Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

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Gold shows, again, that the United States has a spending problem

The global gold market has experienced a radical surge in demand in the past two years, with central banks leading the growth. This trend is expected to continue well into 2025.

Gold prices soared 35% in 2024 and have continued to rise in the first days of 2025, reaching over $2,700 an ounce by mid January 2025. This surge occurred despite the mainstream narrative of easing inflation and the absence of a global recession.

However, annualised inflation is not under control and gold is discounting an unprecedented monetary destruction, which is already evident in currencies like the Brazil real, the UK pound or the Japan yen reaching new lows against a US dollar that loses its own purchasing power due to persistent inflation.

Inflation is not under control

The Consumer Price Index for All Urban Consumers (CPI-U) increased by 2.9% on an annual basis in December 2024, rising 0.4% in the month of December, after increasing 0.3% in November.

Core inflation rose to 3.2% in December, a 0.2% increase in the month. This means that the cumulative inflation measured by CPI since January 2021 is 21.8% and core CPI is 23.5%.

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Many market participants expect inflation to drop quickly, leading to more rate cuts. However, commodities have soared since rate cuts started, government spending is up 10% in 2024, and money supply growth is at 27-month highs.

Without a significant decline in money supply growth and government expenditure, it will be very difficult to reduce annualised inflation significantly.

Sovereign bonds stop acting as a reserve

Persistent inflation is a sign of a de facto default. Additionally, the MSCI Government Bond Index for Developed Markets has recorded a 24% slump between January 2021 and December 2024. As such, sovereign bonds are no longer a safe, reliable and profitable asset for most central banks.

When persistent inflation and weakening government solvency create such a relevant decline in the bonds that usually acted as reserves for global central banks, monetary institutions look for better investments that will strengthen their asset base. Gold is the most obvious.

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Global investors and monetary institutions are turning to gold as protection against currency debasement and rising concerns about the solvency of public finances in developed economies.

Thus, many central banks are abandoning Treasuries and sovereign bonds as reserve assets and replacing them, at least partially, with gold.

Persistent inflation and the slump in currencies and sovereign bonds are clear indications that public debt is too high, governments are overspending and creating a relevant damage in the real economy through higher taxes and record indebtedness.

The central banks that are driving this change in policy see that sovereign bonds will not work as a reliable reserve asset as long as the public sector continues with out-of-control spending.

The harsh reality

The People's Bank of China has been consistently expanding its gold reserves, with recent purchases of 5 tonnes in November 2024 and continued buying in December. Market participants anticipate that this trend will rise in 2025 and 2026.

The Central Bank of Poland has a plan to increase gold reserves from 13% in 2023 to 20%, purchasing 130 tonnes in 2023 and 61 tonnes in 2024. The Russian central bank is already the largest holder of gold reserves relative to total assets and aims to continue purchases into 2025. India, Turkey, Oman and other monetary authorities are following the same policy.

Developed economies have taken for granted that their government bonds will continue to be world reserves and now face the harsh reality: When you push the limits of solvency, demand for sovereign bonds declines and the currency slumps.

The new Trump administration and its secretary of Treasury, Scott Bessent, understand this.

> "The United States does not have a revenue problem, we have a spending problem" - Scott Bessent

Bessent has recently stated that "the United States does not have a revenue problem, we have a spending problem". "Today, spending is out of control", "6 to 7% deficit when there is no recession or war". What does this mean?

That the Treasury will not be able to use its borrowing capacity if there is a downturn, because all limits have been exhausted.

If the United States wants to keep the dollar as the world reserve currency and Treasury bonds as a global reserve asset, it needs to cut spending and strengthen the productive economy.

Gold is not a threat

Bessent understands that gold is not a threat, but a reminder that the US dollar can lose its global position if the government does not do its homework and puts public finances under control.

Bessent also understands that taking no action on excessive government spending will put the US currency and government bond at risk of losing its reserve status.

More countries are seeking to diversify their reserves and hedge against irresponsible developed governments, and gold has emerged as a critical asset - Daniel Lacalle

No leader fears competition. The US dollar can strengthen its purchasing power and end inflation if the government controls public finances. It can only weaken with an irresponsible spending policy.

The rising global demand for gold, spearheaded by central banks, represents a significant shift in the international financial landscape. It is a warning sign for central banks and governments of developed economies. Those who ignore it will fail. Those who understand it will cut spending and strengthen their global position.

More countries are seeking to diversify their reserves and hedge against irresponsible developed governments, and gold has emerged as a critical asset.

This trend is reshaping market dynamics, influencing investment strategies, and potentially altering the balance of global economic power. Government bonds are not an essential item of investor portfolios, while gold is increasingly important.

Central banks are returning to a more logical approach after years of insane money printing. As I always mention, inflation is a de facto default and the trends I have outlined show that developed economies' governments have exhausted their fiscal space and probably irreparably damaged their status as reserve assets.

The United States needs to learn the lesson quickly: Government spending makes you poorer, and excessive spending may destroy the currency you use to collect your salary and save.