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WEEKLY MARKET OUTLOOK

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Higher Interest Rates Suppress Corporate Borrowing

Credit Markets Review and Outlook *by John Lonski*

Higher Interest Rates Suppress Corporate Borrowing

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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: Newly rated loans from high-yield issuers seem to have eased lately relative to high-yield bond issuance.

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Credit Spreads	Investment Grade: We see year-end 2018's average investment grade bond spread exceeding its recent 124 bp. High Yield: Compared to a recent 336 bp, the high-yield spread may approximate 400 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 August 2018's 3.4% to 2.1% by August 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 7.3% to $1.398 trillion, while high-yield bond issuance is likely to fall by 22.7% to $350 billion..

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Ratings Round-Up

U.S. Upgrades Concentrated largely in Oil Industry

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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: U.S. investors, eerie similarities, base metals prices, debt to EBITDA, base metals, trade war, Investment grades, defaults, higher rates, profit growth, credit quality, foreign investors, internal funds, tariffs, borrowing restraint, corporate bonds.

THIS REPORT WAS REPUBLISHED SEPTEMBER 24, 2018 TO UPDATE ECONOMIC FORECASTS FOR THE U.S. AND EUROPE.

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

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Credit Markets Review and Outlook

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

Higher Interest Rates Suppress Corporate Borrowing

An abatement of tariff-related fears reduced the uncertainty surrounding a positive outlook for U.S. corporate earnings. In response, the market value of U.S. common stock quickly approached its record high of August 29, 2018. Moreover, high-yield bonds rallied from already richly-priced levels. In turn, a recent composite high-yield bond spread was thinner than 340 basis points for the first time since the middle of April 2018.

A composite speculative-grade bond yield dipped from September 7's localized high of 6.42% to September 19's 6.32%, which differed considerably from the accompanying rise by the 5-year Treasury yield from 2.82% to 2.95%. By contrast, investment-grade corporate bond yields got caught in the backwash of a Treasury bond sell-off and Moody's long-term Baa industrial company bond yield rose to September 19's 5.09% for its highest daily reading since the 5.14% of March 16, 2016. Worse yet, Barclays Capital's average U.S.-dollar-denominated investment-grade corporate bond yield of 4.10% for September 19 was the highest since early April 2011.

During the three months ended August 2018, the Barclays investment-grade corporate bond yield averaged 84 bp more than its year earlier reading. This was the biggest year-over-year increase for a three-month average since the 140 bp of the span -ended May 2009.

However, the latter was in the declining phase of an interest rate cycle. Today, we are in the upswing phase. During previous upswing phases of interest rate cycles since 1989, the year-over-year increase of the investment-grade corporate bond yield's moving three-month average first reached at least 84 bp on four occasions. The latest was the 140 bp surge of October 2008, which was preceded by the 101 bp increase of June 2006, the 95 bp advance of September 1999, and the 108 bp ascent of June 1994.

Higher Yields Now Trim Investment-Grade Bond Issuance

Unlike the 20% annual drop by the investment-grade corporate bond offerings of the three-months-ended August 2018, investment-grade corporate bond issuance's moving three-month sum defied expectations and soared higher year-over-year by 32% during the span-ended June 2006 and by 49% for the span-ended September 1999. Possible reasons as to why investment-grade bond offerings transcended the bond yield jumps of 2006 and 1999 include overlapping surges by debt-funded mergers and acquisitions and expectations of significantly higher interest rates in the future.

Conforming to the conventional wisdom were the annual declines incurred by investment-grade bond issuance's moving three-month average of 68% for October 2008 and 42% for June 1994. October 2008's span was in the middle of the Great Recession, or when M&A nosedived and interest rate expectations sank. Regarding 1994's second quarter, markets correctly recognized that the underlying lift-off by benchmark Treasury yields would not persist. In response, business borrowers increased their reliance on variable-rate loans with the intent to refinance such debt into fixed-rate bonds once interest rates eased.

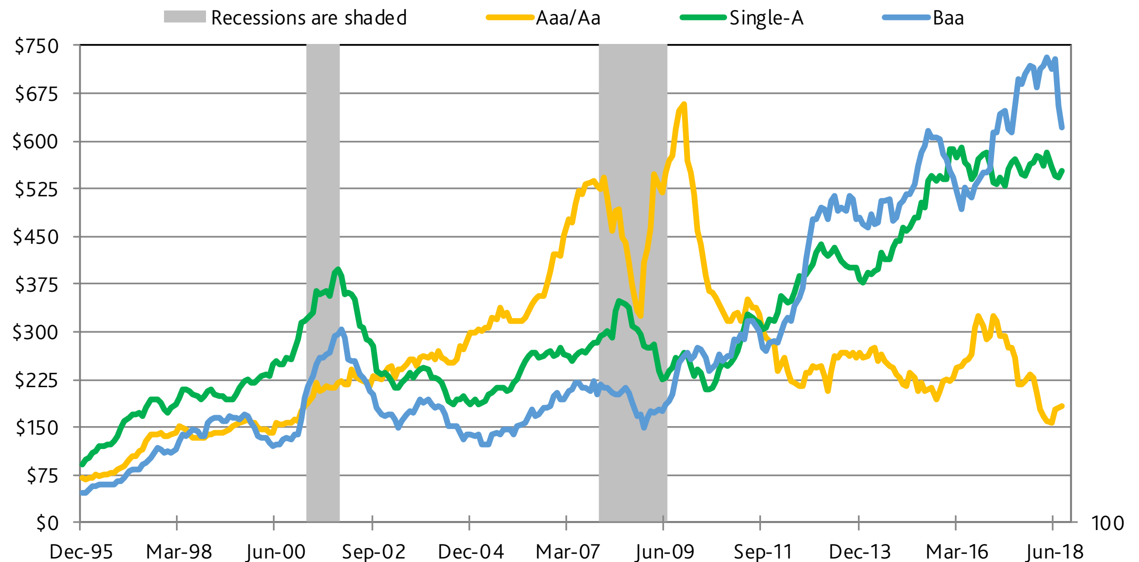
Historically, the absolute level of bond yields has wielded more influence over the issuance of investment-grade corporate bonds than the width of investment-grade bond yield spreads. In response to July-August 2018's 83 bp year-to-year jump by Barclays' investment-grade corporate bond yield to 3.97% and an accompanying 50 bp yearly increase by Moody's long-term Baa-grade industrial company bond yield to 4.90%, the US$-denominated investment-grade bond offerings of the third-quarter's first two months plunged by -37% annually after dipping by -7% annually during 2018's first half.

The July-August dive by investment-grade issuance was entirely the offshoot of a -63% yearly dive by Baa-grade bond issuance following the category's 35% annual rise of 2018's first half. By contrast, July-August showed annual bond issuance gains of 43% for Aaa/Aa and 12% for single-A, which differed considerably from first-half 2018's annual setbacks of -33% for Aaa/Aa and of -6% for single-A.

Riskier Tone of Investment-Grade Offerings May Heighten Impact of Higher Interest Rates

Baa's share of US$-denominated investment-grade bond issuance has risen from the 23% of 2002-2007's business cycle upturn to the 41% of the current recovery. The now riskier hue of outstanding investment-grade corporate bonds hints of a greater sensitivity to higher interest rates on the part of investment-grade corporations. For example, it may take less of an increase by interest rates to prompt investment-grade companies to approach capital spending and staffing with greater caution.

Figure 1: Yearlong Sum of Baa-Grade Corporate Bond Issuance Has Sunk by -15% from Record High of Year-Ended April 2018
US$-denominated corporate bond issuance, 12-month sums in $ billions
source: Dealogic, BEA, Moody's Analytics



High-Yield Bond Issuance Sinks Despite Relatively Thin Spreads

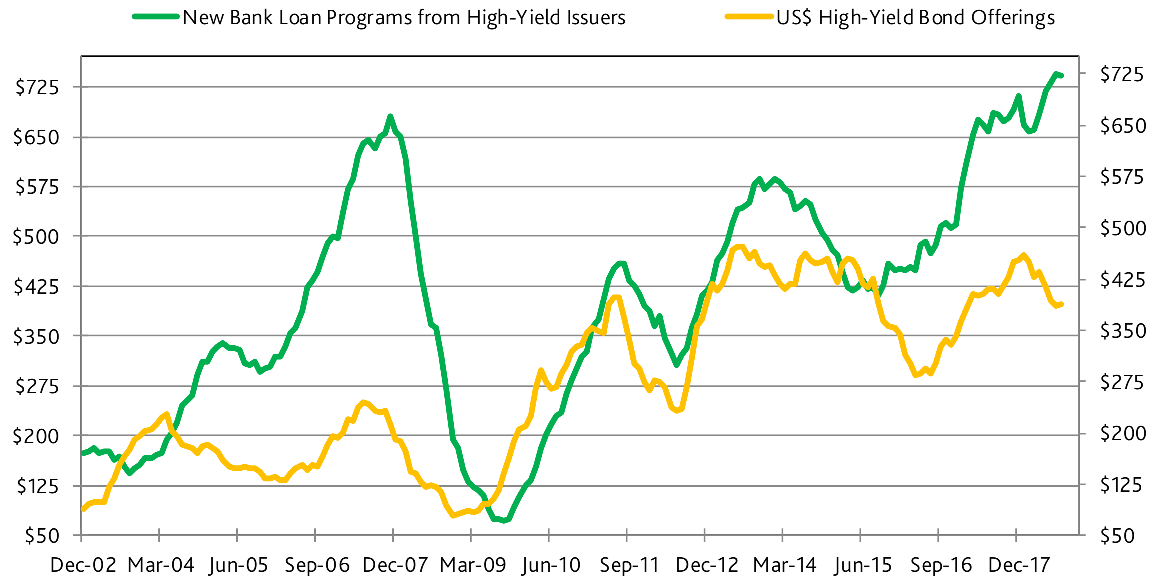
The annual decline of US$-denominated high-yield bond offerings narrowed from the -24% plunge of 2018's first half to the -12% drop of July-August. To a considerable degree, January-August 2018's -22% plummet by high-yield bond offerings can be ascribed to an atypically strong borrower preference for bank loans.

During January-August 2018, newly rated bank loans from high-yield issuers grew by 6.3% year-over-year. The increased reliance on bank loans, especially for the initial finding of acquisitions and spin-offs, has been in response to an easing of bank loan covenants. An estimated 61% of 2018-to-date's newly rated bank loan tranches were related to M&A; for the unfinished third quarter that ratio has soared to a nearly unprecedented 74%. In addition, the stronger preference for variable-rate bank loans, as opposed to fixed-rate bonds, suggests high-yield borrowers are not especially worried over the possibility of a steep and extended climb by benchmark borrowing costs.

Loans Graded Single-B or Lower Lead New Bank Loans

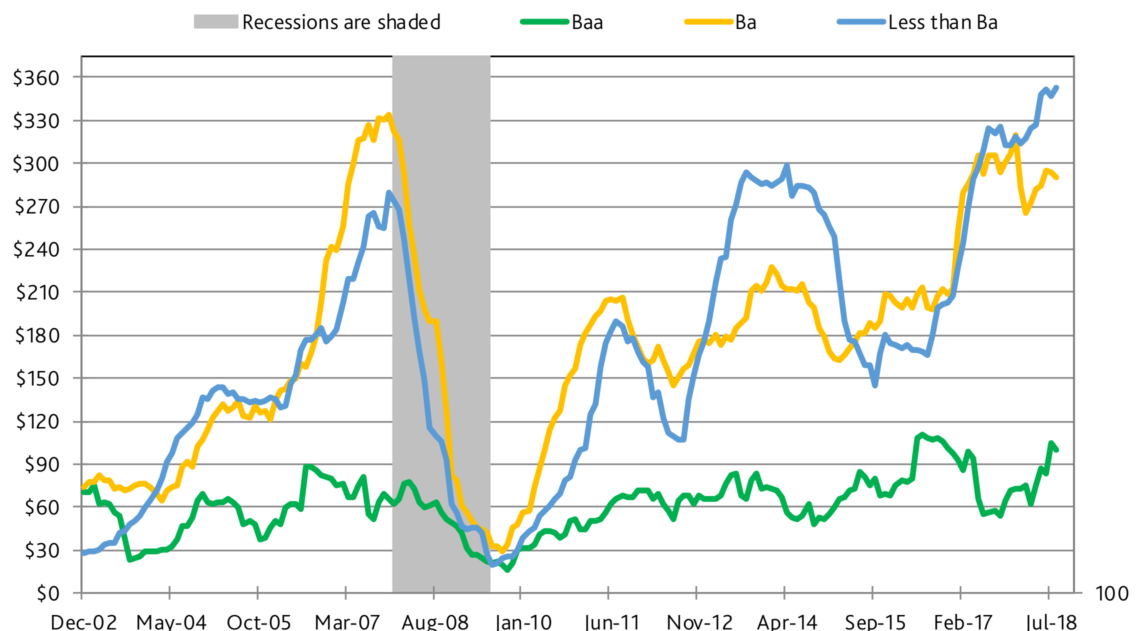
Nevertheless, the annual growth rate for newly-rated bank loans from high-yield issuers has slowed from yearlong 2017's 37.2% surge to the 6.3% of January-August 2018. Although the annual increase for new bank loans accelerated from the 5.1% of 2018's first half to the 11.9% of July-August, early indications hint of a slower pace for September. Indeed, there appears to a pick-up by high-yield bond issuance relative to new bank loans.

Figure 2: High-Yield Bond Offerings Topped New Bank Loan Programs from High-Yield Issuers Only in 2003, 2009 and 2010
moving 12-month sum in $ billions; source: Dealogic, Moody's Analytics



For the 12-months-ended August 2018, the newly rated bank loans from high-yield issuers have been distinguished by a record high $352 billion of loans graded single B or lower. Ba-rated loans set their 12-month high at the $334 billion of the span-ended November 2007, while the Baa group's zenith was set at the $111 billion of the span-ended June 2016. (Please note that issuers having a high-yield corporate family rating of Ba1 or Ba2 often receive a Baa rating for their senior secured loans.)

Figure 3: New Loans Rated Less Than Ba Set New Record High
12-month sums in $ billions; source: BEA, Moody's Analytics



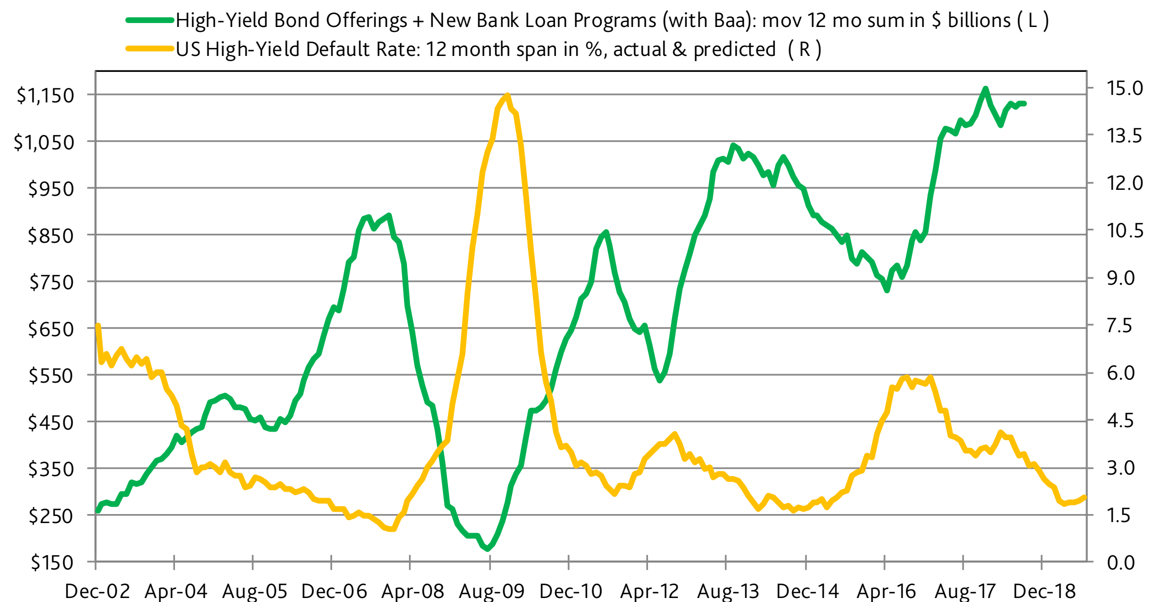
Total High-Yield Borrowing Declines despite Benign Default Outlook

The sum of high-yield bond issuance and new bank loans from high-yield issuers fell by 4.2% year-over-year during January-August 2018 and is expected to decline by 7.2% annually for all of 2018 following

yearlong 2017's 35.5% advance to a record high. Yearlong 2018's likely contraction by high-yield borrowing activity is unusual in that it will occur in the context of a declining high-yield default rate.

Eight of the 10 year-end declines by the default rate since 2001 were accompanied by a calendar year increase for total high-yield borrowing, wherein the median annual changes for those 10 years equaled a 1.2 percentage point decline for the default rate and 30.3% for the annual increase by high-yield borrowing. The two exceptions were year-end 2014's decline of 10.5% by high-yield borrowing despite a 4/10th of a percentage point year-to-year dip by the default rate to 1.8% and 2005's 11.9% shrinkage of borrowing notwithstanding a 6/10th of a percentage point decline by the default rate to 2.4%. The default rate is currently expected to drop by a percentage point from a year earlier to December 2018's prospective 2.6%.

Figure 4: 80% of Year-to-Year Declines by the Year-End Default Rate Were Joined by Growth in High-Yield Borrowing
source: Dealogic, Moody's Analytics



Downgrades' Share of High-Yield Rating Changes May Set New Low

The benign outlook for defaults now finds support from the nearly finished third-quarter's exceptionally low number of high-yield credit rating downgrades. As derived from a methodology that has been employed since 1986, the third-quarter-to-date's credit rating revisions of U.S. high-yield issuers show the 58 upgrades towering over 15 downgrades, while U.S. investment grade credit rating changes included 13 upgrades and five downgrades.

Downgrades' now 21% share of the third quarter's number of U.S. high-yield credit rating revisions is less than its current record low share of 27% from 1993's third quarter. The third quarter of 1993 was at the start of the third year of what would be a very long business cycle upturn.

The most frequently mentioned reasons behind the third-quarter's upgrades include de-leveraging (often through earnings growth), profits growth, improved cash flow, and revenue growth.

Oil and gas industry companies were subject to 12 high-yield upgrades and two high-yield downgrades. After excluding oil and gas companies, the high-yield downgrade ratio of the unfinished third quarter inched up to a still very low 22%.

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

THE U.S.

By Mark Zandi, Chief Economist of Moody's Analytics

On Alert for Missteps

It has been a decade since the financial crisis hit with full force. There has been much economic progress since then. U.S. unemployment, which peaked at 10% at the worst of the ensuing recession, is now below 4% and set to fall further. Incomes and profits are growing strongly, and house and stock prices are at record highs. Household debt loads are light. The benefits of the better economy haven't reached everyone, but most Americans are enjoying better finances.

Especially encouraging for the economy's longer-run performance is that policymakers made substantial reforms to the financial system in the wake of the crisis. The system is on much sounder ground than a decade ago and much less likely to suffer another crisis, at least not on the same scale.

The Dodd-Frank regulatory reforms are the most important. They include requiring the banking system to hold much more capital—the cushion required to absorb losses the system suffers on its lending. The ratio of Tier 1 capital (the highest quality capital) to assets at commercial banks has risen to a rock-solid 13%, compared to no more than 10% leading up to the crisis. Systematically important financial institutions—those that threaten the entire system if they fail—must hold more.

The system also has much stiffer liquidity requirements and better risk management practices, including a stress-testing process that requires large financial institutions to be prepared for events similar to the financial crisis. Prior to the crisis, institutions had difficulty determining the implications of macroeconomic events such as spiking oil prices, rising interest rates, or falling real estate and stock prices on their loan losses, profitability and capital. They have a good grip on this now, and are prepared.

In addition, there is in place a clear process for resolving failing financial institutions that pose a systemic threat. There was no such process in place prior to the financial crisis, and policymakers resolved each failing institution from Bear Stearns to Lehman Brothers to Fannie Mae and Freddie Mac differently. Investors, not knowing where the government backstop stood, were spooked and ran for the proverbial door, precipitating the crisis.

Cookbooks

Large institutions must also write a living will, a kind of cookbook that provides step-by-step instructions on how regulators should wind them down, if necessary. This is a theoretical exercise, so it is unclear how such a process would work out in real time. But regulators are much more likely to avoid a meltdown with a cookbook in hand than by improvising on the fly.

Despite the higher capitalization and increased regulatory oversight of the banking system post-crisis, banks remain very profitable. With the recent corporate tax cut, after-tax return on assets for the entire banking system is back where it was prior to the crisis, when the housing bubble inflated loan growth and masked developing credit problems.

The Federal Reserve and other regulators are willing and able to use so-called macroprudential tools to address problems developing in the financial system. For example, not too long ago regulators issued guidance to banks to be more cautious in their lending on multifamily real estate projects, because there was growing evidence of overbuilding. And several years ago regulators worried about

lending to highly leveraged companies and issued guidance to rein it in. That cooled things off, for a while.

Regulators prior to the crisis explicitly avoided the use of macroprudential tools. The Federal Reserve under then-Chairman Alan Greenspan took the view that regulators were unable to identify whether bubbles were developing in asset markets, such as the housing or commercial real estate markets, and did not feel it appropriate to weigh against them. If there was a bubble and it burst, they reasoned, they would be able to use monetary policy to support markets and the economy if needed. They were clearly wrong.

The Federal Reserve is currently considering whether to use another new tool that it got with Dodd-Frank, namely the countercyclical capital buffer. If the Fed believes that current credit conditions are too frothy, it can raise capital levels for large banks to make it more costly for those institutions to be so aggressive in their lending. The Bank of England has the same tool, which it used after the Brexit vote by lowering capital standards to support markets and the economy.

It is especially unlikely that household lending will be at the root of the next financial crisis. The Consumer Financial Protection Bureau, also formed as part of Dodd-Frank, is now looking over consumer and mortgage lending practices. Many households are not in a position to fully evaluate the loan products they take on. Most pre-crisis subprime mortgages had interest rates that adjusted two years after their origination; homeowners were taken by surprise when their monthly mortgage payments jumped, ultimately forcing many into default.

Combined with new rules making it more difficult to extend loans to households that can't financially support them—the qualified mortgage rule is a good example—it is now more difficult to make bad consumer lending decisions.

Missteps will happen

To be sure, despite all these efforts and others, there will still be missteps by the financial system, and even crises. As the nightmare of a previous recession fades, risk-taking increases. Businesses eventually make investments that don't pay off, developers overbuild, and creditors extend too much credit. It took longer than usual after the Great Recession for risk-taking to revive, likely due to the severity of that downturn, but it has.

Most notable today is heightened lending to already-highly indebted nonfinancial businesses. This so-called leveraged lending has taken off recently, creating concern that these companies will have difficulty navigating the next recession and that resulting bankruptcies and losses will stress the economy and financial system. Regulators appear to be on increasing alert to this potential problem and may utilize macroprudential steps to address it. The sooner the better.

More broadly, by requiring banks to hold more capital and be more liquid, risk-taking is shifting to the less regulated and more opaque part of the financial system known as the shadow system. The shadow system is made up of an array of non-bank institutions, including asset managers, derivative exchanges, payment processors, insurance companies and pension funds.

These institutions are generally not as large as the money center banks, but they are critical to a well-functioning financial system. They are also vulnerable to liquidity squeezes since many rely on the big banks for lines of credit and short-term funding markets, both of which can quickly shut down in a risk-off environment. The next financial event or crisis will likely emanate from this shadow system.

The financial system is in a much better place than it was 10 years ago, and the next crisis appears a long way off, but regulators will need to be vigilant.

Procyclical policy

Complicating matters for regulators are current fiscal and monetary policies, which are procyclical and threaten to pump up risk-taking even more. Large deficit-financed tax cuts and increases in government spending are fueling growth, pushing unemployment lower, and are behind the recent surge in consumer and business confidence. Small businesses have never been as upbeat, and the only time consumers have felt better was in the midst of the internet bubble around Y2K. Even though the fiscal stimulus will begin to fade by the end of next year, under the assumption that the next Congress and President Trump won't come to terms on more tax cuts and spending increases, everyone still has plenty of time to overextend themselves.

Monetary policy also remains highly accommodative. The neutral federal funds rate—that rate consistent with the economy growing at its potential—is estimated at closer to 3% than its current 2%. The Federal Reserve is normalizing monetary policy, but according to its own script a 3% funds rate isn't in the cards until mid-2019. And by then, the neutral rate could be even higher—we estimate the long-run neutral rate to be closer to 3.5%. Cheap credit is rocket fuel for risk-taking.

The upshot: Although a financial crisis on the scale of the last one a decade ago is now much less likely given the reforms put in place, there still can be financial slipups serious enough to undermine even an economy as strong as we have today. Indeed, it is in the best of times, like now, when the errors are made that are the fodder for the next recession.

The week ahead is paced. The U.S. tariffs on $200 billion in imported Chinese goods go into effect. However, the focus will be on the FOMC. We expect the Fed to raise the target range for the fed funds rate next week by 25 basis points to 2% to 2.25%, but this won't be the main event. For one, a rate hike won't surprise anyone, since it is nearly fully priced in by financial markets. This would be the eighth increase since December 2015 and leave the fed funds rate near the low end of some estimates of the long-run equilibrium fed funds rate. However, we don't expect the Fed to send any subtle message that a pause in this tightening cycle is imminent, and we look for a more hawkish message from the new Summary of Economic Projections.

Turning to the economic data, we expect a small upward revision to second quarter GDP growth. The mix of growth won't be appreciably different from the government's second estimate of second quarter GDP. We don't anticipate much better news on housing as new-home sales for August are forecast to have fallen to 623,000 annualized units. Pending home sales likely dropped in August. Elsewhere, we expect a solid gain in durable goods orders, boosted by nondefense aircraft. Away from transportation, the increase in durable goods will be less impressive. The forecast is for both nominal personal income and spending to have risen 0.4% while the core PCE deflator was likely unchanged in August.

	Key indicators	Units	Moody's Analytics	Consensus	Consensus Range	Last
Mon @ 10:00 a.m.	Moody's Analytics Business Confidence for 9/21/18	index, 4-wk MA				
Tues @ 10:00 a.m.	Conference Board Consumer Confidence for September	index	133.6	132.0	129.8 to 137.9	133.4
Wed @ 8:30 a.m.	New-home sales for August	ths, SAAR	623	630	600 to 660	627
Wed @ 2:00 p.m.	FOMC meeting for September	mid-point of target range, %	2.00 to 2.25	2.00 to 2.25		1.75 to 2.00
Thur @ 8:30 a.m.	Jobless Claims for 9/22/18	ths	225	210	200 to 240	201
Thur @ 8:30 a.m.	GDP for 2018Q2-third estimate	% change, SAAR	4.4	4.2	4.1 to 4.5	4.2
Thur @ 8:30 a.m.	Advance durable goods orders for August	% change	3.9	1.9	-1 to 4.8	-1.7
	Excluding transportation	% change	1.0	0.4	0 to 1.5	0.2
Thur @ 10:00 a.m.	Pending-home sales for August	% change	-0.5	-0.2	-1 to 2	-0.7
Fri @ 8:30 a.m.	Nominal personal income for August	% change	0.4	0.4	0.3 to 0.5	0.3
Fri @ 8:30 a.m.	Nominal consumer spending for August	% change	0.4	0.3	0.1 to 0.5	0.4
Fri @ 8:30 a.m.	Core PCE deflator for August	% change	0.0	0.1	0 to 0.2	0.2
Fri @ 10:00 a.m.	University of Michigan consumer sentiment for September-	index	101.0	100.5	99.2 to 101.6	100.8

MONDAY, SEPTEMBER 24

Business confidence (week ended September 21; 10:00 a.m. EDT)

The escalating global trade war appears to be weighing on business confidence. This nervousness is most evident with regard to expectations about business prospects into next year; they are about as weak as they have been at any time during this expansion. Close to one-third of respondents say that prospects are weakening, the highest percentage since the economy was pulling out of the Great Recession at the start of this decade. Businesses' other big concern is around regulatory and legal issues, although this concern is receding with about one-third of respondents saying it is their greatest worry. Worries about the cost and availability of labor are on the rise and now rank as the top concern of nearly one-fourth of respondents.

The four-week moving average in our global business confidence index fell from 32.6 to 31.8 in the week ended September 14.

TUESDAY, SEPTEMBER 25

Consumer confidence (September; 10:00 a.m. EDT)

We look for The Conference Board's consumer confidence index to have risen from 133.4 in August to 133.6 in September. The University of Michigan's preliminary consumer sentiment survey was strong and the weekly Bloomberg consumer comfort index was also strong in mid-September. Hurricane Florence is a downside risk, as it hit around the time the Conference Board normally compiles its responses.

WEDNESDAY, SEPTEMBER 26

New-home sales (August; 10:00 a.m. EDT)

The housing data have generally disappointed recently and we don't expect new-home sales to break from this trend. The forecast is for new-home sales to have fallen from 627,000 annualized units in July to 623,000 annualized units in August.

THURSDAY, SEPTEMBER 27

Jobless claims (week ended September 22; 8:30 a.m. EDT)

Hurricane Florence likely provided a big but temporary boost to initial claims. We look for new filings to have risen from 201,000 to 225,000 in the week ended September 22.

GDP (2018Q2-third estimate; 8:30 a.m. EDT)

We expect second quarter GDP growth to be revised up from 4.2% to 4.4% at an annualized rate. Among the components, we look for a small upward revision to growth in real consumer spending from 3.8% to 3.9% at an annualized rate. The forecast also pencils in upward revisions to nonresidential structures investment, government spending, and the inventory build. A caveat is that inventories will remain a drag on second quarter GDP growth, just a little less than previously reported. Residential investment, net exports and intellectual property will likely be revised lower.

Durable goods orders (August; 8:30 a.m. EDT)

Boeing orders jumped in August and this should provide a big boost to total durable goods orders. We look for durable goods orders to have risen 3.9%. We also anticipate a positive contribution from both nondefense aircraft orders and motor vehicles and parts. Excluding transportation, orders likely increased 1%.

FRIDAY, SEPTEMBER 28

Personal income and spending (August; 8:30 a.m. EDT)

We look for nominal personal income to have increased 0.4% in August. Nominal consumer spending is also forecast to have risen 0.4% in August. For spending, we look for services to provide a good chunk of the boost, thanks to utilities. Turning to inflation, we look for the core PCE deflator to have been unchanged, leaving it up 1.9% on a year-ago basis.

EUROPE

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

U.K. Growth and Euro Zone Inflation Are the Focus

In the spotlight for next week are the final estimate of U.K. second-quarter GDP growth and the euro zone's preliminary CPI estimate for September. We don't expect much fuss from either. First, we are forecasting U.K. GDP growth to be confirmed at 0.4% q/q in the second quarter, up from a 0.2% rise in the previous stanza, matching the Monetary Policy Committee's expectations and its assessment of trend growth. Despite the accelerating headline, the details should corroborate our view that the costs of the currency's depreciation since the Brexit referendum have ultimately outweighed its supposed benefits.

Consumption growth is set to have remained subdued, rising at about half its average rate for the previous two years, despite the fact that warm weather, the World Cup, and the royal wedding were all expected to have boosted food consumption and sales on the high street. To that we add that a much stronger correction was actually warranted after bad weather kept consumers at home during the first quarter and pushed household consumption growth to its lowest in almost two years. Growth in consumption remains depressed by the inflation-led squeeze in real incomes, which came mainly on the sterling-related rise in import prices.

At the same time, the fall in the pound hasn't been translated into export gains, which in theory is the flip side of the currency's depreciation. So next week's figures should confirm that net trade shaved 0.8 percentage point off growth in the second quarter as a plunge in exports offset a smaller decline in imports. The good news is that this was offset by an increase in inventories—particularly nonmonetary gold flows, which are always a main theme in the U.K. GDP release. This means that, excluding the erratic items balance, net trade didn't contribute or subtract from growth. Elsewhere, investment is expected to have ramped up over the quarter, though this needs to be seen mainly as a mean reversion following weak results for the previous quarter. The trend in business investment remains well below rates in previous quarters as well as those in other euro zone countries.

Across the Channel, preliminary CPI figures for the euro zone should confirm that inflation in the currency area remained steady at 2% in September, though we admit that risks are clearly shifted toward a slightly higher reading of 2.1%. That's because we are unsure if the expected dip in energy inflation will be enough to offset both a pickup in the core rate—led by a rebound in package holliday inflation—and an increase in food inflation. Europe's scorching summer damaged crop yields and pushed up prices of fresh produce, and this should be translated into a higher food headline in coming months.

Even if inflation jumps above target for yet another month, we see no reason to change our story about the European Central Bank. We think the ECB's decision to proceed with its announced plan to end asset purchases in December is all but set in stone (and an overshoot in September would further add to this). But we continue to see that the bank won't be pressured to begin lifting the deposit rate until the fourth quarter of next year. There is still no evidence that we are at the start of a marked increase in inflation, with underlying inflation pressures remaining significantly below the central bank's target of 2%.

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	Key indicators	Units	Moody's Analytics	Last
Wed @ 5:00 p.m.	France: Job Seekers for August	mil, SA	3.48	3.46
Thur @ 10:00 a.m.	Euro Zone: Business and Consumer Sentiment for September	index	111.2	111.6
Fri @ 7:30 a.m.	Russia: GDP for Q2	% change yr ago	1.8	1.3
Fri @ 7:45 a.m.	France: Household Consumption Survey for August	% change	0.5	0.1
Fri @ 8:00 a.m.	Spain: Retail Sales for August	% change yr ago	-0.1	-0.4
Fri @ 9:00 a.m.	Germany: Unemployment for September	%	5.2	5.2
Fri @ 9:30 a.m.	U.K.: GDP for Q2	% change	0.4	0.2
Fri @ 10:00 a.m.	Euro Zone: Preliminary Consumer Price Index for September	% change	2.0	2.0

MONDAY, SEPTEMBER 24

No major indicators are scheduled for release.

TUESDAY, SEPTEMBER 25

No major indicators are scheduled for release.

WEDNESDAY, SEPTEMBER 26

France: Job Seekers (August; 5:00 p.m. BST)

France's labour market is struggling to make significant progress amid weaker economic growth in the first half of the year. We expect the number of job seekers ticked up slightly to 3.48 million in August after rising to 3.46 million in July. The August PMI data show that hiring intentions remain high, but current confidence levels reveal that improvements in the labour market could pause unless more demand is generated.

THURSDAY, SEPTEMBER 27

Euro Zone: Business and Consumer Confidence (September; 10:00 a.m. BST)

The euro zone's sentiment indicator likely slid to 111.2 in September. Wavering consumer sentiment is dragging on the outlook for the service sector. The pent-up demand of households appears largely exhausted, and rising fuel prices are leaving the shoppers worse off. We expect that diverging sentiment across the major economies carried into the third quarter; German manufacturers, for example, appear less pessimistic than their peers in France and Italy.

Although the euro zone faces no immediate trade risk, we still do not see the sentiment gauge nearing the stratospheric highs of last year. Not only have the tailwinds abated, but the cyclical factors have turned less supportive as the single-currency bloc entered a more mature phase of the business cycle. Still, we maintain that the above-trend growth of 2% will last this year, which should lift core inflation to just 1.3% by the end of the year and allow the ECB to deliver the first rate hike no earlier than the second half of 2019.

FRIDAY, SEPTEMBER 28

Russia: GDP (Q2; 7:30 a.m. BST)

Russia's GDP growth likely accelerated to 1.8% y/y in the second stanza from 1.3% in the first, making the expansion in the first half of the year a touch above the 1.5% recorded over 2017. A stronger reading in the second stanza would be thanks to manufacturing output, which expanded through the quarter and edged up to 4% y/y in July, suggesting that the strength of the industry carried over to the third quarter. Slightly higher oil prices and a likely easing of the OPEC oil production cap should push the industrial figures even higher next year, creating an upside risk to our conservative forecast. Current account revenues will well exceed the debt repayment needs, but we expect the Ministry of Finance will largely neutralize the effect of the windfall by saving the extra

revenues in the sovereign fund. Investments, however, will remain a drag as the public infrastructure projects are phasing out, and we do not see the fiscal stance turning more accommodative. The private sector will not step up to fill in that gap. Heightened volatility of the ruble, moderately tight credit conditions afforded by the Bank of Russia, and the international sanctions will drag on investment.

France: Household Consumption Survey (August; 7:45 a.m. BST)

French household expenditure on goods likely rose by 0.5% m/m in August, following a meagre 0.1% rise in July. This should have pushed the yearly rate back up to 1%, following a paltry 0.2% gain previously, in line with the average increase for the previous year. Driving the headline the most was likely an increase in household goods spending following a sharp decline in July, which was itself a correction from World Cup-led strength in May and June (demand for televisions surged before the games). Energy spending should have also increased, as the unseasonably hot weather likely kept demand for air conditioning elevated. By contrast, food spending is expected to have corrected somewhat following three consecutive months of increases, though that temperatures remained high in August likely ensured that demand for food products and alcoholic beverages remained relatively solid.

Spain: Retail Sales (August; 8:00 a.m. BST)

Amid rising inflation, we expect that Spain's retail performance weakened in monthly terms in August, keeping the year-ago measure in negative territory for the fourth straight month. Purchase of big-ticket items fell for the first time in four years in the first half, suggesting that Spaniards have made up for the purchases they postponed during the crisis.

But that the volume of supermarket sales fell by 0.9%, while in the same period of the previous year they had risen by 1.8%, shows that purchasing power faltered in 2018 as the higher fuel prices were passed through to consumers.

Germany: Unemployment (September; 9:00 a.m. BST)

Germany's seasonally adjusted unemployment rate likely remained at 5.2% in September, after it fell to this record low in May. German businesses are increasing their labour force, despite the uncertainties and geopolitical tensions such as the continued Brexit negotiations or the introduction of additional controversial import tariffs by the U.S. Strong economic expansion has supported job creation over the last year, though there has been visible cooling this year. Although the German expansion rate ticked up to 0.5% q/q in the second quarter, from 0.4% in the previous stanza, in year-ago terms the growth rate decelerated to 2% from 2.1%, and was well below the 2.8% expansion rate reached at the end of 2017. The tightening labour market is becoming a problem. A poll from the German Chamber of Commerce and Industry showed that around 60% of surveyed companies reported the shortage of skilled workers as the biggest risk facing their businesses.

U.K.: GDP (Q2; 9:30 a.m. BST)

Final numbers should confirm that U.K. GDP grew by 0.4% q/q in the second quarter, accelerating from 0.2% in the previous stanza and matching the Bank of England's expectations and its assessment of trend growth. Yearly growth is similarly to be confirmed at 1.3%, slightly up from 1.2% in the previous quarter. An increase in investment was largely behind the quarterly pickup in momentum. Total investment—which includes business investment, general government investment and investment in dwellings—rose by 0.8% q/q, mean-reverting from a 1.3% decline previously. Business investment alone increased 0.5% q/q, following a 0.4% decline previously, though we caution that this rise brings business investment only to the same rate as the one seen in the fourth quarter of 2017.

The preliminary numbers showed that household spending also picked up, but only slightly by 0.3% q/q, following a 0.2% increase previously. This is disappointing, since we were expecting a sharper rebound following a weather-related hit to services consumption and retail sales in the first quarter.

Also, this is well below the 0.6% average for the past two years. Government spending growth, meanwhile, held steady at 0.4% for the third consecutive quarter, in line with expectations.

The main disappointment came from net trade. Exports shed 3.6% q/q, following no growth previously, while imports were down by 0.8%, following a 0.2% decline previously. This pushed the contribution of net trade down to 0.8 percentage point, highlighting how sterling's depreciation has again failed to help the U.K.'s competitiveness by boosting foreign demand for U.K. goods. This drag from net trade was nonetheless offset by a rise in inventories, especially in the 'net acquisition of valuables' component of inventories. This is due mainly to non-monetary gold flows, which are normally GDP neutral; a rise in imports of non-monetary gold lifts total imports, while on the other hand it boosts inventories. Accounting for this offset, net trade made no contribution to growth.

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

Euro zone inflation likely remained steady at 2% in September, after it peaked at 2.1% in July, though in our view the balance of risks is tilted slightly to the upside. We expect that a further easing in energy inflation offset upticks in food and in core inflation. Accelerating energy inflation was a key feature of the CPI report over the first half of 2018, but the price of the Brent barrel in euro terms was around 41% higher than in September 2017, compared with a stronger 43% reading in August, and should help push energy inflation back to around 8.8%, from 9.2%. We expect base effects will allow energy inflation to cool further to around 4.5% by the end of the year.

By contrast, we expect that the other components of noncore inflation contributed to the headline. First, alcohol and tobacco inflation surged in March because of the tax hike in France, and should remain elevated until base effects kick in next year. Second, food inflation is supposed to pick up slightly over the next few months, in line with the recent rise in food producer prices, as Europe's scorching summer damaged crop yields and pushed up prices of fresh produce.

Regarding core inflation, we are penciling in services inflation to have climbed to 1.4% in September, after it slowed to 1.3% in August. A broad-based fall in the volatile package holiday component of the services rate came as a major drag in August, so we are expecting a mean reversion in September. But a drop in education inflation is expected to keep a lid on the services headline in coming months. Education prices fell in August in some countries, including Germany, and given that they are normally regulated (rising only once a year in most cases), base effects should ensure that this drag remains until August 2019. Still, we maintain that the euro area's tight labour market combined with the ongoing recovery will ensure that services inflation gradually climbs to 1.6% at the end of the year.

We look for core goods inflation to have held ground in September too, though it has scope to heat up over the next few months. Weakness in nonindustrial goods inflation has been a main theme in the latest CPI releases, and the sector's inflation rate remains well below trend. Our view is that a lagged effect from the stronger euro last year could be depressing durables and semidurables prices, but we expect that this will be reversed soon as the euro depreciated sharply and is now reading around 2% lower in year-ago terms against the dollar, while it was reading around 15% higher at the start of the year.

ASIA-PACIFIC

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

Monetary Paths Diverge

Japan's August activity data will be unspectacular. Production momentum in Japan has wavered in recent months, mostly on the back of rising trade war concerns and local weather issues causing disruptions across the supply chain. Production likely fell further in August after a 0.1% decline in July. We expect the unemployment rate to hold at 2.5% for August. We expect full-time jobs to have grown again in August, while part-time jobs will likely rise at a slower pace.

Japan's nominal retail trade likely hit 1.5% y/y in August, broadly similar to July's pace and a decent clip by Japan standards. However, the rise in retail sales belies underlying spending weakness. Much of the increase was because of the increase in fuel sales, which, in turn, largely reflects the runup in oil prices.

Monetary policy paths in Indonesia and New Zealand have firmly diverged. Bank Indonesia has been one of Asia's most aggressive central banks this year. BI has hiked the policy rate by 125 basis points since mid-May in addition to other measures to shore up the rupiah and stem capital outflows. We expect the central bank to deliver a further 25-basis point hike at its September meeting, to 5.75%. On 5 September Bank Indonesia Governor Perry Warjiyo signalled that the central bank would continue taking "pre-emptive" action to address the currency slump.

Meanwhile, the Reserve Bank of New Zealand has settled in for the long haul. The central bank will keep the overnight cash rate at 1.75% in September. In August the RBNZ pushed out until 2020 its expectation for when the next rate movement will occur and reiterated that the scale was balanced as to whether it would be a cut or a hike. We maintain that the next move will be an increase, with economic conditions on a broadly improving trend

	Key indicators	Units	Moody's Analytics	Last
Wed @ 8:45 a.m.	New Zealand Foreign trade for August	NZ$ mil	-125	143
Thurs @ 7:00 a.m.	New Zealand Monetary policy for September	%	1.75	1.75
Thurs @ Unknown	Indonesia Monetary policy for September	%	5.75	5.75
Fri @ 7:00 a.m.	South Korea Consumer sentiment index for September	Index	98.4	99.2
Fri @ 9:30 a.m.	Japan Unemployment rate for August	%	2.5	2.5
Fri @ 9:50 a.m.	Japan Industrial production for August	% change	-0.4	-0.1
Fri @ 9:50 a.m.	Japan Retail trade for August	% change yr ago	1.3	1.5
Fri @ 5:30 p.m.	Thailand Private consumption for August	% change yr ago	5.2	4.8
Fri @ 5:30 p.m.	Thailand Foreign trade for August	US$ bil	3.0	0.9

MONDAY, SEPTEMBER 24

There are no major indicators scheduled for release today.

TUESDAY, SEPTEMBER 25

There are no major indicators scheduled for release today.

WEDNESDAY, SEPTEMBER 26

New Zealand – Foreign Trade – August; Time: 8:45 a.m. AEST (Tuesday, 10:45 p.m. GMT)

New Zealand can't shake those foreign trade deficits. The monthly trade balance is expected to remain in deficit for a third straight month in August, notching NZ$125 million, following the NZ$143 million shortfall in July. The import bill remained relatively large in August amid crude oil prices remaining elevated, alongside a weaker New Zealand dollar. The headline trade balance from the June quarter onward has been contained by strength in the dairy sector, which continued to perform well after weather-related disruptions in the March quarter. The annual trade deficit in the year to July notched NZ$4.4 billion, the widest annual deficit since March 2009. Higher petroleum imports were the key

driver, largely on higher global prices and a weaker exchange rate. Imports of petroleum and products were up 30% y/y in the year to July.

THURSDAY, SEPTEMBER 27

New Zealand – Monetary Policy – September; Time: 7:00 a.m. AEST (Wednesday, 9:00 p.m. GMT)

The Reserve Bank of New Zealand has settled in for the long haul. The central bank will keep the overnight cash rate at 1.75% in September. In August the RBNZ pushed out until 2020 its expectation for when the next rate movement will occur and reiterated that it was balanced whether it would be a cut or a hike. We maintain that the next move will be an increase, with economic conditions on a broadly improving trend; GDP growth and the labour market are already in a healthy spot and are expected to improve over the next year. The RBNZ explicitly noted that inflation is expected to be bumpy over the near term because of one-off domestic price changes and global oil prices, but cautioned against getting excited by this, since the bank will look beyond the volatility.

Indonesia – Monetary Policy – September; Time: Unknown

Bank Indonesia has been one of Asia's most aggressive central bank's this year. It hiked the seven-day reverse repo rate by 25 basis points to 5.5% in August, bringing total tightening since May to 125 basis points. We expect the central bank to deliver a further 25-basis point hike at its September meeting to 5.75%. On 5 September Bank Indonesia Governor Perry Warjiyo signalled that the central bank would continue taking "pre-emptive" action to address the currency slump. This sort of rhetoric has been used in the recent past to signal further imminent rate hikes. BI is at pains to demonstrate it is on the front foot against emerging markets falling out of favour.

FRIDAY, SEPTEMBER 28

South Korea – Consumer Sentiment Index – September; Time: 7:00 a.m. AEST (Thursday, 9:00 p.m. GMT)

The Bank of Korea's consumer sentiment index likely fell to 98.4 in September, down from 99.2 in the prior month. South Korean consumers are increasingly pessimistic, with worries about the health of the economy and their job prospects weighing heavily on overall sentiment. Expectations of domestic economic conditions as well as employment prospects are down at 16-month lows. Consumer sentiment has now been in a downswing since late 2017, and with the economy showing signs of cooling and the labour market weak, sentiment is likely to remain dim.

Japan – Employment Situation – August: Time: 9:30 a.m. AEST (Thursday, 11:30 p.m. GMT)

After two consecutive rises in the unemployment rate, we expect the jobless rate to remain unchanged from July's 2.5%, after it rose from 2.4% in June and 2.2% in May. Much of the recent rise in unemployed is partially due to the expanding labour force, which grew by 80,000 in July. We always thought the early-2018 pace of job growth would be difficult to maintain. That said, labour demand remains firm as evidenced by the rising jobs-to-application ratio. We expect full-time jobs to grow again in August, while part-time jobs will likely rise at a slower pace. Overall, a sustained improvement in income remains elusive despite the tightening labour market.

Japan – Industrial Production – August; Time: 9:50 a.m. AEST (Thursday, 11:50 p.m. GMT)

Production momentum in Japan has wavered in recent months, mostly on the back of rising trade war concerns and local weather issues causing disruptions across the supply chain. Production likely fell further in August after a 0.1% fall in July. There was a broad-based drop in production in July, but declines in information and communications as well as chemicals led the overall drop. Production of electronics has added to growth, although the sharp gains from 2017 are unlikely to be repeated. This is in line with our expectations as the global tech cycle continues to cool this year.

Japan – Retail Sales – August; Time: 9:50 a.m. AEST (Thursday, 11:50 p.m. GMT)

Retail sales strengthened further in July by rising 1.5%. We expect sales to increase 1.3% in August. However, the rise in retail sales belies underlying spending weakness. Much of the increase was because of the rise in fuel sales, which, in turn, largely reflects the runup in oil prices. Japan remains a top-three

net oil importer, so a pickup in oil prices is felt throughout the economy. The outlook for consumption remains mixed. Although spending on nondiscretionary items such as food and medical services remains firm, concerns persist around spending on bigger ticket items.

Thailand – Private Consumption – August; Time: 5:30 p.m. AEST (7:30 a.m. GMT)

Private consumption likely grew 5.2% y/y in August, up from 4.8% in the prior month. Private consumption has grown at a solid pace in recent months, driven by the ongoing surge in car sales. However, motorcycle sales remain weak, suggesting consumers at the lower end of the income scale remain restrained. One issue facing the Thai consumer market is elevated household debt, which is the second highest in Southeast Asia. This crimps spending and could cause further issues once the Bank of Thailand starts an interest rate hike cycle.

Thailand – Foreign Trade – August; Time: 5:30 p.m. AEST (7:30 a.m. GMT)

Thailand's trade surplus likely rebounded to US$3 billion in August, after shrinking to US$860 million in the prior month. In July, export growth slowed for the third straight month and imports continued to rise at a solid pace, largely on a higher oil import bill. Still, foreign demand for Thailand's manufactured products remained solid, with automotive, apparel and footwear, and electronics continuing to increase at a healthy pace. Although the trade surplus likely improved in August, the escalation in trade tensions dims the trade outlook. Indeed, the escalation in trade tensions comes at a bad time in the global trade cycle, with growth in global trade volumes already in a downswing.

The Long View

Newly rated loans from high-yield issuers seem to have eased lately relative to high-yield bond issuance.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group,
September 20, 2018

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 124 basis points eclipses its 122-point mean of the two previous economic recoveries. This spread may be no wider than 130 bp by year-end 2018.

The recent high-yield bond spread of 336 bp is less than what 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

August 2018's U.S. high-yield default rate of 3.41% was less than the 3.51% of August 2017. Moody's Default and Ratings Analytics team now expects the default rate will approximate 2.1% by August 2019 after averaging 1.9% during 2019's second quarter.

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.

Second-quarter 2017's worldwide offerings of corporate bonds showed an annual 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.

Second-quarter 2018's worldwide offerings of corporate bonds eked out an annual increase of 2.8% for IG, but incurred an annual plunge of 20.4% for high-yield, wherein US$-denominated offerings rose by 1.6% for IG and plummeted by 28.1% 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 changes for 2018's worldwide corporate bond offerings are -0.9% for IG and -21.4% 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 U.S.'s subpar recovery. To the degree companies fear significantly higher bond yields, pre-fundings will rise.

The Long View

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 Araujo of Moody's Analytics
September 20, 2018

UNITED KINGDOM

The further growth in U.K. retail sales in August beat market expectations and our forecast, signaling that British consumers are loosening their purse strings despite the fact that most fundamentals remain unfavourable for a pickup in consumer spending. Accordingly, even if we pencil in some mean-reversion in September, August's above-average headline sets retail sales up for a strong 1.3% q/q gain in the third quarter, following an already-impressive 2.1% jump in the second stanza, which was the strongest gain in 17 years.

But this strength looks unsustainable. The biggest driver of the August increase was a spike in household goods sales, notably a 7.8% m/m surge in the furniture and lighting subsector. Not only are furniture sales volatile, but the sector's momentum doesn't chime in with the depressed housing market, which makes a correction in September likely. Also, most of the strong gains in the other store subsector was due to a jump in sales of sports equipment, games and toys. These depend heavily on the bestseller charts for computer games, and CPI figures on Wednesday already hinted at blockbuster releases taking place in August as prices of computer games soared over the month.

That households' fundamentals haven't improved much (or even at all) thus remains our main argument for why this upturn in retail sales is unsustainable. Higher oil prices, rising interest rates, a dwindling housing market, the fiscal squeeze, and the ongoing Brexit saga all ensure that consumer confidence remains low, while consumers' savings intentions have skyrocketed recently. Granted, most of the sterling-related increases in import prices have already been passed through to consumers, and this should help ease the squeeze in consumers' purchasing power in coming months. But nominal wage growth isn't expected to soar, especially as employment intentions have flagged lately, so real wages should rise only modestly.

We thus expect that the third quarter strength in retail won't carry over into the fourth stanza, though a better-than-expected Brexit deal could provide a strong boost to consumer spending next year.

Inflation

August's surge in U.K. consumer price inflation caught markets off guard, but this is largely attributable to the volatility in some sectors, so we expect it is just a blip. Most of the overshoot was because computer games prices rose further, and because of jumps in the prices of theater tickets as well as in air and sea fares, all of which swing wildly.

Computer games prices depend heavily on bestseller charts, and so do theater tickets. We see no reason for prices in those two sectors to continue rising strongly in coming months. Transport services inflation, meanwhile, depends on how prices vary from one month to the next. Air and sea fares normally increase in monthly terms in August because of the summer holidays, but they rose more this August than a year earlier. Higher pump prices are likely behind this, which means that despite an expected correction in September, transport services inflation should remain a touch higher this year than last year. Base effects in oil prices have started to kick in, and this should drive down motor fuel inflation considerably for the rest of this year.

Other developments were in line with our expectations. Inflation eased in most of the other core goods subsectors, corroborating our view that the core rate is set to slow sharply this year now that retailers have already finished passing higher import prices through to consumers. We expect the core goods rate to cool towards zero by the end of the year. Underlying services inflation (which excludes the more volatile subsectors) was unchanged, in line with

our assumption that underlying price pressures remain practically nil in the U.K. economy. We believe services inflation will remain relatively steady at around 2.5% throughout the second half of 2018, though there are some upside risks related to transport services inflation.

All considered, our view is that the CPI headline will slow to the 2% target by the end of the year or by the beginning of 2019.

ASIA PACIFIC

By Katrina Ell of Moody's Analytics
September 20, 2018

MALAYSIA

It has been an eventful 2018 for Malaysia. A new government led by Prime Minister Mahathir Mohamad came to power in May, ending the 61-year rule of the Barisan Nasional party. This marked the first change of government in Malaysia's history. Emerging market assets have fallen out of favour, and although Malaysia has not been as hard hit as some neighbouring economies, it has not been immune. Oil prices have climbed and have been volatile over 2018, with important implications for Malaysia, as it is a net oil exporter.

Downside risks plague the economic outlook, with the trade war between the U.S. and China a primary concern. Malaysia's important manufacturing sector is heavily reliant on foreign demand to fuel growth, and further escalation would crimp global trade flows and broader demand.

We expect Malaysian GDP growth to hit 4.8% in 2018 following 5.9% in 2017, a three-year high. The weaker projection for 2018 is due to a less supportive global environment, lower local infrastructure spending, and the government's broader fiscal consolidation push. June quarter GDP growth slowed for a third consecutive quarter and notched a disappointing 4.5% y/y, with unplanned supply outages in natural gas output and poor weather hurting agriculture being important drags.

Navigating through emerging market ructions

Emerging market assets have fallen out of favour in 2018. Monetary policy normalization in the U.S. has lifted U.S. Treasury yields and strengthened the greenback, resulting in some hefty capital outflows and declines in emerging market currencies. Also, heightened geopolitical tensions, including from the trade war between the U.S. and China, have turned the risk-on investor attitude that generally prevailed in 2016 and 2017. Foreign portfolio investment is a useful gauge of Malaysia's exposure to pressures on emerging markets. In the year to 14 September, foreign portfolio outflows amounted to $2.4 billion. Greater policy uncertainty since the arrival of Malaysia's new government in May has also had an effect.

Falling exchange rates and equity markets provide a useful way to evaluate how various emerging markets have fared within Asia and further abroad. Malaysia has escaped the brunt using these metrics. The ringgit has fallen 2.3% against the dollar this year, while the exchange rate of neighbours the Philippines, Indonesia and India have languished at either record or multiyear lows. Malaysia's equity market is similarly holding up, with the Kuala Lumpur Composite Index up 0.4% year to date.

There are important differences in economic fundamentals between Malaysia and those emerging markets that have fared comparatively poorly, and the prior 2013 taper tantrum, when some EMs were under severe stress, provides a useful point of comparison.

Malaysia is a relative outlier in that it persistently runs a current account surplus. In the June quarter, the surplus was 1.2% of gross national income. This makes Malaysia less vulnerable to sudden adverse swings in market sentiment and exchange rate depreciation, as it would be with a current account deficit, because it relies on its own savings to fund investment.

Also, inflation is subdued. Headline CPI growth slumped in July to more than a three-year low at 0.9% y/y because of the removal of the goods and services tax in early June. But even with the introduction of the sales and service tax from early September, CPI is expected to remain at the bottom end of the central bank's 2.5% to 3.5% target range.

A potential weak spot is the lower ratio of foreign reserves to short-term debt compared with other emerging market peers and its experience in 2013.

Malaysia's foreign reserves have trended lower since April, and in August were $104.2 billion, lower than July's $104.5 billion. August's position is sufficient to finance 7.6 months of retained imports and 0.9 times the short-term external debt, according to the central bank. This is low, including by peer standards.

But it is important to keep in mind that foreign reserves are not the only way for Malaysia to meet external obligations. According to Bank Negara, banks and corporations hold 75% of Malaysia's external assets, so a claim on foreign reserves does not necessarily need to be made to meet external debt obligations.

Increased leverage

There has been a broader trend in Malaysia towards higher debt levels. Government debt has increased from 23% of GDP in 2006 to 38% in 2017, according to the Bank of International Settlements. The Mahathir government has made fiscal consolidation a policy priority, and part of this has meant that some important infrastructure projects have been sidelined. This comprises those related to One Belt One Road, including the $20 billion East Coast Rail Link, China's most prominent infrastructure project in Malaysia, which began construction in 2017 and connects Malaysia's largest port with Thailand, and two gas pipelines worth $2.3 billion.

In early June, the government scrapped the 6% GST, which was an important source of revenue, and replaced it with SST in early September. If it is to meaningfully lower its public debt-to-GDP ratio and keep its 2018 budget deficit target of 2.8% of GDP on track, the government will have to rein in further spending, which will act as a drag on GDP growth.

There are important differences between the prior GST and the SST. Unlike the GST, which covers a wide breadth of goods and services, the SST has traditionally focused on a smaller number of goods, and government coffers become more reliant on oil revenue and less on local, everyday consumption. The multiplier effect from higher consumption because of lower visible taxation at the consumption stage is unlikely to offset the hit to government revenue.

Elevated oil prices are one temporary saving grace for Malaysia. Another lift to near-term consumption (and an added weight on government coffers) is that fuel spending initiatives have increased. Finance Minister Lim Guan Eng announced in early August that the government is spending US$730 million (0.25% of GDP) to stabilize fuel prices until the end of 2018.

Fiscal consolidation seems a sensible strategy in the current climate of a renewed focus on the economic health of emerging markets. However, Malaysia would do well not to pull back too hard and derail the growth engine, particularly given that global demand looks to have passed its peak, so it won't provide the same lift into 2019. Also, the trade war between the U.S. and China is still escalating, posing heightened downside risks to the global outlook.

High household debt

Malaysian households are among the highest-leveraged in Asia. Around 50% of household debt is tied up in residential housing loans, according to Bank Negara. Malaysia has a relatively high homeownership rate; it was 76% in 2016. However, homeownership has become less attainable because it has become less affordable. In 2016, Malaysia's house prices were on average around five times the annual median household income, up from 4.4 in 2009.

The ratio of loans on non-appreciating assets is relatively high at 49.7%, and this includes car and personal loans and credit cards; car loans represented the bulk at 26%. The high debt burden is more prevalent among lower-income households exposed to personal and motor vehicle loans. For 21% of households earning less than RM3,000, more than 60% of their income is used to repay debt.

Correlation between oil prices and the ringgit

Malaysia is a net oil exporter, so it is unsurprising that the ringgit is correlated with oil prices. The correlation coefficient between the ringgit and West Texas Intermediate was 0.8 for the past five years, indicating a strong positive relationship. Oil and gas constitutes around 14% of exports. The channel impacting the broader economy is simple: Higher oil prices lift government tax revenue, production, investment and

exporter receipts. Former Finance Minister Datuk Seri Johari Abdul Ghani estimated that for each U.S. dollar increase in crude oil prices, the government would earn an additional RM300 million (US$240,000) in revenue.

In January 2015 crude oil prices were at a six-year low of $45 per barrel, coinciding with the ringgit also being at a six-year low at 3.63 per U.S. dollar. Lower oil prices in 2015 caused government revenue to slide, compelling it to introduce the GST in 2015 as an alternate income source that is less volatile, given its exposure to the more stable consumer sector.

Since early April 2018 there has been a notable deviation between oil prices and the ringgit, such that the correlation coefficient from 1 April to 14 September was -0.12. We posit that this is likely a consequence of the ringgit being influenced by emerging market ructions, and over the medium term the solid relationship with oil prices will resume.

Moody's Analytics expects the global oil market to remain mostly balanced heading into 2019, preventing oil prices from rising in a sustainable manner. We assume that Saudi Arabia and Russia will increase their output in the second half of 2018. This will partially offset lower Iranian oil output levels. Increasing output from the U.S., Canada and Brazil will also prevent the emergence of a deficit in the global oil market in coming months. All told, the price of WTI will average US$68 per barrel in 2018 and US$67.90 per barrel in 2019, after US$50.90 per barrel in 2017.

Ratings Round-Up

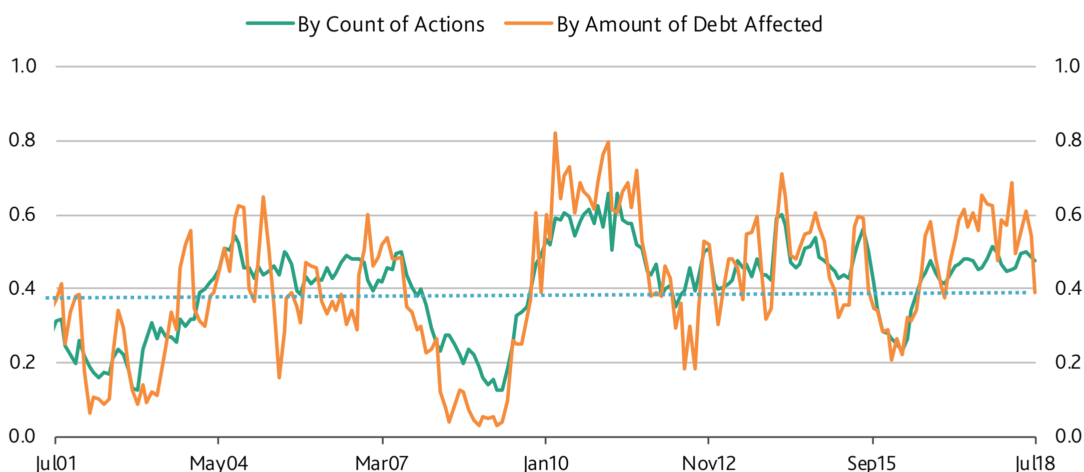
U.S. Upgrades Concentrated largely in Oil Industry

In the U.S., upgrades lead downgrades with eight firms received rating revisions. The contribution of upgrades was strong at 75%. Positive rating changes in recent weeks have been indicative of a strong economy and improving corporate credit quality. U.S. upgrades were concentrated largely in the oil industry, with three oil companies and one oil service company receiving upgrades. The rebound in oil prices has helped stabilize the U.S. oil industry which struggled in 2016. Elsewhere in North America, Canadian Natural Resources Limited was upgraded one notch to Baa2.

Rating revisions were light in Europe, with only five ratings changes: three upgrades and two downgrades. Among the upgraded companies was Swiss chocolate producer, Barry Callebaut AG, which was upgrade to Baa3. The notable downgrade was Greek gambling company Intralot S.A.

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
9/12/18	GREAT WESTERN OIL & GAS COMPANY, LLC-GREAT WESTERN PETROLEUM, LLC	Industrial	LTCFR/PDR		U	B3	B2			SG
9/13/18	NEWFIELD EXPLORATION COMPANY	Industrial	SrUnsec/LTCFR/PDR	2,450	U	Ba2	Ba1			SG
9/13/18	INTERNATIONAL FLAVORS & FRAGRANCES, INC.	Industrial	SrUnsec/LTIR/CP	1,383	D	Baa1	Baa3	P-2	P-3	IG
9/13/18	NRG ENERGY, INC. -NRG REMA LLC	Utility	SrSec	220	D	Caa1	Caa3			SG
9/13/18	CCM MERGER, INC.	Industrial	SrUnsec/SrSec /BCF/LTCFR/PDR	200	U	Caa1	B3			SG
9/17/18	WHITING PETROLEUM CORPORATION	Industrial	SrUnsec/LTCFR/PDR	7,064	U	B3	B2			SG
9/17/18	ABACO ENERGY TECHNOLOGIES LLC	Industrial	SrSec/BCF/LTCFR/PDR		U	Caa1	B3			SG
9/18/18	ALEXANDRIA REAL ESTATE EQUITIES, INC.	Financial	SrUnsec/LTIR/PS	4,575	U	Baa2	Baa1			IG
9/18/18	NORTHERN OIL AND GAS, INC	Industrial	SrUnsec/LTCFR/PDR	126	U	Caa3	Caa2			SG

Source: Moody's

Ratings Round-Up

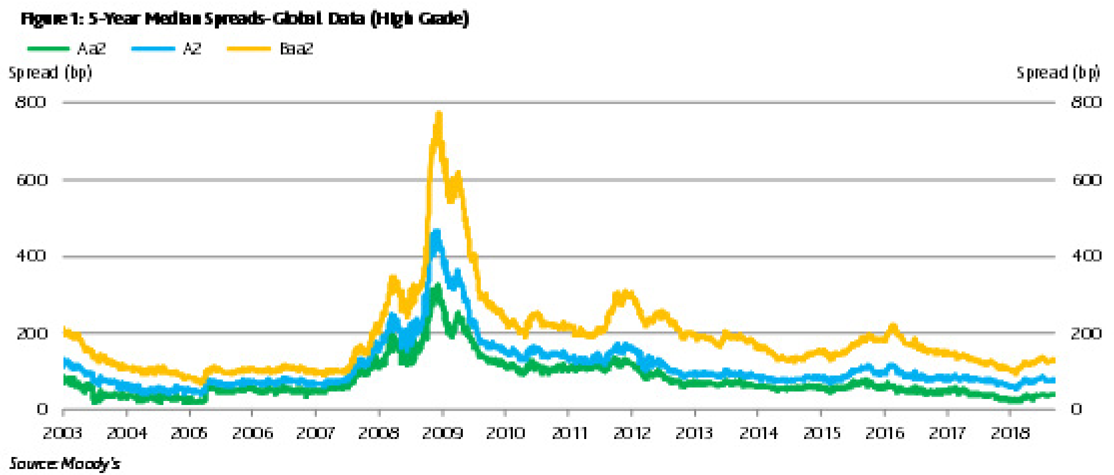
FIGURE 4
Rating Changes: Corporate & Financial Institutions – Europe

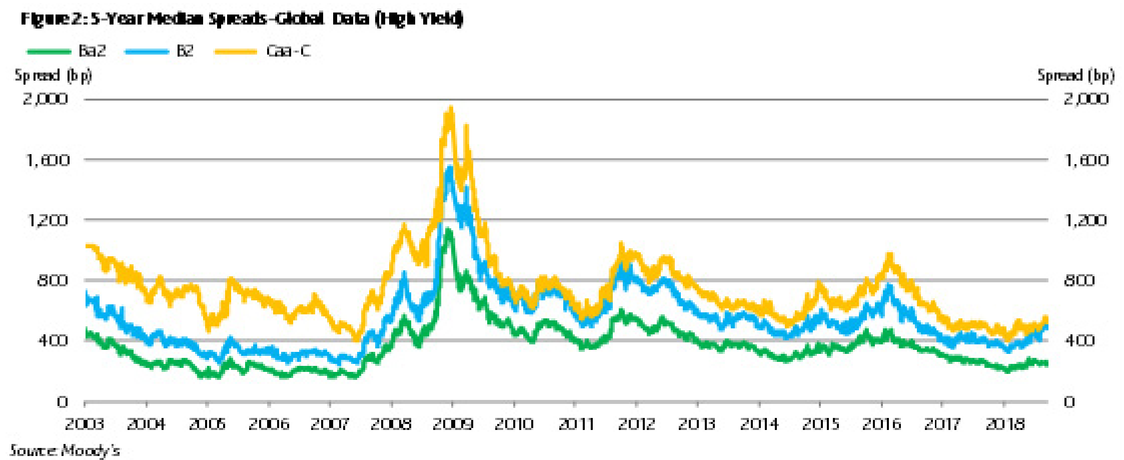
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	Old STD Rating	New STD Rating	IG/ SG	Country
9/12/18	BANCO BILBAO VIZCAYA ARGENTARIA, S.A.-GARANTIBANK INTERNATIONAL N.V.	Financial	SLTD		D	Baa1	Baa3	P-2	P-3	IG	NETHERLANDS
9/12/18	INTRALOT S.A.	Industrial	SrUnsec /LTCFR/PDR	875	D	B1	B2			SG	GREECE
9/14/18	STOREBRAND GROUP -STOREBRAND ASA	Financial	SrUnsec/Sub /LTIR/IFSR	696	U	Baa3	Baa2			IG	NORWAY
9/17/18	VERBUND AG	Utility	SrUnsec /MTN	1,614	U	Baa2	Baa1			IG	AUSTRIA
9/18/18	BARRY CALLEBAUT AG -BARRY CALLEBAUT SERVICES N.V.	Industrial	SrUnsec	1,217	U	Ba1	Baa3			SG	BELGIUM
9/18/18	COOPERATIVA MURATORI E CEMENTISTI C.M.C. DI RAVENN	Industrial	SrUnsec /LTCFR/PDR	671	D	B2	B3			SG	ITALY
9/18/18	GLOBAL OMNIUM, S.L. -AGUAS DE VALENCIA S.A.	Utility	LTIR		U	Baa3	Baa2			IG	SPAIN

Source: Moody's

Market Data

Spreads





CDS Movers

Figure 3. CDS Movers - US (September 12, 2018 – September 19, 2018)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Sep. 19	Sep. 12	Senior Ratings
Avon Products, Inc.	Caa2	Ca	B3
JPMorgan Chase & Co.	Aa3	A1	A3
Citigroup Inc.	A2	A3	Baa1
Morgan Stanley	A3	Baa1	A3
Wells Fargo & Company	A1	A2	A2
Verizon Communications Inc.	A3	Baa1	Baa1
American Express Credit Corporation	Aa2	Aa3	A2
Comcast Corporation	A1	A2	A3
CVS Health	Baa1	Baa2	Baa1
Walt Disney Company (The)	Aa2	Aa3	A2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Sep. 19	Sep. 12	Senior Ratings
General Motors Company	Ba2	Ba1	Baa3
Amazon.com, Inc.	A1	Aa3	Baa1
FedEx Corporation	Baa1	A3	Baa2
American Tower Corporation	B1	Ba3	Baa3
Univision Communications Inc.	B3	B2	Caa1
NextEra Energy Capital Holdings, Inc.	Baa3	Baa2	Baa1
Kroger Co. (The)	Baa3	Baa2	Baa1
Cargill, Incorporated	Baa1	A3	A2
Waste Management, Inc.	A1	Aa3	Baa1
Emerson Electric Company	A2	A1	A2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Sep. 19	Sep. 12	Spread Diff
Sears Roebuck Acceptance Corp.	C	2,691	2,195	495
Sears Holdings Corp.	C	2,294	1,872	422
Neiman Marcus Group LTD LLC	Caa3	853	799	53
Tenet Healthcare Corporation	Caa1	387	376	11
Delhaize America, LLC	Baa1	37	27	10
Genworth Holdings, Inc.	B2	401	395	6
Kroger Co. (The)	Baa1	74	69	5
International Game Technology	Ba2	176	171	5
FedEx Corporation	Baa2	53	50	4
Marsh & McLennan Companies, Inc.	Baa1	38	34	4

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Sep. 19	Sep. 12	Spread Diff
Windstream Services, LLC	Caa2	2,985	3,557	-571
Avon Products, Inc.	B3	631	817	-186
Frontier Communications Corporation	Caa1	1,358	1,496	-139
ServiceMaster Company, LLC (The)	B1	237	329	-93
Penney (J.C.) Corporation, Inc.	Caa2	2,001	2,084	-84
R.R. Donnelley & Sons Company	B3	539	598	-59
Lexmark International, Inc.	Caa1	742	798	-56
K. Hovnanian Enterprises, Inc.	Caa3	1,265	1,310	-45
Dish DBS Corporation	B1	465	508	-43
MBIA Inc.	Ba3	280	321	-41

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (September 12, 2018 – September 19, 2018)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Sep. 19	Sep. 12	Senior Ratings
Italy, Government of	B1	B2	Baa2
United Kingdom, Government of	Aa1	Aa2	Aa2
BNP Paribas	Aa3	A1	Aa3
Total S.A.	Aa1	Aa2	A1
Bankinter, S.A.	Baa2	Baa3	Baa2
Deutsche Telekom AG	Aa3	A1	Baa1
Orange	Aa3	A1	Baa1
Fiat Chrysler Automobiles N.V.	Ba2	Ba3	Ba3
AstraZeneca PLC	Aa1	Aa2	A3
GlaxoSmithKline plc	Aa1	Aa2	A2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Sep. 19	Sep. 12	Senior Ratings
Banco Popular Espanol, S.A.	Baa2	A3	A2
The Royal Bank of Scotland Group plc	Ba1	Baa3	Baa2
Dexia Credit Local	Ba2	Ba1	Baa3
Abbey National Treasury Services plc	Baa1	A3	Aa3
NatWest Markets Plc	Baa3	Baa2	Baa2
Deutsche Bank AG	Ba2	Ba1	A3
HSBC Holdings plc	Baa1	A3	A2
Finland, Government of	Baa2	Baa1	Aa1
UniCredit Bank Austria AG	Baa1	A3	Baa1
FCE Bank plc	Ba1	Baa3	Baa3

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Sep. 19	Sep. 12	Spread Diff
Galapagos Holding S.A.	Caa3	2,791	2,724	68
PizzaExpress Financing 1 plc	Caa1	1,541	1,500	41
Evraz Group S.A.	Ba3	262	250	12
Novafives S.A.S.	B3	384	373	12
Novo Banco, S.A.	Caa2	612	602	11
NatWest Markets Plc	Baa2	80	70	10
Matalan Finance plc	Caa1	735	724	10
Old Mutual Plc	Ba1	22	14	8
Stonegate Pub Company Financing plc	Caa1	182	175	7
Banco Popular Espanol, S.A.	A2	60	53	6

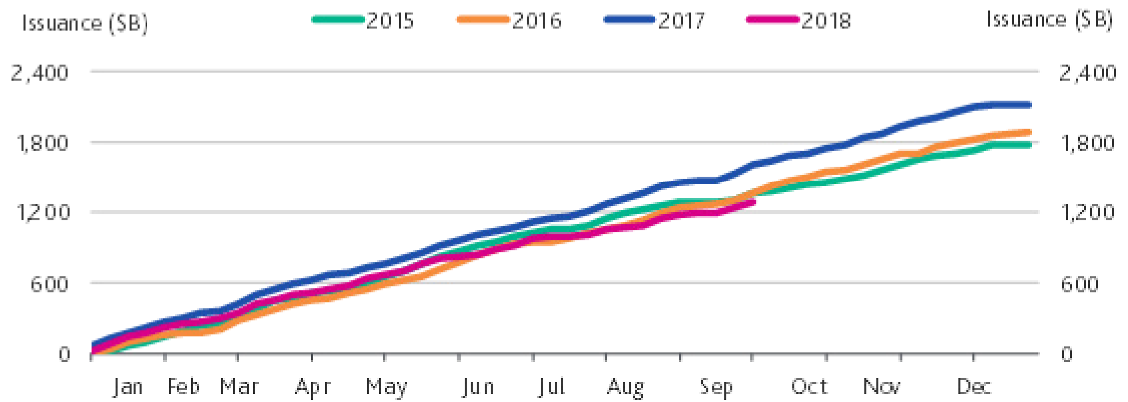
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Sep. 19	Sep. 12	Spread Diff
Astaldi S.p.A.	Caa2	6,859	11,385	-4,526
Casino Guichard-Perrachon SA	Ba1	386	529	-143
Jaguar Land Rover Automotive Plc	Ba2	318	340	-22
Telecom Italia S.p.A.	Ba1	175	195	-20
Italy, Government of	Baa2	198	217	-19
Iceland Bondco plc	Caa1	342	360	-18
Greece, Government of	B3	346	363	-17
Selecta Group B.V.	Caa2	300	315	-15
Suedzucker AG	Baa2	105	119	-14
Bankinter, S.A.	Baa2	65	77	-12

Source: Moody's, CMA

Market Data

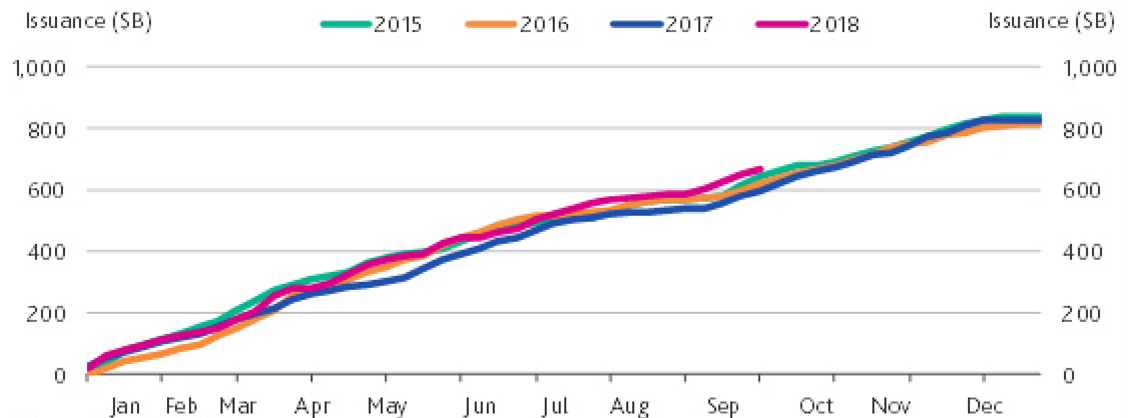
Issuance

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	35.928	3.675	42.677
Year-to-Date	986.393	237.044	1,284.403

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	15.380	2.232	19.869
Year-to-Date	568.892	70.196	668.484

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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There's No Place Like Home for U.S. Investors (Capital Markets Research)

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Profit Outlook Offsets Record Ratio of Corporate Debt to GDP (Capital Markets Research)

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