MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

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Fed's Pause May Refresh a Tiring Economic Recovery

Click here for *Moody's Credit Outlook*, our sister publication containing Moody's rating agency analysis of recent news events, summaries of recent rating changes, and summaries of recent research.

Credit Markets Review and Outlook

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

Fed's Pause May Refresh a Tiring Economic Recovery

As high ranking Federal Reserve officials reiterated many times earlier, monetary policy is not on a preset course. As outlooks for consumer price inflation, business activity and systemic liquidity change, so will monetary policy. Both January 30 release of the FOMC's policy statement and Jerome Powell's ensuing press conference assured markets that any normalization of Fed policy will not be indifferent to downwardly revised economic outlooks, industrial commodity price deflation, and volatile financial markets.

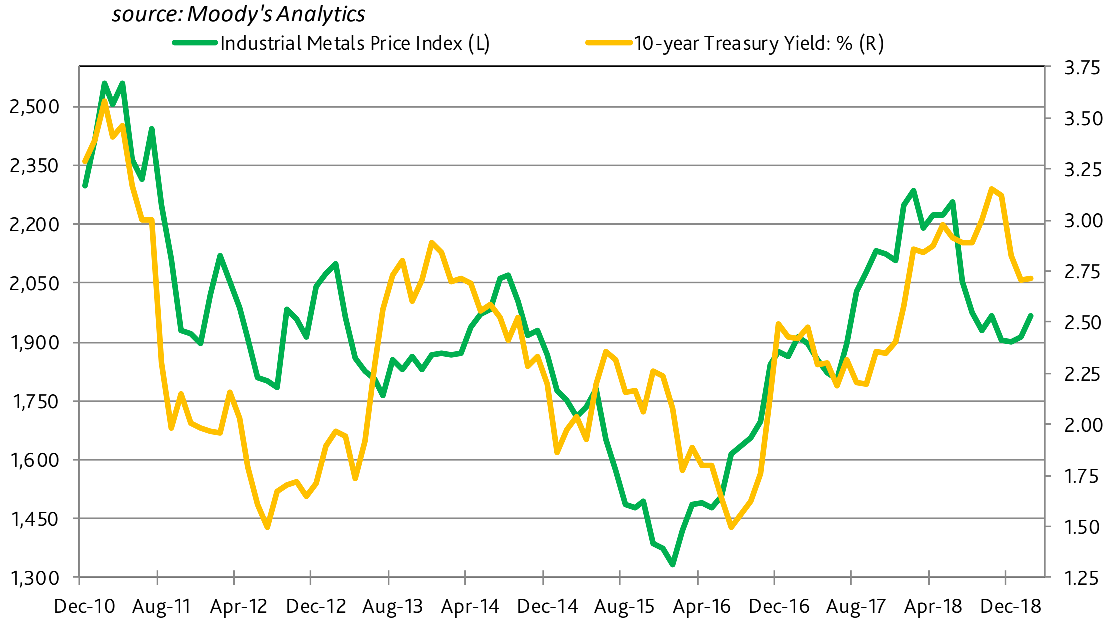
As inferred from the CME Group's FedWatch Tool, the probability assigned to a fed funds midpoint that exceeds its current 2.375% at any point in 2019 has practically vanished. The implied probabilities of a Fed rate hike recently were 1.3% for the FOMC's June 19 meeting, 1.2% for the September 18 meeting, and 1.0% for December 11's meeting. In fact, fed funds futures recently implicitly assigned a much greater 20% probability to the likelihood of a Fed rate cut at the December 11 meeting. However, these implied probabilities can change radically depending on business conditions, inflation expectations, and the outlook for systemic liquidity.

Right now, financial markets anticipate a satisfactory pace for business activity. Once markets sense an acceleration of expenditures, both Treasury bond yields and the implied probability of a Fed rate hike will rise.

Extended Upturn by Base Metals Prices Might End Slide by Treasury Yields

The recent rise by business-cycle-sensitive industrial metals prices hints of a firmer tone to global industrial activity, albeit from subdued pace. Though Moody's industrial metals price index for January 30 was down by 14.2% from its year-earlier-reading, it was up by 6.2% since the end of 2018.

Figure 1: If the Industrial Metals Price Index Extends Its Latest Rise, the 10-Year Treasury Yield May Soon Bottom
source: Moody's Analytics



The record suggests if the industrial metals price index extends its latest climb, the 10-year Treasury yield's slide will come to an end. Nevertheless, according to month-long averages since the end of 1983, the 10-year Treasury yield fell year-over-year for 41, or 84%, of the 49 months showing a yearly decline between 10% and 15% by the base metals price index. The eight deviations from this trend occurred in January 2019, November 2018, February 2014, July-August 1996, and July-September 1984.

However, January 2019's divergence from trend may not persist. Current indications are that February 2019's month-long average for the 10-year Treasury yield will be less than its 2.86% average of February 2018.

Mortgage Applications Hint of Livelier Home Sales and Stable Interest Rates

In addition to industrial metals prices, interest-sensitive spending will offer insight regarding the likely direction of benchmark interest rates. November 2018's sales of new homes well exceeded what were very modest expectations and surged higher by 16.9% monthly to a seasonally adjusted and annualized pace of 657,000 units. November's pace was the liveliest month for new home sales since the 672,000 annualized units of March 2018.

Nevertheless, despite November's strong showing by new homes sold, the sum of the new and existing home sales for the three-months-ended November 2018 contracted by 9.7% annualized from the contiguous three-months-ended August 2018 and dipped by 5.5% year over year.

Fourth-quarter 2018's average for the National Association of Realtors' index of pending sales of existing homes fell by 7.4% year over year before seasonal adjustment and contracted at an annualized rate of 15.2% from 2018's third quarter after seasonal adjustment. Fourth-quarter 2018's seasonally-adjusted average for the index of pending home sales appears to be the lowest of any calendar quarter since 2014's second quarter, or when home sales were beginning to recover from a brief slump triggered by the short-lived jump in Treasury bond yields stemming from the taper tantrum.

The FHLMC's benchmark 30-year mortgage yield averaged 4.78% in 2018's final quarter, which was greater than both the 4.57% of 2018's third quarter and the 3.92% of 2017's final quarter. However, the 30-year mortgage yield's latest decline to the 4.46% month-long average of January may help form a bottom for home sales.

January's 12.8% jump from December 2018 by the Mortgage Bankers Association's index of mortgage applications for the purchase of a home brightens housing's prospects. Nevertheless, as far as predicting existing home sales two to three months hence, pending home sales' 0.89 correlation with future existing home sales is stronger than the 0.74 correlation of homebuyer mortgage applications.

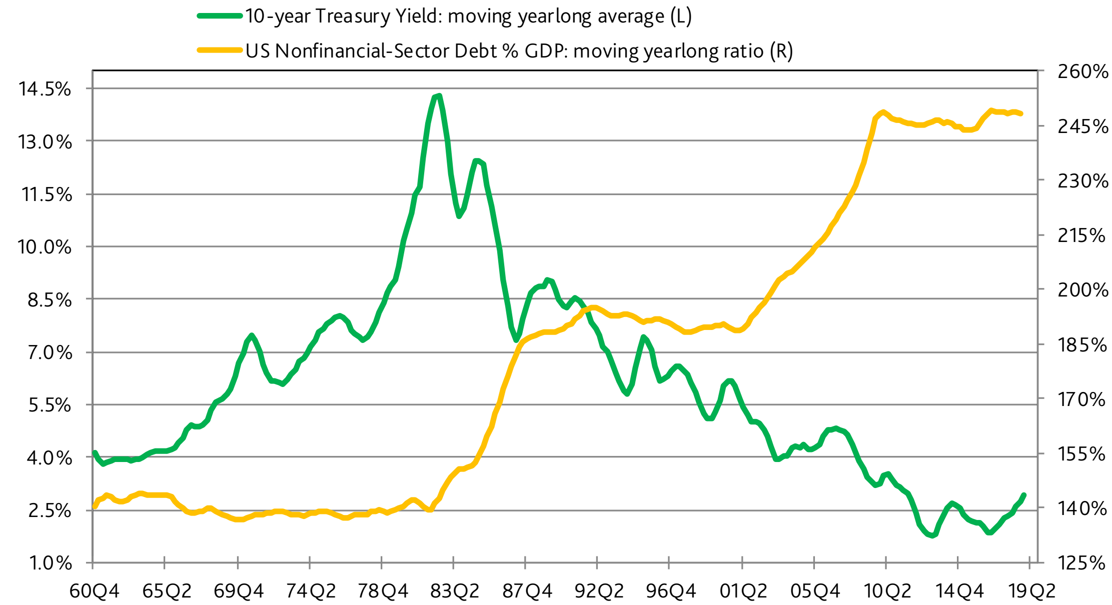
Still, January's outsized 12.8% monthly increase by homebuyer mortgage applications may prove telling. For those six months since December 2011 that showed a greater than 6% month-to-month increase by homebuyer mortgage applications, the accompanying index of pending home sales grew by 1.1% monthly, on average, while the average pace for existing home sales two to three months hence rose by 1.2%, on average.

Higher Systemic Leverage Lowers the Upside for Benchmark Interest Rates

The world's lower-than-anticipated benchmark interest rates of 2019-to-date brings attention to the heightened sensitivity of more highly leveraged economies to interest rate swings. As business activity becomes more dependent on debt to support asset values and fund spending, interest rate fluctuations will exert a greater influence than otherwise over expenditures, financial markets and commodity prices. All else the same, at higher ratios of nonfinancial-sector debt to GDP, a percentage point increase in interest rates may trigger a deeper percentage decline in earnings-sensitive security prices, commodity prices and expenditures. If the U.S. and world economies recently had difficulty shouldering a 3.00% to 3.25% 10-year U.S. Treasury yield, imagine what might happen if the world's benchmark bond yield approached 4%.

Credit Markets Review and Outlook

Figure 2: Nonfinancial-Sector Debt Rises from 2007's 225% to latest 248% of GDP
sources: Federal Reserve, BEA, Moody's Analytics



Historically Low Jobless Rate Will Keep Markets on Edge

Investors continue to take a cautious view if only because of the perceived limitations to growth suggested by today's historically low unemployment rate.

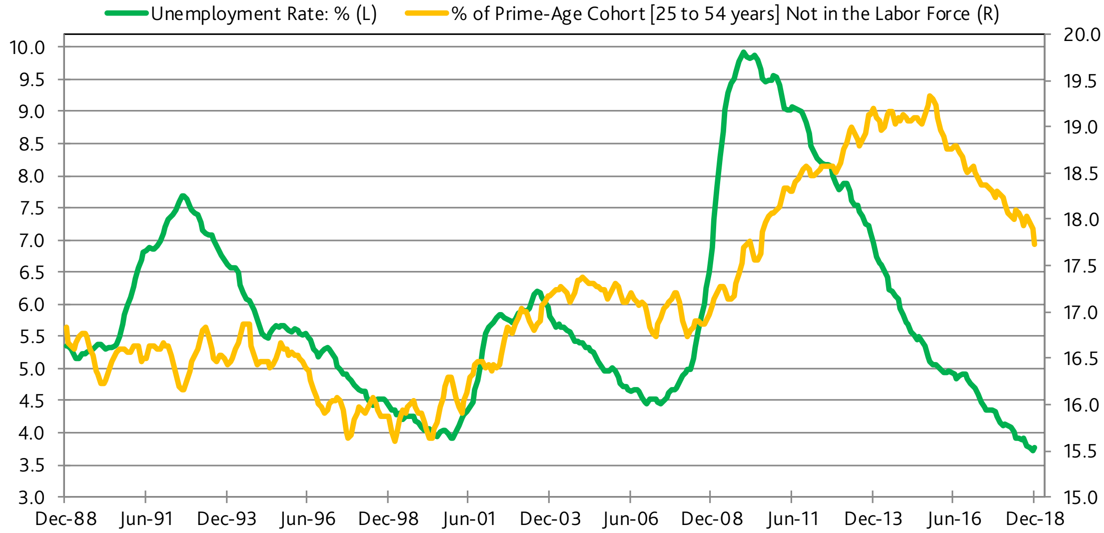
In the past, ultra-low jobless rates often were followed by sharply higher corporate default rates and recessions within a 12-month span. Whether or not history repeats itself remains to seen.

Faster rates of productivity growth and a higher rate of labor force participation for those of prime working age—25- to 54-years old—could allow for the indefinite continuation of the current business cycle upturn. A jump in productivity growth from its 1.2% annual average of the current recovery to something approaching the 2.3% average of 1991-2000's upturn would enhance profitability, prevent a disruptive ascent by defaults, and extend the recovery. And, if the prime working-age participation rate were to rise to its average of the year 2000—or when the jobless rate last approximated 4%—the labor force would increase by 1.9 million people, which equates to 162,000 new entrants per month over a yearlong span.

Figure 3: Relatively Low Labor Force Participation Rate for Prime-Age Americans Suggests U.S. Still Has Room to Grow

moving three-month averages

source: BLS, Moody's Analytics



In conclusion, it may be premature to conclude that the U.S. is close to running out of room to grow. Until inflation expectations turn materially higher or labor costs significantly outpace revenues, further reductions in the jobless rate will be tolerable.

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

THE U.S.

By Ryan Sweet, Moody's Analytics

Over? Did Your Say Over?

Our assumption is that consumer sentiment needs to hold up to limit the spillover effect of the partial U.S. government shutdown on the economy. That assumption could face a test following the sharp decline in the University of Michigan preliminary consumer sentiment survey for January. Sentiment dropped 7.6 points to 90.7, noticeably weaker than our below-consensus forecast. This is a sizable move. For perspective, the average absolute change in the preliminary survey this cycle is 3.1 points. The figure is 2.7 points since the presidential election.

The Federal Reserve has pressed pause on this tightening cycle for the foreseeable future, and it almost sounded like the central bank believes it's over, or very close to it. This differs from our forecast, which anticipates three additional 25 basis point rate hikes and puts the terminal rate at 3.25% for this cycle. However, it's fairly easy to craft a scenario where the Fed leaves rates unchanged this year and where its next move is a rate cut.

A standout from the Federal Open Market Committee statement on Wednesday was that the committee dropped any bias toward hiking rates. In December members expected multiple rate hikes; now they are unsure of the direction of the next move. In fact, the bar for hiking rates was raised noticeably, and strong growth is no longer sufficient enough. During his news conference Fed Chair Jerome Powell said that to justify a rate hike he would need to see very strong growth that pushes the unemployment rate substantially lower. And that isn't all. Powell added that inflation has to accelerate, and inflation expectations need to increase.

Some on the FOMC have hinted that they would stomach above-target inflation, posing another higher hurdle. Also, some of the downside risks to the outlook need to abate before the Fed could resume raising interest rates. Therefore, under a risk management approach the central bank no longer judges further rate hikes are needed. Rather, it has now said, "…the Committee will be patient as it determines what future adjustments to the target range for the federal funds rate may be appropriate…."

For the second consecutive day, we are adjusting our odds of the possible outcomes of Fed meetings this year. We now put the odds of a March hike at 0% (previously 5%), while odds of a hike in June are now 30%, and September is 40%. September is the meeting to watch, because it will occur around the time that the debt ceiling will need to be raised. Given the dysfunction in DC, the central bank would likely not want to raise rates then. The odds of a December rate hike are at 40%.

A probabilistic forecasting approach, which is based on the subjective probabilities of a fed hike versus a cut, would put the fed funds rate at 2.62% at the end of this year, implying roughly one rate hike this year. Turning to 2020, the Fed knows the fiscal stimulus will have faded, and the economy will grow at or below its potential growth rate.

Though the Fed has pivoted, it is adapting to recent developments in financial markets, heightened downside risks to the outlook, and absence of inflationary pressures. Being patient and pausing this cycle within the range of estimates of the long-run neutral rate is appropriate, and could extend the life of this expansion. The Fed has killed its fair share of expansions but likely not this one.

The Fed released an additional statement on the balance sheet. There have been concerns that the decline in the Fed's balance sheet is weighing on the stock market. But we find no overwhelming evidence that this is the case, even though the level of the balance sheet and the S&P 500 have had a correlation coefficient of 0.89 since 2009. The strong correlation between the Fed's balance sheet and equity prices is coincidental rather than causal.

A Granger causality test found the size of the balance sheet does not cause changes in equity prices. This exercise was done with varying lags, and the results did not change. Also, the decline in the balance sheet is unlikely to have a significant impact on equity markets because it lacks the signaling effect about future interest rate policy that accounted for much of the positive impact that quantitative easing had. In addition, most of the portfolio balance effect on term premium comes on announcements via expectations or stock effects rather than via flow effects. Overall, there are likely culprits behind the recent turbulence in financial markets other than the decline in the Fed's balance sheet.

Rather than consider the impact on financial market conditions, the Fed views that the decline in the balance sheet will continue until signs of reserve scarcity emerge, and so far there is not a lot of evidence of this. Though it's been smooth sailing so far, discerning the appropriate level of the reserve balance will become increasingly important.

Our assumption is that the reserve balance could hit $1 trillion, putting the balance sheet between $3 trillion and $3.5 trillion, before reserve scarcity emerges. This estimate is consistent with the Fed's Senior Financial Officer Survey.

Looking ahead, the key incoming data will be the trade deficit, ISM manufacturing survey, jobless claims and consumer prices.

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

BoE Likely to Wait on a Brexit Outcome

The focus will be on the Bank of England but we don't anticipate any fireworks. In December, the Bank of England monetary policy decision conformed to expectations. The Monetary Policy Committee was unanimous in deciding to leave rates unchanged, after it raised them for the second time in a decade in August. At the same time, the MPC reaffirmed that it is in no rush to hike again in coming months, or at least until the Brexit saga is resolved. The bank's minutes included a blunt warning that Brexit-related uncertainties have intensified considerably, and that they are leading to heightened volatility and tighter financial conditions. We maintain that the bank won't dare kick the economy when it is down; Brexit waters are already difficult to navigate the way they are, so the bank is likely to wait until a transition period is secured before moving again. This makes May the most likely date for a next rate hike.

That the bank's short-term growth forecasts were revised down only added to our view. Although this month's decision wasn't accompanied by an inflation report—meaning that there were no revisions to the bank's major forecasts—the BoE highlighted in the meeting's minutes that its nowcasting model for fourth quarter GDP points to growth slowing to only 0.2% q/q in the three months to December, down from an estimate of 0.3% previously. The main drag on growth was expected to come again from investment, which remains subdued on the back of the prolonged uncertainty.

The short-term inflation forecasts were also revised lower, in line with the recent decline in oil prices. The bank now expects the U.K.'s CPI headline inflation will fall below target by January, which would further support its wait-and-see strategy. True, wage growth has picked up strong momentum recently—it jumped to 3.3% y/y in the three months to October, its highest in a decade—but this has not yet translated into stronger underlying inflation pressures. Accordingly, the ONS's measure of core inflation eased further in November, to only 1.8%.

Elsewhere, the bank again warned that the response to a disorderly Brexit—or a no-deal Brexit—is not automatic, meaning that rates could go either up or down depending on different factors. We think it is highly implausible that the MPC will choose to beat down the economy in such a fragile moment—BoE Governor Mark Carney made the same threat before the referendum and still lowered rates—and we maintain that the committee is likely to stimulate the economy in such a case, even if a shock to supply from higher tariffs and a lower exchange rate pushes inflation sharply up in the short term.

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

ASIA-PACIFIC

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

Further Weakness Likely in China's Foreign Trade Data

China's monthly foreign trade data for January will be the focus. December's data were weak and forward estimates suggest further softness in January. In December, exports fell by 4.4% y/y, making the first dip since March. Imports fell 7.6% y/y, the weakest reading since July 2016 and a testament to soft domestic demand. The combination of waning offshore demand alongside the trade war with the U.S. are keeping exports subdued.

Indonesia's GDP growth likely hit 5.1% y/y in the December quarter, cooling from the 5.2% reading in the third stanza. The main drag is forecast from the external sector with commodity price weakness, especially for palm oil, dragging on overall performance. Private consumption looks to have held up relatively well in the face of aggressive monetary tightening through the second half of 2018.

Monetary policy meetings in Thailand and Australia will be uneventful with both central banks are widely expected to keep their policy rates steady in February. Australia's recently released CPI data for the fourth quarter confirm that inflation pressures are subdued, meaning there's no need for the Reserve Bank of Australia to rush to normalize policy settings. The cash rate has been at 1.5% since August 2016. Expectations of interest rate cuts in some circles are premature, not least because nontradables inflation is already relatively elevated.

The Bank of Thailand raised its key policy rate by 25 basis points to 1.75% at its December meeting. It was the first rate hike since August 2011 and marks an end to 44 straight months of ultra-accommodative monetary policy. The central bank had been inching closer to a rate hike in recent months, with three board members voting to raise rates at the November policy-setting meeting. Although the rate hike was expected, this increase was largely motivated by financial stability concerns and the need to create policy space to cushion against unforeseen shocks, rather than to keep price pressures in check. We don't expect further imminent interest rate hikes.

	Key indicators	Units	Confidence	Risk	Moody's Analytics	Last
Tues @ 11:30 a.m.	Australia Foreign trade for December	A$ bil	2	←	1.6	1.9
Tues @ 11:30 a.m.	Australia Retail sales for December	% change	3	↑	0.2	0.4
Tues @ 2:30 p.m.	Australia Monetary policy for February	%	5	←	1.5	1.5
Wed @ 6:05 p.m.	Thailand Monetary policy for February	%	5	←	1.75	1.75
Wed @ Unknown	Indonesia GDP for Q4	% change yr ago	3	↑	5.1	5.2
Fri @ Unknown	China Foreign trade for January	US$ bil	4	←	42.2	57.1

The Long View

Yearlong 2018's trend-like ratio of gross U.S. high-yield borrowing to high-yield debt outstanding favors an unchanged pace for 2019's high-yield borrowing.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group
January 31, 2019

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 137 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 462 bp is thinner that what is suggested by the accompanying long-term Baa industrial company bond yield spread of 223 bp but is roughly consistent with an accompanying VIX of 16.7 points.

DEFAULTS

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

US CORPORATE BOND ISSUANCE

Yearlong 2017's US$-denominated bond issuance rose by 6.8% annually for IG, to $1.508 trillion and soared by 33.0% to $453 billion for high yield. Across broad rating categories, 2017's newly rated bank loan programs from high-yield issuers sank by 26.2% to $72 billion for Baa, advanced by 50.6% to $319 billion for Ba, soared by 56.0% to $293 billion for programs graded single B, and increased by 28.1% to $25.5 billion for new loans rated Caa.

Fourth-quarter 2017 revealed year-over-year advances for worldwide offerings of corporate bonds of 17.6% for IG and 77.5% for high-yield, wherein US$-denominated offerings posted increases of 21.0% for IG and 56.7% for high yield.

First-quarter 2018's worldwide offerings of corporate bonds incurred year-over-year setbacks of 6.3% for IG and 18.6% for high-yield, wherein US$-denominated offerings posted sank by 14.4% for IG and 20.8% for high yield.

Second-quarter 2018's worldwide offerings of corporate bonds eked out an annual increase of 2.8% for IG, but incurred an annual plunge of 20.4% for high-yield, wherein US$-denominated offerings rose by 1.6% for IG and plummeted by 28.1% for high yield.

Third-quarter 2018's worldwide offerings of corporate bonds showed year-over-year setbacks of 6.0% for IG and 38.7 % for high-yield, wherein US$-denominated offerings plunged by 24.4% for IG and by 37.5% for high yield.

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

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

For 2018, worldwide corporate bond offerings sank by 7.2% annually (to $2.322 trillion) for IG and plummeted by 37.6% for high yield (to $376 billion). The projected annual percent changes for 2019's worldwide corporate bond offerings are -0.4% for IG and +2.0% 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 1.3% 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 Anna Zabrodzka of Moody's Analytics
January 31, 2019

GERMANY

The German economy hit the brakes in 2018. Preliminary estimates of the Federal Statistics Office showed that real GDP grew just 1.5% last year, following a 2.5% expansion in 2017. Although this is the ninth consecutive year of economic growth for the biggest euro zone economy, the rate was the slowest in five years.

Official fourth quarter results are not available yet, but the overall 2018 number puts the expansion rate at around 0.3% q/q and 0.9% y/y in the three months to December. This points to an anemic recovery following the unexpected contraction in the third quarter. Although Germany managed to avoid entering a technical recession, which requires two consecutive quarters of declining output, the sharp slowdown in the second half of the year is worrisome and clouds the outlook for 2019. For now, we expect growth to remain at around 1.5% this year before picking up in 2020.

Exports under pressure

Growth in 2018 came largely from domestic demand. Private and government spending rose over the year, though more slowly than in 2017. Particularly welcome was the continued expansion of fixed investment, which gained 3%, similar to last year; the increase was broad-based for machinery and equipment as well as for construction.

Weak external demand led the slowdown in the second half of last year and remains a concern for 2019. Although exports and imports continued to rise in 2018, their pace of increase slowed compared with the previous year, with exports pulling back more than imports. The result is that net exports chipped away at Germany's GDP growth.

Exports have been facing tougher headwinds since mid-2018. The yearly growth of exports has been trending down since the end of 2017 and outright contracted in November 2018 for the first time since mid-2016. But imports have held their ground and gradually chipped away at the trade balance. More worrying is that the drop in export growth in the second half of last year happened just as the euro was depreciating against the U.S. dollar, a sign global developments have dampened demand for German exports outside the currency area despite their improving competitiveness. The euro reached $1.14 in December 2018, its weakest since mid-2017 and a 3.8% depreciation in year-ago terms.

Industrial production growth has been tracking the trend in exports. Production in November plunged to 4.6% year on year, a figure not seen since the global financial crisis, but we think this is an outlier and expect some correction. Still, the trend is clearly to the downside and is driven by a steady decline in manufacturing orders, mainly from abroad but also from the domestic market. Some of the slowdown in the second half of last year falls on car manufacturers. Auto manufacturing has been under strain in the last few months due to new EU regulations on pollution standards. These came into effect in September and hurt sales of new models across Europe as automakers struggled to gain regulatory clearance.

External slings and arrows

Despite only 10 weeks remaining for the official exit of the U.K. from the European Union, uncertainty about what this means for U.K.-EU trade relations is heating up. On January 15, U.K. Prime Minister Theresa May lost the parliamentary vote on her Brexit withdrawal deal in a crushing defeat. This leaves many scenarios on the table, from a complete no-deal hard Brexit to cancelling the whole thing, though the latter is highly unlikely.

Should the first option materialize, German industry would be hit hard. The German Economic Institute expects hard losses for companies should trade tariffs and custom duties be reintroduced; the losses are estimated at over €3 billion. Germany's automotive sector would get hammered since 17.3% of value-added in British automotive consumption originates in Germany. Plus, the sector faces especially high-weighted World Trade Organization tariff rates of around 7.5% in the U.K.

Despite the Brexit turmoil, last year the U.K. remained Germany's third biggest export destination, accounting for 6.7% of total German exports from January to November. Still, compared with 2017, the volume of exports to the U.K. dropped by 3.6% y/y.

Meanwhile, German exports to China ballooned by 9.7% y/y, and we think it likely that China will soon overtake the U.K. in the ranking. But Germany's growing reliance on exports to China could backfire, given the cooling Chinese economy. China's official manufacturing PMI has steadily deteriorated since the middle of last year and finished 2018 at its weakest reading since February 2016.

Adding to the risk are lingering tensions between China and the U.S., which dominated the global geopolitical landscape over the last year. But while the dispute is far from resolved and a full-fledged trade war is still possible, some progress was made at the start of this year.

A cloudier forecast

Faced with the recent economic slowdown and uncertainties surrounding export prospects, the German central bank and several think tanks revised down their projections for 2019.

The Ifo Institute has scaled back its economic forecast substantially from what it predicted in autumn 2018. It now expects growth to slow to 1.1% in 2019, down from 1.9% predicted previously, mainly due to weakness in the automotive industry and uncertainties surrounding the global economy—namely Brexit and unpredictable U.S. policies.

The Bundesbank is more confident that the economy will overcome its latest slowdown, though it acknowledged threats to the outlook. The central bank lowered its projections by 0.3 percentage point to 1.6% for 2019. Moody's Analytics also lowered its forecast for 2019, to 1.5% from the 1.9% expected previously. This was largely down to the recent softness in the production sector, despite healthy gains in domestic demand, indicating just how susceptible the German economy is to external shocks.

Recent reforms to the pension system also could backfire if the economy slows further. As of January 2019, the laws governing social security contributions, among others, were heavily amended. For example, additional contributions will now be shared equally by employer and employee, while previously only the latter paid. Although this could boost consumer spending, it will shift the burden onto employers who will have to incur a high additional cost, which might prevent them from expanding their labour forces.

ASIA PACIFIC

By Katrina Ell and Veasna Kong of Moody's Analytics
January 31, 2019

SOUTHEAST ASIA

Southeast Asia has enjoyed a solid run in the last two years. Having grown at an average annual pace of 4.6% in the three years to 2016, GDP growth picked up to average 5.1% in 2017 and 2018, a touch below the pace set in the decade prior to the 2008-2009 global financial crisis.

Much of this improvement can be attributed to the synchronized global upturn that emerged in the second half of 2016, which provided the impetus for the rebound in export and manufacturing activity throughout the region.

Financial market ructions increased in the second half of 2018, as emerging market assets became less attractive with tighter U.S. monetary policy coming into view. A handful of central banks in the region were forced into aggressive tightening mode to stem outflows and stabilize external positions. Risk aversion was fueled further by the U.S.-China trade war.

With the outlook for U.S. monetary policy less hawkish in 2019, financial markets have been more stable, but there are no guarantees that the relative calm will last, not least because of heightened geopolitical tensions with the unresolved trade war and looming Brexit deadline.

The Long View

MALAYSIA

Malaysia's GDP growth is on a similar slowing trajectory. GDP growth is forecast to hit 4.3% in 2019, after an estimated 4.7% in 2018 and 5.9% in 2017. Malaysia's growth slowed in the second half of 2018 amid softer government investment that included sidelining important infrastructure projects, alongside a less supportive export environment, particularly for liquefied natural gas and palm oil. Mining also took a hit from unplanned outages.

Private consumption was a key driver of GDP growth in 2018 thanks to continued wage and employment growth. We expect private consumption to remain solid in 2019, with some upside for growth in the first half of the year due to the replacement of the goods and services tax with a sales and services tax in September 2018, which covers a much narrower range of goods and services.

In 2018, the government abandoned its earlier fiscal deficit target of 2.8%, later targeting a deficit of 3.7% for the year. The government hopes to lower the deficit to 3.4% in 2019, which could prove a challenge given the narrower sales and services tax. Strained public finances are likely to undermine public investment, which we think will remain on the weak side in 2019.

The outlook for oil prices provides some upside, as Malaysia is a net oil exporter. Moody's Analytics forecasts West Texas Intermediate crude oil to rise from its current levels around US$53 per barrel to average US$59 in 2019 and US$64 in 2020, which will increase government revenues.

INDONESIA

Although Indonesia's economic outlook is also less favourable now due to the heightened global uncertainty, growth prospects remain positive thanks to strength in domestic demand. GDP growth is forecast slow to 5% in 2019, down from a likely 5.1% lift in 2018 and below the government's initial 5.3% growth target for 2019. While the impact of earlier monetary tightening will be felt and dampen firms' investment, continued infrastructure spending should help sustain fixed investment growth.

Some reprieve will also come from the government's election campaign ahead of the April 2019 vote, which should lift government spending. Relative to other Southeast Asian economies, Indonesia is less exposed to cycles in global trade, particularly for manufactured goods. This should provide the economy with some buffer against external headwinds, although weaker investment and industrial activity in its major trading partners could undermine its commodity exports.

For Indonesia, an economy with persistent current account deficits, the ongoing normalization of U.S. monetary policy looms large. Volatility spiked noticeably last year as the U.S. Fed continued on its path of normalization and fragilities in Argentina and Turkey led investors to exit emerging markets, including Indonesia. Capital outflows hurt the rupiah and made it one of Asia's worst performing currencies in 2018. However, Bank Indonesia's aggressive rate hike cycle from May 2018 has helped stabilize the rupiah.

While capital outflows remain an ever-present downside risk, Indonesia's economy appears more resilient than it has in the past, such as during the 2013 taper tantrum, when investors pulled out of emerging markets on expectations of Fed asset purchase tapering.

Inflation is at the lower end of the central bank's 2.5%-to-4.5% target band and is expected to stay comfortably in that range in 2019; foreign reserves are still relatively elevated, equivalent to 6.5 months of imports and government external debt repayments; and Bank Indonesia has been on the front foot alongside improved public sector policy coordination. All of these factors suggest the economy is in a better position to withstand an increase in volatility.

SINGAPORE

Singapore's economy slowed significantly in the back half of 2018, expanding 2.2% y/y after a 4.3% rise in the first half of the year. With global trade poised to cool further in the coming year, this slowdown is expected to carry through into 2019, with GDP growth forecast to slow to 2.3% this year, down from 3.3% in 2018. Manufacturing has already slowed considerably alongside weaker exports, which fell for the first time in eight months in its latest reading. The outlook for the export-manufacturing sector is not bright given signs of slowing in its major export destinations such as China. Moreover, the global tech cycle, which drove export and manufacturing production growth for much of the last two years, is cooling and will likely weigh on GDP growth.

The Long View

With the export-oriented sectors of the economy poised to cool in 2019, much of the impetus for growth will come from Singapore's services sector, which will likely remain solid this year thanks to the finance and insurance, information and communication, and business service sectors. Tourism is also expected to stay healthy on the back of increasing arrivals from elsewhere in Asia, especially China. Construction, which has lagged in recent years, could also provide some modest lift, in line with the earlier increase in contracts awarded.

PHILIPPINES

By recent standards, the Philippine economy had a soft year in 2018, with full-year growth coming in at 6.2%, the weakest pace in three years and below the government's 6.5%-to-6.9% growth target. A number of factors conspired to weaken economic activity in 2018. Although President Rodrigo Duterte's "Build" program promises to improve infrastructure, which has long undermined the country's growth potential, it has also led to some concerns.

Duterte aims to lift infrastructure spending to 7.4% of GDP by 2022 from less than 3% under prior administrations. As of November, 44 out of 75 major infrastructure projects were being implemented, with 11 in the construction phase. By 2022, 31 projects worth about US$9.8 billion are expected to be completed.

To help fund the infrastructure development, the first of five tax reform packages was implemented in 2018. The package, which includes excise taxes on a range of goods, contributed to an increase in price pressures in 2018. Headline inflation neared a decade high of 6.7% y/y in September, and over 2018 averaged 5.2% y/y, well above Bangko Sentral ng Pilipinas' 2% to 4% target range. The increase in price pressures, coupled with the 175-basis point rate hike last year, served to undermine household consumption in 2018.

Ratings Round-Up

Downgrades Dominate U.S. Changes

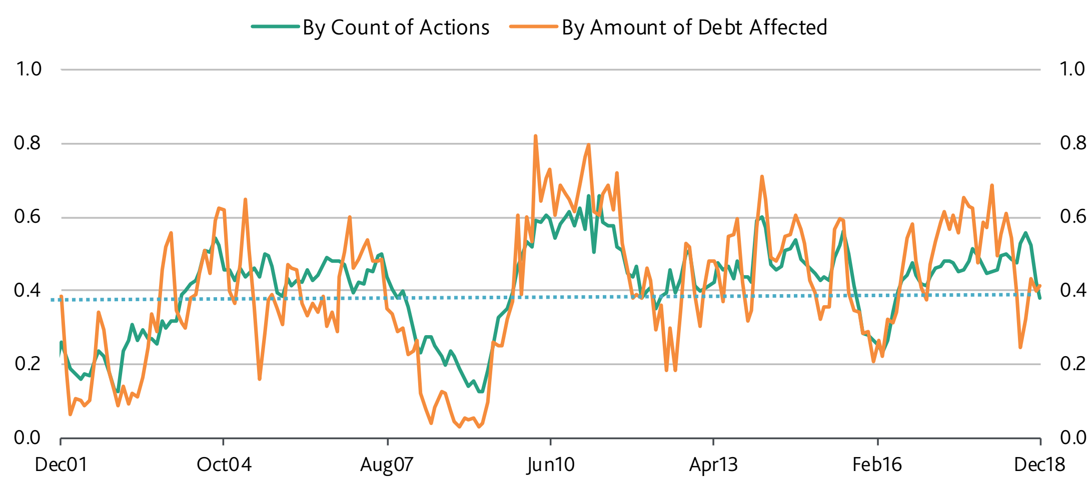
By Michael Ferlez

U.S. rating change activity increased last week, though the trend remained poor. Of the 13 changes, only four were upgrades. Moreover, positive rating changes accounted for a significantly smaller share of affected debt than downgrades. Key rating changes included the downgrade of nearly $9 billion of Cablevisions Systems Corporation's senior unsecured debt. CommScope Holding Company, Inc. also received a downgrade. The telecomm equipment firm's senior unsecured rate was cut to B1 from Ba3, affecting $7.1 billion in debt.

In Europe, rating change activity improved last week. The ratio of positive rating changes accounted for 63% of total activity, up from 50% in the prior week. Despite outnumbering downgrades, upgrades accounted for 34% of week's impacted debt. Upgrades were headlined by Ageas SA/NV. The Belgian bank's long-term issuer rating was upgraded two-notched to A3 from Baa2. Meanwhile, downgrades included Distribuidora Internacional de Alimentacion, S.A. which had its senior unsecured credit rating cut from Caa1 to Caa2.

FIGURE 1

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



* Trailing 3-month average

Source: Moody's

Ratings Round-Up

FIGURE 2

Rating Key

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

Ratings Round-Up

FIGURE 3

Rating Changes: Corporate & Financial Institutions – US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG
1/23/19	CALCEUS ACQUISITION, INC.	Industrial	SrSec/BCF /LTCFR/PDR		U	B3	B2	SG
1/24/19	CABLEVISION SYSTEMS CORPORATION -CSC HOLDINGS, LLC	Industrial	SrUnsec	8,996	D	B2	B3	SG
1/24/19	PAYLESS INC. (NEW)	Industrial	SrSec/BCF /LTCFR/PDR		D	Caa2	C	SG
1/25/19	DIGITAL ROOM HOLDINGS, INC. .	Industrial	SrSec/BCF /LTCFR/PDR		U	Caa2	Caa1	SG
1/28/19	CENTERPOINT ENERGY, INC.	Utility	SrUnsec/BCF /LTIR/Sub/PS	3,640	D	Baa1	Baa2	IG
1/28/19	PREMIERE GLOBAL SERVICES, INC. -AMERICAN TELECONFERENCING SERVICES, LTD.	Industrial	SrSec/BCF /LTCFR/PDR		D	B3	Caa1	SG
1/29/19	ARMSTRONG WORLD INDUSTRIES, INC.	Industrial	SrSec/BCF /LTCFR/PDR		U	B1	Ba3	SG
1/29/19	PG&E CORPORATION	Utility	PDR		D	Ca	D	SG
1/29/19	TRANSDIGM GROUP INCORPORATED -TRANSDIGM INC.	Industrial	SrSec/BCF		D	Ba2	Ba3	SG
1/29/19	DELUXE ENTERTAINMENT SERVICES GROUP, INC.	Industrial	SrSec/BCF /LTCFR/PDR		D	B2	B3	SG
1/29/19	NEW ACADEMY FINANCE COMPANY LLC -ACADEMY, LTD.	Industrial	SrSec/BCF /LTCFR/PDR		D	Caa1	Caa2	SG
1/29/19	COMMSCOPE HOLDING COMPANY, INC.	Industrial	SrUnsec /LTCFR/PDR	7,100	D	Ba3	B1	SG
1/29/19	EXGEN RENEWABLES I, LLC -CONTINENTAL WIND, LLC	Utility	SrSec	635	U	Baa3	Baa2	IG

Source: Moody's

Ratings Round-Up

FIGURE 4

Rating Changes: Corporate & Financial Institutions – Europe

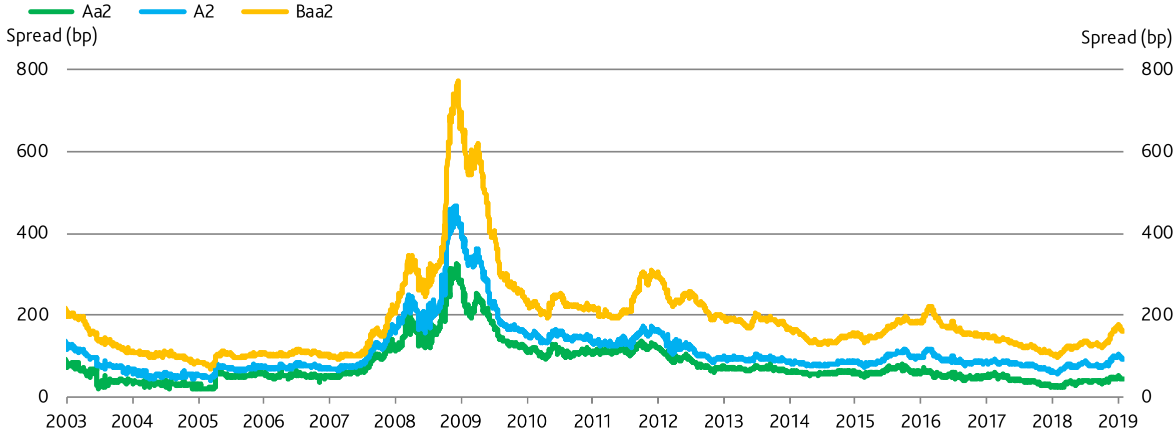
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/SG	Country
1/23/19	METSA BOARD CORPORATION	Industrial	SrUnsec	256	U	Ba1	Baa3	SG	FINLAND
1/23/19	GRUPO ANTOLIN -IRAUSA, S.A.	Industrial	SrSec /LTCFR/PDR	739	D	Ba3	B1	SG	SPAIN
1/24/19	BANK OF CYPRUS PUBLIC COMPANY LIMITED	Financial	LTD		U	Caa1	B3	SG	CYPRUS
1/24/19	HELLENIC BANK PUBLIC COMPANY LTD	Financial	LTD		U	Caa1	B3	SG	CYPRUS
1/25/19	DISTRIBUIDORA INTERNACIONAL DE ALIMENTACION, S.A.	Industrial	SrUnsec/MTN	2,501	D	Caa1	Caa2	SG	SPAIN
1/28/19	TP ICAP PLC	Financial	LTCFR		D	Ba1	Ba2	SG	UNITED KINGDOM
1/29/19	AGEAS (GROUP) -AGEAS SA/NV	Financial	LTIR/JrSub	1,421	U	Baa2	A3	IG	BELGIUM
1/29/19	TIGERLUXONE S.A.R.L.	Industrial	SrSec/BCF /LTCFR/PDR		U	B2	B1	SG	LUXEMBOURG

Source: Moody's

Market Data

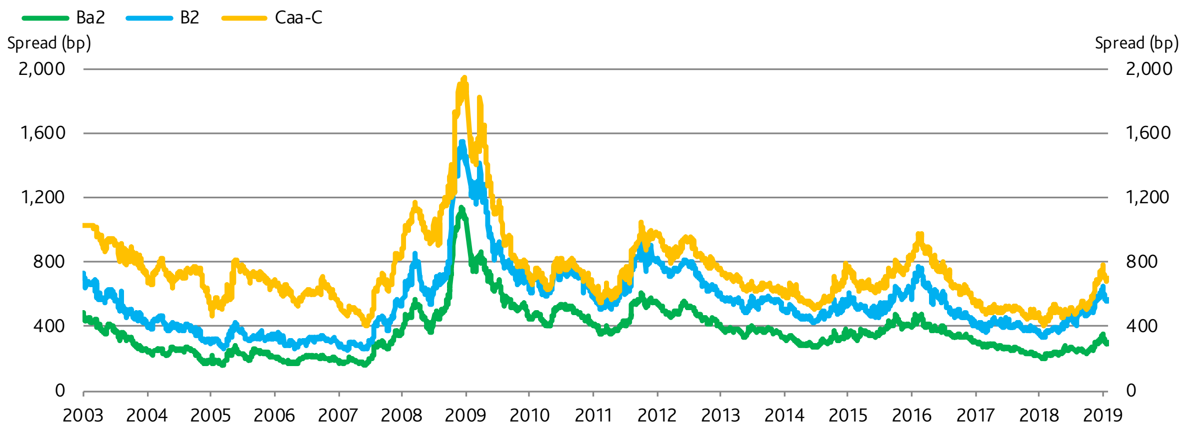
Spreads

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 23, 2019 – January 30, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jan. 30	Jan. 23	Senior Ratings
Humana Inc.	A1	A3	Baa3
Goldman Sachs Group, Inc. (The)	Baa2	Baa3	A3
Wells Fargo & Company	A3	Baa1	A2
Ally Financial Inc.	Ba1	Ba2	Ba3
Comcast Corporation	A2	A3	A3
Citibank, N.A.	Baa2	Baa3	A1
CVS Health	Baa1	Baa2	Baa2
HCA Inc.	Ba1	Ba2	Ba2
Bank of New York Mellon Corporation (The)	A2	A3	A1
Nissan Motor Acceptance Corporation	Baa3	Ba1	A2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jan. 30	Jan. 23	Senior Ratings
Danaher Corporation	Baa1	A2	A2
Lexmark International, Inc.	C	Caa3	Caa1
Caterpillar Financial Services Corporation	Baa1	A3	A3
Pfizer Inc.	Aa2	Aa1	A1
Amgen Inc.	Baa1	A3	Baa1
First Data Corporation	A2	A1	B2
CenturyLink, Inc.	Caa1	B3	B2
Anthem, Inc.	A2	A1	Baa2
Simon Property Group, L.P.	Baa2	Baa1	A2
Sempra Energy	Baa1	A3	Baa1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jan. 30	Jan. 23	Spread Diff
Lexmark International, Inc.	Caa1	995	686	309
K. Hovnanian Enterprises, Inc.	Caa3	3,041	2,831	210
Dean Foods Company	B3	1,066	895	171
Penney (J.C.) Corporation, Inc.	Caa2	3,177	3,079	99
Frontier Communications Corporation	Caa1	2,449	2,390	59
Windstream Services, LLC	Caa2	2,484	2,450	34
CenturyLink, Inc.	B2	443	418	25
R.R. Donnelley & Sons Company	B3	654	634	19
Freeport Minerals Corporation	Baa3	243	226	17
Freeport-McMoRan Inc.	Ba3	230	214	16

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jan. 30	Jan. 23	Spread Diff
Neiman Marcus Group LTD LLC	Ca	1,956	2,230	-274
Weatherford International, LLC (Delaware)	Caa3	2,217	2,399	-182
Xerox Corporation	Ba1	245	289	-45
Nabors Industries Inc.	B1	534	578	-44
Chesapeake Energy Corporation	B3	580	621	-41
HCA Inc.	Ba2	127	166	-39
Hertz Corporation (The)	B3	791	829	-37
American Airlines Group Inc.	B1	318	352	-34
United States Steel Corporation	B2	355	386	-31
Dell Inc.	Ba2	276	306	-30

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (January 23, 2019 – January 30, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jan. 30	Jan. 23	Senior Ratings
HSBC Holdings plc	Baa1	Baa2	A2
Swedbank AB	Aa3	A1	Aa2
Allied Irish Banks, p.l.c.	A3	Baa1	Baa3
ENGIE SA	Aa3	A1	A2
Sanofi	Aa1	Aa2	A1
GlaxoSmithKline plc	Aa2	Aa3	A2
AstraZeneca PLC	Aa3	A1	A3
Unibail-Rodamco SE	A3	Baa1	A2
Veolia Environnement S.A.	Aa3	A1	Baa1
AXA	A1	A2	A2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jan. 30	Jan. 23	Senior Ratings
Orsted A/S	A2	Aa3	Baa1
Landesbank Hessen-Thueringen GZ	A1	Aa3	Aa3
Vodafone Group Plc	Baa3	Baa2	Baa1
Daimler AG	Baa3	Baa2	A2
Volkswagen Aktiengesellschaft	Ba1	Baa3	A3
Fresenius SE & Co. KGaA	Baa3	Baa2	Baa3
CNH Industrial N.V.	Ba1	Baa3	Baa3
Telia Company AB	Aa3	Aa2	Baa1
Nokia Oyj	Baa3	Baa2	Ba1
Telenor ASA	Aa1	Aaa	A3

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jan. 30	Jan. 23	Spread Diff
Galapagos Holding S.A.	Caa3	6,317	6,207	109
Stonegate Pub Company Financing plc	Caa1	347	257	90
Jaguar Land Rover Automotive Plc	Ba3	750	676	74
CMA CGM S.A.	B3	787	736	51
Boparan Finance plc	Caa1	1,176	1,150	26
Unipol Gruppo S.p.A.	Ba2	216	199	18
Vedanta Resources Limited	B2	486	477	9
Nokia Oyj	Ba1	88	82	7
Telenor ASA	A3	28	22	7
Old Mutual Plc	Ba1	24	19	6

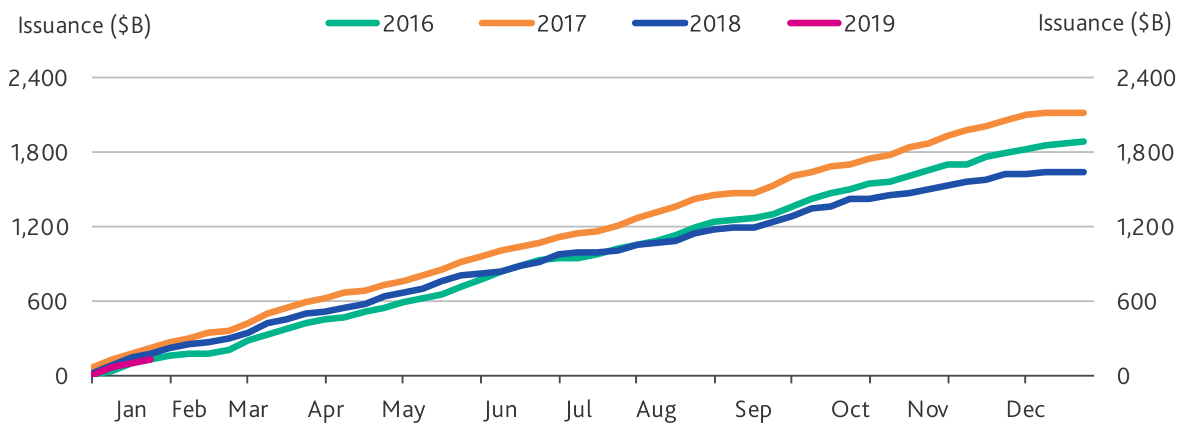
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jan. 30	Jan. 23	Spread Diff
PizzaExpress Financing 1 plc	Caa2	2,321	2,469	-148
Novafives S.A.S.	B3	626	674	-47
Matalan Finance plc	Caa1	721	764	-43
Care UK Health & Social Care PLC	Caa1	103	137	-34
GKN Holdings Limited	Ba2	146	177	-31
Telecom Italia S.p.A.	Ba1	304	330	-26
Altice Finco S.A.	Caa1	516	542	-26
Premier Foods Finance plc	Caa1	289	315	-26
Atlantia S.p.A.	Baa3	165	191	-25
Ineos Group Holdings S.A.	B1	332	356	-24

Source: Moody's, CMA

Issuance

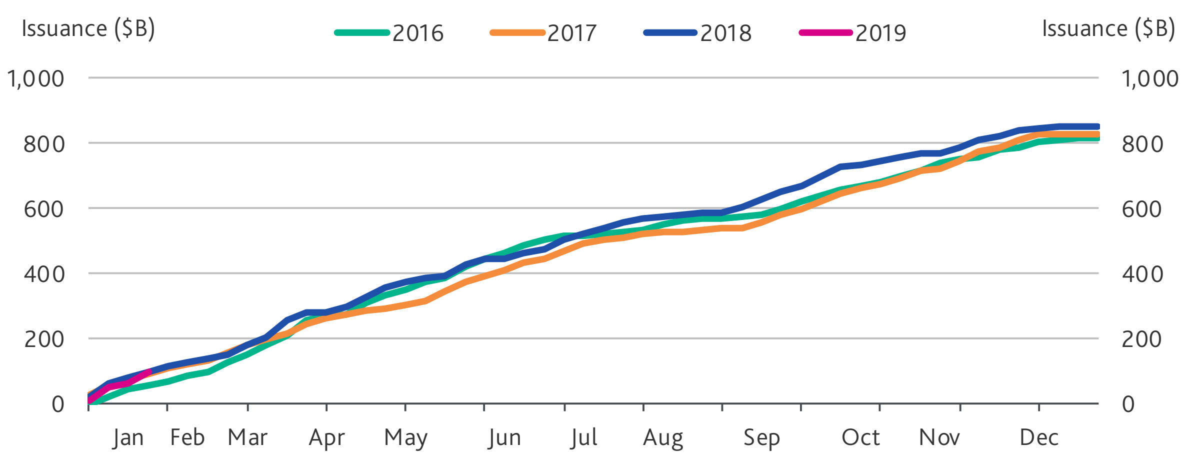
Market Data

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	12.783	11.575	25.568
Year-to-Date	103.384	25.170	132.460

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	32.681	2.248	35.749
Year-to-Date	92.312	5.231	98.826

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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