

U.S. Commodities Markets

Impacts of Russian Military Activity on Wheat and Corn

The recent geopolitical tensions between Russia and the Ukraine have created unwanted global financial market and commodity market volatility. Since Russian President Vladimir Putin recognized the independence of two regions in the Ukraine held by Russian backed separatists earlier this week, futures prices of regionally sensitive agricultural commodities like Kansas City hard red winter wheat (KW) and Chicago soft red winter wheat (W) achieved multi-year highs.

Political risk premiums in financial instruments can be difficult to measure. Given expanding size of Russian military operations in Ukraine we believe that the 20% jump of the KW May 22 contract and the 25% appreciation of the W May 22 contract since Feb. 15, 2022 are not surprising.

Because the scope and size of Russia's political objectives in Ukraine are fluid, we believe that until the situation stabilizes it is difficult to assess the future of Ukraine's ability to produce and export agricultural commodities.

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Russia and Ukraine Are Major Global Exporters of Corn and Wheat

- Next to the EU, Russia is the world's largest wheat exporter. Russian milling wheat is a natural substitute for US HRW and occasionally the two products compete for business in the global export market.
- On Feb. 4, 2022 China and Russia signed a trade agreement that enhances Russia's ability to increase wheat and barley exports to China. China is the fourth largest importer of wheat. The agreement is effective immediately and could help Russia win market share from France and the US.
- Ukraine is fourth largest global corn exporter and over the last 10 years has displaced US corn in markets like the middle east and China. According to the USDA, at 33.5 mmt Ukraine is estimated to have a record large corn export program during MY 21/22.
- According to the most recent Chinese Customs data, through Dec. 2021 Ukraine is the largest corn exporter to China.
- US is the world's largest corn exporter and the third largest wheat exporter. Recent strength of the US dollar combined with the tightest supplies of high protein milling wheat (HRW+HRS) since MY 13/14, US wheat export prices have been uncompetitive to Russia and Ukraine.

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Allied Sanctions do not Target Russian Agricultural Commodity Exports and Were Opposed by China

- As of Thursday Feb. 24, 2022, none of the sanctions by the US, EU or the UK target, curb or ban Russian bulk agricultural commodity exports.
- The sanctions do target Russian banks. Some of these banks finance agricultural commodity export businesses and export activities. According to Bloomberg,

some European banks have begun to restrict commodity trade finance linked to Russia and Ukraine.

- Russia and the US do not engage in bulk agricultural commodity trade.
- At a UN Security Council meeting on Feb. 23, 2022 China did not agree with Russian sanctions and labeled the US actions as “immoral.”

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Russia’s 2014 Annexation of Crimea is not a Comparable Benchmark for Corn and Wheat Exports

- In March 2014 Russia annexed Crimea from Ukraine. Sanctions levied by the US, EU and the UK against Russia did not target Russian agricultural exports or agricultural exporters.
- While military action was confined to the Crimean Peninsula key Russian and Ukraine agricultural seaports remained operational.
- Despite the political turmoil and the annexation of Crimea both Ukraine and Russia exported record large volumes of wheat and Ukraine exported a record volume of corn.

Weighing the Pros and Cons of Export Demand for Corn and Milling Wheat

- According to the most recent data from Bloomberg, since the geopolitical political tensions developed in mid-January, weekly Russian corn, barley, and wheat (milling and feeding) exports from seaports have not declined.
- On Thursday Feb. 24, 2022 Russia’s military was engaged in operations around the key port city of Odessa. Reuters reported that the Ukrainian government closed the ports in Chornomorsk, Mykolayiv, Kherson and Yuzhny. According to UkrAgroConsult, the ports of Odessa, Chornomorsk, Mykolayiv account for 61% of Ukraine’s grain export volume.
- On Thursday Feb. 24, 2022 Russia ordered Sea of Azov closed to the movement of commercial vessels but kept Black Sea ports open. Most Russian wheat exports originate from ports in the eastern Black Sea and the Sea of Azov.
- Because wheat is a politically sensitive commodity it’s probable that buyers in North Africa and the Middle East which include: Iran, Iraq, Morocco, Tunisia and Syria will continue to purchase milling wheat from Russia and Ukraine. We find it noteworthy that the world’s largest wheat importer and Russia’s largest wheat export client, Egypt, has temporarily suspended wheat purchases.
- While it is undermined how long the Russian and Ukrainian aforementioned ports will remain closed, we view these closures as a potentially positive input for US corn and wheat prices. We believe that the longer that the Sea of Azov and the key agricultural exporting ports of Ukraine are closed for shipping, the greater the probability that US corn and wheat export sales can increase.
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Possible Implications for US Commodity Futures

- **Supportive KW and W.** Despite the recent precipitous rise in KW and W prices, we believe that the size, scope, and ambiguity of Russia's military campaign in the Ukraine should continue to provide directional support to the respective curves. We believe that the closure of key agriculture handling ports in Russia and Ukraine combined with reduced commodity export financing for Russian and Ukrainian deals are bullish inputs which can help steer milling wheat export business to the US.
- **Supportive Corn.** While the US corn market has different fundamentals than wheat, we find that Ukrainian port closures has the potential to be beneficial for US corn exports. Reduced export financing for Ukraine corn export deals can also be problematic. We believe that if Ukraine corn exports to China slow or stop, it is probable that the Chinese could switch import business to the US which would be supportive US corn demand and US corn futures prices.

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