Industry Top Trends Update

# Chemicals

## Favorable demand, constrained supply offset rising costs

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## What's changed?

**Rising input costs.** An across-the-board input cost increase, including for chemical raw materials, wages, and transport, has the potential to create challenges for chemical companies into 2023.

**Unexpected earnings strength in certain subsectors.** Favorable demand and pricing conditions, and improved competitive positions vis-à-vis European and Asian competitors in certain chemical subsectors have more than offset effects of rising costs. These subsectors include commodity and specialty agricultural chemicals, titanium dioxide, and petrochemicals.

**Capital markets slowdown.** Rising interest rates and expectations for future rate hikes could dampen financing and refinancing plans at companies that have acquisition financing plans, large capital spending plans, or near-term debt maturities. Interest costs at companies with meaningful variable rate debt will rise.

## What to look out for?

**Demand weakness.** Weakening demand from key end markets such as agriculture, housing, auto, and general industrial could reverse favorable credit conditions that have enabled chemical companies to handle rising costs.

**Supply increases.** Several factors, including supply chain constraints, have reduced global supply in some chemicals, benefitting North American chemical producers. A reversal of these constraints or increases in supply in petrochemicals and other commodity chemicals could weaken earnings.

**Refinancing risk.** At a sector level, refinancing requirements look manageable, but if unfavorable capital market conditions extend well into this year, lower-rated credits with refinancing requirements, in particular, face rising credit risks.

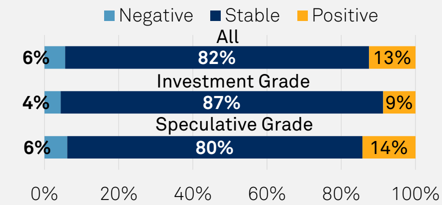
## What if there's a recession?

**Earnings weaken.** Earnings at chemical companies have generally held up or even improved over last year. A recession could flip this situation in some subsectors including petrochemicals, by destroying demand, and ultimately weakening earnings. Subsectors such as agricultural chemicals may be relatively less susceptible to a recession.

**Credit metrics weaken.** Credit metrics have been boosted at many chemical companies by strong earnings and lower net (of surplus cash) debt levels. In a recession, both earnings and cash balances could weaken resulting in a deterioration of credit metrics, although many companies do have some cushion under credit metrics at the current ratings.

**Financial policy becomes increasingly important**. Mergers, acquisitions, and shareholder rewards including buybacks have been important uses of cash during recent periods of earnings strength. How companies respond to earnings weakness and conserve cash will become an important credit factor in a recession.

### Outlook Distribution




### Ratings Statistics (YTD)*

| | IG | SG | All |
|---|---|---|---|
| **Ratings** | 23 | 50 | 73 |
| **Downgrades** | 0 | 1 | 1 |
| **Upgrades** | 1 | 7 | 8 |

Ratings data as of end-June 2022. * Year-to-date

### Ratings Outlook Net Bias