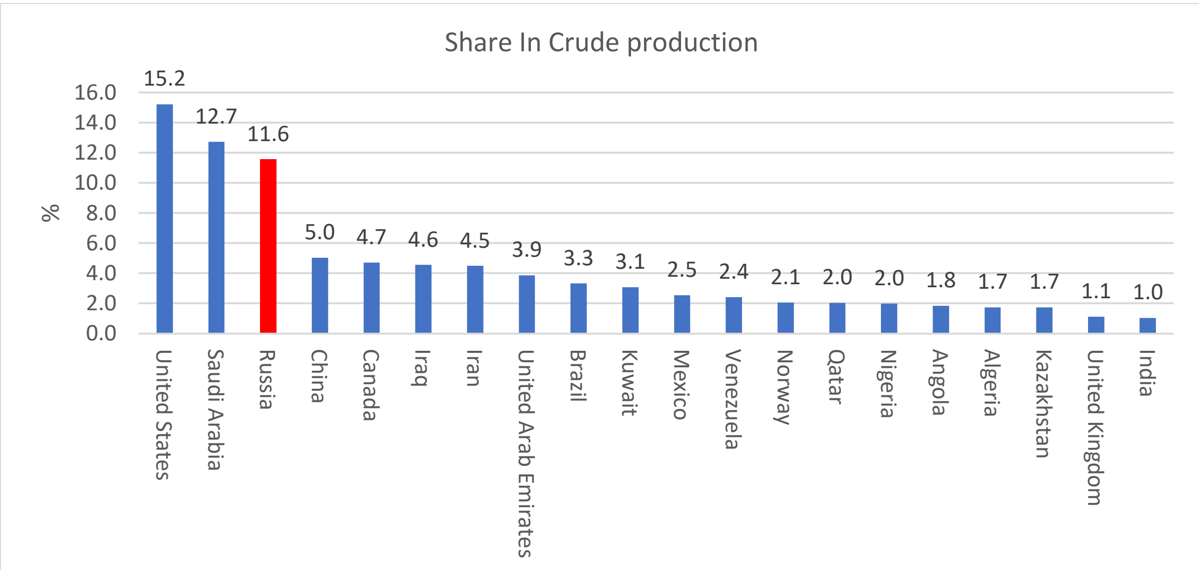
10th March 2022

Price pressures from Ukraine conflict

The war that is going on in Ukraine and the resulting sanctions imposed by the west has upset the economic applecart. Taking Russia out of SWIFT is a payments issue as several countries are trading partners and will counter challenges in making and receiving payments. India too has not been insulated and the government and RBI is working out modalities. The commodity market has gone in for considerable dislocation as both Russia and Ukraine are major players in several commodities. In fact, even if they are not major producers, a possible decline in output has potential to disturb prices. Banning trade with Russia for all commodities except energy (here too some punitive measures have been invoked by the USA) means that there will be upward pressure on prices. Crude oil for instance is the high contact point with the price scaling new heights. This holds for other commodities too.

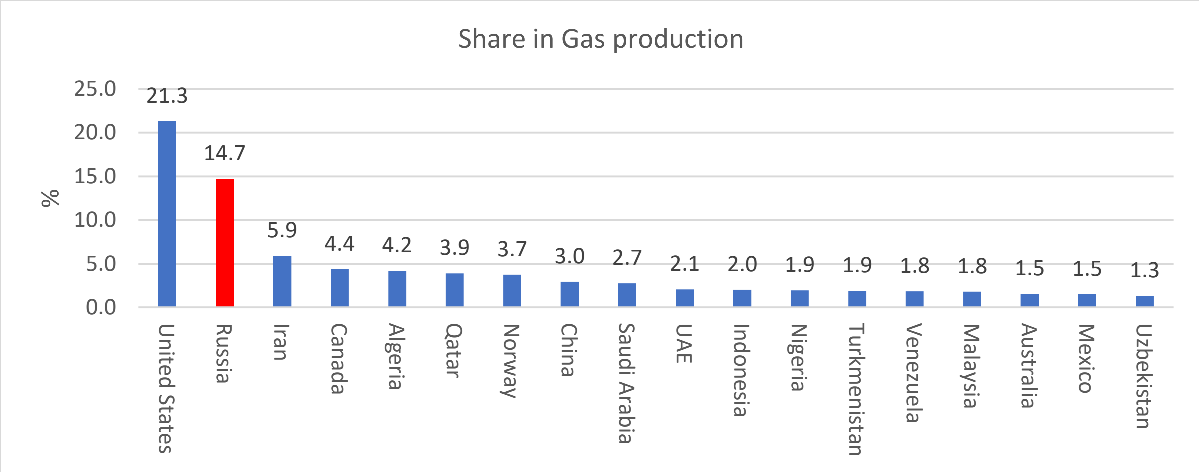
The charts below provide a glimpse of the shares of various countries including Russia and Ukraine in commodities where they have a significant presence. With Ukraine under continuous pressure of attack by Russia overall trade would tend to get impeded. Hence, all commodities dealt with by these two nations will witness volatility. Simultaneously there will be possible opportunities for other countries to try and substitute the supplies from these two nations to restore global equilibrium. But this may not be easy to accomplish as the domestic situation needs to be evaluated and the existence of marketable surplus would be a precondition to take advantage of this situation.

Energy



Source: IEA

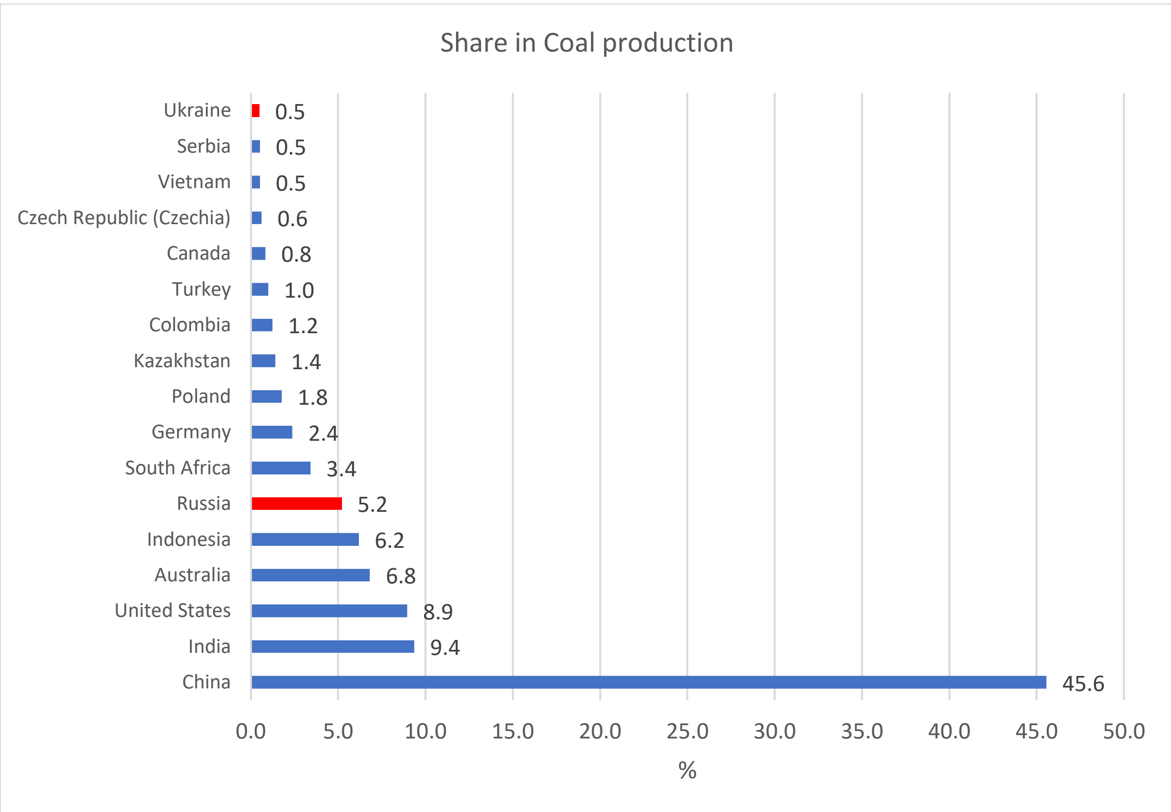
Russia is the third largest producer of crude and hence global crude price increased even before the sanctions came in. OPEC plus is not in a position to increase output and the onus would be on the USA to provide support. This is one reason why Russia is talking of price going up to $ 300/barrel if the extreme case arises. While there is talk of allowing Iran supplies to be permitted, as can be seen from the chart, it will only partly compensate for the output being supplied by Russia. This is one reason as to why the price has been extremely volatile in the upward direction.



Source: Worldometer

In case of gas, Russia is the second largest producer and with Europe virtually deciding to stop taking gas from Russia the impact on price is grim which has already been witnessed in the market. Higher prices of gas also has the potential to increase prices of products where it is a vital input like fertilizers and hence the impact on inflation is two-fold.

The impact on coal would also be there though may not be as sharp as that on crude and gas. Russia does export coal and hence any restrictions on trade of non-oil goods will increase prices even though the physical supply can be supplemented by other countries. Germany, Netherlands and Italy are some of the major importers of goods from Russia.



Metals

Shares of countries in global production (USGS) %

Iron ore	Share in total
World	**100.0**
Australia	34.6
China	13.8
India	9.2
Russia	3.8
Ukraine	3.1

Aluminium	
World	**100.0**
USA	1.3
India	5.7
China	57.4
Australia	2.8
Canada	4.6
Russia	5.4
UAE	3.8

Copper	
World	**100.0**
USA	5.7
China	8.6
Russia	3.8
Chile	26.7
Congo	8.6
Peru	10.5

Steel	
World	**100.0**
China	62.9
India	5.6
Russia	3.8
Japan	4.9
S Korea	3.6

Metal prices have already started moving upwards. Russia has a share of between 3-5% in iron ore, steel, copper and aluminium.

Agricultural products

Shares of countries in farm production (%): USDA

Wheat	
World	**100.0**
USA	**5.8**
India	14.2
China	17.7
Russia	9.8
Ukraine	4.3

Coarse grains	
World	**100.0**
USA	26.6
Russia	2.5
India	3.2
Ukraine	3.6
Brazil	7.9
China	18.7

Oilseeds	
World	**100.0**
USA	21.4
Brazil	22.7
China	10.1
India	6.7
Russia	3.8
Ukraine	3.9

Almost 75% of oilseeds of both Russia and Ukraine is accounted for by sunflower.

In case of farm products, Russia has a share of 9.8% in wheat where it is also an exporter. Combined with Ukraine, the overall share is around 14%. In case of oilseeds it is close to 8% with almost 75% being sunflower seed. Shortage in supplies of sunflower oil has already spooked prices of all edible oils as demand has increased for other substitutes including palm and soybean. India has been confronting high edible oil inflation for the last few months and this will aggravate further. In case of coarse grains, where corn (maize) is the leading product, the output from both these countries is around 6%. Here too there is scope for prices to increase and countries with surpluses will have to pitch in to ensure that physical supplies are available.

Opportunities for India

As per APEDA wheat exports were 2.1 mn tonnes in 2020-21. With high production of 111 mn tonnes expected this year and stocks of 23 mn tonnes with FCI as of March 1st, there is scope for enhancing exports and making up for the possible decline of global supply with Russia being blocked. There will however be quality issues to contend with.

There would also be advantage to be had on refinery products side where exports for the first 10 months were $ 48 bn.

Some of India's exports to Russia include machinery, pharma, nuclear reactors, chemicals. Alternative markets will have to be sought in case trade is not possible.

Vulnerabilities for India

With the war getting prolonged commodity prices would tend to get affected along with supplies. The areas of concern for us would be the following:

- Crude oil imports were around $ 130.2 bn in first 10 months of the year.
- Coal with $ 24.2 bn
- Fertilizers of $ 10.8 bn
- Non-ferrous metals of $ 14.4 bn
- Edible oils of $ 15.9 bn

Concluding remarks

While it would be possible for India to explore pushing exports of products where there are opportunities, the overall impact may not be very significant. Higher prices of commodities due to the conflict will get reflected in higher inflation which is a challenge. Besides fuel products, edible oils poses risk to CPI inflation which can be expected to be in the region of 5.5-6% in FY23 assuming the battle ends by the end of the month and conditions return to normal in the subsequent 3-4 months. Producers have been in the process of passing on higher input costs to the consumers in the last quarter or so and will have to invoke a second round if prices continue increasing. High inflation and the resulting uncertainty will have potential effects on consumption and hence can impact GDP growth going forward.

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