Dollar collapse could be the most significant result of the Russia-Ukraine war as gold rises, analysis warns

Description

USA: The U.S. dollar has been the world's reserve currency since World War II, but as the globe teeters on the verge of the next global conflict as war rages between Russia and Ukraine, a new analysis finds that the dollar is liable to become the biggest casualty.

Wall Street Journal columnist Jon Sindreu began his analysis by asking the question, "What is money?" and going on to note that it's a question economists of the last several hundred years have pondered before pivoting to the one Western sanction against Russia that is liable to have lasting, globe-shifting consequences.

To answer his question, Sindreu pointed to "the blocking of Russia's central-bank reserves," which he said "has revived its relevance for the world's biggest nations—particularly China" because it highlights an inherent risk in "accumulating foreign assets" that will result in "military and economic blocs" drifting even farther apart.

Following Russia's invasion, the U.S. and Western allies blocked the Russian central bank from accessing the vast majority of its $630 billion of foreign reserve currency, adding that "weaponizing the monetary system against a Group-of-20 country will have lasting repercussions."

In a chart, Sindreu pointed out that the vast majority of the more than $15 trillion worth of reserves held by the world's countries is in 'currency' — that is, paper money — while a much smaller amount is held in gold and other investment assets.

"The 1997 Asian Financial Crisis scared developing countries into accumulating more funds to shield their currencies from crashes, pushing official reserves from less than $2 trillion to a record $14.9 trillion in 2021, according to the International Monetary Fund," he wrote.

"While central banks have lately sought to buy and repatriate gold, it only makes up 13% of theirassets. Foreign currencies are 78%. The rest is positions at the IMF and Special Drawing Rights, orSDR—an IMF-created claim on hard currencies," Sindreu added.

The columnist said that for some time, many economists have equated this currency reserve to be akin to savings in a piggy bank, "which in turn correspond to investments made abroad in the real economy."

But some recent events have revealed why that thinking is wrong: With the exception of gold, the other "assets are someone else's liability — someone who can just decide they are worth nothing."

Sindreu went on to list a couple of more recent examples, such as when the IMF cut off the Taliban from accessing Afghanistan's funds and SDR last year, and sanctions against Iran which prove "that holding reserves offshore doesn't stop the U.S. Treasury from taking action."

He went on to point out that while the U.S. and NATO allies have blocked Russian banks from accessing reserves, they have not moved to block new inflows of dollars and euros, mostly through the sale of oil and other energy. Nevertheless, what the U.S. and its Western allies have done is demonstrate the actual risk in holding their currencies as reserves as well, which is driving Russian and Chinese pushes to buy more hard currency.

"[T]he entire artifice of 'money' as a universal store of value risks being eroded by the banning of key exports to Russia and boycotts of the kind corporations like Apple and Nike announced this week," the WSJ columnist pointed out. "If currency balances were to become worthless computer entries and didn't guarantee buying essential stuff, Moscow would be rational to stop accumulating them and stockpile physical wealth in oil barrels, rather than sell them to the West. At the very least, more of Russia's money will likely shift into gold and Chinese assets."

"The risk to King Dollar's status is still limited due to most nations' alignment with the West and Beijing's capital controls," he noted, but that is changing with each action taken by the U.S. and the West that cuts off countries from spending the reserves they were allowed to accumulate.

"Stockpiling commodities is an alternative. The conundrum creates another incentive for Beijing to reduce its trade surplus by reorienting its economy toward domestic consumption, though it has proven challenging," Sindreu wrote, concluding: "What can investors do? For once, the old trope may not be ill-advised: buy gold. Many of the world's central banks will surely be doing it."

by: JD Heyes

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1. Economy-Business-Fin/Invest
2. Main
3. Politics-Geopolitics-Gov.-Events

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