Degussa Market Report

2 February 2023 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	1.952,3	1,7	19,5	2,3
Silver	24,0	-1,0	25,4	-1,7
Platinum	1.008,3	-5,3	8,9	-3,4
Palladium	1.676,6	-6,3	-8,9	-32,6
II. In euro				
Gold	1.775,2	0,1	7,5	4,4
Silver	21,8	-2,5	12,8	0,3
Platinum	916,7	-6,7	-2,2	-1,4
Palladium	1.524,0	-7,7	-18,2	-31,3
III. Gold price in other currencies				
JPY	251.248,0	2,3	3,5	14,5
CNY	13.161,0	2,3	10,4	9,3
GBP	1.575,7	0,4	10,7	10,8
INR	159.577,8	1,9	18,1	10,8
RUB	136.441,7	9,3	36,9	-29,2

Source: Refinitiv; calculations by Degussa.

OUR TOP ISSUES

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

YOU THINK THE GLOBAL ECONOMY IS BRIGHTENING? BEWARE: THE BIG HIT IS YET TO COME ...

Relief is spreading among economic analysts and stock market experts. Energy prices are decreasing noticeably. The energy supply this winter seems secure; in Europe, government support for consumers and producers is available if needed. China is turning away from its zero-covid policy, and production is ramping up again. However, high goods price inflation is still a major concern for consumers and producers, but central banks deliver at least some interest rate hikes to hopefully reducing currency devaluation. So should we bid farewell to crisis and recession worries? Unfortunately, not.

Because there is an overall economic development that is tantamount to a storm but remains unnamed by many experts and investors. And that is *the global contraction of the real money supply*. What does that mean? The real money supply represents the actual purchasing power of money. Example: You have 10 USD, and 1 apple costs 1 USD. So with your 10 USD, you can buy 10 apples. If the apple price increases to, say, 2 USD per piece, the purchasing power of the 10 USD falls to 5 apples. It becomes obvious that the real money supply is determined by the interplay between the nominal money supply and the prices of goods.

The real money supply in an economy can decrease when the nominal money supply goes down and/or goods prices rise. This is exactly what is currently happening around the world. The chart below shows the annual growth rate of the real money supply in the OECD from 1981 to October 2022. The real money supply recently contracted by 7.3 per cent year-on-year. There has never been anything like this before. What is the reason?

The enormous rise in goods prices, i.e. the high inflation, is a consequence of central banks' monetary policy. In the course of the politically dictated lockdowns, they have increased the money supply enormously. For example, the US Federal Reserve has expanded the M2 money stock by around 40 per cent since the end of 2019, and the European Central Bank has increased the M3 money supply by 25 per cent. As the growth in the supply of goods has not kept pace, a huge *money supply overhang* has emerged, which is now met with "cost-push" effects – such as the consequences of "green policies," lockdowns, and the Ukraine war – unleashed in sky-high goods price inflation.

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

(a) Gold

(b) Silver

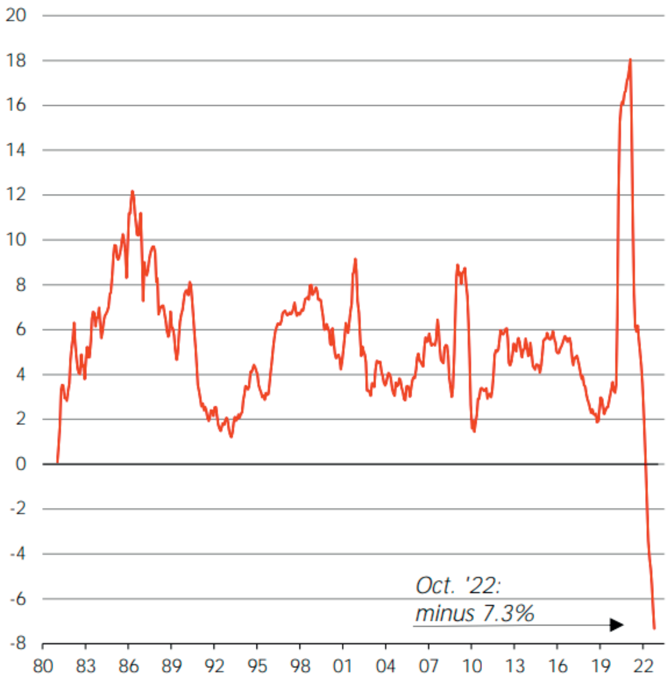
(c) Platinum

(d) Palladium

Source: Refinitiv; graphs Degussa.

The 'real money supply" shrinks like never before ...

Real money stock in the OECD, annual changes in per cent



Source: Refinitiv; calculations Degussa.
*Annual increase in the "broadly defined" money stock minus annual increase in consumer goods prices.

In the meantime, however, nominal money supply growth has fallen sharply again. In the US, it declined by 1.3 zero per cent year-on-year in December 2022, and in the euro area it slowed down to 4.1 per cent. The reason: Loan demand is declining, commercial banks are granting fewer loans, and consequently, the new money supply generated by bank lending is falling. Furthermore, central banks are no longer buying government bonds, which is one reason why the inflow of new money into the economy is drying up.

It may sound paradoxical, but in economic terms, the current high goods price inflation is reducing the money supply overhang, and along with now significantly reduced money supply growth, downward pressure on future inflation is already increasing.

However, if the real money supply shrinks as sharply as it is currently, the signs point to at least an economic slowdown and, more likely, a recession. When the real money supply in the economy shrinks, those holding cash become poorer. They can now no longer purchase the quantities of goods they previously bought- and need to adjust their spending: stop buying more expensive goods, or continue buying more expensive goods while forgoing other things. The result is a drop in aggregate demand.

This phenomenon is, by the way, well known in theory as the "real balance effect." It goes back to the Israeli-American economist Don Patinkin (1922 - 1995). Patinkin wanted to show, among other things, that the national economy can, so to speak, heal itself in crises without the need for government intervention. If, for example, goods prices fall in a recessionary depression, this strengthens the purchasing power of market players if and when the money supply remains unchanged. They can expand their demand for goods, and the economy works its way out of the crisis more or less automatically.

Applied to current conditions, we can see that a rather powerful "*negative* money balance effect" is unfolding: The initial increase in the quantity of money resulted in a rise of the real money supply, which fuelled consumption and production. Then, goods price inflation took off, and, at the same time, monetary expansion slowed down. The result is a very sharp decline in the real money stock, which, in turn, leads to lower economic activity, even recession.

The contraction of output and employment, in turn, exerts downward pressure on (the rise of) goods prices, establishing a new relation between the outstanding money stock and goods prices in accordance with peoples' preferences. Once this adjustment has run its course, and the nominal money stock remains unchanged, goods price inflation dies out. The economy ends up with a higher level of goods prices – when compared with the situation before the nominal money supply had been increased.

So why do central banks want to raise interest rates even further? Monetary authorities fear that doing nothing and waiting in the current regime of sky-high inflation could erode peoples' trust in unbacked paper currencies. That, in turn, would push up market participants' inflation expectations – which, incidentally, is already happening – and create an even bigger inflation crisis further down the road. Moreover, central bank councils usually base their monetary policy on current inflation; they typically have little or no regard for the development of the real money supply.

The central banks are thus – consciously or unconsciously – triggering a "stabilization recession", an economic contraction to break the inflationary wave. At first glance, their plan could most likely work out. Because if the demand for goods drops, companies can only reduce their inventories by cutting prices. The leeway for passing on costs and speculation on future price increases diminishes. Higher wage demands fail to materialize. And most importantly, credit and money supply growth ebb away in a recession, mitigating future inflationary pressure. But at second glance, this is a very explosive approach in the current monetary environment.

A recession will likely put highly indebted economies under severe stress. Many debtors are no longer be able to service their debts. Loan defaults increase. As a result, banks become reluctant to grant new loans and demand repayment of expiring loans. Investor confidence in debt-ridden economies and financial markets is dwindling. The result is a fulminant credit crisis, at least at the scale of the one in 2008/2009: Investors fear that their interest and principal payments will not be made. Credit markets freeze and the unbacked monetary system is headed for collapse.

The economic pain would be enormous, and the political pressure on central banks to lower interest rates again and keep the economy afloat with new credit and more money would be foreseeable: In the hour of need, governments and the public at large will likely see the policy of the least evil in increasing the money supply. Even a sky high inflation policy becomes acceptable from their point of view to escape a perceived even greater evil. There are quite a few examples of this tragic handling of the unbacked paper money system.

Just think of 2008/2009 (the global financial and economic crisis) and 2020/2021 (the crisis after the politically dictated lockdowns): To ward off the crises or keep them as small as possible, central banks lowered interest rates and drastically expanded the money supply. The outcome was inflation – asset price inflation from early 2009 or consumer goods price inflation, which reared its ugly head towards the end of 2021. From this perspective, it is not unlikely that history will repeat itself.

If central banks are not stopped from doing what they are doing – causing boom and bust by manipulating downwards market interest rates and relentlessly expanding the quantity of money created out of thin air – it will eventually lead to a level of inflation well beyond the inflation we have witnessed over the past year and a half. From this perspective, the currently sharply contracting real money stock in the world economy is – it has to be feared – the harbinger of a new round of super-easy monetary policy and super-high inflation, even hyperinflation, further down the road.

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PRECIOUS METALS PRICES

In US-Dollar per ounce

	Gold		Silver		Platinum		Palladium	
I. Actual	**1951,5**		**24,0**		**1008,8**		**1676,3**	
II. Gliding averages								
10 days	1880,1		23,8		1074,2		1766,1	
20 days	1845,9		23,8		1043,4		1752,2	
50 days	1800,9		22,8		1020,6		1837,8	
100 days	1737,6		21,0		961,5		1953,1	
200 days	1776,9		21,1		944,9		2007,2	
III. Estimates for end 2023	**2200**		**29**		**1250**		**1450**	
(1)	*13*		*21*		*24*		*-14*	
Band width	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1900	2360	23,3	32,9	1060	1380	1300	1670
(1)	*-3*	*21*	*-3*	*37*	*5*	*37*	*-22*	*0*
V. Annual averages								
2020	1753		20,2		878		2180	
2021	1804		25,5		1095		2422	
2022	1798		21,7		956		2154	

In Euro per ounce

	Gold		Silver		Platinum		Palladium	
I. Actual	**1774,4**		**21,8**		**917,2**		**1524,2**	
II. Gliding averages								
10 days	1753,6		22,2		1002,0		1647,5	
20 days	1729,2		22,3		977,4		1641,6	
50 days	1710,2		21,7		969,3		1746,9	
100 days	1702,6		20,6		941,3		1920,6	
200 days	1723,1		20,4		916,3		1950,2	
III. Estimates for autumn 2023	**2100**		**28**		**1200**		**1392**	
(1)	*18*		*27*		*31*		*-9*	
Band width	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1820	2300	22,4	31,6	1010	1320	1240	1600
(1)	*3*	*30*	*2*	*45*	*10*	*44*	*-19*	*5*
V. Annual averages								
2020	1535		18		769		1911	
2021	1519		21		921		2035	
2022	1704		21		905		2041	

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

(1) On the basis of actual prices.

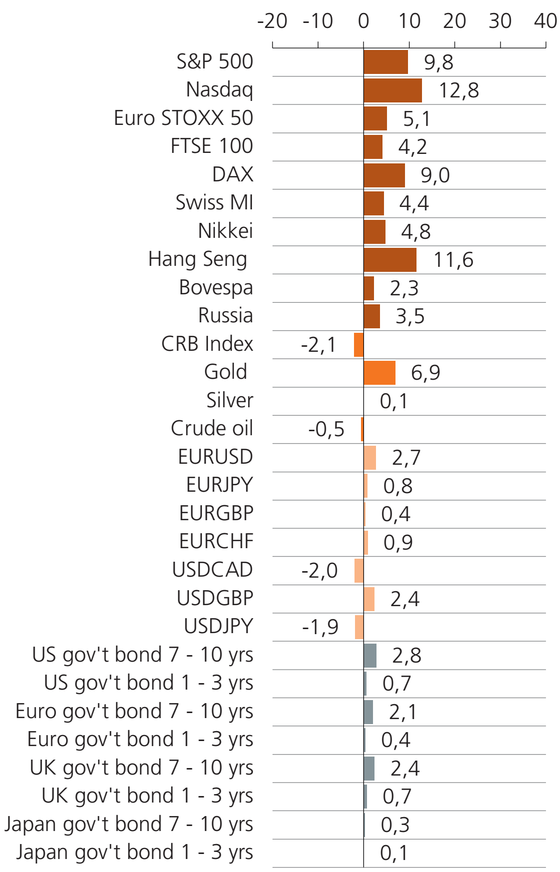
BITCOIN, PERFORMANCE OF VARIOUS ASSET CLASSES

Bitcoin in US dollars

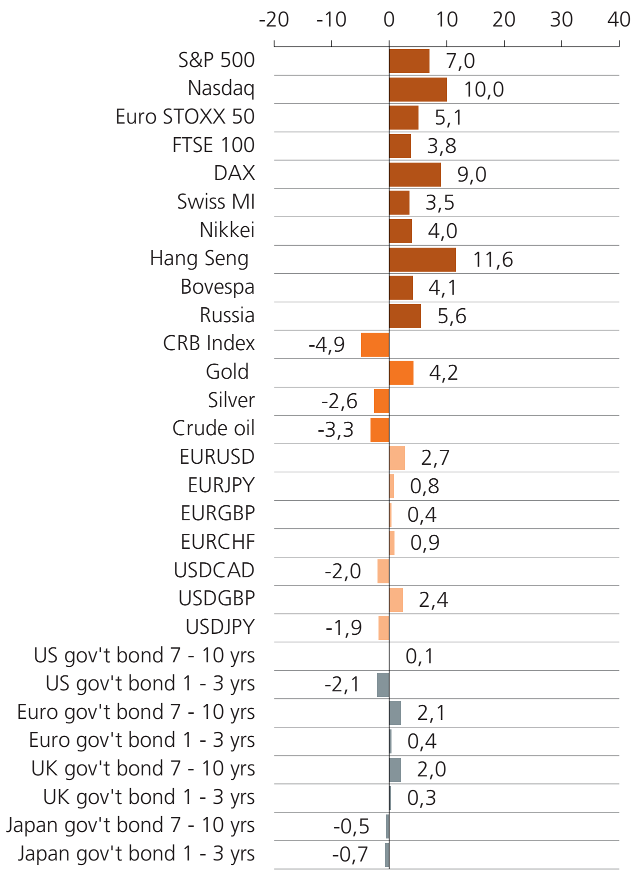
Source: Refinitiv; graph by Degussa.

Performance of stocks, commodities, FX and bonds

(a) In national currencies



(b) In euro



Source: Refinitiv; calculations by Degussa.

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8 December 2022	Some Thoughts About Central Banks' Renewed Interest In Gold
24 November 2022	Some Thoughts About Central Banks' Renewed Interest In Gold
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