Degussa Market Report

28 April 2017 Economics · Finance · Precious Metals

OUR TOP ISSUES

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

France's EUROphoria on the Retreat

Economic problems in France increasingly undermine the political support among the French for the euro project.

ECB is far From Being Trigger-Happy

The ECB is not yet ready to raise interest rates and end bond purchases. In fact, higher borrowing costs could cause tremendous pain for the euro area.

The Czech Abandon Their Euro-Link

The Czech National Bank has abandoned the policy of linking the koruna to the euro - as Switzerland did in early 2015. Other countries may follow.

No Return to 'Normal Interest Rates'

The US Central Bank's plans to shrink its balance sheet do not necessarily mean that interest rates have to go up.

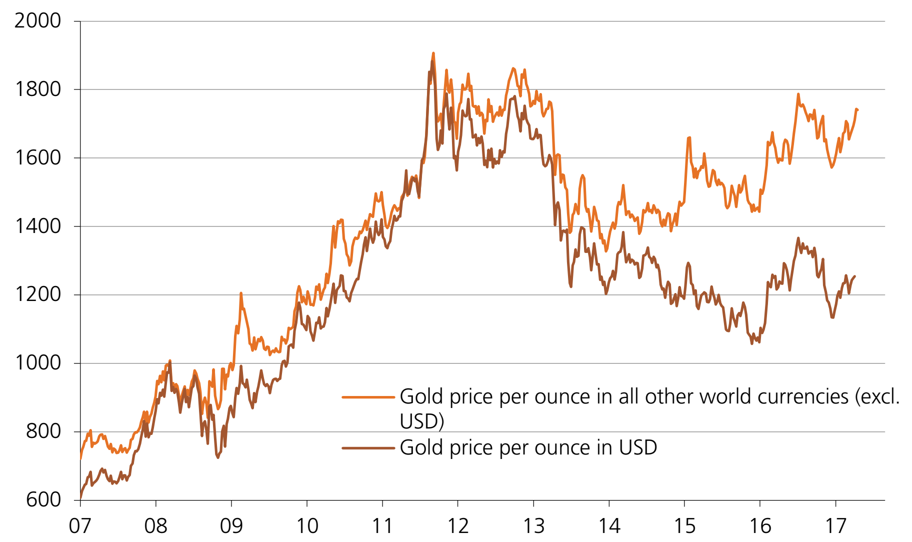
Precious Metals Market Report

The French election and the movements in the credit market pose headwinds for the precious metal markets.

Gold price per ounce

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

January 2007 to April 2017



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.

USD per ounce of gold

USD per ounce of silver

EURUSD

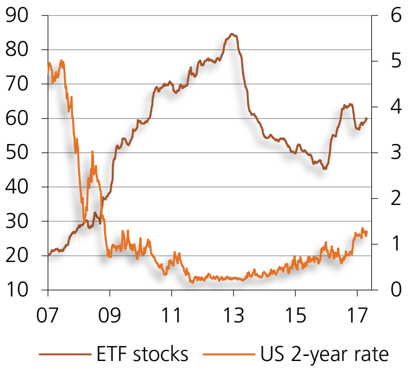
Source: Thomson Financial. Daily data.

Precious metals prices

	Actual (spot)	Change against (in percent): 2 W	3 M	12 M
I. In US-dollar				
Gold	1,265.9	0.9	4.6	-2.1
Silver	17.4	-3.7	-0.7	-2.7
Platinum	948.5	-0.6	-4.4	-11.9
Palladium	817.1	1.7	8.3	31.2
II. In euro				
Gold	1,162.5	-1.9	3.5	2.9
Silver	16.0	-7.4	-1.7	2.4
Platinum	871.4	-4.1	-5.3	-7.3
Palladium	750.2	-1.2	7.2	36.7
III. Gold price in other currencies				
JPY	140,820.0	1.1	2.9	2.4
CNY	8,732.1	0.0	4.7	4.2
GBP	978.9	-3.4	1.6	10.6
INR	81,272.7	1.9	-0.6	-5.2
RUB	72,182.7	0.0	-0.8	-13.6

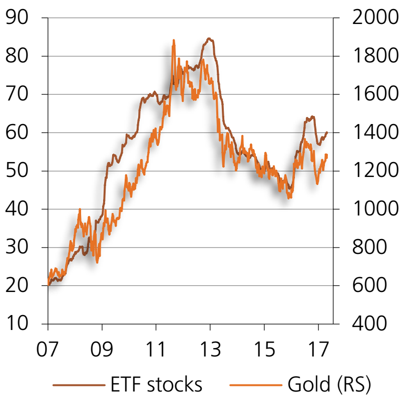
Source: Bloomberg; own calculations.

Gold ETF demand went up as US interest rates moved higher, …
Gold ETFs (million ounces) and US 2-year gov't bond yield in percent



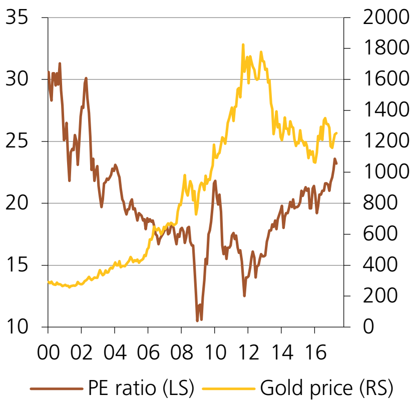
Source: Thomson Financial.

… and this has translated into a higher gold price
Gold ETFs (million ounces) and price of gold (USD/oz)



Source: Thomson Financial; own calculations.

Gold as a hedge against potential set-back in stock markets
Price earnings ratio of the S&P 500 and gold price (USD/oz)



Source: Thomson Financial.

Central Banks Will not Dare to Take Away the Punch Bowl

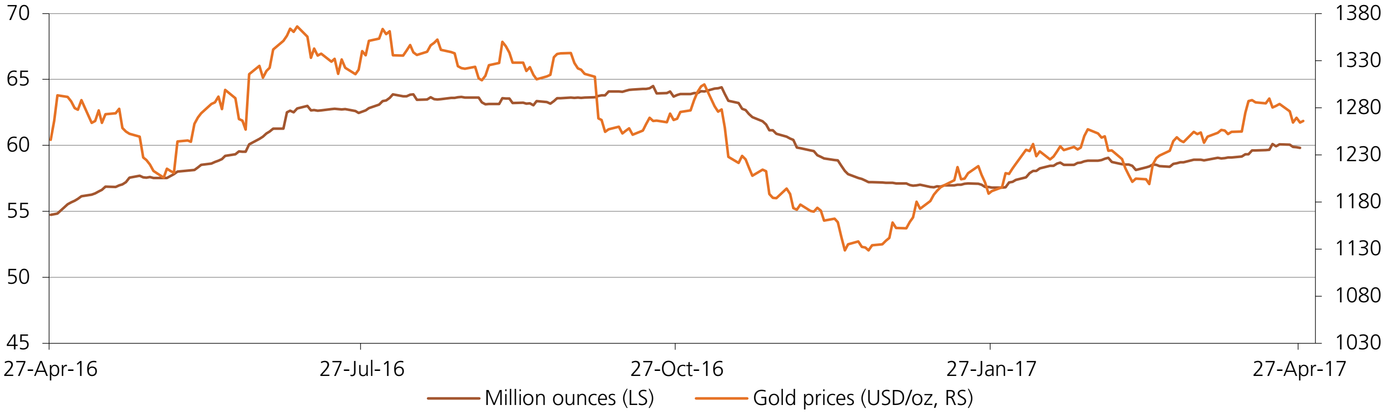
Precious metal prices have been experiencing headwind in recent days for a number of reasons. The outcome of the first round of the French presidential election has lowered investor risk aversion in the international financial system, and it has revived confidence in the euro in particular. What is more, optimism about growth seems to have broadened. For instance, the Chinese economy appears to continue to grow at a decent rate, supporting global demand and stock prices. Most importantly, interest rates are expected to edge up. This seems to have an adverse effect on the price of gold. The key question in this context, however, is: What are the chances for interest rates in the major economies around the world to go up further? There is reason to expect that interest rates in *nominal terms* might increase, that they will not remain at exceptionally low levels for much longer. At the same time, however, it seems to be unlikely that *real interest rates* (nominal interest rates minus inflation) will return to "normal" levels anytime soon. How can we reconcile these two developments?

Debt-to-GDP ratios in most countries have gone up quite substantially in the past year, especially fueled by central banks' extremely low interest rate policies. The policy of cheap money has generated consumption and investment spending financed by additional credit. Ramping up borrowing costs, therefore, would put already overstretched borrowers under even more pressure. It would almost certainly result in a slowdown of economic expansion. In fact, raising interest rates would be tantamount to taking away the punch bowl mid-party, and would make the debt pyramid rather shaky. Why then would central banks want to increase nominal interest rates? Preventing inflation from running wild is one reason. The other reason is that the banking industry cannot survive if interest rates remain at rock bottom, accompanied by a flat yield curve. In other words: Central banks find themselves in a dilemma because higher interest rates would put borrowers under pressure, while low interest rates would threaten the capacity of the banking industry to churn out ever greater amounts of credit and money. However, there is an 'escape route'.

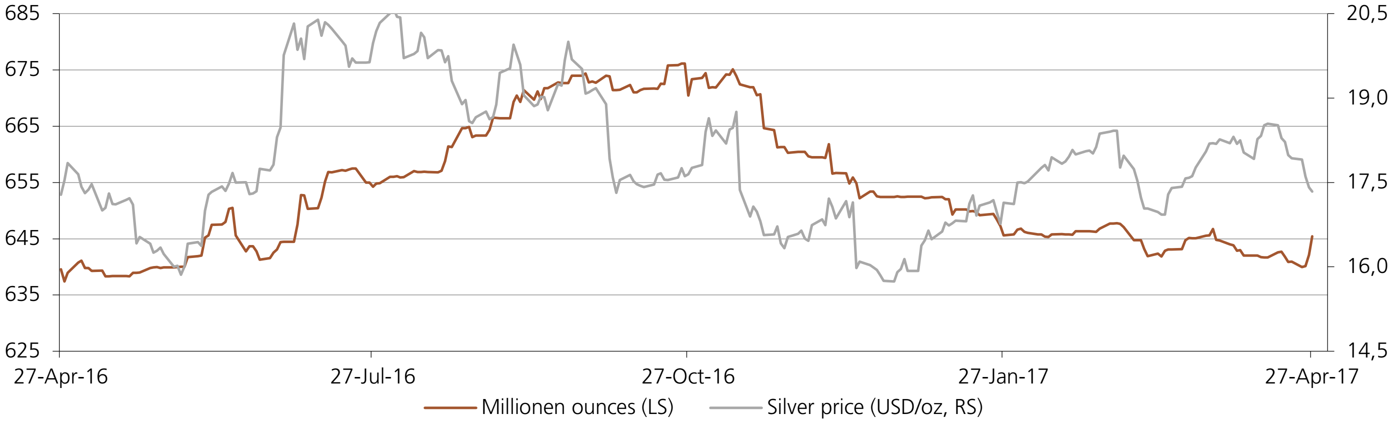
And that is raising nominal interest rates and, at the same time, making sure that inflation goes up as well so that real interest rates (nominal interest rates minus inflation) remain around zero or even in negative territory. This can be achieved in various ways. For instance, central banks can simply raise their official inflation target (from 2 percent to, let us say, 3 or 4 percent per year); or they keep monetizing government and bank debt, thereby increasing the quantity of money. If they keep controlling short- and long-term interest rates, central banks can push real interest rates to politically desired low levels. In other words, the outlook for real (inflation-adjusted) interest on bonds and savings accounts remains bleak. Furthermore, the ongoing meddling of central banks in credit markets causes far-reaching distortions in basically all factor markets and thus malinvestment of scarce resources. This, in turn, increases the probability of a new round of economic and financial disturbances going forward. Bottom line: There are reasons to cling to gold, particularly as portfolio insurance. In contrast to time and savings deposits or bonds with short maturities, gold cannot be debased by monetary policies; it does not lose its purchasing power in the context of negative real interest rates. What is more, gold does not carry a default risk as credit instruments do. In the current market environment, where investors have become increasingly optimistic about the sustainability of global growth and the health of the financial system, we think the current gold price seems to offer a reasonably good bargain for investors with a longer-term investment horizon.

Precious metals prices and ETF holdings

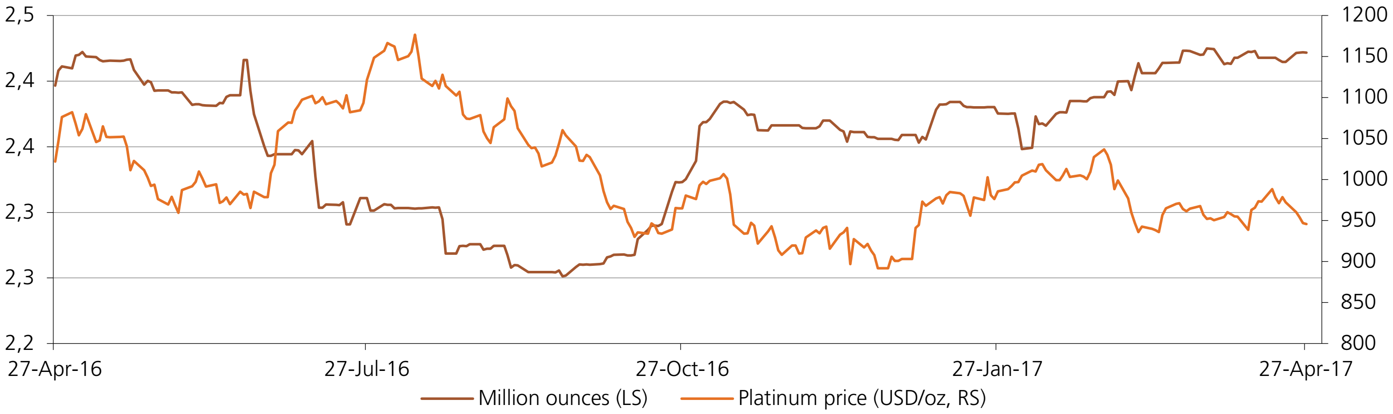
Gold ETFs (million ounces) und gold price (USD/oz)



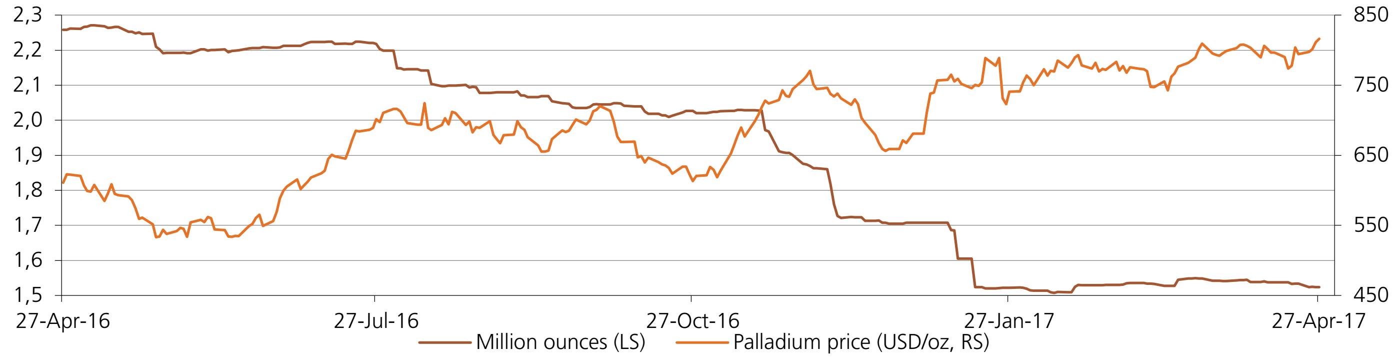
Silver ETFs (million ounces) and silver price (USD/oz)



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



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



Source: Bloomberg.

Precious metals prices

In US-dollar

	Gold		Silver		Platinum		Palladium	
I. Actual	1,265.8		17.4		948.3		817.5	
II. Gliding averages								
5 days	1,271.4		17.6		956.2		800.4	
10 days	1,278.4		17.9		967.1		797.8	
20 days	1,269.6		18.1		961.1		799.3	
50 days	1,248.6		17.9		970.3		785.7	
100 days	1,216.7		17.4		964.7		759.4	
200 days	1,252.3		17.9		993.1		723.1	
III. Projections for 2017	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1,148	1,390	15.9	23.00	906	1,100	700	900
IV. Annual averages								
2013	1,429		24.1		1,487		724	
2014	1,260		19.1		1,382		800	
2015	1,163		15.7		1,065		706	
2016	1,242		17.0		985		617	

In euro

	Gold		Silver		Platinum		Palladium	
I. Actual	1,163.4		15.9		872.5		750.7	
II. Gliding averages								
5 days	1,172.6		16.3		881.9		738.2	
10 days	1,187.3		16.7		898.2		740.9	
20 days	1,186.1		16.9		897.9		746.7	
50 days	1,169.0		16.8		908.6		735.6	
100 days	1,143.4		16.3		906.7		713.6	
200 days	1,155.1		16.5		915.9		668.2	
III. Projections for 2017	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1,118	1,353	15.5	22.40	882	1,071	682	876
IV. Annual averages								
2013	1,079		18.2		1,123		547	
2014	945		14.3		1,035		601	
2015	1,044		14.1		955		633	
2016	1,120		15.4		888		557	

Source: Thomson Financial; own calculations and estimates.

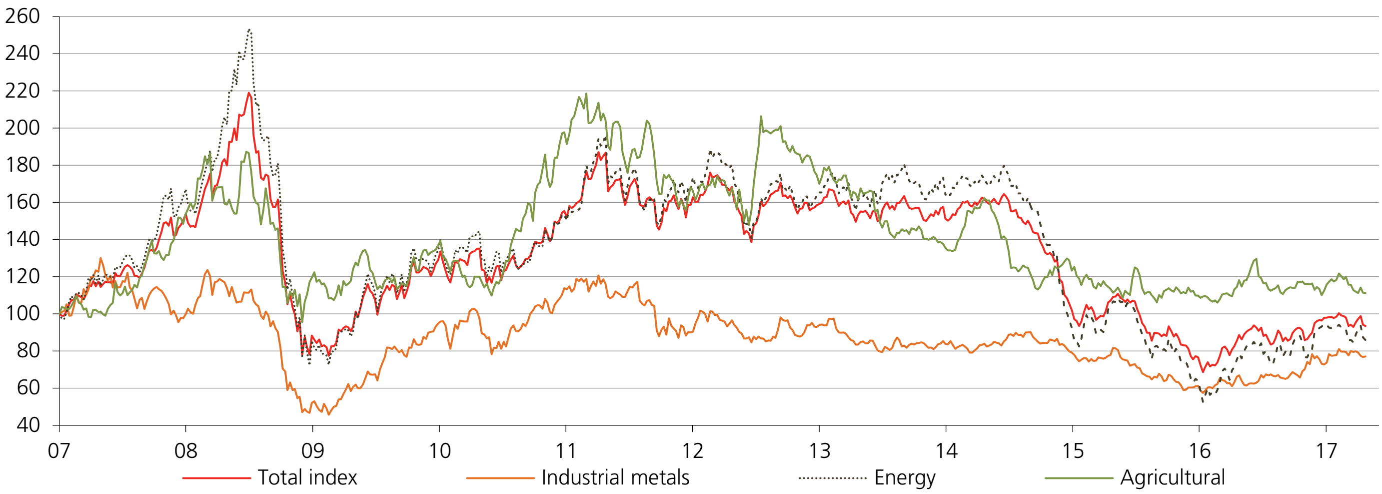
Commodity prices

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	49.29	-0.7	-9.4	-12.7	-1.2	16.0	20.3	22.1
Brent crude oil	51.63	-0.6	-8.1	-11.7	0.6	19.7	19.1	21.8
Gasoline	156.41	-4.9	-12.4	-16.4	-5.3	10.9	19.8	19.8
Heating oil	150.72	-3.0	-8.4	-13.6	-2.7	14.6	16.3	20.2
Gas oil	459.50	-2.0	-8.8	-10.5	-0.2	...	19.4	21.0
Natural gas	3.25	1.9	-0.2	-8.7	5.1	32.5	29.3	37.5
II. Agriculture								
Corn	368.50	1.3	-1.4	1.2	-2.1	-6.0	15.0	15.3
Wheat	433.00	2.9	-3.2	-0.3	-6.2	-15.7	17.0	19.6
Soybeans	956.75	-0.4	-8.2	-6.1	-7.0	7.6	10.6	14.8
Coffee	129.50	-2.6	-16.1	-8.6	-24.5	3.0	23.6	22.0
Sugar	15.43	-6.5	-23.6	-18.1	-25.0	8.1	22.6	21.8
Cotton	77.69	-2.1	2.0	8.8	11.1	33.0	14.8	14.2
III. Industrial metals								
Aluminum	1924.00	-0.5	5.8	13.6	11.0	22.3	14.5	14.4
Copper	5692.00	1.2	-5.0	2.8	17.3	21.2	18.8	21.7
Zinc	2597.00	0.5	-9.2	0.8	5.5	47.2	29.3	27.4
Lead	2205.00	2.9	-7.0	9.3	6.8	25.8	29.3	29.8
Iron ore	62.90	0.2	...	-19.4	0.8	35.6	...	...
IV. Precious metals								
Gold	1265.96	-1.4	4.6	10.3	-0.6	2.8	8.7	10.6
Silver	17.37	-3.1	-0.7	9.1	-2.5	17.2	13.8	16.5
Platinum	948.45	-2.5	-4.4	5.0	-2.8	1.7	13.8	18.7
Palladium	817.13	2.9	8.3	20.0	32.6	65.3	18.1	27.5
V. Ratios								
Gold-silver	72.88	1.5	5.3	0.4	1.9	-12.3	11.0	11.2
Gold-platinum	1.33	1.2	9.3	4.4	2.2	1.0	11.9	14.0
Gold-palladium	1.55	-4.4	-3.3	-7.9	-25.0	-37.8	20.7	26.4
Palladium-platinum	0.86	5.8	13.2	13.5	36.3	62.5	19.1	24.1

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

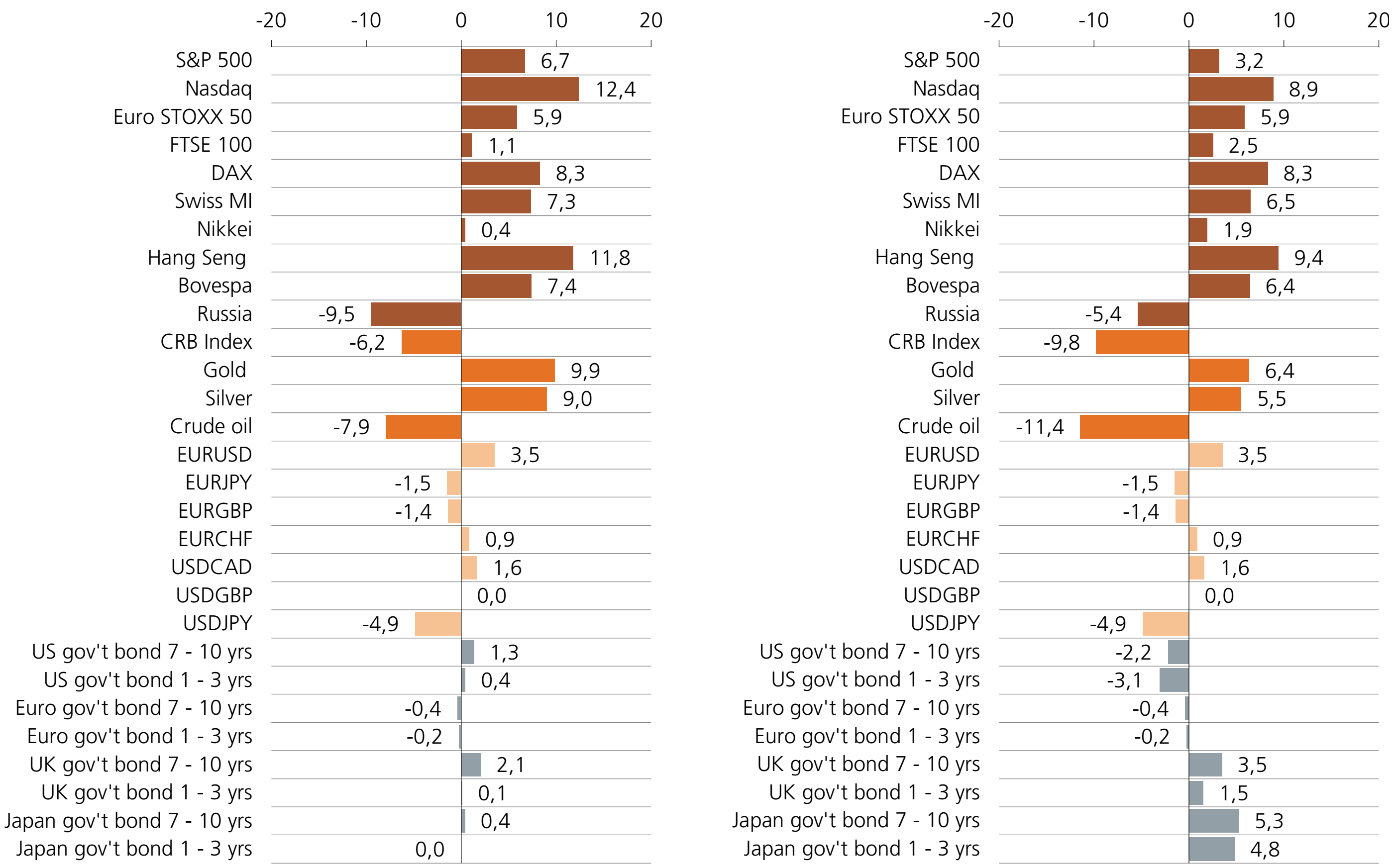
Bitcoin in US dollars

Source: Bloomberg

Performance of stocks, commodities, FX and bonds

(a) In national currencies

(b) In euros



Source: Bloomberg; own calculations

Articles in earlier issues of the *Degussa Market Report*

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