U.S. Corporate Credit Outlook Midyear 2022

Bracing For A Bumpy Ride

S&P Global Ratings

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Key Takeaways

- The U.S. is almost certain to suffer a "slow-growth recession," with corporate borrowers bracing for a sharp reversal in business conditions in the second half of the year—and a more pronounced economic downturn in 2023.
- Still, credit quality has proven resilient, and most companies enjoy solid liquidity positions after highly favorable financing conditions allowed them to refinance at better terms.
- The risks are weighted to the downside. Companies continue to deal with sharply higher input costs—with a finite ability to pass along these costs. If pressures don't ease, or if inflation begins to weigh heavily on demand, profit erosion will inevitably hit credit quality.
- Weakening demand is a key risk. We are already seeing signs of demand deterioration in the most price-sensitive sectors of consumer products and retail, and we expect this to spread to the consumer-facing subsectors of technology and—if advertising budgets are trimmed—to ad-driven media and entertainment providers, as well.

AUTHORS

David C Tesher
New York
+1 212-438-2618
david.tesher
@spglobal.com

Joe Maguire
joe.maguire
@spglobal.com

Yucheng Zheng
yucheng.zheng
@spglobal.com

Molly Mintz
molly.mintz
@spglobal.com

FINANCING CONDITIONS

Nick Kraemer
nick.kraemer
@spglobal.com

Evan Gunter
evan.gunter
@spglobal.com

Nicole Serino
nicole.serino
@spglobal.com

LEVERAGED FINANCE

Minesh Patel
minesh.patel
@spglobal.com

Steve Wilkinson
steve.wilkinson
@spglobal.com

Stephen Anderberg
stephen.anderberg
@spglobal.com

Hanna Zhang
hanna.zhang
@spglobal.com

CORPORATE RATINGS

Chiza Vitta
chiza.vitta
@spglobal.com

Amid the rising risk of recession in the world's biggest economy, U.S. corporate borrowers are bracing for a sharp reversal in business conditions in the second half of the year and into 2023.

As the Federal Reserve tries to navigate a soft landing, there's a growing chance that the central bank's ultra-aggressive monetary-policy tightening, combined with renewed consumer caution, has put a quick stop to the economic momentum that had gained speed since the pandemic-induced downturn. At the same time, runaway inflation—in particular, food and energy costs—is eating into Americans' purchasing power, and consumers have become more price-sensitive (see "Closing Time: The U.S. Retail Party Ends As Consumers Push Back On Inflation," published May 23). Any further belt-tightening could hit those sectors most reliant on consumer outlays, especially if discretionary spending declines substantially.

This is not to say we expect a surge in defaults in the near term. Credit quality has proven resilient so far, and most companies enjoy solid liquidity positions after highly favorable financing conditions during the post-COVID recovery allowed them to refinance at better terms (with lower coupons and longer maturities). Most have ample headroom at their current ratings. We now expect the U.S. trailing-12-month speculative-grade corporate default rate to reach just 3% by March 2023. But that would be more than double the 1.4% in March of this year; in our pessimistic scenario, the default rate would jump to 6%. At the same time, quickly rising borrowing costs could add pressure to those borrowers that need to refinance in the near term—especially those at the lower end of the ratings ladder.

The risks are clearly weighted to the downside. Many corporate borrowers we rate continue to deal with sharply higher input costs—with a waning ability to pass along these costs to customers and consumers. If cost pressures don't ease, and as inflation begins to weigh heavily on demand, the resultant profit erosion will inevitably hit credit quality (see "Credit Conditions North America Q3 2022: Credit Headwinds Turn Stormy," published June 28). Naturally, borrowers that are not in a good position to deal with an economic slump are most vulnerable.

As it stands, the U.S. will almost certainly suffer a "slow-growth recession"—a period of below-potential economic growth, accompanied by an increase in unemployment. And this may be the best-case scenario. There's also a good chance of a "technical" recession, commonly defined as two or more quarters of economic contraction.

While we don't expect a technical recession this year, the weight of extremely high prices amid continued supply chain disruptions and aggressive Fed policy tightening make a downturn next year more likely. S&P Global Economics' qualitative assessment of the risk of recession in the next 12 months is now at 40%, in a range of 35%-45%—with the risk greater in 2023. We now forecast full-year GDP growth of just around 2.0% this year and 1.6% in 2023, down from 2.4% and 2.0%, respectively, in our May interim forecast (see "Economic Outlook U.S. Q3 2022: The Summer Of Our Discontent," published June 27).

With inflation at a 40-year high, central bankers certainly have a tough row to hoe. After consumer prices jumped 9.1% in June from a year earlier (the highest since 1982), markets are now betting the Fed will raise its policy rate a full percentage point at its July 26-27 meeting—thus increasing the chance for a central bank-engineered recession.

The strong labor market and still-high U.S. personal savings rate are helping to stave off a downturn—for now. Given the U.S. has a deficit of roughly 2 million workers (in large part because of demographic issues), headline unemployment may stay low for some time. And the savings rate (on top of the "wealth effect" created by robust gains in house prices) has bolstered spending.

But consumers are becoming increasingly pessimistic, as measured by sentiment indexes, with any financial cushion they accumulated now quickly eroding. In fact, financial fragility is increasing measurably. Our Financial Fragility Indicator (FFI) continues to weaken, reaching negative 1.34 in March, from negative 1.83 at the end of last year. While that's still better than its historical average, suggesting near-term risks are modest, conditions will likely worsen as the Fed aggressively tightens monetary policy (see "Financial Fragility Of U.S. Households And Businesses: On The Rise While Still Below Its Historical Average," published July 11). Importantly, both the household and nonfinancial corporate sectors contributed to the worsening financial fragility, with nonfinancial corporates seeing the biggest jump into riskier territory.

In this light, **weakening demand is a key risk.** The number of companies that have revised their earnings guidance downward—or suspended it altogether—is troubling. Consumer sentiment never recovered to the extent that corporate earnings did in 2021, and sharp stock market declines are erasing much of the wealth effect that supported spending in the face of inflation. High wage gains have also been wiped out by inflation, and household savings (boosted largely by federal stimulus related to the pandemic) are being depleted. We are already seeing signs of demand deterioration in the most price-sensitive sectors of consumer products and retail, and we expect this to spread to the consumer-facing subsectors of technology and—if advertising budgets are trimmed—to ad-driven media and entertainment providers, as well. How and when a consumer pullback will hit travel and lodging remains to be seen. Earnings in these sectors have been bolstered by pent-up demand, but this won't last forever given the discretionary nature of this spending, and as capacity is rebuilt to bring supply closer to historical levels.

Ratings Trends

Earnings in many corporate sectors have returned to pre-pandemic levels, with notable exceptions including leisure and airlines, and companies have refinanced debt to take advantage of low interest rates and push out maturities. These trends have contributed to the improvement in our outlook bias, to just -3%, from close to -45% in mid-2020 (see table 1).

Table 1

Outlook Bias By Sector And Rating Category

Sector	IG	SG ex/CCC	CCC	ALL
Aerospace/defense	(33%)	13%	(33%)	(4%)
Auto/trucks	0%	0%	(50%)	(5%)
Business and consumer services	(17%)	5%	(88%)	(6%)
Capital goods/machinery and equipment	(15%)	(1%)	(64%)	(9%)
Chemicals	4%	6%	(50%)	4%
Consumer products	(13%)	(14%)	(90%)	(21%)
Forest products/building materials/packaging	0%	3%	N/A	2%
Gas	(5%)	12%	N/A	3%
Healthcare	(3%)	(3%)	(69%)	(7%)
High technology	2%	(2%)	(25%)	(2%)
Media, entertainment, and leisure	12%	10%	(44%)	3%
Mining and minerals	17%	2%	(40%)	1%
Oil	(4%)	17%	(27%)	8%
Real estate	5%	9%	100%	7%
Restaurants/retailing	3%	6%	(77%)	(2%)
Telecommunications	(8%)	(6%)	(60%)	(10%)
Transportation	13%	11%	(100%)	9%
Diversified	(33%)	0%	N/A	(25%)
Diversified energy	0%	0%	N/A	0%
Electric	0%	N/A	N/A	0%
Energy merchants	25%	(8%)	N/A	0%
Independent power producers	0%	0%	N/A	0%
Integrated	(50%)	(27%)	(67%)	(38%)
Regulated transmission/transport	0%	N/A	N/A	0%
Regulated utilities	(2%)	(67%)	N/A	(4%)
ALL	**(2%)**	**2%**	**(59%)**	**(3%)**

Note: Corporate and infrastructure ratings. Includes U.S. and Canadian issuers as of July 18, 2022. Outlook bias defined as positive outlooks and credit watches minus negative outlooks and credit watches divided by total number of ratings.
Source: S&P Global Ratings.

Despite intensifying downside risks, the outlook bias overall remains relatively neutral, reflecting our expectation that many issuers can support their ratings just beyond the one-year outlook horizon for speculative-grade ratings, and the two-year horizon for investment-grade. Additionally, the portfolio is buoyed by the oil and gas sector, which was already enjoying higher commodities prices prior to the Ukraine conflict; and while oil has come off its recent highs, we expect the price to remain elevated. Some metals and mining issuers have also had a somewhat similar trajectory. Finally, sectors such as automobiles continue to report that volumes, backlogs, and pricing are holding. Generally, companies are keeping up with maintenance capital spending requirements, although acquisitions are markedly down.

Key Risks

1. Increasing prospect of a recession, weakening demand

Against the backdrop of higher recession risk amid elevated inflation and aggressive Fed policy tightening, the number of companies issuing negative earnings guidance is rising, and many are revising guidance downward, or temporarily suspending it altogether. How consumer and business demand evolves remains a key consideration.

Discretionary spending is likely to be hit first, fueled by diminished purchasing power and consumer fears, even if there isn't a formal recession. For example, consumer durables and retail stores focusing on home, sporting goods, and other categories that benefited during the pandemic are at risk. In the media space, the out-of-home entertainment segment including live events, concerts, and theme parks will likely be hurt first, followed by advertising as advertisers react to weaker sales. Consumers could also cut back their streaming subscriptions or increase churn across services. On the other hand, pent-up demand for travel and leisure activities is still strong, and airlines and hotels look set to enjoy strong near-term revenues during the summer season. Some casual-dining companies are benefiting from ongoing consumer demand for experiences. As people return to office, go out to eat, and take vacations, they are switching to dressier attire from basics, catching some apparel retailers off-guard. However, such momentum may not last long.

Winners and losers may emerge as consumers push back on high prices or become more selective in their spending. For example, off-price and deep discounters and private label consumer products could benefit from the trade-down. Building materials companies that focus on nondiscretionary products such as roofing or heating and cooling systems could be more resilient than manufacturers of more discretionary products such as kitchen cabinetry and bath wares. For the auto sector, though we don't assume any material shifts away from trucks to sedans, consumers could downsize toward entry-level products within each segment.

Business demand is at risk as well. Weakening demand from key end markets such as agriculture, housing, auto, and general industrial could reverse favorable conditions that have enabled chemical companies to handle rising costs. Information technology (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. A 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.

2. Cost inflation, supply issues, labor constraints weigh on margins

Commodities costs could stay elevated. Oil prices remain high and could increase further. With the EU and other nations effectively banning Russian oil, the dearth in supply is unlikely to be made up from OPEC or North American shale producers that continue to remain disciplined on production and focused on generating cash flow to be returned to investors. All this has been occurring despite the COVID-driven shutdowns in China. With China reopening, we are expecting further increases in demand, and with global inventory levels at five-year lows, we will likely see further increases in oil prices, barring a recession. With Europe also trying to reduce its reliance on Russian gas by two-thirds come October, global gas supplies are being diverted to Europe where the Title Transfer Facility (or TTF, a Netherlands-based natural gas exchange) had been at record highs. The Henry Hub price has responded in kind, effectively becoming more globalized. Barring a major recession, we think it's likely that oil and natural gas prices will remain high well into next year.

We forecast the greatest margin expansion in the oil and gas sector this year as it benefits from elevated commodities prices and a geographically robust customer base. While airlines, cruises, and lodging face similar tailwinds, this is partly due to comparisons against a weak 2021 and pent-up demand. We don't expect this to persist given the discretionary nature of this spending, and as capacity is rebuilt to bring supply closer to historical levels. In contrast, consumer products and retail companies are finding it increasingly challenging to maintain margins. We expect margins in these sectors to fall a lot, partly as a result of weakening demand dynamics that will make it more difficult to pass on high input costs (see chart 1).

Chart 1

Pass-Through Ability And EBITDA Margin Trends By Sector

Average EBITDA Margins in 2022 vs. 2021

Question: Reflecting your assumptions for costs, product mix and any other relevant factors, how do you expect average EBITDA margins to develop for 2022 versus 2021?

Cost Pass-through Ability — Question: How easy is it to pass on cost increases?

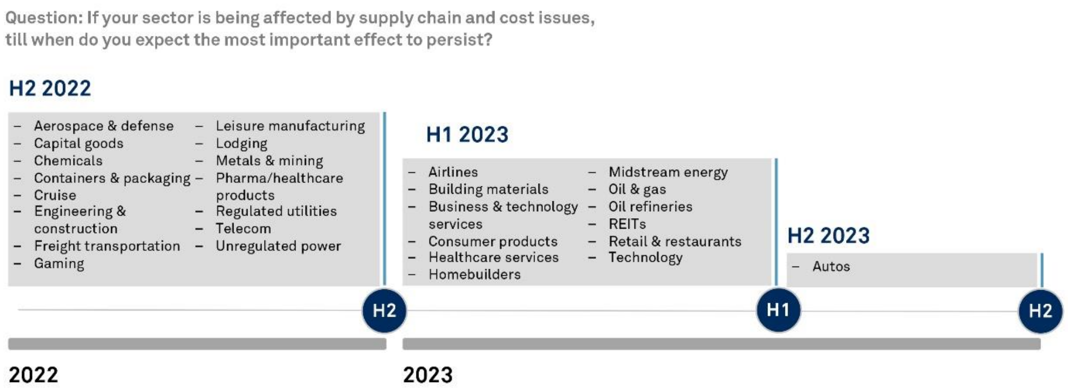
	Rise a lot	Rise moderately	Rise a little	Fall a little	Fall moderately	Fall a lot
Very easy		• Out-of-home entertainment		• Metals & mining • Regulated utilities		
Somewhat easy	• Airlines • Cruise • Lodging	• Aerospace & defense	• Containers & packaging • Leisure manufacturing • Pharma • Technology • Unregulated power	• Autos • Building materials • Capital goods • Chemicals • Engineering & construction • Freight transportation • Gaming • Homebuilders • REITs • Telecom		
Impossible to generalize	• Oil and gas • Oil refineries		• Midstream energy	• Business & technology services		
Somewhat difficult				• Healthcare services	• Film and TV programming production	• Retail & restaurants
Very difficult						• Consumer products

Source: S&P Global Ratings' corporate sector analysts' assessment as of June 23, 2022.

Most industries continue to contend with supply disruptions, with an expectation that there won't be a material improvement until at least the end of the year (see chart 2). Freight costs, backlogs, and shipping delays are generally better than they were six months ago, but still far from pre-pandemic levels. This suggests that logistics and distribution challenges will continue to have cost consequences, and the supply side is unlikely to contribute to easing inflation any time soon.

Chart 2

Most Sectors Expect Supply Bottlenecks To Linger

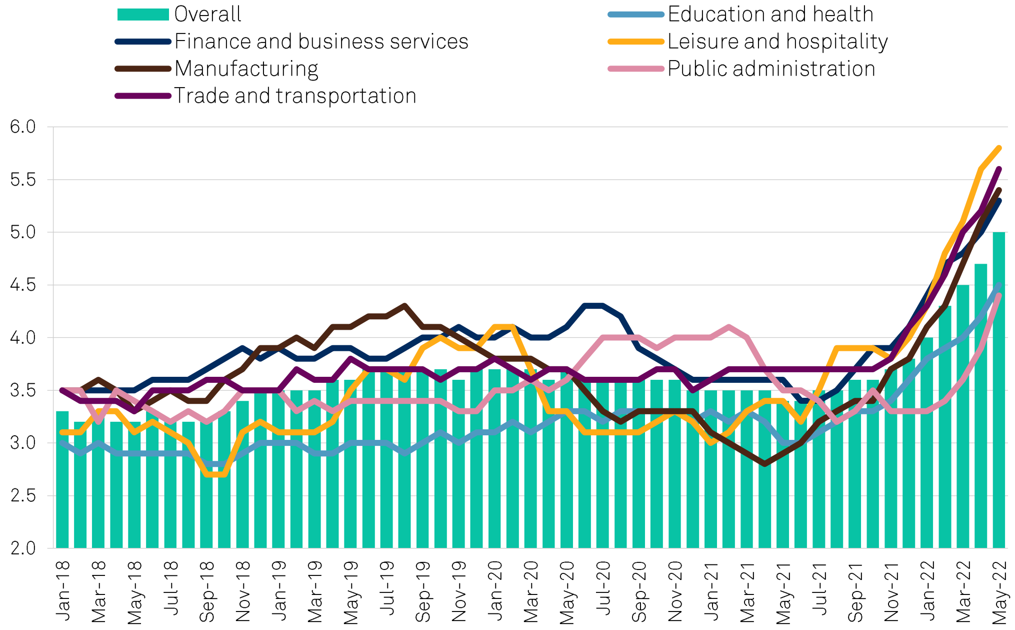


Source: S&P Global Ratings' corporate sector analysts' assessment as of June 23, 2022.

Wage pressures, too, aren't just complicating the job of Fed policy makers as they look to quell inflation, but also adding to corporate costs. In a labor market that has almost two open jobs for every available worker, wage gains for nonsupervisory employees are at the highest in almost four decades—especially in lower-income fields such as leisure and hospitality. Companies added 372,000 jobs in June, on top of May's 384,000; that's well above the average gains under more normal circumstances and brings private-sector employment back to where it was pre-COVID (although public-sector employment is still well below 2019 levels). With headline unemployment remaining at 3.6%, average hourly earnings jumped 5.1% from a year earlier. According to Atlanta Fed Wage Growth Tracker, leisure and hospitality and trade and transportation industries have seen the most wage increase in the past 12 months (see chart 3).

Chart 3

Leisure And Hospitality, And Trade And Transportation Have Seen The Most Wage Increases In The Past 12 Months



Source: Federal Reserve Bank of Atlanta Calculations. The data are 12 month moving averages of monthly median wage growth for each category. Wage computed on an hourly basis. Data as of May 1, 2022.

Looking ahead, the majority of our corporate sectors expect labor costs to rise in the coming 12 months. Labor constraints and costs are particularly acute for some of them. For example, 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. In healthcare, the hard-pressed service providers, such as hospitals, have seen significantly elevated labor costs and staff shortage, especially on nursing.

3. Health of the real estate market

Shortly after the pandemic began in early 2020, the pace of U.S. home-price growth increased dramatically before stabilizing at an approximate annualized 20% rate of appreciation a year or so ago. While this pace is unsustainable, we believe home prices are supported by several fundamental economic factors that are unlikely to end any time soon.

Most significant among these is the demand-supply imbalance. Millennials continue to make up the largest share of homebuyers, and despite this cohort's increasing demand, the past decade marked a period of underbuilding in the residential housing market.

While privately owned housing completions have increased steadily since the Global Financial Crisis (GFC), the figure was less than 1.5 million units (seasonally adjusted, annualized) as of May—well below the more than 2 million in 2006. Because there is a shortage of several million homes in the U.S., the pace of building would have to increase substantially to meet demand in coming years. This dominating driver of prices is unlikely to be entirely offset by opposing factors. Indeed, we expect continued price appreciation nationally, albeit at a more subdued pace, with declines only in certain regions.

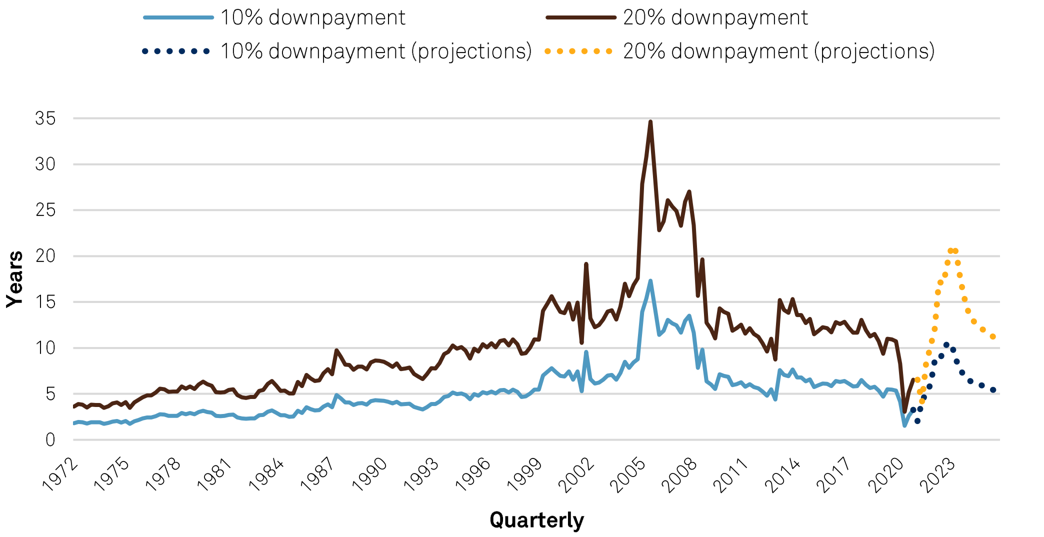
Naturally, interest rates are another important part of the home-price story. From July 2020-November 2021, the 30-year fixed-rate mortgage was typically below 3%. While this eased some of the affordability constraints across the country, it also contributed to upward pressure on home prices. According to the S&P Global Ratings measure of relative housing affordability, the U.S. is roughly 15% overvalued in the aggregate. At a more granular level, approximately 88% of regions we monitor are overvalued, with several by more than 40% and one by almost 70%.

Most Americans take out fixed-rate mortgages to purchase homes. To manage monthly costs in the current rate environment, however, the proportion of adjustable-rate mortgages may increase. The 30-year fixed mortgage rate has increased sharply, and as of mid-June the Freddie Mac survey rate registered 5.78%—the highest since 2008. This rising rate environment has further eroded housing affordability, especially with inflation at a 40-year high. Moreover, higher rates may disincentivize some homeowners to sell—and give up a very low mortgage rate locked in over the past few years—which could exacerbate the supply shortage.

As it stands, roughly 60% of American households may find a typical mortgage for a starter home unaffordable after this year (with affordability defined as mortgage payments at less than 25% of income). It would take roughly a decade for a first-time home buyer to save up a 10% down payment for a starter home in 2025 versus six years from 2010-2019, with lower-income prospective buyers finding it even harder to do so (see chart 4).

Chart 4

Number Of Years To Save For Down Payments, First-Time Homebuyers



Note: Dotted line indicates projections/estimates from 2021 to 2025. Sources: U.S. Census Bureau, U.S. Department of Housing and Urban Development, Freddie Mac, U.S. Bureau of Economic Analysis, Federal Reserve Bank of St. Louis, and S&P Global Ratings Economics Calculations.

Although the most recent reading of the S&P Case-Shiller U.S. National Home Price Index was up 20.4% year-over-year in April, most borrowers lock in mortgage rates two to three months in advance. This suggests that any effect of rising rates on home prices will manifest only in the coming months. As the 10-year Treasury rate and the closely linked 30-year fixed-rate mortgage go up, we expect some downward pressure on home prices. However, the extent to which rising rates offset the effect of the supply-demand imbalance remains to be seen.

Certain corporate sectors are highly correlated with the housing market. For homebuilders, rapidly 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. Softer-than-expected pricing power, rising costs, and increased incentives to complete closings could pressure margins as we head into 2023. In the case of REITs, property types that are more vulnerable to a recession are retail and office, while we expect industrials and rental housing to remain more resilient due to robust demand.

A recession would 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 demand. Office real estate saw the steepest decline in rent during the GFC and took longer to recover, although a decline would likely 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. Meanwhile, 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.

4. Renewed COVID risk

While the economic effect of COVID waves has lessened over time, and official social restrictions far less likely to be implemented, the pandemic is still with us, as the latest variants show. Large surges could be problematic for sectors that are still trying to recover from the worst days of the pandemic. For example, a resurgence of the virus or a new variant could cause the recovery in air travel to slow or reverse. Services sectors as a whole (restaurants, leisure, etc.) remain vulnerable to consumer reluctance. For the healthcare sector, a steep drop in COVID-related admissions could lead to top-line misses should the recovery in non-COVID admissions lag.

5. Geopolitical, policy

Defense demand is supported by an increase to the fiscal 2022 U.S. budget and fiscal 2023 budget proposal, and increased spending by European allies in response to the Russia-Ukraine conflict—but won't begin generating higher revenue until at least next year. Certain sectors already considered key (intelligence, reconnaissance, cyber) will be even more in demand.

Global supply disruptions and inflation due to raw-materials scarcity are critical risks for the auto industry. Specifically, the impact from the disruption of critical auto parts from the region, including wire harness manufacturing in Ukraine, potential shortages for materials like palladium and price hikes for steel, copper, aluminum, and nickel represent key industry risks.

Financing Conditions

PRIMARY CONTACTS

Nick Kraemer
nick.kraemer
@spglobal.com

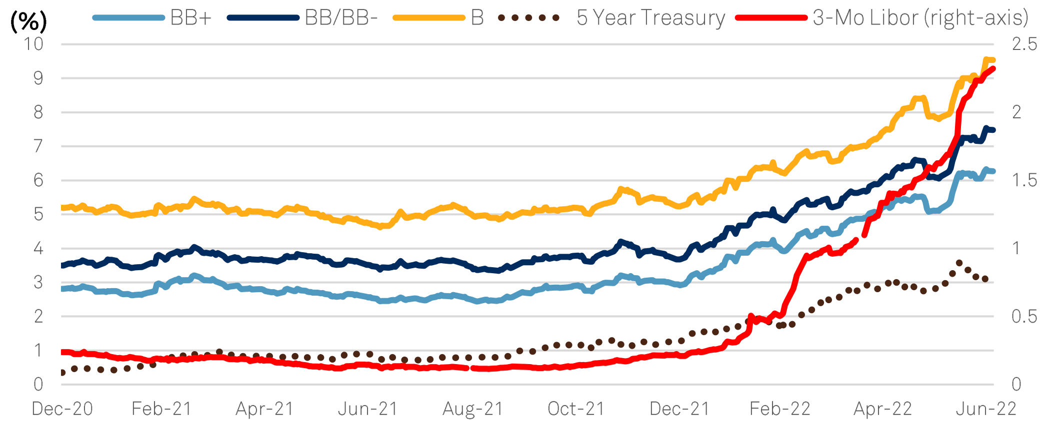
Evan Gunter
evan.gunter
@spglobal.com

Nicole Serino
nicole.serino
@spglobal.com

Financing conditions for borrowers across public and private sectors began the year very favorably, and in line with 2021. But almost as soon as the year began, rates began to rise—and quickly—as sentiment around the Fed's pace and extent of tightening took root. From Treasuries to municipal debt to both fixed- and floating-rate investment-grade and speculative-grade corporate debt, yields have climbing this year (see chart 5).

Chart 5

U.S. Speculative-Grade Corporate Industrial And Treasury Bond Yields

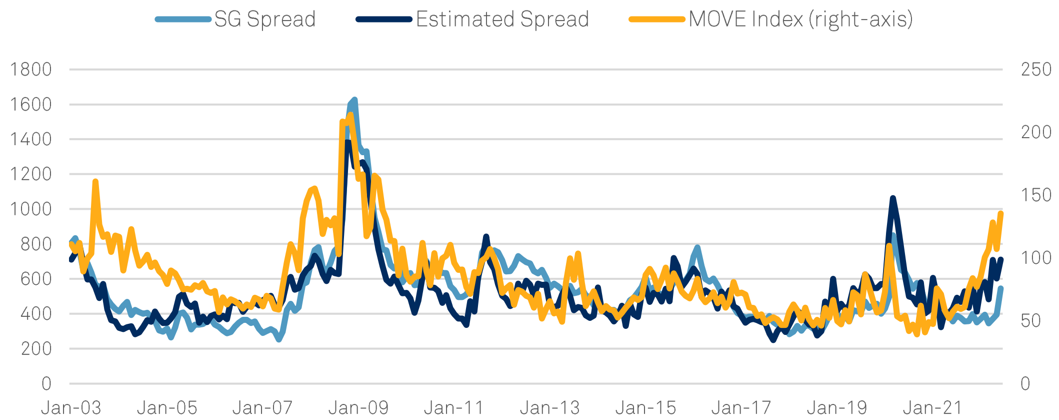


Source: Data as of July 5, 2022. Source: S&P Global Ratings Research.

Because yields on risk-free benchmarks around the world have risen at a faster pace than those on riskier corporate debt, spreads have largely remained subdued. But that has changed in recent weeks as Treasury yields have fallen off, while speculative-grade yields have continued to rise. This could be an early signal of a recession, especially if this divergence in yields persists; in fact, this is often the case during downturns as markets pursue a "flight to safety." And even at current levels, spec-grade corporate spreads may have room to widen (see chart 6). At the end of June, our estimated spread was 711 basis points (bps), 164.5 bps above the actual spread. Adding to the mix, the MOVE index (Merrill Lunch Option Volatility Estimate, which acts as a volatility gauge for Treasuries) is also proportionately higher now relative to speculative-grade spreads. The last time this happened to this extent was in the lead-up to the financial crisis .

Chart 6

Actual Versus Estimated Spreads



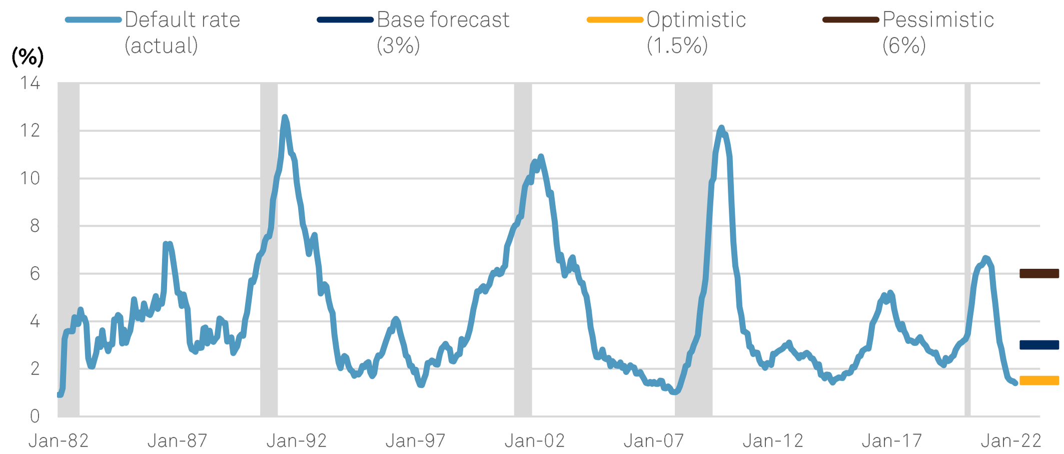
Source: Data as of July 5, 2022. Source: S&P Global Ratings Research.

Year-to-date bond issuance has fallen noticeably across all major asset classes as yields have risen, and arguably at a faster rate of pullback than historically. But this is largely a correction from an abundance of issuance: 2020 and 2021 generally set new—or recent—records for issuance by sector, and what appears to be happening now is a return to more "normal" levels of issuance. Companies, particularly nonfinancial corporates, have used the funds raised in the past two years to refinance debt at better terms, push out maturities, and stockpile cash. In many ways, most issuers don't need to come to market as much as usual, and are being additionally disincentivized by steeply rising yields.

We expect the trailing-12-month speculative-grade default rate to rise to 3% by March 2023. And while that's below the historical average of 4.1% (see chart 7), this doesn't mean risks aren't building. In fact, many are: the cost to fund floating-rate debt is rising quickly, and input costs (including wages) are rising at their fastest rate in more than 40 years, which should start to weigh on earnings. With markets starting to serisouly consider a recession looming, all signs point to an unavoidable rise in credit stress.

Chart 7

U.S. Trailing-12-Month Speculative-Grade Default Rate And Forecast

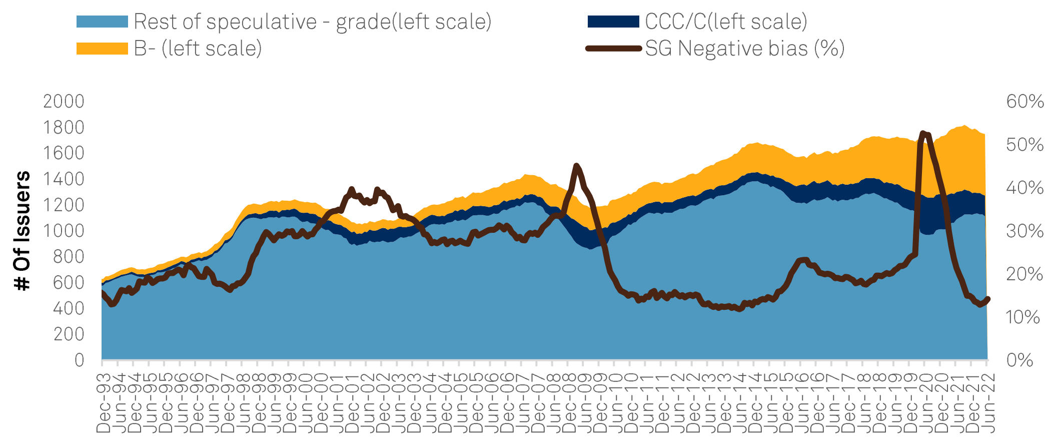


Note: Shaded areas are periods of recession as defined by the National Bureau of Economic Research. Sources: S&P Global Ratings Research and S&P Global Market Intelligence's CreditPro®.

First-half ratings actions among U.S. corporates have generally continued the historically favorable trend of 2021, with upgrades either exceeding or keeping pace with downgrades (see chart 5). Issuers remain relatively resilient as consumers have continued to spend. Any sudden change in this behavior could be espcially painful, given that our corporate ratings population is notably weak (see chart 8). Downgrades from 2020 through today still greatly outnumber upgrades. And the speculative-grade negative bias (the proportion of issuers with a negative outlook or CreditWatch) has started to rise—albeit off of one of its lowest points in history.

Chart 8

U.S. Nonfinancial Corporate Ratings



Note: Data as of June 30, 2022. Source: S&P Global Ratings.

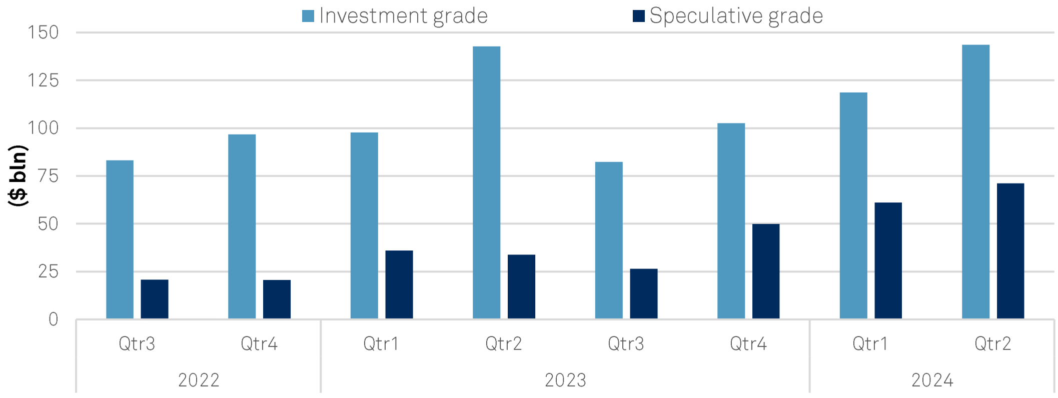
Corporate Maturities Appear Broadly Manageable

U.S. corporate debt maturities pose seemingly little problem in the next 24 months. The maturity wall for nonfinancial corporates doesn't peak until 2026, offering companies several years in which to refinance or pay down debt.

Companies have $221 billion in rated debt (including bonds, notes, loans, and revolving credit facilities) due in the second half of this year, followed by $310.5 billion in the first half of 2023 (see chart 9). Nearly 80% of debt coming due in the next 12 months is investment-grade.

Chart 9

U.S. Nonfinancial Corporate Maturities In The Next 12 Months

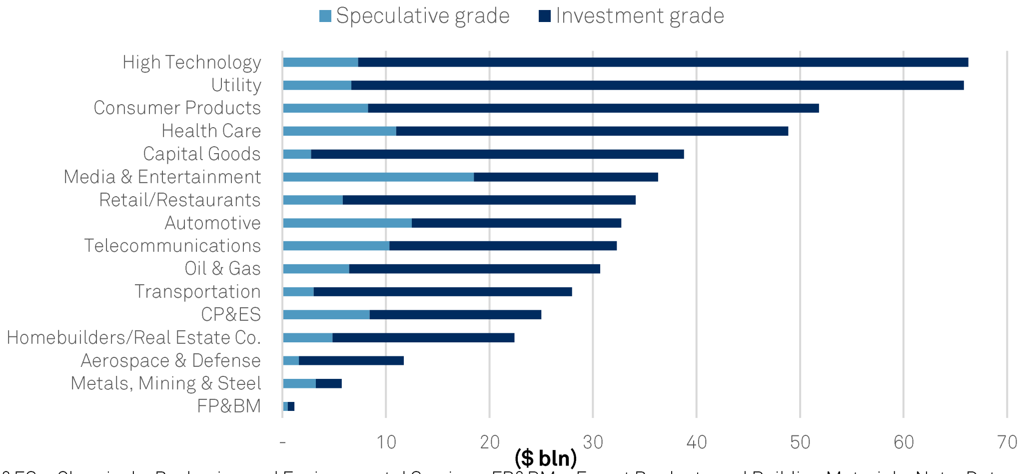


Note: Data as of July 1. Chart shows maturities of nonfinancial corporate debt, including bonds, loans, and revolving credit facilities that are rated by S&P Global Ratings from nonfinancial corporate issuers in the U.S.
Source: S&P Global Ratings Research.

Speculative-grade maturities in the second half total just $41 billion and rise to nearly $70 billion in the first half of 2023. By contrast, capital markets continue to show more than sufficient capacity to meet upcoming refinancing demands (see chart 10). Even with volatile markets contributing to challenging financing conditions for lower-rated borrowers, issuance of speculative-grade bonds and leveraged loans totaled near $350 billion in the first half of 2022. However, individual issuer risks remain. Companies at the low-end of spec-grade, particularly those viewed as distressed by the market, could face higher funding costs and limited options to refinance. These challenges are heightened as investor risk-aversion grows in response to lingering uncertainty and volatility in the primary markets.

Chart 10

U.S. Corporate Maturities In The Next 12 Months By Sector



CP&ES—Chemicals, Packaging and Environmental Services. FP&BM—Forest Products and Building Materials. Note: Data as of July 1. Chart shows maturities through June 30, 2023, of nonfinancial corporate debt, including bonds, loans, and revolving credit facilities that are rated by S&P Global Ratings from nonfinancial corporate issuers in the U.S.
Source: S&P Global Ratings Research.

Leveraged Finance

PRIMARY CONTACTS

Minesh Patel
minesh.patel
@spglobal.com

Steve Wilkinson
steve.wilkinson
@spglobal.com

Stephen Anderberg
stephen.anderberg
@spglobal.com

Hanna Zhang
hanna.zhang
@spglobal.com

Operating and market conditions will likely remain volatile, with risks weighted to the downside into next year as the Fed prioritizes fighting inflation over supporting growth. Financial tightening and other economic friction—e.g., supply chains, labor shortages—will weigh on operating prospects across the speculative-grade universe, and for many vulnerable issuers, our focus will shift to the potential for downgrades. However, as is typical early in a rate-hiking cycle, many issuers' operating performance continues to benefit from growth momentum, healthy profit margins, and demand-driven cost pass-through. Median gross leverage, as reflected in our statistics for a static pool of 1,056 issuers (almost two-thirds of the spec-grade nonfinancial companies we rate in the U.S. and Canada) has returned to 2019 levels (see table 2), and credit measures will likely continue to be relatively favorable as companies report second-quarter results. That said, our ratings are structurally lower than they were pre-pandemic or any time before.

Table 2

Median Gross Leverage (x), Reported Last 12 Months

Issuer Credit Rating*	Entity Count	2019	2020Q1 LTM	2020Q2 LTM	2020Q3 LTM	2020	2021Q1 LTM	2021Q2 LTM	2021Q3 LTM	2021	2022Q1 LTM
BB+	104	3.2	3.4	3.7	3.5	3.2	3.2	3.0	2.8	3.1	2.9
BB	117	3.3	3.5	4.0	4.0	3.8	3.8	3.2	3.0	3.1	3.0
BB-	97	3.9	4.0	4.4	4.3	3.5	3.8	3.1	2.9	3.2	3.4
B+	168	4.8	5.5	6.1	5.6	5.6	5.1	4.4	4.3	4.0	4.1
B	228	5.6	6.4	6.8	6.4	6.4	6.3	6.0	6.0	6.0	6.0
B-	264	7.7	8.3	8.4	8.4	9.5	9.2	8.7	8.7	8.3	8.2
CCC+	81	9.0	9.9	14.8	13.9	14.6	14.6	13.0	13.8	14.0	13.3
CCC	23	9.2	10.3	36.0	20.0	11.9	12.5	11.7	15.9	28.0	21.9
CCC-	3	6.0	6.4	16.5	15.4	8.9	9.5	9.8	10.6	11.1	10.8
CC	2	7.7	6.2	6.0	5.9	5.5	6.4	6.0	7.2	7.9	7.5
Total	**1,087**	**5.3**	**6.1**	**6.7**	**6.4**	**6.4**	**6.2**	**5.6**	**5.6**	**5.6**	**5.4**

*Rating as of June 28, 2022; Leverage is calculated as reported gross debt over reported EBITDA, without adjustment by S&P Global Ratings. The sample in this study is rebalanced each quarter following selection criteria. LTM--Last 12 months. Source: S&P Global Ratings.

Cracks have started to emerge in some vulnerable sectors. While profit growth remains positive overall, the pace has slowed for the third consecutive quarter. Median last-12-month (LTM) EBITDA growth (as reported and without adjustment) declined to 2.8% at the end of March, from 3.8% three months earlier and as high as 10.7% in the second quarter of 2021. There was a decline in EBITDA growth in 13 of the 16 sectors we track, with seven suffering a fall of two percentage points or more.

We believe credit risks will build at the lower end of the credit spectrum, and deficits in free operating cash flow (FOCF) generation are the most significant risk for issuers rated 'B' and below. This population is large, representing more than 60% of our spec-grade portfolio; has high leverage (45% have S&P Global Ratings-adjusted leverage of more than 7.5x); has weak cash flow generation (about 65% reported FOCF-to-debt of less than 3%), and has modest cash balances (about 42% had cash-to-debt of less than 5%). Median LTM FOCF to debt dropped another 1.1 percentage points in the first quarter, to 2.8%, down from 3.9% at year-end 2021 and 7.1% in the first quarter of 2021. This could be problematic for our most vulnerable issuers, especially if earnings pressure causes springing revolving credit facility leverage covenants to trigger and limit borrowing availability.

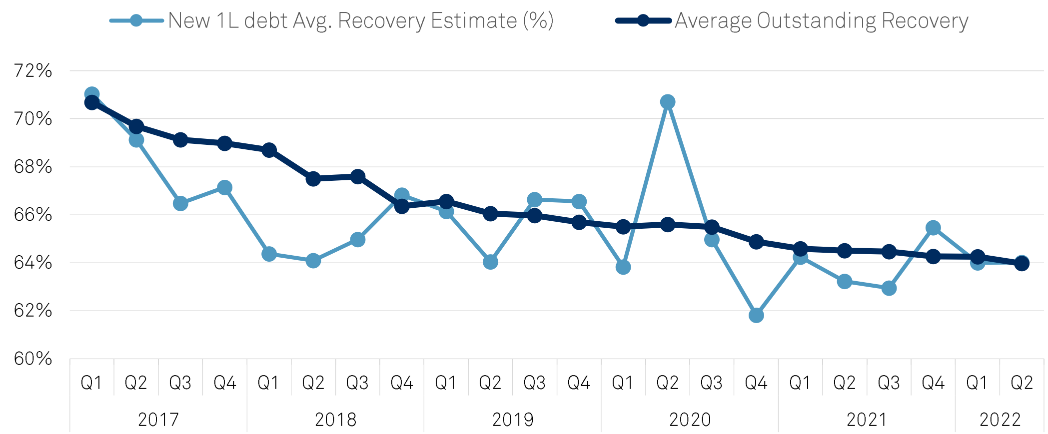
Aggressive policy tightening from the Fed is highly negative for leveraged credit, especially for loan investors, since companies that rely on loan financing tend to be smaller and more highly leveraged. On the other hand, balance sheets for companies even at the lower end of the speculative-grade scale have generally improved enough to withstand a short period of adverse operating conditions. For now, we believe our ratings will be relatively resilient, but we expect the proportion of U.S. spec-grade issuers with negative outlooks will trend back to its historical average levels in the 20%-25% range, from about 15% today. Downgrade risks are building as the cumulative effects of rising interest rates, weaker growth, and inflation take a growing bite out of issuers' profitability and cash flow. In our high-stress downside scenario, where we stress our forecast EBITDA margins by 15% and increase cash interest costs by 2%, the share of issuers generating negative FOCF jumps to about 39%, and we estimate that about 20% of our 'B' and 'B-' ratings become at risk for a downgrade.

Economic (And Credit) Worries Bring Recovery Into Focus

Investors are increasingly focused on recovery prospects amid signs of a turn in the credit cycle. During the long stretch of favorable borrowing conditions, highly leveraged issuers rated 'B' and lower often found that it was relatively easy to finance their investment needs with debt capitalizations dominated by first-lien debt, since this is among the cheapest financing. Naturally, recovery expectations for first-lien debt of the 'B' rated and lower cohort of companies are lower with higher levels of first-lien debt seeking recovery from the same assets (see chart 11).

Chart 11

Expected Recoveries On First-Lien Debt: U.S. And Canada



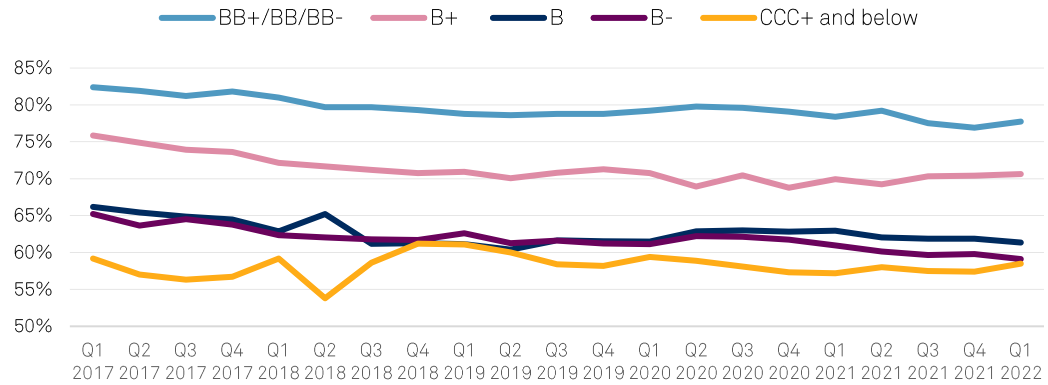
Source: S&P Global Ratings.

In addition, as the proportion of speculative-grade issuers at the low end of the ratings scale has expanded, average recovery prospects for first-lien debt lenders have declined steadily (see chart 12). As a second-order effect, weaker first-lien recoveries also tend to diminish recovery prospects for junior debt lenders, especially for companies with high levels of first-lien debt.

Loan documentation has weakened over time, which may increase event risk. Most documents provide borrowers ample capacity to increase debt or transfer value outside of the credit group, which could decrease lender recoveries even for senior secured lenders at (or near) the top of the debt stack. In recent years, there has been a notable rise in the number of issuers using this flexibility to undertake aggressive restructuring tactics--such as collateral transfers and priming loan exchanges (sometimes more benignly referred to as "asset drop down" and "uptiering" transactions)--that impair first-lien recovery expectations. However, while these transactions remain relatively rare, the risk is that such actions will become more frequent as the market becomes acclimated to them. Also worth noting is that a common denominator for companies that took aggressive restructuring actions in recent years is private equity ownership, which is a risk since roughly 50% of speculative grade firms are sponsor owned.

Chart 12

Average Recovery Prospects for First-Lien Debt: U.S. and Canada



Source: S&P Global Ratings.

Collateralized loan obligations (CLOs)

Despite the increase in negative sentiment and falling loan prices, credit metrics across broadly syndicated loans (BSL) CLO collateral pools continue to be stable, albeit with investors and managers watching closely for any cracks to appear. As of July 1, U.S. BSL CLO collateral pools had an average of 4.01% of assets in their 'CCC' baskets, down from 4.94% at the start of the year and compared with a typical limit of 7.5%, above which the value of the assets is haircut for purposes of calculating the CLO's coverage test ratios. Underneath that average, however, there is a wide range of exposure to 'CCC' assets, with some pre-2020 vintage CLOs (those that went through the pandemic) near their 7.5% threshold, while 2020 and later vintage CLOs tending to be much lower. If more corporate ratings start to suffer downgrades into the 'CCC' category, some of these pre-2020 vintage CLOs could overflow their 'CCC' asset baskets and start to fail junior coverage ratio tests.

Other metrics have also generally been stable. The average rating in CLO collateral pools has barely changed since the start of the year. Assets from companies with ratings on CreditWatch negative have edged up, to 1.35%, from 0.88% in January, but this remains low in absolute terms. As a result of the drop in assets from 'CCC' rated obligors, the average CLO's junior OC test cushion has edged upward ever so slightly, to 4.45% now versus 4.37% at the start of the year.

Related Research

- Global Credit Conditions Q3 2022: Resurfacing Credit Headwinds, June 30, 2022
- Credit Conditions North America Q3 2022: Credit Headwinds Turn Stormy, June 28, 2022
- Economic Outlook U.S. Q3 2022: The Summer Of Our Discontent, June 27, 2022
- Where To Look For Refinancing Vulnerabilities Through 2023 Amid Market Turmoil, June 13, 2022
- Food Fight: U.S. Grocery Leads Retail Sectors Chewed Up By Inflation, Cost Pressures, May 31, 2022
- Searching For Stress Fractures: Evaluating The Impact Of Interest Rate And EBITDA Stresses On U.S. Speculative-Grade Corporates, May 25, 2022
- Closing Time: The U.S. Retail Party Ends As Consumers Push Back On Inflation, May 23, 2022
- The U.S. Speculative-Grade Corporate Default Rate Could Reach 3% By 2023 As Risks Continue To Increase, May 19, 2022
- U.S. Packaged Food Companies Could Fail Additional Inflationary Stresses, April 21, 2022

This report does not constitute a rating action.

North American Industry Top Trends Update

Aerospace and Defense

Commercial aircraft are supply constrained

Ben Tsocanos
New York
ben.tsocanos@
spglobal.com
+1 212 438 5014

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.

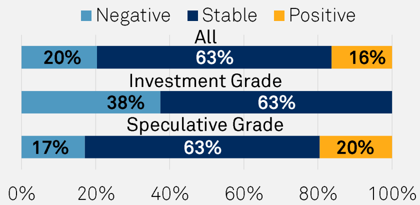
What if there's a recession?

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.

Outlook Distribution

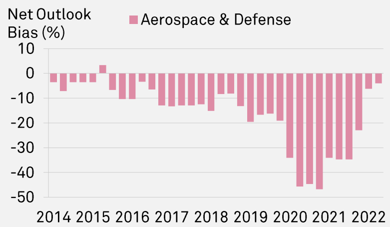


Ratings Statistics (YTD)*

	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



Latest 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

North American Industry Top Trends Update

Autos

Rising costs and demand pressure reduce ratings cushion

Nishit Madlani
New York
nishit.madlani@
spglobal.com
+1 212 438 4070

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.

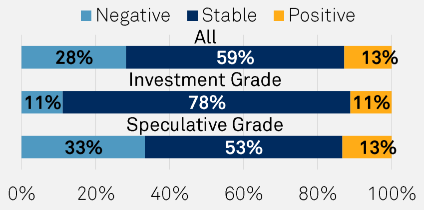
What if there's a recession?

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.

Outlook Distribution

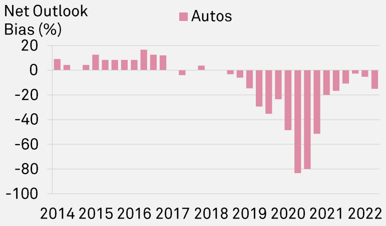


Ratings Statistics (YTD)*

	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



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- 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

North American Industry Top Trends Update

Building Materials

Diminishing tailwinds could pressure ratings

Ana Lai, CFA
New York
Ana.lai@
spglobal.com
+1 212 438 6895

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.

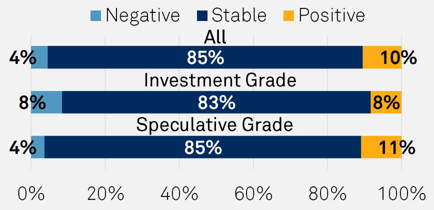
Weaker ability to pass on cost increases. Pushback by consumers could limit pricing power and put greater pressure on margins even if cost pressure subsides to some extent.

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.

Latest 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

Outlook Distribution

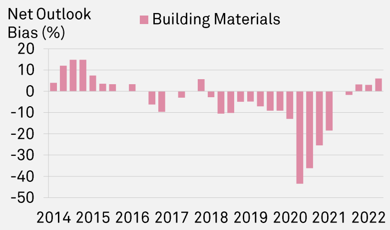


Ratings Statistics (YTD)*

	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



North American Industry Top Trends Update

Capital Goods

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

Don Marleau, CFA
Toronto
donald.marleau@
spglobal.com
+1 416 507 2526

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.

Latest 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

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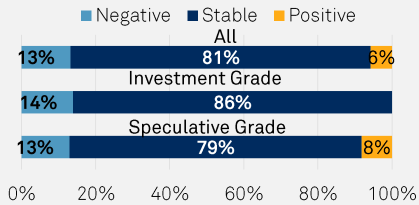
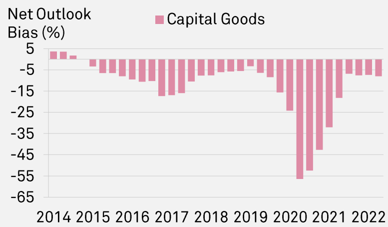


Ratings Statistics (YTD)*

	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



North American Industry Top Trends Update

Chemicals

Favorable demand, constrained supply offset rising costs

Paul Kurias
New York
paul.kurias@spglobal.com
+1 212 438 3486

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.

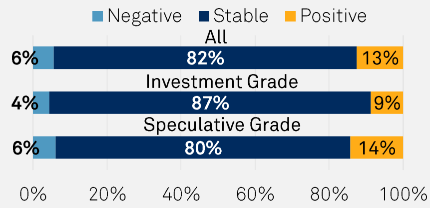
What if there's a recession?

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.

Outlook Distribution

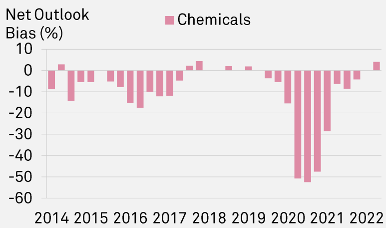


Ratings Statistics (YTD)*

	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



North American Industry Top Trends Update

Consumer Products

A weaker consumer intensifies pressure

Sarah Wyeth
New York
sarah.wyeth@
spglobal.com
+1 212 438 5658

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?

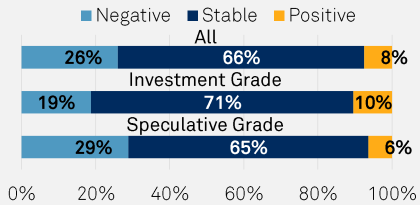
Household staples should fare well. Historically, packaged food companies fare well during a recession--consumers eat at home more and trade down to private label--and we expect that trend to continue.

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.

Latest Related Research

- Credit FAQ: Inflation Hasn't Quenched U.S. Beverage Companies' Thirst For Growth, May 17, 2022
- U.S. Packaged Food Companies Could Fail 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

Outlook Distribution

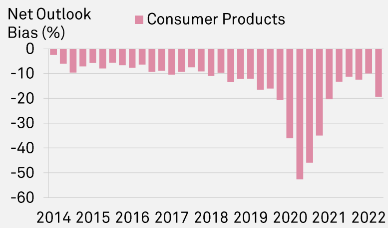


Ratings Statistics (YTD)*

	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



North American Industry Top Trends Update

Health Care

Inflationary pressures on margins

Arthur Wong
Toronto
arthur.wong@
spglobal.com
+1 416 507 2561

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 leant 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.

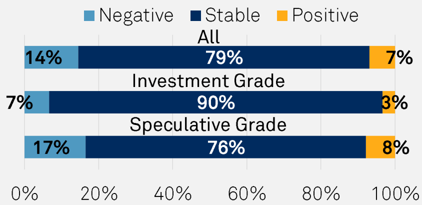
Loosening of labor market? A recession could be a positive for the hard-pressed service providers, such as hospitals, that have seen significantly elevated labor costs, especially on nursing.

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.

Latest 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

Outlook Distribution

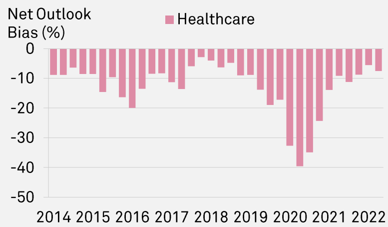


Ratings Statistics (YTD)*

	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



North American Industry Top Trends Update

Homebuilders and Developers

Positive sector outlook moderates in 2H22

Maurice Austin
New York
maurice.austin@spglobal.com
+1 212 438 2077

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.

Latest Related Research

– Real Estate Monitor: Slowing Growth Lies Ahead For U.S. Real Estate Companies, June 8, 2022

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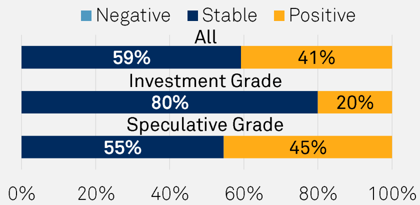
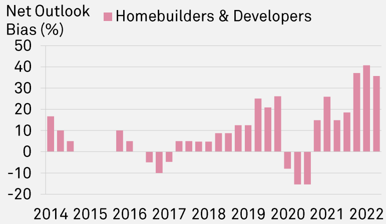


Ratings Statistics (YTD)*

	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



North American Industry Top Trends Update

Hotels, Gaming, and Leisure

Higher ratings on pandemic recovery but recession looms

Emile Courtney
New York
emile.courtney@
spglobal.com
+1 212 438 7824

Melissa Long
New York
melissa.long@
spglobal.com
+1 212 438 3886

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.

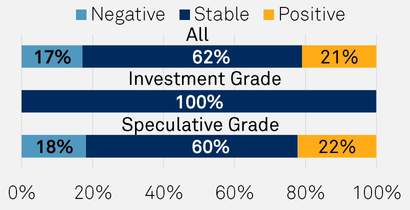
What if there's a recession?

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.

Outlook Distribution

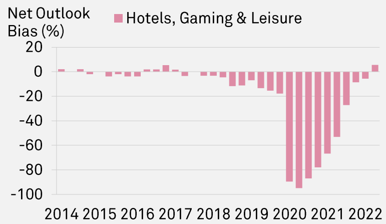


Ratings Statistics (YTD)*

	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



Latest 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

North American Industry Top Trends Update

Media and Entertainment

Pouring recessionary gasoline on a secular fire

Naveen Sarma
New York
naveen.sarma@
spglobal.com
+1 212 438 7833

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.

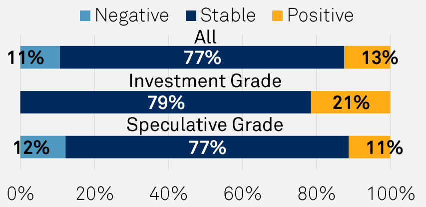
The subscription economy. Media has moved to a consumer-direct subscription model. If their discretionary spending power weakens, consumers could cut back their streaming service subscriptions or increase churn across services.

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.

Latest 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

Outlook Distribution

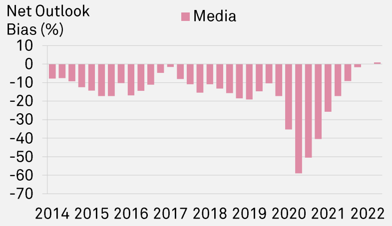


Ratings Statistics (YTD)*

	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



North American Industry Top Trends Update

Metals and Mining

Credit steadies after a big upswing

Don Marleau, CFA
Toronto
donald.marleau@
spglobal.com
+1 416 507 2526

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.

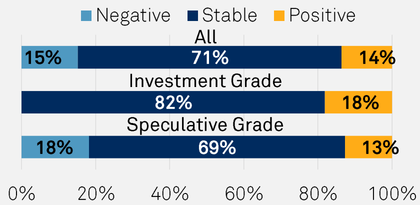
Weaker cash flow amid multiyear capex could consume large cash balances. Companies are often reluctant to cut important capital expenditures in a downturn, exaggerating volatile cash flow measures. The current upswing yielded a huge cash windfall for many companies, which enables continued spending in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

Latest 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

Outlook Distribution

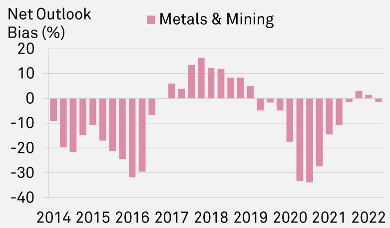


Ratings Statistics (YTD)*

	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



North American Industry Top Trends Update

Midstream Energy

Strong supply and demand dynamics

Michael Grande
New York
michael.grande@
spglobal.com
+1 212 438 2242

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.

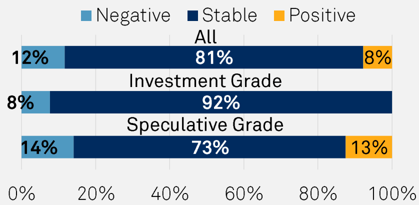
Rating resiliency. Midstream companies have built up a significant financial cushion in their credit profiles over the last few years, which we believe will insulate them if there is a recession.

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.

Latest 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

Outlook Distribution

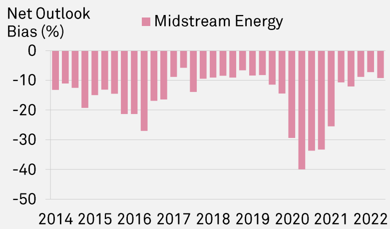


Ratings Statistics (YTD)*

	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



North American Industry Top Trends Update

Oil and Gas

Ratings are supported by debt repayment

Thomas Watters
New York
thomas.watters@
spglobal.com
+1 212 438 7818

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.

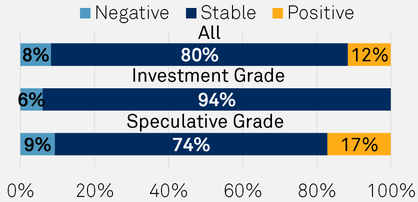
What if there's a recession?

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.

Outlook Distribution

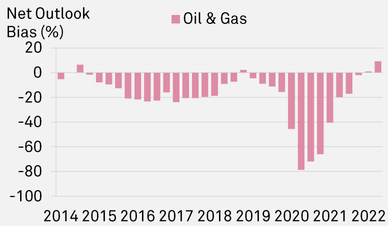


Ratings Statistics (YTD)*

	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



North American Industry Top Trends Update

Real Estate

Fundamentals slowing amid higher recession risk

Ana Lai, CFA
New York
ana.lai@
spglobal.com
+1 212 438 6895

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.

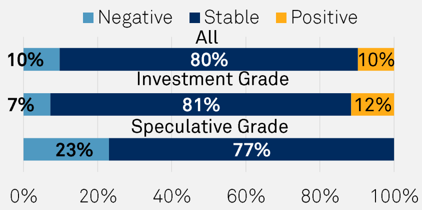
Pressure on asset valuation. Rising rates and slower growth will widen capitalization rates over the next year. This could dampen merger and acquisition (M&A) activities and delay asset disposition plans.

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.

Outlook Distribution

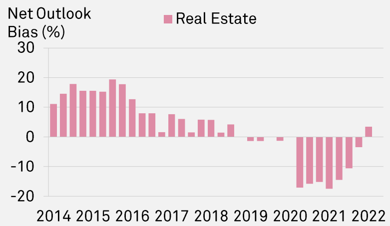


Ratings Statistics (YTD)*

	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



Latest 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

North American Industry Top Trends Update

Regulated Utilities

Credit quality has weakened and credit risks are rising

Gabe Grosberg
New York
gabe.grosberg@spglobal.com
+1 212 438 6043

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.

Latest 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

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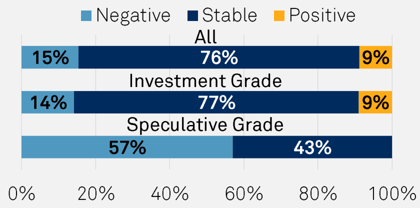

Ratings Statistics (YTD)*

	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

North American Industry Top Trends Update

Retail and Restaurants

Credit quality is at a turning point

Sarah Wyeth
New York
sarah.wyeth@
spglobal.com
+1 212 438 5658

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 dwindles 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.

Latest 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

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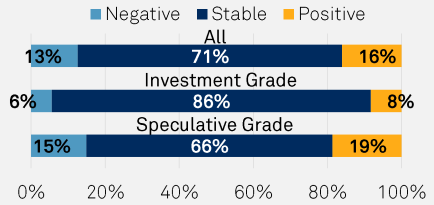
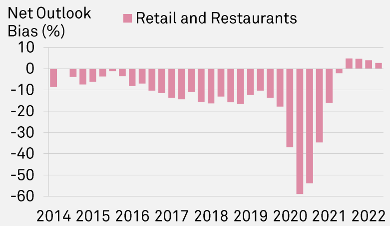


Ratings Statistics (YTD)*

	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



North American Industry Top Trends Update

Technology

Pace of IT spending slowing, margin pressure in play

David Tsui
San Francisco
david.tsui@
spglobal.com
+1 415 371 5063

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

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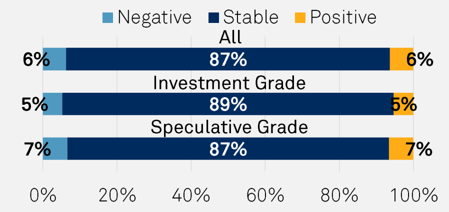
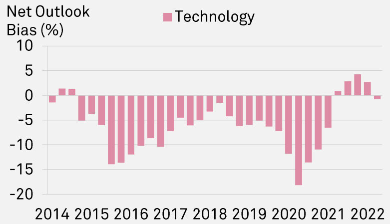


Ratings Statistics (YTD)*

	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



North American Industry Top Trends Update

Telecommunications

Rising costs and slowing growth could hurt credit quality

Allyn Arden, CFA
New York
allyn.arden@
spglobal.com
+1 212 438 7832

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.

Latest 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

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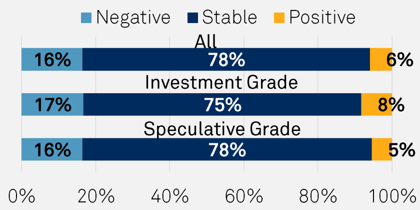
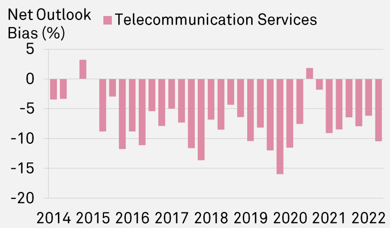


Ratings Statistics (YTD)*

	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



North American Industry Top Trends Update

Transportation

2022 started strong but recession risks cloud the outlook

Philip Baggaley
New York
philip.baggaley@
spglobal.com
+1 646 285 4615

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.

Latest 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

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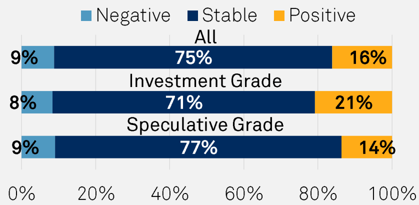
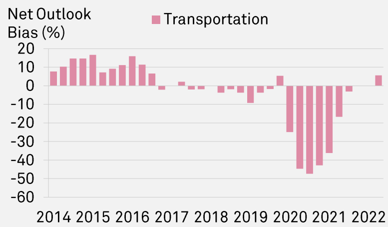


Ratings Statistics (YTD)*

	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



North American Industry Top Trends Update

Transportation Infrastructure

Some signs of more equitable risk share in P3s

Trevor d'Olier-Lees
New York
Trevor.dolier-lees@
spglobal.com
+1 718 710 74512

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.

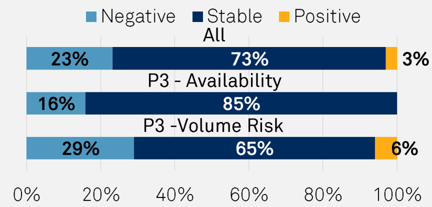
What if there's a recession?

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.

Outlook Distribution



Ratings Statistics (YTD)*

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

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

Latest Related Research

– Outlook For North America Engineering & Construction And Implications For P3 And Muni Infrastructure, April 7, 2022

North American Industry Top Trends Update

Unregulated Power

An unprecedented power price run

Aneesh Prabhu
New York
aneesh.prabhu@
spglobal.com
+1 212 438 1285

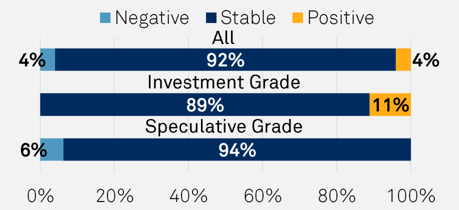
What's changed?

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.

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

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.

Latest 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