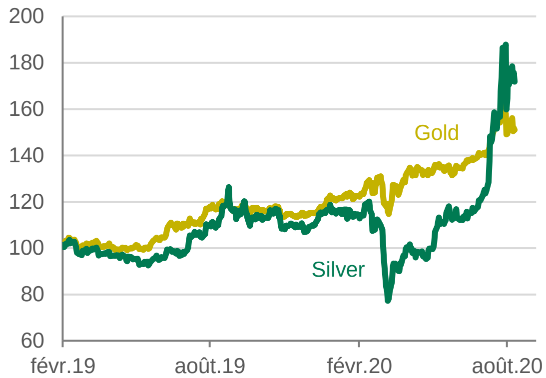
FOREX FOCUS: SILVER FORECAST UPDATE

Marketing Communication

- In recent weeks, silver has experienced huge price swings, moving from levels of around $19 to $29 per ounce.
- The increase reflects a 'catch up' with other precious metals like gold, and an ongoing squeeze on physical inventories.
- We now anticipate a more muted pace of appreciation over the coming months and we have amended our forecasts accordingly.

Chart 1: **Silver caught up with gold**

XAU/USD spot, XAG/USD spot, rebased.



Sources: UBP, Bloomberg Finance L.P.

Chart 2: **Gold-silver ratio is back to normal**

Gold – Silver ratio

Sources: UBP, Bloomberg Finance L.P.

Explosive up move

In July, it was argued that prices for silver were set to increase materially. This view was based on a variety of factors, including the abnormal gold-silver ratio, constrained supplies of physical silver for investor delivery and the improving global manufacturing outlook. Subsequent price action was far more aggressive than we had anticipated. Silver rose from levels of around $19 per ounce at the beginning of July to highs of around $29 by the start of August. The move was not a one-way move either; silver declined to levels of around $23.50 by mid-August, although it recovered these losses and moved back to current levels of around $27.

The sudden price rise and two-way trading resulted in a massive increase in silver volatilities. Three-month implied volatilities rose from levels of around 30% to levels of 55% by mid-August. Silver volatilities always trade with a premium over other precious metals, but the current volatility profile is unsustainable and we believe it is likely to decline notably in the coming weeks (more on this below).

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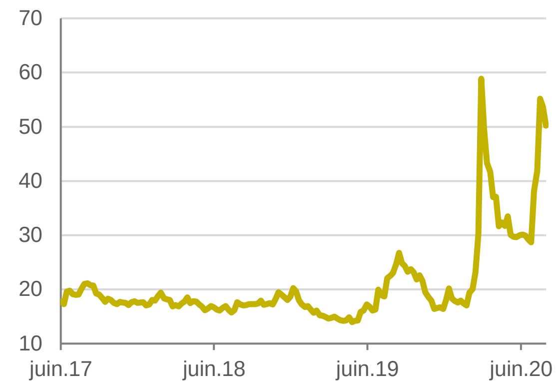
Chart 3: **Huge rise in volatility**

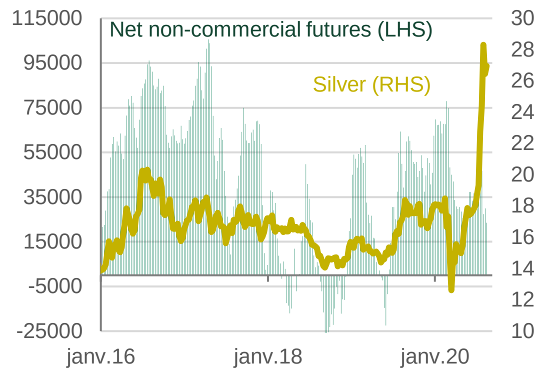
XAG/USD 3-month implied vol, %



Sources: UBP, Bloomberg Finance L.P.

Chart 2: **Gold-silver ratio is back to normal**

Gold – Silver ratio



Sources: UBP, Bloomberg Finance L.P., CFTC

The scramble for physical silver

Investors did not seem to increase net long positioning in silver (or gold for that matter) since it began its rally following the lows in March. CFTC data indicate that net non-commercial long positions have barely moved. However, the net non-commercial data only tell half the story. Open interest declined considerably during the same period, as investors opted to take physical delivery.

Eligible inventories currently stand at 201 million ounces, and if investors opt for physical delivery in September on a similar scale to what happened in August, then there may be a call on nearly 50% of eligible inventories. This will have an impact on spot prices in the short term. By opting for physical delivery, investors are implicitly stating that they believe silver is starting a long-term bull market.

The gold–silver ratio is back to normal

The gold–silver ratio was elevated in July. At the time, it was at levels of around 100, meaning that one ounce of gold could purchase 100 ounces of silver. Silver's sharp price rise led to a decline in the ratio towards more normal levels of around 70. This implies silver is now more fairly valued relative to gold. Consequently, no further aggressive price rises are to be anticipated over the coming weeks, unless gold rallies significantly.

The corollary of this is that silver volatilities are expected to decline. Silver volatilities trade with a premium over other precious metals (it's not known as the devil's metal for nothing!), which reflects silver's status as a semi-precious / semi-industrial metal. Declining volatilities mean that investors who have sold silver puts will fare well.

Improving macro backdrop

Global manufacturing PMI data show that the industrial sector is getting back to work. Manufacturing PMI data in the US and Asia have been robust, and even the eurozone was doing well until August. The improved manufacturing backdrop suggests that silver demand for industrial uses will improve over the coming months. This is a benign development and it will support prices over the medium term.

Despite the modest improvements seen in recent months, central bank support will be unwavering. Central banks will continue to flood markets with liquidity and this will create a constructive environment for precious metals over the medium term. Negative real interest rate profiles in both advanced and emerging markets are here to stay and this will provide the basis for a longer-term rally in precious metals. We think that risks are on the upside for previous metals, because central banks will be inclined to do more rather than less in terms of policy measures. Central banks are likely to become more creative in terms of their policies (negative rate tenders will become more frequent) and this offers upside risks for precious metals' prices.

	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21
Silver (Old)	19.50	21.50	23.00	24.00	25.00	26.00
Silver (New)	25.00	27.00	29.00	30.00	31.00	32.00

Source: UBP / Past performance is not a guide for current or future results.

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