Trade Deficits Are Capital Surpluses

Why tariffs are driving the U.S. stock market down.

By Jeremy J. Siegel

March 12, 2025 5:33 pm ET

New vehicles sit in a parking lot in the Port of Richmond at the bay of San Francisco, June 8, 2023.
PHOTO: CARLOS BARRIA/REUTERS

The Commerce Department reported a record $918.4 billion U.S. trade deficit in 2024. President Trump believes a trade deficit is harmful to the American economy because it signifies that the U.S. is buying more goods and services from abroad than we are selling, depriving domestic workers of good-paying jobs.

But there is a more constructive way to look at a trade deficit. The $918.4 billion deficit reflects an equal $918.4 billion capital surplus. In other words, foreigners are buying $918.4 billion more in U.S. assets—such as stocks, bonds and real estate—than U.S. citizens are buying in foreign assets. This demand for U.S. assets boosted the value of American stocks and bonds and helped fund the country's growing budget deficit. That explains why the market has declined in response to Mr. Trump's restrictions on trade.

A simple example shows the relationship between trade and capital flows. Suppose an American buys a $40,000 Toyota made in Japan. Toyota has three options for what to do with these dollars. It can buy $40,000 worth of U.S. goods or services, in which case there would be no trade deficit. Or, because it expects the American economy to grow, it can invest $40,000 in U.S. capital—say, the S&P 500 index, U.S. government bonds or American real estate. It can also temporarily invest the funds in short-term, interest-bearing assets such as Treasury bills, commercial paper or bank deposits that enhance the lending capabilities of American financial institutions and fund short-term corporate borrowing needs.

What if Toyota doesn’t want to buy U.S. goods or assets? Then it can sell the dollars on the foreign-exchange market. People purchase these dollars either because they want to buy U.S. goods or assets or because they think the dollar will appreciate in value. But even if these dollars are held for speculation, they are usually invested in short-term interest-bearing assets. And if the dollars flowing abroad are held as physical currency, the U.S. still benefits, since these notes are incorporated into the national debt but accrue no interest—essentially an interest-free loan to the U.S. government.

If there were too many dollars flowing abroad, the value of the dollar would sink on the foreign-exchange market. That isn’t the case today. In fact, demand has been so strong that despite the nearly $1 trillion trade deficit, the value of the dollar has been rising for years.

It’s important that the U.S. push for fair trade, which is what the Trump administration is doing. But the trade deficit isn’t always the product of unfair trade policies; it also emerges because foreigners want to participate in the exceptional opportunities provided by U.S. capital markets. Imposing excessive tariffs to curb the trade deficit stanches foreign demand for U.S. assets, leading to lower stock prices and higher interest rates for U.S. firms and consumers.

Mr. Siegel is a professor emeritus of finance at the University of Pennsylvania’s Wharton School and chief economist at Wisdomtree.

Appeared in the March 13, 2025, print edition as 'Trade Deficits Are Capital Surpluses'.