



S.P. HINDUJA

BANQUE PRIVÉE

# House View

MARCH 2022

# Thoughts of the CEO

«Increased geopolitical tensions increase pressure on global commodities markets.»

Since my last publication, the world has changed dramatically, putting into question the World Order we have grown accustomed to over the past 80 years. Whilst investors have been focusing on how quickly central banks were going to tighten monetary conditions to fight inflation earlier in February, attention has shifted abruptly to Russia's invasion of Ukraine more recently. Besides the ensuing humanitarian crisis, this conflict will have a deep impact on global commodities markets.

Russia is a significant commodity producer of energy – providing some 17% of global natural gas and approximately 11% of global oil supplies. Additionally, 40% of the World's palladium, which is an important element used by carmakers to remove toxic emissions from exhaust fumes, is produced by Russia. Other metals used in electric mobility include platinum, copper and nickel, which Russia is an important provider of.

Both Russia and Ukraine are also dominant suppliers of neon, a gas critical in the chip manufacturing process and a byproduct of steel manufacturing, which only adds to the semiconductor supply chain disruptions experienced since the outbreak of the Covid-19 pandemic.

Another worrying effect of the war in Ukraine is the impact on grains and food prices. A total of 20% of the world's demand for corn and c. 14% for wheat comes from the two nations at war. Poor harvests around the world have already pushed food prices to new highs, and the crisis is likely to have further dire consequences for countries depending on wheat and corn from Ukraine in particular.

The commodities industry has been one of the most prominent examples of globalisation over the past thirty years, which brought lower cost in the supply chains, but inadvertently created stronger reliance on certain producers. Heightened geopolitical tensions likely increase the risk of further

price rises and the potential of weaponising some natural resources, like natural gas for instance, as experienced late last year when Russia cut its supply to the European Union by some 25% from a level of traditionally 40% according to the International Energy Agency.

In light of such sharp price movements, investors might wonder whether it is worthwhile taking an exposure in any of the commodity compacts mentioned above to benefit from further price appreciation. Given the highly uncertain outlook of the ongoing military conflict and development in supplying the World with raw materials, it is highly likely that volatility in these markets remains high.

Gold is often cited as a safe haven in times of crises, too. I would like to draw the reader's attention to the fact that during the Global Financial Crisis in 2008 and again when the Covid-19 pandemic broke out in early 2020, the price of Gold has been subject to volatility spikes and its correlation to other asset classes increased significantly in the short term. As a result, we would advise to be cautious before taking any tactical bets in such circumstances and reiterate our view that clients might wish to consider protecting their risky assets.

Finally, a word on central banks. Having embarked on the route to normalisation after extraordinarily loose monetary conditions over the past two years, which has lent strong support to equity markets at the same time, they are now facing the challenge of continuously strong inflation and the prospects of slowing growth, often referred to as stagflation. Whilst they remain vigilant on the former in particular, the risk of any interest rate shock looks remote for now.

Yours sincerely,

Karam Hinduja



## Focus on Turkey

Whilst the Ukraine crisis lays bare the vulnerability of global raw material supplies, potentially pushing inflation higher and weighing on growth prospects - for Eurozone economies in particular - it also sends shock waves farther afield.

Outside the immediate conflict, one of the countries most affected is Turkey, which has strong economic ties with both Moscow and Kyiv. Russia is Turkey's largest import trade partner with a volume of approximately USD 30bn in 2021, representing c. 11% of the country's total imports. The main import item is natural gas – currently about 1/3 of Turkey's energy demand.

The recent unorthodox monetary policy conducted by the nation's central bank, which saw its key 1-week repo interest rate cut aggressively from 19% to 14% between August and December 2021 despite soaring inflation (54.4% year-on-year in February 2022), has weakened the economy profoundly. Unemployment is high (11% as at December 2021) and the lira has lost 90% since the beginning of 2021, leaving the population poorer and angrier.

We recommend investors remain cautious.

**Fig. 1: Turkish Lira**



SOURCE: S.P. HINDUJA BANQUE PRIVÉE

## And India...

India's bilateral trade volume with Russia was only worth about USD 8bn last year with Indian imports exceeding exports by a ratio of 3:1, thus ranking Russia 32nd for exports and 20th for imports. The top import items from Russia being crude oil, coal and petroleum products, the combined share of these imports amount to a mere 2.5% of total supplies.

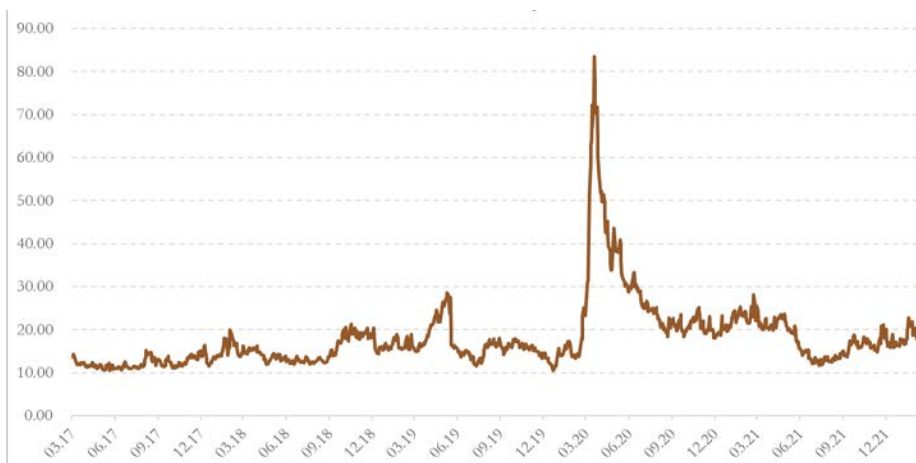
Thus, whilst individual businesses will see their trade with Russia disrupted, the direct impact on the overall economy seems not to be that significant. However, for a country that imports more than 80% of its oil requirements, pressure on inflation is likely to build further.

Since the Reserve Bank of India's (RBI) monetary policy meeting in early February the price for Brent has increased sharply, pushing consumer price inflation to the RBI's upper threshold of tolerance of 6% in January. The central bank's monetary policy committee kept the repo rate, its main lending rate to banks, unchanged at 4% for the tenth consecutive time.

With India's economic recovery slowing in the last three months of 2021 (+5.4% quarter-on-quarter versus 5.9% estimated), the RBI's focus was on continued support to enable a durable and broad-based growth path. Depending on the length of the conflict and its disruptive consequences for energy prices, monetary policy might well have to be reviewed at some stage.

The domestic equity market, for its part, is turning more skittish and has seen volatility, as measured by India's VIX index, increase to its highest level since the outbreak of the pandemic.

**Fig. 2: India NSE Volatility Index**



SOURCE: S.P. HINDUJA BANQUE PRIVÉE

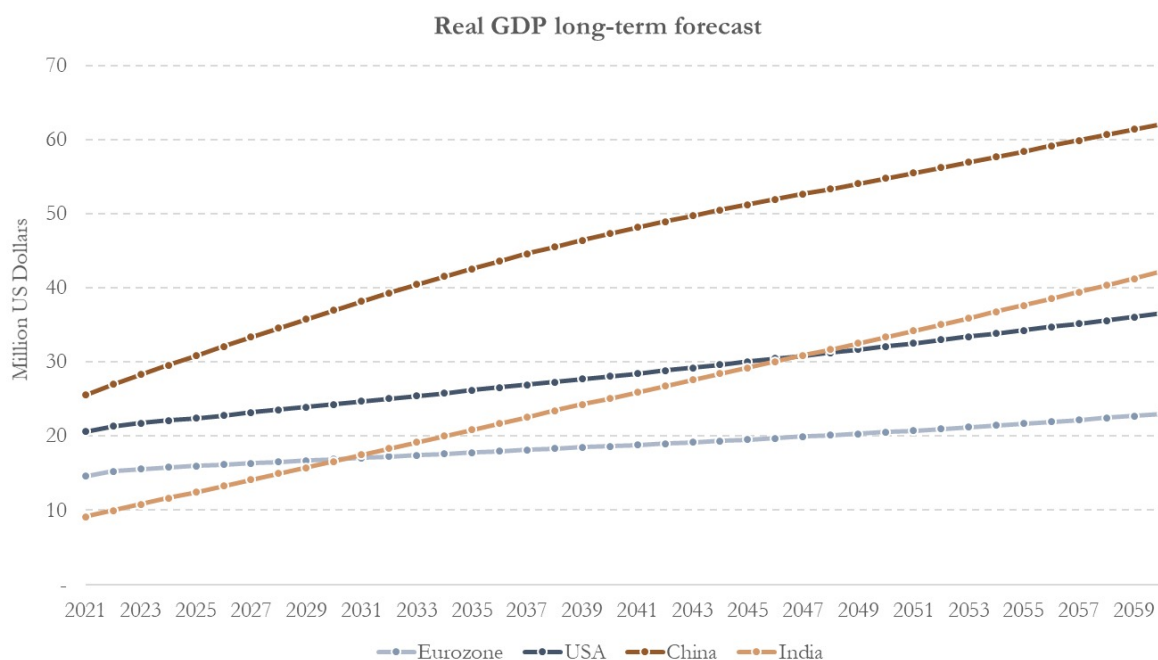


## Figure of the Month

# 15.4

Asian stocks, as measured by MSCI ex-Japan, carry a Price/Earnings ratio of 15.4, which compares to 22.5 for the S&P500 stock index as at 4th March 2022. The relative cheapness of Asian stock markets represents an attractive opportunity to enter or increase one's allocation to a region which promises to continue growing its GDP at a higher rate than many developed economies in the Western Hemisphere. According to OECD forecasts, China and India will be growing at an annual rate of 4.8% and 6.9% from now to 2030, respectively. This compares to 1.9% and 1.7% for US and Europe, respectively, over the same time period.

Longer term both countries will be the leading economies globally. As these economies grow, domestic capital markets will become broader, deeper and more sophisticated, attracting an ever-stronger local institutional investor base, which is likely to maintain a domestic bias in their asset allocation choices, and thus lending a natural support to their markets.



SOURCE: OECD, S.P. HINDUJA BANQUE PRIVÉE



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