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Oil slide continues

Chemical industry will change as a new regional feedstock position influences cost dynamics

As oil continues to collapse past the $30/bbl mark, the global chemical industry faces some new realities if - as looks likely - these low prices persist.

Although the heads of some oil companies such as Shell's Ben van Beurden are still talking up the oil price (he needs a higher price for the proposed $51bn merger with BG Group to make sense), increasing numbers of analysts disagree. International eChem's Paul Hodges has been predicting $20-30/bbl since August 2014 and he has now been joined by the likes of Goldman Sachs and Morgan Stanley in expecting the rout to continue and low prices to persist for years.

On the supply side the oil price crash has cut the number of US exploratory rigs yet production there has dipped only slightly. Meanwhile once sanctions end sometime this year, Iran could bring daily production to 3.6m bbl/day, around 800,000 barrels a day above current production according to the International Energy Agency. That would be the country's highest level of crude output since 2011. Iraq is also ramping up production to record levels.

According to Hodges, there is now a vast energy surplus in coal, gas, oil and renewables: "So it's a market share game, as the Saudis realised when they gave up trying to hold the price 18 months ago. You either sell today, or risk ending up leaving the oil in the ground."

For the chemical industry, a collapsed oil price levels the playing field in terms of feedstock costs. This is good news for naphtha-based regions such as Europe, which had been suffering from years of decline with an oil price so much higher than natural gas and ethane prices elsewhere. As the global ethylene cost curve flattens, we can expect this to be a positive tailwind for naphtha-based producers, especially as they enjoy a broader production portfolio of co-products than their ethane-based peers.

Analysts at HSBC said in January that as oil fell faster than chemical prices in 2015, positive net pricing was the largest driver of operating earnings growth for the European chemical industry.

The explosion of US shale oil and gas production, meanwhile, gave US chemical producers a new and huge advantage over their peers in Europe and Asia. With typical, entrepreneurial zeal the industry grasped this opportunity with a tidal wave of capacity additions planned or under construction with startups from 2016.

However many of these investment decisions were based on oil at up to $100/bbl, giving a big differential between oil and gas values. There may well be delays or cancellations now that oil has collapsed and demand growth has slowed.

Low oil is having a disastrous effect on the finances of oil companies, large and small. One estimate suggests that 250,000 jobs have been shed globally in the oil and gas sector since the price collapse began. Investment by oil majors is being severely curtailed, and this will impact their integrated chemicals operations. We can expect to see more project cancellations or delays in 2016.

Looking at demand, China's economy looks set to endure permanently lower rates of economic growth as its population ages and economy rebalances. This means one of the world's key drivers of oil and energy demand growth will need less fossil fuels, especially as the government there pushes renewables.

Elsewhere, there are signs of slowing of economic growth in the US and many emerging markets are also slowing, especially those reliant on oil export income. Although lower oil prices leave more money in consumers' pockets, there are few signs of this feeding through to more consumer spending at present.

Demand remains the driving factor for chemicals, with trade group Cefic forecasting only a 1% rise in chemicals production across Europe in 2016 because of sluggish domestic and international demand. The American Chemistry Council remains more bullish with a forecast of 3.1% for chemical production (excluding pharmaceuticals) in 2016 after a 3.8% gain in 2015. ■

ICIS and International eChem are publishing a new study, which includes various oil price scenarios:
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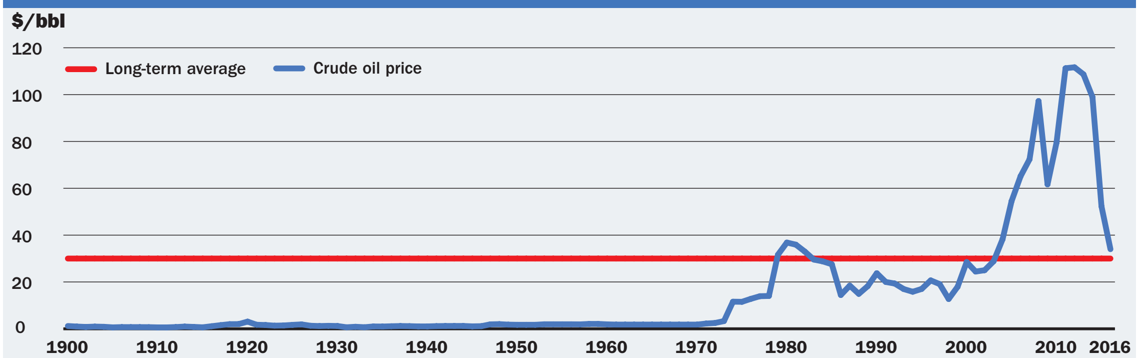
CRUDE OIL PRICES RETURN TOWARDS THE LONG-TERM AVERAGE



SOURCE: International eChem analysis, BP data

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