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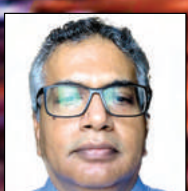
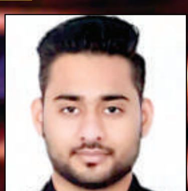
EXCLUSIVE

Rocking the ECONOMY BOAT



MR SHANMUGHAM



MR SINGH

The world of metals facing the brunt of the conflict due to the disruptions and sanctions following the Russian invasion of Ukrane, two of the top producers and exporters of several commodities. Dr V Shunmugam and Naveen Pratap Singh from National Institute of Securities Markets, take stock of ensuing global scenario. "The question is," they ask, "will India be able to bridge supply gaps created by the Russia-Ukraine war and the consequent West sanctions especially in steel.

The Russo-Ukraine war is seemingly making much of an impact on the global economy than what was thought of before it began. Thanks to the commodity power of Ukraine and Russia, for one whose ability to supply has been made physically impossible and the other whose ability to export is legally sanctioned. Be it food, fuels, or metals, Russia and Ukraine put together have an economically significant share. Economic stakeholders across the nations have been impacted from shortage in supplies of many commodities starting from crude oil and sunflower oil to mundane but economically significant commodities such as neon gas that fuels laser used by chip makers from across the world. From EU nations and countries from Africa to Asia have been scrambling around for making good the loss of food grains with supplies from unconventional sources such as India. In this regard, an attempt has been made here to analyse the PSD of key commodities from the region and the dependence of various economies on these commodities. Such an analysis is key to understand the economic impact of the Ukraine-Russia conflict and provide for further course of action and mitigation. From oilseeds and vegetable oils to aluminium and nickel or crude oil and natural gas, supplies from both the nations have been fulfilling the economic needs of developed economies of the EU and the developing African nations. However, these countries are likely to have varied impact depending on the economic importance of the commodity of imports from Russia\Ukraine, substitutability, availability of alternative suppliers, overall price impact of supply shortfall and the per capita income levels of the economies.

The European markets can be a profitable opportunity for Indian steel producers as steel production has stopped in Ukraine and sanctions on Russia has put trade with it at risk.

DECLINING FOOD SUPPLIES AMIDST INCREASING FOOD PRICES

Undoubtedly, Russia and Ukraine together are top producers and exporters of several important grains such as wheat and meslin, sunflower seed or cottonseed oil, barley, maize. Their share of global trade in selected commodities ranged from 53% (sunflower seed), to 36% (wheat), 23% (barley), and 14% (corn). Their exports of sunflower and wheat touch boundaries of every continent. Historically high global prices of wheat are a testimony to the significance of wheat exports of Ukraine/Russia to several global wheat import dependent nations. For example, Turkey, China and Egypt's dependence on agricultural commodity supplies (wheat, barley, corn, colza and sunflower) which these countries having a significant share of 25%, 23% and 22.6%, respectively.

Due to the conflict, a large amount of the world's wheat, corn and barley are trapped between these two nations. This is leading towards continuous rise in food prices in the world. Though there is no ban on grain exports from Ukraine, but in effect the ports are closed and shipments stopped.

In an yet another dimension, the United Nations said that the war's impact on the global food market alone could cause an additional 7.6 million to 13.1 million people to go hungry. Regions like Middle East and North Africa are dependent on the Black Sea as a trading route and imports from Russia and Ukraine. On the other hand, grain exporting countries are fearful about the scarcity and the resultant hoarding that may happen in the markets.

With exports of agricultural products crossing the USD 50 billion mark for the first time during the financial year 2021-22, India is set to aid the world in fulfil those supply gaps thanks to the healthy storage of food grains. As per the provisional figures released by the Directorate General of Commercial Intelligence and Statistics (DGCI&S), agricultural exports rose to USD 50.21 billion in 2021-22, which is about 20% higher compared to the previous year. Wheat exports has recorded an unprecedented growth of more than 273%, jumping nearly four-fold from $568 million in 2020-21 to touch close to $2.12 billion in 2021- 22. India is aiming to export a record 10 million tonne (MT) of wheat in 2022-23 amid rising global demand to fill the void left by the Russia-Ukraine war.

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India is likely to export wheat worth around $4 billion given that prices are expected to rise in the coming months to around $400 to $430 a tonne (inclusive of all costs), especially in North Africa and South-East Asia countries.

In the near term, food prices in world markets should be expected to rise further amidst all uncertainty, because in Ukraine farmers are not ready for the next growing season. The disturbances in logistics lines will lead to global food insecurity.

CHALLENGED METAL SUPPLIES

The world supply of metals (aluminium, copper, nickel, steel) is also facing the brunt of the conflict due to the disruptions and sanctions. Russia is the major exporter aluminium contributing almost 12% to global trade and the 11th largest exporter of nickel ore in the world in 2020. As per Steel Mint, Russia and Ukraine together account for about 10% of global steel exports. They are also largely involved in the export and manufacture of other essential raw materials like neon, palladium and platinum. With palladium, for example, the current trading price of almost US$2,270 per ounce, up over 50% since mid-December, touched even US$3,300 per ounce in mid-March i.e., more than a 100% increase.

The prices of nickel and copper, which are used in manufacturing and infrastructure respectively, have also been soaring. The aerospace industries of the US, Europe and Britain also depend on supplies of titanium from Russia. Boeing and Airbus have already approached alternative suppliers. Nickel is a key raw material used in electric vehicle batteries, and copper is widely seen as an economic bellwether — is extensively used in electrical goods and construction of homes. The U.S. chip industry heavily relies on Ukrainian-sourced neon and Russia, also exports a number of elements critical to the manufacturing of semiconductors, jet engines, automobiles and medicines. High nickel prices have added to the troubles of electric-car makers who have already been struggling with rising costs of raw materials such as lithium and cobalt.

In India, stainless steel manufacturers and end consumers will be impacted by the soaring nickel prices as the metal is used as a raw material. From a high of 81,051.50 USD, nickel futures have cooled down to 33,467.00 USD, however, the manufacturers are finding various alternatives to mitigate the price volatility in the international market. The manufacturers are switching onto different grades of stainless steel which requires a negligible or no percentage of nickel. This will ensure that the consumers will not face any inflationary pressure.

The traditional importing countries from Russia and Ukraine – European Union, Turkey, Mexico and Middle-East are and will continue to face price and supply pressures in commodities like steel, aluminium, copper and nickel. The question is will India be able to bridge supply gaps created by the Russia-Ukraine war and the consequent West sanctions especially in steel.

According to the Ministry of Steel, 11.142 million tonnes of finished steel was exported in the 10-month period of FY22, depicting an increase of 26% YoY (over 8.84 million tonnes in April-January of FY21) with 12.5% of the shipments going to Vietnam. The European markets can be a profitable opportunity for Indian steel producers as steel production has stopped in Ukraine and sanctions on Russia has put trade with it at risk. However, there will be limited scope to increase steel exports to European markets as they are limited by EU's steel quotas. The congestions and diversions in Black Sea will also make Indian exports difficult to reach EU markets. The steel producers can enjoy higher prices for some time but will eventually impact the domestic steel demand and production.

A prolonged Russia-Ukraine geopolitical tensions affecting metal prices will further impact the demand for end-products such as automobiles which pass on the hike in prices.

Tight fuel and energy supplies augmenting prices and OPEC's monopoly of supplies

Russia is the world's third largest oil producer and one of the largest exporters supplying 14% of global crude oil production to markets worldwide. While India's crude oil import requirement is over 86%, it imports 2% of the supplies from Russia. So, the general price rise in crude oil will have spill over effect in terms of inflation. The war has led the Brent crude oil to touch as high as $130 per barrel but has relaxed below $100 per barrel.

This uptick in global crude oil to near $100 a barrel and supply disruptions will impact inflation on the cost side and thus pockets of the consumers. This is apparent from rising petrol and diesel prices which have crossed Rs. 100 per litre & Rs. 95 per litre respectively. Also, the price of CNG and LPG cylinder have increased which will affect the disposable incomes of consumers. Moreover, the transportation of essential goods (food grains, fruits and vegetables) will also get costlier. Consequently, the inflation rate could rise beyond RBI's comfort level. For $10 barrel increase in oil price the inflation is expected to go up by 49 basis points (unless it is absorbed by the government). Moreover, the inflation projection has already crossed the upper tolerance limit of 6% . As of today, it looks like that high food price, commodity prices and oil price will keep the inflation high in near future.

It is time for the primary metal users to turn towards quality secondary metals and the recycling industry works on to improve the processes to match the expectations.

The increased crude prices will also impact India's import bill and widen the current account deficit apart from fuelling imported inflation in the country. India's trade deficit widened to $192 billion in financial year 2021-22 (FY22) as imports hit a record high of $610 billion because the value of inbound petroleum shipments nearly doubled as compared to a year earlier. Increase in import bill will impose more burden on the Government, thereby government expenditure might exceed budgeted estimates which in turn may increase government debt.

WHAT IS THE WAY OUT?

India shall reap the opportunity in the food grains sector by filling the gaps and making the best use of this opportunity to capture new markets. Difference between the higher prices received on exports compared with the MSP at which they were procured should be captured to a maximum extent to make good the fiscal deficit that may arise out of the higher cost of fertilizer subsidies for the farmers. Excessive industrial grade grains shall be converted to ethanol as planned and should be used to increasingly blend with petrol to reduce the price impact and make the best use of grains that may otherwise be rotting in the warehouses. Further, it is time for the primary metal users to turn towards quality secondary metals and the recycling industry works on to improve the processes to match the expectations. Impetus to the recycling industries though fiscal tools or technological assistance will go a long way in reducing the dependence on primary metal imports in many of the base metals.

As reported, India should import technically feasible quantities of the crude oil from Russia within the framework of the global restrictions to ensure cheaper crude oil and hence lower prices of its derivatives. Further allowing domestic natural gas to be sold at market prices benchmarked to imported gas will provide impetus to E&P activities and hence augmentation of domestic natural gas production in the country. Further, it is time that India augments its ethanol production capacities and enhances blending in petrol to reduce its cost in the light of excessive sugar production and availability of molasses. Several pieces of policy reforms unveiled over time in response to such exigencies will help economies maintain resilience but also sail through any future emergencies of this nature. A multilateral action when it comes to PSD of commodities under a set regime would not put in to question such supplies deepening the impact on not only warring countries but also the poorer dependent countries. Such a multilateral framework can provide for resilience of the global economies in times of geo-political turmoil.

(Dr Shunmugam heads the Commodities Education Cell at the National Institute of Securities Markets (NISM), while Mr Singh is a Senior Assistant Manager at the Cell)

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