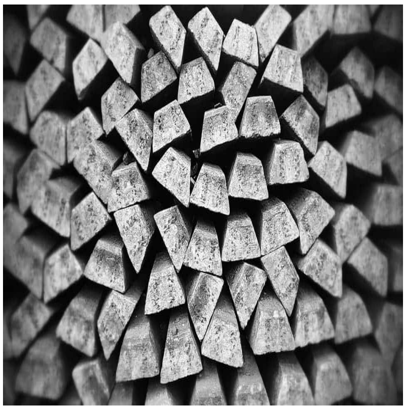

Don’t Expect Silver to Rally Any Time Soon

Description

In recent years, silver has ended up being a very disappointing investment. After hitting a high of US$48.70 during the last great precious metals bull market in 2011, the white metal has declined significantly in value to be trading below US$15.50 per ounce, which is close to its lowest price since April 2016.

Despite growing optimism regarding silver, there are signs that it will remain caught in a protracted slump for some time to come. This is bad news for primary silver miners like **First Majestic Silver Corp.** (TSX:FR)(NYSE:AG) and **Pan American Silver Corp.** (TSX:PAAS)(NASDAQ:PAAS).

Now what?

While silver is classed as a precious metal and historically has had a closely correlated relationship with gold, it has failed to keep pace with its more valuable cousin. Over the last year, the yellow metal has only lost 1.5%, whereas silver has plunged by almost 7%. The reasons for this are quite simple; silver, because of its conductive properties, is as a much an industrial metal like copper as it is a precious metal. That means there are differing and contradictory drivers of its value.

Deteriorating industrial demand is a major headwind for silver, and that is being exacerbated by the threat of a global trade war, which could cause global manufacturing activity to decline sharply. While silver has experienced a physical supply deficit since 2013, the shortfall has been declining to be less than a fifth of what it was back then.

According to some industry analysts, a surplus could emerge in 2018, which would place even greater pressure on silver prices.

This is because industrial consumption of silver has been steadily deteriorating since 2008 to now be 7% lower. Much of that can be attributed to the marked decline in the use of silver in photography, which, by 2017, was less than half of what it had been 10 years earlier.

Demand for silver for use in the fabrication of the photovoltaic cells that make up solar arrays has failed to materialize as predicted. Analysts had forecast that the push to increase the volume of electricity generated from renewable sources across the world would trigger a massive surge in the use of solar power. While global installed solar capacity has expanded nearly fourfold over the last five years, the explosion in the consumption of silver in solar applications has failed to occur.

In fact, demand for silver for use in photovoltaic cells has risen by only 24% since 2011, which is significantly less than the four- to five-times increase some pundits were predicting. The white metal's use in electrical and electronic applications, despite optimistic predictions, has also fallen to be almost 17% lower for that period. Both of these events can be attributed to technological advances and manufacturers moving to use cheaper silver substitutes.

It isn't only weaker demand that is weighing on silver; supply has also grown significantly.

Between 2008 and 2017, mine production expanded by 24%, and this was despite the price of silver averaging just over US$17 per ounce in 2016 and 2017. This debunks claims by silver bulls that because of lower prices, which they claim are close to or below the marginal cost of production, the tempo of mining activity will decrease, causing supply to diminish.

This is because the real cost of mining silver is far lower than many assume. In the case of primary silver miners First Majestic and Pan American, they reported first-quarter 2018 cash costs of US$7.83 and US$1.18 per ounce sold, respectively. That means with silver trading around US$15.50 an ounce, they aren't going to turn off the lights and shutter their operations any time soon.

For base metal miners, which, according to the Silver Institute, are responsible for 59% of all silver production, costs can be even lower. This is because silver is merely a by-product of their mining activities, where they are focused on producing metals such as copper, lead, and zinc. In an environment where those metals are soaring in value, there is an incredible incentive for them to ramp up production, thereby leading to higher silver production.

So what?

The outlook for silver is less than optimistic, despite gold continuing to hold its own. That makes silver miners, especially those with high operating costs, like First Majestic, which reported first-quarter all-in sustaining costs of US$16.01 per ounce produced, unattractive investments.

CATEGORY

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