Degussa Market Report

28 April 2022 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	1.894,2	-2,7	3,6	7,1
Silver	23,6	-4,8	1,2	-9,1
Platinum	913,2	-6,3	-5,1	-23,8
Palladium	2.223,5	-8,3	17,5	-24,2
II. In euro				
Gold	1.784,4	-0,3	11,0	21,3
Silver	22,2	-2,5	8,4	3,0
Platinum	860,3	-4,1	1,6	-13,8
Palladium	2.095,0	-5,9	25,9	-14,2
III. Gold price in other currencies				
JPY	242.225,0	0,1	15,1	25,3
CNY	12.418,1	0,3	6,9	8,5
GBP	1.505,1	0,8	11,4	17,6
INR	144.917,5	1,9	6,4	10,7
RUB	140.169,4	-7,4	2,8	5,4

Source: Refinitiv; calculations by Degussa.

OUR TOP ISSUES

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

THE FED'S BOOM AND BUST CYCLE – AND WHAT IT MEANS FOR YOUR MONEY

The US Federal Reserve (Fed) has started the interest rate hike cycle. Or so it seems. The bank increased the Federal Funds Rate by 0.25 per cent in March 2022, and in May, a 50 basis point rate hike is likely, taking the Federal Funds rate to 0.50 to 0.75 per cent.

Which, admittedly, is still very low by historical standards, especially given the annual US consumer goods price inflation hitting 8.5 per cent in March, and which has caused real interest rates to hit a dramatic record low.

The Fed's policy tightening raises a number of questions. How high will it increase interest rates to bring down inflation? What will be the consequences for the economy and financial markets? Can recession and a capital market crash be prevented? To answer these questions, let us first remind ourselves how today's monetary system – a fiat money system – works.

In a fiat money system, the central bank, in close cooperation with commercial banks, increases the credit supply beyond real savings and expands the quantity of money out of thin air. As a result, the market interest rate is artificially lowered compared to a situation in which the credit and money supply would not have been increased. An artificial economic upswing, a boom, sets in.

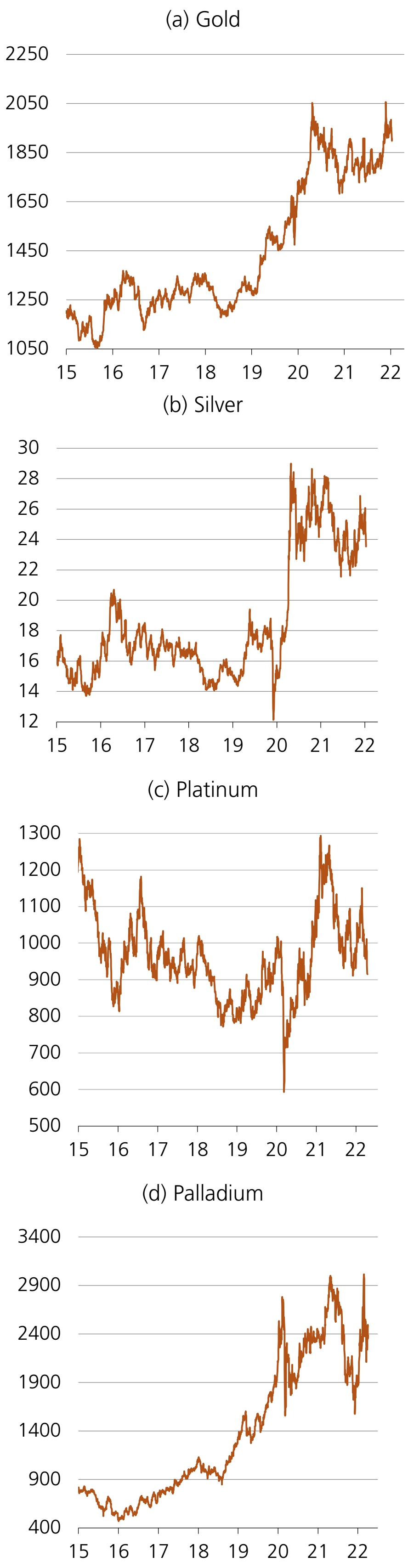
A fiat-money driven boom is inflationary. It erodes the purchasing power of money, distorts relative goods prices, encourages malinvestment, fuels speculative bubbles in asset markets, allows some people to benefit at the expanse of many others, and drives consumers, firms, and governments to accumulate ever greater amounts of debt.

The fiat money boom is not sustainable. It will turn into bust as soon as the increase in credit and money has run its course in terms of pushing up prices and wages. To prevent the bust from unfolding, the central bank usually lowers interest rates further, injects a fresh dose of credit and money into the economy, hoping that a new boom will ensue.

Over time, however, the economy and financial markets become ever more dependent on the continuation of a monetary policy that pushes interest rates to ever-lower levels and expands the quantity of credit and money.

Major economies around the world – be it the US, the euro area, China, Japan, the United Kingdom, Switzerland and many others – have become addicted to

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



Source: Refinitiv; graphs Degussa.

fiat money. Against this backdrop, we can return to the questions we raised at the beginning.

Goods price inflation is unlikely to fall for years if the Fed acts now because the current rise in goods price inflation is fuelled primarily by the expansion of the money supply since the end of 2019.

Since then, the Fed has increased the US money stock M2 by 42 per cent, an enormous monetary overhang that is now translating into higher goods price inflation. It is fair to assume that the Fed's interest rate hikes will, at best, slow down future money supply growth. Still, they will not reduce the current monetary overhang and its inflationary effects.

The elevated goods price inflation will therefore continue for quite some time so that a further significant decline in the purchasing power of the US dollar can be expected in the coming years. The continued economic expansion, accompanied by high inflation (meaning annual CPI inflation between 5 and 10 per cent, at times maybe even higher), appears to be something of a 'best case scenario'.

The 'worst-case scenario' is the Fed pushing the economy and financial markets over the cliff by raising interest rates too high, making large parts of the existing production and employment structure unprofitable and collapse. Unfortunately, the Fed has a terrible track record in this regard.

Just think of the bursting of the New Economy Boom 2000/2002, the global financial and economic crisis of 2008/2009, or especially the Great Depression from 1929 to 1933. The Fed set in motion or at least made significant contributions to the initial boom, which later turned into bust, causing great hardship for the vast majority of the people.

As a response to an unintended economic and financial crash, however, the Fed in our days would, I am inclined to think, likely switch gears relatively quickly and return to an even more inflationary policy – which, of course, could lead to a rather severe inflationary currency crisis.

The inconvenient truth is that the Fed does not know the 'right' interest rate level. Of course, a negative real interest rate of currently around minus 8 per cent is clearly *problematic* as it causes great damage to people's economic prosperity. But how high does the real interest have to rise to get the economy and financial markets back on a healthy path?

Nobody knows. The Fed, meddling with interest rates, is pursuing a 'trial and error process'. In recent years, it is quite obvious that the Fed has pushed interest rates too low, causing an inflation problem that is potentially even bigger than the inflation in the 1970s and 1980s.

With US CPI inflation now at its highest level in more than 40 years, the Fed may have a great incentive to bolster its tarnished credibility as an 'inflation fighter' and raise interest rates sharply in a fairly short period of time. This increases the likelihood of a 'worst-case scenario', a large-scale economic and financial crash.

For if the inflow of new credit dries up and the money stock drops (as borrowers pay off their bank loans and banks rein in their loan supply), goods price deflation will unfold – which could all too easily collapse the fiat money system altogether.

Now, what can you do? What can the investor make of all this? Well, be aware that the boom and bust cycle is alive and kicking.

Suppose you are comfortable with the 'best case scenario"- which would mean, from this author's viewpoint, that the Federal Funds Rate won't be raised above 2.5 to 3 per cent. In that case, you should expect that elevated inflation will not go away anytime soon and that real interest rates will remain in negative territory for longer than many investors are likely anticipating. This makes cash, bank deposits and buy-and-hold bonds pretty bad allocations for your money.

Holding physical gold and silver makes sense for those who wish to maintain liquidity over the medium to long term, and these precious metals are definitely a better choice than time and savings deposits with longer maturities.

Stock markets may be in for a bumpy ride, and certainly not all firms will survive long periods of elevated inflation. Nevertheless, there are still good reasons for investors to remain long in the stock market for now.

Suppose you believe the 'worst-case scenario' outlined above is more likely – implying, I would think, a Federal Funds Rate above 3 per cent. In that case, you may want to increase your physical gold and silver holdings at the expense of your stock market or financial market exposure while still considering the loss of purchasing power as one of your top portfolio risks.

I hope that my talk helped you better understand how the boom-and-bust cycle created by central banks' fiat money can affect your investments – and increase your awareness of how intricate the interplay of the determining factors of boom and bust can be.

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PRECIOUS METALS PRICES

In US-Dollar per ounce

	Gold		Silver		Platinum		Palladium	
I. Actual	**1895,1**		**23,6**		**912,7**		**2215,4**	
II. Gliding averages								
10 days	1948,2		24,9		965,7		2343,0	
20 days	1944,3		24,8		971,8		2332,2	
50 days	1938,6		24,9		1022,9		2465,4	
100 days	1874,8		23,9		1003,5		2238,9	
200 days	1832,9		23,8		1006,7		2214,0	
III. Estimates for end 2022	**2100**		**28**		**1175**		**2261**	
(1)	*11*		*20*		*29*		*2*	
Band width	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1700	2280	21,0	31,0	830	1280	1650	2400
(1)	*-10*	*20*	*-11*	*31*	*-9*	*40*	*-26*	*8*
V. Annual averages								
2019	1382		16,1		862		1511	
2020	1753		20,2		878		2180	
2021	1804		25,5		1095		2422	

In Euro per ounce

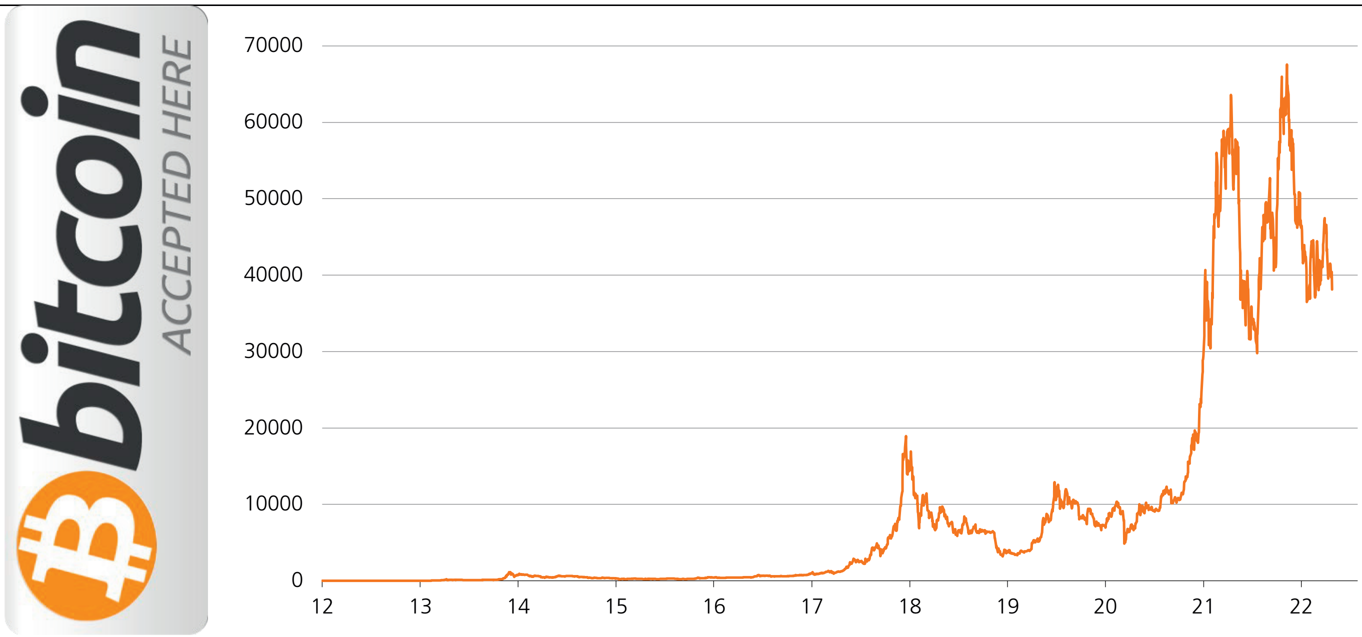
	Gold		Silver		Platinum		Palladium	
I. Actual	**1787,1**		**22,2**		**860,7**		**2089,2**	
II. Gliding averages								
10 days	1806,8		23,1		895,5		2172,6	
20 days	1787,6		22,8		893,3		2144,2	
50 days	1761,6		22,6		928,9		2240,0	
100 days	1680,1		21,4		898,8		2008,1	
200 days	1610,0		20,9		883,5		1943,7	
III. Estimates for end 2022	**1944**		**26**		**1088**		**2093**	
(1)	*9*		*17*		*26*		*0*	
Band width	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1573	2110	19,4	28,7	760	1180	1520	2220
(1)	*-12*	*18*	*-13*	*29*	*-12*	*37*	*-27*	*6*
V. Annual averages								
2019	1235		14		770		1350	
2020	1535		18		769		1911	
2021	1519		21		921		2035	

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

(1) On the basis of actual prices.

BITCOIN, PERFORMANCE OF VARIOUS ASSET CLASSES

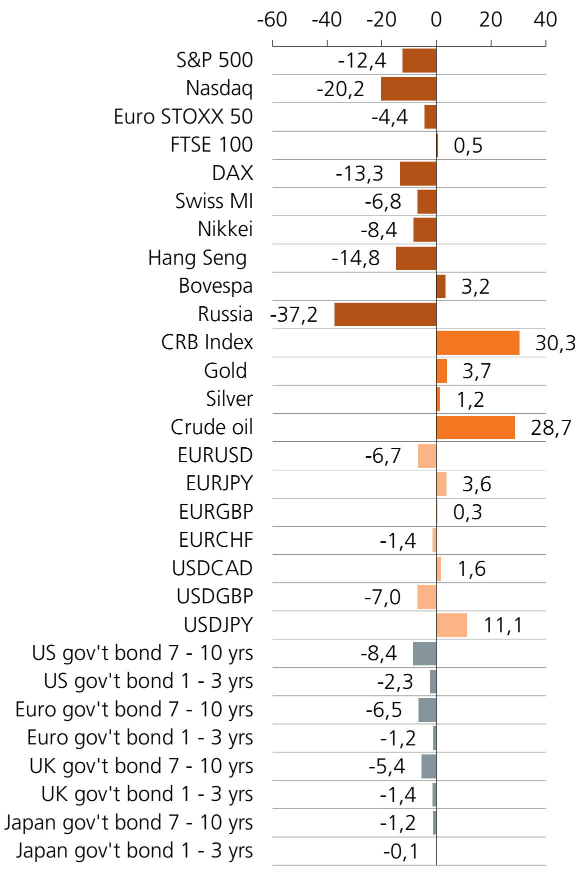
Bitcoin in US dollars



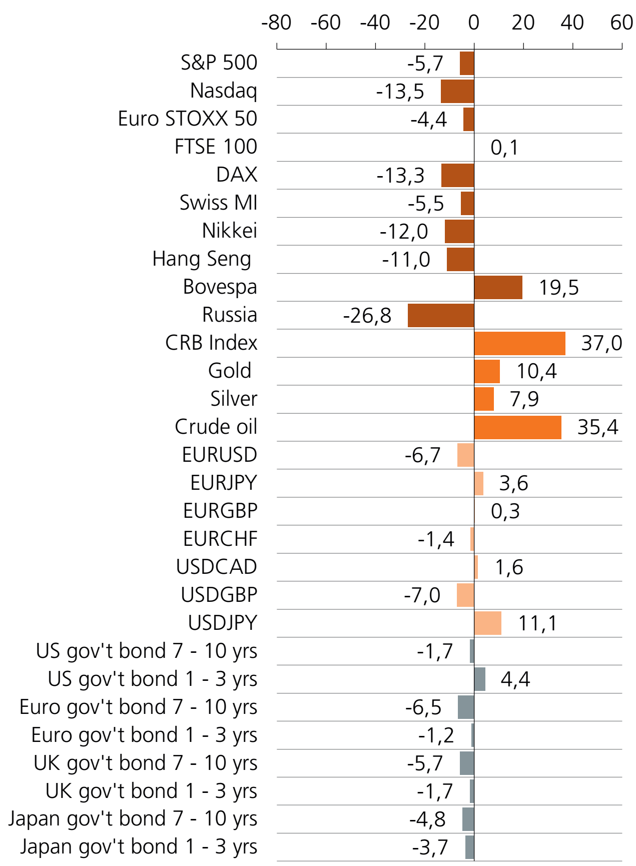
Source: Refinitiv; graph by Degussa.

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
28 April 2022	The Fed's Boom & Bust Cycler – And What It Means For Your Money
14 April 2022	Do You Know What Inflation Really Is? Then Hold Gold And Silver
31 March 2022	How Not To Get Battered
17 March 2022	There is no Return to Normality. The Case for Gold and Silver
3 March 2022	Gold: Too Low For Too Long
17 February 2022	The Inflation beast is bigger than you think it is
3 February 2022	The Bigger Gold Picture
20 January 2022	Outlook for Gold and Silber brighter than you think it is
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
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23 September 2021	Evergrande: China's Potential 'Lehman moment'?
8 September 2021	It All Depends On The Fed's 'Safety Net'
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15 July 2021	Gold and the Monetary Policy Empire of Deception
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25 March 2021	Money Matters For Gold And Silver Prices
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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
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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?

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Editor in chief: Dr. Thorsten Polleit
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Degussa
GOLD UND SILBER.

Frankfurt Headquarters
Kettenhofweg 29 · 60325 Frankfurt
Phone: 069-860 068 – 0 · info@degussa-goldhandel.de

Retail buying and selling outlets in Germany:

Augsburg (shop & showroom)**:** Maximiliansstraße 53 · 86150 Augsburg
Phone: 0821-508667 – 0 · augsburg@degussa-goldhandel.de

Berlin (shop & showroom)**:** Fasanenstraße 70 · 10719 Berlin
Phone: 030-8872838 – 0 · berlin@degussa-goldhandel.de

Dusseldorf (Old Gold Centre): In der KÖ Galerie
Königsallee 60 / Eingang Steinstraße · 40212 Dusseldorf
Phone: 0211-13 06 858 – 0 · duesseldorf@degussa-goldhandel.de

Frankfurt (shop & showroom)**:** Kettenhofweg 25 · 60325 Frankfurt
Phone: 069-860 068 – 100 · frankfurt@degussa-goldhandel.de

Hamburg (shop & showroom)**:** Ballindamm 5 · 20095 Hamburg
Phone: 040-329 0872 – 0 · hamburg@degussa-goldhandel.de

Hanover (shop & showroom)**:** Theaterstraße 7 · 30159 Hanover
Phone: 0511-897338 – 0 · hannover@degussa-goldhandel.de

Cologne (shop & showroom)**:** Gereonstraße 18-32 · 50670 Cologne
Phone: 0221-120 620 – 0 · koeln@degussa-goldhandel.de

Munich (shop & showroom)**:** Promenadeplatz 12 · 80333 Munich
Phone: 089-13 92613 – 18 · muenchen@degussa-goldhandel.de

Munich (Old Gold Centre): Promenadeplatz 10 · 80333 Munich
Phone: 089-1392613 – 10 · muenchen-altgold@degussa-goldhandel.de

Nuremberg (shop & showroom)**:** Prinzregentenufer 7 · 90489 Nuremberg
Phone: 0911-669 488 – 0 · nuernberg@degussa-goldhandel.de

Pforzheim (refinery)**:** Freiburger Straße 12 · 75179 Pforzheim
Phone: 07231-58795 – 0 · pforzheim@degussa-goldhandel.de

Stuttgart (shop & showroom)**:** Kronprinzstraße 6 · 70173 Stuttgart
Phone: 0711-305893 – 6 · stuttgart@degussa-goldhandel.de

Retail buying and selling outlets around the world:

Zurich (shop & showroom)**:** Bleicherweg 41 · 8002 Zurich
Phone: 0041-44-40341 10 · zuerich@degussa-goldhandel.ch

Geneva (shop & showroom)**:** Quai du Mont-Blanc 5 · 1201 Genève
Phone: 0041-22 908 14 00 · geneve@degussa-goldhandel.ch

Madrid (shop & showroom)**:** Calle de Velázquez 2 · 28001 Madrid
Phone: 0034-911 982 900 · info@degussa-mp.es

London Sharps Pixley Ltd. (member of the Degussa Group)
Phone: 0044-207 871 0532 · info@sharpspixley.com