USD outlook: Is There a Tectonic Shift Underway?

By BFI Capital Group

With institutional investors pulling back, political pressure mounting on the Federal Reserve, and alternative assets gaining renewed interest, the cracks in the greenback's long-held dominance have become impossible to ignore. While it is too early to consider the US Dollar's fate sealed, its future is indeed very uncertain.

For years, we've been warning our clients and readers at BFI about the many weaknesses and the growing doubts surrounding the US dollar's global dominance. The rise of BRICS, the Sino-Russian efforts to undermine the greenback's role as the world's reserve currency and the growing pressures on many other nations, especially developing ones, to find an alternative after the Western sanctions against Russia proved to the world how easily the US centric system can be weaponized, have all provided ample ammunition to experts and analysts that have a bearish long-term outlook for the USD.

The last six months have added significant fuel to that fire. As the FT recently highlighted, "The dumping of US assets in favour of Europe's resurgent markets signals the start of a much longer-term move by pension funds and other big institutional money managers to cut back their huge exposure to dollar investments…Wall Street banks say they are seeing signs that investors managing trillions of dollars of assets are starting to trim their US positions, on concerns over erratic policymaking, President Donald Trump's attacks on the Federal Reserve chair and the fallout from the trade war."

Indeed, it's not hard to see why institutional investors would be rattled by the policy uncertainty of the last months, especially given the questions that still remain unanswered on the tariff front and the disruptions that the trade wars already triggered. As many critics have pointed out, it is not even the introduction of tariffs per se that is the problem, what is really disruptive is the size, the scope and especially the mercurial way in which they have been enforced. It's costly, time-consuming and very risky for companies to make changes in their production, operations and trading patterns and to realign supply chains when they are not sure what the rules will be tomorrow or months from now. Instead, it is cheaper and safer to simply stop investing until the dust settles.

Even for conservative investors who are more preoccupied with things such as the record-breaking and clearly unsustainable debt levels of the US economy, there have been policies that also gave them pause too. For instance, the "Big Beautiful Bill", that is projected to add $3.4 trillion to the nation's debt, according to the nonpartisan Congressional Budget Office. The aforementioned pressure on Fed Chair Powell by President Trump to cut rates is also concerning, given that real inflation is still placing a big burden on household budgets (in fact it accelerated to 2.7% in June, from 2.4% in May). The pressure on Jerome Powell has been massively ramped up in recent days, with the US President calling the US central bank chair a "numbskull" and accusing him of "making it difficult for people, especially the young, to buy a house".

Monetary policy aside, however, and whatever one thinks the right policy course is for the Fed, a deeper concern has also emerged regarding the supposed independence of the central bank. Of course, it has been clear for decades that government pressures have and do exert influence over central bankers' decisions, nevertheless Donald Trump's direct attacks against the Fed Chair are reigniting questions over this issue. Reports that the President might take the unprecedented step of firing Powell before his term ends in May are also worrying to investors. As Juan Perez, senior director of trading at Monex USA told Reuters: "What can kill the value of the US dollar, what can absolutely destroy faith in the U.S. dollar, is attacking in any way, shape, or form the independence and authority of the Federal Reserve".

Implications for investors

Due to a combination of the aforementioned factors, the USD has dropped 10% over the last six months alone, according to the US Dollar Index, reaching its lowest point since the Nixon years, when the price of gold was unpegged from the USD in 1973, triggering a rapid decline in the dollar's value. In this exodus from the currency, a lot of investors sought out alternatives, like BTC and gold, which contributed to the price surges of both assets. This shift is clearly understandable given the geopolitical events of the last months as well, of course: the ongoing wars and the surprise conflicts we've recently seen also forced investors to seek safe havens beyond the US currency (or any other fiat currency for that matter).

Still, the big-picture question remains: are we witnessing the beginning of the end of the USD? The straightforward answer is "it's too soon to tell". Many in the past have prematurely sounded the death knell for the dollar only to see it make a roaring comeback months later. Realistically, the currency might be facing some serious headwinds, but it is too well established and too deeply ingrained in the current financial, banking, and trading system. It is not getting dethroned from one day to the next, especially since its challengers (yuan, ruble or a potential BRICS currency concept) have not yet gained the necessary traction or wide enough, systemic adoption on a global level.

That being said, it is also clear that while the currency might not lose its reserve status anytime soon, it will also most likely not further solidify it. As competing superpowers keep working on ways to undermine it and keep chipping away at its power, the pressure could eventually become significant, and as more and more investors understand that a true safe haven cannot be found in fiat money, but as far away as possible from state interventions and manipulations, the more capital will flow to precious metals and crypto.

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