# Beyond Ukraine

## Shelling, Suspicion and Steel:
## Dismantling Ukraine's metals market

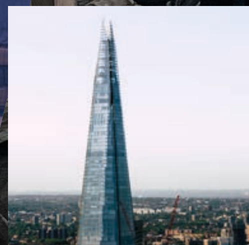
The metal industry's supply chain has suffered greatly in the wake of the crisis in Ukraine. Outside of Ukraine and Russia, the disruption in the supply of metal products will be felt all over the world.


# Production

**Azovstal had been active in growing and extending their output in recent years.** In 2020, 20 new product types were mastered, including two in the area of continuously cast steel semi-finished goods and 18 in the rolled steel segment. Azovstal also received a ship steel certificate and a quality certificate for steel supplies to the United Kingdom from the US Classifier in 2021. Before the plant's operations were halted, the aforementioned manoeuvres signal **the plant's increasing worldwide reach**.

To look at firstly Azovstal itself, the steelworks has become a strategic battleground between Russian and Ukrainian forces. Situated in Mariupol, a key port city and also is part of the industrial region known as the Donbas. **The city has been a key Russian objective since the invasion began.** Its recent capture aids Russia further establishing a land corridor from Russia's border to Ukraine's Crimean Peninsula and also deprives Ukraine of a major port and prized industrial assets.


The Economist found that in 2021 countries that represent more than 77% of global GDP imported significant quantities of at least one base metal from Russia or Ukraine in that year.



Much of the steel used in internationally significant landmarks originates in Ukraine, including the Shard, came from the Azovstal steelworks.

# Azovstal suspended operations on March 20, 2022
# The first time since 1941, when the Germans invaded during WWII

Picture: Dmytro Kozatsky

Prior to the war, Ukraine and Russia accounted for roughly 20% of EU finished steel imports.

**$10 billion**

Pre-war value of SCM group's two Mariupol plants (including Azovstal)

**Over $20 billion**

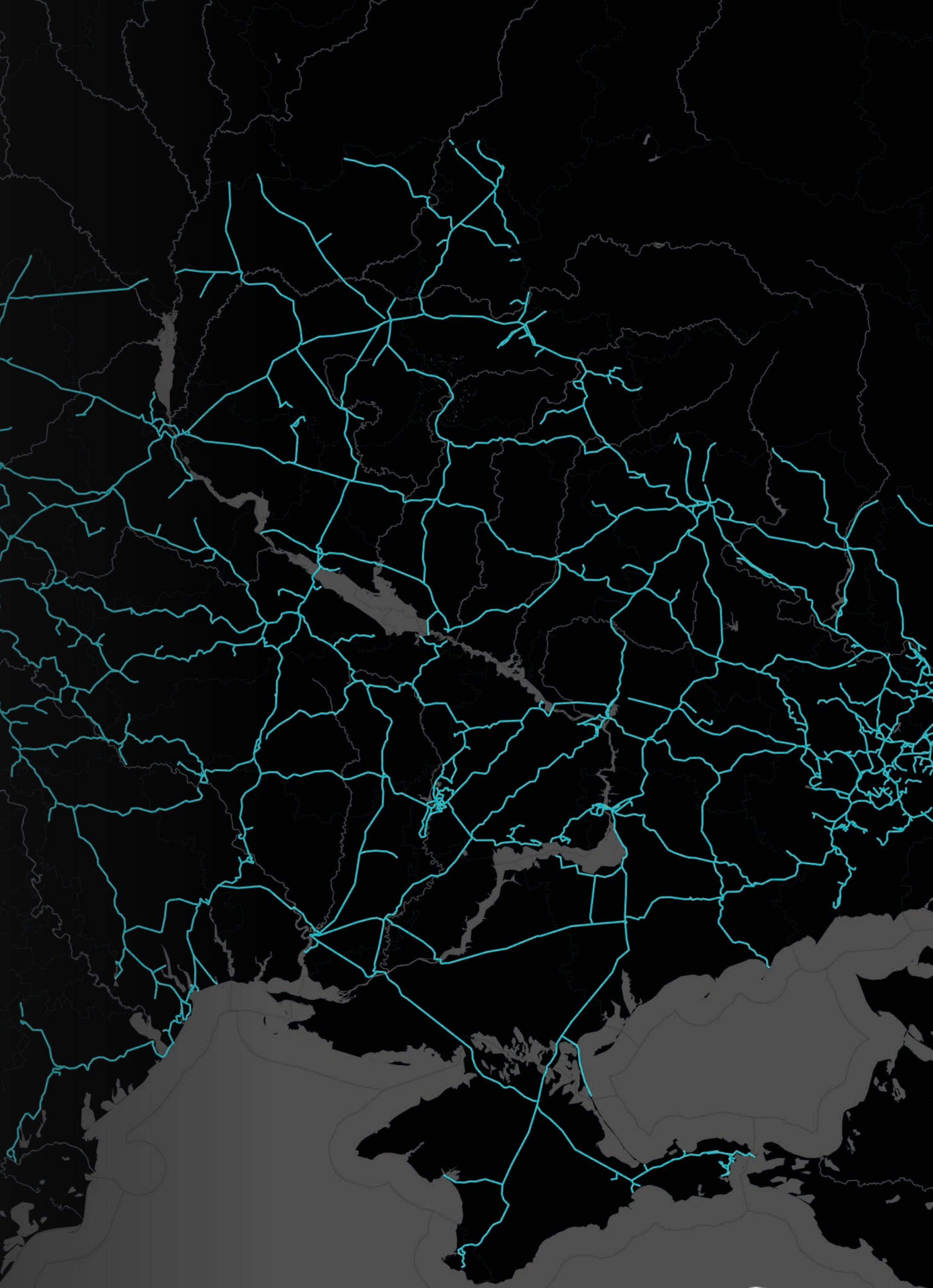
Entire value of SCM's assets damaged due to Russian military assault

# Transport

Azovstal is a prominent player in the worldwide metals market, as well as a significant contributor to Ukraine's internal transportation infrastructure. Azovstal is the sole wide gauge railway and rail fastener manufacturer in Ukraine with Azovstal supplying Kyiv with 200-300 tonnes of rails per year to rebuild tram lines. As Ukraine operates on a wide gauge railway system, there are already difficulties in connecting with the rest of Europe via this method. The majority of EU countries entirely operate on standard gauge railways, meaning the flow of goods to Europe from Ukraine via rail is extremely low.

However, if Ukraine's domestic railways are compromised, the country's export choices are severely limited. Although ports handle the majority of Ukraine's exports, inland areas nevertheless require a means of transporting commodities to these ports. With Ukraine's domestic railway system impaired, many of the country's commodities, including metals will be stranded with few options for export.

While fighting is now mostly confined to the east of Ukraine, Russian military aggression targeting critical assets has severely impeded supply routes elsewhere in the country.



Ferrexpo Plc, a Swiss mining company with a focus on Ukraine, announced on 13 June that it was reducing its iron ore production after a transport route in the southwest of the country, where they have a port in Pivdennyi, was damaged by the country's ongoing conflict, affecting the group's exports to European customers.

Ferrexpo also stated that the conflict has harmed the company's capacity to utilise its barging operations, which delivered 0.8 million tonnes of iron ore in 2021. The company claimed that until an alternative logistics route is agreed upon, the damaged infrastructure is reopened, and/or Ukraine's Black Sea ports restart operations, its output will be curtailed. Unfortunately, given the port's location between Odesa and locations already being targeted by Russia, such as the newly taken Kherson and the recently hit Mykolaiv, this area of Ukraine could become the new Russian focus. The Black Sea is logically the next step after Russia's achievement in shutting off the Sea of Azov.

Despite the fact that Ferrexpo's mining operations are solely in Ukraine, the company is the world's third largest exporter of iron pellets and has branches in Switzerland, the United Kingdom, Dubai, Singapore, China, and Japan. The current situation is already causing substantial challenges for Ferrexpo's production and export, and the situation, particularly their export capacities, is certain to worsen.


This risk is of course not unique to one or two companies. The entire iron and steel industry in Ukraine is centred in the central (Dnipro, Kryvyi Rih, Nikopol), southern (Zaporizhia), and eastern (Donets Basin, Mariupol) areas, with 14 iron ore mining firms, 15 steel mills, and three ferroalloy facilities. These places are all areas of current Russian military interest, which is not a coincidence. Since the start of the conflict, these areas have been subjected to missile attacks and shelling, all of which have the potential to disrupt production and transport routes in and out of these areas. Russian military aggressiveness in these areas shows no indications of abating, meaning Ukraine's metal industry must prepare for a prolonged period of supply chain interruption.

In addition to the inability to export metals out of Ukraine, there are similar issues on the Russian side. Precious metals like gold and palladium were typically sent from Russia to locations such as Switzerland and London by flight. As the majority of Russian flights are grounded, coupled with container shipping lines not stopping at Russian ports, there are less and less ways of getting the metals out of one of the largest metal exporting countries in the world. Exporting Russian gold is facing additional roadblocks in recent days, on 26 June at the G7 summit, it was announced  the UK, US, Japan and Canada will lead G7 to ban import of Russian gold, the country's biggest non-energy export.

# Buyer weariness

As well as physical impediments to Russian and Ukrainian metal supply chains, a psyche has developed amongst buyers who are wary of using Russian metals in light of sanctions. Whilst no direct sanctions have been introduced against the metal industry, self-restrictions of buyers fearing secondary sanctions and general stigma are interrupting existing supply chains.

Several metals businesses have stated that they will not take on new Russian business because of the mounting adversity, while others are actively seeking to detach themselves. This is making it more difficult for Russia's metals producers to export any unsold supply, and it may force them to decrease production if nothing changes by the time long-term agreements expire.

Adding to the difficulty for metal companies sourcing Russian metal, traders say it's nearly impossible to find banks willing to finance new purchases of Russian metals, even in China, the world's biggest metals consumer. Although Chinese bank's reluctance to take on new Russian metal contracts may indicate a reduced probability of any future aid to Russia, or carrying out similar actions in their backyard, the outlook for the metal business is less favourable, based on such major metal importers keeping their purse strings tight.

# Outlook

Depending how long the Russian invasion continues, the fate of the metals industry in Russia or Ukraine varies. In the short-term, supply chain issues are less dire. For instance, due to the 2014 Crimea invasion and shortages in the last 18-24 months, many palladium focused companies, who are incremental for the semiconductor supply chain, introduced risk mitigation measures and have anticipated there will be no short-term impact.

However, these same corporations have expressed their worry about a protracted Russian invasion. Because the semiconductor supply chain is so intertwined, increasing tariffs and trade restrictions will raise industry costs. Production line closures, price rises, and reduced output might all have major implications.

Furthermore, Russian palladium exemplifies one of the most important geopolitical characteristics of crucial minerals: alternate sources are frequently found in equally difficult markets. South Africa is the world's second-largest palladium producer, but its mining sector has been plagued by strikes for the past decade. This emphasises the fact that identifying alternatives is not always a simple fix.



In terms of the conflict itself, there are multiple factors which may contribute to an escalation and continuation in the Russian military offence. President Zelensky had previously raised concerns over the effect of Ukraine's bid to become an official candidate for the EU and that if passed, it is unlikely Russia would view the manoeuvre as anything other than further Western encroachment and punish Ukraine for doing so. Zelensky's concerns appear to have materialised. On 23 June, Ukraine alongside Moldova was granted EU candidate status. On 27 June, Russia fired two Kh-22 anti-ship missiles into central Kremenchuk, Poltava Oblast, hitting the Amstor shopping mall and the Kredmash road machinery plant. The strike was one of Russia's most brazen acts since the beginning of the invasion and the fact it came so shortly after Ukraine's EU candidate cannot be ignored. Increased Russian attacks will undoubtedly hit key industry areas, meaning metal plants and supply routes risk further damage.

There's also an incentive for Russia to keep up the pressure on Ukraine's infrastructure, at least until the winter. With rising gas prices across Europe making government leaders increasingly concerned about the impending winter, Russia may take advantage of this situation and play the long game, continuing to target Ukrainian assets in order to gain concessions from Europe, which may be in a more desperate position by that time.

Of course, this situation will have an impact on the metal business, as many companies will struggle to stay afloat in response to rising overall costs and constantly disrupted supply routes. If alternate sources of key metals are not available, these corporations may have little choice but to increase their risk tolerance in these areas. However, because the threat is posed by state-level missiles rather than sporadic gunfire, it is hard to envisage metals corporations accepting such a risk. Metals firms will need to keep a close eye on geopolitical developments in order to assess and reassess the viability of present risk mitigation measures.

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