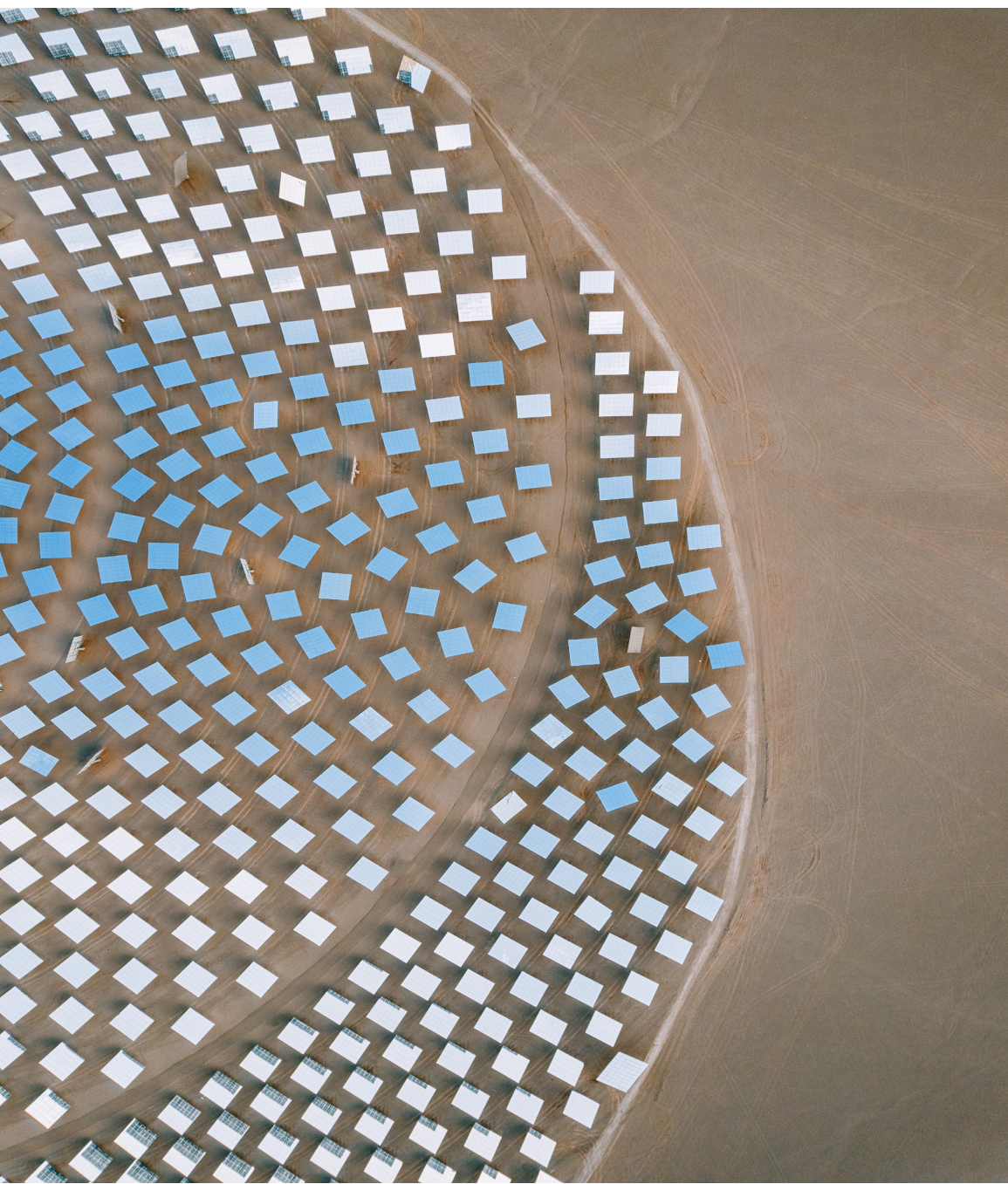


Industry Top Trends Midyear 2022

Relapse, Recession, Resilience

July 25, 2022

This report does not constitute a rating action



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Contents

Industry Top Trends Midyear 2022.....	4
North America	
Aerospace and Defense Commercial aircraft are supply constrained	7
Autos Rising costs and demand pressure reduce ratings cushion	8
Building Materials Diminishing tailwinds could pressure ratings	9
Capital Goods Pricing power and nimbleness hold credit steady...for now	10
Chemicals Favorable demand, constrained supply offset rising costs	11
Consumer Products A weaker consumer intensifies pressure.....	12
Health Care Inflationary pressures on margins.....	13
Homebuilders and developers Positive sector outlook moderates in 2H22.....	14
Hotels, Gaming, and Leisure Higher ratings on pandemic recovery but recession looms	15
Media and Entertainment Pouring recessionary gasoline on a secular fire	16
Metals and Mining Credit steadies after a big upswing.....	17
Midstream Energy Strong supply and demand dynamics.....	18
Oil and Gas Ratings are supported by debt repayment	19
Real Estate Fundamentals slowing amid higher recession risk.....	20
Regulated Utilities Credit quality has weakened and credit risks are rising.....	21
Retail and Restaurants Credit quality is at a turning point.....	22
Technology Pace of IT spending slowing, margin pressure in play.....	23
Telecommunications Rising costs and slowing growth could hurt credit quality	24
Transportation 2022 started strong but recession risks cloud the outlook.....	25
Transportation Infrastructure Some signs of more equitable risk share in P3s	26
Unregulated Power An unprecedented power price run.....	27
Europe	
Aerospace and Defense War raises budgets, but benefits are years away.....	28
Autos Market conditions weaken in Europe.....	29
Building Materials Cost inflation weakens margins and reduces rating cushion.....	30
Capital Goods Supply risk overshadows order backlog.....	31
Chemicals Slowdown, looming gas shortage dim second-half outlook.....	32
Consumer Products Continued price increases test resilience of brands	33
Health Care Inflationary pressures on margins.....	34
Homebuilders and Developers Challenged by softer demand, higher costs and supply chain.....	35
Hotels, Gaming, and Leisure Broad-based rebound continues, but economic risks grow	36
Media and Entertainment Dark sequel: Pandemic survivors to face a new plot twist	37

Industry Top Trends Update Midyear 2022: Relapse, Recession, Resilience

Metals and Mining | Margins contracting but cash flow is adequate for most 38

Oil and Gas | As good as it gets for producers and refiners? 39

Real Estate (REITs) | Inflation boosts revenue but rate rises a challenge 40

Retail and Restaurants | Rising prices will lead to consumers pulling back..... 41

Telecommunications | Stable outlook despite inflation and reduced market access 42

Transportation | Air traffic booms, shipping strong, but macro risks loom..... 43

Transportation Infrastructure | Weakened economies and inflation may undo recovery..... 44

Utilities | Risks rise even if the lights stay on..... 45

Industry Top Trends Midyear 2022

Key Takeaways

- Cost inflation and supply-chain disruption remain rife. Profit margins face pressure.
- Consumption patterns are already changing as cost-of-living pressures bite.
- Energy security has become a big theme, complicating the energy transition.
- Rebuilt balance sheets will soften the blow of a brief recession, but offer less protection against a prolonged one, given elevated debt levels and further financial market volatility likely to follow.
- A European recession triggered by gas supply restrictions could be particularly tough.

What's changed, what matters, what if there's recession?

S&P Global Ratings analysts have published 39 midyear Industry Top Trends updates for Europe and North America. These one-page updates summarize our evolving views, focusing on what's changed, what to look out for, and what a recession might mean. They are drawn from our assessments of more than 5,000 rated corporate and infrastructure entities. All individual Industry Top Trends reports can be accessed [here](#). For updates on Asia-Pacific, please see "[Sector Roundup Asia-Pacific Q3 2022: Inflation and China - Rough Ride Ahead](#)" (July 4, 2022).

Key Themes

A variety of themes emerge from this cross-sectional set of industry views:

Pent-up pandemic demand continues to benefit some sectors. Air traffic is booming, with the airline industry enjoying full planes and high fares. In North America, there is continued surprising rate strength in hotels, theme parks, and Las Vegas gaming--even cruise ship pricing has strengthened for 2023 bookings. In Europe, despite slumping consumer confidence, the tailwind from pent-up demand, backed up by high household savings, is still supporting spending for now, auguring well for sectors relying on trade consumption such as beverages and food services.

Inflation is everywhere, in everything. Surging costs are the nearest thing to a universal theme across the reports, encompassing material, energy, logistics, and labor costs. In some cases, the increases have been extreme. European natural gas, a key energy source for some building materials subsegments, have a spot price about six times higher than in the same period in 2021. Rising wage costs are being felt in sectors as diverse as media and entertainment and health care, where nursing costs are rising sharply.

Profit margins are starting to come under pressure. It is rare to find a sector that hasn't been able to manage these cost pressures by passing them on or by enjoying higher volumes. This speaks to the breadth of inflationary pressures, but also suggests that a more budget-conscious environment will threaten a rapid adjustment to profitability. Sometimes internal industry dynamics have been at play: for example, auto parts suppliers have borne the brunt of supply-chain shortages and higher costs, rather than manufacturers, to the detriment of their ratings. In other cases, higher costs have constrained profitability but not prevented improvement: higher kerosene prices have reduced the benefits to airlines from surging passenger numbers but have not stopped the swing back to profit. Nonetheless, there is little optimism that this benign margin environment can be sustained given slumping consumer confidence, still escalating business costs, and the prospect of faltering growth.

Consumption patterns are already showing changes in the face of inflation. In the U.S., savings rates are now below prepandemic levels and disposable incomes are falling in real terms for many. This is leaving less room for discretionary spending and bringing a more price-sensitive consumer for retail and consumer products. In the U.K., retail sales volumes have seen significant falls. With high inflation rates persisting and interest rates rising, this shift in spending patterns is likely to gather momentum.

Supply chain disruption remains widespread, with both shortages and bottlenecks still widely reported, and exacerbated in some cases by labor shortages. The second half should start to bring improvement in some areas. We anticipate that semiconductor manufacturing capacity expansion plans initiated in late 2019 and early 2020 will start providing meaningful output increases in the second half of this year. Containership capacity is tight, but a ramp-up of vessel deliveries should start to have an impact next year. Nevertheless, two structural factors continue to amplify the disruption stemming from the height of the pandemic: first, continuing lockdowns in China, where the attempt to achieve zero-COVID continues; second, through the impact of the ongoing conflict in Ukraine, which is limiting supplies of foodstuffs, metals, and minerals.

Inventory builds are happening, consuming working capital. For example, we expect European automakers and suppliers will build inventories and unfinished products to avoid unnecessary production halts. We think spending on inventories by U.S. homebuilders and developers will be materially higher this year, mainly to complete homes already on order. Faced with increasingly price-sensitive consumers as the cost-of-living crisis bites, retailers have found themselves saddled with inventory consumers don't want or can't afford anymore. Elevated working capital needs pose significant credit risks, particularly if a rapid downturn eliminates assumed demand.

Energy security has become a big theme, complicating the energy transition. There are also complex factors at play involving investment discipline, investment risks, and pressures from ESG investors. The war in Ukraine has intensified the politicization of Russian gas supplies, shifting immediate energy priorities toward securing supply and storage. Surging fuel and power prices are central to cost-of-living pressures and have become politically important.

For the utility sector this is bringing enormous challenges: undertaking and financing substantial long-term investments in favor of renewable sources, while balancing shorter-term price and supply pressures. U.S. regulated utilities' capital expenditure (capex) hit an all-time high of \$165 billion in 2021, and we expect that figure to increase to more than \$200 billion by 2023. In Europe, we expect the energy transition to require capex to increase at least 20% from the already elevated levels spent over the last three years. The utility sector, normally a safe harbor in recession, is becoming riskier.

For oil, gas, metals, and mining companies, investment discipline has been their hallmark since the commodity crash in 2015, along with a greater focus on renewable power and carbon emissions reduction. Consequently, we don't see substantial step-ups in investment as being likely. This is likely to constrain supply and may mean that, in the event of recession, one of the traditional cyclical balancing mechanisms - sharply reduced commodity prices - are less potent.

Turning to what a recession could mean:

Liquidity cushions are likely to soften the blow of recession. The substantial refinancing and build-up of cash encouraged by pandemic stimulus measures means that many sectors are well-placed to deal with a relatively short mild recession. Really, it is a question of magnitude and duration. Cyclically sensitive industries would still see pressure on credit metrics, but they start from a better place than is typical for a recession. A more severe recession would necessarily be far more challenging across the board, but particularly for sectors not yet fully recovered from the impact of the pandemic such as hotels, gaming, leisure, or real estate.

Refinancing risk remains a concern for weaker issuers. The first half of this year has seen debt issuance slump and brought a rapid repricing of credit risk. The impact has been lessened by the favorable credit conditions preceding this, but speculative-grade issuers remain more at risk from recession, particularly if it appears that stagflation is taking hold, bringing stagnant growth and persistent inflation. Highly leveraged issuers are often relying on stronger EBITDA growth in the next 18-24 months to support refinancing.

Some traditional recession patterns will persist, others could be very different. Telecoms remain a relatively safe harbor, with broadband and mobile services essential to businesses and consumers. In Europe, even under a recession downside scenario, we expect debt-to-EBITDA will only rise by 1.2x for speculative-grade issuers, the second-lowest increase among 19 corporate sectors. Similar resilience is expected in nondiscretionary elements of health care, retail, and consumer products. Defense spending has always been less influenced by cyclical pressures, but heightened geopolitical tensions are likely to bring a reprioritization toward military equipment. Areas of potentially different behavior include utilities--where we see elevated risks as described above-- and media, where the shift to consumer subscriptions and digital advertising--now 70% of total advertising--has brought a much greater sensitivity to consumer spending and a potentially much more rapid slowdown in spending.

A mild recession could help curtail supply-chain problems. The silver lining of a downturn might be a rapid easing of supply-chain and capacity issues. Cooling goods demand could give time for stretched transportation networks--ports, warehouses, and freight transporters--to clear contained and shipment backlogs and hire needed labor. Oil and gas consumption could fall, tempering price pressure. This might bring broader macroeconomic benefits of easing inflation and shortening the interest rate cycle.

A European recession triggered by gas shortages could be tough. For European industries, there is clear concern that, with winter looming, gas supply cuts by Russia to dependent European countries could have severe consequences ranging from margin pressure to curtailed production in industrial sectors such as building materials, capital goods, and chemicals.

Conclusion

This decade has brought extraordinary challenges to the corporate sector: pandemic, recession, recovery, inflation, supply-chain chaos, war, and now a renewed threat of recession. The industry updates that follow provide some reassurance that rebuilt and refinanced balance sheets will offer resilience to recession, particularly if mild and short-lived. A harsher or prolonged recession would prove far more challenging, with debt levels still relatively elevated and some industries yet to fully recover from the pandemic. We hope that these updates provide a useful framework for thinking about the challenges and uncertainties ahead.

Related Research

- [U.S. Corporate Credit Outlook Midyear 2022: Bracing For A Bumpy Ride](#), July 20, 2022
- [If Stagflation Strikes, Loss-Making Corporates Will Double Globally](#), July 12, 2022
- [Recession Risk And Ratings: What Recession Could Mean For European Speculative Grade Nonfinancial Corporates](#), June 23, 2022
- [\[SLIDES\] Inflation, Rate Strains Set In For Asia-Pacific Corporates](#), June 21, 2022
- [Searching For Stress Fractures: Evaluating The Impact Of Interest Rate And EBITDA Stresses On U.S. Speculative-Grade Corporates](#), May 25, 2022
- [\[SLIDES\] Russia-Ukraine Conflict: Implications For European Corporate And Infrastructure Sectors](#), March 16, 2022

Aerospace and Defense

Commercial aircraft are supply constrained

What's changed?

Commercial aerospace revenues and earnings remain below pre-pandemic levels.

Global demand for jetliners, particularly narrowbody, business, and freight aircraft, is strong. U.S. air travel volumes are approaching pre-pandemic levels, supporting aftermarket sales of parts and maintenance services. But the commercial aircraft sector has yet to recover to pre-pandemic levels.

Commercial supply is likely to lag demand. Boeing's ramp up of 737 MAX deliveries and production has been uneven and resumption of 787 deliveries awaits regulatory approval. Supply chain constraints, including shortages and delays for components throughout the value chain, are limiting production growth

U.S. defense spending supports sales growth. The 2022 U.S. defense budget is up 6% from 2021, and the 2023 request represents a 4% increase over 2022. While the Russia-Ukraine conflict may lead to increased spending by European allies, we do not expect it to result in a near-term windfall.

What to look out for?

Resumption of 787 deliveries and MAX deliveries in China. Boeing is seeking FAA approval to resume 787 deliveries after quality issues required remedy, and seeking Chinese government approval to resume deliveries of 737 MAX planes to customers in China, one of its largest markets.

How long will supply problems last? Delays and shortages of certain components are impeding aerospace companies' ability to meet demand. Improvement in the second half of the year would free up working capital and allow companies to make progress meeting backed up orders.

Defense companies may pay higher cash taxes in 2022. U.S. tax rules now require research and development spending to be capitalized, resulting in temporarily higher cash taxes starting in 2022. The rule may be changed or deferred in future legislation, but we assume it stays in place in our forecasts.

What if there's a recession?

The recovery of air travel could falter. Reduced demand would result in lower aftermarket sales for OEMs, component suppliers, and service providers. Orders for new aircraft would likely be less immediately affected, due to pent-up demand.

Stretched supply chains could gain time to recover. Less demand for commercial aerospace aftermarket products, and potential deferrals of new planes, would give suppliers time to catch up on delayed orders. A slower economy would also reduce pressure on materials and labor costs and availability.

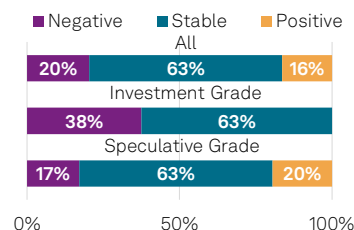
The effect on defense spending would be limited. U.S. national security priorities, including heightened perception of risks and focus on modernization and readiness, would likely insulate defense orders from budgetary pressures.

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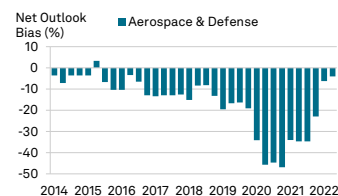


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	8	41	49
Downgrades	0	2	2
Upgrades	0	3	3

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

Ratings Outlook Net Bias



Related Research

[Raytheon Technologies Corp. Ratings Affirmed, Outlook Negative On Uneven Recovery And Higher Tax Payments](#), June 7, 2022

[Jazz Acquisition Inc. Upgraded To 'B-' From 'CCC+' On Improved Credit Metrics; Outlook Stable; Debt Ratings Raised](#), May 13, 2022

Autos

Rising costs and demand pressure reduce ratings cushion

What's changed?

Pressure on sales forecasts. Supply bottlenecks amidst steady demand will create a marginal decline in light vehicle sales in 2022 versus 2021. Though we still expect a gradual supply increase in 2023, affordability risks could curb pent-up demand.

Supply chain disruptions will delay improvement. Chip and other component shortages will hamper supply and reduce visibility on near-term production, which will disrupt cash flows and delay recovery in cash flow metrics by up to six months.

Upside from electric vehicles (EVs). With recent large private sector investments in EV chargers and charging infrastructure, EV sales could exceed our base-case of 15% of U.S. light vehicle sales by 2025 (versus around 6% the first quarter of 2022).

What to look out for?

Higher costs. If the current inflationary phase extends beyond early-2023, it could get very difficult to pass through higher costs to customers in 2023. Cost increases limit outlook revisions from stable and add downside risks to several issuers, especially if cost reduction prospects appear limited.

Suppliers face near-term rating downside. Auto-suppliers will continue to bear the brunt of supply chain shortages and of higher costs. Powertrain suppliers will pursue mergers and acquisitions (M&A) to build out EV capabilities.

Extent of used car price decline will impact new vehicle demand. Used vehicle prices will moderate over the next 12-18 months as affordability challenges emerge and trade-in values decline. Large declines in used prices will shift demand away from new to used, and hence reduce pricing benefits for automakers.

What if there's a recession?

Margin pressure will intensify. Demand for the highest-margin vehicles could shrink. Though we do not assume any material shifts away from trucks to sedans, consumers could downsize towards entry-level products within each segment.

Liquidity cushion will influence downgrade risks. Despite lower fixed cost absorption, most large and mid-tier issuers have low inventory and sufficient liquidity to weather a mild recession, or a scenario where U.S. sales in 2023 plateau at 2022 levels before making a slow recovery in 2024. However, a few lower rated suppliers and discretionary aftermarket suppliers may face distress.

Acceleration of consolidation, especially within the supply base. With potential for even lower valuations, we could see an acceleration of M&A across strategic and private-equity owners, to enhance scale and insulate some traditional suppliers from disruption trends.

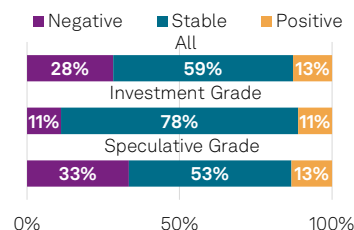
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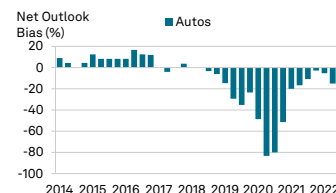


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	9	31	40
Downgrades	0	3	3
Upgrades	2	3	5

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

Ratings Outlook Net Bias



Related Research

[Economic Outlook U.S. Q3 2022: The Summer Of Our Discontent](#), June 27, 2022

[Battery Suppliers, Automakers To Take Charge As Prices Rise](#), May 17, 2022

[Global Auto Sales Forecasts: Russia-Ukraine Conflict Imperils Recovery](#), March 22, 2022

[Industry Top Trends 2022: Autos](#), Jan. 25, 2022

Building Materials

Diminishing tailwinds could pressure ratings

What's changed?

Slowing revenue growth. A cooling housing market, high inflation, and waning consumer confidence is pressuring spending on renovations and remodeling for residential real estate. Commercial real estate building activity is also slowing.

Price increase limits. A weaker demand picture is pressuring margins and cash flow generation. Companies that focus on nondiscretionary products such as roofing or HVAC should be more resilient than manufacturers of more discretionary products such as kitchen cabinetry and bath wares.

Weaker fundamentals and rising inflation. We see potential for more negative rating actions based on slowing operating fundamentals and lower ability to manage inflationary pressures. Given a concentration of private equity ownership, more aggressive acquisitions or shareholder returns could also drive downgrades.

What to look out for?

Elevated commodity costs. Building material companies have already experienced declining margins due to the sharp rise of commodity costs and supply chain bottlenecks. Exposure to lumber, metals, plastics, and oil could pressure margins further as ability to pass through cost increases diminishes.

Shrinking order backlogs. As housing affordability worsens and consumer spending weakens, we expect demand to deteriorate as housing starts and construction activities slow. Exposure to new construction or more discretionary products could see weaker backlogs into 2023.

What if there's a recession?

A decline in discretionary products demand and new construction activity. A more significant pullback in new construction and lower remodeling and renovation activities put issuers more exposed to these segments at higher risk of underperformance, with revenue trends potentially slowing to flat or low-single-digit declines, despite underlying strength in housing. The impact of higher mortgage rates has yet to fully materialize as new home sales and first-time home purchases are declining, a trend that could continue through 2022.

Weaker ability to pass on cost increases. Pushback by consumers could limit pricing power and put greater pressure on margins even if cost pressure subsides to some extent.

Liquidity pressure. Given the concentration of ratings in the low spec grade, many issuers have elevated leverage. Exposure to floating rate debt as rate hikes continue could deplete EBITDA interest coverage and liquidity, key indicators for lower-rated issuers.

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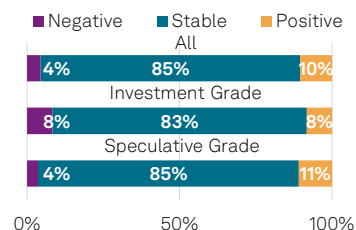
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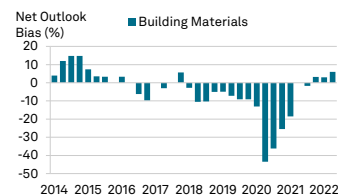


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	12	55	67
Downgrades	0	2	2
Upgrades	0	6	6

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

Ratings Outlook Net Bias



Related Research

[Real Estate Monitor: Slowing Growth Lies Ahead For U.S. Real Estate Companies](#), June 8, 2022

[Real Estate Monitor: Rising Inflation, Rate Hikes Cloud Outlook For U.S. Real Estate Issuers](#), March 30, 2022

Capital Goods

Pricing power and nimbleness hold credit steady...for now

What's changed?

Higher costs and snarled supply chains test pricing power and manufacturing agility. Most manufacturers passed through record-high costs to boost earnings so far in 2022, with pockets of profit and cash flow disruption owing to materials constraints. Commodity prices dropped sharply in June and early July.

Backlogs climb but the PMI drops. The Purchasing Managers Index remains positive, but it has dropped steadily from record levels about a year ago. Meanwhile, backlogs keep climbing with robust demand and tight output.

Our outlook bias has shifted modestly negative. Our negative outlooks are clustered around highly indebted financial-sponsor-owned issuers, as well as some investment-grade names that face company-specific strategic or financial pressures, rather than overarching economic concerns.

What to look out for?

Slower demand could reverse a cyclical upswing in profits. Even if commodity costs are easing and supply chains are opening up, elevated labor and logistics costs could persist. In this case, selling, general, and administrative costs probably won't drop as quickly as revenues or gross profits.

M&A aims to boost modest growth. Most issuers will continue supplementing corporate development and revenue growth with bolt-on acquisitions, but capital markets conditions could hold back larger acquisitions or even divestitures.

Highly leveraged issuers are relying on stronger EBITDA in the next 18-24 months to support refinancing. Several financial-sponsor-owned issuers added low-coupon debt during the pandemic for acquisitions or dividends. Improved cash flow also relies on some working capital release if input costs ease.

What if there's a recession?

Higher rates could strain demand for capital investment. Capital expenditures quickly resumed their 10-year growth trend in 2021, spurred on by an unprecedented drop in interest rates during the pandemic.

A robust commodity sector might offset a chill in discretionary or capital spending. Multiyear capital investment is usually a late-cycle mover, so a robust pipeline could shrink if industrials defer capital spending in the face of higher interest rates or labor costs and availability for installation and construction.

Credit buffer is generally good, but it's starting to erode. Choppy profits and weaker cash flow are coinciding with elevated debt levels in a few cases. Also, we have very few positive outlooks among speculative-grade issuers, indicating little positive credit momentum industrywide.

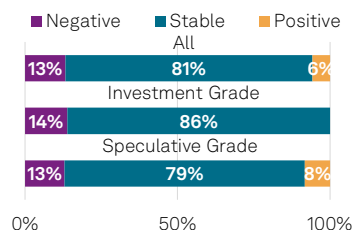
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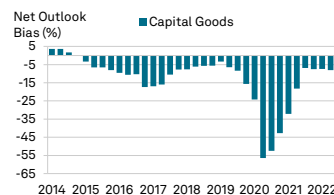


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	36	85	121
Downgrades	0	9	9
Upgrades	0	4	4

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

Ratings Outlook Net Bias



Related Research

[Japan Heavy Industries And Capital Goods: Three Risks To Credit Quality](#), June 8, 2022

[Parker-Hannifin Corp. Ratings Removed From Watch Negative And Affirmed On Good Operating Performance, Outlook Negative](#), June 2, 2022

[Partially Built Equipment Weighed On Deere's Revenue Growth And Cash Flow](#), May 23, 2022

Chemicals

Favorable demand, constrained supply offset rising costs

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.

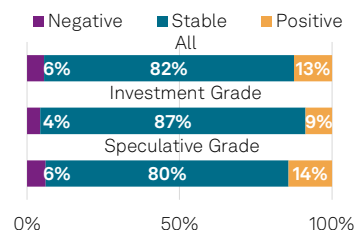
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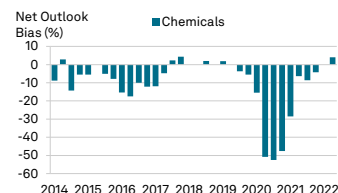


Ratings Statistics (YTD)*

	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



Consumer Products

A weaker consumer intensifies pressure

What's changed?

Consumers' financial health and shopping patterns are dramatically shifting. Consumer savings rates are now below pre-pandemic levels, pointing to the inevitable erosion of excess savings in the face of decades-high inflation. With a focus on value, the deferral of discretionary spending and trade-down poses risks and opportunities in the sector.

Extraordinary inflation will pressure margins into 2023. We expect inflationary pressures to last into the first half of 2023 due to the Russia-Ukraine conflict and ongoing supply chain challenges. With unemployment still relatively low, we expect union contract renewals and labor costs to remain high. Also, high energy costs along with labor shortages will keep freight costs high.

What to look out for?

The weakening operating environment will continue to pressure credit quality. In aggregate across the sector, negative rating outlooks outnumber positive outlooks by more than 3 to 1. Many negative rating actions have been driven by inflation and supply chain bottlenecks, which are not likely to abate until 2023. A weakening consumer on top of these challenges is likely to result in continued pressure on ratings.

Aggressive financial policies could limit financial flexibility at an uncertain time. Difficult financial markets could make debt-funded acquisitions and transformative transactions few and far between, but companies may be pressured to return cash to shareholders in a low-growth environment which could reduce cushion to absorb unexpected shocks.

What if there's a recession?

Household staples should fare well. Historically, packaged food companies fare well during a recession--consumers eat at home more and trade down to private label--and we expect that trend to continue.

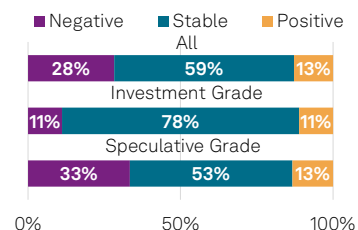
Discretionary categories, especially related to the home, will be challenged. A slowdown in discretionary spending will compound already tough comparisons as companies lap a strong 2021. Many durables benefited from what we believe was a pull-forward of demand for housing-related products. The category has already seen stress due to supply chain challenges. A recession would weaken it further.

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Rating Trends

Outlook Distribution

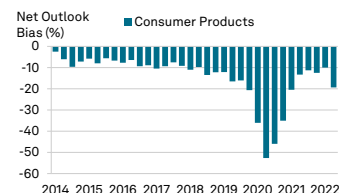


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	48	128	176
Downgrades	2	26	28
Upgrades	5	8	13

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

Ratings Outlook Net Bias



Related Research

[Credit FAQ: Inflation Hasn't Quenched U.S. Beverage Companies' Thirst For Growth](#), May 17, 2022

[U.S. Packaged Food Companies Could Face Additional Inflationary Stresses](#), April 21, 2022

[Russia-Ukraine Conflict Will Test Agribusiness Supply Chain Efficiencies And Consumers' Appetite For More Food Inflation](#), March 18, 2022

Health Care

Inflationary pressures on margins

What's changed?

Outlook no longer has a positive bias. Our outlook for the sector and across all four major subsectors is stable, but with inflation possibly persisting into next year, the labor-intensive services subsector could face downside pressure.

Pharma outlook has improved. As the larger companies de-levered, as legislative activity was quiet, and as COVID-19 lent a halo effect (as well as a financial windfall for some), our outlook on the pharmaceutical subsector improved to stable from negative. Pharma mergers and acquisitions (M&A) has also been strangely muted, though we expect an uptick.

Volumes are back up. Patient volumes have largely recovered to pre-pandemic levels, with organic growth offsetting decline in COVID cases.

What to look out for?

Margin compression. We are projecting mid-single-digit revenue growth for the health care industry in 2022 and 2023. But with inflationary pressures potentially lasting into 2023, higher costs on health care products, transportation, and especially labor will weigh on EBITDA margins and cash flows.

Ability to pass on costs to payors. Negotiations with providers will be difficult, and health care companies will have to absorb higher costs at least temporarily. This should not be an issue for high-rated issuers, but others could see ratings pressure.

Further impact from COVID-19. The recent COVID wave in Europe and the omicron variant led to disruptions, but a steep drop in COVID-related admissions could lead to top-line misses should the recovery in non-COVID admissions lag.

What if there's a recession?

Potential drag on top-line growth. A steep recession will weigh on revenues, given the discretionary component of health care and increasing out-of-pocket costs. However, we believe the decline is manageable and industry will see continued, albeit lower, growth.

Loosening of labor market? A recession could be a positive for the hard-pressed service providers, such as hospitals, that have seen significantly elevated labor costs, especially on nursing.

Delay in return to normal. While the healthcare industry remains largely insulated from a recession, many companies' patient and acuity mixes have yet to normalize, pandemic uncertainties remain, federal aid monies have dried up, and inflation remains persistently high.

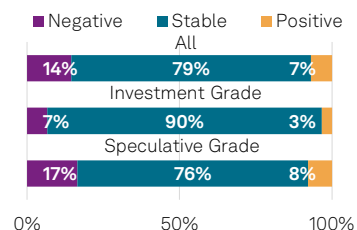
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Rating Trends

Outlook Distribution

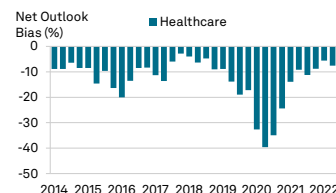


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	30	116	146
Downgrades	4	11	15
Upgrades	8	4	12

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

Ratings Outlook Net Bias



Related Research

[How Business Strength Varies Across Top Branded Pharmaceutical Companies](#), June 17, 2022

[Pharmaceutical Industry's Credit Prospects Brighter Due to Deleveraging, Disciplined M&A Spending, and Subsiding Legal and Reimbursement Risks](#), May 23, 2022

[The Outlook for Health Services Sector is Stable, with a Positive Bias](#), March 21, 2022

Homebuilders and developers

Positive sector outlook moderates in 2H22

What's changed?

Mortgage rates have increased to over 5% from below 3% in early 2022. Coupled with home price growth, this has led to substantial increases in the monthly payments on new mortgages, which could further lower affordability, particularly for first-time homebuyers.

Worsening affordability. Thus far the impact of lower affordability is mostly anecdotal, with incentives and order cancellations starting to tick up. In the second half of the year we expect most rated builders to close on their swelling backlogs so as to avoid deep markdowns and lost sales.

Need to increase inventories. The lack of home inventories has been the key driver of home-price inflation these past 12-18 months. We think spending on inventories will be materially higher in 2022 than last year, mainly to complete homes already on order (i.e., backlog), and for future growth, and in most cases funded via internally generated cash.

What to look out for?

High inflation exacerbating recession concerns. Rising mortgage rates along with weaker economic growth could slow demand for homes in the next year, particularly for prospective first-time homebuyers as affordability worsens.

Slowing price growth and rising costs could limit margin expansion in 2022. As mortgage rates rise from record lows, this could slow the price growth that has sustained margins amid higher costs and an industrywide shift to lower price points. In most cases, added incentives are often more effective than price cuts.

A less-positive sector outlook. With higher mortgage rates and probability of recession, we expect the positive operating momentum for homebuilders to ease, which could limit the number of possible upgrades in the second half.

What if there's a recession?

Weaker demand relative to current levels. With slower economic growth, we would expect sales and deliveries to slow. However, supply constraints are enough to maintain good demand characteristics overall.

Deteriorating profitability. We would expect lower EBITDA margins, which are already at peak levels, as home prices moderate and incentives increase amid continued higher labor, land, and material costs.

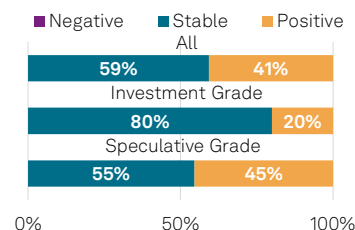
Credit buffer provides some protection. Financial discipline before and during the pandemic has yielded stronger ratios and a widening credit buffer, indicating improved credit quality. We would need to see a substantial deterioration in EBITDA to reduce that credit buffer before taking any negative rating actions.

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Rating Trends

Outlook Distribution

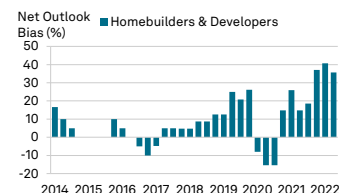


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	5	22	27
Downgrades	0	0	0
Upgrades	0	1	1

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

Ratings Outlook Net Bias



Related Research

[Real Estate Monitor: Slowing Growth Lies Ahead For U.S. Real Estate Companies](#), June 8, 2022

Hotels, Gaming, and Leisure

Higher ratings on pandemic recovery but recession looms

What's changed?

Upgrades. Pent-up demand for travel and leisure activities is driving the recovery in credit measures and some ratings badly hurt during the worst of the pandemic.

Rate strength. Travel and leisure volumes improved and there is continued surprising rate strength in hotels, theme parks, ski venues, Las Vegas, and other leisure activities, even cruise pricing strengthens for bookings in 2023.

Inflation risk to profitability. At some point very high inflation in nondiscretionary consumer items will cause the leisure consumer to pull back on the rate or ticket price they are willing to pay, potentially as labor and other costs continue to rise.

What to look out for?

Summer strength. We assume leisure consumer spending is strong through the summer because people still want their vacation or to engage in leisure activity, but in Q4 of this year and in 2023 we are more cautious.

Low-end gaming. The mid- to high-end leisure consumer is still very strong, but we are hearing about a softening in spending in the low-end gaming customer. It's a small portion of profitability for most casinos, but a signal we're watching.

Inflection-point in cruise. The seasonally strong third quarter should prove to be decisive for the industry with EBITDA turning positive, as nearly all ships are sailing and occupancy is ramping up, but inflation and fuel weigh on margin recovery.

What if there's a recession?

Gaming. Customers may drive to a regional casino rather than fly to Las Vegas, and group convention demand for Las Vegas may soften. But operators have built-in cushion because of surprising revenue and margin strength post-pandemic.

Lodging. At some point the typical link between GDP and lodging demand will return, so we're incorporating macro risks into our base case to ensure cushion in credit measures before raising lodging ratings or revising outlooks to positive.

Cruise. If cruise operators need to lower prices to fill ships, it could slow their ability to dig out from under mountains of pandemic debt, especially if fuel and other costs remain high.

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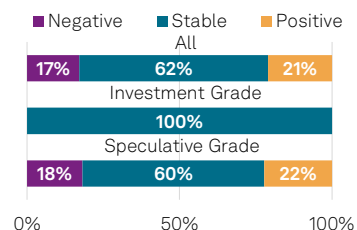
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Rating Trends

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	6	100	106
Downgrades	0	2	2
Upgrades	3	25	28

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

Ratings Outlook Net Bias



Related Research

[Macao Gaming: COVID Surge Clouds The Path To Recovery](#), July 7, 2022

[All-Inclusive Resorts Recovery Drives Investments By Major Hotel Brands](#), June 23, 2022

[U.S. Lodging Trends Move Toward Normal As Macro Risks Rise](#), May 4, 2022

Media and Entertainment

Pouring recessionary gasoline on a secular fire

What's changed?

Putting the pandemic behind. Through 1H 2022, the U.S. media sector performed well. Advertising continued recovering while out-of-home entertainment (OOH) saw strong demand and pricing power.

Inflection point. The pace of media's recovery is slowing as consumer confidence weakens. We recently lowered our U.S. ad forecast to reflect this slowing growth rate. However, OOH remains strong as consumers are still flush with excess cash.

Pressure on streamers. Netflix's disappointing 1Q22 results has led to a reassessment of streaming as a business model and a focus on disciplined spending and profits, as opposed to purely subscriber growth.

What to look out for?

Consumers weakening. Media is dependent on the health of the consumer. Even if there isn't a formal recession, scared consumers may pull back on discretionary spending. This should impact OOH sectors first, such as live events, concerts, and theme parks, followed by advertising as advertisers react to weaker sales.

Advertising is a lagging indicator. Advertising historically trails changes in consumer spending by two quarters due to long-lead-time sectors (TV and billboards). The rise of short-lead-time digital advertising may shorten the lag.

Streaming subscribers. 2022 is test year for streaming with full global competition and normalized content spending. Weak subscriber demand could signal both short-term consumer confidence and long-term business model challenges.

What if there's a recession?

Less pricing power. The sector has changed radically since the 2008/2009 Great Recession. Digital (now 70% of advertising) has shorter lead times and is more directly exposed to consumer spending. TV advertising may be permanently hurt by the addition of new FAST and AVOD streaming options, which will expand TV ad inventory and affect pricing integrity.

The subscription economy. Media has moved to a consumer-direct subscription model. If their discretionary spending power weakens, consumers could cut back their streaming service subscriptions or increase churn across services.

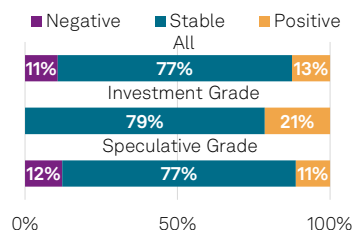
Ratings at risk. Media companies worked hard to fix damaged balance sheets after the pandemic, and opportunistic refinancings have limited near-term maturities. But we believe the sector is more exposed to recession risk than to other macroeconomic risks. Those media companies with more ad-supported models, like radio, digital marketing, and print, may be worse positioned. Global diversified companies could face elevated streaming costs and slowing legacy businesses.

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Rating Trends

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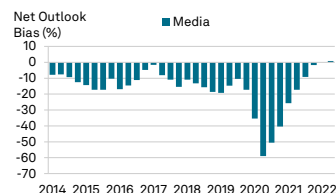


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	14	98	112
Downgrades	0	16	16
Upgrades	0	21	21

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

Ratings Outlook Net Bias



Related Research

[U.S. Advertising Update: 2022 Halftime Score](#), May 24, 2022

[Industry Top Trends 2022: Media and Entertainment](#), Jan. 25, 2022

[U.S. Linear TV's Decline Won't Affect Media Companies Equally](#), Oct. 12, 2021

Metals and Mining

Credit steadies after a big upswing

What's changed?

Credit quality has strengthened after a round of upgrades. Consistent with the global theme, we've upgraded a remarkable 10%-15% of the portfolio in the last year. Even accounting for the sector's volatility, companies built a buffer over several years with restrained capital outlays and debt reduction.

Prices drop with clouds on the economic horizon. Record-high prices in early 2022 have dropped considerably but remain above their long-term averages and well above trough levels. As such, prices still have plenty of downside before hitting cash clearing costs, which could indicate a cyclical trough price in a serious downturn.

Issuers boost shareholder returns and corporate development after years of discipline.

Most large distributions have been from excess cash, with many issuers embedding flexible returns into their capital allocation policies. Also, all-share transactions have helped bolster operating breadth with little debt overhang.

What to look out for?

Prices are volatile and unpredictable. In a downturn, trough prices often test the unit cash costs of high-cost producers, which have been pushed higher by declining ore grades in mining and higher raw material costs overall. On the other hand, steelmaking in the U.S. continues increasing modern capacity with lower-cost scrap inputs, while retiring higher-cost blast furnaces.

Lower valuations and large cash balances could test financial discipline. We expect good cash flows will be directed more to corporate development and shareholder returns than debt reduction, taking into account more than five years of capital spending restraint and a generally favorable demand outlook.

Energy transition means more big investments. Steel and aluminum producers in North America are recasting their output, aiming to reduce emissions by replacing older assets or altering production. Miners look to boost output of key metals to support electrification, such as copper, nickel, cobalt, and lithium.

What if there's a recession?

Lower prices would erode buffer, but our ratings incorporate plenty of volatility. Metals prices cycle more often and more violently than economic data and may even defy the economic outlook. Even so, recent upgrades from years of debt reduction indicates good buffer against rapid downgrades when earnings weaken.

Weaker cash flow amid multiyear capex could consume large cash balances.

Companies are often reluctant to cut important capital expenditures in a downturn, exaggerating volatile cash flow measures. The current upswing yielded a huge cash windfall for many companies, which enables continued spending in a downturn.

Flexible shareholder returns could moderate a downturn. Issuers and investors are becoming more accustomed to a variable payout in this highly cyclical sector.

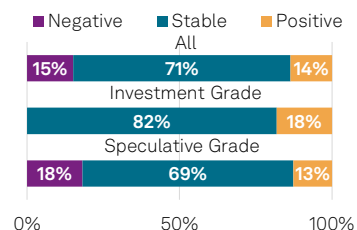
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Rating Trends

Outlook Distribution

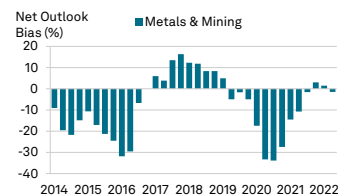


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	11	56	67
Downgrades	0	3	3
Upgrades	3	7	10

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

Ratings Outlook Net Bias



Related Research

[Newmont Corp. Upgraded To 'BBB+' From 'BBB'](#), March 29, 2022

[Barrick Gold Corp. Upgraded To 'BBB+' From 'BBB'](#), March 29, 2022

[Metal Price Assumptions: Shortages Worsen And Prices Spike](#), March 17, 2022

Midstream Energy

Strong supply and demand dynamics

What's changed?

Commodity prices. Strong demand and the supply shock related to the crisis in the Ukraine supports midstream credit quality.

Creditworthiness. Strong prices and volumes are benefiting profitability and cash flows. Most companies are using free cash flow to repay debt and reward shareholders.

Focus on energy security. The Ukrainian crisis highlights the critical importance of traditional energy infrastructure and the need for additional liquified natural gas facilities to bridge the supply gap. This will likely slow the transition to renewables.

What to look out for?

Price volatility, supply disruption. Commodity price volatility will continue as Europe tries to wean itself off Russian natural gas and crude oil barrels are redirected to Asia and elsewhere. The world is short of both commodities, which could move prices higher. An explosion at Freeport LNG, which accounts for about 17% of U.S. exports, caused U.S. natural gas prices to decline after operations were suspended and the facility remains offline. The uncertainty around the direction of prices could be a headwind for the industry, with lower prices dampening profitability and higher prices slowing global economic growth.

Capital markets. Rising interest rates are making refinancing more expensive. Most midstream companies are using free cash flow to fund growth and have limited need to access debt markets. However, speculative-grade companies with upcoming maturities could have a more difficult time refinancing.

Pace of spending, capital allocation. Critical North American infrastructure to transport natural gas both domestically and for export markets will likely boost spending. Companies remain disciplined with capital allocation decisions and continue to be mindful of balance sheets. We are focused on any divergence from current financial policies during the strong commodity cycle.

What if there's a recession?

Price/volume declines. A recession would result in lower prices and volumes but would need to be severe and prolonged for it to impact our view of the sector. Prices are unlikely to drop to levels that would curtail production and volumes for an extended period given global supply constraints.

Rating resiliency. Midstream companies have built up a significant financial cushion in their credit profiles over the last few years, which we believe will insulate them if there is a recession.

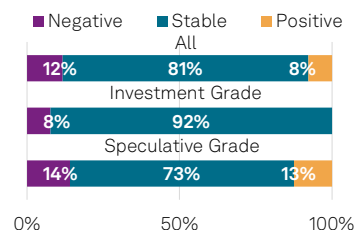
Financial policy. We'd expect a renewed focus on protecting the balance sheet and a deemphasis of shareholder rewards such as dividends increases and share buybacks.

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Rating Trends

Outlook Distribution

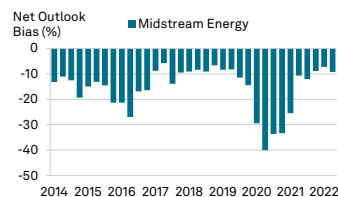


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	40	65	105
Downgrades	0	3	3
Upgrades	2	16	18

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

Ratings Outlook Net Bias



Related Research

[Credit FAQ: Our Latest Views On Energy Transfer L.P.](#), June 6, 2022

[ESG Materiality Map: Midstream Energy](#), May 18, 2022

[Issuer Ranking: North American Midstream Companies, Strongest To Weakest](#), April 11, 2022

Oil and Gas

Ratings are supported by debt repayment

What's changed?

Hydrocarbon prices. Oil prices have strengthened, and, barring a recession, it's likely they'll go higher as the EU looks to bar Russian oil and additional supply likely remains limited. Natural gas prices in the U.S. have also rebounded and are becoming "globalized" on the heels of gas shortages in Europe and heavy demand for liquefied natural gas.

Security first. With Europe facing potential natural gas shortages and oil prices possibly higher due to lower Russian imports, nations who focused on addressing climate change and energy transition are now more concerned about supply and hydrocarbon infrastructure while weaning themselves off of Russian oil and gas.

Refining margins. Insufficient capacity and strong demand have left the world short of crude, refined products, and natural gas. Gasoline, distillate, and jet fuel margins are at unprecedented levels. U.S. refineries are advantaged over European counterparts and are on pace to report record earnings and free cash flow, which they can use to reward shareholders and deleverage balance sheets.

What to look out for?

Further increases in hydrocarbon prices. Natural gas prices could rise significantly especially as Europe tries to reduce its exposure to Russian gas before October, the start of the heating season. Even so, Russia could decide to cut any remaining production to Europe and send global oil and natural gas prices soaring.

North American spending levels. Capex levels for N. American producers are likely to be constrained despite high hydrocarbon prices. Capital markets are still dictating that producers pay down debt and use cash flow for shareholder rewards. When that will change remains to be seen.

Policy headwinds. The Biden Administration and the EU are focused on lowering fuel prices and weighing policy options that could hurt refiners or oil and gas companies, including a crude export ban or a windfall profits tax. Higher retail prices may also dampen demand.

What if there's a recession?

Lower hydrocarbon prices. A steep drop in demand would likely cause prices to fall. However, in the event of a mild recession, we doubt oil and natural gas prices would fall and stay below midcycle prices given the global supply constraints

Rating actions. We would not expect the pace of downgrades for investment grade issuers in the upstream industry to rival prior cyclical troughs due to the amount of debt they've shed. We model our investment-grade ratings at a midcycle price of \$50/55 and \$2.75 for WTI/Brent and natural gas, respectively. Many investment grade E&P companies are focused on debt leverage under 1.5x at similar midcycle prices, a level that could support investment-grade ratings.

Refiners likely to weather the storm. Refining companies have significantly improved their credit profiles, using growing free cash flow to repay debt raised during the pandemic and retaining more excess cash after rewarding shareholders. We expect credit ratios to reach pre-COVID levels and provide a cushion against economic headwinds.

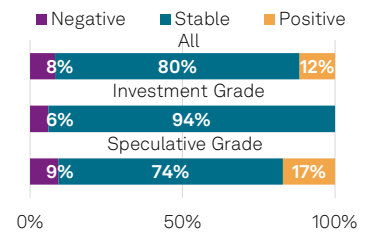
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Rating Trends

Outlook Distribution

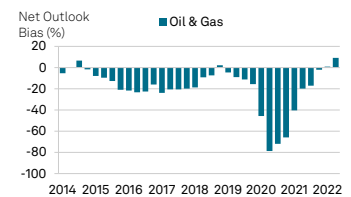


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	68	141	209
Downgrades	2	3	5
Upgrades	5	53	58

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

Ratings Outlook Net Bias



Real Estate

Fundamentals slowing amid higher recession risk

What's changed?

Slower growth ahead. Following a period of solid recovery with operating metrics across many property types reaching pre-pandemic levels, REITs face the prospect of slowing growth over the next two years as inflation pressures consumer spending.

Rising rates curtail capital spending. Given rising borrowing costs, we expect acquisition activity to slow. Debt issuance has slowed significantly in 2022 amid market volatility, and credit spreads have widened significantly. Stock buybacks could also rise in 2022.

Outlooks split positive and negative. Eighty percent of the rated REITs have stable outlooks, with the remaining split almost evenly between positive and negative. Subsectors that have more of a positive bias include residential, industrial, and net-lease REITs, while a more negative rating bias remains for office and retail.

What to look out for?

Slow return to the office. Office REITs will remain pressured due to greater adoption of remote working and weaker job growth. An increasing flight to quality to class-A offices should mitigate downside risk for rated office REITs. But leasing activity will likely remain subdued.

Inflation pressures consumer spending. Real estate generally provides inflationary protection as rents can be reset higher to pass on inflation. However, high inflation in the context of weaker economic growth could limit pricing power and weaken tenant quality, particularly for retail REITs as consumers are likely to cut back on discretionary spending, tempering occupancy gains and rent growth. Properties exposed to more discretionary retailers could be harder hit by rising inflation.

Pressure on asset valuation. Rising rates and slower growth will widen capitalization rates over the next year. This could dampen merger and acquisition (M&A) activities and delay asset disposition plans.

What if there's a recession?

Revenue pressure. A recession will pressure rental growth and occupancy, with retail and office assets hit harder by weaker consumer spending and slower job growth, the primary driver of office space demand. Office real estate saw the steepest decline in rent during the Great Financial Crisis and took longer to recover, although a decline would be more modest if a recession were to occur now, given improved tenant credit quality and well-laddered lease expiration schedules. We expect rental housing and industrial assets to recover more quickly.

Rate hike accelerating. Steep increases in rates could drive a more significant drop in asset values. We expect capitalization rates to widen more for assets with weaker growth prospects, such as discretionary retail and office.

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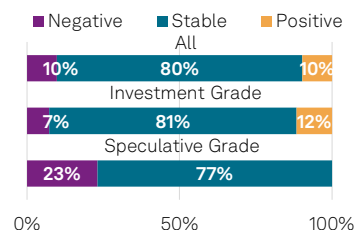
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Rating Trends

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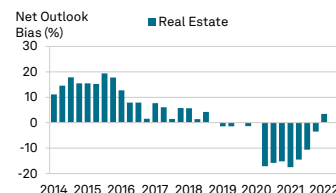


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	69	13	82
Downgrades	3	0	3
Upgrades	6	0	6

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

Ratings Outlook Net Bias



Related Research

[Real Estate Monitor: Slowing Growth Lies Ahead For U.S. Real Estate Companies](#), June 8, 2022

[Credit FAQ: Rising Risks Could Dampen Additional Operating Improvement For U.S. Strip Center REITs](#), April 27, 2022

[Real Estate Monitor: Rising Inflation, Rate Hikes Cloud Outlook For U.S. Real Estate Issuers](#), March 30, 2022

Regulated Utilities

Credit quality has weakened and credit risks are rising

What's changed?

The industry's median rating fell to 'BBB+' from 'A-' and the industry's outlook remains negative. 2022 is on track to be the third consecutive year for downgrades to outpace upgrades.

2021 capital spending was at an all-time high of more than \$165 billion and we expect it grow to more than \$200 billion by 2023.

State regulators approved record levels of securitization issuances to recover costs associated with physical disasters. We view securitization as supportive of credit quality and expect about \$15 billion of securitization to be issued in 2022.

What to look out for?

Weak financial measures. About half of the industry is operating with minimal financial cushion, with less than 100 basis points of cushion from their funds from operations-to-debt downgrade threshold.

Customer bills are becoming less affordable as a result of rising commodity prices, interest rates, inflation, and capital spending.

Rising environmental risks. The increasing frequency of physical risks raises costs and risks for the industry. While the industry has decreased its greenhouse gas emissions by more than 30%, we expect it will still require decades for the industry to reach net zero.

What if there's a recession?

Consistent access to the capital markets could become more challenging. The industry annually operates with more than \$100 billion of negative discretionary cash flow. To finance this large deficit, the industry requires consistent access to the capital markets. Rising interest rates, decreasing equity prices, and inflation could obstruct access the capital markets, potentially pressuring credit quality.

Management of regulatory risk could weaken. Rising customer bills could challenge the industry's ability to consistently pass costs to ratepayers, pressuring the industry's ability to effectively manage regulatory risk.

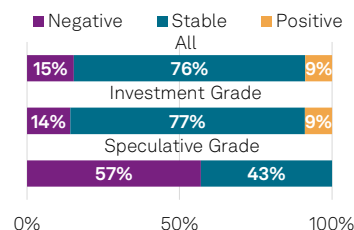
Net-zero goals could be delayed. As customer bill pressure increases, the industry may be forced to slow the pace of energy transition, delaying the timeframe to reach net zero greenhouse gas emission.

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Rating Trends

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	272	7	279
Downgrades	4	1	5
Upgrades	2	0	2

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

Related Research

[Constructive Financial Policy Is Determining Credit Quality--Not Equity Pricing--For N.A. Regulated Utilities](#), June 8, 2022

[Utilities' Early Retirement Of Coal Generation Increases Uncertainty Over Recouping Stranded Investments](#), April 11, 2022

[Developments In North American Utility Regulatory Jurisdictions: From Storm Cost Recovery To Clean Energy Plans](#), March 24, 2022

[How Will North American Utilities Cope With Higher Interest Rates, Steeper Commodity Prices, And Inflation?](#), March 8, 2022

[For The First Time Ever, The Median Investor-Owned Utility Ratings Falls To The 'BBB' Category](#), January 20, 2022

Retail and Restaurants

Credit quality is at a turning point

What's changed?

Consumers are capitulating to inflation. Consumers were price takers in 2021, bolstered by excess savings and slim pickings. A more price-sensitive consumer, compounded by cost inflation, poses near-term risk for many retailers.

Inventories are bloated. Retailers have found themselves saddled with inventory consumers don't want or can't afford anymore. Faced with \$5 gas, rising interest rates, and double-digit inflation at the grocery store, shoppers are foregoing discretionary expenditures and trading down. At the same time, there is a dramatic spending shift to experiences.

What to look out for?

The reopening tailwind will be short-lived. This summer consumers are determined to enjoy in-person activities, including vacations and dinners out, and specialty apparel retailers--such as ones that offer dressy attire--have experienced a snap back in demand. But in our view this is the consumer's last hurrah, likely to fade as excess savings dwindle and reality sets in.

Cost pressures will get worse before they get better. U.S. grocery retailers and distributors face steep margin and profit pressure from cost inflation. Yet grocery suppliers have signaled that more price hikes are on the way. Food retailers will keep market share at the expense of profitability as hard-hit customers look for value. Margins will likely decline in this already low-margin business, but targeted promotions and efficiency measures may offset some risks.

Credit quality is at an inflection point. Positive rating actions have outnumbered negative actions year-to-date, partly due to good operating performance through the first quarter, offset by supply chain and inflationary pressures. However, recent earnings signaled a downward inflection point and we expect a majority of rating actions in the second half of the year to be negative.

What if there's a recession?

Discretionary spending will be spread thin. Subsectors such as specialty apparel, department stores, and home goods retailers will face challenges as consumers defer discretionary spending. Competition for fewer dollars spent will drive the return of a promotional environment, hurting margins and cash flow.

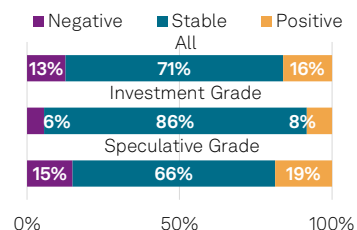
Value players and deep discounters will benefit. Sectors that are well-positioned for tighter consumer budgets, such as off-price retailers, dollar stores, and quick-service restaurants, will benefit from consumers' tightened budgets. Still, these retailers will need to navigate continued cost inflation pressures while they compete for the cost-conscious consumer.

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Rating Trends

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	36	107	143
Downgrades	0	9	9
Upgrades	0	15	15

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

Ratings Outlook Net Bias



Related Research

- [Credit Trends: Food Fight: U.S. Grocery Leads Retail Sectors Chewed Up By Inflation, Cost Pressures](#), May 31, 2022
- [Closing Time: The U.S. Retail Party Ends As Consumers Push Back On Inflation](#), May 23, 2022
- [U.S. Consumers Continue To Shop, Undeterred \(So Far\) By High Inflation](#), Feb. 17, 2022

Technology

Pace of IT spending slowing, margin pressure in play

What's changed?

Macro and IT spending is weaker. We lowered our 2022 IT spending growth forecast to 4.3% in July from 4.5% in May and 5.1% set in March. While our new forecast betters our global GDP forecast, it reflects increased cautiousness in IT spending.

Consumer end market is weaker. Global smartphone and PC shipments declined year-to-date, attributable to China COVID-19 lockdowns affecting supply chain as well as weaker global consumer demand and inventory buildup.

Ratings trending negative. As we revised downward our 2022 IT spending forecast, we also observed rating trends shifting negative for the tech sector overall. This is in stark contrast with the 5:2 positive vs. negative rating action bias in 2021.

What to look out for?

Semiconductor supplies will rise. Although geopolitical concerns and COVID containment measures present the prospect of further supply chain disruptions, we anticipate semiconductor manufacturing capacity expansion plans initiated in late 2019/early 2020 to start providing meaningful output increases in 2H22.

U.S. dollar headwinds. While currency hedges may be in place for some tech providers, helping their bottom lines, pricing actions will be key in determining the impact of a higher U.S. dollar on demand.

Ability to pass along higher costs will be tested. IT budget cuts will affect tech companies' ability and willingness to pass along higher input costs to customers. It remains to be seen who along the tech supply chain will bear the brunt of the margin compression and how cash flows will be impacted.

What if there's a recession?

Further decline in IT spending. IT spending is highly correlated to global GDP, so a severe and lengthy recession in the U.S. could hurt tech companies' performance, especially in hardware. Slowdown in enterprise spending, potentially in the form of reduced data center investments, would be a signal for the entire sector. A shallow recession, however, may only delay--rather than cancel--purchases.

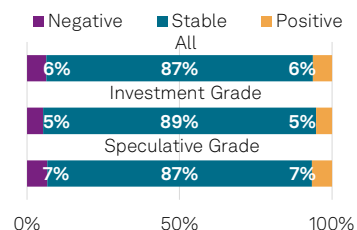
Speculative grade companies will see more rating pressure. During the onset of the COVID-19 pandemic in 2020, many investment-grade rated tech companies with already conservative financial profiles bolstered their liquidity by suspending shareholder returns while continuing to generate strong free operating cash flows. However, speculative-grade ratings, especially those rated 'B-' (representing 35% of U.S. tech ratings), are the most vulnerable given their already weak free cash flow generation and highly leverage capital structure.

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Rating Trends

Outlook Distribution

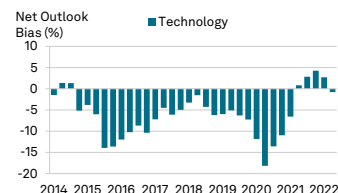


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	57	195	252
Downgrades	1	13	14
Upgrades	5	14	19

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

Ratings Outlook Net Bias



Related Research

[Macro Risks And Diverging End Markets Overshadow U.S. Tech's Mostly Good Results](#), May 9, 2022

[Macroeconomic Uncertainties Matter More Than Rising Interest Rates To Low-Rated U.S. Tech](#), March 29, 2022

Telecommunications

Rising costs and slowing growth could hurt credit quality

What's changed?

Higher inflation and global supply chain issues. Input costs have risen, especially for labor and energy, and we would expect some margin degradation for our rated companies. Lower-rated issuers in particular could get squeezed.

Debt issuance has been scarce. Rising interest rates and weak credit market conditions have limited debt issuance from U.S. telecom and cable providers in the first half of 2022. Lower-rated issuers with more floating rate debt could experience higher interest costs and weaker free cash flow metrics.

Increasing competition in wireless and cable. Cable broadband subscriber growth is moderating due to competition from fixed wireless and fiber-to-the-home (FTTH). Similarly, we expect wireless subscriber growth for the incumbent telcos will slow due to mature industry conditions and increasing competition from the cable providers through their mobile virtual network operator agreements.

What to look out for?

Margin compression. Higher prices for energy, supplies, transport, as well as labor could weigh on margins in the second half of 2022. Additionally, global supply chain challenges could delay orders for equipment, making it difficult for companies to achieve build-out targets, especially for FTTH and spectrum deployments.

Slower cable high-speed data growth. We still expect the cable providers will be able to grow HSD subscribers and revenue in the near-term. However, risks have increased around our forecasts if the pace of new home formation and edge-out activity slow and competition from FTTH and fixed wireless intensifies.

Weaker credit quality and lower ratings. Telecom issuers increased leverage to fund spectrum purchases, network buildouts, and M&A. While telecom is more recession resistant and has less exposure to inflationary pressures than most other corporate sectors, these companies have less cushion at the current ratings to absorb slower earnings growth and weaker cash flow generation.

What if there's a recession?

U.S. telecom and cable is recession resistant. We expect some weakness in top-line trends and profitability, but credit quality should not deteriorate significantly given the recurring, subscription-based revenue models. Broadband and mobile services are essential to businesses and consumers.

Enterprise customers cut IT spending. Telecom providers with greater exposure to business customers could experience greater top line degradation. Growth in cloud-based networking solutions could reduce demand for more expensive legacy products, accelerating revenue declines for U.S. wirelines.

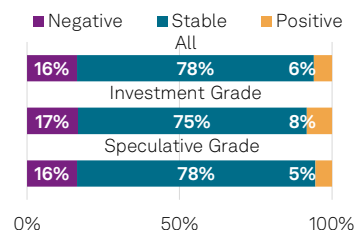
High unemployment could have ripple effects. An economic recession and resultant unemployment could result in higher churn and bad debt expense.

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Rating Trends

Outlook Distribution

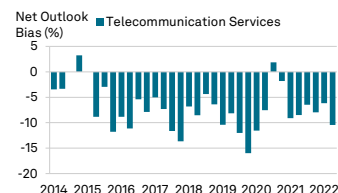


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	12	55	67
Downgrades	0	2	2
Upgrades	1	3	4

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

Ratings Outlook Net Bias



Related Research

[Credit FAQ: Stepped-Up Competition Will Slow U.S. Cable Companies' Growth](#), June 29, 2022

[U.S. Tower Operators Poised To Benefit From 5G, But Credit Risk Looms With M&A And Expansion](#), May 20, 2022

Transportation

2022 started strong but recession risks cloud the outlook

What's changed?

Russia/Ukraine conflict drove up oil prices. Airlines are most exposed, as few hedge and fuel is a large expense item. Most freight transportation companies are better positioned, with fuel surcharges in contracts with corporate customers.

Full planes and high fares. Easing COVID restrictions and pent-up demand are combining to fill airline seats, enabling fare hikes that are offsetting much higher fuel prices. As a result, the financial outlook for 2022 remains encouraging.

Freight transportation demand, and supply chain problems, remain. Most freight transportation providers, particularly package express and trucking, are seeing healthy demand. But supply chain bottlenecks have not eased as much as hoped.

What to look out for?

Air travel demand could soften after Labor Day. Bookings so far remain solid, but a weaker economy could sap demand after the summer surge. Airlines' forward guidance on 2Q earnings calls should be interesting.

When will high prices erode demand? Transportation companies are watching for increasing sensitivity to elevated prices, whether for air travel or goods they move.

Labor cost inflation is beginning to bite. Trucking companies have been dealing with higher costs for a while, and the trend is spreading to more unionized sectors like airlines and railroads, whose contract talks take more time.

What if there's a recession?

The return of travel could run into headwinds. Demand may not fall as much as in a typical recession, given momentum from lifting of COVID restrictions. But airline pricing power and revenues will inevitably come under pressure.

What happens to oil prices? Oil prices normally slump in a recession, but tight supply and effects of the Russia/Ukraine conflict could complicate the picture. Still, we would expect some pullback in prices.

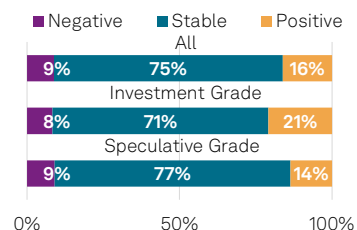
A silver lining in easing of supply chain woes? Cooling demand for goods could give time for stretched transportation networks--ports, warehouses, and freight transporters--to clear container and shipment backlogs and hire needed labor.

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Rating Trends

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	24	44	68
Downgrades	0	2	2
Upgrades	2	6	8

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

Ratings Outlook Net Bias



Related Research

[U.S. Airlines Look To Higher Fares To Offset Rising Fuel Prices](#), April 4, 2022

[Leased Aircraft Stranded In Russia: The Focus Turns To Insurance](#), March 22, 2022

Transportation Infrastructure

Some signs of more equitable risk share in P3s

What's changed?

Surge of financing. On the heels of lower interest rates in the first half of 2022, there were multiple refinancings of debt on public-private partnership (P3) toll roads, as well as new issuances. Rising interest rates could temper this trend.

Increased focus on construction risks. While some projects are either on track or just completed construction, some are seeing significant delays owing to the COVID-19 pandemic, and, more recently, dump truck disruptions around Toronto.

What to look out for?

Shifts in risk sharing. Many major contractors in North America have shifted away from fixed price contracts following several large cost overruns. New approaches are emerging, such as alliance contracting and progressive design-build contracts. These can lower the risk to the contractor but increase risk to projects. We have also seen shifts in risk transfer between public and private sector, with the public sector retaining greater risk, particularly during the construction period.

Transportation is the big winner of the IIJA. The significant flow of new funds from the Infrastructure and Investment Jobs Act (IIJA) is a credit positive. However, prolonged high inflation will erode the federal investment in infrastructure. Nevertheless, we see the law as being an enabler of the greater use of P3, particularly for larger projects that use the Transportation Infrastructure Finance and Innovation Act (TIFIA) or Railroad Rehabilitation and Improvement Financing (RRIF) programs.

Physical risk is rising given the frequency of severe weather events and projects' long-term nature and fixed locations--particularly transportation assets like airports, ports, and projects under construction. Despite this, adaptation measures exist that may help build resilience to the impacts of extreme weather and long-term climate change.

What if there's a recession?

Reduction in traffic and revenues. We would expect a fall in traffic should the U.S. enter a recession, leading to a fall in revenues. While traffic and revenues on many transportation projects have recovered to pre-pandemic levels, some have not. These projects would be under greater pressure.

Limited investment-grade impact. The essential nature of transportation assets and the structural protections that provide liquidity in times of stress have historically helped transportation projects weather recessions. Moreover, investment-grade rated transportation projects are subjected to stresses equivalent to the Great Recession as part of our analysis. Assuming a recession no worse than that, downgrades of investment-grade projects will likely be limited.

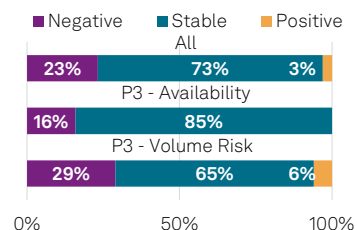
Counterparty pressure. A recession coupled with supply chain issues and higher inflation may impact operating performance of construction contractors with high percentage of fixed-price contracts. This could cause project delays or possibly, where there is a linkage to the contractor, a deterioration in project credit quality.

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Rating Trends

Outlook Distribution



Ratings Statistics (YTD)*

	P3 Availability	P3 Vol. risk	All
Ratings	13	17	30
Downgrades	0	0	0
Upgrades	1	1	2

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

Related Research

[Outlook For North America Engineering & Construction And Implications For P3 And Muni Infrastructure](#), April 7, 2022

Unregulated Power

An unprecedented power price run

What's changed?

An epic bull run. Prices that had barely touched \$40/MWh at the start of 2022 rose to \$100/MWh and \$85/MWh by April for calendar 2022 and 2023, respectively, and retreated to \$60-\$70/MWh levels only after a major outage at an LNG unit. Year 2024-2025 forward prices are still above \$50/MWh and higher than levels at the end of Q1 2022 in both ERCOT and the PJM Interconnection.

Prices in all capacity markets are at their lowest. The decline is particularly severe in PJM, which recorded a new decade-low in the RTO and ComEd zones. EMAAC also cleared an all-time low. PJM market rule changes, returning nuclear capacity, and modest supply additions contributed to the tepid prices. With no real catalyst to spur bidding behavior, we see no significant improvement in the next auction.

Stronger financial performance. Despite concerns of a slowing economy and a heavily hedged position entering the year, financial performance of independent power producers (IPPs) should improve for 2022 compared to expectations at year-end 2021. Unlike power project financings, which may not have adequate liquidity for margining provisions, most IPPs have hedged their economic generation for 2023 and 2024 during the second quarter.

What to look out for?

Retail power. The run-up in wholesale power price is the first real test for retail power companies, especially for asset-light providers. Margins could erode as procurement costs increase and contracts come up for renewal.

Grid stability. In California there is a potential for 1.7GW-1.8 GW shortages across 2022-2025, even when factoring the 11.5 GW new resource target. In the Midwest the capacity auction priced at \$237/MW-day for Zones 1-7, up from \$5 last year, prompting utilities to delay coal plant retirements; and in ERCOT spark spreads have expanded even as the Capacity, Demand and Reserve report tells a story of adequate capacity and reserve margins.

State challenges to EPA rules. We're waiting to see how the implementation of the Cross-State Air Pollution Rule (CSAPR) timeline will proceed after the U.S. Supreme Court limited the Environmental Protection Agency's authority to set standards on climate-changing greenhouse gas emissions for existing power plants.

What if there's a recession?

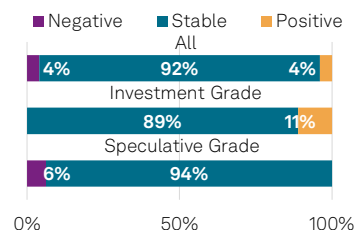
More resilience than other sectors. With strong performances by Vistra, NRG, and others during the pandemic, we have recent history of how the financials have held up through a brief recession. Typically, power companies experience a 3%-4% overall dip lead by a 10%-15% decline in industrial/commercial volumes, which are recovered in about 18 months. IPPs have become more focused on a net long exposure to natural gas and high cash flow yields play.

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Rating Trends

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	9	16	25
Downgrades	0	0	0
Upgrades	0	0	0

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

Related Research

[Power Markets Update: PJM's Capacity Market Auction Lays Another Egg](#), July 12, 2022

[Hedged U.S. Unregulated Power Generators: No Rest For The Weary](#), May 11, 2022

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.

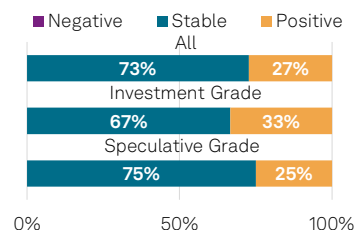
Air travel recovery could falter. Reduced demand would result in lower sales for original equipment manufacturers, component suppliers, and service providers. Orders for new aircraft would likely be less affected, due to pent-up demand.

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Rating Trends

Outlook Distribution

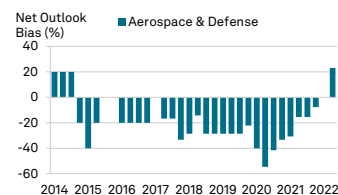


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	3	8	11
Downgrades	0	2	2
Upgrades	2	0	2

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

Ratings Outlook Net Bias



Related Research

[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: Autos](#), Jan. 25, 2022

Autos

Market conditions weaken in Europe

What's changed?

Input cost inflation is here to stay. Mainly an issue for auto suppliers as passing on excess costs with original equipment manufacturers (OEMs) will delay the recovery of profitability post-pandemic. Less of an issue for OEMs as long as pricing and mix remains strong, as is still the case in first-half 2022.

Consumer confidence is already weakening. Lack of visibility on the Russia-Ukraine conflict, expected rising interest rates, and COVID-19 resurgences have translated into plummeting consumer confidence in Europe and likely dampen the recovery of auto sales in 2023, while large order books support sales in 2022.

Supply side shortages will ease, but not end, in second-half 2022. Expectations of a vigorous rebound in production look increasingly uncertain. We expect the stop-and-go production mood could well continue in the next six months, weakening OEMs' capacity to deliver on record high order books and suppliers' ability to ride on full production recovery.

What to look out for?

The pricing dynamic on new and used cars is not sustainable in Europe. Pricing has allowed OEMs to more than offset low volumes linked to supply shortages and cost inflation. We expect pricing to contribute less to revenue growth.

Higher prices of energy, raw materials, freight, and labor will pressure profitability. We expect weaker margins that will be more manageable for OEMs than suppliers. Margin pressure could be further exacerbated by continued strong sales volumes for electric vehicles (EV), which typically have lower gross margins.

Inventory will increase. To avoid unnecessary stops to production, we expect OEMs and suppliers to build inventories of material and unfinished products, which could weigh on operating cash flow.

What if there's a recession?

Auto suppliers will be less exposed than OEMs to weakening demand at first. Passenger car inventories in Europe have bottomed out, so we believe auto suppliers with substantial operations might be more protected in a mild recession and weakening demand because of the need to rebuild inventories.

Weak sales in Europe could extend to 2023. After a decline in light vehicles sales estimated in the mid-single-digit range in 2022, a recession could result in stagnating sales of around 16 million units in the region (down from 20 million-21 million in 2019).

EV mix progression could temporarily slow in Europe. The continent could lose momentum in the progression of EV mix (14.0% in 2021, up from 8.5% in 2020) as consumers might delay purchasing EVs, typically a second vehicle for short distance trips.

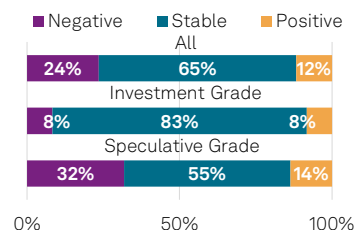
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Rating Trends

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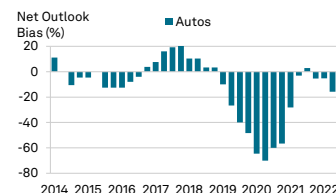


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	12	22	34
Downgrades	0	2	2
Upgrades	2	3	5

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

Ratings Outlook Net Bias



Related Research

- [Battery Suppliers, Automakers To Take Charge As Prices Rise](#), May 17, 2022
- [Global Auto Sales Forecasts: Russia-Ukraine Conflict Imperils Recovery](#), March 22, 2022
- [Industry Top Trends 2022: Autos](#), Jan. 25, 2022

Building Materials

Cost inflation weakens margins and reduces rating cushion

What's changed?

There are significant indirect effects from the Russia-Ukraine war. The conflict and the related governments' responses have further intensified the inflationary and highly volatile cost environment. So far, most companies have passed through these costs to clients, though with some lag, reflecting resilient-if-slowing demand. Nevertheless, we expect 2022-2023 margins to be well below 2021 levels.

Energy costs have risen further. Already-significant cost inflation in 2021 has been amplified, notably for power, oil, and natural gas. The latter, a key energy source in some subsegments, display a spot price of about 6x higher than in the same period in 2021.

The outlook bias has turned negative. Following negative rating actions since March 2022, 20% of the portfolio has a negative outlook, compared with 7% at Jan. 1, 2022. All negative outlooks relate to speculative-grade companies.

What to look out for?

The energy supply could be interrupted. The risk of a natural gas shortage in Europe has escalated since June, following Gazprom's decision to cut supply to several countries. A lack of gas in the sector would likely force some companies to stop production. This might translate into negative rating actions for less diversified companies, or where available rating headroom is limited.

Carbon dioxide (CO2) reduction is still a priority. Companies' plans to reduce CO2 emissions are irreversible, protecting business models ahead of significant carbon cost increases. The Carbon Border Adjustment Mechanism the EU Parliament voted on in June is even more ambitious than the initial plan from July 2021.

Refinancing risk is limited for now. Most private-equity-owned companies refinanced their capital structure in 2019-2021. Nevertheless, new funding at much higher rates will likely add pressure to free operating cash flow.

What if there's a recession?

Weakened demand will further constrain profitability. We anticipate that average volume growth in 2022 will still be positive, at about 1.5%. A recession in 2023 likely means zero or negative volume growth as households will likely postpone their spending. This will limit companies' abilities to pass through inflation costs to clients, adding significant pressure to margins and cash flow.

Negative rating actions will largely center in the speculative-grade category. We anticipate that those companies less diversified by geography and with high leverage will suffer the most. Negative rating actions could exceed those during the pandemic due to pressure from both demand decline and high inflation.

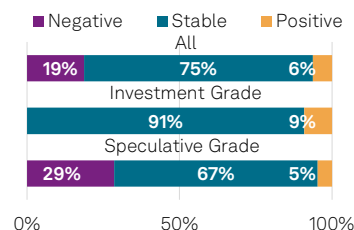
Financial policy will be key in preserving investment-grade ratings. If companies do not moderate their shareholder remuneration, rating headroom built in 2021 will quickly disappear, which could further stress the ratings.

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Rating Trends

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	11	21	32
Downgrades	0	1	1
Upgrades	1	0	1

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

Ratings Outlook Net Bias



Related Research

[Credit FAQ: How The Russia-Ukraine Conflict Affects European Building Materials Companies](#), March 29, 2022

Capital Goods

Supply risk overshadows order backlog

What's changed?

Material cost inflation and supply chain challenges are increasing. Inflationary stress has intensified, putting margin pressure on weak positioned companies, while well positioned companies can still pass on most price increases. Component availability remains a constraint and has broadened testing the flexibility of production networks, sourcing power, leading to higher inventory levels (an increase in safety stock or unfinished goods).

Orders will moderate while backlogs continue to build. Reflecting increasing economic risks and as pent-up demand fades, we expect order intake to moderate in the second half as also indicated by steadily drop in the purchase manager index. Meanwhile, backlogs keep climbing with solid demand, price effects, and tight output. Increased interest rates could strain construction exposed companies over the medium term.

End market recovery and completed restructuring has led to positive rating actions in the first half. Rating actions materialized, mainly in the 'BB' category (five) and has been fueled by faster-than-expected end-market recovery, bringing operating performance to pre-COVID-19 levels or above, supporting deleveraging efforts and improving financial flexibility (in all cases). Rating actions have been supported by completed restructuring efforts (in three cases).

What to look out for?

Gas supply risk and rising energy costs might weigh on competitiveness. Reduced gas supplies to Europe due to the Russia-Ukraine conflict would likely lead to energy cost disadvantages and tremendous pressure on local supply chains, disadvantaging companies with large supply chain, production, or customer exposure to Europe.

Lower-rated companies face refinancing risks. With rising interest rates, weak performing highly leveraged companies might be not able to refinance because the interest burden could become unsustainable even with a like-for-like refinancing.

Acquisitions aim to boost modest growth. Most companies will continue supplementing growth and corporate development with acquisitions and divesting in their industrial repositioning efforts.

What if there's a recession?

A technical recession with a short duration should be digestible for most. The capital goods industry is typically a late-cycle mover and should benefit from its order backlog, which is elevated by higher pricing and soft order executions on component shortages.

A robust commodity and infrastructure sector might offset a chill in cyclical and discretionary sectors. Investment to diversify European energy resources and energy efficiency, as well as U.S. infrastructure bill and EU recovery funds, should provide a tailwind to capital goods activity over the next several years.

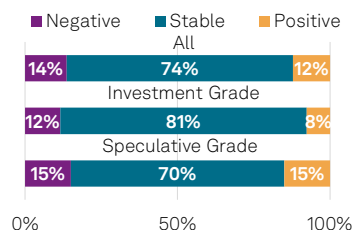
A recession from a gas shortage could be rough. Supply chains would face unprecedented challenges because gas is widely used in processing and production of components. It would also likely lead to intense cost pressure on high energy costs, high interest rates, and depressed demand.

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Rating Trends

Outlook Distribution

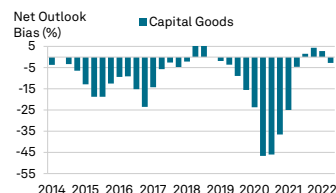


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	26	40	66
Downgrades	0	0	0
Upgrades	1	6	7

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

Ratings Outlook Net Bias



Chemicals

Slowdown, looming gas shortage dim second-half outlook

What's changed?

Companies grapple with strong inflation. Across energy, raw materials, and logistics, the sector has been confronted with massive increases in input-costs since second-half 2021. Most issuers have passed on these headwinds through a strong focus of value over volumes and displayed better pricing power compared with previous inflationary periods.

Demand is at a tipping point. 1H 2022 saw still robust demand and pricing power across the sector despite supply-chain disruptions alongside the Russia-Ukraine conflict and continued lock-downs in China. Many companies reported high (in some cases record) first-quarter results and we anticipate only moderate softening in second-quarter results. For second-half 2022 and into 2023, we anticipate weaker results associated with lower volumes and less favorable pricing on increased economic risks and inflationary pressure.

The sector outlook dims on the slowdown and mounting risks. Many chemicals issuers entered the year with some rating headroom after a strong year 2021 and this buffer has increased year-to-date 2022 in many cases. We still see possible negative rating actions given the mounting risks and potential slowdown in operating results. While still 80% of chemical ratings are on a stable outlook, the proportion of negative outlooks has more than doubled since year-end 2021.

What to look out for?

Natural gas supply cuts loom. Since June 2022, the risk of natural gas shortages has risen following material supply cuts by Russia to several European countries. Consequences of a natural gas shortage could range from margin pressure to curtailed production. This might stress ratings on highly exposed or less diversified issuers.

Demand is weakening. Following a robust first half, we anticipate a demand slowdown in second-half 2022 and continued inflationary pressure. We lowered our expectation for volumes and take into account that companies might find it harder to pass on higher input costs compared with the first half, affecting margins.

Refinancing risk is under control for now. Chemical issuers, with few exceptions, have taken advantage of the favorable refinancing conditions in the past few years and we see limited sector-wide refinancing risk for the remainder of the year.

What if there's a recession?

We expect weaker earnings and credit metrics. Most chemical issuers entered 2022 with some rating headroom. In a recession, we believe that cyclical parts of the sector such as petrochemicals will see weaker credit metrics as lower demand weakens margins and cash flow. We would expect more resilient performance even in a recession for industrial gases, agriculture, and nutrition.

Speculative-grade issuers are more at risk. Given usually higher leverage, less rating headroom, and limited geographic diversification, we consider speculative-grade issuers at higher risk of negative rating actions.

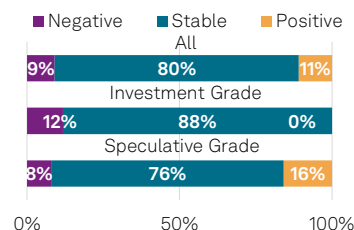
Adjusted financial policy could preserve investment-grade ratings. Our investment-grade issuers usually have more room to maneuver and can curb shareholder remuneration and higher capital spending to preserve ratings.

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Rating Trends

Outlook Distribution

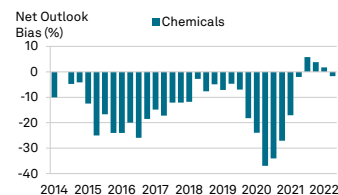


Ratings Statistics (YTD)*

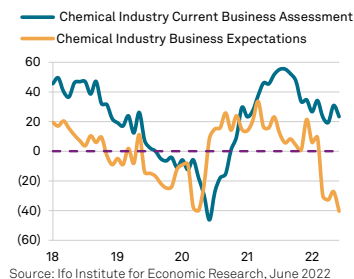
	IG	SG	All
Ratings	17	38	55
Downgrades	0	0	0
Upgrades	1	2	3

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

Ratings Outlook Net Bias



Ifo Sentiment Survey for German Chemical Industry



Source: Ifo Institute for Economic Research, June 2022

Consumer Products

Continued price increases test resilience of brands

What's changed?

The rise in input and operating costs is unrelenting. Consumer products companies continue to pass on price increases to consumers as they battle significant increases in input prices and operating costs.

Excess household savings and sizable pent-up demand prop up spending. The tailwind from pent-up demand, backed by high household savings, will continue somewhat supporting consumer spending for now, which augers well for sectors relying on trade consumption such as beverages and food services.

Yet persistent inflation has begun to erode consumer confidence. Inflation has reached peaks not seen in decades, and this, together with geopolitical conflicts, has begun to dent consumer confidence. Higher prices on essentials have hit disposable income, leaving less room for discretionary spending.

What to look out for?

Consumer spending is likely to slow. As they spend down savings and face higher food, fuel, and energy bills, consumers will increasingly turn more cautious and begin to moderate spending toward the end of this year.

Working capital requirements will be elevated. As supply-side disruptions continue, companies have less room to maneuver working capital and trade terms as their main priority is to secure supplies on time to prevent stock outages.

Flexibility in passing price increases to retailers will become more critical. Retailers, keen to maintain their price perception, will become more discerning as branded consumer goods companies continue passing on higher prices. Brand strength and price-value appeal will become more prominent in negotiations with retailers.

What if there's a recession?

Consumers will cut back on discretionary spending and trade down. Sales volumes will fall as price conscious consumers increase their take up of private label and discount products. Branded consumer goods companies will curtail price rises and take a hit on margins to stem volume declines.

Better capitalized investment-grade companies will fare better. Geographically diversified companies, with solid brands and pricing power, will remain resilient. Investment-grade consumer goods companies that continue to return cash to shareholders can moderate these to preserve their credit quality.

Companies with inflexible cost structures and limited room to pass through higher prices will see credit quality weaken further. This will be the case particularly for highly leveraged companies in the subsectors most exposed to high raw material prices, such as packaged foods and personal hygiene products.

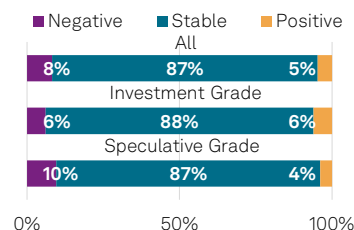
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Rating Trends

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	33	53	86
Downgrades	0	10	10
Upgrades	1	4	5

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

Ratings Outlook Net Bias



Related Research

[Consumer Goods: Unrelenting Inflation Puts Pricing And Brand Power To A Grueling Test](#), July 13, 2022

[European Retailers: Forced To Raise Prices While Wary Of Consumers Cutting Back Spending](#), June 9, 2022

[Russia-Ukraine Conflict Will Test Agribusiness Supply Chain Efficiencies And Consumers' Appetite For More Food Inflation](#), March 18, 2022

Health Care

Inflationary pressures on margins

What's changed?

Outlook no longer has a positive bias. Our outlook for the sector and across all four major subsectors is stable, but with inflation possibly persisting into next year, the labor-intensive services subsector could face downside pressure.

Pharma outlook has improved. As the larger companies de-levered, as legislative activity was quiet, and as COVID-19 lent a halo effect (as well as a financial windfall for some), our outlook on the pharmaceutical subsector improved to stable from negative. Pharma mergers and acquisitions (M&A) has also been strangely muted, though we expect an uptick.

Volumes are back up. Patient volumes have largely recovered to pre-pandemic levels, with organic growth offsetting decline in COVID cases.

What to look out for?

Margin compression. We are projecting mid-single-digit revenue growth for the health care industry in 2022 and 2023. But with inflationary pressures potentially lasting into 2023, higher costs on health care products, transportation, and especially labor will weigh on EBITDA margins and cash flows.

Ability to pass on costs to payors. Negotiations with providers will be difficult, and health care companies will have to absorb higher costs at least temporarily. This should not be an issue for high-rated issuers, but others could see ratings pressure.

Further impact from COVID-19. The recent COVID wave in Europe and the omicron variant led to disruptions, but a steep drop in COVID-related admissions could lead to top-line misses should the recovery in non-COVID admissions lag.

What if there's a recession?

Potential drag on top-line growth. A steep recession will weigh on revenues, given the discretionary component of health care and increasing out-of-pocket costs. However, we believe the decline is manageable and industry will see continued, albeit lower, growth.

Loosening of labor market? A recession could be a positive for the hard-pressed service providers, such as hospitals, that have seen significantly elevated labor costs, especially on nursing.

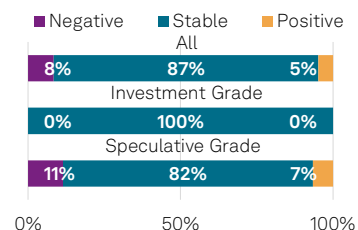
Delay in return to normal. While the healthcare industry remains largely insulated from a recession, many companies' patient and acuity mixes have yet to normalize, pandemic uncertainties remain, federal aid monies have dried up, and inflation remains persistently high.

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Rating Trends

Outlook Distribution

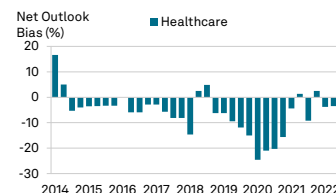


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	22	61	83
Downgrades	0	3	3
Upgrades	0	3	3

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

Ratings Outlook Net Bias



Related Research

[How Business Strength Varies Across Top Branded Pharmaceutical Companies](#), June 17, 2022

[Pharmaceutical Industry's Credit Prospects Brighter Due to Deleveraging, Disciplined M&A Spending, and Subsiding Legal and Reimbursement Risks](#), May 23, 2022

[The Outlook for Health Services Sector is Stable, with a Positive Bias](#), March 21, 2022

Homebuilders and Developers

Challenged by softer demand, higher costs and supply chain

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What's changed?

Higher lending rates and inflation are denting real estate purchasing power, inducing lower demand for newly built residential units. Sales are mostly paid through mortgage loans in Europe and savings accumulated during the pandemic are shrinking due to high inflation.

Costs are on the rise and might not entirely be passed on through price increases. Property developers and their subcontractors are highly exposed to raw material costs, such as steel and cement prices, which have already increased significantly.

New supply remains constrained. Supply chain bottlenecks and labor shortages are limiting volume capacity and delaying deliveries. In some countries, administrative hurdles and low land availability also limit permit granting.

What to look out for?

Developers' sales growth and EBITDA margin will likely soften, mostly in 2023-2024. This is after two years of price increase and some margin expansion.

Built-to-rent investors might be the most affected. Higher interest and caps on rent indexations in some countries to limit inflation's impact on households' purchasing power could undermine expected returns and overall purchase decisions.

Government incentives could be key to supporting demand. First-time buyer schemes, tax exemptions, and bloc acquisitions of social housing initiated by some European governments have proven strong factors in developers' sales.

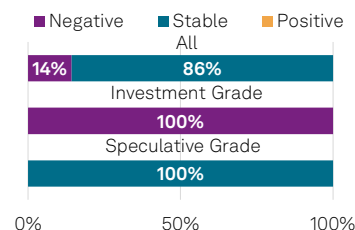
What if there's a recession?

Sales volume and prices would likely contract. Households' economic situations would worsen and further limit their real estate purchasing power.

Property developers would likely increase leverage to fund working capital needs. This would lead to lower cash flow and higher costs.

Rating Trends

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	1	6	7
Downgrades	0	0	0
Upgrades	0	1	1

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

Hotels, Gaming, and Leisure

Broad-based rebound continues, but economic risks grow

What's changed?

The recovery. European leisure operators are on track heading into second-half 2022 to post their best annual performance since pre-pandemic 2019 results, largely uninterrupted by pandemic measures. However, the focus has turned from post-pandemic recovery to potential impacts from increasing economic and geopolitical risks, especially for issuers depending on international travel.

Cost inflation. Costs have been increasing meaningfully since the beginning of the year. Energy, fuel, labor, and financing costs should contribute to upward pressure on costs for the year. Labor remains most significant for rated issuers and so far, has been managed well, but more pressure could come. For now, price increases are offsetting costs, with prices accepted and demand strong.

Retail gaming rebound. In contrast to the challenging comparative period in first-half 2021, the rebound in retail land-based gaming revenue in Europe is underway, with some operators recording quarterly numbers ahead of those in 2019.

What to look out for?

Discretionary spending. With growing economic risks, including persistently high inflation and increasing interest rates, we expect competition to become more intense for leisure spending dollars in household discretionary budgets.

Travel leisure. Pricing trends in 2022 have been very strong. However, with high inflation across Europe, labor shortages, rising COVID-19 infections and geopolitical impacts, we expect pricing to normalize by year-end, following a summer flagged to benefit from strong pent-up demand and dynamic pricing.

U.K. gaming regulation. U.K. gaming operators remain exposed in the near term to the outcomes of the anticipated Gambling Act review white paper. Gaming operators have adopted a number of safer gaming measures ahead of the release, while the paper is expected in third-quarter 2022.

What if there's a recession?

Travel and lodging. In a recessionary environment, we would expect corporate and group to be more pressured than leisure, international and long haul to be more exposed than local, regional domestic, and staycation providers, and midscale and budget brands more resilient than upscale. Franchised and managed lodging should be better positioned vs owned and leased in an increasing rental cost environment.

Gaming. We consider lottery relatively well positioned from a product profile perspective. Operators in markets with particularly strong structural online growth should likely benefit, offsetting any specific product category weakness. Higher-fixed-cost operations will be more affected.

Capital structure and refinancing risk. Rated European leisure issuers are almost exclusively speculative-grade and improvement in credit ratios into 2022 has relied on rebounded earnings, rather than balance-sheet repair. Access to capital and refinancing risk remain important key credit factors in any recession.

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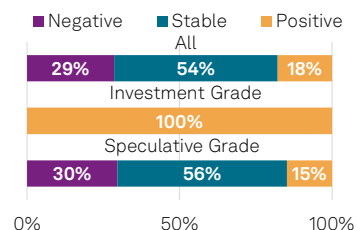
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Rating Trends

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	1	28	29
Downgrades	0	0	0
Upgrades	0	9	9

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

Ratings Outlook Net Bias



Related Research

[European Hotel Industry Fears Inflation And Travel Reticence Could Scupper Its Strong Recovery](#), June 13, 2022

Media and Entertainment

Dark sequel: Pandemic survivors to face a new plot twist

What's changed?

In first-half 2022, most companies performed strongly. Advertising outpaced GDP growth, and out-of-home (OOH) advertising and physical events recovered. Despite a worsening economic outlook, we haven't seen a pullback in advertising spending. Demand for TV and film content remains strong.

Costs are on the rise. Rising wages and talent acquisition lead to weaker margins. Broadcasters continue investing in content and direct-to-consumer (DTC) streaming.

There were several defaults in our rated portfolio. Ahead of interest rate rises, companies rushed to refinance. In cases where capital structures were unsustainable, we treated these transactions as distressed and akin to default. We could see more in the next 12-24 months for companies rated in the 'CCC' category.

What to look out for?

Weaker growth and consumer confidence. We expect lower GDP growth in 2022-2023 and think consumer confidence will dwindle as inflation persists. This could lead to a pullback in advertising (especially digital, which has shorter lead times than traditional), and lower consumer spending.

How business models adapt. The ability to raise prices will be key. In response to weaker subscriber demand, streaming platforms owners introduced free ad-supported options, but they haven't yet reduced programming budgets. There is also a lot less acquisition activity than in 2021, despite lower valuations.

Recovery in travel. As the economic outlook worsens, international travel continues to recover from pandemic lows, and we think easing of restrictions (for example in China) and more normal travel patterns into 2023 will support OOH advertising, as well as trade shows and live events.

What if there's a recession?

Digital media faces a big test. Digital advertising accounts for more than 65% of the industry and continues to grow at double-digit rates thanks to shift to digital media consumption. But it will likely also react more swiftly than traditional advertising to a drop in global growth and consumer spending.

Not all subscriptions are recession-proof. Businesses that rely on B2B subscriptions (such as data, information, and analytics providers) are generally resilient to recessions. But DTC platforms will likely suffer from consumers reducing discretionary spending, which will hurt their top lines and profits.

Companies with high leverage and exposure to affected industries will suffer. Classified and price comparison platforms could be hit by a drop in demand for autos and other products affected by supply chain issues, decreased ecommerce activity, fewer property and car insurance transactions, and lack of energy tariff switching due to rapidly rising prices.

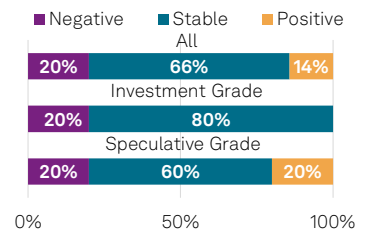
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Rating Trends

Outlook Distribution

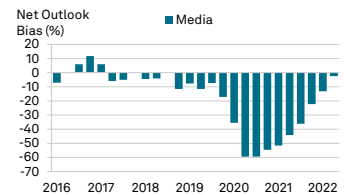


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	10	25	35
Downgrades	0	2	2
Upgrades	0	2	2

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

Ratings Outlook Net Bias



Related Research

[Digital Marketing Group S4 Capital Off Watch Neg On Governance Review And 2021 Results; Ratings Affirmed; Outlook Stable](#), June 27, 2022

[Universal Music Group N.V. Assigned 'BBB/A-2' Ratings; Outlook Stable](#), May 31, 2022

[Publicis Groupe 'BBB' Ratings Affirmed; Outlook Stable](#), May 10, 2022

Metals and Mining

Margins contracting but cash flow is adequate for most

What's changed?

Prices correcting. Chinese lockdowns and recession fears are signaling a likely turn in the cycle for mining and metals companies. Prices that had been strong are typically still above historical averages. But even with supply challenges, demand expectations are now the key factor for prices.

Increasing costs. Diesel, power, machinery, wage bargaining, and now financing costs have been rising as inflation spikes and works its way through value chains.

Decreased Russian and Ukrainian supply. Sanctions and logistical challenges have removed significant volumes of steel, nickel, palladium, coal, and other commodities from European and global markets. Lost sales hit affected producers hard and market and supply chain disruptions continue emerging.

What to look out for?

Rising costs. Production outages can be severe for some, but higher costs are increasingly important for all producers. Differentiators include issuers' overall starting level, currency exposure, and companies' ability to adapt.

Chinese growth hit again by lockdowns. With our revised Chinese 2022 growth forecast now at 3.3%, additional disruption would imply deeper and longer impact on commodities' demand, especially if global inventories recover significantly.

Sustainability and funding. Companies' differing emphases on operations and long-term strategy are becoming more important for investors and lenders.

What if there's a recession?

Commodities and price fluctuations. Prices will move if recessionary fears intensify or crystallize. Some high-cost producers could retrench production expectations in 2023.

New developments halting. The limited development response to expected energy transition demand will moderate, but funded existing plans will likely proceed.

Balance sheets and financial policies. Lower debt than 2015 levels and financial frameworks and distribution policies that were already tested in 2020 are likely to cushion the credit impact of a short or moderate recession.

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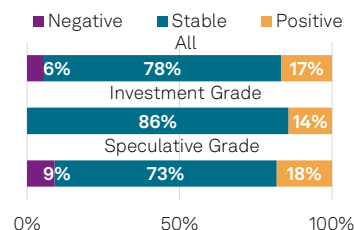
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Rating Trends

Outlook Distribution

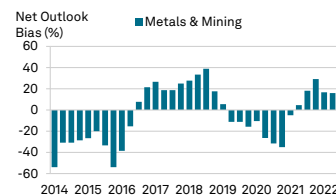


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	7	11	18
Downgrades	0	0	0
Upgrades	2	10	12

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

Ratings Outlook Net Bias



Related Research

[Metal Price Assumptions: Shortages Worsen And Prices Spike As Conflict Roils Metals Trading](#), March 18, 2022

Oil and Gas

As good as it gets for producers and refiners?

What's changed?

Hydrocarbon prices. Oil prices have risen further due to the global supply shock linked to the Russia-Ukraine conflict, compounding an already tight market. Market concerns persist about Russian oil exports since additional supply will likely remain limited. Record natural gas prices in Europe are pulling up prices in the U.S., as demand for liquefied natural gas leaps on shortages in Europe.

Ensuring supply is paramount. At least for the near term. Potential natural gas shortages in Europe and possibly higher oil prices have shifted priorities to securing supply--while weaning the EU off of Russian hydrocarbons--from addressing climate change.

Refining margins. Gasoline, distillate, and jet fuel margins are historically high, for now. Insufficient global capacity and strong demand for refined products, plus an EU ban on most Russian oil imports, have aggravated the shortages.

What to look out for?

Hydrocarbon prices may keep climbing. Natural gas prices could soar as Europe tries to trim its exposure to Russian gas by two-thirds and replenish inventory levels to 80% of capacity by Nov.1--ready for the heating season. Even if this works, Russia could cut remaining supply to Europe, thereby sparking another spike in global natural gas prices. Given the low global inventory, additional reductions in Russian exports could push up oil prices.

Fiscal policy and investment. We don't see meaningful step-ups in producers' spending despite high hydrocarbon prices, inflation, and supply chain issues. Markets are still dictating public producers should pay down debt and reward shareholders, and companies have made emissions pledges.

Policy headwinds, demand pullback. To tackle high gasoline, diesel, and energy prices, the U.S. and the EU, among other authorities, are enacting or considering policies that impact oil and gas groups, including crude export bans or windfall profits taxes. Higher retail prices seem to be tempering demand.

What if there's a recession?

Lower hydrocarbon prices. The questions are about the severity and the duration of a recession. Balances in the oil and natural gas markets would improve with softer demand, allowing prices to decline. However, in a mild recession, oil and natural gas prices are unlikely to decline and stay below midcycle prices given the supply constraints

Rating actions. Downgrades for investment-grade issuers in the upstream industry probably would not rival prior cyclical troughs given debt reduction seen since 2020.

Refiners likely to pull through. Refining companies have significantly improved their credit profiles, using rising free cash flow to repay debt raised during the pandemic and retain more excess cash after rewarding shareholders. Credit ratios should reach pre-COVID-19 levels, softening economic headwinds.

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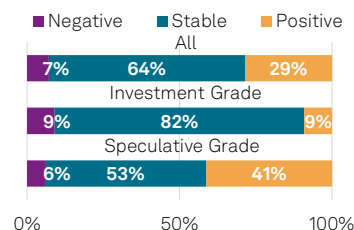
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Rating Trends

Outlook Distribution

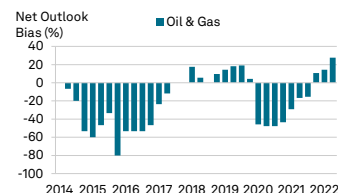


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	11	18	29
Downgrades	0	1	1
Upgrades	3	0	3

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

Ratings Outlook Net Bias



Related Research

[The Dash For Gas Fuels Risks For European Utilities, Slows Energy Transition](#), June 29, 2022

[S&P Global Ratings Raises Oil And Natural Gas Price Assumptions On Further Market Price Step-Ups](#), June 8, 2022

Real Estate (REITs)

Inflation boosts revenue but rate rises a challenge

What's changed?

Debt investor sentiment is significantly weaker, which could weigh on REITs' funding costs and refinancing plans. Bonds' spreads have materially widened in the sector since March 2022, raising risks of access to debt capital markets.

Soaring interest rates could slow investment and push cap rates up. Higher rates should affect investors' expectations for returns and put some gradual pressure on asset revaluations, unless rental income rise or risk premiums reduce.

Higher inflation should drive greater revenue growth. Rents rise with inflation because most leases are indexed to CPI, to the extent tenants can afford this increase, and most costs are passed through to them. Supply also becomes rarer as building costs increase.

What to look out for?

REITs might use shorter debt or alternative funding. Weaker capital markets could prompt REITs to make more use of alternative sources, such as bank mortgages or insurance loans, Schuldschein, and private placements; or issue shorter-maturity debt.

Debt service and LTV metrics will see headwinds, while debt to EBITDA might improve. If cap rates and funding costs rise, the former ratios should weaken or stabilize. The latter could improve as revenue increases and investment moderates, although a recession would likely dampen EBITDA growth.

REITs might invest less and rely more on asset disposals to fund their growth. As both debt and raw materials become more expensive, we believe REITs will likely reduce acquisitions and new developments capital expenditure, and possibly become net sellers.

What if there's a recession?

Revenue growth could erode because tenant demand would likely weaken. GDP contraction would likely hit tenants' capacity and willingness to expand their real estate footprints. Revenue growth might no longer be a catalyst in valuations.

The office segment could be more vulnerable. While the segment has been relatively resilient to the pandemic, it is more cyclical and sensitive to economic downturns. A recession would likely hit corporates' expansion plans and demand for office space.

Retail and hotel recovery post-pandemic could derail. Weaker consumer sentiment and reduced purchasing power would erode retailers and hotel operators' revenue, ultimately affecting their landlords.

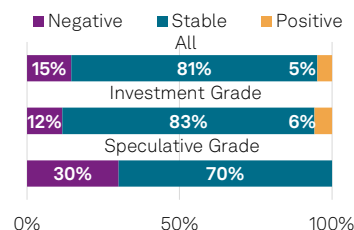
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Rating Trends

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	52	10	62
Downgrades	1	1	2
Upgrades	1	1	2

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

Ratings Outlook Net Bias



Related Research

[When Rates Rise: European REITs' Funding Costs And Cap Rates Climb, So Does Revenue](#), June 16, 2022

[\[SLIDES\] Russia-Ukraine Conflict: Implications For European Corporate And Infrastructure Sectors](#), March 16, 2022

Retail and Restaurants

Rising prices will lead to consumers pulling back

What's changed?

The unrelenting rise in inflation has hit consumer confidence. Rapid--and, in some cases, very steep--rises in fuel, energy, and food prices, and continued tensions from Russia's invasion of Ukraine have severely dented consumer sentiment.

A slowdown in retail sales is in the cards. In the EU and U.K., retail sales have sustained their strong momentum through first-quarter 2022 on high household savings and pent-up demand, but signs of decreased spending are emerging.

Retailers need to maintain favorable price perception. Retailers have passed on higher input and operating costs and prices from their suppliers. However, with consumers looking to moderate their spending, retailers now face the challenge of becoming more price competitive, even as costs are escalating.

What to look out for?

Higher labor, energy, and order-fulfillment costs. Retailers will look to rationalize brick-and-mortar store costs and numbers further as the e-commerce channel remains robust. However, given the high operating leverage, many retailers will struggle to cut these costs to offset a meaningful portion of cost increases.

Already-low retail margins coming under further pressure. Higher input and operating costs will hit margins because sales volume could decline as consumers are hurt by continued high prices. The persistent supply chain and logistical bottlenecks also impede initiatives to gain efficiencies and limit operating costs.

The ability to defend free cash flow. Retailers will be tested on their ability to protect their free cash generation, particularly because working capital needs will be high as sales volumes and margins moderate and supply chain disruptions continue.

What if there's a recession?

Consumer spending is likely to decelerate. Consumers will turn more cautious and begin to cut spending, especially on discretionary items. Some parts of apparel retail, or retailers that didn't fully regain their financial footing from the pandemic, could struggle the most.

Discounters and value retailers will gain market share. Consumers will favor private label over higher-priced branded products. Discount and value retailers will continue to gain market share as consumer look for ways to cut spending.

Highly leveraged retailers and restaurants will suffer the most downgrades. Weaker profitability and cash flow will lead to elevated leverage. The share of entities in EMEA rated 'B-' and below will rise to more than one-fourth (from below 20% currently). Many of these will see their capital structures becoming unsustainable and, inevitably, a few businesses will suffer financial distress.

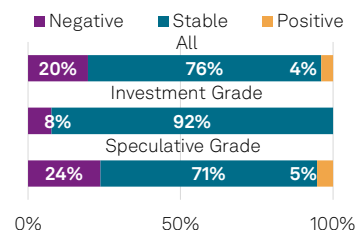
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Rating Trends

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	13	38	51
Downgrades	0	5	5
Upgrades	1	4	5

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

Ratings Outlook Net Bias



Related Research

[Consumer Goods: Unrelenting Inflation Puts Pricing And Brand Power To A Grueling Test](#), July 13, 2022

[European Retailers: Forced To Raise Prices While Wary Of Consumers Cutting Back Spending](#), June 9, 2022

Telecommunications

Stable outlook despite inflation and reduced market access

What's changed?

Inflation is affecting cost structures. While less damaging than in other sectors, higher energy, labor, and material costs pose risks to margins and capital expenditure (capex) budgets. We expect efficiency programs, along with power purchase agreements and energy hedges, will contain the margin impact to low-single-digits before pricing responses. Delayed investments can push capex out, keeping a lid on annual investment budgets at 18% of revenue on average.

Transaction levels have dropped. Telecom refinancing needs are modest after years of extending maturity walls in a near-zero interest rate environment, but about a third of speculative-grade telecom debt is floating rate, and of over €21 billion in 2022-2023 maturities, a quarter is outstanding. These issuers are now facing higher borrowing costs to refinance (currently 7%-8% annual yields).

What to look out for?

The ability to pass through higher costs via price hikes might be uneven. We have seen significant price hikes by operators in Northern Europe markets. While positive for top lines and margin preservation (in some cases even outstripping cost inflation), higher churn could follow if any operators break from the herd. A split could emerge versus Southern Europe markets, which lack contractual escalators and where fierce competition makes price hikes more difficult.

Potential deals to watch include in-market consolidation in Spain, the sale of DT's towers, and the creation of a monopoly fixed-line infrastructure player in Italy.

Outcomes could help clarify the extent governments have rebalanced their priority between incentivizing investment versus customer protection. However, major price hikes could temper the recalibration hinted at last year when wholesale regulation was loosened in several markets, including the U.K. and Spain.

What if there's a recession?

Telecoms are a relatively safe harbor. We expect modest, low-single-digit top-line growth, and the utility-like nature of telecoms should cushion against economic volatility. Even under a recession downside scenario, we expect adjusted debt to EBITDA will only rise by 1.2x for speculative-grade issuers, the second-lowest among 19 corporate sectors.

Asset sales could slow. Rising interest rates could erode the high valuation multiples, and the number of suitors for telecom infrastructure spins, curbing a monetization opportunity that operators have used to increase financial flexibility.

Inflationary price hikes should be handled with care. Operators can point to higher costs and the unmonetized economic value they provided through the pandemic to justify higher pricing. However, aggressive price hikes that push all the pain to customers might be viewed as overreach. If seen to be taking advantage of inflation, operators may inadvertently open the door to competition or regulatory pushback.

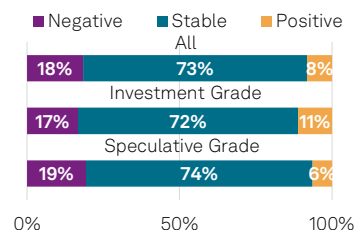
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Rating Trends

Outlook Distribution

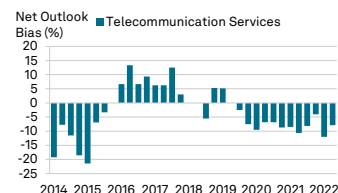


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	18	31	49
Downgrades	0	1	1
Upgrades	0	0	0

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

Ratings Outlook Net Bias



Related Research

[How Cyber Risk Affects Credit Analysis For Global Corporate Issuers](#), March 30, 2022

[EMEA Telecoms: Relative Strength Ranking 2022](#), March 29, 2022

[Industry Top Trends 2022](#)

[Telecommunications](#), Jan. 25, 2022

Transportation

Air traffic booms, shipping strong, but macro risks loom

What's changed?

Air traffic is booming. Europe's airline industry is experiencing a stronger summer than we envisioned now that travel restrictions are all but lifted. Pent-up demand, namely for short-haul leisure trips, is lifting air passenger numbers, and air capacity in third-quarter 2022 is nearing pre-pandemic levels.

Surging oil prices constrain airlines' profitability. Crude oil prices have continued to rise in recent months amid the Russia-Ukraine military conflict and the tightened global supply-and-demand conditions. We assume Brent will average \$100 per barrel (/bbl) for the rest of 2022 and \$85/bbl in 2023.

Port congestion remains severe and containership capacity is tight. We forecast that shipping freight rates might not start moderating (from current all-time highs) until late 2022. From 2023, as the supply chain bottlenecks ease, demand softens, and overall industry capacity increases with the ramp-up of ordered vessel deliveries, rates will decline but remain above 2020 levels.

What to look out for?

High leisure demand may dry up. Although demand for flights is rebounding, increasing headwinds suggest the recovery could decelerate toward end-2022, particularly once pent-up demand is mostly satisfied.

Airlines may charge more. We note markedly higher ticket prices for this summer travel season, with some carriers are reporting higher yields than pre-pandemic levels. Still, the airlines might have trouble raising prices later in the year if inflation causes consumers to cut back on travel. Also, the need to pass-through cost inflation to passengers will build since airlines' hedging contracts rolled into 2023 will likely be at higher prices.

Shipping freight rates could dip amid slowing demand. The intensifying headwinds to trade volumes due to China's stringent COVID-19 policy, the Russia-Ukraine conflict, and rising inflation are rapidly eroding purchasing power, as are potential setbacks from climbing interest rates.

What if there's a recession?

Air traffic recovery would stall. A recession could prevent households from using savings accumulated during the pandemic and might curb discretionary spending, thereby cooling the travel industry's prospects.

Airlines' deleveraging will be slower than expected. Airlines accumulated a lot of debt during the pandemic, and since they face mounting new aircraft investment, their ability to deleverage is limited. Disrupted EBITDA recovery would worsen the already-strained situation.

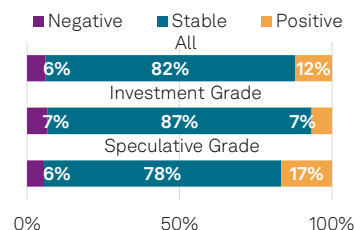
Supply tightness might ease. The heat from the cargo market and the expected drop in volumes would likely alleviate the supply chain disruptions and capacity shortages.

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Rating Trends

Outlook Distribution

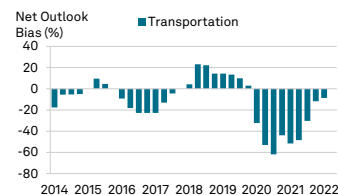


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	15	21	36
Downgrades	0	1	1
Upgrades	0	9	9

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

Ratings Outlook Net Bias



Related Research

- [European Aviation Is Set For A Strong Summer Before Brewing Macro Headwinds Blow In](#), June 8, 2022
- [Omicron Has Only Slowed European Airlines' Climb To Clearer Skies](#), Feb. 17, 2022

Transportation Infrastructure

Weakened economies and inflation may undo recovery

What's changed?

Solid comeback following lifted restrictions. A strong summer season and pent-up demand for travel have ushered airports, railways, and toll roads onto a solid recovery path. Still, the speed of recovery will differ by asset class: Toll roads should reach pre-pandemic levels first, by end-2022, followed by rail by end-2023. Airports are unlikely to fully bounce back until 2025.

Prices on the rise. Escalating inflationary pressure, higher energy costs, and expected increases in capital expenditure could squeeze margins. In 2022, inflation for the eurozone and the U.K. could reach 7.0% and 8.7%, respectively, from about 2.0% before the Russia-Ukraine conflict started.

What to look out for?

Weaker economic prospects may constrain mobility. Despite a rebound in traffic in the first half of 2022, the prospects of low economic growth, less disposable incomes, and higher inflation could curb the momentum, especially after the summer. The rising cost of living could deter travel and passenger transport, and weaker consumption and imports/exports may hit the freight industry.

The ability to pass through real-cost inflation will vary. Depending on the regulatory framework for each asset class and country, the ability to pass through real-cost inflation in a timely manner via higher tariffs will mark each company's ability to withstand inflationary pressures. A strong competitive position to support higher prices without sacrificing volumes will be vital to sustain credit quality. Social pressure may lead governments to mitigate tariff increases on toll roads, despite generally solid contractual framework.

Cost controls and financial flexibility will be critical. Companies that have sustained cost-savings during the pandemic and still have flexibility in capital spending will likely have stronger liquidity buffers against rising costs.

What if there's a recession?

Airports are likely to be most vulnerable. Developments in 2023 will be key for the recovery of European airports, most of which are on negative outlooks. A recession could slow recovery and tighten margins more than anticipated as airports try to revive credit metrics from pandemic impacts.

Rail companies might rely further on the government. Often seen as an essential service and an instrument for climate change goals, railways have received extraordinary government support when needed. Without this help or the rail companies' own countermeasures, recessionary pressure could stunt profitability and cash flow metrics given their high fixed costs.

Toll roads would be more resilient. Despite the negative impact a recession would have on heavy vehicles' traffic, toll roads' strong balance sheets are likely to buffer their credit quality in a downturn. Higher tariffs may trigger discussions on the affordability of some assets.

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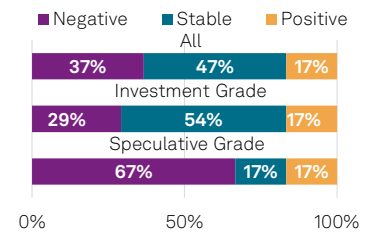
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Rating Trends

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	24	6	30
Downgrades	0	1	1
Upgrades	1	0	1

Ratings data as of end-June 2022. * Year-to-date. Only issuer-level ratings shown.

Related Research

[European Railways Are On Track To A Fuller Recovery](#), July 4, 2022

[European Aviation Is Set For A Strong Summer Before Brewing Macro Headwinds Blow In](#), June 8, 2022

Utilities

Risks rise even if the lights stay on

What's changed?

Increased sector volatility. The Russia-Ukraine conflict has aggravated heavy, preexisting imbalances in European gas markets. The additional physical supply risks have intensified storage concerns and prompted government actions to support affordability.

This makes the sector riskier. Increasingly divergent credit paths are emerging. Low-cost generators with high availability and regulated operations should prove resilient and regulated networks in the U.K. may benefit in the long term from rising inflation (unless their debt is inflation-linked). Gas importers, however, may face greater liquidity pressure, possibly partly offset by political or regulatory support.

That said, ratings on utilities across EMEA have held steady. So far in 2022, none of the upgrades or downgrades have exceeded one notch, confirming a ratings distribution concentrated in the 'BBB' to low 'A' range. However, the negative outlook bias has slightly increased since the Russia-Ukraine conflict tipped the balance of risks and government and industry responses.

What to look out for?

Record high and volatile prices. Dwindling Russian supplies while Europe plans how to accelerate the buildup of renewable energy mean a gas bridge is needed to make the energy transition. Because renewable capacity growth is very gradual and additional LNG supplies before 2025 are limited, power prices will stay high and volatile at least through next winter and into 2025.

Increased investments. The gas bridge and the shift to renewables require capital expenditure to increase at least 20% from the levels spent over the past three years. Although balance sheets will somewhat erode as a result, they are still generally solid, with de-risked portfolios, and typically good access to senior debt.

Green light for previously stalled projects. Nuclear and, temporarily, coal and gas may now be key to meeting the EU's decarbonization targets by providing short-term balance to the power system. But doubling the renewables capacity by 2030 entails high execution risks linked to supply bottlenecks and cost inflation.

Reduced ratings headroom. Higher debt costs, government measures to support affordability, and (notably outside regulated networks) inflation may constrain utilities' credit quality.

What if there's a recession?

A mild recession could ease pressure. Weakening economies consume less gas, tempering the upward pull on prices, and the sting of rising interest rates on utilities' balance sheets may be lighter. A severe recession, however, would put earnings and refinancing more at risk.

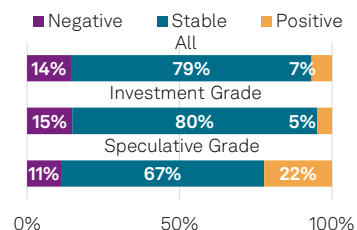
Additional factors to consider. Alongside economic growth, domestic, political, and regulatory risks around energy affordability drive utilities' credit quality. Geopolitical risks, notably from Russia, remain important considerations.

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Rating Trends

Outlook Distribution

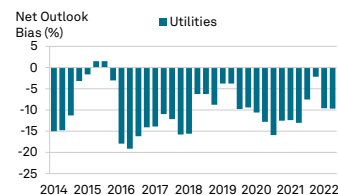


Ratings Statistics (YTD)*

	IG	SG	All
Ratings	81	10	91
Downgrades	4	1	5
Upgrades	1	3	4

Ratings data as of end-June 2022. * Year-to-date. Only issuer-level ratings shown.

Ratings Outlook Net Bias



Related Research

[The Dash For Gas Fuels Risks For European Utilities, Slows Energy Transition](#), June 29, 2022

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