Degussa Market Report

23 November 2018 Economics · Finance · Precious Metals

USD per ounce f 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	1.223.0	-0.8	0.0	-4.0
Silver	14.3	-2.8	-7.8	-12.9
Platinum	840.2	-3.1	0.7	-10.7
Palladium	1.146.0	2.7	23.3	13.9
II. In euro				
Gold	1.074.5	-0.7	2.7	0.4
Silver	12.6	-2.7	-5.3	-8.7
Platinum	738.2	-3.2	3.0	-6.3
Palladium	1.007.0	2.7	26.0	19.0
III. Gold price in other currencies				
JPY	137.961.0	-1.1	0.8	-3.8
CNY	8.492.3	0.0	2.0	0.8
GBP	951.4	0.2	2.1	1.0
INR	86.401.4	1.9	3.2	5.1
RUB	80.250.0	-1.5	5.0	7.7

Source: Thomson Financial; own calculations.

OUR TOP ISSUE

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

The Fed Is Not Our Saviour

"I think we have much more of a Fed problem than we have a problem with anyone else", said US President Donald J. Trump on 20 November 2018. While the press, mainstream economists, and bankers cry wolf, the US President hits the nail on its head: The Fed is the source of significant economic and political trouble. By issuing US dollar out of thin air, it sets into motion unsustainable booms, which sooner or later turn into bust.

"I'd like to see the Fed with a lower interest rate. I think the rate's too high. I think we have much more of a Fed problem than we have a problem with anyone else."

US President Donald J. Trump,
20. November 2018, CNBC.

What is more, the Fed, expanding the US dollar quantity through credit expansion, nurtures the "deep state": Providing it with the financial means to buy voter consent; to increase its impact on all walks of peoples' lives; to make possible its aggressive military adventures on a world-wide scale; and to keep alive and kicking its monetary system – that couldn't survive without an ever deeper state.

Viewed from this perspective, is it not good news that the Fed wants to tighten its policy further? Well, the truth is that Fed interest rate changes do not and cannot solve any problems caused by the Fed's meddling with interest rates in the first place. By its very nature, monetary policy inevitably creates economic distortions – which appear in the build-up and bursting of speculative frenzies and the notorious boom and bust cycles.

By reviewing how the Fed has been setting interest rates in the past, you might get the impression that things have become ever more problematic. Just consider Figure 1 a, which shows annual US nominal GDP growth and the Federal Funds Rate in per cent. Eyeballing these two series suggests that the Fed has set its interest rates more or less in line with nominal GDP growth.

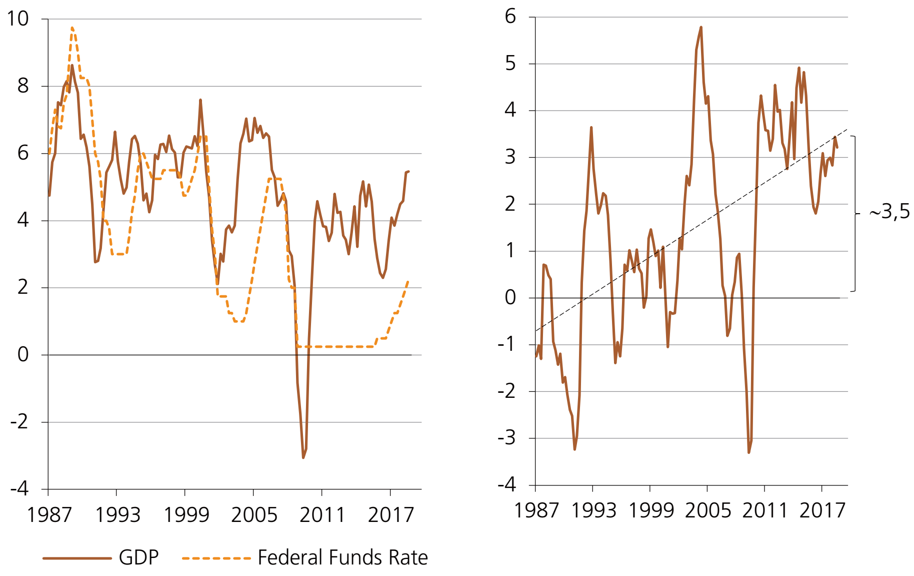
The 'interest rate gap'

Mainstream economists 'would not find any fault with such an interest rate setting. They would argue that the central bank should, in principle, increase its interest rate if and when economic growth accelerates, and it should lower borrowing costs once GDP expansion loses steam. (A formalised version of this viewpoint has been made popular by the concept of "Taylor interest rate rules".)

1 The Fed is getting increasingly expansionary

(a) Annual US nominal GDP growth and Federal Funds Rate in percent

(b) The „interest rate gap" in percentage points [(1)]



Source: Thomson Financial; own calculation. [(1)] Die „

The really interesting finding, however, comes out in Figure 1 b: It shows the difference between annual nominal GDP growth and the Fed's main interest rate in percentage points. Moreover, as we can see, this time series has been drifting upwards: From cycle to cycle, the Fed has allowed the gap between nominal GDP growth and its main refinancing rate to widen. In other words: It appears that the Fed's policy has become increasingly expansionary.

In this context, we have to remind ourselves what artificial lowering of the market interest rate – and this is what the gap between nominal GDP growth and the Fed's main refinancing rate represents – does to the economy. For instance, it inflates asset prices. In the case of stocks, expected future profits are discounted with a lower interest rate, thereby increasing their present value and thus stock prices.

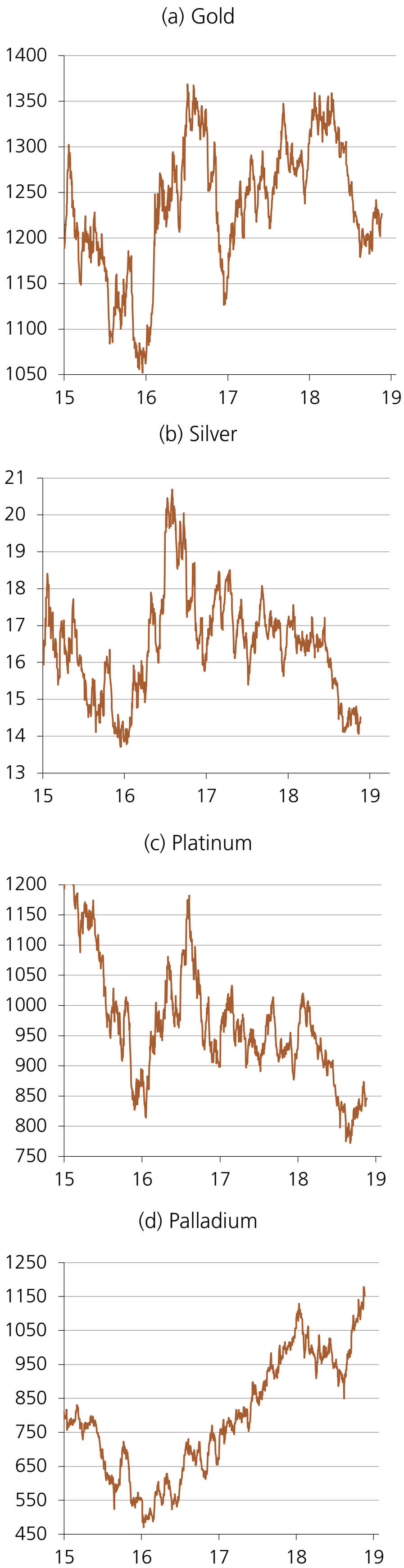
Pretty much the same happens with real estate prices. As asset prices go up on the markets, their value as collateral in credit transactions also rises. Borrowing on the part of asset holders becomes economically more attractive. Lenders, encouraged by collateral gaining in value, ease their lending standards. As a result, rising asset prices set into motion a borrowing and lending spree.

Furthermore, artificially suppressed market interest rates encourage consumption at the expense of savings and induce additional investment. This makes - quite literally speaking - the economy live beyond its means. Initially, output and employment increase. Sooner or later, however, it becomes evident that the "boom" is unsustainable, and that it (other things being equal) inevitably has to turn into "bust".

To fend off the bust, the central bank prevents the artificially lowered interest rate from rising. In fact, to keep the boom going, the central bank has to push the market interest rate to ever lower levels. This is actually what the Fed has been doing for decades: It has set into motion a boom through pushing down market interest rates, and in times of crises, it has lowered borrowing costs even further.

Once the economy recovered, the Fed has raised interest rates, but only very

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



Source: Thomson Financial.

hesitantly. This may explain why the gap between nominal GDP growth and the Fed's key interest rate has grown so substantially over time. With the Federal Funds Rate currently standing in a band of between 2.00 and 2.25 per cent, Figure 1 b would suggest that the Fed's rate hiking spree is pretty close, or has already come, to an end.

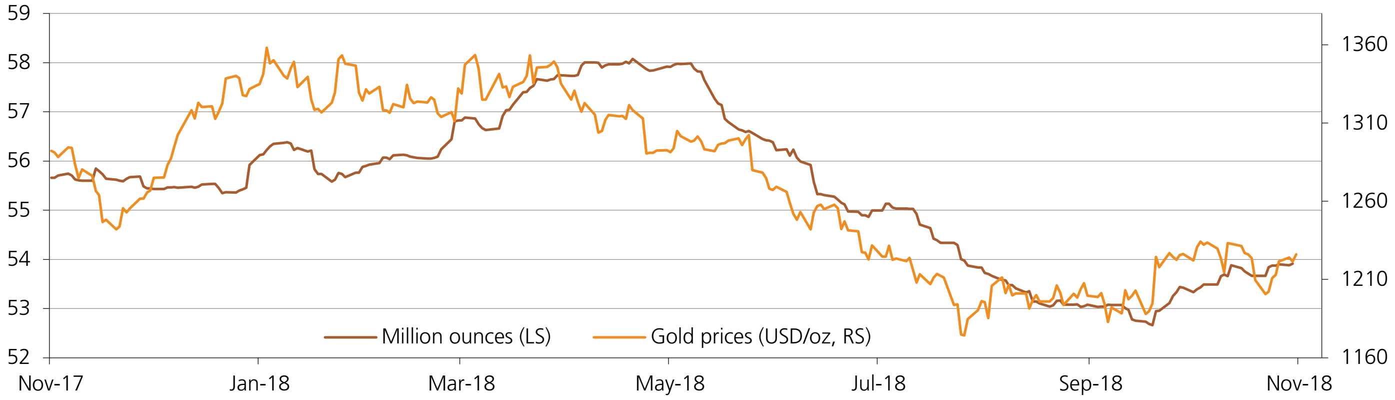
Upside value potential

This conclusion holds an important message for investors, in particular for those thinking about how to structure their portfolio wisely. Monetary policy – not only in the US but also in other currency areas – can be expected to remain inflationary: that is central banks will do their best to keep the quantity of money expanding. In a very low interest rate environment, this will most likely result in a chronic debasement of the purchasing power of currencies.

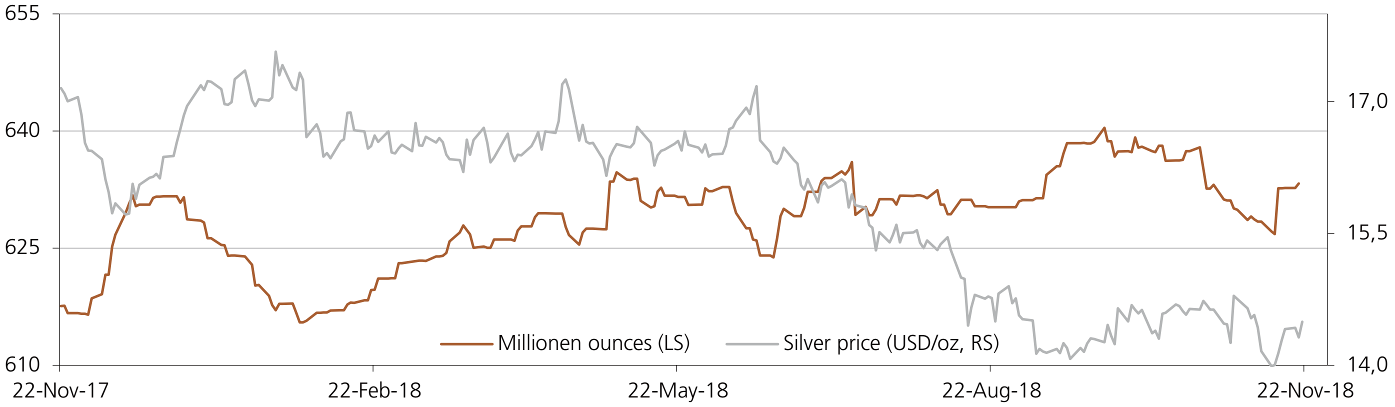
Investors who wish to keep a part of their portfolio in liquid means have good reason to consider gold as a viable option. Generally speaking, gold cannot be debased by monetary policies, and it does not – in contrast to bank deposits – carry any default, or counterparty, risk. By no means less important, gold does not seem to be expensive at current prices. That said, we may say that gold is a portfolio insurance with upside value potential.

Precious metals prices and ETF holdings

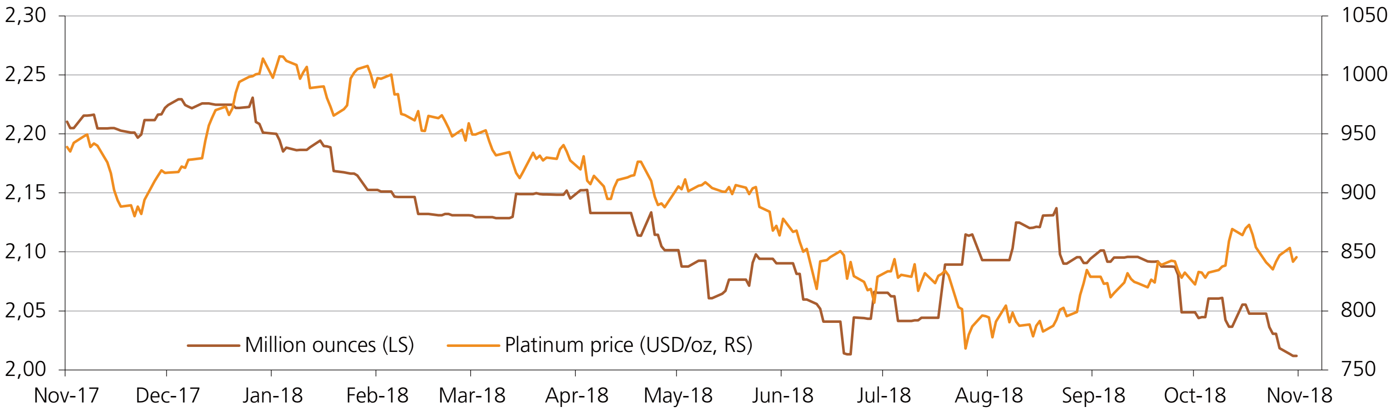
Gold ETFs (million ounces) und gold price (USD/oz)



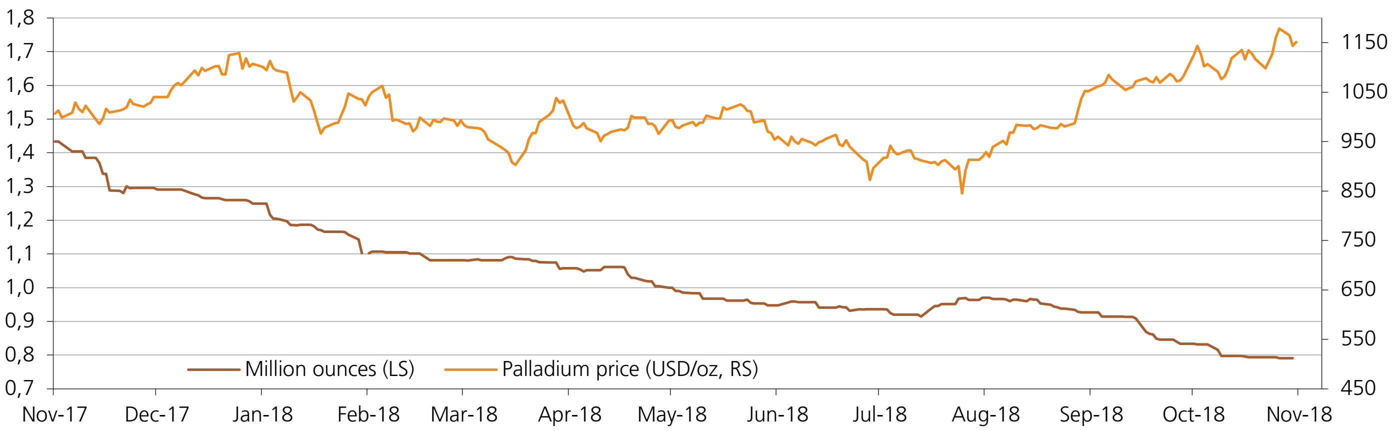
Silver ETFs (million ounces) and silver price (USD/oz)



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	1222.6		14.3		840.2		1146.0	
II. Gliding averages								
5 days	1221.6		14.4		842.0		1157.4	
10 days	1215.2		14.3		846.4		1137.6	
20 days	1222.2		14.4		847.8		1122.4	
50 days	1213.0		14.5		833.8		1086.3	
100 days	1213.5		14.8		822.6		1009.2	
200 days	1262.8		15.7		872.5		997.2	
III. Bandwidths for 2018	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1248	1472	16.0	21.0	936	1048	1033	1261
(1)	*2*	*20*	*12*	*47*	*11*	*25*	*-10*	*10*
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

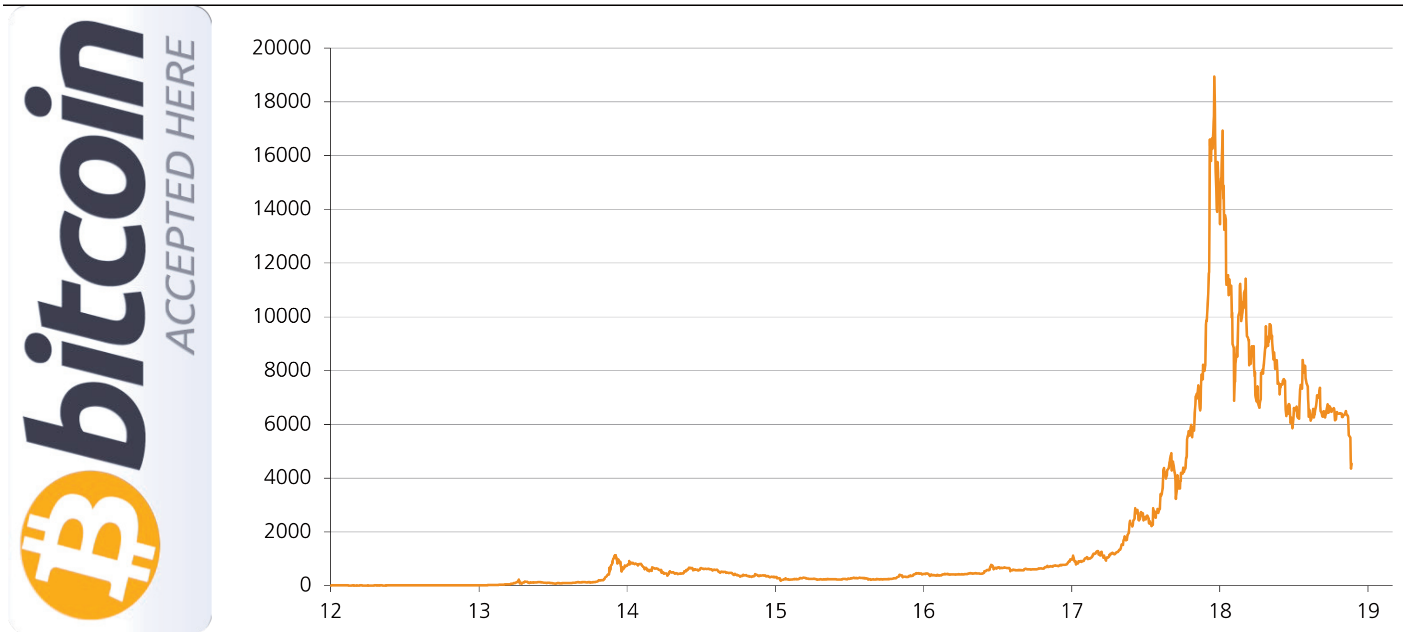
	Gold		Silver		Platinum		Palladium	
I. Actual	1074.6		12.6		738.5		1007.3	
II. Gliding averages								
5 days	1072.1		12.6		739.0		1015.7	
10 days	1069.8		12.6		745.1		1001.4	
20 days	1074.5		12.7		745.3		986.7	
50 days	1054.4		12.6		724.8		944.5	
100 days	1049.9		12.8		711.7		873.6	
200 days	1069.9		13.3		738.8		846.1	
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*	*19*	*10*	*44*	*10*	*23*	*-11*	*8*
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

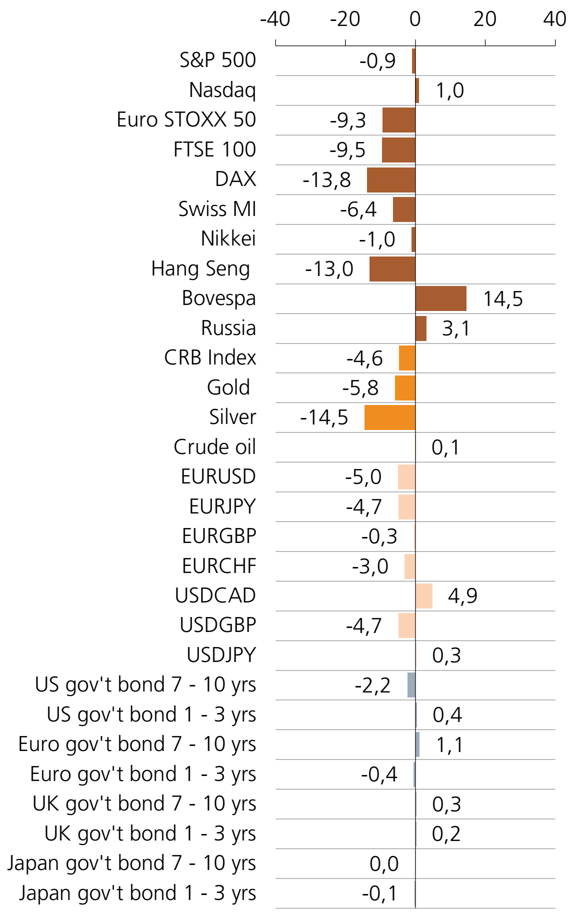
Bitcoin in US dollars



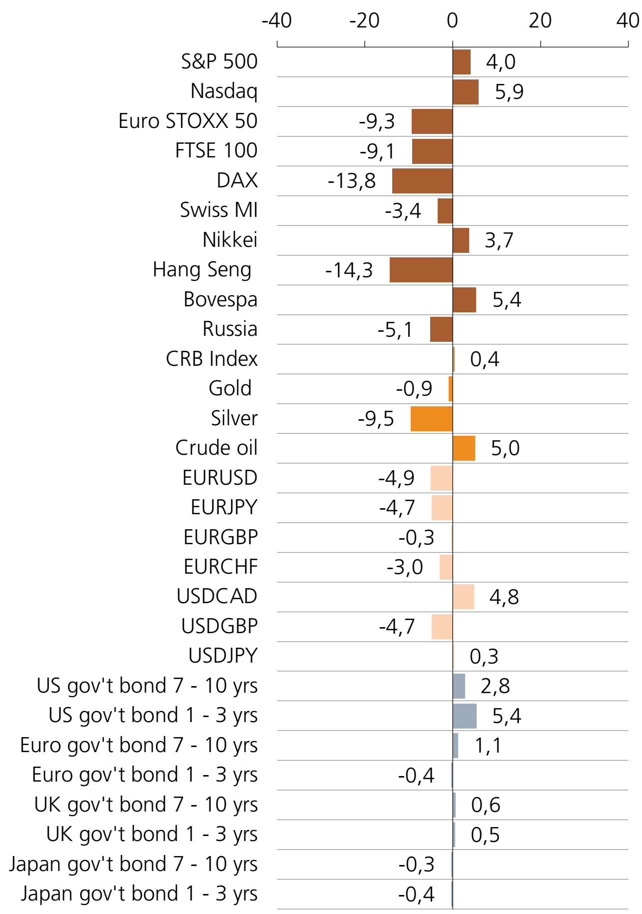
Source: Thomson Financial.

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*

Issue	Content
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