Focus Strong crude weighs on Asian chemicals demand

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By John Richardson

SINGAPORE (ICIS news)--Asia's chemicals industry is being hit by demand destruction as a result of the crude-oil price more than doubling from its crisis low-point, a UK-based chemicals consultant warned on Wednesday. At 12:00 hours Singapore times (0500 GMT), NYMEX light sweet crude for December delivery was trading at $79.65/bbl, more than double its level in December last year.

"Oil at its current price is hindering rather than helping the recovery because we are seeing demand being damaged," said Paul Hodges, chairman of International eChem. "This is because we are already seeing greater caution on the part of those companies that recognise the risks of lower demand for chemicals."

Hodges cited the domino-effect of high fuel prices on overall consumption of chemicals. "For example, as the gasoline price has gone up, people are driving less to the shopping malls in order to buy stuff made from plastics – i.e. discretionary spending."

Crude price may have rapidly risen on hopes of economic recovery but the world continues to be affected by the financial crisis, said Nobuo Tanaka, executive director at the International Energy Agency (IEA).

"Global energy use is set to fall in 2009 – for the first time since 1981 of any significant scale – as a result of the financial and economic crisis," he said in a speech during the Singapore International Energy Week due to end on Friday. But Kanata said that global oil demand growth was set to quickly recover.

The "volatility" in oil pricing was a threat to the levels of investment needed in hydrocarbons and renewable energy to mitigate damage from climate change and prevent future energy price shocks, he added. Tanaka, quoting from the IEA's World Energy Outlook 2009 report, said the financial crisis had resulted in a "19% cut in global upstream oil and gas investment in 2009 over 2008." This represented a reduction of $90bn.

While Tanaka didn't comment directly on whether oil futures speculation contributed to the financial crisis, this is a widely-held view. The last US recession began in December 2007 when crude touched $100/bbl and the sub-prime mortgage crisis took hold, it is argued.

“In our Feedstocks for Profit Study, and I think this still holds, we saw a green light for growth was at $25 a barrel, an amber light at $50 a barrel and red at $75-80 a barrel,” continued Hodges – who shares the view on the role of speculation. The study, by International eChem and oil and gas consultancy Wood Mackenzie, looks at the future availability of cracker and reformer feedstocks in the economic context

“It’s generally accepted that demand destruction occurs at $80-100/bbl,” Hodges added. As real or inflation-adjusted wages decline in the West and unemployment keeps on rising, the concern now is whether a reduction in demand will occur at prices closer to $80/bbl.

And if crude fell back to $40/bbl, based on fundamentals, he warned, it would be hard to distinguish between chemical producers and customers running down inventory and a drop in finished-goods sales. When oil prices collapsed in H2 2008, chemicals producers were left holding high-priced naphtha as their finished-product prices fell.

“Demand visibility in chemicals - even without as yet a collapse in crude – is already extremely poor, making planning very difficult,” said Hodges.   As oil prices go up more working capital is tied up in buying raw materials because naphtha and chemicals prices follow crude, he added.

“This is a major risk in 2010, given the fragile state of the financial system, and the banks’ unwillingness to lend.”

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