BIZCOMMUNITY

Commodity price risk and its effect on sub-Saharan Africa

By Craig Kent

21 Jun 2022

The global commodity market has been suffering from wild mood swings.

Source: freepik

In the early days of the Covid-19 pandemic, entire industries came to an abrupt halt. Border closings, as well as port and factory shutdowns disrupted global supply chains, leading to severe scarcity of materials.

As the worst of the pandemic is winding down, the global economy suffered yet another blow with Russia's invasion of the Ukraine, sending commodity prices soaring, causing new supply-chain challenges and raising the cost of food and fuel.

While South Africa should potentially benefit from the sharp increase in commodity prices, the country is however plagued by structural problems - including electricity shortages, port-, transport- and logistic inefficiencies, as well as labour and product-market rigidities cited in the latest *World Bank Africa Pulse* analysis.

There are many factors at play that affect commodity prices in Sub-Saharan Africa:

Many factors at play

The global growth forecast for 2022 has been reduced to 3.2% (from 4.1%) by The World Bank, due to the impacts from Russia's invasion of Ukraine.
According to the latest *World Bank Africa Pulse* analysis, the economy in sub-Saharan Africa is set to expand by 3.6% in 2022 while South Africa's is only set to grow by 2.1%.

The International Monetary Fund (IMF) sees 2022 inflation at 5.7% in advanced economies and 8.7% in emerging and developing countries, with the pace of consumer-price increases expected to slow to 2.5% and 6.5%, respectively, in each group of nations in 2023.

The war in the Ukraine is likely to increase the likelihood of civil strife as a result of food- and energy-fuelled inflation amid an environment of heightened political instability.

Load shedding in 2022 could cost South Africa's economy R500m per stage per day as economic activity comes to a halt during power cuts.

The recent devastating floods in KZN are adding pressure with damage to infrastructure, adversely affecting transport and logistics.
Then there remains the heightened risk of new riots or security instability, specifically in KZN (South African's main ports province), driven by party leadership battles.

Uncertainty ahead: The state of African consumer sentiment
15 Jun 2022

At the same time, cyber-attacks, extreme weather conditions and economic uncertainties are all contributing factors to increased commodity volatilities, causing major concerns for businesses.

In Aon's 2021 *Global Risk Management Survey*, the risk of commodity price risk and scarcity of materials has registered its highest-ever ranking (number four) since it was added to *Aon's Risk List* in 2009. The global financial crisis in 2008 drove the commodity price risk to a similarly high ranking (number five).

While preparedness for this risk has improved, loss of income in the past 12 months has almost doubled from 28% in the 2019 survey to 50% in 2021.

The top threats

As expected, the food, agribusiness and beverage industries perceive commodity price risk as a top threat. Russia and the Ukraine are both key players in the commodity market, affecting crude oil, natural gas, fertilizer, wheat, barley, rye, maize, cereals, sunflower seeds and sunflower-oil markets.

Meanwhile, the industrials and manufacturing sectors also rated commodity prices as a number one risk. The Institute for Supply Management (ISM), based in Washington D.C., said that "record-long lead times due to port closings, wide-scale shortages of critical basic materials, rising commodities' prices and difficulties in transporting products are continuing to affect all segments" of manufacturing.

For example, since electronic chips have become an essential component in so many products, their shortages not only affected electronics and automobile manufacturers but also firms selling medical devices, chemicals, apparel and even tobacco. CNBC reports that at least 70 Standard & Poor's (S&P) 500 companies highlighted chip shortages during their 2021 second-quarter earnings calls.

There's no telling how long the lag in demand will outpace supply. The big question is whether shortages and price hikes are temporary by-products of the pandemic, as some experts claim, or if the global economy is changing in ways that could permanently hike the cost of doing business and usher in a new era of inflation. Hanna Ziady with *CNN Business* points out that the commodity price risk has huge implications for investors, companies and governments.

Mitigating the risk of volatility

According to experts at Tracc Solutions, business leaders need to formulate a two-pronged strategy to mitigate the risk of commodity-price volatility and escalation by first incorporating detailed cost tracking, projections under various scenarios and risk analytics.

Procurement departments need to become agile and adept within the full gambit of derivative instruments to facilitate the widest possible hedging opportunities.

At the same time, companies should focus on the proximity to raw-material sources and their value-to-sustainability quotient; thus indicating the need for businesses to more frequently revise their medium- and long-term strategies, as well as reviewing their strategic risk indicators.

Given the pressures on commodity pricing, building broader resilience and agility is a partial mitigant to this external threat. Understanding and integrating various risk-management solutions is key to navigating new forms of volatility and solving emerging and long-tail risks. Various risk-management solutions is key to navigating new forms of volatility and solving emerging and long-tail risks.

ABOUT THE AUTHOR

Craig Kent is the head of risk management at Aon South Africa