Degussa Market Report

14 September 2018 | **Economics · Finance · Precious Metals**

USD per ounce of gold

USD per ounce of silver

EURUSD

Source: Thomson Financial.

Precious metals prices				
	Actual (spot)	Change against (in percent): 2 W	3 M	12 M
I. In US-dollar				
Gold	1.205.1	0.0	-7.2	-5.2
Silver	14.2	-3.9	-13.0	-14.0
Platinum	802.1	1.5	-11.0	-11.9
Palladium	977.0	4.4	-0.8	7.4
II. In euro				
Gold	1.036.8	0.0	-6.6	-4.2
Silver	12.2	-3.9	-12.5	-13.2
Platinum	690.1	1.5	-11.0	-11.2
Palladium	841.0	4.9	-0.5	8.4
III. Gold price in other currencies				
JPY	134.297.0	0.2	-4.9	-6.3
CNY	8.250.1	0.6	-0.8	-2.4
GBP	923.2	-1.6	-5.3	-3.5
INR	86.798.1	1.9	-0.8	4.6
RUB	82.488.6	2.1	2.0	12.2

Source: Thomson Financial; own calculations.

OUR TOP ISSUE

*This is a short summary of our fortnightly **Degussa Marktreport**.*

How Fed Policy Relates to the Price of Gold

The monetary policy of the US Federal Reserve (Fed) is again of utmost importance for financial market action, and in particular for those trading and holding gold. On the one hand, the Fed is pushing short-term interest rates higher, making holding gold costlier: The higher the interest is, the higher is the foregone income that could have been earned by holding interest-yielding assets instead of gold. As a result, the demand for gold and thus its market price tends to go down if and when interest rates go up.

On the other hand, the Fed's continued interest rate hiking runs the risk that the current cyclical upswing, which has been set into motion by the Fed's extremely low interest rate policy, becomes unsustainable. If and when interest rates reach too high a level, consumption and investment fall over the cliff, borrowers default on their debt service, and the economy goes into recession. Needless to say that a shrinking economy would put the monetary and financial system under severe pressure – and would most likely increase the demand for a "safe haven" such as gold.

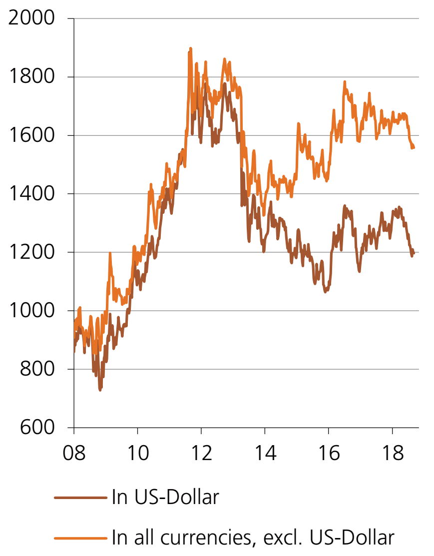
That said, we have come across two opposing trends related to the Fed's monetary policy: While higher interest rates discourage the demand for gold, they stir the risk of a systemic crisis, which would most likely increase the demand for the "gold currency". For the time being, however, investors have remained relatively relaxed and optimistic. The reasons: The economy keeps growing at a decent clip; unemployment is low; credit markets are liquid and provide funding at reasonably low borrowing costs; the stock market keeps roaring full steam ahead.

It is against this backdrop that the savvy investor should not overlook that the current boom has been mainly orchestrated by the Fed's monetary manipulation. The visible effects of this are production and employment gains, rising incomes, favourable order backlogs, etc. However, the less apparent effects typically escape 'peoples' eyes and attention, and that is *malinvestment*. Cheap money and credit policies lead to a distortion of market interest rates: The interest rate falls below its 'natural level' (the level that would prevail had the Fed not provided new credit and money out of thin air).

As a result, firms engage in lofty investment projects – in particular (*roundabout*) investments that take a long time until profits are generated and the costs are recovered. These investments depend crucially on an ongoing low interest rate policy to amortise successfully. If interest rates are sufficiently low, the economy may keep growing nicely for quite a while. However, even then, the underlying malinvestment that builds up under the surface cause firms' output to get out of sync with market demand.

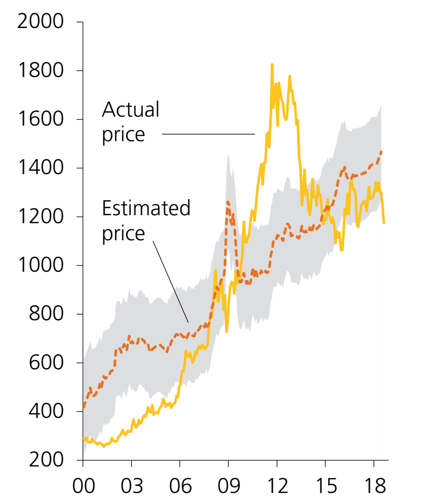
And then all of a sudden "cluster of errors" become obvious: Many firms and many sectors realise that product demand does not live up to expectations, that

Gold price per ounce
in US dollars and all world currencies (excl. the US dollar)*
January 2008 to September 2018



Source: Bloomberg; own calculations. *Calculated from the gold price (USD/oz) and the nominal trade weighted exchange rate of the US dollar. The timeline was indexed at 5 September 2011 with a value of 1.900.

Current gold price is well below its ‚estimated value'
Gold price (USD/oz), actual and estimated [(1)]



Source: Thomson Financial; own calculations. [(1)] Period: January 1972 to July 2018. Explanatory variables: US money stock M2, US short-term real interest rate and corporate credit spread. Grey area: standard error.

investment returns disappoint. This is when the boom turns into bust. Unfortunately, however, we cannot precisely predict when said boom is going to turn into bust (at least not based on scientific, economic knowledge).

Some market observers have already expressed concern that, for instance, the flattening US yield curve could signal that the US economic upswing is in its final stages; or that the exceptionally low unemployment situation indicates that the situation cannot improve any further, foreshadowing future job losses. In the light of the great uncertainty related to such predictions, however, the investor should take them with a grain of salt. What may be possible, at least to some extent, is to identify and point out some conditions of the possibility that the economy takes a turn to the worse.

One of the many "candidates" is the central bank raising interest rates following a long period of artificially low interest rates – especially so because central bankers do not know where the "correct" level of interest rates is. They have no other option than to pursue a "trial and error" process. However, once central bankers have pushed the interest rate too high, the house of cards comes crashing down. This is what the Fed has done on many occasions in the past, and there is no reason why the Fed's would not cause the same kind of damage in what lays ahead. In the current monetary system – which is characterised by unbacked paper money being pumped into the economy through bank credit expansion –, it is unfortunately just a matter of time until a new crisis hits.

From the viewpoint of the savvy investor, who wishes to hold insurance against unfavourable economic and financial developments, gold ranks among the options well worth considering. Gold cannot be debased by central banks running the printing press on a grand scale – which is a very likely scenario once the next crisis unfolds. Besides, gold does not, unlike bank deposits, carry a default risk: It cannot go bankrupt. On top of that, gold does not appear to be expensive at current prices – and thus represents an effective portfolio insurance with upward price potential.

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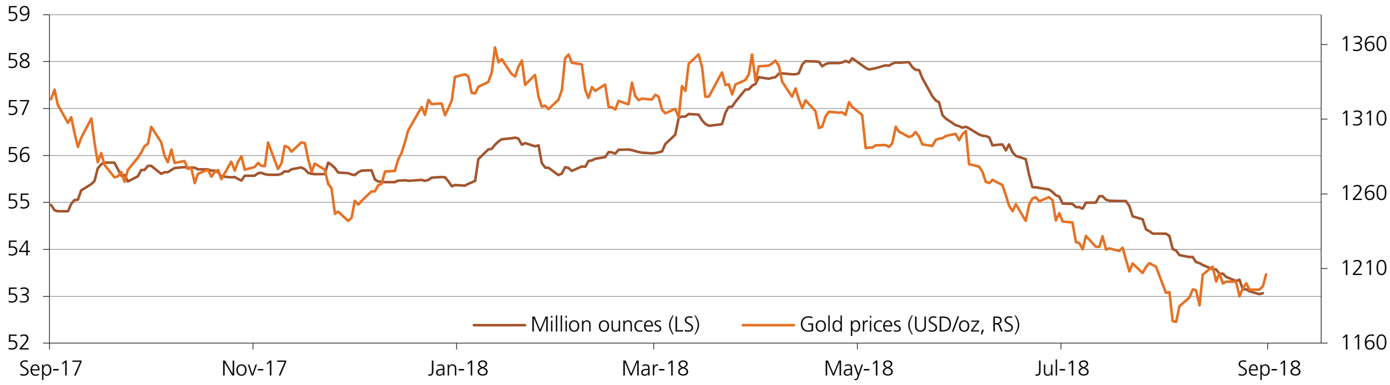
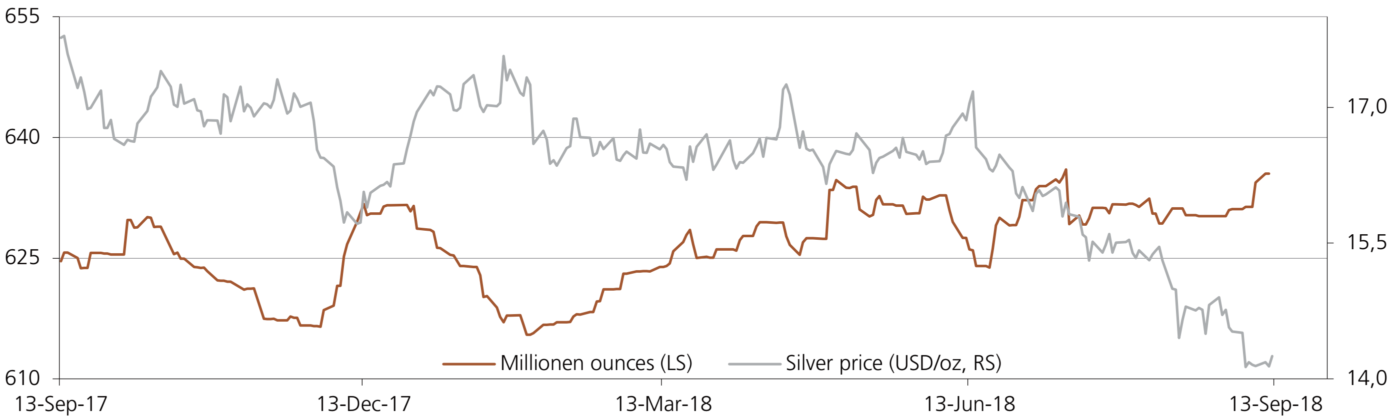
Precious metals prices and ETF holdings

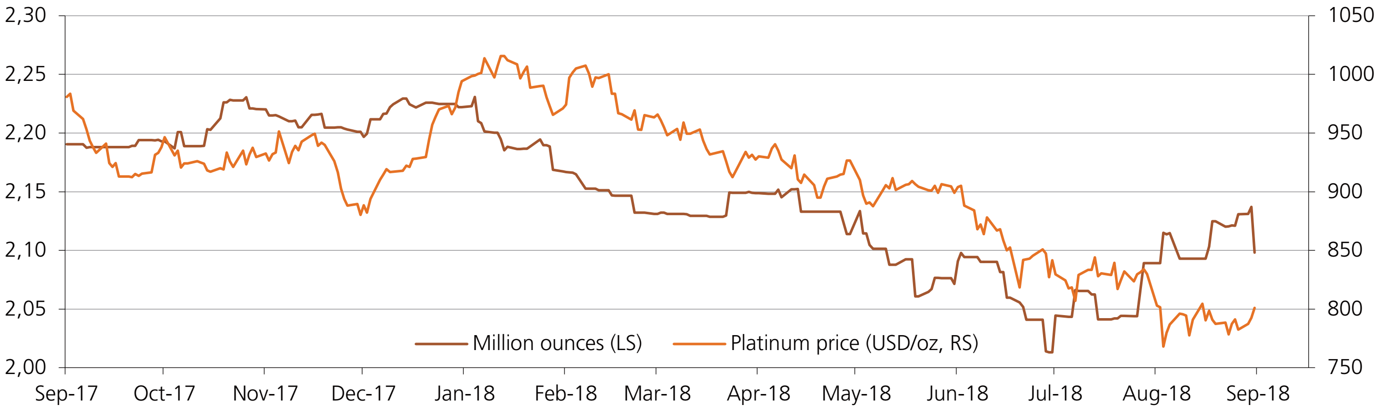
Gold ETFs (million ounces) und gold price (USD/oz)



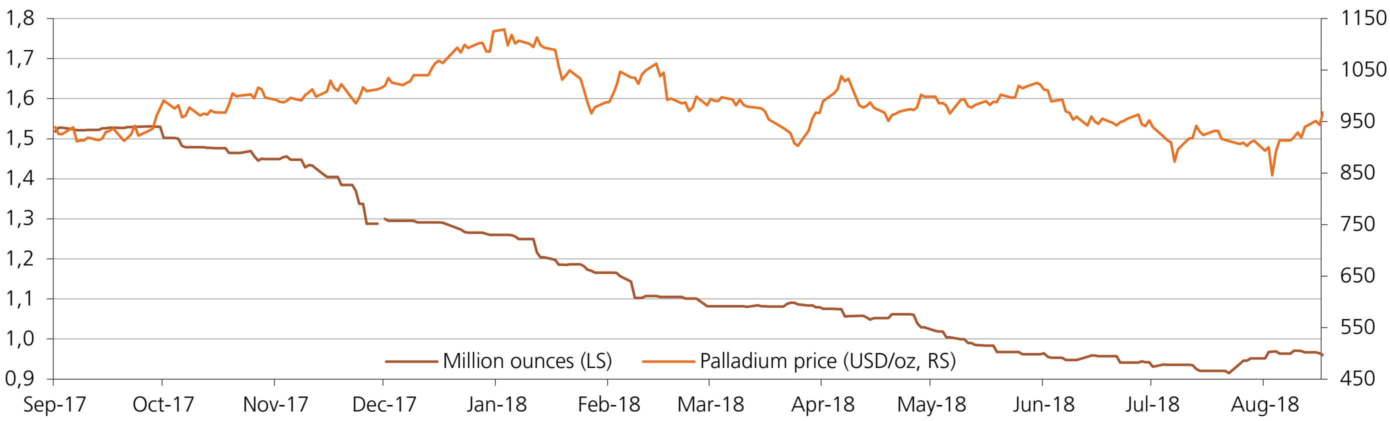
Silver ETFs (million ounces) and silver price (USD/oz)



Platinum ETFs (million ounces) and platinum price (USD/oz)



Palladium ETFs (million ounces) and palladium price (USD/oz)



Source: Thomson Financial.

Precious metals prices

In US-dollar

	Gold		Silver		Platinum		Palladium	
I. Actual	1205.4		14.2		802.1		974.5	
II. Gliding averages								
5 days	1196.9		14.2		787.1		981.0	
10 days	1197.9		14.3		785.4		979.9	
20 days	1196.5		14.5		787.6		950.9	
50 days	1214.0		15.1		811.4		932.2	
100 days	1253.1		15.8		851.9		955.8	
200 days	1286.5		16.2		903.5		988.8	
III. Bandwidths for 2018	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1248	1472	16.0	21.0	936	1048	1033	1261
(1)	*4*	*22*	*12*	*47*	*17*	*31*	*6*	*29*
IV. Annual averages								
2014	1260		19.1		1382		800	
2015	1163		15.7		1065		706	
2016	1242		17.0		985		617	
2017	1253		17.1		947		857	

In Euro

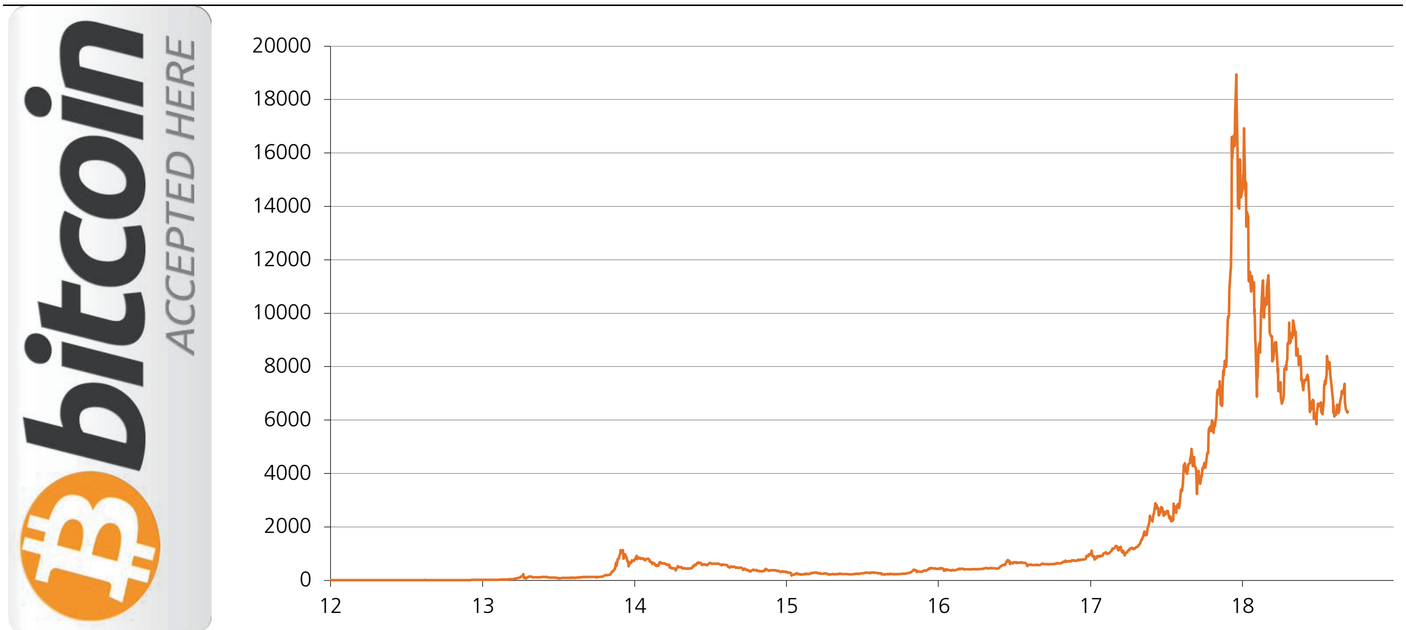
	Gold		Silver		Platinum		Palladium	
I. Actual	1037.3		12.2		690.2		838.6	
II. Gliding averages								
5 days	1031.2		12.2		678.2		845.3	
10 days	1031.6		12.3		676.3		843.8	
20 days	1032.5		12.5		679.6		820.5	
50 days	1045.3		13.0		698.7		802.6	
100 days	1072.1		13.5		728.8		817.8	
200 days	1076.5		13.6		755.4		827.5	
III. Bandwidths for 2018	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1080.8	1274.2	13.8	18.2	810.4	907.6	894.1	1091.7
(1)	*4*	*23*	*13*	*48*	*17*	*32*	*7*	*30*
IV. Annual averages								
2014	945		14		1035		601	
2015	1044		14		955		633	
2016	1120		15		888		557	
2017	1116		15		844		760	

Source: Thomson Financial; own calculations and estiamtes.

(1) Estimated return against actual price in percent.

Bitcoin, performance of various asset classes

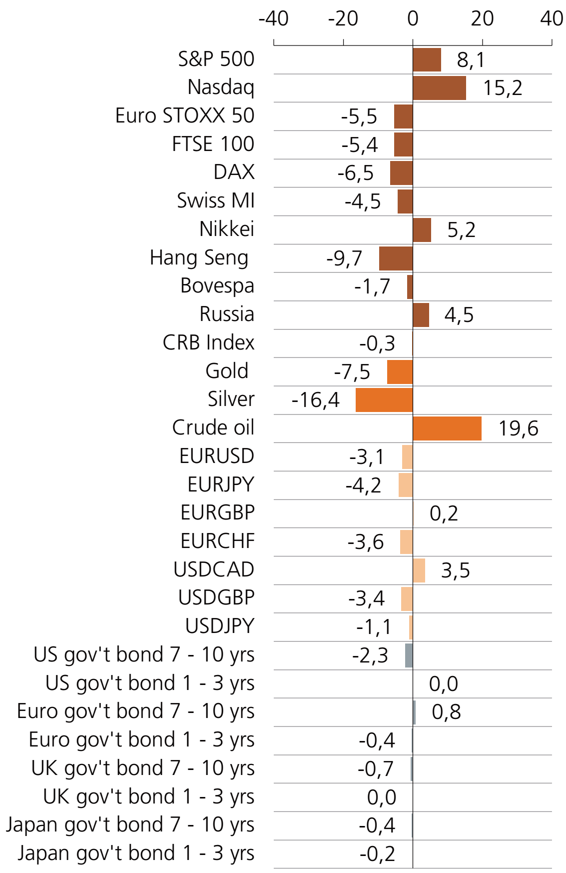
Bitcoin in US dollars



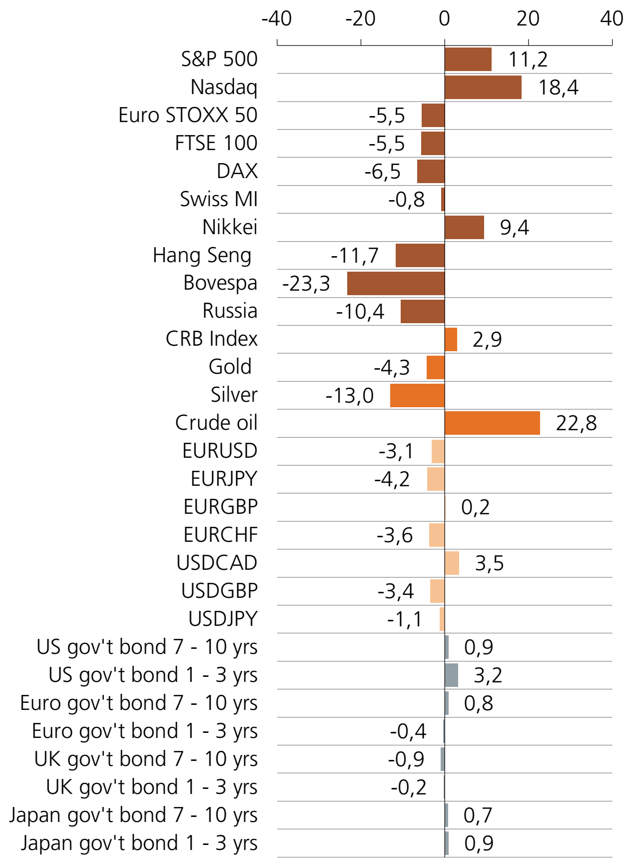
Source: Thomson Financial.

Performance of stocks, commodities, FX and bonds

(a) In national currencies



(b) In euro



Source: Thomson Financial; own calculations

Articles in earlier issues of the *Degussa Market Report*

Issue	Content
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13 April 2017	The Gold Price Rise Tells Us: The Crisis Isn't Over Yet
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3 March 2017	ECB Flirts With Higher Inflation. The Case For Gold
17 February 2017	Gold Gains Ground vis-a-vis the US-Dollar
3 February 2017	Gold Insures Against Risks Lurking in the Financial System

The Degussa Marktreport (German) and the Degussa Market Report (English) are available at:
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