MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK
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Lost That Lovin' Feeling

U.S. recessions are ultimately a loss of faith: Consumers lose faith that they will have a job and pull back on their spending, and businesses lose faith that there will be demand for the good or service they produce, and they lay off workers. A vicious, self-reinforcing cycle takes hold.

There has been a decline in small-business confidence and some but not all measures of consumer sentiment. This has fanned concern about a recession. To highlight this, we calculated z-scores. These measure the standard deviations above or below the mean for the quits rate in healthcare. The z-score shows how many standard deviations each of these surveys of consumer sentiment is from its mean. The recent drop in the University of Michigan consumer sentiment index puts it well below its mean.

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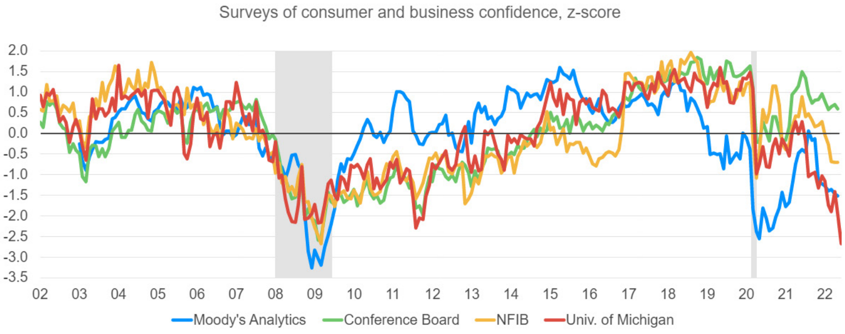
Not All Measures of Confidence Spell Doom and Gloom



Sources: Conference Board, NFIB, Univ. of Michigan, Moody's Analytics

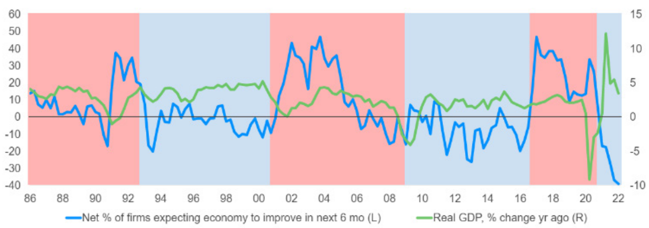
Moody's Analytics and Moody's Investors Service maintain separate and independent economic forecasts. This publication uses the forecasts of Moody's Analytics. Moody's Analytics markets and distributes all Moody's Capital Markets Research materials. Moody's Analytics does not provide investment advisory services or products. For further detail, please see the last page.

The NFIB small business optimism survey and our weekly global business confidence surveys are also lower than their respective means. The standout is the Conference Board consumer confidence index, which remains higher than its average. This measure of sentiment is sensitive to the health of the labor market, which is holding up well even as the economy has weakened.

Something that has garnered attention is the enormous decline in the NFIB small business optimism survey responses about expectations over the next six months. The net percentage of respondents expecting the economy to improve came in at -54%, compared with -50% in April. Expectations have deteriorated noticeably during the past few months from -35% in February. Expectations for the economy to improve are by far the lowest on record.

That said, the situation likely is not as dour as it appears. One reason is that businesses are saying one thing and doing another. Hiring and investment is significantly stronger than would be implied by the poor outlook from the NFIB survey.

Small Business Sentiment Is Much Higher During Republican Presidencies



Sources: BEA, NFIB, Moody's Analytics

We put more stock in what businesses do rather than say because some surveys, including the NFIB, can lean politically in one direction. Indeed, respondents to the NFIB's survey tend to favor Republicans, which isn't surprising, since Republicans have a tendency to be more pro-business than Democrats. In other words, the NFIB survey overestimates growth under Republicans and underestimates it for Democrats.

No good option for Biden on pump prices

President Biden is pushing Congress to suspend the federal gas tax for three months as elevated fuel prices pummel consumer sentiment and push household inflation expectations uncomfortably high. With Republicans largely against the idea, along with some Democrats, it is extremely improbable that the proposed gas tax holiday will ever see the light of day. As a result, no change to the baseline forecast is warranted. Nevertheless, the ill-fated proposal shows just how few good options the White House has in its toolkit to lower gasoline prices in the near term.

A gas tax holiday, even if it were to pass Congress, would provide little relief for consumers. The president's proposal would suspend the 18.4 cents per gallon tax on gasoline and the 24.4 cents per gallon levy on diesel and other fuels through September, costing the federal government at least $10 billion that would otherwise fund the construction, operation and maintenance of highways. While this is not an insignificant amount for the Highway Trust Fund, which relies on revenues collected through these excise taxes, consumers might not even perceive the effect of a gas tax holiday, as the federal gas tax currently accounts for less than 4% of the nationwide cost of a gallon of gasoline. Moreover, in practice, not all of the tax cut would filter through to consumers, as gasoline producers and retailers would pocket some of the reduction. According to the University of Pennsylvania's Penn Wharton Budget Model, between 58% and 87% of three recently enacted gas tax holidays at the state level were passed on to consumers in the form of lower pump prices, with suppliers capturing the rest.

When inflation is as high as it is today, the federal government's priority should be to do no harm. A gas tax holiday does not pass this test. A suspension of the federal gas tax risks boosting gasoline demand at a time when supply is constrained, thereby leading to higher pump prices and adding to inflation. Domestic crude oil production is still below pre-pandemic levels, and refiners are already operating at full tilt. Therefore, the Biden administration would do better to focus on policies that improve the supply of energy rather than support its demand, but here too there are no silver bullets to bring down fuel prices meaningfully in the near term.

The U.S. is already releasing 1 million barrels of oil per day from the nation's Strategic Petroleum Reserve, but it is not clear how effective the SPR is in stabilizing oil prices, particularly when expectations around geopolitical events are influencing prices. Also, opening up more federal lands and waters to oil drilling would not immediately reduce the sticker shock at the pump, as it would take months for new oil wells to become productive. More important, there does not appear to be a regulatory lever that the administration can pull to encourage more investments by energy companies. A clear majority of executives from exploration and production firms believe that investor pressure to maintain capital discipline is the primary reason publicly traded oil companies are showing restraint despite high prices, not government regulations.

Moody's Analytics will continue to monitor policy proposals coming from the White House that seek to combat inflation. Outside of energy, the Biden administration can take further steps to boost the flow of immigration without congressional approval, which would lift the supply of labor and help prevent wage pressures from overboiling in the labor market. Also, the administration is considering reversing some of the trade war tariffs instituted under former President Donald Trump, which would alleviate goods price inflation, though by how much is still unknown given the lack of details so far.

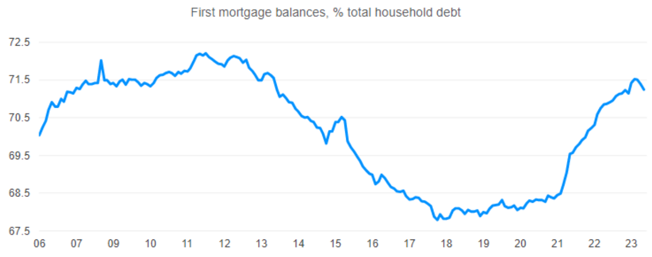
TOP OF MIND

Consumer Borrowing Shift Will Raise Debt Burdens

BY SCOTT HOYT

The composition of U.S. consumer borrowing shifted dramatically as the pandemic ravished the economy. Reduced spending, government stimulus, abundant cash and excess saving undermined borrowing to spend, especially on credit cards and through home equity borrowing. At the same time, low mortgage rates, rising house prices, and changing tastes for less dense residential living boosted mortgage borrowing. The share of household debt accounted for by first mortgages, already more than two-thirds, rose by 3 percentage points to more than 71%, its highest share since the aftermath of the financial crisis about a decade earlier.

Mortgage Borrowing High, but Growth Ending



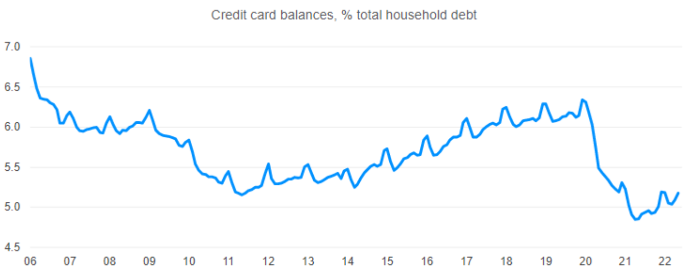
Sources: Equifax, Moody's Analytics

The increase in the share of debt accounted for by first mortgages was largely offset by less debt associated with spending. Just over one-third of the drop in share came from credit card debt and an additional third came from home equity debt. Less student loan debt accounted for much of the rest with auto loan debt and other debt also losing a little share. The share of debt in the consumer finance category remained about the same.

Although the shift in the composition of debt was large, on the order of what happened in the worst and aftermath of the financial crisis, it has already begun to reverse. Many recent economic developments are pushing consumers back toward consumer borrowing and away from mortgage debt at a rate that may imply a faster than expected return to prior borrowing patterns.

Near the top of that list is rapid inflation, exacerbated by the fact that gasoline prices are leading the way. Higher prices, especially of things typically bought on credit cards, such as gasoline, boost transactional use of credit cards. Some of this transactional use is captured as debt because of the way debt is measured. Credit card balances are measured as the balance on a particular day, usually the last day of the month. For this reason, it includes more than the debt that revolves and is charged interest.

Credit Card Borrowing Starting to Recover

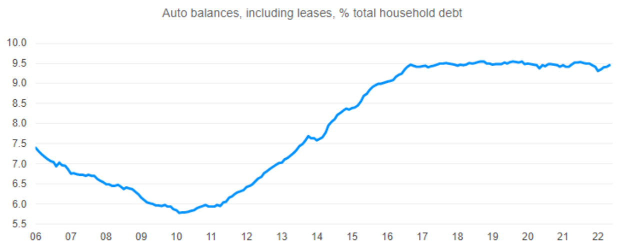


Sources: Equifax, Moody's Analytics

Further, higher prices, combined with the end of virtually all forms of pandemic-related government support to households, are stretching budgets. Consumers will make up some of the difference by withdrawing money from saving accounts and by increased borrowing. These forces are resulting in record growth in credit card balances in March, which is exceeding growth in other forms of debt.

A second factor that will support the switch is the loosening of supply constraints. However, this is not an unambiguous positive for consumer lending. Increased availability of goods will both support purchases and undermine price growth. This is perhaps most clear for auto lending, which has already strengthened but should at least hold its gains in growth.

Auto Borrowing Could Gain Ground



Sources: Equifax, Moody's Analytics

Balance growth has already accelerated to above its pre-pandemic pace because of rising prices, but the gain has been restrained by a declining number of accounts due to fewer auto sales and new loans—the result of supply shortages. As supply comes back online, this situation will reverse. More vehicle availability will support sales and account growth, but growth in prices will slow. Balance growth should hold up, though it is unlikely to accelerate dramatically. Other supply constrained big-ticket items frequently bought on credit will see the same pattern.

Finally, rising interest rates and other developments in housing markets will also support the switch back to consumer borrowing. Mortgage borrowing has been supported by strong home sales and rapidly rising prices. However, both are reversing in the face of rapidly rising mortgage rates and related sharply declining affordability. The pace of home sales has already slowed, and house price appreciation is expected to slow dramatically soon. This will slow growth in mortgage balances significantly.

The current economic environment is contributing to the reversal in the shift toward mortgages and away from consumption-related borrowing that took place in the first two years of the pandemic. This will have negative implications for spending and credit quality, as it will push up debt burdens. Consumption-related loans generally have higher interest rates and shorter terms than mortgages, generating higher payments. While the impact will be gradual, it has the potential to weaken consumer finances even as inflation remains high.

The Week Ahead in the Global Economy

U.S.

After a quiet week, we expect new data on U.S. durable goods orders, which could have implications for our tracking estimate of second-quarter GDP. We'll also get new data on pending-home sales, which likely have dropped again as higher mortgage rates cut into demand. The Conference Board consumer confidence index for June will also be released. This measure of consumer sentiment has held up better than others, including the University of Michigan survey. The Conference Board survey is sensitive to labor market conditions. The labor market remains strong, but hiring has slowed, and this will likely push the index lower for June. We also get the third estimate of first-quarter GDP, but the revision should be small. New data on monthly personal income and spending will be released. The June headline and core PCE deflators could alter the odds of a 75-basis point rate hike by the Fed at its July meeting.

Europe

Top of the releases next week will be the preliminary estimate of the euro zone's harmonized index of consumer prices for June. We expect the inflation rate in the euro zone to accelerate to 8.9% y/y during the month, from 8.1% in May. We foresee a solid tick up in energy and food prices. Crude oil and natural gas futures have been running high this month; meanwhile, there are still signs that oil refiners are unable to keep up with demand, meaning petroleum products prices will likely rise at an even faster rate. We won't have details until the end of the month but expect to see energy factoring heavily in the preliminary estimate. Core inflation will still be on the rise too. As we get into full swing of the tourism season, we forecast services prices to continue growing at a solid rate.

The euro zone's business and consumer sentiment indicator likely slumped in June to 103 from 105 in May. Inflation is dashing consumer sentiment, while prospects for rate hikes will make firms antsy. Current conditions will likely look fine, but firms and consumers will increasingly be more uneasy when looking ahead.

Euro zone unemployment was likely unchanged in May at 6.8%. Preparing for a busy tourist season this summer helped boost employment growth in the previous months. But with headwinds blowing against the economy, firms are becoming more cautious about hiring, and some are even cancelling open positions.

Spain's retail sales likely slowed to a standstill in May after rebounding in April. By contrast, French household consumption of goods likely partially rebounded, rising 0.2% m/m after contracting slightly in the previous month. In Germany, retail sales likely slowed, but continued to grow. Retail sales will underperform as inflation takes away at purchasing power and lower confidence causes households to want to save. That said, we also think that households will want to spend on services this summer, so weaker retail sales will not necessarily mean a contraction in private consumption in the second or third quarters.

We expect to see greater stress in the Russian economy for May. Industrial production likely, slumped by 6.5% y/y after a 1.6% decline in April. Retail sales, meanwhile, likely fell 6% y/y in May. This would be an improvement on the 9.7% y/y drop in April, but retail remains distressed as purchasing power is severely hit and uncertainty is high. Unemployment likely ticked up to 4.3% in May from 4%, with the effect of sanctions causing businesses to close.

Final estimates of the U.K.'s first-quarter GDP will likely be confirmed. GDP therefore will have grown 0.8% q/q in the first three months of the year, slowing from the 1.3% increase in the final quarter of 2021. As was reported in the preliminary estimate, household consumption powered growth as COVID-19 restrictions were removed in January, while government investment also surged, offsetting declines in business investment, government spending and net trade.

Asia-Pacific

China's manufacturing PMI likely will improve in June to 51.1 from May's 49.6. The easing of aggressive movement controls in large cities including Shanghai and Beijing has benefited manufacturing since May. But it is taking time for production to return to normal. Logistics remain under pressure; large ports are seeing bottlenecks and some factories are slowing production because of worker shortages. Still, the employment subcategory will be relatively subdued as firms have been reluctant to add staff while the zero-COVID policy brings uncertainty. The nonmanufacturing PMI is likely to inch above the neutral 50 threshold. Lockdowns have struck services, while the conservative international arrivals policy is hurting tourism and spillover sectors, capping the broader recovery.

Geopolitical Calendar

Date	Country	Event	Economic Importance	Financial Market Risk
26-28-Jun	G7	G7 Summit, hosted by Germany	Medium	Medium
29-30-Jun	NATO	NATO Summit, hosted by Madrid	Medium	Medium
Jun/Jul	Papua New Guinea	National general election	Low	Low
Jul	Japan	House of Councillors election	Medium	Low
12-14-Jul	Pacific Islands Forum	Pacific Islands Forum leaders' meeting	Low	Low
21-Jul	Mercosur	Mercosur 2022 Summit	Low	Low
2-Oct	Brazil	Presidential and congressional elections	High	Medium
Oct/Nov	China	National Party Congress	High	Medium
7-18-Nov	U.N.	U.N. Climate Change Conference 2022 (COP 27)	Medium	Low
15-16-Nov	G20	G20 Heads of State and Government Summit, hosted by Indonesia	Medium	Low

THE LONG VIEW: U.S.

Signs of Weakened Business Investment

BY RYAN SWEET

CREDIT SPREADS

Moody's long-term average corporate bond spread is 158 basis points, similar to that seen last week. The spread is slightly narrower than the 159 bps average in May. The long-term average industrial corporate bond spread narrowed 4 bps to 144. This is identical to May's average.

The recent ICE BofA U.S. high-yield option adjusted bond spread widened from 482 to 532 basis points, the widest since late 2020. The Bloomberg Barclays high-yield option adjusted spread widened this past week from 477 to 525 bps. The high-yield option adjusted bond spreads approximate what is suggested by the accompanying long-term Baa industrial company bond yield spread but wider than that implied by a VIX of 28.8. The VIX fell over the course of the past week.

DEFAULTS

Defaults rose in May as nine Moody's-rated corporate debt issuers defaulted, up from April's revised count of five. The May defaults lifted the global speculative-grade default rate to 2.1% for the trailing 12 months ended in May from 1.9% a month earlier. Six of the month's defaults came from advanced markets and three were from emerging markets.

The year to date global corporate default tally was 39 through May, up from 26 in the same period last year. Across sectors, Construction & Building, with nine defaults, is the largest contributor to defaults so far this year. The banking sector followed with eight. By region, North America had 17 defaults (16 in the U.S. and one in Canada). The rest were from Europe (11), Asia-Pacific (nine) and Latin America (two).

Moody's Credit Transition Model predicts that the trailing 12-month global speculative-grade corporate default rate will rise to 2.8% by the end of 2022 and then climb to 3.3% by May 2023. If realized, these forecast rates would remain below the long-term average of 4.1%.

U.S. CORPORATE BOND ISSUANCE

First-quarter 2020's worldwide offerings of corporate bonds revealed annual advances of 14% for IG and 19% for high-yield, wherein US$-denominated offerings increased 45% for IG and grew 12% for high yield.

Second-quarter 2020's worldwide offerings of corporate bonds revealed annual surges of 69% for IG and 32% for high-yield, wherein US$-denominated offerings increased 142% for IG and grew 45% for high yield.

Third-quarter 2020's worldwide offerings of corporate bonds revealed an annual decline of 6% for IG and an annual advance of 44% for high-yield, wherein US$-denominated offerings increased 12% for IG and soared upward 56% for high yield.

Fourth-quarter 2020's worldwide offerings of corporate bonds revealed an annual decline of 3% for IG and an annual advance of 8% for high-yield, wherein US$-denominated offerings increased 16% for IG and 11% for high yield.

First-quarter 2021's worldwide offerings of corporate bonds revealed an annual decline of 4% for IG and an annual advance of 57% for high-yield, wherein US$-denominated offerings sank 9% for IG and advanced 64% for high yield.

Issuance weakened in the second quarter of 2021 as worldwide offerings of corporate bonds revealed a year-over-year decline of 35% for investment grade. High-yield issuance faired noticeably better in the second quarter.

Issuance softened in the third quarter of 2021 as worldwide offerings of corporate bonds revealed a year-over-year decline of 5% for investment grade. U.S. denominated corporate bond issuance also fell, dropping 16% on a year-ago basis. High-yield issuance faired noticeably better in the third quarter.

Fourth-quarter 2021's worldwide offerings of corporate bonds fell 9.4% for investment grade. High-yield US$ denominated high-yield corporate bond issuance fell from $133 billion in the third quarter to $92 billion in the final three months of 2021. December was a disappointment for high-yield corporate bond issuance, since it was 33% below its prior five-year average for the month.

In the first quarter of 2022, worldwide offerings of investment grade corporate bonds totaled $901 billion, up 12% on a year-ago basis.

In the week ended June 17, US$-denominated high-yield issuance totaled $2.95 billion. This brings the year-to-date total to $96.5 billion. Investment-grade bond issuance was very light ahead of the holiday-shorted week. Investment-grade bond issuance totaled $0.525 billion, bringing its year-to-date total to $781.3 billion. Issuance is still tracking that seen in 2018 and 2019.

U.S. ECONOMIC OUTLOOK

There were some tweaks to the U.S. baseline forecast in June, but the changes were smaller than in prior months. The new baseline forecast factors in the recent tightening in financial market conditions, increases in energy prices, and new data on first-quarter GDP.

Fiscal assumptions

The federal budget deficit will fall from 12.4% of GDP in fiscal 2021 to 4.4% this year and 3.8% the next year. This improvement largely reflects the end of federal pandemic relief and a stronger economy. In the June baseline, the effective personal tax rate was adjusted higher in the near to medium term. The U.S. Treasury Department enjoyed a better-than-expected windfall of individual income taxes in April thanks to soaring asset prices and widening participation in equity markets in 2021. Nevertheless, this is coming at the expense of personal savings. A higher tax bill has led to a faster decumulation of excess personal savings than previously thought.

In its second estimate of first-quarter GDP, the Bureau of Economic Analysis revised personal current taxes to reflect the stronger-than-anticipated filing season and lower refunds, which shaved a full percentage point off the savings rate in the first three months of the year. As a result, excess savings are decumulating at an accelerating rate, though they remain prodigiously above $2.5 trillion. Because of incoming data and fiscal changes to the forecast, the savings rate will average 1.1 and 0.7 percentage point lower in 2022 and 2023 compared with the May baseline.

COVID-19 assumptions

Changes to our epidemiological assumptions were noticeable, but the economic implications are modest as each wave of COVID-19 has a diminishing effect on the economy. Total confirmed COVID-19 cases in the U.S. will be 97.07 million, compared with 88.5 million. The seven-day moving average of daily confirmed cases has been steadily rising since the May baseline and is now 122,000, more than double that seen when we updated the May baseline forecast.

We're sticking with the concept of "effective immunity," which is a rolling number of infections plus vaccinations to account for the fact that immunity is not permanent. The forecast still assumes that COVID-19 will be endemic and seasonal.

Energy price assumptions

The European Union's sixth set of economic sanctions against Russia will create the biggest disruption to the global oil market since the Yom Kippur War. Though a strong vote of confidence in Ukraine, the move will stoke inflation, raise consumer energy bills, and complicate global central banks' task of raising interest rates without tipping their respective economies into recession.

The baseline forecast now has West Texas Intermediate crude oil prices peaking higher than in the prior baseline forecast. However, the timing hasn't changed, and the forecast assumes oil prices peak this quarter, averaging $107 per barrel. The contours of the forecast haven't changed, and the June baseline still has oil prices steadily declining in the second half of this year and throughout next year, approaching $60 per barrel in late 2024.

Nudging GDP lower

Real GDP is expected to increase 2.7% this year, compared with 2.8% in the prior baseline. We have cut our forecast for U.S. GDP growth this year by a total of 80 basis points over the past few months. We nudged the forecast for GDP growth in 2023 down from 2.7% to 2.6%. The economy is still expected to grow above its potential, which is likely between 2% and 2.5%.

Revisions to first-quarter GDP, which is now shown to have declined 1.5% at an annualized rate (previously -1.4%), were a small factor in the revision to GDP growth this year. The weakness in the first quarter was concentrated in net exports and inventories.

Net exports were an enormous weight on first-quarter GDP. Trade has been a consistent weight on GDP growth as demand for consumer goods has been robust. The U.S. consumer is buying a ton of goods and the majority of these are imported. Neither inventories nor trade tell us where the economy is headed.

Declines in GDP during economic expansions have happened before. The three contractions in GDP occurring between the global financial crisis and the COVID-19 pandemic occurred because of some combination of a widened trade deficit and the quarterly oscillations of the inventory build. Consumption, the largest component of GDP, did not contract in those instances, nor did it in the first quarter of 2022. Consumption, particularly on services, accelerated in the quarter.

Our baseline forecast for real GDP growth this year is close to the Bloomberg consensus of 2.6%. The forecast for next year is 0.6 percentage point stronger than the Bloomberg consensus of 2%.

Business investment and housing

Incoming data over the past few weeks point toward weaker U.S. real business investment in the second quarter. Still, growth will be solid and fundamentals, including supportive financial market conditions and better after-tax corporate profits as a share of nominal GDP, should continue to support investment through the rest of this year and into next. Another favorable development for business investment is that the rate of new-business formations has risen recently, tempering concerns that the pandemic could have scarring impacts on entrepreneurship.

We have real business equipment spending rising 6.5% this year, compared with 7% in the May baseline. The forecast is for real business equipment spending to increase 5.2% in 2023, compared with 3.9% next year.

There was a downward revision to housing starts as supply constraints and higher mortgage rates have started to bite into the housing market. Housing starts are expected to be 1.77 million compared with 1.83 million in the prior baseline. Housing starts are expected to total 1.86 million next year, down from 1.89 in the prior baseline.

There are likely only so many homes that can be built each year because of labor-supply constraints and a lack of buildable lots. Some of the labor-supply issues will ease as the pandemic winds down, but the reduction in immigration is particularly problematic for homebuilders' ability to find workers. We cut the forecasts for new- and existing-home sales this year. They are expected to total 6.59 million, lighter than the 6.86 million in the prior forecast. We also cut the forecast for total home sales next year. New-home sales account for about 10% of total home sales.

There were minor tweaks to the forecast for the FHFA All-Transactions House Price Index this year and next. The June baseline has it rising 11.3% this year, compared with 12.2% in the prior baseline. The forecast for 2023 and 2024 continues to expect little house price appreciation.

Labor market

The U.S. labor market remains strong even as job growth is moderating. Trend job growth is between 400,000 and 450,000 per month, but this isn't sustainable and needs to fall to around 150,000 per month later this year or the Federal Reserve's attempt to engineer a soft landing will become increasingly difficult.

Nonfarm employment rose by 390,000, on net, in May, better than either we or the consensus anticipated. The gain leaves nonfarm employment 822,000 below its pre-pandemic peak. This should be recouped over the next few months. However, excluding leisure and hospitality, employment is already above its pre-pandemic peak. Of course, this doesn't account for the jobs that would have been created if the pandemic didn't occur, which is around 5 million.

We have job growth averaging 373,000 per month this year, nearly identical to the gain in the May baseline forecast. Job growth is expected to moderate next year and in 2024. The unemployment rate is expected to average around 3.3% in the fourth quarter of this year before gradually rising over the next couple of years as the effect of tighter monetary policy starts to be felt.

We assume a full-employment economy is one with a 3.5% unemployment rate, around a 62.5% labor force participation rate, and a prime-age employment-to-population ratio a little north of 80%. All of these conditions will be met this summer.

Monetary policy

The minutes from the May meeting of the Federal Open Market Committee signal that the central bank wants to aggressively hike rates at the next couple of meetings to allow officials the potential to pause and assess the effects of policy firming on the economy, inflation and financial markets. This would improve the odds that the Fed engineers a soft landing. Previously, it appeared the Fed was going to hike until something broke, either inflation or the economy. The minutes were lighter on the inflation discussion than in March. On the balance sheet, a number of officials supported eventually selling mortgage-backed securities. The immediate market reaction to the minutes was fairly tame, potentially because there were no big surprises, and we didn't make any changes to our near-term forecast for the fed funds rate.

The Fed has begun its quantitative tightening campaign. If the Fed sticks with its current plan, its balance sheet will decline by about $520 billion this year. This may sound like a lot, but the balance sheet will still be massive, around 37% of nominal GDP. It was less than 20% of nominal GDP before the pandemic. Also, there wasn't a mention of MBS sales in the FOMC's May minutes.

The 10-year Treasury yield has bounced around recently but we didn't make any changes to the baseline forecast. The 10-year Treasury yield will average 3.14% in the final three months. We still have the 10-year Treasury yield averaging 3.25% in the fourth quarter of next year, identical to the May baseline. The June baseline forecast incorporates the recent swing in equity prices, which is the reason for the revision to the forecast. Equity prices are expected to bottom in the first quarter of next year and will resume rising in the second quarter.

THE LONG VIEW: EUROPE

Euro Zone PMI Falls to 15-Month Low

BY ROSS CIOFFI

Flash estimates reported the euro zone's June composite PMI fell to 51.9 from 54.8 in May. This is the lowest reading since February 2021. The services PMI tumbled to 52.8 from 56.1 while the manufacturing PMI was down to 52 from 54.6. To some extent, slower growth in services was expected. The PMI tracks growth in monthly terms, and consumer-facing services such as hotels understandably stalled after growing at a record pace in April and May. Unfortunately, this was not the only problem. Activity in the banking and real estate sectors slumped as financial conditions tightened, and transportation and industrial services stumbled because of weakness in manufacturing.

Manufacturing output and new orders contracted in June from May. Ongoing supply disruptions are holding up factories. But rising costs and faltering consumer and business sentiment are also clamping down on demand. Persistent job growth and long delivery lead times kept the PMI reading above the break-even 50 score. However, employment growth did slow—a sure sign that the demand environment is turning. The silver lining is that this could alleviate inflationary pressures. Indeed, selling price inflation cooled in June. But input cost inflation has been accelerating steeply since April, tempering our enthusiasm.

Overall, the June PMI reflects an increasingly grim picture in the euro zone economy. Although there is still a great deal of momentum from pent-up post-pandemic demand, downside forces—such as supply shortages and inflation—are derailing the recovery. The bloc may grow this summer, but GDP will struggle considerably heading into the fourth quarter.

The U.K.'s composite PMI tells a similar story. The flash reading for June fared slightly better, unchanged from the previous month, at 53.1. The services component was unchanged, at 53.4, while the manufacturing PMI slid to 53.4 from 54.6. The Jubilee likely boosted services activity, with foreign visitors coming in for the event and residents celebrating as well. But new orders were nearly at a standstill for the whole private sector. The July reading may not be as resilient.

Turkish Central Bank leaves policy rate unchanged

The Central Bank of Turkey left its one-week repo rate unchanged, at 14%. Turkey has been running an expansionary monetary policy, which has helped to depreciate the currency and stoke inflation. At the time of writing, the Turkish lira is trading at TL17.363 per USD. The exchange rate is not much changed from the previous trading day, but it is up 7.8% on the previous month and 99.6% from a year earlier. The inflation rate, meanwhile, accelerated to 73.5% year over year in May from 70% in April. So far, there has not been much of an effect on retail sales, as unemployment remains contained and households continue to bring forward expenditures to preempt further price rises. Industrial production has struggled more with output stalling in April after having slumped in March.

Tensions rise in the Baltics

Lithuania has blocked the transit of a number of goods into the Russian territory of Kaliningrad, an enclave on the Baltic that is surrounded by EU states. Lithuania has blocked those goods on the grounds of following EU sanctions. Although the goods—such as metals, coals, construction materials and advanced technologies—are being shipped from mainland Russia, they are passing through Lithuania on their way to the enclave. Russia has threatened retaliations. Because Lithuania is in NATO, we are not expecting a direct military response. Rather, the concern on everyone's mind is that Russia could cut Lithuania off from the BRELL electricity grid that includes Belarus, Russia, Estonia, Latvia and Lithuania. Lithuanian diplomats assert the country is ready for such a situation, but switching electrical grids may not be so easy. If there is no diplomatic resolution and Lithuania is cut off, this would weigh on the Baltics, as countries in the region would likely face blackouts and rationing during the transition period. Either way, the tension here between Russia and the EU is significant and will further drive European markets away from riskier assets.

In the past weeks, gas inflows from Russia have been weakening. Gazprom has blamed this on technical difficulties, but EU leaders have accused the firm of political motivations. Germany raised the alarm about its gas supplies on Thursday, and Berlin is now saying clearly that the country is in a "gas crisis". Its second-level warning states that gas supplies are uncertain, but that there is not yet a need for nonmarket-based measures such as government rationing of gas. German gas supplies are currently at 58%—higher than this time last year. Countries across the EU have been desperately seeking to refill supplies, but tensions with Russia make it uncertain that Germany will enter next winter with full supplies.

China's Potential for Resilience

BY STEVE COCHRANE

China's economic indicators for May illustrate some potential for resilience. Foreign trade rebounded, rising nearly 17% year on year. This was a solid improvement over the 3.7% y/y growth in April, when lockdowns and logistics tie-ups were at their peak. Imports also rose in May after two months of no change—illustrating some improvement in domestic demand and demand for intermediate production goods. Industrial production rose modestly following a sharp downturn the month before. And the M2 money supply and new yuan loans improved, indicating some early effects of enhanced stimulus policies.

India's indicators have also improved in recent months after several sluggish quarters. Industrial production rose more than 7% in April, breaking a streak of subpar performance that goes back to November. Export growth held steady through May, but imports surged because of high commodity prices and hurt the trade balance. Inflation also eased last month, though it remains at a very high 7% over the year and above the central bank's target range.

Even Japan's early indicators for May improved. Monthly export growth at 2.4% was the strongest read since November. Excluding China, exports to Asia were robust and a function of both the weakening yen and economic stability across much of the region. However, exports to China were again sluggish—an indication of supply-chain disruptions in that country—and exports to the U.S. and Europe slowed as supply-chain difficulties hindered auto assembly plants.

Indeed, as Japan takes the brunt of supply-chain disruptions, much of the rest of the APAC region is being supported by exports. Malaysia and Indonesia are getting a boost from palm oil prices; Malaysia is also benefiting from its crude oil exports. This is despite Malaysia's temporary ban on processed chicken exports and Indonesia's experiment with an export ban on palm oil, which recently was softened to a requirement to honour "domestic market obligations". Vietnam's diverse array of export markets and products, the latter ranging from clothing through to electronics, sits behind its resilient export trade.

There are still reasons to be cautious, particularly in the near term for China and India. China's manufacturing PMI remains below the neutral value of 50, due in part to uncertainty about the near-term outlook for domestic and export orders. And despite a rapid rise in the M2 money supply in April and May and a rise in May of new yuan loans—reflecting recent monetary and fiscal policy stimulus measures—retail sales remain weak and consumer confidence is low amid the soft labour market.

Central banks off and running

India's inflation remains very high at 7%, and the Reserve Bank of India raised its benchmark repo rate by 90 basis points over the May and June period. As in China, consumer spending is slow and industrial production modest but showing some recent improvement. There is a good chance that the RBI will continue to try to staunch inflation with rate increases, which could put consumption and production at risk.

Indeed, the greatest risk to the outlook is the need for Asia-Pacific central banks to carefully calibrate policy normalization so as to not raise rates too fast and puncture economic growth, nor raise rates too slowly and risk capital outflows and currency depreciation as spreads with U.S. and European interest rates widen. The Institute for International Finance reports that real capital flows to China were net positive in the second quarter while being net negative in emerging economies outside of China. Aside from China, which is countercyclical with its stimulus policy, and Japan, which is acyclical on account of the Bank of Japan sticking with low interest rates, nearly all APAC countries have initiated monetary policy normalisation. Only Vietnam, Thailand and Indonesia are still waiting. Each will likely commence policy tightening in the third quarter, if not in late June, following the U.S. Federal Reserve's aggressive 75-basis point hike this month.

Although top-line consumer price inflation varies from a relatively low 2.1% in China to 7% in India, food inflation is more uniformly high and likely to rise as high fertilizer and transport costs flow through to final food prices. Export bans or caps on wheat, sugar, chicken, palm oil, and other food commodities are further distorting regional markets. If producers cannot sell products at global prices while paying global input prices for fertilizer and other imported inputs, food commodity export caps could see production ultimately fall rather than rise.

There is a good chance that global crude oil prices will not rise further this year. Brent crude and West Texas Intermediate came off their peaks around $120 per barrel immediately after the EU decision to elevate sanctions on Russian crude and natural gas. However, the new EU sanctions will take time to implement. Prices have fallen back to a range of $110 to $113 per barrel as investment has risen in U.S. fracking fields and OPEC's commitment to monthly production increases.

Global energy prices may not directly exacerbate the inflation of fuel, electricity and transport prices. But they will remain high, and food inflation may continue to rise until energy prices are fully woven into food production. Further driving food inflation will be the difficulty in finding alternative sources for wheat, edible oils, and other food commodities that previously came from Russia or Ukraine.

RATINGS ROUNDUP

Upgrades Dominate in U.S. and Europe

BY MICHAEL FERLEZ

U.S.

U.S. rating change activity was credit positive last week, with upgrades outnumbering downgrades in both count and affected debt. The largest upgraded measured by the amount of affected debt, was issued to Amphenol Corp. On June 21, Moody's Investors Service upgraded the senior unsecured debt and issuer ratings of Amphenol and its subsidiaries to A3 from Baa1.

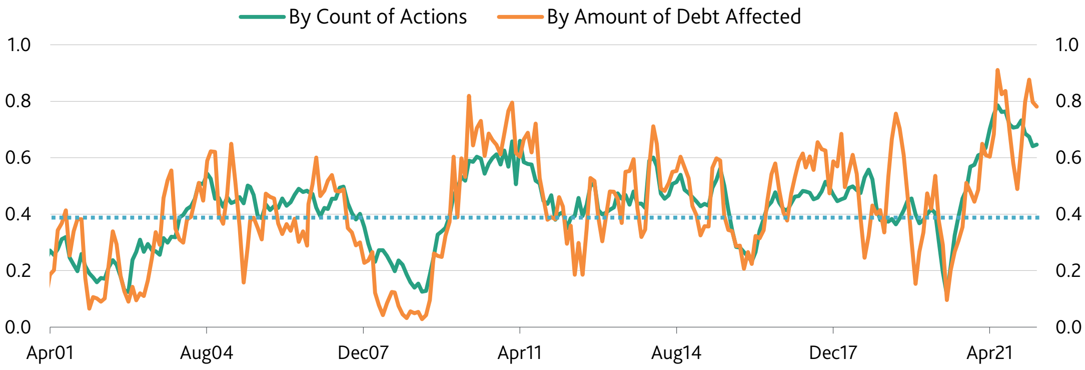
In the rating action, Moody's Investors Service said the upgrade reflected the firm's large-scale and strong credit metrics along with Moody's Investors Service's expectation for Amphenol to continue its conservative financial policies. In total, the upgrade impacted $3.9 billion worth of senior unsecured debt.

Europe

Western Europe saw an increase in activity last week, with a total of nine rating actions. Upgrades accounted for all but two of the week's rating actions and virtually all the reported affected debt. Upgrades were headlined by Compagnie de Saint-Gobain and Novo Banco, S.A., which combined to account for over 90% of the reported affected debt last week.

The larger of those two changes was made to Compagnie de Saint-Gobain, which saw its senior unsecured ratings and its senior unsecured MTN rating upgraded to Baa1 and (P)Baa1, respectively. In the ration action, Moody's Investors Service said the upgrade of Saint-Gobain reflected the firm's strong operating performance last year and the sustained momentum through the first several months of 2022.

FIGURE 1
Rating Changes - US Corporate & Financial Institutions: Favorable as a % of Total Actions



* Trailing 3-month average

Source: Moody's

FIGURE 2
Rating Key

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

FIGURE 3

Rating Changes: Corporate & Financial Institutions - US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/SG
6/15/2022	KOREAN AIR LINES CO., LTD.-HANJIN INTERNATIONAL CORP.	Industrial	LTCFR		U	B2	B1	SG
6/15/2022	GENESYS CLOUD SERVICES HOLDINGS I, LLC-GENESYS CLOUD SERVICES HOLDINGS II, LLC	Industrial	SrSec/BCF		U	B3	B2	SG
6/15/2022	MINIMAX VIKING GMBH-MX HOLDINGS US, INC.	Industrial	SrSec/BCF		U	B1	Ba3	SG
6/15/2022	PM GENERAL PURCHASER LLC	Industrial	SrSec	1200	D	B2	B3	SG
6/16/2022	MACANDREWS & FORBES HOLDINGS INC-REVLON CONSUMER PRODUCTS CORPORATION	Industrial	SrSec/BCF		D	Ca	C	SG
6/16/2022	US SILICA HOLDINGS INC-US SILICA COMPANY, INC.	Industrial	LTCFR		U	B3	B2	SG
6/16/2022	BDF ACQUISITION CORP.	Industrial	SrSec/BCF		D	B2	Caa1	SG
6/21/2022	AMPHENOL CORPORATION	Industrial	SrUnsec	3945.752	U	Baa1	A3	IG
6/21/2022	WILLA MIDCO S.A.R.L.-WERNER FINCO LP	Industrial	SrSec/BCF	265	D	B1	B2	SG
6/21/2022	AFFINITY GAMING OWNER, L.L.C.-AFFINITY INTERACTIVE	Industrial	SrSec	545	U	B3	B2	SG

Source: Moody's

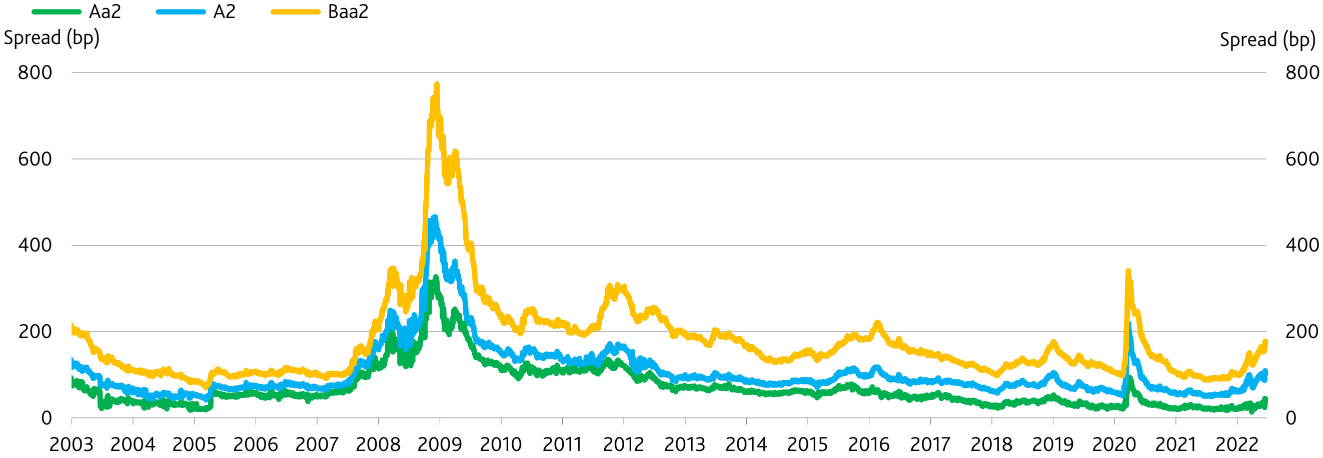
FIGURE 4

Rating Changes: Corporate & Financial Institutions - Europe

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG	Country
6/15/2022	COMPAGNIE DE SAINT-GOBAIN	Industrial	SrUnsec	8902.088	U	Baa2	Baa1	IG	FRANCE
6/15/2022	SPAREBANKEN SOR	Financial	SrUnsec/Jr	198.9585	D	A3	Baa1	IG	NORWAY
6/15/2022	MINIMAX VIKING GMBH	Industrial	LTCFR		U	B1	Ba3	SG	GERMANY
6/15/2022	MINIMAX VIKING GMBH-MINIMAX GMBH	Industrial	SrSec/BCF		U	B1	Ba3	SG	GERMANY
6/15/2022	FS AGRISOLUTIONS INDUSTRIA DE BIOCOMBUSTIVEIS LTDA-FS LUXEMBOURG S.A R.L.	Industrial	SrSec	600	U	B1	Ba3	SG	LUXEMBOURG
6/17/2022	CERBERUS CAPITAL MANAGEMENT L.P.-HAYA REAL ESTATE, S.A.U.	Industrial	PDR		U	Caa3	Caa2	SG	SPAIN
6/21/2022	ALTISOURCE PORTFOLIO SOLUTIONS S.A.-ALTISOURCE S.A.R.L.	Financial	SrSec/BCF		D	Caa1	Caa2	SG	LUXEMBOURG
6/21/2022	NOVO BANCO, S.A.	Financial	SrUnsec	7346.405	U	Caa2	B3	SG	PORTUGAL
6/21/2022	INFOPRO DIGITAL GROUP B.V.-IPD 3 B.V.	Industrial	SrSec	852.2876	U	B3	B2	SG	NETHERLANDS

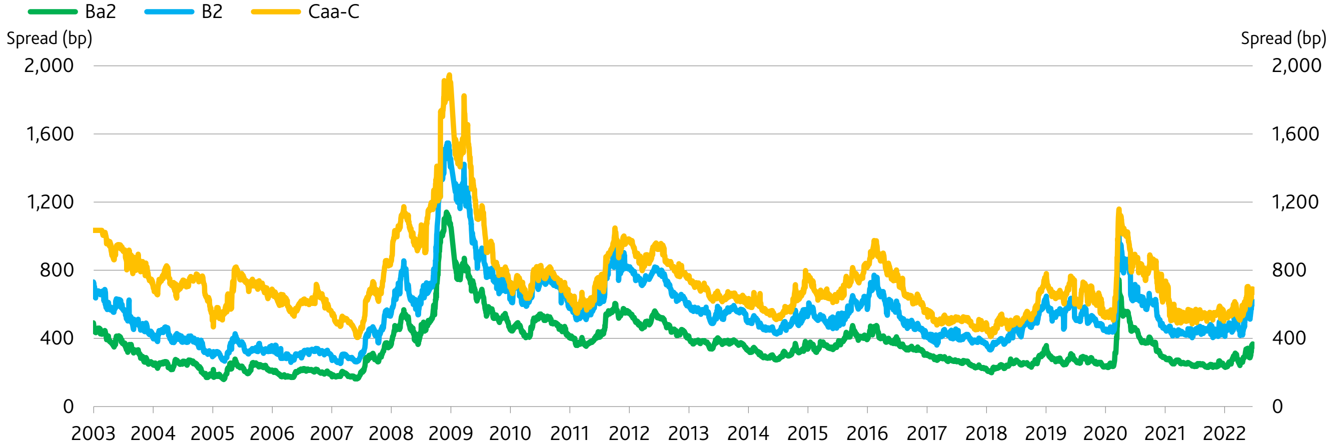
Source: Moody's

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

CDS MOVERS

Figure 3. CDS Movers - US (June 16, 2022 – June 23, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jun. 23	Jun. 16	Senior Ratings
PepsiCo, Inc.	Aa1	Aa2	A1
United Airlines, Inc.	Caa1	Caa2	Ba3
United Parcel Service, Inc.	Aa2	Aa3	A2
Cargill, Incorporated	A2	A3	A2
Becton, Dickinson and Company	Baa1	Baa2	Baa2
Eli Lilly and Company	Aa1	Aa2	A2
Archer-Daniels-Midland Company	A1	A2	A2
Kinder Morgan Energy Partners, L.P.	Aa3	A1	Baa2
Ball Corporation	Ba1	Ba2	Ba1
Tyson Foods, Inc.	A3	Baa1	Baa2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jun. 23	Jun. 16	Senior Ratings
CenterPoint Energy, Inc.	Baa2	A3	Baa2
PepsiCo, Inc.	A2	A1	A1
Philip Morris International Inc.	A2	A1	A2
General Electric Company	Baa3	Baa2	Baa1
Eli Lilly and Company	Aa2	Aa1	A2
FirstEnergy Corp.	Baa3	Baa2	Ba1
Emerson Electric Company	Baa1	A3	A2
Danaher Corporation	A3	A2	Baa1
Archer-Daniels-Midland Company	A2	A1	A2
United Rentals (North America), Inc.	Ba2	Ba1	Ba2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jun. 23	Jun. 16	Spread Diff
Carnival Corporation	B2	1,117	904	214
Royal Caribbean Cruises Ltd.	B2	991	851	139
K. Hovnanian Enterprises, Inc.	Caa3	1,231	1,095	137
Beazer Homes USA, Inc.	B3	821	707	114
Nabors Industries, Inc.	Caa2	683	599	85
Dish DBS Corporation	B3	1,223	1,145	79
iHeartCommunications, Inc.	Caa1	617	540	78
Staples, Inc.	Caa2	1,933	1,858	75
Olin Corporation	Ba1	309	235	74
Hertz Corporation (The)	Caa1	653	588	65

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jun. 23	Jun. 16	Spread Diff
Rite Aid Corporation	Caa2	2,435	2,725	-290
United Airlines, Inc.	Ba3	854	920	-66
American Airlines Group Inc.	Caa1	1,537	1,582	-45
Kohl's Corporation	Baa2	458	496	-38
Gap, Inc. (The)	Ba3	603	628	-25
Hasbro, Inc.	Baa2	94	117	-23
First Industrial, L.P.	Baa2	172	191	-20
DPL Inc.	Ba1	290	309	-19
Yum! Brands Inc.	Ba3	192	205	-13
Cargill, Incorporated	A2	62	72	-10

Source: Moody's, CMA

CDS Movers

Figure 4. CDS Movers - Europe (June 16, 2022 – June 23, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jun. 23	Jun. 16	Senior Ratings
Spain, Government of	Aa3	A2	Baa1
Portugal, Government of	Aa3	A2	Baa2
Italy, Government of	Baa2	Baa3	Baa3
Intesa Sanpaolo S.p.A.	Baa2	Baa3	Baa1
HSBC Holdings plc	Baa1	Baa2	A3
Standard Chartered PLC	Baa1	Baa2	A3
Commerzbank AG	Baa1	Baa2	A1
Dexia Credit Local	Aa1	Aa2	Baa3
Piraeus Financial Holdings S.A.	Caa1	Caa2	Caa1
British Telecommunications Plc	Baa2	Baa3	Baa2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jun. 23	Jun. 16	Senior Ratings
Banque Federative du Credit Mutuel	Baa1	A1	Aa3
BASF (SE)	Baa2	A3	A3
BAWAG P.S.K. AG	Baa3	Baa1	A2
Bankinter, S.A.	Baa3	Baa1	Baa1
CaixaBank, S.A.	A3	A2	Baa1
Credit Agricole Corporate and Investment Bank	A2	A1	Aa3
TotalEnergies SE	A2	A1	A1
ENGIE SA	Baa2	Baa1	Baa1
ENEL S.p.A.	Baa3	Baa2	Baa1
Unibail-Rodamco-Westfield SE	Ba2	Ba1	Baa2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jun. 23	Jun. 16	Spread Diff
Novafives S.A.S.	Caa2	1,469	1,386	84
thyssenkrupp AG	B1	468	395	73
Vedanta Resources Limited	B3	1,157	1,084	73
Iceland Bondco plc	Caa2	1,125	1,066	59
Unibail-Rodamco-Westfield SE	Baa2	296	240	56
Jaguar Land Rover Automotive Plc	B1	873	819	54
Bankinter, S.A.	Baa1	136	86	50
BAWAG P.S.K. AG	A2	133	84	49
Casino Guichard-Perrachon SA	Caa1	1,385	1,339	46
Ardagh Packaging Finance plc	Caa1	730	684	46

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jun. 23	Jun. 16	Spread Diff
Boparan Finance plc	Caa3	1,968	2,358	-390
Vue International Bidco plc	Ca	1,275	1,324	-49
Italy, Government of	Baa3	117	142	-26
Greece, Government of	Ba3	148	174	-26
Telecom Italia S.p.A.	Ba3	382	406	-24
Portugal, Government of	Baa2	48	62	-14
Spain, Government of	Baa1	50	64	-13
Legrand France S.A.	A3	47	56	-9
Dexia Credit Local	Baa3	34	43	-8
Intesa Sanpaolo S.p.A.	Baa1	122	129	-7

Source: Moody's, CMA

CDS Movers

Figure 5. CDS Movers - APAC (June 16, 2022 – June 23, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jun. 23	Jun. 16	Senior Ratings
Korea, Government of	Aa2	Aa3	Aa2
Indonesia, Government of	Baa2	Baa3	Baa2
National Australia Bank Limited	A1	A2	Aa3
Korea Development Bank	Aa2	Aa3	Aa2
Suncorp-Metway Limited	A2	A3	A1
Kookmin Bank	Aa2	Aa3	Aa3
Industrial & Commercial Bank of China Ltd	Baa1	Baa2	A1
Bank of East Asia, Limited	Baa1	Baa2	A3
Bank of China Limited	Baa1	Baa2	A1
Industrial Bank of Korea	Aa2	Aa3	Aa2

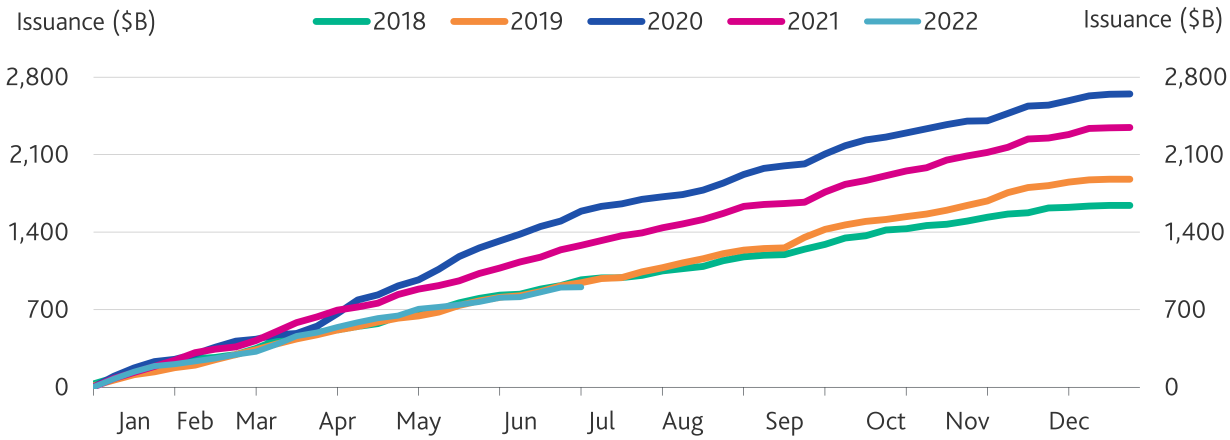
CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jun. 23	Jun. 16	Senior Ratings
Nomura Securities Co., Ltd.	Baa2	A3	A3
MUFG Bank, Ltd.	Aa3	Aa2	A1
Mitsubishi Corporation	Aa2	Aa1	A2
Mizuho Bank, Ltd.	A1	Aa3	A1
Kansai Electric Power Company, Incorporated	Aa3	Aa2	A3
Chubu Electric Power Company, Incorporated	Aa1	Aaa	A3
JFE Holdings, Inc.	A1	Aa3	Baa3
Sumitomo Corporation	Aa3	Aa2	Baa1
NIPPON STEEL CORPORATION	Aa3	Aa2	Baa2
Mitsui & Co., Ltd.	Aa3	Aa2	A3

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jun. 23	Jun. 16	Spread Diff
Pakistan, Government of	B3	1,281	1,217	64
SoftBank Group Corp.	Ba3	472	442	30
Halyk Savings Bank of Kazakhstan	Ba2	468	441	27
Nomura Securities Co., Ltd.	A3	98	72	25
Nissan Motor Co., Ltd.	Baa3	211	187	24
Mizuho Bank, Ltd.	A1	60	48	12
Marubeni Corporation	Baa2	60	48	12
ORIX Corporation	A3	68	57	11
Sumitomo Corporation	Baa1	52	42	10
Flex Ltd.	Baa3	117	107	10

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jun. 23	Jun. 16	Spread Diff
Suncorp-Metway Limited	A1	65	73	-9
Tata Motors Limited	B1	267	275	-8
India, Government of	Baa3	125	130	-6
ICICI Bank Limited	Baa3	123	129	-6
State Bank of India	Baa3	124	130	-6
IDBI Bank Ltd	Ba2	118	124	-6
Telekom Malaysia Berhad	A3	82	87	-5
Export-Import Bank of China (The)	A1	75	78	-4
Export-Import Bank of India	Baa3	113	116	-4
Bank of China Limited	A1	86	90	-4

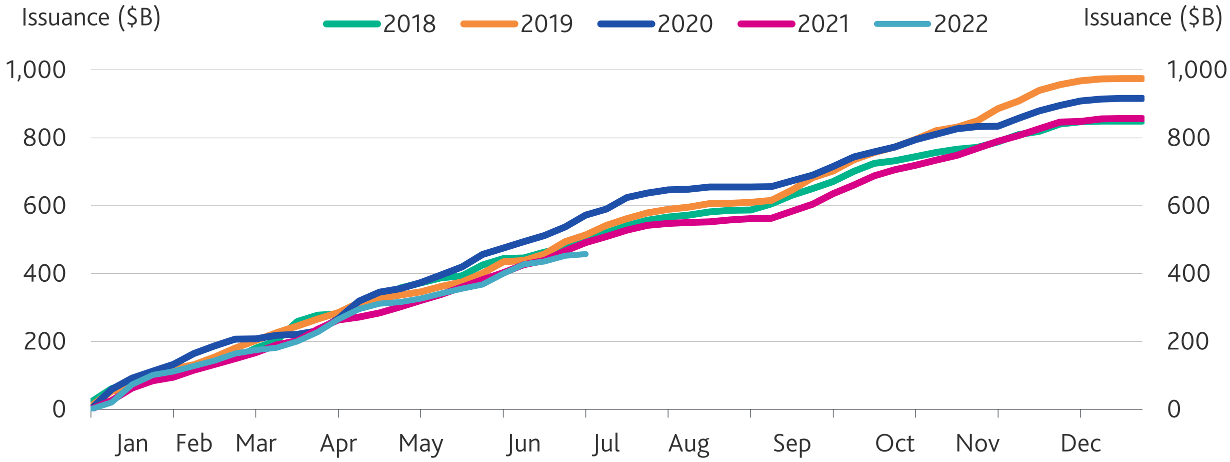
Source: Moody's, CMA

Figure 6. Market Cumulative Issuance - Corporate & Financial Institutions: USD Denominated



Source: Moody's / Dealogic

Figure 7. Market Cumulative Issuance - Corporate & Financial Institutions: Euro Denominated



Source: Moody's / Dealogic

ISSUANCE

Figure 8. Issuance: Corporate & Financial Institutions

		USD Denominated	
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	0.525	2.945	4.383
Year-to-Date	781.322	96.486	903.799

		Euro Denominated	
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	3.729	0.355	4.213
Year-to-Date	423.587	25.609	456.749

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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