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OLD GOLD AND NEW CURRENCY

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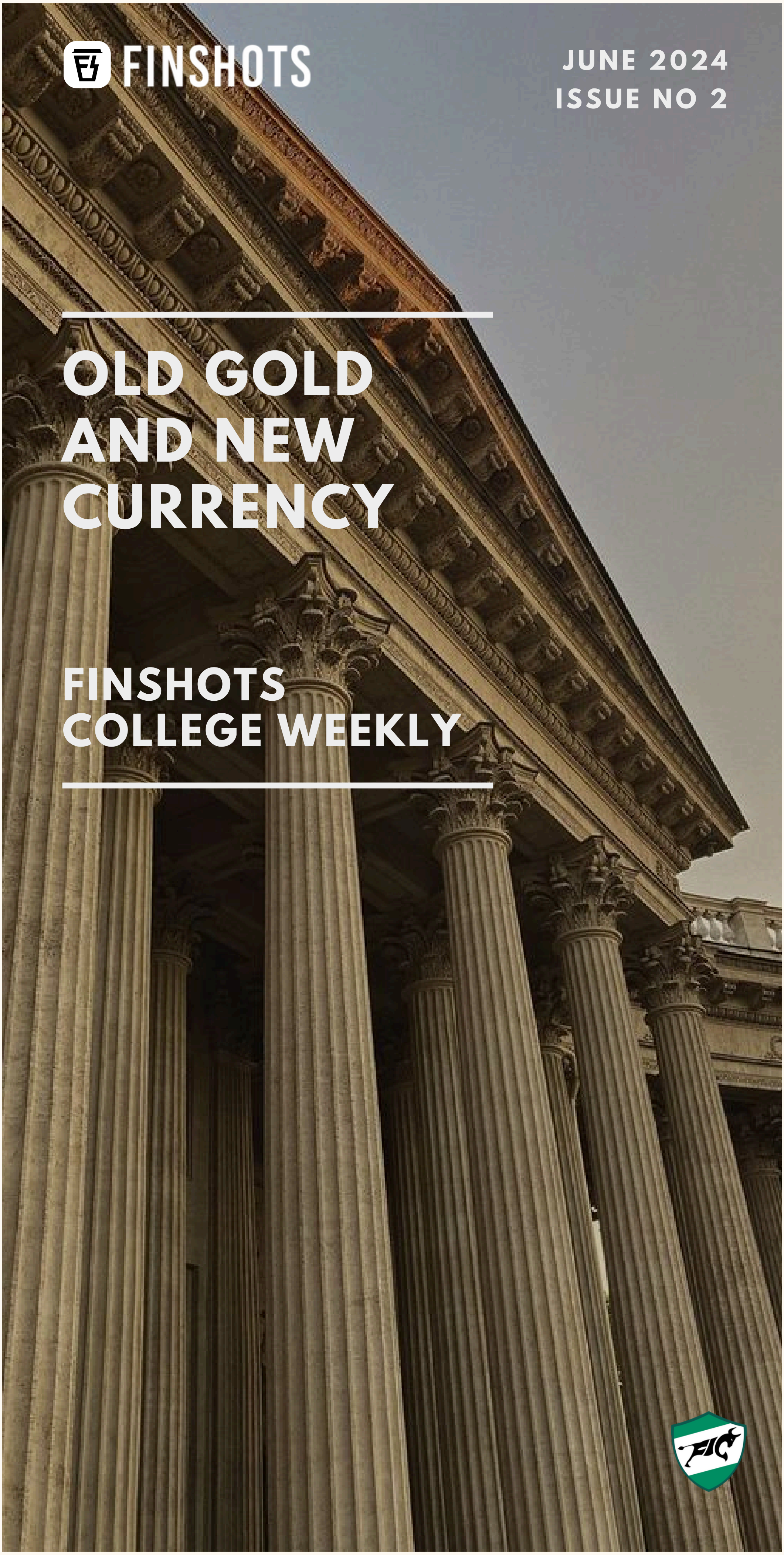

Finshots College Weekly - Old Gold & New Currency

In this week's newsletter, we talk about why India's central bank stacks its gold reserves in UK vaults, ZiG, relationship with money and more.

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The real reason RBI stores its gold in London

Last week RBI said that it had moved 100 metric tonnes of its gold stored in the UK to domestic vaults in FY24. And as one article in Business Today notes — “This significant transfer marks one of the largest movements of gold by India since 1991".

100 metric tonnes of gold does seem like a lot of gold. However, the RBI is currently sitting on 822 metric tonnes of gold. So this is a little over 10% of RBI’s gold holding. The concerning bit however is that there is still over 400 metric tonnes of gold in the UK.

Which begets the immediate question — “Why? Why keep it in the UK and what good is this gold if it’s stored abroad?”

Well, you are right.

Gold stockpiled in a vault is of little use to anyone. It eats space, costs money and slumbers in a dark room. You can only realise gold’s potential when you sell it. However, selling gold can be a bit of a challenge. This may seem counterintuitive to most people, considering gold is almost universally accepted as a medium of exchange, but I am referring to certain logistical challenges. When you are transacting large quantities of gold (say a few tonnes), it becomes imperative to operate in a transparent, liquid market. A market where you have a large number of buyers and sellers. A market where everyone plays fair. And a market that offers competitiveness and some degree of security.

Here, you can get the best price for your gold — irrespective of whether you're buying or selling.

And London has it all.

They have the most liquid market i.e. this is where most buyers and sellers prefer to trade physical gold and it is aided by a robust supporting infrastructure — vaults, specialised transportation companies, bespoke insurers and customs handling firms. The Bank of England vault (where the RBI holds some of its gold) for instance has state-of-the-art security systems, including biometric scanners, motion detectors, 24/7 surveillance, and reinforced construction designed to withstand a variety of physical and electronic threats. They're so secure that they have never had gold stolen from them. Ever.

And there is the LBMA or the London Bullion Market Association. This is the organisation that oversees the gold and silver markets in London. They make sure that the gold isn't bad and that everybody plays fair.

In effect, if RBI ever wanted to store gold or trade in the global markets (exchange the gold for foreign currency for instance), London is the best place to do it.

But wait... Why not another country that has a similar supporting infrastructure?

Or why can't India position itself as a global trading hub for gold?

Well, there are a few challenges.

London didn't just become the central hub for gold trading overnight. Instead, this has been in the making for hundreds of years — going all the way back to the 1600s and the East India Company. Ships laden with gold and precious metals sailed into London, and a market for gold began to take shape from this plunder. Soon, refiners, banks and businesspeople began dabbling in gold. The infamous Rothschilds for instance set up the Royal Mint Refinery in 1852 in London at the precipice of the gold rush. There was gold coming in from California, then Australia and finally South Africa. And considering London was the capital of the British Empire, most of this gold made its way to the metropolitan centre for processing, sale, and use and this only further bolstered London's position in the global market for gold.

By the 20th century, when most countries started backing their currency with physical gold, London had already transformed itself into a global hub for gold trading with most of the supporting infrastructure. All they had to do was hold on to their near monopolistic status. And they did (bar the rise of American influence).

So the question isn't why RBI stores its gold in London. Why are they getting it back now?

Well, RBI says there's nothing to it. But maybe the Indian Central Bank isn't overly keen on holding over 50% of their gold holdings abroad. The US and UK have in the past unilaterally seized Russian gold held in their banks. And this may have spooked some countries. If it can happen to Russia, why can't it happen to us?

Maybe that's why they're de-risking. Maybe holding that much gold in London (for convenience and ease of doing business) may not be the smartest thing to do considering the current geopolitical scenario. And RBI has finally decided to get some of the gold back to India.

Can Zimbabwe's new currency help tackle its hyperinflation?

Six!

That’s how many national currencies Zimbabwe has had in the last 15 years. Thanks to the country’s attempts to tame hyperinflation - a term used to describe excessive price rise, usually over 50% month every month. In Zimbabwe though, that figure touched a whopping 89.7 sextillion per cent year on year at its peak in November 2009. That’s 89.7 followed by 21 zeros by the way. So the country was way overboard the threshold that defined hyperinflation.

And the Zimbabwean government now thinks that their sixth and latest currency, ZiG or Zimbabwe Gold could do the trick.

But wait... How did Zimbabwe even get here, you ask?

Well, to understand that we'll have to go back to 1980 when the South African nation became independent from the British. Minority foreign settlers owned most of the commercial agricultural land in Zimbabwe at the time, leaving local Zimbabweans landless.

This didn't go down well with the government, which brought in land reforms to win the support of its citizens. Over the next three decades it simply transferred land, often forcibly, to the locals. Slowly locals came to own more than 85% of these commercial farms.

But there was a problem. These agricultural lands were the heart and soul of Zimbabwe's trade. It's was the cornerstone of the country's commercial food production engine. But the new owners weren't really equipped to deal with the complexities of commercial farming. With no real knowledge, they switched to growing food for themselves and their families. And that meant that agricultural production dropped. Between 2000 and 2010 alone, food production fell by 60%. This not just led to a food shortage, but also set the stage for massive economic turmoil.

Agricultural export companies had to shut shop and export earnings dwindled. On the other hand, arable but idle lands which were earlier used as collaterals by farmers to get loans, began to lose their commercial value too. Banks suddenly became laden with bad debts and collapsed.

All of this put together meant that the country had no money to even import basic necessities like food and clothing.

So guess what it did? It printed more money! And you know what happens when you simply print money without actually backing it with production of goods and services right?

The supply of money in the economy increases, sparking widespread inflation. By 2009 things went haywire. Zimbabweans couldn't even buy a loaf of bread for 500 million Zimbabwe dollars. Prices were doubling every 24 hours. So people began spending their money as soon as they got it simply because waiting for tomorrow meant paying more for the same goods. That encouraged businesses to jack up prices even more.

The government wasn't helping either. It began introducing currencies of higher denominations. And even printed a 100 trillion Zimbabwe dollar note to keep up with skyrocketing prices. When that triggered a vicious cycle of uncontrolled inflation, it declared inflation illegal and banned price rise!

But sadly, escapism isn't an economic reform. And Zimbabwe had to do something about it. So it began redenominating its existing currency. Simply put, it issued new notes without the zeros. It was probably inspired by Rentenmark, a redenominated currency Germany introduced in the 1920s to tame inflation. But the thing with Rentenmark was that it was printed in limited quantities and was backed by equal amounts of guarantees in the form of mortgages on German land or bonds on its trade, commerce and banking industry.

On the flip side, Zimbabwe didn't even have any real economic reforms or property to back its redenominated currencies. Rather, it simply converted the existing balances of old money into a new currency, not once but multiple times. It didn't stop printing money either.

The bottom line was that none of this worked and the Zimbabwe dollar became worthless.

That's when the government ditched the Zimbabwe dollar and adopted a multi-currency system. So Zimbabweans could transact in foreign currencies, predominantly the US dollar. That way the government wouldn't be tempted to incessantly print money.

They'd only have to deal in currency backed by stable global economies.

It worked! Finally, Zimbabwe's inflation nosedived. By June 2018 its annual inflation dropped to 48%.

But cut to today, hyperinflation is back in the country, topping 500% in recent years.

What the heck happened again; you ask?

Well, the government was itching to launch its own currency to steer economic growth on its own terms and introduced the RTGS (Real Time Gross Settlement) dollar in 2019, only to get back to square one.

Despite that, the government thinks that things could be different with the ZiG.

You see, a couple of years ago the government began issuing 22 carat gold coins that could be easily converted into cash. This inspired the Reserve Bank of Zimbabwe to issue equivalent amounts of digital currency that people could transact with. By March 2024, the central bank sold digital tokens that were worth over 900 kg of gold.

So yeah, the ZiG is Zimbabwe's new currency backed by how much gold the country has. This means that there can only be so much money in the economy that matches its gold reserves. And that's the government's reasoning behind thinking that the ZiG could finally turnaround its economy. But can it?

Look, backing currencies with gold isn't new. It's something that most countries in the world began doing in the 1930s to tackle inflation, following the United States. But back then, countries made sure that they had enough gold and worked together to keep gold prices stable and protect their economy from extreme fluctuations.

But that’s not the case with Zimbabwe. Today no country in the world uses the gold standard. So Zimbabwe has to ensure that it manages price fluctuations by itself. Sure, its Central Bank has gold and cash reserve holdings that are more than 3 times the amount of ZiGs they’ve issued.

But that’s the figure it's officially reporting. And Zimbabweans can find it hard to trust the government or the Central Bank simply because they’ve lied to their citizens in the past. They’ve underreported how much money they printed to keep negative news on their economy under wraps.

Even now, nearly 80% of Zimbabwe’s transactions happen in the US dollar simply because there aren’t enough physical ZiGs people can use. Most of it is in the digital form.

Not just that. Zimbabwe has a problem of illegal street currency dealers. Most people don’t trust the local currency enough to use it efficiently. And you can’t blame them because they’ve seen their currencies collapse multiple times. So whenever they earn in the local currency, they take it to the black market where it gets exchanged at unofficial exchange rates. That not only weakens the local currency but tampers with the exchange rate the Central Bank sets.

And this lost trust is something that the government will have to win back.

Can they do it? We’ll only have to wait and see.

Money Tips

Relationship status with Money: It's complicated

When it comes to money management, there's one thing we don't talk about enough — Our relationship with money.

Why are you a spendthrift? Or on the contrary, what explains your frugality?

Taking a moment to introspect will help you develop a better relationship with your money. So take out your notebook or journal and spend some time with yourself today. We've got some questions to help you get started on this journey. So try and answer as many as you can and take all the time you need:

- What was your relationship with money as a kid? Did your parents discuss money at home and how has that led you to think about money?
- Has your relationship with money changed as you've gotten older?
- What/Who has influenced any change in your money habits?
- What does financial independence or financial freedom mean to you?

If it's too overwhelming, don't forget to take breaks in between. Maybe order some dessert too.

Okay? Then let's move on to the next.

- Do your friends think you spend too much or too little? How does that affect you?
- What do you absolutely love spending money on? And what do you hate spending it on?
- Do you think there are money-related habits that you wish you didn't have? Have your goals been affected by money troubles?
- Does money play a big part in how you define success in life?

Once you're done, don't just shut the book and bury it in a dark corner of your drawer. Take some time to actually reflect on your answers. And while this may not lead to a better relationship with money overnight it will hopefully get you thinking and reveal some patterns soon enough!

And that's all for today folks! If you learned something new, make sure to subscribe to Finshots for more such insights :)

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