MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

Tightening Is Toxic Once Fed Funds Tops Ten-Year

Moody's Capital Markets Research

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Credit Markets Review and Outlook *by John Lonski*

Tightening Is Toxic Once Fed Funds Tops Ten-Year.

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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, "The year-to-year growth rate for the outstanding debt of US nonfinancial corporations slowed from Q1-2016's 7.2% to Q1-2017's 4.9%," begin on page 18.

Credit Spreads	Investment Grade: Year-end 2017 spread to exceed its recent 119 bp. High Yield: After recent spread of 380 bp, it may approximate 425 bp by year-end 2017.
Defaults	US HY default rate: Compared to April 2017's 4.5%, Moody's Credit Policy Group forecasts the US trailing 12-month high-yield default rate to average 3.0% during the three-months-ended April 2018.
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 $341 billion. For 2017, US$ IG bond issuance may rise by 2.7% to a new zenith of $1.45 trillion, while US$-priced high-yield bond issuance may increase by 19.0% to $406 billion, which lags 2014's $435 billion record high.

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Ratings Round-Up *by Njundu Sanneh*

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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: Paris, mediocre, capital, retail, Korea, yields, less, doubt, Venezuela, inflation, CCAR, global, Treasury yield, France, improve, cycle, South Africa, yields.

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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.

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Credit Markets Review and Outlook

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

Tightening Is Toxic Once Fed Funds Tops Ten-Year

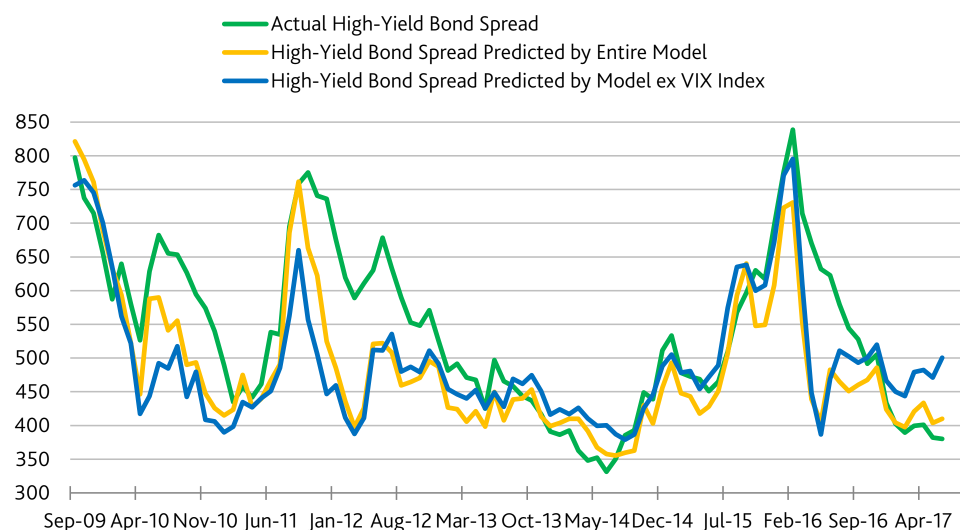
The FOMC is expected to announce a 25 bp hike in the federal funds rate's midpoint to 1.125% on Wednesday, June 14. Despite March 14's 25 bp hiking of fed funds to a 0.875% midpoint, the 10-year Treasury yield fell from March 13's 2.62% to a recent 2.20%. If the 10-year Treasury yield does not climb higher following June 14's likely rate hike, the scope for future rate hikes should narrow.

At each of its end-of-quarter meetings, the FOMC updates its median projections for economic activity, inflation, and the federal funds rate. At the March 2017 meeting, the FOMC's median projections for the year-end federal funds rate were 1.375% for 2017, 2.125% for 2018, and 3.0% for 2019 and beyond. However, the recent 10-year Treasury yield of 2.20% implicitly reflects doubts concerning whether the fed funds rate's long-run equilibrium will be as high as 3.0%.

Perhaps, the FOMC will supply a lower long-run projection for fed funds. Nevertheless, in order to ward off speculative excess in the equity and corporate credit markets, the FOMC may wisely decide to overestimate the likely path of fed funds. The last thing the FOMC wants to do is help further inflate an already overvalued equity market.

Moreover, equity market overvaluation has pumped up systemic liquidity by enough to narrow high-yield bond spreads to widths that now under-compensate creditors for default risk. According to a multi-variable regression model that explains the high-yield bond spread in terms of (1) the VIX index, (2) the average EDF (expected default frequency) metric of non-investment grade companies, (3) the Chicago Fed's national activity index, and (4) the three-month trend of nonfarm payrolls, the high-yield spread's recent projected midpoint of 410 bp exceeds the actual spread of 380 bp. Moreover, after excluding the VIX index from the model, the predicted midpoint widens to 500 bp. The 90 bp jump by the predicted spread after excluding the VIX index is the biggest such difference for a sample that commences in 1996. The considerable downward bias imparted to the predicted high-yield spread by the recent ultra-low VIX of 10.2 points highlights the degree to which a richly priced and highly confident equity market has narrowed the high-yield bond spread. (Figure 1.)

Figure 1: Predicted High-Yield Spread Rises from 410 bp to 500 bp After Excluding Downward Bias Supplied by VIX Index *in bp*

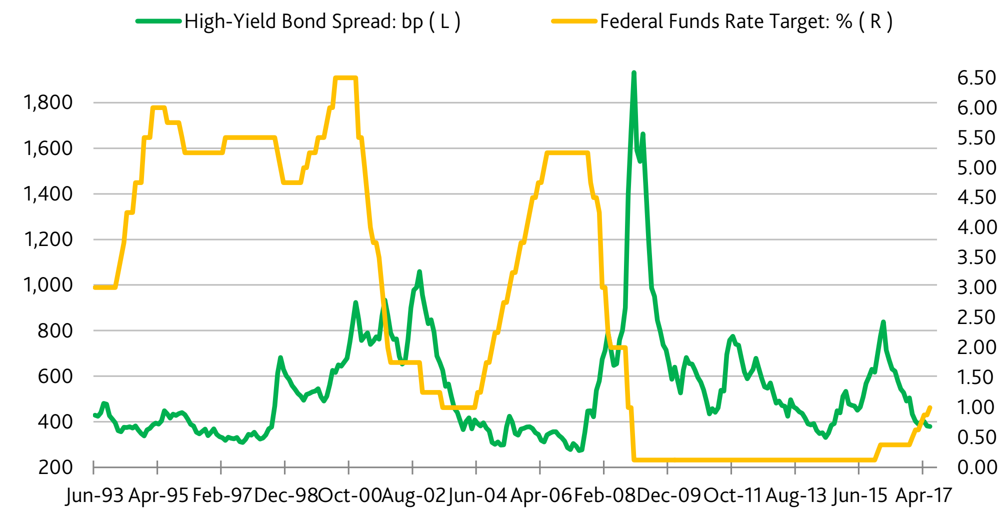


High-yield spreads can narrow amid Fed rate hikes

There is absolutely nothing unusual about financial market conditions easing amid Fed rate hikes. When the fed funds' midpoint was hiked from 0.125% to 0.375% in December 2015, the high-yield bond spread quickly swelled from a November 2015 average of 697 bp to February 2016's 839 bp. However, though

the midpoint is likely to reach 1.125% at the FOMC's upcoming meeting of June 14, the high-yield spread has since narrowed to a recent 380 bp. (Figure 2.)

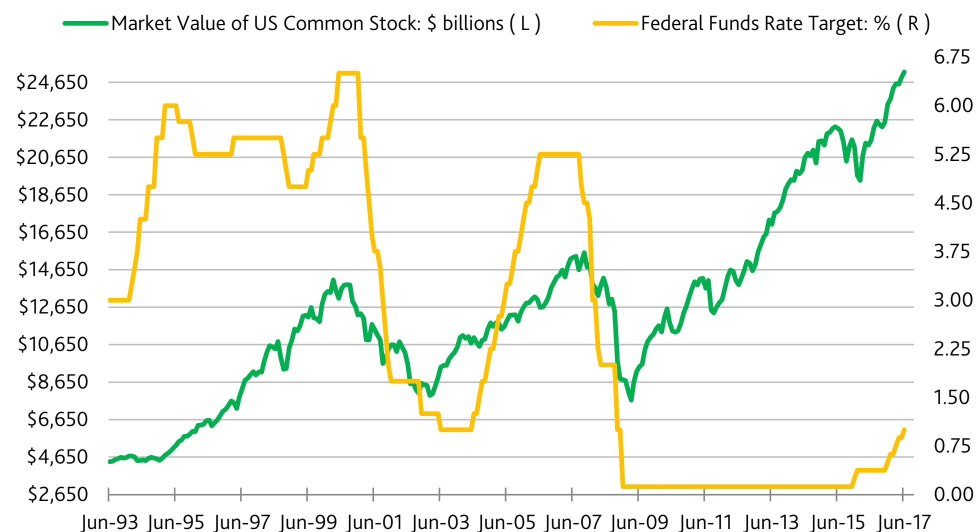
Figure 2: High-Yield Bond Spreads Have Narrowed Amid Cumulative Fed Rate Hikes of 300 bp to 400 bp



Early on, Fed rate hikes often were followed by thinner corporate bond yield spreads. For example at the start of the first tightening cycle of 1991-2000's economic upturn, fed funds was hiked from year-end 1993's 3.0% to 5.5% by year-end 1994. Despite that 2.5 percentage point hiking of fed funds, the high-yield bond spread managed to narrow from Q4-1993's 439 bp to Q4-1994's 350 bp. Not until the 10-year Treasury yield dipped under August 1998's 5.5% fed funds rate did the high-yield spread widen beyond 600 bp.

It's also worth recalling how the market value of US common stock soared higher by 19.4% annualized, on average, from January 1994 through March 2000 despite a hiking of fed funds from 3.00% to 5.75%. However, once fed funds reached 6.00% in March 2000, a grossly overvalued equity market finally crested and began a descent that would slash the market value of US common stock by a cumulative -43% from March 2000's top to October 2002's bottom. (Figure 3.)

Figure 3: Fed Rate Hikes Have Been Very Slow To Stop Equity Rallies In the Past



The series of Fed rate hikes that occurred during 2002-2007's recovery told a similar story. Notwithstanding a steep and rapid ascent by fed funds from the 1% of June 2004 to 5.25% by June 2006, the high-yield bond spread averaged an extraordinarily thin 340 bp from July 2004 through July 2007. At the same time, the VIX index averaged a very low 13.2 points despite the span's 425 bp hiking

of fed funds. Moreover, from June 2004 through October 2007, the market value of US common stock advanced by nearly 11% annualized, on average.

Expect trouble once 10-Year Treasury yield tops fed funds

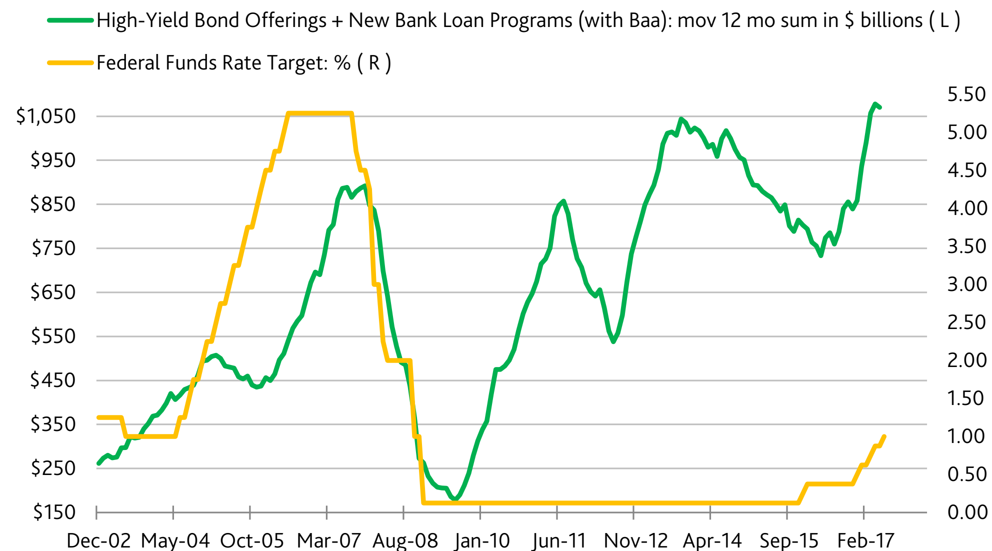
Often a hiking of fed funds will not be followed by a substantial and protracted widening of the high-yield bond spread until the fed funds rate is greater than the 10-year Treasury yield, which equates to an inverted Treasury yield curve. The Treasury yield curve inversions of 1998 and 2000 quickly triggered notable swellings by the high-yield bond spread. Granted that the yield curve inversions of 2006 and 2007 were immediately accompanied by exceptionally thin high-yield spreads; however, a prolonged ballooning of spreads was underway as of late 2007.

Thus, the recent easing of the 10-year Treasury yield may have important implications for the future path of the fed funds rate. Given the subpar tone of the current business cycle upturn, the Fed may not want fed funds to approach the 10-year Treasury yield. If, after June 14's likely rate hike, the 10-year Treasury yield slips under 2.15%, the end to the current series of rate hikes may be closer than commonly thought.

Corporate borrowing activity has thrived amid Fed rate hikes

Thin high-yield bond spreads and a robust equity market explain why high-yield borrowing activity, or the sum of US$-denominated high-yield bond offerings plus newly rated bank loan programs from high-yield issuers, expanded by nearly 28% annualized comparing the year-ended July 2007 with the year-ended June 2004. Moreover, since the December 2015 start to the current series of rate hikes, high-yield borrowing activity has expanded at an average annualized rate of nearly 20%. (Figure 4.)

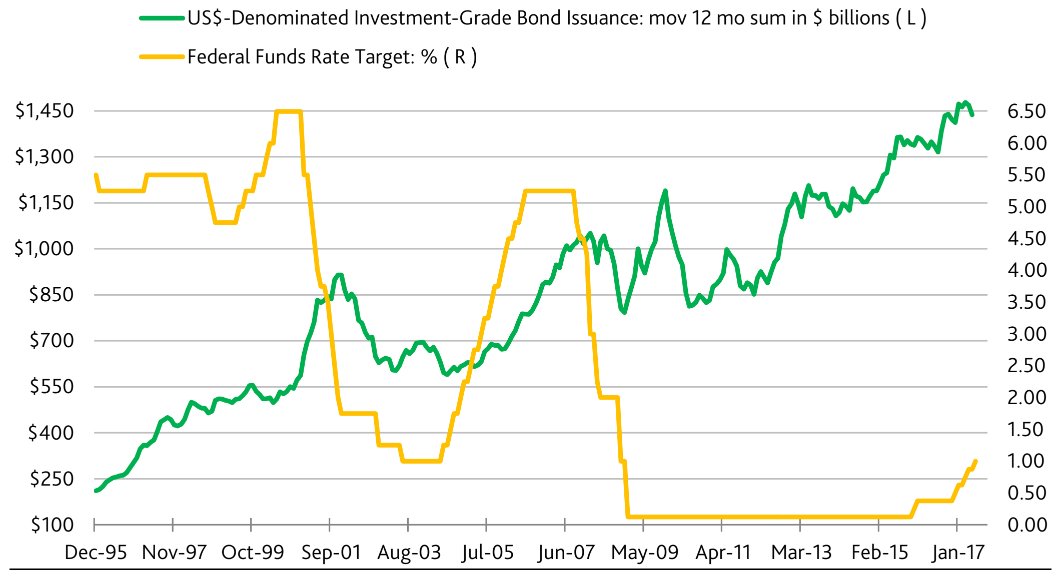
Figure 4: High-Yield Borrowing Activity Has Soared Amid Fed Rate Hikes



In addition, investment-grade bond offerings have prospered amid Fed rate hikes. US$-denominated investment grade bond issuance advanced by 20% annualized, on average, from June 2004 through July 2007. The lively expansion of investment-grade corporate bond issuance transcended an increase by the investment-grade corporate bond yield's moving 12-month average from the 4.59% of the span-ended June 2004 to the 5.73% of the span-ended July 2007. More recently, the moving 12-month sum of investment-grade corporate bond issuance has grown by 4.7% annualized since the ongoing episode of Fed rate hikes began in December 2015. Despite a rise by fed funds' average midpoint from the 0.125% of the 12-months-ended November 2015 to the 0.542% of the 12-months-ended May 2017, the investment-grade corporate bond yield's average dipped from 3.21% to 3.13%, respectively. (Figure 5.)

In summary, markets often prosper during episodes of Fed tightening. However, painful sell-offs eventually materialize once the 10-year Treasury yield becomes indistinguishable from the fed funds rate. In turn, the recent 2.20% 10-year Treasury yield weighs against fed funds rising above 2% if policymakers assign a high priority to preserving the current business cycle upturn.

Figure 5: Investment-Grade Bond Issuance Has Thrived Amid Steep Upturns by the Federal Funds Rate



The Week Ahead – US, Europe, Asia-Pacific

THE US

From Moody's Analytics - Economy.com and the Moody's Capital Markets Research Group

Summary, June 9: The Fed will be in focus in the week ahead. We believe the Fed wants to put the process of normalizing its balance sheet on autopilot this year, since it is unclear whether Fed Chair Janet Yellen will return in 2018. Her term as chair expires in February. Turning back to the incoming data, we look for factory orders to have slipped 0.1% in April. Factory orders and wholesale inventories could have implications for our tracking estimates for both first and second quarter GDP. The ISM nonmanufacturing index likely slipped from 57.5 in April to 57.1 in May. We expect the Federal Open Market Committee to raise the target range for the fed funds rate by 25 basis points to 1% to 1.25% at the June meeting. Since financial markets are pricing in a rate hike, the Fed won't pass up the opportunity to continue to gradually normalize interest rates. We expect a dovish dissent by Neel Kashkari.

More significant, however, the Fed will release its new economic and interest rate projections. Further, if the Fed releases its updated Policy Normalization Principles and Plans, the balance sheet could begin declining soon, as early as September. However, we think it's unlikely these will be released at next week's meeting; all the details would need to be finalized by then.The Fed is more likely to release its updated Policy Normalization Principles and Plans at the September meeting. We view the Fed's balance sheet policy as a complement to, rather than a substitute for, rate hikes. The central bank wants to fully normalize interest rates, and may require more caution with the balance sheet. The Fed would likely prefer that the fed funds rate be close to its long-run equilibrium rate when this tightening cycle ends, and if needed, it can live with a larger balance sheet.

As for the economic and interest rate projections, we anticipate the Fed will cut its forecast for both GDP growth and inflation this year, reflecting incoming data. We don't expect significant changes to the inflation forecast for 2018 or 2019. The Fed will lower its forecast for the unemployment rate for 2017 to 2019. Its estimate of the nonaccelerating inflation rate of unemployment will also come down, potentially to 4.5%. We don't expect changes to the interest rate projections, but there is uncertainty given that some participants have changed. Daniel Tarullo retired and hasn't been replaced. Raphael Bostic is the new president of the Atlanta Fed, and Mark Mullinix replaces Jeffrey Lacker as Richmond Fed president.

We don't expect the Fed's statement to change its assessment that the risks to the economic outlook are roughly balanced. The Fed will have to tone down its assessment of inflation. It noted in May that inflation was running close to the Fed's 2% objective, but that is no longer the case. The Fed likely will not change its assessment of inflation expectations. The Fed is unlikely to provide any significant new guidance about the balance sheet in the statement, leaving that for Fed Chair Janet Yellen's press conference, the FOMC minutes, and the updated Policy Normalization Principles and Plans.

As for the economic data, we expect it to generally come in soft. Industrial production was likely unchanged in May and housing starts will only recoup some of April's decline. The CPI likely slipped 0.1% in May, hurt by energy. Energy will also weigh on retail sales in May.

FRIDAY, JUNE 9

No major economic releases scheduled.

MONDAY, JUNE 12

Business confidence (week ending June 9; 10:00 a.m. EDT)

Forecast: N/A

Despite the unsettled geopolitical environment, global business sentiment has been strong and remarkably stable since October. Businesses aren't as upbeat as when confidence hit its all-time high in

spring 2015, but they are feeling very good. Responses to all nine questions in the survey are generally positive, although hiring and investment are notably good.

Our survey results aren't as strong as various other surveys of business and consumer confidence that have strengthened sharply since the presidential election. According to a recent New York Federal Reserve study, sentiment surveys that depend on canvassing new respondents each time are probably somewhat biased, as those happy with the election results are more likely to respond. Businesses are increasingly fixated on regulatory and legal issues; about one-half of businesses say those are their number one concern. Another one-fifth of businesses say finding qualified labor is their biggest problem. Concern with the strength of their sales and taxes has receded.

The four-week moving average in our global business confidence index rose from 35.6 to 36.2 in the week ended June 2.

TUESDAY, JUNE 13

NFIB survey (May; 6:00 a.m. EDT)

Forecast: N/A
The NFIB small business confidence index has fallen for three consecutive months but remains well above that seen prior to the U.S. Presidential Election. We expect the NFIB index to have risen in May, boosted the House of Representatives vote to send the American Health Care Act to the Senate. Healthcare has been an area of concern for small businesses. Already released data by the NFIB showed an increase in job openings and improvement in hiring plans in May. It's increasingly difficult for small businesses to find qualified workers but the May survey showed that they didn't adjust their compensation plans. Small businesses will likely have to increase wages and training along with considering workers they would not have previously. \

WEDNESDAY, JUNE 14

Consumer price index (May; 8:30 a.m. EDT)

Forecast: -0.1% (headline)
Forecast: 0.2% (core)
We look for the consumer price index to have fallen 0.1% in May. Energy prices were likely a weight. We anticipate a trend-like increase in food prices. Excluding food and energy, we look for the CPI to have risen 0.2% in May. Within core prices, we look for some firming in rents and medical services prices.

May's gain will leave the core CPI up 1.9% on a year-ago basis, identical to that in March but below the 2.3% in January. A good chunk of the deceleration in year-over-year growth in the core CPI recently can be traced to communication prices. Telephone services prices have fallen sharply because of new cellular deals. This drag on core inflation won't be persistent. Medical care services prices have also been a weight recently and may be attributed to new generic drug launches.

Not all of the drags will lift quickly. For example, rents and owner equivalent rent growth has slowed and has pulled core inflation lower. Rents are a sizable and sticky component of the core CPI. Considering the rental vacancy rate has likely bottomed and additional supply will hit the rental market going forward, rent growth could continue to moderate.

On the other hand, there have also been temporary supports to inflation. For example, tobacco and smoking product prices were up 4.2% between March and April, the largest since 2009. Prices were boosted by the increase in taxes in California. This is a one-time lift but it tobacco and smoking products have added several basis points to year-over-year growth in the core CPI.

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

Forecast: 0% (headline)
Retail sales are forecast to have been unchanged in May following a 0.4% gain in April and 0.1% increase in March. Vehicles are expected to subtract 0.1 of a percentage point from retail sales in May. Unit sales dropped 1.3% in May and manufacturers were aggressive with incentives, which will hurt nominal retail sales. Excluding autos, retail sales are forecast to have risen 0.1% in May. Gasoline will be

another weight. Retail gasoline prices fell in May and we expect this will shave 0.1 of a percentage point off total retail sales. Building material store sales were likely a neutral for retail sales.

THURSDAY, JUNE 15

Jobless claims (week ending June 10; 8:30 a.m. EDT)

Forecast: 240,000

Initial claims are volatile this time of year because of the Memorial Day holiday. The incoming data will be for the week after the holiday and we look for initial claims to have dropped to 240,000. But there is considerable uncertainty in the forecast because of the added volatility surrounding holidays. Therefore, a large swing in either direction should be taken with a grain of salt. We will put more stock in the trend, and it paints a favorable picture of the labor market.

Industrial production (May; 8:30 a.m. EDT)

Forecast: 0%(total)

We look for industrial production to have been unchanged in May following a 1% gain in April. The details will be mixed. Manufacturing output likely fell 0.3% in May. Autos will likely be a source of weakness. Motor vehicle and parts production rose 5% in April on the heels of a 3.6% decline in March. April's gain isn't sustainable and we anticipated some payback in May; vehicle sales have softened recently and inventories are piling up.

We anticipate for some cooling in other components that have been strong recently. For example, excluding motor vehicle and parts, manufacturing output was still strong in April, rising 0.7% following a 0.2% decline in March and 0.2% gain in February. Strength was fairly broad-based and the capital spending details were impressive. Business equipment production rose a well-above trend 1.2% in April. The ISM manufacturing survey suggests that manufacturing has lost some momentum in May but this isn't alarming after its hot start to the year.

FRIDAY, JUNE 16

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

Forecast: 1.189 million annualized units (starts)

Forecast: 1.23 million annualized units (permits)

There wasn't a lot to like in April housing starts, but other housing market data have been more upbeat so we don't believe the recovery in residential construction is unraveling. Housing starts fell 2.6% to 1.172 million annualized units in April, well below our and consensus expectations. Revisions to prior months were also unfavorable. Single-family starts rose 0.4% to 835,000 annualized units in April, while multifamily starts dropped 9.2% to 337,000 at an annualized rate. The drop in multifamily starts has fallen for four consecutive months.

Multifamily starts are volatile and unreliable, but the trend has clearly softened, as they have been trending sideways. This shouldn't be surprising, because this segment grew quickly over the past several years. As a share of total housing starts, multifamily fell below 30% in April and below its cyclical peak north of 40% but still above that during the 2000 expansion.

Leading indicators were weak. Single-family permits fell 4.5%, their second consecutive monthly decline. Multifamily permits rose 1.4% in April following a 12.7% gain in March. The gap between single-family starts in permitting places and permits isn't favorable, which is a little concerning. Starts are running ahead of permits, pointing toward softening ahead. The bulk of further improvement in starts will be via single-family, and this is needed to help with the lean inventory issues plaguing the new-home market. Multifamily starts in permitting places are behind permits, which suggests starts could improve somewhat.

Therefore, we look for total housing starts to have risen from 1.172 million to 1.189 million annualized units in May.

EUROPE

By the Dismal (Europe) staff in London and Prague

Summary, June 9: Following the past week's barrage of data, next week will bring no relief. We are expecting industrial production, trade and inflation figures for the euro zone, while in the U.K. the publication of retail sales, unemployment and CPI data will shed more light on the health of British consumers. The Bank of England's monetary policy committee is also scheduled to hold its regular meeting on Thursday, though markets are not anticipating any action following the more-than-disappointing GDP figures for the first quarter, and the similarly downbeat production, construction and exports numbers for April.

Granted, the U.K.'s retail sales soared in April and provided some offset to the disappointments elsewhere. But we are convinced that the 2.3% m/m in sales increase was just a blip, and that consumer spending should continue on a sharp downward trend throughout 2017. All retail leading indicators for May confirm this story, showing that spending likely contracted sharply over the month and corroborating our view that most of April's jump was due to the later-Easter effect boosting sales, even if the figures were supposed to be seasonally adjusted. The CBI Distributive Trade Survey reported that the sales balance fell to +2 in May, from +38 in April, its lowest level since January, forcing retailers to reduce orders and trim stock levels. The British Retail Consortium survey similarly indicated that like-for-like retail sale values dropped by 0.4% y/y in May, from 5.6% in April, while total sales were down by 0.2%. Data from BDO were also downbeat, suggesting that sales in nonfood high-street stores contracted by 1.3% m/m in May, following a 1.9% rise in April. It's important to note that the official retail sales figures are in volume, while surveys report sales in value, meaning that the actual decline in volumes was likely even stronger given how prices are soaring. We are penciling in a 1.3% m/m drop in the official retail sales measure to be released on Thursday.

Meanwhile, inflation in the U.K. likely lost ground in May, down to 2.5% from 2.9%. While at first glance this seems like good news for consumers, we caution that the headline's easing will only be due to seasonal and volatile effects, and not at all to a reduction of price pressures. On the contrary, we expect that core goods and food inflation continued to tick up, as well as energy prices. Two more utility companies raised prices in late April, and these changes will be included in May's data. Services inflation, meanwhile, likely scaled back as the boost that the later timing of Easter this year gave to airfares fades; services prices excluding airfares and accommodation, by contrast, are expected to strengthen, as sterling's depreciation following June's referendum is further passed through to consumers.

Unemployment figures, meanwhile, are expected to show that wage gains remained subdued in April, causing real wages to fall and further depressing households' purchasing power. Employment figures should have climbed again, but we are penciling in a more subdued rise than the one observed since the start of the year. According to Markit, permanent places increased at their slowest pace since September 2016 in April, and growth in starting salaries edged down to a four-month low. In all, combining the easing in inflation, the decline in real wages and the marked slowdown in activity, we do not think the BoE is under any pressure to raise rates or to change its forward guidance. We expect it to stand pat next week, further reiterating that it is ready to look through a period of above-target inflation in order to support the economy.

FRIDAY, JUNE 9

France: Industrial Production (April; 8:00 a.m. BST)

France's industrial production likely increased 0.5% m/m in April, building on an already-sharp 2% increase in the previous month. We are expecting a mean-reversion in construction and energy production to be the main drivers of the headline. Energy production was depressed in February and March as the mild weather depressed demand for heating, but this should mean revert in April; the

month's temperatures returned to normal. Construction also fell sharply in April, without any explicit reason, but our guess is that the bad numbers were due mainly to the timing of contracts. Firms' confidence for the sector remain stable, and output expectations have risen strongly over the month, warranting a strong recovery in April. Elsewhere, manufacturing production should also contribute, but to a lesser extent following March's strong jump; it is likely that machinery and equipment and transport output reverted from March's strong gains, though oil refining should have provided a substantial offset.

Germany: Foreign Trade (April; 8:00 a.m. BST)

Germany's trade surplus likely narrowed slightly in April, to €19.2 billion from €19.6 billion in March, due to the strengthening euro which appreciated by 0.4% on average during the month. The surplus also fell from €22.9 billion recorded in April 2016. Foreign demand for German goods will likely be subdued because of the buildup of unfavorable external conditions. In particular, the shift towards greater protectionism in the U.S. and the U.K.'s vote to leave the EU darken the future of German exports. Net exports contributed to output growth in the first quarter of 2017, after contracting in the second half of last year. However, the increase was driven mainly by the weakness of imports, which barely grew following a strong jump at the end of the year. Export growth also slowed, though to a lesser extent.

MONDAY, JUNE 12

Italy: Industrial Production (April; 9:00 a.m. BST)

Italy's industrial output growth likely slowed in April, following a 0.4% uptick in the previous month. Both high-frequency indicators suggest the recovery in manufacturing has slowed: The manufacturing Purchasing Managers' Index fell to a three-month low of 55.1 in May from a six-year high of 56.2 in April, while manufacturing confidence decreased to 106.9 from 107.7 in April. Although strengthening external demand is benefiting Italian manufacturers, the appreciating euro is weighing on the country's exports. Political uncertainty and slow adjustments in the banking sector pose further downside risks to the outlook.

TUESDAY, JUNE 13

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

The U.K.'s annual headline CPI should have declined to 2.5% y/y in May, from 2.9% in April, as the boost provided to April's numbers from the later timing of Easter this year than last year fades. Airfares, accommodation services and package holiday prices rose strongly in yearly terms in April, after having fallen sharply in March, given that the Easter holidays this year fell on April 16, compared to March 27 in 2016. They are expected to return to their seasonal norms in May, pushing down the contribution of services inflation to the headline. But besides this one-off drag, we expect that higher import prices continued to make their way through to consumer prices over the month, raising the prices of core goods. Electricity prices are also expected to have risen sharply as two more of the big six U.K. energy suppliers hiked fares by the end of April, enacted to offset the pound's slump and the recovery in oil prices; the changes will be included in May's figures for the first time. Meanwhile, food inflation—which normally lags food producer output prices by four months—likely rose further, in line with the sharp rise in food producer inflation, which hit 4% in April.

Survey data corroborate our view: The latest Markit PMI again showed a substantial increase in average purchase prices in manufacturing and services at the start of the second quarter. Output prices also rose quickly, despite slowing somewhat in both sectors. Sellers seem to be passing the higher input prices on to clients much faster than policymakers had anticipated.

WEDNESDAY, JUNE 14

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

Preliminary estimates show that Germany's yearly inflation slid below the ECB's target of close to but below 2%. Annual inflation decelerated to 1.5% in May, not seasonally adjusted, from 2% in the previous month. Behind the slowdown was softer growth in energy prices, which at 2% y/y more than halved the 5.1% growth rate in the previous month. The cooling energy prices likely stemmed from a renewed drop in oil prices. Brent crude fell below $50 per barrel in early May from $52.30 on average in April. But oil prices are still higher than the $46.70 on average in May 2016, and they started to rebound midmonth to about $51 in recent days. The downturn in energy prices is therefore likely temporary. Germany's preliminary results are supported by the flash Markit composite PMI for May, which showed that inflation pressures eased slightly but remained the third highest in nearly six years. The seasonally adjusted CPI likely rose 1.7% y/y in May.

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

The U.K.'s headline unemployment rate was likely unchanged at 4.6% in the three months to April, its lowest since records began in 1975. After the first quarter's figures beat market expectations, with the number of employed increasing and the number of unemployed falling further, some mean-reversion is expected in April, though not enough to offset previous gains. The number of vacancies remained elevated in April, and survey data point to stable momentum in the labour market. They signal further growth in permanent and temporary job placements, although the rate of growth is softening from the previous months; according to Markit, growth in permanent staff placements slowed to its weakest in seven months.

But wages should have again eased, or at best remained steady, since firms are choosing to freeze salaries instead of laying off staff. Markit reports that growth in permanent starting salaries edged down to a four-month low in April. We expect the outlook for wages to remain subdued, while the outlook for jobs should soften somewhat. The labour market responds with a lag to shocks in the economy, and anecdotal evidence shows that firms are scaling back on hiring plans. With uncertainty surrounding Britain's exit from the EU, fewer businesses will likely see fit to launch new projects and step up hiring. We thus expect employment and self-employment to lose ground in 2017.

THURSDAY, JUNE 15

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

U.K. retail sales should have mean-reverted in May following the 2.3% surge in April. We expect them to fall by 1.3% m/m, pushing the yearly rate of growth in sales down to 1%, from 4% previously, 3.3 percentage points lower than its 2016 average. Leading indicators released in recent weeks were all downbeat, suggesting a broad-based weakening in spending over the month on the back of a reversion of the Easter holiday effect, and despite the warm weather and the further drop in pump prices. Data from the Confederation of Business Industry showed that the balance of reported sales fell sharply to +2 in May from +38 in April, its weakest since January. Similarly, the BDO survey showed that sales in value on the high street declined by 1.3% over the month, following a 1.9% increase in April. The British Retail Consortium's survey similarly indicated that like-for-like retail sales values dropped by 0.4% y/y in May, from 5.6% in April, while total sales were down by 0.2%.

The details should reveal that both food and nonfood sales contracted, though clothing sales should also have rebounded somewhat. We maintain that most of last autumn's strength in retail sales was because households tried to beat the expected jump in prices by frontloading purchases they would normally have made in 2017, and we expect retail sales to remain poor as higher 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 (April; 10:00 a.m. BST)

The euro zone's external trade surplus likely narrowed somewhat in April to €28.5 billion after expanding to €30.9 in March. However, the surplus was probably somewhat higher than the €26.6 billion surplus recorded in April 2016. The monthly narrowing was likely driven by the stronger euro, which appreciated by 0.4% on average in April to $1.072 from March, but was still weaker than $1.133 in April 2016. The strengthening economic activity, with the euro zone Markit composite PMI, rising to

a 72-month high of 56.7 in April, is boosting imports, weighing on trade balance. Still, some rise of the manufacturing index has been due to accelerating new exports orders. However, the outlook for exports remains, 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.

FRIDAY, JUNE 16

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

The euro zone's annual harmonized inflation slowed to 1.4% in May from 1.9% in the previous month, according the preliminary estimates. Softer oil price growth and the base effect weighed on the headline figure. Core inflation, meanwhile, slowed to 1% from 1.2% in April due to tepid wage growth. Although wage growth picked up in many euro zone countries at the end of 2016, it remains weak and is keeping core inflation from heating up further. We therefore do not expect quick normalization of monetary policy. But we do think the ECB will change its guidance as a first step towards phasing out quantitative easing later this year.

Russia: Monetary Policy (June; 11:30 a.m. BST)

Price inflation held steady in May, with annual inflation holding close to the central bank's target. Annual inflation slowed across nonfood goods and services, while food prices increased modestly as a result of higher fruit and vegetable prices. A stronger ruble, paired with persistently weak domestic demand, has slowed inflation of consumer prices. Monthly inflation was higher in the city centers of Moscow and St. Petersburg. Russia's central bank dropped rates in May on concerns that inflation was falling faster than anticipated. Downward pressures on inflation should allow the bank to continue cutting back its key policy rate , though still-high price inflation in clothing and housing will factor heavily in that decision making.

ASIA-PACIFIC

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

China is peaking while India experiences a cyclical slowdown

China's economic momentum has likely peaked for now. In the first quarter of 2017, manufacturing grew thanks to improved global tech demand and steady domestic consumer demand. However, these gains are likely over for now, and the economy will settle towards a more subdued, albeit relatively high, growth path.

Purchasing manager sentiment dipped in May, with particularly sharp declines in sentiment on new orders and near-term business expectations. Imports of electrical and high-tech components declined in year-on-year terms in April, suggesting slower production and sales in coming months. Overall, export growth will likely continue over the coming months despite some deceleration.

The transition away from investment continues, with a healthy wage growth of at least 7% annually on a nominal basis since 2011. However, policy moves such as caps on subsidies for energy-efficient vehicles and restrictions on credit growth have crimped household spending. We expect retail sales to have remained firm in May.

China's buoyant housing market has been a pillar of the economy over the past two years, but there is mounting evidence that the market has peaked. This is mostly the result of steady tightening of various rules and restrictions in many cities by local governments. This will likely cause fixed asset investment and industrial production growth to decelerate.

Elsewhere, the cyclical slowdown will also be evident in India. The economy has fumbled after demonetization, with the March quarter GDP showing a sharp deceleration. Disinflation has also intensified, with the consumer price index sitting well below the central bank's 4% target. We expect consumer price and wholesale price inflation remained subdued in May thanks to low food prices. Moreover, the production cycle will remain anemic because of persistent supply bottlenecks.

THURSDAY, JUNE 8

Japan – GDP – 2017Q1

Time: 9:50 a.m. AEST (Wednesday 11:50 p.m. GMT)
Forecast: 0.6%
Japan's second estimate of the March quarter GDP was likely revised up from 0.5% to 0.6%. Consumption growth outperformed in the first quarter, although private investment was relatively mute. We expect a further increase in private investment because more data will be made available, which will likely show the investment number was pushed up.

Australia – Foreign Trade – April

Time: 11:30 a.m. AEST (1:30 a.m. GMT)
Forecast: A$2.5 billion
Australia's trade surplus likely took a hit in April because of disruptions from Cyclone Debbie. The monthly trade surplus likely dipped to A$2.5 billion from A$3.1 billion in March. Commodity shipments were disrupted during the month as coal freight facilities were recovering from the severe cyclone in Queensland. On the positive side, steady demand from China and high global prices continue to support annual growth in exports. Meanwhile, weak domestic demand is keeping a lid on imports.

FRIDAY, JUNE 9

Philippines – Industrial Production – April

Time: Unknown
Forecast: 12%
Philippine industrial production growth likely accelerated to 12% y/y in April from 11.1% in March. The archipelago's manufacturing sector has received a boost in recent months from the uptick in global demand. In particular, this should boost electronics manufacturers. Domestic demand continues to be the main driver of production growth though, as rising incomes fuel consumer spending. Infrastructure projects, both public and private, are supporting industrial production.

Australia – Housing Finance – April

Time: 11:30 a.m. AEST (1:30 a.m. GMT)
Forecast: 1.2%
Australia's booming housing market has lost some steam in recent months, but demand remains upbeat. The number of owner-occupied finance commitments likely ticked up a steady 1.2% in April after March's 0.5% decline. However, the number of commitments is still down compared with the same period last year. Auction clearance rates and house prices have started to cool in the Sydney and Melbourne markets, while the downturn in Perth is starting to reach a trough. Out-of-cycle interest rate hikes, weak wage growth, and stricter lending criteria will likely limit mortgage demand in 2017.

China – Consumer Price Index – May

Time: 11:30 a.m. AEST (1:30 a.m. GMT)
Forecast: 1.1%
Consumer price pressures have steadily risen, but there are signs that the trend will flatten. The housing market is cooling because of ever tighter restrictions. Producer price pressures look to have peaked as commodity supply increases. Outside of food, inflation pressures likely stabilized in May.

China – Producer Price Index – May

Time: 11:30 a.m. AEST (1:30 a.m. GMT)
Forecast: 5.9%
Producer price inflation has climbed rapidly as rising commodity prices pushed up raw material costs. However, this effect is dimming. Producer price inflation is moderating as the boost from commodity prices fades, due to both sated demand and higher supply. The housing market is cooling and this is reducing demand for key inputs.

Malaysia – Industrial Production – April

Time: 2:00 p.m. AEST (4:00 a.m. GMT)
Forecast: 4.2%
Malaysian industrial production likely cooled in April after the 4.5% y/y expansion in March. Production of integrated circuits is easing as the global tech cycle appears to have peaked in the March quarter. Integrated circuits represent around 20% of Malaysian manufacturing and typically follow the tech cycle. Oil production cooled and was a drag on mining output in March, while natural gas was a bright spot. Further weakening is expected for April and May given softer global prices. In particular, oil prices temporarily slumped to a six-month low in May due to global supply glut fears.

Japan – Industry Activity Indexes – April

Time: 2:30 p.m. AEST (4:30 a.m. GMT)
Forecast: -0.1%
Japan's tertiary activities likely declined 0.1% in April following a 0.2% m/m decline in March. Though the overall momentum in services remains uneven, we expect that lower consumer sentiment in April may have caused a lull in spending across various services. Japan's ageing population means that services related to medical health will keep overall spending afloat.

MONDAY, JUNE 12

China – Monetary Aggregates – May

Time: Unknown
Forecast: 10.2%
Credit growth in China remains relatively strong thanks to household demand for mortgages. But it probably stepped down a notch in May to 10.2% from 10.5% in April. Government measures to rein in lending to Tier 1 cities will likely dampen credit growth in coming months. March data nonetheless also show an increase in nonbank lending, possibly indicating that firms are regaining confidence in business conditions.

Japan – Machinery Orders – April

Time: 9:50 a.m. AEST (Sunday 11:50 p.m. GMT)
Forecast: 0.5%
Japan's machinery orders likely decelerated to 0.5% m/m in April from March's 1.4%. Machinery orders tend to be volatile, but there has been an upward trend over the last few months because of the yen's 15% depreciation since November. Manufacturing orders will likely lead the gains in the coming months.

China – Foreign Trade – May

Time: Unknown
Forecast: US$40 billion
China's trade activity has rebounded thanks to the global tech cycle and the domestic investment recovery. Slightly weaker manufacturer sentiment for April could point to a slight deceleration in exports, but continued demand for electronics from the U.S., Europe and other markets will bolster exports over the medium term. Overall, the trade surplus likely rose slightly from April's US$38 billion.

India – Consumer Price Index – May

Time: 10:00 p.m. AEST (12:00 p.m. GMT)
Forecast: 3%

India's consumer price inflation was likely unchanged at 3% in May. Headline inflation has dipped well under the Reserve Bank of India's 4% target. But the central bank remained on hold at the June monetary policy meeting. Further disinflation will likely result in the central bank cutting rates towards year's end. Our inflation outlook suggests that prices could decelerate further because good monsoon rains will lower food inflation.

India – Industrial Production – April

Time: 10:00 p.m. AEST (12:00 p.m. GMT)
Forecast: 2.4%
India's industrial production was likely 2.4% in April, largely unchanged from 2.5% the month prior. Although production for a large economy like India's should be growing at double digits, it hasn't for a while. This suggests that supply bottlenecks continue to crimp overall manufacturing and production across India. We don't expect this trend to change soon.

TUESDAY, JUNE 13

No major economic indicators are scheduled for release.

WEDNESDAY, JUNE 14

South Korea – Employment – May

Time: 9:00 a.m. AEST (Tuesday 11:00 p.m. GMT)
Forecast: 4% Unemployed
We look for Korea's May unemployment rate to be steady at 4%. The labor market has come under two opposing pressures to start 2017. Manufacturing has added to job growth as it benefits from improving global conditions, pushing up export demand. However, this has been offset by weak domestic demand. Weak household and business sentiment has constrained spending. However, the election of a new president may boost domestic conditions, and therefore the labor market, as it puts to rest the political scandals that have dominated public discourse.

China – Fixed Asset Investment – May

Time: 12:00 p.m. AEST (2:00 a.m. GMT)
Forecast: 8.9%
Investment in fixed assets has accelerated of late, partly due to the removal of the drag from mining-related sectors. Manufacturing investment is picking up thanks to the recovery in global markets. However, investment in construction and raw materials is likely to cool as the restrictions on housing start to bite. We expect growth in fixed assets to have remained unchanged y/y in May from April's reading.

China – Industrial Production – May

Time: 12:00 p.m. AEST (2:00 a.m. GMT)
Forecast: 6%
Improving global tech demand has been boosting electronics production, but this seems be entering a lull. Manufacturer sentiment cooled in May, partly on falling new orders. Lower imports of tech components corroborates a softer pipeline of demand. Industrial production likely grew 6% y/y in May, down from 6.5% in April. Much of this comes from a weaker comparison from a year ago.

China – Retail Sales – May

Time: 12:00 p.m. AEST (2:00 a.m. GMT)
Forecast: 10.9%
Retail spending in China continues to outpace industrial production and overall GDP growth, a sign of rebalancing toward consumption. But spending growth is likely to remain flat over the medium term. Reduced subsidies for energy-efficient cars are reducing incentives to spend. The cooling housing market in Tier 1 cities will also moderate household sentiment and spending in related areas. Retail spending likely grew 10.9% y/y in May, a touch higher than the 10.7% in April, partly due to a lower base from a year ago.

India – Wholesale Price Index – May

Time: 4:45 p.m. AEST (6:45 a.m. GMT)
Forecast: 3.2%
India's wholesale prices likely decelerated further to 3.2% y/y in May, down from 3.9% the month prior. Rising commodity prices have boosted energy prices, but this has been more than offset by food price disinflation. A good monsoon season and oversupply of key agricultural commodities have lowered food prices. The trend could continue later in the year because monsoon rains this year are forecast to be normal.

THURSDAY, JUNE 15

Indonesia – Foreign Trade – May

Time: 3:00 a.m. AEST (Wednesday 5:00 p.m. GMT)
Forecast: US$1.23 billion
Indonesia's monthly trade surplus likely narrowed a little in May from April's US$1.24 billion. Lower oil prices likely hurt export receipts over the month, even though we expect volumes held up. Palm oil volumes have recovered from earlier weather damage and prices are still relatively high. The medium-term outlook for palm oil is soft given increasing international efforts to use alternatives since palm oil can cause a harsh environmental impact.

New Zealand – GDP – 2017Q1

Time: 8:45 a.m. AEST (Wednesday 10:45 p.m. GMT)
Forecast: 0.7%
New Zealand's March quarter GDP growth likely ticked up a few notches to 0.7% q/q, from the December quarter's 0.4%. Growth disappointed in the fourth quarter due to poor weather hurting agriculture production and exports. In the first quarter, exports have been going strong thanks to upbeat soft commodity prices, especially for dairy, alongside buoyant offshore demand, especially from China, keeping volumes and values strong. Consumption is also doing well thanks to the low interest rate environment and strong population growth from high net migration. New Zealand is also enjoying a tourism boom; tourism recently overtook dairy as New Zealand's most valuable export. High levels of visitor numbers are an added lift to consumption. New Zealand looks on track to record another above-potential expansion through the first half of 2017, with growth likely to come in a touch above 3%.

Australia – Employment Situation – May

Time: 11:30 a.m. AEST (1:30 a.m. GMT)
Forecast: 5.7% Unemployed
Australia's unemployment rate likely stayed steady at 5.7% in May after declining 0.2 percentage point in April. While employment growth has picked up in recent months, it is still only keeping pace with the expansion of the labor force, leaving the jobless rate steady. The main concern in the labor market comes from the concentration of job creation in part-time positions, which has pushed up the underemployment rate. This is indicative of significant slack in the labor market, which is resulting in persistently weak wage growth.

Indonesia – Monetary Policy – June

Time: Unknown
Forecast: 4.75%
Bank Indonesia will likely keep the policy rate unchanged at 4.75% at its June policy meeting. Inflation pressures are creeping higher, but the central bank has taken measures including delaying scheduled utility price hikes to keep inflation within the 3% to 5% target range. Growth is a little below potential, but further easing is off the table to guard against capital flight, particularly now that the U.S. is hiking rates. Even though Indonesia's external position has improved in recent years, it is still highly vulnerable to capital outflows.

FRIDAY, JUNE 16

India – Foreign Trade – May

Time: Unknown
Forecast: -US$12.5 billion
India's monthly trade deficit likely came down in May, with exports expected to post solid gains. The trade deficit was likely US$12.5 billion, after the $13.25 billion deficit in April. Exports will likely grow by double digits in year-ago terms. Rebounding commodity prices and improved global demand will be the catalyst for exports rising. Imports rose sharply the month prior, and that's unlikely to be repeated because it was related to gold and jewelry during festive seasons.

Singapore – Foreign Trade – May

Time: 10:30 a.m. AEST (12:30 a.m. GMT)
Forecast: 3%
We look for Singapore’s nonoil domestic exports to have expanded 3% y/y in May after declining 0.7% previously. April’s data showed the continued strength of electronics exports, which are benefiting from the upswing in the global tech cycle. However, this was offset by a drop in non-electronics exports. Specifically, shipments of pharmaceuticals dropped in the month. These tend to be volatile month to month, so some payback is likely in May.

Japan – Monetary Policy – June

Time: 2:00 p.m. AEST (4:00 a.m. GMT)
Forecast: ¥80 trillion
The Bank of Japan is set to keep its policy levers unchanged at the June monetary policy meeting. Yield curve control will target the 10-year government bond yield at 0%, while a negative interest rate of 0.1% will continue for excess reserve. Moreover, we expect the BoJ to maintain its asset purchases at a rate of ¥80 trillion per month. Prices have escaped deflation's grasp for now, but underlying inflation remains well below the central bank's 2% target. We don't see the BoJ changing policy soon, and its next move will likely be asset purchase tapering in 2018.

The Long View

The US: The year-to-year growth rate for the outstanding debt of US nonfinancial corporations slowed from Q1-2016's 7.2% to Q1-2017's 4.9%

By John Lonski, Chief Economist, Moody's Capital Markets Research Group,
June 8, 2017

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 119 bp hardly differs from its 122-point mean of the two previous economic recoveries. Any narrowing by this 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 380 bp is less than what is inferred from the spread's macroeconomic drivers and the high-yield EDF metric, but is wider than what is implied by an ultra-low VIX index. The implications for liquidity of regulatory changes merit scrutiny. If regulatory change enhances the market making capabilities of banks, 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 April's 4.5%. Moody's credit policy group edged up its predicted average default rate for Q4-2017 from April's 3.1% to a May's 3.2%. A deeper slide to its 1.85% average of the 18-months-ended June 2015 is unlikely for now.

US CORPORATE BOND ISSUANCE

For 2016, 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

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 1.5% annually for IG and may advance by + 19.5% 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 of Moody's Analytics
June 8, 2017

Eurozone

The euro zone recorded its fastest growth rate in two years in the March quarter. The real GDP expanded by 0.6% q/q in the first quarter, stronger than preliminary estimates and the December stanza's 0.5% pace. High-frequency indicators suggest this buoyant pace will persist through the June quarter. The area's composite PMI held steady at 56.8 in May, unchanged from April's six-year high and far above the average of 55.6 recorded in the three months to March. This is consistent with growth picking up further in the second quarter, to around 0.6% to 0.7%. The impressive momentum is being supported mainly by a stellar manufacturing performance. The details brought even better news, showing that booming manufacturing orders are raising work backlogs and lifting job creation to its fastest in over 10 years, as firms expand capacity to meet the rise in demand. Meanwhile, the euro zone's unemployment rate unexpectedly fell to 9.3% in April, from a downwardly revised 9.4% in March and from 10.2% in April 2016, the lowest rate since March 2009. Cyclical labor market improvement combined with strengthening wage growth in some euro area countries will boost household spending, while broad-based improvement in global demand will support euro area exports. Nevertheless, the jobless rate would be higher if discouraged and underemployed part-time workers were added. The falling unemployment rate could thus mislead, and corporations have no reason to increase wages because of still-high labor underutilization. This is restraining wage growth and widening income inequalities.

Ultra-loose monetary policy and mildly stimulative fiscal policy should also support the rebound in investment, which remains below the pre-crisis level as firms expect demand to stay soft. After slightly less restrictive fiscal policy in 2016, government stimulus will likely boost most euro zone economies this year. While fiscal stimulus to GDP will jump in Germany, France and Italy, fiscal policy will subtract from the expansion in Spain, the Netherlands and Portugal, though less so than in 2016. Although the euro zone's outlook remains upbeat, weaker performance in the U.K. may drag on growth. Final data of U.K. GDP show the service sector as the main culprit of the slowdown in the first quarter, though construction and production output also lost some momentum. In the expenditure breakdown, consumer spending pulled back sharply and is the main drag on growth in 2017.

In June monetary policy meeting, the European Central Bank took a small but symbolically important step toward changing its policy stance, taking future rate cuts off the table for now. The ECB noted that policy rates would remain at present levels for an extended period and well past the horizon of quantitative easing. This is a small change from past forward guidance that said rates would remain at present or lower levels. There remains a bias for extending QE, as the central bank sees this rather than interest rates as their preferred tool to boost inflation. There is plenty of work to be done on the inflation front and we believe the central bank should proceed cautiously as many developed central banks have found it difficult to get inflation to their targets. The ECB didn't make any changes to rates or QE. Our baseline is that the ECB should turn slightly more hawkish later this year, likely announcing its plans for tapering its asset purchases in September but continuing its bond-buying program until at least June 2018. Normalizing the deposit rate should start by the middle of next year, while the repo rate should remain at its current settings at least until the second quarter of 2019.

Although results of the French and Dutch elections removed key political risks to financial markets and calmed investors, a number of important political events are still coming up. Newly elected French President Emmanuel Macron will need a majority in the legislative elections, held in June, to implement his ambitious policy reforms. In Italy, the anti-establishment Five Star Movement is on the rise and may win the parliamentary elections, which are due in May 2018. While in Germany, who wins the general election this September will not make much difference, since both candidates for chancellor are pro-European, liberal leaders.

U.K.

The U.K. economy's growth likely recovered somewhat in the second quarter following a disappointing start to the year. Accordingly, our high-frequency GDP model has begun tracking second quarter growth at 1.9% in annualized quarterly terms and 0.5% not annualized, an acceleration from a mere 0.2% growth in the first quarter. However, this result does not remove our fears that the U.K. economy is set for a rough ride in 2017. Still, the recovery in industrial survey data in May brings some optimism. The latest U.K. Markit/CIPS manufacturing PMI fell only to 56.7 from three-years high of 57.3 recorded in April, and signaled an improvement in operating conditions. Meanwhile, U.K. consumer confidence unexpectedly rose in May to -5 from -7 in April. We find it hard to understand this optimism since it contrasts sharply with our view that the pound's depreciation, the subsequent soar in inflation, and the slowdown in nominal wages will hurt consumer spending throughout 2017. We expect this to be just a blip, likely related to June's elections. The June elections will likely be seen as a sign that a softer exit could be negotiated if Theresa May were to have a larger majority in government. So in months to come, we expect households to shift focus from politics to the state of their finances. Households' expectations about their future financial situation will likely deteriorate sharply and turn negative by the second half of the year, in line with the decline in real wages. We already see evidence that households are tightening their purse strings: Retail sales figures for the past three months have been weak, and advanced indicators for May suggest that the first quarter's weakness likely carried over into the second.

Rising inflation and worsening labor market will weigh on household spending. Although the unemployment rate fell to a record low 4.6% in the first quarter and employment growth gained 0.4% q/q, wage gains lost further momentum in March; excluding bonuses, they slowed to 2.1% y/y from 2.2% in February. This slowdown in pay growth is worrisome, especially in light of the whopping 2.7% jump in inflation reported by the Office for National Statistics in mid-May. That's because higher prices combined with slower pay growth automatically mean households' real wages deteriorate: In monthly terms, real pay plunged by 0.5% y/y in the three months to March, its biggest drop in 2½ years. 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.

Despite the slump in sterling and associated rise in inflation, the weakening British economy is expected to keep the Bank of England on the sidelines. Moody's Analytics expects the Monetary Policy Committee to delay tightening policy until well after the EU exit, gradually raising the main policy rate from mid-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.

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 1.5% in 2017 and 1% in 2018 before gradually strengthening to 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 Alaistair Chan and the Asia-Pacific Staff of Moody's Analytics
June 8, 2017

Japan's data dump this week confirmed that the economy made a spirited start to the June quarter. Industrial production expanded a solid 4% m/m in April thanks to improved global demand and the tailwind from the yen's depreciation. Elsewhere, consumer spending remains weak, with workers' nominal household spending falling 2.4% y/y, despite retail sales rising 3.2% in April. Weak wages will continue to crimp consumption, and much of the rise in retail spending is because of rising fuel costs.

The influx of data led to swings in our high-frequency model's estimate of Japan's GDP growth for the three months to June. Overall, though, the data were a net positive for the second quarter outlook for the Japanese economy. Prior to the week, output was tracking at 0.5% annualized, while at the end it was 1.2%. If this result pans out, the economy would expand for its sixth consecutive quarter, the longest such streak since 2005 and 2006.

The model is also optimistic about the revision for Japan's first quarter performance. The official first estimate for economic growth in the three months to March was 0.5% q/q. However, our model indicates this will be revised up to 0.6%.

Softening global tech demand kept Chinese manufacturers cautious in May. Purchasing manager sentiment data from China showed slower optimism on current production levels, although manufacturers are still expanding production on net. Importantly, manufacturer sentiment improved regarding business expectations, hiring expectations (albeit still showing net negative hiring intentions), and raw materials inventories. The hope is that expected new-product announcements for phones later this year will drive a new upswing in demand and production.

India's GDP growth remains incongruent with high-frequency indicators, despite the statistics office releasing new industrial production and wholesale price indexes. GDP growth decelerated to 6.1% y/y in the March quarter, down from 7% the quarter prior. The result is surprising, given that the removal of high-value currency—86% in circulation—disrupted economic activity in the December quarter. Indicators such as the purchasing managers' index suggest that economic activity slowed sharply in December but recovered in March.

It's tough to get a handle on why growth was slower in March compared with December. At first, we expected growth could decelerate in the March quarter, but this was before the recent high-frequency indicators suggested a pickup in activity. One explanation for the mismatch could lie in the national account surveys themselves. The informal sector of the Indian economy, which was the hardest-hit by demonetization, accounts for around 22% of the economy. Data collection in this sector is difficult and takes time. So there's a good chance that the March quarter numbers reflect the data collected from December.

Ratings Round-Up

By Njundu Sanneh

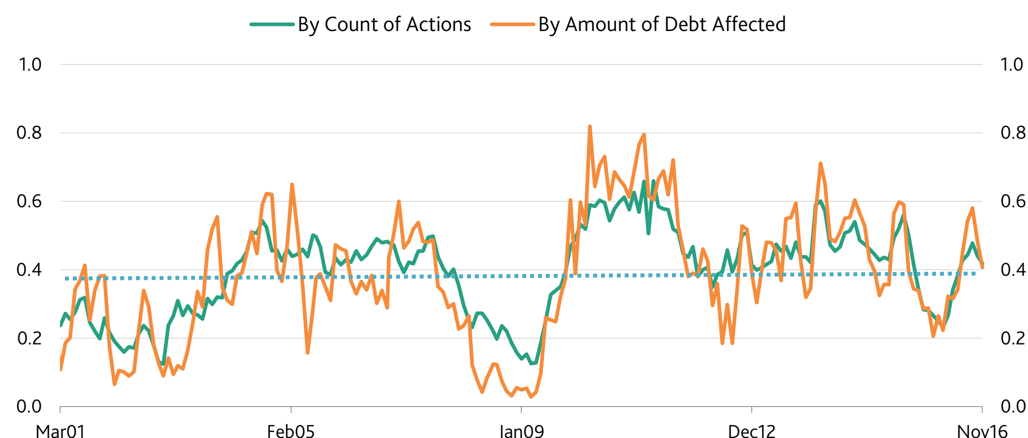
In Rating Changes for the Week, Europe Outperforms US

The number of rating changes bounced back, but US upgrades, after a 17% contribution rate the prior week, were at 33%, still short of the long term average of 40%. The usual suspects retail and energy were part of the poor performance, but downgrades in construction, specialty chemicals, and business services contributed to the low level. Noteworthy upgraded companies included Southwest Airlines, Yonkers Racing Corporation, and American Electric Power Company, Inc. Downgrades included Valspar Corporation, Quality Care Properties, and Virtu Financial.

Europe fares better than the US in its speculative grade default rate as a measure of corporate credit quality. The region saw a positive rating change contribution rate of 45% in the past week and it has generally been recording higher levels of this measure than the US. Financials are prominent for Europe for the second week in a row, featuring Irish and Russian financials with two upgrades each.

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
5/31/17	TRI POINTE GROUP, INC.	Industrial	SrUnsec	1,200	U	B1	Ba3	SG
6/1/17	BRISTOW GROUP INC.	Industrial	SrUnsec/SrSec/BCF/LTCFR/PDR	402	D	B2	Caa2	SG
6/1/17	CPI HOLDINGS I, INC.	Industrial	SrSec/BCF/LTCFR/PDR		D	B1	B2	SG
6/1/17	SOUTHWEST AIRLINES CO.	Industrial	SrUnsec/SrSec	1,741	U	Baa1	A3	IG
6/1/17	TKC HOLDINGS, INC.	Industrial	SrSec/BCF/LTCFR/PDR		D	B1	B2	SG
6/1/17	VIRTU FINANCIAL, INC.	Financial	SrSec	500	D	B1	B2	SG
6/2/17	CARESTREAM HEALTH, INC.	Industrial	LTCFR/PDR		D	B2	B3	SG
6/2/17	YONKERS RACING CORPORATION	Industrial	LTCFR/PDR		U	B2	B1	SG
6/5/17	AMERICAN ELECTRIC POWER COMPANY, INC. - Columbus Southern Power Company	Utility	SrUnsec	1,600	U	Baa1	A2	SG
6/5/17	GYMBOREE CORPORATION (THE)	Industrial	SrUnsec/SrSec/BCF/LTCFR/PDR	171	D	Ca	C	SG
6/6/17	QUALITY CARE PROPERTIES, INC.	Financial	SrSec/LTCFR/BCF	750	D	B2	B3	SG
6/6/17	VALSPAR CORPORATION (THE)	Industrial	SrUnsec	1,550	D	Baa2	Baa3	IG

Source: Moody's

FIGURE 4 Rating Changes: Corporate & Financial Institutions – EUROPE

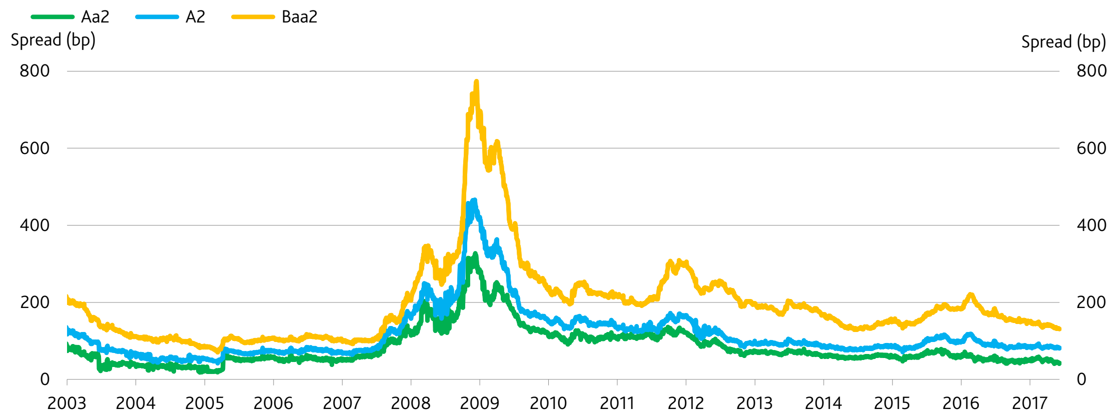
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	Old STD Rating	New STD Rating	IG/ SG	Country
6/1/17	RAIFFEISEN-LANDESBANK STEIERMARK AG	Financial	LTIR/LTD		U	Baa2	Baa1			IG	AUSTRIA
6/2/17	ADRIA GROUP BV - Agrokor D.D.	Industrial	SrUnsec/LTCFR/PDR/LGD	2,009	D	Caa2	C			SG	CROATIA
6/6/17	ALLIED IRISH BANKS, P.L.C.	Financial	SrUnsec/SLTD/Sub/JrSub/MTN	2,668	U	Baa3	Baa2	P-3	P-2	IG	IRELAND
6/6/17	BANK OF IRELAND	Financial	SrUnsec/LTIR/LTD/MTN/sub/jrSub/PS	6,824	U	Baa2	Baa1			IG	IRELAND
5/31/17	UNICREDIT S.P.A.	Financial	SrUnsec/LTIR/SLTD	1,537	D	Baa1	Baa2			IG	ITALY
5/31/17	PETROFAC LIMITED	Industrial	SrUnsec	677	D	Baa3	Ba1			IG	JERSEY
5/31/17	SYNGENTA AG	Industrial	SrUnsec/MTN/CP	2,938	D	Baa2	Ba2	P-2	NP	IG	NETHERLAN
6/2/17	NORSKE SKOGINDUSTRIER ASA	Industrial	SrUnsec/srSec/LTCFR/PDR		D	Caa1	Caa2			SG	NORWAY
6/5/17	BANK URALSIB	Financial	LTD		U	Caa1	B3			SG	RUSSIA
6/6/17	LOCKO-BANK	Financial	LTD		U	B2	B1			SG	RUSSIA
6/6/17	BANCO POPULAR ESPANOL, S.A.	Financial	SrUnsec/MTN/PS/Sub	3,763	D	B1	B3			SG	SPAIN

Source: Moody's

Market Data

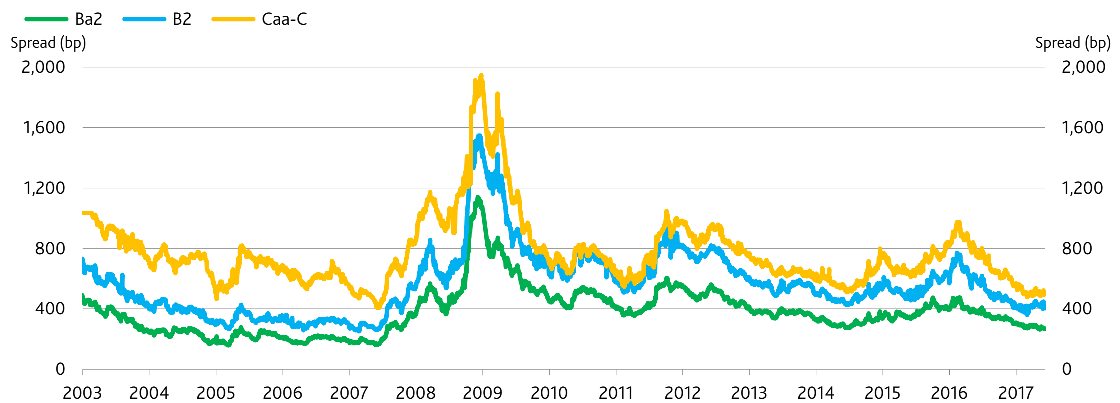
Spreads

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 (May 31, 2017 – June 7, 2017)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jun. 7	May. 31	Senior Ratings
Apple Inc.	Aa3	A1	Aa1
Abbott Laboratories	A2	A3	Baa3
General Motors Company	Ba2	Ba3	Baa3
First Data Corporation	Ba2	Ba3	B3
Capital One Financial Corporation	Baa2	Baa3	Baa1
Simon Property Group, L.P.	Baa3	Ba1	A2
Honeywell International Inc.	Aa2	Aa3	A2
American Express Company	Aa3	A1	A3
Target Corporation	Baa1	Baa2	A2
Norfolk Southern Corporation	Aa3	A1	Baa1

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jun. 7	May. 31	Senior Ratings
Goldman Sachs Group, Inc. (The)	Baa3	Baa2	A3
Wells Fargo & Company	A3	A2	A2
Chevron Corporation	Baa1	A3	Aa2
Dominion Energy, Inc.	A1	Aa3	Baa2
Berkshire Hathaway Inc.	Baa1	A3	Aa2
United Airlines, Inc.	B3	B2	Baa1
Calpine Corporation	Caa1	B3	B2
Rite Aid Corporation	Caa1	B3	B3
Hertz Corporation (The)	C	Ca	B3
ConocoPhillips	Baa2	Baa1	Baa2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jun. 7	May. 31	Spread Diff
Nine West Holdings, Inc.	Ca	5,912	5,692	220
Sears Holdings Corp.	Caa3	3,392	3,277	115
Rite Aid Corporation	B3	413	337	76
Hertz Corporation (The)	B3	1,073	1,003	70
Weatherford International, LLC (Delaware)	Caa1	397	327	70
Frontier Communications Corporation	B2	938	872	67
Parker Drilling Company	Caa1	808	760	48
Chesapeake Energy Corporation	Caa2	694	647	47
Nabors Industries Inc.	Ba3	374	330	44
Anadarko Petroleum Corporation	Ba1	148	129	19

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jun. 7	May. 31	Spread Diff
K. Hovnanian Enterprises, Inc.	Caa3	1,208	1,256	-49
Genworth Holdings, Inc.	Ba3	697	734	-37
Neiman Marcus Group LTD LLC	Caa3	1,591	1,620	-29
Springleaf Finance Corporation	B2	323	346	-23
Sears Roebuck Acceptance Corp.	Caa3	3,407	3,430	-23
Advanced Micro Devices, Inc.	Caa1	215	235	-19
PHH Corporation	B1	331	350	-19
McClatchy Company (The)	Caa2	783	801	-18
Sprint Communications, Inc.	B1	218	234	-16
Corning Incorporated	Baa1	96	112	-16

Source: Moody's, CMA

Figure 4. CDS Movers - Europe (May 31, 2017 – June 7, 2017)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jun. 7	May. 31	Senior Ratings
Banco Popular Espanol, S.A.	Baa3	B3	B3
Matalan Finance plc	Caa2	Ca	Caa2
Credit Agricole S.A.	A2	A3	A1
Banco Santander S.A. (Spain)	Baa2	Baa3	A3
Danske Bank A/S	A1	A2	A2
Statoil ASA	Aa3	A1	Aa3
Switzerland, Government of	Aa2	Aa3	Aaa
Denmark, Government of	Aa1	Aa2	Aaa
Sanofi	Aa3	A1	A1
Greece, Government of	Caa1	Caa2	Caa3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jun. 7	May. 31	Senior Ratings
Astaldi S.p.A.	Ca	Caa2	B3
Barclays Bank PLC	Baa2	Baa1	A1
The Royal Bank of Scotland Group plc	Ba2	Ba1	Ba1
Royal Bank of Scotland N.V.	Baa2	Baa1	A3
DNB Bank ASA	Baa1	A3	Aa2
Smiths Group plc	Baa3	Baa2	Baa2
Unipol Gruppo Finanziario S.p.A.	B1	Ba3	Ba2
Vue International Bidco p.l.c.	B2	B1	B3
Italy, Government of	Ba3	Ba3	Baa2
France, Government of	Aa3	Aa3	Aa2

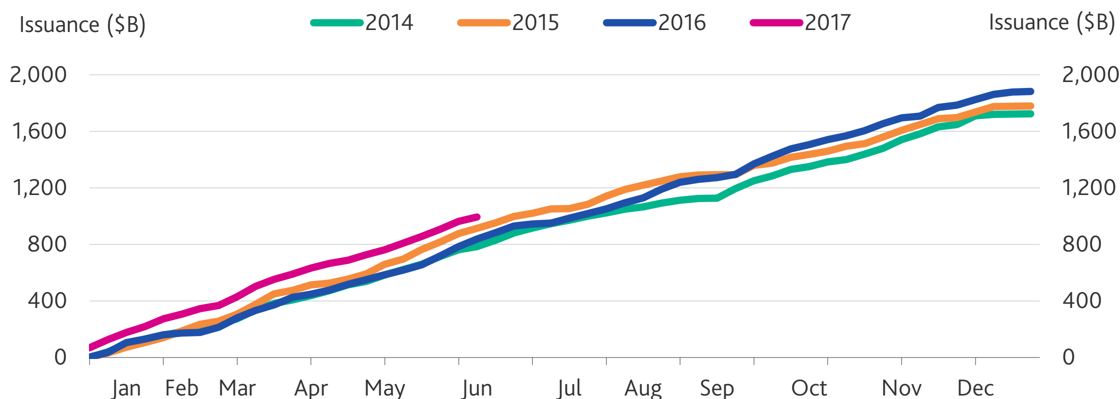
CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jun. 7	May. 31	Spread Diff
Norske Skogindustrier ASA	C	18,607	10,356	8,251
Astaldi S.p.A.	B3	853	752	101
PizzaExpress Financing 1 plc	Caa1	642	609	33
CMA CGM S.A.	B3	571	540	30
Stena AB	B3	623	593	30
Galapagos Holding S.A.	Caa2	719	698	21
Ensco plc	B2	505	489	16
Evraz Group S.A.	B1	308	297	10
Vue International Bidco p.l.c.	B3	224	217	8
Italy, Government of	Baa2	167	161	7

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jun. 7	May. 31	Spread Diff
Banco Popular Espanol, S.A.	B3	90	349	-259
Matalan Finance plc	Caa2	741	992	-251
Banca Monte dei Paschi di Siena S.p.A.	B3	313	358	-45
Eksportfinans ASA	Baa3	492	528	-35
Greece, Government of	Caa3	578	598	-21
Fiat Chrysler Automobiles N.V.	B1	286	301	-15
3i Group plc	Baa1	98	114	-15
Caixa Geral de Depositos, S.A.	B1	276	290	-14
Bank of Ireland	Baa1	79	92	-13
Novafives S.A.S.	B3	333	346	-13

Source: Moody's, CMA

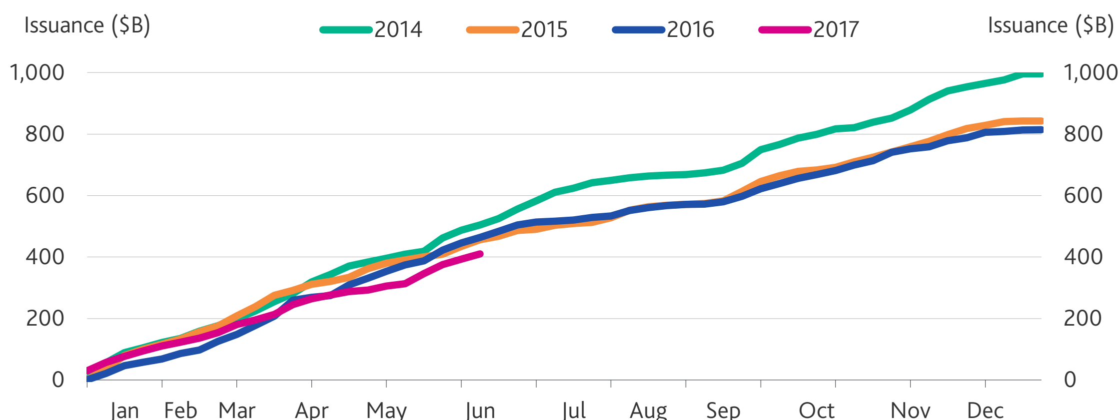
Issuance

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	23.256	1.875	30.726
Year-to-Date	720.449	201.323	994.168

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	12.695	3.076	17.457
Year-to-Date	347.375	45.147	410.235

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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Report Number: 195820

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