Chemicals Outlook

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Chemicals: Market Perform Relative to DB High Yield Index

Continued low-cost feedstocks with similar margins for the Chemicals sector

Our basic theme for 2018 for the Chemicals sector is a continued benefit of low-cost feedstocks for commodity producers leading to another year of solid margins. Margins are expected to be at a similar level as in 2017, which represents a level within the range of prior peaks, but well below the record levels of late 2014. Further, we expect the macro backdrop to be modestly stronger than in 2017. We also expect Chemical producers to focus on continued cost cutting initiatives and M&A to grow in the face of the current macro forecast.

Market Perform rating for the Chemicals sector

The DB HY Chemicals Index has a YTW of 5.36% versus 5.75% for the broad HY Index. Given the outperformance of HY Chemicals over the past year, the yield is now 39 bps tight of the DB HY Index as compared to 14 bps wide at the end of 2016. The current relationship is slightly tight to the average over the past ten years, which has been 22 bps tight of the DB HY Index. Given this relationship is largely in-line, along with the macro backdrop calling for modest growth, we rate the sector Market Perform.

Recommendations include Trinseo and NOVA Chemicals

Our BUY recommendations in the Chemicals sector include the Trinseo 5.375% Senior Notes '25 and the NOVA Chemicals 4.875% Senior Notes '24, 5.000% Senior Notes '25 and 5.250% Senior Notes '27. The Trinseo and NOVA bonds both represent attractive relative value compared to similarly rated names by offering additional yield compared to their peers, while maintaining stronger credit stats.

U.S. Ethylene Up-Cycle to Persist through 2020

While lower oil prices have reduced U.S. ethylene profitability, we still expect U.S. ethylene margins to remain strong and U.S. ethylene producers to remain advantaged versus oil-based producers in Europe and Asia through the rest of the decade. We forecast U.S. ethane-based ethylene cash margins to stay close to the current level of 13 c/lb range through 2018. The 13 c/lb margin is below the 44 c/lb margin achieved in September 2014 (the peak of the peak), but still within the range of prior peaks of 10-15 c/lb. Notwithstanding our view of rising ethane prices, we remain positive on the U.S. ethylene cycle through the rest of the decade (and likely longer) for 2 key reasons: a beneficial oil-to-gas ratio and limited global supply additions.

Global GDP to be up modestly in 2018

The global macro economy is expected to see modestly stronger growth in 2018 as compared to 2017. DB's Global Economics team forecasts global GDP will increase 3.8% in '18 versus 3.7% in '17. Faster progress on tax reform bills in the U.S. and the EU-UK exit deal provided the most recent positive catalysts to growth in 2017. They added to a favorable backdrop of strong economic growth, increasingly supportive fiscal and regulatory policy, and tightening but still easy monetary policy. The DB Global Economics team expects the positive environment to extend into 2018, as the global economy should expand at a strong pace, with the U.S. and Eurozone growing above potential and China slowing down, but only moderately. Political risk, though still present, shouldn't escalate. We expect central banks exit from ultra-accommodative monetary policy to continue very gradually.