Gold, Silver and Oil: Credibility, Collateral and Confidence in a World of "Fiat" Currencies

By Bill Holter
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We live in a world where all currencies are "fiat", none backed by gold, silver, oil or anything else. Yes of course the dollar, otherwise known as the "petrodollar" has functioned and survived (so far) based on oil revenues being recycled back into U.S. Treasury bonds, but this has been changing over recent years. The change has accelerated greatly over the last five years. This era of "fiat" everywhere and real money nowhere is now 44 years long in the tooth and the very first time in human history there was no alternative currency with a real foundation.

Before you tell me "the U.S. is the most powerful military nation in the world, we don't need no stinkin' backing", think this through. Though for a time, this "arrangement" worked and no one could stand up to the U.S., is this still true? Can we impose our will with everyone and everywhere on the planet? Or has our military technology been leapfrogged as evidenced by the USS Donald Cook last year? Can't countries just decide to do business with each other …at the exclusion of the U.S. and use their own currencies to settle? Isn't this what has begun to happen with China and other nations doing individual trade deals? Countries' trade moving away from the U.S. and away from using dollars is as simple as grade school kids gravitating away from the schoolyard bully and deciding to play in harmony amongst themselves.

This 44 year old experiment has always needed "confidence" to exist. At first it worked because the U.S. was not over indebted and had plenty of room to lever up or "reflate" if you will. We still had plenty of untapped or unencumbered collateral left to borrow against, this is no longer so. Once the 2nd Great Depression kicked off in 2007, the Treasury started to run trillion dollar deficits and have now doubled our indebtedness. The Federal Reserve has more than quadrupled their balance sheet to well over $4 trillion that sits on the head of an equity needle of less than $70 billion, they are THE largest and most leveraged hedge fund in the world! The monetary lunacy by no means is confined to the U.S., it spans the globe and is practiced everywhere. Europe and Japan's central banks have done the same, so has China to some extent but with a couple of large caveats.

In order to have monetary confidence, there are two prime necessities, collateral and credibility. In other words, who wants to do business with a bankrupt or someone who cheats or lies? Any business partner or someone you will do business with must be both solvent and truthful, neither of these conditions still exist in the big three monetary nations of the West. Each and every year since 2011 we have been told the Federal Reserve would end QE, begin to tighten and thus normalize interest rates. As I have written several times before, the Fed cannot ever raise interest rates again, this would destroy derivatives, the economy, the Fed's own balance sheet and create a situation where tax revenues would not be enough to pay the interest on federal debt. Raising rates is not an option. Unfortunately, it is the same situation in both Europe and Japan, they have no options left either http://www.zerohedge.com/news/2015-04-10/japan-qe-limit-approaching-goldman--says-boj-risks-losing-crediblity . Japan began a very outsized QE operation last year while the ECB began theirs just two months ago.

Both of these central banks are running into the same problem the Fed did, namely they are and have already taken too much collateral out of the system. "Collateral" is what underlies the shadow banking system's ability to lend, without it credit dries up. It is so bad in Japan that the BOJ is buying more treasuries than are even issued. Not only are they at 100% monetization, they are beyond this. In Europe, the situation is so bad that market participants don't expect a tightening until 2020, (we'll never get there). This is the reason for the euro's recent marked weakness, the realization of how poor business really is and the lack of any options available.

My point for writing this very basic (maybe even boring) piece is to remind those who have been distracted by the propaganda. The bottom line is this, the collateral necessary for the "grand plan" of reflation does not exist. The available collateral has already been encumbered and used in previous efforts. The answer, which has always been "reflation" is now an impossibility.

I mentioned "China with a couple of large caveats" above and needs explaining before we finish. First, China sits in the exact same position the U.S. did in 1929, they have the world's largest manufacturing capacity in a world where demand for this capacity is and will continue to wane. They have attracted huge amounts of capital just as the U.S. did. The second large caveat is China has been importing massive amounts of gold and certainly amassed more than 10,000 tons. The argument can be made they now have 20,000 tons or more.

In my opinion, whether the number is 10,000, 20,000 or even 100,000 tons, it really does not matter. It does not matter because a large part of whatever they have purchased has been delivered FROM Western vaults and highly likely including the FRBNY's custodial holdings for other sovereigns. You see, if the West is left with little to no gold because of clandestine back door sales or even theft, the difference between China having 10,000 tons and 20,000 or more tons is almost meaningless. It is meaningless because China will have the ability to mark the price up in Western currencies and make it all but impossible to ever "catch up." The only way to accumulate gold would be the old fashioned way, "mine it." But this is a very slow and arduous process that takes real work …something of a rarity in today's Western world and will never happen at current prices.

With any announcement of how much gold China has hoarded will come the above realization of what comes next, the price of gold will explode! With an announcement of gold holdings will come credibility that they have collateral followed by the "natural" confidence the U.S. once had …a fairly simple concept if you stand back to look at it.

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Bill Holter writes and is partnered with Jim Sinclair at the newly formed Holter/Sinclair collaboration. Prior, he wrote for Miles Franklin from 2012-15. Bill worked as a retail stockbroker for 23 years, including 12 as a branch manager at A.G. Edwards. He left Wall Street in late 2006 to avoid potential liabilities related to management of paper assets. In retirement he and his family moved to Costa Rica where he lived until 2011 when he moved back to the United States. Bill was a well-known contributor to the Gold Anti-Trust Action Committee (GATA) commentaries from 2007-present.