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CHEMICAL INDUSTRIES ASSOCIATION

FEBRUARY 2023

CIA First Quarter Economic report 2023

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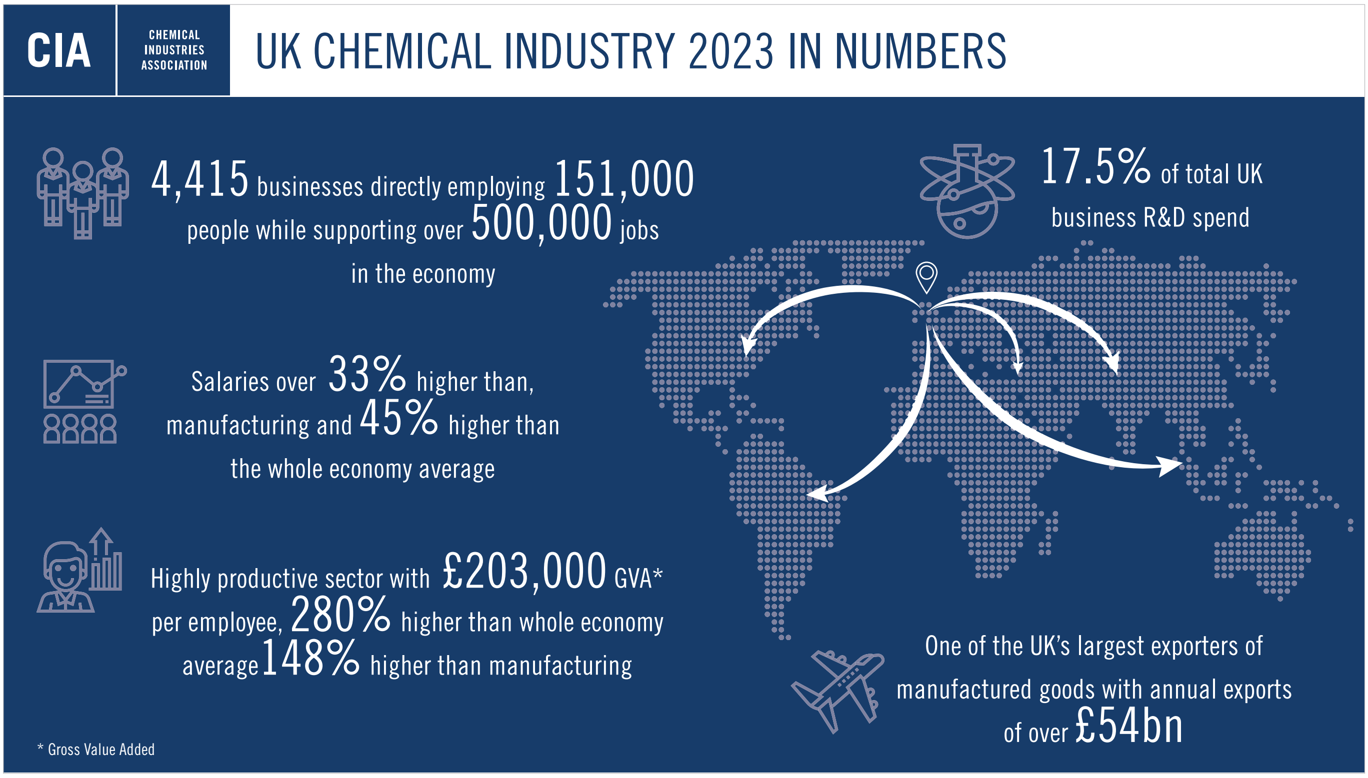
RESPONSIBLE CARE

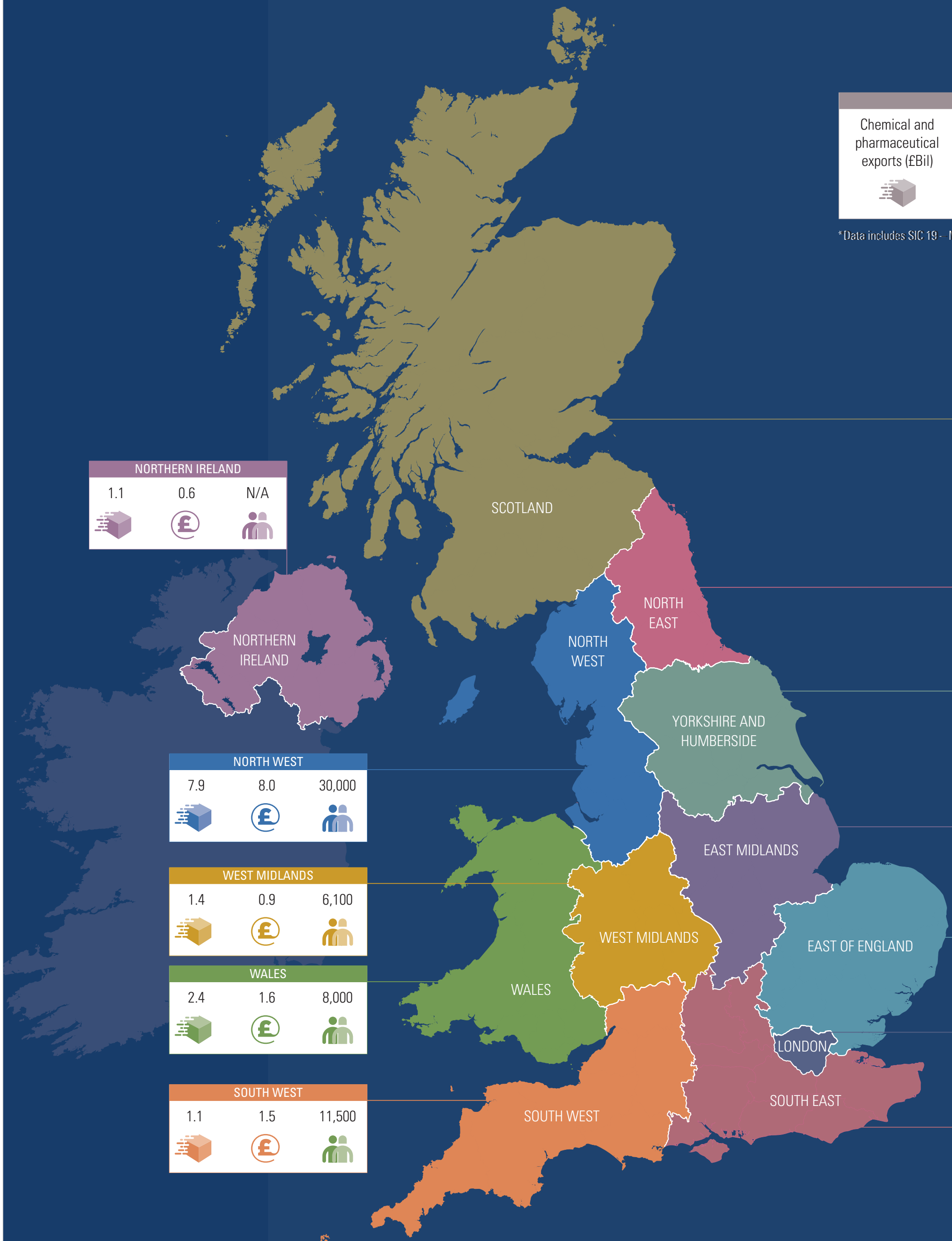
Current shape of the industry



CIA CHEMICAL INDUSTRIES ASSOCIATION

MADE IN THE UK, SOLD ACROSS THE WORLD

Our Chemical Industry



KEY

Region	Chemical and pharmaceutical exports (£Bil)	GVA (£Bil)*	Employment
SCOTLAND	3.0	2.4	10,500
NORTHERN IRELAND	1.1	0.6	N/A
NORTH EAST	2.8	2.1	9,500
YORKSHIRE AND HUMBERSIDE	3.0	3.3	16,500
NORTH WEST	7.9	8.0	30,000
EAST MIDLANDS	1.7	1.4	10,000
WEST MIDLANDS	1.4	0.9	6,100
EAST OF ENGLAND	7.6	3.2	15,000
WALES	2.4	1.6	8,000
LONDON	5.3	0.7	2,500
SOUTH WEST	1.1	1.5	11,500
SOUTH EAST	9.5	5.4	13,500

*Data includes SIC 19 - Manufacturing of coke and petrolium

Figures correct as of Q1 2023.

Source: ONS

Executive summary

I am pleased to present our latest economic report, which has been written by Tom Warren, our Head of Economics.

This report has two sections. The first is a CIA analysis of government data via the Office for National Statistics (ONS) and other countries' statistical agencies. This section assesses the UK chemical industry's performance against that of the wider economy and is followed by a look at what challenges lie ahead. The second section presents the results and further analysis of our own Q4 2022 Business Survey. Unless otherwise specified figures are for the chemical industry excluding pharmaceuticals.

Last year was tough on many fronts, there is an ongoing war in Europe which plunged the region into an energy crisis, the UK experienced double-digit inflation which has delivered the biggest hit to real household income in over 50 years, the UK had three Prime Ministers and four Chancellors, and China's zero-covid policy subdued global demand and slowed supply chains. The fact is, 2023 does not promise to be easy, with many of the challenges faced in 2022 ongoing, as well as new ones emerging. The UK needs to be seen as the place to invest, and for that to be the case, we need Government action, especially in response to the US' Inflation Reduction Act and EU's imminent response.

The latest data published by the ONS provides a first look at GDP, production and trade in 2022. UK GDP grew 4.1% in 2022 and narrowly avoided a recession in the final quarter as output growth was flat. It was a tough time to be a manufacturer, especially in the chemical industry where gas is used as a feedstock and energy source. UK chemical production fell 5.5% in 2022 compared to 2021; however, the fall in output at the end of the year compared to the start was even more severe.

The value of UK chemical and pharmaceutical trade rose over 20% in 2022 driven by significant increases in the price of chemicals rather than an underlying growth in volumes. Inflation remains in the double digits, however, it is expected to fall sharply through 2023 as wholesale energy prices were softer than expected. Tight labour market conditions are pushing up pay across the economy but in the final quarter of 2022 the chemical industry was one of the only sections of the economy to offer an inflation busting total pay increase of 11.3%.

Turning to our survey, it was clear that the industry experienced a challenging end to 2022 with a sharp fall in sales, orders and production. A number of respondents reported shutting down production over the festive period to undertake maintenance and avoid soaring operating costs, a situation that weighed heaving on the survey's performance data. Costs continued to increase in the final quarter but slower than what was expected and experienced in the third quarter of the year.

At first glance, expectations for the first quarter of 2023 look very positive however it is important to remember this data is compared to the challenging end to 2022. Nevertheless, sales to all regions, new orders, and production are all expected to grow while costs are finally expected to begin stabilising. Although cost stabilisation is a step in the right direction, it comes after years of significant growth and is therefore stabilising at a level significantly above the long-run average.

When ranking challenges, energy costs remain top, a situation that has been constant over the last 18-months. Labour costs have leapt into second with raw material costs and shortages pushed into third and fourth. Skills and labour shortages were ranked fifth and sixth, highlighting the current challenge in the industry surrounding recruitment retention and reward.

Steve Elliott
Chief Executive
Chemical Industries Association

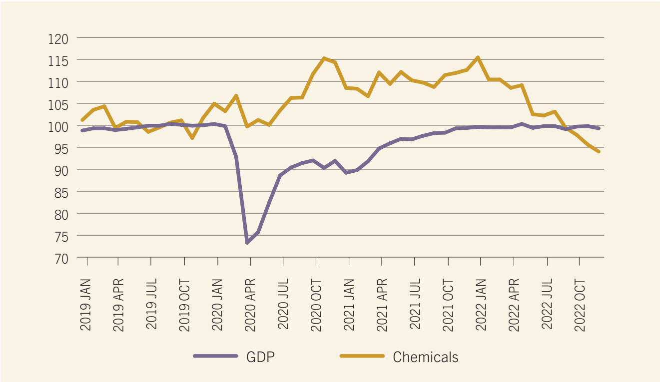
The survey data presented in this report was collected from CIA members between 26 September and 7 October 2022. The macroeconomic data, predominantly sourced from the Office for National Statistics, was gathered up to the end of October 2022.

A tough end to 2022

GDP and Chemical production

The latest official data published by the ONS, with regard to UK GDP, production, and trade was for December 2022, providing first estimates for economic performance in the final quarter of 2022 and year as a whole. Focusing first on GDP, the UK economy narrowly avoided entering a recession, defined as two consecutive quarters of negative growth, in the final quarter of 2022 as growth was flat. However, using the latest monthly consensus forecast published by the Treasury, the UK is expected to enter a recession in 2023 as GDP is projected to contract 0.3% in the first and second quarter of the year. For the year as a whole, UK GDP grew 4.1% in 2022 and using the Treasury forecasts, is expected to contract 0.7% in 2023 before growing 0.9% in 2024.

Graph 1: Monthly index of UK GDP and Chemical Production, Q4 2019 = 100

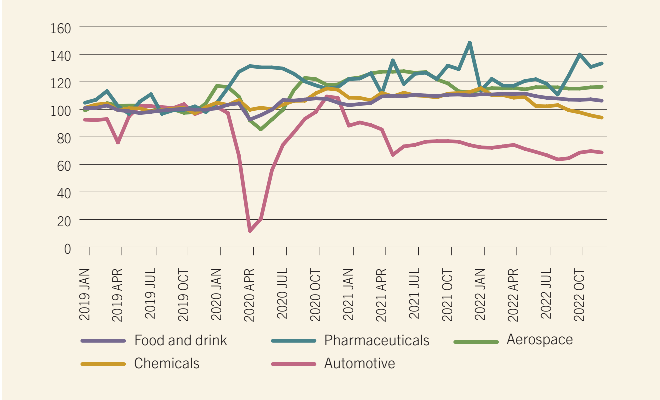


Source: CIA Analysis of ONS data

Turning to the chemical industry, Graph 1 displays the monthly index of UK GDP and chemical production between January 2019 and December 2022. After four years of output growth, in the face of soaring costs and dwindling demand, chemical production fell 5.5% in 2022 compared to 2021. Focusing on 2022 in more detail, chemical output in December was 18.6% lower than in January. It is worth noting that January's chemical production level was the third highest on record so when looking at 2022 as a whole, it improves the figures, however, when comparing to January it makes falls look more severe. The CIA expects UK chemical production to grow from this point but that total output in 2023 will be below 2022 due to the strength displayed in the first half of 2022.

Graph 2 compares the monthly index of production for the chemical industry to the UK's food and drink, pharmaceutical, automotive, and aerospace industries, that along with the chemical industry are colloquially referred to as the 'Manufacturing five' or 'M5' industries.

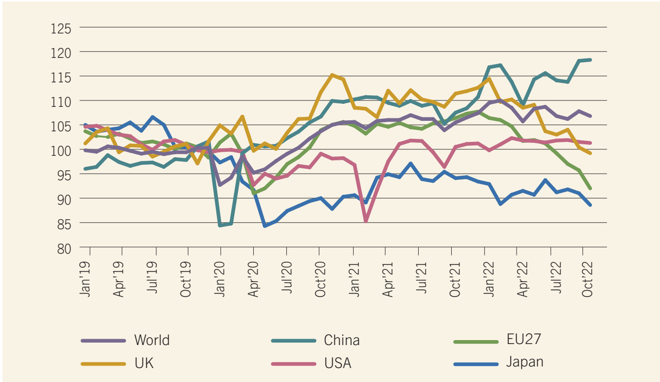
Graph 2: Monthly index of production for the UK M5 industries, Q4 2019 = 100



Source: CIA analysis of ONS data

Last year was tough for UK manufactures with output from the manufacturing sector falling 4.7% compared to 2021. The food and drink industry was the only constituent of the M5 that increased production in 2022 with output growth of a modest 0.6%. Pharmaceutical, automotive, and aerospace output fell 3.3%, 12.1% and 6.0% respectively. Even after a tough year, output from the pharmaceutical, food and drink, and aerospace industries remained 33.5%, 6.3% and 16.4% above pre-pandemic while chemical and automotive output was 6.0% and 31.3% below.

Graph 3: Monthly Index of Production for major chemical producing countries/regions, Q4 2019 = 100



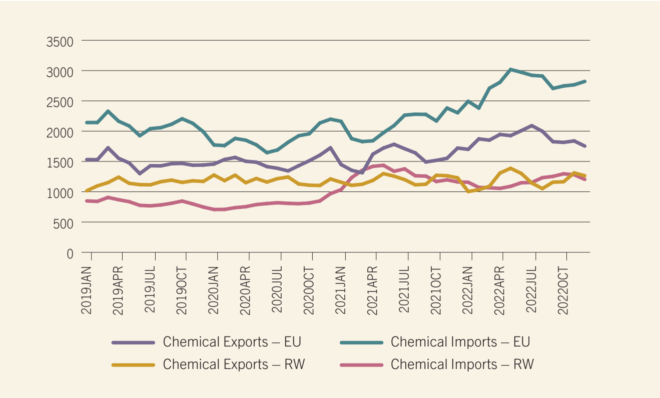
Source: CIA analysis of ONS and Cefic ChemData

Focusing back on the chemical industry and looking internationally, 2022 has been a tale of two stories. Graph 3 displays the monthly index of chemical production for the major chemical producing countries/regions from January 2019 to October 2022. In October 2022, the latest international data available at the time of writing, global chemical output was 2.5% lower than at the start of the year. This fall was driven by the UK and EU27 that in the midst of an energy crisis saw output fall 13.3% and 13.5% respectively in the period. Conversely, chemical output from China and the US, who have not experienced the same energy and cost of living pressures, have increased 1.3% and 1.5%. The Japanese chemical industry has struggled the regain ground lost during the pandemic with 2022 being no exception as output in October 2022 was 4.6% lower than in January 2022.

Trade

Alongside the publication of official GDP and production data, the ONS published its first estimates for the value of trade in 2022. Compared to 2021, the value of UK chemical and pharmaceutical exports rose 14.7% to £62.1 billion. The value of imported chemicals and pharmaceuticals saw an even greater 25.2% rise to £78.8 billion. It is important to note that these figures are in value terms not volume. Given the chemical industry experienced double-digit inflation through 2022, it is likely that the increase in trade values was driven by prices rather than volumes.

Graph 4: Three-month rolling average of UK chemical imports and exports with the EU and Rest of the World, £Mil



Source: CIA analysis of ONS data

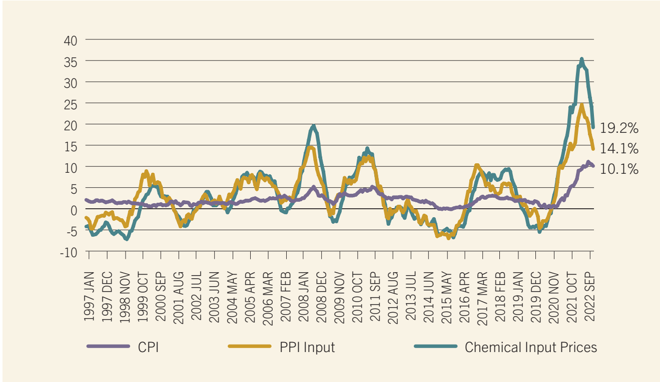
Looking at the trade data in more detail and continuing to focus on 2022, chemical exports rose 11.0% to £36.8 billion which was driven trade with EU. UK chemical exports to the EU rose 17.9% to £22.3 billion, while exports to the rest of the world rose 1.8% to £14.4 billion. The meagre growth in exports to the rest of the world was driven by the two largest chemical producing regions, the US and China. The value of exports to the US fell 11.6% to £4.5 billion while the value of exports to China fell 2.2% to £1.0 billion. Conversely, the growth in exports to the EU was driven by exports with Ireland and France which experienced growth of 58.6% and 16.4% to £5.1 and £2.2 billion respectively.

Changing from exports to imports, the pattern is the same however more extreme. The value of imported chemicals to the UK rose 16.7% to £47.6 billion. This increase can be solely attributed to the EU as the value of chemical imports rose 31.9% to £33.6 billion while imports from the rest of the world fell 8.6% to £14.0 billion. There were big increases in imports from the Netherlands 91.7%, Ireland 25.4%, France 36.0% and Belgium 43.2% to £8.1, £4.9, £4.3 and £4.5 billion respectively. Meanwhile, imports from China and the US fell 45.3% and 6.9% respectively to £3.1 and £3.6 billion.

Prices

Rising prices, both for households and businesses, continues to be one of the greatest economic challenges, however inflation is moving in the right direction and is expected to fall sharply through the second half of 2023 as wholesale energy prices were softer than expected. With that said, the headline rate of inflation in the UK, CPI, was 10.1% in the year to January 2023, down from 10.5% in December and the peak of 11.1% in October 2022. The UK is not alone with its inflationary challenge however sits towards the top of the international field with inflation in the Eurozone: 8.5%, Germany: 8.7%, France: 6.0%, Italy: 10.1%, USA: 6.4%, and China: 2.1%. In response to this inflationary pressure, central banks across the world have steadily increased interest rates over the last 12 months with the current rates in the UK, US and Eurozone being 4.0%, 4.5-4.75% and 3.0% respectively.

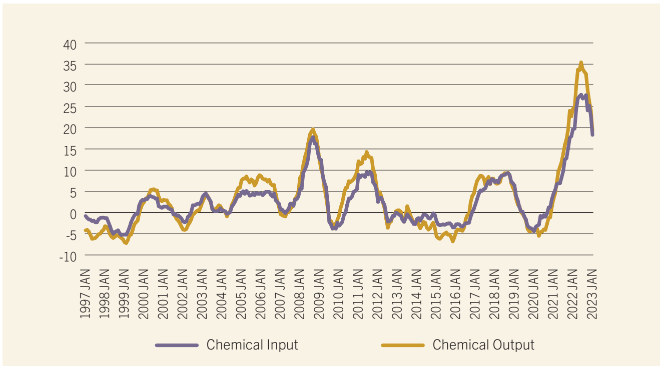
Graph 5: 12-month growth rates of UK CPI, PPI and chemical input prices



Source: CIA analysis of ONS data

Graph 5 displays a timeseries of UK CPI inflation, manufacturing input inflation (PPI input) and chemical input inflation. Moving away from consumer inflation and focusing on the UK manufacturing sector, input prices in the manufacturing sector rose 14.1% in the year to January 2023, down from 16.2% in December. This is the seventh consecutive month that input price growth has decelerated, down from a peak of 24.6% in June 2022. Output prices in the manufacturing sector rose 13.5% in the year to January, down from 14.5% in December. Similar to inputs, this is the sixth consecutive month where output prices have decelerated, down from a peak of 19.9% in July 2022. Input prices have grown quicker than output prices in the manufacturing sector for a staggering 28 consecutive months, inflicting sustained downward pressure on producer's margins for over two years.

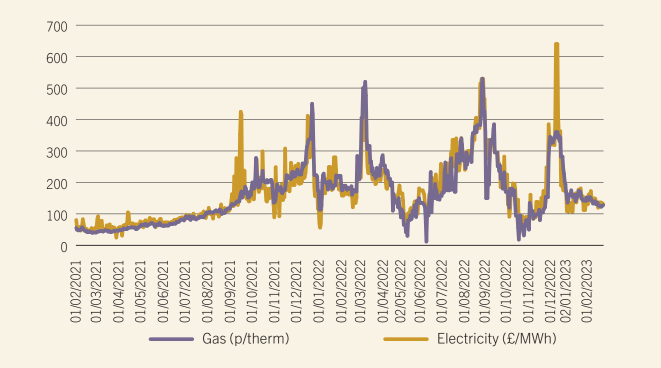
Graph 6: 12 month Chemical input and output price growth rates since 1997



Source: CIA Energy Price Dataset/Inspired Energy

Drilling through the manufacturing sector, price movements in the chemical industry followed a similar decelerating but still elevated, path. Input prices in the chemical industry rose 19.2% in the year to January, down from 24.1% in December and the peak of 35.3% in June 2022. In the same period, output prices rose 18.3%, down from 22.8% in December and the peak of 27.8% in June 2022. Similar to the wider manufacturing sector, input prices have grown quicker than output prices for the last 23 consecutive months.

Graph 7: Day-ahead UK gas and electricity prices over the last 2 years



Source: CIA Energy Price Data, Inspired Energy

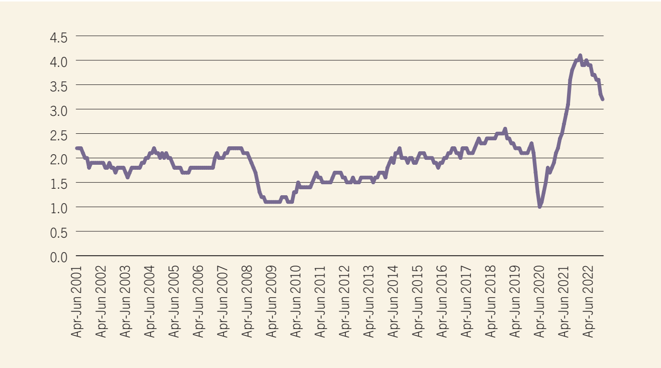
Graph 7 displays the day-ahead wholesale gas and electricity prices in the UK over the last two years. Although remaining significantly higher than the long-run average, recent UK gas and electricity prices have been softer that what was feared as we entered the Winter. This is likely more of a relief to the Chancellor than manufacturing business leaders as it has reduced the cost to Government of their energy support schemes. For chemical business leaders, prices at these levels are still hard to palate and continue to challenge margins.

When the UK's Emissions Trading Scheme (ETS) opened in May 2021, the price of a tonne of carbon was around £45; however, today prices sit around the £83 mark. The recent peak cost of a barrel of oil was $138 back on 7 March 2022. Prices have since abated and settled around the $80 mark, still significantly higher than the average over the late 2010's.

Labour market

The labour market is beginning to show signs of softening but remains tight by historic standards as the dual impacts of Brexit and Covid reduce the supply of labour across the economy. The unemployment rate is at 3.7%, the number of people on payroll continues to increase to 30 million, there remains over 1.1 million job vacancies 77,000 of which are in the manufacturing sector. It is promising to see that the economic inactively rate (which captures those who are aged between 16-64 years old and are not in or actively seeking work) fell 0.3 percentage points in the three months to December, however, is still 1.2 percentage points, or 516,000 people, higher than pre-pandemic.

Graph 8: Manufacturing job vacancies per 100 employees



These tight labour market conditions are pushing up pay across the economy. Total pay, which including bonuses and one-off payments, and regular pay which does not, rose 5.9% and 6.7% in the three months to December compared to the same period in 2021. In real terms (adjusted for CPIH inflation) this constitutes a pay cut on 3.1% and 2.5% respectively. Pay awards in the same period were more generous in the chemical industry where total pay rose 11.3% and regular pay 7.7%, equivalent to a real-terms raise of 2.2% and fall of 1.4% respectively.

Rounding up the official data

Last year was a tough year to run a manufacturing business, especially on in the chemical industry. UK GDP grew 4.1% in 2022, however this was driven by a 5.5% increase in output from the services sector while manufacturing output fell 4.7%. Gas prices soared following Russia's invasion of Ukraine, driving inflation into the double digits and reducing real incomes. For the chemical industry, which uses gas as a feedstock as well as an energy source, this led to input prices in the year to June 2022 increasing by over 35%. Price growth in the chemical industry has begun to abate but remains around 20% and for the last 23 consecutive months, input prices in the chemical industry have growth quicker than output prices, making it almost impossible to find a margin.

The increased costs of production as well as falling domestic and European demand led to a fall in chemical output of 5.5% in 2022. The energy crisis has gripped Europe which has led to a fall in chemical output from the UK and EU, however the same is not true for China and the US who have modestly increased production through 2022.

Despite a fall in UK chemical production, the value of chemical exports rose in 2022. This was driven by the aforementioned price increases rather than an underlying increase in volumes. The UK's labour market remains tight which is pushing up pay across the economy. Total pay which includes bonuses and one-off payments, rose 5.9% in the final quarter of 2022 compared to a year prior, a real-terms (adjusted for inflation) pay cut of 3.1%. In the same period within the chemical industry total pay rose 11.3%, a real-terms pay rise of 2.1%.

Survey results

About the survey

At the close of each quarter, we survey member companies of the Association to get on-the-ground data about current trading conditions and views on what lies ahead. The information from this is incredibly useful in our work and we are grateful to all who respond.

The CIA's Q4 2022 Business Survey was released later than other surveys due to the festive period and was live between the 9 and 20 of January 2023. The survey received responses from around 50% of CIA membership. This edition of the survey was split into three sections. The first and second sections contained the standard industry performance and challenges & opportunities questions. The third section focuses on the Chancellors Spring Budget and what CIA members wanted to see covered in the CIA's Budget Representation. There were three questions in the industry performance section that asked respondents whether the 19 variables listed below had increased, decreased or stayed the same in the final quarter of 2022 compared to the third and what member's expectations were for these variables in the first quarter of 2023 and 12 months' time.

Industry performance variables:

1. Total sales
2. Domestic sales
3. Exports
4. EU exports
5. Rest of the world exports
6. New orders
7. Production levels
8. Capacity utilisation
9. Employee numbers
10. R&D spend
11. Business investment
12. Your level of business optimism
13. Time to deliver
14. Raw material (input) prices
15. Cost of importing
16. Cost of exporting
17. Your energy costs
18. Finished goods (output) prices
19. Your company/site profit margins

When displaying the industry performance data diffusion indexes are used. These are an easy to interpret statistical tool that can be read in the same way as Purchasing Managers Indexes (PMIs) Therefore, any figure below 50 indicates a contraction, above 50 an expansion while 50 means it remained constant.

Industry performance

Performance in final quarter

Table 1 displays the diffusion indexes for the 19 variables mentioned in 'about the survey'. The first column is the diffusion index for the performance in the final quarter, the second column contains the diffusion index for what was expected for the final quarter when respondents were asked in the CIA's Q3 2022 Business Survey, and the third column contains the diffusion index for the performance in the third quarter of 2022. This allows are comparisons to be made between the performance in the final quarter of 2022 compared to expectations and the prior quarter.

Table 1

	Q4 Actual	Q4 Expectation	Q3 Actual
Total sales	32.6	40.6	43.1
Domestic sales	31.0	32.1	39.6
Exports	31.4	37.7	41.5
EU exports	29.1	35.8	37.7
Rest of the world exports	33.3	40.6	44.3
New orders	33.7	36.8	38.7
Production levels	34.9	39.6	33.7
Capacity utilisation	31.7	40.4	35.6
Employee numbers	53.5	52.8	49.0
R&D spend	50.0	50.0	51.9
Business investment	50.0	44.2	51.0
Your energy costs	61.6	76.0	88.2
Raw material (input) prices	66.3	76.0	81.1
Finished goods (output) prices	67.4	73.5	88.5
Cost of importing	65.1	73.1	77.9
Cost of exporting	60.7	70.8	71.7
Your company/site profit margins	29.1	34.6	33.0
Time to deliver	45.3	50.0	52.9
Your level of business optimism	39.5	34.0	32.1

Source: CIA Q4 and Q3 Business Survey

Key take away

- It was a tougher than expected end to the year with the fall in sales experienced in the third quarter accelerating in the fourth.

Sales to all regions, domestic, EU, and the rest of the world fell quicker than what was expected and what was experienced in the third quarter of the year. With weakening demand displayed by the fall in new orders and in the face of significant costs to operate, a number of CIA members shutdown production to undertake any maintenance required on site or to temporarily reduce costs. These optional shutdowns weighed heavily on the production and capacity utilisation data recorded in this survey.

It was positive to see that despite the fall in sales, orders, and production, employee numbers, R&D spending, and business investment largely remained unchanged, with employee numbers actually seeing a small rise. This is understandable however as these three variables are often referred to as the 'slower moving variables' as they tend to have the least volatility quarter-on-quarter due to plans being made on a multiyear basis.

The fact that costs are continuing to rise is unlikely to shock anyone who took part in the survey. However, it was promising to see that the size of the rises were lower than what was expected and experienced in the third quarter. Moreover, it was positive to see that for the second consecutive quarter that growth in output prices was larger than input, however the difference was marginal and not enough to start recovering margins. Further energy price rises were reported by 47% of respondents, down from 80% in the previous quarter, while 42% and 33% of respondents reported an increase in the cost of importing and exporting respectively. Delivery times marginally improved and with all this data in mind, chemical business leader's optimism fell in the final quarter of 2022.

Expectations for the first quarter

Table 2 displays the diffusion indexes for what is expected for each of the 19 variables in the first quarter of 2023.

Table 2

	Q1 Expectation
Total sales	64.0
Domestic sales	59.3
Exports	60.5
EU exports	57.0
Rest of the world exports	60.7
New orders	67.4
Production levels	64.0
Capacity utilisation	64.0
Employee numbers	55.8
R&D spend	50.0
Business investment	55.8
Your energy costs	52.3
Raw material (input) prices	51.2
Finished goods (output) prices	57.1
Cost of importing	58.1
Cost of exporting	59.3
Your company/site profit margins	47.7
Time to deliver	52.4
Your level of business optimism	52.3

Source: CIA Q4 Business Survey

Key take away

- CIA members are optimistic about the first quarter of 2023 however this likely highlights how tough the final quarter of 2022 was rather than a bounce-back recovery.

Compared to the low levels in the final quarter of 2022, sales to all regions are expected to grow strongly in the first quarter of 2023. Exports are expected to perform slightly better than domestic sales, with the rest of the world slightly outperforming the EU market. The increased sales are understandably accompanied by fuller orderbooks, improving production and capacity utilisation.

Focusing on the slower moving variables, modest growth is expected in employee numbers and business investment and R&D expenditure remains largely unchanged. It is promising to see at a time of increased costs of labour and capital that the chemical industry is continuing to invest in the UK.

The CIA started collecting cost data from members through the Business Survey in the second quarter of 2021, and in every subsequent quarter since then, members have reported sharp rises in costs. The latest data shows that costs are expected to stabilise in the first quarter of 2023. Although this is positive in one sense, it is important to remember the size of price increases experienced over the last two years. Output prices are expected to continue rising as chemical producers try to revive margins that have taken a significant hit over the last two years. The cost of trade is expected to continue rising however, the time to deliver remains largely unchanged.

With the increased sales and cost stabilisation in mind, there is a modest increase in chemical business leader's optimism.

Expectations for twelve months' time

When the CIA presented the following findings back to survey respondents, it was broadly expressed by members that all forecasts looking out further than three-to-six months come with high levels of uncertainty and may well be subject to large revisions. Therefore, the data in Table 3 and accompanying comments should be used as a gauge of the sentiment of the industry rather than rigid forecasts.

Table 3

	12-month Expectation
Total sales	72.1
Domestic sales	61.9
Exports	70.9
EU exports	65.1
Rest of the world exports	67.9
New orders	75.6
Production levels	68.6
Capacity utilisation	70.9
Employee numbers	53.5
R&D spend	52.4
Business investment	57.0
Your energy costs	54.7
Raw material (input) prices	47.7
Finished goods (output) prices	60.7
Cost of importing	57.0
Cost of exporting	55.8
Your company/site profit margins	61.6
Time to deliver	50.0
Your level of business optimism	66.3

Source: CIA Q4 Business Survey

Key take away

- CIA members are optimistic that in a year's time production and sales will be in a better position, costs will have largely stabilised and margins improved.

At first glance, this data is very positive. Over 60% of respondents expect an increase in new orders and sales which is translating to increased production and capacity utilisation. Modest increases are expected for employee numbers and R&D spend, while 30% of respondents expect to increase their business investment levels. However, it is important to note that these predictions are where levels are expected to be compared to the final quarter of 2022, which as we have seen previously in the report was a challenging period. Therefore, there is a base effect that is contributing to the magnitude of the diffusion indexes.

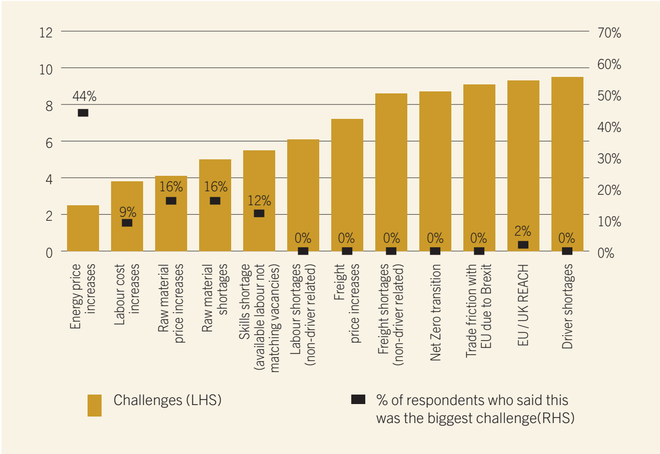
Moving onto costs, energy and raw material costs are expected to broadly stabilise while the prices of finished goods are expected to continue increasing in order to improve margins. The cost of trade continues to slowly increase, however time to deliver is stable.

With all of this data in mind, over 50% of respondents to the CIA's Business Survey expect to be more optimistic in 12 months' time than they are now.

Challenges and Opportunities

The second section of the CIA's Q4 Business Survey focused in more detail on the challenges members face, followed by a look at the opportunities that members identify. The first question in this section asked respondents to rank 12 challenges faced by the industry from greatest to smallest, with '1' signalling the greatest issue and '12' the smallest.

Graph 9: Biggest challenges – smaller the blue bar, bigger the challenge



Source: CIA Q4 Business Survey

This question has been asked in the last six CIA Business Surveys, and up until the latest edition, the top three challenges have remained constant as 'Energy prices', 'Raw material prices' and 'Raw material shortages' although there has been some jostling for position between second and third. However, in the latest survey, the challenges surrounding 'Labour costs' have jumped up the standing to the second biggest challenge. Behind the top four challenges, 'Skills shortages' and 'Labour shortages' were the fifth and sixth biggest challenges, which highlights the current difficulties that the chemical industry is having with recruitment, reward and retention.

It is crucial to note that the challenges deemed the 'smallest' in this data still pose a serious threat to the industry in the mid-to-long term. They, however, are not being felt as acutely as the soaring input costs and supply frictions. It is therefore important that these challenges, including REACH, the net zero transition, and trade friction with the EU, are not underestimated. This point was reiterated by CIA members when they were presented with the data and the CIA will continue work in these areas opposite government and other stakeholders.

The next question asked respondents whether the 12 challenges from the previous question were improving, worsening, or remaining unchanged. Table 4 displays the diffusion indexes of the answers with figures above 50 indicating an improvement, below 50 worsening and 50 equals no change.

Table 4: Diffusion indexes

	Diffusion Index
Energy price increases	31.4
Labour cost increases	2.4
Raw material price increases	42.9
Raw material shortages	68.8
Skills shortage (available labour not matching vacancies)	25.6
Labour shortages (non-driver related)	38.2
Freight price increases	41.7
Freight shortages (non-driver related)	57.8
Net Zero transition	46.1
Trade friction with EU due to Brexit	50.0
EU/UK REACH	44.7
Driver shortages	68.3

Source: CIA Q3 Business Survey

After jumping up the standings to the second biggest challenge, over 97% of respondents reported that the challenge surrounding labour costs is worsening. Energy and raw material prices, skills and labour shortages are all too felt to be worsening. It was promising to see that the challenge around sourcing raw materials was improving, a positive signal for global supply chains. Driver shortages seem to no longer be an issue and understandably, the longer-term challenges are predominantly remaining unchanged.

Moving onto opportunities, when asked what the biggest near-term opportunity was for respondents' companies/sites, understandably the responses were largely business specific however followed a few themes:

1) Improve energy efficiency
2) New products/projects
3) Increasing capacity/production
4) Growth in end markets

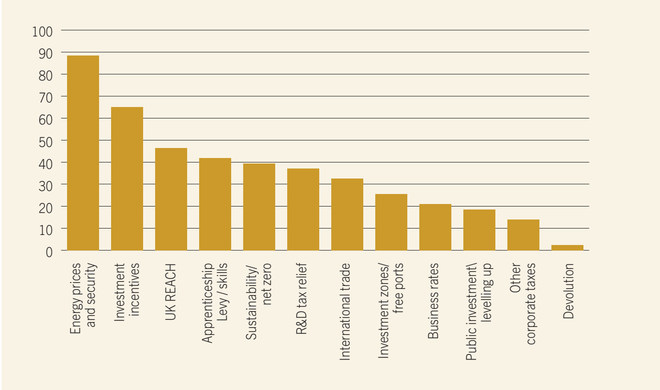
Given the state of the energy market it is understandable that members see energy efficiency as an area of opportunity. It was positive to see that some members felt that there were opportunities to increase output or bringing new products to market.

The Spring Budget

On March 15 this year, the Chancellor will present his Budget, setting out plans for the Government's taxation and spending over the next financial period. Ahead of the Budget, the CIA submitted a Budget Representation to the Treasury on behalf of the UK chemical and pharmaceutical industry. The contents of the CIA's submission was guided by the results gathered from the following questions. The CIA's Budget Representation will be circulated to member companies and published on our website in the run up to March 15.

The first question provided 12 topics and asked respondents which they would like to see covered within the CIA's representation. Graph 10 displays the percentage of respondents that chose each topic. There was also an option to add your own topic if it was felt that something was missing from the list.

Graph 10: Does the Energy Bill Relief Scheme provide sufficient support?



Source: CIA Q4 Business Survey

Understandably, given the current situation surrounding energy, almost 90% of respondents wanted to see energy prices and security covered within the CIA's budget submission. With the US' vast Inflation Reduction Act (IRA) and the EU looking to respond with their own measures, CIA members want to see investment incentives within the UK Budget. UK REACH is the third most requested topic, which is understandable as the Government estimates that the duplication of EU REACH would cost the industry between £1-3 billion. This cost does not improve operations, increase productivity or strengthen health and environmental protection. It is instead a cost for companies to simply duplicate data previously submitted to the EU and largely available on public databases.

The UK has long been calling for reform and improvements to business taxes, such as the apprenticeship levy, R&D tax reliefs, and business rates. Sustainability and net zero as well as international trade are all important areas for the chemical industry and have been represented in the CIA's Budget submission.

Final thoughts on the survey

After eight quarters of growth, the CIA's Q4 Business Survey respondents reported their second successive fall in sales, exports, new orders and production. The final quarter of 2022 was tougher than expected with a number of respondents opting to shutdown production over Christmas to undertake maintenance and avoid significant operating costs. Despite the weak sales and production data, respondents kept employee numbers, R&D spend, and business investment in line with pre-existing plans. Costs continued to rise in the final quarter, however at a slower pace than what was expected and experienced in the third quarter of the year. Alongside rising input costs, the cost of trade increased further which put together, drove down margins in the quarter.

Looking ahead to the first quarter of 2023, respondents were optimistic, however this may reflect just how tough the final quarter of 2022 was. Sales, new orders and production are all expected to increase, so too are employee numbers and business investment while R&D remains constant. Costs are expected to stabilise, albeit at a level significantly higher than the long run average. After years input prices rising quicker than output prices, more respondents expect to increase their output prices in the first quarter than expect an increase in their input costs. This change will help stabilise margins which have taken a battering over the last two years.

When asked about challenges, energy costs remains the largest. The biggest movement in the data compared to the prior quarter surrounded recruitment, retention and reward. Labour costs were voted the fourth biggest challenge in the CIA's Q3 Business Survey, however the latest results puts it second, leapfrogging raw material costs and shortages. Moreover, skills shortages and labour shortages were voted the fifth and sixth largest challenges.

Given respondents' views on the challenges facing the industry, it was understandable that almost 90% of them wanted the topic of energy prices and security covered in the CIA's Budget Representation ahead of the March 15 budget. Other topics include, investment incentives, REACH, sustainability and net zero, and business taxes.

CONTACTS

Tom Warren
Head of Economics
Chemical Industries Association, UK
Tel. +44(0) 20 7963 6788 Mob. +44 (0)7799 892250
Email: WarrenT@cia.org.uk

Simon Marsh
Director of Communications
Chemical Industries Association, UK
Tel. +44 (0) 20 7963 6725 Mob. +44 (0)7951 389197
Email: MarshS@cia.org.uk