



GFMS' Interim Silver Market Review

Fabrication demand forecast to fall by just over 3% this year, largely shaking off impact of the massive price rise in 2006. Only modest growth in mine production and scrap expected. Investment demand has driven price higher and could take silver back to the \$15 level in the next few months.

This evening at the annual New York Silver Dinner organised by The Silver Institute, GFMS presented its interim silver market review. This review included GFMS' provisional supply and demand forecasts for 2006 and the consultancy's expectations for the silver price over the next few months.

The key points from the interim silver market review are:

Supply

- **Mine production** is forecast to increase by some 4 Moz (125 t) or 0.6% this year. Globally in 2006 by source, GFMS predict growth in lead-zinc, copper, and gold by-product (all up by roughly 2%), with primary production, in contrast, expected to fall by some 3%. The outlook for 2007 is for a greater increase of around 16 Moz (500 t) in total silver output, with strong growth forecast to continue into 2008.
- **Scrap supply** is expected to be broadly unchanged this year, in spite of the massive year-on-year rise in silver prices. GFMS point out that scrap supply for silver is far less price-sensitive than for gold (where scrap has surged this year) due to the very different composition of the above-ground stock of fabricated products and much higher margins over the metal value on silver than gold jewellery. Furthermore, a large share of silver scrap supply is from recycled photographic products, which is experiencing a secular decline.
- **Government sales** appear to be on track for a marginal increase. There is strong evidence that Chinese and Russian sales have held up in 2006, probably due to the attractive price level. In addition, India looks likely to sell up to 30 Moz (930 t) into its domestic market.

Demand

- **Fabrication demand** is forecast to fall by just over 3% or nearly 28 Moz (860 t) from 2005's revised level.
- **Industrial** demand was strong over the first half but has slowed in recent months. GFMS are currently forecasting a full year gain of nearly 1% to a new record level. However, demand is expected to fall in 2007 under the impact of much slower growth in global industrial production and a less strong year for the electronics industry.
- **Jewellery & Silverware** fabrication in many countries has been little affected by the silver price rise. However, in the case of the key Indian market, a continued secular shift in favour of investment in bullion instead of high carat jewellery plus the impact of record local prices has had a dramatic impact on demand. Lower Indian fabrication explains much of the near 8% year-on-year global fall forecast for this category.
- **Photographic** use of silver is expected to drop by close to 11% in 2006. Demand continues to be affected by the switch to digital technology. In addition, the high silver price has prompted some economisation in silver use in photographic products, for example consumer film.
- **Coin** minting looks to have enjoyed a strong year in 2006, with a sizeable gain in silver use forecast.





Investment and Stocks

- Investment demand has risen in 2006 for the third consecutive year and may well exceed a net 80 Moz (2,500 t) this year.
- The early part of 2006 was dominated by speculative buying, mainly by hedge funds ahead of the launch of the Exchange Traded Fund (ETF). There then followed a period of massive two-way business in the wake of its launch on 27th April, consisting of both heavy purchases of the fund and large-scale profit taking in the OTC market and on Comex from those that front-ran its launch.
- Silver has been a major indirect beneficiary of the general growth in investor interest in commodities (e.g. silver is 2% of the Dow Jones-AIG Index).
- Private investor demand is also growing outside the more visible commodity basket products and the ETF, although this is still modest in volume and, especially in the United States, bullion investors have been active on both sides of the market.
- Near market bullion inventories have increased this year, with private sector holdings rising by more than the fall in government stocks. Loco-London bullion stocks have increased considerably due mainly to investor demand for the ETF, whose related stocks at end-October had reached just under 104.78 Moz (almost 3,259 t), but also as a result of the slump in Indian imports in 2006.

Prices

- For the first ten months of this year the average silver price basis the London fixing was \$11.24, up no less than 58% year-on-year.
- Investment demand remains the main driver of the price and has raised silver to well above the equilibrium level that would likely prevail in the absence of investment.
- The silver ETF has continued to attract investors. An efficient vehicle therefore exists if / when investor demand surges again. But at some point the ETF could start to represent an overhang, although arguably this risk is moderated partly because the ETF's ownership is broad rather than narrow.
- Industrial demand (half of total fabrication) is vulnerable to a slowdown in world GDP growth / downturn in the electronics cycle next year.
- Mine production growth will start to come into play in 2007, with a substantial rise forecast.
- Nevertheless, GFMS believe that silver is more likely to follow gold's lead (higher) than base metals' direction (lower) over the next year.
- GFMS expect significant price volatility but, over the next few months at the least a bias to the upside, with a spike to \$15/oz very possible.

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