Painful return to reality beckons

Huge challenges face chemical companies as central bank stimulus comes to an end and markets return to supply and demand fundamentals

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The flow of artificial stimulus money is drawing to an end

PAUL HODGES INTERNATIONAL ECHEM

Slowly but surely, reality is returning to oil and feedstock markets. Brent crude prices are returning to their historical level of around $25/bbl and price discovery is returning to currency markets, with the dollar rising strongly against most other major currencies. Yet there is no going back to the future in terms of demand.

Instead, a paradigm shift is under way in this vital area. For the first time in history, domestic demand growth in most countries is being driven by the needs of the lower-earning, lower-spending "New Old" 55+ generation. As the chart shows, 1bn people are becoming "New Olders" between 2000-2030. By then, they will be more than one in five of the global population. In export markets, China's New Normal economic policy has become the basis for its Five-Year Plan for 2016-2020. This sets out a clear pathway towards self-sufficiency in many value chains, meaning that the country will no longer provide a home for surplus domestic product.

Consensus wisdom has thus failed us, yet again. But as I have long feared, it will be chemical companies and investors who have to bear the costs of this failed analysis. The coming year is therefore likely to prove very uncomfortable:

- Boards that have sanctioned export-oriented projects are going to have to consider whether to proceed, or cut their losses. They face binary decisions, with no middle ground.
- Can they be sure that these projects can instead be sustained by increases in domestic demand? And are they really clear about the potential drivers for this demand in the future? The *Financial Times* summarised new research from the US-based Pew Foundation thus:

"Companies struggle to adapt to an over-60s group that is set to drive half of all US spending growth" (Middle class meltdown, 10 December 2015).

PUMPING UP PRICES

This is the Great Unwinding of policy maker stimulus in action, as I have described in previous issues (*ICIS Chemical Business* 3-9 November 2014 and 2-8 March 2015). The problem we face is that over the past decade, via ever-increasing amounts of stimulus and quantitative easing, the world's major central banks have deliberately pumped up prices for financial assets. The aim of this money-printing was explained by then US Federal Reserve Chairman Ben Bernanke in the *Washington Post* on 3 November 2010.

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>
> **BEN BERNANKE, 2010**
> Chairman (then), US Federal Reserve

"Higher stock prices will boost consumer wealth and help increase confidence, which can also spur spending. Increased spending will lead to higher incomes and profits that, in a virtuous circle, will further support economic expansion."

Their economic models assured them, despite all evidence to the contrary from the real world, that stimulus could somehow return us to the demand levels seen during the Baby-Boomer-led Super Cycle. They believed they had become modern “Masters of the Universe”, able to control an economy of 7.3bn people with just the touch of a money-printing machine.

Now, the hollowness of this claim is being exposed, as markets return to being based on the fundamentals of supply and demand, rather than tidal waves of central bank liquidity. The end result is that companies face chaos in both feedstock and product markets. And this chaos could take a long time to resolve itself. This is why we are publishing with ICIS, a major new study that addresses the five critical questions which will dominate every company’s agenda in the next few months:

- Can businesses still plan ahead for demand by simply using a relevant multiple for each product in relation to an IMF GDP growth forecast?
- Can companies continue to assume that oil prices will inevitably return to recent highs, or are prices more likely to stabilise at the $25/bbl level seen before 2004?
- Do China’s New Normal policies mark a complete change of direction from its previous role as the manufacturing capital of the world?
- Will today’s globally ageing population maintain the same levels of demand for autos, housing, or electronics as in the past?
- Should companies focus on new growth areas for demand, in potential megatrend areas such as water, food, shelter, health, mobility and the environment?

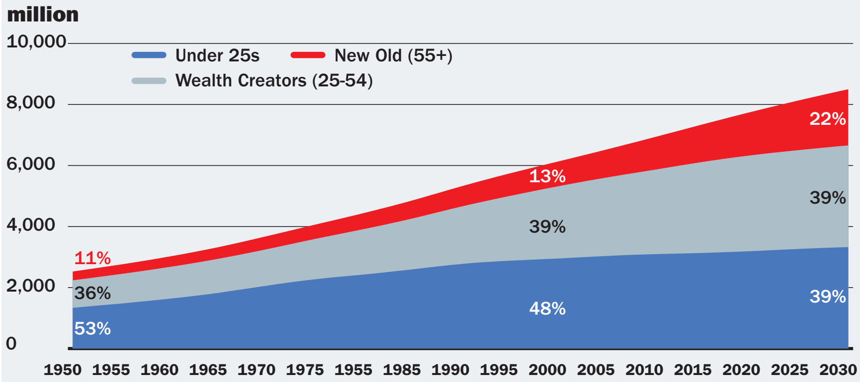
NO MIDDLE GROUND

My key concern is that this chaos will create winners and losers. There will be no middle ground. Winning companies will accept that the world is moving into a New Normal which will be quite different from previous experience. Losers will cling vainly to the hope that change is not inevitable, and that the world will return to the comfortable Old Normal, where constant demand and robust profits were the norm. The year 2015 has thus proved to be the tipping point that I foreshadowed in last year’s outlook:

“The first of these transformational changes is the supply glut that now exists in all the major energy markets – oil, gas, coal and renewables. The second is China’s emergence as an exporter rather than importer of petrochemical and refinery products. The third is the reduction in global growth prospects caused by the impact of today’s ageing global population and high levels of unemployment among young people. The fourth is technologically driven, as ‘the internet of things’ becomes as ubiquitous as the smartphone.” (*ICIS Chemical Business*, 5-11 January 2015)

Of course, all those who claimed oil prices could never fall below $100/bbl, and that China’s double-digit economic growth would continue for decades, will now rush to claim that they always knew the stimulus programmes would fail. In a world dominated by 140-character tweets, and sound-bite news, they imagine no-one will challenge their new claims. But the old phrase “once bitten, twice shy” comes to mind. Ask to see examples of what they were saying a year or even six-months ago on the subject, before agreeing to follow their advice this time around. Having argued with conventional wisdom for some time, I can guarantee you will quickly unmask most claims to have foreseen today’s chaotic reality.

GLOBAL POPULATION SEGMENTS, 1950-2030 (MILLIONS & %)



SOURCE: pH report, UN Population Division

My major concern is the vacuum created by the failure of the stimulus policy to produce the promised results. What is your business to do now, faced by overcapacity in most feedstock and product markets? How can you quickly reposition to open up sustainable new revenue and profit streams? What do you have to do to survive and prosper in this New Normal, when risks are mounting all around you?

ROADMAP FOR THE FUTURE

This is the value proposition for our new Study. We aim to answer the key questions for your business, and provide a roadmap for the future:

- What would be the consequences of $25/bbl oil prices for new olefin and derivative projects – both shale-driven US projects and China coal-to-olefins?
- What is the potential impact on cracker operations and petrochemical/polymer margins of on-purpose propylene production via propylene dehydrogenation from low-cost LPG?
- What does the potential arrival of the “peak car” moment in the global autos market mean for propylene and butadiene (BD)?
- What will be the impact of oversupplied refining markets on the current by-product status of benzene and on key derivatives?
- What is the demand outlook for derivative markets such as purified terephthalic acid (PTA) that are now suffering major oversupply? Is this a wake-up call for other value chains?
- What do these developments mean for inter-polymer competition?

Equally important is that we will then be able to identify your key strategies, in four critical areas:

- How can producers and consumers position themselves to not only survive in this uncertain world, but also build profitable new businesses?
- How can they create more service-based businesses responding to the megatrends of food, water, shelter, health and mobility to establish sustainable profit streams?
- How can companies develop successful pilot programmes to tap the potential of the major growth taking place in the world’s New Old 55+ generation?
- How can investors model the impact of these developments on future cash and revenue flows, and build their confidence over future investment returns?

We are living in very uncertain times. Past performance is no guarantee of future success but it remains the best guide we have. I therefore hope we will have the opportunity to help you overcome current challenges, and build a profitable business for the future. ■

ICIS / INTERNATIONAL ECHEM STUDY

The study “How to survive and prosper in today’s chaotic petrochemical markets: 5 critical questions every company and investor needs to answer” covers the olefins, aromatics and polymers markets. See how feedstocks and product supply and demand will impact your business and investments over the next 10 years.
For more, visit **www.icis.com/contact/supply-and-demand-study**