

Russia-Ukraine crisis remains the key watch-out factor for commodity markets

February 2022 update

Global PMI Review

The Eurozone manufacturing PMI rose to a five-month high of 58.7 in January 2022, from 58 in December, but below the preliminary estimate of 59. The latest reading indicates improving market conditions, with production, new orders, and employment all registering fast increases in January, despite the culminating Omicron wave in the Eurozone. Supply chain problems eased in January, but factory gate charges increased to the second-fastest extent in almost 20 years.

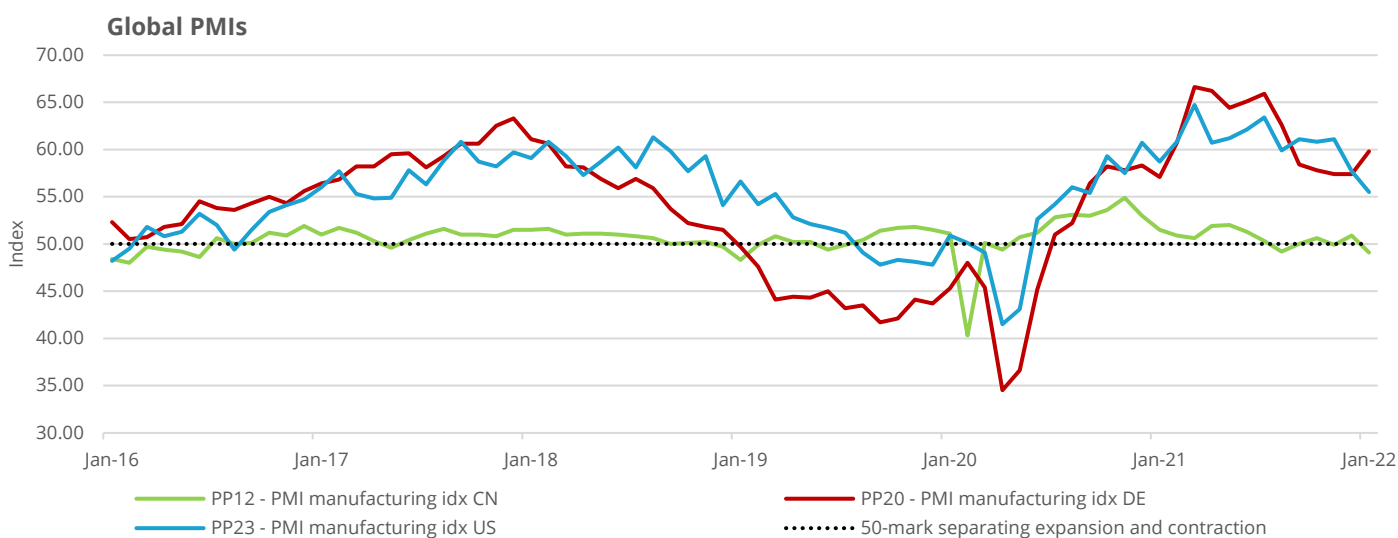
The German manufacturing PMI climbed to a 5-month high of 59.8 in January, but lower than the preliminary estimate of 60.5. Expansions were also seen in Austria, the Netherlands, and Ireland but manufacturing activity slowed in Italy, Greece, and France.

China's Caixin general Manufacturing PMI fell below the 50-threshold mark for the second time in three months. The index was recorded at 49.1 in January, down from 50.9 in December. The manufacturing activity in China decelerated amidst the recent uptick in COVID-19 cases there and the subsequent round of new restrictions. Businesses registered renewed falls in output and new orders during January.

The US manufacturing PMI decreased to 55.5 in January, from 57.7 in December. This was the lowest since October 2020 as output growth was subdued. The manufacturing activity was impacted by the Omicron outbreak, raw material and labour shortages and a reluctance among some business entities to place orders amid hikes in selling prices and longer lead times.

Among other factors was weaker demand as the pace of new orders slowed to a 16-month low, weighed down by weaker demand from both the domestic and export market.

The rate of expansion in backlogs of work fell to the slowest since February 2021, mainly due to the decline in new orders.



Source: Mintec Analytics

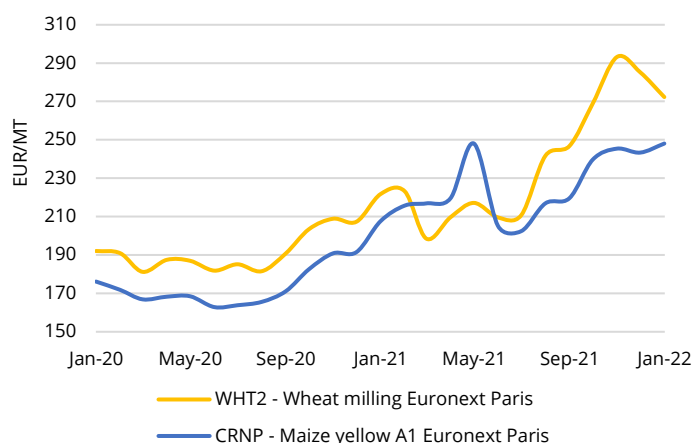
Ukraine-Russia political conflict poses a risk to global commodity markets

In mid-December 2021, Russia issued a set of demands which included a ban on Ukraine entering the North Atlantic Treaty Organization (NATO) and a withdrawal of NATO military forces in Eastern Europe. The US and other NATO allies rejected these demands and warned Russia that harsh economic sanctions would be applied if it invades Ukraine. The political tensions remain high as negotiations between Russia, the US, and other European allies continue, with the hope that a formal solution can be achieved. The Russian troop build-up, along with navy ships deployment in the Black Sea and the Sea of Azov is provoking fears that Russia could launch an invasion imminently, and this speculation is impacting various commodity markets.

The escalation of the conflict could lead to disruptions in trade for grains, vegetable oils, fertilisers, natural gas, crude oil, and metals among many others.

Both Russia and Ukraine are major producers and exporters of grains, accounting for almost 30% of wheat exports, and 18% for maize, globally. Talk of a military confrontation between Ukraine and Russia has put wheat prices under pressure since the beginning of January 2022. The average US wheat price on the Chicago Board of Trade (CBOT) was at USD 272/MT, and the Euronext wheat price reached EUR 285/MT in January 2022, down by 4.5% month-on-month (m-o-m) and 1.9% m-o-m, respectively. Although, the price of EU maize gained 2% m-o-m and stood at EUR 248/MT in January 2022. Adverse weather conditions have likely added to maize supply concerns globally. While there is currently a limited impact on grain prices from the potential conflict in Eastern Europe, future escalations could lead to trade disruptions and grain prices could strengthen. This was observed in late February 2014, when Russia annexed Crimea, with the wheat market rallying by around 20-25% over several months. Given that EU wheat and maize prices are already considerably higher than a year ago (due to other inflationary pressures), by 18% and 19% respectively, a similar increase of 20-25% on the current levels would create a significant challenge for grain buyers. In addition, a rise in grain prices would translate into increased feed prices, which in turn could push the cost of meat production, thus resulting in high meat prices.

EU wheat and maize prices



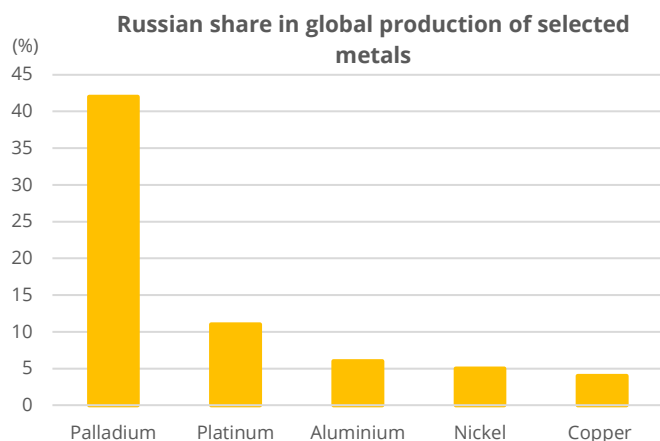
Source: Mintec Analytics

The Ukraine-Russia conflict has also created a level of uncertainty in the sunflower seed and oil markets, as both regions account for over 50% of global sunflower seed and oil production and exports. The Mintec Category Index (MCI) for global vegetable oils increased by 8.8% m-o-m and 32.6% y-o-y to EUR 1,637/MT, in January 2022. Currently, the demand for sunflower oil has increased on the back of the high prices of palm and soyabean oil. According to market sources, major vegetable oils importers (India and China) have thus shifted to sunflower oil as an alternative. While global sunflower seed and oil production are expected to increase in the 2021/22 marketing year (MY), the Russia-Ukraine conflict, if escalated, could disrupt international trade from these key regions, and thus, potentially reinforce the price rally in the vegetable oil complex. Furthermore, prices in the vegetable oil complex are driven by crude oil prices which have continued to rise recently.

The recent price rallies observed in the **crude oil and natural gas markets** mostly reflect growing global demand for fuel, power, and heating, alongside tightening inventories, particularly in the US, and a weaker USD. The Russia-Ukraine tension is one of several factors presently driving the energy markets. **High crude oil prices could raise the cost of fuel-based ethanol, as an alternative to gasoline. This could have ramifications for global sugar prices, as sugar is a key bioethanol feedstock.** White sugar prices at the major InterContinental Exchange (ICE) terminals in New York and London have traded near four-year highs, since Q3 2021, although this is primarily due to resurgent food and confectionary demand, against tight Brazilian supply expectations.

Potential sanctions and trade disruptions could have huge implications for the fertiliser market. **Russia is the biggest supplier of fertilisers globally, and the European food industry is largely dependent on it.** Global fertiliser prices are currently at their highest level since the Financial Crisis in 2008. Thus, any sanctions that would impact the Russian fertiliser market would most likely cause global fertiliser supply to weaken, having a bullish impact on fertiliser prices, and subsequently food prices.

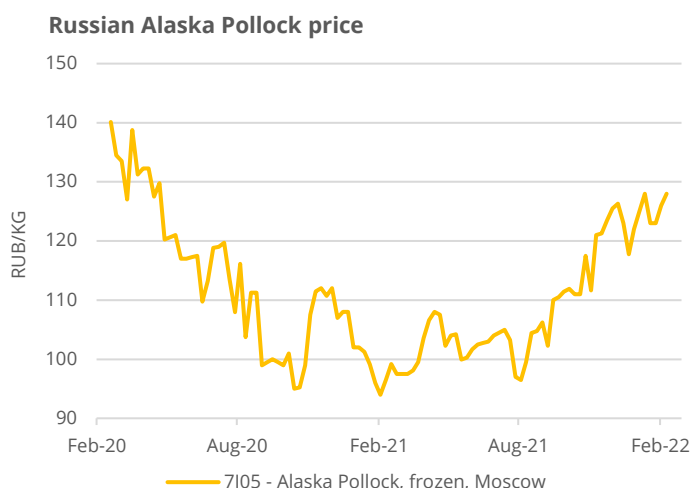
In addition, given that the **Russian metals market share of global supply represents about 60%, the possible sanctions against Russia would likely send prices of metals substantially higher.** Particularly given the current environment whereby inventories across several metals (copper, nickel, aluminium) are already tight. Especially, the exposed commodities such as aluminium and zinc would most likely rally more than copper, given the impact on gas and energy costs in Europe and the risk of smelter stoppages.



Source: USGS

Russia is the world's largest producer and exporter of Alaska pollock, a versatile white fish that is popular for human consumption, as well as an animal feed ingredient. Russia typically exports Alaska pollock to China for further processing into fillets, mince, and surimi (a paste that is used in sushi, fish-fingers, and crab sticks, for example) before the products are re-exported to the US and Europe. However, Russia has invested substantially in domestic processing capacity since 2020, as a strategy to increase value-addition at the source. Subsequently, Russian processed pollock exports to the Western Hemisphere more than tripled y-o-y in 2021, which was particularly pertinent, as Chinese borders were closed for most of the year. At RUB 128/kg (EUR 1.50/kg), the average weekly price of Russian pollock reached a 22-week high on 9th February 2022, which was partly driven by strong demand, in addition to high costs. Pollock demand often spikes in the first quarter, which presents firm price potential, which

would be magnified if Russian exports become disrupted.



Source: Mintec Analytics

Furthermore, **the logistics freight** route via the Black Sea could also be disrupted if the conflict escalates. Approximately 700 dry bulk vessels are loaded at Russian and Ukrainian shipping ports every month. If the conflict disrupts shipments for a prolonged period, these vessels might take alternative cargoes elsewhere, increasing effective supply of vessels. Consequently, the dry bulk market could face a substantial decline in trade and a rise in supply that can bring freight rates down to historical levels.

Energy prices reach record highs amid political tension between Russia and Ukraine

The Brent crude benchmark price rose by USD 10.1/bbl (+14%) in January 2022, to USD 84.7/bbl. A combination of robust demand and a sustained period of tight supply has supported the price in recent months. The price spike has intensified due to the ongoing tension between Russia and Ukraine, with fears that Russia's crude exports could be disrupted, potentially exacerbating the supply shortage. Russia-Ukraine political conflict escalation, including reports of an increased presence of Russian troops at the Ukrainian border, raised uncertainty and fears, thus driving crude oil prices higher at the beginning of February 2022. **Prices peaked on 14th February, at USD 94.41/bbl, the highest level recorded since September 2014.**

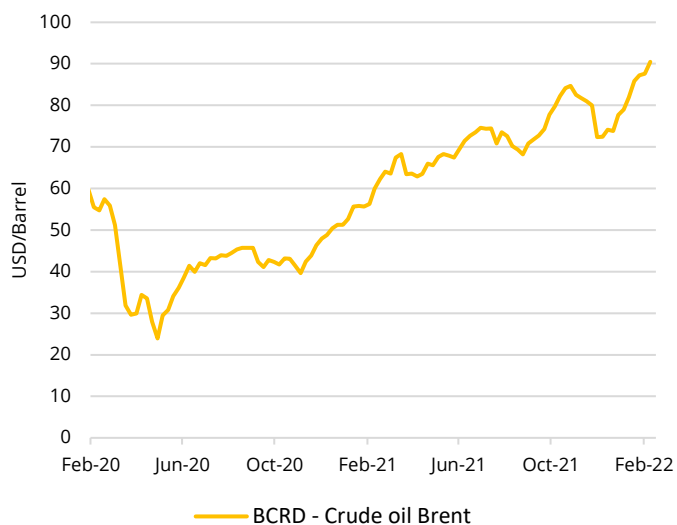
Tensions between Russia and Ukraine are also a key upside risk for European gas prices, as Ukraine is an important transit route for Russian gas into Europe, and Russia is the largest supplier of gas to Europe. **The price of EU ICE natural gas peaked in December 2021 at GBP 269.4/100Therm, up 502% y-o-y, in line with reduced Russian gas supplies into Europe.** Russian gas exports to Europe have been decreasing over the last couple of years and it's due to falling demand because of slower economic activity during the pandemic. However, recently, market participants suggest that Russia's gradual reduction in gas supply has been implemented to attempt to gain approval for the Nord Stream 2, a pipeline connecting Russia and Germany, intended to supply natural gas to homes in Europe. Further disruption on any of these pipelines resulting from the conflict escalation poses a high risk, and threatens a significant peak in prices, as European gas inventories are already at record lows. **Higher natural gas prices in Europe are also likely to drive demand for crude oil, as factories and power plants switch for alternatives to gas power, further driving prices for crude.**

If the situation worsens, the response by Western authorities will be key in determining the impact on the crude oil market. The introduction of any retaliatory sanctions would disrupt exports, thus likely to drive crude oil prices even higher. In addition, there could be damage to energy infrastructure in Russia and Ukraine, directly hitting supplies, again, supporting prices.

However, recent reports on 16th February suggested that Russia is returning troops from Ukraine's border, a positive outlook for Ukraine, potentially signalling de-escalation. Prices of crude oil are set to temporarily decline in line with this news, but remain

elevated until there is further clarity on the long-term outcome.

ICE European Brent crude benchmark



Source: Mintec Analytics

Currency pairs on 14th February 2022

CURRENCY	X/USD	W-o-W %	M-o-M %	Q-o-Q %	Y-o-Y %
European Euro (EUR)	0.88	0.25%	0.08%	0.35%	6.33%
British Pound (GBP)	0.74	-0.49%	0.51%	-1.39%	1.88%
Japanese Yen (JPY)	115.92	-0.70%	-1.72%	-1.73%	-9.46%
Canadian Dollar (CAD)	1.27	0.05%	-1.03%	-0.94%	0.12%
Chinese Yuan (CNY)	6.35	0.10%	0.00%	0.40%	1.62%
Brazilian Real (BRL)	5.20	1.79%	6.49%	4.51%	3.22%
Argentinian peso (ARS)	106.12	-0.41%	-2.12%	-5.56%	-16.56%
Russian Rouble (RBL)	76.05	-0.61%	0.25%	-3.95%	-3.00%
Indian Rupee (INR)	75.36	-0.91%	-1.69%	-1.27%	-3.65%
Norwegian Krone (NOK)	8.80	-0.06%	-0.58%	-1.29%	-3.97%
New Zealand Dollar (NZD)	1.50	0.94%	-1.86%	-5.07%	-7.54%
Turkish Lira (TRY)	13.49	0.79%	-0.19%	-25.97%	-47.95%

Source: Mintec Analytics

Norwegian krone weakens against Euro in February as ECB suggests higher interest rates in 2022

The Norwegian central bank (Norges Bank) implemented its second interest rate hike in three months, in December 2021, raising the base rate to 0.50% from 0.25%. This contributed towards the NOK appreciating by 3.3%, to NOK 9.92 per EUR, during the six weeks ending 12th January 2022. Norges Bank is foreseen to maintain its reductionist monetary policy, earmarking three more rate increases in the 2022 calendar year (CY), with the baseline rate thus expected to rise to 1.25%. This underlines the potential for a strong NOK, below NOK 10 per EUR, from late-Q1 2022 onwards.

However, the EUR appreciated by 1.8% against the NOK during the five weeks to 16th February 2022, as the market reacted to the European Central Bank (ECB) appearing to change its dovish stance, due to surging inflation. The ECB is now increasingly likely to implement higher rates during the CY, as it targets headline inflation below 2.0%.

The timing of further interest rate hikes in both the Eurozone and Norway will have a strong bearing on the performance of the respective currencies in the upcoming months.



Brazilian Real strengthens against the US dollar

The Brazilian Real (BRL) has continued to appreciate against the US Dollar (USD) since mid-December 2021, following an interest rate hike in Brazil in early December 2021, up by 150 basis points to 9.25%. In February 2022, there was another interest rate increase, up to 10.75%, adding further impetus to the BRL. Foreign investors will be incentivised to hold the Brazilian currency amid the higher interest rates.

The Brazilian government is also considering an income tax exemption for foreign investors to invest in domestic corporate bonds. This is likely to strengthen the domestic currency by opening the door for more foreign investment in Brazil's capital markets. Brazil is the top exporter of commodities, including orange juice, soybeans, steel, beef, and chicken. With the expectation of a firming BRL, prices of these commodities could increase in the short term.

However, there are indications of an interest rate hike from the US Federal bank. Higher interest rates in the US may lead to capital outflows and thus a currency depreciation in emerging markets like Brazil.



Source: Mintec Analytics