

Industry Top Trends Update

Aerospace and Defense

War raises budgets, but benefits are years away

What's changed?

The Russia-Ukraine conflict has resulted in some of NATO's top spenders hiking defense budgets. Leading NATO members continue to urge other members to increase their spending toward the 2% of GDP target. However, this will not result in a short-term windfall for aerospace and defense (A&D) companies because it can take years for funds to pass from the point of political approval, through budget allocation, and the tendering process, then to companies that win contracts.

Airbus continues to raise narrowbody production rates. The company targets producing 65 per month by summer 2023 (production fell about 40 per month in the worst of the pandemic) and the plan is to raise this to 75 per month through 2025.

Widebody production remains muted, and cargo has peaked. We do not expect long-haul international travel demand or demand for wide body planes to recover to pre-pandemic levels until at least 2024. The demand for cargo rose during the pandemic, but we believe this has peaked.

What to look out for?

Russia reduces or cuts off Europe's gas supply. This would undoubtedly have a negative impact on A&D issuers, as would be the case across many industries, regardless of how well issuers are managing rising energy costs.

The commercial aerospace supply chain might not keep up with Airbus' ambitions. Delays and shortages of certain components could drag on the supply chain as the company pushes to raise production rates to a historical high.

Inflation has been manageable but isn't making the post-pandemic recovery easier. Many A&D issuers are either well hedged, have high levels of inventory or critical materials, or have contract structures, meaning they can pass through much of the raw material and energy cost increases. This stands for 2022, but management teams have expressed that a prolonged period of high-single-digit inflation through 2023 would become more of a challenge.

What if there's a recession?

The impact on defense companies would be far less than in other industries. European governments, as seen during the pandemic, would continue to prioritize defense spending and ensure that defense production continues. Issuers might need to grapple with short-term labor and raw material cost volatility.

Air travel recovery could falter. Reduced demand would result in lower sales for original equipment manufacturers, component suppliers, and service providers. Orders for new aircraft would likely be less affected, due to pent-up demand.

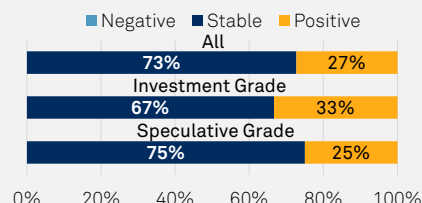
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- [U.K.-Based Aerospace And Defense Company BAE Systems PLC Upgraded To 'BBB+'; Outlook Stable](#), June 28, 2022
- [France-Based Aerospace And Defense Company Thales Upgraded To 'A-' On Stronger Credit Ratios; Outlook Stable](#), June 10, 2022
- [Airbus SE Outlook Revised To Stable On Strong Operating Performance: 'A/A-1' Ratings Affirmed](#), March 30, 2022
- [Industry Top Trends 2022: Aerospace & Defense](#), Jan. 25, 2022

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