MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

Higher Yields and Lower Equities Might Yet Swell Credit Risk

Moody's Analytics Research

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Credit Markets Review and Outlook *by John Lonski*

Higher Yields and Lower Equities Might Yet Swell Credit Risk

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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: An extended sell-off of equities amid rising Treasury bond yields will eventually swell corporate bond yield spreads.

Credit Spreads	Investment Grade: We see year-end 2018's average investment grade (IG) bond spreads exceeding its recent 98 bp. High Yield: Compared to a recent 329 bp, the high-yield spread may approximate 400 bp by year-end 2018.
Defaults	US HY default rate: Compared to December 2017's 3.3%, Moody's Default and Ratings Analytics team forecasts that the US' trailing 12-month high-yield default rate will average 2.4% during 2018's final quarter.
Issuance	In 2017, US$-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 $453 billion. For 2018, US$-denominated IG bond issuance may drop by 5% to $1.432 trillion, while US$-priced high-yield bond issuance grows by 3% to $468 billion.

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Ratings Round-Up *by Njundu Sanneh*

Upgrades Bounce Back

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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: Tax law changes, stocks and spreads, Greek drama, South Korea, Brazil sovereign credit, Greece and Spain, dangers in the outlook, high-yield borrowing, Saudi Arabia, defaults, credit/stocks, China, yields/prices, debt/growth, upside surprise, bulls.

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

Credit Markets Review and Outlook

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

Higher Yields and Lower Equities Might Yet Swell Credit Risk

It has been a volatile week for financial markets. After shrugging off an earlier ascent by the 10-year Treasury yield from year-end 2017's 2.41% to January 26's 2.66% and advancing by 7.1%, the market value of U.S. common stock has since sunk by 1.6% in reaction to a climb by the 10-year Treasury yield to 2.77%. The deeper post-January 26 drop of 3.7% by the interest-sensitive PHLX index of housing-sector share prices underscores the importance of higher Treasury bond yields to the latest retreat by equities. Earlier, or from year-end 2017 through January 26, the index of housing sector share prices was up by 4.9%, which trailed the accompanying advance by the overall equity market.

Unlike equities, the dollar-denominated corporate bond market has been reasonably well behaved. Most investment-grade bond yield spreads narrowed during last week's equity sell-off. The recent 141 basis points spread of Moody's Investors Service's long-term Baa industrial company bond yield average was less than each of its prior month-long averages going back to the 132 bp of February 2005, or just before the breakout of troubling developments pertaining to Detroit's big three automakers. Nevertheless, January 2018's estimated $141 billion of dollar-denominated investment-grade bond issuance was down by 27% from January 2017's pace.

Though the yield spreads of dollar-denominated high-yield bonds widened somewhat from their January 26 close, the latest 329 bp spread of a high-yield composite was thinner than each of its previous month-long averages going back to the 277 bp of June 2007. However, since January 26, only three dollar-denominated high-yield bonds have been issued raising $2.1 billion. The latter two measures are disproportionately small compared January 2018's 81 new high-yield bond offerings that secured $44.0 billion. Still, January 2018's month-long dollar amount of high-yield bond offerings shot up by nearly 21% from January 2017's tally.

The near disappearance of high-yield bond offerings amid the equity market turmoil of late January warns of diminished systemic liquidity if any forthcoming climb by interest rates roils earnings-sensitive financial markets.

Capital Spending Will Determine the Efficacy of Tax Reform Measures

Supply-side economics will be put to the test over the next couple of years. Seldom, if ever before, have policy changes gone to such great lengths to spur business capital spending with the ultimate intent of rejuvenating labor productivity.

Taken together, the drop in the top corporate income tax rate to 21%, the immediate expensing of capital outlays, and new tax incentives aimed at repatriating overseas cash may keep real capital spending's 10-year average annual growth rate above its long-term average of 4% indefinitely. Not only is the recent top corporate income tax rate of 21% the lowest since 1939, but never before has the corporate income tax rate been immediately cut be something as deep as the 14 percentage point drop from the 35% rate that held from 1993 through 2017.

Figure 1: Drop in Top Corporate Income Tax Rate to 21%, Immediate Expensing of Capital Outlays, and Repatriation of Overseas Cash May Keep Real Capital Spending's 10-year Average Annual Growth Rate Above Long-Term Average of 4%
source: Bureau of Economic Analysis

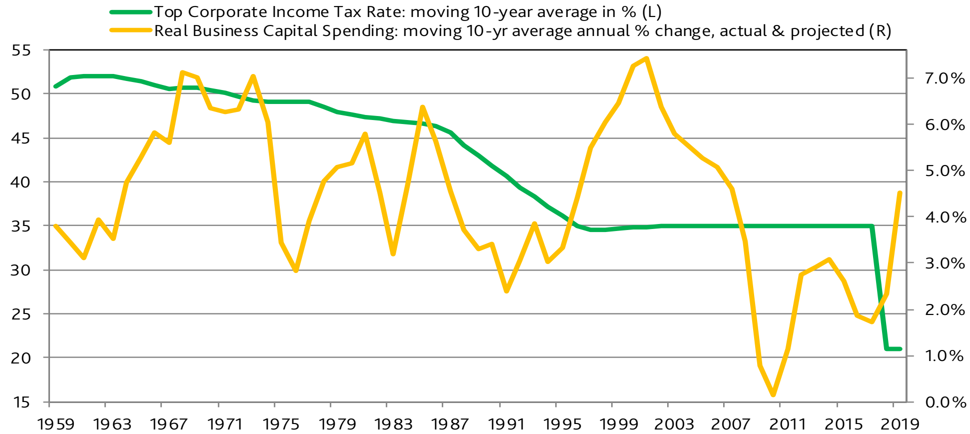
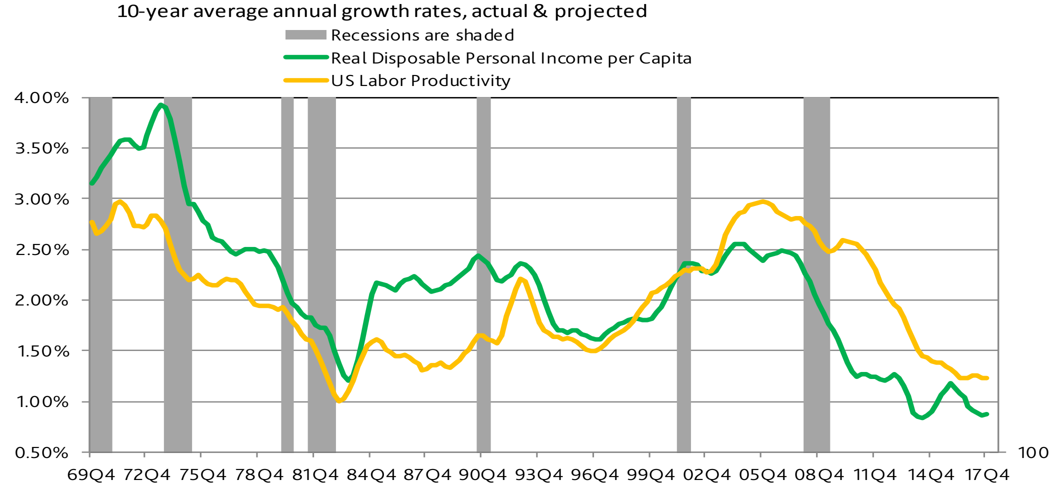


Figure 1 shows how the cutting of the corporate income tax rate from 1986's 46% to 1988's 34% ultimately helped supply a major lift to the trend rate of growth of real business investment spending, which in turn quickened labor productivity's 10-year average annualized rate of growth from the 1.0% of 1983 to the 2.2% of 1992. More recently, a slowdown by productivity's 10-year average annual growth rate from 2007's 2.8% to 2017's 1.2% was joined by a deceleration for the comparably measured growth rate of real disposable personal income per capita from 2.4% to 0.9%, respectively.

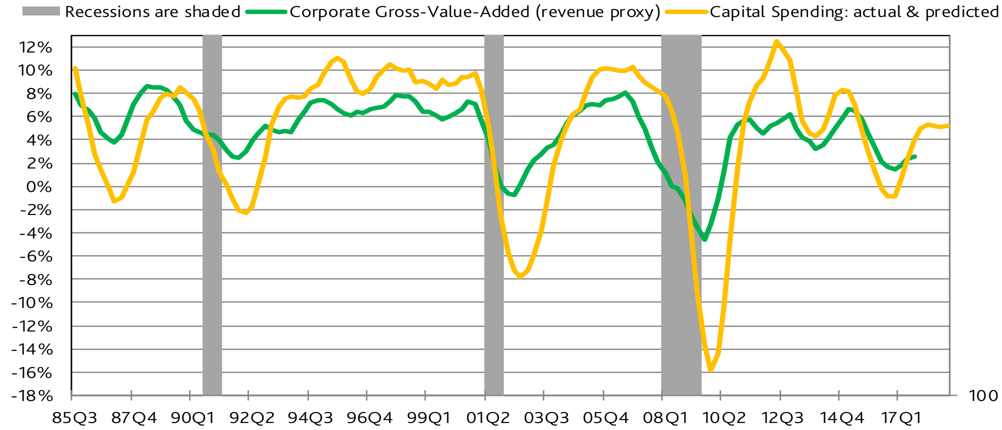
Figure 2: Faster Productivity Growth Would Help to Quicken the Growth of Real Disposable Personal Income per Capita
10-year average annual growth rates, actual & projected



Revenue Outlooks Will Influence the Composition of Capital Outlays

However, the record indicates that an extended and substantial upturn by capital expenditures requires firmly held expectations of sufficiently rapid growth by corporate revenues. The record shows that the growth of corporate gross value added, or corporate revenues net of materials, generates the strongest correlation with the growth of capital outlays among all conceivable macroeconomic drivers. To the degree businesses are unsure of future revenues, increases in capital expenditures are likely to be directed more toward cost-cutting and enhanced product quality, as opposed to an expansion of production capabilities.

Figure 3: Among All Macro Drivers, Capital Spending's Highest Correlation Is the 0.79 With Corporate Gross Value Added
yy % changes for yearlong averages
source: Bureau of Economic Analysis, Blue Chip Economic Indicators, Moody's Analytics



The Supply of Tradable Treasury Debt Is About to Soar

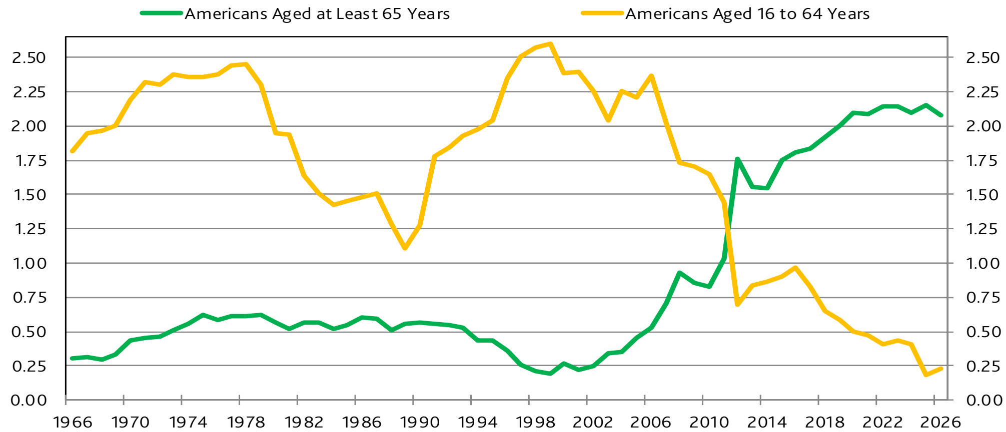
Thus far, 2018 has brought attention to the upward pressure that will be put on Treasury bond yields by both a forthcoming increase in fiscal stimulus and a scheduled reduction in the Federal Reserve's holdings of U.S. Treasury notes and bonds.

According to one estimate, the increase in marketable treasury securities will more than double from just under $500 billion in fiscal-year 2017 to nearly $1.2 trillion in FY 2018. Perhaps not since the Second World War has the supply of tradable U.S. Treasury debt increased by so great of an amount relative to GDP in the context of well-established economic recovery. Conceivably, if the recent and possibly forthcoming climb by Treasury yields destabilizes the equity and corporate bond markets or shrinks interest-sensitive activity, the Fed might be compelled to downsize the planned reduction of its Treasury bond holdings.

Even before the recently enacted tax cuts, a record increase in the number of retirees was expected to widen the federal budget deficit via an increase in mandatory outlays on Social Security and Medicare. Unprecedented demographic change will influence financial markets and business activity during the next 10 years. The average annual increase in the number of Americans aged at least 65 years is expected to soar from the 351,000 per annum of the 10-years-ended 2007 to 1.8 million per annum for the next 10-years. Adding to the difficulty of funding the retirement of so many individuals is the accompanying plunge in the average annual increase in the number of people aged 16 to 64 years (or the working-age population) from the 2.3 million of the 10-years-ended 2007 to the 416,000 of the 10-years-ended 2027.

Credit Markets Review and Outlook

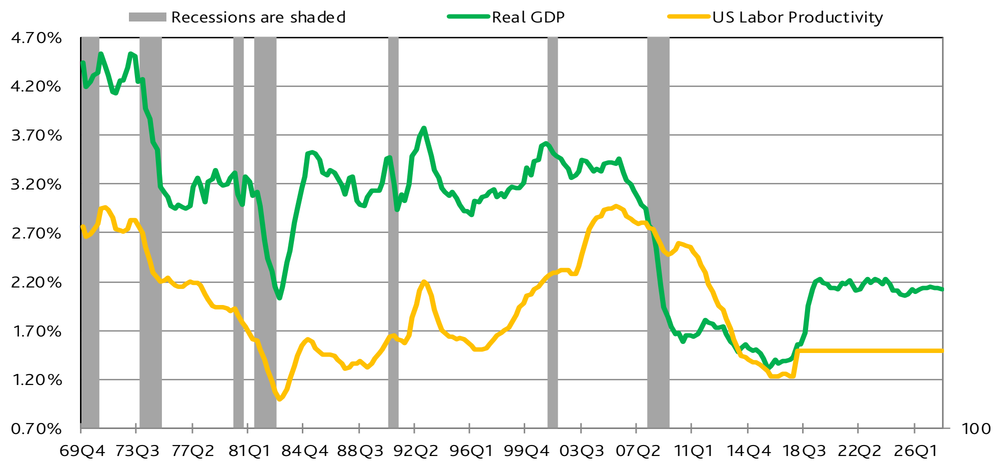
Figure 4: Profound Shift in Age Distribution of US Population May Influence Markets and Business Activity for Years to Come
actual & predicted annual change in millions of people
sources: US Bureau of the Census, Moody's Analytics



Productivity Growth is Key to the Future Pace of Business Activity

In view of how the labor force is expected to grow no faster than 0.5% annually, on average, through 2027, the return of 3% real GDP growth on a recurring basis requires the attainment of a 2.5% average annual rate of growth for labor productivity. Though difficult to achieve, the good news is that the 10-year average annualized growth rate for labor productivity was at least 2.5% from 2003 through 2010 and from 1957 through 1973. Supply-side economics will emerge triumphant if productivity again grows by at least 2.5% annually on a recurring basis.

Figure 5: Real GDP's 10-year Average Annual Growth Rate Could Return to 3% if Productivity Grows by 2.5% on a Recurring Basis
10-year average annual growth rates, actual & projected



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

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

Attention Will Be on Financial Markets

After a hectic week, the economic calendar is very light. The key data will be the December trade deficit, as it could have implications for our tracking estimates of both fourth and first quarter GDP growth. The Senior Loan Officer Survey doesn't get all the attention it deserves, but it will provide a look at lending standards and demand for loans.

With minimal economic data, the attention will be on financial markets as they have hit a bump. We wouldn't describe recent developments in financial markets as concerning; hiccups occur. Still, investors are a fickle bunch. Therefore, it is worth exploring what a drop in equity prices would mean for the U.S. economy. Corrections are normal, happening about every two years since the 1970s. To quantify the impact of falling stock prices, a number of scenarios were run through the Moody's Analytics U.S. macro model.

For each simulation, the drop in stock prices is isolated to one quarter. We assume that prices recover most of the lost ground in the subsequent three quarters, and then converge to the baseline. Based on this, and all else equal, if the S&P 500 fell 5% in one quarter, the economic impact would be small.

A 10% correction in stock prices would slow real GDP growth by 0.75 percentage point over a year. However, the economic costs rise quickly as the decline increases. A 15% or 20% drop in stock prices would shave 1.25 and more than 2 percentage points of GDP growth, respectively.

The damage would be magnified if equities failed to rebound in subsequent quarters, dampening confidence and weighing on consumer spending and business investment. Also, there is a risk that the stock market wealth effect is greater than assumed in our macro model.

The economy can weather sharp declines in equity prices. There are numerous instances when equities have fallen in excess of 10% and the economy weathered it. Still, there is the risk that markets have become conditioned to assume the Fed will respond to each decline in the stock market. This moral hazard issue is difficult to break and, sooner or later, the Fed may have to draw a line. The Fed won't adjust its plan for raising interest rates in March unless the eventual tightening in financial market conditions is altering the economy's trajectory. For now, the Fed may see some tightening in financial market conditions as therapeutic, since it was increasingly concerned about financial stability.

	Key indicators	Units	Moody's Analytics	Consensus	Consensus Range
Mon @ 10:00 a.m.	ISM Nonmanufacturing Index for January	diffusion index	56.7	56.5	55 to 58
Mon @ 10:00 a.m.	Moody's Analytics Business Confidence	index, 4-wk MA			
Mon @ 2:15 p.m.	Senior Loan Officer Opinion Survey				
Tues @ 8:30 a.m.	International Trade for December	$ bil	-52.3	-52.0	-50.0 to -52.7
Tues @ 10:00 a.m.	Job Openings and Labor Turnonver Survey for December				
Thur @ 8:30 a.m.	Jobless Claims for 2/3/18	ths	237	232	225 to 240

The Week Ahead

MONDAY, FEBRUARY 5

ISM nonmanufacturing survey (January; 10:00 a.m. EST)
Forecast: 56.7

The nonmanufacturing segment of the economy softened in December, but it doesn't raise any immediate concerns and we look for bounce back in January. The ISM nonmanufacturing survey fell from 57.4 in November to 55.9 in December. We believe nonmanufacturing improved in January, aided by higher energy prices (a support to mining), decent consumer spending, and a strengthening housing market. Our forecast is for the ISM nonmanufacturing survey's composite index to have risen from 55.9 in December to 56.7 in January. With the January survey, the ISM will release its annual revisions.

Business confidence (week ended February 2; 10:00 a.m. EST)
Forecast: N/A

Global businesses are happy at the start of the year. Abstracting from the weekly vagaries of the survey, a healthy more than 40% of responses to the nine questions in the survey are positive, while less than 10% of the responses are negative. Respondents are notably cheery about present business conditions, as half say they are improving, and respondents expect even better conditions by this summer.

Across the globe, the difference between the percentage of all positive responses and all negative responses to the nine survey questions came in at 36% last week and 35% on a four-week moving average basis. In the U.S., business confidence stood at 40% last week and 40% on a four-week moving average basis.

For historical context, when measurably less than 10% of responses are net positive, as was the case during much of 2008 and the first half of 2009, the economy is in recession. Readings of 20% to 30% are consistent with an economy that is expanding at potential. The global economy is expanding above potential with readings of more than 30%. The all-time low was -30% in December 2008 and the peak was 46% in April 2015.

The four-week moving average in our global business confidence survey increased from 34.3 to 35 in the week ended January 26.

TUESDAY, FEBRUARY 6

International trade (December; 8:30 a.m. EST)
Forecast: -$52.3 billion

We look for the nominal trade deficit to have widened from $50.5 billion in November to $52.3 billion in December. Already-released data showed the nominal goods deficit widened in December by $1.59 billion, reaching $71.58 billion. Nominal goods exports rose 2.7% in December while imports increased 2.5%. The forecast assumes a small decline the services surplus in December. Overall, net exports subtracted 1.1 percentage points from fourth quarter GDP growth.

WEDNESDAY, FEBRUARY 7
No major economic releases scheduled

THURSDAY, FEBRUARY 8

Jobless claims (week ended February 3; 8:30 a.m. EST)
Forecast: 237,000

Initial claims for unemployment insurance benefits can be volatile this time of year, but we expect they will begin to settle down. Initial claims are expected to have risen from 230,000 to 237,000 in the week ending February 3. This would be the second increase in the past four weeks. Our forecast would put new filings above their prior four-week moving average of 235,000.

The Week Ahead

FRIDAY, FEBRUARY 9

No major economic releases scheduled

EUROPE

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

We tweak our call for timing of the next BoE rate hike

All eyes will be on the Bank of England as its Monetary Policy Committee meets Thursday to decide the bank's policy stance. We expect the BoE will again remain on the sidelines. But the fact that the latest activity data for the fourth quarter surprised broadly on the upside has made us rethink our call on timing of the next rate hike. We previously argued that the bank would be able to maintain its breathing space until at least the end of the year due to an easing in price pressures and below-consensus activity figures.

The MPC hasn't met since mid-December and few of its members have spoken out this year, so it is hard for us to assess where the committee actually stands. But the improved growth prospects, together with an easing of the fiscal tightening planned for this year, and the country's recent re-gain of investor confidence certainly bode well for an August rate hike.

The MPC should nonetheless avoid jumping the gun on monetary policy. Brexit uncertainty remains elevated, and risks that the GDP figures are revised lower next month remain significant. To that we add that there is still no evidence that underlying price pressures are picking up. Services inflation isn't moving anywhere and wage growth is still not accelerating. Quite the reverse, our forecast is that pay gains will remain subdued in 2018 on the back of depressed job-to-job moves. What's more, we think that the MPC will be surprised by the extent that inflation moves back to target this year, just as it was caught off guard by inflation's jump following sterling's depreciation in 2017. This week's data brought yet more evidence that corroborates our outlook. The latest European Commission survey showed that the balance of general retailers planning to raise prices over the next three months declined to 45 in January, from 53 in December, its lowest since November 2016. This points to a sharp deceleration in nonenergy goods inflation, and we expect the rate to decline to 1.8% in March, from 2.5% in December. Similarly, the net balance of food retailers that intend to raise prices also fell, down to 42 from 62 previously, and is now reading further below its 72 average in 2017.

This chimes in well with our view that most of the pass-through of higher import prices to consumers is already over, and that the MPC is underestimating the pace at which import-led inflation will cool this year. True, a large majority of services firms still plans to raise prices over the next quarter, but we have observed little correlation between service firms' price expectations as measured by the EC and the official measure of services CPI over the past quarters. To add insult to injury, the appreciation in trade-weighted sterling since the start of this year will automatically force the MPC to reduce its medium-term inflation outlook for core inflation, taking yet further weight off its shoulders.

	Key indicators	Units	Moody's Analytics	Last
Tues @ 10:00 a.m.	Euro Zone: Retail Sales for December	% change	-1.0	1.5
Wed @ 9:00 a.m.	Italy: Retail Sales for December	% change	-0.6	1.1
Wed @ 9:00 a.m.	Germany: Industrial Production for December	% change	-2.0	3.4
Wed @ 1:40 p.m.	Russia: Consumer Price Index for January	% change	0.6	0.4
Thur @ 8:05 a.m.	Spain: Industrial Production for December	% change	1.4	1.0
Thur @ 12:00 p.m.	U.K.: Monetary Policy and Minutes for February	%	0.5	0.5
Fri @ 8:00 a.m.	France: Industrial Production for December	% change	-0.2	-0.5
Fri @ 9:00 a.m.	Italy: Industrial Production for December	% change	1.0	0.0
FrI @ 9:30 a.m.	U.K.: Industrial Production for December	% change	-0.9	0.4
Fri @ 3:00 p.m.	Russia: Foreign Trade for December	$ bil	12.5	11.5

MONDAY, FEBRUARY 5

No major economic indicators are scheduled for release.

TUESDAY, FEBRUARY 6

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

Euro zone retail sales likely fell by 1% m/m in December, partially reversing the 1.5% rise in November. The already-available preliminary country data for the area's major economies have been sobering. Spending on goods declined by 1.9% m/m in Germany, by 1.2% in France, and by 0.6% in Spain. Figures for Portugal were a little brighter, showing that sales in the country rose by 0.3% m/m at the end of the quarter, but they should provide little offset, especially as sales in Greece and Ireland also sagged. We are still waiting on data for Italy, the Netherlands, Austria and Belgium, but the bad news is that we expect sales to have fallen in those four countries, too.

December's broad-based declines are certainly a disappointment, rounding off a rather unimpressive fourth quarter for the currency area's retailers. But we do expect January to bring better numbers, as leading indicators all point to a sharp rebound at the start of the year.

WEDNESDAY, FEBRUARY 7

Italy: Retail Sales (December; 9:00 a.m. GMT)

Italy's retail sales likely retreated at the end of last year, after surging in the previous month. We expect output fell 0.6% m/m, following a 1.3% gain in November. Improving sentiment indicators suggest that household consumption should contribute to overall growth in the last quarter of 2017. Both confidence in retail trade and consumer confidence soared in December, while the retail PMI rose to 49.5 over the month, but pointed to a marginal decline in retail sales. Still, growing consumer confidence and an improving labour market outlook may support domestic demand. Yet soft wage growth is still restraining household spending and the jobless rate needs to drop further to jump-start wage growth and boost household spending even more.

Germany: Industrial Production (December; 9:00 a.m. GMT)

German industrial production likely retreated in December, down by 2% m/m, after jumping by 3.4% in the previous month. In year-ago terms the rate of increase is expected to have ticked down to around 5.5%. On average, industrial production likely rose about 3% in 2017. Robust demand likely supported production. Although German manufacturing orders fell 0.4% m/m in November, they jumped by 8.7% in year-ago terms, with the pace of increase in foreign and domestic orders accelerating compared with the previous month. The Markit manufacturing PMI rose further to 63.3 in December, which is the highest reading since the survey began in 1996, signaling continued strong momentum at the end of the last quarter of 2017. However, the outlook remains clouded as the uncertainty caused by the Brexit negotiations and political deadlock in Germany could hurt the manufacturing sector in coming months.

THURSDAY, FEBRUARY 8

Spain: Industrial Production (December; 8:05 a.m. GMT)

Spain's industrial sector likely performed well in December and accelerated to 1.4% m/m due to unusually harsh weather, which should have boosted energy production. But even if we strip out the one-off boost of the energy sector, the underlying trend seems healthy given the strong PMI. The gauge indicated a large backlog of work and a ramp-up of capacity utilization, which should drive up industrial output. Although the headline manufacturing PMI eased to 55.2 in December from 55.8 previously, businesses assessment of one-year ahead stayed upbeat. Rising sentiment should gradually feed through the industrial sector over 2018.

FRIDAY, FEBRUARY 9

France: Industrial Production (December; 8:00 a.m. GMT)

France's industrial production likely fell by 0.2% in December, following a 0.5% decline in November. But this is nothing to worry about; it should be seen as a further correction from October's eye-watering 1.7% rise. Accordingly, the yearly rate should still have jumped to 3.3%, from 2.5% previously, further above the 2% average recorded for the past 12 months. Energy production should have been the main drag on the headline, correcting a 3.8% jump in November as temperatures in December rebounded and slightly exceeded their long-term average. Mining and quarrying are also expected to have mean-reverted following two consecutive months of rises, but the sector is still a wild card given the disruption in the U.K.'s Forties oil pipeline in December. Manufacturing, by contrast, is expected to have posted better results, especially as we expect that clothing and household goods production increased sharply following underwhelming gains in November. Over the quarter as a whole, production in the country is still expected to have jumped by a sharp 1.8% q/q, accelerating from the third quarter's 0.8% rise.

Italy: Industrial Production (December; 9:00 a.m. GMT)

Italy's industrial production likely rose at the end of the last year, after remaining unchanged in the previous month. We expect output gained 1% m/m, but that the annual expansion rate slowed to 1.9%, from 2.3% previously. Although forward-looking indicators suggested strong momentum in manufacturing at the end of 2017, they eased a bit in December. Manufacturing sentiment slipped to 110.5 from 110.7 in November, while confidence in construction retreated to 127.1 from 132.1 previously. Meanwhile, the manufacturing PMI fell to 57.4 in December from almost a seven-year peak of 58.3 in November. Strong gains in new orders and firming export orders are promising and suggest that industry will buoy the economy in coming months. Neither the political uncertainty ahead of general elections nor the Brexit negotiations have harmed the expansion yet.

U.K.: Industrial Production (December; 9:30 a.m. GMT)

We forecast that U.K. industrial production fell by 0.9% in December, fully reversing November's 0.4% m/m increase. The yearly rate is similarly expected to have fallen sharply to only 0.3%, from 2.5% previously, well below the 2.4% average for the past 12 months. But not much weight should be put on the dire headline. Production in December was likely dragged down by a sharp plunge in mining and quarrying output—we forecast it to have fallen by as much as 18% m/m—as a consequence of the emergency closure of the Forties pipeline at the middle of the month, the U.K.'s biggest pipeline. We do expect a sharp rebound over the coming months. Similarly, energy output is expected to have corrected following a weather-related jump in November, notably as temperatures during the year's closing month were relatively mild.

We expect that manufacturing production will bring much brighter results. We forecast that it grew by 0.7% m/m on a sharp rebound in production of transport equipment, which had fallen sharply in November. Clothing and footwear output, by contrast, should have retreated slightly.

ASIA-PACIFIC

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

China's coming Lunar New Year likely causing some price volatility

China's January price data remain subdued, as factory price pressures are low and the housing market is cooling. Headline inflation remains below the government's 3% target but has been trending higher of late, due to a recovery in food prices. The coming Lunar New Year likely is causing some price volatility that will proceed through February on base effects. Producer price pressures are cooling, as commodity prices have trended down again in the past few months. Prices have declined for iron ore, coal and other commodities due to global oversupply and government policy to stem overcapacity. We expect the slowing trend to persist through the first half of 2018.

China's foreign trade data are also due for January. The relatively large trade surplus likely widened in January as the tradeables sector continues to grow at a robust pace, driven by buoyancy in global demand, particularly in the tech space. There is a wider degree of uncertainty in the forecast than usual given the volatility around the Lunar New Year holiday.

A suite of monetary policy meetings is coming up. India's monetary policy committee will likely become more hawkish in the first meeting of 2018. Inflation has inched higher in recent months, while growth has also picked up. Food prices continue to add the most to headline inflation and there has been a resurgence in fuel prices. Despite this, we think the central bank is unlikely to raise interest rates, preferring to wait for the 2018 monsoon season.

Central banks in Australia and New Zealand are sitting pretty, with their policy rates expected to hold steady through 2018. In both cases, the central banks do not need to be in a hurry to tighten rates, as inflation is subdued and expected to only gradually creep higher this year. Australia's central bank has put a question mark over the outlook for consumption and so do we. Households are feeling frugal in the midst of soft income growth. We expect income growth to only gradually improve over 2018 amid tightening in the labour market. In New Zealand there is high uncertainty around the newly elected government's policy amendments, including tighter visa requirements, higher minimum wages, and increased spending on environmental endeavours. While this uncertainty remains, the central bank will steer clear of causing further ructions with interest rate hikes.

Indonesia's GDP growth likely held steady at 5.1% y/y in the December quarter. This brings full-year GDP growth to 5.1%, at the lower end of the government's 5%-to-5.4% full-year target. Disappointing private consumption has kept GDP growth at the low end of acceptable. While Indonesians have the income, they are reluctant to spend, particularly on big-ticket items. Exports are helping pick up the slack from lagging consumption and have done so through 2017, helped by higher commodity prices.

	Key indicators	Units	Moody's Analytics	Last
Mon @ Unknown	Indonesia GDP for Q4	% change yr ago	5.1	5.1
Tues @ 11:30 a.m.	Australia Foreign trade for December	A$ mil	-230	-630
Tues @ 11:30 a.m.	Australia Retail sales for December	% change	-0.3	1.2
Tues @ 2:30 p.m.	Australia Monetary policy for February	%	1.5	1.5
Tues @ 7:00 p.m.	Taiwan Consumer price index for January	% change yr ago	1.0	1.2
Wed @ 8:45 a.m.	New Zealand Unemployment rate for Q4	%	4.8	4.6
Wed @ 6:00 p.m.	Malaysia Foreign trade for December	MYR bil	9.2	9.9
Wed @ 7:00 p.m.	Taiwan Foreign trade for January	US$ bil	4.7	6.1
Wed @ 9:00 p.m.	India Monetary policy for February	%	6.0	6.0
Thurs @ 7:00 a.m.	New Zealand Monetary policy for February	%	1.75	1.75
Thurs @ Unknown	China Foreign trade for January	US$ bil	59.0	54.7
Fri @ Unknown	Philippines Industrial production for December	% change yr ago	-12.4	-8.1
Fri @ 11:30 a.m.	Australia Housing finance for December	% change	-0.5	-2.1
Fri @ 12:30 p.m.	China Consumer price index for January	% change yr ago	1.6	1.8
Fri @ 12:30 p.m.	China Producer price index for January	% change yr ago	4.2	4.9
Fri @ 3:00 p.m.	Malaysia Industrial production for December	% change yr ago	4.8	5.0
Fri @ 3:30 p.m.	Japan Industry activity indexes for December	% change	0.6	1.1

MONDAY, FEBRUARY 5

Indonesia – GDP – 2017Q4

Time: Unknown
Forecast: 5.1%

Indonesia's GDP growth likely held steady at 5.1% y/y in the December quarter. This brings full-year GDP growth to 5.1%, at the lower end of the government's 5%-to-5.4% full-year target. Disappointing private consumption has kept GDP growth at the low end of acceptable. While Indonesians have the income, they are reluctant to spend, particularly on big-ticket items. This is particularly the case for middle- to high-income earners and could be the result of government efforts to lift tax revenue, including better enforcement of tax rules, which may be dampening consumption. There's some upside risk that third quarter rate reductions could deliver a modest lift to consumption and, in turn, broader growth in the fourth stanza. Exports are helping pick up the slack from lagging consumption and have done so through 2017, helped by higher prices. Sluggish infrastructure investment remains an impediment to potential growth, which we estimate around 7%.

TUESDAY, FEBRUARY 6

Australia – Foreign Trade – December

Time: 11:30 a.m. AEDT (12:30 a.m. GMT)
Forecast: -A$230 million

Australia's monthly trade balance likely recorded a A$230 million deficit in December, from a A$630 million shortfall in November. Higher commodity prices, especially for oil, are lifting the import bill. The relatively strong Australian dollar is taking some of the shine off otherwise upbeat commodity exports, especially for iron ore and coal amid strong Chinese demand. Rural exports, while more volatile, are also doing well. More than 1 million tonnes of beef and veal were exported in 2017. While this is a little less than in 2016, it is a milestone achieved for only the fifth time in history. It was driven by strong demand across Australia's three largest beef markets: the U.S., Japan and South Korea. This year is looking better for rural exports, as beef herds hit a 20-year low in 2017 because of drought and should recover by the second half of 2018.

Australia – Retail Sales – December

Time: 11:30 a.m. AEDT (12:30 a.m. GMT)
Forecast: -0.3%

Australian retail trade likely fell by 0.3% m/m in December, after surging by 1.2% in November due to the flurry of activity around Black Friday sales on 24 November and retailers' promotions and sales ahead of the peak Christmas period of mid- to late December. Another boost to spending was the nationwide release of the popular iPhone X late in October. Looking through the temporary events, retail trade is travelling in the slow lane. Trend spending is running around just 0.2% m/m, a symptom of Australia's sluggish income growth. Households are not willing to dip into their savings to fund consumption as they did in the first half of the year and have turned more frugal. We expect only modest improvements in income growth by the second half of 2018, ensuring that consumption underperforms its long-term trend pace.

Australia – Monetary Policy – February

Time: 2:30 p.m. AEDT (3:30 a.m. GMT)
Forecast: 1.5%

The Reserve Bank of Australia is sitting pretty. The cash rate will hold steady at 1.5% at the central bank's first meeting of 2018. The RBA doesn't need to be in a hurry to tighten rates, as core inflation is below the 2%-to-3% target range and is expected to only gradually gather momentum over 2018 in line with wages. Interest rate normalization isn't expected until early 2019. The central bank has put a question mark over the outlook for consumption and so do we. Households are feeling frugal in the midst of soft income growth. We expect income growth to only gradually improve over 2018 amid tightening in the labour market. The strong Australian dollar presents downside risk to the improving outlook, and if it remains strong interest rate hikes could be further delayed.

Taiwan – Consumer Price Index – January

Time: 7:00 p.m. AEDT (8:00 a.m. GMT)
Forecast: 1%

Taiwan's consumer price index likely increased 1% y/y in January, after ticking up 1.2% in the prior month. Price pressures have been building off a low base, consistent with firmer economic activity and a slowly improving labour market. The labour market is likely to continue improving at a gradual pace in 2018. Along with pay raises for public servants and minimum wage earners this year, that will likely cause price pressures to increase modestly in 2018.

WEDNESDAY, FEBRUARY 7

New Zealand – Employment Situation – 2017Q4

Time: 8:45 a.m. AEDT (Tuesday, 9:45 p.m. GMT)
Forecast: 4.8% Unemployed

New Zealand's unemployment rate likely hit 4.8% in the December quarter after 4.6% in the third, its lowest rate since December 2008. The labour market is in a good place, but health was likely overstated in the third quarter due to the influx of visitors for various sporting events that resulted in a spike in temporary employment. Underutilisation is still relatively elevated, hovering just shy of 12%, but has improved over the past year. The labour market will tighten further, as the newly elected government is planning to reduce annual net migration by 30,000. This is a significant reduction considering the net 71,000 gain in 2016 was a record high, and it should breathe life into mediocre wage growth.

Malaysia – Foreign Trade – December

Time: 6:00 p.m. AEDT (7:00 a.m. GMT)
Forecast: MYR9.2 billion

Malaysia's trade surplus likely remained relatively large in December at MYR9.2 billion, from the MYR9.9 billion recorded in November. Tech is the key strong point, and electrical and electronics were up a solid 21% y/y in November. Palm oil shipments are travelling in a slower lane and were up just 2.7% in November, but they are expected to pick up, with Chinese demand for the edible oil likely to increase in the opening months of 2018. Malaysia's December quarter is tracking strongly, following the stellar third quarter in which GDP growth reached its highest rate since mid-2014.

Taiwan – Foreign Trade – January
Time: 7:00 p.m. AEDT (8:00 a.m. GMT)
Forecast: US$4.7 billion

Taiwan's trade surplus likely narrowed to US$4.7 billion in January, after rising to US$6.1 billion in December. External trade typically cools in January, as economic activity in many trading partners slows due to holidays. External demand remained firm at the end of 2017, with exports rising by a three-month high of 14.8% y/y in December. Exports of electronic components continued to stand out, as did exports of information and communications technology products. With overseas economic conditions likely to remain relatively firm this year, Taiwan is expected to benefit from solid external demand in 2018.

India – Monetary Policy – February
Time: 9:00 p.m. AEDT (10:00 a.m. GMT)
Forecast: 6%

India's monetary policy committee will likely become more hawkish at the first meeting of 2018. Inflation has inched higher in recent months, while growth has also picked up. Food prices continue to add the most to headline inflation while a resurgence in commodity prices has added to fuel costs. Despite this, we think the Reserve Bank of India is unlikely to raise interest rates, preferring to keep the policy rate steady at 6%. A more likely scenario would be that the RBI waits until the monsoon season, and if rains are below average again, the central bank could raise rates in the second half of the year.

THURSDAY, FEBRUARY 8

New Zealand – Monetary Policy – February
Time: 7:00 a.m. AEDT (Wednesday, 8:00 p.m. GMT)
Forecast: 1.75%

The Reserve Bank of New Zealand will keep its official cash rate at 1.75% in February, where it has been since November 2016. We expect the central bank will hold steady through 2018, as low wages alongside subdued core inflation do not warrant near-term tightening. In addition, there is high uncertainty around the newly elected government's policy amendments, including tighter visa requirements, higher minimum wages, and increased spending on environmental endeavours. While this uncertainty remains, the central bank will steer clear of causing further ructions with interest rate hikes. This is necessary, as our preliminary analysis suggests that some forthcoming government policies, including reduced migration, will soften consumption.

China – Foreign Trade – January
Time: Unknown
Forecast: US$59 billion

China's trade surplus was elevated in December, partly as imports growth was quite soft. This was largely due to the lower value of commodity imports because of lower prices. Overall activity in China's tradeables sector continues to grow at a robust pace, driven by strong global demand, particularly in the tech space. Some volatility in the headline trade number is usually seen at the start of the calendar year, but the trade surplus likely rose to US$59 billion in January, from US$54.7 billion in December.

FRIDAY, FEBRUARY 9

Philippines – Industrial Production – December
Time: Unknown
Forecast: -12.4%

The downswing in industrial production growth likely deepened in December. Industrial production likely fell 12.4% y/y, after an 8.1% decline in November. Industrial production has been in a downturn since the start of 2017, much of which reflects the high base from one year earlier. We expect the impact of the high base to fade in 2018, leading to firmer industrial production growth by mid-2018, especially with public works set to ramp up.

Australia – Housing Finance – December

Time: 11:30 a.m. AEDT (12:30 a.m. GMT)
Forecast: -0.5%

Australian owner-occupied housing finance commitments likely fell by 0.5% m/m in December after a 2.1% drop in November. While the headline series is choppy, the underlying trend is becoming clearer, and that is one of emerging softness. Other housing data such as sales prices show that markets in Sydney are cooling and that growth is moderating in Melbourne. This should be increasingly reflected in the slower growth of housing-finance commitments. Forward indicators such as auction clearance rates suggest that the national housing market will broadly cool through 2018.

China – Consumer Price Index – January

Time: 12:30 p.m. AEDT (1:30 a.m. GMT)
Forecast: 1.6%

Headline inflation remains below the government's target but has been trending higher of late due to a recovery in food prices. However, it likely decelerated in year-on-year terms in January in line with seasonal effects, with the forthcoming Lunar New Year likely causing some price volatility. Overall, though, inflation pressures are quiescent, as factory price pressures are low and the housing market is cooling. Consumer price inflation likely cooled to 1.6% in January, down from 1.8% in December.

China – Producer Price Index – January

Time: 12:30 p.m. AEDT (1:30 a.m. GMT)
Forecast: 4.2%

Producer price pressures in China are cooling, as commodity prices have trended down again in the past few months. Prices for iron ore, coal and other commodities have declined due to global oversupply and government policy to stem overcapacity, which has lowered prices of some inputs. This will result in producer price inflation trending lower in the first half of 2018. China's producer price growth likely decelerated to 4.2% y/y in January, down from 4.9% in December.

Malaysia – Industrial Production – December

Time: 3:00 p.m. AEDT (4:00 a.m. GMT)
Forecast: 4.8%

Malaysian industrial production likely cooled to 4.8% y/y in December, from 5% in November. Manufacturing was a strength through 2017, particularly driven by the sustained upswing in the global tech cycle, which recently gathered additional momentum from popular product launches in the December quarter. Manufacturing likely will continue its solid performance in 2018, albeit at a slightly slower pace than 2017. Sustained buoyancy in consumer demand across China, Europe and the U.S. will ensure gradual cooling rather than a sharp slowdown in the electronics space.

Japan – Industry Activity Indexes – December

Time: 3:30 p.m. AEDT (4:30 a.m. GMT)
Forecast: 0.6%

Tertiary activity in Japan accelerated in November to 1.1% m/m after a dismal showing in the two prior months. There was a broad-based increase across all major categories, with wholesale and retail trade, which accounts for around 40% of tertiary activity, making solid gains. We expect industrial activity likely slowed in December to 0.6% m/m, although gains are expected across the various industries. Overall, external demand has wet the sails of the Japanese economy in 2017. Consistent gains on a year-ago basis confirm our view that the economy was in better shape in 2017 and will likely head into 2018 on a strong note.

The Long View

An extended sell-off of equities amid rising Treasury bond yields will eventually swell corporate bond yield spreads.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group,
January 25, 2018

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 98 bp is far under 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 329 bp is less than what is inferred from the spread's macroeconomic drivers and the high-yield EDF metric. 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%, the US high-yield default rate has since eased to the 3.3% of December 2017. Moody's Default and Ratings Analytics team expects the default rate will average 2.4% in Q4-2018. A deeper slide to its 1.85% average of the 18-months-ended June 2015 is unlikely for now.

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.

Fourth-quarter 2016's worldwide offerings of corporate bonds showed annual percent changes of -10.2% for IG and +24.9% for high-yield, wherein US$-denominated offerings fell by 8.5% for IG and advanced by 24.9% for high yield.

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

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.

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). For yearlong 2017 have worldwide corporate bond offerings increasing by 4.0% annually (to $2.499 trillion) for IG and advanced by 41.2% for high yield (to $602 billion). The worldwide corporate bond offerings of 2018 are expected to show annual increases of 3.5% for IG and 2% 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 2.7% for long. A fundamentally excessive climb by Treasury bond yields and a pronounced slowing by expenditures in dynamic emerging market countries are among the biggest threats to the adequacy of economic growth and credit spreads going forward.

EUROPE

By Anna Zabrodzka of Moody's Analytics
February 1, 2018

Euro zone

This past year was likely the strongest for the euro zone economy in a decade. The region's real GDP expanded by 0.6% q/q in the third quarter, following similar increases in the first half of the year. The annual expansion rate accelerated to 2.6%, which is the fastest pace of increase since the beginning of 2011.

Out of the four biggest euro zone economies, the strengthening German and Italian GDP growth rates mainly supported the currency area's total expansion. In contrast, though growth remained strong in Spain and France, it slowed there a bit from the previous quarter.

For all of 2017, output in the euro zone is expected to have expanded by around 2.3%, which would be the fastest growth rate since 2007, when it grew by 3.1%. The expansion is expected to have been relatively broad-based, with GDP growing robustly also in Italy and France after rather disappointing 2016 results.

Strong business optimism indicates good start into 2018

The strong Markit PMI readings at the end of the last year, together with rising new orders and stronger employment growth, mean the euro zone not only ended last year with a bang but will set off confidently into the new year.

The Markit manufacturing PMI climbed to 60.6 in December, its highest reading since the survey began in mid-1997, thanks largely to a surge in output growth in investment goods. Austria, Germany and Ireland had reason to gloat, with their PMIs each soaring to record highs, while France and Greece also posted substantial gains. Despite downticks in the Netherlands, Italy and Spain, the survey still pointed to robust results for these countries at the end of the year.

Also, the European Commission's economic sentiment indicator holds important clues about businesses' risk perception. The euro zone's economic confidence indicator continued strong expansion for the seventh consecutive month in December, reaching 116 points—the highest level since October 2000. Among the euro zone countries, close behind France, Germany recorded the second biggest gain at 1.6 points in December, above the euro area average of 1.4 points, indicating that German businesses remain little troubled by the continued lack of a ruling coalition. On the other hand, weaker sentiment in Spain may partially reflect the lingering uncertainty about Catalonia, while in Italy the reading remained unchanged from the previous month despite the upcoming early election.

Although the overall picture is rosy, we do not expect the euro zone economy will manage to exceed 2017's growth this year. Slowly tightening monetary conditions, the fallout of Brexit negotiations, and already-problematic shortages of skilled labour in some countries may hold back the European expansion.

Moreover, the gradual withdrawal of monetary stimulus will likely weigh slightly on the expansion rate. However, inflation that remains below target and weak credit growth will likely prevent the European Central Bank from any sharp changes in the near term. Although central bankers halved the monthly purchases to €30 billion from January, they extended them until September. For now we expect the ECB to exit from unconventional measures and start increasing the key interest rates at the beginning of 2019.

Although economic growth in 2018 is unlikely to exceed the region's fastest expansion rate in a decade in 2017, some risks are pointing to the potential upside. Stronger expansion in the U.S. supported by the tax overhaul, together with an ambitious reform agenda in France, may boost the European economy more than expected. The latter is especially important from the European perspective. Reducing labour market friction in the second biggest euro zone economy would cut the French unemployment rate, while restructuring public sector spending would bring down the fiscal deficit—two main obstacles to faster potential growth.

Although the number of job seekers has dropped since the end of 2015, the decrease has not been exciting and even stalled somewhat in the middle of the last year, which makes the picture far from rosy.

Political risks still cloud the outlook

Compared with the same time in 2017, political uncertainty seems to be somewhat lower, especially considering the result of the last year's presidential election in France. However, Europe is still not out of the woods, even though political risk seems contained for now. There will be presidential elections in Finland in the first quarter and in Ireland later in the year as well as general elections in Latvia and Sweden, but none of them should derail the economic expansion.

The big unknown is the result of the early elections in Italy, scheduled for March 4. With no clear favourite, nervousness will likely increase over the next few weeks, which will bring economic and political uncertainty and possibly another round of voting. The ruling Democratic party and the opposition Five-Star Movement, or M5S, have been neck and neck in the polls for months, with both credited with around 27% of the vote. Even if the populist M5S wins the general elections in May, governing will be difficult because M5S categorically refuses to form a coalition government with any other party. To pocket as much as 40% of the vote to create a one-party government looks unrealistic.

Germany and Spain

In Germany, the political uncertainty continues, even though Angela Merkel's Christin Democrats won the parliamentary election which was held at the end of September. Since then, Merkel has been struggling to secure a coalition partner to form a government. Finally, the new year brought some breakthrough, and the CDU managed to reach a preliminary agreement with its former coalition partner, the Social Democrats, paving the way for formal negotiations. However, the formal talks will not conclude before Easter, which means that the country will lack a legitimate government for the next three months. The record-long process of forming the government can have far-reaching consequences. In the best-case scenario, the political turmoil in Germany will only postpone debate about the future of the EU until late 2018. But we fear that the prolonged period has already hurt Merkel's position in the EU political arena.

Meanwhile, Spain is still feeling the hangover form Catalonia's attempt at secession in the autumn. The Spanish government estimates that the short-term economic costs of the independence bid amounted to €1 billion in lost revenues; however, the bill could prove to be higher. The early parliamentary elections on December 21 did not bring the results that Madrid was rooting for or ease concerns about the region's economic future. Though furthering the independence agenda in coming months is unlikely, we cannot rule out that the Spanish government and Catalonia's leaders will find themselves caught up in the same bad cycle. We are yet to see how the political uncertainty may spill over to private spending and tourism, but real-time estimates of GDP already signal a slowdown.

ASIA PACIFIC

By Katrina Ell of Moody's Analytics
February 1, 2018

Australia

The Australian economy's enviable run of recession-free GDP growth has entered its 27th year. We forecast economic growth to improve to 2.9% in 2018, from an estimated 2.3% in 2017. Business investment is strengthening, especially from the nonmining sector after years of underperformance. Employment growth is running 1.4 percentage points above its 20-year average, with the majority of jobs created in the past year full-time positions, and highly accommodative monetary policy settings are likely to stay put through 2018.

But downside risks loiter more than usual. The outlook is clouded by concern that income growth will not materially improve this year, ensuring that consumption remains soft, which is worrying given that it accounts of 75% of GDP.

Labour market is key

At first glance, the labour market looks healthy. There's no doubt it has had a stellar run through 2017. The unemployment rate trended lower over 2017 to 5.5% in December, roughly where we estimate full employment to sit. Trend employment growth was 3.3% y/y in December, well above its 20-year average of 1.9%. More than 80% of employment gains in the year to December were in full-time positions. This is a reversal from 2016 when part-time positions were in favour and the underemployment rate was at a record high. The expectation is that the labour market has tightened to an extent that stronger wage growth will occur in the second half of 2018

However, two key observations suggest that the wage price index is unlikely to materially budge from hovering around a record low 2% y/y, adding downside risk to our forecast for stronger GDP growth, given wages are a causal driver of consumption. A material pickup in incomes is needed to unlock consumption from its soft spot.

The first is the Phillips curve, which describes the inverse relationship between unemployment and wages. Australia's Phillips curve has flattened in the past decade, meaning that wages are less responsive to changes in the unemployment rate. Some structural factors are likely at play here.

The rise of the gig economy has contributed to the rise in casual employment. These positions are more flexible and more easily adaptable to changing demand, but there's no union representation, which can hurt wage bargaining. Also, as the positions are more flexible, there's more acceptance that lower wages can be a consequence.

Another structural reason for low incomes could be the higher prevalence of offshoring roles. There's no reliable industry- or economy-wide data measuring the extent of offshoring, but we know that it is an unrelenting phenomenon, given the disparity in operating costs between Australia and the developed world. Employers are not locally replacing jobs lost offshore, so they are not potentially driving up labour costs to secure the appropriate candidate.

The Beveridge curve

Second, the Beveridge curve shows that although Australia's labour market tightened over 2017, it is not tight, particularly relative to recent history. The Beveridge curve shows the negative relationship between the unemployment rate and the job vacancy rate. The position on the curve can provide an indication of broader labour market conditions. For example, when labour market conditions weaken, the unemployment rate will rise and the number of vacancies will fall. This results in a movement down and to the right along the curve. In this circumstance, it is easier for employers to find appropriate labour.

In the past year, the unemployment rate has fallen and the vacancy rate has increased, consistent with a tighter labour market, but relative to recent history the labour market isn't as tight as we may assume. In other words, Australia's labour market has moved slightly up and to the left along the curve. In February, the seasonally adjusted unemployment rate was 5.84% and the vacancy rate was 1.3%. By December, the unemployment rate had fallen to 5.5%, while the vacancy rate had increased to 1.36%.

During this period, wage growth had increased only modestly. This sharply contrasts with 2008: The average unemployment rate over the period was 4.23%, while the vacancy rate was 2.49%, resulting in the labour market hovering at the highest point along the Beveridge curve. The relatively tight labour market of 2008 delivered wage growth of 4% to 4.5%.

Sitting pretty

Growth in compensation of employees has been less than 3% since 2016, well below the 2000-2010 average. With core inflation also below the Reserve Bank of Australia's target of 2% to 3%, and little inflation pressure imminent, the central bank is likely to keep the cash rate unchanged through 2018 before gradual tightening in 2019.

Another motivation for holding the cash rate steady for another year is to keep downward pressure on the currency as the Federal Reserve normalizes policy. This is desirable given the competitive benefits to exports and encourages greater consumption onshore. The Australian dollar has appreciated 7% in the past year and hovers around US$0.79. The RBA has mentioned sustained strength as a downside risk to the improving outlook and we expect the currency to cool to around US$0.75 by the second half of the year as the central bank resists the urge to tighten policy levers.

Cooling housing market

Australia's property market garners much attention locally and abroad, as it is one of the few in the developed world to have not experienced a sizeable correction. Our baseline maintains that this will persist in coming years, even though certain pockets have had unprecedented growth.

Low interest rates have supported the housing market. Values of detached houses in Sydney rose 12% in 2017 after a 10.9% gain in 2016. Home values in Melbourne rose an even stronger 15% in 2017. This hefty house price growth coincided with household debt as a proportion of disposable income running at a concerning 200%, steadily rising since 2013. This is another reason the RBA won't be in a hurry to raise rates, given that already-fragile consumers are grappling with low income growth.

However, housing momentum is fading and growth in values will decelerate across the country through 2018. Our housing model forecasts that values in Sydney will decline by 0.6% in 2018, while those in Brisbane remain flat. Melbourne is still expected to experience respectable, albeit slower, growth in house values in 2018. National prices are forecast to increase 1.7% in 2018 and an additional 0.5% in 2019.

Recent small monthly falls in the Sydney and Melbourne markets support our expectation for cooling, rather than a slump, in the near term. Several factors are at play. Aggressive regulatory action that has included limits on new bank lending exposure to the local housing market, higher borrowing costs especially for investors that tend to carry higher leverage, and improved enforcement of existing legal limits on foreign ownership have started to bear fruit.

Another driver, particularly in the most heated Sydney market, has been increased supply. After several years of strong growth, supply has started to catch up, especially for apartments in the most desirable inner city and suburban areas of Sydney. This has had a helping hand from reduced red tape associated with land release.

If the housing market looks to be on a sharper than expected cooling trend that materially threatens the broader economy given the outsize exposure of consumers and lenders to local property, we have little doubt regulators would step in to try to restore order, at the very least by winding back some regulatory limits.

Ratings Round-Up

By Njundu Sanneh

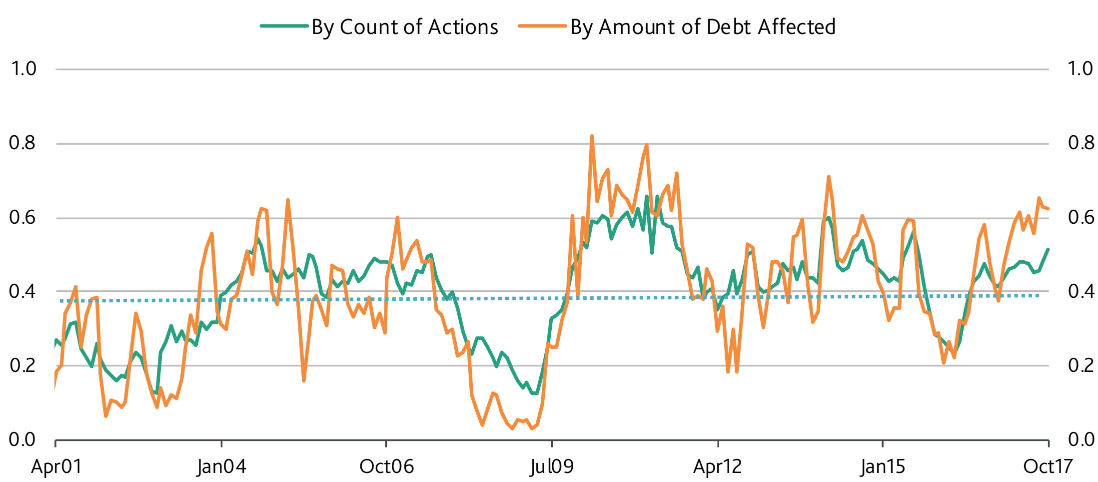
Upgrades Bounce Back

In a week where positive ratings changes were in full strength, sovereign rating action and the technology sector were the main drivers of the ascendancy of rating upgrades in Europe and the U.S., respectively. The rating change included the upgrade of the outlook of the government of Russia to positive from stable and the raising of the country ceiling for foreign currency debt to Baa3/P3 from Ba1/NP. The country risk ceilings for local currency debt were also raised by Moody's Investors Service. The change in outlook and the country risk ceiling upgrades were precipitated by improved institutional strength and economic and fiscal resiliency, and lower vulnerability to external shocks. The sovereign rating action has led to the upgrade of numerous non-financial corporations; Russian companies and/or their subsidiaries account for 13 of the 19 total European rating changes in the past week. The upgraded Russian firms are mainly in the energy, mining and chemicals sectors. The contribution of positive rating changes rose to 89% in Europe for the past week after several weeks of low incidence of positive rating changes albeit the counts were relatively low.

The U.S. positive rating change surge was underlined by the technology sector with four of the 10 total positive rating changes. The tech ratings upgrades for Scientific Games Corporation, AP Gaming HoldCo, Inc.; Compuware Holdings, LLC; and Western Digital Corp. were due to deleveraging using proceeds from an initial public offering, debt refinancing, and increased revenue growth. Some of the notable U.S. downgrades included Sears Holdings Corp. and Oceaneering International, an oil fields services outfit. Sear's downgrade was prompted by a debt exchange plan involving some $4.2 billion of debt in view of the impending maturities and declining unencumbered assets.

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	Old STD Rating	New STD Rating	IG/ SG
1/24/18	SCIENTIFIC GAMES CORPORATION	Industrial	SrSec/BCF	2,450	U	B1	Ba3			SG
1/24/18	VICTORY CAPITAL HOLDINGS, INC.	Financial	SrSec/BCF/LTCFR/PDR		U	B2	B1			SG
1/25/18	CARAUSTAR INDUSTRIES, INC.	Industrial	SrSec/BCF/LTCFR/PDR		D	Ba2	Ba3			SG
1/25/18	SYNIVERSE HOLDINGS, INC.	Industrial	SrUnsec/LTCFR/PDR	429	U	Caa3	Caa2			SG
1/26/18	FREEPORT-MCMORAN INC.	Industrial	SrUnsec/LTCFR/PDR	11,763	U	B1	Ba2			SG
1/26/18	SEARS HOLDINGS CORP.	Industrial	SrUnsec/SrSec/LTCFR/PDR/BCF	1,368	D	Ca	C			SG
1/29/18	BROOKFIELD ASSET MANAGEMENT INC. - TerraForm Global Operating, LLC	Utility	SrUnsec/LTCFRPDR	1,521	U	Caa1	Ba3			SG
1/29/18	COMPUWARE HOLDINGS, LLC	Industrial	SrSec/BCF/LTCFR/PDR		U	B3	B2			SG
1/29/18	DARDEN RESTAURANTS, INC.	Industrial	SrUnsec/MTN/CP	950	U	Baa3	Baa2	P-3	P-2	IG
1/29/18	GATES GLOBAL LLC	Industrial	SrUnsec/SrSec/BCF/LTCFR/PDR/BCF	1,482	U	B2	B1			SG
1/29/18	OCEANEERING INTERNATIONAL, INC.	Industrial	SrUnsec/BCF	500	D	Baa3	Ba1			IG
1/30/18	AP GAMING HOLDCO, INC.	Industrial	LTCFR		U	B3	B2			SG
1/30/18	WESTERN DIGITAL CORPORATION	Industrial	SrUnsec/SrSec/BCF	5,225	U	Ba2	Baa3			SG

Source: Moody's

FIGURE 4

Rating Changes: Corporate & Financial Institutions – Europe

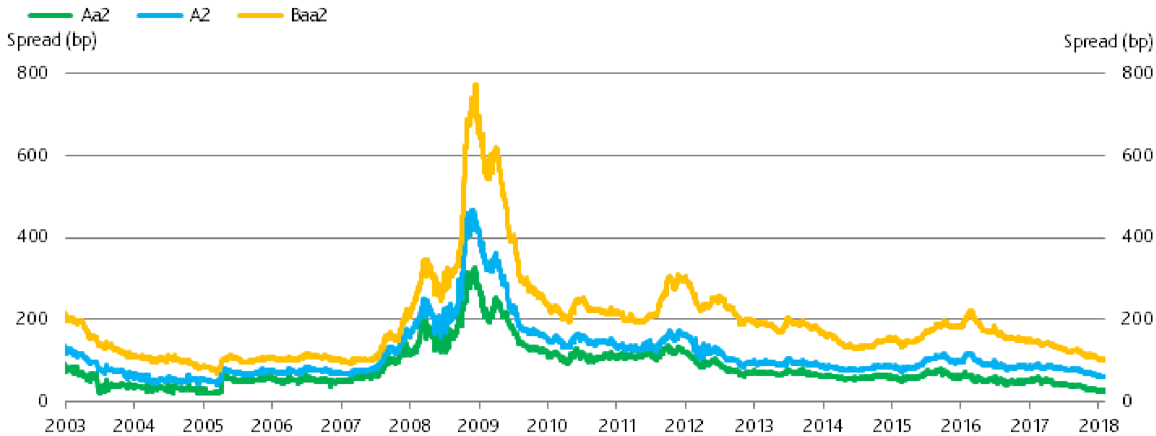
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG	Country
1/26/18	INTERNATIONAL BANK OF AZERBAIJAN	Financial	LTD		U	Caa1	B3	SG	AZERBAIJAN
1/24/18	CEPS, A.S.	Utility	LTIR		U	A2	A1	IG	CZECH REPUBLIC
1/29/18	MMC NORILSK NICKEL, PJSC - MMC Finance DAC	Industrial	SrUnsec	2,750	U	Ba1	Baa3	SG	IRELAND
1/29/18	NLMK - Steel Funding D.A.C.	Industrial	SrUnsec	1,307	U	Ba1	Baa3	SG	IRELAND
1/29/18	PAO NOVATEK - Novatek Finance Limited	Industrial	SrUnsec	1,650	U	Ba1	Baa3	SG	IRELAND
1/29/18	PJSC OIL COMPANY ROSNEFT	Industrial	SrUnsec/MTN	3,600	U	Ba1	Baa3	SG	RUSSIA
1/29/18	PJSC PHOSAGRO - PhosAgro Bond Funding DAC	Industrial	SrUnsec	1,000	U	Ba1	Baa3	SG	IRELAND
1/29/18	SIBUR HOLDING, PJSC - Sibur Securities DAC	Industrial	SrUnsec	1,116	U	Ba1	Baa3	SG	IRELAND
1/29/18	TRANSNEFT, PJSC - TransCapitalInvest DAC	Utility	SrUnsec	1,050	U	Ba1	Baa3	SG	IRELAND
1/25/18	ALGECO SCOTSMAN GLOBAL S.A.R.L.	Financial	SrUnsec/SrSec/LTCFR	2,162	U	Ca	Caa1	SG	LUXEMBOURG
1/29/18	ALROSA PJSC - Alrosa Finance S.A.	Industrial	SrUnsec	1,000	U	Ba1	Baa3	SG	LUXEMBOURG
1/29/18	PAO SEVERSTAL - Steel Capital S.A.	Industrial	SrUnsec/MTN	750	U	Ba1	Baa3	SG	LUXEMBOURG
1/30/18	INTERNATIONAL AUTOMOTIVE COMPONENTS GROUP, S.A.	Industrial	PD	300	D	Caa1	Caa3	SG	LUXEMBOURG
1/29/18	LUKOIL, PJSC -LUKOIL International Finance B.V.	Industrial	SrUnsec	5,096	U	Ba1	Baa3	SG	NETHERLANDS
1/29/18	GAZPROM, PJSC	Industrial	SrUnsec/SLTIR/MTN	27,867	U	Ba1	Baa3	SG	RUSSIA
1/29/18	RUSSIAN RAILWAYS JOINT STOCK COMPANY	Industrial	SrUnsec/LTIR	12,227	U	Ba1	Baa3	SG	RUSSIA
1/29/18	SOCIETE GENERALE = DeltaCredit Bank	Financial	SrSec	89	U	Baa3	Baa2	IG	RUSSIA
1/30/18	WEST BROMWICH BUILDING SOCIETY	Financial	PS	106	D	Caa1	Ca	SG	UNITED KINGDOM

Source: Moody's

Market Data

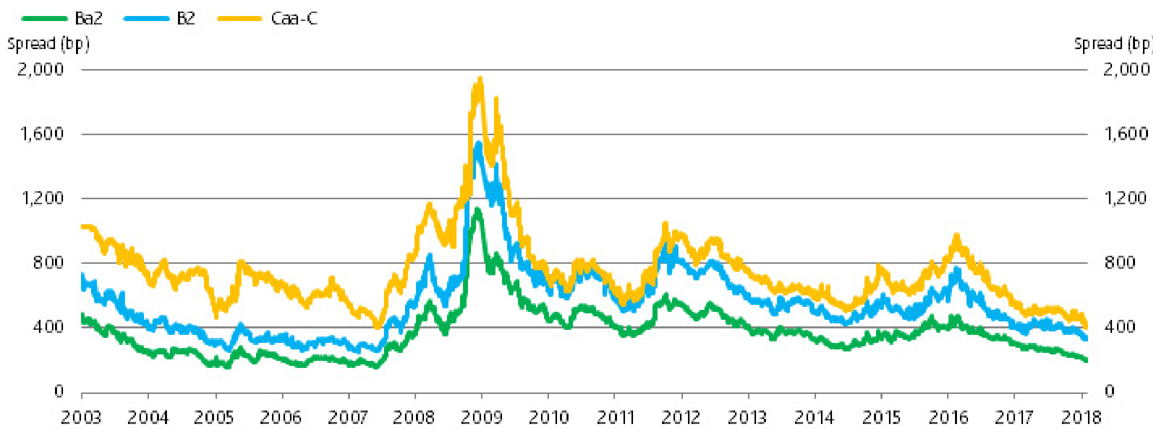
Spreads

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



Source: Moody's

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



Source: Moody's

Market Data

CDS Movers

Figure 3. CDS Movers - US (January 24, 2018 – January 31, 2018)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jan. 31	Jan. 24	Senior Ratings
Xerox Corporation	Ba1	Ba3	Baa3
Applied Materials Inc.	Baa2	Ba1	A3
Avon Products, Inc.	Caa2	Ca	B3
Toyota Motor Credit Corporation	Baa2	Baa3	Aa3
Verizon Communications Inc.	Baa2	Baa3	Baa1
HCA, Inc.	Ba2	Ba3	B1
Abbott Laboratories	A3	Baa1	Baa3
Kinder Morgan Energy Partners, L.P.	A2	A3	Baa3
United Airlines, Inc.	B1	B2	Baa1
Kroger Co. (The)	Baa3	Ba1	Baa1

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jan. 31	Jan. 24	Senior Ratings
Aetna Inc.	A1	Aa2	Baa2
Exxon Mobil Corporation	A1	Aa2	Aaa
Tyson Foods, Inc.	A2	Aa3	Baa2
Ally Financial Inc.	Ba2	Ba1	Ba3
American Express Credit Corporation	Aa2	Aa1	A2
Caterpillar Financial Services Corporation	A2	A1	A3
Amgen Inc.	Aa3	Aa2	Baa1
Bank of New York Mellon Corporation (The)	A3	A2	A1
UnitedHealth Group Incorporated	Aa2	Aa1	A3
Prudential Financial, Inc.	Baa2	Baa1	Baa1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jan. 31	Jan. 24	Spread Diff
Nine West Holdings, Inc.	C	24,037	21,263	2,774
Sears Roebuck Acceptance Corp.	C	2,934	2,794	140
Sears Holdings Corp.	C	2,609	2,484	125
Frontier Communications Corporation	B3	1,584	1,464	121
K. Hovnanian Enterprises, Inc.	Caa3	1,725	1,637	88
Windstream Services, LLC	B3	2,199	2,118	81
MBIA Inc.	Ba3	1,222	1,167	55
AK Steel Corporation	B3	354	310	44
Pride International, Inc.	B3	398	354	44
Chesapeake Energy Corporation	Caa1	608	566	42

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jan. 31	Jan. 24	Spread Diff
Office Depot, Inc.	B2	568	687	-119
Pitney Bowes Inc.	Ba1	361	443	-82
Avon Products, Inc.	B3	768	832	-65
Xerox Corporation	Baa3	81	144	-64
Neiman Marcus Group LTD LLC	Caa3	1,208	1,261	-53
Mattel, Inc.	Ba2	312	364	-52
Staples, Inc.	B3	510	558	-48
Navistar International Corp.	Caa1	240	283	-43
Allegheny Energy Supply Company, LLC	B1	130	165	-35
Dell Inc.	Ba2	185	212	-27

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (January 24, 2018 – January 31, 2018)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jan. 31	Jan. 24	Senior Ratings
Banco Popular Espanol, S.A.	Aa2	A1	Baa3
Santander UK plc	A2	A3	Aa3
The Royal Bank of Scotland plc	A3	Baa1	A3
Abbey National Treasury Services plc	A2	A3	Aa3
Landesbank Baden-Wuerttemberg	Aa3	A1	A1
Eni S.p.A.	A2	A3	Baa1
ArcelorMittal	Ba1	Ba2	Ba1
CNH Industrial N.V.	Baa2	Baa3	Ba2
thyssenkrupp AG	Baa3	Ba1	Ba2
Banco BPI S.A.	Ba1	Ba2	Ba1

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jan. 31	Jan. 24	Senior Ratings
NN Group N.V.	Baa1	A2	Baa2
United Kingdom, Government of	Aa1	Aaa	Aa2
Societe Generale	Aa2	Aa1	A2
BNP Paribas	Aa2	Aa1	Aa3
Banco Bilbao Vizcaya Argentaria, S.A.	A2	A1	Baa1
ABN AMRO Bank N.V.	A3	A2	A1
UniCredit S.p.A.	Baa2	Baa1	Baa1
Banque Federative du Credit Mutuel	Aa2	Aa1	Aa3
ING Groep N.V.	A1	Aa3	Baa1
Bankinter, S.A.	Baa3	Baa2	Baa2

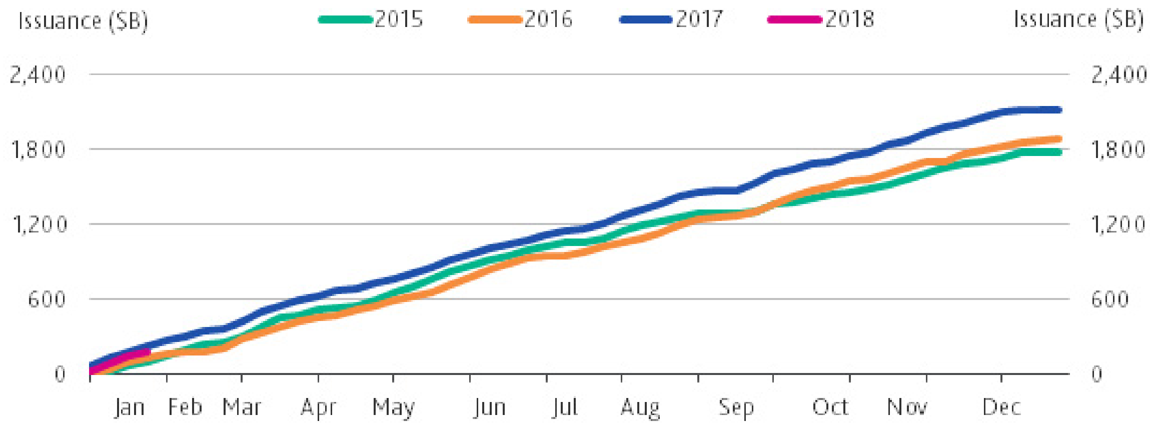
CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jan. 31	Jan. 24	Spread Diff
Astaldi S.p.A.	B3	1,885	1,630	255
PizzaExpress Financing 1 plc	Caa1	864	791	73
Altice Finco S.A.	B3	405	370	34
Iceland Bondco plc	Caa1	327	308	19
Care UK Health & Social Care PLC	Caa1	156	138	18
Scottish Power Limited	Baa1	90	74	17
Vedanta Resources plc	B2	420	402	17
Galapagos Holding S.A.	Caa3	902	885	17
Scottish Power UK plc	Baa1	81	66	15
Ziggo Secured Finance B.V.	B3	172	157	15

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jan. 31	Jan. 24	Spread Diff
Clariant AG	Ba2	48	61	-13
Banco BPI S.A.	Ba1	95	105	-9
Boparan Finance plc	B3	486	493	-7
Stena AB	B3	479	486	-7
The Royal Bank of Scotland plc	A3	39	45	-6
Banco Popular Espanol, S.A.	Baa3	28	34	-6
Landesbank Baden-Wuerttemberg	A1	29	34	-5
thyssenkrupp AG	Ba2	74	79	-5
Hammerson Plc	Baa1	78	83	-5
Santander UK plc	Aa3	35	39	-4

Source: Moody's, CMA

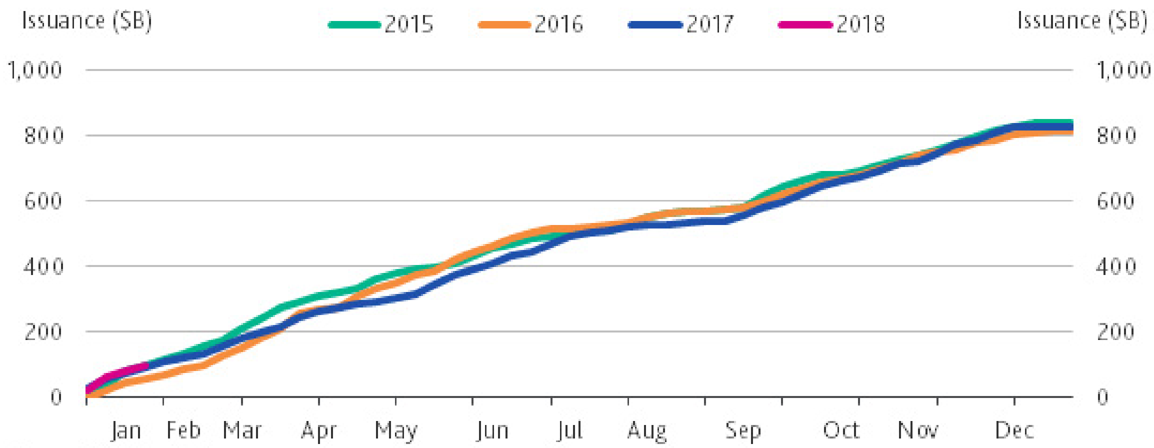
Issuance

Figure 5. Market Cumulative Issuance - Corporate & Financial Institutions: USD Denominated



Source: Moody's / Dealogic

Figure 6. Market Cumulative Issuance - Corporate & Financial Institutions: Euro Denominated



Source: Moody's / Dealogic

Issuance

Figure 7. Issuance: Corporate & Financial Institutions

	USD Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	14.593	14.895	31.623
Year-to-Date	128.423	42.890	181.134

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	11.662	2.432	16.990
Year-to-Date	86.482	6.949	97.327

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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