Degussa Market Report

12 October 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	1.218.1	1.6	-1.9	-4.2
Silver	14.6	2.1	-8.0	-12.8
Platinum	838.0	1.4	2.7	-8.4
Palladium	1.083.9	3.3	14.8	10.6
II. In euro				
Gold	1.051.0	3.0	-1.5	-3.7
Silver	12.6	3.6	-7.7	-12.4
Platinum	723.0	2.7	2.9	-8.3
Palladium	935.0	4.6	15.0	11.0
III. Gold price in other currencies				
JPY	136.756.0	1.3	-0.7	-5.3
CNY	8.432.4	2.6	1.9	0.0
GBP	921.2	0.5	-2.5	-3.7
INR	89.755.7	1.9	5.2	9.1
RUB	80.356.8	0.9	2.1	8.4

Source: Thomson Financial; own calculations.

OUR TOP ISSUES

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

Here Goes The Punch Bowl

There is quite some headwind for gold these days. Perhaps most important, the US Federal Reserve (Fed) has embarked upon an interest rate hiking cycle. According to the Fed's own indication, the Federal Funds Rate will most likely reach 3.4 per cent in early 2020 – quite an increase from its current band that ranges from 2.00 to 2.25 per cent. For sure, rising US borrowing rates are already being felt around the world.

They are putting upward pressure on credit market yields everywhere. But first and foremost, higher US interest rates give gold a hard time because if interest rates go up, the cost of holding gold increases. Holding gold means forgoing income that could be earned by holding interest-bearing securities, for example. It is therefore unsurprising that higher interest rates should lower the demand for gold, and thus, *other things being equal*, the price of gold. But wait: In the world we live in, there is no such a thing as 'other things being equal'.

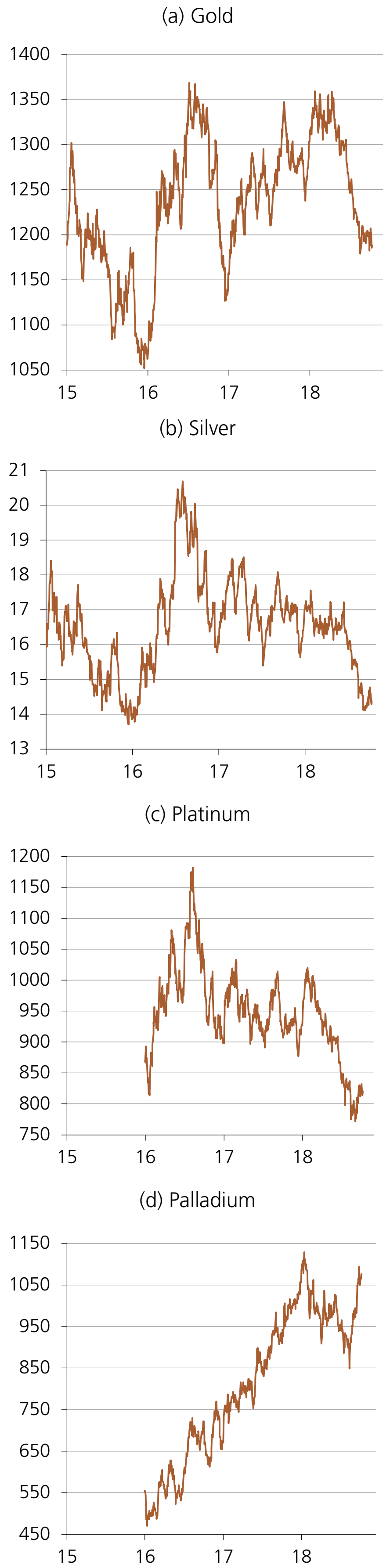
Higher interest rates, caused mainly by the Fed's monetary policy tightening, do have consequences for the world's economic and financial architecture – especially so because the last decade has been a period of artificially lowered interest rates: In the wake of the financial and economic crisis 2008/2009, major central banks have injected the market with a great deal of new credit and money provided at suppressed credit costs. This has not been lost upon economic activity.

For instance, consumption and investment, as well as government, outlays have been financed, and maturing debt has been refinanced, at most favourable borrowing conditions. New investment has been brought on its way helped by the artificially lowered cost of capital. Assets such as stocks, real estate, and housing have strongly gained in price and valuation metrics as future earnings have been discounted at artificially lowered interest rates – thus raising their present values and market prices.

That said, it might not be wise to think that raising interest rates will not affect the economic and financial structure that has been built up in the extended period of the low interest rate policy. On the contrary. An increase in borrowing costs will most likely take the steam out of the current cyclical upswing or – if interest rates go up to too much – put an end to economic expansion and rising asset prices. In other words: The fate of the current cycle is in the hand of the Fed.

However, financial market agents are not worried. They seem to take a rather positive view of the Fed's tightening policy as suggested by the ongoing rise in stock and housing prices. They expect that the economies can cope with higher interest rates, that the Fed will succeed in finding and fixing just the 'right' level of interest rates – a level of interest rates under which the US economy contin-

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



Source: Thomson Financial.

ues to grow, and inflation remains in check. This is, however, a rather daring expectation.

Because neither the Fed nor any other central bank knows the 'right' interest rate level. What monetary policymakers do is pursuing a 'trial and error process': They bring interest rates up as long as positive data on, e.g. employment, GDP, and inflation, keep coming in. Once incoming data deteriorates, e.g. GDP growth decelerates, they stop raising interest rates or, in the extreme case, reverse their interest rate hikes.

What I am trying to say here is the Fed's hiking cycle increases the likelihood that the current boom will, at some point, turn into bust. As investors do not seem to worry too much about the 'risk scenario' or the potential policy consequences it entails – as suggested by relatively tight credit spreads and relatively subdued inflation expectations –, demand for the yellow metal suffers, and this may well explain why the price of gold has come off quite substantially in recent months, falling below 1,200 USD/oz.

While the situation might indeed be unsatisfactory for those holding gold, it could offer an opportunity for those on the lookout for portfolio insurance. The 'gold currency' is a highly liquid means; its purchasing power cannot be debased by monetary policy nor does it carry a default, or counterparty, risk as bank deposits do. The critical question that needs to be answered is: Does it make sense to buy gold at its current price?

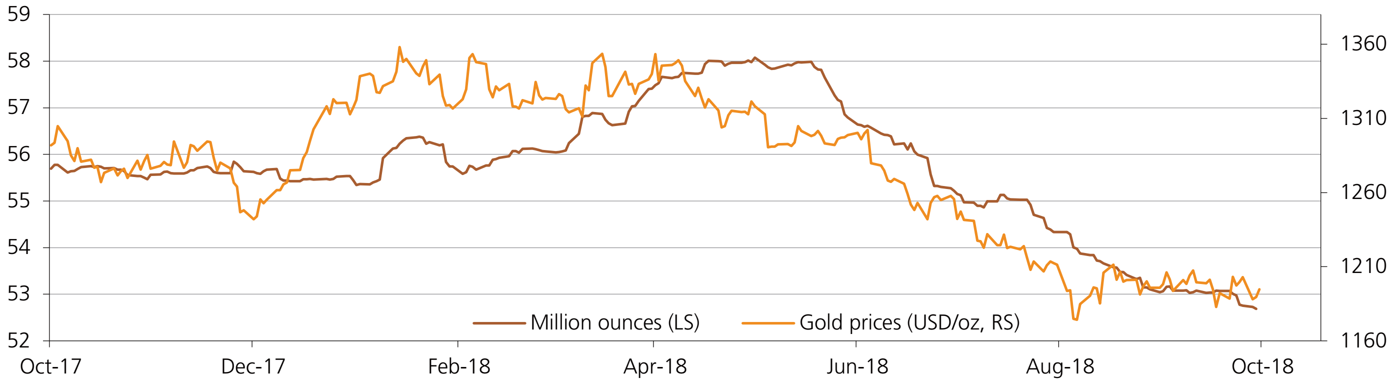
This is, as we all know, a somewhat tricky question to answer – for there is no proper 'formula' for gauging the 'fair value' of gold - the same way as there is no proper formula for calculating the fair value of other currencies, be it the US dollar, euro, or Swiss francs (vis-a-vis their peers). The truth is: There is no doubt quite a dose of speculation involved when buying gold, as is in the decision to hold US dollar, euro, or any other currency.

One way of dealing with this difficulty is taking a long-term view: The longer the investment horizon is (five or more years), the higher the chance that gold proves to be an effective insurance against inflation and/or payment defaults. In this sense, gold offers a service which cannot be provided by alternative (unbacked) currencies such as the US dollar, euro, or British pound. While these properties of gold might not sufficiently be appreciated in 'good times', they certainly will in 'bad times'.

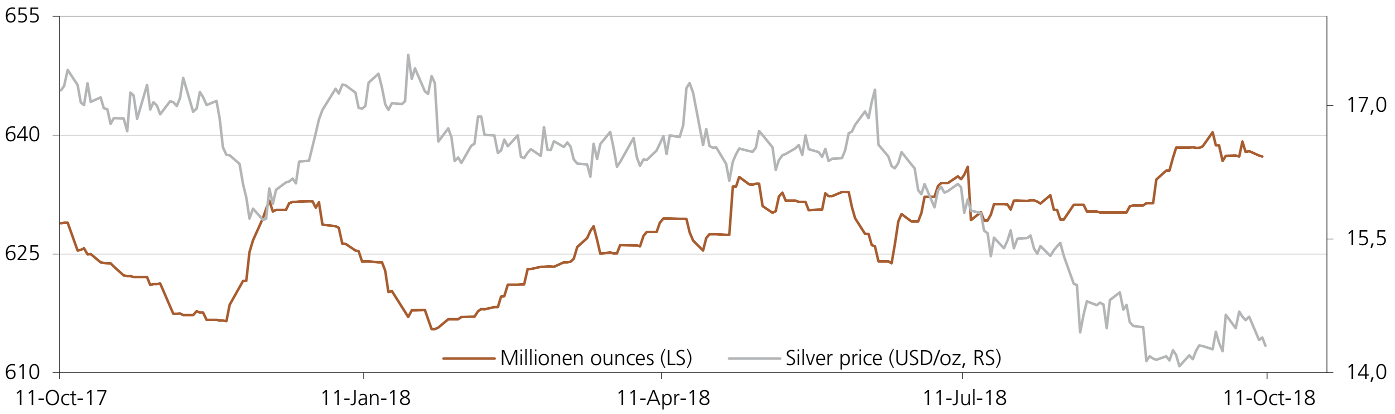
In view of monetary developments around the world, there is a good reason for the savvy investor to think and act long-term oriented, especially so as it is highly likely that central banks, under the leadership of the Fed, will sooner or later cause another bust. This is pretty much certain, I would argue. Interest rate hikes increase the likelihood of the boom turning into bust. It is like taking away a punch bowl at a time when the party guests are in high spirits and do not expect to run out of liquidity, so to speak.

Precious metals prices and ETF holdings

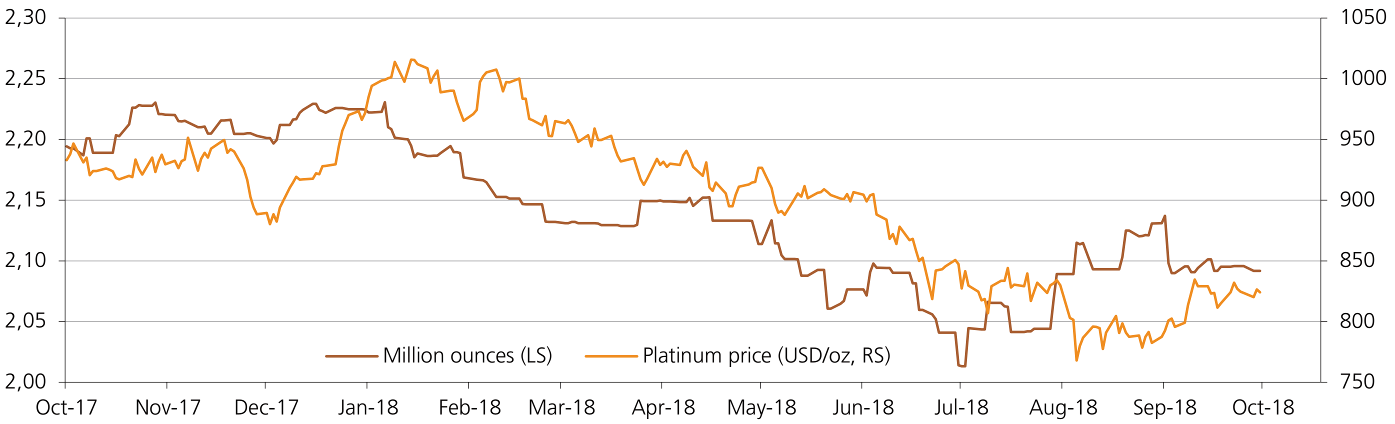
Gold ETFs (million ounces) und gold price (USD/oz)



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	1218.1		14.6		833.6		1083.7	
II. Gliding averages								
5 days	1196.3		14.4		820.4		1072.2	
10 days	1197.4		14.5		822.4		1067.8	
20 days	1198.1		14.4		820.5		1051.1	
50 days	1199.0		14.6		806.9		982.5	
100 days	1230.5		15.4		834.2		970.5	
200 days	1278.6		16.0		893.9		990.0	
III. Bandwidths for 2018	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1248	1472	16.0	21.0	936	1048	1033	1261
(1)	*2*	*21*	*10*	*44*	*12*	*26*	*-5*	*16*
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	1051.3		12.6		719.5		935.4	
II. Gliding averages								
5 days	1039.5		12.6		712.8		931.6	
10 days	1038.0		12.6		712.9		925.6	
20 days	1030.3		12.4		705.5		903.9	
50 days	1034.6		12.6		696.3		847.6	
100 days	1057.8		13.2		717.1		834.3	
200 days	1071.9		13.4		748.8		830.4	
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)	*3*	*21*	*10*	*45*	*13*	*26*	*-4*	*17*
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.

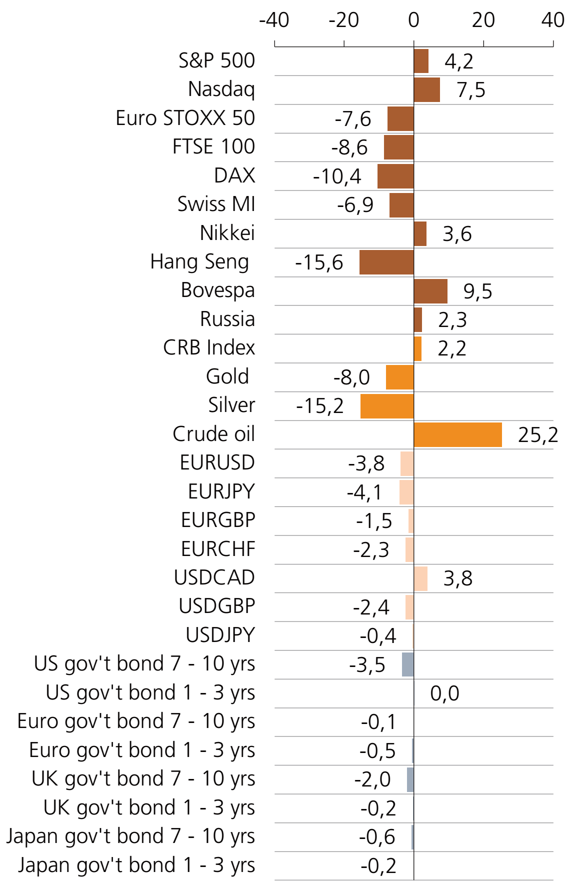
Bitcoin, performance of various asset classes

Bitcoin in US dollars

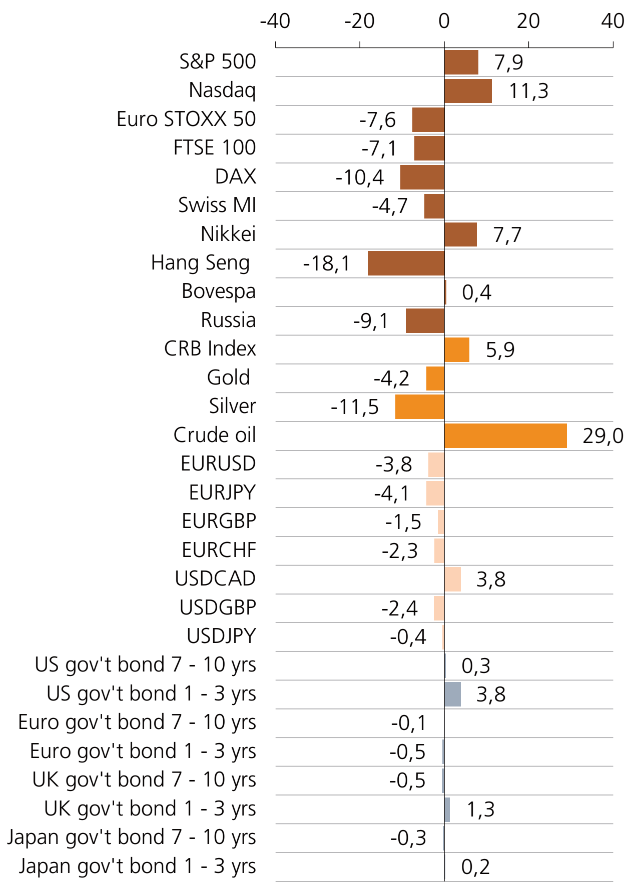
Source: Thomson Financial.

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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3 March 2017	ECB Flirts With Higher Inflation. The Case For Gold

The Degussa Marktreport (German) and the Degussa Market Report (English) are available at:
www.degussa-goldhandel.de/de/marktreport.aspx.

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