Degussa Market Report

28 March 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	1.346.8	1.7	0.4	6.2
Silver	16.5	-0.5	-3.1	-3.9
Platinum	947.0	-1.8	-5.9	0.4
Palladium	976.5	-1.9	-10.6	18.6
II. In euro				
Gold	1.090.1	1.4	0.0	-6.3
Silver	13.4	-0.8	-3.1	-15.2
Platinum	766.5	-2.2	-6.1	-11.5
Palladium	790.0	-2.3	-11.0	4.5
III. Gold price in other currencies				
JPY	141.033.0	-0.2	-4.6	-0.2
CNY	8.499.4	1.5	-1.0	-2.7
GBP	952.5	-0.3	-0.5	-2.7
INR	87.512.5	1.5	2.4	7.4
RUB	77.066.2	2.8	2.0	6.8

Source: Thomson Reuters; own calculations.

OUR TOP ISSUE

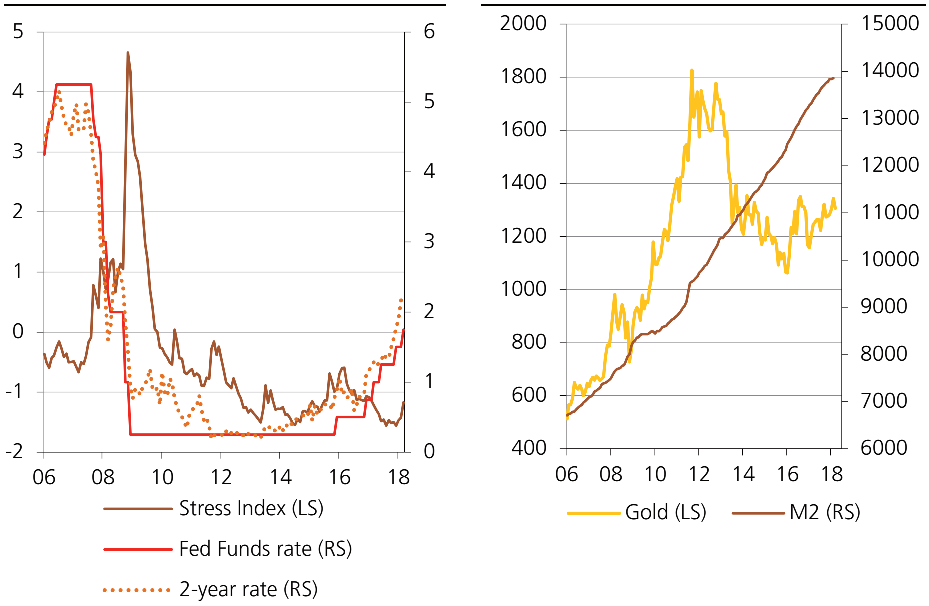
This is a short summary of our fortnightly ***Degussa Marktreport****.*

Walking the Tightrope

On 21 March 2018, the US Federal Reserve (Fed) has raised its key interest rate by another 25bp, bringing the target range for the Federal Funds Rate to 1.50 – 1.75 percent. Perhaps most interestingly, short-term US-rates have gone up quite substantially since 2017, while investor risk awareness has remained relatively subdued – as evidenced by the financial market stress indicator (fig. 1a). The price of gold has continued its upward movement, which set in in 2016, accompanied by an ongoing rise in the quantity of money (fig. 1b).

1 Interest rates, money supply and the price of gold

(a) US interest rates in percent and financial market stress indicator[1] (b) Price of gold (USD/oz) and US money stock M2, bn US-Dollar[2]



Source: Thomson Financial; own calculations. [1] Federal Reserve Bank of St. Louis. It the line goes up (down), market stress increases (declines). [2] Calculated with gov't bonds.

Generally speaking, higher interest rates would argue for lower gold prices: If interest rates rise, the *opportunity costs* of holding gold increase (and vice versa): People forgo interest income they could earn holding interest-bearing securities. At the same time, however, higher interest rates increase the risk of the economic and financial system being hit by a new crisis. Why is that so?

Credit costs have been artificially suppressed to very low levels in the last decade. As a result, economic activity (in the US as well as in other currency areas) has become highly dependent on cheap money: Consumers, firms and governments have taken advantage of low borrowing costs, having refinanced their maturing debt load with new low-interest rate loans. And to take it even further, they have taken on new loans at extremely low interest rates.

Asset prices – such as, for instance, stock and housing prices – have been propelled upwards by exceptionally low interest rates, boosting consumers' and firms' net asset value – and their inclination to spend. By no means less important, companies have made new investments, whose profitability depends heavily on the continuation of the low interest rate environment. If interest rates go up, adjustment pressure is inevitable, dampening economic activity.

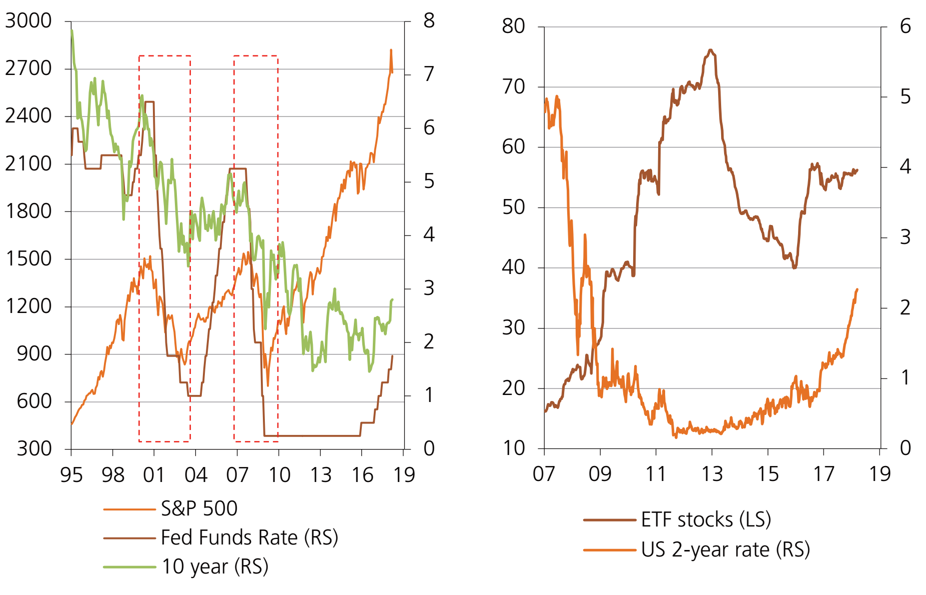
The key question is whether the economies can handle higher borrowing costs, or, more to the point, whether central banks will succeed in bringing interest rates to a level that neither encourages the economy to live beyond its means nor kill off its expansion altogether. Viewed from this perspective, *monetary policy is tantamount to walking a tightrope*. The question is, however: Can central banks do the trick and establish the "correct" level of interest rates?

To cut a long story short, there is unfortunately little reason to believe that central banks will do the right thing (fig. 2a). For instance, the Fed was instrumental in bringing the "New Economy" bubble to its knees in 2000/2001, and it also burst the credit bubble in 2008/2009 – each time by raising interest rates too strongly. (Not to forget that it was the Fed that triggered the bubbles in the first place by an overly generous monetary policy.

2 Crisis risk increases, ETF gold demand steady despite higher rates

(a) US interest rates in percent S&P 500 stock market index

(b) ETF gold stock (mn ounces) and 2 year interest rate in percent



Source: Thomson Financial; own calculations.

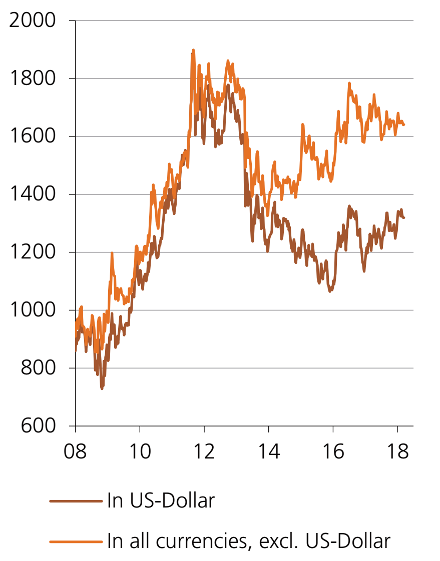
As fig. 2 b shows, the gold demand from gold exchange traded funds (ETFs) has increased quite strongly since the beginning of 2016. This is all the more remarkable as the rise in ETF gold demand has been accompanied by rising US short-term rates. It tells us that investors have obviously increased their demand for gold for non-interest related motives. One of them might be the wish to seek portfolio protection.

Having said that, it ought to be of interest for any investor to think about ways of dealing with a scenario in which the Fed, accompanied by other central banks, crushes the boom by raising interest rates too strongly. It is here where

Gold price per ounce

in US dollars and all world currencies (excl. the US dollar)*

January 2008 to March 2018



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.

gold comes to mind. One of the consequences of a bursting boom are rising credit defaults. The yellow metal does not carry any payment default risk – in sharp contrast to, say, bank deposits and short-term securities.

What is more, gold cannot be debased by central banks' money printing – which may well occur if and when the financial system gets into trouble once again. Then the final question concerns the price of gold. If gold is bought at too high a price, it does not provide the holder with sufficient upward value potential in times of heightened financial stress. However, from our viewpoint, various measures suggest that gold is not expensive at this stage.

Especially given very low credit spreads, subdued default risk concerns, and an ongoing rise in asset prices across the board, it appears that investors assign a fairly small probability to the scenario that the ongoing economic and financial boom might take a hit due to central banks edging up borrowing costs. As a result, the "insurance premium" in the gold price can be expected to be fairly low.

As monetary policy hiking cycles have ended in tears on quite a few occasions in the past, it appears that the price and the timing is right to obtain gold for those who seek portfolio insurance. The savvy Investors should keep in mind: The Fed walking the tightrope is a pretty risky business – for the investor.

Gold In Art

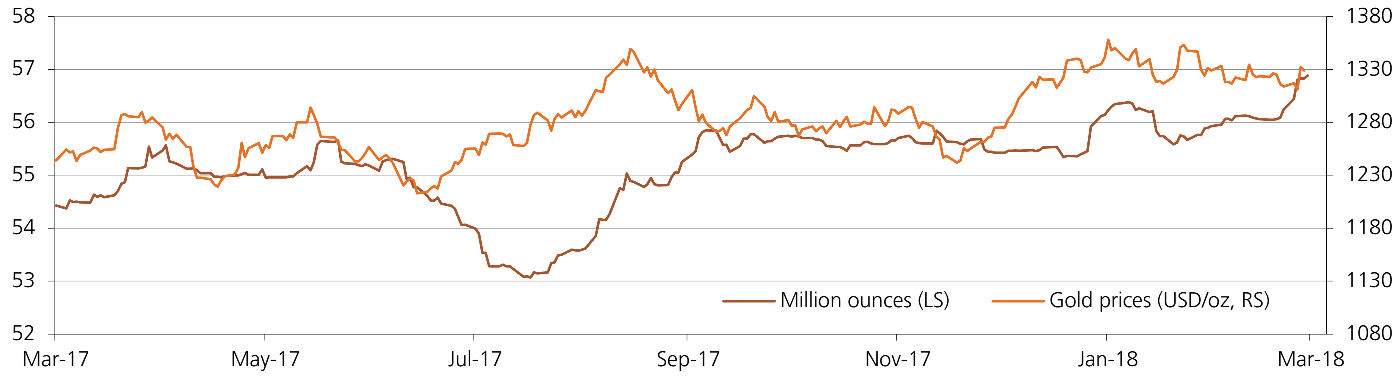
Yves Klein, *Untitled Gold*

Yves Klein (1928 - 1962) is considered an avant-garde artist, a forerunner of *Pop Art*. He is best known for his *monochrome paintings*, especially those in his patented ultramarine blue ("International Klein Blue"), but also in gold and pink. For Klein, the trilogy of the colors blue, gold and red stood for the theological mystery of the Trinity. In gold, Klein saw the Absolute, the Divine, the infinite space.

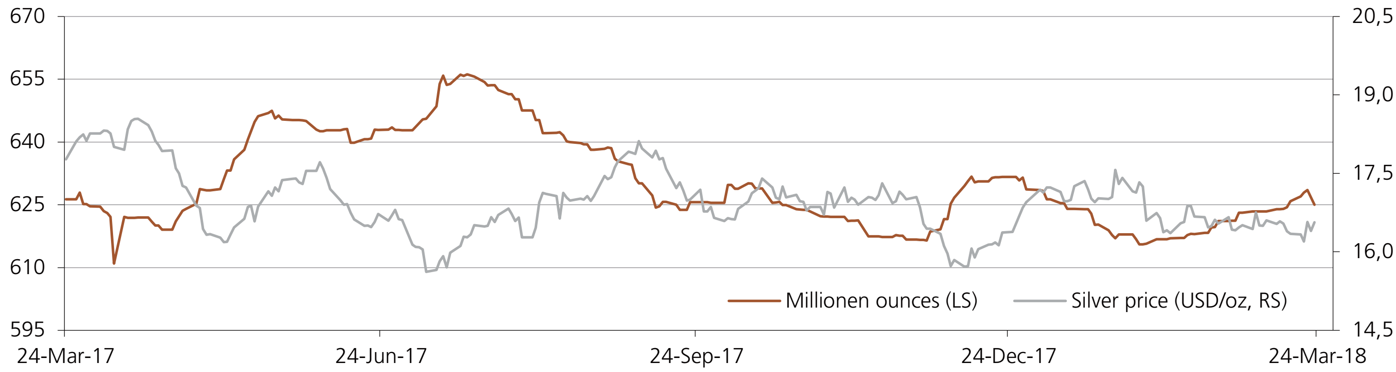
Dr Ruth Polleit Riechert, Art Historian (www.rpr-art.com).

Precious metals prices and ETF holdings

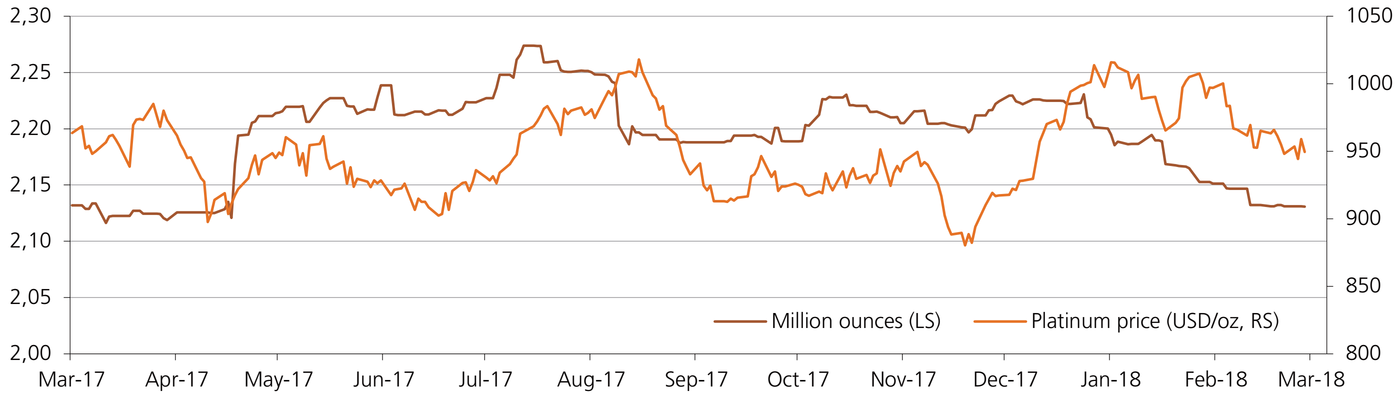
Gold ETFs (million ounces) und gold price (USD/oz)



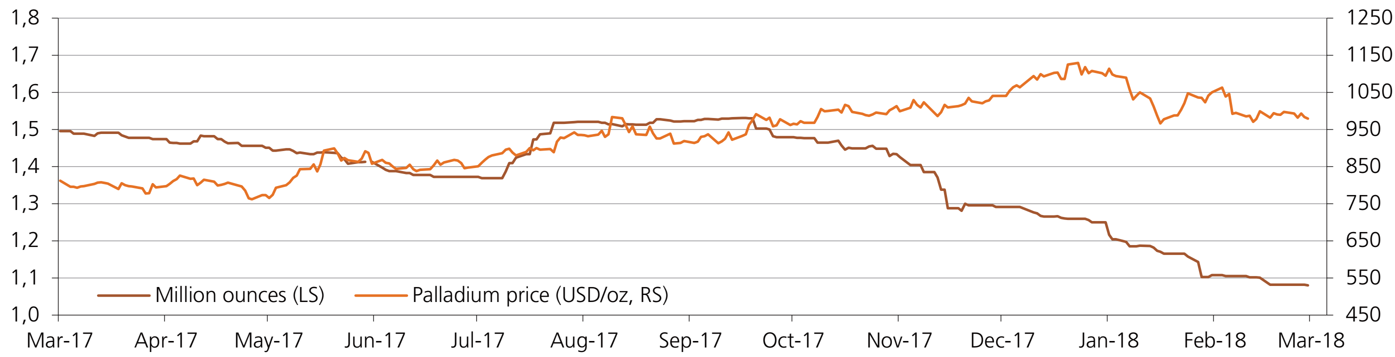
Silver ETFs (million ounces) and silver price (USD/oz)



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	1346.8		16.5		947.0		976.5	
II. Gliding averages								
5 days	1322.6		16.6		958.4		991.0	
10 days	1322.4		16.5		961.1		991.8	
20 days	1328.7		16.6		978.5		1015.4	
50 days	1330.7		16.8		985.7		1045.4	
100 days	1303.6		16.7		953.7		1028.4	
200 days	1289.6		16.8		948.2		967.5	
III. Bandwidths for 2018	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1248	1472	16.0	21.0	936	1048	1033	1261
(1)	*-7*	*9*	*-3*	*27*	*-1*	*11*	*6*	*29*
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	1090.4		13.4		766.7		790.6	
II. Gliding averages								
5 days	1071.4		13.4		776.4		802.8	
10 days	1072.2		13.4		779.2		804.1	
20 days	1077.3		13.4		793.4		823.3	
50 days	1082.5		13.7		801.8		850.7	
100 days	1082.7		13.9		791.9		854.3	
200 days	1088.0		14.2		800.0		815.5	
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*	*2*	*34*	*5*	*17*	*12*	*37*
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.

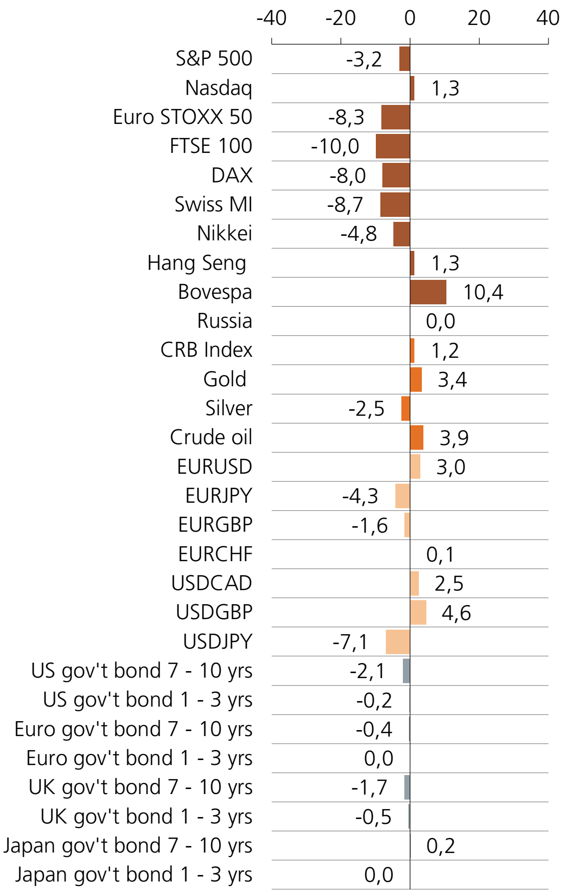
Bitcoin, performance of various asset classes

Bitcoin in US dollars

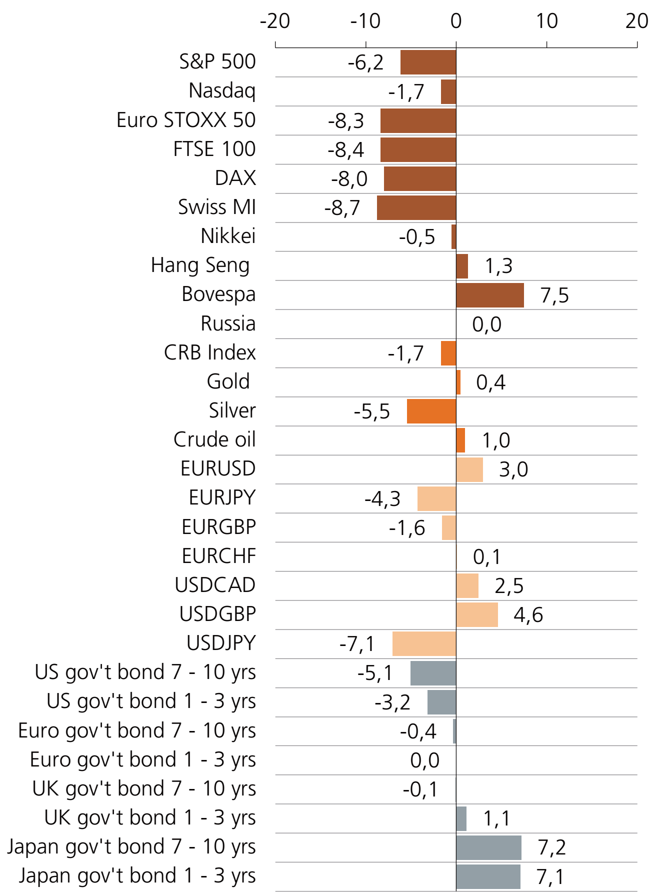
Source: Thomson Financial.

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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3 February 2017	Gold Insures Against Risks Lurking in the Financial System
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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
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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?

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