

The age of a treacherous, falling dollar

Over the past year President Donald Trump has bullied America's allies with tariffs, bludgeoned the Federal Reserve and treated the budget deficit as if it were just a distraction. Yet most asset markets blithely carry on as if nothing were wrong. In the past 12 months the S&P 500 index of stocks has risen by 14% as investors have piled into artificial intelligence (ai). Growth in America is still the envy of the world. The ten-year Treasury yield, which should rise with the risk of inflation or default, is 4.3%, lower than when Mr Trump took his oath of office.

Yet look closely and the picture is darker and more complex. Since a peak in January 2025, the dollar has lost a tenth of its value against a broad basket of currencies. As a result, in foreign-currency terms, the performance of American assets has been poor. When denominated in euros, for example, American stocks have barely risen over the past year.

The currency's fall partly reflects the narrowing of interest-rate gaps between America and the rest of the world. Yet [American institutions are also a source of worry](#), as we report this week. Spasms of investor panic have become more common, as in April 2025 after Mr Trump announced his "Liberation Day" tariffs. In those moments investors flee American assets, causing bonds, stocks and the currency all to fall in value. More common in emerging markets, that has occurred in seven of the past 52 weeks, about three times as often as in the previous decade or so.

When Mr Trump backs off his maddest ideas, normality returns. But the spasms offer glimpses of a topsy-turvy world in which dollar assets are no longer safe. It is an alarming prospect, given that the dollar is the world's reserve currency and that foreigners own more assets in America than Americans own abroad, to the tune of 89% of Uncle Sam's gdp. At the same time, the price of gold has surged to around \$5,000, up about 75% in a year, provoking speculation that investors are protecting themselves against the debasement of the dollar and other tail risks.

This should give pause to those who think that America's financial strength is unbreakable. The latest example of an apparent return-to-normal was Mr Trump's announcement on January 30th that he would nominate Kevin Warsh to lead the Federal Reserve. Mr Warsh is an experienced central banker whose contacts on Wall Street helped the Fed through the global financial crisis of 2007-09. His monetary-policy record is of an overzealous hawk, not a debaser. His nomination caused the dollar to rally and the gold price to fall. Mr Warsh is more technocratic and less partisan than Kevin Hassett, a sycophantic White House adviser and early front-runner.

Yet the small relief rally does not change the big picture. Over the past month alone, during which Mr Trump menaced Greenland, the greenback is down by 1.5% and gold is up 14%. Mr Warsh's history is hawkish but he has undergone a Damascene conversion to interest-rate cuts as Mr Trump has searched for a nominee.

Mr Warsh has two main arguments for looser money. One is that AI will bring about a productivity boom which will enable fast growth while inflation falls. It is true that, all else being equal, more output will bear down on prices, and that recent productivity data are encouraging. However, productivity growth also encourages investment—for example, in data centres—while soaring stockmarkets and economic optimism support more consumer spending. The AI frenzy, if sustained, is more likely [to lead to higher interest rates than lower ones](#). In the dotcom boom of the 1990s the Fed also thought that productivity would keep rates low, before reversing itself at the end of the decade. Mr Warsh also argues that the Fed can offset the stimulus of lower rates by shedding long-dated assets, stepping on the accelerator and the brake at once. The Fed may indeed need to shrink its balance-sheet, though that would mean rewiring the monetary system. In the early 2010s Mr Warsh wrongly warned that [buying assets would trigger high inflation](#); today he asserts that offloading them would be disinflationary. In fact it would have only a small effect.

If the Fed's new chair, once confirmed, persuades his colleagues to go along with big rate cuts, they are likely to prove ill-timed. At 2.8%, America's inflation is still above its 2% target. This year has brought tax cuts and will soon bring tax refunds, [providing a stimulus of about 0.3% of gdp](#). If, as is likely, the Supreme Court rules many of Mr Trump's tariffs unlawful, refunds worth 0.5% of gdp could follow. This combined

monetary and fiscal stimulus could lead to still higher inflation, casting more doubt on dollar assets.

How far can America push its luck? The country is fortunate that investors have few alternatives to holding the greenback. Precious metals are a poor substitute for hard currency, and no bonds rival the volume, liquidity and legal safety of Treasuries. [Foreigners are more likely to shun America's pricey equities](#) than its bonds—and jitters in tech stocks this week show how fast the mood can turn. Though central banks have diversified their reserves, king dollar's share of cross-border banking, trade invoicing, global debt and foreign-exchange deals remains dominant.

Greenbacksliding

All that is a protection against a dollar rout. Yet volatile policymaking and a falling exchange rate make holding the dollar riskier than for decades. Even if Mr Warsh is right about inflation, lower interest rates will further weaken the currency. It has a long way to slide. Despite its recent decline, the greenback is above its long-term average in real terms and, according to our Big Mac index, overvalued against most currencies. The want of alternatives to the dollar condemns foreign investors to bear losses—and should alert American investors to the risk of an alternative emerging one day. Everyone should mourn how an asset that is an investors' haven is increasingly tainted by risks the whole world must now bear.