

COMMODITIES AT WAR: FOOD FIGHT

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Higher prices supported by a considerable percentage of global production coming from Russia and Ukraine have caught many commodities in the crosshairs of the Russian-Ukraine war. Concerns are growing over the ability to source these commodities from outside of Ukraine and Russia. In this series, we explore the implications of the war on specific sectors and the possible ripple effects that may potentially be felt throughout other industries.

Background

In recent decades, the food industry has become more globally intertwined such that changes in the production of natural products from one region have a material effect on the rest of the world. Beginning in 2021, cost input inflation and supply chain pressure became critical risks to the food industry's profitability. In response, food companies have pushed higher costs to consumers in the form of price increases.

Implications of the Russia-Ukraine war on the global food industry

Russia and Ukraine collectively provide almost 30% of the world's wheat exports.^{1,2} Ukraine also accounts for 13% of global corn exports.³ Ukraine's total grain exports have already declined to 500,000 tons per month, compared to 5 million tons before the war.⁴ Ukraine and Russia are also responsible for 46% and 23% of global sunflower oil exports, respectively.⁵ Additionally, Russian troops are "seizing and destroying agricultural machinery, fertilizer, seeds, and fuel stocks,"⁶ so even a swift resolution to the war may not immediately improve supply. The result is continued inflationary pressure on food commodities and, if the war continues and escalates further, food insecurity.

Branded product companies now face the risk that additional price increases will cause volumes to decline. Due to higher grocery bills, consumers, particularly those with lower income, may trade down to private label products.⁷ Food companies with significant scale and pricing power will likely fare better than smaller peers, but taken as a whole, the effects on the food industry are negative.

On the other hand, retailers with a higher mix of private label products will likely outperform given the trading-down behavior and the continuation of consumers eating at home more frequently than pre-pandemic. Restaurants will likely still fare well in the near term as consumers try to catch

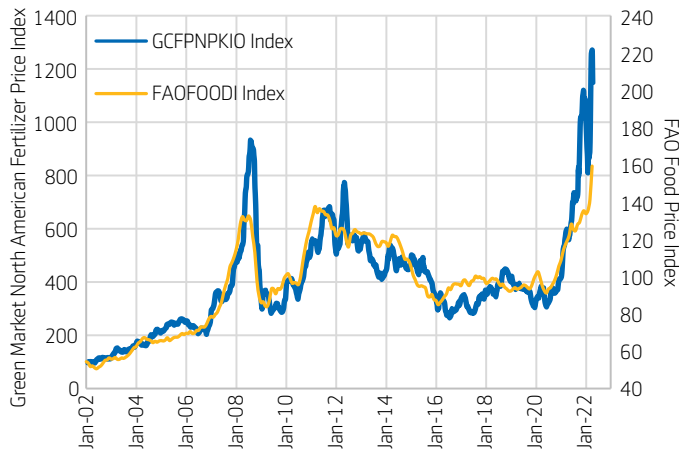
up on lost time. However, we have observed the difference between the Conference Board Consumer Expectations and Consumer Confidence (which tracks 10-year to 2-year spread really well) is currently in the 98.4 percentile, leading us to believe consumer confidence will continue to recede. All of this ultimately means that eating out will become more expensive, therefore, we see increased risk to growth.

Russia and Ukraine are not the sole producers of their commodities. Nevertheless, there is no guarantee that producers in other countries will fully fill in the gap. In the US, farmers are facing high fuel and fertilizer costs, along with long waits for new agricultural equipment. Furthermore, farmers have to manage the risk of commodity price volatility. In other words, while prices of numerous agricultural commodities are currently elevated, farmers face the risk that prices will return to lower levels by the time they are ready to harvest and sell.⁸ An example of this is the "cucumber crisis" in the UK where increased production costs have led to farmers decrease planting from 80 million cucumbers last year to a cool 35 million for the anticipated harvest this summer according to Reuters.

Potential ripple into food insecurity in parts of the world

Consumers are facing higher food prices and potential shortages. The monthly change in the United Nations' Food and Agriculture Organization (FAO) Food Price Index⁹ for March 2022 was the highest in the history of the monthly index at 12.64% revealing the impact of the war, well above the previous peak of 7.71% in August of 2010. The index consists of an export share weighted average of five food price groups. The highest subcomponent in the food price index was vegetable oil at 23.24% (cereals were second at 17.11%), which is leading to shortages in countries such as Indonesia as the government instituted price control and purchase limits.¹⁰

Exhibit 1: Fertilizer and food prices



Source: Bloomberg, FAO and Aegon AM. As of March 31, 2022.

Exhibit 1 shows there is a close historical relationship between fertilizer prices and food prices which suggests higher potential future food prices given the difficulties in the fertilizer market, as discussed in a previous [Aegon AM article](#), the first in this series,¹¹ “With fertilizer availability a concern and farmers potentially applying less fertilizer to their crops given the higher costs, global crop production is at risk of being affected, introducing risks around food shortages and further crop commodity inflation... We believe these dynamics in the fertilizer industry could persist over the next year or two; the actual timeframe depending on the duration and outcome of the war as well as ongoing sanctions.”

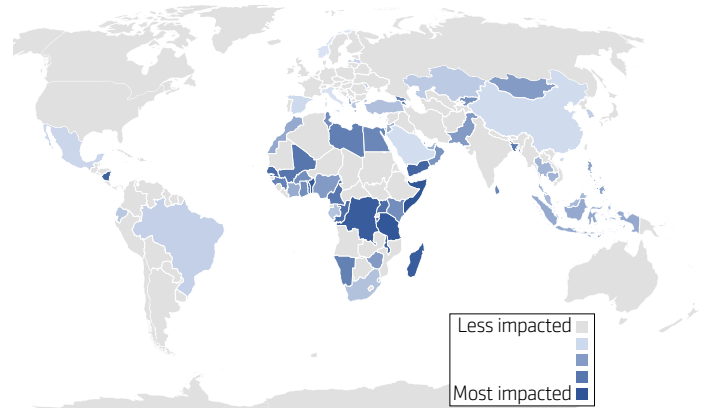
The previous peak in the food price index of August 2010 corresponds with a Russian ban on all grain exports to curb rising domestic food prices due to severe drought.¹² Today we are also beginning to see countries like Argentina, the top global exporter of both soybean meal (41%) and soybean oil (48%), raise their export tax.¹³

Another lesson from the previous food price peak is the correlation between high food prices and social unrest as the August 2010 date was a few months before the beginning of the Arab Spring protests.¹⁴ Today we are seeing food riots in Peru,¹⁵ Pakistan¹⁶ and Sri Lanka,¹⁷ foreshadowing more potential unrest to come. When people are hungry, they tend to do something about it.

To analyze which countries are most at risk of food insecurity, we follow the method of the FAO in their newly-released study, *Assessing Food Insecurity in 2022/23 at National and Sub-National Levels in 50 Countries Vulnerable to the Effects of the Ukraine-Russia Crisis*.¹⁸ The methodology will use two surveys for a current baseline by mid-2022 and follow-up impact in early 2023, as the effects on access to

food will require time to materialize. To screen for countries, they use a combination of wheat import dependency ratio to Russia and Ukraine and a per-capita-GDP for ability to find new sources. Note that this technique focuses on first order effects and does not capture countries with high grain import dependencies to other sources or other secondary effects (for example Peru). By ranking the wheat import dependency ratio and combining with per-capita-GDP rank we can derive a preview of the countries at risk. As a result, we see Sub-Saharan Africa, Southeast Asia and the Middle East/North Africa stand out as regions of potential concern (exhibit 2).

Exhibit 2: FAO assessing food insecurity—Russia-Ukraine war



Source: Aegon AM. As of April 7, 2022.

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