MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

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VIX Is Low, Overvaluation Risk Is Not

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

Credit Markets Review and Outlook

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

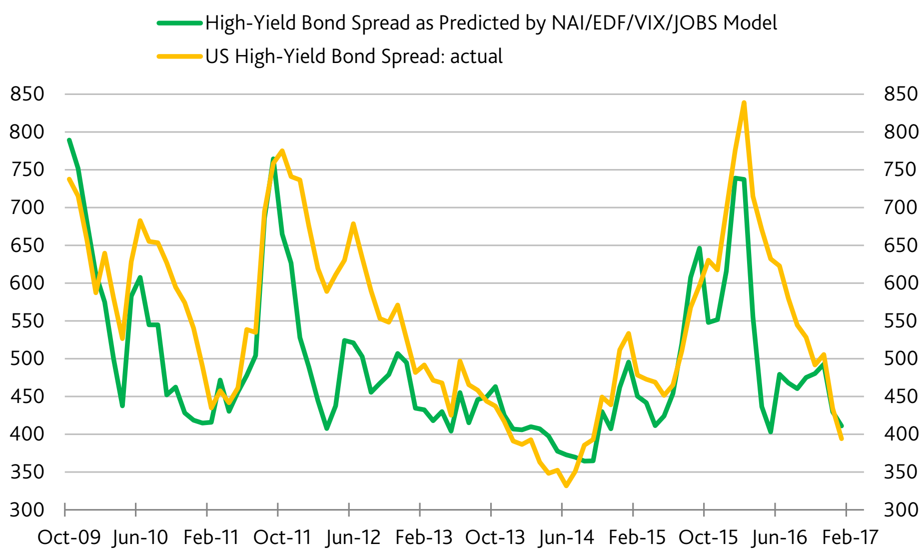
VIX Is Low, Overvaluation Risk Is Not

Overvaluation does not preclude an even higher market value of common stock relative to current and expected corporate earnings. Moreover, provided that the now extraordinarily low VIX index stays under 11.8, a further narrowing by corporate bond yield spreads is likely. However, an increasingly overvalued equity market favors a higher VIX index.

A convincing explanatory model for the high-yield bond spread employs measures of default risk and business activity, in addition to the VIX index. This model recently predicted a 411 bp midpoint for the high-yield spread, which eclipses its recent actual gap of 394 bp. By the way, the latter is the thinnest high-yield spread since September 2014.

What is now the lowest predicted midpoint since April 2015 owes much to an ultra-low VIX index. After removing the VIX index from the explanatory model, the predicted midpoint for the high-yield spread widens to 456 bp. (Figure 1.)

Figure 1: Predicted High-Yield Bond Spread's Predicted Midpoint of 411 bp Tops Recent Actual Spread of 394 bp: in bp



Record highs for stocks, not so for profits

For the first time ever, the blue-chip Dow Jones Industrial average broke above 20,000. Meanwhile, the market value of all US common stock as measured by the Wilshire Index set a new record high.

Nevertheless a popular measure of core profits, though improving, remains well under its apex. Since the moving yearlong estimate of pretax profits from current production peaked at the end of March 2015, the market value of US common stock has climbed higher by 10%. By contrast, the consensus estimates that for the year-ended March 2017, core pretax profits will still trail March 2015's zenith by -5%. Moreover, the consensus does not expect yearlong profits to eclipse its record high until 2018's second quarter.

As inferred from the different directions taken by share prices and profits since March 2015, the US equity market is richly priced, if not significantly overvalued. However, overvaluation does not promise impending doom for share prices.

For example, during 1998-2000's stock market frenzy, though overvaluation first resembled today's excesses in 1998's second quarter, the market value of US common stock continued its ascent until March 2000 despite becoming increasingly overvalued. Amazingly, notwithstanding the accompanying -

7% drop by yearlong profits from December 1997's peak, the market value of US common stock managed to soar by a cumulative 49.5% from 1997's final quarter through the first quarter of 2000.

Not surprisingly, March 2000's unprecedented overvaluation of equities set the stage for a cumulative -43% plunge to October 2002's bottom. Granted that today's overvaluation falls considerably short of the excesses of late 1998 through early 2000, buying into an overvalued market necessarily entails above-average risk.

Based on the historical record, the current rally may not expire soon. Absent another extended bout of profits deflation, the US equity market is likely to set new records regardless of today's overvaluation. For now, the consensus expects pretax operating profits to grow through 2018.

Interest rate risk now poses the biggest danger to stocks

Nevertheless, substantially higher interest rates could temporarily drive the market value of US common stock down by at least -5%. Sharply higher interest rates previously outweighed the positive effect of profits growth and temporarily sank share prices in 1994 and late 1987. In both instances, deep declines by interest rates allowed profits to re-assume its leading role as the primary driver of equity valuation.

Incredibly, 1987's outsized 19% annual advance by core profits was not enough to prevent a stock market crash of frightening severity. In late 1987, the market value of US common stock plunged by as much as -27% from its then record high largely because of a lift-off by the 10-year Treasury yield from a January 1987 average of 7.08% to the 10.36% of October 17, 1987.

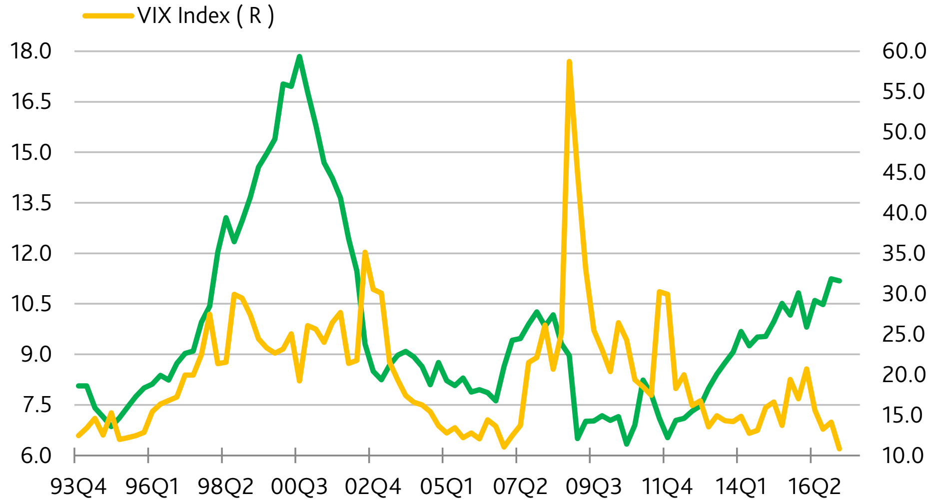
In fact, it was at the morning of October 19, 1987's infamous -18% daily plummet by the market value of US common stock that the benchmark Treasury yield was last above 10%. Who would have thought back then that 30 years later markets would fret over the possibility of a 3% benchmark Treasury yield?

Regarding 1994's far less dramatic episode, a climb by the 10-year Treasury yield's month-long average from October 1993's 5.3% to April 1994's 7.0% helped to sink the market value of common stock by -5.3% from its then record high despite an accompanying 19% annual advance by profits.

Do not underestimate the power of sharply higher benchmark interest rates to pummel share prices. The equity market sell-offs of both 1994 and 1987 occurred despite significant narrowings by medium- and low-grade bond yield spreads. Nor did the declining trends of high-yield defaults offset the selling pressure arising from fast rising Treasury yields.

As inferred from what occurred in 1987 and 1994, the 10-year Treasury yield may need to approach 3% for there to be at least a 50% likelihood of a 5% drop by equities amid profits growth. However, the record also makes clear that an especially disruptive ascent by benchmark yields is likely to be reversed. In order to stabilize share prices, the 10-year Treasury yield's month-long average fell to 8.21% by February 1988 and to 5.65% by January 1996.

Figure 2: Relatively High Ratio for Market Value of Common Stock to Profits Increases Risk of Jump by Today's Ultra-Low VIX Index



Credit Markets Review and Outlook

VIX Index stays low despite risks surrounding overvalued equities

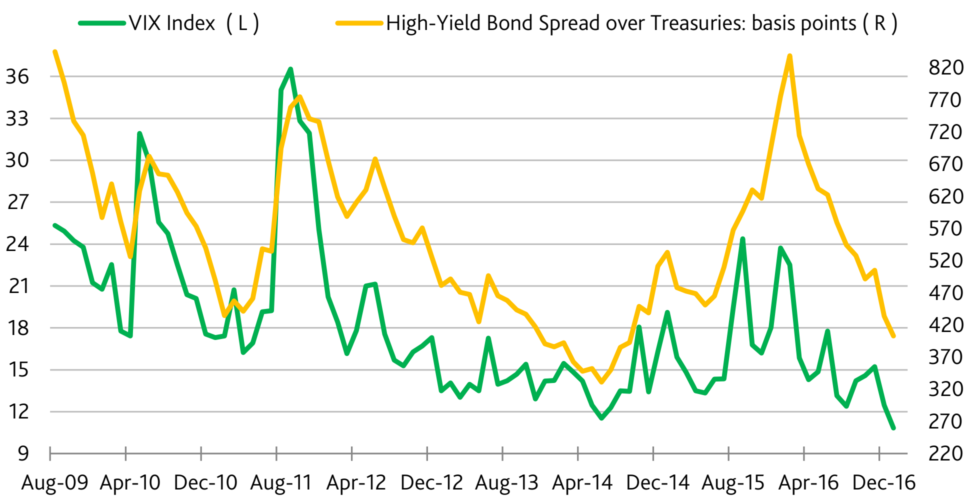
Overvaluation warns of a painful correction in the event market sentiment worsens considerably. In recognition of ample downside risk, the VIX index has tended to be greater in richly priced equity markets, where above-trend VIX indexes have typically been joined by above-average corporate bond yield spreads. (Figure 2.)

In the current market, however, the VIX index has broken from the norm and remained unexpectedly low amid elevated ratios of equity's market value to core profits. The market value of US common stock recently approximated 11.2-times the yearlong estimate for pretax profits from current production for the highest such ratio since the 11.5:1 of 2002's second quarter. It was in 1998's first quarter that common equity's market value last climbed up to 11.2-times core profits. At that time, the VIX index averaged 21.3, which was far above its recent 10.8. Similarly, when the ratio of common equity's market value to profits rose to Q4-2007's previous cycle high of 10.3:1, the VIX index averaged a well above-trend 22.1. Thus, the longer elevated price-to-earnings ratios persist, the more likely is a climb by the VIX index that ordinarily is accompanied by wider corporate yield spreads.

On January 24, 2007 the VIX index closed at a record low 9.89. Ten years later the VIX index closed at the 10.83 of January 25, 2017. The latter was its lowest finish since the 10.32 of July 3, 2014, or when the high-yield bond spread was an exceptionally thin 322 bp. However, even that gap was wider than the 276 bp of January 24, 2007. Do not be surprised if an ultra-low VIX continues to lead the high-yield bond spread lower.

According to the historical statistical relationship, by itself, the recent VIX index of 10.9 predicts a 326 bp midpoint for the high-yield bond spread, which is much thinner than the recent 394 bp. As shown in Figure 3, exceptionally low readings for the VIX index have tended to prompt narrowings by the high-yield spread throughout the current business cycle upturn. (Figure 3.)

Figure 3: Ultra-Low VIX Index Joined by Trend-Like High-Yield Bond Spread ... Medians of 2004-2007 Were 13.6 for the VIX Index and 356 bp for the High-Yield Bond Spread (long-term correlation = 0.90)



Topic of the Week

By Ben Garber, Economist, Moody's Capital Markets Research, Inc.

Asia Economic Commentary

Demonetization Improves Indian Bank Credit Risk Signals

The Indian government's surprise decision to remove high-denomination currency notes from circulation is having a significant impact on the economy and the business sector. Notably, market-based signals of credit risk point to demonetization as a net positive for the country's banks. The large influx of deposits bolsters bank balance sheets and is also greatly increasing potential demand for financial services. Yet Indian banks largely maintain a speculative grade profile, burdened by a high and rising volume of nonperforming assets. Additionally, the deep near-term impact to the economy has created a high level uncertainty about the long-term outlook.

Bank probabilities of default uniformly decline

The November 8 announcement by the Indian government that is was eliminating outstanding INR500 and INR1,000 notes from circulation was a bold attempt to reshape the way the economy functions. The goals of the measure include reducing the scope of the black market and curtailing corruption. If successful, the policy could greatly lift future tax receipts. But the transition to a more digitized financial system creates an obvious and immediate adverse impact on the many industries heavily reliant on cash transactions. Sectors such as real estate and transportation are suffering from the sudden loss of consumer buying power. For the banks, the consequences of the new monetary regime are more complex.

As judged by Moody's Analytics' proprietary probability of default metrics -- the EDF (Expected Default Frequency) -- Indian banks have enhanced their credit risk profiles since the demonetization announcement. The EDF measures for a sample of 16 large public and private Indian banks have all declined from the day before the policy was introduced (Figure 1). These one-year default probabilities are derived from bank balance sheets and equity valuations. The median EDF measure for these banks of 1.12% on November 7 fell to 0.71% as of January 23. Indian banks are benefitting from the tremendous surge of liquidity entering the financial system, which has given a lift to a host of financial securities and reduced borrowing costs.

Figure 1: Indian Bank Credit Risk Metrics

Issuer	1-year EDF Measure on 11/7/2016	1-year EDF Measure on 1/23/2017	Change in EDF Measure Between 11/7/2016 and 1/23/2017	Market-Implied Rating on 11/7/2016	Market-Implied Rating on 1/23/2017	Change in Rating Notches Between 11/7/2016 and 1/23/2017
Axis Bank Limited	0.71%	0.59%	-0.12%	Ba2	Ba1	1
Bank Of Baroda	1.27%	0.78%	-0.49%	B1	Ba3	1
Bank Of India	2.65%	1.13%	-1.52%	Caa1	B1	3
Canara Bank	1.55%	1.10%	-0.45%	B2	B1	1
Central Bank Of India	0.87%	0.64%	-0.24%	Ba3	Ba2	1
HDFC Bank Limited	0.19%	0.14%	-0.04%	A2	A1	1
ICICI Bank Limited	0.72%	0.61%	-0.10%	Ba2	Ba2	0
IDBI Bank Ltd	1.47%	0.92%	-0.55%	B2	Ba3	2
Indian Overseas Bank	0.87%	0.48%	-0.39%	Ba3	Ba1	2
Oriental Bank Of Commerce	4.45%	2.47%	-1.98%	Caa3	Caa2	1
Punjab Bank Ltd	1.47%	1.02%	-0.45%	B2	B1	1
State Bank Of India	0.66%	0.54%	-0.13%	Ba2	Ba1	1
Syndicate Bank	2.09%	1.20%	-0.90%	B3	B2	1
Union Bank Of India	2.85%	1.65%	-1.20%	Caa1	B3	1
United Bank Of India	0.98%	0.53%	-0.45%	Ba3	Ba1	2
Yes Bank Limited	0.53%	0.41%	-0.12%	Ba1	Baa3	1

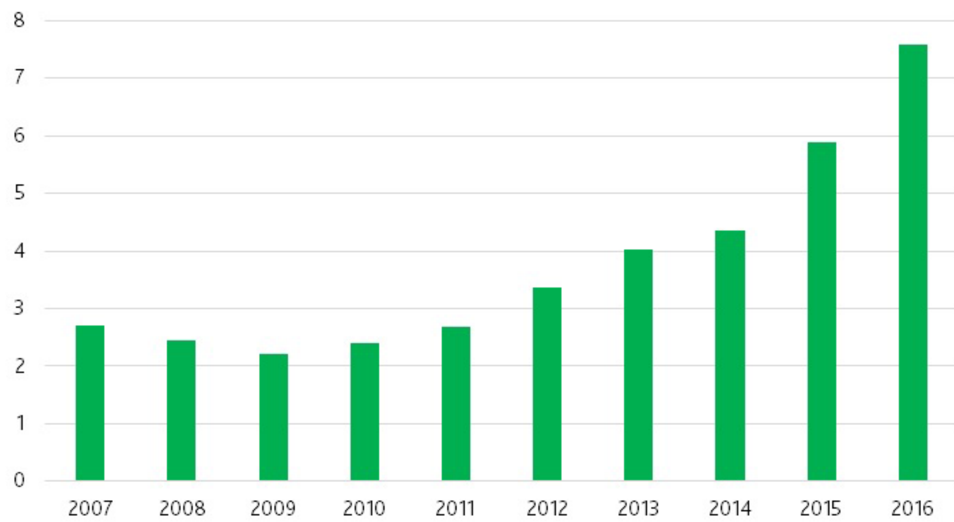
Source: Moody's Analytics

Another way of looking at this shift in credit risk assessments is by converting these default probabilities to ratings in the format of the traditional Moody's Investors Service scale. These market-derived ratings show an improvement of at least one notch for all but one of the banks in our sample. Collectively, the current market-implied ratings puts Indian banks at around the Ba2 and Ba3 rating categories. That position is near the top of the speculative grade classification, which indicates non-negligible but restrained default risk.

The distressed loan hangover is not resolved

Healthy market conditions and the possible rise in retail banking activity can go a long way in bolstering the prospects of Indian banks. Yet those conditions do not obscure the high levels of nonperforming loans. The IMF estimates that 7.6% of the total volume of loans held by the Indian banking sector were not current at the end of 2016, the largest such share in 13 years (Figure 2). That value had risen in excess of 1.5% in each of the past two years, as borrowers' difficulties became particularly prominent in the commodity and construction sectors.

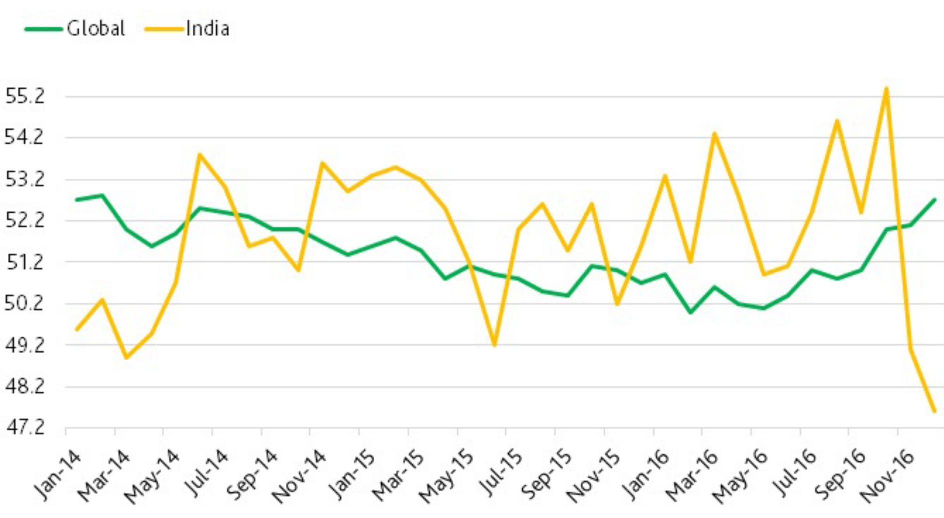
Figure 2: Indian Bank Nonperforming Loans as % of Total Gross Loans



Sources: IMF, World Bank

Banks have some scope to improve their balance sheets as they hold back on new commercial lending and earn income on their currently performing assets. Yet the bulge in distressed debts will ultimately necessitate infusions of new equity capital. Among the large banks, the most problematic institutions reside in the public sector. The only banks in our sample with investment grade market-implied ratings are the private sector banks Yes Bank Limited and HDFC Bank Limited. State directives that guided public sector banking funds to favored industries have contributed to the bad debt problem, and will have to evolve to avoid a recurrence.

Figure 3: Composite Purchasing Manager Indexes



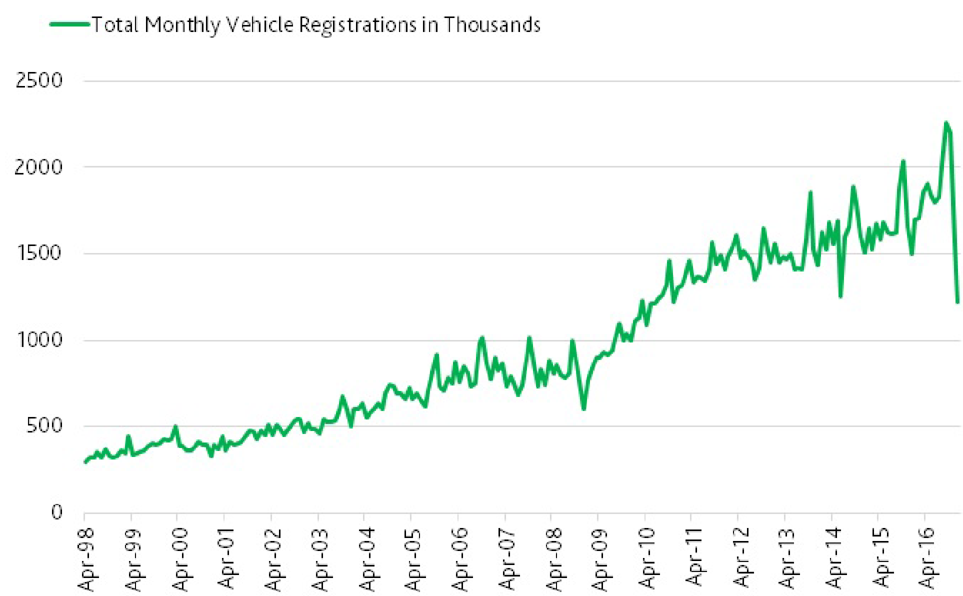
Sources: Markit, Nikkei, Bloomberg

Topic of the Week

Scale of economic disruption is immense

Forecasting the outlook for the Indian banking sector and every other element of the economy cannot be made with a high degree of confidence. An early look at the degree of disruption because of demonization shows cause for concern. Overall business activity as measured by the Nikkei Composite India PMI in December showed the deepest rate of slowdown in over three years (Figure 3). The contractionary index value of 47.6 represents a rapid reversal from the strongly expansionary value of 55.4 in October. India had been the standout leader in global growth rates among major economies throughout most of last year. But as the global PMI index accelerated to the 34-month high of 52.7 in December, India's performance shifted to one of a laggard.

Figure 4: Total Vehicle Registrations*



**Includes passenger, commercial, 3-wheelers, and 2-wheelers, source: SIAM*

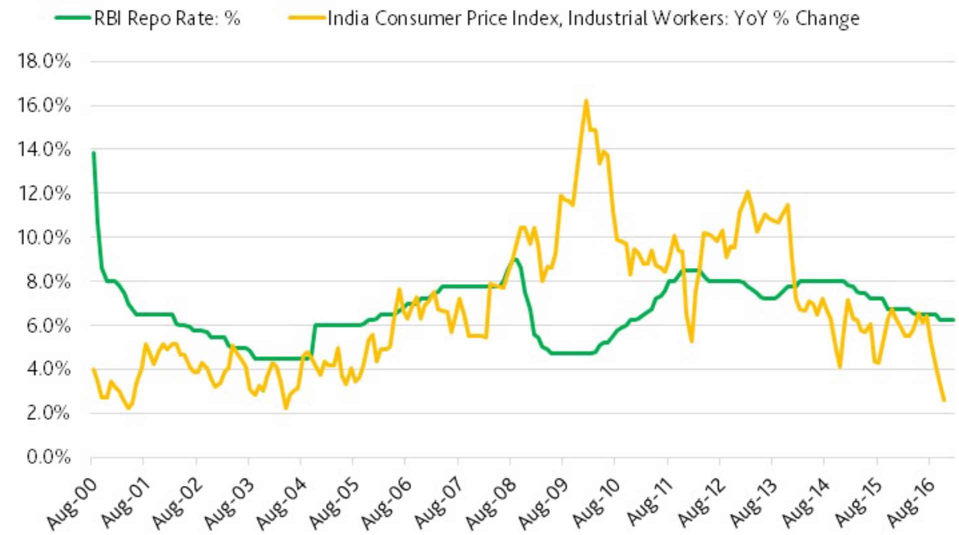
An even more extreme shift in economic activity is seen in the sharp fall in vehicle sales (Figure 4). Sales of passenger and commercial vehicles in December sank to the six-year low of 1.22 million units just three months after achieving the all-time record high of 2.26 million. The lack of cash is fueling a deep retrenchment in consumer spending, while small service firms have reported substantial job cutbacks. Continued progress in facilitating greater withdrawal volumes of new currency and accelerating the adoption of digital payments will be crucial to alleviating the economic slowdown. Yet the speed at which this can be accomplished is not certain, which increases downside economic risks. Growth that falls short well short of expectations can ultimately create negative feedback for the banking system.

The RBI has room to help

The Reserve Bank of India (RBI) has some leeway to moderate the economic slowdown with more accommodative monetary policy. In light of the slump and below trend inflation, the RBI is likely to cut its policy rate to the six-year low of 6.0% on February 7 (Figure 5). Slowing consumer price growth aids the cause, with the yearly change in prices for industrial workers falling to the 12-year low of 2.6% in November. Falling food prices have been leading the disinflationary trend, offsetting increasing energy prices. And additional downward pressure on prices is likely to be observed while consumer spending retreats. Monetary easing can help further guide consumer borrowing costs lower. A drop in interest rates can help the transition to a more prominent and better performing banking sector.

Topic of the Week

Figure 5: India Policy Rate vs. Consumer Price Index



Sources: RBI, CSO

The Week Ahead – US, Europe, Asia-Pacific

THE US

By John Lonski and Ben Garber
Moody's Capital Markets Research Group
Estimates are consensus views. Release times are US Eastern Daylight Time

FRIDAY, JANUARY 27

GDP – Fourth Quarter (Advance Estimate)

Time: 8:30 am
Forecast: 2.2%
A widening trade gap is expected to lead slower GDP growth in the fourth quarter after reaching the fastest rate in two years in the previous quarter. The future effects of trade on US output are rife with uncertainty with regard to the evolution of policy and the value of the dollar. But the underlying pace of consumer spending is holding firm, getting a lift from the recent upside surprise in auto sales.

Durable Goods Orders – December

Time: 8:30 am
Forecast: 2.6% overall, 0.5% ex transportation
Solid recent indicators for industrial demand hint that core durable goods orders can rise for the fourth straight month in December. The new orders reading from the ISM Manufacturing Index jumped to the two-year high of 60.2 last month, raising expectations for near term industrial output. Core durable goods orders have also shown similar vigor of late, rising at the two-year high rate of 5% annualized in the three months ending November.

University of Michigan Consumer Sentiment – January Final

Time: 10:00 am
Forecast: 98.1
The final reading on sentiment in the January Michigan survey is forecast to show only a mild decline from December's multi-year high. Significant increases in consumer inflation expectations in the initial January survey signal that prices are poised to accelerate a bit. That turnaround underpins the more aggressive approach to monetary policy that the Federal Reserve is itching to execute.

MONDAY, JANUARY 30

Personal Income & Spending – December

Time: 8:30 am
Forecast: 0.4% income, 0.5% spending
Strong gains for average hourly earnings can put a halt to the decelerating growth trend in wage and salary income. Wages and salaries grew 4.1% year-over-year in the quarter ending November, the slowest pace in six months. But with average hourly earnings expanding at the seven-year high rate of 2.9% yearly to December, the tightening labor market is giving an added kick to income and spending.

Pending Home Sales Index - December

Time: 10:00 am
Forecast: 1.5%
Rising demand for home mortgages have the Pending Home Sales Index poised to expand in December after the significant decline in the previous month. The moving four-week average of the MBA's index of mortgage applications for home purchases is within 1% of the highest such value since June. Though to the extent that buyers are only now eager to head-off potential additional rate increases, the long-term uptrend in home sales will be sluggish at best.

TUESDAY, JANUARY 31

S&P CoreLogic Case-Shiller Home Price Index – November

Time: 9:00 am
Forecast: 5.0% yearly change in 20-city index
Tight housing inventories can help the Case-Shiller Home Price Index maintain the 4% to 6% annual growth pace that has held for over two years. The 1.89 million existing homes available for sale in December is 27% under the historical average. Though growing briskly, the still depressed level of new home construction gives limited relief to the price-boosting lack of inventory.

Conference Board Consumer Confidence – January

Time: 10:00 am
Forecast: 112.8
The Conference Board measure of consumer confidence will perhaps step back in January after soaring to the 15-year high in December. The burst in optimism was led by the near 20 point jump in the expectations sub-index since October, as consumers anticipate great improvements in economic conditions. Yet the limitations of an aged recovery and an aged population may serve to dampen such inflated attitudes in the months ahead.

WEDNESDAY, FEBRUARY 1

ISM Manufacturing Index – January

Time: 10:00 am
Forecast: 54.8
Positive short-term momentum for the industrial sector can prevent the January ISM Manufacturing Index from backsliding after reaching the two-year high in December. Industrial production expanded annually for the first time in 16 months, rising 0.5% year-over-year in December. Relief from the deep past declines in mining and utility sector output will remove major drags on overall industrial sector performance.

Construction Spending – December

Time: 10:00 am
Forecast: 0.3%
Consistent gains in residential activity can lead overall construction spending higher for the third straight month in December. Housing starts rose 7% year-over-year last quarter, the quickest gain of the past three quarters. That positive trend is joined by private nonresidential construction, which expanded 6% year-over-year in the three months ending November.

FOMC Rate Decision

Time: 2:00 pm
Forecast: 0.5-0.75% fed funds target range
No significant action on monetary policy is likely in February after the Federal Reserve moved in December to lift its policy rate for the first time in a year. Continued uplift for prices and wages can keep the Fed on track to make three quarter-point rate hikes in 2017. Yet dollar strength and the limited feed-through from wages to prices can dampen inflation, allowing the FOMC to act more infrequently.

Vehicle Sales – January

Forecast: 17.7 million
Vehicle sales are forecast to drop in January after unexpectedly leaping to the 11-year high in December. Heavy incentives have interrupted the gradual slowdown in auto sales. Yet after managing a mere 1% year-over-year gain in the fourth quarter, no further maneuvering from sellers is likely to recapture the strong sales growth seen earlier in the recovery.

THURSDAY, FEBRUARY 2

Productivity & Unit Labor Costs – Fourth Quarter Preliminary

Time: 8:30 am
Forecast: 0.5% productivity, 2.4% unit labor costs
Slower output growth and accelerating wage growth is expected to greatly limit the rise in productivity in the fourth quarter. Even after growing at the eight-quarter high rate of 3.1% annualized in the third quarter, productivity showed no change year-over-year. Reduced investment in heavy industry and restrained consumer demand has held back productivity gains over the long-term.

FRIDAY, FEBRUARY 3

Employment Report – January

Time: 8:30 am
Forecast: 163,000 nonfarm payrolls, 4.7% unemployment rate
Job growth is projected to grow admirably in January, keeping new unemployment insurance claims near multi-decade lows. Though the yearly increase in nonfarm jobs has slowed to 2.2 million from the cycle high of 3.1 million, gains are more than keeping up with the rate of population growth. That trend will start to put more upward pressure on wages provided that the economic recovery persists.

ISM Non-Manufacturing Index – January

Time: 10:00 am
Forecast: 57.0
Steady demand for services can keep the January ISM Non-Manufacturing Index near December's 14-month high. Real spending on services lagged for much of the recovery, yet it has stayed above 2% since late 2014. That area of spending is likely to stay firm in the near-term, with the orders component of the Non-Manufacturing Index reaching the 16-month high of 61.6 in December.

Factory Orders – December

Time: 10:00 am
Forecast: 1.1%
As with the expected outcome for durable goods orders, overall factory orders can reverse part of the steep November decline and turn higher in December. The first two months of last quarter brought strong gains for core capital goods orders. That raises the odds that real investment spending outside of inventories can quickly undo the 0.5% yearly decline recorded to the third quarter.

EUROPE

By the Dismal (Europe) staff in London and Prague
Editor's note: The Europe "Week Ahead" material is now provided on Friday, whereas our Weekly Market Outlook is published on Thursday. Accordingly, we will update this material after publication, online, on Friday or Monday.

Summary, January 27: A barrage of top-tier data are expected to be published next week, with the euro zone preliminary fourth quarter GDP being the most important. We expect the currency area's economy to have finished 2016 on a strong note, with growth accelerating in most major countries. Italy is likely the sole exception. As of Friday, most of the available soft and hard data for the three months to December were relatively upbeat, pointing to a strong pickup in the area's industrial and construction performance. Manufacturing production figures for both October and November were solid, and even if we expect a mean reversion in December, total fourth quarter output still should have expanded by 0.9% q/q, compared with an increase of 0.4% in the third quarter. Similarly, after several years of lackluster performance, the outlook for the construction industry brightened by the end of 2016. Construction order books as measured by the European Commission recovered sharply, and so did the IFO construction sentiment in Germany. Low interest rates, low inflation, and a recovering labour market have all contributed to lift homebuilding, while commercial and industrial construction also rebounded. In all, this should have helped push investment higher in the euro area, likely by 2.3% q/q, up from 0.2% in the third quarter.

Data for Germany and Italy will not be released until mid-February, but we think that, across countries, Germany was the main driver of growth. Besides strong investment, German consumers likely continued to spend freely and to be the main driver of growth. But government spending should also have contributed, notably because of higher costs related to the mass arrival of migrants. In trade, we expect real exports to have increase by 1.6% q/q in the fourth quarter, and real imports to have been more subdued because of a jump in the import price deflator. Recovery in oil prices—which are now around 78% higher than at this same point last year—and the depreciation of the euro are the main culprits of this development, as they sent prices of imported goods soaring at the same time that the country's competitiveness improved.

In France, the situation is also rosy, with industrial production and consumer spending set to have strongly rebounded following a poor third quarter. In all, we expect the economy to have expanded by 0.4% q/q, up from 0.2% in the previous stanza. But, in contrast with Germany, net trade should have provided only a moderate boost to GDP growth despite the low base for a rebound, mainly because of disappointing trade with Asia.

Elsewhere, all eyes will be on the Bank of England as the Monetary Policy Committee will meet on Thursday. We do not expect the bank to change its stance on policy, even if we concede it could revise up its short-term inflation expectations. We think that the bank will look though any temporary jump in prices to support the economy through the process of exiting the European Union, as it will argue that inflation should return to target and not become embedded in the economy.

FRIDAY, JANUARY 27

Euro Zone: Monetary Aggregates (December; 9:00 a.m. GMT)

The seasonally adjusted annual growth of the euro zone's M3 money supply likely decelerated a bit in December but remained strong. The M3 money supply is expected to have grown 4.7% y/y, 0.1 percentage point slower than in November. The European Central Bank's program designed to provide an additional stimulus to the economy and widen the bank's balance sheet has been pushing money supply growth higher in recent months. Meanwhile, euro zone inflation hit a 3½-year high in December, exceeding expectations. Although price growth remains below the ECB's 2% target, its acceleration is promising and may lead to a reassessment of future monetary policy steps. Accelerating inflation in Germany may rouse opponents of quantitative easing, and the ECB may cut asset purchases further. The governing council agreed in December that beginning in April, monthly purchases would be €60 billion per month, down from the current €80 billion, which will also impact the M3 aggregate.

MONDAY, JANUARY 30

Germany: Unemployment (January; 9:00 a.m. GMT)

Germany's seasonally adjusted unemployment rate likely remained at 6% in January for a fourth consecutive month after it fell to this record low in October. For the whole of 2016 the rate fell to 6.1%, down from 6.4% in the previous year. Business confidence recovered at the end of the last year and continued to improve at the start of 2017, following a slump in the summer caused by the U.K. Brexit vote. German businesses remain confident in Germany's future expansion, increasing their labor force, despite the uncertainties and geopolitical tensions. The weakening euro, which boosted exports at the end of last year, should also increase demand for German products, which should translate into higher employment. However, the unemployment rate is likely bottoming and it is expected to increase somewhat this year because of the vast inflow of refugees, some of whom will be entering the German labor force.

TUESDAY, JANUARY 31

France: GDP (Q4; 6:30 a.m. GMT)

The French economy likely grew 0.4% q/q in the three months to December after adding 0.2% in the previous quarter. Household consumption was likely the main driver of the increase, while net exports dragged on the final reading. The annual expansion accelerated to 1.4% from 1.2% in the three months to September. For all of 2016 the economy added 1.3%, after a 1.2% gain in 2015. French consumer and business confidence is slowly but surely improving. This reflects a strengthening labor market and a slowly firming recovery in the general economy, as well as fewer fears about the consequences of the U.K. vote to leave the EU. Still, with lack of productive investment and slowly but surely ageing population, France is lacking a real domestic growth engine. Also, the upcoming presidential elections pose both a threat and an opportunity for the country as progressive candidates are standing against populists, helped by Donald Trump's recent victory in the U.S.

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

French household expenditures on goods likely ticked up m/m in December after strengthening by 0.4% y/y in November. Still-low oil prices as well as low prices of most goods, the improving labour market, and a firming, yet slow recovery in the country are helping consumption to creep forward at least on an annual basis. Retail PMI rose to 50.4 in December from 47.3 in the previous month, while employment increased a little and gross margins rose for the first time in almost nine years. Gross margins were still squeezed, though, while stock levels increased somewhat, despite lower purchasing activity. Still, French households are prudent and their precautionary savings remain high at close to 15%, limiting discretionary spending.

Euro Zone: Unemployment (December; 10:00 a.m. GMT)

Euro zone unemployment likely slid to 9.7% in December from 9.8% in the previous month. Compared with December 2015, the rate decreased from 10.5%. Nevertheless, headline unemployment and youth unemployment remain elevated, especially in periphery countries. The euro zone economy continued to expand at the outset of 2017 as January's Flash Composite PMI for the euro was at 54.3, only marginally down from 54.4 in December and significantly higher than a 2012-2016 average of 51.6. Also, employment growth strengthened for the third month running, reaching its fastest rate since 2008. These latest figures attest to the resilience of the single-currency area, at least so far, despite the U.K. vote to leave the EU and market fears of a downturn. The downward trend in the jobless rate should continue in coming months, with improving economic conditions around the monetary bloc, labor market reforms, and a strengthening industrial base in Spain, Ireland and Portugal.

Euro Zone: Preliminary GDP (Q4; 10:00 a.m. GMT)

The euro zone's real GDP likely expanded by 0.4% q/q in the fourth quarter, up from 0.3% in the previous stanza. Growth from a year earlier likely remained at 1.7%. The euro zone economy remained quite resilient to many headwinds in the three months to December and high-frequency data showed that growth accelerated from the previous quarter thanks to strengthening export orders. Although the GDP release will not include the expenditure detail for growth, we expect that stronger consumption expenditure continued to lead the gain, while net exports will contribute only modestly because of higher imports. Although the economy should expand at about the same rate as in 2016, political anxiety about the 2017 voting season could send it off the rails, while tough negotiations over the U.K.'s exit from the EU could curb trade. Still, some offset should come from a firming U.S. economy thanks to Trump's expected fiscal stimulus.

Euro Zone: Preliminary CPI (December; 10:00 a.m. GMT)

Euro zone annual harmonized inflation likely accelerated to 1.3% in January from 1.1% in the previous month. Higher commodity prices, a weakening euro, and ongoing economic expansion will boost euro zone inflation in coming months. As a result of all these factors, the euro zone's long-term inflation expectations implied from market instruments rallied to 1.8% in late January, the highest since November 2015, and Brent oil futures are hovering above $55 per barrel. Yet diverging inflation across the euro zone countries may complicate the ECB's monetary policy. In December, annual inflation accelerated to 2.4% in Estonia, 2.2% in Belgium, and 1.7% in Germany, but it picked up only to -0.2% in Ireland, 0.3% in Greece, and 0.5% in Italy.

WEDNESDAY, FEBRUARY 1

No major economic indicators are scheduled for release.

THURSDAY, FEBRUARY 2

U.K.: Monetary Policy and Minutes (February; 12:00 a.m. GMT)

We expect the Bank of England will maintain its policy stance in February, keeping its key refinancing at 0.25% and its target for asset purchases at £435 billion. The resilience of the economy in 2016—GDP data released on Thursday showed that the economy continued to expand at a brisk pace of 0.6% q/q in the fourth quarter—should not compel the bank to adopt a more hawkish stance, even in view of soaring inflation, as we think that the MPC could revise down its forecasts for growth for this year and the next. Oil prices are jumping fast, and retailers are passing higher import prices though to consumers at a faster rate than in the past. This soon enough will dampen households' purchasing power and appetites for spending. Plus, the weak sterling is failing to boost exports to the extent which was previously expected, meaning that net trade will provide only a small contribution to growth. With investment also expected to remain subdued, we think the MPC will reinforce its view that it will look through a temporary jump in prices to support the economy, as long as higher inflation expectations do not become embedded in the economy.

FRIDAY, FEBRUARY 3

No major economic indicators are scheduled for release.

ASIA-PACIFIC

By Emily Dabbs and the Asia-Pacific economics team of Moody's Analytics

Yen's depreciation puts Japan on a cyclical upswing

Japan was likely in the beginning of a cyclical upswing at the end of 2016 thanks to the currency's sharp depreciation. This will aid Japan's export-orientated manufacturers, and production is set to rise. The uptick in the global tech cycle will also make Japanese electronics more competitive in 2017. A pickup in domestic demand is expected as retail sales and household expenditures increase; the rising stock market will buttress consumption over the coming months. With deflation ebbing and commodity prices rising, the Bank of Japan will remain on hold at its first meeting in 2017.

Elsewhere, the South Korean economy will ride the global tech cycle, which will likely see an uptick in electronic production and exports.

FRIDAY, JANUARY 27

Japan – Consumer Price Index – December

Time: 10:30 a.m. AEST (Thursday 11:30 p.m. GMT)
Forecast: -0.3%
The yen's recent depreciation will put upward pressure on import prices over the coming months, and we expect the core CPI to begin increasing in early 2017. However, downside risks persist, especially if weak domestic demand dampens wages and overall spending. Overall, we expect the core-CPI to have picked up slightly in December.

Singapore – Employment – 2016Q4

Time: 2:30 p.m. AEST (3:30 a.m. GMT)
Forecast: 2% Unemployed
We look for Singapore's unemployment rate to have fallen to 2% in the fourth quarter of 2016, after sitting at 2.1% in the prior two quarters. Advance estimates showed that in the three months to December the city-state's economy expanded at its fastest quarterly pace since 2013. The improvement in manufacturing conditions in particular should be boon for employment. Likewise, service sector employment should also improve. Construction, however, continues to decline, as residential property prices fall. As a result, we expect construction employment to remain weak well into 2017.

MONDAY, JANUARY 30

New Zealand – Foreign Trade – December

Time: 8:45 a.m. AEDT (Sunday 9:45 p.m. GMT)
Forecast: -NZ$639 million
New Zealand's monthly trade deficit likely narrowed further in December after November's NZ$705 million shortfall. Soft-commodity exports are enjoying stronger conditions and in December prices continued rising, mainly on higher prices for dairy, New Zealand's largest export. Global dairy prices began recovering midyear after a sustained slump amid oversupply. Petroleum import growth likely remained upbeat thanks to a low base effect from the slump in prices a year earlier.

Japan – Retail Sales – December

Time: 10:50 a.m. AEDT (Sunday 11:50 p.m. GMT)
Forecast: 1.5%
Japan's retail sales likely rebounded towards year's end. This partially stems from rising commodity prices that will push retail fuel prices higher. Low base effects will also come into play, as retail sales have been weak over the past 12 months. The recent depreciation of the yen and the rise in the stock market will help retail over the coming year.

Thailand – Industrial Production – December

Time: Unknown
Forecast: 2.1%
We expected Thailand's industrial production growth to have slowed to 2.1% y/y in December from 3.8% in November. Despite the easing, this would still give Thai manufacturers a solid end to an otherwise disappointing year. The improvement is mainly attributable to an uptick in global demand helping export-oriented manufacturers. This will boost electronics and motor vehicle production in the coming months.

TUESDAY, JANUARY 31

Japan – Employment Situation – December

Time: 10:30 a.m. AEDT (Monday 11:30 p.m. GMT)
Forecast: 3% unemployed

Japan's low unemployment rate belies the duality in the labor market. Non-regular or temporary workers have seen strong job growth, but they have less wage bargaining power than their full-time counterparts. This has limited overall wage growth but kept Japan's unemployment rate relatively low. A high jobs-to-application ratio suggests that demand for labor remains firm.

Japan – Household Expenditures Survey – December

Time: 10:30 a.m. AEDT (Monday 11:30 p.m. GMT)
Forecast: 1.1%
Japanese workers' household expenditures likely increased towards year's end as optimism stepped up following the yen's recent depreciation. But the overall momentum in expenditures is unlikely to improve drastically in the coming months. This stems from persistently weak wage growth and consumers, who haven't responded positively since the 2014 April sales tax hike.

Japan – Industrial Production – December

Time: 10:50 a.m. AEDT (Monday 11:50 p.m. GMT)
Forecast: 1.1%
Japan's industrial production has strengthened towards the back end of the year thanks to an uptick in the global tech cycle. Japanese electronic producers have benefited from a stronger U.S economy. And the recent drop in the yen will boost their competitiveness against South Korean producers. Moreover, the auto sector should be on stronger footing thanks to a lower currency boosting export-competitiveness.

Japan – Monetary Policy – January

Time: Unknown
Forecast: ¥80 trillion
The Bank of Japan is set to keep its monetary policy unchanged at its first meeting of 2017. The recent uptick in commodity prices is slowing inflation's decline. Moreover, the yen's depreciation is boosting exports, and this will likely continue in 2017. Thus, the central bank will keep its annual pace of monthly bond purchases unchanged at an annualized pace of ¥80 trillion. We also expect the BoJ to keep unchanged its yield curve control policy of targeting the 10-year bond at 0%.

Japan – Housing Starts – December

Time: 4:00 p.m. AEDT (5:00 a.m GMT)
Forecast: 6.6%
Japan's housing market likely finished the year on a strong note. Low interest rates have buttressed the housing market in the major capital cities such as Tokyo and Kyoto. This has caused some concerns about an oversupply across pockets in Tokyo. However, house price growth in other prefectures where the population is declining remains relatively low.

Thailand – Private Consumption – December

Time: 6:30 p.m. AEDT (7:30 a.m GMT)
Forecast: 1.1%
We forecast that Thailand’s private consumption growth slowed to 1.1% y/y in December, down from November’s 1.6% . Persistently weak income growth and consumer sentiment are the main weights on household spending. Spending has also been dampened in recent months by the mourning period following the much revered king’s death, but this should start to lift in the opening months of 2017. Tourism spending has also slowed, as visitor arrivals have plateaued.

Thailand – Foreign Trade – December

Time: 6:30 p.m. AEDT (7:30 a.m GMT)
Forecast: US$2.1 billion
We look for Thailand’s trade surplus to have narrowed to US$2.1 billion in December, compared with November’s US$2.8 billion surplus. Already-released customs trade data have shown that the goods balance narrowed in the month because of the growth in imports exceeding that of exports. Thailand’s exports have improved in recent months thanks to stronger global demand. In particular, shipments of automobiles and electronics products have shown marked improvements.

South Korea – Foreign Trade – January

Time: Unknown
Forecast: US$6.2 billion
Korea's trade environment likely started the year on an upbeat note, with the monthly trade surplus falling to US$6.2 billion as growth in imports outweighs an improvement in exports. Stronger global tech demand is pushing up shipments of semiconductors and other electronic components, while other sectors benefit from a weaker currency. The depreciation of the Korean won is pushing up the value of imports, and this is further exacerbated by rising global commodity prices.

WEDNESDAY, FEBRUARY 1

New Zealand – Employment Situation – 2016Q4

Time: 8:45 a.m. AEDT (Tuesday 9:45 p.m. GMT)
Forecast: 5% unemployed
New Zealand's unemployment rate likely rose to 5% in the December quarter after the third quarter's surprise 0.2-percentage point drop to 4.9%, its lowest rate in eight years. We do not expect employment growth to outperform gains in the labor force for a second consecutive quarter. New Zealand's labor market is improving, receiving a particular lift from the booming housing market, which is driving strong income and employment growth. This will be the third quarter of the new survey methodology so year-on-year comparisons will not be very useful.

South Korea – Industrial Production – December

Time: 10:00 a.m. AEDT (Tuesday 11:00 p.m. GMT)
Forecast: 4.1%
Korean production likely expanded 4.1% y/y in December, ending the year on a relatively upbeat note. Manufacturing is being supported by stronger global demand for electronics, especially semiconductors. Conditions improved slightly in December, but the disappointing new orders indicate that the recovery still has a way to go.

South Korea – Retail Sales – December

Time: 10:00 a.m. AEDT (Tuesday 11:00 p.m. GMT)
Forecast: 1.7%
Household spending likely ended 2016 on an upbeat note, but the outlook is less promising. Online sales in the lead-up to the holiday period are expected to have supported spending over the month, but weak wage growth and high levels of debt will keep a lid on the gains. Difficult domestic conditions are expected to limit growth heading into 2017.

THURSDAY, FEBRUARY 2

Japan – Consumer Confidence – January

Time: 4:00 p.m. AEDT (5:00 a.m. GMT)
Forecast: 43.8
Japan's consumer confidence likely ticked up in January following the yen's recent depreciation. Conditions improved in the prior month as well, and given the positive data over the last month or so, we expect consumers to feel slightly more optimistic about the economic outlook. Moreover, the uptick in global commodity prices will likely see inflation expectations expand over the coming months.

South Korea – Consumer Price Index – January

Time: 10:00 a.m. AEDT (Wednesday 11:00 p.m. GMT)
Forecast: 1.2%
Inflation pressures likely eased slightly in Korea over January, but the trend will point to stronger price growth in coming months. Rising global commodity prices and a surge in the cost of fresh food are pushing up the headline measures. But subdued domestic demand will limit the gains in core inflation measures. The Bank of Korea is unlikely to ease monetary policy to boost demand and inflation given the high level of private demand.

Australia – Foreign Trade – December

Time: 11:30 a.m. AEDT (12:30 a.m. GMT)
Forecast: A$1.8 billion
Australia's monthly trade balance likely remained in surplus in December as export growth outstripped a rise in imports. The rise in global commodity prices—especially iron ore and coal—is pushing up export receipts. Outside of the mining industry, the recent weakness in the aussie is supporting export services such as education and tourism.

FRIDAY, FEBRUARY 3

No major economic indicators are scheduled for release.

The Long View

The US: An expected series of Fed rate hikes may drive new spec-grade bank loans up to a new record high for January

By John Lonski, Chief Economist, and Ben Garber, Economist, Moody's Capital Markets Research Group, January 26, 2017

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 120 bp resembles 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 394 bp is less than what is predicted by the spread's macroeconomic drivers and the high-yield EDF metric, but it is wider than what might be inferred from a now below-trend 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 most recently peaking at August 2016's 5.8%, Moody's credit policy group predicts that the US high-yield default rate will ease from December 2016's 5.7% to 3.9%, on average, during 2017's second half. A return to its 1.85% average of the 18-months-ended June 2015 is unlikely for now.

US CORPORATE BOND ISSUANCE

In 2015, US$-denominated bond issuance advanced by 12.5% annually for IG, to $1.338 trillion and plunged by -18.9% to $353 billion for high yield. Across broad rating categories, 2015's newly rated bank loan programs from high-yield issuers advanced by 23.2% to $67.8 billion for Baa, increased by 22.7% to $207.45 billion for Ba, but plunged by -43.2% to $145.4 billion for programs graded less than Ba.

For 2016, US$-denominated bond issuance rose by 4.5% annually for IG, to $1.397 trillion and dropped by -4.1% to $339 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 -9.4% for IG and -32.9% for high-yield, wherein US$-denominated offerings dipped by -2.9% for IG and plunged by -36.6% for high yield.

Q1-2016's worldwide offerings of corporate bonds showed annual percent declines of -5.0% for IG and -51.4% for hh-yield, wherein US$-denominated offerings were unchanged from Q1-2015 for IG, but plunged by -45.7% annually for high yield.

Q2-2016's worldwide offerings of corporate bonds showed an annual increase of +7.0% for IG and an annual drop of -8.9% for high-yield, wherein US$-denominated offerings inched up by +0.1% for IG and sank by -11.1% for high yield.

Third-quarter 2016's worldwide offerings of corporate bonds showed an annual advances of +19.7% for IG and +43.4% for high-yield, wherein US$-denominated offerings soared higher by +33.9% for IG and by +47.4% for high yield.

In 2017, worldwide corporate bond offerings may rise by 0.1% annually for IG (to $2.389 trillion) and may grow by 2.5% for high yield (to $433 billion).

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 1.125%. In view of the considerable underutilization of the world's productive resources, low inflation should help to rein in Treasury bond yields. As long as the global economy operates below trend, the 10-year Treasury yield may not remain above 2.45% for long. A fundamentally excessive climb by Treasury bond yields and a pronounced slowing by expenditures in dynamic emerging market countries are among the biggest threats to the adequacy of economic growth and credit spreads going forward.

EUROPE

By Tomas Holinka of Moody's Analytics
January 26, 2017

Eurozone

The euro zone economy will likely expand in 2017 at a growth rate similar to last year, driven by stronger exports to the U.S. Higher demand from the U.S. thanks to Trump's fiscal expansion, plus a weakening euro, will bolster European exports. With a gradually increasing fed funds rate due to rising inflation, and a zero interest rate in the euro zone, the euro will weaken close to parity with the dollar by early 2018. This will support the euro area and real GDP is expected to expand by 1.7% in both 2017 and 2018.

Nevertheless, a protracted negotiation and likely 'hard Brexit' could undermine Britain's economic growth even more than expected, dimming the prospects for euro area exports. Other EU countries are unlikely to grant Britain favorable terms of access to the EU's single market if the U.K. insists on limiting free movement of labor. Although the British government will trigger Article 50 in March, the country might not strike a trade deal with the EU, which is crucial for the U.K., until mid-2020. This is beyond the two-year negotiation window, after which trade restrictions are automatically imposed.

Domestic demand, supported by a falling unemployment rate and still-low inflation, may propel growth in many euro area countries. The region's corporates overcame their nervousness from the U.K. exit vote and U.S. presidential election surprisingly well. Rising business confidence thanks to a strengthening global economy and loose monetary policy will encourage firms to hire additional workers, which should ramp up household spending. More generous fiscal policy should also drive up domestic demand. An improving fiscal stance due to lower interest payments should encourage EU governments to enact slightly expansionary fiscal policy in 2017.

The strengthening European economy combined with rising commodity prices may also boost inflation pressures, since stronger demand will help reduce oversupply and prices will slowly climb. Below-potential growth, however, is keeping a lid on inflation, and even rising import prices due to the weakening euro won't be strong enough to move annual price growth near the ECB's close but below 2% target. Yet rising long-term inflation expectations could calm the central bank, as the five-year forward break-even inflation rate climbed to 1.8% in late January, the highest since November 2015.

Despite accelerating inflation, the ECB will keep the key policy rate unchanged until the end of 2019, while maintaining asset purchases until the end of 2017. Nevertheless, rising inflation in Germany, which soared to 1.7% y/y in December from 0.7% in the previous month, may rouse opponents of quantitative easing and prompt the ECB to cut asset purchases further. The governing council agreed in December that monthly purchases would be €60 billion per month beginning in April, down from the current €80 billion. Credit flow remains squeezed in southern Europe. Weak bank profitability and a high share of bad loans are largely to blame. While the zero interest rate and accelerating inflation is a deadly mix for German savers and banks, the high number of nonperforming loans in Italy, Spain and Greece is holding back credit supply. After Italy's government stepped in to rescue Monte dei Paschi di Siena, success in cleaning the balance sheets of other European banks will be crucial.

Stricter regulatory requirements and deepening political woes could increase the volatility in financial markets and weigh on banks' profits and credit creation. Besides ongoing immigration, which has moderated compared with 2015, Europe is challenged by the rising popularity of anti-establishment and anti-European parties. Although a new Italian government was formed promptly after Prime Minister Matteo Renzi's resignation, a push for a snap election in spring 2017 is growing. The surge of protest voices could boost the populist and far-right parties not only in Italy, but also in the Netherlands, France and Germany, where regular parliamentary and presidential elections will be held.

U.K.

U.K. economic growth is predicted to ease to 1% this year and 0.8% next year from predicted 2% growth in 2016. The British economy has so far withstood the referendum blow remarkably well and put to rest most economists' doomsday scenarios. Investment will remain subdued given the risks associated with exit negotiations and weak construction. The country carried on with business as usual; even if confidence tumbled in the aftermath of the vote, it soon rallied despite no one having a clue about the U.K.'s future ties with the EU. Although the economic data are certainly encouraging, we do not think that the country will sail through the exit unscathed. We expect the weakness in sterling to be a key theme over the next few months.

Higher inflation due to weaker pound will equal or slightly exceed the rise in nominal wages, leading real income growth to stall or even go into reverse in 2017. The labor market is expected to falter as a result of the heightened uncertainty over the U.K.'s future, and this could hamper employees' bargaining power and further limit wage growth. Besides weaker households spending, investment will remain subdued given the risks associated with exit negotiations and weak construction, while net exports will benefit little from the weaker currency. Given the weaker than expected expansion in exports and the low level of import substitution, we expect net trade will do little for growth in 2017.

The Bank of England's Monetary Policy Committee currently predicts that CPI will surge to 2.4% in 2017 from 0.7% in 2016, but this may be underestimating just how much sterling's depreciation will drive up inflation. Although the committee highlighted in its November inflation report that it expected the rise in import prices to be gradual and pass through to consumers slowly, evidence from the CPI points to the contrary. Therefore, we are expecting inflation to average 2.9% over the next year and peak at 3.3% in July.

Despite accelerating inflation, the Bank of England will likely hold the interest rate at a record low of 0.25% until early 2020, while keeping its target for asset purchases at £435 billion. But if negotiations between the EU and U.K. go wrong and market risks increase, the bank may cut the rates or expand its QE.

ASIA PACIFIC

By Faraz Syed and the Asia-Pacific Staff of Moody's Analytics
January 26, 2017

India's bold experiment to remove 86% of its currency in circulation—500 and 1,000 rupee notes—will suppress short-term growth . But the scheme, known as demonetization, won't change India's long-term growth prospects.

Moody's Analytics expects GDP growth will decelerate sharply in the final quarter of 2016, and also into the first quarter of 2017. Overall, GDP will likely grow 6.3% in 2017, a noticeable step down from

7.1% expected in 2016. We expect the cyclical slowdown will be limited, and GDP growth will likely normalize to around 8% in 2018.

Demonetization was introduced to tackle corruption. Estimates of so-called black money—undeclared income—in India vary, but it is generally considered to total 20% to 30% of GDP. Those holding high-valued currency have the option to swap out of these notes for cash—such as a new 2,000 rupee note—or deposit the old notes into bank accounts. Since the printing of 2,000 rupee notes has been slow, bank deposits have increased sharply.

Increasing bank deposits means two things. First, exchanging large sums of money requires proof for source of income, and also makes the deposits taxable. Technically, it's supposed to make it easier for authorities to track money for tax purposes, thereby reducing corruption.

The policy is also a onetime penalty for those who choose not to exchange the 500 and 1,000 rupee notes, as they are no longer legal tender. But the boon to government coffers from increased taxes depends on how successfully the incoming deposits and large cash exchanges are tracked.

Second, the increase in bank deposits after demonetization means that there's greater liquidity in India's banking system. Thus, banks need to lower lending rates to attract more borrowers. Major banks have lowered their lending rates across the board by 40 to 90 basis points. For example, the State Bank of India cut its mortgage rate from 9.1% to 8.6%. As deposits rise, the marginal cost of funding for commercial banks has also come down.

But this won't necessarily increase investment because supply bottlenecks and debt overhang still crimp corporate India's appetite for spending. Investment fell for three consecutive quarters in 2016 and is expected to fall further towards the year's end and in early 2017. So overall, the long-term benefits of demonetization remain uncertain.

Parsing through the polarized views on the efficacy of demonetization, there's little doubt over the short-term costs of overhauling high-value notes in an economy where most transactions—more than 90%—are cash-based. High-frequency indicators suggest that growth will slow sharply in the December and March quarters.

The composite Purchasing Managers' Index, which includes manufacturing and services, fell to 47.6 in December, down from 55.4 in October prior to demonetization. A reading below 50 indicates net pessimism, or net contraction. Industry will see growth curbed, especially in the auto sector, because consumers will scale back purchasing plans. Inventories of older car models have increased, which suggests that car production will slow: Vehicle registration fell 11% over the month in December.

Moreover, the latest Manpower survey of employment conditions showed hiring intentions slowed for the first quarter of 2017. And an additional hit to consumer sentiment is expected because uncertainty has increased on the back of the constant rule changes around daily deposit limits for the old currencies.

Though the long-term benefits of demonetization are uncertain, the long-term costs are also limited by India's relatively strong macro foundations. Economic reforms will lead to improvements in the business environment and buttress growth. For example, the goods and services tax, which will likely come into play later this year, will unify trade across India and open markets between states.

Elsewhere, measures of economic stability have improved. Foreign direct investment into India was on a strong footing in 2016 despite the weak domestic investment cycle. As China's economy decelerates, global brands are increasingly looking towards India as the next growth engine. Restrictions to FDI , such as requiring approvals in the single-brand retail markets, will likely be lifted to accommodate the increasing demand.

The optimism bodes well for India's current account deficit, which has come down sharply from the 2013 taper tantrum, when capital left emerging market economies. Strong FDI flows reduce India's reliance on the more volatile portfolio investment flows and provide current account stability. The current account deficit has come down remarkably over the last two years thanks to low fuel prices buttressing the trade balance. While rising global commodity prices pose downside risks to India's trade deficit, Moody's Analytics believes an uptick in exports on a global upswing will help offset higher fuel costs.

Ratings Round-Up

By Njundu Sanneh

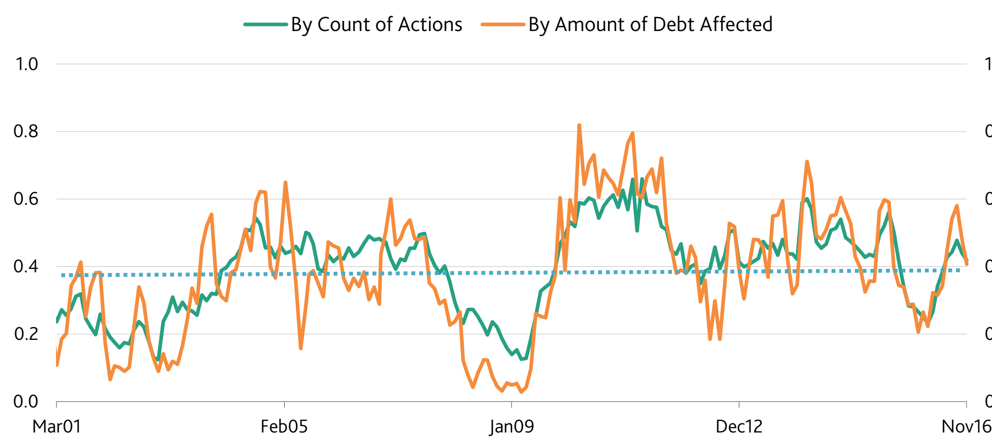
Downgrades in US, Upgrades in Europe

There were 14 US and four European rating changes the past week: mainly of speculative grade industrial companies, with two financial companies from Europe. Downgrades outpaced upgrades in the US, with 10 downgrades to four upgrades over the past week. The struggles of the US retail sector and continuing challenges in the energy sector are reflected in the downgrades of Sears Holding Corporation, Nine West Holdings Inc., and Sierra Hamilton LLC. Sears and Nine West were both downgraded due to poor operating performance and high debt levels despite efforts by both companies to stop the bleeding. In the case of the oil and gas company Sierra Hamilton the downgrade is the result of a missed interest payment in December and the likelihood of a restructuring in the near term.

The European rating change list was divided evenly between financials and industrials. Upgrades were three with only one downgrade. Oil and gas services company Seismic Services PLC of Cyprus was downgraded because of the cancellation or suspension of contracts signed by several oil companies. Related projects were abandoned or put on hold in view of the stalled oil price recovery.

FIGURE 1

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



* Trailing 3-month average

Source: Moody's

FIGURE 2

Rating Key

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

FIGURE 3 Rating Changes: Corporate & Financial Institutions – US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG
1/18/17	CABLE ONE, INC.	Industrial	SrUnsec	900	D	B1	B2	SG
1/18/17	TRANSUNION - Trans Union, LLC	Industrial	SrSec/BCF/LTCFR/PDR		D	B1	Ba3	SG
1/19/17	EXGEN TEXAS POWER, LLC	Industrial	SrSec/BCF		D	B1	B2	SG
1/19/17	NINE WEST HOLDINGS, INC.	Industrial	SrUnsec/Srsec/zbcf/LTCFR/PDR	709	D	Caa3	Ca	SG
1/20/17	INDIANTOWN COGENERATION FUNDING CORP., FL - Indiantown Cogeneration, L.P.	Industrial	Sub	396	U	Ba1	Baa2	SG
1/20/17	MOMENTIVE PERFORMANCE MATERIALS HOLDINGS LLC	Industrial	SrUnsec/SrSec/LTCFR/PDR	1,823	D	Ca	C	SG
1/20/17	SEARS HOLDINGS CORP.	Industrial	SrUnsec/SrSec/LTCFRR/PDR/BCF	1,710	D	Caa3	Ca	SG
1/20/17	SIERRA HAMILTON LLC	Industrial	SrSec/LTCFR/PDR	220	D	Caa3	C	SG
1/22/17	AVAYA, INC.	Industrial	SrSec/LTCFR/PDR	2,683	D	B2	Caa2	SG
1/23/17	TOPS HOLDING II CORPORATION	Industrial	SrUnsec/LTCFR/PDR	640	D	Caa2	Caa3	SG
1/23/17	UNITED CONTINENTAL HOLDINGS, INC.	Industrial	SrUnsec/SrSec/LTCFR/PDR/BCF	7,305	U	B1	Ba3	SG
1/24/17	CHIEF POWER FINANCE, LLC	Industrial	SrSec/BCF		D	B1	B2	SG
1/24/17	CIENA CORPORATION	Industrial	LTCFR/PDR		U	B1	Ba3	SG
1/24/17	KEURIG GREEN MOUNTAIN, INC.	Industrial	SrSec/BCF/LTCFR/PDR		U	Ba3	Ba2	SG

Source: Moody's

FIGURE 4 Rating Changes: Corporate & Financial Institutions – EUROPE

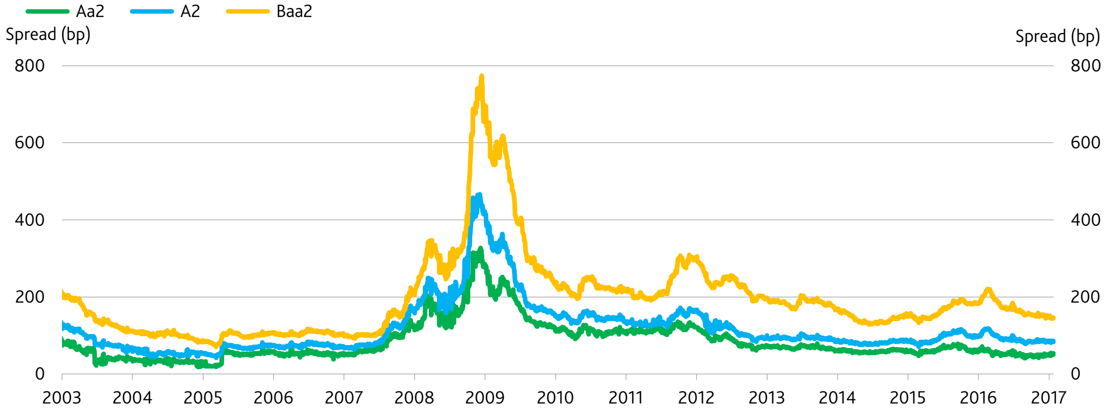
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG	Country
1/24/17	IG SEISMIC SERVICES PLC	Industrial	LTCFR/PDR		D	B3	Caa1	SG	CYPRUS
1/23/17	BANCO COMERCIAL PORTUGUES,	Financial	Sub/MTN/PS	1,388	U	Caa1	B3	SG	PORTUGAL
1/19/17	METALLURGICAL COMMERCIAL BANK	Financial	LTD		U	B2	B1	SG	RUSSIA
1/18/17	LION/GLORIA HOLDCO LIMITED	Industrial	LTCFR/PDR		U	B3	Ba1	SG	UNITED KINGDOM

Source: Moody's

Market Data

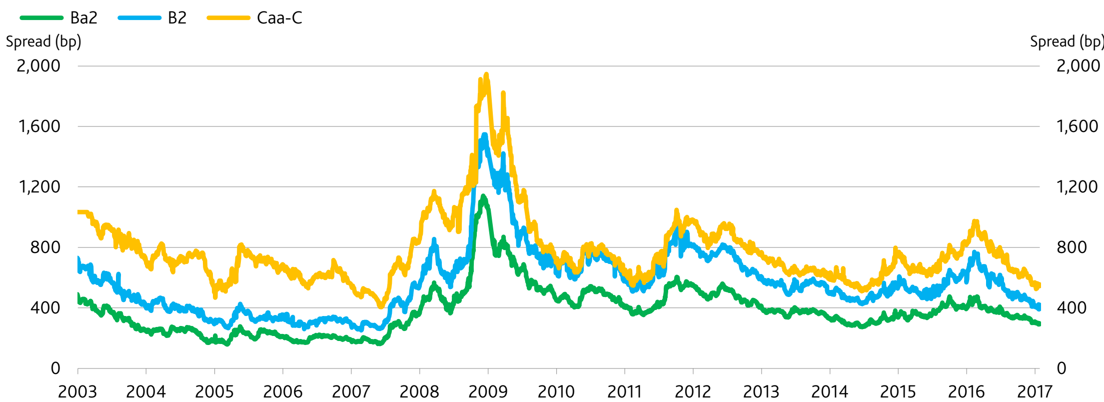
Spreads

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



Source: Moody's

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



Source: Moody's

CDS Movers

Figure 3. CDS Movers - US (January 18, 2017 – January 25, 2017)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jan. 25	Jan. 18	Senior Ratings
Bank of America, N.A.	Baa1	Baa2	A1
Oracle Corporation	Aa3	A1	A1
Johnson & Johnson	Aa2	Aa3	Aaa
21st Century Fox America, Inc	A2	A3	Baa1
CBS Corporation	A3	Baa1	Baa2
Union Pacific Corporation	Aa1	Aa2	A3
Honeywell International Inc.	Aa2	Aa3	A2
United Parcel Service, Inc.	Aa1	Aa2	A1
Newell Brands	Baa1	Baa2	Baa3
Freeport-McMoRan Inc.	B2	B3	B2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jan. 25	Jan. 18	Senior Ratings
Rite Aid Corporation	Ba2	Baa2	B3
CVS Health	A2	A1	Baa1
PepsiCo, Inc.	A3	A2	A1
General Motors Company	Ba2	Ba1	Ba1
FedEx Corporation	A3	A2	Baa2
Norfolk Southern Corporation	A2	A1	Baa1
CSX Corporation	A1	Aa3	Baa1
NRG Energy, Inc.	B3	B2	B1
Penney (J.C.) Corporation, Inc.	Caa2	Caa1	B3
Monsanto Company	Baa1	A3	A3

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jan. 25	Jan. 18	Spread Diff
Rite Aid Corporation	B3	176	71	105
Neiman Marcus Group LTD LLC	Caa2	712	623	89
AK Steel Corporation	Caa1	472	431	42
Hertz Corporation (The)	B2	612	574	38
United States Steel Corporation	Caa1	467	430	36
Talen Energy Supply, LLC	Ba3	778	746	32
Genworth Holdings, Inc.	Ba3	677	654	24
Diamond Offshore Drilling, Inc.	Ba2	363	340	23
Avis Budget Car Rental, LLC	B1	387	371	15
Pride International, Inc.	B1	458	446	12

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jan. 25	Jan. 18	Spread Diff
Sears Holdings Corp.	Caa3	3,175	3,531	-356
GenOn Energy, Inc.	Caa3	2,003	2,118	-115
K. Hovnanian Enterprises, Inc.	Caa3	1,354	1,437	-83
Parker Drilling Company	Caa1	720	803	-83
MBIA Insurance Corporation	Caa2	668	741	-74
Sears Roebuck Acceptance Corp.	Caa3	2,970	3,029	-59
Kate Spade & Company	B1	200	247	-47
Freeport Minerals Corporation	Ba2	309	355	-46
Freeport-McMoRan Inc.	B2	293	337	-44
Weatherford International, LLC (Delaware)	Caa1	427	468	-40

Source: Moody's, CMA

Figure 4. CDS Movers - Europe (January 18, 2017 – January 25, 2017)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jan. 25	Jan. 18	Senior Ratings
Germany, Government of	Aa1	Aa2	Aaa
Netherlands, Government of	Aa2	Aa3	Aaa
Nordea Bank AB	A3	Baa1	Aa3
ABN AMRO Bank N.V.	A3	Baa1	A1
Svenska Handelsbanken AB	A2	A3	Aa2
Bayerische Landesbank	A3	Baa1	A2
Danske Bank A/S	A2	A3	A2
Standard Chartered PLC	Baa3	Ba1	A1
ING Groep N.V.	A3	Baa1	Baa1
Swedbank AB	A2	A3	Aa3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jan. 25	Jan. 18	Senior Ratings
Eksportfinans ASA	Caa1	B1	Baa3
Eurobank Ergasias S.A.	Ca	Caa2	Caa3
Piraeus Bank S.A.	Ca	Caa2	Caa3
Selecta Group B.V.	Ca	Caa2	Caa2
The Royal Bank of Scotland Group plc	Ba1	Baa3	Ba1
Erste Group Bank AG	Ba1	Baa3	Baa1
Alpha Bank AE	Caa2	Caa1	Ca
Banco Popular Espanol, S.A.	Ba3	Ba2	Ba3
Greece, Government of	Ca	Caa3	Caa3
AstraZeneca PLC	A3	A2	A3

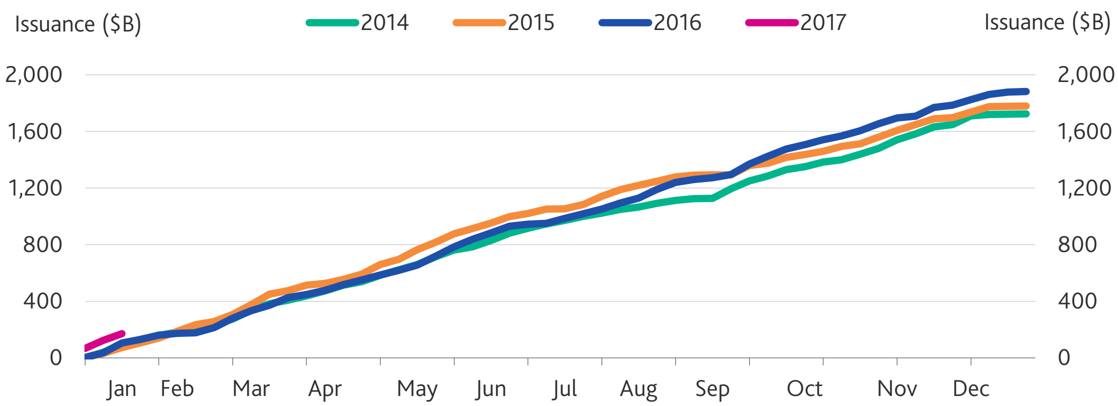
CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jan. 25	Jan. 18	Spread Diff
Eksportfinans ASA	Baa3	441	242	199
Norske Skogindustrier ASA	Caa3	2,743	2,678	65
The Royal Bank of Scotland Group plc	Ba1	145	110	36
Astaldi S.p.A.	B2	805	788	17
Matalan Finance plc	Caa2	1,344	1,328	16
Premier Foods Finance plc	Caa1	403	390	13
Ensco plc	B2	468	456	12
Care UK Health & Social Care PLC	Caa1	674	663	11
Barclays Plc	Baa2	97	87	9
Bank of Ireland	Baa2	156	148	9

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jan. 25	Jan. 18	Spread Diff
CMA CGM S.A.	B3	604	699	-95
Galapagos Holding S.A.	Caa2	820	905	-84
Boparan Finance plc	B2	441	521	-80
Novo Banco, S.A.	Caa1	1,265	1,342	-77
Greece, Government of	Caa3	937	984	-47
Vedanta Resources plc	B3	462	495	-33
Anglo American plc	Ba3	172	204	-32
Evraz Group S.A.	B1	350	376	-26
Stena AB	B3	589	614	-25
Fiat Chrysler Automobiles N.V.	B1	273	296	-24

Source: Moody's, CMA

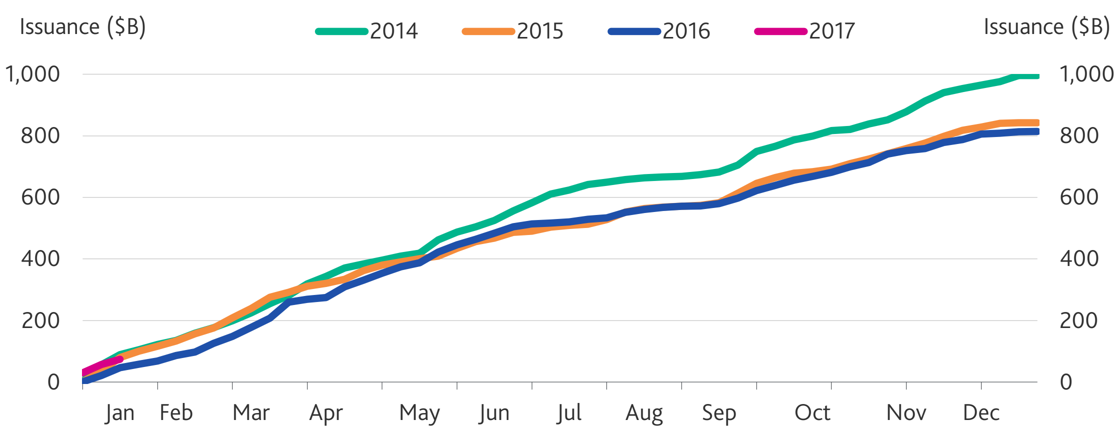
Issuance

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	37.088	7.775	47.255
Year-to-Date	131.504	23.183	171.525

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	13.570	1.593	16.569
Year-to-Date	66.348	5.777	73.602

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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