Degussa Market Report

6 May 2021 **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	1.784.6	0.5	-4.1	2.6
Silver	26.4	1.8	-8.8	44.7
Platinum	1.224.0	1.7	8.6	44.4
Palladium	2.974.1	7.1	32.4	51.6
II. In euro				
Gold	1.487.3	0.4	-3.6	-4.8
Silver	22.0	1.8	-8.4	34.2
Platinum	1.020.1	2.0	9.0	33.9
Palladium	2.479.0	7.2	33.1	40.1
III. Gold price in other currencies				
JPY	194.984.0	0.9	-0.1	4.2
CNY	11.551.7	-0.2	-4.0	-6.8
GBP	1.283.3	0.0	-5.7	-7.8
INR	131.720.6	1.9	-3.1	0.3
RUB	133.603.2	-0.8	-5.5	11.4

Source: Refinitiv; calculations by Degussa.

OUR TOP ISSUES

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

THE DARK SIDE OF YIELD CURVE CONTROL POLICY

The Bank of Japan has been pursuing a monetary policy of "yield curve control" (YCC) since 2016, with which it keeps short and long-term interest rates for Japanese debt securities at around 0 percent. To do this, it buys massive amounts of government bonds. The Central Bank of Australia has been proceeding in a very similar way since March 2020. It keeps the three-year interest rate at 0.1 percentage points through bond purchases. The European Central Bank (ECB) seems to be increasingly warming up to the idea of not only controlling short-term but also long-term interest rates or imposing a cap on them.

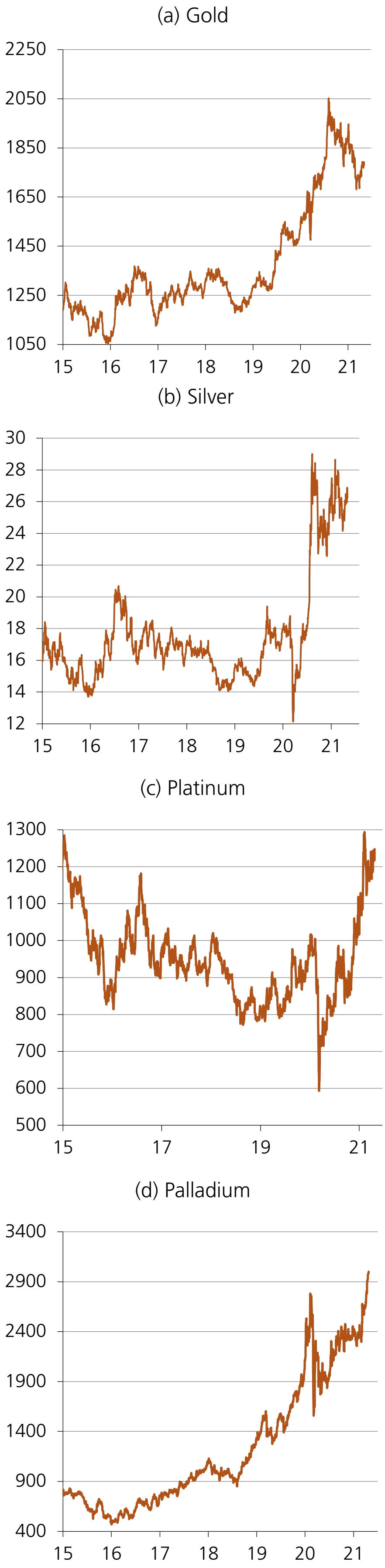
The idea of controlling interest rates is not new. It has already been practiced in the United States of America: from April 1942 to March 1951, the US central bank set short-term interest rates at three-eighths of a percent and long-term interest rates at 2.5 percent. The reason: the Americans financed their World War II expenditures primarily by issuing new debt, which was bought to a large extent by the US central bank and thus monetized; to keep the financing costs low, interest rates were capped. When the Treasury Accord terminated interest rate control, the purchasing power of the greenback was reduced by almost 40 percent.

Can we conclude from this experience that interest rate control policies must necessarily lead to high inflation? On the one hand, the answer is no. For logical reasons, no regularity can be derived from any historical event: experience can only show that something was one way or another, but not that what was seen as inevitable could not have gone differently. On the other hand, there is no way we can say that the interest rate control policy is harmless in any way. In fact, it has the potential to lead to high inflation. A simple reflection underscores this notion.

If a central bank sets an interest rate cap, it is tantamount to setting a minimum price for bonds. If the announced minimum price is above the market-clearing rate—and this is to be expected, otherwise a minimum price would not be required—there is an excess supply on the bond market: the supply of debt rises while the demand for bonds falls. To keep bond prices from falling (and yields from rising), the central bank needs to buy up the excess supply. It pays for the purchases with newly created money, which increases the amount of money outstanding.

The decisive factor for the resulting monetary effect is from whom the central bank buys the bonds. If they come from the holdings of the commercial banks, "only" an expansion of the base money occurs: the bond holdings on the

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



Source: Refinitiv; graphs by Degussa.

banks' balance sheets decrease and, in return, the banks' excess reserves increase. If, on the other hand, the bonds that the central bank buys are sold by nonbanks (such as insurance companies, pension funds or private investors), the base money supply in the banking sector increases, and the commercial bank money supply—M1, M2, M3, etc.—also increases. The same effect occurs when the central bank purchases newly issued national debt, i.e., when it finances the public budget directly by starting up the virtual money printing press.

However, the announcement and enforcement of a minimum price for bonds can trigger a dynamic that is difficult to stop accelerating. The higher the minimum price of the bonds is above their market-clearing price, the greater the volume of debt to be bought or monetized by the central bank. And the greater the resulting expansion of the money supply, the more the market-clearing bond price will go down: if the money supply rises sharply, the market value of the bonds declines, as investors will demand a higher return. In turn, this increases the excess supply on the bond market, which the central bank has to buy to maintain the minimum price. This ominous dynamic is exacerbated when the government borrowing threatens to spiral out of control.

And that is very likely under a monetary policy of interest rate control: if governments can get loans at low interest rates, they will seize the opportunity. Not only will they replace due debt with new debt that has a lower interest rate, but most importantly, they will also increase new debt. The state's hunger for funding is enormous; this is seen not only by experience, but it is also evident in the current economic and political situation: the way out of the corona crisis is seen in the expansion of national debt, in the Keynesian deficit policy, which should lead to more growth and employment. In addition, the states also want to bet on new debt to finance "green politics" or a "great transformation" of the national economies.

This latter aspect is highly significant, as proponents of an interest rate control policy often believe that with the announcement of a floor price for bonds (i.e., an interest rate cap), capital markets will know where they are: investors will then understand that it is unprofitable for them to bet on an interest rate hike, that is, to bet against the central bank. As a result, bond prices remain at the level desired by monetary policy without the central bank having to buy up bonds on a large scale and increasing the quantity of money. Unfortunately, this very assessment did not work out in Japan. From 2016 to the end of 2020, the total assets of the Bank of Japan rose from 75 percent of Japan's gross domestic production to 130 percent at the end of 2020—because the Bank of Japan had to monetize the high national deficits and also parts of the already outstanding national debt to keep interest rates low.

The interest control policy is ultimately an admission of "fiscal dominance." That is, the financial situation of the state determines monetary policy action. Not only does this not bode well for the purchasing power of money, but it can all too easily lead to very high inflation. After all, it is the here and now that counts in day-to-day political business. The future consequences of political decisions are usually given little consideration. In addition, the political incentive to keep expanding the money supply once the measures have been started is pretty great. Initially, it has positive effects: the economy is supported, the plight of unemployment is reduced, and bank and corporate bankruptcies are averted.

But sooner or later, the negative effects of the expansion of the money supply—the rise in asset and/or consumer goods prices—come to light: The purchasing power of money is dwindling, few are better off at the expense of many, the gap between rich and poor widens, distribution conflicts worsen, bitterness in society grows rampant, and production and employment suffer. With an interest rate control policy, there is a particularly great danger that the central banks will slide into an increasingly inflationary monetary policy, not least because artificially lowered interest rates can be expected to fuel governments' deficit spending policies, contribute to the state becoming almighty, and destroy what little is left of the free market economic system.

In his masterpiece Socialism: An Economic and Sociological Analysis (the 1951 translation of his German Gemeinwirtschaft: Untersuchungen über den Sozialismus published in 1922) Ludwig von Mises (1881–1973) wrote clear-sighted the following words, which seem to be of utmost relevance in a period in which central banks peddle the advantages of the policy of yield curve control to the wider public, thereby actually paving the way toward higher inflation:

"The destructionist policy of interventionism and Socialism has plunged the world into great misery. Politicians are helpless in the face of the crisis they have conjured up. They cannot recommend any way out except more inflation or, as they call it now, reflation. Economic life is to be 'cranked up again' by new bank credits (that is, by additional 'circulation' credit) as the moderates demand, or by the issue of fresh government paper money, which is the more radical program.

But increases in the quantity of money and fiduciary media will not enrich the world or build up what destructionism has torn down. Expansion of credit does lead to a boom at first, it is true, but sooner or later this boom is bound to crash and bring about a new depression. Only apparent and temporary relief can be won by tricks of banking and currency. In the long run they must land the nation in profounder catastrophe. For the damage such methods inflict on national well-being is all the heavier, the longer people have managed to deceive themselves with the illusion of prosperity which the continuous creation of credit has conjured up."[1]

This article was published on the website of the Ludwig von Mises Institute, 3 May 2021.

[1] Ludwig von Mises, Socialism: An Economic and Sociological Analysis (New Haven, CT: Yale University Press, 1951), p. 497.

PRECIOUS METALS PRICES

In US-Dollar per ounce

	Gold		Silver		Platinum		Palladium	
I. Actual	**1785.1**		**26.5**		**1224.2**		**2974.2**	
II. Gliding averages								
10 days	1779.4		26.2		1223.7		2927.3	
20 days	1767.2		25.9		1211.4		2816.7	
50 days	1743.1		25.8		1198.0		2622.6	
100 days	1798.0		26.1		1155.6		2487.7	
200 days	1853.4		25.6		1038.6		2390.9	
III. Estimates for end 2021	**2448**		**47**		**1272**		**2710**	
(1)	*37*		*78*		*4*		*-9*	
Band width	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1750	2684	23.0	55.1	950	1472	2280	2910
(1)	*-2*	*50*	*-13*	*108*	*-22*	*20*	*-23*	*-2*
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

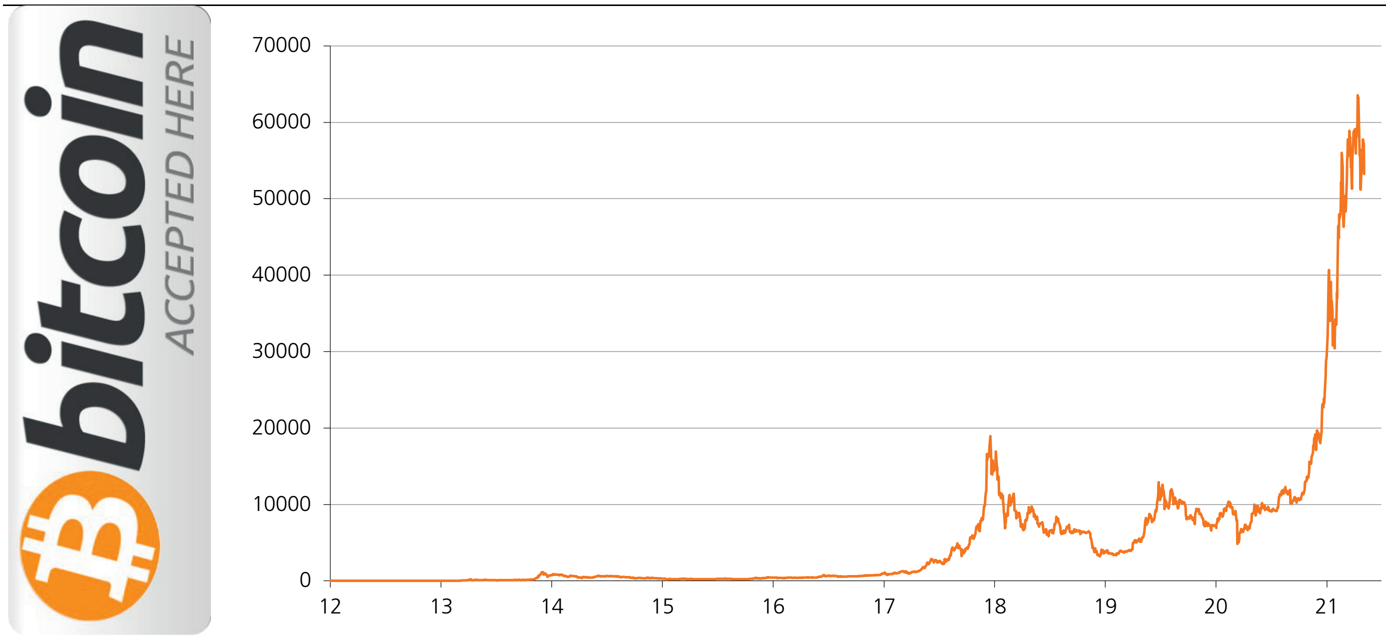
	Gold		Silver		Platinum		Palladium	
I. Actual	**1487.7**		**22.0**		**1020.3**		**2478.7**	
II. Gliding averages								
10 days	1475.3		21.7		1014.6		2427.0	
20 days	1471.9		21.6		1009.0		2345.7	
50 days	1458.8		21.6		1002.6		2194.8	
100 days	1491.8		21.6		959.5		2065.5	
200 days	1552.2		21.4		868.8		2001.7	
III. Estimates for end 2021	**2044**		**39**		**1062**		**2263**	
(1)	*37*		*78*		*4*		*-9*	
Band width	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1470	2260	19.0	46.6	800	1240	1920	2450
(1)	*-1*	*52*	*-14*	*111*	*-22*	*22*	*-23*	*-1*
V. Annual averages								
2017	1116		15		844		760	
2018	1072		13		743		863	
2019	1235		14		770		1350	

Source: Refinitiv; calculations and estimates Degussa. Numbers are rounded.

(1) On the basis of actual prices.

BITCOIN, PERFORMANCE OF VARIOUS ASSET CLASSES

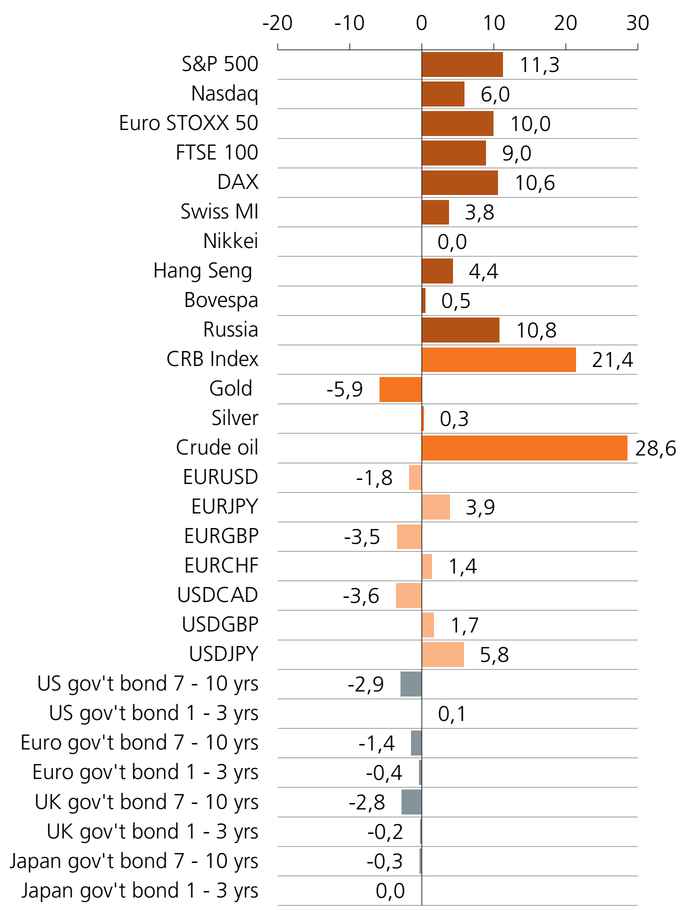
Bitcoin in US dollars



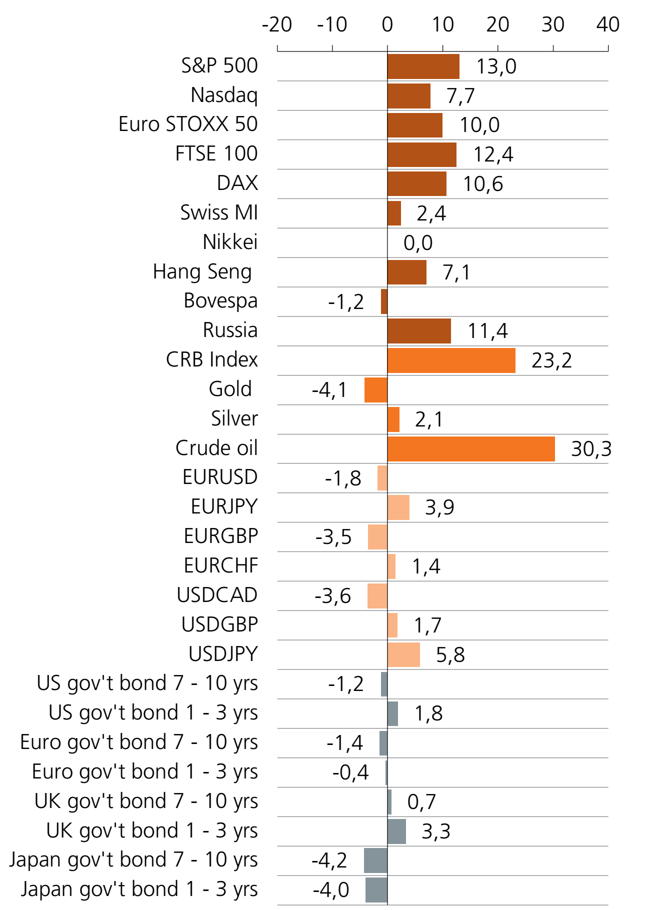
Source: Refinitiv; graph by Degussa.

Performance of stocks, commodities, FX and bonds

(a) In national currencies



(b) In euro



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Articles in earlier issues of the *Degussa Market Report*

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