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President Trump's policies mean major changes for chemicals

A 'war of words'

The current system of globalised supply chains may have to change if President Trump steers the US towards local production while China prioritises reform over growth

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LONDON AND PERTH

“There isn't anybody who knows what is going to happen in the next 12 months. We've never been here before. Things are out of control. I have never seen a situation like it.”

This comment last month from former UK Finance Minister, Ken Clarke, aptly summarises the uncertainty facing the global economy. Major policy changes are now underway in both the US and China – the world's two largest economies. Almost inevitably, they will create structural changes in the petrochemicals and polymers industry.

These changes will not only impact the domestic US and Chinese economies. They will also impact every supply chain which has a link into either economy. Half of Apple's iPhones, for example, are currently made in the Chinese city of Shenzhen, using products from over 200 suppliers from around the

world. Under President Trump's new “America First” policies, it is highly likely that in the future, more and more iPhones will instead start to be made in the US.

This highlights how the world is now moving into the early stages of a “War of Words” scenario, where both the US and China are preparing to develop a totally new trading relationship. Will this develop into an all-out “Global Trade War” scenario, as the new chairman of President Trump's National Trade Council, Peter Navarro, has been advocating since the 2006 publication of his key book, “The Coming China Wars: Where They Will Be Fought, How They Can Be Won”? Will President Trump go ahead with his proposed 35% border tax on imports into the US? Or will the two sides negotiate a less confrontational trading relationship that still takes account of the president's desire to reshore manufacturing to the US?

Nobody can know at the moment. But we do know that China's President Xi is equally

determined to push forward with his reforms for the domestic Chinese economy. He also seems to have finally sidelined Premier Li Keqiang, who has been responsible for economic policy until now. This is a critically important development, as Li has masterminded the stimulus policies that meant China became the key driver for global growth in recent years. Instead, Xi is determined to refocus on his \$6tr “One Belt, One Road” (OBOR) project – which absorbed \$450bn of start-up finance last year. OBOR creates the potential for China to lead a new free trade area including countries in Asia, Middle East, Africa and potentially Europe – just as the US appears to be withdrawing from its historical role of free trade leadership.

TRUMP CHANGES EVERYTHING

It is hard to over-estimate the potential importance of these changes. As President Trump made clear in his recent Inauguration speech, his intention is to completely overturn the

REX SHUTTERSTOCK

framework that has governed the global economy during our working lives:

“We assembled here today are issuing a new decree to be heard in every city in every foreign capital and in every hall of power. From this day forward, a new vision will govern our land. From this day forward, it’s going to be only America first, America first. Every decision on trade, on taxes, on immigration, on foreign affairs will be made to benefit American workers and American families.”

This is why ICIS and International eChem have combined their expertise to launch a new series of quarterly reports, aimed at helping companies and investors understand the challenges and opportunities created by these momentous changes. The first issue focuses on today’s “War of Words”. It presents a detailed examination of the likely impact of President Trump’s new policies, and China’s retreat from stimulus, on the main value chains in petrochemicals and plastics.

President Trump’s intention is to completely overturn the framework that has governed the global economy during our working lives

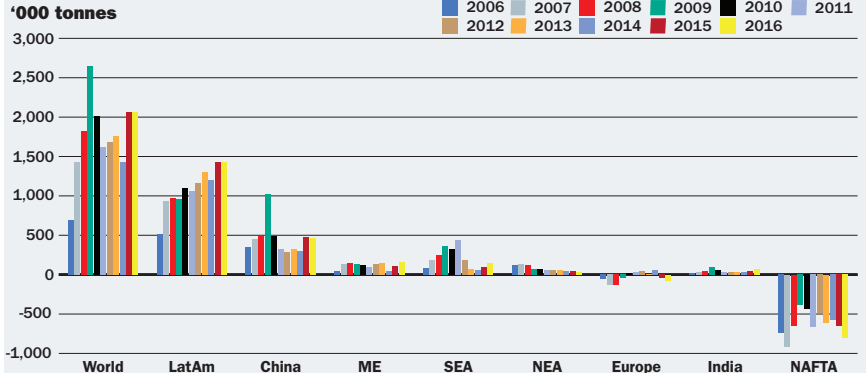
Our industry is in the middle of these historic policy shifts, which will inevitably have a major and long-lasting impact. President Trump may well have eight years in office ahead of him, while President Xi’s term of office will likely be extended for a further five years at October’s 19th Communist Party Congress. So decisions being made over the next few months will essentially define both the medium and longer-term outlook. One of our key conclusions is that prudent companies and investors should therefore utilise this “War of Words” period to start repositioning their business models ahead of the major disruption that lies ahead for supply chains.

NORTH AMERICA CHALLENGE

The imminent start-up of 4.5m tonnes of new North American polyethylene (PE) capacity confirms the scale of the potential challenges ahead. As the chart highlights, US net exports in 2016 were 5,000 tonnes lower than in 2015 – yet normally, one would have expected them to be ramping up in advance of the new capacity coming on line. Even more worrying is that they were 22% lower than their 2009 peak, and exports to China were down by 50% due to its self-sufficiency having increased.

The scope for disappointment later this year – and in turn the potential for the “War of Words” to be replaced by a “Global Trade War” – is obvious.

US POLYETHYLENE NET EXPORT/IMPORT TRADE 2006-2016



SOURCE: IeC Analysis, US Dept of Commerce

Today’s business models based on global supply chains are therefore under major threat, and companies probably have very little time to develop new ones. It seems most unlikely, for example, that the globalisation model of recent decades – whereby raw materials are routinely shipped half-way around the world, and then returned as finished product – will survive for much longer. Companies and investors also have to prepare for the risk that today’s moves are only the start of a more profound shift in the global economy. The current “War of Words” on trade could well evolve into outright protectionism, with countries reimposing the trade barriers of the pre-globalisation era.

The core of the report is therefore a detailed analysis of the four critical value chains – ethylene, propylene, benzene, paraxylene (PX) – which represent the effective “building blocks” of the petrochemicals and plastics industry. It highlights the major inter-regional moves that dominate today’s trade between the US and China, and then identifies the key risks to the continuation of these moves in the future. This analysis enables us to summarise the key implications for producers, consumers, traders and investors in the major regions.

VALUE CHAIN DISRUPTION

The ethylene/polyethylene chain is obviously the most likely to be disrupted, given the size of the new capacity that is about to come on line, together with 750,000 tonnes of new polyvinyl chloride (PVC) capacity. But as we warn in the report, developments in the propylene, benzene and PX value chains are also critical. Equally important is the fact that none of these value chains exist in isolation – the potential for inter-polymer competition is always there, and is certain to be increased by today’s developments.

It is, of course, still early days for both the Trump presidency and China’s abandonment of stimulus. But the report highlights a number of critical issues for everyone associated with

the petrochemicals and plastics industry.

■ Prudent companies and investors will take advantage of the “War of Words” period to start repositioning their business models for the potential end of globalisation. For example, overseas companies who wish to continue to supply the US may want to develop domestic manufacturing options. Similarly, companies operating outside the OBOR group may want to develop strategic relationships that will enable them to participate in its development.

■ Companies and investors will need to question current planning models, based on the concept of global operating rates, cost curves and efficiency. They need to prepare for a world where the ability to operate effectively within key trading blocs may well become the critical driver for profitability

Our aim with this report, which we intend to be the first of a quarterly series, is two-fold. It will give you a clear understanding of the tectonic shifts now underway in the world’s two largest economies. And it will provide you with a detailed road map outlining the potential impact of these developments on your own business and investments. Its value proposition is therefore very simple, namely that a “Business as Usual” scenario is the least likely outcome for the years ahead. ■



Paul Hodges, chairman of International eChem, and **John Richardson**, consultant at ICIS, are lead authors for the “War of Words” Report. This report focuses on key critical developments in the relationship between China and the US and how future trade and business policies are likely to impact the petrochemical markets globally and disrupt the “status quo” of steady economic growth. Interested to find out more? Please email enquire@icis.com.



Click here to watch a video interview with Paul Hodges ahead of the American Fuel and Petrochemical Manufacturers Association conference: tinyurl.com/n5spesk