MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

Moody's Analytics Research

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Optimism Rules Despite Unfinished Slowing of Core Business Sales

Credit Markets Review and Outlook *by John Lonski*

Optimism Rules Despite Unfinished Slowing of Core Business Sales

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The Week Ahead

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

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The Long View

Full updated stories and key credit market metrics: U.S. companies accounted for $82 billion, or 52%, of January's $156 billion of US$-denominated IG corporate bond offerings.

Credit Spreads	Investment Grade: We see the year-end 2020's average investment grade bond spread above its recent 113 basis points. High Yield: Compared with a recent 387 bp, the high-yield spread may approximate 445 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 4.7% for IG to $1.371 trillion, while high-yield supply may grow by 9.2% to $472 billion.

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Ratings Round-Up

Downgrades Account for 11 of 15 U.S. Changes

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Market Data

Credit spreads, CDS movers, issuance.

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Moody's Capital Markets Research *recent publications*

Links to commentaries on: 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, upside risks.

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

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Credit Markets Review and Outlook

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

Optimism Rules Despite Unfinished Slowing of Core Business Sales

The market value of U.S. common stock has been setting new record highs with regularity. The market appears to be supremely confident of two things. First, that a disruptive contraction of corporate earnings will be avoided and, second, that a damaging climb by benchmark interest rates will not occur.

The avoidance of a troublesome ascent by corporate credit defaults was not mentioned mostly because each previous climb by the high-yield default rate above 5% was accompanied by a deeper than 5% drop by pretax recurring profits. As of early February, the Blue-Chip consensus forecast calls for a slight 2.2% annual rise by pretax recurring profits which would be sufficient for the purpose of warding off an equity market sell-off. Of additional importance is how the very modest outlook for core profits weighs against the possibility of a damaging climb by benchmark interest rates.

Speaking of corporate earnings, FactSet reports that fourth-quarter 2019's earnings per share estimate for the S&P 500 improved considerably compared to what was expected at the end of 2019. As of year-end 2019, the FactSet consensus average of equity analysts had the S&P 500 earnings per share of 2019's final quarter shrinking by 1.7% annually. However, as of February 14, the consensus was looking for a 0.9% annual rise by fourth-quarter earnings per share.

In part, the upward revision of estimated EPS was the offshoot of an upward revision of fourth-quarter 2019's projected year-over-year increase for S&P 500 revenue growth from year-end 2019's 2.8% to February 14's 3.6%.

Apparently, the results of S&P 500 member companies bottomed in 2019's third quarter with a 3.1% annual rise by revenues and a 2.2% annual contraction by EPS.

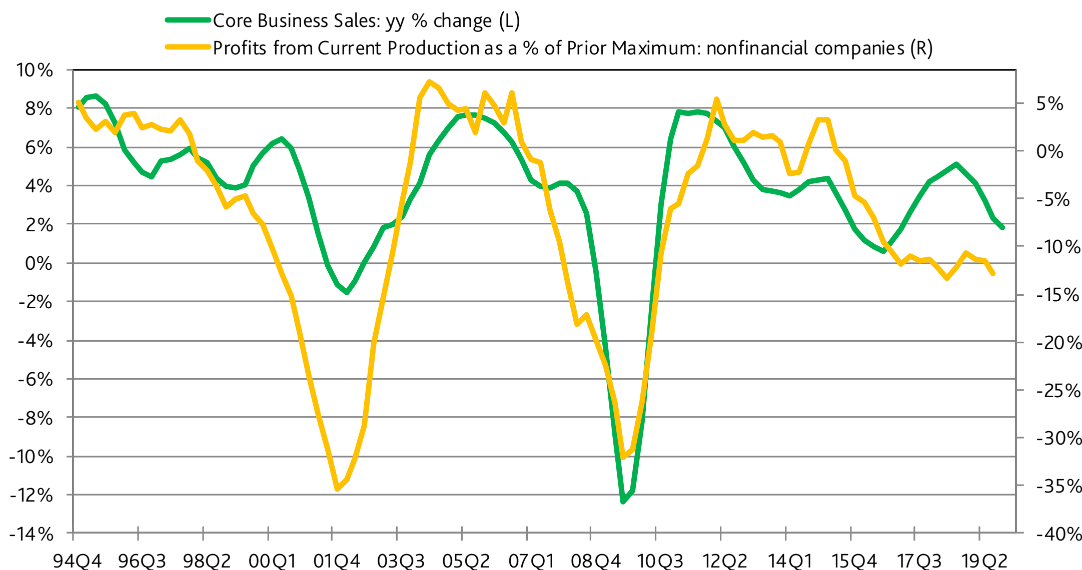
Despite fourth-quarter 2019's upwardly revised outlooks for the S&P 500's member companies, the consensus lowered its projected calendar-year 2020 growth rates from year-end 2019's 5.4% to a recent 5.2% for revenues and from 9.4% to 8.0% for EPS. If expectations of relatively low interest rates persist, equity prices may not suffer much from further downward revisions of EPS growth provided that market participants are confident about the avoidance of a contraction by EPS.

Growth of Core Business Sales Has Yet to Bottom

Unlike the likely third-quarter 2019 bottoming by the year-over-year growth rate of S&P 500 revenues, the annual growth rate for a broad estimate of the core sales of U.S. nonfinancial businesses continued to slow through 2019's final quarter. Here, core business sales exclude sales of identifiable energy products.

After most recently peaking at the 5.4% of 2018's second-quarter, or just prior to the intensification of the U.S.-China trade conflict, the year-over-year increase of core business sales subsequently slowed to the 1.2% of 2019's final quarter. Early indications suggest that core business sales' annual increase ebbed to 1.0% in January 2020.

Figure 1: Recurring Pretax Profits Are Now Menaced by Deceleration of Core Business Sales
yearlong observations
sources: Census Bureau, BEA, Moody's Analytics

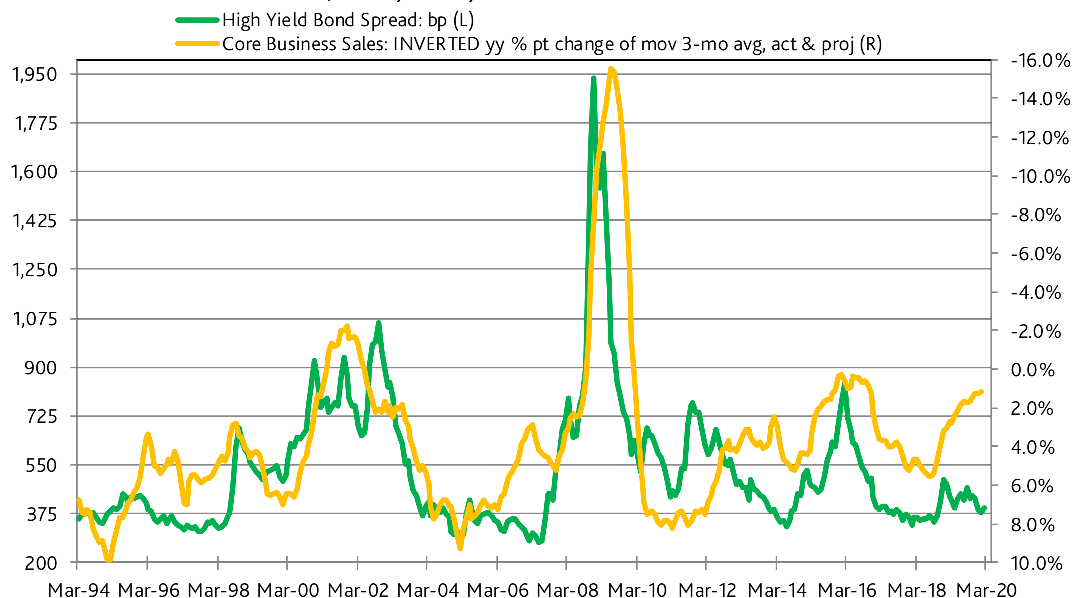


During 2015-2016's profits recession, the annual increase of core business sales slowed from a third-quarter 2014 top of 5.2% to a 0.4% bottom that applied to both 2015's final quarter and 2016's second quarter. In terms of a month-long average, the market value of U.S. common stock would plummet by 12.9% from a May 2015 high to a February 2016 trough.

Nevertheless, the Russell 2000 stock price index of small- to mid-sized companies, which has a stronger correlation than the overall equity market with speculative-grade bonds, incurred a deeper 21.0% plunge from a June 2015 high to a February 2016 bottom.

The latter brings attention to a pronounced widening by corporate bond yield spreads. Prior to the start of the profits recession, a composite high-yield bond spread had bottomed at June 2014's 331 basis points, which is still the thinnest month-long average since June 2007's 277 bp. Thereafter, the high-yield bond spread widened and eventually crested at February 2016's 839 bp, which remains the widest such spread since August 2009's 845 bp.

Figure 2: High-Yield Bond Spread Defies Slowdown by Core Business Sales (INVERTED)
sources: Census Bureau, Moody's Analytics



Credit Markets Review and Outlook

For intermediate-term maturities, Moody's Analytics' yield spread for Baa-rated industrial company bonds widened from July 2014's 127 bp to a February 2016 high of 208 bp. The spread over Treasuries for Moody's Analytics' long-term Baa industrial-company bond yield broadened from April 2014's 144 bp to a February 2016 high of 277 bp.

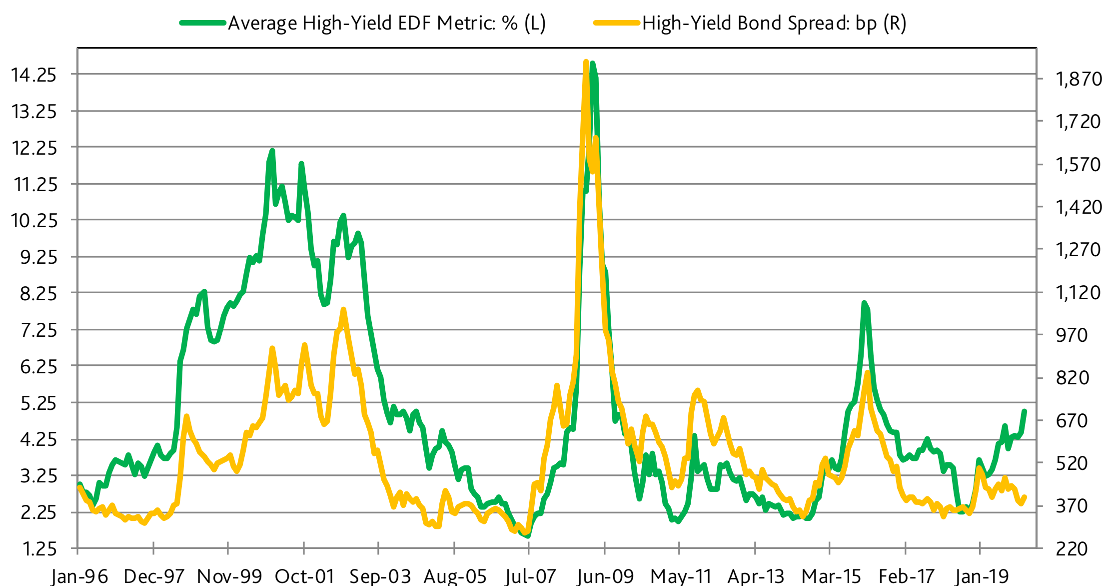
Recent corporate bond yield spreads were 387 bp for high-yield, 128 bp for the intermediate-term industrials, and 177 bp for the long-term industrials.

Market Ignores Average EDF and Takes Its Cue From Median EDF

February-to-date's recent 5.00% average expected default frequency metric of U.S./Canadian high-yield issuers was up considerably from its 3.23% average of February 2019 and exceeded each previous month-long average going back to June 2016's 5.06%. However, June 2016 was home to spreads of 623 bp for high-yield bonds and 542 bp for leveraged loans, both of which were much wider than the recent February-to-date spreads of 399 bp for bonds and 427 bp for loans.

A model which employs the average high-yield EDF and its change over the last three months now predicts a 572 bp February average for the high-yield bond spread that was much wider than the 399 bp of February-to-date.

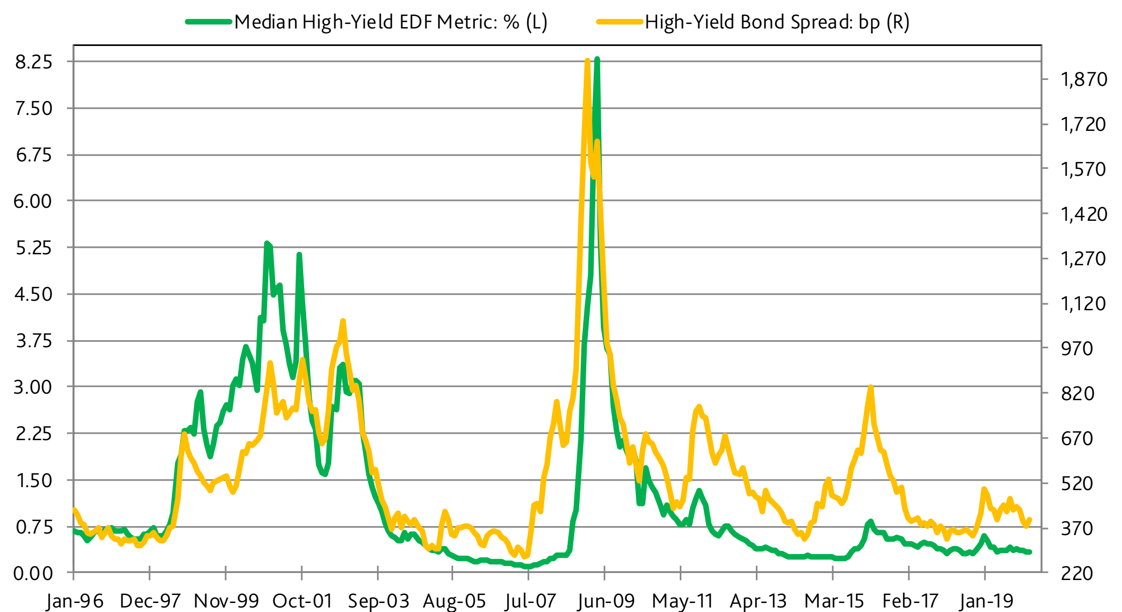
Figure 3: Average High-Yield EDF Metric Warns of a Possibly Wider Than 550 Basis Points High-Yield Bond Spread
source: Moody's Analytics



Unlike the year-to-year jump by the average high-yield EDF, February-to-date's 0.34% median EDF of U.S./Canadian high yield issuers was less than the 0.41% of February 2019 and was well under the 0.65% average of June 2016.

A model which employs the median high-yield EDF and its change over the last three months now predicts a 431 bp average for February's high-yield bond spread, which was very close to the 399 bp average of February-to-date.

Figure 4: Median High-Yield EDF Metric Favors a 431 Basis Points Midpoint for High-Yield Bond Spread
source: Moody's Analytics



Given the 177 bp year-to-year jump by February-to-date's average high-yield EDF, the 7 bp year-to-year drop by the median high-yield EDF is unusual. For the 107 months since 1996 showing at least a 50 bp year-to-year increase by the average high-yield EDF, the median high-yield EDF declined from a year earlier for only 26, or 24.3%, of the sample.

The 26 outliers often came in bunches and occurred during January 1997, June-August 1997, June-July 2001, September 2011, January-July 2012, December 2014 through July 2015, and November 2019 through February 2020. For the 22 months prior to the latest episode, the high-yield bond spread of 12 months later would be higher by 44 bp, on average. However, for 8, or 35%, of the 22 months, the high-yield bond spread of 12 months later would be thinner.

The correlation between the average and median high-yield EDF metrics is a strong 0.91. Moreover, the correlation between the year-to-year changes of the average and median high-yield EDFs also is a strong 0.89.

The high-yield bond spread showed nearly identical coincident correlations of 0.75 with the average high-yield EDF and 0.76 with the median high-yield EDF. In addition, the high-yield default rate showed only a slightly higher correlation of 0.88 with the average EDF of nine months earlier compared to its 0.84 correlation with the median EDF of nine months earlier.

Markets Shrug Off Fed Official's Attempt to Sway Rate Views

High-ranking Fed officials no longer move interest rate views like they did in the past. Though the headline blared, "Fed Vice Chair Clarida throws cold water on traders pricing in a rate cut," the 10-year Treasury yield promptly fell to 1.53%, or 10 bp under fed funds' 1.63% midpoint. Moreover, the accompanying two- and five-year Treasury yields of 1.40% and 1.37%, respectively, reflect the market's view that the Fed's next move will be to cut rates.

Moreover, as derived from the CME Group's FedWatch Tool, the recent implied probabilities of a fed funds midpoint that is less than its current 1.63% were 10% following March 10's Federal Open Market Committee meeting, 53% after the June 10 meeting, and 75% following the September 16 meeting.

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

THE U.S.

By Ryan Sweet of Moody's Analytics

Some Parts of the U.S. Economy Are Feeling the Warmth

The U.S. economy is inherently seasonal and usually only extreme deviations from normal weather significantly affect economic activity. Recent weather has been favorable for some parts of the economy, but that is unlikely to be overly noticeable in first quarter GDP. To gauge weather effects, we lean on heating degree days, a population-weighted measure of how far temperatures are above or below a benchmark level, along with precipitation. The deviation in heating degree days from their prior five-year average shows that weather has been warmer than normal since late December.

To assess weather's potential impact on GDP, we used a simple regression to examine how colder than normal weather, proxied by the deviation in heating degree days during a quarter, would affect GDP growth. We restricted the sample to include only the fourth and first quarter each year, a loose definition of winter.

As expected, deviations in heating degree days have the correct sign (negative), are statistically significant, and suggest that large deviations in temperatures can affect GDP growth. Based on the regression, favorable weather so far has likely added marginally to first quarter GDP growth and maybe enough to offset the drag from residual seasonality. However, first quarter GDP growth will be hurt by Boeing's decision to halt production of the 737 MAX and the outbreak of coronavirus (COVID-19), which combined could shave close to a full percentage point off GDP growth.

Aside from GDP, if the unusually cold weather lingers long enough, it could have some implications for higher-frequency data, including industrial production, employment, construction spending and retail sales.

Some of the strength in housing starts recently is likely weather-related. Though housing starts fell 3.6% in January to 1.567 million annualized units, it reverses little of December's 17.7% gain and leaves starts among the highest levels since 2006. Single-family starts fell 5.9% in January after rising 14.1% in December. Multifamily starts rose 0.7%, their fourth consecutive monthly gain. Housing permits, which are less affected by weather, rose 9.2% in January, more than reversing the decline in December. Both single- and multifamily permits were up in January.

It does appear that favorable weather is depressing the trend in initial claims, but only modestly. To come to this conclusion, we used a simple regression to examine how warmer weather, proxied by the deviation in the four-week moving average in heating degree days from their prior five-year average, would affect the four-week moving average in initial claims.

As expected, deviations in heating degrees from normal explain little of the total fluctuation in the trend in new filings, highlighted by the low R-squared. However, it is still significant and suggests that large deviations in weather can affect new filings. Based on our regression, the warmer than normal weather caused the trend in initial claims to be 5,000 to 10,000 lower than it would have if temperatures were seasonally normal.

We ran individual regressions for the monthly data. The results were not surprising. The weather variables explain little of the monthly fluctuations, evident in the low R2. Still, the signs were generally correct and the weather variable was statistically significant. Therefore, the recent unseasonably warm weather could reduce industrial production via utilities, lower initial claims, and boost residential construction. Weather's impact on retail is a bit fuzzier, but restaurants will benefit while apparel will be hurt.

Next week

The economic calendar looks pretty busy. The key data will include consumer confidence, durable goods orders, new-home sales, revisions to fourth-quarter GDP, personal income, consumption and the PCE price deflators.

EUROPE

By Ross Cioffi of Moody's Analytics

Stagnation Expected on German GDP

Next week's big release will be Germany's fourth-quarter GDP. Preliminary estimates give us a good idea of what's to come. Unfortunately, there isn't much to be excited about. German real GDP likely stagnated in the final three months of 2019. We expect net exports and investments to have detracted from growth; industrial production had its worst quarter all year thanks to December's grim figures. Equipment and machine investment will be to blame for contracting gross investments, but even though construction production plummeted in December, construction likely supported output over the quarter. However, unlike in the rest of 2019, consumption expenditures from both households and the government likely failed to stimulate real growth. Retail sales that had come in far below expectations in December clued us to the possibility that household consumption slowed by year end.

Final estimates of French GDP in quarter four will also be released, and again we have preliminary estimates to guide our forecast. We expect output to have increased by 0.1% q/q in the final stanza of 2019. The fourth quarter saw a slowdown in all components. The most pronounced seems to have been in gross investments, though household consumption also grew at a slower pace than in the third quarter. According to the first estimate, export and import growth balanced out, so net exports offered no support to GDP growth. Activity was severely hit by widespread strikes against the Macron government's pension reform. These dented industrial production—especially oil refining—transport services activities and construction. Refineries were shut due to the strikes as well as for maintenance, while transport services, especially rail services and port activities, ground to a halt. As a result, the strikes created severe disruptions to logistics systems and factory production. Expenditure details also showed that massive destocking did the most damage to growth; activity would have risen 0.3% q/q excluding inventories.

French household consumption should have rebounded from December. We foresee a 0.3% m/m increase in January. Because strikes persisted into the month we expect that rebound was muted. Strikers should have shifted into saving mode, while those who continued working likely put off journeying to the shops as the transit system remained stalled for much of the month.

Regarding French and German unemployment releases, we aren't expecting big month-to-month changes. The seasonally adjusted number of job seekers in France likely increased in January to 3.30 million from 3.29 million in December. The increase likely has more to do with the fallout from general strikes rather than a trend change in French employment. We expect the German unemployment rate to have remained at 5% for February.

Preliminary estimates of euro zone consumer price inflation for February should also have remained close to January's rate, increasing to 1.5% y/y from 1.4%. Base effects in oil markets from the coronavirus will act as a weight on headline inflation. A correction in food prices could also bring the headline rate lower than expected. However, we don't foresee a corresponding fall in core dynamics. Rather core inflation should rebound from its drop in January, supported by price increases in travel and accommodation related services.

We expect that business and consumer sentiment in the euro zone fell to 101.5 in February from 102.8 in January. The coronavirus has been dominating headlines throughout the month, and the question has become not if, but by how much the outbreak will affect firms worldwide. Businesses, and especially those in industry, will drag the index down, while the consumer index won't fall much from its already low reading.

	Key indicators	Units	Moody's Analytics	Last
Tues @ 8:00 a.m.	Germany: GDP for Q4	% change	0.0	0.2
Wed @ 11:00 a.m.	France: Job Seekers for January	mil, SA	3.30	3.29
Thur @ 10:00 a.m.	Euro Zone: Business and Consumer Sentiment for February	index	101.5	102.8
Fri @ 7:45 a.m.	France: Household Consumption Survey for January	% change	0.3	-0.3
Fri @ 7:45 a.m.	France: GDP for Q4	% change	0.1	0.3
Fri @ 9:55 a.m.	Germany: Unemployment for February	%	5.0	5.0
Fri @ 10:00 a.m.	Euro Zone: Preliminary Consumer Price Index for February	% change	1.5	1.4

ASIA-PACIFIC

By Katrina Ell of Moody's Analytics

Coronavirus Casts Uncertainty on China's Manufacturing PMI Forecast

The forecast for China's official manufacturing PMI for February has a higher degree of uncertainty than usual. It is unclear how much manufacturing sentiment will retreat in the wake of the coronavirus. The containment efforts by Chinese authorities to try to curtail the spread of the virus, COVID-19, are unprecedented, and prolonged factory closures in addition to the closure of major transport linkages are a significant blight on normal manufacturing operations. This channel of impact contributed to our significant downward revision in February to the forecast for China's full-year GDP growth in 2020 from 6.1% to 5.4%. Until the virus is contained and the number of infected patients stops rising, the toll on manufacturers and the broader economy will continue to rise.

Japan's January activity data dump is likely to be soft. Retail trade likely continued contracting on an annual basis in January amid the lingering impacts of the consumption tax hike on 1 October. A more significant blight would have been the travel restrictions that were imposed on Chinese tourists heading overseas late in the month as the coronavirus continued to spread. Japan is a relatively large recipient of short-term visitors from China and the Lunar New Year season, with which this travel ban coincided, is a peak season. This would have hurt consumption, with more pronounced impacts expected in February.

India's GDP growth likely hit 4.9% y/y in the December quarter, after the 4.5% expansion in the September stanza, the slowest since 2013. Domestic demand has struggled despite fiscal and monetary stimulus efforts over 2019. Manufacturing and general business operations are particularly weak, with the latter partially constrained by the sluggish pass-through of the Reserve Bank of India's monetary policy reductions.

	Key indicators	Units	Confidence	Risk	Moody's Analytics	Last
Tues @ 8:00 a.m.	South Korea Consumer sentiment survey for February	Index	3	↓	101.7	104.2
Thurs @ Unknown	South Korea Monetary policy for February	%	2	←	1.25	1.25
Fri @ 10:00 a.m.	South Korea Retail sales for January	% change	3	↓	-0.3	0.3
Fri @ 10:30 a.m.	Japan Unemployment rate for January	%	3	←	2.3	2.2
Fri @ 10:50 a.m.	Japan Retail sales for January	% change yr ago	2	←	-1.4	-2.6
Fri @ 10:50 a.m.	Japan Industrial production for January	% change	2	↓	-0.9	1.3
Fri @ 6:30 p.m.	Thailand Foreign trade for January	US$ bil	2	↓	1.0	1.9
Fri @ 11:00 p.m.	India GDP for Q4	% change yr ago	3	←	4.9	4.5
Sat @ 12:00 p.m.	China Official manufacturing PMI for February	Index	2	←	45.2	50.0

The Long View

U.S. companies accounted for $82 billion, or 52%, of January's $156 billion of US$-denominated IG corporate bond offerings.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group
February 20, 2020

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 113 basis points was less than its 122-point mean of the two previous economic recoveries. This spread may be no wider than 120 bp by year-end 2020.

The recent high-yield bond spread of 387 bp is thinner than what is suggested by the accompanying long-term Baa industrial company bond yield spread of 177 bp and the recent VIX of 15.4 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 3.3% for IG and 10.5% 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 2.00% for long. A fundamentally excessive climb by Treasury bond yields and a pronounced slowing by expenditures in dynamic emerging market countries are among the biggest threats to the adequacy of economic growth and credit spreads.

EUROPE

By Barbara Teixeira Araujo of Moody's Analytics
February 20, 2020

UNITED KINGDOM

January's retail sales report brought much-desired good news for the U.K. economy. British retailers enjoyed a good start to 2020, with sales in the sector rising at an above-consensus monthly pace and fully reversing the fall in December. This was in line with our story that the U.K. economy rebounded in January as uncertainty abated after December's general elections, which allowed for the Brexit deal to be ratified. Granted, the yearly trend in retail sales remained weak in January, but this was mainly because of base effects; it should rise strongly in coming months provided that consumers continue to catch up with the spending they postponed in 2019.

Even better is that the details of January's release were rosier than the headline, showing that sales would have increased at a much sharper pace were it not for a plunge in fuel sales, which are volatile. Fuel sales were depressed in January because pump prices rose sharply at the start of the year after having dropped for four consecutive months, and because the bad weather kept people at home. The bad weather and storms carried over into February, but that pump prices fell sharply should ensure that fuel sales rebound at least partially over the month.

Excluding fuel, sales rose across the board at its sharpest pace since May 2018. Especially welcome was the increase in food sales, since it managed to fully offset the falls in November and December. Nonfood sales also increased solidly, with a key upside detail being the jump in clothing sales, which was also the biggest since May 2018. Adding to the cheer, internet sales also soared in January, ensuring that the yearly trend in the sector continued to rise at a double-digit pace.

This year's prospects for retailers remain relatively optimistic, even if the outbreak of COVID-19 and the recent flooding might create noise in the numbers in the short term. Fundamentals for consumers remain solid, as joblessness is reading at a record low and wages continue to increase at a pace above 3%, while even better is that all leading surveys point to a surge in hiring intentions in the first quarter. Adding to that, the 6.2% rise in the National Living Wage in April should further boost consumers' purchasing power, and so should looser fiscal policy.

BANK OF ENGLAND

The U.K.'s January CPI report was a shocker, as it showed that inflation soared to 1.8% y/y, a six-month high, from 1.4% in December. But while the reading came in much higher than markets' expectations, it was in line with the Bank of England's latest forecast, suggesting that the report won't move the needle on the bank's outlook for interest rates. The fact that inflation is progressing in line with the central bank's projections, however, only added to our view that the Monetary Policy Committee can afford to wait a little while before cutting rates. Had inflation continued to disappoint, the bank would probably have had no choice but to add some stimulus to the economy, especially given that downside risks to first-quarter growth have soared following the outbreak of the coronavirus.

The case for standing pat is largely based on hopes that the U.K. economy will regain momentum in the first quarter, following the general elections and the passing of the Brexit deal, both of which reduced uncertainty. Soft data all corroborate this story, but we still need to be sure that the surge in confidence will pass through to the real economy. The main risk is that the coronavirus-related disruptions end up offsetting most of the expected rise in consumer spending and investment, as this would deal a hard blow to the outlook for inflation pressures.

Back to the details of the inflation report, we caution against reading too much into January's rise in the headline. It was mainly because of base effects in energy inflation, and these aren't supposed to last for long. Electricity and gas as well as motor fuels inflation are each expected to fall into deflation from March or April, owing to changes in Ofgem's price cap on electricity bills and to the outlook for oil prices. This should depress headline inflation from the second quarter until the end of the year, and this slide will be only slightly offset by the continued rise in services inflation. We expect inflation will read at around 1.5% y/y by year's end.

This soft inflation rate doesn't mean that the BoE needs to act this year, as it still sees inflation climbing to the 2% target by the end of 2022, in line with its remit. Risks are nonetheless tilted significantly to the downside, so we cannot completely rule out some action during the bank's May meeting, especially if the hard data disappoint.

ASIA PACIFIC

By Katrina Ell of Moody's Analytics
February 20, 2020

CHINA

The coronavirus has brought significant health and economic consequences to China and globally. The channels of economic impact were initially felt in financial markets and via households as travel restrictions on mainlanders hurt consumption and tourism at a local and international level. But with the usual factory closures from the Lunar New Year now being extended by about two weeks and key transport routes grinding to a halt, broader business and supply chain costs are rising.

Complex and integrated global supply chains have become a critical pathway for economic activity. In the case of manufactured goods, global supply chains rely on a vast network of specialization to maximize efficiency. The just-in-time manufacturing model takes efficiency maximization further with the philosophy that, to minimize inventory costs, goods should be received as they are needed. Problems arise and efficiencies are lost when global supply chains are disrupted. This was clear with Japan's 2011 Fukushima nuclear disaster and Thailand's 2011 floods, when extensive disruption to factories, transport linkages and infrastructure led to global shortages of important inputs for auto and tech components, causing extensive interruptions and delivery delays.

This is now occurring in China with transportation and business services halted as containment of the virus, COVID-19, takes priority over economic implications. China is a global manufacturing hub, accounting for around one-fifth of global manufacturing output. China's trading partners will feel varying degrees of pain as a result of the coronavirus.

Auto production

Understanding the complexity of auto production sheds some light. One automobile has around 30,000 parts and within those parts, different raw materials (including steel, aluminum, copper, glass and rubber) and manufacturing processes are used, according to Toyota. So, producing one car from the raw material stage to the finished product is a lengthy process that spans across many factories, regions and economies. China produces the most cars of any single country.

China's auto industry is already feeling the pressure from the virus. China's auto industry has had a tough run and the start of 2020 has brought no relief. Vehicle sales in China fell by 18% y/y in January, after the 0.1% decline in December. Vehicle sales have now declined for 19 consecutive months. According to the Association of Automobile Manufacturers, the coronavirus played a role in the sharp fall in January because factories were closed and consumer demand sharply receded as travel restrictions were imposed in the last two weeks of January. The auto association also noted that on 12 February, only 59 out of 183 factories that manufacture complete cars had resumed production in China. Lunar New Year celebrations, occurring earlier this year compared with 2019, were another drag on the data.

Tech production is similarly complex, and China is a player, especially for semiconductors, flat panel displays, and final assembly of smartphones and PCs.

Longer-term implications

Businesses crave stability and predictability, and China has become less attractive on both fronts in the past two years.

The trade war hurt China's place as a global manufacturing hub. The U.S. is a large final destination for goods, so the imposition of tariffs on Chinese goods imports meant that China became a less attractive place to do business. This accelerated the existing trend in which many businesses were expanding their operations elsewhere, including in Southeast Asia, capturing economies that include Vietnam, Cambodia and Myanmar. Operating costs there are cheaper, the business environment is on a generally improving trend, and the relationship with Washington is not as volatile.

The latest blow is the coronavirus. Large foreign factories for autos, electronics and pharmaceuticals remain closed throughout China, as the coronavirus outbreak has yet to be contained. This has left many businesses facing massive disruption that will continue to impact their bottom lines the longer the outbreak continues. The virus, along with the trade war, will likely serve as a reminder that hefty exposure to one economy is fraught with danger.

The Long View

That being said, these are considered short-term disruptions that will dissipate. The structural shift in supply chains is that to maximise efficiency, supply chains are minimizing distances between suppliers, vendors and the consumer. With China a large and rapidly growing consumer market, China will keep its status as a manufacturing hub due to its proximity to business and consumer demand. Asia's role in meeting the growing needs of the burgeoning Chinese consumer will also cement its high importance in global supply chains. But there will be those that benefit relatively more, reflected by their operating environments, including ease of doing business and operating costs.

Ratings Round-Up

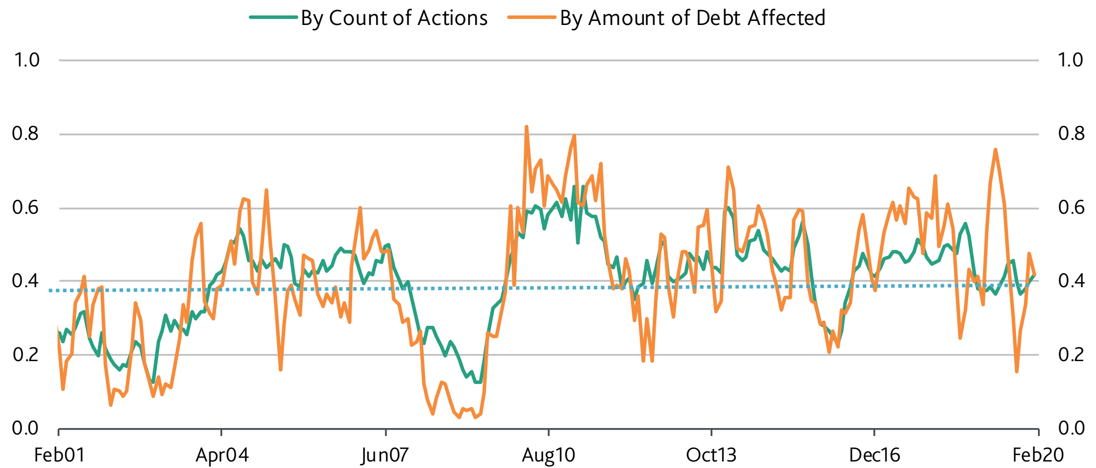
Downgrades Account for 11 of 15 U.S. Changes

By Steven Shields

U.S. rating activity was largely confined to credit downgrades in the latest week. For the period ending February 18, negative ratings changes accounted for 11 of the 15 credit rating changes. Moody's Investors Service downgraded Plantronics Inc.'s senior secured debt from Ba1 to Ba2, impacting approximately $500 million in debt. The change reflects recent performance declines exacerbated by lingering Polycom integration challenges, delays in introducing next generation products and Moody's concerns over the pace of recovery and debt paydown. The rating outlook is negative. Meanwhile, The McClatchy Company's probability of default rating was downgraded from Ca to D following the company's commencement of voluntary bankruptcy proceedings through a plan of reorganization under Chapter 11 of the United States bankruptcy code. However, due to the secured nature of the collateral relative to the remainder of the capital structure and its material outstanding pension liabilities, senior secured notes were upgraded to Caa3 from Ca. The largest downgrade in terms of total debt affected was made to apparel manufacturer Under Armour Inc. following the company's weak 2020 guidance. Under Armour anticipates revenues declining in the low single digit range and operating income in the $105 million to $125 million range, down from $237 million in 2019. Edgewell Personal Care Co. received the largest upgrade in terms of debt affected, at $2.2 billion, with its senior unsecured notes and long-term corporate family rating rising to Ba3 from following the cancellation of its Harry's acquisition.

Rating changes were mixed across Europe, but downgrades accounted for most of the debt affected in the period. German multinational conglomerate Thyssenkrupp AG received a downgrade to its corporate family rating to B1 from Ba3 and its outlook was revised down to negative. The downgrade reflected a further weakening of the firm's operating performance and its highly negative free cash flow during the first quarter of financial year 2019, with reduced likelihood of a material short-term recovery. Moody's Investor Services also downgraded Renault's long-term ratings to Ba1 from Baa3. The downgrade of the French automobile manufacturer reflects weakened operating performance in 2019 to a level no longer in line with its previous Baa3 rating category. Moody's does not expect Renault to be able to restore healthy operating margin levels in the medium term.

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

Ratings Round-Up

FIGURE 3

Rating Changes: Corporate & Financial Institutions – US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	Old STD Rating	New STD Rating	IG/SG
2/12/20	UNDER ARMOUR, INC.	Industrial	SrUnsec	600	D	Baa3	Ba1			IG
2/12/20	ALORICA INC.	Industrial	SrSec/BCF /LTCFR/PDR		D	Caa1	Caa2			SG
2/12/20	GIP III STETSON I, L.P.	Industrial	SrSec/BCF /LTCFR/PDR		D	Ba3	B1			SG
2/13/20	RENFRO CORPORATION	Industrial	SrSec/BCF /LTCFR/PDR		D	Caa1	Caa3			SG
2/13/20	LUCID ENERGY GROUP II BORROWER, LLC	Industrial	SrSec/BCF /LTCFR/PDR		D	B2	B3			SG
2/14/20	F.N.B. CORPORATION	Financial	SrUnsec/LTIR/STD /LTD/Sub/PS	331	U	Baa3	Baa2	P-2	P-1	SG
2/14/20	PLANTRONICS, INC.	Industrial	SrSec/BCF /LTCFR/PDR	500	D	Ba1	Ba2			SG
2/14/20	MCCLATCHY COMPANY (THE)	Industrial	SrSec	536	U	Ca	Caa3			SG
2/14/20	MCCLATCHY COMPANY (THE)	Industrial	PDR		D	Ca	D			SG
2/14/20	CAESARS ENTERTAINMENT CORPORATION-CBAC GAMING, LLC	Industrial	SrSec/BCF /LTCFR/PDR		D	B3	Caa1			SG
2/14/20	RENTPATH, LLC	Industrial	SrSec/BCF/LTCFR		U	Caa3	Caa1			SG
2/14/20	RENTPATH, LLC	Industrial	PDR		D	Caa3	D			SG
2/14/20	WASTE PRO USA, INC.	Industrial	SrUnsec /LTCFR/PDR	500	D	B3	Caa1			SG
2/14/20	ISAGENIX WORLDWIDE, LLC-ISAGENIX INTERNATIONAL, LLC	Industrial	SrSec/BCF /LTCFR/PDR		D	B2	Caa2			SG
2/14/20	PPD, INC.-JAGUAR HOLDING COMPANY II	Industrial	SrUnsec/SrSec /BCF/LTCFR/PDR	1,125	U	B3	B2			SG
2/18/20	EDGEWELL PERSONAL CARE CO.	Industrial	SrUnsec /LTCFR/PDR	2,200	U	B3	Ba3			SG

Source: Moody's

Ratings Round-Up

FIGURE 4

Rating Changes: Corporate & Financial Institutions – Europe

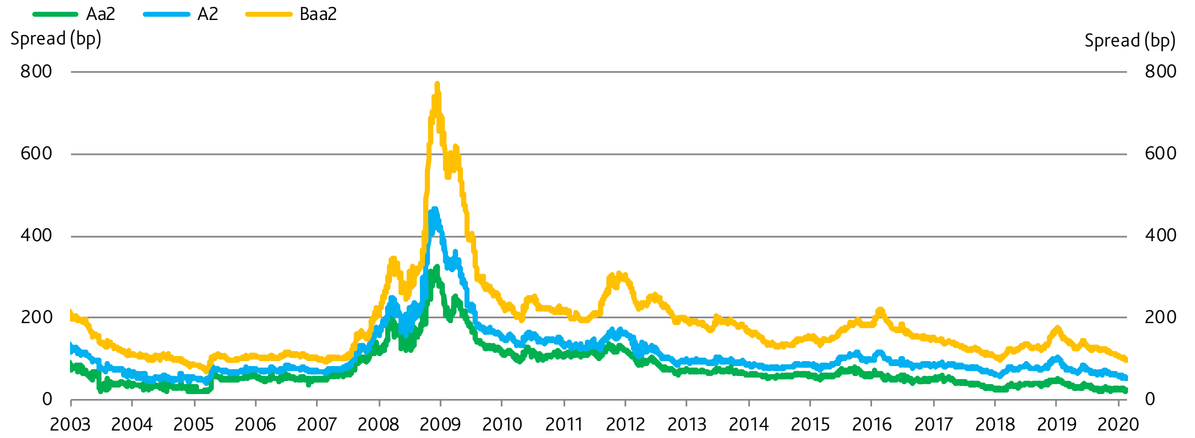
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	Old STD Rating	New STD Rating	IG/ SG	Country
2/12/20	BPER BANCA S.P.A.	Financial	Sub/MTN	542	U	B1	Ba3			SG	ITALY
2/13/20	WERELDHAVE N.V.	Industrial	SrUnsec /LTIR/MTN	82	D	Baa2	Baa3			IG	NETHERLANDS
2/13/20	NMC HEALTH PLC	Industrial	SrUnsec /LATCFR/PDR	400	D	Ba1	Ba2			SG	UNITED KINGDOM
2/13/20	BLUESTEP BANK AB (PUBL)	Financial	LTD		U	Baa2	Baa1			IG	SWEDEN
2/14/20	SK INVICTUS INTERMEDIATE II S.A.R.L.	Industrial	SrSec/BCF /LTCFR/PDR		D	B1	B2			SG	LUXEMBOURG
2/17/20	THYSSENKRUPP AG	Industrial	SrUnsec/LTCFR /PDR/MTN	6,553	D	Ba3	B1			SG	GERMANY
2/17/20	UPM-KYMMENE	Industrial	SrUnsec/LTIR	375	U	Baa2	Baa1			IG	FINLAND
2/18/20	RENAULT S.A.	Industrial	SrUnsec /MTN/CP	5,369	D	Baa3	Ba1	P-3	NP	IG	FRANCE

Source: Moody's

Market Data

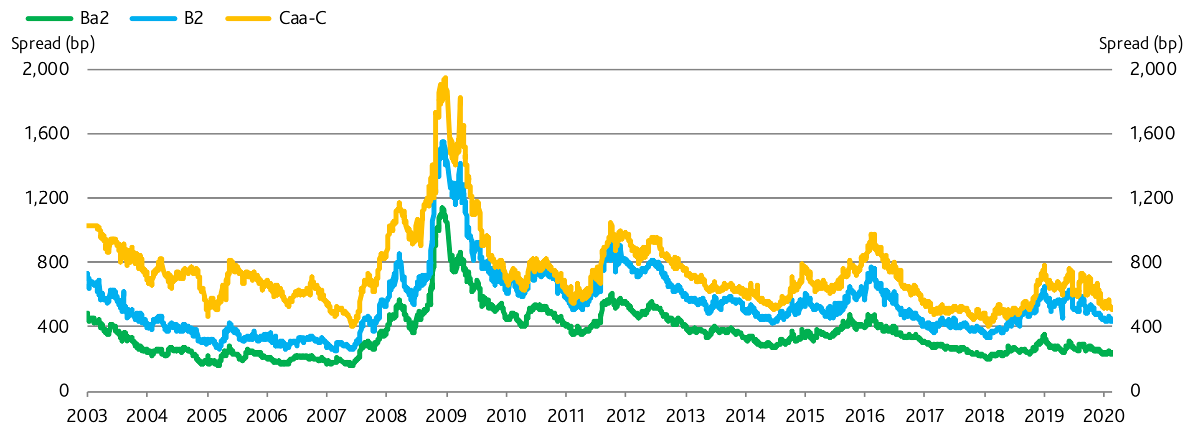
Spreads

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 (February 13, 2020 – February 19, 2020)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Feb. 19	Feb. 12	Senior Ratings
Toyota Motor Credit Corporation	Aa2	Aa3	Aa3
HCA Inc.	Baa2	Baa3	Ba2
Chevron Corporation	A1	A2	Aa2
Williams Companies, Inc. (The)	Baa3	Ba1	Baa3
Kroger Co. (The)	Baa1	Baa2	Baa1
Springleaf Finance Corporation	Ba2	Ba3	Ba3
Freeport-McMoRan Inc.	Ba2	Ba3	Ba1
Delta Air Lines, Inc.	Baa3	Ba1	Baa3
Corning Incorporated	Baa1	Baa2	Baa1
NIKE, Inc.	Baa2	Baa3	A1

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Feb. 19	Feb. 12	Senior Ratings
Unisys Corporation	B2	Ba3	B2
Ally Financial Inc.	Baa3	Baa2	Ba1
Bristol-Myers Squibb Company	Aa2	Aa1	A2
Johnson & Johnson	Aa2	Aa1	Aaa
Intel Corporation	Baa2	Baa1	A1
Bank of America, N.A.	A1	Aa3	Aa2
Nissan Motor Acceptance Corporation	Ba2	Ba1	A3
Conagra Brands, Inc.	Baa3	Baa2	Baa3
Sysco Corporation	Ba2	Ba1	A3
ViacomCBS Inc.	Baa3	Baa2	Baa2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Feb. 19	Feb. 12	Spread Diff
Chesapeake Energy Corporation	Caa3	3,340	2,888	453
Cablevision Systems Corporation	B3	412	377	35
Univision Communications Inc.	Caa2	266	237	29
Diamond Offshore Drilling, Inc.	B3	875	848	27
Unisys Corporation	B2	157	133	24
Ryder System, Inc.	Baa1	85	68	18
American Axle & Manufacturing, Inc.	B2	275	258	17
AutoNation, Inc.	Baa3	436	420	16
Office Depot, Inc.	B3	525	509	16
Embarq Corporation	Ba2	273	258	15

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Feb. 19	Feb. 12	Spread Diff
Frontier Communications Corporation	Caa3	6,450	7,144	-694
Dish DBS Corporation	B1	237	267	-30
Realogy Group LLC	B3	360	387	-27
Staples, Inc.	B3	487	514	-26
Neiman Marcus Group LTD LLC	Ca	4,299	4,324	-25
Mattel, Inc.	B3	226	249	-23
Talen Energy Supply, LLC	B3	702	722	-19
Rite Aid Corporation	Caa3	849	865	-16
R.R. Donnelley & Sons Company	B3	564	579	-15
Expedia Group, Inc.	Baa3	62	75	-13

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (February 13, 2020 – February 19, 2020)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Feb. 19	Feb. 12	Senior Ratings
Unione di Banche Italiane S.p.A.	Baa3	Ba2	Baa3
Banco Bilbao Vizcaya Argentaria, S.A.	A1	A2	A3
Lloyds Bank plc	Aa3	A1	Aa3
The Royal Bank of Scotland Group plc	Baa1	Baa2	Baa2
Commerzbank AG	Aa3	A1	A1
Nationwide Building Society	A1	A2	Aa3
Bayerische Motoren Werke Aktiengesellschaft	A2	A3	A1
Telecom Italia S.p.A.	Ba1	Ba2	Ba1
Vinci S.A.	Aa1	Aa2	A3
ArcelorMittal	Ba2	Ba3	Baa3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Feb. 19	Feb. 12	Senior Ratings
Bankinter, S.A.	A2	Aa3	Baa1
ING Groep N.V.	A3	A2	Baa1
RCI Banque	Ba3	Ba2	Baa1
Airbus SE	A1	Aa3	A2
Renault S.A.	Ba3	Ba2	Ba1
Alstom	A1	Aa3	Baa2
UPC Holding B.V.	B2	B1	B2
Italy, Government of	Ba1	Ba1	Baa3
France, Government of	Aaa	Aaa	Aa2
United Kingdom, Government of	Aa1	Aa1	Aa2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Feb. 19	Feb. 12	Spread Diff
CMA CGM S.A.	Caa1	1,337	1,259	78
Jaguar Land Rover Automotive Plc	B1	468	431	37
thyssenkrupp AG	B1	200	174	25
Sappi Papier Holding GmbH	Ba2	318	298	19
RCI Banque	Baa1	134	117	18
Renault S.A.	Ba1	130	113	17
Novafives S.A.S.	Caa2	749	733	16
Vue International Bidco plc	Caa2	265	250	15
Ineos Group Holdings S.A.	B1	200	186	14
TUI AG	Ba3	252	239	13

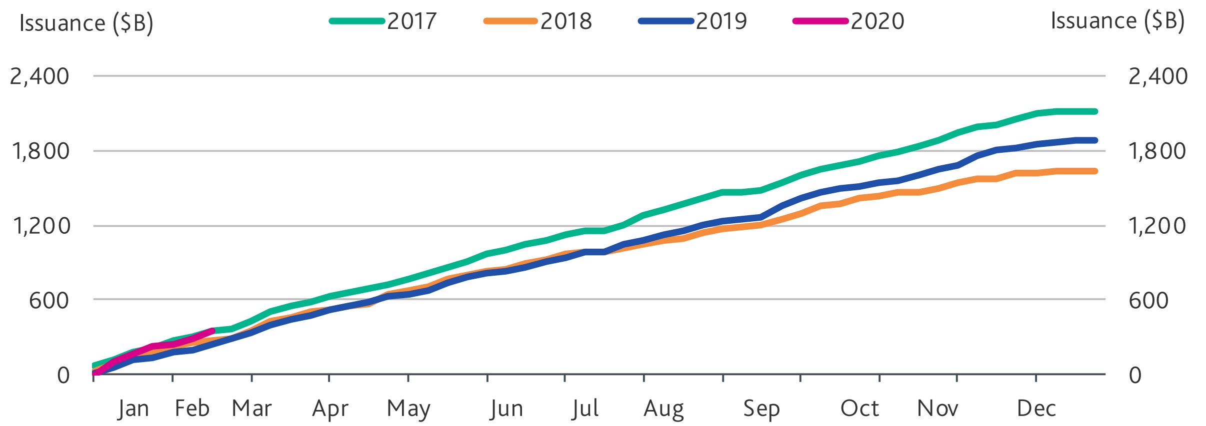
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Feb. 19	Feb. 12	Spread Diff
PizzaExpress Financing 1 plc	Ca	4,630	4,719	-88
Unione di Banche Italiane S.p.A.	Baa3	70	104	-34
Iceland Bondco plc	Caa2	705	721	-16
Iceland, Government of	A2	69	81	-12
Rexel SA	Ba3	79	89	-10
Altice Finco S.A.	Caa1	228	237	-9
Banca Monte dei Paschi di Siena S.p.A.	Caa1	222	230	-8
Telecom Italia S.p.A.	Ba1	103	110	-7
Boparan Finance plc	Caa1	1,427	1,433	-6
Premier Foods Finance plc	Caa1	164	170	-5

Source: Moody's, CMA

Market Data

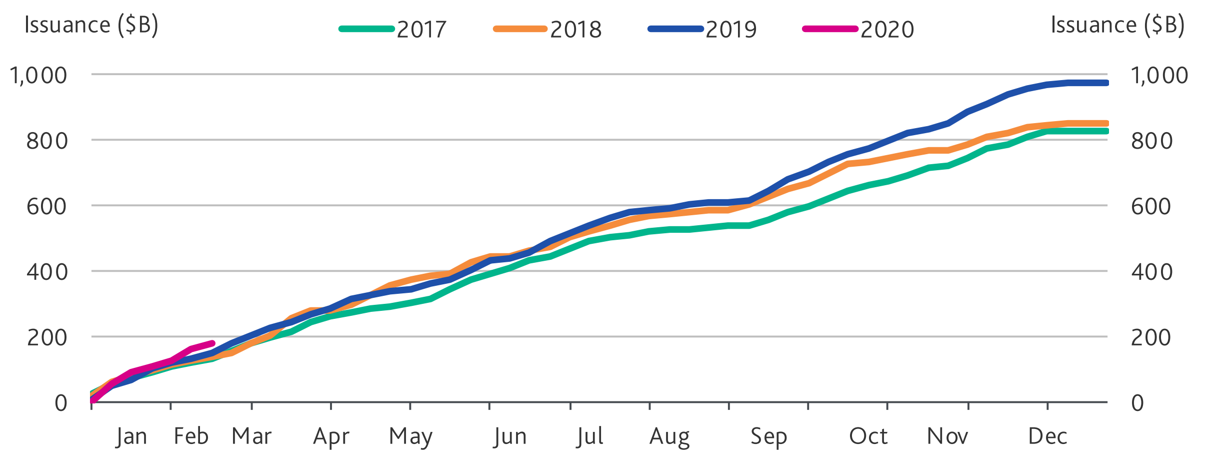
Issuance

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	40.541	14.043	56.549
Year-to-Date	219.448	106.059	343.180

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	11.191	6.930	21.294
Year-to-Date	142.781	31.979	181.905

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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