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A look at how the recent drop in oil prices is affecting the coatings sector.
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Weaker oil prices: a mixed blessing

The coatings sector in Europe was only a few months ago struggling to cope with the effects of soaring costs of their raw materials in the wake of oil price hikes.

By September the outlook for raw material costs had become much brighter. Coatings producers were facing the prospect of a period of soft prices for crude oil and its derivatives, as well as for oleochemicals.

After falling by around a third since the summer to below $100 a barrel, oil prices jumped by $16 a barrel in the third week of September, its biggest ever one-day gain. But analysts observed that the underlying trend continued to be one of much lower oil prices than those prevailing in the first half of the year because of the slowdown in the global economy.

Nonetheless weaker oil prices, which now affect not only petrochemical derivatives but also chemicals sourced from vegetable oils and other renewable raw materials, could be a mixed blessing for the coatings industry in Europe.

The ability of paint companies to benefit quickly from the oil price decrease will depend on how much they have previously been building up their inventories of raw materials and intermediates.

“A lot of coatings and other downstream companies will have stocked up on raw materials in the summer in the expectation that oil prices would rise well above $150 a barrel and perhaps even as high as $200,” said Paul Hodges, chairman of International eChem, a London-based chemicals consultancy.

“Now some of these companies could be in trouble because they will have highly-priced inventories at a time when demand among their end-user customers is declining due to the drop in economic growth in Europe,” he added.

In the longer term there are concerns that raw material producers in Europe will be forced by a possible lengthy drop in sales to shut production capacity, which will cause shortages of supplies of certain chemicals once the region’s economies recover.

Over the last few years the coatings sector has had to endure scarcities in categories like resin intermediates as a result of closures following the last trough in the basic chemicals cycle six to seven years ago.

"There will be a lot of overcapacity in some product areas, particularly due to new plants being built in the Middle East and Asia, so closures will inevitably happen," said Hodges. "Supply and demand is already out of kilter and with the global economic downturn the imbalance will get even worse."

The latest statistics issued in September by the European Chemical Industry Council (Cefic), which covers base and specialty chemicals and downstream products like coatings showed output of paints and inks dropping by 2.6% in June compared with a year ago. In the first six months of this year production of paints and inks went down by almost three percent.

Output of base chemicals was flat in the first half while specialty chemicals production went down by 1.3% in January to June and by three percent in June itself. Dyes and pigment output fell by six percent in the first six months.

However production of chemicals and coatings has been falling while prices have remained high, indicating a time lag between a decrease in demand and price cuts, particularly in raw materials.

In July chemical prices were over eight percent higher than a year ago. But prices of paints and inks were less than one percent higher than 12 months previously.

In fact some producers of coatings raw materials and intermediates were still trying to push through price rises in September in a final effort to compensate for earlier rises in their own input costs which included not only feedstock prices but also costs of energy and transport fuel.

"We will soon see the effects of the slowdown in demand begin to bite," said Hodges. "Downstream users are destocking raw materials instead of buying because they know prices will fall. Producers will then reduce their output and we will get the beginnings of a downward spiral with everyone cutting back."

In a recent report on the outlook for olefin and aromatic feedstocks mainly for polymer supply chains, IeC predicted there would be major overcapacity in this group of raw materials until 2013-15. In the event of a lengthy period of slow global economic growth the overcapacity could persist until 2015-20.

Prices of methanol—a base chemical for resin intermediates—are already dropping sharply as a result of an increase in global production capacity. By August spot methanol prices in Europe were around 50% lower than they were a year ago.

Coatings companies in Europe, which have been switching to renewables for some of their ingredients have found that oleochemicals are being hit even harder by the drop in crude oil prices than petrochemical derivatives

"Prices of vegetable oils, especially palm oil, and crude oil are very closely linked because they are feedstocks for biofuels," said Sarah Hickingbottom, an oleochemicals analyst at the consultancy LMC International, Oxford, England. "It will stay that way until there are changes in policies by governments giving subsidies or financial incentives for the use of biofuels."

Prices of vegetable oils, such as palm oil and rape oilseed, both raw materials for biodiesel, are now based mainly on their calorific value. Prices of palm oil, which has a calorific value only ten percent below that of crude oil, have fallen even more sharply than oil prices with a 50% decline since reaching a peak in March.

Rape oilseed prices in Europe have also tumbled. "Crude oil prices look like they will remain under pressure in the short term and, until this changes, the rape oilseed market will struggle to recover," said Jonathan Lane, a UK-based rape oilseed trader.

The drop in feedstocks costs has come too late for some raw material and intermediate suppliers. Ciba Specialty Chemicals, a leading pigments and additives producer with headquarters in Basel, Switzerland, which made a loss in the second quarter of this year, agreed in September to be taken over by BASF of Germany, which is itself a major raw materials as well as coatings manufacturer. It is highly likely that other financially hard-pressed producers of coating raw materials will also be taken over during a period of restructuring of the European coatings supply chain.