Industry Top Trends Update

Chemicals

Slowdown, looming gas shortage dim second-half outlook

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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. First-half 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 through linked to energy cost 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.

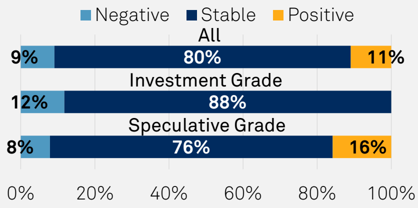
What if there's a recession?

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 adjust their capital allocation from more generous shareholder remuneration and higher capital spending to preserve ratings.

Outlook Distribution

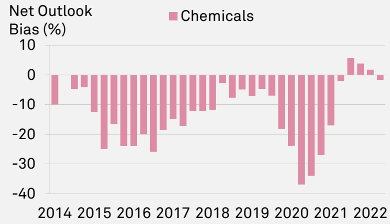


Ratings Statistics (YTD)*

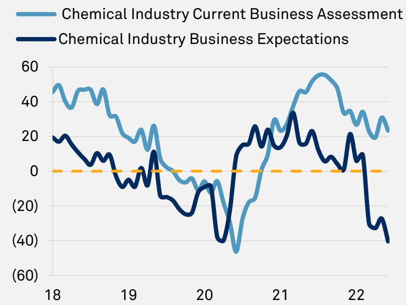
	IG	SG	All
Ratings	17	38	55
Downgrades	0	0	0
Upgrades	1	2	3

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