MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

Moody's Analytics Research

Weekly Market Outlook Contributors:

John Lonski
1.212.553.7144
john.lonski@moodys.com

Yuki Choi
1.212.553.0906
yukyung.choi@moodys.com

Moody's Analytics/Asia-Pacific:

Katrina Ell
+61.2.9270.8144
katrina.ell@moodys.com

Xiao Chun Xu

Moody's Analytics/Europe:

Barbara Teixeira Araujo
+420.224.106.438
barbara.teixeiraaraujo@moodys.com

Moody's Analytics/U.S.:

Ryan Sweet
1.610.235.5000
ryan.sweet@moodys.com

Greg Cagle
1.610.235.5211
greg.cagle@moodys.com

Michael Ferlez
1.610.235.5162
michael.ferlez@moodys.com

Editor
Reid Kanaley
1.610.235.5273
reid.kanaley@moodys.com

Slower Growth amid High Leverage Lessens Upside for Interest Rates

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.

Slower Growth amid High Leverage Lessens Upside for Interest Rates

Both the sell-off of equities and the very limited and slight inversion of the Treasury yield curve at the three- and five-year maturities hint of a possible pause for the latest series of Fed rate hikes. Since September 26's last hiking of fed funds to 2.125%, the 10-year Treasury yield has dropped from 3.05% to a recent 2.87%, and the five-year Treasury yield has sunk from 2.95% to 2.74%.

As inferred from the CME Group's FedWatch tool, the futures market for fed funds implicitly assigns a still relatively high probability of 66% to a 25 basis points hiking of fed funds at the Federal Open Market Committee's December 19 meeting. However, as recently as November 29, the futures market assigned a much higher probability of 83% to the lifting of fed funds to 2.375% at the meeting.

At The September 26 meeting, the FOMC's member forecasts supplied a 3.125% median for yearend 2019's fed funds rate. However, the futures market for fed funds recently assigned only a 15% likelihood to a greater-than-2.625% midpoint for year-end 2019's federal funds rate. By contrast, just a month earlier, the futures market assigned a much greater 62% probability to a yearend 2019 fed funds rate above 2.625%.

Moreover, the 52% probability implicitly assigned by the futures market to a less-than-2.375% fed funds rate by year-end 2019 is now much greater than the 33% odds placed on a 2.375% fed funds rate. Though the implied probabilities are inherently volatile, the futures market now admits to the possibility of a Fed rate cut in 2019.

Monetary policy is never on a pre-determined path. The aim of Fed policy is to stabilize price inflation over time, while avoiding destabilizing increases in unemployment. Because there is no sense of urgency regarding the need for disinflationary rate hikes, the Fed can very much afford to suspend its current firming of monetary policy. Given the steadiness of inflation expectations despite a 3.7% unemployment rate and a firm dollar exchange rate, the FOMC is likely to heed the market's advice and lower its projected trajectory for fed funds.

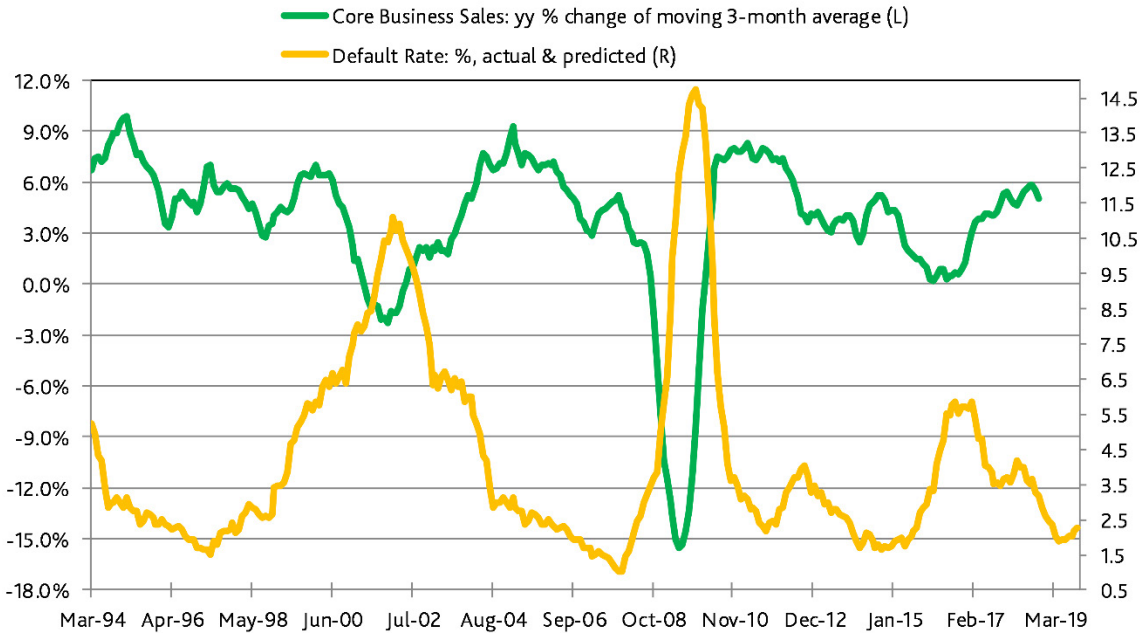
Slowdown by Core Business Sales Has Yet to Alarm

Given the containment of inflation expectations, the 10-year Treasury yield may be flat to lower until signs of rejuvenated business activity proliferate. Much to the contrary, business sales now slow both with and excluding energy products.

An insightful estimate of core business sales excludes sales of identifiable energy products from the sales of retailers, manufacturers, wholesalers, and builders. After posting yearly increases of 5.6% for both the second and third quarters of 2018, core business sales' annual growth rate may have subsided to 4.5% in October, which would be its slowest annual increase on a monthly basis since the 4.1% of January 2018. Nevertheless, a 4.5% yearly increase by core business sales hardly warrants panic.

Core business sales rose by a much slower 0.6% year over year, on average, during the 12-months-ended September 2016 and recession was avoided. However, that span overlapped an 8.4% annual contraction by nonfinancial-corporate profits from current production that helped to lift the high-yield default rate from a September 2014 low of 1.6% to a January 2017 high of 5.9%.

Figure 1: Core Business Sales' Current Pace May Help Ward Off a Disruptive Jump by the Default Rate
source: Bureau of the Census, Moody's Investors Service, Moody's Analytics



A related worsening of the default outlook and slump by core profits prompted a swelling by the long-term Baa industrial company bond yield spread's month-long average from an April 2014 low of 144 basis points to a February 2016 high of 277 bp and a ballooning of the high-yield bond spread from a June 2014 low of 331 bp to a February 2016 high of 839 bp. However, in response to the emergence of a profits recovery, the long-term Baa industrial and high-yield bond spreads had narrowed to 200 bp and 528 bp, respectively, by September 2016.

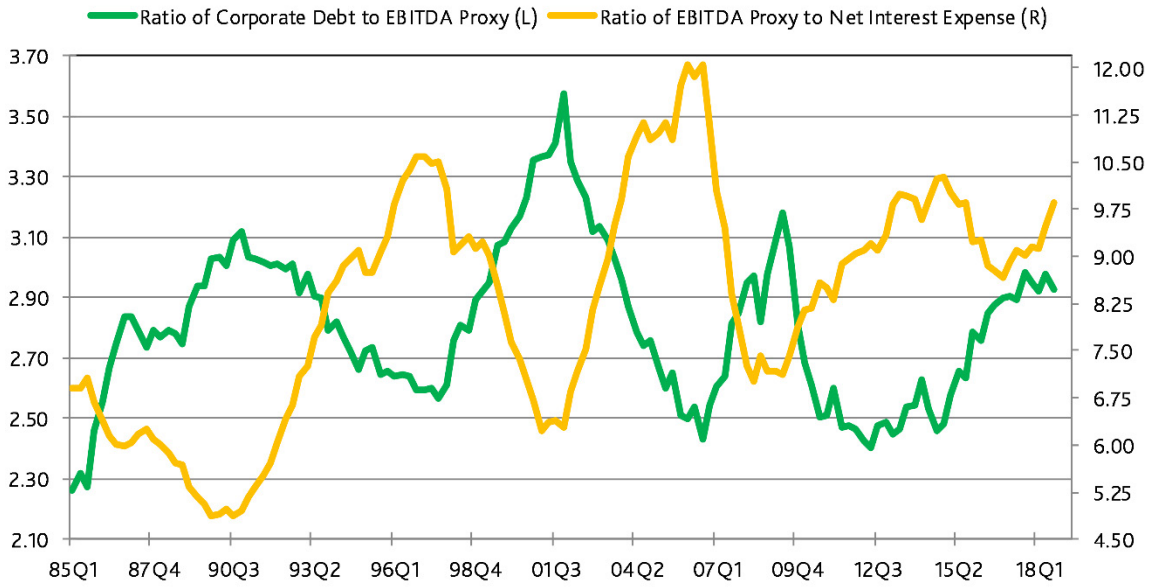
In addition, the 2015-2016 plunge by core profits overlapped a cumulative 12.9% plunge by the month-long average of the market value of U.S. common stock from its then May 2015 high to a February 2016 trough. Nevertheless, by September 2016, a recovery by industrial commodity prices and a positive outlook for corporate earnings had lifted the market value of U.S. common stock up by 15.4% from its February 2016 low.

Ample Interest Coverage Offsets Risks of Elevated Leverage for Now

Higher ratios of income to interest expense, otherwise known as interest coverage, can lead to steeper ratios of debt to income, otherwise known as leverage. Thus, ratios of debt to income are likely to climb higher whenever the growth of income outruns interest expense, especially when lower interest rates reduce interest expense.

As inferred from the Federal Reserve's "Financial Accounts of the United States" and the BEA's GDP accounts, an increase by the ratio of nonfinancial-corporate debt to a proxy for the group's EBITDA from fourth-quarter 2007's 2.85:1 to third-quarter 2018's 2.93:1 was partly in response to an accompanying increase by the ratio of the EBITDA proxy to net interest expense from 7.9:1 to 9.85:1. From 2007's fourth quarter, or the quarter immediately prior to the start of the Great Recession, to 2018's second quarter, U.S. nonfinancial corporations showed modest average annualized growth rates of 3.9% for debt, 3.7% for the EBITDA proxy, and 1.6% for net interest expense.

Figure 2: Elevated Ratio of Corporate Debt to EBITDA Proxy Offset by Well-Above Average Ratio of EBITDA Proxy to Net Interest Expense
US nonfinancial companies; source: Federal Reserve, BEA, Moody's Analytics



Higher Interest Rates End Beneficial Refinancings

The much slower growth of net interest expense relative to debt largely stemmed from declines by the cost of corporate debt. For example, comparisons of the moving three-year averages for the spans ended December 2007 and June 2018 showed Barclays Capital's industrial-company investment-grade bond yield falling from 5.66% to 3.45% and its speculative-grade bond yield sinking from 8.05% to 6.61%. In addition, the comparably measured averages for three-month LIBOR plunged from 4.68% to 1.08%, respectively.

Recently, these corporate benchmarks were at 4.37% for the investment-grade industrial bond yield, 7.19% for the speculative-grade bond yield, and 2.77% for three-month LIBOR. The latest ascent by corporate interest rates has greatly reduced the ability to lower interest expense via the refinancing of outstanding and maturing debt at lower interest rates.

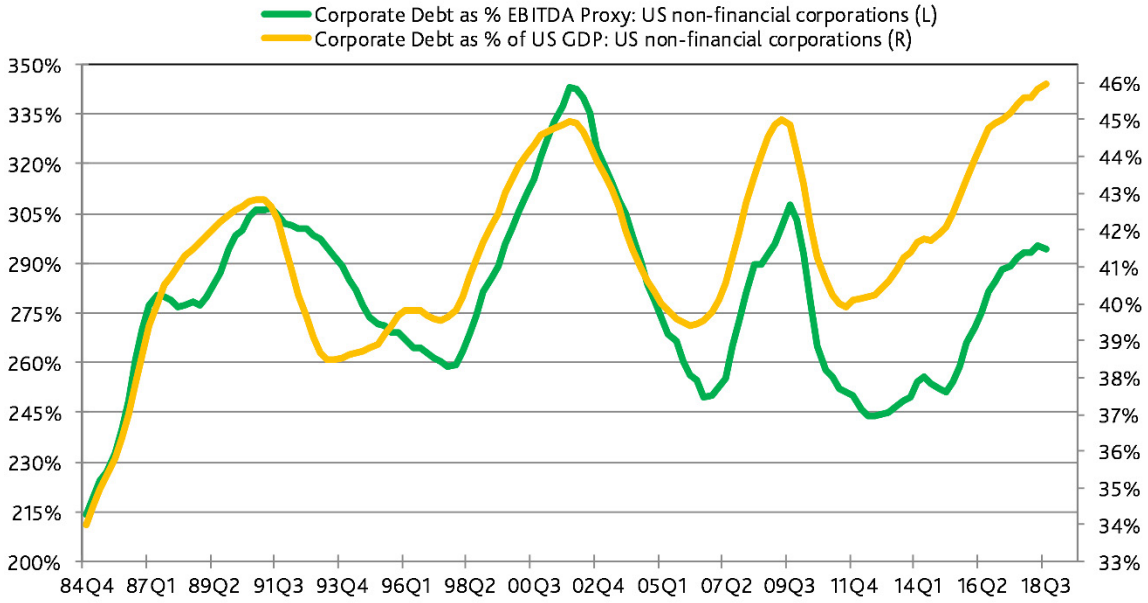
The attractiveness of refinancing can be roughly approximated by the difference between the coupon rate on existing bonds less the yield on new bonds. Of late, the incentive to refinance has dropped considerably. For example, the average coupon on long-term investment-grade industrial company bonds has gone from exceeding its average yield by 82 bp during the three-years-ended June 2018 to barely eclipsing its average yield by a recent 5 bp. In addition, the average coupon of high-yield bonds has gone from topping the average speculative-grade bond yield by 84 bp during yearlong 2017 to recently sinking 82 bp under the spec-grade bond yield.

Ratio of Debt to EBITDA Proxy Fails to Mimic Record High Ratio of Debt to GDP

The Federal Reserve has just released its third-quarter 2018 estimate of U.S. nonfinancial-corporate debt outstanding. According to the Fed, the third-quarter's record high $9.593 trillion of outstanding nonfinancial-corporate debt was up by 6.7% year-to-year. Moreover, in terms of moving yearlong averages, nonfinancial-corporate debt approximated an unprecedented 46.0% of GDP. However, the 294% ratio of nonfinancial-corporate debt to the EBITDA proxy for the year-ended September 2018 was under its prior cycle highs of 308% for September 2009, December 2001's record high 343%, and the 306% of December 2000. Once the EBITDA proxy shrinks sufficiently, both the credit and business cycles may take a turn for the worse.

Figure 3: Record High Ratio of Corporate Debt to GDP Is More Ominous than Recent Ratio of Corporate Debt to EBITDA Proxy

yearlong average ratios; source: Federal Reserve, BEA, Moody's Analytics



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

THE U.S.

By Ryan Sweet, Moody's Analytics

If the Fed Pauses, it Needs to Make the Pause Count

There has been a noticeable repricing by financial markets concerning the odds of the Federal Reserve raising interest rates later this month. Fed funds futures assign a 64% probability of a 25 basis point rate hike at the December meeting. That's still high, but the probability was recently above 80%. The tightening in financial market conditions likely has led markets to do some reassessing of the December meeting. We are not changing our forecast for a 25 basis point rate hike, but that could change if financial market conditions continue to deteriorate and intensify just before the meeting.

For now, we don't see recent developments in financial markets as economic-related. For one, the incoming data has remained solid, both the ISM manufacturing and nonmanufacturing surveys for November exceeded expectations. The key will be the November employment report, released Friday. Our assessment is that if the economic data weakens or financial market conditions tighten even further, there will likely be a dovish shift by the Fed this month—not a pause, but a shift in the rhetoric and interest rate projections. We see odds of the Fed's new interest rate projections showing two rather than three 25 basis point rate hikes for 2019, compared with our forecast for four hikes.

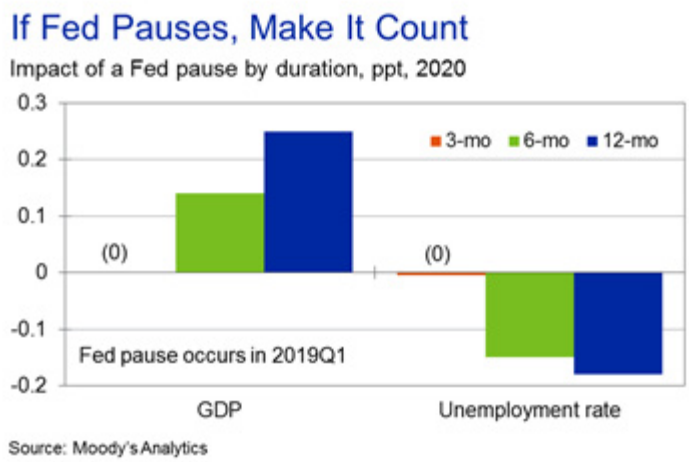
We recognize that odds are rising that the Fed will pause sometime next year. Core inflation will remain below the Fed's 2% objective in the first half of 2019, but that shortfall by itself may not be enough to justify a Fed breather. And while the recent slide in inflation expectations could catch policymakers' attention, they may see it as transitory since market-based measures have a tendency to track changes in global oil prices.

The Fed would pause if the economy is cooling more quickly than it is forecasting, but there isn't any evidence that this is occurring. Over time, the central bank wants GDP growth to move back to 1.8%—the Fed's estimate of the economy's potential growth rate. This would cool the labor market. The central bank would like to see job growth running around 100,000 per month, which would keep the unemployment rate stable and prevent a possible larger overshoot of full employment.

Our tracking estimate is for fourth quarter GDP growth of 2.8% at an annualized rate, and we look for GDP to rise 2.9% in 2019, thanks to an increase in government spending. Incoming economic data have been mixed, and yet there is little evidence suggesting a loss of momentum in the economy. However, things can change. For one, financial market conditions have tightened and the yield curve—the yield spread between short- and long-term Treasuries—continues to compress and is at serious risk of inverting in early 2019. The yield curve gets a ton of attention due to its track record of inverting ahead of recessions, but that normally occurs when the Fed continues to hike interest rates after the inversion. We believe the yield curve will be low among the reasons if the Fed pauses. The Fed can't lower the risk of a recession by simply not hiking rates to avoid an inverted yield curve. Doing so will simply increase the likelihood that the economy would overheat.

The Fed probably recognizes this, and there could be some support within the central bank for not purposely inverting the curve or hiking rates after an inversion. Bottom line: A pause is possible, but the Fed's next opportunity to do so would be at the March 2019 meeting. And a lot can happen between now and then.

If the Fed does pause, it should make the pause count. We ran a few simulations through our U.S. macro model to gauge the impact of a Fed pause based on its duration. Under all simulations, the pause occurred in the first quarter of 2019 and we assumed a resumption of gradual rate hikes, one per quarter, after the pause ended. A quick pause, lasting three months, had no material impact on either GDP growth, inflation or the unemployment rate in either 2019 or 2020.



Next we assumed the Fed pauses for six months. This puts the unemployment rate 0.04 percentage point lower than our baseline for 2019 and 0.15 percentage point less than our forecast for 2020. A six-month pause adds 0.05 and 0.14 percentage point to GDP in 2019 and 2020, respectively. The impact on core inflation is small. Next we looked at a 12-month pause and that lowered the unemployment rate by 0.08 and 0.18 percentage point in 2019 and 2020, respectively. GDP growth is boosted by 0.1 and 0.25 percentage point in 2019 and 2020, respectively.

One important assumption is that the Fed wouldn't hike more aggressively than once per quarter after a pause. If, for example, a hike comes at each meeting, all of the economic benefits from the pause and more would be wiped away. An additional 100 basis points of tightening in 2021 would reduce GDP growth by 0.5 percentage point over the course of the subsequent year

More on the yield curve

Fears about the compression in the U.S. yield curve intensified this week, but our view of what it implies about the health of the U.S. economy hasn't changed.

As a quick refresher, our preferred measure of the yield curve is the difference between the 10-year and three-month Treasury yields. The yield curve gets a lot of attention because of its track record in predicting recession. But correlation doesn't imply causation. The slope of the curve isn't a good predictor of either current of future GDP growth. An inversion in the yield curve doesn't cause a recession; it simply reflects the conditions that eventually lead to a downturn. And when the curve inverts, a recession isn't immediate—recession comes, on average, 13 months after the inversion.

Odds are that the yield curve will invert ahead of the next downturn, but how far ahead is uncertain. That's because the 10-year Treasury yield is no longer a true risk-free rate; global quantitative easing depressed yields and, at its peak, reduced the 10-year yield by 100 basis points.

The yield curve has compressed by 14 basis points since late last week, to 47 basis points. Our probability of recession model now puts the odds of recession in the next 12 months at 27%, compared with 24% last week. There appear to be a few reasons for the compression in the yield curve over the past several trading days. Decomposing the 10-year yield into its three components suggests that the recent slide is attributed to lower long-term inflation expectations. Market-based measures of long-term inflation expectations have a strong correlation with global oil prices, so the drop in inflation expectations isn't surprising. Also, the Fed is partially to blame. Fed Chair Jerome's Powell recent comments were interpreted by financial markets as being dovish, though that wasn't our impression. Still, fed funds futures for December 2019 have dropped, and that is lowering long-term rates. The term premium, which is sensitive to realized inflation, has also slipped.

The Week Ahead

On the short end of the yield curve, the three-month Treasury yield continues to climb. Some of the moves this week could be attributed to additional issuance by the Treasury Department. As we have noted in the past, the issuance binge of Treasury bills this year has put upward pressure on the short end of the yield curve, highlighted by the gap between the three-month Treasury yield and the effective fed funds rate.

The yield curve could invert soon, but that may not signal an immediate recession. One overlooked reason is that monetary policy won't be restrictive. Past inversions in the curve coincided with an actual fed funds rate noticeably above the long-run equilibrium fed funds rate. In other words, monetary policy was restrictive. If the yield curve inverts over the next 12 months, monetary policy will be essentially neutral. It won't turn restrictive until late 2019 and 2020. Even then, the fed funds rate will only be 50 basis points above estimates of the long-run equilibrium rate—not sufficient to cause a recession. Also, we don't believe this Fed will be reckless. If the yield curve is in serious risk of inversion, the Fed could pause its rate hikes, perhaps in March. If the Fed is nervous about the yield curve and inflation outlook, it could, at its December meeting, lower the dot plot to show two rather than three rate hikes next year. We see the odds of this on the rise.

Naturally, a flattening or inversion in the yield curve raises concerns and could affect the economy by hurting business and consumer sentiment, beginning a negative feedback loop. We looked at the rolling correlation between the slope of the yield curve and various measures of consumer and business confidence. The correlations are unstable.

One common theme is that correlations between the yield curve and confidence strengthen noticeably after the recession begins rather than when the curve inverts. Further, we used Granger causality tests, and despite using various lags, there wasn't any evidence that the yield curve Granger-caused changes in sentiment. Though there may not be a direct causal effect, the yield curve does Granger cause changes in stock market returns, which by extension can affect business and consumer sentiment. Therefore, we are not completely discounting the psychological impact that an inversion in the yield curve could have.

Looking ahead to next week, the key economic data will be consumer prices, initial claims, retail sales and industrial production.

We will publish our forecasts for next week's data on Monday on Economy.com.

EUROPE

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

What if Parliament Rejects Teresa May's Brexit Deal?

The week ahead will be extremely busy on both the economic and political fronts. All eyes will be on the U.K. parliament; MPs are expected to vote on the negotiated Brexit withdrawal agreement on Tuesday, and the passing of the deal is crucial for the country to secure the implementation of a transition period lasting from March 2019 until December 2020. However, recent developments suggest that parliament is more likely than not to vote the deal down, which means that chances remain for a no-deal Brexit, or of no Brexit at all.

What would happen if Theresa May's deal is rejected? There are several possibilities The EU Withdrawal Act gives Theresa May up to 21 days to return to parliament and set out what she wants to do next. First, she could announce she intends to renegotiate the Irish backstop, though we think that the European Union wouldn't be willing to go back to the negotiating tables. Second, she could pivot toward a softer Brexit—perhaps the Norway+ option, which would see the U.K. remaining in the customs union and the single market—to try winning the support of Labour MPs. Third, she could call a second referendum, putting her deal to the public's vote, though here she would risk the people voting for a reversal of Brexit. In any of these three situations, we think that an extension of Article 50 would be necessary, though that would require the consent of all 27 other EU member states.

Another possibility is that, instead of calling a second referendum, May calls new elections. The prime minister would need two-thirds majority to trigger general elections, which could be tough to get but not impossible, since the Labour party is likely to see a new vote as a great opportunity to come back to power. If May wins the vote, she would press with her deal; if she loses, Labour is more likely than not to try to renegotiate a much softer Brexit with the EU. Here too the U.K. would need to ask for an extension of Article 50.

May could also resign, triggering a leadership contest within the Conservative party. What this would mean for Brexit would depend on the leader chosen. If it is a hardline Brexiteer, chances of a no-deal Brexit would increase sharply. There is also the possibility that she doesn't resign, but faces a no-confidence vote in her leadership. In the case of a defeat, the Conservative party would have 14 days to choose a new prime minister that commands majority in parliament; if it fails to do so, general elections would be called.

There is also the possibility of no deal being reached at all, and the country leaving the EU with no agreement in place on March 29, 2019. This would be the most disastrous scenario, though the harsh consequences of such an outcome could be cushioned if the EU and U.K. put in place contingency measures for the different sectors of the economy. This means that the economic impact of a no-deal Brexit would vary wildly, depending on the willingness of both parties to prevent a chaotic exit.

The scenarios are innumerous, and right now it is almost impossible to pinpoint the most likely one. However, we remain of the view that Britain will ultimately leave the EU and with some deal in place.

Elsewhere, next week will bring the European Central Bank's December monetary policy meeting. The ECB is in a tough spot, but we continue to think that it will pursue its plan to end quantitative easing this month even though growth has slowed lately and core inflation remains low. The outlook for rate hikes next year isn't promising, though.

	Key indicators	Units	Moody's Analytics	Last
Mon @ 9:00 a.m.	Italy: Industrial Production for October	% change	0.3	-0.2
Mon @ 9:30 a.m.	U.K.: Monthly GDP for October	% change	0.0	0.0
Mon @ 11:00 a.m.	OECD: Composite Leading Indicators for October		99.5	99.5
Tues @ 9:30 a.m.	U.K.: Unemployment for October	%	4.1	4.1
Wed @ 10:00 a.m.	Euro Zone: Industrial Production for October	% change	0.4	-0.3
Wed @ 2:00 p.m.	Russia: Foreign Trade for October	$ bil	18.2	18.5
Thur @ 7:00 a.m.	Germany: Consumer Price Index for November	% change yr ago	2.3	2.5
Thur @ 7:45 a.m.	France: Consumer Price Index for November	% change yr ago	2.2	2.5
Thur @ 12:45 p.m.	Euro Zone: Monetary Policy for December	%	0.0	0.0
Fri @ 8:00 a.m.	Spain: Consumer Price Index for November	% change yr ago	1.7	2.3
Fri @ 10:00 a.m.	Italy: Consumer Price Index for November	% change yr ago	1.9	1.7
Fri @ 11:30 a.m.	Russia: Monetary Policy for December	%	7.5	7.5

ASIA-PACIFIC

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

Close Watch on China Trade Data

China's activity data barrage for November will be the highlight in the week ahead. Stabilisation is expected across most indicators including monetary aggregates, fixed asset investment and industrial production as fiscal and monetary stimulus, however piecemeal, begins to modestly impact. We forecast December quarter GDP growth to remain at 6.5%, bringing full-year GDP growth to 6.6% in 2018. Our forecast will firm, following the November data.

China's foreign trade data for November will be closely watched for the impact of the trade war with the U.S. In the year to October, China's external sector has held up remarkably well. The trade surplus widened to US$34 billion in October, following the US$31.7 billion reading in September. Annual export growth accelerated to 15.6%, up from September's 14.5% expansion. Imports jumped to 21.4% y/y from 14.3%. We forecast the trade surplus to narrow to US$27.2 billion in November. The snooze button has been pressed on the trade war escalation following a meeting between Presidents Trump and Xi on the sidelines of the G20 summit in Argentina. Negotiations over the next 90 days will prove critical for the next steps in the conflict.

On the price front, China's CPI growth likely picked up modestly to 2.6% y/y in November, from October's 2.5%. Food prices will remain the largest upward contributor to headline inflation, likely the result of earlier poor weather lingering and impacting fresh fruit and vegetable prices. CPI growth was up 2.1% y/y YTD in October, comfortably beneath Beijing's 3% target for 2018; the light stays firmly green to release further stimulus heading into 2019.

	Key indicators	Units	Confidence	Risk	Moody's Analytics	Last
Sat @ 12:30 p.m.	China Consumer price index for November	% change yr ago	3	←	2.6	2.5
Sat @ 12:30 p.m.	China Producer price index for November	% change yr ago	3	←	3.4	3.3
Mon @ 10:50 a.m.	Japan GDP for Q3 - second estimate	% change	4	←	-0.3	-0.3
Mon @ Unknown	China Monetary aggregates for November	% change yr ago	3	↓	8.2	8.0
Mon @ Unknown	China Foreign trade for November	US$ bil	2	↑	27.2	34.0
Wed @ 10:00 a.m.	South Korea Unemployment rate for November	%	3	↑	4	3.9
Wed @ 11:00 p.m.	India Industrial production for November	% change yr ago	3	↓	4.9	4.5
Fri @ 10:50 a.m.	Japan Tankan survey for Q4	Index	3	↓	19	19
Fri @ 1:00 p.m.	China Fixed asset investment for November	% change yr ago YTD	3	←	5.7	5.7
Fri @ 1:00 p.m.	China Industrial production for November	% change yr ago	3	↓	5.9	5.8
Fri @ 1:00 p.m.	China Retail trade for November	% change yr ago	2	↓	9	8.6

The Long View

October-November 2018's US$-denominated corporate bond issuance plunged annually by 22% for investment-grade and 70% for high-yield.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group
December 6, 2018

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 138 basis points exceeded its 122-point mean of the two previous economic recoveries. This spread may be no wider than 132 basis points by year-end 2018.

The recent high-yield bond spread of 447 bp is less than what might be inferred from the spread's macroeconomic drivers and the long-term Baa industrial company bond yield spread of 219 bp. The adverse implications for liquidity of possibly significantly higher interest rates merit consideration.

DEFAULTS

October 2018's U.S. high-yield default rate of 3.16% was less than the 3.46% of October 2017. Moody's Default and Ratings Analytics team now expects the default rate will average 2.1% during 2019's third quarter.

US CORPORATE BOND ISSUANCE

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

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

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

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

Second-quarter 2018's worldwide offerings of corporate bonds eked out an annual increase of 2.8% for IG, but incurred an annual plunge of 20.4% for high-yield, wherein US$-denominated offerings rose by 1.6% for IG and plummeted by 28.1% for high yield.

Third-quarter 2018's worldwide offerings of corporate bonds showed year-over-year setbacks of 6.0% for IG and 38.7 % for high-yield, wherein US$-denominated offerings plunged by 24.4% for IG and by 37.5% for high yield.

For yearlong 2016, worldwide corporate bond offerings rose by 2.3% annually for IG (to $2.402 trillion) and sank by 7.8% for high yield (to $426 billion). During yearlong 2017, worldwide corporate bond offerings increased by 4.0% annually (to $2.499 trillion) for IG and advance by 41.2% for high yield (to $602 billion). The projected annual changes for 2018's worldwide corporate bond offerings are -5.4% for IG and -35.3% for high yield.

US ECONOMIC OUTLOOK

The consensus expects that the mid-point for the federal funds rate should finish 2018 at 2.375%. In view of the underutilization of the world's productive resources, low inflation should help to rein in Treasury bond yields. As long as the global economy operates below trend, the 10-year Treasury yield may not remain above 3% for long. A fundamentally excessive climb by Treasury bond yields and a pronounced slowing by

expenditures in dynamic emerging market countries are among the biggest threats to the adequacy of economic growth and credit spreads.

EUROPE

By Barbara Teixeira Araujo of Moody's Analytics
December 6, 2018

EURO ZONE

Friday should be active with release of the final estimate of euro zone third-quarter GDP growth; we expect it to confirm that the currency area expanded by only 0.2% q/q in the three months to September, halving the 0.4% gain in the second quarter and down from 0.7% at the start of the year. Yearly growth is similarly expected to be confirmed at 1.7%, softening from the 2.2% registered in the second stanza.

The key detail from the release will be publication of the expenditure breakdown of growth. We expect that weaker domestic demand was behind the headline's loss of pace. First, machinery and equipment investment likely slowed sharply given the introduction of the EU's new emissions tests for the auto industry on September 1. High-frequency figures have shown that car production declined in August, September and October, as manufacturers struggled with the transition to the new system. On the bright side, we expect that construction investment continued to grow solidly, even if we wouldn't be surprised to see the pace of expansion slowing marginally from the previous stanza.

We look for consumer spending to have remained relatively steady. First, while spending on new cars jumped in July and August as retailers slashed prices to get rid of their pre-new regulation stocks, we expect this jump was almost completely offset by a big correction in September. Second, even if energy spending is expected to have rebounded somewhat from a weather-related plunge in the second quarter, temperatures were above their long-term averages in July and August and likely kept a lid on the increase. Third, high-frequency data suggest retail sales remained only steady over the quarter, while leading data indicate that services spending may have pulled back somewhat.

Slightly better news should come from net trade, though we expect that the sector only modestly contributed to growth, because imports and exports are each expected to have remained subdued. The good news is that the weaker euro and the fiscal boom in the U.S. suggest that the euro zone's trade surplus is set to rebound in the fourth quarter. Elsewhere, we expect that inventories subtracted sharply from growth, mainly because of the destocking in the auto industry.

October data released this week brought welcome news that euro zone retail sales volumes rose for the month by an above-consensus rate, but most of the cheer was offset by September's headline being revised down sharply to show a 0.5% m/m decline instead of a steady reading. Still, it is good that the yearly rate rebounded strongly, climbing back above its previous-year average. We maintain the view that euro zone retail sales will strengthen in the fourth quarter, following the unimpressive reading in the third; fundamentals remain solid and so does the overall level of confidence. We are thus penciling in sales to increase by around 0.5% q/q in the three months to December, fully reversing the previous stanza's 0.1% fall.

UNITED KINGDOM

Wednesday's key piece of news was the sharp decline in the U.K.'s services PMI to only 50.4 in November, from 52.2 in October, a 28-month low. This is only slightly above the 50 stagnation threshold, which suggests that overall services output rose marginally during the month. The economy-wide weighted PMI—consisting of the manufacturing, construction and services gauges—indicates that GDP growth stalled in the middle of the fourth quarter.

Dragging on the services headline was that both business activity and new work expanded at their weakest rates in almost two-and-a-half years. Firms reported that Brexit uncertainty has played a major role in depressing clients' business investment decisions, as well as consumer spending on major items. Confidence regarding the year ahead has also slumped, suggesting that growth won't recover much in the near term, or at least until there is more certainty about the implementation of the Brexit transition period.

ASIA PACIFIC

By Xiao Chun Xu of Moody's Analytics
December 6, 2018

SOUTH KOREA

The employment figures out of South Korea have been disappointing. Although the unemployment rate fell below 4% recently, lower than the OECD average of 5.3%, employment growth slowed to anemic levels this year, particularly during the third quarter. After averaging 1.2% y/y per month in 2007, employment growth fell to only 0.1% y/y per month from July to October.

This is at odds with prior expectations given that a key focus of President Moon Jae-in's agenda has been to boost job creation. Measures include increased subsidies to SMEs—or small and medium-size enterprises—that create entry-level jobs over the next three years, larger subsidies for high school and university graduates in search of employment, and income tax exemptions.

Alongside job creation, income-led growth has been another priority. This has led to an unprecedented rise in the minimum wage rate in 2018 of 16.4% to 7,530 won per hour ($6.70), the largest increase in real terms in the history of the minimum wage system in South Korea. In 2019, the minimum wage rate will rise by an additional 10.9%.

Collectively, these measures were partly meant to address the problem of "labour market duality" in which there are two tiers of workers. The regular tier enjoys high wages, high job security, and social benefits such as unemployment and health insurance. The nonregular tier, typically made up of part-time or temporary workers who tend to work for SMEs, does not possess the same advantages. Another area of concern these measures attempt to address is the youth unemployment dilemma.

However, there are concerns in the business sector and for consumers that the minimum wage rate hikes came at a bad time, as foreign demand for exports has passed its peak and the U.S. and China ramp up protectionist policies. Relative to median wages, South Korea's minimum wage rate was already high by international standards prior to the hike. In 2018 and 2019, South Korea's minimum wage rate relative to the median is likely to be the highest in the world.

The poor employment growth results, however, suggest that the rate hike undermined job creation. In theory, employers have a specific reservation wage to hire low-skill labour, and the hike pushed the wage past this point for some employers in South Korea, where approximately 7% of workers are earning at the minimum wage rate. In addition, the rise in minimum wage rates tends to increase wages at higher levels.

Minimum wage rate recipients benefit from the rate hike and may redirect their higher income to boost the economy, as intended, but they also run the risk of losing their jobs, particularly because they are more likely to be temporary workers. Indeed, the slowdown in employment growth was driven by falls in temporary jobs and SMEs. In the short term at least, the hike may have ended up hurting the people it was intended to support.

Youth unemployment

Another drag on employment in South Korea is youth unemployment, which has wide-ranging and long-term negative effects on the economy. It has implications for young adults' mental health and life satisfaction and the externalities that come along with them. The lack of decent job opportunities for the youth may translate to poor results in the long term, a phenomenon referred to as "scarring".

Young workers are particularly vulnerable to cyclical and short-term effects given they are generally relatively low-skilled and are more likely to be in temporary positions, which have been decreasing steadily. Over the year, youth employment (15- to 29-year-olds) decreased on average 0.4% y/y per month in 2018, after remaining steady in 2017.

Ratings Round-Up

U.S. Downgrades Headlined by CVS Health

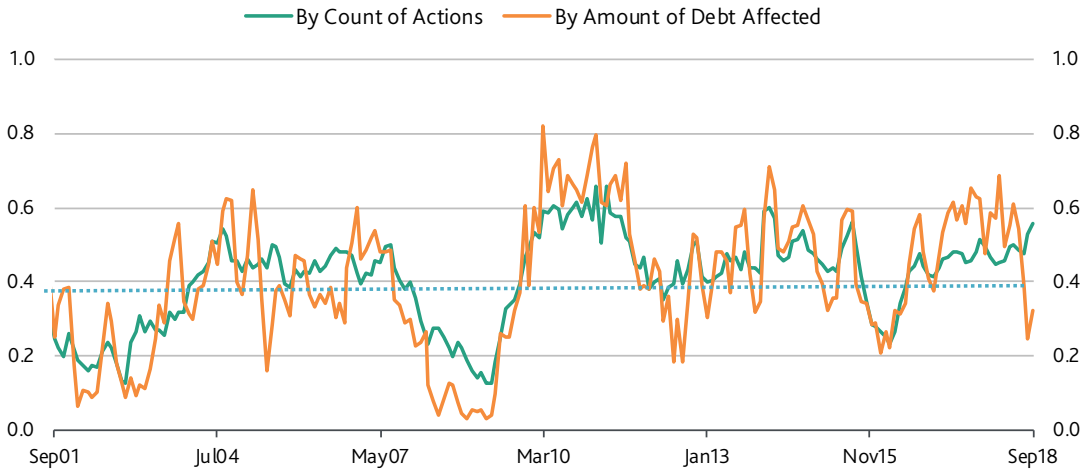
By Michael Ferlez

U.S. rating change activity improved but remains weak. For the period ending December 4, positive rating changes accounted for 40% of total activity up from 0% in the prior week. Downgrades were headlined by CVS Health, which saw its senior unsecured credit rating cut to Baa2 from Baa1, affecting roughly $63 billion in debt. The rating change reflects CVS's recent acquisition of healthcare provider Aetna which significantly increased the firm's debt level as well as weakening several key financial metrics. Upgrades were spread across several industries, on a total of $7.8 billion in debt.

In Europe, ratings softened. The ratio of positive rating changes fell to 33% from 69% in the prior week. Rating activity was concentrated in Europe's largest economies: France, Germany, Italy and the U.K. Although downgrades outnumber upgrades, the total debt affected by upgrades was $9 billion versus $4.5 billion for downgrades. The notable upgrade was CNH Industrial N.V., which saw its senior unsecured credit rating upgraded to Baa3 from Ba1.

FIGURE 1

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



* Trailing 3-month average

Source: Moody's

Ratings Round-Up

FIGURE 2

Rating Key

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

FIGURE 3

Rating Changes: Corporate & Financial Institutions – US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG
11/28/18	CVS HEALTH	Industrial	SrUnsec	62,911	D	Baa1	Baa2	IG
11/29/18	RACKSPACE HOSTING, INC.	Industrial	SrUnsec/SrSec /BCF/LTCFR/PDR	1,200	D	B3	Caa1	SG
11/29/18	MIPL GROUP LIMITED	Financial	SrSec/BCF/LTCFR		D	Ba1	Ba2	SG
11/29/18	SOUTHEAST POWERGEN, LLC	Industrial	SrSec/BCF		U	B1	Ba3	SG
11/29/18	HELIX GEN FUNDING, LLC	Industrial	SrSec/BCF		D	Ba2	Ba3	SG
11/30/18	TOP NEW PARTNERSHIP 2016, L.P.-TECTA AMERICA CORP	Industrial	SrSec/BCF		D	B2	B3	SG
12/3/18	DIAMONDBACK ENERGY, INC.	Industrial	SrUnsec /LTCFR/PDR	2,050	U	Ba3	Ba2	SG
12/4/18	MURPHY OIL CORPORATION	Industrial	SrUnsec /LTCFR/PDR	2,800	U	Ba3	Ba2	SG
12/4/18	ISTAR INC.	Industrial	SrUnsec /LTCFR/Sub/PS	2,950	U	B1	Ba3	SG
12/4/18	TALEN ENERGY SUPPLY, LLC	Utility	SrUnsec	2,661	D	B2	B3	SG

Source: Moody's

Ratings Round-Up

FIGURE 4

Rating Changes: Corporate & Financial Institutions – Europe

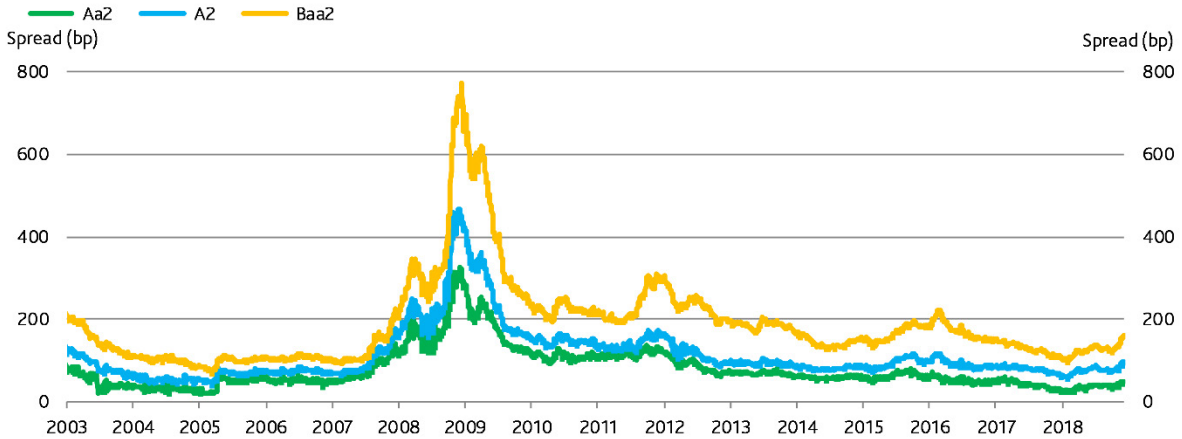
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	Old STD Rating	New STD Rating	IG/ SG	Country
11/28/18	HSH NORDBANK AG	Financial	SrUnsec/LTIR/STD /LTD/MTN/CP	638	U	Baa3	Baa2	P-3	P-2	IG	GERMANY
12/3/18	K+S AG	Industrial	SrUnsec /LTCFR/PDR	567	D	Ba1	Ba2			SG	GERMANY
12/3/18	BANCA MONTE DEI PASCHI DI SIENA S.P.A.	Financial	SrUnsec/MTN	1,253	D	B3	Caa1			SG	ITALY
12/3/18	CNH INDUSTRIAL N.V.	Industrial	SrUnsec/MTN	8,467	U	Ba1	Baa3			SG	UNITED KINGDOM
12/4/18	NOVA LJUBLJANSKA BANKA D.D.	Financial	SLTD		U	Ba1	Baa2	NP	P-2	IG	SLOVENIA
12/4/18	THOMAS COOK GROUP PLC	Industrial	SrUnsec /LTCFR/PDR	1,305	D	B1	B2			SG	UNITED KINGDOM
12/4/18	LA FINANCIERE ATALIAN S.A.S.	Industrial	SrUnsec	1,394	D	B2	B3			SG	FRANCE

Source: Moody's

Market Data

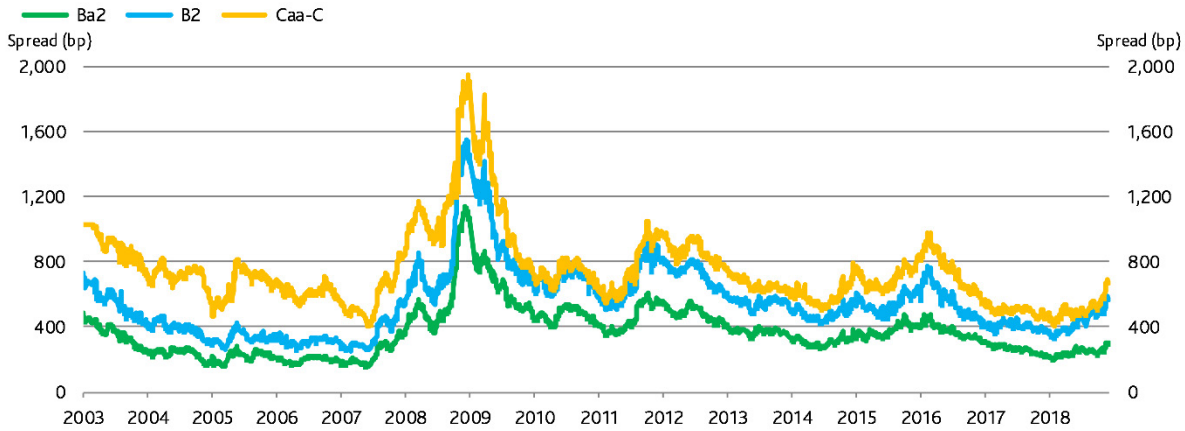
Spreads

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



Source: Moody's

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



Source: Moody's

CDS Movers

Figure 3. CDS Movers - US (November 28, 2018 – December 5, 2018)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Dec. 5	Nov. 28	Senior Ratings
CSC Holdings, LLC	Ba2	B1	B2
Burlington Resources, Inc.	A1	A3	A3
Ally Financial Inc.	Ba1	Ba2	Ba3
American Express Credit Corporation	A1	A2	A2
Exxon Mobil Corporation	Aa1	Aa2	Aaa
Chevron Corporation	Aa1	Aa2	Aa2
Intel Corporation	Aa1	Aa2	A1
Anthem, Inc.	Aa3	A1	Baa2
Honeywell International Inc.	Aa1	Aa2	A2
FedEx Corporation	A2	A3	Baa2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Dec. 5	Nov. 28	Senior Ratings
Xcel Energy Inc.	Baa2	Aa2	A3
Southern California Edison Company	A3	Aa3	A3
JPMorgan Chase Bank, N.A.	A1	Aa3	Aa3
Morgan Stanley	Baa2	Baa1	A3
Wells Fargo & Company	A3	A2	A2
Toyota Motor Credit Corporation	Aa3	Aa2	Aa3
Verizon Communications Inc.	Baa2	Baa1	Baa1
Bank of America, N.A.	A3	A2	Aa3
Walt Disney Company (The)	Aa2	Aa1	A2
Walmart Inc.	Aa2	Aa1	Aa2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Dec. 5	Nov. 28	Spread Diff
Parker Drilling Company	Caa2	4,457	4,099	358
K. Hovnanian Enterprises, Inc.	Caa3	2,340	2,026	314
Neiman Marcus Group LTD LLC	Caa3	1,499	1,328	172
Hertz Corporation (The)	B3	814	728	86
International Lease Finance Corporation	Baa3	171	112	59
Xcel Energy Inc.	A3	84	38	46
Penney (J.C.) Corporation, Inc.	Caa2	3,122	3,078	44
Nissan Motor Acceptance Corporation	A2	156	118	38
United States Steel Corporation	B2	405	372	34
AK Steel Corporation	B3	797	763	34

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Dec. 5	Nov. 28	Spread Diff
Weatherford International, LLC (Delaware)	Caa1	1,648	1,696	-48
Talen Energy Supply, LLC	B2	717	748	-31
Diamond Offshore Drilling, Inc.	B3	504	532	-27
Avis Budget Car Rental, LLC	B1	410	436	-26
Windstream Services, LLC	Caa2	2,830	2,855	-25
Staples, Inc.	B3	528	553	-25
CSC Holdings, LLC	B2	213	227	-15
Hess Corporation	Ba1	161	175	-14
Calpine Corporation	B2	357	370	-13
Murphy Oil Corporation	Ba3	225	238	-13

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (November 28, 2018 – December 5, 2018)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Dec. 5	Nov. 28	Senior Ratings
Eurobank Ergasias S.A.	Caa2	Ca	Caa2
Italy, Government of	Ba3	B1	Baa2
Lloyds Bank plc	A3	Baa1	Aa3
Societe Generale	A3	Baa1	A1
Santander UK plc	A2	A3	Aa3
Poland, Government of	A3	Baa1	A2
Abbey National Treasury Services plc	A2	A3	Aa3
ABN AMRO Bank N.V.	A2	A3	A1
Banco Santander S.A. (Spain)	A3	Baa1	A2
Credit Agricole Corporate and Investment Bank	A2	A3	A1

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Dec. 5	Nov. 28	Senior Ratings
TUI AG	Ba3	Ba1	Ba2
Nationwide Building Society	A3	A2	Aa3
Erste Group Bank AG	A2	A1	A2
Anheuser-Busch InBev SA/NV	Baa3	Baa2	A3
Deutsche Telekom AG	Aa3	Aa2	A3
Bank of Scotland plc	A2	A1	Aa3
Orange	Aa3	Aa2	Baa1
Sanofi	Aa1	Aaa	A1
Unibail-Rodamco SE	A3	A2	A2
Danone	Aa2	Aa1	Baa1

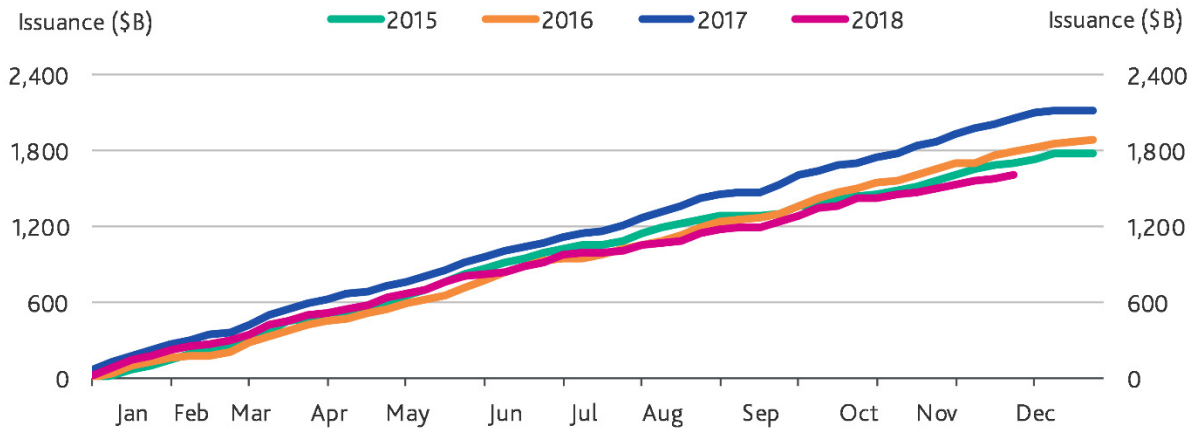
CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Dec. 5	Nov. 28	Spread Diff
Ukraine, Government of	Caa2	648	452	195
PizzaExpress Financing 1 plc	Caa1	2,591	2,493	97
Jaguar Land Rover Automotive Plc	Ba2	651	583	68
TUI AG	Ba2	234	168	67
Novo Banco, S.A.	Caa2	870	813	57
Matalan Finance plc	Caa1	914	867	47
Selecta Group B.V.	Caa1	400	361	39
Deutsche Bank AG	A3	206	181	25
Casino Guichard-Perrachon SA	Ba1	565	541	24
Suedzucker AG	Baa2	140	118	22

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Dec. 5	Nov. 28	Spread Diff
Galapagos Holding S.A.	Caa3	5,480	6,352	-872
Yapi ve Kredi Bankasi A.S.	B1	487	644	-158
Novafives S.A.S.	Caa1	700	759	-60
Care UK Health & Social Care PLC	Caa1	246	281	-36
Altice Finco S.A.	B3	513	538	-25
Unipol Gruppo S.p.A.	Ba1	224	241	-17
Turkey, Government of	Ba1	368	382	-14
Evraz Group S.A.	Ba3	261	275	-14
Russian Agricultural Bank	Ba2	190	202	-13
UniCredit S.p.A.	Baa1	184	196	-12

Source: Moody's, CMA

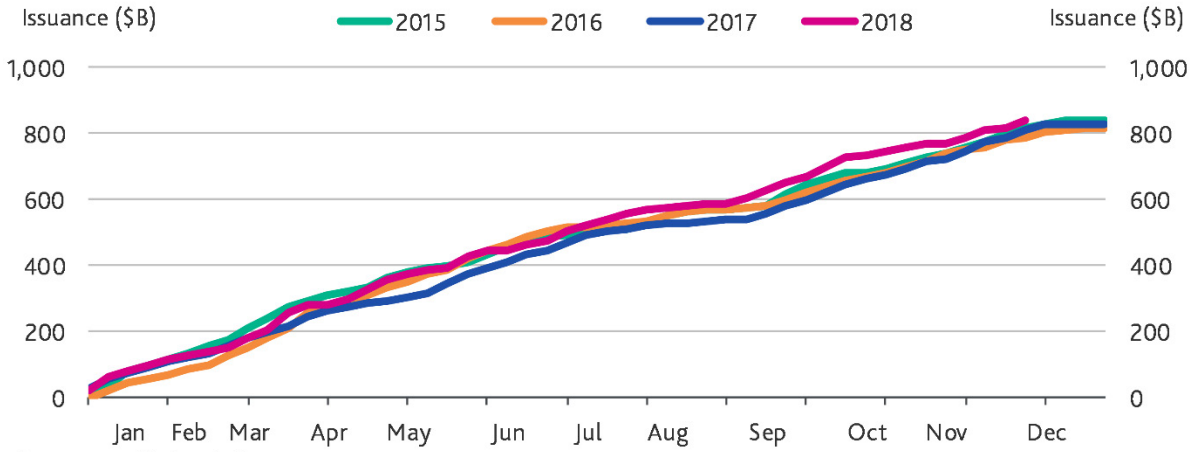
Issuance

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

Market Data

Figure 7. Issuance: Corporate & Financial Institutions

	USD Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	36.518	1.530	39.330
Year-to-Date	1,260.696	274.103	1,610.829

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	19.859	1.047	21.176
Year-to-Date	721.010	85.735	840.029

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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Editor
Reid Kanaley
reid.kanaley@moodys.com

Contact Us

Americas:	1.212.553.4399
Europe:	+44 (0) 20.7772.5588
Asia:	813.5408.4131