Unprecedented Amount of Baa-Grade Bonds Menaces the Credit Outlook

Credit Markets Review and Outlook  by John Lonski
Unprecedented Amount of Baa-Grade Bonds Menaces the Credit Outlook

The Week Ahead
We preview economic reports and forecasts from the US, UK/Europe, and Asia/Pacific regions.

The Long View
Full updated stories and key credit market metrics: The $373 billion of Baa-grade bonds offered by U.S. corporations during January-October 2018 sank by 23% year-over-year.

Credit Spreads
Investment Grade: We see year-end 2018’s average investment grade bond spread exceeding its recent 124 bp. High Yield: Compared to a recent 415 bp, the high-yield spread may approximate 450 bp by year-end 2018.

Defaults
US HY default rate: Moody’s Default and Ratings Analytics team forecasts that the U.S.’ trailing 12-month high-yield default rate will sink from October 2018’s 3.16% to 2.26% by October 2019.

Issuance
In 2017, US$-denominated IG bond issuance grew by 6.8% to a record $1.508 trillion, while US$-priced high-yield bond issuance advanced by 33.0% to a new record calendar-year high of $453 billion. For 2018’s US$-denominated corporate bonds, IG bond issuance may drop by 12.6% to $1.318 trillion, while high-yield bond issuance is likely to fall by 35.2% to $294 billion for the worst calendar year since 2011’s $74 billion.

Ratings Round-Up
U.S. Rating Change Activity Improved

Market Data
Credit spreads, CDS movers, issuance.

Moody’s Capital Markets Research  recent publications
Links to commentaries on: Buybacks, volatility, defaults, Fed policy, yields, profits, corporate borrowing, U.S. investors, eerie similarities, base metals prices, debt to EBITDA, trade war, Investment grades, higher rates, credit quality, foreign investors, internal funds.

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.

Unprecedented Amount of Baa-Grade Bonds Menaces the Credit Outlook

Greater uncertainty surrounding the sustainability of corporate earnings growth has adversely affected the performance of medium- and lower-grade corporate bonds. For example, the spread over Treasuries of a composite speculative-grade bond yield quickly swelled from November 8's 371 basis points to November 14's 415 basis points. Moreover, November 14's composite speculative-grade bond yield of 7.12% soared higher by 111 basis points from a year earlier.

In addition, the long-term Baa industrial company bond yield spread closed at 202 basis points on November 14. Not since September 2016 has the long-term Baa industrial spread remained above 200 basis points on a recurring basis.

If fears over the adequacy of future corporate earnings persist, the upside for benchmark U.S. interest rates is probably well under consensus expectations.

Industrial Commodity Prices Sink as World Business Activity Slows

As long as the dollar exchange rate does not weaken appreciably and inflation expectations are well contained, the FOMC very much has the option of normalizing monetary policy at a more measured pace. Yes, the FOMC will probably hike fed funds' midpoint to 2.375% at its December 19 meeting. However, December 19's policy statement might indicate the Fed's willingness to take a more gradual approach to policy normalization in deference to slumping industrial commodity prices, weakness abroad, and the continued containment of inflation expectations.

Oil is not the only industrial commodity whose price has sunk in response to the lackluster pace of global business activity. Thus far in November, Moody's industrial metals price index has dropped by 11% year over year.

The continuation of deeper-than-10% year-to-year declines by the industrial metals price index will have important implications for Treasury bond yields. The 10-year Treasury yield's three-month average dropped year over year in 97% of the months since June 1985 showing a 10% or deeper year-over-year drop by the accompanying three-month average of the base metals price index. The statistical strength of this relationship is borne out by how the 10-year Treasury yield's moving three-month average fell in a much lower 62% of all observations since June 1985. Nevertheless, so deep of a drop by the base metals price index may have to wait according to the base metals price index's 7.5% annual decline of the past 13 weeks.

Recent precedent supports the possibility of at least a temporary halt to Fed rate hikes. After December 2015's hiking of fed funds, 2015-2016's bout of industrial commodity price deflation helped to delay the next Fed rate until December 2016.

Outstandings of Baa-Rated Bonds Establish a New Zenith

Baa-grade bonds represent investment-grade's lowest broad rating category. As of 2018's third quarter, the outstandings of Baa-rated U.S. corporate bonds rose to a record high $2.83 trillion, which exceeded the $2.62 trillion of outstanding single-A corporates and the $629 billion of outstanding bonds graded either Aaa or Aa. Thus, from the perspective of dollar amounts outstanding, the U.S. investment-grade corporate bond market is now riskier than it was prior to each recession since 1981 and possibly all prior downturns through the late 1940s.
Some credit market analysts have voiced concern over a possible future deterioration in the credit quality of Baa-grade companies. They fear that the next material contraction by corporate earnings may precipitate a record amount of fallen-angel downgrades, or downgrades from the bottom rungs of the investment-grade credit rating’s ladder to high yield.

In turn, the high-yield bond market may need to contend with a large, fallen-angel driven jump in the amount of outstanding speculative-grade bonds exactly when a shrinkage of corporate earnings is likely to drive the high-yield default rate skyward. The combination of a sudden expansion of outstanding high-yield bonds and a fast rising default rate would swell Baa and high-yield corporate credit spreads. In all likelihood, systemic liquidity would be greatly diminished and a credit crunch would ensue.

Record Amount of Baa-Grade Bonds May Presage Record Amount of Fallen-Angel Downgrades

Figure 1: Record High $2.83 Trillion of Outstanding Baa-Grade US Corporate Bonds Leads All Other Broad Rating Categories

Figure 2: Deeper Than 5% Drops by Core Profits from Prior High Led to an Average Peak of 10% for the High-Yield Default Rate

sources: NBER, Moody’s Analytics

High-Yield US Corporate Bonds Outstanding
Single-A US Corporate Bonds Outstanding
Baa US Corporate Bonds Outstanding

Recessions are shaded
High Yield Default Rate: %, actual & predicted (L)
Pretax Core Profits: % dif. from prior peak, U.S. nonfin. corp., yearlong (R)

sources: Moody’s Investors Service, BEA, Moody’s Analytics

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At a minimum, the FOMC should take every precaution with its ongoing firming of monetary policy so as to not risk a slowdown by domestic expenditures that is capable of shrinking profits by enough to significantly boost corporate debt repayment problems.

**Lowest Rung of the Investment-Grade Rating’s Ladder Sets a Record High**
From 2007’s final quarter to 2018’s third quarter, the outstandings of U.S. Baa-grade corporate bonds increased as follows in order of declining credit standing: Baa1 soared by 269% from $321 billion to $1,186 billion; Baa2 ballooned by 146% from $381 billion to $937 billion; and Baa3 (the bottom rung of the investment-grade ratings ladder) swelled by 140% from $294 billion to an unprecedented $705 billion. The outstandings of Baa1 corporate bonds crested in 2017’s third quarter at $1.24 trillion, while the outstandings of Baa2 corporates topped off in 2015’s first quarter at $1.03 trillion.

Also, from 2007’s fourth-quarter to 2018’s third quarter, the outstandings of U.S. high-yield corporate bonds posted the following cumulative percent changes in order of declining credit standing: Ba advanced by 72% from $348 billion to $599 billion; single-B increased by 27% from $353 billion to $447 billion; and Caa dipped by 8% from $194 billion to $179 billion.

**Outstanding Baa3-Grade Bonds Reach Record High 56.8% of Outstanding High-Yield Bonds**
All else the same, investment-grade bonds rated Baa3 are at the greatest risk of incurring a fallen-angel downgrade. Not only are the outstandings of Baa3-grade bonds at a record high, they also approximate an unprecedented 56.8% of high-yield U.S. corporate bonds outstanding. The ratio of outstanding Baa3-grade to outstanding high-yield bonds was significantly lower prior to the last three recessions. More specifically, the ratios were 32.5% prior to the Great Recession, 36.9% prior to 2001’s slump, and just 22.2% at the onset of 1990-1991’s downturn.
In summary, the now record high ratio of Baa3 bonds outstanding to high-yield bonds outstanding warns of a potentially very disruptive surge in fallen-angel downgrades once the next deep and prolonged contraction by profits arrives. As a result, earnings-sensitive securities may respond more adversely to higher interest rates compared to the past. This heightened sensitivity to benchmark borrowing costs suggests that short- and long-term interest rates will peak at levels that are less than current consensus forecasts.
The week ahead – U.S., Europe, Asia-Pacific

The U.S.
By Ryan Sweet, Moody’s Analytics

So Far a Smooth Transition for the U.S. Consumer

The strength of the labor market is helping U.S. consumer spending transition fairly smoothly from a tax cut-induced sugar high into a more modest pace of growth in consumption. Retail sales rose 0.8% in October, better than we and the consensus anticipated.

Autos and gasoline provided a boost to sales, with the latter mostly attributed to higher prices at the pump. The key group is control retail sales—or total sales excluding autos, gasoline, building materials and restaurants—which rose 0.3% for the second consecutive month. Control retail sales in October were up 2% annualized over the prior three months. Given retail sales and consumer prices, we look for real consumer spending to have risen 0.3% in October.

There appears to be a little hurricane effect on October retail sales, as sales at building material stores were up 1%. Nonstore retail sales were a little soft in October, rising 0.4%. This comes on the heels of a 1.3% gain in August. Retail sales at restaurants slipped 0.2% in October, the third consecutive monthly decline.

Some of the recent weakness could be attributed to the hurricanes, which normally weigh on restaurants. We believe that the fading impact from the lower personal income taxes is also weighing on retail sales at restaurants. The tax cuts initially provided a big boost to spending at restaurants and they remain above their pre-tax cut trend, suggesting further payback is likely.

The new data on consumer prices were in line with our expectation and left our subjective odds for a December rate hike by the Fed at 90%. On net, the incoming data were a little unkind for GDP. Retail sales and business inventories reduced our tracking estimates for both third and fourth quarter GDP. Business inventories rose 0.3% in September, in line with our and consensus expectations. The new data put the inventory build in the third quarter around $82 billion at an annualized rate. Revisions to retail sales were unfavorable but not enough to move the needle on our estimate of third quarter real consumer spending growth, which remains at 3.9% at an annualized rate.

Our high-frequency GDP model’s estimate of fourth quarter GDP growth fell from 2.9% to 2.8% at an annualized rate. October retail sales suggest that real consumer spending this quarter will rise 2.7% at
an annualized rate. There were a few other tweaks. The increase in October retail sales at building material stores raised our tracking estimate for real residential investment this quarter from -1.7% to 1% at an annualized rate. The inventory build this quarter looks to be coming in a touch more than previously thought but net exports are now on track to be a larger drag.

The focus for the coming week will be on housing, with new data on housing starts, builder sentiment and existing-home sales. Durable goods orders will also be closely watched, particularly core capital goods orders, a proxy for capital spending. Economic data aside, we will be keeping an eye on oil prices.

It’s difficult to trace all the effects of lower oil prices on U.S. GDP, but there are two clear areas: consumer spending and business investment. Tacking on Monday’s slide, lower oil prices should boost consumer spending by $17 billion to $22 billion over the next year. This isn’t enormous, but it comes as the support from the personal income tax cuts is beginning to fade.

Business investment could be dented by lower oil prices. WTI prices typically lead U.S. active rotary rig counts by two to three months. We built a simple rig counts model for the fourth quarter based on global oil prices. The results showed that counts would average 1,261 in the final three months of this year compared with 1,228 in the third quarter. Rig counts feed into GDP via private fixed investment in mining exploration, shafts and wells. If our estimate is correct, real private fixed structures investment in mining exploration and wells will be roughly neutral for growth this quarter but will be a bigger drag on business investment in early 2019.

Energy has played an important role in boosting nonresidential structures investment ever since the corporate tax cuts were passed. About 80% of the increase in nonresidential structures has been in mining exploration, shafts and wells, and this was more attributable to higher global oil prices leading to an increase in the number of domestic active rotary rigs than to the tax legislation. Assuming the decline in oil prices is sustained, energy will shift from a support to drag on nonresidential structures investment, offsetting some of the boost to GDP from an increase in consumer spending.

The bigger question is how the Federal Reserve views the decline in oil prices. The impact on GDP growth appears to be a small positive, which would argue for the central bank to keep pressing ahead with its plans to gradually raise interest rates. However, lower oil prices coupled with the appreciation in the U.S. dollar is disinflationary. For now, we believe the Fed will view the swings in oil prices as having a transitory effect on inflation and will look through a few months of weaker inflation as long as it can be blamed on oil.

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

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<td>Permits</td>
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<td>Excluding Transportation</td>
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<td>Conference Board Leading Indicators for October</td>
<td>% change</td>
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EUROPE
By Barbara Teixeira Araujo of the Europe staff of Moody’s Analytics in London and Prague

Germany's GDP Likely Took a Q3 Hit

The week ahead will be extremely boring on the data front. The main piece of news will be the second estimate of Germany’s third-quarter GDP growth. We expect it will confirm that the country’s economy fared incredibly badly in the three months to September, with output contracting for the first time since the beginning of 2015. The yearly rate should also be confirmed at a meagre 1.1%, down from 2% in the previous quarter and well below the peak of 2.8% reached at the end of 2017.

Markets will be nonetheless watching closely for the release of the breakdown details. We expect them to show that behind this less than stellar result was mainly weakness in net exports, due notably to a sharp drop in exports. Brexit, the trade war between China and the U.S., the slowdown in global demand, and volatility in emerging markets are all weighting on the performance of German exporters, though base effects following an extremely solid end of 2017 have always warned of a drop in the contribution of foreign trade to growth this year.

Domestic demand, meanwhile, is expected to have been uneven during the quarter. The key downside surprise should have come from consumer spending, notably as Destatis said that consumption contracted during the quarter. This doesn’t chime in with monthly retail sales figures or with the momentum we have observed in employment and wage growth, so our guess is that this was mainly due to sharp drop in car sales in September. In any case, our view is that fundamentals remain extremely favourable for German consumers, which would imply a sharp rebound in the fourth stanza.

By contrast, we expect that government expenditure increased slightly, and so did fixed investment. Our view is that construction output rebounded sharply over the quarter, especially as housing investment has room to rise substantially following a slight deceleration since the middle of last year.

We warn, nonetheless, against reading too much into the third quarter’s disappointing headline. The result was in large part driven by a plunge in car sales and production. Auto manufacturing has been under strain in the last few months due to new EU regulations on pollution standards, which hurt sales of new models across Europe as automakers struggled to gain regulatory clearance. Production has also taken a hit, as manufacturers said they were facing problems in adapting their production lines to the new standards. A sharp rebound is thus expected in the fourth quarter.

In any case, the German government recently lowered its output forecast for this and next year. The 2018 projection was lowered to 1.8% from 2.3%, while for 2019 the forecast was cut by 0.3 percentage point, also to 1.8%, mainly because of trade tensions and labour force shortages. For now, we haven’t yet downgraded our forecasts, which are for growth of 2% in 2018 and 1.9% in 2019.

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<td>Tues @ 2:00 p.m. Russia: Unemployment for October</td>
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ASIA-PACIFIC
By Katrina Ell and the Asia-Pacific staff of Moody’s Analytics in Sydney

Another Trade Deficit Likely for Japan

Asia’s economic data calendar is quiet. Japan’s trade balance likely remained in deficit in October for a fourth consecutive month. High commodity prices have bloated the import bill, while exports to key markets have been under pressure in recent months. An added drag on the trade balance more recently has come from the string of natural disasters in the third quarter, which caused widespread disruption to exports and manufacturing. Industrial production and machinery orders endured sharp falls in September as a result of the damaging typhoon, earthquake and flooding in various parts of the country.

Japan’s core inflation likely continued to oscillate around 1% y/y in October. We forecast a 0.9% reading, following September’s 1%. Oil prices are the primary upward driver, filtering through to other industries including transport and equipment. The Bank of Japan has reaffirmed that monetary settings will remain ultra-loose for the foreseeable future, a sensible strategy with wages and price growth failing to launch. The next major hurdle for Japan’s economy is the sales tax hike from 8% to 10% scheduled for October 2019.

In Thailand and Taiwan, third quarter GDP growth likely mildly cooled from the second stanza. Thailand endured a surprise contraction in exports in September, the first in 19 months. An added drag came from lower tourist arrivals, mainly from China. A boat capsized in July, killing 50 Chinese visitors and leading some planned tours to be cancelled over safety concerns. Taiwan’s economy moves closely with global production cycles, particularly tech. Global tech demand has passed its peak after a sustained upswing. GDP growth will cool further in the December quarter and in 2019. Moody’s Analytics forecast Taiwan to expand 2.5% in 2019, following an expected 2.8% in 2018.

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<td>-239</td>
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<td>Mon @ Unknown Thailand GDP for Q3</td>
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<td>3</td>
<td>-</td>
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<td>3</td>
<td>-</td>
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<td>3</td>
<td>-</td>
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The $373 billion of Baa-grade bonds offered by U.S. corporations during January-October 2018 sank by 23% year-over-year.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group
November 15, 2018

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

The recent high-yield bond spread of 415 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 202 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 -5.5% for IG and -33.2% for high yield.

The financing of acquisitions and shareholder compensation will stand out among 2016’s uses of funds obtained via bond issues and newly-rated bank loan programs. Companies will resort to acquisitions and divestitures in order to better cope with the U.S.’s subpar recovery. To the degree companies fear significantly higher bond yields, pre-fundings will rise.
The Long View

US ECONOMIC OUTLOOK
The consensus expects that the mid-point for the federal funds rate should finish 2018 at 2.125%. In view of the 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
November 15, 2018

UNITED KINGDOM
As of now the state of affairs in U.K. politics can be described as nothing short of chaotic. True, the prime minister managed to gain cabinet backing for her draft Brexit plan (the backing wasn’t unanimous, but at least she got a majority) on Wednesday night, but Thursday morning brought a wave of resignations, as well as rumors that Theresa May could be facing a leadership challenge in coming weeks. In the spotlight was the resignation of the Brexit secretary, Dominic Raab. Raab, together with MPs from both her party and from the opposition, are now voicing concerns about the deal she obtained, contending it ceded too much sovereignty to Brussels. It looks increasingly likely that the deal could be voted down by Parliament a few weeks from now—that is, if May manages to stay in power until then.

If the deal is voted down, one possibility is that May would step down (or be ousted) and a new Conservative leader would take her place. More likely than not, this new prime minister would want to renegotiate the withdrawal agreement with the European Union. But we don’t see how he or she would get more from the EU than May already did (notably considering the thorny issue of the Northern Ireland backstop). This prolonged uncertainty and further clashes would likely cause chaos in markets, weighing on the currency and on sentiment. It would make a no-deal Brexit by March more likely, though one way out would be that scared MPs would simply put the same deal back to a vote again, and pass it.

Another possibility is that the Conservative party doesn’t agree on a new leader, leading to snap elections. Polls show that the Labour party is likely to win such a vote. Either Labour could campaign to hold a new referendum, so as to avoid Brexit, or it would try to negotiate another deal. The latter option would call for a lot of flexibility from the EU side, and likely for an extension of Article 50. It is unclear, though, how much more effort the EU will be willing to put into the negotiations of a new deal. But if a new referendum is held, recent polls clearly suggest that the U.K. people would likely vote to stay. This scenario would be positive for the pound and for business.

One way out for May would be for her to survive a leadership challenge. This would embolden her position, and in this case we see Parliament passing the deal. Otherwise, we think that there is just too much opposition for her to manage to sell her deal to a majority, especially since Labour and the Democratic Unionist Party have already announced they are unlikely to vote for it.

Good news and bad news on employment front
On the employment front in the U.K., the September labour report was similar to the August one in bringing both good and bad news. On the positive side, real pay growth accelerated over the month, giving households a breather following several months of unimpressive gains. But on the downside, we saw evidence that job growth is losing considerable ground, corroborating the downbeat story from leading surveys that employment intentions have deteriorated lately. Accordingly, the details showed that while employment did rise in the three months to September, the pace of the quarterly increase was only a third of that observed since the start of 2017. What’s more, the number of unemployed added 21,000 over the quarter, pushing the unemployment rate up by 0.1 percentage point to 4%. Adding to the woes is that the number of inactive people rose for the second consecutive stanza, which is not at all what we would expect from a tight labour market.

This should ensure that wages won’t pick up much further this year. Granted, we welcomed the fact that the three-month-on-three-month regular wage growth headline jumped to its joint highest in almost 10 years in the September quarter. But that jump was expected, because 1.3 million NHS employees received a planned pay raise of 3% in July. The single-month figures were considerably less optimistic, showing that wage growth decelerated
The Long View

(both including and excluding bonuses) in September, while the annualized monthly increase—a measure often cited by the Bank of England—cooled to its slowest since April.

It’s not all doom and gloom. The recent downtick in inflation combined with the acceleration in wages allowed for real regular wages to rise their sharpest since November 2016. This should offer some respite for consumers, though spending shouldn’t increase much in the second half of this year given the dwindling housing market, the still-subdued confidence levels, and the recent pickup in savings intentions. Our base case scenario is that headline wage growth (including bonuses) will average 2.8% over the year as a whole, up from 2.3% in 2017 but still below the Bank of England’s forecast of 3%.

ASIA PACIFIC
By Vaesna Kong of Moody’s Analytics
November 15, 2018

PHILIPPINES
It has not been a strong six months for the Philippines’ economy. Having started the year with a 6.6% y/y expansion in the first quarter, GDP growth has since slowed noticeably, falling to 6.1% in its latest reading. By expenditure, the slowdown was led by weaker private consumption, which grew by a four-year low of 5.2% y/y. Investment growth also slowed, albeit still in the double digits. However, far and away the biggest drag on growth was net exports, which subtracted 4.1 percentage points from GDP growth. Although exports were up a strong 14.3%, imports increased by even more, contributing to widening of the trade deficit from the prior quarter.

The relatively soft GDP reading was not all that surprising. Imports are surging on the back of President Rodrigo Duterte’s large infrastructure development program, which is driving up demand for imported capital goods. Growth in the Philippines has long been undermined by poor infrastructure, as chronic congestion and logistics issues limit the country’s productive capacity. The Duterte administration aims to lift infrastructure spending to 7.4% of GDP by 2022 from less than 3% under prior administrations. But while the big increase in infrastructure development should leave the Philippines in a good position to take advantage of its favourable demographics, it is also putting pressure on the current account balance.

Merchandise trade deficit
Imports of capital goods have been surging, and on a 12-month rolling sum basis, imports of goods such as construction machinery increased 15.8% y/y in August. This has contributed to a widening merchandise trade deficit, which has increased to US$39 billion (12-month rolling sum). The current account deficit increased to 1.9% of GDP in the first half of 2018, up from 0.7% in 2017.

One result of the weakening external accounts is the falling peso, which has depreciated 5.5% year to date against the dollar, making it one of Asia’s worst-performing currencies this year. Although a weaker peso may be helping to prop up exports, it is also making imports more expensive and is contributing to a significant pickup in price pressures. Headline inflation stayed at 6.7% y/y in October, close to a decade high and well above the central bank’s 2%-to-4% inflation target range.

Accelerating inflation
Beyond the weaker peso, the acceleration in inflation has also been driven by higher food prices, which have been affected by adverse weather conditions. Higher oil prices have also played a role, as has an increase in excise taxes such as for tobacco and alcohol. However, we expect price pressures to gradually ease in 2019, as food supply improves and the transitory impact of the tax increases fades. Rate hikes this year by Bangko Sentral ng Pilipinas should also help to tame inflation.

Notwithstanding this period of slower growth, which we expect to persist in the near term as imports remain strong and the combination of higher inflation, taxes and interest rates undermines consumer spending, we expect the Philippines to remain a standout growth performer in coming years. The economy still benefits from one of the youngest populations in the region, as well as steady inflows of overseas worker remittances and a strong business outsourcing processing industry. Investment is also poised to remain strong due to the ramp-up in infrastructure development. Provided that overheating risks are contained, GDP is projected to grow at a strong 6% to 7% pace over the next few years.
Ratings Round-Up

U.S. Rating Change Activity Improved

By Michael Ferlez

Rating change activity in the U.S. improved last week, with positive rating changes accounting for 60% of total activity. Rating activity was concentrated in the industrial sector and spread over numerous industries. On the upgrade side, Amazon’s senior unsecured debt was upgraded to A3 from Baa1, impacting just over $25 billion of debt. The upgrade reflects recent improvements in the online retailer’s operating performance. B&G Foods Inc. was the other notable upgrade. The food distributor’s senior secured rating was upgraded one notch to Ba1, impacting $1.6 billion in debt. Last week’s improved rating performance is indicative of the broader positive trend in U.S. rating activity being driven by strong economic growth and corporate tax cuts.

European ratings change activity remained strong last week, with upgrades accounting for the majority of rating changes. Companies in the U.K. and Ireland combined for four of the seven rating changes. While the combined rating change activity in Ireland and the U.K. was split, downgrades impacted a larger amount of debt. Notable upgrades included, Irish Avolon Holdings Limited, which was upgraded one notch to Ba2. Meanwhile, Jaguar Land Rover Automotive PLC was downgraded to Ba3 from Ba2, reflecting the firm’s weak operating performance.
## FIGURE 2
### Rating Key

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>BCF</td>
<td>Bank Credit Facility Rating</td>
</tr>
<tr>
<td>CFR</td>
<td>Corporate Family Rating</td>
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<tr>
<td>CP</td>
<td>Commercial Paper Rating</td>
</tr>
<tr>
<td>FSR</td>
<td>Bank Financial Strength Rating</td>
</tr>
<tr>
<td>IR</td>
<td>Issuer Rating</td>
</tr>
<tr>
<td>JrSub</td>
<td>Junior Subordinated Rating</td>
</tr>
<tr>
<td>LGD</td>
<td>Loss Given Default Rating</td>
</tr>
<tr>
<td>LTCF</td>
<td>Long-Term Corporate Family Rating</td>
</tr>
<tr>
<td>LTD</td>
<td>Long-Term Deposit Rating</td>
</tr>
<tr>
<td>LTIR</td>
<td>Long-Term Issuer Rating</td>
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<tr>
<td>MM</td>
<td>Money-Market</td>
</tr>
<tr>
<td>MTN</td>
<td>MTN Program Rating</td>
</tr>
<tr>
<td>Notes</td>
<td>Notes</td>
</tr>
<tr>
<td>PDR</td>
<td>Probability of Default Rating</td>
</tr>
<tr>
<td>PS</td>
<td>Preferred Stock Rating</td>
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<tr>
<td>SGLR</td>
<td>Speculative-Grade Liquidity Rating</td>
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<tr>
<td>SLTD</td>
<td>Short- and Long-Term Deposit Rating</td>
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<tr>
<td>SrSec</td>
<td>Senior Secured Rating</td>
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<tr>
<td>SrUnsec</td>
<td>Senior Unsecured Rating</td>
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<td>SrSub</td>
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<td>STD</td>
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## FIGURE 3
### Rating Changes: Corporate & Financial Institutions – US

<table>
<thead>
<tr>
<th>Date</th>
<th>Company</th>
<th>Sector</th>
<th>Rating</th>
<th>Amount ($ Million)</th>
<th>Up/Down</th>
<th>Old LTD Rating</th>
<th>New LTD Rating</th>
<th>Old LGD</th>
<th>New LGD</th>
<th>IG/SG</th>
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<tbody>
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<td>11/7/18</td>
<td>TRINITY INDUSTRIES, INC.</td>
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<td>Ba2</td>
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<td></td>
<td>SG</td>
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<td>11/7/18</td>
<td>B&amp;G FOODS, INC.</td>
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<td>U</td>
<td>Ba2</td>
<td>Ba1</td>
<td>LGD-5</td>
<td>LGD-4</td>
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<td>11/7/18</td>
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<td>D</td>
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<td>Caa2</td>
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<td></td>
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<td>B2</td>
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<td></td>
<td>SG</td>
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<tr>
<td>11/9/18</td>
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<td>Industrial</td>
<td>SrUnsec</td>
<td>350</td>
<td>U</td>
<td>Ba3</td>
<td>Ba2</td>
<td></td>
<td></td>
<td>SG</td>
</tr>
<tr>
<td>11/9/18</td>
<td>FULLBEAUTY BRANDS HOLDINGS CORP.</td>
<td>Industrial</td>
<td>LTCFR/PDR</td>
<td>D</td>
<td>Ca</td>
<td>C</td>
<td>SG</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>11/12/18</td>
<td>SEMINOLE HARD ROCK ENTERTAINMENT, INC.</td>
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<td>LTCFR/PDR</td>
<td>U</td>
<td>B1</td>
<td>Ba2</td>
<td>SG</td>
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<td></td>
<td></td>
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<tr>
<td>11/13/18</td>
<td>PIONEER ENERGY SERVICES CORP.</td>
<td>Industrial</td>
<td>SrUnsec/SrSec/BCF/LTCFR/PDR</td>
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<td>U</td>
<td>Caa3</td>
<td>Caa2</td>
<td>SG</td>
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Source: Moody’s
### Rating Changes: Corporate & Financial Institutions – Europe

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<th>Sector</th>
<th>Rating</th>
<th>Amount ($ Million)</th>
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<th>New LTD Rating</th>
<th>IG/SG</th>
<th>Country</th>
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<td>11/7/18</td>
<td>AVOLON HOLDINGS LIMITED</td>
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<td>SrUnsec/SrSec</td>
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<td>U</td>
<td>Ba3</td>
<td>Ba2</td>
<td>SG</td>
<td>IRELAND</td>
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<tr>
<td>11/8/18</td>
<td>JOHNSON CONTROLS INTERNATIONAL PLC</td>
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<td>SrUnsec/BCF</td>
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<td>Baa2</td>
<td>IG</td>
<td>IRELAND</td>
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<td>11/12/18</td>
<td>SKF AB</td>
<td>Industrial</td>
<td>SrUnsec</td>
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<td>U</td>
<td>Baa2</td>
<td>Baa1</td>
<td>IG</td>
<td>SWEDEN</td>
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<td>TATA MOTORS LIMITED -JAGUAR LAND ROVER AUTOMOTIVE PLC</td>
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<td>D</td>
<td>Ba2</td>
<td>Ba3</td>
<td>SG</td>
<td>UNITED KINGDOM</td>
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</tbody>
</table>

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 (November 7, 2018 – November 14, 2018)

<table>
<thead>
<tr>
<th>CDS Implied Rating Rises</th>
<th>CDS Implied Ratings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issuer</td>
<td>Nov. 14</td>
</tr>
<tr>
<td>Toyota Motor Credit Corporation</td>
<td>Aa2</td>
</tr>
<tr>
<td>American Express Credit Corporation</td>
<td>Aa2</td>
</tr>
<tr>
<td>Walt Disney Company (The)</td>
<td>Aa1</td>
</tr>
<tr>
<td>United Technologies Corporation</td>
<td>Aa2</td>
</tr>
<tr>
<td>UnitedHealth Group Incorporated</td>
<td>Aa1</td>
</tr>
<tr>
<td>Chevron Corporation</td>
<td>Aa1</td>
</tr>
<tr>
<td>Merck &amp; Co., Inc.</td>
<td>Aa1</td>
</tr>
<tr>
<td>United Parcel Service, Inc.</td>
<td>Aa1</td>
</tr>
<tr>
<td>Abbott Laboratories</td>
<td>Aa2</td>
</tr>
<tr>
<td>Eli Lilly and Company</td>
<td>Aa1</td>
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</table>

<table>
<thead>
<tr>
<th>CDS Implied Rating Declines</th>
<th>CDS Implied Ratings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issuer</td>
<td>Nov. 14</td>
</tr>
<tr>
<td>Reynolds American Inc.</td>
<td>Baa2</td>
</tr>
<tr>
<td>Rite Aid Corporation</td>
<td>C</td>
</tr>
<tr>
<td>Bank of America Corporation</td>
<td>A3</td>
</tr>
<tr>
<td>Ally Financial Inc.</td>
<td>Ba2</td>
</tr>
<tr>
<td>Ford Motor Credit Company LLC</td>
<td>Ba3</td>
</tr>
<tr>
<td>Comcast Corporation</td>
<td>A3</td>
</tr>
<tr>
<td>Caterpillar Financial Services Corporation</td>
<td>Baa1</td>
</tr>
<tr>
<td>International Business Machines Corporation</td>
<td>Baa1</td>
</tr>
<tr>
<td>General Electric Company</td>
<td>Ba3</td>
</tr>
<tr>
<td>General Motors Company</td>
<td>Ba2</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>CDS Spread Increases</th>
<th>CDS Spreads</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issuer</td>
<td>Senior Ratings</td>
</tr>
<tr>
<td>Parker Drilling Company</td>
<td>Caa2</td>
</tr>
<tr>
<td>Weatherford International, LLC (Delaware)</td>
<td>Caa1</td>
</tr>
<tr>
<td>Penney (J.C.) Corporation, Inc.</td>
<td>Caa2</td>
</tr>
<tr>
<td>Frontier Communications Corporation</td>
<td>Caa1</td>
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<tr>
<td>Windstream Services, LLC</td>
<td>Caa2</td>
</tr>
<tr>
<td>Rite Aid Corporation</td>
<td>Caa1</td>
</tr>
<tr>
<td>Diamond Offshore Drilling, Inc.</td>
<td>B3</td>
</tr>
<tr>
<td>General Electric Company</td>
<td>Baa1</td>
</tr>
<tr>
<td>Univision Communications Inc.</td>
<td>Caa1</td>
</tr>
<tr>
<td>Neiman Marcus Group LTD LLC</td>
<td>Ca</td>
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</table>

<table>
<thead>
<tr>
<th>CDS Spread Decreases</th>
<th>CDS Spreads</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issuer</td>
<td>Senior Ratings</td>
</tr>
<tr>
<td>Baker Hughes, a GE company, LLC</td>
<td>A3</td>
</tr>
<tr>
<td>Hertz Corporation (The)</td>
<td>B3</td>
</tr>
<tr>
<td>Avis Budget Car Rental, LLC</td>
<td>B1</td>
</tr>
<tr>
<td>Arconic Inc.</td>
<td>Ba2</td>
</tr>
<tr>
<td>Beazer Homes USA, Inc.</td>
<td>B3</td>
</tr>
<tr>
<td>L Brands, Inc.</td>
<td>Ba1</td>
</tr>
<tr>
<td>American Tower Corporation</td>
<td>Baa3</td>
</tr>
<tr>
<td>E.I. du Pont de Nemours and Company</td>
<td>A3</td>
</tr>
<tr>
<td>Dole Food Company, Inc.</td>
<td>B3</td>
</tr>
<tr>
<td>Cablevision Systems Corporation</td>
<td>B3</td>
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Source: Moody’s, CMA
### CDS Implied Rating Rises

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<tr>
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<th>Nov. 7</th>
<th>Senior Ratings</th>
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<tbody>
<tr>
<td>Belgium, Government of</td>
<td>Aaa</td>
<td>Aa3</td>
<td>Aa3</td>
</tr>
<tr>
<td>Banque Federative du Credit Mutuel</td>
<td>Aa1</td>
<td>A1</td>
<td>Aa3</td>
</tr>
<tr>
<td>Natixis</td>
<td>Aa2</td>
<td>A2</td>
<td>A1</td>
</tr>
<tr>
<td>Landesbank Baden-Wuerttemberg</td>
<td>Aa2</td>
<td>A2</td>
<td>Aa2</td>
</tr>
<tr>
<td>Svenska Handelsbanken AB</td>
<td>Aa2</td>
<td>A2</td>
<td>Aa3</td>
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<tr>
<td>ING Bank N.V.</td>
<td>Aa1</td>
<td>A1</td>
<td>Aa3</td>
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<tr>
<td>SEB</td>
<td>Aa2</td>
<td>A2</td>
<td>Aa2</td>
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<tr>
<td>NatWest Markets N.V.</td>
<td>Aa2</td>
<td>A2</td>
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<tr>
<td>Deutsche Telekom AG</td>
<td>Aa1</td>
<td>A1</td>
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<tr>
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### CDS Implied Rating Declines

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<td>Ca</td>
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<td>Caa2</td>
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<td>Boparan Finance plc</td>
<td>Ca</td>
<td>Caa2</td>
<td>Caa1</td>
</tr>
<tr>
<td>Italy, Government of</td>
<td>B2</td>
<td>B1</td>
<td>Baa3</td>
</tr>
<tr>
<td>Lloyds Bank plc</td>
<td>A3</td>
<td>A2</td>
<td>Aa3</td>
</tr>
<tr>
<td>Societe Generale</td>
<td>A3</td>
<td>A2</td>
<td>A1</td>
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<tr>
<td>Barclays plc</td>
<td>Ba1</td>
<td>Baa3</td>
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<td>Banco Santander S.A. (Spain)</td>
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<td>A3</td>
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<td>A1</td>
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<tr>
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<td>B2</td>
<td>B1</td>
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### CDS Spread Increases

<table>
<thead>
<tr>
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<th>Nov. 7</th>
<th>Spread Diff</th>
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<td>Novo Banco, S.A.</td>
<td>Caa2</td>
<td>928</td>
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<td>Boparan Finance plc</td>
<td>Caa1</td>
<td>936</td>
<td>817</td>
<td>119</td>
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<tr>
<td>Jaguar Land Rover Automotive Plc</td>
<td>Ba3</td>
<td>521</td>
<td>462</td>
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<td>PizzaExpress Financing 1 plc</td>
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<td>thyssenkrupp AG</td>
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### CDS Spread Decreases

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<td>Iceland, Government of</td>
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<td>114</td>
<td>119</td>
<td>-4</td>
</tr>
<tr>
<td>Yapı ve Kredi Bankası A.S.</td>
<td>B1</td>
<td>610</td>
<td>615</td>
<td>-4</td>
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<tr>
<td>Bankirier, S.A.</td>
<td>Baa2</td>
<td>81</td>
<td>84</td>
<td>-3</td>
</tr>
<tr>
<td>DZ BANK AG</td>
<td>Aa1</td>
<td>65</td>
<td>67</td>
<td>-3</td>
</tr>
<tr>
<td>Nokia Oy</td>
<td>Ba1</td>
<td>72</td>
<td>75</td>
<td>-3</td>
</tr>
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</table>

*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
### FIGURE 7

**Issuance: Corporate & Financial Institutions**

<table>
<thead>
<tr>
<th></th>
<th>USD Denominated</th>
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<th></th>
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<tr>
<td></td>
<td>Investment-Grade</td>
<td>High-Yield</td>
<td>Total*</td>
</tr>
<tr>
<td></td>
<td>Amount $B</td>
<td>Amount $B</td>
<td>Amount $B</td>
</tr>
<tr>
<td>Weekly</td>
<td>31.160</td>
<td>0.770</td>
<td>32.573</td>
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<tr>
<td>Year-to-Date</td>
<td>1,193.398</td>
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<td>1,532.259</td>
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<td></td>
<td><strong>Euro Denominated</strong></td>
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<td></td>
</tr>
<tr>
<td></td>
<td>Investment-Grade</td>
<td>High-Yield</td>
<td>Total*</td>
</tr>
<tr>
<td></td>
<td>Amount $B</td>
<td>Amount $B</td>
<td>Amount $B</td>
</tr>
<tr>
<td>Weekly</td>
<td>14.308</td>
<td>1.849</td>
<td>16.214</td>
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<tr>
<td>Year-to-Date</td>
<td>671.003</td>
<td>84.399</td>
<td>787.357</td>
</tr>
</tbody>
</table>

* Difference represents issuance with pending ratings.

Source: Moody’s/ Dealogic
Moody’s Capital Markets Research recent publications

Gridlock Stills Fiscal Policy and Elevates Fed Policy (Capital Markets Research)
Navigating Choppy Markets: Safety-First Equity Strategies Based on Credit Risk Signals
Net Stock Buybacks and Net Borrowing Have Yet to Alarm (Capital Markets Research)
Financial Liquidity Withstands Equity Volatility for Now (Capital Markets Research)
Stepped Up Use of Loan Debt May Yet Swell Defaults (Capital Markets Research)
Financial Market Volatility May Soon Influence Fed Policy (Capital Markets Research)
Equities Suggest Latest Climb by Treasury Yields Is Excessive (Capital Markets Research)
Profits Determine Effect of High Corporate Debt to GDP Ratio (Capital Markets Research)
Higher Interest Rates Suppress Corporate Borrowing (Capital Markets Research)
Middling Ratio of Net Corporate Debt to GDP Disputes Record Ratio of Corporate Debt to GDP (Capital Markets Research)
There’s No Place Like Home for U.S. Investors (Capital Markets Research)
Significant Differences, Eerie Similarities (Capital Markets Research)
Base Metals Price Slump May Dispute Benign Default Outlook (Capital Markets Research)
Profit Outlook Offsets Record Ratio of Corporate Debt to GDP (Capital Markets Research)
Upon Further Review, Debt to EBITDA Still Falls Short as an Aggregate Predictor (Capital Markets Research)
Base Metals Price Drop Suggests All Is Not Well (Capital Markets Research)
Markets Suggest U.S. Fares Best in a Trade War (Capital Markets Research)
Trade War Will Turn Ugly if Profits Shrink (Capital Markets Research)
Investment-Grade Looks Softer and High-Yield Looks Firmer Compared With Year-End 2007 (Capital Markets Research)
Fewer Defaults Strongly Favor a Higher Equity Market (Capital Markets Research)
Higher Interest Rates Will Be the Source of Their Own Demise (Capital Markets Research)
Low Utilization Rate Favors Profits Growth and Fewer Defaults (Capital Markets Research)
Equities Giveth and Taketh Away from Credit Quality (Capital Markets Research)
M&A both Enhances and Diminishes Corporate Credit Quality (Capital Markets Research)
Loan Default Rate May Approach Bond Default Rate (Capital Markets Research)
Outstandings Now Show Leveraged Loans Topping High-Yield Bonds (Capital Markets Research)
Profits Growth Curbs Defaults (Capital Markets Research)
Debt-to-Profits Outperforms Debt-to-GDP (Capital Markets Research)
Foreign Investors Ease Burden of U.S.’ Elevated Leverage (Capital Markets Research)
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