November 2023

Reflecting on 2023, Looking Ahead to 2024

In regard to climate related demand needs, order books should have reached capacity by now. So, why demand is atone nowadays in Europe and what can we expect next from a business standpoint?

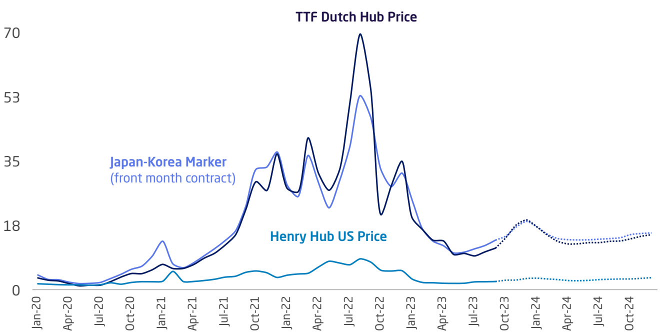
2023: Another *annus horribilis*

Inflation has been a considerable shock. Rooted in the post-Covid recovery of 2021, when shortages were the main driver, inflation has skyrocketed in Europe since Russia launched its war in February 2022 and O&G deliveries became a threat. The price of energy was by far, the main driver of the inflationist trend.

While the price has decreased by almost 3 times in October 2023 versus December 2021 when the post Covid recovery was peaking, the EU Natural Gas Price is still showing a +300.9% versus October 2019 (pre-Covid period). November 2023 Brent Crude Oil in Europe is pointing at +13.1% versus December 2021 average but at -7.4% from October 2023.

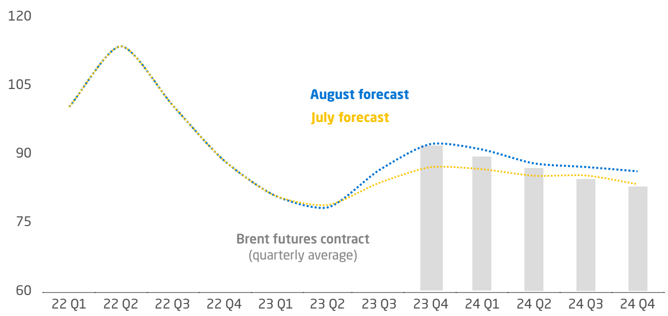
Concerning other goods, the core inflation in the Eurozone (all industrial goods excluding energy production) lended at 3.5% in October 2023. That's compared to 4.1% in September and 6.1% in October 2022. Nevertheless, the core inflation rate remains above from the long term average of 1.90%.

Natural gas prices ($/Mmbtu)



Data: CRU, NYMEX, IMF provided by EMIS/CEIC, ENTSOG

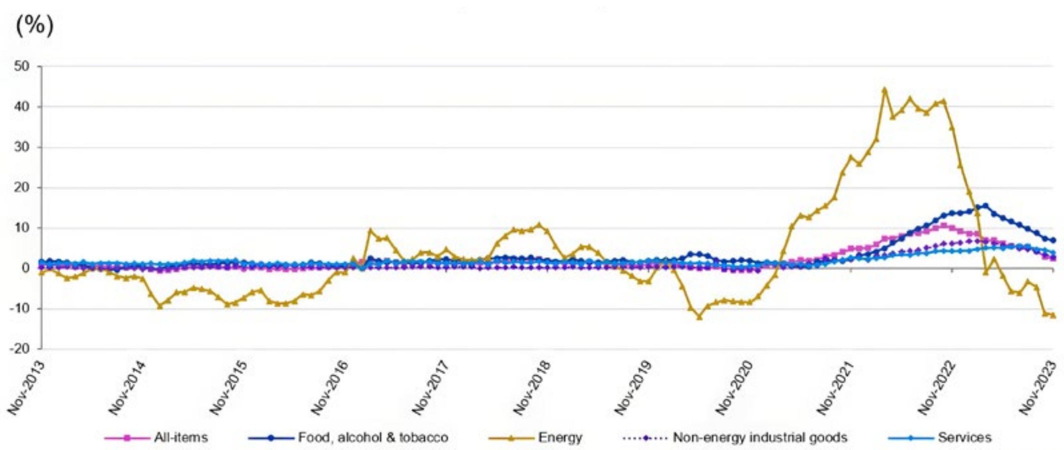
Oil price forecast ($/bbl)



Data: CRU, EIA

Inflation has been a considerable shock

Euro area annual inflation and its main components, October 2013 - October 2023 (%)



Source: Eurostat (online data code: prc_hicp_manr)

To tackle inflation, the EBC has been increasing its key interest rates since September 2022, with the objective of slowing consumption.

They are now settled between 4 and 4.75%. The refinancing rate, which provides the bulk of liquidity to the banking system and is therefore the EBC's key tool for fighting inflation, is now at 4.5%, up from around 0% a year ago. While this rate hampers investments, it helps lowering prices in the long run.

The combination of high input prices and high borrowing rates has muted demand.

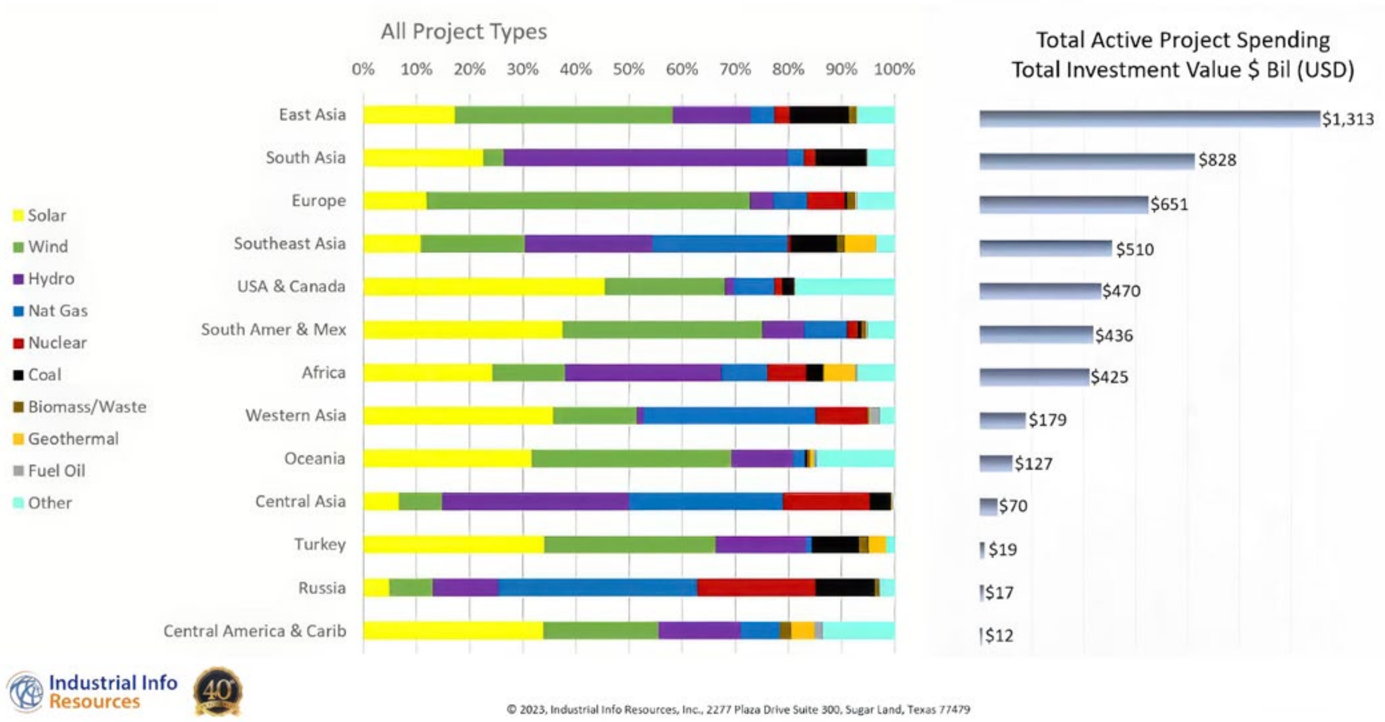
Add to this the fact that a destocking phase has deterred output in 2023 and the Industrial Production Index by sector speaks for itself. All sectors are down.

Without commenting on the fact that China is diversifying its structural demand and on today's volatile and escalating international context, both weighing on confidence and visibility, it's no stretch to say that 2023 has been another *annus horribilis*.

Industrial Production Index Eurozone	YoY Growth (September)
Capital Goods	-7.7%
Durable Consumer Goods	-7.8%
Electricity, gas, steam & AC supply	-5.8%
Energy	-6.0%
Intermediate Goods	-4.7%
Manufacturing	-6.4%
Mining & Quarrying	-8.3%

2024: What can we reasonably expect?

More than US$5 trillion in global projects are set to kick off in 2024-2025 in the energy sector only, as per Industrial Info Resources analysis. Around US$650 billion is set to be effectively invested in Europe during this same period, with the goal of addressing the new Renewables Energy Directive adopted on 9 October 2023 by the European Council. The Directive aims to raise the share of renewables in the EU's overall energy consumption, up to 42.5-45% by 2030 (22% in 2021), in a timeframe of seven years.



More than US$5 trillion in global projects are set to kick off in 2024-2025 in the energy sector only

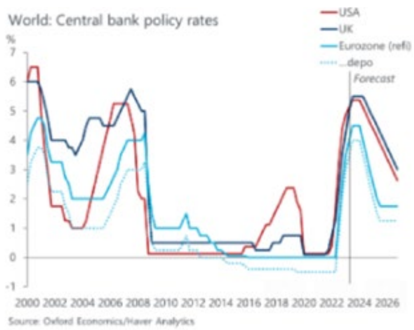
Some Green Deal legislative milestones were achieved in 2023, such as the adoption of EU Renewable Energy Directive and the Building Energy Act. Others will be reached in Sustainable Finances in early 2024, including the disclosure of the full KPIs on EU taxonomy alignment. This would bring more clarity to the impressive ESG normative bindings and thus could provide some funding to start building.

From a borrowing point of view, if the method of high rates to fight inflation has proven successful in past crises, the paradox today is that the economy of the decade is shifting towards an era of infrastructure and equipment. The economy will be primarily sustained by such heavy Capex investments as wind farms, solar fields, dams, bridges, routes, rails, and gigafactories to sustainably supply the pivotal and cascading climate related demand needs.

Those Capex investments require the cheapest and easiest access in order to abate capital costs and to fund in the most useful way, not only the US$ 650 billion energy infrastructure bill in Europe due to start in 2024 and 2025, but all the needs of the mobility, building, and industrial sectors - amongst others - across the supply chain, from mining to household, as everybody will have to invest heavily at some point into a heat pump or an EV.

Positive signs concerning an abatement of the core inflation

It is quite difficult to predict what the behavior of the Central Banks will be in 2024, now that some positive signs concerning an abatement of the core inflation are finally arising. As we are still in the middle of raging wars, nothing is set in stone. But the economic consensus is forecasting a decrease in the course of H1 2024, giving some air to businesses as well as to households. The EBC has already announced a pause from Q4-23, triggered by a slow down in the European economy and the high cost of borrowing.



Afterwards

Due to the huge climate change-driven demand worldwide, inflation will still be an issue driven by the multiplication of material and energy demand bringing prices higher during the course of the recovery, as seen in 2021. To illustrate, OPEC is forecasting strong growth in global oil demand in 2024 and 2025, foreseeing a better conjuncture, led also by China's recovery, underlying a global stimulus but also a rise in price.

Therefore, EBC rates cannot be the unique tool to be used. Temporary measures have also been activated by the Commission lately. The emergency intervention of the EU using the revenue cap regulation, the EU coordinated purchase, the market correction mechanisms to address high energy prices, to rationalize opportunistic inflationist behavior and to protect end users were other means used to fight inflation.

To favor investments, fiscality and a sectoral favored rates approach, depending on ESG reviews, would be some of the differentiation tools, but not the only ones. Even crowdfunding is being discussed at EU level to sum the needed investment of the Energy transition.

From an operational point of view within a geopolitical context on the edge, another mindset is needed. Understanding the underlying demand up front would lead to constituting strategic stocks when prices are still cost-effective and availability not an issue.

For example, fulfilling O&G stocks was one of the first measures organized by the Commission when supply and prices were becoming a concrete theme. Likewise, China has been stockpiling raw material and energy bought during low pricing cycles to ensure profit and production readiness. Wisely managing today's contracts and futures, have never been so determinant. It might help waving the inflationist trends tomorrow.

Access to financing will be decisive

All in all, free market forces and high lending rates will not solve all inflation issues alone in the years to come. Innovation and responsibility in finance, governance and management is a must too. Underlying climate demand is here and quite a lot of European ESG projects are awaiting tailored and affordable Go to pave the way to Net Zero. Access to financing will be decisive.

We at Aperam are committed to sharing all appropriate knowledge to give some clarity over the period and clarity is all an investor, a producer, a consumer needs to make an accurate choice.

Sources:

https://energy.ec.europa.eu/topics/markets-and-consumers/actions-and-measures-energy-prices_en

https://ec.europa.eu/eurostat/documents/2995521/17907993/2-17112023-AP-EN.pdf/ed17ee00-c92c-3bac-8dc7-a4a2bb78074a

https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Inflation_in_the_euro_area

https://fred.stlouisfed.org/series/PNGASEUUSDM

https://fred.stlouisfed.org/series/DCOILBRENTEU

Oxford Economics

Industrial Info Resources

Cristina Marques
Head of Market Insights
cristina.marques@aperam.com