Degussa Market Report

27 April 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	1.316.7	-2.1	-1.2	4.1
Silver	16.5	-0.7	-0.9	-4.4
Platinum	905.5	-2.4	-9.4	-2.3
Palladium	983.8	-0.3	-7.3	19.5
II. In euro				
Gold	1.088.7	-0.2	0.6	-3.5
Silver	13.6	1.3	1.0	-11.3
Platinum	748.7	-0.7	-7.7	-9.8
Palladium	813.0	1.9	-5.6	10.5
III. Gold price in other currencies				
JPY	143.899.0	-0.3	1.0	2.1
CNY	8.346.1	-1.1	-0.8	-3.0
GBP	946.3	0.2	-0.8	-3.7
INR	87.897.6	0.2	1.8	7.8
RUB	82.468.3	-1.1	11.3	15.6

Source: Thomson Reuters; own calculations.

OUR TOP ISSUE

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

Moving Towards Higher Gold Prices

If you were to ask me 'What do you think is currently the most important factor for the gold price?', my answer would probably be: *the interest rate*. On the one hand, the interest rate represents the opportunity costs for holding gold. Generally speaking, the higher the interest rate is, the costlier it is to hold gold, as the gold holder foregoes interest income. That said, rising interest rates would argue for lower gold demand and thus lower gold prices and vice versa.

On the other hand, the interest rate plays the pivotal role for the stability of the economic and financial system. Central banks' artificially low interest rate policies have been instrumental for bringing about the current boom of the world economy. By pushing interest rates down, monetary policymakers have provided significant relief to financially ailing banks and governments and, in particular, inflated prices for stocks and housing prices.

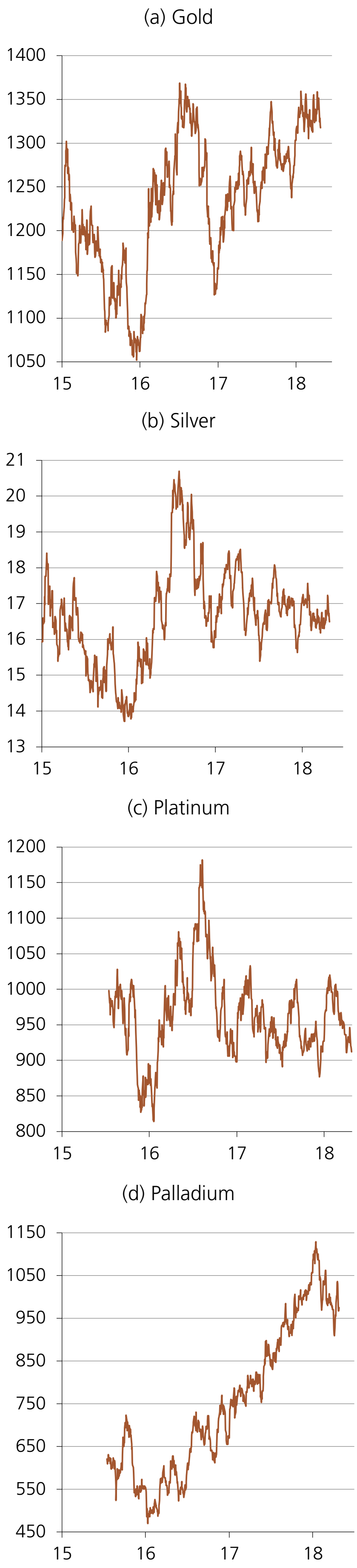
But now the US Federal Reserve has embarked upon an interest rate hiking spree, gradually increasing borrowing costs. This will not be without more extensive effects for the economic and financial system, not only in the US but worldwide. As interest rates go up, asset prices will come under pressure. For instance, future corporate profits will be discounted with higher interest rates, reducing their fair value and thus their market price. What is more, firms will realise that some of their investment returns will fall short of expectations, and certain investments will turn out to be outright failures.

Needless to say that borrowers – consumers, firms, and governments alike – will be hit hard as credit costs go up. They will have to refinance their maturing loans at higher interest rates, and this will reduce their spending power. At the same time, most peoples' 'balance sheet' deteriorates if and when higher interest rates lower the prices for stocks and real estate. Taken together, higher interest rates would most likely dampen economic activity. A slowing down of the economies as interest rates rise would be the positive scenario, though.

The negative scenario would be that central banks will hike "too much", that they will increase interest rates to a level that will push the economy over the cliff. This is by no means an unlikely possibility in view of the more recent experiences with central banking. Take, for instance, the "New Economy Boom", which was initiated by the Fed's very lax monetary policy in the first place, before the Fed itself burst the bubble by implementing a restrictive policy. The same could be observed in the credit market bubble, which became the biggest economic and financial crisis in the Post WW II period.

But is there not a chance that central banks will do the right thing? That they will succeed in bringing interest rates to the 'right level'? Unfortunately, the

Precious metal prices (USD/oz)



Source: Thomson Financial.

chances are pretty slim. This is because no one knows where the 'right level' is. Policymakers follow a 'trial and error' process. Once they realise that an error has been made on their side, it is already too late – as at that point in time the economy is already tanking. That said, it brings some serious risks to the economy and the financial system if and when central bankers meddle with the interest rate.

However, dealing with inflation – in the form of consumer price and/or asset price inflation – will presumably remain the biggest challenge for investors going forward. For if the current rate hiking cycle turns out to provoke yet another recession, central banks would most likely rush to change course, switching back to an ultra-loose monetary policy. Or central banks stop tightening policy soon. In both cases interest rates would return to or remain at artificially low levels, making the continuation of inflation of consumer and/or asset prices a likely scenario.

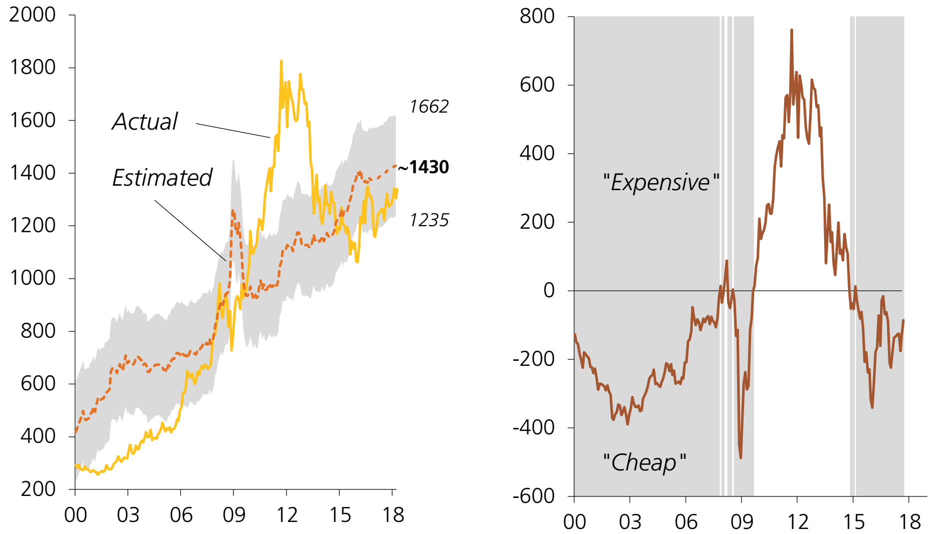
Against this backdrop, the savvy investor has good reasons to take a look at gold. Other than bank deposits and short-term debt instruments the yellow metal does not entail a credit, or counterparty, risk, protecting against a "system crash". What is more, gold cannot be debased by monetary policy – in contrast to fiat currencies. These two properties make gold the "ultimate means of payment" and an effective portfolio insurance against the vagaries of central bank policies. This brings us back to the importance of the interest rate for the price of gold.

A further increase in interest rates would no doubt come with higher risks for economic and financial stability – and it is not too far-fetched to assume that this could be quite supportive for the price of gold, especially in view of the currently rather suppressed credit default and inflation premia in the markets. This conjecture comes with a macroeconomic data set suggesting that the current price of gold trades relatively cheaply – making gold a portfolio insurance with upside value potential – an attractive perspective for the long-term oriented investor.

1 Long-run estimates: price of gold is relatively cheap

(a) Gold price (USD/oz), actual and estimated[(1)]

(b) Deviation of actual from estimated price (USD/oz)



Source: Thomson Financial; own calculations. [(1)] Estimation period: January 1971 to March 2018. Explanatory variables: quantity of money, real short-term interest rates and a credit spread. Grey area: Estimation error.

Gold In Art

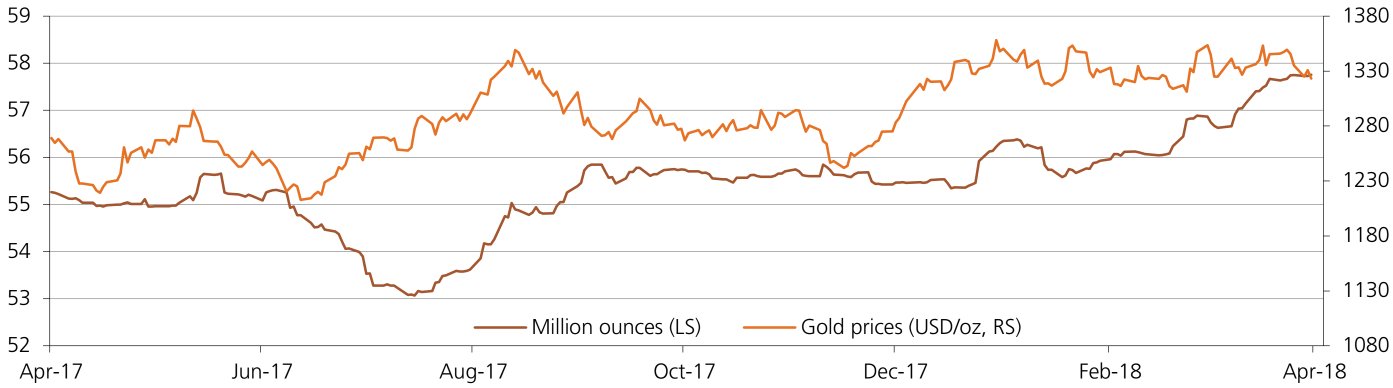
Roni Horn, *Gold Field*

Between 1980 and 1982, the American photo- and object artist Roni Horn (born 1955) created Gold Field: a sculpture in the form of a sheet of 99.9% gold (124.5 x 152.4 x 0.002 cm). Horn has been fascinated by gold since childhood and is mesmerised by the multifaceted mythological and economic significance of the yellow metal, its "simple physical reality". Gold Field is on display in the Solomon R. Guggenheim Museum in New York.

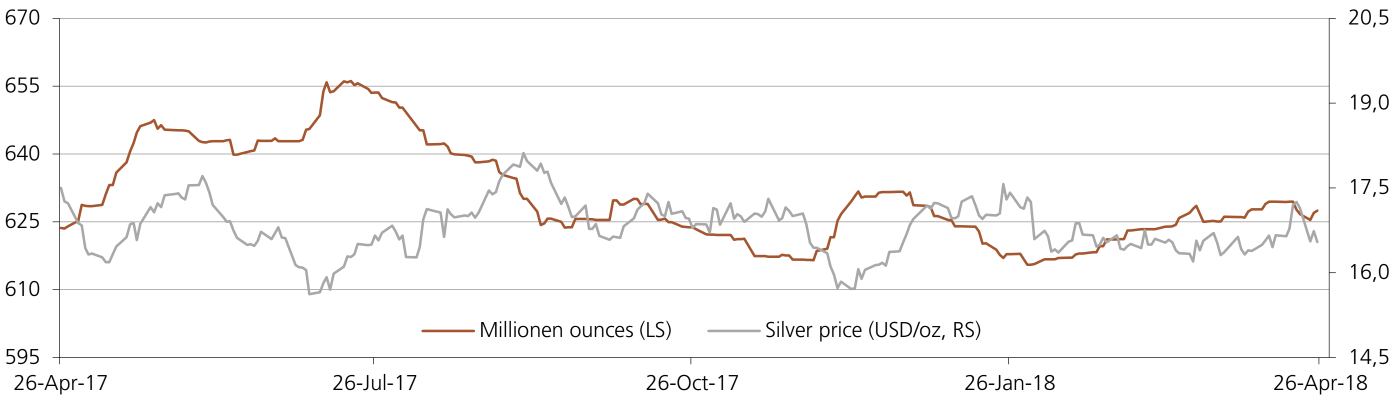
Dr Ruth Polleit Riechert, Art Historian (www.rpr-art.com).

Precious metals prices and ETF holdings

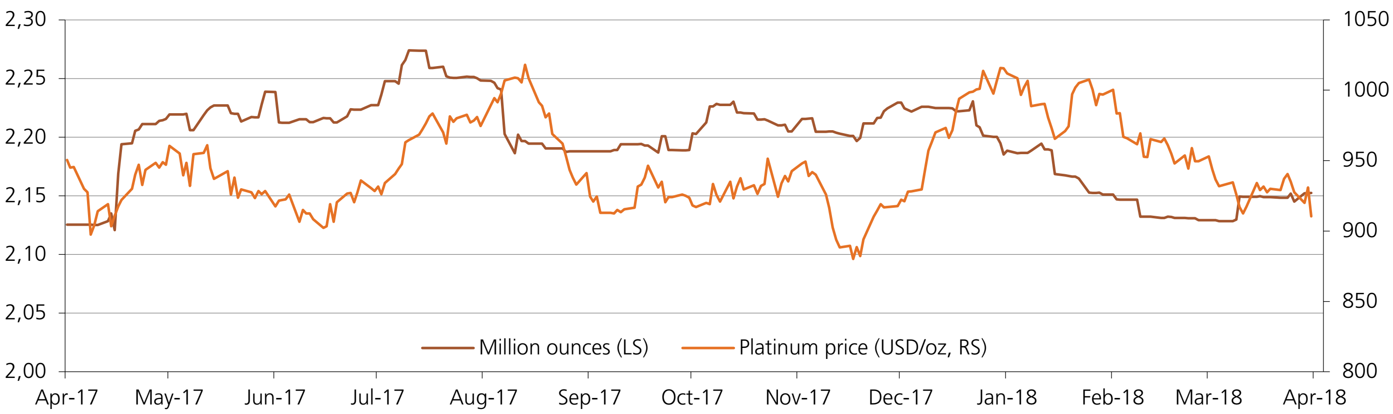
Gold ETFs (million ounces) und gold price (USD/oz)



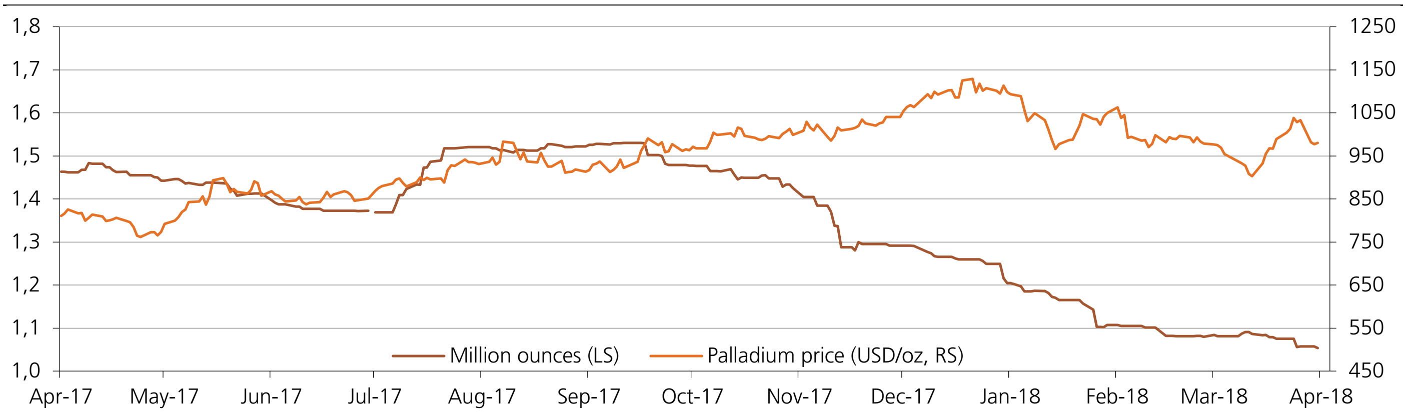
Silver ETFs (million ounces) and silver price (USD/oz)



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	1316.6		16.5		902.2		983.5	
II. Gliding averages								
5 days	1333.6		16.4		918.6		924.8	
10 days	1331.4		16.4		926.7		945.7	
20 days	1330.0		16.4		939.6		966.7	
50 days	1329.6		16.5		964.1		994.9	
100 days	1313.6		16.6		955.6		1023.3	
200 days	1297.1		16.8		949.5		976.5	
III. Bandwidths for 2018	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1248	1472	16.0	21.0	936	1048	1033	1261
(1)	*-5*	*12*	*-3*	*27*	*4*	*16*	*5*	*28*
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

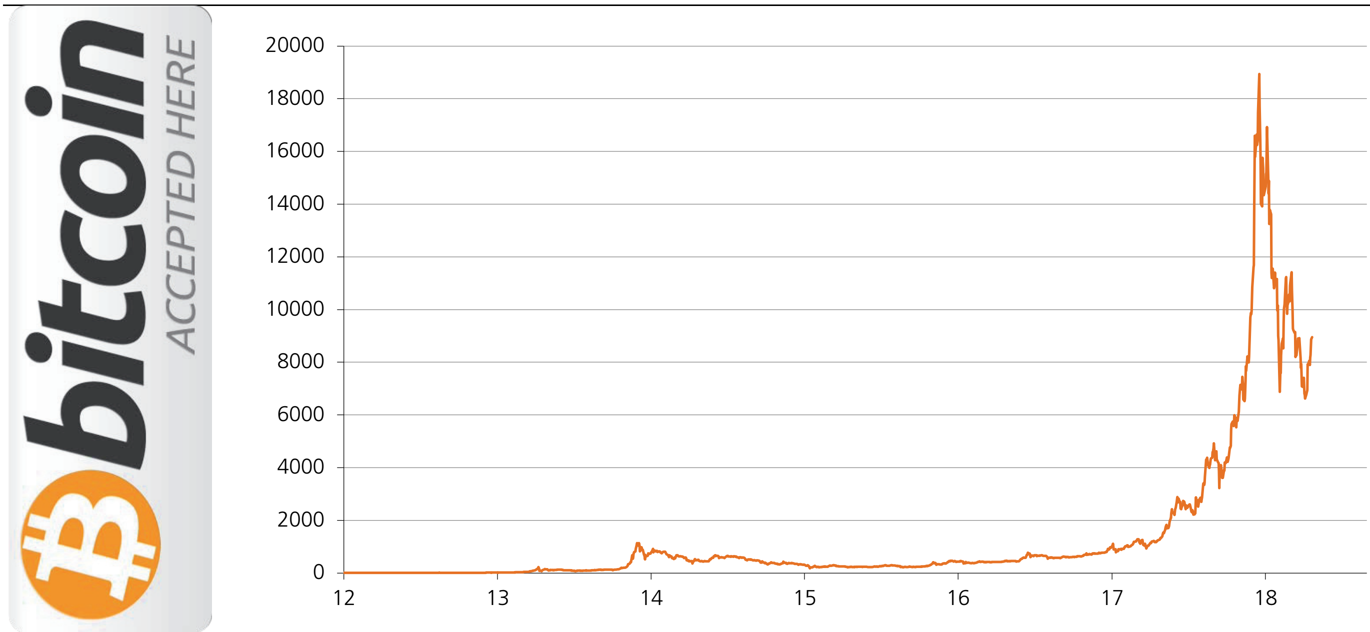
	Gold		Silver		Platinum		Palladium	
I. Actual	1089.0		13.6		746.3		813.5	
II. Gliding averages								
5 days	1085.1		13.4		747.4		752.5	
10 days	1082.6		13.3		753.5		768.9	
20 days	1079.9		13.3		762.9		784.9	
50 days	1078.2		13.4		781.8		806.7	
100 days	1080.0		13.7		785.6		841.7	
200 days	1084.9		14.0		794.2		816.5	
III. Bandwidths for 2018	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1069.2	1260.5	13.7	18.0	801.7	897.9	884.5	1080.0
(1)	*-2*	*16*	*0*	*32*	*7*	*20*	*9*	*33*
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

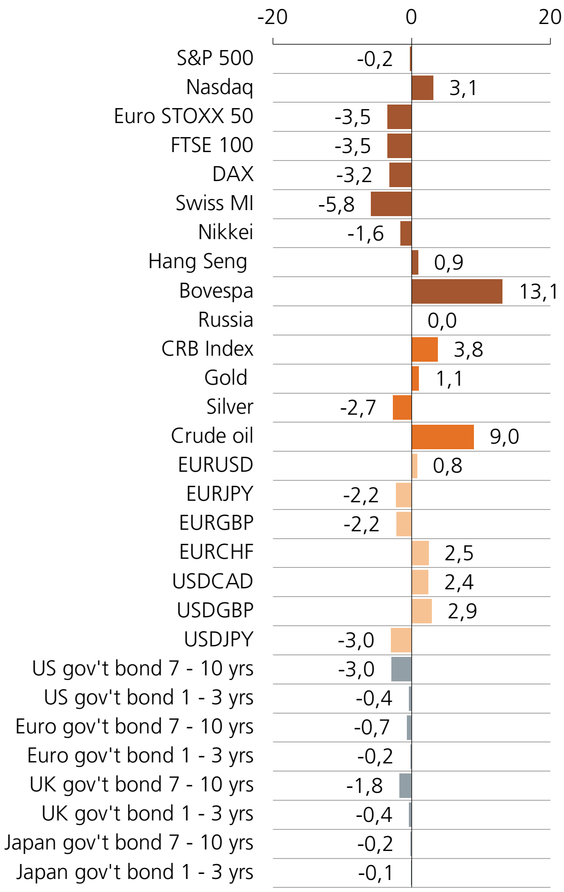
Bitcoin in US dollars



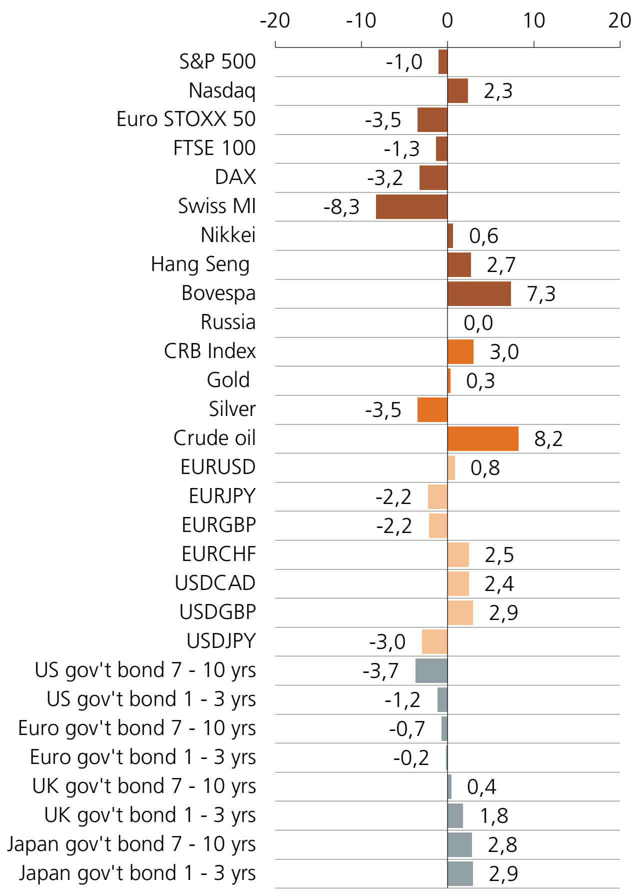
Source: Thomson Financial.

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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11 November 2016	Trump Election Puts Euro Under Pressure
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16 September 2016	Central Banks May Choose Helicopter Money Over Negative Rates

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