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WEEKLY MARKET OUTLOOK

Tariffs Warn of Even Faster Price Inflation and Slower Growth

Moody's Analytics Research

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Credit Markets Review and Outlook

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

Tariffs Warn of Even Faster Price Inflation and Slower Growth

February was a stormy month for financial markets. Worse yet, March got off to a horrible start in response to President Trump's intention to impose import tariffs of 10% on aluminum and 25% on steel despite how costlier aluminum and steel will diminish the global competitiveness of those U.S. manufacturers using these materials. Remember, after having incurred back-to-back monthly setbacks in January and February, auto sales were expected to decline in 2018 prior to the statement on tariffs.

Markets question the need for such tariffs given how employment opportunities have increased considerably over the past year. In addition, such tariffs will add to already elevated worries surrounding price inflation that stem from the considerable upward pressure put on product prices by higher rates of resource utilization. Finally, March 1's tanking of equity markets and jump by the VIX index threaten to lift the cost of financial capital and diminish the confidence of both businesses and consumers.

It's worth noting how earlier and prospective protectionist measures have lifted the price of steel by 20.1% and lumber futures contracts by 13.5% since year-end 2017. By contrast, Moody's industrial metals price index, which excludes both steel and lumber, rose by a smaller 3.4%. In fact, one of the index's six constituents—the spot price of copper—was recently down by 5.2% for the year to date.

Do not be surprised if a very adverse reaction by financial markets forces the administration to reconsider the tariff proposals.

Outlook Was Worsening Before Proposed Tariffs

During February, Treasury bond yields soared higher in response to expectation of a much increased supply of tradable U.S. government debt and January's uncomfortably high readings on consumer price inflation both with and excluding food and energy prices. The early February release of the January employment report stoked fears of a wage-driven upturn by price inflation that might menace markets indefinitely.

Notwithstanding good news on employment and personal income, real consumer spending fell by 0.1% from December to January. In addition, the available results on February's unit sales of cars and light trucks suggest that seasonally adjusted sales fell for a second straight month to their slowest pace since August 2017. Thus, February's real consumer spending might do well to post a slight 0.1% monthly rise.

January also incurred unexpected monthly setbacks for unit sales of new and existing homes. Combining higher-than-expected mortgage yields and financial market volatility with the less favorable tax treatment of home ownership warns of fewer-than-expected home sales during 2018's first half.

And not to be forgotten is January's unexpected second consecutive monthly drop by new orders for nondefense capital goods. Both businesses and investors are likely to lose their appetite for risk. Thus, the still exceptionally thin yield spreads of corporate bonds are likely to widen materially.

Rare Widening of Spreads amid Significantly Higher Treasury Yields

In terms of month-long averages, the 5-year Treasury yield rose from January 2018's 2.38% to the 2.60% of February, while the 10-year Treasury yield increased from 2.58% to 2.86%. Both of these increases were noticeably smaller than the jump by the composite speculative-grade bond yield from a January average of 5.74% to February's 6.23%. In turn, the speculative-grade yield spread over Treasuries widened from January's near current-recovery low of 334 basis points to February's 361 bp average.

February's 28 bp increase by the 10-year Treasury yield despite a 27 bp widening by the high-yield bond spread was highly unusual. Ordinarily, significantly wider yield spreads stem from a deterioration of business activity that prompts a reduction in Treasury bond yields.

As derived from a record of monthly changes that begins with January 1986, for the 28 months showing a monthly increase by the high-yield bond spread between 25 bp to 50 bp, the average 35 bp widening by the high-yield spread was joined by an average decline of 14 bp for the 10-year Treasury yield.

Credit Markets Review and Outlook

Moreover, in only four (including February 2018) of the 28 months of this sub-sample did the 10-year Treasury yield rise from the prior month.

The two months revealing a more extreme anomaly than February 2018 were May 2004's combination of a 39 bp widening by the high-yield spread and 37 bp jump by the 10-year Treasury yield and August 1990's 36 bp broadening by the high-yield spread and accompanying 28 bp increase for the 10-year Treasury yield.

Figure 1: Treasury Bond Yields Move in Direction Opposite to That of High-Yield Spread

Range for Change by High-Yield Bond Spread from Prior Month	number of months *1*	Average Change by High-Yield Spread in basis points (bp) *2*	Average Change by 10-Year Treasury Yield in basis points (bp) *3*
Greater than +100 bp	*13*	173	-33
+75 bp to +100 bp	*15*	83	-24
+50 bp to +75 bp	*21*	63	-22
+25 bp to +50 bp	*28*	35	-14
0 bp to +25 bp	*100*	11	-7
0 bp to -25 bp	*113*	-12	5
-25 bp to -50 bp	*54*	-35	8
-50 bp to -75 bp	*30*	-60	12
-75 bp to -100 bp	*4*	-85	27
Deeper than -100 bp	*9*	-178	18

source: Moody's Analytics

August 1990's incongruity could be explained by the related inflation fears arising from a Gulf War inspired jump in oil prices. Taken together, costlier energy and sharply higher borrowing costs probably worsened the recession of 1990-1991. Worse yet, despite how the high-yield spread widened by another 81 bp, to 702 bp, in September 1990, the 10-year Treasury yield added another 14 bp to peak at 8.89%. The latter now serves as a nearly 29-year high for the 10-year Treasury yield's month-long average.

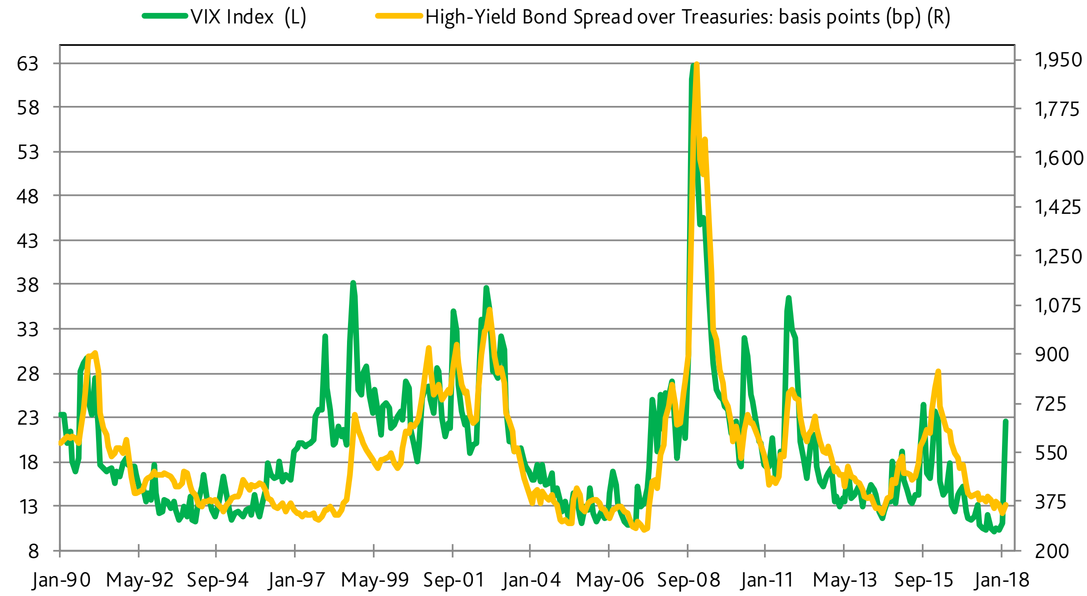
What followed the paradox of May 2004 was far more pleasant. By August 2004, the spread had thinned from May's average by 13 bp to 395 bp as the 10-year Treasury yield sank by 44 bp to 4.28%.

If corporate bond yield spreads continue to widen amid a climb by Treasury bond yields, onerous borrowing costs and a weaker equity market may curb business activity by enough to drive Treasury bond yields lower.

Thinner than 400 bp High-Yield Spread Joins a VIX above 20 Points for First Time in 20 Years

February supplied yet another striking anomaly on the high-yield front. For the first time since June 1998, a VIX index of more than 20 points was joined by a high-yield spread of less than 400 bp, where both are expressed as month-long averages. The VIX indexes supplied in the accompanying chart are all calculated by the CBOE according to the adoption of a new methodology that took effect on September 22, 2003.

Figure 2: February Shows Rare Combination of a VIX Index Topping 20 Points and a High-Yield Bond Spread Under 400 Basis Points
sources: CBOE, Moody's Analytics



June 1998 marked the end of a 15-month-long stretch wherein the high-yield spread remained under 400 bp despite how the VIX index stayed above 20 points. More specifically, from February 1997 through June 1998, the averages were 333 bp for the high-yield spread and 22.6 points for the VIX index. Thereafter and up until a grossly overvalued U.S. equity market peaked in March 2000, the averages were 539 bp for the high-yield spread and 25.8 points for the VIX index.

Notwithstanding how both the spread and the VIX index reflected well above-average anxiety among financial market participants, the market-value of U.S. common stock managed to soar higher by nearly 19% annualized, on average, from June 1998 through March 2000. When also considering the accompanying climb by the high yield default rate from June 1998's 2.8% to March 2000's ordinarily disruptive 6.3%, we better understand why the severity of the equity market's overvaluation of 1999-2000 remains unmatched to this very day.

If the sample is limited to the months after the change in methodology for the VIX index's calculation took effect in September 2003, then February 2018 serves as the only month for which the high-yield spread was less than 400 bp while the VIX index exceeded 20 points.

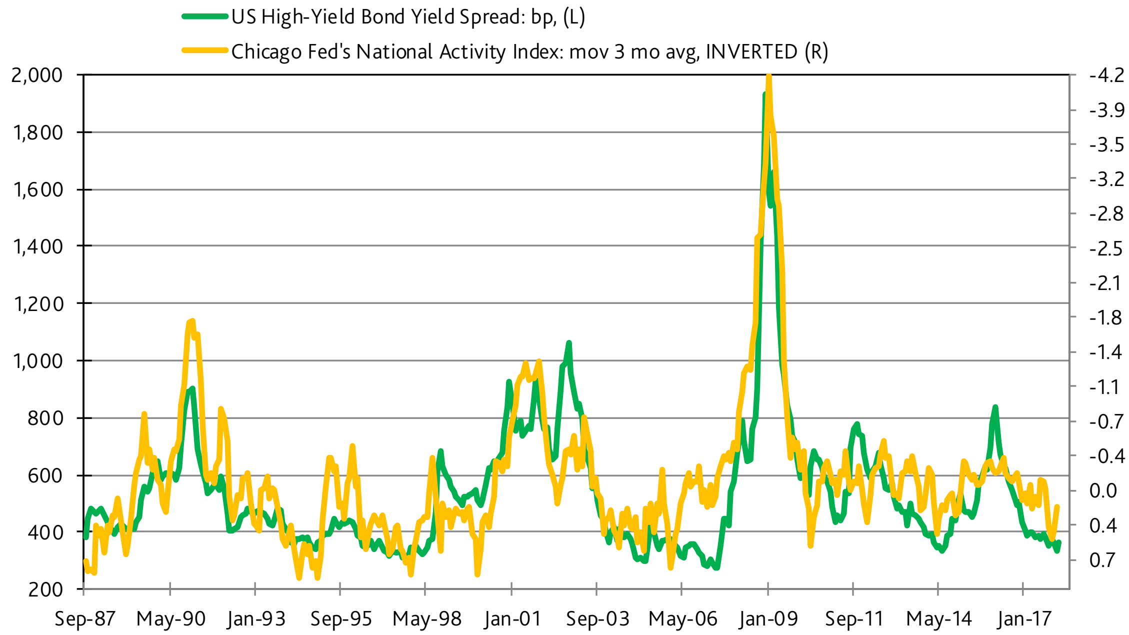
As derived from a simple OLS regression, February 2018's monthly average of 22.5 points for the VIX index favored midpoints for the high-yield bond spread of 622 bp for a sample beginning in January 1990 (r-square equals 0.66) and 658 bp for a sample commencing with October 2003 (r-square equals 0.81). The takeaway is that unless the VIX index remains under 15 points, the high-yield bond spread is likely to break above 400 bp.

High-Yield Market's Best Macro Driver Says Spreads Are Too Thin

Of all conceivable macroeconomic metrics, the high-yield bond spread shows the strongest correlation of -0.83 with the Chicago Fed's national activity index's moving three-month average according to a sample that starts with September 1987. Depending on whether the U.S. economy is performing above or below trend, the NAI's moving three-month average is greater or less than zero.

Since September 1987, the NAI's moving three-month average has ranged from a January 2009 low of -4.20 points to a December 1994 high of +0.89 points. The high-yield bond spread's corresponding three-month averages were 1,732 bp as of January 2009 and 350 bp as of December 1994.

Figure 3: Chicago Fed's 85-variable National Activity Index (INVERTED) Warns of a Wider High-Yield Bond Spread *(correlation = -0.83)*



The NAI's latest moving three-month average of +0.17 is in the fourth decile of a now 365-month sample. The fourth decile's +0.167 average for the NAI's three-month average was accompanied by a 449 bp average for the high-yield bond spread. Moreover, the fourth decile's +0.160 median for the NAI's moving three-month average was joined by a 417 bp median for the high-yield spread.

In turn, February 2018's high-yield spread of 361 bp is unduly thin from the perspective of the NAI's average of the three-months-ended January 2018. Consistent with this view is a simple OLS regression, which shows how the NAI's latest moving three-month average favors a 464 bp midpoint for the high-yield spread.

For purposes of comparison, the averages of the NAI's top decile were +0.67 for the NAI and 393 bp for the high-yield spread. At the bottom decile, the averages were -1.80 for the NAI and 975 bp for the high-yield spread.

For the current recovery to date, the moving three-month average of the Chicago Fed's national activity index has risen no higher than the +0.56 of the span-ended May 2010, or when the early stages of the escape from the Great Recession temporarily lent an upward bias to business activity. For example, profits from current production surged higher by 28.1% year-over-year in Q2-2010. By comparison, this measure of profits grew no faster than 5.3% yearly in Q3-2017 and is expected to increase by 6.3% for 2018.

The NAI has yet to warn of a damaging bout of consumer price inflation. After setting a 2017 peak of +0.49 as of November, the NAI's moving three-month average has since descended to the +0.17 of January 2018. According to the Chicago Fed, an increasing likelihood of a period of sustained increasing inflation has historically been associated with a moving three-month average for the NAI that exceeds +0.70 more than two years into an economic expansion. Thus, the +0.17 point average of the three-months-ended January 2018 falls considerably short of signaling the impending arrival of persistently rapid price inflation.

On a final note, the high-yield default rate shows a meaningful correlation of -0.72 with the NAI's moving three-month average of nine-months earlier. As viewed from the statistical record, the NAI's latest three-month moving average weighs against a decline by the default rate to 2% by January 2019.

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

THE U.S.

By Ryan Sweet and U.S. staff of Moody's Analytics

Watching for reaction to U.S. trade policy

The focus this week will be on U.S. trade policy and whether more trading partners retaliate. For the economic data, the key is the employment report. Our preliminary forecast is for nonfarm employment to have risen by 230,000 in February. The labor market data have been strong with initial claims falling between the January and February payroll reference periods. The Conference Board's labor market differential improved in February, and we don't believe weather was an issue. Job growth also tends to come in stronger than the consensus expectation in February. We look for the unemployment rate to have fallen to 4% and average hourly earnings to have risen 0.2%, lowering year-over-year growth from 2.9% to 2.8%. This may not ease market concerns that inflation pressures will build quickly. However, there is no correlation between monthly changes in average hourly earnings and consumer prices.

One surprise in January was the drop in hours worked. However, this could be weather- and flu-related. Weather was unusually cold leading up to the payroll reference week and there was the so-called Bomb Cyclone. This could affect hours for workers paid biweekly, semimonthly or monthly. Similarly, extended absences from work because of the flu would reduce hours, particularly for hourly workers. We look for the workweek to have risen in February.

Elsewhere, revisions to fourth quarter productivity should be uneventful, while we expect the trade deficit to have widened in January. Factory orders likely dropped in January.

	Key indicators	Units	Moody's Analytics	Consensus	Consensus Range	Last
Mon @ 10:00 a.m.	Moody's Analytics Business Confidence	index, 4-wk MA				38.3
Mon @ 10:00 a.m.	ISM Nonmanufacturing Index for February	diffusion index	60.1	58.9	57.8 to 60.6	59.9
Tue @ 10:00 a.m.	Factory Orders for January	% change	-1.8	-1.2	-1.8 to 0.5	1.7
Wed @ 8:15 a.m.	ADP National Employment Report for February	change, ths		200	175 to 310	234
Wed @ 8:30 a.m.	Productivity and Costs for 2017Q4, final	% change, SAAR	-0.1	-0.1	-0.3 to 2.0	-0.1
	Unit Labor Costs	% change, SAAR	2.3	2.1	-0.1 to 2.5	2.0
Wed @ 8:30 a.m.	International Trade for January	$ bil	-55.4	-55.0	-55.9 to -51.0	-53.1
Wed @ 2:00 p.m.	Beige Book					
Thur @ 8:30 a.m.	Jobless Claims for 3/3/18	ths	220	220	215 to 235	210
Fri @ 8:30 a.m.	Employment Situation for February	change, ths	230	205	160 to 300	200
	Average Workweek	#	34.4	34.4	34.3 to 34.5	34.3
	Unemployment rate	%	4.0	4.0	4.0 to 4.1	4.1
	Average Hourly Earnings	% change	0.2	0.2	0.1 to 0.3	0.3

MONDAY, MARCH 5

Business confidence (week ended February 23; 10:00 a.m. EST)

Forecast: N/A

Global businesses are feeling good, the recent swings in global financial markets notwithstanding. Sentiment is especially strong in the U.S., likely buoyed by the recent corporate tax cuts. Abstracting from the weekly vagaries of the survey, a strong not quite one-half of responses to the nine questions posed in the survey are positive, while less than one-tenth of the responses are negative.

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

Across the globe, the difference between the percentage of all positive responses and all negative responses to the nine survey questions came in at 38% last week and 38% on a four-week moving average basis. In the U.S., business confidence stood at 42% last week and 41% 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 between 20% and 30% are consistent with an economy that is expanding at potential. The global economy is expanding above potential with readings of over 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 index rose from 37.7 to 38.3 in the week ended February 23.

ISM nonmanufacturing survey (February; 10:00 a.m. EST)

Forecast: 60.1

We look for the ISM nonmanufacturing index to have inched higher, rising from 59.9 in January to 60.1 in February. The ISM surveys capture changes in both economic conditions and sentiment, with the latter likely will still be boosted by tax legislation. Also, higher global oil prices are helping mining. Construction will likely limit the improvement, as the housing-related data have weakened recently.

TUESDAY, MARCH 6

No major economic releases are scheduled.

WEDNESDAY, MARCH 7

ADP National Employment Report (February; 8:15 a.m. EST)

Forecast: N/A

The ADP National Employment report showed that private nonfarm employment rose 234,000 between December and January. The composition of job creation across company sizes changed a bit. Midsize companies remain the strongest performers, adding 91,000 jobs and besting their average of 88,000 jobs per month in 2017. Performance at large companies rebounded, adding 85,000 jobs, well above the 62,000 job per month pace last year. Growth at small companies slowed a bit, but still added 58,000 jobs. This represents a weakening from a strong fourth quarter but is in line with average growth over the past year.

The average absolute difference between the first print of ADP and the Bureau of Labor Statistics estimate of private employment has been 60,000 over the past six months.

International trade (January; 8:30 a.m. EST)

Forecast: -$55.4 billion

We expect the nominal trade deficit to have widened from $53.1 billion in December to $55.4 billion in January. Already-released data show the advance goods deficit came in at $74.4 billion, well above December's $72.3 billion deficit. The details were also downbeat, with nominal goods exports falling 2.2% and imports dropping 0.5% in January. The widening in the advance goods deficit was a little surprising because the relatively late Lunar New Year should have helped the trade balance, as the typical preholiday surge in East Asian factory production was not expected to have occurred this January. The forecast looks for a similar change in the goods deficit as shown in the advance report. We look for a small decline in the services surplus.

The Week Ahead

THURSDAY, MARCH 8

Jobless claims (week ended March 3; 8:30 a.m. EST)

Forecast: 220,000

Initial claims for unemployment insurance benefits likely rose by 10,000 to 220,000 in the week ended March 3. This would reverse the prior week's 10,000 decline and would be only the second increase in the past five weeks. The prior week contained Presidents Day, and holidays often introduce additional volatility into initial claims.

FRIDAY, MARCH 9

Employment situation (February; 8:30 a.m. EST)

Forecast: 230,000
Forecast: 4% (unemployment rate)
Forecast: 0.2% (average hourly earnings)

Our preliminary forecast is for nonfarm employment to have risen by 230,000 in February. The labor market data have been strong with initial claims falling between the January and February payroll reference periods. The Conference Board's labor market differential improved in February, and we don't believe weather was an issue. Job growth also has a tendency to come in stronger than the consensus expectation in February. For the unemployment rate, we look for it to have fallen to 4% and average hourly earnings to have risen 0.2%, lowering year-over-year growth from 2.9% to 2.8%.

One surprise in January was the drop in hours worked. However, this could be weather- and flu-related. Weather was unusually cold leading up to the payroll reference week and there was the so-called Bomb Cyclone. This could affect hours for workers paid biweekly, semimonthly or monthly. Similarly, extended absences from work because of the flu would reduce hours, particularly for hourly workers. We look for the workweek to have risen in February.

EUROPE

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

Another barrage of top-tier data for the U.K. and euro zone

Following two busy weeks, the week ahead brings another barrage of top-tier data for the U.K. and euro zone economies. Among the major releases will be the final GDP and retail sales figures for the euro zone, as well as industrial production numbers for all the main European economies. But in the spotlight will be the European Central Bank, whose monetary policy committee is expected to meet Thursday to decide on the single-currency area's policy path. Markets have been jittery lately, betting that the monetary stimulus is likely to be removed at a faster rate than previously expected across developed economies, since growth figures have surprised strongly to the upside over the past few months. And while we agree that this will be the year central banks stir to action, we do not expect much news out of Thursday's meeting.

Our view is that Mario Draghi will refrain from making any changes to the bank's forward guidance, while we also expect him to reaffirm the ECB's dovish bias. First, inflation pressures remain subdued, with preliminary data showing that the area's headline inflation cooled to only 1.2% in February, from 1.3% in January, further below the ECB's 2% target. Second, all leading surveys on the health of the economy dipped in February, suggesting—as we expect—that growth in the area has already peaked and that the expansion should slow in 2018. Third, the recent turmoil in financial markets signals that now is hardly the time to turn more hawkish and risk a further selloff in asset prices.

That said, we do expect that the bank will turn more hawkish by summer. The CPI breakdown showed that price pressures eased in February only because of declines in the noncore inflation components, while underlying price pressures intensified somewhat. True, the core rate was steady at 1% in February, but services and nonenergy goods inflation each picked up, suggesting that risks regarding an upward revision to the data when final numbers are released two weeks from now are clearly tilted to the upside. This corroborates our story that the Phillips curve—an inverse relationship between inflation and unemployment—is not dead, and that underlying inflation pressures will gradually reach 1.5% by the end of this year, in line with the significant improvements in the labour market.

Not only the core rate will rise, but also energy and food inflation. First, the sharp drop in food inflation in January came because of a shock in the supply of fresh produce in February 2017 that was due to cold weather, while the same was not observed this year. This suggests that the rate will mean-revert soon. Second, base effects mean that energy inflation should accelerate from next month and peak in June, provided that oil prices remain at current levels around €52 per Brent barrel. The rise in energy inflation should also boost the core rate itself, notably via increases in transport services inflation, which is strongly correlated to oil prices.

Our base-case scenario is that the headline inflation rate should jump to around 2% by summer, while the core rate will increase gradually to 1.5%. This is much higher than the ECB's current expectations that the core will reach only 1.1% by the end of the year. This buildup of domestically generated inflation pressures will allow the ECB to end quantitative easing in the fourth quarter, via a gradual taper to zero, before beginning to lift the deposit rate at the start of 2019. The main refinancing rate will not rise until the third quarter of 2019.

	Key indicators	Units	Moody's Analytics	Last
Mon @ 10:00 a.m.	Euro Zone: Retail Sales for January	% change	-0.5	-1.1
Tues @ 1:40 p.m.	Russia: Consumer Price Index for February	% change	-0.1	0.3
Wed @ 10:00 a.m.	Euro Zone: GDP for Q4	% change	0.6	0.7
Thur @ 11:00 a.m.	OECD: Composite Leading Indicators for January		100.2	100.2
Thur @ 12:45 p.m.	Euro Zone: Monetary Policy for March	%	0.0	0.0
Fri @ 8:00 a.m.	France: Industrial Production for January	% change	-0.8	0.5
Fri @ 8:05 a.m.	Spain: Industrial Production for January	% change	0.5	0.9
Fri @ 9:00 a.m.	Germany: Industrial Production for January	% change	0.5	-0.6
Fri @ 9:30 a.m.	U.K.: Industrial Production for January	% change	1.0	-1.3

MONDAY, MARCH 5

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

Euro zone retail sales likely fell by 0.5% in monthly terms in January, failing to reverse the 1.1% decline in December. Most of the preliminary country data for the area's major economies haven't been made available yet, but the already-published number were sobering. Spending on goods plunged by sharp 1.9% m/m in France, on top of an already-grim 1.2% decline in December and much below-consensus expectations of a small rebound. Similarly, retail sales in Germany declined by 0.7% m/m, after a 1.1% fall in December. We are still waiting on data for Italy, Spain, the Netherlands, Austria and Belgium, but the bad news is that we expect sales to have fallen in those five countries, too.

January's broad-based declines are certainly a disappointment, though we caution that it was a sharp fall in energy spending that dragged the most on the headlines. January's temperatures read above their long-term average throughout the Continent, depressing demand for heating. Elsewhere, the details were a little more promising. The truth is, we cannot understand why the sales in most food and nonfood stores underperformed over the month. The good news is that leading indicators suggest that February numbers will be much better, but January's weak figures have undoubtedly created downside risks to growth over the first quarter as a whole.

TUESDAY, MARCH 6

No major economic releases are scheduled.

WEDNESDAY, MARCH 7

Euro Zone: GDP (Q4; 11:00 a.m. GMT)

The final estimate of the euro zone's fourth quarter GDP should confirm that the single-currency economy ended 2017 on a strong note, growing by 0.6% q/q, only slightly below the third quarter's rate at 0.7%. In yearly terms, growth is expected to have also edged down slightly, to 2.7%, from 2.8% previously. Already-released individual country figures suggest that the expansion was broad-based, with Germany and France again leading the pack. Both countries registered GDP growth of 0.6% q/q in the fourth quarter, the same rate as the euro zone as a whole. For Germany this result represented a slight deceleration from the 0.8% gain in the third quarter, but in France it actually accelerated from 0.5% in the previous stanza, helping lift the yearly rate of expansion to 2.5%, its fastest since 2011. The deceleration in Germany is nothing to fret about, though, since full-year growth still soared to 2.5%, from 1.8% in 2016, its fastest since 2011. Full-year GDP growth in France came in at a more subdued but still-impressive 2%, from 1.1% in 2016. Spain's growth again outpaced that for the area as a whole, remaining steady at 0.7% q/q, while Italy's GDP underperformed and grew by just 0.3%, slowing from 0.4% previously.

Across sectors, the area's main growth driver was likely higher investment in manufacturing. In France, manufacturing soared on the back of higher domestic and export orders, but Germany too is expected to have provided strong support. Accordingly, industrial production figures showed that factory growth surged by 1.5% q/q in the three months to December, accelerating further from a 1.3% gain in the previous stanza. The area's industries have benefited from higher domestic orders on the back of the broad-based recovery, but foreign demand is also expected to have increased dramatically. Trade figures for the main member countries showed that net trade's contribution to growth rebounded strongly in the final stanza of the year, as exports jumped. We expect that household consumption slowed because of a plunge in energy consumption, while government consumption should have remained steady.

THURSDAY, MARCH 8

Euro Zone: Monetary Policy (March; 12:45 a.m. GMT)

We expect the ECB's March meeting to be a quiet affair. Rates will be kept unchanged, and so will the bank's quantitative easing program. Also, our view is that Mario Draghi will refrain from making any changes to the bank's forward guidance, while we also expect him to reaffirm the ECB's dovish bias. First, inflation pressures remain subdued, with preliminary data showing that the area's headline inflation cooled to 1.2% in February, from 1.3% in January, further below the ECB's 2% target. Second, all leading surveys on the health of the economy dipped in February, suggesting—as we expect—that growth in the area has likely already peaked and that the expansion should slow in 2018. Third, the recent turmoil in financial markets signals that now is hardly the time to turn more hawkish and risk a further selloff in asset prices.

However, we do expect the bank will turn more hawkish by this summer. The CPI breakdown showed that price pressures eased in February solely because of declines in the noncore inflation components, while underlying price pressures intensified somewhat. True, the core rate was steady at just 1% in February, but services and nonenergy goods inflation each picked up, suggesting that risks regarding an upward revision to the data when final numbers are released two weeks from now are clearly tilted to the upside. This corroborates our story that the Phillips curve is not dead, and that underlying inflation pressures will gradually reach 1.5% by the end of this year, in line with the significant improvements in the labour market.

This buildup of domestically generated inflation pressures will allow the ECB to end QE in the fourth quarter, via a gradual taper to zero, before beginning to lift the deposit rate at the start of 2019. The main refinancing rate will not rise until the third quarter of 2019.

FRIDAY, MARCH 9

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

France's industrial production likely fell by 0.8% in January, offsetting the 0.5% increase in December. But this is nothing to worry about, since a decline was widely expected on the back of a plunge in energy production. The yearly rate should have remained robust at 3.3%, well above the 2.3% average recorded for the past 12 months. Energy production was probably dented by a drop in demand for heating due to January's unseasonably mild weather— over the month, temperatures exceeded their long-term average by 3°C in the country as a whole, and by 5°C in some regions—and we are penciling an 8% m/m plunge in the sector's output. What's more, mining and quarrying is also set to have mean-reverted following a strong December, when the closure of the U.K.'s Forties oil pipeline raised demand for oil. Manufacturing is more of a wild card, but we expect it increased further on the back of a jump in transport equipment output and also of a rise in food production. All leading surveys on the manufacturing sector were upbeat at the start of the year, suggesting that the upswing in the sector has carried over into the first quarter of 2018, though we caution that the bar for improvement is high following the 2.2% q/q jump in industrial production in the fourth quarter.

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

We expect that the industrial sector growth pulled back to 0.5% m/m in January, following a 0.9% gain in December thanks to the outsize contribution of energy, which is unlikely to extend beyond the winter season. Deteriorating business sentiment pointed to the slowdown in industrial performance. The manufacturing PMI slid to 55.2 in January, down from 55.8 in the closing month of 2017. Likewise, confidence in industry shed 0.6 point in January, with orders declining from the peak registered in the final quarter of last year.

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

German industrial production likely recovered somewhat in January, adding 0.5% m/m after shedding 0.6% at the end of last year. In year-ago terms, the rate of increase is expected to have ticked down to around 6% from 6.7% in December. Robust demand likely supported production. German manufacturing orders jumped by 3.8% m/m in December, and they increased by 6.8% in year-ago terms; however, the pace of the yearly increase in foreign and domestic orders decelerated slightly compared with the previous month. Although the Markit manufacturing PMI retreated to 61.1 in January, from the survey's record high of 63.3 reached in December, it continued to signal that the strong momentum carried over to the start of the new year. Even so, the outlook remains clouded as the uncertainty caused by Brexit negotiations and political struggles in Germany could hurt manufacturing in coming months.

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

We forecast that U.K. industrial production rebounded sharply by 1% m/m in January, almost fully reversing December's 1.2% decline. The yearly rate is similarly expected to have edged back up to 1.4%, from 0% previously, though that still leaves it below the 2.1% average for the past 12 months. Driving the upswing was likely a mean reversion in the mining and quarrying figures, following the plunge caused by the emergency closure of the Forties pipeline, the U.K.'s largest, in mid-December. The pipeline was reopened a few days before the end of last year, meaning that the sector was back to business as usual in January. Energy output, by contrast, is expected to have provided an offset, since demand for heating was depressed over the month—as it was in the other European economies—as a result of above-average temperatures.

We expect manufacturing production to have increased at a rate similar to that recorded in December, 0.3% m/m. The subsector picture is uneven, but all leading surveys show that foreign demand for Britain's industrial products remains strong, especially given the lower pound, which is boosting output in the sector as a whole. We warn, however, that sharp price rises are already starting to dampen domestic demand, while capacity constraints are beginning to bite because Brexit uncertainty is preventing firms from investing to increase capacity. We thus expect manufacturing output to slow over 2018, compared with the 2.1% increase in 2017.

ASIA-PACIFIC

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

China's trade surplus likely narrowed further in February

Japan had an impressive 2017, with GDP expanding in the fourth stanza for the eighth consecutive quarter. The preliminary estimate showed GDP growth notched 0.1% q/q, down from 0.6% in the third quarter. We believe the headline will be unrevised with the second estimate. Private consumption and nonresidential investment will likely add to GDP growth, while net exports will remain a drag because of a sharp rise in imports. A key risk to our forecast stems from the volatility around private nonresidential investment due to the fact that only supply-side data are included in the preliminary estimate. However, it's generally more stable towards the year's end, which justifies our unchanged forecast.

A suite of China's February data will be released. China's trade surplus likely narrowed further in February, but underlying conditions will be difficult to gauge given the usual distortion from the Lunar New Year holiday. We're eagerly awaiting March data to get our first unbiased view of the opening quarter of 2018.

February data will confirm that consumer price inflation pressures in China are stable and quiescent, beyond the Lunar New Year distortion. Low raw materials costs have lowered energy and transport inflation. Domestic demand is rising at a healthy pace, and the housing market, which had been driving inflation, looks to be cooling. Producer price inflation fell to a 14-month low in January as metals, food, energy and materials price inflation eased. Prices for iron ore, coal and other commodities have declined on account of global oversupply and government policy stemming overcapacity.

The Bank of Japan is expected to keep its policy levers unchanged at the March monetary policy meeting. We expect no material changes, and some market speculation of official tapering announcements remains off the mark. Instead, the BoJ will likely slow its asset purchases towards the year's end, and it's unclear whether the central bank will signal its intentions publicly.

Australia's GDP growth likely notched 0.7% q/q in the December quarter, following the 0.6% expansion in the September quarter. Household consumption and net exports should have made a positive contribution. Nonmining investment is doing well and picking up the slack from mining investment's drag. This is a reflection of the upbeat mood of businesses, which are yet to pass on higher profits to employees via meaningful wage increases. Full-year GDP growth should be 2.3% in 2017, from 2.6% in 2016, marking Australia's 26th year without recession. The record is expected to be uninterrupted in 2018, with GDP growth forecast at 3%.

	Key indicators	Units	Moody's Analytics	Last
Mon @ 3:00 p.m.	Malaysia Foreign trade for January	MYR bil	7.8	7.2
Tues @ 10:00 a.m.	South Korea Consumer price index for February	% change yr ago	1.3	1.0
Tues @ 11:30 a.m.	Australia Retail trade for January	% change	0.3	-0.5
Tues @ 2:30 p.m.	Australia Monetary policy for March	%	1.5	1.5
Wed @ 11:30 a.m.	Australia GDP for Q4	% change	0.7	0.6
Wed @ 7:00 p.m.	Taiwan Consumer price index for February	% change yr ago	1.1	0.9
Wed @ 7:00 p.m.	Taiwan Foreign trade for February	US$ bil	4.6	2.4
Thurs @ Unknown	China Foreign trade for February	US$ bil	20.0	20.3
Thurs @ 10:50 a.m.	Japan GDP for Q4 - second estimate	% change	0.1	0.6
Thurs @ 11:30 a.m.	Australia Foreign trade for January	A$ mil	-350	1,360
Fri @ 12:30 p.m.	China Consumer price index for February	% change yr ago	2.5	1.5
Fri @ 12:30 p.m.	China Producer price index for February	% change yr ago	3.9	4.3
Fri @ Unknown	Japan Monetary policy for March	¥ tril	80	80

MONDAY, MARCH 5

Malaysia – Foreign Trade – January

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

Forecast: MYR7.8 billion

Malaysia's monthly trade surplus likely widened in January to MYR7.8 billion, from the MYR7.2 billion notched in December. Annual export growth likely picked up from its lull in December, coming in at 4.9% y/y. We expect tech shipments will remain a bright spot amid robust consumer demand. Another bright spot will be palm oil, which had a tough time in December. A rebound is expected through the first quarter, as Malaysia has suspended export duties on crude palm oil.

TUESDAY, MARCH 6

South Korea – Consumer Price Index – February

Time: 10:00 a.m. AEDT (Monday, 11:00 p.m. GMT)

Forecast: 1.3%

South Korean consumer prices likely ticked up 1.3% y/y in February, after rising just 1% in the prior month. Headline inflation has remained comfortably below the Bank of Korea's 2% target in recent months because of base effects and muted demand-side pressures. Indeed, excluding food and energy, inflation slowed to a 65-month low in January. With inflation likely to stay mild, the Bank of Korea is expected to leave its key policy rate at 1.5% in the near term.

Australia – Retail Sales – January

Time: 11:30 a.m. AEDT (12:30 a.m. GMT)

Forecast: 0.3%

Australia's consumers are feeling frugal. Retail trade likely rose 0.3% m/m on a seasonally adjusted basis in January, following the 0.5% slump in December. The underlying weak pulse is clear with the less volatile trend data, which show retail trade was up just 2% y/y in December, well shy of its long-term average of around 4%. Stronger income growth is key to unlocking consumption from its soft spot. Income growth had very modest improvements in the second half of 2017 and further mediocre gains are expected over 2018, which should keep consumption relatively subdued at least through the first half of the year.

Australia – Monetary Policy – March

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

Forecast: 1.5%

The Reserve Bank of Australia is sitting pretty, and it will hold the cash rate steady at 1.5% at its March meeting. 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. There's no question 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 delayed further.

WEDNESDAY, MARCH 7

Australia – GDP – 2017Q4

Time: 11:30 a.m. AEDT (12:30 a.m. GMT)

Forecast: 0.7%

Australia's GDP growth likely notched 0.7% q/q in the December quarter, following the 0.6% expansion in the September quarter. This would bring annual growth to 2.7% in the fourth quarter, a notch lower than the third's 2.8% expansion. Household consumption likely added 0.3 percentage point to GDP growth after a 0.1-percentage point contribution in the prior quarter. Net exports should also be a positive following the third quarter's nil contribution. Nonmining investment is doing well and picking up the slack from mining investment's drag. This is a reflection of the upbeat mood of businesses, which have yet to pass on higher profits to employees via meaningful wage increases. Full-year GDP growth should be 2.3% in 2017, from 2.6% in 2016, marking Australia's 26th year without recession. The record is expected to be uninterrupted in 2018 with GDP growth forecast at 3%.

Taiwan – Consumer Price Index – February

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

Forecast: 1.1%

Taiwan's consumer price index likely increased 1.1% y/y in February, after edging up 0.9% in the prior month. Despite firmer economic conditions, price pressures have remained subdued, as a firmer Taiwan dollar and slower growth of fruit and vegetable prices have kept a lid on inflation. Although price pressures are likely to creep up this year, as the impact of a high base on fresh produce prices fades and as wages increase for public servants and minimum wage earners, a negative output gap is likely keep inflation subdued.

Taiwan – Foreign Trade – February

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

Forecast: US$4.6 billion

Taiwan's trade surplus likely increased to US$4.6 billion in February, after narrowing to US$2.4 billion in the prior month. Exports rose at a healthy pace in January, but were eclipsed by stronger import growth, which narrowed the trade surplus to a 26-month low. However, imports likely cooled in February, suggesting the trade surplus should rebound in its latest reading. With overseas economic conditions expected to remain relatively firm in 2018, Taiwan should benefit from solid external demand this year, although export growth will cool from 2017.

THURSDAY, MARCH 8

China – Foreign Trade – February

Time: Unknown

Forecast: US$20 billion

China's trade surplus fell sharply to US$20.3 billion in January, down from US$54.7 billion in December. Imports surged, which may have been a result of importers getting goods in early ahead of the Lunar New Year. It will be hard to gauge the direction of trade, but while tech exports likely faltered during the holiday, manufacturing sentiment remains upbeat; hence there will likely be a recovery in March. Another low trade balance is expected for February, though, likely around US$20 billion.

Japan – GDP – 2017Q4
Time: 10:50 a.m. AEDT (Wednesday, 11:50 p.m. GMT)

Forecast: 0.1%

Japan ended 2017 on a strong note, with GDP expanding for the eighth consecutive quarter. The first estimate showed the seasonally adjusted December quarter GDP rose 0.1% over the quarter, down from 0.6% previously. We believe the second estimate is unlikely to be revised. Private consumption and nonresidential investment likely added to GDP growth, while net exports remained a drag as a result of a sharp rise in imports. A key risk to our forecast stems from the volatility around private nonresidential investment. Because only supply-side data are used in the preliminary estimate, the second estimate tends to be revised. However, it's generally more stable towards the year's end, which justifies our unchanged forecast.

Australia – Foreign Trade – January
Time: 11:30 a.m. AEDT (12:30 a.m. GMT)

Forecast: -A$350 million

Australia's monthly trade balance likely remained in deficit in January, coming in with an A$350 million shortfall after the A$1.36 billion deficit in December. Cooler oil prices alongside the higher Australian dollar likely weakened the import bill in January. But relief will be short-lived, as global financial market ructions in February brought the Australian dollar lower. Softness in oil prices brought relief. Hard commodity exports are doing well, having recovered from their lull in mid-2017, and buoyant global demand over 2018 should keep the current state of play.

FRIDAY, MARCH 9

China – Consumer Price Index – February
Time: 12:30 p.m. AEDT (1:30 a.m. GMT)

Forecast: 2.5%

Inflation pressures in China are stable and quiescent. Low raw materials costs have lowered energy and transport inflation. Domestic demand is rising at a healthy pace and the housing market, which had been driving inflation, looks to be cooling. Food prices, which had been falling, likely spiked higher in February because of Lunar New Year effects. Consumer price inflation likely rose to 2.5% in February, from 1.5% in January.

China – Producer Price Index – February
Time: 12:30 p.m. AEDT (1:30 a.m. GMT)

Forecast: 3.9%

Producer price inflation fell to a 14-month low in January as metals, food, energy and materials price inflation eased. Prices for iron ore, coal and other commodities have declined because of global oversupply and government policy stemming overcapacity. Thus producer price inflation will trend lower in the first half of 2018. China's producer price growth likely decelerated to 3.9% y/y in February, from 4.3% in January.

Japan – Monetary Policy – March
Time: Unknown

Forecast: ¥80 trillion

The Bank of Japan is expected to keep its policy levers unchanged at the March monetary policy meeting. The bank will maintain its monthly annualised purchase target of Japanese government bonds at ¥80 trillion. Moreover, the BoJ will target long-term interest rates through its yield curve control policy; the target for the 10-year JGB is 0%. The short-term interest rate target is -0.1% on excess reserves. We expect no material policy changes, and some market speculation of official tapering announcements remains off the mark. Instead, the BoJ will likely slow its asset purchases towards the year's end, and it's unclear whether it will signal its intentions publicly. But given the economy's recent improved momentum, it's clear that the BoJ's next move will be tightening, not further loosening, of monetary policy.

The Long View

Issuers from China limited February's yearly plunge by US$-denominated high-yield bond offerings to 37%.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group,
March 1, 2018

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 104 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 353 bp is less than what is inferred from the spread's macroeconomic drivers, the high-yield EDF metric, and the VIX index. The adverse implications for liquidity of possibly significantly higher interest rates merit consideration.

DEFAULTS

After setting its current cycle high at January 2017's 5.8%, the U.S. high-yield default rate has since eased to the 3.2% of January 2018. Moody's Default and Ratings Analytics team expects the default rate will average 2.2% during the three months ended January 2019. 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 an annual rise of 2.1% for IG and a 0.3% uptick 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 2.8% 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 Reka Sulyok of Moody's Analytics
March 1, 2018

Euro Zone

Strong and sustained GDP growth in the euro zone has relieved pressure on the European Central Bank to continue with further stimulus. We estimate that the monetary bloc's expansion will peak in the first half of 2018 and then slow to trend by 2020. But the gradual slowdown shouldn't derail monetary policy normalization. European yields should begin rising by 2019, and that should highlight country-specific risks. High public debt and feeble economic policies, for example, render southern euro area members especially vulnerable to policy normalization. In years to come, the challenge will be to escape the debt trap.

Spain

The Spanish government strove to deliver 1.2 percentage point of GDP fiscal consolidation over 2017 to reduce its fiscal shortfall to just 3% and exit the European Commission's excessive deficit procedure. Along with the fiscal discipline, a strong cyclical upswing helped alleviate Spain's debt burden. The debt-to-GDP measure is estimated to have come in a touch below 99% of GDP last year, down from the peak of 100.4% in 2014. Spain is a textbook example of how to resolve the structural problems that emerged in the immediate aftermath of the sovereign debt crisis. After significant labour reforms in 2012, employment became the main engine of the economic recovery, relieving much of the fiscal distress.

However, the design of fiscal federalism threatens the country's debt position. Spain's regional governments have already piled up sizable debt to plug their financing gap, since they systematically ran higher-than-planned deficits in the past. There are no mechanisms to reinforce the budget plan on a regional level, because the regional governments are unable to beef up revenues with additional taxes. Most important, though, is that regions can easily get away with budget overruns, since they firmly believe that Spain's central government would not let them default on their debt. The government is currently the biggest creditor, as Madrid introduced a fiscal mechanism in 2012 to grant long-term loans on favorable conditions to regional governments. As long as those credit conditions remain soft, regions are better off overstating their spending needs while leaving any efficiency or sustainability concerns aside.

Italy

Italy seems most exposed to the risks of the ECB's tightening cycle, given its soaring debt above 130% of GDP and ailing financial sector. But the problems may run even deeper than that, with the economy stuck in a slow-growth rut for the last decade. Since the sovereign crisis in 2012, Italy has lagged behind the rest of the euro zone. And lackluster economic growth is all the more worrying because it cannot offset the increasing costs of rolling over maturing debt, meaning that the debt stock to GDP is still on the rise. By contrast, Spanish debt stopped increasing in 2015 and the government is on track to lower its debt stock by a cumulative 2.6 percentage points of GDP in the next two years, though the tapering of the QE program should raise debt refinancing costs.

Debt servicing costs put the Italian government in a precarious position before the upcoming election in early March. To keep the headline deficit under control, Italy has been accumulating primary surpluses of around 2.6% of GDP over the last three years. Streamlining revenues did not go as intended: Privatization efforts brought only 0.1% of GDP to the coffers. At the same time, the corporate tax rate was cut from 27.5% to

24%, while postponing the VAT tax increase and reversing the 2011 pension reforms puts a lot of strain on the next budget. Markets seem to reckon that the uncertainty in the fiscal plans may exacerbate the debt problem over the medium term. Italy will face a boatload of policy decisions as slow economic growth starts to take its toll, while the long end of the yield curve will come undone, adding to the debt servicing costs.

Italy's anti-establishment Five Star Movement is currently the strongest contender in the March elections, with 28% of support. Although the party is unlikely to form a majority government, its unorthodox program panders to an electorate fed up with fiscal austerity. The party plans to seek debt restructuring and renegotiate the EU's strict fiscal rule, while it had earlier flagged the possibility of leaving the euro zone. But credit default swap prices show just how investors in the sovereign bond markets feel about this: Concerns over Italy's ability to fulfill future obligations, together with the anti-euro sentiment, hiked the prices.

Greece

Greece is a cautionary tale. Austerity measures and painful reforms followed the two bailouts received from the Eurogroup and the IMF, first in 2010 and then in 2012. The economy marked an important milestone in 2017, when it is estimated to have grown by 1.6% following seven years of contraction. Even better, the European Commission found that Greece may be eligible to exit the bailout program sometime in the second half of this year, as originally planned. The Greek government also signaled that it aims to leave the program with a €19 billion precautionary buffer, around 10% of GDP. That seems politically motivated, since Greece would only need to secure access to emergency standby facilities to calm investors before it returns to market financing.

The country's debut in international markets was promising. Greece issued five-year bonds in the amount of €3 billion at a 4.6% yield in July 2017, while the reference 10-year yields are staying low, close to what they were before the financial crisis. The government likely needs to test the waters again this year, as it faces a larger chunk of bond principals maturing. Meanwhile, the bailout-related loan repayments only start from 2020, which should give the country some breathing space in the near term.

But Greece has suffered from the dire fiscal austerity, cutting back on expenditures dramatically. Staying afloat even with the bailouts was not easy and deprived the population. No wonder IMF economists pleaded for debt relief recently to stave off another near miss in the medium term.

Future governments might discontinue tight spending, which could sap Greece of financial wriggle room again. But with the 2012 experience still fresh in mind, we see little reason for the EU to give in to debt relief. More likely is another restructuring and stretching the loan repayments. This could boost investor confidence and prompt the Greek government to further the reform agenda.

ASIA PACIFIC

By Veasna Kong of Moody's Analytics
March 1, 2018

South Korea

Underpinned by the upswing in global tech demand and strong investment activity, South Korea's economy expanded by a three-year high in 2017. That momentum is expected to carry over to 2018, with the government boosting expenditure this year and private consumption likely to benefit from a large minimum wage hike and government efforts to boost employment and welfare. That is expected to help offset weaker investment growth and a moderation in exports, which will likely cool off a high base. GDP is forecast to expand 3% this year, down marginally from the 3.1% lift in 2017.

Despite the economy's recovery, the labour market has remained relatively lackluster. Youth unemployment continues to be uncomfortably high, even as the overall unemployment rate fell to around 3.7% in the back half of 2017, down from 4% in April. The mild improvement was helped by a noticeable lift in manufacturing and public sector jobs in the second half of 2017. Meanwhile, the services industry, which employs about 70% of the workforce, continued to increase its headcount in 2017. Overall, employment ticked up a modest 1.2% y/y in 2017, about the same as in the prior year.

One issue holding back progress is the dual nature of the labour market. South Korea's labour market consists of two tiers. One is for regular employees, who benefit from the social safety net, higher wages, and greater job security due to tight dismissal regulations and high severance costs.

The other is for nonregular workers, such part-time and temporary employees, who typically earn less than regular workers—often for the doing the same job—and have less job security and training and are less likely to benefit from the social safety net. Mobility from nonregular to regular employment is difficult. Beyond the impact on women, older workers and youth—the three groups disproportionately affected by the dual labor market—it also undermines consumer spending and productivity growth.

Against that backdrop, a key focus of President Moon Jae-in's agenda is to boost job creation and kick-start income-led growth. On top of his US$9.9 billion stimulus package last July, Moon's 2018 budget features the biggest spending increase since the global downturn in 2009. Spending is set to rise 7.1%, the bulk of which is for welfare, healthcare, and labor market initiatives.

Minimum wage earners also received a 16.4% y/y wage increase at the beginning of this year. Although that's likely to boost private consumption, future minimum wage increases will need to be carefully timed and balanced against the adverse impact on businesses, particularly small and medium-sized enterprises. Moon has pledged to raise minimum wages a further 33% by 2020.

Investment poised to cool

Business investment has expanded noticeably since mid-2016, thanks to low interest rates, rising business confidence, and surging tech demand, but growth has cooled recently, with forward indicators suggesting further moderation ahead.

Indeed, construction activity was strong through to early 2017, as residential and commercial real estate construction both ramped up. However, residential construction starts have fallen significantly since and are likely to moderate further this year, as building permits have been on the decline. The government is also cutting infrastructure outlays in favor of increased welfare spending, which is likely to weigh on construction activity.

South Korea's housing market has cooled on the back of tighter macroprudential regulations since 2016 to curb speculation and financial stability risks. Loan-to-valuation ratios have been reduced, debt-to-income ratios have been lowered, transfer taxes have increased, and this year new debt-service ratio caps and increased capital gains taxes will be introduced. Mortgage loan growth has fallen noticeably as a result, as has house price inflation, which has been in a downturn since early 2016.

Meanwhile, facilities investment has been boosted by replacement demand as well as the rebound in export manufacturing. Investment in the tech sector has been especially strong, thanks to booming demand for electronics and chips. Machinery and equipment investment in the information and communications technology sector surged in the first three quarters of 2017, but cooled in the final stanza of the year. We expect further moderation through 2018, even as tech giants such as Samsung, LG and SK Hynix collectively plan to invest about US$74 billion through to 2024.

Risks bear watching

Tensions on the Korean Peninsula escalated over 2017, as North Korea ramped up its weapons-testing. Although the recent de-escalation of tensions has raised hopes of a sustained easing of military frictions, South Koreans remain skeptical of Pyongyang's motives, and Kim Jong-un has made clear his nuclear arms program is nonnegotiable. However, the economic implications of North Korea's provocations have so far been minimal, with consumer sentiment improving noticeably.

Heightened tensions on the Korean Peninsula come at a time of souring trade relations between U.S. and South Korea. Indeed, rising protectionism in the U.S.—South Korea's second largest trading partner—is a significant downside risk for South Korea's export-dependent economy. Frictions center on South Korea's large merchandise trade surplus with the U.S. since the U.S.-Korea Free Trade Agreement, known as KORUS, came into force in 2012.

Adding fuel to fire is the Trump administration's recent decision to slap high tariffs on imports of washing machines, and talk of heavy import tariffs and quotas on steel, of which South Korea accounts for 10%.

The Long View

Since KORUS came into force in 2012, South Korea's goods and services trade surplus with the U.S. more than doubled from US$7.7 billion to US$17.6 billion in 2016, largely as result of the rise in the goods surplus, especially in passenger cars. In 2017, the U.S. imported US$15.7 billion worth of South Korean passenger cars, while it exported just US$1.5 billion to South Korea.

That said, in services trade, the U.S. enjoys a healthy surplus of US$10 billion, up from US$7.5 billion in 2012. Trump has threatened to withdraw the U.S. from KORUS and the two sides are renegotiating the agreement. However, any changes to KORUS are unlikely to make a material difference to America's persistent trade deficits, as South Korea accounted for just 3.5% of the deficit in 2016.

Bank of Korea in a bind

With economic activity firming, year-average inflation inched up towards the Bank of Korea's 2% target in 2017. However, inflation has been on the low side of the target in recent months and eased to an 18-month low of 1% y/y in January on weaker gains in food and transportation prices and a dip in communication, recreation and culture prices.

Base effects are also at play, as the impact of adverse weather contributed to strong food price inflation through the middle of 2016, and the base effect of city electricity price cuts in the third quarter of 2016 is fading. Still, even after excluding food and energy prices, inflation eased to a 65-month low of 1.2% y/y in January, suggesting demand-side pressures have softened.

Under the circumstances, the Bank of Korea's decision to increase its key policy rate by 25 basis points to 1.5% in November 2017—the first rate hike since 2011—was somewhat of a surprise. Although South Korea's near-term growth prospects are favorable, the outlook for inflation is less sanguine, given the mix of forces such as volatile oil prices and the appreciation of the won, which has kept a lid on imported inflation. Meanwhile, inflation expectations, as measured by the 10-year break-even inflation rate, remains low, staying below 1% through most of 2017.

Financial stability concerns factored prominently in the Bank of Korea's decision to tighten monetary policy in November. The central bank was growing increasingly wary of leaving rates too low for too long, and with economic growth in an upswing, November was seen as an ideal time to adjust the level of monetary accommodation to curb financial risks.

South Koreans have been on a debt binge in recent years, with household debt rising to around 94% of GDP from 76% in 2010, well above the 75% typical for advanced economies. Not only has that undermined consumption, as consumers have had to allocate a larger share of their incomes to service the debt, it has also increased the economy's vulnerability to adverse shocks.

Although we expect consumer spending to firm in 2018 on the back of the large minimum wage hike and the government's expansionary policies, demand-side pressures are likely to be dampened somewhat by softening investment activity. Along with an elevated won, that's expected to keep inflation subdued, suggesting that the Bank of Korea is likely to remain on the sidelines in the near term.

Ratings Round-Up

By Njundu Sanneh

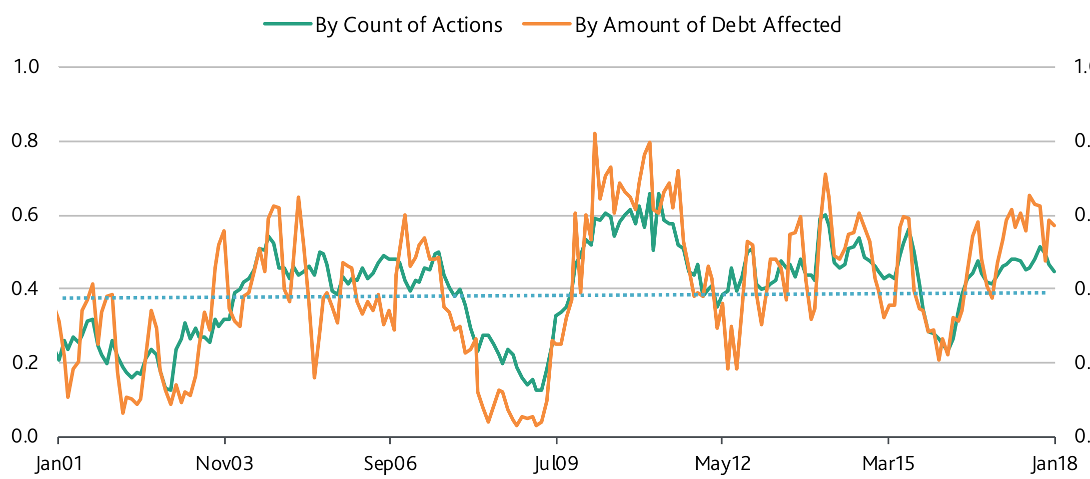
Greek Sovereign Upgrade Provides Boost

The upgrade of Greece's issuer rating on February 21 has occasioned the upgrade of various ratings for Greek banks and an industrial company. The positive rating revisions of Greek entities skewed the week's rating changes distribution firmly toward positive rating changes, with all but one European rating change being upgrades. The contribution of positive rating changes to total rating changes was 90%. The upgrade of Greek banks was prompted by the rise in the country's bank deposit ceiling rating following the sovereign upgrade and the increase in unsecured liabilities that can absorb losses in a bankruptcy event. Notwithstanding the improvements in Greek bank credits, the banks are exposed to substantial non-performing loans and a difficult operating environment. The distinction for the singular rating downgrade goes to Galaxy FinCo. Limited a U.K. extended warranty and service provider. Galaxy's downgrade was prompted by, among other things, the shift in strategy toward more costly insurance and maintenance services products that require regulatory capital and the distribution of GBP 75 million to shareholders.

In the U.S., rating change activity was spread across a broad spectrum of sectors with upgrades and downgrades evenly split at seven apiece. General Mills, Inc., VeriSign, Inc., and Tops Holding II Corp. highlight the downgraded companies. General Mills' downgrade was driven by its proposed acquisition of Blue Buffalo Pet Products, Inc. which will increase leverage as part of the acquisition funded by debt issuance. Significant upgraded companies include FTS International, Inc., Cypress Semiconductor Corp., and Arch Coal. The downgrade of FTS International, an oil services firm, reflects reduced leverage as it paid off significant amounts of its debt following its IPO. The increased capital spending by upstream companies would also continue to benefit its operating performance.

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
2/21/18	CYPRESS SEMICONDUCTOR CORPORATION	Industrial	SrSec/BCF/LTCFR/PDR/SGL	1,081	U	Ba3	Ba2	SG
2/21/18	VERISIGN, INC.	Industrial	SrUnsec/LGD	3,600	D	Ba1	Ba2	SG
2/22/18	ARCH COAL, INC.	Industrial	SrSec/BCF/LTCFR/PDR/SGL	300	U	B1	Ba3	SG
2/22/18	DOWNSTREAM DEVELOPMENT AUTHORITY	Industrial	LTCFR/PDR		D	B3	B2	SG
2/22/18	MARTIN MIDSTREAM PARTNERS L.P.	Industrial	SrUnsec/LTCFR/PDR	400	D	B3	Caa1	SG
2/22/18	TOPS HOLDING II CORPORATION	Industrial	SrSec/SrUnsec/LTCFR/PDR	702	D	Caa1	Ca	SG
2/23/18	CONSOLIDATED AEROSPACE MANUFACTURING LLC	Industrial	SrSec/BCF/LTCFR/PDR	265	U	B3	B2	SG
2/23/18	GENERAL MILLS, INC.	Industrial	SrUnsec/MTN	8,076	D	A3	Baa2	IG
2/26/18	AES CORPORATION (THE) -AES EL SALVADOR TRUST II BIS	Utility	SrSec/LTCFR	310	U	B3	B2	SG
2/26/18	COTIVITI CORPORATION	Industrial	SrSec/BCF/LTCFR/PDR	900	U	B1	Ba3	SG
2/26/18	LEARNING CARE GROUP (US) NO. 2 INC.	Industrial	LTCFR/PDR		D	B2	B3	SG
2/26/18	WADDELL & REED FINANCIAL, INC.	Financial	LTIR		D	Baa3	Ba1	IG
2/27/18	FTS INTERNATIONAL, INC.	Industrial	SrSec/BCF/LTCFR/PDR	987	U	Caa2	B3	SG
2/27/18	LEXMARK INTERNATIONAL, INC.	Industrial	SrUnsec/LTCFR/PDR	341	D	Ba3	B3	SG

Source: Moody's

Ratings Round-Up

FIGURE 4

Rating Changes: Corporate & Financial Institutions – Europe

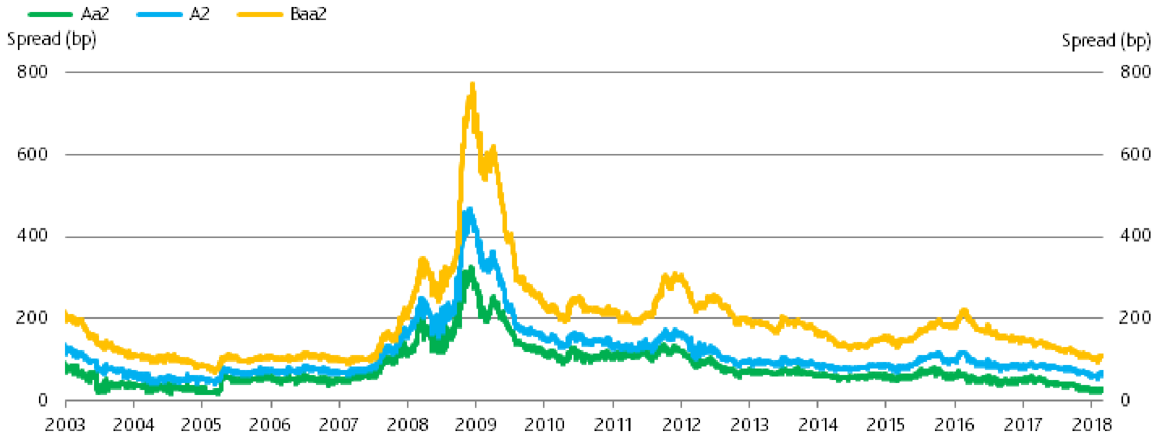
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG	Country
2/20/18	FAURECIA SA	Industrial	SrUnsec/LTCFR/PDR	1,722	U	Ba3	Ba1	SG	FRANCE
2/23/18	GALAXY FINCO LIMITED	Industrial	PDR		D	B1	B2	SG	UNITED KINGDOM
2/23/18	HELLENIC TELECOMMUNICATIONS ORGANIZATION S.A.	Industrial	SrUnsec/LTCFR/PDR/MTN	1,368	U	B3	B1	SG	GREECE
2/25/18	PROLOGIS EUROPEAN LOGISTICS FUND FCP-FIS	Industrial	SrUnsec/LTIR/MTN	6,449	U	Baa1	A3	IG	LUXEMBOURG
2/26/18	STORA ENSO OYJ	Industrial	SrUnsec/LTCFR/PDR/MTN	2,042	U	Ba2	Ba1	SG	FINLAND
2/27/18	ALPHA BANK AE	Financial	SrUnsec/MTN	24,251	U	(P)Caa2	(P)B3	SG	GREECE
2/27/18	CAIXA GERAL DE DEPOSITOS, S.A.	Financial	SrUnsec/LTD/Sub/JrSub/MTN/PS	22,738	U	B1	Ba3	SG	PORTUGAL
2/27/18	EUROBANK ERGASIAS S.A.	Financial	SrUnsec/MTN	22,877	U	(P)Caa2	(P)B3	SG	GREECE
2/27/18	NATIONAL BANK OF GREECE S.A.	Financial	SrUnsec/LTD/MTN	14,221	U	Caa3	Caa2	SG	GREECE
2/27/18	PIRAEUS BANK S.A.	Financial	SrUnsec/LTD/MTN	37,594	U	Caa3	Caa2	SG	GREECE

Source: Moody's

Market Data

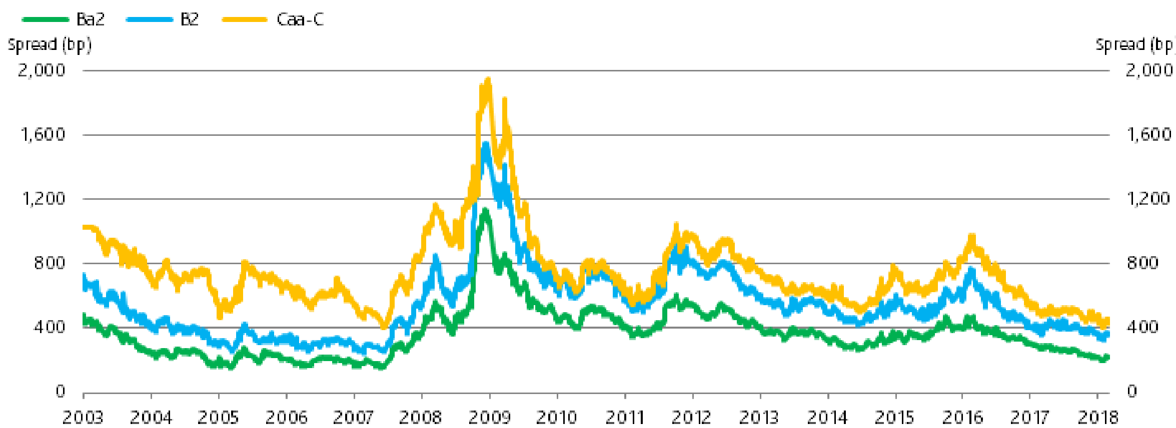
Spreads

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



Source: Moody's

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



Source: Moody's

Market Data

CDS Movers

Figure 3. CDS Movers - US (February 21, 2018 – February 28, 2018)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Feb. 28	Feb. 21	Senior Ratings
Electronic Data Systems Corporation	A3	Baa2	Baa2
Colgate-Palmolive Company	Aa3	A1	Aa3
Citibank, N.A.	Baa2	Baa3	A1
Enterprise Products Operating, LLC	Baa3	Ba1	Baa1
Southern Company (The)	Baa2	Baa3	Baa2
Viacom Inc.	Baa3	Ba1	Baa3
Plains All American Pipeline L.P.	Ba1	Ba2	Ba1
Ball Corporation	Baa2	Baa3	Ba1
Chesapeake Energy Corporation	Caa1	Caa2	Caa1
Sherwin-Williams Company (The)	Baa2	Baa3	Baa3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Feb. 28	Feb. 21	Senior Ratings
Bank of New York Mellon Corporation (The)	Baa1	A2	A1
Waste Management, Inc.	A3	A1	Baa2
AutoZone, Inc.	Baa2	A3	Baa1
MBIA Inc.	Ca	Caa2	Ba3
Comcast Corporation	A2	A1	A3
Oracle Corporation	A3	A2	A1
Coca-Cola Company (The)	Aa2	Aa1	Aa3
Wal-Mart Stores, Inc.	Aa2	Aa1	Aa2
Johnson & Johnson	Aa1	Aaa	Aaa
CVS Health	Baa3	Baa2	Baa1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Feb. 28	Feb. 21	Spread Diff
MBIA Inc.	Ba3	927	794	133
Sears Holdings Corp.	C	4,100	4,009	91
Sears Roebuck Acceptance Corp.	C	4,107	4,016	91
Talen Energy Supply, LLC	B1	855	766	89
Nordstrom, Inc.	Baa1	333	266	67
Staples, Inc.	B3	515	464	51
MBIA Insurance Corporation	Caa2	880	831	48
Pride International, Inc.	B3	500	461	40
Dean Foods Company	B2	350	314	36
Realogy Group LLC	B1	241	207	34

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Feb. 28	Feb. 21	Spread Diff
Nine West Holdings, Inc.	C	33,766	36,796	-3,030
R.R. Donnelley & Sons Company	B2	632	756	-124
McClatchy Company (The)	Caa2	892	970	-78
Penney (J.C.) Corporation, Inc.	B3	782	836	-54
Frontier Communications Corporation	B3	1,502	1,552	-50
Tenet Healthcare Corporation	Caa1	402	451	-49
Hertz Corporation (The)	B3	718	757	-39
Chesapeake Energy Corporation	Caa1	690	718	-28
AutoNation, Inc.	Baa3	419	439	-20
AES Corporation, (The)	Ba2	129	147	-19

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (February 21, 2018 – February 28, 2018)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Feb. 28	Feb. 21	Senior Ratings
Orsted A/S	A2	Baa3	Baa1
Landesbank Hessen-Thueringen GZ	A1	A3	A1
Care UK Health & Social Care PLC	Ba2	B1	Caa1
Spain, Government of	A3	Baa1	Baa2
Banco Bilbao Vizcaya Argentaria, S.A.	A3	Baa1	Baa1
Abbey National Treasury Services plc	A2	A3	Aa3
Banco Santander S.A. (Spain)	A1	A2	Baa1
Danske Bank A/S	Aa2	Aa3	A1
Erste Group Bank AG	A1	A2	A3
Raiffeisen Bank International AG	Baa1	Baa2	A3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Feb. 28	Feb. 21	Senior Ratings
Old Mutual Plc	A1	Aa2	Ba1
PostNL N.V.	Baa1	A2	Baa2
France, Government of	Aa1	Aaa	Aa2
Lloyds Bank Plc	A2	A1	Aa3
CaixaBank, S.A.	Baa2	Baa1	Baa2
HSBC Holdings plc	Baa1	A3	A2
ING Bank N.V.	Aa2	Aa1	Aa3
Orange	A3	A2	Baa1
Volkswagen Aktiengesellschaft	Baa2	Baa1	A3
Deutsche Bahn AG	Aa1	Aaa	Aa1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Feb. 28	Feb. 21	Spread Diff
Ensco plc	B3	459	423	36
Unipol Gruppo S.p.A.	Ba2	134	114	20
UPC Holding B.V.	B2	158	150	9
PostNL N.V.	Baa2	46	39	8
Banca Monte dei Paschi di Siena S.p.A.	B3	121	115	6
Old Mutual Plc	Ba1	34	28	6
Eksportfinans ASA	Baa3	462	458	4
Novafives S.A.S.	B3	153	149	4
Suedzucker AG	Baa2	63	60	4
Koninklijke KPN N.V.	Baa3	60	57	3

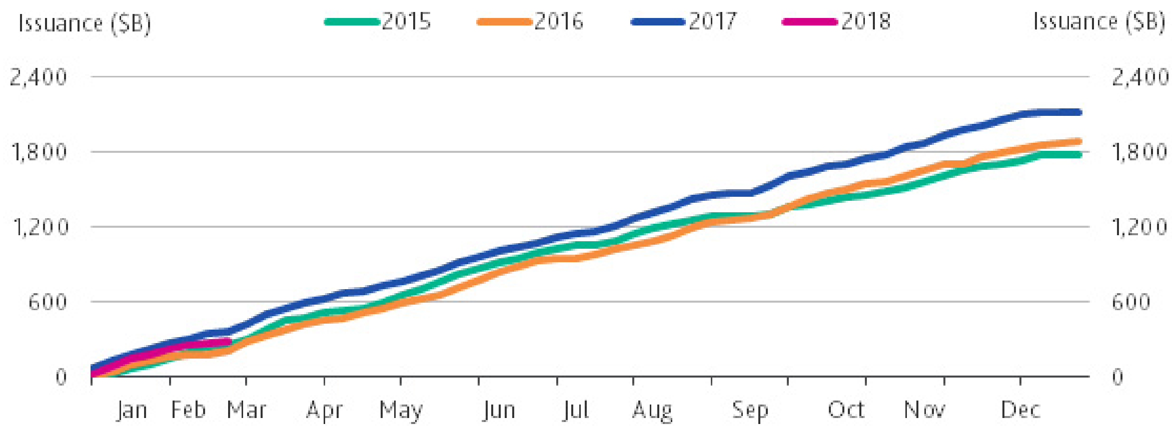
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Feb. 28	Feb. 21	Spread Diff
Astaldi S.p.A.	B3	2,657	2,714	-57
Boparan Finance plc	B3	459	512	-53
Care UK Health & Social Care PLC	Caa1	132	173	-41
Orsted A/S	Baa1	37	73	-36
Selecta Group B.V.	Caa2	378	413	-35
Sappi Papier Holding GmbH	Ba2	342	359	-17
CMA CGM S.A.	B3	397	411	-13
Vedanta Resources plc	B2	409	421	-12
Stena AB	B3	500	511	-12
Yorkshire Water Services Finance Limited	Baa2	69	79	-10

Source: Moody's, CMA

Market Data

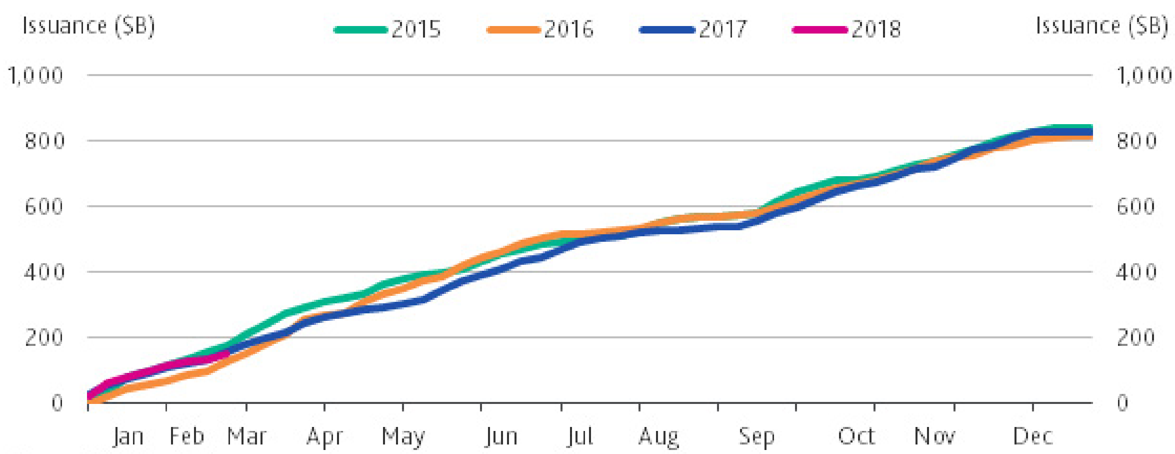
Issuance

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



Source: Moody's / Dealogic

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



Source: Moody's / Dealogic

Market Data

Figure 7. Issuance: Corporate & Financial Institutions

	USD Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	17.958	6.700	24.858
Year-to-Date	221.267	62.222	290.430

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	9.100	0.862	14.456
Year-to-Date	127.943	11.385	147.939

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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