U.S. Commodities Markets

Military Action In Ukraine Remains A Global Wheat Price Risk

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In our May strategy note we highlighted our top five risks that have the greatest potential to impact commodity prices in 2023. These include the U.S. debt ceiling debate, a U.S./ Global recession, the El Nino climate pattern, military activity in Ukraine, and the growing geopolitical tensions with China. With the U.S. debt ceiling still lingering, and the El Nino climate pattern in full swing, we focus on our fourth item on this list: How intensifying military activity in Ukraine can impact regional and global food prices.

Since Russia invaded Ukraine in late February 2022, the impact on global commodity markets has been acute. From nickel to industrial gases like neon and krypton to agricultural commodities such as wheat and corn, the price reverberations have sent waves of logistical and financial ambiguity throughout global supply chains.

We believe that Russia's withdrawal from the informal safe corridor's agreement combined with intensifying military activity directed toward Ukraine agricultural assets presents overlooked upside price risks to U.S. and French wheat and corn futures.

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Assessed Russian Controlled Territory as of Sept. 22, 2023

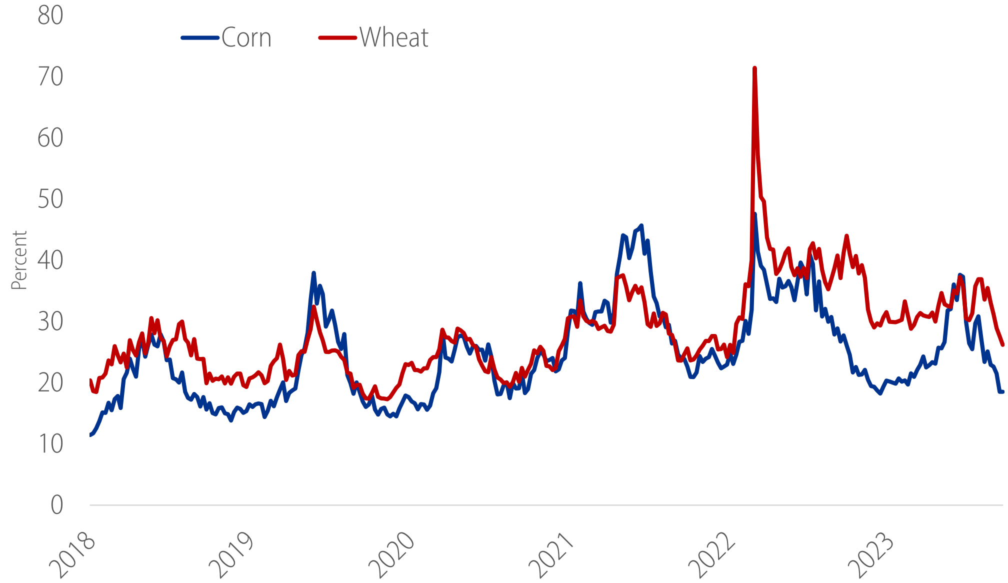
Source: Institute for the Study of War, AEI's Critical Threats Project, and HilltopSecurities.

We See Three Primary Variables Underpinning These Price Risks to Corn and Wheat

- Russia's continued reluctance to sign an agreement guaranteeing safe passage of Ukraine agricultural maritime exports.
- Escalating Russian attacks on Ukraine.
- Russia's structural appetite to own U.S. dollars. Because the global commodity trade is settled in U.S. dollars, it is in Russia's interest to increase wheat exports during the negotiation process.

As Russia withdrew from the agreement in July, U.S. corn, Chicago and Kansas City wheat implied seasonal volatility spiked to the second highest level since 2022.

Weekly Implied Volatility



Source: HilltopSecurities.

Volatility remained elevated as Russia began escalating attacks on agricultural storage facilities near key port cities of Odessa and around the Danube.

Despite the amplifying geopolitical risks, we believe the financial markets have grown complacent and are largely discounting a growing probability of increased political driven volatility in the corn and wheat markets.

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During August, Corn and Wheat Volatility Declined as Global and U.S. Fundamentals Turned Bearish

A projected 2.20 bbu MY 23/24 U.S. ending corn stocks figure, combined with a record 55.0 mmt Brazilian export program, and a strengthening U.S. dollar helped push prices lower. Falling Chicago soft and Kansas City hard wheat volatility was largely attributed to a growing and record large 49.0 mmt, +3.0 mmt YoY, MY 23/24 Russian wheat export program which has made U.S. wheats uncompetitive in the global markets.

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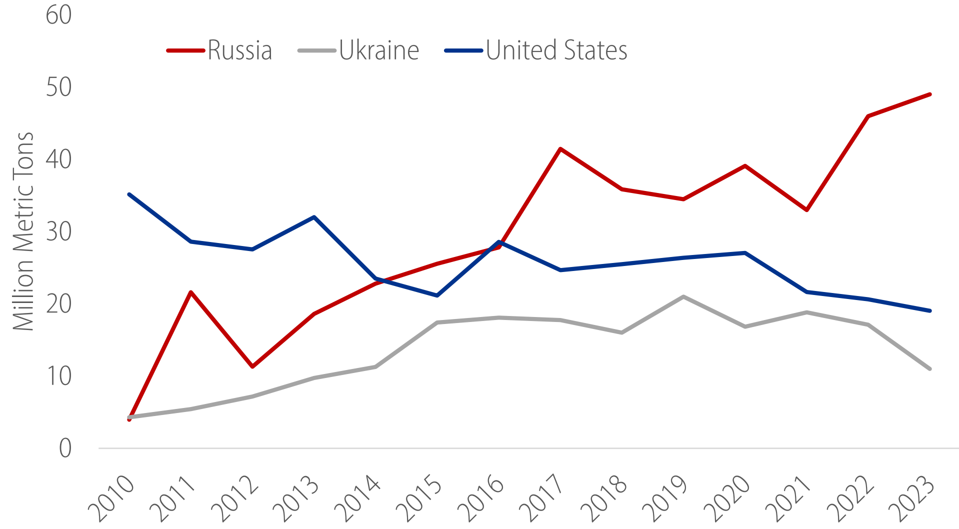
Russian Wheat Exports Creating Price Stability



Source: USDA and HilltopSecurities.

The current Ukraine driven geopolitical risk structure focuses on two key events that we believe can suppress global export supplies and reignite upwards price pressures for U.S. corn and wheat futures.

We believe that increased Russian and Ukraine military activity are risks that can slow agricultural exports while increasing volatility.

Ukraine Price Risk #1 - Restarting the Grain Deal Is Conditional Upon Russia's Questionable Demands

Since terminating the last temporary grain deal, Russia has been requesting the removal of obstacles that were implemented immediately at the start of the conflict. Indeed, after Russia invaded Ukraine, banks, insurers, and shipping companies steered clear of any Russian-related shipment and some of the states in the Baltics have stopped handling Russian exports. The two key items that represent the foundation of Russia's demand are:

1. Reopen an ammonia pipeline that traverses Ukraine.
2. Reconnect Rosselkhozbank, a state-owned agriculture lender, to the SWIFT international bank payment system.

Thus far, Turkish Prime Minister Recep Erdogan has urged the adoption of some of Russia's demands, but the UN and members from the G-20 have been reluctant to agree.

Ukraine Price Risk #2 - Increasing Military Activity Can Cause Volatility To Rise

- **Russia.** Russia has been increasing the number of drone attacks on Odessa and along the Danube River. These attacks have targeted Ukraine agricultural equipment and grain storage facilities, elevators, and infrastructure at the two river ports which have become the alternative routes to the Black Sea.
- **Ukraine.** Responding to the Russian attacks, Ukraine has launched drone attacks inside of Russia. Attacks have focused on an array of targets including energy facilities and government buildings.

We believe that any supply disruptions in the Black Sea can help stimulate risk asset flows back to the CME and Matif corn and wheat markets.

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Add to the Above a Slightly Bullish Leaning Global Wheat Fundamental Backdrop

- Dryness in Argentina, Australia, Canada, and India is suppressing global production and exports. At an estimated 207.3 mmt, MY 23/24 global exports are still robust, but the trend is downward.
- A rain-impacted EU wheat harvest, 125 mmt soft wheat -.3 mmt YoY, is boosting production but is creating quality issues and eroding protein levels. This protein deficit can hasten demand for high protein Russian milling wheat.
- Global wheat ending stocks, less-China, are at the lowest level since 2016.

HTS Commodities Views

We believe that Russia's aggressive military action against Ukraine agricultural targets, could eventually cause Ukraine corn and wheat exports volumes to contract further, which can in turn pressure supplies and increase volatility and prices.

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In an ironic twist, for a second consecutive year Russian wheat exports are forecast at a record level, 49.0 mmt, +3.0 mmt YoY. These supplies are helping to maintain a sense of regional and global price stability, reducing inflationary pressures in the regional North African and Middle East while suppressing wheat and corn volatility.

How long the region, and the world, can depend on Russian wheat exports remains a complex equation. However, because Ukrainian and Russian wheat and corn exports tend to peak during the first and fourth quarters, monthly export consistency can be ambiguous during politically sensitive periods. We believe that any supply disruptions in the Black Sea can help stimulate risk asset flows back to the CME and Matif corn and wheat markets.

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If supply disruptions in the Black Sea develop, we like owning high protein U.S. wheat and see opportunities to express this sentiment through relative value positions. Owning KC/W in the prompt month, December '23, is a tactical option. Because the U.S. soft wheat balance sheet is tighter than corn, we see value in being long Chicago wheat/corn in the December '23 contract.

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