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US CHEMICAL EXPORTS TO TAKE BIGGER HIT IN 2ND ROUND OF TARIFFS

By Joseph Chang



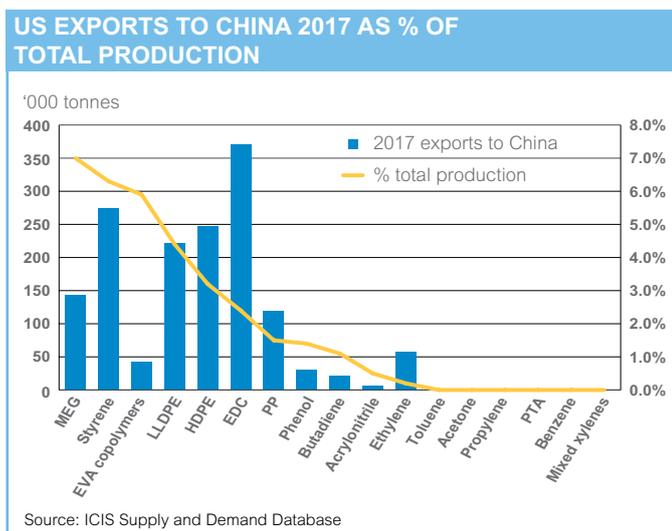
US CHEMICAL EXPORTS TO TAKE BIGGER HIT IN 2ND ROUND OF TARIFFS

BY JOSEPH CHANG AUGUST 2018

The second round of US and China tariffs, each comprising 25% on \$16bn in imports and going into effect on 23 August, will hit US commodity chemical exports to China far harder, as the impact on comparable China exports to the US should be negligible.

However, the overall impact on high-volume commodity chemical markets could be less than many anticipate, at least from this latest round. The first round of US and China tariffs of 25% on \$34bn in imports excluded chemicals.

US commodity chemical products most impacted based on exports to China as a percentage of total production in 2017 are monoethylene glycol (MEG), styrene, EVA copolymers, linear low density polyethylene (LLDPE), high density PE (HDPE), and ethylene dichloride (EDC), based on an analysis of select chemicals trade flows in the ICIS Supply and Demand Database.



PE EXPORTS DIVERTED

For LLDPE, US exports of around 222,000 tonnes to China in 2017 accounted for 10.0% of its total LLDPE exports, and 4.4% of total production. In the first half

of 2018, the US exported 155,000 tonnes of LLDPE to China, or 9.9% of total exports.

The US is also bringing on massive amounts of LLDPE capacity in 2018 and 2019, primarily targeted for export, so planned exports to China in the future would most assuredly have been higher.

Already PE trade flows are shifting as material is being diverted by traders to southeast Asia – Vietnam in particular – as well as Europe. And Latin American PE buyers expect to get access to cheaper material in the short term.

In the long run, the loss of China as an export market for LLDPE and HDPE would be a big one, unless US producers can shift exports in a meaningful way elsewhere.

CEOs of US producers have argued that trade flows will simply shift but not impact the global supply/demand dynamics in the long run, with China importing more PE from elsewhere, and the US exporting more to other regions such as Europe.

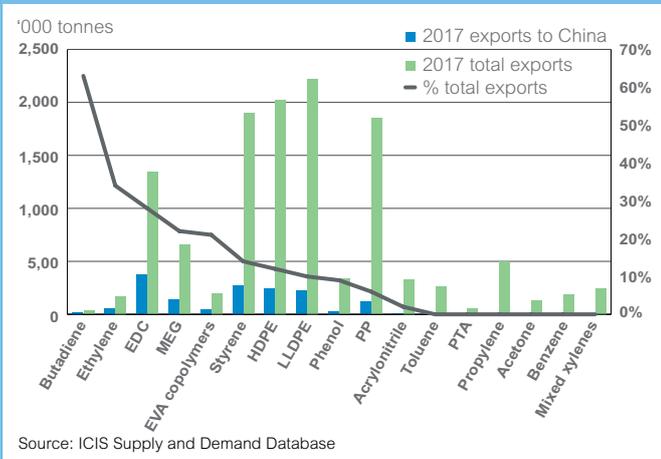
However, John Richardson, senior Asia consultant at ICIS, offers a different view. “We estimate that China will account for 51% of global net HDPE and LLDPE net imports (imports minus exports) across the major deficit regions and countries in 2018-2025,” said Richardson in the ICIS Asian Chemical Connections Blog.

“This means that over the shorter term – this year and 2019 – China will have a similarly dominant role as the world’s biggest importer. It also means that it is mathematically impossible for the US to... comfortably place its big increases in production without exporting to China,” he added.

EXPORTS IN CONTEXT

To understand the potential impact on markets, it is important to keep the export volumes in context with total production, as even if US exports of a particular product to China are a large proportion of total exports, they could represent a very small percentage of overall production.

US EXPORTS TO CHINA 2017 AS % OF TOTAL EXPORTS



the ICIS analysis, the US exported 144,000 tonnes/year of MEG to China in 2017, which accounted for 21.9% of total US exports, and 7.0% of total production.

In the short term, US-based MEG producers will face challenges to divert cargoes to other locations, while in the mid-to-long term, changes in trade flows will be inevitable to cater to new capacity in the US. Potential alternative destinations would be Europe, southeast Asia and India. US exports to China should decline significantly in 2018 instead of growing alongside further strong downstream polyester growth.

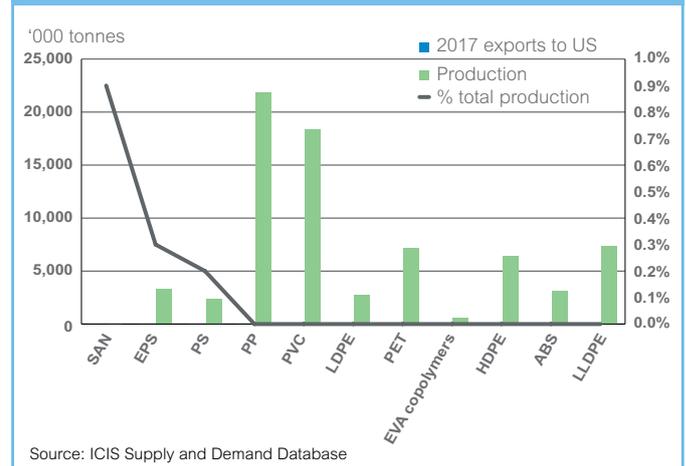
In China, tariffs on US MEG imports will have a limited impact, as imports from the US are just 2.1% of total imports.

No doubt there will be disruptions in global markets stemming from the second round of US-China tariffs but in the case of commodity chemicals, likely far less than many expect.

IMPACT ON CHINA EXPORTS

For China's commodity chemical exports, the impact of US tariffs will be negligible. For the 11 select commodity products China exports to the US analysed by ICIS that come under tariff, none represent even 1% of total China production and most are closer to zero.

CHINA EXPORTS TO US 2017 AS % OF TOTAL PRODUCTION



China's expandable polystyrene (EPS) and polystyrene (PS) exports to the US in 2017 comprised just 0.3% and 0.2% of total production, respectively. As a percentage of total exports, EPS exports to the US represented 3.6% while PS exports were 7.3% of the total.

A good example is butadiene (BD). Even as US BD exports to China comprised a whopping 63% of total US exports in 2017, the volume of about 21,000 tonnes was minimal, representing just 1.1% of total US production.

On a less extreme scale, US EDC exports to China were around 28% of total EDC exports, while the volume of about 371,000 tonnes was 2.4% of total US production.

Players in the US EDC market said the impact will likely be minimal. "It's not 'no problem', but it's not much of a problem," said a US producer active in global EDC markets.

US EDC players actually expect that US EDC imported to China will be exempt from the tariffs if it is used to make polyvinyl chloride (PVC), which is then exported. That re-export exemption should allow for a significant volume of sales to the region, though less than the market has taken in the past.

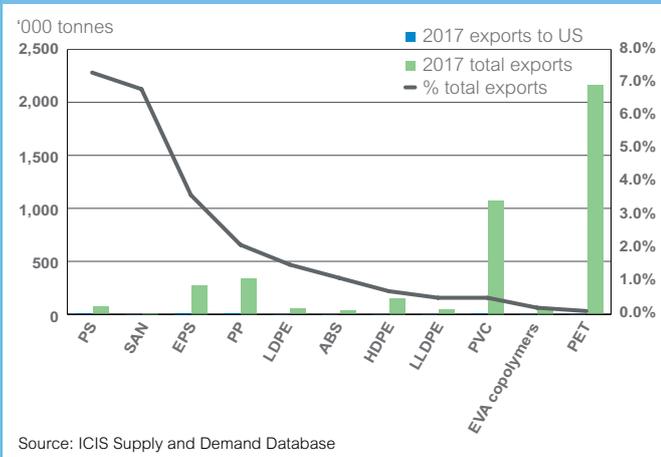
Earlier in August, China revised its second-round list to exclude EDC's main downstream product PVC but kept EDC on the list.

One scenario is that buyers in China pay higher prices for EDC as they seek supply from southeast Asia and the Middle East, where prices are likely to move up to match the level of the US price plus tariffs. Meanwhile, US producers will focus on gaining sales in Europe, southeast Asia, India, Egypt, Brazil and markets in the Mediterranean.

MEG IMPACTED

MEG is one of the US markets to be most impacted. In

CHINA EXPORTS TO US 2017 AS % OF TOTAL EXPORTS



Yet we are talking about less than 10,000 tonnes of EPS and just over 5,000 tonnes of PS – small volumes. For the 11 China commodity chemical exports to the US analysed, not one surpassed 10,000 tonnes in volume in 2017. And aside from EPS, PS and styrene acrylonitrile (SAN), the others did not even amount to 0.1% of total China production.

ACC SOUNDS ALARM

In the above analysis we have covered certain commodity chemicals and polymers, but the overall impact is much more widespread. In the specialty chemicals arena where suppliers are more limited, the impact could be greater. And then there is the impact from many other manufacturing goods coming under tariff, which would indirectly impact demand for chemicals and polymers.

The American Chemistry Council (ACC) is the sounding alarm at the second round of tariffs, as well as the looming third round, which involves the US planning to impose 25% tariffs on an additional \$200bn of Chinese imports,

and China imposing up to 25% tariffs on another \$60bn in US imports.

The second round of US tariffs impact \$2.2bn of chemicals and plastics from China, while China's second-round list includes \$2bn in chemicals and plastics from the US, according to the ACC.

“Companies that rely on imported inputs from China to manufacture goods in the United States will be faced with higher costs. Multinationals will be hit especially hard,” the ACC said. “Higher priced inputs make it more expensive for companies – both foreign and domestic – to do business in the United States, thus deterring investment and economic growth in this country.”

The result will be supply chain disruptions and reduced US manufacturing competitiveness, the trade group noted.

THIRD ROUND OF TARIFFS

And then there is the third round of US-China tariffs, which are on the table for late September.

In this next round of planned US tariffs on \$200bn in Chinese imports, around \$16.3bn in chemicals and plastics from China will be impacted (based on the ACC's estimate of a total \$18.5bn impacted from all three rounds), while China's retaliatory tariffs of 5-25% on another \$60bn in US imports will hit an estimated \$8.8bn in US exports of chemicals and plastics to China, according to the ACC. “Many chemical manufacturers will be impacted negatively by the tariffs from both sides (China and the US) and will see a reduction in their competitiveness,” said the ACC.

However, for the overall economies, China stands to lose far more than the US, according to ICIS senior consultant James Ray.

“Global investors believe the steps the US is taking make

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the US a better investment and China a worse investment as evidenced by the stock markets especially after each new round of tariff announcements,” said Ray.

“There is no doubt that a serious and sustained trade war could disrupt global trade, but a small skirmish that represents a fraction of a percentage of the global GDP, would barely shift the global trade flow. The financial impact of tariffs announced so far will have a very small impact on the consumers of both countries – low single digits of the annual household income,” he added.

The consultant is optimistic on an eventual resolution of the US-China trade dispute as well as the prospects for the US chemical industry even in the face of China tariffs.

“The bottom line is that the sky is not falling. The US and China are just entering the first round of negotiations to level a playing field which has steeply favoured China in the past in hopes of strengthening the relationship between the two great countries. Disrupting the status quo is necessary to bring your largest supplier to the negotiating table, and the US has done exactly that,” said Ray.

“With abundant, low-cost natural gas and shale oil, the US is a low-cost producer and will easily be able to sell its products and still make a profit,” he added.

Additional reporting by Bill Bowen, Felita Widjaja, Eric Su, Tarun Raizada, Linda Naylor and Zachary Moore



ABOUT THE AUTHOR

JOE CHANG
GLOBAL EDITOR, ICIS CHEMICAL BUSINESS

Joseph Chang is Global Editor of ICIS Chemical Business, a weekly publication focusing on macro trends and the analysis of drivers of chemical prices worldwide. He has been with ICIS and one of its predecessor publications for over 20 years, specializing in coverage of financial topics such as macroeconomics, capital spending patterns, equity and debt markets, and mergers and acquisitions. Joseph has a degree in Finance and International Business from New York University's Stern School of Business.

Joseph.Chang@icis.com

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