Degussa Market Report

27 October 2017 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	1.267.6	-2.0	-1.8	8.1
Silver	16.8	-2.2	-1.5	1.9
Platinum	916.0	-1.8	-5.8	0.5
Palladium	970.5	-0.3	4.5	26.1
II. In euro				
Gold	1.087.5	-0.5	0.4	-1.8
Silver	14.4	-0.7	0.8	-7.5
Platinum	785.8	-0.4	-3.7	-8.2
Palladium	831.0	1.1	6.7	14.3
III. Gold price in other currencies				
JPY	144.465.0	-0.5	2.3	7.6
CNY	8.415.7	-1.2	-1.9	4.2
GBP	963.4	-1.2	-3.8	2.7
INR	82.176.6	-2.3	-0.5	2.1
RUB	73.327.0	-1.8	-3.0	-2.5

Source: Thomson Reuters; own calculations.

OUR TOP ISSUES

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

The Interest Rate Becomes A „Crash Factor“

The US Federal Reserve (Fed) is on an interest rate hiking spree. It has started raising rates in December 2015, and since then it has pushed the Federal Funds Target Rate from a band of 0,0 – 0,25 percent to 1,00 – 1,25 percent. What is more, the Fed has also started shrinking its balance sheet as from October by basically not reinvesting the redemption it receives on its US Treasury and Agency MBS portfolio. Meanwhile, the European Central Bank (ECB) is also sending signals, suggesting that it wants to take its foot somewhat off the monetary policy gas pedal (even though raising rates is not entirely around the corner yet).

Are we headed for a full-fledged interest rate hiking cycle? Well, it seems so. But wait: *Maybe this time it is different?* Asking such a question is undoubtedly justified because the current economic upswing has been accompanied, if not induced, by a monetary policy of ultra-low interest rates. Easy credit conditions have spurred credit-financed consumption and investment, and have translated into higher production and employment. What is more, extremely low interest rates have inflated asset prices – such as the prices of stocks and real estate in particular.

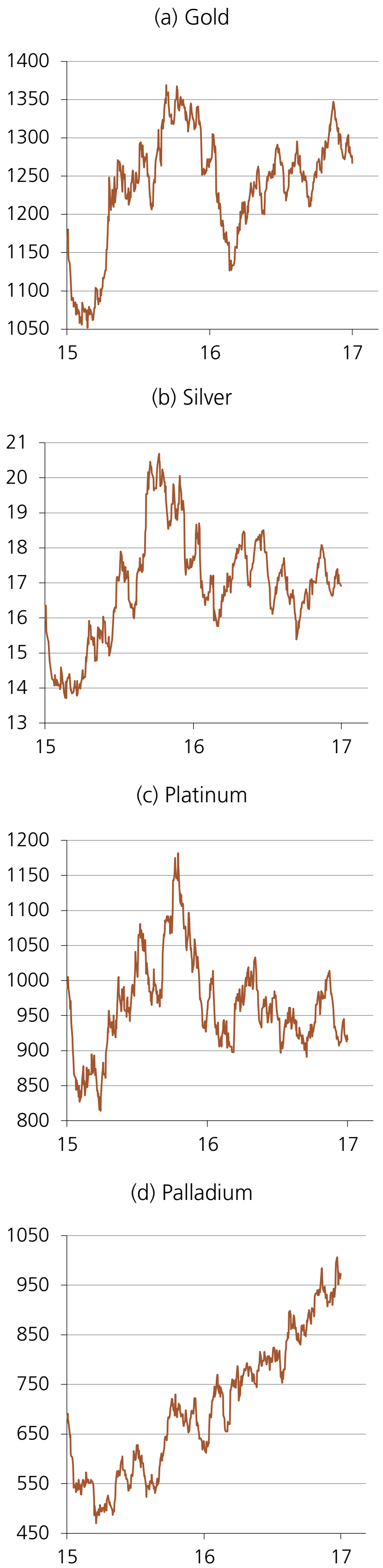
The ‘safety net’

Perhaps most important, central banks have put out a ‚safety net‘: They seem to be determined to fend off a new economic crisis and a financial market downturn by all means necessary. This at least appears to be the conclusion many investors have drawn from central bank policies delivered in the last decade. Why else would borrowing costs have remained suppressed, credit spreads narrowed, and financial market stress indicators as well as stock market volatility measures fallen to record lows? In other words: Risk premia have been effectively squeezed out of the price action in financial markets. This is, however, a rather dangerous development.

The truth is that central banks’ safety nets have caused a price distortion on an epic scale. This, in turn, has allowed the debt binge to continue. According to data provided by the Bank for International Settlement (BIS), at the end of 2007, total debt of the private sector (excluding financial institutions) and public sector stood at 212% of the world's Gross Domestic Product (GDP). At the end of 216, it was 265%. *The world economy has thus not de-leveraged, it has actually increased its leverage!* Of course, this was only possible by central banks’ excessively expansionary monetary policies. Against this backdrop, the pressing question is: What is going to happen if interest rates go up?

Higher interest rates have the potential to prick the bubble and make the credit pyramid coming crashing down. A rise in interest rates would make it hard for many consumers to service their debt, would reveal malinvestment and result in

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

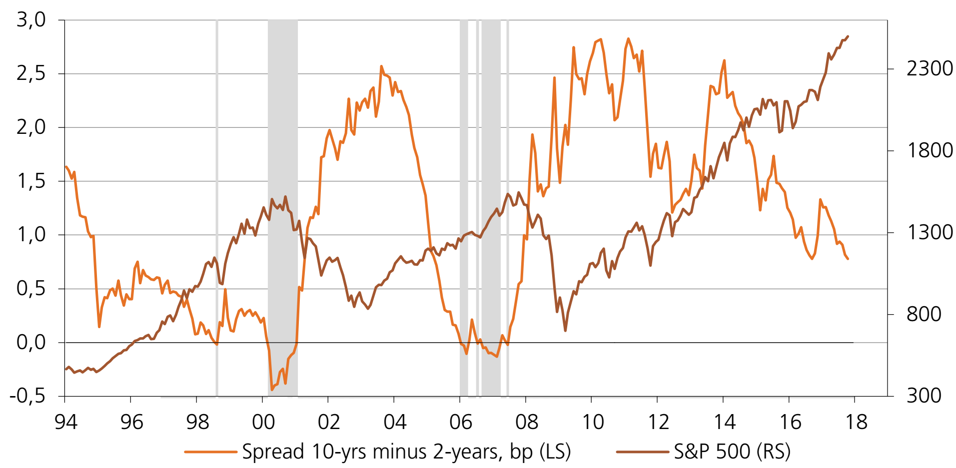


Source: Thomson Financial.

corporate losses, and stock and housing prices would ultimately follow the law of gravity. Credit markets could become jittery as borrowers run the risk of defaulting on their debt, with banks having limited capacity to absorb payment losses in their loan books. These examples may suffice to illustrate a scenario in which central banks take away the Halloween candy (aka low interest rates).

Maybe interest rates will go up just a little bit? Well, the Fed pursues a policy of for bringing interest rates back up very slowly. Presumably, it hopes that this makes it easier for the economy to adjust to a regime of higher interest rates. By doing so, the Fed might perhaps shave of some growth points, but it might prevent a crash. The Fed's slow and gradual approach to tighten monetary policy is reducing the risk that it could „be raising interest rates too much too fast", pricking the bubble, and bringing down the house of (credit) cards. However, the risk remains that the Fed will mess things up.

1 A flattening yield curve might become a problem for stock prices
Share of the US yield curve and S&P 500



Source: Thomson Financial; own estimates. Grey area: Long-term yield is equal, or below, short-term yield.

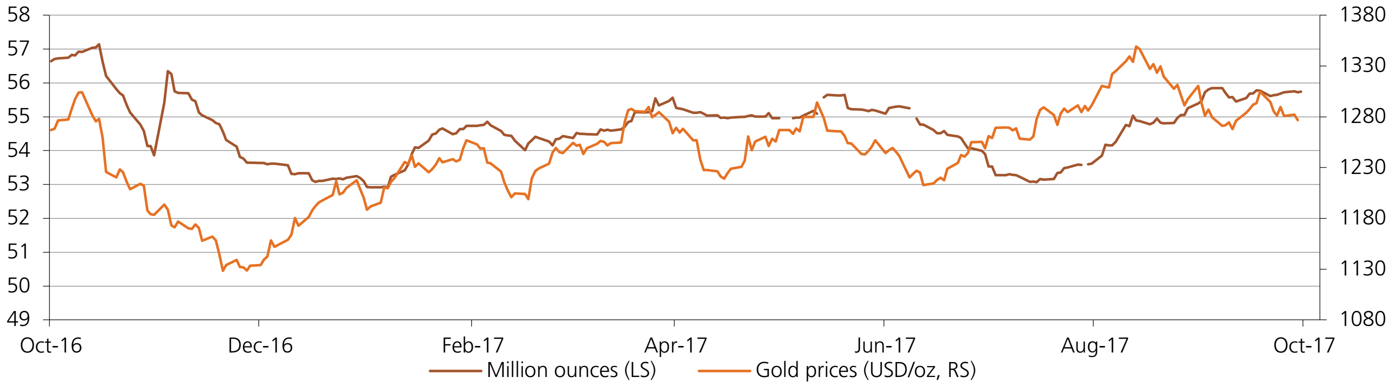
A smart case for portfolio insurance

Let us be honest: Given central banks' track records, there is fairly little - actually, next to no - reason for investors to expect monetary policy makers to do the right thing. In fact, central banks have been the very source of speculative bubbles, artificial booms, and the debasement of the money, subsequently bursting bubbles and turning booms into bust. After many years of excessively low interest rates, aggressive debt expansion and, most notably, a near-collapse of risk premia in financial markets, the monetary policy of raising interest rates is increasing the risk that something that has to come down at some point will inevitably come down sooner rather than later.

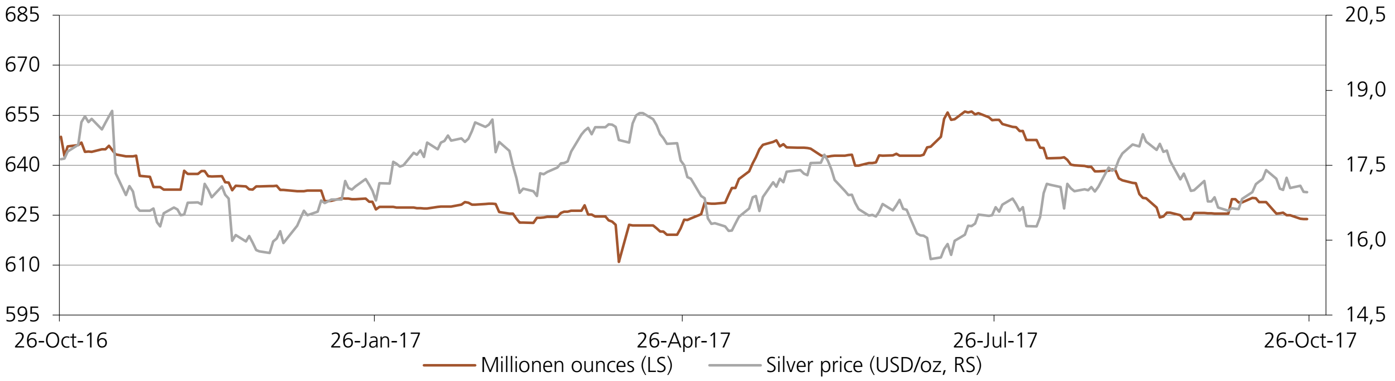
The prudent investor may not jump ship yet. But he/she is well advised to seek an insurance against "central bank policy causing big trouble". One option is holding gold and silver. The investor can be assured that the purchasing power of the yellow metal cannot be reduced by central bank action. Furthermore, gold does not carry a default or payment risk like, say, bank deposits or short-term debt paper. By no means less important: Given its current price, gold can be viewed as effective portfolio insurance, providing the investor with an upside price potential. It gives the investor the chance to sell gold at an elevated price in times of crisis and buy great assets at depressed prices from the proceeds – thereby increasing the investor's return on investment considerably.

Precious metals prices and ETF holdings

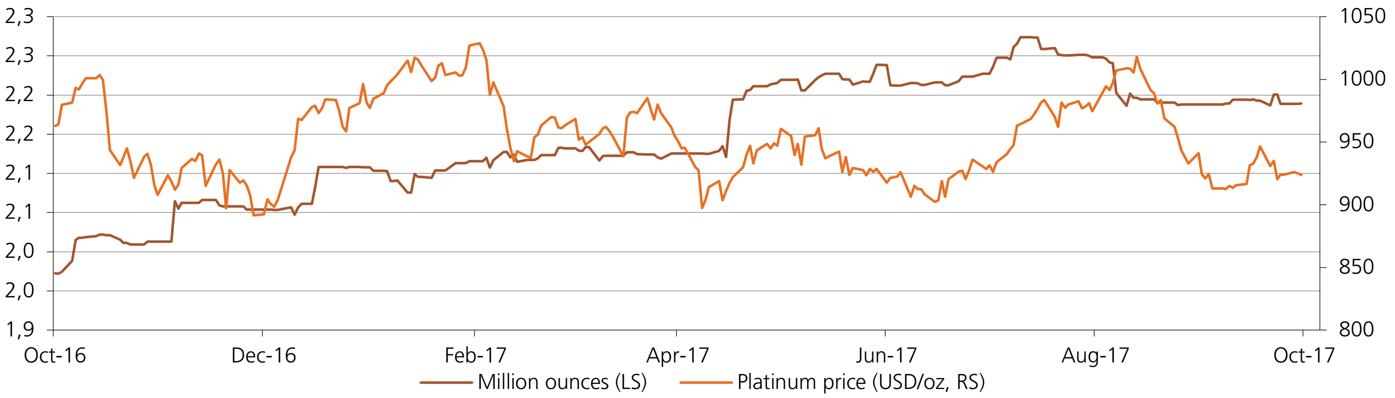
Gold ETFs (million ounces) und gold price (USD/oz)



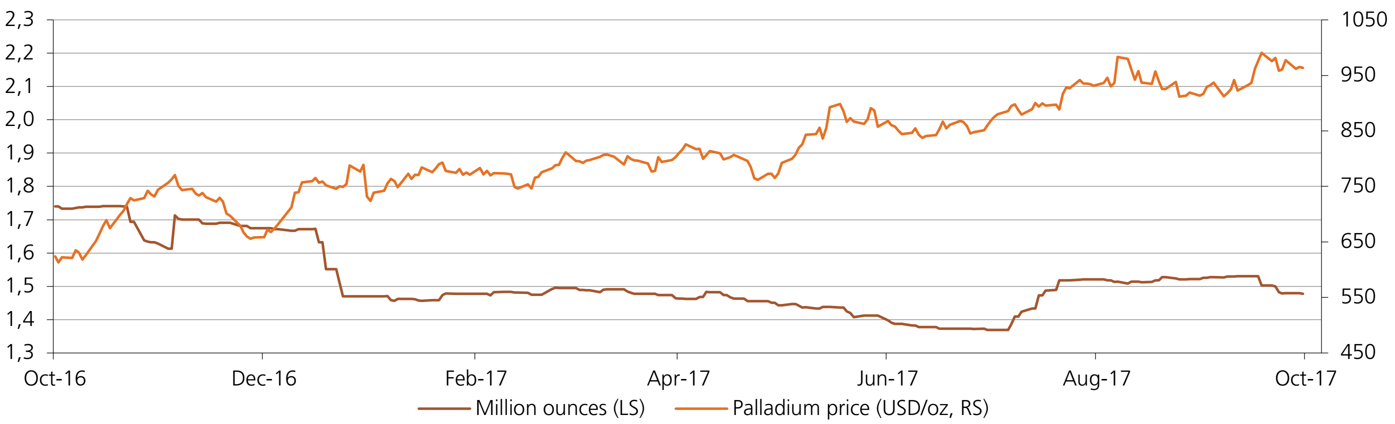
Silver ETFs (million ounces) and silver price (USD/oz)



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	1268.2		16.8		913.3		970.3	
II. Gliding averages								
5 days	1279.5		17.0		918.2		965.6	
10 days	1285.7		17.1		926.3		976.9	
20 days	1282.8		17.0		921.2		954.1	
50 days	1300.2		17.2		953.4		942.5	
100 days	1275.6		16.9		942.8		906.5	
200 days	1259.4		17.2		953.6		846.2	
III. Projections for 2017	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1148.0	1390.0	15.9	23.0	906.0	1100.0	700.0	900.0
IV. Annual averages								
2013	1429		24		1487		724	
2014	1260		19		1382		800	
2015	1163		16		1065		706	
2016	1242		17		985		617	

In euro

	Gold		Silver		Platinum		Palladium	
I. Actual	1087.4		14.4		783.0		831.9	
II. Gliding averages								
5 days	1085.1		14.4		778.7		818.9	
10 days	1089.9		14.5		785.2		828.1	
20 days	1088.7		14.4		781.7		809.7	
50 days	1097.0		14.5		804.4		795.3	
100 days	1093.4		14.4		808.1		776.8	
200 days	1122.3		15.3		850.8		752.2	
III. Projections for 2017	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1000.4	1211.3	13.8	20.0	789.5	958.6	610.0	784.3
IV. Annual averages								
2013	1079		18		1123		547	
2014	945		14		1035		601	
2015	1044		14		955		633	
2016	1120		15		888		557	

Source: Thomson Financial; own calculations and estimates.

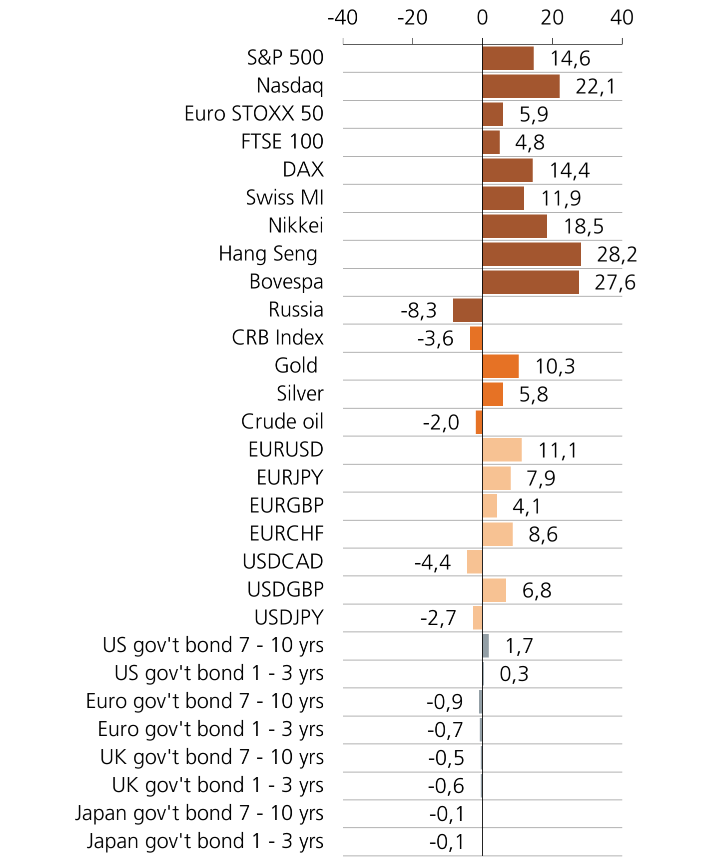
Bitcoin, performance of various asset classes

Bitcoin in US dollars

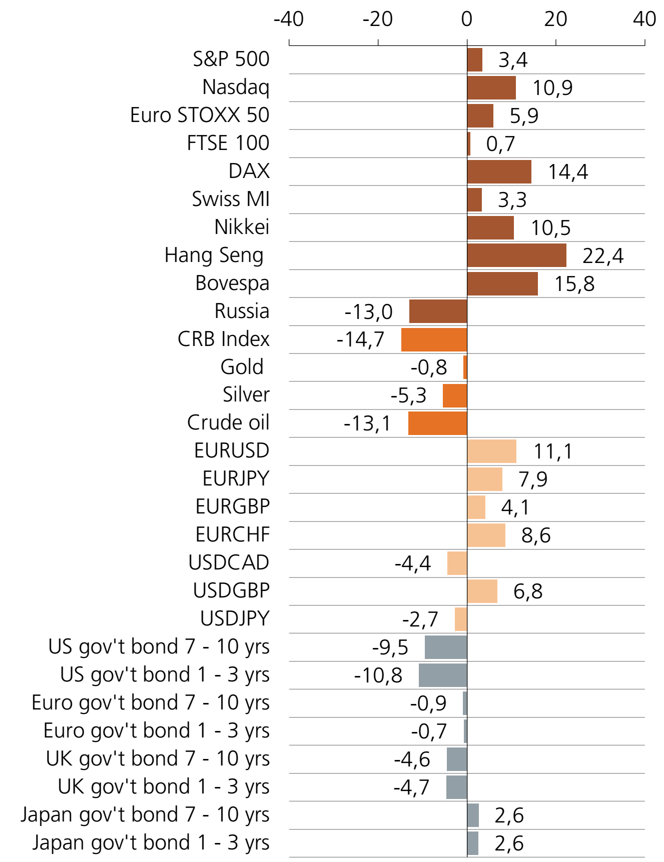
Source: Thomson Financial.

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
27 October 2017	The Interest Rate Becomes A "Crash Factor"
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29 September 2017	The German Election Outcome Might Turn Up The Heat On The Euro
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18 August 2017	Gold in Times of Boom and Bust
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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*
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24 June 2014	The Credit Cycle and the Price of Gold
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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

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