MOODY'S ANALYTICS

# WEEKLY MARKET OUTLOOK

Moody's Analytics Research

*Weekly Market Outlook Contributors:*

John Lonski
1.212.553.7144
john.lonski@moodys.com

Yuki Choi
1.212.553.0906
yuckyung.choi@moodys.com

*Moody's Analytics/Asia-Pacific:*

Katrina Ell
+61.2.9270.8144
katrina.ell@moodys.com

*Moody's Analytics/Europe:*

Barbara Teixeira Araujo
+420.224.106.438
barbara.teixeiraaraujo@moodys.com

*Moody's Analytics/U.S.:*

Ryan Sweet
1.610.235.5000
ryan.sweet@moodys.com

Greg Cagle
1.610.235.5211
greg.cagle@moodys.com

Michael Ferlez
1.610.235.5162
michael.ferlez@moodys.com

Editor
Reid Kanaley
1.610.235.5273
reid.kanaley@moodys.com

# Rising Default Rate May Be Difficult to Cap

## Credit Markets Review and Outlook *by John Lonski*

Rising Default Rate May Be Difficult to Cap

» FULL STORY PAGE 2

## The Week Ahead

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

» FULL STORY PAGE 6

## The Long View

Full updated stories and key credit market metrics: As of January 21,16 of the month-to-date's 31 high-yield bond issues were from Chinese entities.

| | |
|---|---|
| Credit Spreads | Investment Grade: We see year-end 2019's average investment grade bond spread close to its recent 139 bp. High Yield: Compared to a recent 465 bp, the high-yield spread may approximate 525 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 December 2018's 2.8% to 3.4% by December 2019. |
| 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 1.9% for IG to $1.300 trillion, while high-yield supply grows by 7.7% to $299 billion. A significant drop by 2019's high-yield bond offerings would suggest the presence of a recession. |

» FULL STORY PAGE 10

## Ratings Round-Up

Mostly Upgrades in a Light Week for Changes

» FULL STORY PAGE 14

## Market Data

Credit spreads, CDS movers, issuance.

» FULL STORY PAGE 16

## Moody's Capital Markets Research *recent publications*

Links to commentaries on: High-yield bonds, stabilization, growth and leverage, buybacks, volatility, defaults, Fed policy, yields, profits, corporate borrowing, U.S. investors, eerie similarities, base metals prices, debt to EBITDA, trade war, Investment grades, higher rates.

» FULL STORY PAGE 21

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

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# Credit Markets Review and Outlook

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

## Rising Default Rate May Be Difficult to Cap

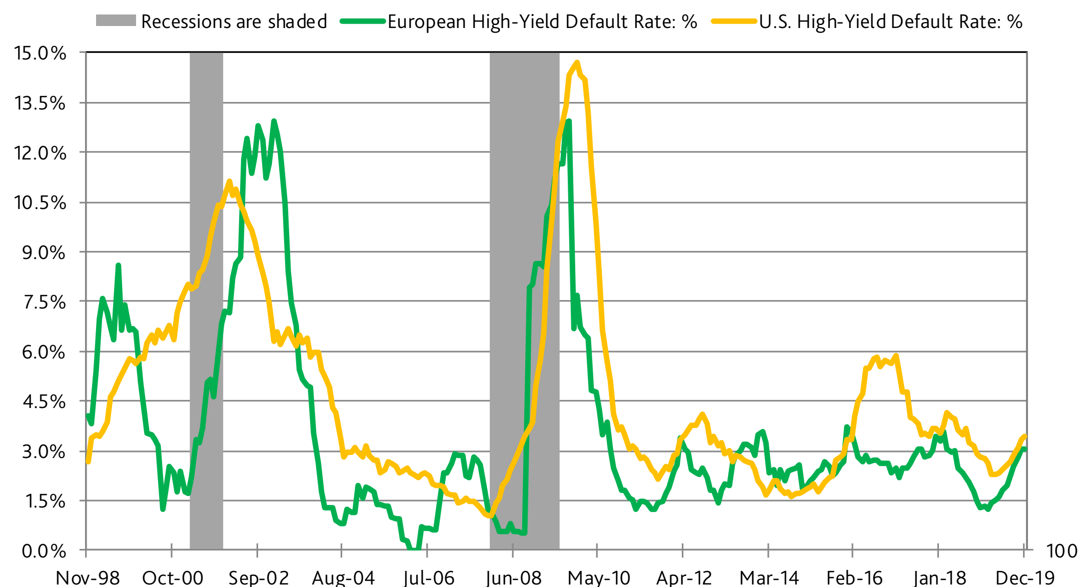
Because of its acute sensitivity to the business-cycle and corporate earnings, the high-yield credit market will have more to worry about this year. For starters, domestic expenditures will no longer receive an extraordinary lift from federal tax cuts. Worse, the limitations placed on the deduction of state and local income and property taxes from federal income taxes will be felt once residents of high-tax states file their 2018 tax returns in early 2019.

In addition, early 2019's spending by consumers and businesses will be curbed by the ongoing partial shutdown of the U.S. government. Moreover, 2019's slump by home sales will reduce the host of expenditures that ordinarily follow the purchase of a home with a lag. Finally, trade disputes are likely to lessen the outlays of adversely affected parties.

What influences U.S. credit quality does not stop at America's borders. Business activity in the U.S. will also be challenged by slower expenditures growth in China, Europe and Japan. Over the past year, the International Monetary Fund has lowered its projected growth rate for 2019's world economy from 3.9% to 3.5%. Recent news of significantly slower export growth from major exporting countries complements downwardly revised forecasts for global growth.

As of early January, the default-research analysts of Moody's Investors Service project that by the spring of 2019, the high-yield default rates of both the U.S. and Europe will climb higher together. By 2019's final quarter, the default rates of Europe and the U.S. are expected to post their biggest percentage point increases over a three-month span since November 2015 through February 2016. Thus, unless markets are convinced that any unfolding upswing by default rates will be of limited height, corporate credit spreads could widen considerably later in 2019.

**Figure 1: The European and U.S. High-Yield Default Rates Are Likely to Start Rising Together This Spring**
*sources: Moody's Investors Service, NBER, Moody's Analytics*



### *High-Yield Market Slumped During 2015-2016's Global Slowdown*

High-yield credits with exposure to industrial commodities suffered during the last global slowdown of 2015-2016. As global economic growth slowed from 2014's 3.6% to 2016's 3.2%, the month-long average price per barrel of West Texas Intermediate crude oil plummeted by 71% from a June 2014 high of $105.21 to a February 2016 bottom of $30.56. In addition, Moody's industrial metals price index sank by 36% from an August 2014 high of 2,070 points to a January 2016 low of 1,335 points. The global slowdown and related industrial commodity price deflation prompted a 15.5% plunge by pretax profits from current production from a fourth-quarter 2014 high to a fourth-quarter 2016 bottom.

In anticipation of a sharply higher default rate, the month-long average of a composite high-yield bond spread ballooned from a June 2014 low of 331 basis points to a February 2016 high of 839 bp. And the high-yield default rate jumped up from a September 2014 trough of 1.6% to a January 2017 peak of 5.9%.

The damage inflicted on U.S. financial markets and industries vulnerable to industrial commodity price deflation would have been worse had benchmark Treasury yields not plunged and had the Fed not paused after hiking fed funds in December 2015. For example, the 10-year Treasury yield's month-long average sank from a December 2013 high of 2.89% to a February 2016 low of 1.77%. Recently, the 10-year Treasury yield has dropped from a November 8, 2018 high of 3.24% to January 24's 2.72%. Given the recent 10-year government bond yields of 0.005% for Japan, 0.23% for Germany, and 1.21% for the U.K., continued weakness abroad may further suppress U.S. benchmark yields and, thereby, benefit interest-sensitive spending in the U.S.

Already there is reason to believe that early 2019's lower-than-anticipated Treasury bond yields might spur interest-sensitive spending. During the two weeks ended January 18, homebuyer mortgage applications posted their highest two-week average since the Mortgage Bankers Association commenced a new sampling procedure in September 2011.

For now, the current global deceleration lacks the severity of 2014-2016's slump. By the IMF's estimate, the expected 3.5% growth projected for 2019's world economy is faster than 2016's 3.2%. Moreover, the January-to-date averages for the price of WTI crude oil and the industrial metals price index are still well above their 2016 lows. More specifically, January-to-date's $50.70 average price for WTI crude is 28% under August 2018's post-2014 high of $70.78, while the accompanying 1,891-point average for the base metals price index is 17% less than its post-2014 high.

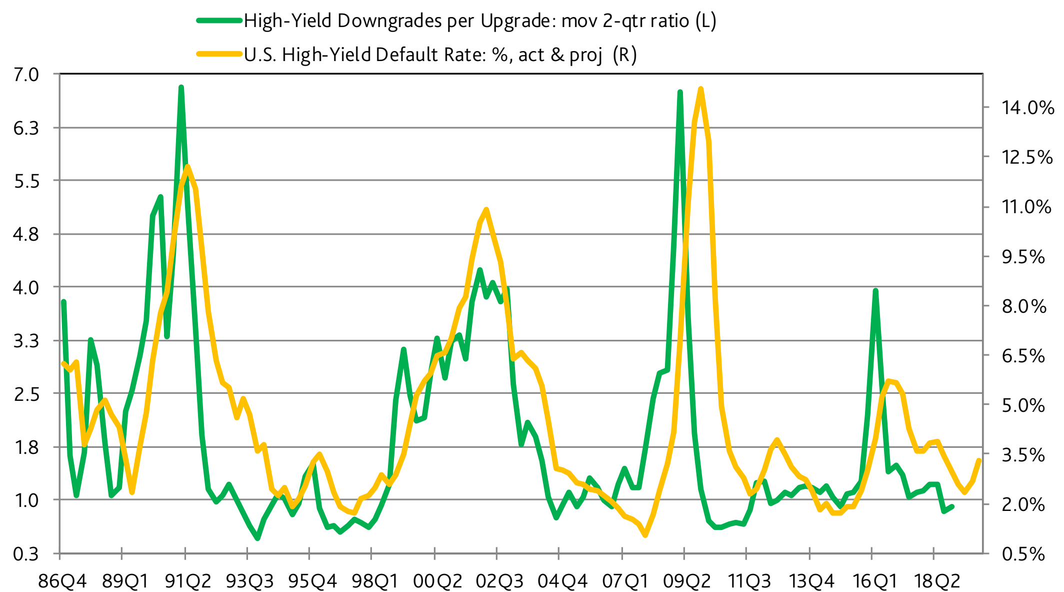
### *Rating Changes Weigh Against a Less-than-than 400 bp Spread for High-Yield Bonds*

During the profits recession and industrial commodity price deflation of 2015-2016, the downgrade-to-upgrade ratio of U.S. high-yield credit rating revisions soared from the 0.98:1 of 2014's final quarter to a first-quarter 2016 peak of 4.5:1. For now, a repeat of that disruptive ascent seems unlikely during 2019.

After plunging to a near record low of 0.37:1 in 2018's third quarter, the U.S. high-yield downgrade to upgrade ratio jumped up to 1.45:1 in the fourth-quarter, its highest reading since the 2.13:1 of 2016's final quarter.

Third-quarter 2018's high-yield downgrade to upgrade ratio of 0.37:1 overstated any lasting improvement in high-yield credit quality. For a sample commencing with 1986's first quarter, only the 0.36:1 of 1993's third quarter was lower. However, the latter was much closer to yearlong 1993's 0.66:1. By contrast, the 0.37:1 ratio of 2018's third quarter was well under yearlong 2018's high-yield downgrade to upgrade ratio of 1.07:1.

**Figure 2: Default Rate Forecast Senses Significantly More High-Yield Downgrades than Upgrades in 2019**
*sources: Moody's Analytics, Moody's Investors Service*



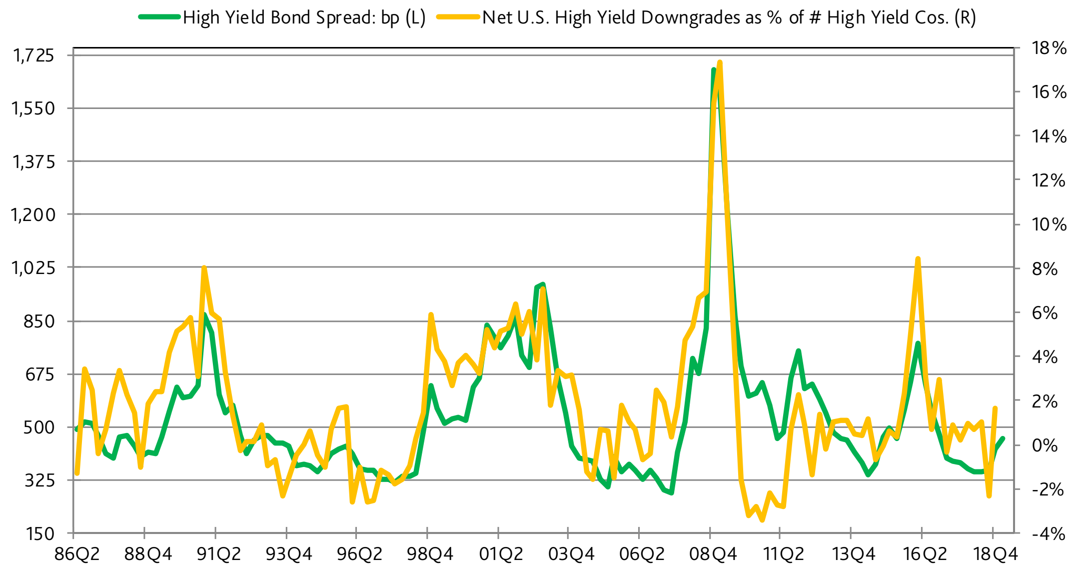

The median high-yield downgrade-to-upgrade ratio of the available 132-quarter sample (January 1986 through December 2018) is 1.29:1. In only 38, or 29%, of the 132 quarters was the downgrade ratio less than 1.0:1, which equates to fewer downgrades than upgrades.

By no means did fourth-quarter 2018's upturn by the high-yield downgrade:upgrade ratio to 1.45:1 signal impending doom for high-yield credits. But, it does warn of the difficulty, if not impossibility, of quickly returning the now 465 bp high-yield bond spread to its 373 bp average of yearlong 2018. Coincidentally, last year's average for the high-yield spread was the thinnest since the 341 bp of yearlong 2006.

If the high-yield downgrade ratio remains close to fourth-quarter 2018's 1.45:1, the historical record suggests the high-yield bond spread will remain close to 500 bp.

However, from the perspective of credit rating revisions, the high-yield downgrade to upgrade ratio does not show the strongest correlation with the high-yield bond spread. Rather, net downgrades—or the number of downgrades less the number of upgrades—as a percent of the number of high-yield issuers generates a stronger correlation of 0.79 with the high-yield bond spread's quarter-long average compared to the spread's 0.58:1 correlation with the downgrade to upgrade ratio. If net high-yield downgrades remain close to fourth-quarter 2018's 1.6% of the number of high-yield issuers, the midpoint for the high-yield bond spread approximates 490 bp. Unless downgrades become much less frequent vis-a-vis upgrades, the scope for a lasting drop by the high-yield bond spread is limited.

**Figure 3: Net High-Yield Downgrades Warn Against Expecting an Extended Rally by High-Yield Bonds**
*source: Moody's Analytics*



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

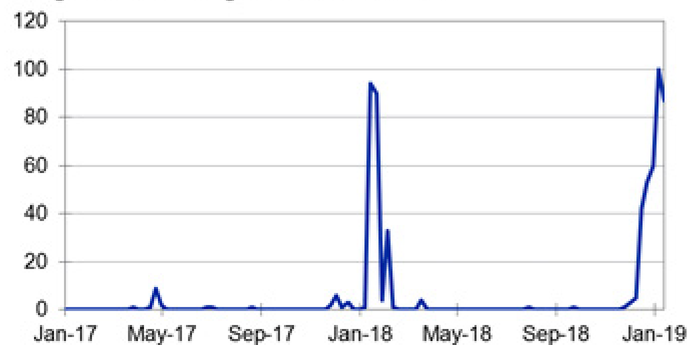
THE U.S.
By Ryan Sweet, Moody's Analytics

## Some Getting the Yips about Recession

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

Sentiment can be fickle, and it's difficult to pinpoint the main catalysts for the decline in January. But odds are that the turbulence in equity markets and the partial government shutdown are the big factors. The University of Michigan survey is sensitive to perceptions of personal finances. Therefore, it's not surprising that the survey is strongly correlated with stock and gasoline prices. We had anticipated that lower gasoline prices would have limited the decline in January, but they didn't. Given that the stock market has been moving higher recently, sentiment could bounce back soon, but the government shutdown is the wild card.

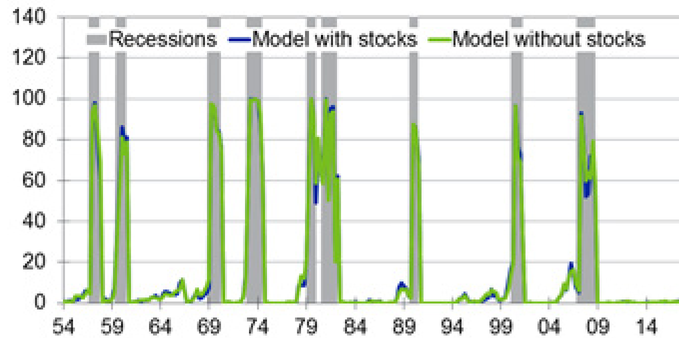
It's difficult to quantify the impact of the shutdown on sentiment, but it is clearly on people's minds. We used Google Trends to obtain the relative popularity of Google searches for "government shutdown" in the U.S. Google Trends provides total searches for a term relative to the total number of searches done on Google over time.




Google Trends adjusts search data to make comparisons between terms easier. To do this, each datapoint is divided by the total searches of the geography and time range it represents, to compare relative popularity. The resulting numbers are then scaled to a range of 0 to 100. The assumption is that an increase in a term's relative search popularity would imply that it is on consumers' minds and affecting sentiment.

Given the jump in searches, odds are that the shutdown contributed to some of the drop in sentiment in January. Looking at the 2013 shutdown, sentiment fell in the month the shutdown occurred and bounced back after it ended. The same pattern could play out this time, but the shutdown will need to end soon.

There are some concerns that if the shutdown continues through the rest of the first quarter it could cause GDP to contract. This isn't unrealistic. The economic costs of the shutdown will only continue to mount, and we find some lingering issues of residual seasonality that cause growth in the first three months of the year to come in soft. Even if first-quarter GDP contracts, it should be chalked up to mostly the impact of the shutdown, which is temporary. Also, given that potential growth is lower this expansion than in the past, declines in GDP will be more frequent.




Still, fears of a recession have roiled financial markets recently, but those fears are both premature and overdone. Financial market conditions have tightened and coincided with a slowing in the economy, and this does imply a higher risk of recession.

However, there is a disconnect between what markets assess as the risks of a recession and what the economic data imply. For example, our model based solely on the economic data continues to put the odds of a downturn in the next 12 months at 26%, but the model that uses only financial market variables jumped in December to 43%.

One thing we can say definitively is that the economic record suggests that stock market drops contribute little to recession odds. Using variants of our recession probability model at one-year-ahead and one-quarter-ahead prediction horizons, we find the model is relatively insensitive to the inclusion of stock market performance.

Rather, it's the shape of the yield curve and corporate bond spreads that are boosting our financial model's odds of recession. We tried variants of the model that allowed for an asymmetric response to gains and losses in the stock market, but the recession odds barely differed.

Markets are not alone in seeing heightened recession risks. The recent Duke CFO Global Business Outlook survey showed nearly half of U.S. chief financial officers believe that the U.S. will be in recession by the end of 2019, and 82% believe that a recession will have begun by the end of 2020.

Economists also seem a little spooked. The Philadelphia Fed's Survey of Professional Forecasters shows economists have increased their subjective odds of a decline in GDP, ranging from one quarter to four quarters ahead. Some economists could simply have a case of the yips. Since many missed the last recession and don't want to miss two downturns in a row, some could call the next one prematurely.

Overall, we don't believe a recession is imminent. 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 to be overly threatening at this time.

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

# May's Brexit Plan B Is Up for Discussion

The week ahead will bring much more excitement than the past one on the data front, while ongoing Brexit chaos will continue to keep us busy. The U.K. parliament is scheduled to discuss and vote on amendments to Theresa May's Brexit plan B on Tuesday. We don't expect MPs to reach any consensus, and the prime minister's plan B gave them little that would be enough to break the current deadlock. On the contrary, we expect that the discussion will be heated, with several MPs proposing amendments on a second referendum and on preventing a no-deal from happening—by means of automatically asking for an extension of Article 50 if March 29 approached and no deal is signed. It is hard to say if any of those amendments will pass.

There could be widespread support for avoiding a no-deal exit, but we don't know if May would allow Tory ministers and MPs a free vote on the matter. With regard to a second referendum, neither the Labour nor the Conservative's leadership officially support a People's Vote. That means the chances for an amendment commanding a majority aren't very high, unless the Labour party changes its view last minute. In any case, our view remains that the most likely deal will be one based on a full customs union. Once May sees that no other option will command majority in the House of Commons, she is more likely than not to opt for such a deal even considering that hardliners in her party might rebel against her. Elsewhere, we still see chances of a no-deal being very low, while of late the chances of a second referendum being held and Brexit cancelled have increased considerably.

On the data front, the main highlight will be the release of the preliminary estimate of the euro zone's fourth-quarter GDP growth. We expect it to show that the currency area expanded by 0.2% q/q in the three months to December, the same rate as in the previous stanza. This should have pushed yearly growth down to 1.2%, from 1.7% in the third quarter and as much as 2.4% at the start of 2018. Full-year growth, meanwhile, is expected to have slowed to 1.8%, down from 2.5% in 2017. Across countries, we expect that figures in Germany and Italy disappointed again. We are penciling in a 0.1% q/q rise in the former's GDP, which is disappointing following the 0.2% decline in the third stanza. Italy's GDP likely contracted by 0.1% q/q or held steady, after it fell by 0.1% in the third quarter, which puts the country at risks of a technical recession.

In France, we are forecasting that GDP rose by 0.3% q/q, an increase similar to the one recorded in the three months to September. However, the risks to our forecasts are tilted heavily to the downside given the widespread disruptions caused by the 'yellow vests' protests. The protests depressed manufacturing activity and also caused road blockages and damaged consumers' moods. Spain's GDP expectations are a bit better; we expect the country's economy to have expanded by 0.5% q/q in the fourth quarter, marginally lower than the already impressive 0.6% rise in the third stanza.

Overall, one-off factors were the main reason the euro zone economy lost so much momentum in the second half of 2018. Trade tensions, Brexit uncertainty, volatility in emerging markets, political unrest in France, as well as new EU regulations regarding emissions (which severely dented output in the auto industry) were all to blame, and they helped create a favorable base for a rebound in 2019. But with uncertainty over a sharper-than-expected slowdown in growth becoming entrenched, it is more likely than not that there is now a permanent component to this loss of pace.

Elsewhere, the euro zone's preliminary CPI figures for January are also in the pipeline. We expect them to show that inflation pressures in the currency area cooled further at the start of the year, to only 1.5%, from 1.6% in December. We expect that a further cooling of energy inflation, in line with base effects related to oil prices, will have dragged the most on the headline. This should have fully offset expected rebounds in services and food inflation. Services inflation has been depressed in January due to base effects in transport and package holidays prices, while food inflation has read much below its trend over the past couple of months, warranting a mean-reversion.

Last but not least, we expect that euro zone's unemployment rate held steady at a ten-year low of 7.9% in December. Employment gains in the euro area have slowed over the past couple of months but are still consistent with a further decline in the unemployment rate in 2019.

| | Key indicators | Units | Moody's Analytics | Last |
|---|---|---|---|---|
| Tues @ 8:00 a.m. | Spain: Unemployment for Q4 | % | 13.8 | 14.6 |
| Wed @ 7:45 a.m. | France: Household Consumption Survey for December | % change | 0.1 | -0.3 |
| Wed @ 7:45 a.m. | France: GDP for Q4 | % change | 0.3 | 0.3 |
| Wed @ 8:00 a.m. | Spain: Retail Sales for December | % change | 0.5 | 0.4 |
| Wed @ 10:00 a.m. | Euro Zone: Business and Consumer Sentiment for January | index | 106.9 | 107.3 |
| Thur @ 7:00 a.m. | Germany: Retail Sales for December | % change | -0.7 | 1.4 |
| Thur @ 9:00 a.m. | Germany: Unemployment for January | % | 5.0 | 5.0 |
| Thur @ 9:00 a.m. | Italy: Unemployment for December | % | 10.6 | 10.5 |
| Thur @ 10:00 a.m. | Euro Zone: Preliminary GDP for Q4 | % change | 0.2 | 0.2 |
| Thur @ 10:00 a.m. | Euro Zone: Unemployment for December | % | 7.9 | 7.9 |
| Fri @ 10:00 a.m. | Euro Zone: Preliminary Consumer Price Index for January | % change | 1.5 | 1.6 |

## ASIA-PACIFIC

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

# Deterioration Expected in China's Manufacturing PMI

All eyes will be on China's official manufacturing PMI for January. The index slumped in December to 49.4, its lowest level in three years, and we expect further deterioration in January, to 49.3. Concerning in December was that weakness was broad-based with production, new orders, and new export orders each softening. The trade war with the U.S. is an easy scapegoat for the deterioration, but the broader pullback in global demand, along with Beijing's own ailing domestic demand, is also at play. The government has stepped up policy support since mid-2018, but it has been measured and piecemeal, ensuring that a recovery remains off the cards.

Japan's unemployment rate likely held at 2.5% in December. The labour market is the resoundingly bright spot in Japan's economy and it is in its best position in decades by numerous metrics. Unfortunately, the virtuous cycle of rising prices, wages and consumption remains elusive. The Bank of Japan further downwardly revised its forecasts for core CPI growth for 2019 to 1% to 1.3%, from 1.5% to 1.7%, another signal that the 2% inflation goal is unlikely in the near term.

Australia's quarterly CPI data are unlikely to move the Reserve Bank of Australia. We expect headline CPI growth remained at 0.4% q/q in the December quarter. The bottom line is that there's no hurry to normalise interest rates, with inflation and unit labour costs expected to only gradually gather pace over the next year. Hikes are unlikely to come into view until mid-2020.

| | Key indicators | Units | Confidence | Risk | Moody's Analytics | Last |
|---|---|---|---|---|---|---|
| Wed @ 10:50 a.m. | Japan Retail sales for December | % change yr ago | 4 | ← | 1.3 | 1.4 |
| Wed @ 11:30 a.m. | Australia CPI for Q4 | % change | 3 | ↓ | 0.4 | 0.4 |
| Wed @ 3:00 p.m. | Malaysia Foreign trade for December | MYR bil | 3 | ← | 6.9 | 7.6 |
| Wed @ 4:00 p.m. | Japan Consumer confidence for January | Index | 3 | ↓ | 42.5 | 42.7 |
| Thurs @ 10:00 a.m. | South Korea Retail sales for December | % change yr ago | 3 | ↓ | 2.0 | 0.5 |
| Thurs @ 10:50 a.m. | Japan Industrial production for December | % change | 4 | ← | 0.4 | -1.1 |
| Thurs @ 1:00 p.m. | China Official manufacturing PMI for January | Index | 3 | ← | 49.3 | 49.4 |
| Thurs @ 6:30 p.m. | Thailand Foreign trade for December | US$ mil | 5 | ← | 90 | 665 |
| Thurs @ 7:00 p.m. | Taiwan GDP for Q4 | % change yr ago | 4 | ↓ | 2.8 | 2.3 |
| Fri @ 10:00 a.m. | South Korea Consumer price index for January | % change yr ago | 2 | ↓ | 1.5 | 1.3 |
| Fri @ 10:30 a.m. | Japan Unemployment rate for December | % | 3 | ↑ | 2.5 | 2.5 |
| Fri @ Unknown | South Korea Foreign trade for January | US$ bil | 3 | ↑ | 3.2 | 4.6 |

# The Long View

## As of January 21,16 of the month-to-date's 31 high-yield bond issues were from Chinese entities.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group
January 24, 2019

### CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 139 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 465 bp is thinner that what is suggested by the accompanying long-term Baa industrial company bond yield spread of 226 bp and a VIX of 19.2 points.

### DEFAULTS

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

### US CORPORATE BOND ISSUANCE

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

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

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

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

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

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

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

For 2018, worldwide corporate bond offerings sank by 7.2% annually (to $2.322 trillion) for IG and plummeted by 37.6% for high yield (to $376 billion). The projected annual percent changes for 2019's worldwide corporate bond offerings are -0.6% for IG and +1.6% for high yield.

### US ECONOMIC OUTLOOK

As inferred from the CME Group's FedWatch Tool, the futures market recently assigned an implied probability of 24% to at least one hiking of the federal funds rate 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.

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## EUROPE

By Barbara Teixeira Araujo of Moody's Analytics
January 24, 2019

### UNITED KINGDOM

All eyes were on British Prime Minister Theresa May as she delivered her much-anticipated Brexit plan B to the U.K. parliament Monday.

It is an understatement to say her speech was disappointing. It didn't bring anything new, and notably it brought very little with potential to break the current parliamentary deadlock on the Brexit deal. May only reinstated that a deal is needed to avoid a no-deal Brexit, and that she intends to go back to Brussels to ask for more reassurances and/or changes in what regards the Irish backstop. True, she did say she will consult MPs from different parties over the next few days—which is a very smart strategy, since she would be then making any success on Brexit a shared responsibility—so as to gauge their views on how to improve the terms of her deal. But given that the EU has repeatedly said that the withdrawal agreement is closed and won't be reopened to negotiations—EU politicians claim the deal the U.K. got is the best and only possible deal—it is very unlikely that any concessions May gets from the EU would be able to command a majority of MPs on a second vote.

Also, May delivered little in what regards the two current biggest demands from lawmakers, which are ruling out a no-Brexit and holding a second referendum. First, the prime minister insisted that the EU would not allow article 50 to be extended unless the UK had a plan for approving a deal, meaning the only way to avoid a no-deal Brexit would be to revoke article 50. This goes against what several MPs had been asking, which is an amendment that would see Article 50 extended were March 29 arrive with no deal on the table. On the referendum, May said that a second vote would be extremely harmful for social cohesion, as it would undermine the faith of the people on the U.K. democracy.

May's plan B will be discussed by parliament on January 29, and MPs will be able to vote and pass amendments to the deal on the same occasion.

All in, then, our take is that Mat's plan B added little to our scenarios and forecasts. We expect that May will get little from the EU in what regards the backstop, which means that a full customs union remain on the table. It is likely the only option that would command majority in parliament (even if this would upset hardliners Tories). A second referendum similarly remains likely, given that MPs are sure to table such an amendment on January 29. We continue to think that a no-deal is a non-starter; everyone would oppose to it, so we don't think that either May or the EU would oppose extending Article 50 if the other option was a cliff-edge exit.

### ECB

The European Central Bank's monetary policy minutes and press conference Thursday were snoozers. The bank left policy rates unchanged and stressed its commitment to reinvest the proceeds of the maturing securities purchased under quantitative easing (which amount to a whopping €2.6 trillion) for an extended period beyond the date when it will start raising interest rates.

Markets were expecting that the bank would drop from its press statement any hints regarding the summer of 2019—the ECB currently claims that rates will remain unchanged at least until then—as the recent deterioration in the euro area's outlook makes it hard to believe that the bank would be able to move on rates anytime this year. But our view has always been that ECB President Mario Draghi wouldn't want to fan any fears regarding an impending recession in the currency area, preferring instead to wait and see until more data for 2019 have come in.

That Draghi sounded dovish during his press conference only added to our view that a rate hike in 2019 looks unlikely. Notably, the bank has shifted the balance of risks surrounding the euro zone economy to the downside, from a broadly balanced assessment previously. Draghi said that while one-off factors have been responsible for most of the slowdown in the currency area this year (such as the trade war, new regulation on emissions for the car

industry, and Brexit negotiations), there is now a permanent component to this loss of pace. Accordingly, he acknowledged the persistence of uncertainties related to geopolitical factors and the threat of protectionism, vulnerabilities in emerging markets, and financial market volatility. On the upside, Draghi said that most of these uncertainties were expected to abate soon.

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## ASIA PACIFIC

By Katrina Ell of Moody's Analytics
January 24, 2019

### CHINA

China's GDP growth is easily dismissed for its lack of credibility, but the latest fourth quarter GDP print still provides important information, not least confirming that China's economy lost momentum through 2018.

Growth decelerated to 6.4% y/y in the final quarter of 2018, a low not seen since the global financial crisis. For the full year, GDP expanded 6.6% in 2018, the weakest expansion since 1990 and down from the 6.8% gain in 2017. Although the moderation in growth in 2018 was expected, the pace and breadth of the slowdown was somewhat of a surprise.

A major drag was investment, which cooled noticeably though 2018, reflecting earlier tightening measures by the central bank to curb credit excesses, especially in shadow lending, as well as the ongoing battle to reduce overcapacity in heavy industry and to tighten environmental standards. But there were tentative signs of stabilization in December, with fixed asset investment growth remaining at 5.9% y/y, up from the recent low of 5.3% in August, thanks to an improvement in public investment and stabilization in manufacturing investment.

Retail sales also improved in December, to 8.2% y/y from November's 8.1%. The headline was helped by robust spending on daily necessities, which continued to grow by double digits. But auto sales remained a drag, declining for the eighth straight month, a sign that local consumers are continuing to hold back on discretionary spending. It was encouraging to see industrial production growth pick up, albeit modestly, after slowing markedly through 2018 as local investment cooled and global demand softened. In December, China's exports fell for the first time since March 2018, with overseas demand for high-tech products declining significantly from a year earlier.

Although China's economy clearly lost momentum through 2018, there are reasons for some optimism about China's near-term growth prospects. Beijing has turned its attention over recent months to stabilizing growth. Measures include cuts to the reserve requirement ratio, a push to increase bank lending and public works, tax cuts, and higher tax reimbursement rates for exporters dealing with U.S. tariffs. More stimulus measures are likely to be implemented this year and could include increased government expenditure, especially for infrastructure; additional tax cuts aimed at smaller enterprises; a higher quota for local government bond issuance; and further reserve requirement ratio cuts. We think further easing is likely to be measured, as reducing financial sector risks remain high on the agenda. All told, these measures should at the very least help soften the economy's slowdown in 2019.

The 90-day trade war truce agreed to on the sidelines of the last G-20 summit expires on 1 March. Absent a deal, the existing 10% tariff imposed by the U.S. on US$200 billion in Chinese goods imports will rise to 25%. But pressure is building on both sides to agree to a deal. China is already grappling with uncomfortably weak economic activity, while some U.S. firms that depend on inputs from China also have higher costs, which are undermining profits. Thus, a more lasting solution could be reached sooner rather than later. This would help lift sentiment and the veil of uncertainty that has clouded the global economy since mid-2018, which has likely undermined private investment. As things stand, we expect the Chinese economy to expand 6.3% in 2019.

## The Long View

### JAPAN

The Bank of Japan kept monetary settings on hold in January. The most interesting takeaway was the BoJ's near-term forecasts. Core CPI growth (excludes food, includes energy) is expected to pick up to 1% to 1.3% y/y in 2019, weaker than the 1.5%-to-1.7% forecast in October. The central bank noted what we already knew—that the CPI showed "relatively weak developments compared to the economic expansion and labour market tightening." The bottom line is that while Japan's economic outlook has shown signs of sustained improvement and the labour market remains in its best position in decades, inflation has not followed suit.

Even more worrying, core inflation has largely been propped up by high oil prices. Core-core CPI (excludes food and energy) was just 0.1% y/y in December, while core CPI came in at 0.7%, with the most recent peak of 1% happening in October.

For a while it looked as though the BoJ would manage to shift expectations that Japan's economy would eventually see that virtuous cycle of rising prices, wages and economic growth. But now it seems as though even the BoJ has lost faith that its 2% inflation target will be achieved in the foreseeable future.

## Ratings Round-Up

# Mostly Upgrades in a Light Week for Changes

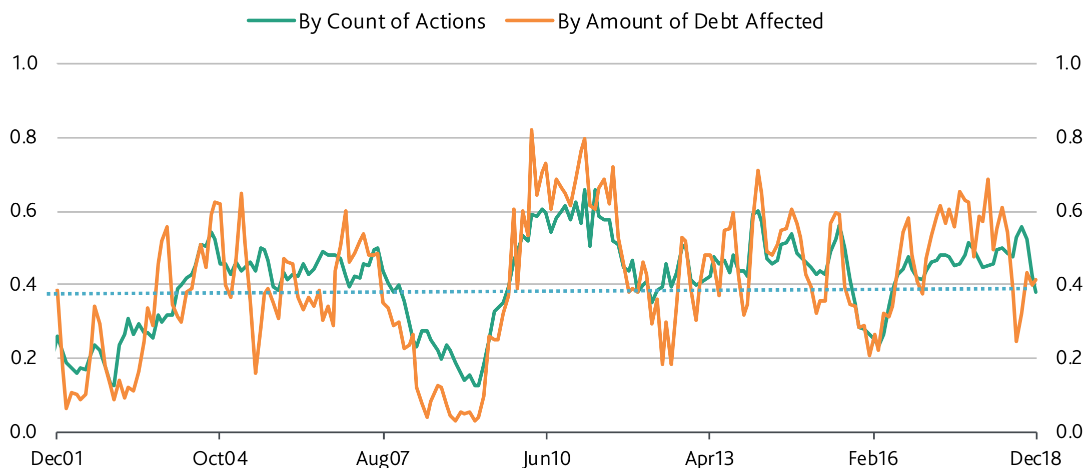
By Michael Ferlez

It was a light week for U.S. rating change activity. Despite the decline in activity, the distribution of changes was favorable. Only two companies received changes last week, both were upgrades. HCA Healthcare, Inc saw its senior secured debt upgraded from Ba1 to Baa3, reflecting the ability of unsecured debt to absorb first losses. Meanwhile, Ping Identity Corporation was the other upgrade. The software firm was upgraded to B2, from B3.

Rating changes were similarly sparse in Europe, with only two changes. New Look Secured Issuer PLC received a downgrade. The U.K. retail firm saw its senior unsecured credit rating cut to C from Caa3, impacting roughly $1.4 billion in debt. Meanwhile, Keter Group B.V. received the sole upgrade.

FIGURE 1

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




* Trailing 3-month average

*Source: Moody's*

FIGURE 2
### Rating Key

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

FIGURE 3
### Rating Changes: Corporate & Financial Institutions – US

| Date | Company | Sector | Rating | Amount ($ Million) | Up/ Down | Old LTD Rating | New LTD Rating | IG/ SG |
|---|---|---|---|---|---|---|---|---|
| 1/17/19 | HCA HEALTHCARE, INC. -HCA INC. | Industrial | SrSec/BCF | 13,800 | U | Ba1 | Baa3 | SG |
| 1/18/19 | ROARING FORK INTERMEDIATE, LLC -PING IDENTITY CORPORATION | Industrial | SrSec/BCF /LTCFR/PDR | | U | B3 | B2 | SG |

*Source: Moody's*

FIGURE 4
### Rating Changes: Corporate & Financial Institutions – Europe

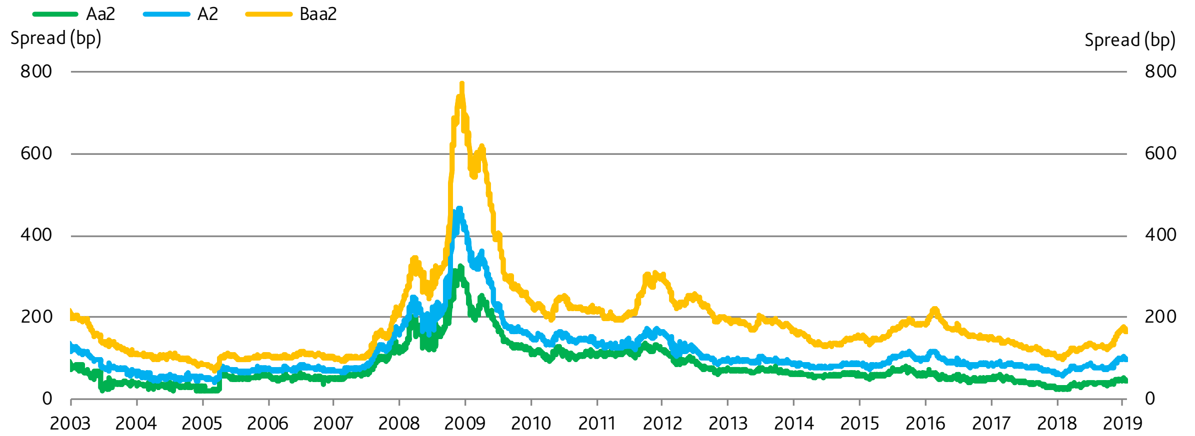
| Date | Company | Sector | Rating | Amount ($ Million) | Up/ Down | Old LTD Rating | New LTD Rating | Old LGD | New LGD | IG/SG | Country |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1/17/19 | NEW LOOK RETAIL GROUP LIMITED -NEW LOOK SECURED ISSUER PLC | Industrial | SrSec | 1,374 | D | Caa3 | C | | | SG | UNITED KINGDOM |
| 1/18/19 | KETER GROUP B.V. | Industrial | LGD | | U | | | LGD-4 | LGD-3 | SG | NETHERLANDS |

*Source: Moody's*

# Market Data

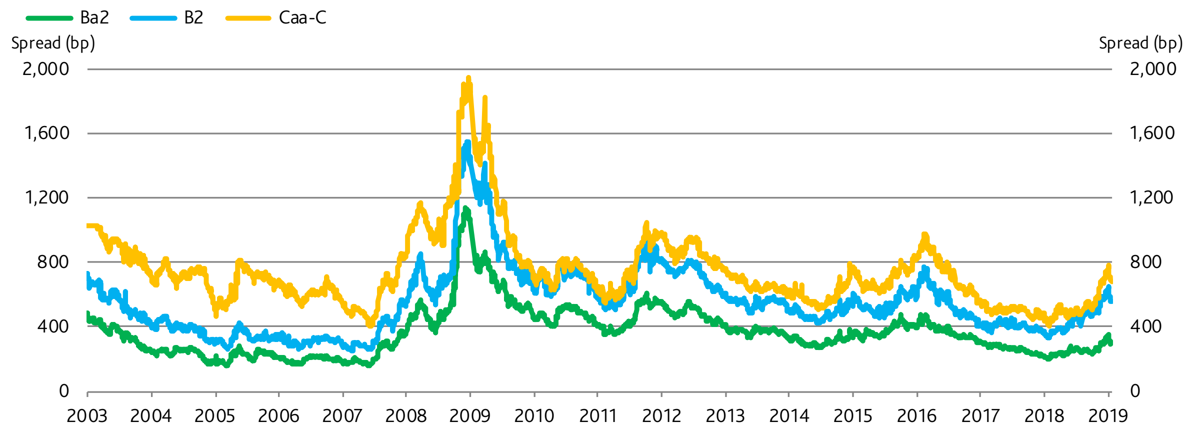
## Spreads

Figure 1: 5-Year Median Spreads-Global Data (High Grade)




*Source: Moody's*

Figure 2: 5-Year Median Spreads-Global Data (High Yield)




*Source: Moody's*

# CDS Movers

Figure 3. CDS Movers - US (January 16, 2019 – January 23, 2019)

| CDS Implied Rating Rises | CDS Implied Ratings | | |
|---|---|---|---|
| Issuer | Jan. 23 | Jan. 16 | Senior Ratings |
| Arconic Inc. | B1 | B3 | Ba2 |
| Citigroup Inc. | Baa1 | Baa2 | Baa1 |
| Bank of America Corporation | A3 | Baa1 | A3 |
| American Express Credit Corporation | Aa3 | A1 | A2 |
| Walt Disney Company (The) | Aa1 | Aa2 | A2 |
| McDonald's Corporation | Aa1 | Aa2 | Baa1 |
| International Business Machines Corporation | Baa1 | Baa2 | A1 |
| Home Depot, Inc. (The) | Aa1 | Aa2 | A2 |
| Amazon.com, Inc. | A2 | A3 | A3 |
| Medtronic, Inc. | Aa1 | Aa2 | A3 |

| CDS Implied Rating Declines | CDS Implied Ratings | | |
|---|---|---|---|
| Issuer | Jan. 23 | Jan. 16 | Senior Ratings |
| Abbott Laboratories | A2 | Aa3 | Baa1 |
| Humana Inc. | A3 | A1 | Baa3 |
| Philip Morris International Inc. | A3 | A2 | A2 |
| Merck & Co., Inc. | Aa2 | Aa1 | A1 |
| CCO Holdings, LLC | Ba2 | Ba1 | B1 |
| Altria Group Inc. | Baa3 | Baa2 | A3 |
| Cigna Holding Company | A2 | A1 | Baa2 |
| Caterpillar Inc. | A2 | A1 | A3 |
| Cox Communications, Inc. | Baa2 | Baa1 | Baa2 |
| Occidental Petroleum Corporation | Baa1 | A3 | A3 |

| CDS Spread Increases | | CDS Spreads | | |
|---|---|---|---|---|
| Issuer | Senior Ratings | Jan. 23 | Jan. 16 | Spread Diff |
| K. Hovnanian Enterprises, Inc. | Caa3 | 2,831 | 2,700 | 131 |
| Weatherford International, LLC (Delaware) | Caa3 | 2,399 | 2,286 | 113 |
| Penney (J.C.) Corporation, Inc. | Caa2 | 3,079 | 2,992 | 86 |
| Windstream Services, LLC | Caa2 | 2,450 | 2,386 | 64 |
| Nabors Industries Inc. | B1 | 578 | 531 | 48 |
| Dean Foods Company | B3 | 895 | 847 | 48 |
| Frontier Communications Corporation | Caa1 | 2,390 | 2,351 | 38 |
| Interval Acquisition Corp | B1 | 263 | 227 | 36 |
| AK Steel Corporation | B3 | 873 | 846 | 27 |
| KB Home | B1 | 328 | 303 | 25 |

| CDS Spread Decreases | | CDS Spreads | | |
|---|---|---|---|---|
| Issuer | Senior Ratings | Jan. 23 | Jan. 16 | Spread Diff |
| Arconic Inc. | Ba2 | 259 | 389 | -129 |
| Neiman Marcus Group LTD LLC | Ca | 2,230 | 2,309 | -80 |
| SLM Corporation | Ba2 | 385 | 431 | -46 |
| Mattel, Inc. | B1 | 435 | 480 | -44 |
| iStar Inc. | Ba3 | 358 | 385 | -27 |
| Talen Energy Supply, LLC | B3 | 640 | 666 | -26 |
| Goodyear Tire & Rubber Company (The) | Ba3 | 291 | 312 | -21 |
| Springleaf Finance Corporation | B1 | 327 | 347 | -20 |
| Staples, Inc. | B3 | 462 | 480 | -18 |
| Nissan Motor Acceptance Corporation | A2 | 122 | 139 | -17 |

*Source: Moody's, CMA*

## Market Data

Figure 4. CDS Movers - Europe (January 16, 2019 – January 23, 2019)

| CDS Implied Rating Rises | CDS Implied Ratings | | |
|---|---|---|---|
| Issuer | Jan. 23 | Jan. 16 | Senior Ratings |
| Italy, Government of | Ba2 | Ba3 | Baa3 |
| Ireland, Government of | Aa2 | Aa3 | A2 |
| UniCredit S.p.A. | Ba1 | Ba2 | Baa1 |
| Total S.A. | Aa1 | Aa2 | A1 |
| BASF (SE) | Aa3 | A1 | A1 |
| Iberdrola International B.V. | A2 | A3 | Baa1 |
| Casino Guichard-Perrachon SA | Caa1 | Caa2 | Ba1 |
| UBS AG | Aa2 | Aa3 | Aa3 |
| Telia Company AB | Aa2 | Aa3 | Baa1 |
| Airbus SE | Aa2 | Aa3 | A2 |

| CDS Implied Rating Declines | CDS Implied Ratings | | |
|---|---|---|---|
| Issuer | Jan. 23 | Jan. 16 | Senior Ratings |
| Legal & General Group Plc | Baa2 | A1 | A2 |
| Ziggo Secured Finance B.V. | Ba3 | Ba1 | B3 |
| Nordea Bank AB | Aa3 | Aa2 | Aa3 |
| Nationwide Building Society | Baa1 | A3 | Aa3 |
| Erste Group Bank AG | A2 | A1 | A2 |
| Bayerische Motoren Werke Aktiengesellschaft | Baa2 | Baa1 | A1 |
| Bankinter, S.A. | Baa3 | Baa2 | Baa2 |
| Allied Irish Banks, p.l.c. | Baa1 | A3 | Baa3 |
| Telecom Italia S.p.A. | B2 | B1 | Ba1 |
| Banca Monte dei Paschi di Siena S.p.A. | Caa1 | B3 | Caa1 |

| CDS Spread Increases | | CDS Spreads | | |
|---|---|---|---|---|
| Issuer | Senior Ratings | Jan. 23 | Jan. 16 | Spread Diff |
| Galapagos Holding S.A. | Caa3 | 6,207 | 4,886 | 1,321 |
| Ziggo Secured Finance B.V. | B3 | 233 | 149 | 84 |
| Boparan Finance plc | Caa1 | 1,150 | 1,068 | 82 |
| Jaguar Land Rover Automotive Plc | Ba3 | 676 | 607 | 69 |
| Telecom Italia S.p.A. | Ba1 | 330 | 285 | 45 |
| Eurobank Ergasias S.A. | Caa2 | 945 | 912 | 33 |
| Piraeus Bank S.A. | Caa2 | 939 | 906 | 33 |
| National Bank of Greece S.A. | Caa2 | 731 | 705 | 26 |
| Alpha Bank AE | Caa2 | 706 | 681 | 25 |
| Banca Monte dei Paschi di Siena S.p.A. | Caa1 | 463 | 438 | 25 |

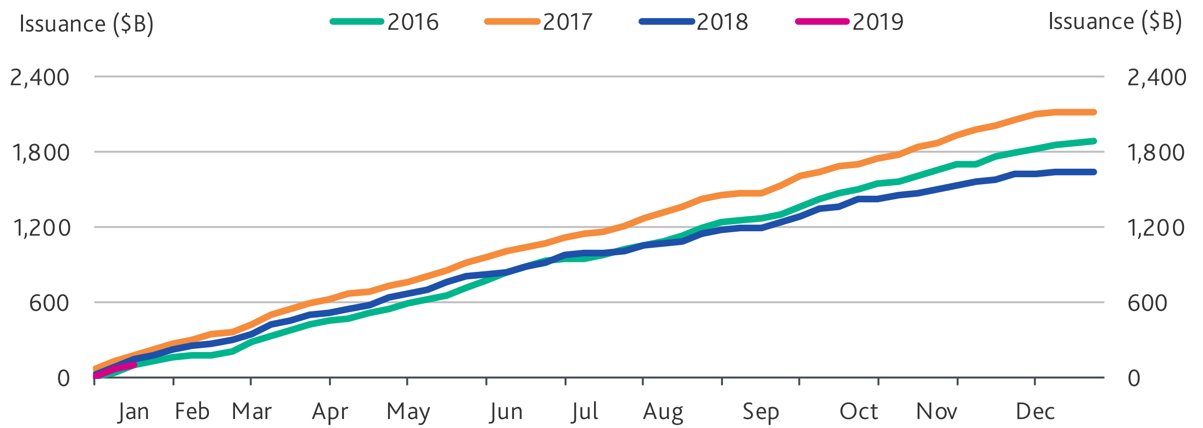
| CDS Spread Decreases | | CDS Spreads | | |
|---|---|---|---|---|
| Issuer | Senior Ratings | Jan. 23 | Jan. 16 | Spread Diff |
| Casino Guichard-Perrachon SA | Ba1 | 520 | 570 | -50 |
| Matalan Finance plc | Caa1 | 764 | 798 | -34 |
| Greece, Government of | B3 | 389 | 413 | -24 |
| Selecta Group B.V. | Caa2 | 356 | 373 | -18 |
| Care UK Health & Social Care PLC | Caa1 | 137 | 153 | -16 |
| TUI AG | Ba3 | 179 | 192 | -13 |
| Sappi Papier Holding GmbH | Ba2 | 285 | 296 | -11 |
| Old Mutual Plc | Ba1 | 19 | 28 | -10 |
| Iceland Bondco plc | Caa1 | 392 | 402 | -10 |
| ING Groep N.V. | Baa1 | 81 | 89 | -9 |

*Source: Moody's, CMA*

Market Data

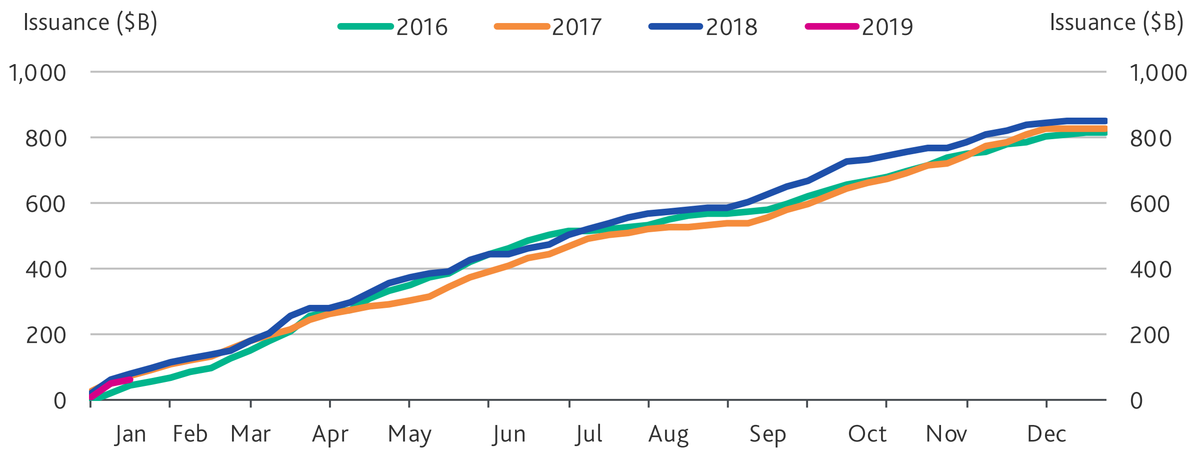
## Issuance

**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 | 33.514 | 9.050 | 43.954 |
| Year-to-Date | 90.394 | 13.145 | 106.029 |

| | Euro Denominated | | |
|---|---|---|---|
| | Investment-Grade | High-Yield | Total* |
| | Amount $B | Amount $B | Amount $B |
| Weekly | 11.386 | 0.000 | 11.517 |
| Year-to-Date | 58.087 | 2.983 | 61.831 |

* Difference represents issuance with pending ratings.

*Source: Moody's/ Dealogic*

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**Editor**
**Reid Kanaley**
reid.kanaley@moodys.com

**Contact Us**

| | |
|---|---|
| Americas: | 1.212.553.4399 |
| Europe: | +44 (0) 20.7772.5588 |
| Asia: | 813.5408.4131 |

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