

Backwardation

Backwardation is a situation where the market price today (i.e. the spot price) of a commodity is greater than the futures price of that commodity.

This is an unusual situation. Normally the futures price of a commodity is greater than the expected future price of that commodity (known as contango), and the expected future price of a commodity is greater than the market price of that commodity today (i.e. the spot price).

Backwardation does not happen frequently or last very long. It usually occurs after a shock of some kind that causes the market price of a commodity to spike upward. The immediate need to have the commodity is so great that the spot price rises above the futures price.

Contango and backwardation are sometimes referred to as “opposites” of one another. They are opposites in the sense that contango is the situation that normally prevails and backwardation is the abnormal situation.