The chemical industry in Italy: situation and outlook

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For information: Centro Studi Federchimica
Phone. 02/34565.337 – Mail aei@federchimica.it

Recovery has been consolidating in Italian economy

It's now a fact that 2017 will show a good pace of growth for Italian economy (GDP: 1.6%). Can it be concluded that the crisis is over and Italy has undertaken a robust and lasting path of growth?

2017 can be considered as an exceptional year, characterized by a spectrum of very favourable external conditions (in terms of world growth, oil price, euro exchange rate and interest rates).

2018 is expected to be

- **another good year in terms of external conditions** (stable and widespread global growth, with a limited worsening of supply conditions),
- **but also a delicate year, in relation to Italian high public debt**,
- in presence of general elections, with a new electoral law and the normalization of ECB monetary policy, which will bring about a gradual reduction in purchases of Italian government securities followed by an increase in interest rates.

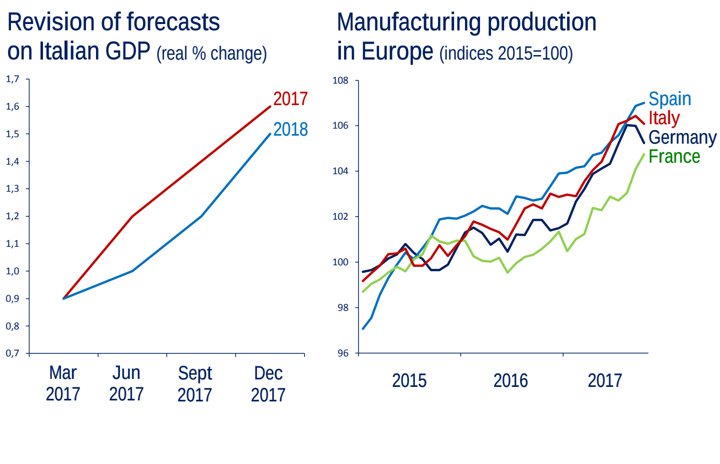
After all the false starts of the past years, a solid recovery is finally on going in Italy, which is reflected

- in the systematic upward revision of economic forecasts, not only for 2017 but also for 2018
- and in the expansion of manufacturing production by nearly 3%, in line with other main European countries.

It can be said that for the Italian manufacturing industry the long-lasting crisis is over:

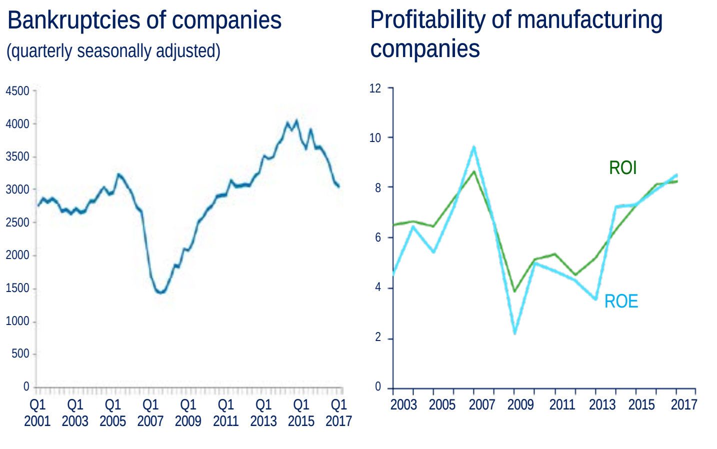
- the selection process – which has taken a toll especially on small and less structured companies – is broadly over, as demonstrated by the decline in bankruptcies;

Economic growth consolidates in Italy



Source: Prometeia, Eurostat

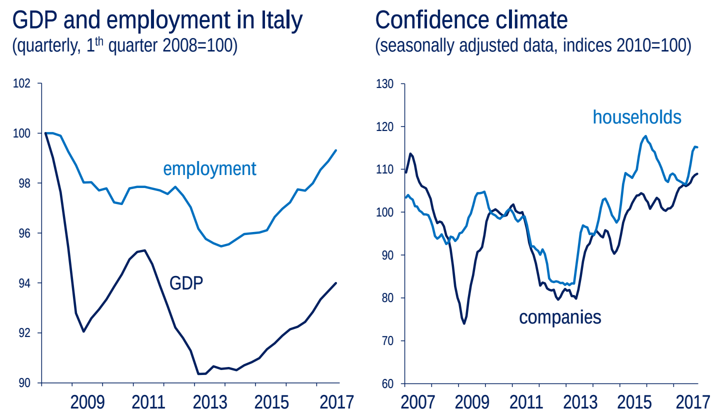
Declining bankruptcies and increasing profitability show the exit from the crisis



Source: Cerved, Prometeia-Intesa Sanpaolo

- companies having survived the crisis – also thanks to competitive repositioning – show, on average, profitability similar to pre-crisis level;
- the share of companies with high levels of profitability has increased as well.

Strong recovery of employment and a more positive confidence climate



Source: Istat, Prometeia

Recovery is becoming self-sustaining because:

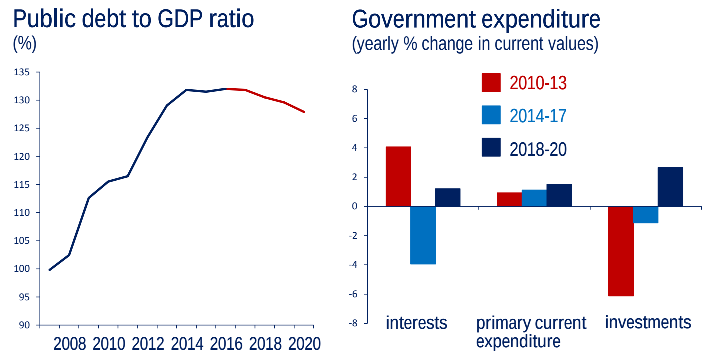
- contrary to other cycles of expansion, also employment is significantly increasing;
- a more positive confidence climate contributes to unblock spending decisions and supports more "normal" purchasing behaviours, i.e. less influenced by the feeling of insecurity and emergency fuelled by the crisis;
- as a consequence, private consumption and investment, i.e. domestic demand, are growing,
- with benefits for almost all industrial sectors.

Italian fiscal policy will no longer be expansive

European authorities will not adopt an overly strict approach, given that

- the change in monetary policy will not result in a dramatic and immediate upsurge in the funding cost of Italian public debt;
- excessively restrictive measures by shrinking economy does not improve debt sustainability but rather they undermine it;
- dangerous anti-Europeans feelings must not be stirred up.

Gradual reduction of public debt in order to avoid risks of financial instability



Fiscal policy: no longer expansive

Will limited resources be well targeted ?

Will the momentum of reforms continue ?

Source: Istat, Prometeia

In any case, in order to avoid financial instability,

- Government will have to lay down the basis at least for a slow reduction of public debt to GDP ratio;
- as a consequence, **fiscal policy will no longer be expansive**.

Given the importance of this issue and European requirements, it can be assumed that any forthcoming elected Government will act in this direction. Government action could be, instead, more or less incisive in relation to

- decision on how to allocate the limited available resources;
- and the momentum of reforms.

Italian recovery will continue at stable pace in 2018

Economic growth in Italy is expected to continue in 2018 at a stable pace (GDP +1.5% after +1.6%), despite the gradual reduction in the support granted by fiscal and monetary policies.

Investment in machinery, equipment and transport means will be the most dynamic component of domestic demand and will strengthen (+6.0% in 2018 from +5.0% in 2017)

- driven by substantial fiscal incentives for capital goods (Super-amortization and Hyper-amortization confirmed in large part also for 2018),
- in presence of significant need to modernize facilities – after the standstill of investments during the recession – and improved self-financing capacity of companies.

Investment in constructions – after a still uncertain and disappointing 2017– will see the first signs of a slow recovery (+1.3% after +0.1%). In particular,

- public investment will benefit from public funds which has already increased during the last 2 years (road and rail network, school buildings), assuming that they will finally translate into actual expenditure and construction sites (given that uncertainties related to the new Public Procurement Code have been overcome);
- new housing will see a first timid increase, given the rise in the number of dwelling building permits, while signals coming from non-residential building are still mixed;
- building renovation will continue to show moderate increase, but it won't accelerate view the continual reconfirmation of fiscal incentives and the complexity of the works which are supported by the new bonuses (namely seismic prevention and multi-dwelling buildings).

In 2018 Italian growth will continue in line with 2017

Macroeconomic outlook for Italy (real % change, unless otherwise specified)	2016	2017	2018
GDP	1.1	1.6	1.5
Private consumption	1.5	1.4	1.4
Government spending	0.5	0.9	0.3
Gross fixed investment			
- machinery, equipment and transport means	4.2	5.0	6.0
- constructions (*)	-0.6	0.1	1.3
Exports of goods and services	2.6	5.1	4.4
Imports of goods and services	3.3	5.5	4.8
Inflation (%)	-0.1	1.2	1.0
Total employment	1.4	1.2	0.6
Households' disposable income	1.6	0.8	1.4

Note: (*) excluding property transfer costs
Source: Prometeia, Ance

Private consumption will maintain a stable rate of growth (+1.4% as in 2017), supported by a further increase in households' disposable income in real terms (+1.4%) thanks to

- the steady rise in the number of hours worked and the improvement in employment (+0.6% after +1.2% of the current year), despite the progressive reduction in hiring incentives;
- anti-poverty measures and contract renewal for public employees;
- in presence of moderate wage increases in the private sector (with beneficial effects on competitiveness of companies)
- and of a still low inflation (+1.0% in 2018 after +1.2% in 2017).

Government spending will be affected by the need to gradually reduce public debt to GDP ratio (+0.3% after +0.9% in 2017).

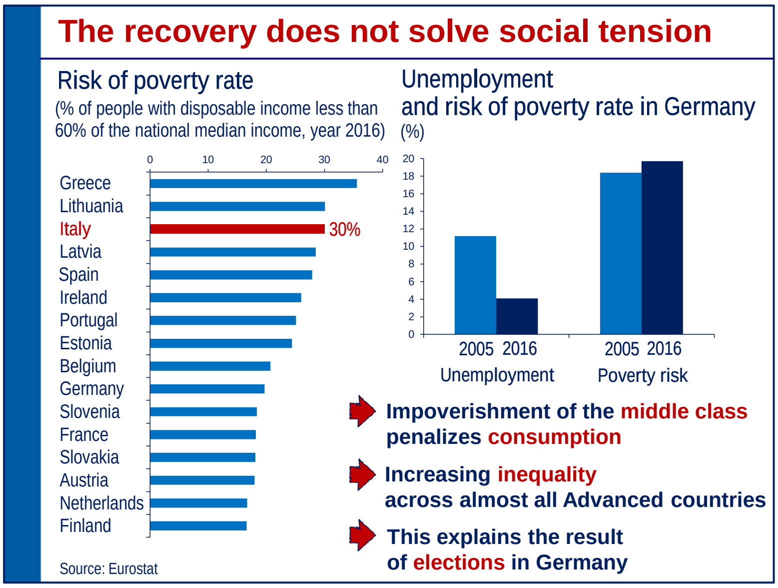
Exports will maintain the momentum of sustained growth, also thanks to the capacity of Italian companies to gain market shares (+4.4% from +5.1% in 2017). **Imports** will be dynamic as well (+4.8% after +5.5%) thanks to the recovery of domestic market in a context of increasing international openness of supply networks and, in some sectors, of the replacement of national production lost with the crisis.

Still a scenario of deep changes and challenges

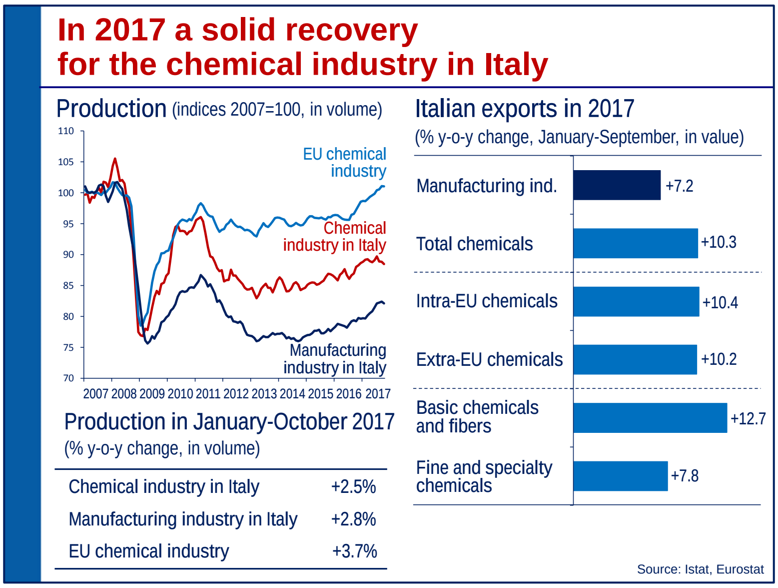
The continuation of the recovery in the coming years should not be regarded as a return to "normality" defined as a stable and predictable framework. On the contrary, many signals indicate that companies, workers and the country as a whole will still have to face a challenging and, to a certain degree, unpredictable scenario in the coming years.

In particular, increasing social disparity will have the most important implications

- in Italy nearly one third of all people are at risk of poverty and have difficulty in facing relevant or unexpected expenses;
- more in general, the impoverishment of the middle class – which is the back bone of consumption – penalizes especially consumer goods;
- this is not only an Italian trend, but it is common to the majority of the Advanced countries: even in Germany despite unemployment is at a historical low, the poverty risk rate has increased;
- this means that social unease is the result of the crisis but also of other structural factors, as a consequence it will not necessarily be solved by the recovery;
- such a situation explains the result of elections in Germany and, more in general, the dissatisfaction and disorientation feelings that risk to fuel populism and instability.



In 2017 a solid recovery for the chemical industry in Italy, thanks to improved domestic demand and impetus of exports

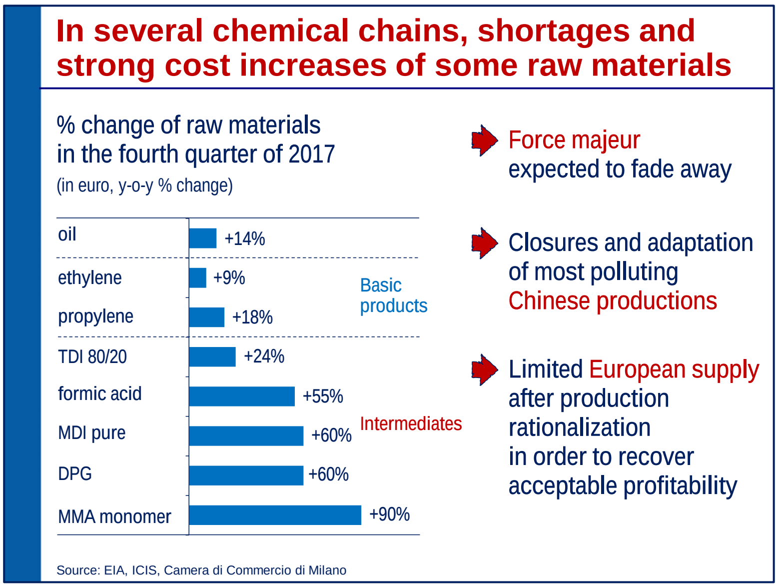


After a somewhat disappointing 2016, **2017** shows an encouraging picture for the chemical industry in Europe and in Italy. Recovery is finally underway and Italy – which is the third European chemical producer – grows at a good rate (+2.5% year-on-year in the period January-October), although lower than the European average (+3.7%).

Improvements emerge on several fronts, giving solidity to the recovery:

- **exports** have risen sharply (+10.3% in value during the first 9 months versus +7.2% of the manufacturing average) and the chemical industry confirms as the **third exporting Italian sector**, after machinery and means of transport;
- this expansion is widespread both in terms of geographical areas (EU +10.4% and non-EU +10.2%), and sectors (basic chemicals +12.7% and fine and specialties +7.8%);
- a favorable international environment is associated with a good **competitive capacity** of the chemical companies in Italy; in fact, basic chemicals trade deficit has declined by more than 2 billions euros since 2007 and, during the same period, fine and specialty chemicals surplus has increased by almost 2.5 billions euros;
- but the real novelty is the resumption of **domestic demand**, which is no longer confined solely to automotive sector, but extended to all customer sectors (with the partial exception of constructions that show some slight signals of recovery in infrastructure works, while residential building has not achieved stability yet).

Tensions along supply chains, because of shortages and strong price increases of some raw materials



Demand situation is generally positive, while **profitability** conditions are more diversified in relation to the type of feedstock used and the position along the chemical supply chains.

In 2017 **petrochemical** prices have rebounded from the low levels of 2016 (in the fourth quarter ethylene +9% and propylene +18%), in line with oil price trend and in presence of a physiological time lag. Oil price has recently began to grow again (also because of tensions in Middle East and the crisis in Venezuela). However, the upward phase is not likely to go further and, in 2018, oil price is expected on average around 60$ a barrel, given that current levels

- on the one hand, reactivate US shale oil productions;
- on the other hand, despite the prolongation of OPEC-Russia agreement throughout 2018, invite participating countries themselves not to fully respect the production cuts.

In the downstream, some shortages of important raw materials remain and lead to cost increases in many supply chains (for example adhesives and intermediates for cosmetics). These tensions are due to a combination of different factors:

- the impact of force majeur is expected to fade away;
- while the Chinese engagement concerning environmental protection – which has already led to the closure of many productions – will continue requiring substantial investments and some time for adaptation;
- the slowdown of Chinese demand may mitigate, at least in part, the situation;
- in any case – after the crisis of 2008-14 – European supply has been substantially rationalized in order to recover acceptable level of profitability and, as a consequence, struggles to meet demand in recovery phases and easily experience tensions in case of force majeur.

In 2018 a robust growth of chemical industry in Italy will continue

Chemical production in Italy will close 2017 with an increase of 2.6%, as a result of

- a strong impetus of exports (+5.0% in volume versus +3.5% of imports);
- and the improvement in domestic demand (+2.0%).

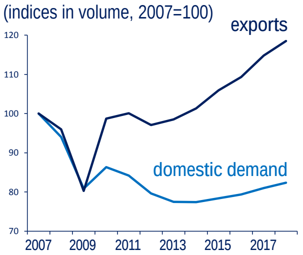
If Italian and European political framework will not be affected by renewed outbreaks of uncertainty, **in 2018 chemical industry in Italy will continue to grow at robust rate (+2.0%), even if more limited compared with 2017**.

Outlook for the chemical industry in Italy

	2016 billions of €	% change in volume 2017	2018
Domestic demand	58,7	2.0	1.7
Imports	34,7	3.5	2.5
Exports	27,6	5.0	3.2
Production	51,6	2.6	2.0

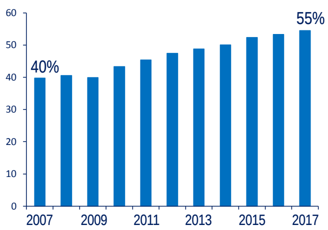
Domestic demand and exports

(indices in volume, 2007=100)



Exports share on turnover

(%)



Source: Istat, Federchimica

- Chemical exports will remain dynamic (+3.2% in volume) thanks to good European and World demand, notwithstanding the moderate appreciation of euro/$ exchange rate (already in act in the second part of 2017 and producing some slowdown in US and Chinese markets);
- consolidation of domestic demand will continue (+1.7%) but it will not accelerate because of a physiological slowdown in the automotive sector and a recovery still too limited and uncertain in constructions.

Exports share on turnover – which now exceeds 50% on average showing an increase of 15 % points since 2007 – attests how chemical industry in Italy has learned to cope with a domestic market growth which is bound by the need to gradually reduce public debt to GDP ratio.

The strong repositioning towards international markets involves

- **both Italian companies, which in many cases have production facilities abroad;**
- **and foreign-owned companies, due to an important process of specialization of Italian facilities inside groups, which has led to an exports share on turnover in many cases even higher than 75%.**

Chemical industry, a sector worth investing in because it's leader in Sustainability

Chemical industry is one of the sectors which has withstood the crisis most effectively – limiting losses in terms of companies, productions and employees – and which has undertaken competitive repositioning and technological upgrading of products with already visible results.
In fact,

- even though the sector is highly cyclical and has suffered from the collapse of the domestic market, it has increased **its share on Italian manufacturing, in terms of value added;**
- **and it has been able to gain global market shares, in particular compared to other European competitors.**

As shown by the comparison with the manufacturing average based on all available indicators, **chemical industry has a real leadership in Sustainability with regard to its three dimensions:**

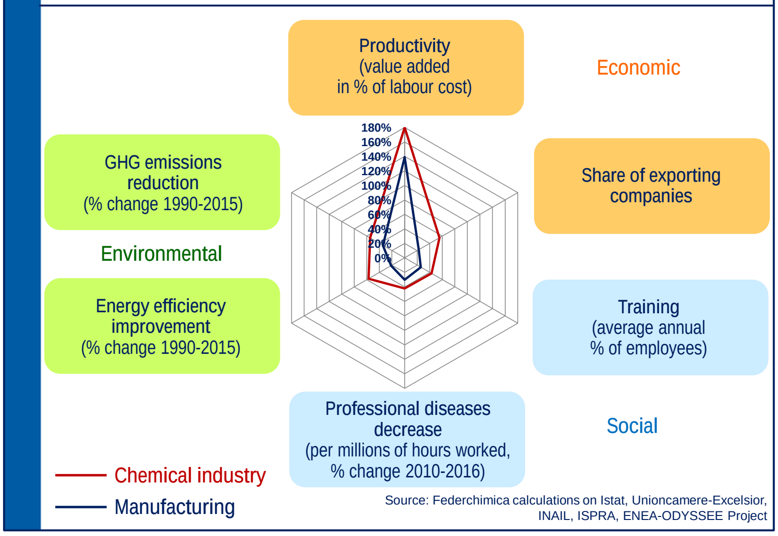
- **environmental,**
- **but also social and economic.**

Chemical industry, a sector worth investing in

Furthermore, **chemical industry is a driver of Sustainability for the whole system**:

- it offers innovative intermediates, supporting the competitiveness of Italian manufacturing as a whole;
- its technological solutions help downstream sectors to reduce greenhouse gas emissions, in particular in civil uses and transport which represent almost 60% of total emissions in Italy
- and they will make a major contribution also to Circular Economy.

Leader in all three dimensions of Sustainability



It's important that the regulatory system – both in setting rules and in their application by Public Administration – takes into account the three dimensions of Sustainable Development which are all equally relevant, giving that

- stricter rules compared to other European competitors, time-consuming red tape and uncertainties do not lead to greater protection of health, safety and environment, but only to a loss of competitiveness and collective well-being;
- without investments and growth it's not possible to create jobs neither to protect environment.