

First, a quick word on the current market structure, according to an analysis of the most recent Commitment of Traders Report (COT). The \$2+ rally in silver prices off the recent lows was as a result of paper trading on the COMEX between the commercials and speculators, and not due to any notable developments in the real world of supply and demand. This is usually the case and was expected, given the nice COT set up I had written about previously

<http://www.investmentrarities.com/04-14-09.html> Simply put, the short term price moves are still COMEX-generated.

Whereas there was very little price risk before the recent rally, commercial selling and speculator buying on the rally has moved us away from the very low-risk situation that previously existed. As expected, the raptors (the smaller commercials) did most of the selling, liquidating long positions, but there was also some new short selling from the big concentrated shorts (which I was hoping wouldn't take place). Does this mean we could go down short term? Sure. Does this mean we could still go up short term? Sure. Does this mean if we do have a sharp sell-off it will only be due to manipulative tricks by the commercials on the COMEX? Absolutely. What does this have to do with the long term? Absolutely nothing. The long term has more to do with the subject of today's article.

The release of the Silver Institute's Annual World Survey has resulted in a rash of stories suggesting a large surplus of silver. According to the story, if it was not for record investment demand, the price of silver would have declined because of the surplus. As you probably know, analyzing the specifics of supply and demand is exactly what I do, so I am going to present the specifics as I see them.

Let's define the words "surplus" and "deficit" in the context of this report. A surplus

is where you end up with more of something than you started with, after all supply and demand factors are considered. A deficit means you ended up with less.

I've had much experience in dealing with alleged silver surpluses. In the mid-1980's, the idea of a silver surplus was widely accepted as responsible for the low price. In private reports, I wrote this was bogus, and that the only surplus was in paper short positions by the big commercials on the COMEX, same as now. Back then, the CFTC would routinely dismiss my allegations of a short side manipulation by pointing to the supposed silver surplus as the cause for depressed prices.

With the benefit of hindsight, it is clear there was no silver surplus back then and that the CFTC and any others who clung to that supposition were dead wrong. My proof? The fact that we have much less silver bullion above ground today than we had back then, to the tune of billions of ounces. Billions of ounces don't disappear in a surplus, only in a deficit. a hard look at the facts will confirm there was no surplus.

For the sake of this discussion, I'll accept the figures provided in the survey, compiled by Gold Fields Mineral Services (GFMS) for the Silver Institute. But I must tell you that there is some doubt to the accuracy. There are some notable discrepancies in their figures compared with an earlier report by the CPM Group, another recognized statistical provider. One key discrepancy was the GFMS mine production figure of 681 million ounces, which was 130 million ounces, or 23% larger than CPM's figure. Truth is that I feel both services understate the real fundamental situation in silver. From the figures, I don't think a case can be made for a surplus. The survey can be found at www.silverinstitute.org Here is the pertinent table from the Silver Institute:

World Silver Supply and Demand (million ounces)

(totals may not add due to rounding)

Supply

	2007	2008
Mine Production	664.2	680.9
Net Government Sales	42.3	30.9
Old Silver Scrap	181.9	176.6
Producer Hedging	-	-
Implied Net Disinvestment	-	-
Total Supply	888.4	888.4

Demand

	2007	2008
Fabrication		
Industrial Applications	453.5	447.2
Photography	124.8	104.8
Jewelry	163.5	158.3
Silverware	58.8	57.3
Coins & Medals	39.7	64.9
Total Fabrication	840.3	832.6
Producer De-hedging	23.5	5.6

Implied Net Investment	24.7	50.2
Total Demand	888.4	888.4

There are only a few key figures we need focus on. The first is the 2008 mine production number of 680.9 million ounces. Although it is not spelled out in the Survey's highlights, to my knowledge, this is the largest amount of silver ever mined in history, a notable achievement.

Next, I'm going to ask you to jump to Total Fabrication. (I'll come back to the other supply components in a moment). First, let's define fabrication as the conversion of a raw material into a finished product. Total Fabrication for 2008 is 832.6 million ounces.

Let's stop and compare the two numbers I have highlighted so far. According to the Survey, the world fabricated, or converted into finished products, 151.7 million more ounces of silver than it mined, even though it mined a record amount. This is an important point. As it has for more than 70 years, the world fabricated more silver than it mined. Every single ounce of mined silver was fabricated (consumed) and then some. No surplus so far.

Of course, you can't use or fabricate silver that doesn't exist. So after using all the silver that was mined, the 152 million ounces that were fabricated above and beyond mine production had to come from somewhere. That somewhere was from the other sources of supply. Those sources include recycled silver scrap of 176.6 million ounces and net government sales of 30.9 million ounces, or a total of 207.5 million ounces.

Silver Surplus?

Adding this 207.5 million ounces to mine production of 680.9 million ounces, gives us a total supply of 888.4 million ounces, as indicated in the report. Subtracting total fabrication demand of 832.6 million ounces from total supply of 888.4 million ounces leaves a total of 55.8 million ounces. This 56 million ounces is what many are referring to as a surplus. Not so fast.

The 30.9 million ounces that came from net government sales is listed as supply, but this is clearly silver that came from existing inventories of silver, not new production. Therefore, it automatically reduces the amount of existing stocks by that same amount. Further, GFMS states elsewhere in their presentation that world government silver stocks are around 72 million ounces and near exhaustion. What they didn't say is that these remaining government silver stocks are the lowest in more than 500 years. Remember our definition of "surplus?" Since this 30.9 million ounces of "supply" was just a withdrawal from existing inventory, we must subtract it from the 55.8 million ounce "surplus", because it didn't add to the amount of silver in existence. This leaves us with a 24.9 million ounce surplus.

Likewise, a certain amount of the recycled old scrap of 176.6 million ounces undoubtedly came from silver from above ground stocks, thereby not qualifying as adding to a surplus. If we use a conservative 25 million ounces from above ground inventory, it means we had no surplus at all. The Silver Institute's numbers prove no silver surplus, since no silver was added to bullion inventory.

Some may be disappointed that there was no big deficit in the silver market, as had been the case for more than 60 years. But no one should be surprised. This is something I started writing about more than two years ago

<http://www.investmentrarities.com/03-20-07.html> The simple fact is that world silver

inventories have been depleted to such an extent, some 95% over the past half-century, that there is little silver left to support a continued deficit. There are about one billion ounces of silver bullion equivalent inventories left in the world. This report shows no big additions or subtractions from that inventory.

Some may claim that the fabricated silver adds to the above ground inventory, particularly jewelry, silverware and coins, like American Silver Eagles. I agree that such silver still exists, but because it is not available for melting into bullion form at anywhere near current prices, it shouldn't be counted as bullion-equivalent inventory. For instance, there must be near 200 million ounces of Silver Eagles fabricated over the life of the 23 year program from the US Mint, yet I doubt even a single Eagle has ever been melted for its silver content because they can be sold at a premium to their silver content. Why melt something to get less than you could sell it for? Same with the other forms of silver fabrication. Look at current recycling patterns, gold objects are being melted in record quantities, silver objects are not. When and if that changes, we'll consider it as inventory.

Aside from proving there was no surplus in silver in 2008, the survey pointed out that investment demand was the dominant factor responsible for the price rise to the highest level in 28 years. Investment demand in silver is unique from other commodities. That's because silver is both an industrial commodity and, as one of the two popular precious metals, a primary investment asset. No other commodity has that dual role. There is little direct investment in other industrial commodities, like crude oil, copper, zinc, or lead.

In gold, there is widespread investment buying, but little industrial consumption. That means that gold inventories always grow, while silver inventories have shrunk

for 65 years. Funny, how there is little talk of surplus in gold, despite almost no industrial consumption, yet there is constant talk of surplus in silver, where every ounce mined and recycled is absorbed by industrial fabrication.

Net silver investment demand has been a very rare occurrence over the past 25 years. It only emerged over the past three years. What makes silver investment demand so unique is that virtually no current production and supply is available for investment. All of it is spoken for. The only quantities available for investment are from existing inventories provided by sales from existing silver owners. Considering how little silver remains in terms of ounces and in dollar amounts, it makes silver potentially explosive. Plus, the silver held today appears to be in strong and diverse hands. A relatively small amount of capital coming into silver can have an outsized impact.

The Silver Institute and GFMS do not address this possibility. They are not given to promoting silver. If anything, there is always a negative underlying tone regarding silver's future price prospects in their reports. Why the silver miners support the Silver Institute and pay for that negative price tone is a mystery. They should form their own promotional organization, like the gold miners have done with the World Gold Council.

Nowhere in the survey is any mention of the concentrated short position in COMEX silver, even though the amount held short is documented at running in the hundreds of millions of ounces. Nowhere in the survey is any mention of the constant debate about manipulation of the price of silver. It's as if sticking their heads in the sand will make it go away for the Silver Institute and GFMS. Nowhere in the survey is there any mention of the investigation by the Enforcement Division of the CFTC. I'm not

holding my breath that the incompetent CFTC will do the right thing, but nothing could be more important in any objective annual review of any commodity than the fact that the chief regulator of that commodity is conducting an active investigation concerning manipulation.

While the Silver Institute is reporting on record silver investment demand, they never predicted it. They have never made bullish predictions on silver, no matter what the facts. I, on the other hand, predicted the investment rush in silver <http://www.investmentrarities.com/01-22-08.html> I bring it up, not to pat myself on the back, but to explain why we should continue to see strong silver investment demand.

The silver story is so compelling, and the facts so clear, that more investors will learn of it as time passes. There will be lulls in investment buying and surges, as there has been in the past. But it will continue. The amount of silver coming out of the ground and through recycling is spoken for by fabrication and that's not about to change. The amount of silver remaining in existing inventories and available for investment purchase is limited and not about to change. The number of investors who will come to learn of the remarkable facts concerning the silver story, however, must change and their buying will tilt the equation against the manipulators. As more people become educated to the real silver story, they will buy. Phony stories about surpluses won't prevent that.

Finally, to set the record straight, I unintentionally snubbed a friend in last week's article about President Johnson's speech announcing the removal of silver from coinage in 1965. Charles Savoie wrote of this in great detail some three years ago. http://www.silver-investor.com/charlessavoie/cs_march06_lbjgwbsilver.htm I read the

Silver Surplus?

article back then, but it had slipped my mind. Sorry Charlie.