

The Russian invasion of Ukraine has pushed up the prices of many commodities, from gas to wheat. It has also highlighted the growing threat that raw materials will be used as a foreign policy weapon.

By Emiko Terazono, Neil Hume and Nic Fildes

Turned upside down by political risk

Like many people, Gary Sharkey has been constantly checking the news for the latest developments on the Russian invasion of Ukraine. But his interest is not just personal: as procurement director of Hovis, one of Britain's biggest bakers, Sharkey is responsible for buying in everything from grains for bread to steel for machinery.

Russia and Ukraine are important grain exporters, between them accounting for almost a third of the world's traded wheat. For Hovis, the surge in wheat prices caused by the invasion and the sanctions on Russia have important cost implications for its business.

"Ukraine and Russia – the flow of grains from the Black Sea is so important for the world market," says Sharkey as exports from both countries have virtually come to a halt.

It is not just the grains. Sharkey also points to the jump in the price of aluminium. The price of the lightweight metal, used in everything from cars to beer cans and bread tins, is on course to hit a record high above \$3,475 a tonne – partly a reflection of the fact that Russia is the second-largest exporter.

"Everything has gone up. There is a political risk premium built into a lot of the products," says the 55-year-old executive, noting the 51 per cent rise in wheat and the near 600 per cent rise in wholesale European gas prices over the past 12 months.

The invasion of Ukraine has cast a pall over the commodities sector because it has made it impossible to ignore the geopolitical faultlines that run through many markets for key raw materials.

The conflict itself and sanctions on Russia are causing disruption in a number of markets – especially wheat. The rising cost of energy has important ripple effects in other commodity markets, including for the cost of fertiliser used by farmers.

On top of that, commodity traders and purchasing managers are growing

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Increasingly worried about the way that many raw materials have the potential to be used as weapons of foreign policy – especially if a new cold war develops that divides Russia, and potentially China, from the west.

For most of the past three decades, the commodities industry has been one of the most striking examples of globalisation, which has created vast riches for the trading houses that connect buyers and sellers of raw materials.

Although many individual projects in areas such as mining were always wrapped up in politics, the markets themselves have been built around the expectation of open global supply. Procurement executives such as Sharkey at Hovis worried about prices but much less about being able to actually source the raw materials they need.

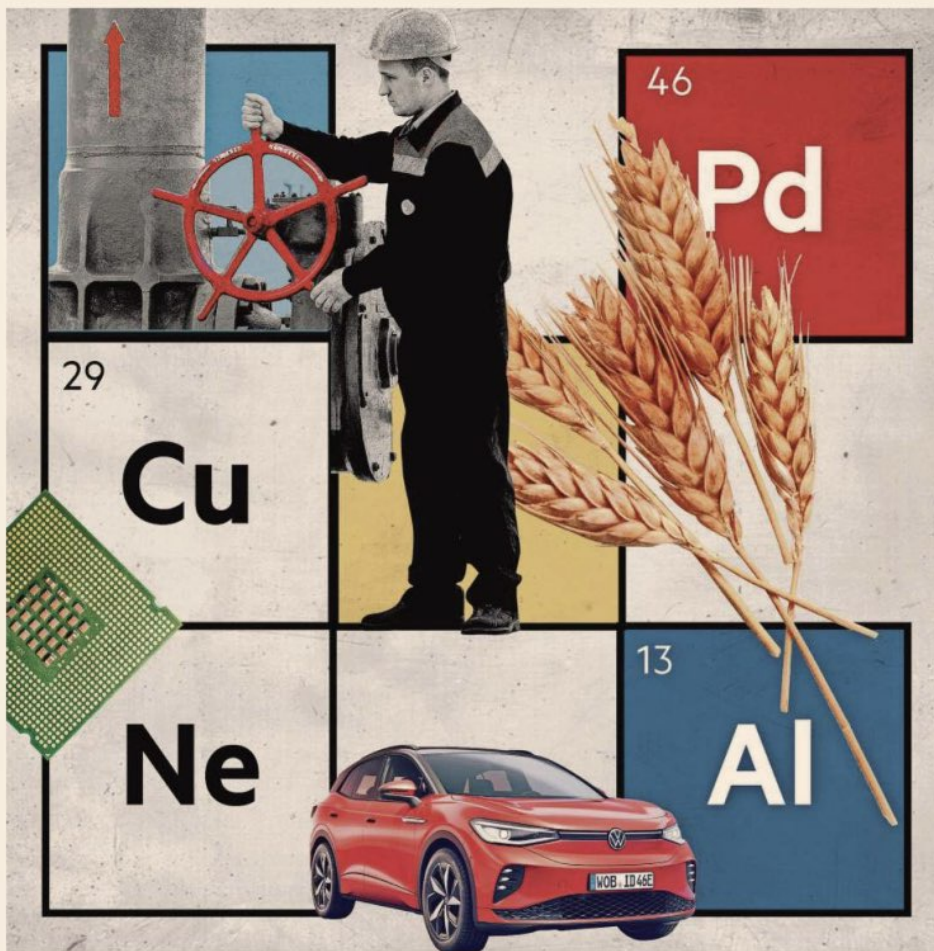
The shift in mindset in the commodities sector has been building for a decade. As tensions between the US and China have grown, Beijing's control of supplies of rare earths – metals used in many aspects of manufacturing – raised concerns that raw material supplies could become political weapons.

But over the past two years, two separate events have concentrated minds even further. The Covid-19 pandemic highlighted the perils of relying on a handful of countries, which led to severe supply chain disruptions. In from grains to energy to metals, Russia's invasion of Ukraine has served as a reminder of how some countries wield considerable influence over raw material supplies thanks to their large market share of vital commodities.

As well as being Europe's main supplier of gas, Russia is also dominant in the markets for a number of other important commodities, such as oil, wheat, aluminium and palladium.

"Commodities have been weaponised for a long time... it's always a question of when does a state pull the trigger," says Frank Fannon, former assistant US secretary of state for energy resources.

The short-term response to the Ukraine war from some companies and governments has been to increase stockpiles of important raw materials. In the long-run, it is forcing the industry



40-50%
Exports of neon coming from Russia and Ukraine

17%
Global natural gas produced in Russia

40%
World's palladium output sourced from Russia

80%
World's rare earths produced in China

to consider alternative supply chains that can bypass the likely economic and financial conflict that is building between Russia and the west.

"Definitely the world is much more concerned about the problem [of geopolitics] than it was 10-15 years ago," says Jean-Francois Lambert, a former banker and commodities consultant who advises financial institutions and trading firms. "Then it was about globalisation. It was just about efficient supply chains. Now people are worrying, are we going to have supply, are we going to have access?"

Weaponising gas

Market shocks from producers controlling a large share of production of certain commodities are not new. The oil shock in the 1970s, when Opec's oil embargo led to soaring crude oil prices, caused stagflation among oil-importing countries around the globe.

Since then, trade has become more globalised and markets interconnected. But as businesses sought to cut costs in their supply chains, they became more reliant on certain producers, from grains to computer chips, leaving them vulnerable to sudden disruption.

The prospect of natural resources being used as a weapon has been brought to life by Russia's use of gas exports to Europe. Russia accounts for about 40 per cent of the EU's gas consumption. But, in the fourth quarter of last year, Russian exports to north-west

Europe fell between 20 and 25 per cent, according to the International Energy Agency, after Russia's state-backed gas company Gazprom adopted a strategy of only meeting long-term contractual commitments and not offering extra supplies in the spot market.

In January, Fatih Birol, head of the IEA, blamed rising gas prices on Russia withholding gas from Europe. "We believe there are strong elements of tightness in the European gas market due to Russia's behaviour," he said.

Even as Germany last week halted the approval process for Nord Stream 2, a tweet from Dmitry Medvedev, former president and deputy head of Russia's security council, was considered by some to be a veiled threat about the region's reliance on Russian gas. "Welcome to the brave new world where Europeans will soon be paying €2,000 per 1,000 cubic meters of gas!" Medvedev said.

"Any time there is a concentration of supplies, there is a risk that is hard to avoid," says Randolph Bell, director at US international relations think-tank the Atlantic Council. "Clearly [Russia is] using gas as a political tool."

For analysts, the imposition of sanctions on Russia's central bank – which has caused a slump in the rouble and has been accompanied by declarations of "economic war" by European politicians – only increases the risk that Russia could withhold supplies of certain commodities.

If that happens, Russia's dominance in certain metals and rare gases could have repercussions in multiple supply chains. When aluminium company Rusal was blacklisted by financial institutions in 2018 after US sanctions, prices soared by a third, wreaking havoc in the car industry.

The country is a key producer of palladium, which carmakers use to remove toxic emissions from exhaust fumes, as well as platinum, copper and nickel, which are used in the batteries for electric cars. Russia and Ukraine are also the dominant suppliers of neon, a byproduct of steel manufacturing and a critical raw material for chip manufacturing.

Neon is sourced and purified by sev-

eral specialised Ukrainian companies, according to US research group Techcet. When Russia invaded eastern Ukraine in 2014, the price of neon jumped 600 per cent, causing massive disruption in the semiconductor industry. "We anticipate an extended period of geopolitical tensions and risk premiums across all underlying commodities following Russia's invasion of Ukraine," said Natasha Kaneva, analyst at JPMorgan.

Perhaps one of the more worrying effects of the war in Ukraine has been the impact on grains and food prices. The conflict comes at a time when food prices are already high, the result of poor harvests around the world.

Ukraine still has sizeable inventories to export from last year's harvest, and the export disruption could "have dire consequences for food insecurity in already-fragile countries dependent on Ukrainian grain," says Caitlin Welsh, director of the global food security programme at the Center for Strategic and International Studies, a US think-tank.

For the 14 countries where Ukrainian wheat is an essential import, almost half already suffer from severe food insecurity, including Lebanon and Yemen, according to CSIS. But the impact would not be limited to these countries. Russia's invasion has caused energy prices to soar, and risks "pushing food insecurity skyward," she says.

Even before Moscow's attack on Ukraine, geopolitical tensions had seeped into global food markets. Prices for key fertilisers jumped last year after the EU announced sanctions over human rights abuses against Belarus, a leading potash producer, and China and Russia, also large fertiliser exporters, put in place export curbs to safeguard domestic supply.

An acute shortage of fertilisers gripped rural India – which relies on overseas purchases for about 40 per cent of its key crop nutrients – in the final months of 2021, leading to protests and clashes with the police in the central and northern parts of the country. Ganesh Nanote, a farmer in India's state of Maharashtra, was caught up in the scramble for plant nutrients ahead of the planting season for the winter crop.

"There was a shortage of DAP [diammonium phosphate] as well as potash," he says, adding that although he managed to get alternative nutrients for a higher price, his chickpea, banana and onion crops were affected. "The rise in fertiliser prices has led to losses."

Some analysts believe that growing Russian influence in former Soviet states could eventually create a situation where Moscow has strong influence over the global grains market – especially if it were to prevail in Ukraine. Belarus is closely allied to Russia, while Moscow recently sent troops to shore up the government in Kazakhstan, another large wheat producer. "We can start to see food becoming a weapon again in some strategic game," says David Laborde, senior research fellow at International Food Policy Research Institute.

Aware of the heightening anxiety over the concentration in commodity supply, some governments are taking steps to try to mitigate the effects by increasing inventories. "People are now building more buffer inventories compared with 10 or 15 years ago. We saw that coming already from the Covid-era. Everyone is realising that efficient supply chains are for when the world was perfect, for normal times," says Lambert.

Egypt, for example, has stocked up on wheat, with the government saying it had enough of the staple until November from imports and the expected local harvest. The minister of supply said the tensions between Russia and Ukraine made for "a state of uncertainty in the market", and that Egypt had diversified its purchases and was in discussions to hedge its buying with investment banks.

Alternative supply chains

If stockpiling is a short-term reaction to the crisis, the long-term response might repeat what has happened over the past decade in rare earths, the minerals used in high-tech products from wind turbines to electric vehicles.

China controls about four-fifths of

'It was about globalisation 10-15 years ago. Now people are worrying, are we going to have supply and access?'

global output, and its readiness to use its position came to the fore in 2010, when it cut limited exports, leading to a surge in prices. "The problem with China is the concentration of supply chain power they have. They have shown [a willingness] to use that concentration of power to realise geopolitical muscle," says Bell at the Atlantic Council.

In order to reduce dependence on China for rare earths, the US, Japan and Australia have spent the past decade planning ways to develop new supplies.

The US defence department has backed several projects, including the huge Lynas project in Kalgoorlie, in Western Australia. The state is the home to several other new mines, one of which the Australian government has backed.

At one potential scheme, the Yangbana project in Western Australia, being developed by Hastings Technology Metals, workers are building paved roads around Gascoyne Junction, which sits about 25km to the west of Mount Augustus, an isolated rock hill twice the size of the more famous Uluru, formerly known as Ayers Rock.

Once fully operational in two years' time, Hastings expects that Yangbana will supply 8 per cent of global demand for neodymium and praseodymium, two of the 17 rare earth minerals and the most in demand.

In the UK, Sharkey at Hovis says he is falling back on his long standing contacts to secure supplies. "Making sure you are at the top of the list, that's where many years of good supplier relationships come to the fore," he says. "You're really engaging with suppliers at different levels now than we probably were a couple of years ago to ensure that we've got continuity of supplies throughout our businesses."

Companies directly reliant on Russia and Ukraine for commodities need to be thinking of what lies ahead, he says. "What does agriculture look like in Ukraine? Those displaced, when will they be coming back? Will they come back?" asks Sharkey. "Heads are now turning to what things will look like in the longer term. There's a lot of uncertainty for next year and longer."

Additional reporting by Heba Saleh

