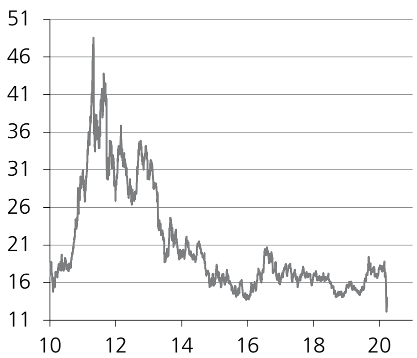
Degussa Market Report

26 March 2020 Economics · Finance · Precious Metals

USD per ounce of gold

USD per ounce of silver



EURUSD

Source: Refinitiv; graphs by Degussa.

Precious metals prices				
	Actual (spot)	Change against (in percent): 2 W	3 M	12 M
I. In US-dollar				
Gold	1.612.9	-3.6	10.3	25.3
Silver	14.4	-16.9	-14.9	-4.8
Platinum	736.1	-18.3	-18.0	-13.1
Palladium	2.302.3	-10.3	24.3	62.1
II. In euro				
Gold	1.480.8	-0.1	12.2	29.0
Silver	13.2	-13.9	-13.4	-2.0
Platinum	675.8	-15.3	-16.6	-10.3
Palladium	2.114.0	-7.0	26.5	66.7
III. Gold price in other currencies				
JPY	179.390.0	1.8	12.6	25.1
CNY	11.467.8	-1.1	11.4	32.7
GBP	1.354.2	5.6	19.8	37.8
INR	123.163.3	1.9	17.6	38.3
RUB	125.994.4	9.8	34.2	50.1

Source: Refinitiv; calculations by Degussa.

OUR TOP ISSUES

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

WITH MEGA-BAILOUTS, GOVERNMENTS ARE THE BIG WINNERS

The growing concerns about the consequences of the COVID-19 coronavirus have led to a global demand and supply shock: the demand for goods and services has collapsed, and because international production and value chains are now also disrupted, output slows down, and its former level can no longer be maintained.

The demand and supply shock brings the division of labor in the individual countries and thus internationally to a standstill. The damage is colossal and threatening. The fine division of labor is the engine that drives the economic prosperity of the world's population. It cannot be switched off with impunity. If the shutdown continues, supply shortages of vital goods will be inevitable for people around the world.

Above all, however, the unbacked paper money system, which has been established worldwide, has been severely shaken by the slump in production and incomes, and this could ultimately have fatal consequences for the global economy; price action in financial markets has already given us a taste of this (as the figure below shows). Whether in the USA, Europe, Asia, or Latin America, unbacked paper money systems are found everywhere.

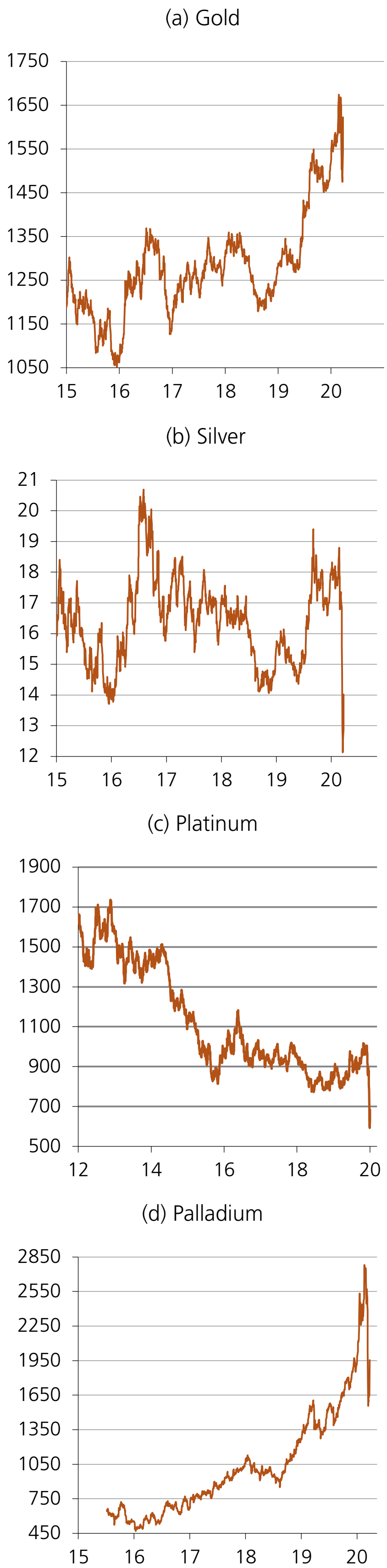
UNBACKED PAPER MONEY SYSTEMS

In an unbacked paper money system, the central bank, in close cooperation with the commercial banks, expands the money supply by extending loans. It amounts to an increase in the money supply out of thin air (ex nihilo): new money is put into circulation that is not covered by "real savings." Economists are only too well aware that such an unfunded monetary system inevitably causes crises.

The unbacked paper money system cannot stand one thing: a drop in income, a drop in the price of goods. This is because then the overindebtedness of companies, households, and, above all, states comes to light—the whole paper money swindle is exposed. And that is the reason why the states are now intervening more heavily than ever ("all in") with their central banks in the economic and societal system.

Interest rates have been cut as far as possible to provide relief to borrowers and keep the debt pyramid from collapsing. Financially ailing states and banks have

Precious metal prices (USD/oz) in the last 4 years



Source: Refinitiv; graphs by Degussa.

access to unlimited cash injections from the central bank if necessary. However, unlike in the financial and economic crisis of 2008/2009, the private sector is now also on fire: companies and private households are threatened by bankruptcy.

Most companies are indebted; they have to pay interest and principal on an ongoing basis. If sales collapse, firms no longer earn anything and run into financial difficulties. If companies become insolvent, jobs will be lost, and the storm will ultimately reach private households, the consumers, who will then also have no money to service their debts.

This is when banks step on the "credit brake": they are no longer willing or able to prop up shaky borrowers, let alone lend them new money. However, if the inflow of new loans to the national economy dries up, basically all debtors will end up in a tight spot. They cannot repay their loans, and they can also no longer get new loans that could replace their liabilities coming due.

Loan defaults are increasing. The credit supply is shrinking—and exacerbating the bankruptcy problem. Banks are experiencing credit defaults that deplete their equity, and they, too, are experiencing difficulties. In other words: The "credit boom" that drove economies and fueled the debt incentive is bursting. The boom is turning into a bust.

BANKING "BAILOUT"

In Germany, for instance, there has already been a reaction to "master" the crisis, with an expansion of short-time work benefits and tax deferrals, but above all with loan guarantees provided by the state-owned bank KfW. This means that the state makes the taxpayer responsible for squaring the bill for any loan default in an emergency; the taxpayer must once again serve as a credit default insurer.

If the placebo pill works, trust returns, stumbling debtors get new bank loans, and loan defaults remain low, the taxpayer gets off lightly. But if the maneuver fails and loan defaults occur, a lot of money will be needed. The state will have to incur new debt, which will then presumably be bought up by the European Central Bank (ECB). This creates new central bank money.

And the new money is paid out to the banks directly: on their balance sheets, credit claims are exchanged for balances with the central bank. It's pretty clear: it will be those banks in particular that will be protected by the state guarantees. The banks get this insurance virtually free of charge, on top of the collateral that borrowers have already given them, and which banks can use. So it will be the taxpayer who will have to shoulder the bill.

GUARANTEEING CREDIT

Things will be less pleasant for borrowers. Struggling companies can be saved from insolvency if and when they get new loans thanks to state guarantees. But their debt is increasing: either the interest and principal payments are temporarily suspended and capitalized—that is, they are added to the outstanding loan amount to be serviced subsequently—or the new loans are used to pay the debt service of the old loans.

At this point, it should be borne in mind that many companies will most likely suffer a permanent loss of sales due to the crisis: even if the demand for goods should normalize again at some point, the lost sales will not be recuperated. As a result, firms' debt-to-earning power ratio will deteriorate and their cost of capital will increase (other things being equal).

In December 2019, German banks had credit claims of more than €4,000 billion in their balance sheets. If the banks receive a loan guarantee from the state, which, let's say, secures 80 percent of the loan claims, the guarantees of €553 billion announced by the KFW would result in bank loans of a good €690 billion, i.e., collateral for almost 17 percent of the outstanding bank loans.

In the euro area as a whole, outstanding bank loans amounted to a massive €18,591 billion at the end of last year. If euro governments were to follow the German credit guarantee example, they would have to accept considerable contingent liabilities for their households. This, in turn, will presumably drastically lower their credit rating on the financial markets—especially since all countries are already overstretched financially.

HELICOPTER MONEY

It would not be surprising if sooner or later people called for the issuance of helicopter money. The US administration seems to be moving in this direction already: on March 17, US Treasury secretary Steve Mnuchin announced that the US wants to send checks to its citizens by mail, something to the amount of $1,000 per person. You may argue that formally this is a tax refund. But as all the US dollars will be created out of thin air, the procedure comes relatively close to a form of helicopter US dollar issuance.

From a technical point of view, it is indeed quite easy to issue helicopter money: every account holder receives a "monetary gift" from the central bank and can use it to go shopping or service his/her outstanding debts. However, the issuance of helicopter money is difficult to control politically: it wouldn't take long, and the central bank would be drowning in requests for monetary gifts.

Be that as it may, the issuance of helicopter money is very alluring, especially in a situation in which the debt pyramid threatens to collapse as recession-depression looms on the horizon and people strongly believe that inflation of goods prices is a blessing and the "least evil" policy. Under these conditions, helicopter money will likely be distributed at some point to stimulate consumption and ease debtors' financial strain.

ALMIGHTY STATE

Whether the unsecured paper money system survives the current crisis depends significantly on whether (i) the state's credit guarantees succeed in warding off a wave of bankruptcies and (ii) investors regain confidence in the system and credit markets return to normal. There should be no doubt, however, that a life-threatening situation has arisen for the unbacked monetary system. The probability of things going wrong this time is not zero.

But a breakdown is not yet inevitable. The states and their central banks can still pull "new rabbits out of the hat." For example, faltering banks could be recapitalized by countries injecting new money that they receive from the ECB as equity capital; or states could finance themselves and consumers as well as firms with the issuance of helicopter money. One thing is pretty certain: without govern-

ment intervention, without their market manipulations, the unbacked money system could no longer be maintained.

And that should make citizens extremely concerned indeed. Crises regularly lead to an increase in government power. The causes of crises are habitually mis- and reinterpreted: the free market has failed, it will be said, and now only the state can help—even though the state and its central bank are the main culprits causing financial and economic crises.

They are the ones who started and encouraged the debt economy with their unbacked paper money system, a system that sooner or later must collapse. This time, the trigger of the crisis is the concern about the consequences of the coronavirus. How aggressively the states intervene in the global market and societal system also plays an important role; that is, the extent to which states seize the opportunity to expand their power.

SERFDOM

The more apparent it becomes that the unbacked monetary system does not work—that it causes crises—the higher is the tendency for people to turn a blind eye to this very truth. The more uninhibitedly collectivist-socialist measures are reinterpreted as "rescue policies" on the part of politicians and mainstream economists, the more such interventions are welcomed by the general public and approved.

Every crisis caused by the unbacked paper money system expands the power of states over economic and social life, and unfortunately, once the state has expanded its power, its expansion will not be reversed. As a result, the economy will become increasingly entangled with state socialist policies over time as the state and its central bank fight the crisis whose seeds they planted.

If people do not want to turn away from the unbacked paper money system, it is predictable that sooner or later everything will be subordinated to one goal: to strengthen the state—to provide it with ever more powers and with unlimited financial resources. And this means that the free markets (or what little is left of them), and thus also civil and entrepreneurial freedoms, will be stifled more and more.

Given current events, it is therefore far from exaggerated to say that without a "bailout" of the system, a global depression is inevitable. But with a bailout comes serfdom.

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PRECIOUS METALS PRICES

In US-Dollar per ounce

	Gold		Silver		Platinum		Palladium	
I. Actual	**1612.6**		**14.4**		**736.1**		**2302.4**	
II. Gliding averages								
10 days	1541.0		13.6		694.3		1786.9	
20 days	1590.3		15.4		787.1		2173.3	
50 days	1584.7		16.9		904.4		2329.6	
100 days	1537.1		17.1		914.3		2105.5	
200 days	1505.5		17.1		897.4		1844.9	
III. Estimates, end 2020	**1695**		**25**		**1256**		**1536**	
(1)	*5*		*73*		*71*		*-33*	
Band width	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1459	1931	19.8	28.8	1020	1492	1300	1772
(1)	*-10*	*20*	*38*	*101*	*39*	*103*	*-44*	*-23*
V. Annual averages								
2017	1253		17.1		947		857	
2018	1268		15.8		880		1019	
2019	1382		16.1		862		1511	

In Euro per ounce

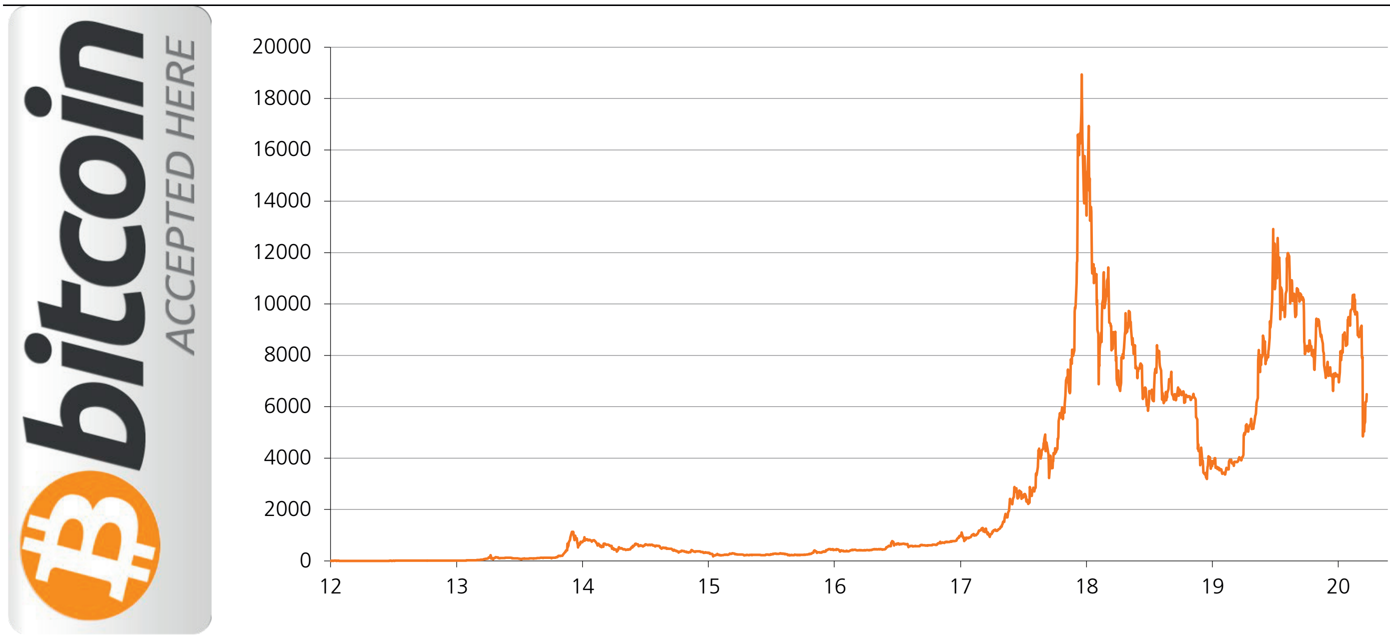
	Gold		Silver		Platinum		Palladium	
I. Actual	**1481.0**		**13.2**		**676.0**		**2114.4**	
II. Gliding averages								
10 days	1409.7		12.5		634.1		1633.0	
20 days	1439.8		13.9		711.5		1964.7	
50 days	1440.8		15.4		822.0		2117.5	
100 days	1391.7		15.5		827.5		1906.7	
200 days	1358.7		15.4		809.7		1665.8	
III. Estimates, end 2020	**1580**		**23**		**1170**		**1430**	
(1)	*7*		*76*		*73*		*-32*	
Band width	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1360	1800	18.6	27.0	950	1390	1210	1650
(1)	*-8*	*22*	*41*	*104*	*41*	*106*	*-43*	*-22*
V. Annual averages								
2017	1116		15		844		760	
2018	1072		13		743		863	
2019	1235		14		770		1350	

Source: Thomson Financial; calculations and estimates Degussa. Numbers are rounded.

(1) On the basis of actual prices.

BITCOIN, PERFORMANCE OF VARIOUS ASSET CLASSES

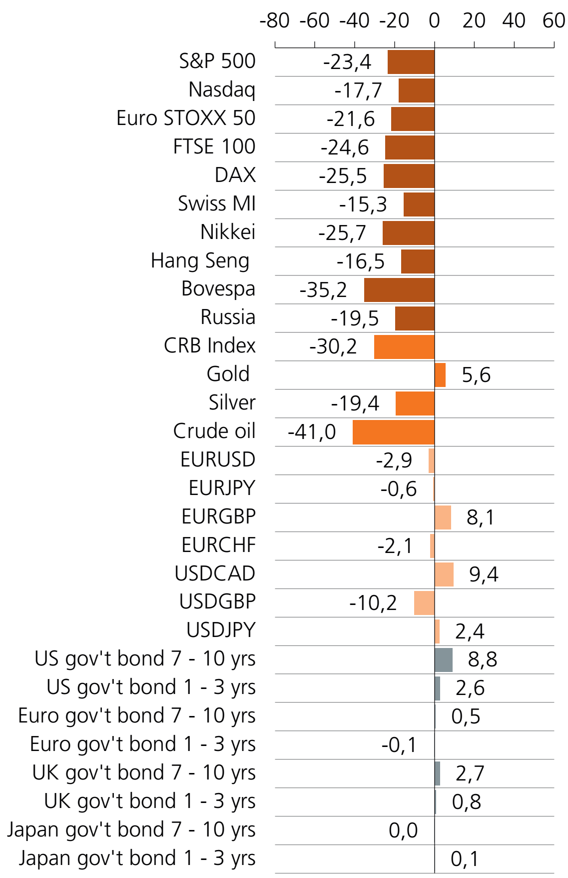
Bitcoin in US dollars



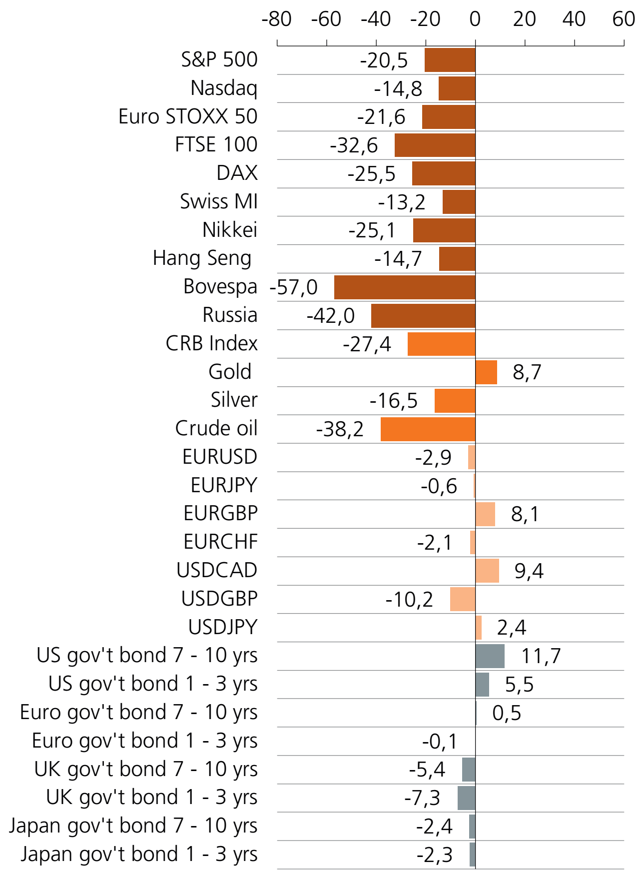
Source: Refinitiv; graph by Degussa.

Performance of stocks, commodities, FX and bonds

(a) In national currencies



(b) In euro



Source: Refinitiv; calculations by Degussa.

Articles in earlier issues of the *Degussa Market Report*

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13 February 2020	Gold-ETFs Versus Physical Gold: Difference Matters
30 January 2020	Do Not Think The Era Of Boom And Bust Has Ended
23 January 2020	Bull Markets, No Bubble Markets: Gold And Silver In 2020
19 December 2019	The Inflation Sham
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21 November 2019	Asset Price Inflation and the Price of Gold
7 November 2019	ETFs Drive Gold Demand
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10 October 2019	Let's Get Physical With Gold And Silver
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12 October 2018	Here Goes The Punch Bowl
28 September 218	The Fed's Blind Flight
14 September 2018	How Fed Policy Relates to the Price of Gold

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