MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

Successful Rate Cuts Are Short and Shallow; Failures Are Deep and Extended

Moody's Analytics Research

Weekly Market Outlook Contributors:

Moody's Analytics/New York:

John Lonski
Chief Economist
1.212.553.7144
john.lonski@moodys.com

Yukyung Choi
Quantitative Research

Moody's Analytics/Asia-Pacific:

Katrina Ell
Economist

Moody's Analytics/Europe:

Barbara Teixeira Araujo
Economist

Moody's Analytics/U.S.:

Ryan Sweet
Economist

Michael Ferlez
Economist

Editor
Reid Kanaley

Contact: help@economy.com

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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: In July, Chinese issuers supplied 35.5% of the number and 22.1% of the dollar amount of new US$-denominated high-yield bond offerings.

Credit Spreads	Investment Grade: We see year-end 2019's average investment grade bond spread above its recent 113 basis points. High Yield: Compared with a recent 425 bp, the high-yield spread may approximate 465 bp by year-end 2019.
Defaults	US HY default rate: Moody's Investors Service's Default Report has the U.S.' trailing 12-month high-yield default rate dipping from June 2019's actual 3.0% to a baseline estimate of 2.9% for June 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 1.9% for IG to $1.3 trillion, while high-yield supply grows by 24.5% to $345 billion. The very low base of 2018 now lends an upward bias to the yearly increases of 2019's high-yield bond offerings.

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Ratings Round-Up
Upgrades Dominate U.S. Activity

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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: Fed moves, spreads, yield collapse, inversions, unmasking danger, divining markets, upside risks, rating changes, high leverage, revenues and profits, riskier outlook, high-yield, defaults, confidence vs. skepticism, stabilization, buybacks, volatility.

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Credit Markets Review and Outlook

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

Successful Rate Cuts Are Short and Shallow; Failures Are Deep and Extended

Since 1984, there have been seven distinct series of Fed rate cuts. Four of the seven rate cut episodes occurred amid a mature business cycle upturn and managed to stave off a recession. They happened in 1985, 1987, 1995, and 1998. Each of the four successful rate-cut series helped to rejuvenate business activity and boost inflation risks by enough to eventually prompt a series of Fed rate hikes.

The rate-cut installments of 1987, 1995 and 1998 were brief. From beginning to end, the three episodes lasted only 11.3 months, on average. The shortest was the six months of November 1987 through April 1988 and the longest was the 20 months of July 1995 through February 1997.

For the brief easing of 1987-1988, fed funds fell by only 56 basis points. Each of the Fed easings of 1995-1997 and 1998-1999 was accompanied by a cumulative 75-basis point paring of the federal funds rate.

For the three series of rate cuts that overlapped a recession—1989-1994, 2001-2004, and 2007-2015—the fed funds rate averaged a cumulative plunge of 581 basis points. Because the current fed funds rate of 2.375% cannot be slashed by more than 500 basis points, the next recession will probably include another installment of quantitative easing that is likely to drive the 10-year Treasury yield under 1.5%. Thus, recent consensus forecasts that have the 10-year Treasury yield remaining in range of 2% to 2.5% through the end of 2020 implicitly preclude a recession through 2020.

Rate cuts that succeed at fending off a recession tend to be accompanied by relatively mild declines for the 10-year Treasury yield. Thus, if the forthcoming episode of monetary accommodation proves effective, the 10-year Treasury yield may not spend much time under 1.9%.

Mid-Cycle Easings Often Benefit Stocks and Corporate Bonds

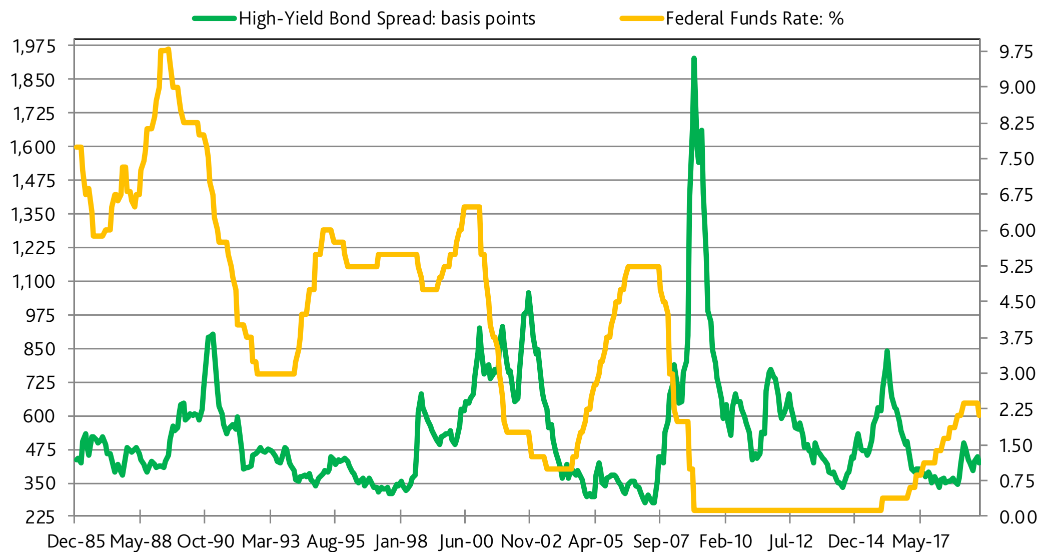
Almost by definition, a mid-cycle easing of monetary policy wards off recession. And that may help to explain why share prices tend to rise during and immediately after mid-cycle rate cuts.

Sometimes, the equity market's reaction has been awesome. Partly in response to a 10.6% drop by the month-long average of the market value of U.S. common stock from July 1998 to September 1998, a lowering of fed funds commenced in September 1998 and lasted through May 1999. The quickness with which the Fed removed an inverted yield curve helped to spark a 31.6% average annualized advance by the market value of U.S. common stock from September 1998's bottom to March 2000's top.

In addition, the Fed's mid-cycle easing of 1998-1999 facilitated a narrowing of the high-yield bond spread from October 1998's 681 basis points to a June 1999 low of 495 basis points. Fed easings that were both deep and extended overlapped recessions that punished equity markets and swelled corporate bond yield spreads.

Credit Markets Review and Outlook

Figure 1: High-Yield Bond Market Has Strong Reason to Fear the Early Stages of a Deep and Extended Lowering of Fed Funds
source: Moody's Analytics



Fed's Latest Move Will Be a Flop if Business Sales Slow Further

If Jerome Powell's reference to a mid-cycle easing of monetary policy proves true, then a recession will probably not arrive until after 2020. Regardless of what Powell of any other Federal Open Market Committee member says, the Fed will respond to persistently subpar business sales with a cutting of the federal funds rate.

The numbers on the business revenue front have not been pretty. Without a doubt, business activity has slowed to a decidedly below-trend pace.

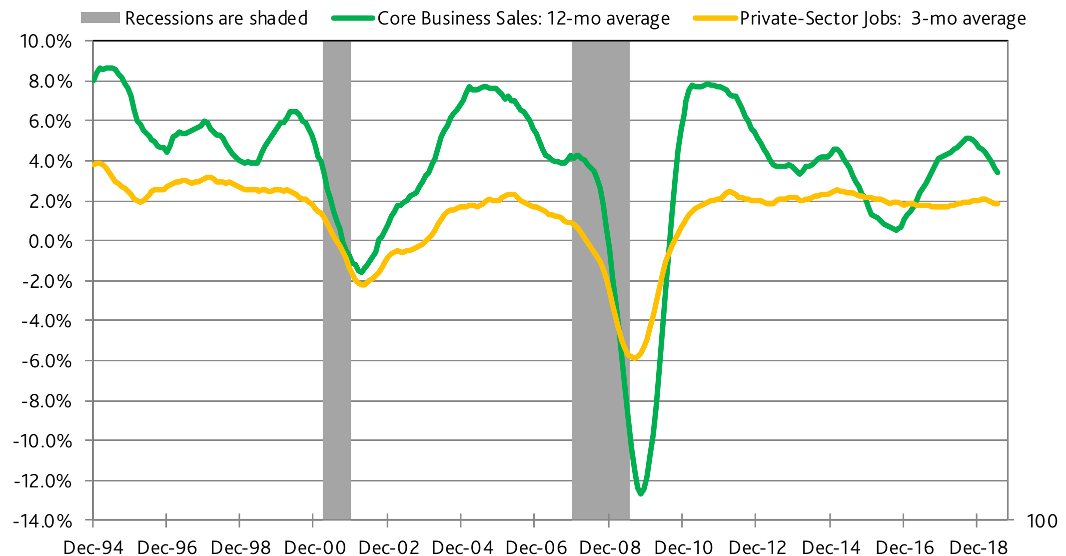
The yearly growth rate for the most readily available aggregate proxy for U.S. business sales has plunged from the 7.4% of 2018's second quarter to a prospective 1.9% for 2019's second quarter. After excluding sales of identifiable energy products, the comparably measured growth rate of core business sales slowed from 5.7% to 2.2%.

Business capital spending has already decelerated in response to the below-trend growth of business sales. The hope is that business sales will not weaken by enough to prompt widespread cutbacks in staff.

Core Business Sales Influence Private-Sector Payrolls

Since 1994, the correlation between the year-over-year percent changes of private-sector payrolls' moving three-month average and core business sales' moving 12-month average is a very significant 0.86. If the now 3.8% annual increase of core business sales' moving 12-month average were to slow to the 2% of the three-months-ended June 2019, the average monthly increase of private-sector payrolls might fall under the 156,000 of 2019's second quarter to something less than 75,000 new jobs per month. The latter would probably prompt deep rate cuts by the Federal Reserve.

Figure 2: Private-Sector Payrolls Growth to Slow Until Core Business Sales Regain Speed
yy % changes
sources: Census Bureau, BLS, NBER, Moody's Analytics



Nevertheless, amid the business sales slump of 2016, the average monthly increase of private-sector payrolls bottomed at the 136,000 new jobs of the three-months-ended May 2016, which was well above the payrolls' contraction predicted by core business sales' 0.5% annual rise of the 12-months-ended September 2016. Apparently, business confidence in a rejuvenation of revenues, perceived shortages of labor, and modest wage growth shielded payrolls from the layoffs that typically accompany a pronounced deceleration of business sales.

The Fed did not cut rates in response to 2016's braking of sales growth partly because fed funds' midpoint was an already ultra-low 0.375% following December 2015's rate hike from a record low 0.125%. Despite the absence of a rate cut, the 10-year Treasury yield's month-long average sank from December 2015's 2.25% to July 2016's 1.5% bottom.

Powell may prove correct about a relatively brief and shallow cutting of fed funds if a rejuvenation of business sales capable of expanding profits arrives later this summer.

Fed Rate Cuts May Improve Outlook for U.S. Companies Having Overseas Exposure

The FOMC ascribed the lowering of fed funds' midpoint from 2.375% to 2.125% to below-trend consumer price inflation and subpar growth abroad. Second-quarter 2019's actual and prospective results from the S&P 500's member companies highlight the drag of lower-than-expected growth outside the United States.

According to a July 26 release from FactSet employing actual results and consensus estimates, as a whole, S&P 500 companies are likely to report a 4% yearly rise by revenues and a 2.6% annual decline by earnings per share. However, the projected results differ considerably depending on a company's exposure to the world economy.

For companies deriving more than half of their revenues from customers in the U.S., the second-quarter's prospective 6.4% annual advance by revenues was joined by the 3.2% growth of earnings per share. By contrast, companies deriving less than 50% of sales from U.S. customers showed year-over-year setbacks of -2.4% for revenues and -13.6% for earnings per share.

Credit Markets Review and Outlook

The decidedly subpar performance of foreign economies has yet to trigger disruptive sell-offs of foreign equity and bond markets. The resilience of overseas financial markets partly stems from the ultra-accommodative monetary policies of major central banks such as the European Central Bank and the Bank of Japan.

Though July 31's Dow Jones stock price index for companies domiciled outside the U.S. was up by 10% since year-end 2018, it was down by 5.2% from a year earlier. Well outrunning the rest of the world was the market value of U.S. common stock that was higher by 19.2% for 2019-to-date and by 5% year-to-year.

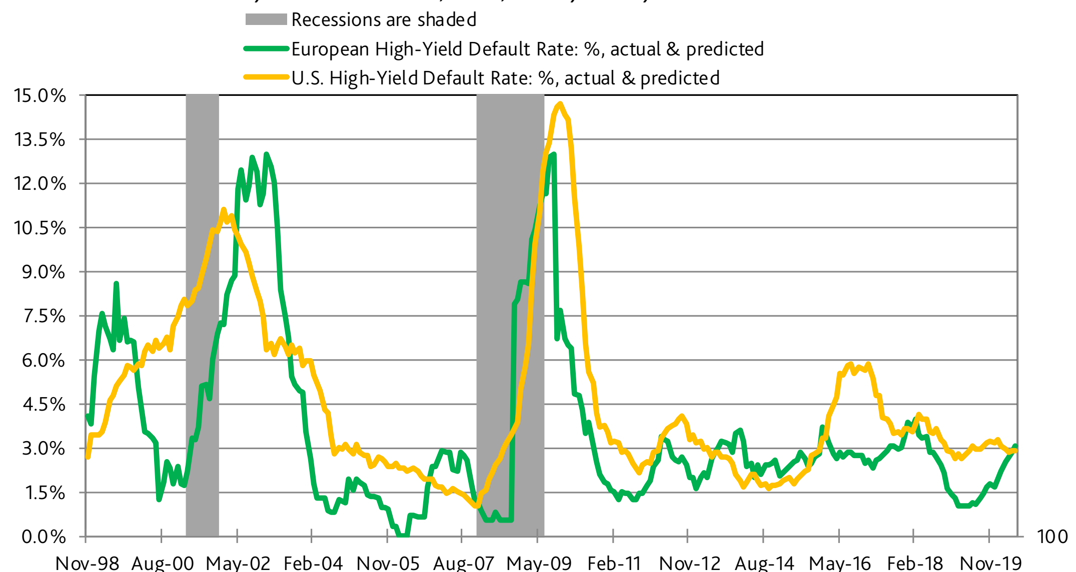
However, the equity price showings of smaller U.S. companies lagged the overall U.S. market. For example, the Russell 2000's year-to-date advance of 16.8% was countered by its yearly decline of 5.7%, while Value Line's geometric stock price index's 13.1% 2019-to-date advance was not enough to prevent a 7.4% yearly drop.

Europe's Default Rate Is Expected to Rise to U.S. Default Rate

Notwithstanding downwardly revised estimates of euro zone economic growth, the month-long average of a Credit Suisse euro-denominated high-yield bond spread narrowed from July 2018's 414 basis points and December 2018's 555 basis points to July 2019's 398 basis points. Moreover, despite how the 1.9% average annual rise by the euro zone economies of the five-years-ended 2018 lagged the U.S.'s comparable growth rate of 2.4%, June 2019's 1.1% high-yield default rate for Europe was less than the U.S.'s 3%.

However, complementing expectations of a U.S. economy that outpaces the euro zone by more than a full percentage point, on average, during 2019-2020, Europe's default rate is expected to rise to 3% by June 2020, while the U.S. default rate approximates 2.9%. (The default rate projections are those of Moody's Investors Service.)

Figure 3: European High-Yield Default Rate Is Expected to Approach U.S. Default Rate by 2019's Second Quarter
sources: Moody's Investors Service, NBER, Moody's Analytics



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

THE U.S.

By Ryan Sweet of Moody's Analytics

Fed's Former Clarity Is Now Confusion

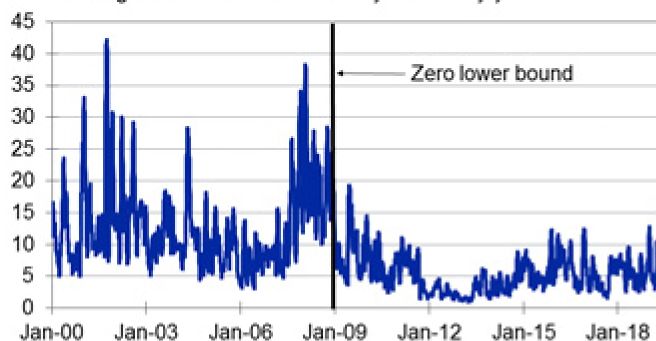
Since the last recession, the Federal Reserve has taken significant steps to become more transparent but with that comes some trials and tribulations. Financial markets interpreted Wednesday's Fed statement and post-meeting press conference as slightly hawkish, which contributed to the drop in equity prices and rise in the two-year U.S. Treasury yield. Markets were hoping for the Fed to adopt an explicit easing bias for September but that didn't occur.

The statement introduced more uncertainty for a second rate cut in September by watering down the Fed's policy guidance to "act as appropriate" with the preface, "As the Committee contemplates the future path of the target range for the federal funds rate… ." The Fed also changed its promise to "closely monitor" developments to a weaker "continue to monitor." During the press conference, Fed Chairman Jerome Powell said that the Federal Open Market Committee intends its "midcycle adjustment" to "adjust policy to be somewhat more accommodative," implying that this is unlikely the beginning of a long easing cycle and that the incoming data and the Fed's assessment of the risks to the outlook will determine if and when another cut is needed.

The Fed would prefer to limit any forward guidance to medium- and long-run forecasts, but in the past few weeks, markets' attention has been more on the near term. This creates a headache for the Fed because it doesn't have a perfect crystal ball, so it needs to maintain flexibility in setting monetary policy. It doesn't, and shouldn't, commit to a preset course for the fed funds rate.

Financial markets want clarity that the Fed isn't willing to provide, so uncertainty surrounding monetary policy is rising. This isn't necessarily bad, as uncertainty around monetary policy has been low during this expansion. We reached this conclusion after calculating a six-week rolling standard deviation in the two-year Treasury yield.

We chose six weeks because that is approximately the length of time between FOMC meetings. The two-year Treasury yield is sensitive to changes in expectations about monetary policy. Therefore, high uncertainty would be reflected in the rolling standard deviation.



We find evidence that the rolling standard deviation has risen recently, but it's not unusually high. Uncertainty will likely remain higher than that seen for most of this expansion even as markets have cut the probability of a rate cut at the remaining FOMC meetings this year. Our subjective odds put the likelihood of a cut in September at 45% and in December at 35%. Both are noticeably lower than that implied by fed funds futures.

All told, a little more uncertainty about monetary policy could be a good thing. It could make the Fed's job in managing market expectations easier, particularly now that it has tied the path of the fed funds rate to the incoming economic data, geopolitical risks and trade policy.

Looking ahead

The economic calendar is pretty light next week. The key data include the ISM nonmanufacturing index, jobless claims and producer prices. The Fed's Senior Loan Officer Survey will also be released.

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

EUROPE

By Barbara Teixeira Araujo of Moody's Analytics

Grim News Likely for U.K.'s GDP

Next week will bring the long-awaited second-quarter GDP figures for the U.K. We expect them to be grim and to show that the country's economy stalled in the three months to June, though risks are tilted towards a small contraction. While markets may fret over the figures—and we are sure that there will be a lot of talk regarding a coming recession—the no-change in GDP should not be overread. It will follow an unsustainable rise in the first stanza, which was mainly due to firms at home and abroad rushing to build up their inventories ahead the initial March deadline for Brexit. We had long warned that this would warrant a sharp mean-reversion in the three months to June, so we weren't surprised to see all of the high-frequency indicators showing a sharp deterioration in manufacturing production in April and May. Further, we are betting that another decline in June will round off one of the worst quarters ever for British manufacturers. The bad news is that we expect that this weak trend was carried over into July, though on the upside the new October 31 Brexit deadline suggests another round of stockpiling soon.

Adding to base effects related to stockpiling, auto manufacturers brought forward planned summer maintenance shutdowns to April as part of contingency Brexit planning—they wanted to prevent major disruptions had the U.K. left the EU with no deal on March 31. Consequently, car production plunged by double-digits over the month. Factories went back to business as normal in May, but April's collapse will still be a major dent to the quarterly numbers. Accordingly, our forecast is that manufacturing production will have plunged by around 2% q/q over the quarter, following a 1.9% rise in the first stanza. In industrial production, we expect that energy production will have risen sharply, even though we are forecasting a sharp decline for June in line with the rise in temperatures. Mining and quarrying, by contrast, should have contracted, but only slightly. This means that the sector isn't expected to have either detracted or added to growth. Adding together manufacturing, energy, and mining and quarrying, we forecast that industrial production declined by around 1.5% q/q over the second quarter as a whole.

The bad news is that construction output should also have declined over the quarter, even if we expect rather upbeat figures for June. We are penciling in a 0.7% q/q decline, which will have reversed half of the first stanza's 1.5% jump. There is no sugarcoating the construction figures, though; investment in

construction—especially in commercial—is one of the hardest hit by Brexit uncertainty, and this will remain so until there is more clarity on negotiations.

Elsewhere, we expect that the services sector will save the day in the second quarter and offset weakness in the two other main sectors of the economy. We are penciling in a 0.3% q/q rise in services output, but this is conditional on our forecast that production in the sector rose by 0.2% m/m in June, following no growth in May. We already know that retail sales rose by 0.7% q/q in the second quarter, which should give a boost to retail and wholesale activities. The problem is that high-frequency data are pointing towards a decline in accommodation and food services activities—which is odd, as we had expected that the quarter's above average temperatures would have boosted demand for trips and consumption at bars and restaurants—while output in the financial and insurance subsector is also expected to have declined. Notably, companies continued to relocate part of their operations to continental Europe, fearing what will happen to their 'passporting rights' when the U.K. finally leaves the EU. Our hope is that most other consumer-related services subsectors will have seen their production rise over the quarter, in line with the further pickup in wage growth and the still-solid labour market.

We expect some rebound in the third quarter—especially if firms start to stockpile again—but overall the pace of increase should average only around 0.1% to 0.2% q/q in the third and the fourth quarters. This will mean that full-year growth should come in at 1.3%, worsening on a 1.4% rise in 2018. All of this is conditional on a smooth Brexit outcome, which should include yet another extension of Article 50 at least until the end of the year.

	Key indicators	Units	Moody's Analytics	Last
Tues @ 2:00 p.m.	Russia: Consumer Price Index for July	% change	4.9	0.0
Wed @ 7:00 a.m.	Germany: Industrial Production for June	% change	0.4	0.3
Thur @ 7:00 a.m.	Spain: Industrial Production for June	% change	0.2	0.3
Thur @ 11:00 a.m.	OECD: Composite Leading Indicators for June		98.9	99.0
Fri @ 7:45 a.m.	France: Industrial Production for June	% change	1.5	2.1
Fri @ 9:30 a.m.	U.K.: Monthly GDP for June	% change	0.2	0.3
Fri @ 9:30 a.m.	U.K.: GDP for Q2	% change	0.0	0.5
Fri @ 10:00 a.m.	Italy: Consumer Price Index for July	% change yr ago	0.4	0.8
Fri @ 2:00 p.m.	Russia: Foreign Trade for June	$ bil	13.0	11.8

ASIA-PACIFIC

By Katrina Ell of Moody's Analytics

Several Central Banks Face Policy Decisions; Outcome Uncertain

A handful of central bank meetings will be in the spotlight and the outcomes more uncertain than usual. We expect the Reserve Bank of India to reduce its policy rate by 25 basis points to 5.5% at its August meeting. This brings cumulative easing so far this year to 100 basis points. An important development at the June monetary policy meeting was that the RBI changed its stance from "neutral" to "accommodative." After holding onto its neutral stance even after cutting rates by 50 basis points this year, the central bank finally is calling a spade, a spade.

Elsewhere, central banks in Australia and New Zealand are expected to keep their policy rates steady, but further easing is on the cards in 2019 for both. Odds are both central banks will next move in October, but the likelihood of the Reserve Bank of New Zealand moving in August is elevated. The Reserve Bank of Australia has already reduced the cash rate by 50 basis points this year, so we think the RBA will take a wait-and-see approach to assess the impact of earlier monetary stimulus and more expansionary fiscal policy coming on line.

The Week Ahead

Pressure has increased on the Bank of Thailand to cut rates to ease the baht, which has gained 4.2% against the U.S. dollar this year, making it Asia's strongest performer. But a rate cut may not have much effect on the exchange rate since Thailand's real rates are already relatively low. Instead, the BoT has taken steps toward easing the baht. The more likely driver of an interest rate cut in Thailand is further deterioration in the growth outlook. In June, the BoT downwardly revised its 2019 GDP growth forecast for a third time in six months, this time to 3.3%; in March the forecast was 3.8%. The economy grew 4.1% in 2018.

China's foreign trade data for July will be closely watched. Expectations are that exports and imports will each continue contracting in annual terms. Imports were down by 7.3% y/y in June and have fallen more than exports, which slumped by 1.3% in June. This has widened the trade surplus. But the slump in imports is more a consequence of weakness in shipments coming from the U.S., rather than being a comment on weakened domestic demand.

Indonesia's GDP growth likely cooled to 5% y/y in the June quarter, from 5.1% in the March quarter. Weakened external demand hurting the export and manufacturing engines is a key input to the weaker performance. Some moderate improvement in overall activity is expected following the disruption and uncertainty ahead of the elections in April, in which incumbent President Joko Widodo reclaimed victory.

	Key indicators	Units	Confidence	Risk	Moody's Analytics	Last
Mon @ Unknown	Indonesia GDP for Q2	% change yr ago	3	←	5.0	5.1
Tues @ 11:30 a.m.	Australia Foreign trade for June	A$ bil	3	←	5.3	5.8
Tues @ 2:30 p.m.	Australia Monetary policy for August	%	3	↓	1.0	1.0
Wed @ 12:00 p.m.	New Zealand Monetary policy for August	%	2	↓	1.5	1.5
Wed @ 5:00 p.m.	Thailand Monetary policy for August	%	3	↓	1.75	1.75
Wed @ 5:00 p.m.	India Monetary policy for August	%	3	←	5.50	5.75
Thurs @ 12:00 p.m.	Philippines GDP for Q2	% change yr ago	2	←	6.2	5.6
Thurs @ Unknown	China Foreign trade balance for July	US$ bil	2	↓	35.2	51.0
Fri @ 9:50 a.m.	Japan GDP for Q2	% change	2	←	0.2	0.6
Fri @ 11:30 a.m.	China Consumer price index for July	% change yr ago	3	←	2.7	2.7
Fri @ 11:30 a.m.	China Producer price index for July	% change yr ago	3	↓	0.4	0

The Long View

In July, Chinese issuers supplied 35.5% of the number and 22.1% of the dollar amount of new US$-denominated high-yield bond offerings.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group
August 1, 2019

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 113 basis points is under its 122-point mean of the two previous economic recoveries. This spread may be no wider than 130 bp by year-end 2019.

The recent high-yield bond spread of 425 bp is thinner than what is suggested by both the accompanying long-term Baa industrial company bond yield spread of 184 bp and the recent VIX of 18.3 points.

DEFAULTS

June 2019's U.S. high-yield default rate was 3.0%. The high-yield default rate may average 3.2% during 2019's final quarter, according to Moody's Investors Service.

US CORPORATE BOND ISSUANCE

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

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

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

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

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

Second-quarter 2019's worldwide offerings of corporate bonds revealed an annual setback of 2.5% for IG and an annual advance of 17.6% for high-yield, wherein US$-denominated offerings sank by 12.4% for IG and surged by 30.3% for high yield.

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

For 2018, worldwide corporate bond offerings sank by 7.2% annually (to $2.322 trillion) for IG and plummeted by 37.6% for high yield (to $376 billion). The projected annual percent increases for 2019's worldwide corporate bond offerings are 3.7% for IG and 19.8% for high yield. When stated in U.S. dollars, issuers based outside the U.S. supplied 60% of the investment-grade and 57% of the high-yield bond offerings of 2019's first half.

The Long View

US ECONOMIC OUTLOOK

As inferred from the CME Group's FedWatch Tool, the futures market recently assigned an implied probability of 70% to a cutting of the federal funds rate at the September 18, 2019 meeting of the Federal Open Market Committee. In view of the underutilization of the world's productive resources, low inflation should help to rein in Treasury bond yields. As long as the global economy operates below trend, the 10-year Treasury yield may not remain above 2.5% 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 Edward Friedman of Moody's Analytics
August 1, 2019

EURO ZONE

A number of developed central banks have turned dovish recently, signaling they will be easing monetary policy. Some already have. The Federal Reserve cut rates this week and its tool kit isn't as depleted as other central banks, particularly in Europe.

The European Central Bank will likely cut interest rates and use quantitative easing in September. Major economies such as Germany and Italy are flirting with recession and the ECB is considering a dive deeper into the unknown, lowering its own policy rate even further negative. Therefore, this is a good time to revisit negative interest rates.

The first descent

Switzerland and Sweden were the first to take the plunge in early 2015. Their central banks set their policy rates below 0% for the first time in history.

The idea was to protect their export industries by preventing their exchange rates from appreciating too much. Over the preceding year the ECB had lowered its own policy rate to near 0%, and was heavily engaged in a program of sovereign-bond buying, putting upward pressure on the Swiss and Swedish exchange rates. The unprecedented policy was supposed to be temporary, but it has persisted for more than four years.

As the ECB's bond buying continued, the volume of debt bearing a negative interest rate soared and now exceeds $10 trillion.

The bulk of all negative interest debt is euro-denominated and in Europe, though a sizable chunk is Japanese. Not all of the debt is sovereign. Some is corporate, and a portion of that is even high-yield, a term that becomes an oxymoron in a world of negative interest rates.

Bond buyers do not actually pay a coupon for the privilege of lending to borrowers in this world. Much of the existing debt consists of older issues in which the normal order prevails—that is, the borrower pays a coupon to the lender. However, the market price of this debt has risen so much that the yield to maturity is below 0%. More striking is that new issues exist, consisting of a 0% coupon and a maturity value below the issue value. Borrowing via these instruments is truly beyond free.

The ECB's reasons

The ECB pushed interest rates below 0% for the same reason it or any other central bank engages in accommodative monetary policy, to stimulate credit-sensitive borrowing and spending to support a faltering economy. Recall that although the recession in the U.S. ended in 2009, the euro zone had a second downturn beginning in early 2011. That second recession resulted from the European debt crisis associated with the heavy debt burdens of countries such as Greece, Portugal, Ireland, Spain and Italy. Although milder than the Great Recession, it was of longer duration, lasting six quarters through the first quarter of 2013.
Negative interest rates worked to some extent. Corporate debt issuance in Europe rose substantially after 2013 and stayed elevated.

More important, euro zone real GDP growth, which had been negligible from 2010 to 2013, averaged more than 2% per year from 2015 through 2018. Some of that transition was simply the initial stage of the recovery from the second recession. To parse the effect of negative rates, we ran a simulation of the Moody's Analytics global model under the assumption that interest rates, both short and long, would have been 100 basis points higher, roughly the difference between the world of negative rates and one of positive rates. The result is that real GDP growth would have been 0.4 percentage point lower each year. Real fixed investment would have been approximately a full percentage point per year lower.

The lender's decision

The question that begs to be answered is how negative interest rates can exist at all. After all, a household or business should be able to avoid them by placing the assets in physical cash.

The problem is that cash is cumbersome when it comes time to engage in transactions. Safety deposit boxes carry rental fees, as would placement in the bank's vault. Execution of an instruction to a bank to put the cash in an account so that funds could be transmitted would also come at a cost.

Nonetheless, European banks have found themselves caught in the middle. The ECB's accommodative policies have brought down lending rates, reducing net interest margins. But banks cannot risk posting negative interest rates on retail deposits because that would at the least destroy goodwill and potentially result in a run. There may be more room for negotiation with large depositors such as businesses, which must engage in large numbers of transactions, and whose alternatives for temporarily holding funds such as liquid securities are themselves earning negative interest.

Regardless, there seems to be a lower limit to what more the ECB can do, and it may not be far off. A business or individual might pay a small amount to hold negotiable funds, but past a certain point a run on the entire euro zone banking system would become a systemic risk.

Flooding the system with liquidity amid negative interest rates in principle could boost inflation, but that has not occurred and seems unlikely in the near term ahead of a possible downturn.

The other risk is that Europe is in a liquidity trap and that there is no bang for the buck in further easing. As noted, new bond issues featuring a 0% coupon are available now and yet new issuance has not accelerated.

ASIA PACIFIC

By Katrina Ell of Moody's Analytics
August 1, 2019

ASIAN CENTRAL BANKS

The tally of central banks in Asia that have cut their policy rates this year has risen quickly. In the past week, Indonesia and South Korea have come off the sidelines, joining India, Malaysia, the Philippines, New Zealand and Australia. Nonwidening interest rate differentials with developed economies are giving central banks in emerging markets the room to cut. For most, further easing is on the cards for the second half of 2019.

Economies in Asia tend to flourish when global demand is buoyant and operate below potential when it is not. The latter situation is happening. Exports and manufacturing are struggling in most economies across the region, justifying the need to shore up domestic demand.

Also driving the easing stance is that the global outlook is plagued with downside risk. The trade war between the U.S. and China is unresolved. Our baseline is that the existing tariffs will remain in place at least through the remainder of 2019.

The Long View

Uncertainty limits policy potency

Expectations of further monetary policy easing do not change the narrative that below-potential expansions will proceed into 2020. The potency of further expansionary monetary policy is limited by the unfavourable backdrop. Additional rate cuts make credit creation more attractive, but the global environment of heightened geopolitical risks is not one where firms want to invest. The Moody's Analytics weekly business confidence survey confirms that businesses across the globe remain anxious, and sentiment is well down from a year ago.

Also, lending rates are already very low in most economies. Concerns about policy space to insulate against a sudden, exogenous shock will remain relevant.

Will BoJ walk the talk?

Soft inflation, a trade dispute with South Korea, slowing global demand, the U.S.-China trade war, and the October consumption tax hike could be the perfect storm that forces the Bank of Japan to up the stimulus ante. The BoJ signaled in June and reaffirmed at its July meeting that it is ready and willing to add stimulus, if necessary. Governor Haruhiko Kuroda indicated that the BoJ could combine bigger asset purchases with interest rate cuts if the risks to global growth materialize and further hurt Japan's already weakened economy.

For Japan, adding monetary stimulus is less straightforward, not least because negative interest rates have undesirable consequences on profitability for commercial banks. But the problem is that the BoJ needs to at least signal its willingness to loosen policy further, given the yen would likely suffer as major central banks offshore turn dovish. If the easing bias in the U.S. and Europe continues, it will put upward pressure on the yen. It's a problematic time now that Japan's exports slumped for a seventh straight month in June, so further eroding export competitiveness with a strong exchange rate is most unwelcome. Our baseline is that the central bank will keep policy settings steady, as it did at the July policy meeting.

Time to move the goal posts?

The Bank of Japan is not forecast to hit its elusive 2% inflation target in the foreseeable future. Core CPI growth (excluding food but including oil) cooled to 0.6% y/y in June, its weakest pace since July 2017. This follows from core CPI growth hitting 0.8% in May. In the year to June, core CPI has risen 0.77% y/y. Although the planned increase in the consumption tax rate from 8% to 10% in October will trigger inflation expectations and cause a temporary rise in prices, the medium-term impact will be to depress domestic demand and further slow inflation.

It could be argued that lowering the inflation target to 1% could be beneficial, since the 2% target is not credible. But doing so would have risks. The BoJ's unrelenting commitment to the 2% target sends an important signal. If the BoJ lowers the target, it could erode the central bank's credibility; if the central bank gave up on the 2% goal then why would the 1% goal be any different?

It's also important to remember that reaching the inflation target is not a means to an end. Welfare maximization is important and includes steady job creation and macroeconomic stability. There has been progress in this area; the labour market is its tightest in decades, helped by the aging population, and wage growth has improved. While improvement in both has not been to the extent desired, improvement is nonetheless significant. Arguably, some of the shift came from the government and central bank changing expectations. They became consistently optimistic from 2013 that their vision of a virtuous cycle of rising prices, wages and consumption would be a reality. Expectations of a more optimistic scenario partly delivered.

Ratings Round-Up

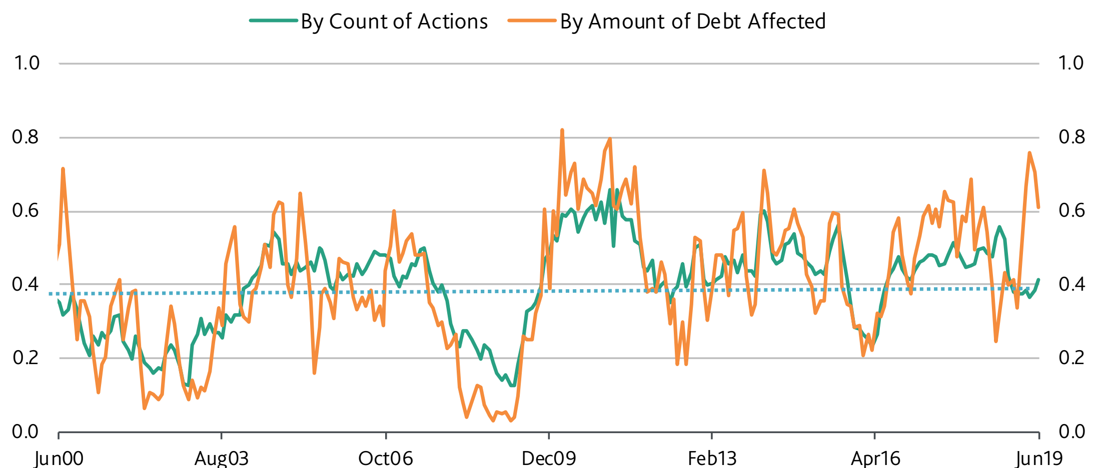
Upgrades Dominate U.S. Activity

By Michael Ferlez

U.S. rating change activity improved last week, with upgrades outnumbering downgrades. For the week ended July 27, positive rating changes accounted for 55% of total activity, up from 50% in the previous update. While the composition of changes improved, activity remained largely confined to speculative-grade industrial companies. Notable upgrades included Expedia Group Inc. The U.S. travel technology company saw its senior unsecured credit rating raised to Baa3 from Ba1, affecting $3.7 billion in debt. The upgrade reflected the improvement in the firm's corporate governance following the acquisition of Liberty Expedia. On the downgrade side, SESI LLC saw its senior unsecured credit rating cut from B2 to B3, reflecting the oil field servicing company's weak cash flow generation prospects and increased refinancing risks. The downgrade affected $1.3 billion in corporate debt.

European rating activity remained light, but the composition was strong. Upgrades outnumbered downgrades 4 to 2 and accounted for the majority of affected debt. All four upgrades last week were made to Portuguese banks, reflecting their improving credit fundamentals and the Moody's Investors Service upgrade of the banking Macro Profile of Portugal to "Moderate+" from "Moderate." The notable downgrade was to Aston Martin Lagonda Global Holdings PLC. The U.K. auto manufacturer saw its senior secured credit rating cut to B3 from B2, affecting $943 million in debt. According to Moody's Investors Service, the downgrade was the result of poor progress in volume growth and profitability for 2019, continuing the firm's high negative free cash flow and high leverage.

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
7/24/19	SUPERIOR ENERGY SERVICES, INC.-SESI, L.L.C.	Industrial	SrUnsec /LTCFR/PDR	1,300	D	B2	B3	SG
7/24/19	KIOWA POWER PARTNERS, L.L.C.	Utility	SrSec	281	U	Baa2	Baa1	IG
7/24/19	AMERICAN DENTAL PARTNERS, INC.	Industrial	SrSec/BCF /LTCFR/PDR		D	B1	B2	SG
7/24/19	DELTA TUCKER HOLDINGS, INC. -DYNCORP INTERNATIONAL INC.	Industrial	LTCFR/PDR		U	B2	B1	SG
7/25/19	YRC WORLDWIDE INC.	Industrial	SrSec/BCF /LTCFR/PDR		U	Ba3	Ba2	SG
7/25/19	DTZ UK GUARANTOR LIMITED -DTZ U.S. BORROWER, LLC	Industrial	SrSec/BCF /LTCFR/PDR		U	B1	Ba3	SG
7/26/19	EXPEDIA GROUP, INC.	Industrial	SrUnsec	3,723	U	Ba1	Baa3	SG
7/26/19	KENAN ADVANTAGE GROUP, INC.	Industrial	SrSec/BCF /LTCFR/PDR	405	D	B1	B2	SG
7/29/19	BALL METALPACK	Industrial	SrSec/BCF /LTCFR/PDR		D	B3	Caa1	SG
7/29/19	VIANT SERVICES, INC.-VIANT MEDICAL HOLDINGS, INC.	Industrial	SrSec/BCF /LTCFR/PDR		D	B1	B2	SG
7/30/19	AEROJET ROCKETDYNE HOLDINGS, INC.	Industrial	SrUnsec /LTCFR/PDR	300	U	B2	B1	SG

Source: Moody's

Ratings Round-Up

FIGURE 4

Rating Changes: Corporate & Financial Institutions – Europe

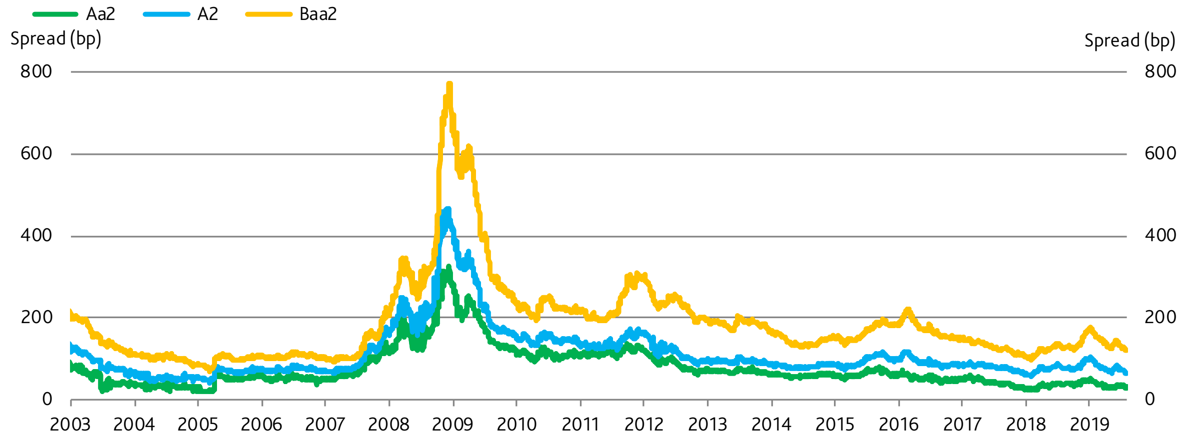
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	Old STD Rating	New STD Rating	IG/ SG	Country
7/24/19	CAIXA GERAL DE DEPOSITOS, S.A.	Financial	STD/LTD /Sub/MTN/PS	1,362	U	Ba1	Baa3	NP	P-3	SG	PORTUGAL
7/24/19	BANCO SANTANDER S.A. (SPAIN)-BANCO SANTANDER TOTTA, S.A.	Financial	LTD		U	Baa2	Baa1			IG	PORTUGAL
7/24/19	BANCO COMERCIAL PORTUGUES, S.A.	Financial	SrUnsec/STD /LTD/Sub /MTN/PS	1,124	U	Ba2	Ba1			SG	PORTUGAL
7/24/19	NOVO BANCO, S.A.	Financial	LTD/Sub	445	U	Caa1	B2			SG	PORTUGAL
7/29/19	ASTON MARTIN LAGONDA GLOBAL HOLDINGS PLC	Industrial	SrSec /LTCFR/PDR	943	D	B2	B3			SG	UNITED KINGDOM
7/30/19	SPARKASSE KOELNBONN	Financial	JrSrUnsec /LTD/MTN	8	D	A3	Baa1			IG	GERMANY

Source: Moody's

Market Data

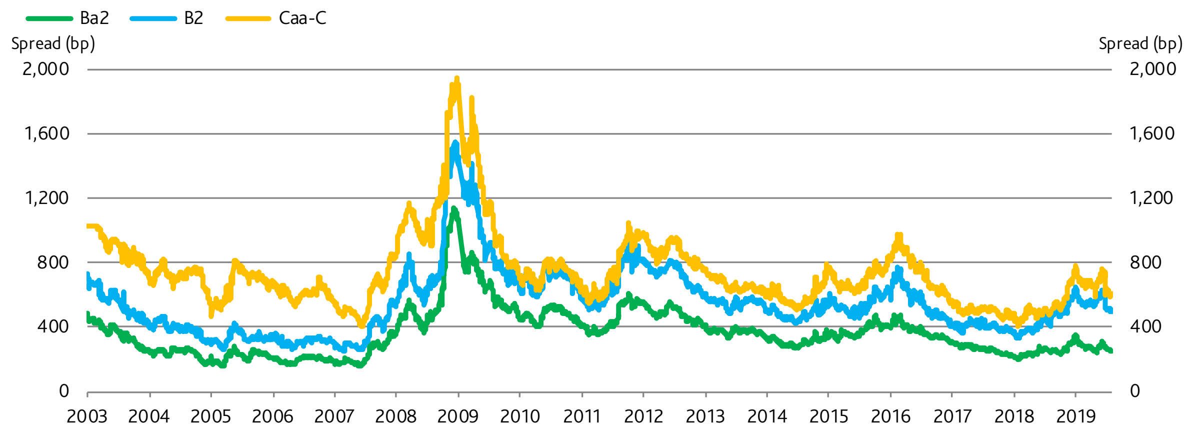
Spreads

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



Source: Moody's

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



Source: Moody's

Market Data

CDS Movers

Figure 3. CDS Movers - US (July 24, 2019 – July 31, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jul. 31	Jul. 24	Senior Ratings
Walt Disney Company (The) (Old)	Aaa	Aa1	A2
PepsiCo, Inc.	A1	A2	A1
Amgen Inc.	A1	A2	Baa1
Amazon.com, Inc.	Aa3	A1	A3
NextEra Energy Capital Holdings, Inc.	Baa1	Baa2	Baa1
Mondelez International, Inc.	A1	A2	Baa1
Sprint Communications, Inc.	Ba3	B1	B3
Southern Company (The)	A3	Baa1	Baa2
Tyson Foods, Inc.	A2	A3	Baa2
Tenet Healthcare Corporation	B3	Caa1	Caa1

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jul. 31	Jul. 24	Senior Ratings
BellSouth Corporation	Ba1	Baa2	Baa2
JPMorgan Chase & Co.	A1	Aa3	A2
Citigroup Inc.	Baa1	A3	A3
JPMorgan Chase Bank, N.A.	Aa3	Aa2	Aa2
Ford Motor Credit Company LLC	B1	Ba3	Baa3
CVS Health	Baa3	Baa2	Baa2
Procter & Gamble Company (The)	Aa1	Aaa	Aa3
Bank of America, N.A.	A2	A1	Aa2
Cisco Systems, Inc.	Aa1	Aaa	A1
FedEx Corporation	Baa3	Baa2	Baa2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jul. 31	Jul. 24	Spread Diff
Penney (J.C.) Corporation, Inc.	Caa3	5,884	5,545	339
Frontier Communications Corporation	Caa2	3,502	3,197	305
Dean Foods Company	Caa2	2,693	2,491	202
Realogy Group LLC	B2	950	821	129
Dish DBS Corporation	B1	479	402	77
Neiman Marcus Group LTD LLC	Ca	3,721	3,663	58
Office Depot, Inc.	B3	515	465	50
L Brands, Inc.	Ba1	306	269	37
Nordstrom, Inc.	Baa1	230	194	36
BellSouth Corporation	Baa2	99	63	36

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jul. 31	Jul. 24	Spread Diff
Nabors Industries Inc.	B1	543	645	-101
Talen Energy Supply, LLC	B3	737	812	-75
Tenet Healthcare Corporation	Caa1	461	527	-66
K. Hovnanian Enterprises, Inc.	Caa3	1,811	1,877	-65
Chesapeake Energy Corporation	B2	919	968	-49
Staples, Inc.	B3	492	530	-38
AK Steel Corporation	B3	798	835	-37
Rite Aid Corporation	Caa2	1,509	1,542	-33
EOG Resources, Inc.	A3	77	107	-30
Cablevision Systems Corporation	B3	327	357	-30

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (July 24, 2019 – July 31, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jul. 31	Jul. 24	Senior Ratings
Proximus SA de droit public	A3	Baa2	A1
SEB AB	Aa1	Aa2	Aa2
Anheuser-Busch InBev SA/NV	A2	A3	Baa1
KBC Group N.V.	Baa1	Baa2	Baa1
KBC Bank N.V.	Aa1	Aa2	Aa3
Alliander N.V.	A2	A3	Aa2
Fortum Oyj	A2	A3	Baa2
DEPFA BANK plc	B1	B2	A2
Brisa Concessao Rodoviaria S.A.	A2	A3	Ba2
Swedish Match AB	A3	Baa1	Baa2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jul. 31	Jul. 24	Senior Ratings
Italy, Government of	Ba3	Ba2	Baa3
United Kingdom, Government of	Aa3	Aa2	Aa2
Barclays Bank PLC	Baa2	Baa1	A2
Barclays PLC	Ba1	Baa3	Baa3
Banco Bilbao Vizcaya Argentaria, S.A.	A3	A2	A3
HSBC Holdings plc	Baa1	A3	A2
Credit Agricole S.A.	Aa2	Aa1	A1
Banco Santander S.A. (Spain)	Aa3	Aa2	A2
The Royal Bank of Scotland Group plc	Ba1	Baa3	Baa2
UniCredit S.p.A.	Ba1	Baa3	Baa1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jul. 31	Jul. 24	Spread Diff
PizzaExpress Financing 1 plc	Caa2	5,553	4,378	1,175
Boparan Finance plc	Caa1	3,355	3,080	275
CMA CGM S.A.	B3	1,300	1,187	113
Matalan Finance plc	Caa1	759	707	52
Vedanta Resources Limited	B2	471	430	42
Eksportfinans ASA	Baa1	546	509	37
Novafives S.A.S.	Caa1	500	465	35
Hammerson Plc	Baa1	122	99	23
TUI AG	Ba2	361	339	23
Iceland Bondco plc	Caa2	379	358	21

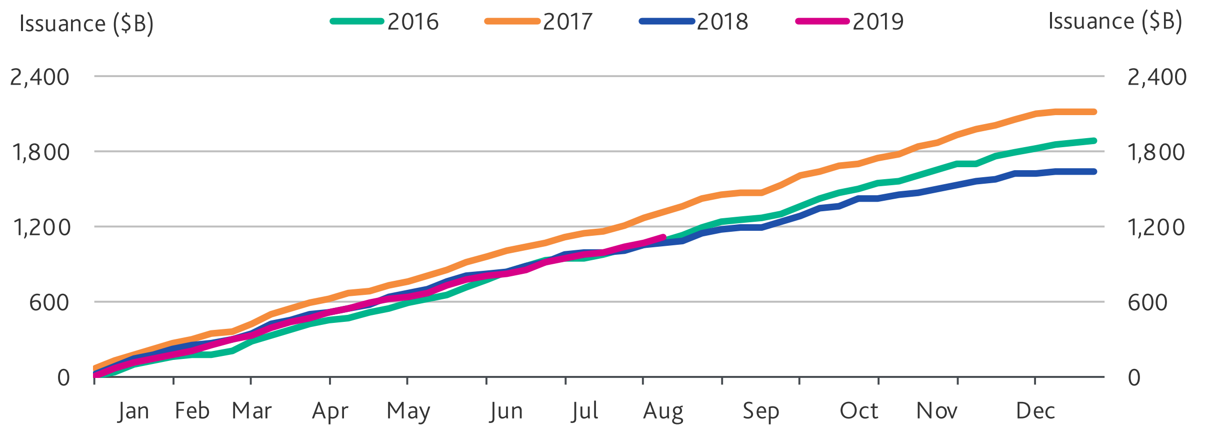
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jul. 31	Jul. 24	Spread Diff
DEPFA BANK plc	A2	201	213	-12
Proximus SA de droit public	A1	48	58	-10
KBC Group N.V.	Baa1	55	64	-9
Virgin Media Finance PLC	B2	104	112	-8
METRO Finance B.V.	Ba1	107	112	-6
UPC Holding B.V.	B2	46	51	-5
KBC Bank N.V.	Aa3	23	27	-4
Piraeus Bank S.A.	Caa2	826	830	-4
Koninklijke KPN N.V.	Baa3	104	108	-4
Alpha Bank AE	Caa1	627	631	-3

Source: Moody's, CMA

Market Data

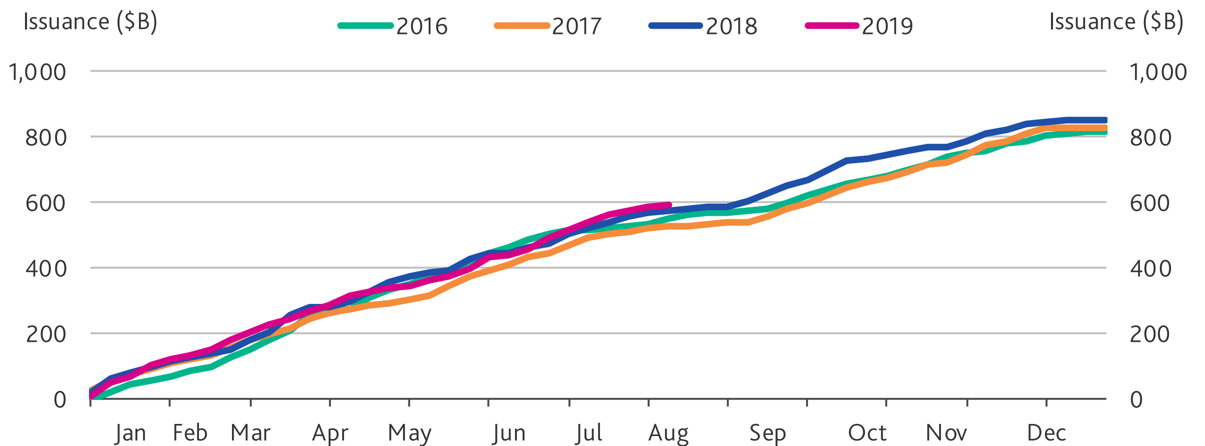
Issuance

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	32.038	3.225	39.674
Year-to-Date	800.318	248.545	1,111.957

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	2.653	1.087	4.527
Year-to-Date	520.733	54.438	592.277

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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Report Number: 1188386

Editor
Reid Kanaley
help@economy.com

Contact Us

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

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