Opinion **Global Economy**

What strong gold says about the weak dollar

The US has been weaponising its currency — but that comes with a cost

RUCHIR SHARMA

The oldest and most traditional of assets, gold, is now a vehicle of central bank revolt against the dollar © Akos Stiller/Bloomberg

Ruchir Sharma YESTERDAY

The writer is chair of Rockefeller International

Today commentators overwhelmingly agree that a weakening US dollar cannot possibly lose its status as the world's dominant currency because there is "no alternative" on the visible horizon. Perhaps, but don't tell that to the many countries racing to find an alternative, and such complacency will only accelerate their search.

The prime example right now is gold, up 20 per cent in six months. Surging demand is not led by the usual suspects — investors large and small, seeking a hedge against inflation and low real interest rates. Instead, the heavy buyers are central banks, which are sharply reducing their dollar holdings and seeking a safe alternative. Central banks are buying more tons of gold now than at any time since data begins in 1950 and currently account for a record 33 per cent of monthly global demand for gold.

This buying boom has helped push the price of gold to near-record levels and more than 50 per cent higher than what models based on real interest rates would suggest. Clearly, something new is driving gold prices.

Look closer at the central bank buyers, and nine of the top 10 are in the developing world, including Russia, India and China. Not coincidentally, these three countries are in talks with Brazil and South Africa about creating a new currency to challenge the dollar. Their immediate goal: to trade with one another directly, in their own coin. "Every night I ask myself why all countries have to base their trade on the dollar," Brazilian president Luiz Inácio Lula da Silva said recently on a visit to China, arguing that an alternative would help "balance world geopolitics".

Thus the oldest and most traditional of assets, gold, is now a vehicle of central bank revolt against the dollar. Often in the past both the dollar and gold have been seen as havens, but now gold is seen as much safer. During the short banking crisis in March, gold kept rising while the dollar drifted down. The difference in the movement of the two has never been so large.

And why are emerging nations rebelling now, when global trade has been based on the dollar since the end of the second world war? Because the US and its allies have increasingly turned to financial sanctions as a weapon.

Astonishingly, 30 per cent of all countries now face sanctions from the US, the EU, Japan and the UK — up from 10 per cent in the early 90s. Until recently, most of the targets were small. Then this group launched an all-out sanctions attack on Russia for its invasion of Ukraine, cutting off Russian banks from the dollar-based global payment system. Suddenly, it was clear that any nation could be a target.

Too confident in the indomitable dollar, the US saw sanctions as a cost-free way to fight Russia without risking troops. But it is paying the price in lost currency allegiances. Nations cutting deals to trade without the dollar now include old US allies such as the Philippines and Thailand.

The number of countries with central banks looking at ways to launch their own digital currency has tripled since 2020 to more than 110, representing 95 per cent of the world's gross domestic product. Many are testing these digital currencies for use in bilateral trade — another open challenge to the dollar.

Though some doubt a dominant dollar matters for the US economy, high demand for the currency in general tends to lower the cost of borrowing abroad, a privilege America sorely needs today. Among the top 20 developed economies, it now has the second highest fiscal and current account deficits after the UK and the second highest foreign liabilities (as reflected in its net international investment position) after Portugal.

The risk for America is that its overconfidence grows, fed by the "no alternative" story. That narrative rests on global trust in US institutions and rule of law, but this is exactly what weaponising the dollar has done so much to undermine. It rests also on trust in the country's ability to pay its debts, but that is also slipping, as its reliance on foreign funding keeps growing. The last line of defence for the dollar is the state of China, which is the only economy sufficiently large and centralised to challenge US currency supremacy — but even more deeply indebted and institutionally dysfunctional.

When a giant comes to rely on the weakness of rivals, it's time to look hard in the mirror. When it faces challenges from a "barbaric relic" such as gold and new contenders like digital currency, it should be looking for ways to strengthen trust in its finances, not taking its financial superpower status for granted.