Orwellian Global Economy? "Backwardation", Negative Interest Rates and the Gold Market

By Bill Holter
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We live in a truly messed up and Orwellian world if you will.

In many parts of Europe, interest rates are negative. Savers "pay" for the privilege of banks to hold their money, lenders pay sovereign treasuries to lend, new homeowners who borrow to buy property are paid to borrow. This situation where borrowers get paid and lenders pay also exists between banks which is really strange because you would think bankers understand money and interest …just a little?

As a question to set the foundation, I ask you this; if you could sell something today for $100 and be contractually guaranteed to be ABLE to buy it back 30 days later at $99, would you do it? I hope your answer is not only yes, but you return with "how many times can I do this, it's free money?!". In the real world, this is called arbitrage. Rarely does the condition ever exist on a single exchange, normally when it does exist it happens over two or more exchanges and even time zones. The discrepancy can be miniscule as billions of dollars scan the globe 24 hours a day looking for this situation and lock the profit in until there is no more to be had. Arbitrage is a big business and for the most part, RISK FREE. The condition described above is called "backwardation", the remedy is ALWAYS arbitrage.

Please notice I bold printed three words, "able, risk-free, and always". Starting with the first word "able", if we changed that word to either possibly or cannot, the whole equation changes as the trade is no longer risk free and will not ever be done without risk assessment. As I understand it, physical gold is in backwardation in London and silver in Asia. Why has not big money stepped in and arbitraged the "guaranteed" profits out of these markets?

The answer of course is that the profit is not guaranteed. The reason backwardation is persistent is because the fear of not being able to get your metal back 30 days into the future. It is being deemed by the market that gold today (a bird in the hand thing) is more valuable than a "promise" to get it back in 30 days …because promises are made to be broken! The fear obviously exists of a failure to deliver in the future, there can be NO other explanation why physical gold in hand is more expensive than gold 30 days in the future. If you would like to tell me that the situation exists because interest rates are negative then please explain to me how interest rates can be negative and the logic behind it!

Andrew Maguire spoke of this again last Friday, he also spoke of the new "Allocated Bullion Exchange" (ABX) which was set to begin in late April and has been pushed back a few weeks. I must confess to giving out incorrect information last month, I believed this was an offshoot of the SGE, Shanghai Gold Exchange, it is not. Their homepage is up but not yet fully functional. ABX intends to arbitrage the differences between the various global gold exchanges …on a PHYSICAL basis. In other words, when one buys they ask for delivery and when one sells they will deliver the real product. We will soon see how willing the shorts are to pummel metals prices with weeks or even months worth of global production "on paper". I believe it is entirely possible to see LBMA cleaned out and followed by COMEX of their inventories within a very short timespan. An operation as such would not require huge amounts of capital, $10-$20 billion should be more than enough to do the trick!

After writing the above, news has come out the IMF board meeting to discuss China's inclusion to the SDR has been postponed. A decision and announcement must be done prior to sometime in October. I am still of the mind that China will put their cards on table and include audited numbers. Will they request or even demand an audit from the other players?

I don't think they have to overtly, by auditing their own gold they are "politely" asking the others to provide proof of theirs.

I point this out because of the connection involved between backwardation and whether or not the Western powers really do have the gold. The connection is of course the "supply" and whether it will continue to be forthcoming. The arbitrageurs seem not willing to take the risk it won't be, not even for 30 days. Otherwise the backwardation would not exist. If the supply has in fact been surreptitiously coming from Western vaults and questions come regarding official numbers, the supply may discontinue and the "I want my gold" moment will be at hand.

As Andrew said, "this will accelerate the process of re set". I agree and would add, it's been a long time coming, the tail should never have been allowed to wag the dog but then again, in what world do borrowers get paid to borrow?

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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.