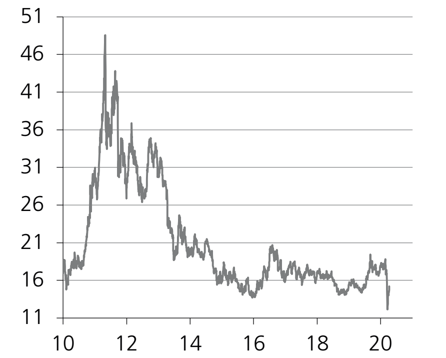
Degussa Market Report

9 April 2020 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	1.647.6	10.0	8.6	28.4
Silver	14.9	18.7	-16.3	0.0
Platinum	734.1	20.1	-23.7	-17.1
Palladium	2.195.4	33.7	13.1	58.2
II. In euro				
Gold	1.513.8	8.1	11.9	32.3
Silver	13.7	16.4	-13.7	3.1
Platinum	674.5	18.7	-21.5	-14.6
Palladium	2.017.0	31.4	16.5	63.1
III. Gold price in other currencies				
JPY	179.273.0	8.0	8.8	25.4
CNY	11.633.2	9.5	10.2	34.6
GBP	1.330.9	3.5	16.4	35.2
INR	125.416.7	1.9	15.9	40.3
RUB	124.236.0	4.0	32.3	49.9

Source: Refinitiv; calculations by Degussa.

OUR TOP ISSUES

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

THE BOOM AND BUST THEORY THAT DOES NOT CRASH

Quite a few people may wonder why the global fiat money system has not yet collapsed. The fiat money system did not crash in the financial and economic crisis 2008/2009 when a great many people feared the debt pyramid would come crashing down. And it has not gone belly up in the current corona-virus crisis, in which governments all over the world have shut down economic activity, making production fall over the cliff and unemployment skyrocketing. Doesn't all this contradict the Austrian Business Cycle Theory (ABCT), which says that a fiat money induced boom must end in a bust?

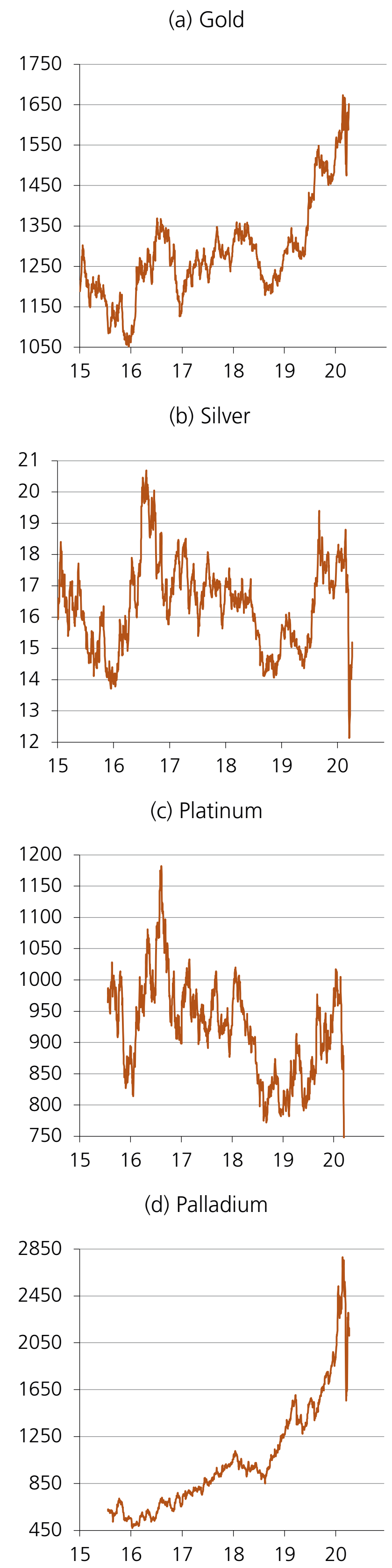
The answer is no; it does not. The ABCT, as was developed in particular by Ludwig von Mises, is an a priori theory. Its statements are consistently grounded in the irrefutably actual logic of human action. As such, the ABCT tells us precisely what happens to the economy if and when the central bank, in close cooperation with commercial banks, increases the quantity of money through credit expansion: The market interest rates will be artificially suppressed, consumption increased at the expense of savings, and additional investment induced. The economy, starting to live beyond its means, enters a boom period.

Once the additional credit and money injection have worked their way through the economic system affecting wages and goods prices, the market interest rate returns to its original level. Consumption declines, savings increase, and new investments turn out unprofitable – as entrepreneurs realise that their economic calculation had been corrupted by the artificial suppression of the market interest rate. It turns out that overconsumption and malinvestment are the consequences of the boom; that the production structure had been misguided – and must be corrected, which happens through the bust.

It is in this sense that the ABCT informs us that the boom must (sooner or later) end in a bust. Its reasoning, as irrefutably correct as it is in terms of the logic of human action, cannot be used without caveat to explain the real word, though. This is because the ABCT, like any other theory, holds true ceteris paribus, under the notion of *other things being equal*. To give a simple illustration: If the central bank injects new money into the economy through credit expansion, and if the free market is allowed to work, and if there are no other factors like increases in productivity, then the boom will turn into bust.

The real world, however, is a different pace. Not only do consumers and producers change their behaviour as time goes by, but there is also government action which affects the working of the economic system. Most importantly,

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



Source: Refinitiv; graphs by Degussa.

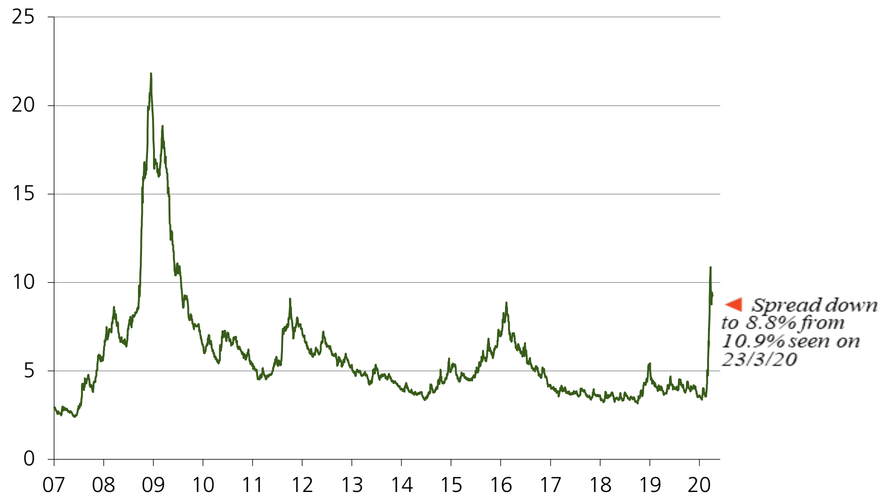
government interference in the market place is on the rise. It clamps down on the very forces that can, and usually do, turn a boom into bust. After the latest financial and economic crisis, 2008/2009 central banks put a "safety net" under the financial markets and the economies: Businesses and investors can now assured that central banks, in time of need, will come to the rescue and bail them out.

The same has happened in late March 2020, when governments all over the world – as a reaction to the political decision to shut down economic activity – put together gigantic "bail-out" packages – meant to support credit markets and extending loans and unemployment benefits to struggling businesses and consumers. Of course, governments do not have all the money promised to the victims of the "lockdown" at hand. And the money cannot be obtained by raising taxes or by issuing new bonds in the capital markets without making interest rates go up.

Central banks have started doing the dirty work by rolling out the biggest "backstop" for financial markets and the economy ever. To prevent the bust, they manipulate the interest rates downwards and print up ever greater amounts of money if necessary. In particular, and most importantly, central banks have entered the corporate and bank credit markets. They have lowered the cost of credit and capital in general. The beneficiaries are big business, Wall Street and, of course, highly levered investors, banks, and the financial industry in general.

1 Fed "bail out" eases stress in the credit market

Credit spread in the US High Yield market in per cent[1]



Source: Federal Reserve Bank of St. Louis; Graph Degussa. [1] ICE BofA US High Yield Index Option-Adjusted Spread.

Does this not just postpone the inevitable bust, one may ask? The ABCT even helps to find an answer to this question. To start with, of course there would be a recession-depression like bust at some point if and when market forces have the space to restore the economy to equilibrium. However, neither politicians, bankers, entrepreneurs, nor employees want this to happen. This gives a Carte Blanche to governments and their central banks – supported by a public who is becoming increasingly fearful of job losses and personal ruin – to go ahead and do away with what little is left of the free market system.
To escape the bust, the free market system is transformed into a Befehlswirtschaft: A system in which the means of production remain formally in private hands, but in which the state, and the special interest groups running

the state, are really in the driver's seat by dictating and controlling goods prices, interest rates and wages, labour conditions and incomes, and even nationalising and managing banks and entire industries etc. This was the model the German National Socialist erected in the late 1930s: The state dictated what was to be produced by whom, when and where, and at what costs.

History does not repeat itself, but sometimes, it rhymes. The Western world is increasingly, and quite rapidly so, bidding farewell to the idea of the free market system – driven by the attempt of fending off the inevitable bust as a consequence of a decade long debt binge caused and made possible by central banks' fiat money regime. While this may indeed keep away the bust for quite some time, it will weaken output and employment gains. Peoples' standard of living does no longer improve at an acceptable clip, or it may even decline; and with it comes impoverishment and perhaps even social unrest.

These are the very ingredients that facilitate the rise of the totalitarian state. So the unpalatable truth is that without allowing for a bust, a big crash, the fiat money system and with it all the forces working towards the aggrandisement of the state are here to stay and will predictably get worse. The hefty price of upholding the current boom and the economic and social structure it has brought about is the end of the free market society as we knew it. That said, one should be hesitant to find relief that central banks seem to have succeeded once again fighting the bust.

The ABCT in its traditional formulation enlightens us about the consequences of how the free market system turns an artificial fiat-money-induced boom into bust. It thereby also helps us to understand what actions will most likely be taken by those who want to prevent the boom from ending in a bust: The free society, the free market order, will become the victim. Fiat money – other things being equal – is a sure way of gradually, little by little, overthrowing the present order. In this sense, it is a tool of Marxists' stealthy agitation, seek-ing to overthrow capitalism, the private property society.

In retrospect it was presumably premature to interpret the latest crash of stock prices – the S&P 500 stock market index shed 33 per cent from 12 February 2020 to its low on 24 March 2020 – as an indication of the approaching end of the fiat money regime. The power of governments and central banks over economic and societal affairs has not been broken. On the contrary. One must fear that it has gathered further strength in the course of the latest "lockdown": More and stronger than ever, states and their central banks dismantle the free market system, cementing their fiat money and ultimately erecting the almighty state.

The ABCT is a boom and bust theory that does not crash. It offers timeless truths about the economic consequences if and when fiat money is injected into the economy. We know that a boom must result in a bust. But we do not and cannot forecast with certainty when it will occur. It all depends on the "special conditions" under which the fiat money regime operates. In a hampered market economy, the boom might very well last longer than one would expect. And the final crash might appear in a rather different format if and when governments increasingly shut down the free market system: namely tyranny.

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PRECIOUS METALS PRICES

In US-Dollar per ounce

	Gold		Silver		Platinum		Palladium	
I. Actual	**1647.8**		**14.9**		**734.1**		**2191.6**	
II. Gliding averages								
10 days	1621.8		14.4		728.8		2189.8	
20 days	1581.4		14.0		711.6		1988.4	
50 days	1596.6		16.2		849.3		2290.5	
100 days	1552.5		16.9		898.1		2150.5	
200 days	1516.7		17.0		893.0		1878.1	
III. Estimates, end 2020	**1695**		**25**		**1256**		**1536**	
(1)	*3*		*66*		*71*		*-30*	
Band width	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1459	1931	19.8	28.8	1020	1492	1300	1772
(1)	*-11*	*17*	*33*	*93*	*39*	*103*	*-41*	*-19*
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

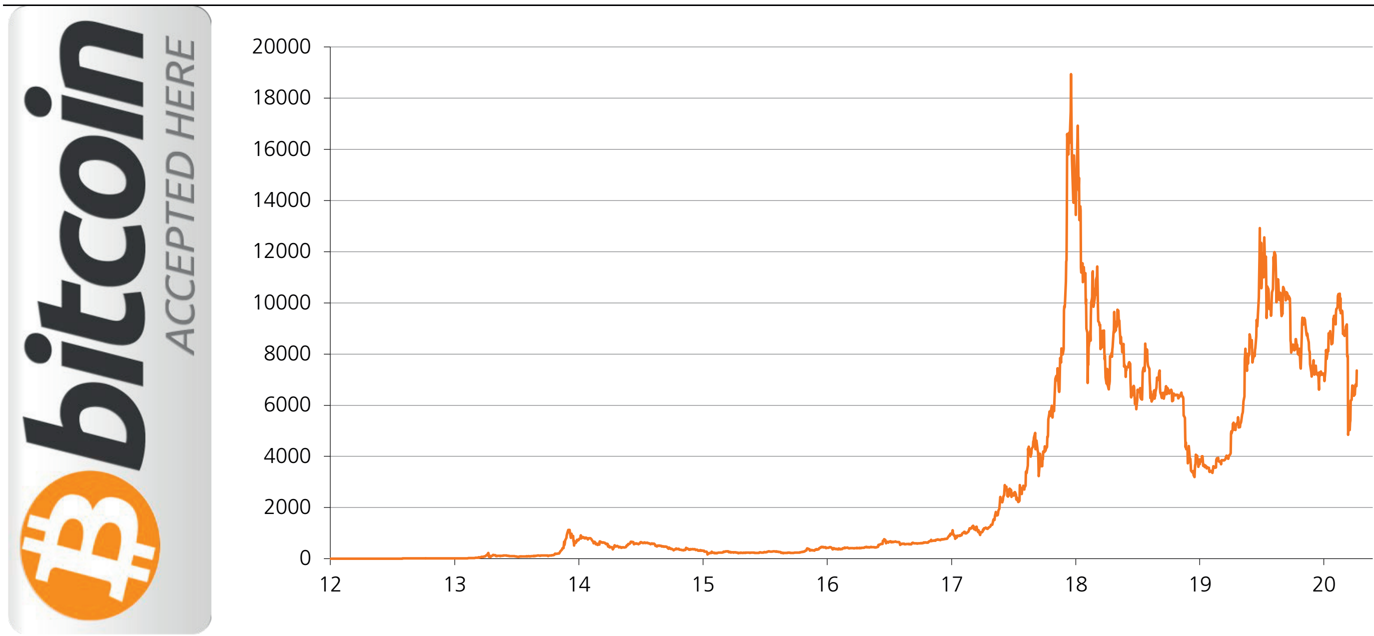
	Gold		Silver		Platinum		Palladium	
I. Actual	**1514.6**		**13.7**		**674.8**		**2014.6**	
II. Gliding averages								
10 days	1485.7		13.2		667.6		2005.5	
20 days	1447.7		12.8		650.8		1819.3	
50 days	1455.7		14.8		774.2		2087.8	
100 days	1407.3		15.3		813.6		1949.6	
200 days	1371.3		15.4		807.2		1698.7	
III. Estimates, end 2020	**1580**		**23**		**1170**		**1430**	
(1)	*4*		*69*		*73*		*-29*	
Band width	*Low*	*High*	*Low*	*High*	*Low*	*High*	*Low*	*High*
	1360	1800	18.6	27.0	950	1390	1210	1650
(1)	*-10*	*19*	*35*	*97*	*41*	*106*	*-40*	*-18*
V. Annual averages								
2017	1116		15		844		760	
2018	1072		13		743		863	
2019	1235		14		770		1350	

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

(1) On the basis of actual prices.

BITCOIN, PERFORMANCE OF VARIOUS ASSET CLASSES

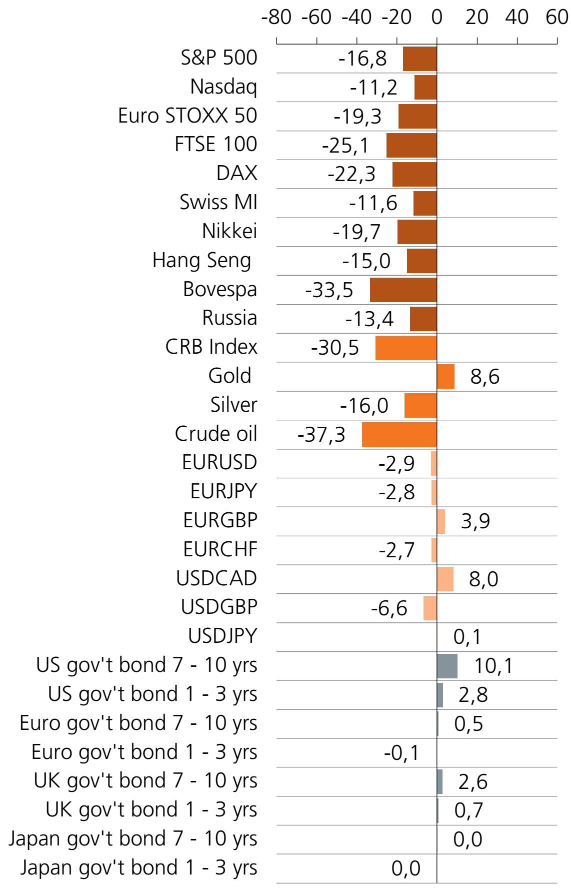
Bitcoin in US dollars



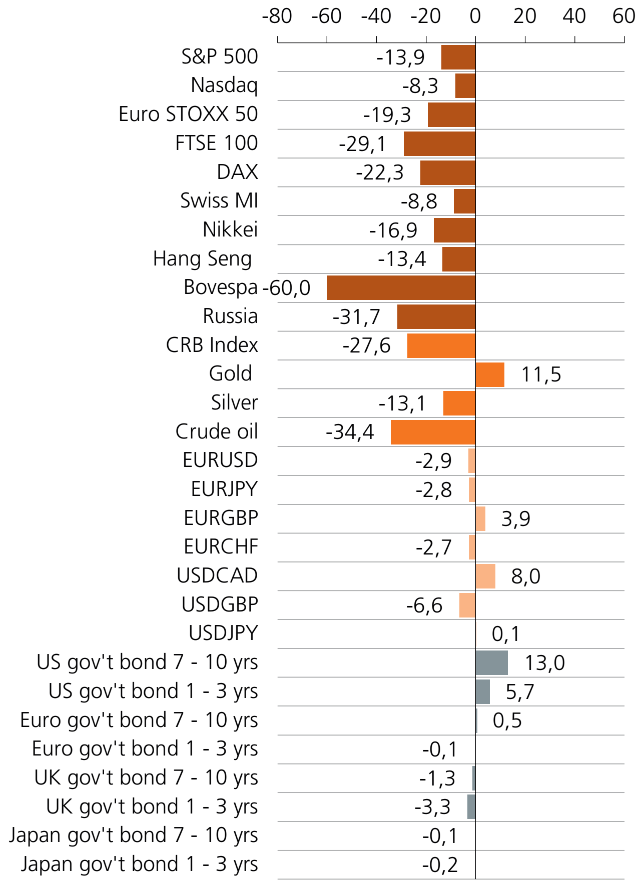
Source: Refinitiv; graph by Degussa.

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*

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26 March 2020	With Mega Bail Outs, Governments Are The Big Winners
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13 February 2020	Gold-ETFs Versus Physical Gold: Difference Matters
30 January 2020	Do Not Think The Era Of Boom And Bust Has Ended
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28 September 218	The Fed's Blind Flight

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