

GOLD MARKET UPDATE

The Tables Turn

August 12, 2025

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"People, including economists and financial experts, didn't realize that the most important thing in the 20th century was not World War I, World War II, or the disintegration of the USSR, but rather the August 15, 1971, disconnection between the U.S. dollar and gold." Dr. Yao Yudong, Vice Chair, People's Bank of China

Most of us do not understand how important gold once was in the global financial system. Until 1909, a rapidly expanding international trading system was dependent on gold backed Bills of Exchange for settlement. Anticipating the world war to come, European countries suspended the gold standard in 1909 in order to debt finance an arms race. After the war and its inflationary consequences, the developed world was not able to fully regain the traditional gold standard for long. Trade faltered and finally collapsed as the Great Depression unfolded, leading to another world war.

As WW2 was ending, agreement was reached at Bretton Woods to launch a new gold exchange system based on the dollar. More than half of the world's currencies had disappeared and the US held an enormous 22,000 tonnes of gold. To return to price stability, the gold price was fixed at \$35 per oz, the price prior to the war.

This new arrangement lasted only until 1971 when the US stopped exchanging gold for dollars. There was simply not enough gold at \$35 per oz to redeem the flood of dollars being created by the US government and Federal Reserve. The US could have kept the principle of a gold exchange and allowed the gold price to rise but the administration feared the dollar would lose its status to gold. From that moment, the unbacked dollar supported an exploding credit market that grew 10 times faster than the US economy, expanding an extraordinary 226 times from 1971 to 2024.

With gold out of the system, US Treasuries became the only financial market deep enough to cycle huge US trade imbalances. As a result, Treasuries became the preferred central bank asset, a huge benefit to the US which effectively had its trade deficits financed. It finally took six years of zero interest rates and QE following the Global Financial Crisis to stop UST accumulation in its tracks, killing this 'exorbitant privilege'. In 2014, central banks started to sell USTs for gold.

Bloomberg analysts calculate that the gold market now has equivalent volume and liquidity to Treasuries and lower volatility! With \$3.8 trillion in Treasuries still on hand, foreign central bank gold purchases have much further to go.

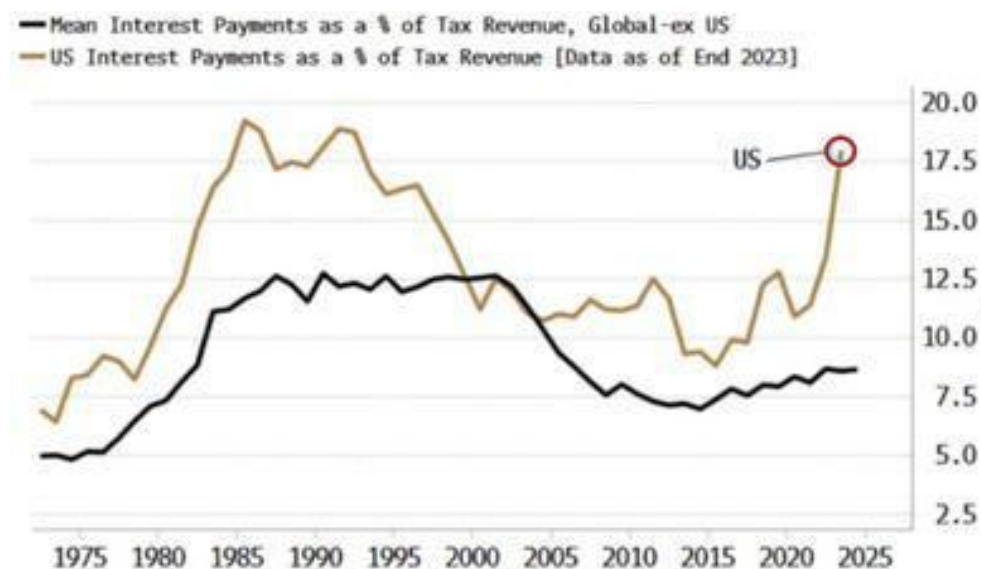
The US also had the world's only neutral trade settlement currency. This advantage has finally been weakened by the US dollar's increasing use as a geopolitical weapon. The last straw was the 2022 imposition of sanctions on Russia and its trading partners. BRICS started using gold for final settlement, replacing the USD.

The transition to a new global financial system is accelerating. To support the dollar as the pre-eminent trade currency and to find more buyers for the hugely disproportionate and growing Treasury market, the Trump administration is gambling on stable coins. The Genius Act and related legislation have regularized the rules around stable coins to give the USD a further edge in transaction settlement and deepen the UST market. Stable coins are typically backed by short term USTs to keep their one-to-one relationship to the dollar.

Curiously, Tether Holdings SA, the world's largest stable coin issuer, has quietly established its own vault in Switzerland and acquired 80 tons of gold reserves valued at around \$8 Billion, totaling about 5% of its assets. The company says it plans to expand these reserves, claiming gold is logically "safer" than national currencies.

China is moving swiftly in the other direction, taking over global gold market trading volumes and pricing via the Shanghai Gold Exchange with fully backed futures and physical ETFs. China is also strongly encouraging its citizens to save in physical gold. However, its biggest initiative has just begun: the SGE is shifting vault capabilities offshore to internationalize the yuan by providing it with gold backing. Chinese importers will buy product in yuan and offer net settlement in gold, avoiding the dollar.

As America goes digital, China goes physical, in effect creating a new Bretton Woods system. Who will win? China and the other BRICS have a huge net positive annual trade balance while the digital USD trading block taking shape from US tariff policy has huge corresponding deficits. We think the gold block will therefore outperform the digital USD. In any case, gold is back at the heart of the global financial system, money once again and, in our view, going much higher.



"The US fiscal and debt situation IS among the worst in the world, and among the most acute (what interest expense as a % of receipts denotes.)" Luke Gromen