

Press Evening Chemical Business Germany

1 March 2016 in Frankfurt

Speech – Dr Utz Tillmann, Director-General of the VCI

Ladies and Gentlemen:

A turbulent business year came to an end for the German chemical industry. There had been hopes for brisker chemical business, but largely these hopes did not materialise. Once more, our expectations did not come true.

I. A glance back at the chemical business year 2015

Basically, the prerequisites had been favourable for a robust upswing: Given the special factors of the weak euro, cheap oil and low interest rates, the German economy gained in speed last year. The gross domestic product grew by 1.4 percent. But contrary to our hopes, the upturn of the overall economy did not reach industry.

Industrial production improved only somewhat, i.e. by 0.5 percent. There was even a slight minus for the building sector. This was reflected in the weak developments in the domestic demand for chemicals.

Until roughly mid-2015 there was no reason to worry. But then we saw more and more cracks in the global economy. There was a strong slowdown in many emerging markets. Russia and Brazil fell into deep recession.

China turned from the growth driver to a cause for concern. Current turbulences at the Chinese stock markets reflect the profound structural problems in that country. In this environment, global industrial production only improved by 2 percent in 2015. The weak situation of industry dampened the demand for chemicals globally.

This was felt by the German chemical industry too. After an altogether good first half-year, it came as a surprise that companies had to reduce production in the 2nd half 2015. As a supplier to almost all industrial sectors, our industry felt right away the change in speed in the emerging markets. The companies responded fast to the drop in demand by adapting their productions. The described downtrend became faster at the end of the year.

Meanwhile, the preliminary official figures are available for almost all economic indicators:

- Altogether, there was only slight growth for the chemical-pharmaceutical industry in Germany. **Production** in the overall year 2015 merely grew by 0.7 percent – with pharma improving strongly while all other sectors shrunk by 0.7 percent on average.
- The **capacity utilization** of production plants was not satisfactory. At 83.5 percent it was at the lower end of what is normal in our industry.
- **Prices** dropped by 2.8 percent. With sluggish sales, falling raw material prices were passed on fast to the customers.
- Chemical industry **sales** fell by 0.4 percent to 190 billion euros. Foreign sales of chemical companies improved by 0.3 percent; domestic business was disappointing: sales to German customers declined by 1.5 percent.
- Irrespective of weak growth, the German chemical industry hired more **staff** in 2015 (+0.5 percent). The total number of persons employed went up to 447,000.

The huge differences between the individual **chemical sectors** are striking. While pharma business prospered and specialty chemicals improved altogether, some parts of basic chemistry saw production decreases.

The growth in production by 0.7 percent is solely attributable to the pharma business (+3.7%) and to specialty chemicals (+1.3%). By contrast, the production of polymers (+0.3%) and inorganic chemicals (+0.7%) barely grew. Manufacturers of consumer chemicals (-3.4%) and petrochemicals (-3.1%) recorded major setbacks.

The drop for **petrochemicals** should be seen in a particularly critical light. This sector had to reduce production for the fifth consecutive year. Here, a structural problem becomes evident which has clearly to do with the competitiveness of the location Germany: High raw material and energy costs combined with low market dynamics led to major declines in production.

It is food for thought that this process lasted, irrespective of last year's low oil prices. German petrochemistry should be internationally competitive, given the weak euro and cheap naphtha.

II. Figures from the 4th quarter 2015

Ladies and Gentlemen:

As touched upon earlier, the business year 2015 ended with a disappointing 4th quarter for the German chemical industry. All the important indicators pointed downward at the end of the year. Only employment remained stable. Here the figures:

- Seasonally adjusted, **production** fell by 2.6 percent against the previous quarter. In the annual comparison against 2014, the drop in production was much lower (-0.8 percent).
- **Capacity utilisation** in the industry was only at 83.8 percent. Thus, the capacity utilisation of plants is still just in the long-term average range.
- **Producer prices** continued to fall in the last quarter 2015 (-1.6 percent). After nine months of stable prices for chemical and pharmaceutical products, in the 4th quarter 2015 producer prices fell by 1.6 percent against the previous three months. Chemicals were 2.9 percent less costly than in the previous year.
- As compared with the previous quarter, **sales** dropped by 1.5 percent to 43 billion euros. In a 12-month comparison, domestic sales fell by 0.9 percent. The weakness of emerging markets was fully reflected in foreign sales. Business with customers abroad was 1.6 percent below the level of the previous year.
- **Employment:** The number of staff remained stable as compared with the previous quarter. Since the global economic crisis 2009 the chemical industry has created over 30,000 new jobs.

III. Outlook 2016

Irrespective of the weak last quarter 2015, so far the chemical companies are not dissatisfied with their business situation. Most recently, they saw the current situation largely positively. Mainly the falling raw material costs contributed to this. Given the decline of the crude oil price, most companies still did good business, even with falling sales.

But the following clearly emerged at the end of last year: The low **oil prices** do not only have positive effects on the industry. It is only advisable for customers to

stock up their receiving warehouses early when oil and chemical prices are rising. In view of the current price developments, purchasers are taking a rather reserved attitude.

Consequently, the nosedive of oil prices adversely affects chemical sales. Traditionally, this effect is particularly strong towards the end of the year. Customers are reducing stocks. Both facts combined led to the unfavourable quarterly results at the end of 2015.

Further business developments will strongly depend on the economic environment. Our appraisal of this: The outlook remains good for Germany's national economy. For 2016, some economic researchers are holding out prospects of up to 2 percent growth. We do not share their optimism. Firstly, the special factors are becoming weaker. Secondly, a brisker overall economy does not reach industry.

The situation of industry is decisive for the chemical business. This is where the problem becomes evident: Also in 2016, **industrial production** in Germany is likely to achieve only moderate growth by 0.5 percent. Against this backdrop, domestic sales should hardly improve for the German chemical industry.

Business is looking better in Europe. Meanwhile, the economy has gained in speed in the EU. Unlike in Germany, this benefits industry in many countries. In 2016 the production of European industry is likely to grow by 1.0 percent. This will be to the advantage of the German chemical industry too, with rising exports to neighbouring countries in the present year.

Prospects are moderate for our **overseas exports**, as our sales markets are showing signs of weakness:

- Most recently, the economy has cooled in the USA due to lower oil prices. At present, fracking is no competitive advantage. Effects of the interest rate reversal are going in this direction too.
- Japan's economy is stuttering as a growth motor.
- The major point of concern for the companies is the development in China. Our forecast: The slowdown of economic growth will continue in 2016.
- Only low impulses are coming from the other emerging markets.
- Russia does not come out of recession due to low oil prices and sanctions.
- The economy of Brazil will continue shrinking in 2016.

Altogether, foreign demand should improve only slightly in the present year – even though the weak euro stimulates exports and the low oil price strengthens the competitiveness of German producers.

In view of the most recent developments, a minor downward correction of our forecasts for 2016 becomes necessary, as compared with the VCI press conference of December 2015¹.

Here our latest forecast:

- Chemical production will improve by 1 percent.
- Chemical prices are likely to fall by 0.5 percent, because lower raw material costs need to be passed on rapidly to customers.
- Chemical industry sales should rise somewhat to 191 billion euros (+0.5 percent). With stagnating business in Germany, foreign sales could expand slightly.

IV. Framework conditions and long-term development

Ladies and Gentlemen:

What conclusions can we draw from the most recent developments?

Firstly: A home-grown need for action

The generally positive trend in the German overall economy is solely attributable to the earlier mentioned special effects. But these effects are already becoming weaker. Realistically, this means the following: At present, there is no self-reliant upswing, and there is the risk of Germany sliding into **recession**.

This has to do with the great importance of industry for our economy model. Over 22 percent of value creation in Germany and some 84 percent of German export goods originate from industry. As compared with other national economies, industry has clearly more weight in our country.

This is the core of the problem: The upturn of the overall economy does not reach industry. The key figures show this. In 2015, **industrial production** in Germany

¹ Forecast 2016, given at the press conference on 8 December 2015: production +1.5%, prices 0%, sales +1.5%

merely grew by 0.5 percent. Growth will be only negligibly higher in 2016. This is also reflected in the chemical industry – irrespective of strong pharma production.

Industry is losing shares in the overall economic performance. If these developments become permanent, de-industrialisation is threatening for Germany.

Therefore, we see a considerable need for industrial policy action. The federal government and the German federal states need to work for economic impulses. The alliance “Future of industry / Zukunft der Industrie” – where the VCI has joined forces with 15 partners from politics, trade unions and business associations – identifies priorities and develops measures. The goal is to ensure international competitiveness for the core of the German economy. This includes better framework conditions for innovations and energy supplies.

A few days ago, the Alliance highlighted in a joint declaration what is necessary for this. Speaking for the Alliance partners, federal economics minister Gabriel demanded, inter alia, to attach equal political importance to the EU’s 20-percent goal for industry’s share in GDP and to the 20-percent climate protection goal.

The current moment in time would be favourable for reforms. The difference in competitiveness is low because of the oil price and the weak euro. Now, better planning security could reverse investment decisions to the benefit of the location Germany.

Secondly: The special role of China

The dependence of the German chemical industry on developments in **China** is much stronger than it seems at a first glance – even though only 3.6 percent of German chemical exports go to China.

For a better assessment: Today, China is the second largest national economy worldwide in terms of GDP, following the USA. China ranks first in terms of industrial production. As regards the chemical industry, China has been the number one globally since 2009.

So far, the German chemical industry has strongly benefited from China’s economic miracle. Since 2004, our exports to China have grown by 14.4 percent annually on average. It is true that imports from China have risen too, but our **foreign trade surplus** has increased continually. The Chinese market needs more chemicals than can be produced domestically.

Moreover, German chemical companies increasingly built distribution and production sites locally. In total, 179 subsidiaries of German chemical companies are currently active in China. These subsidiaries combined achieve sales of over 16 billion euros and employ around 47,000 staff. Today, China is the second important production location abroad for German chemical companies, after the USA.

Over the past 20 years China has developed into the by far largest chemical market worldwide. Obviously, such breath-taking growth comes with high **investments**. There were nowhere else more investments in the chemical industry than in the People's Republic of China: some 91.3 billion euros in 2014 alone.

Unlike, for example, in the steel industry this investment boom did not lead to overcapacities in China – because China remains a net importer of chemicals.

However, with the creation of huge production capacities, China will import fewer basic chemicals from the Middle East in the future. New sales markets will be sought for Middle Eastern overproduction – also in Europe. Thus, weaker growth in China indirectly brings import pressure for Europe's basic chemistry.

The end of China's economic boom impacts many of our globally operating customer industries. Mechanical engineering companies or carmakers strongly depend on business with China. For this reason, economic weakness of China also dampens our domestic business.

At the same time, we should see the overall picture: Even with much slower growth in China in the future, the People's Republic will remain a dynamic industry location. This increases the demand for chemicals.

For the German chemical industry, long-term prospects are and remain good in China. The importance of China as a sales market and a production site will continue to grow in the coming 15 years.

V. Some closing words

Ladies and Gentlemen:

Together with the economic research institute PROGNOSE, the VCI has recently updated our long-term forecasts to 2030. Based on these projections, we are convinced of the following: If the framework conditions for industrial production can be improved, the chemical industry has a good perspective at the location Germany. The alliance “Future of Industry” could pave the way for this.

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