Industry Top Trends Update

Capital Goods

A rapid recovery

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What's changed?

The sector outlook has stabilized. The net negative outlook bias among issuers we rate in Europe, the Middle East and Africa--a measure of future downgrade risk--sunk to 6% as of June from 50% a year ago. Most rating actions in 2021 have been positive, and the risk of defaults has eased, even at the low end of the rating scale.

The fast global economic rebound is supporting the sector's growth. We revised our 2021 global GDP growth forecast up to 5.9% and see upside risks. Crucially, the U.S. and China--which account for almost 40% of the global economy--are both growing rapidly. This boosted industrial production and orders in the first half of 2021. We expect growth will continue, but with somewhat slowing momentum, and that 2021 will mark a significant expansion in terms of top lines and margins for the capital goods sector.

How is recovery taking shape?

The eurozone is seeing rapid growth of orders and production. IHS Markit revised its Eurozone Manufacturing Purchasing Managers Index to a record high of 63.4 in June 2021, and new orders experienced their third-fastest reported increase ever. The positive momentum lifted the capital goods sector's output and order books due to increased investment and use of manufacturing output-related consumables and services, which we expect to continue throughout the year. We see strong momentum in all main end markets, barring commercial aerospace.

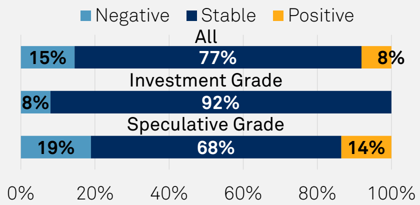
We expected improvement in the sector's performance and credit metrics. On a global basis, in 2021, we forecast revenue growth for the rated capital goods sector of 25%, after a marked contraction of 21% last year, and operating margins nearly recovering to 2019 levels (forecast aggregated EBITDA margin 14.4% in 2021 versus 14.7% in 2019). We also expect aggregated sector credit metrics will significantly improve during 2021 from stronger operating performance and return to pre-pandemic levels in 2022.

What are the key risks around the baseline?

Material price increases and supply-chain constraints. The price of most raw materials jumped due to the post-pandemic rebound, which is likely to slow margin expansion across the sector. However, we expect that supply-chain constraints for most materials and components will slowly ease in the second half of the year. We also think in certain cases, such as microchips, the shortage will boost investment in production capacity and benefit companies providing manufacturing technology.

Spikes in COVID-19 outbreaks during the fall and winter. Vaccine hesitancy rather than supply in Europe may prevent countries from reaching targeted vaccination levels over the summer. Additionally, the spread of variants could delay recovery of sectors that were already severely hit, like aerospace. While we do not include a new wave of shutdowns in our sector base case, we see a potential downside in the form of slowing recovery toward the year-end if governments reintroduce pandemic-related restrictions in the main European economies.

Outlook Distribution



Ratings Statistics*

	IG	SG	All
Ratings	25	37	62
Downgrades	0	2	2
Upgrades	0	5	5

Ratings data as of end-June, 2021. *Year to date

COVID-19 Heat Map

Capital Goods	
Estimated Recovery To 2019 Credit Metrics	**2022**
Potential Negative Long-Term Industry Disruption	--

2020 Versus 2019		
Revenue Decline	**EBITDA Decline**	**Incremental Borrowings**
5% to 10%	15% to 25%	5 to 10%

2021 Estimates Versus 2019	
Revenue Decline	**EBITDA Decline**
0 to 10%	0 to 10%