

Peterson Institute for International Economics

The Trump administration's policies and global financial risk

February 26, 2025, 9:00 AM to 10:00 AM EST

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[00:00:13.08] - Nicolas Véron

Good morning, good afternoon, good evening, wherever you are in the world. I'm Nicolas Véron. It's my pleasure to introduce this new session and, as I will explain in a minute, last session of the Financial Statement Series at the Peterson Institute for International International Economics. Last session, not because we're dissatisfied with the series, but we have decided at the Institute that given changes in the environment, we would adjust our portfolio of series and events. So we will be back soon. I will be back soon with more exciting productions at the Institute, but with a slightly different twist in terms of theme. It happens that this is the 100th episode of the Financial Statement series, and I couldn't be more proud of the work that has been done since the dark days of the COVID lockdown when the series started together with the one on Trade Winds, pioneered by Anabel Gonzalez and now spearheaded by Cecilia Malmström. We started in June 2020, 100 episodes, all thanks to Yvonne Priestley, who retired in the meantime, Jessica Parada, who is leading the effort now on the organizational side, and all the colleagues, Michal Roka, who heads the team for events at the Institute, JC Bascope, who gives indispensable technical support, as well as Femi Shiondende, the publications team of the Institute and communications, which have been incredibly helpful in, you know, all the visual and promotion of the series.

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And of course, the leader of the Institute, Adam Posen, who has suggested the idea in the first place and has been constantly supportive. Thank you all for having made this possible. And again, this is the new beginning, because we will be back soon with more. We're ending on a high note because I couldn't think of better speakers to tackle a very topical issue than Charles Goodhart and Agathe de Marais. Charles Goodhart needs no introduction, of course. He's one of the most titanic— maybe that's not the word— he's a titan of the global economic and financial analytical environment. He started economics at Cambridge. He got his PhD at Harvard in 1962, which is some depth of experience for the rest of us. He started teaching at Cambridge on the history of British banks. He then joined the Department of Economic Affairs in

the British government, the London School of Economics, and the Bank of England in 1968, where he was active for a long time until 1987 as a senior advisor. Since 1980, and then, of course, back at the London School of Economics since 1986 and now as Emeritus Professor of Banking and Finance. He co-founded the Financial Markets Group at the LSE with Mervyn King in 1986.

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It's become a leading center on financial stability and financial policy issues. He has authored far too many publications that I could cite. Even the most significant of them, it would be the entire hour. I will just mention a few books. *Evolution of Central Banks*, which is a real classic. *Of Central Banking Historiography* in 1988. Recently, in 2020, with Manoj Pradhan, *The Great Demographic Reversal: Aging Societies, Waning Inequality, and Inflation Revival*. I can say with very specific memories that Charles warned about the inflation revival before it was cool, and he got a fair measure of flak for that. In this, as in so many other issues, he was proven very wide—prescient? Sorry, I was groping for the word. And my personal favorite of course is *The Official History of the Basel Committee on Banking Supervision* published in 2011 and also a classic for the nerds. Agathe de Marais studied at Sciences Po Paris and at Columbia University New York. She got her degree, master's degree in both places in 2009 in economic policy and international finance. She worked during those years also at the US Embassy in Paris. After that, she was an analyst for BNP Paribas in Moscow and an economic analyst also for the French state in the Embassy of France in Moscow, then in Beirut.

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As you can see, she is well prepared for the kind of global perspective that we will embrace today. In 2017, she joined The Economist Intelligence Unit, which, as you know, is the economic consultancy arm of The Economist magazine and group. She became the regional director for Europe and the global forecasting director for the Economist Intelligence Unit. And in 2023, a bit less than 2 years ago, she joined the European Council on Foreign Relations as a senior policy fellow based in London. She authored a book called *Backfire: How Sanctions Reshaped the World Against US Interests* while she was at the EUI, published in 2022. And that's also very germane to our topic today. With that, and sorry for having been a bit long in my initial remarks, over to you, Charles. What should we worry about with the moves that surprise us every day of the Trump administration?

[00:05:41.10] - Charles Goodhart

There are so many scary things happening around the world nowadays that I hardly dare look at the news any longer. But I think I'd like to outline 4 things that in the financial field that worry me particularly. The first is financial stability. We are still at a time where asset prices are highly elevated, housing and equities. If you look at stock markets, there are sort of levels that have hardly been seen before. Under these circumstances where there'd been undoubtedly an asset boom over the last many years. It would be the time when normally one would think that it would be a right thing to tighten, uh, on regulation against the possibility that things could go wrong after a boom, particularly because one wants to lower regulations when difficulties actually do hit. But rather than tightening regulation, we are at a time when regulations are being, shall we say, best queried, at worst cast aside without much worry. And that means that if things do turn down, and things can go wrong, we could be in a year or two at very considerable risk. And the cry to weaken regulation in pursuit of growth is fine if it's done in moderation, but if you take it too far, you leave yourself exposed to considerable danger.

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Second thing that I want to talk about and worry about is fiscal dominance. We all in advanced economies but notably in the USA, are in a position where the debt ratios are very high, historically high. They've only been this high previously in periods of war, and wars fortunately end. If you look at the projections that are being made by the CBO, Office for Budget Responsibility in the UK, the outlook is still for the debt ratio to continue. And, uh, the new administration has just put its budgetary ideas before the House of Representatives, and they indicate that the debt is going to go on up. And that means that at some stage there's likely to be increasing concern about what all that implies for interest rates. And that means that governments are particularly likely to put increasing pressure on central banks to stabilize the situation by lowering interest rates and allowing the money supply to increase quite sharply. At those— under those circumstances, we could be in for severe inflationary pressures. And inflationary pressures which may lead those in power to start blaming inflation on individual price rises, and we could go back to price controls, wage and price controls.

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My third worry is about Europe. Uh, the fiscal position in Europe is in many cases as bad as it is in the USA, or nearly as bad. And Europe is marked with little unity, little leadership, and is now under much greater pressure from a combination of the need to raise defense expenditures considerably, and also there's a problem about increased tariffs. How Europe, which is in many cases, as in France, as Nicholas will know only too well, is not in very good shape politically. What— what— and the American economy is at least much more vibrant than the European economy. So how on earth is Europe going to cope under the added pressures that the Trump

administration is placing upon it? What's going to happen there? I find that very difficult to decide how it's going to work and what can be done. Um, finally, much more medium-term concern, uh, climate change. We're clearly not doing enough to reduce the upward movement in average temperatures, um, and at some stage it will become much harder for our economies to adjust. And by the time that there is a general public awareness that we have reached a point at which our lives and our economies and our societies may be under increasing pressure.

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It may be a bit too late to actually avert the different— the dangers. So just to repeat, those are my sort of four concerns: financial stability in a world that now seems keen to deregulate, fiscal dominance in a world where fiscal pressures are not under control, the weakness of Europe, particularly under the pressures imposed on it by the new American administration, and finally, uh, we're not doing enough on climate change, and in some cases countries are even moving away from their previous efforts to, to deal with that. So that's my set of worries for the moment. Enough, I think, to be getting on with.

[00:11:54.22] - Nicolas Véron

I'm sure we'll have more. Agathe.

[00:12:00.03] - Agathe Demarais

Thanks a lot, Nicholas. I'm delighted to be here with you all today. So I will actually add a fifth worry to the worrying list from Charles. And for this discussion, because it was also linked to Trump's coming to power, I thought I would add a few worries on my side about the impact of Trump's policies on the global financing and financial landscape, and more precisely, the risks that Trump will fuel further fragmentation of the global financial landscape. And I would say that there are 3 trends that I find really interesting to watch, and I would argue that Trump's coming to power will turbocharge these trends because a number of countries will be very keen to try to mitigate the uncertainty from Trump. And the uncertainty from Trump also means that these countries will want to reduce reliance on US-controlled financial channels. So the three themes that I'm taking a close look at at the moment, the first one is of course a big buzzword and it's about digitalization. I don't think that there is any chance the US dollar will lose its status as the global currency of choice anytime soon, but I think that we are starting to see trends towards digitalization, especially in countries that are at odds with the US.

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I'm thinking of Russia here, for instance. 3 years ago, Russia was using Western currencies for 80% of its cross-border trade. This share is now down to 20%. So under duress, this shows that it is possible in conflict scenarios especially to de-dollarize. And I think that we are also seeing this in China. China now uses the renminbi for around half of its global trade, including trade with Hong Kong. So that's quite significant from my perspective. That's the first brick in the edifice of fragmentation of the global financial landscape. The second brick is about alternatives to SWIFT. And here I think that it's really interesting to take a look at what is being done in China with CIPS. It's a much smaller alternative to SWIFT. SWIFT is the global Rolodex connecting all banks, but CIPS, the Chinese alternative, already connects around 1,600 banks around the world, including all American and all European banks. And what China is trying to do here is to have a backup, a Plan B, in case it were to be disconnected from Swift, as happened to Iranian banks in 2012. And this lesson wasn't lost on China. So I think that it's important to keep track of these developments because of course having access to Swift gives a lot of leverage and power to Western economies to also take a look at what's happening in terms of transactions.

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And then the final trend that I think is interesting to keep a close eye on is about the rise in central bank digital currencies. It's not crypto. I remember when we were having a, some thinking, um, Nicola, um, about what we could discuss today, we mentioned crypto, but it's not crypto. It's, it's really digital currencies that are stored on the wallets of people, central bank digital currencies. And these are actually completely, um, immune, not connected to Western financial channels. And we're seeing, of course, China doing things and having actually very serious developments in the field with the yuan, which is already used by 300 million Chinese people. We are also seeing some developments with the BRICS countries. Well, Russia didn't really manage to get some approval for BRICS Bridge, which would be some sort of a system for CBDCs to be exchanged between BRICS countries at the latest summit of the BRICS countries in Kazan. But I think we shouldn't discount these developments. So when we put it altogether, digitalization, alternatives to SWIFT, and also central bank digital currencies, these are my worries because when we put it all together, we can see that as time passes, there are great chances that countries that are at odds with the US or also groups involved in illicit activities could completely bypass Western financial channels.

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And I would argue that Trump's coming to power and the uncertainty related to Trump's actions in the financial field will probably turbocharge the adoption of these mechanisms. And this is

certainly something that worries me. So that would be my, my fifth worry to add to Charles' long list already. And I'll stop here for the conversation to start.

[00:16:23.05] - Nicolas Véron

So in a way, everything you talked about, Agathe, is about what is sometimes described in a laudatory or dismissive way as the plumbing. I'd like to turn back to Charles on that. How important is the plumbing?

[00:16:42.03] - Charles Goodhart

Oh, I think very, um, I— but one of the things that Agathe didn't mention is that the countries which now are less sure about American developments, uh, what else are they going to go for? I think the answer there is gold. And again, I think that Uh, the US is in the process of trying to ensure that the main gold market, uh, is in America, in Chicago COMEX, rather than in London. And, uh, that's again one of the areas, uh, the likely role of gold in future is I think an important area, and it actually feeds back into my concerns about fiscal dominance. Because if there is a greater worry about the debt sustainability in the US, one of the actions that I think that the Secretary of the Treasury will take will be to revalue gold from the— its present value that is held in the books to the present current market value, which would actually knock a very large chunk out of the calculated debt ratio that the US has. I have to say that rather sadly, uh, my own country, the UK, has actually sold virtually all our gold mistakenly, um, and we'd be one of the few countries, uh, which would get no benefit whatsoever from a revaluation of their gold hoards.

[00:18:35.15] - Nicolas Véron

We're back to the barbarous relic.

[00:18:39.16] - Charles Goodhart

Yes.

[00:18:40.20] - Nicolas Véron

Which is kind of depressing. Was a full 20th century of fiat money for nothing? I mean, is that— how do you look at it in long-term perspective?

[00:18:52.16] - Charles Goodhart

Well, it's again, this is a slightly different paragraph. Which is that insofar as the world is becoming even more divided than before, we've got the geopolitical fragmentation that Agathe mentioned, and we've got an increasing range of countries now including Europe concerned about their relationship with the United States so that you don't want to put all your eggs in the US T-bond market. What else do you do? And there really in many ways isn't another serious alternative to the US dollar except gold. Or does Agathe not agree with that?

[00:19:37.17] - Nicolas Véron

Agathe, I'd like to challenge you on the euro, maybe challenge you both, because on the face of it, the euro is convertible, the aggregate fiscal situation of the eurozone is not quite as bad as the US situation. Even so, some member states, of course, have, you know, question marks about their fiscal trajectories. And we see, including in recent days about defense, you know, one taboo being lifted after another in terms of fiscal mutualization in various ways. So, so in full awareness, of course, of what Charles told us about Europe being under much greater pressure. Would you champion the euro as an alternative, or is that a dead end?

[00:20:22.20] - Agathe Demarais

Well, of course I would, because I'm French. Well, but I would—

[00:20:26.20] - Nicolas Véron

I would go back to that. The universal correlation, actually, that's true.

[00:20:31.13] - Agathe Demarais

But I would, I would simply go back to the point about gold. I couldn't agree more with you, Charles, about gold. And actually, something that I found quite interesting is seeing February 2022 and the full-blown invasion of Ukraine as really a turning point, but not— well, actually maybe not a turning point, but an acceleration point for financial fragmentation. And that's a time when we saw many central banks pile on more gold. And I think that there was the question here also of having an asset that is sanctions-proof because everything is also linked at the end of the day with US sanctions policies. And I think that a number of countries today when we discuss these topics are also worried about the unpredictability of Trump in the field of trade, of course, but also sanctions. On the question about euro, so of course I would champion the euro. I think there are two ways to see the latest developments in Europe. I think on the one hand, it is very positive that we are seeing a lot of discussions these days about more defense spending, more innovation financing, you know, building on the Draghi report, but also more awareness that the EU is being left behind by the US and Chinese economies.

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And I think that there is this realization and maybe this wake-up call within Europeans to actually realize that we are gradually becoming less and less important and less and less relevant on the global economic scene. And of course, that's certainly not something that is a welcome development. But I think that there's realization, it's starting actually, some, many policymakers I would say, are starting to realize that this is certainly happening. And then on the other hand, there's the question of what do we make of Trump? Is he a threat or is he an opportunity for Europe to actually double down on the reference that Europe should be undertaking anyway? And my view is that Trump 2.0, this second term of Trump, is actually an opportunity for Europeans to have an inward look at their own weaknesses. I'm thinking of completing the single market here, for instance. There is a very interesting study from the IMF that shows that intra-EU trade barriers are equivalent to a 45% tariff on intra-EU trade. Well, that's certainly something that Europeans could take a look at. It's also a good time for Europeans to try to develop ties to developing economies through trade agreements.

[00:23:10.07]

Signing the EU-Mercosur free trade agreement would be a great development, of course, here. And I was mentioning innovation financing. You can see I'm not French. I think I'm one of the very few French people actually in favor of the deal. And the final one that I wanted to mention is really about innovation financing. And we are seeing this realization within well, among Europeans these days, that these are reforms that need to be done. So I would hope that Trump will actually be a wake-up call and an opportunity that Europeans can seize to undertake these reforms. But of course, that's not a given, and only time will tell.

[00:23:51.24] - Nicolas Véron

So Charles, go ahead.

[00:23:55.04] - Charles Goodhart

I wish I shared your optimism about the likelihood of Europe taking up this challenge to develop greater unity and greater purpose. And I look at the political situation in many of the European countries, including your own France and Germany and the Netherlands and Belgium, um, and it worries me. And until we get a more stable political situation, I don't see much likelihood of the kind of taking up your challenge that you would like to see. I wish I felt otherwise, but I don't. Are you optimistic that Europe will rise to this challenge?

[00:24:47.17] - Agathe Demarais

I would say—

[00:24:48.16] - Nicolas Véron

Yeah, sorry. I would say I— I would say I thought something, but go first.

[00:24:54.16] - Agathe Demarais

I think we will see changes. I am optimistic that we will see changes and I would actually, I agree with all of your points. I think my main idea is that if we Europeans avoid spending too much time responding to Trump, we'll actually be in a better place to implement the reforms that we need to implement anyway. And one of the reasons for that is that if we want to respond to Trump, to the tariffs, et cetera, et cetera, well, I think that there is a huge potential for political fragmentation among EU member states, because I struggle to see EU member states agreeing on how to respond to Trump in a very cohesive fashion. We have very varying degrees of reliance on the US as an export market, also as a source of imports. Some EU countries even want retaliation to follow WTO rules. Well, I think we would have a host of issues. So I think that the less we try to respond to Trump and the more we take this inward look, the better. Then the question is, will that be enough? I'm not entirely sure about this, but I'm an optimist. So I would hope.

[00:26:06.15] - Charles Goodhart

That's exactly why I don't think that the euro is a reasonable alternative to the dollar at the moment, because the potential for political fragmentation in Europe is now so large.

[00:26:23.19] - Nicolas Véron

So we're going to have more discussions about Europe at the Peterson Institute, actually. So I don't want this session to be only about that, even so that exchange to me was very illuminating on the trade-offs. I would like still to, to ask a question and directed to Charles about this. I mean, let's assume Europe doesn't change. Let's assume there is a certain continuity and stability from the current status quo, which is, as we know, halfway house full of risks, etc. But gold is not very scalable, as we know. So if there is a massive shift away from the dollar, if let's assume the dollar, heaven forbid, ceases to be viewed as a safe asset, isn't the euro the kind of only second best there is in the world, given that it is, with all its flaws, it is still, you know, it survived the eurozone crisis. It's a convertible currency. It has capabilities that gold doesn't have.

[00:27:24.04]

Charles

[00:27:24.25] - Charles Goodhart

I think at the moment, given the choice between holding gold and holding euros, I'd rather hold gold.

[00:27:31.25] - Nicolas Véron

That's a clear answer. Um, but, uh, but if you assume that trillions of dollars want to make that move, does it stay the same?

[00:27:41.18] - Charles Goodhart

Uh, there comes a point where gold would actually become so high the price would be so high. I think that it would be dangerous to do that. I don't think we're there yet.

[00:27:58.12] - Nicolas Véron

We're talking about tail risk today. So let's imagine, and we'll come back to the US situation, that there is a materialization of a tail risk that severely undermines the reputation of US dollar assets as safe assets.

[00:28:12.16] - Charles Goodhart

This is, I think, strongly against the aims and wishes of the Trump administration. I think that the Trump administration will do all that it can to maintain the dollar hegemony, and I think it was intending to do quite a lot. I waited, and I wait to see the policies that it's going to be introducing for that purpose.

[00:28:40.28] - Nicolas Véron

We're getting back slowly to our main topic here, but you still haven't answered my question. If hypothetically the dollar was to lose or to have its reputation severely undermined as a safe asset, wouldn't the euro be the kind of leader by default?

[00:29:00.14] - Charles Goodhart

Perhaps I might add that the pound is politically— and the political situation in the UK is not far from perfect, but at any rate, we've got a stable government, so that the— and it's got a massive majority. It doesn't have to go to the polls again for nearly 5 years, 4 and a half years. So given the choice between pound and the euro, I think I'd back the pound.

[00:29:29.24] - Nicolas Véron

Um, I have a question. We have a number of questions from the audience, and I'll come to them in a moment, but I still want to temporarily close the chapter on gold. Does any of you— I don't— know how much of European gold is held in the US at this point, of the gold reserves of the central banks of Europe, including the UK?

[00:29:52.07] - Charles Goodhart

The UK has very little gold reserves. And the answer is, I have no idea where the gold reserves of European countries are held, whether in New York Fort Knox or elsewhere?

[00:30:05.25] - Nicolas Véron

Well, I think Fort Knox doesn't have a lot of foreign gold, but New York certainly does. I remember the Bundesbank repatriating their own a couple of years ago, which was considered ridiculous at the time. I don't know what the current state is. Okay, let's move to the questions from the audience, and we have a number of them. I'll start with a question from Lena Komileva, which is about essentially the market reaction to Trump so far. So maybe starting with you, Agathe, have you been surprised that, you know, with, you know, some surprising stuff coming from the US government every day for some time, we haven't seen very, very much market turmoil?

[00:30:52.01] - Agathe Demarais

Well, I don't think that I would say I have been surprised, but I would say that financial markets will probably be one of the only potential restraining factors on Trump. Because I completely agree with Charles that the US administration is very keen to conserve the hegemony of the US dollar. And I think that financial markets movements will certainly be watched very closely in Washington, and that could be a restraining factor. I think that we've seen actually some movements around Tesla, if I'm not mistaken, over the past days, and this certainly signals that some people are not entirely happy with some of the new policies of the US administration. But I think that it'll take a bit of time before some of Trump's policies bite. That's also another factor. You know what I'm thinking of tariffs mainly. When you take a look at sentiment and especially sentiment among firms in the US, it has dropped quite steeply since Trump's coming to power

and starting to impose or announce the imposition of tariffs. And I think that But slowly this will bite and this will certainly be, from my perspective at least, a restraining factor on transactions, especially in the trade field, because of course tariffs are a tax and at the end of the day the tax will impose costs on American firms and American consumers.

[00:32:15.02]

So I would expect at some point that American firms will react and we'll see some movements on financial markets.

[00:32:22.28] - Nicolas Véron

Charles, Patrick Conahan asked a variant of the same question, and I'll read his question. Does the erratic behavior of the new US administration imply a new level of political risk in and from the US, which has not yet been priced in, into either bond or equity markets? What's your view?

[00:32:46.12] - Charles Goodhart

A difficult question. Um, one of the immediate impact of the election of the new administration, uh, was to provide a boost to, um, corporate confidence in the US because the new administration is strongly in favor of corporations, will reduce taxes. Particularly corporate taxes, and will reduce regulations which they regard as onerous on them. So there was, I think, naturally a bit of a sharp rise in equity and other prices and in confidence. However, the degree of uncertainty is so much, is so great that if you don't know what is going to happen, you tend to take no decisions, and you tend to put off investment and other decisions until the world becomes a bit clearer. And I think that uncertainty is now, uh, bearing down, uh, clearly not only on the US but more or less everywhere else in— pretty well in the world. So that's going to be a restraining, depressing factor which will come into effect. Again, we don't know what is going to happen in the tariff field. That's one of the main fields of uncertainty, and we don't know how that's going to play out, but the likelihood is it's not going to be good.

[00:34:32.24]

The effect of tariffs generally, and the retaliation is likely to be that inflation will be greater more or less everywhere and output will be less. So this will be a restrictive factor that will be increasingly bearing down on our— all our economies, which I think then reinforces my, my worry that at some stage The effects of all of this could lead to financial difficulties, both in the US, in Europe, and more widely yet in many of the southern countries of the world and elsewhere.

[00:35:21.14] - Nicolas Véron

So there's a question from Stephen Cecchetti, which I think is right in your field, Agathe, about the danger that could come from further weaponization of finance and the dollar by the US administration. Stephen mentioned the fact that, you know, Visa and MasterCard could withdraw from various places, that kind of things. Again, plumbing, but very important, as both of you said. What I read to Steve's question, what can and should the rest of the world do to ensure resilience, its resilience to the American potential attack on the global financial system? Steve's words. Agathe.

[00:36:01.13] - Agathe Demarais

Well, I think that the US has long been weaponizing the global financial system to advance its foreign policy goals. I think that this is definitely something that we've been seeing for quite a while with financial sanctions to advance US foreign policy interests. So I don't think that there is a risk the US will do it. It's already doing it using the clout of the US dollar in particular to advance its foreign policy goals. Then the to mitigate this risk, I think it all goes back to the uncertainty question. And that's actually a word that we've mentioned quite a bit of times today already. And I think that this is what makes adjustments very difficult. We have no idea what Trump will be doing. I don't think he knows himself. I'm not entirely sure that he knows which policies he's going to implement in a week's time. And so of course, that makes it extremely difficult to react or to adjust or to prep ahead of time for such policies, be it around tariffs. Well, firms cannot really prepare ahead if they don't know what's going to happen, but also around the financial risk. What I do think will happen is that a number of countries that know they will be in the firing line with the US, I'm thinking of China here, will double down on reducing their reliance on US financial channels or the US currency.

[00:37:28.14]

We've mentioned digitalization, we've mentioned alternatives to SWIFT, we've mentioned central bank digital currencies. To me, this is a trend that is going to happen. It would have happened even if Trump hadn't come to power again. But I think that lessons from Trump 1 showed that he can target anyone at any time for any reason. I'm thinking of the sanctions against Rusal, the Russian aluminum giant in 2018 that had to be reversed actually only after a few weeks because they were so— well, they had such huge ripple effects globally that the US had to backtrack. I think this was a good example of the fact that anyone can be targeted. And I would say that a number of countries know this, so they will probably try to reduce reliance on the US. But that's, that's very difficult. But, you know, at least they can invest in the euro or the British pound. So they have alternatives to go back to our debate.

[00:38:19.12] - Nicolas Véron

I'd like to circle back with you for a few more minutes and also invite Charles to interject on SWIFT, because SWIFT, as is well known, is a European-based global infrastructure. It's based in Belgium under EU law. And there was a perception until maybe the day before tomorrow—before yesterday— that, you know, that made it basically part of the West and US and Europe lumped together from, say, the perspective of Russia or China. And that's exactly how it worked with Iran and with Russia in the past. But is that a guide to the future? Now we have a German chancellor saying that Europe has to be independent from the US. Even so, he comes from a very Atlanticist background. We see the US voting against all of Europe except Hungary in the UN General Assembly about Ukraine. So is this Is SWIFT on the US side or on the European side if there is a US-Europe divide?

[00:39:21.11] - Agathe Demarais

I think on the US side because SWIFT has no alternative. SWIFT needs to retain access to the US dollar. I think SWIFT doesn't exist if it doesn't have access to the US dollar. So if push comes to shove, I think—

[00:39:33.01] - Nicolas Véron

So messaging system?

[00:39:35.03] - Agathe Demarais

To go with the US. I think, you know, that's essentially what happened in 2012 when SWIFT had to disconnect some Iranian banks. Most Iranian banks from its work.

[00:39:48.05] - Nicolas Véron

Can I challenge you on that? Because in 2012, the EU was on the side of the US, so it was joining UN sanctions under UN Aegis. Uh, you say SWIFT needs access to the dollar, but SWIFT doesn't have a balance sheet. It's a messaging system. They can operate without, uh, you know, uh, they, they are not dollar-centric in the way they are constructed. Uh, they're of course dollar-centric because they're part of the global financial system, which is dollar-centric, but that's all. There's nothing that gives privileged role to the dollar unless with other financial infrastructure, by the way, unless, for example, the CLS Bank, on which we also had a session in this series. But, but SWIFT is not a dollar-labeled institution. So, so is it that straightforward, Charles?

[00:40:31.27] - Charles Goodhart

No, I don't think it is. But I think we are at a moment where we could find that the international financial mechanism needs really fairly major urgent changes. Uh, and SWIFT, as you say, is located in, in Belgium, but, um, I can see the possibility of arrangements occurring whereby Trump will threaten to raise, for example, tariffs against Europe quite strongly unless SWIFT is relocated to the US. It's just the sort of thing that he would do. It's a deal, you know. I will not impose 25% tariffs on everything European if you move SWIFT to Philadelphia. What would the Europeans do then?

[00:41:40.12] - Nicolas Véron

Agathe?

[00:41:41.05] - Agathe Demarais

Well, I think to go back to your previous point, Nicolas, I think that if the US says SWIFT cannot process financial transactions in US dollar anymore, that would be a very difficult development for SWIFT. And I think a number of banks would be looking for alternatives. To SWIFT. And of course there could be an American alternative. We could imagine that Trump would be all too happy to create an American alternative to SWIFT. I completely agree with Charles. We have no idea. The US could, well, try to make a deal with Europeans on trade in return for concessions on anything else. And it all goes back to the question of unpredictability and uncertainty. We have no idea. And that makes it very difficult to prep because also preparation is costly. In time and energy and all the things you don't do while you're prepping. So, and also the scenarios that we're looking at are black swans. I mean, it's very hard to imagine them. And so you don't even want to be prepping for all of these scenarios, which are slightly crazy, if not completely crazy.

[00:42:49.08] - Nicolas Véron

You know, the US voting with Belarus, Eritrea, and North Korea on Ukraine against 26 of the 27 member states of the EU plus the UK, Japan, Indonesia, South Korea, and more, was a little bit of a black swan as well, wasn't it?

[00:43:06.20] - Agathe Demarais

And Russia declaring that it's very happy with the US balanced take on Ukraine in response to that UN vote. That is quite something. But, you know, I don't think that we could have predicted that only a few weeks ago, maybe a few months ago. And to be honest, I think that things were

worse than many of us expected in the US. I personally wasn't expecting that things would go that fast in a number of areas.

[00:43:33.03] - Nicolas Véron

We are not going to enter this, you know, comparison of notes with hindsight. I know that one of our audience participants made a proposal that Trump would have a Trump Swift system in which 3% of every transaction would go directly to his pocket. I take that as a joke. So Charles, we're talking about the uncertainty of the policies. There has been a lot of chatter, as you know, of the Mar-a-Lago accord. Scott Bessant has alluded to that in the past. That's, of course, a reference to the Plaza and Louver Accords of the 1980s, which you remember well. How serious is that chatter?

[00:44:15.29] - Charles Goodhart

I don't think it's serious just at this moment. Um, no one quite knows whether the administration's policies will lead to the dollar appreciating or depreciating. Um, there's some suggestion that the uncertainty that we're talking about will slow American growth. That could lead to the dollar depreciating. There are other concerns that the imposition of tariffs could lead to the dollar appreciating. Um, I don't think, given the uncertainties, I don't know that we're in a position to have the kind of accord that we had at Plaza and the Louver and the other accords. I don't think it's viable yet. And in particular, the concerns that you've been raising about America and Europe now feeling that they're sort of falling out from their previous close embrace. Uh, it's very difficult to have an accord, I think, at this moment. Um, and again, the, uh, the president's preference for a deal would mean that rather than an accord, it would be much more likely that the president would threaten the other countries with adverse policies unless they were prepared to take steps which helped the dollar to move in whichever direction the president at that point, point in time wanted it to go.

[00:46:01.16]

I think we're not in, we're not in a, in a world in which accords seem very likely at the moment. We're in a world of deals determined by a process of threat and counter-threat. Nor can we—

[00:46:19.23] - Nicolas Véron

we have another question about Russia, and that one I'll direct to you, Agathe. Ilze Wilke is asking what leverage Europe can have on Russia if they don't have the US on their side. That's my understanding of the question. And that's a plausible scenario going forward. So in terms of

economic sanctions on Russia, can Europe on its own impose pressure on Russia, or without the US in the coalition, is that hopeless?

[00:46:51.18] - Agathe Demarais

So I was very pessimistic until I started doing some thinking about this topic a few weeks ago. I think I was, I was very pessimistic, you know, about this potential for a US U-turn on Russia sanctions. And, you know, on paper, you would think Okay, then Western sanctions won't have any bite and it'll be the end of it. And the EU will not manage to impose sanctions that are powerful on Russia on its own. But actually, when you take a look at things, I would argue that EU sanctions are the ones that matter the most to Moscow. When you take a look at economic ties between Russia and the rest of the world, the EU is the big one. Russia didn't have a lot of trade ties with the US. Russia absorbed just 0.4% of US exports in 2021. That's the same level as Guatemala. So in terms of trade ties, the EU is the big one. And EU sanctions currently restrict 58% of EU exports to Russia based on 2021 data. So that's the big one. The second one for Russia that matters a lot, and it's also in the trade sphere, it's all about energy sanctions.

[00:47:59.16]

And Russia's loss of the EU market, which I would make it clear here is not due to sanctions, it is due to Putin's decision to cut off the gas tap to Europe. But still, I think that we could link it to the broader picture. And I think that here again, the EU is the big one because the EU used to be the main buyer of Russian gas. So the EU has leverage. And then there's the question of Western firms being present in Russia, which are very important because they're usually massive suppliers of technology. And also train workforce. And again, the US is a minor player. It's mostly European firms actually when you take a look at the data and many of them have stayed in the Russian market, by the way. So I would argue overall that the EU has much more leverage than it thinks. There are two caveats to this analysis. The first one is that the US has leverage in the form of concessions potentially on two things. Export controls on energy technology, which is crucial for Russia because Russia needs to build new oil and gas fields to remain a major energy power.

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And at the moment it can't do that because of US export controls. So that's leverage for the US. And the second leverage is US curbs on Russia's ability to place external debt at a time when Russia's fiscal buffers are being depleted. I published an op-ed in Politico this morning about this, but that's another topic. The second caveat Caveats is about EU unity, of course, because we could imagine a Trump deal with Hungary in return for Hungary's veto for the renewal of EU

sanctions that has to take place at unanimity every 6 months. So that's the two caveats. But overall, I am less pessimistic than I used to be on this topic. And I think that the EU has more leverage and more importance than it thinks in these discussions.

[00:49:48.06] - Nicolas Véron

Charles, do you want to comment on this?

[00:49:50.03] - Charles Goodhart

I agree with Agathe's economics. I think her politics are wishful thinking, and again, she did mention Hungary. I think that the— if Europe, if the EU was unified and had clear, successful political leadership, everything she said would be absolutely correct. Problem is, it doesn't.

[00:50:16.10] - Nicolas Véron

Right.

[00:50:16.17] - Charles Goodhart

It's not only Hungary, I mean, it's the right-wing parties in Austria, and elsewhere, I think the likelihood, the political likelihood of Europe going it alone under these circumstances is actually very slim.

[00:50:33.18] - Nicolas Véron

EU undermined by Austria-Hungary, that's the takeaway. The question from Christian Chavagneux, which is quite fundamental, that's for you, Charles. You told us that the Trump administration would do everything to maintain US dollar hegemony or hegemony, I always hesitate. Christian is asking, do you think Trump will go as far as suppressing the Fed independence?

[00:51:01.13] - Charles Goodhart

Oh, yes. Well, one of the things one's always got to remember is that central bank independence is far less solid, except in Europe, than most people think. Because the government in virtually every other country, like the US, Canada, UK, the government actually appoints the governor. And there's no doubt that when Jay Powell comes to the end of his time, if not before, Trump will appoint somebody who will turn up at the White House and simply say, what do you want, boss? Um, and you don't have to actually sort of end the, the so-called

independence if you appoint the senior people, and you will have the ability effectively to do that. And again, um, remember that Over the last decades, since 1890 until very, very recently, interest rates, both real and nominal, were trending down. There was never any significant, persistent, serious occasion for the governments in the countries to get upset and worried by their central banks. And because the central banks were doing what the governments would have liked anyhow. So in a world in which we're going to get into fiscal problems and inflationary problems and all the rest of it, and the central bank in pursuit of its price stability inflation target free mandate starts having to keep interest rates high or raising them, the government in the last resort has the whip hand.

[00:52:57.17]

With the exception of Europe, because the ECB is set up under treaty and you need to have a union— unanimity to get rid of the ECB. Every other country, the degree of independence that central banks have got, I won't say is paper thin because they've got a reputation, it would be politically difficult to do it, but it ain't very strong. And never was very strong.

[00:53:25.10] - Nicolas Véron

I want to circle back to this dollar question. So basically, what you're painting as— I don't know if it's your baseline, but certainly a very plausible scenario— is a scenario of fiscal dominance where the Fed loses perception and reality of independence, cannot resist the US government in terms of fighting inflation. But you seem to— I want to make sure I and our audience understand you well. You seem to imply that this would not undermine the centrality of the dollar in the system, correct?

[00:54:00.15] - Charles Goodhart

No, it would in the longer run. But I don't know. Remember how LBJ harangued Arthur Burns back in the 1970s? You wouldn't because you're too young. But he did, and they did. And if LBJ can do it, I think what Trump will do in terms of whoever he appoints as the next chair of the Federal Reserve Board. That's right.

[00:54:32.26] - Nicolas Véron

But there was the end of the Bretton Woods system, and, you know, a lot of things happened as a consequence. So what I'm struggling with is the assumptions that the international monetary system would not be affected in its kind of general landscape by such a development?

[00:54:48.08] - Charles Goodhart

Oh, it would, it would, but not immediately, not immediately, um, because it would take time for the pressures on the Fed to support the U.S. T-bond market to result in significant persistent increases in inflation. So, you know, nothing happens overnight, and I think the likelihood of a president telling the— effectively more or less instructing the Fed to support the T-bond market by more QE is a highly likely scenario. Nothing is certain, of course, but quite likely.

[00:55:37.11] - Nicolas Véron

No, with apologies to Agathe, but I want to ask you one more question and we have a few minutes left to circle back to your very first point. You, you, you talk, Charles, about, you know, basically saying this is not the ideal time to weaken regulation. It's fine if done in moderation, but not necessarily going to be so. I have a vivid memory of your, yourself in February 2007 warning against systemic risk. You're the only person I met at that time who was doing that. I know others who are doing it, but I didn't meet them or hear them live. You were right. How do you think we're in this similar moment? Is it plausible that we might encounter major systemic financial turmoil in the near term, or are we better prepared than we were in 2007?

[00:56:34.20] - Charles Goodhart

I think we're okay for the next 9 months or so. I, I'm in— I expect Trump to succeed in bringing about, uh, a cessation of hostilities, uh, over Ukraine. I think that that will lead to significantly lower gas prices and maybe even slightly lower oil prices. That will hold inflation in check. The ending of the Ukraine hostilities will, I think, be a boost to confidence and growth. And I think that as a result, things will go quite well over the next 9 months or so. After that, I, I think a degree of instability is indeed very likely to occur, and I wouldn't be at all surprised if we had development of a severe downturn and recession developing in the advanced economies in 2007-8.

[00:57:46.21] - Nicolas Véron

Agathe, you have the last word.

[00:57:49.01] - Agathe Demarais

I completely agree. I think that say in the next 9 to 12 months, we'll probably have a nice period for the US economy, but I would argue that things are going to start to take a turn for the worse afterwards when the impact, especially of tariffs, is going to bite inflation. So I think that then things could get very tricky for a Trump administration. While Charles was talking, I was trying to

imagine the Trump administration blaming the previous administration for this situation, but 'But maybe it'll be too late afterwards.' So I was trying to imagine the reasonings that they would have to explain the situation. But I think that after this initial period of nice conditions, things will probably take a turn for the worse. And then of course, if we add geopolitics with quite a lot of tensions, tensions with China in particular, then we have quite a mix for uncertain developments, I would say, in the coming years.

[00:58:49.09] - Nicolas Véron

Your words are timestamped, and who knows how we will look at them in retrospect in a year or two of time. These were the last words of the 100th session of the Financial Statements Series. These were the last words of the Financial Statements Series. But as I said at the beginning, we will come up with more very shortly to keep the debate ongoing on the key issues of the day and time as we did today. Thanks so much to Agathe Desmarais, to Charles Goodhart, to the nearly 200 individuals who spoke in this series, and to my fantastic colleagues at the Peterson Institute who have made it all possible. And I look forward to the next iterations of our conversations in a slightly different format, but with the same spirit. Thank you so much.