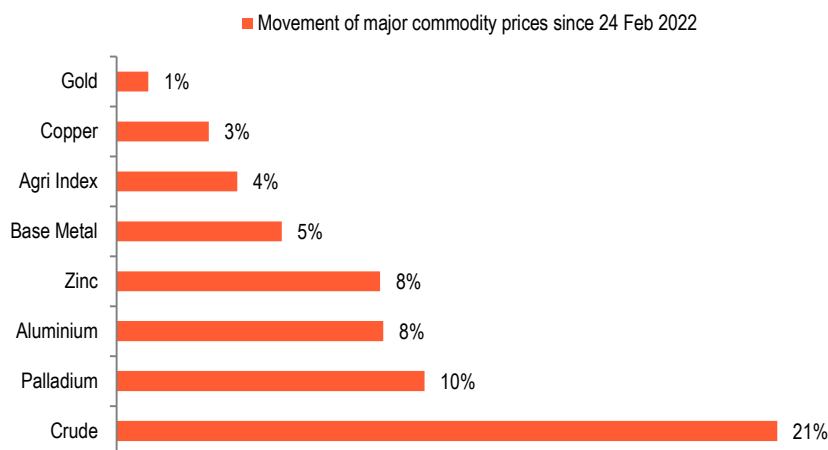


Where are commodity prices headed?

The escalating geopolitical tension between Russia and Ukraine has impacted commodity prices to a considerable extent. Since 24 Feb 2022, when the speech was made by the Russian President indicating an imminent attack, international oil prices increased sharply by ~21%. In absolute terms, crude prices went up by US\$ 20/bbl to its current trading level of US\$ 116/bbl.

Not only oil, other commodities also faced the brunt. Wheat prices are currently at a 14-year high while aluminum prices also rose to a record peak level. Notably, in 2014, when Russia annexed Crimea, then a Ukrainian territory with majority of Russian population, international oil price (20 Feb 2014), was trading at US\$ 110/bbl.

Fig 1. Impact of war on major commodity prices:



Source: Bloomberg, Bank of Baroda Research

What Russia and Ukraine's trade basket says?

We have looked closely at the exports basket of Russia and Ukraine, to understand which commodities will be impacted the most in the near term. Evidently, crude oil is the first commodity to be impacted followed by petroleum products and natural gas. Other than that, Russia also exports coal, metals, petrochemicals and fertilizers. Notably, Russian high-quality exports meet 10% of European coal-fired plant demand.

OPEC has already signaled that it would not ramp up production to lower prices. Thus, oil would continue to see its upward spiral. Interestingly during the financial crisis oil had crossed the US\$ 146/bbl mark.

Another important commodity that would be impacted is palladium. It is used by automakers for catalytic converters to curb emissions. Russia is the biggest producer of palladium (91 metric tons in 2020 compared to 80 metric tons in 2015). This is an important commodity as the world is focusing on ESG goals.

Table 1. Crude oil has the major share in Russia's export basket

Top 5 commodities which Russia exports	US\$ bn	Current share in exports
Crude Oil	110	22.4%
Petroleum Products	70	14.2%
Natural Gas	56	11.3%
Machine and Equipment	33	6.6%
Ferrous Metals	29	5.9%

Source: CEIC, Bank of Baroda Research

Speaking of Ukraine, cereals have the major share in export basket followed by iron and steel and animal or vegetable fats. Within cereals, corn, wheat, rapeseed and soybeans have a dominant share. Agri Index (Roger) thus increased by 4%, post the announcement of war.

Table 2. Cereals have the major share in Ukraine's export basket

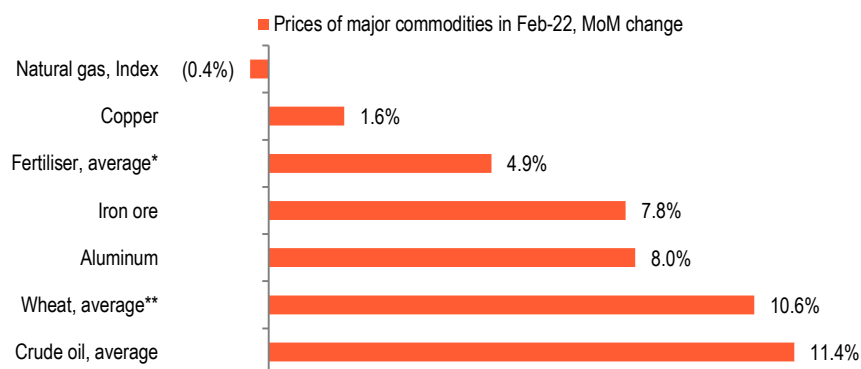
Top 5 commodities which Ukraine exports	US\$ bn	Share of Exports
Cereals	9.4	19.1%
Iron and steel	7.7	15.6%
Animal or vegetable fats, oils, and other products	5.8	11.7%
Ores, slag, and ash	4.4	8.9%
Electrical machinery and equipment	2.6	5.2%

Source: <https://comtrade.un.org/data>, Bank of Baroda Research, Note: Data as of 2020

How have prices moved in February over January 2022?

Recent data published by World Bank on commodities also show the impact of war. In Feb'22, major commodity prices rose following escalated geopolitical tensions. *We believe the uptrend in commodity prices is likely to persist* until some dialogue on peace is forthcoming. Central banks worldwide are also anticipating the shocks. Bank of Canada raised rates for the first time since Oct-18 by 25bps. Even US Fed Chair signalled of a 25bps rate hike in Mar'22, on account of overheating of inflation. Thus, it poses serious risk to inflation print globally which is already running at record high levels for US, Germany and UK.

Fig 2. According to World Bank data, commodity prices have increased in Feb over January



Source: World Bank, Bank of Baroda Research, *: Average of the components such as DAP, phosphate rock, Potassium chloride, TSP, Urea, **Average of SRW and HRW, Note: for natural gas the pace of decline has fallen from -16.7% seen in Jan'22

The price increase was also witnessed in case of the oil complex in February. Prices of soybean increased by 9.2%, soy oil by 8.6%, and palm oil by 13.1%.

Concluding remarks

The war has impacted commodity prices almost across the board and hence no country is insulated against this impact. Countries using fossil fuels for running vehicles or heating would face a lot of inflationary pressure. In India it has been noticed that companies have started passing on the higher cost of raw materials to the consumers. The new wave of commodity price increases will further pressurise inflation. India will be susceptible to secondary and tertiary impact of inflation in commodities like fuel, coal, edible oils, fertilizers etc. This in turn will be an issue that the MPC would have to contend with when it meets in April.

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