

Flash Economics

N° 79

July 4, 2025

The risk that the United States' external deficit may become unfinanceable

The United States' external deficit is currently financed through the purchase of dollar-denominated assets, primarily public securities, by countries such as Japan, the Eurozone, the United Kingdom, and the United Arab Emirates.

However, these purchases of dollar assets could decline significantly in the future due to:

- the anticipated depreciation of the U.S. dollar;
- the fall in oil prices, resulting from increasing oil overproduction, and consequently the fall in revenues of oil-exporting countries;
- the rise in long-term interest rates in Japan, driven by higher inflation feeding through into interest rates, leading Japanese investors to substitute Japanese bonds for foreign bonds they currently hold;
- the perceived risk that American technology stocks are overvalued, with excessively high valuations prompting a shift away from US equities in favour of, in particular, European equities;
- the continued rise in the United States' public debt ratio.

If the US external deficit becomes difficult to finance, a sharp decline in domestic demand may follow, caused by falling stock market indices (with the associated negative wealth effect) and a rise in long-term interest rates.

Patrick Artus

Senior Economic Advisor

patrick.artus-ext@ossiam.com

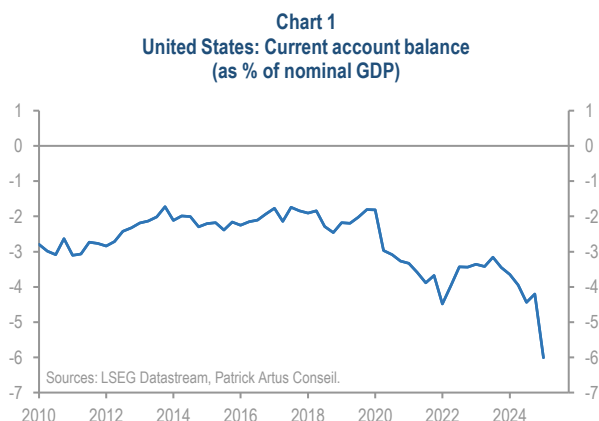
✕ @PatrickArtus

in Patrick Artus

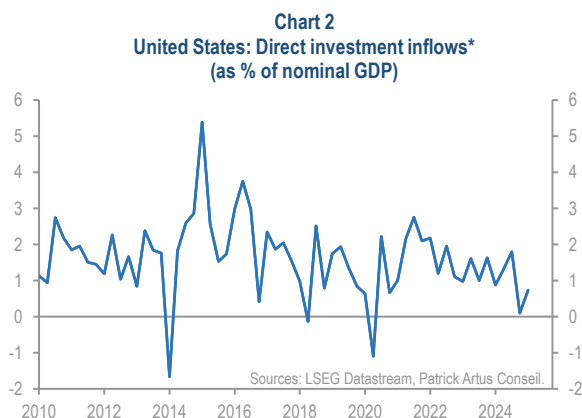
Marketing communication: this document is a marketing presentation. It has not been prepared in accordance with legal requirements designed to promote the independence of investment research; and it is not subject to any prohibition on dealing ahead of the dissemination of investment research.

How is the United States' external deficit financed?

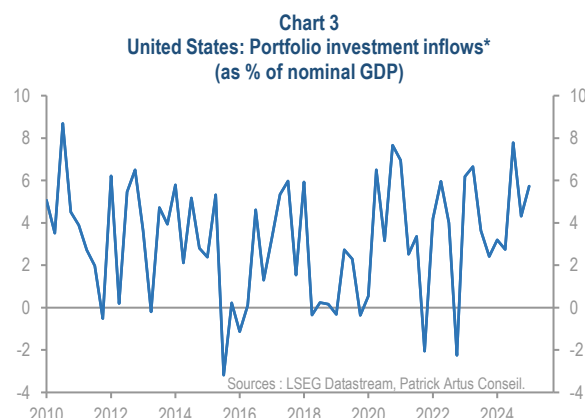
The United States has a significant current account deficit (Chart 1).



This deficit is financed by purchases of American assets by non-residents: direct investment by companies (Chart 2), and purchases of shares and bonds (Chart 3).

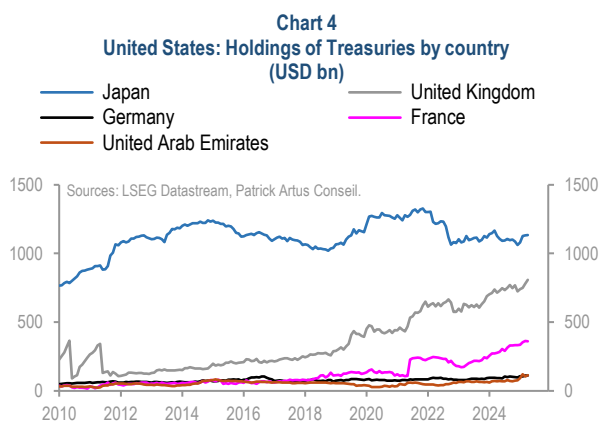


(*) Direct investment inflows are capital inflows leading to an increase in liabilities (in this case for the United States) and therefore have a positive sign.



(*) Direct investment inflows are capital inflows leading to an increase in liabilities (in this case for the United States) and therefore have a positive sign.

We know the breakdown of countries investing in US Treasury debt: these are mainly Japan, European countries, the United Kingdom, and the United Arab Emirates (Chart 4).



The risk of a financing problem for the US external deficit

A financing problem for the US external deficit could stem from several causes:

1. **The expectation of continued depreciation of the U.S. dollar (Charts 5a/5b)**, either resulting from a deliberate attempt to reduce the U.S. dollar's role as a reserve currency, or from a shift to a more expansionary monetary policy.

Chart 5A
Euro/dollar exchange rate (EUR 1 = USD...)



Chart 5B
United States: Real effective exchange rate (2010.M1 = 100)

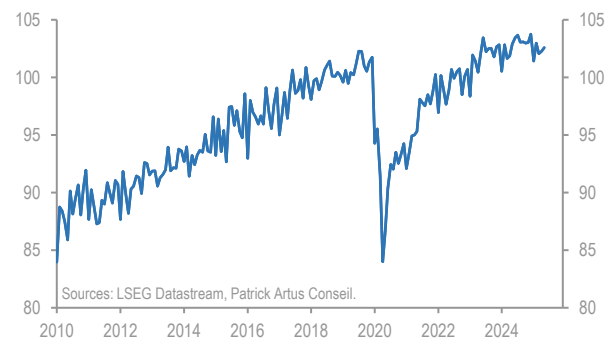


2. **The decline in oil prices (Chart 6)**, caused by oversupply amid stagnating global oil demand (Chart 7), which would eliminate the current account surpluses of oil-producing countries.

Chart 6
Oil price (Brent, \$/bbl)



Chart 7
World: Oil consumption (million bbl/day)

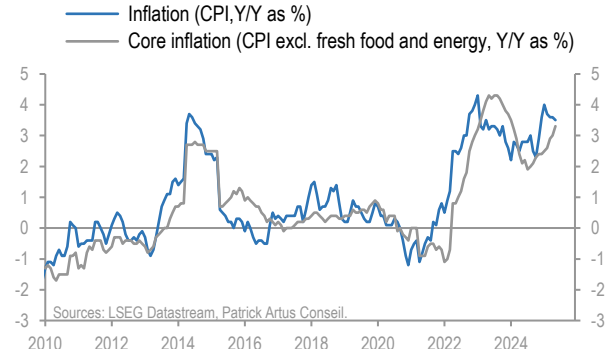


3. **The rise in long-term interest rates in Japan**, linked to the currently high inflation observed in Japan (Charts 8/9), which will encourage Japanese bondholders to substitute Japanese bonds for US bonds in their portfolios.

Chart 8
Japan: Interest rate on 10-year government bonds (as %)



Chart 9
Japan: Inflation and core inflation (as %)



4. **A growing perception among investors that US tech stocks are overvalued (Charts 10/11)**, which would discourage them from holding American equities, possibly in favour of European equities.

Chart 10
Stock index of the Magnificent Seven (01.06.2012 = 100)



Chart 11
NASDAQ: P/E ratio



5. **The anticipation of a sustained rise in US public debt**, due to the tax cuts enacted by the Trump administration and the large public deficits they imply (Charts 12/13), which could reduce foreign demand for US Treasuries.

Chart 12
United States: Public debt (as % of nominal GDP)

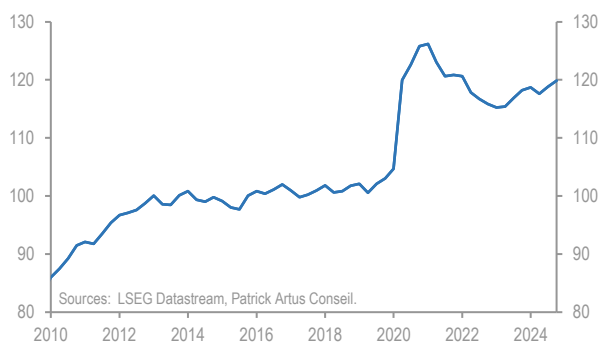
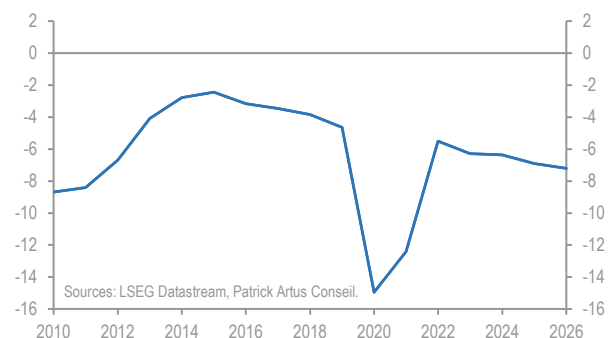


Chart 13
United States: Budget deficit (as % of nominal GDP)



Summary: What are the consequences if the United States' external deficit becomes difficult to finance?

We have seen that there is a real risk that the United States' external deficit may become difficult to finance due to the anticipated depreciation of the U.S. dollar, the expected decline in oil prices, increased investor appetite for Japanese debt, concerns about the overvaluation of US technology stocks, and the sharp rise in US public debt.

If this financing difficulty materialises, a necessary contraction in domestic demand would follow, driven by falling stock market indices (with the associated negative wealth effect) and rising long-term interest rates.

Disclaimer

Ossiam, a subsidiary of Natixis Investment Managers, is a French asset manager authorized by the Autorité des Marchés Financiers (Agreement No. GP-10000016). Although information contained herein is from sources believed to be reliable, Ossiam makes no representation or warranty regarding the accuracy of any information of which it is not the source. The information presented in this document is based on market data at a given moment and may change from time to time. This material has been prepared solely for informational purposes only and it is not intended to be and should not be considered as an offer, or a solicitation of an offer, or an invitation or a personal recommendation to buy or sell participating shares in any Ossiam Fund, or any security or financial instrument, or to participate in any investment strategy, directly or indirectly. It is intended for use only by those recipients to whom it is made directly available by Ossiam. Ossiam will not treat recipients of this material as its clients by virtue of their receiving this material. All performance information set forth herein is based on historical data and, in some cases, hypothetical data, and may reflect certain assumptions with respect to fees, expenses, taxes, capital charges, allocations and other factors that affect the computation of the returns. Past performance does not predict future returns. Any opinions expressed herein are statements of our judgment on this date and are subject to change without notice. Ossiam assume no fiduciary responsibility or liability for any consequences, financial or otherwise, arising from, an investment in any security or financial instrument described herein or in any other security, or from the implementation of any investment strategy. This information contained herein is not intended for distribution to, or use by, any person or entity in any country or jurisdiction where to do so would be contrary to law or regulation or which would subject Ossiam to any registration requirements in these jurisdictions. This material may not be distributed, published, or reproduced, in whole or in part.