WEEKLY MARKET OUTLOOK
SEPTEMBER 8, 2022

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This August Was Different

The strength of the U.S. labor market gives the Federal Reserve cover to continue hiking interest rates aggressively. The August employment report is what the Fed wants. Employment growth moderated and monthly gains in average hourly earnings cooled. Also, the labor force participation rate increased. If sustained, higher participation would help alleviate some labor supply issues. The prime-age employment-to-population ratio also increased, rising from 80% to 80.3%.

The August employment report doesn't settle the debate on whether the Fed will hike the target range for the fed funds rate by 50 or 75 basis points later this month. Financial markets view it as a toss-up. They are pricing in 65 basis points of tightening at the September meeting of the central bank's Federal Open Market Committee. What will determine the size of the rate hike is the September consumer price index.

The Fed needs to tighten monetary policy sufficiently to slow GDP growth to a below-potential pace to rebalance supply and demand in the labor market enough to bring down wage growth and inflation. The July Job Openings and Labor Turnover Survey data suggest that the weakness in GDP hasn't helped rebalance labor supply and demand. Monetary policy can't directly affect labor supply, but it can impact demand.

August employment comes in better than expected

Nonfarm employment increased by a net 315,000 jobs, modestly stronger than either we or the consensus anticipated. The net revision to the prior two months subtracted 107,000 jobs. The three-month moving average in nonfarm employment was 378,000 in August, a slight step down from 402,000 in July.

Goods-producing employment increased 45,000 in August following a 66,000-job gain in July. Within goods, mining and logging rose 7,000, in line with that seen over the prior two months. Construction employment continues to hold up, even though it is interest-.

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rate sensitive and residential investment has weakened recently. Construction employment added 16,000 in August after rising 24,000 in July.

Private services employment increased 263,000 in August, noticeably weaker than the 411,000 gain in July. Despite the shift from spending on goods to services, retail employment growth remained strong. It was up 44,000 in August following a 29,000 gain in July and 22,000 in June. Transportation and warehousing employment increased 5,000, while information rose 7,000.

Temporary help services employment was up 12,000 in August compared with 9,000 in July. Temporary help is normally a leading indicator and declines ahead of recessions. Elsewhere, education and healthcare increased 68,000 after jumping 118,000 in July.

Average hourly earnings rose 0.3% in August, in line with our forecast. The gain in August leaves average hourly earnings up 5.2% on a year-ago basis, matching the gain in July. The labor income proxy rose 0.2% in August, noticeably weaker than that seen over the past several months.

Rising for right reason

Household employment increased 442,000, while the number of unemployed rose 344,000. Duration of unemployment rose, as did the labor force. The labor force participation rate increased from 62.1% to 62.4%. The unemployment rate increased from 3.5% to 3.7%. Unemployment rates across demographic cohorts generally rose in August.

The rush is on

The debate about whether the Federal Reserve raises the target range for the fed funds rate by 50 or 75 basis points later this month hasn't ended, but U.S. companies know borrowing costs are going to get more expensive and are tapping the corporate bond market before it does. Average U.S. investment-grade funding costs have jumped and will likely climb further after the September meeting of the central bank's Federal Open Market Committee.

With higher funding costs coming, investment-grade and high-yield corporate bond issuance has risen and should remain solid ahead of the September 21 meeting. The pattern of an issuance binge before FOMC meetings could be the norm for the rest of the year. Beyond September, markets are pricing in rate hikes of 48 basis points at the November FOMC meeting and 25 basis points at the December meeting.

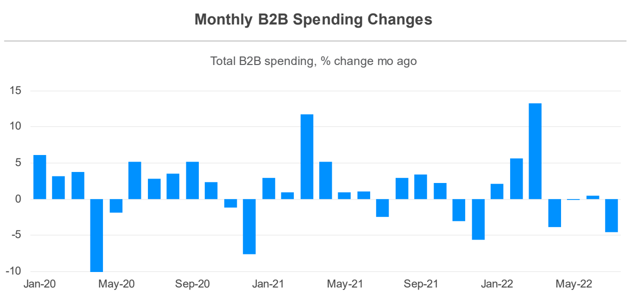
Markets are not fully pricing in rate hikes at any of the first couple of FOMC meetings next year and are betting on a terminal rate just south of 4%. Under this scenario markets expect the Fed to return inflation to target soon, according to inflation swaps, which are priced on the CPI. Year-over-year growth in the CPI of 2.5% would be consistent with the Fed's inflation objective, and inflation swaps are betting this occurs in 2025.

TOP OF MIND

U.S. B2B Spending Decelerates

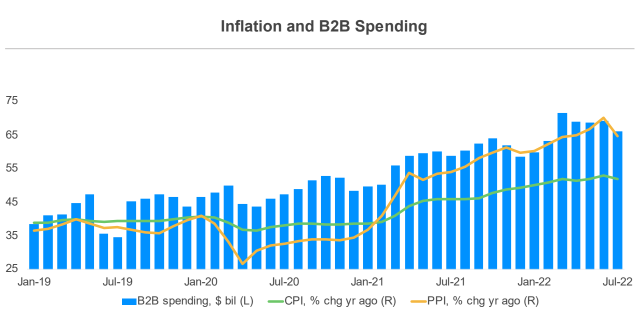
BY MATT COLYAR

Business-to-business, or B2B, spending, dipped in July. On a seasonally adjusted basis, B2B spending fell 2.5% from June. Compared with a year earlier, spending was up 12.4%, which marks four consecutive months of decelerating growth and is the lowest annual rate since early 2021, when comparisons were to the period before the COVID-19 pandemic began.

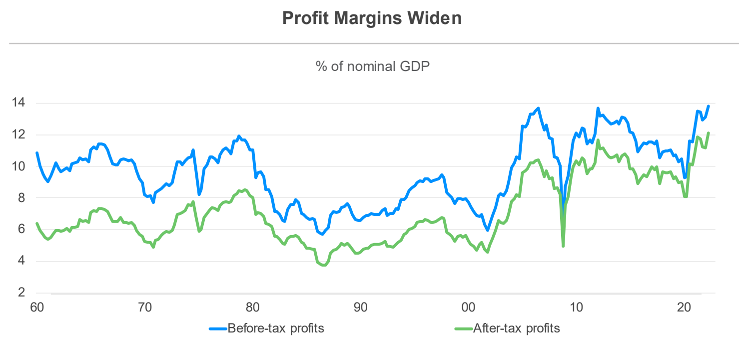


Source: Moody's Analytics Pulse

However, the deceleration in B2B spending is less worrisome than might initially be assumed. The data do not control for changes in prices. From June to July, the producer price index fell 1.9% and the consumer price index was unchanged. Businesses have contended with rapid cost increases for more than a year, and there are early indications that the worst of the current bout of inflation in the U.S. was contained to the first half of the year. Notably, B2B spending on food, fuel, oil and gas has declined for consecutive months after rising sharply in the spring.



Source: Moody's Analytics Pulse



Source: BEA, Moody's Analytics Pulse

Further, U.S. businesses appear to have had surprising success passing through cost increases to consumers. According to the Bureau of Economic Analysis, after-tax corporate profits, measured as a share of nominal GDP, were their highest on record in the second quarter. At 12.1%, they were a full percentage point higher than in the first quarter.

There are several reasons to explain the more price-insensitive U.S. consumer. First, household balance sheets are in strong condition. Generous fiscal stimulus, curtailed spending opportunities, and low debt burdens have given families the cushion to absorb rising costs. Most important is the strength of the labor market. While expected to finally show signs of slowing when August's payroll data are released, job growth in 2022 has exceeded expectations. Preliminary benchmark revisions to job growth in 2021 and early 2022 show the labor market performed even better than previously estimated.

The near-term outlook for the U.S. consumer, and businesses, is modest. Monetary policy tightening is designed to squeeze aggregate demand out of the economy to pull inflation down toward the Fed's target. Rising borrowing costs will undermine spending, particularly on big-ticket items. Firms, less inclined to raise the increasingly pricey capital needed to expand their operations, are likely to hold-off near-term growth plans.

The Week Ahead in the Global Economy

U.S.

The U.S. economic calendar will be busy. We are likely to learn whether the Federal Reserve will hike the target range for the fed funds rate later this month by 50 basis points or 75.

The key data will be in the August consumer price index. Odds are that the headline CPI fell slightly in August because of the drop in gasoline prices. Excluding food and energy, the CPI is likely to have risen because of added upward pressure from rents. On a year-ago basis, the headline CPI will still be up more than 8% for August. Growth in the core CPI likely accelerated, which may not sit well with the Fed.

Other data include initial claims for unemployment insurance benefits, retail sales, import prices and industrial production.

Europe

We anticipate a 0.1% m/m decline in U.K. GDP for July. Although we expect there to still be upward momentum from consumer spending on services, government consumption likely ticked lower as COVID-19 spending decreased. We're also likely to see some weaker investments as production sectors struggled amid high costs, supply chain snarls, and slowing client demand.

U.K. retail sales likely declined 0.2% m/m in August. When households are spending, they are still privileging services, and with inflation in double digit territory disposable incomes are becoming increasingly squeezed. Indeed, the inflation rate likely accelerated to 10.2% y/y in August from 10.1%. Core pressures and food inflation were likely still building, though cheaper gasoline prices will have offered relief. Unfortunately, inflation is nowhere near its peak yet with another massive hike in the country's gas and electricity price cap scheduled for October.

The Bank of England will therefore continue hiking at its policy meeting next week. We are pencilling in a 50-basis point hike of the bank rate to 2.25%. However, in this environment the unemployment rate was likely unchanged with the labour market remaining tight. We anticipate that the rate held at 3.8% for the July quarter. In the midst of the summer tourism season, firms are still having trouble filling vacancies particularly in the consumer services sectors. But we expect to see some more upward pressure toward the end of the year.

Industrial production in the euro zone likely slumped 0.3% m/m in July following June's 0.7% increase. Manufacturing surveys like the Purchasing Managers Index reported activity cooling. Firms are facing both lower client demand and higher costs. There are still backlogs to work through, which will continue preventing a steeper downturn.

The euro zone's external trade balance likely fell to a deficit of €22.6 billion in August from a surplus of €20.6 billion a year earlier. This will make for a smaller deficit than there was in June (€24.6 billion) due to the easing price of crude oil imports. Indeed, falling crude prices allowed consumer gasoline prices to decline over the past month, lowering energy inflation in the euro zone's harmonized index of consumer prices. Still, the HICP inflation rate accelerated to 9.1% in August from 8.9% in July due to both core and food inflation strengthening.

Finally, we expect the Central Bank of Russia cut its policy rate by 50 basis points to 7.5%. The lower rate will help ease lending conditions and mitigate some of the downside forces on the Russian economy. With inflation trending lower, the CBR can cut rates, but the inflation rate is still high and the CBR may be nearing the end of its cutting cycle.

Asia-Pacific

China will release a suite of activity data for August, including industrial production, retail sales and fixed-asset investment. We expect the prints to be softer than in July for all bar retail sales. Private sector infrastructure investment remains weak because of China's zero-COVID policy. Infrastructure spending is ramping up, and this will provide some relief later this year and into 2023.

We expect Australia's unemployment rate to have remained steady at 3.4% in August as job vacancies soared and the number of overseas workers remained soft. July saw a contraction in the labour force; a further decline could suggest a turning tide for the labour market.

New Zealand's GDP is expected to have grown 1.4% q/q in the June quarter after declining in the March quarter. Net exports are likely to again weigh on GDP because services exports have yet to meaningfully improve. Meanwhile an increase in petrol imports in the quarter due to the closure of New Zealand's last refinery will have dampened growth. New Zealand's strong consumer sector and the start of new infrastructure projects will support GDP.

Geopolitical Calendar

Date	Country	Event	Economic Importance	Financial Market Risk
9-Sep	Peru	Banco Central de Reserva monetary policy announcement	Medium	Medium
11-Sep	Sweden	General election	Low	Low
15-Sep	United Kingdom	Bank of England monetary policy announcement	Medium	Medium
19-26 Sep	U.N.	U.N. General Assembly	Medium	Medium
20-Sep	Sweden	Riksbank monetary policy announcement	Low	Low
21-Sep	Brazil	Banco Central do Brasil monetary policy announcement	Low	Low
20-21-Sep	U.S.	Federal Open Market Committee meeting	High	High
22-Sep	Japan	Bank of Japan monetary policy announcement	Medium	Low
22-Sep	Switzerland	Swiss National Bank monetary policy announcement	Medium	Low
22-Sep	Norway	Norges Bank monetary policy announcement	Medium	Low
25-Sep	Italy	General election	Low	Low
29-Sep	Mexico	Banxico monetary policy announcement	Low	Low
30-Sep	India	Reserve Bank of India monetary policy announcement	Medium	Low
30-Sep	Colombia	Banrep monetary policy announcement	Low	Low
2-Oct	Brazil	Presidential and congressional elections	High	Medium
4-Oct	Australia	Reserve Bank of Australia monetary policy announcement	Medium	Low
16-24-Oct	China	National Party Congress	High	Medium
20-21-Oct	European Union	European Council summit	Low	Low
27-Oct	Euro zone	European Central Bank monetary policy announcement	Medium	Medium
28-Oct	Japan	Bank of Japan monetary policy announcement	Medium	Low
1-Nov	Australia	Reserve Bank of Australia monetary policy announcement	Medium	Low
1-2-Nov	U.S.	Federal Open Market Committee meeting	High	High
3-Nov	United Kingdom	Bank of England monetary policy announcement	Medium	Medium
3-Nov	Norway	Norges Bank monetary policy announcement	Medium	Low
6-18-Nov	U.N.	U.N. Climate Change Conference 2022 (COP 27), hosted by Egypt	Medium	Low
8-Nov	U.S.	Midterm elections	High	Medium
15-16-Nov	G-20	G-20 Heads of State and Government Summit, hosted by Indonesia	Medium	Low
18-19-Nov	APEC	Economic Leaders' Meeting, hosted by Thailand	Low	Low
24-Nov	Sweden	Riksbank monetary policy announcement	Medium	Low
7-Dec	Australia	Reserve Bank of Australia monetary policy announcement	Medium	Low
7-Dec	India	Reserve Bank of India monetary policy announcement	Medium	Low
13-14-Dec	U.S.	Federal Open Market Committee meeting	High	High
15-Dec	United Kingdom	Bank of England monetary policy announcement	Medium	Medium
15-Dec	Euro zone	European Central Bank monetary policy announcement	Medium	Medium
15-Dec	Switzerland	Swiss National Bank monetary policy announcement	Medium	Low
15-Dec	Norway	Norges Bank monetary policy announcement	Medium	Low
15-16-Dec	European Union	European Council summit	Low	Low
20-Dec	Japan	Bank of Japan monetary policy announcement	Medium	Low

Our September Baseline Nudges Inflation Higher for 2022

BY RYAN SWEET

CREDIT SPREADS

Moody's long-term average corporate bond spread narrowed from 164 to 160 basis points over the past week. It is below the 176-basis point average in August. The long-term average industrial corporate bond spread narrowed by 5 basis points to 145. It averaged 160 basis points in August.

The ICE BofA U.S. high-yield option adjusted bond spread narrowed from 503 to 498 basis points. The Bloomberg Barclays high-yield option adjusted spread widened this past week from 484 to 485 basis points. This compares with an average high-yield spread of 1,000 basis points during recent recessions and an average of 350 outside of recessions. The high-yield option adjusted bond spreads approximate what is suggested by the accompanying long-term Baa industrial company bond yield spread but are wider than implied by a VIX of 24. The VIX decreased over the course of the past week.

DEFAULTS

Despite the drop in the default count from last month, the trailing 12-month global speculative-grade default rate held steady at 2.1% at the end of June, the same reading as at the end of May.

The default tally reached 43 in the first half of the year, up from 29 in the same period last year. Across sectors, Construction & Building remains the largest contributor to defaults with 11. The banking sector followed with eight. By region, North America had 18 defaults (17 in the U.S. and one in Canada). The rest were from Europe (12), Asia-Pacific (11), and Latin America (two).

In accordance with our credit conditions outlook, we lifted our one-year baseline global speculative-grade default rate forecast to 3.7% from last month's 3.3%. If realized, the new forecast will inch closer to the historical 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 second quarter, corporate bond issuance weakened. Worldwide offerings of investment grade corporate bonds totaled $548 billion, down 21% on a year-ago basis. US$ denominated high-yield corporate bond issuance was $38 billion in the second quarter, down from $63 billion in the first three months of the year. High-yield issuance is down 79% on a year-ago basis.

In the week ended August 31, there was no US$-denominated high-yield issuance. This keeps the year-to-date total at $114.2 billion. Investment-grade bond issuance totaled $615 million in the same week, bringing its year-to-date total to $1.023.5 trillion. Issuance is normally light in August and is still tracking that seen in 2018 and 2019.

U.S. ECONOMIC OUTLOOK

We made some adjustments to the U.S. baseline forecast in September. Among the notable changes is monetary policy as the Federal Reserve has signaled that it will front-load rate hikes. Therefore, we pulled a rate hike from early next year and changed November from a 25- to 50-basis point rate hike. We don't anticipate the Fed cutting interest rates to return to the neutral rate until early 2025. This compares with the August baseline that had cuts starting in late 2023. Changes to the forecast for employment, inflation, unemployment rate and GDP were minor. The outlook for housing deteriorated as higher mortgage rates and rising prices cut into affordability.

Our baseline forecast is still for the Fed to engineer a soft landing and the economy to skirt a recession, while inflation, over time, returns to the central bank's target.

Fiscal assumptions

The September baseline forecast incorporates the effects of President Biden's announced changes to student loan relief. While the announcement made a big splash, the macroeconomic consequences are minimal. There are three principal avenues by which student loan forgiveness and the resumption of federal student loan repayments in January affect growth. First, the end to the student loan freeze after this year will reduce household cash flow and thus consumer spending. Second, debt cancellation will increase household net worth and thus consumer spending via a positive net wealth effect. Finally, the two policies will increase interest rates due to more federal government debt.

By itself, ending the student loan moratorium reduces real GDP growth in 2023 by an estimated 18 basis points, increases the unemployment rate by 8 basis points, and reduces inflation by 11 basis points. In isolation, debt forgiveness increases real GDP growth by 13 basis points, reduces the unemployment rate by 6 basis points, and increases inflation by 8 basis points. Ultimately, the net of the two policies is a wash in the near term.

Energy price forecast and assumptions

The baseline forecast assumes West Texas Intermediate crude oil prices peaked in the second quarter. The September baseline forecast includes the recent slide in WTI crude oil prices, which are expected to average $95.30 per barrel this quarter and $98 in the final three months of the year.

Recession concerns, appreciation in the U.S. dollar, and a number of countries releasing some of their oil reserves have helped push global oil prices lower recently. Oil prices are still expected to steadily decline in 2023 and the first half of 2024. Oil prices bottom in 2024, a touch below $65 per barrel. This is the same as in our August baseline.

There are a number of risks to the forecast. Prices could soar past our baseline projection if the EU quickly adopts a strict ban on Russian oil. Prices also would be higher if Russia has trouble replacing its European customers or if OPEC halts its production increases. On the downside, an Iranian nuclear deal would tank prices. A Russia-Ukraine cease-fire or a weaker Chinese rebound from its self-induced zero-COVID shuttering of population centers could also send prices lower.

Trimming the GDP forecast, but not for 2022

The September baseline incorporates the revisions to second-quarter GDP. Real GDP fell 0.6% at an annualized rate in the second quarter, the second consecutive decline. This is a smaller drop than in the government's advance estimate of second-quarter GDP, where it was shown to have fallen 0.9% at an annualized rate.

Though GDP has declined for two consecutive quarters—a rule of thumb for a recession—we don't have a recession in the baseline forecast. GDP is only one of many variables that the National Bureau of Economic Research, the de facto arbiter of U.S. business cycles, uses to define a recession. Its stated definition is a "significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in production, employment, real income and other indicators." Outside of GDP, the other key data on which the NBER relies have generally continued to increase, including nonfarm employment, real consumer spending, industrial production, and weekly hours worked. Even real personal income—excluding transfers, another variable it watches—is flat to increasing.

The baseline forecast is for real GDP growth to increase in the second half of the year. The September forecast is for GDP to rise 1.3% at an annualized rate, which is less than our high-frequency GDP model's tracking estimate of 2%. Therefore, the risk bias, or the difference between our high-frequency GDP model's estimate of third-quarter GDP growth and our official forecast, is 0.7 of a percentage point. The forecast is for GDP to rise 0.6% at an annualized rate in the fourth quarter, less than the 1% at an annualized rate in the August baseline.

The forecast is for a 1.4% increase in real GDP next year, a touch lighter than the 1.5% in the August baseline. We also shaved 0.1 of a percentage point off GDP growth in 2024, as it is now expected to rise 2.6%.

Our baseline forecast for real GDP growth for next year is above the Bloomberg consensus of 1%. The forecast for 2024 is 0.9 percentage point higher than the Bloomberg consensus of 1.7%.

Business investment and housing

We didn't make any noticeable changes to the forecast for real business equipment spending this year. It is expected to increase 4.5% compared with the 4.6% gain in the prior baseline. We didn't change the forecast for real business equipment spending in either 2023 or 2024, since fundamentals didn't change appreciably between the update of the August and September baseline forecasts. Growth is expected to moderate as the share of banks tightening lending standards on commercial and industrial loans breached the threshold that has been consistent with a recession in the past. We doubt recession fears will vanish soon, and this should boost high-yield corporate bond spreads.

The interest-rate-sensitive segments of the economy have weakened, which is not surprising as the Federal Reserve is front-loading rate hikes. Housing starts are expected to be 1.58 million compared with 1.64 million in the prior baseline. Housing starts are expected to total 1.55 million next year, down from 1.56 million in the August baseline. Housing starts are forecast to increase in 2024, totaling 1.63 million.

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.

A decline in affordability has cut into our forecast for home sales, which are expected to total 5.89 million this year, less than the 6.27 million in the August baseline. We also cut the forecast for total home sales next year to 5.81 million, compared with 6.14 million in the prior baseline. Home sales will come under pressure from higher mortgage rates, which are contributing to the deterioration in housing affordability. New-home sales account for about 10% of total sales and existing-home sales make up the remainder.

There were revisions to the forecast for the FHFA All-Transactions House Price Index this year and the subsequent two years. The August baseline has it rising 15.9% this year compared with 12.9% in the prior baseline. The revision is mostly attributable to incoming historical data. The forecasts for 2023 and 2024 are for house prices to increase 0.9% and 2.4% respectively. In the August baseline, we didn't have house prices falling in either 2023 or 2024.

Labor market

The U.S. labor market remains very strong, but job growth has moderated. Nonfarm employment increased by a net of 315,000 jobs, modestly stronger than either we or the consensus anticipated. The net revision to the prior two months was -107,000. The three-month moving average in nonfarm employment was 378,000 in August, a slight step down from 402,000 in July.

Goods-producing employment increased 45,000 in August following 66,000 in July. Within goods, mining and logging rose 7,000, in line with that seen over the prior two months. Construction employment continues to hold up even though it is interest rate-sensitive and residential investment has weakened recently. Construction employment added 16,000 in August after rising 24,000 in July.

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Household employment increased 442,000, while the number of unemployed rose 344,000. Duration of unemployment rose, as did the labor force. The labor force participation rate increased from 62.1% to 62.4%. The unemployment rate increased from 3.5% to 3.7%. Unemployment rates across demographic cohorts generally rose in August.

The August employment report didn't warrant significant changes to the baseline forecast. We have job growth averaging 371,000 per month this year before dropping to 103,000 in 2023 and then accelerating to 124,000 in 2024. Job growth next year is weaker than that needed to keep the unemployment rate stable.

The forecast is for the unemployment rate to average 3.7% in the fourth quarter of this year, identical to that in the

August baseline. The unemployment rate rises next year, averaging 4.1% in the final three months of the year, compared with 4% in the August baseline. The unemployment rate falls in 2024, averaging 3.8% in the fourth quarter.

We assume a full-employment economy is one with approximately 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%. The labor force participation rate is close but still 0.4 of a percentage point below this threshold.

On the surface, there appears to be a disconnect between employment and GDP. The correlation coefficient between average monthly job growth in a given quarter and annualized growth in real GDP since 2000 is 0.71. Granger causality tests show that the causation between job and GDP growth runs both ways. The results didn't change when using different lags. This isn't surprising. Still, job growth has been stronger than GDP growth—but the disconnect between it and employment isn't unusual. Initial reports are volatile and subject to revision, and thus don't always tell similar stories.

Beyond data issues, there are real differences in how output and the labor market respond during the business cycle. For example, firms normally adjust workers' hours before adding or subtracting staff, which can cause output to rise or fall before employment does. Also, if we factor in productivity growth, it doesn't appear that employment and GDP are telling different stories.

Risks to our employment forecast are balanced. On the downside, per Okun's law, a 1-percentage point deceleration in GDP growth over the course of a year would decrease employment growth by around 800,000 jobs per year. This would also increase the unemployment rate by about 0.5 percentage point. However, the Fed's latest Beige Book noted that employers continued to keep hiring even as growth slows because they have a ton of open positions and need to make up for lost work.

Monetary policy

Federal Reserve Chair Jerome Powell's speech at Jackson Hole in late August was hawkish and introduced additional upside risk to our forecast for a 3.5% terminal fed funds rate this cycle. Powell's comments nudged the market-implied path for the fed funds rate higher; markets have the terminal rate a touch north of 3.8%. Powell emphasized that "estimates of longer-run neutral rates are not a place to stop or pause" and that "restoring price stability will likely require maintaining a restrictive policy stance for some time to come."

Powell emphasized that the bar is high for the central bank to start reducing the size of rate hikes as it manages the risks of declaring a premature victory over inflation. The core personal consumption expenditure deflator rose 0.1% in July, leaving it up 6.3% on a year-ago basis following a 6.8% gain in June. This isn't overly welcome news for the Fed, which wants concrete signs that inflation is steadily moving toward its 2% objective. Powell acknowledged that rate hikes are going to cause "some pain" for households and businesses.

There were some changes in the forecast for the fed funds rate. We expect a 50-basis point rate hike at the September meeting, but the August consumer price index could tilt the Fed toward a 75-basis point rate hike. Rather than hiking by 25 basis points in November, we now forecast a 50-basis point hike. There is still one additional hike of 25 basis points in December. The Fed then pauses, and we expect this pause to last longer than we did in the August baseline. We don't anticipate that the Fed will cut interest rates to return it to the neutral rate until early 2025 compared with the August baseline that had cuts starting in late 2023.

We continue to use the approach for forecasting the fed funds rate on a monthly basis to better align changes with the fed funds rate and updates from the FOMC meetings. The monthly forecast is then rolled up into our quarterly forecast. The top end of the fed funds rate averages 3.45% in the fourth quarter of this year.

It's possible that to tame inflation the Fed will have to raise the fed funds rate more than is called for in the baseline. The September baseline has the CPI rising 8% this year (7.8% in the August baseline) and 3.8% in 2023 (3.4% in the prior baseline). The CPI is expected to rise 2.2% in 2024.

The 10-year Treasury yield has resumed rising, and this was incorporated into the new baseline. However, there were no material changes to the forecast for this year. We have the 10-year Treasury yield a touch higher next year than in the August baseline. The 10-year Treasury yield next year is still below its equilibrium rate. The equilibrium 10-year Treasury yield is 3.75%, which is equal to nominal potential GDP growth.

With the new forecast for the fed funds rate, the difference between the 10-year and the fed funds rate inverts in the fourth quarter of this year. It's a modest inversion and it remains inverted through the end of 2024.

THE LONG VIEW: EUROPE

New U.K. PM Outlines Inflation Measures

BY DAVID MUIR and ROSS CIOFFI

New U.K. Prime Minister Liz Truss has outlined how the government intends to address the rising cost of energy facing households and businesses. The loosening of fiscal policy will support growth, but we continue to see an elevated recession risk. With the rise in Ofgem's price cap scrapped, inflation will peak at a considerably lower level than envisaged in the September baseline forecast. However, we have not changed our expectations around the path for interest rates.

The Energy Price Guarantee will limit the price suppliers can charge households per unit of gas for two years, beginning 1 October. For the average household, this will mean an energy bill of around £2,500 per year. But since each household will continue to receive a subsidy of £400, the net cost is somewhat lower, and broadly comparable to the price cap of £1,971 currently in place. The cap had been set to rise to £3,549 in October, and probably even higher in January. Equivalent support for businesses was announced, though this will run for six months.

The cost of the EPG will be funded by government borrowing, with the government paying energy suppliers the difference between the market price and the capped price; Chancellor Kwasi Kwarteng said the cost will be set out in a fiscal statement later this month. Estimates put the total cost in the range of £100 billion to £150 billion, though it will be dependent on the evolution of wholesale energy prices.

The freeze in energy prices seems likely to lessen the degree of gloom among households and means inflation will peak at a significantly lower level than in the September baseline. We previously saw it rising to around 13% in October and 16% in January, when the Ofgem price cap was set to rise—with prices frozen, we expect inflation to peak at around 11% in the autumn. Nevertheless, pressures on household budgets will remain intense and the recession risk continues to be elevated. Further fiscal loosening may be announcement later this month, with the PM having pledged to reverse the 1.25-percentage point rise in National Insurance contributions implemented in April.

Although inflation is set to peak at a lower level in the autumn than projected by the Bank of England in its August forecast, we think this is unlikely in itself to prompt the Monetary Policy Committee to raise rates at a more moderate pace. The Committee's focus is on influencing wage and price dynamics that drive inflation for a longer horizon. Indeed, the support to growth provided by the loosening of fiscal policy is likely to reinforce, and potentially add to, the Committee's bias to pursue the forceful approach to raising rates implied in its August monetary policy report.

In recent days, markets have reacted negatively to the scale of additional borrowing likely required by the policy measures. Ten-year gilt yields have risen above 3% for the first time since 2014, which is about 120 basis points higher than early August. On Wednesday, sterling fell to its lowest level against the U.S. dollar since 1985. With markets unsettled by the arrival of a new prime minister, and the additional borrowing, the government will need to outline credible tax and spending policies for putting public finances on a sustainable path.

ECB picks up the pace

The European Central Bank increased its three policy rates by 75 basis points at its meeting Thursday. The ECB promised continued policy tightening but left some ambiguity concerning whether it will continue with the 75-basis point pace, or slow again to 50 basis points at the October meeting. On the one hand, it acknowledges that prevailing rates are still highly accommodative, and it also revised its inflation forecast significantly higher, to 8.1% for 2022, to 5.5% for 2023, and to 2.4% for 2024. On the other hand, the ECB referred to its decision as front-loading. This frontloading may very likely extend with another 75-basis point hike in October. But, as of our September baseline, we are penciling in a 50 basis point hike for the October meeting.

Rate Hikes Yet to Stop Aussie Households

BY HARRY MURPHY CRUISE

Australian GDP defied headwinds in the June quarter, growing 0.9% from the March quarter. Against a backdrop of raging global inflation, the country faced successive COVID-19 waves, supply-chain snarls, and even floods. But the economy took it all in its stride. Households were the biggest support, showing a willingness to spend despite higher cost-of-living pressures and squeezing borrowing costs. For the Reserve Bank of Australia, which is trying to temper domestic demand, surging household spending is unwelcome news.

A fall in non-dwelling construction pushed business investment lower. Wet weather compounded problems caused by materials and labour shortages. Despite that, machinery and equipment investment jumped 3.9%. With the labour market tighter than an uncle's shirt at Christmas lunch, businesses are increasingly looking to capital to meet their production needs. In addition, surging mining profits and a global renewable energy push is lifting mining investment around the country. New mining exploration activity is on par with the peak of the 2012 mining boom.

Speaking of commodities, export volumes bounced back from the fall in the December and March quarters. Not only did volumes improve, but surging commodity prices handed Australia a pay rise. The terms of trade reached a record high of 130.7 across the June quarter. A bounce in imports undid some, but certainly not all, of these gains, driven by a sharp jump in service imports (mostly overseas travel).

Government spending continued to unwind from elevated levels. It fell 0.8% from the March quarter. Meanwhile, increased state and local government infrastructure spending and additional federal dollars for defence pushed public investment up 5.9%.

A fall in dwelling investment was the key negative for the quarter. With house prices falling steadily around the country, new dwelling investment and ownership transfers went backwards. Like non-dwelling construction, labour and materials were in short supply. Forward indicators of housing starts and approvals remain weak, suggesting future gains will be hard to come by.

Combined, these trends lead us to expect GDP growth of 3.6% in 2022.

RATINGS ROUNDUP

Year-to-Date Upgrades Outnumber Downgrades

BY STEVEN SHIELDS

U.S.

U.S. corporate rating changes were again mixed in the period. Though downgrades outnumbered upgrades 5:3, positive rating changes comprised nearly three-quarters of the affected debt. The largest change, impacting $7.2 billion, was issued to Novelis Inc. According to Botir Sharipov, Moody's Investors Service senior credit officer, "The ratings upgrade reflects Novelis' strengthened balance sheet following the reduction in gross debt since FQ1 2021, leading positions in packaging and ground transportation markets, a geographic breadth of its global operations and its ability to maintain a strong credit profile commensurate with a Ba2 rating in a potentially distressed economic environment when the company might have to increase borrowings to fund its large growth program."

Meanwhile, Moody's downgraded Party City Holdings Inc.'s ratings, including its corporate family rating to Caa1 from B3. The downgrades reflect the impact of Party City's deteriorating profitability on its liquidity, free cash flow and credit metrics. Operating performance has been impacted by rising costs in its supply chain, helium shortages and declining demand because of inflationary pressures in the broader macroeconomic environment.

In July, 53% of ratings actions issued by Moody's Investors Service were favorable and credit upgrades comprised more than 80% of the total affected debt. Year to date, Moody's Investors Service has issued 234 credit upgrades and 174 downgrades. The highest number of upgrades by subsector have been issued to exploration and midstream energy firms thanks to rising prices, while consumer durables have received the highest number of downgrades.

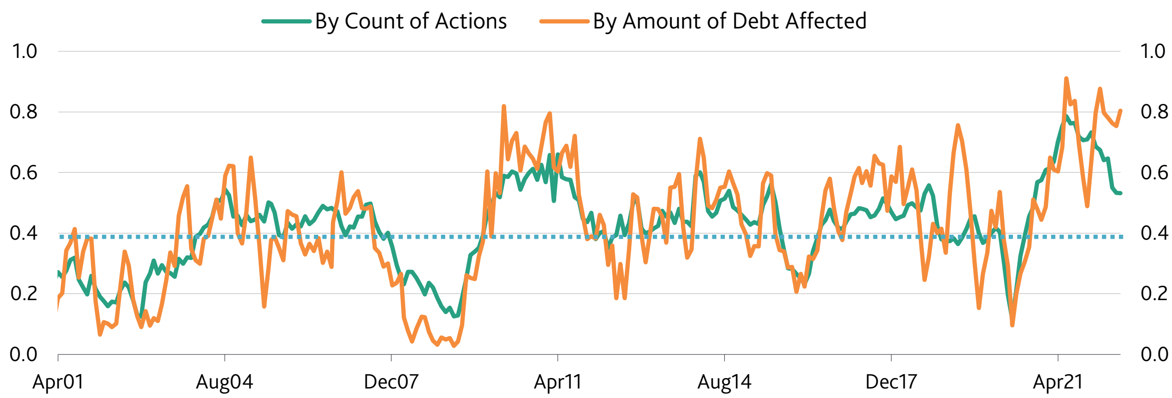
Europe

Rating activity remained light across Western Europe with Moody's Investors Service issuing just two changes. Air Liquide S.A.'s long-term issuer rating and senior unsecured notes were raised to A2 from A3. The upgrade reflects Moody's expectation that Air Liquide will continue to improve its credit metrics to a level commensurate with an A2 rating and sustain these metrics through a range of economic scenarios. The A2 rating incorporates the stability and resilience of Air Liquide's earnings and cashflow generation, as well as the company's continued balanced financial policy.

A downgrade was issued to Bright Bidco B.V. on September 2. Moody's downgraded the firm's corporate family rating to C from Caa3 and the probability of default rating to D-PD from Caa3-PD. Moody's also downgraded the senior secured term loan B rating and the $100 million senior secured revolving credit facility rating to C. The rating action follows the filing of petitions by Lumileds Holding B.V. and nine of its affiliates including BBBV seeking relief under chapter 11 of the United States Bankruptcy Code.

RATINGS ROUND-UP

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
8/31/2022	HARSCO CORPORATION	Industrial	SrUnsec/SrSec/BCF/ LTCFR/PDR	500	D	B1	B3	SG
8/31/2022	HINDALCO INDUSTRIES LIMITED-NOVELIS CORPORATION	Industrial	SrUnsec/LTCFR/PDR	7202.748	U	B1	Ba3	SG
8/31/2022	HUDSON RIVER TRADING LLC	Financial	SrSec/BCF/LTIR/LTCFR		D	Ba2	Ba3	SG
8/31/2022	PARTY CITY HOLDCO INC-PARTY CITY HOLDINGS INC.	Industrial	SrSec/SrUnsec/LTCFR/ PDR	2673.338	D	B3	Caa1	SG
9/1/2022	BEP DIAMOND TOPCO L.P.-BEP ULTERRA HOLDINGS, INC.	Industrial	SrSec/BCF/LTCFR/PDR		U	B3	B2	SG
9/1/2022	COLGATE ENERGY PARTNERS III, LLC	Industrial	SrUnsec	1000	U	B3	B2	SG
9/1/2022	TIGER ACQUISITION, LLC	Industrial	SrSec/BCF/LTCFR/PDR		D	B1	B2	SG
9/1/2022	OSG GROUP HOLDINGS, INC.-OUTPUT SERVICES GROUP, INC.	Industrial	PDR		D	Caa2	D	#N/A

Source: Moody's

FIGURE 4

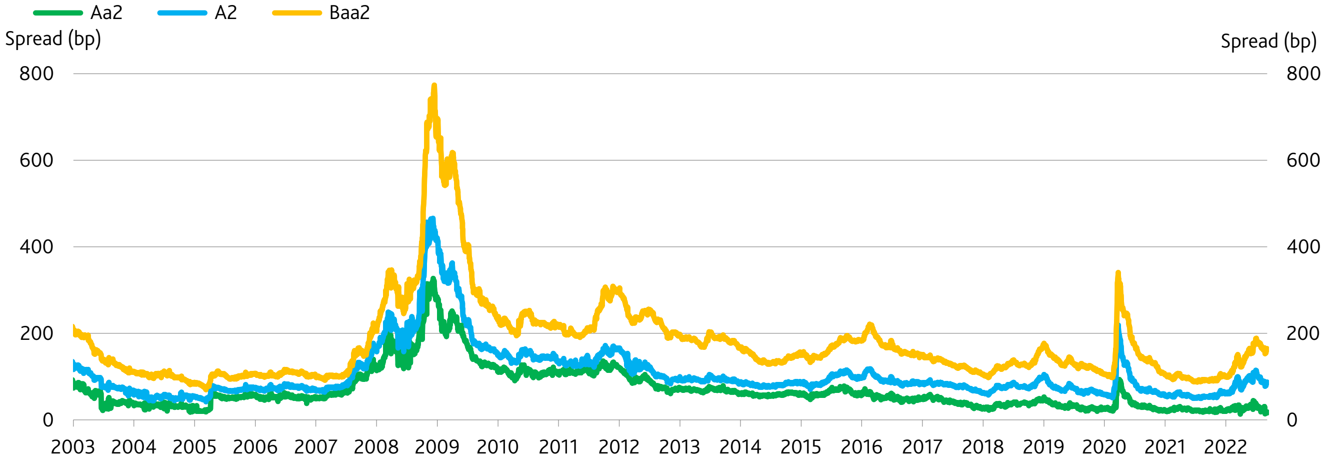
Rating Changes: Corporate & Financial Institutions - Europe

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG	Country
9/2/2022	BRIGHT BIDCO B.V.	Industrial	SrSec/BCF/LTCFR/PDR		D	Caa3	C	SG	NETHERLANDS
9/6/2022	AIR LIQUIDE S.A.	Industrial	SrUnsec/LTIR/MTN/CP	9473.876	U	A3	A2	IG	FRANCE

Source: Moody's

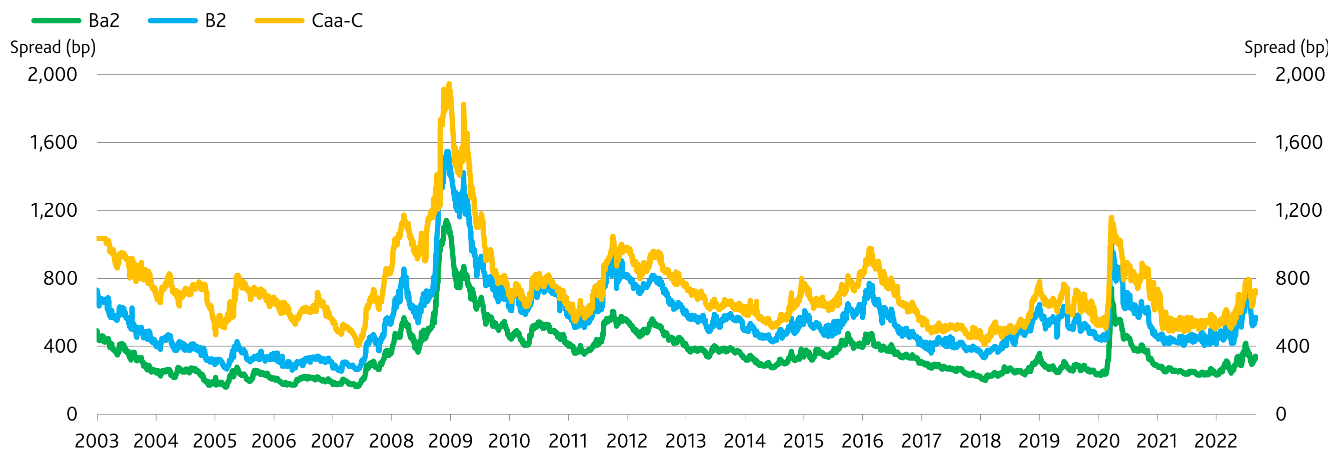
MARKET DATA

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 (August 31, 2022 – September 7, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Sep. 7	Aug. 31	Senior Ratings
AT&T Inc.	Baa2	Baa3	Baa2
Ally Financial Inc.	Ba1	Ba2	Baa3
Oracle Corporation	Baa2	Baa3	Baa2
Boeing Company (The)	Baa3	Ba1	Baa2
Coca-Cola Company (The)	Aa3	A1	A1
Procter & Gamble Company (The)	Aa2	Aa3	Aa3
Bank of New York Mellon Corporation (The)	A1	A2	A1
Lowe's Companies, Inc.	A2	A3	Baa1
Carnival Corporation	Caa1	Caa2	B3
Southern Company (The)	A2	A3	Baa2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Sep. 7	Aug. 31	Senior Ratings
Toyota Motor Credit Corporation	Aa3	Aa2	A1
Caterpillar Financial Services Corporation	A1	Aa3	A2
U.S. Bancorp	A1	Aa3	A2
Philip Morris International Inc.	Baa3	Baa2	A2
Starbucks Corporation	Baa1	A3	Baa1
Constellation Brands, Inc.	Baa1	A3	Baa3
Archer-Daniels-Midland Company	A2	A1	A2
Boston Properties Limited Partnership	Baa1	A3	Baa1
Marriott International, Inc.	Baa2	Baa1	Baa3
OneMain Finance Corporation	B3	B2	Ba2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Sep. 7	Aug. 31	Spread Diff
Newell Brands Inc.	Ba1	258	227	31
Meritage Homes Corporation	Ba1	298	268	30
Service Properties Trust	B1	464	434	29
SLM Corporation	Ba1	576	552	25
Avis Budget Car Rental, LLC	B2	470	449	21
Nabors Industries, Inc.	Caa2	659	638	20
Macy's Retail Holdings, LLC	Ba2	517	499	18
iHeartCommunications, Inc.	Caa1	665	648	17
Regency Centers, L.P.	Baa1	138	121	17
Nissan Motor Acceptance Company LLC	Baa3	302	286	16

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Sep. 7	Aug. 31	Spread Diff
American Airlines Group Inc.	Caa1	1,324	1,468	-144
United Airlines Holdings, Inc.	Ba3	824	916	-92
Royal Caribbean Cruises Ltd.	B3	936	1,014	-77
Carnival Corporation	B3	1,065	1,115	-51
Delta Air Lines, Inc.	Baa3	466	503	-37
Rite Aid Corporation	Caa2	1,873	1,908	-34
International Game Technology	B2	428	456	-28
Liberty Interactive LLC	B2	1,256	1,280	-24
Beazer Homes USA, Inc.	B3	691	716	-24
Dish DBS Corporation	B3	1,404	1,425	-21

Source: Moody's, CMA

CDS Movers

Figure 4. CDS Movers - Europe (August 31, 2022 – September 7, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Sep. 7	Aug. 31	Senior Ratings
BPCE	A1	A2	A1
HSBC Holdings plc	Baa1	Baa2	A3
Barclays PLC	Baa2	Baa3	Baa2
ENGIE SA	Baa1	Baa2	Baa1
E.ON SE	Baa2	Baa3	Baa2
Sanofi	Aa3	A1	A1
Heineken N.V.	Aa2	Aa3	Baa1
Tesco Plc	Baa2	Baa3	Baa3
BASF (SE)	Baa2	Baa3	A3
Bayer AG	Baa2	Baa3	Baa2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Sep. 7	Aug. 31	Senior Ratings
Banco Santander S.A. (Spain)	Baa1	A3	A2
ABN AMRO Bank N.V.	A3	A2	A1
Banque Federative du Credit Mutuel	Baa1	A3	Aa3
Landesbank Baden-Wuerttemberg	A1	Aa3	Aa3
Piraeus Financial Holdings S.A.	B3	B2	Caa1
Alpha Services and Holdings S.A.	B1	Ba3	B3
Bank of Ireland	Baa3	Baa2	A1
United Utilities PLC	A1	Aa3	Baa1
Deutsche Lufthansa Aktiengesellschaft	B2	B1	Ba2
ASML Holding N.V.	Aa2	Aa1	A2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Sep. 7	Aug. 31	Spread Diff
Boparan Finance plc	Caa3	2,243	2,124	119
Sappi Papier Holding GmbH	Ba2	361	310	52
Casino Guichard-Perrachon SA	Caa1	3,013	2,965	48
Novafives S.A.S.	Caa2	1,635	1,590	45
Vue International Bidco plc	C	664	640	25
thyssenkrupp AG	B1	597	580	17
Unibail-Rodamco-Westfield SE	Baa2	279	269	11
Banque Federative du Credit Mutuel	Aa3	86	77	9
Alstom	Baa2	232	223	9
Ardagh Packaging Finance plc	Caa1	1,121	1,113	8

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Sep. 7	Aug. 31	Spread Diff
Stena AB	B2	502	538	-36
Lanxess AG	Baa2	245	267	-22
BASF (SE)	A3	123	138	-15
Marks & Spencer p.l.c.	Ba1	403	417	-14
Hamburg Commercial Bank AG	Baa1	226	238	-12
Evonik Industries AG	Baa2	103	113	-11
Nokia Oyj	Ba2	151	162	-11
EWE AG	Baa1	118	129	-11
Virgin Media Finance PLC	B2	478	489	-11
UPC Holding B.V.	B3	373	384	-11

Source: Moody's, CMA

CDS Movers

Figure 5. CDS Movers - APAC (August 31, 2022 – September 7, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Sep. 7	Aug. 31	Senior Ratings
China, Government of	A2	A3	A1
Development Bank of Kazakhstan	Ba1	Ba2	Baa2
Kia Corporation	Baa1	Baa2	Baa1
Japan, Government of	Aaa	Aaa	A1
Australia, Government of	Aaa	Aaa	Aaa
Korea, Government of	Aa1	Aa1	Aa2
India, Government of	Baa2	Baa2	Baa3
China Development Bank	Baa1	Baa1	A1
Indonesia, Government of	Baa2	Baa2	Baa2
Export-Import Bank of Korea (The)	Aa1	Aa1	Aa2

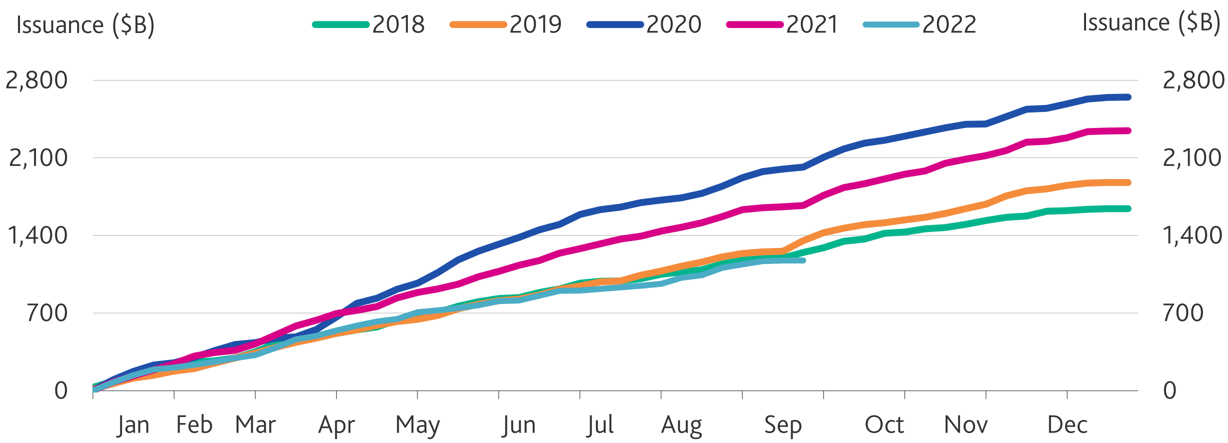
CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Sep. 7	Aug. 31	Senior Ratings
Commonwealth Bank of Australia	A2	A1	Aa3
Export-Import Bank of China (The)	A3	A2	A1
Australia and New Zealand Banking Grp. Ltd.	A2	A1	Aa3
Mitsubishi Corporation	Aa2	Aa1	A2
Kyushu Electric Power Company, Incorporated	Aa1	Aaa	Baa3
Chubu Electric Power Company, Incorporated	Aa1	Aaa	A3
Nissan Motor Co., Ltd.	Ba1	Baa3	Baa3
JFE Holdings, Inc.	A1	Aa3	Baa3
Sumitomo Corporation	Aa3	Aa2	Baa1
Japan Tobacco Inc.	Aa3	Aa2	A2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Sep. 7	Aug. 31	Spread Diff
SoftBank Group Corp.	Ba3	490	468	22
Halyk Savings Bank of Kazakhstan	Ba2	462	440	22
Nissan Motor Co., Ltd.	Baa3	181	172	10
SK Hynix Inc.	Baa2	175	166	9
India, Government of	Baa3	117	110	7
Mitsubishi Corporation	A2	39	32	6
Reliance Industries Limited	Baa2	115	109	6
Sumitomo Corporation	Baa1	46	39	6
Marubeni Corporation	Baa2	49	42	6
JFE Holdings, Inc.	Baa3	52	47	5

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Sep. 7	Aug. 31	Spread Diff
Development Bank of Kazakhstan	Baa2	245	262	-17
Malayan Banking Berhad	A3	84	92	-8
Malaysia, Government of	A3	70	77	-7
Indonesia, Government of	Baa2	108	113	-6
Tata Motors Limited	B1	302	308	-6
China, Government of	A1	67	71	-4
Philippines, Government of	Baa2	98	102	-4
Vietnam, Government of	Ba2	132	135	-4
Thailand, Government of	Baa1	58	60	-2
Oversea-Chinese Banking Corp Ltd	Aa1	45	47	-2

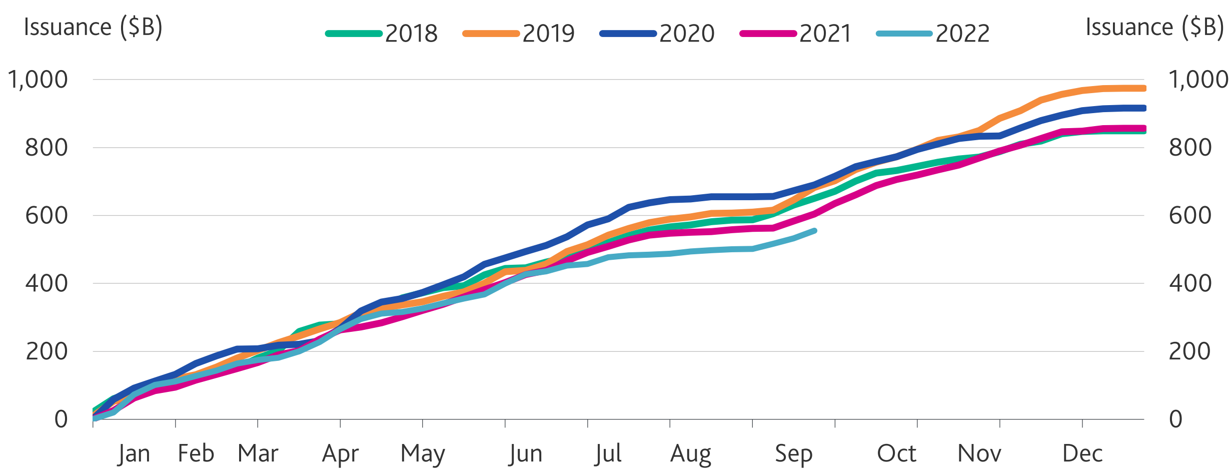
Source: Moody's, CMA

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

Figure 8. Issuance: Corporate & Financial Institutions

	USD Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	0.615	0.000	1.157
Year-to-Date	1,023.459	114.234	1,175.045

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	21.282	1.498	22.915
Year-to-Date	517.175	29.585	555.599

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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Report Number: 1341638

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