Industry Top Trends Update

Technology

Pace of IT spending slowing, margin pressure in play

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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?

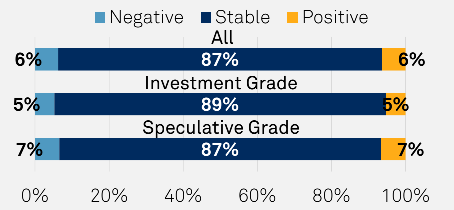
Further decline in IT spending. IT spending is highly correlated to global GDP, so a severe and lengthy recession in the U.S. could hurt tech companies' performance, especially in hardware. Slowdown in enterprise spending, potentially in the form of reduced data center investments, would be a signal 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.

Latest 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

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