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Time for a new business approach

Chemicals leaders should prepare for long-term low economic growth by switching to new business models based on a demand focus, net zero carbon and services

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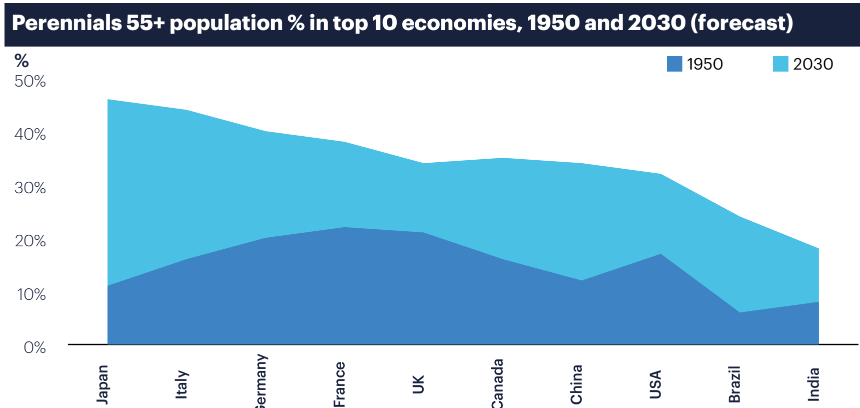
Perennials 55+ population % in top 10 economies, 1950 and 2030 (forecast)



Source: New Normal Consulting analysis; UN Population Division data

A new year is a time for looking forward, rather than backward. And whilst we can all regret the end of globalisation, the arrival of 2024 reminds us of the need to refocus on the future rather than the past. We also need to ignore the siren voices telling us that a new 'Goldilocks economy' of low interest rates and booming demand is set to return. A year ago, after all, the same people were telling us that a strong post-Covid recovery in China was set to reignite global growth.

As the saying reminds us, "Fool me once, shame on you: Fool me twice, shame on me". Instead, we need to focus on what the chemical industry is trying to tell us about the outlook. It is the best leading indicator for the global economy. And it has been warning for some time that, in reality, companies and investors face the most challenging outlook since the end of the Second World War.

We first highlighted these challenges here in the form of the 4 Horsemen of the Apocalypse nearly 18 months ago (*ICB 5–11 August 2022*). As we warned then, one key issue is that "Few have experienced a 1970s style recession. But a similar situation is developing today – a toxic combination of geopolitics, energy shortages and rising inflation".

Unsurprisingly, therefore, the industry's warning that we are moving back to a world of winners and losers has been largely ignored. Many, perhaps even most, of the potential losers have failed to recognise the risks that they face. Instead, they continue to assume that central banks will always rush to the rescue. We saw this demonstrated before Christmas, with most commentators starting to argue that the economy was set for a so-called "soft landing" in which interest rates would quickly return to zero.

The problem with this assumption is simply that interest rate changes take 12 – 18 months to work their way through the economy. And so, even if rates have now peaked, the full impact of the rate rises since March 2022 is only now about to hit key markets such as construction, autos and electronics. In addition, the two super-critical 'dividends' of the past 30 years are now reversing:

- One is that the 'demographic dividend' of constant growth and low inflation created by the BabyBoom generation has come to an end. And increasing life expectancy means that the Boomers are no longer dying at retirement age. Instead, they are becoming a replacement economy.
- Secondly, we have lost the 'peace dividend' created by the end of the Cold War in 1989. Instead, we have two major wars underway – in Europe and the Middle East. War is one of the Four Horsemen, and it highlights the major costs likely to be involved in the race to rearm.

Financial markets are therefore likely to experience a potentially painful 'wake-up call' as reality intrudes on their fairytale expectations for a so-called "soft landing".

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This background is likely to dominate as we move through 2024 and so helps us to answer the key questions that we now face:

- What will drive chemical markets in 2024?
- How can companies adapt to survive or even thrive in these challenging times?
- Longer-term, how will the industry look in 2030?

2024's potential winners will be those who recognise that business models have to change from being supply-driven to become demand-led, due to the end of the demographic dividend. It is no longer possible to assume that global growth will always average around 3% a year, and that petrochemical product demand will be a multiple of this. The reason is simply that the world's Top 10 economies are two-thirds of global GDP. And as the chart shows, eight of them are ageing rapidly.

Back in 1950 the G10 populations were all very young. Only about 15% were in the Perennials 55+ age range. But yesterday's 'demographic dividend' has become today's 'demographic deficit'. The Perennials proportion will have more than doubled by 2030 to around 35%. Brazil and India are the only exceptions, with a Perennials proportion of 24% and 18% respectively. But both countries are relatively poor, and together only account for 5% of global GDP.

The issue is simply that today's population growth is now being driven by increasing life expectancy, rather than births. Birth rates have been below replacement levels of 2.1 babies/woman in the wealthy western economies

since 1970. Essentially, the Boomers are therefore becoming the Perennials. And whilst increasing life expectancy is good news for them personally, it is bad news for economic growth. As government data shows, they are essentially a replacement economy. They already own most of what they need, and their incomes decline as they move into retirement.

This matters for the global economy because consumption is 60% – 70% of GDP in western economies. And consumer spending peaks by age 55, before falling 30% or more by the age of 75. Since 2000, this impact has been disguised by the central banks' reckless stimulus policy. They have essentially tried to "print babies". But their failure is evident in the vast pile of global debt that the policy has created. Instead of the promised growth, this has now reached an eye-watering $310tn, nearly double 2008's level. And, of course, this debt is now creating an additional major headwind for the economy, as interest rates rise to reflect the increasing risk that over-indebted corporate and country borrowers will likely default.

In addition, we have now lost the 'peace dividend' that enabled governments to reduce defence spending after the end of the Cold War. This freed up trillions of dollars for spending on domestic priorities such as health, education and transport. By 1998, US President Bill Clinton was even able to boast in his State of the Union address that the US had achieved a balanced budget for the first time in 30 years. But fast forward to today, and Russia's economy is back on a war footing as President Putin has confirmed. In response, Germany's Defence Minister, Boris Pistorius, has already suggested that the government may well need to follow Sweden's example and reintroduce conscription.

The chemical industry has been warning for some time that, in reality, companies and investors face the most challenging outlook since the Second World War

The next few years are therefore likely to be very different from anything that we have known in our working lives. Some of us do, of course, remember the Cold War. But none of us have ever lived in an economy facing a major demographic deficit and a record level of debt. And so scenario planning is therefore essential in the face of this uncertainty.

In the short-term, it seems prudent to plan for a lengthy and probably deep recession in 2024/5. The disruption and higher costs caused by the problems at the Suez and Panama Canals are just one sign of today's more challenging environment, and will likely help to confirm the end of global supply chains. It would also seem sensible to consider potential "second-order impacts" from the ending of the demographic and peace dividends. As we have seen in Argentina, populist leaders are already emerging to claim that they have simple answers to these complex questions. With more than half of the world's population going to the polls this year, the scope for surprises seems uncomfortably high.

At the same time, companies have to accelerate their focus on building a more service-based business, based on providing solutions rather than products. As ICIS data confirms, 20 years of stimulus has created vast over-capacity. This has already reached 200m tonnes in the six major petrochemical value chains, with another 50m tonnes expected by 2030. In turn, as we saw last year, producers are already well on the way to losing pricing power.

The good news, however, is that major new markets are opening up, for those willing to make the transition to the New Normal world. Net zero needs are creating a once-in-a-lifetime opportunity to reduce emissions and costs by adopting modern technology. And the one billion Perennials in the top 10 economies are woefully underserved by existing suppliers, who seem to imagine their needs are limited to adult diapers and zimmer frames. 2024 is likely to be very difficult, but it is also likely to see potential longer-term winners focusing on these major new opportunities and building out highly profitable new offerings for the future. ■

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Net zero carbon agenda can fuel businesses in a low GDP growth environment