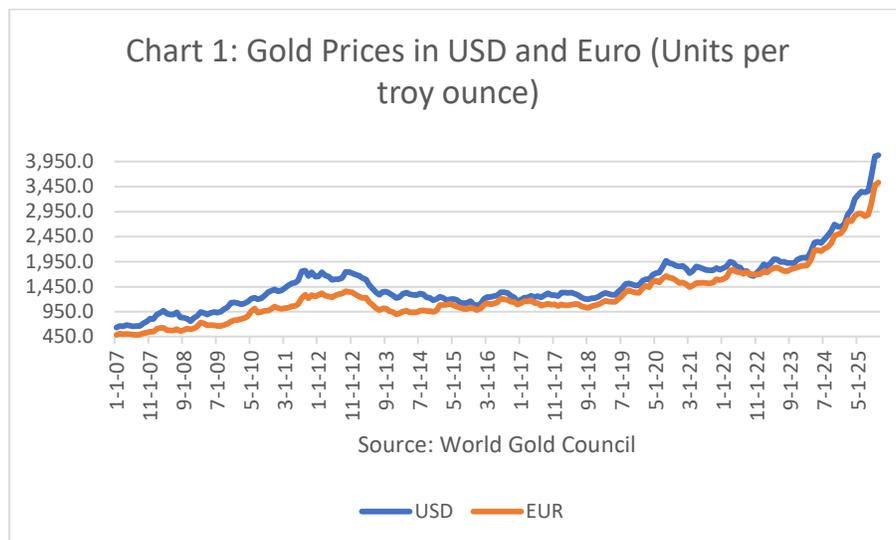


## Gold: Another Fatal Financial Attraction?

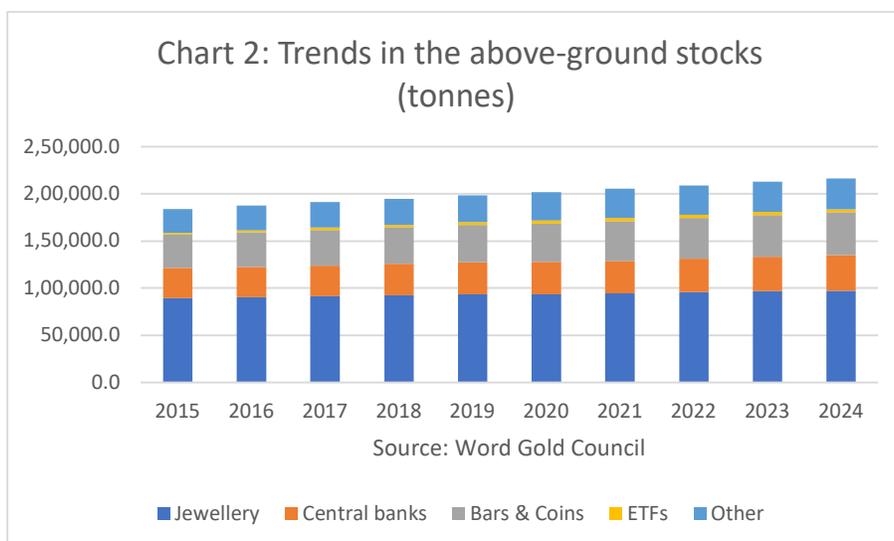
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Asset price inflation has never worried analysts and policymakers as much as inflation in the prices of goods and services. And among assets, inflation in the price of gold has been the least disconcerting because of the faith that its prices reflect some notion of intrinsic value. But with gold prices denominated in dollars having risen by around 60 per cent during 2025, and more than doubled over the last two years, there are some signs of discomfort. While a part of this rise reflects the depreciation of the dollar in recent times, the inflation in gold prices denominated in euros was also at a high of more than 40 per cent in 2025 and above 90 per cent over the last two years (Chart 1). The Bank of International Settlements (BIS) has cautioned that this is reflective of intensified speculation in asset markets in general and that can unwind and deliver investor losses with damaging external effects.



Gold price inflation is by no means new. Under the Bretton Woods arrangement that linked the dollar to gold (at \$35 per troy ounce) and other currencies to the dollar, inflation in the dollar price of gold as well as its price in many other currencies was ruled out. That changed in 1971 when the US under President Nixon broke the link between the dollar and gold fearing excess demand for converting the greenback into the yellow metal. Once gold had formally stopped being the anchor for global currency values, inflation in its price denominated in those currencies was a possibility.

In principle such inflation could be significant since the supply of gold is constrained by limited reserves and the difficulty of extracting it in pure form, while the demand for it was elastic since it is the preferred store of value asset. The metal did not erode with age and was seen as being a relatively liquid asset. However, there were factors that tempered demand. To start with, crucial among the sources of demand for the metal were central banks that held their reserves partly in gold, besides in other safe and liquid assets like US Treasuries. At the end of 2024, close to a fifth (17 per cent) of the global stocks of gold were being held by central banks (Chart 2).

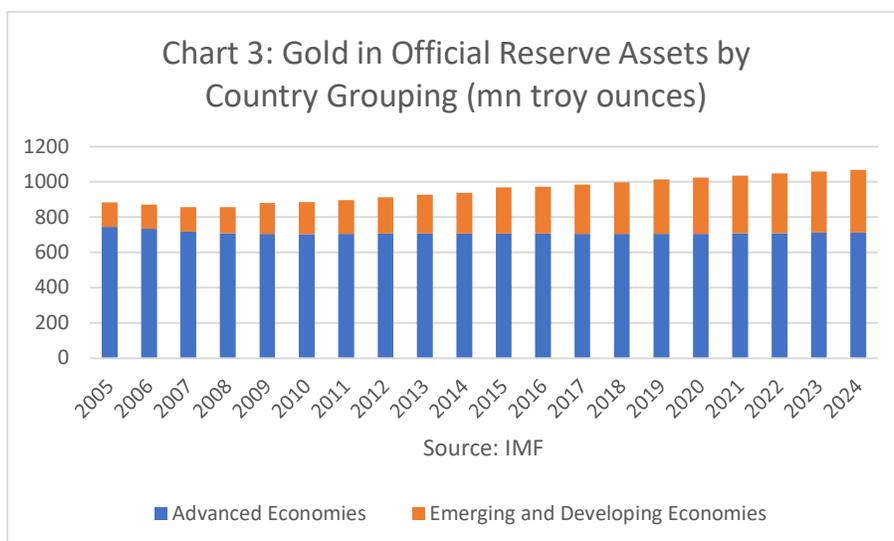


In general, central banks do not sharply raise reserves or change the structure of their portfolios. It also helped that, despite the end of the Bretton Woods arrangement and the deficits that the US began recording in the current account of its balance of payments, the dollar continued to hold ground as the world's principal reserve currency. That made dollar denominated financial instruments safe assets and dampened safe-haven demand for gold.

Second, even though around two-thirds of gold stocks are held by private sources (individuals and private institutions), both as a store of value and a hedge against inflation and uncertainty, increases in such demand was limited by the difficulty and cost of storing the yellow metal. In the event, despite the limits on raising supply, demand too was not completely elastic, reining in explosive increases in the price of the metal.

However, in the post-World War II era, ever since the end of the Bretton woods agreement, there have been periods when gold has been a go-to asset for central banks and wealth holders looking for a safe investment of their reserves or surpluses. Demand for gold rises in times of uncertainty, as happened for example at the time the oil shocks in the 1970s and following the developed country financial crisis in 2008, when the value of the metal reached highs that were record peaks historically speaking. Moreover, there have been new central bank players from countries with growing surpluses looking for assets to widen the portfolio of safe and liquid assets in which they held their reserves. Among them have been the likes of central banks from China, India and Kazakhstan, for example.

Most recently, as a result of the uncertainties arising from geopolitical tensions that have led to the US trying or threatening to exclude countries like Russia, China and other BRICs members, besides say Venezuela, from the dollar transaction universe, countries have been working to reduce their dependence on the dollar. This has involved restructuring their reserve portfolios. But the acquisition of gold by emerging and developing countries has been a longer-term trend, with gold reserve holdings of this group rising from 148.9 million troy ounces in 2007 to 356.6 million in 2024 (Chart 3). This occurred at time when the holdings of advanced economy central banks were stagnant, rising marginally from 708.3 million ounces to 712.5 million ounces. However, while this contributed to a medium-term increase in gold demand, it cannot be the principal explanatory factor for the recent price spike.



That explanation seems to turn on the increased integration of the gold market with the overall financial system, characterised by continuous change. One such change is the emergence of exchange traded funds (ETFs) through which retail investors, with smaller surpluses, can seek exposure to asset markets at one remove. They invest in these exchange traded funds which in turn invest in targeted assets. Recent years have seen an increase in the popularity of gold-backed exchange traded funds, which has meant that private investors, including retail investors can invest in gold without having to hold the metal in large quantities. The tonnage of gold held to back gold ETF assets rose from 3,200 in the third quarter of 2024 to 3,838 in the third quarter of 2025, or by 20 per cent in a single year. That would at the margin have driven demand and influenced prices.

But this is not the only form of integration of gold and financial assets. The other is the effort of stablecoin issuers to use gold as a backing for their stablecoin issues. According to figures from Jefferies quoted by the *Financial Times*, at the end of September 2025, stablecoin issuer Tether, with 116 tonnes of gold reserves, was the second largest holder of gold outside of central banks. The holdings were “roughly equal” to those of the central banks in Korea, Hungary and Greece. Tether’s purchases of gold were estimated at 2 per cent of global demand and 12 per cent of that of central banks in the third quarter of 2025. That would again at the margin alter the demand-supply balance and therefore price of gold.

In sum, financial shifts have increased the presence of retail investors in the market for gold held as investment. That would mean that when prices of gold tend to rise for all the conventional reasons like increased uncertainty or shifts in the portfolio choices of central banks, retail investors expecting the price rise to continue could rush to gold in the expectation that prices would only continue to rise. That is what has happened recently and underlies the spike in prices. But that makes gold price spikes more speculative than they used to be, creating the possibility of a sharp downturn. The BIS has a point.

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