed by committees that meet irregularly—meaning their strategy cannot turn on a dime. Despite this shock-absorbing feature, their enthusiasm for America has diminished. “Many international investors are fretting about the end of US hyper-exceptionalism,” says Huw van Steenis of Oliver Wyman, a consultancy. “The need for better diversification will be the lasting conclusion of whatever happens from here.”

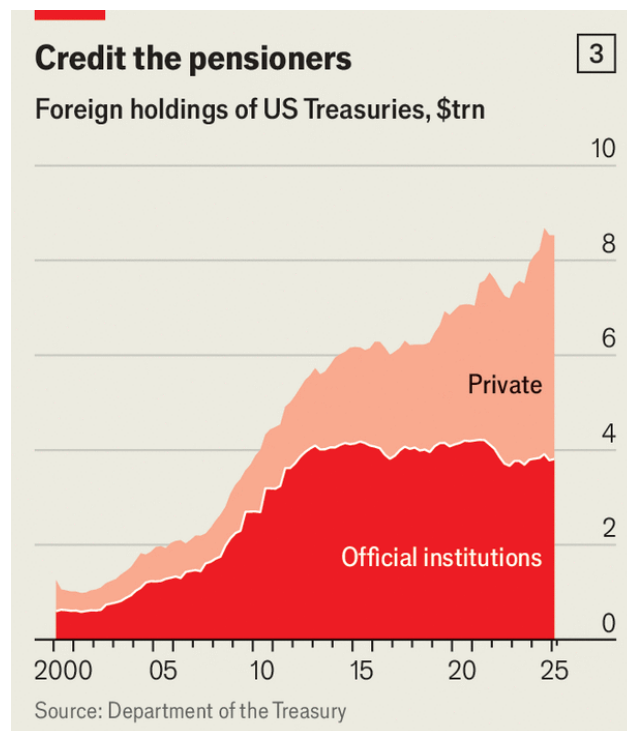


Chart: The Economist

Even if dollar dominance is only diminished at the margin—with institutions reducing their holdings of American assets, rather than fireselling them—that will make America's fiscal profligacy much more difficult to maintain. The government runs a budget deficit worth 7% of GDP and its interest bill has ballooned in recent years, meaning higher bond yields would cause profound problems. On April 10th the House of Representatives approved the Senate's plan for a budget that could add \$5.8trn to deficits over the next ten years, according to the Committee for a Responsible Federal Budget, a think-tank. That is more, in cash terms, than Mr Trump's first-term tax cuts, the response to the covid-19 pandemic in 2020 and President Joe Biden's stimulus and infrastructure bills combined.

Overseas investors do not lack for reasons to park their money elsewhere. Yet those looking to limit exposure to Mr Trump's whims face a challenge: the dollar has no obvious successor. Following the second world war, when Britain's immiseration meant that the pound could not function as a global currency, the greenback was a perfect candidate to replace it. The currencies into which central bankers are today shifting their investments are relative minnows, with stock and bond markets too small to replace the dollar.

The euro was once seen as a possible replacement for the greenback. It may eventually prove to be so, if the continent's politicians take advantage of the present opening. But investors will want proof that the design flaw in the currency union—credit risk in its government debt, arising from uncertainty about which borrowing will ultimately be backstopped by the European Central Bank—truly has been resolved. Germany's debt, regarded as the safest kind by global investors, runs to \$3trn or so, around a twelfth of the American total. Europe's corporate-debt markets are also small.

Could the yuan climb the currency hierarchy? Although China's economy is big enough to support a far larger role, progress in internationalising the currency has been halting at best. The yuan makes up just over 2% of global central-bank reserves, a figure that has declined since a peak four years ago. Chinese officials show no interest in scaling back their extensive capital controls, a move that would be required to entice foreign money. And the state's occasional and unpredictable shakedowns of the private sector have been more damaging than any policy pursued by the Trump administration.

Instead of liberalising its currency, China wants to fortify its financial system against America. The People's Bank of China has established swap lines with central banks overseas, and set up its own platform for overseas payments to reduce reliance on SWIFT, a messaging system for bank payments based in Belgium. Such experiments will not see the yuan supplant the dollar. But, according to Martin Chorzempa of the Peterson Institute for International Economics, another think-tank, they may limit the influence of the greenback beyond America's borders, providing an alternative to countries that have been severed from Western finance.

## The dirtiest shirt

If America's government degrades the dollar's role, whether by design or by accident, other countries may try to defend themselves by throwing up barriers to capital and falling back on new and less sophisticated financial networks. Without a true successor, the result would probably be a world of competing currency blocs, inadequate alternatives to Treasuries, barriers to trade and reduced efficiency. The past few weeks have been a taste of such a future—and they have not been pleasant.

# Poor countries would miss King Dollar

Even though they normally like a weaker greenback

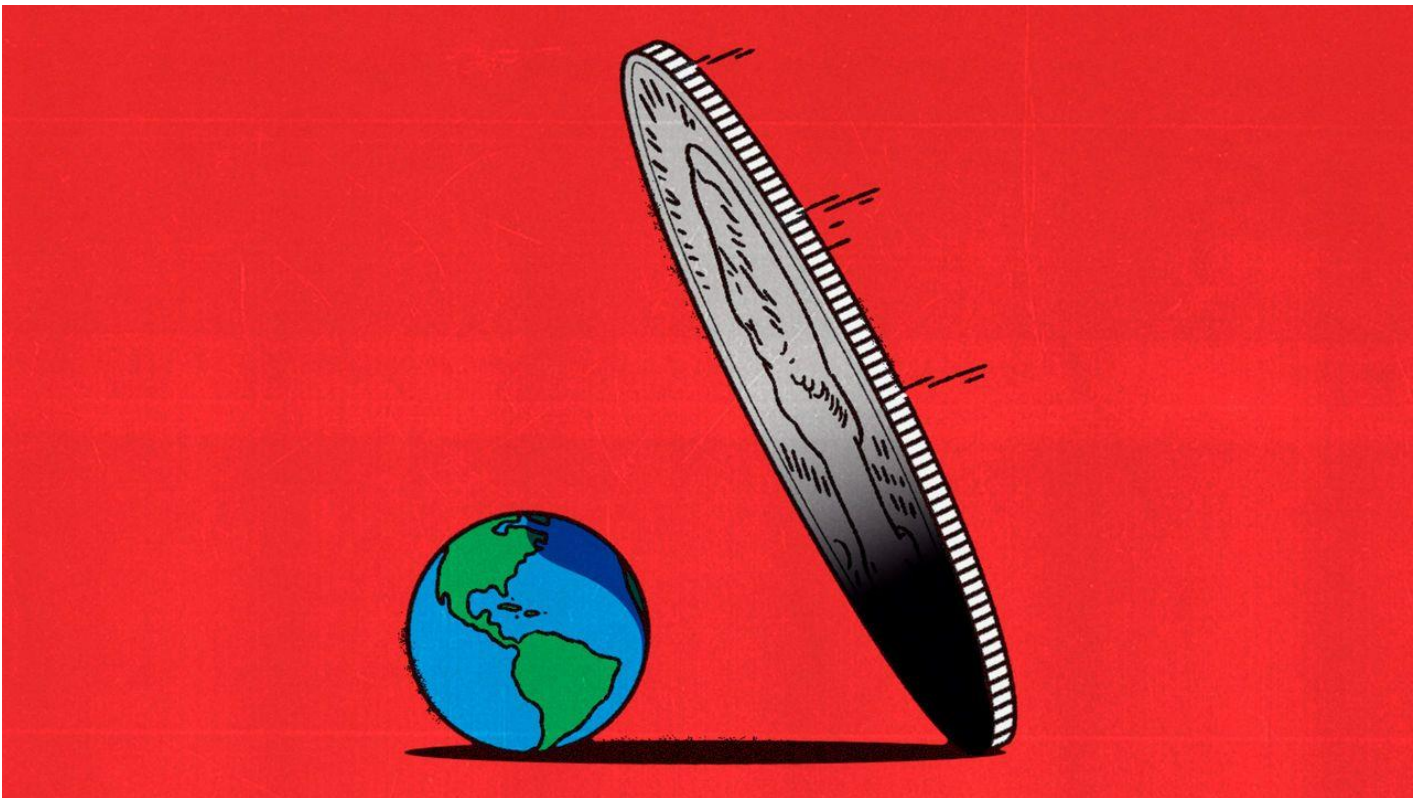


Illustration: Alberto Miranda

A falling dollar is normally good for the developing world. Because poor countries borrow more in the greenback than rich ones, their debt bills become less burdensome. At the same time, imports become cheaper, providing a balm to foreign reserves that are often stretched, and investors become more optimistic. So it was from 1971 to 1978 (the last time poor countries really splurged on infrastructure) and from 2004 to 2008 (when commodity exporters became unexpectedly flush)

This time things will be different. Since April 1st the dollar has dropped by 4% against a basket of rich-world currencies and a Treasury sell-off has threatened its position as the world's reserve currency. Yet emerging economies are more vulnerable than before Donald Trump's tariff announcement. Today's dollar weakness reflects not a typical downturn, but Mr Trump's bid to reshape the global trading order. A combination of weaker American demand and higher trade barriers will hurt economic growth in poorer countries, which depends on exports. Cheaper dollars will not cushion the blow.

An MSCI index which tracks 24 currencies relative to the dollar is up by 0.5% since April 2nd, when Mr Trump let loose his tariffs on the world, hardly enough to boost governments' balance-sheets. Countries that will be hit hard by Mr Trump's measures, including those in "Factory Asia" and many in Africa, have seen their currencies fall even more sharply than the dollar. Vietnam's dong plunged to a record low on April 8th, for instance. Even after Mr Trump rolled back many of his levies, few have recovered their losses. Meanwhile, stockmarkets are struggling even more—since April 1st, the Dow Jones emerging-markets index has fallen by 4%—and, according to Schroder's, an asset manager, the value of emerging-markets corporate credit is falling, too.

Poor economies tend to grow by selling to consumers in rich ones. In the best-case scenario, goods that would have gone to America will now head to China and Europe, albeit at a discount and with the expense of navigating new borders and markets. In the worst-case scenario, big economies might raise their own trade barriers in order to protect domestic industries. Emerging markets are struggling with both tariffs and the uncertainty they engender. The combination has sent growth forecasts into the red, and pushed up risk premia (the extra costs that poor countries pay to borrow) on bonds and stocks. This shock may drive central banks to cut interest rates. That, in turn, would wipe out any remaining benefits of a weaker dollar for government balance-sheets.

Indeed, the cost of borrowing in dollars has already increased for emerging economies, according to JPMorgan Chase. The bank's index of yields on emerging-market sovereign bonds is now 0.8 percentage points above its five-year average. It is not just the most heavily indebted countries, such as Pakistan and Sri Lanka, that are affected. So far this month no emerging market has issued any foreign bonds, according to Tellimer, a research firm.

Whereas developing countries will adapt to the trade shock, the dollar may be gone for good as the world's dominant currency. Barry Eichengreen of the University of California, Berkeley, does not expect any single currency to claim its crown, with dollars, euros and yuan vying for supremacy. In this world, nobody would benefit much from "exorbitant privilege", the discount on borrowing America now enjoys.

Developing countries would be even worse off, however, since they would bear the risk of the transition. Central banks in the world's poorest countries might get caught out as they attempt to manage decades-long dollar obligations while financing imports and investments in euros or yuan. Most would have to choose one of the three big currencies, Mr Eichengreen believes. Imports and exports would then orientate towards other countries in that bloc, representing a temporary but extra cost for companies; transactions between blocs, meanwhile, would be hostage to geopolitical tension. The dollar's loss may be good news for China and Europe. It is anything but for the rest of the world.

## Stockmarkets do not reward firms for investing in Trump's America

*The perils of reshoring*



Illustration: Satoshi Kambayashi

What do the following three companies have in common? Stellantis, owner of the Fiat, Jeep and Chrysler brands; Merck, which makes the world's bestselling cancer drug; and Barry Callebaut, a Swiss chocolate-maker, which is particularly proud of its ruby flavour, neither sweet nor bitter.

One answer: their capital-expenditure (capex) plans. All three have announced investments in America since Donald Trump won last year's presidential election. In January Stellantis (whose largest shareholder part-owns The Economist's parent company) said that it would build the next Dodge Durango in Detroit and reopen an assembly plant in Illinois, putting union members back to work. Two months later Merck announced the opening of a vaccine plant in North Carolina. And on April 10th Barry Callebaut said it would expand a plant in America to help it cope with the "disruptive environment" Mr Trump's new administration has created.

Mr Trump is, of course, delighted by this kind of news. The White House added the chocolate-maker to a list of more than two dozen companies that have announced investments in America since the president's return to power. "We are already seeing progress in reshoring American industry," it said.

The spending is presumably good for America. But is it good for the companies themselves? Even the president should care about this question. Trump Media, one of his firms, has just launched new investment accounts that let people bet their money on MAGA themes like "Made in America". So do capex announcements that gratify Mr Trump also please shareholders?

In theory, the answer is ambiguous. The impact of capex on a company's share price can be sweet, bitter or neither. An optimistic view is that such spending ought to lift share prices. Why else would companies do it? Managers have strong incentives to care about what shareholders think. And shareholders have reason to defer to a firm's judgment about the deployment of capital. That is, after all, why investors entrust their capital to a firm in the first place.

Other theories are less optimistic. Institutional investors may have short time horizons, punishing any costly plan that privileges distant years over the next quarter. Alternatively, managers may have skewed incentives of their own. They may be tempted to build a corporate empire with money that would be better returned to shareholders. According to a third, "efficient markets" view, investment is neither bitter nor sweet. A company's share price will already reflect its expected capital outlays in the future. Capex announcements will move the price only if they deviate from these expectations.

Most studies find that share prices respond positively to capex announcements, if only weakly. The firms showcased by the White House have a couple of extra things going for them. Moving production to America will help them escape Mr Trump's tariffs, as he himself points out. Another potential benefit is winning the president's goodwill. Indeed, some bosses made their announcements standing alongside Mr Trump.



Despite all this, shareholders appear unconvinced. Of the listed companies that are featured in the White House press release, 20 have made firm capex announcements. In only 11 out of these 20 cases was the company's share price higher on the day after the announcement than on the day before. Moreover, 15 of these companies have underperformed their national equity market since Mr Trump won last year's election. A simple, equal-weighted average of these stocks has fallen by almost 12% in dollar terms since election day, compared with the 7% decline in the S&P 500 index of big American firms.

Many of the companies have idiosyncratic problems. Barry Callebaut has been hurt by the volatile price of cocoa. Merck has encountered weak demand in China for its otherwise successful human-papillomavirus vaccine. Stellantis bade farewell to its contentious chief executive in December.

And the firms' plans may reflect fear more than enthusiasm. Their decision to expand operations in America so early in Mr Trump's term could suggest they were unusually exposed to his tariff plans, and the "disruptive environment" levies have created. Certainly, for Stellantis, Merck and Barry Callebaut, Mr Trump's second term has not been a box of chocolates. Another thing all three have in common: a slump in their share price since election day of over 20%.

## Can the euro go global?

With the dollar faltering, European policymakers have an opportunity

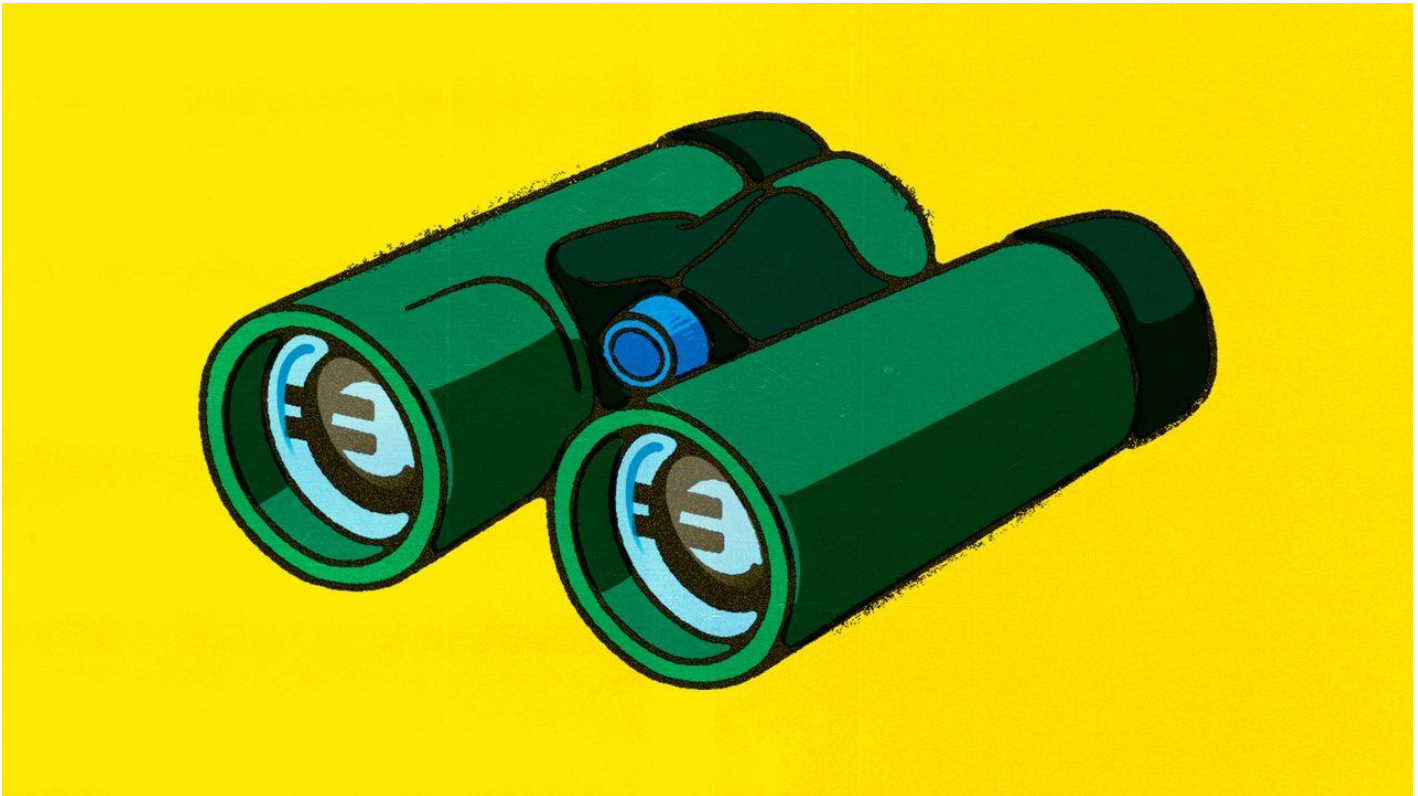


Illustration: Alberto Miranda

Europe's first reserve currency was the tetradrachm, upon which was inscribed an owl. The symbol of wisdom was intended to inspire trust in the rulers of ancient Athens. Indeed, the bird features on the Greek version of the €1 coin today.

That is not the only way in which the tetradrachm would be recognisable to modern economists. As Barry Eichengreen of the University of California, Berkeley, notes, across history every leading currency has belonged to a republic or democracy; Athens was the latter. Restraint on the powerful, as provided by voters, promises a degree of stability—a crucial ingredient, along with a large economy and military might, for any reserve currency. It is the absence of such stability in America today that is prompting investors and policymakers to question the dollar's role as the world's reserve currency.

With the greenback struggling, could this be the euro’s moment? Both Christine Lagarde, president of the European Central Bank (ecb), and Paschal Donohoe, head of the Eurogroup, a forum for euro-zone finance ministers, have recently spoken about ways to enhance the currency’s international role. The euro is not about to supplant the dollar. But it may serve an increasingly important function. And if policymakers seize the moment, potentially epochal shifts in the global financial order could work to Europe’s benefit.



Chart: The Economist

Since its birth in 1999, the euro has been a contender for global status. In the run-up to the financial crisis of 2007-09, European officials were hopeful that it might, in time, rival the dollar. Then came the euro crisis of the 2010s. The ECB was not set up to be a lender of last resort, which made government bonds vulnerable to runs. Europe’s banking system was split along national lines and prone to doom loops connecting shaky sovereign debt with shakier financial institutions. Capital markets were too small to compensate for such risk. The euro zone provided few safe assets for those looking to park cash: bond issuers were either too parsimonious (in the case of Germany) or lacked credibility (in the case of Italy and Spain). Common debt, backed by the whole bloc, barely existed. Dismal economic-growth prospects then forced short- and long-term yields below zero. With European assets offering low returns, there was little demand for euros, and no global role for the currency.

## Shifting plates

Today the euro is a solid but distant second to the dollar, counting for a fifth of global central-bank reserve holdings against the greenback's three-fifths, with similar numbers for foreign-currency bond issuance. Over the past decade, as the world has gradually diversified away from the dollar, the euro has struggled to gain ground. Yet some European officials now believe that may change, for four reasons.

The first is that the euro zone's financial architecture has become more secure. The ECB has emerged as a lender of last resort in all but name, a process that began in response to the euro crisis under Mario Draghi, then the central bank's president. During the covid-19 pandemic the bank established a bond-buying programme with a budget of more than €1.8trn (\$2.1trn). When yields on sovereign bonds widened uncomfortably quickly amid inflation in 2022, policymakers set up an unlimited bond-purchasing scheme to prevent such spreads from blowing out in future.

Investors have also seen that the European Union will support struggling governments, and will do so in a generous fashion. During the pandemic, the bloc created a recovery plan worth €807bn, funded by common EU debt, to aid laggards. Moreover, the ECB is now firmly established as the supervisor of Europe's 114 largest banks, which together hold 82% of the continent's total banking assets.

On top of this, investing in Europe has become more straightforward—a second reason for optimism. Europe's pandemic-recovery fund created lots of common debt, and thus safe assets that are truly European. Germany is even about to start spending big, amid a continent-wide, deficit-funded binge on defence spending, which officials believe should rise from 2% to 3.5% of GDP in the coming years.

The third reason is that Europe's institutions now look more attractive, at least when compared with America's. Hard-right parties are strong and gaining ground in countries including Germany and France. One is in power in Italy. At the same time, however, the euro is the common currency of 20 sovereign states, and has a fiercely independent central bank overseeing it. Members would struggle to agree on any change to how the currency is governed, let alone the sort required to weaponise it for geopolitical gain. What is more, sanctions on other countries would require the consent of all 27 EU members. The rule of law is central to every aspect of the EU; the bloc's checks and balances are not in doubt. Nor is the broad consensus, forged over decades of compromise and conciliation, that the EU should be as open as possible to trade and foreign investment. The ECB has created a framework for providing euro liquidity to non-euro countries, which could be more attractive to crisis-stricken countries than the Fed's swap lines if Mr Trump continues on his current course. Nobody wants to give the American president leverage.

## Old continent, new tricks

And then there is the final reason for optimism: the state of international commerce. As America withdraws from global trade, Europe will come to play a more important role. Goods and services invoiced in euros will create ancillary markets in the currency, including in trade financing, insurance, and hedging derivatives for interest rates and currencies. Although over-the-counter (off-exchange) currency derivatives remain dominated by the dollar, interest-rate derivatives in euros have recently overtaken those in the greenback. New trade links will also lead to the creation of euro-based credit and deposit accounts across the world, which will, in turn, create demand for euro assets and, ultimately, euro central-bank reserves, since any lender of last resort must stock up on the currencies held by local financial institutions.

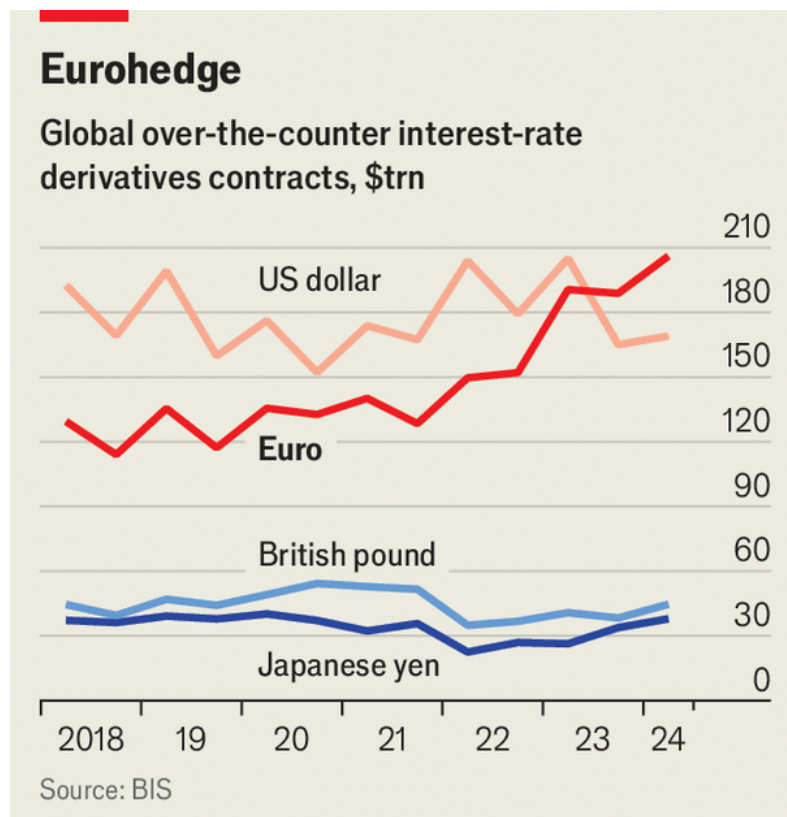


Chart: The Economist

Europe has a chance to assume leadership of a new liberal trading order, which would create opportunities to shape the financial system. Ursula von der Leyen, president of the European Commission, cheerfully notes how “many countries around the world [want] to work closer with us”. According to research by the ECB, in the 2000s the euro zone’s eastern neighbours began to invoice trade in euros because of closer commercial ties with the bloc; the same dynamic may now play out

elsewhere. Capital tends to follow geopolitical alignment. Research by Elisabeth Kempf, then of the University of Chicago, and co-authors finds that asset managers and banks invest less in countries led by governments with political leanings different to their own (as measured by their political donations or affiliations).

Yet such opportunities will not fall into the lap of European policymakers. Difficult reforms will be required, too. For a start, countries with lots of debt, not least France and Italy, will have to foster economic growth so that they remain fiscally sustainable, rather than adding to the pile of investible bonds simply to make their budgets work. Germany, the Netherlands and the Scandinavian countries face the opposite task: they need to use their fiscal space for investment, in the process creating safe assets. Economic growth across the EU would help lift returns of all euro assets, including government bonds, in turn making them still more attractive.

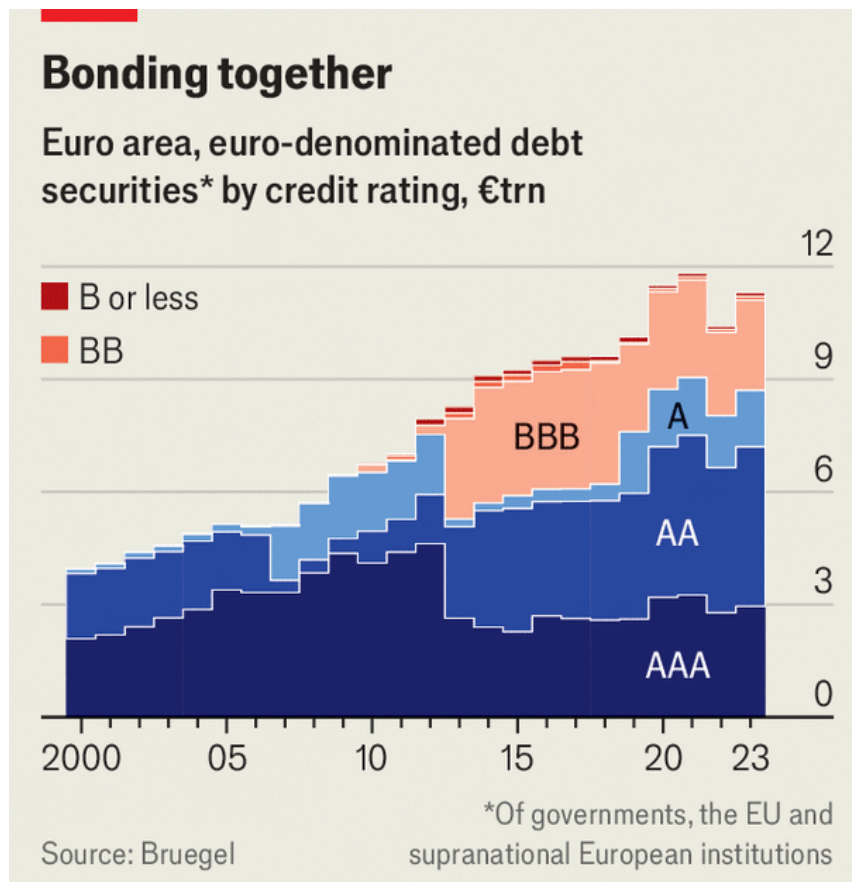


Chart: The Economist

Europe also needs larger and deeper capital markets to give investors more assets in which to put their money. Policymakers have so far focused on easy gains when seeking to tie fragmented national

markets together, concerning themselves with matters such as the process by which assets are securitised, rather than more contentious topics such as the harmonisation of bankruptcy laws and business regulation. Faster progress on the ECB's plans to connect third countries to its internal payments system would help, as would an international leg for the digital euro.

European officials would like to make the continent less dependent on both America and China. A more international euro would lower borrowing costs for national governments, which would be supremely helpful at a time of rising defence spending. For the moment, few politicians will spell out such ambitions, since they are aware that doing so would provoke the wrath of the Trump administration. But that does not matter. International finance has a logic of its own, and it can bring down currencies even in the absence of grand speeches. Just ask the Athenians.

# Technology AI models could help negotiators secure peace deals

Some are being developed to help end the war in Ukraine

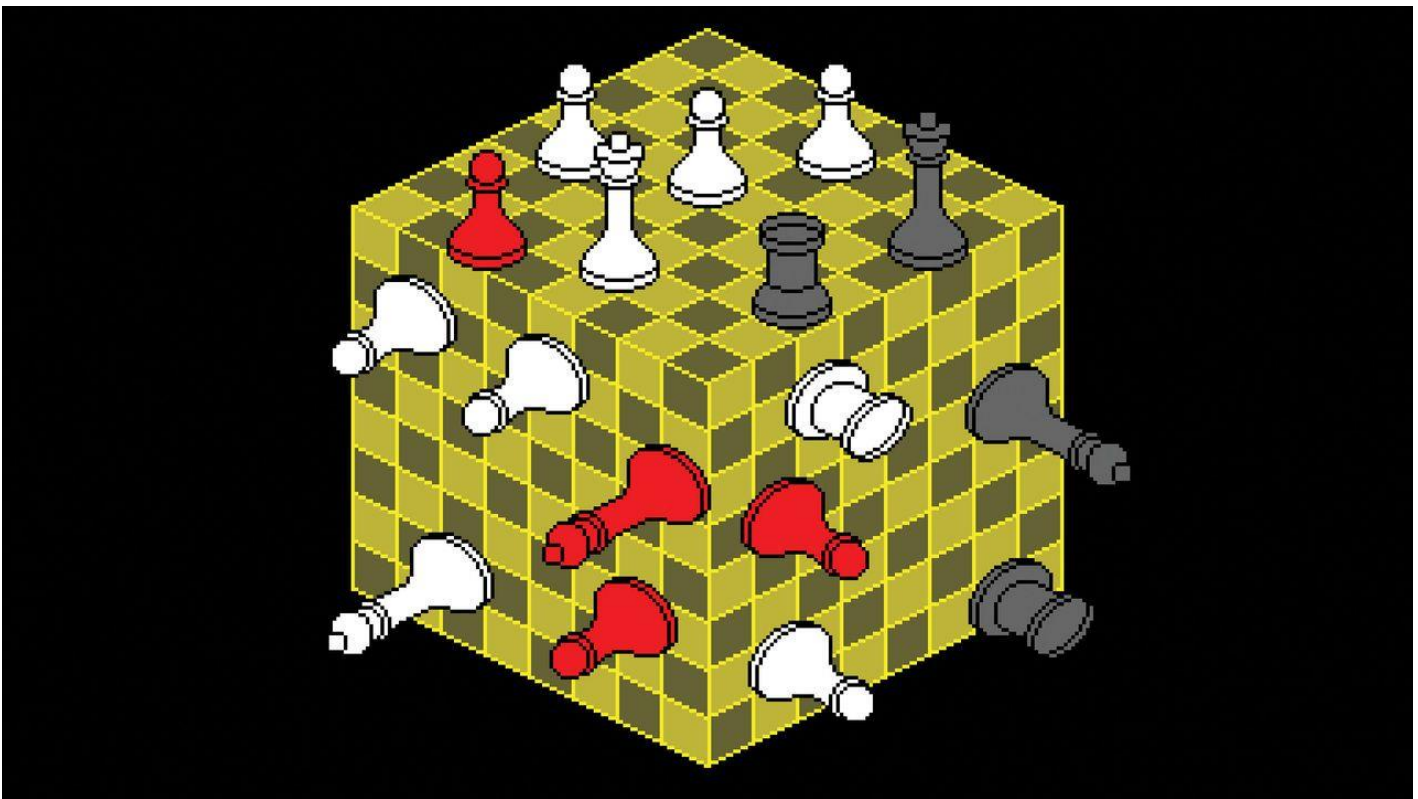


Illustration: Nick Little

IN A MESSY age of grinding wars and multiplying tariffs, negotiators are as busy as the stakes are high. Alliances are shifting and political leaders are adjusting—if not reversing—positions. The resulting tumult is giving even seasoned negotiators trouble keeping up with their superiors back home. Artificial-intelligence (AI) models may be able to lend a hand.

Some such models are already under development. One of the most advanced projects, dubbed Strategic Headwinds, aims to help Western diplomats in talks on Ukraine. Work began during the Biden administration in America, with officials on the White House's National Security Council (NSC)



offering guidance to the Centre for Strategic and International Studies (CSIS), a think-tank in Washington that runs the project. With peace talks under way, CSIS has speeded up its effort. Other outfits are doing similar work.

The CSIS programme is led by a unit called the Futures Lab. This team developed an AI language model using software from Scale AI, a firm based in San Francisco, and unique training data. The lab designed a tabletop strategy game called “Hetman’s Shadow” in which Russia, Ukraine and their allies hammer out deals. Data from 45 experts who played the game were fed into the model. So were media analyses of issues at stake in the Russia-Ukraine war, as well as answers provided by specialists to a questionnaire about the relative values of potential negotiation trade-offs. A database of 374 peace agreements and ceasefires was also poured in.

Thus was born, in late February, the first iteration of the Ukraine-Russia Peace Agreement Simulator. Users enter preferences for outcomes grouped under four rubrics: territory and sovereignty; security arrangements; justice and accountability; and economic conditions. The AI model then cranks out a draft agreement. The software also scores, on a scale of one to ten, the likelihood that each of its components would be satisfactory, negotiable or unacceptable to Russia, Ukraine, America and Europe. The model was provided to government negotiators from those last three territories, but a limited “dashboard” version of the software can be run online by interested members of the public.

The Futures Lab is also designing add-on models for the simulator. Each is a bot trained on studies of, and speeches and writings by, a different political or military leader. To help negotiators work out how China’s president, Xi Jinping, might react to a scenario, for example, an AI alter ego, dubbed “Xibot”, is being developed. The bots also stimulate creativity, says Benjamin Jensen, the lab’s director. His team has already produced three such AI “advisers” that reason in the distinct styles of George Patton, Genghis Khan and Sun Tzu.

Britain’s Foreign Office, meanwhile, is helping fund a more ambitious AI negotiations adviser that is being developed at the University of California, Berkeley. A lab there is training a model exclusively on documents relating to America’s NSC, including minutes of meetings that stretch back to 1951. The idea, says Andrew Reddie, the project’s leader, is to produce a versatile AI adviser for negotiators. The model will produce talking points in a wider range of “voices” than CSIS’s bot advisers.

Demand for such models is high, reckons a negotiator based in London who advises senior government officials in talks on war and peace. When discussions are in full swing behind closed doors, negotiators can lack a way to quickly gauge the opinion of superiors back home, says the adviser (who asked to remain anonymous owing to the sensitive nature of her work). She therefore often needs to pause talks

to make contact, which breaks momentum and gives the other side time to regroup. A negotiating team with an AI model that allows it to speed up its tempo in talks, she says, could gain an edge. A good simulator may also be able to flag potential sticking-points early, she adds, as well as helping negotiators see through the eyes of an unsavoury or unrelatable adversary.

Consummate AI diplomats of this sort are still some way off. In tests to identify differences in the negotiation styles of seven AI models, the Futures Lab found that some, including DeepSeek, Gemini and Llama, are particularly “escalatory”. In one scenario Llama opted to use force in a whopping 45% of runs. In other cases, notes Jacquelyn Schneider of Stanford University’s Hoover Institution, a model’s code may be overly conciliatory. Her team compiles data on how various AIs play war games involving negotiation, and briefs congressional staffers on the findings. The “risk-averse” camp includes GPT-4, an OpenAI model Dr Schneider describes as partial to “Obama’s foreign policy”.

Comparative analysis such as Dr Schneider’s could improve future models. So might a new AI project at DARPA, a research agency at the Pentagon. Called CODORD, it aims to convert natural human language about acceptable and unacceptable actions, as well as obligations, into code. That, it is hoped, will help models better hew to a human leader’s intent.

Futures Lab’s next step is to soup up its Ukraine-talks simulator with game theory, which models decision-making by predicting the likely actions of stakeholders based on their goals, motivations and levels of influence. Whereas language models make inferences from existing data, game theory employs deductive reasoning from first principles. Folding it in should give the simulator firmer footing to spot logical errors or unmerited results, says Yasir Atalan, a data scientist at the lab.

One game-theory model to be added is called “Competition in the Shadow of Technology”. Its equations, developed by Futures Lab to increase a country’s negotiating power, calculate the best time for secret military capabilities to be revealed.

The lab also has its eyes on a game-theory model called Predictioneer’s Game which, as a stand-alone system, has an impressive record. Its developer, Bruce Bueno de Mesquita, has used the model to advise clients, including America’s Central Intelligence Agency and the Pentagon, on subjects including nuclear negotiations with Iran and North Korea. A three-day session with the software (and Dr Bueno de Mesquita) can cost \$300,000. Though cagey with details, he says he currently discusses the model’s take on “a wide array” of crises with officials at the State Department.

The model has had impressive results. In 2023 Predictioneer’s Game forecast that peace talks on Ukraine would begin in early 2025. In the early days of the conflict in Gaza, the model laid out how

Israeli positioning might change if Yahya Sinwar and Ismail Haniyeh, two leaders of Hamas, were ever to exit the picture. That has been borne out by developments following their deaths in 2024, says Dr Bueno de Mesquita. Now 78 years old, he plans to publish the model's equations for anyone to use.

All this is heady stuff. AI's potential to reshape security talks, says Rose Gottemoeller, America's chief negotiator with Russia for New START, a treaty on nuclear arms that took effect in 2011, is "really remarkable". If the technology catches on, diplomacy may become a field in which AI models reach deals with one another. Whether humans can hold on to a seat at the table is up for discussion.

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