MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

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Economic Growth Slows as Ratio of Debt to GDP Climbs Ever Higher

Credit Markets Review and Outlook *by John Lonski*

Economic Growth Slows as Ratio of Debt to GDP Climbs Ever Higher

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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

Full updated stories and key credit market metrics: After plunging from a year earlier in May, high-yield bond issuance remains muted thus far in June.

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Credit Spreads	Investment Grade: We see year-end 2018's average investment grade bond spreads exceeding its recent 127 bp. High Yield: Compared to a recent 364 bp, the high-yield spread may approximate 425 bp by year-end 2018.
Defaults	US HY default rate: Moody's Default and Ratings Analytics team forecasts that the U.S.' trailing 12-month high-yield default rate will sink from April 2018's 3.7% to 1.5% by April 2019.
Issuance	In 2017, US$-denominated IG bond issuance grew by 6.8% to a record $1.508 trillion, while US$-priced high-yield bond issuance advanced by 33.0% to a new record calendar-year high of $453 billion. For 2018's US$-denominated corporate bonds, IG bond issuance may drop by 7.0% to $1.404 trillion, while high-yield bond issuance is likely to fall by 10.4% to $406 billion..

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Ratings Round-Up

U.S. Rating Revisions Turn Negative

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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: Defaults, higher rates, profit growth, credit quality, foreign investors, internal funds, tariffs, borrowing restraint, corporate bonds, tax law changes, stocks and spreads, Greek drama, South Korea, Brazil sovereign credit.

THIS REPORT WAS REPUBLISHED JUNE 11, 2018 TO UPDATE ECONOMIC FORECASTS FOR THE WEEK AHEAD.

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

Credit Markets Review and Outlook

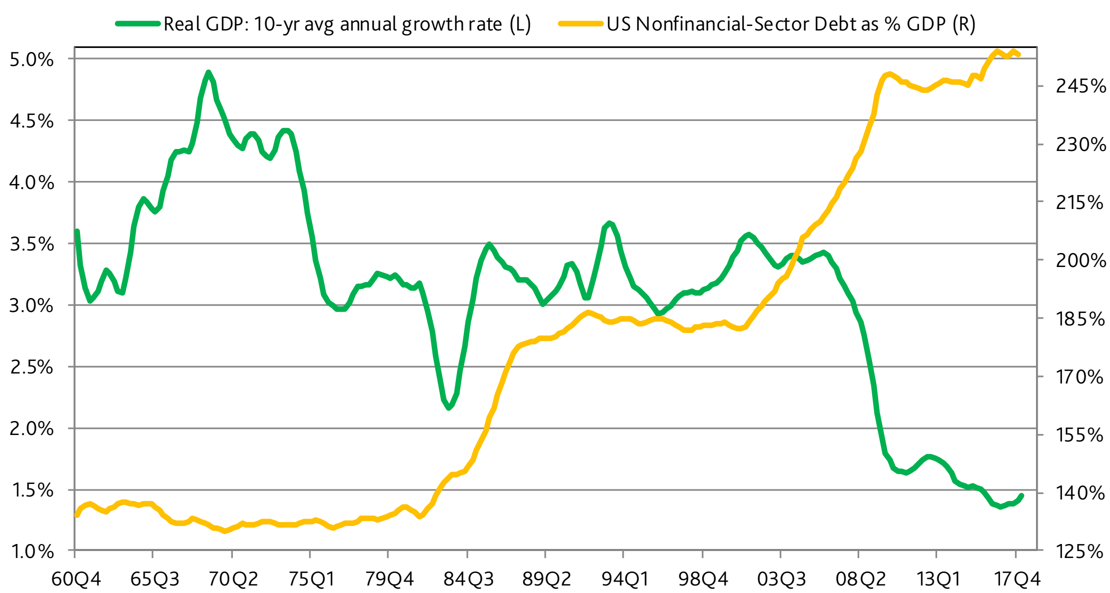
By John Lonski, Chief Economist, Moody's Capital Markets Research, Inc.

Economic Growth Slows as Ratio of Debt to GDP Climbs Ever Higher

Perhaps the speed at which GDP grows relative to debt matters more than the ratio of debt to GDP. The faster GDP grows relative to debt, the lower might be the risks surrounding the repayment of debt obligations. Expressed differently, the greater the return from debt capital, the lower should be the incidence of delinquencies, charge offs, and defaults. When productively employed, debt capital can more than pay for itself.

The U.S.' ratio of private and public nonfinancial-sector debt has soared from 1968's 131% to 2017's 253% of 2017. Nevertheless, the 10-year average annualized growth of U.S. real GDP decelerated from the 4.9% of the span-ended 1968 to the 1.4% of the span-ended 2017. Over time, higher ratios of U.S. nonfinancial-sector debt to nominal GDP failed to prevent a deceleration by U.S. real GDP's 10-year average annualized growth rate. Additional debt may have warded off hard times, but it apparently fell considerably short of lifting the underlying pace of business activity.

Figure 1: As Real GDP's 10-year Average Annual Growth Rate Slows, Ratio of US' Private & Public Nonfinancial-Sector Debt to GDP Climbs Higher



Just as the velocity of money (or the ratio of GDP to the M2 money supply) has slowed over time so has the velocity of debt (or the ratio of GDP to nonfinancial-sector debt). Today each dollar of nonfinancial-sector debt is accompanied by only $0.40 of GDP. By contrast, in 1968, each dollar of debt was joined by $0.76 of GDP. Each additional dollar of debt may now add considerably less to GDP than it did 50 years ago.

The Productivity of Debt Varies Across Business Cycle Upturns

Similar to how the relationship between M2 growth and GDP growth varies over time, the relationship between nonfinancial-sector debt growth and economic growth is far from constant. The 37% cumulative increase by nonfinancial-sector debt of the current business cycle upturn has been joined by a cumulative 38% increase in nominal GDP. In stark contrast, during the previous economic recovery of 2002-2007, the cumulative 37% increase by nominal GDP lagged far behind the 65% expansion of nonfinancial-sector debt. The imbalance of 2002-2007 reflects an excessive increase in home mortgage debt that outran personal income by enough to ultimately spark a mortgage repayment crisis.

Credit Markets Review and Outlook

Though 1991-2000's upturn had the cumulative 73% increase by nominal GDP outpacing debt's 69% increase, the high-yield default rate trended higher from 1998's second half into the start of 2001's recession. However, the late payment rates of household debt were relatively well behaved.

Figure 2: Nominal GDP Growth Lagged Far Behind Nonfinancial-Sector Debt Growth During Recoveries of 1983-1990 and 2002-2007

Business Cycle Upturn	Cumulative % Growth of Debt *1*	Cumulative % Growth of GDP *2*	Ratio of GDP Growth to Debt Growth *3*
December 1982 - June 1990	122%	75%	0.62
April 1991 - February 2001	69%	73%	1.06
December 2001 - November 2007	65%	37%	0.57
July 2009 - present	37%	38%	1.01

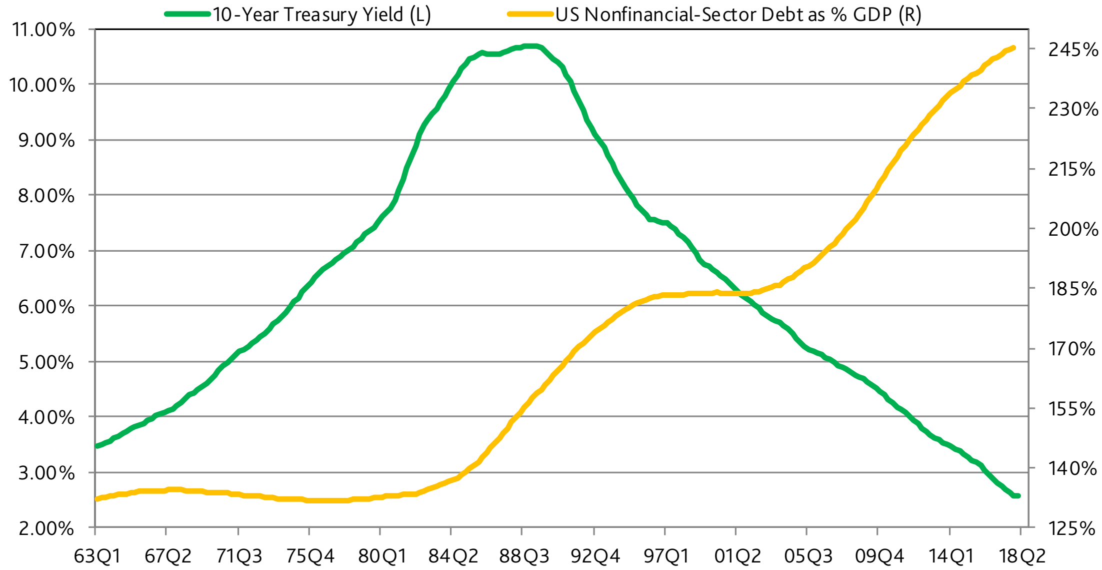
sources: Federal Reserve, BEA, Moody's Analytics

Treasury Bond Yields Decline Amid Rising Ratio of Debt to GDP

Despite how nonfinancial-sector debt moving 10-year average has increased from 1978's 132% to 2017's 245% of nominal GDP's moving 10-year average, the 10-year Treasury yield's accompanying moving 10-year average fell from 7.22% to 2.59%. The declining trend of the 10-year Treasury yield amid a rising ratio of debt to GDP seems counterintuitive. After all, shouldn't an increase in the supply of debt relative to overall economic activity lower the price of credit market instruments and, thereby, put upward pressure on interest rates?

In all likelihood, expectations concerning core consumer price inflation and real economic growth wield more influence over interest rates than the amount of outstanding debt relative to GDP. It may be nonsensical to expect interest rates to decline as outstanding debt rises relative to GDP all else being the same. Nonetheless, a high ratio of debt to GDP may create a repayment burden that heightens the economy's sensitivity to higher interest rates. If each percentage point increase by interest rates slows business activity more quickly as the ratio of debt to GDP climbs higher, the upside for benchmark interest rates may be lower than otherwise as an economy's debt leverage steepens.

Figure 3: Elevated Ratio of Private & Public Nonfinancial-Sector Debt to GDP Reins in Treasury Bond Yields
moving 10-year averages
sources: Federal Reserve, Moody's Analytics



Nominal GDP's Underlying Growth Rate Leads Treasury Bond Yields

The record shoes that the growth of nominal GDP tends to lead the path taken by the 10-year Treasury yield. When nominal GDP's 10-year average annualized growth rate accelerated from the 5.1% of the span-ended 1963 to its 10.6% zenith of the span-ended 1981, the 10-year Treasury yield's moving 10-year average would increase from 1963's 3.56% to 1981's 8.69% and would not crest until reaching the 10.69% of 1988.

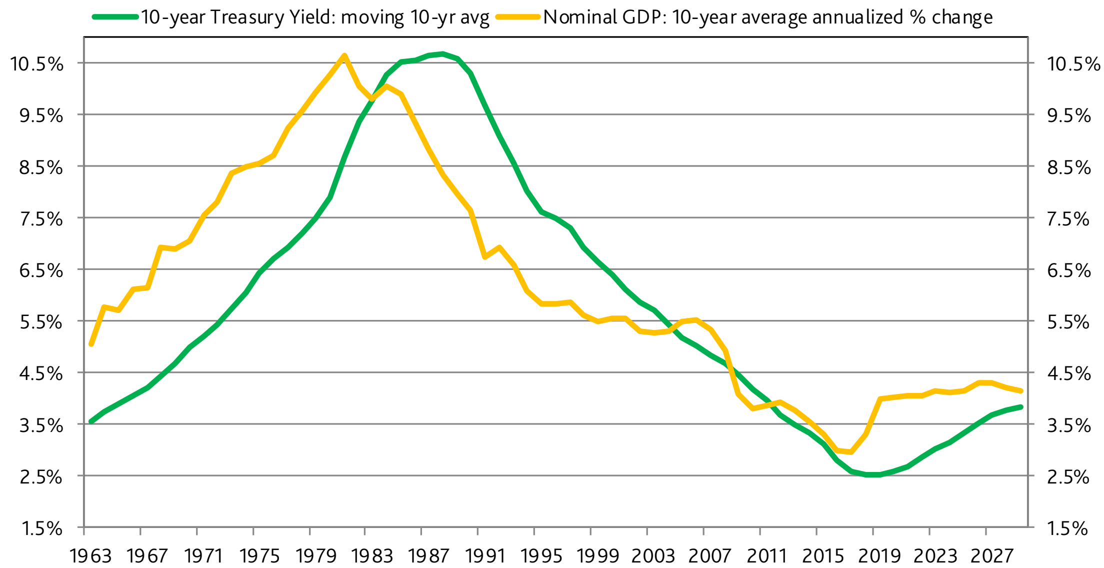
Note how nominal GDP's 10-year average annualized growth rate exceeded the 10-year Treasury yield's moving 10-year average through 1981. Thus, there is no guarantee that the 10-year Treasury yield will be equal to or greater than nominal GDP growth.

By 1988, the 10-year average annualized growth rate of nominal GDP had slowed to 8.3%. A subsequent deceleration by nominal GDP's 10-year annualized growth rate to 2017's 3.0% was joined by a drop for the moving 10-year average of the 10-year Treasury to 2017's 2.59%.

According to the recent trend and the latest Blue Chip consensus forecasts, nominal GDP's 10-year average annual growth rate bottomed in 2017 and is likely to rise to 3.3% in 2018. Thereafter, the 10-year growth rate is expected to inch higher until peaking at the 4.3% of the span-ended 2027. By 2027, the 10-year Treasury yield's moving 10-year average is expected to have reached 3.69% and is projected to extend its climb to 3.85% by 2029.

Apparently, the Treasury bond yield forecasts of the Blue Chip consensus make no allowance for the likelihood of a recession by 2029. After climbing up from 2017's 2.33% to 3.0% in 2018 and 3.4% in 2019, the consensus has the 10-year Treasury yield remaining at 3.8% from 2020 through 2024 and then averaging 3.9% during 2025 through 2029. To the contrary, when the next recession arrives most likely well before 2029, the benchmark Treasury bond yield will probably temporarily sink under 2%.

Figure 4: Blue Chip Consensus Puts Averages Over the Next 10 Years At 4.17% for Nominal GDP Growth and 3.85% for the 10-year Treasury Yield
10-year observations, actual & predicted



Federal Debt Accelerates as Debt Growth Elsewhere Is Unchanged

On June 7, the Federal Reserve released its first-quarter 2018 estimates of outstanding private and public nonfinancial-sector debt via the Financial Accounts of the United States. In a manner that helps to explain 2018's upswing by interest rates, the year-to-year growth rate of the U.S.' private and public nonfinancial-sector debt quickened from Q1-2017's 3.7% to Q1-2018's 5.1%. However, that acceleration was the offshoot of a jump by the annual increase of U.S. government debt from Q1-2017's 3.3% to Q1-2018's 7.4%. The remaining nonfinancial-sector debt grew by 3.9% yearly for both Q1-2017 and Q1-2018.

The year-to-year growth rate for U.S. nonfinancial-corporate debt edged higher from Q1-2017 5.0% to Q1-2018's 5.2%. First-quarter 2018's $5.426 trillion of outstanding U.S. nonfinancial-corporate bonds increased by 4.3% annually, while the $5.396 trillion of outstanding nonfinancial-corporate debt excluding bonds and mortgages advanced by 7.1% annually. In 2017's first quarter, the annual increases were nearly identical at 5.2% for bonds and 5.3% for debt excluding bonds and mortgages.

The simultaneous slowing of bond growth and acceleration by the outstandings of variable-rate business loans and commercial paper suggest companies do not expect an extended and large increase by benchmark Treasury bond yields.

The much faster growth of Treasury debt vis-a-vis corporate bonds helps to explain why the average 10-year Treasury yield jumped up from Q1-2017's 2.44% to Q1-2018's 2.76%, while corporate bond yield spreads over Treasuries narrowed from 167 bp to 153 bp for the long-term Baa industrial company bonds and from 397 bp to 353 bp for high-yield bonds.

The Week Ahead – U.S., Europe, Asia-Pacific

THE U.S.

By Ryan Sweet of Moody's Analytics

All signs point to a fed funds rate hike

It's a busy week. We expect the Federal Open Market Committee to raise the target range for the fed funds rate by 25 basis points to 1.75% to 2%, as the labor market is strong, inflation is approaching the central bank's 2% target and GDP growth is clearly accelerating. Our high-frequency GDP model has second quarter GDP growth on track to rise 4% at an annualized rate, implying the unemployment rate has nowhere to go but lower. This will fan concerns within the FOMC that the labor market will noticeably overshoot NAIRU, bringing significant challenges for the central bank down the road.

A small technical realignment of the IOER—interest on excess reserves—relative to the top of the target range for the fed funds rate is likely in June. Since the target range was established in December 2008, the IOER has been set at the top of the target range to help keep the effective federal funds rate within the range. Lately the spread of the IOER over the effective federal funds rate had narrowed to only 5 basis points. A technical adjustment of the IOER to a rate 5 basis points below the top of the target range could keep the effective federal funds rate well within the target range. This change was suggested in the May FOMC minutes. There will be some changes to forward guidance and we look for a modest hawkish change to the interest rate projections for this year and next.

On the data front, the core CPI likely rose 0.2% and favorable base effects will put year-over-year growth at 2.3%. We look for a decent gain in retail sales in May while industrial production was likely soft.

	Key indicators	Units	Moody's Analytics	Consensus	Consensus Range	Last
Mon @ 10:00 a.m.	Moody's Analytics Business Confidence	index, 4-wk MA				36.1
Tues @ 6:00 a.m.	NFIB Small Business Survey for May	index	105.0	104.8	104.0 to 105.5	104.8
Tues @ 8:30 a.m.	Consumer Price Index for May	% change	0.2	0.2	0.2 to 0.4	0.2
	Core CPI	% change	0.2	0.2	0.1 to 0.2	0.1
Wed @ 8:30 a.m.	Producer Price Index for May	% change	0.3	0.3	0.2 to 0.5	0.1
	Core PPI	% change	0.2	0.2	0.1 to 0.3	0.2
Wed @ 2:00 p.m.	FOMC Monetary Policy for June	%	1.75 to 2.00	1.75 to 2.00	1.50 to 2.00	1.50 to 1.75
Thur @ 8:30 a.m.	Jobless Claims for 6/9/18	ths	225	222	217 to 227	222
Thur @ 8:30 a.m.	Import Prices for May	% change	0.7	0.5	0.3 to 1.0	0.3
	Excluding fuels		0.3	0.2	0.1 to 0.2	0.1
Thur @ 8:30 a.m.	Retail Sales, advanced for May	% change	0.4	0.4	0.1 to 0.5	0.3
	Excluding autos	% change	0.4	0.5	0.3 to 0.6	0.3
Thur @ 10:00 a.m.	Business Inventories for April	% change	0.3	0.3	0.3 to 0.4	0.0
Fri @ 8:30 a.m.	NY Empire State Manufacturing Survey for June	index	17.1	18.0	16.0 to 23.0	20.1
Fri @ 9:15 a.m.	Industrial Production for May	% change	0.1	0.3	-0.1 to 0.6	0.7
	Capacity Utilization	%	77.7	78.2	77.8 to 78.5	78.0
Fri @ 10:00 a.m.	Michigan sentiment for June, preliminary	index	97.8	98.4	97.2 to 100	98.0

MONDAY, JUNE 11

Business confidence (week ended June 8; 10:00 a.m. EDT)

Forecast: N/A

Global businesses remain optimistic. Sentiment is especially strong in the U.S., as it has been for much of the past several years, likely most recently buoyed by corporate tax cuts. The strong confidence is impressive given the recent volatility in global financial markets, and prospects for higher U.S. tariffs and heightened trade tensions between the U.S. and many of its trading partners.

However, global business sentiment has softened a bit in recent weeks. Behind the softening is rising nervousness around the business outlook by year's end. Expectations are near the bottom of the range that has prevailed throughout much of this economic expansion.

Businesses' biggest concern is around regulatory and legal issues, although this concern is receding with about one-third of respondents saying those are their greatest worry. Worries about the cost and availability of labor are on the rise and are now the top concern of nearly one-fourth of respondents.

The four-week moving average in our global business sentiment survey fell from 37.1 to 36.1 in the week ended June 1.

TUESDAY, JUNE 12

Consumer prices (May; 8:30 a.m. EDT)
Forecast: 0.2% (headline)
Forecast: 0.2% (core)

We look for both the headline and core CPI's to have risen 0.2% between April and May. We look for a fairly modest gain energy prices in May while food prices are forecast to have risen 0.1%. Excluding food and energy, the CPI likely rose 0.2% (0.22% unrounded). We look for some payback for the weakness in airfare and used vehicle prices in April. Rents likely moderated in some in May after firming in April. On a year-ago basis, the headline CPI was likely up 2.7% while the core index rose 2.3%.

WEDNESDAY, JUNE 13

Producer price index (May; 8:30 a.m. EDT)
Forecast: 0.3% (headline)
Forecast: 0.2% (core)

The forecast is for producer prices to have risen 0.3% in May. Some of the gain is attributed to higher energy prices but a drop in food prices will provide a little offset. Excluding food and energy, the PPI likely rose 0.2%. On a year-ago basis, the headline and core PPI's were likely up 2.9% and 2.3%, respectively.

THURSDAY, JUNE 14

Jobless claims (week ended June 9; 8:30 a.m. EDT)
Forecast: 225,000

Initial claims for unemployment insurance benefits are expected to have risen from 222,000 to 225,000 in the week ending June 9. This would leave new filings in line with their prior four-week moving average. New filings are not a perfect measure of layoffs since the propensity for a laid-off worker to file a claim, also known as the take-up, fluctuates depending on where the economy is in the business cycle. With the labor market tight and a large number of job openings, the take-up rate is low.

Retail sales (May; 8:30 a.m. EDT)
Forecast: 0.4% (total)

Our preliminary forecast is for retail sales to have risen 0.4% in May. Vehicle sales likely were a neutral for total retail sales growth even though unit sales fell in May. Higher gasoline prices likely boosted nominal spending at gasoline stations and is forecast to have added 0.1 percentage point to retail sales growth. Building material store sales were weak in April but that was likely weather-related. Still, we don't expect any contribution from building material store sales in May. Excluding autos, retail sales likely rose 0.4%.

We will finalize our forecast for retail sales after the CPI.

FRIDAY, JUNE 15

Industrial production (May; 9:15 a.m. EDT)
Forecast: 0.1% (total)

Industrial production was likely up 0.1% in May. Autos were likely a drag on industrial production but this will be slightly more than offset by a rise in utilities and mining production. The rise in utilities is likely weather related as May was warmer than normal. Rising global energy prices should continue to support gains in mining output.

EUROPE

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

ECB to meet amid doubts about its next steps

Following two busy weeks, the period ahead brings an additional barrage of top-tier data for the U.K. and euro zone economies. Among the major releases will be the final CPI and industrial production figures for the euro zone, as well as unemployment, retail sales and inflation figures for the U.K. But in the spotlight will be the European Central Bank, whose monetary policy committee is expected to meet on Thursday to decide on the single-currency area's policy path. June's meeting is especially important, because the recent turmoil in financial markets due to the political chaos in Italy has raised doubts about the ECB's next steps. We previously expected that the ECB would use this pre-summer meeting to announce its strategy on ending its asset purchase programme, but we have shifted our expectations and now forecast that the bank will wait until July before announcing that QE will be finished via a gradual taper to zero in the fourth quarter.

Our view is that the recent jump in the area's headline inflation rate should provide enough cover for the bank to proceed with its tapering plans. Final CPI figures due Friday should confirm that inflation accelerated to 1.9% in May, from 1.2% in April, on the back of increases in energy and services inflation. The CPI data are unlikely to give the MPC any summer breather. The recent rise in Brent prices will push energy inflation higher in June and July, leading the headline rate to jump past 2%. True, services inflation should edge back slightly in June, after it surged on the back of a reversal of the Easter effect in May. But our view is that services inflation will gradually pick up from July, in line with the developments in the labour market, while the trend in core goods and food inflation is also to the upside.

The ECB is thus likely to be afraid of delaying action on QE when inflation is at target and growth remains solid, and of losing this window of opportunity. The prospect of rate hikes next year, however, is fading rapidly. Already, market-implied short-term interest rates for the end of next year have plunged over the past few weeks. Growth is clearly slowing—we expect that the euro zone's expansion will ease to 2% in 2018, from 2.5% last year—while core inflation pressures are still a far cry from the ECB's target of 2%. Market volatility and the recent rise in two-year yields in Italy and other southern European countries only add to the woes. Our view is thus that the bank will wait at least until summer 2019 before announcing a first hike in the deposit rate. The move should come by the third quarter, while the main refinancing rate should not be raised before the start of 2020.

The Week Ahead

	Key indicators	Units	Moody's Analytics	Last
Mon @ 9:00 a.m.	Italy: Industrial Production for April	% change	-0.2	1.2
Mon @ 9:30 a.m.	U.K.: Industrial Production for April	% change	-0.1	0.1
Tues @ 9:30 a.m.	U.K.: Unemployment for April	%	4.2	4.2
Wed @ 8:00 a.m.	Spain: Consumer Price Index for May	% change yr ago	2.0	1.1
Wed @ 9:30 a.m.	U.K.: Consumer Price Index for May	% change yr ago	2.4	2.4
Wed @ 10:00 a.m.	Euro Zone: Industrial Production for April	% change	-0.7	0.5
Wed @ 11:00 a.m.	OECD: Composite Leading Indicators for April		100.0	100.0
Thur @ 7:00 a.m.	Germany: Consumer Price Index for May	% change yr ago	2.2	1.5
Thur @ 7:45 a.m.	France: Consumer Price Index for May	% change yr ago	2.3	1.8
Thur @ 9:30 a.m.	U.K.: Retail Sales for May	% change yr ago	2.9	1.4
Thur @ 12:45 p.m.	Euro Zone: Monetary Policy for June	%	0.0	0.0
Fri @ 10:00 a.m.	Italy: Consumer Price Index for May	% change yr ago	1.2	0.6
Fri @ 10:00 a.m.	Euro Zone: External Trade for April	€ bil	15.0	26.9
Fri @ 10:00 a.m.	Euro Zone: Consumer Price Index for May	% change yr ago	1.9	1.2
Fri @ 11:30 a.m.	Russia: Monetary Policy for June	%	7.3	7.3
Fri @ 2:00 p.m.	Russia: Industrial Production for May	% change yr ago	1.4	1.3

MONDAY, JUNE 11

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

Industrial production in Italy likely contracted by 0.2% m/m in April, following a 1.2% increase in March. Business and consumer confidence is retreating as the political and economic uncertainty intensifies. Weaker gains in output and new orders drove down Italy's Markit manufacturing PMI to its lowest in six months in May, signaling reduced activity ahead. Global capacity constraints are a concern, as supply-side constraints are lengthening delivery times and pushing up input prices. Consumer demand has softened domestically and abroad due to elevated political uncertainty and slower economic growth, contributing to the decline in production.

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

We forecast that U.K. industrial production shed 0.1% m/m in April, reversing a 0.1% gain in March. This should have pushed the yearly rate down to only 2.5%, from 2.9% previously, though it still exceeds the 1.7% average for the past 12 months. Across sectors, developments were likely mixed. Growth in energy production is expected to have dragged the most on the headline, the same story as in the other European countries. Temperatures climbed sharply in April throughout Europe, and in the U.K. they read 1°C above their seasonal norm over the month, following an unseasonably chilly end to the first quarter. This is expected to have depressed demand for heating and thus for utilities production. By contrast, mining and quarrying likely recovered following declines in February and March, which were largely attributable to planned maintenance in pipelines and oil fields.

Production in the manufacturing sector was probably unimpressive, following an already-disappointing 0.1% decline in March, the second in a row. The picture for the subsector is uneven, but drops in machinery and equipment and in other manufacturing output are expected to have offset increases in pharmaceuticals and electrical equipment. All leading surveys show that the support to growth in manufacturing output from sterling's depreciation is fading now that more than 18 months have passed since the Brexit vote. Capacity constraints are also biting because Brexit uncertainty is preventing firms from investing to increase capacity.

TUESDAY, JUNE 12

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

The U.K.'s headline unemployment rate likely held steady at 4.2% in the three months to April, its lowest since 1975. Growth in the number of employed persons is expected to have eased somewhat following a sharp jump in the January quarter, while the number of unemployed likely fell marginally following an increase previously, the first since the start of 2012. Survey data for May remained upbeat, showing that permanent staff appointments continued to rise at a marked pace in the middle of the quarter, and so did growth in temp billings. This led to severe staff shortages, underpinning further increases in salaries.

We nonetheless expect that employment growth will slow in 2018 compared with 2017's strong gains, as now little slack remains in the economy.

WEDNESDAY, JUNE 13

Spain: Consumer Price Index (May; 8:00 a.m. BST)

Spain's headline inflation likely picked up to 2% in yearly terms in May from just 1.1% recorded previously, driven by higher fuel and electricity prices. We expect core prices were largely unchanged from a month ago. Consumption languished in the first three months of the year and we are penciling in further softening as the oil price pass-through constrains the purchasing power of households. In the near term, a strong rebound in commodity prices coupled with an uptick in tourism-related services could temporarily drive the headline above the ECB's target. But the underlying picture is not one of mounting price pressures. A slowdown in GDP growth and in labour absorption implies subdued domestic demand.

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

The U.K.'s annual headline CPI should have remained steady at 2.4% in May, as rises in motor fuels and in transportation services inflation are expected to have been offset by declines in electricity, food and core goods prices. First, the recent jump in Brent prices to an average $77 per barrel in May, compared with $50 in May 2017, is expected to have boosted motor fuels' contribution to the headline by 0.25 percentage point, from 0.11 percentage point in April. Second, transport inflation should have rebounded sharply over the month following an early Easter-related decline in April, lifting services inflation and the core rate by 0.2 percentage point.

By contrast, electricity inflation is likely to have cooled further. Although several of the U.K.'s big six electricity companies hiked electricity and gas prices in May last year, most of this year's rises will only come in June, warranting a dip in electricity inflation's contribution to the headline in May before a rebound at the end of the quarter. And food inflation is also expected to have edged back somewhat, in line with the easing in producer price food inflation recently, while most of the U.K.'s food retailers have already finished passing through the sterling-related jump in import prices to consumers. Core goods inflation should have weakened to 1.8%, from 2.1%, given the stabilization of import prices over last year. Our view is that core goods inflation will fall to about zero by the end of 2018.

Higher electricity and fuel prices should nonetheless push the headline higher, likely to 2.7%, by June and July, though base effects will ensure that it falls swiftly in the third and fourth quarters, before hitting target at the end of the year.

Euro Zone: Industrial Production (April; 10:00 a.m. BST)

Industrial production in the euro zone likely fell by 0.7% m/m in April, fully reversing a 0.5% rise in March. Across countries, already released figures have been dismal; output excluding construction plummeted by 1.7% m/m in Germany, by 0.7% in Spain and by 0.5% in France. Results are not yet available for Italy, or for any countries outside the core economies, but we expect that data there won't bring much joy either. The main story behind the broad-based disappointments is that higher-than-average temperatures across the Continent depressed demand for heating and thus energy production in most countries following jumps in February and March. We are more optimistic about manufacturing, since we expect that upbeat results in France will partially offset Germany's dire numbers. Leading indicators for May have nonetheless come in soft, confirming our view that production will slow in 2018 following the stellar results for 2017, though they still point to a solid pace of expansion.

THURSDAY, JUNE 14

Germany: Consumer Price Index (May; 7:00 a.m. BST)

Preliminary estimates show that Germany's yearly inflation accelerated sharply in May, reaching 2.2% and climbing above the ECB's target of close to but below 2% for the first time since early 2017. The rate of increase in both goods and services prices accelerated strongly from April. Food price inflation ticked up to 3.5% in May. Energy prices also spiked, reaching 5.2% y/y, up from 1.3% in April largely due to a further increase in oil prices. The price of Brent crude gained 6.8% m/m and 53% y/y to $76.87 per barrel on average in May. Meanwhile, the euro weakened against the U.S. dollar, falling to $1.18 in May from $1.23 in the previous month, adding some inflation pressures. The seasonally adjusted CPI likely reached 2.2% y/y in May as well.

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

Rising oil and food prices pushed French harmonized inflation up to 2.3% y/y in May, from 1.8% in the previous month. But services inflation, which is a better gauge of underlying demand, did not budge, indicating that price pressures are practically nil despite the labour market tightening and stronger pay gains. We expect that higher oil prices will remain the main driver of the headline in coming months, possibly keeping the headline above the ECB's target for a while. Core inflation should only gradually firm in coming months as GDP growth will bounce back from the lackluster Q1 performance and print around 0.5% to 0.6% q/q.

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

U.K. retail sales likely grew by a further 1% m/m in May, building on an already-strong 1.4% gain in the previous month. This should have pushed the yearly rate up sharply to 2.9%, from 1.4% in April, more than doubling the past-year average of 1.4%. Over the month, the main source of growth was likely a further rebound in spending in weather-sensitive sectors after a bitterly cold first quarter, as temperatures in May remained elevated. The royal wedding and the Champion League's final are expected to have provided a boost, too. Accordingly, leading indicators for May have come in rather strong—the BRC gauge of like-for-like sales rose to 2.8% y/y, from a 4.2% decline in April, while the CBI reported sales balance recovered to +11 in May, from -2 previously. Despite our optimistic forecasts for May, we remain cautious about the outlook for retail sales in 2018. Households' borrowing costs are set to rise, take-home pay has recently been squeezed by an increase in the minimum pension contributions, and the housing market remains in the doldrums; this all should keep a lid on consumer spending. The good news is that real wages returned to growth recently, which should in turn boost consumer confidence.

Euro Zone: Monetary Policy (June; 12:45 p.m. BST)

We expect the ECB's June meeting won't be as exciting as markets expect. First, rates will be kept unchanged and so will the bank's quantitative easing program. Second, we think that Mario Draghi now will refrain from making any changes to the bank's forward guidance. He is likely to wait until July before announcing that QE will be finished via a gradual taper to zero in the fourth quarter. The recent turmoil in financial markets combined with soft data for the second quarter underpins our forecast of no move next week, but we still expect that the recent jump in the area's headline inflation rate will provide enough cover for the bank to proceed with its tapering plans later this year. To that we add that CPI data is unlikely to give the MPC any breather over the summer. The recent rise in Brent prices will push energy inflation higher in June and July, lifting the headline rate past 2%.

The prospects for rate hikes next year, however, have faded. Growth is clearly slowing—we expect the euro zone's expansion will ease to 2% in 2018, down from 2.5% last year—while core inflation pressures are still a far cry from the ECB's target of 2%. Market volatility and the recent rise in two-year yields in Italy and other southern European countries only add to the woes. Our view is that the ECB will wait at least until summer 2019 before announcing a first deposit rate hike. The move should come by the third quarter, while the main refinancing rate should not begin being lifted before the beginning of 2020.E

FRIDAY, JUNE 15

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

Inflation in Italy likely strengthened in May as price pressures increased. We expect inflation accelerated to 1.2% y/y, following a disappointing 0.6% gain in April. According to preliminary estimates, the rising cost of unprocessed food and nonregulated energy products drove the uptick. Producer prices are increasing as a result of supply-side constraints, and this is contributing to rising construction costs due to higher material costs. Price growth will likely pick up this year as steady economic growth and an improving labour market drive up material and labour costs.

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

The euro zone's external trade balance likely narrowed to around €15 billion in April, following a surplus of €26.9 billion at the end of the first quarter. The balance was in surplus of €15.7 billion in April 2017. Imports and exports are each expected to have remained muted. Slowing economic activity within the single-currency bloc likely weighed on imports in the first quarter of the year. Preliminary estimates showed that the quarterly expansion rate almost halved in the three months to March compared with the end of 2017. Meanwhile, various geopolitical tensions are keeping the outlook for the euro zone trade balance clouded.

The British exit from the EU may hamper trade between the two parties in the coming years, and the impact of Trump's policies, including recent steel import tariffs, could curb euro zone exports to its biggest trade partner, or even result in a global trade dispute.

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

Final CPI figures for the euro zone should confirm that inflation soared to 1.9% in May, from 1.2% in April, on the back of increases in energy and services inflation. Higher Brent prices are expected to have pushed energy inflation to around 6.1%, from 2.6% in April, while base effects will ensure that this upward trend carries into the summer. But core inflation is expected to have picked up as well, to 1.1%, from 0.7% in April. This uptick was likely due solely to a rebound in services inflation to 1.6%, from 1%, as the Easter effect reversed and boosted transportation inflation. Nonenergy goods inflation, by contrast, likely cooled to just 0.2%. This is again well below its 0.5% average for the past six months, and likely due to still-subdued clothing inflation. We forecast that food inflation accelerated slightly.

Russia: Monetary Policy (June; 2:00 p.m. BST)

The Bank of Russia will likely stand pat at its June meeting and keep the key rate at 7.25%. Considering the latest wave of economic sanctions, the likely inflation effect of the weaker ruble's pass-through from April, and rising oil prices, a moderately tight stance appears appropriate. With the latest estimate of the neutral rate upwardly revised to 6% to 7%, policy normalization might draw to an end this year. Governor Elvira Nabiullina has hinted that businesses should not hold out hope for eternally declining rates, and should start preparing for policy hikes in the near future. The central bank may take a pause until the exact details of the government's tax overhaul and the budget drafts are known. Equally important is for policymakers to wait for more data to better understand how the economy is coping with the sanctions.

ASIA-PACIFIC

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

China's May data will show strength in Q2, with the usual weak spots

China's May activity and price data are the highlight this week and ongoing strength is expected, but with the usual weak spots. China's industrial production accelerated in April, with growth in automotives and electronics outweighing continued softness in mining industries. Heavy industrial goods output remains constrained by overcapacity. Positive manufacturer sentiment for new orders suggests a pickup in May production, although there are some concerns of a slowdown ahead if trade tensions escalate. China's retail trade lost steam in April but the outlook remains positive. Auto sales have been slowing but increased subsidies for certain electric cars should reverse the trend. Steady wage growth and good employment conditions underpin growth in retail spending.

Credit growth in China continues to decelerate as part of the government's renewed commitment to clamp down on financial risks. The central bank has been cracking down hard on shadow forms of lending, and restrictions and increased transparency on local government borrowing are also slowing credit growth. That said, the People's Bank of China's late-April reserve ratio cut will free up funds in the near term for banks to lend.

Investment in fixed assets in China slowed in April. Overcapacity in heavy industry and lower prices for commodities mean the outlook for the sector remains grim. Outside mining, though, public-led infrastructure spending is outperforming, and is alleviating softness in residential construction.

Inflation pressures in China remain quiescent, with food price disinflation leading the overall index lower. High pork supplies are keeping prices at a multiyear low. Elsewhere, housing-related inflation has been kept under control thanks to government cooling measures in major cities. One risk is potential trade restrictions, which could raise soybean, beef, and other prices. Consumer prices likely cooled to 1.7% y/y in May, from the 1.8% gain in April.

India's consumer price index reached a four-month high in April and we expect further acceleration in May. Inflation is likely to edge higher in the near term because of oil prices and the weaker rupee, which has been one of Asia's worst performing currencies this year as emerging market outflows have heated up. The Reserve Bank of India increased the repo rate to 6.25% at its June monetary policy meeting to try to stem capital outflows and anchor inflation expectations. Further tightening is on the cards if pressure continues from the rupee and more broadly capital outflows.

We expect India's trade deficit widened in May. Besides the weaker rupee, high oil prices have kept the trade deficit relatively large. India is the world's third largest oil importer, sourcing around 80% of its oil needs from overseas, so is vulnerable to oil price rises.

	Key indicators	Units	Moody's Analytics	Last
Mon @ 9:50 a.m.	Japan Machinery orders for April	% change	1.0	-3.9
Tues @ Unknown	China Monetary aggregates for May	% change yr ago	8.5	8.3
Tues @ 11:30 a.m.	China Consumer price index for May	% change yr ago	1.7	1.8
Tues @ 11:30 a.m.	China Producer price index for May	% change yr ago	3.8	3.4
Tues @ 10:00 p.m.	India Consumer price index for May	% change yr ago	4.8	4.6
Tues @ 10:20 p.m.	India Industrial production for April	% change yr ago	6.6	4.4
Thurs @ 11:30 a.m.	Australia Unemployment rate for May	%	5.5	5.6
Thurs @ 12:00 p.m.	China Fixed asset investment for May	% change yr ago YTD	6.8	7.0
Thurs @ 12:00 p.m.	China Industrial production for May	% change yr ago	7.1	7.0
Thurs @ 12:00 p.m.	China Retail sales for May	% change yr ago	10.3	10.3
Fri @ Unknown	India Foreign trade for May	US$ bil	-15.2	-13.7
Fri @ 9:00 p.m.	South Korea Unemployment rate for May	%	3.8	3.8
Fri @ Unknown	Japan Monetary policy for June	¥ bil	80	80

MONDAY, JUNE 11

Japan: Machinery Orders (April; 9:50 a.m. AEST; Sunday, 11:50 p.m. GMT)

Japan's core machinery orders likely rose by 1% m/m in April, following the 3.9% fall in March. Machinery orders are volatile, and 2018 has been no different. Looking through the monthly jumps, core machinery orders have averaged a 2.1% monthly expansion through the first three months of the year, a decent pace by all accounts. Machinery orders lead capital expenditure by six to eight months. We expect Japan's capital expenditure pipeline to improve in the second half of 2018, but a large uptick in spending after the above-trend growth last year remains unlikely.

TUESDAY, JUNE 12

China: Monetary Aggregates (May; Unknown)

Credit growth in China continues to decelerate as part of the government's renewed commitment to clamp down on financial risks. The central bank has been cracking down hard on shadow forms of lending, and restrictions and increased transparency on local government borrowing are also slowing credit growth. That said, the People's Bank of China's late-April reserve ratio cut will free up funds for banks to lend. M2 likely grew 8.5% y/y in May, up from 8.3% in April.

China: Consumer Price Index (May; 11:30 a.m. AEST; 1:30 a.m. GMT)

Inflation pressures in China remain quiescent, with food price disinflation leading the overall index lower. High pork supplies are keeping prices at a multiyear low. Elsewhere, housing-related inflation has been kept under control thanks to government cooling measures in major cities. One risk is potential trade restrictions, which could raise soybean, beef and other prices. Consumer prices likely rose 1.7% y/y in May, down slightly from a 1.8% increase in April.

China: Producer Price Index (May; 11:30 a.m. AEST; 1:30 a.m. GMT)

Producer price inflation rose slightly in April in year-on-year terms because of a low comparison a year earlier. With global prices declining recently for iron ore, coal and other commodities, price pressures remain minimal. Government policy to stem overcapacity continues to weigh on demand. That said, there was likely another rebound in May in year-on-year terms because of the weak reading in May 2017. China's producer price growth likely rose to 3.8% y/y in May, from 3.4% in April.

India: Consumer Price Index (May; 10:00 p.m. AEST; 12:00 p.m. GMT)

India's consumer price index reached a four-month high at 4.6% y/y in April and we expect further acceleration in May, to 4.8%. The Reserve Bank of India aims to keep inflation around the midpoint of its 2% to 6% inflation target range. Inflation is likely to edge higher in the near term because of oil prices and the weaker rupee, which has been one of Asia's worst performing currencies this year as emerging market outflows have heated up since April. The RBI increased the repo rate to 6.25% at its June monetary policy meeting to try to stem capital outflows and provide some anchor to inflation expectations. Further tightening could be on the cards if the rupee and more broadly capital outflows continue to pressure India.

India: Industrial Production (April; 10:20 p.m. AEST; 12:20 p.m. GMT)

India's industrial production likely improved to 6.6% y/y in April, from the five-month low of 4.4% in March. Production hit a bump in March due to the combination of a high base effect and a broad-based slowdown in most other categories, except for consumer nondurables. Production has improved in the June quarter thanks to the monsoon shaping up to be decent, improved vehicle sales, and the government's renewed infrastructure focus driving higher spending in the capital sector.

WEDNESDAY, JUNE 13

No major economic indicators are scheduled for release.

THURSDAY, JUNE 14

Australia: Employment Situation (May; 11:30 a.m. AEST; 1:30 a.m. GMT)

Australia's seasonally adjusted unemployment rate likely dropped to 5.5% in May, after rising to 5.6% in April. The more closely watched trend data continue to please. The trend participation rate rose to 65.7% in April, its highest since records began in 1978. Trend employment growth is hovering just shy of 3% y/y, above its 20-year average of 2%, although it has cooled in recent months from its pace slightly above 3%. Leading indicators point to ongoing labour market tightening, though at a slower pace than in 2017. This is already evident in the 2018 data, with part-time employment staging a return after full-time positions outpaced last year.

China: Fixed Asset Investment (May; 12:00 p.m. AEST; 2:00 a.m. GMT)

Investment in fixed assets in China slowed in April, with mining-related investment continuing to weigh on overall investment. Overcapacity in heavy industry and lower prices for commodities mean the outlook for the sector remains grim. Outside mining, though, public-led infrastructure spending is outperforming and is alleviating softness in residential construction. Total fixed asset investment likely grew 6.8% y/y for the year to May, down from 7% for the year to April.

China: Industrial Production (May; 12:00 p.m. AEST; 2:00 a.m. GMT)

China's industrial production accelerated in April, with growth in automotives and electronics outweighing continued softness in mining industries. Heavy industrial goods output remains constrained by overcapacity. Positive manufacturer sentiment for new orders suggests a pickup in production, although there are some concerns of a slowdown further ahead if trade tensions escalate. Industrial production likely grew 7.1% y/y in May, up slightly from 7% in April.

China : Retail Sales (May; 12:00 p.m. AEST; 2:00 a.m. GMT)

China's retail trade lost steam in April but the outlook remains positive. Auto sales have been slowing but increased subsidies for certain electric cars should reverse the trend. Automakers are already ramping up production in anticipation. Steady wage growth and good employment conditions underpin growth in retail spending. Electronics sales continue to see strong growth. Retail spending likely rose 10.3% y/y in May, the same as in April.

FRIDAY, JUNE 15

India: Foreign Trade (May; Unknown)

India's trade deficit likely widened to US$15.2 billion in May, after holding about steady with a US$13.7 billion deficit in April. The spike in global oil prices is keeping the trade deficit relatively large. India is the world's third largest oil importer, sourcing around 80% of its oil needs from overseas, so is vulnerable to oil price rises. Another factor keeping the deficit relatively large is India's rupee, amongst Asia's worst performing currencies this year as emerging market outflows gather momentum. The weaker exchange rate has made imports more expensive, added to inflation, and eroded household and business purchasing power, an undesirable combination for an economy that has only just shaken off the impacts of demonetisation.

South Korea: Employment (May; 9:00 a.m. AEST; Thursday, 11:00 p.m. GMT)

South Korea's unemployment rate likely held steady at 3.8% in May. Despite improving in April, the labour market remained soft, with employment rising by less than 1% for the third straight month, which suggests hiring is being undermined by the large minimum wage hike at the start of the year. The youth unemployment rate remains uncomfortably high. President Moon Jae-in recently won approval for a supplementary budget (US$3.55 billion), which he hopes will lower youth unemployment below 8% by 2021. Although a positive move, the labour market will likely stay soft in the near term.

Japan: Monetary Policy (June; Unknown)

The Bank of Japan remains firmly on the sidelines, and talks of monetary tightening are off the mark. The bank will maintain its monthly annualised purchase target of Japanese government bonds at ¥80 trillion in June. Moreover, the BoJ will target the long-term interest rates through its yield curve control policy, a 0% target for the 10-year JGB and a -0.1% interest rate on excess reserves to target the short-term rate. The BoJ's forecasts on growth and CPI were altered only slightly in April; the bank upwardly revised its growth but revised down its inflation projections. These were minute, however. The only material change at April's policy meeting was the BoJ's dropping the timeline to reach its 2% inflation target, which was previously 2019 but had little credibility of being delivered by then.

The Long View

After plunging from a year earlier in May, high-yield bond issuance remains muted thus far in June.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group,
June 7, 2018

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 127 bp eclipses its 122-point mean of the two previous economic recoveries. This spread is more likely to be wider, as opposed to narrower, a year from now.

The recent high-yield bond spread of 364 bp is less than might be inferred from the spread's macroeconomic drivers and the long-term Baa industrial company bond yield spread. The adverse implications for liquidity of possibly significantly higher interest rates merit consideration.

DEFAULTS

After setting its current cycle high at January 2017's 5.8% and subsequently bottoming at January 2018's 3.3%, April's U.S. high-yield default rate equaled 3.7%. Moody's Default and Ratings Analytics team expects the default rate will average 1.9% during Q1-2019.

US CORPORATE BOND ISSUANCE

Yearlong 2017's US$-denominated bond issuance rose by 6.8% annually for IG, to $1.508 trillion and soared by 33.0% to $453 billion for high yield. Across broad rating categories, 2017's newly rated bank loan programs from high-yield issuers sank by 26.2% to $72 billion for Baa, advanced by 50.6% to $319 billion for Ba, soared by 56.0% to $293 billion for programs graded single B, and increased by 28.1% to $25.5 billion for new loans rated Caa.

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

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

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

Fourth-quarter 2017 revealed year-over-year advances for worldwide offerings of corporate bonds of 17.6% for IG and 77.5% for high-yield, wherein US$-denominated offerings posted increases of 21.0% for IG and 56.7% for high yield.

First-quarter 2018's worldwide offerings of corporate bonds incurred year-over-year setbacks of 6.3% for IG and 18.6% for high-yield, wherein US$-denominated offerings posted sank by 14.4% for IG and 20.8% for high yield.

For yearlong 2016, worldwide corporate bond offerings rose by 2.3% annually for IG (to $2.402 trillion) and sank by 7.8% for high yield (to $426 billion). During yearlong 2017, worldwide corporate bond offerings increased by 4.0% annually (to $2.499 trillion) for IG and advance by 41.2% for high yield (to $602 billion). The projected annual percent changes for 2018's worldwide corporate bond offerings are +2.0% for IG and -9.6% for high yield.

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

US ECONOMIC OUTLOOK

The consensus expects that the mid-point for the federal funds rate should finish 2018 at 2.125%. In view of the considerable underutilization of the world's productive resources, low inflation should help to rein in Treasury bond yields. As long as the global economy operates below trend, the 10-year Treasury yield may not remain above 3% 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.

EUROPE

By Barbara Teixeira Arajuo and Martin Janicko of Moody's Analytics
June 7, 2018

EURO ZONE

First quarter final GDP numbers for the euro zone all but confirmed that the single-currency area slowed at the start of 2018. Despite the easing, though, the pace of expansion remained solid and well above the average for the past two years. And to that we add that base effects from a roaring end to 2017 were always expected to depress the first quarter headline, chiefly in manufacturing, while the bad weather in February and March also took a toll on retail sales, services consumption and building activities. We forecast that the fading of base effects and the jump in temperatures in April and May will ensure that second quarter growth rebounds to 0.5% q/q, which would chime in with our expectations of a gradual return to a more sustainable growth rate of around 2%.

The key detail of this final release was the publication of the expenditure and production components of GDP. They were in line with our expectations. Net trade dragged on the headline as exports corrected following an unsustainable jump at the end of 2017, and our view is that a decline in exports of finished manufacturing goods, particularly of transport equipment, did most of the damage. But we caution that exports in the sector are volatile, especially aeronautic sales, so this was expected following the previous stanza's surge. Some offset came from the slight fall in imports, though here the devil is in the detail, too. Real imports were softer than they should have been, because the import deflator jumped on the back of higher oil prices. A revision in months to come can't be ruled out.

That investment slowed sharply was also behind the headline's easing. Machinery and equipment investment was the main culprit, mean-reverting from a strong jump in the previous stanza. Capacity constraints in France and Germany soared following rapid growth in the sector's output at the end of last year, putting a lid on the expansion. But the production breakdown showed that investment in construction similarly lost momentum on the back of weather-related disruptions in building activities across the Continent in the middle of the quarter.

Government spending was unchanged over the quarter, but here too is a silver lining. Technical adjustments in Germany's budget spending pushed down the headline, but this warrants a correction in the second stanza. Elsewhere, the main upside surprise came from the fact that consumer spending accelerated. We and the consensus had expected that the bad weather in February and March, which depressed retail sales, would have taken a toll on total spending as well. Even better is that prospects for spending in the second quarter remain solid, with spending on the High Street set to jump in April and May.

Trade war?

The U.S., as expected, has imposed import duties on European, Canadian and Mexican metals. In particular, the Trump administration carried through with promised tariffs of 25% on steel and 10% on aluminum. Reaction was swift. Mexico introduced custom duties on—among other items—pork and cheese. Canada raised duties on steel and aluminum to match those imposed by the U.S. Europe will now tax bourbon, jeans, and peanut butter. The numbers present a clear picture. The highest shares of steel imports to the U.S. come from Canada, the E.U. and Brazil, while U.S. steel is currently about 13% pricier than Europe's.

The near-term economic impact will be rather small: In 2017, the EU exported $5.3 billion in steel and $1.3 billion in aluminum to the U.S. The cost of the tariffs is estimated at $2 billion to $3 billion for Europe, with steel and aluminum accounting for about 2% of global trade, and 1% of the U.S. or EU economies could be affected directly. But escalation into a real trade war cannot be ruled out. Also, the measures are incompatible with the principles of specialisation in international trade and generally go against the rules of the World Trade Organisation.

One thing is certain: The number of U.S. jobs will not increase much in these sectors. First, it is not international trade that is driving down the employment. Rather, it is automation—a fact unlikely to change any time soon. Second, the U.S. job market is close to full employment, so sharp increases in specific sectors are rather unlikely. Meanwhile, all involved parties will eventually feel the economic pain. For example, unit production costs for some U.S. car manufacturers, such as Ford, General Motors and Fiat Chrysler could increase by $34 to $68, while consumers may pay up to 1% more for their cars.

More important, if the fight escalates into a full-fledged trade war, the pain could become quite severe in the long run.

ASIA PACIFIC

By Veasna Kong and Faraz Syed of Moody's Analytics
June 7, 2018

INDIA

The Indian economy has had an eventful few years. But after the hit of demonetization and the largest tax reform in the country's history in the space of less than a year, the recovery that emerged in the second half of 2017 gained momentum in the first quarter of this year, with GDP expanding 7.7% y/y, the fastest pace of growth since the second quarter of 2016. By expenditure, the increase was driven by a welcome surge in fixed investment and government consumption, while private consumption also increased noticeably. On the external front, export growth cooled, likely owing to a high base from a year ago, while imports continued to grow at a robust double-digit pace. The strong performance in the first three months supports our view that India's economy is on track to expand 7.4% in 2018, up from a four-year low of 6.3% in 2017.

Domestic demand on the mend

One of the economy's weak spots over recent years has been fixed investment, which has been undermined by excess capacity and weak balance sheets. Following years of excesses, large parts of the corporate sector remain saddled with debt from state banks. With much of the debt nonperforming, that has hamstrung banks' ability and willingness to lend, which has inhibited investment. In the first half of 2017, investment conditions were further undermined by the ill effects of demonetization—the removal of about 86% of the currency in circulation in November 2016. Demonetization caused widespread disruptions, particularly in the informal and cash-intensive sectors of the economy, such as manufacturing and construction. These issues caused fixed investment growth to slide to a 2½-year low in the three months to June 2017.

However, fixed investment growth improved noticeably in the second half of 2017. In the first quarter of 2018 it accelerated to its fastest pace since the second quarter of 2016. An improvement in bankruptcy resolutions and the government's capital infusion are contributing to a noticeable pickup in credit growth, which is helping to fuel a resurgence in investment. Bank loan growth was as low as 4.1% y/y in 2017, below the trough during the depths of the global financial crisis. But loan growth has since staged a mild recovery, averaging more than 10% y/y in the first three months of this year. Although nonperforming loans remain an issue, steps to strengthen the banking system, such as the capital injections, are expected to gradually lift credit growth.

Since demonetization

Private consumption also appears to be strengthening. Indian consumers, especially at the lower end of the income scale, have had a particularly tough time of late. The government has largely failed to deliver on its promise to double farmer incomes, while demonetization hit poorer Indians especially hard, because most of their transactions are cash-based. But with the shock of demonetization fading and the agricultural sector likely to benefit from another year of normal monsoons, prospects for private consumption spending have brightened.

Private consumption growth has been in cyclical downturn since the end of 2015, when growth was up around a nine-year high. Spending took a big hit in the first quarter of 2017, amid the chaos of demonetization. However, excluding the blip in the final quarter of 2017, private consumption has staged a modest recovery. It can be hard to get a high-frequency read of household spending in India, given the data limitations, but data on motor vehicles sales can be instructive. Passenger car sales—an indicator of spending by more affluent consumers—were relatively unscathed following demonetization, with sales dipping only temporarily in December 2016 before rising in the months after. In contrast, less affluent consumers struggled, as sales of motorcycles and three-wheelers slumped, with the latter contracting in year-ago terms for nine months after demonetization. Positively, vehicle sales have since recovered, with motorcycle and three-wheeler sales still rising at a double-digit pace.

It has been four years since Prime Minister Narendra Modi swept to power promising to rid the economy of corruption, create 10 million jobs a year, improve business conditions, lift the poor, and implement structural reforms. Opinion is divided on Modi's performance. Proponents point to his prudent fiscal management and an improvement in India's ease of doing business rankings, and new bankruptcy code, among other things. His opponents highlight issues such as the botched implementation of demonetization, confusion about the new general services tax, and slow progress on reforms.

Elections in 2019

With just another year to run in his five-year term, Modi's reform agenda is likely to stall as the focus turns to winning the general election in 2019. Modi's Bharatiya Janata Party is a favourite to retain government, having solidified power by forming governments in 21 out of 29 states. However, although the BJP has a majority in the Lower House of parliament, which is needed to form government, it has only 58 out of 245 seats in the Upper House. This has been a key reason for the impasse over touted reform, as legislation can be blocked by opposition parties. Members of the Upper House are selected based on votes in the state and territory elections. However, they can be replaced only once their term has expired. Since BJP has increased its power in the state elections, it can fill the retired members of the Upper House with its own party members. All this, in theory, should make it easier for reforms to pass if the BJP wins the election and keeps majority in the Lower House. But it's not so clear-cut.

Although the BJP will make inroads in the Upper House, it's unlikely to gain a majority there. This means that passing reforms through the Upper House will remain difficult, albeit easier than the past few years. Meanwhile, although opinion polls suggest Modi remains a popular prime minister, opinion polls can be unreliable in India. There tends to be a significant disconnect between election outcomes and opinion polls, possibly due to poor rural coverage of the polls. Moreover, past election results suggest Indians tend to hold anti-state incumbency views, which could work against the BJP.

Risks are tilted to the downside

Although India's growth prospects have brightened following the twin shocks of demonetization and GST implementation, memories of the 2013 taper tantrum—when capital exited emerging markets on expectations of reduced bond-buying by the U.S. Federal Reserve—linger. During that episode, the rupee depreciated by more than 20%, inflation was in double digits, and the current account deficit was as wide as 6.9% of GDP.

Fast forward to 2018; with the Fed on the cusp of delivering another rate hike, it is not surprising that some are drawing parallels with 2013. Already, Bank Indonesia hiked its policy interest rate by 25 basis points—the first since 2014—to help stem capital outflows. Other emerging markets, such as Argentina and Turkey have also taken action, fueling speculation that India may be next to follow suit.

As a net importer of goods and services, the Indian economy runs persistent current account deficits. That means the economy is reliant on external financing to balance the books and is vulnerable to capital flows, which can swing significantly as investors search for the best returns. Foreign capital inflows to Indian debt and equity markets have slowed significantly since mid-April, suggesting investors are becoming less enthusiastic about prospects in India. On a rolling 12-month basis, inflows into the Indian equity market have fallen to lows not seen since October. Meanwhile, inflows into the debt market have declined to their lowest level since mid-2017.

Aside from expectations of a Fed rate hike in June (and more down the road), another issue contributing to the shift in investor sentiment is the rally in oil prices, which have risen about 68% since mid-2017 and 20% in 2018 alone. As India is the world's third largest oil consumer—about 80% of which is imported—a persistent run-up in oil prices increases the country's import bill and is likely to put pressure on its external balances. Beyond that, higher oil prices increase price pressures, weaken the rupee, undermine consumer demand, and can hurt industrial profits. In addition, higher oil prices could weaken India's public finances, as fuel subsidies may have to increase.

June's Rate Hike

The Reserve Bank of India lifted its key policy interest rate by 25 basis points to 6.25% at its latest policy meeting, which likely marks the start of a mild rate hike cycle. It was the first rate increase since January 2014 and was likely prompted by three key developments. First, GDP growth accelerated to 7.7% y/y in the first quarter of 2017, the fastest pace of growth since the second quarter of 2016 and confirming that the economy is recovering well from twin shocks of demonetization and the new GST.

Second, consumer price inflation has perked up of late, thanks to firmer economic activity, the increase in oil prices, and the weaker rupee. Although the outlook for oil prices is uncertain, higher oil prices are sure to feed into local price pressures, with CPI inflation averaging 4.6% y/y in the first four months of 2018, up from 4.2% in the prior four months. Third, capital inflows have slowed noticeably in recent months, and the U.S. Fed is widely expected to hike rates at its upcoming monetary policy meeting, increasing pressure on the RBI to stabilise capital flows.

The monetary policy committee has been less hawkish under Governor Urjit Patel than previous governor Raghurram Rajan. Indeed, despite the rate hike, the RBI insists that its monetary policy stance remains neutral. Regardless of the RBI's stance, June's preemptive strike is a clear sign that the RBI believes price pressures are building. And with the Fed on the cusp of delivering another rate hike and the rupee showing signs of weakness, the RBI's decision to hike rates looks like a good one.

Ratings Round-Up

By Njundu Sanneh

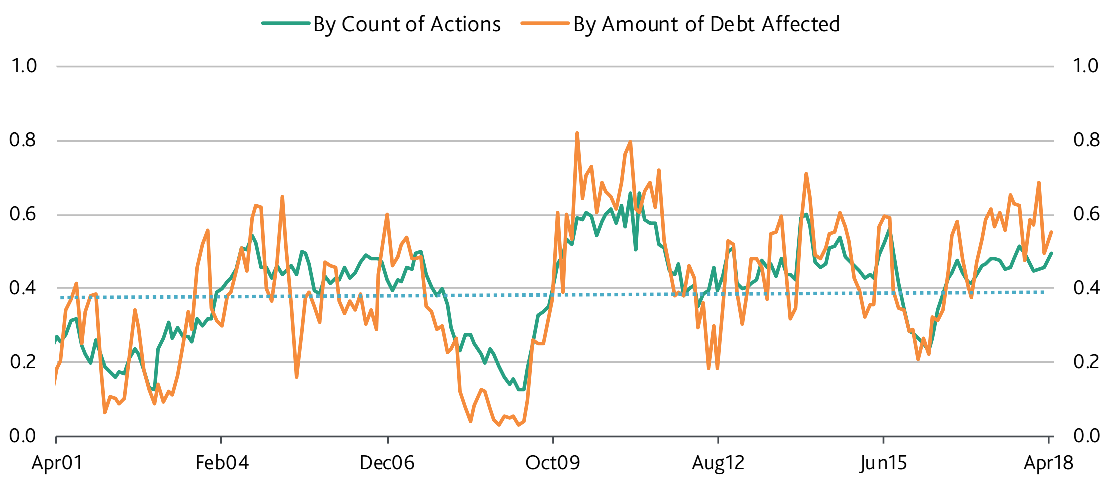
U.S. Rating Revisions Turn Negative

The weekly rating changes took a turn for the worse as downgrades bested upgrades by a margin of 4 to 1, a reading not seen so far this year. The trailing 3-month average U.S. favorable rating changes as a percent of total rating changes remains strong at 49% as of April. This followed a two-month period where this metric, which is less volatile than the weekly data, trended downward, albeit slightly. The benign interest rate environment and fairly low corporate borrowing costs, even for speculative grade firms, means the rating revisions activity is unlikely to remain on this trajectory for long. The handful of positive rating revisions span several industries among which were multiline insurance, rail transportation and oil services. The downgrades cut across several industries such as media, pharmaceuticals, automotive parts and consumer products.

In Europe rating revisions for the past week were spread across several countries. The common trend was that financials were the most prevalent and the rating actions, unlike in the U.S., were mainly positive with a favorable-to-total rating changes ratio of 88%. Some of the major firms affected included BNP Paribas, HSBC, and Banco Bilbao Vizcaya Argentina.

FIGURE 1

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



* Trailing 3-month average

Source: Moody's

Ratings Round-Up

FIGURE 2

Rating Key

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

FIGURE 3

Rating Changes: Corporate & Financial Institutions – US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	Old STD Rating	New STD Rating	IG/ SG
5/30/18	ARTESYN EMBEDDED TECHNOLOGIES, INC.	Industrial	SrSec/LTCFR/PDR	233	D	B3	Caa1			SG
5/30/18	CD&R TZ PURCHASER, INC.	Financial	SrSec/BCF		D	B2	B3			SG
5/31/18	ROUGH COUNTRY, LLC	Industrial	SrSec/BCF		D	B2	B3			SG
5/31/18	SIERRA DELAWARE HOLDINGS, INC. -SIERRA ENTERPRISES LLC	Industrial	SrSec/BCF		D	B1	B2			SG
6/1/18	HARTFORD FINANCIAL SERVICES GROUP, INC. (THE)	Financial	SrUnsec/JrSub/PS	6,545	U	Baa2	Baa1			IG
6/1/18	UNION PACIFIC CORPORATION	Industrial	SrSec/SrUnsec /LTIR/MTN/PS	19,782	D	Aa2	Aa3			IG
6/1/18	ASSURANT, INC.	Financial	SrUnsec/LTIR/IFSR /Sub/PS/CP	2,025	D	Baa2	Baa3	P-2	P-3	IG
6/1/18	MOOD MEDIA CORPORATION -MOOD MEDIA BORROWER, LLC	Industrial	SrSec/LTCFR/PDR	175	D	Caa1	Ca			SG
6/1/18	JFL-NRC HOLDINGS, LLC -NRC US HOLDING COMPANY, LLC	Industrial	SrSec/BCF/LTCFR/PDR		U	B3	B2			SG
6/1/18	TRANSWORLD SYSTEMS, INC.	Industrial	SrSec/LTCFR/PDR	880	D	Caa2	C			SG
6/1/18	VISUAL COMFORT GROUP, INC.	Industrial	SrSec/BCF		D	B1	B2			SG
6/4/18	KANSAS CITY SOUTHERN	Industrial	SrUnsec/BCF/CP	2,634	U	Baa3	Baa2	P-3	P-2	IG
6/4/18	FRANKLIN RESOURCES, INC.	Financial	SrUnsec/Sub/JrSub/PS	700	D	A1	A2			IG
6/4/18	BAYER GROUP-BAYER CORPORATION	Industrial	SrUnsec/MTN/PS	13,018	D	A3	Baa1			IG
6/4/18	TENNECO INC.	Industrial	SrUnsec/LTCFR/PDR	725	D	Ba2	B2			SG
6/4/18	MINIMAX VIKING GMBH	Industrial	SrSec/BCF/LTCFR		D	Ba3	B1			SG
6/4/18	HORIZON GLOBAL CORPORATION	Industrial	SrSec/BCF/LTCFR/PDR		D	B1	B2			SG
6/5/18	IBERDROLA S.A. -BERKSHIRE GAS COMPANY	Industrial	LTIR		U	Baa1	A3			IG

Source: Moody's

Ratings Round-Up

FIGURE 4

Rating Changes: Corporate & Financial Institutions – Europe

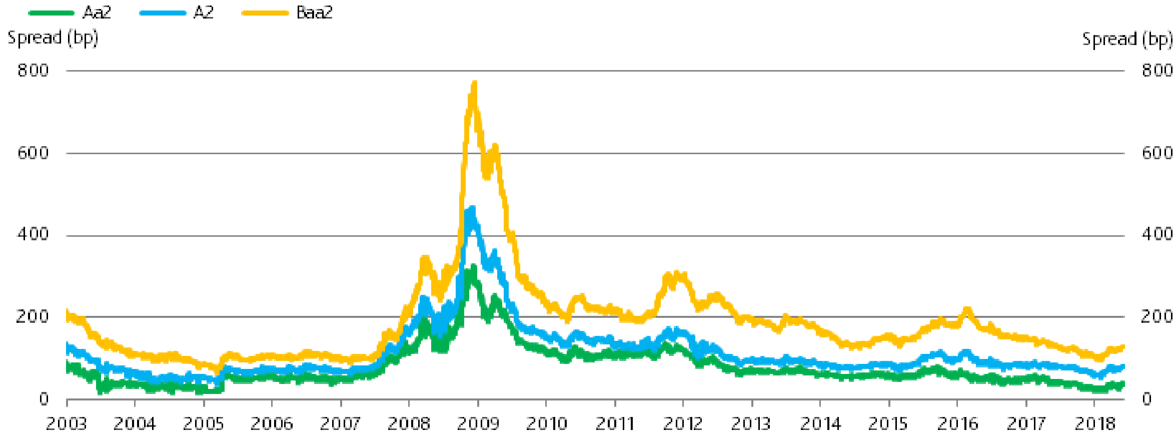
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG	Country
5/30/18	BNP PARIBAS -BNP PARIBAS FORTIS SA/NV	Financial	JrSub	1,105	U	Ba3	Ba2	SG	BELGIUM
5/30/18	STOREBRAND GROUP -STOREBRAND ASA	Financial	SrUnsec/LTIR	92	U	Ba1	Baa3	SG	NORWAY
5/30/18	LEGAL & GENERAL GROUP PLC	Financial	SrUnsec/LTIR/Sub /JrSub/MTN/CP	4,682	U	A3	A2	IG	UNITED KINGDOM
5/30/18	HSBC HOLDINGS PLC -HSBC BANK PLC	Financial	Sub/JrSub/MTN	5,699	D	A3	Baa1	IG	UNITED KINGDOM
5/30/18	BUPA LTD. -BUPA FINANCE PLC	Financial	SrUnsec/Sub	2,066	U	Baa1	A3	IG	UNITED KINGDOM
5/30/18	TATA STEEL LTD. -TATA STEEL UK HOLDINGS LIMITED	Industrial	LTCFR		U	B3	B2	SG	UNITED KINGDOM
5/30/18	SAMPO PLC	Financial	SrUnsec/LTIR /Sub/MTN	4,000	U	Baa1	A3	IG	FINLAND
5/30/18	UNIPOL GRUPPO S.P.A.	Financial	SrUnsec/LTIR /MTN	2,120	U	Ba2	Ba1	SG	ITALY
5/30/18	ATRADIUS N.V. -ATRADIUS FINANCE B.V.	Financial	Sub	292	U	Baa3	Baa2	IG	NETHERLANDS
5/30/18	AGEAS (GROUP) -AGEAS SA/NV	Financial	LTIR/JrSub	1,458	U	Baa3	Baa2	IG	BELGIUM
5/30/18	NN GROUP N.V.	Financial	SrUnsec/LTIR /Sub/MTN	3,032	U	Baa2	Baa1	IG	NETHERLANDS
5/31/18	BANCO BILBAO VIZCAYA ARGENTARIA, S.A.	Financial	SrUnsec/JrSrUnsec /LTIR/SLTD/MTN	11,384	U	Baa1	A3	IG	SPAIN
5/31/18	ATLANTICA YIELD PLC	Industrial	SrUnsec /LTCFR/PDR	255	U	B2	B1	SG	UNITED KINGDOM
6/4/18	GROUPE CREDIT AGRICOLE -BANKOA, S.A	Financial	LTD/PS		U	Baa2	Baa1	IG	SPAIN
6/4/18	CITYCON OYJ	Industrial	SrUnsec/LTIR	1,872	D	Baa1	Baa2	IG	FINLAND
6/5/18	EDA - ELECTRICIDADE DOS ACORES, S.A.	Utility	LTCFR		U	Ba3	Ba2	SG	PORTUGAL

Source: Moody's

Market Data

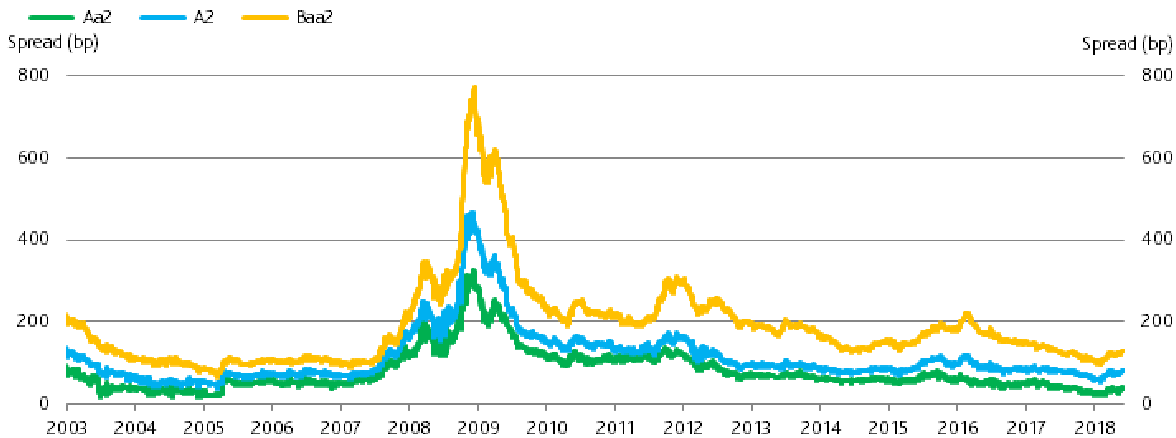
Spreads

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



Source: Moody's

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



Source: Moody's

Market Data

CDS Movers

Figure 3. CDS Movers - US (May 30, 2018 – June 6, 2018)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jun. 6	May. 30	Senior Ratings
JPMorgan Chase & Co.	A2	A3	A3
Citigroup Inc.	A3	Baa1	Baa1
Morgan Stanley	Baa1	Baa2	A3
Ford Motor Credit Company LLC	Baa3	Ba1	Baa2
Bank of New York Mellon Corporation (The)	A1	A2	A1
Amazon.com, Inc.	A2	A3	Baa1
Berkshire Hathaway Inc.	Baa1	Baa2	Aa2
Lowe's Companies, Inc.	Aa3	A1	A3
Target Corporation	A1	A2	A2
International Paper Company	Baa1	Baa2	Baa2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jun. 6	May. 30	Senior Ratings
MBIA Insurance Corporation	C	Caa2	Caa2
R.R. Donnelley & Sons Company	Ca	Caa2	B3
American Express Credit Corporation	A1	Aa3	A2
Walt Disney Company (The)	Aa3	Aa2	A2
Oracle Corporation	A1	Aa3	A1
Amgen Inc.	A2	A1	Baa1
United Technologies Corporation	Aa3	Aa2	A3
U.S. Bancorp	Aa2	Aa1	A1
Union Pacific Corporation	Aa2	Aa1	Baa1
Abbott Laboratories	A2	A1	Baa2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jun. 6	May. 30	Spread Diff
Sears Roebuck Acceptance Corp.	C	2,027	1,669	357
Sears Holdings Corp.	C	1,686	1,389	297
Parker Drilling Company	Caa2	1,457	1,363	94
Avon Products, Inc.	B3	985	934	51
Hertz Corporation (The)	B3	953	926	27
Avis Budget Car Rental, LLC	B1	363	346	17
McClatchy Company (The)	Caa2	385	368	17
Nabors Industries Inc.	B1	303	290	13
Diamond Offshore Drilling, Inc.	Ba3	285	273	12
Univision Communications Inc.	Caa1	273	262	11

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jun. 6	May. 30	Spread Diff
K. Hovnanian Enterprises, Inc.	Caa3	1,119	1,751	-632
Windstream Services, LLC	Caa1	1,749	2,007	-257
Talen Energy Supply, LLC	B1	685	772	-87
Penney (J.C.) Corporation, Inc.	Caa1	1,130	1,203	-73
Lexmark International, Inc.	Caa1	1,289	1,354	-65
Frontier Communications Corporation	Caa1	1,375	1,433	-59
Neiman Marcus Group LTD LLC	Caa3	918	976	-57
MBIA Inc.	Ba3	593	644	-50
Bunge Limited Finance Corp.	Baa2	128	171	-42
Weatherford International, LLC (Delaware)	Caa1	472	505	-33

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (May 30, 2018 – June 6, 2018)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jun. 6	May. 30	Senior Ratings
Allied Irish Banks, p.l.c.	Aa3	Baa2	Ba1
Novo Banco, S.A.	Caa2	Ca	Caa2
Spain, Government of	Baa2	Baa3	Baa1
Barclays Bank PLC	A2	A3	A2
Lloyds Bank Plc	Aa2	Aa3	Aa3
Banco Bilbao Vizcaya Argentaria, S.A.	Baa3	Ba1	A3
NatWest Markets Plc	A1	A2	Baa2
Barclays Plc	Baa3	Ba1	Baa3
Intesa Sanpaolo S.p.A.	Ba2	Ba3	Baa1
HSBC Holdings plc	A3	Baa1	A2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jun. 6	May. 30	Senior Ratings
Societe Generale	Baa1	A3	A1
Credit Agricole S.A.	A3	A2	A1
BNP Paribas	A3	A2	Aa3
Deutsche Bank AG	Ba3	Ba2	Baa2
Credit Agricole Corporate and Investment Bank	A3	A2	A1
Erste Group Bank AG	A3	A2	A2
Raiffeisen Bank International AG	Baa3	Baa2	A3
Orange	A3	A2	Baa1
Banca Monte dei Paschi di Siena S.p.A.	B3	B2	B3
Equinor ASA	Aa1	Aaa	Aa3

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jun. 6	May. 30	Spread Diff
Galapagos Holding S.A.	Caa3	1,487	1,250	237
Casino Guichard-Perrachon SA	Ba1	377	315	62
Boparan Finance plc	Caa1	472	454	18
Raiffeisen Bank International AG	A3	82	66	16
Sappi Papier Holding GmbH	Ba2	363	350	13
Erste Group Bank AG	A2	56	47	9
Deutsche Bank AG	Baa2	155	147	7
Sky plc	Baa2	58	52	5
TDC A/S	B1	272	268	4
GKN Holdings plc	Ba1	99	95	4

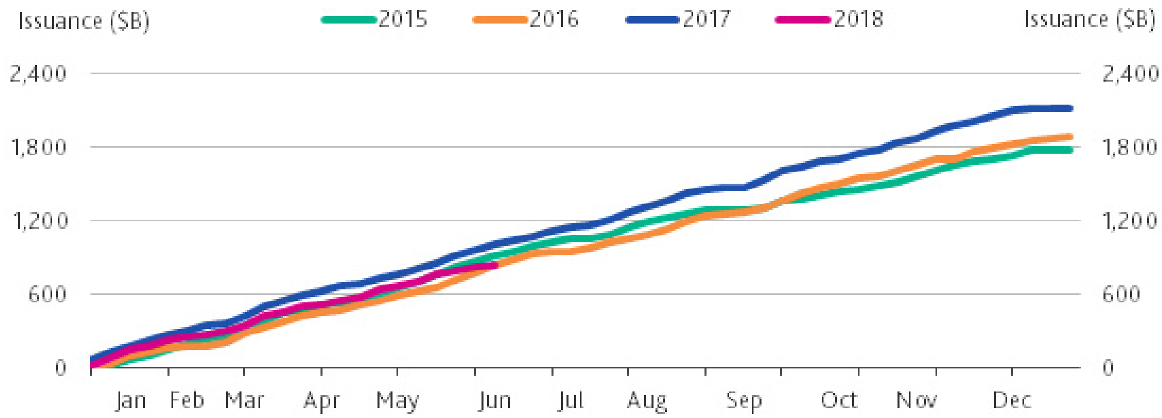
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jun. 6	May. 30	Spread Diff
Astaldi S.p.A.	Caa1	1,589	2,770	-1,182
Novo Banco, S.A.	Caa2	696	835	-138
Matalan Finance plc	Caa1	714	809	-95
Vedanta Resources plc	B2	402	458	-57
Allied Irish Banks, p.l.c.	Ba1	40	74	-34
UniCredit S.p.A.	Baa1	139	165	-27
Iceland Bondco plc	Caa1	338	362	-24
UniCredit Bank AG	Baa2	120	143	-23
UniCredit Bank Austria AG	Baa1	104	125	-20
Premier Foods Finance plc	Caa1	295	315	-20

Source: Moody's, CMA

Market Data

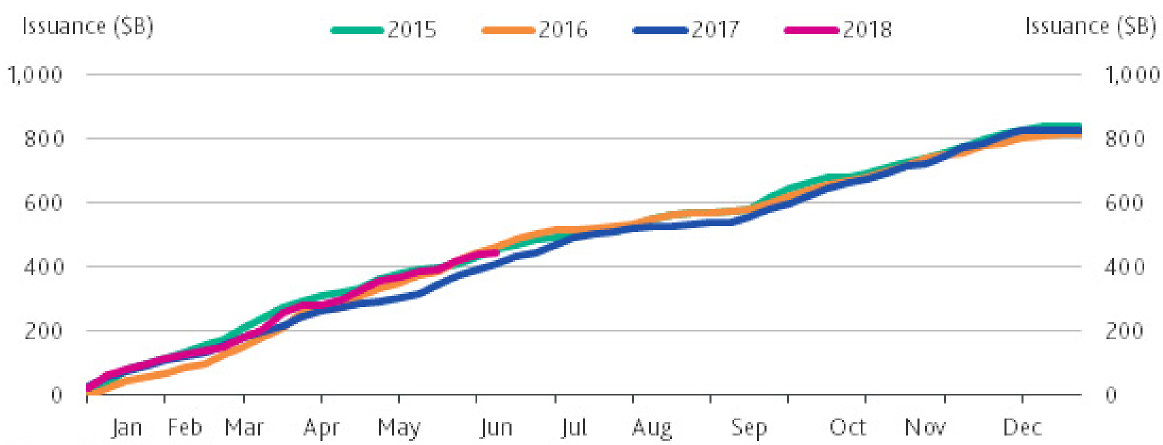
Issuance

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

Market Data

Figure 7. Issuance: Corporate & Financial Institutions

	USD Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	8.678	1.638	10.365
Year-to-Date	637.382	162.362	831.862

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	1.920	0.000	2.286
Year-to-Date	368.915	53.047	442.474

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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