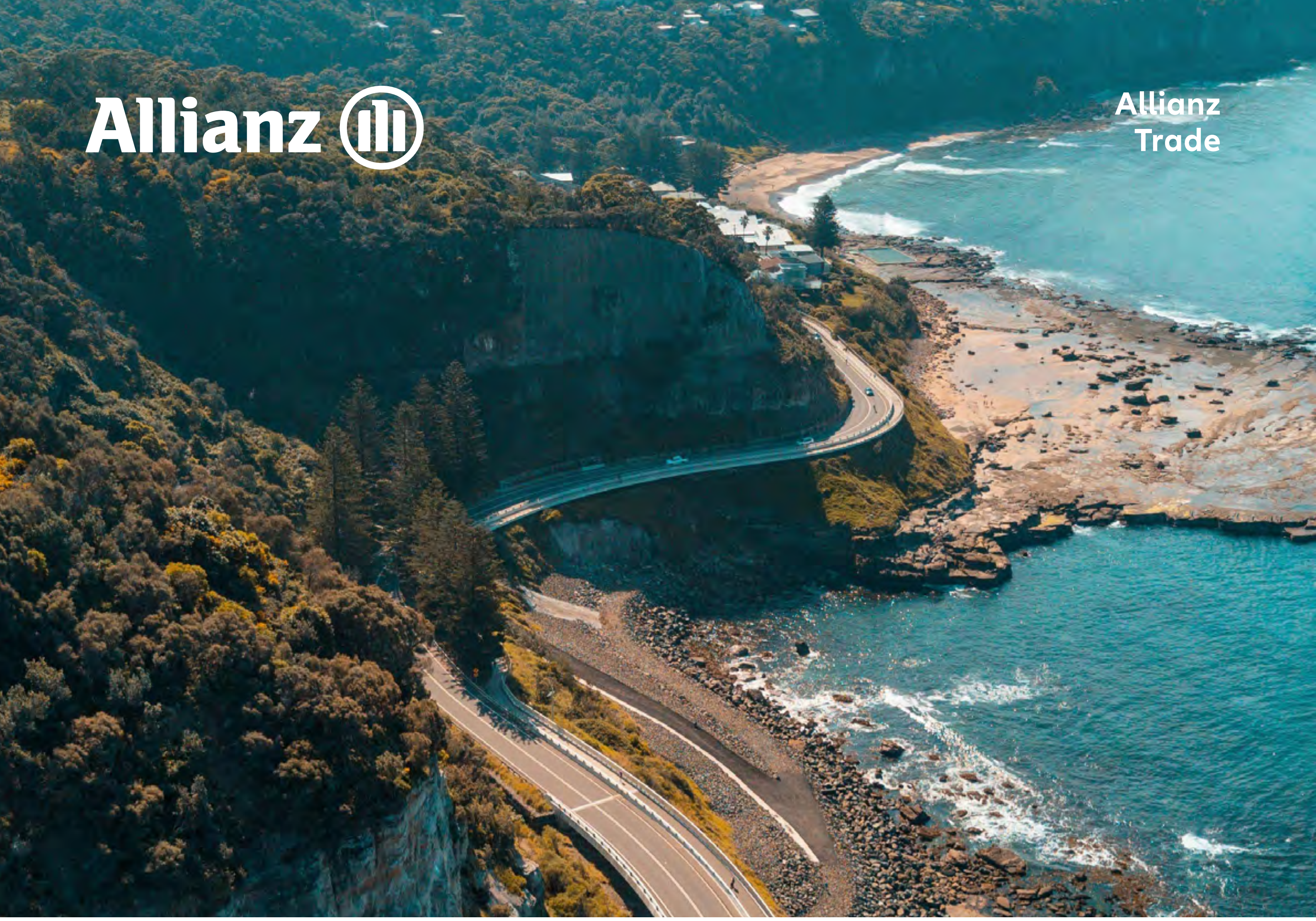

4 September 2024

Allianz Research

Sector Atlas 2024: the outpriced, the outcasts and the outliers

Executive summary

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- **Heavy political agenda to test global economic resilience once more.** Global growth bottomed out in H1, but the global manufacturing sector is still in excess supply, and demand remains sluggish especially in the Eurozone. We expect global GDP growth at +2.8% in 2024 and 2025, with growth slowing to +1.7% in the US and reaching +1.4% in 2025 in the Eurozone. China will continue to manage its growth slowdown (+4.3% in 2025).

- **Corporate earnings towards a recovery?** The latest earnings season has delivered mixed results: global revenues grew by +3.5% y/y but revenues stalled for European corporates (-0.7% y/y) while US and Asia-Pacific firms both reported growth at +4.5% y/y. Nevertheless, 58% of global corporates, including 59% of European ones, beat expectations. From a profitability perspective, global earnings grew by +14.7% y/y. US firms reported +10% y/y in earnings growth with 69% beating expectations while 53% of European ones also beat expectations despite reporting -2.5% y/y growth. A few sectors mostly related to technology are outperforming, while others struggle. In the US, S&P 500 firms showed moderate growth, but concerns about future earnings are still lingering. In Europe, cyclical sectors and the luxury industry – a long-time outperformer – are slowing. Banks are holding up well despite heightened economic uncertainties. Looking forward, economic resilience and easing monetary policy could support further growth and the earnings recovery.

- **Looking closer into sectors, we identify 3 main clusters: (i) sectors facing weaker demand and lower pricing power, (ii) sectors facing supply chain and geopolitical challenges and (iii) industries with stable or improving outlook.** In the first cluster, we have sectors like pulp & paper, chemicals, agrifood, retail, textiles and household equipment where limited growth and pressured margins dominate the outlook. Supply chain and geopolitical issues are still significantly weighing on industries such as transportation, energy, and transport equipment, where demand remains resilient but operational and geopolitical hurdles persist. Stable or improving sectors, including pharmaceuticals, automotive, computers and IT services, benefit from technological advances such as AI which is boosting corporate IT spend and steady demand through structural trends (e.g. demographics, green transition etc.). However, some of these sectors face specific challenges like regulatory risks.

- **Given this context, the majority of our sector ratings fall into the 'Medium' or 'Sensitive' risk categories.** 87% of all ratings across regions fall into these two ratings. Like last year, there is notable variation in risk levels between regions, with Asia generally being safer and Latin America being more at risk. In terms of industries, pharmaceuticals and software & IT services tend to have stronger ratings, while construction, textiles, and metals are considered riskier. Compared to the pre-Covid period, most sectors are still below 2019 despite the recovery in ratings. Changes in ratings over the last four quarters are pointing to several sectors standing out. Household equipment, chemicals, construction and textiles are standing out with an overall negative balance. On the contrary, the recovery in ratings proved to be substantial in the auto sector, in transportation and in machinery equipment. But this is not a surprise since those sectors were the ones most downgraded after the onset of the pandemic.

Country and Sector Matrix

Region	Country	Automotive manufacturers	Automotive suppliers	Construction	Transportation	Chemicals	Pharmaceuticals	Agrifood	Textiles	Paper	Electronics	Metals	Retail	Machinery & Equipment	Transport equipment	Software & IT Services	Household equipment	Computers & Telecom	Energy
North America	US	Medium	Medium	Medium	Medium	Medium	Low	Medium	Sensitive	Medium	Medium	Medium	Medium	Medium	Sensitive	Medium	Sensitive	Medium	Medium
	Canada	Medium	Medium	Medium	Medium	Medium	Low	Medium	Sensitive	Medium	Medium	Medium	Sensitive	Medium	Sensitive	Medium	Sensitive	Medium	Medium
Latin America	Brazil	Sensitive	Sensitive	Sensitive	Sensitive	High	Medium	Medium	High	Sensitive	Sensitive	Medium	Sensitive	Sensitive	Sensitive	Medium	Sensitive	Sensitive	Medium
	Mexico	Medium	Medium	Sensitive	Medium	High	Low	Medium	High	High	Sensitive	Sensitive	Medium	Sensitive	Medium	High	Sensitive	Medium	High
	Colombia	Sensitive	Sensitive	High	Sensitive	Medium	Sensitive	Sensitive	High	Medium	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Sensitive	Medium	Sensitive	Sensitive
	Peru	Sensitive	Sensitive	High	Medium	Medium	Low	Medium	Sensitive	Medium	Sensitive	Medium	Medium	Medium	Sensitive	Medium	Medium	Medium	Medium
	Ecuador	Medium	Medium	High	Sensitive	Sensitive	Medium	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Sensitive	Sensitive	Medium	Medium	Medium	High
	Uruguay	Medium	Sensitive	Sensitive	Sensitive	Medium	Medium	Medium	High	Medium	Sensitive	Sensitive	Sensitive			Medium	Sensitive	Medium	Medium
	Panama	Sensitive	Sensitive	High	Sensitive	Medium	Low	Low	Sensitive	Medium	Medium	High	Medium			Medium	Medium	Medium	Medium
	Chile	Sensitive	Medium	High	Medium	Medium	Low	Medium	Sensitive	Sensitive	Sensitive	Medium	High	Sensitive	Sensitive	Medium	Sensitive	Medium	Medium
	Costa Rica	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Low	Low	Sensitive	Sensitive	Medium	Sensitive	Sensitive	Sensitive		Medium	Sensitive	Medium	Medium
	Dominican Republic	Medium	Medium	Sensitive	Medium	Medium	Low	Medium	Sensitive	Sensitive	Medium	Sensitive	Sensitive	Medium		Medium	Sensitive	Medium	Medium
	Guatemala	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Low	Low	Sensitive	Sensitive	Medium	Sensitive	Sensitive	Sensitive		Medium	Sensitive	Medium	Medium
Western Europe	France	Medium	Sensitive	Sensitive	Sensitive	Medium	Low	Medium	High	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Sensitive	Medium	Sensitive	Sensitive	Sensitive
	Germany	Medium	Sensitive	Sensitive	Sensitive	Sensitive	Low	Sensitive	Sensitive	Sensitive	Medium	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Sensitive	Medium	Sensitive
	Spain	Medium	Sensitive	Sensitive	Sensitive	Sensitive	Low	Sensitive	Sensitive	Sensitive	Medium	Sensitive	Medium	Medium	Sensitive	Medium	Sensitive	Medium	Sensitive
	Italy	Sensitive	High	Sensitive	Sensitive	Medium	Low	Medium	Sensitive	Medium	Medium	Sensitive	Sensitive	Medium	Medium	Medium	Sensitive	Medium	Sensitive
	UK	Sensitive	High	High	Sensitive	Medium	Low	Sensitive	Sensitive	High	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Sensitive	Medium	Sensitive
	Netherlands	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Low	Sensitive	Sensitive	Sensitive	Medium	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Sensitive	Medium	Sensitive
	Switzerland	Medium	Sensitive	Sensitive	Medium	Sensitive	Low	Medium	Sensitive	Sensitive	Medium	Sensitive	Medium	Medium	Medium	Medium	Sensitive	Medium	Sensitive
	Sweden	Medium	Sensitive	Sensitive	Sensitive	Medium	Low	Medium	Sensitive	Medium	Medium	Medium	Sensitive	Medium	Low	Low	Sensitive	Low	Low
	Norway	Sensitive	Sensitive	Sensitive	Medium	Medium	Low	Low	Medium	Sensitive	Medium	Medium	Sensitive	Medium	Medium	Low	Sensitive	Low	Low
	Belgium	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Low	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Sensitive	Medium	Sensitive
	Austria	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Low	Sensitive	Sensitive	Sensitive	Medium	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Medium	Medium	Sensitive
	Denmark	Medium	Medium	Sensitive	Medium	Medium	Low	Medium	Sensitive	Sensitive	Medium	Medium	Sensitive	Sensitive	Medium	Low	Sensitive	Medium	Medium
	Greece	Medium	Sensitive	Sensitive	Sensitive	Medium	Low	Medium	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Medium	Medium	Medium
	Finland	Medium	Sensitive	Sensitive	Sensitive	Medium	Low	Medium	Sensitive	Medium	Medium	Sensitive	Sensitive	Medium	Sensitive	Low	Sensitive	Medium	Medium
	Portugal	Medium	Sensitive	Sensitive	Sensitive	Medium	Low	Medium	High	Medium	Medium	Sensitive	Sensitive	Medium	Sensitive	Medium	Sensitive	Medium	Medium
	Ireland	Sensitive	Sensitive	High	Sensitive	Medium	Low	Medium	Sensitive	Sensitive	Medium	Sensitive	Sensitive	Medium	Sensitive	Low	Sensitive	Medium	Medium
	Luxembourg	Sensitive	Sensitive	Sensitive	Medium	Sensitive	Low	Medium	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Sensitive	Medium	Medium	Medium	Medium	Sensitive
Central & Eastern Europe	Turkey	Sensitive	Sensitive	High	Sensitive	Sensitive	Low	Sensitive	High	Sensitive	High	Sensitive	Sensitive	Medium	Sensitive	Medium	Medium	Medium	High
	Poland	Sensitive	Sensitive	High	High	Sensitive	Low	Medium	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Low	Sensitive	Medium	Sensitive
	Czech Republic	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Medium	Sensitive	Medium	Medium	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Sensitive	Low	Medium
	Romania	Sensitive	Sensitive	High	Sensitive	Sensitive	Low	Medium	Sensitive	Medium	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Low	Sensitive	Medium	Medium
	Hungary	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Medium	Medium	Sensitive	Medium	Medium	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Sensitive	Medium	Sensitive
	Croatia	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Sensitive	High	Medium	Sensitive	Medium	Medium
	Bulgaria	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Medium	Sensitive	Medium	Medium	Sensitive	Sensitive	Sensitive	Sensitive	Low	Sensitive	Medium	Medium
	Slovenia	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Sensitive	Medium	Medium	Sensitive	Medium	Medium
	Lithuania	Sensitive	Sensitive	Sensitive	Sensitive	Sensitive	Low	Medium	Sensitive	Medium	Medium	Sensitive	Sensitive	Sensitive	Sensitive	Low	Sensitive	Low	Medium
	Latvia	Medium	Medium	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Medium	Medium	Medium	Sensitive	Sensitive	Medium	Sensitive	Low	Sensitive	Medium	Medium
	Estonia	Medium	Medium	Sensitive	Sensitive	Medium	Medium	Medium	Medium	Sensitive	Medium	Sensitive	Sensitive	Medium	Medium	Medium	Sensitive	Low	Medium
	Slovakia	Medium	Sensitive	High	Sensitive	Sensitive	Medium	Medium	Sensitive	Sensitive	Medium	Sensitive	Sensitive	Medium	Sensitive	Low	Sensitive	Sensitive	Sensitive
Africa & Middle East	Algeria	Sensitive	Sensitive	Sensitive	Medium	Medium	Medium	Medium	Sensitive	Medium	Medium	Sensitive	Sensitive	Sensitive	Sensitive	Medium	Sensitive	Medium	Low
	Morocco	Medium	Medium	Sensitive	Sensitive	Medium	Low	Low	Sensitive	Medium	Medium	Sensitive	Medium	Medium	Medium	Low	Medium	Low	Medium
	Saudi Arabia	Medium	Medium	Sensitive	Medium	Medium	Low	Low	Sensitive	Medium	Sensitive	Sensitive	Medium	Sensitive	Sensitive	Medium	Medium	Medium	Low
	UAE	Medium	Medium	Sensitive	Medium	Medium	Low	Low	Sensitive	Medium	Sensitive	Sensitive	Medium	Sensitive	Sensitive	Medium	Medium	Medium	Low
	Israel	Medium		High	Sensitive	Medium	Medium	Low	Sensitive	Medium	Medium	Medium	Sensitive	Medium		Low	Sensitive	Sensitive	Medium
	Qatar	Medium	Medium	Sensitive	Medium	Medium	Low	Low	Sensitive	Medium	Medium	Sensitive	Medium	Sensitive	Sensitive	Medium	Medium	Medium	Low
	Kuwait	Medium	Medium	High	Sensitive	Medium	Low	Low	Sensitive	Medium	Sensitive	Sensitive	Medium	Sensitive	Sensitive	Medium	Medium	Sensitive	Medium
	Oman	Medium	Medium	Sensitive	Medium	Medium	Low	Medium	Sensitive	Medium	Sensitive	Sensitive	Medium	Sensitive		Medium	Medium	Medium	Low
	Bahrain	Medium	Medium	Sensitive	Medium	Medium	Low	Medium	Sensitive	Medium	Sensitive	Sensitive	Medium	Sensitive		Medium	Sensitive	Medium	Medium
	South Africa	Medium	Medium	High	Sensitive	Medium	Low	Medium	High	Sensitive	Sensitive	High	Sensitive	Medium	Sensitive	Medium	Medium	Medium	High
Asia Pacific	Japan	Medium	Medium	Sensitive	Medium	Medium	Low	Low	Medium	Medium	Medium	Medium	Sensitive	Low	Medium	Low	Medium	Medium	Medium
	Australia	Medium	Medium	Sensitive	Medium	Medium	Low	Low	Medium	Sensitive	Medium	Medium	Medium	Medium	Medium	Low	Medium	Low	Medium
	China	Medium	Medium	High	Sensitive	Medium	Low	Medium	Sensitive	Sensitive	Medium	Sensitive	Medium	Medium	Medium	Low	Medium	Medium	Sensitive
	India	Medium	Medium	Medium	Sensitive	Medium	Low	Medium	Sensitive	Medium	Medium	Sensitive	Sensitive	Medium	Medium	Low	Medium	Medium	Medium
	Indonesia	Medium	Medium	Sensitive	Sensitive	Medium	Low	Medium	High	Medium	Medium	Sensitive	Sensitive	Medium	Medium	Low	Medium	Medium	Sensitive
	Malaysia	Medium	Medium	Sensitive	Medium	Medium	Low	Medium	Sensitive	Medium	Medium	Sensitive	Medium	Medium	Medium	Medium	Medium	Medium	Medium
	Singapore	Medium	Medium	Sensitive	Medium	Medium	Low	Medium	Medium	Medium	Medium	Sensitive	Medium	Medium	Medium	Low	Medium	Medium	Sensitive
	Philippines	Medium	Medium	Medium	Sensitive	Medium	Low	Medium	Sensitive	Medium	Medium	Medium	Medium	Medium	Medium	Low	Medium	Medium	Medium
	Korea (South)	Medium	Medium	Sensitive	Sensitive	Medium	Low	Low	Medium	Medium	Medium	Sensitive	Medium	Medium	Medium	Medium	Medium	Medium	Medium
	New Zealand	Medium	Medium	Sensitive	Medium	Low	Low	Low	Sensitive	Sensitive	Medium	Medium	Medium	Medium	Medium	Low	Medium	Low	Low
	Thailand	Medium	Medium	Sensitive	Sensitive	Low	Low	Medium	Sensitive	Medium	Medium	Sensitive	Sensitive	Medium	Medium	Medium	Medium	Medium	Medium
	Taiwan	Medium	Medium	Medium	Medium	Medium	Low	Low	Sensitive	Sensitive	Medium	Medium	Medium	Medium	Medium	Medium	Medium	Medium	Medium
	Vietnam	Medium	Medium	Medium	Sensitive	Low	Low	Medium	Sensitive	Medium	Medium	Sensitive	Medium	Medium	Sensitive	Low	Medium	Low	Sensitive
	Hong Kong	Medium	Medium	Medium	Medium	Medium	Low	Medium	Sensitive	Sensitive	Medium	Sensitive	Medium	Medium	Medium	Medium	Medium	Medium	Low

- Low risk: sound fundamentals; very favorable or fairly good outlook.
- Medium risk: signs of weaknesses; possible slowdown.
- Sensitive risk: structural weaknesses; unfavorable or fairly bad outlook.
- High risk: imminent or recognised crisis.

Agrifood

Despite challenges from climate change to geopolitics, the sector remains steady

Sector rating

M Medium risk for enterprises

Strengths & weaknesses

- Steady and growing market thanks to growing population
- High pricing power for most companies and producers
- Diverse market with growing demand for alternative products (proteins, plant-based etc.

- Vulnerable to climate change: More frequent and severe floods and droughts affect crops and livestock
- Food-processing and packaged-food companies continue to struggle with high energy, transportation and input costs.
- Labor shortages, especially in the upstream segment and in Western Europe
- Global inflation has exacerbated price competition

Sector overview

What to watch?

- Food security and geopolitics: Since 2022 and the war in Ukraine, food security is back on most countries' agenda. From strategic stockpiling to export curbs, a number of policy decisions are reshaping the market.
- Climate change and extreme weather events: Changes in temperature, humidity and rainfall patterns, as well as the frequency of extreme weather events (storms, droughts, wildfires) and the "El Nino"/"La Nina" phenomena in 2024 are affecting farming practices and output capacity.
- Energy crisis: Despite the energy crisis being less acute, prices for fuel and fertilizers remain high and are pressuring profitability for firms in the sector.
- New consumption trends: From the rise of weight-loss drugs to the shift towards plant-based diets to online grocery shopping, the sector needs to adapt to shifting consumer trends.

The global agrifood market has grown significantly, rising from USD8.3trn in 2021 to an expected USD9.1trn in 2024. It is projected to reach about USD12.5trn by 2029 (i.e. an expected +6.5% CAGR over 2024-2029). This growth is being driven by a number of factors such as population growth, technological advancements and also shifting consumer preferences. The ongoing war in Ukraine has added new challenges and uncertainties to the sector. Since 2023, most food commodity prices have consolidated with the exception of coffee and cocoa, which reached historical highs.

Overall, despite retreating prices for most agrifood commodities, they remain higher than they were before the pandemic, which has been weighing on cost structures. So far, despite declining volumes (both in production and sales), the non-reductible nature of food products has allowed firms in the sector to compensate for lower volumes with higher sales prices. In 2023, EBITDA margin for food manufacturing firms stood at about 11% despite revenues slightly declining. The beverage segment has been able to continue to grow both revenues (about 10%) and earnings.

Subsectors

Upstream: Companies engaged in the production of agricultural commodities from cereals to fresh fruits and vegetables to cattle.

Downstream food products: Firms involved in processing and transforming the extracted raw materials and animal products into consumable products. The full chain includes processing, packaging, transporting and transforming the food products.

Beverages: Companies that produce and supply any type of beverage. The beverage industry contains two main categories: non-alcoholic beverages (such as juice, sodas, soft drinks, coffee, tea and bottled water) and alcoholic beverages (beers, wines, and distilled beverages - also known as spirits).

Automotive

Significant challenges for auto manufacturers and suppliers amid the bumpy EV transition

Sector rating

S Sensitive risk for enterprises

Strengths & weaknesses

- Easing supply-chain disruptions
- Declining costs of batteries and EVs
- Government support and investments in fostering EV transition
- Rapidly evolving battery technology and smart services
- Growth opportunities in emerging markets

- Softening demand in major car markets
- Deteriorating pricing power and profitability of car manufacturers and suppliers
- Elevated geopolitical tensions between the West and China
- Uncertainty on policies and trade affecting EV adoption
- Intensifying price war among car manufacturers

Sector overview

What to watch?

- Critical raw material prices, battery costs and EV prices
- Cross-border investment flows regarding green transportation
- Government incentives and regulations on EVs
- Any event leading to another major supply-chain issues
- Industrial policies and their impact on trade and investment
- Strategic alliances and partnerships in the automotive industry
- Advancements in autonomous driving technology

2024 has proven to be a challenging year for auto manufacturers and suppliers. After a strong post-pandemic rebound, the tide has turned as pent-up demand has been tapped out and supply has piled up,weighing on automakers' pricing power. The three largest car markets – China, Europe and the US – have all seen softening demand. Globally, Brazil and Mexico were the only large markets with double-digit growth in the first half of the year. Average selling prices have fallen notably across major markets, leading to a deterioration in profitability for key automakers. The picture is also bleak for auto suppliers as their margins are being squeezed amid dropping demand and increasing investment costs due to the EV transition.

Competition has intensified as the rise of Chinese EVs remains a significant challenge to legacy carmakers. Despite their shrinking margins and decelerating demand for EVs, legacy carmakers cannot afford to miss out on the sector's structural changes, even though the transition is likely to be bumpy in the near future. At the moment, most are still struggling to produce affordable EV models profitably, while Chinese EVs keep gaining traction with their massive cost advantages and proven quality. This has prompted carmakers to continue investing in less profitable EV models or to seek other potential options such as hybrids as they navigate the challenging environment, putting further pressure on their profitability.

Additionally, we think political uncertainty is the main variable in the sector's trajectory going forward. The carrots and sticks imposed by the public sector have played a key role in driving EV adoption and developing EV infrastructure, from China's massive subsidies to the US's industrial policies to the EU's ambitious goals.

Trade measures are heating up as the US raised tariffs on Chinese EVs to 100%, and the EU followed suit with a more moderate scope. While the US's move is more symbolic, in our view, despite the significant number, the stakes are higher for Europe due to its stronger trade ties with China in the auto sector. Increasing retaliation from China is expected if tensions esclate, which could backfire on Europe's own companies. Nevertheless, we also anticipate increasing investments by Chinese carmakers in Europe to circumvent the tariffs.

The reshuffling also brings opportunities to emerging markets despite their smaller market size. Brazil and Thailand are experiencing rapid growth as governments roll out supportive green policies, and Mexico is seeing surging investment inflows, becoming one of the biggest beneficiaries of elevated geopolitical tensions between the West and China.

Subsectors

Automotive manufacturers: In the short run, the start of the easing cycle will lead to lower borrowing costs for consumers, providing some support for sales increases. Over the longer run, the EV transition remains the key structural factor defining the future of the industry. For automakers, this poses both challenges and opportunities as the major attribute of a car is shifting from engine capacity to battery and software capabilities. Legacy automakers have to adapt to the new landscape by investing in green technology while also managing the shift in consumer preferences and regulatory demands. This transition will require substantial financial resources and strategic planning to ensure they remain competitive in the evolving market.

Automotive suppliers: Auto suppliers are having a tough time navigating their way through the EV transition amid slowing demand and higher costs. As price competition among car manufacturers intensifies, more pressure is imposed on suppliers, leading to longer billing cycles and further squeezed margins. Some small suppliers are being forced out due to unprofitability, while some of the largest suppliers, who on average have a stronger financial positions and larger scale to manage the transformation from combustion engines to electric drives, have announced job cuts as they cut costs and restructure to stay viable.

Chemicals

A slight improvement on the way, but challenges persist for European firms

Sector rating

M Medium risk for enterprises

Strengths & weaknesses

- Very diversified end-markets, which limits dependence on purchases from a certain sector
- Companies in the 'specialty chemicals' and 'food-chemicals' subsectors enjoy a relatively higher pricing power thanks to the specificity of the products they offer and steady demand that has proven to be less affected by the current economic cycle
- The increased production of electric vehicles represents an opportunity for lithium producers (essential for manufacturing electric batteries)
- The ecological transition also represents an expansion opportunity for companies operating in the biofuels business, while chemicals used for the production of paper and cardboard will also continue to be highly demanded by the packaging industry

- Large investments needed for capital expenditures and research & development projects
- As an energy-intensive sector, highly vulnerable to energy prices
- High reputational risk and many ESG-linked challenges to cope with, including decarbonization, water and soil utilization, employee's and customer's healthcare, among others.
- Future revenues for the petrochemical segment will be threatened by the lower use of plastics and derivatives in the face of new stricter environmental regulations

Sector overview

What to watch?

- Continuation of geopolitical risks: The conflict in Ukraine has lasted much longer than initially expected, affecting chemical production in Europe due to above-average energy prices. As long as the situation lasts, there will continue to be challenges and disruptions for the sector's supply chain in Europe. Meanwhile, the US and China have been benefiting from a competitive cost advantage, absorbing also the market that Russia has lost.

- Still tight financing conditions in developed economies (Europe & US) will continue to affect companies in rolling over their debt.

- Higher money allocation on capex and R&D will boost innovation in the sector: The incorporation of Artificial Intelligence (AI) and Machine Learning (ML) will accelerate new products discovery, while also improving production efficiencies.

- Re-industrialization: Supportive governmental measures and decisions by companies will be key in determining the evolution of the sector in 2024-2025.

- The role of China: China is by far the main consumer and producer of chemicals in the world. Its economic activity and level of self-sufficiency in chemical products will continue to have an important impact on the sector worldwide, especially for petrochemicals, for which China has been expanding its capacity.Tighter financing conditions in developed economies (Europe & US) to continue affecting companies rolling over debt

- Growth opportunities arising from the decarbonization plans of other sectors: The higher demand for biofuels represents a potential business expansion for players in the petrochemical sector. Also, lithium producers will gain a lot of demand from manufacturers of electric vehicles, while producers of chemicals used in the production of paper and cardboard will also continue to be highly demanded by the eco-packaging industry.

While global chemicals output increased by +2.3% y/y (because of China's reopening), global revenues fell by around -14% y/y last year, affected by lower volumes and by lower prices to a lesser extent. China, which dominates this market both by capacity and consumption, had a weaker-than-expected reopening year, with demand not being at the high levels observed before. Still, China's reopening implied a higher chemicals production output (+9.6% y/y, the only region that saw positive growth), which triggered a chemicals surplus that put downward pressure on prices globally. This was particularly the case for petrochemicals, for which China alone accounted for nearly 60% of the global rise in petrochemical capacity in 2023, which led prices to decline from the peaks of 2021-2022.

Destocking and the weak economic sentiment have been the two main headwinds holding back the demand recovery. Furthermore, companies in end-markets around the world overstocked over 2021 and 2022. As a result, they prefered to use the excess inventory during 2023 instead of re-stocking. On top of destocking, the US and Europe have also been fighting against stubborn inflation, which has hit economic activity. This has in turn impacted local chemicals demand, which has been particularly weak on the Old Continent where recession fears were persistent throughout the year. By business segment, base chemicals suffered the largest sales deterioration (-18% y/y), while intermediates & derivatives sales fell by -14% y/y and petrochemicals by around -12% y/y.

The US is absorbing the market share that European companies have lost. Vastly affected by the conflict in Ukraine, Europe's production fell by -8.0% y/y in 2023, falling behind the US (-1.0% y/y) and China (+9.6%). This regional loss of competitiveness was mainly explained by a drop in production of petrochemicals (-10.6% y/y) and polymers (-10.5% y/y), with consumer chemicals being the only sub-sector that increased production in the Old Continent (+3.2% y/y). The overall regional decline in production was largely explained by the fact that natural gas and electricity accounts for around 65% of the total energy consumption for the European chemical industry. As energy prices remained high last year, many companies stopped the production of certain products while others even closed some manufacturing plants. The production of fertilizers in particular relies a lot on natural gas as feedstock. As a result, many firms stopped producing ammonia and urea (the chemicals with highest exposure to natural gas and electricity prices), forcing farmers to cover their needs by buying imported fertilizers from other regions such as the US or Asia.

So far in 2024, the sector's global capacity is still outpacing demand, making it difficult for companies to raise prices as much as they would like. But as consumer spending becomes more robust and the global economic outlook gradually recovers (towards the second half of the year), we should see a more noticeable improvement in chemicals demand and in companies margins, mostly in the US where the sector not only benefits from lower natural gas prices but also from easier access to energy.

Subsectors

Basic or commodity chemicals: Chemical substances used as a starting material for the production of a wide variety of other chemicals. Examples include chlorine (used as a disinfectant and for water treatment), sulfuric acid (used in metallurgy, for refining petroleum products or the production of explosive materials), vinyl chloride (used to produce PVC for wall coverings, houseware and automotive parts), aluminum sulfate (used for water treatment, in agriculture and in paper production), sodium carbonate (used in the manufacture of detergents, soaps and paper), acetone (commonly used in pharmaceuticals) and titanium dioxide (used in the cosmetic and food industries), among others. Under this sub-sector, we find another distinction – petrochemicals - when looking to the origin of the raw material. Petrochemicals are also organic chemicals, but they are made from crude oil and natural gas. Examples include olefins, methanol, butadiene, benzene, ethylene glycol, polyethylene, etc. They are used as raw materials in the manufacture of polymer products such as plastic, detergent, adhesive, rubber, tires, food packaging and elastic bands.

Specialty chemicals: Specialty chemicals are a range of compounds that are produced in smaller quantities when compared to basic chemicals as they are high-value products that are sold based on functionality, and following certain formulations that make them "special". Under this sub-sector we can find a variety of classifications according to the end-market, such as antibiotics, adhesives, pesticides, fertilizers, cleaners, inks, paints and coatings, fragrances, chemicals for the food & beverage industry (food additives and flavors) etc. In terms of commercial applications, producers within the specialty chemicals sub-sector cater to the needs of their customers on an individual level (production is tailor-made under certain specifications), and because of this these chemicals can be sold at very high prices.

Construction

Cyclical hurdles and long-term opportunities

Sector rating

S Sensitive risk for enterprises

Strengths & weaknesses

- Growing focus on sustainable and green construction
- Stabilizing construction costs after significant hikes in recent years
- Increased investment in infrastructure development
- Enhancement of smart cities pushing advancements in construction

- Recent downturns due to the highly cyclical nature of the sector
- Shortage of skilled labor in developed countries
- Cost control and schedule management challenges
- Regulatory and environmental challenges

Sector overview

What to watch?

- Subdued construction activity and new orders
- Progress of housing market recovery with the start of the easing cycle
- Green regulation, both an opportunity and a risk for the sector
- Public policies on infrastructure investment

As a highly cyclical sector, construction has faced significant downturns in recent years due to persistent inflation and elevated interest rates, which have reduced housing demand and increased costs for builders. Rapidly rising mortgage rates, combined with high inflation, have significantly reduced housing affordability, leading to a drop in new mortgages and housing investments. As demand falls, costs are rising: material and labor costs have skyrocketed and financing conditions have tightened. Consequently, a growing number of projects are being delayed or abandoned as builders' margins come under pressure, leading to a surge in business insolvencies in the sector.

Recently, there have been positive signs as the easing cycle begins: demand is picking up, with housing loans increasing for the first time since early 2022 and investment activities starting to rebound. Construction price indices have begun to decline, inflation in building materials has reversed and construction confidence indicators have stabilized. Although construction activities and building permits are still subpar, supply is expected to gradually catch up as housing prices bottom out and construction costs further stabilize.

On a more positive note, the demand for infrastructure construction remains strong and will continue growing. Structural changes, such as decarbonization and digitization, are taking place globally and are expected to persist for decades, requiring substantial capital. As governments ramp up investment and roll out policies to foster the green transition and infrastructure development, the construction sector is poised for long-term growth. Still, there is a USD15trn gap between projected investment and the amount needed to provide adequate global infrastructure by 2040, prompting the private sector to increase its presence in infrastructure investment.

On the public market side, there has been notable expansion over the past ten years. The market capitalization of listed infrastructure globally, as proxied by the Dow Jones Brookfield Global Infrastructure Index, increased by +64.3% over the decade, reaching USD1.5trn by the end of July 2024. This trend is also visible in private investments: As one of the fastest-growing asset classes in the private market, unlisted infrastructure in Europe has expanded from merely USD1.4bn of assets under management in 2000 to USD425.2bn in 2022, a more than 300-fold surge.

Subsectors

Residential construction: This segment includes the construction of new homes and apartments, as well as the renovation and repair of existing ones.

Non-residential construction: The construction of commercial buildings (offices, retail), industrial buildings (factories, warehouses, data centers) and public buildings (schools, hospitals etc.).

Infrastructure construction: Construction of large-scale public projects such as highways, bridges, railways, airports and utilities.

Construction services: Services related to construction, such as architectural and engineering services, project management etc.

Electronics

In recovery

Sector rating

M Medium risk for enterprises

Strengths & weaknesses

- Broad customer base (consumer electronics, automotive, telecommunications, industry, etc.)
- Digitalization of the economy and AI boost to drive long term growth
- Technology intensive sector with strong barriers to entry at the higher end

- Commodity electronic components: fragmented, low barrier to entry, low margin
- Many segments are saturated and require a lot of investment and innovation to grow their markets (smartphones, computers etc.)
- Highly cyclical sector

Sector overview

What to watch?

- China-US tensions and "semiconductor war"
- Emerging technologies such as AI that could boost demand and drive further innovation in the sector
- Industry 4.0 will be about automation and control systems which will require more semiconductors and electronic components
- Purchasing-power crisis and households' intentions to make large purchases (e.g. computers, smartphones etc.)

2023 was a challenging year for electronic components and especially for semiconductors, which recorded 9% lower sales than in 2022. In 2024, global sales are expected to rebound by over +10% and revenues should beat the 2022 industry record by about 2%. Volumes should rebound, thanks to strong demand related to emerging technologies such as AI that are fueling the need for increased computing power. The continued rise of electric vehicles should also benefit the sector. Moreover, production and inventories are also normalizing, which should smoothen supply chains through more predictable lead times and prices.

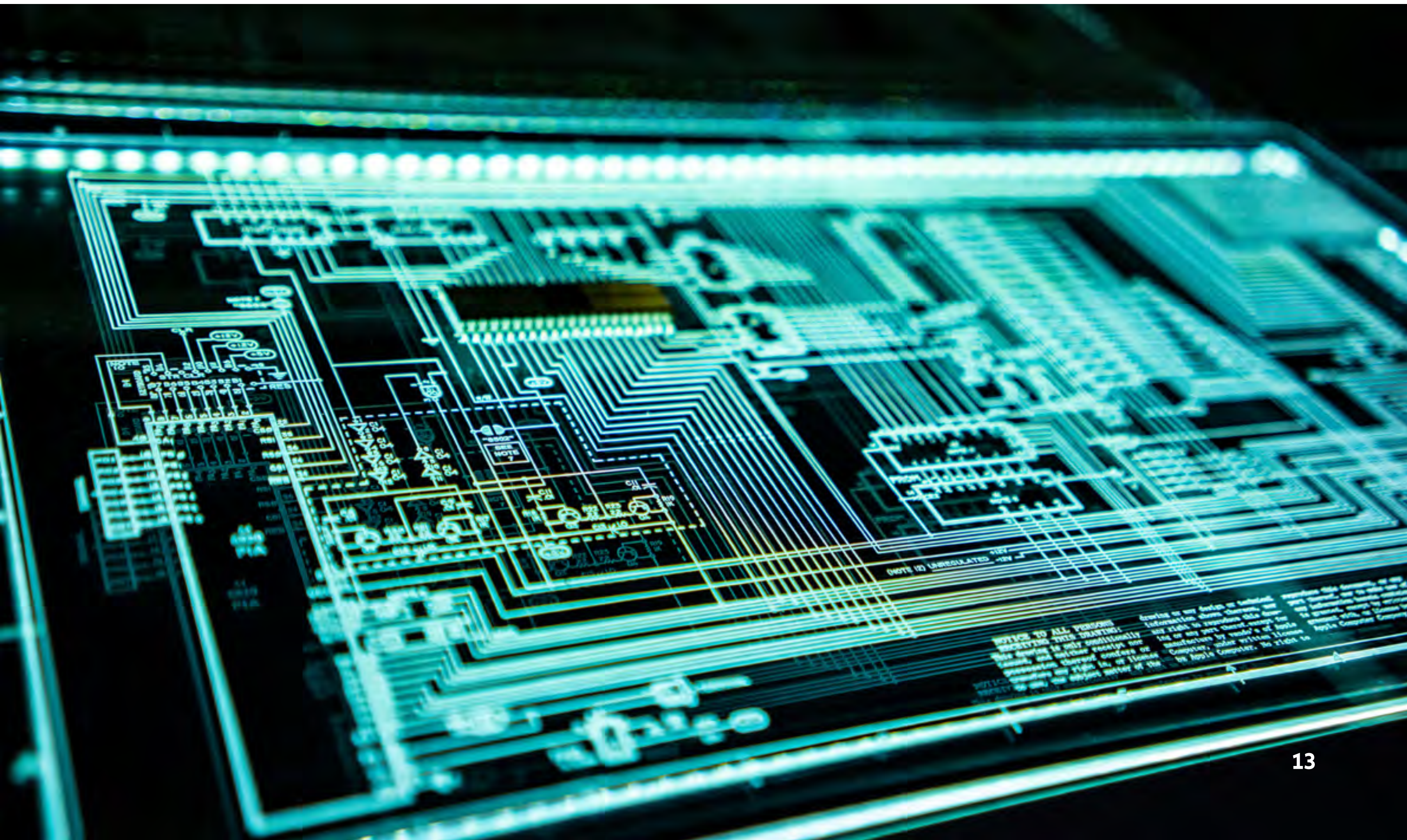
Despite the challenging landscape, the semiconductor sector posted an EBITDA margin of about 30% in 2023. Both revenues and earnings are expected to grow by double-digits in the next five years. The sector also continues to exhibit a strong push for innovation – R&D spending accounted for about 14% of sales.

The ongoing tech cold war between the US and China is a major risk for the industry as China is both a key client and player in the global supply chain of semiconductors. These tensions have led to significant trade restrictions but each regional powerhouse (i.e. China, the US and the EU) has also decided to implement strong policies to foster R&D and domestic manufacturing capacities. For instance, the Chips act in the US has already been driving strong growth in industrial manufacturing. Corporates in the sector can benefit from these policies and their financial incentives. Asia's dominance in the sector is unlikely to be challenged in the future but Europe and the US could reduce their current over-reliance.

Subsectors

Electronic components can be loosely divided between semiconductors and other active / passive electronic components and sub-systems.

Semiconductors serve different purposes (computing, storage, power management, communication, etc.) and are found in pretty much each and every electronic device. Product markets are generally concentrated and dominated by a handful of global players. The remainder of the industry is far more fragmented and generally more commoditized, with companies manufacturing everything from printed circuits boards to electronic displays through to resistors, capacitors and switches.



Energy

Renewables going through some turbulence

Sector rating

M Medium risk for enterprises

Strengths & weaknesses

- Strong push for energy transition
- Better fundamentals for oil & gas
- Enhanced policy support to renewables through various instruments
- Strong alignment of climate and energy security goals
- Focus on industrial strategy as countries seek to strengthen their sovereignty

- Geographic imbalances in investment
- Weak electric grid infrastructure in many economies, including the US and the UK
- Uncertainties over longer-term demand for fossil fuels
- High upfront spending required for clean-energy investments
- High financing requirements
- Vulnerability to geopolitical risk

Sector overview

What to watch?

- Financing costs and interest rate
- Green regulation, an opportunity for renewables & power and a risk for oil & gas
- Price war in the solar industry
- Recovery of the wind industry after a troubled 2023
- Policy support to renewables
- Geolopolitical developments (war in Ukraine, China-US tension, war in the Middle East etc.)

After recovering to pre-pandemic levels in 2023, global oil demand is projected to peak by 2030. Improvements in energy efficiency and the fast deployment of electric vehicles (EVs) will lead to a slowdown in demand. Despite this decline, sectors such as airlines and chemicals will continue to sustain oil demand due to the current lack of alternatives. Furthermore, emerging economies where decarbonation is too costly will continue to seek out fossil fuels for longer.

The ongoing energy crisis in Europe has boosted clean energy investment. In the US, the Inflation Reduction Act is also fueling investments into renewables and electric mobility and there are a number of other initiatives in Europe, Japan, China and elsewhere. 2023 was the first year on record with more investment in solar energy (about USD380 bn) than in oil & gas (USD370 bn).

Despite strong growth prospects, the wind industry is currently facing significant challenges. Supply-chain disruptions, rising material costs and logistical issues have led to increased project delays and higher expenses. Additionally, financial instability among key players has exacerbated these problems, leading to uncertainty in future investments. Some large wind turbine manufacturers have reported substantial losses, prompting a re-evaluation of project timelines and strategies. The sector is currently going through a recovery phase.

Likewise, the solar industry is not immune to shocks. The solar photovoltaic (PV) sector is currently experiencing a price war, driven by overcapacity and intense competition among manufacturers in China. This competition has led to a significant drop in solar panel prices, making solar energy more affordable but also squeezing profit margins for manufacturers. While this price decline benefits consumers and accelerates the adoption of solar technology, it poses financial challenges for manufacturers who are struggling to maintain profitability amidst rising production costs and supply-chain disruptions. These challenges are particularly acute for European manufacturers.

Against this backdrop, integrated oil & gas companies managed to post an EBIDTA margin close to 30% in 2023 while firms in the power segment had an EBIDTA margin of 15%. Growth prospects for both segments are strong as earnings per share are expect to rise by double digits in the next five years.

Subsectors

Fossil fuels: This includes oil, gas and coal operations. Firms can be involved in upstream or downstream processes.

Power: Firms in electricity generation whether through fossil fuels, nuclear, solar, wind, hydro or other forms of renewable energy.

Grids and storage: This includes firms managing and building infrastructure needed to distribute and store energy.

Household Equipment

Hit by purchasing-power crisis

Sector rating

S Sensitive risk for enterprises

Strengths & weaknesses

- Demographics and urbanization drive strong demand
- Innovation in smart home devices
- Some very strong niches (robotic appliances, health & wellness equipment, small kitchen appliances etc.)

- Highly cyclical sector
- Concentrated distribution networks (i.e. specialty retailers)
- Equipment rate is high for a number of products (TV sets, kitchen appliances etc.)
- Furniture segment is highly fragmented

Sector overview

What to watch?

- Purchasing power crisis and households' intention to make large purchases (e.g. appliances, furniture etc.) as well as their intention to buy housing
- Real estate market developments (new residential buildings, volume of transactions etc.)
- Interest rate and consumer credit flows
- Prices of raw materials, especially metals

After a strong post-pandemic boom, thanks to pent-up demand, consumer electronics, appliances and furniture sales declined from 2022 onwards. The purchasing-power crisis along with the slow renewal of equipment meant that demand plummeted. Furthermore, the decline in transactions and new building in most real estate market also hit the sector.

Nevertheless, there are strong growth prospects for specific product categories such as smart home devices, robotics and health-related devices. AI and digital technologies could also allow some players to boost revenues through improved customer experience (e.g. virtual reality, hyper customization etc.).

Despite a challenging environment, consumer electronics companies posted an EBIDTA margin close to 9% in 2023 while firms in the furniture segment had an EBIDTA margin of 10%. Nevertheless, growth prospects are stronger for the electronics segment, which is poised to grow earnings per share by over +15% the next five years while growth should be closer to +10% for firms involved in furniture manufacturing.

Subsectors

Household Equipment comprises different industries involved in the design and manufacturing of domestic equipment for households. While companies exhibit very different profiles between segments, they have in common a strong sensitivity to consumer spending and a reliance on Asia-Pacific, mostly China, for their manufacturing activities. Mature economies still make up the vast majority of demand.

- Consumer electronics: audio and video equipment, computers, mobile phones etc. Product markets are now largely mature and driven by replacement sales. A handful of companies generally dominates their markets and focus on design, R&D, marketing etc. while outsourcing manufacturing to contract manufacturers. Asia-Pacific concentrates more than 85% of global turnover. Mexico is the only significant manufacturer outside of the region.
- Household appliances: small appliances (home care, personal care, cooking aids…) and large appliances (refrigerators, ovens, dishwashers, washing machines…). Much like for consumer electronics, product markets are largely mature and dominated by a few large global players and smaller niche, regional competitors. Asia-Pacific's share of global turnover stands at about 80%. Other manufacturing countries include Germany, Italy, Turkey and the US.
- Furniture and furnishings is, on the contrary, a highly fragmented industry dominated by small- and medium-sized companies working closely with designers and retailers. A few mature economies, including Germany, Italy and the US, still have a significant presence in the industry.

IT Services

Digitalization and AI to support the sector

Sector rating

L Low risk for enterprises

Strengths & weaknesses

- The digitalization of the economy is a strong long-term driver
- Broad B2B customer base
- High value added and strong margins in many segments
- Recurring revenues

- Low barriers to entry
- Reliance on corporate IT spend
- Regulation on data and privacy can be a hurdle for European firms
- High concentration in certain services (cloud, cybersecurity etc.)
- High fragmentation and competition in consulting, programming and managed services

Sector overview

What to watch?

- The adoption of AI will boost demand for IT services
- Regulation around data and privacy
- Evolution of cyber risk
- Labor and skill shortages among IT workers

The global IT services grew by about +6% in 2023 and is expected to grow by close +10% in 2024. Global IT spend should increase, driven by the US and the UK, where it is expected to reach close to USD130,000 and USD80,000 per employee, respectively. As AI is being deployed among firms, a majority of IT managers are planning to invest in AI-powered software and services.

Although IT services is traditionally a high-margin industry with recurring cash flows, start-ups or companies operating in frontier markets have been facing pressure from rising interest rates and labor costs. The sector is labor-intensive and has seen an acceleration in wage growth amid fierce competition for talent and a shortage of skilled labor in emerging applications.

Computer services companies posted an EBIDTA margin close to 10% in 2023. Growth prospects are also quite strong for the sector, which is poised to grow earnings per share by +15% the next five years.

Subsectors

The industry can be divided into five main subsegments - companies generally operate across many segments. While IT consulting and programming is a fragmented activity , the managed services, software and data processing segments are far more concentrated with regional and global players..

- **Consulting** is about helping organisations make the best possible use of digital technologies to operate more efficiently.
- **Programming** is about developing custom digital tools to help organisations reach their business objectives.
- **Managed services** is about outsourcing the management of the IT infrastructure to a third-party company.
- **Software** are complex, generic programmes that can are made available to a variety of corporate customers.
- **Data processing,** including cloud computing, is about collecting and treating large quantities of data for corporate customers.

Machinery and Equipment

Elevated backlogs have provided production stability, but new orders and revenue will continue to be threatened by the economic uncertainties

Sector rating

M Medium risk for enterprises

Strengths & weaknesses

- High barriers to entry since a lot of investments in technology and capex need to be made in order to keep up with innovation and expansion
- Strong long-term growth potential in robotics and process automation. The adoption of Artificial Intelligence (AI) is expected to further expand demand for smart and cutting-edge machinery
- Companies with exposure to AI and automation will continue to have pricing power, given the limited offering amid surging demand
- Revenue diversification: Very heterogeneous clients and end-markets, serving companies and people in all regions and all kind of industries

- Cyclical sector, with companies are hit hard during recession periods due to falling demand and lower prices
- Complex and fragmented supply chain, which makes the sector highly vulnerable to supply disruptions or bottlenecks
- Capital-intensive sector, with large investments and R&D expenditures necessary to expand business and offer new products that adapt to new client needs in each end-market
- Susceptible to commodity access and prices since metals such as aluminium, copper, steel and nickel are heavily used for machinery building

Sector overview

What to watch?

- Global economic outlook: Macroeconomic conditions have slightly improved from 2023. However, the global economic recovery remains relatively slow, with global GDP expected to grow only by +2.8% in 2024 and 2025, which could put the sector's growth at risk in the short-term.

- Industrial policy: Industrial policies and subsidies are back with a bang, especially in major economies such as the US, China, India, Germany and Brazil. Governments are increasingly getting involved in setting industrial priorities and supporting strategic industries through subsidies to promote innovation and technology diffusion.

- Business confidence and manufacturing index: As indicators of future development in manufacturing businesses, both are key to predict the evolution of the sector in the short-term. So far in 2024, manufacturing confidence and PMIs have been gradually improving from last year's low, but current levels are not very promising.

- Improved supply chains: The supply-chain bottlenecks observed over 2021 and 2022 eased throughout 2023 as global trade was broadly muted, with transported volumes falling considerably. This has been very positive for machinery producers, who used to be highly dependent on parts suppliers from all over the world.

- Commodity prices: Prices of most metals have gradually declined over 2023 (from the peaks of 2022) due to the gloomy economic outlook. However, there is still a lot of price volatility in the spot market. While steel and nickel prices have corrected significantly, aluminum and copper prices have been climbing recently. These cost fluctuations could have considerable repercussions on the sector's margins in the short-term.
- Disinflation: Concerns around persistent inflation have been declining as some improvements have been observed on both sides of the Atlantic. In the US, we expect inflation at 3.0% in 2024 (from 4.1% in 2023) and in the Eurozone we expect 2.4% (from 5.4%). Nevertheless, higher-for-longer interest rates could affect companies' financials as this sector in particular tends to be highly leveraged.
- AI adoption: Big players in the sector have started to implement AI and machine learning in their production processes. With all sectors looking for efficiencies, being able to bring to the market leading edge machinery represents a great opportunity for companies to enlarge their market shares. We believe the ongoing industrial innovation and automation boom (particularly the adoption of AI) will generate multiple benefits both for sellers and users of machinery products. Companies with a more complete portfolio that combines hardware, software, cutting-edge technology and services will largely control this market.

The global machinery & equipment sector has a market value of around USD280bn and relies heavily on the APAC and North America regions, where revenues represent 34% and 30%, respectively, of the total market. The rest is split between EMEA (18%), South America (11%) and the rest of the world (11%).

As one of the most cyclical sectors, machinery & equipment is often hit hard during slowdowns and recessions. This was the case of 2020's pandemic-linked downturn, when revenues fell by -10% y/y on average. However, the post-pandemic rebound was significant as various end-market customers resumed operations and increased new orders quickly, making revenues to jump by around +12% in 2021 and +15% in 2022. Then, revenues faced a deceleration in 2023, growing only by +3% y/y (versus an average sector revenue growth of +6% in the last five years). This slowdown was explained by the recession fears arising from central banks raising interest rates to control inflation, which led to lower demand for machinery.

The high levels of accumulated backlogs observed in most of 2023 and easing supply-chains provided an above-average output capacity for the sector, with companies being able to ramp up production and increase deliveries to customers. More recently, backlogs have declined significantly as production rates have been exceeding softening new orders. For 2024, we expect new orders to remain mostly muted and revenues to grow by +2% y/y due to the persistent economic and political uncertainty, co,pounded by ongoing geopolitical tensions. Indeed, many companies, both manufacturers and buyers of machinery & equipment, have been cautious in terms of investment and restocking, adopting a "wait and see" approach.

The cooling in new orders has been observed mostly from farmers and construction companies. On the one hand, farm fundamentals have weakened, which has led companies in the upstream-food sector to reduce their capex for agricultural machinery and farm-equipment purchases. On the other hand, construction spending remains restrained due to still-high interest rates. Mining equipment volume could also decline in 2024 after an increase of +3% y/y on units sold in 2023 for this particular industry. However, in the mid to long-term, sales of metals & mining equipment are poised for continued expansion, with demand expected to accelerate from companies exploding key raw materials such as aluminum, copper, lithium, nickel and rare earth minerals, as all industrial sectors continue to develop their net-zero transition. In our view, the technology sector is the only one planning capex increases this year, from which we expect an enlarged demand for industrial machinery used in the manufacture of semiconductors, gadgets and tech devices.

Subsectors

The machinery & equipment sector includes the following sub-sectors: construction machinery, heavy trucks, agricultural & farm machinery, industrial machinery, mining equipment and robotics.

Metals

Green rush off to a slow start

Sector rating

S Sensitive risk for enterprises

Strengths & weaknesses

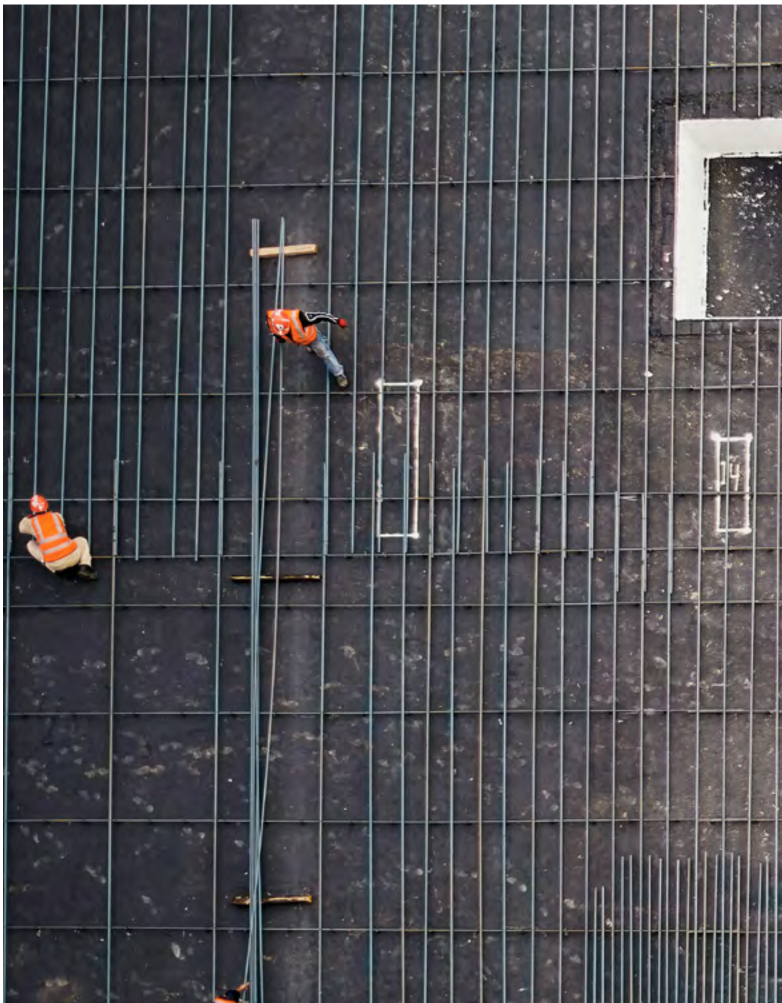
- Increasing demand for metals, especially those critical to renewable energy technologies and electric vehicles, which could quadruple by 2040 compared to 2020 in a Net-Zero scenario
- Despite volatility, many metals still have higher prices than their historical averages, boosting profitability for the sector
- Government focus on critical materials could increase support for the sector
- Firms' strong liquidity positions

- High exposure to geopolitical tensions and conflicts
- Fragmented supply chain at risk of disruptions
- Mining companies are facing increasing pressure related to ESG (water use, biodiversity, social impacts etc.)
- High capital intensity
- Extensive mine lead times

Sector overview

What to watch?

- Rising interest rates
- Green regulation, both an opportunity (through higher demand) and a risk (because of higher regulatory requirements)
- Public policies on critical materials
- Policies related to electric vehicles and wind energy
- Capex in the sector and especially exploration announcements by mining companies
- Mining lead times
- Geopolitical developments (war in Ukraine, China-US, Middle East etc.)



The global base metal market is projected to exceed USD1.1trn by 2030, with the global base mining market expected to reach over USD740bn. Recent growth and expansion in the global metals sector, including mining companies, have been fueled by rising demand in developing economies, the energy transition (from renewable energy to electric mobility) and high metal prices.

In 2023, metal prices remained relatively stable, with base metal prices increasing by +3.6% due to resilient demand, supply constraints in some segments (such as cobalt) and transportation issues. The average EBITDA margin for the metals and mining sector was approximately 13% in 2023, a significant decrease from 2022 but still reflecting strong profitability. Firms in the sector also maintained strong liquidity, with an average current ratio of 1.6 in 2023.

However, the sector faces challenges, including geopolitical tensions, environmental regulations and the need for technological innovation. The ongoing Russia-Ukraine war and high energy and input costs are expected to continue to pressure profitability in 2024. Despite the significant needs for the green transition, many firms have opted to limit their mining development plans. The sector continues to face a growth dilemma as miners need to invest more in exploration to ensure sufficient supply but in the downsteam subsector capital expenditures are set to decrease by about -4% in 2024, while upstream investments should increase by a meagre +4%.

Subsectors

Steel production: This is a significant segment of the metals sector, with steel being a critical material in construction, automotive and many other industries.

Metal processing and manufacturing: Firms involved in the processing of raw metals into finished products or components used in various industries (other than steel).

Iron-ore mining: Mining of iron ore for steelmaking industries

Base-metal mining: Mining of non-ferrous metals such as aluminum, copper, zinc and lead.

Precious-metals mining: Mining of gold, silver, platinum etc., mostly used for jewelry and as a form of investment.

Paper

A sluggish demand recovery but the worst is over

Sector rating

S Sensitive risk for enterprises

Strengths & weaknessesAtis egiliam. Eperibus omnos Ad simis adducerus intrae, publi,

- Increasing demand for boxes and packaging made of cardboard and paper with the exponential development of e-commerce
- Further growth potential in the medium and long term, driven expectations of exponential population growth
- Greater environmental awareness will continue to promote the use of paper packaging instead of plastic, especially in the food industry

- Increasing digitalization: With remote working becoming the “new normal”, digital connections and communication will continue to increase, resulting in reducing use of notebooks, paper sheets and printed books in the future
- Deforestation: the excessive use of land for planting and felling trees represents a great reputational risk for the sector
- Vulnerability to energy and chemicals access and prices: higher input costs are damaging the margins of the pulp subsector, particularly in Europe

Sector overview

What to watch?

- Evolution of e-commerce: The packaging segment is highly correlated to online sales as e-commerce is the main market for selling cardboard boxes and corrugated cartons.

- New regulations for packaging: Governments, notably in Europe, have been encouraging a greater use of paper and cardboard to replace plastic packaging, particularly for food-packaging purposes.

- Energy crisis: With electricity and natural gas prices in Europe still above normal levels, the region continues losing competitive advantage versus peers in the US.

- Increased consumption of paper-derived sanitary products: This will be driven by the growing population in developing countries and government aid seeking to generate more access to essential household products in developed countries.

- Increasing digitalization: This will continue to reduce the use of printing and writing paper.

- Evolution of the housing and construction market in the main wood-demanding economies (US and China) and building renovations in Europe.

2023 was a tough year for the pulp & paper sector. Revenues fell by around -15.2% y/y on average (five-year historical compound annual growth rate: +5.7%), driven by the contraction in both prices and volume sparked by the global economic slowdown, on one hand, and China's reopening on the other, which increased global paper capacity, adding to the existing oversupply.

The global deterioration in demand caused paper prices to drop, making the sector one of those that lost the most pricing power last year. However, there were differences between sub-sectors. While newsprint saw the biggest contraction in demand (-16% y/y), pulp was the only one to record volume growth (+2.5% y/y).

By revenue, the market share of each subsector has not changed from last year. As of today, wrapping and packaging is the largest (53%), followed by printing & writing paper (23%), sanitary (12%), newsprint (5%) and others (7%). By geography, the top five pulp & paper producers remain China, the US, Japan, Germany, Canada and Sweden.

Overall, the pulp & paper sector is energy and raw materials intensive, notably dependent on chemicals and natural gas for transforming raw wood into pulp and then into other derived sub-products. Unfortunately, many chemicals producers in Europe reduced or stopped the production of certain products in 2023 due to the huge amounts of natural gas needed to operate. As a result, companies in the pulp & paper sector were forced to source from other chemicals suppliers in China, the US and Canada, which reduced profitability. Operating margins moved from a five-year historical average of 8.9% to only 5.3% in 2023. The margin deterioration was particularly exacerbated in Europe by the above-average prices of natural gas and electricity. We do expect operating conditions will start to improve gradually in the second half of 2024 as cost pressures continue easing from 2023 levels. Yet, energy and transportation costs have lately proven to be very volatile as geopolitical tensions persist, which could ultimately put the margin recovery at risk.

We expect revenues to remain weak this year, increasing by only +1.2% y/y, followed by +5.1% in 2025. This small improvement should be supported by the fact that destocking is ending in many end-markets, and consumer spending will gradually start to improve as inflation is moderating. Improvements in inflation should also lead to interest rates cuts, which should also help the housing market to gradually recover, supporting demand for timberland and wood.

Subsectors

Paper packaging: Although business activity was broadly weak in all sub-sectors in 2023, paper packing was resilient, with global capacity increasing by +4% and global demand by +1% y/y. The packaging sub-sector is today valued at around USD940bn and is expected to grow the most in the coming years, boosted by the accelerated development of e-commerce and the packaging transition of other end-markets such as food (which accounts for 33% of packaging demand), which is gradually reducing its reliance on plastics. In fact, paper & board was the most used packaging material in 2023, just ahead of rigid & flexible plastics, with metal being the 3rd and glass the 4th. Although the outlook for the sector suggests limited price increases, packaging has been the best positioned segment in terms of margin protection, thanks to resilient demand.

Freesheet, newsprint, and printing & writing paper: The printing and writing sub-sector is a fragmented market that has been shrinking in size due to digitalization. Both the supply of and demand for printing and writing paper have declined by about -25% from the levels recorded a decade ago, especially in North America (-51%). In 2023, global demand fell by -9.6% y/y, with demand for uncoated mechanical paper falling the most (-18.4% y/y). Newsprint is in the same situation: Global demand decreased by -66% versus a decade ago (and -16% y/y) to around 10mn MT in 2023. Although the decline is visible around the world, Eastern Europe recorded the sharpest drop last year (-28% y/y), followed by Oceania (-23%) and Western Europe (-21%).

Pulp: This market is less fragmented than the other subsectors as it is a capital-intensive industry with high chemicals consumption. The majority of companies operating in this segment are located in Brazil, Chile, Canada and Northern Europe, while the most pulp-consuming country in the world is China, which demands around 50% of global pulp production. In terms of pulp trade, around 55mn MT of pulp was shipped across the world in 2023 (+2.5% y/y), of which 59% was bleached hardwood kraft and 41% bleached softwood kraft. We believe that pulp prices should continue to decline in the short-term, given that supply will continue to outpace pulp demand, particularly because of capacity additions coming from Latin American producers.

Forest, wood and timberland: Lumber and wood product prices declined by around -6% in 2023, mostly due to lower demand from the construction sector, which has been struggling since interest rates began to rise on both sides of the Atlantic. Nevertheless, some stabilization could be observed in 2024 as housebuilding activity should start to slowly recover in the second half of the year.

Pharmaceuticals

Pandemic-driven revenue growth fades, but robust pipeline of new medicines will assure growth in the mid-term

Sector rating

L Low risk for enterprises

Strengths & weaknesses

- Large-scale sector with a wide, stretched market, offering a wide variety of products and services worldwide
- Low fragmentation: the top 5 players together hold 30% market share, while the top 10 hold 50% of the market.
- High barriers to entry, notably as the sector requires significant investments in R&D as well as highly trained personnel (scientists), which is too costly for new companies.
- Despite the high expenditure in R&D (around 19% of revenues), companies in this sector are able to generate sufficient cash from operations to cope.
- Chronic disease cases have risen globally, making people more dependent on medicines and health supplements, which guarantees demand.
- Access to healthcare has been improving globally, especially in developing regions such as LatAm and Asia.
- Pricing power for treatments that benefit from patent protection since companies that produce generic drugs cannot replicate the formula. In parallel, this allows branded-drug sellers to have larger margins and absorb the inflation effect (higher ingredient prices).

- In order to ensure the safety, efficacy and quality of medicines, the pharmaceuticals sector is highly supervised and controlled, both globally (international standards) and locally (FDA in the US or EMA in Europe).
- Constant competition from generics and biosimilar drug producers as they can offer equally effective products at lower prices. As a result, generic drug-makers are constantly struggling to increase their profit margins.
- Although the approval processes for new medicines have been somewhat simplified in the last few years, they are still complex and lengthy, which delays the launch of new products to the market.
- The biggest players in this sector are American (and some European), which means that access to many medicines is not easy or affordable for people living in developing countries (LatAm, Africa, Asia).

Sector overview

What to watch?

Aging population: Life expectancy at birth has been rising progressively and today it is at 73.2 years on average (75.6y for women and 70.8y for men). At the beginning of the century, the average was 67.1 years.

Growing population: The global population is currently at 8bn and this figure is projected to reach 8.5bn in 2030. The more people there are, the greater the number and frequency of new infections and diseases on the planet. This represents a persistent challenge for companies focused on doing research and development on new drugs and vaccines. To ensure sanitary stability, a lot of capital and human resources have to be invested.

Faster approval processes: The number of annual FDA approvals of new products has increased markedly, thanks to its initiatives to speed up the processes and make it more efficient. In 2023, the FDA approved 55 new drugs, while between 2018 and 2022 the average number of annual approvals was 49 products and between 2013 and 2017 it was 36.

Pandemic-driven revenues were completely eroded in 2023: In 2020 and 2021, revenues in the sector grew on average by +8% and +15% y/y, respectively, vastly driven by pandemic-related sales. However, they peaked in 2022 when sales grew only by +1.2%, declining then by -2.1% in 2023.

Anti-obesity drugs boom: A wave of new drugs launched to fight diabetes and obesity are generating a furor among consumers around the world, generating exponential revenue growth for the laboratories behind this discovery, which have already built an oligopoly. With nearly half the world's population expected to be obese or overweight by 2030, demand for these products will continue to skyrocket, offering a significant boost to revenues in the coming years.

Rivalry with generic drug-makers will intensify in 2024 as the number of expiring patents will increase. Patents last 20 years on average so it is crucial to continue investing in R&D and innovating to get new ones that allow manufacturers of branded drugs to remain relatively protected against generic-drug players. It is estimated that once a generic drug is available in the market, it can cut the revenue of the branded drug by around 70%-80%.

Competition will also grow from specialty drugs or biopharmaceutics, i.e. drugs manufactured from biological sources (living organisms such as microbial cells or plant cell cultures), implying higher production costs and therefore higher prices. Despite being more expensive, biopharmaceutical products are becoming popular, given their proved capacity to treat previously untreatable illnesses. In parallel, in the same way that branded drugs face competition from generics, biopharmaceutical products also face competition from biosimilars, which are an imitation (almost an identical copy) of original biopharmaceutics.

AI incorporation: Artificial intelligence will start to play a key role in laboratories, generating time savings through the automation of clinical trials and faster discovery, development and marketing processes, bringing more efficiencies to the entire production chain of the pharmaceutical industry.

Having proved its prowess to the world during the challenging pandemic crisis of 2020-2022, business activity in the health industry expanded significantly, with the top 30 pharmaceutical companies in the world consolidating revenues of USD891bn in 2022, a peak never seen before, given the record speed at which laboratories managed to create new Covid-19 vaccines and related treatments. With the health crisis behind us, revenues in 2023 declined by -2.1%, but margins improved a bit, thanks to lower input costs.

For 2024, we expect revenues to jump by around +5% y/y, with increases of +6% and +7% in the US and Europe, respectively, and a slight decline of -2% y/y in APAC. This improvement should be supported by new drugs addressing untreated diseases.

In terms of consumption, the world's top five importers of pharmaceutical drugs are the US, Germany, Switzerland, Belgium and China. In terms of production, the US and Europe are and will remain the industry leaders by far. For reference, Big Pharma in the US generates around USD450bn of revenues per year, which is 1.3x higher than that of European peers and 4.6x higher than that of Asian peers.

Historically, sales growth in the pharmaceutical sector has always been driven by the oncology and immunology segments, and these two areas have also been the focus of the sector's research & development spending. However, in 2024, one of the areas where sales growth rates will be particularly high is the weight-loss business segment, which includes treatments for diabetes and obesity. As of today, there are four treatments that, on top of being approved by the FDA and the EMA, have no major side effects in patients. However, these successful drugs have been developed and commercialized by few companies, which, by operating under an oligopoly, have managed to gain pricing power. Revenues for these companies are expected to soar by +25% on average this year, after jumping +27% in 2023. Demand will be particularly high in North America, given the large share of the population suffering from obesity. More precisely, 43% of Americans are considered obese (vs an average of 25% for the OECD group). As a result, diabetes and hypertension are the two most common diseases in the country.

The Inflation Reduction Act will have an impact for drugmakers in the US as high drug prices continues to weigh on American households. Per year, a US citizen spends USD1,432 on medicines, which is 2.3x more than the average of OECD nations. Just across the border, Mexico's per capita spending is 2.2x less than the OECD average. As this situation continues, we expect more political actions to control prices. With the implementation of Biden's IRA, the sector should prepare to see changes in the way prices are negotiated. For instance, this year for the first time Medicare will be negotiating with pharmaceutical companies the price of 10 expensive and highly used drugs, with new lower prices being applicable from January 2026. Further negotiations will follow in 2025 to cover a full list of 30 drugs, with the potential to save Medicare USD98.5bn over a decade.

For the long-term, the main pillar for the industry to remain relevant is innovation. As of today, there are still hundreds of diseases that cannot be fully prevented or cured, which means there is a lot of room for science exploration and growth potential. M&As are an efficient and commonly used way to generate greater synergies and boost innovation in this industry and we expect this strategy to be strongly deployed in the years to come. Oncology will continue to be the focus of R&D as it is still the number one source of income for pharmaceuticals. As of today, there are around 16,000 different cancer-related drugs in the pipeline, of which 43% are in the pre-clinical phase and 18% in the discovery phase. Immunology holds second place, with 5,775 drugs in the pipeline, while diabetes ranks third with 1,400.

Subsectors

Drugs manufacturers:

a. **Active Pharmaceutical Ingredients (API):** API is the part of any medication that produces the intended health effects. They are produced from raw materials with a specified strength and chemical concentration. Examples of APIs include: ibuprofen, loratadine, omeprazole and acetaminophen. All drugs are made up of two core components (APIs and excipients). The excipients are chemically inactive substances, such as lactose or mineral oil in the pill, which are used to help the medication remain stable and to control its absorption.

b. **Patented drugs (also known as branded or original drugs):** Original drugs refers to drugs that have been approved for marketing after many tests and rigorous clinical trials (there are four phases before the post-market monitoring). This takes about 15 years of R&D and millions of dollars of investments. Only large multinational pharmaceutical firms are able to develop original drugs, which benefit from a patent period of 20 years. But once the patent expires, other manufacturers can start to produce generic versions of the drug.

c. **Generic drugs:** Drugs that are not branded but that are very similar to a branded drug in terms of dosage, administration, safety and performance. Generic drugs tend to be cheaper and therefore more accessibl, since their manufacturers did not have to invest in discovering/creating a new formula but only replicate an existing one

d. **Biotechnology:** This is the merging of biology and technology, refering to the branch of applied science that uses living organisms and molecular biology to produce healthcare-related products. Today, approximately 17% of total drug revenue is derived from biopharmaceuticals, which are mostly used in oncology, metabolic disorders and infectious diseases. The term biopharma describes companies that use both biotechnology and chemicals in their R&D.

Contract Research and Manufacturing Services (CRAMS): The field encompasses those services in the pharmaceutical and biotechnology industries that require extensive R&D and large-scale manufacturing facilities. It is a clinical term used for referring to outsourcing and it is one of the fastest-growing segments in the sector today.

Drug marketing: This refers to the marketing of drugs and medical devices by private and public organizations to doctors, clinicians and consumers as drugs/treatments need to adopt particular marketing strategies to be sold effectively.

Retail

Headwinds for specialized retail

Sector rating

S Sensitive risk for enterprises

Strengths & weaknesses

- Strong buffers for consumers in advanced economies (resilient labor markets, wage growth, savings)
- Digital & e-commerce can drive growth, especially in emerging markets

- Highly cyclical sector
- Strong competition and limited differentiation capacity for a number of players
- Brick & mortar retail challenged by e-commerce

Sector overview

What to watch?

- Consumer confidence, wage growth and consumer credit
- Growth of hard discount in major markets
- Vacancy rates in commercial real estate

Food retailers have been through a volatile couple of years. With the pandemic people spent more time at home and with restrictions on eating-out opportunities, food sales surged in 2020 and well into 2021, before gradually returning to pre-pandemic levels in early 2022. The war in Ukraine and the following period of very strong inflation was also an extraordinary time, with sales in volume on the downside but turnover in value terms on the upside. However, now food retailers have many products in disinflation or even with prices decreasing. Consequently, food sales in volume, which had been diminishing for a while, finally bottomed out in late 2023 in the US and in many European countries. They are now rebounding in many markets. Retailers also had to adapt their e-commerce logistics and strategy in response to the post-Covid consumer behaviour shifts, with online sales figures still growing and/or higher than pre-pandemic in many markets. Furthermore, tight financial conditions seen across most countries continue to weigh on leveraged retailers although softening interest rates in coming quarters will provide some relief.

Non-food retail

The post-pandemic pent-up demand for many goods meant booming sales for many non-food retailers. However, it was mostly equipment with long life cycles that was purchased in 2020-2021 and consumers have shifted their splurging to services, meaning lower sales for a number of goods. Against this backdrop, most product categories have been experiencing sluggish growth since 2023. In the US, health and personal care continue to grow at a fast pace while furniture sales in volume have been decreasing steadily. In the Eurozone, most sales in specialized stores have been decreasing in volume terms in 2023. Digital sales have been progressing in the US and the UK but have been mostly flat in continental Europe.

Like many other sectors, retailers managed to offset some of the declining volume by passing on higher prices to consumers. On the cost side, wage growth, high energy prices and increased financing costs are also still weighing on a number of firms in the sector. Against this backdrop, we saw in 2023 some specialized retailers go bust or having major financial issues. Overall, general retailers and specialized retailers had an EBIDTA margin of 7% in 2023 while food retailers an EBIDTA margin at 6%. However, the outlook for specialized retailers is much more challenging as falling volumes can no longer be compensated by higher prices and pricing power is waning.

Subsectors

Fast-moving consumer goods (food, personal care, house care, etc.): Traditionally the most resilient segment of the industry with little volatility in consumer spending and high industry concentration. The main challenge for retailers is to adapt their store mix to address changing consumer preferences.

Furniture, electronics, appliances, hobby and leisure: Segments with generally higher profit margins but greater volatility as they sell discretionary consumer goods. Fierce competition from e-commerce specialists. Uncertain transition from a brick-and-mortar to click-and-mortar business model.

Apparel and accessories: Much like other discretionary spending, apparel and accessories see reduced consumer spending when the economy decelerates.

Beauty and cosmetics: Very dynamic sales globally pushed by the retail expansion of luxury companies.

Department stores: Department stores face very strong competition from online stores. The segment is cutting capacities in North America and is starting to adapt in Europe, but still growing in other regions of the world.

E-commerce specialists: Buoyant top line growth but still elusive profitability for the vast majority of players.

Telecom

5G, data, fiber to support growth while New Space might become a challenger

Sector rating

M Medium risk for enterprises

Strengths & weaknesses

- Strong barriers to entry
- High value added and strong margins
- Data consumption and digitalization of the economy are a long-term support
- Limited exposure to economic cycle in advanced economies
- Emerging technologies and new consumer trends provide growth opportunities

- Mature and highly competitive markets in advanced economies
- Capital intensive sector
- High leverage among a few large US and European firms in the sector
- Higher exposure to economic cycles in developing markets

Sector overview

What to watch?

- Fiber deployment in markets with lower intake
- Development in NewSpace, i.e. firms providing telecom services thanks to low Earth orbit satellites
- 5G uptake in advanced markets
- Interest rates and financing conditions that can challenge leveraged players

The deployment of fiber networks is accelerating, with significant investments aimed at enhancing broadband connectivity in many countries. The global rollout of 5G is also continuing, with 5G connections reaching half of the global population as of end 2023. 5G cover 95% of the population in China and 90% of the population in the US, while Europe is trailing behind at 70%. There are also significant growth opportunities in emerging markets (10% coverage in LatAm and MENA, 20% in APAC ex-China). 5G is expected to become the dominant subscription type by 2028 and it represents a huge opportunity for the sector. Furthermore, global data consumption is expected to grow from 136 exabyte (EB)/month to 174 EB/month in 2024, which should benefit the sector. Over the last couple of years, we also witnessed the growth of low Earth orbit (LEO) satellite players, which have been growing steadily as internet providers, especially in emerging markets. Over the longer run, they could compete with traditional telecom players.

Companies in the sector have been facing higher interest rates and some have been compelled to reduce capital expenditures which could to be detrimental to longer-term prospects. Amid a major purchasing-power crisis, many firms in the sector did not increase prices while their own costs were increasing with energy prices and wage increases. Nevertheless, telecom companies posted an EBIDTA margin of 31% in 2023.

Subsectors

Landline and mobile telecommunications. The biggest players operate in both segments, but it is not the case in emerging economies.

Consumer and business telecommunications. Some niche players focus on the specific needs of corporates.

Cable companies.

Satellite telecommunications including New Space.

Mobile Virtual Network Operators (MVNO) are companies focusing on marketing mobile services while renting network capacity to traditional operators.

Textiles

Continued and broad-based deceleration

Sector rating

S Sensitive risk for enterprises

Strengths & weaknesses

- Reactive, flexible and integrated supply chains
- Luxury and sportwear are strong segments in the sector
- Innovative sector both in terms of products and business models

- Highly cyclical sector
- Fashion retail is high concentrated
- Sustainability issues (labor, environmental impact etc.)

Sector overview

What to watch?

- Consumer confidence, wage growth and consumer credit
- Developments of new business models (i.e. ultra-fast fashion) and new consumer trends (i.e second-hand)
- Commodity prices (cotton, fibers etc.)

Despite the inflationary backdrop in 2023, the non-luxury textile segment grew by +4% y/y in Europe and by +6.5% in China as demand was resilient. In the US, sales flatlined in 2023. In 2024, non-luxury sales are expected to grow by +1.5% in Europe, +1% in the US and +5% in China. The luxury segment fared much better in 2023 across regions with growth of +13.5% in Europe, +2% in the US and +9% in China. Nevertheless the momentum should slow down, with +4%, +3% and +5% expected in 2024 for Europe, the US and China, respectively.

Overall, consumer spending on fashion remains under pressure and trends such as ultra-fast fashion brands and the purchase of second-hand goods are only gathering steam. Although positive for sales volumes, ultra-fast fashion is contributing to pushing prices down and forcing the whole supply chain to adapt to an even faster pace, putting pressure on margins. The growth of the second-hand market is being boosted by online platforms and embraced by retailers that are introducing trade-in programmes for old clothes for sustainability and branding motivations.

Firms in the sector are also facing higher labor costs and higher prices for commodities and energy, which is weighing on profitability. However, despite this challenging environment, non-luxury companies posted a stable EBIDTA margin at 11% in 2023.

Subsectors

Textiles: about 50% of industry turnover. Textile manufacturers serve mostly the needs of the clothing and home improvement industries, to a lesser extent other industries (automotive, etc.)

Apparel: about 30% of industry turnover. Apparel manufacturers are mostly contractors to which large fashion retailers outsource the actual manufacturing of their clothes and accessories.

Leather and shoes: about 20% of industry turnover. Leather goods and shoes generally have distribution channels that are distinct from apparel.

Asia Pacific concentrates 80% of the industry's turnover, with China's share standing at 50-60% across most segments, the remainder being split between India, Bangladesh, Vietnam and Indonesia. Excluding Asia, Turkey and Mexico also have sizeable textile industries exporting to the European and U.S. markets, respectively. Some countries producing high end or technologically advanced fabric have kept a significant manufacturing base (Italy, France, Germany, Japan in particular).

Transport Equipment

Faster production has increased deliveries and reduced backlogs

Sector rating

S Sensitive risk for enterprises

Strengths & weaknesses

- High pricing power since there are few manufacturers capable of engineering and building tailor-made transportation equipment, particularly in aviation (an oligopoly with very few well-recognized players).
- Lot of growth potential for the transportation sector in general, especially for the rail transportation market, with governments looking to encourage green mobility.
- In some cases, construction contracts are signed with governments (state-owned transportation companies), which gives greater reliability of repayment.
- Construction periods for transport equipment tend to be long (several years), allowing companies to anticipate production capacity and forecast income in advance, and therefore better manage working capital.

- Very capital-intensive sector as it is necessary to invest both in R&D (design and engineering of state-of-the-art models) and in capex and infrastructure for the construction and assembling of the equipment to be sold.
- Highly leveraged sector. Given the large size of contracts and how expensive manufacturing is, companies require a high level of disposable working capital over the construction period as in most cases they will be fully paid only on delivery.
- As steel and aluminum are the main metals used for the manufacturing of trains, airplanes and vessels, profitability is vulnerable to commodity price volatility, though sales are agreed on a fixed-price contract basis.
- A market that demands high precision, high-quality finished products and safety. Any failure of a structural component, manufacturing defect or accident can have huge negative consequences for both the operator and the manufacturing company.
- Cyclicality: demand tends to accelerate in economic boom periods when transportation companies can afford to enlarge their capex, while investments decrease significantly during economic slowdowns.

Sector overview

What to watch?

- Stricter environmental regulations: In a society that is increasingly aware of the need to reduce CO2 emissions, the transportation sector is facing stricter international regulations (as it is responsible for around 25% of global CO2 emissions). For transport operators to achieve the green transition, transport-equipment manufacturers must invest even more in innovation so that they can create greener ships and aircraft. As a result, we expect new hydrogen-based or electric models to be launched in the aviation sector in the coming years, intensifying competition in an oligopolistic market where no player wants to lose market share.
- Easing of supply chains: Industry-wide supply-chain bottlenecks have eased substantially in the past quarters, allowing for the faster delivery of transport equipment. Financially speaking, this is positive for companies' fundamentals given that the backlog is transformed into finished products faster, meaning companies can enlarge their operating cash flow. Nevertheless, the aviation segment is still struggling on this front as some suppliers have been failing to cope with increasing demand, causing plane-makers to to fall short of their delivery targets.
- Commodity prices: Prices of most metals gradually declined over 2023 (from the peaks of 2022) due to the gloomy economic outlook. However, there is still a lot of price volatility in the spot market. While steel and nickel prices have corrected significantly, aluminum and copper prices have been climbing recently. These cost fluctuations could have considerable repercussions on the sector's margins in the short-term.
- Labor market: The "great resignation" movement and staffing issues observed in 2022 and 2023 (difficulty to find and recruit engineers and skilled workforce) have eased in 2024. However, in the aviation industry, raising labor costs have become a new challenge, with companies having to raise salaries to retain competent employees.
- Disinflation: Concerns around persistent inflation have been declining, with some improvements on both sides of the Atlantic. In the US, we expect inflation at 3.0% in 2024 (from 4.1% in 2023), and in the Eurozone 2.4% (from 5.4%). Nevertheless, higher-for-longer interest rates could affect companies' financials as this sector in particular tends to be highly leveraged.
- Space race: We expect the competition to develop spacecraft to intensify in the coming years, with new Chinese players entering in the market as well. Countries with high investment capacity in innovation and R&D such as the US, Europe, Russia and China will continue running the race to find solutions that will allow transportation to the space/moon.
- Growing defense market: Companies in the aviation and maritime sectors have been increasing their market share in the defense segment (military helicopters, jet fighters, aircraft carriers, submarines, etc.). The US, Russia and China spend the most on military equipment.

Aviation: TCommercial aircraft deliveries have improved in 2023 (+10% y/y) and are expected to climb by +12% in 2024. Although narrowbody airplanes are the best sellers in volume terms (accounting for 81% of annual global deliveries), widebody planes posted the highest growth rate in production last year (+15% y/y). However, aircraft makers are still far below the delivery levels seen prior to the pandemic as supply-chain challenges have persisted for longer, while Boeing has been struggling with quality/safety problems. This lower production capacity of brand-new planes has been positive for companies in the aftermarket, who have seen demand for parts and repair services soar.

Vessels: Ship prices continue rising in 2024 (tankers: +11% y/y, bulkers: +12% y/y and containerships: +6% y/y), thanks to robust demand as the global merchant fleet is aging (the average age of commercial ships exceeds 20 years). Old ships are not only less fuel-efficient but are also more polluting. As a result, shipping companies with old fleets are unable to comply with the stricter international standards for CO2 emissions. In the past two years, vessel sales have reached record highs and further growth is on the horizon, with revenues for 2024 and 2025 expected to remain above USD50bn annually, thanks to the large-scale fleet renewal that is in the pipeline. Indeed, shipyards around the world have announced that they are operating at their maximum capacity.

Trucks OEMs: Supply-chain constraints have improved, accelerating production rates and boosting delivery volumes after years of poor output due to a lack of supply. In Europe, for instance, new heavy truck registrations grew by +13.5% y/y in 2023. However, as new orders are not increasing at the same pace as the output, backlogs have been declining. Still, we can expect demand to start to increase for electric trucks as companies have to shift away from diesel-powered trucks.

Market practice in purchasing contracts: The manufacturing process of transport equipment is costly and time-consuming as it can take about 2-4 years to design and build a brand-new vessel, airplane or train. Because of the long duration of projects, there are risks throughout the process and a lot can go wrong. Therefore, purchase contracts often go hand-in-hand with insurance bonds (bid bonds, performance bonds and advance payment bonds). In many cases, the transportation company places an order for several units, which considerably enlarges the size of the contract. This is why we tend to see transactions backed by an export credit agency (ECA).

Backlogs: The large increase in capex of companies in the transportation industry during 2021 and 2022 led to a backlog in 2023 not seen before. However, backlogs have declined significantly in 2024 as output has improved, with companies delivering more and faster. In parallel, the weak economic context has caused new orders to slow down, making it hard for the backlogs to increase again.

New orders could increase in H2 2024. The weak economic outlook, notably for the US and Europe, has deteriorated business confidence. As a result, new order volumes have remained relatively weak in the past quarters, with transportation companies being cautious in terms of cash utilization. However, new orders could start to jump in the second half of the year in anticipation of interest rates cuts that could have a positive effect on the overall economy. For the mid to long term, the pressing need to decarbonize the transportation sector will keep orders rising, especially in the shipping and airlines industries.

Subsectors

Aircraft manufacturers (aeronautics): Companies involved in the design, engineering and assembly of any kind of vehicle that is manufactured to fly in the air, including planes (commercial and cargo planes, private jets, military jets and propeller planes) and helicopters (civil and military). The US and France are the world's largest producers of aircraft.

Shipyards: Companies that build and repair any type of water-transport vehicle, such as yachts, cruise ships, container and dry bulk vessels, military vessels, oil and chemical tankers, ferries, ice-breakers etc. By revenue, this market is vastly dominated by South Korean, Chinese and Japanese companies, followed by European companies.

Rolling-stock manufacturers: Companies involved in the entire process of designing, manufacturing, assembling and testing rolling stock. Wagons/trains can be used for both passenger and cargo transport and can be high-speed or not. This market is lead by China and Europe.

Trucks OEMs: Manufacturers of trucks or camions, which are normally used for cargo transportation, for carrying other vehicles or dry-bulk commodities. Trucks vary in size, power and configuration. While most are still powered with diesel fuel today, electric trucks are gradually being introduced to the market.


HANJIN
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Transportation

A speedy recovery will not be enough to achieve a speedy decarbonization

Sector rating

S Sensitive risk for enterprises

Strengths & weaknesses

- Government support in the form of public infrastructure (ports, airports, roads, railways etc.), given its crucial role in enabling trade, tourism and daily mobility.
- Monopoly or oligopoly in some countries, which gives companies pricing power.
- In the cargo segment, shipping companies benefit from 1) bunker fuel being cheaper than car diesel or jet kerosene and 2) the largest transport capacity: today's largest vessels can transport up to 24,000 containers, which explains why 85% of global trade is transported by sea.
- Rail transportation is rarely privatized. In most cases, rail companies are state-owned, which gives them relatively easy access to financing and grants (vs airlines which have a lower credit profile).

- Fuel-price volatility constantly affects margins as it is the main cost for transportation firms. So far in 2024, bunker oil, diesel, kerosene and biofuel prices have declined from the peaks observed in 2022 and 2023 but they remain relatively high, weighing on companies' earnings
- Increasingly criticized for its negative environmental impact, especially airlines (anti-flying social movements).
- Capital-intensive sector as companies need an expensive fleet of airplanes, buses, trucks, vessels etc, which must be frequently renewed and have high maintenance costs.
- Highly leveraged as companies rely on a huge amount of debt to acquire and expand their fleets.
- Since it mostly transports freight, maritime transportation is very cyclical so both prices and volumes depend on economic activity (trade).
- Airlines have faced tough competition since the arrival of low-cost carriers.
- Compared to maritime transport, road transport faces higher labor costs that are not proportional to the capacity of trucks despite its lower transportation capacity (a truck can carry only 1 container, while a vessel can transport 20,000).
- Road transportation companies depend on government budgets for road infrastructure, which remains less developed in developing countries, limiting expansion. In other geographies, the toll system is too expensive.countries, the toll system is too expensive.

Sector overview

What to watch?

Stricter environmental regulations: Transport accounts for around 24% of global CO2 emissions, and road travel accounts for 3/4 of transport emissions. We believe that international regulations aiming to reduce GHG emissions are going to become increasingly tougher, impacting all kind of transportation means. Aviation and maritime sectors are hardest to decarbonise because of the sizeable amount of investment to be done to renew fleets and the slow pace of technological improvements. Also, alternative fuels will have to be more widely available and cost-competitive versus conventional fuels (SAF for instance is 2.5x more expensive than kerosene).

Carbon pricing power: Transportation companies that manage to decarbonize their fleet faster will gain more competitiveness and pricing power over competitors that are lagging on greening their fleets. This is because all companies in all sectors are required to reduce (and report) their greenhouse gas emissions, with scope 3 emissions coming not from the company's direct business but from transportation services.

Airlines

- Demand has been strong in all geographies, proving that traveling is no longer discretionary but has become a staple in people's budgets. Unlike in past recessions, inflation and the economic slowdown have not deterred consumers from spending on travelling. In fact, demand for hospitality and transportation services continues to grow even though Revenue per Available Room (RevPAR) and airline ticket prices remain high. According to the World Tourism Organization (UN Tourism), in Q1 2024, international tourism reached more than 285mn travelers, +20% more than in Q1 2023, and representing 97% of pre-pandemic levels (Q1 2019), with Europe, Africa and Middle East already surpassing 2019 volumes.

- Trends such as the rise of working from home – which was expected to curb business travel – and the flight-shame movement have also not dented the demand for travel, though domestic travel traffic bounced back to pre-pandemic levels quicker than international travel. This year, the volume of global air passengers is expected to hit an all-time high (+10.4% y/y), with Asia-Pacific and North America leading the growth, while Africa and Latin America lag.
- However, there are four factors that will continue threatening airlines' margins in the short term: 1. higher wages (personnel have bargaining power through strikes), 2. higher than pre-pandemic jet-fuel prices (which represent 30% of total costs), 3. higher ground charges (airport fees), 4. the shortage of aircrafts, which started with the pandemic's supply-chain bottlenecks and has been exacerbated by Boeing's recent safety issues.
- Limited capacity: In 2018-2019, the sector saw around 1,600 annual aircraft deliveries globally. With a shortage of parts disrupting production, deliveries fell by half in 2020 and began to improve progressively afterwards. In 2023, aircraft deliveries grew by +11% y/y and for 2024 they should increase by +16% y/y. Yet, volumes remain below normal, pushing airfares up.
- In parallel we can also expect demand for leasing aircrafts to increase as this allows airlines to operate without leveraging and without incurring high maintenance costs. Today around 40% of the global fleet is leased and 60% is owned. We estimate that in the next five years the ratio will be 46%/54%.

Maritime

- Greening of the sector: Approximately 11bn tons of goods are carried by sea every year worldwide (85% of total global trade), a figure that is estimated to triple by 2050. Though maritime transportation is currently responsible for only about 3% of global greenhouse-gas emissions, this share could surge to 17% by mid-century if no action is taken today. Carriers know that besides being a challenge, decarbonizing also represents a market-gain opportunity for those players that are ahead in the greening of their fleets as rising demand for clean transportation will give them carbon pricing power. As of today, 13 of the world's 30 largest shipping companies have already set a net-zero target between 2040 and 2060 and the sector's capex is expected to continue growing in 2023 and 2024 after two record years. However, the maritime sector will have to invest a minimum of USD23bn per year to achieve its climate targets.
- Ageing fleet: In 2023 the world fleet consisted of around 105,500 vessels of 100 gross tons and above (an increase of only +3.6% y/y). What is concerning is the speed at which the world fleet is aging and depreciating. Last year, commercial ships had an average age of 22.2 years (25-30 years being the technical lifespan). Compared to a decade ago, the global fleet has aged by an average of two years, with over half of the fleet now exceeding 15 years of age. The least developed countries own the oldest fleet but are also the ones with the fewest resources to accelerate the greening of this sector. International support is essential so that these countries can comply with the IMO's new greenhouse-gas reduction targets.
- The sector's capacity is expected to grow in 2024-2026 as shipyards around the world continue operating at capacity to accelerate deliveries in the short-term. Indeed, the extra cash generated by the sector over 2021 and 2022 has allowed big players to enlarge their capital expenditures for the purchase of new vessels. However, a portion of incoming new vessels are intended to replace the retired/old ones.
- Shipping prices volatility: Climate change (droughts in the Panama Canal) and geopolitical tensions (Suez Canal and Strait of Hormuz) have been disrupting maritime traffic and thereby changing the routes, extending transportation time, increasing fueling costs and altering freight prices. As geopolitical conflicts and climate threats persist, we can continue to expect a lot of volatility in ocean freight prices.

Rail:

- One of the biggest constraints for rail companies is the constant need for investments, both for the development of the railway networks and their signaling systems, as well as for the acquisition of rolling-stock. Nevertheless, in some regions (notably in Europe) companies receive government support in the form of grants to cover capex needs.
- We believe that increasing environmental awareness will boost revenues for rail transportation in the coming years as people will prefer to take a train over a flight for short-distance trips.as people will prefer to take a train over a flight for short-distance trips

Road:

- The 2021-22 2021-22 shortage of drivers eased over 2023. However, labor will continue to pose a challenge. The road sector has the most organized and strongest unions within the entire transportation industry, which gives them high bargaining power. Indeed, the sector saw significant salary increases for drivers across different geographies last year, which will continue to weigh on companies' margins. In the long term, the aging workforce will create another challenge: how to attract and replace current drivers that will be retired in few years, since new generations increasingly prefer other types of work, especially in developed countries.
- In developed countries, especially in Europe, electric buses and trucks are increasingly being introduced. Therefore, adapting roads to offer a wide electricity supply will remain a priority and a challenge.
- Companies in the road transportation segment have been facing weakening demand in the past quarters, in line with the weakened global economic outlook. This together with rising costs, particularly higher labor, and still-high diesel prices, have been weighing on truckload carriers' revenue and earnings in 2024.

Airlines: The outlook for airlines has improved dramatically. Passenger yields, i.e. the average amount paid by a passenger to fly one kilometer (revenue per RPK), are expected to further strengthen by +3.2% y/y this year, given strong demand and limited capacity, setting the stage for overall revenue growth of around +6.5% y/y, totaling USD967bn (from USD838bn in 2019). Furthermore, after three loss-making years, the airline industry reported a net profit of USD27.4bn in 2023 – earlier than expected. This was already +3.9% higher than the 2019 level. For 2024 the industry anticipates a full-year profit of USD30.5bn. However, profitability will not look the same across regions, due to geopolitics. Aircraft fuel oil is the biggest operating cost for airlines and although jet prices have remained moderated year to date, this input cost is one of the most volatile since supply and therefore prices are conditional on geopolitical matters and regional capacity. On top of this, fueling costs change notoriously from one region to another, with Latin American airlines being more vulnerable to kerosene price changes.

Decarbonization: This is and will be the main challenge of this industry in the short, medium and long term, given that the technology necessary to decarbonize the sector has not yet been developed on a large scale. The Sustainable Aviation Fuel (SAF) market remains in its early stages of development, which means low supply and a very high prices. To achieve a significant increase in SAF production, cooperation between the government and key players in the industry is essential.

Maritime: Disruptive events in recent years have highlighted the risks of trade choke points. The accidental obstruction of the Suez Canal in 2021, droughts in the Panama Canal in 2023-2024 and, more recently, the crisis in the Red Sea reveal how much global shipping routes depend on certain tight passages. The ongoing Red Sea crisis suggests that at a time of sufficient shipping capacity and relatively muted demand, alternatives can be found (year-to-date, the number of containerships crossing the Bab-El-Mandeb Strait is -76% lower than usual, while shipping volume around the Cape of Good Hope has soared by +193%). Other key maritime choke points could come under increased scrutiny in a world of rising uncertainty: Around 30% of oil traded on the world's oceans passes through the Hormuz Strait, while the Malacca Strait accounts for 25-30% of global trade and 40% of the world's containerships passes through the Taiwan Strait. As there is still a lot of uncertainty regarding geopolitical tensions and trade tariffs, shipping prices continue to show a lot of volatility, especially container freight rates. While they initially rose significantly in the first two months of the attacks on ships in the Bab-El-Mandeb Strait (+87% Dec vs Nov and +177% Jan vs Nov) and reached a peak of USD3,964/forty-foot per container by the end of January, prices then started to sequentially decline over March and April (to USD2,706) as supply chains adapted to disruptions and the sector's capacity was outpacing fragile demand. However, recent announcements of potential trade tariffs to China have sent maritime transport prices skyrocketing again reaching a new peak this year (USD4,716). As of today, the WCI index is +181% higher than a year ago, or in other words it is 3.2x higher than the pre-pandemic usual level of USD1,450/forty-foot.

Rail: Europe is one of the regions where rail transportation is most developed, given the small size of the continent (reduced distances between cities/countries), the flexibility for crossing borders within the Schengen Area and the capital investments made by governments to install an extensive railway network. In Europe, this sector has historically been state-owned, with each country having its own rail-transportation company that ensures mobility through the entire territory. For this, each country oversees investing the necessary amount for the expansion and renovation of railway networks, as well as for the purchase of rolling stock. In the same way, governments can fix prices, which creates a certain monopoly within each territory. Nevertheless, since 2021, an EU "rail-market liberalization" project has been agreed, which aims to progressively liberalize the commercial long-distance rail market to encourage competition between operators and therefore improve services quality and offering for travelers in Europe. Other countries such as the US, China, India, and Japan also rely on rail transportation. However, in these countries, trains are more used for the transport of merchandise (cargo) than for passenger transportation.

Road: The 2020-2021 health crisis halted government investment in roads and infrastructure in many geographies, especially in developing regions such as Asia, LatAm, and Africa, where it is precisely the lack of transport infrastructure investment that has been inhibiting growth. In contrast, in developed regions such as Europe and the US, governments have implemented new infrastructure projects during the crisis, aiming to drive economic and employment growth. For instance, the European Commission has been working on a Trans-European Transport Network (for railways and roads), aiming to connect 424 cities and imposing a minimum speed of 160km/h. The network is planned to be fully completed by 2040. For companies running inter-city buses and coaches, one of the main challenges is to be able to transform their fleets towards electric vehicles, which is relatively easier to finance in Europe than in any other region of the world. But before fully switching away from diesel, the region requires more electric charging station, both on highways and in cities.

Subsectors

The transportation sector encompasses all kind of companies providing the means for transporting people and goods from one geographical place to another.

Air transport: Companies that use aircraft (owned or leased fleet) as a means of transportation, regardless of the distance (short or long-haul).

a. Traditional airlines.

b. Low-cost airlines: They offer the same transport facility of traditional airlines but with a reduced offer of services that enables lower costs, and therefore lower air-ticket prices.

Maritime transport: All kind of transportation services through boats, including:

a. Cruise ships: large passenger ships used mainly for vacationing purposes.

b. Vessels: container ships, oil tankers, chemical tankers, gas and LNG tankers, dry bulk carriers, car carriers (ro-ro ships).

c. Ferries: mainly for short trips across rivers, harbors and channels or between islands.

Rail/train transport: Another way for moving people and goods over short and long distances (both underground and over the surface). Train systems run on metal rails, which allows the rolling stock to benefit from lesser frictional resistance and therefore to attach more load in terms of wagons or carriages. Besides being the means of transport that emits the least CO2, it is also the one that is less affected by weather turbulence.

Road transport: This segment includes companies that offer the movement of people and goods through trucks, buses, coaches and taxi-cabs, both in urban perimeters and on highways.

Sector risk methodology

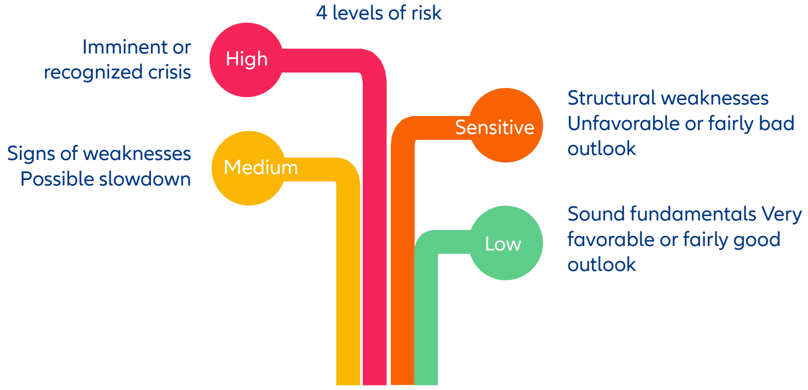
The Sector Risk Rating by Allianz Trade Economic Research assesses the risk of non-payment by companies in 18 sectors across 70 countries around the world. It is measured on a four-level scale from Low to High.

Sector risk assessments are based upon the forward-looking evaluation of four key determinants – demand, profitability, liquidity and business environment – using Allianz Trade internal data and expert judgments, as well as hard data from secondary sources.

Our grading system uses a unique methodology which combines data and expert judgments to assess the risk of nonpayment at a sector level across the top 70 countries of the world.

Sector Risk Rating

4 levels of risk



4 levels of risk based on 4 key components

The Sector Risk Rating is based on the evaluation of four components that are analyzed globally for each sector

Demand: Outlook for companies' turnovers based on the organic growth, fundamentals and price competition of the sector

Profitability: Outlook for companies' margins and profits depending on the evolution of prices in raw materials/ commodities, on labor costs and fluctuations in supply and capacity

Liquidity: Outlook for companies' cash positions and financing risks, based on access to financing and payment performance, and

Business environment: Any technological innovations, new government subsidies and changes in legal framework that can alter business models and companies' strategies.

A quantitative and qualitative grading system

Our grading system is a unique combination of indicators and expert judgements dedicated to assessing the short-term outlook of the four sub-components of our sector risk ratings.

The indicators are based on Allianz Trade internal data and hard data from secondary sources.

The expert judgments capitalize on the microeconomic expertise of Allianz Trade credit analysts, who closely monitor risk in companies all over the world, and the sector advisors of the Economic Research team, who analyze industry trends globally.

These judgments are collected using a standardized and consistent quarterly questionnaire.

Sector risk ratings are designed to complement Allianz Trade' Country Risk ratings and individual buyer risk assessments.

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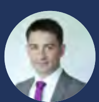

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