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WAITING FOR GODOT

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The original title for this article was *Timing Hyperinflation* with an overlong subtitle *The Saga of Unraveling Global Fiat Money Issued on the Strength of Irredeemable Promises of Governments*. On second thought I changed it for fear of turning off serious readers suspecting that it was written by a prankster to be released on next April Fool's Day. So the new title *Waiting for Godot* stands.It obviously calls for an explanation.

In 1952 Samuel Beckett wrote a play with the title *En attendantant Godot* that has subsequently become world famous. In his play the author demonstrates with unforgettable force the pre-conscious visceral form of expectation, similar to the Jewish peoples' waiting for the Messiah, or Christendom's waiting for the second coming of Christ. The question asked by the impatient 'gold bug' population arises in view of the instinctive waiting for hyperinflation in the wake of the "latter-day miraculous proliferation of money". It is motivated by the quantity theory of money (QTM), a faulty doctrine. The superficial observer misses the individual's effort to shape the future and the fact that , to this extent, what is happening is caused by teleological forces (as distinct from forces shaped by causality). The expectation of future always builds on empirical foundations, but regularly exceeds the level of experience. Reasonable monetary policy ought to be able to figure out what consequences follow from government interference.

My readers bombard me with the question: "How much longer do we have to wait for Godot (read: hyperinflation?)". "Why has the prognostication for permanent gold backwardation failed to materialize during the past decade? The question is justitied.

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I have devoted the greater part of my life to the task of studying hyperinflations throughout the ages. For some six decades I was trying to analyse the problem. I have established the New Austrian School of Economics (NASOE) that attracted brilliant students from all over the world, and conferred several Master's and Ph.Degrees. Some of these doctoral dissertations, written under our program have beaten new paths by using such novel concepts as the gold basis and cobasis. Members of our alumnus contributed important new results to monetary science, for example, proving the important theorem that permanent gold backwardation inevitably brings about hyperinflation in its wake.

Personally, I was motivated by my experience of growing up in a family burdened with the memory that the pension of my grandfather, a government engineer, was wiped out in 1926. He lived to be 90 and was condemned to penury to the rest ofhis life. This was followed, twenty years later, by the pension of my father, a school principal, being wiped out in 1946.

I felt that I was targeted next. My daily experience in paying for food, medical care, legal fees, for tuition of my five children confirmed this intuitive fear. The deprivation caused by the experience of my grandparents and parents left an indelible mark on me.

I decided that I shall not take it lying down. Although I was trained as a mathematician and made a career as a university professor (of mathematics and statistics),I have become an autodidactic monetary scientist specializing in the study of hyperinflations. To my utter amazement I have found that virtually all my colleagues, students of monetary hyperinflations were ignoring the 'endgame' in the gold markets as the drama of destruction of the purchasing power of fiat paper money was unfolding. There are two approaches to the problem: one is *quantitative* or statistical, the other *qualitative*. The former is essentially number-crunching. It was quite clear to me that this was a dead-end street. My departure had to be different. I wanted to pass from an *inductive* to a *deductive* methodology.

This article consists of excerpts from my book *Credit* (see References below) in which the problem is treated in full. I consider my greatest contribution to monetary science the shifting of the focus from the gold *price* to the gold *basis,* that is, the spread between the future and the spot price of gold. Typically it is *positive*. The gold price seismographically picks up a lot of 'noise' while missing false-carding in the gold markets. By contrast, the gold basis is a pristine market indicator filtering out noise while revealing false-carding wherever it occurs.

False-carding in the gold market

As readers familiar with the card game bridge well know, rules governing endgame are very different from those governing the middle-game and the pre-game auction. In the endgame the knowledge of the distribution of cards yet to be played is all-important. Players having a better grasp of the constellation of those cards win. Here false-carding designed to fool the opponents come to the fore. Not surprisingly, in the endgame of the hyperinflationary phase of the saga of the unravelling of irredeemable currency false-carding becomes a favorite ploy frequently applied by the powers-that-be. For example, a gold mining concern may be selling gold faster or more slowly than justified by its output. Also, central and bullion banks and hedge funds publish fake statistics on their holdings of bullion and on their maturing gold lease contracts and forward sales of gold. The reason for leasing gold and selling it forward – a self-defeating manouvre *per* se from the point of view of the gold mines – is justified by the fact that the gold lease market and forward gold sales is the hotbed in which false-carding strives. Forward selling and leasing of gold bullion is also a favorite playfield of banks involved in the gold trade.

When a central bank leases gold to a bullion bank it assumes the risk that it may never see its leased gold ever again. The latter promptly sells it to silk-road countries, the bottomless pit absorbing any amount of the precious yellow since times immemorial. The former, the central bank knows this, but it also knows that bank examiners accept paper gold as fully equivalent to physical gold, thanks to the corruption of bank examination standards, compromising the process of auditing. (Never mind that the world's banking system has been insolvent since August 15, 1971, the day on which the U.S. defaulted on its short-term gold obligations.)

For many a year in my lectures and articles I have drawn attention to the unique phenomenon of *permanent gold backwardation* as a foolproof indicator of the progressive scarcity of gold deliverable against maturing futures contracts. The endgame drama features episodes of sporadic backwardation of gold, indicated by the gold basis dipping into negative territory for greater or lesser periods. These episodes are temporary at first, with the gold basis bouncing back into its normal positive range, thus reestablishing normal *contango* in the gold futures markets (a condition whereby the price of gold for more distant future delivery is necessarily higher than that for nearby future delivery, the opposite of *backwardation*). The upshot is that the length of sporadic spells of gold backwardation gets progressively longer making physical gold ever more scarce, severely squeezing short interest.

Anti-Keynes

The consensus pushed by mainstream economists almost all of whom are staunch supporters of global fiat money based, as it is, on irredeemable promises of governments, is that the problem of inflation has been disposed of through successful government measures such as QE (quantitive easing), ZIRP (zero interest policy) blowing bubbles in the bond, stock and real estate markets. Governments have also succeded in their war on gold: the precious yellow has been marginalized. Gold has been put where it belongs: in the dog-house, so they say.

Thus, inflation is no longer a threat thanks to 'wise' government monetary policy in manipulating the rate of interest. This article aims at exploding the myth of government omnipotence by focusing on the outstanding weak point of mainstream economics, i.e., Keynesianism, namely, the denigration of capital and dismissing the problem of capital destruction. However, all that these 'wise' government policies have accomplished was to let the capital structure of the world enter an advanced state of decay. We are witnessing the wholesale progressive destruction of capital. As a result, inflation will come back with vengeance and, ultimately, global fiat money will unravel causing hyperinflation that we may, for the pourposes of this essay, may define as the whole destruction of the purchasing power of money.

We shall see that the decay of capital can be put in a time-frame and the coming doomsday can be pinpointed. This will be done through refining our theory of permanent gold backwardation. The theory of *primary gold backwardation* will be augmented by the theory *of secondary gold backwardation.*

Endgame in the gold market

We all know from logic and from history that fiat currency is going to fail. Every experiment with it ended in fiasco sooner or later. The fact that the current experiment survived longer than any previous one proves nothing. In addition, the regime of global fiat currency has become the fast-breeder of irredeemable debt. Again, logic tells us that the construction of such a Babelian Debt Tower cannot continue forever. It will collapse like its biblical forerunner did in the fulness of time, burying the conceited builders under the rubble. The problem confronting the monetary scientist is to predict *when* this cataclysmic event will take place.

The curious thing is that this is not how it played out during the past ten years or so. What is going on? Have governments and economists in their pay figured out a way to put economic law into abeyance? In the past decade the Federal Reserve System of the United States (FED in the sequel) created fiat dollars in unprecedented amounts counted in quadrillions setting a precedent to a hoard of me-tooing fellow central banks without triggering hyperinflation.

The purpose of this essay is to reveal how this was possible.

The short answer is that the analysis in terms *primary* gold backwardation must be refined through the introduction of the *secondary* gold backwardation.

The gold price getting irrelevant

To recapitulate, research at NASOE concluded that the gold price is not *per se* a reliable indicator of hyperinflation in the making. More reliable is the *gold basis* and *cobasis*. A negative gold basis makes physical gold progressively scarcer, paving the way towards permanent gold backwardation. Continuing wholesale withdrawal by sellers offering to sell physical gold brings about a situation where no cash gold is available for purchase *at any price* denominated in an irredeemable currency. Sellers do not see how they can replenish their inventory through ordinary trading of gold futures contracts.

The mechanism of gold delivery

In what follows I indicate how I propose to refine the theory of permanent gold backwardation to explain the lag between cause and effect. Strictly speaking gold futures markets trade capacity for warehousing-space for gold, and the gold basis is just the price of that warehousing space. We have to familiarize ourselves with the nitty-gritty of making and taking delivery on gold futures contracts. I apologize to my readers for the complexity of the following description of the mechanism of gold delivery on the gold futures markets. Quite possibly this mechanism was made contorted deliberately by the principals of the old futures markets in order to protect trading by erecting a firewall to protect trading against 'predatory' long interest trying to corner the market.

In talking about warehousing we mean *allocated gold,* in which case the warehouse certificate in the possession of the owner of gold specifies the exact weight, fineness and the serial number of the gold bar covered. There are well-known risks involved in owning unallocated gold, starting with the potential bankruptcy of the warehouse itself.

Even when we limit ourselves to the warehousing of allocated gold, not all gold certificates are created equal. The gold futures exchanges (the largest of which is COMEX in New York) appoint warehouses whose certificates are acceptable in delivery on gold futures contracts.

It may come as a surprise to my readers that delivery on gold futures never involves delivery of physical gold directly. It involves delivery of gold certificates. At any given time there may be 12 gold futures contracts outstanding that correspond to the calendar months. However, only half of them are actively traded: February, April, June, August, October, December.

The procedure of taking delivery on a gold futures contract is as follows. Holders of a maturing long contract who intend to take delivery must give notice of their intention on *first notice day*. At the same time they must capitalize their account with the exchange 100 percent (zero-margin). Holders of short contracts, of course, are also subject to the zero-margin rule. In addition, they must deposit with the exchange a gold certificate issued by an exchange-approved warehouse.

7 Now we have come to the crucial point that plays a role in refining our theory of permanent gold backwardation.

Two varieties of warehouse certificates are distinguished:

1. Certificates on ***registered*** gold.
2. Certificates on ***eligible*** gold.

THERE IS NO DIFFERENCE BETWEEN GOLD COVERED BY THESE TWO VARIETIES.

THE DIFFERENCE IS BETWEEN THEIR ACCEPTABILITY IN THE DELIVERY PROCESS:

Certificates on registered gold are acceptable unconditionnally; certificates on eligible gold *are not acceptable.* I beg the reader to bear with me while I explain this cumbersome and seemingly superfluous provision that is crucial in understanding secondary gold basis and secondary gold backwardation.

Thus, then, there are two markets for gold certificates, one for those on registered gold and, another, on eligible gold.

Recall that it is arbitrage between the spot gold market and futures gold market that is responsible for *primary* gold backwardation.

Similarly, arbitrage between the market for gold certificates on registered gold and the market for gold certificates on eligible gold is responsible for *secondary* gold backwardation.

The question arises naturally what motivates market participant to carry an inventory of either variety of gold certificates.

The motivation for carrying an inventory of certificates on *registered* gold is to be first in line for getting the physical gold (recall that physical gold may be in short supply and may even be unavailable in case of permanent gold backwardation.)

The motivation for carrying an inventory of certificates on *eligible* gold is mainly speculation on the gold price most economically. Not surprisingly, the price of certificates on registered gold is higher than that of certificates on eligible gold, in spite of the fact that the very same physical gold is backing either variety.

The market does not directly quote prices on certificates on registered and eligible gold, but they can be extrapolated from data released by the exchange, such as the number of certificates of either variety outstanding.

Gold certificates moving from the registered to the eligible category reflects the opinion of market participants in the firing line how many gold certificates are in existence for every ounce of physical gold. Clearly, at any given time there is an overissue , (just as airlines are known to overbook seats, the principals of go;d exchanges overissue gold certificates). When it happens, holders of long gold futures contracts who are bumped are typically offered a bribe in the form of a premium on the price of the certificate on registered gold. The premium may move holders of certificates on registered gold to give up their priority and take the certificate on eligible gold. It is also possible that they do not want to deliver their certificates because they do not see a chance to replace them through the regular trading of gold futures contracts. In short, they may not want to hold the proverbial bag.

Secondary gold contango manifests itself by the condition whereby certificates on registered gold command a premium. Secondary backwardation means that the price of certificates on eligible gold goes to a premium.

Recall that primary gold backwardation is about the scarcity of spot gold relative to gold futures contracts. Likewise, secondary gold backwardation is about the scarcity of certificates on registered gold relative to those on eligible gold. This means that scarcity of spot gold obtains relative to gold futures. Thus secondary gold backwardation implies primary gold backwardation for the stronger reason. It indicates the reluctance of holders of gold certificates to put their certificates on registered gold into harm's way (i.e. to risk that their certificate on registered gold will be called).

As we have seen, there is a positive difference between the price of gold certificates on registered and eligible gold called the *secondary gold basis.* I leave it to my students to define *secondary gold cobasis* and study the interplay between the two.

Lest someone think that the emergence of dual gold certificates is due to making arbitrary rules by exchange principals, I point out that, in effect, it comes about due to the organic development gold futures trading. It is part of the firewall constructed to prevent long interest from engineering a corner (that would hurt mostly the exchange principals). The system of dual gold certificates is the gatekeeper. If the inventory of physical gold is getting too low in the exchange-approved warehouses and the open long interest in gold futures contracts approaches critical mass, then the clearing house of the exchange shuffles the gold certificates on registered and eligible gold.

A short course on the history of the legal position of gold in the U. S.

Under this caption I deal with the interesting question why the 'powers-that-be' allowed gold futures trading to go ahead in the U.S. in 1975, in a *volte face* of earlier Treasury policy.

During the period 1933-1975 the ownership and trading of gold was criminalized in the U.S. pursuant to F.D. Roosevelt's suspension of the monetary clauses of the Constitution. Of course, the suspension was tantamount to trampling on the rights of the citizens and an abominable restriction of freedom. Change occurred in 1975 when the ban was lifted and ownership and futures trading in gold was allowed. What is in the background of this change of heart? First of all, it must be emphasized that – as the executive order made it very clear – the easing was on a 24-hour basis and could be withdrawn at any time without prior notice.

However, since the writ of the U.S. government stops at the water, in foreign countries gold markets continued to trade gold, invariably quoting premium dollar prices, indicating dollar debasement. This was a major embarrassment. At first, there was no ban on Americans to own and to hold and trade gold overseas. Such a ban was imposed later, during the Eisenhower administration.

Mainstream economists (virtually all of them staunch supporters debt-based fiat money) came to the conclusion that the system leaked like a sieve, and suggested that the way to stop leakage is to allow gold futures trading. They were hoping that the availability of paper gold

1 would suppress or at least temper the appetite for real gold. They were inspired by a metaphor of Keynes:

> People want the moon, but, of course, they cannot have the moon. So the government must convince them that blue cheese (*sic!*) is just as good, and order the central bank to produce it galore to make them happy.

(taken verbatim from his magnum opus *The General Theory*. 1936.)

Such shabby Keynesian musings were used to justify the trampling on the American Constitution.

So why did the U.S. government legalize gold trading? Well, because it saw the proliferation of paper gold an effective (even the only) way to deflect hyperinflation.

Secondary Gold Basis Measuring Capital Destruction

We have seen that the primary gold basis can be thought of as the price of warehousing space for gold. It measures the ratio of paper and physical gold in existence. What does the secondary gold basis measure? Well, secondary gold basis measures the ratio of gold certificates on registered and eligible gold in existence. In other words, it indicates how many ounces of gold in certificates have been issued on every ounce of physical gold. When this number reaches the critical mass, chain reaction ensues. People start scrambling to get out of paper gold and into physical gold. The secondary gold basis may be thought of as the price to be paid for hoarding registered gold certificates. Thus, then, the secondary gold basis is *the price of insurance against default on paper gold.* In this view, the secondary gold basis is a measure of decay in the capital structure of the world. Recall that **gold is the only form of capital that is not subject to decay or destruction, while all other forms of capital, whether physical or whether financial *are.***

To recapitulate, our refined theory of permanent gold backwardation in introducing secondary gold backwardation scrutinizes the endgame in the gold markets. It focuses on the jockeying of people to get into position where they have control over the only indestructible form of capital, *gold* in existence.

The new element is the importance of the endgame in the gold market that has been ignored thus far. I submit that once we make it part of the theory of permanent gold backwardation, we shall have a handle on the problem of timing hyperinflation. Primary backwardation in gold hard on the heels of secondary backwardation heralds hyperinflation, not too far behind.

1 Our conclusion is that an early warning system of hyperinflation must involve monitoring arbitrage between the markets for registered and eligible gold certificates on the gold futures exchanges.

So where are we in 2018 in terms of secondary backwardation heralding hyperinflation? Here is my answer: Almost every day information surfaces according to which the pyramid of paper gold that is being constructed on each ounce of physical gold held by government Treasuries, central and bullion banks. Just this past week, as reported by Chris Powell, the Secretary-Treasurer of GATA, the Gold Anti-Trust Action Committee on January 31, 2018, Six bank employees have been arrested on charges of rigging the precious metals markets, see Rory Hall's article *Golden Rays and Silver Linings* on the website www.Gold-Eagle.com, see also video, https://youtube/c47XZMvdqoM.

Just confirmed by the Senate the new Chairnan of the FED Jerome Powell by a vote of 84-13 remarkable because of its wide margin. He is on record to favor a "weak dollar" along with President Trump. This raises the question what can we expect when the sitting president and his chief monetary advisor both publicly declare that they both "like the weak dollar". Think about it: Shouldn't the President be impeached for high treason on charges that he is urging a monetary policy of a weak dollar on his FED Chairman,which is tantamount to endorsing the embezzlement of the funds of the people entrusted on the member banks of the FED?

What does it say about the paper - gold pyramid constructed on every ounce of physical gold in existence?

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How will gold traders in the market for paper gold and gold certificates react to such a rotten state of monetary affairs in the U. S. and in the world?

Is the monetary system of the world not running headlong intoself-destruction?

Reference:

Antal E. Fekete, with the editorial assistance of Peter van Coppenolle, *CREDIT and the two sources from which it springs: the propensity to save and the propensity to consume. A treatise on gold and interest, Budapest, 2018,* order it from: antal.fekete@gmsil.com

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