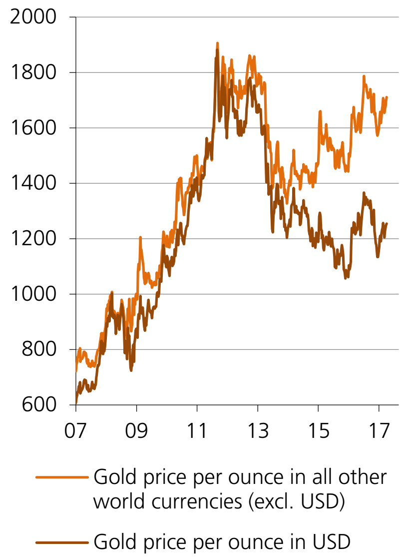
Degussa Market Report

13 April 2017 Economics · Finance · Precious Metals

"The purpose of the issue of paper money is generally to relieve the financial necessities of the government. It is a costly expedient … . It is peculiarly liable to be the subject of political intrigue and of popular misunderstanding."

—Frank A. Fetter, 1905, p. 240

Gold price per ounce
in US dollars and all world currencies (excl. the US dollar)*
January 2007 to April 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.

OUR TOP ISSUES

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

The Gold Price Rise Tells Us: The Crisis Isn't Over Yet

The latest upward gold price move should be taken as a reminder that the "crisis" is far from being over.

The price of gold has been edging higher lately, having reached 1,285 USD per ounce, bringing the price gain to 10 percent since the beginning of the year. The perhaps most obvious reasons for the price move are presumably growing geopolitical tensions: Most notably the US air strike in Syria and a potential military confrontation with North Korea. Events like these typically increase investor demand for gold as a 'save haven', driving up its price.

At the same time, we shouldn't overlook that the price of gold in basically all the key currencies – US-dollar not included – has already been rising since the fall of 2013 and that the price of gold in US-dollar has been going up since early 2016. What is more, the upward drift of the price of gold occurs at a time when the US Federal Reserve (Fed) is actually increasing borrowing costs.

At first glance, such a development may seem surprising, as higher US interest rates should be negative for the demand for gold and thus its market price: If and when interest rates go up, the opportunity costs of holding gold increase. Holders of gold miss out on revenues they could alternatively pocket by holding interest-bearing securities. Higher interest rates tend to lower the demand for gold. However, in recent times, this economic rationale did not seem to apply.

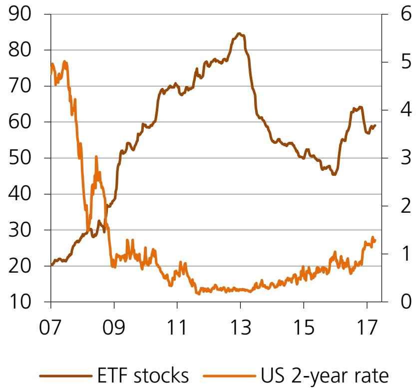
For instance, gold exchange traded funds (ETFs) keep enjoying inflows, translating into a higher demand for physical gold and driving up its price – despite higher short-term interest rates in the US. This suggests that institutional investors, who are seeking exposure to the gold market through ETF purchases, do not only retain their interest in the yellow metal but seek to increase it further.

One explanation might be the growing awareness that a number of systemic risk factors keep building up in the international economic and financial system – and that holding gold provides investors with insurance against adverse price movements in the marketplace.

The prospect of even higher US interest rates will predictably put not only the US but also other economies around the world under pressure. Higher rates are not only painful for overstretched borrowers, but they will also slow down economic expansion, thereby potentially paving the way towards the next credit disaster.

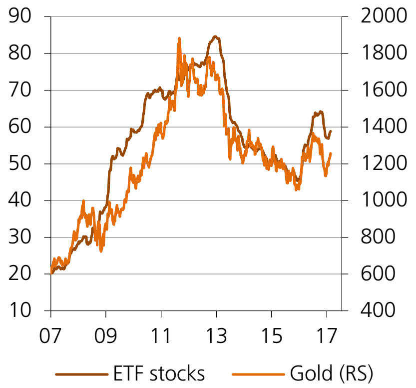
Needless to say, higher US interest rates spell trouble for emerging market economies in particular. Many of them rely on capital inflows and have borrowed in US-dollar when the conditions were cheap. The tightening of US-dollar liquidity and an increase in debt costs would very likely put an end to growth and em-

Gold ETF demand has gone up despite higher US interest rates, …
Gold ETFs (million ounces) and US 2-year gov't bond yield in percent



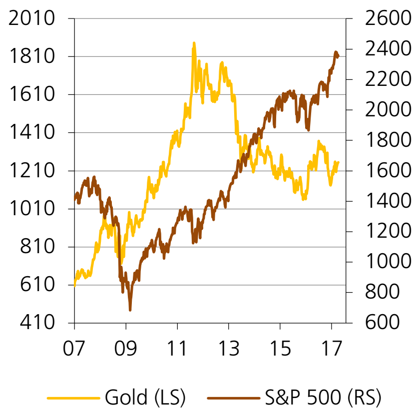
Source: Thomson Financial.

… having translated into a higher gold price
Gold ETFs (million ounces) and price of gold (USD/oz)



Source: Thomson Financial; own calculations.

Gold as a hedge against adverse price action in financial markets
S&P 500 stock market index and gold price (USD/oz)



Source: Thomson Financial.

ployment gains in these regions – and the fallout would certainly be felt in the industrialized world as well.

The Eurozone remains in deep trouble. Economic growth remains anemic, unemployment high, and the support for the European integration project among the people is dwindling. The truth is that the euro's existence more than ever depends on the European Central Bank (ECB) continued monetizing of debt and expanding the quantity of money.

Perhaps most important, the Eurozone's outsized banking system is in dire straits. Many banks suffer from non-performing loans and low profitability. The increasing divergent political forces within Europe will make putting together further support packages to "bail out" ailing Eurozone banks increasingly difficult.

Finally, current valuation levels in quite a few markets, in particular in the bond and housing markets, but also in some pockets of the equity market – warrant caution from an investor's point of view. Many have presumably been seeking protection against a possible event of adverse market price action.

The perhaps biggest threat, however, comes from central bank policies: The ongoing excessively expansionary monetary policies in many countries around the world have been fueling an artificial recovery that can only be sustained if central banks succeed in pumping more credit and money than ever into the system - at artificially low interest rates.

This kind of policy follows the maxim of "keeping the boom going", whatever it takes. So, if and when the economies start to falter, or if and when a sell-off in financial markets sets in, central banks can, and must, be expected to turn to even more expansionary policies.

In other words, central banks have already put the economies on an inflationary path – which will become even more inflationary if and when economic growth and financial markets turn sour, as they seem to consider churning out ever greater amounts of money as the lesser evil – compared to the unfolding recession-depression.

In such an environment, gold is attractive for at least three reasons. Firstly, it is the "hardest currency". It is the ultimate means of payment and therefore the "natural" substitute for unbacked paper monies. Secondly, the purchasing power of gold cannot be debased by political expediency. And thirdly: Gold doesn't carry a default risk as e.g. bank deposits and bonds do.

On a final note, to us, the current gold price appears to be a decent bargain. In fact, buying gold at current prices offers a portfolio insurance which has considerable upside price potential. In any case, the latest upward gold price move should be taken as a reminder that the "crisis" is far from being over.

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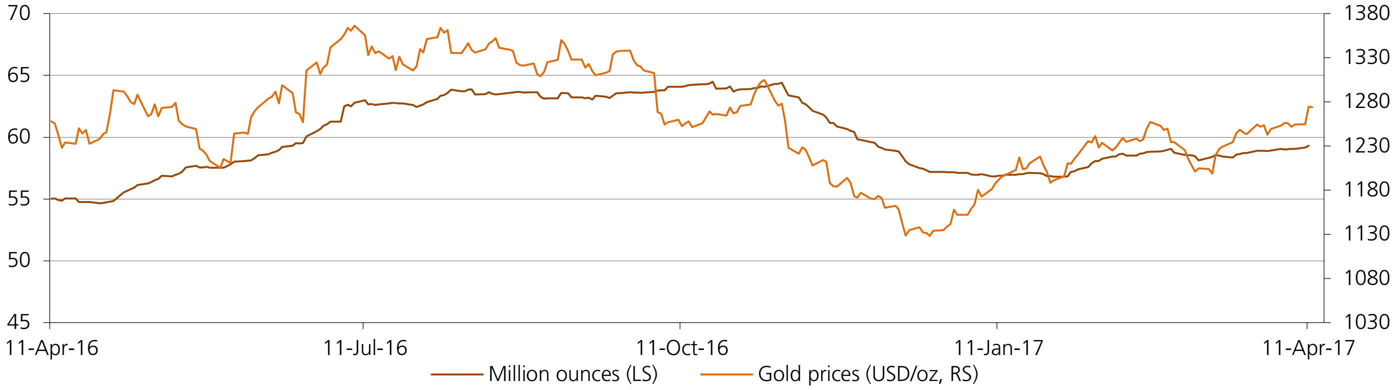
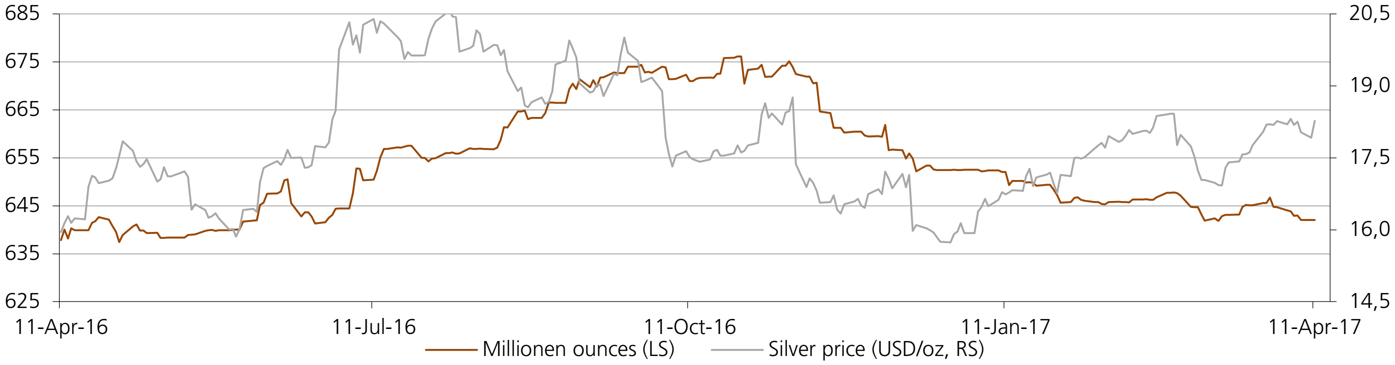
Precious metals prices and ETF holdings

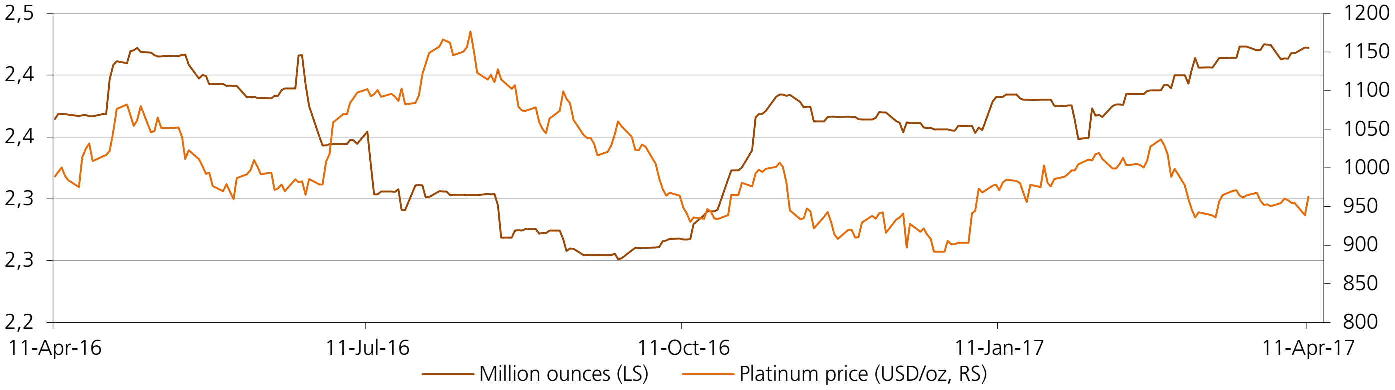
Gold ETFs (million ounces) und gold price (USD/oz)



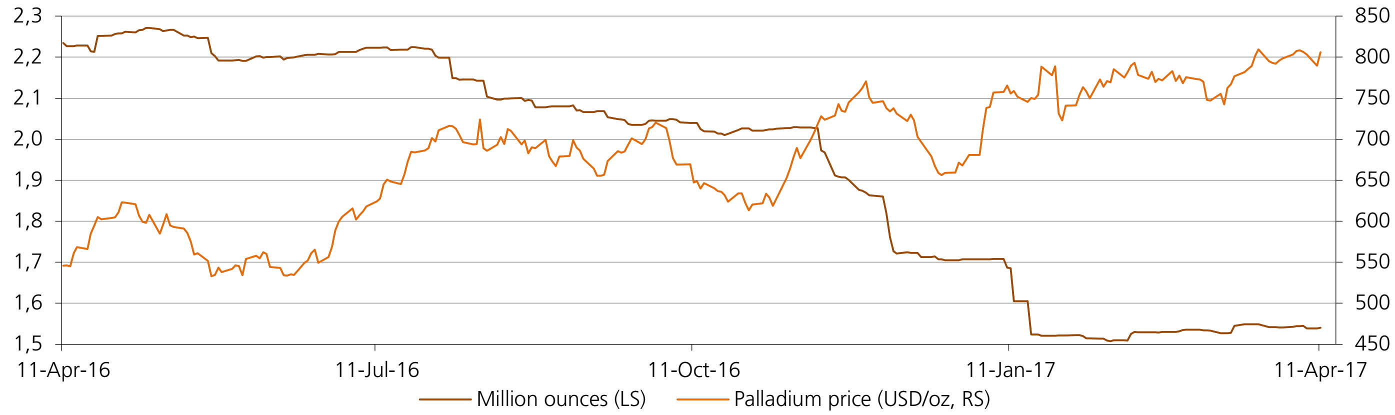
Silver ETFs (million ounces) and silver price (USD/oz)



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



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



Source: Bloomberg.

Precious metals prices

In US-dollar

	Gold		Silver		Platinum		Palladium	
I. Actual	1,284.6		18.5		973.6		803.5	
II. Gliding averages								
5 days	1,263.4		18.2		953.4		796.8	
10 days	1,257.3		18.2		953.0		799.7	
20 days	1,250.7		18.0		958.5		795.0	
50 days	1,237.7		17.8		978.4		780.2	
100 days	1,205.5		17.2		959.7		753.4	
200 days	1,255.5		18.1		999.5		714.1	
III. Projections for 2017								
	Low	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1,148	1,390	15.9	23.00	906	1,100	700	900
IV. Annual averages								
2013	1,429		24.1		1,487		724	
2014	1,260		19.1		1,382		800	
2015	1,163		15.7		1,065		706	
2016	1,242		17.0		985		617	

In euro

	Gold		Silver		Platinum		Palladium	
I. Actual	1,204.4		17.3		912.4		753.1	
II. Gliding averages								
5 days	1,189.2		17.2		897.4		750.0	
10 days	1,180.2		17.1		894.6		750.7	
20 days	1,166.4		16.8		893.8		741.4	
50 days	1,160.7		16.7		917.6		731.6	
100 days	1,134.2		16.2		903.1		708.8	
200 days	1,156.3		16.6		920.4		659.0	
III. Projections for 2017								
	Low	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1,118	1,353	15.5	22.40	882	1,071	682	876
IV. Annual averages								
2013	1,079		18.2		1,123		547	
2014	945		14.3		1,035		601	
2015	1,044		14.1		955		633	
2016	1,120		15.4		888		557	

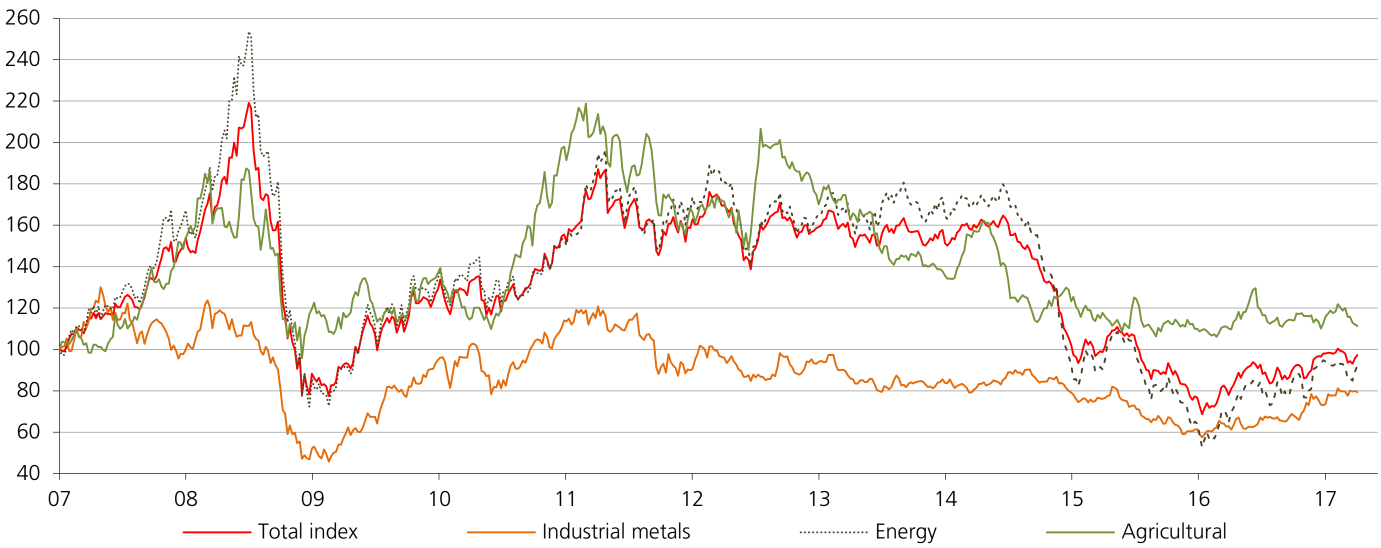
Source: Thomson Financial; own calculations and estimates.

Commodity prices

Selected commodity prices	Actual price in US-dollar	Change against (in percent): 1 week	1 mth	3 mths	6 mths	12 mths	Volatility (in percent): 30 days	90 days
I. Energy								
WTI crude oil	53.11	5.0	-1.5	-5.2	7.2	25.8	24.7	22.8
Brent crude oil	55.59	3.8	-1.1	-4.9	8.3	28.8	22.7	21.9
Gasoline	174.17	2.3	-2.5	-6.9	5.4	23.5	15.9	18.7
Heating oil	165.20	4.9	0.4	-5.3	6.6	25.6	18.3	20.2
Gas oil	496.25	5.4	-1.1	-3.0	8.4	…	21.0	21.3
Natural gas	3.19	-0.1	-0.7	-10.0	4.1	32.0	33.2	39.6
II. Agriculture								
Corn	376.00	1.1	0.6	3.2	-0.1	-4.1	13.4	15.9
Wheat	446.25	1.7	-0.2	2.8	-3.3	-13.1	15.3	19.2
Soy beans	947.75	0.2	-8.4	-6.4	-7.4	7.2	9.6	15.9
Coffee	140.60	-0.7	-8.9	-0.8	-18.0	11.9	15.6	19.9
Sugar	16.74	-0.8	-17.1	-11.2	-18.6	17.2	20.3	21.4
Cotton	76.23	-3.0	0.1	6.8	9.0	30.5	13.9	13.8
III. Industrial metals								
Aluminum	1921.00	-2.1	5.6	13.5	10.8	22.1	13.4	14.1
Copper	5767.00	-1.2	-3.7	4.2	18.8	22.8	17.5	22.1
Zinc	2570.00	-7.3	-10.1	-0.2	4.4	45.7	26.7	28.2
Lead	2250.00	-3.8	-5.1	11.6	9.0	28.4	22.5	29.0
Iron ore	76.49	0.2	…	-2.0	22.6	64.8	…	…
IV. Precious metals								
Gold	1285.44	2.9	6.2	12.0	0.9	4.3	10.4	11.8
Silver	18.48	1.1	5.6	16.0	3.7	24.6	15.1	20.7
Platinum	972.58	2.3	-2.0	7.7	-0.4	4.3	16.8	21.8
Palladium	801.99	0.4	6.3	17.8	30.2	62.2	18.4	28.2
V. Ratios								
Gold-silver	69.53	1.5	0.5	-4.2	-2.7	-16.3	8.7	13.3
Gold-platinum	1.32	0.5	8.3	3.5	1.3	0.1	11.1	16.1
Gold-palladium	1.60	2.5	0.0	-4.7	-22.4	-35.6	17.1	25.9
Palladium-platin	0.82	-2.3	8.1	8.3	30.1	55.1	16.6	25.3

Source: Bloomberg; own calculations.

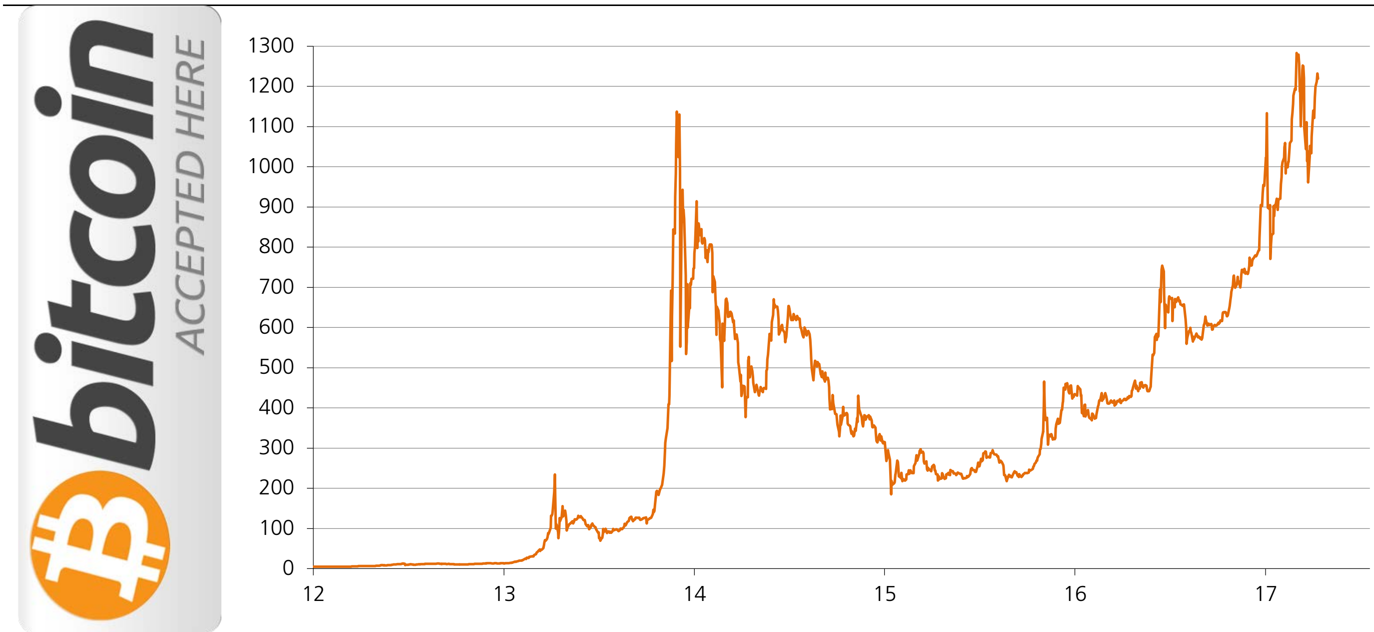
S&P commodity prices (in US dollar terms)



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

Bitcoin, performance of various asset classes

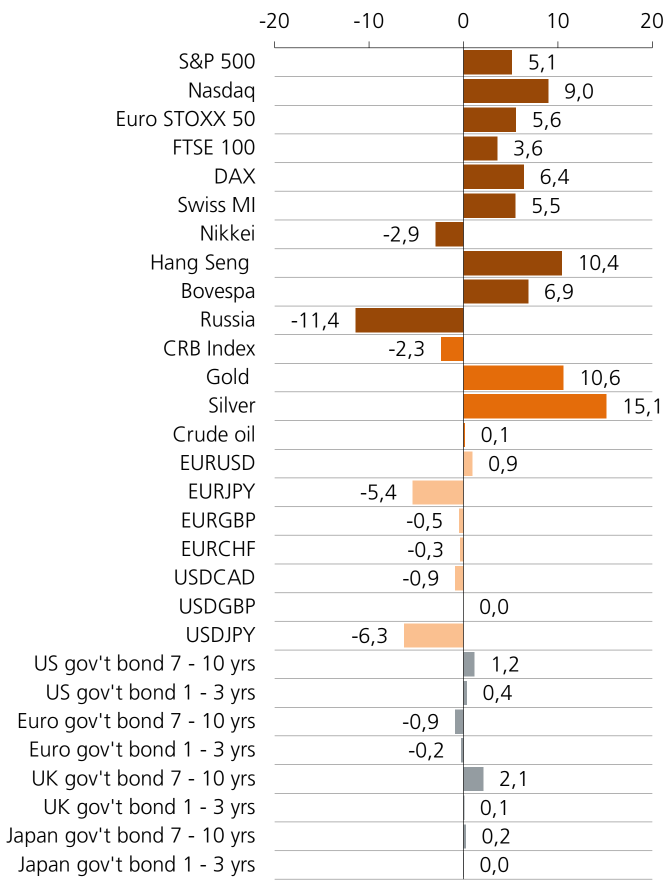
Bitcoin in US dollars



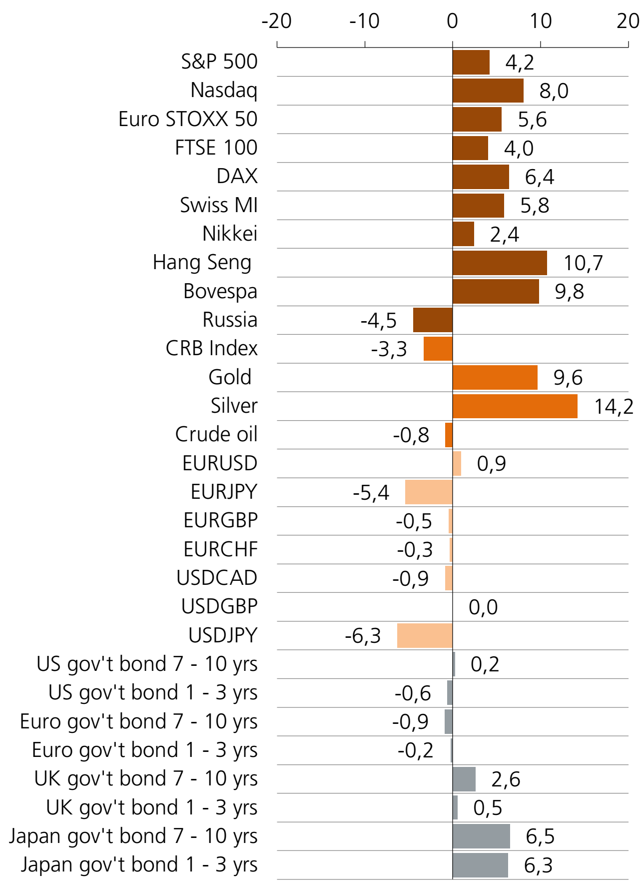
Source: Bloomberg

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*

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31 March 2017	ECB Negative Interest Rate Policy Will Come to an End
17 March 2017	The Fed's Half-Hearted Attempt of Monetary Tightening
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
20 January 2017	The Year of Change
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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	*No English issue due to summer break*
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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