Default Outlook Again Defies Unmatched Ratio of Corporate Debt to GDP

**The Long View**

Full updated stories and key credit market metrics: After sinking by 24% annually in 2018’s final quarter, January’s amount of new loans rated Baa or lower advanced by 30% from January 2018.

**The Week Ahead**

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

**Credit Spreads**

- **Investment Grade**: We see year-end 2019’s average investment grade bond spread above its recent 129 basis points.
- **High Yield**: Compared to a recent 434 bp, the high-yield spread may approximate 500 bp by year-end 2019.

**Defaults**

US HY default rate: Moody’s Investors Service forecasts that the U.S.’ trailing 12-month high-yield default rate will dip from January 2019’s 2.6% to 2.4% by January 2020.

**Issuance**

For 2018’s US$-denominated corporate bonds, IG bond issuance sank by 15.4% to $1.276 trillion, while high-yield bond issuance plummeted by 38.8% to $277 billion for high-yield bond issuance’s worst calendar year since 2011’s 274 billion. In 2019, US$-denominated corporate bond issuance is expected to dip by 0.7% for IG to $1.267 trillion, while high-yield supply grows by 11.0% to $308 billion. A significant drop by 2019’s high-yield bond offerings would suggest the presence of a recession.

**Ratings Round-Up**

U.S. Change Activity Improves

**Market Data**

Credit spreads, CDS movers, issuance.

**Moody’s Capital Markets Research recent publications**

Links to commentaries on: Confidence vs. skepticism, Fed pause, default rates, high-yield bonds, stabilization, growth and leverage, buybacks, volatility, Fed policy, yields, profits, corporate borrowing, U.S. investors, eerie similarities, base metals prices, trade war.
Credit Markets Review and Outlook

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

Default Outlook Again Defies Unmatched Ratio of Corporate Debt to GDP

In terms of a moving yearlong average, U.S. nonfinancial corporate debt rose to a record high 46.0% of GDP as of the span-ended September 2018. Nonfinancial corporate debt's 6.4% year-over-year increase for the 12-months-ended September 2018 outran nominal GDP's comparably measured rise of 5.0%. As derived from the Federal Reserve's "Financial Accounts of the United States," the growth of nonfinancial corporate debt (to $9.3 trillion) was led by a 12.4% annual increase for the outstandings of loans and commercial paper (to $2.73 trillion) and a 10.6% increase for mortgage debt (to $578 billion), both of which well outran the 3.5% rise for bonds (to $5.99 trillion).

Figure 1: Default Rate Outlook Defies Yet Another Record High Ratio of Corporate Debt to GDP

Previous record highs for the ratio of corporate debt to GDP (hereafter I will refer to nonfinancial-corporate debt as corporate debt) were attained in 2009’s second quarter, 2001’s final quarter, and 1990’s final quarter. Each previous cycle peak for the ratio of corporate debt to GDP either coincided with or was quickly followed by cycle highs for the U.S. high-yield default rate’s calendar-quarter average of 14.5% in 2009’s final quarter, 10.9% in 2002’s first quarter, and 12.2% in 1991’s second quarter.

Response of Default Rate to Corporate Debt to GDP Ratio Has Been Asymmetrical

Of additional interest has been the tendency of the default rate to move in the direction taken by the ratio of corporate debt to GDP. For 39, or 91%, of the 43 quarters since 1985 showing a year-to-year decline by the ratio of corporate debt to GDP, the default rate also fell from its year-earlier reading.

However, the relationship weakens when the ratio of corporate debt to GDP rises from its year-earlier reading. Only 26, or 53%, of the 49 yearly increases by the corporate debt to GDP ratio of between 0.0 and 1.0 percentage points was joined by a yearly increase for the default rate.

Nevertheless, the expected relationship strengthens when the corporate debt to GDP ratio increases year to year by more than a percentage point. In this case, 31, or 77.5%, of the 40 such climbs were accompanied by a yearly increase for the default rate.
Credit Markets Review and Outlook

Of the 26 instances where the default rate fell yearly despite a less than 1 percentage point rise by the corporate debt to GDP ratio, 12 have occurred since 2012. The latest such violation of the hypothesized relationship happened during 2018’s third quarter, or when the default rate fell by 0.2 of a percentage point yearly despite an accompanying 0.6 percentage point increase for the ratio of corporate debt to GDP.

Though 2018’s third quarter marked the 26th consecutive quarter showing a year-to-year increase by the ratio of corporate debt to GDP, the high-yield default rate still fell from a year earlier in 14 of those quarters. Since 2011, the default rate rose alongside a rising ratio of corporate debt to GDP during the spans covering April 2012 through March 2013 and, most recently, April 2015 through March 2017.

The earlier span saw the average annual increase of core business sales slow considerably from the 7.6% advance of the 24-months-ended March 2012 to the 4.3% of the 12-months-ended March 2013. Nevertheless, the rise by the default rate was comparatively mild—from a third-quarter 2011 low of 2.30% to a third-quarter 2012 high of 4.0%. Helping to rein in 2011-2012’s rise by defaults were the continued growth of core profits, albeit at a slower pace, and an equity market rally.

However, worries stemming from much slower core business sales growth and a related bout of industrial commodity price deflation widened the high-yield bond spread’s month-long average from March 2012’s 589 basis points to a June 2012 high of 679 bp. Signs of softer business activity gave rise to expectations of another round of quantitative easing by the Federal Reserve. By late August, Ben Bernanke fulfilled such expectations and the high-yield bond spread would narrow to 471 bp by March 2013.

Systemic Liquidity Matters Greatly to the Default Outlook
The latter brings attention to the critical importance of sufficient systemic liquidity to the avoidance of an extended and disruptive climb by the default rate.

Once markets are incapable of confidently predicting a peak for a rising default rate, vulnerable credits may be denied access to reasonably priced financial capital. Such a breakdown of systemic liquidity will boost defaults by enough to leave behind only sufficiently viable credits. Thereafter, substantially lower benchmark borrowing costs will set the foundation for the stabilization of corporate credit and financial markets.

The last episode of simultaneous year-to-year increases by the ratio of corporate debt to GDP and the high-yield default rate began in April 2015 and ended with March 2017. During this span, not only did the yearly increase of core business sales average merely 1.6%, but the yearlong average of nonfinancial-corporate pretax profits from current production would sink by 10.9% from June 2015’s zenith to the average’s latest bottom of March 2017.

Once again, ample systemic liquidity rescued a number of troubled credits, especially those highly leveraged businesses having considerable negative exposure to a 71% plunge by the price of WTI crude oil from a June 2014 high of $105 per barrel to a February 2016 low of $31. Ample liquidity and a recovery by pretax profits prevented the quarterly default rate from rising above its 5.7% top of 2016’s third quarter.

Pretax Profits Influence the Default Rate
A subsequent recovery by pretax profits from current production to the 8.2% annual advance of the 12-months-ended September 2018 that owed much to the coincident 5.3% annual increase of core business sales facilitated a slide by the default rate to the 3.0% of 2018’s final quarter.

Partly because of the improved outlook for systemic liquidity brought on by the Fed’s more flexible approach to monetary policy, the default research group of Moody’s Investors Service lowered its baseline forecast of fourth-quarter 2019’s average U.S. high-yield default rate from 3.3% as of early January 2019 to 2.4% as of early February. The latest Blue Chip consensus forecast of annual growth rates for pretax profits from current production of 4.1% for 2019 and 2.3% for 2020 complement the still benign outlook for defaults.
The drop by a composite high-yield bond spread from its latest 564 bp peak of January 3, 2019 to a recent 434 bp also reflects less worry over a possibly disruptive climb by defaults. Nevertheless, a default prediction model employing the high-yield bond spread favors a 3.3% midpoint for November 2019's default rate, which eclipses the 2.9% of November 2018.

Though the ratio of corporate debt to GDP may have something to say about where the default rate ultimately peaks, the behavior of the default rate may depend much more on pretax profits and systemic liquidity. And even the supposed relationship between the default rate’s amplitude and the ratio of corporate debt to GDP may be problematic. Consider how the quarterly default rate recently rose no higher than 5.7% in 2016’s third quarter despite how corporate debt approximated a near record high 44.8% of GDP.

**Figure 2: Rising Trend for Profits Countered the Loss of Credit Quality to Steep Ratios of Corporate Debt to GDP in Late-1980s and Today**

*US nonfinancial corporations*

sources: BEA, Moody’s Analytics

Profits from Current Production: yearlong, % change from prior high (L)

Corporate Debt as % of US GDP: yearlong average (R)

Today's Relatively Narrow High-Yield Spread Counters Elevated Ratio of Debt to GDP

At each of the three aforementioned peaks for the default rate, pretax profits from current production had dropped considerably from its then record high, while financial liquidity had contracted significantly. A financially crippling loss of liquidity could be inferred from the high-yield bond spreads averages of 1,203 bp for 2009’s second quarter, 837 bp for 2001’s final quarter, and 870 bp for 1990’s final quarter. The high-yield bond spread’s nearly 1,500 bp average of the nine-months-ended June 2009 only worsened matters for corporate credit during the financial crisis.

Note that during the latest prolonged contraction of profits, the high-yield spread’s average peaked at the 776 bp of 2016’s first quarter. However, the loss of liquidity to that seemingly very wide spread was mitigated by how spread widening had been skewed toward companies having considerable exposure to industrial commodity price deflation.
Figure 3: High-Yield Bond Spread Now Largely Downplays Record High Ratio of Nonfinancial-Corporate Debt to GDP

*Sources: Federal Reserve, BEA, Moody's Analytics*

- Green line: High-Yield Bond Spread in basis points (bps) (L)
- Orange line: Nonfinancial-Corporate Debt as % of US GDP yearlong average (R)
The Week Ahead – U.S., Europe, Asia-Pacific

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

Retail Sales Deliver a Valentine’s Day Massacre

December U.S. retail sales were significantly weaker than we and the consensus anticipated, and they seem out of line with other data. Nominal retail sales fell 1.2%, compared with our forecast for them to fall 0.1% and the consensus expectation for a 0.1% gain. The consensus forecast error was among the largest since 2009, highlighting the magnitude of the surprise.

Weakness was broad-based and the key control retail sales group—total retail sales excluding autos, gasoline, building materials and restaurants—fell 1.7%. Response rates were normal, suggesting that neither sampling nor processing issues were likely behind the drop in retail sales. This would imply that revisions should not be larger than normal in either direction. The drop in control retail sales puts real consumer spending down 0.4% in December. This cut our estimate of fourth quarter real consumption growth to 2.9% at an annualized rate.

Some noise is normal in retail sales, and it’s difficult to square the drop with the strength of the labor market and the acceleration in wage growth. Therefore, the most likely explanation for the drop in control retail sales is the sudden and significant tightening in financial market conditions in late 2018.

Outside of the control group, lower gasoline prices weighed on nominal spending at gasoline stations, and weather may have hurt restaurants. Sporting good and hobby store sales were down 4.9% in December, the largest decline since the recession. This includes toy stores, and the closure of Toys R Us may have hurt sales in this category and the seasonal adjustment factor may have magnified the drop, but we would have assumed that they would be shifted to other retail segments, including nonstore. However, nonstore retail sales dropped sharply in December.

A surge in spending in January isn’t guaranteed. Though financial market conditions improved, the government shutdown was likely a bigger drag than in December. Also, unseasonably cold weather likely weighed on retail sales.

Also, we are watching tax refunds with regard to spending, since they can affect U.S. consumer spending from month to month. Our rule of thumb is that the average marginal propensity to consume for tax refunds is 0.33. Therefore, large deviations in tax refunds can have an impact on consumer spending.
January normally isn’t a big month for tax refunds. That’s because the IRS doesn’t begin accepting tax returns until late in the month. This year the IRS began accepting returns on January 29. Refunds matter more for consumer spending in February. So far this year they are running behind their prior five-year average.

However, part of the reason is that, in an effort to reduce fraud, the IRS delays tax refunds until mid-February for those households claiming either the Earned Income Tax Credit or Additional Child Tax Credit. This has had a significant effect over the past couple of years, but another reason for tax refunds even lagging behind last year’s pace is the partial federal government shutdown, which created some backlog. Also, the average tax refund is less than that at a comparable period in 2018, according to the IRS.

For perspective, year-to-date refunds are $8.95 billion this year, compared with $12.758 billion in 2018, and are the lowest since 2014. Assessing the implications for consumer spending isn’t that straightforward. For example, we modeled month-to-month growth in nominal personal consumption expenditures using the deviation in tax refunds from their prior five-year average as a share of disposable income. As expected, deviations in tax refunds explained little of the fluctuation in nominal consumer spending, highlighted by the low R-squared. Further, tax refunds were not statistically significant, even though we limited the sample of regression to January through May—months in which, we believe, tax refunds would have the biggest impact on consumer spending.

One possible reason that tax refunds were not significant is that large deviations don’t appear to occur frequently. Also, consumers can use savings and revolving credit to temporarily fill the void left by delays in tax refunds, which would minimize the effect on spending.

As was the case last year, refunds should increase significantly in the second half of February, unless there is another partial government shutdown. We still have the odds of another shutdown at 25%. But to consider the potential impact a refund delay would have on personal spending, we estimate the cumulative impact on consumer spending per week that tax refunds are delayed in February:

- A one-week delay in refunds = $16 billion annualized reduction in Q1 spending.
- A two-week delay in refunds = $40 billion annualized reduction in Q1 spending.

All told, we will be keeping a close eye on tax refunds, and if there is another partial government shutdown, the impact on consumer spending in the first quarter could be noticeable.
Next week brings the minutes from the January meeting of the Federal Open Market Committee. Also, December durable goods orders will be released along with Existing-home sales.

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

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**EUROPE**

By Barbara Teixeira Araujo of Moody’s Analytics in Prague

**Euro Zone Inflation Cools Sharply**

The week ahead will again bring loads of economy data. Front and center will be January’s final CPI figures for the euro zone. They are expected to confirm that inflation pressures in the currency area cooled sharply to only 1.4% over the month, the lowest since December 2017. We nonetheless caution against reading too much into January’s decline. It is expected to have been entirely due to an easing in noncore inflation pressures already in the pipeline because of base effects in oil prices. The core rate meanwhile should have increased slightly on the back of a pickup in services inflation.

Accordingly, we expect that euro zone services inflation accelerated further following a plunge in November, on seasonal volatility in package holidays and accommodation prices, and only a modest correction in December. Core goods inflation, meanwhile, likely remained steady as a decline in clothing inflation should have offset a jump in household goods inflation.

Regarding the noncore components, we expect the main drag will have been from yet another pullback in energy inflation. But this shouldn’t ring any alarm bells. 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 $57 per barrel, the lowest reading in a year. This is good news for consumers, since it should help alleviate the pressure on their purchasing power.

In the noncore components, food inflation should stop its slide, since it was already reading below trend in November. Autumn’s above-average temperatures and unseasonably mild weather may have prevented fresh produce prices from rising to the same extent they did in 2017, keeping the yearly rate contained. We are expecting some correction in the coming months.

All in all, December’s inflation report will make for a dovish reading, but we don’t think markets should worry too much. The easing in energy inflation has long been penciled in, while base effects and one-off factors would be the likely cause of a disappointing food headline. The truth is that prospects for a rate hike next year have declined sharply, which should make the European Central Bank adopt a more dovish bias. We thus expect the ECB will stand pat on rates throughout 2019 and soon change its forward guidance, which currently implies a rate hike in the fourth quarter.

Our outlook is for euro zone core inflation to accelerate in 2019 in line with the tightening of the labor market, but its pace of gains should be only gradual. This means that the expected slowdown in energy inflation should push the headline CPI rate further down in coming months.

Elsewhere, markets will watch closely Germany’s final GDP numbers for the fourth quarter. They should bring the expenditure breakdown of growth; we expected that domestic demand, mainly investment in construction and machinery and equipment, as well as government spending, supported the economy the most. Consumer spending is also expected to have contributed, but its pace of expansion likely remained subdued, while net exports should have remained a severe drag on headline GDP growth. Inventories are a wild card, but we expect they declined as well. For the headline, we expect the statistical office to confirm that GDP only flattened in the fourth quarter, which is extremely disappointing given that it had fallen by 0.2% q/q in the third. The good news is that prospects for the
first quarter of 2019 are a bit better, though growth should further slow over the year as a whole compared to 2018, as global growth falters and political and economic uncertainties remain the word of the day.

### Key indicators

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### ASIA-PACIFIC

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

#### The Bank of Japan’s Elusive Inflation Target

The economic data calendar is a smorgasbord. Japan’s core CPI (excluding food) likely rose to 0.9% y/y in January, following December’s 0.7%. Although energy costs remain the primary driver of inflation, those costs are adding less to overall inflation because of the fall in oil prices towards the end of 2018. Core-core inflation, which excludes food and energy prices, is even lower at 0.3% y/y. The Bank of Japan is expected to stay quiet in 2019, licking its wounds after continually downwardly revising its inflation forecasts. Its latest core CPI estimate for the 2019-2020 fiscal year has been reduced by 0.5 percentage point to 0.9% and the 2020-2021 forecast has been reduced by 0.1 percentage point to 1.4%, keeping the BoJ’s 2% target out of reach.

Thailand’s GDP growth is expected to have accelerated to 4.3% y/y in the December quarter from 3.3% in the third stanza. Private consumption was an important support to the economy through 2018 as exports and manufacturing waned amid softer offshore demand. An important support to the fourth quarter was the pickup in exports after the unexpected contraction in the third. Tourist arrivals and spending were also hurt in the third quarter by a tourist boat accident in July, which discouraged visitors. Thailand’s 2018 full-year GDP growth is expected to reach 4.3%, following 3.9% in 2017.

Singapore’s monthly nonoil domestic exports are being closely watched given they are a good barometer of the slowdown in Asia’s production cycle. We expect nonoil domestic exports fell for a second straight month in January, with electronics a persistently key drag. Anecdotal evidence supports the view that the U.S.-China trade war has harshly impacted the tech sector given the heavily integrated supply chains and China being a key manufacturing hub for assembling final goods.
The Long View

After sinking by 24% annually in 2018’s final quarter, January’s amount of new loans rated Baa or lower advanced by 30% from January 2018.

By John Lonski, Chief Economist, Moody’s Capital Markets Research Group
February 14, 2019

CREDIT SPREADS
As measured by Moody’s long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 129 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 434 bp is thinner than what is suggested by the accompanying long-term Baa industrial company bond yield spread of 214 bp but is roughly consistent with an accompanying VIX of 15.7 points.

DEFAULTS
January 2019’s U.S. high-yield default rate of 2.6% was less than the 3.6% of January 2018. Moody’s Investors Service now expects the default rate will average 2.4% 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.

US ECONOMIC OUTLOOK
As inferred from the CME Group’s FedWatch Tool, the futures market recently assigned an implied probability of merely 2% to at least one Fed rate hike in 2019. 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
February 14, 2019

GERMANY

Thursday brought a barrage of fourth-quarter GDP data for the euro zone countries. In the spotlight were Germany’s figures, which were the last to be released from the four major currency area’s economies. They were bad, showing that the country only barely avoided entering a technical recession in the second half of 2018. GDP flattened in the fourth quarter, which is a rather disappointing result given that it had already fallen by 0.2% q/q in the third stanza.

At least the commentaries from the statistical office—the growth breakdown is not yet out—suggest that the overall picture is not as bad as the headline indicates. Domestic demand still supported growth, as investment, consumer spending and government consumption all rose from the previous quarter. By contrast, the hit to the headline again came from net trade—in line with the slowdown in global growth—while inventories are also expected to have declined.

Prospects for the first quarter are better, because we expect that some of the many one-offs that hit the Germany economy in the second half of 2018 will fade. Notably, the car industry is finally making progress adapting to the new EU emission rules, while water levels in the country’s main rivers have returned to normal. The hope now is that the U.S. and China manage to find themselves a deal, avoiding a full-blown trade war, and that the U.K. and the EU avert a no-deal Brexit. Elsewhere, we expect that the global slowdown will continue to weigh on the export performance of the country in 2019.

Our forecast is that Germany’s economy will grow by only 1.3%-1.4% in 2019, down from 1.5% in 2018 and as much as 2.5% in 2017. Risks to the outlook remain considerable, but economic fundamentals remain solid, especially in what regards the health of consumer finances.

UNITED KINGDOM

While January’s sharp drop in U.K. inflation pressures caught markets by surprise, we had long advocated that January would be the month in which the Office for National Statistics’ headline CPI rate would finally fall back below the Bank of England’s 2% target after two years of overshoot. What markets missed was the drop in electricity inflation that followed utility regulator Ofgem’s introduction of a cap on standard variable tariffs on January 1. The electricity CPI series is entirely derived from standard variable tariffs—it doesn’t take into account fixed-rate contracts—which means the decline in SVT energy bills in January translated to a sharp 0.2-percentage point drop in electricity’s contribution to overall inflation. We expect electricity inflation to remain where it is during the coming months, which means that overall inflation is unlikely to jump back to target any time soon.

Motor fuels inflation also fell in January, to 0.7%, on the back of base effects in oil prices. It should continue to decline in February and remain relatively steady in March. Provided that the price of the Brent barrel remains steady at around $62, it will then continue its slide during the second and third quarters of 2019.

And while core goods inflation remained steady in January, we remain of the view that nonenergy goods inflation will reach zero by the end of spring, now that it has been more than a year since retailers finished passing higher import prices through to consumers.

The good news is that the trend in underlying services inflation seems better now than it did a few months ago. Granted, services inflation rose in January mainly due to a correction in airfares—which are volatile and had collapsed in December—but price pressures in the broad services sector are clearly picking up, albeit gradually. We expect that the services headline will remain steady in February, but it should end the year at around 2.7% to 2.8%, compared with 2.5% currently.
Overall, we maintain that the direction of travel is to the downside. Any rebound in services inflation—in line with the tight labour market—is unlikely to be enough to offset lower core goods, electricity and motor fuels inflation. For the BoE, this means that softer headline and core inflation pressures combined with lower growth will allow the Monetary Policy Committee to stay put for as long as there is still no clarity on what the U.K.-EU future relationship will look like. The BoE wouldn’t want to kick the economy when it’s down, and the lower inflation pressures will give it justification to stick to its wait-and-see strategy.

**ASIA PACIFIC**

By Katrina Ell of Moody’s Analytics
February 14, 2019

**AUSTRALIA**

The Reserve Bank of Australia dropped its unrealistically strong view of the economy in its February Statement on Monetary Policy. GDP growth is now forecast to be 3% in 2019 and 2.75% in 2020, weaker than the 3.25% in 2019 and 3% in 2020 forecasts in the November statement. This is in line with our forecast, which has GDP growth at 2.9% in 2019 and 2020.

Households are the critical driver of the RBA’s weaker trajectory. Household final consumption accounts for 60% of GDP. Several headwinds have materialised in recent months that make GDP growth unlikely to stay above potential (estimated to be around 3%) through the medium term. First, the housing market slowed a little more than expected in the second half of 2018, and that weakness is forecast to hang around through 2019 in the previously most heated markets of Sydney and Melbourne. The housing market is a critical stimulant of consumption via wealth effects, and most, including the RBA, took for granted how much the slowing market would hurt consumption and have a broader economy-wide impact.

**Housing slowdown**

But it’s important not to overstate the slowdown in the housing market. The RBA observed that national house prices increased by almost 50% in the five years to September 2017, while they have fallen by around 8% since then. While affordability has improved in the most desirable cities after the strong prior growth, it is still a stretch to service an average mortgage for a middle-income household in Sydney and, to a lesser extent, Melbourne without being considered under “mortgage stress,” where at least 30% of a household’s income goes to the mortgage each month.

Against this backdrop of the slowing housing market is sustained weakness in income growth. While the wage price index has been on a gradual uptrend for two years, the improvement has not been impressive, rising only 0.4 percentage point over this period to hit 2.3% y/y in the September quarter. We know that there’s a strong correlation between income growth and consumption in Australia, and we know that there’s a one-way causal link from income to consumption. Another drag is ever-present household debt, which, at 200% of disposable income, is contributing to tepid household spending.

**Tightening purse strings**

Households pulled back on discretionary spending in the second half of 2018 after an unsustainably strong first half. They are only going to tighten their purse strings further in 2019. Indeed, the RBA downwardly revised its forecast for wages, expected to peak at 2.6% in December 2020 and remain there in the forecast horizon, weaker than the prior expectation of 3% by June 2021. This is coming despite labour market tightening during the past two years, pushing the unemployment rate to a low 5%, roughly considered “full employment.”

We are not changing our baseline forecast that the RBA will keep rates steady until mid-2020 before a gradual tightening cycle will begin. But risks to this outlook have materially increased since December. Financial markets are pricing in a 50% chance of a 25-basis point rate cut this year, but we think this is premature. The most likely scenario is that the cash rate will stay at 1.5% for even longer than expected, but economic data for early 2019 will shape this view, and our odds of a rate cut in 2019 are at 30%.
Ratings Round-Up

U.S. Change Activity Improves

By Michael Ferlez

U.S. rating change activity improved last week, though the overall trend remained weak. Although upgrades only accounted for 35% of total rating changes, they represented 85% of impacted debt. Notable upgrades included Baxalta Inc., which saw its senior unsecured debt raised to Baa2 from Baa3. The upgrade followed the closing of Takeda Pharmaceutical Company Limited’s purchase of Baxalta’s parent, Shire plc. The other notable upgrade was to Ally Financial Inc. The financial services firm was upgraded to Ba2 from Ba3 impacting $12.4 billion in debt. Downgrades were largely concentrated in industrial sectors. Notable downgrades included Westinghouse Air Brake Technologies Corp., which saw its senior unsecured credit rating lowered one-notch to Ba1.

The trend in European rating change activity continued to improve last week following the upgrade of Russia’s sovereign credit rating. Russia’s debt upgrade resulted in upgrades to 19 Russian firms. The two largest upgrades were Gazprombank and Russian Railways Joint Stock Company. Both firms were upgraded one-notch to Baa2, impacting a combined $34 billion in debt.

FIGURE 1
Rating Changes - US Corporate & Financial Institutions: Favorable as % of Total Actions

* Trailing 3-month average
Source: Moody’s
## FIGURE 2

### Rating Key

<table>
<thead>
<tr>
<th>Code</th>
<th>Description</th>
<th>Abbreviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>BCF</td>
<td>Bank Credit Facility Rating</td>
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<tr>
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<td>Corporate Family Rating</td>
<td>MTN</td>
</tr>
<tr>
<td>CP</td>
<td>Commercial Paper Rating</td>
<td>Notes</td>
</tr>
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<td>Bank Financial Strength Rating</td>
<td>PDR</td>
</tr>
<tr>
<td>IFS</td>
<td>Insurance Financial Strength Rating</td>
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<tr>
<td>JrSub</td>
<td>Junior Subordinated Rating</td>
<td>SLTD</td>
</tr>
<tr>
<td>LGD</td>
<td>Loss Given Default Rating</td>
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</tr>
<tr>
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<td>Long-Term Corporate Family Rating</td>
<td>SrUnsec</td>
</tr>
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<td>LTD</td>
<td>Long-Term Deposit Rating</td>
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</tr>
<tr>
<td>LTIR</td>
<td>Long-Term Issuer Rating</td>
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</table>

<table>
<thead>
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<th>Amount ($ Million)</th>
<th>Up/Down</th>
<th>Old LTD Rating</th>
<th>New LTD Rating</th>
<th>IG/SG</th>
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<tbody>
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<td>Baa3</td>
<td>Baa2</td>
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<td>Ca</td>
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<td>Aaa</td>
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<td>SG</td>
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<td>U</td>
<td>B3</td>
<td>B2</td>
<td>SG</td>
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<td>SG</td>
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<td>Caa3</td>
<td>Ca</td>
<td>SG</td>
<td></td>
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<tr>
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<td>Financial</td>
<td>SrSec/BCF/LTCFR</td>
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<td>D</td>
<td>Caa2</td>
<td>Ca</td>
<td>SG</td>
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<td>Ba3</td>
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<tr>
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<td>TRUCK HOLDINGS INC.-TRUCK HERO, INC.</td>
<td>Industrial</td>
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<td>B2</td>
<td>B2</td>
<td>SG</td>
</tr>
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<td>B2</td>
<td>Ba3</td>
<td>SG</td>
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<tr>
<td>2/11/19</td>
<td>PROJECT SILVERBACK HOLDING CORP.</td>
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<td>B3</td>
<td>B3</td>
<td>SG</td>
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<td>Baa3</td>
<td>Ba1</td>
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<tr>
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<td>D</td>
<td>Caa1</td>
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</tr>
<tr>
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<td>B3</td>
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</table>

Source: Moody’s
## FIGURE 4
### Rating Changes: Corporate & Financial Institutions – Europe

<table>
<thead>
<tr>
<th>Date</th>
<th>Company</th>
<th>Sector</th>
<th>Rating</th>
<th>Amount ($ Million)</th>
<th>Old LTD Rating</th>
<th>New LTD Rating</th>
<th>IG/SG</th>
<th>Country</th>
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</thead>
<tbody>
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<td>SG</td>
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<td>Ba1</td>
<td>Ba3</td>
<td>SG</td>
<td>RUSSIA</td>
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<td>Ba2</td>
<td>Ba3</td>
<td>IG</td>
<td>RUSSIA</td>
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<tr>
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<td>Ba2</td>
<td>Ba1</td>
<td>SG</td>
<td>RUSSIA</td>
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<td>Baa3</td>
<td>Baa2</td>
<td>IG</td>
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<td>Baa2</td>
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<td>LTIR</td>
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<td>Baa3</td>
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<td>IG</td>
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<td>2/12/19</td>
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<td>Baa2</td>
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<td>2/12/19</td>
<td>ABH FINANCIAL (ALFA)-ALFA-BANK</td>
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<td>LTD</td>
<td>U</td>
<td>Ba2</td>
<td>Ba1</td>
<td>SG</td>
<td>RUSSIA</td>
</tr>
<tr>
<td>2/12/19</td>
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<td>IG</td>
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<td>RUSHYDRO, PJSC-RUSHYDRO CAPITAL MARKETS DAC</td>
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<td>Ba3</td>
<td>Ba2</td>
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</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 (February 6, 2019 – February 13, 2019)**

<table>
<thead>
<tr>
<th>CDS Implied Rating Rises</th>
<th>CDS Implied Ratings</th>
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</thead>
<tbody>
<tr>
<td>Issuer</td>
<td>Feb. 13</td>
</tr>
<tr>
<td>Ford Motor Credit Company LLC</td>
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<tr>
<td>Sprint Communications, Inc.</td>
<td>B3</td>
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<tr>
<td>Xerox Corporation</td>
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</tr>
<tr>
<td>United Rentals (North America), Inc.</td>
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</tr>
<tr>
<td>Springleaf Finance Corporation</td>
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</tr>
<tr>
<td>MGM Resorts International</td>
<td>B3</td>
</tr>
<tr>
<td>Arconic Inc.</td>
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<table>
<thead>
<tr>
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</thead>
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</tr>
<tr>
<td>Dish DBS Corporation</td>
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</tr>
<tr>
<td>R.R. Donnelley &amp; Sons Company</td>
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</tr>
<tr>
<td>McClatchy Company (The)</td>
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</tr>
<tr>
<td>Toyota Motor Credit Corporation</td>
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</tr>
<tr>
<td>American Express Credit Corporation</td>
<td>A1</td>
</tr>
<tr>
<td>Dow Chemical Company (The)</td>
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<td>Kinder Morgan, Inc.</td>
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<tr>
<td>Valero Energy Corporation</td>
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<td>Halliburton Company</td>
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<table>
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</thead>
<tbody>
<tr>
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<td>Senior Ratings</td>
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<td>Weatherford International, LLC (Delaware)</td>
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</tr>
<tr>
<td>K. Hovnanian Enterprises, Inc.</td>
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</tr>
<tr>
<td>McClatchy Company (The)</td>
<td>Caa2</td>
</tr>
<tr>
<td>Dish DBS Corporation</td>
<td>B1</td>
</tr>
<tr>
<td>Frontier Communications Corporation</td>
<td>Caa1</td>
</tr>
<tr>
<td>AK Steel Corporation</td>
<td>B3</td>
</tr>
<tr>
<td>Goodyear Tire &amp; Rubber Company (The)</td>
<td>Ba3</td>
</tr>
<tr>
<td>Univision Communications Inc.</td>
<td>Caa2</td>
</tr>
<tr>
<td>Diamond Offshore Drilling, Inc.</td>
<td>B3</td>
</tr>
<tr>
<td>Anadarko Petroleum Corporation</td>
<td>Ba1</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>Mattel, Inc.</td>
<td>B3</td>
</tr>
<tr>
<td>YRC Worldwide Inc.</td>
<td>Caa1</td>
</tr>
<tr>
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<td>Ca</td>
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<tr>
<td>Springleaf Finance Corporation</td>
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</tr>
<tr>
<td>Hertz Corporation (The)</td>
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<tr>
<td>Penney (J.C.) Corporation, Inc.</td>
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</tr>
<tr>
<td>Pitney Bowes Inc.</td>
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</tr>
<tr>
<td>Realogy Group LLC</td>
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</tr>
<tr>
<td>Dean Foods Company</td>
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</tr>
<tr>
<td>SLM Corporation</td>
<td>Ba2</td>
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*Source: Moody's, CMA*
### Market Data

**Figure 4. CDS Movers - Europe (February 6, 2019 – February 13, 2019)**

<table>
<thead>
<tr>
<th>CDS Implied Rating Rises</th>
<th>CDS Implied Ratings</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Issuer</strong></td>
<td>Feb. 13</td>
</tr>
<tr>
<td>Italy, Government of</td>
<td>Ba3</td>
</tr>
<tr>
<td>Unione di Banche Italiane S.p.A.</td>
<td>B1</td>
</tr>
<tr>
<td>Ardagh Packaging Finance plc</td>
<td>B1</td>
</tr>
<tr>
<td>Ziggo Secured Finance B.V.</td>
<td>Ba3</td>
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<td>UniPol Gruppo S.p.A.</td>
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<td>Ba2</td>
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<tr>
<td>Sappi Papier Holding GmbH</td>
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<td>Heathrow Finance plc</td>
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<th>CDS Implied Rating Declines</th>
<th>CDS Implied Ratings</th>
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<td>Feb. 13</td>
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<tr>
<td>Alpha Bank AE</td>
<td>Caa3</td>
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<tr>
<td>Novo Banco, S.A.</td>
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<td>CMA CGM S.A.</td>
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<tr>
<td>Matalan Finance plc</td>
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<td>TUI AG</td>
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<td>NatWest Markets N.V.</td>
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<td>Deutsche Telekom AG</td>
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<td>Volkswagen Aktiengesellschaft</td>
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<tr>
<td>Sanofi</td>
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<td>Prudential Public Limited Company</td>
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<th>CDS Spreads Increases</th>
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<td>Marks &amp; Spencer p.l.c.</td>
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<td>Publicis Groupe S.A.</td>
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<td>Matalan Finance plc</td>
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*Source: Moody’s, CMA*
Market Data

Issuance

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

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

Source: Moody's / Dealogic
Figure 7. Issuance: Corporate & Financial Institutions

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<tr>
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<td>Amount</td>
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<td>$B</td>
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<tr>
<td>Weekly</td>
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<td>Year-to-Date</td>
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<td>Investment-Grade</td>
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<tr>
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<tr>
<td>Weekly</td>
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<td>1.366</td>
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<tr>
<td>Year-to-Date</td>
<td>119.611</td>
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<td>128.934</td>
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* Difference represents issuance with pending ratings.  
Source: Moody’s/ Dealogic
Moody’s Capital Markets Research recent publications

Equity Analysts’ Confidence Contrasts with Economists’ Skepticism
Fed’s Pause May Refresh a Tiring Economic Recovery (Capital Markets Research)
Rising Default Rate May be Difficult to Cap (Capital Markets Research)
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Upper-Tier Ba Rating Comprises Nearly Half of Outstanding High-Yield Bonds (Capital Markets Research)
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Core Profit’s Positive Outlook Lessens Downside Risk for Credit (Capital Markets Research)
Unprecedented Amount of Baa-Grade Bonds Menaces the Credit Outlook (Capital Markets Research)
Navigating Choppy Markets: Safety-First Equity Strategies Based on Credit Risk Signals
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Financial Liquidity Withstands Equity Volatility for Now (Capital Markets Research)
Stepped Up Use of Loan Debt May Yet Swell Defaults (Capital Markets Research)
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Middling Ratio of Net Corporate Debt to GDP Disputes Record Ratio of Corporate Debt to GDP (Capital Markets Research)
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Significant Differences, Eerie Similarities (Capital Markets Research)
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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)
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Trade War Will Turn Ugly if Profits Shrink (Capital Markets Research)
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<tr>
<td>Editor</td>
<td>Europe: +44 (0) 20.7772.5588</td>
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<tr>
<td>Reid Kanaley</td>
<td>Asia: 813.5408.4131</td>
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