MOODY'S ANALYTICS

# WEEKLY MARKET OUTLOOK

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# Net High-Yield Downgrades Drop from Dreadful Readings of March and April

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

Net High-Yield Downgrades Drop from Dreadful Readings of March and April

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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: After growing by 87% annually during 2020's first half, US$-denominated bond offerings may dip by 5% annually during the second.

| | |
|---|---|
| Credit Spreads | Investment Grade: We see the year-end 2020's average investment grade bond spread under its recent 148 basis points. High Yield: Compared with a recent 635 bp, the high-yield spread may approximate 620 bp by year-end 2020. |
| Defaults | US HY default rate: According to Moody's Investors Service, the U.S.' trailing 12-month high-yield default rate jumped from May 2019's 3.1% to May 2020's 6.4% and may average 11.9% during 2020's final quarter. |
| 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 grow by 44.0% for IG to \$1.886 trillion, while high-yield supply may rise by 1.0% to \$437 billion. |

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# Credit Markets Review and Outlook

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

## Net High-Yield Downgrades Drop from Dreadful Readings of March and April

More than anything else, the unknown course of COVID-19 remains the biggest threat to the business outlook. However, even if COVID-19 risks are eliminated and U.S. real GDP growth potentially reaches 5% or faster in 2021, U.S. economic activity will quickly return to its long-term growth rate of between 1.8% to 2.0%.

The aging of the U.S. population and workforce, as well as average annual labor force growth of between 0.3% and 0.5% during the next 10 years will make it all but impossible to sustain economic growth at a rate materially above 2%, unless the average annual rate of labor productivity growth well exceeds its 1.2% rise of the 10-years-ended 2019.

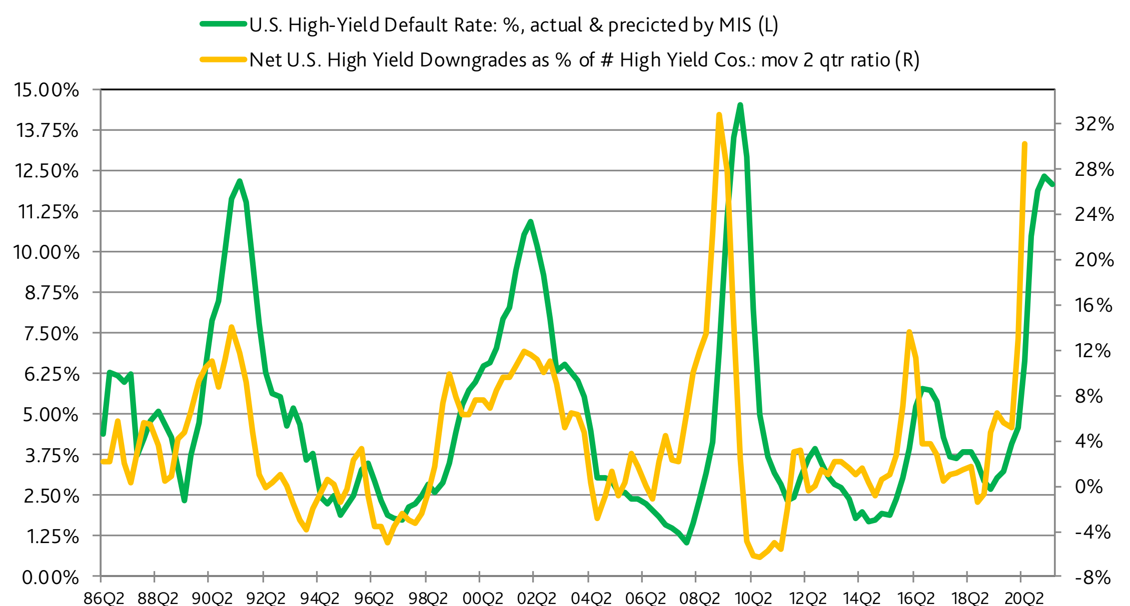
Net high-yield downgrades equal the difference between the number of high-yield downgrades and upgrades. The second-quarter's declining trend for net high-yield downgrades complements the change in the direction of high-yield credit spreads. In terms of preliminary estimates, the number of U.S. high-yield net downgrades dropped from April 2020's 214 to May's 90. A rough extrapolation from recent trends suggests that net high-yield downgrades may ease to 50 in June.

During 2020's first quarter, U.S. high-yield net downgrades rose from January's -1 to February's very manageable 19 and then soared to March's 176 largely in response to the destructive force of COVID-19.

### Net High-Yield Downgrades Warn of a Much Higher Default Rate

The high-yield default rate exhibits a lagged response to the moving two-quarter ratio of net high yield downgrades to the number of high-yield issuers. The coincident correlation between the high-yield default rate and the net high-yield downgrade ratio is an unimpressive 0.46. However, the U.S. high-yield default rate's calendar-quarter average shows much higher correlations of 0.81 and 0.82 with the net high-yield downgrade ratios of two and three quarters earlier and of 0.75 with the ratio of four quarters earlier.

**Figure 1: Net High-Yield Downgrades Concurs with Forecast of 13% Default Rate for 2021's First Quarter**
*sources: Moody's Investors Service, Moody's Analytics*



## Credit Markets Review and Outlook

As recently as September 2018, the moving two-quarter net high-yield downgrade ratio bottomed at -1.8% meaning that the number of high-yield upgrades topped the number of downgrades during the six-months-ended September 2018. After rising to 6.5% as of June 2019 (or 2019's first half), the net high-yield downgrade ratio had eased to 5.2% by December 2019.

However, the harsh impact of COVID-19 quickly pushed the net high-yield downgrade ratio up to 13.1% for the six-months-ended March 2020. A preliminary estimate has the net high-yield downgrades of 2020's first half soaring to 30.2% of the number of high-yield issuers in the second half. The latter would be second only to the record-high 32.8% ratio of the six-months-ended March 2009.

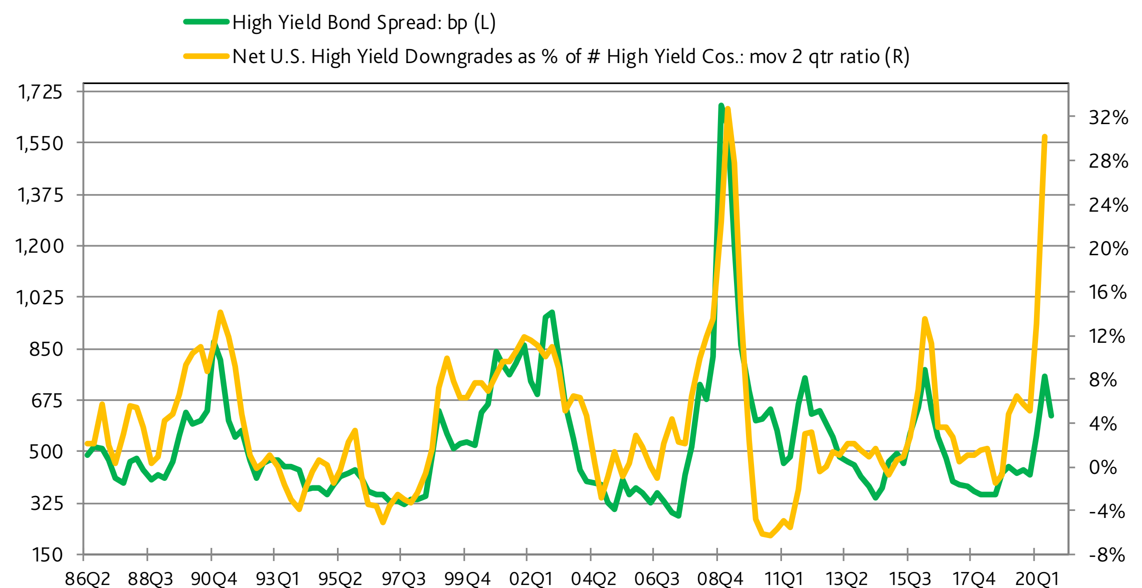
When incorporated into an ordinary least squares model, the prospective 30.2% net high-yield downgrade ratio of 2020's first half predicts a 14.1% midpoint for the average U.S. high-yield default rate of 2021's first quarter. The later exceeds early June's average baseline estimate of 12.3% as supplied by default researchers from Moody's Investors Service.

### High-Yield Bond Market Shrugs Off Near Record High for Net Downgrades

The high-yield bond market appears convinced that the worst is over for high-yield credit rating revisions. The deep decline by net high-yield downgrades from April's peak of 214 to possibly fewer than 50 in June helps to explain why a composite high-yield bond spread has narrowed from a March 23 high of 1,220 basis points to June 17's 610 bp. (For purposes of comparison, Bloomberg/Barclays high-yield bond spread has dropped from a March 23 high of 1,100 bp to June 17's 561 bp.)

Nevertheless, the composite high-yield bond spread's recent five-day average of 635 bp is surprisingly narrow given the prospective 30.2% net high-yield downgrade ratio of the six-months-ended June 2020. Statistically speaking, the latest net high-yield downgrade ratio has been associated with a 1,250 bp midpoint for the high-yield bond spread. Moreover, when the net high-yield downgrade rose to a record-high 32.8% for the span-ended March 2009, first-quarter 2009's high-yield bond spread averaged 1,604 bp.

**Figure 2: High-Yield Bond Market Shrugs Off Near Record-High Ratio of Net High-Yield Downgrades to Number of High-Yield Issuers**
*source: Moody's Analytics*




The now very wide gap between the high-yield bond spread predicted by net high-yield downgrades less the actual high-yield spread warns of a wider high-yield bond spread by the second quarter of 2021. for 65% of the 20 observations showing at least a 114 bp difference between the high-yield bond spread predicted by net high-yield downgrades less the actual high-yield spread, the high-yield spread was wider a year later.

For the 20 observations, the average premium of the predicted spread over the actual spread was 146 bp, while the actual spread of one year later was higher by 87 bp, on average.

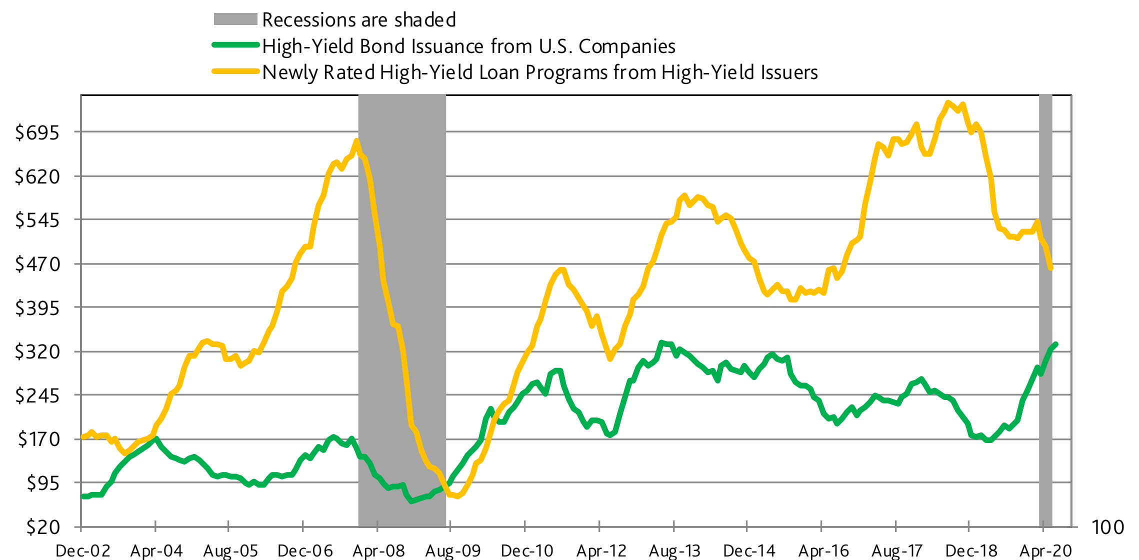
For 70% of the 20 observations showing a deeper than -114 bp difference between the predicted high-yield bond spread less the actual high-yield spread, the high-yield spread was narrower a year later. For the 20 observations, the average discount of the predicted spread over the actual spread was -249 bp, while the actual spread of one year later was thinner by -204 bp, on average.

### High-Yield Bond Issuance Sets Record High Amid Elevated Uncertainty

Despite the still well above-average spreads of high-yield bonds and credit-analyst expectations of a higher default rate, second-quarter 2020's issuance of high-yield bonds by U.S. companies is likely to reach a record high $120 billion.

However, unlike second-quarter 2020's likely 88% year-over-year surge by U.S. company high-yield bond offerings, newly rated loans from high-yield issuers are now on track to plunge 58% annually for the second quarter. To a considerable degree, newly offered high-yield bonds now refinance outstanding loans.

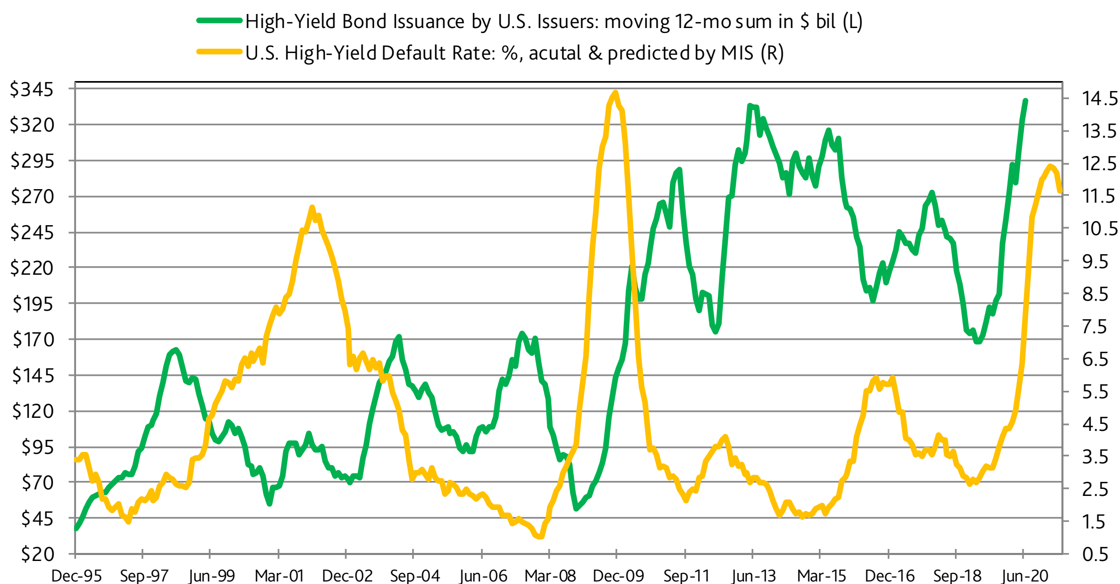
**Figure 3: High-Yield Bond Issuance's Moving 12-Month Sum Approaches New Record-High as Newly Rated Loans from High-Yield Issuers Sink**
*moving 12-month sums in $ billions*
*sources: Dealogic, Moody's Investors Service, NBER, Moody's Analytics*




High-yield bond offerings from U.S. companies plunged in response to the two previous recessions and ascents by the high-yield default rate. Perhaps the resilience of both the high-yield bond market and high-yield bond offerings can be ascribed to expectations of a skewing of defaults toward smaller firms having mostly loan debt outstanding.

**Figure 4: High-Yield Bond Issuance Sets Record High Despite Fast Rising Default Rate and COVID-19 Uncertainties**

*sources: Dealogic, Moody's Investors Service, Moody's Analytics*



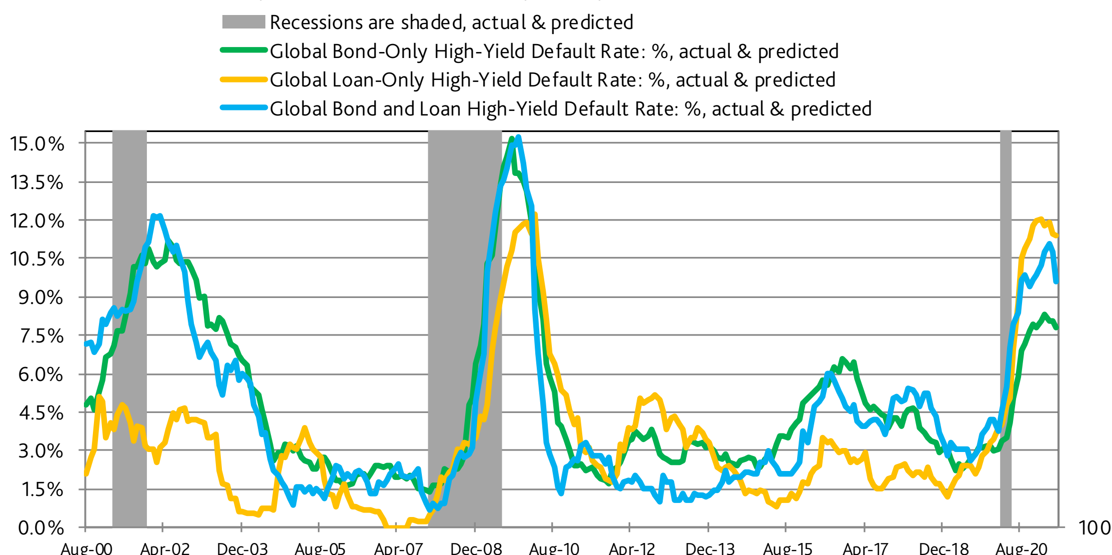

## High-Yield Loan Default Rate Is Likely to Top Bond Default Rate

Moody's Investors Service expects the global loan-only default rate of high-yield issuers to rise from May 2020's 5.1% to a January 2021 peak of 12.1%, while the bond-only default rate climbs up from May 2020's 4.1% to a February 2021 peak of 8.3%. Meanwhile the global default rate for high-yield issuers of both bonds and loans is projected to increase from May 2020's 7.1% to a 11.1% top by March 2021.

**Figure 5: In a Sharp Break from the Past, the Loan-Only High-Yield Default Rate Is Expected to Peak Well Above the Bond-Only Default Rate**

*One-year global default rates*

*sources: Moody's Investors Service, Moody's Analytics*



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

## THE U.S.

By Kwame Donaldson of Moody's Analytics

## Inequality, Segregation and Slow Prosperity in the Housing Market

Despite the extraordinary shutdowns and economic disruptions imposed by public health officials to slow the spread of COVID-19, house prices in April increased at the fastest pace since 2018. Gains were broad-based; every state registered year-over-year growth in house prices.

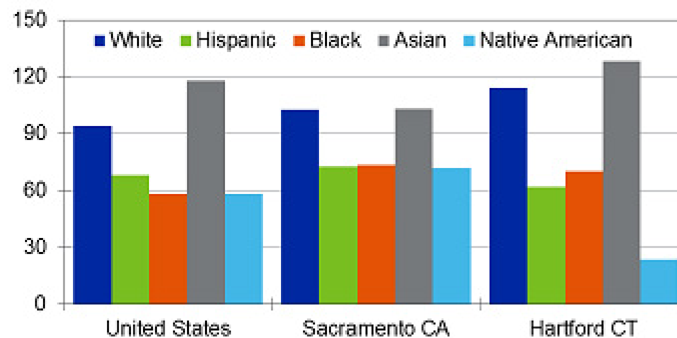
Defying expectations, house price trends have accelerated since the fall. Existing-home sales plummeted in April, and this tightening supply supported house price growth more than weakening demand dampened it.

Ultra-low mortgage rates are also boosting the housing market, but the full effect is muted because bankers are growing more hesitant to make loans. Mortgage lenders are tightening standards with more rigorous income, credit-score and down-payment conditions. Greater overall risk in the economy is a factor, but so is leaner and more uncertain working capital. One major concern is that mortgage originators must continue paying interest and principal to their investors, at a time when more and more borrowers are unable to pay.

The coronavirus outbreak is undoubtedly dealing a blow to construction, but the latest reports do not show the extent of the damage. Construction spending increased in May, but this should be viewed with caution, as there is a likelihood that these figures will be revised lower in future months. Though the federal government has not issued specific mandates to the construction industry, supply chain disruptions and state and local mandates to limit or suspend most commercial construction projects will weigh on spending levels.

### Inequality linked to slower growth

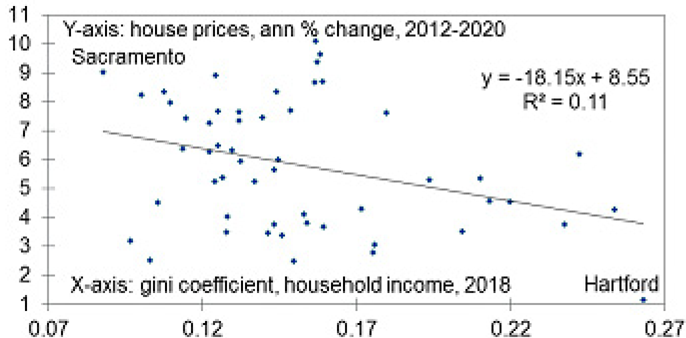
Average household income in the U.S. was $86,800 in 2018, according to a Moody's Analytics analysis based on data from the Census Bureau's American Community Survey. Families headed by Asian and white householders earned more than average, while Hispanic, black and Native American households earned less.




While this pattern is repeated in every corner of the U.S., the degree of income inequality among racial and ethnic groups varies by metropolitan area. For example, following the nationwide pattern, Asian

households in Sacramento CA and Hartford CT have the highest income, while Native American families earn the least. But the gap between these groups is much wider in Hartford. Native American households in Sacramento earn 70% as much as Asians, while this ratio is only 18% in Hartford.

Based on the Gini coefficient, the most commonly used measure of income inequality in economics, Sacramento has the least amount of racial inequality among the 53 major metro areas in the U.S. with more than 1 million residents, and Hartford has the most. The chart below plots these major metro areas; the graph measures the Gini coefficient for each metro area along the x-axis.




The y-axis measures annualized house price growth between 2012 and 2020, according to CoreLogic. The scatterplot reveals a weak, negative correlation between income inequality and house price growth. For example, Hartford, the metro area with the most income inequality, also had the slowest house price growth, while house price growth in Sacramento, the metro area with the least income inequality, was the fourth highest. The regression equation in the chart above indicates that if Hartford had matched Sacramento's level of income equality, its homeowners might have seen prices grow by an additional 3.6 percentage points per year between 2012 and 2020.

The negative correlation between income inequality and house price growth has many potential explanations, but one can be ruled out immediately. The correlation is not due to the specific eight-year period of house price growth highlighted in the chart above. Moody's Analytics reviewed these correlations over each of the last 16 years and found a negative relationship 12 times.

House price growth is not the only measure of economic health that is negatively correlated with income inequality. In each of the last 16 years, employment growth and GDP growth were also weaker in cities with more inequality. Faster house price growth may be a consequence of the healthier labor market in cities where pay is more equitable.

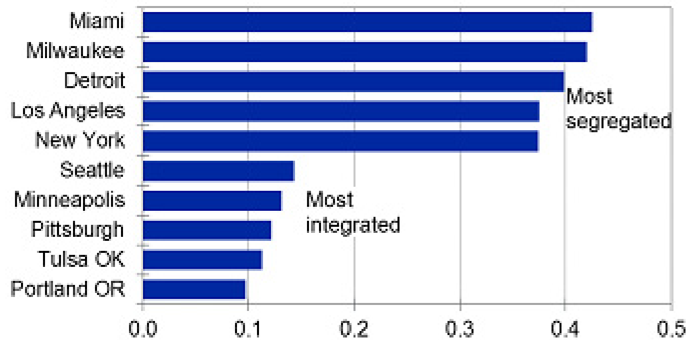
Geography might help explain some this relationship. Each of the 14 metro areas with the highest income inequality is east of the Mississippi River except for Memphis, which straddles the Mississippi. Major cities in Texas, the Mountain West, and the Pacific Coast rank lower. Many western cities, including Austin, Seattle and Denver, are built around high-tech industries that have enjoyed healthy recent growth and have less history of racial discrimination.

### Segregation, slow growth linked

Income inequality is not the only measure of social stagnation that is negatively correlated with house price growth; racial segregation and economic growth are also inversely linked. To measure racial segregation, Moody's Analytics compared the metro area's racial distribution with this distribution within public-use micro areas. PUMAs are subregions of metro areas with between 100,000 and

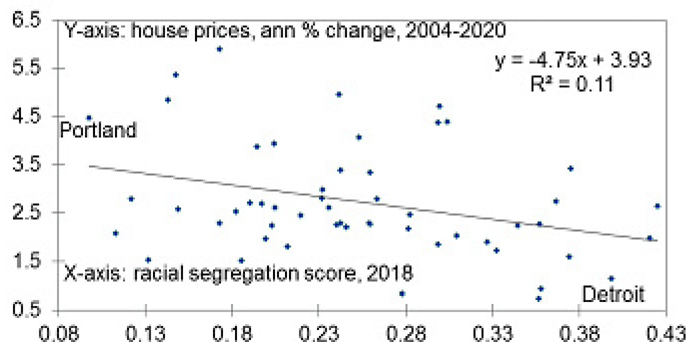
200,000 residents. The Census Bureau clusters together communities and neighborhoods with close political and economic ties in PUMAs.

The racial segregation score measures how much the racial distribution within PUMAs deviates from the racial distribution in the whole metro area. A higher score results from a heavier concentration of a racial or ethnic group in a PUMA. Detroit is one of the most racially segregated metro areas in the nation by this measure, and Portland OR is the least segregated.




Moody's Analytics reviewed only the 53 metro areas in the U.S. with at least nine PUMAs, which almost perfectly corresponds to the 53 metro areas with at least 1 million residents.

The chart below plots each metro area's racial segregation score along the x-axis and annualized house price growth along the y-axis. The scatterplot reveals another weak and negative correlation between racial inequality and house price growth. If Detroit had matched Portland's level of racial integration, its homeowners might have enjoyed an additional 1.4 percentage points of house price growth per year from 2004 to 2020.




The finding is not specific to this 16-year period. The racial segregation score is negatively correlated with house price growth in each of the last 16 years reviewed by Moody's Analytics.

This result also applies to other measures of economic health. Racial integration also tended to boost employment growth and GDP growth in the largest metro areas over each of the last 16 years. However, it may be that some of these other economic gains result from racially integrated housing markets and robust house price growth. Local labor markets benefit from housing markets that encourage workers to prioritize shorter commutes or access to productivity-enhancing amenities over being partitioned into racial and ethnic enclaves.

### Outlook and risks

Martin Luther King, Jr. said that "the arc of the moral universe is long, but it bends toward justice." His forecast aligns with the findings presented in this article. Metro areas with persistent racial disparities have slower growth in house prices, employment and GDP than those that do not. Faster growth in each of these measures may be reinforcing the others in a virtuous circle. Economic incentives should encourage more income equality and racial integration, but recent events confirm that unwinding entrenched racial inequities is a painfully slow process.

This long-term forecast has downside risk. It is possible that the marginal resident in areas with high degrees of social stagnation prefers this arrangement. Such residents are implicitly sacrificing faster economic growth to maintain the status quo, and the findings in this article reflect the foolish preferences of rational economic agents. If this is the case, then metro areas with persistent disparities will not achieve their full economic potential unless these attitudes change.

### Next week

The key data will be the new-home sales, unemployment insurance benefits, revisions to Q1 GDP, personal income and spending along with durable goods orders.

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### EUROPE

By Barbara Teixeira Araujo of Moody's Analytics

## Continued, but Slow Recovery

The week ahead will bring very little top-tier data for Europe, but we will get a barrage of confidence indicators for June. They are expected to confirm that the European economies continued to recover after bottoming out in April, as COVID-19 lockdown measures were further lifted. For instance, we expect that the area's flash composite PMI rose to 44 from 31.9 in May and the low of 13.6 in April. The details should show that the services sector recovered the most this month as almost all economies had reopened restaurants, nonessential stores and leisure facilities by the start of June. Yes, some restrictions remain and turnover in the High Street and in restaurant visits are still below normal levels given that people remain cautious, but it is a beginning. Indeed, we expect that retail sales and consumer-faced services activities have risen sharply in June, building on May's tentative rebound. Adding to that, travel bans have been lifted in some European countries during June, and hotels were allowed to reopen, which likely gave a boost to the transport and hospitality industries. Evidence from air and road traffic also suggest that tourism began slowly returning to life after their complete shutdown in mid-March.

The manufacturing industry is also expected to recover this month, but not by a lot, since most factories were already open in May. Our view is that the euro zone's manufacturing PMI rose to 48 in June from 39.4 in May. We expect that both domestic and foreign orders remained subdued, with the plunge in global trade keeping a lid on the performance of the euro zone's export sector. Prospects for exports remain weak, especially as the pandemic still hasn't peaked in some parts of the globe, while a second wave of the virus is happening in others (notably China), which is resulting in reimposed restrictions. Given that the euro zone is an extremely export-dependent economy, we expect that any rebound in its manufacturing industry will remain contained by the weak performance of foreign trade during the rest of this year. This is true especially for Germany, which exports an outsized share of its GDP—mainly to China and the U.S.

Household sentiment also likely rebounded this month, and we expect both Germany's GfK consumer confidence gauge and France's INSEE consumer confidence index to have increased. It looks like the short-term work schemes put in place by the different euro zone governments were largely successful in preventing unemployment from soaring and incomes from collapsing—evidence for the main euro area countries shows almost a third of the workforce could have benefitted. This means that the economy's aggregate purchasing power hasn't fallen as sharply as we initially expected, meaning there is scope for a sharp rebound in spending once restrictions fall away. Unfortunately, many jobs were lost for good as companies fell through the cracks, while evidence suggests that even people who were able to keep their employment decided to increase precautionary savings as they remain wary about the future. So, while consumer confidence likely recovered in June, it will remain much below precrisis levels for some time, tainting the prospects of a V-shaped rebound in activity.

Lastly, we expect that the number of France's jobseekers rose further in May, following a historic jump in April. While the government's Chomage Partiel programme allowed for many people to keep their jobs even if they had their hours reduced, anecdotal evidence indicates that many people were made redundant, while claims for unemployment benefits soared. Given that the labour market is a lagged indicator of growth, we expect unemployment will continue to rise in coming months. Indeed, our view is that it will peak at a bit over 10% over the summer, from 8.7% in April.

| | Key indicators | Units | Moody's Analytics | Last |
|---|---|---|---|---|
| Thur @ 11:00 a.m. | France: Job Seekers for May | mil, SA | 4.80 | 4.32 |
| Fri @ 9:00 a.m. | Spain: Retail Sales for May | % change | 5.3 | -20.4 |

ASIA-PACIFIC

By Shahana Mukherjee of Moody's Analytics

## New Zealand's Central Bank Likely to Hold Steady in June

We expect the Reserve Bank of New Zealand to keep its official cash rate unchanged at 0.25% at its June meeting. This follows an announcement in May when the central bank left the policy rate unchanged but significantly stepped up its quantitative easing program, nearly doubling its bond-purchasing program to NZ$60 billion from NZ$33 billion and expanding it to include inflation-indexed bonds.

The COVID-19 pandemic has severely impacted the economy's prospects, despite an effective handling of the health crisis within borders. The combined effects of the domestic and external restrictions have undermined growth, with GDP having contracted by 1.6% on a quarterly rate in March, the sharpest quarter fall since 1991, on the back of a sharp decline in investment spending, consumption and exports. This is set to deepen though the June quarter, as the full effects of the shock to global trade and a weakened labour market materialize over this period, but the central bank is expected to avoid taking the Official Cash Rate into negative territory and continue providing support through liberal quantitative easing.

South Korea's consumer sentiment is likely to have moderated in June after a surprise increase in May. The economy had initially made considerable progress in managing the localised COVID-19 outbreak due to aggressive testing and contact tracing. The economy, however, continues to be severely impacted by the shock to overseas sales, with exports having contracted by 23.7% in May, and the unemployment rate having risen to 4.5% from 3.8% in April. While the easing of restrictions in Western economies is a positive development and suggests that the shock to global trade may have bottomed out in May, the risk of a second wave of infections in China and prevailing uncertainty in external demand, combined with weak employment prospects and rising geopolitical frictions, are expected to weigh on consumer confidence in June.

| | Key indicators | Units | Moody's Analytics | Confidence | Risk | Last |
|---|---|---|---|---|---|---|
| Wed @ 12:00 p.m. | New Zealand Monetary Policy for June | % | 0.25 | 3 | ← | 0.25 |
| Fri @ 7:00 a.m. | South Korea Consumer Sentiment for June | Index | 73.0 | 3 | ↓ | 77.6 |

# The Long View

## After growing by 87% annually during 2020's first half, US$-denominated bond offerings may dip by 5% annually during the second.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group
June 18, 2020

### CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 148 basis points far exceeded its 122-point mean of the two previous economic recoveries. This spread may be no wider than 145 bp by year-end 2020.

The recent high-yield bond spread of 635 bp is thinner than what is suggested by the accompanying long-term Baa industrial company bond yield spread of 224 bp and the recent VIX of 32.9 points. The latter has been statistically associated with a 937-bp midpoint for the high-yield bond spread.

### DEFAULTS

May 2020's U.S. high-yield default rate of 6.4% was up from May 2019's 3.1% and may approximate 12.3%, on average, by 2021's first quarter.

### US CORPORATE BOND ISSUANCE

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.

First-quarter 2020's worldwide offerings of corporate bonds revealed annual advances of 17.7% for IG and 26.5% for high-yield, wherein US$-denominated offerings increased by 43.7% for IG and grew by 21.4% 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 changes for 2020's worldwide corporate bond offerings are a 7.7% rise for IG and a 6.9% drop for high yield.

### US ECONOMIC OUTLOOK

An unfolding global recession will rein in Treasury bond yields. As long as the global economy operates below trend, 1.25% will serve as the upper bound for the 10-year Treasury yield. Until COVID-19 risks fade, substantially wider credit spreads are possible.

## EUROPE

By Barbara Teixeira Araujo of Moody's Analytics
June 18, 2020

### UNITED KINGDOM

The Bank of England delivered what markets were expecting in June—raising quantitative easing by £100 billion to a total of £745 billion—but the meeting struck a rather hawkish tone. First, the bank's chief economist, Andy Haldane, voted against the increase, arguing that the economy was recovering faster than expected and that the bank could afford to wait before announcing more stimulus. Second, the committee took a positive tone in the minutes, claiming that the recent evidence suggests that the contraction in GDP in the second quarter will likely be less severe than initially forecast. Third, by announcing that the QE programme is expected be completed around the turn of the year, the bank implied that the pace of asset purchases will be significantly reduced over the coming weeks and months; this suggests that the monetary stance will actually be tightened instead of loosened. If the current pace of purchases were to be maintained, purchases would be exhausted by the end of the summer. Fourth, there were no indications that the bank even discussed negative interest rates, as markets were expecting. But we have long claimed that negative interest rates wouldn't make much of a difference for the U.K. economy right now, with other alternatives—notably some lowering of the interest rates on funds provided through the TFSME programme—looking more effective.

Despite these hawkish turns, we maintain our forecast that the bank will need to announce more QE purchases before the end of the year. Although growth will rebound, we expect that the recovery will be slow, and that GDP will still take a couple of years before reaching precrisis levels. Risks regarding a second wave of infections will keep a lid on the rebound, but so will fears regarding a no-deal Brexit. Households should thus remain cautious and increase their precautionary savings for the rest of the year, while investment will remain in the doldrums as firms will be afraid to make big-ticket commitments. The weak external trade environment will do little to offset the weakness at home.

Adding to our view, the BoE highlighted in the meeting's minutes that it is worried about prospects for employment, with the latest high-frequency data all pointing towards a material deterioration in the labour market. That's important, because over the last few years the central bank has put much more weight on unemployment data than on the activity numbers. That said, though, the committee noted in the minutes that some members are now placing more weight on the GDP figures. In any case, our forecasts are for both GDP growth and the labour market to remain below potential for some time still, warranting more QE eventually.

### EURO ZONE

Wednesday brought a barrage of data for Europe, and in the spotlight was the 14.6% m/m drop in euro zone construction activity in April. It built on a downwardly revised 15.7% fall in March, leading construction to decline at a record pace of 28.4% in yearly terms. Civil engineering and building construction each plunged, and in both cases the yearly slump was the worst on record.

But while bad, the result wasn't unexpected. The COVID-19 crisis meant that several construction plants closed across the currency area as projects were postponed and as stay-at-home orders were enforced. The picture differs across countries, however. For instance, while construction plummeted by 32.6% m/m in France, building on a 42.3% decline in March, it was down by only 4.1% in Germany (following a 1% rise in March). This is mainly because the containment measures were much less strict in Germany than in France, while also they started to be eased earlier.

The good news is that the lockdown has already been relaxed across all European countries, which suggests that construction should rebound sharply in May. That said, it will remain well below pre-crisis levels, and it will take some time before it normalizes. With uncertainty set to remain elevated due to fears of a second wave of infections, companies and households won't give the green light to big investment projects just yet.

## ASIA PACIFIC

By Shahana Mukherjee of Moody's Analytics
June 18, 2020

### JAPAN

The economic costs of the COVID-19 pandemic continue to rise for Asia. In the latest development, Japan's trade suffered another shock, as exports sharply contracted in May by 28.3% on yearly terms, following a 21.9% decline in April. The decline was broad-based but led by significant reductions in the shipment of transport equipment, and general-purpose and electrical machinery. This marks the 18th consecutive decline in foreign sales and the sharpest one recorded since 2009.

The underlying drivers of the May performance were not very different from April. The sharper slowdown in May reflects the effects of simultaneous lockdowns in the U.S., Europe and parts of Asia, as exports to these markets contracted by 50.6%, 35.4% and 12% on yearly terms, respectively. The slowdown also partially reflects the effects of the nationwide lockdown in Japan, which was eased from around mid-May but is likely to have hurt companies' ability to process export orders for most of the month. As in April, China-bound shipments continued to improve and partially offset the net decline, falling by a relatively narrower margin of 1.9%.

### Little cushion

Another reason Japan's exporters are acutely impacted is because the economy's export basket is made up of goods that provide little cushion to counter the cyclical downside forces. The pandemic and subsequent containment efforts have induced supply-side as well as demand-side shocks, both of which have severely undermined Japan's position. Demand for durable goods such as cars and other vehicles continues to weaken, affecting demand for Japan's transport equipment, which makes up around 17% of its total merchandise exports. Large-scale shutdowns in most parts of the world and a bleak near-term business outlook have dented demand for production goods, affecting demand for general-purpose and electrical machinery, which cumulatively makes up nearly 41% of Japan's total exports. Consequently, the three commodity groups have continued to contribute the most to the net decline.

In comparison, the 26.2% yearly decline in imports in May resulted from a sharp decline in mineral fuel imports, but also lower transport equipment and machinery imports. A significant share of the reduced import bill can be attributed to cheaper oil imports, but it also partially reflects reduced industrial and consumption activity, considering that the economy was in lockdown for nearly half of May.

### Costs rising by the day

The costs from the COVID-19 pandemic are rising by the day. With the U.S., India and Russia recording sharp increases in new cases, China now facing new risks from a second wave of infections, and geopolitical tensions between the U.S. and China, external conditions remain challenging and will weigh more heavily on global trade in the months ahead. Internal risks may also increase unless the health crisis is fully controlled and consumer confidence improves. The government has already mobilized substantial resources, and the Bank of Japan increased the nominal size of its lending packages for cash-strapped firms to US$1 trillion in June from US$700 billion in May in another boost to cushion the economy from the fallout from the crisis.

While Japan is already in a technical recession and the cumulative effects of the domestic and external lockdowns will materialize through a sharp contraction in June, the easing of restrictions across the world suggests that the worst for trade may have bottomed out in May. A clear emphasis on protecting the labour market outcomes is important at this stage, as it impacts household income, the appetite for spending, and eventually, how soon deflation pressures ease. As things stand, downside risks for Japan from a potential second wave of infections and the uncertainty in external demand remain elevated, and a deep recession in 2020 is imminent.

## Ratings Round-Up

# Racing Sees Downgrades

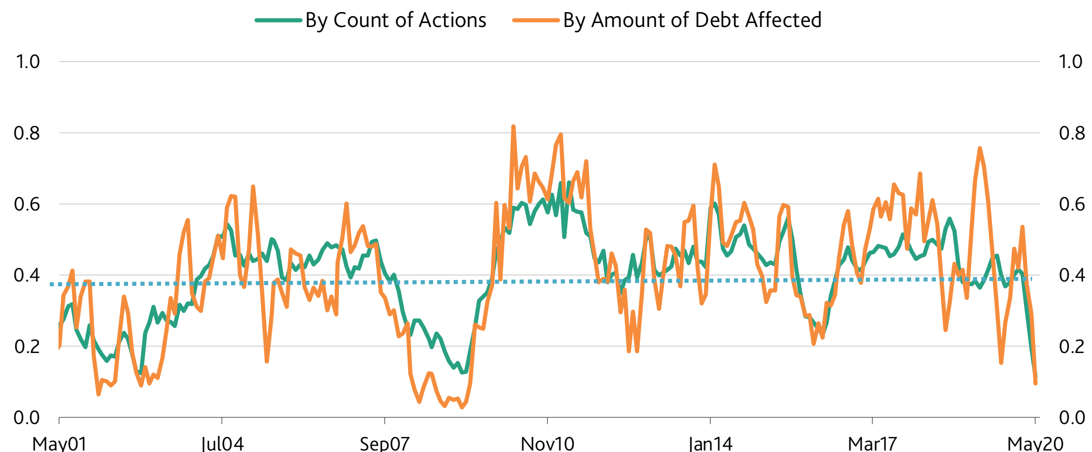
By Michael Ferlez

U.S. corporate credit quality continues to deteriorate as a result of the global recession. So far this year, downgrades have outnumbered upgrades by a factor of four, with the business services and oil exploration and production industries experiencing the most downgrades. For the week ended June 16, downgrades accounted roughly three-quarters of U.S. rating changes, but only 39% of affected debt. Business services and consumer services suffered the most downgrades, at four each. The most notable downgrade was made to The Brinks Company. Moody's Investors Service downgraded the U.S. security-services company's corporate family rating and senior unsecured credit rating by one notch to Ba2 and Ba3, respectively. The downgrade reflects the negative impact the COVID-19 pandemic has had on the firm's operations and credit metrics. Other notable downgrades included NASCAR Holdings LLC, Speedway Motorsports LLC, and JetBlue Airlines Corp. Meanwhile, upgrades were headlined by Comstock Resources, Inc, which saw its senior unsecured credit rating raised to Caa1 from Caa2, and its corporate family rating upgraded to B3 from Caa1. Moody's Investors Services upgrade of the U.S. oil and gas exploration and production company reflects the firm's improved liquidity position and its natural gas hedges which place it in a better position to withstand a low natural gas environment. The upgrade impacted $1.5 billion in outstanding debt.

The trend in European rating change activity improved last week. In the period ended June 16, there were 12 total changes, split evenly between upgrades and downgrades, breaking the recent trend in which downgrades have firmly outnumbered upgrades. Rating change actively was evenly split across Europe, with no single country receiving more than two rating changes. The notable downgrade last week was made to Schaeffler Finance B.V., which saw its senior secured notes cut to Ba1 from Baa3. The downgrade reflects the decline in the firm's operating profit margins and higher levels of financial leverage. The downgrade affects $3.2 billion in debt. Meanwhile, Sweedish Telefonaktiebolaget LM Ericsson saw its senior unsecured credit rating upgraded from Ba2 to Ba1. The upgrade reflects the firm's success implementing its strategic plan, which has increased the firm's operating performance and margins.

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 |
|---|---|---|---|---|---|---|---|---|
| 6/10/20 | SPEEDWAY MOTORSPORTS, LLC | Industrial | SrUnsec/LTCFR | 350 | D | B1 | B2 | SG |
| 6/10/20 | APEX TOOL GROUP, LLC. | Industrial | SrUnsec/SrSec /BCF/LTCFR | 325 | D | Caa1 | Caa3 | SG |
| 6/10/20 | NASCAR HOLDINGS, LLC | Industrial | SrSec/BCF/LTCFR | | D | Ba2 | Ba3 | SG |
| 6/11/20 | BRINK'S COMPANY (THE) | Industrial | SrUnsec/LTCFR | 600 | D | Ba2 | Ba3 | SG |
| 6/11/20 | JETBLUE AIRWAYS CORP. | Industrial | SrSec/BCF | | D | Ba1 | Ba2 | SG |
| 6/11/20 | SERTA SIMMONS BEDDING, LLC | Industrial | SrSec/BCF | | D | Caa3 | Ca | SG |
| 6/11/20 | NN, INC. | Industrial | SrSec/BCF/LTCFR | | D | Caa1 | Caa2 | SG |
| 6/11/20 | NEP GROUP, INC-NEP/NCP HOLDCO, INC | Industrial | SrSec/BCF | | D | Caa1 | Caa2 | SG |
| 6/12/20 | IQOR HOLDINGS INC.-IQOR US, INC. | Industrial | SrSec/BCF/LTCFR | | D | Caa1 | Ca | SG |
| 6/12/20 | GLOBALTRANZ ENTERPRISES, LLC | Industrial | SrSec/BCF/LTCFR | | D | B2 | B3 | SG |
| 6/12/20 | MED PARENTCO., LP. | Industrial | SrSec/BCF/LTCFR | | D | Caa2 | Caa3 | SG |
| 6/15/20 | PYXUS INTERNATIONAL, INC. | Industrial | SrSec | 275 | D | Caa2 | Caa3 | SG |
| 6/15/20 | PGX HOLDINGS, INC. | Industrial | SrSec/BCF/LTCFR | | U | C | Caa3 | SG |
| 6/15/20 | 24 HOUR FITNESS WORLDWIDE, INC. | Industrial | SrSec/BCF/LTCFR | | D | Caa3 | Ca | SG |
| 6/15/20 | CENTENNIAL RESOURCE DEVELOPMENT, INC. -CENTENNIAL RESOURCE PRODUCTION, LLC | Industrial | SrUnsec | 900 | U | Caa3 | Caa2 | SG |
| 6/16/20 | COMSTOCK RESOURCES, INC. | Industrial | SrUnsec/LTCFR | 1,475 | U | Caa2 | Caa1 | SG |
| 6/16/20 | SHIFT4 PAYMENTS, LLC | Industrial | LTCFR | | U | B3 | B2 | SG |

*Source: Moody's*

## Ratings Round-Up

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

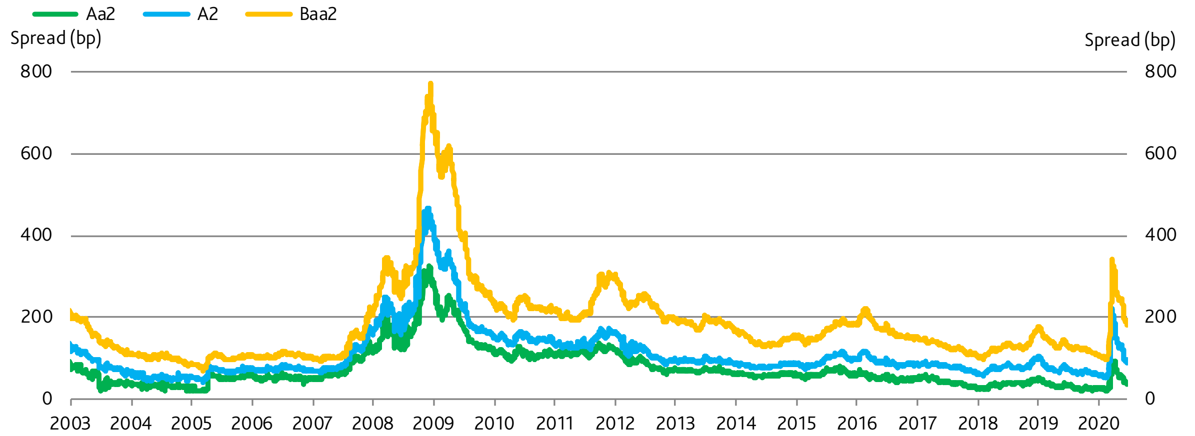
| Date | Company | Sector | Rating | Amount ($ Million) | Up/ Down | Old LTD Rating | New LTD Rating | IG/SG | Country |
|---|---|---|---|---|---|---|---|---|---|
| 6/10/20 | EUROPCAR MOBILITY GROUP S.A. | Industrial | SrUnsec/LTCFR | 1,743 | D | Caa1 | Caa3 | SG | FRANCE |
| 6/10/20 | GRUPO ALDESA S.A. | Industrial | LTCFR | | U | Caa1 | B1 | SG | SPAIN |
| 6/12/20 | PAX MIDCO SPAIN | Industrial | SrSec/BCF/LTCFR | | D | B1 | B3 | SG | SPAIN |
| 6/15/20 | TELEFONAKTIEBOLAGET LM ERICSSON | Industrial | SrUnsec/LTCFR/MTN | 2,125 | U | Ba2 | Ba1 | SG | SWEDEN |
| 6/15/20 | IHO BETEILIGUNGS GMBH-SCHAEFFLER FINANCE B.V. | Industrial | SrSec/SrUnsec/MTN | 3,149 | D | Baa3 | Ba1 | IG | NETHERLANDS |
| 6/15/20 | ANACAP FINANCIAL EUROPE S.A. SICAV-RAIF | Financial | SrSec/LTCFR | 350 | D | B2 | B3 | SG | LUXEMBOURG |
| 6/16/20 | MHP SE | Industrial | LTCFR | | U | B3 | B2 | SG | CYPRUS |
| 6/16/20 | TRAVELPORT HOLDINGS LIMITED-TRAVELPORT FINANCE (LUXEMBOURG) S.A.R.L. | Industrial | SrSec/BCF/LTCFR | | D | Caa3 | Ca | SG | LUXEMBOURG |
| 6/16/20 | METINVEST B.V. | Industrial | LTCFR | | U | B3 | B2 | SG | NETHERLANDS |
| 6/16/20 | FERREXPO PLC | Industrial | LTCFR | | U | B3 | B2 | SG | SWITZERLAND |
| 6/16/20 | BLUESTEP BANK AB (PUBL) | Financial | LTD | | U | Baa1 | A3 | IG | SWEDEN |
| 6/16/20 | EVEREST BIDCO SAS | Industrial | SrSec/BCF/LTCFR | | D | B1 | B2 | SG | FRANCE |

*Source: Moody's*

# Market Data

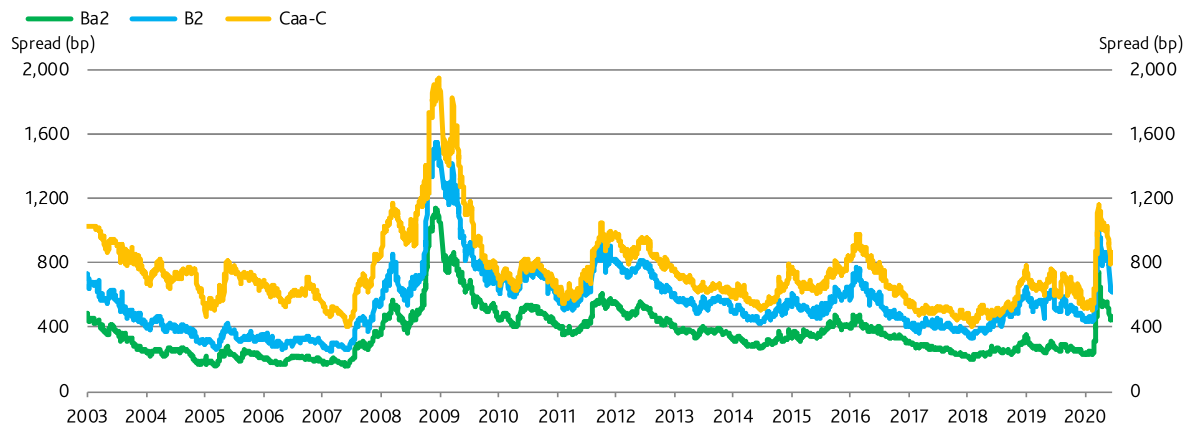
## Spreads

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 (June 10, 2020 – June 17, 2020)**

| CDS Implied Rating Rises | CDS Implied Ratings | | |
|---|---|---|---|
| Issuer | Jun. 17 | Jun. 10 | Senior Ratings |
| Applied Materials Inc. | Aa3 | Baa2 | A3 |
| Boeing Company (The) | Ba2 | B1 | Baa2 |
| Southwest Airlines Co. | Ba1 | Ba3 | Baa1 |
| HP Inc. | A1 | A3 | Baa2 |
| Meritage Homes Corporation | Ba3 | B2 | Ba2 |
| Consolidated Edison, Inc. | A1 | A3 | Baa2 |
| Citigroup Inc. | Baa1 | Baa2 | A3 |
| AT&T Inc. | Baa3 | Ba1 | Baa2 |
| JPMorgan Chase Bank, N.A. | A1 | A2 | Aa2 |
| Morgan Stanley | Baa1 | Baa2 | A3 |

| CDS Implied Rating Declines | CDS Implied Ratings | | |
|---|---|---|---|
| Issuer | Jun. 17 | Jun. 10 | Senior Ratings |
| Carnival Corporation | Ca | Caa2 | Ba1 |
| Cardinal Health, Inc. | A1 | Aa2 | Baa2 |
| R.R. Donnelley & Sons Company | Ca | Caa2 | B3 |
| Ashland LLC | Baa2 | A3 | Ba1 |
| Oracle Corporation | A1 | Aa3 | A3 |
| PNC Financial Services Group, Inc. | Aa2 | Aa1 | A3 |
| Calpine Corporation | Ba2 | Ba1 | B2 |
| Kinder Morgan, Inc. | A2 | A1 | Baa2 |
| NRG Energy, Inc. | Ba1 | Baa3 | Ba2 |
| McKesson Corporation | Aa3 | Aa2 | Baa2 |

| CDS Spread Increases | | CDS Spreads | | |
|---|---|---|---|---|
| Issuer | Senior Ratings | Jun. 17 | Jun. 10 | Spread Diff |
| Staples, Inc. | B3 | 1,481 | 1,166 | 314 |
| Nabors Industries, Inc. | B3 | 2,298 | 1,990 | 308 |
| Royal Caribbean Cruises Ltd. | Ba2 | 1,476 | 1,209 | 267 |
| Carnival Corporation | Ba1 | 1,033 | 768 | 265 |
| United States Steel Corporation | Caa2 | 1,293 | 1,135 | 157 |
| R.R. Donnelley & Sons Company | B3 | 1,005 | 886 | 119 |
| Pitney Bowes Inc. | B1 | 1,233 | 1,143 | 90 |
| American Airlines Group Inc. | Caa1 | 2,130 | 2,055 | 75 |
| L Brands, Inc. | B2 | 604 | 551 | 53 |
| Avis Budget Car Rental, LLC | B3 | 864 | 814 | 50 |

| CDS Spread Decreases | | CDS Spreads | | |
|---|---|---|---|---|
| Issuer | Senior Ratings | Jun. 17 | Jun. 10 | Spread Diff |
| Chesapeake Energy Corporation | C | 28,453 | 38,593 | -10,139 |
| K. Hovnanian Enterprises, Inc. | Caa3 | 2,279 | 2,446 | -167 |
| Talen Energy Supply, LLC | B3 | 1,171 | 1,227 | -56 |
| Southwest Airlines Co. | Baa1 | 181 | 228 | -46 |
| UDR, Inc. | Baa1 | 531 | 576 | -45 |
| Meritage Homes Corporation | Ba2 | 243 | 289 | -45 |
| Macy's Retail Holdings, Inc. | B1 | 736 | 780 | -44 |
| General Electric Company | Baa1 | 153 | 195 | -42 |
| Occidental Petroleum Corporation | Ba1 | 581 | 621 | -40 |
| Ford Motor Company | Ba2 | 476 | 515 | -39 |

*Source: Moody's, CMA*

## Market Data

**Figure 4. CDS Movers - Europe (June 10, 2020 – June 17, 2020)**

| CDS Implied Rating Rises | CDS Implied Ratings | | |
|---|---|---|---|
| Issuer | Jun. 17 | Jun. 10 | Senior Ratings |
| DZ BANK AG | A2 | Baa1 | Aa1 |
| Legrand France S.A. | A2 | Baa1 | A3 |
| Barclays PLC | Baa2 | Baa3 | Baa2 |
| NatWest Markets Plc | Baa2 | Baa3 | Baa2 |
| Lloyds Bank plc | Aa2 | Aa3 | Aa3 |
| Telecom Italia S.p.A. | Ba1 | Ba2 | Ba1 |
| Atlantia S.p.A. | B1 | B2 | Ba3 |
| BAWAG P.S.K. | Baa3 | Ba1 | A2 |
| Bayer AG | A1 | A2 | Baa1 |
| ArcelorMittal | Ba2 | Ba3 | Ba1 |

| CDS Implied Rating Declines | CDS Implied Ratings | | |
|---|---|---|---|
| Issuer | Jun. 17 | Jun. 10 | Senior Ratings |
| Royal Dutch Shell Plc | A3 | A1 | Aa2 |
| France, Government of | Aa1 | Aaa | Aa2 |
| Societe Generale | A1 | Aa3 | A1 |
| BNP Paribas | A1 | Aa3 | Aa3 |
| Portugal, Government of | Baa1 | A3 | Baa3 |
| UniCredit Bank AG | Baa1 | A3 | A2 |
| Total S.A. | A1 | Aa3 | Aa3 |
| Nationwide Building Society | A2 | A1 | A1 |
| Bayerische Motoren Werke Aktiengesellschaft | Baa2 | Baa1 | A2 |
| UniCredit Bank Austria AG | A3 | A2 | Baa1 |

| CDS Spread Increases | | CDS Spreads | | |
|---|---|---|---|---|
| Issuer | Senior Ratings | Jun. 17 | Jun. 10 | Spread Diff |
| Matalan Finance plc | Caa2 | 7,224 | 5,021 | 2,203 |
| Vedanta Resources Limited | B3 | 1,478 | 1,091 | 387 |
| TUI AG | Caa1 | 1,192 | 1,122 | 70 |
| Deutsche Lufthansa Aktiengesellschaft | Ba1 | 322 | 278 | 45 |
| CMA CGM S.A. | Caa1 | 1,106 | 1,069 | 37 |
| Vue International Bidco plc | Caa2 | 840 | 811 | 29 |
| Fiat Chrysler Automobiles N.V. | Ba2 | 250 | 222 | 27 |
| Banca Monte dei Paschi di Siena S.p.A. | Caa1 | 231 | 215 | 17 |
| Unibail-Rodamco-Westfield SE | A3 | 203 | 186 | 17 |
| Ineos Group Holdings S.A. | B2 | 297 | 282 | 15 |

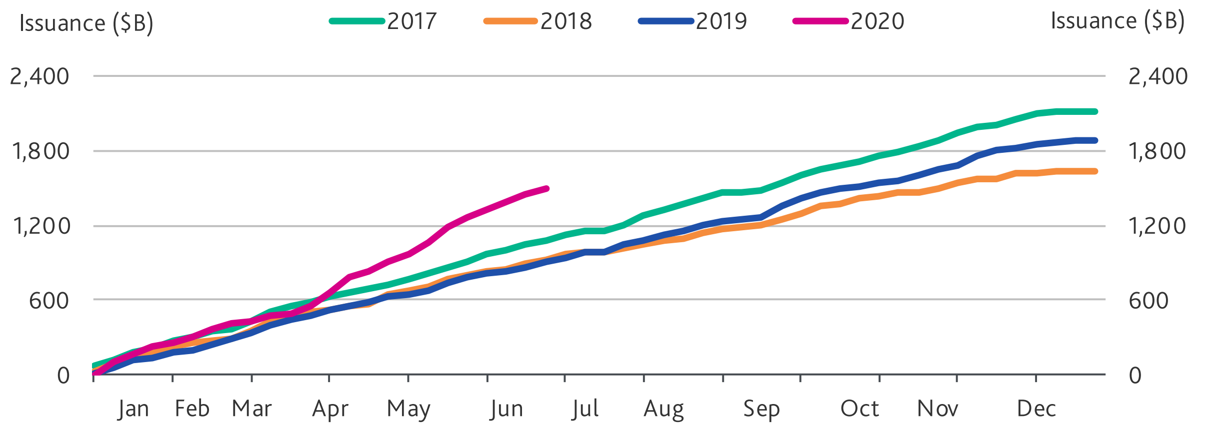
| CDS Spread Decreases | | CDS Spreads | | |
|---|---|---|---|---|
| Issuer | Senior Ratings | Jun. 17 | Jun. 10 | Spread Diff |
| Selecta Group B.V. | Caa2 | 3,730 | 3,936 | -206 |
| PizzaExpress Financing 1 plc | C | 13,408 | 13,604 | -196 |
| Jaguar Land Rover Automotive Plc | B1 | 869 | 926 | -57 |
| Boparan Finance plc | Caa1 | 923 | 972 | -50 |
| Casino Guichard-Perrachon SA | B3 | 609 | 654 | -46 |
| Virgin Media Finance PLC | B2 | 221 | 249 | -28 |
| Sappi Papier Holding GmbH | Ba2 | 399 | 426 | -27 |
| thyssenkrupp AG | B1 | 282 | 306 | -24 |
| GKN Holdings Limited | Ba1 | 249 | 266 | -17 |
| Premier Foods Finance plc | Caa1 | 170 | 187 | -17 |

*Source: Moody's, CMA*

## Market Data

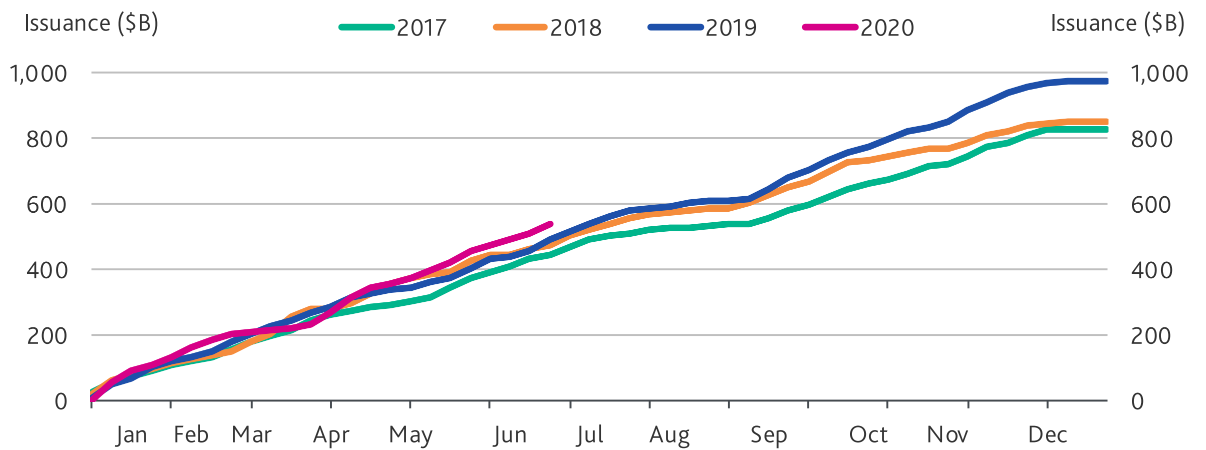
### Issuance

**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 | 32.835 | 13.810 | 48.542 |
| Year-to-Date | 1,206.517 | 246.794 | 1,498.700 |

| | Euro Denominated | | |
|---|---|---|---|
| | Investment-Grade | High-Yield | Total* |
| | Amount $B | Amount $B | Amount $B |
| Weekly | 18.557 | 3.966 | 25.047 |
| Year-to-Date | 473.583 | 50.369 | 537.205 |

* Difference represents issuance with pending ratings.

*Source: Moody's/ Dealogic*

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