Strong central bank buying, lower US rates and recovering exchange-traded-fund demand should push the gold price higher. (UBS)

Gold has become the diversifier of choice

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The global reserve and trading currency order is undoubtedly evolving. We have been receiving inquiries from our clients on the sustainability of US-dollar dominance on a regular basis.

Based on a wide range of indicators we track to try to gauge where the global monetary system may be headed, we believe a US-dollar-centric world will continue for years to come, even as the landscape becomes more diverse going forward, with several currencies and even commodities—gold central among them—playing critical roles. Here's why:

Global currency regimes are sticky. The US dollar dominates financial markets and international trade. Changes in the world's dominant currency have historically taken a long time to materialize. Even as great economic powers rise and fall, their currencies' reserve status tends to survive well past the peak of their influence. The latest IMF survey on the currency composition of global foreign exchange reserves reveals that the share of US dollars held by central banks still stands at almost 60% , roughly stable over the last four years. The greenback is also used in over 47% of global payments and dominates 84% of trade finance contracts, according to SWIFT. For comparison, 23% of all global payments were made in euros, with its trade finance share at just 6%. The numbers for the Chinese renminbi were less than 5% and 5%, respectively.

Liquidity is king. Liquidity ranks near the top of the properties that global reserve managers and those involved in international trade look for in a currency. The US dollar remains the world's dominant currency in this realm: it is on one side of 88% of all trades, according to the latest survey by the Bank for International Settlements (BIS). It also offers deep derivatives markets—forwards, swaps, options, etc.—giving market participants the ability to efficiently hedge exposure.

Stability and safety matter. The US political atmosphere and fiscal accounts are no doubt experiencing serious challenges, yet the situation in competing jurisdictions is also dire; in the land of the blind, the one-eyed man can remain king. The US still ranks highly in various gauges of institutional strength including market openness (the prevalence of capital controls, for example), regulatory quality and efficiency, and rule of law. In this context, the US continues to attract large flows of foreign investment. The US-centric AI technological revolution is cementing the country's reputation for innovation and acting like a magnet for foreign capital. Of course, the US must treat the privilege of issuing the world's preeminent currency with care. Outsized fiscal deficits, together with recurrent debt limit sagas, are eroding confidence. Foreign investors are watching the electoral race with angst, and reports that the independence of the Fed may be questioned aren't helping. Please see our latest **Election Watch report** for more information.

Geopolitics enter the equation: Although shifts in the global currency order typically take place at a glacial pace, rising geopolitical tensions can trigger quicker adjustments. China, for instance, is working to accelerate the yuan's internationalization as relations remain tense with the US. These efforts are unlikely to yield overnight success, and de-dollarization initiatives from groups like BRIC represent today **more bark than bite**, yet they do plant the seeds of a more diversified currency landscape ahead.

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All in all, we think the dollar's reign will live on. At the same time, it will likely make some room for competitors along the way. As of late, gold has stood out amongst them.

Central bank buying of gold accelerated after Russia's invasion of Ukraine. Central banks have purchased well over two thousand tons of gold in the last two years—the fastest pace in history, according to the World Gold Council. As the yellow metal carries no credit or counter-party risk, some deem it as being better insulated from financial sanctions, particularly those from the emerging world. These institutions look set to continue accumulating gold going forward, with 81% of those polled in a recent World Gold Council survey expecting to see higher global gold holdings by central banks in the year ahead.

In addition to strong central bank buying, lower US rates and recovering exchange-traded-fund demand should push the gold price higher: we see it rising to USD 2,600/oz by yearend. Gold can also be an effective hedge against concerns about geopolitical polarization, the US fiscal deficit, inflation, or a weaker US dollar.

Those looking for opportunities outside of the US dollar should also consider the Swiss franc, which we rate as most preferred. The Swiss National Bank is unlikely to cut interest rates much further from here, and the currency offers safe-haven qualities amid political uncertainty in the US and Europe.

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