Degussa Market Report

10 December 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	1.247.8	2.1	3.9	-2.1
Silver	14.6	2.6	0.8	-11.0
Platinum	789.7	-5.8	0.9	-16.1
Palladium	1.224.0	9.4	24.8	21.6
II. In euro				
Gold	1.096.5	1.7	6.0	2.4
Silver	12.8	2.3	2.8	-6.7
Platinum	694.0	-6.1	2.3	-12.0
Palladium	1.076.0	9.0	27.5	27.2
III. Gold price in other currencies				
JPY	140.648.0	1.9	5.5	-1.9
CNY	8.576.2	1.0	4.6	1.8
GBP	980.3	2.8	5.9	4.1
INR	88.403.8	1.9	3.7	7.6
RUB	82.831.3	2.4	2.2	11.2

Source: Thomson Financial; own calculations.

OUR TOP ISSUES

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

The Fed Supports Gold

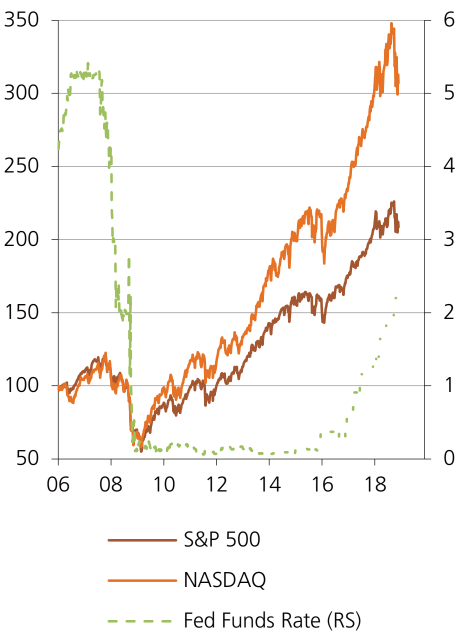
On 28 November 2018, the chairman of the Federal Reserve (Fed) said that "Interest rates are still low by historical standards, and they remain just below the broad range of estimates of the level that would be neutral for the economy — that is, neither speeding up nor slowing down growth". How should one interpret these words? Two interpretations seem to assert themselves.

First, the chances for another interest rate hike in December have been greatly diminished. Second, the continuation of the interest rate hiking cycle has been put into doubt. Prior to Mr Powell's remarks, the Fed was suggesting it could raise its short-term interest rate to 3.4 per cent by 2020 (implying one 0.25 per cent hike in December 2018, three rate hikes in 2019 and a final hike in 2020).

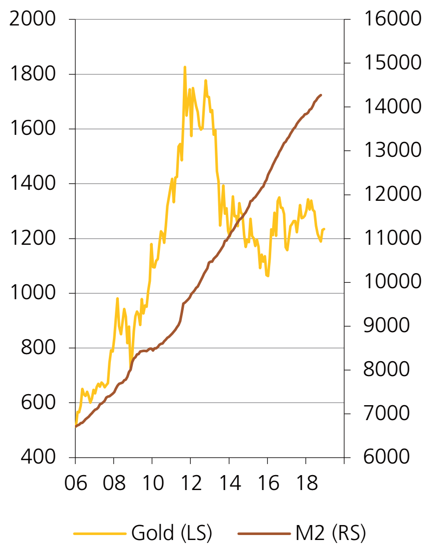
This very interest rate trajectory, however, could now be off the table. For once the Fed "pauses", it will take quite a set of rather favourable economic and financial data to allow the Fed further rate hikes. Especially so if the Fed suggests that the current interest rate level might be already fairly close to the "natural interest rate level" – that is the level at which there could be steady growth at low inflation.

1 Rising US interest rates put stock prices under pressure, while gold seems to remain 'underpriced'

(a) US stock price indices and Federal Funds Rate in percent

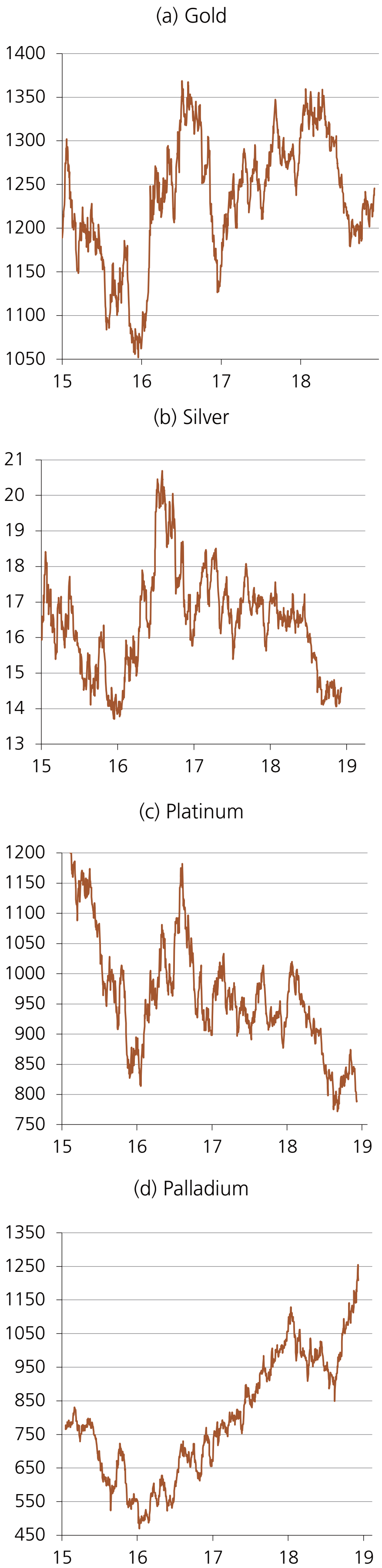


(b) US money stock M2 (USD bn) and gold price (USD/oz) [1]



Source: Thomson Financial; own calculation. [1] The graph is meant to indicate an upward price potential for gold, not a price target.

Precious metal prices (USD/oz) in the last 4 years



Source: Thomson Financial.

The current level of the Federal Funds Rate, while being positive in nominal terms, is actually negative in real (inflation-adjusted) terms. Real long-term interest rates have also remained fairly close to the zero in many credit market segments. What is the reason that the Fed recoils from bringing the interest rate (especially in real terms) back to a higher, historically more normal level?

One answer that comes to mind is the economy's increased dependence on very low interest rates. Since the outbreak of the financial and economic crisis in 2008/2009, borrowers could rely on exceptionally low interest rates. Maturing debt could be refinanced at ever lower interest rates, and new borrowing was possible at most favourable rates.

Exceptionally low interest rates have been fuelled an economic recovery, or to be more precise: an artificial upswing ("boom"). While output and employment have been improving, however, the economic expansion has also brought about malinvestment. Suppressed market interest rates have propelled stock and housing prices upwards, and this has also bloated up the equity in consumers' and firms' balance sheets.

That said, ramping up interest rates entails the risk to undo all the pleasant effects of a hitherto exceptionally expansionary money policy. This is a painful truth the Fed might have become aware of. With the stock market having become jittery following the latest series of interest rate increases, monetary policymakers at the Fed might have become wary as well – for it wishes to keep the boom going.

And the Fed certainly does not stand alone. The European Central Bank (ECB) has been insinuating it might end its zero and negative interest rate policy towards the end of 2019. But given the ongoing financial and economic calamities in the euro area, it is hard to see that euro interest rates could be raised in the foreseeable future. Likewise in Japan and China, there is hardly a discernible political willingness that could bring interest rates up.

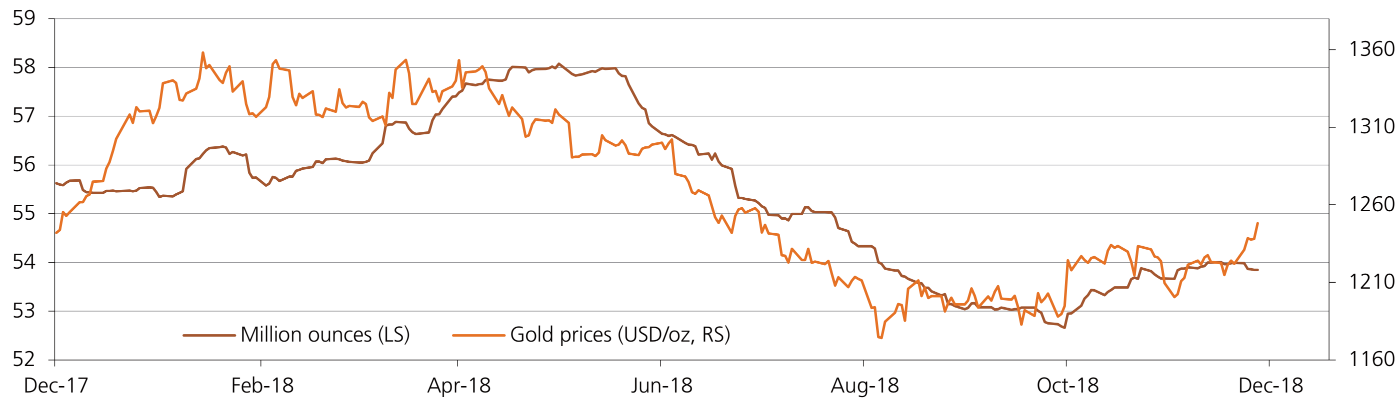
All things considered, it seems the Fed's interest rate hiking cycle has basically come to an end already; the chance for a return to positive real interest rates (in high-grade credit markets) is fairly small indeed. Under such conditions, economic expansion may well continue for quite a while, and asset prices – and their assessment scales – could remain elevated. However, the vulnerability of the financial and economic structure is indubitably set to increase.

This is when gold comes into play. The price of gold should benefit from a continuation of the exceptionally low interest rate regime, especially so if and when real interest rates remain in negative territory (or move back into it), because then the opportunity costs of holding gold go down compared to time- and savings deposits, for example. What is more, zero or negative interest rates are likely to continue to fuel an inflationary credit- and money expansion.

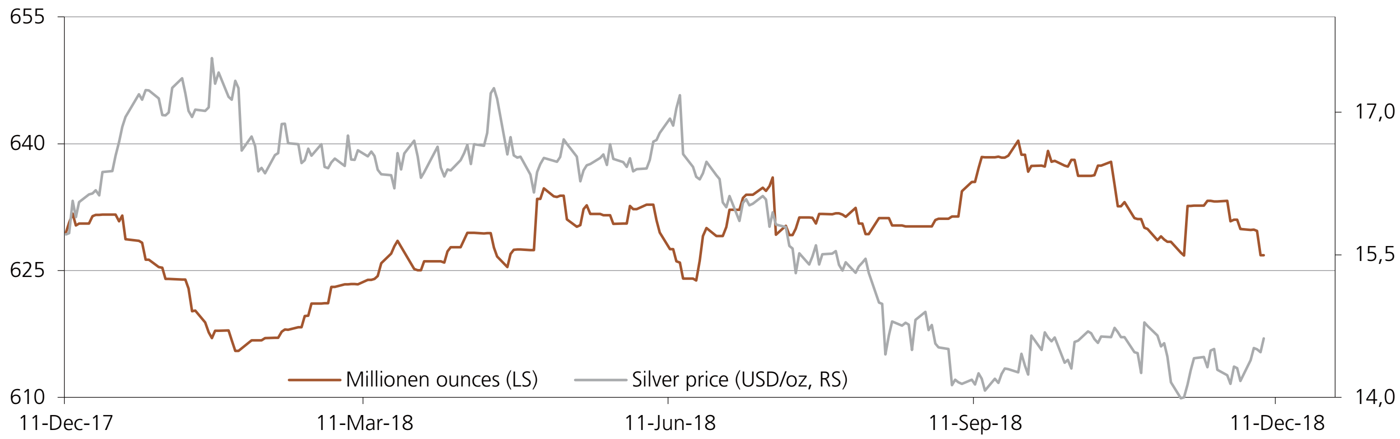
That said, holding a part of one's liquid means in the form of "gold money" should provide an effective hedge against the vagaries of central bank monetary policies – especially so because gold does not appear to be dear at current prices. In other words: Gold can be viewed as portfolio insurance which has a considerable upward value potential – especially so when investor confidence in central banks starts to decline.

Precious metals prices and ETF holdings

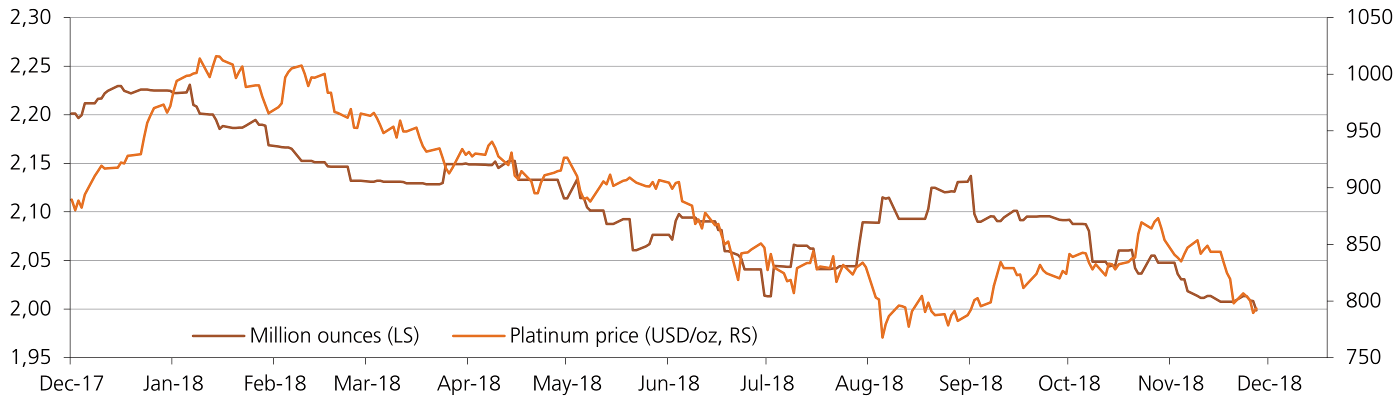
Gold ETFs (million ounces) und gold price (USD/oz)



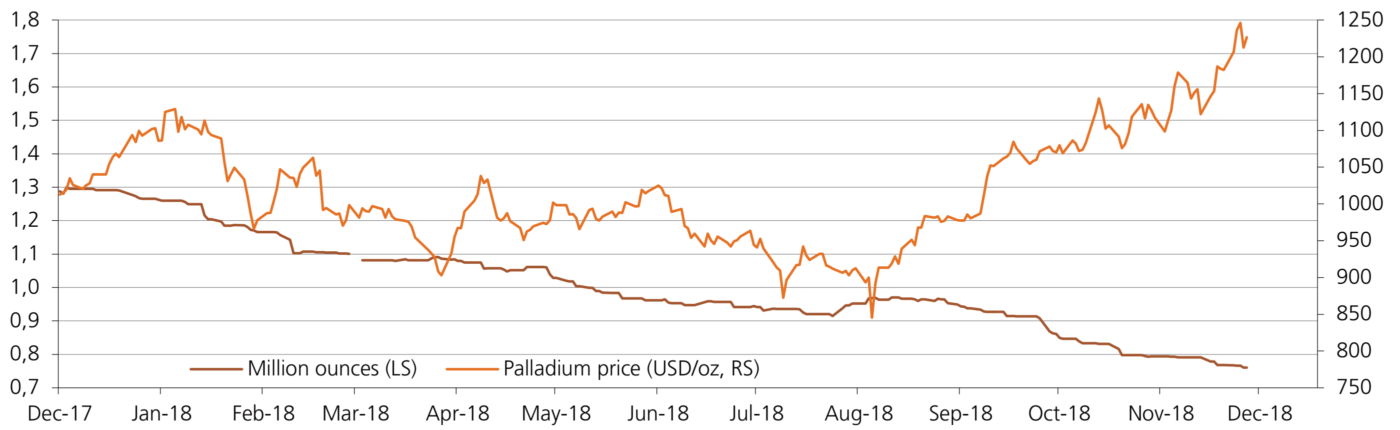
Silver ETFs (million ounces) and silver price (USD/oz)



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	1247.8		14.6		789.7		1224.0	
II. Gliding averages								
5 days	1239.8		14.5		795.8		1228.0	
10 days	1229.6		14.4		811.9		1198.7	
20 days	1223.2		14.3		827.1		1170.7	
50 days	1220.2		14.5		833.6		1123.5	
100 days	1211.9		14.6		821.0		1040.3	
200 days	1256.6		15.5		862.0		1006.7	
III. Bandwidths for 2018	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1248	1472	16.0	21.0	936	1048	1033	1261
(1)	*0*	*18*	*9*	*43*	*19*	*33*	*-16*	*3*
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	1096.8		12.8		694.2		1075.9	
II. Gliding averages								
5 days	1091.1		12.8		700.4		1080.8	
10 days	1084.0		12.7		715.8		1056.8	
20 days	1077.7		12.6		728.8		1031.4	
50 days	1068.6		12.7		730.0		984.0	
100 days	1052.4		12.7		712.9		903.9	
200 days	1070.0		13.2		733.8		858.7	
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)	*-1*	*16*	*8*	*41*	*17*	*31*	*-17*	*1*
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.

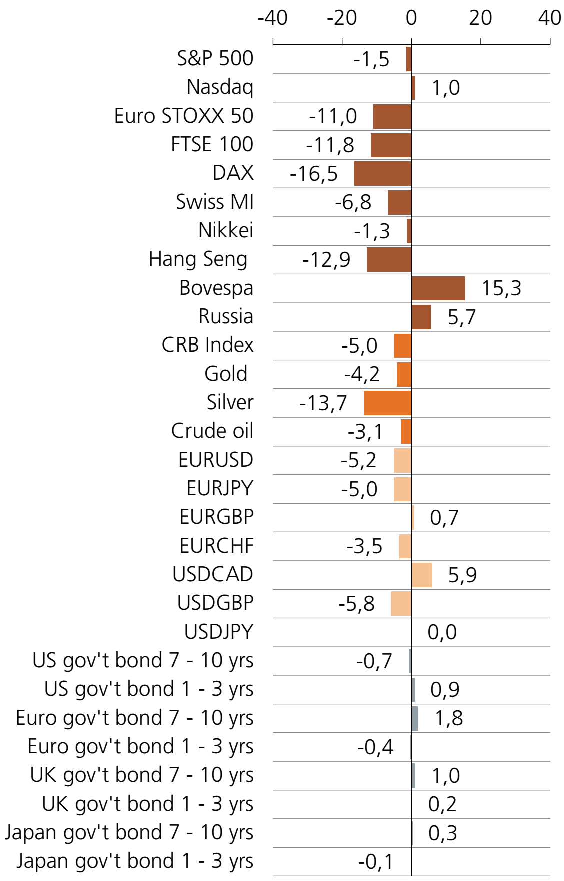
Bitcoin, performance of various asset classes

Bitcoin in US dollars

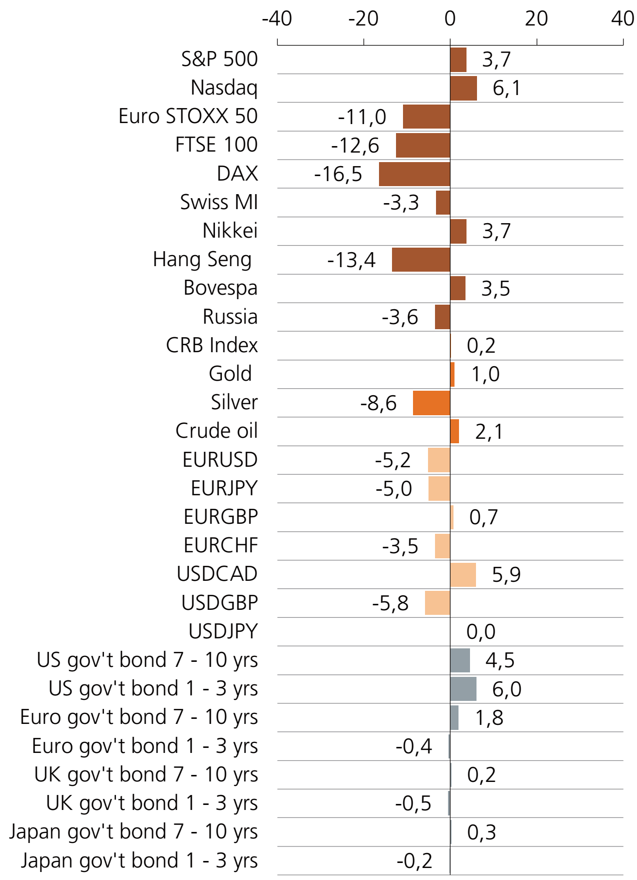
Source: Thomson Financial.

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*

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23 November 2018	The Fed Is Not Our Saviour
9 November 2018	The Missing Fear – And The Case For Gold
26 October 2018	President Trump is right: The Fed Is A Big Problem
12 October 2018	Here Goes The Punch Bowl
28 September 218	The Fed's Blind Flight
14 September 2018	How Fed Policy Relates to the Price of Gold
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28 April 2017	Central Banks Will not Dare to Take Away the Punch Bowl

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