MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

Dangers Lurk Amid 2018's Positive Outlook

Moody's Analytics Research

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Credit Markets Review and Outlook *by John Lonski*

Dangers Lurk Amid 2018's Positive Outlook.

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The Week Ahead

We preview economic reports and forecasts from the US, UK/Europe, and Asia/Pacific regions.

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The Long View

Check our chart here for forecast summaries of key credit market metrics. Full updated stories, "High-yield spreads remain thin despite how the less favorable tax treatment of interest expense may adversely affect at least 25% of high-yield issuers," begin on page 14.

Credit Spreads	Investment Grade: Year-end 2017 spread to eclipse its recent 107 bp. High Yield: Compared to a recent spread of 365 bp, it may approximate 375 bp by year-end 2017.
Defaults	US HY default rate: Compared to November 2017's 3.4%, Moody's Default and Ratings Analytics team forecasts that the US' trailing 12-month high-yield default rate will average 2.4% during 2018's third quarter.
Issuance	In 2016, US$-IG bond issuance grew by 5.6% to a record $1.412 trillion, while US$-priced high-yield bond issuance fell by 3.5% to $341 billion. For 2017, US$-denominated IG bond issuance may rise by 7.4% to a new zenith of $1.517 trillion, while US$-priced high-yield bond issuance may increase by 32.7% to $452 billion, surpassing 2014's record $435 billion.

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Ratings Round-Up *by Njundu Sanneh*

Defaults Surprise in November

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Market Data

Credit spreads, CDS movers, issuance.

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Moody's Capital Markets Research *recent publications*

Links to commentaries on: Saudi Arabia, defaults, credit/stocks, China, yields/prices, debt/growth, Spain, upside surprise, bulls, less fear, Fed & BoJ, inflation, market triggers, hurricanes, data in sync, Harvey, inflation, yields, Korea, jobless rate, spreads, Saudi Arabia.

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Click here for *Moody's Credit Outlook*, our sister publication containing Moody's rating agency analysis of recent news events, summaries of recent rating changes, and summaries of recent research.

Credit Markets Review and Outlook

By John Lonski, Chief Economist, Moody's Capital Markets Research, Inc.

Dangers Lurk Amid 2018's Positive Outlook

Earnings-sensitive markets thrived in 2017. Though late 2016's outlook for 2017's pretax operating profits proved to be fairly accurate, the market value of U.S. common stock still soared higher by 18% to a new record high. Several developments explained why the market value of common equity outran the growth of core profits in 2017. First, the market strongly believes in the efficacy of forthcoming tax law changes and has effectively shrugged off whatever harmful effects may arise from a wider federal budget deficit. Moreover, a recent study from Moody's Investors Service concludes that while most US companies will be better off following the enactment of corporate tax reform, at least a quarter of highly-leveraged companies will be worse off.

Not All Companies Will Benefit from Proposed Tax Reform

The cut in the top corporate income tax rate from 35% to 21% and the ability to immediately fully expense capital spending will outweigh the loss of full interest deductibility for almost all investment-grade issuers. However, the loss of full tax deductibility of interest expense will adversely affect the after-tax earnings of a number of high-yield companies. About 26% of high-yield issuers will be worse off under the House plan and 36% will be worse off under the Senate proposal because of how the House plan allows interest expense to be deductible up to 30% of EBITDA, while the Senate's version limits the deductibility of interest expense up to 30% of EBIT. (EBITDA equals earnings before interest costs, taxes and depreciation, while EBIT equals earnings before interest and taxes, thus EBITDA exceeds EBIT by the amount of depreciation expense.)

Higher Yields and Wider Spreads Will Increase the Costs of Reduced Interest Deductibility

The share of high-yield companies that are worse off because of the loss of the full deductibility of interest expense might become larger in the event benchmark interest rates jump sharply and/or high-yield credit spreads widen materially. In addition, the less favorable tax treatment of business interest expense might become most apparent during a credit crunch, which, in all likelihood, would also be accompanied by shrinkages of both EBITDA and EBIT that automatically reduce the amount of interest expense eligible for deductibility.

In general, anything that increases the after-tax cost of debt also increases the risk of more defaults during the next bout of financial stress. Nevertheless, over time, businesses might be expected to adjust to the less favorable tax treatment of interest costs by assuming less debt than otherwise. For now, the market has been largely indifferent to high-yield's potential loss of financial flexibility in view of how a recent high-yield bond spread of 369 basis points (bp) was thinner than its 2017-to-date average of 384 bp.

Malfunctioning Phillips Curve Lifted Equities and Corporates in 2018

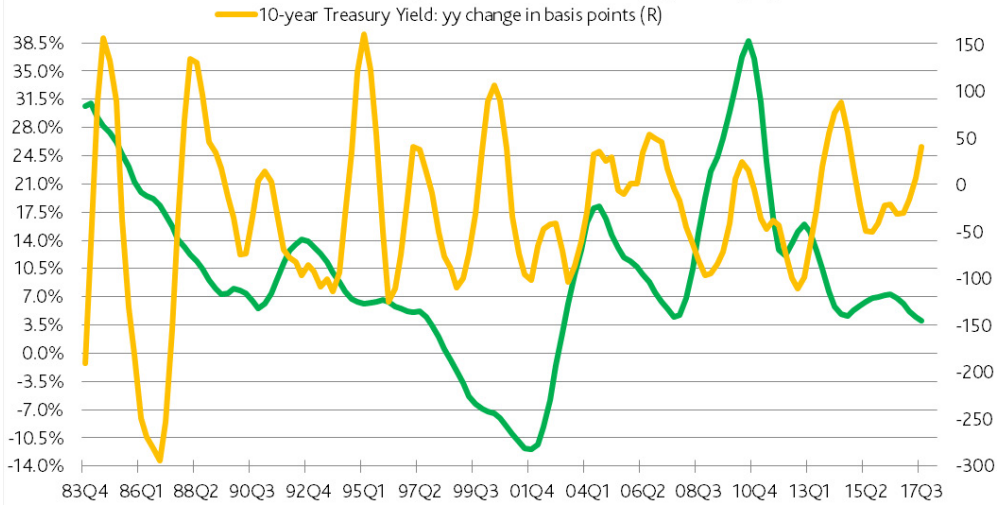
Secondly, the valuation of earnings-sensitive securities received a boost from 2017's lower-than-expected Treasury bond yields and heightened confidence in the long-term containment of inflation expectations. Though 2017's three Fed rate hikes adhered to the expectations of year-end 2016, the 10-year Treasury yield 2.32% average of 2017-to-date fell considerably short of the Blue Chip consensus' prediction of a 2.7% average for yearlong 2017's 10-year Treasury yield. Moreover, the 10-year Treasury yield's fourth-quarter-to-date average of 2.36% is far under year-end 2016's prediction of a 2.9% average for 2017's final quarter.

Basically, the consensus got Treasury bond yields wrong in 2017 because the Phillips curve failed to deliver as 2017's lower than expected unemployment rate was joined by slower than anticipated consumer price inflation. At the start of 2017, the Blue Chip consensus projected a decline by the unemployment rate from Q4-2016's 4.7% to an expected 4.5% for Q4-2017 that would be joined by accelerations for the annual increases of (i) the average hourly wage from December 2016's 2.9% to an expected 3.1% for December 2017 and (ii) the CPI from Q4-2016's 1.7% to Q4-2017's 2.4%. As it turned out, despite November 2017's lower-than-anticipated jobless rate of 4.1%, November 2017 also revealed slower than expected annual increases of 2.5% for the average wage and 2.2% for the CPI.

Containment of Inflation Expectations Lowers VIX Index and Narrows Spreads

Had it not been for the containment of inflation expectations despite the lowest unemployment rate in nearly 17 years, Treasury bond yields would now be noticeably higher and price-to-earnings ratios would be lower. In addition, a more uncertain long-term outlook for inflation probably would have led to a higher VIX index. Given the strong correlation between the VIX index and corporate bond yield spreads, a much higher VIX index would have been joined by significantly wider gaps between corporate bond yields and Treasury yields. Thus, the containment of inflation expectations benefited corporate credit not only by reining in benchmark Treasury yields, but also by helping to narrow spreads via a perceived improvement in long-term prospects for systemic liquidity.

Figure 1: Annual Percent Change of Tradable US Treasury Notes and Bonds Fails to Show a Positive Correlation with the 10-year Treasury Yield's Annual Basis Points Change
moving yearlong averages; source: Federal Reserve, Moody's Analytics



One of the bigger threats to 2018's outlook involves a worsening of inflation expectations that drives interest rates up to levels that weaken equities, increase the VIX index and widen spreads. What appears to be a lively finish to 2017 supports expectations of a climb by real GDP growth from 2017's prospective 2.3% rise to a range of 2.5% to 3% for 2018. The tendency of benchmark interest rates to rise when business activity accelerates favors higher short- and long-term borrowing costs in 2018.

However, unlike the wider spreads of late 2016 that supplied plenty of room for spread narrowing and, thus, allowed corporate bond yields to decline despite an accompanying rise by benchmark Treasury yields, the much thinner spreads of late 2017 imply corporate bond yields are more likely to rise with Treasury yields in 2018. A steep enough climb by the yields of Treasuries and corporates would lower share prices not only by lessening the relative attractiveness of expected returns from richly-priced equities, but also by dimming prospects for credit-sensitive expenditures.

Furthermore, a weaker equity market and a higher VIX index would diminish systemic liquidity and, thereby, increase the default risk surrounding more marginal speculative-grade credits. Thus, too steep of a climb by interest rates constitutes one of the bigger dangers to 2018's otherwise benign outlook for corporate credit.

Next Profits Slump Will Wreak Havoc

A fundamentally excessive climb by interest rates also risks an outright contraction by profits capable of triggering bear markets in both equities and corporate credit. The likely avoidance of a material and extended contraction by corporate earnings is critical to achieving at least a satisfactory performance by corporate bonds and stocks in 2018.

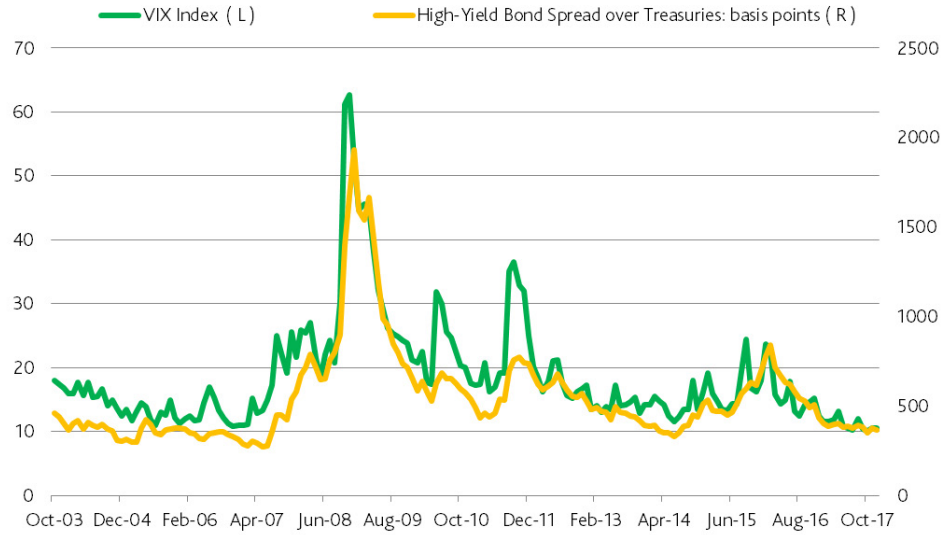
Less than three years ago, the moving yearlong average of pretax operating profits sank by 7.5% from a Q2-2015 top to a Q3-2016 bottom. In response to 2015-2016's profits slump, the market value of US common stock plunged by 16% from a June 2015 top to a February 2016 bottom, while the high-yield

bond spread ballooned from June 2014's current cycle bottom of 323 bp to February 2016's cycle high of 879 bp. However, the latter proved to be an overreaction to a temporary and limited ascent by the high-yield default rate from September 2014's now 10-year low of 1.6% to January 2017's localized peak of 5.8%.

Markets May Quietly Absorb Fed's Passive Reduction of Bond Holdings

The record suggests that the Treasury bond market may be able to cope with the Fed's gradual paring of its holdings of U.S. Treasury notes and bonds. In the past, the credit market frequently absorbed a faster increase in the amount outstanding of tradable Treasury notes and bonds sending without the spur of significantly higher Treasury bond yields. Nevertheless, the conventional wisdom holds that as U.S. Treasury bond debt that is not held by the Fed grows more rapidly compared to the previous year, the steeper should be the accompanying annual increase by the 10-year Treasury yield. However, during the past 25 years, the year-over-year percent change of US Treasury bond debt that is available to the market shows an insignificant inverse correlation of -0.05 with the 10-year Treasury yield's accompanying year-over-year percentage point change.

Figure 2: Ultra-Low VIX Index Helps to Rein In High-Yield Bond Spreads (correlation = 0.90)
source: CBOE, Moody's Capital Markets



An increased supply of tradable Treasury bonds often does not drive Treasury bond yields materially higher. For example, though the yearly percent increase of tradable Treasury notes and bonds outstanding quickened from Q3-2014's 5.3% to Q3-2015's 7.2%, the 10-year Treasury yield's quarter-long average still fell from Q3-2014's 2.50% to Q3-2014's 2.22%. Thus, the release of Treasury notes and bonds now held by the Fed into the overall market does not assure an increase by Treasury note and bond yields.

Complacency of the Inflation Front Is Ill-Advised

The bigger risk to financial markets would be upwardly revised inflation expectations that send bond yields up to burdensome levels. One cannot deny the possibility that the Phillips curve will come back with a vengeance and wreak havoc on financial markets. The likely application of fiscal stimulus amid a relatively tight labor market could make even the 3% 10-year Treasury yield now predicted for 2018's final quarter seem unsustainably low.

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The Week Ahead – US, Europe, Asia-Pacific

THE US

By Ryan Sweet of Moody's Analytics

Attention on fiscal policy and tax legislation

The attention will remain on fiscal policy. Odds are high that the House and Senate conference committee members reconcile the two congressional tax plans shortly. It's unlikely that any changes would affect our impact of tax legislation on GDP growth over the next couple of years. We believe it will add a few tenths of a percentage point to GDP growth per annum in the short run but have no impact on the economy's potential growth rate.

As for the economic data, housing will be a focus, with the release of starts along with new- and existing-home sales. We look for a sizable gain in existing-home sales, but new-home sales likely fell in November. Durable goods orders will bounce back after falling in October.

Already-released data point toward a modest gain in real consumer spending in November, but the key for monetary policy will be the core PCE deflator. If inflation doesn't accelerate, debate within financial markets about whether or not the Fed should pause this tightening cycle will intensify.

Markets are likely misreading the Fed. The central bank's unemployment forecast will continue to be revised lower, showing a larger overshoot, and this will likely nudge the Fed's interest rate projections higher.

In our view, the unemployment rate has nowhere to go but lower, and this should worry the Fed; the economy could overheat, and returning the economy to full employment without triggering a recession is increasingly difficult. The Fed's statement also changed its expectation for the labor market from "strengthen further" to "remain strong." In other words, if the unemployment rate doesn't stop falling soon, a more aggressive path for interest rates will likely be needed. For perspective, every 0.1-percentage point reduction in the Fed's forecast for the unemployment rate implies an additional 20-basis point increase in the fed funds rate.

	Key indicators	Units	Moody's Analytics	Consensus	Last
Mon @ 10:00 a.m.	Moody's Analytics Business Confidence for 12/15/17	index, 4-wk MA			37.2
Mon @ 10:00 a.m.	NAHB Housing Market Index for December	index	70	70	70
Tue @ 8:30 a.m.	Current Account for 2017Q3	$ bil	-116.0	-117.2	-123.1
Tue @ 8:30 a.m.	New Residental Construction for November	mil, SAAR	1.218	1.250	1.290
	Permits	mil, SAAR	1.265	1.280	1.297
Wed @ 10:00 a.m.	Existing-Home Sales for November	mil, SAAR	5.73	5.53	5.48
Thur @ 8:30 a.m.	Jobless Claims for 12/16/17	ths	230	231	225
Thur @ 8:30 a.m.	GDP for 2017Q3-third estimate	% change, SAAR	3.3	3.3	3.3
Thur @ 8:30 a.m.	Philadelphia Fed Survey for December	index	22.3	20.5	22.7
Thur @ 10:00 a.m.	Conference Board Leading Indicators for November	% change		0.3	1.2
Fri @ 8:30 a.m.	Personal Income for November	% change	0.5	0.4	0.4
Fri @ 8:30 a.m.	Personal Spending for November	% change	0.4	0.4	0.3
Fri @ 8:30 a.m.	Core PCE Deflator for November	% change	0.1	0.1	0.2
Fri @ 8:30 a.m.	Advanced Durable Goods Orders for November	% change	1.8	2.0	-0.8
	Excluding Transportation		0.7	0.5	0.9
Fri @ 10:00 a.m.	Michigan sentiment for December, final	index	97.3	97.1	96.8
Fri @ 10:00 a.m.	New-Home Sales for November	ths, SAAR	645	651	685

MONDAY, DECEMBER 18

Business confidence (week ended December 15; 10:00 a.m. EST)

Global businesses have felt good all year, but they are feeling particularly upbeat as the year comes to an end. Sentiment remains strong across much of the globe, consistent with an economy that is expanding above its potential. The most encouraging aspect of the survey is that the percentage of respondents that are upbeat about conditions going into next year remains sturdy.

Businesses are increasingly fixated on regulatory and legal issues, as about one-half of businesses say those are their largest concern. An additional one-fifth of businesses say finding qualified labor is their biggest problem. Concern with the strength of their sales and taxes has significantly receded.

The four-week moving average in our business confidence index increased from 36.5 to 32.3 in the week ended December 8.

NAHB housing market index (December; 10:00 a.m. EST)

We look for the NAHB housing market index to have remained at a healthy 70 in December. Homebuilder stock prices have been little changed over the past month, which will likely keep builder sentiment in check. The prospect for corporate tax reform should provide a floor for the index in December. Also, the improvement in the labor market should remain a support, as builders should feel fairly upbeat about their near-term prospects.

TUESDAY, DECEMBER 19

Housing starts (November; 8:30 a.m. EST)

Housing starts rose 13.7% to 1.29 million annualized units in October, leaving them above their third quarter average of 1.164 million annualized units. Single-family housing starts increased 5.3% to 877,000 annualized units, which was in line with our forecast. The forecast error was in multifamily, as starts were up 36.8% to 413,000 annualized units in October, more than our forecast for 332,000 annualized units. Multifamily starts are volatile, and October's gain was likely payback for the past few months when starts had been soft.

Total housing starts rose in three of the four regions, suggesting that rebuilding following the hurricanes was not the only reason for the gain. Looking through the recent volatility, the trend in housing starts has been little changed recently. The 12-month moving average was 1.201 million annualized units in October, nearly identical to the level for most of this year and up 2.8% on a year-ago basis.

Turning to November, we look for starts to have dropped to 1.218 million annualized units. The decline will be concentrated entirely in multifamily. The forecast assumes that single-family starts were little changed. Total housing permits are forecast to have come in at 1.265 million annualized units.

WEDNESDAY, DECEMBER 20

Existing-home sales (November; 10:00 a.m. EST)

Existing-home sales are expected to have risen 4.6% to 5.73 million annualized units in November. Sales will be above their third quarter average of 5.39 million annualized units, suggesting broker commissions will add to growth in real residential investment in the final three months of this year. Pending-home sales, which lead existing by one to two months, were up 3.5% in October. Unadjusted for seasonal variation, the increase in pending is even more impressive, rising 16.1%, the largest for any October since 2012. We expect the strength in pending-home sales to be reflected in existing.

THURSDAY, DECEMBER 21

Jobless claims (week ended December 16; 8:30 a.m. EST)

We expect initial claims for unemployment insurance benefits to have risen by 5,000 to 230,000 in the week ended December 16. This would reverse some of the prior week's decline. Claims can be volatile this time of year because of the holidays, therefore it's difficult to be overly confident in the forecast. Claims will be less useful in assessing the health of the labor market over the next several weeks because of the holidays.

The incoming data will include the payroll reference week. We will be keeping a close eye on the advance and prior week data for California because of the wildfires. New filings for California, which are not adjusted for seasonal variation, have bounced around over the past couple of weeks. This isn't uncommon around natural disasters as they normally depress new filings before boosting them. Despite the volatility over the past couple of weeks, initial claims in California are lower than at a similar time last year and are following a the pattern over the past five years. Therefore, it doesn't appear that the employment impact of the wildfires will be significant.

GDP (2017Q3-third estimate; 8:30 a.m. EST)

Third quarter GDP was likely unrevised from 3.3% at an annualized rate in the third estimate. The upward revision to real services spending, implied by the Quarterly Services Survey will be offset by the likely downward revision to goods consumption. Beyond the QSS, we look for a small downward revision to intellectual property investment. Incoming data point toward a small upward revision to capital spending, net exports and inventories. However, the revisions should be small. Our forecast is below our tracking estimate of 3.4%, but this estimate doesn't take into consideration revisions to the data that haven't been released yet. Therefore, our official forecast is a touch lower and looks for no revision to GDP growth.

FRIDAY, DECEMBER 22

Personal income and spending (November; 8:30 a.m. EST)

Nominal personal income likely rose 0.5% in November after rising 0.4% in each of the prior two months. Wages will provide the bulk of the support to nominal income growth in November. The labor income proxy for all private workers rose 0.7% in November. Turning to nominal spending, we look for a 0.4% increase. Retail sales point toward a strong gain in consumer goods spending excluding gasoline and autos. Higher gasoline prices should provide a support to nominal spending on gasoline while we look for vehicles to be a small drag. The drop in utility production points toward weakness in household spending on utilities in November. The savings rate likely fell from 3.2% to 3.1%.

We look for the core PCE deflator to have risen 0.1% (0.08% unrounded) between October and November, leaving it up 1.5% on a year-ago basis. The core CPI rose 0.1% in November while the PPI was more mixed. The details of the PPI and CPI can be mapped to the personal consumption expenditure deflator. The PPI is most important regarding medical care pricing in the PCE deflator. The medical care deflator accounts for almost 20% of the core PCE index, and close to 85% of the medical care index is derived from PPI inputs. After the PPI is released, we have a strong sense of where the broader medical care index will end up. Many of the PPI inputs are related to medical care, but the PPI is also used as source data for several other categories in the PCE price index, including various measures of insurance and financial services costs. For inputs that are not related to medical care pricing, inflation has been firmer than the aggregate core measure for much of the past year. These components account for only about 6% of the core PCE deflator, so they do not have a significant influence on the broader core index. But with every tenth counting on inflation, we should still monitor these PPI measures.

Durable goods orders (November; 8:30 a.m. EST)

We look for durable goods orders to have risen 1.8% in November after falling in October. Transportation should be positive for orders in November and gains should be fairly broad-based. We expect nondefense aircraft orders to have risen in November. Nondefense aircraft likely also increased but less than that implied by Boeing orders, which were concentrated in the lower-priced planes. This should limit the gain in nondefense aircraft orders in November. Industrial production for motor vehicles points toward an increase in motor vehicle and parts orders. Excluding transportation, we look for a 0.7% gain in durable goods orders in November.

New-home sales (November; 10:00 a.m. EST)

New-home sales came in noticeably better in October. There was payback for the recent hurricanes, as sales that were going to close in August and September appear to have been pushed into October. New-home sales are counted when the contract is signed. Other factors are supporting sales, including lower mortgage rates. New-home sales rose 6.2% in October to 685,000 annualized rate. September sales were downwardly revised, as new-home sales are now shown to have risen 645,000 at an annualized rate (previously 667,000). We expect payback in November with new-home sales falling to 645,000 annualized units. The forecast assumes a downward revision to October, which has been the norm recently.

EUROPE

By Barbara Teixeira Araujo and Europe staff of Moody's Analytics in London and Prague

U.K. GDP will likely confirm the slower growth indicated in the latest estimate

The week before Christmas will be extremely calm in what regards both data and political events. In the U.K., we will get final GDP data for the third quarter, and we expect that the headline will only confirm the latest estimate that the country's economy grew by 0.4% q/q in the three months to September, accelerating slightly from a 0.3% reading in the second stanza of the year. Similarly, the yearly rate is expected to be confirmed at 1.5%, the same rate as in the previous quarter—the lowest since the start of 2013. The details should show that household consumption accelerated sharply, likely to 0.6% q/q, from 0.2% previously, while investment disappointed and net trade dragged on growth. The bad news is that we don't expect this pace of growth in consumer spending to be sustained in coming quarters; we see it mainly as a blip. The figures in the three months to September were likely boosted by erratic movements in energy consumption and jump in car spending, which should both mean-revert at the end of the year. True, retail sales surprised strongly on the upside in November and are set to increase by around 1.2% in the final stanza of the year. But we caution that retail sales are weakly correlated to overall spending, notably as consumers normally scale back spending elsewhere in order to finance their purchases in the high street, and this should be especially true now that real wages are falling. Even worse is that the headline retail figure is actually misleading, since it increased mainly on the back of Black Friday sales. This new U.S.-imported seasonal pattern has not yet been fully incorporated into the adjusted numbers, so the theoretical seasonally-adjusted increase should be much smaller than the one published by the ONS. And while the GDP numbers will still incorporate these poorly-adjusted figures, all high frequency indicators of consumption growth, such as consumer confidence, housing market indicators and reports from the Bank of England's Agents, point to a slower pace of expansion in the fourth quarter.

U.K. investment should come in at 0.2% q/q, decelerating from a 0.5% rise in the three months to June. While we should acknowledge that business investment is not downright falling in light of the Brexit uncertainty, at 0.2% q/q, the pace of growth more than halves the growth rate recorded over the past few years. This is disappointing mainly because it shows how companies, especially in the manufacturing industry, are failing to respond to the pound's slump to the extent policymakers had expected. And that will be corroborated by the fact that net trade likely shaved 0.5 percentage point off growth. That exports likely fell further by 0.7% q/q in the three months to September is yet further evidence that the U.K.'s competitiveness in the global market failed to improve to the extent implied by the pound's slump. That's because exporters raised their prices rapidly, while Brexit woes disrupted the usual mechanism that when export prices rise, new companies will want to invest in their export capacity to profit from this new market.

The situation is much brighter across the Chanel. France GDP numbers are expected to confirm that the French economy grew by 0.5% q/q in the three months to September. While this represents a modest slowdown from the upwardly-revised 0.6% gain in the previous stanza, the year-on-year rate is still expected to have shot up to 2.2%, from 1.8% previously, its highest since 2011. Domestic demand provided the main support to growth, as both household consumption and investment grew strongly. Accordingly, consumer spending is set to have accelerated to 0.5% q/q, from 0.3% in the second quarter, on the back of a 1.6% rise in energy consumption—notably as September's below-average temperatures boosted demand for heating—and of a jump in sales of clothing. But services spending is also expected to have gained ground, up to 0.4% q/q, from 0.2% in the second quarter. Even better is that investment also likely increased, up by 0.8% q/q and building up on an already-strong 1% increase in the previous stanza.

Foreign trade by contrast likely dragged, but that was already expected following the second quarter's jump. That's because imports likely rose by a strong 2.5% q/q in the third quarter, following a mere 0.2% increase in the previous stanza, on the back of a replenishing of inventories. Stock-building and imports are strongly correlated in France, especially in the transport sector, and the story in the third quarter is that after sales of aeronautic equipment soared in the second quarter, companies rushed to

replenish their stocks in the third. As a result, inventories also rose strongly and offset the plunge in net trade. Exports, meanwhile, decelerated to only 0.7% q/q, though this was expected following the 2.3% jump in the three months to June. In all, net trade is expected to have shaved 0.6 percentage point off the GDP headline.

We will release our forecasts for upcoming Europe economic data on Monday.

	Key indicators	Units	Moody's Analytics	Last
Mon @ 9:00 a.m.	Italy: Foreign Trade for October	€ bil	5.2	4.0
Mon @ 10:00 a.m.	Euro Zone: Consumer Price Index for November	% change yr ago	1.5	1.4
Tues @ 3:00 p.m.	Russia: Retail Sales for November	% change yr ago	0.0	3.0
Tues @ 3:30 p.m.	Russia: Unemployment for November	%	5.1	5.1
Wed @ 8:00 a.m.	Germany: Producer Price Index for November	% change yr ago	2.9	2.7
Wed @ 11:00 a.m.	Germany: Ifo Business Climate Index for December	index	117.0	117.5
Fri @ 6:30 a.m.	France: GDP for Q3	% change	0.5	0.6
Fri @ 7:45 a.m.	France: Household Consumption Survey for November	% change	2.0	-1.9
Fri @ 9:00 a.m.	Italy: Consumer and Business Confidence for December	index	108.5	108.8
Fri @ 9:30 a.m.	Spain: Foreign Trade for October	€ bil	-2.9	-2.1

MONDAY, DECEMBER 18

Euro Zone: Consumer Price Index (November; 10:00 a.m. GMT)

Euro zone annual harmonized inflation accelerated to 1.5% in November from 1.4% in the previous month, according to preliminary estimates. Higher energy prices contributed the most to the headline, while food price growth moderated a bit. Core inflation remained at 1.1%, as both services inflation and nonenergy goods inflation held steady. We expect core inflation to stay muted for some time, but we caution that the cyclical trend remains up. The latest result will nonetheless mean that the ECB was right in late October to reinforce its dovish bias, and we don't expect it to tighten monetary conditions much further in 2018.

TUESDAY, DECEMBER 19

No major indicators are scheduled for release.

WEDNESDAY, DECEMBER 20

Germany: Producer Price Index (November; 8:00 a.m. GMT)

Producer price growth likely accelerated in November to 2.9% y/y, from 2.7% in the previous month. Details of the November Markit manufacturing PMI showed that input prices increased for the 16th consecutive month, mainly because of rising demand and prices of raw materials, and the rate of increase accelerated to the fastest since April 2011. Selling prices were hiked as well, and the rate of increase picked up to the fastest since June 2011. Brent crude rose above $60 per barrel in November, compared with $57.51 on average in October. Meanwhile, the euro depreciated to $1.17 from $1.18 in the previous month, but remained above November 2016's level of $1.08, weighing on inflation pressures. Overall, robust economic activity in Germany has been supporting price growth.

THURSDAY, DECEMBER 21

No major indicators are scheduled for release this day.

FRIDAY, DECEMBER 22

France: GDP (Q3; 6:30 a.m. GMT)

Final GDP data are expected to confirm that the French economy grew by 0.5% q/q in the three months to September, slowing slightly from a upwardly revised 0.6% gain in the previous stanza. The year-on-year rate is expected to have shot up to 2.2%, from 1.8% previously, its strongest since 2011. Domestic demand should have contributed the most to growth, as household consumption and investment surged. Consumer spending is set to have accelerated to 0.5% q/q, from 0.3% in the second quarter, on the back of a 1.6% rise in energy consumption—particularly as September's

below-average temperatures boosted demand for heating—and of a jump in sales of clothing, since annual sales started later this year than last year, boosting July's sales volumes. But services spending is also expected to have ramped up to 0.4% q/q, from 0.2% in the second quarter. Investment also expanded, by 0.8% q/q and building on an already-strong 1% increase in the previous stanza. Investment in manufacturing rose 0.8% q/q, from a 0.5% rise in the second quarter, but this gain was offset by slowdowns in construction and services capital expenditures.

Foreign trade by contrast likely dragged, which was expected following the second quarter's jump. That's because imports likely surged by 2.5% q/q in the third quarter, following a mere 0.2% increase in the second, on the back of a replenishing of inventories. Stock-building and imports are strongly correlated in France, especially in the transport sector, and the story in the third quarter is that after sales of aeronautic equipment soared in the second quarter, companies rushed to replenish their stocks in the third. As a result, inventories also skyrocketed and offset the plunge in net trade. Exports, meanwhile, decelerated to only 0.7% q/q, though this was expected following the 2.3% jump in the three months to June. In all, net trade is expected to have shaved 0.6 percentage point off the GDP headline.

France: Household Consumption Survey (November; 7:45 a.m. GMT)

French household expenditures on goods likely rose by 2% m/m in November, fully reversing October's 1.9% plunge and pushing the yearly rate back to 1%, from a 0.6% contraction previously. This would still be below the past year average at 1.1%, but we think that a further rebound will come in December. Sales have been unusually volatile lately, but we caution that this is mostly on the back of one-off factors. For instance, while October's unseasonably mild weather depressed energy consumption, November's temperatures turned sharply lower, raising demand for heating. Similarly, we expect that clothing sales rebounded following weakness in October, notably as the colder weather should have boosted consumers' interest in retailers' new winter lines. Elsewhere, we are penciling in mean reversions in most other subsectors of retailing following the broad-based weakness in October, though the standout should be a soar in the sale of household goods. We note that Black Friday sales were probably not included in the retail sales figures for November, and the different countries' indexes are normally compiled around the second or third week of the month.

Spain: Foreign Trade (November; 9:30 a.m. GMT)

We expect the Spanish trade deficit deteriorated to €2.9 billion in October because of weaker export performance over the month. Amid the bitter row between Catalonia and the Spanish government, more than 3,000 companies left Catalonia and relocated to other regions. The political uncertainty may have weighed on exports, although it is hard to say by how much. But we do not think the political situation will hurt trade; we expect exports to bounce back and hover around €24 billion, given the sector has managed to stay competitive. Accounting for seasonal and calendar effects, Spain's unit labour cost decreased by 0.1% y/y in the third quarter, down from a moderate 0.5% in the previous quarter, which should keep labour-intensive exports cost competitive.

ASIA-PACIFIC

By Katrina Ell and the Asia-Pacific staff of Moody's Analytics in Sydney

External demand will be Japan's primary growth engine into 2018

Japan's exports are expected to have increased again in November, buttressing the overall trade surplus. External demand will be Japan's primary growth engine into 2018. Exports across Asia have been solid thanks to an uptick in the global tech cycle, which is expected to continue towards year's end.

Singapore's exports likely cooled in November. Unlike other tech exporters in the region, Singapore's electronics exporters have had noticeable slowing since May, while non-electronic exports have picked up since the middle of this year. A high base from a year earlier is likely to inhibit export growth further in coming months.

New Zealand is the last to release third quarter national accounts. GDP growth likely cooled a whisker from the September quarter. Growth was driven by higher construction activity and business services. Building activity rebounded after the 1.1% q/q slump in the June quarter. Retail volumes cooled over the third stanza and rose 0.2% q/q, following the surge in the prior quarter due to major sporting events and the subsequent influx of overseas visitors. The central bank recently noted that the output gap was around zero. We estimate annual GDP growth will hold steady at 2.5%.

	Key indicators	Units	Moody's Analytics	Last
Mon @ 10:50 a.m.	Japan Foreign trade for November	¥ bil	350	323
Mon @ 11:30 a.m.	Singapore Foreign trade for November	% change yr ago	9.4	20.9
Wed @ 8:45 a.m.	New Zealand Foreign trade for November	NZ$ mil	-420	-871
Wed @ 7:30 p.m.	Thailand Monetary policy for December	%	1.5	1.5
Thurs @ 8:45 a.m.	New Zealand GDP for Q3	% change	0.6	0.8
Thurs @ 4:00 p.m.	Japan Monetary policy for December	¥ tri	80	80
Fri @ 7:00 p.m.	Taiwan Domestic trade for November	% change yr ago	3.5	3.2
Fri @ 7:00 p.m.	Taiwan Industrial production for November	% change yr ago	3.0	2.8

FRIDAY, DECEMBER 15

India – Foreign Trade – November

Time: Unknown
Forecast: -US$13.5 billion

India's exports likely continued to rise in November. The seasonally adjusted trade deficit is expected to narrow from October's US$14 billion. Strong export demand from India's major trading partners helped exports of major commodities such as engineering goods. Imports are expected to rise sharply but won't be enough to offset the rise in exports. Overall, higher commodity prices continue to weigh on India's import ledger, and that's unlikely to change in coming months.

Japan – Tankan Survey – 2017Q4

Time: 10:50 a.m. AEDT (Thursday, 11:50 p.m. GMT)
Forecast: 19

The mood amongst Japan's largest manufacturers reached a decade high in the September quarter as they brushed aside the threat of North Korea and enjoyed the sustained lift from buoyant global demand, especially on the tech front. However, we expect a slight pullback in sentiment in the final quarter on the back of slowing tech demand. The Tankan index of large manufacturers is expected to fall to 19, after 22 in the September quarter. The survey is an important input into monetary policymaking, and gives weight to the Bank of Japan's upbeat economic outlook. The survey will likely corroborate other high-frequency indicators that suggest domestic demand is slowing in the second half of 2017.

Indonesia – Foreign Trade – November

Time: 1:00 p.m. AEDT (2:00 a.m. GMT)
Forecast: US$1.36 billion

Indonesia's monthly trade surplus likely widened to US$1.36 billion in November from a US$900 million surplus in October.

MONDAY, DECEMBER 18

Japan – Foreign Trade – November
Time: 10:50 a.m. AEDT (Sunday, 11:50 p.m. GMT)
Forecast: ¥350 billion

Japan's trade balance likely improved to ¥350 billion from October's ¥323 billion. Exports are expected to have increased again in November, buttressing the overall trade surplus. We expect exports to have increased over the month and over the year, confirming our view that external demand will remain Japan's primary growth engine. Exports across Asia have been solid thanks to an uptick in the global tech cycle, which is expected to continue towards year's end. Moreover, the yen's depreciation in 2017 has boosted export values, with strong penetration of autos into the European and North American markets. Exports of machine and manufactured equipment will lead Japan's export boom in 2018.

Singapore – Foreign Trade – November
Time: 11:30 a.m. AEDT (12:30 a.m. GMT)
Forecast: 9.4%

Singapore's exports likely grew 9.4% y/y in November, after surging 20.9% in the prior month. Notably, October's surge was driven by a 28.5% increase in non-electronic exports, while electronic exports grew just 4.5%. Indeed, electronic exports have slowed noticeably since May, while non-electronic exports have picked up since the middle of this year. However, even as overall electronic exports have softened, demand for integrated circuits, disk media and PCs remains strong. Although external demand is likely to remain firm, a high base from a year earlier is likely to inhibit export growth in coming months.

TUESDAY, DECEMBER 19

No major economic indicators are scheduled for release.

WEDNESDAY, DECEMBER 20

New Zealand – Foreign Trade – November
Time: 8:45 a.m. AEDT (Tuesday, 9:45 p.m. GMT)
Forecast: -NZ$420 million

New Zealand's monthly trade deficit likely narrowed to NZ$420 million in November, from a NZ$871 million deficit in October. Dairy export values probably remained a bright spot, as they have been throughout 2017 because of high global prices amid buoyant Chinese demand. Export values will likely follow volumes lower into 2018 as the impact of lower global soft commodity prices starts filtering through to lower export receipts. The monthly trade deficit remained relatively large in October because of a jump in machinery purchases, led by parts for turbo jets and propellers. These expensive, one-off purchases often cause wide and unexpected swings in the trade balance.

Thailand – Monetary Policy – December
Time: 7:30 p.m. AEDT (8:30 a.m. GMT)
Forecast: 1.5%

The Bank of Thailand will likely hold its key policy interest rate at 1.5% at its December policy meeting.

Despite improved economic conditions, soft demand-side pressures and a firm baht have kept inflation well below the central bank's 1% to 4% target range so far this year; it is averaging just 0.7% y/y. Private consumption remains subdued, while private investment continues to be relatively weak. Despite increased pressure on the Bank of Thailand to cut its policy rate as a result of the firm baht, we expect the central bank to keep rates on hold into 2018.

THURSDAY, DECEMBER 21

New Zealand – GDP – 2017Q3

Time: 8:45 a.m. AEDT (Wednesday, 9:45 p.m. GMT)
Forecast: 0.6%

New Zealand's GDP growth likely hit 0.6% q/q in the September quarter after the June quarter's 0.8% expansion. This keeps annual growth about steady and around potential at 2.5%. The Reserve Bank of New Zealand noted in its November policy statement that the output gap was around zero. Third quarter growth was driven by higher construction activity and business services. Building activity rebounded after the 1.1% q/q slump in the June quarter. Retail volumes cooled over the third stanza and rose 0.2% q/q following the surge in the prior quarter due to major sporting events and the subsequent influx of overseas visitors. The data do not change our view that monetary tightening is off the cards until early 2019.

Japan – Monetary Policy – December

Time: 4:00 p.m. AEDT (5:00 a.m. GMT)
Forecast: ¥80 trillion.

The Bank of Japan remains comfortably on the sidelines, and it will be the last global central bank to taper its large-scale asset purchase program. We expect the BoJ to keep its policy levers unchanged. The central bank kept the monthly annualised purchase target of ¥80 trillion unchanged. The bank will target the long-term interest rates through its yield curve control policy, while a -0.1% interest rate on excess reserves will target the short-term rate. Underlying inflation remains elusive; we don't see inflation rising above 1%, let alone hitting the central bank's 2% target.

FRIDAY, DECEMBER 22

Taiwan – Domestic Trade – November

Time: 7:00 p.m. AEDT (8:00 a.m. GMT)
Forecast: 3.5%

Taiwan retail sales likely grew 3.5% in November, up from 3.2% in October. Retail sales have improved noticeably in recent months, coinciding with the sustained upswing in consumer confidence. Consumer confidence surged to a 29-month high in November, as a booming stock market, public service wage increases next year and plans for new labour laws boosted confidence. Upbeat consumer confidence and a modestly improving labour market should support retail sales in coming months.

Taiwan – Industrial Production – November

Time: 7:00 p.m. AEDT (8:00 a.m. GMT)
Forecast: 3%

Taiwan industrial production likely grew 3% y/y in November, after ticking up 2.8% in the prior month. Firm demand for semiconductors and other tech products should support manufacturing output into 2018, particularly with economic conditions abroad expected to remain favourable. Still, downside risks include a slowing mainland Chinese economy and souring cross-straits relations that could undermine supply chains. Power supply issues will also need watching, especially in light of a recent power outage and the government's commitment to phase out all nuclear power plants by 2025.

The Long View

The US: Since 1995, US$-IG bond issuance fell annually in only two of the 15 years overlapping mature economic upturns

By John Lonski, Chief Economist, Moody's Capital Markets Research Group,
November 30, 2017

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 107 bp is far under its 122-point mean of the two previous economic recoveries. This spread is more likely to be wider, as opposed to narrower, a year from now.

The recent high-yield bond spread of 365 bp is less than what is inferred from the spread's macroeconomic drivers and the high-yield EDF metric. The adverse implications for liquidity of possibly significantly higher interest rates merit consideration.

DEFAULTS

After setting its current cycle high at January 2017's 5.8%, the US high-yield default rate has since eased to the 3.4% of November. Moody's Default and Ratings Analytics team expects the default rate will average 2.4% in Q3-2018. A deeper slide to its 1.85% average of the 18-months-ended June 2015 is unlikely for now.

US CORPORATE BOND ISSUANCE

Yearlong 2016's US$-denominated bond issuance rose by 5.5% annually for IG, to $1.411 trillion and dropped by -3.5% to $341 billion for high yield. Across broad rating categories, 2016's newly rated bank loan programs from high-yield issuers advanced by 45% to $98 billion for Baa, rose by 2% to $212 billion for Ba, and soared by 43% to $208 billion for programs graded less than Ba.

Q4-2015's worldwide offerings of corporate bonds showed annual percent declines of -8.7% for IG and -51.4% for high-yield, wherein US$-denominated offerings dipped by +1.3% for IG and plunged by -45.1% for high yield.

Q1-2016's worldwide offerings of corporate bonds showed annual percent declines of -4.9% for IG and -51.4% for high-yield, wherein US$-denominated offerings rose by +1.3% from Q1-2015 for IG, but plunged by -45.1% annually for high yield.

Q2-2016's worldwide offerings of corporate bonds showed an annual increase of +6.3% for IG and an annual drop of 5.2% for high-yield, wherein US$-denominated offerings dipped by -2.2% for IG and sank by -6.3% for high yield.

Third-quarter 2016's worldwide offerings of corporate bonds showed an annual advances of +19.5% for IG and +42.8% for high-yield, wherein US$-denominated offerings soared higher by +34.1% for IG and by +46.4% for high yield.

Fourth-quarter 2016's worldwide offerings of corporate bonds showed annual percent changes of -10.2% for IG and +24.9% for high-yield, wherein US$-denominated offerings fell by -8.5% for IG and advanced by +24.9% for high yield.

First-quarter 2017's worldwide offerings of corporate bonds showed annual percent increases of +7.7% for IG and +110.6% for high-yield, wherein US$-denominated offerings advanced by +17.1% for IG and by +98.3% for high yield.

Second-quarter 2017's worldwide offerings of corporate bonds showed an annual percent decline of -6.3% for IG and an increase of +8.3% for high-yield, wherein US$-denominated offerings fell by -6.4% for IG and grew by +5.8% for high yield.

Third-quarter 2017's worldwide offerings of corporate bonds showed an annual percent decline of -1.6% for IG and an increase of +6.6% for high-yield, wherein US$-denominated offerings dipped by -0.7% for IG and grew by +4.3% for high yield.

For yearlong 2016, worldwide corporate bond offerings rose by 2.3% annually for IG (to $2.402 trillion) and sank by -7.8% for high yield (to $426 billion). In 2017, worldwide corporate bond offerings may rise by 3.5% annually for IG and may advance by 37.6% for high yield. The worldwide corporate bond offerings of 2018 are expected to show annual increases of 2.5% for IG and 6.0% for high yield.

The financing of acquisitions and shareholder compensation will stand out among 2016's uses of funds obtained via bond issues and newly-rated bank loan programs. Companies will resort to acquisitions and divestitures in order to better cope with the US's subpar recovery. To the degree companies fear significantly higher bond yields, pre-fundings will rise.

US ECONOMIC OUTLOOK

The consensus expects that the mid-point for the federal funds rate should finish 2018 at 2.125%. In view of the considerable underutilization of the world's productive resources, low inflation should help to rein in Treasury bond yields. As long as the global economy operates below trend, the 10-year Treasury yield may not remain above 2.45% for long. A fundamentally excessive climb by Treasury bond yields and a pronounced slowing by expenditures in dynamic emerging market countries are among the biggest threats to the adequacy of economic growth and credit spreads going forward.

EUROPE

By Tomas Holinka of Moody's Analytics
December 12, 2017

The European economy performed better than we expected this year. Although we predicted that it would grow at about the same rate as in 2016, the actual numbers were even more optimistic. Neither the unprecedented 2017 voting season nor the Brexit negotiation harmed the expansion. Even after the European Central Bank began to dismantle monetary stimulus, the strengthening euro didn't derail the export-driven recovery, while the improving labour markets boosted household spending. The main growth drivers shifted this year, with domestic demand contributing more compared with net exports as the end of the year approaches. Besides household spending, fixed investment also performed exceptionally well; after many years of subdued growth or even contraction, European companies stepped up investment.

A broad-based recovery

The latest data showed that the recovery is becoming entrenched and broad-based. Growth has been strengthening not only in the Baltic countries, but also in large euro area countries such as Germany, France and Italy. Outside the euro area, Romania's annual growth led the pack, with real GDP expanding by 8.6% y/y in the third quarter. Russia started to claw back in 2017, with real GDP gaining 1.8% in the three months to September. Across the Channel, however, the U.K. remains the sick man of Europe, with the British economy growing a meagre 1.5% y/y.

High-frequency indicators suggest the expansion should continue across Europe in early 2018. The euro area surprise index hit a record high for this year in late November, though it declined a bit afterwards, meaning that actual macro data exceeded market expectations, and the latest European Commission survey puts economic sentiment at its highest level since 2000. Meanwhile, the euro zone's final composite PMI for November jumped as well. A surge in industrial activity led the gains, with the area's manufacturing index increasing to 60.1, its second-best reading since records began in 1997, while the service sector also expanded.

Firming sentiment in Germany, Europe's powerhouse, is also boosting demand for imports of transport equipment, electronics, and other auto components. Central and Eastern Europe's strengthening exports, mainly to Germany, are supporting these local economies. More important, we see convergence between hard and soft economic data, implying less risk to the rosy 2018 corporate forecasts for Europe.

Strengthening domestic and foreign demand has pushed the euro zone's capacity utilization up to 83.8% in the fourth quarter of 2017, above the pre-crisis peak in 2008 and from 82.3% a year earlier, resulting in rising employment. The euro zone's jobless rate fell to 8.8% in October, its lowest reading since January 2009, and we expect unemployment to trend further downward in the next six to nine months. Yet despite diminishing labour market slack, it remains high in some southern European countries, especially Greece, Cyprus, Portugal, Spain and Italy. Labour may thus be far more underutilized than the recent unemployment rate would suggest, and this larger labour market slack is keeping a lid on wage growth.

Increasing automation, robotics engineering, and capital expenditure in general, however, may hinder wage growth. Improving revenue prospects and slowly rising operating margins sparked optimism among corporates and helped lift investment. But although this could boost productivity growth, capital expenditure will reduce demand for labour, weighing on average wages.

The auto industry, one of the main drivers of current growth and an important employer in Europe, is a good example. Although growing output of electric cars may boost the economy, more automation during production and the relative simplicity of these cars compared with petrol cars will reduce demand for mechanics and other employees. So despite rising salaries for some professionals, the average salary in the sector may not increase as much.

This is not the case for the CEE economies, however. Firming wages in Romania, the Czech Republic, and Baltic countries, together with labour shortages, are pushing inflation up, prompting the central banks in the region to tighten monetary policy. After two rate hikes already this year, the Czech National Bank may deliver another hike in December or early next year. We still expect the bank to raise the key policy rate to 0.75% in February from the current 0.5%, though the risks are skewed towards an earlier hike. Similarly, we expect the Polish central bank to hike rates in the second half of 2018, while central banks in Hungary and Romania will likely postpone the first interest rate hike until 2019.

This is in sharp contrast with the ECB, which will continue to buy government and corporate bonds and other assets next year. Although central bankers will halve the monthly purchases to €30 billion from January, they are extending them until September. However, if inflation stays below target the bank will postpone the exit from unconventional measures, and interest rates will increase later than in the currently expected second quarter of 2019. The risk of a stronger euro and possible renewed spike in bond yields will mitigate Germany's call for faster normalization of interest rates.

Meanwhile, after the rate hike in late 2017, the Bank of England will likely keep interest rates on hold next year because of cooling inflation and softer growth. Despite that, monetary conditions will remain tighter in the U.K. than in the euro zone because of above-target inflation and quicker recoveries in credit. Given that U.K. banks have raised more capital, more quickly, credit to households and nonfinancial corporations in the U.K. has grown more quickly in recent years.

Yet the outlook for credit and economic growth is uncertain in the U.K. because of outstanding concerns about the Brexit negotiation and future trade deal with the EU. Having already ruled out Norway-style membership in the single market, the best option for Britain is a free trade agreement like the one Canada has with the EU. But the CETA agreement took seven years to negotiate, while the U.K. has around 1½ years. Even with some transition period it would be difficult to abolish all tariffs on goods immediately; some of them would be phased out over three to seven years. Elevated anxiety over future trade conditions will undermine the U.K. economy and we expect real GDP to grow only by 1.3% next year, down from an expected 1.5% in 2017.

Political anxiety abates

Political risk seems contained for now. True, there will be presidential elections in the Czech Republic, Finland and Russia in the first quarter and in Ireland later next year, and general elections in Hungary, Latvia, Sweden and Italy, but none of them should derail the economic expansion. Although the Italian general election may increase nervousness, as the anti-European and populist Five Star Movement is still neck and neck with the ruling Democratic party in the polls, we don't expect this will spill over to the markets.

The political uncertainty hasn´t hurt Europe's expansion so far, and the economy is heading for its best year-on-year performance since 2007. Neither German Chancellor Angela Merkel's struggle to form a governing coalition nor Catalonia's vote to separate from Spain have left significant marks on the euro area. The economy is in much better shape than a year earlier and could withstand any fallout stemming from political anxiety after the elections.

But this doesn't mean that populism is well and truly gone. Politicians across the Continent should address income inequality and regional poverty, which are largely what is fueling discontent with globalization and the centrist-liberal status quo. If mainstream party leaders fail, populists could score big victories in the next elections and European integrity will be no longer assured.

Despite the narrowing output gap, inflation ¶n most core European countries will not heat up much in coming months. Although OPEC extended supply cuts of 1.8 million barrels per day through the end of 2018, it may change this decision by mid-2018 if non-OPEC countries increase their market share. Especially Russia may be tempted to regain its market share, while ongoing tension between Saudi Arabia and Iran may boost oil exports further. Core inflation should pick up only moderately because of weak wage growth in Italy and Spain, where significant labour market slack remains.

A rosy picture, yet...

While the overall picture is rosy, we don't expect the European economy will manage to exceed 2017's growth next year. Slowly tightening monetary conditions, the fallout of Brexit negotiations, and labour shortages in some countries may hold back the European expansion. And realistically, economic growth in 2018 is unlikely to exceed the region's fastest expansion rate in a decade.

But we see the risks to the 2018 growth forecasts on the upside. Stronger expansion in the U.S. supported by tax reform, together with weak oil prices and an ambitious reform agenda in France, may boost the European economy more than expected. Reducing labour market friction would cut the French unemployment rate, while restructuring public sector spending would bring down the fiscal deficit, two main obstacles to faster potential growth.

ASIA PACIFIC

By Katrina Ell of Moody's Analytics
December 13, 2017

AUSTRALIA

It's strange examining third quarter data when the fourth stanza has almost passed, but the Australian Bureau of Statistics isn't known for timely national accounts data. Australia is the last major Asia-Pacific economy to release quarterly GDP numbers. Despite the tardiness, the national accounts gives valuable insight, especially on the investment front in the absence of a reliable monthly gauge.

Australia's GDP growth hit 0.6% q/q in the September quarter following an upwardly revised 0.9% (previously reported as 0.8%) gain in the June stanza. Annual growth accelerated to 2.8% from the prior 1.8% gain. The annual growth figure is now hovering at potential, which we estimate is around 3%. However, momentum is overstated, given low base effects. In the September quarter of 2016, the Australian economy contracted by 0.5% q/q, only the fourth quarterly contraction in 25 years. This was driven by a sharp fall in investment alongside higher imports. During this period, annual growth slowed by 1.3 percentage point to 1.8%.

Private investment booms

Private investment was a bright spot in the third quarter because of a sharp rise in non-dwelling construction, which made the largest contribution to GDP growth at 0.9 percentage point. Nondwelling construction has often become a proxy for mining investment, and the third quarter gain is likely due to the installation of two liquefied natural gas platforms in Western Australia and the Northern Territory.

LNG exports are expected to pick up late in the fourth quarter amid increased production capacity. The Wheatstone project began production earlier in October after a two-year construction phrase and shipped its first export to Japan late in the month. Wheatstone is the sixth of eight projects included in a A$200 billion LNG construction boom that is now in its final stretch. Once the remaining two

projects are finalized, Australia could topple Qatar as the world's biggest LNG exporter. Australia has recently become the world's second largest exporter of LNG.

Public investment didn't score as well in the third quarter, declining by 7.5% q/q. This is mainly payback after a boost in the June quarter from the acquisition of the Royal Adelaide Hospital from the private sector.

The housing market has cooled in 2017, and price growth is expected to keep decelerating through 2018; this will keep downward pressure on dwelling investment. For instance, dwelling price growth in Sydney was 5% y/y in November, well down from its double-digit growth in 2016 and earlier in 2017. This is the result of the lagged impact of earlier macroprudential action that has included higher borrowing costs for homebuyers, especially investors or those taking out interest-only loans. The Australian Prudential Regulation Authority has also imposed limits on bank portfolio exposure to new mortgages.

Owner-occupied housing finance commitments tend to track house price growth and are a good gauge of the underlying pulse. Data released this week show October commitments rose just 0.3% m/m on a trend basis. Growth has slowed substantially from earlier in 2017.

An interesting tidbit we have observed in recent years: Housing regulation in New Zealand tends to lead Australia's by at least a year. The Reserve Bank of New Zealand was on the front foot trying to cool certain heated housing pockets such as Auckland well before the Australian Prudential Regulation Authority introduced housing-targeted measures, even though both economies were experiencing strong price growth in some areas. Just recently, the RBNZ announced it had eased some macroprudential measures in light of softer house price growth. Now that Australia's housing market has cooled, APRA may follow suit with minor reversals in the next year.

Households missing in action

At first glance it was a relief that consumption made a positive contribution to GDP growth, but the details were less pleasing, as spending was concentrated on essential items while discretionary purchases suffered. We calculated that nondiscretionary items rose an average 0.6% over the quarter, and discretionary spending fell by 0.7%.

Of the nondiscretionary items, utility spending rose 1.4% q/q, food was up 1%, rent gained 0.6%, and insurance and financial services grew 1.3%. On the discretionary front, clothing spending fell 1% q/q, recreation and culture was down 0.6%, and spending at cafes and restaurants fell by 0.9%. All told, softness in the consumer sector was largely masked by spending on nondiscretionary items. The monthly retail trade data do not capture nondiscretionary spending as thoroughly as the national accounts; over the third quarter retail volumes were up just 0.1% q/q.

We know from earlier testing that consumer sentiment does not have a causal relationship with retail spending, but incomes do. Sentiment is a symptom of weak income growth, rather than a forward indicator of spending behaviour. The Westpac consumer sentiment index fell to 99.7 in November, below the neutral 100 that indicates optimists equal pessimists. Overall, consumers have been downbeat through most of 2017, concerned about family finances and the economic outlook.

At 2% y/y, income growth is hovering near a record low, so it's little surprise households have pulled back on discretionary purchases, while other costs such as utilities rose in the third quarter because of seasonal price hikes. The net household saving ratio rose to 3.2% in the third quarter, higher than the decade low of 3% in the June quarter, suggesting that consumers aren't willing to keep dipping into their savings to fund discretionary purchases. It's concerning that household consumption is weak, given that it constitutes 75% of GDP.

Businesses are faring better than consumers at the moment. This is reflected in soaring private investment, lofty gains in company profits, and strong employment growth, particularly full-time, through 2017. Unfortunately, this has not yet flowed through to stronger income growth, and there are likely several factors at play. The first is cyclical: Low productivity is mooted as a reason for benign wages in the developed world. More Australia-specific is that underemployment has been very high in Australia and the correlation with income growth is around -0.88. Underemployment has started to edge lower as full-time positions outpace part-time, and our baseline scenario is for the tighter labour market to yield stronger income growth by mid-2018. Although Australia's Phillips curve has flattened in the past decade, there is still a reasonable relationship between unemployment and income growth.

Some structural factors: The rise of the gig economy has contributed to the rise in casual employment. These positions are more flexible and more easily adapt to changing demand, but there's no union representation, which can hurt wage bargaining. Also, as the positions are more flexible, there's more acceptance that lower wages can be a consequence.

Another structural reason for low incomes could be the higher prevalence of offshoring roles. There's no reliable industry- or economy-wide data measuring the extent of offshoring, but we know that it is an unrelenting phenomenon, given the disparity in operating costs between Australia and the developed world. Employers are not locally replacing jobs lost offshore, so they are not potentially driving up labour costs to secure the appropriate candidate.

All told, these structural factors suggest that national income growth is unlikely to enjoy a significant rebound but rather gradual and modest improvement in 2018.

How's the fourth quarter tracking?

Our high-frequency GDP tracker suggests a 2.7% y/y expansion in the December quarter following the barrage of October activity data this week. Retail trade came in at a strong 0.5% m/m, although this was payback for sustained weakness through the third quarter, when retail turnover fell an average 0.3% m/m.

October foreign trade data weren't inspiring, as merchandise exports fell by 2% m/m amid lower iron ore prices and, to a lesser extent, volumes. The iron ore spot price increased by 22% from its late-October slump to US$71.51 per metric tonne in early December. We expect this will enable iron ore export receipts to improve heading into 2018 as higher global prices are incorporated into contracts; usually the lag is short. It's too early to determine whether volumes will be adversely affected by higher prices.

We maintain our view that monetary tightening is firmly off the table for at least another year as the central bank sits on the sidelines waiting for consumption to show meaningful signs of a pickup. Our expectation is that the Australian dollar will depreciate around an additional 3% against the U.S. dollar over the next six months, serving to encourage more consumption onshore and lift export competitiveness and helping core inflation return to and creep through the central bank's 2% to 3% target range.

Ratings Round-Up

By Njundu Sanneh

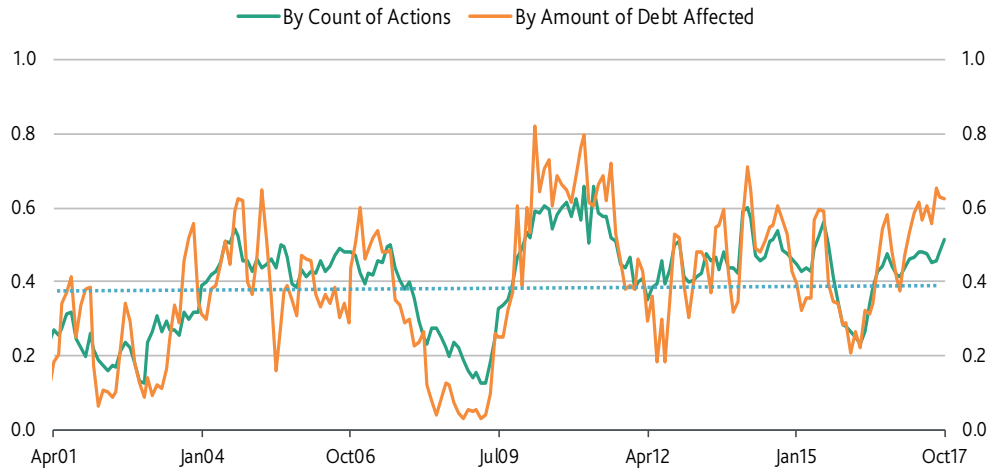
Defaults Surprise in November

The weekly rating revisions continue to be skewed towards downgrades with the retail sector in the forefront in both the U.S. and Europe. The contribution of positive rating changes did improve over the past week but the story is mainly downgrades with retail, consumer durables and the energy sector tilting the balance towards downgrades. There were a total of four retail sector names and they were all downgraded with two from the U.S. and the other two from Europe. The U.S. retailer Charming Charlie LLC, initiated Chapter 11 bankruptcy proceedings on December 11, a move that amounts to default. The November Moody's Monthly Default Repot also noted a rebound in defaults for the month. Defaults increased to 10 in November reaching double digits for the first time in many months. The energy and metals and mining sector combined with the retail sector to push the count of defaults upward and the global speculative grade default rate jumped to 3.0% in November from 2.8% in October. This jump is seen to be transitory as it is forecast to end the year at 2.8%.

The low speculative grade spreads with U.S. spreads hovering around 350 bp way below the five-year average of 509 bp reflect liquidity in the credit markets and low which has been favorable for speculative grade issuers for some time now. This and the expanding global economic environment are supportive of a downward trend in defaults and downgrades.

FIGURE 1

Rating Changes - US Corporate & Financial Institutions: Favorable as % of Total Actions



* Trailing 3-month average

Source: Moody's

FIGURE 2

Rating Key

BCF	Bank Credit Facility Rating	MM	Money-Market
CFR	Corporate Family Rating	MTN	MTN Program Rating
CP	Commercial Paper Rating	Notes	Notes
FSR	Bank Financial Strength Rating	PDR	Probability of Default Rating
IFS	Insurance Financial Strength Rating	PS	Preferred Stock Rating
IR	Issuer Rating	SGLR	Speculative-Grade Liquidity Rating
JrSub	Junior Subordinated Rating	SLTD	Short- and Long-Term Deposit Rating
LGD	Loss Given Default Rating	SrSec	Senior Secured Rating
LTCF	Long-Term Corporate Family Rating	SrUnsec	Senior Unsecured Rating
LTD	Long-Term Deposit Rating	SrSub	Senior Subordinated
LTIR	Long-Term Issuer Rating	STD	Short-Term Deposit Rating

FIGURE 3 Rating Changes: Corporate & Financial Institutions – US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	Old STD Rating	New STD Rating	Old LGD	New LGD	IG/ SG
12/6/17	FLAVORS HOLDINGS INC.	Industrial	SrSec/BCF/LTCFR/PDR		D	B3	Caa2					SG
12/6/17	LAREDO PETROLEUM, INC.	Industrial	SrUnsec/LTCFR/PDR	800	U	B3	B2					SG
12/6/17	SF CC INTERMEDIATE HOLDINGS, INC. - Smart & Final Stores LLC	Industrial	SrSec/BCF/LTCFR/PDR		D	Ba1	Ba2					SG
12/6/17	VISTA OUTDOOR INC.	Industrial	SrUnsec/LTCFR/PDR	350	D	B2	B3					SG
12/7/17	PRESIDIO HOLDINGS INC.	Industrial	LTCFR/PDR		U	B2	B1					SG
12/7/17	SHERIDAN INVESTMENT PARTNERS II, LP	Industrial	SrSec/BCF/LTCFR/PDR/LGD		U	Caa3	Caa1			LGD-4	LGD-3	SG
12/7/17	TROPICANA ENTERTAINMENT, INC.	Industrial	SrSec/BCF/LTCFR/PDR/LGD		U	B1	Ba3			LGD-4	LGD-3	SG
12/8/17	CHURCHILL DOWNS INCORPORATED	Industrial	SrUnsec	600	D	B1	B2					SG
12/8/17	GULF FINANCE, LLC	Industrial	SrSec/BCF/LTCFR/PDR		D	B2	B3					SG
12/11/17	MATTEL, INC.	Industrial	SrUnsec/LTCFR/CP	2,150	D	Baa3	Ba3	P-3	NP			IG
12/11/17	METROPISTAS	Industrial	SrSec	435	D	Ba3	B1					SG
12/12/17	CHARMING CHARLIE LLC	Industrial	SrSec/BCF		D	Caa1	Ca					SG
12/12/17	CHESAPEAKE ENERGY CORPORATION	Industrial	SrUnsec/SrSec/LTCFR/PDR/BCF/LGD	9,034	U	Caa2	Caa1			LGD-4	LGD-3	SG
12/12/17	CONTURA ENERGY, INC.	Industrial	SrSec/BCF/LTCFR/PDR		D	B2	Caa1					SG
12/12/17	SEDGWICK, INC.	Financial	SrSec/BCF		D	B1	B2					SG

Source: Moody's

FIGURE 4 Rating Changes: Corporate & Financial Institutions – EUROPE

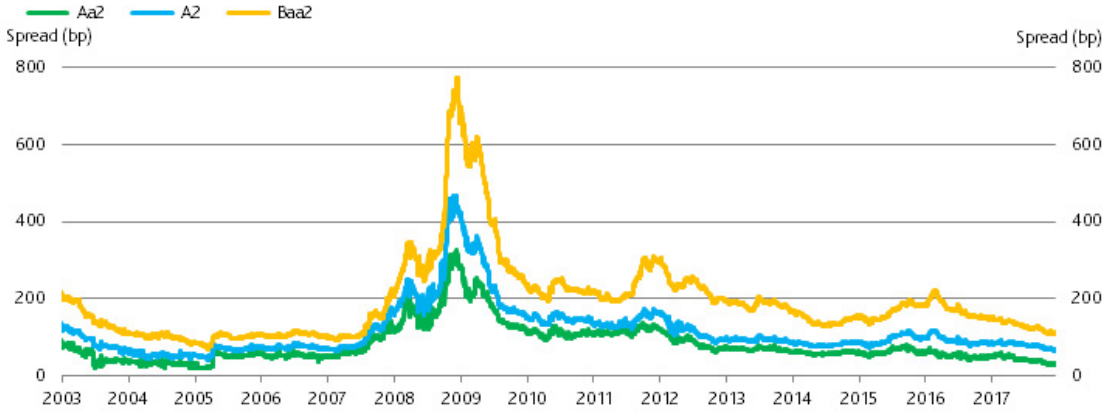
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG	Country
12/7/17	STEINHOFF INTERNATIONAL HOLDINGS N.V.	Industrial	SrUnsec/LTIR	943	D	Baa3	B1	IG	AUSTRIA
12/7/17	ROSSETI, PJSC	Utility	LTCFR/PDR		U	Ba2	Ba1	SG	RUSSIA
12/7/17	CYBG PLC	Financial	LTD Sub	637	U	Baa2	Baa1	IG	UNITED KINGDOM
12/8/17	HOUSE OF FRASER (UK & IRELAND) LIMITED	Industrial	SrUnsec/LTCFR/PDR	221	D	B3	Caa1	SG	UNITED KINGDOM
12/8/17	NEW LOOK RETAIL GROUP LIMITED	Industrial	SrUnsec/SrSec/LTCFR/PDR	1,666	D	Caa3	Ca	SG	UNITED KINGDOM

Source: Moody's

Market Data

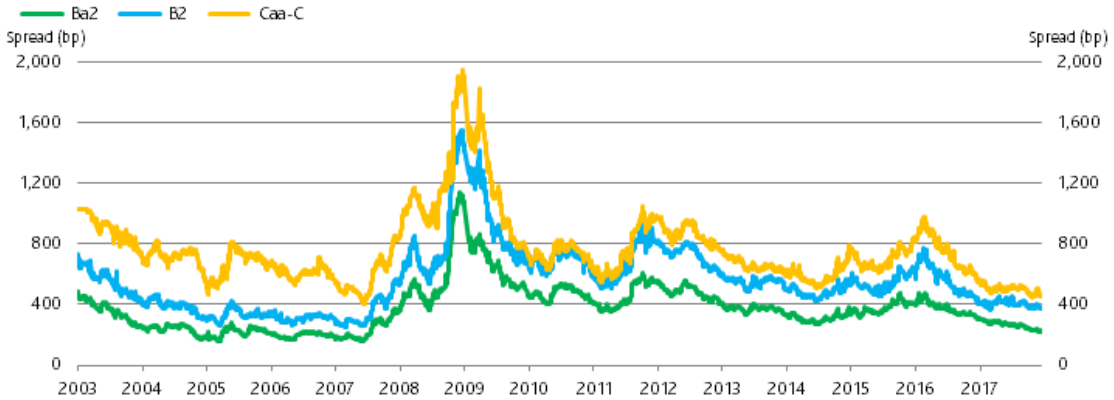
Spreads

Figure 1: 5-Year Median Spreads-Global Data (High Grade)



Source: Moody's

Figure 2: 5-Year Median Spreads-Global Data (High Yield)



Source: Moody's

CDS Movers

Figure 3. CDS Movers - US (December 6, 2017 – December 13, 2017)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Dec. 13	Dec. 6	Senior Ratings
21st Century Fox America, Inc	A1	A3	Baa1
Rite Aid Corporation	Caa2	Ca	B3
Hertz Corporation (The)	Caa1	Caa3	B3
Comcast Corporation	A2	A3	A3
Citibank, N.A.	Baa1	Baa2	A1
Wal-Mart Stores, Inc.	Aa1	Aa2	Aa2
Amgen Inc.	Aa2	Aa3	Baa1
Procter & Gamble Company (The)	Aaa	Aa1	Aa3
Time Warner Inc.	A3	Baa1	Baa2
Anthem, Inc.	A2	A3	Baa2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Dec. 13	Dec. 6	Senior Ratings
Xerox Corporation	B1	Ba3	Baa3
CIT Group Inc.	Baa3	Baa2	Ba2
Newmont Mining Corporation	Baa2	Baa1	Baa2
Mattel, Inc.	B2	B1	Ba2
CMS Energy Corporation	A3	A2	Baa1
V.F. Corporation	Baa3	Baa2	A3
Murphy Oil Corporation	Ba3	Ba2	Ba3
ONEOK, Inc.	Baa3	Baa2	Baa3
Dole Food Company, Inc.	B1	Ba3	B3
Diamond Offshore Drilling, Inc.	B2	B1	Ba3

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Dec. 13	Dec. 6	Spread Diff
K. Hovnanian Enterprises, Inc.	Caa3	2,347	1,991	356
Neiman Marcus Group LTD LLC	Caa3	1,432	1,323	109
MBIA Inc.	Ba1	1,328	1,222	105
Mattel, Inc.	Ba2	335	241	94
MBIA Insurance Corporation	Caa2	1,117	1,071	45
Cablevision Systems Corporation	B3	431	391	41
Penney (J.C.) Corporation, Inc.	B3	1,190	1,149	40
Xerox Corporation	Baa3	190	162	28
Pride International, Inc.	B2	480	455	24
R.R. Donnelley & Sons Company	B2	675	656	19

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Dec. 13	Dec. 6	Spread Diff
Nine West Holdings, Inc.	Ca	15,497	18,035	-2,539
Sears Roebuck Acceptance Corp.	Ca	3,387	3,918	-531
Sears Holdings Corp.	Ca	3,013	3,485	-472
Windstream Services, LLC	B3	1,996	2,165	-169
Hertz Corporation (The)	B3	711	812	-101
CenturyLink, Inc.	B2	465	566	-100
Dell Inc.	Ba2	214	257	-44
Avis Budget Car Rental, LLC	B1	285	325	-40
Frontier Communications Corporation	B3	1,539	1,565	-26
Avon Products, Inc.	B3	978	1,005	-26

Source: Moody's, CMA

Figure 4. CDS Movers - Europe (December 6, 2017 – December 13, 2017)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Dec. 13	Dec. 6	Senior Ratings
Lloyds Bank Plc	Aa3	A2	Aa3
Finland, Government of	A3	Baa2	Aa1
Dexia Credit Local	Ba1	Ba2	Baa3
HSBC Holdings plc	A1	A2	A2
Banco Santander S.A. (Spain)	Aa2	Aa3	Baa1
Natixis	Aa2	Aa3	A2
ENEL S.p.A.	Baa1	Baa2	Baa2
Deutsche Telekom AG	Aa2	Aa3	Baa1
ENGIE SA	A1	A2	A2
Sanofi	Aa1	Aa2	A1

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Dec. 13	Dec. 6	Senior Ratings
Portugal, Government of	Ba2	Ba1	Ba1
CaixaBank, S.A.	Baa3	Baa2	Baa2
Swedbank AB	Aa2	Aa1	Aa3
Prudential Public Limited Company	Baa1	A3	A2
Lanxess AG	Baa2	Baa1	Baa3
Fortum Oyj	Baa1	A3	Baa1
Old Mutual Plc	Aa3	Aa2	Ba1
Virgin Media Finance PLC	B1	Ba3	B2
CMA CGM S.A.	B3	B2	B3
DEPFA Bank plc	B2	B1	Baa2

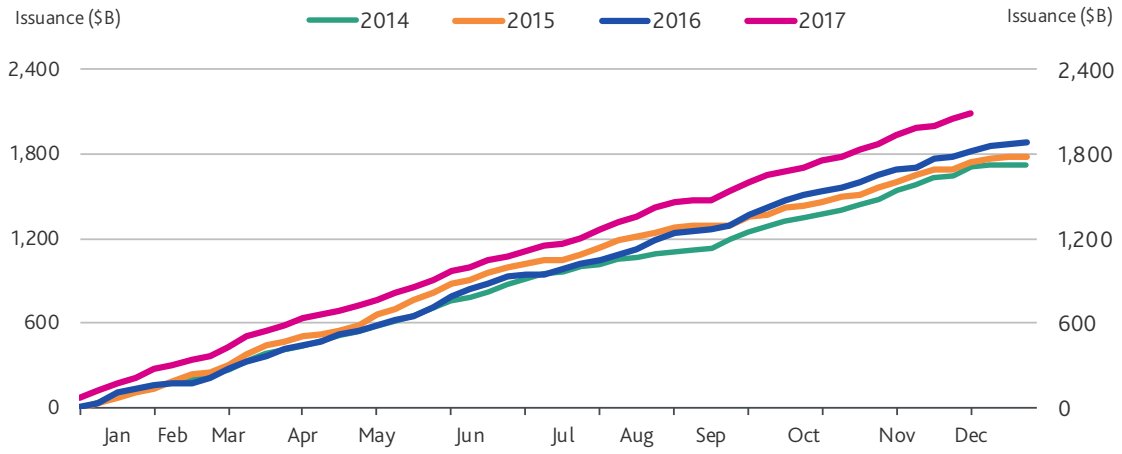
CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Dec. 13	Dec. 6	Spread Diff
Galapagos Holding S.A.	Caa2	912	784	128
Boparan Finance plc	B3	729	680	49
Ensco plc	B3	489	465	25
CMA CGM S.A.	B3	359	341	18
Vue International Bidco p.l.c.	B3	215	204	11
Wm Morrison Supermarkets plc	Baa3	73	67	5
Stonegate Pub Company Financing plc	Caa1	213	209	5
Banca Nazionale Del Lavoro S.p.A.	Baa3	80	75	5
CaixaBank, S.A.	Baa2	65	62	4
Bankinter, S.A.	Baa2	78	74	4

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Dec. 13	Dec. 6	Spread Diff
Astaldi S.p.A.	B3	2,759	2,952	-193
Greece, Government of	Caa2	379	418	-39
Evraz Group S.A.	B1	251	270	-19
Altice Finco S.A.	B3	398	411	-13
Finland, Government of	Aa1	45	55	-10
Unione di Banche Italiane S.p.A.	Baa3	97	105	-9
Vedanta Resources plc	B2	408	417	-9
Dexia Credit Local	Baa3	103	111	-8
Unipol Gruppo S.p.A.	Ba2	120	125	-6
PizzaExpress Financing 1 plc	Caa1	785	791	-6

Source: Moody's, CMA

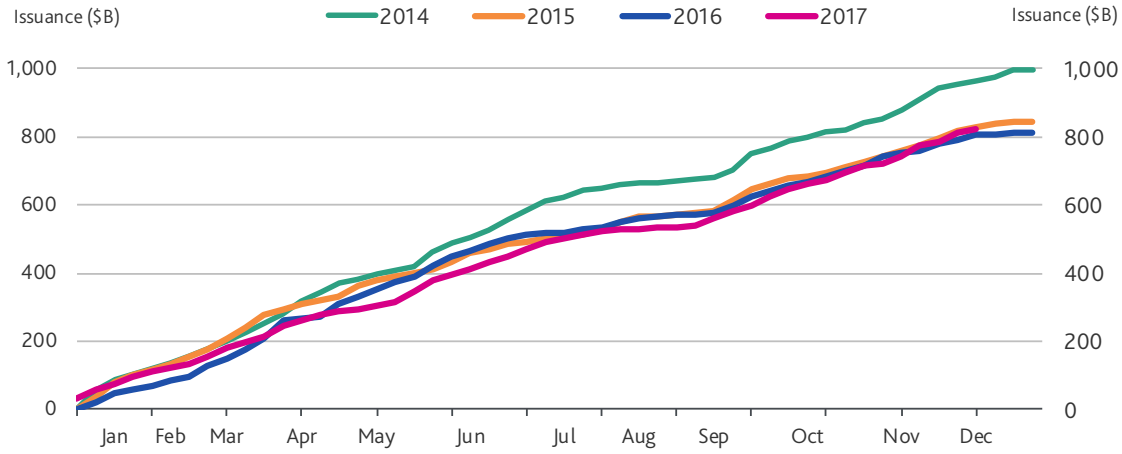
Issuance

Figure 5. Market Cumulative Issuance - Corporate & Financial Institutions: USD Denominated



Source: Moody's / Dealogic

Figure 6. Market Cumulative Issuance - Corporate & Financial Institutions: EURO Denominated



Source: Moody's / Dealogic

Figure 7. Issuance: Corporate & Financial Institutions

	USD Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	23.479	16.005	42.979
Year-to-Date	1,489.470	444.417	2,089.106

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	9.307	4.612	14.590
Year-to-Date	664.524	114.246	824.554

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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