MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

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Not Even the Great Depression Could Push the Baa Default Rate Above 2%

Credit Markets Review and Outlook *by John Lonski*

Not Even the Great Depression Could Push the Baa Default Rate Above 2%

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The Week Ahead

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

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The Long View

Full updated stories and key credit market metrics: Investors now pressure Baa credits to deleverage in order to lessen risk of a fallen-angel downgrade.

Credit Spreads	Investment Grade: We see year-end 2019's average investment grade bond spread above its recent 120 basis points. High Yield: Compared to a recent 391 bp, the high-yield spread may approximate 450 bp by year-end 2019.
Defaults	US HY default rate: Moody's Investors Service forecasts that the U.S.' trailing 12-month high-yield default rate will fall from February 2019's 2.7% to 1.7% by February 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 1.2% for IG to $1.292 trillion, while high-yield supply grows by 13.9% to $316 billion. A significant drop by 2019's high-yield bond offerings would suggest the presence of a recession.

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Credit spreads, CDS movers, issuance.

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Moody's Capital Markets Research *recent publications*

Links to commentaries on: Upside risks, outstandings and ratings changes, high leverage, revenues and profits, Fed moves, riskier outlook, high-yield, defaults, confidence vs. skepticism, stabilization, growth and leverage, buybacks, volatility, monetary policy, yields, profits.

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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.

Not Even the Great Depression Could Push the Baa Default Rate Above 2%

During the first four months of 2019, the credit rating revisions of U.S. high-yield issuers showed downgrades outnumbering upgrades by a margin of 2.34:1, where the latter compared most unfavorably with 2018's yearlong ratio of 1.04:1.

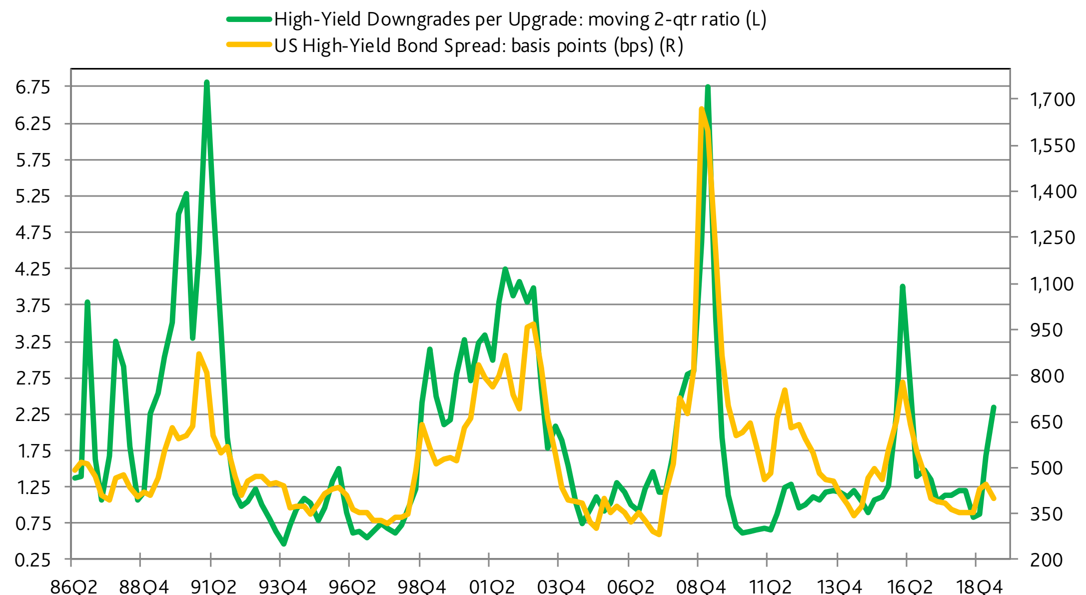
Over the long term, or during 1986-2018, high-yield downgrades exceeded upgrades by a ratio of 1.49:1. By comparison, the high-yield downgrade per upgrade ratio was a lower 1.35:1 during the five years ended 2018.

The moving five-year ratio of high-yield downgrades per upgrade bottomed at the 0.78:1 of the span-ended 1997 and peaked at the 2.84:1 of the span-ended 2003. Note how the beginning of the five-years-ended 2003 coincided with the great equity bubble of 1998-2000. Ultimately, some shareholders paid dearly for ignoring 1998-2000's marked deterioration of corporate credit quality.

A continuation of early 2019's very high ratio of high-yield downgrades per upgrade would probably eventually widen April 2019's below-trend month-long average of 398 basis points for the high-yield bond spread by at least 200 bp.

Figure 1: Latest Upswing by High-Yield Downgrades per Upgrade Warns of Wider High-Yield Bond Spread

source: Moody's Analytics

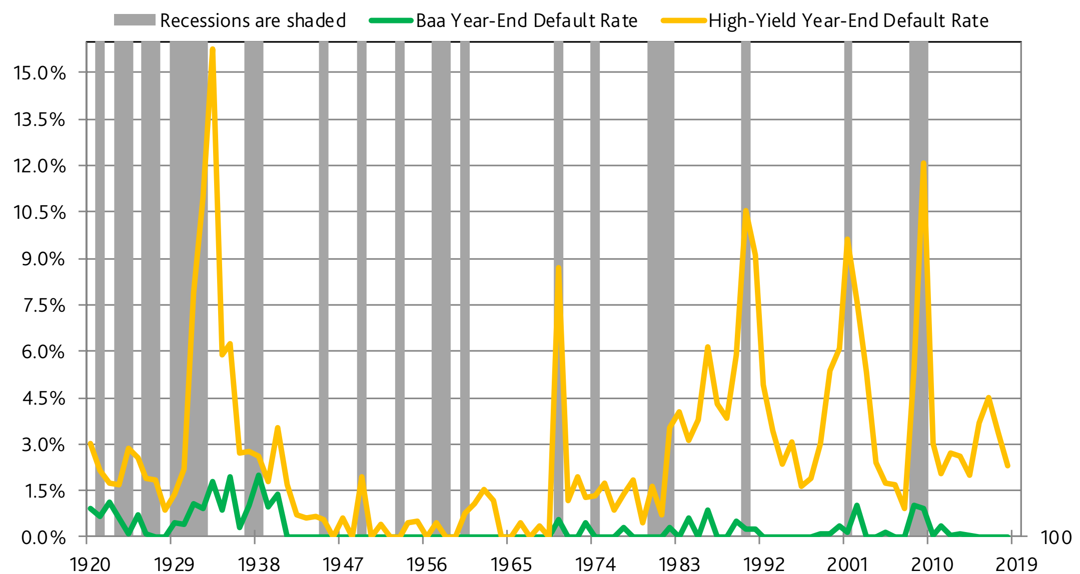


The now positive trend of Baa-industrial credit rating revisions is nearly diametrically opposed to the negative trend of high-yield rating changes. Though the U.S. corporate credit rating revisions of January-April 2019 showed the number of high-yield downgrades more than doubling the number of upgrades, the number of Baa-rated industrial company upgrades exactly doubled the number of Baa-industrial downgrades. More specifically, for rating revisions affecting Baa-grade U.S. industrial companies, the ratio of downgrades per upgrade fell from yearlong 2018's already constructive 0.91:1 to the even better 0.50:1 of January-April 2019.

The latter was very much consistent with the negligible number of Baa-grade defaults during the last four years. Despite the supposed risks inherent to having Baa-grade bonds now account for 46% of the dollar amount of outstanding U.S. investment-grade corporate bonds, the default rate of Baa-grade corporate debt equaled 0.0% for the years-ending 2015, 2016, 2017, and 2018. This default rate will move higher in 2019, but only because of a special event that took the form of California's wildfires.

Regarding the Great Recession, the Baa default rate was 1.02% at the end of 2008 and 0.93% at the end of 2009. The record high year-end default rate for Baa-grade companies was set way back in 1938 at 1.99%. During 1931-1935, the Baa year-end default rate averaged 1.31%, which was well above its 0.3% average of the last 99 years. For purposes of comparison, high-yield's year-end default rate averaged 9.4% during 1931-1935.

Figure 2: For the Last 99 Years, the 0.3% Average Annual Default Rate of Baa-Rated Issuers Was Far Under the 2.8% of High-Yield Issuers
sources: Moody's Investors Service, NBER, Moody's Analytics



Since 1920, the 0.3% annual average of the Baa category's year-end default rate was but a fraction of the high-yield default rate's 2.8% annual average. For the 35-years-ended 2018, or 1984-2018, the Baa-grade default rate averaged a somewhat lower 0.2% and the high-yield default rate averaged a much higher 4.3%.

Record High Five-Year Cumulative Default Rate of Baa-Grade Issuers Was Manageable

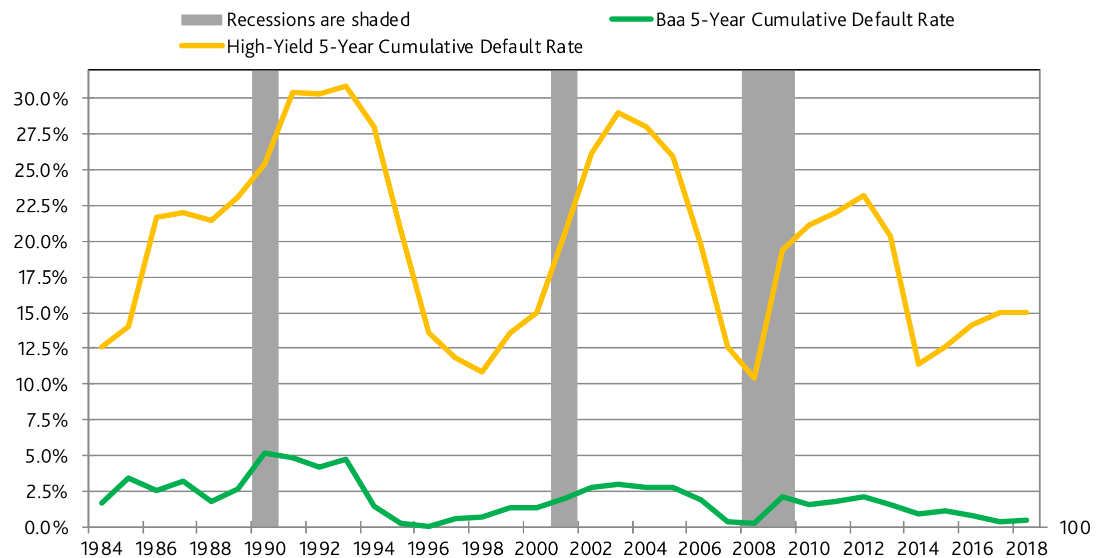
For 1983-2018, the average five-year cumulative default rates were 1.5% for Baa and 19.1% for high-yield. A cumulative five-year default rate equals the percent of issuers at the end of any year that default during the next five years.

During 1983-2018, the five-year cumulative default rate for Baa-grade issuers ranged from a 0.0% low for the five years following 1991 to a 5.22% high for the five years following 1985. For the five years since 2013 (which ended with 2018) the cumulative default rate was an imperceptible 0.47%. Expressed differently, merely 0.47% of the Baa-rated issuers from year-end 2013 had defaulted by the end of 2018.

In addition, the 1983-2018 sample showed that the five-year cumulative default rate for high-yield issuers ranged from a low of 10.4% for the five years following 2003 to a high of 30.8% for the five years following 1985. For the latest observation that used the high-yield issuers of year-end 2013 as its base, the cumulative five-year high-yield default rate was a below average 15.0%.

Figure 3: 1984-2018's Average Five-Year Cumulative Default Rates Were 2.0% for Baa-Grade Issuers and 19.8% for High-Yield Issuers

sources: Moody's Investors Service, NBER, Moody's Analytics



1.7% Core PCE Price Index Inflation Has Been the Norm for the Last 25 Years

Talk that the latest deceleration by core PCE price index inflation may prove transitory contradicts core inflation's long-term trend. The current annual rate of core PCE price index inflation approximates what has been the norm during the last 25 years. During the past quarter of a century, the core PCE price index has risen at an average annualized rate of 1.7%, which matched the 1.7% yearly increase of 2019's first quarter and was a tad faster than the 1.6% of March 2019.

In terms of the calendar-quarter observations of the past 25 years, the annual rate of core PCE price index inflation peaked at the 2.5% of 2006's third quarter—the only time the annual rate of core PCE price index inflation reached 2.5%. In fact, the annual rate of core PCE price index inflation exceeded 2% in only 25, or 25%, of the last 100 quarters (or the past 25 years). In other words, core inflation of 2% to 2.5% has been far more transitory than the current core inflation rate of 1.7%.

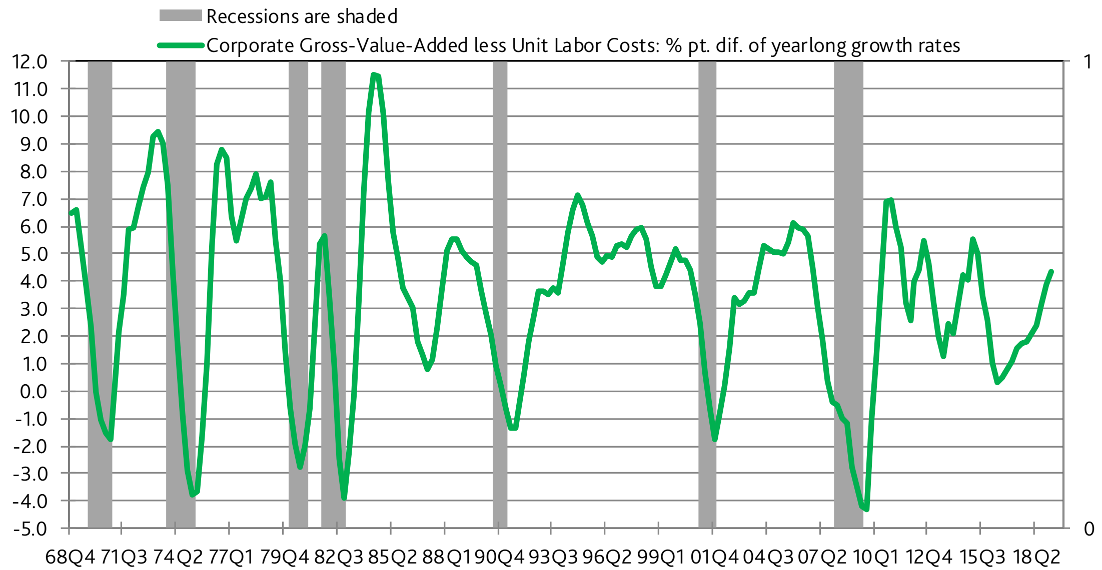
Stagnant Unit Labor Costs Bode Well for Low Inflation and the Business Cycle Upturn

First-quarter 2019's much faster than expected labor productivity growth and a surprising 0.9% annualized quarter-to-quarter contraction by unit labor costs suggest that an even lower U.S. unemployment rate may not spark an unwanted upturn by core consumer price inflation. First-quarter 2019's 2.4% year-to-year increase by labor productivity was the fastest such advance since 2010. Moreover, the first quarter's imperceptible 0.1% year-to-year rise by unit labor costs revealed that faster hourly wage growth has yet to add much to labor cost pressures.

The difference between the year-over-year growth rates of corporate gross-value-added and unit labor costs offers insight regarding where the U.S. is in the business cycle. Each recession since 1947 has been associated with corporate gross-value-added lagging behind the growth of unit labor costs, where both metrics are expressed in terms of an annual percent change of a moving yearlong average.

For the year-ended March 2019, the 5.3% annual increase by corporate gross-value-added outran unit labor costs' accompanying 0.9% rise by an atypically wide 4.4 percentage points. The fact the latter was up considerably from its 2.1 percentage point gap of the year-ended March 2018 implies recession risk is now on the low side. By contrast, prior to the onset of the Great Recession, the difference between the growth rates of corporate gross-value-added outran and unit labor costs plunged from 2006's 4.4 percentage points to 2007's -0.4 points.

Figure 4: Since 1947, a Recession Was Nearby When Unit Labor Costs Outran the Gross-Value-Added of US Corporations Over a Yearlong Span
sources: NLS, BEA, NBER, Moody's Analytics

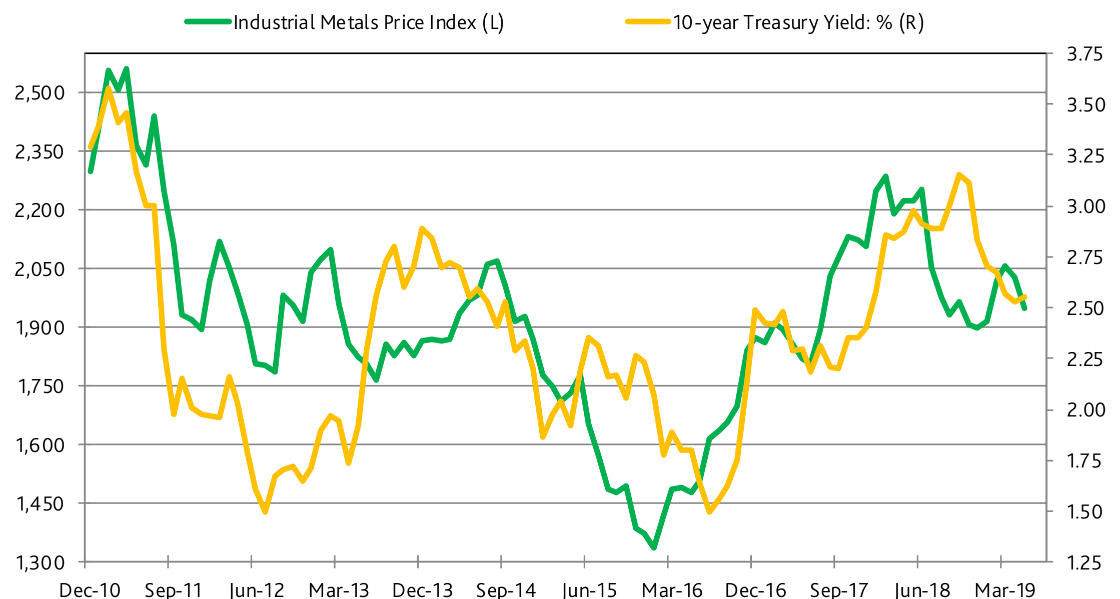


Latest Slide by Industrial Metals Price Index Favors Lower Treasury Bond Yields

According to the recent behavior of Moody's industrial metals price index, global industrial activity has slowed and inflation risks have declined. In terms of moving yearlong averages, the annual percent change of Moody's industrial metals price index shows a strong correlation of 0.79 with the IMF's estimate of world economic growth. On May 1, the industrial metals price index sank by 1.87% daily to its lowest close since January 24, 2019. The year-to-year decline of the industrial metals price index deepened from the 8.7% of April 2019's month-long average to May 1's 11.1%.

Since the end of 1982, the industrial metals price index's month-long average has dropped from a year earlier by 5% or deeper in 142 months. For 119, or 84%, of those months, the 10-year Treasury yield's month-long average was less than its year earlier reading. Accordingly, the latest deepening of the annual decline by the base metals price index favors a 10-year Treasury yield that will remain well under 3%.

Figure 5: Latest Slide by Industrial Metals Price Index Hints of Lower 10-Year Treasury Yield
source: Moody's Analytics



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

THE U.S.

By Ryan Sweet, Moody's Analytics

A Hawk in Dove's Clothing

The outcome of the Federal Open Market Committee meeting wasn't surprising, but Fed Chairman Jerome Powell's presser didn't go smoothly. In discussing inflation, Powell resorted to the dreaded "transitory" factors to explain the below-target inflation. To be fair, Powell isn't wrong about the very recent deceleration in inflation. Some of the recent weakening in inflation is transitory, but that doesn't apply to the past couple of years.

We identify three reasons that core inflation should accelerate through the remainder of this year and into next. Some of the very recent weakness in core inflation is attributed to financial services, shelter and healthcare, with the latter being the most significant for the core PCE deflator. These shortfalls are not attributed to the business cycle.

For example, a good chunk of the weakness in healthcare prices is due to the direct and indirect effects of the Affordable Care Act. The drag on consumer prices from public-payer healthcare costs is fading and should soon be in the past. Some of the weakness in the core PCE deflator in January was attributed to a drop in financial services prices, which are closely tied to changes in the S&P 500.

However, time will tell if Powell had another slip of the tongue, or if he is putting more emphasis on the Fed's forecast of inflation over the next couple of years. The latter would have hawkish implications for monetary policy. Shifting back toward its forecasts would be inconsistent with the Fed's mantra of being data dependent and counter to its rhetoric over the past several months.

Not long ago, Powell was putting greater emphasis on realized inflation and inflation expectations moving higher to warrant the Fed raising rates. Now, Powell appears to be looking for reasons to ignore the muted inflation. He could be right or the use of "transitory" in Wednesday's news conference could come back and haunt him, particularly if financial markets begin to question the Fed's plan to keep rates unchanged this year.

For now, we are keeping our subjective odds for the outcomes of each of the remaining FOMC meetings unchanged and don't anticipate a rate hike until early next year.

The Fed did lower the interest rate on excess reserves to 2.35% from 2.4%. This is the third technical adjustment since the beginning of last year and is an effort to push the effective fed funds rate toward the midpoint of its target range. The effective rate was trading toward the top end of the range.

Q1 and Q2 GDP tracking update

U.S. factory orders came in a little stronger than expected in March. New orders were up 1.9%, compared with our forecast of 1.7% and 1.5% for the consensus. The revisions to core capital goods orders were small relative to the advance durable goods report; they are now shown to have risen from 1.3% to 1.4%. Shipments of core capital goods were revised up from -0.2% to 0%.

Inventories were up 0.4% in March, and nondurable goods stockpiles gained 0.6%. The new inventory data foreshadow an upward revision to first-quarter inventories, raising our tracking estimate for first-quarter GDP growth from 3.2% to 3.4% at an annualized rate. There was no impact on our high-frequency GDP model's estimate of second-quarter GDP growth, which remains on track to rise 1.7% at an annualized rate.

Given the new data over the past couple of days, including construction spending and factory orders, we have updated our estimates of monthly U.S. GDP through February. GDP is estimated to have risen 1.3% (not annualized) in January and to have fallen 0.6% in February.

Looking ahead

The economic calendar is lighter, but the key data include consumer and producer prices along with the trade deficit. The Fed will also release its Senior Loan Officer Opinion Survey.

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

EUROPE

By Barbara Teixeira Araujo of Moody's Analytics

Look for Upbeat GDP Figures from the U.K.

All eyes next week will be on the publication of first-quarter GDP figures for the U.K. While we expect results to be very upbeat—we are penciling in a 0.5% q/q increase, up from 0.2% in the fourth quarter—we would warn against reading too much into the start of the year's economic momentum. All soft and hard data released until now have confirmed that stockpiling ahead of March and April's Brexit deadlines played a huge role in boosting activity in the three months to March. But this isn't expected to be sustained. On the contrary, it warrants a sharp reversion in the second quarter, already corroborated by the grim survey figures for April.

Looking into the sectoral details, we expect that output rose across the board in the first quarter. The spotlight will be on the rise in U.K. industrial output—we expect a 1% q/q increase, following a 0.8% decline in the previous stanza—as the sector benefitted greatly from firms and households' decisions to build stocks ahead of Brexit. Across subsectors, the key upside detail is expected to be a rise in manufacturing output. The later has increased sharply by 1.1% m/m and 0.9% in January and February, respectively, and is expected to have risen a further 0.3% m/m in March in line with survey indicators. Internal as well as external demand for food products and pharmaceutical goods are expected to have risen the most, but all manufacturing subsectors are expected to have performed well over the month and over the quarter as a whole. By contrast, we expect that energy output declined slightly over the quarter, as February and March's above average temperatures depressed demand for heating and are expected to have fully offset January's rise in electricity production.

We expect that U.K. services output also rose strongly over the quarter. We are penciling in a 0.4% q/q increase, a very good result given that it would build on an already-strong 0.5% jump in the fourth stanza. Supporting the increase is expected to have been mainly an output jump in the distribution sector. Transport and storage as well as accommodation and food services production are also expected to have contributed. Notably, high-frequency retail sales data showed that retail sales soared by an eye-watering 1.6% q/q in the three months to March as consumers entirely shrugged off the buildup of Brexit uncertainties and spent freely on the high street. Households are benefitting from a tight labour market, a strong pickup in nominal wage growth and fading inflation pressures, all of which should continue in coming months. But the quarter's above-average temperatures should have also contributed to the rise in retail sales while at the same time boosting output in bars and cafes. Elsewhere, we expect that stockbuilding gave a strong boost to the transportation and storage industries. Anecdotal evidence suggests that delivery times were stretched to record highs over the month, while there was a general shortage of storage space, notably of chilled products.

Last, we expect good results for the construction sector. Data for January and February showed that construction rose sharply over those months, boosted mainly by the mild weather. And while soft data for March point to some correction, we still expect that construction rose by 1.3% q/q for the first stanza as a whole, fully reversing a 0.5% decline in the fourth quarter. We caution nonetheless that this result is extremely odd; anecdotal evidence had suggested that housebuilding and commercial real estate activities were put on hold because of Brexit uncertainties. We wouldn't rule out that upcoming revisions to the sector's data could paint a different picture a few months from now.

	Key indicators	Units	Moody's Analytics	Last
Mon @ 10:00 a.m.	Euro Zone: Retail Sales for March	% change	0.1	0.4
Tues @ 2:00 p.m.	Russia: Consumer Price Index for April	% change	5.3	5.3
Wed @ 6:00 a.m.	Germany: Industrial Production for March	% change	1.2	0.7
Thur @ 7:00 a.m.	Spain: Industrial Production for March	% change	-0.4	-1.1
Fri @ 7:45 a.m.	France: Industrial Production for March	% change	-0.5	0.4
Fri @ 9:00 a.m.	Italy: Industrial Production for March	% change	0.1	0.8
Fri @ 9:30 a.m.	U.K.: Monthly GDP for March	% change	0.2	0.2
Fri @ 9:30 a.m.	U.K.: GDP for Q1	% change	0.5	0.2
Fri @ 10:00 a.m.	Italy: Retail Sales for March	% change	0.1	0.1

ASIA-PACIFIC

By Katrina Ell of Moody's Analytics

China's Trade Surplus Likely Narrowed

China's April data will be a highlight. The foreign trade data will be closely watched for signs of improvement in global demand and domestic demand. We look for the trade surplus to have narrowed in April and annual export growth will not maintain the burly 14.2% y/y pace of March, which was likely related to Lunar New Year seasonality. Imports have slumped since the U.S.-China trade war escalated, as shipments from the U.S. have tumbled in year-on-year terms given the movement away from some U.S. goods.

China's M2 money supply growth likely hit 8.5% y/y in April, from 8.6% in March. There is some upside risk to the forecast given the monetary stimulus measures that have begun bearing fruit and have contributed to a general, albeit measured, improvement in credit growth. Notably, shadow financing remains on a downtrend.

CPI growth likely ticked up to 2.5% y/y in April, from the five-month high of 2.3% in March. Higher food prices are likely to remain the largest upward contributor, with disruptions to pork supply from African swine flu leading to gains in pork prices, a staple of the Chinese diet. PPI growth likely continued it modest upward climb to 0.5% y/y in April, from 0.4% previously. This is a welcome development given the adverse impact on industrial profits from producer prices flirting with deflation.

Central banks in Australia, New Zealand and Thailand will hold monetary policy meetings and are expected to keep their policy rates steady. Odds have recently increased that the Reserve Bank of Australia could deliver a 25-basis point cut, bringing the cash rate to 1.25%. Moody's Analytics is not in this camp. Odds increased after a weaker-than-expected March quarter CPI print, in which headline inflation cooled to 1.3%, from 1.8% in the December quarter. The RBA has previously stated that a consistent rise in the unemployment rate would be needed to justify monetary easing. The labour market remains healthy; the unemployment rate is hovering at a low 5% and employment growth is consistent with further modest rises in wage growth.

Indonesia's March quarter GDP growth likely came in at 5.2% y/y, unchanged from the December quarter's pace. Household consumption has benefitted in the past year from the cap on energy prices and increased cash handouts ahead of the April elections, in which President Joko Widodo claimed another five-year term. Financial markets reacted positively to his victory, as the incumbent is generally seen as leading a well-functioning government, even if the pace of infrastructure improvement has fallen short of initial expectations. Export growth has struggled amid weakened prices for important commodities including palm oil and softer demand from large markets including China.

The Week Ahead

	Key indicators	Units	Confidence	Risk	Moody's Analytics	Last
Mon @ Unknown	Indonesia GDP for Q1	% change yr ago	4	↑	5.2	5.2
Tues @ 11:30 a.m.	Australia Foreign trade for March	A$ bil	2	←	3.2	4.8
Tues @ 11:30 a.m.	Australia Retail sales for March	% change	3	↓	-0.3	0.8
Tues @ 2:30 p.m.	Australia Monetary policy for May	%	3	↓	1.5	1.5
Wed @ 2:00 p.m.	New Zealand Monetary policy for May	%	3	↓	1.75	1.75
Wed @ Unknown	Thailand Monetary policy for May	%	4	←	1.75	1.75
Wed @ Unknown	China Foreign trade for April	US$ bil	3	↑	28.8	32.6
Thurs @ 11:30 a.m.	China Consumer price index for April	% change yr ago	3	←	2.5	2.3
Thurs @ 11:30 a.m.	China Producer price index for April	% change yr ago	3	←	0.5	0.4
Thurs @ 12:00 p.m.	Philippines GDP for Q1	% change yr ago	3	↑	6.2	6.1
Thurs @ 2:30 p.m.	Japan Consumer confidence survey for April	Index	3	←	40.1	40.5
Fri @ 10:20 p.m.	India Industrial production for March	% change yr ago	2	↑	1.2	0.1
Fri @ Unknown	China M2 money supply for April	% change yr ago	3	↑	8.5	8.6

The Long View

Investors now pressure Baa credits to deleverage in order to lessen risk of a fallen-angel downgrade.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group
May 2, 2019

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 120 basis points resembles its 122-point mean of the two previous economic recoveries. This spread may be no wider than 138 bp by year-end 2019.

The recent high-yield bond spread of 391 bp is much thinner than what is suggested by the accompanying long-term Baa industrial company bond yield spread of 188 bp and is slightly narrower than what is suggested by the recent VIX of 14.2 points.

DEFAULTS

March 2019's U.S. high-yield default rate of 2.4% was less than the 4.2% of March 2018. Moody's Investors Service now expects the default rate will average 1.9% during 2020's first 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.

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.

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 2.3% for IG and grew by 7.1% for high yield.

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

For 2018, worldwide corporate bond offerings sank by 7.2% annually (to $2.322 trillion) for IG and plummeted by 37.6% for high yield (to $376 billion). The projected annual percent increases for 2019's worldwide corporate bond offerings are 1.5% for IG and 10.8% for high yield. When stated in U.S. dollars, issuers based outside the U.S. supplied 60% of the investment-grade and 61% of the high-yield bond offerings of 2019's first quarter.

The Long View

US ECONOMIC OUTLOOK

As inferred from the CME Group's FedWatch Tool, the futures market recently assigned an implied probability of 0.0% to at least one Fed rate hike in 2019. In view of the underutilization of the world's productive resources, low inflation should help to rein in Treasury bond yields. As long as the global economy operates below trend, the 10-year Treasury yield may not remain above 3% for long. A fundamentally excessive climb by Treasury bond yields and a pronounced slowing by expenditures in dynamic emerging market countries are among the biggest threats to the adequacy of economic growth and credit spreads.

EUROPE

By Barbara Teixeira Araujo and Brendan Meighan of Moody's Analytics
May 2, 2019

UNITED KINGDOM

The Monetary Policy Committee's unanimous decision to leave rates unchanged in May contrasted with an extraordinarily hawkish press conference by the bank's president Mark Carney. Carney repeatedly warned that markets' current expectations of only one rate hike over the two-year forecast period are out of touch with reality, as the bank expects excess capacity to emerge as soon as next year. This is in line with our view that markets were wrong in extrapolating the European Central Bank's and the Fed's dovish U-turns to the Bank of England; the situation in the U.K. is not comparable to that of the euro zone or of the U.S., especially since there is a lot of pent-up demand in the country following two years of an uncertainty-led loss of momentum.

In other words, the story is that rate hikes are coming but not just yet, as Brexit uncertainty is still weighing heavily on the country's activity and preventing the BoE from doing much. Uncertainty should continue throughout this year—which should ensure that growth remains below potential over 2019 as a whole—but the fading of woes conditional on the reaching of an agreement on a smooth Brexit transition period should push the economy into higher gear next year, leading to an emerging of excess capacity. Attesting to that is that the bank revised up its growth forecasts for 2020 and 2021, to 1.6% and 2.1%, respectively.

That the bank projects inflation to jump above target by the start of 2021 and increase thereafter only corroborates the need for faster-than-expected rate hikes over the next two years. And worth noting is that inflation forecasts were actually revised slightly lower in May, due to a downward-sloping sterling oil future curve. But this looks overdue given the current developments in the oil market, which means that inflation has the potential to overshoot the target by an even larger extent in two years' time. Adding to that is evidence from wage growth, which clearly points to a buildup of underlying inflation pressures down the road—pay growth remained at 3.5% y/y in the three months to February, its strongest in a decade—while labour market gains remain solid.

We thus maintain that at least one rate hike is warranted before the end of this year, likely by November. Although this is conditional on our judgment that Brexit uncertainty will be resolved over the next few weeks or months, even if Theresa May's deal doesn't pass and Article 50 is extended beyond October 31, we don't think the BoE would want to wait too long and risk CPI inflation from overshooting the 2% target further ahead. We are expecting two rate hikes per year from 2020.

EURO ZONE

Preliminary euro zone GDP growth for the first quarter gained 0.4% q/q, beating our forecast of 0.1%. This is a marked improvement on the 0.2% expansion in the previous two quarters and is impressive given the weakness in German and Italian growth, but is in line with year-ago quarterly growth rates.

Preliminary numbers for France's first quarter GDP growth printed at 0.3% q/q, the same rate as in the previous two stanzas, and 1.1% y/y, up from 1%. Domestic demand's contribution to the headline rebounded slightly, driven by a 0.4% increase in household consumption, despite slight downticks in investment and government consumption. Net exports were a drag as exports remained at a standstill compared with the prior quarter's 2.2% growth, while imports continued to grow at 0.9%, down from the previous quarter's 1.2%.

Unemployment figures also impressed. The euro zone's jobless rate dropped to 7.7%, its lowest since October 2008, and beat the consensus forecast of 7.8%. Across major countries, unemployment fell or remained stable everywhere. The key upside detail in this jobs report was Italy's unemployment rate falling to 10.2% in March from 10.5% in February, putting to rest some fears about the Italian economy.

March's report builds on the preceding month's evidence that the euro zone's labour market remains robust despite the recent economic slowdown, as it is a lagging indicator of growth. Similarly, despite avoiding recession by the skin of its teeth last quarter, Germany's seasonally adjusted unemployment rate remained at 4.9% in April after it dropped to this record low in March. The number of unemployed declined by about 12,000 following a 7,000 decrease in March. The labour market has performed well over the last few years despite the introduction of the minimum wage in 2015 and its gradual increases, combined with the vast inflow of refugees into Germany.

ASIA PACIFIC

By Katrina Ell, Veasna Kong and Xiao Chun Xu of Moody's Analytics
May 2, 2019

SOUTH KOREA

South Korean exports fell in April for a fifth consecutive month but the annual decline continued to moderate. Exports fell by 2% y/y in April, after the 8.2% fall in March and 11.4% drop in February. Trade in South Korea is a barometer for the outlook of neighbouring Asian countries since it is released early, and this report brings optimism for the entire region since it shows improvement in the export picture. Exports in Asia generally grew at a slower pace in 2018 compared with 2017 and this translated to slower GDP growth.

By product group, South Korea's semiconductor exports, normally the country's biggest earner, continued to slump because of falling prices of chips, down 13.5% y/y in April, after a 16.6% fall in the prior month, reaffirming the belief that the tech cycle is truly on a sustained downswing. Samsung reported a 60% y/y decrease in operating profit for first quarter to $US5.37 billion, the lowest since the third quarter of 2016. Ship and vessel exports surged 53.6% in April, though it is hard to draw conclusions from this on the rest of the economy given how volatile the industry is.

The Bank of Korea expects that global economic growth will moderate in 2019 with gains in China expected to slow, which will impact South Korean exports significantly. Exports to China declined for the sixth consecutive month, down 4.5% y/y in April, though the fall is comparatively much less than the falls experienced in the previous months. Exports to the U.S. continued to partly offset these falls, growing 3.9%.

According to the Bank of Korea's Business Survey Index, business sentiment of export-oriented manufacturing improved in April for the third consecutive month, albeit only slightly. The improvement in sentiment may be due to optimism over the China-U.S. trade negotiations, which is also reflected in the rising South Korea stock index, though the gains have moderated after the peak at end of February.

CHINA

China's manufacturing PMI slipped to 50.1 in April, down from a six-month high of 50.5 in March. April marked the second month that the manufacturing PMI has remained above the neutral 50 mark. Most components lost a little ground over April, including the production, new orders, raw materials and inventories subindexes. Notably, the new export orders component remained in contraction territory for the 11th straight month at 49.2, indicative of the weakness in global trade.

Global merchandise trade had been driven by the synchronized upturn in global growth from around mid-2016. But international trade faded in 2018, with the disruptions and drop in sentiment caused by the trade war exacerbating the slowdown. The moderation in local investment has also weighed on the manufacturing sector, reflecting Beijing's earlier efforts to clamp down on elevated financial system risks. Beijing has since moved to ease credit conditions, among other measures to boost growth that have begun to gain traction.

China's March economic data surprised on the upside, with first quarter GDP up 6.4% y/y, above expectations and marking an end to three consecutive quarters of slowing growth. However, the overall PMI remains just above the expansion/contraction threshold, indicating manufacturing conditions are still soft.

The Long View

We'll likely witness further improvement in manufacturing conditions as fiscal and monetary stimulus efforts continue to bear fruit. Speculation of a trade deal between the U.S. and China will also help reduce the threat of further tariff escalation.

Ratings Round-Up

Improvement in U.S. Corporate Credit Quality

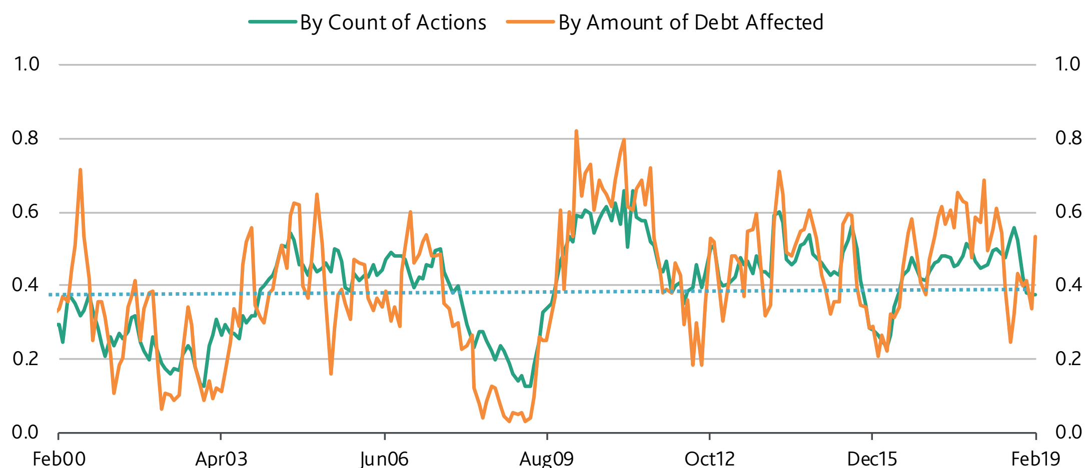
By Michael Ferlez

U.S. corporate credit quality improved last week, with positive rating actions accounting for 64% of total changes. Downgrades remained confined to smaller, speculative-grade companies and accounted for none of the reported debt. Last week's upgrades were headlined by Visa Inc., which saw its senior unsecured credit rating upgraded from Baa2 to Baa1. The U.S.-based electronic payments company was upgraded reflecting its strong brand, leading industry position, and favorable growth prospects. The other notable upgrade was MasterCard Inc., another U.S. electronic payment company. MasterCard saw its senior unsecured debt upgraded to A1 from A2. In total, the two electronic payment companies accounted for 70% of affected debt.

European rating activity increased last week, though the quality remained poor. Downgrades outnumber upgrades by a ratio of 3:2. Despite being outnumber, upgrades accounted for the majority of affected debt. Notable upgrades include Sky Ltd., which saw its senior unsecured credit rating increased to A3 from Baa2. The upgrade reflects Sky Ltd.'s parent, Comcast Corp., receiving the required consents needed to guarantee Sky Ltd.'s bonds. The upgraded affected $10 billion in debt. On the downgrade side, Garfunkelux Holdco 2 S.A. (Lowell) saw its senior secured and senior unsecured credit rating cut to B3 from B2. The downgrade reflects the firm's weak financial performance, high leverage, debt maturity concentration in 2022 and 2023, and relatively weak underlying cash flows.

FIGURE 1

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



* Trailing 3-month average

Source: Moody's

FIGURE 2
Rating Key

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

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
4/24/19	MARATHON OIL CORPORATION	Industrial	SrUnsec/MTN/CP	5,537	U	Ba1	Baa3	SG
4/24/19	MOLINA HEALTHCARE, INC.	Financial	SrUnsec/IFSR		U	B3	B2	SG
4/25/19	SERTA SIMMONS BEDDING, LLC	Industrial	SrSec/BCF /LTCFR/PDR		D	Caa2	Caa3	SG
4/25/19	DIGITAL ROOM HOLDINGS, INC. .	Industrial	LTCFR/PDR		D	B2	B3	SG
4/26/19	CSM BAKERY SOLUTIONS LIMITED	Industrial	SrSec/BCF /LTCFR/PDR		D	Caa2	Caa3	SG
4/26/19	IMAGINE! PRINT SOLUTIONS, LLC	Industrial	SrSec/BCF /LTCFR/PDR		D	Caa2	Caa3	SG
4/29/19	PVH CORP.	Industrial	SrUnsec	1,060	U	Ba2	Baa3	SG
4/29/19	ACL I CORPORATION-COMMERCIAL BARGE LINE COMPANY	Industrial	SrSec/BCF /LTFR/PDR		D	Caa2	Caa3	SG
4/29/19	ZEP INC.	Industrial	SrSec/BCF /LTCFR/PDR		D	Caa2	Ca	SG
4/29/19	CARETRUST REIT, INC.	Financial	SrUnsec/LTCFR	300	U	Ba3	Ba2	SG
4/30/19	POPULAR, INC.	Financial	SrUnsec/LTIR/LTD /Sub/JrSub/MTN/PS	1,567	U	B2	B1	SG
4/30/19	CUMBERLAND FARMS, INC.	Industrial	SrUnsec /LTCFR/PDR	300	U	B3	B1	SG
4/30/19	MASTERCARD INCORPORATED	Industrial	SrUnsec	5,842	U	A2	A1	IG
4/30/19	FIRST BANCORP-FIRSTBANK PUERTO RICO	Financial	LTIR/LTD		U	Caa1	B3	SG
4/30/19	VISA INC.	Industrial	SrUnsec/LTIR	16,750	U	A1	Aa3	IG
4/30/19	CBRE GROUP, INC. -CBRE SERVICES, INC.	Industrial	SrUnsec/BCF	1,025	U	Baa2	Baa1	IG
4/30/19	HOTSHINE INTERMEDIATECO, INC. -MISTER CAR WASH	Industrial	LTCFR/PDR		D	B2	B3	SG

Source: Moody's

Ratings Round-Up

FIGURE 4

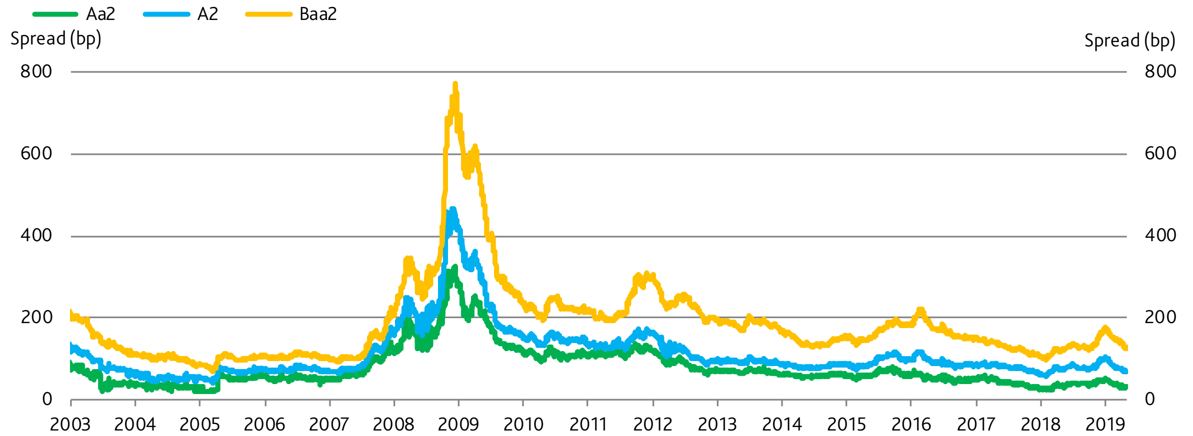
Rating Changes: Corporate & Financial Institutions – Europe

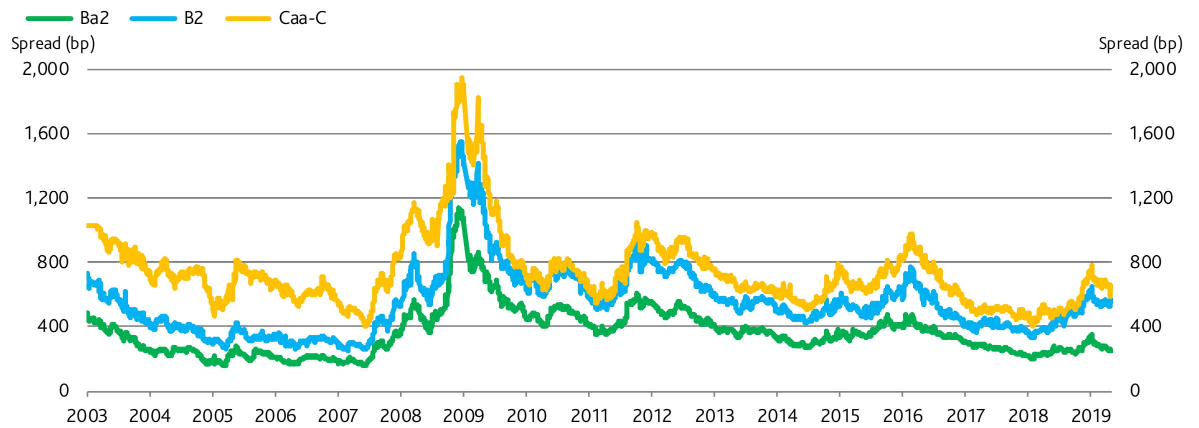
Date	Company	Sector	Rating	Up/ Down	Old LTD Rating	New LTD Rating	IG/SG	Country
4/24/19	JYSKE BANK A/S	Financial	SrUnsec/STD /LTD/MTN	U	Baa1	A2	IG	DENMARK
4/24/19	SYDBANK A/S	Financial	LTD/MTN	U	A2	A1	IG	DENMARK
4/24/19	MALLINCKRODT PLC-MALLINCKRODT INTERNATIONAL FINANCE SA	Industrial	SrUnsec/SrSec /BCF/LTCFR/PDR	D	B1	B2	SG	LUXEMBOURG
4/25/19	TRANSPORTATION INVESTMENTS HOLDING LIMITED-GLOBALTRANS INVESTMENT PLC	Industrial	LTCFR/PDR	U	Ba2	Ba1	SG	CYPRUS
4/25/19	NOVACAP GROUP HOLDING	Industrial	SrSec/BCF /LTCFR/PDR	D	B1	B2	SG	FRANCE
4/26/19	THOMAS COOK GROUP PLC	Industrial	SrUnsec /LTCFR/PDR	D	B2	B3	SG	UNITED KINGDOM
4/26/19	GARFUNKELUX HOLDCO 2 S.A.	Financial	SrSec/SrUnsec /LTCFR	D	B2	B3	SG	LUXEMBOURG
4/26/19	ANACAP FINANCIAL EUROPE S.A. SICAV-RAIF	Financial	SrSec	D	B1	B2	SG	LUXEMBOURG
4/26/19	B2HOLDING ASA	Financial	LTIR	D	Ba3	B1	SG	NORWAY
4/29/19	COMCAST CORPORATION - SKY LIMITED	Industrial	SrUnsec/MTN	U	Baa2	A3	IG	UNITED KINGDOM
4/29/19	CIA. SIDERURGICA NACIONAL-CSN RESOURCES S.A.	Industrial	SrUnsec/LTCFR	U	B3	B2	SG	LUXEMBOURG
4/29/19	CITYCON OYJ	Industrial	SrUnsec /LTIR/MTN	D	Baa2	Baa3	IG	FINLAND

Source: Moody's

Market Data

Spreads





Market Data

CDS Movers

Figure 3. CDS Movers - US (April 24, 2019 – May 1, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	May. 1	Apr. 24	Senior Ratings
Ford Motor Company	Ba2	B1	Baa3
Ford Motor Credit Company LLC	Ba2	Ba3	Baa3
HCA Inc.	Ba1	Ba2	Ba2
General Electric Company	Baa3	Ba1	Baa1
CSC Holdings, LLC	Ba1	Ba2	Ba3
United Airlines, Inc.	Ba2	Ba3	Baa2
American Tower Corporation	Ba2	Ba3	Baa3
Univision Communications Inc.	B3	Caa1	Caa1
Constellation Brands, Inc.	Ba1	Ba2	Baa3
Crown Castle International Corp.	Baa3	Ba1	Baa3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	May. 1	Apr. 24	Senior Ratings
Anadarko Petroleum Corporation	A3	Aa3	Ba1
Kerr-McGee Corporation	A2	Aa2	Ba1
Darden Restaurants, Inc.	A3	Aa3	Baa2
United Parcel Service, Inc.	A3	A1	A1
USG Corporation	B1	Ba2	Ba2
JPMorgan Chase & Co.	A3	A2	A2
Apple Inc.	Aa1	Aaa	Aa1
Verizon Communications Inc.	Baa1	A3	Baa1
American Express Credit Corporation	Aa3	Aa2	A2
John Deere Capital Corporation	A3	A2	A2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	May. 1	Apr. 24	Spread Diff
Neiman Marcus Group LTD LLC	Ca	3,013	2,497	516
Dean Foods Company	Caa1	2,920	2,487	433
USG Corporation	Ba2	233	153	80
Diamond Offshore Drilling, Inc.	B3	412	346	65
Pitney Bowes Inc.	Ba2	443	379	63
Weatherford International, LLC (Delaware)	Caa3	1,459	1,422	37
Frontier Communications Corporation	Caa1	2,537	2,504	33
Chesapeake Energy Corporation	B2	596	570	25
Freeport-McMoRan Inc.	Ba2	182	158	24
Freeport Minerals Corporation	Baa2	185	161	24

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	May. 1	Apr. 24	Spread Diff
Penney (J.C.) Corporation, Inc.	Caa2	2,826	2,932	-106
K. Hovnanian Enterprises, Inc.	Caa3	1,928	2,019	-90
Rite Aid Corporation	Caa1	1,356	1,424	-69
Avon Products, Inc.	B3	357	410	-53
Hertz Corporation (The)	B3	650	682	-32
Ford Motor Company	Baa3	187	218	-31
Ford Motor Credit Company LLC	Baa3	173	201	-28
YRC Worldwide Inc.	Caa1	723	749	-26
Staples, Inc.	B3	584	606	-21
Beazer Homes USA, Inc.	B3	355	376	-20

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (April 24, 2019 – May 1, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	May. 1	Apr. 24	Senior Ratings
Stonegate Pub Company Financing plc	Ba2	B1	Caa1
Italy, Government of	Ba2	Ba3	Baa3
BNP Paribas	Aa2	Aa3	Aa3
Portugal, Government of	Baa1	Baa2	Baa3
Banco Bilbao Vizcaya Argentaria, S.A.	Baa1	Baa2	A3
Bankia, S.A.	Baa3	Ba1	Baa3
UniCredit S.p.A.	Baa3	Ba1	Baa1
Commerzbank AG	Baa2	Baa3	A1
Svenska Handelsbanken AB	Aa1	Aa2	Aa2
Sanofi	Aa1	Aa2	A1

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	May. 1	Apr. 24	Senior Ratings
Electricite de France	Baa1	A3	A3
Bayerische Landesbank	A1	Aa3	Aa3
Deutsche Telekom AG	A2	A1	Baa1
Allied Irish Banks, p.l.c.	Baa2	Baa1	Baa3
BASF (SE)	Aa2	Aa1	A1
Iberdrola International B.V.	A2	A1	Baa1
BNP Paribas Fortis SA/NV	Aa3	Aa2	A2
LafargeHolcim Ltd	Baa3	Baa2	Baa2
Vivendi SA	A2	A1	Baa2
Airbus SE	Aa3	Aa2	A2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	May. 1	Apr. 24	Spread Diff
Galapagos Holding S.A.	Caa3	10,091	6,649	3,441
Jaguar Land Rover Automotive Plc	Ba3	565	530	34
NIBC Bank N.V.	Baa1	93	75	18
Novafives S.A.S.	B3	510	492	18
Anglo American plc	Baa2	124	109	15
TUI AG	Ba3	254	240	15
Casino Guichard-Perrachon SA	Ba3	468	454	14
ArcelorMittal	Baa3	156	146	10
CMA CGM S.A.	B3	777	769	9
Heathrow Finance plc	Ba2	202	194	8

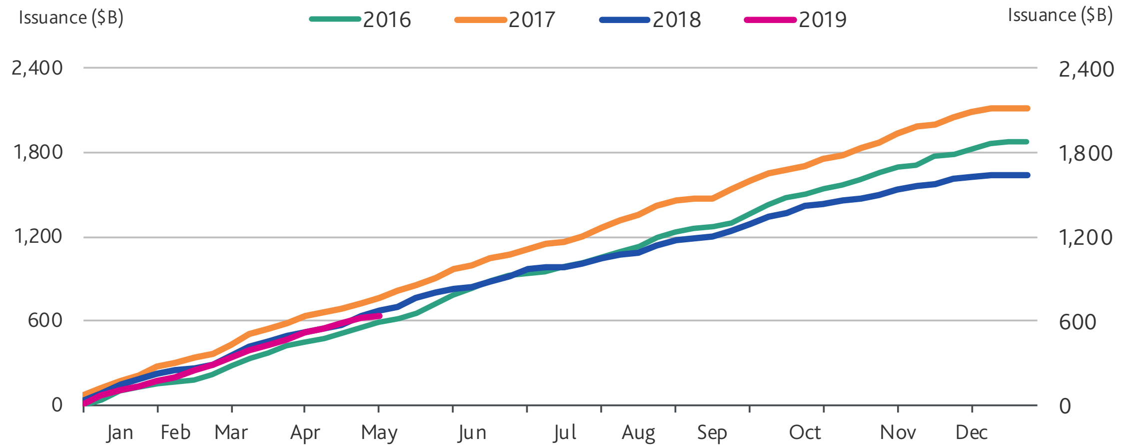
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	May. 1	Apr. 24	Spread Diff
Novo Banco, S.A.	Caa2	331	548	-217
Boparan Finance plc	Caa1	1,580	1,686	-107
PizzaExpress Financing 1 plc	Caa2	2,675	2,737	-62
Caixa Geral de Depositos, S.A.	Ba1	117	141	-25
Valeo S.A.	Baa3	99	119	-20
Rexel SA	Ba3	110	121	-11
Stonegate Pub Company Financing plc	Caa1	194	204	-11
Suedzucker AG	Baa3	145	156	-11
Italy, Government of	Baa3	178	188	-10
Eurobank Ergasias S.A.	Caa1	890	900	-10

Source: Moody's, CMA

Market Data

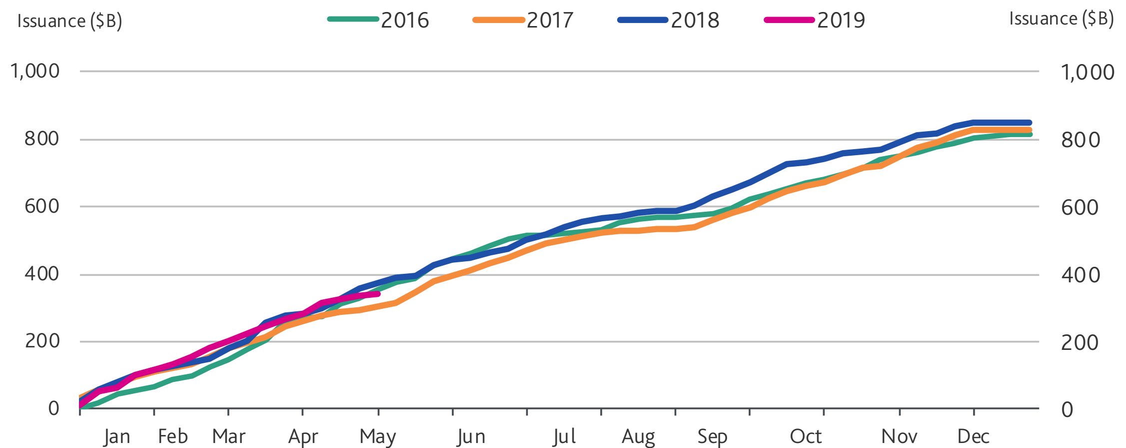
Issuance

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	10.862	6.850	18.387
Year-to-Date	467.060	142.239	640.785

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	5.612	2.911	8.579
Year-to-Date	303.653	33.294	342.949

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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Subdued Outlook for Revenues and Profits Portend Lower Interest Rates (Capital Markets Research)

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