June 2010

Budgeting for a new normal – A mid-year Update

by Paul Hodges, Chairman,
International eChem

In association with ICIS news

Contact:
www.icis.com
phodges@internationalechem.com
www.internationalechem.com
www.icis.com/blogs/chemicals-and-the-economy

EXECUTIVE SUMMARY

There has been tremendous interest in the Budget Outlook that I originally posted last October in my 'Chemicals and the Economy' blog. Publication in expanded format in the New Year as a White Paper, 'Budgeting for a New Normal', led to over 2000 people downloading a copy in the first 24 hours.

As we have now reached mid-year, it seems appropriate to review developments.

The starting point for the original post was a belief that growth was returning to the global economy, although maybe not at the high levels to which we became accustomed in the 2003-7 Boom period. It therefore aimed to present some ideas on how the industry might best navigate the next few years, and where we are headed in terms of economic growth and chemical demand.

Its main argument was that the current extended downturn, like those of the early 1980's and 1990's, is acting as a period of transition. It suggested that we may experience a 'New Normal' as the global economy recovers, rather than a return to the previous Boom period.

As before, this update therefore first looks at the state of the global economy, and then covers the outlook for key chemical markets such as construction/housing and autos, as well as the latest views expressed by chemical companies themselves on the outlook.

CONTENTS

Global chemical production improving, but at 2007 levels 4

2010 sees a strong seasonal upturn in H1 5

Auto sales have been boosted by stimulus measures 7

China's lending is being scaled back 9

Financial markets anticipate a strong economic recovery 11

Oil and oil products inventory are at high levels 12

New plants ordered in the boom period are coming online 13

The banking system is still fragile 15

There is a risk that the crisis now enters a new stage 16

Companies remain cautious after seasonal upturn 18

The global economy may now be at a cross-roads 20

Conclusions 21

About the Author 22

About ICIS 22

Global chemical production improving, but at 2007 levels

Chart 1, based on new American Chemistry Council (ACC) data, shows that production growth had indeed begun to return in the second half of last year. The dark blue line represents the global picture, and indicates that demand bottomed in Q1 last year and then began to rebound as destocking was replaced by restocking down the value chain.

The strongest performance was seen in the Middle East, which of course is benefiting from its access to advantaged cost feedstocks. It has been building a large number of new plants, many of which are now beginning to come onstream. Its production was up 21% versus Q1 2007.

The other strong performance came from Asia Pacific, led by China, where an unprecedentedly large stimulus programme had been introduced by the government in Q1 2009, leading to a sharp recovery. Its production was up 18%.

In the Western economies, where most chemical demand is situated, the position was less rosy. Western Europe showed the best recovery, under the influence of the major stimulus programmes adopted by most governments. It was up 4.1%.

But Central & Eastern Europe suffered from the inability of many governments to afford any stimulus. Its volume was at 93% of the 2007 level.

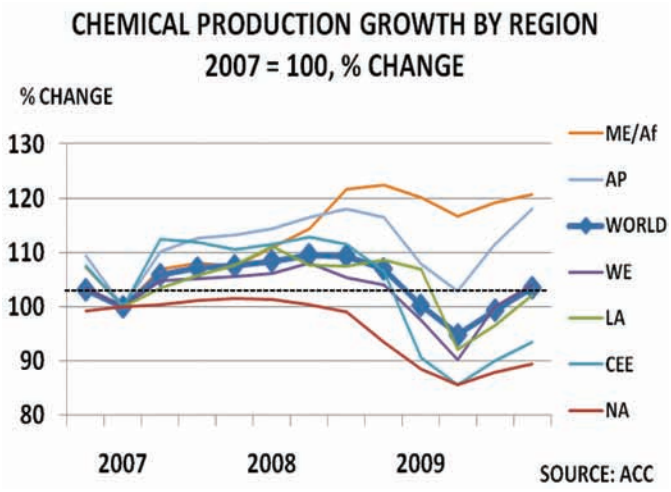

Chart 1: Global Chemical Production

North America, the epicentre of the Crisis, saw production severely restricted by the downturn in key automotive and housing markets. This was in spite of the double benefit provided by falling prices for gas feedstock supplies, and by strong export demand to Asia. Its production was at 90% of 2007's level.

Underlying these differing regional performances, lies one worrying statistic. Overall, production was back at the same level as at the end of 2006. The growth seen in 2007 and the first half of 2008 had disappeared. And in spite of all the stimulus programmes, the world was not seeing a V-shaped recovery, where demand was rebounding to the pre-Crisis level.

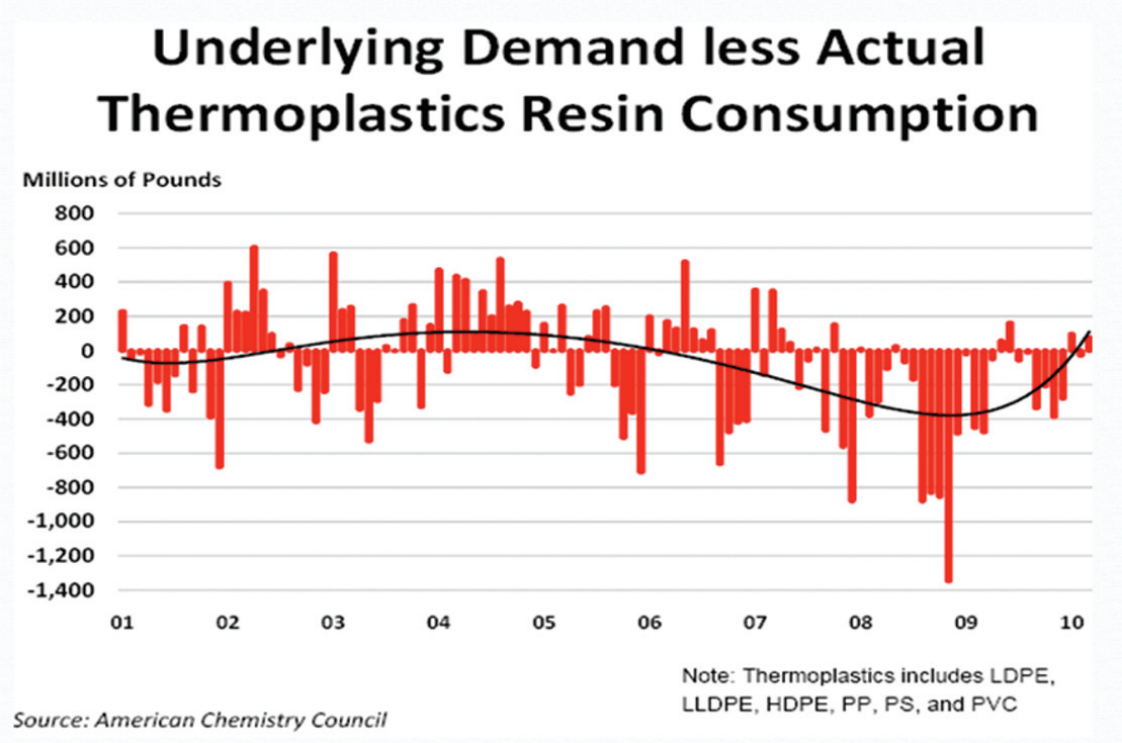

Chart 2: US Polymer Inventories rebuild in Q1

2010 sees a strong seasonal upturn in H1

The chemical industry has a seasonal bias to its production. The first six months are usually the strongest half, as H2 sees a slowdown in demand due firstly to the summer vacation season, and then to the tendency for companies to destock ahead of year-end, and the Christmas holiday period.

2009 was an exception to this pattern. The first quarter saw major destocking down the value chain, in the aftermath of the oil price collapse from $147/bbl to $31/bbl. And as we went into Q4 2009, it was clear that CFOs were anxiously reducing inventory and working capital, to avoid a repeat of the problems they had faced in 2008.

2010, however, has returned to the seasonal pattern, assisted by the severe destocking in Q4 2009. The red columns in Chart 2 (from the ACC) illustrate this, by showing underlying demand less actual consumption of the major thermoplastics (PE, PP, PS and PVC).

2010 sees a strong seasonal upturn in H1 (continued)

The black line shows that restocking took place down the value chain in the first quarter of 2010, as companies anticipated a return of some consumer demand. The ACC estimate actual consumption at 4.91bn lbs (2.23 million tonnes), whilst total purchases were 4.96bn lbs. Thus 48m lbs of inventory were added in Q1, after a stock drawdown of 294m lbs in Q4.

The second quarter should also be relatively strong, for seasonal reasons, but the outlook for the second half is less clear. Governments' justification for their extraordinary stimulus measures was set out by Larry Summers, US economics chief, last year. He suggested these would provide 'escape velocity', whereby the economy would escape from the downturn like a 3-stage space rocket leaving Earth:

- Government spending stops the downturn becoming worse
- Companies gain time to rebalance their inventories
- Consumers gain confidence and begin spending again

The first two stages have now taken place, but the likely future strength of consumer spending is still unclear. My own view remains that we are heading towards a 'New Normal', where spending is much reduced versus that seen in the 2003-7 Boom period. And, of course, now governments have spent the money on the stimulus programmes, there is also a new question – how is this debt to be financed?

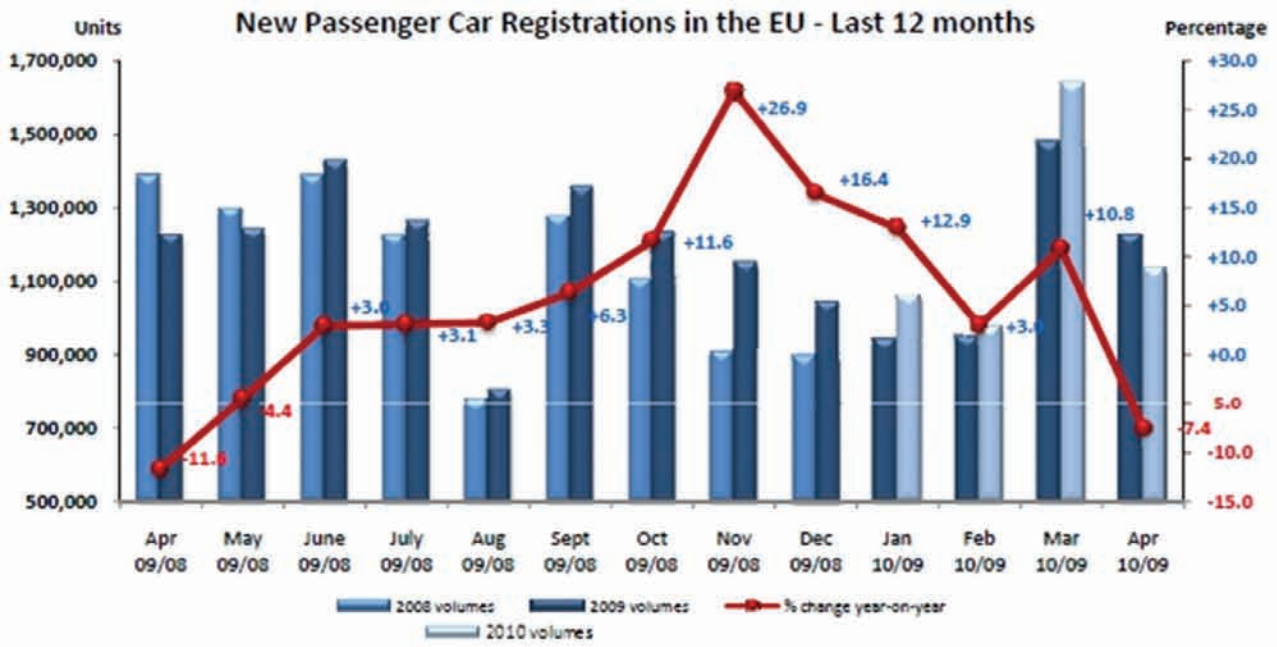

Chart 3: European auto sales benefit from Stimulus

Auto sales have been boosted by stimulus measures

The automotive industry, along with housing, has been one of governments' main targets in their efforts to stimulate the economy. Almost every country that could afford a programme has adopted one, usually adding a 'green agenda' spin to it by focusing on the replacement of older, less-efficient autos.

Consumers, being offered government money to do something that was becoming inevitable, have taken up these offers in relatively strong numbers. In the US, sales revived to c1 million/month in the July-August period as a result of its $3bn spend. But even so, total 2009 volumes were just 10.4 million, worth $31bn of chemical sales (based on the ACC estimate of $2973/auto). This compares with a 15-17m market between 1995-2007, worth $45-50bn at today's value.

Chart 3, from the European auto manufacturers association (ACEA), shows a similar pattern for EU auto sales. The dark blue columns represent 2009 sales by month, versus 2008 sales in light blue. It shows that 2009 volumes began to recover in Q2, as the German government launched its €2.5k/auto incentive scheme in advance of September's election.

Auto sales have been boosted by stimulus measures (continued)

Other countries then followed, providing major support for total EU sales through to Q1. UK sales in March, for example, were the largest in the EU at 400k, in advance of May's election. The red line shows month-by-month performance as a percentage of 2008, and this clearly peaked in Q4. April saw the first fall for 10 months, and ACEA are not optimistic about the outlook for the rest of 2010, warning that 'government support has ended or begun to fade out and the economic situation remains difficult.

Hungary, however, provides an interesting insight into what might have happened more generally, in the absence of stimulus spending. Hungary was not able to afford such a programme, and in fact had to increase sales tax (VAT) to help finance its deficit. As a result, auto sales collapsed. They were down 53% in March, with total sales of just 4371 autos in a country of 10m people.

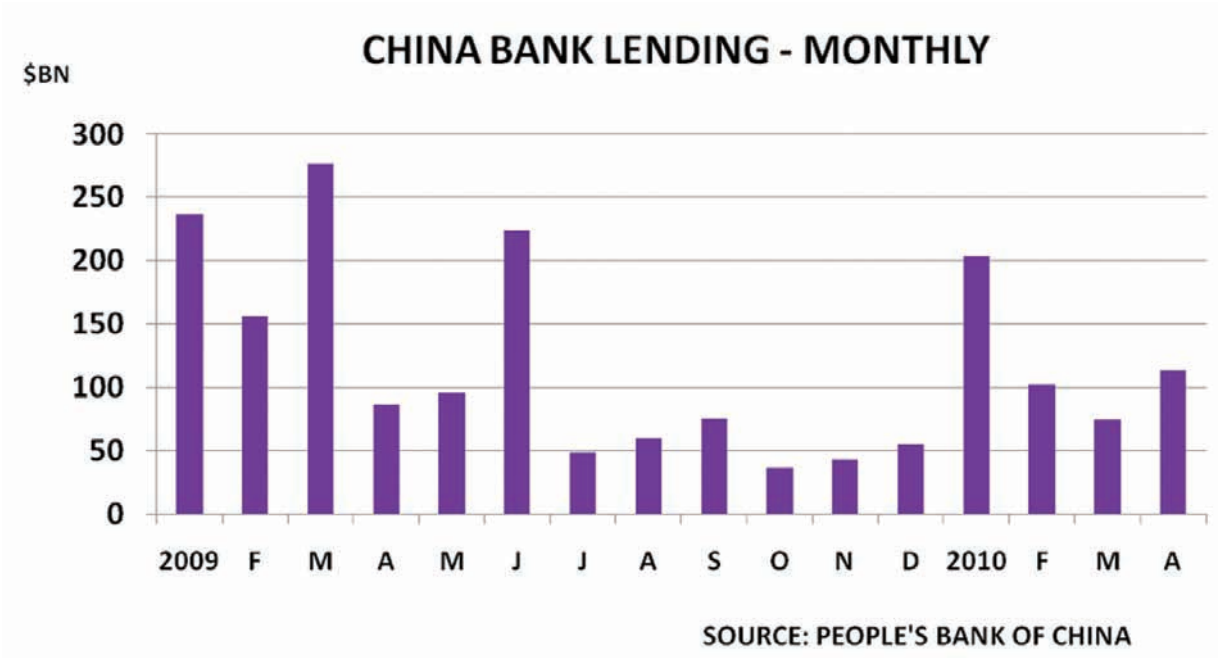

Chart 4: China's bank lending slows

China's lending is being scaled back

In Q1 last year, China was facing mounting unemployment, with over 23 million jobs lost as its export-oriented economy suffered from the downturn in its key markets. In response, the government announced a massive $580bn stimulus programme, and also began an unprecedented lending programme. By the end of the year, this amounted to $1.4trn – double the lending total for 2008, and equal to 1/3rd of total GDP.

The Wall Street Journal rightly called this "one of the biggest credit expansions in history". And pretty clearly, it was undertaken from a position of weakness in the economy rather than strength. The idea seems to have been to buy time, in the way suggested by Larry Summers, with the end-point being a restructuring of the economy towards more of a domestic focus.

Of course, some of this money will have been spent wisely on infrastructure and other projects, that will provide long-term value. But inevitably, some of it must have been siphoned off into speculative activities. And one can see the results of this in the housing market, where prices in Hainan, for example, rose 53% in the year to March. Equally in Shanghai, the average apartment now costs $200k although average wages are just $5k/year.

China's lending is being scaled back (continued)

The government is trying to tackle this problem by reducing its lending again. As the chart shows, lending was down 43% in Q1 versus 2009, with February and March seeing a very significant slowdown. It also tightened criteria for home loans, and there is increasing talk that a property tax may be introduced to help curb the speculative mania. Given that a key aim for the government is to avoid social unrest, such measures became inevitable after premier Wen Jiabao called the market a "wild tiger".

China's stimulus programme has been an enormous boost for the chemical industry, both in Asia and other regions. In Q1 2010, for example, Dow Chemical sold 20% of its US polyethylene production in Asia, thanks to the strong demand seen there. Total chemical production over the past year in both North America and Europe would certainly have been lower without the opportunity for major export sales to Asia.

Financial markets anticipate a strong economic recovery

Governments have paid particular attention to restoring confidence in financial markets over the past year. This is understandable, since the activities of some large players nearly pushed the global economy into a major depression in Q4 2008. But it has also had unintended consequences.

The chart above shows one of these, namely the close correlation that has developed between movements in the US S&P 500 stock market index and the price of crude oil as measured by the benchmark, WTI. In my view, this has now reached the point where it actively threatens the prospect for recovery, due to the 'demand destruction' caused by high oil prices.

My concern is based on the fact that consumers have to drive their cars, and pay their heating bills etc, before they have any money to spend on the discretionary items that create demand for a wide range of chemical products. And so the higher the oil price, the bigger the potential impact on demand.

Chart 5: Financial markets have become correlated

As we know from the experience of 2007-8, and the earlier 1979-80 period, much of this impact is hidden as prices rise. Purchasing managers have to keep buying, to allow sales to be made of their company's products, and their bonuses often partly depend on their success in 'beating the market'. In a rising market, the easiest way to do this is to buy forward, thus helping to create the illusion that demand remains strong.

It is only when prices stop rising that reality breaks through, as companies begin to reduce the stocks they have built up. History never repeats itself exactly, and so hopefully we are unlikely to suffer a repeat of the dramatic collapse that we witnessed between Q4 2008 – Q1 2009. But recent falls in oil and stock markets have already led to signs of distress selling by speculative polymer players.

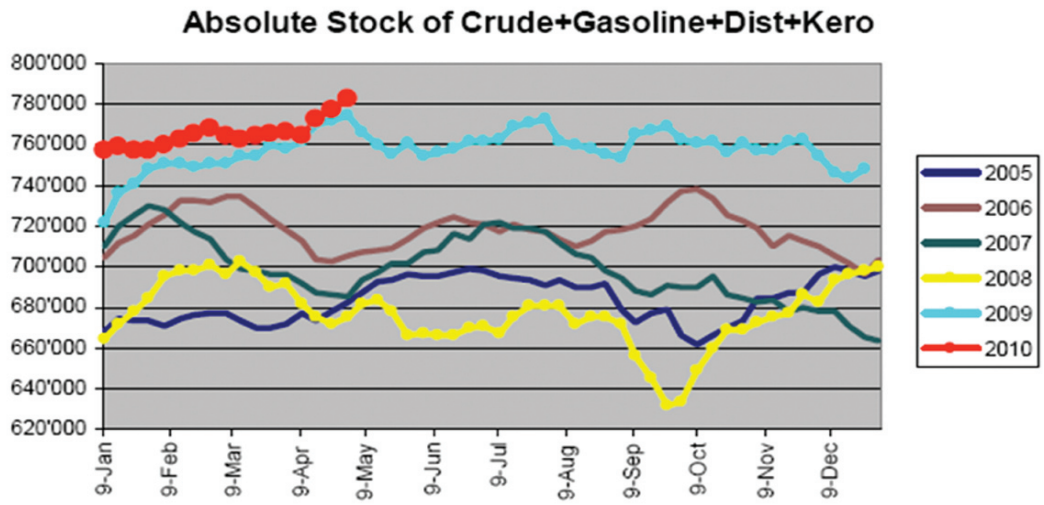

Chart 6: US oil/product stocks at high levels

Oil and oil products inventory are at high levels

The risk caused by higher oil prices at a time of low demand growth is due to the behaviour of financial investors. They have continued to bid up the price of crude oil, even though actual stocks of oil and oil products have reached multi-year highs around the world. They are convinced that Summers' policy is correct and that a rapid V-shaped recovery is underway, and so underestimate the risk of allowing stocks to build so much ahead of demand.

Chart 6 from PetroMatrix shows 2010 stocks (red line) of crude, gasoline, distillate and kerosene on a week by week basis in the USA. They totalled 780k bbls in early May, and are even higher than in 2009 (light blue), when destocking severely reduced demand. And they are much higher than in 2008 (yellow) or other recent years.

The problem is that the trading in financial markets has been greatly influenced by the entry of pension funds and others, who have bought the argument that commodities such as oil offer a low-risk way to diversify their investments. But higher prices in commodities and stock markets are in fact two sides of the same coin. Both depend on real demand emerging, as government support is withdrawn.

The reality is that crude oil demand in 2009 was, like chemical demand, reduced to 2006 levels. So, in the absence of geo-political disruption, it could easily be several years before we once again have a tight supply/demand balance in oil markets. Meanwhile, high oil prices will simply reduce chemical demand, as consumers will have less discretionary cash to spend after paying for essentials such as heating and transport costs.

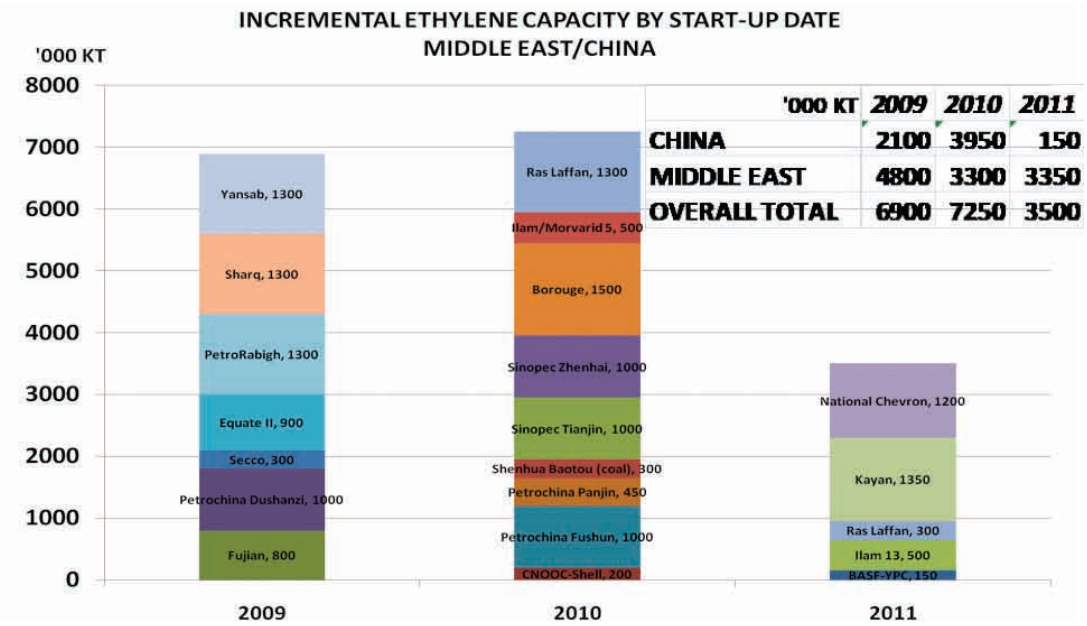

Chart 7: New ethylene capacity arrives in the Middle East and China

New plants ordered in the boom period are coming online

It is a rule of business that costs are certain, whilst sales are less certain. And this axiom seems also to be coming true when we look at supply/demand balances for the major petchem products.

We have already seen how demand is now much reduced compared to that seen in recent years. And there are good reasons to expect demand growth to remain subdued for the next few years. But the plants ordered during the Boom period are now starting to be completed, and to come online.

Chart 7 summarises the position for ethylene. It looks at the start-up schedules for those projects located in the Middle East and China, as these represent the majority of the new capacity expected. And it shows that 6.9 MT started up last year, mainly in H2, whilst another 7.25 MT is scheduled to come online during 2010.

Ethylene is a market of c115 MT, growing in line with global GDP. Thus this new capacity added 6% to capacity last year, and will add a similar proportion this year, to a market that will be lucky to grow at half this rate. Plus, of course, there are the other new crackers and cracker expansions, most notably in Asia, that are also scheduled to arrive.

New plants ordered in the boom period are coming online (continued)

Whilst there have inevitably been some delays (these are major projects, after all), the timings of all these new investments remain very similar to those developed for our 2008 'Feedstocks for Profit' Study. So unfortunately, the market will still see increasing over-capacity for the next couple of years, whilst the new capacity comes online.

Equally, the experience of previous downturns in the early 1980's and 1990's suggests that plant closures are very hard to achieve, even when they are operating at low rates and margins. This is because they are often closely tied to a refinery or other feedstock source, and so the closure decision of older plants has to be reviewed in relation to a roll-through analysis of the whole complex.

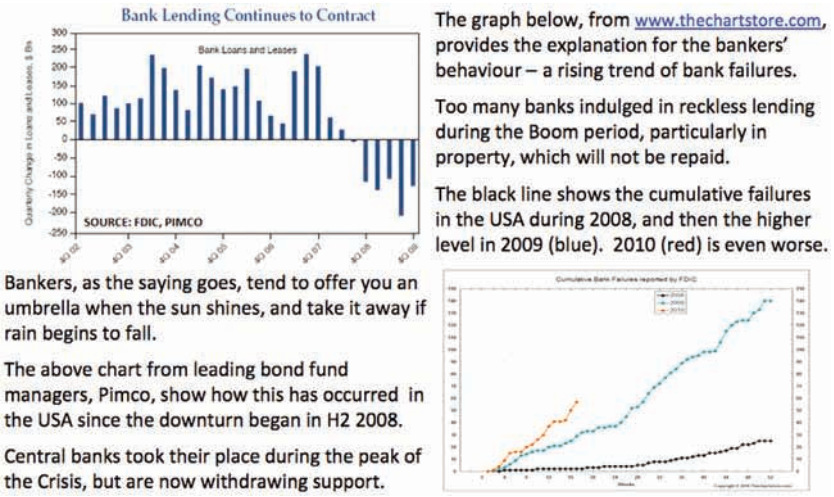

Chart 8: US banks have a solvency problem

The banking system is still fragile

One of the key lessons for those who lived through the Great Depression in the 1930's was that banks could not be trusted to maintain lending during a severe downturn. This was handed down from parents to children until the 1980's, when it was forgotten. Now a new generation, at least in the West, is having to relearn this fact of life.

The graph in Chart 8, on the left, from Pimco, the world's largest bond fund managers, shows how banks have sharply cut back their lending in the USA since the Crisis began. The same picture is true for other developed countries. Part of this is due to the banks need to reduce their leverage, as discussed in the original White Paper. But part is due to a growing fear that their existing loans may not all get repaid.

This fear is well-founded, as can be seen from the chart on the right from www.thechartstore.com, which highlights the increasing number of US banks closed by the authorities in 2008 (black line), 2009 (blue) and 2010 to date (red). Until now, the position has been somewhat balanced by the willingness of central banks to take the place of the traditional banking sector. But providing liquidity is not the same as guaranteeing solvency.

Equally, whilst central banks can help to reduce the cost of loans, by lowering interest rates, they cannot take on a day-to-day role of lending to the small and medium-sized businesses that are the lifeblood of most economies. Yet companies' need for working capital to fund their business has been increased as a result of higher oil prices being passed through the chain.

It is a known fact that more businesses go bust during an upturn in business, than during a sudden crash. The reason is that they run out of working capital, even though their new orders are all profitable. If the banks can't, or won't, lend to cover this shortfall, then demand growth for chemicals will inevitably be reduced in turn.

Greece has become the first-ever Eurozone country to require a bailout.

It has agreed an €80bn ($105bn) loan from other Euro countries, and €30bn from the IMF.

The government has also announced €30bn of spending cuts. GDP may not recover to the 2009 level until as late as 2017.

Plus, of course, Portugal, Spain and Italy have similar unsolved economic problems.

Unemployment, and fear of unemployment, drives protectionism, as voters try to maximise the number of domestic jobs.

The graph below from www.chartoftheday.com shows how US employment since the Crisis (red line) has fallen much further than the 1950 -1999 average (blue) in recessions, or in the period after the 2001 recession (green).

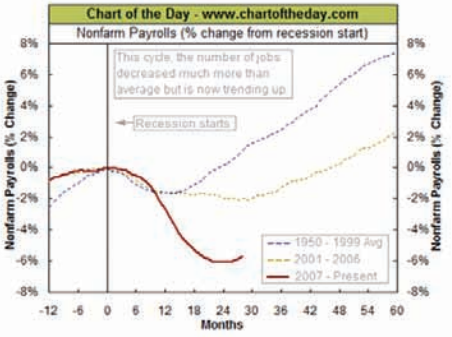

Chart 9: Sovereign risk and unemployment have both risen

There is a risk that the crisis now enters a new stage

By now, according to Summers' argument, Western consumers should be starting to regain their confidence and start spending again. But the evidence so far, as we have seen for key areas of chemical demand, is certainly inconclusive. And we may, instead, be at a cross-roads where a new set of problems begin to emerge.

One is the problem of sovereign risk, where countries become unable to service their debts. This occurred in Latin America during the 1980's downturn. And we have already seen this happen most spectacularly with Iceland, where the economy imploded when its major banks went bust. Iceland had been, of course, the country with the highest GDP/capita in the world, prior to the crash.

Now, as described in Chart 9, we are seeing similar problems emerge in Europe, where many countries had also been living beyond their income during the Boom years. Greece, a Eurozone member, has needed a €110bn rescue package from the other euro countries and the International Monetary Fund (IMF). This will cause a long-lasting recession, as the price of the loan is that Greece cuts back its spending quite dramatically.

There is a risk that the crisis now enters a new stage (continued)

Worryingly, other Eurozone countries such as Portugal, Spain and Italy may well find themselves facing similar pressures, particularly if recovery remains elusive. This would create a vicious circle, where banks would face losses on their loans, whilst demand would be reduced by spending cuts. Exporting countries, such as Germany, would then be hit in turn, causing their own domestic demand to suffer.

Another related problem is that of unemployment. For 25 years until 2008, the world saw a virtuous circle develop whereby the rich countries increasingly off-shored much of their manufacturing activity to Asia (particularly China) and other developing regions. These jobs were replaced by employment in service industries, many associated with the financial sector, which grew very strongly.

Thus Western consumers got the benefit of lower-priced goods, whilst the emerging countries gained employment and began to become consumers themselves. This was wonderful for the chemical industry, as it created new demand and supported existing demand. But now the circle may be turning vicious.

Unemployment has been rising in the West, and shows few signs of reducing in the short-term. As the second chart above, from www.chartoftheday.com shows, US unemployment has been worse, and lasted for longer, than the average for all recessions between 1950 – 1999.

Understandably, therefore, consumers are more worried about their jobs, and are asking why jobs can't be returned to their domestic economy. In turn, globalisation is being replaced by a more regional focus, and politicians are beginning to increase tariffs and duties to protect domestic industries.

There is, therefore, a clear risk, if the economy doesn't begin to improve, that Western consumers, who are also voters, will begin to demand a greater focus on job growth at home. Equally, this would fatally undermine the export-based development model which has seen China's exports increase from 20% of GDP to 37% between 2000 – 2007.

China is already trying to stimulate its domestic economy, but this will take time to achieve. As we saw in Q1 2009, its export-related jobs can be lost overnight if Western consumers can no longer afford the product being made. And future jobs are certainly at risk if Western politicians impose tariffs in response to domestic pressure from worried voters.

Air Liquide. "In a context that remains contrasted, this first quarter of 2010 marks the return to growth".
Akzo Nobel. "Expect pressure from further raw material cost increases and remain cautious about the strength of the recovery".
Ashland. "Asia-Pacific remained the most difficult market for recovering raw materials costs; Europe remains tough due to the competitive environment".
BASF. "Limited supplies of certain chemicals as well as restocking of inventories among customers buoyed demand.... We expect that national stimulus programmes around the world will wind down. Further recovery is therefore not certain and surprises cannot be ruled out for 2010."
Bayer. "The decline in business momentum at HealthCare and CropScience was being offset by the recovery at MaterialScience".
BP. "Petrochemicals margins would come under pressure due to new capacity coming on stream".
Celanese. Asia is "the only region in the world that's growing".
Cepsa. "A more buoyant global operating environment with better product prices".
Clariant. "We expect the economic recovery to remain fragile and raw material costs to further rise heading into the seasonally weaker second half of the year".
Cognis. "Business conditions improved due to a pickup in worldwide demand, especially in Europe".
ConocoPhillips. "Chemicals experienced improved market conditions."
Cytec. "There is still some uncertainty about the recovery, and higher energy prices will show up in our costs for the second quarter."
Dow. "Demand growth was returning in developed markets, with strengthened consumer spending in areas such as electronics, appliances and automotive ...balancing out challenges in residential and commercial construction, inflation in emerging markets and sovereign debt issues in southern Europe".
Dow Corning. "Seeing this recovery in demand in nearly every industry and geography we serve".
DSM. "Uncertainties remain in the medium-term economic outlook."
DuPont. "Expected stronger sales growth operating margins as global economic improvements continued, with particularly strong demand in Asia Pacific.
Eastman. "Expected continued volatility in raw material and energy costs".
ExxonMobil. "Q1 chemical product sales were 6.488MT, up by 961KT in Q1 2009, primarily due to improved global demand".
Honeywell. "The timing and shape of the recovery is uncertain and we remain conservative in our planning assumptions".

Idemitsu Kosan. "Demand for petrochemical products recovered, assisted by China's economic stimulus package."
INEOS. "Just as the orders dried up suddenly in August 2008 so they have abruptly resumed in the past couple of months".
Kemira. "Uncertainty remained regarding the development of demand".
Lubrizol. "Do not expect full recovery to our 2008 volume level until 2011...also expect tight supply conditions for some of our raw materials that will result in upward cost pressure."
Occidental. "Significant margin erosion in 2009 carried over into the first quarter of this year."
Olin. "Had a Q1 operating rate of 75%, compared with 65% in Q1 2009."
PetroChina. "Ethylene output surged 37% year on year in Q1, with production of other petrochemicals also strong.
PPG. Saw continued "moderate recovery" in several of its global end-use markets over the quarter."
Quaker. "Anticipate somewhat lower product volume in H2 ...due to credit-tightening actions in China, seasonal factors, the ending of inventory restocking and the conclusion of tax incentives for auto purchases in several countries".
Reliance. "Domestic demand for most petrochemical products remained strong in the January to March period, with polymers demand up by 19% and demand for polyester and fibre intermediates up by 15%".
Rhodia. "The upward trend in raw material and energy costs is expected to continue".
Rockwood. "Difficult to determine what impact customer inventory rebuild is having on our sales."
SABIC. "Overcoming the impacts of the global financial crisis, as well as continuing our strategy of growth and investment in new industrial plants".
Shell. "Industry refining margins had significantly declined reflecting reduced demand for refined products".
Sherwin Williams. "Sales were slightly stronger than we anticipated, although domestic demand remains soft".
Sinopec. "In light of state stimulus policies, demand... grew steadily and the company took various proactive measures to expand the market and optimise the product mix".
Syngenta. "Expects volume growth from Q2 onwards".
Tessenderlo. "Visibility on H2 remains low".
TOTAL. "Chemicals has benefited from the economic recovery since the start of the year."
Trelleborg. "Warned that the demand scenario remains uncertain".
Unilever. "Commodity costs will increase in the second half, economies remain sluggish and competitive intensity will remain high".
Vopak. "We notice the first signs of structural recovery of the European chemicals market."
Wacker. Focused on " improving our cost structures and increasing our competitive edge."

Chart 10: Company comments on the Outlook

Companies remain cautious after seasonal upturn

Chart 10 shows the latest summary of company comments on the Outlook, as posted recently on the blog. The first quarter certainly saw the expected seasonal boost, as companies restocked down the value chain. But Asia, particularly China, remains the main focus of growth.

PetroChina, Reliance and Sinopec all see a continuing boom underway there, with Sinopec highlighting the importance of "State stimulus measures".

Dow Corning is certainly bullish, seeing "recovery in nearly every industry and geography". Whilst Cognis, also focused on 'green markets', detects improved demand in Europe. But although Dow sees "demand growth returning in developed markets", it notes significant "challenges" remain.

Equally, Akzo Nobel seems typical of the majority when noting it remains "cautious about the strength of the recovery". BASF also notes that "recovery is not certain". And several companies, including Rhodia, worry about the "uptrend in raw material and energy costs."

The global economy may now be at a cross-roads

Chart 11 featured in the original White Paper, and it is helpful to re-visit it now, to examine what has changed and what has stayed the same.

- The first two assumptions of the Consensus Scenario are clearly already looking doubtful. Oil rose sharply above $70/bbl, and there has been little sign of a V-shaped recovery in core petchem markets on a global basis. Some might argue that Asia has seen something close to a V-shaped recovery, due to China's influence, but it remains to be seen whether this can be sustained through H2 as bank lending is reduced.

- The third assumption is still correct, and it is a worry that company earnings are being maintained by job cuts, instead of revenue growth. Unemployment seems unlikely to fall much in the Western world over the rest of this year, and may well increase in countries such as Greece and the Baltic states, where massive budget cuts are having to be made by governments.

Equally, whilst we cannot be sure that we have avoided the L-shape, it is still too early to tell whether this is the fate that awaits us. Certainly populations are aging in the West and in China, whilst Japan is already experiencing this problem. It therefore remains a real threat.

Chart 11: Scenarios 2010-12

For the moment, therefore, we are still in the Stimulus scenarios. Governments around the world have spent prodigious amounts on supporting their countries' economies over the past 18 months, since the Crisis began. Some of this was direct, to support auto sales and housing, as we have seen: some was indirect, in support for the banking sector.

But these programmes are coming to end. And the bill for them must start to be paid. This could prove very deflationary in countries where investors lose confidence, and refuse to lend enough money to finance the debt that has been generated. I also suspect that we will see an increasing focus by investors on 'return *of* capital', rather than 'return *on* capital', particularly if financial markets fail to maintain their recent rally.

Conclusions

The chemical industry is a cyclical business. And it usually has seasonal cycles within its longer-term cycles. Thus, unfortunately, whilst I would like to believe that the first quarter of 2010 will prove the start of a sustained recovery, I fear it is more likely instead to represent a temporary respite from the longer-term downtrend.

Supply/demand balances are still getting worse, rather than better, for the major petchem and polymer products. And many of the countries hosting the new capacity have a quite different set of priorities from those in the West. Maintaining high levels of employment, and social order, are much more important than maximising company profits.

And whilst economists talk about a need to rebalance the world economy, so that emerging nations consume more and Western countries save more, this is easier said than done. Many emerging nations have no social safety net, so individuals have to maintain relatively high personal savings rates to fund unexpected emergencies. Equally, western consumers have become used to high levels of borrowing to fund their lifestyle.

This suggests that it will be very hard to reach a global consensus through the G-20 Group (of the world's leading economies), or in other international bodies, on how the Crisis can be overcome. Instead, we are more likely to see individual nations continuing to adopt their own policies, irrespective of whether these promote or detract from global stability.

Thus, as I wrote in the original White Paper, I fear:

- **Exchange rates** will continue to be very volatile, and make planning difficult.
- Other **financial markets,** including commodities such as oil, may also see continued volatility, in particularly if the recent rally now gives way to a further downtrend.
- **Protectionism** will increase. The chemical industry has been a great beneficiary from globalisation over the past 25 years, and so a rise in trade and duty barriers would have a major impact on future growth.
- **Geopolitics** still has the potential to disrupt the global economy, and strains may intensify if politicians become more insular and nationalistic in their approach.
- **Debt markets** are revving up to provide us with further nasty surprises, and there remains a striking lack of consensus on how to repair the damage already done.

Conclusions (continued)

Extended downturns are difficult times. We would all like the certainties of future growth to return. It is therefore understandable that Summers' argument holds a lot of attractions, even amongst people who suspect it will prove to be wishful thinking. My own view is that full recovery will take much longer than he, or the financial community, currently expect. Sadly, disappointment is part of the experience of extended downturns.

But if I am right in suggesting that this is going to prove an extended downturn, like those of the early 1980's and 1990's, then we have to accept that we will also have to live with continued uncertainty. This then places a premium on building flexibility into our plans, and testing them against potential alternative outcomes.

Harold Macmillan, the former UK prime minister, summed up this dilemma when asked once about "his greatest worries". He famously replied, "Events, dear boy, events". This remains a good watchword for all of us, as we progress through the uncertainties of the current downturn towards the 'New Normal'.

Chart sources:

American Chemistry Council: Chart 1, Chart 2

European Automobile Manufacturers' Association: Chart 3

People's Bank of China: Chart 4

PetroMatrix: Chart 6

PIMCO, www.thechartstore.com: Chart 8

www.webwinds.com, www.chartoftheday.com: Chart 9

About the Author

International eChem (IeC) are trusted commercial advisers to the global chemical industry and its investment community. Our team is independent, and has an in-depth understanding of the issues, and of the 'real world' in which clients operate, due to our experience in working with many of the world's major companies and financial institutions.

International eChem's aim is to bring Creative Energy to Important Issues. They specialise in the area of Business development, providing commercial leadership to help businesses compete profitably in global markets.

Paul Hodges is a trusted adviser to major chemical companies and the investment community. He has worked in the chemical industry for 30 years. Initially he spent 17 years as a senior executive with one of the world's leading companies (ICI), both in England and the USA, where he held senior executive positions in petrochemicals and chloralkali, and was Executive Director of a $1 billion ICI business.

He founded IeC in 1995, and has strong professional relationships with the leading players, and follows developments on a detailed day-to-day basis. He writes the 'ICIS Chemicals and the Economy' blog (www.icis.com/blogs/chemicals-and-the-economy), and has been recognised in the Financial Times and elsewhere for his success in correctly forewarning of the global financial crisis.

Paul is a Freeman of the City of London. He is a graduate of the University of York, and subsequently studied with the IMD business school in Switzerland.

About ICIS

Trusted market intelligence for the global chemical and energy industries.

ICIS aims to help companies in global commodity markets improve their revenues and profits by providing high quality, timely, commercially useful information, business leads and brand positioning across the globe.

Our products include;

ICIS pricing – unbiased and independent chemical and oil price reporting.

ICIS news – chemical news from around the world as it happens.

ICIS Heren – the leading specialist information provider for the gas, power and carbon markets.

ICIS Chemical Business – analysis of the chemical markets