Degussa Market Report

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	1.768.0	-1.3	-2.5	-6.8
Silver	21.9	-5.3	-8.3	-16.9
Platinum	918.1	-3.7	-9.3	-13.9
Palladium	1.608.9	-8.0	-34.8	-34.3
II. In euro				
Gold	1.568.2	-0.9	2.2	0.9
Silver	19.4	-4.9	-3.8	-9.8
Platinum	814.4	-3.3	-5.1	-6.9
Palladium	1.427.0	-7.6	-31.8	-28.7
III. Gold price in other currencies				
JPY	201.052.0	-1.0	0.8	2.6
CNY	11.250.3	-1.8	-3.9	-9.2
GBP	1.333.2	-0.7	1.2	-3.9
INR	134.453.6	1.9	1.7	-3.0
RUB	130.392.9	-3.3	-1.6	-6.9

Source: Refinitiv; calculations by Degussa.

OUR TOP ISSUES

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

WELCOME TO A NEW CHAPTER IN THE BOOM-AND-BUST-CYCLE-DRAMA

What lies ahead is undoubtedly a rather sensitive chapter in the boom-and-bust-cycle-drama caused by US monetary policy: The US Federal Reserve (Fed) is about to end its ultra-easy course. The reason: after many years of exceptionally low interest rates – with most real, i.e. inflation-adjusted, interest rates even in the negative territory – and a huge inflow of newly created money into the economic and financial system, goods price inflation is rearing its ugly head.

In November this year, US consumer goods prices rose 6.8 per cent compared to the previous year, the highest rate since 1982. In September, US house price inflation was 19.5 per cent year-on-year. What is more, from the end of 2019 to December 2021, the prices for agricultural goods rose by 47 per cent and for industrial metals by 44.5 per cent. Most notably, the US stock market index S&P 500 gained around 58 per cent. What will happen if and when the Fed begins its "fight against inflation" by raising interest rates and reining in money supply growth?

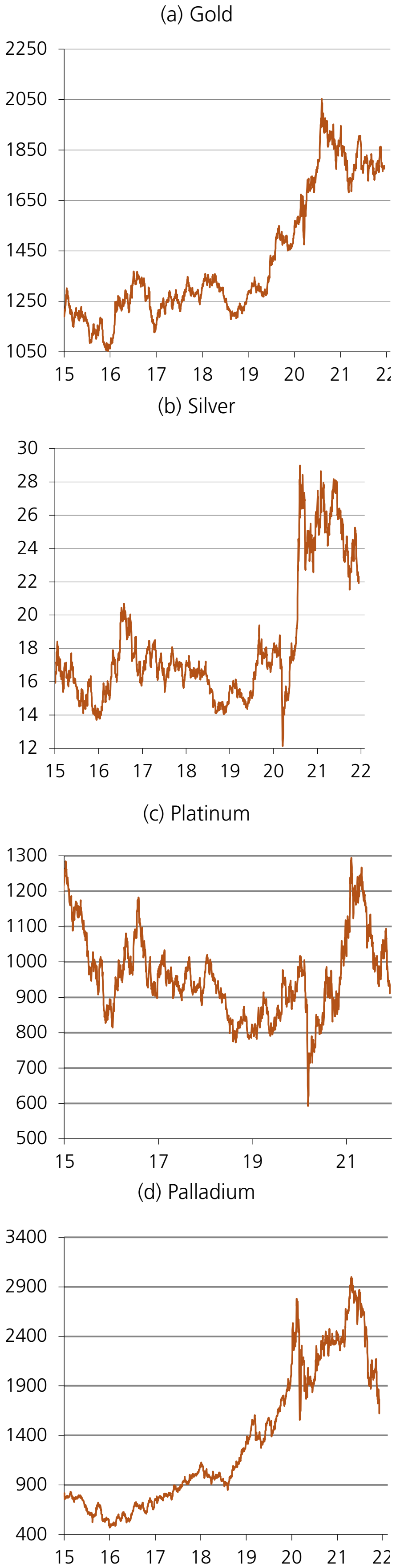
THE AUSTRIAN BUSINESS CYCLE THEORY

Looking at the Austrian Business Cycle Theory (ABCT) will help answer this question. First of all, it makes us understand what the Fed's expansionary monetary policy has done to the economic and financial system. In early 2020, in response to the politically dictated lockdown, the Fed pushed interest rates to extremely low levels, started monetising debt and effectively put a 'safety net' under the financial system: it promised investors to ward off any politically undesirable credit defaults.

The Fed has increased the M2 money supply by around 40 per cent since the end of 2019, largely by buying the government's newly issued bonds and paying for them with US dollar created out of thin air. The government, in turn, paid out the money to private households and firms, resulting in an increase in M2. The extra money is now being used to purchase goods and services, not only consumer goods but also assets such as stocks, bonds, real estate, housing, etc. The dramatic expansion of M2 explains much of the recent higher goods prices.

The Fed's policy of artificially lowering interest rates has also contributed to driving up goods prices. In the case of stock prices, the reason is obvious. A decline in interest rates lowers firms' borrowing costs, translating into higher

Precious metal prices (USD/oz), last seven years



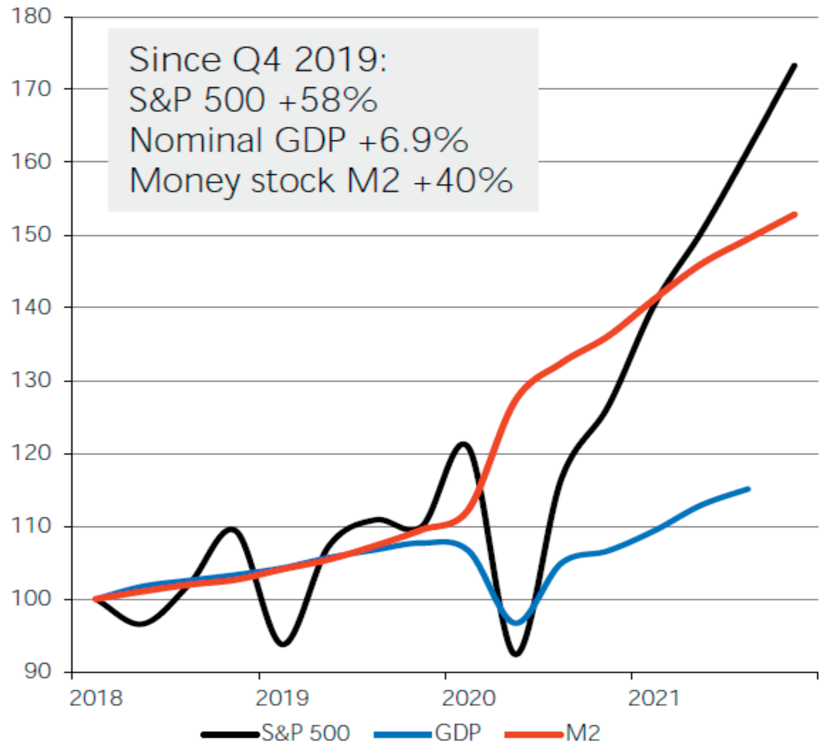
Source: Refinitiv; graphs Degussa.

profits, which drive up stock prices. In addition, the Fed's suppression of the interest rates makes investors discount future profits at a lower rate, resulting in higher present values and thus higher stock prices. The same applies to housing.

Even commodity prices – such as, for example, energy – are affected by the Fed's extremely low interest rate policy. Commodities are typically priced according to their discounted marginal value product. What does that mean? Investors value a commodity according to its contribution to future profits, discounted to the present. The lower the current interest rate is, the higher a commodity's present value will be. (In other words, commodity prices would be lower had interest rates not pushed to extremely low levels – other things being equal).

The Fed has created a huge 'inflationary monetary overhang'

*US GDP, S&P 500 and US money stock M2**



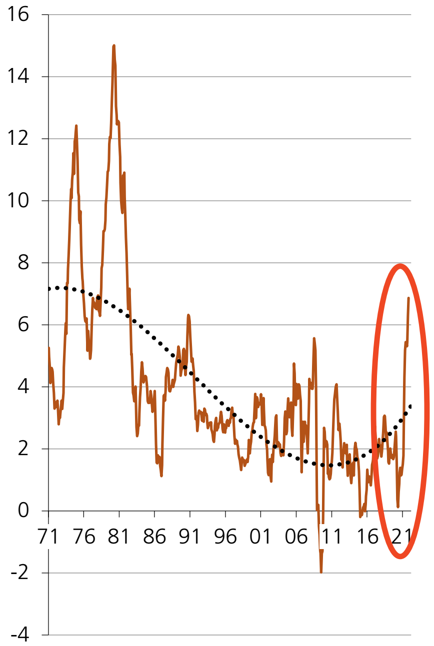
Source: Refinitiv; calculation Degussa.
Series are indexed (Q1 2018 = 100). S&P 500: 14 Dec '21; Nominal GDP: Q3 '21; US M2: 23 Nov '21.

Most importantly, the Fed's artificial lowering of the interest rate has distorted the production and employment structure. It has led firms to increasingly invest in more time-consuming sectors (capital goods industries) at the expense of investing in less time-consuming sectors (consumer goods industries). As a result, employment has been diverted from the consumer goods industry and into the capital goods industry, while investors such as banks, insurance companies, pension funds, etc., have invested their money more in the capital and less in the consumer goods industries.

What happens if and when the Fed raises the interest rate? First of all, higher interest rates reduce credit and money supply growth and thus goods price in-

US consumer price inflation the highest since 1982

Consumer prices, annual changes in per cent



Source: Refinitiv; calculations Degussa. Dotted line: estimated underlying trend.

flation. Of course, even a slowdown in monetary expansion can trigger a sharp decline in asset prices such as stock and housing prices. For investors may get rid of equity and real estate investments if they expect monetary tightening will deprive them of the hitherto generous support for rising asset prices.

What is more, the rising interest rate is causing consumers to restore their preferred consumption-savings proportions. Savings increases at the expense of consumption. Firms then realise that the demand for their products is below expectations. Their investments turn out to be unprofitable. Investing in plant and equipment comes to a shrieking halt. Jobs are cut. The capital goods industry is hit particularly hard: rising interest rates reveal that firms have invested too much in capital goods and too little in consumer goods production.

The ensuing recession-depression, the bust, is the painful adjustment process through which the economy corrects the misallocation of scarce resources caused by the inflation-driven boom. Prices in the capital goods sectors have risen too sharply during the boom, and must be allowed to fall during the bust so that capital goods prices, wages, and the deployment of capital goods and labour in the production process realign output with actual demand. The Fed's plan to tighten its policy would work towards the necessary adjustment process of the production and employment structure.

INFLATION IS A POLICY THAT CANNOT LAST

The strong increase in prices for goods and services across the board – a direct result of the lockdown policy – is now translating into a massive wave of inflation, made possible by the enormous "monetary overhang" created by the Fed. This clearly shows that the policy of increasing the money supply and pushing interest rates to extremely low levels can go only so far: The public is becoming increasingly dissatisfied with higher inflation, which is putting pressure on monetary policymakers in Washington to take action.

What is to be expected from the Fed? There are two possible scenarios: (1) The Fed means business, it really wants to lower consumer goods price inflation back towards the 2 per cent mark; or (2) the Fed just wants to keep inflation from spiralling out of control, but it does not want to abandon the 'new regime of increased inflation'.

Scenario (1) is not impossible, but it is relatively unlikely. Under the prevailing economic and political doctrine, the Fed is not meant to curb inflation at the expense of triggering another economic and financial crisis. Weighing the costs of a recession against the costs of higher inflation, the latter is considered the lesser evil. Especially since a large number of people have probably not lived through a period of high inflation and do not know much about the economic, social, and political damage caused by persistent higher inflation.

Scenario (2) appears to be more likely. That means that the Fed would take its foot off the monetary policy accelerator a little – by reducing its monthly bond purchases (that is, reducing the rate of increasing the quantity of money) and/or raising interest rates. However, such tightening of policy would not intend to cause a recession-depression to rebalance the economy. It only intends to keep inflation from spinning out of control and, at the same time, allowing inflation to settle at a higher level in the range of 4 to 6 per cent per year permanently.

In scenario (2), the Fed would make the US economy enter a regime of elevated inflation. Doing so would most likely postpone the inevitable for a while, but it would not solve the underlying inflation problem. It would exacerbate the problems caused by inflation by taking resorting to even higher inflation. The truth is that inflation is a policy that cannot last. This is a central insight of the ABCT. Ludwig von Mises (1881-1973) was well aware of the inflation problem and warned against any such inflation policy:

"With regard to these endeavors, we must emphasize three points. First: Inflationary or expansionist policy must result in overconsumption on the one hand and in mal-investment on the other. It thus squanders capital and impairs the future state of want-satisfaction. Second: The inflationary process does not remove the necessity of adjusting production and reallocating resources. It merely postpones it and thereby makes it more troublesome. Third: Inflation cannot be employed as a permanent policy because it must, when continued, finally result in a breakdown of the monetary system."

Given recent price developments in the financial markets, investors seem to be betting on something along the lines of scenario (2), which, if they read the near future correctly, must raise serious concern about what is going to happen further down the road in terms of inflation and the economic, social and political destruction it will cause.

Against this backdrop I guess it is not really necessary to explain in detail why it makes sense for the long-term oriented investor to keep physical gold and silver in his/her portfolio.

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PRECIOUS METALS PRICES

In US-Dollar per ounce

	Gold		Silver		Platinum		Palladium	
I. Actual	**1768.1**		**21.9**		**917.0**		**1608.3**	
II. Gliding averages								
10 days	1780.0		22.3		938.7		1775.6	
20 days	1796.5		23.1		971.5		1861.8	
50 days	1797.1		23.6		1013.1		1967.3	
100 days	1790.1		23.6		1003.2		2143.5	
200 days	1794.1		25.0		1084.1		2441.7	
III. Estimates for end 2021	**2448**		**47**		**1272**		**2710**	
(1)	*38*		*115*		*39*		*68*	
Band width	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1750	2684	23.0	55.1	950	1472	2280	2910
(1)	*-1*	*52*	*5*	*151*	*4*	*61*	*42*	*81*
V. Annual averages								
2018	1253		17.1		947		857	
2019	1268		15.8		880		1019	
2020	1382		16.1		862		1511	

In Euro per ounce

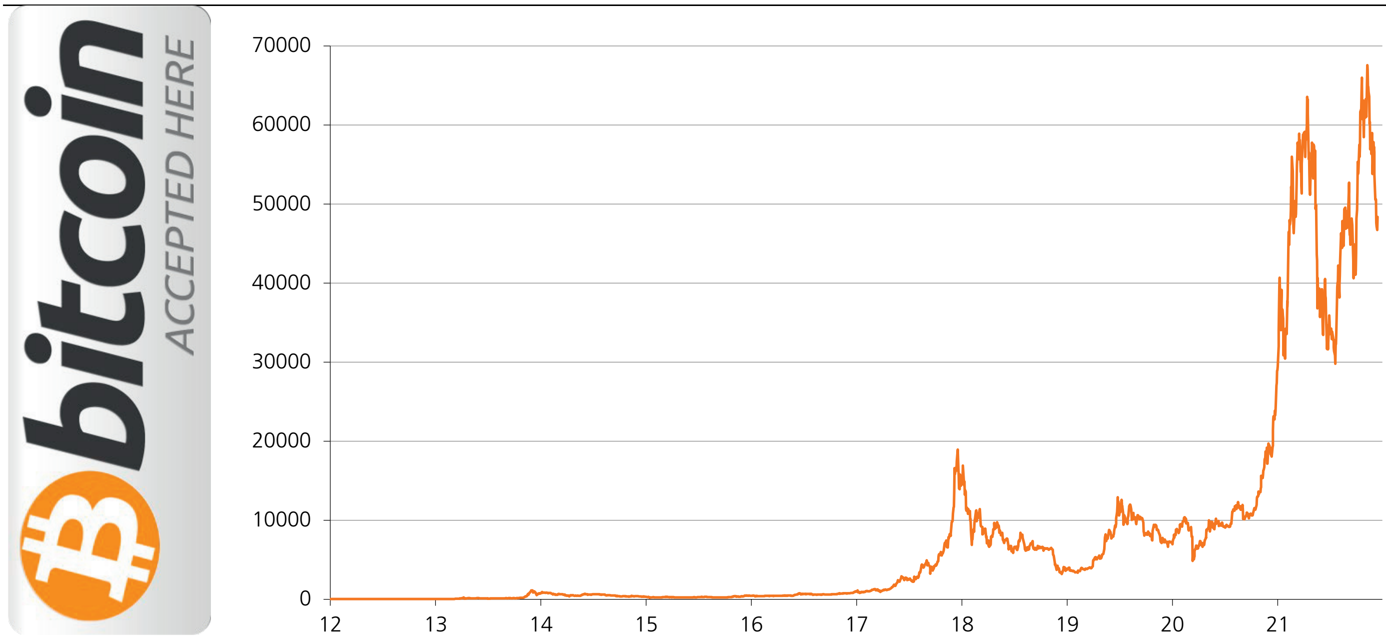
	Gold		Silver		Platinum		Palladium	
I. Actual	**1569.1**		**19.4**		**813.8**		**1427.3**	
II. Gliding averages								
10 days	1576.4		19.8		831.3		1572.5	
20 days	1592.2		20.5		861.0		1650.1	
50 days	1569.3		20.6		884.3		1717.0	
100 days	1542.5		20.4		864.3		1844.0	
200 days	1521.7		21.2		918.4		2065.5	
III. Estimates for end 2021	**2044**		**39**		**1062**		**2263**	
(1)	*30*		*102*		*30*		*59*	
Band width	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1470	2260	19.0	46.6	800	1240	1920	2450
(1)	*-6*	*44*	*-2*	*139*	*-2*	*52*	*35*	*72*
V. Annual averages								
2018	1116		15		844		760	
2019	1072		13		743		863	
2020	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

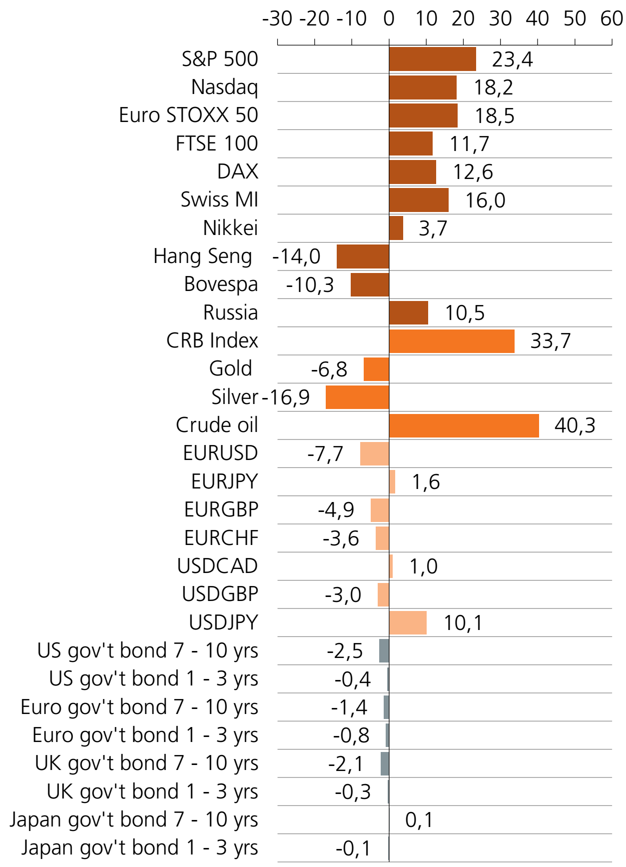
Bitcoin in US dollars



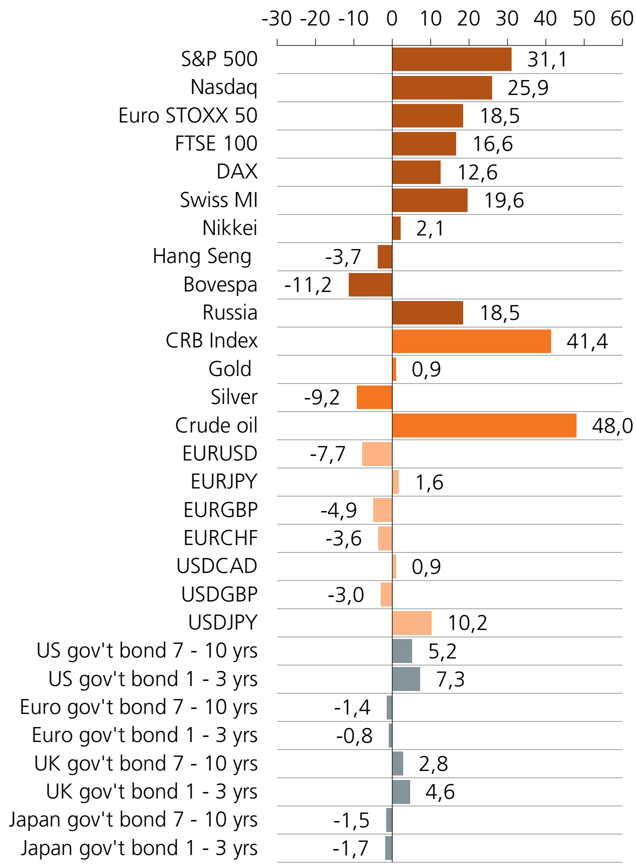
Source: Refinitiv; graph by Degussa.

Performance of stocks, commodities, FX and bonds

(a) In national currencies



(b) In euro



Source: Refinitiv; calculations by Degussa.

Articles in earlier issues of the *Degussa Market Report*

Issue	Content
16 December 2021	Welcome to a new chapter in the boom-and-bust-drama
2 December 2021	Inflation Is Not Temporary But Here To Stay
18 November 2021	The Case Against Gold And Silver. Revisited
4 November 2021	Stagflation Is Rearing Its Ugly Head
21 October 2021	At A Crossroads. It Is Time For Gold And Silver
7 October 2021	Here Comes The Inflation Beast
23 September 2021	Evergrande: China's Potential 'Lehman moment'?
8 September 2021	It All Depends On The Fed's 'Safety Net'
26 August 2021	Our Money Gets Thrown Under The Bus
12 August 2021	The Crime of 1971
29 July 2021	Gold And The Market Fear That Is Not
15 July 2021	Gold and the Monetary Policy Empire of Deception
1 July 2021	Investors believing the impossible, making the price of gold falter
17 June 2021	Gold Against Neglected Risks
2 June 2021	Gold And Inflation
20 May 2021	The Price Correction In The Crypto Space Is Not The End …
6 May 2021	The Dark Side of the Yield Curve Control Policy
22 April 2021	Bitcoin and the Golden Opportunity
8 April 2021	On Precious Metal 2021 Price Forecasts
25 March 2021	Money Matters For Gold And Silver Prices
11 March 2021	Interest Rates are to the Price of Gold What Gravity is to the Apple
25 February 2021	The Dangers Of Digital Central Bank Money
11 February 2021	Gold Is Not In Bubble Territory
28 January 2021	It Is High Time To Buy Gold And Silver
14 January 2021	The Great Gold And Silver Bull Market Is On
17 December 2020	Gold Against US-Dollar Risk. A Value Proposition
3 December 2020	Keep Your Cool – And Physical Gold And Silver
19 November 2020	It is Going to be Wild. Hold on to Physical Gold
5 November 2020	For In Fire Gold Is Tested
22 October 2020	The Policy of Inflating Everything, Not Only The Price Of Gold
8 October 2020	President Trump Is Good For Gold, Or Isn't He?
24 September 2020	Get Physical With Gold
10 September 2020	The Inflation Threat And The Case For Gold
27 August 2020	We Need Sound Money To Regain and Defend Our Liberties
13 August 2020	Gold And Silver Prices Are Set To Trend Even Higher
30 July 2020	The Big Short In Official Currencies
16 July 2020	"World Gold Price" Hits A New Record
2 July 2020	Some Things You Need To Know About Money

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www.degussa-goldhandel.de/de/marktreport.aspx.

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