MOODY'S
ANALYTICS

WEEKLY MARKET OUTLOOK

Moody's Analytics Research

Weekly Market Outlook Contributors:

Moody's Analytics/New York:
John Lonski
Chief Economist
1.212.553.7144
john.lonski@moodys.com

Yukyung Choi
Quantitative Research

Moody's Analytics/Asia-Pacific:
Shahana Mukherjee
Economist

Moody's Analytics/Europe:
Barbara Teixeira Araujo
Economist

Moody's Analytics/U.S.:
Ryan Sweet
Economist

Dan White
Economist

Michael Ferlez
Economist

Emily Mandel
Economist

Colin Seitz
Economist

Editor
Reid Kanaley

Contact: help@economy.com

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Unprecedented Demographic Change Will Shape Credit Markets Through 2030

Credit Markets Review and Outlook *by John Lonski*

Unprecedented Demographic Change Will Shape Credit Markets Through 2030

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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: Recent corporate bond yield spreads reflect expectations of an unfolding business cycle upturn.

Credit Spreads	Investment Grade: We see the year-end 2020's average investment grade bond spread under its recent 154 basis points. High Yield: Compared with a recent 629 bp, the high-yield spread may approximate 620 bp by year-end 2020.
Defaults	US HY default rate: According to Moody's Investors Service, the U.S.' trailing 12-month high-yield default rate jumped from May 2019's 3.1% to May 2020's 6.4% and may average 11.9% during 2020's final quarter.
Issuance	For 2019's offerings of US$-denominated corporate bonds, IG bond issuance rose by 2.6% to $1.309 trillion, while high-yield bond issuance surged by 55.8% to $432 billion. In 2020, US$-denominated corporate bond issuance is expected to grow by 43.1% for IG to $1.873 trillion, while high-yield supply may rise by 1.7% to $440 billion.

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Ratings Round-Up

Recession Forcing Global Downgrades

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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: High tech, complacency, Fed intervention, transcendence, speculation, default risk, credit stress, rate cuts, optimism, coronavirus, corporate credit, spreads, leverage, rate sensitivity, sentiment, VIX, fundamentals, next recession, liquidity.

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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.

Unprecedented Demographic Change Will Shape Credit Markets Through 2030

Even without COVID-19, long-term prospects for U.S. economic growth fell considerably short of what held during the second half of the 20th century. Only if the average annual rate of labor productivity growth far exceeds its 1.2% rise of the 10 years ended 2019 might the average annual rate of U.S. real GDP growth well surpass 2% through 2030. Achieving labor productivity growth of at least 2% on a recurring basis probably requires another wave of technological innovation comparable to the introduction of internet technology during the late 1990s.

Partly in response to the implementation of new communications and computing technologies, labor productivity advanced by an extraordinarily rapid 3.0% annualized, on average, during 1997-2000. In turn, the breakneck rate of productivity growth supplied a 4.5% average annualized surge by U.S. real GDP.

In addition, U.S. economic growth during 1997-2000 was spurred by very favorable demographic changes. During 1997-2000, the number of Americans aged 20 to 64 years (a proxy for the U.S.' working-age population) grew by an outsized 2.25 million annually, on average, while the number of those aged 65 years and older rose by merely 227,000 annually.

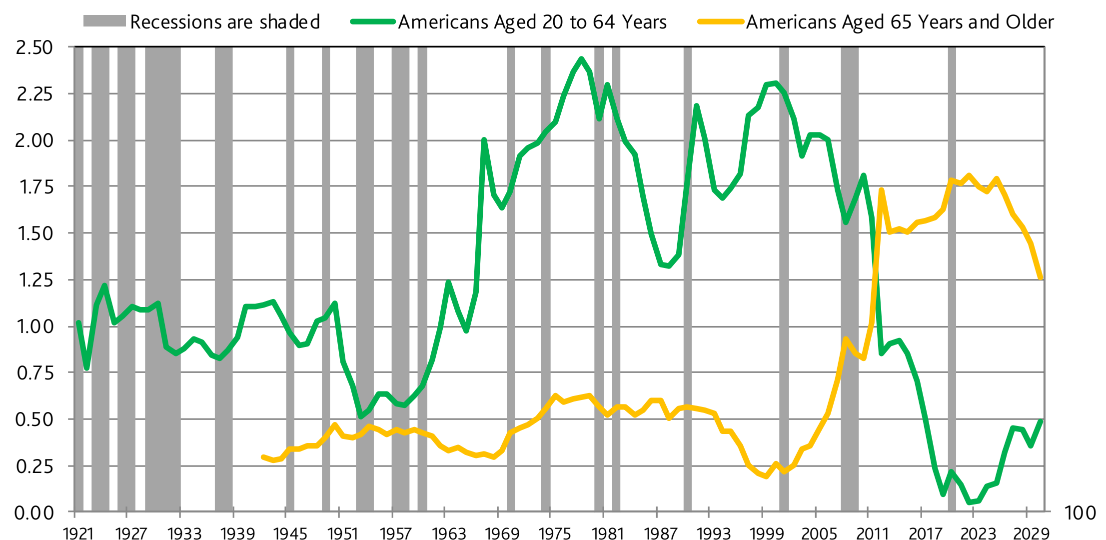
By contrast, the demographic outlook for the next 10 years differs drastically from what held amid the very rapid U.S. real GDP growth of 1997-2000. For the 10 years ended 2030, demographers projected average annual increases of only 241,000 for the number of Americans aged 20 to 64 years and 1.676 million for those older than 64 years.

Within the latter category, the number of Americans aged at least 80 years is expected to increase by 607,000 annually on average through the 2030s. Thus, current projections have the 607,000 average annual increase by the 80-years-and-older age cohort topping the 241,000 of the 20-to-64-years age cohort, or what traditionally captures the size of the workforce.

Figure 1: Unprecedented Aging of U.S. Population Will Rein In Growth, Inflation, and Interest Rates Post COVID-19 Recession

actual & predicted annual increases in millions of people

sources: Census Bureau, NBER, Moody's Analytics



Do the FOMC's Long-Term Rate Forecasts Aim to Rein In Speculation?

In all likelihood, the unprecedented aging of the U.S. population will rein in U.S. economic growth, inflation, and interest rates into the 2030s. Though the Federal Open Market Committee's long-term forecast of 1.8% U.S. real GDP growth seems plausible, the accompanying long-term forecasts of 2% for PCE price index inflation and 2.5% for the federal funds rate may prove to be too high.

The more appropriate long-term projections might be 1.7% for PCE price inflation and 1.5% to 1.75% for fed funds. During the five years ended December 2019, fed funds averaged 1.10% amid what was a livelier demographic backdrop compared to what awaits the U.S. through 2030.

Nevertheless, the FOMC has strong reason to bias its long-term interest rate forecasts upward. By significantly overstating the long-term forecast for the fed funds, Fed policymakers discourage private- and public-sector borrowers from becoming overly confident regarding the longevity of historically low benchmark interest rates.

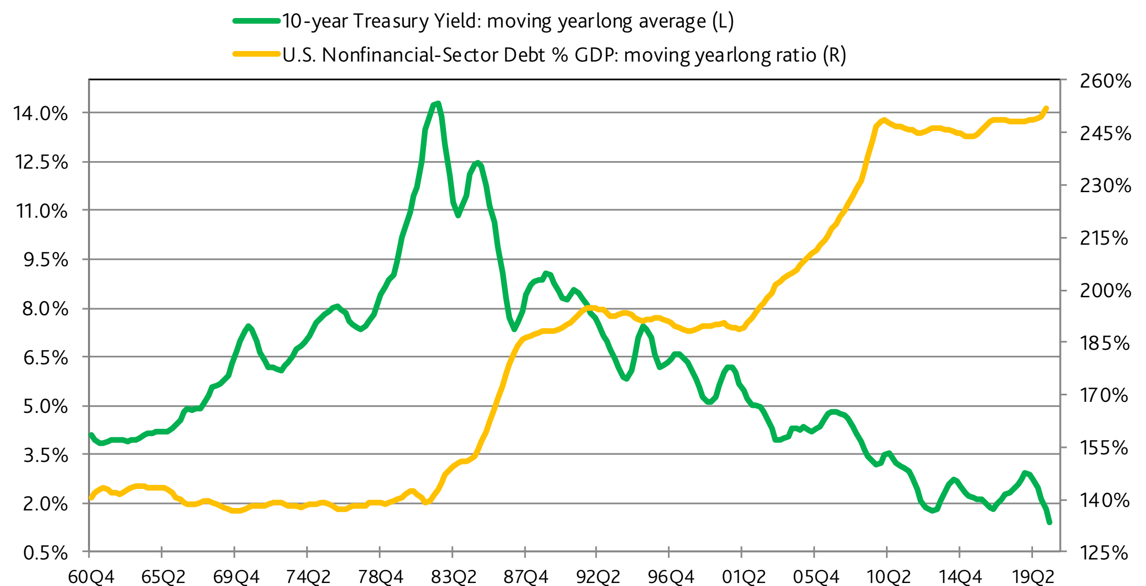
Exceptionally strong expectations of a very long stay by a low federal funds rate might drive systemic leverage—or the ratio of total U.S. nonfinancial-sector debt to GDP—up to heights that increase the vulnerability of business activity and financial markets to adverse external shocks (such as a pandemic).

Rate Cuts May Do Less to Spur Spending Amid High Systemic Leverage

As systemic leverage increases, business activity might be expected to respond more negatively to higher interest rates and less positively to lower rates. In other words, as the ratio of nonfinancial-sector debt to GDP climbs higher, each percentage point drop in Treasury bond yields will generate a smaller percent increase in business activity, while each percentage point increase in Treasury bond yields prompts a deeper percent decline in business activity.

And, thus, we end up with a seemingly paradoxical inverse relationship between systemic leverage and the 10-year Treasury yield. For example, as the ratio of U.S. private and public nonfinancial-sector debt rose from the 192% of the 10 years ended 1999 to the 247% of the 10 years ended 2019, the accompanying average for the 10-year Treasury yield fell from 6.6% to 2.4%, respectively.

Figure 2: Elevated Ratio of U.S. Nonfinancial-Sector Debt to GDP Lends a Downward Bias to Benchmark Interest Rates
sources: Federal Reserve, BEA, Moody's Analytics



It also should be mentioned that real GDP's average annualized rate of growth over a 10-year span slowed from 1999's 3.2% to 2019's 2.3%. In all likelihood, higher leverage was more a way of coping with a downshifting of the underlying pace of economic activity, as opposed to being a primary driving force behind the secular deceleration of economic growth.

Finally, the U.S. unemployment rate's moving 10-year average rose from the 5.8% of the span ended 1999 to the 6.2% of the span ended 2019. Because of the labor force's slower growth, the U.S. labor market has held up comparatively given the pronounced secular deceleration of economic growth.

Long-Term Average of 2.5% for Fed Funds May Require Less Than 3.5% Jobless Rate

During the 24 months ended February, a 3.73% average for the unemployment rate was accompanied by a 2% average for the federal funds rate. By implication, a long-term average of at least 2% for the federal funds rate may require a long-term average no greater than 4% for the unemployment rate.

Thus, the FOMC's median long-term forecast of 4.1% for the unemployment rate seems to be inconsistent with the FOMC's median long-term projection of 2.5% for the federal funds rate.

Indications are that the Fed will not allow U.S. Treasury bond yields to rise to levels that might impede the attainment of full employment. If U.S. Treasury bond yields rise by enough to imperil efforts to reach full employment, the Fed will increase its holdings of U.S. Treasury bonds until Treasury yields fall by enough to facilitate a lowering of the unemployment rate. The avoidance of unwanted dollar exchange-rate depreciation and the containment of U.S. inflation expectations will allow Fed policy to pursue its full-employment goal.

Second Quarter's Record-High Net High-Yield Downgrades Mask April-to-June Plunge

Net high-yield downgrades equal the difference between the number of high-yield downgrades and upgrades. An unofficial tally of U.S. company credit rating revisions showed 29 net high-yield downgrades for the first 23 days of June. A rough estimate suggests that net high-yield downgrades may approximate 50 in June.

The second quarter's declining trend for net high-yield downgrades complements the change in the direction of high-yield credit spreads. In terms of still preliminary estimates, the number of U.S. high-yield net downgrades had previously dropped from April's 216 to May's 90. (Because of an extraordinarily large number of COVID-19-driven downgrades, net downgrades will probably be revised higher.)

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

Net high-yield downgrades were much lower during 2017-2019, or when Bloomberg/Barclays high-yield bond spread averaged 369 basis points compared to June 24's 594 bp. The average number of net high-yield downgrades per month were 17 for calendar-year 2019, 1 for 2018, and 2 for 2017.

Regarding 2015-2016's profits recession, the average number of net high-yield downgrades per month were 12 for 2015's third quarter, 30 for 2015's fourth quarter, 49 for 2016's first quarter, and 16 for 2016's second quarter. Despite 2015-2016's lower frequency of net high-yield downgrades, Bloomberg/Barclays average 685 bp high-yield bond spread of December 2015 through April 2016 Bloomberg was well above its latest 594 bp. The path taken by the high-yield bond spread during the COVID-19 recession more closely resemble its behavior during 2015-2016's profits recession compared to the broad economic recessions of 2008-2009 and 2001.

High-Yield Bond Issuance Recession Lasted Just One Month Thus Far

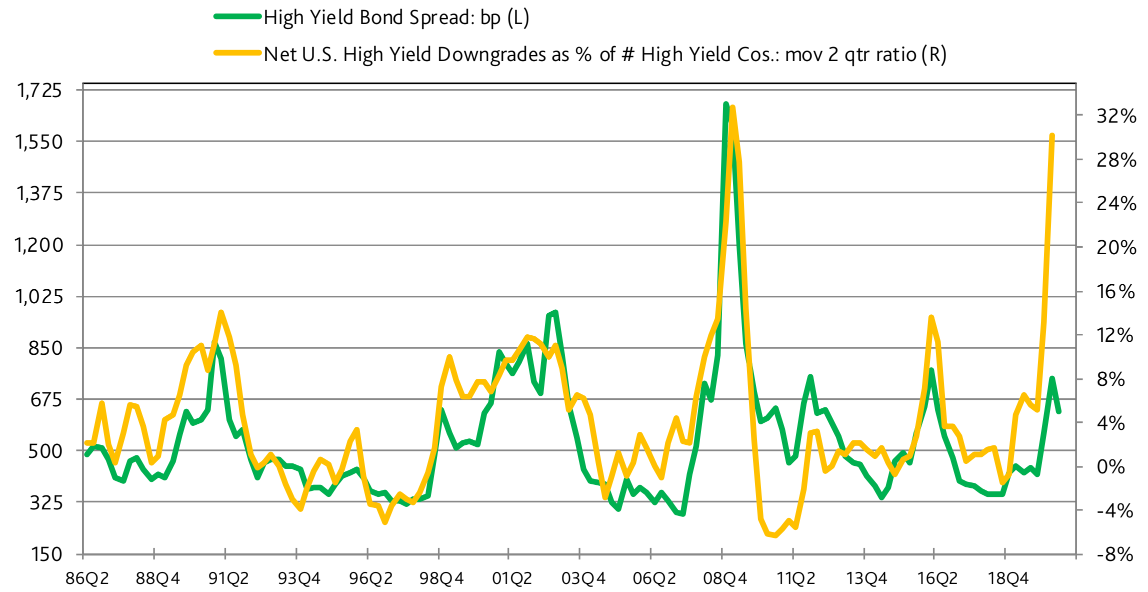
Moreover, the high-yield bond issuance recession lasted just one month, for now. After plunging by 84% from a year earlier in March (to $6 billion), second-quarter 2020's worldwide offerings of US$-denominated high-yield bonds posted a year-over-year advance of at least 36%, to $147 billion. The latter is very close to 2014's second-quarter record high of $154 billion. By contrast, such high-yield bond issuance incurred a year-over-year plunge of 57% during 2008's Great Recession year.

The high-yield bond market has performed remarkably well given the record-high incidence of net high-yield downgrades. For 2008-2009's Great Recession, after averaging 10 per month in 2017, the average number of net high-yield downgrades per month jumped up to 42 in 2008 and 37 in 2009.

During the Great Recession, the average number of net high-yield downgrades per month peaked at the 76 of 2009's first quarter. For 2020's second quarter, net high-yield downgrades may average a record-high 119 per month.

However, as a percent of the number of U.S. high-yield issuers, the prospective net high-yield downgrades of the two quarters ended June falls short of the 32.9% record high of the two quarters ended March 2009. More specifically, net high-yield downgrades are likely to approximate 30.2% of the number of high-yield issuers during 2020's first half. In view of how a composite high-yield bond spread averaged a record-high 1,678 in 2008's final quarter and 1,604 bp in 2009's first quarter, the spread's 744 bp average of the second quarter to date (never mind the recent 629 bp) seems unsustainably thin.

Figure 3: High-Yield Bond Spread Is Much Narrower Compared to What Is Suggested by Net High-Yield Downgrades
source: Moody's Analytics



However, the high-yield bond market may be assuming a stabilization of net high-yield downgrades, while also recognizing the degree to which high-yield downgrades have been skewed toward high-yield issuers having only loan debt outstanding. Nevertheless, a recent leveraged loan spread of 620 bp was well under its 1,527-bp average of October 2008 through March 2009.

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

THE U.S.
By Dan White, Emily Mandel and Colin Seitz of Moody's Analytics

Risks Rising for State and Local Budgets: COVID Stress-Test Update

After almost three full months into the COVID-19 pandemic, state and local government budget risks are at an all-time high as revenue uncertainty abounds. Complicating issues more, budget deadlines have become much tighter and the specter of a second wave of widespread infections has amplified the potential revenue losses in our more severe scenarios.

The biggest question remains how much, if any, help is on the way.

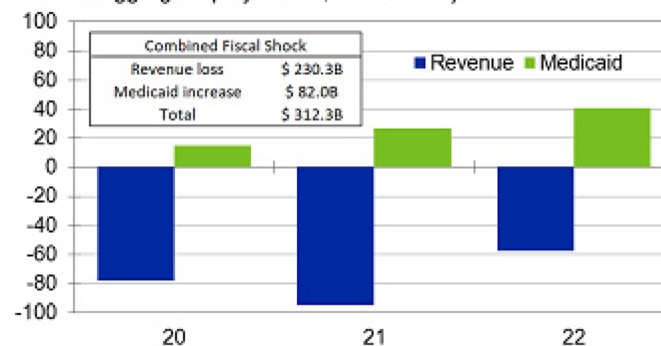
Under baseline economic assumptions, we project that Congress and the White House will need to enact approximately $500 billion in additional flexible aid to states and local governments over the next two fiscal years to avoid major damage to the economy.

This is based on a refresh of our April state budget stress tests to include the most up-to-date economic scenarios and data, as well as a rough estimate of local government revenue shortfalls relative to those state results. Local government shocks are estimated at approximately 48% of state government shocks based on work done by the Upjohn Institute for Employment Research and Brookings Institution.

The stress-test results are based on our proprietary state revenue and Medicaid models versus a flat-budget baseline, or what states would need just to keep the lights on and avoid layoffs. The estimates do not include any real discretionary budget increases or address any long-term structural problems such as pensions or other post-employment benefits.

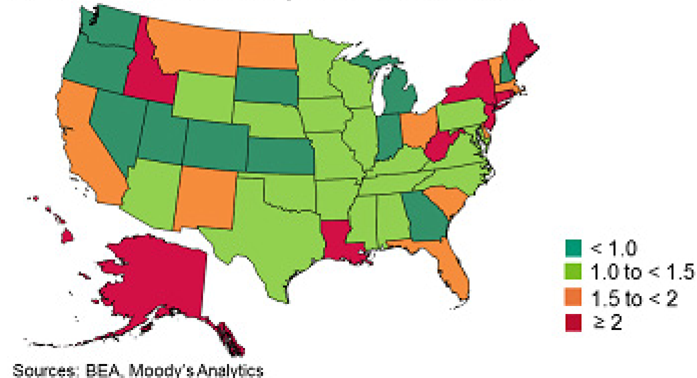
Baseline

Through the end of fiscal 2022, the fiscal shock to state budgets under baseline economic assumptions is projected to be $312 billion. This roughly matches what was our more severe scenario projection during the April stress-testing exercise. Both revenues and Medicaid spending are significantly impacted, with much of the stress concentrated in fiscal 2021, which begins this July for most states.



When potential shortfalls at the local government level are added, total fiscal drag on the economy over the next 2½ years comes out to be almost $500 billion. Relying on economic multipliers from

some of our previous research, we estimate that such a severe drag could shave as much as 3 full percentage points from real GDP and erase about 4 million jobs.

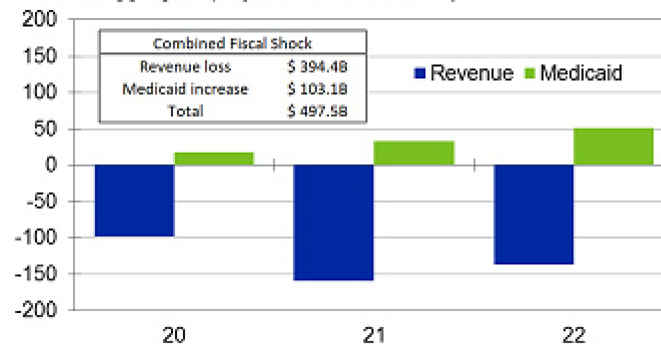


The baseline forecast assumes, from an economic perspective at least, that the worst of the pandemic is passed, followed by a continuing sluggishness until a vaccine can be established late next year.

Second wave

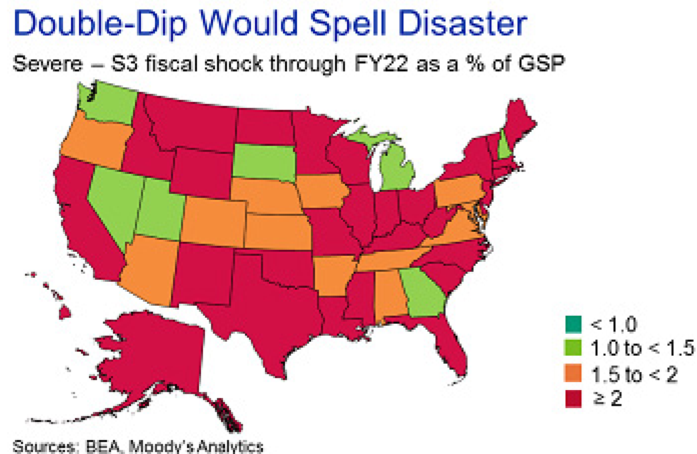
However, the risk of a potential second wave of infections resulting in another COVID-19-induced recession toward the end of this year has increased. Our more severe S3 scenario captures this possibility, with the economy taking much longer to recover relative to the baseline. In a true double-dip recession, real GDP may not fully recover until early 2023, and total employment would remain below 2019 levels until at least 2025.

The fiscal impacts of such a scenario would generate a level of budget stress not seen since the Great Depression. Through fiscal 2022, our modeling suggests that state budgets would be shocked by $498 billion.



Coupled with corresponding shortfalls at the local level, the total amount of fiscal drag from a double-dip recession could reach almost $750 billion. Using past data on economic multipliers, we estimate

that such a drag could shave almost 5 full percentage points from real GDP and erase more than 6 million jobs.



The magnitude of the fiscal shocks estimated in this exercise is more than even the most well-run state or local government can handle without having to make substantive spending cuts or tax increases. These fiscal actions will have economic consequences, amplifying the business cycle and damaging the recovery. Because state and local governments are for all practical purposes unable to borrow to finance current operations, only the federal government is in a position to cushion the blow to the economy.

Time is short

The scope of aid being requested is certainly unprecedented in size and warrants significant scrutiny. For example, the $1 trillion in aid recently approved as part of the house's HEROES Act would be enough to raise the eyebrows of even the most aggressive advocates of fiscal stimulus. Though the magnitude of such an aid package is certainly up for debate, the timing should not be.

Many state officials are still grappling with how to close out fiscal 2020, which ends for most states in less than a week. After that they will likely begin to convene special legislative sessions in late summer and early fall to address shortfalls for fiscal 2021, and shortly thereafter state and local governments will begin work in earnest on spending plans for fiscal 2022.

Given the uncertainty around the potential for a second widespread outbreak and the unprecedentedly massive size of the aid being requested, the wisest course of action would be to approve $500 billion in additional aid over the next two fiscal years as quickly as possible.

That will provide state and local government policymakers sufficient breathing room to avoid having to make economically disastrous fiscal decisions, and should a second virus outbreak actually occur, federal policymakers will have plenty of time to consider the prospect of additional aid over future fiscal years if necessary.

If the federal government fails to act quickly enough, state and local policymakers will have to go into impending budget negotiations with no knowledge of how much, if any, aid is headed their way. This will require them to be even more cautious than usual to the detriment of the economy. More than 1.5 million government workers have already been laid off since the pandemic began. Without quick action, millions more could be next.

Next week

The key data will be the June employment report, ISM manufacturing survey, Conference Board consumer confidence, construction spending, ADP National Employment Report, and the nominal trade deficit.

EUROPE

By Barbara Teixeira Araujo of Moody's Analytics

Price Inflation to Remain Muted

The week ahead will bring a barrage of economic releases for Europe. In the spotlight will be the preliminary CPI figures for the different euro zone countries and for the currency area itself. We expect them to show that headline inflation pressures eased further in June across all countries—our view is that prices in the currency area actually fell by 0.1% year over year following a 0.1% rise in May, the first decline in four years. This drop should come despite a small pickup in energy inflation, which has been deep in negative territory for two months. We expect that the decline started to gradually lose pace in June, in line with the continued pickup in oil prices from their April nadir. Brent prices fell below $20 during the second half of April, but are now around $40. That this is still below the average of $64 recorded for June 2019 suggests that energy inflation will remain in negative territory for some time. Granted, pump prices depend not only on Brent prices but also on distribution and operating costs. But that demand has been significantly hit by the COVID-19 crisis—with people stuck at home and travel limited—and suggests that gas stations are likely to keep a lid on any increase in prices at the pump for the time being.

Our view is that this marginal rise in energy inflation will be offset by a further easing in core inflation pressures. Retail business are already slashing prices to get rid of stock they accumulated during the lockdown, while the drop in incomes and the job losses are expected to weigh on overall demand for goods and services, ensuring that prices remain contained over the coming months. Granted, developments are expected to be volatile across sectors. For instance, hairdressers have reported an increase in prices charged as social-distancing restrictions have limited their activity while demand for haircuts surged, and prices for flight tickets for some routes increased because of a sharp reduction in the number of flights available. But overall, all high-frequency indicators suggest that households remain cautious and are reining in spending, especially given the increased risks of a second wave of the coronavirus. This will lower the pricing power of retailers and services providers, especially in the hospitality industry.

For this reason, we expect euro zone CPI inflation to remain below zero during the summer and to only gradually rebound later in the year. It should remain below the ECB's 'close to but below' 2% target throughout 2021, warranting continued monetary stimulus by the central bank.

Elsewhere, we expect that the currency area's labour market report will show that unemployment rose to 7.8% in May from 7.3% in April. This isn't really bad news, as we and markets were expecting a much sharper increase a couple of months ago due to COVID-19 crisis. There are two main reasons why the rise in unemployment in the euro zone was contained until now. First and foremost, the short-term work schemes put in place by the different national governments. Those schemes allowed for firms to temporary furlough their workers without having to make them redundant, with their salaries being paid by the government during the time they were out of work. The latest numbers suggest that almost a third of the currency area's workforce benefited from these programmes. If these furlough workers had actually been laid off, the currency area's unemployment rate would have jumped to over 30%.

The second reason why we think unemployment hasn't increased much isn't as noble. It is mainly related to the ILO's methodology. Many people who were laid off or who were out of work during March and April were actually discouraged to look for a job, which means they were counted as inactive in the labour force survey, and not as unemployed. According to the ILO's definitions, someone who is not working is only counted as unemployed if they have actively looked for work in the past four weeks. Indeed, we have seen that the labour force declined across most major euro zone countries during the lockdown period, though the eye-watering drop in Italy stood out. Inactivity rose

so strongly in Italy that it pushed the unemployment rate in the country down to 6.3% in April from 9.1% in February, and that's despite the 1.7% drop in employment. With restrictions being eased and the economy gradually reviving, we expect that people will soon start searching for a job again, which should give a boost to the labour force and, perversely, raise the unemployment rate.

	Key indicators	Units	Moody's Analytics	Last
Mon @ 10:00 a.m.	Euro Zone: Business and Consumer Sentiment for June	index	85.0	67.5
Tues @ 7:45 a.m.	France: Household Consumption Survey for May	% change	7.2	-20.3
Tues @ 8:30 a.m.	Spain: GDP for Q1	% change	-5.2	0.4
Tues @ 9:30 a.m.	U.K.: GDP for Q1	% change	0.0	-2.0
Tues @ 10:00 a.m.	Euro Zone: Preliminary Consumer Price Index for June	% change		0.1
Wed @ 8:00 a.m.	Germany: Retail Sales for May	% change	2.9	-5.3
Wed @ 8:55 a.m.	Germany: Unemployment for June	%	6.6	6.3
Thur @ 9:00 a.m.	Italy: Unemployment for May	%	6.7	6.3
Thur @ 10:00 a.m.	Euro Zone: Unemployment for May	%		7.3

ASIA-PACIFIC

By Shahana Mukherjee of Moody's Analytics

Eased Restrictions Abroad Should Improve South Korean Trade

South Korea's June trade will be the highlight on the economic calendar. We expect exports to decline by 6.5% in yearly terms in June, whereas imports are likely to contract by 15%. This follows a 23.7% decline in exports in May, and a 21.1% decline in imports. Our expectation of a relatively moderate decline is based on the easing of restrictions in parts of Europe, the U.S. and parts of Asia since late May. As a result, production has resumed in these economies in varying capacities. Further, early estimates of June trade hint at improvements in the shipments of semiconductors and aggregate export volumes, with increases in demand from China. These developments are likely to have extended through most of June and lifted the decline seen since March.

China's official manufacturing PMI is expected to settle at 51.5 in June, following a reading of 50.6 in May. China's economic activity has resumed since the regional shutdown was eased in March, but production has moderated, with the PMI fluctuating around 50 since April. One reason for this is that new export orders remained weak through May, as a number of large economies were at least partially under lockdown over the period. We expect the downward pressure from weak demand to have marginally eased in May, which, combined with domestic recovery, is expected to lift the manufacturing PMI in June.

Japan's May unemployment rate is expected to rise to 2.9% from 2.6% in April. Japan's economy suffered a dual shock from the slump in external demand and the domestic lockdown in April, which undermined household sentiment further. While the current employment levels do not suggest a significant deterioration, a sharp rise in the number of furloughed workers and declining participation rates are indicative of the fragility in labour market conditions. While companies are tapping into the special loan schemes to meet short-term operational costs, significant losses for several companies and increased uncertainty regarding the near-term business outlook for many others may cause them to realign investment plans and forgo workers.

	Key indicators	Units	Moody's Analytics	Confidence	Risk	Last
Mon @ 9:50 a.m.	Japan Retail Sales for May	% change yr ago	-6.0	3	↑	-13.7
Tues @ 9:00 a.m.	South Korea Retail Sales for May	% change	6.1	3	↑	5.3
Tues @ 9:50 a.m.	Japan Unemployment rate for May	%	2.9	3	↓	2.6
Tues @ 11:00 a.m.	China Manufacturing PMI for June	Index	51.5	3	↓	50.6
Wed @ 9:50 a.m.	Japan Tankan Survey for Q2	Index	-38.0	3	↓	-8.0
Wed @ 10:00 a.m.	South Korea Foreign Trade for June	US$ bil	0.2	3	↓	0.4
Wed @ 3:00 p.m.	Japan Consumer Confidence for June	Index	28.0	3	↑	24.0
Thur @ 9:00 a.m.	South Korea CPI for June	% change yr ago	0.1	3	↑	-0.3
Fri @ 11:30 a.m.	Australia Foreign Trade for May	A$bil	7.2	3	↓	8.8
Fri @ 11:30 a.m.	Australia Retail Sales for May	% change	-3.5	3	↓	-17.7

The Long View

The 10-year Treasury yield trended lower following each of the three previous recessions.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group
June 25, 2020

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 154 basis points far exceeded its 122-point mean of the two previous economic recoveries. This spread may be no wider than 145 bp by year-end 2020.

The recent high-yield bond spread of 629 bp is thinner than what is suggested by the accompanying long-term Baa industrial company bond yield spread of 235 bp and the recent VIX of 32.4 points. The latter has been statistically associated with a 935-bp midpoint for the high-yield bond spread.

DEFAULTS

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

US CORPORATE BOND ISSUANCE

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

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

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

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

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

For 2019, worldwide corporate bond offerings grew by 5.4% annually (to $2.447 trillion) for IG and advanced by 49.2% for high yield (to $561 billion). The projected annual percent changes for 2020's worldwide corporate bond offerings are a 6.7% rise for IG and a 6.2% drop for high yield.

US ECONOMIC OUTLOOK

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

EUROPE

By Barbara Teixeira Araujo of Moody's Analytics
June 25, 2020

EURO ZONE

The European Central Bank set up a new euro system repo facility, called EUREP, which is aimed at providing euro liquidity to central banks outside the euro zone. Central banks will be able to borrow euros against euro-denominated debt, with the facility expected to run until June 2021. The timing of the announcement is odd, as financial market conditions are relatively stable now, but the ECB's decision reinforces the argument that the central bank is committed to continue doing whatever it takes to support the economy through the COVID-19 crisis. It sends a message that the ECB is not out of firepower, and that it is watching conditions closely.

Prospects of a new trade war between the U.S. and Europe continued to batter stock markets. On Wednesday, the U.S. outlined plans to impose tariffs on 30 products worth $3.1 million in European exports. The products include olives, beer, gin, pastry and cakes. Although the notice still needs to undergo a month-long public comment period, chances that the tariffs will go through are high. The timing couldn't be worse, as further political uncertainty would only hinder the post-pandemic recovery. We already expect that the U.K.'s and the euro zone's GDP will take at least two years to reach precrisis growth rates, and an escalation of the global trade war would drag this out even longer. To this we add Brexit woes. After taking a breather during the worst of the lockdown, negotiations between the EU and the U.K. are underway again but seem to be going nowhere. And that the U.K. has formally ruled out an extension of the transition period makes a no-deal Brexit at the end of the year more likely, which should further weigh on economic prospects.

June's flash PMIs confirmed that the European economies continued to recover after reaching rock bottom in April, in line with the further easing of COVID-19 lockdown measures. The euro zone's flash composite PMI climbed to 47.5 from 31.9 in May, driven higher by a rise to 51.3 from 32.1 in France, and to 45.8 from 32.3 in Germany. Rebounds were recorded across the services and manufacturing sectors, but the former stole the spotlight with a sharp 16.8-percentage point increase.

Although these numbers are better than the consensus for a lesser rebound, they indicate that activity in the currency area actually fell further in June from May's record lows. That's because the PMIs normally ask respondents how activity compares with the previous month, and any reading below 50 signals a contraction. Our view is that respondents are likely comparing activity to normal levels, which would come in line with other economic evidence and the reopening of factories and nonessential services across all euro zone countries. As a result, the PMIs are suggesting that activity has rebounded sharply in June—which would be consistent with a V-shaped recovery in the short term—but that overall levels of production remain subdued. This jibes with anecdotal evidence showing that most firms are not planning to return to normal levels of capacity anytime soon.

Although a recovery is undoubtedly underway, output will remain below prepandemic levels for some time. Many people lost their jobs despite the short-term work schemes, while companies were forced to permanently shut their doors. Combined with the bleak prospects for global trade and lingering fears of a second wave of infections, we think the rebound in output will slow in the second half of the year, ensuring that the second quarter's slump in GDP won't be fully reversed and that activity will decline sharply over 2020 as a whole. Our forecast for the euro zone is for GDP to contract by 7.3% in 2020.

GERMANY

Germany's Ifo business climate index climbed to 86.2 in June from 79.7 in May, reversing all of its decline since February. Both the current conditions and the expectations indexes rose; the former was up to 81.3 from 78.9, while the latter increased to 91.4 from 80.5. The Ifo reiterates the message from the flash PMIs, which showed a strong rebound in activity at the end of the second quarter. And the numbers for July should be even better, as restrictions were eased further, especially related to travel. Although consumers remain cautious, there is evidence that more Germans are booking domestic vacations instead of travelling abroad, which should boost the country's hospitality sector. Like in the U.K., Germany's tourism imports (what Germans spend abroad) exceed tourism exports (what foreign tourists spend in Germany). As a result, we think there is scope for a faster rebound in the tourism industry in Germany than in other European countries that rely heavily on foreign tourists, such as Spain and Greece.

FRANCE

The INSEE's business climate indicator for France showed that the French economy gained further ground in June. The business climate index rose to 77.8 from 59.9, with increases recorded across all main subsectors, though the sharp 25.6-point rise in service confidence was a highlight. But that France suffered a bigger hit in April and May than Germany did—as the lockdown by the French government was stricter and lasted longer—means that base effects are in place for a sharper June rebound.

UNITED KINGDOM

the U.K. CBI Distributive Trades Survey's sales balance rose to -37 in June from -50 in May, below forecasts for a sharper rebound but consistent with the fact that nonessential retail stores were allowed to reopen only by mid-month, after remaining closed for all of April and May. Although a further uptick in the indicator should be in the pipeline for July—as lockdown restrictions are set to be eased further—a majority of retailers reported they expect the pace of decline to be steeper in July than in June (-48 vs. -37). We do not think this will happen since pent-up demand is expected to boost sales in July, but it is understandable that retailers remain skeptical. The odds of a second wave of the virus are rising, while the government's furlough scheme is expected to be wound down from August and end in October, which should result in further job losses. Our view is that, after an initial jump following the easing of restrictions, consumer spending will likely remain lackluster until the end of the year as households hold back on their willingness and ability to buy.

ASIA PACIFIC

By Shahana Mukherjee of Moody's Analytics
June 25, 2020

NEW ZEALAND

Policymakers in the Asia-Pacific region face varied economic priorities as the focus shifts towards reviving the economy in the post-restrictions phase. New Zealand is a case in point. In line with market expectations, the Reserve Bank of New Zealand kept its official cash rate unchanged at the record low 0.25% and maintained the pace of quantitative easing at its June meeting.

This announcement follows the central bank's decision last month to nearly double its bond-purchasing program to NZ$60 billion from NZ$36 billion. Similar to last month, the central bank signalled willingness to ease policy to support an economy rattled by the pandemic.

New Zealand's near-term economic prospects are challenging. While New Zealand is one of the few countries to have successfully contained the internal spread of the coronavirus, there are fears that the fallout from the outbreak will be greater than initially expected. The strict lockdown had a severe impact on local businesses. Monthly data on electronic card transactions reported by local retailers showed that purchases declined by a sharp 51.6% in annual terms in April, following a much narrower 5.6% decline in March.

Labour market woes

While the shock from a slump in external demand has been somewhat delayed and moderated for New Zealand, with exports having contracted by 4% in yearly terms in April, the impact from the hit to tourism and the domestic shutdown has weighed heavily on the labour market. Further, while the quarterly unemployment rate rose from 4% to 4.2% in the March quarter, a weekly employment indicator reported by Statistics New Zealand showed that the number of paid jobs fell sharply from 2.22 million to under 2.1 million (or by 5%, peak to trough) during the lockdown in April.

Despite the softness in demand, an effective handling of the health crisis and the easing of restrictions has allowed spending to revive. This was reflected in the number of paid jobs reported for the third week of May, which rose to nearly 2.19 million. The pace of recovery in the post-restrictions phase will depend on two crucial aspects. First, it will depend on how soon consumer sentiment improves and household spending is restored, which will aid employment. The second factor will be how extensively travel restrictions are eased. A pickup in domestic travel will support the severely impacted tourism-exposed industries, but a selective easing of international restrictions, especially with countries that have brought the outbreak under control, will serve as an important lever to enhance the recovery. This is particularly important for New Zealand, considering that 20% of total employment is generated by tourism, which is amongst the highest in the world, second only to Thailand and the Philippines.

The global policy response to combating the COVID-19 crisis has been sharp. On the monetary front, central banks in major economies have stepped up asset purchases to keep borrowing costs low. While the RBNZ's actions are

The Long View

aligned well with the global trend and it may even step up quantitative easing further in the months ahead to meet additional liquidity needs, a consideration of negative interest rates is likely to prove more complex for New Zealand and one that will be resisted. The increased focus on fiscal policy to sustain support will continue in the near term, and depending on how well domestic spending rebounds, the situation may warrant additional support through potentially another extension of the wage subsidy scheme, which is in place until September.

Ratings Round-Up

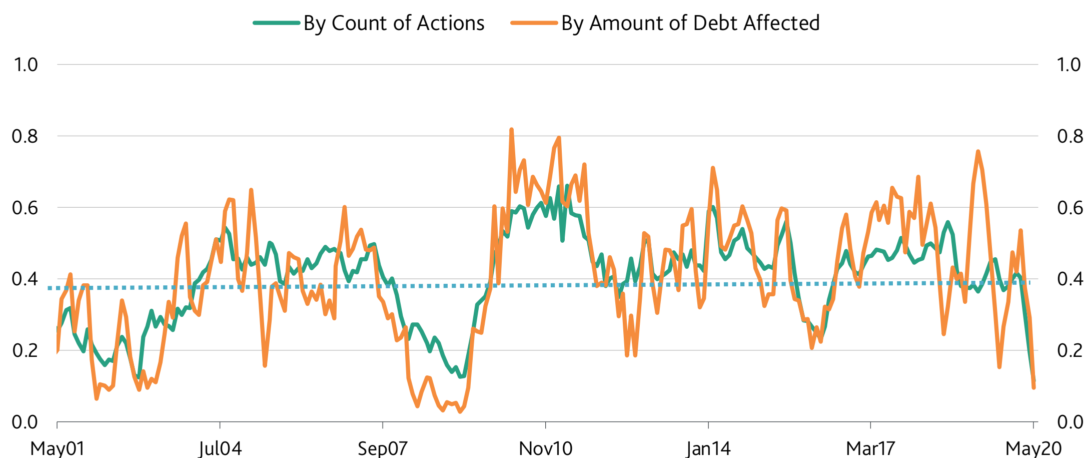
Recession Forcing Global Downgrades

By Michael Ferlez

U.S. rating change activity increased last week, though corporate credit quality is suffering as a result of the global recession. Through the end of May, rating change activity by both the number of actions and the amount of debt affected is quickly approaching the lows of the Great Recession. Few industries have been spared from the recession, but business services, consumer-oriented industries, and the oil industry have so far bore the brunt of the downgrades. For the week ended June 23, downgrades accounted for 71% of total rating changes and roughly three-quarters of affected debt. The most notable downgrade was made to Carnival Corporation, which saw its senior unsecured credit rating cut to Ba2 from Ba1. Moody's Investors Service's downgrade of the U.S. cruise line reflects the $1.5 billion in secured debt ahead of its unsecured debt in the capital structure and Carnival's recent issuance of $4 billion of senior secured notes, which accounts for roughly a quarter of the firm's outstanding debt. The downgrade affected $4.6 billion in outstanding debt. Another notable downgrade is Caesars Resort Collection, LLC, which saw its corporate family rating cut to B2 and its existing senior unsecured notes downgraded from B3 to Caa1.

European rating change activity weakened last week, with downgrades firmly outnumbering upgrades. In the period ended June 23, downgrades accounted for 82% of total activity and accounted for 89% of affected debt. The Netherlands received the most rating changes with four, followed by Germany with two, and France, Norway, Portugal, Spain, and the United Kingdom each with one. The most notable European rating change last week was the downgrade of French auto supplier Faurecia. The firm saw its corporate family rating and senior unsecured rating cut to Ba2 from Ba1. The downgrade of Faurecia by Moody's Investors Services was the result of the firm's increased debt levels, pushing leverage above Moody's expectations for a Ba1 rating. The downgrade impacted $2.4 billion in 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
6/17/20	VIASAT, INC.	Industrial	SrSe	1,200	U	B1	Ba3			SG
6/17/20	CAESARS ENTERTAINMENT CORPORATION -CAESARS RESORT COLLECTION, LLC	Industrial	SrUnsec/SrSec /BCF/LTCFR/PDR	3,400	D	B3	Caa1			SG
6/17/20	ULTIMATE SOFTWARE GROUP, INC. (THE)	Industrial	SrSec/BCF/LTCFR/PDR		U	B2	B1			SG
6/17/20	ELDORADO RESORTS, INC.	Industrial	LTCFR/PDR		D	B1	B2			SG
6/17/20	CARDTRONICS PLC-CARDTRONICS, INC.	Industrial	SrUnsec	600	D			B1	B2	SG
6/18/20	GARTNER, INC.	Industrial	SrUnsec/SrSec/BCF	800	U	B1	Ba3			SG
6/18/20	MILLENNIUM PARK HOLDCO, INC.	Industrial	SrSec/BCF/LTCFR/PDR		U	Caa1	B3			SG
6/18/20	GHX ULTIMATE PARENT CORPORATION	Industrial	SrSec/BCF		U	B3	B2			SG
6/18/20	FORMING MACHINING INDUSTRIES HOLDINGS, LLC	Industrial	SrSec/BCF/LTCFR/PDR		D	B3	Caa1			SG
6/19/20	TENNECO INC.	Industrial	SrUnsec/LTCFR/PDR	1,450	D	B3	Caa1			SG
6/19/20	MONOTYPE IMAGING HOLDINGS INC.	Industrial	SrSec/BCF/LTCFR/PDR		D	B2	B3			SG
6/19/20	CENTRALSQUARE TECHNOLOGIES, LLC	Industrial	SrSec/BCF/LTCFR/PDR		D	B3	Caa1			SG
6/19/20	WATERBRIDGE MIDSTREAM OPERATING LLC	Industrial	SrSec/BCF/LTCFR/PDR		D	B1	B3			SG
6/19/20	ASP NAPA HOLDINGS, LLC.-NAPA MANAGEMENT SERVICES CORPORATION	Industrial	SrSec/BCF/LTCFR/PDR		D	B3	Caa1			SG
6/22/20	MEREDITH CORP.	Industrial	SrSec/BCF		D	Ba2	Ba3			SG
6/22/20	SIGANATURE AVIATION PLC	Industrial	SrUnsec/LTCFR/PDR	1,150	D	Ba2	Ba3			SG
6/22/20	SM ENERGY COMPANY	Industrial	SrUnsec/PDR	2,436	U	Ca	Caa2			SG
6/22/20	BEASLEY BROADCAST GROUP, INC.-BEASLEY MEZZANINE HOLDINGS, LLC	Industrial	SrSec/BCF/LTCFR/PDR		D	B1	B2			SG
6/22/20	AAC HOLDINGS, INC.	Industrial	SrSec/BCF/LTCFR		D	Caa2	Ca			SG
6/22/20	DRIVE CHASSIS HOLDCO, LLC	Industrial	LTCFR/PDR		D	B2	B3			SG
6/22/20	PHOTO HOLDINGS, LLC-SHUTTERFLY, LLC	Industrial	SrSec/SrUnsec /BCF/LTCFR/PDR	1,085	D	B1	B2			SG
6/23/20	CARNIVAL CORPORATION	Industrial	SrUnsec	4,620	D	Ba1	Ba2			SG
6/23/20	MINERALS TECHNOLOGIES INC.	Industrial	SrSec/BCF		U	Ba2	Ba1			SG
6/23/20	TERRIER MEDIA BUYER, INC.	Industrial	SrSec/BCF		D	Ba3	B1			SG

Source: Moody's

Ratings Round-Up

FIGURE 4

Rating Changes: Corporate & Financial Institutions – Europe

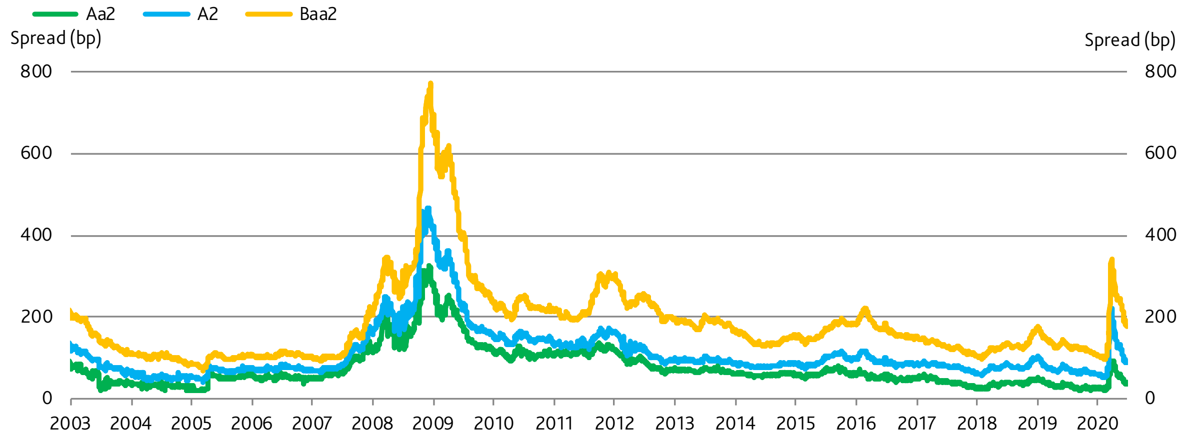
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/SG	Country
6/17/20	ENQUEST PLC	Industrial	SrUnsec/LTCFR/PDR	677	D	Caa1	Caa2	SG	UNITED KINGDOM
6/18/20	HEMA B.V.	Industrial	SrSec/SrUnsec /LTCFR/PDR	839	D	Caa2	Caa3	SG	NETHERLANDS
6/18/20	ADLER GROUP -ADLER PELZER HOLDING GMBH	Industrial	SrSec/LTCFR/PDR	391	D	B2	B3	SG	GERMANY
6/19/20	FAURECIA	Industrial	SrUnsec/LTCFR/PDR	2,404	D	Ba1	Ba2	SG	FRANCE
6/19/20	WIRECARD AG	Industrial	SrUnsec	559	D	Baa3	B3	IG	GERMANY
6/19/20	DUFRY AG	Industrial	SrUnsec/LTCFR/PDR	1,733	D	Ba3	B1	SG	NETHERLANDS
6/19/20	HURTIGRUTEN GROUP AS	Industrial	SrSec/BCF /LTCFR/PDR	336	D	B3	Caa1	SG	NORWAY
6/22/20	FLUTTER ENTERTAINMENT PLC-STARS GROUP HOLDINGS B.V. (THE)	Industrial	SrUnsec/SrSec/BCF	1,000	U	Caa1	Ba2	SG	NETHERLANDS
6/22/20	LIBERTY LATIN AMERICA LTD. -VTR FINANCE N.V.	Industrial	LTCFR		U	B1	Ba3	SG	NETHERLANDS
6/23/20	NH HOTEL GROUP S.A.	Industrial	SrSec/LTCFR/PDR	399	D	Ba3	B2	SG	SPAIN
6/23/20	TAP S.G.P.S.-TRANSPORTES AEREOS PORTUGUESES, S.A.	Industrial	SrUnsec/LTCFR/PDR	419	D	Caa1	Caa2	SG	PORTUGAL

Source: Moody's

Market Data

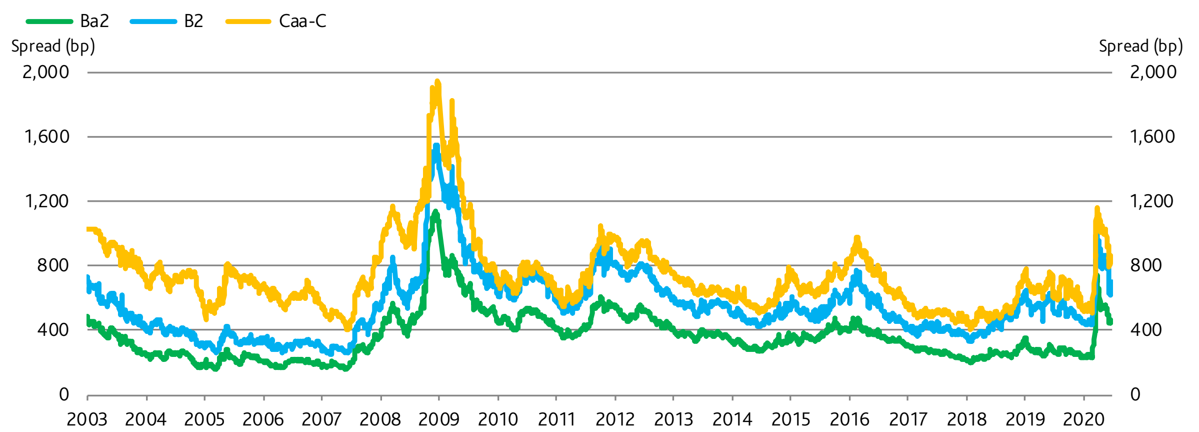
Spreads

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



Source: Moody's

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



Source: Moody's

Market Data

CDS Movers

Figure 3. CDS Movers - US (June 17, 2020 – June 24, 2020)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jun. 24	Jun. 17	Senior Ratings
Microsoft Corporation	Aa1	Aa2	Aaa
Exxon Mobil Corporation	A2	A3	Aa1
Philip Morris International Inc.	A2	A3	A2
Capital One Financial Corporation	Baa3	Ba1	Baa1
Apache Corporation	B1	B2	Ba1
Noble Energy, Inc.	Ba1	Ba2	Baa3
Hilton Worldwide Finance, LLC	Ba2	Ba3	Ba2
Qwest Corporation	Ba1	Ba2	Ba2
Marathon Oil Corporation	B2	B3	Baa3
GATX Corp.	Ba1	Ba2	Baa2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jun. 24	Jun. 17	Senior Ratings
Ralph Lauren Corporation	Baa2	A1	A3
Eastman Chemical Company	A1	Aa2	Baa3
Block Financial LLC	Baa3	Baa1	Baa3
Citigroup Inc.	Baa2	Baa1	A3
Bank of America Corporation	Baa1	A3	A2
JPMorgan Chase Bank, N.A.	A2	A1	Aa2
Morgan Stanley	Baa2	Baa1	A3
Ford Motor Credit Company LLC	B3	B2	Ba2
Citibank, N.A.	Baa3	Baa2	Aa3
CVS Health	A1	Aa3	Baa2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jun. 24	Jun. 17	Spread Diff
Chesapeake Energy Corporation	C	31,596	28,453	3,142
American Airlines Group Inc.	Caa1	2,677	2,130	547
Staples, Inc.	B3	1,969	1,481	489
Royal Caribbean Cruises Ltd.	Ba2	1,868	1,476	393
Carnival Corporation	Ba2	1,423	1,033	390
K. Hovnanian Enterprises, Inc.	Caa3	2,432	2,279	153
Pitney Bowes Inc.	B1	1,373	1,233	140
L Brands, Inc.	B2	723	604	119
Macy's Retail Holdings, Inc.	B1	850	736	113
Avis Budget Car Rental, LLC	B3	963	864	100

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jun. 24	Jun. 17	Spread Diff
Marathon Oil Corporation	Baa3	364	405	-41
Nissan Motor Acceptance Corporation	Baa3	307	343	-36
AutoNation, Inc.	Baa3	408	442	-33
Pioneer Natural Resources Company	Baa2	200	225	-26
ONEOK Partners, L.P.	Baa3	153	173	-19
DPL Inc.	Ba1	322	336	-14
Service Corporation International	Ba3	157	170	-12
Mack-Cali Realty, L.P.	B1	112	121	-9
Chevron Corporation	Aa2	67	75	-8
FedEx Corporation	Baa2	111	118	-7

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (June 17, 2020 – June 24, 2020)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jun. 24	Jun. 17	Senior Ratings
Alliander N.V.	A1	Baa2	Aa2
Landesbank Baden-Wuerttemberg	A1	A3	Aa3
Boparan Finance plc	Caa1	Caa3	Caa1
France, Government of	Aaa	Aa1	Aa2
Norddeutsche Landesbank GZ	Baa2	Baa3	A3
Compagnie de Saint-Gobain SA	A3	Baa1	Baa2
Swisscom AG	A2	A3	A2
Valeo S.A.	Ba1	Ba2	Baa3
Ziggo Bond Company B.V.	Ba1	Ba2	B3
Coca-Cola HBC Finance B.V.	Aa3	A1	Baa1

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jun. 24	Jun. 17	Senior Ratings
Natixis	Aa3	Aa2	A1
Barclays PLC	Baa3	Baa2	Baa2
Banco Santander S.A. (Spain)	A1	Aa3	A2
ING Groep N.V.	A3	A2	Baa1
Commerzbank AG	Baa1	A3	A1
DZ BANK AG	A3	A2	Aa1
Total S.A.	A2	A1	Aa3
ENEL S.p.A.	Baa1	A3	Baa2
ENGIE SA	Aa2	Aa1	A3
Credit Suisse Group AG	Baa2	Baa1	Baa2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jun. 24	Jun. 17	Spread Diff
Matalan Finance plc	Caa2	7,997	7,224	773
Selecta Group B.V.	Caa2	4,114	3,730	384
PizzaExpress Financing 1 plc	C	13,504	13,408	96
TUI AG	Caa1	1,273	1,192	81
Deutsche Lufthansa Aktiengesellschaft	Ba1	383	322	61
RCI Banque	Baa2	244	213	31
Renault S.A.	Ba2	236	206	30
Fiat Chrysler Automobiles N.V.	Ba2	277	250	27
thyssenkrupp AG	B1	308	282	27
Jaguar Land Rover Automotive Plc	B1	895	869	26

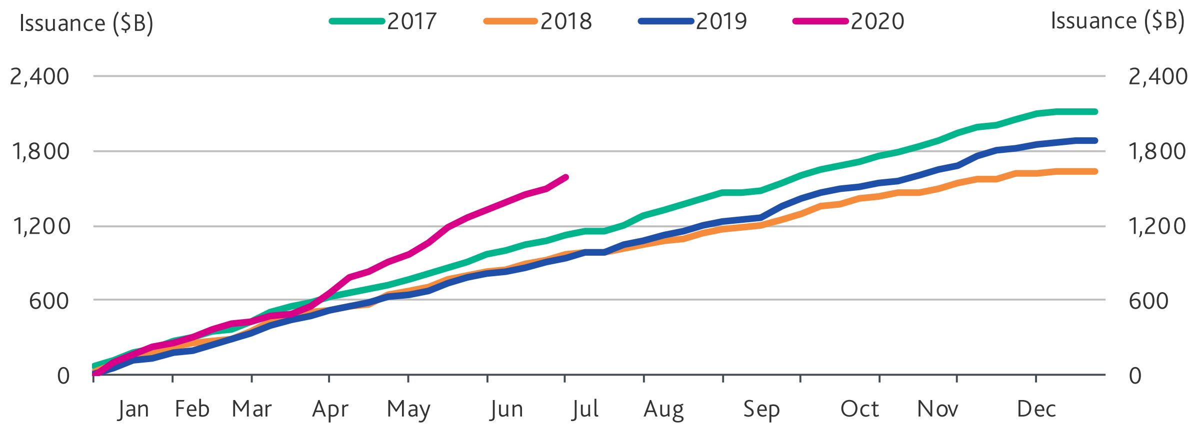
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jun. 24	Jun. 17	Spread Diff
Boparan Finance plc	Caa1	694	923	-228
Vedanta Resources Limited	B3	1,339	1,478	-139
Iceland Bondco plc	Caa2	759	858	-98
Piraeus Bank S.A.	Caa2	794	856	-61
Wienerberger AG	Ba1	339	367	-28
Alliander N.V.	Aa2	47	71	-23
Permanent tsb p.l.c.	Baa2	207	228	-21
Novafives S.A.S.	Caa2	1,274	1,286	-12
Norddeutsche Landesbank GZ	A3	84	92	-8
Pearson plc	Baa2	95	103	-8

Source: Moody's, CMA

Market Data

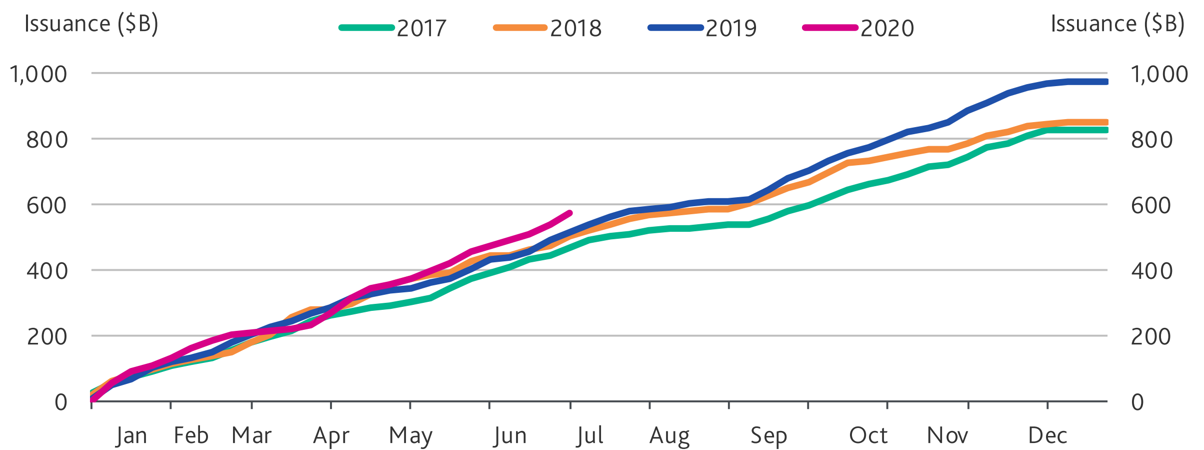
Issuance

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	65.198	20.535	89.839
Year-to-Date	1,271.715	267.329	1,588.539

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	29.250	2.687	35.405
Year-to-Date	502.833	53.056	572.610

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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Report Number: 1235538

Editor
Reid Kanaley
help@economy.com

Contact Us

Americas:	1.212.553.4399
Europe:	+44 (0) 20.7772.5588
Asia:	813.5408.4131

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