

Press Release

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HALF-YEAR STOCKTAKING OF THE CHEMICAL-PHARMACEUTICAL INDUSTRY 2022

Germany increasingly faces competition problems as a business location

- ◆ Prices for raw materials and energy soared in the 1st half-year
- ◆ Production barely grows (+ 0.5%); excluding the pharma share a drop by 3%
- ◆ Forecast for production in the full year 2022: volume decline by 1.5%
- ◆ Gas supply: working together on solutions
- ◆ Prioritization and reassessment of the EU's political agenda are necessary
- ◆ Speed up licensing procedures also for industry projects

The chemical-pharmaceutical industry faced numerous challenges in the first half of the year: Long delivery times and high freight costs as well as shortages in inputs and materials hampered the business activities of companies. This was aggravated by soaring prices for raw materials and energy, especially natural gas. In this difficult setting, the industry was able to expand production only slightly by 0.5 percent, according to the stocktaking by the German chemical industry association Verband der Chemischen Industrie (VCI) for the first six months. Excluding pharmaceuticals, the output even fell by 3 percent. It was partly possible to pass on the rising production costs to customers. Due to the development of producer prices (+21.5 percent), the industry's sales increased by 22 percent to 130 billion euros compared to the previous year.

The sales increase masks the real economic situation in Germany's third-largest industry: Volumes sold in the classic chemical business are falling, the order backlog has largely been reduced, and the capacity utilization of plants has dropped to 80 percent. At the same time, the profit margins of many companies are coming under ever more pressure, as the costs of raw materials and energy rose by more than a third on average from January to June compared to the previous year. For a considerable share of companies – over 20 percent – this cost increase was even more than 50 percent.

The VCI found this out in a representative industry survey among its membership. At the same time, it is becoming more and more difficult for

businesses to pass on higher costs to customers through price increases. Over 50 percent were only able to pass on less than half of the cost increase. This, combined with falling sales volumes, adversely affected the companies' earnings situation. Around 70 percent of businesses already report a drop in profits; some of them are already making losses.

Almost all **sectors** of the industry saw production decreases in the 1st half 2022. Fine and specialty chemicals were hit particularly hard with a decline of 9 percent. Manufacturers of inorganic and organic basic chemicals as well as consumer chemicals had to curb their production only slightly (-0.5 percent). Only the polymers sector held its own in the period under review, recording an increase of 3 percent against the previous year. The production of pharmaceuticals went up by 8.5 percent due to the special situation of corona.

Outlook and forecast

The VCI expects high pressure on earnings for the industry also in the 2nd half of the year. VCI President Christian Kullmann: "At the moment, we do not see any noticeable easing in energy and raw material costs. Natural gas is likely to remain significantly more expensive than in other regions of the world. Against this background, the industry location Germany is increasingly facing a competition problem – not only in the energy-intensive sectors." The VCI is now anticipating a 1.5 percent decline in the industry's production for the full year 2022 - with price-intensive but adequate energy and raw material supplies. For chemicals business alone, the association is even expecting a drop in volume by 4 percent. However, much depends on how the course in the industrial policy will be set in the coming months, Kullmann emphasised.

Gas supply: working together on solutions

In an exchange with the German Federal Government and the Federal Network Agency (Bundesnetzagentur), the industry is preparing for various scenarios of reduced gas supplies from Russia. Kuhlmann described the character of the talks: "Driven by common sense and in a constructive manner, we are looking for solutions together." He added that pragmatic action was also expressed this week with the adoption of the laws on reducing gas consumption and keeping backup power plants on standby. Kullmann: "Nobody wants coal-fired power plants anymore. But in the current situation they help us to temporarily deal with the gas shortage." The industry is grateful to the German government for its promise to allow coal-fired power plants that were already shut down to go back on the grid.

Prioritization and reassessment of the EU's political agenda

The association misses such political pragmatism in Brussels. From the VCI's view, the balance between the environmental and climate agenda and preserving international competitiveness needs to be readjusted. According to Kullmann, the bureaucrats in the Commission have largely lost touch with the reality in companies and markets. At EU level, around 150 pieces of regulation are currently being planned or drafted, often with a multi-billion impact on industry. Kullmann criticized: "We demand a clear prioritization of those legislative projects that Europe really needs now. Our SMEs in particular simply cannot keep up any longer with the Brussels tsunami of rules." It is no longer possible to constructively manage the wave of regulation, neither for the Member States nor for business. "Let us drive forward important regulation together – and leave the rest for quiet times," the VCI President urged the EU institutions.

The same applies for the planned carbon border adjustment mechanism which the EU Parliament advocates. However, according to the VCI, this measure does not work for the industry as an alternative to free allowances. Especially for dealing with exports, no solution can be seen and a WTO-compliant design "is still written in the stars". These points urgently need to be clarified in the negotiations between the Council and the Parliament. Kullmann stressed that it would be more promising, as recently announced at the G7 summit in Elmau, to promote initiatives for global climate protection with a "Climate Club". Kullmann: "The future does not belong to those who isolate themselves. The future belongs to those who win partners for their ideas."

Speed up licensing procedures also for industry projects

The VCI speaks for applying the principle of "build first and approve later" not only to the urgently needed LNG terminals for landing and feeding-in liquefied natural gas but also to the licensing of industry projects – in order to accelerate the transformation of the economy and make the location more attractive. The reason is that the number of foreign investment projects has been falling noticeably since 2017. Essentially, this is due to high energy costs, huge bureaucratic obstacles and, above all, lengthy licensing procedures, as analyses by Ernst & Young currently show.

Therefore, the VCI is calling for an act to speed up planning and approval procedures, which also includes the licensing of industrial plants. In the current situation, one cannot afford a “ban on thinking” in politics. Drafts for such an act have been ready in Berlin for quite a while. But unfortunately, the adoption of the German federal administration-federal states pact to accelerate planning and approval procedures is a long time coming. "The opportunity to promptly enact measures with nationwide effect has just been missed at the conference of the federal administration and the federal states. This is a mistake of consequence," Kullmann stated.

In mid-February, the VCI presented a concept on how planning and approval procedures can be shortened everywhere in Germany without compromising due diligence and safety. About 1,500 procedures for industrial plants, based on the federal immission control act, are completed every year in Germany. At present, such procedures with environmental impact assessment and public participation usually take five to eight years until approval is granted.

Logistics problems in rail transport are becoming even more acute

Rail transport is currently under extreme strain. This is felt by the industry in deliveries of raw materials and goods. The VCI warns of an additional worsening due to upcoming construction activities that cause backlogs, congestion at junctions and delays. According to Kullmann, these limitations pose an immense threat to the industry's sites: "Upgrading the rail network is the right step. But this should not be done everywhere at the same time, so that trains cannot run any longer." As a "solution", DB Cargo suggests to the industry to shift 20 percent of its transports from rail to truck, even though the traffic density on roads is high, too, and there is a shortage of truck drivers. Instead, the VCI demands that construction work on parallel lines should be carried out in a time-scaled approach. Another demand is to optimize the dialogue with industry as a customer group.

The VCI represents the interests of around 1,900 companies from the chemical-pharmaceutical industry and sectors close to chemistry in contacts with politicians, public authorities, other industries, science and media. In 2021, the VCI member companies realised sales of roughly 220 billion euros and employed over 530,000 staff.

Contact: VCI Press Office, phone: +49 69 2556-1496, E-Mail: presse@vci.de
<http://twitter.com/chemieverband>