Dutch chemical industry outlook: Calmer waters after sharp declines

Rising energy prices have hit the Dutch chemical industry hard since the second quarter of 2022. As supply-side issues diminish, production is now stabilising. The weakened international economy is tempering demand though. And input prices remain structurally higher than before, which is weighing on the competitiveness of chemicals companies

Chemical plant in Rotterdam, Netherlands

Dutch chemical industry in calmer waters

After a very turbulent 2022, things have calmed down a bit for the Dutch chemical industry in 2023. The risk of potential gas shortages has significantly decreased due to government measures and alternative supply. The European gas price has come down from a record high to a level that is about two to three times higher than before 2021. This makes chemical production on a larger scale profitable again. Chemicals producers are not out of the woods though. It is expected that the European gas price will remain structurally higher than in the past, partly due to the largely diminished supply of Russian gas, which has unfavourable effects on intercontinental competitiveness and growth prospects of the chemical industry.

Higher cost levels and weak demand are holding back potential growth

The significant production contraction continued in the first two months of this year, followed by production stabilisation in March and April. Renewed inventory buildup is expected to allow for some growth from the second half of this year. As the reopening boost to service consumption is nearing its end, goods consumption can gradually regain some ground. When producers also find their inventory levels too low relative to expected sales, an early-cycle industry like the chemicals sector is at the forefront of ramping up production. The reopening of the Chinese economy can also provide demand impulses for European chemicals customers. While this will not fully compensate for earlier contractions it can lead to a considerably high year-on-year growth in 2024. However, it is unlikely that production levels will quickly return to pre-energy crisis levels due to increased cost levels and weak demand.

Weakened demand most influential for limited short-term recovery

The difference with 2022 is that in 2023 and 2024 demand factors are playing an increasingly dominant role instead of supply factors. As supply-side issues rapidly diminish, the weakened economy continues to temper demand domestically and internationally. It is positive that the current global inventory reduction is expected to fade away and China is no longer experiencing lockdowns. Additionally, the catch-up growth in demand for services is likely to have a less negative impact on goods demand from the second half of this year. On the other hand, persistent inflation and higher interest rates continue to weigh on final demand. Economic growth expectations for all major international chemicals markets are significantly lower than before.

Production relatively well maintained...

Despite high energy prices, chemicals producers have managed to maintain production at a fairly good level for a long time. Compared to 2021, production levels in 2022 contracted only by about 4% on average, while gas consumption by chemicals producers decreased by an average of 28% in 2022. The prolonged decline during the year resulted in a production level that at the start of the second quarter of 2023 has stabilised at a level approximately 20% lower than the average pre-pandemic level in 2019, the year before the pandemic. Gas consumption by chemicals producers has increased again, but in June 2023 it was still about 30% lower than in 2019. Although production figures for May and June are not yet available, the gradual increase in gas consumption indicates a potential end to the production contraction.

... thanks to cost-saving measures, alternative energy sources, and imported semi-finished goods

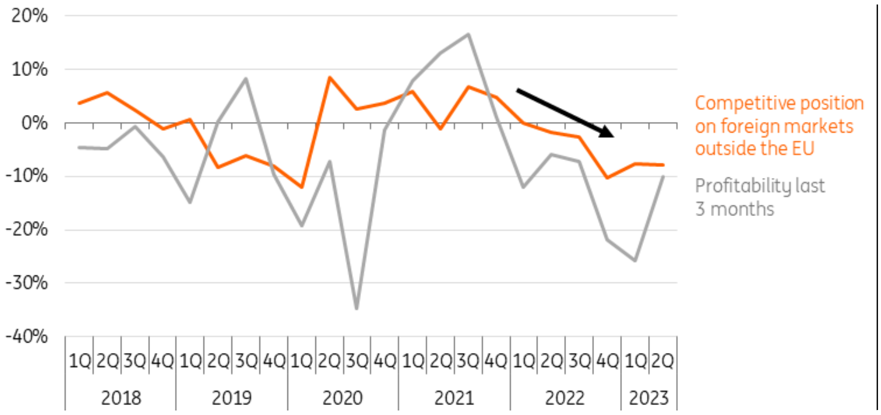
Chemicals producers have reduced their consumption by implementing gas-saving measures and using alternative energy sources more frequently. Production remained relatively high because energy-intensive semi-finished goods were increasingly imported from non-European Union countries such as the US or Asian countries. The imported products serve as substitutes, allowing the production of the final product to be maintained. For example, ammonia needed for fertiliser production. This process is still going on this year although in a less prominent manner than before.

Profit and competitiveness under pressure despite gas price decrease

Despite the significant decrease in gas prices, the chemical industry still faces margin pressure. At the beginning of the second quarter, producers did observe improved profitability. However, they are hardly more optimistic about their competitiveness in markets outside the EU. Energy price volatility in Europe is greater than elsewhere and the structurally higher energy prices have a negative impact on investments and competitiveness for the longer term. Lower purchase prices will have a positive impact on margins in the coming year, but substantial demand growth is needed for structural improvement. There is currently no sign of that.

Profitability and competitiveness under pressure

Assessment of profitability and competitive position by chemicals manufacturers*



Source: CBS, ING Research

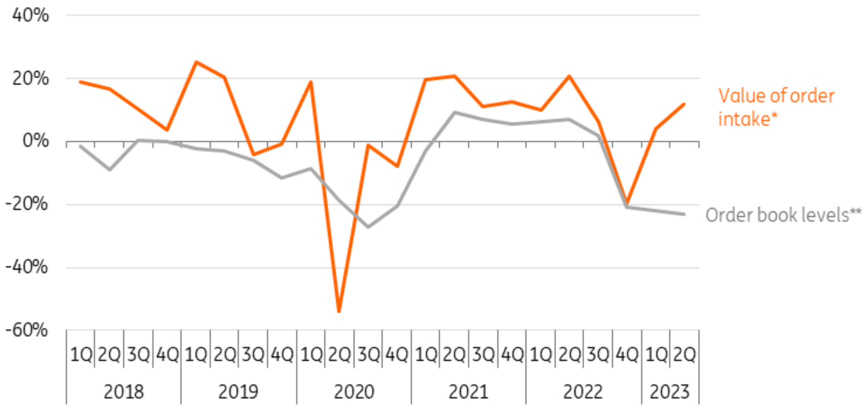
*balance of positive and negative entrepreneurs

More new orders, but producers remain pessimistic

Chemicals producers have been seeing their order flow increase for a while now, but this has not yet resulted in a change in sentiment. They are still very negative about their order books. Before production picks up again, sales inventories need to be rapidly reduced. This is feasible as inventories are relatively low in the chemical industry and fluctuate much more than in other sectors. At the same time, a decline in demand is quite widely seen as the main impediment to growth by chemicals producers right now.

Producers pessimistic about order books, but order intake increases

Assessment of order intake and order book levels by chemicals manufacturers



Source: CBS, ING Research

*balance of number of entrepreneurs that sees the value of the order intake for the next 3 months increasing or decreasing **balance of positive and negative entrepreneurs

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