MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

Moody's Analytics Research

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Baa-Grade Credits Dominate U.S. Investment-Grade Rating Revisions

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.

Baa-Grade Credits Dominate U.S. Investment-Grade Rating Revisions

In 2018's final quarter, the 22 downgrades of U.S. investment-grade companies included nine that were at least partly ascribed to mergers, acquisitions and divestitures and three that were linked to equity buybacks. Only half, or 11, of fourth-quarter 2018's U.S. investment-grade downgrades were primarily driven by worsened operating or market fundamentals.

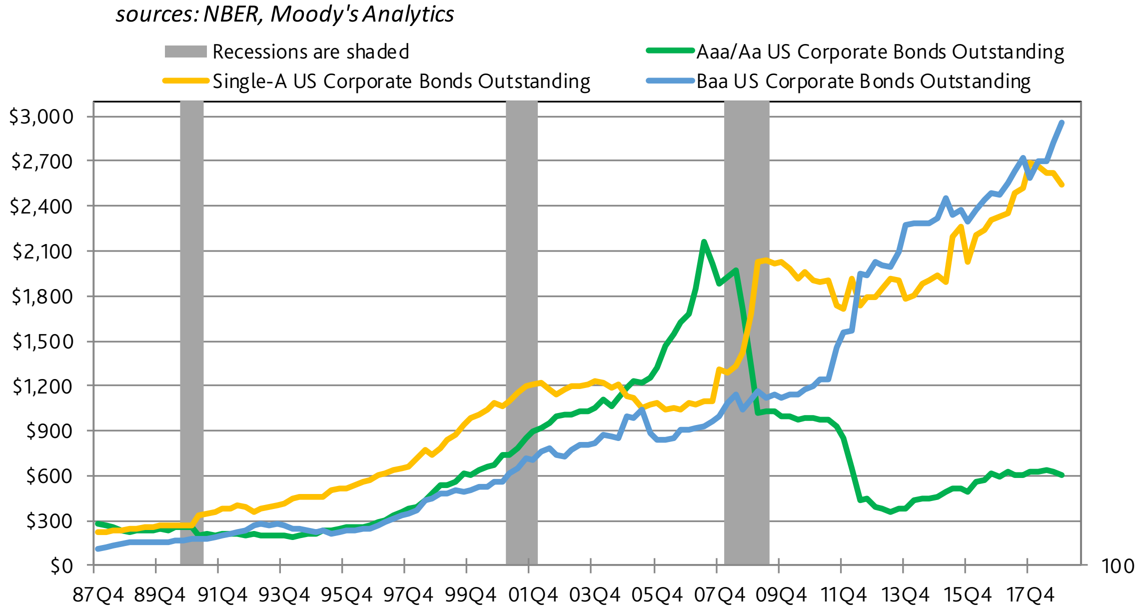
Fifteen of the 22 investment-grade downgrades were from Baa ratings, while six lowered a rating from either A2 or A3 to Baa1. Only one downgrade did not involve the Baa category, that being the downgrade of a global beverage maker from Aa3 to A1.

Baa-grade ratings figured in 88% of 2018's U.S. investment-grade downgrades and 82% of the accompanying upgrades. For 2017's investment-grade rating changes, the Baa rating was mentioned in 77% of the downgrades and 84% of the upgrades.

The frequency with which Baa ratings appear among investment-grade rating revisions should not be a surprise. In terms of dollar amounts of outstanding bonds, year-end 2018 showed the Baa category supplying a record $2.958 trillion, or an unrivaled 48.5% of the $6.106 trillion of investment-grade bonds from U.S. companies. By contrast, during the 10-years-ended 2007, the Baa category's share of outstanding investment-grade corporate bonds did not vary by much from the span's 25.8% average.

Unlike year-end 2018's 14.5% annual increase by the stock of Baa-rated U.S. corporate bonds, the outstandings of single-A U.S. corporates shrank by 5.4% annually, to $2.548 trillion. The outstandings of single-A U.S. corporate bonds peaked at the $2.692 trillion of year-end 2017. Moreover, single-A corporate bond's share of the U.S. investment-grade bond market crested at the 52.7% of June 1995. Mostly because of what proved to be an unsustainably high 46.7% share of bonds graded either Aaa or Aa, the percent of outstanding corporates rated single-A sank to 29.1%, on average, during 2006-2007.

Figure 1: Year-End 2018's Annual Percent Changes for Outstanding U.S. Investment-Grade Corporate Bonds Were -3.7% for Aaa/Aa, -5.4% for Single-A, and +14.5% for Baa
billions
sources: NBER, Moody's Analytics



Credit Markets Review and Outlook

The fourth-quarter's sole fallen-angel downgrade from investment- to speculative-grade affected a Baa3 rating, which is the bottom rung of both the Baa group and all investment-grade rating notches. This company's principal line of business is office imaging products. Five of the final quarter's investment-grade rating reductions lowered the rating to Baa3.

Fourth-quarter 2018's $674 billion of outstanding Baa3-grade bonds was down from the record high $705 billion of the third quarter, but up from the $649 billion of 2017's fourth quarter. The year-over-year increases for outstanding bonds of 2018's final quarter showed the 3.9% rise of the Baa3 group lagging far behind the 27.2% surge by Baa2-grade bonds to a record $1.065 trillion and the 11.2% advance by Baa1-rated bonds to $1.219 trillion.

Only one of the fourth-quarter's 11 investment-grade upgrades was linked to M&A. Seven of the upgrades applied to Baa ratings, wherein four lifted Baa3 ratings. Ten of the 11 investment-grade upgrades were primarily driven by improved fundamentals.

Improved Fundamentals Benefitted 2018's Investment-Grade Rating Changes

Downgrades' share of the number of U.S. investment-grade credit rating revisions barely rose from yearlong 2017's 45% to 2018's 47%. However, when limiting the count to rating changes that are primarily driven by fundamentals, the downgrade ratio fell from 2017's 49% to 2018's 34%. The latter partly reflects an acceleration by the annual growth rate of pretax profits from current production from 2017's 3.2% to 2018's prospective 7.8%. Meanwhile, for those U.S. investment-grade rating revisions that were primarily the offshoot of special events, the downgrade ratio rose from 2017's 55% to 2018's 70%.

For investment-grade rating revisions linked to M&A, the downgrade ratio dipped from 2017's 60% to 2018's 58%. For investment-grade revisions linked to shareholder compensation on the downside and infusions of common equity capital on the upside, the downgrade ratio rose from 2017's 57% to 2018's 83%. Other special-event rating revisions can stem from acts of nature, litigation, and changes in capital structure. Also, a special-event can occur in the context of a rating change that is primarily driven by fundamentals.

Very Low Jobless Rate May Add to Future Default Risk

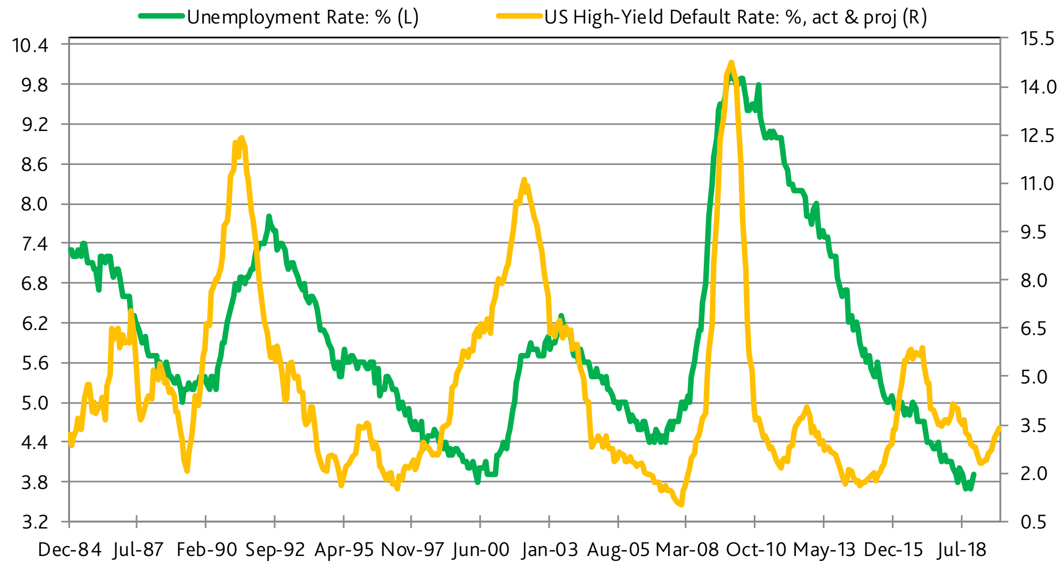
Though it goes largely unmentioned, the corporate credit market may be fearful of a now historically low unemployment rate. Ultra-low unemployment rates have tended to signal a debilitating contraction of profits either because of a largely depleted available supply of qualified labor or a very restrictive monetary policy.

Since year-end 1984, the U.S. high-yield default rate would be greater a year later in 183, or 46.1%, of the sample's 397 months. However, the default rate would be greater a year later for 21, or 84%, of the 25 months showing an unemployment rate of less than 4.3%. For the 25 months coinciding with an extraordinarily low jobless rate, the default rate of 12 months later would be up by 1.8 percentage points, on average.

At the other extreme, for 21, or 91.3%, of the 23 months showing an unemployment rate above 9%, the default rate would be lower 12 months later by 5.4 percentage points, on average.

Credit Markets Review and Outlook

Figure 2: High-Yield Default Rate Was Higher a Year Later in 84% of the Months Showing an Unemployment Rate of Less than 4.3%
sources: Labor Department, Moody's Analytics



Surveyed Economists Differ Radically from Fed Funds Futures on Likelihood of 2019 Rate Hike

Professional forecasters and the futures market are now very far apart when it comes to predicting the likely course of the federal funds rate in 2019. As of early January, merely 4% of the respondents to a Blue Chip survey expected an unchanged federal funds rate throughout 2019. Thus, 96% of the respondents expected at least one rate hike in 2019.

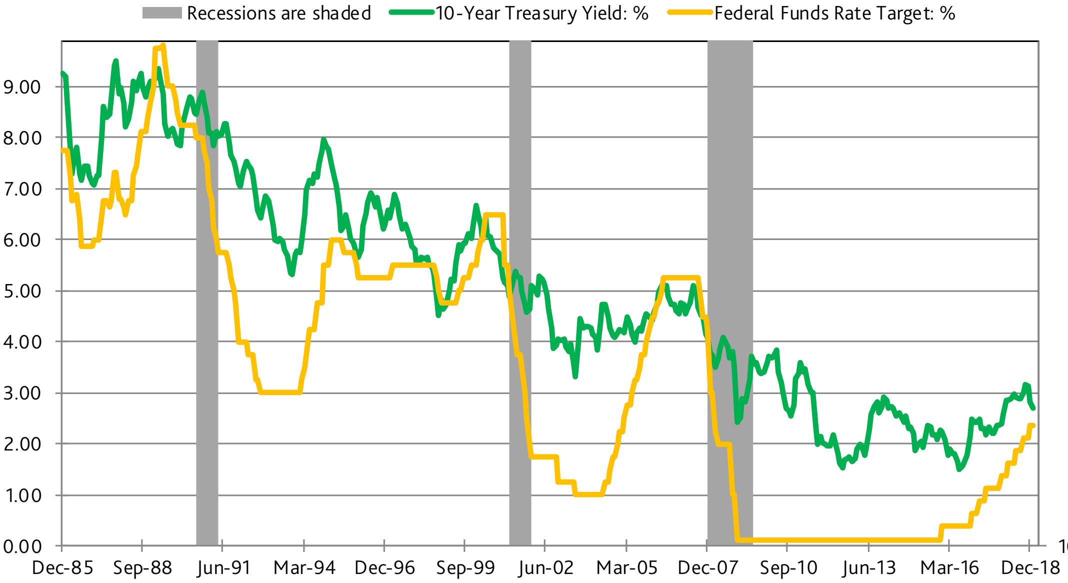
In stark contrast, as inferred from the CME Group's FedWatch Tool, the highest probability now assigned to a greater-than-2.375% midpoint for the federal funds rate at some point in 2019 was recently 19%.

Conceivably, the participants in the Blue Chip survey may not fully appreciate how the latest series of Fed rate hikes differs from previous tightenings. Each of the earlier firmings of monetary policy going back at least 60 years was not accompanied by something akin to the ongoing passive reduction of the Fed's bond holdings that now puts additional upward pressure on interest rates.

In other words, less of an increase in the federal funds rate may be necessary to ward off an inflationary overheating of aggregate expenditures because of the simultaneous upward pressure put on interest rates by the Fed's release of bonds into the publicly-traded credit market.

Given today's two-pronged nature of monetary firming, the current episode of Fed rate hikes may more quickly accomplish its mission of sufficiently cooling business activity.

Figure 3: Recent Slide by 10-Year Treasury Yield Weakens Case for Another Fed Rate Hike
sources: Federal Reserve, NBER, Moody's Analytics



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

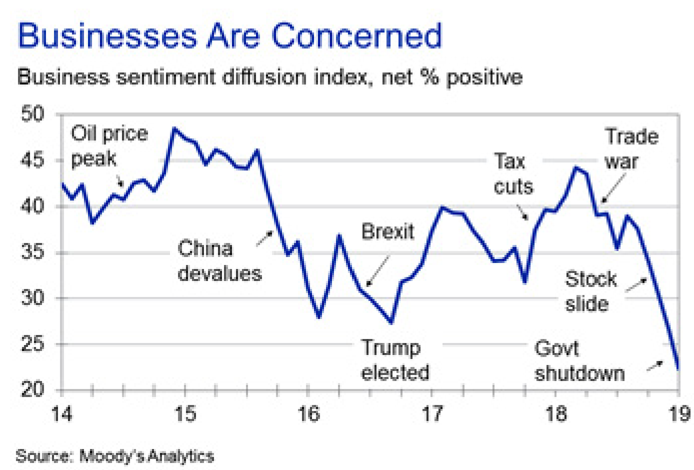
THE U.S.
By Mark Zandi, Moody's Analytics

A Wobbly Start

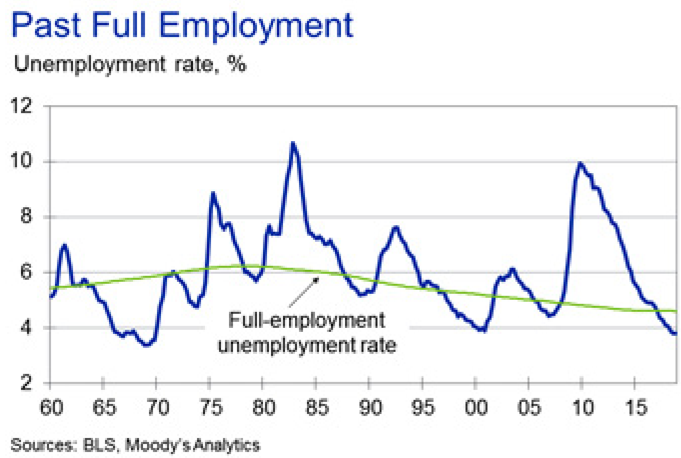
The U.S. economy has gone a bit wobbly at the start of 2019. Just last summer the economy was experiencing some of its strongest growth of the current expansion. The deficit-financed tax cuts had pumped up real GDP growth to an almost 4% annualized pace, and unemployment fell quickly below 4%.

Growth has since throttled back, with real GDP growth tracking closer to 2.5% in last year's final quarter, and there are signs growth may be even softer as this year begins. The economic data fog is thicker than usual, since the government shutdown has shuttered some of the statistical agencies and their data releases. However, private sector reports suggest post-Christmas retail sales have slumped, as have home sales. Business investment has flatlined in recent months, and the trade deficit is widening because of weaker global growth and a stronger U.S. dollar.

Investor and business views of the economic outlook have darkened considerably. At its low point on December 24, the stock market had sold off by 20% from its peak to unofficially mark the end of one of the longest-running bull markets in history. Stock prices have since recovered about half their losses, but investors are seemingly discounting a recession dead ahead. CFOs of major corporations are also worried about a recession, according to a long-running Duke University survey, and our own weekly survey of businesses has fallen sharply in recent weeks.



Most economists, including us, are more sanguine about this year. Growth is slowing, but this has been largely by design. Since the economy is operating well past most estimates of full employment—which we judge would be reflected by a 4.5% unemployment rate—the previously outsize growth reasonably raised concerns the economy might overheat.



The Federal Reserve responded by steadily normalizing rates in an effort to slow the economy's growth closer to its potential, which we put at 2% real GDP growth. Indeed, even now the economy's growth likely remains above its potential.

Who is right, the downbeat investors and businesses or the more upbeat economists? The answer hinges on how events play out in Washington DC in coming months. But that is extraordinarily difficult to handicap.

Government shutdown

The partial shutdown of the federal government is the most pressing concern. Some 800,000 federal workers are not getting paid, and fewer than half of those are working. The jobs of several hundred thousand workers in the private sector who rely on government contracts are likely also being disrupted. The nearly month long shutdown is already the longest in history.

While it is a huge financial hit to the workers not getting paid, so far the shutdown hasn't had a material impact on the broader economy. Much of the shutdown has occurred during the quiet holiday season, and it is only recently that workers missed their first paycheck. The Trump administration is also triaging impacted government operations and restarting activities whose absences threaten to disrupt the economy. Most notable are the IRS paying refund checks and providing tax information necessary for mortgage loans to close, and the Department of Agriculture issuing food stamps. State and local governments have also stepped up to fill some of the void left by federal officials.

Even so, economic damage from the shutdown will soon mount. A wide array of activities that matter to the economy over time are not getting done: The Small Business Administration isn't providing loans to small businesses; the USDA isn't providing financing for farmers; the Securities and Exchange Commission isn't doing the work necessary to allow companies to issue stock and go public; and the Food and Drug Administration has stopped its safety inspections. At some point the federal workers not getting paid but being asked to work may decide not to show up, including TSA agents and air traffic controllers.

Things look bleak given the heated political standoff between President Trump and House Democrats over close to $6 billion in funding for a southern border wall, but we expect a resolution to the impasse in the next few weeks. The personal stories of hardship created by the shutdown will be too much for the president and lawmakers to bear politically. If so, the shutdown will show up in the economic data but not for very long as government workers eventually get their back pay, and other disruptions will be limited.

However, if the shutdown continues for any longer, the broader economy will suffer. If the president and lawmakers haven't figured things out by the end of March, we estimate the shutdown will reduce first-quarter real GDP growth by approximately 0.5 percentage point. Of that, about half will be due to the lost hours of government workers, and the other half to the hit to the rest of the economy. Even this may be optimistic, since we assume the administration keeps triaging government functions. The dark irony is that if the shutdown lasts this long, the dollars and cents cost to the economy will be more than $25 billion. That sum would go a long way toward paying for the border security that many agree is necessary.

Debt limit brinkmanship

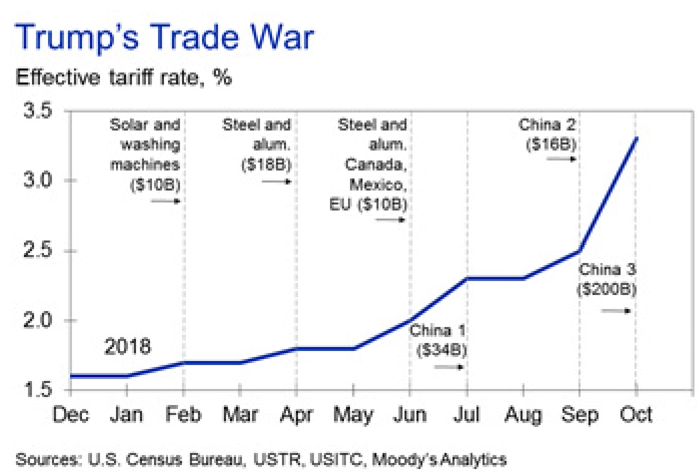
If the shutdown lasts much past March, the economic costs could mushroom as it conflates with other sources of political brinkmanship such as the Treasury debt limit. The debt limit, which sets the legal maximum of outstanding Treasury debt, will be reinstated on March 1. The Treasury will have enough cash to manage around the limit for a while—how long depends on the strength of the April tax filings—but under any scenario it will run out of options by late summer.

Previous brushes with the debt limit, the last one being in 2013, ended just in time with an agreement to increase the limit. The same is widely expected this time around, since the economic consequences of not doing so would be overwhelming. That the U.S. government pays its bills on time, whether that be a payment to a Treasury bond investor or a Social Security recipient, is a bedrock of the global financial system. Missing a payment, even briefly, will cause investors to immediately re-evaluate the safety of a U.S. Treasury bond and demand a higher interest rate to compensate for a risk they had not thought existed. The costs will be enormous and endure for generations.

That said, each brush with the debt limit seems to be further inuring lawmakers and investors to the risks of even engaging in brinkmanship over it. In times past, investors would express their deep angst as the drop-dead date approached, pushing up short-term interest rates and credit default swap spreads on Treasury bonds. This was less so in 2013. And without pressure from investors, some lawmakers seemed less concerned about what would happen on the other side of a missed payment by the U.S. government. This doesn't augur well for later this year when lawmakers and the president must raise the debt limit once again.

Trump trade war

Then there is the trade war. Trump and Chinese President Xi Jinping agreed late last year to a cease-fire to talk things over. The cease-fire means that the current U.S. tariffs on $250 billion in Chinese imports will remain in place, and in exchange, Xi agreed to import more from the U.S.



Higher Chinese tariffs on imports from the U.S., which were put into place in retaliation for the higher U.S. tariffs, will remain in place. The Chinese also agreed to negotiations over intellectual property rights and access to their large market, with a 90-day deadline to show results.

Not much of substance is expected to come out of these negotiations, save for steps the Chinese were likely to take anyway. This won't stop Trump from making some type of deal with the Chinese and declaring victory, as in the recent deal he struck with Canada and Mexico—which adds nothing more than a few tweaks to the existing North American Free Trade Agreement—or last summer's handshake deal with the EU—which has, to date, led to no meaningful change in the U.S. trade relationship with the EU.

If Trump follows the script, we expect—a deal with the Chinese sometime this spring and a de-escalation in the trade war—then our economic outlook will not change appreciably. That is, when push comes to shove, Trump will agree to a face-saving, largely inconsequential trade deal with the Chinese. Getting China to play fairly in the global economy will have to wait for another day and another approach.

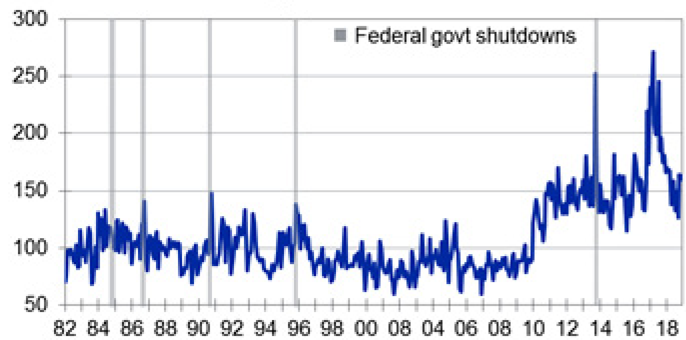
Yet, given the outsize personalities and tricky politics involved, it's not difficult to envisage the talks breaking down. If the negotiations do falter and the trade war re-escalates, the economic outlook will quickly turn darker.

Self-fulfilling prophecy

Ultimately, how much economic damage is wrought by the political maelstrom in Washington will depend on the collective psyche. That psyche is clearly fragile, with the partisan battles top of mind for many. The Philly Fed's measure of partisan conflict—an index of the frequency of newspaper articles reporting political disagreement about government policy normalized by the total number of articles—is elevated.

DC Discord Creates Lots of Angst

Partisan conflict, index avg of 100=1990



Sources: Federal Reserve Bank of Philadelphia, Moody's Analytics

It won't take much more to push on-edge investors and businesses over the brink. Their current seeming pessimism about the economic outlook will be affirmed. The economists are betting (admittedly without a lot of conviction) that the president and lawmakers know and are sensitive to this and will pull back on the brinkmanship before it is too late. It won't take very long to determine who's right.

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

EUROPE

By Barbara Teixeira Araujo of Moody's Analytics in Prague

Brexit Confusion Goes On

The week ahead will be extremely light on the economic data front, but it doesn't matter. We will have our hands full with all the ongoing Brexit confusion in the U.K. This is likely to overshadow even the European Central Bank monetary policy meeting for January. As of now, no one actually knows what lies ahead for the Brexit negotiations. The British parliament voted down Theresa May's withdrawal agreement on Tuesday, but she survived a no-confidence vote on her government Wednesday and held onto power. This means May remains the one person leading the talks with the European Union, and the one expected to deliver on the result of the 2016 referendum.

Accordingly, May is scheduled to present to Parliament some sort of plan B on Brexit this coming Monday, January 21. But it is still uncertain what this plan will consist of. While she could announce that she is heading back to Brussels to try to get new reassurances from the EU regarding the main sticking points of the agreement—notably related to the Northern Ireland backstop—our view is that she has already exhausted all the margin of maneuver she had with the EU. Maybe the EU will be willing to tweak one or two points from the withdrawal deal, but that is unlikely to be sufficient to convince enough MPs to vote with the prime minister, especially given the size of this week's defeat.

One option for May is to hold a series of indicative votes on various options for Brexit over the next week to help break the parliamentary deadlock; the options could be a permanent customs union, a second referendum, a hard Brexit involving a free-trade agreement, a no-deal Brexit and so on. However, we don't know if the prime minister would be open to doing as much, since this could weaken her position, cause rebellion among Tory hardliners, and lead to a likely breakup of the Conservative party.

In any case, what is scheduled is that parliament will have the chance to discuss any plan B on Tuesday, January 29, and vote on a series of amendments to it. Already, MPs have pledged amendments on a second referendum and in opposition to a no-deal Brexit. It is still uncertain if any option will command a majority.

What looks increasingly likely, though, is that the U.K. will need to ask for an extension of the Article 50 deadline to allow for the mess at home to be solved. The good news is that the EU already announced that it is open to an extension of a few months—likely until July—though we think that the British government will have to provide Brussels at least some reassurance that a final plan is in the making.

This would mean, though, that uncertainty for companies and households remains the word of the day, depressing confidence and activity for yet a couple of quarters. The latest data all but show that firms have postponed most major decisions for the time being, depressing investment, and they should continue to do so until they have more clarity on the shape of the U.K.-EU future relationship. The story is similar for consumers, especially regarding home buying decisions. The latest Bank of England Credit Conditions survey showed that demand for new house loans is expected to fall at the fastest pace since 2011 in the first quarter of this year.

In all, we continue to see a permanent customs union as the most likely scenario for the future U.K.-EU relationship. But chances of a new referendum being held and Brexit being cancelled have risen considerably lately, especially given that recent polls show that public support for remaining in the EU has soared lately.

A Norway-style type of Brexit remains less likely than a permanent customs union, unless Labour gets to power. This would be possible only through new elections; these would be called only if the prime minister resigned or if a new no-confidence vote were to oust Theresa May. We don't think either of these options are likely in the coming weeks. Last but not least, our view remains that the chances of a no-deal Brexit are low; no one in the U.K. wants it, and the story is the same in the EU. Politicians on both sides of the Channel will do whatever it takes to prevent a cliff-edge exit.

	Key indicators	Units	Moody's Analytics	Last
Tues @ 9:30 a.m.	U.K.: Unemployment for November	%	4.1	4.1
Thur @ 12:45 p.m.	Euro Zone: Monetary Policy for January	%	0.0	0.0
Fri @ 2:00 p.m.	Russia: Unemployment for December	%	4.9	4.8
Fri @ 5:00 p.m.	France: Job Seekers for December	mil, SA	3.40	3.41

ASIA-PACIFIC

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

China's Economy on an Entrenched Cooling Trend

The last of China's 2018 data will be released. We expect fourth quarter GDP growth printed at 6.5% y/y, unchanged from the third quarter's pace. This will bring full-year growth to 6.6% in 2018, weaker than the 6.8% recorded in 2017, but stronger than the forecast 6.3% for 2019. China's economy is on an entrenched cooling trend amid weaker global conditions alongside softening domestic demand, the latter largely by design. Piecemeal stimulus measures will continue to be released over 2019 to bolster economic conditions, but the response will remain measured compared with prior downturns.

December's activity data dump will continue to show evidence of stimulus in some parts. Monthly fixed asset investment has been the most responsive. We forecast fixed asset investment to improve to 6% y/y YTD in December, continuing to gradually climb from its August slump at 5.3%. Restarting infrastructure investment and reserve requirement ratio cuts are helping to stabilize investment. Elsewhere, industrial production has not been on the same improving trend. Industrial production has tracked manufacturing and manufacturing sentiment lower over the year amid softer conditions in domestic and offshore demand.

South Korea's economy likely rose by 0.5% q/q in the final quarter of 2018, following the third quarter's 0.6%. Annual growth is forecast to slow to 2%, after hitting 2.7% in the third quarter. On an annual basis, we expect a broad-based slowdown with household consumption and exports in particular travelling in a slower lane. With external trade slowing and employment growth staying weak, we expect economic conditions to stay relatively soft into 2019.

GDP growth in the Philippines likely hit 6.8% y/y in the fourth quarter, after slowing to 6.1% in the third. Improvement is expected in private consumption after a slump in the third quarter on higher food prices squashing discretionary spending. Imports of goods also accelerated to double digits, a consequence of the government's large infrastructure spending program. Full-year GDP growth remains on track to expand 6.5% in 2018.

The Week Ahead

	Key indicators	Units	Confidence	Risk	Moody's Analytics	Last
Mon @ 1:00 p.m.	China GDP for Q4	% change yr ago	4	←	6.5	6.5
Mon @ 1:00 p.m.	China Fixed asset investment for December	% change yr ago YTD	3	↓	6.0	5.9
Mon @ 1:00 p.m.	China Industrial production for December	% change yr ago	3	↑	5.6	5.4
Mon @ 1:00 p.m.	China Retail sales for December	% change yr ago	3	↓	8.5	8.1
Tues @ 10:00 a.m.	South Korea GDP for Q4	% change	3	↓	0.5	0.6
Wed @ 8:45 a.m.	New Zealand CPI for Q4	% change	4	←	0.4	0.9
Wed @ 10:50 a.m.	Japan Foreign trade for December	¥ bil	3	←	-210.7	-492.2
Wed @ Unknown	Japan Monetary policy for January	¥ tril	5	←	80	80
Thurs @ 8:45 a.m.	Australia Unemployment rate for December	%	4	←	5.1	5.1
Thurs @ 1:00 p.m.	Philippines GDP for Q4	% change yr ago	2	↓	6.8	6.1
Thurs @ Unknown	South Korea Monetary policy for January	%	3	←	1.5	1.75
Fri @ 8:00 a.m.	South Korea Consumer sentiment index for January	Index	3	←	96.8	97.2

The Long View
January 2019's dollar-denominated high-yield bond issuance is on track to plunge by 68% from January 2018's pace.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group
January 17, 2019

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 144 basis points exceeded its 122-point mean of the two previous economic recoveries. This spread may be no wider than 140 bp by year-end 2019.

The recent high-yield bond spread of 466 bp is thinner that what is suggested by the accompanying long-term Baa industrial company bond yield spread of 230 bp and a VIX of 18.4 points.

DEFAULTS

December 2018's U.S. high-yield default rate of 2.8% was less than the 3.7% of December 2017. Moody's Investors Service now expects the default rate will average 3.3% during 2019's fourth 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.

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.

Fourth-quarter 2018's worldwide offerings of corporate bonds incurred annual setbacks of 23.4% for IG and -75.5% for high-yield, wherein US$-denominated offerings plunged by 26.1% for IG and by 74.1% for high yield.

During yearlong 2017, worldwide corporate bond offerings increased by 4.1% annually (to $2.501 trillion) for IG and advanced by 41.5% for high yield (to $603 billion).

For 2018, worldwide corporate bond offerings sank by 7.2% annually (to $2.322 trillion) for IG and plummeted by 37.6% for high yield (to $376 billion). The projected annual percent changes for 2019's worldwide corporate bond offerings are -0.4% for IG and +1.6% for high yield.

US ECONOMIC OUTLOOK

As inferred from the CME Group's FedWatch Tool, the futures market recently assigned an implied probability of 19% to a year-end 2019 federal funds rate that exceeds its current 2.375%. In view of the underutilization of the world's productive resources, low inflation should help to rein in Treasury bond yields. As long as the global economy operates below trend, the 10-year Treasury yield may not remain above 3% for long. A fundamentally excessive climb by Treasury bond yields and a pronounced slowing by expenditures in dynamic emerging market countries are among the biggest threats to the adequacy of economic growth and credit spreads.

EUROPE

By Barbara Teixeira Araujo and Brendan Meighan of Moody's Analytics
January 17, 2019

UNITED KINGDOM

U.K. Prime Minister Theresa May survived a no-confidence vote Wednesday, reducing the odds that her government will face a general election in coming weeks. Still, there remains considerable uncertainty surrounding Brexit. May still has to break the Brexit deadlock in Parliament and come up with a deal that will satisfy both lawmakers in Europe and the U.K. as well as deliver on the 2016 referendum result.

May will attempt to establish a Brexit outcome that would command the support of a majority of MPs and put a new proposal before Parliament as early as Monday. If approved, May would then take the plan back to Brussels for further negotiations.

U.K. inflation pressures eased further in December, with the CPI up 2.1% on a year-ago basis, compared with 2.3% in November and well below the 3% seen in early 2018. The deceleration in inflation should allow the Bank of England to stand pat even if wage pressures have increased lately. The BoE is in a difficult position. While higher rates are likely warranted now, it would be hard for the central bank to tighten given the political and economic instability; it wouldn't want to kick the economy while it is down.

EURO ZONE

The final report on euro zone December inflation confirmed that the CPI headline cooled sharply over the month—to its lowest since April—raising further questions about the wisdom of the central bank's decision to halt its quantitative easing program at the end of 2018. But we caution against reading too much into December's decline; it was entirely because of an easing in noncore inflation pressures, which were already in the pipeline because of base effects in oil prices. The core rate managed to hold ground, with services and core goods inflation each remaining steady.

True, we had expected that services inflation would accelerate somewhat following a plunge in November, because of seasonal volatility in package holidays and accommodation prices. But we are not sounding any alarms here, as the disappointment came mainly because of a plunge in the volatile transport services headline. Elsewhere, that core goods inflation held ground was expected, though we still see the trend in the sector as being to the upside on the back of the lagged effect of the lower euro.

Regarding the noncore components, the main drag came from another pullback in energy inflation. Base effects in oil prices were always forecast to depress energy inflation in the final quarter of 2018 and into 2019, especially now that Brent prices have fallen to $60 per barrel, the lowest reading in a year.

All in all, then, while December's inflation report makes for a dovish reading, we don't think that markets should worry too much about it. But the truth is that prospects for a rate hike this year have declined sharply, which should make the ECB adopt a more dovish bias.

The Long View

ASIA PACIFIC
By Katrina Ell of Moody's Analytics
January 17, 2018

CHINA
A growing consensus is that a more lasting solution to the U.S.-China trade spat will be reached sooner rather than later. Pressure is building on both sides to make a deal. China is grappling with uncomfortably weak domestic demand as it tries to address the hefty financial risks the economy is carrying. The trade war is undesirable since it is adding to pressure on manufacturers and exporters and hurting broader economic sentiment. Some U.S. firms have felt the brunt of higher tariffs, especially tech firms given the heavy exposure of their supply chains to China; the tariffs are denting profits. A sign of the broader strain has been observed with Chinese and U.S. equity markets being pulled to the downside by the conflict.

We have taken a first look at a handful of likely outcomes from the trade war. For this preliminary assessment, we assume that no further escalation of tariffs occurs and that the existing tariffs are removed over time.

Will China deliver on industrial change?
The Chinese government undoubtedly gives a competitive edge to its own in global and local markets. While most countries provide various forms of direct or indirect protectionism, including subsidies and import taxes, the Trump administration argues that China does this more than most via forced technology transfer, nontariff barriers, and theft of trade secrets. China's economy is large, growing and lucrative, but foreign investors have struggled to reap its benefits and operate on a level playing field.

China has shown willingness to address this area. From January, China gave its supreme court greater powers to handle intellectual property disputes. Under the newly introduced system, appeals around so-called specialized knowledge, including patents and trade secrets, will bypass the provincial courts and go to the supreme court. In the past, the provincial courts have been criticized for favouring local interests and for a lack of consistency in decisions. The idea is that via the supreme court there will be greater transparency and protection of broader intellectual property.

At first glance, this is an important win for the Trump administration, but it's important to remember that copyright and trademark disputes will continue going to the provincial courts, and these make up around 80% of all intellectual property disputes in China, according to the Nikkei Asian Review.

Also, legislation is being drafted to make it more difficult for Chinese firms to ask foreign firms to transfer their technology. This seems another win in theory, but the reality is that China prefers an under-the-radar approach with this sensitive issue. In this way, it's difficult to track enforcement and effectiveness of any newly introduced legislation.

On balance, China likely will give a little ground but won't completely fall in line. The Trump administration likely will take credit for the ground it achieves.

History is a useful guide: The U.S. has a long history of discomfort with China's industrial policies. Back in 1991, the U.S. raised concerns about China's reported flouting of intellectual property rights. From 1991 to 1994, negotiations took place that culminated in China committing to strengthening its enforcement of intellectual property rights and adopting more market-friendly measures. But clearly, the issue remains a concern to present day.

Supply-chain adjustment is critical
China is a global manufacturing hub, but because of rising operating costs firms have adjusted some supply chains to other, lower-cost countries. Economies of scale mean that China will remain a mammoth manufacturing hub for the foreseeable future, but its importance will diminish over time. There's been anecdotal evidence that the trade war brought forward plans to move out of China and into other parts of Asia, notably Southeast Asia, which is desirable for its lower labour costs and proximity to China. Quantifying the extent that this existing trend has accelerated is difficult.

Trade flows can adjust over a relatively short period to avoid tariffs, and countries not involved in the trade dispute are able to gain market share. In theory, when tariffs are removed, it would be assumed that shipments resume as they did prior to the tariffs, but this is not automatically the case. Once market share is lost, it doesn't automatically return.

The U.S. grain embargo on the Soviet Union from 1980 to 1981 is a useful case in point. U.S. President Jimmy Carter in January 1980 cut exports of wheat and corn to the Soviet Union as a political statement after the Soviets entered Afghanistan in 1979. The embargo remained until 1981. Countering the potency of the embargo was that other countries increased their grain exports to the Soviet Union, including Argentina, Brazil, Canada, Europe and Australia.

Total U.S. exports of corn, soybeans and wheat had only minor impacts during the 15-month partial embargo, but the impact was lasting on market share. This is once again an issue, as China has imposed tariffs on a number of U.S. goods imports, including important agriculture products such as soybeans.

Was it worth it?

It's unknown if the bilateral relationship between the world's two largest economies will be permanently damaged. In October, China's Foreign Minister Wang Yi said that "a glass is easily broken, but difficult to repair," talking about China-U.S. relations. Beijing made clear inroads cementing ties with other important trading partners in 2018 and is likely to continue to do so in 2019, particularly as its One Belt One Road program extends its reach. The U.S. may continue to be left out of important global discussions, whether it intends to be or not.

There's no straightforward answer as to whether the trade war is worth it. It's difficult to know if China would have conceded as much as it apparently has so far on its industrial policies had the Trump administration not levelled constant threats of escalating tariffs. Structural change to China's trade practices was a clear objective of the trade war.

But along the way, there have been notable causalities. These have included uncertain trade policy delaying investment decisions; weaker economic sentiment driving more cautious behavior; higher inflation in the U.S., especially of consumer goods, hurting purchasing power; and large U.S. tech firms and others who rely on manufacturing from China enduring higher input costs from the tariffs.

Ratings Round-Up

U.S. Downgrades Outnumber Upgrades

By Michael Ferlez

U.S. rating change activity picked up last week, though the trend remained weak. For the week ending January 15, positive rating changes account for 35% of total changes. Although the number of upgrades were outnumbered by downgrades, they nevertheless accounted for 47% of affected debt. On the downgrade side, PG&E Corporation was downgraded on two separate occasions during the week. The California-based utility's senior unsecured credit rating was first cut from Baa2 to Ba3, then subsequently cut to Caa3. Moody's Investors Service downgraded PG&E to reflect the high likelihood that the utility would file for bankruptcy. The firm's financial position has weakened significantly in recent months as liabilities from the string of California wildfires rose.

Rating change activity in Europe was light. There were only two changes, one upgrade and one downgrade.

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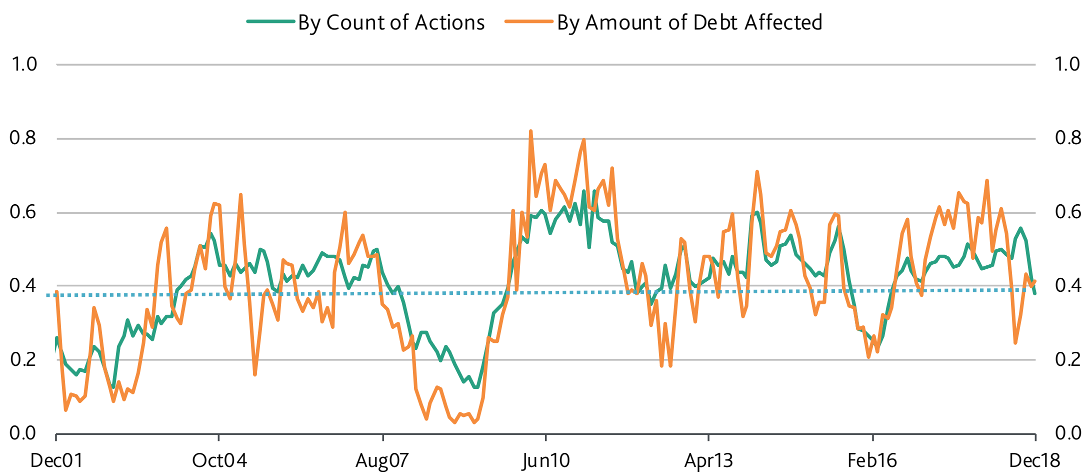
FIGURE 1

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

Ratings Round-Up

FIGURE 3

Rating Changes: Corporate & Financial Institutions – US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG
1/9/19	CARPENTER TECHNOLOGY CORPORATION	Industrial	SrUnsec /LTCFR/PDR	550	U	Ba2	Ba1	SG
1/9/19	HCP, INC.	Industrial	SrUnsec/MTN	5,360	U	Baa2	Baa1	IG
1/9/19	LAGO RESORT & CASINO, LLC	Industrial	SrSec/BCF /LTCFR/PDR		D	Caa3	C	SG
1/10/19	PG&E CORPORATION	Utility	SrUnsec/BCF /LTIR/Sub/PS/CP	17,838	D	Baa2	Ba3	IG
1/10/19	LEGACY RESERVES INC. -LEGACY RESERVES LP	Industrial	SrUnsec /LTCFR/PDR	349	D	Caa3	Ca	SG
1/11/19	VALERO ENERGY CORPORATION -VALERO ENERGY PARTNERS LP	Industrial	SrUnsec	1,000	U	Baa3	Baa2	IG
1/11/19	API HEAT TRANSFER THERMASYS CORPORATION	Industrial	SrSec/BCF /LTCFR/PDR		D	B3	Ca	SG
1/14/19	PG&E CORPORATION	Utility	SrUnsec/BCF /LTIR /LTCFR /Sub/PDR/PS	17,838	D	Ba3	Caa3	SG
1/14/19	METLIFE, INC.	Financial	PS	1,500	U	Baa3	Baa2	IG
1/14/19	CT TECHNOLOGIES INTERMEDIATE HOLDINGS, INC.	Industrial	SrSec/BCF /LTCFR/PDR		U	Caa3	Caa1	SG
1/14/19	CHARLOTTE RUSSE HOLDING, INC. (NEW) -CHARLOTTE RUSSE, INC. (NEW)	Industrial	SrSec/BCF /LTCFR/PDR		D	Caa1	C	SG
1/15/19	STEELCASE INC.	Industrial	SrUnsec	250	U	Baa3	Baa2	IG
1/15/19	CROCKETT COGENERATION, LP	Utility	SrSec	135	D	B1	Caa3	SG
1/15/19	PANOCHE ENERGY CENTER, LLC	Industrial	SrSec	266	D	Baa3	Caa2	IG
1/15/19	KINDER MORGAN, INC. -RUBY PIPELINE, LLC	Industrial	SrUnsec	694	D	Baa3	Ba2	IG
1/15/19	POST HOLDINGS, INC.	Industrial	SrUnsec/SrSec/BCF /LTCFR/PDR	10,775	U	B3	B2	SG
1/15/19	TOPAZ SOLAR FARMS LLC	Industrial	SrSec	1,100	D	Baa2	Caa2	IG
1/15/19	EXGEN RENEWABLES IV, LLC	Industrial	SrSec/BCF		D	Ba2	B2	SG

Source: Moody's

Ratings Round-Up

FIGURE 4
Rating Changes: Corporate & Financial Institutions – Europe

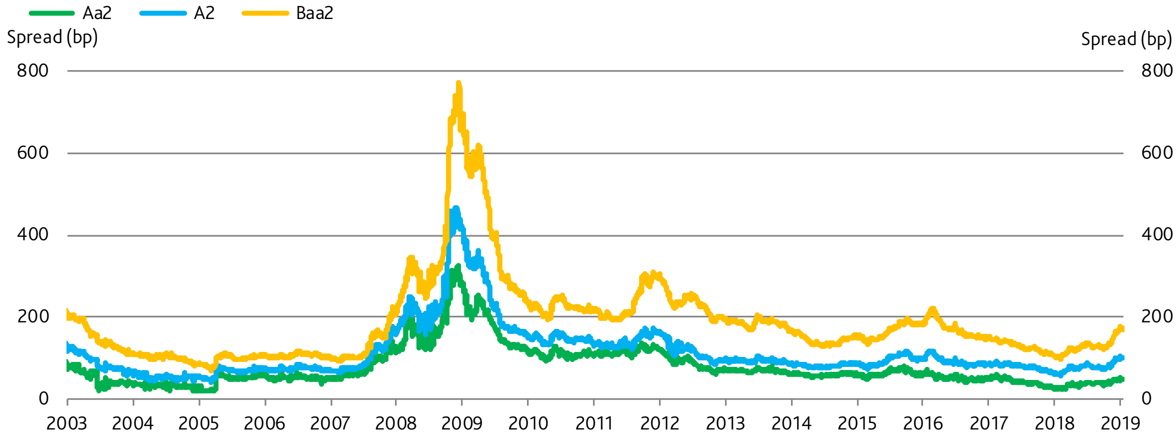
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	Old LGD	New LGD	IG/SG	Country
1/11/19	DEUTSCHE APOTHEKER - UND AERZTEBANK EG	Financial	JrSrUnsec	40	D	A1	A2			IG	GERMANY
1/11/19	TECHNICOLOR S.A.	Industrial	SrSec/BCF/LTCFR /PDR/LGD		D	B1	B2	LGD-3	LGD-4	SG	FRANCE
1/15/19	OP FINANCIAL GROUP-OP INSURANCE LTD	Financial	IFSR		U	A3	A2			IG	FINLAND
1/15/19	PIAGGIO & C. S.P.A.	Industrial	SrUnsec /LTCFR/PDR	287	U	B1	Ba3			SG	ITALY

Source: Moody's

Market Data

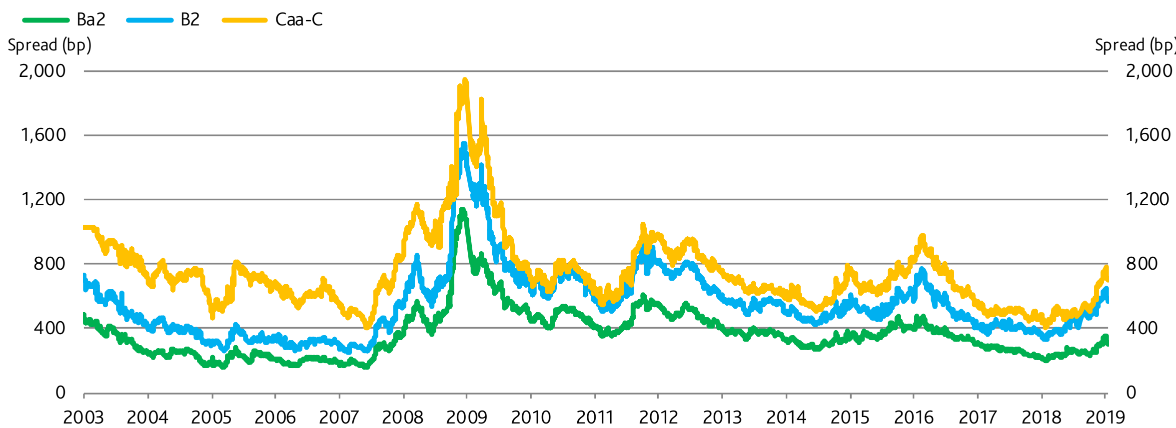
Spreads

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



Source: Moody's

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



Source: Moody's

Market Data

CDS Movers

Figure 3. CDS Movers - US (January 9, 2019 – January 16, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jan. 16	Jan. 9	Senior Ratings
Hertz Corporation (The)	Caa2	Ca	B3
Talen Energy Supply, LLC	Caa1	Caa3	B3
AK Steel Corporation	Caa2	Ca	B3
AT&T Inc.	Baa3	Ba1	Baa2
Philip Morris International Inc.	A2	A3	A2
Dish DBS Corporation	Caa1	Caa2	B1
Kroger Co. (The)	Baa2	Baa3	Baa1
Crown Castle International Corp.	Baa3	Ba1	Baa3
Plains All American Pipeline L.P.	Baa3	Ba1	Ba1
Praxair, Inc.	Aa2	Aa3	A2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jan. 16	Jan. 9	Senior Ratings
Cigna Corporation	A2	Aa2	Baa1
Radian Group Inc.	B2	Ba2	Ba2
MGIC Investment Corporation	B2	Ba2	Ba2
Ford Motor Company	B2	Ba3	Baa3
CSC Holdings, LLC	B2	Ba3	B2
Altria Group Inc.	Baa2	A3	A3
Sprint Communications, Inc.	B3	B1	B3
Xerox Corporation	B3	B1	Ba1
MGM Resorts International	B2	Ba3	Ba3
Exelon Corporation	A1	Aa2	Baa2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jan. 16	Jan. 9	Spread Diff
Penney (J.C.) Corporation, Inc.	Caa2	3,618	3,121	497
Weatherford International, LLC (Delaware)	Caa1	2,100	1,701	399
Windstream Services, LLC	Caa2	3,087	2,873	214
K. Hovnanian Enterprises, Inc.	Caa3	2,639	2,425	214
Frontier Communications Corporation	Caa1	2,440	2,259	181
Neiman Marcus Group LTD LLC	Ca	1,887	1,722	166
Chesapeake Energy Corporation	B3	800	668	133
Dean Foods Company	B3	876	753	124
Rite Aid Corporation	Caa2	1,241	1,140	101
Diamond Offshore Drilling, Inc.	B3	613	526	87

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jan. 16	Jan. 9	Spread Diff
General Electric Company	Baa1	186	202	-17
Arconic Inc.	Ba2	397	411	-15
Baker Hughes, a GE company, LLC	A3	112	123	-10
Talen Energy Supply, LLC	B3	730	737	-7
Meritor, Inc.	B1	302	308	-6
NRG Energy, Inc.	Ba3	135	139	-4
FCA US LLC	Ba2	129	134	-4
Comcast Cable Communications, LLC	A3	42	46	-4
International Game Technology	Ba2	255	259	-4
TRW Automotive Inc.	Baa3	47	51	-4

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (January 9, 2019 – January 16, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jan. 16	Jan. 9	Senior Ratings
Alpha Bank AE	Caa1	Caa3	Caa2
UniCredit Bank Austria AG	Aa3	A2	Baa1
Piraeus Bank S.A.	Caa2	Ca	Caa2
National Bank of Greece S.A.	Caa1	Caa3	Caa2
CMA CGM S.A.	Caa1	Caa3	B3
Novafives S.A.S.	Caa1	Caa3	Caa1
Spain, Government of	Baa1	Baa2	Baa1
Intesa Sanpaolo S.p.A.	Ba1	Ba2	Baa1
Deutsche Bank AG	Ba1	Ba2	A3
UniCredit S.p.A.	Ba1	Ba2	Baa1

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jan. 16	Jan. 9	Senior Ratings
Natixis	A2	Aa2	A1
Nationwide Building Society	Baa1	A2	Aa3
Bank VTB, PJSC	B2	Ba3	Ba1
Unipol Gruppo S.p.A.	B2	Ba3	Ba2
Virgin Media Finance PLC	B2	Ba3	B2
Evraz Group S.A.	B2	Ba3	Ba2
Premier Foods Finance plc	B3	B1	Caa1
Lloyds Bank plc	Baa1	A3	Aa3
Abbey National Treasury Services plc	A3	A2	Aa3
Turkey, Government of	B3	B2	Ba3

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jan. 16	Jan. 9	Spread Diff
Galapagos Holding S.A.	Caa3	6,093	5,429	664
Marks & Spencer p.l.c.	Baa3	221	183	38
Matalan Finance plc	Caa1	948	913	35
Russian Standard Bank	Caa2	1,102	1,068	34
Stena AB	B3	657	624	32
Suedzucker AG	Baa3	165	136	30
NEXT plc	Baa2	158	131	27
CMA CGM S.A.	B3	739	718	20
Metsa Board Corporation	Ba1	106	86	20
Eurobank Ergasias S.A.	Caa2	945	930	15

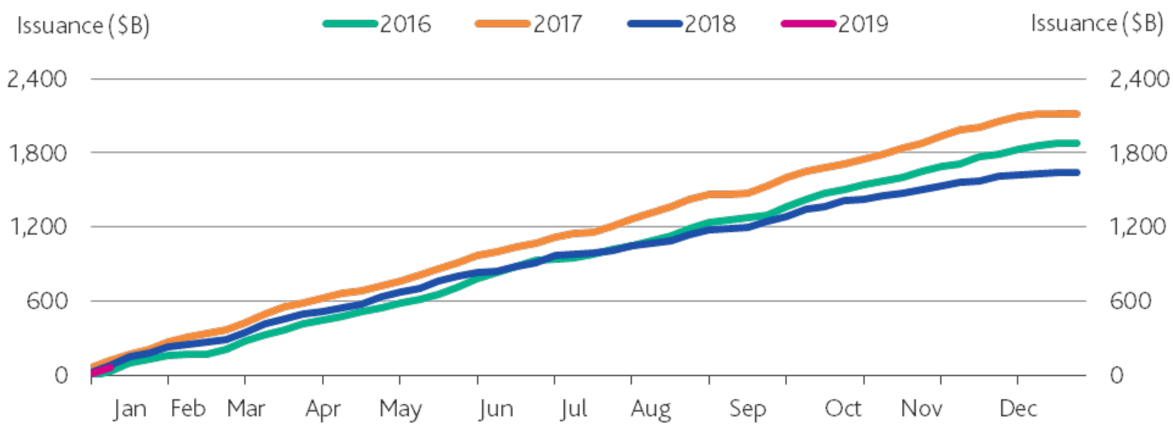
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jan. 16	Jan. 9	Spread Diff
PizzaExpress Financing 1 plc	Caa2	2,696	2,778	-82
Sappi Papier Holding GmbH	Ba2	288	352	-64
Boparan Finance plc	Caa1	1,227	1,273	-46
Care UK Health & Social Care PLC	Caa1	172	205	-33
Turkey, Government of	Ba3	341	366	-25
Intesa Sanpaolo S.p.A.	Baa1	161	179	-18
Akbank TAS	B1	457	473	-17
UniCredit S.p.A.	Baa1	160	175	-16
Banco Sabadell, S.A.	Baa3	118	134	-16
Novo Banco, S.A.	Caa2	964	980	-16

Source: Moody's, CMA

Market Data

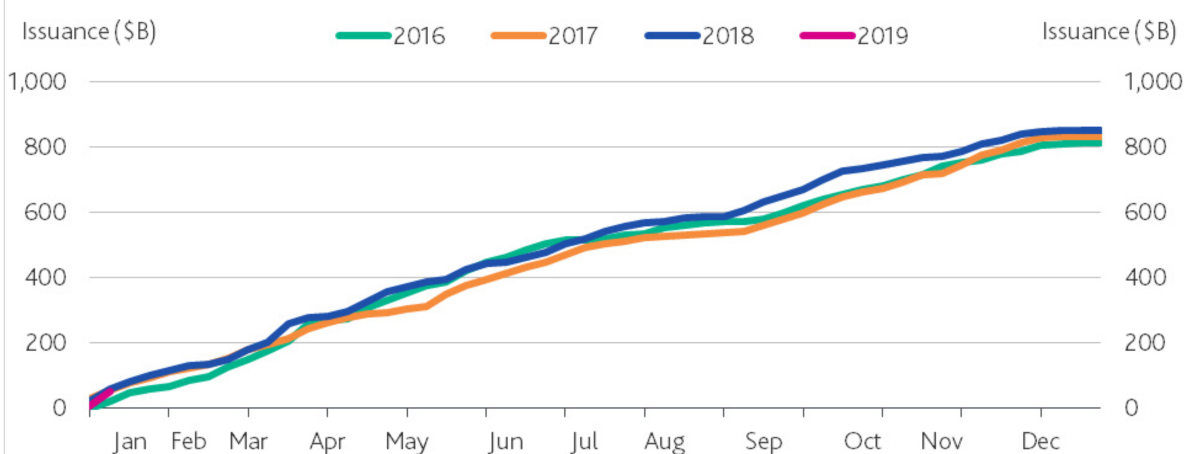
Issuance

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	45.280	3.200	49.580
Year-to-Date	56.880	4.095	62.075

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	38.715	2.983	42.123
Year-to-Date	46.701	2.983	50.313

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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