MASTER'S DEGREE IN MANAGEMENT

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"INTERNATIONAL ECONOMICS"

"THE NEW GLOBAL ECONOMIC FRAGMENTATION: THE NEW ROLE OF UNITED STATES BY DONALD TRUMP IN REDIFINING THE INTERNATIONAL TRADE ORDER"

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INTRODUCTION

The foreign exchange market represents a central hub of the international economy, reflecting the interaction between monetary dynamics, national economic policies, and global geopolitical scenarios. Exchange rate determination, far from being a purely technical process, encompasses complex factors that include market participants' expectations, capital movements, balance of payments equilibrium, and, increasingly frequently, geopolitical and energy shocks. In recent years, and particularly in the 2022-2024 period, international tensions have redefined the stability parameters of currency markets. The war in Ukraine, the resulting energy imbalances, and restrictive trade policies have heightened volatility, in many cases strengthening the dollar as a safe-haven currency and calling into question the centrality of other currencies. At the same time, technological competition between the United States and China and post-COVID reshoring policies have introduced new elements of economic fragmentation, impacting value chains and the distribution of capital flows. Within this scenario, the United States remains a key player, both as the issuer of the main international reserve currency and as a political and commercial player capable of influencing global balances. However, questions arise about the sustainability of this hegemony over the next decade, in light of systemic challenges ranging from the accumulation of public debt to growing competition from emerging economies. The situation that has led to geopolitical tensions in the Gaza Strip following the October 7, 2023, attack is also extremely tense, further prompting the selection of specific policies such as rearmament. The United States, in this case too, is determining the direction of domestic policy choices in various countries, particularly NATO allies, which are allocating funds from their budgets for defense.

This thesis aims to first analyze the theoretical foundations of the foreign exchange market and the main interpretative approaches, before addressing the new global context marked by geopolitics, energy, and instability. Subsequently, we will assess the current and future role of the United States in the international monetary and trade order, attempting to outline prospects and possible scenarios for its evolution over the next decade.

1. THEORETICAL FOUNDATION OF THE FOUNCTIONING OF THE FOREIGN EXCHANGE MARKET

Premise

The foreign exchange market constitutes the backbone of international finance, enabling the valuation, exchange, and hedging of national currencies in a continuous and decentralised global network. It is a complex ecosystem in which monetary values are constantly negotiated, reflecting the interplay of economic fundamentals, market expectations, and political developments. Far from being a static or monolithic structure, the FX market is a dynamic arena in which transactions take place across time zones and regulatory systems, involving actors as diverse as commercial banks, central banks, multinational corporations, institutional investors, and speculative traders. Understanding the functioning of this market is essential for analysing exchange rate movements, especially in an era marked by geopolitical instability, shifting trade patterns, and structural transformations in the global economy. Periods characterised by heightened market uncertainty and persistent inflationary pressures have further increased the importance of adopting theoretical frameworks capable of explaining both long-term trends and short-term volatility. While exchange rate movements are often anchored in macroeconomic fundamentals such as price levels, interest rates, and balance of payments positions, they are equally sensitive to investor sentiment, informational asymmetries, and sudden shocks capable of disrupting established equilibria. The current configuration of the foreign exchange market is the product of a long historical evolution, shaped by global economic, political, and technological transformations. The origins of currency exchange transactions can be traced back to ancient times, when the introduction of the first gold coins in the sixth century BC laid the foundations for a monetary system based on a universally recognised medium of exchange. Over the centuries, the increasing use of precious metals as a unit of account contributed to a relatively stable monetary framework, paving the way for more formalised systems of exchange rate regulation. In the nineteenth century, England's adoption of the gold standard in 1819, followed shortly thereafter by the United States in 1834, ushered in an era in which the convertibility of currencies into gold represented the ultimate guarantee of monetary stability. By the 1870s, other major powers such as France, Germany, and Japan had joined this system,

reinforcing an international monetary order that endured—albeit with interruptions—until the outbreak of the First World War. The twentieth century brought a new arrangement with the Bretton Woods system, which from 1944 to 1971 established a regime of fixed but adjustable exchange rates, anchoring major currencies to the US dollar, itself convertible into gold. This framework provided stability during the post-war reconstruction period, but eventually gave way under the pressures of growing capital mobility and imbalances in the US balance of payments, leading in 1973 to the adoption of a floating exchange rate regime. The era of flexible exchange rates ushered in greater volatility and renewed the centrality of national monetary policies. Events such as the 1985 Plaza Accord—where leading industrial economies coordinated a depreciation of the US dollar to address trade imbalances—demonstrated that international cooperation could still exert a significant influence on currency markets. In the 1990s, the signing of the Maastricht Treaty in 1992 laid the foundations for European monetary union and the creation of the euro, while the advent of online trading from 1996 onwards revolutionised access to and participation in the market. Today, the FX market is a global financial infrastructure characterised by continuous operation and unprecedented volumes, where political decisions, technological innovations, and geopolitical shocks constantly interact in determining currency values. This historical trajectory shows that the structure and dynamics of the modern foreign exchange market are the result of centuries of evolution, in which institutional change, regime transitions, and technological advances have progressively shaped the environment in which currencies are traded. The academic literature offers multiple approaches to understanding exchange rate determination. Long-run perspectives are grounded in the theory of Purchasing Power Parity, which links exchange rate movements to relative price levels across countries, and in the monetary approach, which emphasises the role of money supply, inflation, and output. These models assume that prices adjust fully over time, leading to equilibrium conditions in which currencies reflect underlying economic fundamentals. In contrast, short-term analyses acknowledge the presence of price stickiness and the role of currencies as financial assets whose value is influenced by interest rate differentials, expectations of future movements, and opportunities for arbitrage. Within this framework, the concepts of covered and uncovered interest parity describe how market forces tend to align returns across currencies, whether exchange rate risk is hedged or left open. Such mechanisms illustrate how changes in monetary policy, shifts in global risk appetite, or major geopolitical events can lead to rapid exchange rate adjustments, sometimes overshooting

their long-run equilibrium values. This chapter is structured to provide a comprehensive theoretical foundation for the analyses developed in the subsequent sections of the thesis. It begins with an examination of the institutional architecture of the FX market and the functions performed by its key participants. It then turns to the theoretical underpinnings of Purchasing Power Parity, discussing its limitations in light of empirical evidence. The discussion proceeds to the monetary approach to long-run exchange rate determination and to the asset approach that dominates short-run analysis, with particular attention to interest rate parity conditions and the role of expectations. Finally, the chapter integrates these perspectives within the broader balance of payments framework, linking trade, income flows, and capital movements to currency valuation. By weaving these strands together, the chapter underscores that while classical theories remain indispensable as analytical benchmarks, the realities of the twenty-first century FX market require an integrated perspective—one that accounts for the interaction between structural economic forces, political dynamics, and behavioural factors in shaping exchange rate outcomes.

1.1 Foreign exchange market: structure, operators and tools

The foreign exchange market functions as a decentralised, over-the-counter (OTC) network rather than a centralised exchange. It is best understood as a multi-layered system in which different participants interact according to their specific roles, objectives, and access to liquidity. At its core lies the interbank market, where the largest commercial and investment banks conduct high-volume transactions, both on their own behalf and for their clients. These institutions act as market makers, quoting bid and ask prices that serve as a global benchmark for exchange rate formation , arriving to a optimal market making in the foreign exchange market, the market maker's holdings in the different currencies are modelled as stochastic processes that are influenced by both the stochastic exchange rates and the stochastic customer buy and sell orders. The market maker can control their own bid and ask price quotes and, additionally, can buy and sell at other market participants' quotes. The resulting stochastic control problem consists of a controlled diffusion problem for the optimal quotes and a singular control problem for optimal trades at other market participants' quotes. A Markov chain approximation is used to derive optimal strategies. (Optimal Market Making in the Foreign Exchange Market Luitgard A. M. Veraart)). Surrounding this core is the dealer-to-customer segment, which includes multinational corporations, asset managers, hedge funds, and other institutional investors.

Their participation serves various purposes: facilitating international trade, managing portfolio currency exposure, or pursuing speculative opportunities. Corporate treasuries, in particular, play a pivotal role in currency risk management—especially in multinational companies such as Apple, which operate on a truly global scale. For such firms, fluctuations in exchange rates can significantly impact financial performance. For example, in 2023–2024, due to the appreciation of the US dollar, Apple's foreign revenues, when converted into dollars, fell by approximately 3–5%, as reported in the company's quarterly financial statements.To mitigate such volatility, Apple's treasury adopted hedging strategies. In practice, this involves the use of forward contracts to "lock in" the exchange rate at which future revenues will be converted. This means that even if the dollar strengthens further against the euro or the yuan, Apple knows in advance the conversion rate it will apply, thus protecting revenues from adverse currency movements. A concrete illustration: if in 2024 Apple anticipates receiving one billion euros in revenue from European sales, it can enter into a forward contract today to convert that sum at a predetermined rate. Consequently, even if the dollar appreciates over the next six months, the company will not incur exchange-rate-related losses. This hedging approach has allowed Apple to reduce revenue volatility from foreign markets and maintain greater financial predictability. (REUTERS, 6.02.2025; APPLE 10-K ANNUAL REPORT). The strength of the US dollar can also negatively affect product pricing in markets where the local currency has weakened, making goods more expensive and potentially dampening demand. Currency hedging, therefore, is essential not only to safeguard revenues but also to preserve competitiveness across global markets. Institutional investors also carefully consider these dynamics. For instance, an Asian pension fund holding US dollar-denominated assets may opt to hedge its currency exposure to avoid losses from sudden exchange rate swings. Hedging and capital reallocation strategies are frequently driven by interest rate differentials: when the Federal Reserve raises interest rates, the dollar tends to appreciate, attracting capital inflows. A common manifestation of this mechanism is the carry trade strategy, where investors borrow in a low-interest-rate currency, such as the Japanese yen (which in 2024 maintained rates close to zero), to invest in US dollars, where rates were higher (over 5% in 2024). This interest rate differential creates opportunities for profit but also entails risks associated with sudden currency movements. Central banks are equally central to the functioning of the FX market, acting both as participants and as monetary authorities. Through direct interventions—buying or selling their own currency—or indirect measures via monetary

policy adjustments, they influence exchange rates to achieve objectives such as price stability, export competitiveness, or control over capital flows. These actions can be unilateral or coordinated with other monetary authorities, as in past instances of joint intervention. Technological innovation has profoundly reshaped the operational mechanisms of the market. Electronic brokerage platforms, algorithmic execution, and high-frequency trading have enhanced the speed of price discovery and the efficiency of order matching, while also fragmenting liquidity across multiple venues. The settlement infrastructure, anchored by systems such as CLS, ensures that large-value transactions are cleared and settled securely and promptly, reducing counterparty risk in a market that operates seamlessly across all time zones (Using a new and unique data set of foreign currency settlement instructions provided by CLS Bank, we investigate activity and liquidity in the foreign exchange market. In the major currency pairs, CLS settlement volume shares are similar to those reported in the BIS triennial surveys. They are also similar to shares computed from EBS trade data reported by Mancini, Ranaldo and Wrampelmeyer (2013) (MRW), but only for currency pairs that do not belong to the "UK Commonwealth" pairs, for which EBS coverage is limited. We estimate Amihud (2002) illiquidity ratios from CLS submissions and Olsen price records, and examine the correlations between these ratios and price impact estimates based on high frequency EBS data and reported by MRW. The correlation is 0.748, but with marginal statistical significance and only when the commonwealth pairs are excluded from the analysis. When the commonwealth pairs are included, the correlation drops to -0.130 insignificant. We believe that, as with the volume estimates, this reflects EBS' limited coverage of the commonwealth currency pairs. The common liquidity factor in our illiquidity ratios constructed from all major pairs is highly correlated, however, with the factor based only on non-commonwealth pairs, suggesting that liquidity factors constructed from EBS data may be good proxies for factors based on broader samples. Our data include numerical identifiers for counterparties to each trade which allows us to estimate market concentration by currency pair. We find that trading is more concentrated (across participants) in less actively traded currencies, which typically exhibit lower liquidity. (FX Market Metrics: New Findings Based on CLS Bank Settlement Data Joel Hasbrouck & Richard M. Levich)). Ultimately, the functioning of the FX market is driven by a combination of fundamental and behavioural forces. On one side, exchange rates reflect macroeconomic variables such as inflation, interest rates, and trade balances; on the other, they are influenced by expectations, speculative positioning, and shifts in global risk

sentiment. In sum, while the foreign exchange market operates as a highly complex, decentralized and technologically advanced network shaped by a multitude of actors and behavioural forces, its dynamics cannot be understood solely through the lens of microstructural mechanisms. Long-term exchange rate movements also reflect underlying macroeconomic relationships that serve as theoretical benchmarks for both academics and policymakers. Among these, the concept of Purchasing Power Parity (PPP) stands out as one of the most enduring and widely debated frameworks. The following section will examine PPP in depth, discussing its theoretical foundations, empirical limitations, and relevance for analysing the impact of protectionism, inflation differentials, and geopolitical shocks on currency valuation.

1.2 Purchasing power parity(ppp) and his criticism

The Purchasing Power Parity (PPP) theory constitutes one of the most fundamental approaches to understanding long-term exchange rate determination[1]. At its core, PPP posits that the exchange rate between two currencies should adjust in such a way that identical goods or services cost the same in each country when expressed in a common currency. This concept, often summarized by the "law of one price", provides a theoretical benchmark for assessing currency misalignments and potential adjustments over time. Traditionally, a distinction is made between absolute PPP and relative PPP. The absolute version states that the nominal exchange rate between two currencies should equal the ratio of their price levels, implying that a standardized basket of goods has the same value across borders once converted. The relative version, on the other hand, focuses on changes in exchange rates as determined by inflation differentials between countries. While absolute PPP offers a theoretically elegant benchmark, empirical applications typically favour the relative version, as it accounts for dynamic factors such as ongoing inflation and structural adjustments in national economies. Historically, PPP has played an important role in international economics and policymaking. In the aftermath of the Second World War, the theory provided a useful conceptual lens for evaluating the stability of currencies under the Bretton Woods system. During the Latin

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[1] Graeme A. Hodge, Carsten Greve and Anthony E. Boardman *"Introduction: the PPP phenomenon and its evaluation"*

American debt crises of the 1980s, PPP estimates were widely used to assess the extent of currency overvaluation, thereby shaping IMF adjustment programs and lending conditionalities. Similarly, in the early 2000s, the OECD and several U.S. policymakers employed PPP calculations to argue that the Chinese renminbi was undervalued relative to the U.S. dollar, fueling debates on exchange rate manipulation, global trade imbalances, and competitive devaluations. Yet, despite its intuitive appeal, PPP has been the subject of significant empirical criticism[2]. The main limitation lies in the unrealistic assumption of frictionless markets. Transaction costs, tariffs, and other trade barriers prevent the equalization of prices across countries. Moreover, differences in consumption baskets—shaped by cultural preferences, climate conditions, or structural economic characteristics—mean that identical goods are often priced differently even when tradable. For instance, while wheat may be a staple in both Europe and North America, the weight of this product in the consumer price index differs substantially, affecting PPP calculations. Another major challenge concerns the role of non-tradable goods and services. Housing, healthcare, and many locally provided services cannot be arbitraged internationally, creating persistent deviations from parity. This problem is especially visible in highly developed economies where services account for the majority of GDP. Exchange rates, furthermore, are not determined solely by trade in goods and services: capital flows, interest rate differentials, speculative expectations, and geopolitical events can generate sustained deviations from PPP. The so-called "PPP puzzle" in the academic literature refers precisely to this phenomenon: the empirical finding that real exchange rates tend to revert to their PPP-implied values only very slowly—often over horizons of three to five years or even longer. This slow mean reversion undermines the use of PPP as a short-term forecasting tool. Recent contributions to the literature have highlighted further weaknesses, particularly the effects of price stickiness and market segmentation. Even within highly integrated regions such as the European Union, price levels for identical products often diverge. These divergences can be explained by differences in VAT regimes, distribution costs, labour market structures, and corporate strategies in brand positioning. For example, retail prices for consumer electronics or pharmaceutical products frequently vary significantly across EU member states, contradicting the expectation that full integration should bring about absolute parity. A more contemporary

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[2] Joseph D. Alba, Donghyun *Park "An empirical investigation of purchasing power parity (PPP) for Turkey"*

illustration of PPP's shortcomings is provided by the Big Mac Index, developed by The Economist. By comparing the price of a McDonald's Big Mac across countries, the index offers a simplified measure of currency misalignments. Although initially conceived as a humorous tool, the index consistently reveals systematic deviations from PPP. In 2024, for example, the Swiss franc appeared markedly overvalued against the dollar, while the Indian rupee was significantly undervalued. Yet these divergences did not lead to macroeconomic instability: Switzerland maintained its reputation as a safe-haven currency, while India continued to register strong economic growth. These cases demonstrate that exchange rate misalignments, as measured by PPP, do not automatically translate into economic crises or policy failures. An additional layer of critique comes from the inability of PPP to account for financial shocks and capital mobility. The Asian financial crisis of 1997 is a clear example: currencies such as the Thai baht and the Indonesian rupiah collapsed far beyond levels justified by relative inflation. These movements reflected sudden capital flight and speculative attacks, not disequilibria in goods markets. Similarly, the Japanese yen during the 2000s often deviated from PPP predictions because of carry trade dynamics and expectations around Bank of Japan interventions. These episodes highlight the fact that exchange rates are not merely equilibrating mechanisms for goods prices, but also barometers of financial stability and investor sentiment. A structural critique relates to the Balassa-Samuelson effect, which highlights how higher productivity growth in tradable sectors of emerging economies tends to raise overall wages, thereby increasing the price of non-tradables and leading to persistent real exchange rate appreciation. This explains why rapidly developing countries often appear "overvalued" according to PPP, even though such appreciation reflects structural convergence rather than misalignment. Latin American economies in the 1980s and 1990s, for instance, often exhibited significant PPP deviations not only because of inflation but also due to structural rigidities and external dollarisation. Finally, the PPP framework fails to incorporate **the** strategic manipulation of exchange rates by governments. In the early 2000s, China was repeatedly accused of maintaining the renminbi undervalued to foster export-led growth. These choices, though inconsistent with PPP, were part of a deliberate development strategy with profound implications for global trade imbalances and geopolitical relations. In such contexts, PPP may indicate the "direction" of misalignment but offers no insights into the political economy forces sustaining it. In conclusion, while the PPP theory remains a central pillar of international economics, its practical application is fraught with limitations. It provides a valuable

long-term reference point but cannot serve as a sufficient tool for short-term prediction or policy design. The persistence of deviations, the influence of non-tradables, capital market dynamics, and political interventions all undermine its empirical robustness. Nevertheless, PPP continues to play a normative role: by defining an equilibrium benchmark, it frames the debate on currency valuation, competitiveness, and external sustainability in a world where exchange rates are shaped as much by politics and finance as by relative prices.

1.3 Monetary approach of exchange rate over a long period

The monetary approximation of the exchange rate represents one of the most enduring attempts to explain currency movements through the prism of macroeconomic fundamentals. Rooted in the quantity theory of money, the approach suggests that, in the long run, the value of a currency is determined by relative money supplies, the velocity of circulation, and the demand for money in different economies. In this sense, exchange rates ultimately reflect the balance between monetary expansion and real economic activity across countries. This theoretical framework became central in the aftermath of the collapse of the Bretton Woods system, when the transition to floating exchange rates exposed the limitations of traditional parity-based mechanisms. Purchasing Power Parity (PPP) continued to offer a long-term anchor, but it could not adequately explain the volatility and persistence of deviations observed in practice. It was precisely in this vacuum that the monetary approach gained prominence, arguing that differences in monetary policies such as inflation rates, money supply growth, and interest rate dynamics drive the trajectory and timing of exchange rate adjustments. Yet, the question of predictability of exchange rates in a floating regime has long been debated. A turning point was represented by the seminal work of Meese and Rogoff (1983), which demonstrated the inability of fundamental-based models to outperform a random walk in out-of-sample forecasting. Their contribution cast a shadow of skepticism on the capacity of macroeconomic fundamentals to generate reliable predictions, inaugurating a decades-long debate. Subsequent surveys, such as Rossi (2013) and Engel (2014), confirmed this cautious position, highlighting the persistent lack of robust empirical evidence supporting exchange rate predictability. However, recent scholarship has started to challenge this

orthodoxy. A groundbreaking contribution comes from Darvas and Schepp (2024), who, contrary to the dominant skeptical view, provide novel empirical evidence supporting the predictive power of a theoretically grounded model[3]. Their methodological innovation rests on the class of present-value models with rational expectations elaborated by Engel and West (2005). Specifically, Darvas and Schepp argue that the gap between the fundamental exchange rate and the spot rate (the so-called *error correction term*)can be effectively approximated by the synthetic forward exchange rate over long maturities. This synthetic forward, derived from spot rates and domestic and foreign interest rates, becomes a crucial indicator: while its predictive capacity is weak for short horizons, at longer maturities (3, 5, or 10 years) it captures the rebalancing forces driving currencies toward their fundamental values. The empirical design of their study is particularly innovative. Applying the model to daily data on the GBP/USD exchange rate over the exceptionally long horizon 1979–2024, with an initial estimation window (1979–1989) and an out-of-sample evaluation extending until 2024, the authors set a new benchmark in the literature. Whereas previous studies using high-frequency data tended to focus on microstructural determinants—such as order flows (Rime et al., 2010) or intermediary risk (Yin, 2020)—or on purely statistical and machine learning approaches (Plakandaras et al., 2015; 2017), Darvas and Schepp root their analysis firmly within a macroeconomic framework, reconnecting forecasting practice to theoretical fundamentals. The results are remarkable and unprecedented in scope. First, all specifications of the model—based on forwards of 3, 5, and 10 years, as well as a combined specification—significantly outperform the random walk in terms of Mean Squared Forecast Error (MSFE) across all horizons, ranging from one day to five years. As the authors themselves emphasize, *"all four versions of our model statistically significantly outperform the random walk in out-of-sample forecasting across all studied horizons"* (Darvas & Schepp, 2024, p. XX). This finding is extraordinary given the nearly 35-year out-of-sample period. Second, the model demonstrates an unexpectedly strong ability to predict the direction of change of exchange rates, achieving success rates above 60% for horizons between six months and five years. This is a stark contrast to traditional forward rates, which rarely exceed 50%. As the authors note, *"among the 40 direction-of-change statistics reported for our models, all are above 50%, with 37 of them statistically significant at least at the 10%*

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[3] Zsolt Darvas and Zoltán Schepp *"Forecasting the daily exchange rate of the uk pound sterling against the us dollar"*

level" (Darvas & Schepp, 2024, p. XX). Third, the most striking contribution concerns the investment implications. Strategies based on the model's forecasts generated average annualized excess returns between 2% and 4%, results that are both statistically significant and economically meaningful, being comparable to the average overnight rate in the UK over the same period (3.9%). These returns outperform traditional carry trade strategies, many of which fail to achieve statistical significance. Moreover, robustness tests on transaction costs confirm that returns remain positive unless costs exceed 16.8 basis points, a level above that faced by most institutional investors. The implications of this research are twofold. For market participants, the model provides a predictive tool capable of identifying episodes of currency overvaluation and undervaluation, thereby offering a valuable basis for portfolio strategies. For monetary authorities, it represents a more solid benchmark than traditional assumptions of unpredictability, guiding interventions aimed at aligning exchange rates with fundamental values. In this light, the integration of PPP benchmarks with the monetary approach gains renewed importance. While PPP provides the long-term anchor, the monetary model illuminates the mechanisms of adjustment, and the innovations of Darvas and Schepp show that, under refined specifications, fundamentals can indeed yield predictive accuracy, even at high frequencies and across multi-decade horizons. This breaks with decades of skepticism and reopens the debate on the practical utility of fundamental-based exchange rate models, suggesting that monetary approximation remains not only theoretically relevant but also empirically robust. In conclusion, the evolution of the literature on exchange rate predictability—from the skepticism inaugurated by Meese and Rogoff to the more recent innovations of Darvas and Schepp—demonstrates how economic research oscillates between phases of doubt and renewed confidence in theory-based models. Monetary fundamentals, despite the globalization of financial markets and the dominance of speculative dynamics, continue to play a central role in explaining long-term currency trajectories. Yet, historical evidence shows that such dynamics do not unfold in isolation: exchange rates are also the product of exogenous shocks, geopolitical tensions, and systemic crises that can either amplify or derail theoretical adjustment mechanisms. It is precisely from this perspective that the following section turns to the energy shocks, protectionist policies, and currency crises of the 1920s, which represent a crucial testing ground for understanding how the principles of monetary approximation and purchasing power parity intersect with political and geopolitical disruptions. By examining these episodes, it becomes possible to assess whether and to what extent theoretical models can

capture the real turbulence of currency markets, thus offering a more comprehensive interpretation of the vulnerability of exchange rates to geopolitical attack.

1.4 A short-term approach to capital: expetations and interest rate-based

In the analysis of exchange rate dynamics, short-term capital movements have traditionally been framed within the logic of interest rate differentials and speculative expectations[4]. The uncovered interest parity (UIP) condition, one of the pillars of international macroeconomics, suggests that in equilibrium the expected depreciation of a currency should equal the interest rate differential between two countries. This framework reflects the aspirational belief that capital mobility leads to a swift alignment between domestic and foreign returns, anchoring exchange rates to fundamentals through arbitrage[5]. Yet, the empirical literature, most notably Meese and Rogoff (1983), long cast doubt on the predictive power of such models, showing that in practice they often failed to outperform the naïve random walk. Recent developments, however, point toward a more nuanced perspective. The empirical results obtained by Darvas and Schepp (2024) represent a significant departure from the skeptical tradition inaugurated by Meese and Rogoff. By employing a synthetic forward exchange rate as a proxy for the fundamental value of currencies, they demonstrate that forecasting models can achieve accuracy superior to the random walk across a wide range of horizons. In all tested specifications — whether based on forward maturities of three, five, or ten years, or in their combined form — the Mean Squared Forecast Error (MSFE) is significantly lower than that of the random walk, and the difference is statistically robust. As the authors explicitly state, "all four versions of our model statistically significantly outperform the random walk in out-of-sample forecasting across all studied horizons" (Darvas and Schepp, 2024, p. XX). The strength of these findings lies not only in their statistical performance but also in the length and richness of the dataset: nearly 35 years of daily GBP/USD observations, with horizons ranging from one-day-ahead to five years. Beyond point accuracy, the directional capacity of the model also proves remarkable. Whereas simple forward rates

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[4] William H. Branson and Thomas D. Willett; *"Policy toward short-term capital movements: some implications of the portfolio approach"*

[5] K. C. Chan, G. Andrew Karolyi, Francis A. Longstaff and Anthony B. Sanders *"An Empirical Comparison of Alternative Models of the Short-Term Interest Rate"*

rarely exceed the 50% success threshold in predicting the direction of exchange rate changes, the synthetic forward model consistently achieves higher accuracy. For instance, the probability of correctly anticipating directional changes ranges between 55–60% for the three-year horizon, 58–62% for the five-year horizon, and surpasses 60% for the ten-year specification, with the combined model approaching 65% in certain cases. The authors highlight that "among the 40 direction-of-change statistics reported for our models, all are above 50%, with 37 of them statistically significant at least at the 10% level" (ibid.). An additional contribution of Darvas and Schepp's (2024) study lies in its systematic confirmation of the superiority of the synthetic forward exchange rate model relative to the random walk, both in terms of forecast error and directional accuracy. Across all specifications—three, five, and ten-year forwards, as well as the combined model—the MSFE remains consistently and significantly lower than the benchmark, with robustness extending across horizons from a single day up to five years. Directional predictability similarly surpasses chance, with success rates between 55–60% at three years, 58–62% at five years, and consistently above 60% at ten years, while the combined model achieves results close to 65%. This is particularly striking when compared with simple forward rates, which rarely exceed 50% and often fail to attain statistical significance. A further dimension of practical importance concerns the application of these forecasts in investment strategies. Returns generated by portfolios constructed on the basis of the model's predictions average between 2% and 4% on an annualized basis, levels that are not only statistically significant but also economically relevant. Indeed, they rival or surpass the performance of traditional carry trade operations, which in many instances lack statistical robustness. As Darvas and Schepp emphasize, "the average annualized excess return of our trading strategies is 2–4%, which is both statistically significant and economically relevant" (2024, p. XX). When set against the average overnight rate in the UK of 3.9% during the same period, these results underline the concrete value of the model for practical investment decisions. Transaction cost analysis further strengthens the conclusion: for the gains to be nullified, transaction costs would need to exceed 16 basis points, a threshold far above those normally incurred by institutional investors. Nevertheless, these encouraging results should not obscure certain limitations. Predictive success rates of around 60–65%, while impressive relative to the benchmark, still imply that a substantial share of exchange rate variability remains unexplained. In other words, the model reduces uncertainty but does not eliminate it. Historical episodes reinforce this caution: during the interwar years, speculative pressures

on sterling after Britain's return to the gold standard, or the recurrent volatility of the German mark, often rendered interest rate differentials insufficient to stabilize expectations. As Eichengreen (1992) and Kindleberger (1973) emphasize, short-term capital flows frequently acted as amplifiers of fragility rather than as mechanisms of correction, highlighting the persistent vulnerability of financial systems to regime changes and exogenous shocks. From a methodological standpoint, the synthetic forward exchange rate constitutes a powerful attempt to approximate the "fundamental" value of a currency by abstracting from transient market noise. Yet, as Obstfeld and Rogoff (1995) remind us, exchange rates remain embedded in a complex nexus of macroeconomic, financial, and geopolitical forces that no single model can fully capture. The impressive results obtained for GBP/USD over three and a half decades suggest that predictability is not entirely illusory, but they also raise the question of whether such findings can be generalized across different currency pairs and institutional contexts. For policymakers, these insights provide a valuable instrument to identify misalignments and to guide potential interventions in the foreign exchange market. For financial investors, the capacity to systematically generate excess returns signals a break from the traditional assumption of market efficiency. At the same time, both actors must recognize the structural limits of these models: sudden shifts in risk appetite, liquidity crises, or political shocks can quickly erode their predictive value. Ultimately, the short-term capital approach, enriched by the synthetic forward exchange rate methodology, reframes the debate on exchange rate determination. It demonstrates that exchange rates are not entirely random, that informed strategies can outperform naïve benchmarks, and that the interplay between interest rate differentials and speculative dynamics remains a fertile field of inquiry. Rather than offering definitive answers, the approach contributes to a more nuanced understanding of how short-term financial forces interact with long-term structural determinants—an intersection that continues to shape both the theory and the practice of international monetary relations.

1.5 Balance of payments and macro-determinants of valuation flows

The balance of payments (BoP)[6] constitutes the most complete statistical representation of a country's economic interaction with the global system. It does not merely serve as an accounting tool; rather, it reflects the deep interconnection between real and financial spheres, capturing the fundamental macroeconomic imbalances that shape international adjustment. Within this framework, the concept of valuation flows has progressively acquired centrality. These flows emerge from changes in the valuation of assets and liabilities due to exchange rate movements, interest rate shifts, fluctuations in equity prices, and global portfolio reallocations. They reveal that external adjustment is not driven solely by trade balances or net borrowing, but equally by the financial re-pricing of a country's international balance sheet. The macro-determination of valuation flows rests on several intertwined mechanisms. Exchange rate movements are the most immediate and visible factor: a depreciation of the domestic currency increases the domestic value of foreign-denominated assets while reducing the real burden of domestic-currency liabilities, thereby improving the net foreign asset (NFA) position. Conversely, appreciation may lead to valuation losses, even in the presence of trade surpluses. This exchange-rate channel is particularly important in periods of monetary instability, as shown during the interwar years, when sterling's depreciation altered the relative wealth position of British creditors and debtors. A second determinant lies in interest rate differentials, which affect the relative attractiveness of fixed-income assets across borders. A tightening of monetary policy in a core economy, such as the United States in the late 1920s or again in the early 1980s, tends to raise the yield on domestic assets, attracting capital inflows while simultaneously reducing the market value of existing bonds elsewhere. These valuation shocks can destabilize debtor countries, forcing adjustments not through trade flows but via abrupt changes in external balance sheets. Third, equity and asset price cycles play an increasingly significant role in shaping valuation flows. The globalization of financial markets means that stock market booms or busts in one country reverberate internationally, altering the wealth of investors and influencing the sustainability of external positions. Commodity price fluctuations produce similar effects for resource-dependent economies, where shifts in terms of trade directly affect the valuation of export-linked assets. Finally, macroeconomic policy

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[6] Anthony Philip Thirlwal "*Balance of Payments Constrained Growth Models: History and Overview*"

choices condition valuation outcomes in decisive ways. Expansionary fiscal policies financed by foreign borrowing may initially sustain growth, but if not matched by productivity gains, they expose the country to valuation risks once interest rates rise or the currency weakens. Likewise, monetary regimes—whether fixed, floating, or managed—define the degree of exposure to valuation effects. In this sense, valuation flows cannot be analyzed in isolation: they are the outcome of a broader macroeconomic constellation that includes trade balances, policy credibility, capital mobility, and investor expectations. This perspective resonates with Anne Krueger's 1969 critical review of balance-of-payments theory. Krueger argued that unlike trade theory, which rests on unified models from Ricardo to Heckscher-Ohlin, the BoP framework remained fragmented across the elasticity, absorption, and monetary approaches. Each of these illuminated one side of adjustment: the role of price responsiveness (elasticity), the link between external balances and internal spending (absorption), or the monetary roots of external disequilibria (monetary approach). Yet none alone captured the systemic complexity of international adjustment. Krueger's call for synthesis is echoed in the modern treatment of valuation flows: only by integrating exchange rate dynamics, interest rate movements, domestic absorption, and financial portfolio adjustments can one fully understand how countries confront persistent external imbalances. The interwar experience offers a vivid historical lesson. Britain's adherence to the gold standard in 1925 created a structural misalignment: current account deficits coexisted with fragile capital inflows, while valuation losses on sterling assets exacerbated instability, culminating in the crisis of 1931. Germany, heavily reliant on short-term foreign loans, found itself exposed to valuation reversals once global risk aversion rose. These cases illustrate that valuation effects were not marginal corrections but rather central forces driving systemic collapse. In modern times, the experience of the United States underscores the reverse phenomenon: as Gourinchas and Rey (2007) show, valuation gains have often offset persistent current account deficits, underpinning what they term the "exorbitant privilege" of the dollar. In conclusion, the macro-determinants of valuation flows demonstrate that external adjustment is a multi-dimensional process. It is shaped not only by the visible balance of trade but also by the less visible, yet equally powerful, re-pricing of financial positions across borders. For policymakers, this insight carries a dual warning: deficit countries cannot rely indefinitely on favorable valuation effects to mask structural weaknesses, while surplus countries must recognize that accumulated reserves are vulnerable to global financial cycles. The balance of payments

must therefore be interpreted as more than an identity of flows: it is a dynamic reflection of systemic interdependence, where trade, capital, and valuation interact in shaping both national strategies and global stability.

Concluding remarks Chapter 1

The first chapter has laid out the theoretical foundations for understanding exchange rate dynamics and external adjustment. Beginning with the monetary and long-term perspectives, and progressing through the short-term interest rate approach and finally the balance of payments framework, we have seen how exchange rates are the outcome of multiple and interacting forces. Each theoretical strand—monetary approximations, capital flows, and balance-of-payments approaches—contributes valuable insights but also reveals significant limitations when applied in isolation. The integration of valuation flows into the analysis confirms the need for a broader and more systemic perspective: external balances are not the product of a single mechanism, but rather the result of overlapping channels involving trade elasticities, domestic absorption, monetary conditions, capital mobility, and asset price dynamics. The historical evidence from the 1920s and 1930s demonstrates how failure to account for these interconnections often produced severe crises, while modern examples highlight the continuing relevance of these mechanisms in a world of globalized finance. This comprehensive framework, developed in Chapter 1, provides the necessary conceptual foundation for the subsequent parts of the thesis, where the interwar experience of exchange rate instability will be analyzed in detail against the backdrop of protectionism, energy shocks, and currency crises.

2. GEOPOLITICS, ENERGY AND INSTABILITY: THE NEW GLOBAL CONTEXT (2022-2024)

Premise

The years between 2022 and 2024 have marked one of the most turbulent phases in the contemporary global economy, a period where geopolitics, energy markets, and monetary instability have become deeply intertwined. Unlike earlier decades in which economic cycles and financial crises could often be analyzed through conventional macroeconomic frameworks, this new era has been characterized by the return of geopolitics as a primary driver of exchange rate dynamics. The outbreak of the war in Ukraine in February 2022, the subsequent energy shock in Europe, the escalation of technological rivalry between the United States and China, and the widespread resurgence of protectionist measures have profoundly reshaped the functioning of international markets. At the center of this transformation lies the foreign exchange market, which has acted as both a barometer and a transmission channel of global uncertainty. The sharp fluctuations of the euro, the ruble, and the dollar in the aftermath of Russia's invasion of Ukraine, the strengthening of the U.S. currency amid global risk aversion, and the debate over the internationalization of the Chinese renminbi and the digital yuan illustrate how currency valuations have become inseparable from geopolitical considerations. Exchange rates have not only mirrored shifts in energy flows and trade balances but have also reflected investors' perceptions of security, strategic dependence, and systemic risk. Energy markets, in particular, have emerged as a crucial determinant of monetary stability. The weaponization of natural gas by Russia, the European rush to secure alternative supplies, and the volatility of oil prices in response to OPEC+ decisions have demonstrated that energy security is no longer a peripheral issue but a central factor in shaping currency dynamics and global competitiveness. Yet the geopolitical role of commodities extends far beyond hydrocarbons. Recent empirical research shows how critical resources for the green transition—such as copper, cobalt, and palladium—have become increasingly exposed to political instability and concentrated supply chains[7]. This shift signals what has been described as a transformation from a "well-to-wheel" to a "well-to-mine" world, where the bottlenecks of global growth are not only in energy production but also in the

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[7] Lyubov Doroshenko, Ivan De Crescenzo, Loretta Mastroeni, Alessandro Mazzoccoli *"Geopolitical risks, critical materials and energy transition: insights from wavelet analysis"*

extraction of strategic minerals. An in-depth wavelet analysis of commodity prices and geopolitical risks (Darvas & Schepp, 2024; Caldara & Iacoviello, GPR Index) confirms that different commodities respond very differently to geopolitical shocks. Natural gas emerges as the quintessential geopolitical commodity: its price dynamics have shown strong coherence with geopolitical risk since the annexation of Crimea in 2014, and especially after the 2022 invasion of Ukraine. Russia's manipulation of supply flows, the sabotage of Nord Stream, and Europe's emergency diversification strategies have made gas markets a direct transmission channel of geopolitical instability into currency markets. Palladium, heavily concentrated in Russia and South Africa, has also exhibited strong sensitivity to shocks, with prices spiking in response to sanctions and political turmoil. By contrast, copper behaves more like a barometer of global industrial cycles than a geopolitical asset, responding primarily to demand fluctuations from China. Cobalt presents a more complex picture: although it is geopolitically vulnerable—given its reliance on extraction in the Democratic Republic of Congo—its risks are not fully captured by conventional indices such as the GPR, revealing an asymmetry of information between real geopolitical fragility and market perception. These findings highlight a critical point for both theory and policy. The Geopolitical Risk Index tends to capture shocks that are salient in Western media (such as energy crises or Russian metals), while underestimating risks in less visible contexts, such as African mining. This introduces a structural bias into financial markets: what is not perceived by the information system does not fully enter pricing mechanisms, leaving hidden vulnerabilities. For the foreign exchange market, this means that valuation flows can deviate significantly depending on whether geopolitical shocks are visible or underreported. Finally, the post-COVID global context has been marked by the resurgence of protectionist policies, from reshoring and export controls to new forms of industrial policy and subsidy races. These measures, while designed to strengthen national resilience, have also contributed to fragmenting the global economy and reshaping international capital flows. The combination of protectionism, energy shocks, and geopolitical rivalry has thus created a systemic risk cycle in foreign exchange markets, challenging the assumptions of classical models and underscoring the need for a more integrated framework of analysis. This chapter will therefore examine in detail how geopolitical conflict, energy volatility, technological competition, and protectionist measures have converged to redefine the global monetary environment between 2022 and 2024. By analyzing case studies such as the euro–ruble dynamics after the Ukraine war,

the strong dollar phenomenon, the debate around the digital yuan, and the resurgence of trade barriers, it seeks to provide a comprehensive account of how global instability is shaping the valuation of currencies in the current decade.

2.1 The war in Ukraine: euros, rubles and dollar

The outbreak of the Russian-Ukrainian conflict in February 2022 has profoundly reshaped the global financial and commodity landscape, producing effects that go far beyond the military dimension. The war has acted as a catalyst of instability, intertwining geopolitics, energy security, and monetary dynamics, and laying bare the vulnerabilities of an interconnected world economy. A first dimension concerns the behaviour of national currencies. The Russian ruble experienced a dramatic depreciation of more than sixty percent in the immediate aftermath of the sanctions imposed by Western countries, reflecting both capital flight and the withdrawal of multinational enterprises. The Ukrainian hryvnia followed a similar trajectory, weakened by the collapse of productive capacity and the outflow of refugees. In contrast, the US dollar appreciated markedly, confirming its role as a global safe-haven asset, while gold prices also surged as investors sought protection from geopolitical and inflationary risks. The euro, instead, faced a paradox: despite being a major global currency, it suffered from the continent's direct exposure to Russian energy supplies, generating volatility and renewed debates on the structural weaknesses of the European Monetary Union. The energy dimension magnified these monetary turbulences. Oil prices surged above one hundred dollars per barrel, while natural gas prices registered unprecedented increases, reaching peaks that reverberated throughout the European energy system. Russia's control over gas exports, and the subsequent disruption of flows through Nord Stream, demonstrated that energy can be deployed as a geopolitical weapon, with direct consequences on exchange rate volatility, inflation, and industrial competitiveness. In parallel, agricultural markets suffered from the blockade of Ukrainian grain exports and from restrictions on fertilizers, particularly phosphates, where Russia and Belarus play a dominant role. This chain of disruptions contributed to global food inflation, exacerbating vulnerabilities in emerging and developing economies. The consequences extended also to global supply chains. The semiconductor industry, heavily dependent on Ukrainian neon (around ninety percent of global supply) and Russian palladium (thirty-five percent of global supply), faced

bottlenecks that disrupted the automotive and electronics sectors worldwide. What emerged was a new recognition that critical resources are deeply intertwined with geopolitical conflicts, and that currencies, inflation, and growth trajectories are inseparable from the availability of these strategic inputs. The integration of empirical evidence from recent academic research further confirms this picture. Studies using wavelet coherence analysis demonstrate that commodities such as natural gas and palladium are highly sensitive to geopolitical risk, with strong correlations between their price dynamics and spikes in the Geopolitical Risk Index (GPR), particularly during the war in Ukraine. In contrast, copper behaves more as a cyclical barometer of the global economy, responding primarily to Chinese demand and industrial cycles, while cobalt reveals structural fragilities not fully captured by Western-based indices, highlighting an asymmetry of information. This implies that the geopolitical sensitivity of certain commodities—especially those extracted in fragile regions such as the Democratic Republic of Congo—remains underrepresented in traditional measures of risk. By combining these perspectives, a comprehensive vision emerges. On one side, the war has demonstrated the immediate effects of geopolitical shocks on currencies and energy prices, reinforcing the role of the dollar and safe-haven assets while destabilizing the euro and peripheral currencies. On the other side, the structural analysis of commodities reveals that the global transition towards clean energy is itself subject to geopolitical vulnerabilities, as the control of critical resources becomes a lever of international power. From a policy standpoint, these dynamics carry significant implications. For investors, they suggest the need to anticipate geopolitical risks and to diversify portfolios towards assets less exposed to sudden shocks. For central banks, they imply that exchange rate interventions and inflation management cannot be separated from geopolitical considerations. For governments, they underline that energy security and resource diversification are not only economic priorities but also geopolitical imperatives. In conclusion, the war in Ukraine has accelerated the convergence between geopolitics, commodities, and financial markets. The ruble, the euro, and the dollar have become symbols of this reconfiguration: the first weakened by isolation, the second destabilized by dependency, the third strengthened by its centrality. At the same time, natural gas, palladium, copper, and cobalt embody the material foundations of a new global order, where the values of war are measured not only on the battlefield but also in the volatility of currencies, the fragility of supply chains, and the redefinition of global economic power.

2.2 Volatility and energy shocks in foreign exchange market: the case of the strong dollar

The years 2022–2024 have been marked by an unprecedented convergence of geopolitical tensions, energy shocks, and global financial volatility, with the US dollar at the centre of these dynamics[8]. The appreciation of the dollar in this period cannot be understood as the result of a single factor, but rather as the product of several intertwined mechanisms: the asymmetric impact of the energy crisis, the aggressive tightening of US monetary policy, and the renewed perception of the dollar as the ultimate safe haven in times of systemic uncertainty. Europe, highly dependent on Russian gas, suffered the heaviest burden of the energy crisis triggered by the war in Ukraine. Rising import prices, combined with record inflation, eroded competitiveness and undermined investor confidence, leading the euro to fall to parity with the dollar for the first time in twenty years. Emerging economies also faced mounting difficulties: countries such as India, although benefitting from discounted Russian oil, saw their current accounts deteriorate as energy import costs surged, with their currencies approaching historical lows against the dollar. The strengthening of the dollar acted through multiple transmission channels. On the one hand, the United States' relative energy independence meant that the shock of oil and gas prices translated into improved terms of trade compared to energy-importing regions, reinforcing the dollar's value. On the monetary front, the Federal Reserve's rapid rate hikes widened interest differentials vis-à-vis Europe and Japan, attracting global capital flows into dollar-denominated assets. Finally, the geopolitical dimension amplified this dynamic: in a context of war on European soil, supply chain disruptions, and fears of financial contagion, investors sought refuge in the dollar, whose role as the global reserve currency was further strengthened. Yet this process carried contradictions. While the United States benefited from reduced import prices and more contained inflation, the rest of the world faced higher costs for dollar-denominated commodities and increased debt burdens for economies with liabilities in foreign currency. The International Monetary Fund noted that the appreciation of the dollar raised refinancing risks for several emerging markets, aggravating the challenges of debt sustainability. Understanding how these shocks transmitted to the real economy requires moving beyond aggregate explanations and looking at the microeconomic frictions that govern firm behaviour. Two classic contributions provide an illuminating perspective: Krugman's

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[8] Catherine L. Mann *"How long the strong dollar?"*

theory of pricing-to-market and Caplin and Krishna's model of employment adjustment costs. Taken together, they explain why exchange rate shocks, especially those associated with energy crises and dollar strength, do not translate immediately or proportionally into changes in trade balances, production, or employment. According to the pricing-to-market framework, exporters under imperfect competition adjust their foreign prices only partially when exchange rates fluctuate[9]. When the domestic currency appreciates, foreign prices tend to remain relatively stable in local currency, while exporters absorb the shock by reducing their mark-ups. Conversely, when the domestic currency depreciates, exporters do not fully reduce foreign prices, preferring instead to restore profitability. In both cases, the pass-through of the exchange rate to final prices is incomplete, and the immediate expenditure-switching effect of currency movements is attenuated. At the same time, Caplin and Krishna show that firms face significant costs when adjusting employment levels[10]. Hiring, firing, and reorganising production are not instantaneous processes but involve financial and organisational frictions. As a result, firms tend to delay or smooth their adjustment, resorting first to internal measures such as reducing overtime, freezing recruitment, or postponing investment. This means that even when profit margins are squeezed by an appreciation or temporarily boosted by a depreciation, the response of production and employment is gradual rather than immediate. The combination of these two frictions—price segmentation abroad and adjustment costs at home—produces aggregate outcomes that are highly relevant for interpreting the recent strong-dollar cycle. The trade balance responds more slowly than expected, with the so-called J-curve becoming flatter and longer. Moreover, hysteresis effects may emerge: a prolonged appreciation consolidates the position of foreign competitors and induces domestic exporters to defer investment, making it more difficult to regain lost ground even if the exchange rate later returns to more favourable levels. Similarly, a depreciation does not automatically translate into a rapid export expansion if firms prefer to rebuild margins before expanding production capacity. These mechanisms help to explain several puzzles that emerged during the 2022–2024 episode. Large depreciations in some currencies did not correct external deficits quickly because pass-through was incomplete and employment rigidities slowed the real adjustment. In certain

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[9] Krugman, P. 1986. "*Pricing to market when the exchange rate changes.*"

[10] Caplin, A., and K. Krishna. 1986 *"A simple dynamic model of employment"*

advanced economies, manufacturing employment remained surprisingly resilient despite compressed margins, as firms preferred to retain skilled workers rather than incur the long-term costs of layoffs and rehiring. Imported inflation also failed to move one-for-one with the exchange rate, as pricing-to-market strategies broke the mechanical link between currency movements and consumer prices, especially in sectors characterised by oligopolistic structures or strong brand power.   The strong dollar thus revealed itself as a paradoxical force: a stabiliser for the United States but a destabiliser for much of the global economy, amplifying the difficulties of energy importers and debtors in foreign currency. The episode confirms that the exchange rate alone cannot act as a rapid adjustment mechanism for trade imbalances. What matters is the credibility and persistence of currency movements, since only when firms perceive them as durable do they gradually translate into changes in output and employment. This has important policy implications. Relying exclusively on devaluations to restore competitiveness risks disappointment if pass-through is incomplete and employment adjustments remain sluggish. Policies that reduce labour-market frictions—such as training, mobility programmes, and lower hiring costs—can accelerate the real effects of a favourable exchange rate. Likewise, industrial strategies that strengthen brand power and product differentiation can help exporters withstand adverse appreciations by increasing their pricing autonomy. In the end, the experience of 2022–2024 demonstrates that volatility in the foreign exchange market, amplified by energy shocks and geopolitical risks, produces slow and asymmetric real adjustments. The appreciation of the dollar, while immediate in financial markets, translated only gradually into trade balances and employment because firms smoothed their responses through pricing strategies and costly adjustments of productive capacity. For this reason, moving the exchange rate is necessary but not sufficient: only when combined with measures that reduce real rigidities and strengthen competitive structures does the signal of the currency become an effective instrument for restoring external balance and sustaining long-term growth.

2.3 US-China technology competition and currency tension

The confrontation between the United States and China in the period 2022–2024 must be understood not as a mere commercial dispute over tariffs or trade balances, but as the manifestation of a deeper and structural rivalry for global technological leadership. Washington has long accused Beijing of engaging in unfair practices, including forced

technology transfers, intellectual property theft, heavy subsidies to state-owned enterprises, and cyber espionage. These accusations are framed in opposition to Beijing's industrial policies, particularly *Made in China 2025* and *China Standards 2035*, which the United States perceives as a direct threat to its technological and strategic primacy. For China, however, technology represents power itself: self-sufficiency, endogenous innovation, and the ability to set global standards are seen as indispensable conditions for achieving the status of a fully sovereign great power, even at the cost of partial decoupling from the United States. The rivalry unfolds across multiple fronts. Tariffs were one of the earliest and most visible instruments of pressure, with the United States imposing duties on more than 250 billion dollars' worth of Chinese goods, to which China responded with countermeasures on American exports. Yet, the more strategic dimension concerns technology and national security. Through mechanisms such as CFIUS and the 2018 FIRRMA law, the United States has blocked Chinese acquisitions of strategic companies—such as Lattice Semiconductor or attempted deals with Qualcomm—and severely restricted access to advanced technologies. The cases of ZTE and, most prominently, Huawei, demonstrate how the line between trade, security, and geopolitics has blurred: Huawei was accused of sanction violations and espionage, placed on the *entity list*, and treated both as a threat and as a bargaining chip in negotiations. This contestation has also extended to currency tensions. Washington has accused Beijing of manipulating the renminbi to sustain export competitiveness, while China has responded that volatility in USD/CNY is largely driven by the strength of the dollar and US fiscal and monetary policies. Meanwhile, structural differences in financial development mean that, while the dollar has benefitted from safe-haven flows during global crises, the renminbi has oscillated between efforts at internationalization—such as the Belt and Road Initiative and the promotion of CIPS as an alternative to SWIFT—and episodes of depreciation whenever capital outflows intensified. The result is a fragile balance: China aspires to a greater role for the renminbi, but convertibility constraints, capital controls, and underdeveloped financial markets limit its global credibility, especially compared to the resilience of the dollar. Within the United States itself, two visions compete. A pragmatic camp, represented by figures such as Mnuchin and Kudlow, recognises the challenges posed by China but advocates for multilateral and cooperative solutions. A more hawkish faction, embodied by Navarro, Lighthizer, and Ross, argues for a genuine decoupling, convinced that only by disentangling value chains, capital, and technology flows can America contain China's rise. This internal division reduces the coherence of

US strategy and reinforces Beijing's perception that Washington's ultimate objective is structural containment rather than a balanced adjustment of trade relations. On the Chinese side, the ambition is not only to acquire advanced technologies but also to set the rules of global governance. With its industrial strategies and its efforts to expand renminbi-based trade, Beijing aspires to rewrite the standards of global production, finance, and connectivity. However, complete decoupling remains highly complex: the global economy is deeply interconnected, and many US allies—particularly the European Union and Japan—share concerns about China's practices but are reluctant to be forced into an exclusive alignment, as their economic interests remain closely tied to the Chinese market. The systemic consequences of this rivalry are far-reaching. First, it generates instability in global value chains, especially in sectors such as semiconductors, rare earths, and critical minerals, which are highly exposed to geopolitical shocks. Second, it undermines the multilateral trading system, already weakened by the crisis of the WTO and unilateral American actions. Third, it risks leading to a forced decoupling, with higher costs for firms and consumers, reduced investment, and declining trust in global markets. Crucially, the conflict combines competition with interdependence: neither power can afford a complete rupture without inflicting damage upon itself. From a macro-financial perspective, these tensions are increasingly reflected in currency markets. The dollar has emerged reinforced as a safe-haven currency, benefiting from crises and from its centrality in high-tech trade and finance. The renminbi, while advancing modestly in global reserves and settlements, remains vulnerable to capital flight and policy interventions, reflecting the tension between China's ambitions and its financial limitations. This asymmetry produces what may be termed a "currency tension trap": the dollar's dominance is magnified by systemic crises, while the renminbi's internationalization remains fragile and contested.

In conclusion, the US–China technological and economic rivalry is not a temporary dispute but a structural confrontation over models of development and visions of world order. Tariffs, accusations of currency manipulation, and trade disputes are only surface manifestations. At the core lies the race for technological supremacy, intrinsically linked to currency power. The future will depend on whether the two powers can transform their rivalry into a regulated competition rather than a destructive conflict. In the absence of a structural compromise, the likely outcome is a more fragmented and unstable global economy, in which exchange rates act not merely as economic variables but as amplifiers of systemic geopolitical rivalry.

2.4 Post-Covid protection policies: reshoring,export restrictions, interest rates and expectations

The COVID-19 pandemic represented an unprecedented shock to the global economy[11]. By the end of February 2021, more than 113 million infections and 2.5 million deaths had been recorded worldwide, and the "Great Lockdown" paralysed transportation, disrupted supplies, halted labour mobility and fragmented global value chains (GVCs) on an unprecedented scale. What initially appeared as a health emergency soon became an economic contagion: the very structure of GVCs, built on dense interconnections, amplified the spread of shocks across borders. Pre-existing trade frictions—most notably those between the United States and China—further exposed vulnerabilities and contributed to the perception that globalisation had reached a structural turning point. UNCTAD mapped four possible post-COVID trajectories for international production: diversification, replication, reshoring (domestic value chains, DVCs), and regionalisation (regional value chains, RVCs). Of these, reshoring and regionalisation shorten production chains, reflecting the desire to reduce reliance on geographically distant suppliers and to insulate economies from systemic shocks. This acceleration, however, did not emerge ex nihilo. Already after the 2008–09 financial crisis, world trade and GVC growth had slowed, converging with global GDP growth or even declining in share. Three mega-trends—technology, governance, and sustainability—were already reshaping the GVC paradigm. The pandemic acted as a trigger, amplifying these transformations and forcing governments and firms alike to reconsider their production footprint. Technological innovation (automation, robotics, blockchain, 3D printing) enabled proximity production; political pressures and weakening multilateralism tilted the balance towards national and bilateral arrangements; sustainability concerns and public "green plans" demanded more local, traceable, and environmentally compliant supply networks. Together with rising nationalism, trade wars, and climate change, these forces, identified by Enderwick and Buckley, have undermined the hyper-globalised model of the 1990s and early 2000s. In this new context, public policies have proliferated. Before the pandemic, a number of advanced economies had already experimented with reshoring incentives. The United States under Obama supported high-tech reshoring through fiscal incentives,

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[11] Stefano Elia, Luciano Fratocchi, Paolo Barbieri, Albachiara Boffelli, Matteo Kalchschmidt "*Post-pandemic reconfiguration from global to domestic and regional value chains: the role of industrial policies*"

infrastructure and "manufacturing universities," while Trump focused on tariffs and cost competitiveness. France launched "Colbert 2.0," Korea incentivised returns with limited success, the UK promoted local supplier matching, and Taiwan introduced ambitious re-entry programmes during the US–China trade war. Yet results were uneven: as the Korean case shows, without ecosystems of skills, innovation, and infrastructure, financial incentives alone proved insufficient. After 2020, policies multiplied and became more targeted. India launched schemes to reduce dependence on China in pharmaceuticals, creating bulk drug parks and subsidising domestic API production. Japan supported both reshoring and nearshoring with generous subsidies, particularly for health-sector SMEs, and approved dozens of projects. France rolled out a comprehensive plan, including the re-shoring of the entire paracetamol supply chain, funds for strategic sectors like aerospace and electronics, and simplification of bureaucratic procedures. Korea refocused on high-tech reshoring, coupling subsidies with automation. The EU promoted a pharmaceutical strategy and pilot projects for Mediterranean textile supply chains. Regional alliances such as the Japan–India–Australia Supply Chain Resilience Initiative demonstrated a new willingness to orchestrate value chains at the macro-regional level. These initiatives reveal a profound shift in policy design. Pre-COVID reshoring policies were slow, generalist and often centred on single firms. Post-COVID programmes accelerated dramatically, focused on strategic sectors (healthcare, high-tech, critical raw materials) and increasingly targeted entire supply chains or consortia. Moreover, geography expanded: from pure back-shoring to combinations of back- and near-shoring, with regionalisation emerging as a credible long-term strategy. Packages became multi-lever—combining tax relief, financing, infrastructure, labour training, and innovation support—while one-stop shops and streamlined procedures encouraged adoption. The impact on macroeconomic dynamics has been profound. Export restrictions multiplied, from food (India's wheat ban) to energy (Russia's gas leverage) and industrial inputs. The tightening of monetary policy in advanced economies—above all the Federal Reserve—exacerbated global tensions by strengthening the US dollar, forcing emerging economies into defensive rate hikes at the cost of growth. At the same time, governments invoked the rhetoric of strategic autonomy: the EU in its notion of "open strategic autonomy," China through its "dual circulation" strategy, and the US through reindustrialisation measures like the CHIPS Act and Inflation Reduction Act. These aspirations reflect not only protection against vulnerabilities but also the ambition to redesign global hierarchies of production and power. UNCTAD's framework identifies a

clear gap: while many policies target firm-level reshoring or single industries, there remains an absence of macro-regional governance capable of orchestrating regional value chains across sectors. Filling this gap requires supranational coordination, aligning incentives, selecting strategic sectors such as pharmaceuticals, semiconductors, batteries, and solar, and integrating sustainability goals into industrial policy. The lesson is clear: financial incentives alone are not enough. Effective reshoring and regionalisation demand skilled human capital, innovation ecosystems, robust infrastructure, and orchestrators capable of rebuilding entire supply chains. In addition, resilience requires smart and open reshoring, avoiding autarkic closures and instead building "open strategic autonomy." Evidence-based policymaking, combining ex-ante and ex-post evaluation, and foresight tools linking resilience, geopolitics, and climate, are essential to guide interventions. In conclusion, the post-COVID era marks the transition from hyper-globalised GVCs towards shorter, more resilient, and more strategically governed supply chains. Protectionist policies—reshoring, export restrictions, interest rate manoeuvres, and sovereignty discourses—are not isolated measures but interconnected responses to the same vulnerabilities. They reflect a shift from efficiency to resilience as the guiding principle of global economic governance. The challenge ahead is to pursue this autonomy without succumbing to destructive protectionism: to construct an open strategic autonomy that safeguards resilience while preserving the benefits of selective integration in an interdependent world.

2.5 The systemic risk cycle in foreign exchange markets

Foreign exchange markets are not merely arenas for relative price adjustments between currencies. They are the nervous system of global finance, transmitting shocks, amplifying imbalances, and transforming local disturbances into global crises. What can be termed the *systemic risk cycle* in FX markets reflects the recurrent pattern whereby apparently contained events—bank runs, housing busts, sovereign defaults, sudden rate hikes—spread across borders and asset classes, becoming systemic disruptions. In this sense, the FX market functions both as a thermometer of risk and as an amplifier of systemic stress. Classical banking theory highlighted the role of self-fulfilling panics. In the models of Bryant (1980) and Diamond & Dybvig (1983), bank runs emerge when depositors, uncertain about liquidity needs, all choose to withdraw simultaneously because they expect others to do so. Even solvent banks collapse under such runs.

Friedman and Schwartz (1963) interpreted many nineteenth-century US crises through this lens. Policy-makers drew on this logic during the 2007–2008 crisis, extending deposit guarantees. Yet the Irish case in 2008 shows the limits: the problem was not a panic but the collapse of a property bubble, leading to a sovereign banking crisis. Beyond panics, many crises originate from asset price collapses. Gorton (1988) and Calomiris & Mason (2003) show that US crises often stemmed from weak fundamentals rather than pure runs. Real estate bubbles, fuelled by cheap credit and low rates, are among the most dangerous triggers. The US subprime boom (Reinhart & Rogoff, 2009; Taylor, 2008) exemplifies this: when the bubble burst, losses on securitized mortgages devastated banks and spilled over into the real economy. Spain and Ireland saw similar patterns, amplified by current account deficits and capital inflows. Sovereign defaults add another channel, as with Greece in 2011, which destabilized banks heavily exposed to public debt. Rising interest rates represent yet another source of systemic fragility: with rates at historic lows, any tightening reduces bond values, creating balance sheet stress across financial institutions. The third dimension is contagion: crises spread through interbank linkages, common exposures, and herd behavior. Bear Stearns was rescued in 2008 due to fears of contagion; Lehman Brothers' collapse later that year proved how justified those fears were. Money market funds "broke the buck," interbank lending froze, and global trade contracted dramatically. Theoretical work by Allen & Gale (2000b) shows incomplete networks are more fragile, while Wagner (2010) and Ibragimov et al. (2011) emphasize that excessive diversification into similar assets increases correlation and systemic risk. FX crises are also magnified by currency mismatches: banks and firms borrow in foreign currency but earn revenues in local currency. The Asian crisis of 1997 is a textbook example: Korea, Thailand and others accumulated dollar-denominated debt without sufficient reserves. When exchange rates collapsed, insolvencies multiplied, and recessions deepened. Since then, many emerging economies have built massive FX reserves as insurance (China being the prime case). During 2007–08, US dollar swap lines provided by the Federal Reserve to other central banks were critical: the Eurozone alone required over $400 billion in dollar liquidity. To this classical picture we can add a modern, asset-pricing perspective. Building on Merton's (1973) ICAPM, Atanasov & Nitschka decompose market risk into cash-flow news (permanent shocks) and discount-rate news (transitory shocks), extending this framework from equities to currencies[12]. Their central finding is

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[12] Victoria Atanasov and Thomas Nitschka *"Foreign Currency Returns and Systematic Risks"*

that FX returns, like equity returns, embed exposure to systemic factors. The mechanism works as follows. High-yield currencies—those targeted in carry trades—tend to depreciate when US equity markets suffer negative cash-flow news. They are therefore risky assets, rewarding investors with higher average returns. Low-yield currencies, by contrast, appreciate during equity downturns, acting as hedges. Empirical evidence (1983–2010) shows a monotonic pattern: cash-flow betas are strongly positive for high-interest currencies, negative or low for low-interest ones. While discount-rate betas also matter, the dominant driver is the exposure to permanent cash-flow shocks. In cross-sectional regressions, this ICAPM-based decomposition explains FX returns far better than the classical CAPM, though at the cost of implying implausibly high risk aversion levels. This perspective deepens our understanding of the systemic risk cycle in FX markets. Not only do panics, asset collapses, contagion, and mismatches transmit crises, but currencies themselves embody systemic factors that overlap with equity markets. The US dollar illustrates this dual role: as a global safe-haven, it tends to appreciate in periods of negative cash-flow news, reflecting its role as a systemic hedge.In conclusion, systemic risk in FX markets is multi-layered. It stems from banking fragilities (runs, insolvencies), macroeconomic imbalances (bubbles, sovereign risk, rate hikes), network contagion, currency mismatches, and shared global risk factors (cash-flow news). Currencies are not neutral relative prices but vehicles that transmit and amplify global shocks. Policy responses must therefore go beyond isolated measures, addressing the system as a whole: macroprudential tools, coordinated liquidity provision, and international cooperation are essential to mitigate the propagation of crises in today's interconnected world.

3. THE CURRENT ROLE OF THE UNITED STATES IN THE GLOBAL TRADE AND MONETARY ORDER

Premise

The international environment in 2025 is characterized by a complex overlap of geopolitical crises and economic transformations, which are profoundly impacting global trade trends and national economic policies. Overall, uncertain expectations are impacting investor confidence, which is impacting growth.

The ongoing geopolitical events, particularly the Israeli-Palestinian crisis, the ongoing war in Ukraine, and widespread tensions in the Middle East, represent factors of instability

3.1 The ongoing geopolitical events in 2025: the geopolitical crisis in Israel and the economic measures taken

In addition to the Russo-Ukrainian war, discussed in previous chapters, an event that is decisively affecting the international balance of power is the escalation taking place in Israel, following the attack by the Palestinian terrorist group Hamas on October 7, 2023 (which resulted in the deaths of over a thousand young Israelis). Following this attack, the Israeli government adopted a hard line, also considering the hostage-taking by the terrorist group Hamas.

The Israeli-Palestinian conflict is generating a series of profound repercussions on the economic and financial stability of the State of Israel, with effects that have gradually spread to global markets. The October 7 attack and subsequent military operations immediately heightened the perception of geopolitical risk in the region, triggering a flight to safe-haven *assets* and a rapid devaluation of the shekel[13]. The Bank of Israel

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[13]The *shekel* (Hebrew: שקל חדש, *shekel ḥadash* (meaning "new shekel")) is the official currency of Israel. Its ISO code is ILS (*Israeli New Shekel*) and the most used symbol is ₪ . It is divided into 100 agorot and was introduced in 1985 to replace the "old shekel" (ILS at a rate of 1 new shekel = 1000 old shekels) as part of an economic stabilization plan following a period of hyperinflation. Since then, it has been managed and regulated by the Bank of Israel, which is responsible for monetary policy and financial stability in the country. The shekel is a *freely convertible currency* and is today considered relatively stable, being widely used not only within Israel, but also in the Palestinian Territories (West Bank and Gaza) for many daily transactions.

responded by announcing an extraordinary program of foreign exchange market interventions, which included, among other things, sales of up to $30 billion and additional *swap lines* of $15 billion, aimed at stabilizing the currency and containing volatility [14]. This policy initially had a stabilizing effect, but in the following months, as the internal situation worsened, its effectiveness diminished. Meanwhile, *rating agencies* have progressively downgraded their sovereign credit ratings (an indicator of low confidence). In April 2024, S&P downgraded Israel from AA- to A+, and to A in October of the same year. [15]Fitch also downgraded its rating to A with a negative [16]outlook in August 2024, while Moody's, at the beginning of 2025, reduced its rating to Baa1, also with a negative outlook negative[17]. These decisions were motivated by the structural increase in fiscal risk and the deterioration of the macroeconomic outlook, in particular, the public deficit, which rose to 6.9% of GDP in 2024, reflects the impact of the direct and indirect costs of the conflict, estimated at a total of NIS 250 billion to 300 billion by mid-2024[18].

The real economy suffered an immediate blow: in the fourth quarter of 2023, GDP contracted by around 20% in annualized terms, largely due to military mobilization and the partial shutdown of key sectors such as tourism and high-tech. However, the International Monetary Fund has predicted a moderate recovery starting in 2025, with growth around 3.2–3.3%[19]. Volatility in domestic stock markets was significant: the Tel Aviv stock exchange recorded immediate crashes at the end of 2023, followed by a gradual rebound, reaching new highs in January 2025, also supported by the truce expectations discussed in those months[20]. The effects on the cost of capital were also visible through credit markets. One indicator of country-related risk is the Credit Default Swap (CDS), an insurance-financial derivative contract through which the buyer of the contract protects himself from the risk of default by a debtor (which may be a sovereign state, a bank, or a company). In practice, whoever buys the CDS pays a premium. A CDS is a periodic (insurance-like) protection offered to a counterparty, known as *the protection*

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[14] Bank of Israel (2023), *Bank of Israel to Sell Up to $30 Billion in Foreign Exchange,* Press Release, 9 October 2023.
[15]S&P Global Ratings (2024), *Israel Long- Term Foreign Currency Rating Lowered to 'A+' On Conflict Impact; Outlook Negative,* 18 April 2024.
[16] Fitch Ratings (2024), *Fitch Downgrades Israel to 'A'; Outlook Negative,* 12 August 2024.
[17] Moody's Investors Service (2025), *Moody's Downgrades Israel's Ratings to Baa1; Outlook Remains Negative,* February 2025.
[18] Israel Ministry of Finance (2024), *Government Debt Report 2024,* Jerusalem.
[19]International Monetary Fund (2025), *Israel – World Economic Outlook Database,* Washington, DC
[20]Reuters (2025), "Tel Aviv Stocks Hit Record as Ceasefire Hopes Rise," January 15, 2025.

seller. In exchange, the latter agrees to compensate the buyer in the event of a credit event affecting the underlying issuer (e.g., default, debt restructuring, or non-payment of coupons). The CDS spread (expressed in basis points on an annual basis) reflects the cost of the protection: the higher it is the greater the perceived risk of default of the debtor (for this reason, CDSs are often used as a synthetic indicator of a company's country or credit risk).

Following the events described, five-year *credit default swaps* (CDS) on Israel showed a sharp increase during 2024, signaling a rapidly increasing risk premium, although they returned to more moderate levels in 2025 thanks to a partial improvement in the perception of stability. Despite these difficulties, the Israeli Treasury has maintained relatively favorable access to international markets, placing five billion dollars in five- and ten-year bonds in February 2025, with total demand of over 23 billion, a sign of continued global investor confidence.

3.2 Global trade implications of the Palestinian crisis

The financial aspects described are having commercial repercussions that must be described in global terms. Indeed, the energy sector and trade routes are the culprits of the ongoing crisis. The preventive closure of the Tamar gas field in October 2023, following security concerns, has reduced exports to Egypt and slowed supplies of liquefied natural gas to Europe. At the same time Houthi attacks in the Red Sea[21] have forced much of the maritime traffic to divert to the Cape of Good Hope, with a collapse in transit through the Suez Canal and an increase in insurance costs related to *war- risk premiums* for ships bound for Israel and the Gulf area[22]. The Israeli technology sector, the backbone of the economy, has shown remarkable resilience, despite the reduction in the number of deals. Investment volumes in startups have exceeded three billion dollars (this data refers to the period from the end of 2023 to the beginning of 2024), with a growing focus on cybersecurity and defense-related applications. In 2025, fewer but larger rounds are observed, a symptom of a more careful selection by venture capital[23].

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[21]Bloomberg (2023), "Israel Orders Shutdown of Tamar Gas Field Amid Gaza Conflict" 9 October 2023.
[22]International Monetary Fund (2024), *Red Sea Shipping Disruptions and Global Trade Flows,* IMF Blog, 24 January 2024.
[23]Startup Nation Central (2024), *High-Tech Investment Report 2023–2024,* Tel Aviv

In 2025, among other things, Israeli fruit exports, particularly those related to the citrus sector, show a recovery compared to the collapse recorded in the aftermath of the military escalation in 2023. According to data from the United States Department of Agriculture (USDA), in the 2024/2025 marketing year, shipments of fresh citrus fruits from Israel stood at around 112,000 tons, an increase of 17.9 percent compared to the previous season, although remaining below pre -conflict levels (USDA, *Citrus Annual Report* , 2024). Agricultural exports, however, are facing structural difficulties, especially related to the increase in maritime transport costs and risks associated with the security of routes, aggravated by the attacks in the Red Sea that have made it necessary to divert ships to longer and more expensive routes. Added to these factors is the rise in insurance premiums for shipments, which has reduced the competitiveness of Israeli products in distant markets, particularly in Asia. Despite these constraints, the domestic sector has maintained a certain capacity to absorb production, stabilizing prices and guaranteeing income to farmers. This flexibility has made it possible to contain the negative effects on agricultural company balance sheets but has also led to a lower realization of profit potential on international markets. The importance of the "Jaffa" brand and of prized varieties, such as pink grapefruits, lemons and "easy peelers", has helped maintain demand in more profitable market segments, partially offsetting high logistics costs[24]. The crisis has acted as a catalyst for financial instability, through three main channels: immediate pressure on currency and credit markets, increased tax and insurance costs related to the conflict, and the impact on energy and logistics value chains. Israel's ability to mitigate these shocks has relied on the active intervention of its central bank, its continued solid access to international debt markets, and the structural resilience of its technology sector, but long-term risks remain high, especially in terms of fiscal sustainability and dependence on an unstable geopolitical context. Globally, the Israeli-Palestinian crisis is having significant consequences not only on the political and humanitarian level, but also on the trade system. The international dimension of this conflict is clear from its impact on logistics chains, energy flows, and the balance of financial markets. One of the most immediate effects has been on the maritime transport

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[24]On the macroeconomic level, fruit and vegetable exports remain a significant component of Israel's trade balance. In 2024, export sales of fruit, nuts, and related products exceeded $900 million (Trading Economics, 2024). According to industry estimates, the overall fruit and vegetable market in Israel could reach $6.26 billion in 2025 (Mordor Intelligence, 2024). This demonstrates the strategic importance of the agri-food sector not only in terms of exports, but also for domestic consumption and distribution.

sector, with the Houthi attacks in the Strait of Bab. El Mandeb and the Red Sea, in solidarity with Hamas, have made navigation towards the Suez Canal, the main artery for trade between Asia and Europe, extremely risky. Many shipping companies have chosen to divert routes by circumnavigating the Cape of Good Hope, extending delivery times by about two weeks and increasing the costs of maritime transport and insurance (IMF, *Red Sea Shipping Disruptions,* 2024). These events impacted the prices of imported and exported goods globally, increasing inflationary pressure and reducing the competitiveness of some markets. Energy prices represented a further transmission channel of the crisis. The temporary closure of the Israeli Tamar gas field in October 2023, as anticipated, reduced flows to Egypt and its liquefaction terminals, delaying LNG supplies to Europe. Although Israel's direct influence on the global gas market is not comparable to that of major producers, the disruptions contributed to fueling energy price volatility in an already fragile environment due to the consequences of the war in Ukraine. Financially, markets responded with a significant increase in risk premiums. Indeed, globally, uncertainty fueled greater risk aversion, temporarily strengthening safe-haven assets such as the dollar and gold, and supporting the prices of defense and security companies, which saw increased demand for military and technological systems. The crisis described above has also impacted trade in primary goods, confirming how regional conflicts can have tangible repercussions on global food markets, already under pressure from climate change and other geopolitical tensions. In short, the global trade impacts of the Israeli-Palestinian crisis are manifesting themselves through increased logistics and insurance costs, disruptions to energy flows, repercussions on partners' trade balances, and increased volatility in financial and agricultural markets. These effects, despite originating from a regional conflict, demonstrate the high degree of interconnectedness of the global economy and the vulnerability of global value chains to geopolitical shocks.

3.3 The crisis in the Middle East East and Ukraine and the effects on the industry of the States United

The crisis in the Middle East, which worsened in 2025, is having significant effects on the US economy and industry, with impacts manifesting themselves along three main lines:
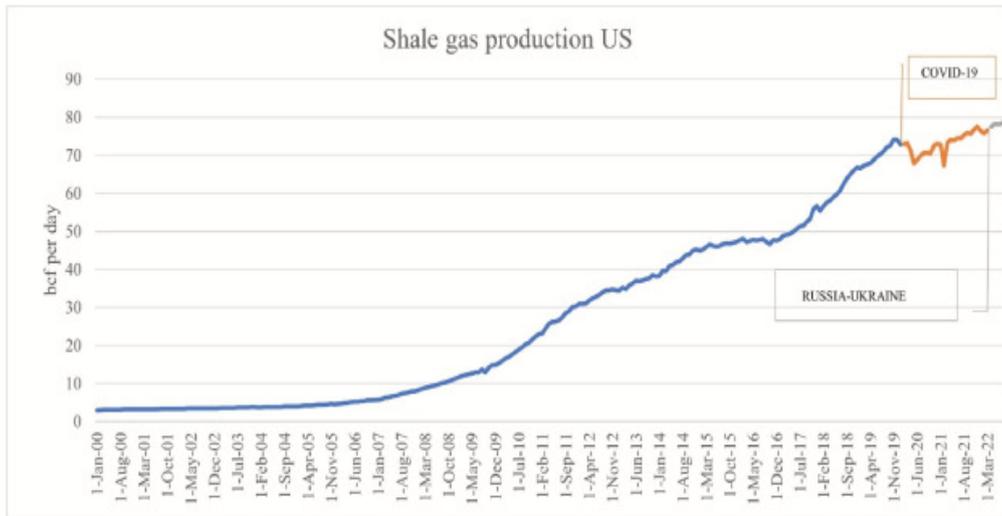- The energy sector;

- The defense;

- Global supply chains.

From an energy perspective, the United States has benefited in part from the increased uncertainty surrounding the security of supplies in the Eastern Mediterranean. The situation in Ukraine has been discussed in previous chapters, but the instability of shipping routes in the Red Sea and the Suez Canal must also be considered, which has prompted several European and Asian countries to increase their purchases of US liquefied natural gas, considered safer and more reliable than that from the Middle East. This has led to increased demand for US LNG, strengthening the country's role as a global energy exporter (this information was released by the US Energy Information Administration, 2024).

LNG is an acronym for *Liquefied Natural Gas* it is natural gas (mainly methane) that is heated to approximately -162 ° C , thus turning it into a liquid state and reducing its volume by approximately 600 times compared to its gaseous state (in this form it is much easier and more convenient to transport by ship, especially over long distances, where pipelines cannot reach). In the United States, LNG has taken on a strategic role in the last ten years, thanks in fact to the development of *shale gas,* (extraction from shale rocks), the USA has become one of the world's leading producers of natural gas and, starting in 2016, has begun exporting it in liquefied form through coastal terminals (today the United States is the leading global exporter of LNG, with terminals in Texas, Louisiana and other Gulf states). American liquefied gas is mainly directed towards Europe (growing strongly after the reduction in Russian supplies starting in 2022) and Asia (especially Japan, South Korea, China, and India)[25]. The following figure shows the surge in shale gas production.

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[25] Solarin, S. A., Lafuente, C., Gil-Alana, L. A., & Goenechea, M. (2024). COVID-19 pandemic, Russia-Ukraine conflict and shale gas development: Evidence from fractional integration, *Heliyon, 10* (7).

Source: Solarin , SA, et al. (2024)

This export capacity makes U.S. LNG both an economic tool, bringing significant revenue to the energy sector, and a geopolitical one, strengthening trade and diplomatic relations with importing countries.

At the same time, however, the volatility of crude oil prices, driven by regional tensions and the reactions of OPEC+ [26], has impacted industrial costs and inflation in the United States, with second-order effects on manufacturing margins.

The following figure shows the inflation trend in the US.
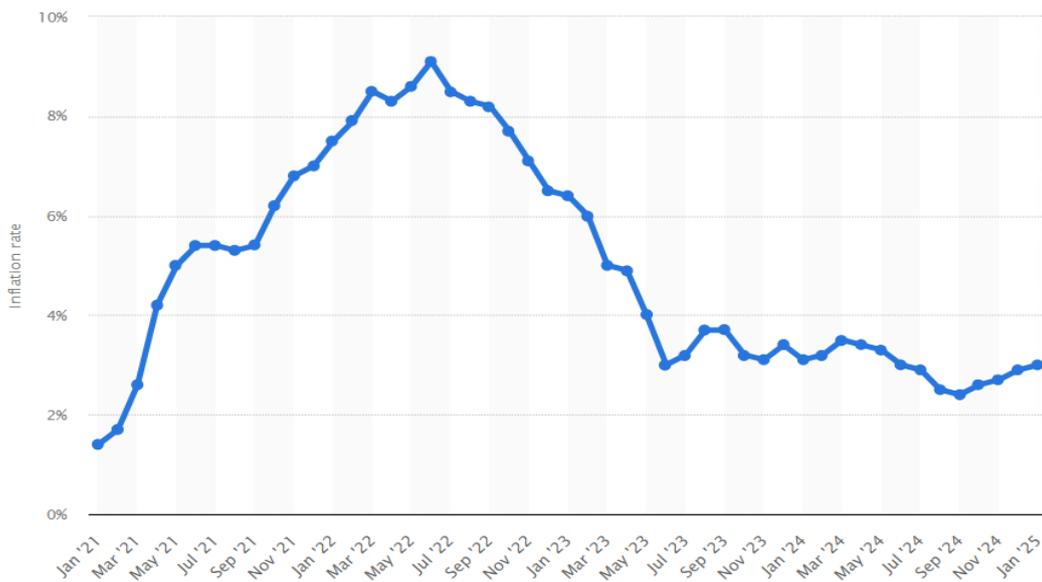
Source: Statista.com (2025)

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[26]OPEC+ is an expanded cartel that unites the world's major oil exporters (OPEC plus other partners such as Russia) to coordinate production and influence global energy prices.

Besides energy, the defense sector has benefited most immediately and visibly from the crisis, as rising tensions in Ukraine and the Middle East have fueled international demand for armaments, air defense systems, and military technologies. U.S. companies in the sector (including Lockheed Martin, Raytheon Technologies, Northrop Grumman, and others) have been hit hard by the crisis. Grumman and General Dynamics have seen a particularly strong increase in orders and share prices in 2024 and 2025. [27]This trend has been supported both by direct orders from Israel and regional partners and by increased military spending in Europe and Asia, which has seen the United States as a strategic supplier. The American defense industry has thus strengthened its global leadership position, inserting itself into a context of "widespread rearmament" fueled by geopolitical instability. Below is an image showing the growth in spending on military aircraft compared to civilian ones (2023).

United States Defense Market: Active Fixed Wing Aircraft, in Units, United States, 2023
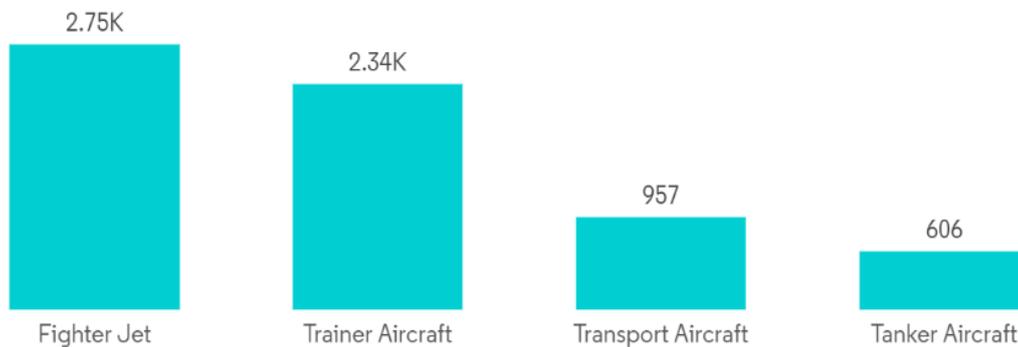
Source: Mordor Intelligence (2024)

US supply chains, however, have come under negative pressure. Disruptions in Red Sea trade have increased transportation costs and lengthened delivery times for goods from Asia, impacting key industrial sectors such as automotive and electronics[28]. While the United States does not directly rely on the Suez Canal for its trade, rising global freight and insurance prices have also had indirect effects on American imports, particularly for

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[27] Congressional Research Service, 2024.

[28]World Bank (2024). *Commodity Markets Outlook: Conflict and Commodities,* Washington, DC

intermediate products used by manufacturing industries[29]. Overall, the Russia-Ukraine and Israeli-Palestinian crises have produced a mix of differentiated effects for US industry: opportunities for the energy and defense sectors, and additional costs for globalized production chains. These developments highlight the dual nature of geopolitical crises for the American economy, which simultaneously benefits from new trade opportunities and suffers from increased uncertainty and systemic costs.

3.4 Donald Trump's tariff policy: tools, economic aspects and global implications (2018–2025)

US President Donald Trump's trade policy has marked the explicit return of tariff protectionism to the center of the US economic agenda. Section 232 of the *Trade Expansion Act* of 1962 is a provision that allows the President of the United States to impose tariffs or restrictions on imports if the Department of Commerce deems them to pose a threat to national security. The notion of security is not limited to military matters but also includes industrial sectors considered strategic to the country's economic autonomy. A well-known example is the Trump administration's use of this measure in 2018, introducing 25% tariffs on steel and 10% on aluminum, arguing that heavy dependence on foreign trade could weaken American production capacity in the event of a crisis. This instrument has often been criticized internationally as a form of protectionism justified on security grounds. Section 301 of the *Trade Expansion Act The 1974 Act,* on the other hand, is designed to address trade practices deemed unfair by other countries. It grants the US Trade Representative (USTR) the power to initiate investigations and, if necessary, impose punitive duties or other retaliatory measures. It has been used extensively against China, accused of intellectual property theft, imposing mandatory technology transfers on foreign companies, and adopting discriminatory industrial policies. Between 2017 and 2018, the use of Section 301 led to the introduction of cross-tariffs between the United States and China, marking the beginning of the so-called "trade war" between the two powers.

Section 301 negotiations with China, until the new tariff cycle in 2025, the US's declared objective has been to "rebalance" the trade balance, relocate production, and strengthen

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[29]International Monetary Fund, 2024.

manufacturing employment. In practice, the choice to broadly and selectively increase tariffs has generated redistributions between sectors and families, costs for consumers, foreign retaliation, and a reorganization of global value chains[30]. The United States has leveraged three main legal bases: Section 232 (national security; steel and aluminum), Section 301 (China's unfair practices on Intellectual Property), and Property IP and technology transfers) [31], and, in 2025, additional announcements and measures, such as the threat of generalized "reciprocal tariffs" later remodulated with sectoral carve -outs and postponements [32].

The result was an increase in the average rate applied: in 2018–2019 through progressive lists on hundreds of billions of dollars of imports from China; in 2025 with an initial estimated jump towards levels close to 30% on average, subsequently reduced by exemptions and adjustments. [33]Looking back at the first significant interventions, in 2018–2019, 25% tariffs were imposed on four "lists" of Chinese imports up to a total of over 300 billion dollars, with subsequent increases/adjustments. In 2020, "Phase 1" with China began, and in 2025 the administration announced a very broad tariff package, later partially mitigated by exemptions for goods/countries and deferrals, while the tariff hike continued on some sectors (steel, aluminum, automotive) and partners. Below is the average tariff trend.

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[30] Amiti, M., Redding, S. J., & Weinstein, D. E. (2019). *The Impact of the 2018 Tariffs on Prices and Welfare,* Journal of Economics Perspectives, 33(4), 187–210.

[31] Section *301 of* the Trade Act of 1974 is the legal instrument by which the President of the United States (through the US Trade The United States Representative (USTR) can adopt unilateral trade measures – such as tariffs – against countries deemed guilty of unfair, discriminatory practices or practices that infringe the trade rights of the United States. In the case of China, the Trump administration (starting in 2018) used *Section 301* after an investigation that concluded that Beijing: imposed forced technology transfers on foreign companies; did not adequately protect American intellectual property (patents, trademarks, copyrights); and provided subsidies that distorted competition. For this reason, when you read *"Section 301 tariffs"* in official USTR documents or academic articles, it is often misleading *related to IP",* means that those duties were justified by reference to violations of intellectual property rights and practices related to technology transfer in China.

[32] US Trade Representative (USTR). (2018–2020). *Section 301—China Tariff Actions* (Lists 1–4; official notes and press releases).

[33] McKibbin, W.J., et al. (PIIE). (2025, June 25). *The Global Economic Effects of Trump's 2025 Tariffs,* PIIE Working Paper 25-13 (and SSRN version).

Average US Tariff Rate (2017–2025)
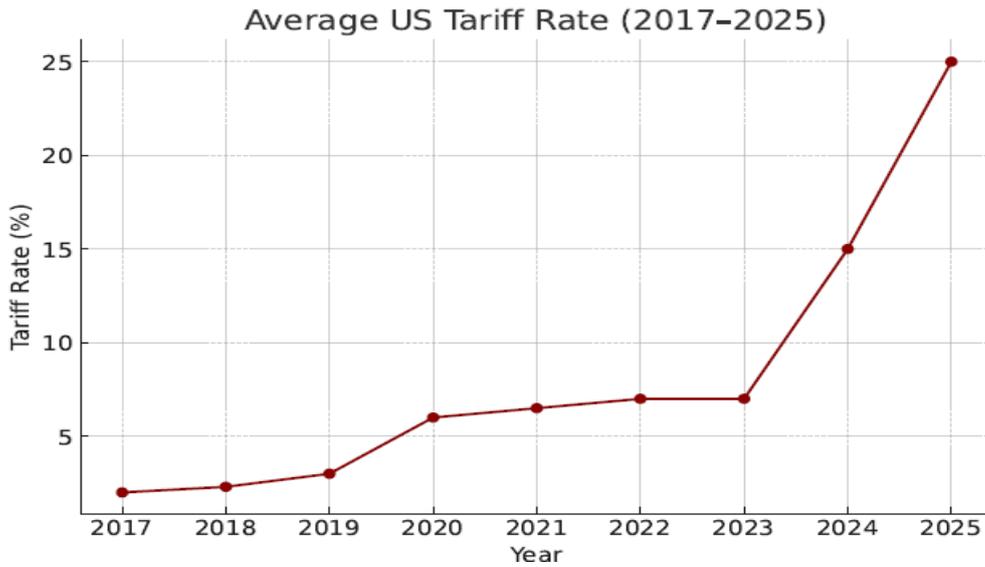
Source: Personal elaboration on data from: McKibbin, W.J., et al. (PIIE). (2025)

3.4.1 The economic effects

Micro-empirical evidence shows that the *pass -through* of tariffs to domestic prices was high: price increases were rapidly passed on to final and intermediate goods, reducing households' [34]real income and compressing the margins of importing firms.

The Penn Wharton Budget Model estimates significant long-term macro effects: GDP - 6%, wages -5%, and a loss of income over the lifetime of the median family measurable in tens of thousands of dollars [35].

Independent analyses (Tax Foundation, Yale Budget Lab) converge on an increase in consumer prices in the order of 1–2 percentage points and an average annual burden per family in the order of $1,300–$3,100 [36]. Evidence also shows that the cost fell largely on US businesses and consumers, not on foreign sellers (PIIE, 2025). Below is a graph illustrating the estimated impact of the tariffs on GDP and wages.

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[34]Amiti, M., Redding, S. J., & Weinstein, D. E. (2019). *The Impact of the 2018 Tariffs on Prices and Welfare,* Journal of Economics Perspectives, 33(4), 187–210.
[35] Penn Wharton Budget Model (PWBM), 2025
[36] Tax Foundation, 2025; Yale Budget Lab, 2025

Estimated Impact of Tariffs on GDP and Wages (2017–2025)
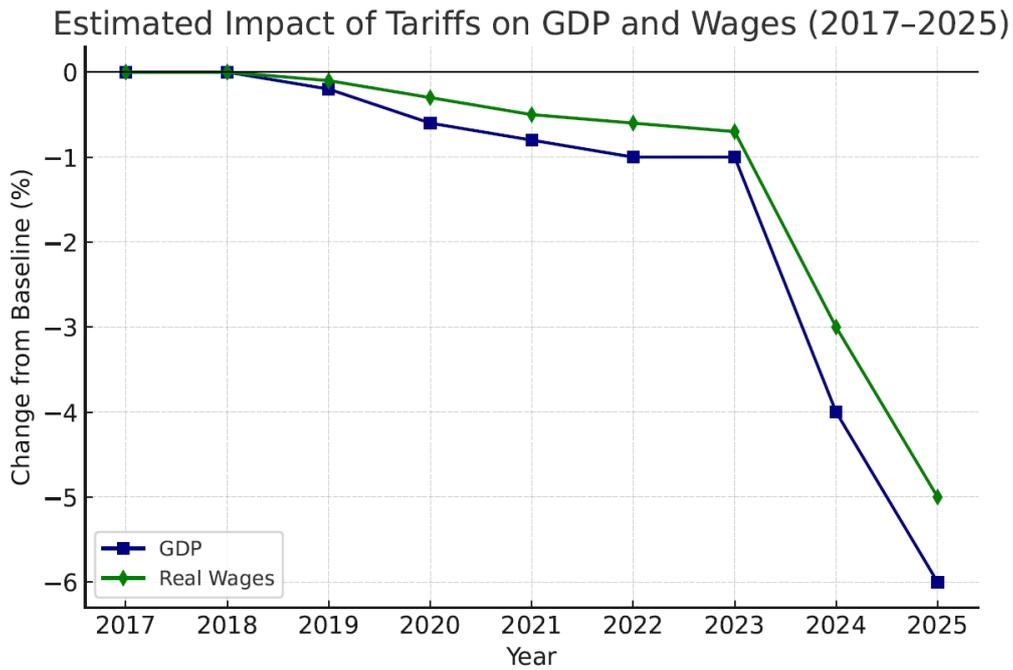
Source: Personal elaboration on data from: Yale Budget Lab, 2025

Some "protected" sectors (e.g., steel) saw higher prices and revenues; but upstream and downstream sectors (automotive, machinery, electronics) saw increases in component costs and delays in supplies. The new 2025 cycle amplified uncertainty: after the announcement of "across-the-board" tariffs, *carve -outs* [37] and exemptions mitigated the average impact, but also increased regulatory volatility, complicating procurement and investment plans.

From a public perspective, in 2025 customs collection increased significantly, with very significant contributions from Chinese imports and, to a non-negligible extent, from allied partners, but the extra revenue is cyclical and does not compensate for the losses in welfare and efficiency estimated by the models [38].

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[37]A carve - out is a corporate transaction in which a company decides to separate and make independent part of its activities. – for example a division, a branch of a company or a subsidiary – while maintaining, at least in some cases, a link with it.
[38]PWBM, 2025; PIIE, 2025.

US Tariff Revenues (2017–2025, USD billions)

Source: PIIE (2025)
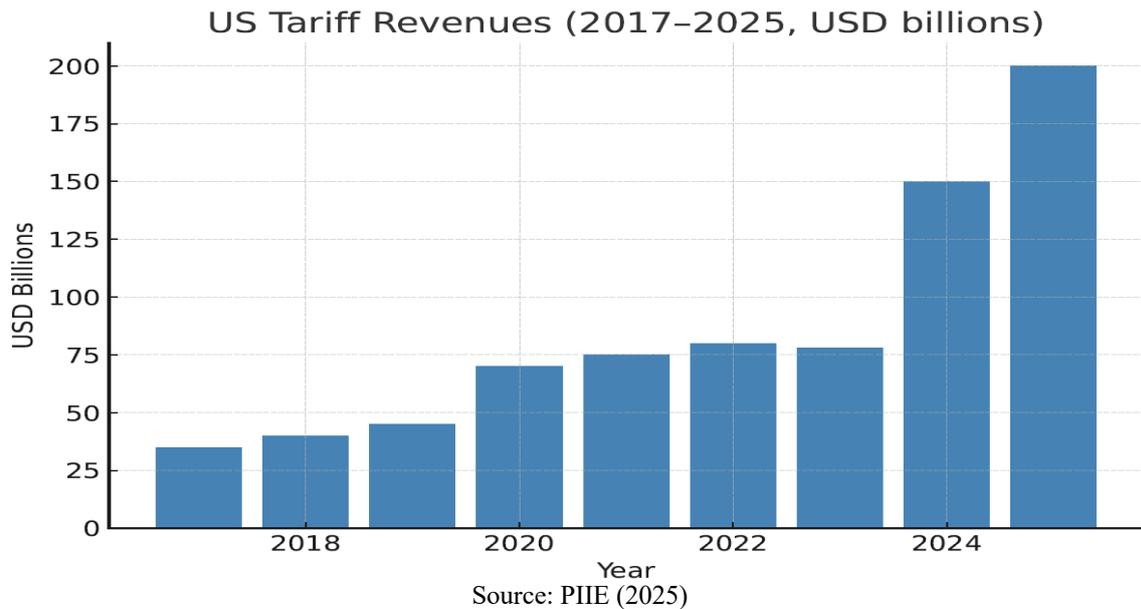
3.4.2 International trade post-US tariffs

Trump's tariff policy, as anticipated, pursued the objectives of re-localization and strengthening negotiations, however the accumulated evidence suggests that, at the levels observed, the tariffs increased domestic prices and made supplies chain more costly and less predictable, with benefits concentrated in certain sectors and costs spread across families and businesses. The impact on international trade is different, affecting not only bilateral flows but also multilateral ones and global value chains. The measures introduced during 2025 have led to an increase in the average US effective VAT rate to around 22-23%, a level not seen since the early twentieth century[39].

While the US has seen a widespread rise in consumer prices, with sectors such as clothing, textiles, and electronics particularly affected[2], internationally, US tariffs have led to reductions in exports to the US from many partners, with countries such as China experiencing the greatest impacts. However, these effects were partially offset by a greater direction of exports towards other alternative markets, Asia and Europe first and foremost, as well as by "trade diversion" which saw companies move their supply chain by choosing suppliers from third countries less subject to high tariffs[40].

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[39] The Budget Lab, "Where We Stand: Fiscal, Economic, and Distributional Effects of All US Tariffs Enacted 2025 Throughpril. " Yale Budget Lab, April 2, 2025.

[40] Fajgelbaum, Pablo D.; Goldberg, Pinelopi K.; Kennedy, Patrick J.; Khandelwal, Amit K. "The Economic Impacts of the US–China Trade War." NBER Working Paper No. 29315, 2021

One of the most significant effects is the contraction of global trade flows: according to recent analyses, world trade has reduced by 5.5-8.5% compared to what it would have been in the absence of the tariff shock, with international supply chains (Global Value Chains , GVCs) particularly affected as they are linked to multiple imports and exports through passages in different countries[41].

At the same time, countermeasures and retaliation by other countries have amplified the negative effects on some US exporting sectors, reducing foreign demand for previously freely accessible goods, such as agricultural and manufactured products[42]. Political and trade uncertainty have also played a role: exporting companies and those dependent on imported components have been forced to restructure their supply chains. Chains, adjustments to international contracts, and additional logistics costs and unexpected duties[43]. A further effect is on relative prices and competitiveness. With the increase in US tariffs, the dollar, as seen in the previous chapter, has strengthened, making US exports more expensive on international markets. At the same time, foreign companies exporting to the United States are facing higher costs, loss of market share, and, in some cases, reductions in production scale or shifting production to countries with more favorable tariff rates. Overall, it can be concluded that the 2025 US tariffs have generated not only a domestic protective effect (limited to specific sectors), but also a series of distortions in international trade: a decrease in US-partner bilateral trade , diversion to third countries, losses for US exporters who suffer retaliation, increased import costs for consumers and businesses, and a high degree of uncertainty that can hamper international investment.

The following table simplifies the effects described.

Effect / size	Description	Mechanism / key elements
Reduction in bilateral trade	Exports to the United States (or to the country imposing the tariffs) decrease	Foreign products become more expensive for US consumers due to tariffs; export demand drops
Trade diversion (trade diversion)	The affected exporting countries lose quotas, which are acquired by other third countries	Unaffected exporting firms can offer similar products at more competitive prices in markets with lower tariffs.

[41] CEPR / V-OXEU, "Roaring tariffs: The global impact of the 2025 US trade war." May 2025.
[42] JP Morgan Global Research. "US Tariffs: What's the Impact?" 2025.
[43] UC Davis, "Tariffs Can Improve US Economy, But Global Trade Realities and Retaliation Could Offset Gains", 2025

Effect / size	Description	Mechanism / key elements
Rising domestic prices / inflation	US consumers and businesses face price hikes on imported goods subject to tariffs	The duty is passed on to final prices, especially if there are no domestic substitutes
Cost for producers using imported inputs	Companies that use imported raw materials or components experience an increase in production costs	The tariff on inputs (not only on finished products) reduces the competitiveness of sectors having dependence on global chains
Retaliation and trade escalation	The affected countries respond by imposing tariffs against the exports of the country that imposed the tariffs.	The countermeasures further restrict global trade and generate instability in trade relations
Effects on GDP and global growth	The tariff can reduce domestic and global economic growth	Inefficiencies, lower production and declining exports contribute to reducing GDP
Distributive / redistributive effects	The impact weighs differently on income groups, sectors and regions	Low-income households spend a larger share on goods subject to tariffs; protected sectors gain, but other sectors with higher costs lose.
Possible theoretical paradox (Metzler, Lerner, etc.)	In specific cases, the imposition of a tariff could have unexpected effects on foreign or domestic prices.	For example, Metzler 's paradox suggests that in theoretical situations the relative domestic price of the imported good might decrease after a tariff.

3.4.3 The impacts of US tariffs on the EU and Italy

The increase in tariffs by the United States in 2025 has had significant consequences for the Italian and European economies. According to estimates by Confindustria, Italy risks losing approximately 20 billion euros in exports and over 118,000 jobs, with sectors such as mechanics, transport equipment, wine, and high-end typical food products particularly exposed[44]. The contraction in trade with the US is also reflected in gross domestic product: calculations indicate a loss of approximately 0.25% of GDP as early as 2025, with a possible overall reduction of up to 0.8% by 2027 in the absence of compensatory measures. A summary table of the effects is provided below[45].

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[44]Reuters, "US Tariffs Could Cost Italy up 0.8% GDP, Business Lobby Says," July 21, 2025.
[45]The impact is marked in sectors that are heavily dependent on the US market, such as fashion, luxury goods, and agri-food. In these sectors, tariffs reduce the competitiveness of Italian products, which are already characterized by relatively high prices.

Italian sector	Level of exposure / motivation	Estimated effects / evidence
Agri-food / wines / oils / cheeses	Very exposed sector because many Italian exports to the USA are "Made in Italy "food products	The tariffs imposed affected wines (~15%), extra virgin olive oil, cheeses, pasta, and preserves (e.g., 25% tariffs on cheese, olives/oil, etc.). Exports of extra virgin olive oil fell by 17%, and processed tomato products by 17% in the previous scenario.
Machinery / equipment / mechanics	It is a typical Italian sector and a significant part of exports to the USA	The 15% tariff (in the new US-EU agreement) includes products such as machinery and finished goods, impacting exporters' margins.
Automotive / motor vehicles / components	Italian vehicles and auto parts shipped to the US market face additional duties	Confindustria's analysis cites vehicles, mechanics and pharmaceuticals among the sectors affected by possible 30% tariffs.
Fashion / clothing / leather goods / luxury accessories	A symbolic sector of Italian exports of finished consumer goods	Fashion companies are absorbing 15% tariffs to maintain competitiveness, and the threat of tariffs is rocking the sector.
Metals / steel / aluminum (Section 232)	These materials are often subject to special duties related to "national security"	Under the new tariff framework, European steel and aluminium are hit by duties of up to 50% unless derogated.
Pharmaceutical / chemical	Although partly protected by exemptions, it is present among the sectors cited as risky	In a worst-case scenario, tariffs could damage pharmaceutical export prospects if exemptions were not fully implemented.

At European level, however, the aggregate consequences appear more limited: the affected exports represent less than 3% of the European Union's GDP[46].

However, the sectoral damage remains significant, particularly in steel and aluminum, where 50% tariffs remain in place despite the containment agreements reached with Washington. European institutions estimate that overall EU growth could decline by between 0.2% and 0.8% in the coming years, depending on the actual extent of the tariffs and the responses adopted by individual member states[47].

Following the bilateral agreement that set a 15% tariff cap on most European exports, uncertainty has been limited. In this context, Italy and its companies are pursuing market diversification strategies and investing in productivity and quality, especially in the luxury and food sectors, in an attempt to mitigate the loss of competitiveness in the US market.

[46]ICGAM, "Trade War Update: US-EU Trade Deal Reduces Policy Uncertainty and Downside Growth Risks," July 30, 2025.
[47]World Economic Forum, "The EU-US Trade Deal Explained: EU Competitiveness", 2025.

3.5 Trump's demands for NATO: increased military spending

Since 2018 Donald Trump has been making a burden sharing the linchpin of its Atlantic line, urging allies to respect (and exceed) the 2% of GDP target for defense. In 2025, political pressure is intertwined with a change of pace within the North Atlantic Treaty Organization (NATO): on the eve of and during the Hague Summit, it was reiterated that all allies are converging on 2% already in 2025, with additional long-term commitments to finance "core" capabilities by 2035 (NATO documents and statements by the Secretary General). The starting data that measures the effectiveness of US "moral suasion" is eloquent: according to SIPRI, NATO members that have reached at least 2% have increased from 11 in 2023 to 18 in 2024, with an Alliance average equal to 2.2% of GDP [48]. On the macro level, the increase in defense spending acts as a demand stimulus (public procurement, capital investment, R&D, skilled employment) but presents fiscal and distributional *trade –offs*. The economic literature reports that public spending multipliers vary with the cycle and with the spending mix: recent work distinguishes between purchases of goods (which have lower multipliers) and labor-intensive services (higher)[49]. For the United States, further structural defense increases are estimated to improve security but increase the deficit if not accompanied by higher revenues or cuts elsewhere. In short, security and aggregate demand benefits are expected in the short term; higher fiscal pressure in the medium to long term[50]. At the sectoral level, the spending push is concentrated on the defense industrial base (munitions, missiles, avionics, C2, cyber). The industrial strategy and the 2024-25 allocations target capacity and supply bottlenecks. chain, with dedicated investments to increase throughput and resilience [51]. Local economic impacts show income multipliers of up to 1.6, with an existing but not explosive direct employment impact. In 2024, the Aerospace & Defense sector generated $995 billion in total activity and $443 billion in economic value (approximately 1.5% of GDP), providing direct and indirect employment to millions of workers and supporting exports (higher military spending tends to translate into stronger orders and backlogs along these supply chains). Below is a figure showing the trend in military spending by NATO allies (2014-2025).
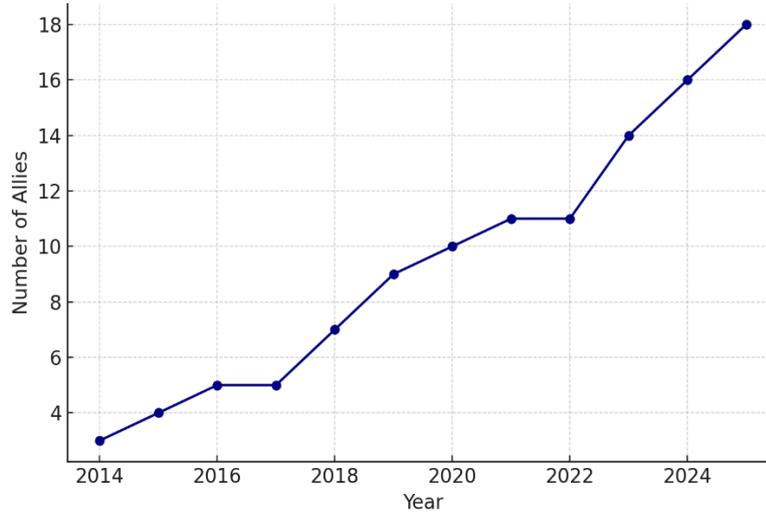
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[48] SIPRI. *Trends in World Military Expenditure, 2024* (April 2025). www.sipri.org.
[49] www.econoweb.
[50] www.cbo.gov.
[51] www.business.defense.gov.

NATO Allies Meeting the 2% Defense Spending Target (2014–2025)

Source: Personal processing based on bsuness.defence.gov (2025)

3.5.1 The repercussions on allied countries

For the EU, accelerating towards (and beyond) 2% of military spending means reallocating national budgets with a significant aggregate macroeconomic impact across sectors (shipbuilding, defense electronics, and ammunition). EDA data for 2025 indicate European spending of approximately 2.1% of current GDP, with a value increase of €381-392 billion, and confirmation of the regime shift also for *dual -use applications* (space, cyber, and reliable semiconductors)[52].

Trump's pressure to "pay more" has therefore accelerated this convergence, while fueling intra-European political debate on efficiency, duplication, and strategic autonomy. In general, the calls for increased military spending have had a real impact on allies' alignment with NATO targets and on the recovery of defense in advanced economies. Economic analysis suggests the following effects are possible:

(i)   Stimulating demand and production capacity in the short term;

(ii)   multipliers but not "pure Keynesian "and sensitive to the cycle and composition of spending;

(iii)   Tighter budget constraints in the medium term;

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[52]www.eda.europa.eu.

(iv)   geopolitical benefit that doesn't fully factor into GDP metrics but motivates public intervention. In Europe, the adjustment to the 2% spending target is underway; in the US, investments (munitions, critical supply chains) are being prioritized.

Defense Spending as % of GDP (2019–2025)
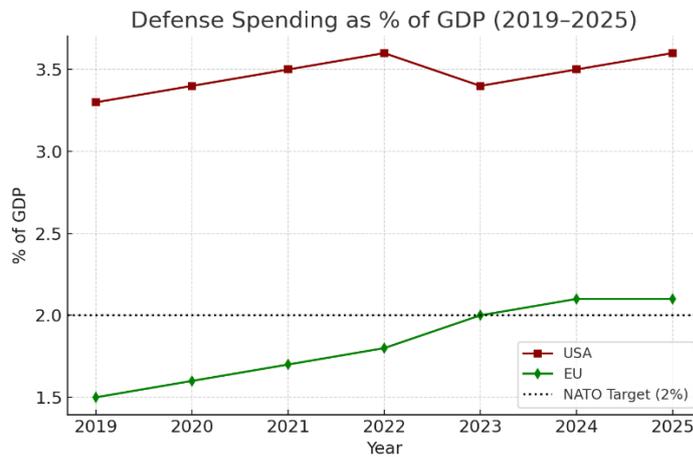
: Personal processing from eda.europa.eu

3.6 Trump and the boycott of Russian oil purchases

In September 2025, US President Donald Trump publicly renewed pressure on Europe and NATO allies to "immediately" cease purchases of Russian oil, linking this choice to the strengthening of the American sanctions package against Moscow, guilty of not stopping the attacks in Ukraine[53]. The European Union, already subject to the ban on the import of Russian crude oil "by sea" (from 5 December 2022) and petroleum products (from 5 February 2023), intensified coordination with the G7 on the *price in 2025. cap* , reducing the threshold on crude oil from 60 to 47.6 dollars a barrel and announcing additional measures on products and "shadow *fleet "(shadow fleet), that is, the network of oil tankers and maritime services that allows Moscow to evade controls. From a strictly* macro-energy perspective, the main lever is no longer crude oil directed to the EU (already prohibited by sea) but rather three channels:

- The EU's purchase of Russian LNG, still significant in 2025;
- Trade in refined products derived from Russian crude oil processed in third countries;
- The *enforcement* of the *price cap* on transport, insurance and services.

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[53]Bloomberg; The Guardian; Fox News

According to CREA estimates, in 2025, China will absorb approximately 47% of Russian crude oil exports, India 38%, and the EU 6%. However, the EU remains the largest buyer of LNG, absorbing approximately 50% of Russian exports. This would explain why Washington has asked Brussels for further tightening: not so much for crude oil (currently, EU demand is virtually zero) but for LNG. Today, the "shadow fleet" has allowed Moscow to circumvent the cap described, hence the intensification of sanctions and blacklisting of vessels and operators in 2025.

3.6.1 The global risk of rising oil prices

Based on the above, the net effects of a further contraction in Russian oil purchases depend on three variables: the participation of major non-G7 buyers (India and China), the elasticity of OPEC + supply, and, finally, Russia's logistical capacity to divert flows[54]. In 2025, OPEC+ cuts/reopenings and increased production by some non-OPEC+ countries have contributed to cooling prices from the early-year highs; in a scenario of more stringent cap enforcement and reduced outlets to the EU, the effect on global prices is ambiguous: increases are possible if Russian supply declines, but also decreases/neutrality if Moscow is forced to widen discounts to Asia or if OPEC+ and other producers compensate.

For the EU, the main cost is on LNG and refined product logistics: replacing Russian liquefied gas requires spot/ term contracts with the US, Qatar and Africa and possible transitory increases in regional gas (and electricity) prices during peak seasons.

For the United States, however, as anticipated in the previous pages, a European clampdown on Russian flows tends to push demand for US LNG and, in part, for US crude oil and products, with positive effects on exports, but also with the political risk of being perceived as economic "beneficiaries" of the restriction [55]. In summary, Trump's request has a strong political-strategic value, aiming to realign incentives among allies, pushing the EU to eliminate residual pockets of demand for Russian energy (LNG, "indirect diesel"), and to set the tone of negotiations with third-party players (primarily India and China, currently the largest buyers of Russian crude oil). In September 2025,

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[54]Reuters, "EU likely to propose G7 lowering price cap," May 19, 2025; "India's Russian oil imports set to rise despite US punitive tariffs," August 28, 2025.
[55]Reuters, "EU likely to propose G7 lowering price cap," May 19, 2025; "India's Russian oil imports set to rise despite US punitive tariffs," August 28, 2025.

the EU has already taken steps towards a 19th sanctions package with a ban on LNG and a further price cut cap, as well as an intensification of the contrast to the shadow fleet.

A problem of internal cohesion remains, requiring management of the differential impacts among member states most exposed to spot gas and maritime flows. Moreover, the idea of combining tariffs or secondary measures against buyers of Russian oil is politically sensitive and could frustrate partners like New Delhi, which increased purchases in 2025 despite US pressure. In short, while the request by allies to eliminate Russian oil (and energy) purchases is economically consistent with the Kremlin's goal of reducing war revenues, the effectiveness of such a measure depends on G7-EU coordination and, above all, on the response of India and China.

## 3.7 Trump's initiatives and their impact on global monetary policy

US policy is deciding the global economic fate in many ways.

For example, the introduction of US tariffs under the Trump administration has put pressure on many central banks, forcing them to revise their monetary policy trajectories to address external shocks such as imported inflation, market uncertainty, and changes in trade flows. These reactions add to those already underway following the outbreak of the war in Ukraine, which deserve further analysis. In this latter circumstance, the European economy suffered a severe shock, particularly in the energy sector, and, consequently, the European Central Bank's monetary policy was affected. The most immediate effect, in addition to manifesting itself through the energy shock, was the increase in geopolitical uncertainty, which, as is well known, has economic implications. The drastic reduction in gas and oil supplies from Russia has triggered a surge in energy prices, which has pushed euro area inflation to record levels, averaging 8.4% in 2022 and peaking above 10% in some member states.

This dynamic forced the ECB to abandon the negative interest rate policy that had characterized the previous decade. In July 2022, the institution decided on its first rate hike in over eleven years, increasing by 50 basis points, thus ushering in a phase of monetary normalization. Over the next two years, Frankfurt continued with rapid and significant increases, raising the deposit rate to 4% to anchor inflation expectations. This path, however, increased the risk of recession, especially in countries most dependent on Russian gas imports, and opened a delicate discussion on the distributional effects of

monetary policy in an area characterized by strong structural divergences. In addition to the rate hike, the ECB had to address the threat of financial fragmentation resulting from the widening of sovereign spreads. To prevent differences in financing costs between member states from compromising the unity of the currency area, the Transmission mechanism was introduced in July 2022. Protection Instrument (TPI), an instrument aimed at containing unjustified divergences in government bond yields and ensuring the effective transmission of monetary policy.

In 2025, with inflation gradually declining but still hovering around 2.5%, the ECB has adopted a prudent stance, maintaining high rates, preferring to consolidate the credibility of its policies and monitor geopolitical developments. Below is a figure illustrating the trend in interest rates adopted.

ECB Key Interest Rates, 2019-2025
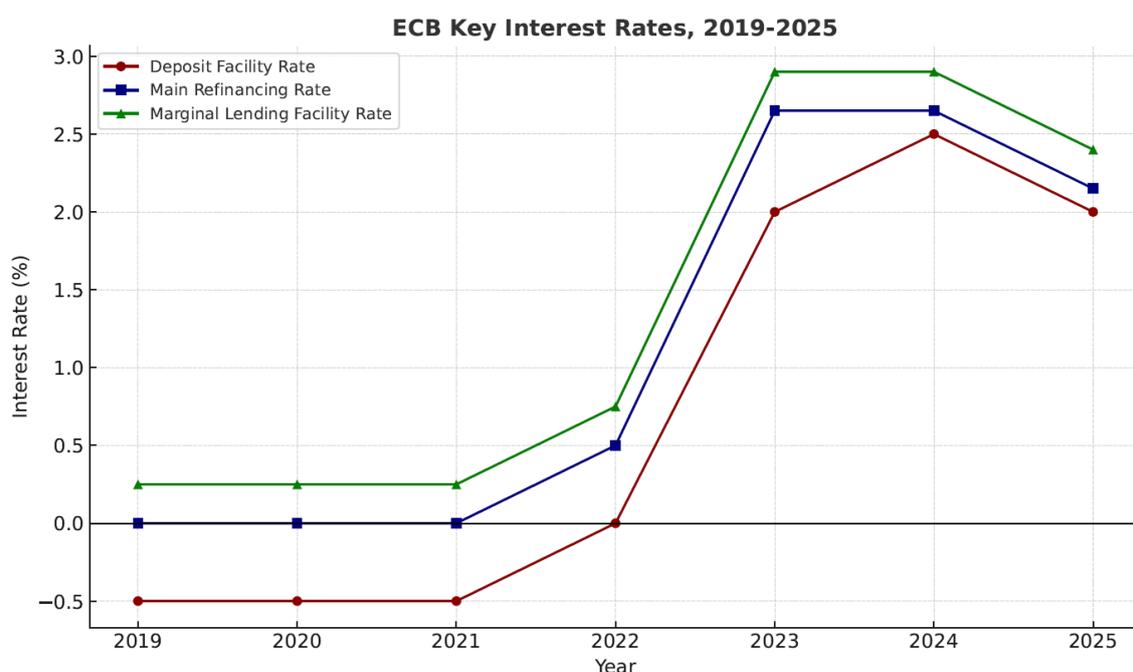
Source: Own calculation based on data from EBA (2025)

The war in Ukraine continues to pose a significant risk, not only for energy prices, but also for the stability of supply chains and their interactions with national fiscal policies[56]. Trump's tariffs have added new concerns by increasing the price of imported goods for

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[56]Overall, the conflict transformed the ECB's monetary policy, which from being primarily geared to supporting growth found itself operating as the main lever for containing supply-side inflation, in a context of high uncertainty and the constant threat of financial fragmentation. This experience demonstrates how large-scale geopolitical shocks can redefine central banks' priorities, imposing complex trade-offs between price stability, economic growth, and the institutional cohesion of the euro area.

the US and also have effects "outside US borders": countries that rely heavily on US imports or whose supply chains rely on inputs affected by the tariffs find themselves receiving "indirect pass-throughs" of inflation. The Central Bank, which pursues price stability objectives, has thus found itself faced with the challenge of deciding whether to respond by raising interest rates to neutralize imported inflation or to wait for these effects to subside, risking inflationary expectations becoming entrenched. In general, the uncertainty generated by U.S. trade policy (including tariff announcements, retaliatory measures, and sudden policy changes) has complicated macroeconomic forecasting for global central banks. Many have adopted a "*wait -and- see* "approach, meaning they have delayed or slowed down interest rate decisions to better assess the cumulative impact of tariffs on growth, inflation, and international trade. This is also because overly aggressive policies can jeopardize domestic growth if the environment turns recessionary. In the United States, the tension between the goal of containing inflation and preserving full employment is requiring close attention from the Federal Reserve. The Bank has decided to introduce a mechanism for the ongoing monitoring of the effects of foreign trade as a relevant variable[57]. In Europe, the European Central Bank (ECB) has expressed concern about the inflation risks of US tariffs (particularly inflation on imported inputs and the cost of finished goods), considering that such pressures could delay the path to monetary normalization (i.e., the gradual reduction of interest rates) if inflationary pressures persist. A less visible effect is the potential lowering of the so-called *natural rate* (neutral rate). In this regard, the study *Tariffs, Trade Wars, and the Natural Rate of Interest* [58] suggests that an intense trade war, such as the one in the US, reduces global demand for investable goods, disrupts trade flows, and increases country risk, all factors that tend to depress the neutral rate. The following figure, taken from the cited study, highlights the relationships described.

[57] The Budget Lab, "Where We Stand: Fiscal, Economic, and Distributional Effects of All US Tariffs Enacted 2025 through April." 2025.
[58] Mehrotra, N. (2025). *Tariffs, Trade Wars, and the Natural Rate of Interest,* NBER Working Paper W34206
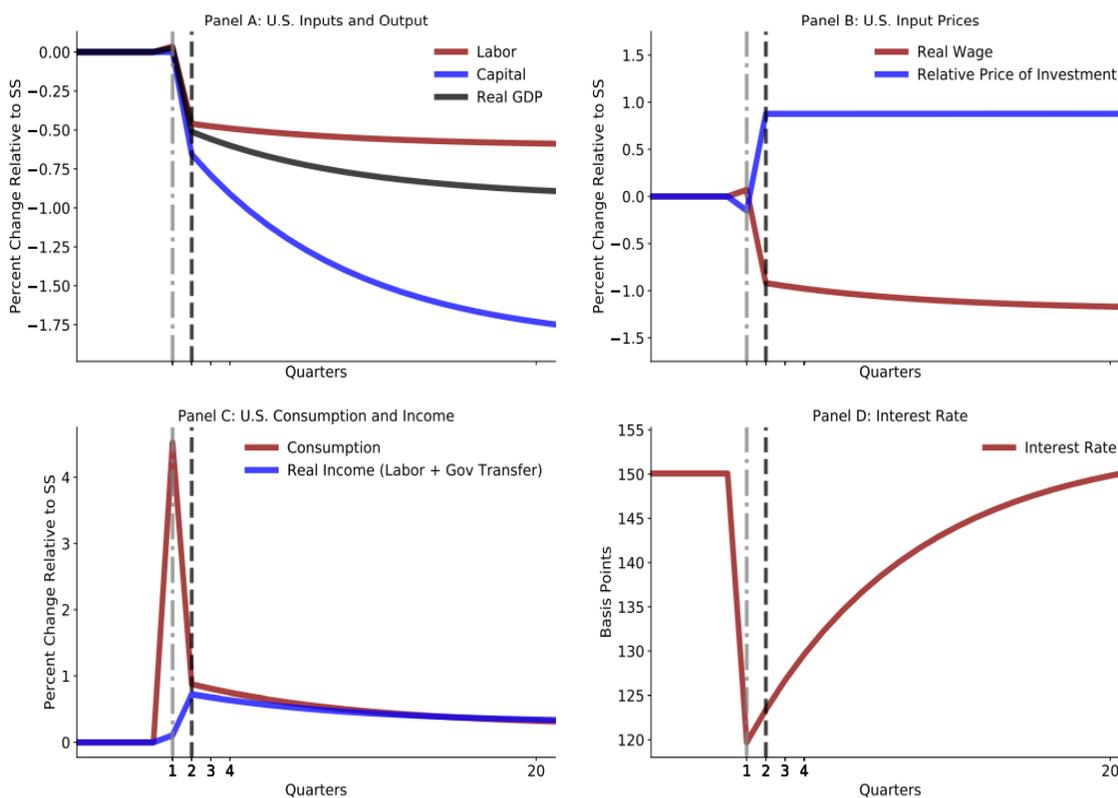
Source: Mehrotra, N. (2025)

The Figure analyzes four aspects of the tariff increase: (i) the response of capital and labor as well as the trend of real income in the United States, (ii) the trend of relative prices in investment and real wages, (iii) consumption and real income, and (iv) the interest rate.

When the tariff is announced (first quarter) and subsequently implemented (second quarter), a decline in the employment of capital and labor is observed, which leads to a contraction in US real GDP: about –0.5% immediately after the tariff takes effect and up to –1% in the long run.

The mechanism is linked to the increase in the relative price of investments, which reduces the demand for capital, and the simultaneous decline in real wages (–1%), linked to rising prices, which leads to fewer workers and firms requiring fewer inputs. Consumption is financed through reduced savings and increased use of income from capital assets. This occurs both as a result of the expected increase in consumer prices (which leads to early purchases) and the decline in global interest rates (–30 basis points at the time of the announcement), which makes it more convenient to consume immediately. Finally, similar dynamics are observed globally: in Europe and China, relative prices of investments are rising, albeit to a lesser extent than in the United States, contributing to the overall movement of international interest rates. In short, the effect of global monetary policies in response to US tariffs, which determine the mechanisms

described, demonstrates a fragile equilibrium. On the one hand, central banks must mitigate inflationary effects and uncertainty; On the other hand, they must prevent countermeasures from compromising domestic growth or destabilizing financial markets. The law, with its normative framework, serves as both a limit and a reference point; at the same time, central bank mandates, institutional independence, and international obligations provide frameworks that constrain monetary policy responses. The main concerns concern the evolution of these balances, which are explored in more detail below.

4. THE FUTURE ROLE OF THE UNITED STATES: PROSPECTS FOR THE NEXT DECADE

Premise

The international economic landscape in recent years has been strongly influenced by US economic policy decisions, particularly the policies introduced by Donald Trump upon his first inauguration and reiterated in his new term. Expansionary fiscal policies, a protectionist approach to trade, and the desire to reshape economic relations with key *partners* have had immediate effects, but more importantly, they have fueled expectations that influence the behavior of operators and global financial markets. Analyzing Trump's economic program, with its objectives and tools, allows us to better understand the possible trajectories for the US economy and global balance. In particular, it is important to examine the expected effects in terms of growth, employment, investment, and fiscal sustainability, as well as the repercussions on international trade relations. In this context, the currency market plays a central role, reflecting and amplifying economic and political dynamics. Indeed, exchange rate expectations, particularly the euro/dollar exchange rate, are a key indicator not only of confidence in the economic fundamentals of the two blocs but also of perceptions regarding geopolitical and monetary stability. Another important aspect concerns the exchange rate against the Chinese renminbi (yuan), a currency increasingly used in international trade and a potential long-term competitor to the dollar's dominance as the global reserve currency. The following chapter therefore aims to analyze Trump's economic policy program and its expected effects on the economy, before delving into the outlook for the main exchange rates, the euro/dollar and the dollar/yuan. This investigation will highlight how political choices and currency dynamics are closely intertwined, offering a useful framework for interpreting the transformations underway in the international economic landscape. Future projections must be interpreted in light of the international economic and geopolitical context, which is undergoing profound transformation, characterized by the intertwining of new global tensions, power politics, and the reorganization of value chains. The United States, as the leading economic and military power, plays a decisive role in the development of these dynamics, both through its domestic political choices and the magnitude of its impact on global equilibrium. In this context, the projected increase in US military spending is crucial for understanding future scenarios. On the one hand, this increase represents a driving force for the defense industry and technological innovation, with direct effects on economic growth; on the other, it raises significant questions about fiscal sustainability

and the geopolitical balance it will generate, as it may also stimulate emulation among allies and strategic competitors.

In addition to these concerns, the evolution of international trade is also increasingly uncertain. The era of intense globalization appears to be giving way to a fragmented system, in which regionalization processes, the use of protectionist policies, and a focus on the resilience of supply chains are strengthening. Analyzing trade with a *forward-looking perspective looking* means, in short, considering not only traditional economic variables, but also the growing weight of geopolitical, environmental, and technological factors, which will certainly shape the trajectories of trade in the coming decades.

In this scenario, the future role of the United States in the global landscape remains central, albeit increasingly contested. While the dollar remains the reference currency in international markets and the American economy retains a strong capacity to attract capital and innovation, competition with emerging powers, primarily China and India, opens up unprecedented scenarios of economic multipolarity. A forward-looking assessment highlights the challenges the United States will face in maintaining its economic and political leadership, as well as the opportunities arising from its ability to adapt to a rapidly changing global context. The following chapter therefore aims to analyze, from a prospective perspective, three closely interconnected aspects: the economic impacts of increased American military spending, the evolving trends of international trade, and the role of the United States in the new global balance.

4.1 The political program Donald Trump's economic

Donald Trump's economic program is based on a combination of various factors: on the one hand, trade protectionism, tax cuts, deregulation, and, on the other, policies aimed at stimulating domestic production, under the slogan *America First. The Cuts and Jobs Act (TCJA)* of 2017 is a cornerstone of this legislative approach. The law's central focus is a reduction in the corporate tax rate (from 35% to 21%) and cuts in individual taxes, with the goal of increasing household after-tax income and incentivizing business investment. Studies by the Tax Policy Center and the Congressional Research Service shows that the TCJA was initially successful in stimulating production in the short term, increasing disposable income, but that the long-term effects on growth, investment and public debt are more limited and uncertain[59].

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[59] Congressional Research Service, *Economic Effects of the Tax Cuts and Jobs Act* (2025).

As seen in the previous chapter, the tariff measures introduced during the Trump presidency have become an integral part of his political and economic framework. The tariffs on products from China and other trading partners have had a significant two-fold effect: on the one hand, they have protected certain domestic sectors and increased pressure on international partners to renegotiate trade terms in favor of the United States. On the other, they have generated additional costs for US consumers, disruptions in supply chains, and retaliatory reactions that have reduced the potential benefits. The evolution of these measures is the subject of various studies.

Recent analyses, such as those from Yale's *Budget Lab*, estimate that all tariffs approved in 2025, including those with countermeasures by other countries, will reduce US real GDP growth by approximately 0.9 percentage points by the end of the year, with a persistent negative effect on output levels in subsequent periods[60]. Regarding deregulation, Trump's program calls for revisions or complete elimination of regulations in various sectors: energy, environment, and finance, believing that this measure will reduce costs for businesses and stimulate production expansion. This strategy, combined with tax cuts, aims to increase the United States' external competitiveness, boost domestic production, and attract foreign investment, or at least encourage the internal localization of production that would otherwise be imported. However, the fiscal sustainability of such policies is emerging as a central issue: many projections show that continuing tax cuts will lead to increases in the federal deficit in the order of several trillion dollars over the next 5-10 years (which may need to be offset by higher revenues or spending cuts) [61].

4.1.1 The expected effects on the world economy

The overall expected impact of Trump's economic policies on international trade, investment, and global industry appears mixed: while investment in some sectors is being stimulated and domestic production has been boosted, partly due to fiscal policies, tariffs and international responses could introduce uncertainty, fragmentation in global value chains, and inflationary pressures, which could require governments to make adjustments.

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[60]Yale Budget Lab, *Where We Stand: Fiscal, Economic, and Distributional Effects of All US Tariffs Enacted 2025 Through April 2025*

[61] Rasool, S., Reinsch W.A., and Denamiel T., Revenue Implications of Tax Cut and Jobs Act Provisions in 2025, CSIS, December 19, 2024

The issue of increased tariffs introduced by the US is generally generating many negative expectations internationally.

The following figure shows expectations for future GDP growth in EU countries and Italy.
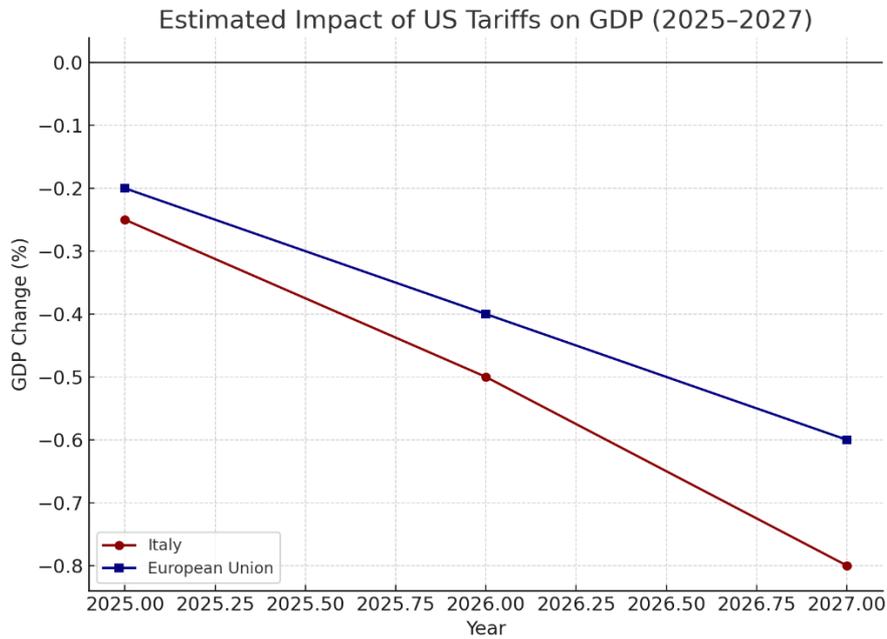
Source: Personal elaboration from Rasool S. et al. (2025)

Specifically, the graph shows an estimate of the impact of US tariffs on the gross domestic product (GDP) of Italy and the European Union over the period 2025–2027. The horizontal axis represents the years considered, while the vertical axis measures the percentage change in GDP compared to a baseline scenario without tariffs.

The estimated effect is negative in both cases, but more pronounced for Italy than the European Union average, as it reflects the high dependence of Italian exports on the US market. The trend therefore highlights a "cumulative impact" of tariffs: the trade shock does not end in the short term, but tends to propagate over time, progressively eroding economic growth. From an economic point of view, as anticipated, these differences can be explained by the Italian production structure, which is more dependent on exports to the US market in sectors such as manufacturing and agri-food, which are particularly exposed to tariff measures, while the European Union, thanks to greater sectoral and geographical diversification, is able to partially compensate with access to other markets, reducing the average impact. Among the studies that confirm these conclusions, those of the European Commission (2023) and CEPS (2024) demonstrate that Member States with

an economy more oriented towards exports to the United States are more vulnerable to protectionist policies[62].

In addition to these studies, analyses by the International Monetary Fund (IMF, 2023) [63]and the OECD (2024) [64]have highlighted that a persistent increase in tariff barriers translates not only into welfare losses for consumers and businesses, but also into a decline in investment due to uncertainty, with effects that tend to consolidate in the medium term. According to a study by Confindustria (2024)[65], Italy, due to its high trade openness and specialization in intermediate goods, could suffer greater repercussions (in the order of 2 or 3 percentage points) than the European average in terms of GDP reduction and loss of competitiveness. Overall, the previous graph supports the idea that US tariffs determine a significant economic cost not only for direct trading partners, but also for global macroeconomic stability. Italy appears particularly penalized, and this confirms the need for a common response from the European Union, aimed at strengthening the resilience of member states and collective negotiating capacity in relations with Washington.

4.2 Exchange rate expectations: Euro/Dollar

EUR/USD exchange rate forecasts tend to point to moderate euro appreciation in the coming months, but risks remain that could cause the exchange rate to fluctuate in alternative scenarios. Several financial institutions estimate that this exchange rate could reach around $1.19 per euro by September-October 2025, potentially rising to $1.22-$1.23 in spring 2026, should U.S. monetary policy show signs of easing and the eurozone demonstrate economic and fiscal stability (as predicted by JP Morgan and UBS) [66].

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[62]CEPS (2024), *EU Trade Policy in a Fragmented World: Adjusting to US Tariffs.* Brussels: Center for European Policy Studies; European Commission (2023), *Impact Assessment of US Tariffs on EU Member State* . Brussels.
[63]IMF (2023), *World Economic Outlook: Fragmentation and Trade Policy Uncertainty,* Washington, DC.
[64]OECD (2024), *Trade Policy and Global Value Chains: Implications of US Tariff Measurements*. Paris: OECD Publishing.
[65]Confindustria (2024), *Trade Policy Scenarios: Impacts of US Tariffs on the Italian Economy,* Rome.
[66]UBS Wealth Management, *Euro Forecast 2025-2026,* 2025, in capital.com.

EUR/USD Exchange Rate: Historical and Forecast (2019-2026)
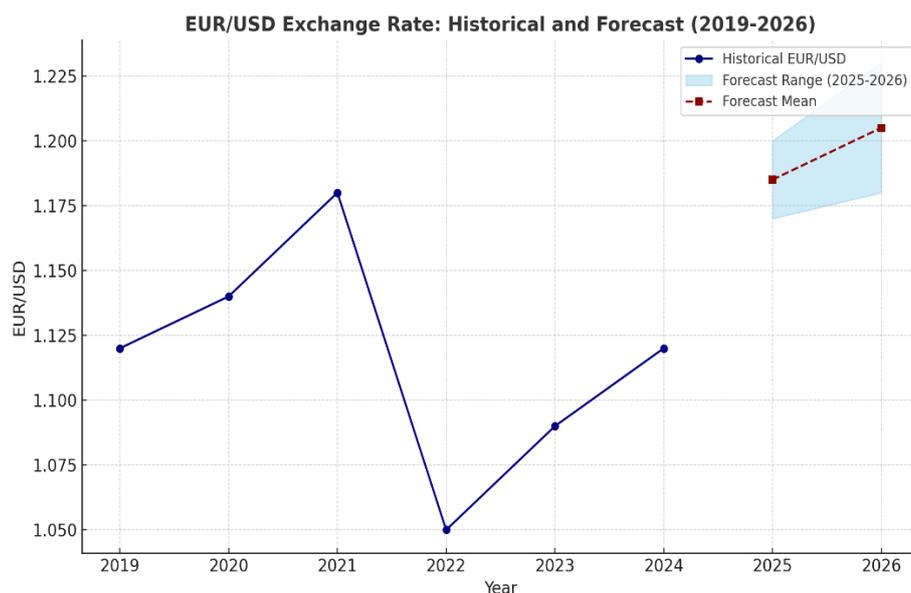
Source: Own elaboration on JP Morgan data (2025)

Other less optimistic scenarios suggest that the exchange rate could remain in the range 1.14-1.18 by the end of 2025, especially if the Federal Reserve maintains relatively high interest rates or if new external shocks (political or energy) emerge that suggest the dollar as a safe haven currency [67]. Overall, average expectations are for the euro to gradually improve against the dollar, supported by factors such as a possible weakening of the dollar due to expansionary US fiscal policies, domestic political uncertainty in the United States, or pressure on interest rates. However, this positive outlook is contingent on a number of factors: the inflationary environment in the United States, the Fed's actions, and the macroeconomic performance of the eurozone remain decisive factors.

### 4.2.1 Dollar/Yuan exchange rate expectations

JP Morgan has lowered its forecast for the end-2025 USD/CNY rate from 7.30 to 7.15 yuan per dollar, anticipating further strengthening of the yuan towards 7.10 during 2026[68]. There is no shortage of alternative forecasts emerging that place the USD/CNY rate between 7.30 and 7.20 by the end of 2025, with modest variations and volatility related to Chinese domestic policies, US/China interest rates, and movements in international trade[69]. Importantly, the Chinese central bank (PBoC) is continuing to set its reference

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[67]HSBC / Berenberg, forecasts on EUR/USD end-2025 and medium term, in currencynews.com
[68]JP Morgan, "USD/CNY Forecast Revised : Easing Tariff Risks and De- Dollarization Trends", 2025
[69]ABN AMRO, "FX Weekly — New USD/CNY Forecasts," May 2025.

rate ("fixing") around 7.20, despite the international environment and the improving outlook for the yuan, suggesting an objective of stabilizing expectations through administrative interventions (exchange rate management), rather than allowing the free market to express high volatility.
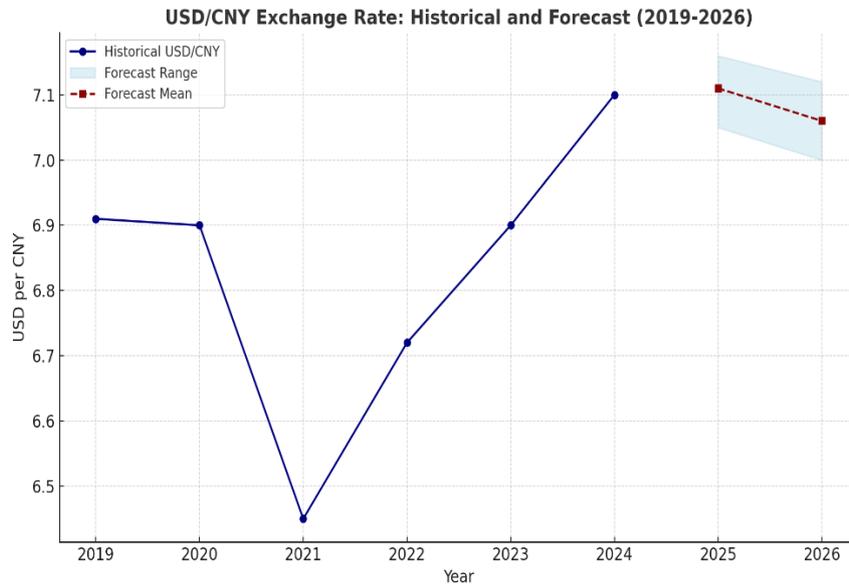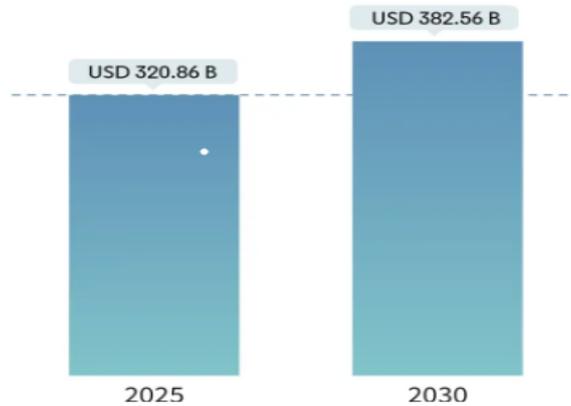

Source: Own elaboration on ABN AMRO data (2025)

4.3 Expected impacts of increased US military spending

The following graph represents the expected trend of the US defense market, 2025-2030 expressed in billions of dollars.

US Defense Market
Market Size in USD Billion
CAGR 3.58%

Source: Mordor Intelligence (2024)

In 2025 the size of the sector is estimated to be around $320.86 billion, while for 2030 the projection reaches approximately $382.56 billion, implying an overall growth of over $60 billion over five years, with an estimated compound annual growth rate (CAGR) of 3.58%.

This trajectory reflects the planned expansion of defense spending in the United States, linked not only to the Pentagon's budget increase but also to the growing demand for new advanced military technologies. Among the main *drivers* of this growth are the modernization of the armed forces, investments in air and missile defense systems, cybersecurity, space, and artificial intelligence applied to the military sector. From a macroeconomic perspective, this growth in the US defense market has significant implications: on the one hand, it represents a strong stimulus for domestic industry, supporting employment, research, and innovation; on the other, it raises questions about fiscal sustainability, as continued growth in defense spending could contribute to the widening federal deficit. Internationally, it is expected to strengthen the United States' role as a global military leader, but also to push allies, particularly NATO members, to increase their defense budgets, fueling a generalized upward trend in military spending.

The expected increase in US military spending in the coming years is part of an international context characterized by growing geopolitical rivalry, trade tensions, and heightened attention to global security, as discussed in the previous pages. These factors have the potential to generate a series of far-reaching impacts, reaching well beyond US borders and involving economies, alliances, investment flows, and strategic assets. First, in the future, increased US military spending will drive global demand in the global

defense industry. Manufacturers of weapons, military vehicles, aircraft, electronic defense systems, and dual -use technologies will benefit from increased orders, not only from the Pentagon, but also from allied countries that, under pressure or for strategic convenience, will follow the push toward modernization. This could lead to improvements in the sector's global production capacity, technological innovation, and the diffusion of advanced know-how in industries that previously faced significant barriers to entry. Furthermore, this increase is expected to impact trade flows and international exchanges. Countries exporting defense products and related technological components could see significant growth in their exports to the United States, with benefits for their trade balance and employment in related sectors. At the same time, however, incentives for domestic production in allied nations will also increase (a phenomenon that could generate import substitution effects and international competition). A third area of impact will concern global monetary and financial policy.

In the face of increased US spending, US Treasuries are expected to continue to serve as a safe haven, strengthening the dollar's role as a reserve currency. This could translate into pressure on the dollar's exchange rate, with effects on emerging market countries holding foreign currency-denominated debt. These countries could experience greater volatility in currency markets and increases in debt servicing costs, especially in a scenario of rising global interest rates. Furthermore, increased military spending is likely to have implications for geopolitical alliances. In addition to NATO allies, other strategic partners could also feel politically incentivized or obliged to increase military spending in order to maintain their defense credibility or avoid a perceived deficit in the *military burden.* All of this could lead to increased financial commitment in Europe, Asia, and the Pacific, with consequences for national budgets and the distribution of resources between defense, *welfare*, and infrastructure. Another possible future effect will be an intensification of the technological arms race*:* the United States will likely invest in advancing technologies such as artificial intelligence, autonomous systems, space defense, and cybernetics[70]. This could generate positive externalities of technological progress, but also risks related to proliferation, regional destabilization, and ethical and regulatory dilemmas in the use of advanced military technologies. Finally, the impact on global fiscal and debt policies must be considered, as increased American military spending could exacerbate the US fiscal deficit if not accompanied by hedging policies

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[70]AIA (Aerospace Industries Association), *Facts & Figures: Economic Impact of US Defense Industry.*

(revenue increases, cuts elsewhere, efficiency improvements). International markets will pay increasing attention to sovereign debt levels and country risk, which could translate into higher risk premiums on US securities, but also on foreign securities perceived as correlated. Finally, foreign central banks and international investors may reshape their sovereign investment portfolios, favoring defensive assets or those with lower currency risk. Below are the implications of the expansion of US military spending.

Scope	Main benefits of increased military spending
Defense industry	- Increased orders from the Pentagon and allied countries- Growth of companies producing weapons, vehicles, aircraft and dual -use technologies- Expansion of global production capacity in the sector
Technological innovation	- Boosting innovation (AI, autonomous systems, space defense and cybernetics) - Dissemination of advanced know-how in high-tech sectors - Reducing entry barriers for new businesses
International trade	- Increase in exports of defense products and technological components - Improvement of the trade balance and employment in exporting countries - Incentives for domestic production in allied countries (import substitution)
Finance and monetary policy	- Strengthening the dollar's role as a reserve currency - US Treasuries as a global safe haven - Increased capital flows to the US in uncertain scenarios
Geopolitics and alliances	- Incentive for NATO countries and strategic partners to increase military spending - Strengthening defense credibility and burden Sharing - Greater coordination between allies in Europe, Asia and the Pacific
Technological progress and spillover	- Positive externalities for civil sectors (dual - use technologies) - Greater US industrial and scientific competitiveness - Potential American leadership in new critical technologies
Global markets and investments	- Attractiveness of US government bonds for international investors - Reorientation of sovereign portfolios towards assets considered safe - Relative stability for dollar investments

In addition to these aspects, many concerns are also widespread. Below is a summary.

Scope	Main disadvantages
Public spending and deficit	- Rising US fiscal deficit if not offset by new revenues or cuts - Sovereign debt growth with long-term sustainability risks - Higher risk premiums demanded by investors on US bonds
Global financial markets	- Pressure on the dollar exchange rate (appreciation or volatility) - Increase in debt service costs for emerging countries indebted in dollars - Increased volatility in international currency markets
Trade and production	- International competition for supplies of weapons and technologies - Import substitution effects in allied countries, with loss of market share for the USA - Risk of fragmentation of global value chains
Internal resources	- Increased military spending at the expense of welfare, infrastructure, and civilian research - Possible distortion of investments in favor of the defense sector to the detriment of other productive sectors - Risk of allocative inefficiencies in the US economy
Risks of dependence and imbalances	- Excessive dependence of allies on the US defense industry - Possible trade tensions with partners developing autonomous capabilities - Risk of trade imbalances in the event of a slowdown in global arms demand

4.4 International trade: a forward analysis looking

International trade in the coming years will be strongly influenced by three main dynamics: the reorganization of global value chains, the impact of geopolitical tensions, and technological transformation. These factors, combined, will lead to a more fragmented landscape than the period of accelerated globalization of the 1990s and 2000s, but at the same time more resilient and oriented toward new forms of interdependence.

A first key element concerns the regionalization of supply chains. Trade wars, the pandemic, and international conflicts (in Ukraine and the Middle East) have, in fact, pushed many companies to diversify their supply sources and reduce their dependence on single production hubs. In the coming years, we are likely to witness a strengthening of intra-regional trade, particularly in Asia, where China will continue to play a predominant role, but with growing participation from countries such as India, Vietnam, and Indonesia. In this scenario, the United States and Europe will promote *friendshoring and near-shoring* [71] policies aimed at reducing strategic vulnerability in critical sectors such as semiconductors, energy, and defense.

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[71] *Near -shoring* means relocating part of the production or supply chains to countries geographically close to the final consumer market with the aim of reducing logistics costs, shortening delivery times and reducing the risks associated with global shocks or supply disruptions chain. Friend- shoring (or ally-shoring) indicates the moving of production or supply to politically and economically allied or "friendly" countries, even if not necessarily geographically close, with the aim of reducing dependence on countries considered unstable or potentially hostile, favouring reliable partners with similar values or rules (for example in terms of trade, rights, security).

A second factor that will influence the future economic balance concerns geopolitical tensions and protectionist policies. The introduction of tariffs and trade restrictions by the United States towards China and the European Union, combined with symmetric responses, could lead to a potential consolidation of opposing economic blocs. In such a scenario, the World Trade Organization (WTO) may struggle to maintain its mediating role, with the risk of a return to more bilateral and less multilateral trade. However, in global sectors such as energy and critical raw materials, international cooperation will remain inevitable, especially in the context of the energy transition. WTO and IMF data tend to reflect a declining trend in international trade starting in 2026.

The following figure shows this expected trend.
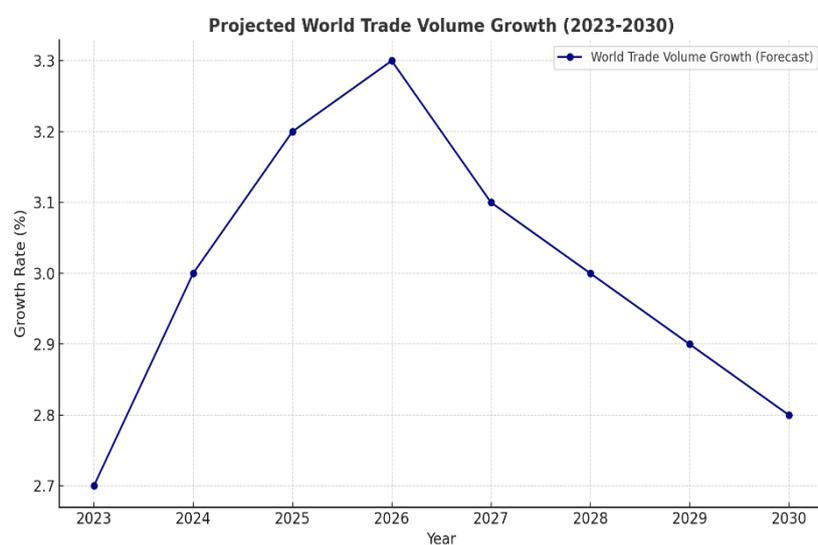
Source: Own elaboration on WTO and IMF data (2025)

Finally, technological transformation and the green transition could decisively shape future trade dynamics. Trade in digital goods and services, the role of cross-border e-commerce, and the spread of artificial intelligence in supply chains. The growing importance of sustainability certificates and the growing importance of supply chains will radically change the nature of international trade. Economies that are quickest to embrace the required transformation will benefit. Environmental policies such as the *Carbon Border Adjustment, the European Central Bank Mechanism* (CBAM) could introduce new regulatory variables that will shape global trade relations. Looking ahead, international trade is not expected to collapse, but will reorganize according to more

complex logics, where security and resilience will have equal, if not greater, weight than economic efficiency. The era of accelerated globalization will give way to a "selective globalization," with differential effects across countries and sectors and new opportunities for emerging economies that can position themselves as strategic alternatives in value chains[72].

4.5 The role of the States United in the global landscape: an analysis perspective

As described in the previous pages, the United States has significantly influenced the current international economic landscape and will undoubtedly continue to be its central player. However, its future role looks more complex and challenging than in the past. After dominating the global economic system for much of the 20th century and maintaining undisputed leadership in the technological, financial, and military sectors, the United States now faces a context of growing multipolarity, in which new economic powers (primarily China and India) are investing in expanding their industries, necessitating new outlets.

Financially, the dollar remains the world's leading reserve currency and the dominant instrument in international trade, representing approximately 58% of global foreign exchange reserves in 2024[73]. It will likely retain this primacy in the coming decades, but its centrality will be progressively eroded by attempts at de-dollarization promoted by regional blocs such as the BRICS and by the growing use of the Chinese renminbi (yuan) in some strategic sectors of global trade.

On the industrial and technological front, the United States, given its current investments, will continue to lead in research and development, especially in the fields of artificial intelligence, biotechnology, aerospace, and military technologies. However, America's future role will depend on its ability to maintain a competitive advantage in a context of rapid innovation in Asia and aggressive industrial policies by the European Union and China. US trade and industrial policy will remain a determining factor in the global landscape, the adoption of protectionist policies (which emerged under the Trump administration and are set to continue) indicate that the United States will tend to prioritize the defense of internal strategic supply chains, with effects on multilateral trade

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[72] Evenett, S. & Baldwin, R. (2020). *Revitalizing Multilateralism: Pragmatic Ideas for the WTO*. CEPR Press.
[73] IMF, 2024.

(this could further weaken the WTO governance system , but, at the same time, strengthen America's negotiating position at the bilateral and regional level)[74].

Finally, the United States will face a long-term fiscal challenge. Increased public spending on defense, the energy transition, and the pressure of an aging population risk widening the federal deficit and public debt, with possible consequences for international financial stability[75]. In this context, maintaining confidence in US Treasury securities will be crucial to preserving the role of the dollar and the United States as guarantors of global stability. Looking ahead, the role of the United States will therefore remain central, but more contestable: on the one hand, the US will continue to exert global political, economic, and technological influence; on the other, its leadership will be challenged by new powers and an international context characterized by geopolitical fragmentation, competition for resources, and disruptive technological transformations. Growth expectations will therefore favor the US, but also China and the EU countries, albeit to different degrees. Below is a figure that shows the trend of the US GDP, of the China and the European Union, with increasing trends.
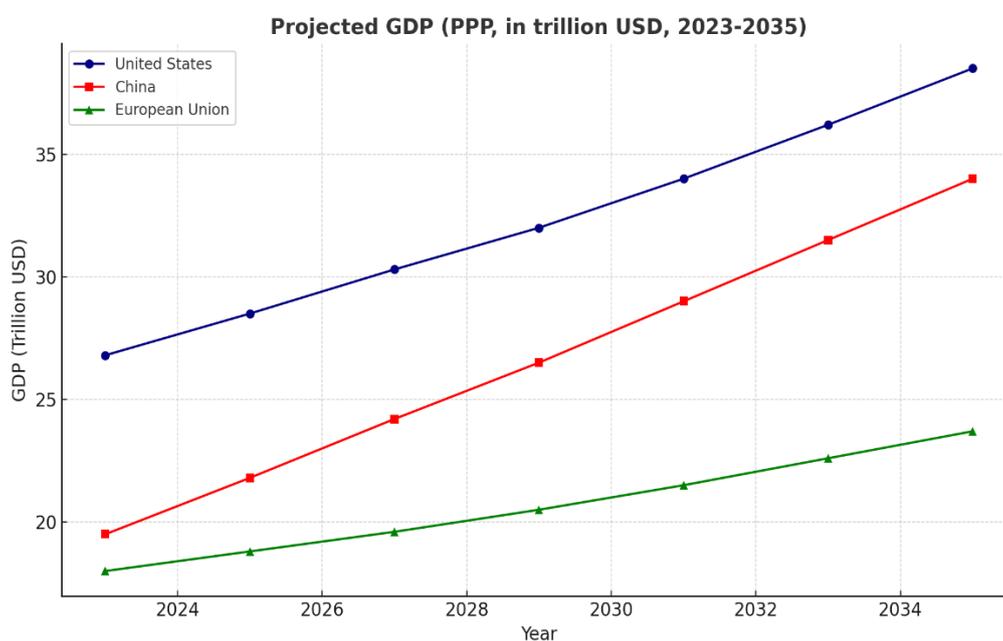
Source: Processing staff on WTO data (2023)

[74]World Bank (2023). *Global Economic Prospects: Fragmentation and Uncertainty.* Washington, DC.
[75]World Bank (2023). *Global Economic Prospects: Fragmentation and Uncertainty.* Washington, DC.

CONCLUSIONS

The paper has shown how geopolitical dynamics influence macroeconomic balances and how the United States is proving to be decisive in global trends, both in terms of currency and trade.

The United States' role in the international monetary system is central, but it is currently undergoing transformations that highlight both its resilience and vulnerabilities. The dollar continues to be the primary reserve currency and reference currency for international trade, but it is also the preferred denomination for debt.

Confidence in US financial markets, their liquidity, and the credibility of its institutions further strengthen this position, creating a constant demand for dollar-denominated assets. Added to this is the United States' ability to exert geopolitical influence through currency leverage, making the dollar not only an economic instrument but also a means of political power.

However, in recent years, the dollar's share of international reserves has slowly declined, partly because several economies, including China and the European Union, are seeking to reduce their dependence on the dollar by promoting the use of their currencies in trade and experimenting with alternative payment systems.

The conflicts in Ukraine and Palestine have highlighted how contemporary wars have repercussions that go far beyond the territorial and military dimension, profoundly impacting international economic balances. The war in Ukraine, in particular, has triggered a redefinition of global energy and trade chains, causing sharp increases in commodity prices, especially gas and wheat, and contributing to widespread inflation that has pushed central banks into more restrictive monetary policies. Europe has been among the hardest hit, having had to rapidly diversify its energy sources, while Russia has sought new trade outlets, strengthening ties with China and other emerging countries. In this sense, the conflict has accelerated processes of economic fragmentation and increased the use of geopolitical instruments such as sanctions and the "weaponization" of energy and financial resources. The Israeli-Palestinian conflict, despite its varying intensity and scale, is also having significant effects, especially through increased perceptions of risk in the Middle East. Instability in the region is creating problems for the transport of goods and energy markets, fueling international financial volatility. Furthermore, President Trump has also called on NATO allies to allocate greater resources to defense, which has

helped cement his economic hegemony, given that the US arms industry is the world's strongest.

Overall, both conflicts described have accentuated a trend toward the regionalization of the global economy, in which national security considerations increasingly prevail over economic efficiency. This will lead to increased transaction costs, a redefinition of trade flows, and a growing recourse to protectionist policies. At the same time, instability is fueling demand for safe-haven assets, cyclically strengthening the dollar and US Treasuries, but weakening the prospects for balanced growth in emerging markets, which are more exposed to currency volatility and debt costs. The thesis offered a reinterpretation of these tensions, highlighting how, in the future, there will be significant recourse to monetary policies aimed at containing currency fluctuations and macroeconomic dynamics.

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