Degussa Market Report

29 August 2019 Economics · Finance · Precious Metals

USD per ounce of gold

USD per ounce of silver

EURUSD

Source: Thomson Financial; graphs by Degussa.

Precious metals prices	Actual (spot)	Change against (in percent): 2 W	3 M	12 M
I. In US-dollar				
Gold	1.539.9	2.9	20.0	28.2
Silver	18.3	7.9	22.4	26.1
Platinum	871.0	1.4	-1.7	11.3
Palladium	1.477.2	3.9	6.4	50.6
II. In euro				
Gold	1.388.4	3.9	21.3	34.2
Silver	16.5	8.8	23.8	31.9
Platinum	785.3	2.7	-0.5	15.8
Palladium	1.332.0	5.0	7.7	57.8
III. Gold price in other currencies				
JPY	162.874.0	3.0	13.9	22.2
CNY	11.029.9	4.3	27.6	34.5
GBP	1.259.3	1.2	27.9	36.0
INR	110.471.5	1.9	23.6	29.6
RUB	102.364.0	4.8	23.5	26.4

Source: Thomson Financial; calculations by Degussa.

OUR TOP ISSUES

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

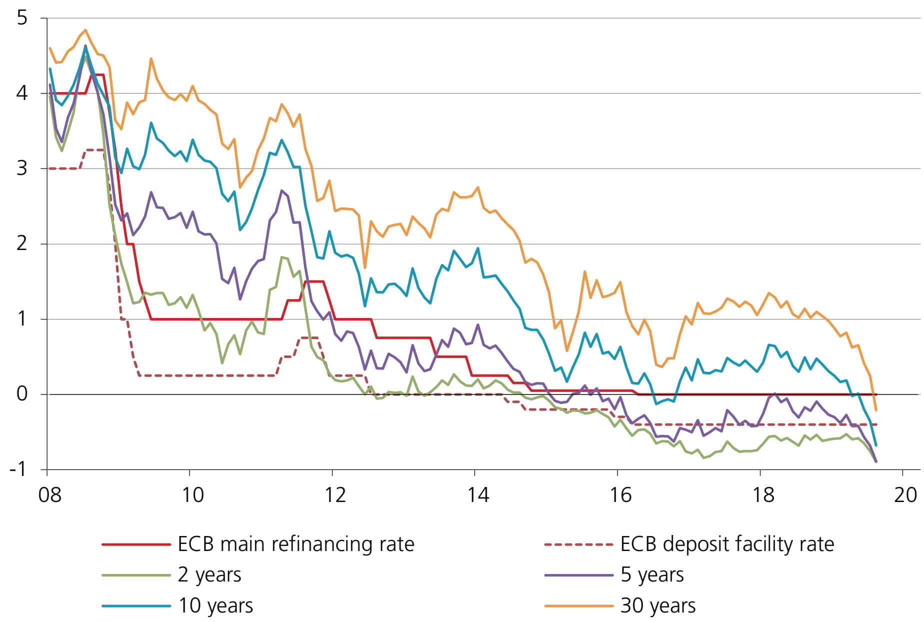
The Disaster of Negative Interest Policy

Those who had hoped that things could not get worse with the monetary policy of the European Central Bank (ECB) have been proven wrong. At its last meeting on 25 July 2019, the Governing Council of the ECB kept interest rates unchanged: the main refinancing rate was kept at 0.00% and the deposit rate at -0.40%. At the same time, however, ECB President Mario Draghi has prepared the ground to lower interest rates even further in the coming months. What is the reasoning behind that?

According to the ECB Governing Council, inflation is too low, and the euro area economy is too weak. It was precisely this assessment that signaled to the markets to expect a rate cut in the near future. It has now become very likely that the deposit rate will be lowered by 0.2 percentage points to -0.60% at the next ECB meeting in September; and the main refinancing rate could drop to -0.20%. The continued path into the negative interest world, however, has quite dramatic consequences.

1 All German gov't bond yields have been pushed below zero

ECB key interest rates and German gov't bond yields in percent

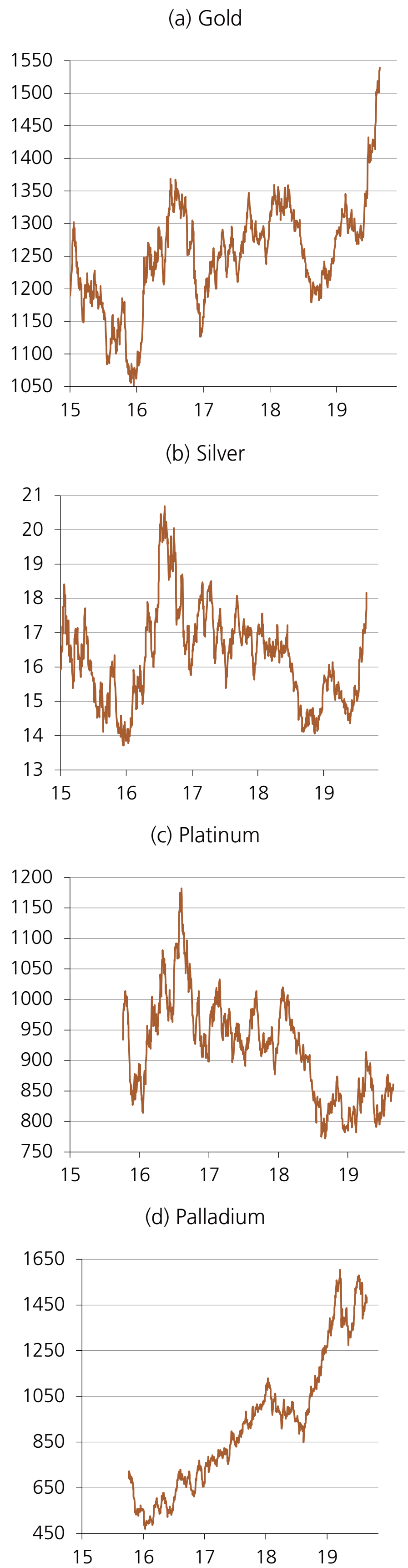


Source: Thomson Financial; graphic Degussa.

The Essence of the Interest Rate

This becomes clear when considering what the interest rate stands for. In short, it represents the value discount that a later satisfaction of a want suffers com-

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



Source: Thomson Financial; graphs by Degussa.

pared to an earlier satisfaction of the same want (under otherwise identical circumstances). The “pure” or “originary” interest rate is positive — always and everywhere. It cannot disappear, it cannot go to zero, let alone fall below the zero line; the logic of human action informs us that the pure interest rate cannot be thought away from human actions and values.is this humorous saying: “It walks like a duck, it sounds like a duck, and it walks

However, there is the “new negative interest rate theory,” saying that the “new natural interest rate” — or: the “social pure interest rate” — has become negative. And while this theory is wrong, it has already found its way into monetary policymaking; presumably because it is highly attractive to the state and those groups closely associated with it because if the central bank forces interest rates into negative territory, running into debt becomes a profitable business, and financially ailing states and banks can reduce their debt burden at the expense of creditors.

The fact that many market interest rates in the euro area are now in the negative range is by no means an evidence of the validity of the “negative interest rate theory.” Market interest rates are manipulated to the core. They are dictated by central banks — and not just the short-term, but also the long-term interest rates: The monetary authorities buy debt securities, thereby increasing their prices and lowering their returns. That is why many interest rates have become negative; it is not a “natural” development; it has been orchestrated by the ECB.

Negative Interest Rates for All

Is it conceivable that in the euro area consumer-, home construction-, and corporate loans will soon be offered at a negative interest rate? Yes, it is possible, indeed. To illustrate how this could occur, we assume that euro commercial banks get credit from the ECB for minus 2% per annum: Banks borrow 100 euros, and after one year, they pay 98 euros back. So the banks easily reap a profit of 2 euros. However, the ECB will let the banks only borrow at negative interest rates under the condition that they lend the money.

To stick with our example: A bank borrows 100 euro for one year at minus 2% per year from the ECB. It lends the money to consumers at, say, minus 1% (giving them €100 and getting €99 back after one year). Overall, the bank makes a profit of 1 euro: It earns 2 euros by borrowing from the ECB while losing 1 euro in the lending business. A twisted world, and it does not bode well for the prosperity of the economies.

The Way into the Planned Economy

If anyone can suddenly get a loan with a negative interest rate, then it is to be expected that the credit demand will get out of hand. To prevent this from happening, the ECB will have to resort to credit rationing: It determines in advance how many new loans it wishes to hand out, and then allocates this amount of credit. The credit market no longer decides who gets what and when and on what terms and conditions; those decisions are made by the ECB.

According to which criteria should loans be allocated? Should anyone who asks for credit get something? Should employment-intensive economic sectors be favored? Should the new loans only go to ‘the industries of the future’? Should weakening industries be supported with additional credit? Or should Southern Europe get more than Northern Europe? These questions already indicate that the planned economy is established through a policy of negative interest rates.

This article was published on 22 August 2019 by the Ludwig von Mises Institute, Auburn, US Alabama. It is also available in Spanish.

More than ever it will be the ECB that reigns over credit: It will effectively determine what will be financed and produced and where and when; it will determine who will be in a position to buy and consume on credit. As a central planning authority, the ECB — or the groups that greatly influence its decisions — determines everything: which industries will be promoted or suppressed; which economies are allowed to grow stronger than others; which national commercial banks are allowed to survive and which are not. Welcome to the planned economy in the Eurozone!

Speculative Bubbles

But that is not enough. The process toward ever lower interest rates drives asset price inflation: Stocks, houses, and land — everything becomes more expensive. Because the lower the interest rate, the higher the present value of future payments and thus the market prices of assets. The low interest rate policy facilitates a spectacular inflation of prices in the asset markets; a gigantic speculation bubble is pumped up.

This initially offers investors high returns. At the same time, however, the future yield prospects worsen. This can be explained as follows: Zero interest rates make investors bid up the prices of stocks and houses until the expected future returns of these assets are close to the zero interest rate set by the central bank. In the extreme case, when the central bank sets negative interest rates, expected market yields can even fall below zero.

Once central bank policy has succeeded in pushing all returns to or below zero, the free market economy is about to end. Without a positive return in sight, saving and investing stops: Because acting man has a positive originary interest rate, it does no longer pay off to save and invest. The division of labor economics comes to a shrieking halt. Replacement and expansion investments will no longer take place. Capital consumption begins, and the modern economy falls back into a primitive subsistence economy.

The End of the Free Society

The monetary policy of zero and negative interest rates — if it is consistently thought through — leads to the demise of (what little is left of) the free society as we know it in the Western world. The destructive effects of a negative interest rate policy are not immediately obvious to most people, because the path toward negative interest rates may be accompanied by an artificial economic upturn that gives the impression that the economy looks good, even though it effectively lives off its substance.

Only gradually, the damage becomes visible. Economic growth is dwindling; political conflicts over income distribution are increasing; the state becomes more and more powerful; the degree of freedom for citizens and businesses decreases; and at some point, asset prices collapse and the bubble bursts as economic performance becomes increasingly impaired: Companies make less profit, jobs are lost, and consumers must rein in their demand.

All this leads to economic impoverishment and, most likely, eventually to political chaos. The negative interest rate policy proverbially cuts off the branch on which the welfare democracy of the Western world is sitting. The harmful consequences of a negative interest rate policy are already clearly visible today. If central banks are not prevented from pushing interest rates to zero or into negative territory, this will turn out to be one of the greatest tragedies of our time.

Precious metals prices

In US-dollar per ounce

	Gold		Silver		Platinum		Palladium	
I. Actual	1539.4		18.3		869.0		1476.3	
II. Gliding averages								
5 days	1522.2		17.5		854.2		1474.6	
10 days	1516.0		17.3		848.4		1466.1	
20 days	1494.3		17.0		851.4		1451.4	
50 days	1443.6		16.2		840.8		1504.0	
100 days	1369.7		15.5		841.9		1433.9	
200 days	1327.7		15.4		831.2		1400.7	
III. Estimate for end 2020	1690		22.9		930		1570	
Bandwidths	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1440	1840	16	26	780	990	1380	1650
(1)	*-6*	*20*	*-11*	*44*	*-10*	*14*	*-7*	*12*
IV. Annual averages								
2016	1242		17.0		985		617	
2017	1253		17.1		947		857	
2018	1268		15.8		880		1019	

In euro per ounce

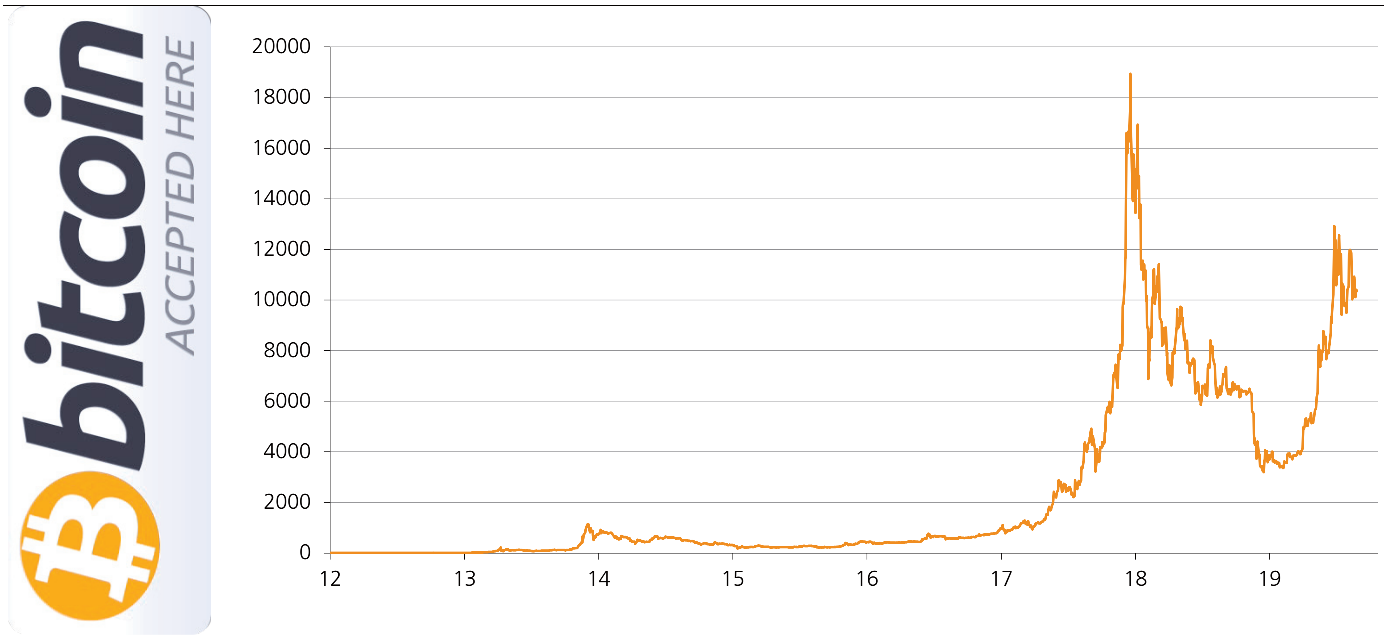
	Gold		Silver		Platinum		Palladium	
I. Actual	1388.4		16.5		783.8		1331.6	
II. Gliding averages								
5 days	1371.5		15.8		769.6		1328.5	
10 days	1365.2		15.6		764.0		1320.3	
20 days	1341.8		15.3		764.5		1303.3	
50 days	1288.6		14.4		750.5		1342.1	
100 days	1221.6		13.8		750.9		1278.7	
200 days	1177.2		13.6		736.9		1241.9	
III. Estimate for end 2020	1580		22		870		1470	
Bandwidths	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1350.0	1730.0	15.3	24.8	730.0	930.0	1290.0	1550.0
(1)	*-3*	*25*	*-7*	*50*	*-7*	*19*	*-3*	*16*
IV. Annual averages								
2016	1120		15		888		557	
2017	1116		15		844		760	
2018	1072		13		743		863	

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

(1) Estimated return against actual price in percent.

Bitcoin, performance of various asset classes

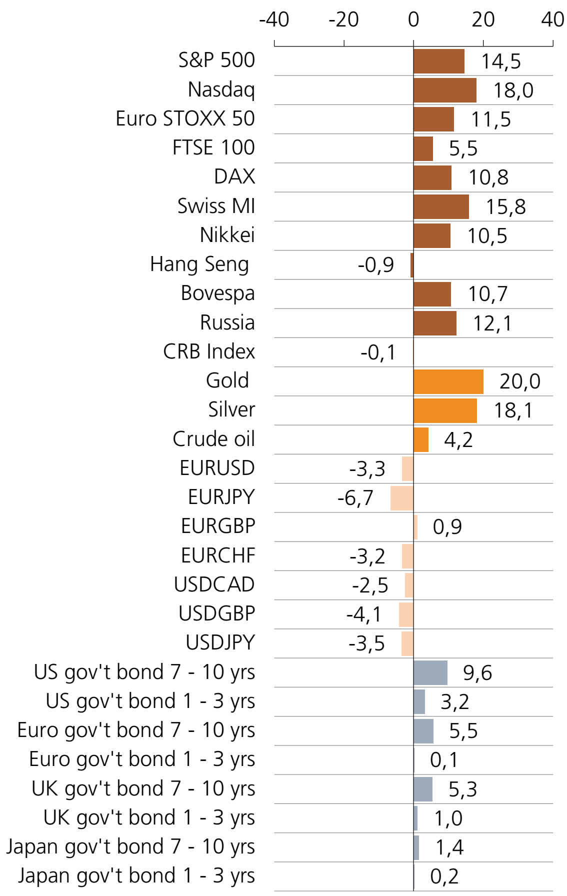
Bitcoin in US dollars



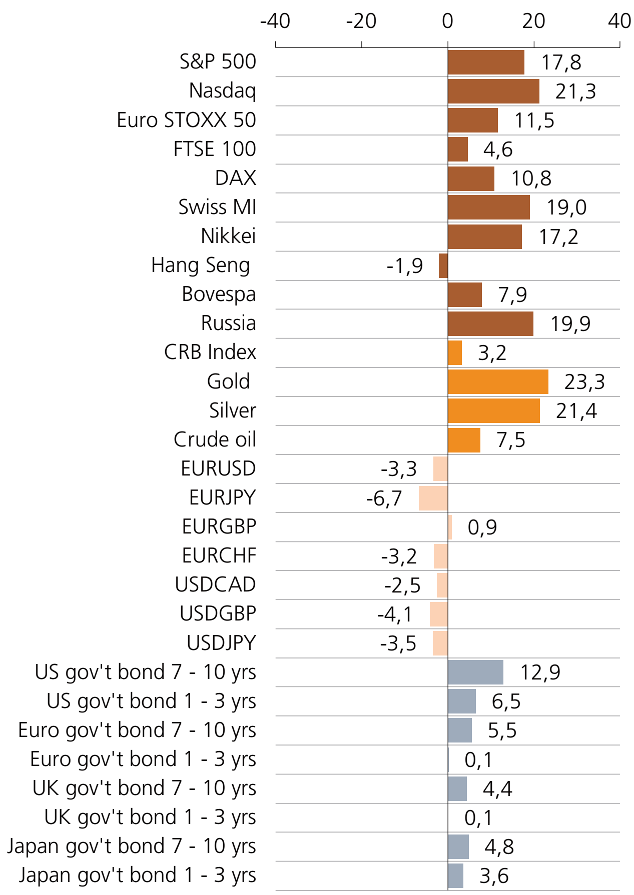
Source: Thomson Financial; graph by Degussa.

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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4 July 2019	It Looks Like A Gold Bull Market, It Feels Like A Gold Bull Market – Maybe It Is A Gold Bull Market?
19 June 2019	Good Money, Bad Money—And How Bitcoin Fits In
6 June 2019	Gold Outshines The US Dollar
23 May 2019	The Boom That Will Have It Coming
9 May 2019	The Crusade Against Risk
25 April 2019	A Sound Investment Rationale for Gold
11 April 2019	Be Prepared For All Possibilities. The Case For Gold
28 March 2019	Sword of Damocles Over Asset Prices
14 March 2019	The Big Central Banks Increase the Case for Gold
28 February 2019	The Fed Takes Full Control of the Bond Market – And Raises The Value of Gold
14 February 2019	Everything You Always Wanted to Know About Karl Marx and Central Banking (*But Were Afraid To Ask)
1 February 2019	Pay Attention, Gold Investor: ‘This Time is not Different’
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10 December 2018	The Fed Supports Gold
23 November 2018	The Fed Is Not Our Saviour
9 November 2018	The Missing Fear – And The Case For Gold
26 October 2018	President Trump is right: The Fed Is A Big Problem
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28 September 218	The Fed’s Blind Flight
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Imprint
Marktreport is published every 14 days on Thursdays and is a free service provided by Degussa Goldhandel GmbH.
Deadline for this edition: 29 August 2019
Publisher: Degussa Goldhandel GmbH, Kettenhofweg 29, 60325 Frankfurt, Tel.: (069) 860068-0, Fax: (069) 860068-222
E-Mail: info@degussa-goldhandel.de, Internet: www.degussa-goldhandel.de
Editor in chief: Dr. Thorsten Polleit
Degussa Market Report is available on the Internet at: http://www.degussa-goldhandel.de/infothek/marktreport/

Degussa
GOLD UND SILBER.

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

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

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