

Chemicals

Sluggish demand and still-high costs pressure credit quality

This report does not constitute a rating action

What's changed?

Industry conditions in petrochemicals and fertilizers are off peak. In fertilizers, prices for potash and phosphate declined sharply versus the record highs seen in 2022, but 2023-2024 prices should remain broadly above 2021 averages. In petrochemicals, a tough macroeconomic environment is depressing demand in several end-markets, at the time of new capacity additions, notably in Asia. We believe this combination will lead to an oversupply in 2023 and 2024, which will weaken olefin and polyolefin prices, and in turn margins, cash flow, and credit metrics.

Outlook bias is firmly negative and here to stay. Despite negative rating actions since the start of 2023, 22% of our portfolio remains on a negative outlook, broadly on par with 20% on Dec. 31, 2022. Most negative outlooks relate to high-yield issuers.

The challenge is to keep both the volumes and the prices. Sluggish demand and low confidence create an environment of slowing volume growth and still-high costs, despite receding raw material prices. Management actions to protect margins and working capital release can help credit quality, but top-line growth is key to ratings stability.

What to look out for?

The cost of capital is growing amid selective market access. The risk of inaccessible financial markets is relevant particularly for lower-rated issuers with refinancing requirements. They may have seen weaker results over the past six months or so, making it more difficult to address forthcoming maturities and at significantly tighter conditions.

Companies face pressure from customers to lower prices. Most specialty chemical issuers should be able to hold on to price gains and release them in an orderly manner as recovery in demand and receding cost inflation set in, but will need careful price/volume mix management to protect margins and advance order books.

Higher capital expenditure is needed to meet carbon-dioxide-reduction goals. Petrochemicals, and fertilizers in particular, face tightening environmental regulations in Europe, increasing carbon dioxide costs, and unavoidable investments to transition operations to lower carbon-dioxide intensity. Fast movers will reap the business benefits, but not before significant capital outlays, eroding free cash flow in the interim.

What are the key risks around the baseline?

Continuing subdued demand with no recovery in the second half of 2023. Soft demand, notably stemming from below-expectations recovery in China and notwithstanding low inventory levels in several chemical value chains, will weigh further on ratings.

Geopolitical risks include the ongoing war in Ukraine, as well as further escalation of U.S.-China tensions. The latter would cause great difficulties for global trade and chemical supply chains, which rely on the timely and efficient flow of critical materials.

High and volatile energy costs return to Europe. The EU's natural gas inventory levels were at 73% of capacity as of June 13, 2023, placing Europe in reasonably good shape to restock levels for the winter. The renewal of gas supply disruptions and abrupt price volatility would hurt European chemical producers' operating rates and weigh on competitive positions.

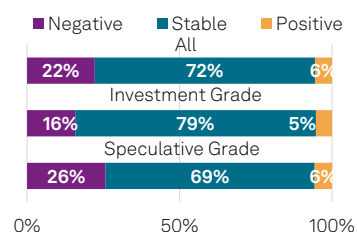
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Rating Trends

Outlook Distribution

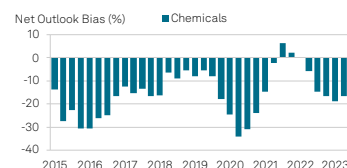


Ratings Statistics (YTD)*

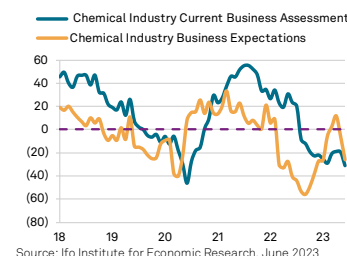
	IG	SG	All
Ratings	19	35	54
Downgrades	0	4	4
Upgrades	1	2	3

Ratings data as of end-Jun 2023. * Year-to-date. Current ratings only.

Ratings Outlook Net Bias



Ifo Sentiment Survey for German Chemical Industry



Source: Ifo Institute for Economic Research, June 2023