

# China uncertainty, crude decline roil chemical markets

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The recent drop in crude oil prices will have a near-term impact on basic chemical and plastics demand, with buyers pausing to assess whether the fall means mean "lower prices tomorrow" in their respective markets, says Mark Eramo, global business development v.p. with IHS Chemical. "Ultimately, the impact on short-term demand will depend on inventory levels. The pause in demand will enable a lowering of inventory, and to the extent that inventory levels are relatively low, given limited time to restock since the last downward dip in crude prices, the demand we see in markets will be directly related to real demand," Eramo says.

The period between late summer and the holidays typically brings a surge in demand for consumer goods. If underlying GDP holds, "the pause may not last too long before real demand forces buyers back into the markets," Eramo says. "Bottom line, we are expecting a pause in demand, a lowering of any inventory in the system, and lower prices in the near term until crude oil prices stabilize."

## Price impact

The impact is showing up in petrochemical prices. Some European September ethylene settlements were reported last week at €945/m.t. (\$1,063), down 9% from August levels. "We expect that European [polyethylene] and [polypropylene] prices in September will move down by at least the drop in the feedstock costs, but buyers will be pushing for even more," says Mike Smith, v.p./Europe, Mideast, and Africa for IHS Chemical. "After the restocking mode in the first half of the year, we are now firmly in the destocking mode. In some ways, 2015 seems to be a repeat of 2014."

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"Oil price volatility is creating a nightmare for companies planning investments," Bari says. "The long-term recovery case, should it come to fruition, has the most significant implications for the market. Since oil dynamics drive marginal production cost and price-setting mechanisms for many chemicals, plastics, and fibers, a prolonged oil price recovery could diminish the feedstock advantage of ethane relative to a more cost-competitive naphtha."

## » Many global supply chains would feel impact of significant slowdown. «

If crude oil prices do not recover within five years, the second wave of new ethane crackers in North America will likely be postponed to 2025. The result would be tighter ethylene supply and higher profitability for naphtha-based producers in Europe and Asia. Assuming a long-term recovery, ethylene demand would grow at an average annual rate of 4.5% during 2015-20, and capacity would grow just over 3%, IHS Chemical says. During 2020-25, ethylene demand would grow at an average annual rate of 4%, and capacity would grow under 1%. The result would be severe supply shortages similar to those of the late 1980s, Bari says.

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## China at 'epicenter' of chemical demand

In China, meanwhile, the yuan devaluation reflects the downward trend of the country's economy. China is at the "epicenter" of the supply/demand balance in most basic chemical, fibers and plastics markets, Eramo says. "If there is a significant slowdown in demand for China, then many global supply chains that are ultimately supplying the manufacturing machine in China will feel it, resulting in lower operating rates and lower prices."

Eramo says it is too early to make a call on the long-term impact of developments in China. "There is tremendous momentum built up in various supply chains around the world that rely on manufacturing in China for durable and nondurable goods and this will not change in a short period of time," he says.

Assessments of long-term growth in China must consider changes in government policy that attempt to balance market-driven growth with historical controls as well as changes in the balance between domestic and export demand growth, Eramo adds. "Overall, we remain positive on long-term demand growth for chemicals, fibers and plastics in China, as its already sizable economy continues to expand and the appetite for durable and nondurable goods grows accordingly."

A weaker yuan makes China's imports of energy and raw materials more expensive, but the low-oil price is a more material issue for the petrochemical industry. "China is significant as a net buyer of energy, and a weaker currency will not spur demand growth in this globally significant market," says Roger Green, senior director/consulting at IHS Chemical. Currency effects balance out. "There's an element of indifference in Chinese industrial consumers, with higher-cost raw materials being offset by higher sales value [in yuan terms]," Green says. "There will be pockets of the petrochemical market where Chinese surpluses will apply downward pressure on pricing, such as in purified terephthalic acid—one of the few petrochemicals where China is in surplus. A modest uplift to competitiveness will of course strengthen the export position of China."

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Assessments of long-term growth in China must consider changes in government policy that attempt to balance market-driven growth with historical controls as well as changes in the balance between domestic and export demand growth, Eramo adds. "Overall, we remain positive on long-term demand growth for chemicals, fibers and plastics in China, as its already sizable economy continues to expand and the appetite for durable and nondurable goods grows accordingly."

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