RBC Capital Markets

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Russia/Ukraine: Darkness Falls

Update the on Russian Invasion of Ukraine

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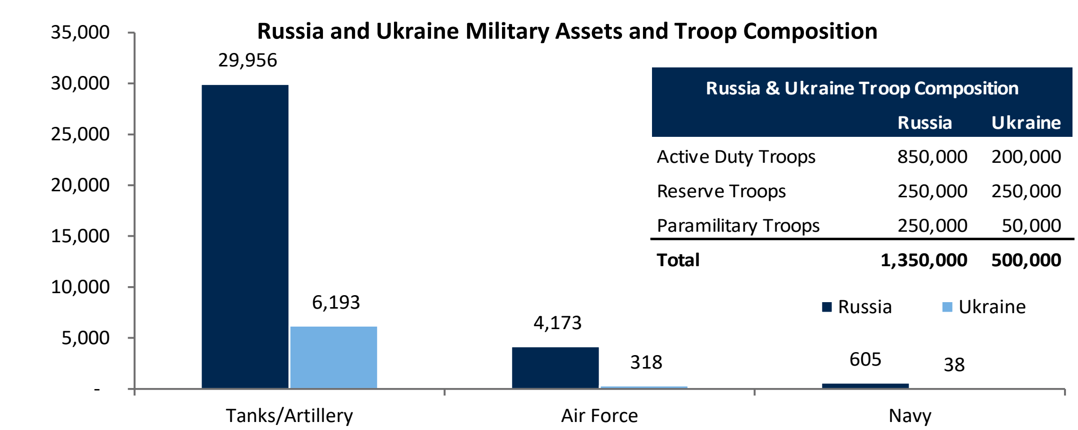
- **With Vladimir Putin ordering a full-scale invasion of Ukraine, raising the specter of a dire humanitarian crisis in Europe, Western powers are poised to impose the most punitive sanctions to date on Moscow in an effort to effectively sever the country's access to global capital markets.** Though President Putin stated that his special military operation would be in eastern Ukraine, the grave warnings of the US intelligence community about a much wider military offensive have been borne out with explosions occurring in multiple cities, strikes on critical infrastructure, and troops pouring into the country from three fronts.
- **Crude prices have broken the $100 barrier for the first time since 2014.** Though there have been no physical supply disruptions yet, there are serious concerns that Russia could move to restrict commodity exports in response to US sanctions which will likely include the blacklisting of the three largest financial institutions (VTB, Sperbank and Gazprombank), export controls on critical technology such as semiconductors, and individual sanctions on members of Putin's inner circle. An expulsion from the SWIFT payments could also be looming.
- **With the notable exception of the Nord Stream 2 pipeline project, which has already been halted, the White House has gone to great lengths to convey that it will not target the Russian energy sector and exacerbate an already tight supply situation.** Senior US officials have been engaged in a frenetic diplomatic effort to try to secure additional supplies to backfill potential disruptions. They have seemingly made more headway on the gas side with key producers agreeing to temporarily waive destination clauses. These additional gas volumes could mitigate a disruption from Ukraine, which appears a very clear and present danger, but will be insufficient if Russia is intent on curtailing supplies through the other key European pipelines such as Yamal and Nord Stream 1.
- **White House efforts to secure additional oil volumes from Saudi Arabia and the other OPEC producers with spare capacity have not proved successful to date.** As we noted in our Riyadh trip report, Saudi Arabia remains very reluctant to alter the current OPEC easing schedule, hence it looks almost certain that the White House will soon announce another strategic SPR release coordinated through the IEA. The size of the stockpile release will likely be larger than the November sale and will potentially involve more sweet barrels this time around.

Figure 1 – Russia and Ukraine Military Assets and Troop Composition



Source: Global Fire Power, CIA World Fact Book, RBC Capital Markets

All values in USD unless otherwise noted.

Priced as of prior trading day's market close, ET (unless otherwise stated).

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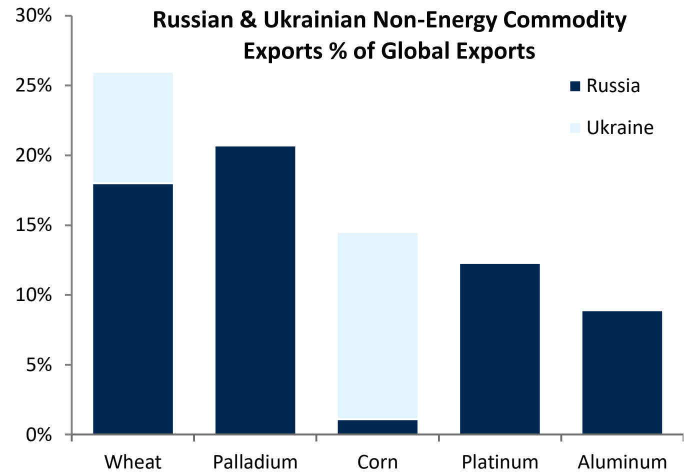
Figure 2 & 3 – Russian international reserves, Russia & Ukraine non-energy commodity exports



Source: ITC, Bloomberg, RBC Capital Markets

- **Of course, given Russia's role as a commodity superstore, the economic impact of this crisis could extend well beyond oil and exacerbate the current global inflationary dynamics.** We've continued to highlight the risk to non-energy markets given Russia's role as a commodities superstore and Ukraine's breadbasket status. As Russia and Ukraine combined account for 25% of global wheat exports and Ukraine alone for 13% of corn exports, the food price inflation risk stemming from this conflict appears acute. Given the recent Russian Black Sea naval deployments, we think there is a considerable risk that Ukraine's ports may be inoperable if active fighting commences. Around 90% of Ukrainian grain exports are transported by sea. Russia is also the largest producer of ammonium nitrate, a critical component in fertilizer, and has already moved to curtail exports of this product ostensibly to support the domestic agricultural sector.
- **Rising commodities and key fiscal reforms have allowed Russia to build a substantial foreign exchange and sovereign wealth fund war chest. International reserves currently stand above $630bln, the highest levels ever, giving the country additional bandwidth to withstand Western sanctions and a potential loss of export revenue.** Some market participants contend that Russia would not want to risk their position as a reliable supplier, but since they have just plunged Europe into the gravest security crisis since WW2, we do not think we should be naive about the willingness of the Russian leader to play the commodity export card in pursuit of his revanchist agenda.

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