Degussa Market Report

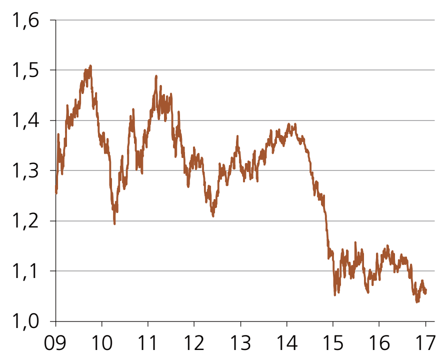
31 March 2017

Economics · Finance · Precious Metals

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	1,242.7	3.1	7.8	0.8
Silver	18.1	6.2	13.7	17.7
Platinum	945.9	0.4	4.7	-3.1
Palladium	794.7	6.3	16.7	41.1
II. In euro				
Gold	1,162.7	3.0	6.4	7.4
Silver	16.9	6.7	12.4	25.4
Platinum	885.2	0.9	3.3	3.3
Palladium	743.5	6.4	14.5	50.3
III. Gold price in other currencies				
JPY	138,992.6	0.5	3.5	0.2
CNY	8,564.7	3.1	6.5	7.4
GBP	997.8	0.7	7.3	16.5
INR	80,602.6	1.9	2.9	-1.1
RUB	69,507.9	-2.0	-1.5	-16.1

Source: Bloomberg; own calculations.

OUR TOP ISSUES

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

ECB Negative Interest Rate Policy Will Come to an End

The ECB will have to end its negative interest rate policy sooner or later. Real interest rates, however, are likely to remain in the negative territory, making a case for gold.

Gold Price Resists Higher US Rates

So far, the price of gold, primarily driven by ETF demand, seems to resist the outlook of US interest rates grinding higher this year bravely.

Trump and the New Dollar Shortage

If President Trump succeeds in cutting taxes substantially, it will most likely have a substantial impact on global production and trade and, most important, the US dollar's reserve position.

Swiss Franc Remains Attractive

FX market interventions on the part of the SNB cannot cover up the fact that the Swiss Franc has appreciation potential against the euro.

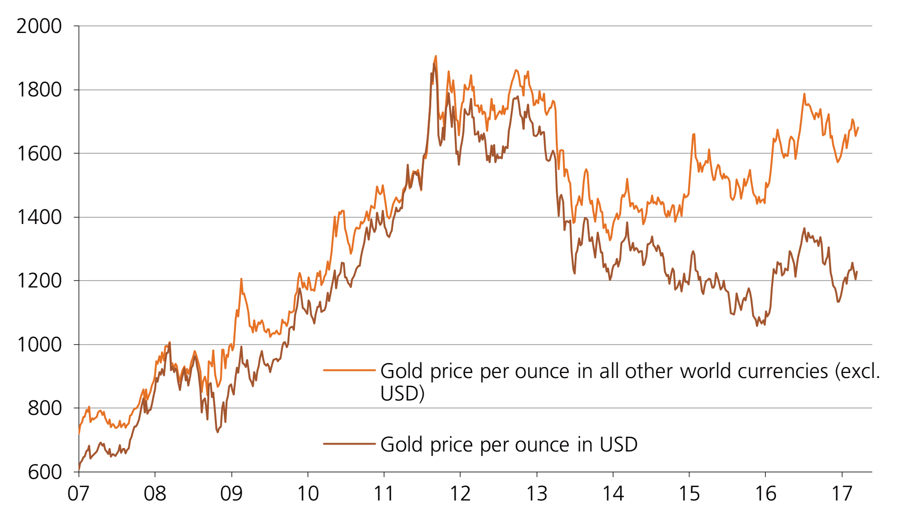
Precious Metals Markets

US interest rates and the external value of the US dollar exchange are likely to remain key drivers for precious metal prices.

Gold price per ounce

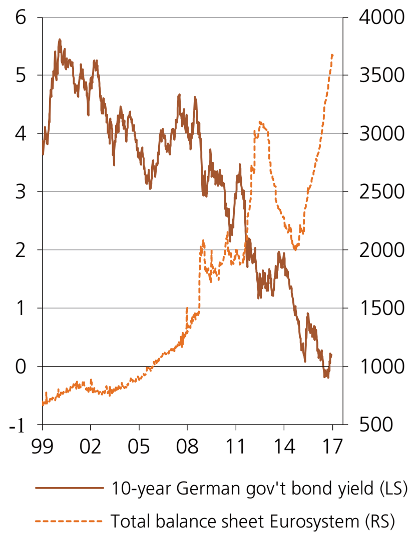
in US dollars and all world currencies (excl. the US dollar)*

January 2007 to March 2017



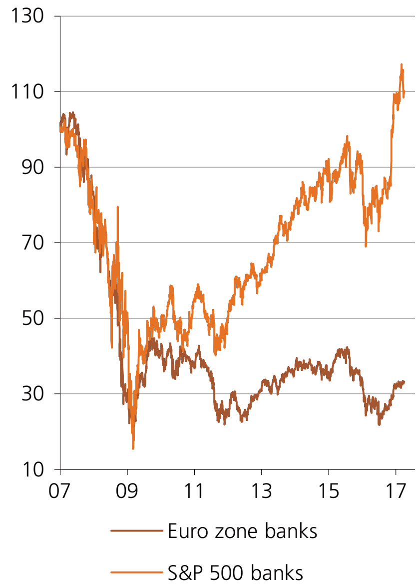
Source: Bloomberg; own calculations. *Calculated from the gold price (USD/oz) and the nominal trade weighted exchange rate of the US dollar. The timeline was indexed at 5 September 2011 with a value of 1.900.

ECB buys bonds, thereby pushing up prices and lowering yields
ECB balance sheet (euro bn) and 10-year Bund yield in percent



Source: Bloomberg. Eurosystem = ECB plus national central banks.

Stock prices of euro area banks strongly suppressed
Indices of banks stocks in the US and the euro area[1)]



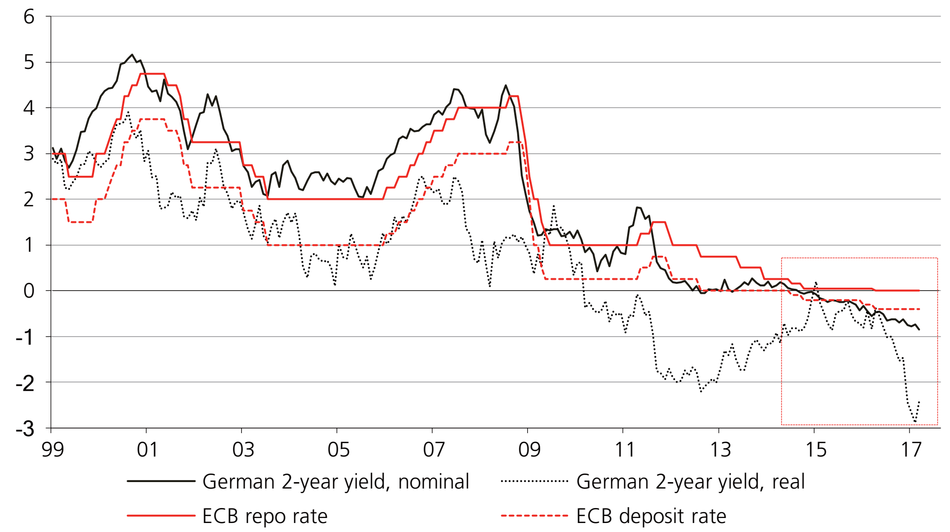
Source: Thomson Financial; own calculations. [1)] January 2007 = 100.

ECB Negative Rate Policy Will Come To An End

The ECB will have to end its negative interest rate policy sooner or later. Real interest rates, however, are likely to remain in the negative territory, making a case for gold.

The European Central Bank (ECB) pushed its deposit rate to minus 0.4 percent in April 2016. In other words: Banks must pay 0.4 percent per annum on their excess reserves held at ECB accounts. This, in turn, has far-reaching consequences. To start with, banks seek to evade this "penalty rate", especially by buying government bonds.

Nominal and real negative interest rates
ECB interest rates and yield of German 2-year bonds in percent



Source: Thomson Financial; own calculations. Real rate = Nominal rate minus inflation.

That inevitably pushes bond prices up and lowers bond yields. Moreover, the ECB keeps monetizing government debt as well. The result is a tremendous downward pressure on the yield environment. For instance, the real (inflation-adjusted) return on short-term German bonds currently stands at around *minus* 2.5 percent per annum.

Negative interest rates (both nominal and in real terms) contribute to lowering the debt burden of financially overstretched states and banks. In fact, negative interest rates force the ratio between outstanding public debt and gross domestic product to shrink. Such a monetary policy benefits borrowers. The creditor, of course, has to foot the bill.

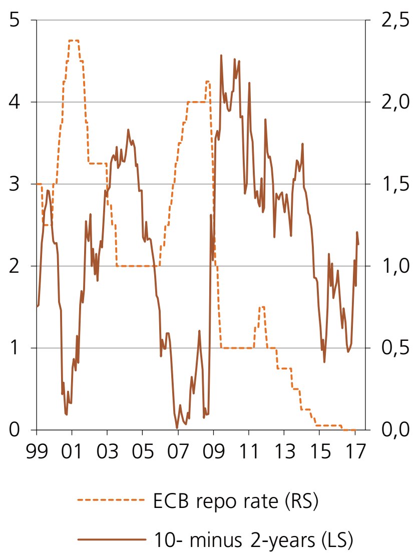
At the same time, however, Eurozone banks suffer from the ECB's negative interest rate policy. On the one hand, they find it increasingly difficult to remain profitable in an environment of extremely suppressed interest rates. On the other hand, they run into higher costs due to negative deposit rates (and the costs keep rising as the ECB creates more and more excess reserves in the banking system).

Banks are under pressure to impose negative rates on client accounts. Given negative deposit rates, clients are most likely to withdraw (at least part of) their deposits in cash. In other words: Bank could experience a (huge) cash drain, resulting in a funding gap. Banks are therefore likely to increasingly push the ECB to end the policy of keeping the deposit rate in negative territory.

New experiment

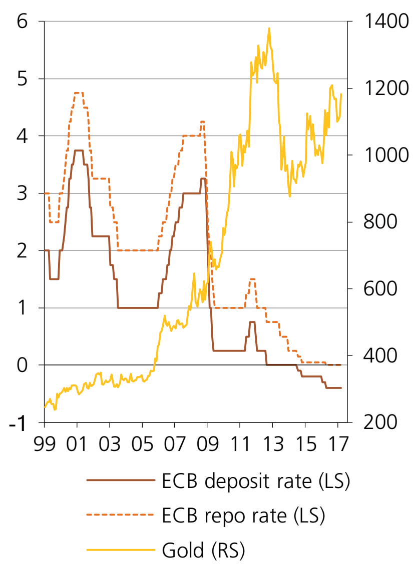
It would be premature, however, to expect relief for savers and investors. If the ECB relents, it would presumably bring the deposit rate back to zero. This, in turn,

Euro area yield curve has flattened since 2009
ECB key interest rates in percent and yield spread in basis points[1)]



Source: Thomson Financial; own calculation. [1)] 10- minus 2-year German Bund yields.

Interest rates went down, the price of gold went up
ECB key interest rates in percent and the price of gold (EUR/oz)



Source: Thomson Financial; own calculation.

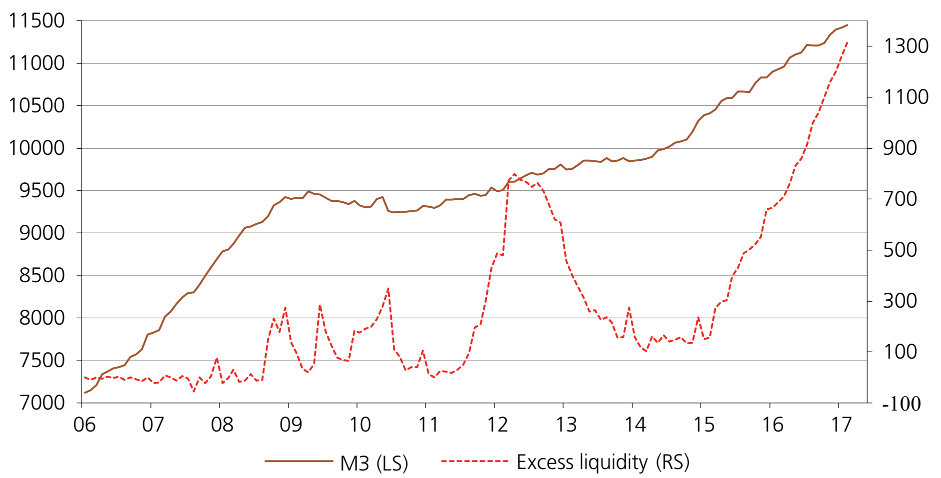
would bring all bond yields back up and above the zero line. To prevent the interest rate from rising too much, the ECB will have to continue manipulating long-term bond yields.

This can be achieved by continued bond purchases. In fact, the ECB can set long-term yields at politically desired levels. It simply declares a certain minimum price for bonds. The market prices of bonds will converge towards the minimum price and will not fall below such a level. By monetizing debt, the ECB expands the outstanding quantity of money, driving up inflation at the same time.

The new regime will most likely look like this: Eurozone bond yields in nominal terms will go up slightly. Inflation will also go up, reaching or even exceeding nominal yields. This, in turn, will force real return (that is nominal yields minus inflation) into negative territory. If inflation does not go up too much, most depositors and investors can be expected to stick to their fixed-income holdings.

The new interest rate regime would be quite positive for banks: The yield curve would remain sufficiently steep, which should turn out to be profitable for banks in terms of lending. At the same time, the negative short-term interest rates help to debase their liabilities against depositors and investors. In fact, the ECB policy would amount to a large-scale bank bail-out program.

ECB monetizes debt, increases the quantity of money
Euro area banks' excess liquidity and money stock M3, euro bn



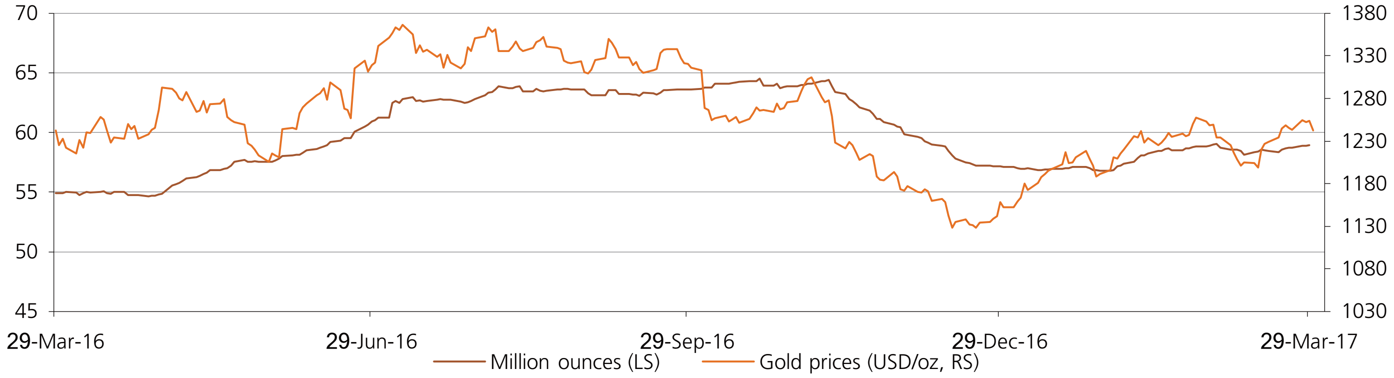
Source: Thomson Financial.

In the light of the political desire to keep the euro together, the ailing Eurozone banking industry has indeed to be bailed out by the ECB. It seems therefore likely that the ECB will end its policy of a negative deposit rate sooner rather than later in favour of increasing inflation. Such a policy will entail an ongoing debasement of peoples' life savings in euro-denominated bank deposits and bonds.

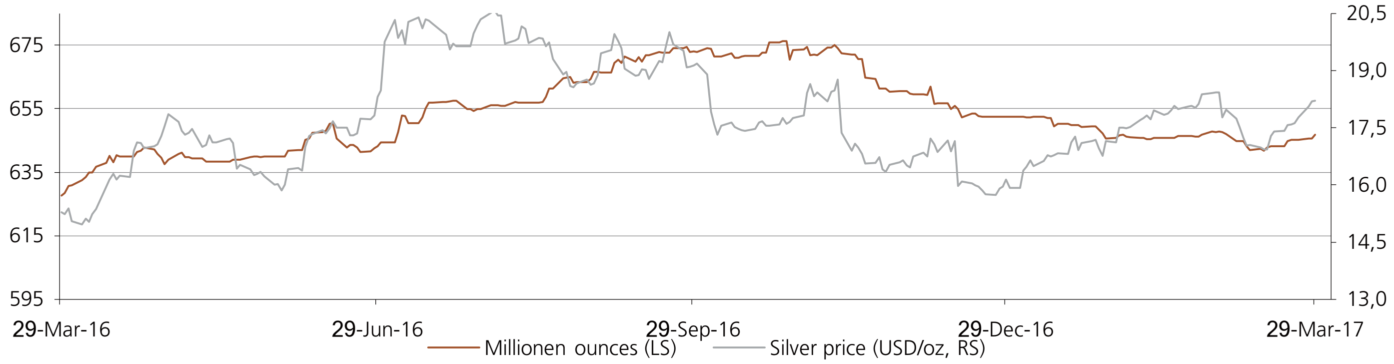
Against this backdrop, there is a strong case for holding gold. In an environment of negative real yields, the yellow metal has become an attractive alternative to time- and savings deposits as well as short-term bonds. Holding gold also serves as a hedge against any payment defaults and bank failures. Given its current price, we think that gold is now a particularly good bargain for savers in the Eurozone.

Precious metals prices and ETF holdings

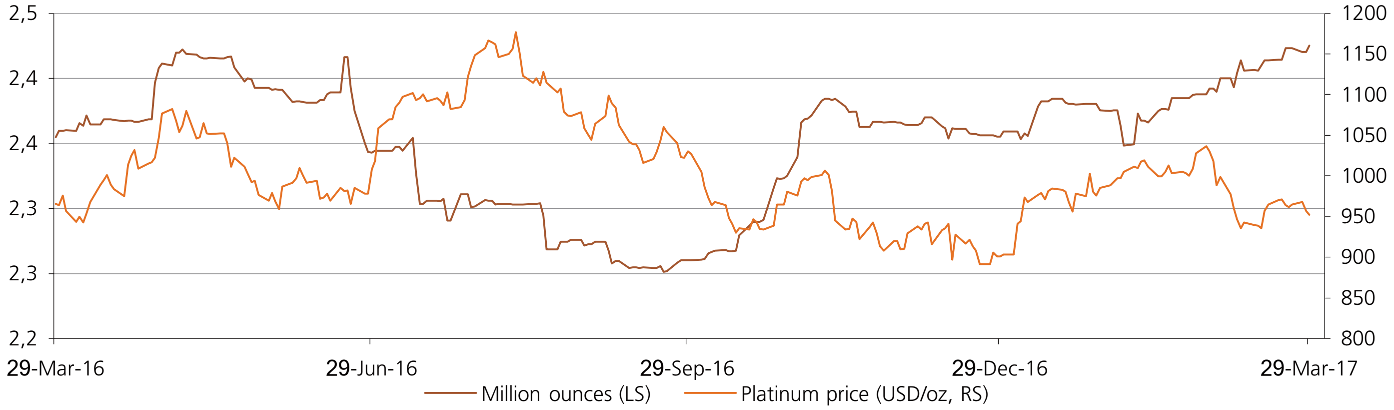
Gold ETFs (million ounces) und gold price (USD/oz)



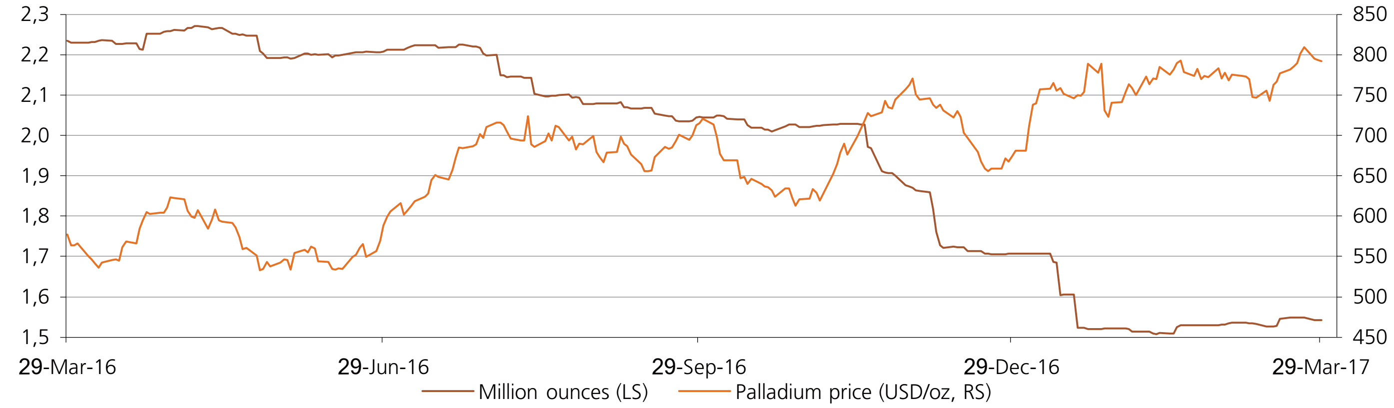
Silver ETFs (million ounces) and silver price (USD/oz)



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	1,249.8		18.3		954.0		796.0	
II. Gliding averages								
5 days	1,252.4		18.1		962.4		798.0	
10 days	1,246.2		17.8		963.7		792.9	
20 days	1,229.2		17.5		958.8		775.4	
50 days	1,227.6		17.7		983.4		771.8	
100 days	1,201.7		17.1		958.3		745.7	
200 days	1,258.9		18.1		1,002.6		704.4	
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	1,164.2		17.0		888.7		741.5	
II. Gliding averages								
5 days	1,158.7		16.7		890.4		738.3	
10 days	1,154.5		16.5		892.8		734.6	
20 days	1,147.9		16.4		895.5		724.1	
50 days	1,149.6		16.5		921.0		722.7	
100 days	1,130.5		16.1		901.5		701.5	
200 days	1,157.2		16.6		921.5		648.9	
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.

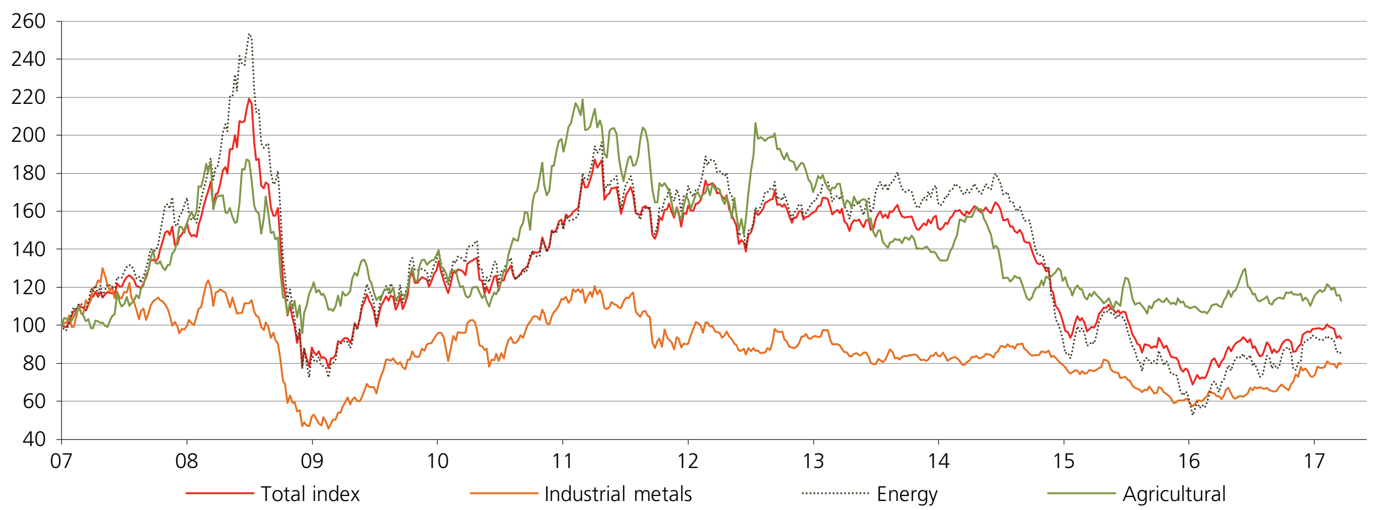
Commodity prices

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	50.34	2.1	-10.2	-3.9	-1.6	15.8	24.7	28.4
Brent crude oil	52.90	2.2	-8.9	-1.2	0.7	21.1	22.8	27.8
Gasoline	168.23	5.2	-9.6	-1.6	2.3	19.1	18.6	23.8
Heating oil	155.84	3.3	-10.4	-2.4	-0.9	19.5	19.8	25.3
Gas oil	471.25	2.8	-7.9	1.5	2.1	...	24.0	24.9
Natural gas	3.22	7.1	-9.2	0.0	8.6	22.8	39.1	38.4
II. Agriculture								
Corn	357.75	-2.7	0.1	0.6	1.2	-12.2	13.3	16.3
Wheat	421.50	-3.4	0.2	1.4	-3.8	-20.0	19.2	21.2
Soy beans	962.75	-3.7	-4.9	-8.2	-0.9	6.6	10.9	16.0
Coffee	139.30	-1.9	-0.1	-8.9	-11.1	9.2	20.9	22.1
Sugar	16.72	-8.0	-13.1	-13.2	-24.5	22.5	25.5	24.7
Cotton	76.42	-2.5	7.6	6.1	10.8	22.4	13.8	14.2
III. Industrial metals								
Aluminum	1972.00	3.0	16.5	13.9	17.9	29.8	13.5	14.0
Copper	5956.00	0.4	7.6	2.2	22.4	30.6	18.1	22.8
Zinc	2870.00	-0.4	11.4	6.2	20.7	76.8	24.1	30.6
Lead	2351.50	2.7	16.6	-0.6	10.7	36.9	23.9	34.5
Iron ore	79.73	0.2	2.1	0.7	38.0	92.6	...	...
IV. Precious metals								
Gold	1243.03	1.1	8.3	5.8	-5.5	11.2	10.8	11.9
Silver	18.10	4.0	13.7	9.7	-5.6	27.0	17.8	21.1
Platinum	945.89	-2.0	4.7	4.0	-7.9	8.5	18.3	21.7
Palladium	794.68	2.3	16.7	2.7	10.3	59.1	19.6	28.9
V. Ratios								
Gold-silver	68.65	-2.9	-5.4	-3.6	0.0	-12.2	11.3	13.7
Gold-platinum	1.31	2.6	2.8	1.7	2.4	2.9	11.2	16.3
Gold-palladium	1.56	-1.0	-7.1	2.6	-14.5	-30.3	18.4	26.4
Palladium-platinum	0.84	3.6	10.7	-0.8	19.7	47.5	19.4	26.8

Source: Bloomberg; own calculations.

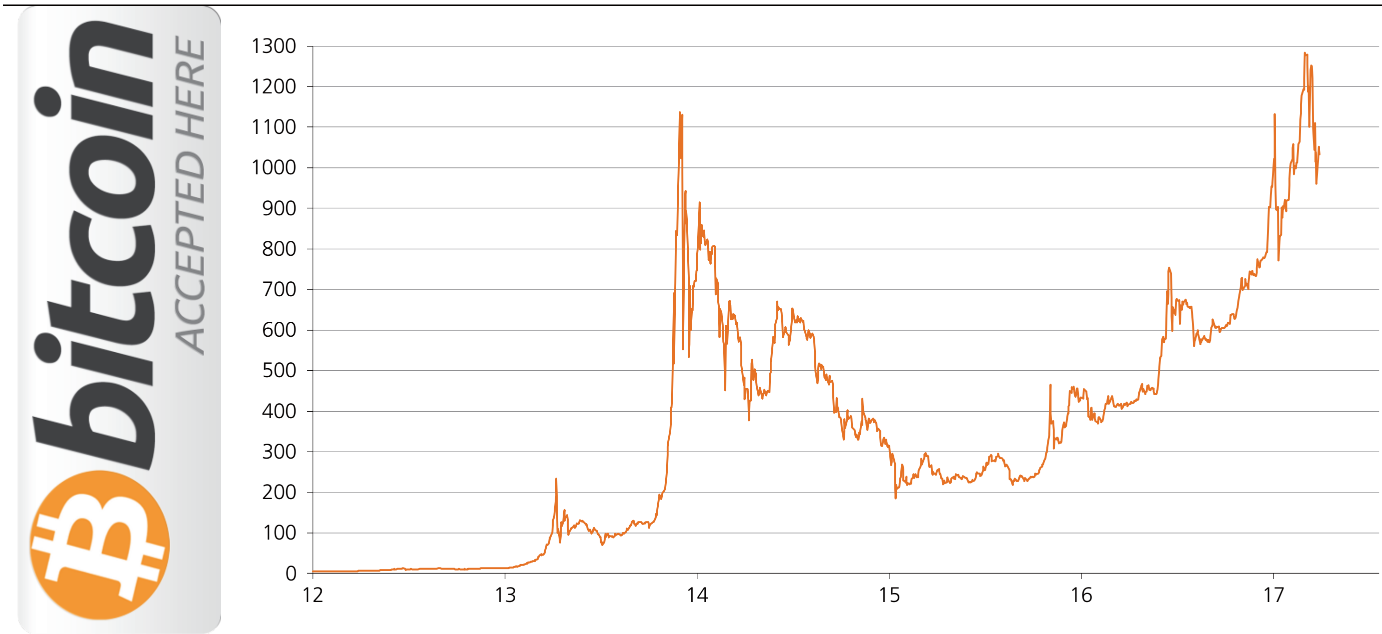
S&P commodity prices (in US dollar terms)



Source: Bloomberg. Series are indexed (January 2007 = 100).

Bitcoin, performance of various asset classes

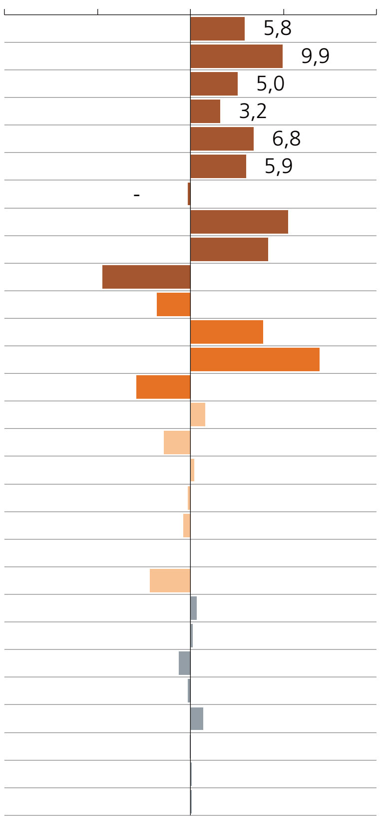
Bitcoin in US dollars



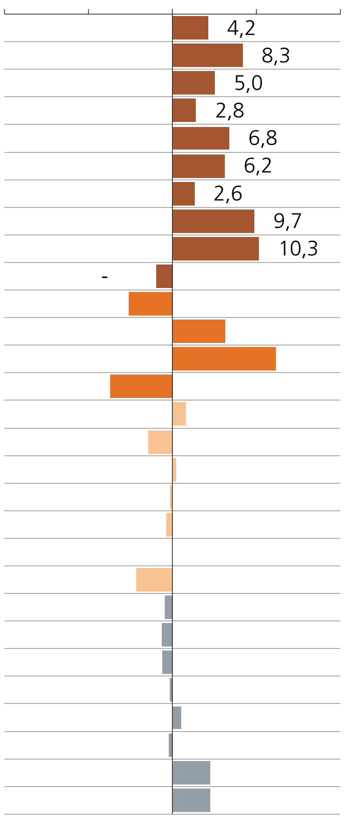
Source: Bloomberg

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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3 March 2017	ECB Flirts With Higher Inflation. The Case For Gold
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3 February 2017	Gold Insures Against Risks Lurking in the Financial System
20 January 2017	The Year of Change
20 December 2016	Gold Rather Than Euro
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
14 October 2016	Amid Uncertainty, Opportunity Knocks
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*
22 July 2016	The Demise of the Interest Rate – the Comeback of Gold Money
8 July 2016	Escaping the Euro Trap
24 June 2014	The Credit Cycle and the Price of Gold
10 June 2016	Savvy Investors Say Yes to Gold and Stocks Despite Prospective Fed Rate Hike
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
15 April 2016	A World without Returns
1 April 2016	Helicopter Euros Hovering on the Horizon
18 March 2016	Gold and Stocks Protect Against ‘Helicopter-Euros’

The Degussa Marktreport (German) and the Degussa Market Report (English) are available at:
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