JOSEPH CHANG NEW YORK

Virus slams stocks

The surge in coronavirus cases in South Korea, Italy and Iran dashed any hope that much of the outbreak would be contained. Equity markets are are waking up to the devastating impact

US and global chemical equity prices plunged on 24 February and kept on falling through the morning of 27 February on the growing reality about the impact on the worldwide economy from the coronavirus losing containment.

The overall stock market is finally coming to terms with the rising probability of a global recession - something the debt market has been signalling for weeks.

Among the US-based chemical companies hit hard during the three-day span to 26 February were Dow (-10.9%), LyondellBasell (-10.3%), Huntsman (-10.9%), Eastman (-10.6%), Celanese (-10.3%), Olin (-13.0%), Trinseo (-17.7%), AdvanSix (-19.5%), Tronox (-20.1%) and Univar (-21.1%).

European chemical stocks likewise were hit hard, with Germany-based BASF down 7.0%.

The broader US market as measured by the S&P 500 declined 6.6% during that period. Clearly, chemicals are faring worse.

The surge in coronavirus cases in South Korea, Italy and Iran dashed any hope that much of the outbreak would be contained within China. There will undoubtedly be a greater hit to manufacturing and overall economies as travel to and from the affected regions is restricted, and more manufacturing plants shut down.

"It will have a decidedly negative effect in China, and other nations - including the US - will be affected as well. At some point, many small firms in China will run out of cash. Also, many workers aren't getting paid," said Kevin Swift, chief economist at the American Chemistry Council (ACC).

In an effort to preserve cash flow, chemical companies may look to scale down capital expenditures (capex) for growth projects, along with shutting down less efficient operations

Nouriel Roubini, professor of economics at NYU's Stern School of Business and co-founder of consultancy Rosa and Roubini Associates, said in a bylined FT article on 26 February that investors are still too complacent about the coronavirus impact.

THREE-DAY CARNAGE FOR US CHEMICAL STOCKS
% CHANGE – THREE DAYS TO 26 FEB

Company	Price 21 Feb	Price 26 Feb	% Change
Dow	$48.30	$43.05	-10.9%
LyondellBasell	$82.91	$74.39	-10.3%
Westlake	$61.94	$56.29	-9.1%
Eastman	$73.60	$65.81	-10.6%
Huntsman	$20.90	$18.62	-10.9%
DuPont	$52.43	$47.26	-9.9%
Celanese	$107.98	$96.87	-10.3%
PPG	$118.91	$109.09	-8.3%
Axalta	$29.02	$26.57	-8.4%
AdvanSix	$17.73	$14.27	-19.5%
Chemours	$19.44	$15.55	-20.0%
Tronox	$9.70	$7.75	-20.1%
Trinseo	$28.08	$23.11	-17.7%
Olin	$19.06	$16.58	-13.0%
Methanex	$33.69	$29.47	-12.5%
Ashland	$81.23	$75.89	-6.6%
FMC	$106.58	$96.89	-9.1%
Albemarle	$92.43	$85.65	-7.3%
W.R. Grace	$63.13	$56.73	-10.1%
Univar	$22.94	$18.10	-21.1%

SOURCE: Yahoo Finance

"It is becoming clear that this is a global pandemic rather than a China-focused epidemic. And we do not know yet how many other countries in Asia and other parts of the world will experience a severe outbreak - most likely many more," said Roubini, whose dire forecasts in the 2000s had earned him the moniker "Dr Doom" in the media.

Roubini contends that the view that the economic impact will peak before the end of the first quarter now looks very shaky, and that both global business and consumer confidence will take big hits.

The potential spread of coronavirus across Europe and through major manufacturing hubs is becoming a real fear. The impacted areas in the northern Italy regions of Lombardy and Veneto include the financial

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CORONAVIRUS, BREXIT – FREE WEBINAR

Chemical markets and associated supply chains are going through a tumultuous time, with the coronavirus spreading from China around the world.

In Europe, Brexit negotiations are about to get underway with the two sides seemingly further apart than ever.

Join ICIS senior consultant, Asia, John Richardson and ICIS Chemical Business Deputy Editor, Will Beacham, for a free webinar in association with the European Association of Chemical Distributors (Fecc).

Click here to visit the web page where you can register for the event – at 11am Central European Time on Friday 6 March – which is aimed at all participants in the supply chain, including producers, distributors and downstream users. ■

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centre Milan, as well as manufacturing hubs. Like Germany, Italy is heavily dependent on manufacturing and exports. Italy reported a 0.3% decline in Q4 2019 GDP and a Q1 decline would tip it into recession.

Florian Hense, European economist at Berenberg Bank, noted the coronavirus' spread close to industrial hubs in Europe, pointing out that northern Italy, Switzerland, southern Germany and Austria comprise a "big supranational industrial hub".

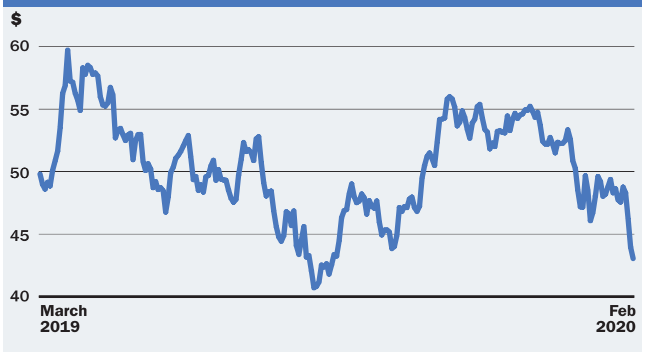
"Investors had been thinking the coronavirus impact could be just a China issue and a seasonal one, and that we'd see a V-shaped recovery. And then they hoped it would be largely contained to Asia, but now you have Italy," said Paul Hodges, chairman of consultancy International eChem.

"Maybe China can get back to some sense of normal by the end of Q1, but this isn't a V-shaped recovery. Even if nothing else happens, people will be very cautious in their spending," he added.

Economists are ratcheting down GDP forecasts as the coronavirus outbreak spreads.

On 22 February, UBS chairman Axel Weber said on Bloomberg TV that the bank projects global Q1 GDP to drop to just 0.5% from 3.5% in the year-ago period, with China GDP negative.

DOW STOCK PRICE



CHINA ECONOMIC PRESSURE

China's economy is under huge pressure with property sales down 79% and apartment sales being heavily discounted, car sales down 92%, ports at a standstill and a number of property developers at high risk of default, said Hodges.

With demand severely depressed and logistics still an issue with travel restrictions and labour shortages, those exporting to China - such as US commodity chemicals and polymers producers - will suffer.

But those importing critical components from China will also take a hit. Shortages in automotive and electronic components are already wreaking havoc on supply chains around the world.

Fiat Chrysler is shutting down a car plant in Serbia while Hyundai and Renault had to halt production lines in South Korea because of parts shortages. US-based Apple announced it will miss Q1 revenue expectations because of both iPhone production shortfalls and lower demand in China.

The impact on the US chemical sector from the China disruptions will be material. China's share of global polymers demand has risen from 22% in 2003 when the SARS crisis hit, to around 43% today, according to data compiled from the ICIS Supply and Demand Database.

In terms of dollar value, the US exported \$10.1bn in chemical products to China in 2019, representing 7.6% of total US chemical exports - this was down 14.4% from 2018, due in large part to tariffs, pointed out Martha Moore, senior director - policy analysis and economics, at the American Chemistry Council (ACC).

In addition, more than \$3.4bn in US chemicals were exported indirectly in other products such as agricultural goods, plastics products and motor vehicles in 2018, she added.

Expect Q1 2020 earnings season to be disappointing for the chemical sector, with a high likelihood of lingering impacts through the second quarter as well.

"Interestingly, we're still hearing from some managements that Q1 2020 is on track 'except for the impact of coronavirus'. We fully expect to see an earnings confessional period play out in a few weeks' time," said Frank Mitsch, analyst at Fermium Research, in a 19 February note.

CORONAVIRUS THE CATALYST?

In the bigger picture, the coronavirus outbreak could be the catalyst for a global recession.

The global economy has been propped up by more than 10 years of ultra-cheap interest rates, leading to ballooning debt levels. Yet, even with all this stimulus, growth has been anemic because of ageing demographics, International eChem's Hodges contends.

"There is going to be a reckoning, and the coronavirus looks as though it is the catalyst. There are so many companies out there with little margin for error because they've levered up," said Hodges.

Chemical companies need to ramp up contingency planning, taking into account scenarios that have the spread of coronavirus tapering down at the end of Q1, at the end of Q2 and at the end of 2020.

"Whether you think the risk of a potentially large impact is 20% or 50%, you have to prepare for a real possibility that a large number of companies will go bankrupt, and ask: What will happen to my supply chain?" said Hodges.

"Companies have to get back to a planning mentality, and think about what they would do differently in these scenarios. You can't just lean on central banks to wave a magic wand. Can [the US Fed's] Jerome Powell make iPhone components?" he added.

In an effort to preserve cash flow, chemical companies may look to scale down capital expenditures (capex) for growth projects, along with shutting down less efficient operations.

STOCKS AND BONDS

The stock and debt markets had been telling two very different stories, until 24 February.

Equity prices had largely shrugged off the potential coronavirus impact as temporary, roaring to new highs in the US through early February. But the US debt market has seen Treasury yields plummet, signaling a severe economic slowdown or recession.

"The bond market is doing its job and telling you there is no demand. One of these markets has to be wrong," said Hodges.

Yet for now, expect the world's central banks to provide another round of stimulus. China's central bank is already providing massive amounts of liquidity for financial markets and low-interest rate loans for businesses. The coronavirus represents an existential threat to China's government and its plans for world economic dominance - despite already high levels of debt in the system, expect it to pull out all the stops.

The European Central Bank (ECB) has kept rates near zero following the global financial crisis of 2008-2009.

However, new ECB president Christine Lagarde in early February told the European Parliament that the low interest rate environment has "significantly reduced the scope for the ECB and other central banks worldwide to ease monetary policy in the face of an economic downturn".

And the US Federal Reserve has been hesitant about signalling another cut in interest rates. Fed officials thus far have talked up the strength of the US economy and downplayed the possibility of a rate cut in the wake of the coronavirus outbreak.

But the Treasury market has other ideas - the benchmark 10-year Treasury yield hit an all-time low of 1.31% as of 26 February, indicating it believes additional rate cuts are on their way. ■

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