Crisis in Ukraine: The Global Risks to Commodities

From oil and gas to petrochemicals and fertilisers

By Wood Mackenzie
Theme: Global Economy
Global Research, March 07, 2022
Wood Mackenzie 25 February 2022

***

The geopolitical tensions caused by the conflict in Ukraine has had an immediate effect on the global economy and markets. There will be lasting implications for commodities, energy policy and the energy transition.

The world's dependence on Russia for certain commodities cannot be overstated – from gas, coal, oil, iron ore, aluminium, platinum group metals and zinc to copper, lead, petrochemicals and fertilisers. Many major international oil and gas companies, utilities and miners are invested in Russia.

Our global team has analysed the risks to commodities and corporate exposure, as well as the wider economic fallout. Read on for a brief outline of our views. For more detail, fill in the form to contact our experts.

Gas: short-term pragmatism, long-term change coming

The situation in Ukraine piles more pressure onto a European gas market that was already going through its worst crisis on record. Russian pipeline imports account for 38% of EU demand. If the EU were to impose sanctions that stopped Russian gas flows today, it could muddle through this winter, but struggle to build gas inventories for next winter. Prices would climb. Industries would need to shut down. Inflation would spiral. The European energy crisis would, we believe, trigger a global recession.

But Russia, too, would suffer if it halted gas flows. Consequently, we think business as usual is the most likely outcome, though the EU will inevitably be forced to question its dependency on Russian gas.

Coal: shock from European loss of Russian coal would ripple through global markets

Having to replace Russian coal volumes would result in a price shock to global coal markets and a coal shortage in Europe. Russian coal accounts for roughly 30% of European metallurgical coal imports and over 60% of European thermal coal imports. The primary issue with replacing Russian coal exports in Europe is its reliance on Russia's particular quality of coal.

Coal-fired power currently accounts for around 14% of Europe's generation mix. The impact on European power markets from a Russian coal shortage would not be as significant as gas. Crucially, though, Europe may not be able to depend on coal plants to make up for gas-fired generation losses.

Crude oils and refined products: too big to fail?

Crude oil

Although a risk, we do not expect Russia to curtail its oil exports in response to sanctions because its revenues would be sharply reduced. One sanction under consideration is blocking Russia from the SWIFT communication system and other dollar payment infrastructure. Russia has alternative payment methods, but the transition could disrupt exports temporarily.

Russia and Saudi Arabia are partners in an OPEC+ production restraint agreement. The Saudis have shown little appetite for helping the US deal with higher oil prices. In the case of an actual oil supply cut-off, OPEC would be more likely to consider using spare capacity to help offset losses.

Contact our experts with the form above to find out our views on the short- and longer-term direction of crude prices.

Refined products

Russian diesel/gas oil is of greater significance to Europe, as the region imports more than 8% of its demand from Russia. Fuel oil and residues are traded globally and often consumed as feedstocks by US Gulf Coast refiners or as bunker fuel for commercial shipping in Asia. As for crude oil, we do not expect a turn away from Russia's refined product exports.

We do not expect a demand surge based on gas-to-oil switching if the crisis affects Russia's gas exports. Fuel switching demand for heating in Europe is limited to Germany. In the power generation sector, European oil-fired capacity is either idled or shuttered, limiting the upside to oil demand.

Metals: supply disruption risk to already tight markets

Ukraine has few metal extraction and processing production facilities of scale, so the disruption to production will have a relatively small impact globally. Ceasing the output and export of certain commodities, such as aluminium, platinum group metals and iron ore, however, would have a disproportionate impact, as markets are already under supply pressure.

Of greater consequence are any limits on the ability of Russian producers to import raw materials to or export finished products from Russia. Another concern is whether counterparties are willing or able to transact with their offshore entities. As sanctions ratchet up, any metals and mining companies whose shareholders have links to the Kremlin are at risk.

Contact our experts for more on the potential disruptions to metal supply.

Petrochemicals: an obstacle to Russia's major expansion plans

The short-term impact of the situation in Ukraine is likely to be felt through two main petrochemical channels: energy prices and sanctions. Any additional premiums will probably have to be absorbed in the form of reduced margins.

The precise impact of sanctions will depend on their final form. Russia accounts for just under 16% of total European petrochemical production, with its highest exposure in the polyethylene chain. This makes Russia an important – but not critical – contributor to the industry.

Corporate: international exposure

IOC exposure to Russia is concentrated in the hands of a few: BP and TotalEnergies have by far the largest positions of the Majors. Wintershall DEA is proportionately the most exposed through its two large upstream JVs with Gazprom and the current crisis could influence the timing of its IPO.

Stricter rules around access to the international financial system could hurt IOCs' ability to receive dividends and other payments. Targeted sanctions against their Russian partners seem unlikely, but would present a much more profound challenge.

In the power sector, only legacy investments remain. They are are neither core nor strategic. The Russian metals and mining industry has seen similar diminishing international involvement. Glencore is the last one left, but its exposure accounts for less than 1% of its market capitalisation.

Economics: avoiding energy trade disruption could avert severe impact on the global economy

Russia's economy is in a better position to withstand sanctions than it was in 2014 when it annexed Crimea. The conflict hurts Ukraine's economy most. If energy flows are affected, the global impact could be severe. Neither Russia nor the Western allies will want to disrupt flows, but it cannot be ruled out.

Russia has built a reserve cushion that could soften the impact of sanctions short term. Being frozen out of international bond markets means new sovereign debt needs to be financed domestically. Reserves cover the US$ 50 billion due in principal repayments on government debt through 2025.

In Ukraine, the conflict risks disrupting economic activity and causing damage to capital stock. Its economy is likely to be back in recession in 2022 unless the situation de-escalates quickly.

Contact our experts to find out more.

*

Note to readers: Please click the share buttons above or below. Follow us on Instagram, @globalresearch_crg and Twitter at @crglobalization. Forward this article to your email lists.

Crosspost on your blog site, internet forums, etc.

Featured image is from oilprice.com

Articles by: Wood Mackenzie