MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

Moody's Analytics Research

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Leading Credit-Risk Indicator Signals a Rising Default Rate

Credit Markets Review and Outlook *by John Lonski*

Leading Credit-Risk Indicator Signals a Rising Default Rate

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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: For January-August 2019, US$-denominated corporate bond offerings dipped by 2% annually for investment-grade, but advanced by 20% for high-yield.

Credit Spreads	Investment Grade: We see year-end 2019's average investment grade bond spread marginally above its recent 127 basis points. High Yield: Compared with a recent 466 bp, the high-yield spread may approximate 475 bp by year-end 2019.
Defaults	US HY default rate: Moody's Investors Service's Default Report has the U.S.' trailing 12-month high-yield default rate rising from July 2019's actual 3.0% to a baseline estimate of 3.2% for July 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 2.9% for IG to $1.313 trillion, while high-yield supply grows by 29.0% to $358 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

One Upgrade, One Downgrade Among U.S. Energy Firms

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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: Corporate credit, 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, volatility.

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

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Credit Markets Review and Outlook

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

Leading Credit-Risk Indicator Signals a Rising Default Rate

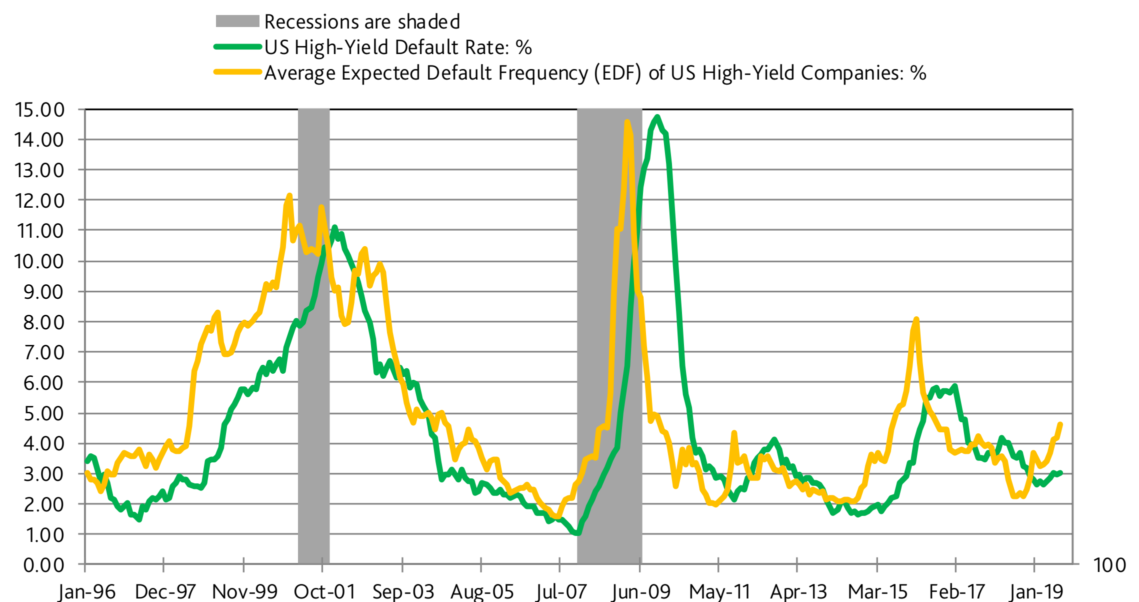
The month-long average for the expected default frequency metric of U.S./Canadian high-yield issuers climbed from August 2018's 2.38% and July 2019's 4.16% to 4.59% in August. The ascent by the high-yield EDF was joined by a widening of the high-yield bond spread's month-long average from August 2018's 354 basis points and July's 422 bp to August's 468 bp.

Since the statistic was introduced in January 1996, August marked the fourth time the high-yield EDF metric's month-long average increased sequentially to at least 4.59%. The previous occurrences and the accompanying high-yield bond spreads were August 2015 (568 bp), August 2008 (800 bp), and August 1998 (469 bp). Given the near equivalence between the high-yield bond spreads of August 2019 and August 1998, the bond market senses that any forthcoming increase by the default rate will be well contained.

Both the high-yield bond spread and the high-yield default rate increased significantly by the ninth month following the three incidents. For example, the increase by the high-yield default rate from August 2015's 2.3% to May 2016's 5.5% coincided with a widening of the high-yield bond spread from 568 bp to 632 bp. Similarly, the default rate's surge from August 2008's 3.2% to May 2009's 11.0% was accompanied by a widening of the high-yield spread from 800 bp to 1,189 bp. By contrast, the increase by the default rate from August 1998's 2.6% to May 1999's 4.65% was joined by a comparatively mild widening of the high-yield spread from 469 bp to 513 bp.

As inferred from the statistical record, August's high-yield EDF metric of 4.59% favors an increase by the default rate from a recent 3% to 4% by May 2020. Nevertheless, it is possible that enough improvement in the outlooks for cash flows and pretax profits could prevent a significant widening by the high-yield bond spread from Tuesday's 465 bp.

Figure 1: Average High-Yield EDF Signals a Forthcoming Climb by the High-Yield Default Rate
yy % changes for yearlong averages of U.S. nonfinancial corporations
Sources: NBER, Moody's Analytics



More than Trade Tensions Weigh on Financial Markets and the Business Outlook

Whether the administration is Democratic or Republican and regardless of the rationale, burdensome government intervention in often anathema to businesses. Nevertheless, the higher costs, supply-chain

disruptions and unknown outcome of trade disputes between the U.S. and other countries are not the only hindrances that explain the current slowdown in business activity.

For one thing, as shown by the substantial downward revision of 2018's core pretax profits from current production, companies allowed labor costs to rise too rapidly vis-a-vis revenues. For nonfinancial corporations, the 3/10ths of a percentage point trimming of 2018's annual increase by their gross value added (or net revenues) from 5.0% to a restated 4.7% was much less of a drag on profitability than was the 8/10ths of a point upward revision for employee compensation's annual increase from 4.2% to a now 5.4%.

A tighter labor market gets some of the blame for the faster growth of operating costs. Still, too many businesses overestimated their ability to pass on higher costs to product prices, as well as the underlying demand for their products. The secular deceleration of household expenditures brought on by the unprecedented aging of advanced economies (that eventually will be shared by China) warns businesses not to overstate the future trajectory of unit sales.

In addition, the latest slowdown by manufacturing activity partly stems from the rapid accumulation of inventories that began in 2018's third quarter and ended with 2019's first quarter. After growing by $27 billion annually, on average, during 2016-2017, the annualized pace of real inventory accumulation soared to an average annualized pace of $99 billion during July 2016 through March 2019. Second-quarter 2019's $69 billion addition to real inventories suggests that businesses are still burdened by unwanted inventories.

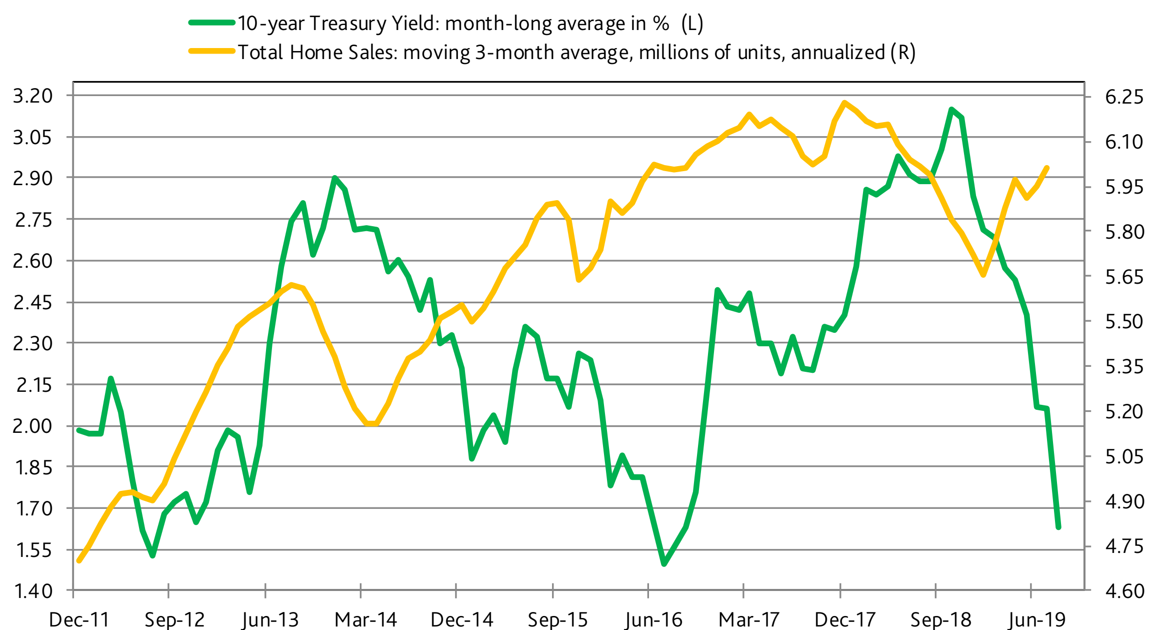
Plunge by Benchmark Treasury Yields Hints of New Cycle High for Unit Home Sales

Business activity is still recovering from an earlier unduly steep climb by benchmark interest rates. In a typical lagged response to an ascent by the 10-year Treasury yield's month-long average from June 2017's 2.19% to October 2018's now eight-year high of 3.15%, the moving three-month average for unit sales of new and existing homes plunged by 9.2% from December 2017's current cycle high to January 2019's latest bottom.

A subsequent drop by benchmark Treasury yields facilitated a 6.3% increase by total unit home sales' moving three-month average from January's trough, as of July 2019. Given the depth of the drop by benchmark bond yields, home sales' three-month average might be expected to rise by at least 3.6% from July's reading and, thereby, set a new high for the current upturn.

Figure 2: Latest Plunge by Treasury Bond Yields May Lead Unit Home Sales Up to New Cycle High

Source: National Association of Realtors, US Census Bureau, Moody's Analytics



Upwardly Sloped Yield Curve Helped Contain 2015-2016's Profits Recession

The current global slowdown bears some similarity to the temporary slump of 2015-2016. Recently, many were quick to note how the ISM index of U.S. manufacturing activity fell to a marginally contractive 49.1 points in August 2019 for its lowest score since the 47.8 points of January 2016. However, a single month's downbeat ISM reading on U.S. manufacturing lacks the severity of the five straight months of contractive scores posted by the ISM factory index during the span-ended February 2016.

The subsequent recoveries by both financial markets and business activity from 2015-2016's slowdown partly stemmed from a drop by the 10-year Treasury yield's month-long average from June 2015's 2.36% to July 2016's 1.50%. Moreover, the brevity of the slowdown also could be indirectly attributed to the avoidance of a yield curve inversion.

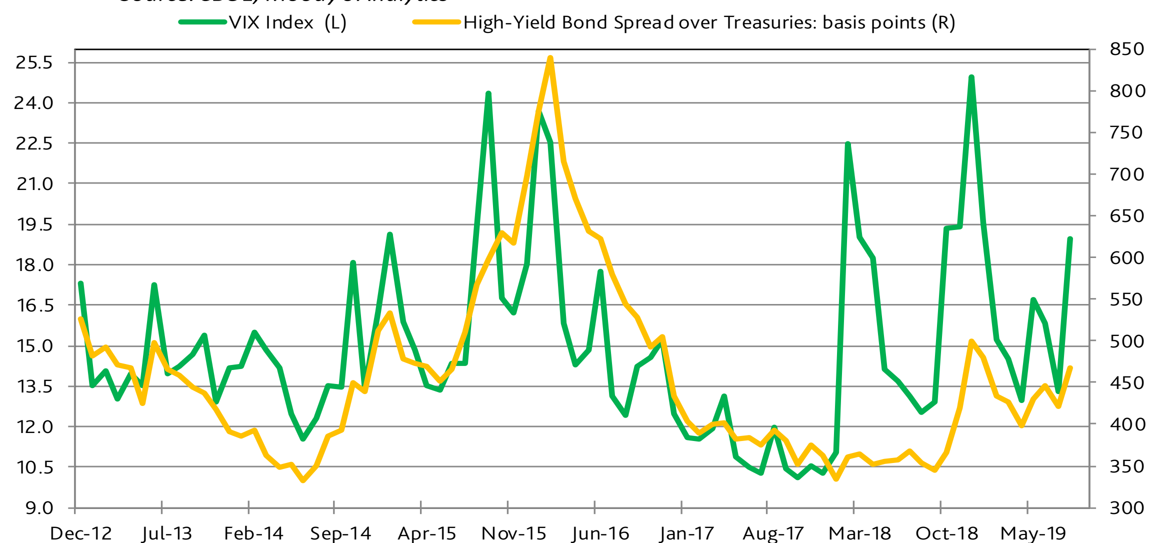
Though the federal funds rate was ratcheted up by 25 bp in December 2015 from 0.125% to a still extraordinarily low 0.375%, the yield curve maintained a decidedly positive slope. During 2015-2016, the 10-year Treasury yield averaged 173 bp more than fed funds, wherein the gap bottomed at the ample 113 bp of July 2016.

If need be, the Federal Open Market Committee might decide to move the federal funds rate under the 10-year Treasury yield at its October 30, 2019 meeting. Moreover, the failure of the 10-year Treasury yield to rise much above 1.6% suggests that a 1.375% midpoint for fed funds is likely by year-end 2019.

A positively sloped Treasury yield curve of 2015-2016 helped to explain why for only the second time since 1969, the span's profits recession did not trigger a business cycle downturn. Nevertheless, the profits contraction figured in a ballooning of the high-yield bond spread from June 2015's average of 465 bp to December 2015's 697 bp and, ultimately, to a February 2016 peak of 839 bp. The swelling of spreads was linked to a 12.9% plunge by the market value of U.S. common stock's month-long average from May 2015's then record-high to a February 2016 bottom and a lift-off by the month-long average of the VIX from May 2015's 13.3 points to the 23.1-point average of January-February 2016.

To underscore just how different the current situation is from 2015-2016, August 2019's average high-yield bond spread of 468 bp resembled its June 2015 average, or before the worst of the slowdown took hold. Thus far, trade-related tensions have overlapped a month-long average for the high-yield bond spread that has been no greater than the 499 bp of December 2018. And, for the period from December 2018 through August 2019, the 445 bp average of the high-yield bond spread has been well under its 635 bp average of July 2015 through September 2016, or when the high-yield spread's month-long average exceeded 500 bp for 15 consecutive months.

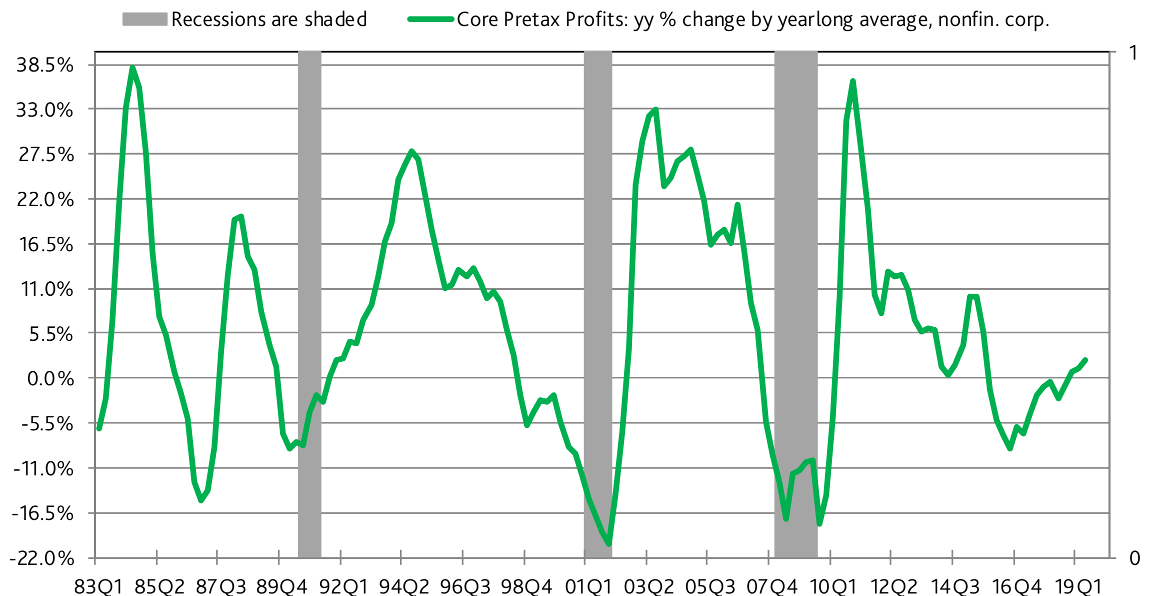
Figure 3: Unlike 2015-2016, High-Yield Bond Market Has Been Relatively Indifferent to Trade-Driven Stock Market Volatility
Source: CBOE, Moody's Analytics



Credit Markets Review and Outlook

The only other time since 1969 where a profits recession neither led nor accompanied an economic recession was during 1986-1987. During July 1985 through June 1987, the 10-year Treasury yield averaged 128 bp more than the effective federal funds rate. Helping to stave off a yield curve inversion was the cutting of the federal funds rate from December 1985's 7.75% to the 5.88% of August 1986 through December 1986.

Figure 4: Positively Sloped Yield Curve Helped to Sustain Economic Growth Following Profits Recessions of 1986-1987 and 2015-2016
Source: BEA, NBER, Moody's Analytics



Equity Market Consensus Foresees a Repeat of 2015-2016's Brief Correction

On balance, equity market professionals see the current global slowdown as resembling 2015-2016's short-lived slump. According to a recent report from FactSet, the consensus forecast of equity analysts calls for an acceleration by the aggregate earnings per share (EPS) growth of the S&P 500's member companies from 2019's 1.5% to 2020's 10.7% partly because of a quickening by revenue growth from 4.4% to 5.6%, respectively. For purposes of comparison, after rising by an imperceptible 0.1% annually, on average, during 2015-2016, S&P 500 EPS jumped 12.0% annually in 2017. At the same time, the annual decline by the U.S. government's broader measure of pretax profits from current production narrowed from the 2.6% average of 2015-2016 to 2017's 0.3%.

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

THE U.S.

By Maria Cosma of Moody's Analytics

Trade War Chicken

Over the weekend, the Trump administration imposed a 15% tariff on about $111 billion worth of Chinese goods imports. This is the first of two fresh tariff waves in the U.S.-China trade war. The second wave is scheduled for December 15 on the remaining $156 billion worth of Chinese goods imports. China is retaliating with tariffs on a total of $75 billion worth of U.S. goods imports, also on September 1 and December 15.

With these latest tariff volleys, the U.S. and China are currently locked into a game of economic chicken. A game of chicken typically ends one of two ways: either one party blinks and gives way, or both parties get hurt. However, at some point it becomes too late for anyone to duck out, and both parties are doomed to mutual destruction. As the tariff volleys intensify, the odds that the U.S. and China are pulled into an economic downturn, and take the rest of the world with them, are rising. At some point, a trade deal will not be enough to avert a global recession.

Escalation recap

By now it may be hard to remember how exactly the trade war went from bad to much worse in less than a month. Following the imposition of higher duties on existing waves of tariffs in June, trade talks resumed between the U.S. and Chinese officials in Shanghai at the end of July. It's not entirely clear how successful these negotiations were, but by August 1, President Trump tweeted that all remaining Chinese goods imports would face a 10% tariff on September 1. Trump cited China's lack of agricultural purchases and continued sale of fentanyl as reasons for the tariff hike.

Chinese officials did not issue their own tariff threats in response. However, over the next few days, China's currency devalued to below 7 yuan per dollar, helping to keep Chinese exports competitive in the U.S. in spite of the tariffs. In response, the U.S. Treasury Department labeled China a currency manipulator, a largely symbolic move.

However, halfway through August, a string of weak economic reports from abroad coupled with an intraday inversion of the 10-year and two-year yield curve rattled financial markets. Trump issued some trade war relief by announcing that the $300 billion tariff list would be applied in two waves to protect U.S. consumers during the holiday shopping season. Notably, this was the first time that the president admitted that tariffs could hurt American consumers.

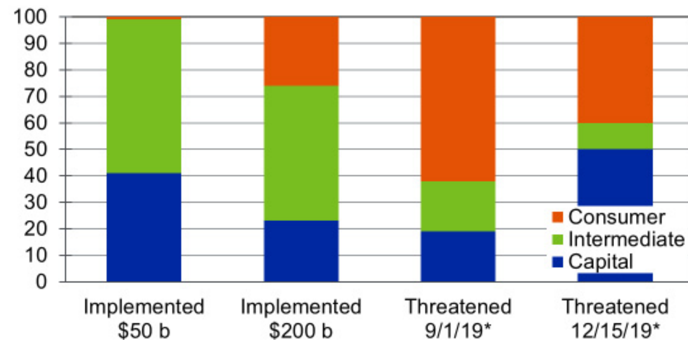
Within 10 days, China issued its tariff retaliation plan. Duties of 5% and 10% will be imposed on the same dates as the new U.S. tariffs on about $75 billion worth of goods imports. Trump immediately lashed back, raising the threatened tariff rate to 15% and announcing that existing tariffs on about $250 billion worth of Chinese goods would jump from 25% to 30% on October 1.

Although the U.S. and China agreed to resume trade talks at the G-7 summit a week before the scheduled tariffs, no progress was made in the interim. Thus, on September 1, both countries followed through with their tariff threats. As of September 3, China has filed its third suit against the U.S. with the World Trade Organization over this latest escalation.

Consumers in the cross fire

Consumer spending and sentiment will be the key tipping points for how the trade war affects the U.S. economy. Until now, consumers, who make up the backbone of the U.S. economy, have been largely shielded from the effects of the trade war, as the Trump administration has targeted intermediate goods for tariffs. The September 1 list marks the first large deviation from this trend.

To assess the composition of tariffed and threatened products, we converted the Harmonized Tariff System (HTS) product codes to the United Nations' Broad Economic Categories for three types of goods: capital, intermediate and consumption goods. These conversions are included in the full list of U.S. products with HTS and NAICS codes. We then divided each tariff wave into product lists based on good type and used the Census Bureau's USA Trade data tool to estimate the value of each list. To do this, we had to convert the eight-digit HTS codes to their broader six-digit category, so the estimates are not an exact representation of the product lists. Nevertheless, they are a good approximation of the value of goods subject to higher tariffs using the latest year of import statistics (2018).



With the September 1 tariffs, consumers will start to feel the impacts of the trade war. While consumer goods only made up about 1% of the $50 billion tariff wave and 26% of the $200 billion tariff wave, they will make up 62% of the value of the September 1 list and 40% of the value of the threatened December 15 list. Although many businesses will try to swallow some of the higher costs, consumer prices will ultimately rise due to the higher duties. Rising prices, and even the anticipation of rising prices, could significantly weaken consumer sentiment and lead to a drop-in consumption. If that happens, a downturn is almost a guarantee.

Stockpiling before, rerouting after

If the past couple of tariff waves are any indication, U.S. importers will likely respond to the tariffs in two steps. First, in the period between the tariff threat announcement and the implementation date, they will significantly increase import orders, stockpiling goods ahead of the tariff hike. Second, they will start to reroute their supply chains, sourcing products from other countries such as Vietnam and Mexico.

What is decidedly unlikely to happen is that producers will bring back factories in the U.S. In fact, it appears that the trade war has had the opposite effect. Rising costs of capital and intermediate goods have squeezed profits for manufacturers, driving the drop in the ISM's manufacturing index. Other factors are also to blame for manufacturing's current weakness, but overall, it appears the trade war is hurting, not helping, the U.S. factory sector.

View the entire version of our Tariff Tracker.

Looking ahead

The economic calendar is lighter next week. The key data include retail sales, consumer prices, University of Michigan consumer sentiment, and initial claims.

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

EUROPE

By Barbara Teixeira Araujo of Moody's Analytics

A Watch on British GDP and the ECB Meeting

Next week will bring a barrage of economic data for the euro zone and the U.K., but we expect Britain's monthly GDP for July to steal the spotlight. We anticipate a 0.2% m/m rise in output, after GDP stalled in June, though risks are tilted toward a lower reading of 0.1%. The three-month on three-month rate should have held steady, improving on a 0.2% decline in the quarter to June. Yet, we caution against reading too much into this gain of momentum. A rebound has been penciled in since the extremely weak results at the end of the second quarter, while all leading data suggest that the U.K. economy lost further pace going into August as Brexit-related uncertainty reached its peak.

Across sectors, we expect that activity rose in construction and services, but industrial production is a wild card. Surveys for U.K. manufacturing came in extremely mixed in July, but the story overall was of a sector languishing from a drop in demand from abroad and continued weakness at home. So, while we expect that output in some subsectors rebounded following one-off declines in June, our guess is that the performance of U.K. factories remained subdued overall. We thus forecast an additional 0.2% m/m in manufacturing output, which should have built on a similar decline in June. By contrast, July's temperatures climbed much above their long-term average and likely boosted demand for air conditioning and thus energy production. We caution, though, that output in the sector has risen by a cumulative 4.6% since March, which probably kept a lid on the increase. Mining and quarrying production is also expected to have increased slightly.

In U.K. construction, we are only calling for an increase because June's fall warrants some mean reversion. Building companies should continue to feel the brunt of the heightened uncertainty, as commercial and housing projects get pushed further into the future due to lack of clarity about economic prospects. This should be true for as long as Brexit is unresolved. The situation is a bit more promising for the services sector, which is the economy's largest. Consumer-facing services activities have been relatively strong over the past months and should have continued to be in July, as consumers benefitted from a still-solid labour market and higher wage growth. We are penciling in a 0.2% m/m rise in services output, following no growth in June.

In the euro zone, the highlight of the week will the European Central Bank's monetary policy meeting on Thursday. As of now, market expectations are nearly unanimous that the bank will cut the deposit rate. We foresee a cut of 10 to 20 basis points, which would bring the rate the ECB charges on excess reserves to -0.5% or -0.6%.

The rationale behind a rate cut is that, over the past year, the euro zone economy has lost significant momentum. Germany is especially worrisome. It is on the brink of recession as the global slowdown has weighed heavily on the exports that its manufacturing economy depends upon. True, other major economies such as France and Spain are holding up much better than Germany, but there is no denying that growth has slowed across the board. Adding to that, the ECB should speak to the fact that inflation has remained below target. It may need to acknowledge that expectations have come progressively unanchored.

We are expecting some measures to compliment the rate cut. We are now betting that the bank will restart its quantitative easing programme to the tune of €50 billion in bond purchases per month. Admittedly, legal and political obstacles remain for new asset purchases, but our guess is that the ECB will tweak its rules a bit. Also, our view is that the ECB will announce a tiered system for reserve remuneration to ease the pain banks feel from negative rates.

	Key indicators	Units	Moody's Analytics	Last
Mon @ 9:30 a.m.	U.K.: Monthly GDP for July	% change	0.2	0.0
Mon @ 11:00 a.m.	OECD: Composite Leading Indicators for July		99.0	99.1
Tues @ 7:45 a.m.	France: Industrial Production for July	% change	1.5	-2.3
Tues @ 9:00 a.m.	Italy: Industrial Production for July	% change	-0.3	-0.2
Tues @ 9:30 a.m.	U.K.: Unemployment for July	%	3.8	3.9
Wed @ 7:00 a.m.	Spain: Industrial Production for July	% change	0.4	-0.2
Wed @ 2:00 p.m.	Russia: Foreign Trade for July	$ bil	13.6	12.5
Thur @ 7:00 a.m.	Germany: Consumer Price Index for August	% change yr ago	1.4	1.7
Thur @ 7:45 a.m.	France: Consumer Price Index for August	% change yr ago	1.4	1.3
Thur @ 10:00 a.m.	Euro zone: Industrial Production for July	% change	0.7	-1.6
Thur @ 12:45 p.m.	Euro zone: Monetary Policy for September	%	0.0	0.0
Fri @ 8:00 a.m.	Spain: Consumer Price Index for August	% change yr ago	0.3	0.5
Fri @ 10:00 a.m.	Euro Zone: External Trade for July	bil euro	16.8	20.6

ASIA-PACIFIC

By Katrina Ell of Moody's Analytics

China's Exports Likely Up Ahead of New U.S. Tariffs

China's exports likely enjoyed a temporary lift in August ahead of further U.S. tariffs coming into effect on 1 September. Exports were up by 3.3% y/y in July, squashing expectations for a further contraction. Front-loading will likely lift exports in the fourth quarter, ahead of further tariffs on Chinese goods imports into the U.S. beginning in mid-December. As front-loading fades in early 2020, the outlook is for ongoing weakness in the export sector, as forward indicators suggest continued weakness in global demand.

The second estimate of Japan's June quarter GDP growth was likely unchanged from the preliminary estimate at 0.4% q/q. Net exports were a weak spot after unsustainable strength in the March quarter. There were visible recoveries in consumption and investment. The second quarter performance was better than expected. With the consumption tax hike scheduled for October, we expect consumption to pick up and maintain the upward trend in GDP in the September quarter, before a gradual slowdown sets in thereafter.

China's headline CPI inflation likely gathered further pace in August, from July's 2.8% y/y. Food prices are the main upward contributors. In July, food prices were up by 9.1% y/y, driven by fresh fruit prices, which increased by 39.1% y/y on account of poor domestic harvests. Pork prices were the other major contributor and remained elevated due to significant supply shortages, rising by 27% y/y in July. Core CPI growth has been steady around 1.6% y/y, a testament to the underlying weakness in domestic demand. Producer price growth likely contracted again in August, keeping pressure on local industrial profits.

	Key indicators	Units	Confidence	Risk	Moody's Analytics	Last
Mon @ Unknown	China Foreign trade for August	US$ bil	2	←	41.3	45.1
Mon @ 9:50 a.m.	Japan GDP for Q2 - second estimate	% change	3	←	0.4	0.4
Tues @ 11:30 a.m.	China Consumer price index for August	% change yr ago	3	↑	2.9	2.8
Tues @ 11:30 a.m.	China Producer price index for August	% change yr ago	3	↓	-0.2	-0.3
Tues @ Unknown	China Monetary aggregates for August	% change yr ago	3	↑	8.4	8.1
Wed @ 9:00 a.m.	South Korea Unemployment rate for August	%	4	←	4.0	4.0
Thurs @ 9:50 a.m.	Japan Machinery orders for July	% change	2	↓	-6.7	13.9
Thurs @ 10:00 p.m.	India Consumer price index for August	% change yr ago	3	←	3.1	3.2
Thurs @ 10:20 p.m.	India Industrial production for July	% change yr ago	2	↓	2.2	2.0
Fri @ Unknown	India Foreign trade for August	US$ bil	2	←	-14.2	-13.4

The Long View

For January-August 2019, US$-denominated corporate bond offerings dipped by 2% annually for investment-grade, but advanced by 20% for high-yield.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group
September 5, 2019

CREDIT SPREADS

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

The recent high-yield bond spread of 466 bp is thinner than what is suggested by both the accompanying long-term Baa industrial company bond yield spread of 202 bp and the recent VIX of 17.3 points.

DEFAULTS

July 2019's U.S. high-yield default rate was 3.0%. The high-yield default rate may average 3.2% during 2020's first quarter, according to Moody's Investors Service.

US CORPORATE BOND ISSUANCE

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

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

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

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

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

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

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

For 2018, worldwide corporate bond offerings sank by 7.2% annually (to $2.322 trillion) for IG and plummeted by 37.6% for high yield (to $376 billion). The projected annual percent increases for 2019's worldwide corporate bond offerings are 2.2% for IG and 21.2% for high yield. When stated in U.S. dollars, issuers based outside the U.S. supplied 60% of the investment-grade and 57% of the high-yield bond offerings of 2019's first half.

US ECONOMIC OUTLOOK

As inferred from the CME Group's Fed Watch Tool, the futures market recently assigned an implied probability of 96% 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 2.00% for long. A fundamentally excessive climb by Treasury bond yields and a pronounced slowing by expenditures in dynamic emerging market countries are among the biggest threats to the adequacy of economic growth and credit spreads.

EUROPE

By Barbara Teixeira Araujo of Moody's Analytics
September 5, 2019

UNITED KINGDOM

Brexit will be postponed, again.

Sterling bounced back on Thursday from its slump earlier in the week, hitting a five-week high against the dollar and a one-month high against the euro as opposition and rebel Tory lawmakers managed to pass legislation on Wednesday night that would prevent a no-deal Brexit from happening on October 31. The legislation, known as the Benn bill, still needs to be approved by the House of Lords and receive royal assent before it becomes law, but all points to the process being finalized by Monday night.

Given that several ministers have confirmed the government will comply with the Benn bill if it becomes law—calming fears that Prime Minister Boris Johnson might ignore it and press on with a no-deal Brexit anyway—our view is that the chances of a cliff-edge Brexit by Halloween have lessened significantly. Since there has been no breakthrough with talks with the EU, our baseline is that Brexit will be postponed until at least January 31, and that general elections will be held between now and then. We have long claimed that the U.K. would face elections before the final decision on Brexit was made.

The Conservatives are leading the polls, which means that Britain could still crash out of the EU with no agreement in place if they run and win on a no-deal Brexit platform. It remains to be seen how Labour will frame its stance; all evidence suggests they would run on a platform of putting the vote back to the people, which raises the odds of Brexit being reversed. In any case, neither Labour nor the Tories seem likely to win a majority, meaning that they would need to rely on alliances with smaller parties. Parliamentary arithmetic's suggest that a Labour-led coalition has the greatest chance of success, as support for the Remain parties exceeds that for the Leave ones.

Amid all the Brexit chaos, U.K. Chancellor Sajid Javid on Wednesday announced his spending plans for fiscal 2020-2021. Markets welcomed the move. They saw it as a formal end to several years of austerity. Day-to-day departmental spending is expected to rise by as much as £13.4 billion next year. That is 4.1% in real terms, the first increase since 2007 and the biggest since 2004. No departmental budget is set to fall next year, though some will remain frozen in real terms.

This increase amounts to around 0.6% of GDP, meaning that the chancellor would still meet the Conservative's fiscal rules for keeping the cyclically adjusted deficit below 2% in 2020-2021. That's because the Office for Budget Responsibility's spring forecasts were for the deficit to amount to 1.4% in fiscal 2020-2021. We caution nonetheless that the OBR's forecasts are based on growth forecasts that are too optimistic. The momentum in the U.K. economy has fallen much below expectations since April, which means that the autumn forecasts for the deficit in percentage of GDP are likely to be raised even excluding the chancellor's new spending plans.

Plans for up to £20 billion of tax cuts alongside expected increases in capital spending only complicate matters further for the chancellor. But we don't think he is sweating much about it, as he indicated Wednesday that he plans to soon review the government's current fiscal framework. In addition to the 2% golden rule, the Conservative's other main fiscal rules are for debt to GDP to fall by 2020-2021, and for the budget to be balanced

by 2025. We have long advocated that this government would be much less strict on the fiscal front and that fiscal policy would support growth next year. So, this announcement didn't strike us as a surprise and doesn't now change our GDP forecasts.

All in, our view remains that Wednesday's spending review was an open effort to shore up support for the government ahead of potential elections next month or in November. Given that the spending changes don't kick in until next April, chances are that they could be changed or cancelled altogether by a new government, and a new budget, later this year.

ASIA PACIFIC

By Katrina Ell of Moody's Analytics
September 5, 2019

AUSTRALIA

Australia's GDP growth hit its slowest pace since 2009 in the June quarter, with a 1.4% y/y expansion, down from the downwardly revised 1.7% in the March quarter. The strength over the second quarter primarily came from exports and mining. On a production basis, mining was up by 3.4% q/q, with coal and liquefied natural gas particular strengths. LNG capacity coming on line increased, while iron ore production volumes recovered after weather disruptions over the March quarter. This lifted mining profits up by 10.6% over the quarter.

Household consumption was unsurprisingly subdued, with a mediocre 0.2-percentage point contribution to GDP growth over the quarter. Household consumption likely will enjoy a boost in the September quarter, a consequence of the government's income tax cuts taking effect broadly from early July. But given consumers' underlying caution, a decent chunk is expected to have been saved, dampening the broader economic lift. We expect the household saving ratio to rise in the September quarter, after dipping in the June quarter to 2.3%, from 3% in the March quarter.

A rebound in household consumption will remain elusive, given the outlook is for income growth to remain subdued in coming quarters. The close causal relationship between wage growth and consumption cannot be ignored. Consumers' somber mood was demonstrated with new car sales down by 10.1% y/y in August, according to the Federal Chamber of Automotive Industries. New car sales tend to be a decent barometer of discretionary consumer demand. The expected ongoing but gradual improvement in the Sydney and Melbourne housing markets will, however, be a continuing support as the negative wealth effects fade.

A focus on the budget surplus

The extent to which the household sector improves will guide how the broader economy performs and how aggressive the Reserve Bank of Australia needs to be with lowering the cash rate, as the government has made it clear that materially more expansionary fiscal policy is off the cards given the preoccupation with the budget surplus.

We forecast the next 25-basis point reduction to occur in October. If the RBA delivers another 50 basis points worth of rate cuts as the market suggests, it could trigger a pickup in the Sydney and Melbourne housing markets more aggressive than policymakers feel comfortable with. This is because it would likely lead to further household leveraging, a problem given that households haven't deleveraged at an aggregate level. As a result, we would expect that the recently eased macroprudential policies regarding lending standards would be reintroduced in some form to curtail activity.

On an annual basis, GDP growth is likely to improve from the September quarter. Low base effects rather than the guarantee of improved economic conditions will be the fundamental driver. This should see full-year GDP growth improve to 2% in 2019, still the weakest pace in a decade.

Ratings Round-Up

One Upgrade, One Downgrade Among U.S. Energy Firms

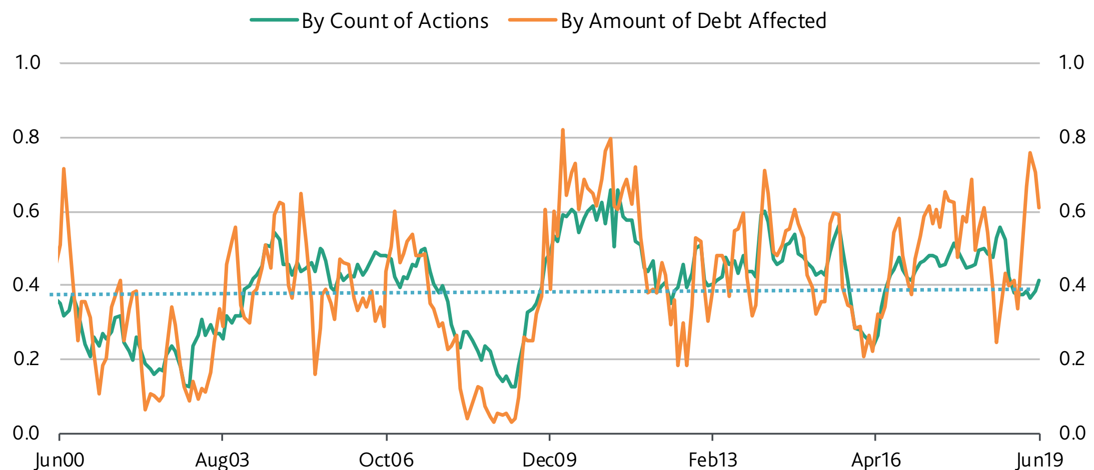
By Michael Ferlez

U.S. rating change activity was comparatively light, with only three changes in the latest week. Two were downgrades and one an upgrade. Downgrades accounted for over 70% of affected debt. Last week's sole upgrade was made to Endeavor Energy Resources L.P. The U.S. energy firm saw its senior unsecured credit rating upgraded to B1 from B2, affecting $1 billion in debt. The upgrade reflected the firm's strong financial leverage and cash flow metrics as well as sizeable holdings of productive areas in the Midland Basin. On the flip side, U.S. oil servicing firm Oceaneering International Inc. saw its senior unsecured rating cut to Ba2 from Ba1. The downgrade affected $800 million in debt. The last, and most notable, rating change was to United States Steel Corp. Moody's Investors Service downgraded U.S. Steels' senior unsecured credit rating to B3 from B2. The downgrade reflected several factors, including the expected weakening in debt protection and softening demand in key end markets, among others. The downgrade affected $1.8 billion in debt. Although downgrades have been consistently outnumbering upgrades for over a year, rating change activity has yet to raise any red flags for the broader U.S. economy.

European rating change activity was similarly light, with only two changes, both upgrades. The most notable change was to Avast Holding B.V. The Dutch software company saw its corporate family rating and senior secured credit rating lifted to Ba2 from Ba3. The Moody's Investors Service upgrade reflected Avast's strong performance over the past year as well as its decision to voluntarily reduce debt. The other upgrade for the week was made to Unipol Banca S.P.A. Moody's Investors Service affirmed the Italian bank's senior unsecured rating at Ba3 and upgraded its long-term deposit rating to Baa3 from Ba1.

FIGURE 1

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



* Trailing 3-month average

Source: Moody's

Ratings Round-Up

FIGURE 2

Rating Key

Code	Description	Code	Description
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
8/29/19	OCEANEERING INTERNATIONAL, INC.	Industrial	SrUnsec/BCF /LTCFR/PDR	800	D	Ba1	Ba2	SG
8/29/19	ENDEAVOR ENERGY RESOURCES, L.P.	Industrial	SrUnsec /LTCFR/PDR	1,000	U	B2	B1	SG
9/3/19	UNITED STATES STEEL CORPORATION	Industrial	SrUnsec /LTCFR/PDR	1,750	D	B2	B3	SG

Source: Moody's

FIGURE 4

Rating Changes: Corporate & Financial Institutions – Europe

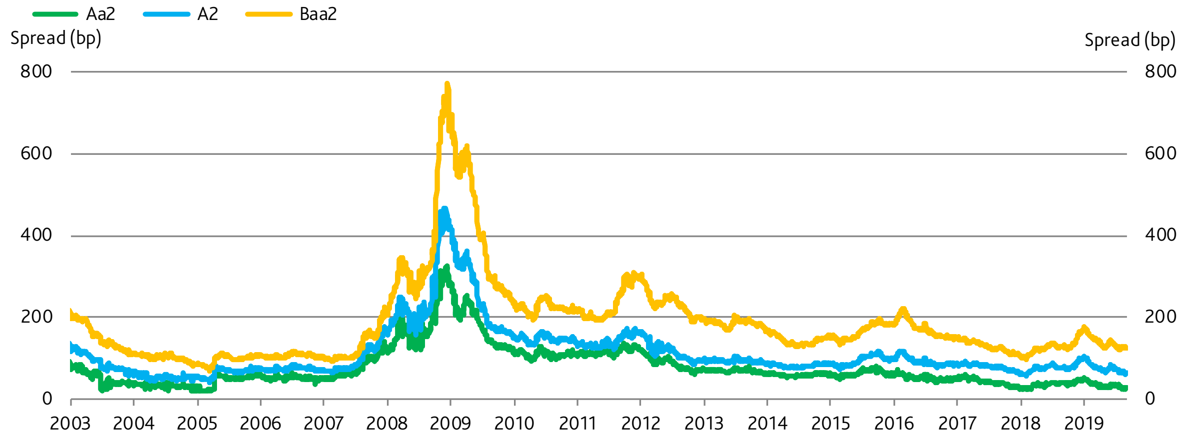
Date	Company	Sector	Rating	Up/ Down	Old LTD Rating	New LTD Rating	Old STD Rating	New STD Rating	IG/ SG	Country
8/30/19	BPER BANCA S.P.A.-UNIPOL BANCA S.P.A.	Financial	STD/LTD	U	Ba1	Baa3	NP	P-3	SG	ITALY
9/2/19	AVAST HOLDING B.V.	Industrial	SrSec/BCF /LTCFR/PDR	U	Ba3	Ba2			SG	NETHERLANDS

Source: Moody's

Market Data

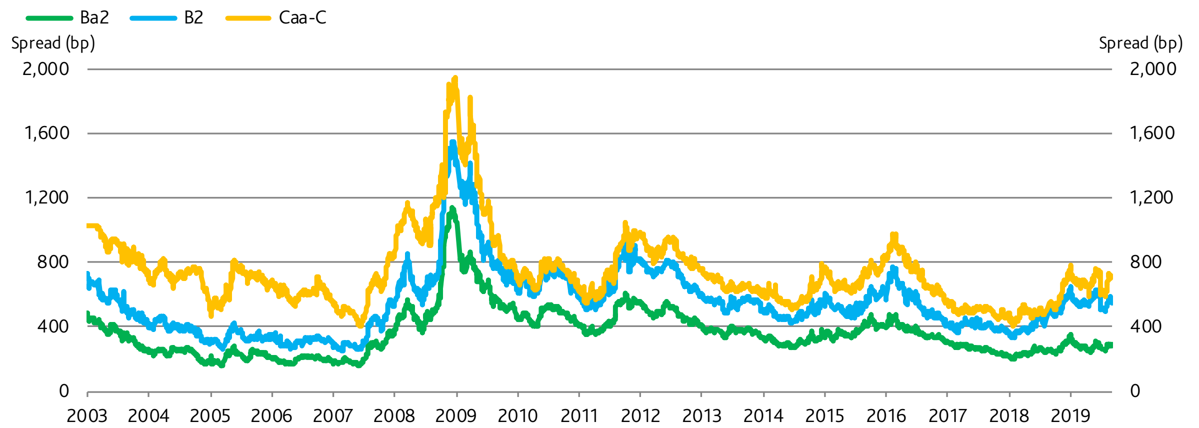
Spreads

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



Source: Moody's

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



Source: Moody's

Market Data

CDS Movers

Figure 3. CDS Movers - US (August 28, 2019 – September 4, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Sep. 4	Aug. 28	Senior Ratings
JPMorgan Chase & Co.	A1	A2	A2
JPMorgan Chase Bank, N.A.	Aa3	A1	Aa2
Morgan Stanley	Baa1	Baa2	A3
Ally Financial Inc.	Baa3	Ba1	Ba2
Citibank, N.A.	Baa2	Baa3	Aa3
General Electric Company	Ba2	Ba3	Baa1
General Motors Company	Ba1	Ba2	Baa3
Bank of America, N.A.	A1	A2	Aa2
Nissan Motor Acceptance Corporation	Baa3	Ba1	A3
Conagra Brands, Inc.	Baa2	Baa3	Baa3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Sep. 4	Aug. 28	Senior Ratings
PepsiCo, Inc.	A2	A1	A1
HCA Inc.	Ba1	Baa3	Ba2
Philip Morris International Inc.	Baa2	Baa1	A2
Chevron Corporation	A2	A1	Aa2
CenturyLink, Inc.	B3	B2	B2
Charles Schwab Corporation (The)	A3	A2	A2
Sempra Energy	A1	Aa3	Baa1
Welltower Inc.	Ba1	Baa3	Baa1
Archer-Daniels-Midland Company	Baa3	Baa2	A2
ERAC USA Finance LLC	Baa3	Baa2	Baa1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Sep. 4	Aug. 28	Spread Diff
Neiman Marcus Group LTD LLC	Ca	5,383	4,727	656
Realogy Group LLC	B3	1,004	792	212
Dean Foods Company	Caa3	3,819	3,662	157
Frontier Communications Corporation	Caa3	5,314	5,178	136
Navistar International Corp.	B3	348	317	31
Chesapeake Energy Corporation	B2	1,253	1,233	20
Owens Corning	Ba1	119	104	15
Cablevision Systems Corporation	B3	337	323	14
Univision Communications Inc.	Caa2	349	336	13
Embarq Corporation	Ba2	299	286	13

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Sep. 4	Aug. 28	Spread Diff
Penney (J.C.) Corporation, Inc.	Caa3	3,744	4,483	-740
R.R. Donnelley & Sons Company	B3	620	691	-71
Dell Inc.	Ba2	181	242	-61
Rite Aid Corporation	Caa2	1,955	1,996	-41
K. Hovnanian Enterprises, Inc.	Caa3	1,885	1,921	-36
AutoNation, Inc.	Baa3	428	456	-28
Avis Budget Car Rental, LLC	B1	246	274	-27
Pitney Bowes Inc.	Ba2	547	572	-25
L Brands, Inc.	Ba1	320	345	-24
Dish DBS Corporation	B1	474	497	-23

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (August 28, 2019 – September 4, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Sep. 4	Aug. 28	Senior Ratings
Italy, Government of	Ba2	Ba3	Baa3
Intesa Sanpaolo S.p.A.	Baa3	Ba1	Baa1
UniCredit S.p.A.	Baa3	Ba1	Baa1
UniCredit Bank Austria AG	A3	Baa1	Baa1
UniCredit Bank AG	Baa1	Baa2	A2
Unione di Banche Italiane S.p.A.	Ba2	Ba3	Baa3
Eni S.p.A.	A1	A2	Baa1
Danone	Aaa	Aa1	Baa1
Autoroutes du Sud de la France (ASF)	Aa1	Aa2	A3
Ardagh Packaging Finance plc	Ba3	B1	B3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Sep. 4	Aug. 28	Senior Ratings
Spain, Government of	A2	A1	Baa1
Deutsche Bank AG	Baa3	Baa2	A3
Lloyds Bank plc	A3	A2	Aa3
Barclays PLC	Ba1	Baa3	Baa3
Portugal, Government of	A2	A1	Baa3
ING Bank N.V.	Aa1	Aaa	Aa3
Credit Agricole S.A.	Aa2	Aa1	A1
The Royal Bank of Scotland Group plc	Ba1	Baa3	Baa2
Banque Federative du Credit Mutuel	A1	Aa3	Aa3
Credit Agricole Corporate and Investment Bank	Aa2	Aa1	A1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Sep. 4	Aug. 28	Spread Diff
PizzaExpress Financing 1 plc	Caa2	7,035	6,333	702
Barclays PLC	Baa3	97	89	8
NatWest Markets Plc	Baa2	85	77	8
The Royal Bank of Scotland Group plc	Baa2	98	90	8
Bankinter, S.A.	Baa1	60	52	8
Banco Comercial Portugues, S.A.	Ba1	156	149	7
Casino Guichard-Perrachon SA	B1	801	794	7
Atlantia S.p.A.	Baa3	124	117	7
Sappi Papier Holding GmbH	Ba1	319	312	7
Bankia, S.A.	Baa3	76	70	6

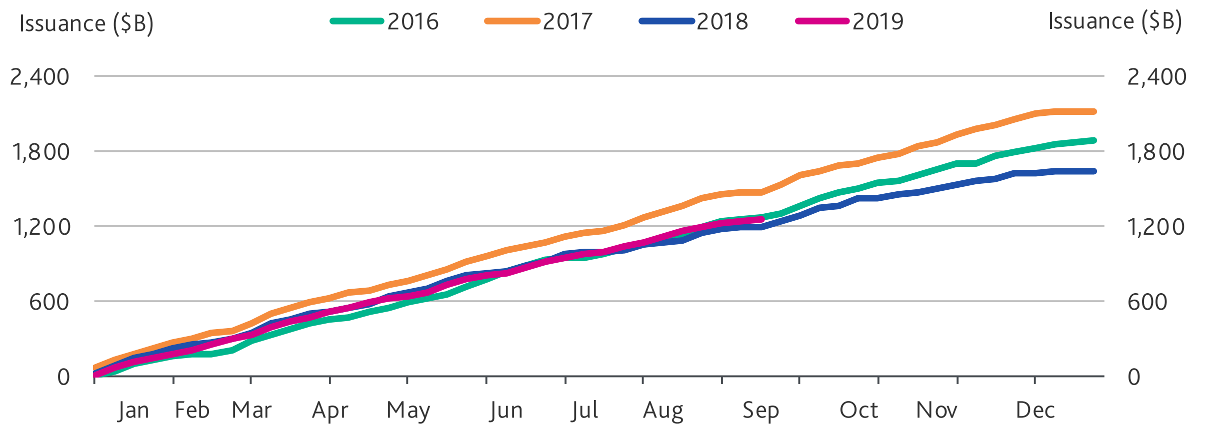
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Sep. 4	Aug. 28	Spread Diff
Boparan Finance plc	Caa1	2,855	3,467	-612
CMA CGM S.A.	B3	1,298	1,386	-88
Stena AB	B3	560	594	-33
Eksportfinans ASA	Baa1	496	525	-29
Altice Finco S.A.	Caa1	276	304	-28
Matalan Finance plc	Caa1	881	904	-23
Italy, Government of	Baa3	142	163	-22
Novafives S.A.S.	Caa1	507	527	-20
Eurobank Ergasias S.A.	Caa1	766	784	-18
Unione di Banche Italiane S.p.A.	Baa3	138	155	-17

Source: Moody's, CMA

Market Data

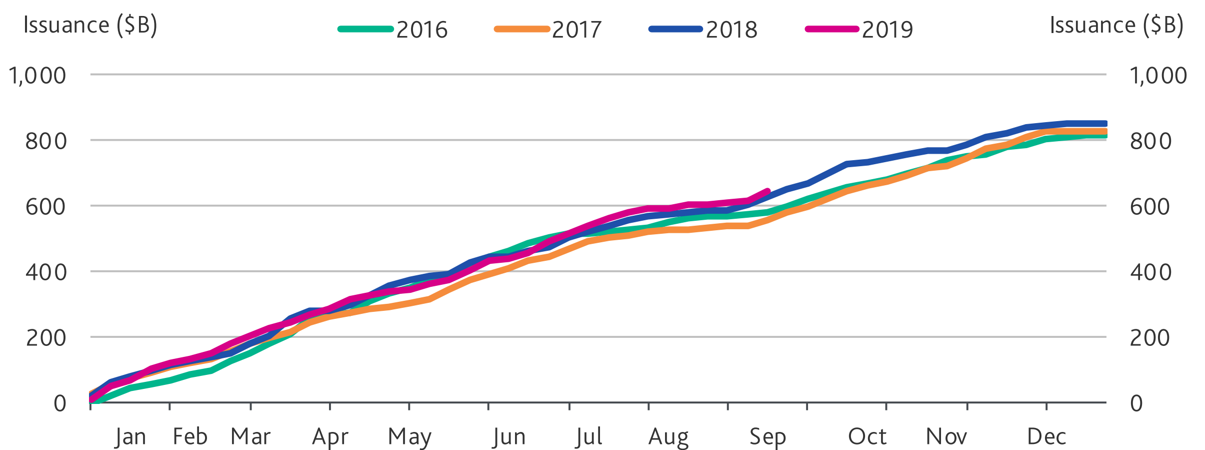
Issuance

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	4.700	1.105	5.980
Year-to-Date	905.830	278.475	1,249.698

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	20.755	0.000	29.198
Year-to-Date	557.694	58.594	642.728

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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