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WEEKLY MARKET OUTLOOK

Moody's Analytics Research

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Next Recession May Lower 10-year Treasury Yield to Range of 0.5% to 1%

Credit Markets Review and Outlook *by John Lonski*

Next Recession May Lower 10-year Treasury Yield to Range of 0.5% to 1%

» FULL STORY PAGE 2

The Week Ahead

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

» FULL STORY PAGE 6

The Long View

Full updated stories and key credit market metrics: September 2019's $184 billion of US$-denominated investment-grade corporate bond offerings trailed only January 2017's $193 billion and the May 2016's $189 billion.

Credit Spreads	Investment Grade: We see year-end 2019's average investment grade bond spread marginally above its recent 127 basis points. High Yield: Compared with a recent 467 bp, the high-yield spread may approximate 480 bp by year-end 2019.
Defaults	US HY default rate: Moody's Investors Service's Default Report has the U.S.' trailing 12-month high-yield default rate rising from August 2019's actual 2.9% to a baseline estimate of 3.9% for August 2020.
Issuance	For 2018's US$-denominated corporate bonds, IG bond issuance sank by 15.4% to $1.276 trillion, while high-yield bond issuance plummeted by 38.8% to $277 billion for high-yield bond issuance's worst calendar year since 2011's $274 billion. In 2019, US$-denominated corporate bond issuance is expected to rise by 6.4% for IG to $1.360 trillion, while high-yield supply grows by 35.7% to $377 billion. The very low base of 2018 now lends an upward bias to the yearly increases of 2019's high-yield bond offerings.

» FULL STORY PAGE 9

Ratings Round-Up

Speculative-Grade Companies Dominate Changes

» FULL STORY PAGE 13

Market Data

Credit spreads, CDS movers, issuance.

» FULL STORY PAGE 16

Moody's Capital Markets Research *recent publications*

Links to commentaries on: Liquidity and defaults, cheap money, fallen angels, corporate credit, Fed moves, spreads, yields, inversions, unmasking danger, divining markets, upside risks, high leverage, revenues and profits, riskier outlook, confidence vs. skepticism.

» FULL STORY PAGE 21

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.

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Credit Markets Review and Outlook

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

Next Recession May Lower 10-year Treasury Yield to Range of 0.5% to 1%

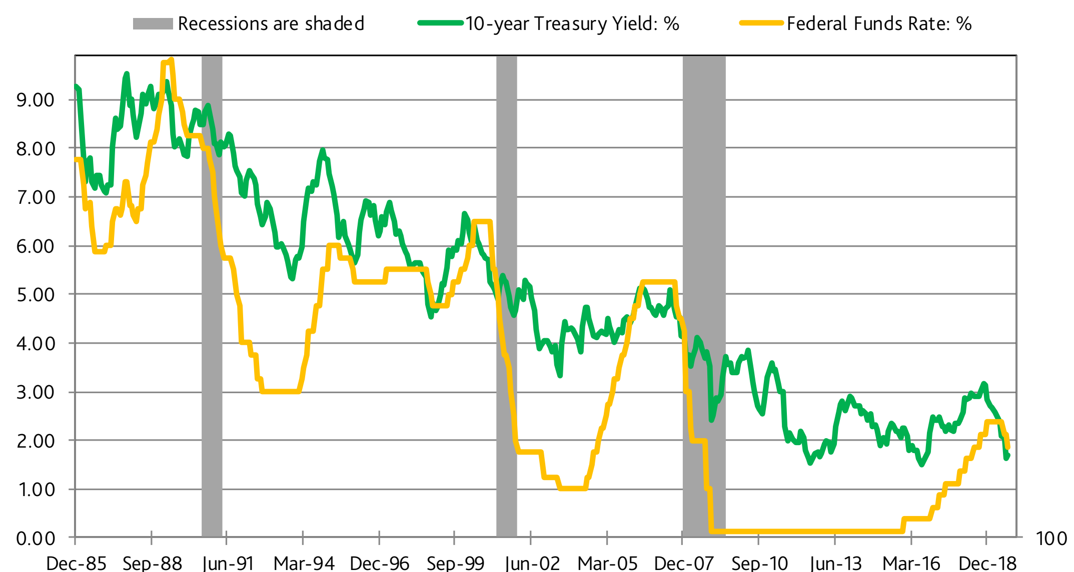
Despite today's ultra-low yields, Treasury bonds may still pay off handsomely once recession strikes. Accordingly, Treasury bond yields are likely to set new multi-decade and possibly new record lows within the next five years.

Any claim that the U.S. Treasury bond market is in a bubble that will soon inflict deep losses on unwitting holders of long-duration debt implicitly assumes that the U.S. will avoid a recession and begin to grow by at least 2.3%, on average, during the next five to 10 years. History warns us that such an assumption borders on the heroic.

Treasury bond yields will not lift-off if U.S. real GDP growth averages 2% or slower. As inferred from the 10-year Treasury yield's most recent August 28 low of 1.48%, the next recession will probably drive the 10- and 30-year Treasury bond yields down to ranges of 0.5% to 1% and 1.0% to 1.5%, respectively. A look at the recent government bond yields of other advanced economies lends credibility to the 10-year Treasury yield eventually bottoming in a range of 0.5% to 1.0%.

The federal funds rate sank by roughly five percentage points, on average, before and after the three previous recessions. However, given the latest fed funds rate of 1.875%, another five-percentage point plunge by fed funds is impossible. Thus, either (i) the Fed via quantitative easing or (ii) the market may have to lower the 10-year Treasury yield to something less than 1% if expenditures are to grow rapidly enough to restore jobs lost to the next recession.

Figure 1: Fed Funds Sank by Five Percentage Points, on Average, Following Three Latest Recessions ...10-year Treasury Yield May Need to Drop Under 1%
sources: Federal Reserve, NBER, Moody's Analytics



Futures Market Sees a Fed Rate Cut but No Recession

The September employment report may or may not corroborate recent weak readings on business activity. If September's private-sector payrolls grow by fewer than 100,000 jobs, the Federal Open Market Committee will probably lower fed funds midpoint to 1.625% on October 30. However, if a downbeat September jobs report drives the 10-year Treasury yield under 1.5%, triggers a deeper sell-off of U.S. equities, and swells the high-yield bond spread by 100 basis points, the FOMC may vote for a 50 bp slashing of fed funds to 1.375% at the October 30 meeting.

Recently, fed funds futures assign an implied probability of 88% to a 25 bp cutting of fed funds on October 30. Nevertheless, the CME Group's FedWatch Tool revealed that the futures market also assigned an implied probability of merely 52% to fed funds' midpoint being lowered to 1.375% at the December 11, 2019 meeting of the FOMC. Thus, the fed funds futures market does not view a recession as being imminent.

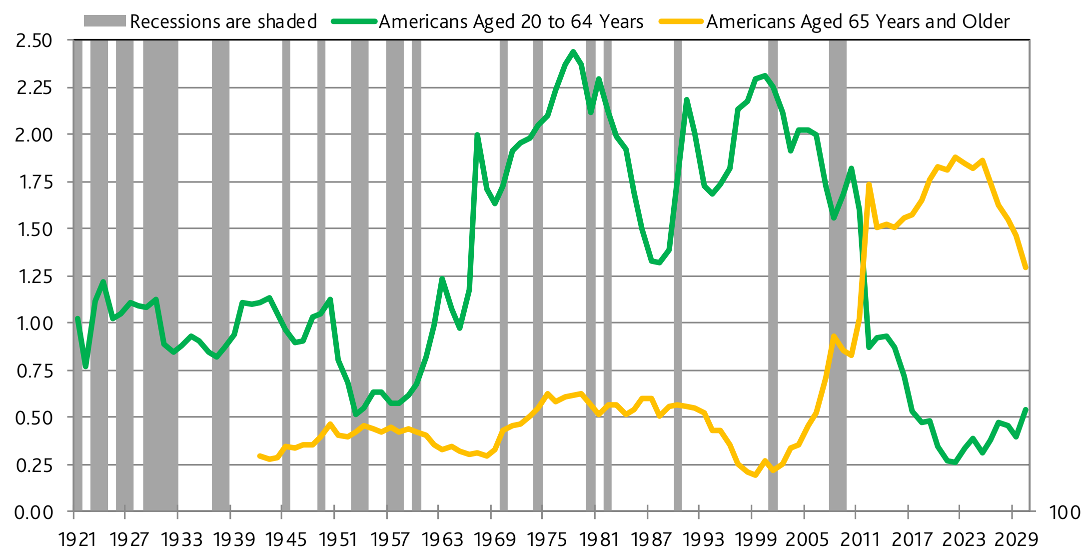
Aging Population and Workforce Leaves Room for a Lower Jobless Rate

By itself, today's historically low U.S. unemployment rate signals above-average recession risk. Prior to 2018, the unemployment rate was less than or equal to 4% during 2000 and 1969. Soon thereafter, recessions materialized in 2001 and 1970. In part, the difficulty of moving the jobless rate under 4% and a climb by benchmark interest rates in response to an increase in perceived inflation risk helped to slow household expenditures by enough to prompt the layoffs that triggered a recession.

However, a recession has yet to immediately follow yearlong 2018's average jobless rate of 3.9%. Perhaps, the aging of both the U.S. workforce and population has reduced the underlying growth rates of wages and price inflation by enough to allow for a lowering of benchmark interest rates despite a historically low unemployment rate.

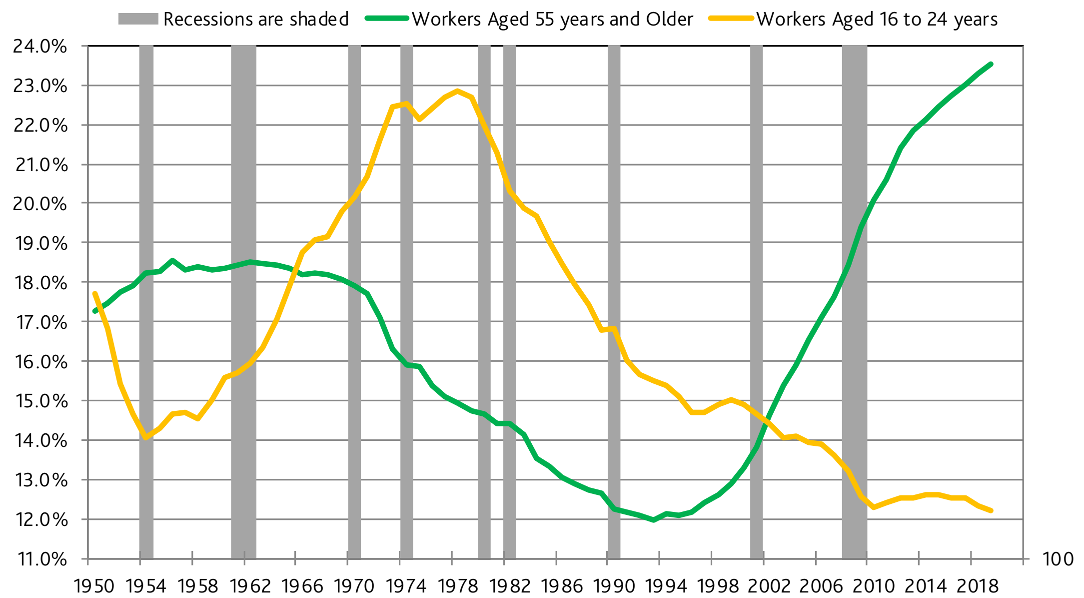
The slower underlying rates of growth for business activity and prices that are common to aging economies necessitate lower benchmark interest rates. When U.S. real GDP growth last topped 4% annually during 1997-2000, the number of Americans aged 20- to 64-years old grew by 2.3 million annually, on average. In 2020, the population of the 20- to 64-year age cohort is expected to rise by a record low 345,000. This record low extends all the way back to 1921. (Some readers might see something noteworthy in the decline by the average annual increase in the 20- to 64-year age cohort from the 1.053 million of 1921-1929 to the 881,000 of 1931-1939.)

Figure 2: Annual Increase in Number of 20- to 64-Year Old Americans Plunges from 1997-2000's 2.3 Million Average to 2020's Record Low 345,000
actual & predicted annual increases in millions of people
sources: Census Bureau, NBER, Moody's Analytics



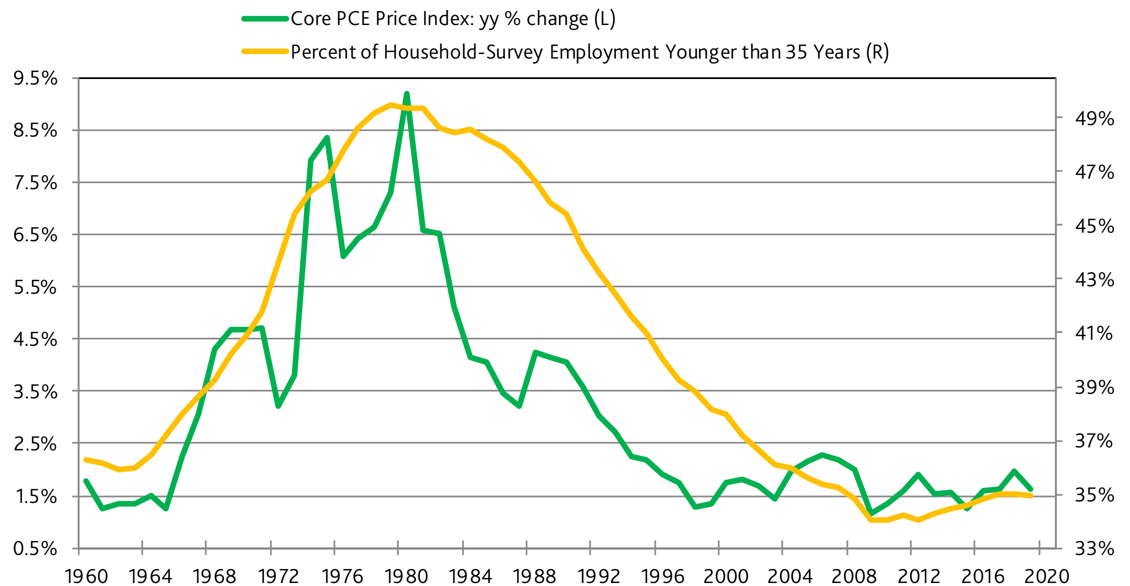
Meanwhile, after rising by merely 230,000 annually, on average, during 1997-2000, the number of Americans aged at least 65 years is expected to surge higher by a record 1.83 million individuals in 2020. The latter helps to explain why a record 23.7% of household survey employment consists of individuals aged 55 years and older. The current percent of workers aged at least 55 years is much greater than 1969's 18.2% and especially 2000's 12.7%, or when the U.S. jobless rate was last less than 4%.

Figure 3: Record High 23.7% of U.S. Employment (via Household-Survey) Is at Least 55 Years of Age
sources: BLS, NBER, Moody's Analytics



Moreover, since 1960, the correlation between the percent of U.S. employment no older than 35 years and the annual rate of core PCE price inflation is a remarkably strong 0.82. When core inflation averaged 7.4% annually during 1978-1981, a historically high 49.3% of employment consisted of individuals who were no older than 35 years. For the current upturn, workers no older than 35 years have averaged a much lower 34.5% of employment and core inflation has averaged a much slower 1.6% annually. If only because of the disinflationary implications of unprecedented demographic change, the Fed has no excuse not to get the federal funds rate under the recent 1.53% 10-year Treasury yield as soon as possible.

Figure 4: Percent of U.S. Employment Younger than 35 Years of Age Shows Strong 0.82 Correlation with Core PCE Price Inflation
sources: BLS, BEA, Moody's Analytics



Credit Markets Review and Outlook

High-Yield Downgrades per Upgrade Have Yet to Reach a Recessionary Height

The incidence of U.S. high-yield credit rating downgrades relative to upgrades sometimes offers insight regarding the nearness of a business cycle downturn. Prior to the July 1990 onset of 1990-1991's recession, the moving yearlong ratio of high-yield downgrades per upgrade soared from the 1.70:1 of the span-ended June 1989 to the 4.25:1 of the span-ended June 1990. Similarly, prior to March 2001's start to the 2001 recession, the yearlong high-yield downgrade per upgrade ratio increased from 1999's 2.31:1 to 2000's 3.25:1.

However, prior to the Great Recession, high-yield downgrades per upgrade posted only a mild rise from 2006's 1.10:1 to 2007's 1.41:1. The latter brings attention to how the deterioration of household credit, as opposed to business credit, was the primary driver behind the financial crisis and Great Recession of 2008-2009. Still, by June 2009, the moving yearlong ratio of high-yield downgrades per upgrade would peak at a near record high 4.55:1. A pronounced contraction of systemic liquidity brought on by the financial crisis partly explains the related steep upswings by the high-yield downgrade per upgrade ratio and the high-yield default rate from a year-end 2007 low of 1.0% to November 2009's post Great Depression peak of 14.7%.

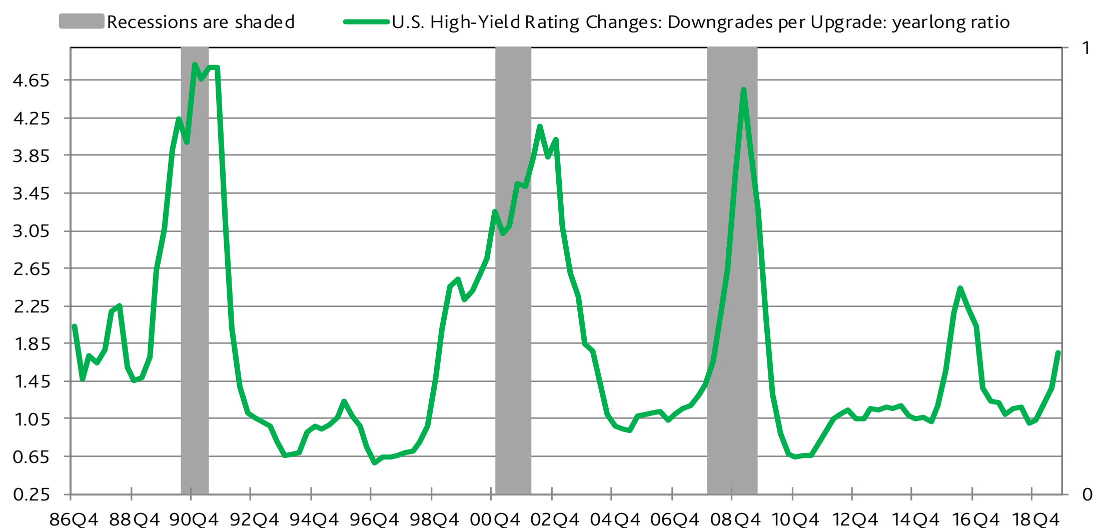
As inferred from an admittedly limited record, recessions were either impending or present each time the yearlong high-yield downgrade per upgrade ratio broke above 2.50:1. After bottoming at the 0.64:1 of 2010, the profits recession and industrial commodity price deflation of 2015-2016 would lift the yearlong high-yield downgrade per upgrade ratio to the 2.43:1 of the span-ended June 2016. However, systemic liquidity was largely maintained because of 2016's very low average federal funds rate of 0.40% and an average 10-year Treasury yield of 1.84%.

A recovery by profits and industrial commodity prices helped to lower the high-yield downgrade per upgrade ratio to 1.01:1 as of the year-ended September 2018. Subsequently, a deterioration of business sales and profitability have lifted the yearlong high-yield downgrade per upgrade ratio to the 1.75:1 of September 2019.

Nevertheless, the yearlong ratio's latest rise masks a 2019-to-date easing by the quarter-long high-yield downgrade per upgrade ratio. After dropping from first-quarter 2019's 2.27:1 to the 1.90:1 of the second quarter, the quarterly high-yield downgrade per upgrade ratio dipped to the third quarter's 1.73:1.

Perhaps, the resolution of trade conflicts and sufficient reductions in benchmark interest rates will rejuvenate business sales and end the latest climb by the high-yield downgrade per upgrade ratio. To the contrary, if business sales continue to slow, both the credit and business cycles will drop into a very painful phase.

Figure 5: Elevated Ratio of High-Yield Downgrades per Upgrade Preceded the Recessions of 1990-1991 and 2001
sources: Moody's Investors Service, NBER, Moody's Analytics



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

THE U.S.
By Ryan Sweet of Moody's Analytics

All Eyes on September Employment

We look for U.S. nonfarm employment, released tomorrow, to have risen by 161,000 from August to September, a hair better than the 150,000 average over the prior six months. Private job growth can be soft in September, but we anticipate that the hurricanes in the Septembers of 2017 and 2018 caused the seasonal adjustment factor to become more favorable this year.

From time to time, there are some identifiable quirks with monthly employment. For example, depending on whether the payroll reference week occurs early or late in the month, its timing can bias the first print of employment.

Since 2000, the first print of September employment has fallen below consensus expectations in 15 of 18 instances, too frequently to be a fluke. We separated Septembers into those where the reference week was early and late in the month. Most of the instances when employment was weaker than consensus expectations occurred when the reference week ended the 15th of the month or later. This year the end of the payroll reference week was early. Therefore, we don't expect as much downward bias.

The labor market data have been mixed. Initial claims remained low between the August and September reference periods. The ADP National Employment report showed that private employment increased 135,000 in September. We expect government employment to have risen by 20,000 in September, with 15,000 attributed to hiring associated with the 2020 census. We forecast private employment to have risen 141,000, not far off ADP's estimate. The UAW strike will not have any impact on the September employment data, as the strike began after the payroll reference week.

We look for the unemployment rate to have remained at 3.7%. We forecast average hourly earnings rose 0.2%, leaving them up 3.2% on a year-ago basis. The average workweek likely remained at 34.4 hours.

Next week

The economic calendar is a little lighter next week. The key data include the consumer price index for September, initial claims, import prices and consumer confidence. Given the recent weakness in the ISM surveys and escalation of the trade tensions between the U.S. and Europe, we believe a Fed rate cut later this month is very likely. Still, we don't anticipate the minutes from the last Federal Open Market Committee meeting, to be released Wednesday, to significantly alter our view. Claims remain key. If layoffs steadily climb that would be fodder for a recession.

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

EUROPE

By Barbara Teixeira Araujo of Moody's Analytics

An Uncertain Future for Johnson's Brexit Plan

Brexit will again dominate the headlines in a busy week, as U.K. negotiations with the EU are ongoing after the publication of Prime Minister Boris Johnson's plan for an alternative solution to the Northern Ireland backstop impasse. The EU received Johnson's proposals with broad skepticism, but EU leaders haven't gone all the way to dismissing them, which implies at least some openness to putting Johnson's plan on the negotiating table. But issues with the proposals are many, and our view is that the two parties won't manage to ultimately find common ground. Notably, the EU is unlikely to accept Johnson's proposals for avoiding customs checks at the Northern Ireland-Ireland border—a top priority for both the EU and U.K. The prime minister proposed that, instead of physical checks at the border, customs checks would rely on technology and remote checks in designated locations. Johnson claims that efforts to ensure this technology works would come during the transition period. But the EU has repeatedly said it cannot rely on a pledge of finding the right technology, especially since no solution appears to exist that would address smuggling and fraud.

Another major issue relates to Northern Ireland having a say regarding staying in the single market. Under Johnson's plan, Northern Ireland would leave the customs union but would stay in regulatory alignment with the single market's rules to avoid product standard and safety checks at its border—especially with regard to food and animal products. Given that the whole U.K. would not follow the same regulation as the EU, this means that all goods entering the island of Ireland from Great Britain would needed to be checked, effectively creating a border in the Irish Sea. While would be a major concession from the U.K.—creating a border in the Irish Sea was a red line for Theresa May—the problem is that the U.K. is proposing that Northern Ireland will have a say on remaining aligned with the single market rules. It would vote on it at the end of the transition period on December 2020, and then every four years. This won't go well with the EU. It means that Northern Ireland would have the power to unilaterally ruin the whole deal. What would happen if Northern Ireland voted not to stay aligned with the single market rules by late 2020, or in 2024? In the absence of a backstop plan, borders would need to be erected, with Ireland or the EU having no say. Our view is that this will be the main sticking point in the upcoming talks.

While small, there is the chance of an agreement. In that case, the final deal would be put to parliamentary vote in the U.K. Past experience has taught us that this is no easy hurdle—Theresa May's deal was defeated three times—especially now that the Conservatives have lost their parliamentary majority. If the deal is rejected, the Benn Act implies that the prime minister would need to seek another extension of Article 50 until next year. While Johnson may try to circumvent the law and push for a no-deal Brexit, our view is that in such a case the Labour party would call for a no confidence vote in the government and win. An interim government would then ask for an extension before calling new elections. All in, our baseline remains that the U.K. won't leave by October 31 and that Brexit will be delayed yet again. Given the lack of a common Brexit strategy among lawmakers and the people, repeated delays can't be ruled out.

Elsewhere next week, markets' focus will be on the publication of the U.K.'s GDP figures for August. Leading data for the U.K. economy have been dismal lately, suggesting that the country could have entered technical recession in the third quarter. But let's not forget that GDP rose by as much as 0.3% in July, marking a strong start to the quarter. Accordingly, even if GDP falls by 0.2% m/m in August and then by a similar amount in September, it would still rise by 0.2% q/q over the stanza as a whole, fully reversing the fall in the three months to June. It would take a sharp 0.5% m/m fall in each August and September to push GDP growth into negative territory. Our view is that it is extremely unlikely that GDP fell by that much during those months, especially because risks to car production were tilted to the upside in August—several factories stayed open because their usual summer closures were brought forward to April due to contingency planning—while overall manufacturing production is expected to

have risen strongly in September as firms began stockpiling again in advance of the October 31 Brexit deadline.

Our forecast has GDP falling by 0.2% m/m in August, following a 0.3% rise in July. We expect that construction output plunged on the back of continued uncertainty as services activities contracted marginally. Manufacturing output, by contrast, should have risen on the jump in car production.

	Key indicators	Units	Moody's Analytics	Last
Tues @ 7:00 a.m.	Spain: Industrial Production for August	% change	0.3	-0.4
Tues @ 7:00 a.m.	Germany: Industrial Production for August	% change	0.3	-0.6
Tues @ 9:00 a.m.	Italy: Retail Sales for August	% change	0.5	-0.5
Tues @ 11:00 a.m.	OECD: Composite Leading Indicators for August		98.9	99.0
Thur @ 7:45 a.m.	France: Industrial Production for August	% change	0.6	0.3
Thur @ 9:00 a.m.	Italy: Industrial Production for August	% change	0.7	-0.7
Thur @ 9:30 a.m.	U.K.: Monthly GDP for August	% change	-0.2	0.3
Fri @ 7:00 a.m.	Germany: Consumer Price Index for September	% change yr ago	1.2	1.4
Fri @ 8:00 a.m.	Spain: Consumer Price Index for September	% change yr ago	0.1	0.3
Fri @ 2:00 p.m.	Russia: Foreign Trade for August	$ bil	12.8	11.2

ASIA-PACIFIC

By Katrina Ell of Moody's Analytics

Import Slump Likely Boosted China's Trade Surplus

China's September foreign trade data will be in the spotlight. The trade surplus is expected to remain relatively large given the slump in imports, a direct consequence of imports from the U.S. declining sharply. Exports are expected to have remained under pressure in September following the 1% y/y contraction in August. Like imports, exports to the U.S. are declining steeply on a year-on-year basis and were down by 16% in August.

China's M2 money supply likely ticked up a notch to 8.3% y/y in September, from 8.2% in August. Beijing has stepped up monetary support, given the uncomfortable slide in activity data that has further materialized in the September quarter. The government cut the loan prime rate in late September and will likely continue to move in gradual increments to further encourage credit creation. That being said, a strong rebound is off the table given Beijing's stated desire to avoid large and far-reaching stimulus measures of the past.

India's industrial production likely cooled a little in August after the surprisingly strong 4.3% y/y gain in July. The government has announced new regulatory and spending measures aimed at reviving the rural sector and encouraging foreign direct investment. However, stronger domestic demand will not fully compensate for a slowdown in the global economy as rising trade barriers with the U.S. cap Indian exports.

	Key indicators	Units	Confidence	Risk	Moody's Analytics	Last
Tues @ Unknown	China Foreign trade for September	US$ bil	2	←	39.2	34.8
Thurs @ 10:50 a.m.	Japan Core machinery orders for August	% change	2	↑	-1.1	-6.6
Thurs @ Unknown	China Monetary aggregates for September	% change yr ago	3	←	8.3	8.2
Fri @ 11:00 p.m.	India Industrial production for August	% change yr ago	2	←	3.7	4.3

The Long View

September 2019's $184 billion of US$-denominated investment-grade corporate bond offerings trailed only January 2017's $193 billion and the May 2016's $189 billion

By John Lonski, Chief Economist, Moody's Capital Markets Research Group
October 3, 2019

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 127 basis points is wider than its 122-point mean of the two previous economic recoveries. This spread may be no wider than 130 bp by year-end 2019.

The recent high-yield bond spread of 467 bp is thinner than what is suggested by both the accompanying long-term Baa industrial company bond yield spread of 197 bp and the recent VIX of 19.3 points.

DEFAULTS

August 2019's U.S. high-yield default rate was 2.9%. The high-yield default rate may average 3.4% during 2020's first quarter, according to Moody's Investors Service.

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.

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.

First-quarter 2019's worldwide offerings of corporate bonds revealed annual setbacks of 0.5% for IG and 3.6% for high-yield, wherein US$-denominated offerings fell by 3.0% for IG and grew by 7.1% for high yield.

Second-quarter 2019's worldwide offerings of corporate bonds revealed an annual setback of 2.5% for IG and an annual advance of 17.6% for high-yield, wherein US$-denominated offerings sank by 12.4% for IG and surged by 30.3% 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 6.4% for IG and 27.6% for high yield. When stated in U.S. dollars, issuers based outside the U.S. supplied 60% of the investment-grade and 57% of the high-yield bond offerings of 2019's first half.

US ECONOMIC OUTLOOK

As inferred from the CME Group's Fed Watch Tool, the futures market recently assigned an implied probability of 88% to a cutting of the federal funds rate at the October 30, 2019 meeting of the Federal Open Market Committee. 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 2.00% for long. A fundamentally excessive climb by Treasury bond yields and a pronounced slowing by expenditures in dynamic emerging market countries are among the biggest threats to the adequacy of economic growth and credit spreads.

EUROPE

By Barbara Teixeira Araujo and Ross Cioffi of Moody's Analytics
October 3, 2019

EU

The World Trade Organization authorized the U.S. to raise tariffs on $7.5 billion of goods from the EU as retribution for unfair subsidies to European aircraft manufacturer Airbus. The verdict comes after 15 years of dispute between the U.S. and EU over advantages enjoyed by competing aircraft producers Boeing and Airbus. However, the ruling was not the final chapter in the dispute, since the case against Boeing will be finalized in 2020.

The tariffs will be active from 18 October and will slap a 10% duty on products from the aeronautics industry in the four countries that make up the Airbus consortium: The U.K., France, Germany and Spain. Tariffs of up to 25% will also extend to other sectors like food products, luxury goods and clothing, and will apply to other countries. When it comes to cheese imports, for example, 25 more member states will be targeted.

The risk is that given the extent of transatlantic trade, the effects of these tariffs could weigh on European economic figures, even if modestly. The tariffs on the aeronautics sector will hit France particularly hard because of the sector's importance to the economy. Exports of planes, helicopters and spacecraft made up around 13% of French exports to the U.S. in 2017 for a total value of $4.6 billion. The duties on agricultural products will be painful for countries like Spain and Italy, which are major exporters of food products. Olive oil accounted for 3.9% of Spanish exports to the U.S. in 2017, totaling $553 million, while cheese made up 0.7% of Italian exports to the U.S. and totaled $317 million.

The Tuesday ruling was part of a 15-year-old case at the WTO, an institution President Trump has regularly maligned. The development should not be seen as a direct part of the U.S. trade wars. However, in the current climate, it will be difficult to separate it from White House trade policy. Should Trump go through with the automotive tariffs he has threatened for November, which would not be authorized by the WTO, the EU would have another basis for further retaliatory tariffs.

The trade war seems to be heating up in the Atlantic, and this will crush economic sentiment. Manufacturing is already in recession in the euro zone, and the real costs and uncertainty created by the tariffs will only add to European manufacturers' pain and depress investment as businesses and consumers consider wait-and-see strategies.

EURO ZONE

With the exception of euro zone retail sales, the European economic data released Thursday were awful. The batch of final PMI surveys were particularly bleak, confirming our fears that the full-blown recession in the euro zone's manufacturing sector is now leaching into the other sectors of the economy. The currency area's final composite PMI came in much lower than the flash estimate at only 50.1—50 is the threshold that separates expansion from contraction—suggesting that activity in the private sector stagnated in September. This was the lowest reading in more than six years. While weakness remained centred on manufacturing—that PMI read at only 45.7 in September—the services sector index fell sharply to 51.6 from 53.5, below the initial estimate of 52.

Across countries, Germany is acting as the major drag on euro zone growth. Its composite PMI fell sharply to only 48.5, the lowest in almost seven years, as activity plunged in manufacturing and rose only slightly in services. GDP still increased in the other major economies, but only barely. The main risk is that this slowdown in overall output and in new orders will soon translate to a deterioration in the country's labour market. While employment still rose in the euro zone's private sector, the pace of job creation was only modest and one of the lowest since 2016. If households start feeling the pinch of the slowdown, our outlook for the euro zone economy will need to be revised substantially downwards, as it currently relies on consumer spending remaining solid and offsetting weakness in the external and in the investment fronts.

If the figures for the euro zone were bad, the results for the U.K. were even worse. We had expected that the services sector kept the British economy afloat in September—figures released earlier in the week suggested that manufacturing and construction output fell over the month. But the services PMI came in below the 50 threshold, falling to 49.5 from 50.6 in August and marking one of the index's lowest readings over the past decade. Unsurprisingly, firms broadly cited Brexit as a reason for the decline. The weighted average of the PMIs—including the services, manufacturing and construction index—plunged to 48.8 in September from 49.7 in August, its lowest since July 2016.

The PMIs suggest that the U.K. economy contracted by 0.1% q/q in the third quarter, which would mean that it entered a technical recession given the second stanza's 0.2% fall. We are more optimistic and pencil in a 0.2% q/q increase, as we expect that car production rebounded sharply along with overall manufacturing output. But risks are tilted heavily to the downside.

ASIA PACIFIC

By Katrina Ell of Moody's Analytics
October 3, 2019

CENTRAL BANKS

Central banks across Asia have been responsive to the deterioration in the global economic outlook this year. Most have embraced interest rate cuts with vigour in a bid to shore up domestic demand. In many cases, the other important channel of monetary policy transmission is via the exchange rate. Easier monetary settings have, in some cases, encouraged exchange rate depreciation and lifted export competitiveness, which is important given that exports can be a large share of the economy.

While many central banks across the region already have policy rates at or near record lows, there is still space to move benchmark interest rates lower. This is important, as downside risks facing the global economy are high, particularly with the U.S.-China trade war and Brexit still unresolved. Our baseline remains for central banks to make further reductions in their policy rates in the December quarter.

With elevated tensions in the Middle East, elevated oil prices may not be just transitory but rather have medium-term upward implications on oil prices. This is likely to erode the ability of central banks in Asia to offer more monetary stimulus, as there would be significant flow-through to domestic inflation. At present, inflation is generally at the bottom end of central bank target levels. In this situation, fiscal policy would be expected to play a larger role shoring up activity.

CHINA

The People's Bank of China has stepped up the monetary stimulus following a string of disappointing August activity data. The loan prime rate was reduced by 5 basis points to 4.2%, marking the second downward adjustment in the LPR since changes were made to the benchmark interest rate on 19 August. It also follows the latest reserve requirement ratio cut taking effect on 16 September. The goal of the LPR reduction is in line with the government's strategy to lower financing costs for smaller, private enterprises, which need ongoing support and improved access to credit amid the slowdown in global and domestic demand. It is also aimed at improving funding access, not least due to shadow financing support being less abundant.

The cumulative reduction in the LPR is 11 basis points, well shy of the usual downward adjustment made to policy rates. The small adjustment could be due to the PBoC experimenting with the potency of the policy rate. It could also be due to Beijing keeping to its overarching goal that it does not want to create further debt bubbles down the road; the objective remains to deliver more sustainable growth with a nod to understanding

that additional policy support is necessary now. With this, the five-year LPR, which is a reference rate for new mortgages, was held steady at 4.85%. But the move is also an important signal in itself; the PBoC has graduated to using policy-rate adjustments, rather than the ongoing reserve requirement ratio adjustments, which are already at their lowest level since 2009 after downward adjustments in the past year. Further easing across the suite of PBoC monetary levers is expected heading into 2020.

AUSTRALIA

The Reserve Bank of Australia cut the cash rate by 25 basis points to 0.75% in October. Financial markets put the odds at 80% of this reduction occurring. Further cuts are in the pipeline. The last paragraph of the monthly statement gives the most insight into the direction of policy and this phrase was telling: The RBA "is prepared to ease monetary policy further if needed to support sustainable growth in the economy." Given that the cash rate is already at 0.75%, the likelihood that the RBA will turn to unconventional methods in 2020 to provide that additional monetary policy support is high.

The consensus has emerged that unconventional methods will be deployed when the cash rate reaches 0.5%, and this is expected in the March quarter of 2020. Measures likely would be aimed at lowering the Australian dollar. This could involve buying government bonds to lower long-term yields. The Australian dollar has been a good shock absorber. It has fallen by around 4.6% against the dollar in the past year, coinciding with rising concerns about cooling global growth and the escalating trade war. The weaker aussie has supported exporters, and the large trade surplus contributed to the first current account surplus in 44 years in the June quarter.

The government billed the income tax offset that captured low- to medium-income households from 1 July as an important support to consumers, who have been grappling with low wage growth for years. But it turns out, the stimulatory impact has been much less than expected. According to the Australian Tax Office, the average tax refund has increased only by A$250 in the 2018-2019 financial year, well short of the maximum income tax offset offered of A$1,080. It is also well acknowledged that households are not in the mindset of increasing discretionary spending in this environment but are instead using any additional cash to pay down debt, a situation that further limits the stimulatory impact. Given this, a wise strategy for the government could be to look at greater infrastructure investment that has near-term employment and income benefits to the consumer as well as improved productivity down the road.

INDONESIA

Bank Indonesia cut the policy rate by a further 25 basis points in September, bringing cumulative easing this year to 75 basis points. Like August's move, the rate cut in September was delivered as a "preemptive measure" due to heightened global risks and to safeguard Indonesia's growth outlook. Concern around the deteriorating global growth outlook has forced central banks to act. In Indonesia's case, the central bank is specifically trying to shore up credit demand from corporates and households.

Bank Indonesia has been given the breathing space to reduce rates because of the Federal Reserve's easing stance. Had the Fed not eased rates in September, BI likely would have held steady as well given its acute concern about maintaining external stability. At the end of the day, Indonesia is vulnerable to sudden adverse swings against emerging markets, particularly given its current account deficit, even though this has narrowed relative to last year.

PHILIPPINES

The Philippines' central bank reduced its policy rate by 25 basis points to 4%. This brings cumulative easing this year to 75 basis points. The need to bolster domestic demand drove the latest rate cut and follows June-quarter GDP growth slowing to 5.5%, its weakest pace in more than five years. Inflation has cooled substantially since last October. The CPI forecast is for 2.9% in 2020 and 2021, comfortably within the central bank's 2%-to-4% target range. The inflation forecast for 2019 was reduced by 0.1 percentage point to 2.5%. The path for future rate cuts will remain "data dependent," according to the central bank. We expect to see at least one more 25-basis point reduction in 2019.

Ratings Round-Up

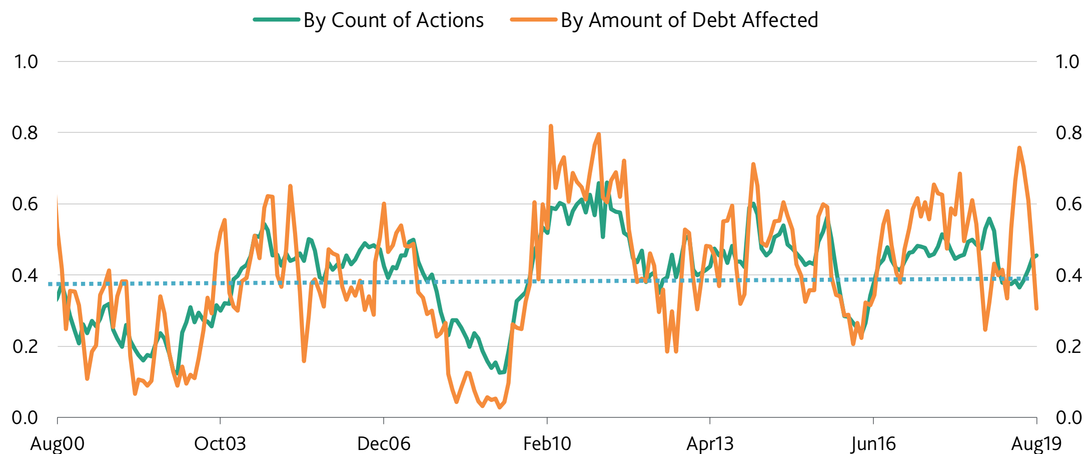
Speculative-Grade Companies Dominate Changes

By Michael Ferlez

The recent trend in rating change activity continued in the latest week, with all but one of the eight total changes affecting speculative-grade companies. Although downgrades have consistently outnumbered upgrades this year, the trend is largely indicative of idiosyncratic struggles at the corporate level and not a broader weakness in the macro economy. In the U.S., last week's notable change was made to Fluor Corporation. The U.S. engineering and construction firm saw its senior unsecured credit rating downgraded from Baa2 to Baa3. The Moody's Investors Service downgrade reflected the recent deterioration in the firm's operating results and credit metrics. The downgrade affected $1.6 billion in debt.

European rating change volume increased for the week, but the overall trend remained poor. Downgrades accounted for 69% of total rating changes and 90% of affected debt. Downgrades were headlined by CMA CGM S.A. The French transportation company saw its senior unsecured credit rating cut to Caa1 from B3 while its outlook was changed to stable from negative. The downgrade by Moody's Investors Service reflects CMA CGM's weakening liquidity profile over the past year and affected $2.3 billion of the company's debt. The rest of the rating activity in Europe was spread across a number of industries and countries, with all changes affecting speculative-grade companies.

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

FIGURE 3

Rating Changes: Corporate & Financial Institutions – US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG
9/25/19	BLUESTEM GROUP INC. -BLUESTEM BRANDS, INC.	Industrial	SrSec/BCF /LTCFR/PDR		D	Caa1	Caa2	SG
9/26/19	FLUOR CORPORATION	Industrial	SrUnsec/CP	1,647	D	Baa2	Baa3	IG
9/26/19	STG-FAIRWAY ACQUISITIONS, INC.	Industrial	SrSec/BCF /LTCFR/PDR		U	B2	B1	SG
9/26/19	VISTA OUTDOOR INC.	Industrial	SrUnsec /LTCFR/PDR	350	D	B3	Caa1	SG
9/27/19	CONSOLIDATED COMMUNICATIONS HOLDINGS, INC. -CONSOLIDATED COMMUNICATIONS, INC.	Industrial	SrUnsec/SrSec /BCF/LTCFR/PDR	500	D	B3	Caa1	SG
9/27/19	KESTREL ACQUISITION, LLC	Industrial	SrSec/BCF		D	Ba3	B1	SG
9/27/19	BW NHHC HOLDCO, INC.	Industrial	SrSec/BCF /LTCFR/PDR		D	B2	B3	SG
9/30/19	ANNA HOLDINGS, INC. -ACOSTA, INC.	Industrial	SrUnsec/SrSec /BCF/LTCFR/PDR	1,600	D	Ca	C	SG

Source: Moody's

Ratings Round-Up

FIGURE 4

Rating Changes: Corporate & Financial Institutions – Europe

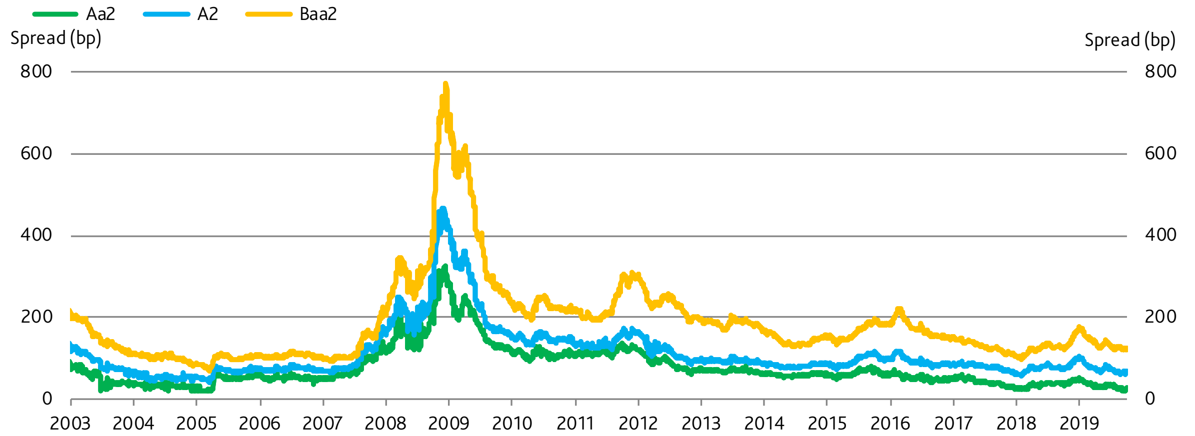
Date	Company	Sector	Rating	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG	Country
9/25/19	CMA CGM S.A.	Industrial	SrUnsec/SrSec /BCF/LTCFR/PDR	D	B3	Caa1	SG	FRANCE
9/25/19	GRUPO ALDESA S.A.	Industrial	SrSec/LTCFR/PDR	D	B3	Caa1	SG	SPAIN
9/26/19	LECTA S.A.	Industrial	SrSec/LTCFR/PDR	D	Caa1	Ca	SG	LUXEMBOURG
9/26/19	SIGNET JEWELERS LIMITED -SIGNET UK FINANCE PLC	Industrial	SrUnsec	D	Ba2	Ba3	SG	UNITED KINGDOM
9/26/19	RONESANS GAYRIMENKUL YATIRIM A.S.	Industrial	SrUnsec/LTCFR	D	B1	B2	SG	TURKEY
9/27/19	BANK VTB, PJSC -VOZROZHDENIE BANK	Financial	LTD	U	Ba2	Ba1	SG	RUSSIA
9/27/19	GRUPO ANTOLIN -IRAUSA, S.A.	Industrial	SrSec/LTCFR/PDR	D	B1	B2	SG	SPAIN
9/27/19	NOVAFIVES S.A.S.	Industrial	SrSec/LTCFR/PDR	D	B3	Caa1	SG	FRANCE
9/30/19	HEIDELBERGER DRUCKMASCHINEN AG	Industrial	SrUnsec/LTCFR/PDR	D	B3	Caa1	SG	GERMANY
9/30/19	SOVCOMBANK PJSC	Financial	LTD	U	Ba3	Ba2	SG	RUSSIA
9/30/19	BRIGHT BIDCO B.V.	Industrial	SrSec/BCF /LTCFR/PDR	D	B3	Caa1	SG	NETHERLANDS
10/1/19	ABANCA CORPORACION BANCARIA, S.A.	Financial	LTD/Sub	U	Ba2	Ba1	SG	SPAIN
10/1/19	SYNCREON GROUP HOLDINGS B.V. -SYNCREON GROUP B.V.	Industrial	LTCFR/PDR	U	Ca	B3	SG	NETHERLANDS

Source: Moody's

Market Data

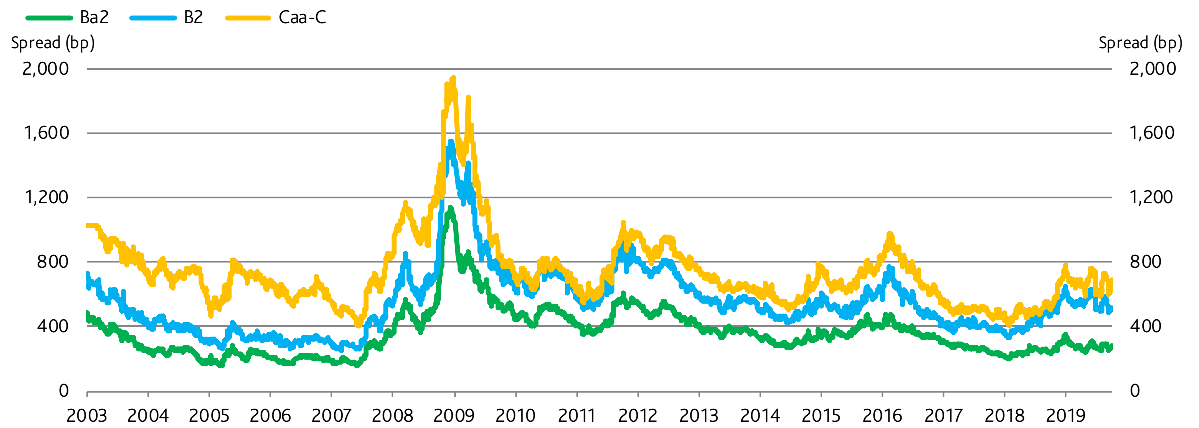
Spreads

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 (September 25, 2019 – October 2, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Oct. 2	Sep. 25	Senior Ratings
PolyOne Corporation	A2	Baa2	Ba3
Federal Realty Investment Trust	A3	Baa2	A3
Ashland LLC	Aa3	A2	Ba3
PepsiCo, Inc.	A1	A2	A1
Bank of New York Mellon Corporation (The)	A1	A2	A1
Amazon.com, Inc.	Aa3	A1	A3
Eli Lilly and Company	Aa2	Aa3	A2
Waste Management, Inc.	A3	Baa1	Baa1
Medtronic, Inc.	Aa2	Aa3	A3
AvalonBay Communities, Inc.	A3	Baa1	A3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Oct. 2	Sep. 25	Senior Ratings
Diamond Offshore Drilling, Inc.	C	Caa2	B3
Freeport-McMoRan Inc.	B2	Ba3	Ba1
Citigroup Inc.	Baa2	Baa1	A3
Ally Financial Inc.	Ba1	Baa3	Ba2
McDonald's Corporation	Aa2	Aa1	Baa1
Bristol-Myers Squibb Company	Aa3	Aa2	A2
HCA Inc.	Ba2	Ba1	Ba2
General Electric Company	Ba2	Ba1	Baa1
American Express Company	A1	Aa3	A3
Chevron Corporation	A2	A1	Aa2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Oct. 2	Sep. 25	Spread Diff
Frontier Communications Corporation	Caa3	10,489	8,807	1,682
Diamond Offshore Drilling, Inc.	B3	1,009	693	316
Nabors Industries Inc.	B1	1,190	886	304
Chesapeake Energy Corporation	B2	1,377	1,128	249
AK Steel Corporation	B3	1,117	949	168
United States Steel Corporation	B3	752	674	77
Talen Energy Supply, LLC	B3	883	810	73
McClatchy Company (The)	Caa2	1,724	1,652	73
SLM Corporation	Ba2	361	302	59
Tenet Healthcare Corporation	Caa1	460	410	49

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Oct. 2	Sep. 25	Spread Diff
Dean Foods Company	Caa3	3,221	3,701	-480
Neiman Marcus Group LTD LLC	Ca	5,363	5,452	-89
Meritage Homes Corporation	Ba2	197	251	-54
Penney (J.C.) Corporation, Inc.	Caa3	3,089	3,141	-53
Navistar International Corp.	B3	355	407	-52
Univision Communications Inc.	Caa2	310	357	-47
DPL Inc.	Ba1	336	359	-23
Smithfield Foods, Inc.	Ba1	134	154	-20
PolyOne Corporation	Ba3	48	66	-18
Owens Corning	Ba1	115	130	-16

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (September 25, 2019 – October 2, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Oct. 2	Sep. 25	Senior Ratings
France, Government of	Aaa	Aa1	Aa2
Spain, Government of	Aa3	A1	Baa1
Deutsche Bank AG	Baa2	Baa3	A3
Portugal, Government of	Aa3	A1	Baa3
Santander UK plc	Baa2	Baa3	Aa3
Nationwide Building Society	A3	Baa1	Aa3
Vodafone Group Plc	Baa1	Baa2	Baa2
Eurobank Ergasias S.A.	Caa2	Caa3	Caa1
Veolia Environnement S.A.	Aa2	Aa3	Baa1
Merck KGaA	Aa1	Aa2	Baa1

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Oct. 2	Sep. 25	Senior Ratings
Atlantia S.p.A.	B1	Ba2	Baa3
Pearson plc	Baa1	A2	Baa2
HSBC Holdings plc	Baa1	A3	A2
Standard Chartered PLC	Baa2	Baa1	A2
Daimler AG	Baa2	Baa1	A2
Landesbank Baden-Wuerttemberg	A2	A1	Aa3
Telecom Italia S.p.A.	Ba3	Ba2	Ba1
Banco Comercial Portugues, S.A.	Ba3	Ba2	Ba1
AstraZeneca PLC	Aa2	Aa1	A3
FCE Bank plc	Ba1	Baa3	Ba1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Oct. 2	Sep. 25	Spread Diff
PizzaExpress Financing 1 plc	Caa2	6,164	5,939	226
Iceland Bondco plc	Caa2	585	526	59
TUI AG	Ba2	364	321	43
Atlantia S.p.A.	Baa3	200	160	40
Vedanta Resources Limited	B2	521	485	36
Matalan Finance plc	Caa1	844	808	36
Casino Guichard-Perrachon SA	B1	629	597	32
Jaguar Land Rover Automotive Plc	B1	746	720	26
Novafives S.A.S.	Caa2	731	706	25
Virgin Media Finance PLC	B2	123	109	14

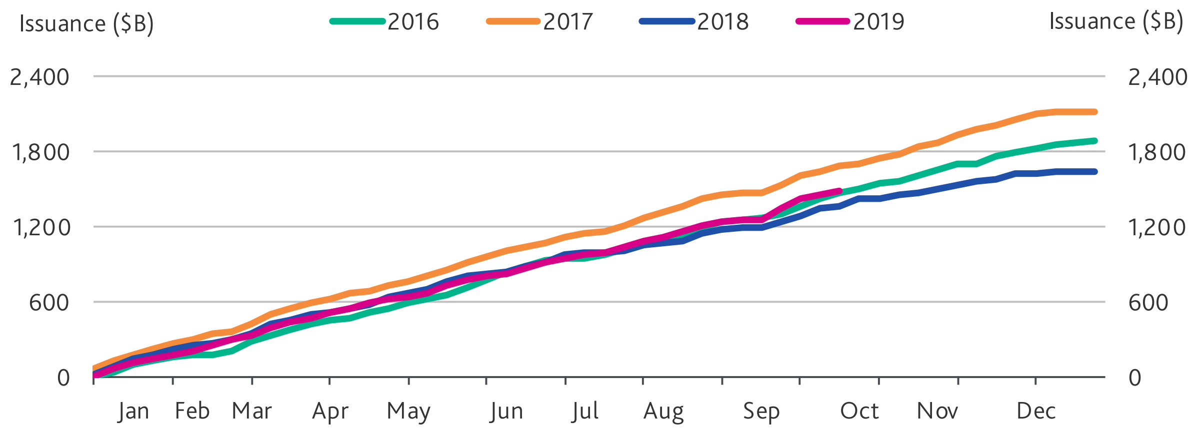
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Oct. 2	Sep. 25	Spread Diff
Sappi Papier Holding GmbH	Ba1	329	394	-65
CMA CGM S.A.	Caa1	1,503	1,544	-42
Boparan Finance plc	Caa1	2,028	2,047	-19
Stena AB	B1	537	555	-18
TDC A/S	B1	149	162	-13
Greece, Government of	B1	198	209	-11
Heathrow Finance plc	Ba1	196	206	-11
Eurobank Ergasias S.A.	Caa1	715	725	-10
National Bank of Greece S.A.	Caa1	559	567	-8
Italy, Government of	Baa3	125	131	-6

Source: Moody's, CMA

Market Data

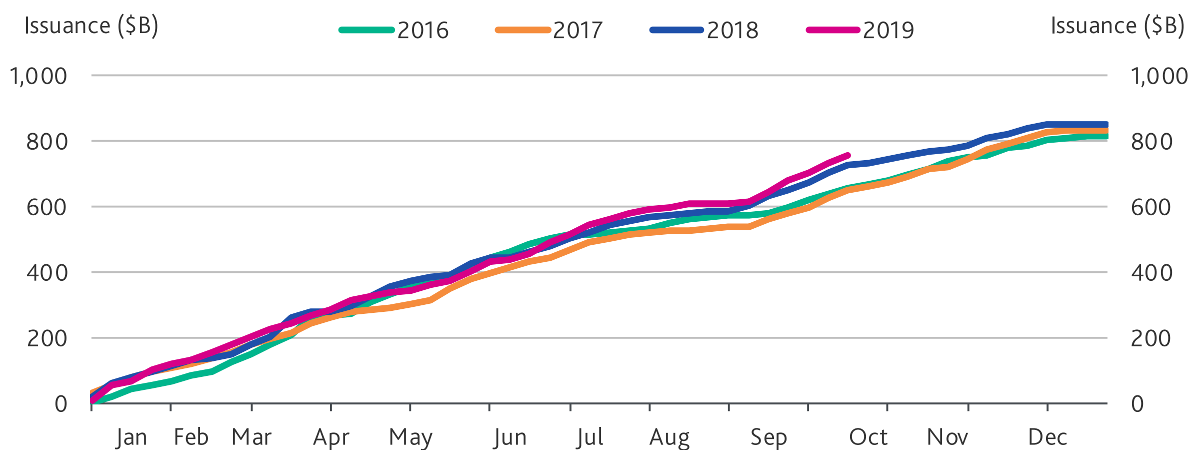
Issuance

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	20.338	8.190	31.446
Year-to-Date	1,091.453	320.657	1,493.501

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	14.897	4.056	19.873
Year-to-Date	660.832	72.663	754.701

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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