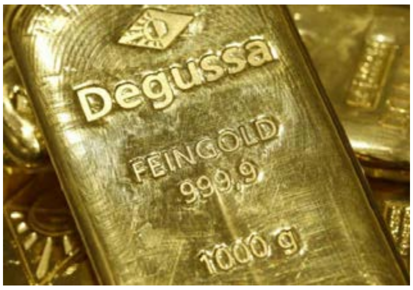
Degussa Market Report

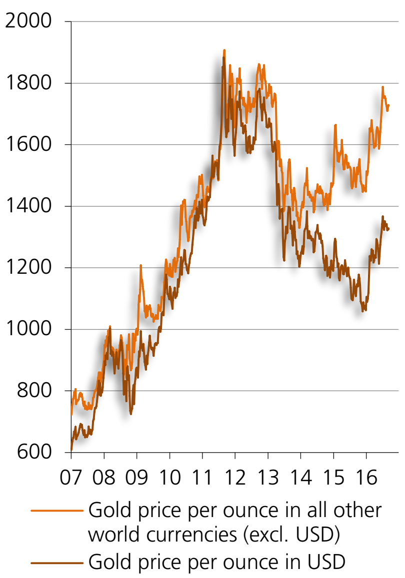
16 September 2016 Economics · Finance · Precious metals



Inflation "is the inevitable result of a policy which regards all the other decisions as data to which the supply of money must be adapted so that the damage done by other measures will be as little noticed as possible."

— Friedrich August von Hayek, 1960, S. 333.

Gold price per ounce
in US dollar and all world currencies (excl. the US dollar)*
January 2007 till September 2016



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**.*

Central Banks May Choose Helicopter Money Over Negative Rates

The US Federal Reserve (Fed) is considering raising rates. Is the "normalization" of interest rates about to happen which savers and investors have been yearning for? Most likely not. Policymakers are merely realizing that the policy of zero rates — or even negative rates as in the euro area or Switzerland — doesn't work as intended.

The wider public is very much against it. Banks, for instance, run into trouble because their profits come under severe pressure in an environment of zero, let alone negative, interest rates. Bank clients start protesting as their bank deposits no longer earn a positive return. They even start redeeming their deposits in cash, thereby causing bank refinancing gaps.

Negative Rates Under Another Name

However, central banks are quite unlikely to abandon the idea of pushing real — that is inflation-adjusted — interest rates into the negative. What they might have in mind is allowing for "somewhat higher" nominal interest rates, accompanied by "somewhat higher" inflation, making sure that real interest rates remain in, or fall into, negative territory.

In this vein, the Federal Reserve of San Francisco suggested in a paper published on 15 August 2016 that monetary policy should rethink and possibly allow for an inflation of more than 2 percent.[1] The debate about higher inflation — say, 4 rather than 2 percent — is actually an old one; in academic circles it comes and goes in waves.

The central argument is that a somewhat higher inflation would "grease the wheel" of the economy, thereby supporting production and employment. Another argument has it that higher inflation would make it easier for the Fed to pull the economy out of recession, especially so if and when the "neutral interest rate" has come down considerably.

The truth is, however, that inflation — be it 2, 4, or more percent — doesn't make a society better off. On the contrary. For instance, inflation corrupts economic calculation, thereby causing entrepreneurs to make the wrong decisions. The stimulus inflation initially is due to the errors which it produces.

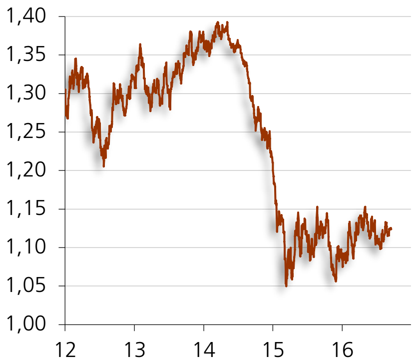
What is more, inflation only works if and when it comes unexpectedly, thereby benefiting some at the expense of others. "Surprise inflation," however, can

[1] See J.C. Williams, "Monetary Policy in a Low R-star World," FRBSF Economic Letter, 15 August 2016.

USD per ounce of gold

USD per ounce of silver

EURUSD



Source: Bloomberg.

Precious metals prices				
	Actual (spot)	Change against (in percent): 2 W	3 M	12 M
I. In US-dollar				
Gold	1,316.8	-0.3	-0.4	18.1
Silver	19.0	2.1	3.1	31.2
Platinum	1,034.8	-3.6	1.6	13.7
Palladium	659.0	-4.4	10.4	1.1
II. In euro				
Gold	1,170.8	-0.8	-1.5	17.4
Silver	16.9	1.7	1.6	30.5
Platinum	920.1	-3.9	0.1	13.1
Palladium	586.2	-5.0	8.8	0.4
III. Gold price in other currencies				
JPY	134,504.6	0.0	-1.0	0.8
CNY	8,790.1	-1.0	0.1	24.0
GBP	994.8	-1.1	0.3	35.0
INR	88,058.0	1.9	-0.9	20.6
RUB	85,333.9	-0.5	1.3	16.8

Source: Bloomberg; own calculations.

never be more than a temporary incentive. Sooner or later, people will discover that they have been tricked and adjust their behavior accordingly.

Consider a case in which the central bank promises an inflation rate of 2 percent. After people have entered into their contracts, the central bank increases inflation to 4 percent. People will learn and expect future inflation to be 4 or even 5 percent. The central bank, if it wants to stimulate again the economy, has to bring inflation further up.

This kind of policy would ultimately lead to high or even hyperinflation — which has been observed in many countries around the world. However, if the central bank succeeds in (1) raising inflation from, say, 2 to 4 percent on a one-off basis and (2) simultaneously controlling nominal yields, it potentially deleverages the economy, bringing down debt-to-income ratios.

If, for instance, the Fed fixes interest rates at, say, 2 percent and pushes inflation to 5 percent, real interest rates fall to minus 3 percent. Moneyholders would be ripped off. The same holds true for investors in debt, issued by states, banks, and corporates. Debtors, in turn, would presumably welcome a policy of negative real rates that come with somewhat higher inflation.

It therefore doesn't take much to expect that in particular politically powerful and highly indebted borrowers would do their very best to push the central bank to bring up inflation and, at the same time, put a lid on nominal interest rates. To press their case, they will make sure that an economic theory in support of inflation and negative interest rates is propagated to the public at large.

How to Drive Up Price Inflation

But can a central bank really ramp up inflation? It sure can. Inflation — in the sense of higher prices — is ultimately a monetary phenomenon. Technically speaking, the central bank can expand the quantity of money at any time and any amount politically desired, as the central bank has a monopoly on money production.

For instance, the central bank can purchase debt in the market against issuing newly created money. Or, in extremis, it can also issue "helicopter money." The central bank hands out money for free to governments, consumers, and entrepreneurs in the amount deemed necessary to push inflation upward.

Central banks are highly politicized, and they will act in a way that is politically expedient. Once the debt burden has become unsustainable and growth disappointing, it becomes increasingly difficult to prevent an inflation policy. It was Ludwig von Mises who clearly understood the political dimension of inflation:

"We have seen that if a government is not in a position to negotiate loans and does not dare levy additional taxation for fear that the financial and general economic effects will be revealed too clearly too soon, so that it will lose support for its program, it always considers it necessary to undertake inflationary measures.

Thus inflation becomes one of the most important psychological aids to an economic policy which tries to camouflage its effects. In this sense, it may be described as a tool of antidemocratic policy. By deceiving public opinion, it permits a system of government to continue which would have no hope of receiving the approval of the people if conditions were frankly explained to them."[2]

Against this backdrop it would be surprising if governments and their central banks will not opt at some stage for higher inflation in an attempt to escape the problems their policies and the issuance of unbacked paper money has caused in the first place. Alas, it wouldn't be the first time in monetary history that unbacked paper money would be deliberately debased.

This article was published by the Ludwig von Mises Institute, Auburn, US Alabama, on 9 September 2016.

[2] Ludwig von Mises, "Stabilization of the Monetary Unit — From the Viewpoint of Theory," in: The Cause of the Economic Crisis: And Other Essays Before and After the Great Depression (Ludwig von Mises Institute, Auburn, 2006), p. 38.

Precious metals prices, actual and projections (per ounce)

In US-dollar

	Gold		Silver		Platinum		Palladium	
I. Actual	1,316.2		19.0		1,031.7		655.7	
II. Gliding averages								
5 days	1,322.4		19.0		1,042.8		659.5	
10 days	1,329.2		19.3		1,062.4		673.2	
20 days	1,327.2		19.1		1,070.4		680.2	
50 days	1,335.3		19.6		1,101.1		681.8	
100 days	1,305.7		18.5		1,059.0		626.1	
200 days	1,241.2		16.8		991.9		583.1	
III. Projections								
	Rante		*Range*		*Range*		*Range*	
	Low	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
Q3 2016	1,175	1,320	17.6	19.5	850	1,130	640	700
Q4 2016	1,251	1,360	17.1	20.1	800	1,170	660	730
Q1 2017	1,279	1,390	17.8	20.9	1,040	1,220	700	760
Q2 2017	1,306	1,420	18.5	21.8	1,080	1,270	730	790
IV. Annual averages								
2013	1,398		23.4		1,473		725	
2014	1,252		18.6		1,370		805	
2015	1,154		15.5		1,043		684	
2016 (projected)	1,209		17.3		931		619	

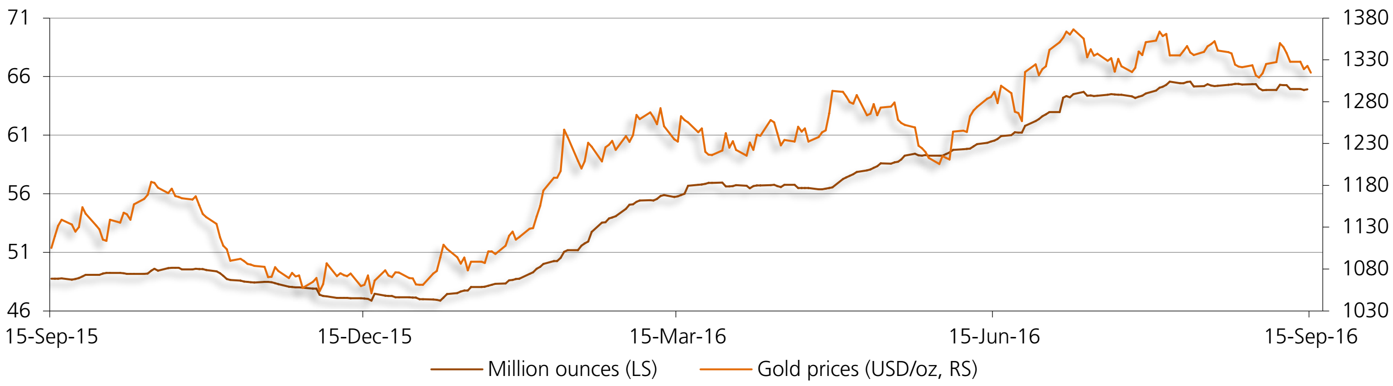
In Euro

	Gold		Silver		Platinum		Palladium	
I. Actual	1,169.6		16.9		916.7		582.6	
II. Gliding averages								
5 days	1,176.4		16.9		927.7		586.7	
10 days	1,184.9		17.2		947.1		600.1	
20 days	1,181.3		17.0		952.7		605.4	
50 days	1,197.3		17.6		987.3		611.2	
100 days	1,165.2		16.5		945.0		558.8	
200 days	1,113.6		15.0		889.8		523.2	
III. Projections								
	Range		*Range*		*Range*		*Range*	
	Low	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
Q3 2016	1,058	1,189	15.8	17.6	766	1,018	577	631
Q4 2016	1,180	1,283	16.1	19.0	755	1,104	623	689
Q1 2017	1,279	1,390	17.8	20.9	1,040	1,220	700	760
Q2 2017	1,306	1,420	18.5	21.8	1,080	1,270	730	790
IV. Annual averages								
2013	1,052		18		1,108		545	
2014	949		14		1,036		611	
2015	1,045		14		945		619	
2016 (projected)	1,098		16		846		562	

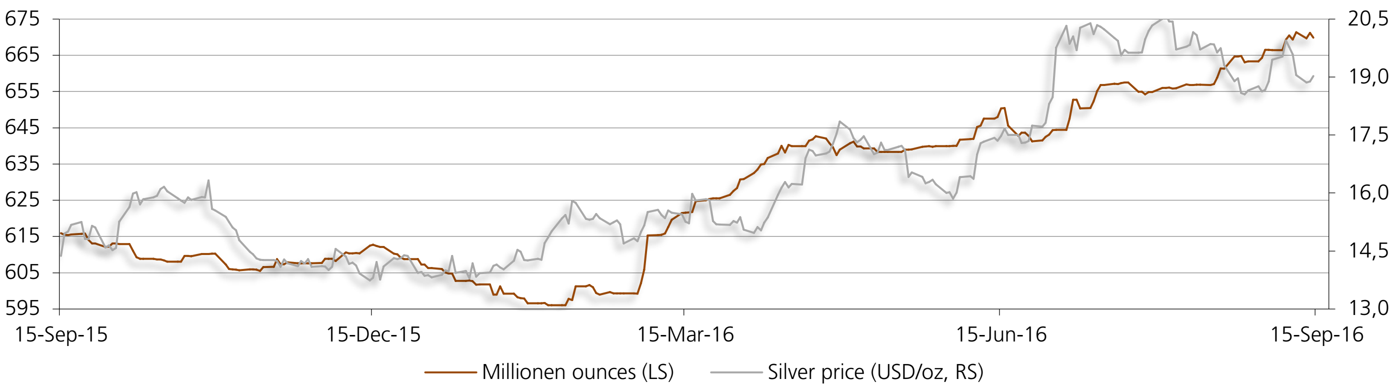
Source: Bloomberg; own calculations. Projections of Degussa Goldhandel GmbH (end of quarter); numbers are rounded.

Precious metals prices and ETF holdings

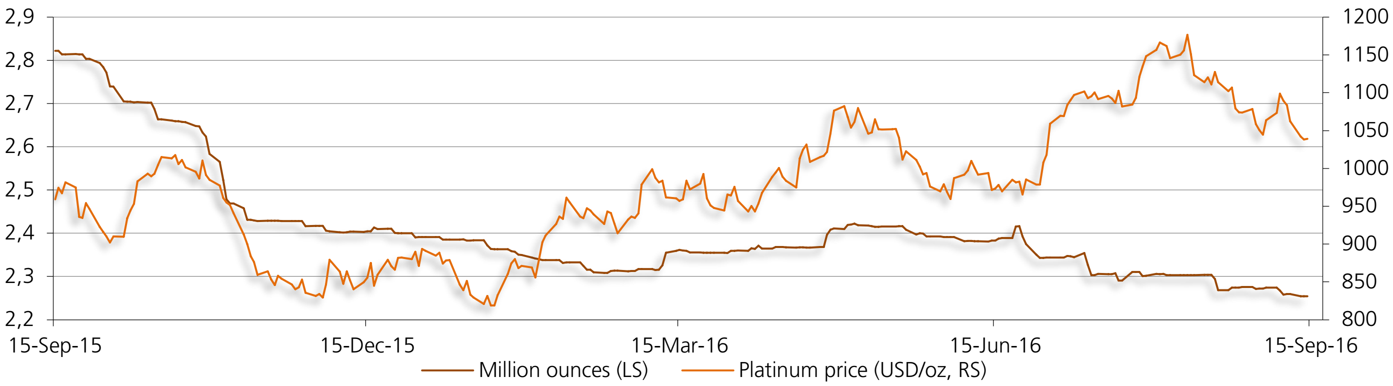
Gold ETFs (million ounces) und gold price (USD/oz)



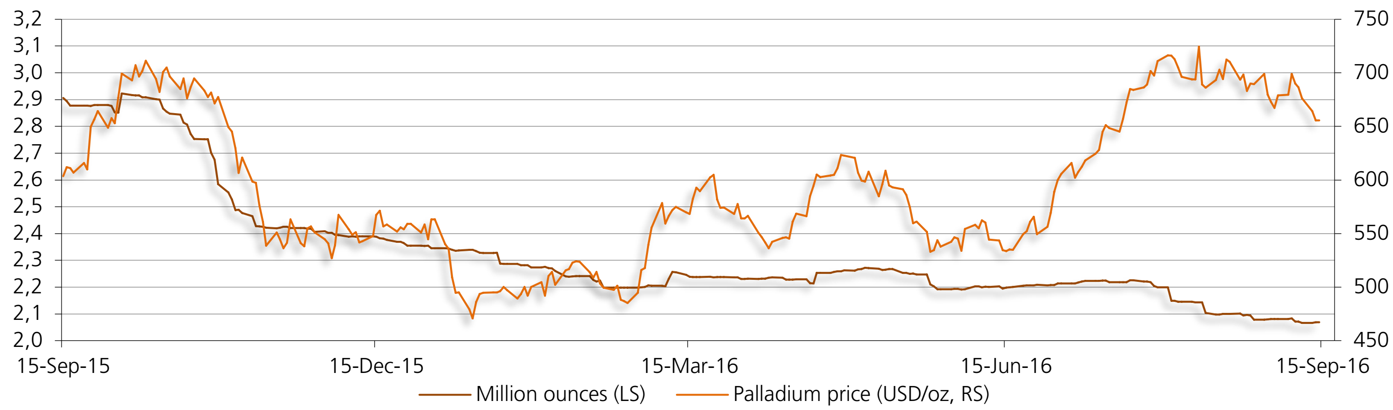
Silver ETFs (million ounces) and silver price (USD/oz)



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



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



Source: Bloomberg.

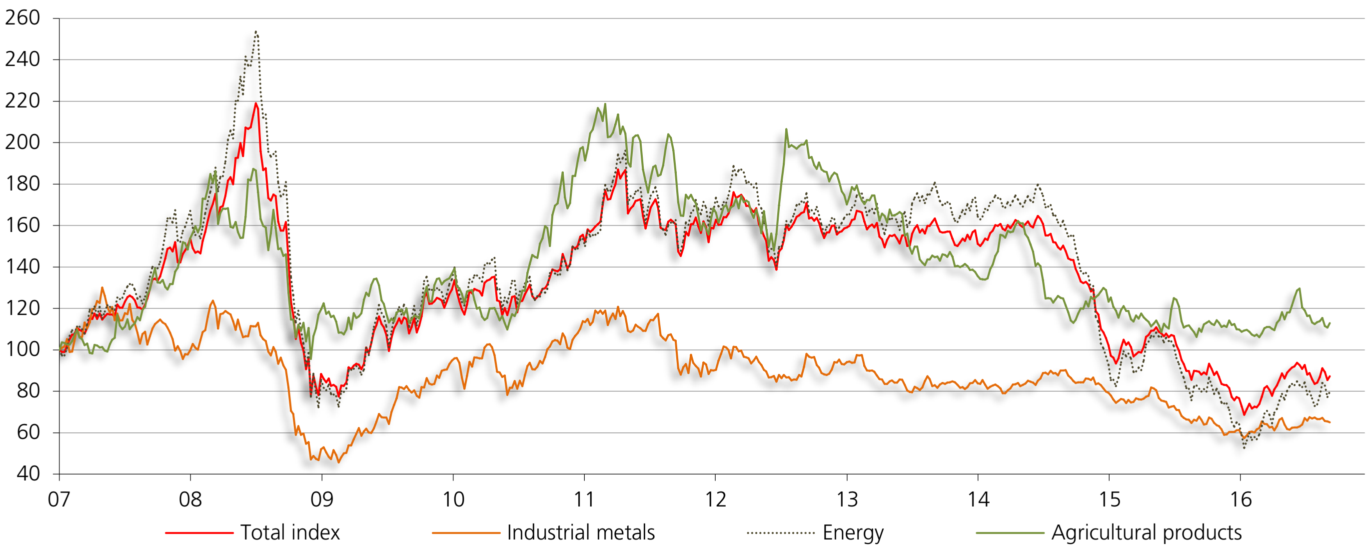
Commodity prices

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	43.86	-1.3	-11.6	-12.8	3.6	-18.6	40.0	37.7
Brent crude oil	46.53	-0.6	-7.9	-8.5	8.8	-22.2	38.6	36.5
Gasoline	142.59	9.5	1.0	-2.2	12.7	-7.2	40.7	36.5
Heating oil	141.56	0.4	-7.3	-7.6	10.1	-19.2	34.8	34.1
Gas oil	414.25	0.1	-8.8	-10.2	7.1	...	32.6	30.9
Natural gas	2.92	4.6	-0.9	15.5	27.6	-4.6	36.9	36.6
II. Agriculture								
Corn	330.00	0.5	-11.1	-19.2	-10.5	-16.5	19.3	26.6
Wheat	399.50	0.1	-14.2	-19.0	-20.7	-25.9	21.8	24.0
Soy beans	950.50	-0.2	-17.6	-10.0	2.8	5.0	19.5	27.7
Coffee	148.90	-1.7	0.4	18.0	12.0	5.4	22.8	28.8
Sugar	21.16	1.9	3.6	18.0	31.9	59.2	26.6	26.4
Cotton	67.72	-0.1	5.5	6.6	17.2	5.6	25.7	23.8
III. Industrial metals								
Aluminum	1586.00	-0.5	-3.8	1.9	4.3	-2.0	12.3	14.8
Copper	4771.50	3.1	-1.5	2.2	-1.6	-8.8	13.9	17.3
Zinc	2274.00	-3.8	8.1	18.3	25.2	18.7	15.1	20.4
Lead	1960.50	0.9	9.6	15.3	15.0	15.2	17.3	19.4
Iron ore	55.00	0.2	2.6	16.5	3.4	0.2	...	...
IV. Precious metals								
Gold	1317.08	-0.6	0.1	8.4	6.9	20.2	8.8	14.4
Silver	19.05	-2.0	3.1	18.9	23.9	28.9	21.2	25.1
Platinum	1034.84	-2.7	1.6	5.7	6.1	5.2	20.9	21.0
Palladium	658.97	-3.0	10.4	20.5	17.0	7.7	33.3	28.5
V. Ratios								
Gold-silver	69.15	0.9	-2.9	-8.8	-13.7	-6.6	14.0	17.1
Gold-platinum	1.27	2.0	-1.5	2.6	0.8	14.3	15.2	15.9
Gold-palladium	2.00	1.8	-9.3	-10.1	-8.7	11.8	27.8	28.4
Palladium-platinum	0.64	0.2	8.6	14.0	10.5	2.2	18.1	21.4

Source: Bloomberg; own calculations.

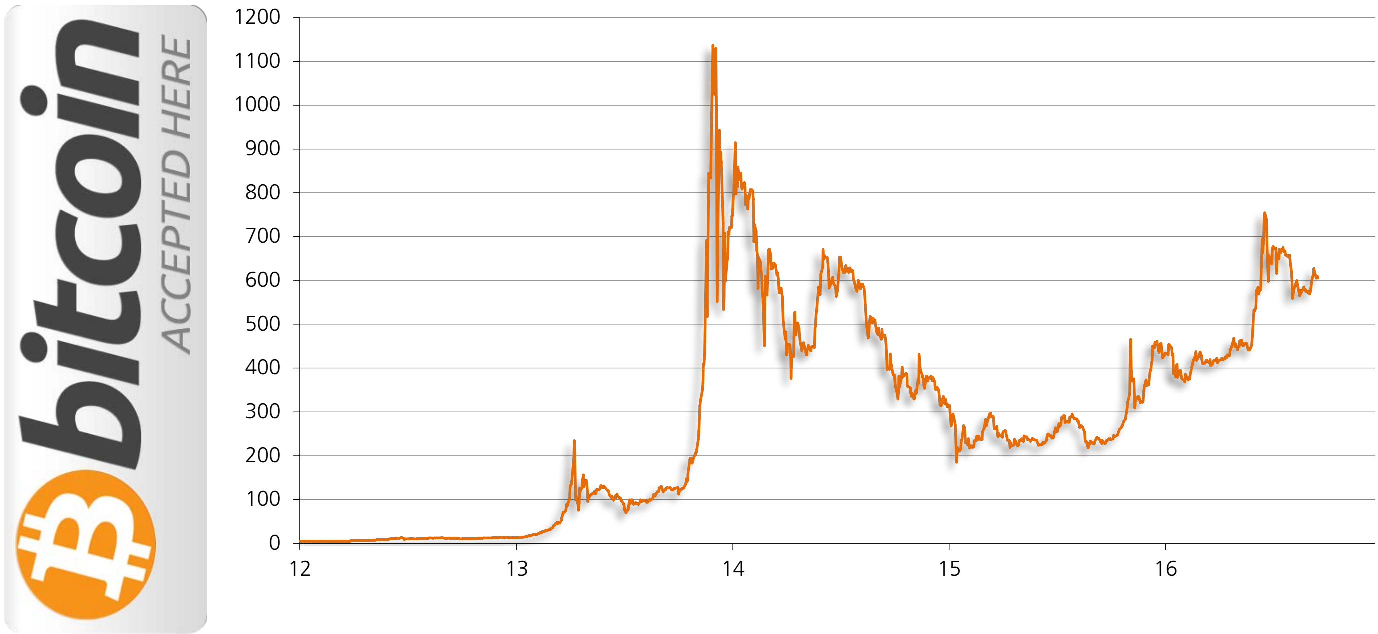
S&P commodity prices (in US-dollar terms)



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

Bitcoin, performance of various asset classes

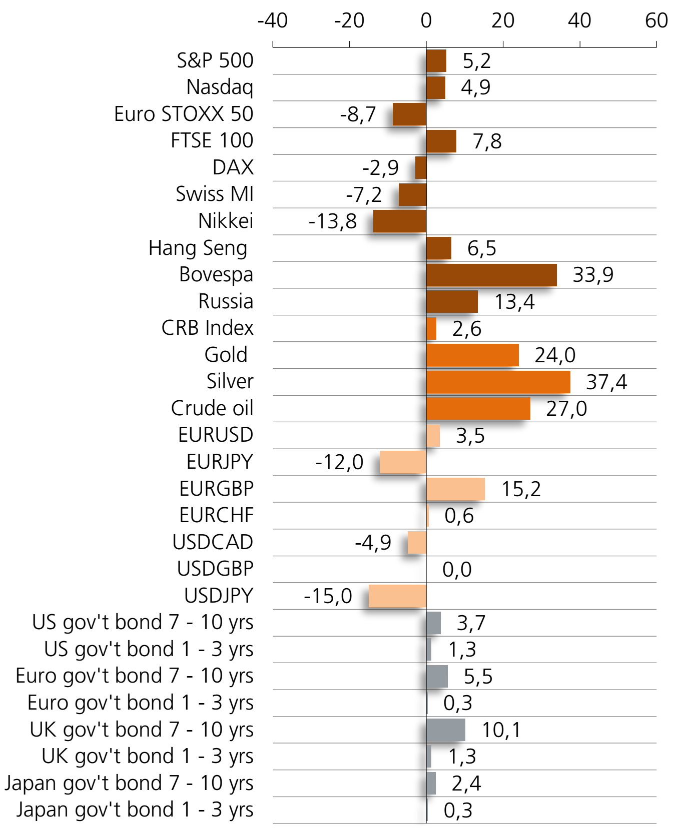
Bitcoin in US-Dollar



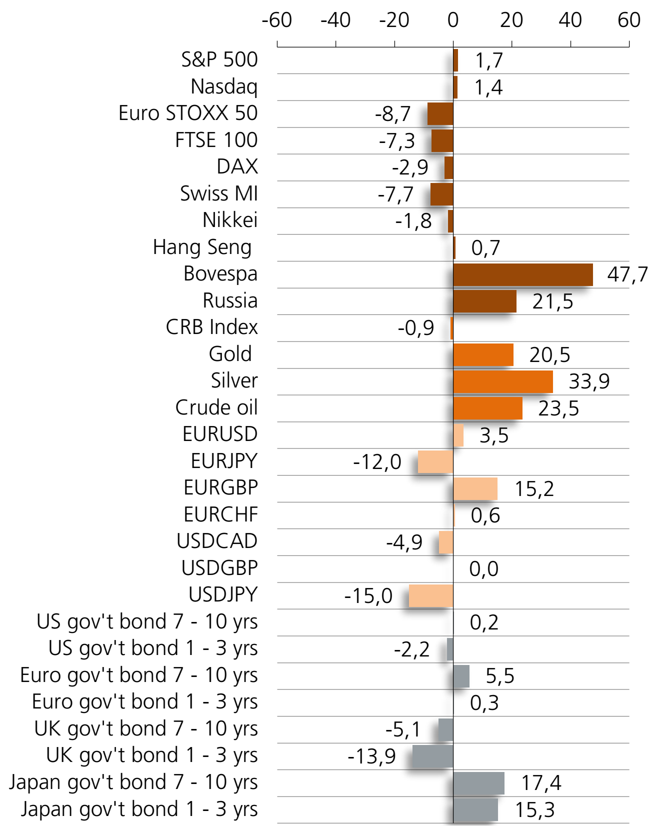
Source: Bloomberg.

Performance of stocks, commodities, FX and bonds

(a) In national currencies



(b) In Euro



Source: Bloomberg; own calculations.

Articles in earlier issues of the *Degussa Market Report*

Issue	Content
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 End 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 2016	The Credit Cycle and the Price of Gold
10 June 2016	US Fed wants to raise rates further - investors should cling to gold and stocks
27 May 2016	The Illusion of Central Bank Independence and the Consequence for the Gold Price
13 May 2016	The Fight Against "Secular Stagnation" and What It Means for Gold and Silver Prices
29 April 2016	US dollar 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'

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

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