MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

Moody's Analytics Research

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Richly Priced Stocks Fall Short of 1999-2000's Gross Overvaluation

Credit Markets Review and Outlook *by John Lonski*

Richly Priced Stocks Fall Short of 1999-2000's Gross Overvaluation

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The Week Ahead

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The Long View

Full updated stories and key credit market metrics: January's 7.8% rise by worldwide investment-grade corporate bond offerings included a 23.0% jump by US$-denominated supply.

Credit Spreads	Investment Grade: We see the year-end 2020's average investment grade bond spread above its recent 111 basis points. High Yield: Compared with a recent 402 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 December 2019's actual 4.2% to a baseline estimate of 3.5% for December 2020.
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 6.7% for IG to \$1.397 trillion, while high-yield supply may grow by 4.6% to \$452 billion.

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Ratings Round-Up

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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.

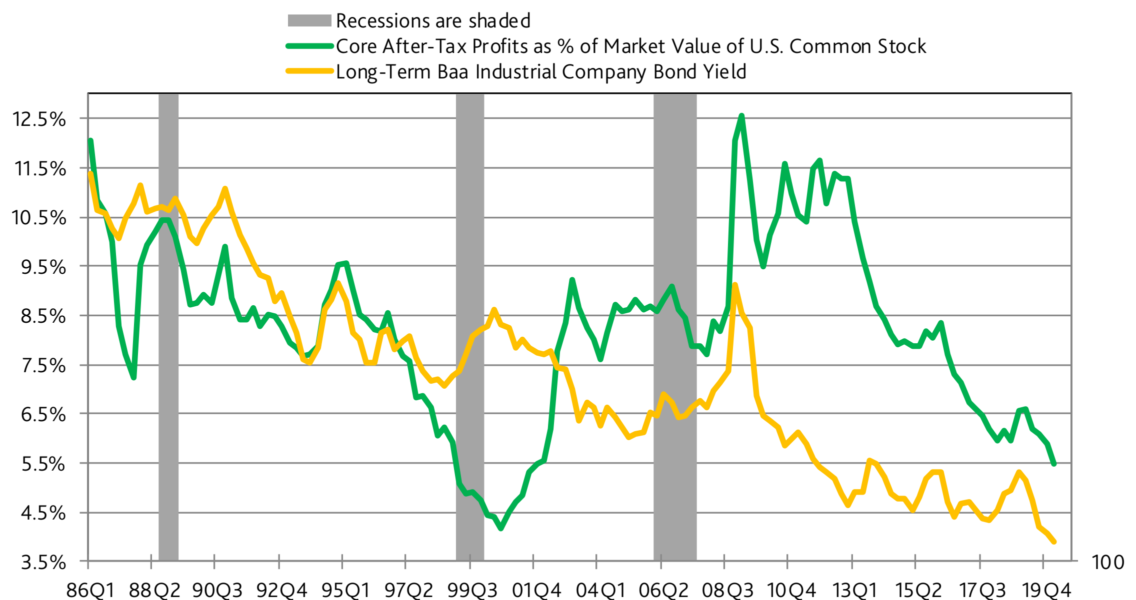
Richly Priced Stocks Fall Short of 1999-2000's Gross Overvaluation

All else the same, the market value of U.S. common equity needs to rise by another 28% before it matches the severity of its gross overvaluation of 1999-2000. When equity market overvaluation was at its worst during the 12-months-ended September 2000, Moody's Analytics' long-term Baa industrial-company bond yield averaged 8.36%. Today, the long-term Baa industrial yield is a much lower 3.90%.

Moreover, during the 12-months-ended September 2000, the market value of U.S. common stock averaged 22.5-times the lagging one-year average of after-tax profits excluding extraordinary gains and losses, or core after-tax profits. By contrast, the market value of common equity was recently at 17.5-times core after-tax profits' lagging one-year average.

Making matters worse for the year-ended September 2000 was how the 4.4% ratio of the lagging one-year average of core after-tax profits to the market value of common stock was far under the accompanying 8.36% long-term Baa industrial bond yield. In stark contrast, today's estimated 5.5% ratio of after-tax profits to the market value of equities is greater than the recent 3.90% long-term Baa industrial yield.

Figure 1: Ratio of After-Tax Profits to Market Value of U.S. Common Stock Exceeds Long-Term Baa Industrial Company Bond Yield
sources: BEA, Dow Jones, Moody's Analytics



Credit Quality Fared Much Worse During 1999-2000

Another important distinction between the current situation and the 12-months-ended September 2000 concerns today's comparatively better state of corporate credit quality. For one thing, during the 12-months-ended September 2000, the average expected default frequency metric of U.S./Canadian high-yield issuers averaged 6.8% and the high-yield bond spread averaged 586 basis points.

By contrast, the averages of January 2020 were 4.49% for the high-yield EDF metric and 382 bp for the high-yield bond spread. Though the recent readings of 4.76% for the high-yield EDF and 402 bp for the high-yield bond spread were up from their January averages, both had declined from the 2020-to-date highs of 5.01% for the EDF and 436 bp for the high-yield spread.

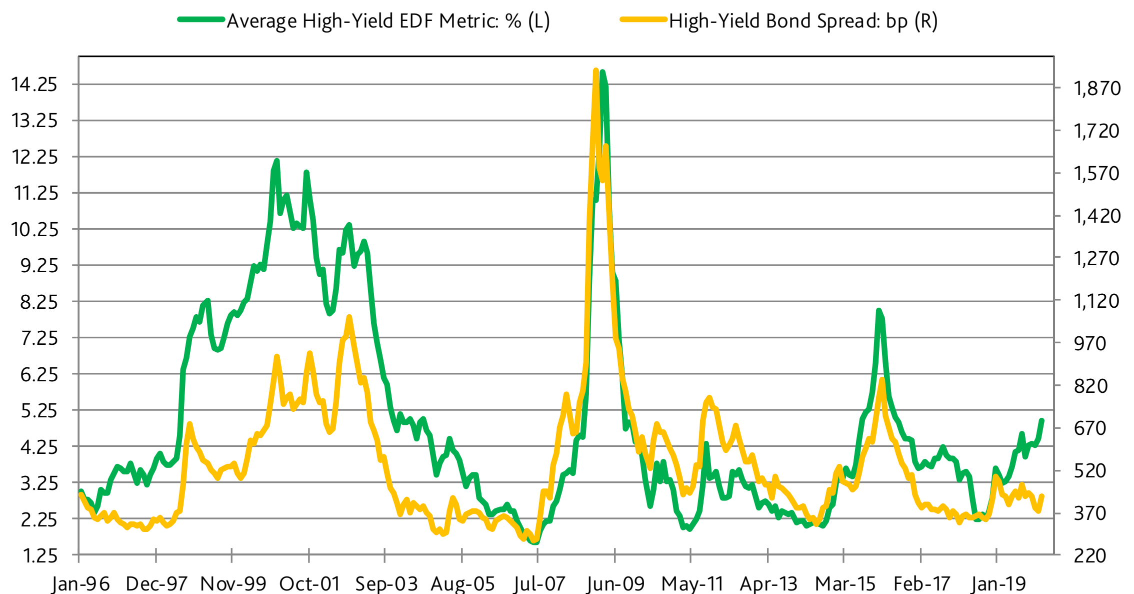
Finally, the gross stock-market overvaluation of 1999-2000 was made even more remarkable by how it transcended an ascent by the U.S. high-yield default rate from December 1998's 3.4% to September 2000's 6.8%. At first glance, the latest climb by the default rate from December 2018's 2.8% to December 2019's 4.2% may seem ominous, but by October 2020 the default rate may be in a range of 3.1% (according to the recent high-yield bond spread) to 4.1% (according to the latest average high-yield EDF metric). By comparison, Moody's Investors Service's early January 2020 baseline estimate of 3.7% for October's default rate is between the two estimates. The sense is that the recent high-yield bond spread may be underestimating default risk.

EDF and Spreads at Odds Over Future Default Rate

February 5's average EDF metric of 4.76% surpassed each of its month-long averages going back to July 2016's 4.9%, or when the high-yield bond spread averaged 579 bp.

Both the latest high-yield EDF metric of 4.76% and its 34 bp rise over the last three months have been statistically associated with a 547 bp midpoint for the high-yield bond spread. To the contrary, February 5's composite high-yield bond spread was a much thinner 402 bp. The latter was also less than its 472 bp median of 1996-2019. By contrast, February 5's high-yield EDF metric of 4.76% was well above its comparably measured median of 3.82%.

Figure 2: Average High-Yield EDF Metric Warns of a Possibly Wider Than 500 Basis Points (bp) High-Yield Bond Spread
source: Moody's Analytics



Both the high-yield EDF and the high-yield bond spread serve as forward-looking predictors of the default rate. Statistically speaking, the high-yield EDF outperforms the high-yield bond spread at predicting future default rates.

Because the average high-yield EDF metric does not commence until January 1996, the following analysis employs the same starting date for the high-yield bond spread. The high-yield EDF metric and bond spread will be used to predict the high-yield default rate of nine months later. Thus, the EDFs and bond spreads from January 2016 through March 2019 were used to predict the default rates of October 1996 through December 2019.

The medians of January 2016 through March 2019 were 3.79% for the high-yield EDF and 491 bp for the high-yield bond spread, while the median default rate of October 1996 through December 2019 was 3.35%. Thus, it seems reasonable that an above-median EDF now predicts a default rate of 4.1% that is above its 3.35% median, while the recent less-than-median high-yield bond spread of 402 bp foresees a default rate that is less than its sample median.

Credit Markets Review and Outlook

Profits Growth May Sustain an Overvalued Equity Market

By itself, overvaluation typically does not trigger a prolonged and deep sell-off. Rather, a material shrinkage of profits that is accompanied by expectations of even lower profits often serves as the driving force behind a major equity market correction.

Both S&P 500 earnings per share and a broader estimate of recurring pretax profits were roughly unchanged in 2019. If recurring pretax profits drop by 5% in 2020, the overall equity market is likely to sink by 10% or deeper.

According to recent consensus forecasts, equity analysts expect S&P 500 EPS to increase by 9% in 2020, while economists expect recurring pretax profits to rise by 2.5%. If true, a jarring equity-market sell-off should be avoided. Nevertheless, both positive outlooks for corporate earnings are challenged by consensus forecasts of slower economic growth for 2020.

At a minimum, any return of perceptible profits growth requires an upturn by the yearly increase of core business sales that has slowed from a third-quarter 2018 peak of 5.4% to the 1.4% of 2019's final quarter.

Record Smashing Month for High-Yield Bond Offerings

Speaking of speculative-grade bonds, January 2020 was home to a record-high $89.6 billion of high-yield bond issuance worldwide that was up by a considerable 110.6% from a year earlier. The old zenith was the $82.1 billion of November 2019.

In January 2020, an unprecedented $31.6 billion of high-yield corporate bonds were issued by borrowers from emerging market countries. The category's former record high was the much lower $18.8 billion from January 2018. Chinese borrowers offered $14.3 billion of high-yield bonds in January 2020, which was a record high for the group.

January 2020's $69.2 billion of US$-denominated high-yield bond offerings was also a record high. The former zenith was November 2019's $60.2 billion.

Though January 2020's $34.7 billion of high-yield bonds offered by businesses domiciled in the U.S. soared higher by 77.1% from January 2019, January 2020's tally was well under the category's $50.4 billion record high of November 2019. U.S. based borrowers supplied 39% of January's record worldwide high-yield bond issuance, which was less than yearlong 2019's 45% share.

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

THE U.S.

By Bernard Yaros of Moody's Analytics

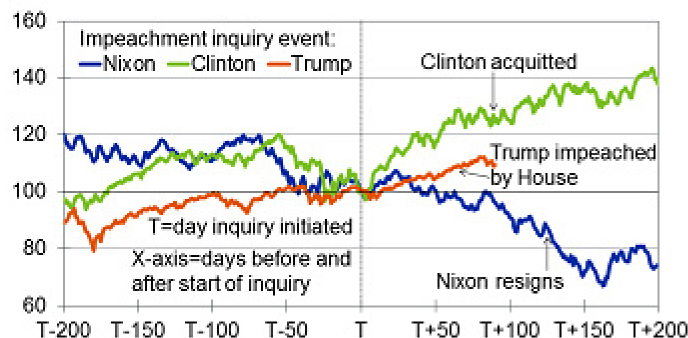
What Trump's Acquittal Means for the Economic Outlook

The U.S. Senate voted Wednesday to acquit President Trump on both articles of impeachment, concluding the months-long impeachment inquiry into Trump's controversial Ukraine phone call. When House Speaker Nancy Pelosi announced on September 24 that the House would launch an inquiry against the president, Moody's Analytics posited several downside risks to the U.S. economy. None of those risks ever materialized.

Non-event, so far

We initially feared that political rancor over impeachment would lead to greater dysfunction in the fiscal 2020 federal budget process. Though it took lawmakers more than 80 days into the fiscal year to pass a budget, that was still less than half the average number of days it has taken Congress to get its budgetary act together during the preceding 10 fiscal years. Most important, no partial government shutdown occurred.

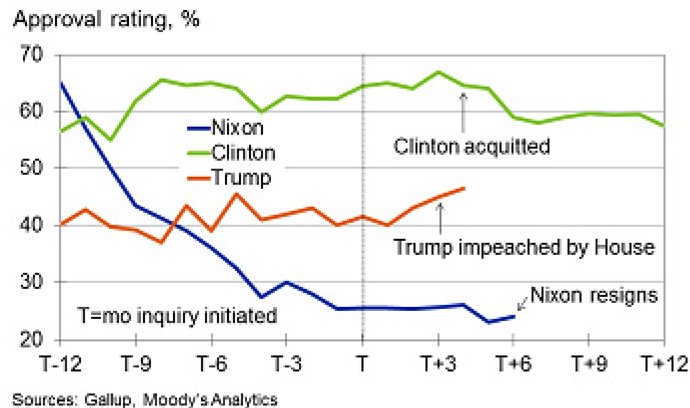
It was also difficult to discern any impact on stocks from the impeachment proceedings against Trump. The S&P 500 rallied nearly 8% between September 24, when Pelosi announced a formal inquiry, and December 18, when the House passed two articles of impeachment against Trump. This rally was largely driven by improving odds of a de-escalation in U.S.-China trade tensions, as well as an accommodative Fed. Even recent hiccups in stocks during the Senate impeachment trial have had more to do with fears over the coronavirus outbreak.



Though impeachment seems to have had no effect on the economy so far, it can still alter the economic outlook by impacting the 2020 presidential election outcome. In September, Moody's Analytics unveiled our 2020 election models, which we are updating each month. Impeachment will almost certainly be on the minds of voters on Election Day, and the president's approval rating, an omnipresent variable in our models, ought to capture any impeachment effect between now and November 3.

The Nixon and Clinton impeachment events offer two vastly different examples of how impeachment has impacted past presidential approval ratings. As soon as the Nixon administration's attempt to cover up the break-in at the Democratic National Committee headquarters came to light, Nixon's

approval rating cratered from as high as 66% to as low as 22%. By the time the House launched a formal inquiry into the Watergate scandal in February 1974, Nixon's approval had hit rock bottom. In stark contrast, Clinton's approval may have benefited from impeachment. During the Senate trial, his approval rating reached a personal all-time high of 69%.



Trump's approval rating seems to be following the Clinton playbook. His approval headed upward during the inquiry, even hitting a personal best of 49% at the end of January.

Although Trump has had the lowest average approval rating of any modern-day president, his approval has been the least volatile of all. This is a crucial caveat from a modeling perspective. Our election models look at the two-year change in approval rather than the level, because the former allows for more statistically significant results. As long as his approval rating is higher on Election Day than the near 41% it was two years earlier, then our approval variable will help, not ding him.

Besides approval, impeachment may also influence state-by-state voting patterns on Election Day. For the first time ever, our election models incorporate nonincumbent party turnout as an explanatory variable. We don't attempt to forecast nonincumbent turnout in 2020, but rather use it as a lever by which to crank out three different turnout scenarios: one in which nonincumbent turnout is at its historical average across states; another in which it matches record highs across states; and a final one in which it sinks to historical lows across states. We do this to bookend a range of likely outcomes in 2020.

If Democrats and Democrat-leaning independents were to turn out in record numbers out of frustration with Trump's acquittal and his individual attributes, then the average of our models predicts that the Democratic candidate would win the White House with 279 Electoral College votes to Trump's 259. Under this high nonincumbent turnout scenario, Democrats would only flip three states—Michigan, Pennsylvania and Wisconsin—that went red in 2016.

Harnessing impeachment

This would be a razor-thin margin of victory, and it underscores that the onus will be on Democrats, not Trump, to harness impeachment to their advantage. The president is heading into Election Day with two major tailwinds at his back: the economy and the historic advantage of being the incumbent. Further, this turnout scenario highlights the risk to Democrats that impeachment backfires. If impeachment were to also rally Trump's base and bring more Republican-leaning independent voters into the fold, that would cut into the benefit of any impeachment-induced jump in nonincumbent turnout. All else equal, Trump only needs to win one of the three above-noted states to retain the Oval Office. As in 2016, the outcome in these states will likely come down to just tens of thousands of voters. This is a small enough margin for impeachment to potentially swing one of these states in the

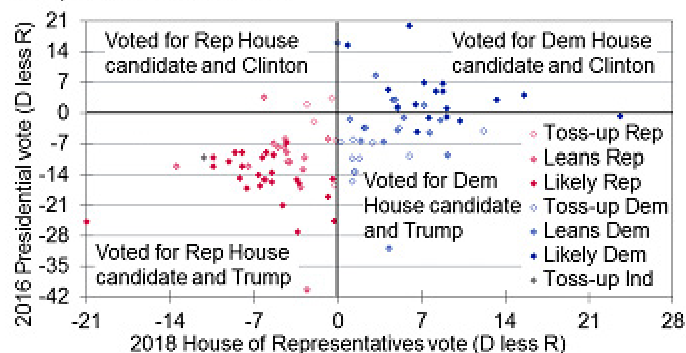
direction of one candidate or another, with major implications for the overall Electoral College outcome.

If impeachment does impact who wins the White House in 2020, it will have meaningful consequences for the economy. If impeachment were to backfire on Democrats and lead to Trump's re-election, he would likely double down on his current economic policies. Trump would also be unlikely to reappoint Fed Chairman Jerome Powell, instead replacing him with someone who shares the president's views on monetary policy. However, if impeachment were to help elect the Democratic candidate, economic policy would be flipped on its head. At a minimum, the Trump tax cuts for higher-income and wealthy households, as well as business investment, would be allowed to expire in the next years as they are set to do under current law.

The outcome of the presidential election also has implications for fiscal policy. However, any major change to federal spending and tax policy will require cooperation by Congress. As a result, the congressional elections in 2020 will be just as important as the presidential race in determining the course of fiscal policy in the next years.

2020 congressional elections

Prior to Trump's Ukraine phone call, the biggest check on Democratic enthusiasm to pursue impeachment was the more than 30 House Democrats who represent districts that Trump carried in 2016. Republicans need to flip less than 20 seats to regain a House majority. Therefore, the path to a Republican majority cuts through these competitive Democratic-held districts.

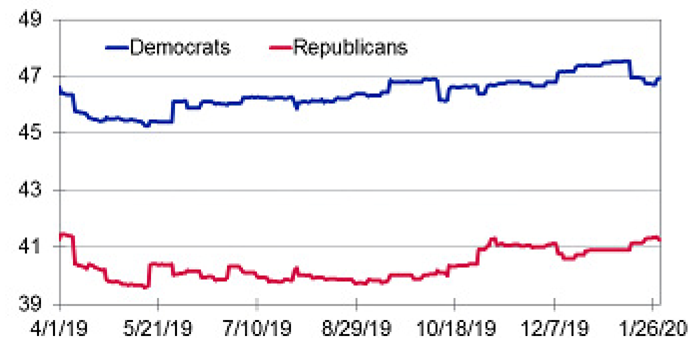


In the 1998 midterm elections, impeachment was widely believed to have backfired on House Republicans, who suffered a net loss of four seats. While it may not sound like a huge numerical loss, it was a historically anomalous result. Besides 1998, the only other time since WWII that the incumbent president's party gained House seats during a midterm election year was in 2002, when national unity after the 9/11 terrorist attacks buoyed George W. Bush's approval.

Despite the potential backlash from impeachment, all but three House Democrats in Trump-won districts voted for both articles of impeachment against the president. Among the three Democrats, who bucked their party on the historic vote, one even decided to switch parties. However, the good news stops there for House Republicans with regard to the upside potential from impeachment.

The congressional generic ballot is a poll question asking voters which party they will support in the elections for Congress, and we find that it is one of the most statistically significant variables in predicting House election outcomes. A tracking estimate of the most recent generic ballot polls currently puts Republicans at a 5.7-percentage point disadvantage, which hasn't changed much during

the impeachment probe. A deficit of this size in the generic ballot for the incumbent president's party implies Republicans will remain in the House minority with only 197 seats.



Moody's Analytics is also following a handful of Senate elections in which the incumbent candidates face competitive races and could be up against the ropes for their stance on impeachment during the Senate trial. Of the 34 Senate seats that are in play, 22 are held by Republicans, and Democrats only need a net gain of three or four seats to win back the Senate majority (depending on which party wins the White House, since the vice president can break ties in the Senate).

The path to a Democratic Senate majority is narrow, though. Only two of these 22 Republican seats are in states that Hillary Clinton carried in 2016: Colorado and Maine. Moreover, political expert opinion considers only two other seats competitive: Arizona and North Carolina. At the same time, Democrats will have to defend seats in Michigan and most notably Alabama, where Democrat Doug Jones is arguably the most vulnerable senator of either party.

Therefore, a lot would have to go their way for Democrats to flip the Senate. It's too early to tell whether impeachment will break in favor of one party or the other in these competitive races, where the advantage of incumbency and state-specific political idiosyncrasies often matter as much or more than the national political environment.

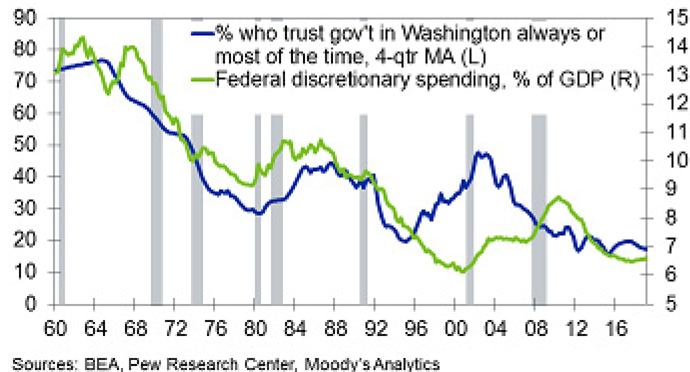
The makeup of Congress after 2020 will matter significantly for fiscal policy. If Republicans were to retain the Oval Office and Senate and win back the House, a second round of tax cuts would be back on the table. If Democrats were to retain the House and regain the Senate and presidency, fiscal legislation from healthcare to student debt would be in play.

Where did all the trust go?

Over the past 80 years, public trust in the U.S. government has deteriorated significantly. In 1964, 77% of Americans said they could trust Washington DC at least most of the time. Today, only 17% say the same. In the intervening years, public trust has taken a beating from the Vietnam War to the Watergate scandal to political assassinations and the 2009 financial crisis. Trump's acquittal in the Senate is more likely than not to hurt trust in government, with nearly half of Americans supporting the president's impeachment and an equally hefty share of the country skeptical of the inquiry's merits to begin with. Yet, political scandals may not be entirely to blame for the sharp decline in public trust since the early 1960s.

If we map federal discretionary spending as a share of GDP onto the declining share of Americans trusting in Washington, the two concepts move eerily close in tandem. Correlation isn't causation.

However, discretionary spending on everything from education to infrastructure and the military is what Americans most associate with the government.



Ultimately, the biggest, long-run risk from the Trump impeachment process is that it worsens partisan politics for years to come, with ill consequences for the federal budget, the economy, and public trust in government. At some point in the future, lawmakers need to pass a combination of entitlement, tax and immigration reform. If not, mandatory spending on everything from Social Security, Medicare, and interest on the debt will increasingly crowd out the discretionary portion of the budget. This would hamstring the government's ability to head off a major crisis in the future, which would only exacerbate existing disillusionment with Washington's effectiveness.

Next week

The economic calendar is lighter. The key data include consumer prices, retail sales and industrial production.

EUROPE

By Barbara Teixeira Araujo of Moody's Analytics

U.K. Growth Likely Stalled in the Fourth Quarter

The week ahead brings a host of economic releases for Europe, but the spotlight will be on the preliminary estimate of U.K. fourth-quarter GDP. We expect growth all but stalled in the three months to December, in line with the peaking of Brexit-related uncertainty prior to the December 12 general elections. This follows a 0.4% q/q increase in the fourth quarter, which itself can be seen mainly as a rebound following the second quarter's decline. We caution nonetheless that risks to our forecast are severely tilted to the downside, so we would not be surprised if the final result showed a downright decline in GDP in the three months to December.

Across sectors, we expect the main drag to come from a decline in U.K. industrial production—we are penciling in a 0.5% q/q drop, following a meagre 0.1% rise in the third quarter. Manufacturing likely did the most damage, falling by 0.8% q/q and fully reversing the 0.1% rise previously. Most of the decline in manufacturing was likely due to the fact that several factories shut down for part of November because of earlier contingency planning in case a no-deal Brexit had happened on October 31. Accordingly, manufacturing production plunged by 1.7% m/m in November, with declines recorded across most subsectors. We expect that December brought some mean reversion, but elevated

uncertainty likely kept a lid on any rebound. Elsewhere in industrial production, we expect that a strong 1.8% q/q jump in energy production offset a big part of the drop in manufacturing. Temperatures in October and November fell below their long-term averages across the U.K., boosting demand for heating. Granted, temperatures rose sharply in December—they read as much as 2°C above their seasonal norms—but we don't expect that this led to a drop in energy production that was strong enough to erase the gains early in the quarter.

U.K. construction output is also expected to have declined in the fourth quarter, but only slightly. We are penciling in a 0.1% q/q decline, which is good news given that this follows a strong 1.2% rise in the previous stanza. Risks to our forecast are balanced, since the results for December are a wild card. We are penciling in a 0.4% m/m drop in construction output over the month, after a 1.9% m/m rise in November. On the upside, the month's mild temperatures could have given a boost to building activities—especially homebuilding, which has performed well recently given consumers' renewed appetite for housing purchases—which could mean that construction activity actually rose slightly over the month. On the downside, that uncertainty peaked in December could have led to an even sharper correction.

Services activity is meanwhile expected to have stalled or only slightly increased in the fourth quarter, after a 0.5% q/q increase in the third. We don't have much leading data for the services sector, but we already know that retail sales dropped sharply in the three months to December as consumers became cautious and adopted wait-and-see strategies. Retail spending nonetheless account for only a small share of services spending, and we expect that the results elsewhere were better. Notably, we are expecting a correction in accommodation and food services activities following two quarters of decline.

Regarding the expenditure breakdown, we expect that weakness was broad-based across the growth components. U.K. domestic demand should have slowed considerably, as consumer spending likely increased only slightly while business investment dropped following no growth in the previous quarter. All leading and anecdotal evidence show that managers decided to sit on investment plans as they waited for more clarity on the Brexit front. We expect that the only major support to domestic demand came from government spending, following a one-off decline in the third quarter.

Regarding the external sector, we expect that net trade detracted from growth after it boosted third-quarter growth by a staggering 2.4 percentage points. That's because exports likely declined sharply after a one-off 7.9% q/q jump in the three months to September. The main drag is expected to have come from euro zone exports, which soared in the three months to September mainly because several countries in the currency area rushed to stockpile prior to the October 31 Brexit deadline. This warrants a correction in the fourth quarter. Imports, meanwhile, likely remained steady or declined slightly, in line with the lackluster momentum in domestic demand.

Germany will also release its preliminary estimate of fourth quarter growth next Friday. We expect that the news there was a bit better than in the U.K., but the figures are unlikely to be anything to write home about. We are penciling in a 0.1% q/q increase, as a mean-reversion in investment and rising consumer spending and investment likely offset a drop in net exports.

	Key indicators	Units	Moody's Analytics	Last
Mon @ 10:00 a.m.	Italy: Industrial Production for December	% change	-0.8	0.1
Mon @ 11:00 a.m.	OECD: Composite Leading Indicators for December		99.4	99.3
Tues @ 9:30 a.m.	U.K.: Monthly GDP for December	% change	0.2	-0.3
Tues @ 9:30 a.m.	U.K.: GDP for Q4	% change	0.0	0.4
Tues @ 1:00 p.m.	Russia: Foreign Trade for December	$ bil	13.1	12.3
Wed @ 10:00 a.m.	Euro Zone: Industrial Production for December	% change	0.1	0.2
Thur @ 7:00 a.m.	Germany: Consumer Price Index for January	% change yr ago	1.6	1.5
Fri @ 7:10 a.m.	Germany: Preliminary GDP for Q4	% change	0.1	0.1
Fri @ 8:00 a.m.	Spain: Consumer Price Index for January	% change yr ago	1.1	0.8
Fri @ 10:00 a.m.	Euro Zone: External Trade for December	€ bil	18.1	20.7

ASIA-PACIFIC

By Katrina Ell of Moody's Analytics

Depleted Pork Supplies Keep China's Headline Inflation Elevated

China's headline inflation likely remained elevated in January, as depleted pork supplies continue to put upward pressure on food prices as a result of the outbreak of African swine flu. Food price inflation cooled a little in December to 17.4% y/y, from 19.1% in November, amid government efforts to temper pork prices in time for Lunar New Year celebrations from late January to early February. Food prices will remain elevated at least through the first half as pork supplies remain subdued and more recently the outbreak of Avian flu has led to culling of chickens to contain an outbreak. Producer prices are expected to record their seventh consecutive drop in January as lower commodity prices and disruption from the coronavirus impact have already weakened domestic demand.

China's money supply growth likely picked up in January and will accelerate further in February, as the People's Bank of China has increased support in the wake of the coronavirus outbreak. On Monday, the People's Bank of China injected CNY1.2 trillion into the financial system via reverse repo operations, reportedly the largest single-day injection on record, to "ensure sufficient liquidity supply." Estimates are that CNY1.05 trillion (US$151 billion) worth of reverse repos matured on Monday, meaning that CNY150 billion on net will be injected. In addition, banks will be provided with CNY300 billion to lend to firms impacted by the virus, including foreign firms. The PBoC has signaled that further stimulus could be made available over the next week.

The blow to China's economy is significant. Consumer-facing sectors were the first to feel the brunt of efforts to contain the virus and at first this disproportionately hit Hubei province, where the outbreak began. The virus has decimated the usual peak tourist season, with closures and cancellations of planned celebrations in a bid to quell the spread of the virus. The economic costs have spread throughout China, with important transport links suspended and major cities in full or partial lockdown. The aggressive containment efforts will only exacerbate the economic pain.

Malaysia's GDP growth likely slowed to 4.1% y/y in the December quarter, following the 4.4% expansion in the September quarter. Private consumption has been an important support to the economy, while external demand has been weak, particularly as the tech cycle has endured a downswing. Exports contracted 1.4% in the third quarter, following the second quarter's 0.1% increase. Some improvement is expected in exports in the fourth quarter.

	Key indicators	Units	Confidence	Risk	Moody's Analytics	Last
Mon @ 12:30 p.m.	China CPI for January	% change yr ago	3	↑	4.6	4.5
Mon @ 12:30 p.m.	China PPI for January	% change yr ago	2	←	-0.4	-0.5
Mon @ Unknown	China M2 money supply for January	% change yr ago	3	↑	8.7	8.7
Wed @ 10:00 a.m.	South Korea Unemployment rate for January	%	3	←	3.7	3.8
Wed @ 12:00 p.m.	New Zealand Monetary policy for February	%	4	←	1.0	1.0
Wed @ 3:00 p.m.	Malaysia GDP for Q4	% change yr ago	3	←	4.1	4.4
Wed @ 11:00 p.m.	India CPI for January	% change yr ago	3	←	6.9	7.4
Wed @ 11:00 p.m.	India Industrial production for December	% change yr ago	2	↓	0.5	1.8

The Long View

January's 7.8% rise by worldwide investment-grade corporate bond offerings included a 23.0% jump by US$-denominated supply.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group
February 6, 2020

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 111 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 402 bp is thinner than what is suggested by the accompanying long-term Baa industrial company bond yield spread of 176 bp and the recent VIX of 14.9 points.

DEFAULTS

December 2019's U.S. high-yield default rate of 4.2% was up from December 2018's 2.8% and may average 3.6% 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 3.5% for IG and 5.5% 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 6, 2020

UNITED KINGDOM

The U.K. final PMI figures for January corroborated our view that the Bank of England was right to pause for thought during its last monetary policy meeting. The composite PMI rose to a 16-month high of 53.3 from 49.3 in December, boosted by sharp increases in all of the economy's three main sectors. It is consistent with activity rising by 0.3% q/q in the first quarter, above the BoE's expectations of 0.2%.

We have long claimed that there would be a post-election bounce in activity during the first months of 2020, meaning that a rate cut wasn't warranted just yet. We don't have any hard data for January, but all other survey data have come in line with our view and with the PMIs. They broadly show that consumers and businesses, who sat on major decisions throughout 2019, decided to profit from the easing of uncertainty in January following the passing of the Brexit deal. The manufacturing PMI rose sharply to 50 in January from 47.5 in December, boosted by stronger growth in output as well as new domestic orders. Stronger demand for consumer and intermediate products was largely behind the improvement, with firms citing lower uncertainty as the main cause for the rise. The services PMI also surged, up to a 16-month high of 53.9 in January from 50 in December. A key upside detail was that optimism among service providers jumped to its highest in almost five years, which suggests that growth should remain relatively solid in coming months.

The coronavirus does represent a major risk to first-quarter growth, and even more worrying is that we still don't know how broadly the virus will spread and how virulent it will be. The hit will surely be felt by some sectors more than others, with the U.K. tourism industry particularly vulnerable given the large number of Chinese travelers the country normally receives. The goods exports sector is also feeling the pain, as the disruption of Chinese supply chains is causing demand for U.K. imported goods to plummet. If the virus spreads to Europe, we expect that would hurt across the board, with consumer spending as well as investment set to decline sharply. This is not our base case right now; our baseline is only for a minor 0.1-percentage point impact. We were previously expecting a 0.3% q/q gain, but we have lowered our forecast to 0.2%, with risks tilted to the downside.

GERMANY

December's German factory orders sorely disappointed Thursday. Total orders plunged by 2.1% m/m, adding to the 0.8% decline in November. In yearly terms, orders tumbled by 8.6%. Orders for capital goods decreased by 3.9% m/m and for consumer goods by 3.8%, but on a positive note, those for intermediate goods increased by 1.4%.

A steep decline in orders from the euro zone drove December's drop. Euro zone orders plunged by 13.9%, while extra-euro zone orders rose by 2.1% m/m. We suspect France was a major culprit behind the fall since businesses there faced protests that targeted the nation's transport and distribution infrastructure.

Even if Germany's manufacturing recession bottomed out, Thursday's release implies that the industry's slump will drag on for the next few months. We expect German real GDP grew by 0.1% q/q in the last quarter of 2019 and that it will recover further in the new year. But December's decline looks to be the start of a chilly winter for orders. Assuming a modest 1% m/m rebound in January's orders, in yearly terms orders would still tumble by 5.6%.

Growth will be hard to come by in January and February, however, as manufacturers around the world feel the pain from the coronavirus. Demand should bounce back once fears abate and quarantine measures are relaxed, but until then demand for industrial goods will be hit hard.

At least the January construction PMIs offered some better news. The index rose in Germany, France and Italy. The biggest improvement was in Italy; although the sector remains in contraction, the index climbed to 49 from 47.7 previously. France enjoyed slight gains, to 50.9 from 50.4, while momentum stayed strong in Germany, with the index rising to 54.9 from 53.8.

January construction growth in Germany was led by residential projects, but commercial plans contributed as well. Confidence improved, and the sector is still adding to employment in the country. As it stands, the construction sector will continue to prop up growth while manufacturing fails to muster any strength.

ASIA PACIFIC

By Katrina Ell of Moody's Analytics
February 6, 2020

ASIA-PACIFIC REGION

Restrictions on travel to and from China have ramped up across the globe in a bid to quell the spread of the coronavirus. Countries in the Asia-Pacific region so far to restrict arrivals from China include New Zealand, Australia, the Philippines, Indonesia, Taiwan, Macau, Indonesia, Malaysia, Japan, South Korea, India, Myanmar, Pakistan, Singapore and Vietnam. The number of infected patients stands at over 17,000, with the majority of cases being from China. The number of infected now far exceeds that of the 2002-2003 SARS outbreak, which stood at just over 8,000.

Travel restrictions are hurting recipient countries' tourism, education and broader consumption. To gauge just how much pain those economies would endure from the drop-off in arrivals from the mainland, we looked at tourism as a share of GDP and the most popular destinations for Chinese to travel.

Hong Kong receives the largest share of mainland tourists and in 2019 accounted for 27% of total arrivals from the mainland. Hong Kong has long been a popular destination for arrivals from the mainland, but this plummeted in 2019 due to the protests related to China's involvement and influence there. It is therefore not surprising that Hong Kong's share of outbound mainland tourists has tumbled from 41% in 2014. Also, Hong Kong's tourism share of GDP has shrunk in recent years. It peaked at 6% in 2013 and steadily fell to 4.4% by 2018. Hong Kong has lost out to other destinations, particularly as those in Asia become more attractive for mainland visitors for leisure and business. Other countries have relaxed visa requirements, for example, and Hong Kong also has no new tourist attractions while other destinations, including in Southeast Asia, improve their attractiveness as places to do business.

In Macau, the government stopped issuing new individual travel visas for visits by mainlanders. On 30 January, this sent the number of arrivals from the mainland down by 92% y/y compared with the 2019 Lunar New Year celebrations, according to the Macau Government Tourism Bureau. In addition, flights from the mainland and Macau were suspended until early February, with an extension of the suspension likely. This is creating serious economic consequences for Macau, given that tourism accounted for 28% of GDP in 2018 and Macau received around 16% of outbound mainland visitors in 2019.

In Japan, South Korea, Vietnam and Thailand, visitors from the mainland typically account for more than 25% of their total arrivals. The ban on Chinese international tour groups has caused mass cancellations, and the uncertainty on how long this will last is hurting consumption, tourism and hospitality services in these economies.

Ratings Round-Up

Boeing Downgrade Reflects Tumultuous Year

Steven Shields

U.S. rating activity ramped up this week with several notable firms receiving credit downgrades. For the period ending February 4, negative changes accounted for nearly 78% of the total debt affected.

Moody's Investors Service downgraded The Boeing Co.'s senior unsecured bonds from A3 to Baa1, impacting $21.2 billion in debt. The sharp downgrade reflects a tumultuous past year for Boeing. Uncertainty continues to loom as to when the 737 MAX will be ungrounded. Moody's Investors Service expects that restoration of the 737 MAX production system and Boeing's credit profile will take until 2023. Financial, operational, regulatory and reputational risk remain elevated.

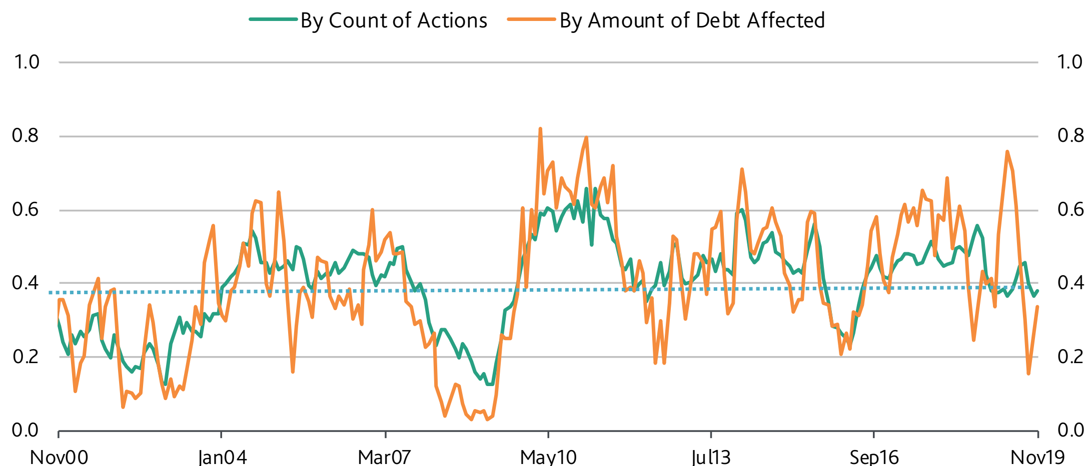
Meanwhile, Tanger Factory Outlet Centers Inc. also suffered a credit downgrade in the period. The real estate investment trust's senior unsecured notes were downgraded from Baa1 to Baa2. Like many REITs in the retail sector, Tanger has been unable to buck the troubling trend of lower occupancy levels and the rapidly changing retail environment toward e-commerce. The firm's rating outlook remained negative. Similarly, Gamestop Corp. received a downgrade to its Corporate Family Rating to B2 from Ba2. The downgrade of the company's CFR reflects weaker-than-anticipated sales and operating performance, driven largely by declines in new hardware and software sales. The company will continue to face performance pressure through most of calendar year 2020 as customers continue to delay purchases ahead of the anticipated late 2020 new console launches.

D.R. Horton Inc. received an upgrade to its senior unsecured notes to Baa2, reflecting its conservative financial strategy, strong balance sheet, robust cash flow generation, and the firm's large market share in many of its geographic markets.

European firms were also largely confined to credit downgrades during the period, with downgrades comprising five of the six rating changes. Moody's Investors Service downgraded water utility, Severn Trent PLC, to Baa1 from A3. The rating reflects Severn Trent's exposure to recent regulatory changes made by Water Services Regulation Authority (Ofwat). Specifically, the rating actions reflect Moody's expectation that key financial metrics will fall outside the boundaries for the previous A3 and Baa1 ratings for the operating and holding company, respectively, for the entirety of AMP7. Barclays Bank PLC received the lone upgrade across Europe. Moody's rates Barclay's issuer and senior unsecured debt at Baa2 long-term, impacting $109 billion in outstanding debt.

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
1/29/20	TANGER FACTORY OUTLET CENTERS, INC.	Financial	SrUnsec/Sub/PS	1,150	D	Baa1	Baa2			SG
1/29/20	D.R. HORTON, INC.	Industrial	SrUnsec	2,450	U	Baa3	Baa2			IG
1/29/20	GIGAMON INC.	Industrial	SrSec/BCF		D	B2	B3			SG
1/29/20	CARECENTRIX, INC.	Industrial	SrSec/BCF /LTCFR/PDR		D	B1	B2			SG
1/29/20	VIZIENT, INC.	Industrial	SrUnsec/SrSec /BCF/LTCFR/PDR	300	U	B3	B2			SG
1/29/20	ALLEN MEDIA, LLC	Industrial	PDR		U	B3	B2			SG
1/30/20	BOEING COMPANY (THE)	Industrial	SrUnsec	21,150	D	A3	Baa1			IG
1/30/20	DOMINION ENERGY, INC.-PUBLIC SERVICE COMPANY OF NORTH CAROLINA, INC.	Utility	SrUnsec	100	D	A3	Baa1			IG
1/30/20	DOMINION ENERGY, INC. -SCANA CORPORATION	Utility	SrUnsec/LTIR/CP	4,067	U	Ba1	Baa3	P-3	P-2	SG
1/30/20	WGL HOLDINGS, INC.-WASHINGTON GAS LIGHT COMPANY	Utility	SrUnsec/MTN/CP	1,296	D	A2	A3	P-1	P-2	IG
1/30/20	GAMESTOP CORP.	Industrial	SrUnsec /LTCFR/PDR	436	D	Ba2	B3			SG
1/30/20	BED BATH & BEYOND INC.	Industrial	SrUnsec	1,500	D	Baa3	Ba2			IG
1/30/20	STEINWAY MUSICAL INSTRUMENTS, INC.	Industrial	SrSec/BCF /LTCFR/PDR		U	B3	B2			SG
1/30/20	PARSLEY ENERGY LLC -JAGGED PEAK ENERGY LLC	Industrial	SrUnsec	1,000	U	B3	Ba3			SG
1/30/20	PUGNACIOUS ENDEAVORS, INC -PUG LLC (VIAGOGO)	Industrial	SrSec/BCF /LTCFR/PDR		D	Ba3	B2			SG
1/31/20	C&S WHOLESALE GROCERS, INC. -C&S GROUP ENTERPRISES LLC	Industrial	SrSec/LTCFR/PDR	400	D	Ba3	B1			SG
1/31/20	NBG INTERMEDIATE HOLDINGS, INC-KNB HOLDINGS CORPORATION	Industrial	SrSec/BCF /LTCFR/PDR		D	B1	Caa1			SG
1/31/20	RECORDED BOOKS HOLDINGS INC-RECORDED BOOKS, INC	Industrial	PDR		U	Caa1	B3			SG
1/31/20	ACPRODUCTS HOLDINGS, INC.-ACPRODUCTS, INC.	Industrial	LTCFR/PDR		U	B3	B2			SG
2/3/20	BRIGGS & STRATTON CORPORATION	Industrial	LTCFR/PDR		D	B2	B3			SG
2/4/20	HARLAND CLARKE HOLDINGS CORP.	Industrial	SrSec/BCF	800	D	B3	Caa1			SG
2/4/20	FIRST AMERICAN PAYMENT SYSTEMS, L.P.	Industrial	PDR		D	B2	B3			SG
2/4/20	THE OCTAVE MUSIC GROUP, INC.	Industrial	PDR		D	B2	B3			SG
2/4/20	FORTRESS TRANSPORTATION AND INFRASTRUCTURE INVESTO	Financial	SrUnsec/LTCFR	1,150	U	B1	Ba3			SG

Source: Moody's

Ratings Round-Up

FIGURE 4

Rating Changes: Corporate & Financial Institutions – Europe

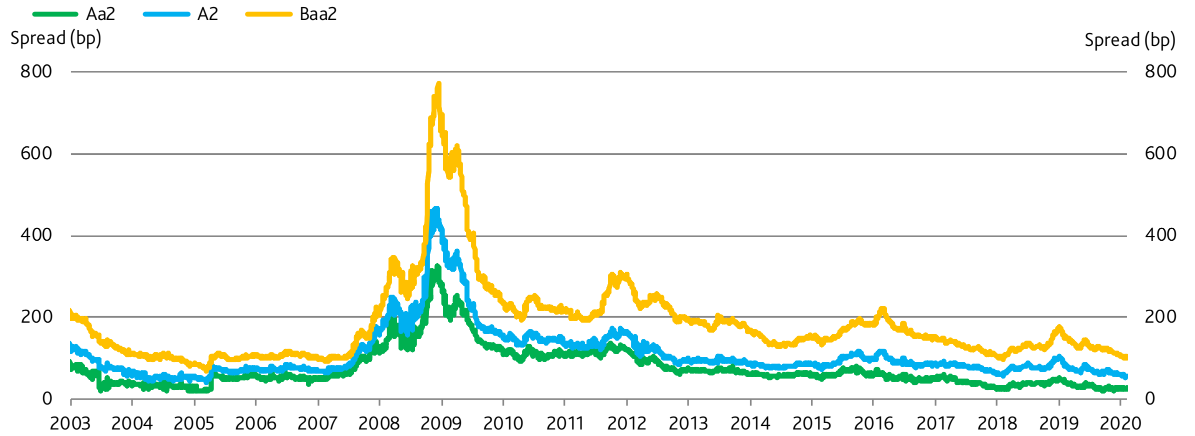
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	Old STD Rating	New STD Rating	IG/ SG	Country
1/29/20	HEIDELBERGER DRUCKMASCHINEN AG	Industrial	SrUnsec /LTCFR/PDR	228	D	Caa1	Caa2			SG	GERMANY
1/29/20	CALFRAC WELL SERVICES LTD.-CALFRAC HOLDINGS, LP	Industrial	SrUnsec /LTCFR/PDR	650	D	Caa1	Caa3			SG	CANADA
1/29/20	BARCLAYS PLC-BARCLAYS BANK PLC	Financial	SrUnsec/STIR/LTIR /LTD/Sub/JrSub /MTN/PS/CP	109,778	U	A2	A1	P-3	P-2	IG	UNITED KINGDOM
1/31/20	SEVERN TRENT PLC	Utility	SrUnsec /LTIR/MTN	4,318	D	A3	Baa1			IG	UNITED KINGDOM
1/31/20	FABRIC (BC) S.P.A.	Industrial	LTCFR/PDR		D	B1	B2			SG	ITALY
2/4/20	CMA CGM S.A.	Industrial	SrSec/BCF /LTCFR/PDR	2,355	D	B2	B3			SG	FRANCE

Source: Moody's

Market Data

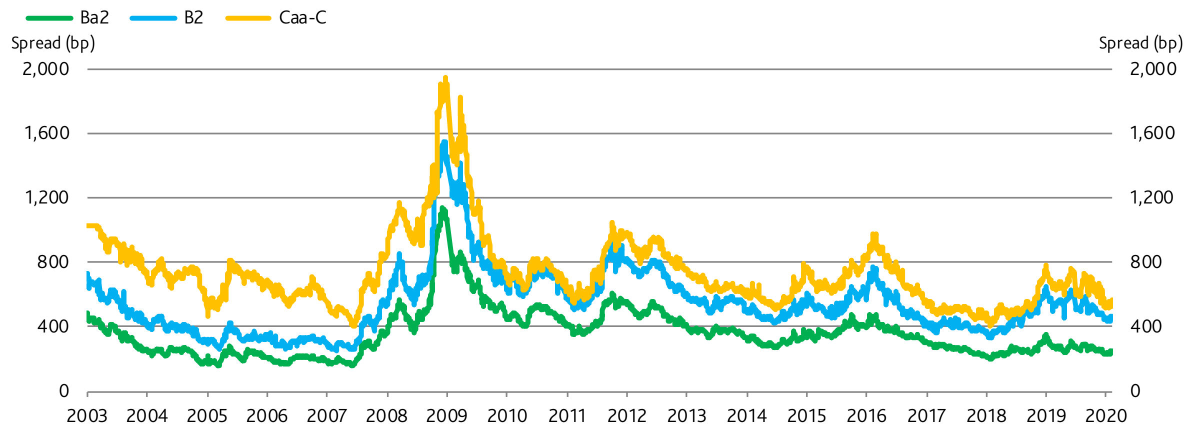
Spreads

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 (January 30, 2020 – February 5, 2020)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Feb. 5	Jan. 29	Senior Ratings
Navistar International Corp.	Ba2	B3	B3
United Airlines, Inc.	Ba2	B1	Ba3
Diamond Offshore Drilling, Inc.	Caa2	Ca	B3
JPMorgan Chase & Co.	Aa3	A1	A2
JPMorgan Chase Bank, N.A.	Aa2	Aa3	Aa2
Morgan Stanley	A3	Baa1	A3
Ally Financial Inc.	Baa2	Baa3	Ba1
Toyota Motor Credit Corporation	Aa2	Aa3	Aa3
Citibank, N.A.	Baa1	Baa2	Aa3
McDonald's Corporation	Aa1	Aa2	Baa1

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Feb. 5	Jan. 29	Senior Ratings
Simon Property Group, L.P.	Baa1	A2	A2
Burlington Resources, Inc.	Baa1	A2	A3
Advanced Micro Devices, Inc.	Baa1	A2	Ba3
Verizon Communications Inc.	A2	A1	Baa1
John Deere Capital Corporation	A3	A2	A2
Oracle Corporation	A3	A2	A1
Exxon Mobil Corporation	A2	A1	Aaa
Caterpillar Financial Services Corporation	A3	A2	A3
Bristol-Myers Squibb Company	Aa2	Aa1	A2
United Technologies Corporation	A1	Aa3	Baa1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Feb. 5	Jan. 29	Spread Diff
Chesapeake Energy Corporation	Caa3	2,872	2,779	94
Univision Communications Inc.	Caa2	263	185	77
Neiman Marcus Group LTD LLC	Ca	4,237	4,190	46
Pride International, Inc.	Caa2	1,585	1,544	41
Embarq Corporation	Ba2	265	236	29
Beazer Homes USA, Inc.	B3	200	177	22
Unisys Corporation	B2	319	300	19
Staples, Inc.	B3	519	503	16
Sprint Communications, Inc.	B3	380	367	13
Noble Energy, Inc.	Baa3	110	98	12

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Feb. 5	Jan. 29	Spread Diff
Frontier Communications Corporation	Caa3	6,670	8,939	-2,269
McClatchy Company (The)	C	1,555	1,822	-267
Penney (J.C.) Corporation, Inc.	Caa3	3,076	3,276	-200
Navistar International Corp.	B3	126	286	-160
Rite Aid Corporation	Caa3	884	953	-69
United States Steel Corporation	B3	584	646	-63
Talen Energy Supply, LLC	B3	769	825	-56
Diamond Offshore Drilling, Inc.	B3	734	784	-50
American Airlines Group Inc.	B1	165	194	-29
Realogy Group LLC	B3	433	461	-28

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (January 30, 2020 – February 5, 2020)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Feb. 5	Jan. 29	Senior Ratings
Finland, Government of	Aaa	Baa1	Aa1
Deutsche Bank AG	Baa1	Baa2	A3
Intesa Sanpaolo S.p.A.	Baa2	Baa3	Baa1
HSBC Holdings plc	A3	Baa1	A2
UniCredit S.p.A.	Baa2	Baa3	Baa1
Greece, Government of	Ba1	Ba2	B1
Vodafone Group Plc	Baa1	Baa2	Baa2
Bankinter, S.A.	Aa3	A1	Baa1
NatWest Markets N.V.	Aa1	Aa2	Baa2
ENEL S.p.A.	Baa1	Baa2	Baa2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Feb. 5	Jan. 29	Senior Ratings
Portugal, Government of	A1	Aa3	Baa3
ING Groep N.V.	A2	A1	Baa1
Credit Agricole Corporate and Investment Bank	Aa2	Aa1	Aa3
Santander UK plc	A3	A2	Aa3
Natixis	A3	A2	A1
Orange	Aa3	Aa2	Baa1
Nationwide Building Society	Baa1	A3	Aa3
Landesbank Baden-Wuerttemberg	Baa1	A3	Aa3
KBC Group N.V.	Baa1	A3	Baa1
Credit Suisse Group AG	A3	A2	Baa2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Feb. 5	Jan. 29	Spread Diff
Valaris plc	Caa2	1,797	1,750	46
Boparan Finance plc	Caa1	1,412	1,368	43
CMA CGM S.A.	Caa1	1,094	1,069	25
thyssenkrupp AG	Ba3	182	165	17
UPC Holding B.V.	B2	145	137	8
Iceland, Government of	A2	80	75	5
Ziggo Secured Finance B.V.	Caa1	124	119	4
Ziggo Bond Company B.V.	B3	125	120	4
Novafives S.A.S.	Caa2	772	768	4
ArcelorMittal	Baa3	149	146	3

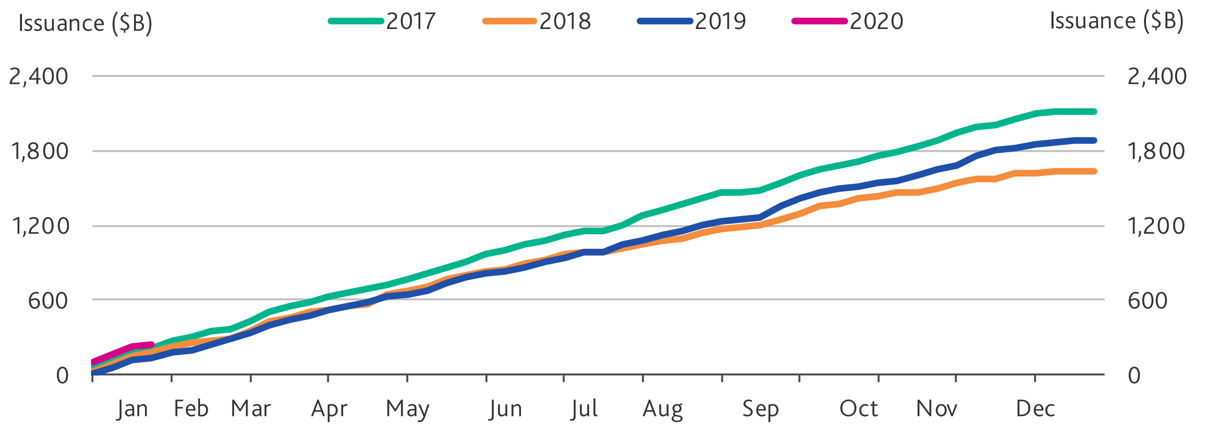
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Feb. 5	Jan. 29	Spread Diff
PizzaExpress Financing 1 plc	Ca	4,694	4,968	-274
Finland, Government of	Aa1	8	49	-41
Jaguar Land Rover Automotive Plc	B1	411	436	-26
Casino Guichard-Perrachon SA	B3	624	648	-24
Atlantia S.p.A.	Ba2	169	188	-19
Intesa Sanpaolo S.p.A.	Baa1	56	73	-17
TUI AG	Ba3	305	323	-17
Greece, Government of	B1	95	106	-11
Unione di Banche Italiane S.p.A.	Baa3	106	117	-11
Italy, Government of	Baa3	93	103	-10

Source: Moody's, CMA

Market Data

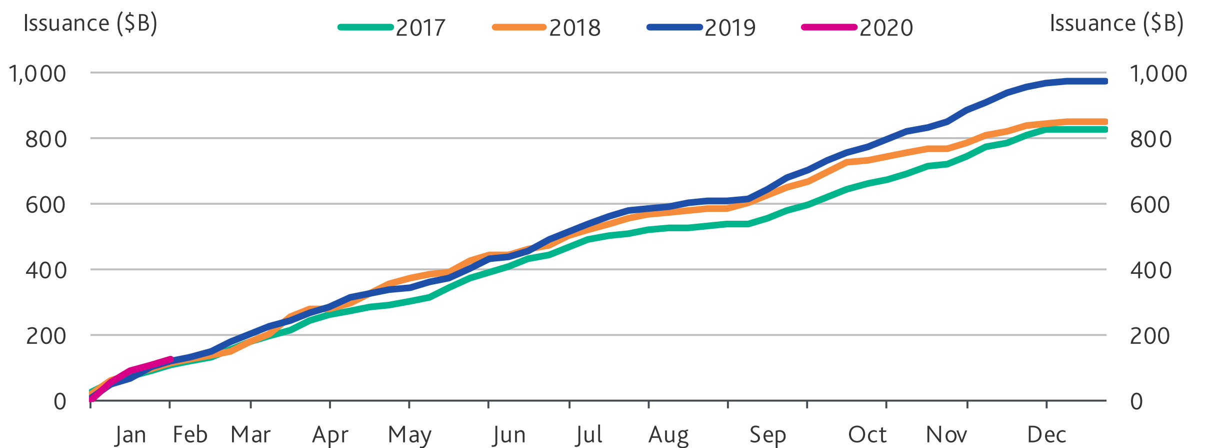
Issuance

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	11.345	3.925	16.674
Year-to-Date	153.107	69.205	236.965

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	10.741	2.962	17.094
Year-to-Date	101.943	19.498	127.180

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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How Corporate Credit Might Burst an Equity Bubble (Capital Markets Research)

Positive Earnings Outlook Requires Flat to Lower Interest Rates (Capital Markets Research)

Overvalued Equities Increase Corporate Credit's Downside Risk (Capital Markets Research)

High-Yield Rating Changes Say High-Yield Bond Spread Is Too Thin (Capital Markets Research)

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