S&P Global Ratings

Capital Goods

Global friction could grind down growth in 2025

January 14, 2025

This report does not constitute a rating action.

What's changed?

U.S. spending priorities set to shift. Up to two-thirds of U.S. Inflation Reduction Act (IRA) and CHIPS Act funds could be spent/committed before the new administration is in place, so capital goods industry growth looks good for 2025. But some investment plans are being reconsidered.

Energy transition remains a key support in EMEA. Investments in energy infrastructure gained momentum, supported by the data center boom and orders from grid operators, which have an estimated investment need of more than 600 billion euro in grid infrastructure by 2030.

Shifts in economic policies weigh on issuers in Asia. A new U.S. administration could affect business sentiment in Asia, where demand is already slow. U.S.-China friction, including potentially more tariffs, could weigh on the profits of rated exporters and deter investment.

What are the key assumptions for 2025?

Revenue rebounds after 12-18 months of destocking. Modest global capital expenditure (capex) growth could help boost industry revenue growth into the mid-single digits.

Steady costs and margins support robust ratios. Three years of good industry conditions support credit stability, but debt load is higher after a cautious few years.

What are the key risks around the baseline?

Higher-for-longer interest rates push off spending and hamper refinancing. Rates remain elevated despite recent central bank cuts, which could affect the economic rationale or funding for large investments or cause distress for smaller, highly leveraged issuers.

Tariffs or supply chain turmoil increase costs or disrupt demand. Capital goods companies around the world showed good cost pass-through under tariffs in 2018 and supply chain disruptions 2021-22, but pricing power will likely weaken if demand slows.

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Ratings Trends: Capital Goods

Chart 1
Ratings distribution

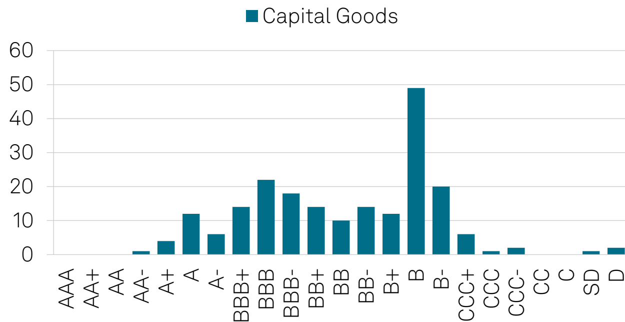


Chart 2
Ratings distribution by region

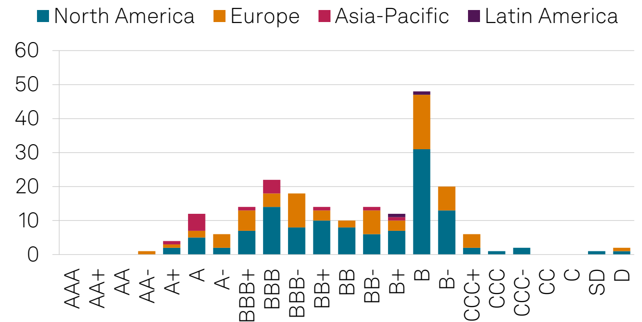


Chart 3
Ratings outlooks

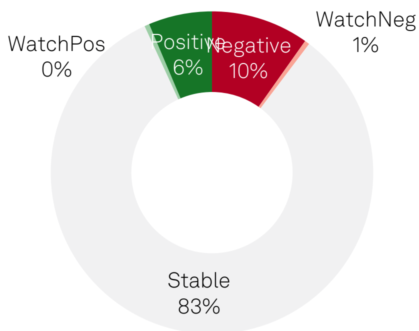


Chart 4
Ratings outlooks by region

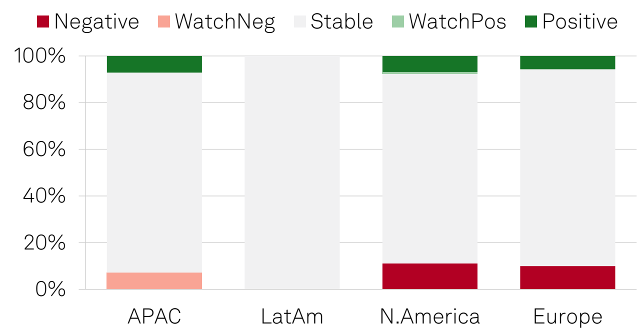


Chart 5
Ratings outlook net bias

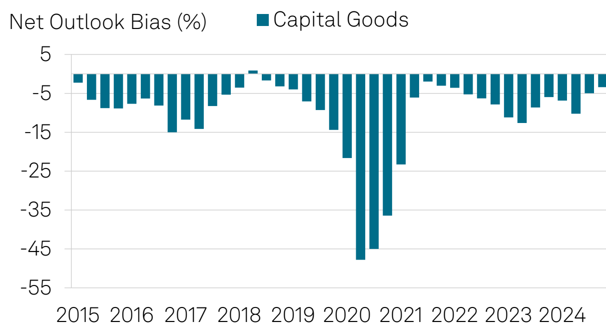
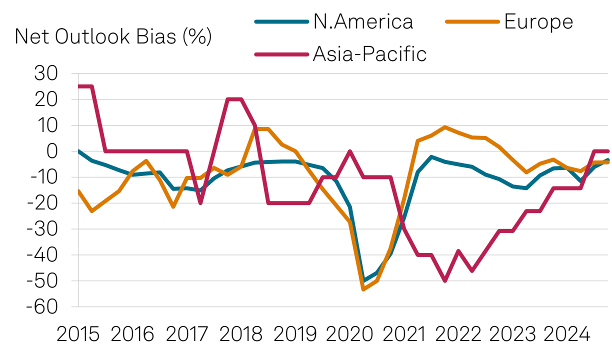


Chart 6
Ratings net outlook bias by region



Source: S&P Global Ratings. Ratings data measured at quarter-end.

Industry Outlook

Ratings trends and outlook

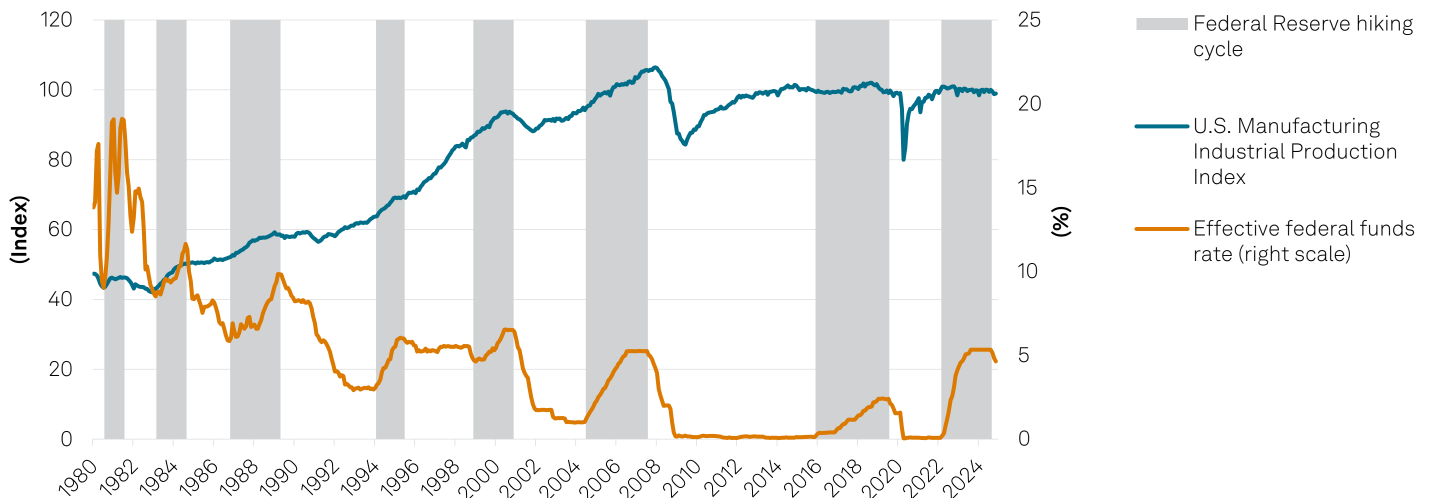
Credit quality in global capital goods looks steady and robust heading into 2025. Upgrades outstripped downgrades around the world in 2024, and the negative outlook bias is nearing a decade low of only 5%. Overall, less than 10% of ratings have a negative outlook and only about 5% have a positive outlook, indicating that only 2%-3% of ratings might change in 2025. Our credit outlooks around the world have converged to a 5% negative bias, as negative pressure in Asia-Pacific (APAC) eased, while North America and Europe, the Middle East, and Africa (EMEA) held steady through 2024. Most of that negative bias, however, remains among the smaller, highly leveraged issuers, which only represent about 20% of the rated debt in the portfolio. We use outlooks to signal at least a one-in-three chance of a rating change with 12 months for speculative-grade issuers and up to 24 months for investment grade.

Destocking has run longer than expected, and it continues. Revenue growth slowed to almost 0% in 2024 compared to our 2% forecast in last year's Industry Credit Outlook, as destocking persisted throughout the year, so earnings basically held steady year-over-year. Low credit spreads contributed to a $40 billion jump in investment-grade debt levels in the second half of 2024, which increased the industry's debt leverage heading into 2025. That said, we forecast those debt levels to drop by $30 billion in 2025, indicating that much of the new debt is being used to refinance near-term maturities.

Interest rates have started chilling demand, but backlogs still look good. Companies cited the impact of interest rates on investment decisions in late 2024, although we believe any spending caution is also motivated by the U.S. administration change and geopolitical instability. Multiyear investments from decisions in 2022 and 2023 supported growing revenues and earnings, offsetting typical headwinds we'd expect by now from the sharp rise in interest rates. It takes time for firms to adjust capex budgets, so any capital goods demand weakness could lag the interest rate cycle peak in 2023 and 2024 by a year or two, which could be 2025 or 2026. In most cases since 1980, manufacturing was flat or declined in real terms within a year or two of finishing a rising rate cycle (see chart 7).

Chart 7

Tighter monetary policy typically cools U.S. manufacturing production with a lag



Data through November 2024. Source: Federal Reserve Economic Data, Federal Reserve Bank of St. Louis.

Credit buffer holds steady heading into 2025. Steady EBITDA in 2024 and cautious decisions around shareholder returns and mergers and acquisitions (M&A) leave most capital goods companies around the world with good buffer in credit ratios for a cyclical downturn. We forecast a bounce in revenue in 2025, supported by long-dated spending decisions. Considering current ratio buffer and growing credit strength since 2021 for issuers rated 'BB' and higher, a cyclical downturn would need to coincide with more aggressive debt usage to affect many ratings in the next year or two. Issuers rated 'B' and lower likely need continued good financial performance to ensure a smooth path to refinancing.

Defaults remain low, but refinancing risk looms for leveraged issuers. Four capital goods issuers defaulted around the world in 2024, which is only about 1.5% of the global portfolio. These companies were all sponsor-owned leveraged buyout (LBO) firms with high leverage. That default rate is lower than the overall trailing 12-month speculative-grade corporate default rate of about 4% as of September 2024. On the other hand, two-thirds of the negative outlooks in the industry are among companies we rate 'B' or lower, highlighting refinancing risk in 2025 and 2026 if they miss their profit targets or if interest rates remain elevated.

The outlook bias is positive among investment-grade and crossover credits. Large global companies like Mitsubishi Heavy Industries, Trane Technologies, Carrier Global, and Packaging Corp. of America all have positive outlooks, which could portend some rare upgrades among 'BBB' and 'BBB+' rated issuers. In contrast, 3M is the largest issuer in the capital goods portfolio with a negative outlook, after incurring large settlements and spinning off its health care division. In addition, a cluster of potential fallen angels (KION Group AG, Prysmian, and Leggett & Platt) are rated 'BBB-' with negative outlooks.

Main assumptions about 2025 and beyond

1. Global business spending and capex support higher revenue in 2025.

Destocking flattened global capital goods revenue growth to below 1% in 2024. Capital spending across all industries in the U.S. looks robust, potentially growing 4%-5% in 2025, a bit slower in EMEA at 3%-4%, and only 1%-2% in APAC. That said, issuers remain cautious in early 2025 owing mostly to uncertainty around U.S. trade and investment policies, which could have a significant impact on revenue and costs.

2. Solid demand enables cost pass-through, even if tariffs rise.

Revenue tailwinds and steady operating costs could enable about 40 basis points (bps) of EBITDA margin expansion to a decade-high 17.7%. The tariff impact of various proposals could pressure input costs again, but we assume good pass-through that mostly neutralizes the effect. In a scenario of steady costs and slow-growing revenue, manufacturing free cash flow still needs to fund growing working capital before seeing more free cash flow.

3. Ratio buffer is solid for midcycle conditions.

Many capital goods companies around the world have been on a cautious footing since 2023 when interest rates started rising. Industry conditions have been better than expected while debt usage for corporate development has been moderate. Debt levels rose in 2024 to prefund maturities, so global median debt leverage rose to 3.1x from 2.9x year-over-year. Some debt paydown and rising EBITDA should bring that back to 3x in 2025.

Demand looks good heading into 2025. We expect the completion of large projects will drive equipment purchases that support revenue growth for capital goods companies. The 12-18 month phase of destocking could be closing, and S&P Global Market Intelligence's Purchasing Managers' Index (PMI) surveys indicated global business activity expanded for a thirteenth straight month in November. At the same time, the PMI indicates U.S. manufacturing remained in contraction most of 2024, but the global PMI has been aligned with 2% GDP growth most of the year. Consequently, capacity utilization in U.S. manufacturing continued to drift lower in late 2024, according to the Fed's Industrial Production and Capacity Utilization measure. Also, the service PMI has been running ahead of the manufacturing PMI, which highlights the trend of cautious new investment we've seen most of 2024, supported by good parts and service demand. That said, manufacturing is bouncing back with a lift from replenishment in the U.S., linked in part to stocking up ahead of possible tariffs. S&P Global Market Intelligence's PMI also shows that inflation pressures remained near a four-year low because of softer labor markets, lower input costs, slow growth in goods prices, and few supply shortages.

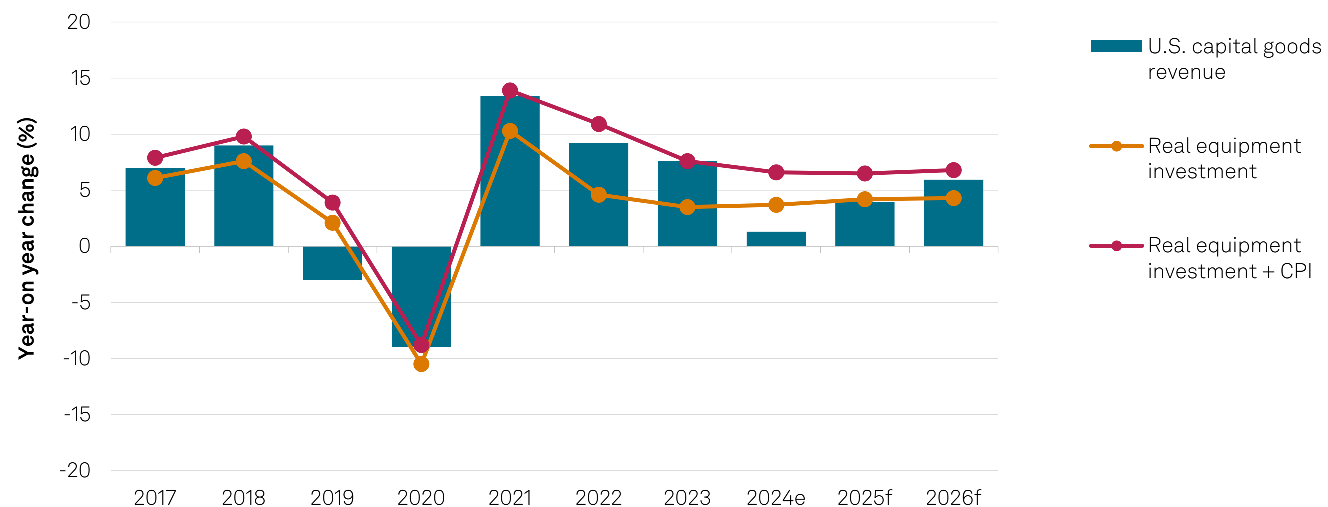
Our economists forecast U.S. GDP growth to slow gradually to 2% or below starting next year. The eurozone will continue its gradual recovery in 2025 to reach its potential growth rate, while China's growth will slow toward 4% as the U.S. tariffs weaken exports and investment. Our economists forecast at least 4% U.S. real equipment growth in 2025 and 2026, which should enable mid-single-digit revenue growth if companies can pass through small price increases.

Key U.S. economic indicators all turn positive for the first time in several years. Our economists' forecasts for revenue drivers like nonresidential construction, equipment investment, and residential construction are all positive in 2024 and 2025, in contrast with a mix of positive and negative growth in recent years (see chart 8). Nonresidential construction boomed in 2023 after the IRA and CHIPS Acts were enacted. The computer/electronic/electrical category (spending on plants producing electric vehicle batteries and microprocessors) fell 8.8% (annual rate) in Q3 2024, suggesting this category may have seen its peak in growth. Spending on data centers, on the other hand, has increased in all but one of the last 16 months with more growth in the pipeline for data centers and power. The growth in public infrastructure spending appears to have flattened. Housing starts have steadied after declining in 2022 and 2023, so aggregate residential spending should grow slowly in 2025 (0.8%) and accelerate in 2026 (2.6%).

Chart 8

Demand and pricing power

Equipment investment and inflation drive capital goods revenue



e—Estimate. f—Forecast. Source: S&P Global Ratings.

EMEA economic outlook remains muted for 2025. Our economists forecast about 1.6% GDP growth compared to 2024 (expected about 1.2%), behind the expected economic expansion for North America (2.2%) and Asia Pacific (4.3%). Reflecting their late-cyclical nature, we expect some slowdown to hit less globally diversified companies towards the middle of 2025 when order backlogs have been eaten up. PMI Manufacturing for the eurozone is staying at about 45, which is below the level that is indicating expansion (above 50). The eurozone manufacturing index indicates a 29th consecutive month of contraction. Notably, Germany, France, and Italy remain below the average, which indicates that destocking and normalization of inventories is taking longer than expected, and likely portends the continuation of subdued order intake through the first half of 2025. We note that order backlogs for most are approaching normalized levels, leaving little buffer in case of continued weaker demand.

On the other hand, companies exposed to energy transition or data centers continue to enjoy strong order intake and growing order books. Overall, we believe growth will further moderate in 2025 compared to 2024 as the manufacturing sector continues to bottom out.

APAC economic outlook will be more volatile in 2025. Our economists forecast the region’s economic and credit conditions will become more volatile amid uncertain trade and foreign policies by the incoming U.S. administration. More tariffs against Chinese exports are likely to be imposed. Our economists’ base case factors in a rise in the effective U.S. tariff rate on Chinese imports to 25% from 14% from the second quarter of 2025, and retaliation by China in kind. China's GDP growth could slow to 4.1% in 2025 and to 3.8% in 2026, amid limited stimulus to bolster consumption. China’s slower economic growth, soft consumption sentiment, and weak property sector will continue to weigh on overall demand on capital goods. Countries with a large trade surplus with the U.S. such as Vietnam, Thailand, Malaysia, and India could be vulnerable to universal tariffs. Chinese producers may cut prices to stay competitive, while increasing exports to outside the U.S. The global trade slowdown could curb growth and squeeze Asia-Pacific currencies and exporters' revenues. We expect the region's growth to slip to 4.2% in 2025 and 4.1% in 2026, even as domestic consumption in emerging APAC remains supportive.

Large infrastructure investments in APAC support heavy industries. China’s government policies support demand growth in certain markets, such as thermal and nuclear power generation equipment. Demand for railway equipment in China is also expanding amid higher passenger ridership and higher maintenance needs. We expect Japan’s heavy industries will benefit from increased demand for electricity, increased defense spending, and commercial aircraft. We revised the outlook of Mitsubishi Heavy Industries to positive in July 2024 because we see a stronger likelihood of steady improvement in companywide profitability. This is due mainly to favorable orders and improved profitability in the company's power generation and defense businesses. The outlook revision also reflects our view that improved performance around these core businesses and its disciplined financial management will maintain the company's key cash flow metrics at stronger levels than we previously assumed. This is even as growth investments, including for decarbonization, increase.

For power generation equipment in China, we see solid demand for thermal power equipment on the back of supportive government policies. New orders for wind power equipment continue to grow and reached a five-year high thanks to continued support from government policy and accelerated project approval, though pricing still remained low. Key manufacturers entered into an agreement in late 2024 to promote disciplined pricing strategy, although it remains to be seen whether prices can improve amid fierce industry competition. We expect demand for conventional power generation equipment as a stable power source will likely remain solid amid a data center boom. This will benefit companies like Mitsubishi Heavy Industries and Shanghai Electric.

By comparison, issuers handling short cyclical mass products might perform less favorably, amid a stagnant factory automation market in China and slower demand for construction machinery and air conditioning equipment in Europe, despite a gradual recovery in demand for some of these products.

Construction in the U.S. flattens after a couple of good years, but infrastructure grows. S&P Global Ratings' economists believe U.S. nonresidential structures investment growth will be 0.1% in 2025 versus 3.4% in 2024 and a strong 10.8% in 2023. The computer/electronic/electrical category (spending on plants producing electric vehicle batteries and microprocessors) has been driving nonresidential construction growth for the past three years, but a decline in late 2024 suggests this category may have already seen its peak in growth. Data center construction has increased in all but one of the last 16 months, with more growth in the pipeline and added construction in the power sector. Infrastructure spending remains a bright spot, as $1.8 trillion in federal grants, loans, incentives, tax credits, and other financial assistance works its way through the U.S. economy. Infrastructure construction spending is on track to grow by 7.5% in 2024, according to S&P Global Market Intelligence (U.S. Infrastructure Focus Report, Dec. 2, 2024), down from growth of 11.6% in 2023. The strongest segments to date this year have been water and sewer and power. At the same time, we expect the availability of skilled construction labor will remain tight, pushing up wages and construction costs.

Low grain prices weigh on demand for agriculture equipment. The cyclical agriculture equipment market will be among the more challenging end markets for industrial companies, in our view; its peak to trough sales will fall by 30% through the end of 2025, greater than our previous expectations of 25%. Farmer cash income held up better than we anticipated in the U.S., as the United States Department of Agriculture (USDA) only forecasts cash income will be down 1.1% to $158.8 billion. Still, it is a significant fall since 2022, when it was $225 billion. Cash receipts for farmers have declined significantly due to lower commodity prices. Production expenses, meanwhile, have fallen, but remain relatively high. We assume the agriculture equipment rebound will not take place until 2026. Furthermore, we believe the new U.S. administration and potential tariff wars could weigh heavily on farmers and that immigration policy could weigh on farm labor.

During the last round of trade friction that affected U.S. agricultural exports to China, the U.S. government provided support to affected farmers, and tariffs yielded agreements to buy U.S. agricultural products to resolve the trade dispute. With a view to considerable end-market volatility, the leading equipment manufacturers in the space—Deere & Co. (A/Stable/A-1), CNH Industrial N.V. (BBB+/Stable/A-2), and AGCO Corp. (BBB-/Positive/--)—maintain relatively strong balance sheets for the rating, with S&P Global Ratings-adjusted debt to EBITDA under 1x, 2x, and 3x, respectively, as of Sept. 30, 2024 (Oct. year end for Deere & Co.).

We're expecting a soft year in 2025 for U.S. heavy equipment manufacturers, which we attribute to caution in construction spending. In the U.S., higher interest rates and affordability issues continue to weigh on residential construction spending, which we expect to grow just 0.1%. Falling electrical construction spending, which went through a post-pandemic boom, should weigh on nonresidential structures investment. We believe the data center boom and spending associated with power generation will offset this decline, resulting in 0.8% growth. We also believe infrastructure spending will continue to be positive for demand, with roughly 40% of the projects associated with the $1.2 trillion Infrastructure Investment and Jobs Act (IIJA). Construction spending should show a modest rebound in 2025 in Western Europe, with growth from infrastructure leading the way.

Other end markets within heavy equipment will be mixed, in our view. We believe mining companies will continue to exhibit capital discipline, while power generation equipment will

continue to benefit from the data center buildout. In APAC, we continue to expect low demand for construction machinery, particularly in China. The property sector in that country is still struggling and confidence remains subdued, despite being partly compensated by moderate growth in infrastructure investment. We also anticipate sluggish demand for construction machineries in ASEAN (Association of Southeast Asian Nations) countries as persistently high interest rates slow the progress of construction projects. We believe demand for the mining sector in APAC will gradually decline due to lower commodity prices, although it should remain higher than in previous downturns.

U.S. equipment rentals are poised for continued healthy demand in 2025, allowing them to maintain stable performance. We expect megaproject spending to continue to benefit demand for equipment rentals, supported by spending tied to the IIJA and CHIPS Act, along with a sector-wide focus on reshoring to de-risk supply chains. However, near-term demand could be affected by shifts in project timing or disbursement of federal funds.

As interest rates cuts take hold, we expect a recovery in demand for smaller, local, and regional projects, which are typically highly sensitive to interest rates. Following multiple years of rental rate increases, we believe they will largely stabilize due to normalized supply conditions in the original equipment market and modest rate dilution from megaproject revenues, which tend to carry higher volumes and lower rates due to competitive bidding. We view national equipment rental peers as well-positioned to benefit from megaprojects given their large fleet sizes and wide-reaching branch networks. The gradual shift in customers' preference toward asset-light, rental-focused operating models remains a longer-term driver of growth in equipment rental demand. Over the past decade, equipment rental penetration has increased, and we expect it will continue, fueled in part by high-growth specialty equipment product lines. Overall, we believe organic rental revenue for large equipment players will continue to increase in 2025 as fleet utilization remains solid.

European equipment rentals keep growing despite weak construction. In Europe, the European construction sector continues to be marked by negative output growth in 2024 owing to the high interest rates and persistent inflation which undermine consumer confidence. In 2025, we still believe in a weak European construction sector outlook with about 1.5% market growth. However, we expect the largest European rental equipment peers to continue to outpace the construction output in 2025-2026 as supporting long term trends, such as improved cost efficiencies of renting versus owning and lower carbon footprint from newest rented equipment should result in higher rental penetration rates in most of the European countries.

As with the broader capital goods sector, the disruption of macroeconomic expansion due to developments around geopolitics or U.S. trade policy pose a risk to our forecast. However, if end market conditions unexpectedly deteriorate, we believe equipment rental companies can rapidly reduce capex to preserve cash generation.

Automation landscape looks steady with potential for some upside in 2025, after some destocking that had worked its way through in 2024. We expect 2025 to be generally favorable for companies with investments related to these key megatrends.

While M&A continues to support inorganic growth, the fundamentals and longer term prospects should continue to provide healthy profitability and favorable operating trends for most companies aligned with automation. We continue to expect backlogs and order rates to continue to moderate in 2025 from historical highs, but we believe the overall demand trends should support longer term growth and overall credit quality. Our view hinges on the ongoing challenges around labor availability—particularly skilled labor—which have increased the urgency for many companies to automate their operations and increase the efficiency of their plants. Costs to

automate have decreased over time and companies continue to balance their return on investments relative to labor constraints and safety considerations.

Despite these medium-term megatrends, earnings for APAC issuers engaged in automation as a core business will likely recover slower in some end markets, such as EVs and batteries, amid economic slowdown in China.

Electrification and energy transition demand appear entrenched. The dynamics in the residential end markets over the longer term continue to drive the increased need for electrification. With a shortage of housing stock and the existing housing being older, the need for improved energy efficiency, more strict safety requirements, and to some extent regulation is supporting the increased need for electrification. We also expect the longer-term adoption of electric vehicles and trends toward energy storage and of heat pumps should align with the overall demand trends of electrification.

Amid the intensifying global trend toward decarbonization, Japanese heavy capital goods companies such as Mitsubishi Heavy Industries have seen a significant increase in new orders for gas-fired power generation equipment in the last couple of years; as in much of APAC, meeting growing electricity needs is prioritized over decarbonization targets for now. Demand for new gas-fired power plants will remain high compared with other regions in our view. Japanese capital goods companies will likely continue to benefit from growing demand for gas-fired power assets in the next three to five years.

But decarbonization brings new challenges for the industry. Renewable power projects are more complex and face more severe competition, and future development of greener technologies for power generation may shift the competitive landscape in the long term.

Credit metrics and financial policy

Good performance and steady policies among U.S. issuers. The North American business landscape is more stable than it's been the last few years, with supply chains moderately improving and cost inflation normalizing. Also, we note continued adherence to long-established financial policies for most issuers rated 'BB' and higher, with little indication of loosening targets for debt usage. We believe that general industrial companies should fare well and should be stable for the most part, driven by decent economic activity, pricing power, healthy backlogs and order rates compared to pre-pandemic levels, and overall decent consumer consumption expected in 2025. While the uncertainty about tariffs is still an overhang, we believe many of the rated companies have implemented changes in supply chains through relocating facilities, onshoring operations, and producing in-country. While the magnitude and actual implementation of tariffs could become pronounced, the impact should be manageable, particularly given some the risk management and mitigating factors that were implemented in the last period.

For example, many companies have automated parts of their business to rely less on labor; have alternative sources for key inputs to offset potential shortages; and have alternative shipping and transportation methods where they did not exist before. From a cost inflation perspective, many companies have successfully passed on price increases particularly for mission-critical products.

EMEA capital goods companies look to buy more growth. For investment-grade issuers we expect stable to slightly improving credit metrics. We estimate gradual improvement in profitability should yield sound free cash flow generation. We expect continued M&A spending to further support the portfolio transformation, as recently displayed by the acquisition of Altair by Siemens AG. However, we believe investment-grade issuers remain committed to their financial policy and are carefully matching free operating cash with spending on M&A or shareholder returns. For speculative-grade issuers, we might see some deterioration of credit metrics due to

some end-market weaknesses, but overall most companies are targeting a more conservative balance sheet to support the higher cost of debt.

APAC issuers maintain their financial discipline. The creditworthiness of APAC capital goods companies is generally stable, even if interest rates and sluggish economies slow APAC growth. We estimate revenues and margins will recover in 2025, mainly supported by increased orders for heavy machinery and power grids. We expect that most issuers will maintain their high technological capabilities and solid business foundations, while improving profitability should absorb the financial burden from increased growth investments.

Construction machinery, which is relatively susceptible to economic fluctuations, will likely see revenues and margins decline from 2024 to 2025, but heavy machinery will benefit from increased orders, and Hitachi and others will benefit from increased investments in IT and digital transformation. We expect continued headwinds with interest rates remaining high and the economy slowing, as well as the expected impact of tariffs. Growth investments and shareholder returns are also likely to increase. Where orders increase, the burden of working capital will also increase. However, APAC issuers are generally managing costs and working capital with financial discipline and in some sectors with improved cash flow, and will absorb these burdens to the extent necessary to control key financial indicators.

In China, growing demand in key end-markets and leading market positions should support moderate earnings growth of our rated companies. We expect financial headroom to remain adequate over the next one to two years, amid profit expansion and disciplined investment.

Key risks or opportunities around the baseline

1. Get comfortable being uncomfortable with uncertainty.

A wide range of risks could affect our base-case for a small improvement in revenue and EBITDA in 2025, including tariffs, interest rates, labor, and new spending policies after a boom in manufacturing construction.

2. The maturity wall approaches and triggers more distress for the riskiest credits.

Strains began to show in 2024 with a few defaults, many from liability management exercises, which re-tranche the capital structure of a distressed issuer when a healthy refinancing appears unlikely.

3. Investment juggernaut transcends politics and interest rates.

Large spending could persist another 2-3 years, making for a robust 5-6-year cycle of favorable industry conditions with only episodic demand pressure (like destocking in 2023-24).

Evolving risks set to converge in 2025, most notably labor, supply chain, interest rates, energy transition, and technology. In 2025, U.S. labor should remain tight and incentivize manufacturing investments in Mexico, Asia ex-China, and Canada, although some companies could be holding off on committing new capital to these places because of the U.S. tariff threat. Supply chains could get disrupted by tariffs on growing sources of goods into the U.S. Interest rates appear to be holding at elevated levels, which are often the harbinger of weaker manufacturing. Spending on the energy transition will likely change, favoring conventional sources of power like natural gas, as well as solar and nuclear.

U.S. tariffs could drag on profits, but most companies have options. We estimate the share of imports from China in U.S. critical manufacturing (metals, machinery, electrical equipment, transport equipment) has declined to 10.2% in 2023 from 13.8% in 2017, so companies clearly adjusted their sourcing after tariffs were imposed. At the same time, we estimate that exports to

China account for about 11% of capital goods revenue, which would likely be highly specialized products with little incentive for retaliatory tariffs.

No chill in the forecast for HVAC manufacturers. We rate four HVAC original equipment manufacturers (OEMs) in the U.S., and several Japanese manufacturers we rate also produce HVAC systems. Financial policy decisions will remain a key rating focus for our rated HVAC OEMs in 2025 since we assume operating tailwinds will persist and support continued organic free operating cash flow (FOCF) growth. In 2025 we forecast year-over-year organic revenue growth in the mid-single-digit percent area, on average, across the rated OEMs on both pricing and volume, and for S&P Global Ratings-adjusted margins to remain steady to up modestly from the benefits of volumes on operating leverage. Following several quarters of destocking in the HVAC distribution channels, we assume volumes in residential HVAC in 2025, particularly in the U.S., will grow generally in line with GDP growth trends, though we note some potential volume disruption towards the first half of 2025 as OEMs and distributors unload inventory using the legacy R410A refrigerant. We also assume OEMs benefit from price increases in the high-single-digit percents on a majority of their residential products given the industry requirement to transition to the newer A2L class of refrigerants, which have higher product costs. Our forecast also assumes continued good revenue growth in commercial HVAC, supported by current solid backlogs, improving payback horizons for new equipment, and indications that some commercial verticals such as health care, education, and particularly data centers, will continue to drive good demand for larger applied HVAC projects. Lastly, we assume service revenue, which is generally higher margin, will continue to grow given our assumption for growth in applied products, since applied systems are complex and customers prefer the OEMs to provide service.

We assume HVAC OEM's will allocate their growing FOCF towards shareholder returns and bolt-on acquisitions. We believe Lennox International Inc. and Johnson Controls International PLC (JCI) will manage discretionary spending to levels that will maintain their publicly stated leverage targets. For Carrier Global Corp and Trane Technologies Inc., neither of which has a publicly stated leverage target, we believe both will maintain their leverage in line with, or below, most recent levels.

We saw a few portfolio shake-ups in 2024, with asset divestitures completed by Carrier and a few announced by JCI. Carrier used divestiture proceeds initially for debt repayment, until it deleveraged towards levels it operated at prior to its large acquisition of Viessmann in January 2024, after which the company allocated proceeds towards shareholder returns. While JCI has not stated a specific level, if any, of expected gross debt reduction from asset sale proceeds, we assume the company allocates proceeds such that its leverage remains at the lower end of its target range.

Given expected restructuring efforts and more operational focus on areas of the HVAC industry where each company maintains leading market share already, we believe divestitures may drive EBITDA margin benefits at both Carrier and JCI over time.

Renewables face political pressure while OEMs seek to restore profitability. Notably, we expect profitability to improve at some of the largest renewables companies we rate. GE Vernova and Siemens Energy will continue to improve on profitability after significant equipment-related hiccups. We expect both companies to attain S&P Global Ratings-adjusted EBITDA margins in the mid- to high-single-digit percentage range in 2025 following several different charges. GE Vernova took an approximately $700 million charge in the third quarter of 2024 related to wind blade failures (in Nantuck and the Dogger Bank, an offshore wind facility in the U.K.). We believe these are indications that the industry is still early in its maturity, and think these companies will continue to see fits and starts in the coming years.

These companies face political pressure in the U.S., where we expect the next administration to advocate for conventional power sources. We believe international businesses will remain more receptive to renewable energy while U.S. natural gas businesses will get a boost. Globally, we expect grid businesses to continue to perform well due to the need to upgrade aging infrastructure, as well as the need to hook up renewable power to existing power landscapes. The energy transition will persist, but the pace of change (and profitability) could be slower than anticipated. Accordingly, we believe segments of companies that cater to new technologies could take longer to reach profitability.

Issuers in APAC could face economic headwinds and cost pressures. Further downside in the U.S. economy or China property market could prolong the slowing growth trend, and keep demand stagnant in certain markets (e.g., factory automation for manufacturing). Slowing global growth could dampen earnings, particularly for those issuers dealing with mass market products that have higher sensitivity to macroeconomic conditions. Cost pressures are possible from tight labor conditions, high raw material and utility prices, and supply-chain disruption. Issuers involved in power generation are under pressure to decarbonize and invest more in new technologies. However, APAC is relatively more accepting of conventional, stable power sources.

Related Research

- Great CapExpectations: Tech, Utility Spending Power Capital Goods Revenue Growth In 2025, Jan. 13, 2025
- Tear Sheet: Schneider Electric S.E., Dec. 20, 2024
- Full Analysis: Koch Companies LLC, Dec. 18, 2024
- Tear Sheet: CNH Industrial N.V., Dec. 16, 2024
- Research Update: Siemens Energy Outlook To Stable On Better Operating Performance, High Demand, Net Cash Position; 'BBB-' Rating Affirmed, Dec. 16, 2024
- Tear Sheet: 3M Co., Dec. 6, 2024
- Full Analysis: Deere & Co., Dec. 5, 2024
- Rating Action News: Johnson Controls International PLC's Proposed Senior Unsecured Notes Rated 'BBB+', Dec. 4, 2024
- Full Analysis: Emerson Electric Co., Nov. 26, 2024
- Bulletin: Siemens' Acquisition Of Altair Boosts Its Competitive Position, Nov. 04, 2024
- Full Analysis: Parker-Hannifin Corp., Sept. 26, 2024
- Gas Power Remains Key Pillar For Japan Capital Goods Makers, Aug. 1, 2024
- Research Update: Rockwell Automation Inc. Downgraded To 'A-' From 'A' On More Aggressive Financial Policy; Outlook Stable, July 2, 2024
- Evolving Risks For Credit Quality In U.S. Capital Goods, June 18, 2024

Industry Forecasts: Capital Goods

Chart 9
Revenue growth (local currency)

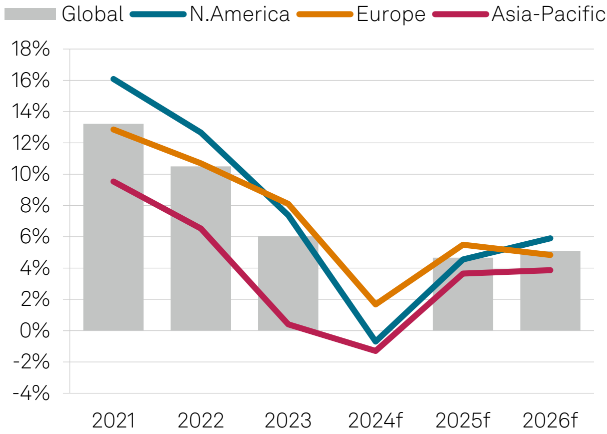


Chart 10
EBITDA margin (adjusted)

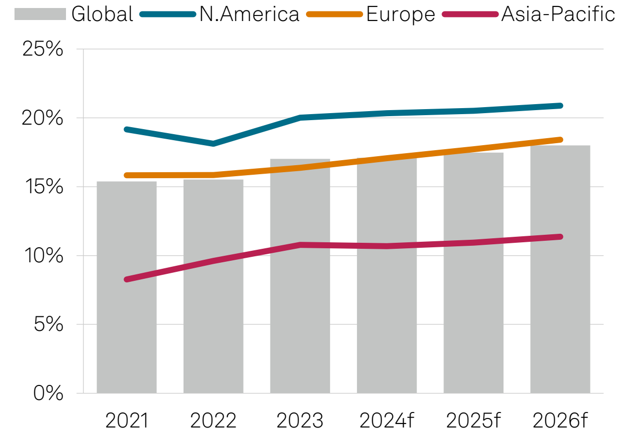


Chart 11
Debt / EBITDA (median, adjusted)

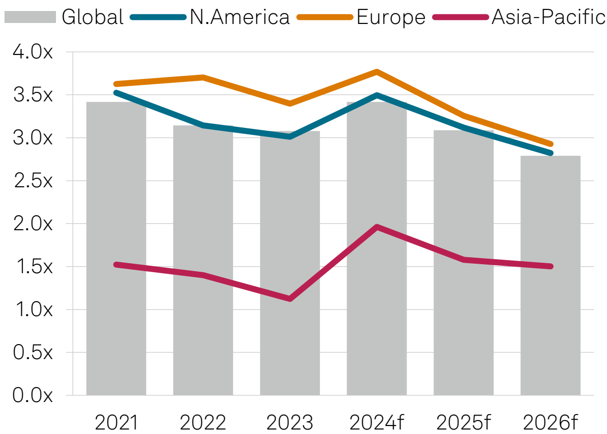
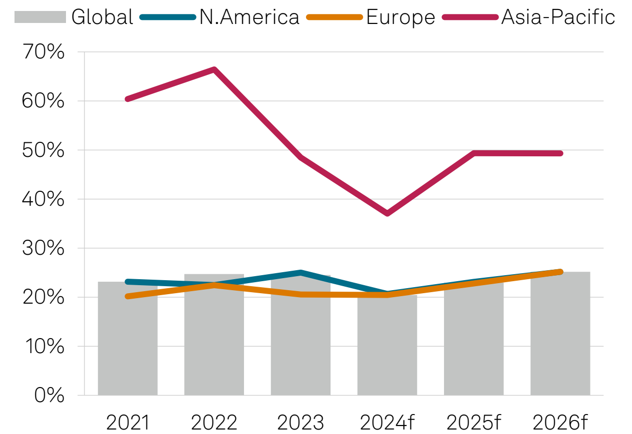


Chart 12
FFO / Debt (median, adjusted)



Source: S&P Global Ratings. f = forecast.
Revenue growth shows local currency growth weighted by prior-year common-currency revenue share. All other figures are converted into U.S. dollars using historic exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO—Funds from operations.

Cash, Debt, And Returns: Capital Goods

Chart 13

Cash flow and primary uses

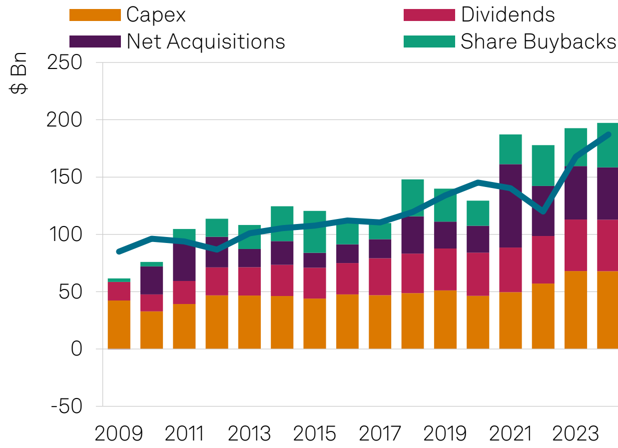


Chart 14

Return on capital employed

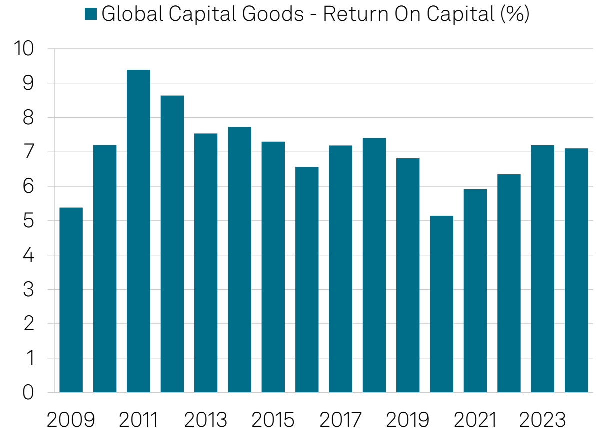


Chart 15

Fixed- versus variable-rate exposure

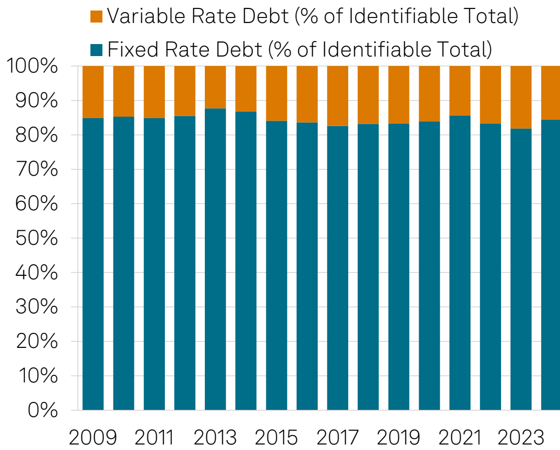


Chart 16

Long-term debt term structure

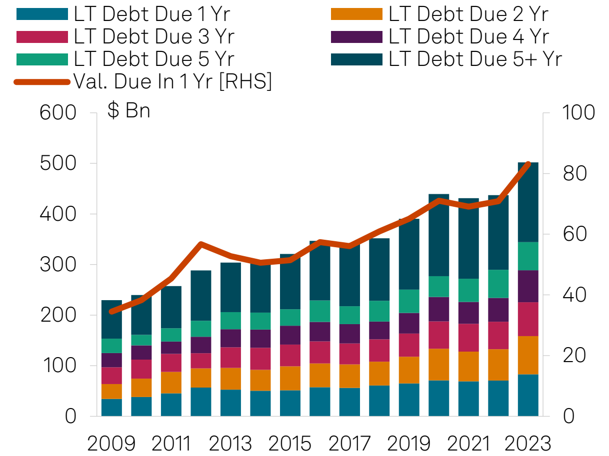


Chart 17

Cash and equivalents / Total assets

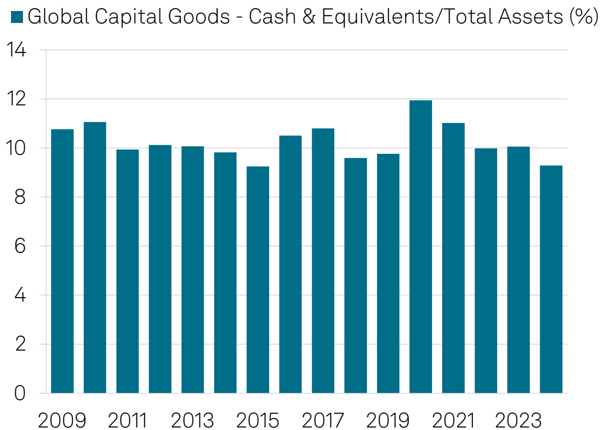
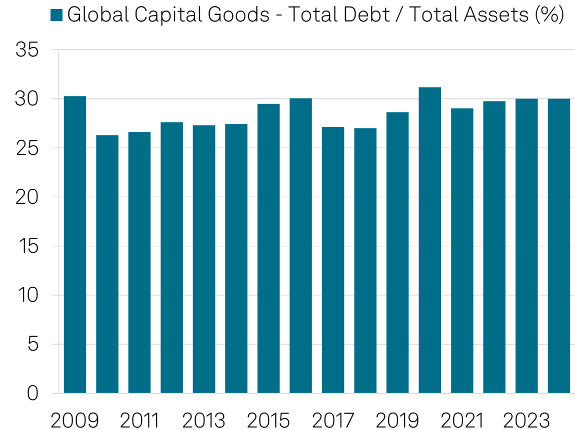


Chart 18

Total debt / Total assets



Source: S&P Capital IQ, S&P Global Ratings calculations. Most recent (2024) figures use the last 12 months' data.

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