MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

Higher Interest Rates Will Be the Source of Their Own Demise

Moody's Analytics Research

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Credit Markets Review and Outlook *by John Lonski*

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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: A slower pace for corporate bond issuance helps to curb balance-sheet leverage.

Credit Spreads	Investment Grade: We see year-end 2018's average investment grade bond spreads exceeding its recent 124 bp. High Yield: Compared to a recent 358 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 6.7% to \$1.407 trillion, while high-yield bond issuance is likely to fall by 8.9% to \$413 billion..

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Ratings Round-Up

U.S. Rating Changes Dominated by Industrial and Utility Sectors

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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: Profit growth, credit quality, default rates, 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 MAY 29, 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.

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Credit Markets Review and Outlook

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

Higher Interest Rates Will Be the Source of Their Own Demise

The remedy of higher interest rates is taking effect. The risk of an overheating of financial markets and business activity appears to be waning.

The market value of U.S. common stock has been unable to return to its record high of January 26 ever since the 10-year Treasury yield has risen from its 2.56% average of 2018's first 36 days to 2.88% since then. In turn, the S&P 500's forward-looking price-to-earnings ratio has eased from January 26's 18.7:1 to a recent 17.1:1. Not only will a less exuberant equity market rein-in wealth-driven spending by consumers, it will also curb business expenditures by containing the market valuation of business assets and increasing the cost of equity capital. Moreover, a less vibrant equity market may prompt creditors to demand additional compensation for default risk when lending to businesses.

More than recent problems arising in several emerging market countries challenge forecasts of an extended stay by a greater-than-3% 10-year Treasury yield. In addition, there are signs of a loss of momentum by interest-sensitive activity in the U.S.

Higher Interest Rates Outweigh Favorable Default Outlook

Notwithstanding the lift ordinarily supplied by expectations of a significantly lower high-yield default rate, May-to-date's plummet by US$-denominated corporate bond issuance hints of possibly lower U.S. Treasury yields six to 12 months hence.

The 6.37% average composite speculative-grade bond yield of the first 22 days of May was up by 63 basis points from its comparably measured 5.74% average of May 2017. In response to this jump by the speculative-grade bond yield, May-to-date's issuance of US$-denominated high-yield bonds has plunged by 46% from its year earlier pace. Thus far in 2018, a 25 bp annual rise by the composite speculative-grade bond yield to a year-to-date average of 6.16% has pared high-yield bond offerings by 16% year-over-year.

For 11 of the 15 years since 1988 showing an annual decline by high-yield bond issuance, the 10-year Treasury yield's yearlong average would decline during the following calendar year. The median annual change by the 10-year Treasury yield in the year following the 15 annual contractions by high-yield bond issuance was -29 bp.

In addition, a 75 bp ascent by the 4.06% average composite investment-grade corporate bond yield of the first 22 days of May from its year earlier average of 3.31% triggered a 31% year-over-year drop by May-to-date's issuance of US$-denominated investment-grade corporate bonds. Since year-end 2017, offerings of US$-denominated investment-grade corporate bonds have shrunk by 9% annually in response to a 40 bp increase by the composite investment-grade bond yield to a 2018-to-date average of 3.77%.

Since 1988, the annual total for investment-grade bond offerings fell in only six calendar years, where the 10-year Treasury yield's yearlong average declined during four if the following calendar years. The median annual change by the 10-year Treasury yield in the year following the six annual contractions by investment-grade bond issuance was -42 bp.

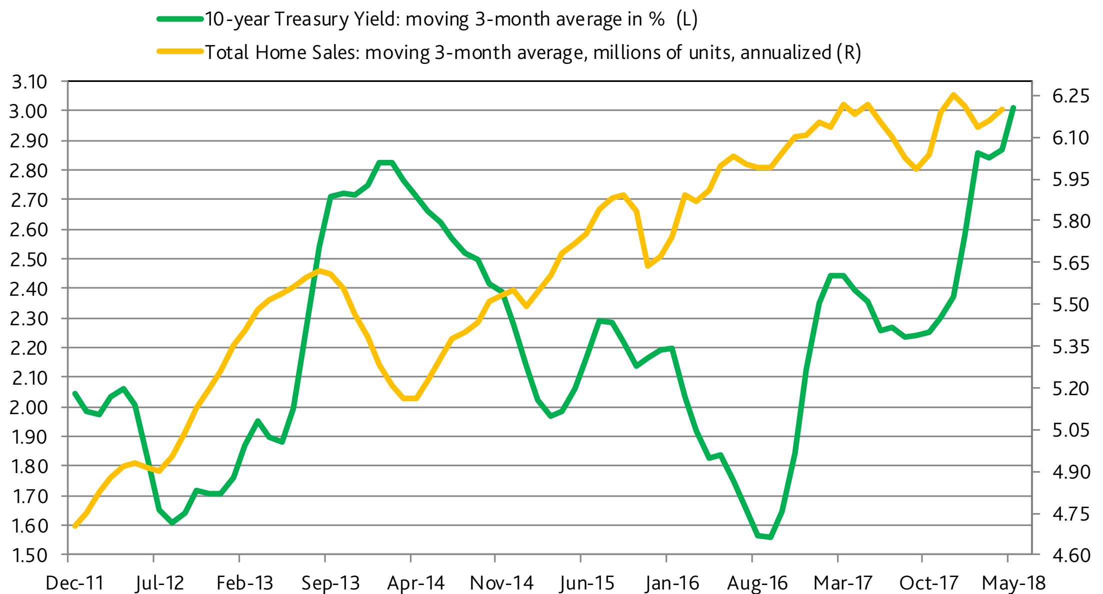
Higher Mortgage Yields Offset Lowest Jobless Rate since 2000

The return of a 3% 10-year Treasury yield is making itself known in the housing industry. Markets have already priced in a loss of housing activity to the highest mortgage yields since 2011.

Thus far in 2018, the 11% drop by the PHLX index of housing-sector share prices differs drastically from the accompanying 3% rise by the market value of U.S. common stock. In addition, the CDS spreads of housing-related issuers show a median increase of 78 bp for 2018-to-date, which is greater than the overall market's increase of roughly 23 bp. Finally, 2018-to-date's -1.97% return from high-yield bonds is worse than the -0.13% return from the U.S.' overall high-yield bond market.

Despite the lowest unemployment rate since 2000, the sum of new and existing home sales dipped by 0.7% year-over-year during January-April 2018. Unit home sales may not soon accelerate by enough to strengthen the case for higher Treasury yields. First-quarter 2018's average index of pending sales of existing homes contracted by 11.5% annualized from 2017's final quarter on a seasonally-adjusted basis, while shrinking by 3.7% year-over-year before seasonal adjustment. The recent record suggests that the 10-year Treasury yield will ultimately follow home sales.

Figure 1: Topping Off of Unit Home Sales Would Lead a Cresting of Treasury Bond Yields
sources: National Association of Realtors, US Census Bureau, Moody's Analytics



March 2018's 7% yearly drop by the NAR's index of home affordability showed that the growth of after tax income was not rapid enough to overcome the combination of higher home prices and costlier mortgage yields. March incurred the 17th consecutive yearly decline by the home affordability index. The moving three-month average of home affordability now trails its current cycle high of the span-ended January 2013 by 23%.

Fewest Applications for Mortgage Refinancings since 2000

The highest effective 30-year mortgage yield in seven years has depressed applications for mortgage refinancings. For the week-ended May 18, the MBA's effective 30-year mortgage yield reached 5.01% for its highest reading since the 5.04% of April 15, 2011. The effective 30-year mortgage yield's latest four-week average of 4.95% was up by 63 bp from the 4.32% of a year earlier.

The yearly increase by the effective 30-year mortgage yield's moving four-week average last swelled by at least 63 bp during the span-ended July 12, 2013. The 10-year Treasury yield's month-long average would climb from July 2013's 2.56% to a December 2013 peak of 2.89%. Thereafter, a decline by unit home sales had helped to lower the 10-year Treasury yield to 2.53% by July 2014.

As of May 18, 2018, the Mortgage Bankers Association's seasonally-adjusted weekly index of applications for mortgage refinancings sank to its lowest reading since December 29, 2000. Nevertheless, it should be noted that the MBA commenced a new sample on September 16, 2011.

During the four-weeks-ended May 18, applications for mortgage refinancings sank by 19.6% year-over-year. Moreover, the latest moving 13-week average of applications for mortgage refinancings is a very deep 77.8% under its current cycle high of October 12, 2012.

By contrast, mortgage applications from prospective homebuyers are holding up much better. During the four weeks ended May 18, the MBA's average index for homebuyer mortgage applications dipped by 0.9% from the contiguous four-weeks-ended April 20, 2018, as the year-over-year increase slowed from April 20's 6.6% to May 18's 3.5%.

The sum of new and existing sales of single-family homes sank annually in only nine of the calendar years since 1988. In eight of those nine years, the 10-year Treasury yield's yearlong average fell in the following calendar year. For the nine years following a drop by single-family home sales, the median annual change for the 10-year Treasury yield's yearlong average was -41 bp.

In summary, the longer that higher interest rates weigh on business activity and financial markets, the closer is a peak for bond yields. Nonetheless, just as it is overly presumptuous to predict the nearness of a 4% 10-year Treasury yield, it is premature to declare an impending top for the benchmark Treasury yield.

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

THE U.S.
By Ryan Sweet of Moody's Analytics

Fed Aiming for 2%-ish

The minutes from the May Federal Open Market Committee meeting signaled that the central bank is open to letting inflation modestly and temporarily overshoot its 2% objective. This is the right approach. There are economic benefits to a modest inflation overshoot, including boosting nominal wage growth. Another benefit is that it strengthens the Federal Reserve's credibility. With inflation having been persistently below the Fed's objective, the public may have begun to assume the central bank is content with, or can't meet, its own goals. This undermines the effectiveness of monetary policy. Therefore, a slight overshoot of inflation would prove that the Fed can still generate inflation, helping boost inflation expectations.

The key now is understanding how much of an inflation overshoot the Fed would tolerate. Though the decline in the unemployment rate in April occurred for the wrong reason (a drop in labor force participation), a sub-4% joblessness rate over time will put upward pressure on wage growth and inflation. Therefore, odds are rising that inflation will overshoot the Fed's 2% target by more than the central bank anticipates. Our belief is that the Fed would grow uncomfortable with growth in core inflation approaching 2.5%.

The minutes also hinted that changes to the post-meeting statement and positioning of the interest rate on excess reserves are coming soon. The minutes also signaled a rate hike will occur soon, likely in June. There was discussion of some changes that could be needed. A few participants noted that if increases in the target range for the federal funds rate continued, the federal funds rate could be at or above their estimates of its longer-run normal level before long.

Therefore, some participants noted it might soon be appropriate to revise the forward-guidance language in the statement indicating that the "federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run" or to modify the language stating that "the stance of monetary policy remains accommodative."

A small technical realignment of the IOER relative to the top of the target range for the fed funds rate is likely coming. Since the target range was established in December 2008, the IOER rate 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 rate over the effective federal funds rate has narrowed to only 5 basis points. A technical adjustment of the IOER rate to a level 5 basis points below the top of the target range could keep the effective federal funds rate well within the target range.

Turning to the recent data. U.S. residential investment isn't off to a good start this quarter, and odds are rising that it declines. Existing-home sales fell 2.5% to 5.46 million annualized units in April. This was near our forecast of 5.49 million and the consensus forecast of 5.57 million. April's decline puts existing-home sales a little below their first quarter average of 5.51 million annualized units. Sales are likely being hurt by lean inventories and a decline in affordability.

Existing-home sales didn't alter our high-frequency GDP model's estimate of real residential investment this quarter, which is for a 2.4% annualized gain. However, existing coupled with new-home sales lend downside risk to residential investment this quarter. Helping support our tracking estimate of real residential investment are house prices. Median existing-house prices were up 5.3% on a year-ago basis in April. This is a positive for broker commissions, which feeds into GDP via residential investment.

All told, first quarter GDP growth is tracking 3.1% at an annualized rate, but risks are tilted toward the downside.

The Week Ahead

The economic calendar heats up next week. The focus will be on May employment, PCE deflators and revisions to first quarter GDP.

	Key indicators	Units	Moody's Analytics	Consensus	Consensus Range	Last
Tues @ 10:00 a.m.	Moody's Analytics Business Confidence for 5/25/18	index, 4-wk MA				37.9
Tues @ 10:00 a.m.	Conference Board Consumer Confidence for May	index	127.5	128.0	125 to 130.0	128.7
Wed @ 8:15 a.m.	ADP National Employment Report for May	change, ths		187	170 to 225	204
Wed @ 8:30 a.m.	Advanced goods deficit for April	$ bil	-70.5	-71.1	-72.5 to -69.5	-68.0
Wed @ 8:30 a.m.	GDP for 2018Q1-second estimate	% change, SAAR	2.1	2.3	2.0 to 2.5	2.3
Wed @ 2:00 p.m.	Beige Book					
Thur @ 8:30 a.m.	Jobless Claims for 5/26/18	ths	230	225	220 to 284	234
Thur @ 8:30 a.m.	Nominal Personal Income for April	% change	0.3	0.3	0.1 to 0.5	0.3
	Nominal Personal Spending for April	% change	0.4	0.4	0.2 to 0.5	0.4
	Core PCE deflator forApril	% change	0.1 (0.12 unrounded)	0.1	0.0 to 0.3	0.2
Thur @ 10:00 a.m.	Pending Home Sales for April	%change	0.5	0.5	0.0 to 1.0	0.4
Fri @ 8:30 a.m.	Employment Situation for May	change, ths	170	185	155 to 220	164
	Average Workweek	#	34.5	34.5	34.5 to 34.6	34.5
	Unemployment rate	%	3.9	3.9	3.8 to 4.0	3.9
	Average Hourly Earnings	% change	0.1	0.2	0.1 to 0.3	0.1
Fri @ 10:00 a.m.	Construction Spending for April	% change	1.1	0.9	0.5 to 2.0	-1.7
Fri @ 10:00 a.m.	ISM Manufacturing Index for May	diffusion index	59.0	58.0	56.6 to 60.0	57.3
Fri @ 4:00 p.m.	Vehicle sales for May	mil, SAAR	16.65	17.1	16.5 to 17.89	17.15

TUESDAY, MAY 29

Business confidence (week ended May 25; 10:00 a.m. EDT)

Businesses across the globe remain stalwartly confident. Heightened trade tensions and volatile global financial markets have had no discernible impact on sentiment. 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. In the history of this survey, which began in 2003, the only time sentiment has been stronger on a consistent basis was in early 2015.

Businesses' biggest concern is around regulatory and legal issues, although this concern is receding with about one-third of respondents saying such issues 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 confidence survey fell from 39 to 37.9 in the week ended May 18.

Conference Board Consumer Confidence (May; 10:00 a.m. EDT)

The Conference Board's consumer confidence index is forecast to have dropped from 128.7 in April to 127.5 in April. Fundamentals are mixed. The stock market is a small positive, but this is more than offset by rising gasoline prices. However, the Conference Board survey is less sensitive to either stock prices or gasoline prices than the University of Michigan survey. The labor market is key for the Conference Board survey. It remains strong even though initial claims have edged higher recently. High-frequency measures of consumer confidence point toward a drop in the Conference Board survey, primarily the weekly Bloomberg survey.

WEDNESDAY, MAY 30

ADP National Employment Report (May; 8:15 a.m. EDT)

The ADP National Employment report showed that private employment rose by 204,000 between March and April. Private employment has risen by at least 200,000 for six consecutive months. The

composition of job creation across company sizes has remained fairly consistent, with growth slowing in most segments as overall payroll gains moderated in April. Midsize companies are the strongest performers, adding 88,000 jobs in April. Performance at small companies has been steady in 2018, adding 62,000 jobs and averaging gains of nearly 60,000 over the last four months.

The average absolute difference between the first print of ADP and the Bureau of Labor Statistics estimate of private employment has averaged 67,000 over the past six months.

GDP (2018Q1-second estimate; 8:30 a.m. EDT)

Our tracking estimate for first quarter GDP growth remains at 2.1% at an annualized rate, compared with the government's advance estimate of 2.3%. We expect the inventory build to be revised lower along with growth in real consumer spending.

THURSDAY, MAY 31

Jobless claims (week ended May 26; 8:30 a.m. EDT)

We look for initial claims for unemployment insurance benefits to have declined from 234,000 to 230,000 in the week ended May 26. The incoming data are for the week before Memorial Day and initial claims can be choppy around holidays, adding uncertainty to the forecast. We expect the four-week moving average to have risen from 220,000 to 225,000. The increase in the four-week moving average doesn't signal a significant weakening in the labor market. 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.

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

The forecast is for nominal income growth to have risen 0.3% in April, identical to the gain in each of the prior two months. Wages will likely add 0.2 percentage point to growth in nominal personal income in April. The labor income proxy rose 0.2% in April, but this likely understates wage growth. The labor income proxy is for the week including the 12th and was biased lower because for the 15th of the month fell outside of the reference week. Nominal wage income is for the entire month, and we believe wage growth was likely a little stronger than that implied by the labor income proxy. We look for a trend-like 0.1 percentage point contribution from nonwage income.

Nominal consumer spending is expected to have risen 0.4% in April. We don't expect any contribution from vehicle sales. Unit sales fell, but retail sales at automobile dealers edged higher in April. Higher prices should provide a little support to nominal spending at gasoline stations. Services should post a trend-like 0.3% gain, boosted by a weather-related increase in utility spending.

We look for the core PCE deflator to have risen 0.12% in March, lowering year-over-year growth from 1.9% to 1.8%.

FRIDAY, JUNE 1

Employment situation (May; 8:30 a.m. EDT)

Our preliminary forecast is for nonfarm employment to have risen by 170,000 between April and May. We look for the unemployment rate to have remained unchanged while average hourly earnings increased 0.1%.

We will update our employment forecast next week.

ISM manufacturing survey (May; 10:00 a.m. EDT)

Manufacturing conditions appear to have improved in May. Our preliminary forecast is for the ISM manufacturing index to have risen from 57.3 in April to 59 in May, reversing a good portion of the

decline in April. On an ISM-composite basis, the regional Fed manufacturing survey's improved in May and this points toward a gain in the national ISM index. Within the details, we look for new orders and production to increase. The increase in the production index could be limited by slower supplier deliveries. According to the ISM, April was the 19th consecutive month of slowing supplier deliveries. There were noted lead-time extensions in many areas, supplier labor shortages, and transportation delays and uncertainty in the steel and aluminum markets.

Vehicle sales (May; 4:00 p.m. EDT)

We expect vehicle sales to have fallen from 17.17 million annualized units in April to 16.65 million in May. This would be the fourth decline in the past six months. Through May, vehicle sales would be averaging 16.92 million annualized units, compared with the 17.2 million in the first three months of the year. Talk of tariffs on imported vehicles unlikely affected sales in May. It could bring forward some sales, but this will likely be more noticeable in June.

EUROPE

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

Expect a rebound in euro zone inflation

The week ahead will bring preliminary euro zone CPI figures for May, and we are confident they will show that inflation in the currency area rebounded to 1.4% at the middle of the second quarter, after it edged back to only 1.2% in April. Stronger energy prices and a rebound in services inflation are expected to have been the main factors behind the acceleration, but core goods inflation likely gained some ground too. Energy inflation is expected to have been boosted by the further rise in Brent prices, as the price of a Brent barrel soared to $80 at the middle of the month and is now reading in euro terms around 42% higher than in May 2017, compared with 20% in April. We thus expect energy inflation to pick up to 4% in May, from 2.6% in April. Regarding the other components of noncore CPI, food inflation is expected to have edged back slightly after a jump in April, but alcohol and tobacco inflation is expected to have continued to provide a significant boost to the headline after jumping in March on the back of tax hikes in France. Accordingly, we expect tobacco inflation to remain elevated until base effects kick in next year.

Regarding core inflation, we are penciling in a jump in services inflation following Easter-related plunges in airfares, accommodation and package holiday prices in April. Easter Sunday fell on April 1 this year, while last year it fell on April 16, which means that the services inflation figure was distorted at the start of the quarter by calendar-related effects, warranting a correction in May. Accordingly, we expect that services inflation will rebound to 1.3%, after it plunged to 1% in April. Elsewhere, we expect that core goods inflation also will accelerate, likely to 0.5%, from 0.3%. Weakness in non-industrial goods inflation has been a main theme in the latest CPI releases, and though a rebound was observed in April, the sector's inflation rate remained well below trend. The main reasons for the disappointing figures have been persistent deflation in healthcare goods in France and drops in clothing and shoe prices in most major countries. We can't understand why price pressures in the textile sector are so low, but volatility is not uncommon in the sector, so we are penciling in a recovery in coming months. Supporting our forecast is that the PPI points to a trend in core goods inflation of around 0.6%.

We long have been advocating that the trend in the euro zone's inflation rate is to the upside this year. First, we expect that the headline will jump past the European Central Bank's 2% target by summer, provided that oil prices hold at their current levels of around $79 per Brent barrel. That's because base effects will continue to push energy inflation up significantly over the next six months, leading it to peak at around 7%-8% in June, up from 2% in March. And the rise in oil prices will support not only energy inflation but also the core rate, as transportation prices are sensitive to the price of fuel. Elsewhere in the core, we expect that the tight labour market combined with the ongoing recovery will help gradually lift services inflation to around 1.7% at the end of the year. Core goods inflation will also accelerate, but to a lesser extent, since the euro remains strong. Risks are now tilting to the upside,

though, as the currency depreciated lately and now is reading around 7.3% higher against the dollar in year-ago terms, down from 14.5% in April.

We thus maintain our forecast that inflation will pick up this year. Notably, our view is that core inflation will accelerate to around 1.4% to 1.5% by year's end, allowing the European Central Bank to end its asset purchase programme via a gradual taper to zero in the fourth quarter, while the deposit rate should start being raised from the first quarter of next year. But we will watch the economic data closely, since further disappointments on the growth front or a stubbornly low core rate could delay the ECB's decisions.

	Key indicators	Units	Moody's Analytics	Last
Mon @ 5:00 p.m.	France: Job Seekers for April	mil, SA	3.40	3.42
Wed @ 7:45 a.m.	France: Household Consumption Survey for April	% change	-0.5	0.1
Wed @ 7:45 a.m.	France: GDP for Q1	% change	0.3	0.7
Wed @ 8:00 a.m.	Germany: Retail Sales for April	% change	-0.3	-0.6
Wed @ 8:05 a.m.	Spain: Retail Sales for April	% change	0.1	0.4
Wed @ 9:00 a.m.	Germany: Unemployment for May	%	5.3	5.3
Wed @ 10:00 a.m.	Euro Zone: Business and Consumer Sentiment for May	index	110.0	112.7
Thur @ 12:05 a.m.	U.K.: Consumer Confidence for May	index	-9.0	-9.0
Thur @ 8:30 a.m.	Spain: GDP for Q1	% change yr ago	0.7	0.7
Thur @ 9:00 a.m.	Italy: Unemployment for April	%	10.9	11.0
Thur @ 10:00 a.m.	Euro Zone: Preliminary Consumer Price Index for May	% change	1.4	1.2
Thur @ 10:00 a.m.	Euro Zone: Unemployment for April	%	8.4	8.5
Fri @ 9:00 a.m.	Italy: GDP for Q4	% change	0.3	0.3

WEDNESDAY, MAY 30

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

French household expenditure on goods likely fell by 0.5% m/m in April, fully reversing the 1.9% decline in January. This should push the yearly rate down to only 1.3%, following a 2.3% rise previously, though it should remain slightly above the 1.1% average increase recorded for the previous year. Dragging most on the headline was likely a plunge in energy spending, following strong results for February and March. Temperatures fell below their long-term averages in both months, but they climbed considerably in April, reading 2.4 °C above seasonal norms and making this April the third warmest since 1900. This should have depressed demand for heating, though the flip side will be that the warm weather likely boosted footfall and clothing sales. But spending on cars are expected to have fallen sharply following a jump in March, while food spending likely remained relatively steady.

France: GDP (Q1; 7:45 a.m. BST)

Final GDP data are expected to confirm that France's economy expanded by 0.3% q/q in the three months to March, decelerating from a 0.7% gain in the previous stanza. But risks are tilted to the downside, as monthly production data showed that manufacturing production fell by 1.8% q/q in the first stanza, much sharper than the 1.1% decline that fed into the initial GDP release. We expect that this will be offset by an upward revision in the construction data.

Regarding the expenditure breakdown, the biggest drag on the headline was likely a slowdown in private investment, especially in manufacturing. We thus expect the final data to show that investment rose by only 0.4% to 0.5% q/q, down from a first estimate of 0.6% and slowing from a 1.1% increase in the previous quarter. Elsewhere, we expect that growth in consumer spending was unchanged at 0.2% q/q, while government consumption was likely steady, above the initial estimates of a marginal slowdown. Regarding the external sector, we expect that the final numbers will confirm that net trade's contribution to growth was neutral following the fourth quarter's jump, since both imports and exports were likely unchanged. The good news is that exports should recover somewhat in the second quarter, though we caution that imports should also jump strongly as firms will need to start replenishing their inventories soon following a depletion at the end of last year. Stock-building and imports are strongly correlated in France, especially in the transport sector.

Germany: Retail Sales (April; 8:00 a.m. BST)

German retail likely remained muted in April after contracting during the first quarter of this year. Sales are expected to have retreated by 0.3% from March, when they fell by 0.6%. In year-ago terms, sales also likely contracted by 0.3%. The Markit retail PMI slipped further in April, to a nine-month low of 51 from 51.5 March, pointing to weaker improvement in the sector during the month. Meanwhile, the GfK consumer climate indicator for April recovered somewhat to 10.9 after dipping to 10.8 in the previous month, but decreased again to 10.8 for May. Consumption expenditure continued to support Germany's expansion during the past year, although the contribution weakened from previous years. Conservative German households will likely not increase their spending significantly in coming months because the outlook remains uncertain.

Spain: Retail Sales (April; 8:05 a.m. BST)

Retail sales likely printed at 0.1% m/m in April, down from the 0.3% gain in the previous month when the Easter holiday encouraged shopping. Retail growth appears to be gradually slowing in Spain. True, the April reading of the consumer confidence indicator improved to -0.7, after tumbling to -3.5 in March. But that the indicator is hovering in negative territory means more consumers are pessimistic about the future, and thus the current reading is consistent with weakening aggregate demand. We expect retail to grow around this pace on average for the rest of the year, which means that the sector will expand 1.6% y/y, down from 1.9% in 2017.

WEDNESDAY, MAY 30 (CONTINUED)

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

Germany's seasonally adjusted unemployment rate likely remained at 5.3% in May, after it fell to this record low in March. German businesses remain confident in the country's future expansion, increasing their labour force, despite the uncertainties and geopolitical tensions, such as the continued Brexit negotiations or the introduction of steel import tariffs by the U.S. The strong economic expansion has supported job creation over the last year, though there has been some cooling at the beginning of this year. The preliminary estimate shows that GDP growth slowed to 0.3% q/q, after expanding by 0.6% previously. In year-ago terms, the expansion rate decelerated to 2.3% in the first quarter, from 2.9% prior. The unemployment rate is likely bottoming out. Germany experienced a vast inflow of refugees two years ago, some of whom will be entering the German labour force in the coming years, which together with the persistent lack of a skilled labour force will likely push the unemployment rate higher.

THURSDAY, MAY 31

Spain: GDP (Q1; 8:30 a.m. BST)

The preliminary first quarter GDP report shows Spain is still in a sweet spot, with GDP gaining 0.7% from the previous quarter. The country has been enjoying at least a 0.7% quarterly expansion rate since the second half of 2014, beating expectations of a slowdown since 2016. We believe that construction, which in 2017 started to shake off its slump, contributed to the strong reading just as it did in the final quarter of 2017, when the sector expanded by 4.8% y/y. Further, the seasonal hike in energy demand was stronger than a year ago, since unusually harsh weather spurred demand for heating and electricity. Electricity consumption, usually a good gauge of demand, rose to 5.1% y/y in March from a solid 3.6% in February. The first quarter's pleasant surprise may be a fluke, however. The first quarter unemployment report did not give enough evidence that permanent hiring would outpace temporary jobs, suggesting that labour underutilization may persist in 2018, keeping a lid on GDP growth.

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

The unemployment rate in Italy likely dropped in April, to 10.9% from 11% in March. The jobless rate has been trending lower since the beginning of 2017 as stronger economic growth increases labour demand. Youth unemployment remains one of the highest in the EU but is improving, along with the inactivity rate. However, weaker domestic market conditions in the coming year will likely restrict growth and slow employment gains. The unemployment rate will fall at a slower pace as a result. Although we are optimistic that labour market conditions will improve this year, Italy's labour force has a long way to go on the road to recovery and necessary structural reforms may be delayed by political strife.

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

Euro zone inflation likely picked up to 1.4% in May, from 1.2% in April, boosted by higher core and noncore inflation. Regarding the noncore components of the index, food inflation is likely to have edged back slightly following a jump in unprocessed food prices in April, but we expect that the contribution of alcohol and tobacco inflation to the headline remained high after surging in March on the back of tax hikes in France. Energy inflation is expected to have soared further, as oil prices rose sharply over the month and were in euro terms 42.7% higher than in May 2017, while in April they were only 20.1% higher than in the same period of the previous year. If oil prices hold at their current levels of around $79 per Brent barrel, energy inflation will continue to heat up over the next few months and peak in June. Chances are that this will push the inflation headline above the ECB's 2% target.

Regarding core inflation, developments across countries have been volatile lately, but we expect that the trend is to the upside. Accordingly, we expect that core inflation accelerated to 1% in May, from 0.7% in April, on the back of rebounds in services and core goods inflation. First, the early timing of Easter this year compared with 2017 depressed airfares, accommodation and package holidays inflation in April, warranting a correction in May. We thus expect that services inflation climbed to 1.3%, from 1% previously. And we forecast that nonenergy goods inflation accelerated to 0.5%, from 0.3% in April, due to a rebound in clothing inflation.

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

The euro zone's unemployment rate likely dipped to 8.4% in April, from 8.5% in March, its lowest reading since the end of 2008. That's because, even if the euro zone's headline unemployment rate remained only steady in March, that joblessness fell in most of the area's economies clearly pointed to a decline in the rate in April, or even to a downward revision to the March headline. But we suspect that employment gains are starting to slow in the euro area, in line with the recent dips in the headline confidence numbers, though job growth will remain solid nonetheless. The Markit PMI release found that, even if pressure on capacity was alleviated to some extent by a further robust increase in employment in April, the rate of job creation slipped to its lowest in nine months, while job gains moderated in manufacturing and services alike. But a slowdown was always expected, particularly in countries such as Germany, Austria and the Netherlands where there is little slack remaining in the job market. We expect the downward trend in joblessness to persist in quarters to come, and we forecast that the euro zone's unemployment rate will reach 8% to 8.1% by the end of 2018.

FRIDAY, JUNE 1

Italy: GDP (Q1; 9:00 a.m. BST)

Italy's GDP growth likely held steady in the first quarter, expanding 0.3% q/q, but slowed to 1.4% on a year-ago basis. Global demand for Italian goods and services bolstered the country's economic performance, with recent data indicating strong gains in exports of capital goods, mostly to trading partners in the EU. However, business confidence has fallen since the start of the year as a stronger currency and capacity constraints limit output, signaling slower growth in the coming quarters. In addition, political uncertainty is weighing on business and consumer sentiment, holding back consumer spending and investment in the first quarter. Political strife is unlikely to derail Italy's expansion, but weak governance and insufficient structural reform in the coming year put risks to the downside. Growth prospects remain moderate, and Italy's economic growth will likely slow to 1.3% in 2018.

ASIA-PACIFIC

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

Japan's consumers likely a little less cautious

An influx of Japan's activity data for the second quarter is due. The general takeaway is that the economy is performing at a relatively decent pace in the first half of 2018, albeit slower than the solid run enjoyed in 2017. Japan's unemployment rate likely held at 2.5% in April. Forward-looking indicators suggest ongoing buoyancy in employment growth. The rise in the labour force is also promising; although not all the additional workers have found jobs, on net, there's been an increase in

employment. The sustained tightening of the labour market suggests that wages in Japan should increase, but this is yet to materialize, with the annual spring wage negotiations labeled mediocre.

Japan's industrial production has been on the mend in February and March, after a terrible performance in January, when a 4.5% m/m decline was recorded. Production is in a reasonably decent position given continued strong demand for Japanese tech products, while domestic consumption of big-ticket items including automobiles is robust. Retail trade is on a broadly cooling trend, while consumers likely became a little less cautious in May from the broad-based weakening experienced in April.

China's manufacturing sentiment declined mildly in April, according to the official index, but it remains optimistic on net. Firms are reporting higher production thanks to both higher domestic and export-oriented demand, although there are emerging concerns regarding new export orders. Some of this relates to the impasse over U.S. trade negotiations. The recent postponing of mutual tariffs is a positive step, but talks so far have not led to significant progress on the more complex and controversial issues.

The Indian economy is improving in the first half of 2018, with GDP growth expected to accelerate to 7.7% in the March quarter, up from 7.2% the quarter prior. Consumption remains the key driver, though we expect investment to lend a helping hand after years of wilderness. External demand improved in 2017, but a sharper rise in commodity imports caused net exports to detract from overall GDP growth. Sustained strength in global oil prices means that India's import bill will remain bloated in the first half. Elsewhere, the final estimate of South Korea's GDP growth was likely unchanged at 1.1% q/q in the first quarter, up from a 0.2% fall in the prior quarter. Gains were broad-based across consumption, investment and exports. The improvement in investment was especially encouraging, as growth had been decelerating through 2017.

	Key indicators	Units	Moody's Analytics	Last
Tues @ 7:00 a.m.	South Korea Consumer sentiment survey for May	Index	106.6	107.1
Tues @ 9:30 a.m.	Japan Unemployment rate for April	%	2.5	2.5
Wed @ 9:50 a.m.	Japan Retail trade for April	% change yr ago	1.3	1.0
Wed @ 3:00 p.m.	Japan Consumer sentiment survey for May	Index	43.4	43.6
Thurs @ 9:00 a.m.	South Korea Retail trade for April	% change	1.9	2.7
Thurs @ 9:50 a.m.	Japan Industrial production for April	% change	1.5	1.2
Thurs @ 11:00 a.m.	China Manufacturing PMI for May	Index	51.2	51.4
Thurs @ 5:30 p.m.	Thailand Private consumption for April	% change yr ago	3.4	2.6
Thurs @ 5:30 p.m.	Thailand Foreign trade for April	US$ bil	2.5	3.0
Thurs @ 10:00 p.m.	India GDP for Q1	% change yr ago	7.7	7.2
Fri @ Unknown	South Korea Foreign trade for May	US$ bil	5.9	6.6
Fri @ 9:00 a.m.	South Korea Consumer price index for May	% change yr ago	1.7	1.6
Fri @ 9:00 a.m.	South Korea GDP second estimate for Q1	% change	1.1	-0.2

TUESDAY, MAY 29

South Korea – Consumer Sentiment Index – May

South Koreans have been feeling less upbeat of late, as the labour market has shown signs of weakness, international trade tensions have risen, and optimism surrounding President Moon's policies is fading. That being said, the recent de-escalation of North Korea tensions is positive and could provide some upside. Consumer sentiment likely slipped to 106.6 in May.

Japan – Employment Situation – April

Japan's labour market remains a bright spot as job growth continues to expand at a steady pace. The seasonally adjusted unemployment rate likely held steady at 2.5% in April. Forward-looking indicators suggest ongoing buoyancy in employment growth. The rise in the labour force is also promising; although not all the additional workers have found jobs, on net, there's been an increase in employment. The sustained tightening of the labour market suggests that wages in Japan should increase, but this is yet to materialize, with the annual spring wage negotiations labeled mediocre.

WEDNESDAY, MAY 30

Japan – Retail Sales – April

Japan's retail sales are on a broadly cooling trend. Retail sales likely rose by 1.3% y/y in April, after the disappointing 1% gain in March and 1.7% increase in February. Domestic demand and specifically private consumption are on a weaker footing than at the same time last year. While the gains in the labour market have been firm at the start of 2018, spending has been relatively sombre. There remains an important question mark over whether there will be significant improvements in income growth over 2018. Japan's labour market is in its best position in decades, but so far decent income growth hasn't been achieved.

Japan – Consumer Confidence – May

Japan's consumer confidence index likely lost a little ground in May to 43.4, after slipping to 43.6 in April. There was a broad-based softening in April, with employment prospects falling the most despite more than 1 million jobs being created in the first quarter. Households are worried about the fading economic momentum; Japan's economy isn't enjoying the same buoyant conditions that it did over 2017. A highlight in the April sentiment survey was the rise in inflation expectations, with more consumers expecting prices to go up again next year. This bodes well for Japan's reflation prospects, although we don't see inflation hitting the central bank's 2% target.

THURSDAY, MAY 31

South Korea – Retail Sales – April

South Korean retail sales likely grew 1.9% m/m in April. Retail sales surprised on the upside in March, with the large minimum wage hike at the beginning of this year likely providing sales with a boost. However, with the job market showing signs of weakness and consumer sentiment dimming in recent months, we expect retail sales growth to soften in April.

Japan – Industrial Production – April

Japan's industrial production has been on the mend in February and March, after a terrible performance in January when a 4.5% m/m decline was recorded. We expect industrial production hit 1.5% m/m in April. Production is in a reasonably decent position given continued strong demand for Japanese tech products, while domestic consumption of big-ticket items including automobiles is robust. We expect industrial production to remain firm through the first half of 2018, but a slowdown is likely in the second half as the tech cycle moves further beyond its peak.

China – Manufacturing PMI – May

China's manufacturing sentiment declined mildly in April, according to the official index, but it remains optimistic on net. Firms are reporting higher production thanks to both higher domestic and export-oriented demand, although there are emerging concerns regarding new export orders. Some of this relates to the impasse over U.S. trade negotiations. The recent postponing of mutual tariffs is a positive step, but talks have not led to significant progress so far. We expect the official PMI declined by 0.2 point to 51.2 in May.

Thailand – Private Consumption – April

Private consumption likely grew 3.4% y/y in April, after a 2.6% rise in the prior month. Thai consumers, particularly at the low end of the income scale, have struggled with weak agricultural prices, elevated debt, and soft income growth of late. Still, consumer sentiment has risen noticeably recently, which is providing some lift to spending. A strong tourism sector is also helping. Tourist arrivals were up 15.4% y/y in the first quarter, with arrivals from China rising significantly thanks to the introduction of new routes from China. Hotel bookings three months in advance have risen notably of late, suggesting a strong few months ahead.

Thailand – Foreign Trade – April

Thailand's trade surplus likely fell to US$2.5 billion in April, after rising to US$3 billion in March. Export growth slowed to an 11-month low in March, even as exports of electronics remained strong, thanks to firm demand for computer parts, integrated circuits and telecommunication equipment. However, exports of agricultural and automotive products both weakened, with exports of agricultural goods particularly weak. Although external demand remains firm, we expect export growth to remain relatively mild, as a high base from a year earlier is likely to inhibit gains.

India – GDP – 2018Q1

The Indian economy is improving in the first half of 2018, with GDP growth expected to accelerate to 7.7% in the March quarter, up from 7.2% the quarter prior. Consumption remains the key driver, though we expect investment to lend a helping hand after years of wilderness. External demand improved in 2017, but a sharper rise in commodity imports caused net exports to detract from overall GDP growth. Sustained strength in global oil prices means that India's import bill will remain bloated in the first half, which could spill over to softer manufacturing and higher inflation. India is the world's third largest oil importer.

FRIDAY, JUNE 1

South Korea – Foreign Trade – May

South Korea's foreign trade surplus likely narrowed to US$5.9 billion in May, after narrowing to US$6.6 billion in April. Although exports slipped in April in year-ago terms, external demand remained healthy, with the level of exports remaining elevated. The decline in exports during April was largely because of a high base from a year earlier, when exports surged by a multiyear high of 24.1%. Excluding exports of ships and maritime facilities, which surged in April 2017, exports were up a healthy 10.4% y/y. Trade tensions with the U.S. eased somewhat recently as South Korea managed to dodge a hefty 25% steel tariff while the U.S. gained improved access to the South Korean car market.

South Korea – Consumer Price Index – May

South Korean consumer prices likely increased 1.7% y/y in May. Headline inflation climbed to a six-month high in April, driven higher by food and beverage prices and by clothing and footwear prices, which rose by eight- and 18-month highs, respectively. Two factors keeping a lid on price pressures are the elevated won and the softening labour market. South Korea's jobless rate rose to a multiyear high recently amid sluggish job growth.

South Korea – GDP – 2018Q1

GDP growth likely held at the advance estimate of 1.1% q/q in the first quarter of 2018, up from a 0.2% fall in the prior quarter, according to its final estimate. The modest rebound was driven by a 3% q/q lift in gross fixed capital formation, as construction and facilities investment firmed from the prior quarter. Meanwhile, exports were also stronger, up 4.4% after a 5.3% fall in the December quarter. All up, the South Korean economy grew largely as expected in the first quarter. The improvement in investment was especially encouraging, as growth had been decelerating through 2017.

The Long View

A slower pace for corporate bond issuance helps to curb balance-sheet leverage.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group,
May 24, 2018

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 124 bp approximates 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 358 bp resembles what is inferred from the spread's macroeconomic drivers and the VIX index. 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 +2.2% for IG and -4.6% 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 of Moody's Analytics
May 24, 2018

UNITED KINGDOM

U.K. retail sales recovered in April following weather-related weakness in March. It was impressive that the monthly increase exceeded the consensus expectations, sending the pound higher following Wednesday's selloff. But we caution that looking past the monthly volatility the underlying trend in sales in the three months to April remained only flat, compared with stronger results for the same period last year. We thus haven't changed our forecast that household spending on goods will only gradually recover this year, following 2017's slowdown.

Looking at the details, the monthly rise came on the back of rebounds across the board. Fuel, food and nonfood sales rose following broad-based declines in March, as cold weather and heavy snowfall disrupted travel and depressed footfall at the end of the first quarter. Accordingly, most of April's strength was due to rises in weather-sensitive sales subsectors; clothing sales surged following two months of declines, as the below-average temperatures likely depressed demand for retailers' spring collections in February and March, while sales of sport equipment also rose sharply. We suspect that the latter's rise was mostly due to a surge in sales of outdoor equipment. Similarly, sales of alcoholic drinks soared, as did sales in all types of food stores. And while the sharp rise in fuel sales came as the main upside detail, following a plunge in March due to snow-induced road closures, it still failed to reverse most of the previous month's decline.

May should bring a small mean reversion from April's strength, as higher oil prices are set to depress fuel sales. And the outlook is still far from promising; we expect that consumers will continue to struggle this year. Soaring oil prices, rising interest rates, a dwindling housing market, and the ongoing fiscal squeeze will weigh on consumers' confidence and will to buy. Consumer savings intentions spiked in the first quarter, suggesting that households are becoming increasingly cautious.

On the bright side, most of the sterling-related increases in import prices have already been passed through to consumers, with the recent CPI figures showing that food and core goods inflation has already begun to decelerate. The softer CPI figures combined with a further acceleration in basic wages suggest that the squeeze on consumers' purchasing power is finally easing, with real wages set to return to growth soon. We nonetheless caution that although wages will gradually rise, they won't soar.

The April report on U.K. consumer price inflation may have again undershot the consensus, but it was in line with our and the Bank of England's expectations, so our view is that an August rate hike remains likely. Corroborating this story is that most of April's dip in the headline rate was because of an early-Easter-related plunge in transportation inflation, which should be corrected in May, while motor fuels inflation is set to continue soaring over the next couple of months on the back of higher Brent prices.

Though we do think the monetary policy committee will hike in August, we are not claiming that underlying price pressures are significantly rising in the U.K. economy, which would warrant the start of a tightening cycle. Our view is that domestically generated inflation remains subdued, and that core inflation will moderate this year much faster than the MPC expects, following 2017's import-related hike in retailing prices.

But since the MPC is already inclined to hike rates sooner rather than later, as it forecasts that there is little slack in the economy, we don't think it will lose August's window of opportunity. If it does not act by then, the next possible move could come only by November, which is risky given that is only a month after the U.K.

government will need to agree on a final withdrawal deal with the European Union. Progress on the Brexit front has been significant this year, but reaching a final deal is not guaranteed; the thorny issue of Northern Ireland's border still has to be resolved, while several MPs have claimed new elections are likely soon since they don't believe that Theresa May will manage to solve the standoff.

ASIA PACIFIC

By Katrina Ell of Moody's Analytics
May 24, 2018

CHINA

Trade tensions between China and the U.S. have eased, with both sides pledging over the weekend to not engage in a trade war. China and the U.S. have each suspended plans to impose billions of dollars of tariffs on each other. China has also promised to "significantly increase purchases" of U.S. goods, reportedly agreeing to "meaningful increases in U.S. agriculture and energy exports," according to the White House. It has been reported that China would increase purchases of U.S. agricultural products by 35% to 45% this year and increase energy purchases over the next three to five years.

At first glance this is an important step forward because it reduces the likelihood of a trade war between the U.S. and China. This bilateral relationship is arguably the world's most significant, so a trade war would have devastating consequences for global supply chains and the otherwise upbeat global outlook. But the details from this pledge have been scarce and significant unanswered questions and points of differences remain as trade negotiations continue.

It's not as easy as it seems

The Trump administration's request for China to reduce the annual trade surplus by the magic number of "at least US$200 billion" wasn't confirmed by China.

Also, while China has pledged to buy substantially more U.S. goods, there's a limit to the number of goods that China can actually buy from the U.S. and limits on the increased goods that the U.S. can produce to meet Beijing's demand. Reducing the goods deficit would in practice likely involve a dramatic reduction in Chinese shipments to the U.S. Unintended consequences could be the disruption of U.S. supply chains and forcing input costs higher amid scarcer or more expensive alternative supplies.

Didn't get into the weeds

The more controversial and complex sticking points between the U.S. and China remain unaddressed. In particular, the Trump administration's discomfort with Beijing's "Made in China 2025" development strategy won't be easy to fix. President Donald Trump has requested that the Chinese government remove all government support for the plan and supporting industries.

This is a big ask, since this is Beijing's fundamental strategy to transform into a high-income economy and move up the value chain to becoming a high-tech producer. The historical backbone of China's economy has been low-cost manufacturing, but its competitiveness is being eroded by rising operating costs, including labour.

Other areas remain ambiguous. For instance, China vaguely promised to "advance relevant amendments" to its regulation, according to the White House. No timeline or further details were provided.

Uneven industrial policy

Industrial policy, including barriers for foreign firms doing business in China, remains uneven. For instance, Chinese electric vehicle makers operating in China are able to use their pick of foreign batteries. But foreign electric vehicle makers operating in China must use Chinese batteries, which are often inferior to those offshore.

All told, the lack of specific commitments has eroded expectations that the Trump administration will deliver meaningful structural changes in its bilateral relationship with China.

The Long View

The Trump administration's approach to the Chinese technology company ZTE Corp. is a useful example of how initial tough talk ultimately evolved into a softer stance. Last week Trump indicated that it would help ZTE get back on its feet after the Commerce Department banned U.S. companies from selling to the firm for seven years.

This followed ZTE's pleading guilty in 2017 to violating U.S. sanctions by illegally shipping U.S. goods and technology to Iran and North Korea. ZTE then allegedly lied about disciplinary actions imposed upon senior employees relating to the illegal shipments. The Commerce Department ban is the result of ZTE's failure to comply with that agreement.

A shift in attitude

The shift in the Trump administration's attitude to helping ZTE came only days after ZTE said it was ceasing "major operating activities" due to export sanctions placed on it by the U.S. government. As one of the world's largest telecom equipment makers, ZTE relies on U.S. companies including Qualcomm and Intel for components.

Clearly, the bargaining chips do not solely rest with the U.S. The adverse impact of this seven-year ban doesn't lie only with ZTE; it also hurts supply chain partners, including in the U.S. ZTE has previously indicated that it has paid more than US$2.3 billion to U.S. exporters in 2017.

The global tech supply chain is so heavily interdependent that putting pressure on one major supplier has ripple effects across the globe. A case in point of the high interdependence occurred in 2011 with Japan's Fukushima nuclear disaster and then severe flooding in Thailand. Both had a devastating global impact on the tech supply chain given the just-in-time business model.

A finer detail

It's worth delving into a finer technical detail of the bilateral goods trade between China and the U.S. According to the National Bureau of Statistics, China ran a trade deficit of US$261 billion with the U.S. in 2015, while the U.S. Census Bureau shows a US$367 billion trade deficit. This is a significant discrepancy and partly reflects how the international conventions of measuring goods exports differ from those for measuring imports.

Exports are usually valued on a free on board (FOB) basis, while imports are valued on a cost, insurance and freight (CIF) basis. This means that the value of imported goods as measured by the importing nation is higher than the same goods measured by the exporting nation.

Ratings Round-Up

By Kathryn Asher and Michael Ferlez

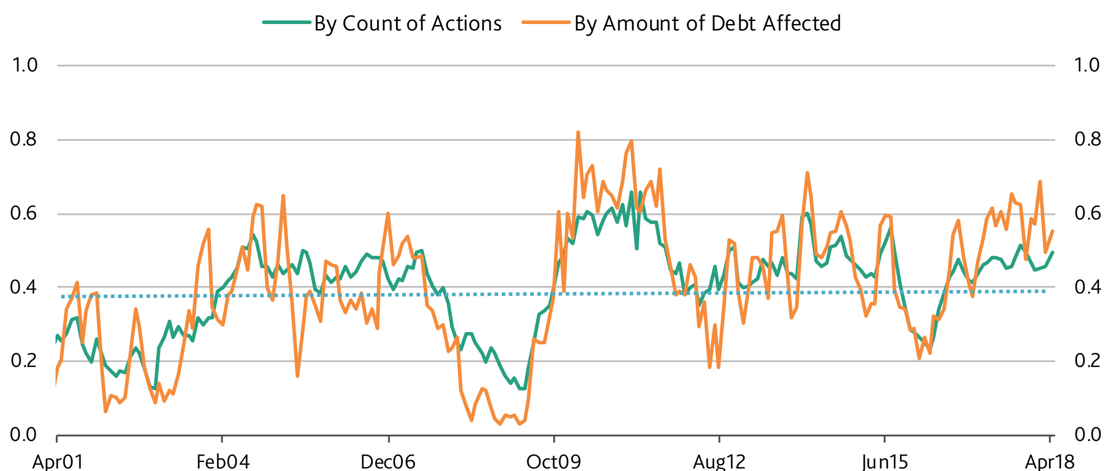
U.S. Rating Changes Dominated by Industrial and Utility Sectors

The industrial and utility sectors dominated U.S. activity – accounting or all the rating changes in the prior week. The ratio of positive rating changes to total rating changes in the U.S. was 55%. The notable upgrades were First Data Corporation and Micron Technology, Inc. First Data Corporation was upgrade to reflect improving debt leverage while strong free cash flow was a factor in Micron Technology's upgrade. On the downgrade side, Mattel, Inc. was downgraded to B1. The firm recently announced it would liquidate one of its flagship retailers – Toys "R" Us.

Meanwhile, the ratio of positive rating changes to total rating changes in Europe was 75%. This is a much brighter picture than the previous week, when downgrades accounted for slightly over half of the total rating revisions in Europe. Rating revisions were exclusively in the financial and industrial sectors. Among the upgrades, were two Greek banks: Alpha Bank AE and Eurobank S.A. Alpha Bank's upgrade was in response to the bank's expanding deposits in Greece and a reduction of its emergency liquidity assistance over the last few quarters. Eurobank's upgrade can be traced to expanding deposits in Greece, and the bank's recently issued Tier 2 bond. These activities result in lower loss severity for junior depositors and senior debt creditors of the banks, leading to the upgrades from Caa3 to Caa2 for both banks.

FIGURE 1

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



* Trailing 3-month average

Source: Moody's

FIGURE 2

Rating Key

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

FIGURE 3

Rating Changes: Corporate & Financial Institutions – US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG
5/16/18	NORTHERN OIL AND GAS, INC	Industrial	LTCFR/PDR		U	Caa2	Caa1	SG
5/17/18	AQUARION COMPANY	Utility	SrUnsec/LTIR	360	U	Baa3	Baa2	IG
5/18/18	NORTHWESTERN CORPORATION	Utility	SrUnsec/BCF	450	D	Baa1	Baa2	IG
5/18/18	GRUPO FRIBOI-JBS USA LUX S.A.	Industrial	SrUnsec/SrSec /BCF/LTCFR	3,700	U	B2	B1	SG
5/18/18	JFL-NRC HOLDINGS, LLC -NRC US HOLDING COMPANY, LLC	Industrial	PDR		U	Caa1	B3	SG
5/21/18	MATTEL, INC.	Industrial	SrUnsec	1,000	D	Ba3	B1	SG
5/21/18	MICRON TECHNOLOGY, INC.	Industrial	SrUnsec/LTCFR /PDR	1,199	U	Ba3	Ba2	SG
5/21/18	CROCKETT COGENERATION, LP	Utility	Senior Secured	135	D	Ba3	B1	SG
5/22/18	FIRST DATA CORPORATION	Industrial	SrSec/SrUnsec /BCF/LTCFR/PDR	8,710	U	Ba3	Ba2	SG
5/22/18	EMPIRE GENERATING CO, LLC	Industrial	SrSec/BCF		D	Caa2	Caa3	SG
5/22/18	PT HOLDINGS, LLC-PT INTERMEDIATE HOLDINGS III, LLC.	Industrial	SrSec/BCF		D	B2	B3	SG

Source: Moody's

Ratings Round-Up

FIGURE 4
Rating Changes: Corporate & Financial Institutions – Europe

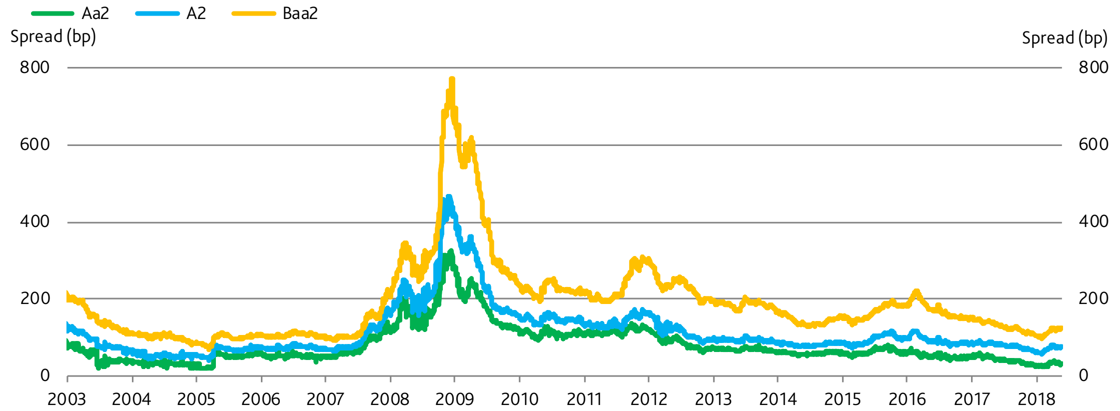
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	Old STD Rating	New STD Rating	IG/ SG	Country
5/16/18	SYDBANK A/S	Financial	SrUnsec /SLTD/MTN	0	U	Baa1	A2	P-2	P-1	IG	DENMARK
5/16/18	INDUSTRIAL AND COMMERCIAL BANK OF CHINA LIMITED-ICBC STANDARD BANK PLC	Financial	Sub	500	U	Ba1	Baa3			SG	UNITED KINGDOM
5/16/18	CEVA HOLDINGS LLC-CEVA GROUP PLC	Industrial	SrSec/SrUnsec /BCF/LTCFR/PDR	668	U	Caa1	B1			SG	UNITED KINGDOM
5/21/18	OMV AG	Industrial	SrUnsec/LTIR /JrSub/MTN	7,370	U	Baa1	A3			IG	AUSTRIA
5/21/18	BRIGHT BIDCO B.V.	Industrial	SrSec/BCF /LTCFR/PDR		D	Ba3	B1			SG	NETHERLANDS
5/22/18	ALPHA BANK AE	Financial	SrUnsec/LTD /MTN	588	U	Caa3	Caa2			SG	GREECE
5/22/18	EUROBANK ERGASIAS S.A.	Financial	SrUnsec/LTD /MTN	103	U	Caa3	Caa2			SG	GREECE

Source: Moody's

Market Data

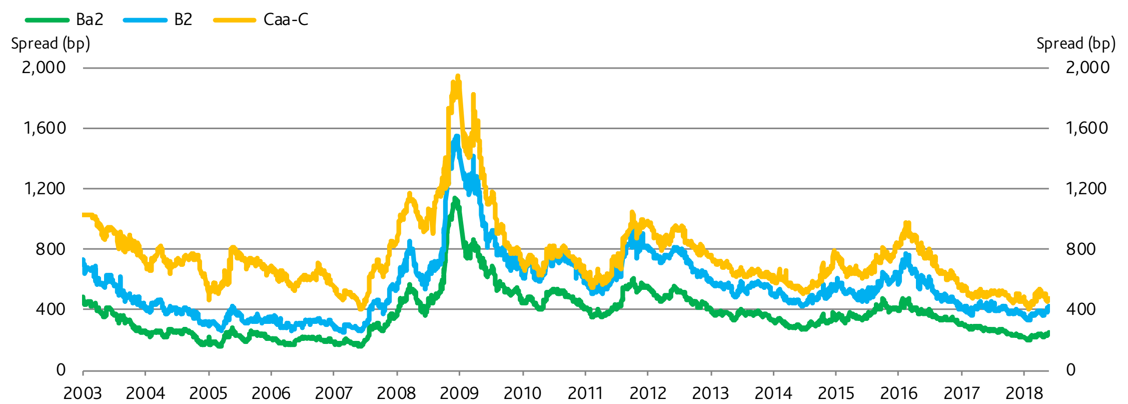
Spreads

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



Source: Moody's

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



Source: Moody's

Market Data

CDS Movers

Figure 3. CDS Movers - US (May 16, 2018 – May 23, 2018)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	May. 23	May. 16	Senior Ratings
American Financial Group, Inc.	Ba2	B3	Baa1
Amazon.com, Inc.	A3	Baa2	Baa1
United States of America, Government of	Aaa	Aa1	Aaa
JPMorgan Chase & Co.	A2	A3	A3
Citigroup Inc.	A3	Baa1	Baa1
Wells Fargo & Company	A3	Baa1	A2
Morgan Stanley	Baa1	Baa2	A3
Toyota Motor Credit Corporation	A3	Baa1	Aa3
Bank of America, N.A.	A2	A3	Aa3
Microsoft Corporation	Aa1	Aa2	Aaa

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	May. 23	May. 16	Senior Ratings
HSBC Finance Corporation	A2	A1	Baa1
Kraft Heinz Foods Company	Ba1	Baa3	Baa3
United Airlines, Inc.	B3	B2	Baa1
General Mills, Inc.	Baa3	Baa2	Baa2
NRG Energy, Inc.	B1	Ba3	B1
Campbell Soup Company	Ba1	Baa3	Baa2
HP Inc.	Baa2	Baa1	Baa2
L Brands, Inc.	B3	B2	Ba1
Applied Materials Inc.	Baa3	Baa2	A3
Texas Instruments, Incorporated	A2	A1	A1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	May. 23	May. 16	Spread Diff
Penney (J.C.) Corporation, Inc.	B3	1,158	970	188
Frontier Communications Corporation	Caa1	1,342	1,206	136
Lexmark International, Inc.	Caa1	1,311	1,256	54
Hertz Corporation (The)	B3	866	821	45
Campbell Soup Company	Baa2	114	75	39
Avon Products, Inc.	B3	885	852	32
USG Corporation	Ba1	363	339	24
Talen Energy Supply, LLC	B1	834	812	21
Nordstrom, Inc.	Baa1	207	187	21
Bunge Limited Finance Corp.	Baa2	169	148	21

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	May. 23	May. 16	Spread Diff
American Financial Group, Inc.	Baa1	138	336	-198
K. Hovnanian Enterprises, Inc.	Caa3	1,730	1,808	-79
Chesapeake Energy Corporation	Caa1	524	587	-63
Dish DBS Corporation	B1	609	652	-42
Macy's Retail Holdings, Inc.	Baa3	180	211	-30
Mattel, Inc.	B1	405	435	-29
MBIA Insurance Corporation	Caa2	769	798	-29
Neiman Marcus Group LTD LLC	Caa3	991	1,010	-19
Windstream Services, LLC	Caa1	2,027	2,043	-16
Parker Drilling Company	Caa2	1,323	1,339	-16

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (May 16, 2018 – May 23, 2018)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	May. 23	May. 16	Senior Ratings
ABN AMRO Bank N.V.	A2	A3	A1
DZ BANK AG	Baa1	Baa2	Aa3
Bank of Ireland	Aa2	Aa3	Baa1
Autoroutes du Sud de la France (ASF)	Baa1	Baa2	A3
LafargeHolcim Ltd	Baa2	Baa3	Baa2
United Utilities PLC	Baa2	Baa3	Baa1
Schneider Electric SE	Aa2	Aa3	Baa1
Telefonaktiebolaget LM Ericsson	Ba1	Ba2	Ba2
Scottish Power Limited	Baa3	Ba1	Baa1
United Utilities Water Limited	Baa2	Baa3	A3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	May. 23	May. 16	Senior Ratings
Spain, Government of	Baa1	A2	Baa1
Banco Santander S.A. (Spain)	Baa1	A2	Baa1
Banco Popular Espanol, S.A.	Baa1	A2	A2
Italy, Government of	Ba2	Ba1	Baa2
France, Government of	Aa1	Aaa	Aa2
Societe Generale	A1	Aa3	A1
Barclays Bank PLC	A3	A2	A2
Ireland, Government of	Aa2	Aa1	A2
BNP Paribas	Aa3	Aa2	Aa3
Banco Bilbao Vizcaya Argentaria, S.A.	Baa2	Baa1	Baa1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	May. 23	May. 16	Spread Diff
Astaldi S.p.A.	Caa1	2,101	1,490	611
Italy, Government of	Baa2	147	106	41
Banca Monte dei Paschi di Siena S.p.A.	B3	180	144	36
PizzaExpress Financing 1 plc	Caa1	1,055	1,019	35
Matalan Finance plc	Caa1	755	722	33
Leonardo S.p.a.	Ba1	158	132	27
Unione di Banche Italiane S.p.A.	Baa3	122	99	23
Portugal, Government of	Ba1	94	72	22
Casino Guichard-Perrachon SA	Ba1	292	270	22
Telecom Italia S.p.A.	Ba1	146	125	21

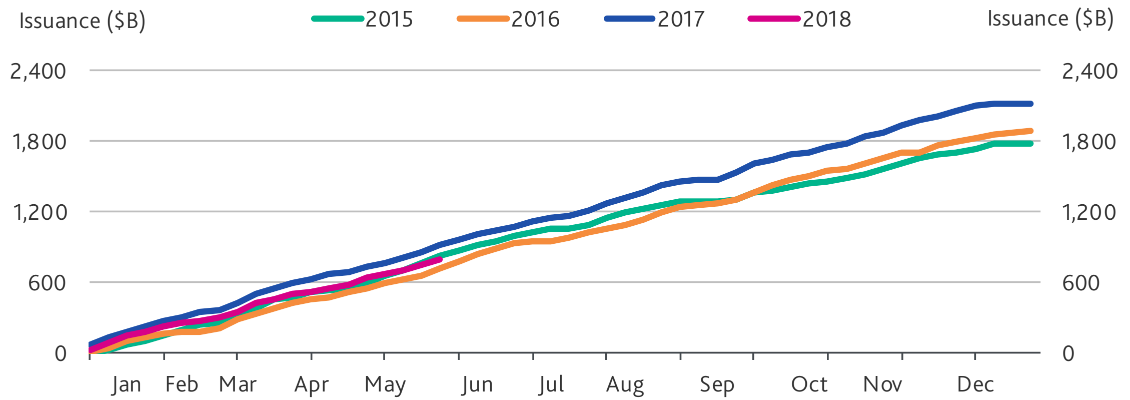
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	May. 23	May. 16	Spread Diff
Galapagos Holding S.A.	Caa3	1,210	1,231	-21
Vedanta Resources plc	B2	431	438	-7
Vue International Bidco p.l.c.	B3	217	224	-6
ABN AMRO Bank N.V.	A1	43	47	-4
Dexia Credit Local	Baa3	106	109	-3
NIBC Bank N.V.	Baa1	66	69	-3
FCE Bank plc	Baa2	98	100	-2
NN Group N.V.	Baa2	43	44	-2
Stonegate Pub Company Financing plc	Caa1	270	272	-2
Scottish Power UK plc	Baa1	83	84	-1

Source: Moody's, CMA

Market Data

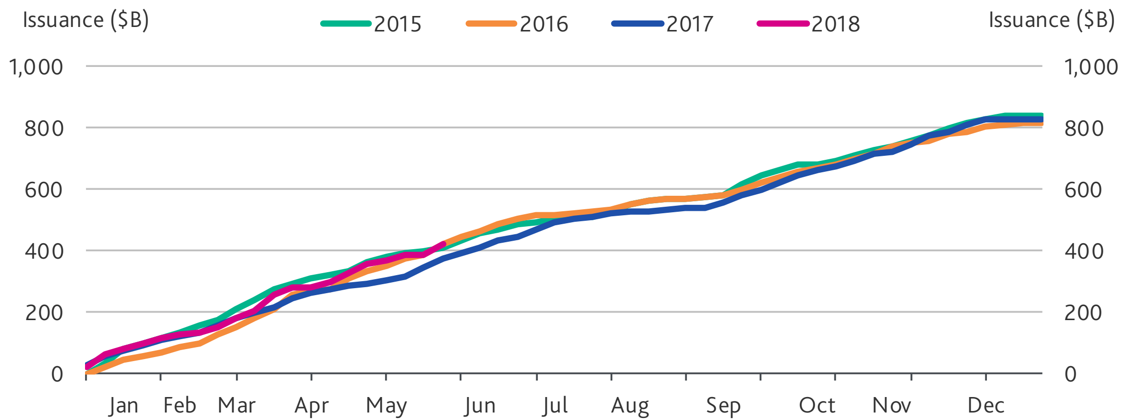
Issuance

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	28.509	4.735	35.210
Year-to-Date	597.805	156.388	789.595

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	27.485	1.850	31.716
Year-to-Date	350.873	51.209	420.567

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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