



# Market Musings

Global Rates, FX &amp; Commodities Strategy

7 February 2025

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▶ COMMODITIES

▶ GLOBAL MARKETS

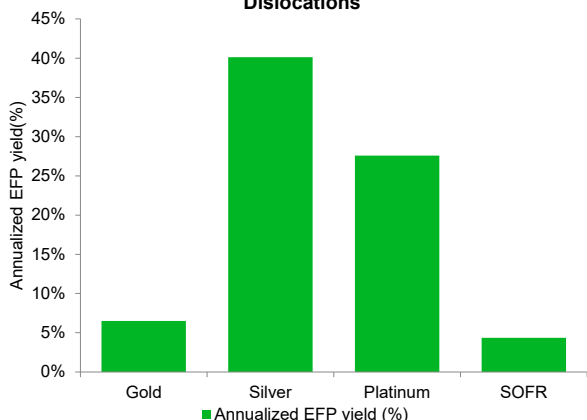
## This Isn't the #SilverSqueeze You've Heard About, It's the One You Can Buy Into

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Senior Commodity  
Strategist

- The threat of tariffs catalyzed a tidal wave of metal movement into the US, associated with severe dislocations that have impacted the metals complex. Inadvertently, this has accelerated the drain on London's 'free floating' silver inventories. The market is still seemingly sleepwalking into a #silversqueeze that we think is unlikely to be resolved without substantially higher prices.
- The LBMA's stockpile of 'free floating' inventories has now already drained to levels that are likely to disrupt the silver market's structure. Further, we argue that liquidity in London silver is significantly thinner than currently suggested by our estimates of 'free floating' inventory levels alone, implying that any further draws from current levels will catalyze an increasingly convex market reaction.
- Importantly, we think the recent disruptions in silver markets won't be as easily resolved as assumed, requiring significantly higher prices to reach the strike price necessary for pressure release valves to kick in. This isn't the #silversqueeze you've heard about, it's the one you can buy into.

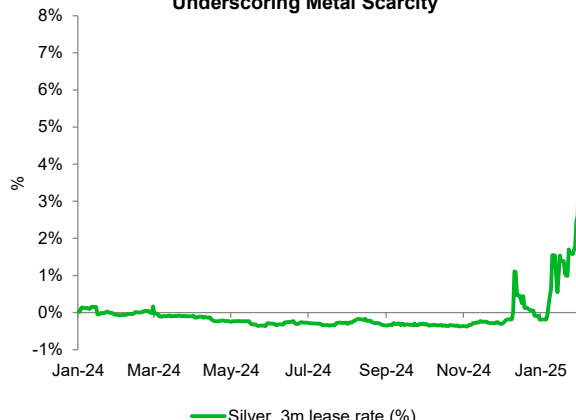
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Trade War Fears Breed Extreme Precious Metals Dislocations



Source: TD Securities, Bloomberg

Silver Lease Rates Surge Underscoring Metal Scarcity

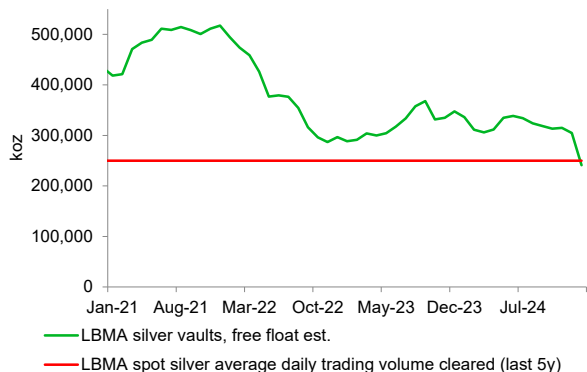


Source: TD Securities

The threat of tariffs on precious metals has resulted in severe dislocations across the metals complex. Disruptions in silver markets are even more acute than in its sister-metals, reflecting the unique implications of this disruption for this market. Case in point: EFP yields in silver now trade north of +25% annualized, in comparison to +6% in gold at time of writing. While this partly reflects the relative ease of conducting arbitrage across these metals — as a bulkier metal, silver is harder and costlier to mobilize — we think silver's unique disruptions are increasingly related to the consequence of years of structural undersupply, which have eroded London's 'free floating' inventories to critically low levels, and which are exacerbated even further by the increasingly fragmented global trading regime.

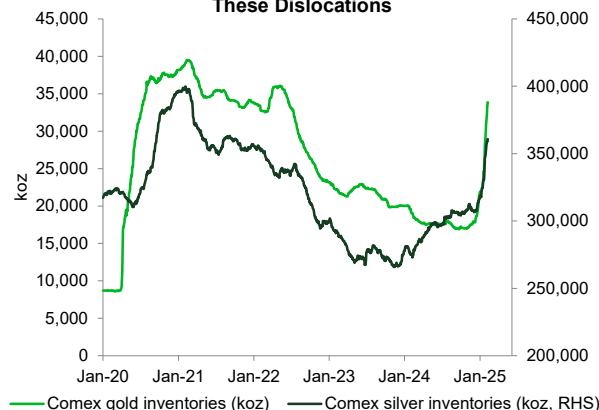
Ultimately, these dislocations have incentivized a tidal wave of metal movement into the US which persist to this day. Critically, we think this has already inadvertently drained LBMA inventories below critical levels for the market's structure. Our latest estimates of London's 'free float' suggests that January alone eroded roughly 64moz from the stockpile, bringing the total 'free float' slightly below the average daily trading volume for spot silver on the LBMA. In this context, it should not come as a surprise that London silver now trades in a backwardation with 1m lease rates surging to as high as 8% this week, despite an outlook for solar demand which presents significant headwinds relative to the last year. This fits into our view that the set-up in silver markets is transitioning from a demand-boom to a liquidity crisis.

LBMA 'Free Float' Now Challenging Critical Threshold for Market Structure



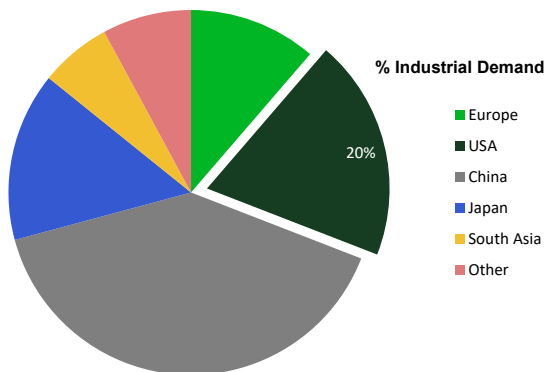
Source: TD Securities, LBMA

Tidal Wave of Metal Hits the US as a Result of These Dislocations



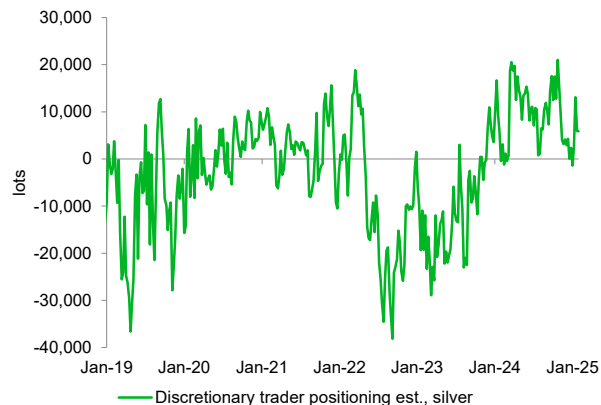
Source: TD Securities, Bloomberg

USA Remains a Significant End-User for Silver



Source: TD Securities

Where Have All the Fundamental Traders Gone?



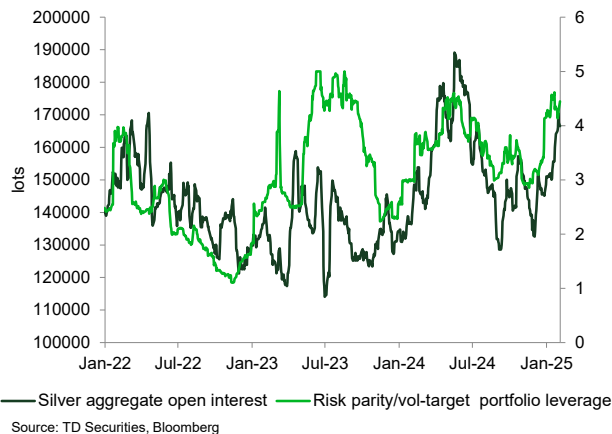
Source: TD Securities

Considering the 'free float' now sits below average daily trading volumes, we think liquidity is already severely constrained. Any further draws in London inventories should have an increasingly convex market reaction. With EFP yields still sitting north of +25% annualized (reaching up to +45% annualized earlier this week), disruptions continue to attract metal into the US to this day, which we expect will increasingly disrupt the market's structure. The flow of metal is likely to persist as a result over the coming weeks, and our analysis suggests that historically, such inventory trends have a required substantial period of time before they have begun to reverse in silver. Most importantly, we also argue the pressure release valves required for markets to clear the ongoing imbalance will necessitate significantly higher prices before they kick in, suggesting London inventories won't be rebuilt as easily assumed.

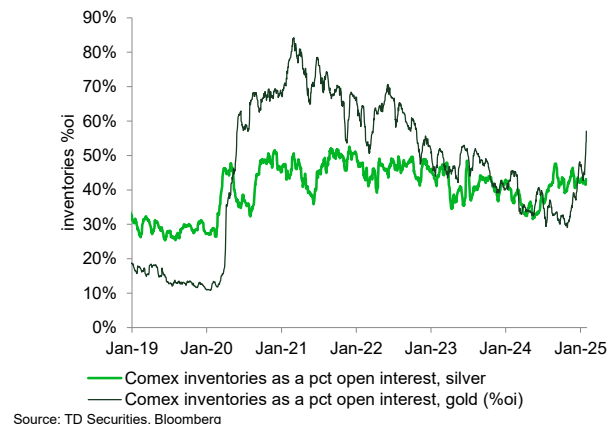
We also remain mindful that the US remains a significant end-user destination for silver, in contrast to gold. US industrial demand alone accounted for 20% of global industrial demand, equivalent to a market that is roughly half the size of China's industrial demand. At the same time, the US remains the most significant region for physical investment and a significant global region for coin & medal fabrication along with electrical demand. Tariffs on Mexican silver may not directly impact EFPs, given the metal is more directly used in industrial applications, but would likely add strain to the global supply chain. Conversely, while the bars vaulted in the Comex are unlikely to be used for such industrial demand applications, the US' significant relevance to global silver markets adds another layer of complexity around the reshuffling required for the global supply chain in order to meet these applications — all of which suggest that recent disruptions will not be as easily resolved as currently assumed.

Further, speculative interest in silver remains more contained than in gold, with CTA and risk parity funds alone driving the overwhelming majority of the variation in spec positioning across Comex silver, whereas macro funds remain remarkably flat in silver markets. Interestingly, the most significant increase in participation over the last weeks has been associated with Shanghai traders, which have added more than 13 million ounces of notional silver to their books since they returned to their seats following Chinese New Year celebrations. Nonetheless, the lack of discretionary trader participation is remarkable, considering the extremely convex set-up, and ultimately suggests the market is still sleepwalking into this #silversqueeze.

What Really Drives Open Interest in Commodities Markets?



In Contrast to Gold, Comex Silver Deliveries Have Not Outpaced The Rise in Open Interest



Additionally, our analysis suggests the 'free float' overstates the level of inventories that are eligible for CME delivery by a significant margin. We estimate LBMA vault inventories from archived bar lists, in order to account for the reshuffling in inventories that has likely occurred over the last months. After accounting for (1) metals originating from jurisdictions which are tariffed, which carry sanctions or reputational risk, and (2) bar specs that are ineligible for the CME, we estimate that only roughly 60% of the LBMA's inventories are eligible for delivery within Comex vaults. This suggests that the pool of London inventories that can be mobilized to address the dislocation in EFPs is ultimately significantly smaller than the 'free float' itself, which points to a further constraint on liquidity.

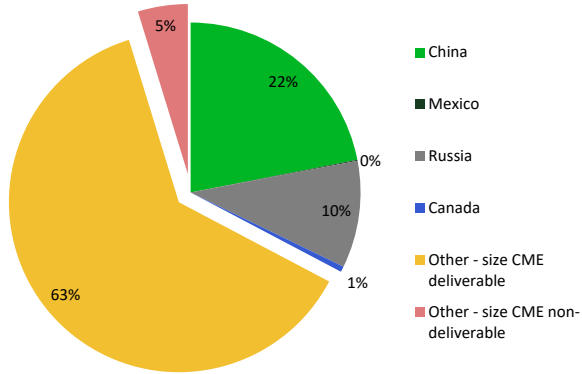
While on the one hand, this can temporarily place a cap on the degree to which London silver can tighten, given that a significant portion of the inventories are ineligible to be used for the purposes of this arbitrage and will therefore remain in London, plausible conditions exist in which this may lead to an even more significant tightening in London. On the other hand, if the dislocation in gold dissipates more easily than in silver, incentives to recast silver may be exacerbated, which may erode London inventories further below critical levels. Should lease rates remain persistently elevated, procurement behavior may also adapt in favour of outright purchases, lending direct support to flat prices.

Under the hood, recent price action in OTC silver markets continues to add credence to our view, with the backwardation in London silver reaching levels for which there is no precedent in recent history. Silver EFPs remain significantly more elevated than for gold, forwards remain tight across the term structure, which reflects both the relative ease of participation in the arbitrage, and increasingly, the unique implications of a market set-up that features a structural deficit that has ballooned to epic proportions in recent years. Flat prices have risen thus far, but the XAUXAG ratio suggests that price action has continued to lag gold's, despite the more significant implications for silver markets. However, given the recent strength in manufacturing activity data, silver should outperform based on its historical relationship with PMIs. The recent relative weakness rather reflects exceptional strength in gold as central banks have increased support to the yellow metal, but also reflects a segmented market in which discretionary trader buying activity has been more concentrated in gold markets, whereas this cohort still remains broadly flat in silver.

Ultimately, this is a compelling set-up for explosive upside convexity, necessitating higher prices in order to unlock inventories from unconventional sources. Historically, when price discovery is the mechanism by which markets find balance, the strike price required to do so tends to be multiples larger than assumed. Silver's balance sheet, fundamental, microstructural and positioning outlooks all favour higher prices. With inventories having already drained to critical level, we expect an increasingly convex reaction function from this moment

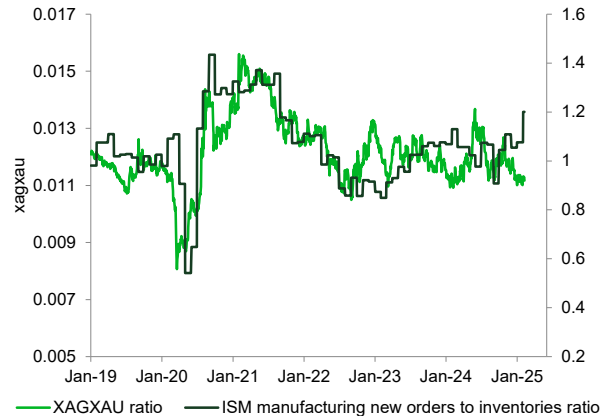
forward. We expect forwards to tighten further, higher lease rates and a significant increase in flat prices before the market imbalance is resolved.

**Estimated London Silver Vault Holdings by CME Deliverability Accounting for Brand/Size**



Source: TD Securities

**Silver Catch-Up Has Many Fundamental Merits**



Source: TD Securities, Bloomberg



# Recent Publications

## Global Rates, FX & Commodities Strategy

Global Macro		
Region	Publication	Date
Weekly	Upcoming Week - The Big Three (3 Feb)	31 Jan
	Week Ahead: Canada Macro Market Movers	3 Feb
	Week Ahead: US Macro Market Movers	3 Feb
Commentary	BoE Commentary: Cuts Like a Knife	6 Feb
	Trading the BoE	5 Feb
	China Hits Back, Countdown to Trump-Xi Call	4 Feb
	Canada and Mexico Get a Reprieve	3 Feb
US	Trump Week Two: Moving the Chains	5 Feb
	Feb 1 Tariffs: Why Can't We Be Friends?	30 Jan
	An Early Look at the US January CPI	27 Jan
	Trump Week One: Signed and Sealed	27 Jan
Canada	Feb 1 Tariffs: Why Can't We Be Friends?	30 Jan
Europe	Updating our UK CPI Forecasts	5 Feb
	Next on Trump's Radar: Europe	5 Feb
Rates		
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US	Weekly Fund Flows - Bonds Lead Inflows, Equities Dragged by Tariff Concerns	7 Feb
	February Refunding: Beam Me Up, Scotty	5 Feb
	Trump Week Two: Moving the Chains	5 Feb
	US Rates Vol: Dry January	4 Feb
Canada	Weekly Fund Flows - Bonds Lead Inflows, Equities Dragged by Tariff Concerns	7 Feb
	Feb 1 Tariffs: Why Can't We Be Friends?	30 Jan
	Weekly Fund Flows - Solid Demand For DM Bond Funds Continues	24 Jan
Europe	Weekly Fund Flows - Bonds Lead Inflows, Equities Dragged by Tariff Concerns	7 Feb
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## Global Rates, FX & Commodities Strategy

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