

What's Hot: Russia's strike on Odesa casts doubts on grain deal

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Ukraine signed a deal – the 'Black Sea Initiative' with Turkey and the United Nations (UN), concurrent with Russia signing the same deal with Turkey and the UN on July 22. The agreement is initially valid for a period of 120 days. This would allow safe passage in and out of three of Ukraine's Black Sea ports including Odesa for the export of grain and oilseeds. However, a day after signing the international agreement, Russia launched a missile attack on Ukraine's key grain-exporting port of Odessa.

Grain deal at risk after Russian attack

The attack on Odessa appeared to violate the terms of the agreement since parties to the agreement committed not to undertake attacks against merchant vessels or port infrastructure engaged in the initiative, according to Andriy Sybiha, deputy chief of staff to Ukrainian President Volodymyr Zelenskiy. We would expect Ukraine to require firm international security guarantees before opening Odesa and making it vulnerable to Russian aggression. The attack on Odesa casts doubts on the resumption of port activity as it raises the risk for shippers and insurers. As Ukraine stands to benefit (agriculture accounts for 10% of GDP) more than Russia from the current deal it raises questions on the true intentions behind Russia's acceptance of the deal.

Plenty of loopholes to fill before returning to initial Ukrainian export capacity

In the run up to the deal, agricultural commodity prices have come under immense price pressure as the Black Sea Initiative would alleviate the tight supply situation particularly for North African, Middle Eastern and Asian markets. While the deal is a step in the right direction, it still falls short of a full resumption of Ukrainian export flows. Prior to the war, Ukraine had exported up to 7mn tonnes of grain per month. The current deal targets 4.5 – 5mn tons of exports per month, from only three ports (Odesa, Chornomorsk and Pivdennyi) that combined represents around half of Ukraine's port capacity. However, the key grain port of Mykolaiv is not included in the deal as it remains a target in the ongoing conflict. Further de-mining of Ukrainian ports won't be required as it has been agreed that Ukrainian pilots will navigate commercial vessels through Ukrainian waters to avoid mines. As active hostilities continue its hard to contemplate the normalisation of Ukrainian grain exports.

Source: UkrAgroConsult, Bloomberg, WisdomTree as of 30 June 2022.

Historical performance is not an indication of future performance and any investments may go down in value.

Agricultural commodities poised for a rebound after excessive pessimism

Wheat, corn, soybean, and soybean oil have witnessed a sharp correction in prices in recent weeks over the prospect of additional supply from Ukraine. According to Commodity Futures Trading Commission (CFTC), speculative positioning across wheat, corn, soybean, and soybean oil declined by 123%, 53%, 48% and 66% over the prior month¹ respectively. This highlights excessive pessimism in the market over easing supply situation aided by the Black Sea initiative alongside waning demand stemming from concerns over a recession.

The selloff in wheat prices has been a function of long liquidation as opposed to the market wanting to turn outright short as seen in corn, soybean, and soybean oil. According to the International Grains Council (IGC), global wheat stocks in 2022/23 are forecast to contract to a four-season low, led by drawdowns in India and the main exporters, with inventories among the exporters (US and Europe) potentially the lowest in nine years. The US wheat stocks to use ratio at 35.332 is the lowest in six years. Wheat's price decline defies fundamentals, and we expect the ongoing risk to supply to support prices higher.

Source: Bloomberg, WisdomTree as of 21 July 2022.

Forecasts are not an indicator of future performance and any investments are subject to risks and uncertainties.

In the case of corn, USDA estimates global stocks to use ratio at 26.5% in 2022/23 which is in line with the 10-year average. As a more fertiliser intensive crop, we believe corn's price is discounting the impact of the vast reduction in fertiliser applications in the Northern hemisphere over spring. A sharp rise in fertiliser prices have been prohibitive for use by farmers. This is likely to lower global yields over the next year. The natural gas price rally has impacted fertiliser prices. As gas prices continues to rise, we expect the uptrend in fertiliser prices to continue which could result in reduction of farmers usage placing global agricultural yields at risk, causing further supply pressure.

Source: Bloomberg, WisdomTree as of 22 July 2022.

Historical performance is not an indication of future performance and any investments may go down in value.

Conclusion

Agricultural commodity prices have succumbed to the pressure of the Black Sea initiative, alongside recessionary fears. However, we expect sentiment to improve as investors realise that until the conflict lasts, significant hurdles remain before Ukraine returns to normalisation of its grain export flows.

1 Source: Bloomberg as of 19 July 2022

2 United States Department of Agriculture (USDA)

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