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Trump's Emerging Market Behavior Is Unsettling Investors. How It Could Hit Markets. -- Barrons.com

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Investors have typically penalized emerging markets such as Turkey, Argentina, and China due to concerns about the independence of the central bank, government intervention in the private sector, and rampant overspending.

Now economists and strategists are raising similar concerns about the U.S., which has historically been the paragon of a developed market. They see unnerving parallels to emerging markets in the actions that President Donald Trump (javascript:void(0);) is taking in his second term, as he uses the power of the White House in unconventional ways to swiftly upend geopolitical and economic norms.

Although stocks and financial assets have grown in value since Trump's second inauguration in January, experts say that if these patterns continue, investors may see a reduction in the premium that U.S. assets have long commanded. That could mean weaker long-run returns for stocks or, more immediately, higher bond yields and a continuation in the weakness of the dollar that has emerged this year.

In just the past two weeks, Trump has put new pressure on Federal Reserve Chair Jerome Powell (javascript:void(0);) to cut interest rates, warned judges to not rule against his tariffs, fired the head of the Bureau of Labor Statistics (javascript:void(0);) after unflattering revisions to job numbers, called for the ouster of the chief executive of Intel, and sought unprecedented concessions from companies and countries that want to access U.S. markets or avoid export restrictions.

Those actions come against newly heightened concern that the U.S. fiscal deficit is unsustainable -- and more so after Trump's tax and spending plan became law earlier this year, probably further widening the deficit.

"What is the norm in many emerging markets is becoming the new norm in the U.S. That includes undercutting of agencies that gather data," says Eswar Prasad (javascript:void(0);), formerly head of China research at the International Monetary Fund (javascript:void(0);) and currently an economics professor at Cornell University (javascript:void(0);).

"The three elements of an institutional framework that are crucial to the U.S. dollar's dominance are rule of law, a system of checks and balances, and the independence of the central banks, and each of those pillars is significantly being undercut," Prasad says. That dollar dominance has been a factor in the premium that U.S. assets have typically commanded.

The stock market has been unfazed, with the S&P 500 and other indexes forging new highs amid optimism about artificial intelligence and the benefits of tax cuts. But economists and strategists caution that policy shifts could begin to weigh on stocks if cracks emerge in the optimism around AI to reshape the economy and fuel corporate spending.

Those drawing parallels to emerging markets say that the U.S. isn't susceptible to the type of currency-devaluation crises that send investors stampeding for the exits abroad. Though Prasad and others see challenges ahead for the dollar, they believe that it remains secure as the world's reserve currency. That provides a major layer of insulation against financial shocks, which few see changing anytime soon.

Still, some of the changes in Trump's second term are chipping away at the exceptionalism that allows U.S. assets to command a premium. Over the past 15 years, the S&P 500 traded at an average of 17.5 times forward 12-month earnings, compared with 11.5 times for the Shanghai Composite index and Argentina's S&P Merval Index and just seven times for Turkey's Borsa Istanbul (javascript:void(0);) 100 index.

To be sure, the U.S. market is composed of some of the biggest and most successful technology companies, which helps explain the lofty price of U.S. assets. Even if concerns about policies weaken the U.S. premium, that could be more than offset by the productivity gains coming on the back of AI spending. Stronger economic growth of 3%-plus could also mitigate debt concerns.

But stock and bond markets -- in the U.S. but also abroad -- are likely to become more volatile as the rules-based system that governed trade, corporate decision-making, and global economics is shaken up. "In a world where the existing rules are not going to be maintained, we are going to have much more volatility," Prasad says.

U.S. interest rates are also likely to be higher than they might otherwise be as investors demand a greater premium for holding longer-term assets in the face of uncertainty about how the U.S. handles its widening fiscal deficit. The dollar's reserve-currency status has roughly lowered U.S. borrowing costs by 1.0 to 1.5 percentage points, according to estimates from emerging-markets-oriented Breakout Capital. Even if the dollar maintains its reserve currency status, more countries and institutional investors diversifying away and using other currencies or gold to trade could take away some of that borrowing cost discount, raising rates.

Strategists see institutional investors and central banks looking to diversify from their overweighting in U.S. assets, especially amid the uncertainty created by these shifts and questions about central bank credibility. Even if at the margin, that could raise borrowing costs modestly and probably weaken the dollar against other currencies.

China-Like Parallels

Free-market purists are alarmed by Trump's growing influence over corporate affairs. An incomplete list of notable moments would include recent warnings by Trump to Walmart (javascript:void(0);) and others to not raise prices as they deal with the impact of tariffs, a social-media post urging Goldman Sachs (javascript:void(0);) to fire its top economist because of his view that tariffs could boost inflation, and statements that the billions in investment funds that countries have committed as part of initial trade agreements will be spent at the president's discretion.

Many countries, notably including China, have long directed investment to critical sectors. The U.S. has also shifted toward a more muscular industrial policy in recent years. The Biden administration boosted spending on renewable energy and domestic semiconductor production. But analysts note that those efforts were backed by congressional legislation that, in the case of chips spending, was bipartisan.

Trump, however, is using the power of the presidency to personally direct a reshaping of the economy. Treasury Secretary Scott Bessent in a Fox Business interview on Tuesday likened recent agreements with Japan, South Korea, and Europe to invest billions in critical industries to these countries funding a sovereign-wealth fund -- one the president can tap to invest at his direction. The White House has insisted that the president has this power, despite other countries' differing understandings of the nature of the investments.

The White House didn't respond to requests for comment for this article.

The administration also took an unusual tact in resolving national-security concerns over the acquisition of Pittsburgh-based U.S. Steel (javascript:void(0);) by Japan's Nippon Steel (javascript:void(0);). The Trump administration took a " golden share" that allows it to influence business decisions in ways that are still unclear.

There are parallels in China. Beijing recently took golden shares in Alibaba Group Holding (javascript:void(0);), Tencent Holdings (javascript:void(0);), and other internet companies following a multiyear crackdown. The use of the golden shares gives Beijing a vehicle of state control over private enterprises .

That crackdown began with the abrupt cancellation of Ant Financial (javascript:void(0);)'s multibillion-dollar public offering in 2020, days after Alibaba (javascript:void(0);) and Ant (javascript:void(0);) co-founder Jack Ma (javascript:void(0);) criticized Chinese regulators. Investors rethought the companies' growth prospects as a result of Beijing's intervention. Chinese internet companies lost billions in market value.

Government involvement in companies is typically met with investor trepidation amid worries that capital may not be allocated based on market dynamics. That's one reason Trump's push for concessions and investment pledges raises red flags as companies try to curry favor or steer clear of policies that may impinge on their profitability.

While the increased private sector involvement and China-like moves might seem distant concerns for the market, a reaction could come sooner to worries about the unsustainable and widening U.S. fiscal deficit. The U.S. relies on foreign investors to fund that spending, and they may demand higher compensation to stick around.

U.S. debt surpassed $37 trillion this week, or 100% of gross domestic product.

Though developed-market Japan has a much higher debt load, economists see clear parallels to the U.S. -- not just in its debt burden but also in its push to continue to spend by finding ways around fiscal rules and other restraints.

Argentina offers a view of the extreme fallout from such practices. It suffered painful bouts of soaring inflation -- most recently 140% -- as a result of decades of soaring fiscal deficits, facilitated by the central bank's willingness to print money. Argentina is just beginning to recover from the years of lost investor confidence, sky-high inflation, and currency devaluation.

While politicians everywhere like to complain about high interest rates, investors need to assess whether the central bank can push back against that pressure.

Turkey is an example of what happens when central banks are unable to resist powerful politicians' desire to keep spending despite lenders' concerns. President Recep Tayyip Erdo an fired three central bank heads from 2019 to 2021, eventually installing a central bank board willing to bend to his unorthodox monetary policy view of pushing rate cuts to combat inflation. That effort compromised the economy's health as inflation soared to 85%, prompting Erdo an to make a U-turn in 2023.

The Fed's unique structure makes it resistant to outside pressure. Rates are set by the 12 voting members of the Federal Open Market Committee, who include regional bank presidents not appointed by the president.

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The Fed isn't likely to bend entirely to Trump's desires for lower interest rates after Powell's term as Fed chair ends in May. But even debating the Fed's independence may make investors question the premium placed on U.S. assets, said Apollo Global (javascript:void(0);) Chief Economist Torsten Sløk (javascript:void(0);). What to watch, says Sløk, will be the approach of Powell's replacement to the Fed's dual mandate of inflation and full employment and to organizational structure. If the new chair reorganizes the structure or fires different individuals or heads of departments, Sløk says that could make investors reassess the central bank's ability to withstand pressure.

Bessent has suggested such changes are coming. Among his criteria for a new Fed chair is "the ability to run and revamp the organization, because it's really gotten bloated," he told Fox Business.

Economists are closely watching for reactions among foreign investors, who own 30% of Treasuries. While central banks have been diversifying their reserves for years, the dollar's almost 10% decline this year has strategists alert for signs of a broader selloff of U.S. bonds amid Trump's policy shifts.

That is putting newfound interest in the appetite for three-year and 10-year bond auctions, which have shown pockets of weakness, though not yet at alarming levels. If demand for U.S. bonds continues at a healthy pace, it gives credence to the idea that the dollar's reserve currency status is providing enough of a buffer against other concerns. But if demand falters, investors could begin to adopt some of the emerging market outlook.

That test will unfold slowly. While Joyce Chang, global head of research at J.P. Morgan (javascript:void(0);), expects bond investors to require more payment given the size of the deficit, she notes that Treasury funding needs are well covered this year. But with roughly $5 trillion in new debt set to be issued from 2026 to 2029, bond yields will probably start to be a concern for markets next year, she says.

Deficit worries are hardly new. But strong U.S. institutions have helped keep those concerns from driving up bond yields. Now, that may be changing.

"When politics stop respecting institutions, the ability of institutions to create a better policy environment diminishes," says Raghuram Rajan (javascript:void(0);), finance professor at the University of Chicago (javascript:void(0);) and former head of India's central bank (javascript:void(0);).

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