Responsible Investment

Market Insights

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BSP
BENEFIT STREET PARTNERS
by Franklin Templeton

Weather Risk and Credit Resilience: The El Niño Effect

More extreme weather patterns are creating operational and financial challenges for businesses as heat, drought, flooding and changing rainfall alter the availability and cost of key inputs. El Niño brings this risk into sharper focus. Its effects will extend across multiple markets, but the most direct exposure is likely to sit in food ingredients and food manufacturers where input production is concentrated in a relatively small number of regions and weather disruption can take time to flow through supply chains. BSP Ltd's view is that lenders should assess how prepared borrowers in the space are to manage such disruption, as weather shocks can quickly test margins, liquidity and operational resilience. Climate-related impacts should therefore form part of the assessment of a company's creditworthiness.

El Niño is a global recurring weather event that can alter rainfall, temperatures and storm activity across key producing regions, with effects that vary by commodity and location. Drier conditions in Southeast Asia can weigh on palm oil yields, affecting a widely used ingredient in cooking oils, baked goods and packaged foods. Weaker monsoon rainfall in India can affect sugar production and contribute to tighter export availability. Changes in sea temperatures in the eastern Pacific can reduce anchovy catches off Peru, constraining global fishmeal supply. This can raise feed costs for aquaculture and livestock producers worldwide and, ultimately, increase the price of farmed fish. These impacts can affect food businesses through higher input costs, supply constraints and changing consumer demand as food prices rise.

Cocoa illustrates how quickly the impacts of El Niño can move through the value chain. During the 2023-24 El Niño, changing rainfall patterns in West Africa disrupted production in a region responsible for the majority of global cocoa supply. Cocoa prices rose above $10,000 per tonne in 2024-25, compared with the roughly $3,000 per tonne that had prevailed through much of the preceding decade. Higher costs could be passed through in part, but the effect on the sector was broader: consumer demand weakened, products were reformulated and higher inventories increased cash requirements.

In 2026, uncertainty around El Niño is already creating challenges for chocolate and confectionery manufacturers. Heavy rainfall in West Africa, coupled with the rising probability of a particularly intense El Niño event, has increased concerns about the current cocoa crop and pushed spot prices higher over the summer. Further weather disruption through the winter could tighten cocoa supply, increasing raw-material costs, putting pressure on margins and requiring manufacturers to manage pricing, inventory and liquidity carefully.

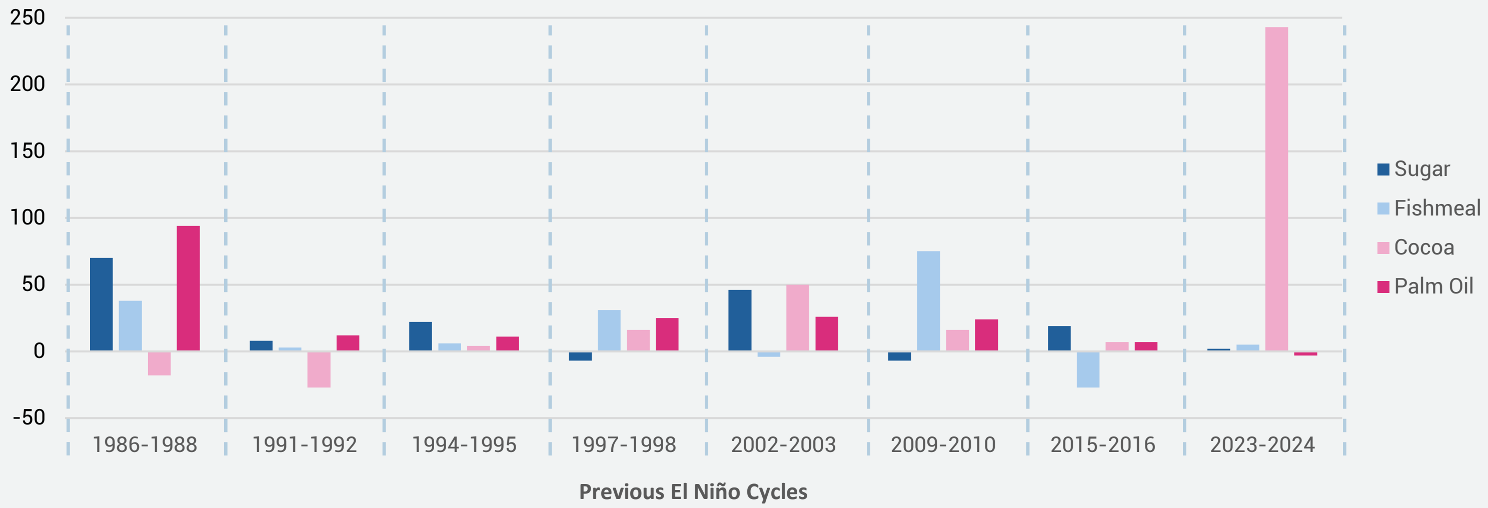
For BSP Ltd, the extent of this climate-related risk depends less on sector classification than on a company's operating and financial flexibility. Ingredient suppliers with contractual pass-through mechanisms, diverse sourcing and stronger margins may be better placed to manage volatility than those reliant on annual price negotiations.

Food manufacturers face a more difficult balance: they must recover higher ingredient costs while retailers and consumers may resist further price increases. Businesses may also build inventories as supply uncertainty rises, increasing working-capital needs.

BSP Ltd believes climate risk should form part of the credit assessment. In our view, lenders should consider how weather disruption could affect a company's cash flow and financial flexibility, whether management can secure alternative supplies or manage price exposure, and whether the company has sufficient liquidity to withstand a prolonged shock. BSP Ltd also believes that adaptation is equally important: investment in resource efficiency and operational continuity can benefit a business through strengthening its resilience while reducing costs over time.

The outlook for El Niño remains uncertain, and its effect on individual commodities will depend on its intensity, timing and regional weather patterns. That uncertainty is itself relevant. Businesses cannot control the weather, but they can reduce the extent to which a weather event becomes a balance-sheet event. For BSP Ltd, climate is becoming an important underwriting consideration: companies that identify climate-related vulnerabilities early and maintain the operational and financial capacity to respond should be better positioned to protect earnings, liquidity and credit quality through periods of disruption.

Percentage Change in Select Commodity Prices During Previous El Niño Cycles (vs. preceding non-El Niño years)



Source: MacroBond (S&P Global, Central Reserve Bank of Peru, World Bank).

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