

## NORD45 MONTHLY: MARCH 2022

---

### GLOBAL MACRO

The Russo Ukrainian war is in its third week and events have unfolded stunningly quickly since February 24th, its launch date. Russian progress has been slow but what's more surprising is Western unity. It's not often the West agrees on much and yet, three weeks later we have sanctions, oil bans, property confiscations and the nuclear option of banning Russia from SWIFT all being implemented. Markets have been volatile, but the overriding themes have been commodity and rate inflation. In the scheme of things stocks have been quiet outside of Russia.

Putting aside the lack of due process in confiscating Oligarch yachts and mansions, there is definitely a smell of uncertainty that some of these sanctions have potentially devastating blowback on the West. None less than the expulsion of Russia from SWIFT and the freezing of Russia Central Bank reserves overseas, notably at the US Federal Reserve. It doesn't take a big leap of faith to imagine that many central banks are now reconsidering their US Dollar deposits at the Fed if they can be frozen or confiscated due to US policy makers disagreement with the depositors. This will have a profound effect on the US dollar reserve status in the medium term despite its good intentions.

Banning Russia from utilizing the Dollar also has a feeling of nostalgia to it because just as in the days of the USSR, it is likely that Russia will resort to all kinds of commodity barter to survive. This would be beyond its considerable holdings of physical gold. Their pivot Eastwards could as easily be described as convenience for both parties; Russia has considerable resources and China has technology and hard cash.

In among all this mess, the Federal Reserve has still got to repair its policy error by raising rates to fight what is becoming a worsening inflation situation. Just today CPI touched 7.9%, a 40-year record. We continue to believe they will raise, if somewhat less aggressively at the start. If anyone is confused how a Fed can raise rates, while still easing in QE and also flooding the Repo market in dollars due to the contagion of blowback effects from sanctions in Russia, you are not alone. We continue to believe the Fed will not nearly be aggressive enough to tackle inflation and we are entering a very clear stagflationary period, telegraphed by multiple leading indicators, not least of which is the shape of the US Treasury Bond curve.

---

### AGRICULTURAL COMMODITIES

While all commodities are priced based on their supply and demand, agricultural commodities benefit from omnipresent demand due to the necessity of food and its relatively low-price elasticity. This dynamic means we often focus on potential supply shocks, which usually result in upwards price movement. To prepare ourselves for these potential moves, we look at planting, weather, and crop conditions, from which supply shocks typically derive. We also consider the potential for government intervention, and often steer away from regions where such a possibility exists, due to unpredictability of these events and their size and scope. Today, however, the market is yearning from a supply shock not seen in the agricultural commodities markets for decades: war.

The commodities most affected by the Ukrainian-Russian conflict are grains and oilseeds. To properly assess the degree of change in supply, we must consider Ukraine and Russia separately. Russian exports the bulk of its grains to the Middle East and North Africa (MENA), specifically Egypt, Turkey and Iran. Its vegetable oils and meals are exported mainly to China, as well as the MENA. We do not believe these trade flows will be severely interrupted, as each of these trading partners does not necessarily have an affiliation for the West and will prioritize their own food security, without which they will have larger problems locally. Although supply routes themselves are disrupted, and the insurance for these journeys is expensive or unattainable, governments of countries who need these goods will

find a way to support the trade. Ukraine however, will have a supply issue as many farmers are less likely to plant goods at all.

In its latest grains report, USDA forecasts lower 2021/22 exports from Ukraine of corn and wheat between 16 and 18%. Given the spring planting season would typically begin in the next 4 to 8 weeks, we conclude that this forecast must assume some sort of conflict resolution. Given where prices are moving, especially in wheat, the market is pricing in a more dire situation. If the conflict is resolved in time for planting, even if only part of Ukraine's arable land is available, prices of wheat and corn could drop precipitously. Aside from grains and oilseeds, there are immense knock-on effects from the reduced availability of fertilizers, and increased food protectionism.

Russia's fertilizer exports are mainly directed to the EU, Brazil, China, and the US. The Chinese are likely to continue this flow, and Brazilian farmers of grains, oilseeds, and cotton are currently harvesting goods ahead of winter, and thus immediate fertilizer demand is low. The EU and US, on the other hand, could have a difficult time obtaining fertilizers ahead of their planting seasons, which are expected to start in the coming 4 to 8 weeks. While prices and the current supply constraints are likely to encourage planting of wheat and corn, we note that soybean has no fertilizer requirement for economic yields. Farmers who are unable to obtain fertilizer will likely change their plans and plant more soybean than initially intended. If this does become the case, we believe the oilseeds market, although constrained by less supply of sunflower from Ukraine, will have a larger than expected influx of supply in September and October of this year.

We started the year citing that ever-rising commodity prices could eventually see an emergence of increased food protectionism and stock building from governments around the world. With the Ukrainian-Russian conflict now raging, a supply shock in key agricultural commodities from these regions is resonating, causing prices to rise significantly. Hungary, Serbia and Egypt have outright banned exports of their most important agricultural commodities, Moldova has taken the same approach, albeit only for one month, and Indonesia, the world's biggest producer and exporter of palm oil is forcing exporters to allocate significant shipping volumes towards the local market. Turkey and Argentina have also taken actions to control exports of agricultural goods. In each of these cases, governments are trying to not only to curb inflation, but ensure food security for their populations. While this course of action may make sense locally, it hampers global supplies, and further increases prices on the global market.

Countries taking protectionist measures are net importers with insignificant supply implications, except for Indonesia and Argentina, whose actions have been limited thus far. If protectionism seeps into larger exporting markets in a meaningful way, it will significantly affect prices. More importantly, however, it would redraw the agricultural supply chains around the world, directing more countries to become self-reliant on food production and processing, from beginning to end. Supply chains are already being redrawn due to the pandemic and now the Eastern European conflict, from energy to manufacturing. We suspect that nations across the globe will also begin a similar trend in food and agriculture commodities. We know from our own experience, there is plenty of room for improvement in the agricultural supply chain.