“Something” Just Happened! China’s Gold Stocks, Dumping of US Treasuries, Quantitative Tightening (QT), Oil Markets

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Theme: Global Economy

“Something” happened three weeks ago. While we cannot be sure “what” exactly happened, we can speculate. We have many dots and lots of data points to help us but first it needs to be pointed out, even if wrong in conclusion …just the knowledge alone that “something changed” is enough. If you know something has changed, you can take clues and look at various markets for inflection points. Currently, most markets are stretched to various limits. Whether it be zero bound credit markets, equities, real estate, commodities or gold and silver, all values had reached extreme highs or lows.

Something changed three weeks ago and a series of events began. It all started with China announcing 600 additional tons of gold. This was followed by the IMF rebuff of China, the three yuan devaluations and three “coincidental” explosions. Then equity markets around the world (which were already weak) began to violently unravel and finally spilled over to the U.S.. This tested the PPT’s limits (which were apparently $23 billion last week).

There were other behind the scenes dots which I missed and would like to add here before theorizing. In the gold arena, the GLD inventory supposedly rose over the last two weeks even though gold was “weak” and being sold. This was against a backdrop of very deep backwardation going out a full six months in London. The current backwardation is further out in time and far larger in price than EVER before! These two data points are in exact divergence to a dropping gold price. Why would there be buying in GLD if gold was being panic sold? Also, if real gold was being dumped, how could it be in backwardation or shortage? Wouldn’t “sales” make product extremely plentiful?

There were several more major anomalies in gold. As of Friday, there were 63 August contracts still open …even though the contract went off the board. This has NEVER happened in 40 years! How is this possible? The day before on Thursday, there were 552 contracts open. Can someone please explain to me why the shorts would not have delivered gold (like they did in the old days) on the first or second delivery day rather than waiting to the last day? Someone has to pay for storage, why would the short want to pay for storage they are contractually able to deliver nearly 30 days prior and avoid the charges. Are they having problems sourcing gold? Just like several mints who have gone to rationing or halts of production …and exactly as the backwardation is suggesting?

Over in silver, did you know they had confirmed volume on Thursday of 122,482 contracts traded? Did you know this represents 612 MILLION ounces of silver …or over 87% of annual global silver production ex China and Russia? How in the world does 87% of a full year's production trade in just several hours? Doesn't this go against commodity laws? AND, silver was pummeled on Thursday so it was supposed to represent PANIC SELLING. Who was panicking and needed to sell all that silver so fast? …especially since the U.S. Mint just raised premiums and started rationing dealers because they couldn't keep up with DEMAND! Let's not forget the Royal Canadian Mint, they have suspended sales of silver Maples! Why or how could this be? Everyone has been selling silver but the mint could not source any? This defies pre school logic!

Let me give you another very strange data point. The FRBNY (New York Fed.) always reports custodial gold holdings on the 28th or 29th of the month for the previous month. They missed July 29th and reported on August 20 NO GOLD was shipped (to Germany for their repatriation program) when month after month they have been reporting close to 10 tons out the door. What's going on?

Before telling you what I think has changed, we need to look at what China has just done. China has sold $100 billion worth of Treasury bonds over the last two weeks. Before they sold these, they devalued their yuan by about 5% which is the same thing as making their dollar holdings worth 5% more in yuan …so they increased their sale by the equivalent of $5 billion! Please understand the following because it is VERY important, we have not experienced hyper inflation in the U.S. because the debt was always "sterilized". We actually exported the inflation to other nations and as long as they did not sell the actual dollars (if they sold Treasuries), the trade remained sterilized. It was reported Friday China had actually sold their dollars realized from the Treasury sales for …you guessed it YUAN! This drove the yuan up versus the dollar so China added even more to their trade. Brilliant!

This topic deserves an entire writing and I'll undertake it later. Suffice it to say, the Federal Reserve had to buy the $100 billion worth of bonds. This is "reverse" QE or as they now say "QT" (quantitative tightening). As the great credit unwind continues, more and more Treasuries from China and other sources will hit the market and force the Fed to buy them. This will take more and more "space" on the Fed's balance sheet but they will have **NO CHOICE** unless they want interest rates to skyrocket. In the end, the inflation we exported for so many years will come washing back on our shores like a tidal wave!

OK, what do I think "happened" three weeks ago? On the original writing, I erroneously believed the SGE had not reported withdrawals for the last two weeks, this was incorrect and they have in fact reported withdrawals. This led me to believe China was no longer being delivered gold. No proof of this yet but it will mathematically happen. Why? Because the simple math says so. China/India can only import more than total production for as long as Western vaults have metal to dishoard. Once non delivery does happen and becomes known, our hoard of "power" will be gone and so will the façade of financial strength. Our standard of living will collapse into third world status hand in hand with a broken financial system.

Something behind the scenes has caused markets all over the world to convulse. The likely candidate involves leverage and most probably derivatives. As I wrote last week, "dead bodies must be strewn everywhere", call them walking dead institutions or whatever. We have experienced 5% and even 10% moves in various markets in less than a week's time or even in just one day. Many derivatives are carried with just one or two percent margin, in other words the moves have been big enough to completely wipe out equity. Winners become losers when the losers cannot pay and default.

There is one more piece of news that may be nothing at all or it may fit hand in hand with the above. King Salman of Saudi Arabia announced a visit for this coming week with president Obama.

http://www.nytimes.com/2015/08/27/world/middleeast/saudi-arabia-king-plans-to-visit-us.html?partner=rss&emc=rss&_r=0

The press has speculated the meeting has to do with the Iran deal or even aggressions with Yemen. I don't think so. My guess is King Salman may be coming to Washington to say "the deal is off". The "deal" being Henry Kissinger's early 1970's petrodollar. I suspect Saudi Arabia will inform our commandeer in chief, they will begin accepting yuan for oil. The Saudis have over the last year or more done many trade deals with both Russia and China. It should only follow at some point they do not use dollars but instead use their own currencies.

Before finishing, Saudi Arabia increased their oil production at the behest of Washington to injure Russia. I think the price drop got way out of control as the algos took over. The drop was so severe it has seized up the U.S. fracking industry and put at least $500 billion worth of energy credit in jeopardy while China has filled up her storage reserves with cheap oil. If I am correct about the gold default, China/Russia have also made strategic strides in trade with Iran and Saudi Arabia in preparation.

The important thing is you understand "something" very big has happened and trends are changing in many markets. The leverage in all markets suggests a "holiday" will occur because the unwinding cannot be orderly. The "unwinding" by the way will need to undue the credit built upon credit going all the way back to Aug. 15, 1971!

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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.