

OUR TOP ISSUES



Gold is a currency. It is still, by all evidence, a premier currency. No fiat currency, including the dollar, can match it."

— Alan Greenspan,
Council of Foreign Affairs,
29 October 2014

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

Gold Insures Against Risks Lurking in the Financial System

There are still quite a few risks lurking in the international financial system. Gold is an effective insurance against these risks.

Export Champion Germany Under Pressure

From an economic viewpoint, it appears to be unjustified to blame Germany for its chronic export surpluses. Problematic are trade deficit countries, though.

The Basis of Contract for the Euro Dwindles Away

The problems with the euro cannot be solved by renationalizing currencies. However, a denationalization of money might well prove to be a solution.

A Case For Economic Globalization

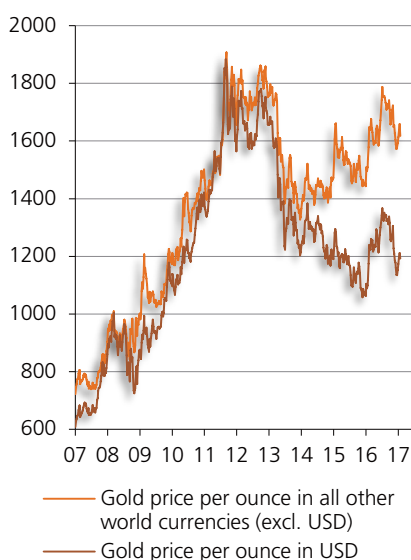
The economic dimension of globalization is the pillar upon which our prosperity rests. It is - in contrast to the political dimension of globalization - indispensable.

Precious Metal Markets

Uncertainty as far as the future path of interest rates is concerned and money moving in and out of gold ETFs exert a strong impact on price action.

Gold price per ounce in US dollars and all world currencies (excl. the US dollar)*

January 2007 to February 2017



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

Gold Demand Trends Full Year 2016

On 3 February 2017, the World Gold Council published *Gold Demand Trends Fully Year 2016* (klikk [here](#)). Gold demand was up 2 percent against 2015, reaching 4,308.7 tonnes. Gold-ETF demand reached 531.9 tonnes, the second highest ever. Jewellery and central bank purchases were down year-on-year, however. In 2016, total gold supply was up 5 percent against last year.

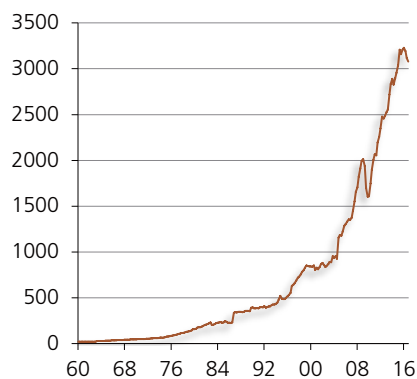
Precious metals prices

| | Actual (spot) | Change against (in percent): | | |
|--|---------------|------------------------------|------|-------|
| | | 2 W | 3 M | 12 M |
| I. In US-dollar | | | | |
| Gold | 1.214,5 | 1,4 | 3,5 | -2,0 |
| Silver | 17,4 | 3,3 | 5,3 | 17,2 |
| Platinum | 994,1 | 0,9 | 9,3 | 6,6 |
| Palladium | 752,8 | 0,2 | -2,7 | 52,3 |
| II. In euro | | | | |
| Gold | 1.128,9 | 0,3 | 1,8 | -0,4 |
| Silver | 16,1 | 2,6 | 3,7 | 18,4 |
| Platinum | 924,3 | 0,1 | 7,6 | 7,8 |
| Palladium | 698,9 | -0,7 | -3,9 | 53,7 |
| III. Gold price in other currencies | | | | |
| JPY | 137.326,2 | 0,2 | 2,4 | -1,3 |
| CNY | 8.341,0 | 1,2 | 2,8 | 3,2 |
| GBP | 969,6 | -1,2 | 3,1 | 9,4 |
| INR | 81.777,8 | 1,9 | 1,5 | -2,7 |
| RUB | 72.059,0 | 1,0 | -4,3 | -22,0 |

Source: Bloomberg; own calculations.

Foreigners have run up some substantial US-dollar debt

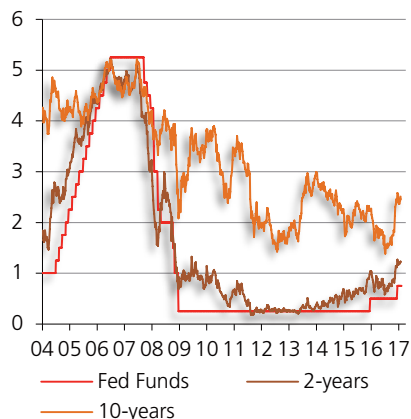
US dollar denominated debt issued by non-US borrowers, in USD bn



Source: Thomson Financial.

US rates are moving upwards - the Fed is expected to hike further

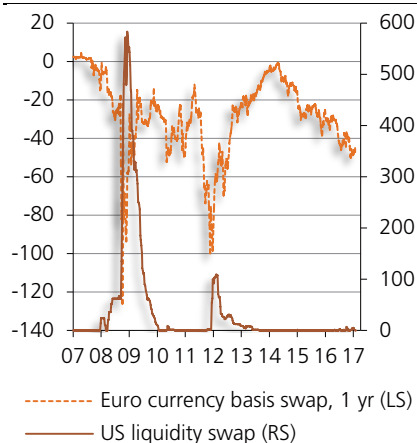
Selected US interest rates in percent



Source: Thomson Financial.

Nervousness in international credit markets seems to be picking up

Euro Cross Currency Basis-Swap (in basis points) and US dollar liquidity swaps, USD bn



Source: Bloomberg.

Gold Insures Against Risks Lurking in the Financial System

There are still quite a few risks lurking in the international financial system. Gold is an effective insurance against these risks.

So much should be clear: The US presidency of Donald J Trump will bring far-reaching changes in terms of economic and political matters, and their impact will be felt worldwide. That said, the road ahead may well become bumpy. In what follows we will highlight four developments in the international financial system - developments to which we think precious metal investors should pay close attention.

US dollar debt of non-US borrowers is high. Since the start of the 21st century, non-US borrowers have strongly increased their funding in US dollar denominated debt. This development was only temporarily brought to a halt during the economic and financial crisis of 2008/2009.

The reason for the rise in US dollar debt is obvious: Central banks, in particular, under the leadership of the US Federal Reserve (Fed), slashed interest rates to extreme low levels. In Q3 2016, outstanding US dollar debt taken up by non-US borrowers amounted to 3,112 USD billion - just slightly below the record level of 3,228 USD billion seen in Q4 2015. It is fair to assume that many borrowers expect to roll over their maturing US dollar debt into new US dollar loans at low interest rates. That said, the world financial system is, perhaps more than ever, highly dependent on easy access to US dollar funding provided at low interest rates.

The Fed wants to push up interest rates. Financial markets expect the Fed to raise interest rates further this year. The expectation is that the Federal Funds Rate (currently at 0.75 percent) will be edged up to 1.30 percent at the end of 2017 (according to a Bloomberg survey). 10-year Treasury yields (currently at 2.40 percent) are seen as reaching 2.80 percent by the end of this year. These rate levels would presumably allow keeping the US economy going and fueling the upward drift of asset prices, especially in the stock market. What is more, ongoing low US interest rates should enable US dollar borrowers to roll over their debt at still relatively favorable terms. However, if the Fed embarks upon a much more hawkish course, the world economy and financial markets could suffer badly (in this context see the box below).

„Fed Crashes“

Should rising US rates be a cause of concern for the investor? Well, this is a pretty good question as the last two Fed hiking cycles both ended in crisis.

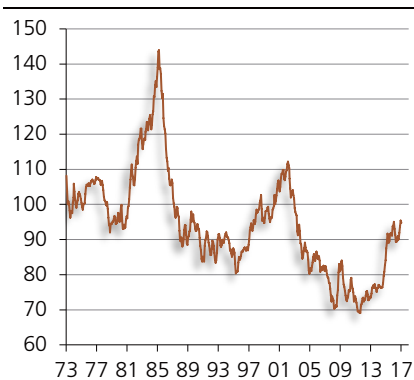
The Fed had started raising rates from the middle of 1999 to 6.5 percent in May 2000. What followed was the collapse of the "New Economic Boom". The decline in stock prices started in summer 2000. By October 2002, the S&P 500 had lost around 50 percent of its market capitalization - even though the Fed had begun lowering rates from January 2001 and had pushed down the Federal Funds Rate to 1.25 percent in October 2002. After that up until October 2007, stock prices rose by 100 percent.

From the middle of 2004, the Fed started hiking rates again. The central bank raised its main interest rate in small steps to 5.25 percent by June 2006. Again, it didn't take long for stock prices to crash. They fell 56 percent by March 2009. Obviously it didn't make much of an impression on stock market investors that the Fed had lowered its interest rate to 0.25 percent by December 2008.

In both cases the Fed pricked the very financial market bubbles it had actually helped to

US dollar has been appreciating since around 2012

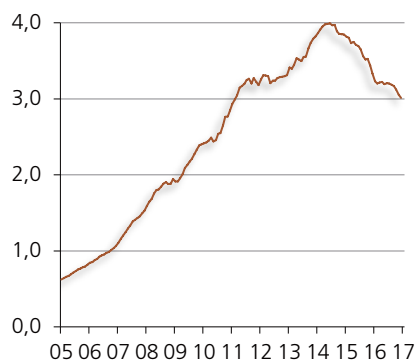
Trade weighted exchange rate of the US dollar¹⁾



Source: Bloomberg. ¹⁾ A rising (falling) line is indicative of an appreciating (depreciating) US dollar exchange rate.

China's foreign exchange reserves keep dwindling

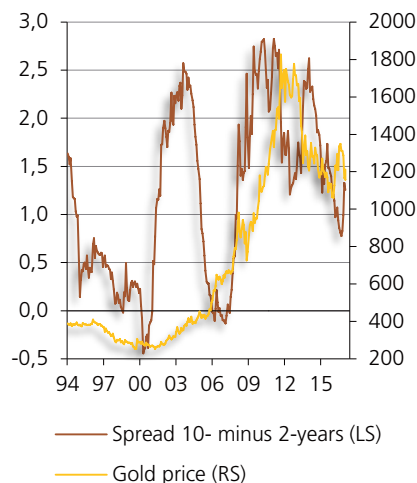
Chinese currency reserves, USD bn



Source: Thomson Financial.

Steep US yield curve supports the price of gold

Gold price (USD/oz) and spread 10- minus 2 year US rates in percentage points



Source: Bloomberg; own calculation.

create by its easy monetary policy in the first place. The bursting of the bubbles was in both cases accompanied (if not caused) by a flattening of the yield curve. This, in turn, was essentially like putting a sudden brake on the flow of bank credit supply. This is because banks typically lend long-term and fund their credit extensions short-term. If the yield curve is steep, bank lending is a profitable. If, however, the curve flattens out, or becomes negative (as short rates exceed long rates), banks rein in their credit supply. As the inflow of new credit and money dries up, however, the economic and financial boom comes crashing down.

US dollar credits for the world financial system. Having established so-called "liquidity swap agreements", the major central banks in the world, under the tutelage of the Fed, have basically changed everything: Under liquidity swap agreements, central banks provide, if needed, (unlimited) credit to each other. For instance, the Fed is willing to lend US dollars to the European Central Bank (ECB), which, in turn, can lend the US dollars to euro area banks in need of Greenbacks. In other words: Central banks have ousted basically all remaining credit default concerns in international credit markets.

Whether or not a bank can service its debt - be it in domestic or foreign currency - has become a matter of central bank decision. The question now is: Will the Trump administration allow the Fed to continue with this practice - that is the Fed making monetary policy also for other parts of the world? If the Fed's ability, or willingness, to inject unlimited US dollars into the financial system is put into question, financial markets may well become jittery, to put it mildly. In fact, a drying up of US dollar liquidity could trigger a new round of turbulence.

Future US dollar policy. The new US administration might wish to talk down the US dollar, thereby improving the international price competitiveness of US export firms and support domestic producers by making imported goods less affordable. Interestingly, the Deutsche Bundesbank provided ammunition for such a reaction: It said recently that the rather expansionary ECB policy since 2014 has devalued the euro by 6.5 percent against the US dollar. However, any American attempt to bring down the US dollar may well end in a competitive devaluation spiral - which could be fairly harmful for international trade and finance.

These four factors might suffice to show that there are quite a few risks lurking in the international financial system. They may work in two ways. A disruption of international flows may well translate into financial market turmoil. Or a dysfunctional financial system could cause the real economy to take a negative turn. In any case, central banks are most likely to return to "crisis mode" if and when economic growth dwindles and/or financial markets run into trouble. Monetary policies would presumably return to zero rates coupled with monetary expansion.

This is, by no means, all good news. In fact, a return to an extremely expansionary monetary policy might ultimately cause something of a *currency crisis*: that is, people becoming concerned about the purchasing power of their monies. In contrast to a *credit crisis* (which occurred in 2008/2009), a currency crisis is very hard, perhaps impossible, for central banks to rein in. For they would have to raise rates sharply, causing borrowers to default on their debts. That said, there is thus good reason to seek protection as far as the investor portfolio is concerned. Gold does not carry a default risk, and it cannot be debased at the expediency of central banks. As was pointed out in the last Degussa Market Report, 20 January 2017 (click [here](#)), the current price of gold allows investors to obtain portfolio insurance at attractive terms. This holds particularly true for investors from the euro area. The latter have good reason to seek protection against the risk of the euro being debased or breaking apart.

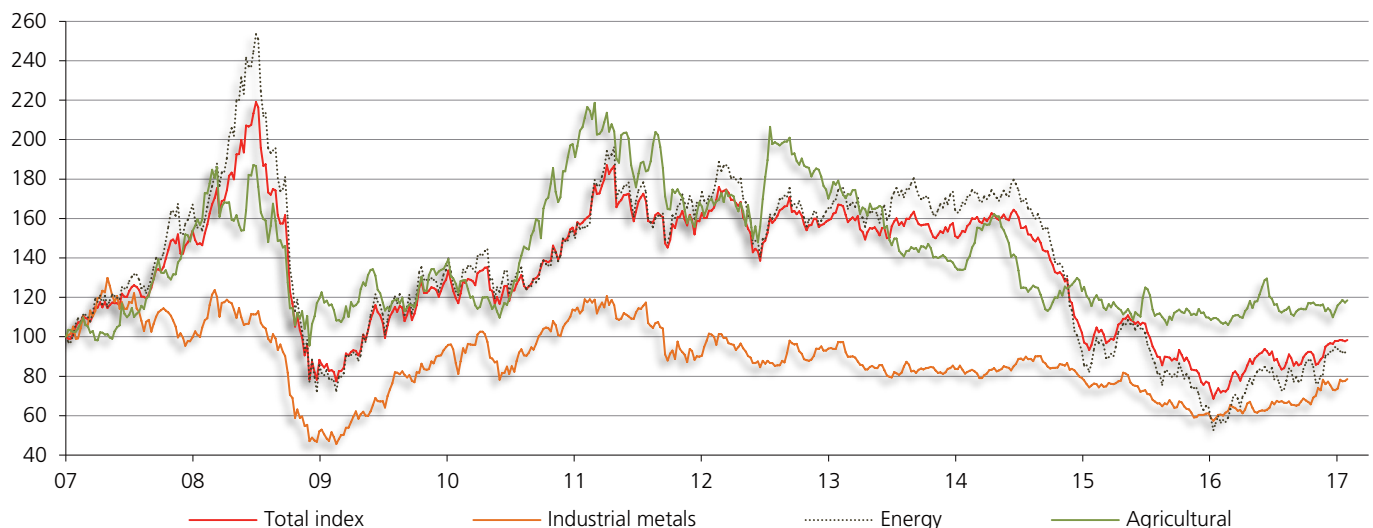
Commodity prices

Selected commodity prices

| | Actual price in US-dollar | Change against (in percent): | | | | | Volatility (in percent): | |
|-------------------------------|------------------------------|------------------------------|-------|--------|--------|---------|--------------------------|---------|
| | | 1 week | 1 mth | 3 mths | 6 mths | 12 mths | 30 days | 90 days |
| I. Energy | | | | | | | | |
| WTI crude oil | 53.86 | 1.2 | 5.2 | 10.8 | 13.3 | 19.8 | 25.1 | 32.4 |
| Brent crude oil | 56.56 | 1.0 | 6.6 | 12.1 | 15.7 | 21.4 | 25.0 | 30.6 |
| Gasoline | 154.43 | -3.1 | 2.1 | 6.2 | 14.0 | 19.1 | 27.4 | 29.7 |
| Heating oil | 166.32 | 0.0 | 4.2 | 7.7 | 11.1 | 19.1 | 25.4 | 29.1 |
| Gas oil | 504.25 | 2.0 | 9.9 | 11.6 | 15.3 | ... | 20.3 | 27.1 |
| Natural gas | 3.20 | -0.4 | -3.9 | 0.0 | -2.5 | 13.1 | 52.5 | 43.7 |
| II. Agriculture | | | | | | | | |
| Corn | 367.50 | -0.6 | 5.5 | 1.3 | 12.7 | -6.5 | 17.2 | 20.4 |
| Wheat | 434.50 | 1.5 | 7.9 | 0.2 | 5.9 | -16.3 | 25.5 | 23.0 |
| Soy beans | 1037.25 | -2.8 | -0.4 | 1.8 | 9.4 | 16.3 | 20.0 | 17.3 |
| Coffee | 145.95 | -4.7 | -3.1 | -12.9 | -2.8 | 6.3 | 24.9 | 26.2 |
| Sugar | 20.55 | 1.8 | 3.7 | -4.7 | 0.0 | 36.1 | 26.6 | 27.2 |
| Cotton | 76.91 | 5.3 | 7.4 | 10.9 | 16.5 | 18.3 | 16.6 | 17.2 |
| III. Industrial metals | | | | | | | | |
| Aluminum | 1819.00 | -1.4 | 5.0 | 4.9 | 12.7 | 20.7 | 14.9 | 15.0 |
| Copper | 5945.00 | 3.4 | 2.1 | 22.5 | 28.8 | 26.4 | 21.8 | 22.5 |
| Zinc | 2880.00 | 4.1 | 6.6 | 17.0 | 24.7 | 79.0 | 25.6 | 31.6 |
| Lead | 2332.00 | 1.0 | -1.4 | 12.9 | 22.4 | 30.1 | 35.1 | 34.0 |
| Iron ore | 83.44 | 0.2 | 5.4 | 33.8 | 45.6 | 92.3 | ... | ... |
| IV. Precious metals | | | | | | | | |
| Gold | 1214.90 | 0.4 | 3.4 | -4.6 | -7.1 | 14.4 | 12.0 | 14.0 |
| Silver | 17.45 | 2.1 | 5.7 | -2.1 | -6.5 | 25.7 | 18.1 | 27.3 |
| Platinum | 997.30 | 2.0 | 9.6 | 2.2 | -5.1 | 11.6 | 22.6 | 23.4 |
| Palladium | 759.47 | -3.7 | -1.8 | 23.3 | 13.2 | 35.2 | 38.7 | 32.0 |
| V. Ratios | | | | | | | | |
| Gold-silver | 69.67 | -1.7 | -2.1 | -2.6 | -0.6 | -9.0 | 12.4 | 17.6 |
| Gold-platinum | 1.22 | -1.7 | -5.7 | -6.7 | -2.2 | 2.4 | 18.4 | 17.7 |
| Gold-palladium | 1.60 | 4.5 | 5.0 | -22.6 | -18.0 | -15.4 | 36.6 | 30.5 |
| Palladium-platinum | 0.76 | -6.1 | -10.2 | 20.5 | 19.2 | 21.0 | 31.3 | 29.7 |

Source: Bloomberg; own calculations.

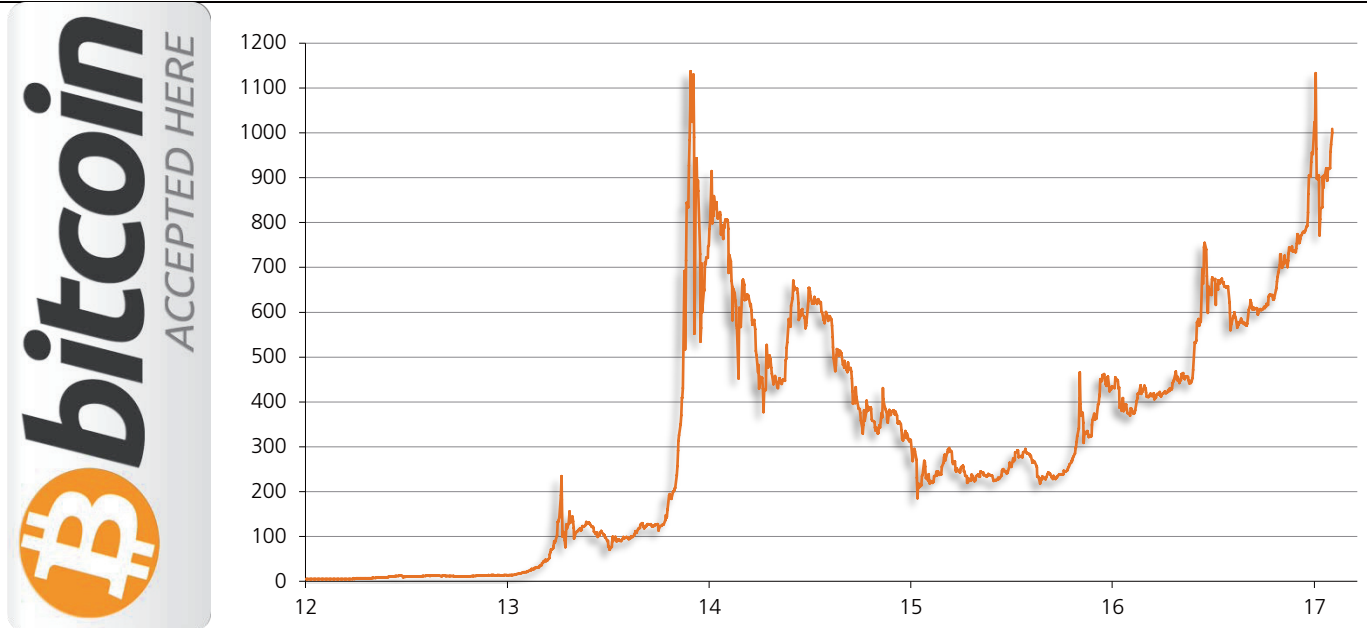
S&P commodity prices (in US dollar terms)



Source: Bloomberg. Series are indexed (January 2007 = 100).

Bitcoin, performance of various asset classes

Bitcoin in US dollars

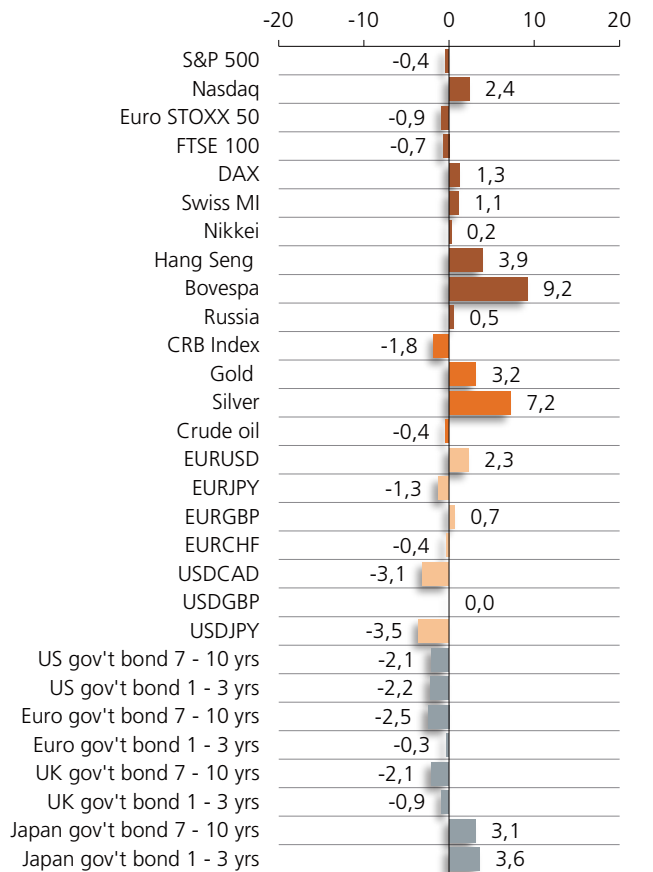
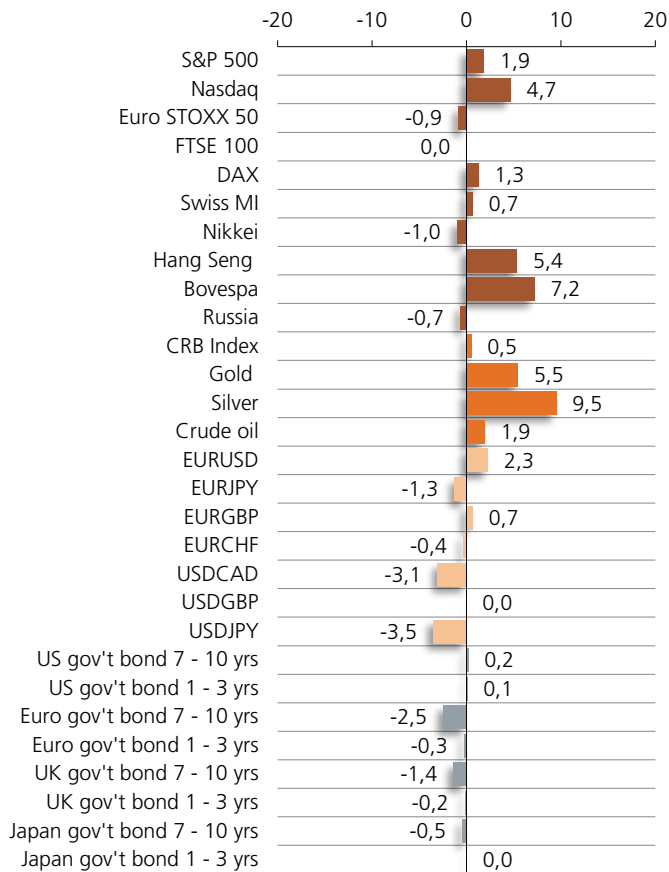


Source: Bloomberg

Performance of stocks, commodities, FX and bonds

(a) In national currencies

(b) In euros



Source: Bloomberg; own calculations

Articles in earlier issues of the *Degussa Market Report*

| Issue | Content |
|-------------------|--|
| 3 February 2017 | Gold Insures Against Risks Lurking in the Financial System |
| 20 January 2017 | The Year of Change |
| 20 December 2016 | Gold Rather Than Euro |
| 25 November 2016 | Mr Trump Loves Gold. Does Gold Love Him Back? |
| 11 November 2016 | Trump Election Puts Euro Under Pressure |
| 28. October 2016 | US Presidential Elections and the Price of Gold |
| 14 October 2016 | Amid Uncertainty, Opportunity Knocks |
| 30 September 2016 | On the Debt Ratio and the Price of Gold |
| 16 September 2016 | Central Banks May Choose Helicopter Money Over Negative Rates |
| 2 September 2016 | No return to "normal" interest rates |
| 19 August 2016 | Debt Monetized En Masse to Fend Off the Euro Crash? |
| 5 August 2016 | <i>No English issue due to summer break</i> |
| 22 July 2016 | The Demise of the Interest Rate – the Comeback of Gold Money |
| 8 July 2016 | Escaping the Euro Trap |
| 24 June 2014 | The Credit Cycle and the Price of Gold |
| 10 June 2016 | Savvy Investors Say Yes to Gold and Stocks Despite Prospective Fed Rate Hike |
| 27 May 2016 | Central Banks' Illusory Independence and the Price of Gold |
| 13 May 2016 | The Fight Against "Secular Stagnation" and Its Consequences for Gold and Silver Prices |
| 29 April 2016 | US Dollar's Dominance Challenged By Gold |
| 15 April 2016 | A World without Returns |
| 1 April 2016 | Helicopter Euros Hovering on the Horizon |
| 18 March 2016 | Gold and Stocks Protect Against 'Helicopter-Euros' |

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