

SILVER OUTLOOK TO Q2 2022: SURFING ON AN INDUSTRIAL REBOUND

August 2021

As we noted in [“Gold Outlook to Q2 2022: Needs to catch up with inflation reality”](#), gold looks severely under-priced and we expect the metal to catch up with the persistently high inflation that we have seen over recent months. With a strong correlation to gold, silver prices should gain as gold stages an upside correction. Moreover, a continued economic recovery should bode well for the metal given its high industrial usage.

FRAMEWORK

In “Gold and silver: similar, but different”, we argued that silver’s price performance is 80% correlated with gold. In our modelling framework, gold price is therefore the main driver of the silver price. However, we also find the following variables as important drivers of the silver price:

- + Growth in manufacturing activity – more than 50% of silver’s use is in industrial applications¹ (in contrast to gold where less than 10% comes from that sector²). We use the global manufacturing Purchasing Managers Index (PMI) as a proxy for industrial demand.
- + Growth in silver inventory – rising inventories signal greater availability of the metal and hence is price negative. We use the futures market exchange inventory as a proxy.
- + Growth in mining capital investment (CAPEX) – the more mines invest, the more potential supply we will see in the future. Thus, we take an 18-month lag on this variable. Given that most silver comes as a by-product of mining for other metals, we look at mining CAPEX across the top 100 miners (not just monoline silver miners).

GOLD OUTLOOK TO Q2 2022: NEEDS TO CATCH UP WITH INFLATION REALITY

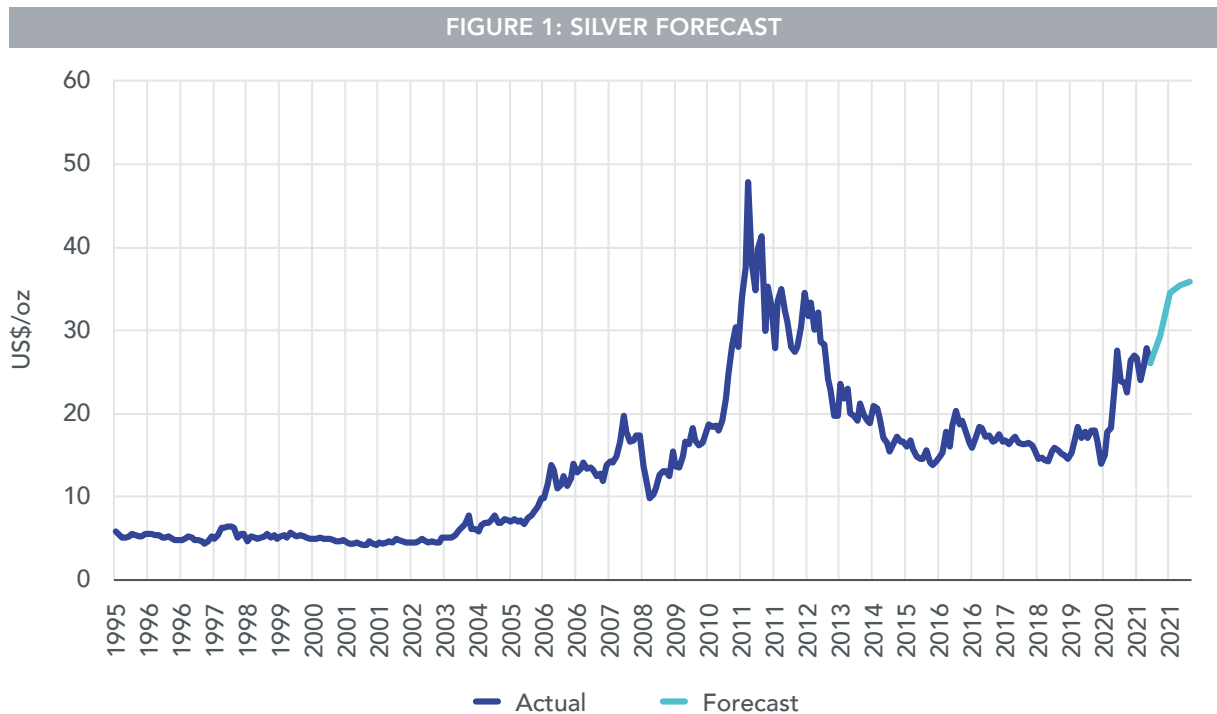
Even though gold could face headwinds from rising Treasury yields and cooling inflation, gold still needs to catch up with the high level of inflation that we see today. In our consensus gold scenario, even though inflation cools from 5.4% on June 21 to 2.6% in Q2 2022, inflation is still relatively elevated compared to the historical average, which should be positive for gold prices. A relatively stable US dollar is unlikely to drive gold prices in either direction. However, in economic recovery with moderating inflation, we think that investor sentiment towards gold could trim. In the consensus scenario, gold prices could rise to US\$1890/oz by Q2 2022, which is 6.5% above Q2 2021.

¹ World Silver Survey 2021, Silver Institute and Metals Focus, July 2021

² Gold Focus 2021, Metals Focus

SILVER FORECASTS

We believe that silver will outpace gold, to gain 37.5% over the coming year³ versus 6.5% for gold. By Q2 2022, we expect silver prices to trade at around US\$35.81/oz. A rebound in industrial activity will bode well for the demand for the metal. Meanwhile, a contraction in mining capital expenditure and a reduction in silver inventory on exchange, point to tightening supply.



Source: WisdomTree (forecasts), Bloomberg (historic data), data available as of close 31 July 2021. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

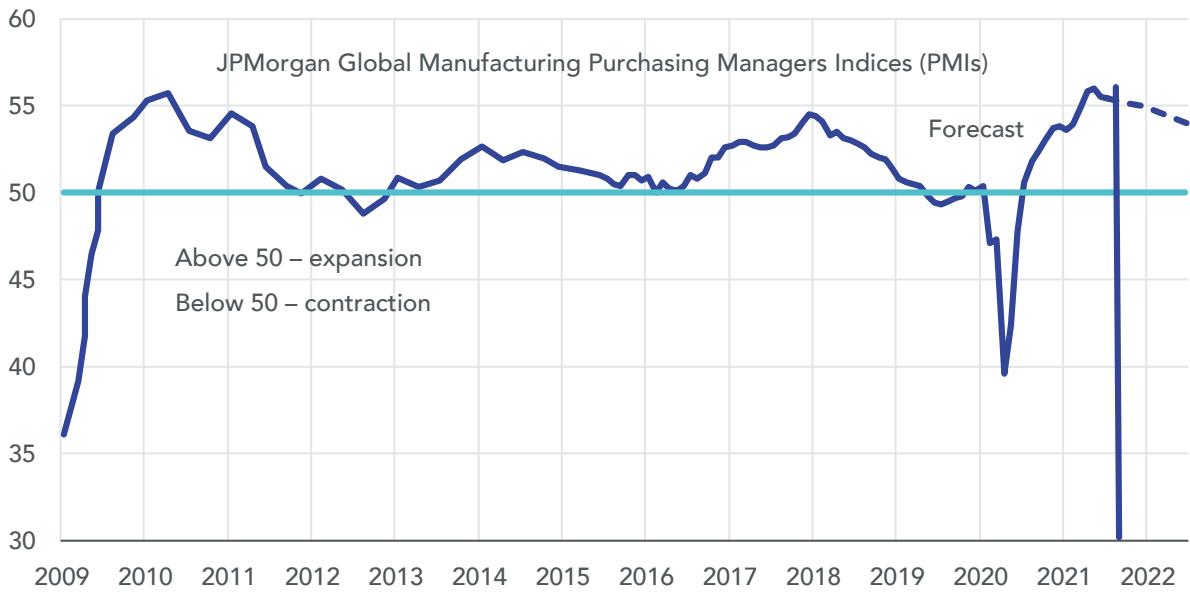
INDUSTRIAL DEMAND TO CONTINUE TO RECOVER

Manufacturing Purchasing Managers Indices (PMIs) have risen strongly in the past year and have been at an expansionary level (post-50 region) for 13 consecutive months (Figure 2). Although the reading had peaked back in May 2021, the level still remains strong and we expect PMIs to remain in expansionary mode for the full forecast horizon. Metals Focus expect industrial offtake to rise to a record high of 524 million ounces in 2021⁴ as economies open and green initiatives provide a tailwind for demand.

³ Q2 2021 to Q2 2022

⁴ World Silver Survey 2021, Silver Institute and Metals Focus, July 2021

FIGURE 2: GLOBAL PMIS

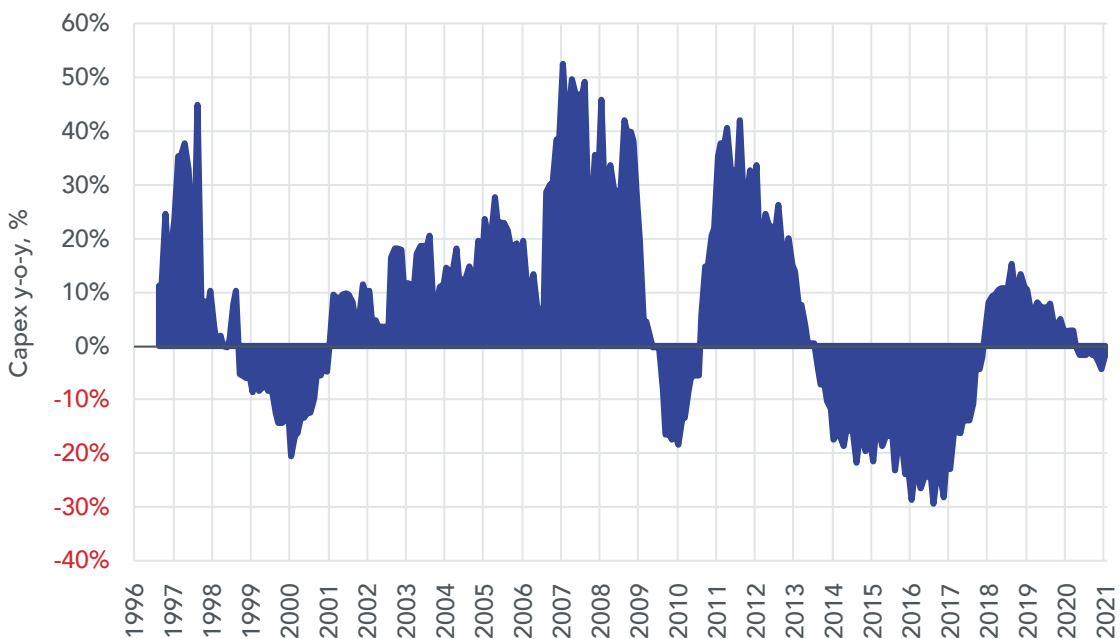


Source: WisdomTree, Bloomberg. Actual data: January 2009 to July 2021. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

MINING CAPITAL EXPENDITURE

Capital expenditure in mining industry has been declining in the face of the pandemic. That should help tighten the supply of silver. We acknowledge there has been a rebound of mining activity in 2021 after social distancing slowed production in 2020. However, we believe that aspect is already priced in.

FIGURE 3: MINING CAPITAL EXPENDITURE



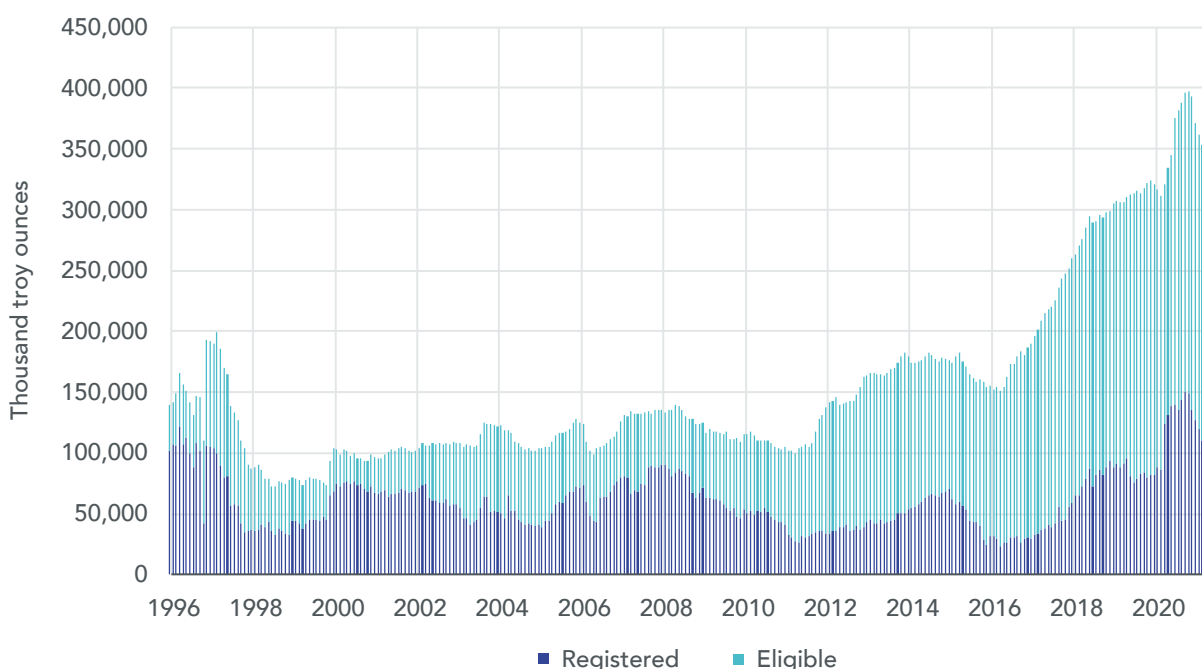
Source: Bloomberg, data available as of close 31 July 2021. **Historical performance is not an indication of future performance and any investments may go down in value.**

SILVER INVENTORY

In 2020, the inventory of silver held at Comex rose. That in part was driven by the exchange trying to pad out inventory to assure investors that there is plenty of the metal available at a time when some investors were concerned about there being sufficient gold at the exchange when planes were grounded, and refineries were shut. Although the concerns were not directed at silver, the exchange increased silver inventory alongside gold.

Since peaking at the end of December 2020, silver inventory on exchange has been declining. We expect that inventory will continue to decline. After accounting for the demand from exchange traded commodities (ETCs), silver demand outstripped silver supply by 251 million ounces in 2020, outpacing the supply deficit of 60 million ounces in 2019⁵. Metals Focus forecasts another supply deficit of 125 million ounces in 2021 (after ETC investments), which will mark the third consecutive year of supply deficit⁶.

FIGURE 4: COMEX SILVER INVENTORY



Source: WisdomTree, Bloomberg. January 1996 to July 2021. Comex is a futures and options trading market, now owned by Chicago Mercantile Exchange. **Historical performance is not an indication of future performance and any investments may go down in value.**

ENERGY TRANSITION AND ELECTRIFICATION TO BOOST SILVER DEMAND

One of the major themes that we at WisdomTree have been highlighting for 2021 and beyond is that the energy transition is intensifying. We are moving away from the use of hydrocarbons towards more renewable sources of energy, and we are rotating towards electric vehicles, away from internal combustion engine vehicles.

Focusing on renewable sources of energy, silver is a key component of photovoltaics (solar panels). Around 10% (105 million ounces) of all silver uses are expected to be in photovoltaics in 2021 and its use in this category has doubled since 2014⁷. There is more silver being used in photovoltaics than in the silverware and photography

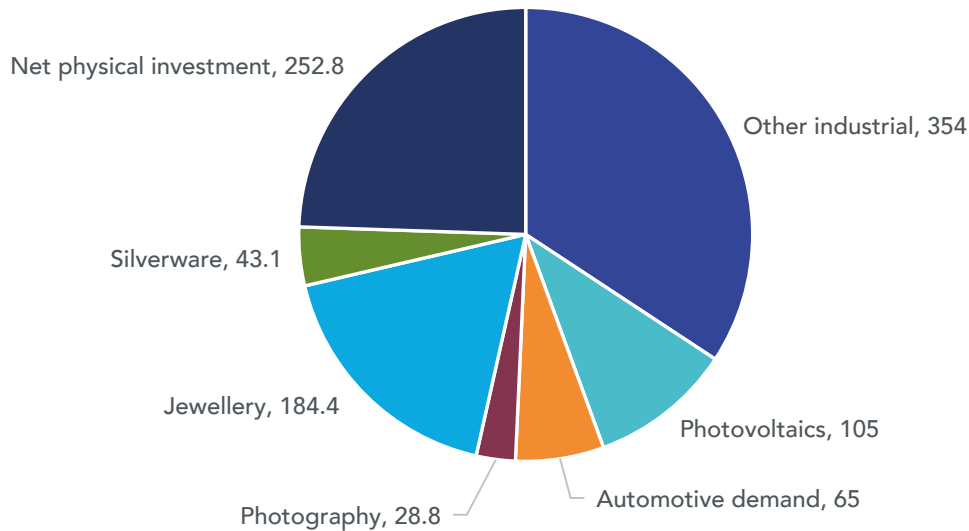
⁵ World Silver Survey 2021, Silver Institute and Metals Focus, July 2021

⁶ World Silver Survey 2021, Silver Institute and Metals Focus, July 2021

⁷ World Silver Survey 2021, Silver Institute, Metals Focus

categories combined. Given the commitments to net zero emissions by 2050 from European Union, United States, Japan, South Korea, and similar commitments by China by 2060, we expect the use of photovoltaics to expand. Despite the trend of thrifting – applying less quantity of silver per solar application - we expect the volume of solar installations to expand aggressively over the coming decades given the renewable aspirations.

FIGURE 5: SILVER SOURCES OF DEMAND, 2021 FORECAST, MILLION OUNCES



Source: WisdomTree, Metals Focus, Silver Institute, July 2021. Excludes exchange inventory changes and Exchange Traded Commodity flows. **Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.**

Silver’s use in renewable power generation doesn’t stop at photovoltaics. Silver-bearing sensors are used in turbines, grid management systems, smart switches. Silver oxide batteries can also be used for energy storage systems.

Silver’s use in vehicles has been expanding in general with greater use of electric components such as semiconductors, sensors, harnesses, controls, fuses, switches and displays. That is being accelerated by electric vehicles. Electric vehicles have a greater need for sensors to monitor battery usage and the functioning of other electrical components. Additionally, there is a role for silver in the charging infrastructure. As vehicles become more autonomous, the electrification and demand for silver in cars is likely to continue to grow.

According to the Silver Institute⁸, silver’s use in the automotive industry was around 61 million ounces in 2020. That is similar to the amount of silver that was used in photovoltaics back in 2015. The Silver Institute expects silver usage in the automotive sector to reach 88 million ounces by 2025, which is only 17 million ounces shy of the size of the photovoltaic industry today.

CONCLUSIONS

In addition to the upside correction that gold should receive this year, silver will be bolstered by a green economic recovery. A renewed focus on meeting climate goals will intensify the electrification of transport and increase demand for photovoltaics. Both of these trends will be positive for silver demand.

⁸ Silver’s Growing Role in the Automotive Industry, January 2021

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