MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

Swelling of Low-Grade Spreads Looms

Moody's Capital Markets Research

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Credit Markets Review and Outlook

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

Swelling of Low-Grade Spreads Looms

Markets became slightly unhinged at the prospect of a US military confrontation with North Korea over the latter's nuclear weapons program. As of August 10's early afternoon trading, the market value of US common stock had declined by -1.2% from its August 8 close, or just prior to the intensification over the North Korean conflict. In a more immediate response to jitters surrounding the possibility of a very destructive conflict, a composite high-yield bond spread widened from August 8's 371 bp to August 9's 387 bp as the accompanying speculative-grade bond yield jumped up from 5.57% to 5.72%.

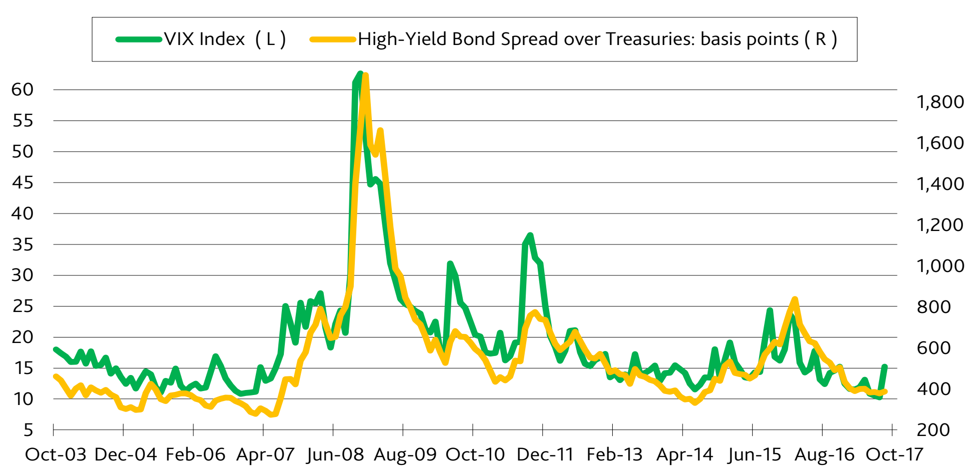
Nevertheless, high-yield spreads are still unduly thin, even from the perspective of a now higher VIX index.

Models that only employ the average and median EDF (expected default frequency) metrics of US/Canadian high-yield issuers now favor a midpoint for the high-yield bond spread of between 443 bp (according to the median high-yield EDF) and 517 bp (according to the average high-yield EDF). Moreover, even before North Korean tensions rose, the high-yield spread had widened from an August 1 low of 362 bp in response to the realization that markets had overstated the underlying strength of US business activity.

Yet another subpar reading on labor productivity growth warns not only of an overpricing of earnings-sensitive securities, but it also brings attention to a possible overstaffing of US businesses. Seldom have payrolls grown so briskly for so long amid persistently subpar real GDP growth.

Suddenly, the VIX index no longer lends critical support to extraordinarily thin corporate bond yield spreads. After having risen from its 10.15-point average of the first seven days of August to the 10.96 of August 8, the VIX index subsequently soared to an early-afternoon August 10 reading of 15.2. The latter has been statistically associated with a 452 bp midpoint for the high-yield bond spread. Unless the median high-yield EDF and the VIX index recede from recent readings, the high-yield bond spread will soon top 400 bp. (Figure 1.)

Figure 1: VIX Index Suddenly Jumps Above 15 Points and Warns of the Widest High-Yield Bond Spread since December 2016 (correlation = 0.90)



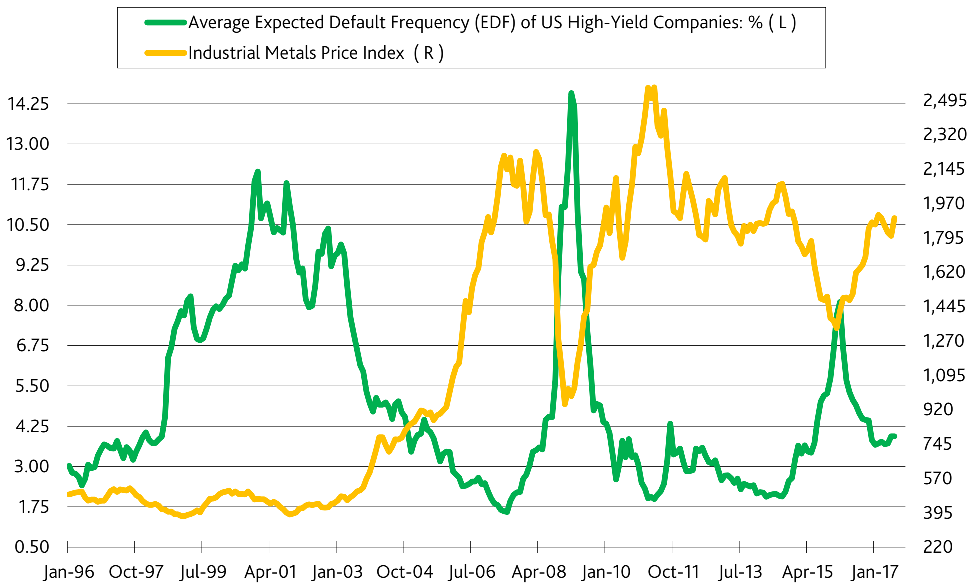
Moody's Base Metals Price Index sets new three-year high

On August 9, 2017, Moody's Industrial Metals Price Index closed at its highest daily reading since September 10, 2014. However, August 9's reading remained a deep -24.2% under its record high of April 11, 2011 that was set amid above-trend global economic growth. When the world economy expanded at an above trend 4.8% during 2010-2011, few expected global growth would slow to 3.3%, on average, through 2016.

The moving 13-week average of the base metals price index is now higher by +20.3% year-over-year, which is consistent with a material expansion of global industrial activity. World trade grows briskly again. And economic activity in both China and the Eurozone top expectations. For example, the year-over-year increase by China's industrial output accelerated from the 6.0% of 2016's first half to the 6.9% of 2017's first half.

Since 1989, world economic growth shows a relatively strong correlation of 0.81 with the annual percent change of the industrial metals price index. According to the same methodology, world growth revealed smaller correlations of 0.73 with the price of copper, 0.68 with the price of oil, and 0.51 with US real GDP growth. Thus, the base metals price index's 26% year-over-year advance of 2017-to-date lends considerable support to the IMF's forecast of an acceleration by world economic growth from 2016's 3.2% to 3.5% for 2017. (Figure 2.)

Figure 2: Average High-Yield EDF MetricTends to Jump Higher When the Industrial Metals Price Index Sinks



Base metals price inflation often narrows high-yield spreads

The inverse correlations between coincident movements by the high-yield bond spread and the base metals price index are quite meaningful, wherein growth by the base metals price index tends to narrow the high-yield spread. For a sample beginning in January 1994, the high-yield spread's year-to-year change by month shows an inverse correlation of -0.66 with the base metals price index's annual percent change.

When comparing the moving three-month average with the prior contiguous three-month average, the correlation between the change in the high-yield spread and the accompanying change in the base metals price index firms to -0.69, while a comparison of the six-month average with the prior contiguous six-month average strengthens the inverse correlation to -0.71.

When the base metals price index's moving three-month average exceeds its average of the previous contiguous three-months, the accompanying three-month average of the high-yield bond spread is thinner than its average of the contiguous three months about 78% of the time. By contrast, the high-yield bond spread's moving three-month average widened from its average of the contiguous three-months for 67% of the 121 comparably measured declines by the base metals price index.

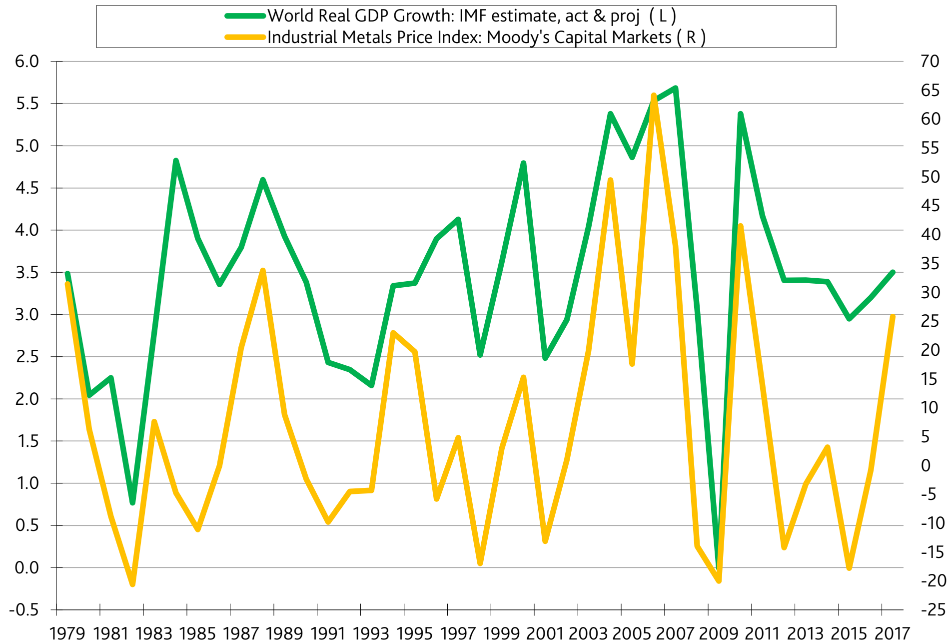
Thus, high-yield spreads are less likely to widen if base metals price deflation is avoided. However, recent advances by the VIX index and the latest readings on the average and median high-yield EDF metrics may overrule the tendency of base metals price inflation to at least contain spreads. Worse yet, spread widening will be even more severe if heightened uncertainty deflates base metals prices.

Default risks subside when base metals prices advance

The average high-yield EDF metric estimates the likely frequency of default among US and Canadian high-yield issuers nine to 12 months hence. The high-yield EDF exhibits an even greater sensitivity to swings by the base metals price index than does the high-yield bond spread.

The year-to-year percentage point change of the average high-yield EDF shows a comparatively strong inverse correlation of -0.73 with the year-to-year percent change of Moody's industrial metals price index. This sample commences in January 1997 and ends with July 2017. (Figure 3.)

Figure 3: Recent Surge by Industrial Metals Price Index Supports Quickening of World Economic Growth to 3.5% in 2017 (correlation since 1989 = 0.81) annual % changes



By contrast, the yearly change of the average high-yield EDF reveals a smaller inverse correlation of -0.39 with the yearly percent change of the price of crude oil. The price of crude oil may grab the headlines, but, over time, the base metals price index matters more as far as explaining changes in default risk.

Oil price inflation's tendency to trigger broadly based increases in operating costs, as well as its deleterious impact on household purchasing power, helps to explain the softer inverse correlation between oil prices and default risk.

Moreover, oil price inflation's comparatively high correlation with PCE price index inflation further detracts from its inverse correlation with default risk. By stoking PCE price index inflation, oil price inflation increases the risk of a fundamentally excessive climb by short- and long-term interest rates that are capable of weakening debt repayment capabilities.

In terms of year-to-year percent changes, the PCE price index shows a stronger correlation of 0.42 with the price of WTI crude oil compared to its 0.21 correlation with the industrial metals price index. It should be added that there is no correlation between the underlying inflation rate, or core PCE price index inflation, and the annual rates of change for either the price of crude oil or the base metals price index. In turn, long-term investment strategies might best ignore wide swings in PCE price index inflation that mostly stem from swings in energy prices and instead focus on the more stable pace of core PCE price index inflation.

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The Week Ahead – US, Europe, Asia-Pacific

THE US

From Moody's Analytics - Economy.com and the Moody's Capital Markets Research Group
(Updates are made on Mondays.)

Summary, August 14: The upcoming week is fairly busy and the data will have implications for second and third quarter GDP. We look for nominal retail sales to have risen 0.4% in July but Amazon's Prime Day adds some additional uncertainty to the forecast. There will be a number of reports on manufacturing. We look for manufacturing industrial production to have risen 0.2% in July and it will be more impressive excluding motor vehicle and parts. July is when the annual auto retooling occurs and we believe this will lead to a decline in motor vehicle and parts industrial production. The first two regional Fed manufacturing surveys for August will help us assess how factory conditions are doing midway through the third quarter.

Housing starts are expected to have slipped between June and July. Starts were boosted at the beginning of the year because of the unseasonably warm weather. Abstracting for this, the trend in housing starts is at the high end of the range seen since the second half of 2015. Our forecast is for starts to steadily increase in the second half of the year, but risks are that they fall short of our expectation. Supply constraints remain, including the lack of buildable lots and difficulty in finding qualified workers, with the latter boosting wages. Also, construction material costs are rising, including for random lengths framing lumber; and the imposed tariff on Canadian softwood lumber won't help U.S. builders on the cost front.

We expect the minutes of the Federal Open Market Committee's July meeting to signal that an announcement on the beginning of normalizing the balance sheet will occur in September. Key Fed officials have argued that the decision on the timing is more sensitive to growth and labor market conditions than to inflation. Still, inflation will have to improve for the Fed to justify raising interest rates again this year. There is time for that to happen, since the next rate hike is unlikely before December. We don't expect the minutes to provide a ton of guidance on the timing of the next rate hike.

MONDAY, AUGUST 14

Business confidence (week ending August 11; 10:00 a.m. EDT)

Forecast: N/A
Businesses remain upbeat, suggesting the global economic expansion is still firmly intact and global growth is just above potential. Sentiment among global businesses is good, but it has softened a bit since the spring. Confidence is back almost where it was just prior to the U.S. presidential election. Though it is hard to draw any strong conclusions from this, it would be consistent with a growing sense that the new administration and Congress will not be able to come to terms on a major reform of the U.S. tax code, something that U.S. businesses have been especially excited about.

The four-week moving average in our global business confidence index fell from 31.4 to 30.4 in the week ended August 4.

TUESDAY, AUGUST 15

Import prices (July; 8:30 a.m. EDT)

Forecast: 0%
We look for import prices to have been unchanged between June and July. Import prices fell 0.2% in June and slipped 0.1% in July. Based on our assessment of West Texas Intermediate and Brent crude oil prices, we look for import oil prices to have fallen modestly in July. Natural gas prices likely fell in July as well. Excluding fuels, we forecast import prices rose a trend-like 0.1%. The depreciation in the U.S.

dollar should begin to put some modest upward pressure on nonfuel import prices. Fluctuations in the dollar affect import prices with a lag.

Retail sales (July; 8:30 a.m. EDT)

Forecast: 0.4% (total)
Forecast: 0.4% (ex auto)
Nominal retail sales are forecast to have increased 0.4% in July following a 0.2% decline in June and 0.1% drop in May. Unit vehicle sales rose 0.4% in July but new-vehicle prices fell between June and July. Lower prices will weigh on nominal spending on motor vehicles. Therefore, the forecast assumes that vehicles will be neutral for nominal retail sales growth in July, leaving nonauto retail sales up 0.4% in July. Based on our seasonal adjustment of retail gasoline prices, we anticipate nominal spending at gasoline stations was a small positive for total retail sales growth. Building material stores will be neutral for sales growth in July.

The wild card is nonstore retail sales. July included Amazon's Prime Day. Other retailers had similar events and this should have provided a boost to nonstore sales. There are some potential issues. For one, sales are recorded when a product is delivered but this shouldn't be a big issue. The Amazon Prime Day occurred early in the month. The bigger issue is that spending for Amazon Prime Day may have come at the expense of spending elsewhere. All told, we expect Amazon's Prime Day to have added 0.1 of a percentage point to July retail sales growth.

NAHB housing market index (August; 10:00 a.m. EDT)

Forecast: 65
|The NAHB housing market index is forecast to have risen 1 point to 65 for August. This would reverse some of July's gain but keep the index below its first half average of 68. The recent housing data has been mixed but we believe residential investment will continue to improve over time. Homebuilder stocks have dropped over past month, which could weigh on the NAHB housing market index. However, there has been a tendency for the index to increase in August, having done so for the past five years. That could be a fluke, but it swayed us to pencil in a small improvement in the NAHB index for August.

WEDNESDAY, AUGUST 16

Housing starts (July; 8:30 a.m. EDT)

Forecast: 1.210 million annualized units (starts)
Forecast: 1.263 million annualized units (permits)
Housing starts are expected to have fallen from 1.215 million in June to 1.210 million in July. Starts were boosted at the beginning of the year because of the unseasonably warm weather. Abstracting for this, the trend in housing starts is at the high end of the range seen since the second half of 2015. Our forecast is for starts to steadily increase in the second half of the year, but risks are that they fall short of our expectation. Supply constraints remain, including the lack of buildable lots and difficulty in finding qualified workers, with the latter boosting wages. Also, construction material costs are rising, including for random lengths framing lumber; and the imposed tariff on Canadian softwood lumber won't help U.S. builders on the cost front.

Still, the lumber tariff may not have a significant effect on homebuilding. U.S. production could increase and builders could import lumber from other countries. Also, they could pass through some of the increase to the consumer as long it doesn't significantly jeopardize affordability, which would weigh on demand. Recent earnings calls by the largest U.S. homebuilders showed little sign they are worried that the tariff will hurt construction in the near term.

THURSDAY, AUGUST 17

Jobless claims (week ending August 12; 8:30 a.m. EDT)

Forecast: 241,000
Initial claims for unemployment insurance benefits are forecast to have fallen by 3,000 to 241,000 in

the week ended August 12. This would reverse the gain in the prior week and the second decline in the past four weeks. New filings remain low. The modest decline would put the four-week moving average at 243,000 in the week ended August 12, leaving it little changed between the July and August payroll reference weeks. This would suggest solid job growth. However, August employment has a tendency to fall short of consensus expectations.

Industrial production (July; 9:15 a.m. EDT)

Forecast: 0.3%

Industrial production is forecast to have risen 0.3% in July following increasing 0.4% in June and gaining 0.1% in May. Messages on manufacturing have been mixed. The ISM manufacturing production index fell 1.8 points in July but the manufacturing data in the July employment report, primarily hours worked, were decent. July is also when the annual auto retooling occurs and we expect this to have weighed on manufacturing production. All told, we have manufacturing industrial production rising 0.2% in July. Outside of manufacturing, we look for a decent gain in mining, consistent with active rotary rig counts. Utility production should provide a small support to total growth in industrial production but weekly production data doesn't signal that weather was an issue.

FRIDAY, AUGUST 18

University of Michigan Survey (August-prelim; 10:00 a.m. EDT)

Forecast: 94

The University of Michigan's consumer confidence is expected to have risen from 93.4 in July to 94 for August, according to the preliminary survey. Fundamentals would suggest that sentiment should fall in August but high-frequency measures of sentiment, including the Bloomberg Consumer confidence index have improved. We believe stock prices are negative for sentiment as are gasoline prices. Rising tensions between the U.S. and North Korea may weigh on sentiment but the escalation in rhetoric likely occurred late, if at all, during the survey period. Therefore, we don't believe the preliminary survey will capture any impact. The labor market remains a clear positive for sentiment but the Michigan survey is less sensitive to labor market conditions than its Conference Board counterpart. Inflation expectations warrant close watch. The Michigan's measure of 5- to 10-year inflation expectations rose from 2.5% to 2.6% in July. We don't anticipate another improvement, since global oil prices—which have a strong correlation with the Michigan's measure of long-term inflation expectations—haven't made a noticeable break higher over the past couple of weeks.

EUROPE

By the Dismal (Europe) staff in London and Prague
(Updates are made on Mondays.)

<u>Summary, August 11</u>: Chances are that the coming week's renewed barrage of U.K. data will add to the past week's disappointments, though we are not expecting results to be as dismal as Thursday's. In the spotlight will be inflation, retail sales, and pay growth figures, and they should all show that 2017's consumption-led slowdown is well on track. Price rises likely gained further momentum in July, while nominal wage growth is expected to have remained weak, pushing real wages deeper into negative territory and denting consumers' will to spend even further.

First, we expect that U.K. inflation rose to 2.7% in July following June's unexpected dip to 2.6%, pushed higher by a pickup in both core and noncore prices. Regarding noncore inflation, food prices likely gained more ground, given that food producer output prices jumped further to 5.8% y/y in June, from 5.7% in May, on the back of the lower currency; this exceeds by more than 3 percentage points food consumer inflation, which was 2.3% at the end of the second quarter. Food consumer prices normally lag food producer output prices by three to six months, so we are penciling in food consumer prices to have gained 2.8% y/y in July, and expect they will continue to rise throughout the second half of 2017 and reach around 5% by the end of the year. Elsewhere, energy inflation should also have picked up, as another of the U.K.'s 'Big Six' electricity companies decided to hike natural gas prices by 5.5% and electricity prices by 6% at the end of June, and the data will be the first time this is incorporated in July's figures. But the rise in food and electricity prices should have been offset by an unseasonal dip in alcohol prices in July, and by a plunge in motor fuels inflation; official data already show that pump prices fell by a sharp 1.6% at the start of the third quarter.

Regarding core inflation, we expect that prices of core goods continued to climb in response to the surge in import costs. Retailers continued to hike prices in July and were expected to raise them further in August and September, reports the European Commission and the Bank of England's Agents Summary of Business Conditions, though evidence is that goods price inflation should reach its peak soon. Services inflation, meanwhile, should have remained relatively steady or accelerated slightly as a mean-reversion in prices for recreation and culture is expected to have offset a slowdown in airfare inflation.

We expect that U.K. wage growth remained steady at around 2% excluding bonuses in June and that it likely slowed to 1.9% in July, so this additional pickup in consumer inflation means that real wages likely slid further into negative territory. This, combined with July's unseasonably rainy weather, is expected to have weighed on retail sales at the start of the third quarter. Although the survey data releases until now have been mixed, we expect that a pullback in clothing and household goods' sales was the main drag on sales in July, offsetting a small rebound in food and fuel spending. Fuel spending likely rose on the back of the further drop in pump prices, while food spending is expected to have rebounded following two months of declines. In all, we are penciling in retail sales to have risen only 0.2% m/m in July, pushing the yearly rate down to 1.4% from 2.9% in June.

FRIDAY, AUGUST 11

Germany: Consumer Price Index (July; 7:10 a.m. BST)

Preliminary estimates show that Germany's yearly inflation edged closer to the European Central Bank's target of close to but below 2%. Annual inflation accelerated to 1.7% in July, not seasonally adjusted, from 1.6% in the previous month. Behind the acceleration was faster growth in energy prices, which rose by 0.9% y/y after stalling in the previous month. The cooling energy prices likely stemmed from a renewed recovery in oil prices. Brent crude rose above $50 per barrel in late July after dropping to just above $45 in the middle of the previous month. On the other hand, the strengthening euro has been tamping down inflation pressures. The euro appreciated to $1.18 at the end of July, its strongest since early 2015. The flash Markit composite PMI for July showed that input inflation pressures accelerated slightly but that growth of output prices eased, though remaining strong overall. The seasonally adjusted CPI likely added 1.8% y/y in June.

France: Consumer Price Index (July; 7:45 a.m. BST)

Preliminary data point to steady annual harmonized inflation of 0.8% y/y in July and a slight cooling over the month. The underlying drivers did not change much from the previous month: manufactured goods and services inflation were stable in year-ago terms. Food inflation cooled over the year, with seasonal fresh products dropping more than they did a year ago. Summer tourism may prop up demand and drive up service prices in the coming month, but we caution that this would be a temporary effect and have little to do with the health of domestic demand. With no sign of a strong rebound in demand conditions, we expect inflation to stall in month-ago terms for the rest of the year.

Italy: Consumer Price Index (July; 9:00 a.m. BST)

Italy's annual EU-harmonized inflation remained unchanged at 1.2% in July from the previous month, according to the preliminary estimates. Core inflation, which excludes energy and seasonal food products, slowed to 0.8% from 1% in June, signaling weak demand-led inflation. Subdued wage growth due to labour market slack and restrained household spending will weigh on inflation in coming quarters. With high so-called "hidden" unemployment—including the discouraged population of those unable to find suitable work and underemployed part-time workers—both wage growth and underlying inflation will be tepid. The hourly wage index rose only 0.4% y/y in the first half of 2017, undermining household spending. Without more job openings and a lower unemployment rate, wages won't increase and inflation will remain sluggish.

Russia: Foreign Trade (June; 2:00 p.m. BST)

Foreign trade was the key component holding up the Russian economy during its recent downturn, but the boost from net exports is beginning to fade. Most of the softer growth comes from an increase in imports; demand for foreign goods is rising due to the stronger ruble and healthier household consumption. Energy will weigh on exports. Oil accounts for roughly 30% of exports, and Russia's production is still capped under supply quotas. Oil prices also slipped in June. Finally, Western sanctions will prevent a rebound in foreign investment, keeping the balance of payments lower. Overall, these trends will cause a small decline in the trade balance to $8.3 billion.

MONDAY, AUGUST 14

Euro zone: Industrial Production (June; 9:00 a.m. BST)

Industrial production likely declined by 1% m/m in June, partially reversing May's 1.3% gain. Individual country data released over the past week showed that factory growth in Germany, France and Spain mean-reverted over the month following robust results for May, though this did not prevent industrial production in all countries from expanding strongly over the second quarter as a whole. While industrial output fell by 1.1% m/m in Germany and in France, and by 0.1% in Spain, in all countries the yearly rate remained well above the past-year average, and the quarterly increase in the three months to June rose above 1%. The story in Italy was even rosier, as industrial production in the country rose by a strong 1.1% in June, building on an already-sharp 0.7% increase in May. We expect that industrial output rose in almost all of euro zone's countries in the June stanza, in line the extremely upbeat recent survey data.

Across sectors, we expect that the monthly declines were broad-based, with a strong mean-reversion in production of capital goods likely being the main dampener on the headline. Transport equipment probably slumped following extremely upbeat results for May, though machinery and equipment production should also have fallen.

TUESDAY, AUGUST 15

Germany: Preliminary GDP (Q2; 7:10 a.m. BST)

Germany's quarterly expansion rate likely remained robust in the second quarter. Real GDP should have grown by 0.5% q/q in the three months to June following a 0.6% gain at the start of 2017. The annual expansion rate likely held steady at 1.7%.

Private consumption likely continued to power the output growth, thanks to the booming labour market. But accelerating inflation, which reached 1.8% y/y on average in the second quarter, likely dampened private spending's contribution to growth. Investment should have continued to recover, while the gradually appreciating euro likely weighed on exports. The average Markit manufacturing PMI reading for the second quarter was the highest in six years, reaching 56.8, pointing to economic growth of 2% y/y.

The outlook for this year is clouded, as the tailwinds supporting growth over the last few years will subside and political uncertainty abroad and at home add to the risks.

U.K.: Consumer Price Index (July; 9:30 a.m. BST)

The U.K.'s annual headline CPI should have accelerated to 2.7% in July, from 2.6% in June, on the back of rises in both core and noncore prices. Regarding the noncore rate, while motor fuels inflation should have stepped back as fuel prices fell by around 1.6% during the month, and alcohol inflation should have dipped given that alcohol prices rose in July 2016 against the seasonal norm, both food and electricity prices are expected to have jumped. Another of the U.K.'s 'Big Six' electricity companies, EDF Energy, had hiked natural gas and energy prices by the end of June—so the data will be incorporated in July's figures—while food inflation likely rose to 2.8%, in line with the recent pickup in food producer prices.

Regarding core inflation. we still expect that higher import prices continued to make their way through to retailing prices over the month, raising the prices of core goods such as clothing, household goods and recreational goods. Services inflation, by contrast, likely remained steady as toy inflation likely mean-reverted from a big dip in June, offsetting a decrease in transport inflation.

WEDNESDAY, AUGUST 16

U.K.: Unemployment (June; 9:30 a.m. BST)

The U.K.'s headline unemployment rate was likely unchanged at 4.5% in the three months to June, its lowest since records began in 1975. The number of employed is expected to have again increased while the number of unemployed likely fell further, building on the strong gains over the past quarter. The number of vacancies remained elevated in June, while survey data pointed to additional labour market gains at the end of the second quarter. They signaled further growth in permanent and temporary job placements, with the rate of growth picking up from the previous months; according to Markit, growth in permanent staff placements was the strongest in 27 months, while temp billing increased at the fastest rate in nearly 2½ years.

But wages should have at best remained steady, or even further eased, since firms are choosing to freeze salaries instead of laying off staff. The BoE's Agents Summary of Business Conditions showed that pay awards remained clustered at around 2% to 3% at the end of June despite recruitment difficulties edging further up. On a brighter note, Markit reported that growth in permanent starting salaries should soon start to rebound. Starting salaries are not reflective of the whole U.K. economy, though, since few people are choosing to move jobs given the recent Brexit-related uncertainty. We still expect the outlook for wages to remain subdued, and for the outlook for jobs to soften somewhat in the second half of the year. The labour market responds with a lag to shocks in the economy, and anecdotal evidence shows that firms are scaling back on hiring plans and choosing productivity improvements and automation over job creation.

THURSDAY, AUGUST 17

U.K.: Retail Sales (July; 9:30 a.m. BST)

U.K. retail sales likely increased just 0.2% in July, following June's 0.6% m/m rise. This should have pushed the yearly rate of growth in sales down to only 1.4%, from 2.9% previously. Leading indicators released in recent weeks have been mixed, but we expect that the further drop in real wages combined with the poor weather depressed sales in the high street, particularly for clothing. Data from the BDO showed that sales in the high street fell by 0.6% y/y in July, dragged down by a 3.5% drop in fashion sales. The BDO tracker does not account for sales in food stores, though, and we expect that food sales rose slightly over the month, recouping at least part of May and June's losses. Accordingly, the Confederation of British Industry's balance of reported sales, which includes food spending, increased to 22 in July from 12 in June. Similarly, the British Retail Consortium's survey indicated that like-for-like retail sales values increased by 0.9% y/y in June, mainly on the back of higher food sales.

Fuel sales, meanwhile, should have also jumped given that pump prices fell further in July following a big drop in June. In all, though, retail sales are set to remain poor throughout the second half of 2017 as accelerating inflation combined with limited wage growth erodes real wages and consumers' purchasing power throughout the year, curbing households' will to spend.

Euro Zone: External Trade (June; 10:00 a.m. BST)

The euro zone's external trade surplus likely expanded to €25 billion in June after increasing to €21.4 billion in May. However, the surplus was likely lower than the €30 billion surplus in June 2016. The recent strengthening of the euro has weighed on exports outside of the single-currency area. The currency appreciated by 1.6% on average in June to $1.12 from May, and was little changed from $1.12 in June 2016. Firming economic activity, with the euro zone's manufacturing PMI climbing to a six-year high of 57.4 in June, from 57 in May, is weighing on the trade balance. The outlook remains uncertain, especially for exports, following the U.K.'s decision to leave the EU and the shift towards greater protectionism in the U.S. In 2016, the U.S. and the U.K. were key euro zone trading partners.

Euro Zone: Consumer Price Index (July; 10:00 a.m. BST)

The euro zone's annual harmonized inflation remained unchanged at 1.3% in July from a month earlier, according the preliminary estimates. Soft oil price growth and the strengthening euro weighed on the headline figure. Although core inflation accelerated to 1.3% from 1.2% in June, it remained subdued because of tepid wage growth and ongoing labour market slack in the southern European countries. Softening inflation pressure is in line with the preliminary PMI for manufacturing and services in July. While headline inflation will be volatile this year, core inflation should slowly heat up. Yet the rise won't be strong enough to trigger a change in the ECB's monetary policy soon. After no change in forward guidance in July, we expect the ECB will shed some light on its future steps in September or October. Although we will have to wait for asset purchases to be terminated or policy rates to rise, the central bank will likely change its forward guidance.

Russia: Retail Sales (July; 3:00 p.m. BST)

Russian retail is showing signs of life. For three consecutive months, year-over-year gains have been solid. Increases have been entirely due to nonfood products, underscoring the assumption that the Russian consumer is healthy. Tame inflation and low interest rates coupled with the recovering macro economy will provide further support, allowing retail to rise a healthy 2.0% on a year-ago basis. Wage pressures, however, will hold back stronger gains. Although real wages are rising, increases have been somewhat disappointing compared with other health markers. A tightening labour market will soon stimulate stronger wage growth, allowing retail to continue its rebound.

FRIDAY, AUGUST 18

No major indicators are scheduled for this date.

ASIA-PACIFIC

By Katrina Ell and the Asia-Pacific economics team of Moody's Analytics

China's July data dump should paint a generally positive picture

China's July data dump should paint a generally positive picture. Chinese tech manufacturers are ramping up production ahead of new global product launches later this year. Increasing component imports along with positive manufacturer sentiment point to further growth in production. The main downside risk is heavy industry, which may be feeling the effects of the housing slowdown in major cities. Retail trade likely accelerated in July. The slowing housing market in Tier 1 cities may be a sign of household spending shifting into other discretionary spending such as automobiles and household appliances. Tech spending is also growing strongly thanks to demand from younger Chinese.

Money supply growth in China has been slowing on account of the central bank's clampdown on nonofficial credit growth. Tighter interbank funding has crimped trust lending and other forms of shadow finance. Investment in fixed assets has decelerated in the past few months after a bounce in

February and March. Mining investment continues to slide, but signs of a bottom are apparent as supply constraints coupled with demand due to housing and other construction have boosted prices.

Preliminary June quarter GDP data are coming in. Japan likely expanded a brisk 0.7% q/q following a 0.3% rise in the quarter prior. Consumption strengthened in the June quarter thanks to a moderate increase in wages and disposable income. Net exports likely contributed positively to GDP growth. Elsewhere, Philippine GDP growth likely accelerated to 6.8% y/y in the second quarter, compared with 6.4% in the opening three months of the year. The main boost will come from exports, which have been expanding rapidly in recent months, largely because of stronger shipments of electronics. Meanwhile, domestic factors have remained conducive to strong growth.

Japan's monthly trade surplus likely widened in July. We expect export growth to continue accelerating, but import growth to decelerate as commodity prices come off the boil. This should buttress the trade balance. The global tech cycle is in full swing, and Japan's tech firms are well placed to deliver electronic goods across the supply chain.

THURSDAY, AUGUST 10

Philippines – Industrial Production – June

Time: Unknown
Forecast: 5.8%
Philippine industrial production growth likely held at 5.8% y/y in June. The archipelago's manufacturers are benefiting from stronger demand at home and abroad. Domestically, private investment and consumption are expanding rapidly as positive demographics and infrastructure improvements propel the economy towards GDP growth around 7%. External demand for Philippine goods, particularly electronics, is improving thanks to the synchronized upswing in global economic conditions.

New Zealand – Monetary Policy – August

Time: 7:00 a.m. AEST (Wednesday 9:00 p.m. GMT)
Forecast: 1.75%
The Reserve Bank of New Zealand will keep rates on hold at 1.75% at its August policy meeting. We do not expect gradual policy normalization to begin until mid-2018. The central bank has explicitly communicated its neutral bias to keep upward pressure off the currency, which has been rising at the hand of higher dairy prices. Earlier measures to cool the heated property market pockets such as Auckland appear to be bearing fruit with activity cooling, a welcome development that means the central bank does not have to get off the sidelines and begin hiking interest rates earlier than it would like.

Japan – Machinery Orders – June

Time: 9:50 a.m. AEST (Wednesday 11:50 p.m. GMT)
Forecast: 1.1%
Machinery orders likely increased 1.1% in June after a 3.6% drop in May. The monthly series is volatile and generally leads capital investment by six to eight months. Looking through the most recent weakness, which we believe to be temporary, a broad-based pickup in investment is likely in the second half of the year thanks to ongoing strength in export-oriented manufacturing.

Malaysia – Industrial Production – June

Time: 2:00 p.m. AEST (4:00 a.m. GMT)
Forecast: 4.4%
Malaysian industrial production likely remained upbeat in June, rising 4.4% following the 4.6% y/y gain in May. Production is mainly being buoyed by electronics due to strong global tech demand ahead of product launches later in 2017. Solid tech demand is helping absorb softness in mining production, especially from crude oil from sluggish prices. Malaysia is heavily exposed to the global tech cycle with integrated circuits representing around 20% of Malaysian exports.

Japan – Industry Activity Indexes – June

Time: 2:30 p.m. AEST (4:30 a.m. GMT)
Forecast: 0.6%
Japan's industrial activity likely rose 0.6% in June after a 0.1% drop in May. Month-to-month momentum has been choppy, but year-ago gains have been more consistent. Overall, tertiary activity likely rose in line with retail sales in June. The trend will improve only if persistent wage growth is realized.

FRIDAY, AUGUST 11

Hong Kong – GDP – 2017Q2

Time: 6:30 p.m. AEST (8:30 a.m. GMT)
Forecast: 0.6%
Hong Kong's economic recovery continued through into the second quarter. The housing market continued gaining momentum, which has boosted household sentiment. Meanwhile exports have picked up on the back of global tech and commodities to China. These factors are helping wages growth recover, albeit at a modest pace.

India – Industrial Production – June

Time: 10:20 p.m. AEST (12:20 p.m. GMT)
Forecast: 1.1%
Factory conditions across India remain restrictive because of supply bottlenecks. Industrial production rose 1.7% y/y in May, and it's likely to have decelerated to 1.1% in June. Weak corporate sector balance sheets are crimping the investment cycle and thus production has also been weak. For a large economy like India, production should be expanding at full tilt.

Monday, August 14

China – Monetary Aggregates – July

Time: Unknown
Forecast: 10%
Money supply growth in China has been slowing on account of the central bank's clampdown on nonofficial credit growth. Tighter interbank funding has crimped trust lending and other forms of shadow finance. Bank lending for mortgages continues to drive credit growth, but the slowdown in housing activity in Tier 1 cities will dampen demand. The M2 measure of money supply likely grew 10% y/y in July, from 9.4% in June, partly on a weak comparison a year earlier.

New Zealand – Retail Trade – 2017Q2

Time: 8:45 a.m. AEST (Sunday 10:45 p.m. GMT)
Forecast: 0.6%
New Zealand's retail trade volumes likely remained upbeat through the second quarter at 0.6%, following the March quarter's 1.5% q/q brisk pace. Households are upbeat thanks to the solid labour market alongside very low borrowing costs and so have kept their purse strings loose, increasing discretionary purchases. Stubbornly weak income growth, however, is taking some of the shine off spending. We expect consumption will remain upbeat through the rest of the year with interest rates remaining on hold in accommodative territory and strong population growth from high net migration lifting domestic demand.

Japan – GDP – 2017Q2

Time: 9:50 p.m. AEST (Sunday, 11:50 p.m. GMT)
Forecast: 0.7%
Japan's preliminary estimate of the June quarter GDP will likely show the economy expanded a brisk 0.7% q/q, following a 0.3% rise in the quarter prior. Consumption strengthened in the June quarter thanks to a moderate increase in wages and disposable income. Net exports likely contributed positively to GDP growth. We expect the GDP deflator declined despite core inflation rising over the

quarter. The first estimate tends to be revised heavily because of private investment data not fully available during the first estimate. We expect private investment likely rose, albeit at a slower pace than in the previous quarter.

China – Fixed Asset Investment – July

Time: 12:00 p.m. AEST (2:00 a.m. GMT)
Forecast: 8.4%
Investment in fixed assets has decelerated in the past few months after a bounce in February and March. Mining investment continues to slide but signs of a bottom are apparent, as supply constraints coupled with demand due to housing and other construction have boosted prices. Steady, healthy manufacturing investment growth continues on the back of stronger global and domestic demand. We expect growth in fixed assets to have decelerated to 8.4% in the year to July, down from 8.6% in the year to June.

China – Industrial Production – July

Time: 12:00 p.m. AEST (2:00 a.m. GMT)
Forecast: 7%
Chinese tech manufacturers are ramping up production ahead of global product launches later this year. Rising component imports along with positive manufacturer sentiment point to further growth in production. The main downside risk is heavy industry, which may be seeing the effects of the housing slowdown in major cities. Industrial production likely grew 7% y/y in July, down from 7.6% in June.

China – Retail Sales – July

Time: 12:00 p.m. AEST (2:00 a.m. GMT)
Forecast: 11.2%
Retail spending in China accelerated in June, as robust income growth keeps consumers confident. The slowing housing market in Tier 1 cities may be a sign of household spending shifting into other discretionary spending such as automobiles and household appliances. Tech spending is also growing strongly thanks to demand from younger people. Retail spending likely increased 11.2% y/y in July, after a 11% gain in June.

India – Consumer Price Index – July

Time: 10:00 p.m. AEST (12:00 p.m. GMT)
Forecast: 1.7%
India's headline CPI likely picked up in July to 1.7% y/y. After a sharp deceleration in June to 1.5%, we reckon prices have likely bottomed as base effects and key pulse prices will likely pick up in coming months. However, with the monsoon season tracking at around normal rainfall, we don't see prices accelerating sharply over the coming months. With the Reserve Bank of India cutting rates in early August, and prices likely bottoming out, further rate cuts are unlikely this year.

Tuesday, August 15

Indonesia – Foreign Trade – July

Time: Unknown
Forecast: US$1.32 billion
Indonesia's monthly trade surplus likely narrowed to US$1.32 billion in July, from US$1.63 billion in June. Annual export growth likely rebounded from June's contraction, which was driven by the different timing of the annual Eid al-Fitr holiday. This was the first fall in nine months. A similar contraction occurred with imports. Beyond the seasonality, oil exports are struggling with the sustained lull in oil prices. Nonoil and gas exports are helping pick up the slack as a result of buoyant global demand.

Wednesday, August 16

India – Foreign Trade – July

Time: Unknown
Forecast: -US$12.8 billion
India's monthly trade deficit likely narrowed to US$12.8 billion in July after June's US$13 billion deficit. Export growth remains firm, although imports are rising at a faster pace. Exports of major commodities such as engineering goods and petroleum goods have risen thanks to improved global demand and rebounding commodity prices. But the import ledger is also widening because of commodity prices.

Thailand – Monetary Policy – August
Time: 2:00 p.m. AEST (4:00 a.m. GMT)
Forecast: 1.5%
The Bank of Thailand will leave its monetary policy rate at 1.5% at its August meeting. The rate has been at this record low since April 2015. Thailand's economy is being pulled in two directions in the middle of 2017. Export-facing sectors, particularly manufacturers of electronics and autos, are receiving a boost from the upturn in global demand. But domestic demand remains fairly weak. Private consumption growth has trended down in the year to date, while investment has been in the doldrums for more than three years.

India – Wholesale Price Index – July
Time: 4:45 p.m. AEST (6:45 a.m. GMT)
Forecast: 0.5%
Low food prices have caused wholesale inflation to decelerate sharply. Wholesale prices likely decelerated in July to 0.5% after a 0.9% rise in June. Food and energy prices are expected to decline or decelerate in coming months. Moreover, India's meteorological department has forecast normal monsoon rains for the coming months. If these forecasts materialise, food prices could decline further.

Thursday, August 17

Japan – Foreign Trade – July
Time: 9:50 a.m. AEST (Wednesday, 11:50 p.m. GMT)
Forecast: ¥150 billion
Japan's monthly trade surplus likely widened in July to ¥150 billion after it narrowed in the prior month to ¥81 billion. We expect export growth to continue accelerating but import growth to decelerate as commodity prices come off the boil. This should buttress the trade balance. Overall, improved global demand, particularly in the key markets of North America and China, is also boosting export values on a year-ago basis. The global tech cycle is in full swing, and Japan's tech firms are well-placed to deliver electronic goods across the supply chain.

Singapore – Foreign Trade – July
Time: 10:30 a.m. AEST (12:30 a.m. GMT)
Forecast: 9%
We expect Singapore's nonoil domestic export growth to have improved to 9% y/y in July, from 8.2% in June. Exports from the city-state have been growing strongly year to date thanks to stronger tech demand boosting electronics production. With a new wave of product launches scheduled, this trend will persist in the remainder of the year. Biomedical and specialty chemical exports should improve in the coming months as well.

Australia – Employment Situation – July
Time: 11:30 a.m. AEST (1:30 a.m. GMT)
Forecast: 5.6% Unemployed
Australia's unemployment rate likely held steady at 5.6% in July. The Australian labour market has improved in the year to date, with jobs growth picking up. Particularly encouraging has been the uptick in full-time job creation. Given this, we look for the July jobs report to show that the underemployment rate fell from its record high. This will be the first step towards reducing the labour market slack that has suppressed wage growth in recent years.

Friday, August 18

Malaysia – GDP – 2017Q2

Time: 10:00 a.m. AEST (12:00 a.m. GMT)
Forecast: 5.1%
Malaysia's economy has lost a little steam from the burly pace in the March quarter. GDP growth likely cooled to 5.1% y/y in the June quarter, from 5.6% previously. We expect manufacturing growth cooled, after accelerating by 0.9 percentage point in the previous quarter to 5.6% y/y. Malaysia's economy is heavily exposed to the tech cycle so the bulk of the manufacturing gains were driven by tech, which is unlikely to have maintained that pace in June. Softer manufacturing should have flowed through to weaker consumption and export performance. For instance, Malaysian exports hit a six-month low in June. Full-year growth is forecast at 4.8% in 2017.

Philippines – GDP – 2017Q2

Time: 12:00 p.m. AEST (2:00 a.m. GMT)
Forecast: 6.8%
Philippine GDP growth likely accelerated to 6.8% y/y in the second quarter, compared with 6.4% in the opening three months of the year. The main boost will come from exports, which have been expanding rapidly in recent months largely because of stronger shipments of electronics. Meanwhile, domestic factors have remained conducive to strong growth. Private consumption will grow rapidly for the foreseeable future thanks to rising incomes and favorable demographics. Investment will also expand rapidly as a result of a mixture of private and government projects.

Taiwan – GDP – 2017Q2

Time: 6:00 p.m. AEST (8:00 a.m. GMT)
Forecast: 2.4%
Taiwan's economy has been somewhat sluggish, but data for the final month of the second quarter show signs of recovery. Exports of tech components were strong, and industrial production growth accelerated as a result. Taiwan's economy is feeling the rising tide across the Asia supply chain. Second estimates for Taiwan's second quarter GDP are likely to be upwardly revised to 2.4%, from the advance 2.1% estimate..

The Long View

The US: A bottoming of the high-yield EDF (Expected Default Frequency) metric warns of a topping off by high-yield borrowing activity

By John Lonski, Chief Economist, Moody's Capital Markets Research Group,
August 10, 2017

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 111 bp is under its 122-point mean of the two previous economic recoveries. Further narrowing by this thin spread may be limited by more cash- or debt-funded acquisitions, spin-offs, stock buybacks, and dividends. Subpar growth by business sales and pretax profits will also add to credit risk, as will a rising risk of high-yield defaults.

The recent high-yield bond spread of 387 bp is less than what is inferred from the spread's macroeconomic drivers and the high-yield EDF metric, and a now higher VIX index. The implications for liquidity of regulatory changes merit scrutiny. If regulatory change enhances the market making capabilities of banks, corporate bond yield spreads may be thinner than otherwise.

DEFAULTS

After setting its current cycle high at January 2016's 5.9%, the US high-yield default rate has since eased to June's 3.8%. Moody's Default and Ratings Analytics team expects a 3.0% average for the default rate of 2018's first quarter. 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.

The Long View

Second-quarter 2017's worldwide offerings of corporate bonds showed an annual percent decline of -6.7% for IG and an increase of +7.5% for high-yield, wherein US$-denominated offerings fell by -6.2% for IG and grew by +4.9% 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 2.1% annually for IG and may advance by 22.7% 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 mid-point of the range for fed funds should finish 2017 no greater than 1.375%. 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 and Barbara Teixeira Araujo of Moody's Analytics
August 10, 2017

Eurozone

The euro area's GDP growth neither surprised nor disappointed. The economy expanded 0.6% q/q in the three months to June, following downwardly revised 0.5% growth in the first quarter. Accelerating expansion in Spain and robust growth in France contributed the most to the gain. If real GDP in Germany and Italy, to be published in mid-September, surprises on the upside, the euro zone would have grown even more in the second quarter. Since our forecasts are relatively pessimistic, with GDP adding 0.2% in Italy and 0.4% in Germany, we expect the euro area's quarterly GDP growth will be revised up. A solid performance in Germany and Italy could also improve our forecast for euro zone growth in 2017. Growth was broad-based across all major components. Booming exports drove the headline, in line with the strengthening global economy, though domestic demand likely helped considerably. Political risks are subsiding, reform efforts are under way in France after Emmanuel Macron's party won the general election, and Italy's banking crisis seems contained for now.

The euro zone performed exceptionally well in the first half of 2017, but it would be unwise to think that the economy will keep expanding at this rate. The area's composite PMI for manufacturing and services suggests that the recent growth spurt lost momentum for a second month running in July. This could be a warning sign. Tightening monetary conditions may halt the economic recovery, while persistent labour market slack could keep household spending growth relatively subdued. The euro has strengthened by 12% against the dollar so far this year, undermining the price competitiveness of the euro zone's exports, while 10-year German government bond yields, a European benchmark, surged around 30 basis points over recent months.

Although the euro zone's jobless rate dropped in June to an 8½-year low of 9.1%, the high share of underemployed part-time workers and discouraged population of those unable to find work remain a concern. Without more job openings and a lower unemployment rate, wages won't increase much and domestic consumption will stay in the doldrums. . Although we have seen no signs of slowing trade with the U.K., despite the British decision to leave the EU, this may change in coming years after the U.K. formally withdraws from the EU and starts renegotiating trade deals. Similarly, though U.S.

President Trump has not yet introduced any measures against Germany or other European countries, the U.S. protectionist rhetoric poses a threat. Despite these headwinds, we expect the euro zone economy to expand 1.9% this year, surpassing the 2016 rate, before slowing to 1.6% in 2018.

With a higher true unemployment rate tamping down wage growth, core inflation could continue to surprise on the downside, delaying normalization of the ECB's monetary policy. After no change in forward guidance in July, we expect the ECB will likely announce its plans to taper asset purchases in September or October but continue its bond-buying program until at least June 2018. We don't expect the bank to start raising the deposit rate back into positive territory before the second quarter of 2018, when it terminates its purchases.

UK

Preliminary second quarter GDP numbers added to the increasing evidence that Britain's economic momentum will slow sharply this year following 2016's shocking EU-exit vote. Although real GDP expanded by 0.3% q/q in the second quarter, accelerating slightly from a 0.2% increase at the start of the year, we still assume that gains will average only 0.2% q/q in the second half of 2017. The details showed that growth depended entirely on services, while factory growth and construction declined. What's worrying is that the momentum in service is not expected to last, since its growth was mainly supported by a mean reversion in retail sales, which had plunged in the first quarter. Meanwhile, the decline in manufacturing confirms our fears that the economy will fail to rebalance from consumption towards foreign trade and investment.

This all but crushes the Bank of England Monetary Policy Committee's current expectations. And we cannot come up with a happier story: Unlike the MPC, we believe manufacturing will get little support from the slump in the pound. The uncertainty surrounding exit negotiations is sure to prevent investment from picking up strongly despite the weaker pound making U.K. assets more profitable for foreigners, while the fact that U.K. exporters raised prices sharply offset most of the competitiveness gains brought by the weaker currency. Leading and hard export data released since the start of the year have all disappointed, and that's despite the pickup in world trade, suggesting that sterling's latest depreciation has done practically nothing. In line with our expectations, the Bank of England kept its policy stance unchanged in August, leaving the bank rate at the record low of 0.25% and its target for asset purchases at £435 billion. The decision was supported by downward revisions to the outlook for growth and wages, while inflation expectations were raised only at the margin. With growth expected to disappoint in coming quarters, as real wages fall and Brexit-related uncertainty persists, the bank likely won't raise rates until at least the beginning of 2019. Fiscal policy will support the BoE's accommodative monetary policy. The government has abandoned its plan to close the budget deficit by 2020 and has confirmed plans to lower the corporate tax rate from the current rate of 20% to 17% by April 2020 and increase government spending to prop up waning economic activity.

Rising inflation and worsening labor market will weigh on household spending. Labour market figures added to the gloom of the previous data barrage, as they showed that real wages plunged further into negative territory in the quarter to May. Including bonuses, real pay growth shed 0.7% q/q, as nominal wage growth slowed to only 1.8% from 2.1% previously, and inflation peaked at 2.9% in May. It's true that, excluding bonuses, the drop in real wages was less pronounced, but we caution that this was because of distortions caused by the financial sector; wages deteriorated in all other sectors of the economy. Given that we expect inflation to average 2.8% this year and peak at 3.1% later this year, household spending—the engine of U.K. growth—should pull back in line with the deterioration in consumers' purchasing power. The outlook for wages, meanwhile, is dire. All hiring surveys point to a deterioration in pay settlements, especially for first hires, while anecdotal evidence shows that firms are unwilling to raise wages until they know more about the future relationship between the U.K. and the EU.

The forthcoming exit negotiations and anxiety about the U.K.'s future at home and abroad should keep sentiment about the general economic outlook for the next year in negative territory, with risks tilted to the downside depending on how negotiations go. Real GDP growth is expected to decelerate from 1.8% in 2016 to around 1% in 2017 before gradually strengthening to 1.2% in 2018 and settle around 1.8%, its new post-exit potential growth rate, around 0.2 percentage point lower than it would have been were the U.K. to stay in the EU.

ASIA PACIFIC

By Katrina Ell and the Asia-Pacific Staff of Moody's Analytics
August 10, 2017

Australian consumers are an interesting bunch. The Australian economy has enjoyed an enviable two-decade run without recession, but households are not celebrating. Trend nominal retail trade was 3.6% y/y in June, below its decade average of 4.2% and 20-year average of 5.1%.

Similarly, the trend consumer sentiment index from the Melbourne Institute was 96.4 in July, below the neutral reading of 100 that separates optimists from pessimists. Consumers have been pessimistic since December on a seasonally adjusted basis. The consumer sentiment index decade average is 104.8, suggesting consumers are generally mildly upbeat. Households have become less upbeat over time; the 20-year average sentiment reading was 107.8.

There has been some improvement on the retail front recently. Retail values rose an average 0.6% m/m in the second quarter, up from the 0.1% monthly average in the March quarter. Volumes have strengthened. Retail volumes expanded 1.5% q/q in June, up from the previous quarter's 0.2% q/q and the strongest result since March 2013. Preliminary estimates suggest household consumption will contribute 0.7 to 0.8 percentage point to second quarter GDP growth, up from the 0.3-percentage point contribution in the first quarter.

The correlation coefficient between the Melbourne Institute consumer sentiment index and retail trade was just 0.21 from 1991 to 2017. A Granger causality test did not find a causal relationship. Yet, looking beneath the weak headline and volatility in each of the series, there is a stronger relationship.

A three-year rolling correlation revealed that in relatively severe upswings and downswings the correlation between sentiment and spending strengthens. For instance, around 2009, when the global economy was struggling and Australia was teetering on the verge of recession, consumers became very pessimistic given the economic and financial market ructions at home and abroad, and consumption sharply pulled back. During periods of normalcy it appears there is too much noise in the data for the strong correlation to remain.

The Reserve Bank of Australia made a fleeting mention in its August policy statement that new entrants to the retail market will put downward pressure on inflation. The elephant in the room is the arrival of Amazon. The online retail giant is setting up warehouses and expected to begin local shipping in 2018.

Australian brick-and-mortar retailers have struggled to keep up with online retailing, and the arrival of Amazon will be an even bigger challenge. To some extent, restrictive shipping costs have shielded local retailers from online overseas retailers. That will change when Amazon sets up a local warehouse. In the U.S. and U.K., consumers over time buy a greater variety of products from Amazon as they become more familiar with the site. A similar trend is expected in Australia.

If Amazon is successful, it will result in retail job losses, as fewer staff are required in stores. This has occurred in the U.S. and is blamed for brick-and-mortar stores continually closing. It will also put downward pressure on clothing and other consumer durable prices. This impact has already occurred with the advent of fast fashion such as H&M and Uniqlo setting up a local presence, but is expected to intensify with Amazon.

The RBA didn't deliver any surprises in August. The central bank expectedly left the cash rate on hold at 1.5% and it should stay put until mid-2018. The flexibility to keep rates low is thanks to inflation remaining below the lower bound of the RBA's target band of 2% to 3%.

The central bank's thinking on the currency was interesting in the August statement. The aussie has appreciated 10.5% this year against the greenback and almost 5% in the past month to around a two-year high. The RBA was forthright in observing that the appreciation could be “weighing on the outlook for output and employment.” Yet the central bank isn't expecting the strength to last, with the official economic forecasts being "largely unchanged." If the bank was expecting the aussie to continue appreciating, it would have lowered its forecasts.

The RBA still expects economic growth to gradually improve over the next 12 months, pushing inflation into the target range and putting downward pressure on the unemployment rate. Indeed, there are already some positive signs. The six-month moving average in full-time employment growth is at its highest since 2011. This trend will have to continue for some time if it is take the existing slack out of the labour market and encourage wage growth, which remains very low by historical standards. This improvement will also be necessary for a consistent, sustainable improvement in household spending.

Our baseline scenario is that the RBA will keep interest rates steady at 1.5% until the June quarter of 2018. Under this assumption, GDP growth will rise 1.8% in 2017 and strengthen to 2.4% in 2018. Financial markets agree that the cash rate will be on hold for around another year.

An interesting exercise is to see how sensitive the economy is to changes in the cash rate, particularly as there has been loud chatter in the past quarter about the potential for both rate hikes or rate cuts in the near term. Rate hike chatter has been driven by concerns that the property market will reaccelerate, and this has broader financial stability implications given the large exposure of Australian banks and households to local property. Rate cut talks have been generated by concern the economy still hasn't got enough momentum and nonmining investment is still lagging where it should be.

We modeled the impact of the RBA beginning its interest rate normalisation from the third quarter of 2017 and by early 2019 the economy is back to its neutral rate, which we estimate to be around 3.5%. Under this scenario, GDP growth is 0.9 percentage point lower over the three-year forecast horizon to 2019. Inflation is 1.4 percentage points lower and the currency appreciates to US$0.78, from the baseline assumption of steady depreciation to US$0.73 by mid-2018.

We also modelled the RBA beginning interest rate reductions from the September quarter of 2017. Under this scenario, inflation is 0.5 percentage point higher over the three-year forecast horizon, GDP growth is 0.4 percentage point higher, and the currency troughs at US$0.719 early 2018.

This exercise confirms that the economy is more sensitive to interest rate hikes, rather than further interest rate cuts, at this point in the cycle. That is, the benefit of further interest rate reductions when lending rates to businesses and households are already very low is marginal. We have previously noted that further interest rate cuts are undesirable, particularly given the property market has started to cool in the worrying pockets and additional rate cuts could reignite the frothiness, with marginal broader benefit to the economy.

Ratings Round-Up

By Njundu Sanneh

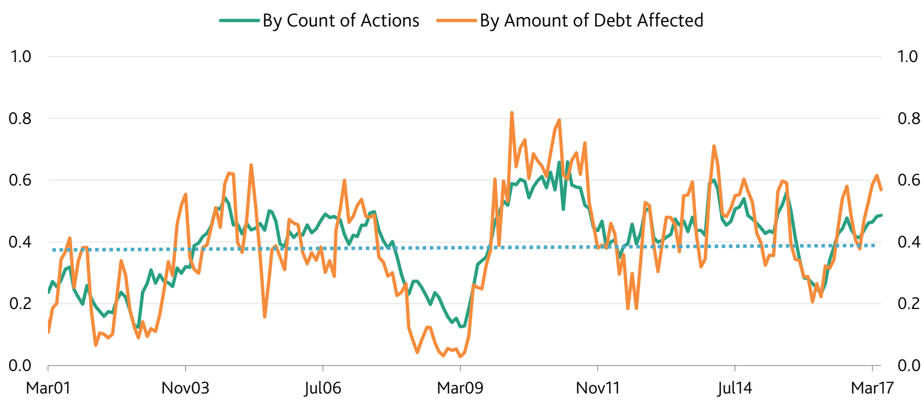
Global Spec Grade Default Rate Continues to Ease

US and Europe ratings' fates diverged this past week. The US rate was at 54% positive, slightly lower than the 57% last week but still well above the 40% long-term average for the metric. Europe on the other hand saw a sharp drop in the contribution of positive rating changes to 25% from 82% the week earlier. The short European rating changes list was dominated by United Kingdom firms where Moody's took rating action on 11 building societies and banks. The only non UK rating change was that of Schneider Electric SE a French heavy machinery manufacturer.

Tight speculative grade spreads notwithstanding, the hawkish central bank environment in developed markets has helped ease the global speculative default rate which ended July at 3.1% from 4.8% a year ago. The Moody's July Monthly Default Report projects the default rate to end the year at 2.7% and to fall further to 2.2% a year from now..

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

Ratings Round-Up

FIGURE 3 Rating Changes: Corporate & Financial Institutions – US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG
8/2/17	CONTINENTAL BUILDING PRODUCTS, INC. - Continental Bldg Products Operating Co LLC	Industrial	SrSec/BCF/LTCFr/PDR		U	B1	Ba3	SG
8/2/17	KUEHG CORP.	Industrial	SrSec/BCF		U	B2	B1	SG
8/2/17	PACKAGING CORPORATION OF AMERICA	Industrial	SrUnsec	1,650	U	Baa3	Baa2	IG
8/3/17	METRO-GOLDWYN-MAYER INC.	Industrial	LTCFR/PDR		D	Ba1	Ba2	SG
8/3/17	MURPHY OIL CORPORATION	Industrial	SrUnsec	5,600	U	B1	Ba3	SG
8/3/17	SCIENCE APPLICATIONS INTERNATIONAL CORP	Industrial	LTCFR/PDR		U	Ba3	Ba2	SG
8/3/17	VALVOLINE INC. - Valvoline Finco Two LLC	Industrial	LGD	375	U			SG
8/4/17	MICRO HOLDING CORP.	Industrial	SrSec/BCF/LTCFR/PDR		D	B1	B2	SG
8/4/17	MOLINA HEALTHCARE, INC.	Financial	SrUnsec/IFSR	1,030	D	Ba3	B2	SG
8/4/17	WALTER INVESTMENT MANAGEMENT CORP	Financial	SrUnsec/SrSec/BCF/LTCFR	575	D	Caa3	Ca	SG
8/7/17	WEEKLEY HOMES, LLC	Industrial	SrUnsec	400	U	Caa1	B3	SG
8/8/17	STAPLES, INC.	Industrial	SrUnsec	1,000	D	Baa2	B3	IG

Source: Moody's

FIGURE 4 Rating Changes: Corporate & Financial Institutions – EUROPE

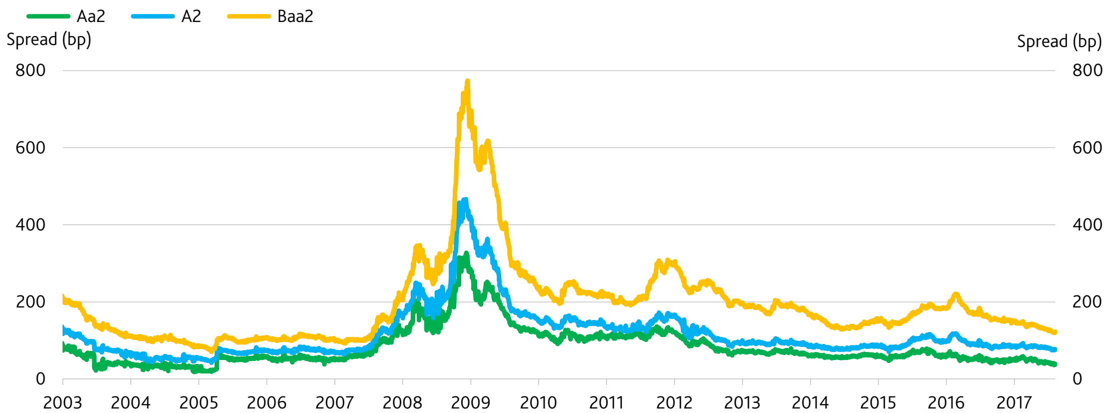
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	Old STD Rating	New STD Rating	IG/ SG	Country
8/3/17	SCHNEIDER ELECTRIC SE	Industrial	SrUnsec/LTIR	6,676	D	A3	Baa1			IG	FRANCE
8/2/17	LEEDS BUILDING SOCIETY	Financial	SrUnsec/SLTD/Sub/MTN	1,175	D	A2	A3	P-1	P-2	IG	UNITED KINGDOM
8/2/17	PRINCIPALITY BUILDING SOCIETY	Financial	SrUnsec/MTN/SLTD/Sub/PS	78	U	Baa3	Baa2	P-3	P-2	IG	UNITED KINGDOM
8/4/17	ICICI BANK LIMITED - ICICI Bank UK Plc.	Financial	SrUnsec/LTD Sub/JrSub/MTN	577	D	A3	Baa1			IG	UNITED KINGDOM

Source: Moody's

Market Data

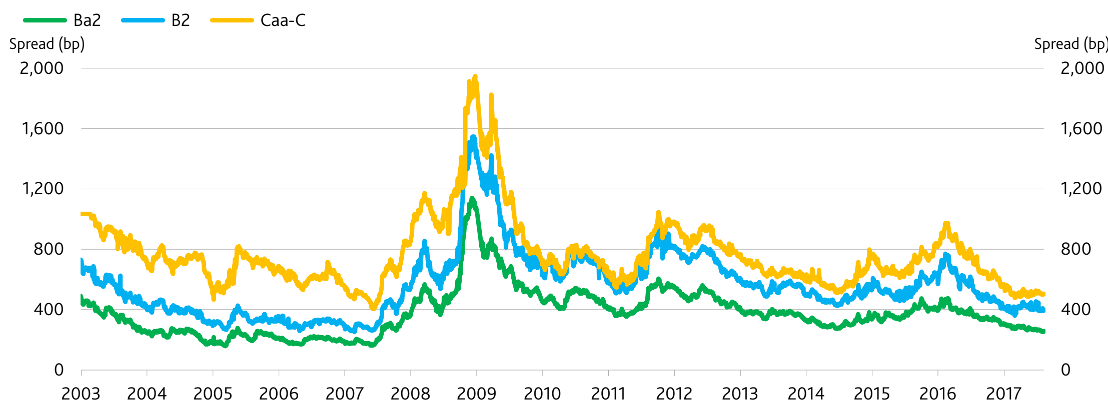
Spreads

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 (August 2, 2017 – August 9, 2017)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Aug. 9	Aug. 2	Senior Ratings
Chevron Corporation	A3	Baa1	Aa2
Calpine Corporation	B3	Caa1	B2
Praxair, Inc.	Aa3	A1	A2
Marathon Oil Corporation	Ba3	B1	Ba1
Avis Budget Car Rental, LLC	B3	Caa1	B1
Ryder System, Inc.	Baa1	Baa2	Baa1
Realogy Group LLC	B1	B2	B1
Xcel Energy Inc.	Aa3	A1	A3
Macy's Retail Holdings, Inc.	B2	B3	Baa3
PPG Industries, Inc.	Baa1	Baa2	A3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Aug. 9	Aug. 2	Senior Ratings
Wyndham Worldwide Corporation	Ba3	Baa3	Baa3
United Technologies Corporation	Aa3	Aa1	A3
Anthem, Inc.	A2	Aa3	Baa2
General Mills, Inc.	A2	Aa3	A3
Colgate-Palmolive Company	A1	Aa2	Aa3
Hartford Financial Services Group, Inc. (The)	A1	Aa2	Baa2
AT&T Inc.	Baa3	Baa2	Baa1
Verizon Communications Inc.	Baa3	Baa2	Baa1
Bank of America, N.A.	Baa1	A3	A1
American Express Credit Corporation	Aa2	Aa1	A2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Aug. 9	Aug. 2	Spread Diff
Windstream Services, LLC	B2	1,256	884	372
Nine West Holdings, Inc.	Ca	6,141	5,867	274
Frontier Communications Corporation	B2	1,130	934	196
Sears Holdings Corp.	Caa3	3,637	3,502	135
Sears Roebuck Acceptance Corp.	Caa3	3,489	3,359	129
McClatchy Company (The)	Caa2	1,122	1,045	77
Tenet Healthcare Corporation	Caa1	517	444	73
Avon Products, Inc.	B3	689	617	71
Wyndham Worldwide Corporation	Baa3	141	75	66
Unisys Corporation	B3	575	510	65

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Aug. 9	Aug. 2	Spread Diff
Hertz Corporation (The)	B3	987	1,048	-61
Parker Drilling Company	Caa1	977	1,018	-41
Genworth Holdings, Inc.	Ba3	673	710	-36
PSEG Power LLC	Baa1	209	244	-35
Macy's Retail Holdings, Inc.	Baa3	246	270	-24
Calpine Corporation	B2	406	423	-18
NRG Energy, Inc.	B1	234	250	-17
Embarq Corporation	Ba1	174	188	-14
Interval Acquisition Corp	Ba3	190	204	-14
Navistar International Corp.	Caa1	368	381	-13

Source: Moody's, CMA

Figure 4. CDS Movers - Europe (August 2, 2017 – August 9, 2017)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Aug. 9	Aug. 2	Senior Ratings
Alpha Bank AE	Ca	C	Caa3
Bank of Ireland	Baa1	Baa2	Baa1
National Grid Electricity Transmission plc	A3	Baa1	A3
Solvay SA	A3	Baa1	Baa2
Adecco Group AG	A2	A3	Baa1
Astaldi S.p.A.	Ca	C	B3
Storebrand ASA	B1	B2	Ba1
Italy, Government of	Ba2	Ba2	Baa2
United Kingdom, Government of	Aaa	Aaa	Aa1
Germany, Government of	Aaa	Aaa	Aaa

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Aug. 9	Aug. 2	Senior Ratings
Societe Generale	A2	Aa3	A2
BNP Paribas	A1	Aa2	A1
Credit Agricole Corporate and Investment Bank	A1	Aa2	A1
AXA	A1	Aa2	A2
BNP Paribas Fortis SA/NV	A1	Aa2	A2
Swiss Reinsurance Company Ltd	A1	Aa2	Aa3
France, Government of	Aa1	Aaa	Aa2
Belgium, Government of	Aa1	Aaa	Aa3
Barclays Bank PLC	A3	A2	A1
Credit Agricole S.A.	Aa3	Aa2	A1

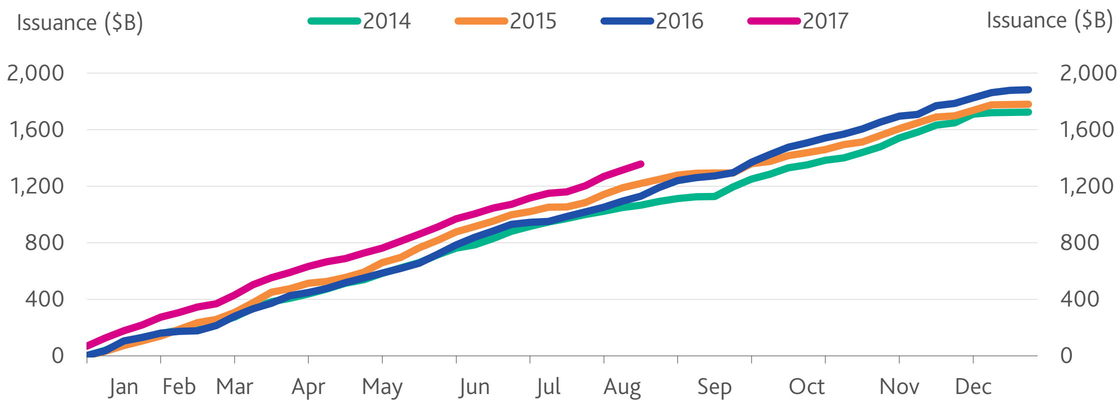
CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Aug. 9	Aug. 2	Spread Diff
Norske Skogindustrier ASA	C	37,445	37,153	291
PizzaExpress Financing 1 plc	Caa1	959	823	135
Galapagos Holding S.A.	Caa2	869	816	52
Novo Banco, S.A.	Caa2	1,245	1,222	22
Premier Foods Finance plc	Caa1	341	321	21
Iceland Bondco plc	Caa1	282	265	18
Banco Popular Espanol, S.A.	Ba1	66	53	13
Boparan Finance plc	B2	481	467	13
Matalan Finance plc	Caa2	611	598	13
Barclays Plc	Baa2	79	67	12

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Aug. 9	Aug. 2	Spread Diff
Astaldi S.p.A.	B3	829	892	-63
Banco BPI S.A.	Ba3	202	239	-37
Caixa Geral de Depositos, S.A.	B1	200	223	-23
Pearson plc	Baa2	89	106	-17
Greece, Government of	Caa2	518	529	-11
Unipol Gruppo S.p.A.	Ba2	145	153	-8
Banco Comercial Portugues, S.A.	B1	221	228	-7
MAN SE	A3	76	83	-7
Bankia, S.A.	Ba1	75	81	-6
CMA CGM S.A.	B3	460	466	-6

Source: Moody's, CMA

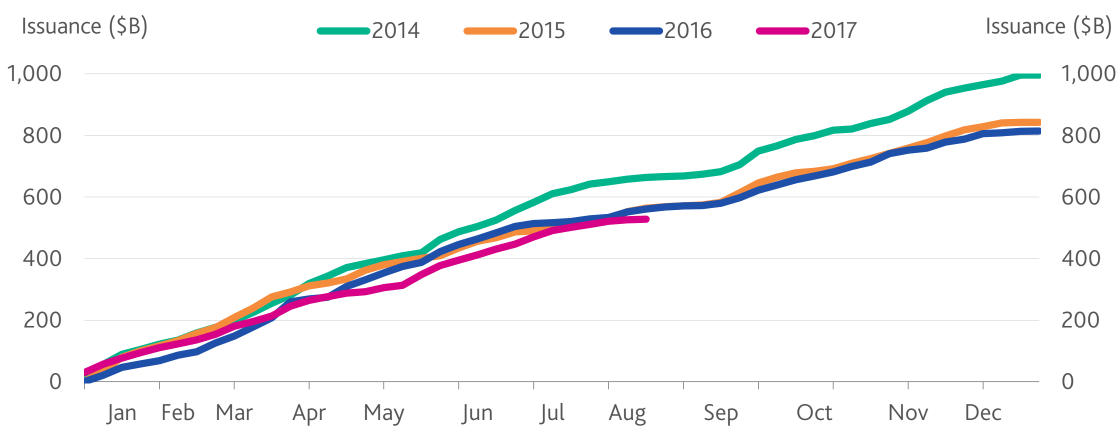
Issuance

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	25.269	10.605	43.472
Year-to-Date	963.398	273.658	1,356.762

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	0.166	0.325	1.030
Year-to-Date	437.916	61.483	527.463

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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