Euler Hermes Economic Research

Euler Hermes Germany

Industry Report

Chemicals in Germany: A window of opportunity that must not be missed

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Executive summary

- With over EUR100bn in exports in 2014, the chemical sector is the third largest export engine for Germany. In 2015-16, the lower euro and the pick-up in demand in Europe will add EUR7.9bn and EUR11.3bn of additional exports.
- Low oil prices will boost the industry's operating margins by 0.5pp in 2015 to 12.6%. However, this good news may not be enough to stimulate investments in Germany in the chemical sector. In 2015, capital spending abroad will increase almost six times as fast as in Germany.
- Boosting net domestic capital assets and R&D spending are key strategies for German chemical companies to maintain high quality positioning. Favorable short-term drivers should not be an excuse, they should be an opportunity.

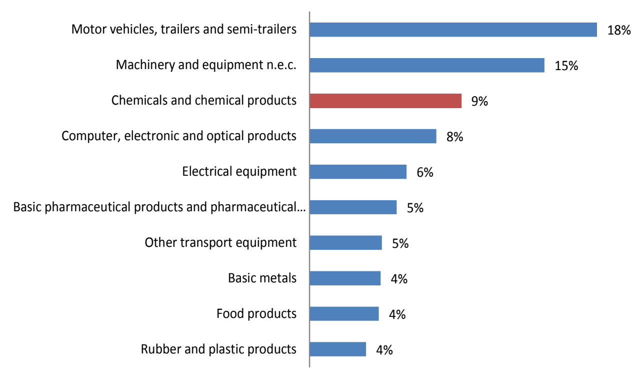
With over EUR100bn in exports in 2014, the chemical sector is the third largest export engine for Germany

The chemicals industry is in Germany's top three of export sectors, accounting for 9% of total exports in 2014. Globally, Germany is number 1 exporter of chemical products with an 11% market share, followed by the U.S. (10%). The sector as a whole has a strong international orientation with an export ratio of 58%, 10pp over the German average. When taking into account foreign sales in the automotive sector (18% of chemical outputs), this ratio increases to 70%.

In 2015 and 2016, the lower euro and the pick-up in demand in Europe will add EUR7.9bn and EUR11.3bn of additional exports

Euler Hermes expects German chemicals' exports to further strengthen in 2015 and 2016. This outlook confirms a recent opinion survey conducted by Destatis in the German chemical sector showing that export perspectives in Q1 2015 are twice as high than their May 2014 level.

Chart 1: Top Ten Export Sectors in Germany in 2014 (% of the country's total exports in value)

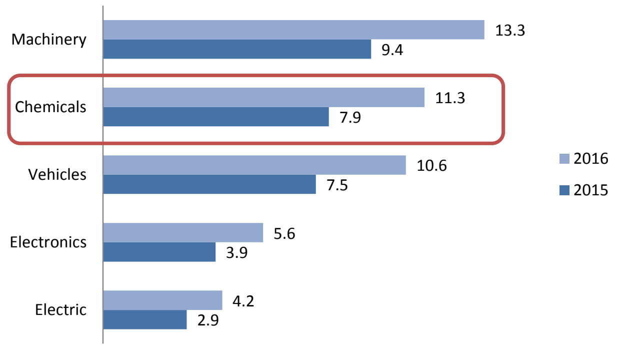


Source: Destatis

Overall, German chemicals' exports gains are expected to reach EUR7.9bn in 2015 and EUR11.3bn in 2016, accounting for about 20% of Germany's total gains over the period. There are two reasons for this acceleration: (i) The favorable EUR/USD exchange rate. The euro is expected to remain signficantly lower than during 2010-2014 at 1.14 euros for a dollar. This should give a price advantage to German chemicals companies and boost their export revenues by up to 20% over the next two years -see chart 2; and (ii) The ongoing economic recovery across Europe. The European Union remains the main market for German chemicals (over 50% of total exports); it will contribute to the industry dynamism, while the Russian and Ukrainian turmoil will have minimal impact since these two countries account for only 4% of their sales abroad.

The rising labor costs in Germany (including the introduction of a minimum wage) will have no impact on the chemical sector's competitiveness as the industry already employs at higher wages, reflecting the focus in quality engineering and the already low labor intensity.

Chart 2: German potential export gains in 2015 and 2016 (EUR bn)



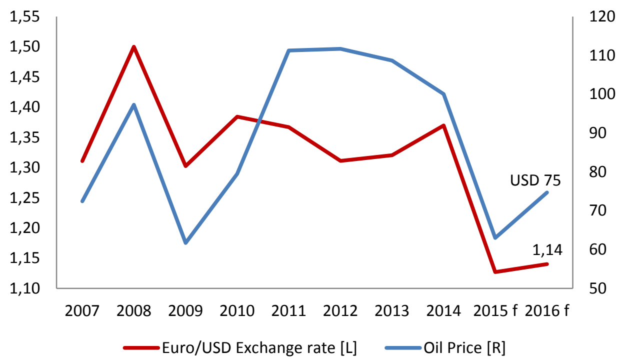
Sources: IHS, IMF, Chelem, Euler Hermes

Low oil prices will further boost German chemical industry's operating margins by 0.5pp in 2015 to 12.6%

Chemicals are one of the most energy intensive sectors. Oil prices have an impact on the industry through two main channels: (i) the impact on gas prices. Gas represents 30% of energy consumption; and (ii) the pricing along the value chain, as oil is a key input for petrochemicals and plastics. Taking into account chemical subsectors, energy costs can represent up to 85% of total operating costs in petrochemicals.

The drop in oil prices, with a barrel expected to average USD63 (compared to USD100 in 2014), is thus likely to reduce costs by up to 30% for that type of activity and have a sizeable positive impact on the operating margins for the entire industry. Euler Hermes expects margins to increase by +0.5pp in 2015 to 12.6%, after a +0.1pp rise in 2014 for the major players of the German chemical industry.

Chart 3: Evolution of the EUR/USD exchange rate and of the Brent price (USD/barrel; annual average)



Sources: Bloomberg, Euler Hermes

Good news may not be enough to stimulate investments in Germany: In 2015, capital spending abroad will increase almost six times as fast as in Germany

Short-term boosters are not necessarily here to stay: for instance oil prices could increase as soon as 2016 (USD75/barrel) pointing to the pivotal role of energy costs in the industry's competitiveness and investment behavior. Energy intensive sectors have had a tendency to invest less in Germany than the rest of the manufacturing sector. Investments follow growth prospects and forward visibility when it comes to key input costs. The uncertainties surrounding the energy policy and reforms (*Energiewende*) have been a major drag to domestic investments for the chemical sector.

Chart 4: Operating margins for the top 8 German chemical firms (% of total turnover)

	2009	2012	2013	2014	2015 (f)
Operating margins	7%	10%	12%	12,1%	12,6%

Sources: Kepler, Bloomberg, Euler Hermes

Capital spending is expected to increase by 3% domestically and 17% abroad in 2015; Euler Hermes expects 1% and 9% respectively in 2016. Between 2010 and 2016, domestic capital spending will have increased by 15% when it increased by 128% abroad.

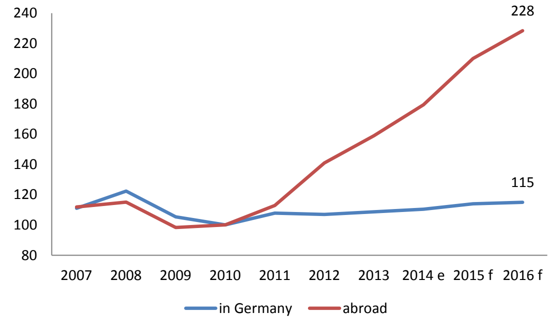
R&D investments are critical to keep a top notch positioning and world class reputation

After a continued decline between 2008 and 2012, R&D expenditures have rebounded to 3.6% in 2014. The upward trend should continue in 2015 and is likely to stabilize in 2016 at 3.7%. This spending is crucial for the industry's competitiveness for two main reasons: (i) it leads to an increase in the energy efficiency ratio and might thus enable firms to be less impacted by relatively higher energy costs; and (ii) it increases the share of specialty chemicals in total production, the latter being much less sensitive to price competition than basic chemicals.

The German chemicals sector benefits from an alignment of stars as both short-term profitability drivers (exchange rate and energy costs) are very favorable to the industry. However, investments in capital and R&D are pivotal to the long-term development of the industry. They have suffered from the ongoing uncertainty around the energy policy and the demand in Europe for the past years and need further attention now rather than later.

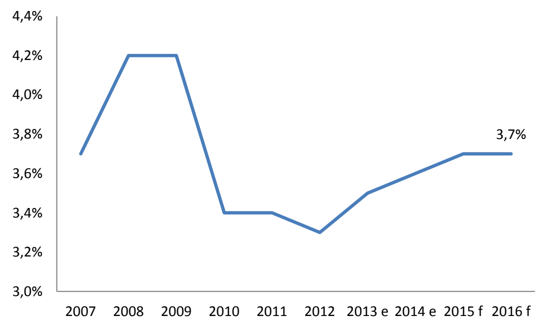
Indeed, the German chemicals sector appears to be an exception. It is the only sector with an above-average export ratio and high R&D expenditures but where net fixed assets have decreased over the past ten years, down -4.8%, while they have increased by 15% in the automotive industry according to Deutsche Bank. This reduction occurred despite rising demand and output, showing that increased productivity has been the main asset of German chemicals sector in recent times. Reducing energy intensity and increasing specialization are proven long term strategies that need to be repeated and built upon. The German chemical industry should not get caught in a trap of short-term complacency but look to further extend its market lead.

Chart 5: Capital spending of the German chemical industry (indices, basis 100=2010)



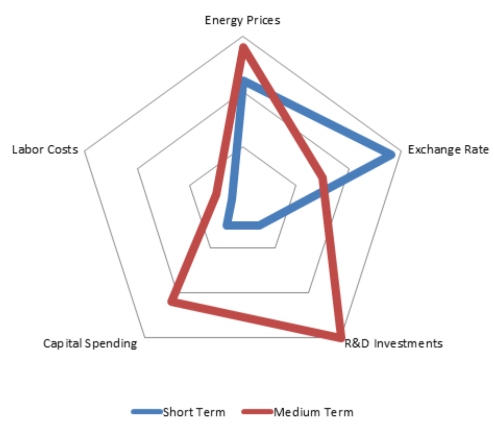
Sources: Destatis, VCI, Euler Hermes

Chart 6: R&D expenditure of the German chemical industry (% of turnover)



Sources: VCI, Euler Hermes

Chart 7: What to watch for German Chemicals?



Sources: Oxford Economics, Euler Hermes. Factors that are far from the center point have the highest impact.

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