

Investors in petrochemicals industry face overcapacity, disappointing growth

OVERVIEW

The global petrochemicals industry finds itself in deep trouble as production capacity has surged, prices have fallen, and demand has slowed. The industry also faces rising risks from geopolitical fragmentation, disruption of global trade, rising competition from bio-based polymers and recycling, and potential legal exposure as microplastics research advances.

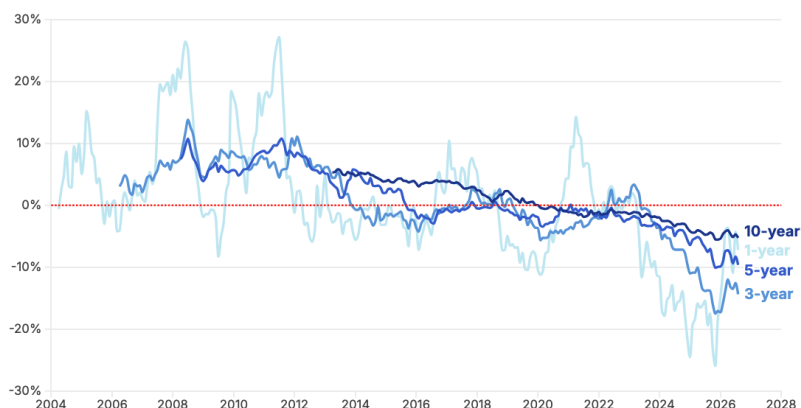
UNDERPERFORMANCE

The petrochemicals industry produced a disappointing 7.05% annualized rate of return between 2016 and 2026, compared to 12.30% for global equity markets as a whole. The decline in petrochemical stocks suggests an extended downward trend, and the underlying structural factors behind this trend merit sober evaluation.

The global petrochemicals industry has entered an extended period of financial underperformance driven by too much supply and not enough demand. Most major chemicals have seen large additions to production capacity, and slowing global economic growth drags down demand growth for petrochemicals.

Chemicals industry stocks underperform the broad market

Spread between annualized returns of chemicals industry equities and Bloomberg World all-cap index. Positive values indicate chemicals sector outperforms benchmark for preceding 1, 3, 5, or 10 years, negative values indicate underperformance.



Spreads calculated between returns of Bloomberg World Chemicals Large, Mid & Small Total Return Index (ticker: WCHMLST) and Bloomberg World Large, Mid & Small Total Return Index (ticker: WLST).
Source: Bloomberg, IEEFA calculations

IEEFA

LONGER-TERM RISKS

A poor demand outlook and significant overcapacity will continue to create headwinds. In the longer term, these risks are exacerbated by geopolitical dislocations, increased regulatory risk as new multilateral agreements emerge, substitutes for virgin petrochemicals, and potential litigation:

- **China slowdown:** Demographic and economic transitions in China are driving a slowdown in a key petrochemical demand center.
- **Trade uncertainty:** Further trade policy dislocations threaten to pour cold water on the growth prospects of cyclical industries, including chemicals.
- **Bio-based feedstocks:** Against a backdrop of slowing demand growth, even modest volumes could further pressure prices and margins.
- **Recycling:** Increased recycling in a low-demand growth environment portends narrower margins for chemical producers.
- **Microplastics:** Emerging scientific and medical evidence may strengthen the link between microplastics and health and environmental issues, with plaintiffs already seeking damages.

INVESTORS

"We are now in a different era where the industry's future is unlikely to resemble its past."

Dan Cohn, IEEFA Energy Finance Analyst

Institutional investors should exercise discretion and perform conservative underwriting of any potential investments in the petrochemicals industry. A range of options is available to protect portfolios from further losses of value.

