MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

Equity Analysts' Confidence Contrasts With Economists' Skepticism

Moody's Analytics Research

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Credit Markets Review and Outlook

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

Equity Analysts' Confidence Contrasts With Economists' Skepticism

Notwithstanding January's bigger-than-expected addition to payrolls, the futures market recently assigned a mere 3% probability to a hiking of fed funds at any point in 2019. As further inferred from the CME Group's FedWatch Tool, the futures market believed a rate cut is more likely than a rate hike. Compared to the implied 3% likelihood of a rate hike, the futures market put the odds of fed funds finishing 2019 at a rate under its current 2.375% at 17%.

Growing confidence about the avoidance of a 2019 Fed rate hike and indications of an underperforming global economy helped to lower the 10-year Treasury yield from its 2.69% close following the February 1 release of January's jobs report to 2.66% during the afternoon of February 7.

Interest-sensitive spending on housing and motor vehicles will help give direction to Treasury bond yields. Despite the outsized jump in payrolls, January's seasonally-adjusted unit sales of cars and light trucks fell by 5% from December 2018.

Elsewhere, a drop by December's index of pending home sales warned of fewer unit sales of existing homes during early 2019. Of a more recent vintage, a seasonally-adjusted index of mortgage applications for the purchase of a home started 2019 with gusto but subsequently has declined sequentially for three straight weeks.

Nevertheless, because of the fleeting influence of severe winter weather, January's soundings on household expenditures may offer little insight as to what lies ahead for consumer outlays. However, in the event that significantly lower mortgage yields do not spark a recovery by unit home sales, a Fed rate cut may be more likely than a hike in 2019. Furthermore, if unit home sales continue to drift lower, the 10-year Treasury yield will probably dip under 2.5% later this year.

Equity analysts differ starkly from economists on 2020's earnings outlook

Yes, prognosticators of corporate revenues and earnings have turned more cautious, but they have yet to even hint of a drop by profitability capable of swelling corporate bond yield spreads and ending the long-lived business cycle upturn. Though equity analysts surveyed by FactSet expect the member companies of the S&P 500 to incur a shallow 0.8% year-to-year dip by first-quarter 2019's earnings per share, the consensus also looks for a quick resumption of earnings growth.

More specifically, the consensus believes the calendar-year growth rate of S&P 500 earnings will drop from 2018's unsustainably fast 20.2% to 2019's 5.6%. The projected deceleration by earnings stems from (i) the loss of the one-time boost to earnings supplied by 2018's corporate income tax cuts, (ii) a predicted slowing by revenue per share growth from 2018's well above-trend 8.7% to 2019's 5.3%, and (iii) an anticipated quickening of operating costs.

Regarding operating costs, worry over labor cost pressures largely stems from the unemployment rate's decline from a 2017 yearlong average of 4.4% to 2018's 3.9%. The last roughly comparable drop by the unemployment rate's yearlong average occurred when the jobless rate fell from the 4.5% of 1998 and the 4.2% of 1999 to 2000's 4.00%.

Back then, the growth of unit labor costs jumped from 1998-1999's average annualized increase of 1.7% to 2000's 3.6%. Unit labor costs' faster climb of 2000 was joined by a 5.8% annual contraction by pretax profits from current production, or core profits.

Today's response by unit labor costs and core profits has been far different. Instead of accelerating, unit labor costs' year-over-year growth slowed from yearlong 2017's 2.2% to the 1.4% of January-September 2018. The deceleration of unit labor costs lent support to January-September 2018's 7.9% year-over-year increase by core profits, which differs drastically from core profits' drop of 2000.

Credit Markets Review and Outlook

For the 12-months-ended September 2018, the 4.8% year-over-year increase by corporate gross-value-added—a proxy for corporate revenues net of non-labor production costs—well outran unit labor costs' accompanying 1.6% rise. In the past, the faster growth of unit labor costs relative to corporate GVA has been associated with a recession.

As inferred from the Blue Chip consensus predictions for nominal GDP, corporate GVA is expected to rise from 2017's 4.0% to 5.1% in 2018. Thereafter, corporate GVA is expected to slow to 4.5% in 2019 and 3.7% in 2020.

The tone of the FactSet consensus forecast for S&P 500 revenues per share differs somewhat from Blue Chip's implied consensus projections for corporate GVA. After rising from 2017's 6.4% to 2018's prospective breakneck pace of 8.7%, the annual increase of S&P 500 revenues is projected to slow to 5.3% in 2019 and edge higher to 5.4% in 2020.

Both Blue Chip and FactSet expect slower sales growth in 2019, which is consistent with steady, if not lower, benchmark interest rates. However, for 2020, Blue Chip's economists foresee a further slowing by net revenues, while FactSet's equity analysts sense slightly faster growth for S&P 500 revenue per share.

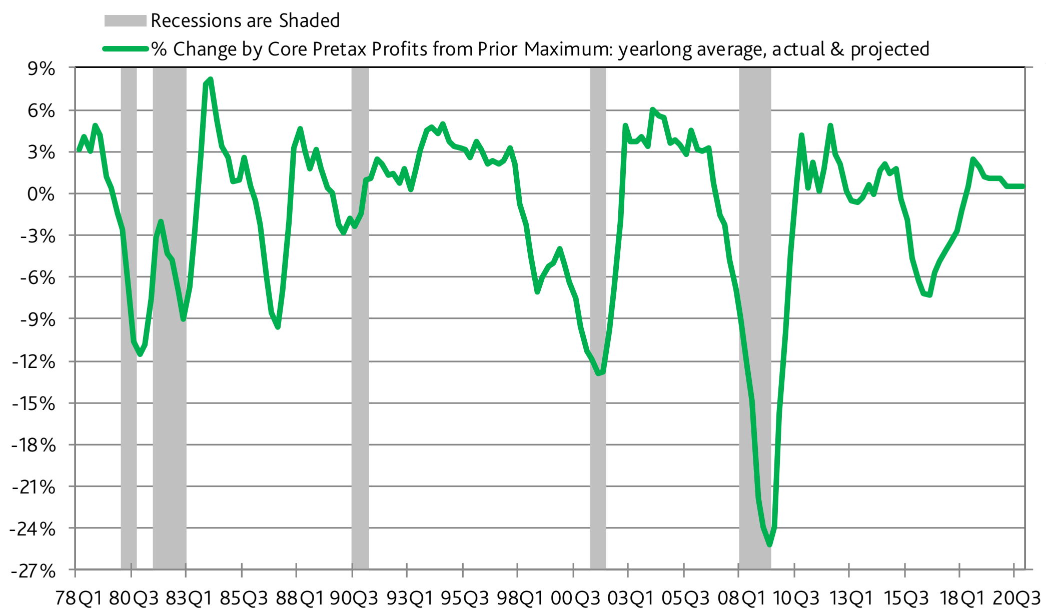
The realization of the equity analysts' 2020 revenue forecast may require a reduction by the unemployment rate to something no greater than 3.5%. Nevertheless, the FactSet consensus does not believe that so low a jobless rate will not put enough upward pressure on labor costs to prevent an improvement in operating leverage, which can be inferred from 2020's widening of the gap between earnings growth and revenue growth.

In a seemingly bold manner, FactSet's consensus believes S&P 500 earnings per share will accelerate from 2019's projected 5.6% annual increase to an 11.2% advance in 2020. In a radically different take on 2020's corporate earnings, the Blue Chip consensus expects core profits growth will slow from 2018's prospective 7.8% annual increase to 4.6% in 2019 and, then, barely rise by 2.2% in 2020.

Regarding 2020's outlook, surveyed economists exhibit less complacency than surveyed equity analysts. Worth noting is that as of early January, the Blue Chip consensus expected U.S. real GDP growth to slow from 2019's 2.6% to 1.9% in 2020 and the likelihood of a recession to rise from 2019's 25% to 2020's 37%.

Since 1979, the yearlong average of core profits has incurred seven contractions that lowered core profits by more than 1% from its then record high. The last such contraction occurred during 2015-2016. Each of the five recessions since 1979 was accompanied by a contraction of core profits.

Figure 1: Each of the Last Five Recessions Were Associated with a Contraction by Core Profits
sources: BEA, NBER, Blue Chip Economic Indicators, Moody's Analytics



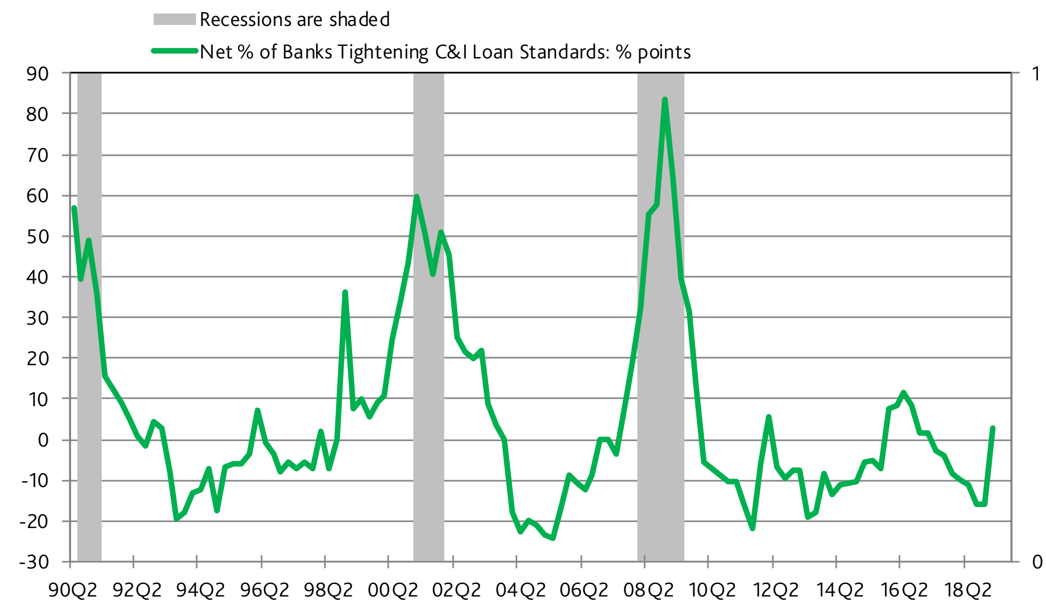
More banks widen than narrow business loan spreads for first time in nine years

If high-yield bond spreads continue to narrow, banks may (i) end early 2019's tightening of business loan standards and (ii) halt the widening of the interest rate spread over the cost of funds that banks charge on business loans. Otherwise, a continued firming of business loan guidelines and a widening of spreads charged on business loans will help to slow business activity and, thereby, put upward pressure on the high-yield default rate and downward pressure on benchmark interest rates.

As derived from the Federal Reserve's quarterly survey of senior bank loan officers, the net percentage of banks tightening commercial and industrial (C&I) loan standards rose from the -15.9 percentage points of 2018's final quarter to the +2.8 points of 2019's first quarter. The latter broke a string of seven consecutive quarters showing a greater percentage of surveyed banks easing standards compared to the percent tightening standards.

During the seven consecutive quarters of more relaxed standards, the net percent of banks tightening business loan guidelines averaged -9.8 points. First-quarter 2019's net percent of banks tightening C&I loan standards was the highest since third-quarter 2016's +8.5 points.

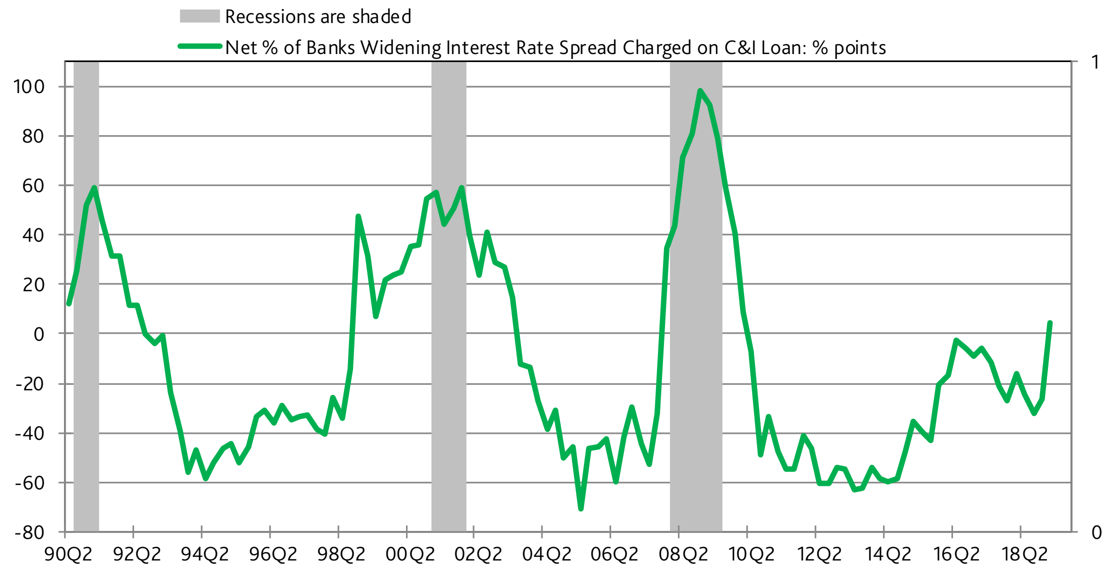
Figure 2: Net Percent of Banks Tightening Commercial & Industrial (C&I) or Business Loan Standards Jumps
sources: Federal Reserve, NBER, Moody's Analytics



In an even more jarring break from the recent trend, the net percent of banks widening the interest rate spread charged on C&I loans soared from fourth-quarter 2018's -26.5 percentage points to first-quarter 2019's +4.2 points, which was the highest, or most restrictive, such reading since the +9.1 points of 2010's first quarter.

In each of the previous 35 quarters, or beginning with 2010's second quarter, the percent of banks narrowing the loan spread over the cost of bank funds exceeded the percent widening the spread. During this extended 35-quarter-long span, the net percent of banks widening the interest rate spread charged on business loans averaged -37.2 percentage points.

Figure 3: Net Percent of Banks Widening Spreads on Commercial & Industrial (C&I) Loans Is Highest in Nine Years
sources: Federal Reserve, NBER, Moody's Analytics



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

THE U.S.

By Bernard Yaros, Moody's Analytics

The Outlook after Trump's State of the Union

President Trump delivered his second State of the Union address Tuesday night, calling for an end to political gridlock but without offering any major concessions to Democrats. On the one hand, the calls for unity and references to recent bipartisan legislation reflect a president whose eyes are set on scoring other policy wins before the 2020 election that would need bipartisan support such as infrastructure, drug pricing, trade policy, and paid family leave. On the other hand, when it came time to address a potential end to the budget standoff over border security, he ceded no ground on his demand for a border wall, nor did he extend a clear carrot to Democrats on immigration.

Budget battle

Moody's Analytics is sticking to our prior call that politicians will avert another shutdown this month. Had Trump declared a national emergency in his SOTU, that would have upended ongoing negotiations by a bipartisan conference committee tasked with arriving at a border security deal. It would have further hardened the positions of both parties 10 days before the next deadline to keep the government open, complicating the path to a reasonably graceful resolution to the current budget stalemate.

We expect the bipartisan committee will come up with a conference report that increases border security spending without funding a border wall. It would most likely pass Congress, but what happens next is the biggest question. We believe Trump would sign the deal into law and then use emergency powers to begin wall construction. However, another shutdown would ensue if the panel fails to hash out an agreement or if Trump vetoes it. Even if we are wrong, another shutdown would not last as long as the previous one, given the sheer blowback politicians would receive from the public.

The nastier the budget standoff over border security becomes, the less likely Trump and Democrats will be able to work together even on issues where common ground exists. And risks are stacked to the downside in this respect. Trump did not make any clear concession on immigration, as he did in his first SOTU when he included in an immigration plan a path to citizenship for 1.8 million undocumented immigrants who came to the country as minors.

On Tuesday, he only made an oblique reference to wanting legal immigrants "to come into [the] country in the largest numbers ever." Moreover, he admonished Democrats on "ridiculous, partisan investigations." A shift from unified to a divided government has historically produced a fivefold increase in the number of congressional hearings—a dynamic that is especially strong in the House. It is all but certain House Democrats will use their oversight powers on the president, which further muddles the potential for bipartisanship on common-ground issues.

Infrastructure

Infrastructure has long been considered fertile terrain on which the president and Democrats could break ground together. After the new tax law, Trump's infrastructure plan, released a year ago, was supposed to make the next big splash in federal fiscal policy. Yet the plan failed to gain traction in Congress, and the potential for a bipartisan compromise on infrastructure remains highly improbable. A month after the president unveiled his plan, Senate Democrats released their own proposal, which called for significantly more direct federal infrastructure investment than the Trump plan. Most important, the Senate Democrats' plan would be financed by scaling back a handful of the new tax law's key provisions. This would be a nonstarter for the White House.

Although a standalone infrastructure bill is unlikely to happen, that does not preclude the possibility of future legislation increasing infrastructure outlays. When it comes time to negotiate new caps on defense and nondefense discretionary spending for fiscal 2020 and 2021, more infrastructure funding could serve as a starting point for such negotiations.

Drug pricing

Besides infrastructure, Trump was expected to also make a pitch for lowering the prices of prescription drugs, and he did so Tuesday night without too many details. Yet past actions by his administration signal the direction he is taking to tackle drug pricing.

In late October, Trump proposed pegging payments for drugs covered by Medicare Part B to an international index of drug prices in other advanced economies. The Centers for Medicare and Medicaid Services could begin testing this new payment model in 2020 in 50% of the U.S. Over a five-year period, prices for most drugs in Medicare Part B would gradually approach those paid for the same drugs in other advanced economies. While this five-year pilot program does not need congressional approval, Congress would need to pass legislation to make the "international pricing index" permanent and applicable to all drug prices paid by Medicare.

Democrats have previously advocated for Medicare to negotiate lower drug prices. Also, the Obama administration in 2016 proposed a countrywide experiment to reduce payments for many drugs covered by Part B of Medicare. That said, Democratic lawmakers are skeptical about the president's plan, and Republicans are unlikely to rally around it.

Even more recently, the White House has called for banning rebates paid by drugmakers to pharmacy benefit managers, who pass most of these discounts along to insurers and then to consumers in the form of lower premiums. Though healthier consumers can benefit from the lower premiums, sicker ones are stuck with higher out-of-pocket costs, since they have to pay the full list price of expensive drugs, in spite of the rebate. In his SOTU, Trump did call for "price transparency for American patients," which alluded to the proposal. However, the reception to the plan in Congress has been lukewarm.

Trade

Trade policy was another highly anticipated item on the agenda for Trump's second SOTU. Further escalation in the trade conflict with China has been on hold since the end of November, as the Trump administration has held off on planned increases in tariffs as it works toward a resolution with Beijing. In his address, Trump did not up the ante on President Xi Jinping but only repeated his call for a trade deal with China that includes protection of intellectual property rights and a reduction in the U.S. trade deficit. All told, his comments do not change our baseline assumption that Trump will make some type of deal with the Chinese and declare 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.

Trump also called on Congress to pass the U.S. Reciprocal Trade Act, which would allow the president to raise tariffs in response to duties that U.S. goods face abroad. However, this is uncertain, given some bipartisan momentum that has taken place in Congress to limit the president's power to impose tariffs unilaterally on national security grounds.

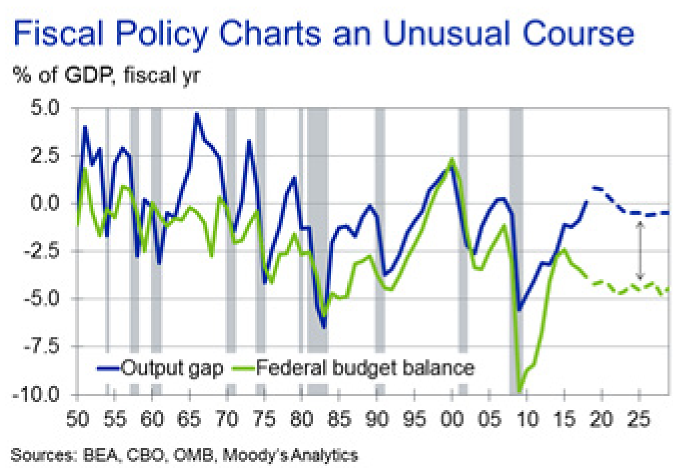
What Trump did not say

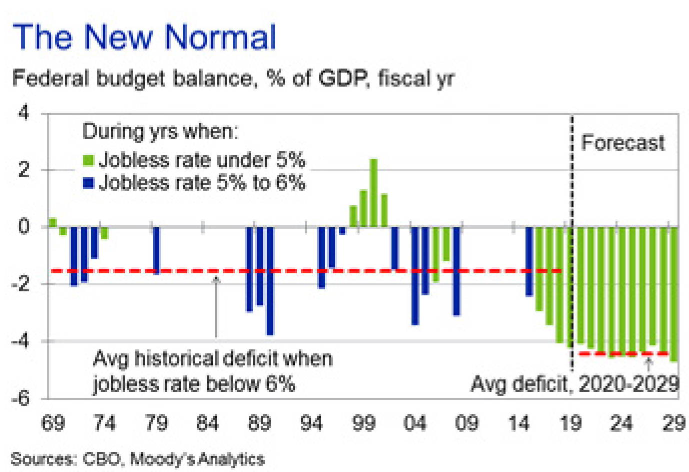
There were several items on the fiscal to-do list for the near and long term that went unaddressed in Tuesday's SOTU.

Trump did not touch upon the debt limit, which sets the legal maximum of outstanding Treasury debt and will be reinstated on March 1. Had Trump signaled a willingness to wrap a debt-limit suspension into the budget deal we expect to see this month, he could have provided some early relief to financial markets. Previous brushes with the debt limit ended just in time with an agreement to increase the limit, and the same is widely expected this time around, but not without causing jitters in financial markets.

Trump also did not address the sequester—the automatic budget cuts that would take place if Congress cannot agree upon new discretionary spending caps for fiscal 2020 and 2021. However, he did allude to the large increases in military spending, which would be imperiled by the sequester. If Republican lawmakers push for increased defense funding for next fiscal year, as they have done in the past, Democrats would probably require that such an increase be matched with a similar boost to nondefense funding. Our baseline assumption is that lawmakers will clinch a deal extending defense and nondefense funding at current levels for the next two fiscal years in which the caps are still in effect.

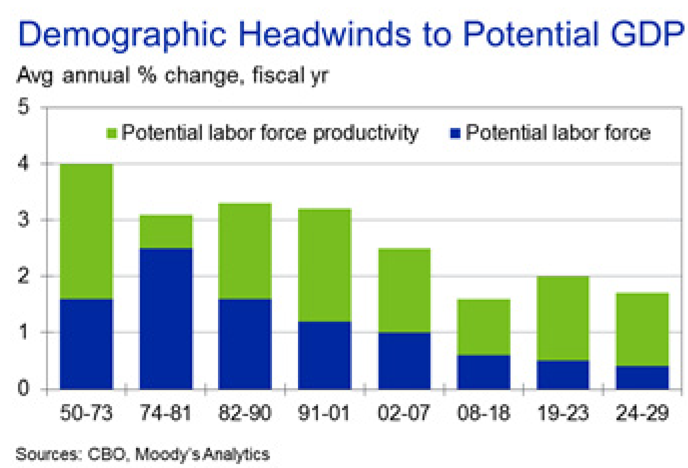
A good chunk of Trump's speech was spent touting a strong U.S. economy. However, he did not mention that despite a robust economy, federal fiscal conditions are deteriorating. Even though actual GDP is running above its potential, the federal deficit is increasing as a share of U.S. output, which is historically anomalous, save for during the Korea and Vietnam wars. Historically, the deficit has averaged 1.5% of GDP in those years when the unemployment rate was below 6%. Over the next years, the Congressional Budget Office projects unemployment will stay below 6% but the deficit will average a much higher 4.4% of GDP.





Part of the reason is the combination of deficit-financed tax cuts and large spending increases that were both passed under Trump. However, the divergence between the economic expansion and the deficit began even before Trump took office and largely reflects a graying U.S. population that is boosting old-age entitlement spending. Entitlement reform, a historically dicey topic, was not mentioned in the SOTU, even though it will be necessary to prevent the federal debt burden from reaching unprecedented levels in the next decades.

Immigration was another large area of focus in the address. Though Trump stated, "Legal immigrants enrich our nation and strengthen our society in countless ways," there was no clear argument about the economic importance of immigration. U.S. population growth slowed for the third consecutive year in 2018 to its slowest pace since 1937. As the population ages, we are seeing fewer births and more deaths, which is reducing the pace of natural population growth. As a result, the U.S. is becoming increasingly reliant on international migration to sustain growth in both the population and potential GDP, which is the sum of growth in productivity and the labor force.



All told, the president's comments Tuesday night did not move the needle on our baseline fiscal policy assumptions. In terms of the policies most important to the federal fiscal outlook, lawmakers will be keen to avoid another shutdown fiasco, and any potential misstep on the debt limit or the sequester would be too costly for lawmakers not to blink.

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

What Will May Say?

The week ahead will be extremely busy for the U.K. economy. And it is no surprise that the focus will remain on the politicians and on their handling of the Brexit mess. Theresa May vowed to go back to the EU and try to renegotiate the terms of the Irish backstop included in the withdrawal agreement, and she is expected to update parliament Wednesday on any progress. We don't expect that she will manage to come home with a fully renegotiated deal by then, which means that the uncertainty is more likely than not to carry over into the second half of February.

On Thursday, MPs will get to debate Brexit developments and could pass new amendments to the Brexit bill, as they did on January 29. We expect that amendments regarding a second referendum and a mandatory extension of Article 50 to be put to votes, and so is an amendment that will try to shift control of the process away from government and give parliament a chance to define Brexit. It is unclear that any of these amendments will pass. We maintain that May will manage to find herself a deal that commands a majority, even if that implies shifting toward a softer approach—i.e. remaining in the customs union—in order to gather the support of Labour MPs. In any case, it looks like an extension of Article 50 is imminent, since it is unlikely that both the U.K. and the EU parliament could approve a final withdrawal deal in less than 50 days. Elsewhere, we continue to think that the chances of a no-deal Brexit are very small; no one wants it and both the EU and the U.K. will do whatever it takes to avoid it.

On the data front, all eyes will be on the publication of fourth quarter GDP figures for the U.K. We expect them to be grim. All soft and hard data for the three months to December have confirmed our fears that uncertainty took a huge toll on the U.K economy's performance at the end of 2018 (and the start of 2019), as firms and households adopted wait-and-see strategies and avoided making any major commitments given little clarity on the future of the U.K.-EU relationship. Accordingly, we expect that GDP fell by 0.2% m/m in December, pushing growth in the final quarter of the year to as low as 0.2% q/q, from 0.6% in the third stanza. We caution nonetheless that risks are tilted towards an even weaker reading.

Across sectors, we expect that December's output fell across the board. First, U.K. services sector activity is expected to have declined by 0.2% m/m, following a 0.3% increase in November. November's results were boosted by Black Friday sales—which raised output in the distribution sector— but December brought some correction. Accordingly, sales data have shown that the performance of retailers plunged in December, which resulted in fourth quarter sales falling 0.2% from the third quarter. Elsewhere in the services sector, we expect that output in accommodation & food services, real estate activities and professional, scientific and technical activities also fell in December, correcting from unusually strong results over the previous two months. This would help push growth in the broad services sector down to only 0.3% q/q in the fourth quarter as a whole, from 0.5% in the third.

We also expect industrial production activity to have been contained in December, which is extremely disappointing, since factory growth fell in both October and November. Over the quarter, we expect that industrial production fell by as much as 1.1% q/q, following a 0.6% rise previously. Above-average temperatures at the end of the year—which took a toll on electricity production—were among the main culprits of this downbeat performance. But manufacturing is also expected to have disappointed. It was likely dragged down by lower external demand, due to the global slowdown in economic growth, and a plunge in investment at home.

Last, we expect better results from the construction sector. Data for October and November showed that construction activity rose sharply over those months, boosted mainly by the mild weather. And while soft data for December point to some correction, we still expect that construction activity rose by 1.3% q/q for the fourth stanza as a whole, building on a 2.3% increase in the third quarter. We caution nonetheless that this result is extremely odd; anecdotal evidence suggests that housebuilding and commercial real estate activities were put on hold because of Brexit uncertainties.

	Key indicators	Units	Moody's Analytics	Last
Mon @ 9:30 a.m.	U.K.: Monthly GDP for December	% change	-0.2	0.2
Mon @ 9:30 a.m.	U.K.: GDP for Q4	% change	0.2	0.6
Mon @ 11:00 a.m.	OECD: Composite Leading Indicators for December		99.2	99.3
Mon @ 2:00 p.m.	Russia: Foreign Trade for December	$ bil	18.8	19.0
Wed @ 9:30 a.m.	U.K.: Consumer Price Index for January	% change yr ago	1.7	2.1
Wed @ 10:00 a.m.	Euro Zone: Industrial Production for December	% change	-0.2	-1.7
Fri @ 8:00 a.m.	Spain: Consumer Price Index for January	% change yr ago	1.0	1.2
Fri @ 9:30 a.m.	U.K.: Retail Sales for January	% change yr ago	3.0	3.0
Fri @ 10:00 a.m.	Euro Zone: External Trade for December	bil euro	19.5	19.0
Fri @ 2:00 p.m.	Russia: Industrial Production for january	% change yr ago	2.4	2.0

ASIA-PACIFIC

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

Keeping a Close Eye on China's Money Supply

A handful of China's monthly activity data for January will be the highlight. The usual distortion from the Lunar New Year celebrations that occurs in the first two months of the calendar year is likely to be reduced this year given that the celebrations occurred in February in both 2018 and 2019. China's monthly money supply data are being closely watched for evidence of stimulus and recently have been on an uptrend, as the government has increasingly turned to expansionary measures. We expect M2 money supply growth picked up to 8.2% y/y in January, after rising to 8.1% in December. The People's Bank of China cut the reserve requirement ratio by a 100 basis points in January, following earlier cuts of a cumulative 250 basis points in 2018. The reduction in the reserve requirement ratio, alongside other easing measures, should provide stabilization in the first half of 2019.

China's inflation picture remains subdued. CPI growth cooled in December to its slowest pace in over two years and likely remained there in January. The continued downtrend in upstream prices suggests further softening ahead, keeping the light green for further stimulus in 2019 to lift domestic demand. Producer price growth slumped to 0.9% y/y in December, the weakest reading since September 2016 and down from 2.7% in November. Producer price inflation is forecast to have decelerated in January for a seventh straight month.

Japan's economy is likely to narrowly avoid slipping into a technical recession in the December quarter. We forecast GDP growth to have risen by 0.1% q/q in the fourth quarter, following the 0.6% contraction in the third stanza on the back of a string of natural disasters causing significant disruption to manufacturing, exports and consumption over the period. Most of the disruption had passed by the fourth stanza and a decent, although choppy, improvement was observed in important manufacturing sectors. Net exports are poised to make a modest upward contribution to GDP growth, while household final consumption will also likely be mildly positive, at best.

India's consumer price growth is likely to remain below the Reserve Bank of India's 4% medium-term inflation target in January for a sixth straight month, keeping the door wide open for the central bank to maintain its easing bias. Elsewhere, the Reserve Bank of New Zealand will keep the policy rate steady and is unlikely to consider moving until mid-2020.

	Key indicators	Units	Confidence	Risk	Moody's Analytics	Last
Mon @ Unknown	China Monetary aggregates for January	% change yr ago	3	↓	8.2	8.1
Tues @ 11:00 p.m.	India Consumer price index for January	% change yr ago	3	↑	2.1	2.2
Tues @ 11:00 p.m.	India Industrial production for December	% change yr ago	2	←	4.9	0.5
Wed @ 7:00 a.m.	New Zealand Monetary policy for February	%	5	←	1.75	1.75
Wed @ 10:00 a.m.	South Korea Unemployment rate for January	%	3	←	3.8	3.8
Thurs @ 10:50 a.m.	Japan GDP for Q4 - advance estimate	% change	3	↓	0.1	-0.6
Thurs @ 3:00 p.m.	Malaysia GDP for Q4	% change yr ago	3	↓	4.5	4.4
Fri @ 12:30 p.m.	China Consumer price index for January	% change yr ago	3	←	1.8	1.9
Fri @ 12:30 p.m.	China Producer price index for January	% change yr ago	3	↓	1.1	0.9
Fri @ Unknown	Indonesia Foreign trade for January	US$ bil	3	↑	-1.4	-1.1
Fri @ Unknown	India Foreign trade for January	US$ bil	2	←	-14.7	-13.1

The Long View

The ongoing rally in high-yield credit stems from growing confidence in a continued expansion of profits.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group
February 7, 2019

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 131 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 432 bp is thinner that what is suggested by the accompanying long-term Baa industrial company bond yield spread of 212 bp but is roughly consistent with an accompanying VIX of 16.4 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 increases for 2019's worldwide corporate bond offerings are 0.1% for IG and 2.8% 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 3% 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 7, 2019

UNITED KINGDOM

February's Bank of England monetary policy decision and press conference didn't rock the boat. The bank, as expected, left its rates unchanged, while its main message was again that heightened uncertainty and the global slowdown are leading to much weaker than expected economic momentum in the U.K. We thus see no reason to change our forecast that the bank won't dare kick the economy when it is down; Brexit waters are difficult to navigate the way they are, so the bank should wait until some sort of transition period is secured before moving again on rates. This makes May the most likely month for a next rate hike, though there is still the possibility that Article 50 will be extended and the Brexit can kicked down the road.

That the bank's growth forecasts were revised sharply down only added to our view. U.K. GDP is now expected to grow by as little as 1.2% in 2019, which would be the lowest performance recorded since the financial crisis in 2009. The main drag on growth is expected to come again from investment, which remains subdued because of the prolonged uncertainty, but net trade and household consumption are also expected to slow.

Inflation forecasts also were revised lower, in line with the recent decline in oil prices. The bank now expects U.K. CPI headline inflation to average only 1.9% this year, below its 2% target, which would further support its wait-and-see strategy. Recent wage growth shows strong momentum—it jumped to 3.4% y/y in the three months to November, its highest in a decade—but this has not yet translated into stronger underlying inflation pressures.

On the upside, the MPC still sees scope for a strong rebound in U.K. growth later this year, provided a Brexit transition period is secured. Consumer spending represents the biggest upside risk to the forecasts, but investment also is expected to pick up strongly. Since the MPC continues to see inflation remaining above target at the end of the forecast period if the transition is secured as soon as this month or next, there could be the need for even more than the market's three expected rate hikes over the next three years.

GERMANY

Wednesday's news on the data front only added to Tuesday's woes, especially for Germany. The country's two main economic releases—factory orders for December and the construction PMI for January—surprised to the downside, confirming our fears that the end-of-the-year broad-based loss of momentum likely carried over into 2019. It is still early, but these grim reports signal that the first quarter's numbers are likely to disappoint, which could lead us to soon revise down our forecasts for full-year growth in 2019.

Germany's factory orders plunged by as much as 1.6% m/m in the final month of 2018, against our expectations of at least some recovery following an already grim November. Even worse is that orders are now falling by a sharp 7% in yearly terms, which is the fastest pace of decline recorded in more than six years. These dismal numbers mirror all other survey figures for the country. While trade tensions continue to take a huge toll on manufacturing, the global slowdown and the lower momentum at home are also to blame. Indeed, orders from outside the euro zone plunged by 5.5% m/m in December, while domestic orders were down by 0.6%. In all, it looks as though any rebound in German industrial activity at the first half of this year will be sluggish.

Elsewhere, that the country's construction PMI fell sharply in January was also a letdown. It now reads worryingly close to the 50 stagnation mark, dragged lower by a sharp decline in commercial building. But all is not doom and gloom, as most of the hit to construction in January is expected to have been due to bad weather—snowstorms, ice and cold—creating scope for a rebound in February. New orders remained relatively robust, suggesting that underlying demand conditions remain positive, while confidence regarding the outlook for the next year remained at a six-month high.

ASIA PACIFIC

By Steven Cochrane and Katrina Ell of Moody's Analytics
February 7, 2019

CENTRAL BANKS

Asian central bankers are likely breathing sighs of relief following the press conference by U.S. Federal Reserve Chairman Jerome Powell after the Federal Open Market Committee's meeting on January 30. Powell sent a clear signal that the Fed was in no rush to raise rates further this year, saying, "The case for raising interest rates has weakened somewhat." He said the Fed would take a "patient" approach toward further rate hikes. Moody's Analytics puts the odds of a March hike at 0%, the odds of a June hike are 30%, and September and December each have a probability of 40%.

It was the Fed's normalization policy through 2018—including four 25-basis point hikes on the federal funds rate last year and nine overall over the past four years—that was an important factor in the volatility of foreign exchange rates in parts of Asia last year. This led to quick reaction by several central banks to raise local policy rates to stem the weakness of local currencies and stabilize the bruised confidence of investors and policymakers.

Countries with negative current accounts and high exposure to U.S. dollar-denominated debt and foreign investors, particularly Indonesia, India and the Philippines, experienced the most volatility in the second half of last year as capital began to flow toward rising yields of U.S. Treasuries. The often lofty declines in currencies last year and relative stability so far this year is a reasonable barometer of the state of play.

The Fed's dovish stance means that the interest rate spreads between the U.S. and emerging markets should not be expected to widen much this year, so Asian central banks will be able to step back and watch local economic and inflation trends as they set policy, rather than be forced to react to U.S. interest rate hikes.

Further, it will make the job easier for policymakers in Singapore and Hong Kong to maintain the value of their currencies, which are managed by monetary policy, versus the dollar. Even in the Middle East, where many countries try to maintain a constant spread between their policy rates and the U.S. to peg their currencies to the dollar, the task has just become easier.

INDONESIA AND THE PHILIPPINES

Central banks in Indonesia and the Philippines were amongst the most active in the region in 2018, each delivering interest rate hikes of a cumulative 175 basis points.

Bank Indonesia and the Bangko Sentral ng Pilipinas are expected to have a less eventful 2019, compared with 2018. BI expectedly kept the reverse repo rate at 6% at its January meeting. BI Governor Perry Warjiyo noted in January that rates are near their peak, and the Moody's Analytics baseline is for monetary policy settings to remain steady in 2019.

There has been speculation that interest rate cuts could be on Indonesia's near-term horizon. But we think this is premature. The bottom line is that BI is acutely aware that, although financial market conditions have calmed, risks of another flare-up are elevated not least because of heightened geopolitical risks including the looming Brexit deadline and still-unresolved U.S.-China trade war. BI has made it clear that it is prioritizing stability over growth, which is not conducive to near-term rate cuts.

Indonesian policymakers should be commended for their commitment to external stability in 2018. Bank Indonesia and the government appeared to work in unison for the shared goal. In addition to interest rate hikes and dipping into foreign reserves, the government restricted imports, offered tax breaks, and encouraged the use of domestic fuel sources to reduce the import bill and the current account deficit and to more broadly stabilize external positions.

Further reducing the likelihood of interest rate cuts is that domestic demand has held up relatively well, and lending rates have not followed the same aggressive upward climb as the monetary policy rate.

The Long View

In addition to capital outflows, the Philippines was driven into aggressive monetary tightening mode in 2018 due to elevated inflation. CPI growth hit a decade high at 6.7% y/y in September and October because of earlier tax changes and food shortages.

The central bank met on 7 February and kept policy settings steady, not least because CPI growth is well past the peak (it slowed to 5.1% y/y in December) and is expected to keep cooling in 2019. January's inflation data due next week are forecast at 4.9% y/y.

We attach a 40% probability that the central bank will reverse some of the tightening in the first half of 2019. Flagging domestic demand has been under pressure so would be an important contributor. But given that inflation remains above the central bank's 2%-to-4% target range, this could be pushed out to later in 2019.

INDIA

The Reserve Bank of India surprised markets with a 25-basis point rate cut in February, bringing the repo rate to 6.25%. This was the first interest rate cut since August 2017 and followed from 50 basis points worth of hikes in 2018. The RBI changed its stance to "neutral" from "calibrated tightening" at its February meeting. Reading between the lines, the RBI is following the same path as the government, which has taken a more expansionary stance to shore up domestic demand ahead of the general elections scheduled for April or May. February's policy meeting was the first for new Governor Shaktikanta Das, after the prior Governor Urjit Patel resigned in December.

Cooling inflation enabled the RBI to make the shift from hiking rates in 2018 to potentially easing in 2019. CPI growth has been on a downward trend since peaking in May at 4.9%. CPI growth hit 2.2% y/y in December, its softest pace since June 2017, after the 2.3% recorded in November. Declining vegetable prices, including prices of pulses, have led to India's recent disinflation trend, which now sees inflation sitting well below the central bank's 4% target for the fifth consecutive month. Food prices were the primary driver of the slowdown, with yearly prices down by 1.5% in December. Food prices account for nearly half of the overall consumer price basket so it's little surprise that large swings in food inflation can cause headline inflation to fluctuate.

Ratings Round-Up

U.S. Credit Activity Weakens

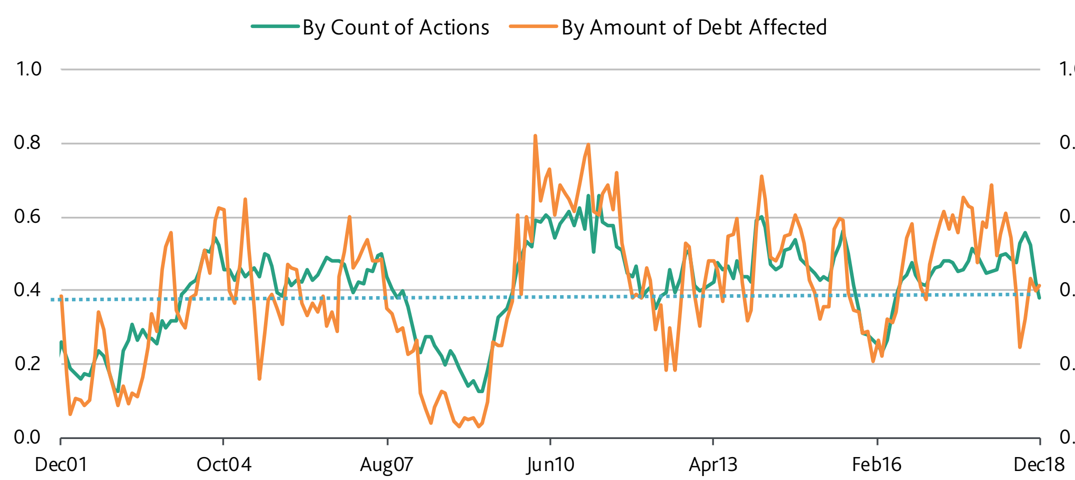
By Michael Ferlez

U.S. credit activity weakened for the week ending February 5, continuing a many-week trend of downgrades outnumbering upgrades. Only two firms received upgrades last week. The most notable was Platform Specialty Products Corporation, which saw its senior unsecured credit rating lifted to B2 from Caa1. On the downgrade side, CSC Holding, LLC saw its senior unsecured credit rating cut to Ba3 from Ba2, impacting $14 billion in debt. Although downgrades have consistently outnumbered upgrades in recent months, the downgrades have largely been confined to smaller companies with speculative credit ratings. The trend for larger investment-grade companies is more sanguine in part thanks to corporate tax cuts, which have left many firms flush with cash.

European rating change activity declined last week, with only two firms receiving rating changes, both upgrades. BNP Paribas Fortis's junior subordinated debt was upgraded to Baa3 from Ba2. Elsewhere, Bulgarian bank Investec Bank plc. saw its medium term note rating raised to A1 from A2. Together, both upgrades affected a combined $2.7 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

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

FIGURE 3

Rating Changes: Corporate & Financial Institutions – US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG
1/30/19	IPC CORP.	Industrial	SrSec/BCF /LTCFR/PDR		D	B3	Caa2	SG
1/30/19	CHANGE HEALTHCARE HOLDINGS LLC	Industrial	SrUnsec/SrSec /BCF/LTCFR/PDR	1,000	D	B3	Caa1	SG
1/30/19	LESLIE'S POOLMART, INC.	Industrial	SrSec/BCF /LTCFR/PDR		D	B1	B2	SG
1/31/19	GRIFFEY HOLDINGS, INC.-GETTY IMAGES, INC.	Industrial	LTCFR/PDR		U	Caa1	B3	SG
2/2/19	PLATFORM SPECIALTY PRODUCTS CORPORATION	Industrial	SrUnsec /LTCFR/PDR	800	U	Caa1	B2	SG
2/4/19	CABLEVISION SYSTEMS CORPORATION -CSC HOLDINGS, LLC	Industrial	SrUnsec /SrSec/BCF	14,820	D	Ba2	Ba3	SG
2/4/19	WINEBOW GROUP, LLC, THE	Industrial	SrSec/BCF /LTCFR/PDR		D	B2	Caa1	SG
2/4/19	ROBERTSHAW HOLDINGS S.A.R.L.-ROBERTSHAW US HOLDING CORP. (NEW)	Industrial	SrSec/BCF /LTCFR/PDR		D	B1	B3	SG
2/5/19	CHARLOTTE RUSSE HOLDING, INC. (NEW)-CHARLOTTE RUSSE, INC. (NEW)	Industrial	PDR		D	Ca	D	SG

Source: Moody's

Ratings Round-Up

FIGURE 4

Rating Changes: Corporate & Financial Institutions – Europe

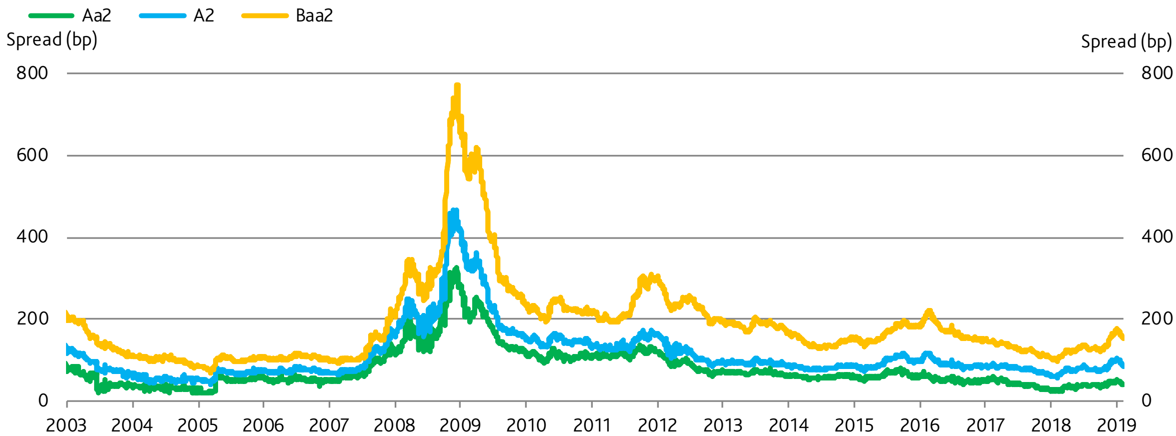
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/SG	Country
1/31/19	BNP PARIBAS-BNP PARIBAS FORTIS SA/NV	Financial	JrSub	1,087	U	Ba2	Baa3	SG	BELGIUM
2/1/19	INVESTEC HOLDINGS LTD -INVESTEC BANK PLC	Financial	LTD/Sub/MTN	1,630	U	A2	A1	IG	UNITED KINGDOM

Source: Moody's

Market Data

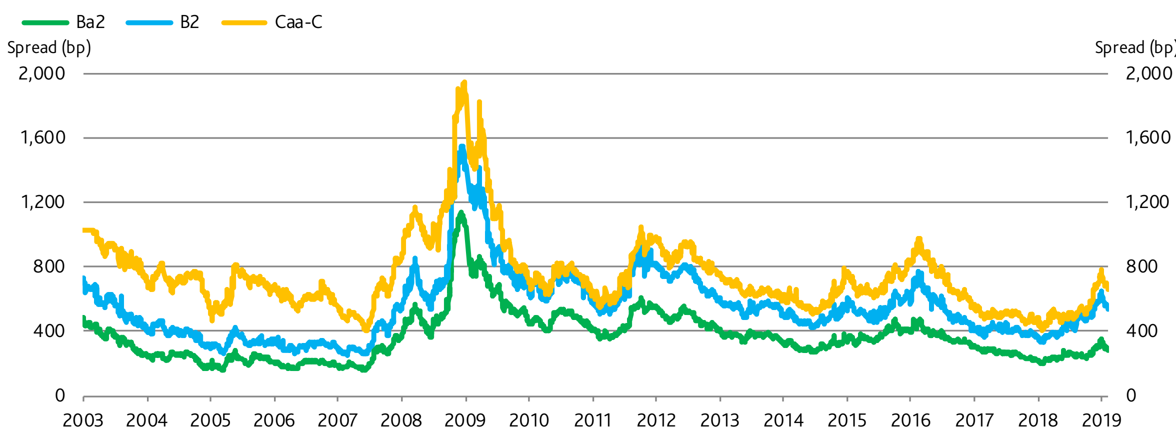
Spreads

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 30, 2019 – February 6, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Feb. 6	Jan. 30	Senior Ratings
Encompass Health Corp.	Ba2	B1	B1
Toyota Motor Credit Corporation	A1	A2	Aa3
Comcast Corporation	A2	A3	A3
Amgen Inc.	A3	Baa1	Baa1
International Business Machines Corporation	A3	Baa1	A1
General Motors Company	Ba1	Ba2	Baa3
First Data Corporation	A1	A2	B2
Berkshire Hathaway Inc.	Baa1	Baa2	Aa2
Dominion Energy, Inc.	A1	A2	Baa2
Kinder Morgan Energy Partners, L.P.	Aa3	A1	Baa2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Feb. 6	Jan. 30	Senior Ratings
FedEx Corporation	Baa2	A3	Baa2
Liberty Interactive LLC	B2	Ba3	B2
Gap, Inc. (The)	B2	Ba3	Baa2
Goldman Sachs Group, Inc. (The)	Baa3	Baa2	A3
Apple Inc.	Aa1	Aaa	Aa1
John Deere Capital Corporation	Baa1	A3	A2
United Technologies Corporation	A1	Aa3	Baa1
Intel Corporation	Aa3	Aa2	A1
Enterprise Products Operating, LLC	Baa2	Baa1	Baa1
Becton, Dickinson and Company	Baa3	Baa2	Ba1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Feb. 6	Jan. 30	Spread Diff
K. Hovnanian Enterprises, Inc.	Caa3	3,367	3,041	325
Frontier Communications Corporation	Caa1	2,588	2,449	139
Penney (J.C.) Corporation, Inc.	Caa2	3,268	3,177	91
Pitney Bowes Inc.	Ba1	440	422	18
FedEx Corporation	Baa2	73	57	16
Rite Aid Corporation	Caa2	1,157	1,142	15
Chesapeake Energy Corporation	B3	588	580	9
Exelon Generation Company, LLC	Baa2	105	98	7
Block Financial LLC	Baa3	99	94	5
McClatchy Company (The)	Caa2	617	612	5

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Feb. 6	Jan. 30	Spread Diff
Neiman Marcus Group LTD LLC	Ca	1,173	1,956	-783
Weatherford International, LLC (Delaware)	Caa3	1,595	2,217	-622
AK Steel Corporation	B3	712	863	-151
Avon Products, Inc.	B3	579	678	-99
Talen Energy Supply, LLC	B3	583	652	-70
Dish DBS Corporation	B1	561	630	-69
Nabors Industries Inc.	B1	470	534	-64
Dean Foods Company	B3	1,004	1,066	-63
Avis Budget Car Rental, LLC	B1	381	426	-44
Hertz Corporation (The)	B3	750	791	-41

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (January 30, 2019 – February 6, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Feb. 6	Jan. 30	Senior Ratings
Credit Agricole S.A.	A1	A2	A1
Anheuser-Busch InBev SA/NV	Baa1	Baa2	Baa1
Deutsche Telekom AG	Aa3	A1	A3
Orange	Aa3	A1	Baa1
Volkswagen Aktiengesellschaft	Baa3	Ba1	A3
BASF (SE)	Aa2	Aa3	A1
Fresenius SE & Co. KGaA	Baa2	Baa3	Baa3
National Grid Electricity Transmission plc	A2	A3	A3
Atlantia S.p.A.	Ba1	Ba2	Baa3
ArcelorMittal	Ba2	Ba3	Baa3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Feb. 6	Jan. 30	Senior Ratings
Koninklijke KPN N.V.	Ba1	A2	Baa3
Sunrise Communications Holdings S.A.	Ba1	A2	B1
Italy, Government of	B2	Ba3	Baa3
Iceland, Government of	A3	A1	A3
Marks & Spencer p.l.c.	B1	Ba2	Baa3
Lloyds Bank plc	Baa1	A3	Aa3
Ireland, Government of	Aa3	Aa2	A2
Portugal, Government of	Baa3	Baa2	Baa3
Intesa Sanpaolo S.p.A.	Ba2	Ba1	Baa1
HSBC Holdings plc	Baa2	Baa1	A2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Feb. 6	Jan. 30	Spread Diff
Sunrise Communications Holdings S.A.	B1	134	51	83
Koninklijke KPN N.V.	Baa3	125	52	74
Vue International Bidco plc	Caa3	395	362	32
Italy, Government of	Baa3	208	190	18
Ineos Group Holdings S.A.	B1	345	332	13
Banco Sabadell, S.A.	Baa3	144	134	10
Barclays Plc	Baa3	126	119	7
UniCredit S.p.A.	Baa1	151	143	7
Iceland, Government of	A3	53	46	7
Intesa Sanpaolo S.p.A.	Baa1	161	155	6

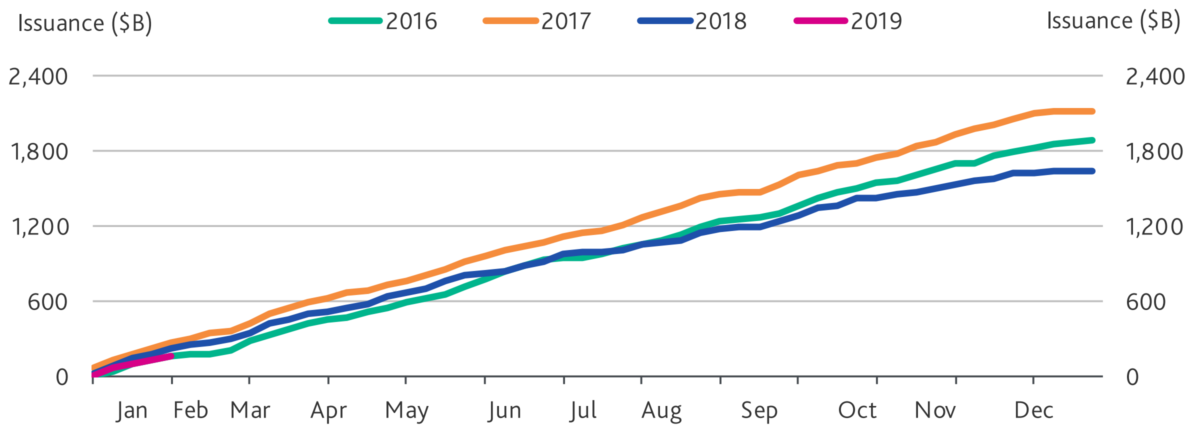
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Feb. 6	Jan. 30	Spread Diff
Galapagos Holding S.A.	Caa3	5,691	6,317	-626
CMA CGM S.A.	B3	688	787	-99
PizzaExpress Financing 1 plc	Caa2	2,233	2,321	-88
Matalan Finance plc	Caa1	651	721	-70
Novafives S.A.S.	Caa1	576	626	-51
Stonegate Pub Company Financing plc	Caa1	305	347	-42
Ardagh Packaging Finance plc	B3	274	313	-39
Eurobank Ergasias S.A.	Caa2	904	942	-38
Piraeus Bank S.A.	Caa2	898	935	-38
Altice Finco S.A.	Caa1	479	516	-37

Source: Moody's, CMA

Market Data

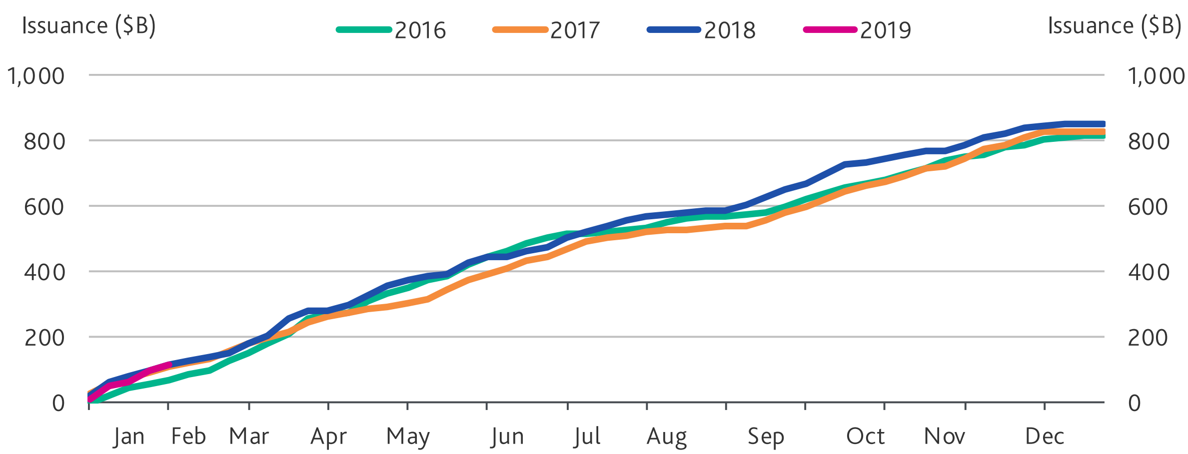
Issuance

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	19.949	13.350	35.383
Year-to-Date	124.247	38.520	169.628

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	14.992	0.657	16.410
Year-to-Date	107.999	5.888	116.147

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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