Cheap ethylene cheers users

Prices for ethylene, the starting point for everything from motor car trim to soft drinks cartons, are approaching historic lows in some markets.

The weakness, emanating from Asia, is expected to provide relief to hard-pressed packaging companies, manufacturers and speciality chemicals companies, which have been unable to pass on higher costs to customers.

Rexam, a UK paper and packaging group badly affected by high raw material prices, said yesterday: "The Far East must have a depressing influence on western prices and that will be good for us and good for our customers."

The spot price of ethylene in South Korea has fallen to $340 a tonne because of the slump in demand – half what it was in the region early last year.

Peter Blair, analyst with Salomon Smith Barney, says there is scope for the price to fall below $300 this year. Merrill Lynch, the US investment bank, sees prices falling by a quarter.

Furthermore, South Korean producers are reported to be offering additional discounts of between 15 per cent and 20 per cent for customers willing to pay cash.

Ethylene is one of the basic building block chemicals and the most capital-intensive part of the chemicals business. "Cracked" or separated from naphtha, the oil and gas extract, it is used to make the polyethylene for plastic bags and shampoo bottles, the polypropylene for car bumpers, the styrene for heat resistant cups and the ethylene glycol for polyester fibre.

Because it is a gas, it is rarely transported any distance – two-thirds is transformed into by-products at the same plant where it is extracted, and most of the rest stays within the region. So, while Korean prices have tumbled, European supply has held up well and prices currently remain tight at just above $500 a tonne.

However, specialists believe an attack on costs is inevitable. "There is a knock-on effect in derivative products, where price differentials are quickly arbitraged away. You have an influx of cheap polyethylene into Europe. That pushes down prices of polyethylene made here and if they fall they push down the price of ethylene," Mr Blair says.

The situation is exacerbated by a sharp increase in world supply. Several new crackers started operating at the end of last year and pushed world production up 7.1 per cent from 83.6m tonnes in 1996 to 89.5m tonnes in 1997. By contrast, consumption only increased 5.7 per cent, according to Chem Systems, a management consultancy for the oil and chemicals industry.

Richard Sleep of Chem Systems says: "Last year saw the largest increase in ethylene capacity there has ever been."

So far, the big European manufacturers such BP, ICI and Enichem have resisted lowering their prices. Consequently, they have profited as naphtha prices fell and margins widen.

Last week, the leading US groups – Dow, Dupont and Millennium – hinted, with their fourth-quarter figures, that commodity prices outside Asia would fall this year.

"When that happens," said Martin Evans of Sutherlands, the agency broker, "it will be pay-back time for the manufacturers who were hit so badly when prices were squeezed up a couple of years ago."

Peter John