MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

Fed Rate Cuts May Fall Short of Stabilizing Markets

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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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: January-February 2020's high-yield bond offerings from U.S. companies soared higher by 98% year-over-year.

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Credit Spreads	Investment Grade: We see the year-end 2020's average investment grade bond spread above its recent 121 basis points. High Yield: Compared with a recent 468 bp, the high-yield spread may approximate 550 bp by year-end 2020.
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 January 2020's actual 4.2% to a baseline estimate of 3.8% for January 2021.
Issuance	For 2019's offerings of US$-denominated corporate bonds, IG bond issuance rose by 2.6% to $1.309 trillion, while high-yield bond issuance surged by 55.8% to $432 billion. In 2020, US$-denominated corporate bond issuance is expected to rise by 2.8% for IG to $1.346 trillion, while high-yield supply may grow by 7.6% to $465 billion.

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Moody's Capital Markets Research *recent publications*

Links to commentaries on: Optimism, coronavirus, corporate credit, thin spreads, leverage, rate sensitivity, sentiment, VIX, fundamentals, next recession, liquidity and defaults, cheap money, fallen angels, Fed moves, yields, inversions, unmasking danger, divining markets.

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Credit Markets Review and Outlook

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

Fed Rate Cuts May Fall Short of Stabilizing Markets

Markets are trying to "price-in" an event for which there is no readily known precedent. Volatility will rule until COVID-19-related risks reverse course.

Since COVID-19 first pressured U.S. equities following January 17's close, the market value of U.S. common stock as measured by the old Wilshire Index has plunged by 9.3%, or by an estimated $3.2 trillion. Among the indices that have fared worse than the overall market since January 17 are the deeper setbacks of 14.5% for the Dow Jones Transportation Average, 14.1% for the KBW bank stock price index, 11.7% for the PHLX semiconductor share price index and 10.3% for the Russell 2000 stock price index for small- to mid-sized companies. Among the indices that have fared better than the overall market since January 17 are the shallower declines of 7.7% for the NASDAQ, 7.0% for the PHLX index of housing-sector share prices, and 3.5% for the Dow Jones Utility Average.

Nevertheless, even with the latest drop, the market value of U.S. common equity needs to sink by another 22% if it is to return to its now 34-month low of December 24, 2018.

The dive by share prices revealed a flight from risk that explains a deep drop by Treasury yields. From January 17 to February 27, the five-year Treasury yield sank from 1.62% to 1.09%, the 10-year Treasury yield plunged from 1.82% to 1.28%, and the 30-year Treasury yield fell from 2.28% to 1.78%.

The now deep discounts of the five- and 10-year Treasury yields to the 1.63% midpoint for the overnight federal funds rate reflect an increase in perceived recession risks that may soon be reversed by a series of Fed rate cuts. As inferred from the CME Group's FedWatch Tool, the futures market recently assigned an implied probability of 59% to a March 18 rate cut, which was up considerably from February 20's 9% implied probability. Regarding the Federal Open Market Committee's April 29 meeting, the recent implied probabilities are 88% for a less-than-1.63% fed funds midpoint and 42% for a less-than-1.38% midpoint. For the FOMC's June 10 meeting, the implied likelihood of a less-than-1.38% fed funds midpoint jumps up to 68%.

Federal Reserve policymakers must now deal with unprecedented risks. By themselves, Fed rate cuts will not remedy the COVID-19 virus.

What the Fed can do is help to facilitate access to financial capital for those households, businesses and local governments that incur cash flow problems owing to the virus. The Fed will attempt to prevent a highly communicable virus from sparking a ruinous bout of financial contagion.

Lower Yields Spur Homebuying, but Core Business Sales Still Struggle

Lower Treasury bond yields have supplied a lift to home sales. January's seasonally-adjusted pace for new home sales soared by 7.9% monthly and by 18.6% year-over-year to an annualized pace of 764,000 units, which was the liveliest month since the 778,000 units of July 2007. Also, January's index of pending sales of existing homes jumped by 5.2% from the prior month and advanced by 6.7% from January 2019 (where the latter increase was prior to seasonal adjustment).

However, recent data suggest that the year-over-year increase of core business sales slowed from the 1.2% of 2019's final quarter to 0.9% for January 2020. Of course, the strains of COVID-19 will add to the difficulty of simply maintaining fourth-quarter 2019's lackluster pace.

Lowest Long-Term Single-A and Baa Yields since Early- to Mid-1950s

The latest dive by benchmark Treasury yields should promote the refinancing of outstanding investment-grade corporate debt. The lengthening of debt maturities at lower interest rates is constructive for corporate credit quality. To the degree that maturities are longer and interest expense is lower, higher aggregate ratios of corporate debt to various measures of corporate earnings may be overstating any loss of credit quality to the leveraging-up of corporate balance sheets.

Though the spreads over the 30-year Treasury for Moody's Analytics' long-term industrial company bond yields widened from January 17's 102 basis points for single-A and 171 bp for Baa to February 26's 114 bp for single-A and 192 bp for Baa, the yields declined from 3.30% to 2.96% for single-A and from 3.99% to 3.74% for Baa. The single-A industrial yield is now the lowest since 1953 and the Baa industrial yield is among the lowest since 1956.

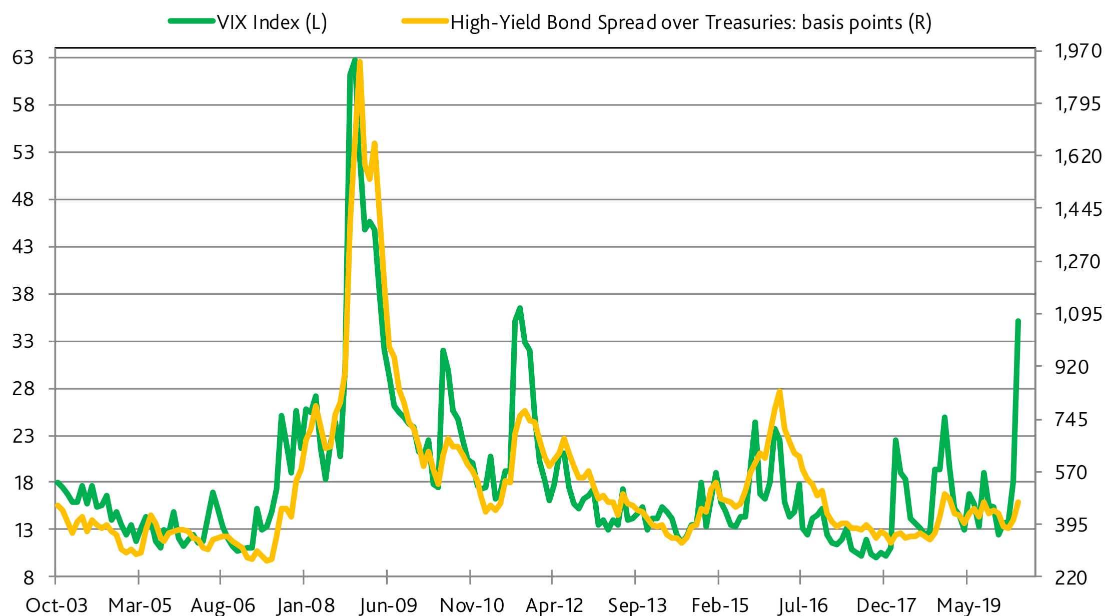
VIX Warns of Wider than 750 bp High-Yield Bond Spread

COVID-19 risks have weighed more heavily on the high-yield corporate bond market compared to investment-grade. Not only has a composite high-yield bond spread widened from January 17's 362 bp to February 26's 468 bp, but the underlying composite speculative-grade bond yield has soared from 5.26% to 5.85%, respectively. Still, the latter was less than its 6.20% average of calendar-year 2019.

The current widening of the high-yield bond spread falls considerably short of what is suggested by the lift-off of equity market volatility. The VIX has soared from a January 17 close of 12.1 points to February 27's 35.2 points. The latter topped each close for the VIX since the 36.1 points of December 24, 2018, or when the market value of U.S. common stock formed its last major bottom and a composite high-yield bond spread equaled 558 bp.

By contrast, February 26's high-yield bond spread of 468 bp was atypically thin given the accompanying VIX of 27.6 points. As derived from a sample that begins in October 2003, a high-yield bond spread of 468 bp is slightly above its 447 bp median, while a VIX of 27.6 points is far above its 15.7-point median. More specifically, a VIX of 27.6 points is in the sample's top decile, while the thinnest width of the high-yield bond spread's top decile is 775 bp.

Figure 1: High-Yield Bond Spread Has Yet to Mimic Latest Lift-Off by the VIX
sources: CBOE, Moody's Analytics



As statistically inferred from the historical record, a VIX of 27.6 points has been associated with a 720 bp midpoint for the high-yield bond spread, while a VIX of 35.2 points has been linked to a high-yield spread of nearly 1,000 bp.

High-Yield Spread Has Defied Elevated VIX Four Times During Current Upturn

Nevertheless, the high-yield spread does not always widen in response to a substantially higher VIX. For example, despite how the VIX jumped sharply vis-a-vis the high-yield spread during (i) October 2018-December 2018, (ii) February 2018–April 2018, (iii) August 2011–November 2011, and (iv) May 2010-June 2010, the high-yield spread did not swell appreciably and the VIX would sink shortly thereafter.

Figure 2: Four Episodes of Current Economic Recovery Where High-Yield Spread Predicted by VIX was More than 175 bp Above Actual Spread

Episode	Average VIX	Average High-Yield Bond Spread Predicted by VIX	Actual Average High-Yield Bond Spread	Average % Change by Market Value of Common Stock 12 Months Later	Average High-Yield Bond Spread 12 Months Later
	points	*basis points*	*basis points*	*%*	*basis points*
	1	*2*	*3*	*4*	*5*
May 2010-June 2010	30.9	889	655	20.1%	500
August 2011–November 2011	34.1	979	742	17.6%	565
February 2018–April 2018	19.9	578	359	5.1%	419
October 2018-December 2018	21.2	615	428	13.8%	419

Twelve months following the four episodes of a very high VIX and a much lower than expected high-yield bond spread, the market value of U.S. common stock climbed higher by 14%, on average, and the high-yield bond spread showed an average year-to-year decline of 72 bp. Still, there is no assurance that the high-yield bond spread will continue to show only a muted response to a VIX that exceeds more than 90% of its earlier readings.

Prior to the current business cycle upturn, August-September 2007 was the only stretch where the high-yield spread was much thinner than the spread predicted by a relatively high VIX. And unlike the four episodes of the current recovery, the high-yield spread ballooned from its 448 bp average of August-September 2007 to the 850 bp of August-September 2008, while the market value of U.S. common stock averaged a year-over-year plunge of 14.0% for August-September 2008.

August-September 2007's high-yield bond market may have failed to price in the risks recognized by the equity market because of how the start of the Great Recession was mostly the consequence of a collapse by household credit quality, as opposed to being primarily the offshoot of a deterioration of corporate credit quality. Had there been no home mortgage crisis, the high-yield default rate would not have skyrocketed from December 2007's now 38-year low of 1.0% to November 2009's post Great Depression high of 14.7%. Could it be that today's high-yield bond market has yet to fully price in the risks stemming from a possibly unprecedented threat to public health?

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

THE U.S.

By Ryan Sweet of Moody's Analytics

The Federal Reserve May Need to Step in

COVID-19 poses downside risk to the U.S. economy, and though there are limits to monetary policy, the Federal Reserve may need eventually to step in. An emergency rate cut is unlikely, as these are rare. The most likely outcome is that the Fed continues to wait and see how financial market conditions fare and whether the coronavirus is having significant direct or indirect impacts on the U.S. economy.

However, we are not ruling out that the Fed could act. Investor sentiment needs a boost, and normally investors turn to the Fed, anticipating a "Powell put." The term "Powell put" isn't as ubiquitous as either the Yellen, Bernanke or Greenspan puts. The idea of a Fed put garnered attention in the 1980s and 1990s under former Fed Chairman Alan Greenspan.

Setting a floor

Derived from the concept of a put option, these terms refer to central bank policies that effectively set a floor for equity valuations. Fed Chairman Jerome Powell seems less sensitive to stock prices than some former chairs, but he recognizes that a substantial decline in equity markets could alter the outlook for the U.S. economy. So, a Powell put exists, but equity prices likely have not fallen enough to trigger it. The Fed likely viewed the stock market as being a little frothy—we agree.

We constructed several valuation metrics and compared them with actual stock prices. Each metric is constructed as the fitted values from a linear regression of stock prices on a proxy of fundamental value, including GDP, corporate earnings, and discounted free cash flow, measures that capture earnings and interest rates. All these metrics showed that the stock market was overvalued.

While the selloff in the stock market may not worry the Fed, credit markets could. The Fed can stop credit markets from freezing up; and that is one way to protect the economy. The Fed's objective would be to prevent a supply-side shock, like coronavirus, from spilling over into the demand side of the economy. We are watching high-yield corporate bond spreads, which are widening, but it will have to continue before it sounds alarms at the Fed.

Odds on the FOMC

We will be revisiting our subjective odds of a rate cut for the rest of this year's Federal Open Market Committee meetings. While monetary policy has its limits and cannot cure the coronavirus, the Fed is not powerless.

If financial market conditions continue to tighten, odds of a rate cut will increase. The Fed has shown that it will respond more quickly to an inversion in the yield curve, and a rate cut could help bolster investor sentiment. It may not cure all that troubles in financial markets, but it could help. Still, we believe the key is not equity but rather credit markets. Making sure credit markets don't freeze is critical.

The impact of the coronavirus on U.S. GDP will be less than in China. The hit to the U.S. economy will come via reduced US goods exports to China, less spending in the U.S. by Chinese tourists, and a drop in domestic production because of supply chain disruptions. We expect this drag on the U.S. economy to be 0.45 percentage point on first-quarter GDP growth, but this is likely a little optimistic, particularly given the supply chain impact and evidence the virus has spread beyond China.

The U.S. economy will experience growth of only 1.3% in the first quarter (annualized), down by 0.6 percentage point because of the virus. Growth in 2020 is now expected to be 1.7%, down 0.2 percentage point. The U.S. economy's potential growth is estimated at near 2%.

Our previous assumption that the virus will be contained to China proved optimistic, and the odds of a pandemic are rising. We previously put the odds of a pandemic at 20% (see our Alternative Scenario), but we now put them at 40%. A pandemic will result in global and U.S. recessions during the first half of this year. The economy was already fragile before the outbreak and vulnerable to anything that did not stick to script. COVID-19 is way off script.

COVID-19 came out of nowhere. It may be what economists call a black swan—a rare and inherently unforeseeable event with severe consequences.

Next week

In a flurry of reports we will get a look at February employment from ADP, Challenger, and on Friday the Labor Department surveys. There will also be releases on January construction spending, the CoreLogic home price index, February vehicle sales and the ISM manufacturing and nonmanufacturing indexs for February.

EUROPE

By Barbara Teixeira Araujo of Moody's Analytics

Stagnation Expected on German GDP

Next week will mark the start of trade talks between the U.K. and the EU. Both parties aim to negotiate and ratify a free trade agreement by the end of the transition period, December 31. Not only does this timeline looks fanciful—FTAs normally take years, not months, to be negotiated—but it looks like talks are dead in the water before they even begin. Both sides have substantially toughened up their rhetoric over the course of the past week, and the U.K. even threatened to walk out of negotiations in June if not enough progress is achieved by then.

The sticking point will be what is commonly known as the "level playing field". In order to avoid product dumping, the EU is asking the U.K. to remain aligned with its rules and regulations in return for access to the common market of goods. Indeed, in its recently-published mandate for negotiations, the EU has asserted that the U.K. needs to uphold EU requirements in the areas of state aid, competition, state-owned enterprises, social and employment standards, environmental standards, climate change and relevant tax matters. The problem here is that Prime Minister Boris Johnson is adamant that the U.K. won't be bound by EU regulations after the end of the transition period. He therefore insists he will not commit to any regulatory alignment. In its negotiating mandate, the U.K. asks for a comprehensive trade agreement supplemented by other agreements including fisheries, enforcement, transport and energy. In practice, the U.K. government is aiming for a rather thin, barebones FTA with a series of side deals to cover remaining issues.

Our baseline remains that the U.K. and the EU will extend the transition period, since they won't manage to reach any common ground by the end of the year, and that the final deal will be more comprehensive than the one the U.K. is aiming for now—including tariff-free trade on goods and several deals for the services sector. But our "Barebones deal" scenario is looking increasingly likely—it corresponds exactly to what the U.K. is asking for, which is a rather thin deal negotiated by year-end, with remaining issues to be separately discussed over 2021. A third possibility is that there is no deal by the end of the year, and that the U.K. and the EU default to trading under World Trade Organization rules as of January 1, 2021. This is the worst-case scenario from an economic point of view. It would result in barriers to trade and severe disruptions to supply chains. As of now, we estimate that the

chances of a no-deal by year-end are at around 20%. But, if brinkmanship continues, those odds are likely to rise soon.

Also next week, we will get a barrage of economic reports for the euro zone. In the spotlight will be the final PMIs for February, which should confirm that sentiment remained elevated at the middle of the quarter despite the surge in COVID-19-related virus fears. We caution nonetheless that the PMI reports do not cover the period following the spike in coronavirus cases and deaths in Italy. Our view is that March's numbers will be much worse, especially as anecdotal evidence points to an increase in supply-chain disruptions over the month. All in, we continue to expect that euro zone GDP will flatline in the first quarter, as Italy enters technical recession (virus containment measures put in place in the country will result in a significant loss in output) and Germany's economy stalls. Some upside should come from France, but we caution that any rebound there will be limited by the fact that December's strikes and protests carried into 2020.

On the bright side, we expect that the coronavirus-related disruptions and hit to growth will be contained to the first half of the year. Our full-year outlook is for continued growth in the euro zone, as consumers fundamentals remain strong and the manufacturing industry's downturn is bottoming out. Indeed, we expect unemployment figures to be released next week will show that euro zone's joblessness remained steady at a low 7.4% in January, which should continue to support wage growth and purchasing power in coming months. Retail sales figures for January should add to this picture; we expect that retail sales rose sharply at the start of the year across most of the currency area's economies, reversing most of the weakness recorded for the end of 2019.

	Key indicators	Units	Moody's Analytics	Last
Tues @ 9:00 a.m.	Italy: Unemployment for January	% change	9.9	9.8
Tues @ 10:00 a.m.	Euro Zone: Preliminary Consumer Price Index for February	% change	1.4	1.4
Tues @ 10:00 a.m.	Euro Zone: Unemployment for January	%	7.4	7.4
Wed @ 8:00 a.m.	Germany: Retail Sales for January	% change	1.8	-3.3
Wed @ 9:00 p.m.	Italy: GDP for Q4	% change	-0.3	0.1
Wed @ 11:00 a.m.	Euro Zone: Retail Sales for January	% change	1.2	-1.6
Fri @ 9:00 a.m.	Spain: Industrial Production for January	% change	0.8	-1.4
Fri @ 9:00 a.m.	Italy: Retail Sales for January	% change	-0.1	0.5
Fri @ 2:00 p.m.	Russia: Consumer Price Index for February	% change yr ago	3.2	2.4

ASIA-PACIFIC

By Katrina Ell of Moody's Analytics

South Korean Trade Data Will Show Effects of Coronavirus

A suite of data will be released that begin to show insights into the economic toll that the coronavirus is causing. South Korea's foreign trade data for February will be closely watched. The preliminary trade data, covering exports and imports for the first 20 days of February, showed a 3.7% y/y slump in shipments to China. But there were some bright spots. In particular, exports to the U.S. and Vietnam rose by 24% and 20% y/y, respectively, as South Korea benefited early in the month from some substitution away from China, with memory chips and car components key beneficiaries. South Korea's average exports per working day fell by 9.3%, following the average 3.2% fall in the first 10 days of February, a clear sign of the disruption to supply chains and demand that the virus is causing. With the number of confirmed cases of COVID-19 in South Korea jumping in the past week, the disruption to South Korea's economy and important export and manufacturing industries will keep rising until containment occurs.

Japan's consumer sentiment data for February will also be released. Sentiment was resilient in January and had improved after the 1 October consumption tax hike. But with the number of confirmed COVID-19 cases continuing to rise globally and with Japan a relatively large recipient, household sentiment will have retreated meaningfully in February.

Australia's December quarter GDP growth likely hit 0.4% q/q, unchanged from the September quarter's pace. Preliminary data show that construction and dwelling investment was a drag over the quarter. Exports are expected to have improved, while household consumption likely added around 0.25 percentage point. The bush fires, which accelerated from November, hurt household consumption and tourism during the peak season and this drag continued into the March quarter, with the unprecedented and sustained air pollution impacting the metropolitan areas.

	Key indicators	Units	Confidence	Risk	Moody's Analytics	Last
Mon @ Unknown	South Korea Foreign trade for February	US$ bil	3		0.8	0.6
Tues @ 10:00 a.m.	South Korea CPI for February	% change yr ago	3		1.4	1.5
Tues @ 2:30 p.m.	Australia Monetary policy for March	%	3		0.75	0.75
Tues @ 4:00 p.m.	Japan Consumer confidence survey for February	Index	2		38.2	39.1
Wed @ 11:30 a.m.	Australia GDP for Q4	% change	3		0.4	0.4
Wed @ 3:00 p.m.	Malaysia Foreign trade for January	MYR bil	2		9.2	12.6
Thurs @ 11:30 a.m.	Australia Foreign trade for January	A$ bil	2		4.9	5.2
Fri @ 11:30 a.m.	Australia Retail sales for January	% change	3		0.2	-0.5

The Long View

January-February 2020's high-yield bond offerings from U.S. companies soared higher by 98% year-over-year.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group
February 27, 2020

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 121 basis points was less than its 122-point mean of the two previous economic recoveries. This spread may be no wider than 125 bp by year-end 2020.

The recent high-yield bond spread of 468 bp is thinner than what is suggested by the accompanying long-term Baa industrial company bond yield spread of 192 bp and the recent VIX of 35.2 points.

DEFAULTS

January 2020's U.S. high-yield default rate of 4.2% was up from January 2019's 2.6% and may average 3.8% during 2020's final quarter according to Moody's Investors Service.

US CORPORATE BOND ISSUANCE

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.

Third-quarter 2019's worldwide offerings of corporate bonds revealed annual advances of 15.2% for IG and 56.8% for high-yield, wherein US$-denominated offerings soared higher by 36.8% for IG and 81.3% for high yield.

Fourth-quarter 2019's worldwide offerings of corporate bonds revealed annual advances of 15.3% for IG and 329% for high-yield, wherein US$-denominated offerings dipped by 0.8% for IG and surged higher by 330% for high yield.

For 2019, worldwide corporate bond offerings grew by 5.4% annually (to $2.447 trillion) for IG and advanced by 49.2% for high yield (to $561 billion). The projected annual percent increases for 2020's worldwide corporate bond offerings are -1.2% for IG and 5.7% for high yield.

US ECONOMIC OUTLOOK

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 1.75% 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
February 27, 2020

EURO ZONE

Thursday brought more evidence that business and consumer sentiment remained strong in February across the euro zone, which doesn't chime in with the surge in coronavirus-related fears and the disruptions caused by the virus' containment measures. The European Commission's index of euro zone economic sentiment actually rose from 102.6 in January to a nine-month high of 103.5, on increases in manufacturing, services and consumer sentiment. But the survey was conducted before the spike in cases and deaths in Italy, suggesting that sentiment may falter in March, especially if infections continue to rise in the Continent.

News was also rosy in the U.K. The country's ESI soared to a 10-month high of 95.5 from 90.7 in January. Behind the rise was mainly a jump in industrial sentiment to an eight-month high and a rise in consumer confidence to its strongest since August 2018. But sentiment in the services and retail sectors also increased sharply. These numbers tell a story similar to that of the flash PMIs released last week and all but corroborate our view that the U.K. economy rebounded sharply at the start of the year in line with the fading of political uncertainty after the passing of the Brexit deal.

It is still hard to estimate the impact of COVID-19 on first-quarter growth in the U.K. and the euro zone. Our view is that U.K. GDP rose by 0.2% q/q—only 0.1% lower than our pre-virus forecast of 0.3%—as we expect that there was a lot of pent-up demand unleashed in January and February, especially as firms and households had sat on investment decisions through 2019. In the euro zone, GDP should have all but flatlined after a meagre 0.1% rise in the fourth quarter—the euro area is more reliant on trade with China than the U.K. Depending on developments at home and overseas, we would not rule out a small contraction. The hit to the economy in the U.K. and the euro zone is coming via reduced goods exports to China, less spending by Asian tourists, and a drop in domestic production because of supply chain disruptions. Adding to that, virus containment measures in Italy are set to take a heavy toll on the country's GDP, and this is likely to spill over to neighboring economies. We still don't have a rate cut by the European Central Bank in our baseline, but odds are tilted toward an increase in stimulus by summer.

ASIA PACIFIC

By Katrina Ell of Moody's Analytics
February 27, 2020

CHINA

The economic implications of the coronavirus are significant. The outbreak has dealt a deep hit to China's economy, and policymakers there have unveiled a suite of measures to soften the impact. They include liquidity injections and reductions to the loan prime rate, as well as tax cuts, subsidies, and reducing some government fees.

Our tally of China's cumulative lost output since the Wuhan travel restrictions were imposed on 23 January stands at 1.3 percentage point. A high proportion of the economic toll is coming from the government's containment efforts to stop the spread of the virus, rather than the cost of treating infected patients and the associated increased health costs.

Epicenter of the virus

While China is the epicenter of the virus, with 97% of confirmed cases across the globe being reported there, economic damage is being felt elsewhere, particularly in Asia. This is because China is an important stimulant for demand in the region and it is a global manufacturing hub, so the resulting supply chain disruptions from the severe hit to economic activity have significant ripple effects. Our February baseline update downwardly revised estimated global GDP growth in 2020 by 0.4 percentage point to 2.4%.

Policymakers throughout Asia are swiftly responding as the number of infected patients continues to climb. Indonesia, the Philippines and Thailand reduced interest rates in February. Singapore has announced a generous

fiscal stimulus package. Further measures are likely across the region if the number of infected patients and impacted countries continues to rise.

The expected economic hit increased since mid-February with a spike in cases outside of China, capturing South Korea, Japan, Italy and Iran. Financial markets have retreated on this development as the opportunity to contain the virus outside of China narrows.

Understanding Asia's exposure

The Asia-Pacific region's exposure to the virus is significant. The most important channel of impact is via the close trading relationship with China. China is the largest trading partner for most economies across the region, and with economic activity in China severely depleted by the virus, the repercussions will flow through to the rest of the region. Supply chains are disrupted, weakened domestic demand in China is hurting demand for final goods, and commodity prices are slumping. There is no other country in Asia or globally that so many economies throughout the Asia-Pacific region are so heavily tied to.

From the suite of countries we examined, Taiwan stands out as having the largest trade exposure to China, at around 26% of GDP. China is a critical manufacturing hub for Taiwanese firms given its lower operating costs and relative economies of scale, even though some industries have moved operations back to Taiwan in recent years. China is also a large employer of Taiwanese citizens and an important source of final demand. Tourism from the mainland has also been a lucrative market for Taiwan

At the other end of the scale are Australia and New Zealand, where trade exposure to China stands at around 7% of GDP. But exposure is still significant. China is the largest export destination for both economies, and the strong export performance has been an important driver of economic prosperity in the past decade.

In Australia, China's strong demand for hard commodities drove an unprecedented mining investment boom that contributed to Australia's impressive run of almost 30 years without a technical recession. China's burgeoning middle class with a rising appetite for a higher-protein diet has led New Zealand's soft commodity exports including dairy and meat to blossom and become New Zealand's largest export earner.

Ratings Round-Up

U.S. Downgrades Limited to Small, Speculative-Grade Companies

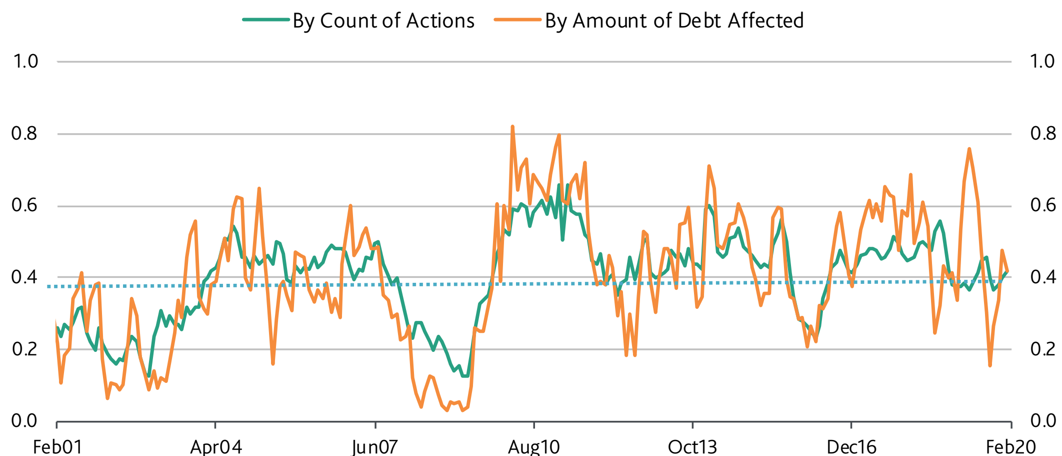
By Michael Ferlez

U.S. rating change activity remained largely confined to credit downgrades in the latest week. For the period ending February 25, downgrades accounted for two-thirds of rating change activity. Consistent with recent trends, last week's downgrades were limited to small, speculative-grade companies and were spread across several different industries. Last week's downgrades were headlined by Guitar Center Inc. The retail store saw its senior unsecured credit rating cut to Caa2 from Caa1. Moody's Investors Service downgrade reflects the firm's high leverage, limited cash flow and the rising probability that the firm will have to restructure its balance sheet due to the looming 2021 debt maturities. The downgrade affected $635 million in debt. Despite last week's relatively poor performance, rating change activity is not raising any red flags for broader U.S. economy.

European rating activity was light last week with only two changes, both downgrades. Central Nottinghamshire Hospitals PLC saw its senior secured credit rating downgraded to Baa1 from A3, affecting $458 million in debt. Moody's Investors Service downgrade reflects the deterioration in the firm's project operating performance in recent months. Moody's Investors Service also downgraded the senior secured rating of Auris Luxembourg II S.A to B3 from B2. Moody's also downgraded the firm's Corporate Family Rating to B3 from B2. Moody's downgrade of Auris Luxembourg II S.A reflects the entities operating underperformance at both Sivantos and Widex since their merger.

FIGURE 1

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



* Trailing 3-month average

Source: Moody's

FIGURE 2

Rating Key

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

FIGURE 3

Rating Changes: Corporate & Financial Institutions – US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/SG
2/19/20	NPC INTERNATIONAL, INC.	Industrial	SrSec/BCF /LTCFR/PDR		D	Caa3	C	SG
2/19/20	LIFETIME BRANDS, INC.	Industrial	SrSec/BCF /LTCFR/PDR		D	B1	B2	SG
2/19/20	VISTAGE INTERNATIONAL, INC.	Industrial	SrSec/BCF /LTCFR/PDR		U	Caa2	Caa1	SG
2/20/20	WARNER MUSIC GROUP CORP. -WMG ACQUISITION CORP.	Industrial	SrUnsec	325	U	B3	B2	SG
2/20/20	AKORN, INC.	Industrial	SrSec/BCF /LTCFR/PDR		D	Caa1	Caa3	SG
2/20/20	VIP CINEMA HOLDINGS, INC.	Industrial	SrSec/BCF /LTCFR/PDR		D	Caa2	C	SG
2/20/20	ADVANTAGE SOLUTIONS INC.- ADVANTAGE SALES & MARKETING INC.	Industrial	LTCFR/PDR		U	B3	B2	SG
2/21/20	GUITAR CENTER HOLDINGS, INC -GUITAR CENTER INC.	Industrial	SrSec /LTCFR/PDR	635	D	Caa1	Caa2	SG
2/24/20	CENTRAL SECURITY GROUP, INC.	Industrial	SrSec/BCF /LTCFR/PDR		D	Caa2	Ca	SG
2/24/20	LIGHTNING ACQUISITION, LLC -GREENWAY HEALTH, LLC	Industrial	SrSec/BCF /LTCFR/PDR		D	B3	Caa1	SG
2/25/20	SCIENCE APPLICATIONS INTERNATIONAL CORP	Industrial	SrSec/BCF		U	Ba2	Ba1	SG
2/25/20	ERC FINANCE, LLC	Industrial	SrSec/BCF /LTCFR/PDR		D	B2	B3	SG

Source: Moody's

FIGURE 4
Rating Changes: Corporate & Financial Institutions – Europe

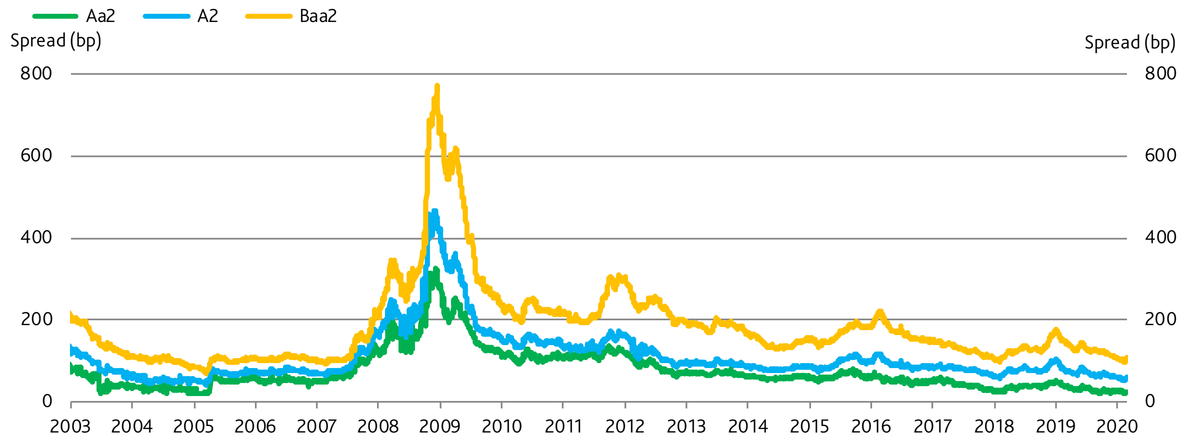
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG	Country
2/19/20	CENTRAL NOTTINGHAMSHIRE HOSPITALS PLC	Industrial	SrSec	458	D	A3	Baa1	IG	UNITED KINGDOM
2/20/20	AURIS LUXEMBOURG II S.A.	Industrial	SrSec/BCF /LTCFR/PDR		D	B2	B3	SG	LUXEMBOURG

Source: Moody's

Market Data

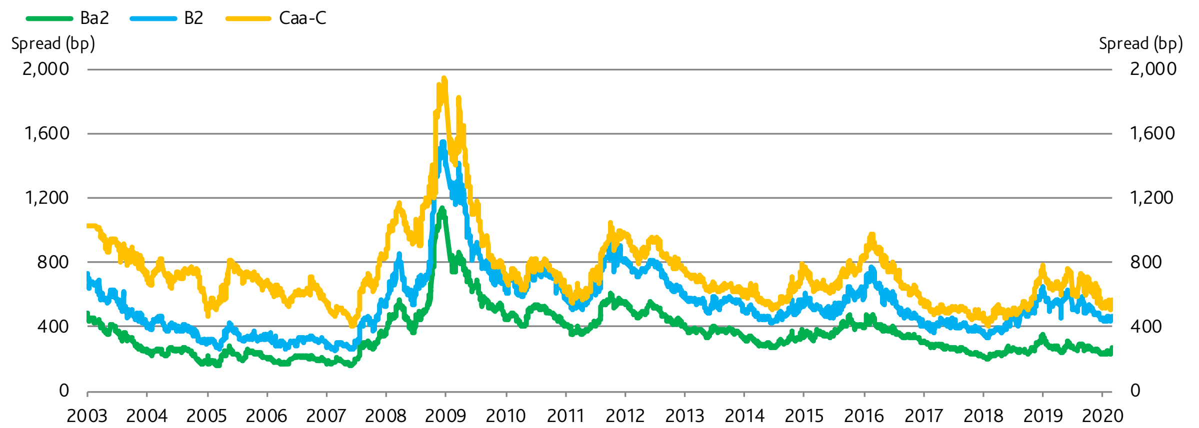
Spreads

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 (February 20, 2020 – February 26, 2020)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Feb. 26	Feb. 19	Senior Ratings
Microsoft Corporation	Aa3	A2	Aaa
Exxon Mobil Corporation	Aa3	A2	Aaa
3M Company	Aa2	A1	A1
PepsiCo, Inc.	A1	A3	A1
United Technologies Corporation	Aa2	A1	Baa1
Merck & Co., Inc.	Aa3	A2	A1
NextEra Energy Capital Holdings, Inc.	A3	Baa2	Baa1
Medtronic, Inc.	Aa2	A1	A3
Hershey Company (The)	A3	Baa2	A1
Costco Wholesale Corporation	Aa3	A2	Aa3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Feb. 26	Feb. 19	Senior Ratings
United Airlines, Inc.	B3	Ba2	Ba3
Ball Corporation	Baa2	A2	Ba1
Royal Caribbean Cruises Ltd.	Ba3	Baa3	Baa2
Nabors Industries, Inc.	C	Caa2	B1
Ashland LLC	A2	Aa2	Ba1
United Airlines Holdings, Inc.	B2	Ba2	Ba3
Freeport Minerals Corporation	B2	Ba2	Baa2
Starwood Hotels & Resorts Worldwide Inc.	Baa2	A2	Baa2
JPMorgan Chase & Co.	A2	Aa3	A2
Citigroup Inc.	Baa1	A2	A3

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Feb. 26	Feb. 19	Spread Diff
Chesapeake Energy Corporation	Caa3	4,090	3,340	750
Frontier Communications Corporation	Caa3	7,054	6,450	604
Penney (J.C.) Corporation, Inc.	Caa3	3,298	2,987	312
Neiman Marcus Group LTD LLC	Ca	4,593	4,299	294
Diamond Offshore Drilling, Inc.	B3	1,139	875	265
Nabors Industries, Inc.	B1	906	675	231
K. Hovnanian Enterprises, Inc.	Caa3	1,242	1,078	164
American Airlines Group Inc.	B1	297	156	141
AK Steel Corporation	B3	394	256	139
United Airlines, Inc.	Ba3	246	121	126

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Feb. 26	Feb. 19	Spread Diff
Vornado Realty L.P.	Baa2	82	87	-5
EOG Resources, Inc.	A3	64	67	-3
Boston Properties Limited Partnership	Baa1	66	68	-2
Hershey Company (The)	A1	48	50	-2
ONEOK Partners, L.P.	Baa3	86	88	-2
RPM International Inc.	Baa3	81	83	-2
Dole Food Company, Inc.	Caa1	198	200	-2
NextEra Energy Capital Holdings, Inc.	Baa1	49	51	-1
HP Inc.	Baa2	83	84	-1
Entergy Corporation	Baa2	54	54	-1

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (February 20, 2020 – February 26, 2020)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Feb. 26	Feb. 19	Senior Ratings
Natixis	A1	A3	A1
Landesbank Baden-Wuerttemberg	A2	Baa1	Aa3
NXP B.V.	A2	Baa1	Baa3
United Kingdom, Government of	Aaa	Aa1	Aa2
Spain, Government of	Aa3	A1	Baa1
Barclays Bank PLC	A2	A3	A1
Portugal, Government of	Aa2	Aa3	Baa3
Banque Federative du Credit Mutuel	Aa3	A1	Aa3
ING Groep N.V.	A2	A3	Baa1
Bankia, S.A.	A3	Baa1	Baa3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Feb. 26	Feb. 19	Senior Ratings
Rexel SA	Ba2	Baa3	Ba3
Italy, Government of	Ba2	Ba1	Baa3
Deutsche Bank AG	Baa2	Baa1	A3
Intesa Sanpaolo S.p.A.	Baa3	Baa2	Baa1
HSBC Holdings plc	Baa1	A3	A2
The Royal Bank of Scotland Group plc	Baa2	Baa1	Baa2
UniCredit S.p.A.	Baa3	Baa2	Baa1
Credit Agricole Corporate and Investment Bank	Aa2	Aa1	Aa3
Greece, Government of	Ba2	Ba1	B1
Standard Chartered PLC	Baa1	A3	A2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Feb. 26	Feb. 19	Spread Diff
PizzaExpress Financing 1 plc	Ca	5,154	4,630	524
CMA CGM S.A.	Caa1	1,733	1,337	396
Boparan Finance plc	Caa1	1,621	1,427	194
TUI AG	Ba3	348	252	96
Matalan Finance plc	Caa1	976	881	95
Novafives S.A.S.	Caa2	832	749	82
Casino Guichard-Perrachon SA	B3	682	609	73
Stena AB	B3	420	349	71
Iceland Bondco plc	Caa2	773	705	69
Selecta Group B.V.	Caa1	361	304	56

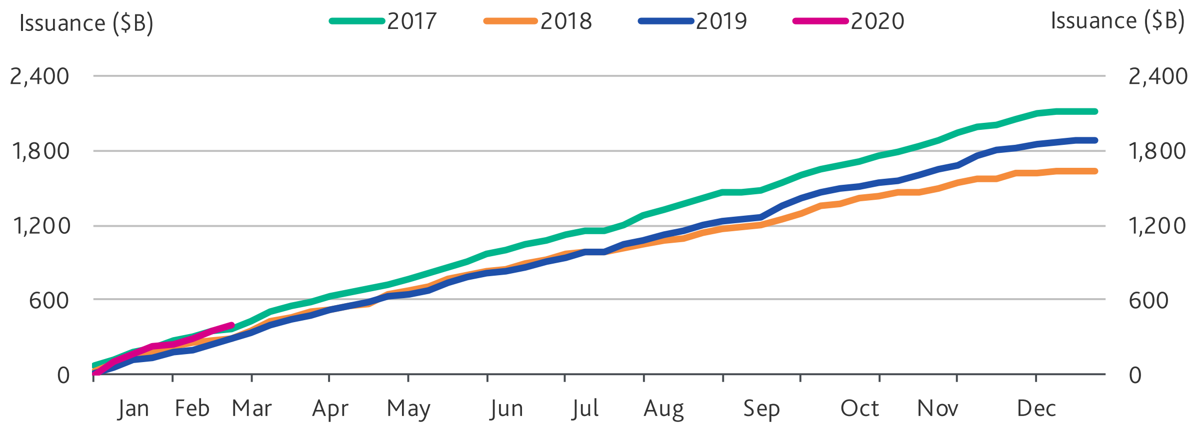
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Feb. 26	Feb. 19	Spread Diff
Belgium, Government of	Aa3	12	12	-1
Norway, Government of	Aaa	9	10	-1
United Kingdom, Government of	Aa2	18	18	0
Alpha Bank AE	Caa1	616	616	0
FCE Bank plc	Ba1	96	96	0
National Bank of Greece S.A.	Caa1	553	553	0
NXP B.V.	Baa3	45	45	0
Iceland, Government of	A2	69	69	0
Lafarge SA	Baa2	30	30	0
France, Government of	Aa2	14	14	0

Source: Moody's, CMA

Market Data

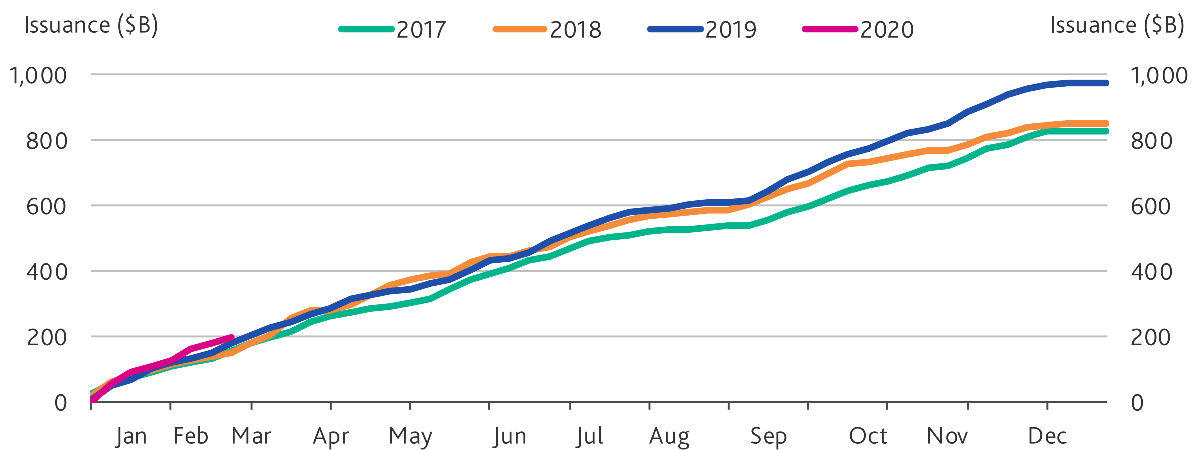
Issuance

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

Figure 7. Issuance: Corporate & Financial Institutions

	USD Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	42.795	10.235	54.365
Year-to-Date	267.091	117.044	401.738

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	14.657	2.702	17.697
Year-to-Date	159.894	34.681	200.416

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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Report Number: 1216475

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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