

# Commodities: Does the Russia/Ukraine conflict reinforce the bull case?

BY ADAM O'CONNOR | 9 March 2022

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History tells us that geopolitics rarely matters for markets, except when it does, and then it's the only thing that matters. Recent announcements from Western officials were significant and historic, and countered the prevailing belief among analysts that the West wouldn't risk short-term economic pain in order to damage the Russian war effort.

The medium-term implications of an escalation in military activity are a potential increase in fiscal spending from major powers and, with it, a further inflationary impulse. However, the footprint the region has in the global commodities markets and the implications of major disruption to energy and agricultural production and supply could reinforce the existing case for commodities markets broadly.

## The bull case for commodities

- Commodities are broadly considered one of the best inflation hedges amongst conventional assets and have historically tended to show a low correlation with traditional assets, during hiking cycles.
- Demand for commodities has remained strong and is now above pre-pandemic levels, with China having recently restarted stimulus in response to weak data and the European fiscal recovery fund now being spent.
- Inventories are extremely tight, the lowest since 1990,<sup>1</sup> with minimal spare production capacity. The ability for supply to respond is limited, due to a lack of capital investment across commodity sectors.
- The slow supply response is arguably structural not cyclical. Amongst other factors, the rise of ESG considerations has limited the availability of capital for capex investment needed to increase supply capacity to meet future demand. It has also likely raised the price level required to attract new investment. This is particularly the case in US shale, which has effectively placed a ceiling on the oil price over the last decade.

## Ukraine/Russia – Commodity supply shock

Together, Russia and Ukraine represent the world's largest wheat export bloc with a more than 25% share of global wheat exports, while Ukraine alone accounts for almost 15% of global corn exports. Unlike energy, where there remains some, albeit limited, ability for a supply response, there simply isn't the ability for agricultural supply to ramp up if Europe's breadbasket is removed from the map (Ukraine's planting season is weeks away from commencing). This is particularly so if key shipping zones for agricultural commodities (i.e. the Black Sea) become flashpoints.

Thus, any ongoing war-related disruptions to supply could put further upward pressure on already high world food prices – which in turn could boost profits for producers.

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