COVID-19 and the Russian invasion of Ukraine

A working paper on the consequences of the current crisis

BY ASCAME AND THE ALEXANDRIA CHAMBER OF COMMERCE

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**Introduction**

The impact of current events goes beyond the borders of one state or continent, rather affecting the whole world. The provision of food goods and production supplies, as well as maintaining price stability, have become the world’s most important challenge after the second year of the Covid-19 pandemic. Moreover, Russia’s war on Ukraine has exacerbated the global economic situation, with its repercussions coinciding with those of the pandemic and the recession that countries are still trying to recover from.

Wheat prices have risen over the past year as a result of the decline in the proportion of global crops and supply in the face of strong and growing demand, making the consequences of this war extremely serious for wheat and grain markets in general and supply chains. On its first day, the war led to a 6% increase of wheat prices, and this increase may not be the last in the coming period, due to concerns about the consequences of the war on farmers and producers. Moreover, the Russia-Ukraine conflict has resulted in high oil and gas prices, increased transport and insurance costs, instability of trade and disruption of traffic in Russian and Ukrainian ports, as well as restriction of bank transfers to and from Russia only.

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**The effect of the war on the grain market and supply chains**

Wheat prices hit their highest levels since mid-2008, as markets tried to measure the consequences for grain and oilseed supplies of the conflict between Russia and Ukraine, two of the world’s largest exporters. The disruption of supplies from the Black Sea region has put pressure on prices and increased food price inflation, at a time when the affordability of production and transport is a major concern around the world, following the economic damage caused by the Covid-19 pandemic.

Moreover, Ukraine is home to 25% of the world’s fertile land, producing wheat that feeds many countries,
Furthermore, the global economic conditions worsened as the effects of the recession were exacerbated by a sharp decline in the economic activity, the exit of employment from industry, and the decline in shipping and productivity, which generally led to a crisis in supply chains. This was evident in the United States market, where the demand for goods increased compared to services, putting global manufacturing sectors and supply chains under unprecedented pressure. The repercussions of the conflict include container shortages, significant price increases, port congestion, and slowing operations.

In addition to this, the economic provinces between the Eastern and Western poles of the world have raised insurance prices, leading to higher prices for most commodities and energy, and if this unprecedented increase in prices continues, it is expected to lead to a decrease in disposable income, which will negatively affect purchasing power and thus reduce the overall demand level, exacerbating the Stagflation of the pre-war world economy.

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which means the war will affect food prices around the world. If the war continues until the harvest in July this year, wheat prices are expected to jump 30% and corn could jump 20%.

In addition to the problems of agriculture and harvesting — the current planting season for summer crops and its effects on the availability of goods next year — logistical turmoil and rising energy and transport costs are affecting wheat prices, as Russia is also a major supplier of natural gas and fertilizers, and international sanctions on Russia are likely to damage wheat market mechanisms and increase prices.

On the other hand, Ukraine is the largest producer of sunflower seeds, followed by Russia. In 2020, Ukraine’s total oilseed crushing capacity was about 23 million metric tons, of which 19 million metric tons were allocated to sunflower seeds, according to data from the U.S. Department of Agriculture.

Concerning the supply chains, the outbreak of the Russian-Ukrainian war led to the closure of Ukrainian ports and the suspension of exports, disrupting the supply chains of grain and oilseeds. At the same time, Russian port shipping companies are considered areas of conflict and war, resulting in risk allowances and higher insurance fees for ships, as a result of sailing in war zones that put them at risk, which is an additional cost of Russian import contracts and export contracts for potatoes, onions and manufactured products to Russia. This has led to increased food prices and a significant increase in domestic production costs in the agriculture sector.

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Impact on oil and energy prices

Global energy markets have been affected the most by the Ukrainian crisis, with prices rising strongly in recent times. Oil prices exceeded $100 per barrel, followed by other energy costs, most notably natural gas and petroleum products such as diesel. Brent crude futures rose to $113.8 per barrel in March 2022 from $66.5 per barrel in April 2021, the highest level since 2014. This will lead to higher shipping and land transport costs within countries, and thus higher food prices, which will reflect on the overall budget of countries and affect growth targets, reducing the ECB's projected growth rates for 2022 to 3.7% from 4.2%

Russia is the world's second-largest crude oil producer and provides about 35% of Europe's natural gas supply and 50% of Germany's natural gas supply. Rising energy prices pushed up inflation-linked bonds (securities with higher payouts in line with inflation), sharply reducing real yields (borrowing costs after inflation), while so-called recovery compensation has risen sharply, indicating that the risk of inflation looms over future financial markets even after the crisis.
There is also a direct impact on Europe's natural gas supply, which is introduced in many areas, so the impact of the shortage of natural gas supply would be reflected in other fuel products. In addition, the prices of energy products are linked to those of other products as a result of their impact on production, transport, and storage costs, which exacerbates the seriousness of the current inflation wave — mainly caused by the Corona-19 pandemic — and the effects of this increase in energy prices may be evident in developing countries.

This is also in line with the plans to fight climate change, as Europe tries to move away from fossil fuels (coal prices doubled in the first weeks of March) and find alternatives to fossil fuels such as natural gas from the Middle East. Moreover, the United States can take oil from Venezuela. This rise in fuel prices will lead governments to look for different alternatives because it is something that all governments must work to resolve, at a time when there is no solution unless the war is over, which does not seem very likely.

The FAO Food Price Index showed an increase in nominal and real terms (includes vegetable oil, sugar, coffee, cereals, etc.) and the increase in fertilizer prices contributed to this, given that Russia is a huge source of fertilizers. If prices remain high, this will lead to a delay in the recovery. Crops and food inflation could continue for a longer period, which was evident in the sharp, almost daily, fluctuation of stock indices in global stock exchanges, due to the intensity of the conflict between Russia and Ukraine.

Finally, it is worth noting that, even if the war ends now, the damage that occurred during it cannot be reversed, and it may take some time for the global economic system to regain its balance.

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