

Upside risks remain for the commodities complex

Commodity markets remain vulnerable to Russia-Ukraine developments. Tightness in several commodities means that markets are likely to be more sensitive to any supply shocks. Tightness in energy and some agricultural commodities is set to persist for the foreseeable future



Russia's invasion of Ukraine has sparked concerns over food security. Malaysia recently banned the export of chicken

EU leaders agree on a Russian oil ban

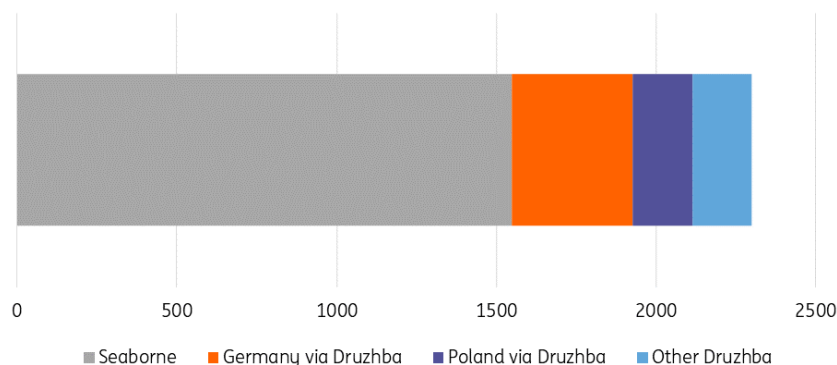
EU leaders have finally agreed on a watered-down ban on Russian oil and refined products. The ban will only apply to seaborne crude oil imports, which will be phased out over the next six months, and refined products, which will be wound down over the next eight months. From the 2.3MMbbls/d of Russian crude oil that the EU imports, around two-thirds are seaborne imports. However, we believe the EU will reduce flows by more than this, given that Germany and Poland (which are the largest receivers of oil via the Druzhba pipeline) have signalled that they will work towards reducing Russian imports to zero.

This means that around 90% of Russian oil flows to the EU could be affected. Given the gradual phasing out of Russian oil under the ban, the impact on the market should be much more limited than if we were to see an overnight ban. Instead, buyers in the EU will have time to source other

supplies, which should allow for a more orderly shift in trade flows.

Russian oil flows to the EU

Seaborne vs. Druzhba pipeline (Mbbls/d)



Source: Eurostat, IHS Markit, ING Research

How easy it will be to shift trade flows depends on the appetite for key importers outside of the EU to increase their share of Russian oil purchases. Given the significant discount available for Russian Urals, we suspect the likes of India and China will increase the amount of Russian oil they import. This should in theory free up supply from other origins for EU buyers. Whilst OPEC is sitting on enough spare capacity to meet the EU shortfall, the group has been reluctant to increase output more aggressively than it currently is.

OPEC continues to hold the view that the market is balanced and that the volatility in the market is due to geopolitical risks. In addition, it is important to remember that Russia is part of the OPEC+ alliance, and so will have some influence on what the group decides when it comes to output policy. We do not think OPEC will tap more aggressively into its limited spare capacity, which suggests that the oil market will be in deficit over 2H22, which should see prices edge higher (Brent at \$125/bbl over 4Q22). Demand destruction has helped to ease some of the tightness in the market although clearly not enough to fully offset the Russian supply losses we expect as we move through the year.

There are clear risks to our view. To the upside, the biggest risk would be if we were to see secondary sanctions placed on Russian oil. This would make it much more difficult for Russia to sell into markets like India and China, which would mean that the global market would be even tighter than we expect. We also assume that Iranian oil supply will grow over 2023. If this fails to materialise, it will leave the market tighter than we are currently predicting for next year.

On the downside, the potential for further Covid-related lockdowns in China over the course of the year could weigh on oil demand.

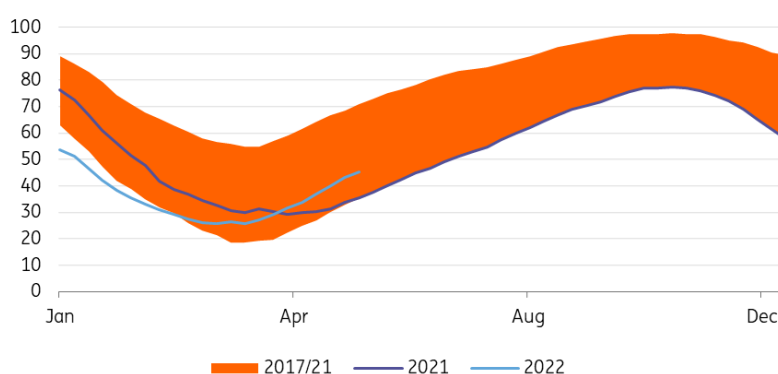
However, the bigger downside risk is if we see a de-escalation in the war or even an end to it (hopefully). This would likely see a significant amount of risk premium given back. Given the steps already taken by the EU, we do not believe that the EU would revert to its old ways and be highly dependent on Russia. However, de-escalation in the war could at least slow the process of moving away from Russian oil.

Natural gas looking more comfortable, but still plenty of uncertainty

European natural gas prices have eased significantly over the last month. In fact, prices are at their lowest levels since the start of the war. This is despite Russia having stopped gas supplies to Bulgaria, Finland, Poland, and more recently the Netherlands. These four countries made up roughly 13% of Russian flows to the EU in 2021. These buyers refused to agree to a new payment mechanism where they open a Gazprombank account to pay euros or dollars, which would then be converted to roubles. This is despite the European Commission suggesting that paying into a Gazprombank account should still be allowed, as long as the transaction is complete once euros or dollars are paid into the Gazprombank account, rather than after the conversion to roubles.

Fundamentally, the European gas market is in a more comfortable state. European gas inventories are 46% full compared to the five-year average of 49%, and above the 37% seen at this stage last year. Strong LNG imports have helped to improve the supply situation in Europe. And if we do not see any disruption to Russian gas flows this summer, European gas inventories should be more than comfortable going into the next heating season. However, no disruption to Russian gas flows is a big assumption to make. Additional buyers could refuse to accept Russia's new payment terms, which would see further gas flows from Russia cut. There is also the potential that Russia retaliates to the EU oil ban by stopping or significantly reducing gas flows. It is due to this uncertainty that we believe European gas prices will remain well supported as we head into the next heating season.

European gas inventories (% full)



Source: GIE, ING Research

Ukrainian supply hit and protectionist measures in agricultural markets

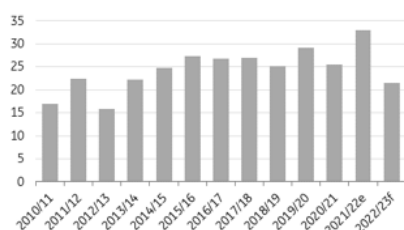
Disruption to Ukrainian agricultural exports remains a concern for global markets. Grain exports from Ukraine remain significantly affected. Exports are not possible through ports, so instead, we are seeing volumes transported via neighbouring countries. However, capacity constraints mean the volumes are significantly lower than what can be shipped via Black Sea ports. Over the first 19 days of May, Ukraine managed to export 643kt of grains (of which 96% was corn), compared to a little over 1.8mt in May 2021. There are efforts to remove blockades of Ukrainian ports. However, this will likely be difficult given that Russia will want some concessions to be made before doing so.

The impact of the war has not only had an effect on 2021/22 shipments, but it will also have longer-term effects, specifically on 2022/23 output. Ukrainian corn and sunflower seed production are expected to be down 54% and 37% respectively due to lower plantings, whilst wheat (of which most would have been in the ground prior to the war) is also likely to suffer in the 2022/23 season, with output expected to fall by 35% year-on-year.

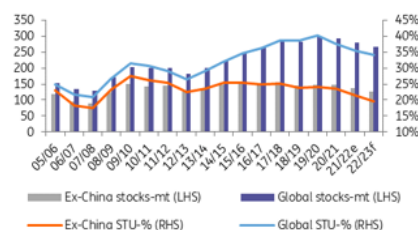
The expected decline in Ukrainian wheat supply, along with some declines from other regions, means that global wheat stocks are expected to decline to their lowest levels since 2016/17. However, more than 50% of global wheat stocks are estimated to sit in China (and are unlikely to ever be exported). Looking at ex-China stocks gives better insight into how tight the market is. Ex-China wheat stocks are forecast to finish 2022/23 at their lowest levels since 2008/09, which suggests that wheat prices will continue to trade at elevated levels.

Global wheat market to continue tightening

Ukraine wheat output (m tonnes)



Global vs Ex China wheat ending stocks



Source: USDA, ING Research

It is very clear that Russia's invasion of Ukraine has sparked concerns over food security. There is the direct impact in the form of lost Ukrainian supply, whilst there is also the indirect impact where higher fertiliser prices potentially have an impact on global agricultural yields. Governments will want to avoid a repeat of the Arab Spring that we saw a little more than a decade ago. For some, it is too late. Sri Lanka is a good example of how food shortages have already contributed to unrest. There will be a push by governments to ensure adequate food supply and attempts to rein in domestic inflation, particularly in some emerging markets. Recently, we saw Indonesia briefly ban palm oil exports, India surprised the market by banning wheat exports, which was then followed by the Indian government also imposing a 10mt export limit for sugar this season, and finally, Malaysia has banned the export of chicken. As concerns continue to grow, we could very well see this protectionist stance spread. This leaves a scenario where key importers scramble to boost stockpiles, whilst some exporters limit flows. Overall, this would be a bullish scenario for agricultural commodity prices.

Author

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@asia.ing.com

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