

Trading Oil for Gold: China's Gold-Backed Petro-Yuan Market, Threatens the US Dollar?

By [Bill Holter](#)

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China recently announced they will [trade oil for yuan "backed" by gold](#). The story has gotten some press (none of it mainstream mind you), and many have questions as to what it really means. While quite complicated as a whole, when you break this down into pieces I believe it is a quite simple and logical end to Bretton Woods.

For a background, China has had an exchange open for about a year where gold can be purchased with yuan, though the volumes so far have been miniscule to this point.

China has also been all over the world inking trade deals (in yuan) and investing in all sorts of resources from oil to gold to grains, they have made no secret about this.

With the most recent example [here](#). They have trade arrangements and treaties with Russia, Iran and many other non Western nations. They have also "courted" many Western nations privately (remember their meeting with the King of Saudi Arabia?) and actually lured many with their "Silk Road" plans via the AIIB which was huge news last year (but nearly forgotten by Americans at this point?).

We also know China has been a huge importer of gold for the last 4-5 years and done so publicly via Shanghai receipts and deliveries.

So what exactly does "oil for yuan" mean? In my opinion, China is basically leading a "mutiny FOR the bounty" (we'll explain this shortly). The only things holding the dollar up from outright death for many years has been the oil trade (and other trade commerce) between nations and settled in dollars. Anyone wanting to buy oil had to first buy dollars in order to pay for the trade. Anyone getting out of step and suggesting they would accept currency other than dollars was dealt with swiftly and harshly (think Saddam and Mohamar). In other words, the U.S. military "enforced" the deal Henry Kissinger made with the Middle East (lead by Saudi Arabia) where ALL oil was settled in dollars. International trade settlement alone supported the dollar after the Nixon administration defaulted on its promise to exchange one ounce of gold for \$35.

China is now suggesting THEY will be the ones to trade oil and not use the dollar for settlement. Instead, settlement will be in yuan. But why now?

I believe for one of two reasons or more likely both. First, and as we have recently spoken about, it very well may be that the US military technology has been cracked or leap frogged. It is looking like a distinct possibility and if so, China/Russia now have less fear of U.S. military "retribution".

The other possibility pertains to gold. We have no way of knowing whether or not the "bottom of the barrel" as far as gold reserves is in sight but we can have a pretty good idea.

Physical demand for gold has exceeded mine supply by some 1,500 tons for the last 20 years, "Scrap" supply can not have made up the shortfall. The only place the gold to supply for delivery can have come from are Western (think Ft. Knox) vaults. If the Chinese know their "supplier" of gold is at or near zero, this could also explain "why now". My bet is both, military technology AND lack of gold supply are at work here.

The next question is this, does China want to become the world's reserve currency? I do not think so as they have seen economies of the issuers of the reserve currency destroyed time after time throughout history. Rather, China wants to lead the parade away from the dollar or at least steer it. Whether via a larger slice of the SDR pie, or another as yet to be introduced currency I do not know.

What we do know: the U.S. is broke and very likely nearly out of gold. The U.S. has "led" the world with an iron fist and trampled many in its wake ...pissing off nations all the while over the last 20+ years in particular. China knows this and also knows the rest of the world will follow them just as school kids will follow the one who stands up to the school bully. Besides, on the surface it certainly looks like better (more fair) trade and settlement terms for anyone who goes along.

Wrapping this up, we need to know "what" all this means? Most importantly it means the world will have an alternative to settling in dollars ...which means less overall demand for dollars. This alone will weaken the dollar much further than the huge move we have already seen. A weaker dollar will mean much higher prices (inflation) for the imported goods we no longer manufacture at home.

There is a bigger problem here that few are thinking of yet. How will the U.S. settle trade if the dollar becomes so weak it becomes shunned ...AND we have no gold for international settlement left? This is a very serious question and one pertaining directly to the standard of living for Americans.

Answering the question as to the meaning of "mutiny for the bounty", this is simple. You can think of "bounty" as "prosperity" if you will. Prosperity in today's world means you produce goods and trade, trade, trade! By and large I believe the world wants peace and prosperity ...which go hand in hand and are not mutually exclusive. If the world is offered a "more fair" way to settle trade, will they go for it? You bet! Especially if they are offered "cover" or protection from the U.S. military ...for trading in a currency they deem more fair than dollars!

So it seems to me, China is leading a world that is ready to follow in a direction away from dollars. As for gold, it will explode in price in terms of a weakening dollar but there is potentially more. China without ANY DOUBT is THE largest holder of gold on the planet. It is for this reason China now has the ability to "price" gold wherever they want to. In other words, China can mark the price of gold to the moon which will do several things. It will make them the wealthiest nation on the planet while at the same time making it extremely expensive and difficult for anyone to catch up by amassing their own gold horde.

As to the yuan becoming gold backed, I doubt it in reality. I highly doubt they will ever "exchange" their current gold horde. It is more likely they will only exchange further gold

accumulated from this point forward but that is a story for another day.

We have speculated for several years that China might try to supplant the dollar. It now makes sense and one would have to wonder why they wouldn't lead the mutiny if they were to become the new captain?

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About the author:

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.

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