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Currencies Are Not Valued. They Are Priced.

Supply and demand is the kindergarten version. Here is the real architecture — and why it matters right now.

Your economics teacher told you that currency value is determined by supply and demand. That is the kindergarten version. A currency is not valued the way a painting is valued — by what someone thinks it is worth. It is priced the way a bond is priced — by the intersection of forces most people never see and nobody fully controls. Three systems set that price simultaneously: markets, central banks, and geopolitical power. Remove any one of them and the currency collapses. The dollar has all three. The yuan has one and a half. That gap is the most important fact in global finance right now, and almost nobody is explaining it clearly.

Markets are the visible layer. Currencies trade like assets — their price reflects interest rate differentials, capital flows, trade balances, and expectations about future policy. Higher rates attract capital, which bids up the currency. Lower rates push capital elsewhere, which weakens it. When the Federal Reserve raised rates aggressively in 2022 and 2023, the dollar strengthened roughly 15 percent against major currencies not because America was suddenly more productive but because the yield differential made dollar assets more attractive. The market priced that differential in real time. This is also why markets move on anticipated policy rather than actual policy — by the time the Fed cuts, the currency has already adjusted to where traders thought it would go.

Central banks set the gravity. The market layer operates within a baseline force that the central bank determines through interest rates, balance sheet policy, and — most importantly — inflation credibility. A central bank trusted to control inflation anchors expectations, which anchors the currency. A central bank that loses that credibility — through political pressure, inconsistent signaling, or policy that serves short-term objectives over long-term stability — finds that markets reprice the currency downward regardless of what interest rates say. Turkey's lira lost 80 percent of its value against the dollar between 2018 and 2023 not because Turkish markets collapsed but because the central bank's credibility collapsed first. The gravity field failed. Everything else followed.

Geopolitical power is the hidden layer most analysts ignore. This is the layer that actually explains the dollar's dominance. Reserve currency status creates structural baseline demand: every central bank that holds dollars as reserves is a permanent buyer regardless of yield. Global commodity pricing in dollars creates demand from every country that needs oil, copper, or wheat. Sanctions power gives the dollar coercive value that no other currency possesses — access to dollar clearing is not just a financial convenience, it is a condition of participating in the global economy. And institutional credibility — rule of law, deep capital markets, political stability — creates a trust premium that currencies with weaker institutions cannot replicate by monetary policy alone. This is why the dollar remained the world's reserve currency through decades of US deficits, two financial crises, and four administrations with wildly different economic philosophies. The geopolitical layer held even when the market and monetary layers wobbled.

The yuan fails on this third layer — and the failure is structural, not cyclical. China refuses to allow free capital movement, independent monetary policy, transparent institutions, or market-driven pricing. The yuan is managed, not valued. Its price is whatever the People's Bank of China says it is within a controlled band. The reason Beijing maintains this control is not stubbornness. It is necessity: China's total debt has reached 312 percent of GDP, per IMF data, sustained by a financial system in which state banks absorb losses that would destroy any privately disciplined institution. Capital account opening would expose that system to external pricing discipline it cannot survive. The yuan cannot become a genuine reserve currency without the capital account opening that would trigger the domestic financial collapse Beijing has spent twenty years preventing. The closed loop is not a policy choice. It is a structural permanent condition.

Which brings us to the most uncomfortable observation in global finance right now. The dollar's dominance rests on all three layers functioning simultaneously. The market layer is healthy. The monetary layer is under pressure — Kevin Warsh, confirmed as Fed chair after testifying to Senate independence, signaled 100 basis points of rate cuts within weeks of confirmation, a transformation from five years of hawkish inflation warnings that the bond market has received skeptically. The geopolitical layer is being actively eroded: every secondary sanction that catches a neutral party teaches another country that dollar dependency is a liability; the dollar's share of global reserves has fallen from 73 percent in 2000 to 57 percent today; and the Mar-a-Lago Accord's deliberate depreciation strategy is taxing the $450 billion in Saudi reserves and the $3.2 trillion in Chinese reserves simultaneously — making both Washington's argument for diversification on Beijing's behalf.

The dollar is not being replaced. The yuan cannot replace it for the structural reasons above. But a currency's dominance doesn't require a replacement to erode. It requires only that the three systems sustaining it stop pulling in the same direction. The market layer is fine. The monetary layer is wobbling. The geopolitical layer is being degraded by its own operator. That is the architecture of the current moment — and it is more consequential than any single rate decision, trade policy, or bilateral negotiation will tell you.

Supply and demand is where the conversation starts. This is where it actually lives.

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