MOODY'S
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WEEKLY MARKET OUTLOOK

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Replay of Late 1998's Drop by Interest Rates May Materialize

Credit Markets Review and Outlook *by John Lonski*

Replay of Late 1998's Drop by Interest Rates May Materialize

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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: During January-February 2019, US$-denominated corporate bond issuance fell by 4.7% yearly for investment-grade and grew by 4.7% for high-yield.

Credit Spreads	Investment Grade: We see year-end 2019's average investment grade bond spread above its recent 126 basis points. High Yield: Compared to a recent 422 bp, the high-yield spread may approximate 495 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 rise from January 2019's 2.6% to 2.4% by January 2020.
Issuance	For 2018's US$-denominated corporate bonds, IG bond issuance sank by 15.4% to $1.276 trillion, while high-yield bond issuance plummeted by 38.8% to $277 billion for high-yield bond issuance's worst calendar year since 2011's 274 billion. In 2019, US$-denominated corporate bond issuance is expected to rise by 1.8% for IG to $1.299 trillion, while high-yield supply grows by 11.8% to $310 billion. A significant drop by 2019's high-yield bond offerings would suggest the presence of a recession.

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Ratings Round-Up

Greek Upgrades Lead Europe Changes

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Market Data

Credit spreads, CDS movers, issuance.

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Moody's Capital Markets Research *recent publications*

Links to commentaries on: High-yield, defaults, confidence vs. skepticism fed pause, stabilization, growth and leverage, buybacks, volatility, monetary policy, yields, profits, corporate borrowing, U.S. investors, eerie similarities, base metals prices, trade war.

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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.

Replay of Late 1998's Drop by Interest Rates May Materialize

Weakness abroad and a faltering demand for U.S. output now put downward pressure on both earnings-sensitive securities' prices and benchmark Treasury yields. The equity and high-yield credit rallies will be put on hold until the earnings outlook stabilizes. Worth recalling is how the booming U.S. economy of late 1998 did not prevent the Fed from cutting rates in order to contain risks arising from economic weakness abroad. Late 1998 is distinguished from the current situation by how U.S. real GDP growth is now much slower than its pace above 4.5% in 1998's second half.

On March 7, not only did the European Central Bank slash its forecast for 2019's euro zone economic growth from 1.7% to 1.1%, the ECB also revised upward its projection for the euro zone's 2019 unemployment rate from 7.8% to 7.9%. For the U.S. at least, year-over-year increases by the unemployment rates often are hallmarks of a recession.

Projections of slower economic growth and higher unemployment complemented the lowering of the ECB's consumer price inflation forecast from 1.6% to 1.2%. Thus, more in the way of monetary accommodation may be necessary if the ECB is to reach its 2% inflation target for the euro zone.

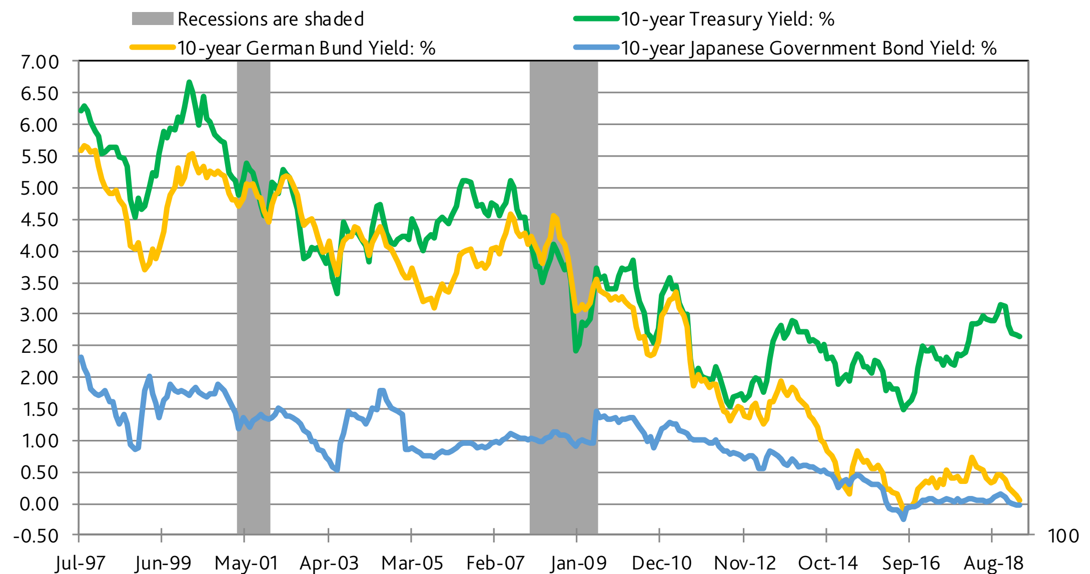
These downward revisions prompted ECB President Mario Draghi to announce that key ECB interest rates are likely to remain at current levels through the end of 2019. In further response to the downside risks now facing the euro zone outlook, Mr. Draghi added that the ECB will reinvest principal payments from maturing bonds of the ECB's asset portfolio well past the start of hiking the ECB's key interest rates (whenever that might be). In other words, there will be no tapering of the ECB's considerable bond holdings as long as ample monetary accommodation is needed to assure sufficient systemic liquidity.

In quick response to the ECB's more downbeat assessment of euro zone prospects, European equity markets moved lower by 0.40% to 0.60%. By contrast, the market value of U.S. common stock sank by a deeper 1.0% during the afternoon trading of March 7.

Sovereign government bond yields plunged in response to the euro zone's downwardly revised outlook. For example, the 10-year German government bond yield fell from March 6's 0.13% to 0.06% for its lowest reading since the 0.03% of October 25, 2016, or when the 10-year U.S. Treasury yield closed at 1.76%. Thus, until convincing upward momentum is reestablished for U.S. business activity, the 10-year U.S. Treasury yield is likely to fall under its recent 2.65%.

Figure 1: World's Ultra-Low Bond Yields Are the Offshoot of Slack and Disinflationary Global Business Activity

sources: Dow Jones, NBER, Moody's Analytics



Foreign Purchases of U.S. Output Sag

Despite a very low unemployment rate, a near record low ratio of first-time claims for state jobless benefits to employment, and the material expansion of private-sector payrolls, spending on U.S. output has faltered.

Regarding the world's demand for U.S. products, trade disputes and the second-half 2018 strengthening of the dollar exchange rate significantly lowered foreign purchases of U.S. production. After growing by 0.5% per month, on average, during 2018's first half, U.S. exports shrank by 0.5% monthly, on average, during the second half. December 2018's wider than anticipated U.S. trade deficit warns of a downward revision for the annualized quarterly growth rate of fourth-quarter 2018's real GDP from a preliminary estimate of 2.6% to a pace closer to 2%.

U.S. Consumer Spending Slows

Domestic demand for U.S. output also has sagged. Higher borrowing costs, more selective consumer lending criteria, aggressive consumer product price hikes, the U.S. government shutdown, diminished support from 2018's personal income tax cuts, the much reduced deductibility of state and local taxes from federal income taxes, and a heavier household debt burden explain why a seemingly very firm U.S. labor market has not supplied more lift to household expenditures.

After slowing from third-quarter 2018's 3.5% to the 2.8% of 2018's final quarter, real consumer spending's annualized sequential increase is likely to decelerate to a range of 1.25% to 1.75% in 2019's first quarter. Lending support to this possibility are the back-to-back monthly declines by seasonally-adjusted unit sales of light motor vehicles of 4.7% in January and 0.9% in February.

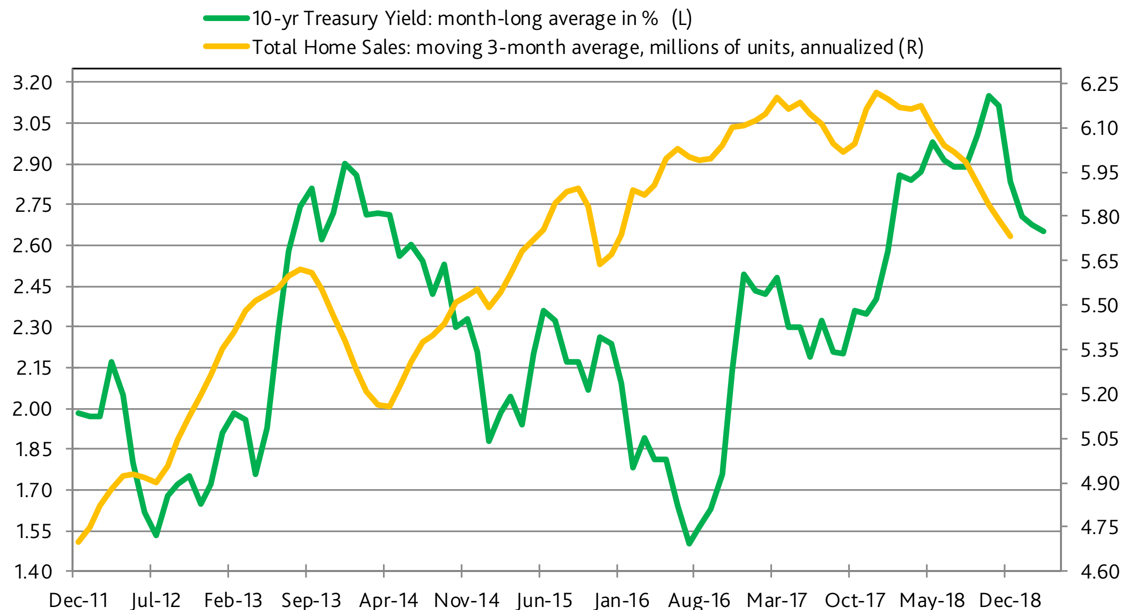
In addition, the outlook for home sales has yet to respond with convincing vigor to the latest slide by the 30-year mortgage yield from a fourth-quarter 2018 average of 4.78% to the 4.42% average of January-February 2019.

The Mortgage Bankers Association's seasonally-adjusted index of homebuyer mortgage applications got off to a fast start in 2019, but has since eased. In January, the index of mortgage applications from potential homebuyers soared higher by 12.8% from the prior month to its highest month-long average since the index's estimation methodology was changed in September 2011. However, the homebuyer mortgage applications index would then plunge by 10.3% monthly in February. Moreover, the year-over-year increase of the moving four-week average of homebuyer mortgage applications slumped from January 25's 6.0% to March 1's 0.6%.

Credit Markets Review and Outlook

The continuation of lackluster auto sales and the lack of a material recovery by home sales would favor a further slide by benchmark Treasury yields. To a large extent, 2019-to-date's nearly 16% advance the PHLX index of housing-sector share prices anticipated a stimulatory interest rate environment. Conceivably, the U.S. 10-year Treasury yield could drop under 2.5% by summer.

Figure 2: Treasury Bond Yields May Fall Until Unit Home Sales Recover Convincingly
sources: National Association of Realtors, Census Bureau, Moody's Analytics



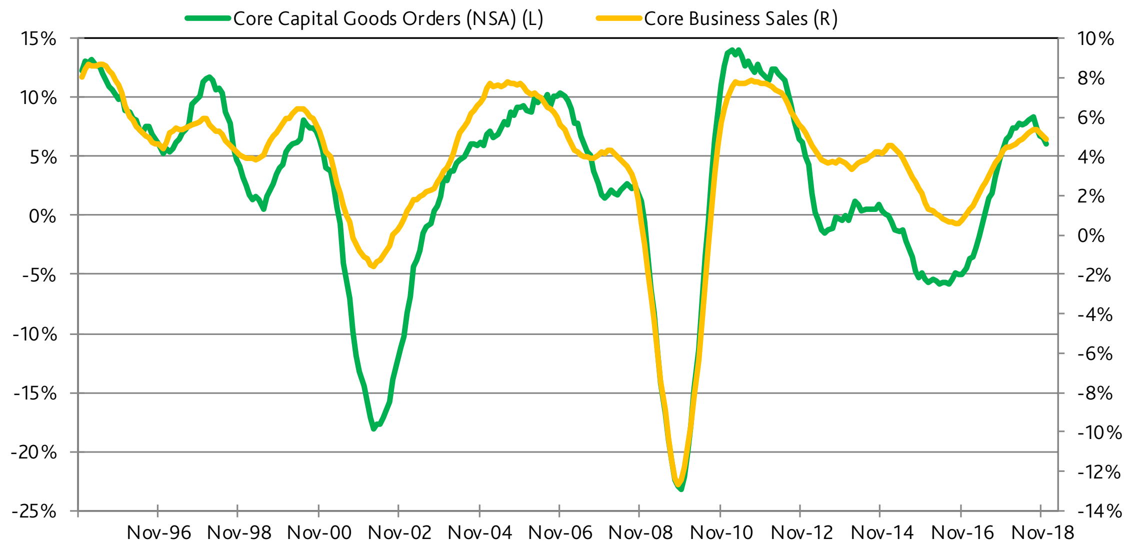
Capital Spending Is Expected to Slow ...

The annualized quarterly increase for real capital spending by U.S. businesses is expected to slow from the 6.2% of 2018's final quarter to a first-quarter 2019 range of 2.25% to 2.75%. Yearlong 2018's outsized 7.0% advance by real business investment spending owed much to the extraordinary boost supplied by the start to the more favorable tax treatment of capital spending. In 2019, real capital spending may slow to a range of 3.5% to 4.5%.

Slower early 2019's business spending on equipment could be inferred from the pronounced slowing of core capital goods orders, or new orders for nondefense capital goods excluding aircraft. After expanding at an annualized pace of 6.8% through the first three quarters of 2018, core capital goods orders contracted by 4.1% annualized from the third to the final quarter of 2018. However, despite how core capital goods order contracted by 3.7% annualized from the third to the final quarter of 2016, yearlong 2017's real business investment spending still grew by 5.3% annually.

In terms of the year-over-year percent changes of moving 12-month averages, core capital goods orders generate a strong correlation of 0.90 with business sales excluding sales of identifiable energy products, or core business sales. In a manner that warns of slower growth for 2019's business outlays, the year-over-year increase of core business sales abruptly slowed from the 5.3% of January-September 2018 to the 3.5% of 2018's final quarter.

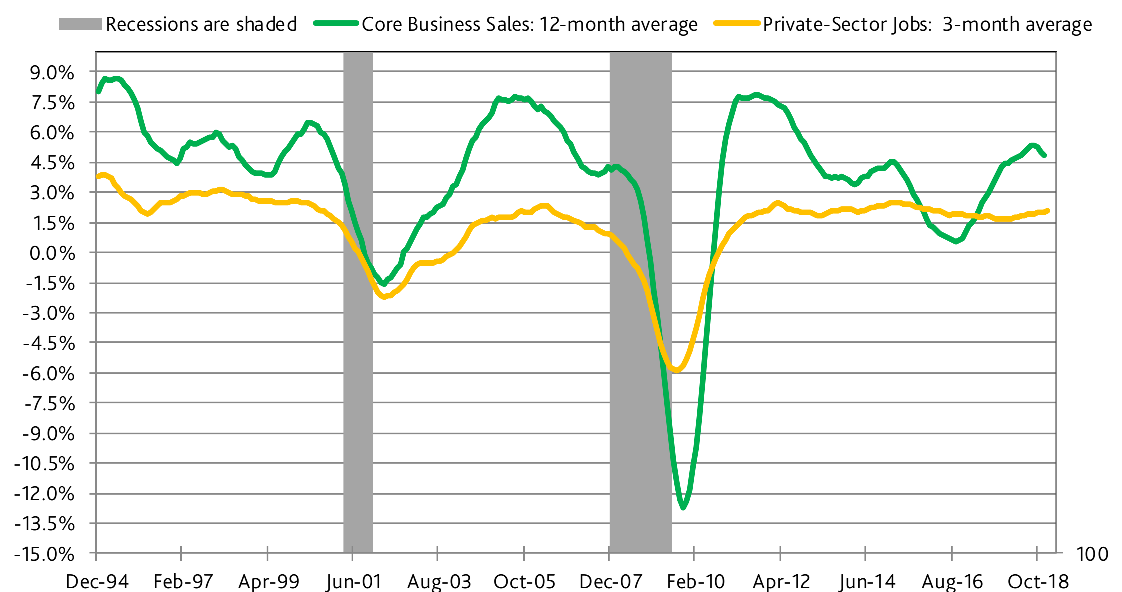
Figure 3: In Terms of Annual Percent Changes Core Capital Goods Orders Show a Strong Correlation of 0.90 with Core Business Sales
yy % changes of yearlong sums
sources: Census Bureau, Moody's Analytics



And Business Hiring May Follow

The correlation between the annual percent changes of private-sector payrolls' moving three-month average and core business sales' moving 12-month average is a highly significant 0.86. Hiring activity cannot proceed independently of business sales indefinitely.

Figure 4: More Pronounced Slowdown by Core Business Sales Would Curb Private-Sector Hiring
yy % changes
sources: Census Bureau, BLS, NBER, Moody's Analytics



Global Slack May Prompt a Replay of 1998-1999

Heightened global uncertainty can drive U.S. benchmark interest rates lower even if domestic business activity outperforms trend. U.S. benchmark interest rates last fell amid a very low unemployment rate and rapid U.S. economic growth during late 1998. In response to financial market stress emanating from weak emerging market economies, the federal funds rate was cut from August 1998's 5.50% to 4.75% by November 1998. Moreover, the 10-year Treasury yield's month-long average sank from June 1998's 5.50% to December 1998's 4.65%.

Credit Markets Review and Outlook

Late 1998's reduction by short- and long-term interest rates was striking given the exceptional underlying strength of U.S. business activity. For example, second-half 1998's averages were 4.5% for the U.S. unemployment rate, 3.9% for the year-to-year increase of the hourly wage, and 5.9% for real GDP's annualized quarterly increase. After expanding by 4.5% annually in 1998, real GDP advanced by 4.8% annually in 1999. Driving U.S. benchmark rates lower was the pronounced deceleration by estimated economic growth for the rest of the world from 1997's 3.9% to 2.1% in 1998.

In stark contradiction to what might be inferred from the Phillips curve, yearlong 1999's core PCE price index inflation barely rose to 1.4% from its 1.3% annual rise of 1998's second half despite 1999's accompanying yearlong readings of 4.2% for the jobless rate and 3.7% for hourly wage growth.

Late 1998's drop by U.S. interest rates helped to remedy an ailing world economy. In 1999, an acceleration by U.S. real GDP growth to 4.8% helped to stoke an estimated 3.3% growth rate for the rest of the world. After bottoming at December 1998's 4.65%, the 10-year Treasury yield's month-long average reached 5.90% when Fed rate hikes resumed in June 1999. By November 1999, the fed funds rate had returned to 5.50%.

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

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

There Is Still Life in this Expansion

Though the U.S. economy has transitioned from a mid- to late-stage expansion, this expansion has plenty of life left in it. The labor market is strong and shows little sign of overheating and while GDP growth has slowed, it has been orderly. Also, financial market conditions have improved recently, thanks partly to the dovish pivot by the Federal Reserve.

The economy will hit some bumps this year, but worries about a recession are premature. Generally, recessions occur because imbalances develop in asset prices or the economy overheats, generating inflation pressures that cause the Fed to aggressively raise interest rates. Neither appears overly threatening at this time. In fact, the risk of a policy mistake by the Fed has diminished noticeably, implying lower odds of a recession over the next 12 months.

A pause is justified as inflation pressures are muted. The labor market is tight, but inflationary implications are not significant and in fact are diminishing. The gap between the actual unemployment rate and many economists' estimates of the non-accelerating inflation rate of unemployment, or NAIRU, is shrinking (combination of lower NAIRU estimates and a rise in the actual unemployment rate). Still, the unemployment rate could fall even further without stoking significant inflation, since the slope of the Phillips curve remains flat.

We used 10-year and 15-year rolling regressions to estimate the Phillips curve to allow us to get an idea of the pass-through from the labor market to inflation. The results suggest that every percentage point deviation from NAIRU would boost year-over-year growth in the core personal consumption expenditures deflator between 5 and 10 basis points. This would suggest that the labor market could continue to tighten, and the immediate implications for inflation are limited. There is the risk that this is nonlinear, and that the inflationary implications are greater the bigger the overshoot of NAIRU.

There are still some pockets of weakness in the economy, including housing. Past increases in mortgage rates have weighed on residential investment and home sales. The good news is that mortgage rates have fallen recently and will provide a boost to housing, but it will take a little time. We are fairly confident that housing will improve as new-home sales, which are among the first to respond to lower mortgage rates, rose from a revised 599,000 annualized units in November (previously 657,000) to 621,000 in December. There were downward revisions to new-home sales in September and October, but they were nowhere near as large as the revision to November. The trend in new-home sales remains weak, but the good news is that it is no longer deteriorating.

Something we are keeping a close eye on is business confidence. Our weekly business confidence survey has dropped noticeably and is well off what was seen this time last year. That's likely due to significant tightening in financial market conditions in the fourth quarter of last year, ongoing trade tensions between the U.S. and China, Brexit concerns, and the dysfunction in Washington DC. However, given that financial market conditions have improved recently we would anticipate that sentiment should begin to improve. This is already visible in the U.S. ISM manufacturing surveys, NAHB housing market index, and global PMIs, but our weekly survey has failed to turn.

All told, our probability of recession model that uses only economic data puts the odds a recession in the next 12 months at 28%. The model that relies only on financial market variables also has fallen and is at 33%.

Looking ahead to next week, among the key data scheduled to be released are retail sales, industrial production, consumer prices, construction spending and business inventories.

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

EUROPE

By Barbara Teixeira Araujo of Moody's Analytics in Prague

Parliament to Vote, and Vote and Vote

The week ahead will bring a barrage of releases for the European countries, but the focus again will be on U.K. politics. British Prime Minister Theresa May is expected to come back from Brussels with a tweaked withdrawal agreement or at least some reassurances on the Northern Ireland backstop. Her new deal will be put to an important vote Tuesday, but we expect May to lose yet again by a large margin. We think it highly unlikely that a majority of MPs will support her, notably as reports from Brussels suggest that negotiations with the EU have reached an impasse and that not much progress has been made over the past two weeks.

At least this no longer means a cliff-edge Brexit in light of the passage of the Cooper amendment by parliament last week. Accordingly, if her deal is rejected, the next step is for May to hold a vote Wednesday on whether to leave the EU without a deal. We expect a large majority of MPs to vote no. If that's the case, May would have to hold yet another vote Thursday, this one on an extension of Article 50. In our view it is more likely than not that the extension voted by parliament will be for a short-term one, with Brexit Day postponed by a few months. May would go then to Brussels and ask the EU to agree to the extension. Several European politicians have said they wouldn't accept an extension without clear motivation—meaning that May would need to present them with good reason to accept that postponement would be meaningful for reaching an agreement. But we continue to expect that the EU would accept an extension of Article 50 no matter what, since everyone wants to avoid the cliff-edge.

Still, the long-term Brexit story would remain unchanged by an extension, which only kicks the can down the road. For the economy, it would mean that the uncertainty would drag at least until the summer, further denting business investment and household consumption.

On the data front, the focus will be on U.K. monthly GDP for January. We expect that activity in the country rose by a meagre 0.1% from the prior month, failing to rebound from a 0.4% decline in December, though we caution that risks are tilted toward an even lower reading. This should have pushed growth in the three months to January to as low as 0.1% q/q, down from 0.4% in the three months to November. On the upside, we expect that services activity rebounded somewhat over the month on higher consumer spending. High-frequency data for the retailing sector suggest that retailers enjoyed a comfortable start to the year following December's dismal results, which were largely a correction following a Black Friday-related boost in November. Car sales are also expected to have increased, following several months of declines related to the introduction of the EU's new emissions regulations for the auto sector.

Meanwhile, January's temperatures fell back in line with their seasonal norms and should have pushed up demand for heating and thus energy production after several months of underperformance. But manufacturing output is expected to have contracted for yet another month, due to the long-lasting Brexit uncertainty and the slowdown in external demand. The outlook for the construction industry is also downbeat. Firms and households are expected to have largely delayed major decisions on building projects. They will continue to do so as long as there is no deal on the Brexit front.

Elsewhere, we will get final February inflation data for the euro zone on Friday. We expect the CPI report to confirm that inflation rose slightly to 1.5% y/y at the middle of the second quarter from 1.4% in January. But we caution that only noncore inflation pressures are expected to have increased, as the core rate likely will be confirmed at only 1%, down from 1.1% previously, on the back of a seasonal plunge in services inflation. Base effects in oil prices should push energy inflation further down from April, following a stable reading in March, but we still see the direction of travel in core inflation as

tilted to the upside. Prospects for a rate hike this year are nonetheless nonexistent, and we maintain that the ECB will not move on rates until mid-2020.

	Key indicators	Units	Moody's Analytics	Last
Mon @ 7:00 a.m.	Germany: Industrial Production for January	% change	0.5	-0.4
Mon @ 8:00 a.m.	Spain: Retail Sales for January	% change	0.3	-0.6
Mon @ 11:00 a.m.	OECD: Composite Leading Indicators for January		99.0	99.2
Tues @ 9:30 a.m.	U.K.: Monthly GDP for january	% change	0.1	-0.4
Wed @ 8:00 a.m.	Spain: Consumer Price Index for February	% change yr ago	1.1	1.0
Wed @ 10:00 a.m.	Euro Zone: Industrial Production for January	% change	1.2	-0.9
Thur @ 7:00 a.m.	Germany: Consumer Price Index for February	% change yr ago	1.6	1.4
Thur @ 7:45 a.m.	France: Consumer Price Index for February	% change yr ago	1.5	1.4
Thur @ 2:00 p.m.	Russia: Foreign Trade for January	$ bil	18.1	18.9
Fri @ 10:00 a.m.	Italy: Consumer Price Index for February	% change yr ago	1.0	0.9
Fri @ 10:00 a.m.	Euro Zone: Consumer Price Index for February	% change yr ago	1.5	1.4

ASIA-PACIFIC

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

Stimulus Efforts Improve China's Credit Growth

China's credit growth is on an improving trend thanks to the government stepping up monetary stimulus efforts in recent months. We look for M2 money supply to have held at 8.4% y/y in February, after rising by 0.3 percentage point in January. Total social financing hit a record high CNY4.64 trillion in January and is the broadest gauge of credit growth in China. The number of corporate sector loans jumped in January and accounted for around 80% of new business; Beijing has been targeting the small-business segment of the market, which has struggled in aggregate with the slowdown in domestic demand. The National People's Congress confirmed that both monetary and fiscal stimulus measures will play a greater supportive role in 2019 as the government tries to stabilize growth.

China will release fixed asset investment, industrial production and retail trade for the combined January-February period to try to alleviate the seasonality associated with the Lunar New Year. Fixed asset investment improved further at the start of 2019, likely rising to 6.2% y/y in January-February, from December's 5.9%. This reflects the government's infrastructure push. Further gains, albeit measured, are expected over the next year.

The Bank of Japan will hold policy settings and growth and inflation forecasts steady at its March policy meeting. In February, the BoJ lowered its growth and CPI forecasts. Core CPI growth is forecast at 0.9% y/y in the 2019-2020 fiscal year, confirming the 2% inflation goal is out of reach for the foreseeable future. The BoJ has turned more dovish in recent months, following July's meeting when it allowed greater flexibility to yield curve control, a move that we believe was intended to pave the path for tightening. But with growth and inflation slipping towards the end of 2018, the BoJ will remain the laggard central bank globally, and tightening policy seems unlikely in 2019.

The Reserve Bank of India has an easing bias, and has already delivered a 25-basis point cut in February. This partially reverses the 50 basis points worth of reluctant hikes in 2018 to help stabilize India's external position amid a wave of emerging market outflows. This easing bias has been enabled by CPI growth cooling. In January CPI growth hit 2% y/y and we expect it hit 2.1% in February. Lower food prices have led headline inflation lower on the back of lower output prices for agricultural goods.

The Week Ahead

	Key indicators	Units	Confidence	Risk	Moody's Analytics	Last
Mon @ Unknown	China Monetary aggregates for February	% change yr ago	3	⬅	8.4	8.4
Tues @ 11:00 p.m.	India Consumer price index for February	% change yr ago	2	⬇	2.1	2.0
Tues @ 11:00 p.m.	India Industrial production for January	% change yr ago	2	⬇	3.5	2.4
Wed @ 10:00 a.m.	South Korea Unemployment rate for February	%	3	⬇	4.2	4.4
Wed @ 10:50 a.m.	Japan Core machinery orders for January	% change	3	⬅	0.5	-0.1
Thurs @ 1:00 p.m.	China Fixed asset investment for January-February	% change yr ago YTD	2	⬅	6.2	5.9
Thurs @ 1:00 p.m.	China Industrial production for January-February	% change yr ago	3	⬇	5.8	5.7
Thurs @ 1:00 p.m.	China Retail sales for January-February	% change yr ago	3	⬅	8.1	8.2
Fri @ 3:00 p.m.	Indonesia Foreign trade for February	US$ bil	2	⬅	-0.98	-1.16
Fri @ Unknown	India Foreign trade for February	US$ bil	2	⬅	-13.5	-14.7
Fri @ Unknown	Japan Monetary policy for March	¥ tril	5	⬅	80	80

The Long View

During January-February 2019, US$-denominated corporate bond issuance fell by 4.7% yearly for investment-grade and grew by 4.7% for high-yield.

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

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 126 basis points exceeded its 122-point mean of the two previous economic recoveries. This spread may be no wider than 140 bp by year-end 2019.

The recent high-yield bond spread of 422 bp is thinner that what is suggested by the accompanying long-term Baa industrial company bond yield spread of 205 bp and an accompanying VIX of 17.1 points.

DEFAULTS

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

US CORPORATE BOND ISSUANCE

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

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

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

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

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

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

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 1.7% for IG and 5.3% for high yield.

US ECONOMIC OUTLOOK

As inferred from the CME Group's FedWatch Tool, the futures market recently assigned an implied probability of merely 2.0% 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 of Moody's Analytics
March 7, 2019

EURO ZONE

The European Central Bank's March monetary policy meeting was as dovish as it could get. Not only did the ECB announce new stimulus through the launching of new TLTROs—Targeted Longer-Term Refinancing Operations—but the bank also changed its forward guidance on rates, stating it is unlikely to move on them before the start of next year. Adding to that, ECB President Mario Draghi was at his most dovish during the news conference; he even hinted that the Governing Council discussed extending the forward guidance to March 2020, which would be much more consistent with markets' current expectations.

It was easy for Draghi to justify his dovish tone and the announced measures, as the ECB on Thursday sharply revised down its inflation and growth forecasts for this year and next. Euro zone GDP is now expected to expand by only 1.1% in 2019, down from a previous forecast of 1.7% and down from 1.8% in 2018. Underpinning this slowdown will be mainly external factors—the slowdown in China and volatility in emerging markets, a potential deceleration in the U.S. due to reduced fiscal stimulus and lower confidence resulting from the trade war—but internal factors will also play a role. In the spotlight is the euro zone's auto industry, which was hit hard at the end of 2018 by new EU regulations. Italy is also in the spotlight, as prolonged uncertainty there has the scope to push the economy further into recession following two consecutive quarters of contraction.

While Draghi insisted he is confident in the ECB's baseline forecasts—meaning that chances of a recession are very low—he said that the ECB decided to maintain the balance of risks as tilted to the downside. This is not common practice for the bank, as it normally changes the balance of risks to 'broadly balanced' when it announces new stimulus. If this wave of dovish comments was not enough, here is the cherry on top: Draghi kept insisting that the ECB is providing more stimulus to the economy instead of just avoiding unwarranted tightening. Sure enough, the bank's TLTRO programme surpassed expectations. As many as seven TLTRO operations will be held from this September until March 2021, with banks being able to borrow as much as 30% of their outstanding loans to the economy with a maturity of two years.

In all, we were nonetheless puzzled by Draghi's ultra-dovish tone, notably as this year's slowdown in euro area growth did not come out of the blue. We and other economists had forecast this long ago, which makes the ECB's abrupt change in stance look overdue. The good news is that this means upward surprises are now more probable than downward ones, which could create some opportunity for the ECB to act if the data stabilize or improve.

OECD

The OECD, as expected, slashed its 2019 growth forecasts for all major world economies, warning that Brexit uncertainty and the ongoing trade war are seriously hurting global prospects. The world economy is now expected to grow by only 3.3% this year, down from 3.6% in 2018 and 3.7% in 2017.

Across the world's 10 largest economies, China and India are again expected to grow the most, by 6.2% and 7.2%, respectively. And while India's growth should accelerate slightly from last year, China's economy is slowing (it grew by 6.6% in 2018) and dragging most of the other smaller Asian economies with it. Following suit is the U.S., whose GDP is expected to grow by 2.6% this year, though we caution that this marks a slowdown from the 2.9% recorded for 2018. Canada's economy is also losing momentum; it should grow by 1.5% in 2019, down from 1.8% previously.

The situation in Europe is more complicated, with Germany's forecast halved to only 0.7% for 2019. This marks a sharp pullback following growth of 1.4% in 2018 and 2.5% in 2017. Given that the German economy is export-oriented, it is no wonder that the country is one of the hardest-hit by the cooling in global trade.

Another key downside detail was that the OECD now expects Italy's GDP to actually contract this year, by 0.2%, following a meagre 0.8% gain in 2018. As long as political uncertainty in the country remains the word of the day, confidence will remain subdued, which will keep investors on the sidelines. On the upside, the French economy should perform a bit better; at 1.3%, growth there is expected to outpace the euro zone average (1%) this year.

Underpinning this forecast is mainly that the French economy is less exposed to the global trade slowdown than are Italy and Germany, though domestic demand in the country is also expected to strengthen this year.

Elsewhere, the OECD revised down its expectations for U.K. growth as well, though this doesn't come as a surprise given that persistent uncertainty is taking a huge toll on the country's momentum. The U.K.'s GDP should grow by only 0.8% this year after gaining a paltry 1.4% in 2018, but that's provided that a deal is soon found with the EU. The U.K. economy would by contrast plunge into recession in the no-deal scenario.

ASIA PACIFIC

By Katrina Ell of Moody's Analytics
March 7, 2019

JAPAN

Stronger wage growth in Japan is key to unlocking that elusive virtuous cycle of rising wages, prices and consumption in the country. Prime Minister Shinzo Abe is in the midst of the seventh straight annual campaign to compel firms to increase wages at the spring wage negotiations. In December, Abe said his ideal would be to see firms increase wages by 5%, an unrealistic ask. Global demand has softened, so the already emerging weaker export and manufacturing picture replicated in many economies in Asia is expected to hang around in 2019.

Japanese corporates are notoriously cautious, so they are unlikely to release retained earnings to wages with any vigour. For decades Japanese firms have prioritized job stability over stronger income growth, a reasonable strategy given that deflation has gripped the economy for many years. Taking a leap of faith that the slowdown will not last seems unlikely. Indeed, March-quarter GDP growth is tracking at an uninspiring 1% q/q annualized, following the 1.4% expansion in the December quarter, according to preliminary estimates.

Wages have improved but not enough to kick-start meaningful and sustained improvement in private consumption and inflation. The tighter labour market is at least partly to thank for the uptick in wages. In January the unemployment rate was a low 2.5%, where it has hovered for over a year. The job-to-applicant ratio was 1.63, near its highest level on record. There is a reasonable correlation between Japan's vacancy rate and wages. As the vacancy rate rises, employers are forced to offer higher wages to secure the right candidate.

Flatter Phillips curve

But the improvement in wages is measured, considering that the labour market is in its best position in decades. The reason is the flatter Phillips curve. Part of the flattening reflects a trend in lower-paid, nonregular workers, which includes part-time and temporary employees. Regular workers generally work full time, are directly hired by the employer, and receive bonuses along with other employee benefits such as leave. The average lifetime income for nonregular workers is about 60% of regular workers' levels.

Part-time employment has increased from around 15% in the early 1990s to 30% in 2017. Although the rate of increase in the share of nonregular workers has slowed, the situation has not reversed. Labour market reform to further encourage growth in regular workers, relative to nonregular, is needed to boost employment; when meaningful changes occur, we should see sustained improvement in income and price growth.

For inflation to reach the elusive 2% mark, wages will likely have to rise at least 3% on a consistent basis. There's little indication that this will occur over the coming year.

Inflation falls short

Core CPI (excluding food) growth was up 0.8% y/y in January after the 0.7% gain in December. Core inflation is the Bank of Japan's preferred measure and it remains well shy of the 2% target. Core-core CPI (excluding food, alcohol and energy) added 0.3% y/y, from 0.1% previously, providing confirmation that fuel, rather than domestic demand, is the primary upward driver of price growth.

Since launching quantitative easing in 2013, the BoJ has continually pushed out the timing for reaching its 2% inflation target, and it's not looking any closer. The BoJ is expected to stay quiet in 2019, licking its wounds

after continually downwardly revising its inflation forecasts. Its latest core CPI estimate for fiscal 2019-2020 has been reduced by 0.5 percentage point to 0.9%, and the 2020-2021 forecast has been reduced by 0.1 percentage point to 1.4%, keeping the BoJ's 2% target out of reach.

We expect the central bank to maintain quantitative easing and a negative interest rate policy through to 2020. Although the BoJ may slow its pace of asset purchases as it runs out of Japanese government bonds to purchase, overall monetary policy will remain ultra-accommodative.

A good barometer of longer-term inflation expectations is calculated by subtracting the 10-year nominal government bond from the 10-year inflation-linked bond. Using this measure for the past two years, inflation expectations have hovered around 0.4%.

Looming consumption tax hike

The next major obstacle for Japan's economy is the 2% consumption tax hike to 10% scheduled for October. Private consumption, which accounts for around 60% of Japan's GDP, remains fragile at best. The economic track record after consumption tax hikes isn't good; consumption and GDP declined after the previous two sales tax increases, in 1997 and 2014.

We believe the tax hike will likely lead to a decline in consumption, and the economy could slip into a small recession. However, a fallout similar to the previous tax hikes is unlikely. The degree of slowdown may not be as severe because ¥2 trillion out of the ¥5 trillion from the revenue will be diverted to fiscal stimulus. Although Japanese governments notoriously spend less on fiscal stimulus than originally planned, fiscal spending of some form will partially offset lower consumption. An increase in investment prior to Japan's Olympic Games in 2020 could also help.

Ratings Round-Up

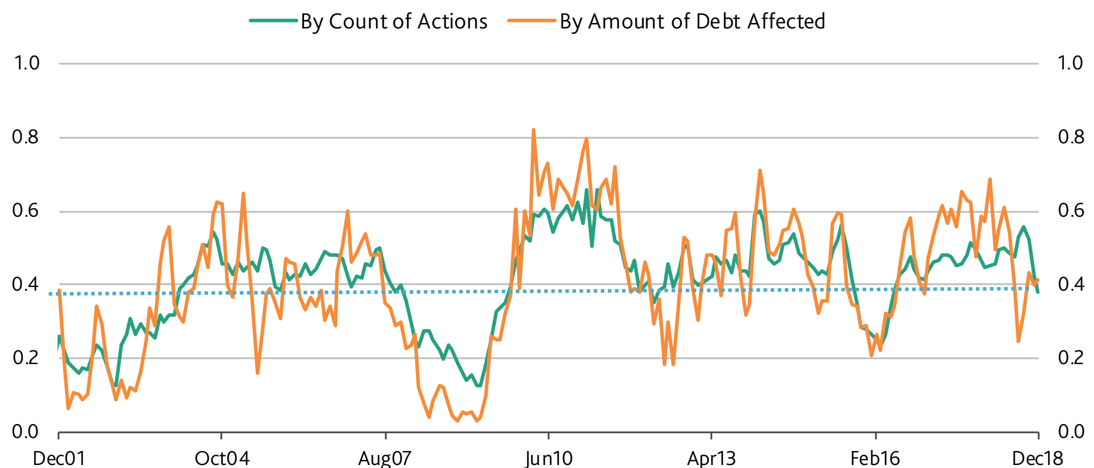
Greek Upgrades Lead Europe Changes

By Michael Ferlez

U.S. rating activity improved last week, with positive rating changes accounting for 42% of total activity, up from 23% in the prior week. Despite again being outnumber by downgrades, upgrades nevertheless accounted for nearly all the affected debt. Notable upgrades included Thermo Fisher Scientific Inc. and Free Port – McMoran Inc. Together, the two upgrades accounted for $27 billion of debt. Although downgrades have largely outnumbered upgrades over the past several months, downgrades have largely been confined to small speculative-grade companies, with relatively small amount of outstanding debt. Additionally, with the U.S. economy now in the late stages of the economic expansion, there is less upside to positive rating changes. Still, the trend in rating activity bears close watching. It is an important barometer for the health of U.S. economic expansion.

Rating change activity in Europe was much stronger last week thanks to upgrades of several Greek banks. The National Bank of Greece S.A. and Alpha Bank AE were both upgraded from Caa2 to Caa1, while Hellenic Telecommunications Organization S.A was upgraded from B1 to Ba2. The rating changes followed the upgrade of Greece's sovereign credit rating from B3 to B1 sovereign, reflecting the improving economic conditions in Greece. Outside of Greece, the other notable upgrade was to Anglo American PLC. The U.K.-based mining company's senior unsecured debt was upgrade to Baa2 from Baa3 reflecting reduction in debt and improving production cost positions.

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



* Trailing 3-month average

Source: Moody's

FIGURE 2

Rating Key

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

FIGURE 3

Rating Changes: Corporate & Financial Institutions – US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG
2/27/19	FREEPORT-MCMORAN INC.	Industrial	SrUnsec /LTCFR/PDR	9,804	U	Baa3	Baa2	IG
2/27/19	ACCURIDE CORPORATION	Industrial	SrSec/BCF /LTCFR/PDR		D	B3	Caa1	SG
2/27/19	DIPLOMAT PHARMACY, INC.	Industrial	SrSec/BCF /LTCFR/PDR		D	B1	B2	SG
2/28/19	DEAN FOODS COMPANY	Industrial	SrUnsec /LTCFR/PDR	700	D	B3	Caa1	SG
2/28/19	MANITOWOC COMPANY, INC. (THE) -MTW CRANES ESCROW CORP	Industrial	SrSec/LTCFR/PDR	260	U	B3	B2	SG
2/28/19	POWER MIDCO, LLC -POWERTEAM SERVICES, LLC	Industrial	SrSec/BCF		D	B2	B3	SG
2/28/19	CLOUD PEAK ENERGY INC.-CLOUD PEAK ENERGY RESOURCES LLC	Industrial	SrSec/SrUnsec /LTCFR/PDR	347	D	Caa2	Ca	SG
3/1/19	THERMO FISHER SCIENTIFIC INC.	Industrial	SrUnsec	17,267	U	Baa2	Baa1	IG
3/1/19	MEDIACOM COMMUNICATIONS CORPORATION	Industrial	SrUnsec/SrSec /BCF/LTCFR/PDR	200	U	B1	Ba2	SG
3/1/19	ROYAL DUTCH SHELL PLC-SHELL ENERGY NORTH AMERICA (US), L.P.	Utility	LTIR		U	A3	A2	IG
3/1/19	AFFORDABLE CARE HOLDING CORP.	Industrial	SrSec/BCF /LTCFR/PDR		D	B2	B3	SG
3/4/19	BRISTOW GROUP INC.	Industrial	SrSec/SrUnsec /LTCFR/PDR	752	D	B2	Caa1	SG

Source: Moody's

FIGURE 4

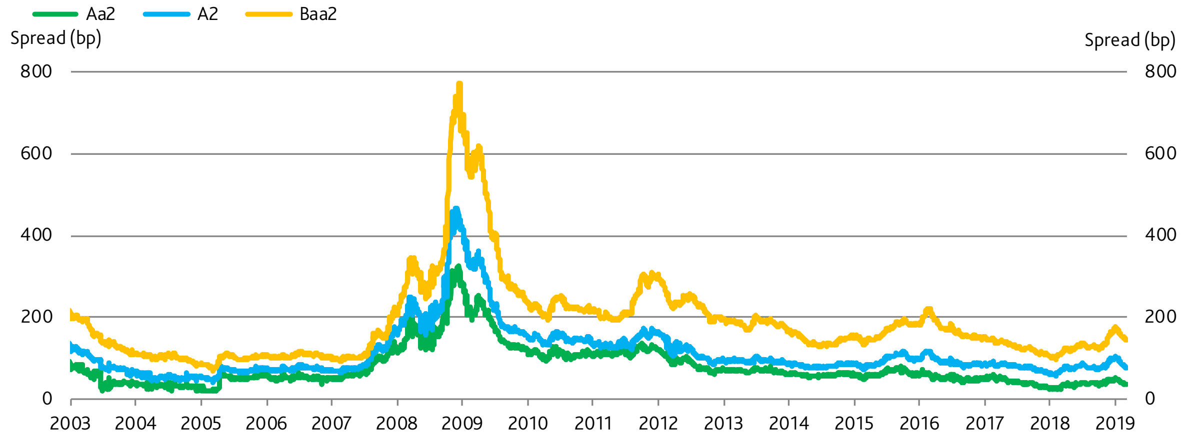
Rating Changes: Corporate & Financial Institutions – Europe

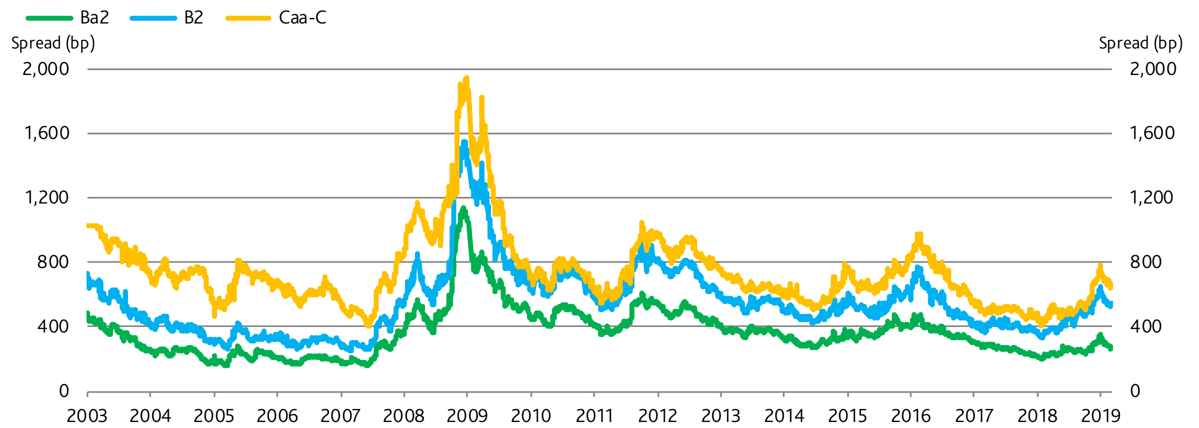
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/SG	Country
2/27/19	SENVION S.A.	Industrial	SrSec /LTCFR/PDR	455	D	Caa1	Caa2	SG	LUXEMBOURG
2/28/19	SOLOCAL GROUP S.A.	Industrial	SrSec /LTCFR/PDR	453	D	B3	Caa2	SG	FRANCE
3/4/19	ANGLO AMERICAN PLC	Industrial	SrUnsec/LTIR /MTN/CP	10,511	U	Baa3	Baa2	IG	UNITED KINGDOM
3/5/19	NATIONAL BANK OF GREECE S.A.	Financial	LTD/MTN		U	Caa2	Caa1	SG	GREECE
3/5/19	ALPHA BANK AE	Financial	SrUnsec/LTD /Sub/MTN/PS	2,083	U	Caa2	Caa1	SG	GREECE
3/5/19	HELLENIC TELECOMMUNICATION S ORGANIZATION S.A.	Industrial	SrUnsec/LTCFR /PDR/MTN	1,196	U	B1	Ba2	SG	GREECE

Source: Moody's

Market Data

Spreads





Market Data

CDS Movers

Figure 3. CDS Movers - US (February 27, 2019 – March 6, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Mar. 6	Feb. 27	Senior Ratings
Gap, Inc. (The)	Ba1	Ba3	Baa2
Citigroup Inc.	Baa1	Baa2	Baa1
Wells Fargo & Company	A3	Baa1	A2
Oracle Corporation	A1	A2	A1
Caterpillar Financial Services Corporation	A3	Baa1	A3
United Technologies Corporation	A1	A2	Baa1
PepsiCo, Inc.	Aa2	Aa3	A1
Cisco Systems, Inc.	Aa2	Aa3	A1
First Data Corporation	A1	A2	B2
United Airlines, Inc.	Ba2	Ba3	Ba3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Mar. 6	Feb. 27	Senior Ratings
Illinois Tool Works Inc.	A2	Aa3	A2
Ford Motor Credit Company LLC	B1	Ba3	Baa3
Pfizer Inc.	Aa2	Aa1	A1
General Electric Company	Ba1	Baa3	Baa1
McKesson Corporation	Baa3	Baa2	Baa2
Boston Scientific Corporation	A1	Aa3	Baa2
Emerson Electric Company	A2	A1	A2
Lennar Corporation	Ba2	Ba1	Ba1
ERP Operating Limited Partnership	Aa3	Aa2	A3
Hertz Corporation (The)	Ca	Caa3	B3

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Mar. 6	Feb. 27	Spread Diff
Neiman Marcus Group LTD LLC	Ca	1,941	983	958
Dean Foods Company	B3	1,604	1,226	378
Frontier Communications Corporation	Caa1	2,398	2,263	136
K. Hovnanian Enterprises, Inc.	Caa3	3,606	3,488	118
Hertz Corporation (The)	B3	765	663	102
Weatherford International, LLC (Delaware)	Caa3	1,774	1,677	96
R.R. Donnelley & Sons Company	B3	767	686	81
Rite Aid Corporation	Caa2	1,244	1,175	69
Avon Products, Inc.	B3	585	517	68
AK Steel Corporation	B3	765	702	63

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Mar. 6	Feb. 27	Spread Diff
Penney (J.C.) Corporation, Inc.	Caa2	3,010	3,506	-495
Office Depot, Inc.	B3	429	486	-57
Gap, Inc. (The)	Baa2	132	183	-50
Interval Acquisition Corp	B1	220	268	-48
Tenet Healthcare Corporation	Caa1	335	372	-37
Wyndham Destinations	Baa3	144	180	-36
Dell Inc.	Ba2	200	221	-21
TEGNA Inc.	Ba2	171	188	-18
Murphy Oil Corporation	Ba2	151	166	-14
Avis Budget Car Rental, LLC	B1	266	276	-11

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (February 27, 2019 – March 6, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Mar. 6	Feb. 27	Senior Ratings
Ireland, Government of	Aa2	A1	A2
Spain, Government of	Baa1	Baa2	Baa1
Barclays Bank PLC	Baa1	Baa2	A2
Barclays Plc	Baa3	Ba1	Baa3
Abbey National Treasury Services plc	Baa2	Baa3	Aa3
The Royal Bank of Scotland Group plc	Baa3	Ba1	Baa2
Nationwide Building Society	Baa1	Baa2	Aa3
Swedbank AB	A1	A2	Aa2
Bayerische Motoren Werke Aktiengesellschaft	Baa1	Baa2	A1
SEB AB	Aa3	A1	Aa2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Mar. 6	Feb. 27	Senior Ratings
BNP Paribas Fortis SA/NV	A2	Aa3	A2
Rabobank	Aa2	Aa1	Aa3
Credit Agricole S.A.	Aa3	Aa2	A1
Natixis	Baa1	A3	A1
ING Groep N.V.	Baa2	Baa1	Baa1
Deutsche Telekom AG	Aa3	Aa2	A3
Ukraine, Government of	Caa3	Caa2	Caa1
Swiss Reinsurance Company Ltd	Aa2	Aa1	Aa3
TDC A/S	Ba1	Baa3	Ba3
SKF AB	Baa1	A3	Baa1

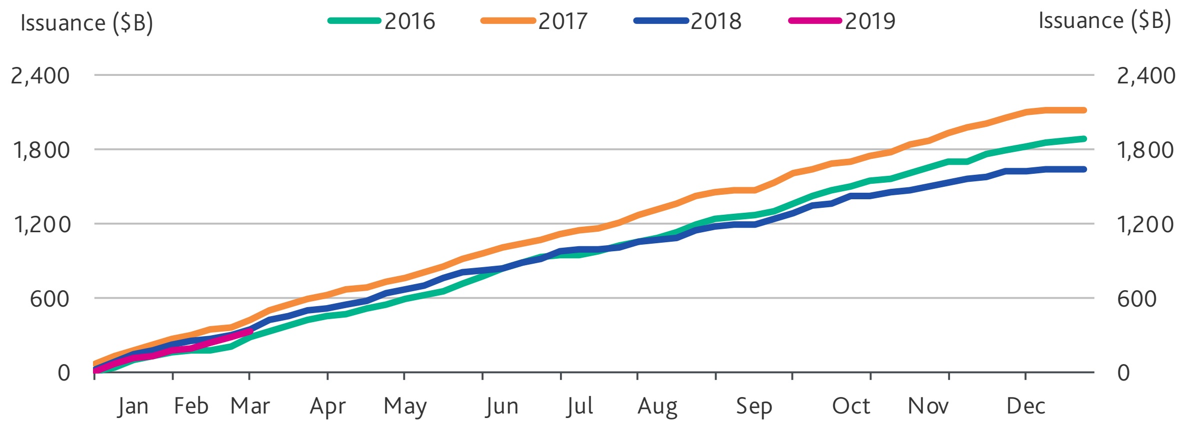
CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Mar. 6	Feb. 27	Spread Diff
Weatherford International Ltd. (Bermuda)	Caa3	1,978	1,870	107
CMA CGM S.A.	B3	660	618	42
Novafives S.A.S.	Caa1	620	578	42
Ukraine, Government of	Caa1	618	590	28
Russian Standard Bank	Caa2	1,217	1,189	28
Galapagos Holding S.A.	Caa3	6,802	6,777	25
PizzaExpress Financing 1 plc	Caa2	2,216	2,191	25
Yapi ve Kredi Bankasi A.S.	B1	428	411	17
Eksportfinans ASA	Baa3	457	440	17
UPC Holding B.V.	B2	100	83	17

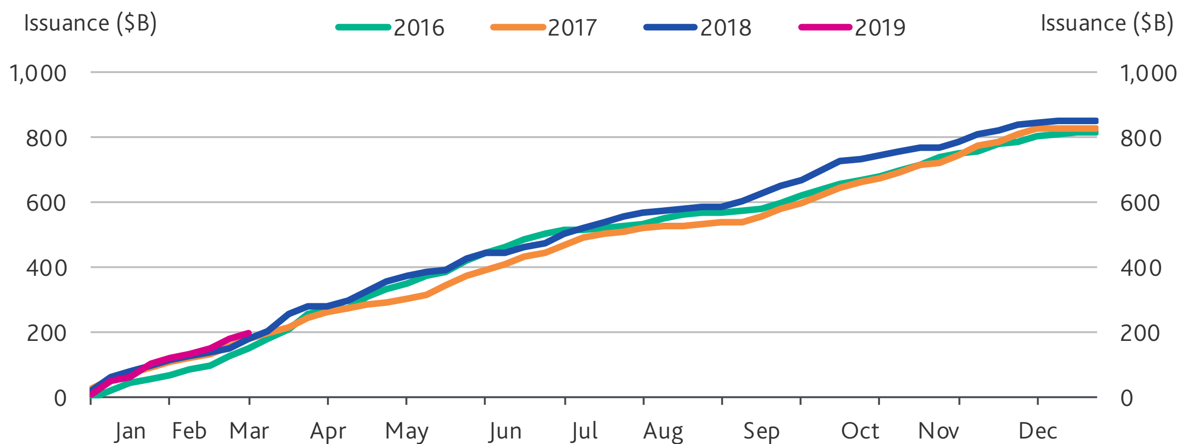
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Mar. 6	Feb. 27	Spread Diff
Jaguar Land Rover Automotive Plc	Ba3	567	621	-53
Sunrise Communications Holdings S.A.	B1	86	130	-44
Cyprus, Government of	Ba2	101	126	-25
Boparan Finance plc	Caa1	1,160	1,183	-23
Greece, Government of	B3	334	355	-21
Koninklijke KPN N.V.	Baa3	85	102	-17
Selecta Group B.V.	Caa1	283	299	-17
Unione di Banche Italiane S.p.A.	Baa3	237	253	-16
Casino Guichard-Perrachon SA	Ba1	404	420	-15
Italy, Government of	Baa3	187	201	-14

Source: Moody's, CMA

Market Data

Issuance





Market Data

Figure 7. Issuance: Corporate & Financial Institutions

	USD Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	33.041	7.770	41.933
Year-to-Date	245.422	69.820	329.152

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	17.983	3.067	21.360
Year-to-Date	183.805	13.711	200.623

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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