Oct 1, 2009 – Understanding Silver Availability

UNDERSTANDING SILVER AVAILABILITY

One of the key forces destined to greatly impact the long-term price of silver is future availability. It is also one of the least understood factors in the study of silver. Let me first define what I mean by availability. It is the amount of silver that could be bought freely and openly at or near the current price. By my definition, the available supply is not total above ground inventories, or total production, or total resources in the ground. While these are very important factors in the silver (or any other commodity) market, they have nothing to do with availability. As an analyst who studies these factors closely, I wish to establish that there is a very big difference between total supply and available supply. Great rewards will flow to those who understand and act on that difference.

The amount of available silver is only the amount that can be bought today. While this is true for all commodities, including gold, the difference between available supply and total supply is critically important and unique to silver. There are a number of special things that make the availability of silver more critical than in any other commodity. These special factors are easy to understand and verify.

First, as a consumed commodity, like copper, corn or crude oil, the current production of silver is largely used up. The production is spoken for already, by known demand. That is the purpose of the production of all commodities in the first place. We produce all of them so that they can be utilized and consumed. Therefore, the amount of consumption or utilization automatically reduces the availability of any commodity's total production. In the case of silver, all of the current annual mine production (680 million ounces) is consumed by fabrication utilization. In fact, we must recycle scrap silver to the tune of 200+ million ounces in order to satisfy total fabrication demand. The world has been consuming silver in this manner for 100 years. So, we can make the statement that the entire world mine production of silver is unavailable after normal fabrication demand.

In this circumstance, silver is the same as any consumed commodity. The world consumes the entire 30 billion barrels of oil it produces each year, as well as the 15 million tons of copper it produces, and the 25 billion bushels of corn it grows. Sometimes, we produce a bit more than we consume, and we call this condition a surplus and we witness an increase in world inventories. Sometimes, we consume a bit more than we produce. We call this a deficit condition, and world inventories shrink by the amount we over-consume. But, by and large, the world consistently consumes what we produce when it comes to commodities. It can be said there is not much available supply after we subtract normal consumption.

The same is true with existing above ground inventories. Yes, there are, obviously, above ground stocks of silver and all commodities. For instance, my estimate for above-ground world inventories of silver bullion has long been one billion ounces. But there is a big difference in what exists as inventories and what percentage of those existing inventories are actually available for sale at current prices. The percentage that may be for sale is incredibly small. I think I may be overstating the amount if I were to say 5% or 10 % of existing silver inventories may be available over the course of an entire year. On a much shorter time frame, say weeks or months, very little silver inventory is available. That's why there was shorting in the SLV, in my opinion, to the tune of 30 million ounces in the past few weeks. That quantity of silver is just not available in the short term.

So, what makes the question of available supply so special in silver, more so than in any commodity?

It's silver's dual role as not only an industrial commodity, but also as a recognizable investment asset. That is the wild card; the special characteristic unique to silver among all commodities. If the amount of production and consumption of copper, or corn, or crude oil is balanced in a given year, the price would most likely remain largely unchanged. That's because these commodities are not considered primary investments. Investors don't regularly buy physical amounts of these commodities in their customary wholesale unit of trade. It's not practical to physically buy 25,000 lbs. of copper, or 5000 bushels of corn, or 1000 barrels of oil in physical form.

The situation is much different in silver. Total mine and scrap production can be in perfect balance in a given year, yet the price can change radically, depending on what happens to physical investment demand. Investors buy physical silver in many forms, including the standard industrial unit of 1000 oz bars. In fact, thanks to the introduction of the various forms of silver exchange traded funds (ETFs) over the past few years, investment in 1000 oz. silver bars is a prevalent form of direct investment demand in silver. Over 400 million ounces of silver are now held in the publicly owned ETFs and similar vehicles. The vast majority of this silver appears to be held by investors for the long term. This silver is not for sale at current prices. Thus, this silver is not available to the market.

Make no mistake – the new silver purchased by investors in the future is in direct competition with the silver needed by industrial consumers. No other industrial commodity (save perhaps platinum or palladium) has this unique profile. It is what sets silver apart. This certain current and future buying competition is the long-term turbo-charger to price for years to come.

Let me introduce an idea and an example that might drive this point home. Available supply is very limited and can only grow slowly in an orderly price environment. Mines and refiners can only supply a very small amount of silver on a daily basis, no more than 2.5 million ounces a day. All that silver is spoken for in ongoing fabrication demand. Those that own inventories don't sell even that amount of real silver on daily basis. Yet, literally overnight, investors can, and do, demand from time to time, tens of millions of ounces. It's hard to have a surge of silver supply (other than paper selling), but it's easy to have a surge in demand. Therefore, it is only a matter of time before a collision occurs between almost unlimited investment demand crashing into very limited available supply. The only thing that has prevented that collision from occurring to date is the paper selling tricks of the manipulative shorts.

The example I would use to highlight my point is that recently, Barrick Gold announced the imminent construction of a big gold/silver mine that, when completed in four years, should produce more than 30 million ounces of silver annually. That's a lot of silver for a mine (Pascua-Lama) to produce in a year and that mine will be among the world's largest. But let's put that amount of silver into perspective. Over a two-week period recently, over 30 million ounces of silver was purchased by investors in the big silver ETF, SLV. Not 30 million ounces for a year, four years from now, but 30 million ounces right now. The only reason the price did not explode is because SLV investors were cheated by big short sellers in SLV shares who, because they couldn't supply the real silver as required by the prospectus, sold shares short instead. You may ask if they can do this indefinitely. I assure you that they can't. That crooked game is coming to an end. Count on it.

Comparing Gold

What about gold? Certainly, gold is a prime direct investment asset. More investment money flows into gold than any other commodity. But there is a big difference between gold and any other commodity, including silver. Gold is primarily used for jewelry and as an investment asset, with a very small portion of annual mine and scrap production used industrially. As such, much of the current gold production is available for direct investment. Remember, none of current silver mine production is available for investment, with little total production (mine plus scrap) available for investment. This is not intended as a knock on gold, just as a statement of fact. Most of the total gold production is available for investment purposes; little of the total silver production is available for investment. It should go without saying that in these circumstances, any investment buying in silver should have a disproportionate impact on price.

As time has passed, great amounts of gold have been accumulated in the world. The opposite situation has evolved in silver, whereas 60 years of deficit consumption has reduced world bullion inventories by 95%. Many are still hesitant to accept the fact that because of this pattern, there is actually more gold bullion in the world than there is silver bullion. Given gold's high price relative to silver and the resultant market capitalization of each, much more gold is available for sale at current and higher prices than silver.

There is a tremendous amount of investment money in the world, ready to pounce on the next promising opportunity. The tightness in the availability of silver means it won't be able to accommodate increased investment demand. There is no way that hot, big investment money can suddenly plow into silver without a shock to the price. It is nothing short of a miracle that someone big hasn't stumbled onto silver recently. It is only a matter of time before someone big does. You must be positioned before that occurs.

There is an incredibly small amount of real silver available to the world's investors. I would guess no more than 100 million ounces in a given year. Over the past few years, more than that amount has been purchased in all forms. This silver bought in the past came from other investors, including Berkshire Hathaway's Warren Buffett. This transfer of investor silver is now largely behind us. Now the real competition between investors and users is about to begin. It promises to be a fierce competition destined to result in sharply higher prices.

Up until now, the price of silver has been largely contained (even though it has kept pace or exceeded the returns for any other asset over the past 5 to 10 years). The reason for the price containment lies principally in the silver manipulation, where paper short sales have succeeded in depressing the price. But the introduction of the investment vehicles that deal in physical silver and the potential pressure by regulators on the manipulators, as well as the growing awareness by investors of the merits of silver, will make the manipulation a thing of the past. Paper short sales will be overwhelmed by physical buying at some point. That point appears close at hand. When you put the end of the manipulation together with the shockingly small amount of real silver actually available for purchase, you have the necessary preconditions for an historic price explosion. As the world comes to learn how little silver is available for investment, a rush to buy must commence. Do your buying before it commences.

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