



The Ides of March and the Consequences of War



It would seem that the *Ides of March* (15 March) and the political upheavals associated with such a historic date have come upon the world this year sooner than expected. Just hours after promising the opposite, Vladimir Putin fulfilled Joe Biden's prediction by sending hundreds of thousands of Russian troops across the border to invade neighbouring Ukraine. The background to this war and the impact it may have been succinctly explained by Peter Little, from the Investment Management Department of Anchor Capital, in a recent article prepared for investors, but his thoughts could apply just as well for those in the mining and metallurgical world.

The cause of the conflict lies in the fact that Russian President Vladimir Putin is unhappy about North Atlantic Treaty Organisation (NATO) forces encroaching on Russia's western border, with Ukraine representing the last major buffer between NATO members and Russia. The Ukraine government, on the other hand, is pushing for closer ties with the West.

This conflict, however, has far broader geopolitical ramifications. China has stated that it backs Moscow in opposing the expansion of the Western military alliance to include Ukraine and other eastern European countries, all of whom were previously part of the old Russian Federation. Russia, in turn, has endorsed China's policy on Taiwan, saying it opposed Taiwan's independence and sovereignty 'in any form'. The two powers have gone on to warn of the risk of an arms race in the Asia-Pacific region. Such matters portend a situation far wider and more serious than initially may seem the case.

In terms of Russia and Ukraine's global economic significance, those countries represent about 2% of global economic activity and about 2.4% of the global population, so their economies are not particularly material in the greater scheme of things. However, should this conflict spill over into Europe and the USA, and China become heavily involved in such an armed conflict, their combined economic strength could become significantly more meaningful on a global basis.

As regards commodities, Russia is the world's third-biggest oil producer after the USA and Saudi Arabia, producing 10mn barrels per day (bbl/day) or about 10% of the global oil supply. Russia's energy commodities play a particularly meaningful role in the EU's energy needs. Namely, Russia provides about 25% of Europe's energy supply in the form of solid fuels, natural gas, and petroleum products. Russia and Ukraine are also meaningful contributors to the global food chain, representing approximately:

- 25% of the total global trade in wheat
- 20% of global corn sales
- 80% of all sunflower oil exports

What does all this foretell for the South African mining and metallurgical industry and this country's economy as a whole?

In terms of *economics and commodity prices*, once the invasion began, asset prices reacted sharply – gold jumped \$40 an ounce; oil went above \$100 for the first time since 2014; and share markets around the world recorded significant losses. If the conflict continues, there are predictions of well over \$100 a barrel for oil and R30 per litre for petrol in Gauteng. Such costs would have considerable impact across all facets of the South African economy, pushing prices even higher than they are at present.

Furthermore, if denied the rich oil and gas energy resources from Russia, the UK and Europe would struggle to maintain sufficient power to *support the production of goods throughout all sectors* of their economies. Of particular concern are products emanating from the iron, steel, and ferro-alloy industries, all of which require, in the course of their manufacture, inordinately high heat and power inputs. The importation of iron, steel, and ferro-alloy goods from the EU and UK for use in South Africa's mining, metallurgical, transport, building, and renewable energy industries therefore could be significantly compromised.

The sanctions currently being implemented against Russian banks and other financial agencies may well prevent the importation of Russian commodities into South Africa. One such example includes speciality high-value carbon reductants for the South African metallurgical industry.

Similarly, those South African companies that derive significant profits from brownfield and greenfield mining, metallurgical, or other large industrial projects in Russia and Mongolia *may well suffer serious losses* if such projects were cancelled due to violent conflict in the region or to the consequences of sanctions.

On the other hand, should sanctions against Russia take hold, Russia's platinum and palladium production, which is currently in deficit, would suffer further, thereby leaving the *global market open to South African producers*, and at higher prices. Sasol would be a significant beneficiary of the higher *oil prices*, and *unprecedented opportunities could emerge for South African wheat, maize*, and other agricultural and food commodities through replacing Russian markets in Europe and the UK.

Time will tell what will happen in the next few days, weeks, and months, but of one thing we may all be certain – life as we all knew it will change, but to what extent is unknown. It would be wise to consider steps in the short to medium term that need to be planned for.

Ref: Peter Little, Fund Management, Anchor Capital

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