

Manufacturing in the Mediterranean

Dom Pavlopoulos, Cement Business Research, provides an analysis of the European markets around the Mediterranean.

Introduction

This article refers to the recently published reports by Cement Business Research (CemBR) on the markets of east and west coastal Mediterranean. The European markets contained within these reports are: Cyprus, Greece, Albania, Bosnia, Croatia, Slovenia, Italy, France, Spain, Portugal, the UK, and Ireland. These markets are in, or very near, the Mediterranean rim and therefore are subject to the overall changes of the region.

What are the recent events that are influencing the conditions in these markets? Some of these events have nothing to do with the European markets in question and are related to other industries in the region. Some of these events can be summarised as follows:

- Unabated capacity additions in Turkey.
- Overall overcapacity in the Gulf States, particularly in the large industries of Saudi Arabia and the UAE.
- Increased capacity additions in Egypt.

- Switch of Algeria from a cement importer (some have called Algeria the cement sponge of the Mediterranean) to a highly competitive potential exporter.
- Overcapacity in Tunisia and Morocco.

CemBR's recent report on the Gulf and North Africa clearly shows that this region urgently needs to export excess capacity to wherever it can.

So, how do these events influence the situation of the European markets in the vicinity of the Mediterranean rim?

Supply outstrips demand in Mediterranean Europe

Firstly, let us consider the overall picture of the twelve markets that make up the coastal Mediterranean region of Europe.

It can be seen from the data shown in Figures 1 and 2 that the European markets of the Mediterranean rim face an unattractive supply/demand balance. It must be noted that



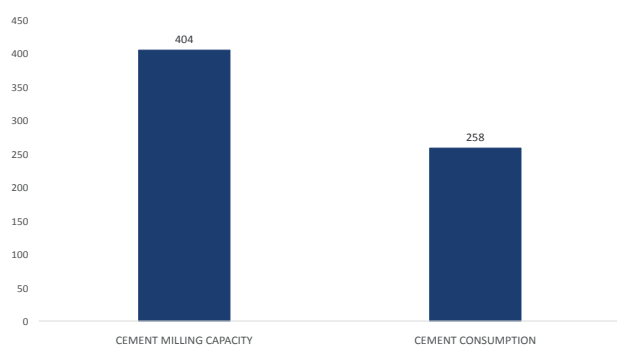


Figure 1. Supply/demand balance in the Gulf and North Africa region (includes Turkey) for 2017 (million t).

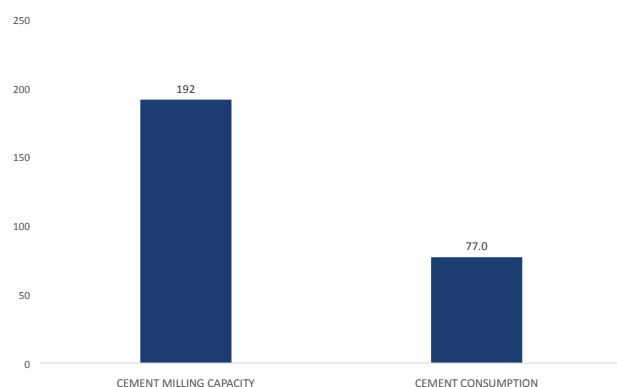


Figure 2. Supply/demand balance of the coastal Mediterranean European markets for 2017 (million t).

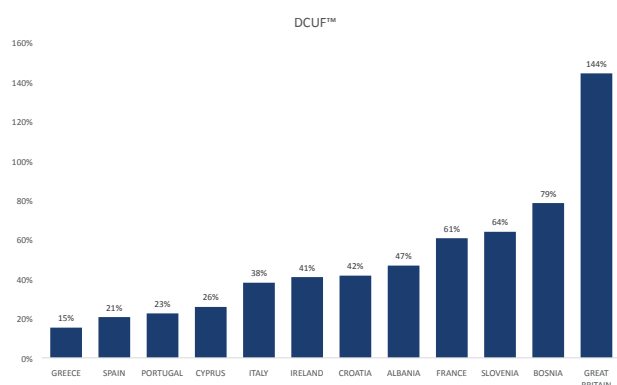


Figure 3. DCUF for the 12 coastal Mediterranean European markets for 2017.

there is the possibility that the cement milling capacity (which includes integrated nameplate capacity and grinding plants' nameplate milling capacity) may be overestimated in countries such as Italy, France, and Spain. In these countries, given the nature of the assets, actual effective capacity may be somewhat lower.

In any case, these imbalances vary from market to market. There are very few markets however that experience a cement deficit. CemBR has established a metric called Domestic Capacity Utilisation Factor (DCUF™), which is the direct ratio between domestic demand and indigenous milling capacity. This metric does not take into consideration international trading (imports/exports) and therefore does not represent actual capacity utilisation rates. However, this metric

is useful to see the propensity of an industry to import/export and as such defines the behaviour of the market participants.

Using the data from Figure 3, it can be surmised that industries with low DCUFs have a propensity to export, whereas markets with high DCUFs will import.

How about actual utilisation rates?

This report has examined the international trading of these markets and the impact of imports/exports on actual utilisation rates of the industries.

In most cases of very low DCUFs, the industries have been exporting more than they have been importing. As such, the actual utilisation rates are higher than the DCUFs. This applies to industries such as Greece, Spain, Portugal, Cyprus, Italy, Ireland, Croatia, Albania, and Slovenia. There are two exceptions to this rule, namely France and Bosnia, which show lower actual utilisation rates than DCUFs. This is explained by the higher level of imports than exports to/from these markets. The reasons behind this discrepancy are complex and explained in a recently published report. In 2017, CemBR has estimated that exports increased, and actual utilisation rates have improved further, particularly for industries such as Spain, Portugal, and Greece. The EU Emissions Trading Scheme (ETS) 50% production requirement has compelled many such industries to export. How this is going to pan out in the future is yet to be established.

What about demand projections?

Demand is expected to recover in all markets that make up coastal Mediterranean Europe. Growth in most of Europe has returned, albeit at a subdued rate. The latest trade war fears have also affected the region, depressing further growth expectations. Nevertheless, demand is projected to grow at an average rate of just below 2% CAGR between 2017 and 2022. The report suggests that most, if not all, of these industries are not expected to add new capacity during the forecasting period (2017 – 2022).

This projected growth, although welcome (as demand behaviour similar to the period between 2006 and 2016, when significant demand reversals were experienced in all these markets, is not expected), it does not make a significant difference to the overall DCUF for these markets.

There is an improvement in DCUF from 40% to 44% for the total region. It is also observed that most countries currently experiencing low DCUFs are likely to continue at low levels during the whole of the forecasting period. As such, the propensity of these industries to export, all else being equal, will continue to be strong in the next five years.

What drives exports (apart from excess capacity)?

As eluded to earlier, the EU ETS plays a significant role in the propensity of these industries to export. Most of

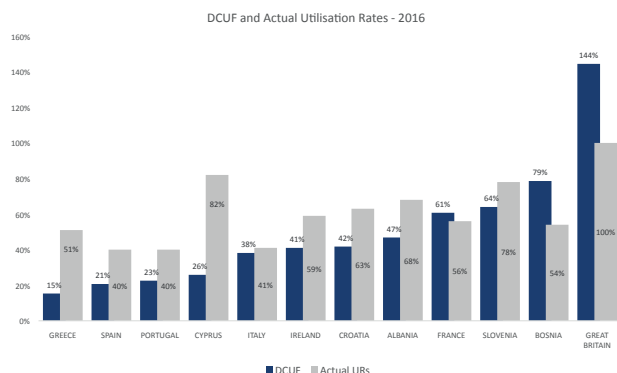


Figure 4. DCUFs and actual utilisation rates for the 12 coastal Mediterranean European markets for 2016.

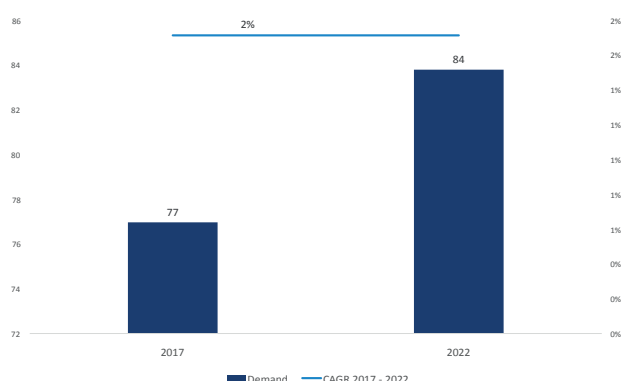


Figure 5. Demand in 2017 and 2022 (million t) and CAGR 2017 – 2022.

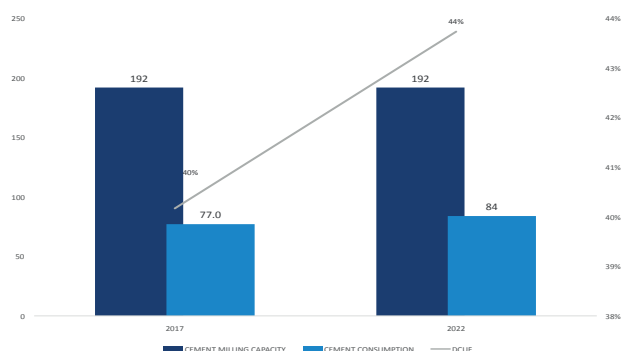


Figure 6. Supply/demand balance and DCUFs in 2017 and 2022.

these markets are members of the EU ETS and as such are required to produce over 50% of the previously allocated capacity-based carbon credit allocation in order to receive carbon credits.

In the past (2005 – 2012), when the ETS did not require producers to exceed the 50% production mark, the industries in question were skewed toward keeping otherwise obsolete assets operational (particularly after the significant demand reversals of the period). In other words, they would keep uneconomical plants open, operating at very low utilisation rates, while benefiting from the carbon credits allocated to these assets. The financial results of many major European producers for the period 2006 – 2012 would attest to this behaviour.

However, the EU ETS has caught up with this and the 2013 – 2020 phase requires at least 50% actual production to release all the allocated carbon credits. So, since 2013 many industries in Europe actively pursued exports in order to bring their production levels to over 50%. The price for carbon credits has been volatile during this period, starting at very high levels and then dropping significantly. Recently, carbon credit prices have recovered, reaching around €14 in May 2018 and climbing to around €17 in August 2018.

So, in addition to the low DCUFs, most of the industries examined will have an additional incentive to export (to at least reach 50% of allocated capacity) as carbon credits have shown significant recovery in price recently. This will vary from industry to industry and even among the various producers. The precise strategies the various producers operating in these markets will follow cannot be known: some may choose to withdraw uneconomical assets, whereas others may opt to continue to produce in order to benefit from the carbon credits. This may depend on whether they view the carbon credits as a cost or a benefit. This is indeed a very complicated issue requiring specific attention from company to company or even from plant to plant. It must also be noted that in some of these markets, there have been attempts to shut down capacity with varying levels of success.

What happens next?

Assuming that no more capacity is withdrawn, these markets will need to continue their exporting activities well into the future. At the same time, several North African producers also have the need to export their excess capacity. There have been several news items recently indicating that North African producers are not only targeting West African markets, traditional destinations for European producers, but have also begun exporting to Europe.

The next chapter is therefore still unfinished, but the indications from the research and analysis are compelling. Too many excess capacity producers chase too few deficit markets in the region. Naturally, the European indigenous producers may attempt to safeguard their markets by providing several arguments against imports, such as carbon leakage, quality issues, supplier reliability, and other such notions.

Many interested parties have asked to consider the implications of this developing situation and define certain scenarios regarding the future of the Coastal Mediterranean European markets. This work is ongoing. For now, the European markets in and near the Mediterranean Sea are likely to experience significant changes going forward. 🌐

About the author

Dom Pavlopoulos is a member of CemBR's team responsible for sales and marketing. Pavlopoulos was also involved in the research effort behind the reports on coastal Mediterranean.