Degussa Market Report

13 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	1.351.9	2.1	2.7	9.3
Silver	16.7	2.5	1.9	-0.9
Platinum	932.3	0.1	-3.3	-0.6
Palladium	962.5	-0.4	-1.4	21.3
II. In euro				
Gold	1.093.1	1.6	1.6	-2.0
Silver	13.5	2.0	0.8	-10.9
Platinum	753.8	-0.6	-4.4	-11.2
Palladium	778.0	-0.9	-2.5	8.7
III. Gold price in other currencies				
JPY	144.423.0	2.0	0.9	3.3
CNY	8.470.3	1.6	2.2	-0.5
GBP	953.4	1.3	0.2	-0.4
INR	88.218.2	2.2	4.1	11.4
RUB	84.614.9	10.6	10.2	20.9

Source: Thomson Reuters; own calculations.

OUR TOP ISSUES

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

The Risk of a Currency Crisis

"The reports of my death are greatly exaggerated", quipped Mark Twain in response to a newspaper report that said he was on his deathbed. The same could be said about many fiat currencies. Whether we are looking at the US dollar, the euro, the Japanese yen or the British Pound. In the wake of the financial and economic crisis of 2008/2009, quite a few commentators painted a rather bleak future for them: high inflation, even hyperinflation, some even forecast their collapse. That did not happen. Instead, fiat money seems to be still in great demand. In the United States of America, for instance, peoples' fiat money balances relative to incomes are at a record high.

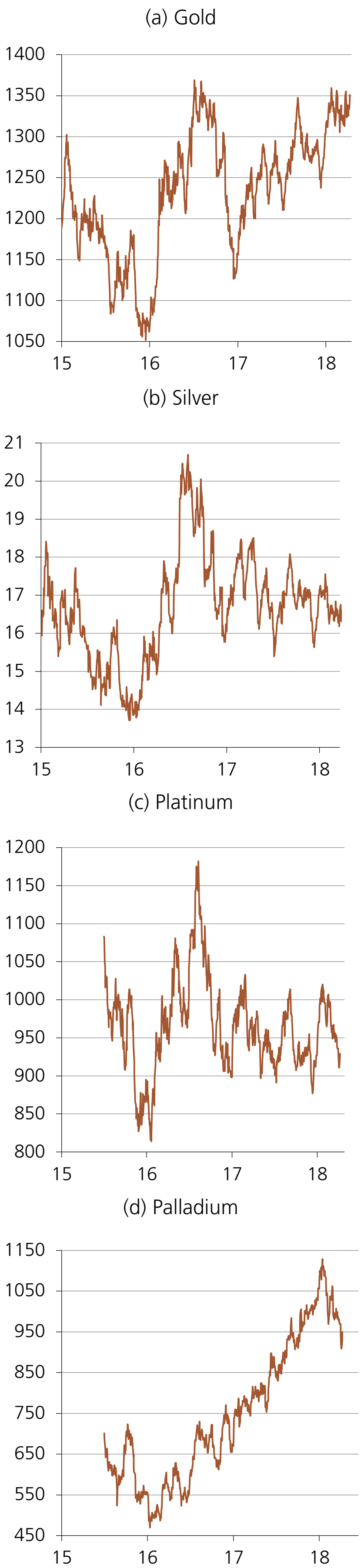
How come? Central banks' market manipulations have succeeded in fending off credit defaults on a grand scale: Policymakers have cut interest rates dramatically and injected plenty of new cash into the banking system. In retrospect, it is clear why these operations have prevented the debt pyramid from crashing down: 2008/2009 was a "credit crisis". Investors were afraid that states, banks, consumers and companies might no longer be able to afford their debt service – meanwhile, investors did not fear that inflation could erode the purchasing power of their currencies (as evidenced by dropping inflation expectations in the crisis period).

Central banks can no doubt cope with a credit default scenario: As the monopoly producer of money, central banks can provide financially ailing borrowers with any amount deemed necessary to keep them afloat. In fact, the mere assurance on the part of central banks to bail out the financial system if needed suffices to calm down financial markets and encourages banks to refinance maturing debt and even extend new credit. Cheap and easy central bank funding prompted lenders and borrowers to jump right back into the credit market. The debt binge could go on.

Monetary policymakers' unprecedented market interventions have not only prevented the global debt pyramid from crashing down, but they have also set into motion a renewed economic upswing ("boom"), which, however, has increased the world economy's debt load significantly. From the end of 2007 to the third quarter of 2017, global debt has risen by almost 35 percentage points to 245 percent of global GDP. (To approximate Mark Twain's words: Rumours of deleveraging in the global financial system are greatly exaggerated!) Particularly tricky is that the debt growth in the last decades has taken place in an environment of remarkably suppressed borrowing costs.

Maturing debt, as well as new debt, has been financed at very low interest rates. As a result, economic activity can be assumed to depend on the continuation of central banks' expansionary monetary policy more than ever. If interest

Precious metal prices (USD/oz)



Source: Thomson Financial.

rates remain artificially low, the global boom stands a good chance to continue. However, if interest rates rise, and reach a level that is too high, the current boom will turn into bust. Against this background, the monetary policy that governments, banks, large and small companies, unions, workers, shareholders, and savers are calling for is quite apparent: "Keep it going, whatever it takes".

As soon as economic activity starts to falter – whether due to central banks' interest rate increases or a negative fall-out of political interventions (such as a "trade war") –, it is foreseeable that central banks will switch back to an "expansionary", or: inflationary, policy of possibly even lower interest rates, more lending and money creation. It is pretty clear where this journey is taking us. The Austrian economist Ludwig von Mises put it succinctly: "In the opinion of the public, more inflation and more credit expansion are the only remedies against the evils which inflation and credit expansion have brought about."

The effect of artificially lowered interest rates is doing great economic harm, though. It discourages savings, boosts consumption, and encourages investments – the kind of investments that would not have been undertaken had the interest rate not been manipulated downwards. Artificially suppressed borrowing costs make debt burdens of consumers, firms, and governments rise. The result is a distortion of the economies' production and employment structure. To keep the boom going and prevent the bust, central banks push interest rates to ever lower levels, making sure that the credit and money supply keeps growing.

While such a monetary policy can prevent a credit crisis occasionally, it runs the risk to eventually resulting in a "currency crisis". In a currency crisis, investors become worried that the purchasing power of their money will go down. A currency crisis would be a severe threat to the fiat money system, possibly even exceeding the drama of a credit crisis. This is because central banks would have to dispel peoples' inflation concerns at some point by tightening monetary policy for all eyes to see: hiking interest rates and reigning in credit and money supply growth. This would, of course, deal a massive blow to financially overstretched economies.

However, one should not prematurely jump to the conclusion that the next turmoil – and in a fiat money system the next crisis not a question of if but of when – will necessarily be a currency crisis. We may even witness yet another credit crisis. Who knows? The crucial point is peoples' demand for money: As long as the demand for fiat currencies keeps pace with the growth in their supply, central banks can get away with their actions. For, in this case, any increase in the supply of fiat currency will be willingly held by the people, while price inflation of goods and asset prices remains well in check.

But is the demand for money really holding up? As mentioned earlier, in the US money holdings relative to GDP stand at a record level. At the same time, however, stock and housing prices have inflated quite considerable (see the graphs at the end of this article). This is evidence that consumers and firms have not merely kept their increased money holdings idle but have exchanged them to acquire assets. As money is increasingly offered against stocks and real estate, the prices of these goods increase, lowering the purchasing power of money – a development which is not well (or not at all) captured by official consumer price statistics.

The financial crises 2000/2001 and 2008/2009 have resulted in increasingly inflationary monetary policies – as evidenced by the ongoing expansion of the quantity of money through credit expansion relative to output, provided by ever lower interest rates. The symptoms of these policies are rising consumer prices and, in particular, increasing asset prices such as stock and housing prices. It would be undoubtedly misleading to accept the widely spread narrative that price inflation is no longer a problem, or that current monetary policies would not cause inflation. The truth is that inflation is alive a kicking.

How long can an inflation policy last? Mises's answers: "Probably as long as people are convinced that the government, sooner or later, but certainly not too late, will stop printing money and thereby stop decreasing the value of each unit of money. When people no longer believe this, when they realize that the government will go on and on without any intention of stopping, then they begin to understand that prices tomorrow will be higher than they are today. Then they begin buying at any price, causing prices to go up to such heights that the monetary system breaks down."

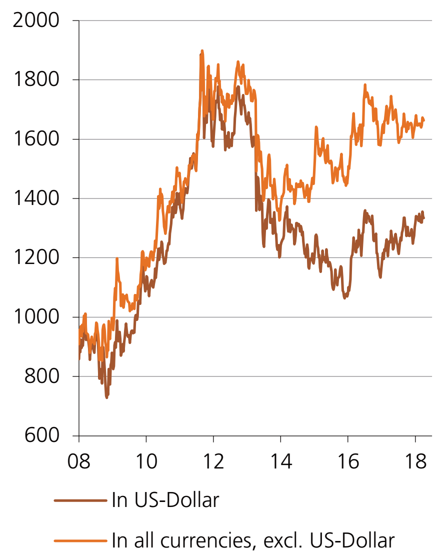
It does not have to end this way, though. Inflation is a man-made policy, and it can be put to a halt at any time. Unfortunately, however, the support for ending inflating the economies is pretty small – from academia, politicians, and the public at large. Under this condition, central banks can be expected to continue unabashedly as long as the possibilities of inflation have not been fully exhausted. However, as price inflation may still go on for quite a while, accompanied by boom and bust, the risk of a currency crisis is growing. The concern that it might be a currency crisis that could eventually bring down the fiat money system is by no means an exaggeration.

In view of the risks that come with an increasingly overstretched fiat money system, we consider gold as an effective insurance: The value of gold cannot be debased by central bank policies, and gold – in contrast to fiat money deposits and short-term debt – does not carry any default risk. Bought at current prices, gold is an insurance that has upward value potential.

Gold price per ounce

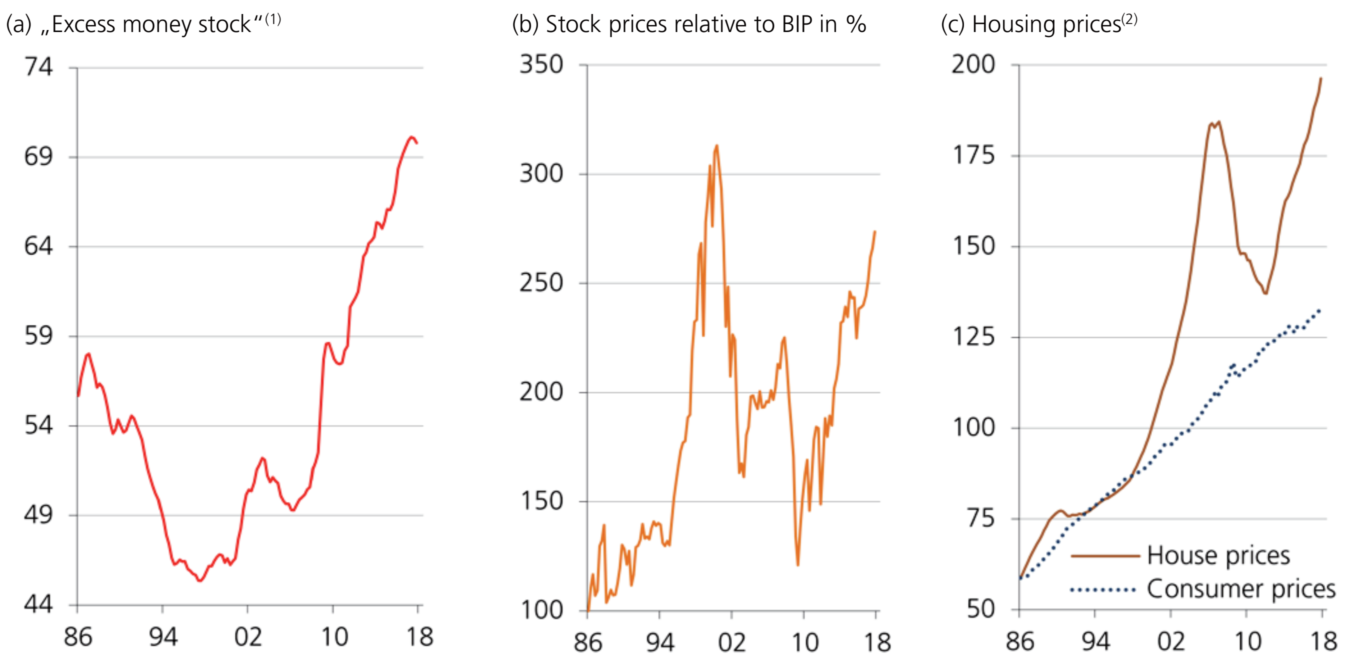
in US dollars and all world currencies (excl. the US dollar)*

January 2008 to April 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.

US: Rising money supply increases asset prices



Source: Thomson Financial; own calculations.

(1) US money stock M2 in percent of US GDP.

(2) Shiller house price index.

Gold In Art

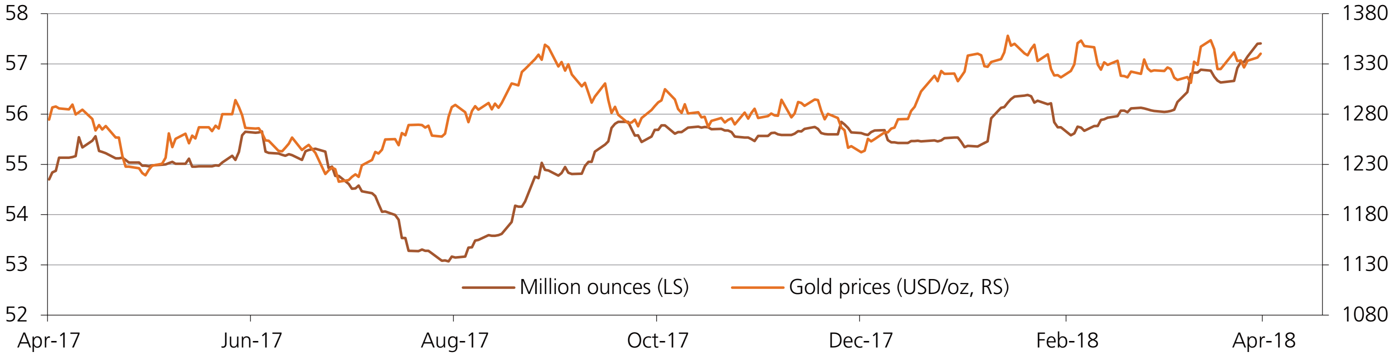
St Mark's Basilica, Venice

The photo above shows the interior of the *Patriarchal Cathedral Basilica of Saint Mark* (Italian: *Basilica Cattedrale Patriarcale di San Marco*) in Venice, viewed from the gallery above the main entrance. The origins of this Byzantine-style architecture, which lies at the eastern end of the *Piazza San Marco*, date back to 828. The upper walls and the entire ceiling are covered with *gold glass tesserae*, creating the shimmering overall effect. One of the most famous pieces of equipment of the cathedral is the *gold antependium* of the high altar, the so-called *Pala d'oro*.

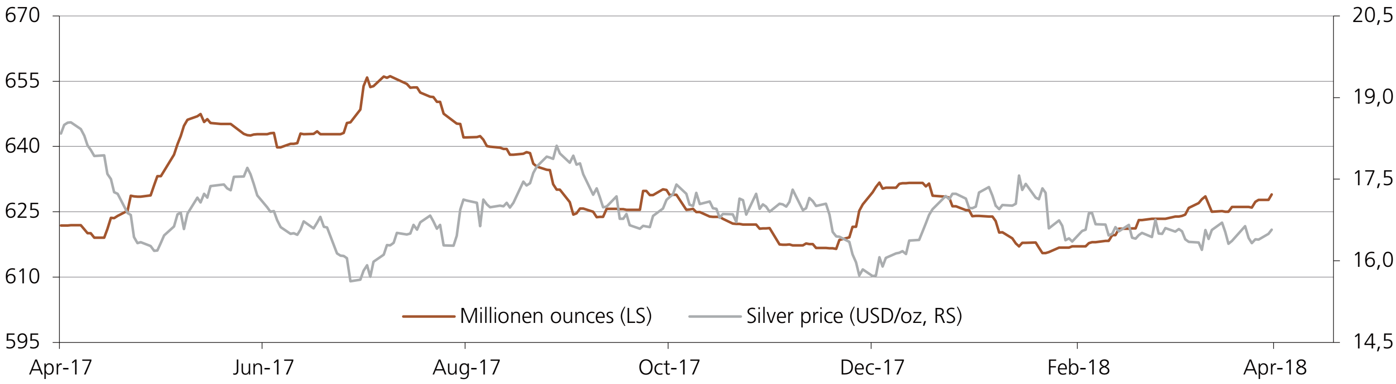
Dr Ruth Polleit Riechert, Art Historian (www.rpr-art.com).

Precious metals prices and ETF holdings

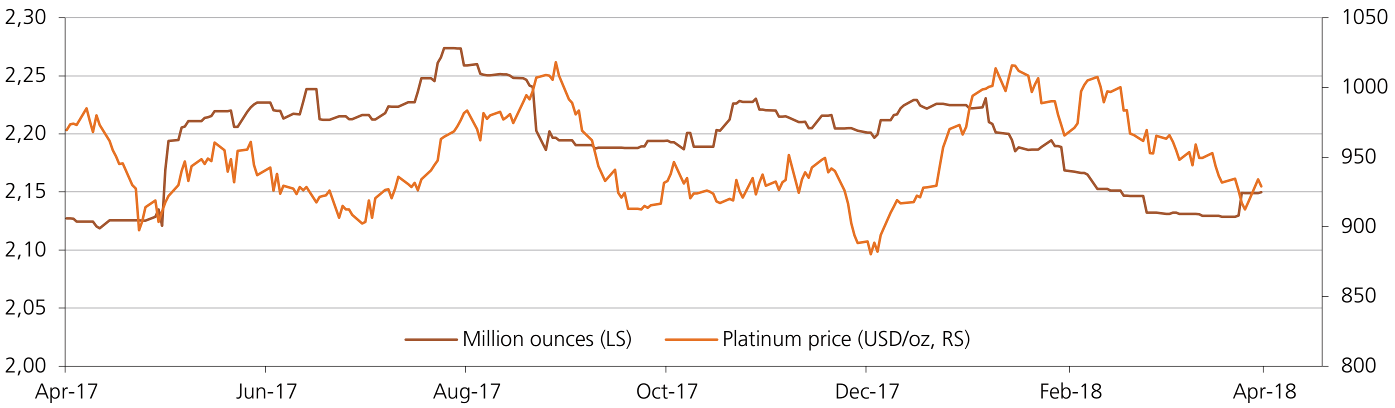
Gold ETFs (million ounces) und gold price (USD/oz)



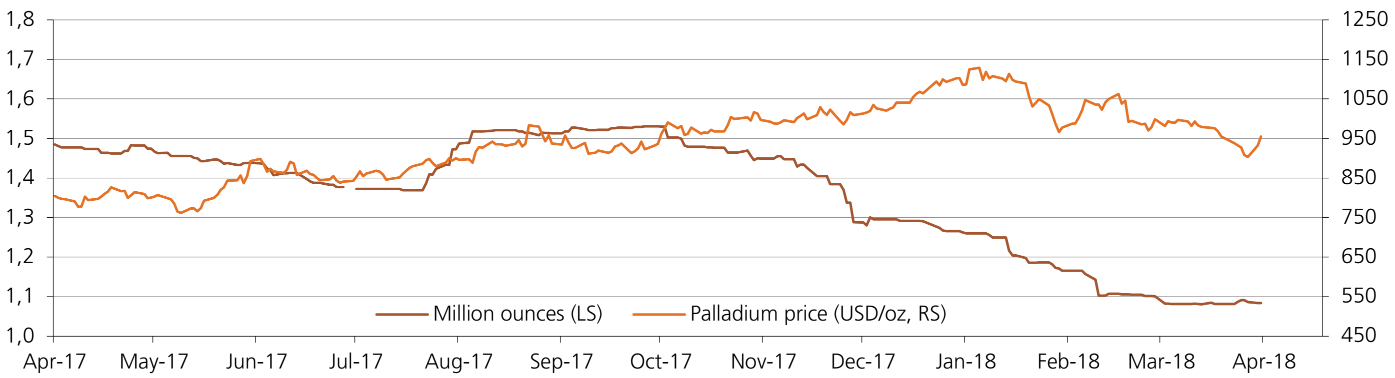
Silver ETFs (million ounces) and silver price (USD/oz)



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	1352.2		16.7		932.1		961.8	
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)	*-8*	*9*	*-4*	*26*	*0*	*12*	*7*	*31*
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

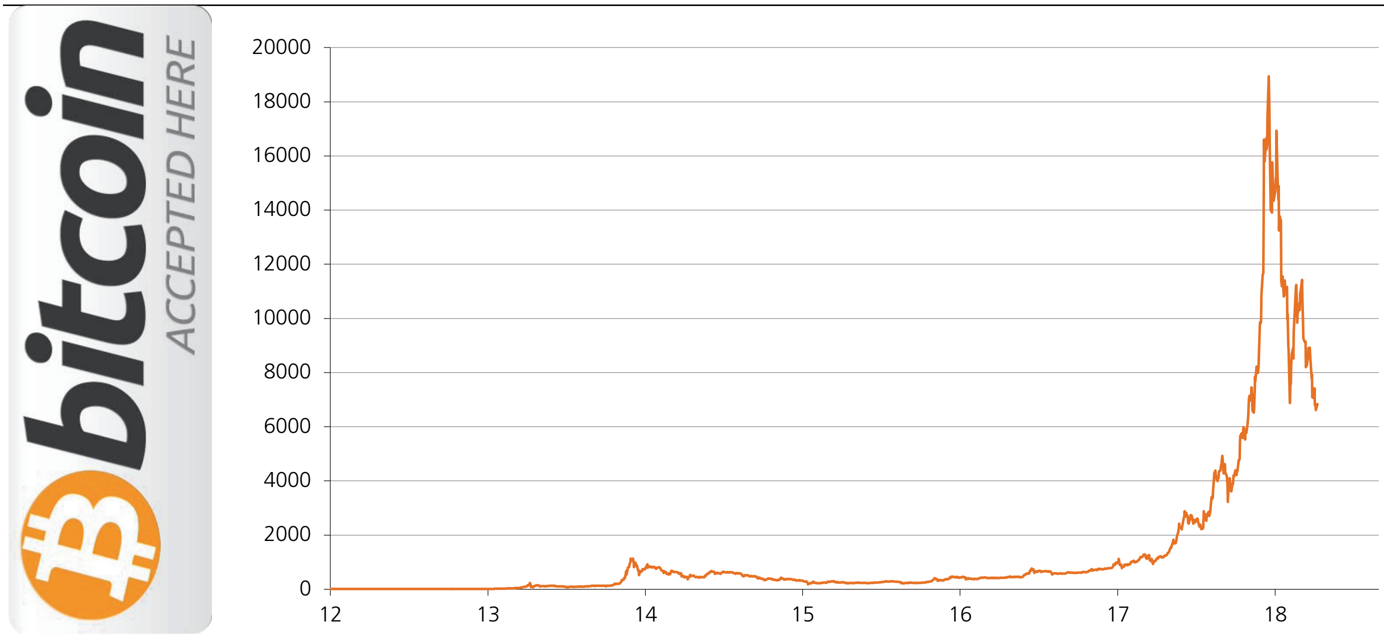
	Gold		Silver		Platinum		Palladium	
I. Actual	1093.8		13.5		754.0		778.0	
II. Gliding averages								
5 days	1085.1		13.4		747.4		752.5	
10 days	1082.6		13.3		753.5		768.9	
20 days	1079.9		13.3		762.9		784.9	
50 days	1078.2		13.4		781.8		806.7	
100 days	1080.0		13.7		785.6		841.7	
200 days	1084.9		14.0		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*	*15*	*2*	*33*	*6*	*19*	*14*	*39*
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

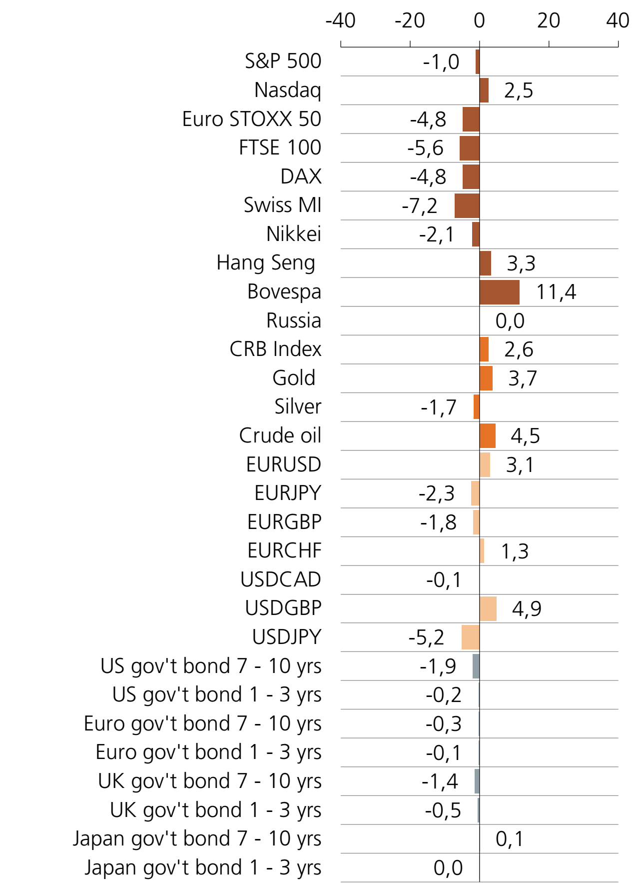
Bitcoin in US dollars



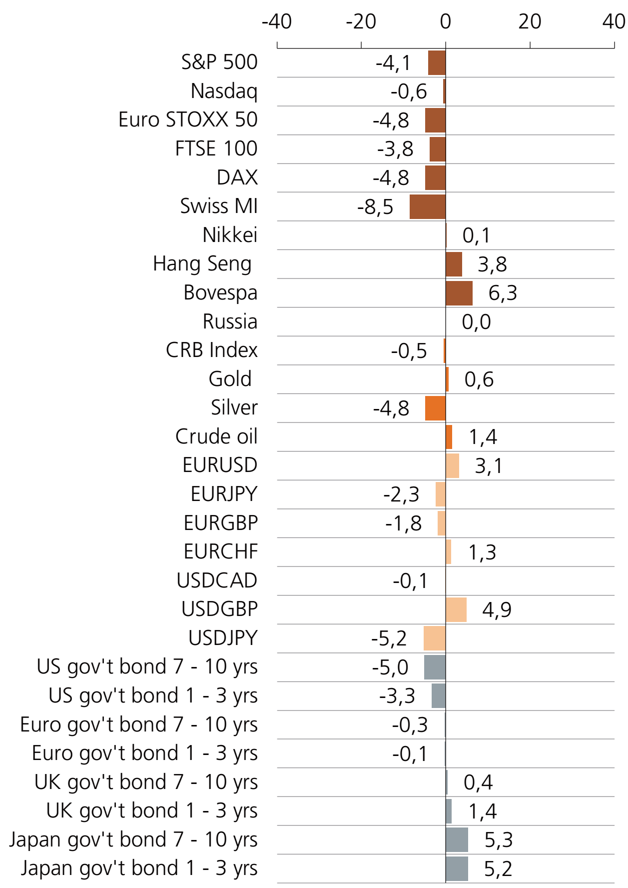
Source: Thomson Financial.

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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29 March 2018	Walking the Tightrope
16 March 2018	Gold, Interest Rates, And Money
2 March 2018	Gold in Times of Boom and Bust
16 February 2018	The Fed Makes The Stock Market A Risky Place
2 February 2018	Central Banks Put a Safety Net Under Financial Markets
19 January 2018	Chances And Risks For Investors in 2018
21 December 2017	New Competition: Gold and Crypto Currencies Against Fiat-Monies
8 December 2017	It Is Just Another Inflationary Boom
24 November 2017	There Is, And Will Be More, Inflation
10 November 2017	Calm Markets: The Great Mystery
27 October 2017	The Interest Rate Becomes A "Crash Factor"
13 October 2017	The Great Complacency
29 September 2017	The German Election Outcome Might Turn Up The Heat On The Euro
15 September 2017	A Case for Gold in the Investment Portfolio
1 September 2017	On the Intrinsic Price of Gold
18 August 2017	Gold in Times of Boom and Bust
4 August 2017	The Underpriced Risk
21 July 2017	The Fed Remains on Course – to Trouble
7 July 2017	Gold And The Blockchain
23 June 2017	The Super-Bubble in Danger
9 June 2017	Trapped in Boom-and-Bust
26 May 2017	The Make-Believe World of Fiat Money
12 May 2017	The Fed Will Likely Chicken Out on Planned Rate Hikes
28 April 2017	Central Banks Will not Dare to Take Away the Punch Bowl
13 April 2017	The Gold Price Rise Tells Us: The Crisis Isn't Over Yet
31 March 2017	ECB Negative Interest Rate Policy Will Come to an End
17 March 2017	The Fed's Half-Hearted Attempt of Monetary Tightening
3 March 2017	ECB Flirts With Higher Inflation. The Case For Gold
17 February 2017	Gold Gains Ground vis-a-vis the US-Dollar
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

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Imprint
Marktreport is published every 14 days on Fridays and is a free service provided by Degussa Goldhandel GmbH.
Deadline for this edition: 16 February 2018
Publisher: Degussa Goldhandel GmbH, Kettenhofweg 29, 60325 Frankfurt, Tel.: (069) 860068-0, Fax: (069) 860068-222
E-Mail: info@degussa-goldhandel.de, Internet: www.degussa-goldhandel.de
Editor in chief: Dr. Thorsten Polleit
Degussa Market Report is available on the Internet at: http://www.degussa-goldhandel.de/infothek/marktreport/