

**WEEKLY MARKET
OUTLOOK**

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Inside Economics Podcast:



What if Gasoline in the U.S. Goes to \$6? \$7?

The pain U.S. consumers are feeling at the pump will get worse before it gets better. Wholesale gasoline prices lead retail gasoline prices by two weeks and there isn't any good news. Wholesale gasoline prices point toward an increase in average U.S. gasoline prices from \$5 to \$5.50 over the next couple of weeks. Critical to the forecast for growth and inflation is that energy prices, including gasoline, are near their peaks and will steadily decline through the rest of this year and into next.

What if we're wrong? If global energy prices haven't peaked, and additional oil supply doesn't hit the market, then U.S. retail gasoline prices could climb even further. To assess the potential costs of significantly higher retail gasoline prices, we ran two scenarios through our global macroeconomic model.

In the first scenario, U.S. prices at the pump average \$6 per gallon in the latter half of 2022. In the second scenario, prices surge to \$7 per gallon. In both scenarios, gasoline prices quickly return to our baseline forecast by mid-2023. A general rule of thumb is that a \$10 increase in the price of a barrel of oil results in a \$0.25 increase in the price of a gallon of gasoline. Further, every penny change in retail gas prices adds or subtracts \$1.28 billion in consumer spending over the course of a year. Therefore, the economic costs of higher gasoline prices increase quickly and are likely nonlinear. Gasoline prices at \$6 or \$7 would be psychological thresholds and would likely weigh heavily on consumer sentiment and potentially increase the economic costs of higher prices at the pump.

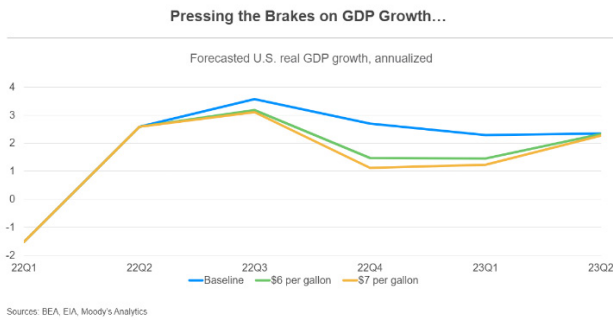
Gasoline prices at \$6 per gallon shave 0.4 percentage point off U.S. GDP growth in the third quarter, dragging output from the annualized growth rate of 3.6% in our baseline to 3.2%. In the final quarter, the hit to GDP growth is 1.2 percentage points. The decline is a function of a reduction in real consumer spending.

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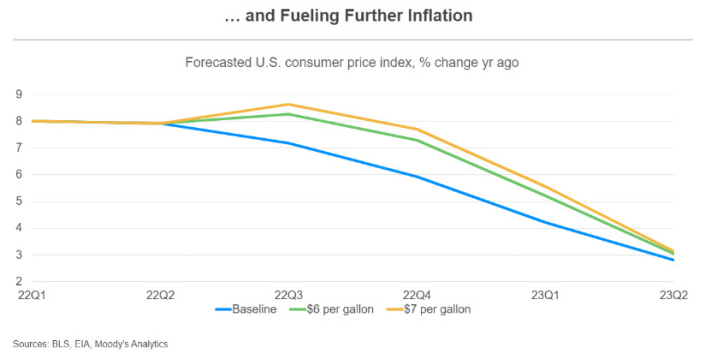
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U.S. [consumer prices](#), which we forecast to moderate steadily after peaking in the first half of 2022, instead accelerate to an average of 8.3% in the third, more than a percentage point higher than our baseline. In the fourth quarter, prices rise 7.3%, 1.4 percentage points hotter than our forecast of a 5.9% increase. In total, prices rise 7.8% in 2022, 0.6-percentage point higher than our forecast of 7.2%.



In our second and more severe scenario, we push gasoline prices up another dollar, averaging \$7 per gallon in the second half of this year. This scenario requires the price of a

barrel of oil to be more than \$200 per barrel in the final two quarters. As would be expected, the economic situation worsens.



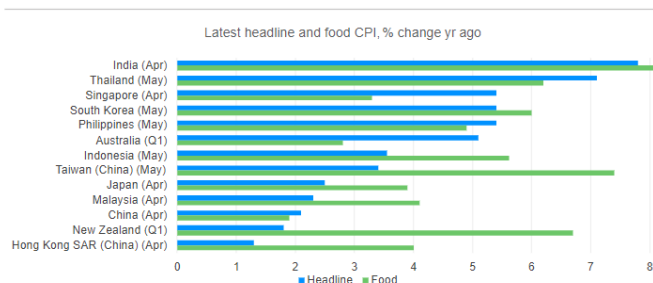
At \$7 per gallon, GDP growth in the U.S. slumps to 3.1% in the third quarter and 1.1% in the fourth. This marks a half percentage point and 1.6-percentage point reduction from our baseline, respectively. The inflationary impacts of \$7 gas are similarly pronounced. The CPI jumps 8.6% in the third quarter and 7.7% in the fourth..

Food Protectionism Hits the Asia-Pacific Region

BY GABRIEL TAY

Geopolitical forces are coming to bear on global food security. Whether it is palm oil from Indonesia, wheat and sugar from India, or chicken from Malaysia, major food producers are tightening export policies to tame inflation and shore up domestic supplies. Russia's invasion of Ukraine could hardly have come at a worse time for global food logistics given the pandemic still has supply chains clogged up.

Piping Hot Food Inflation Across APAC Economies



Sources: National statistics boards, Moody's Analytics.

In the latest episode of food protectionism, [India](#) imposed export restrictions on sugar in May. The move came on the heels of an export ban on wheat and limits sugar exports to 10 million metric tonnes for the year to September. According to the Indian Sugar Mills Association, some 8.5 million tonnes of sugar exports have already been contracted for the period. In addition, anyone wanting to export sugar before the end of October will need government clearance.

India is under particular pressure to temper food prices because it has the highest headline and food inflation in the Asia-Pacific region. Headline CPI growth soared to 7.8% y/y in April, its highest in seven years. Food prices, which drove that acceleration, rose 8.1% y/y, up from 7.5% in March.

India's sugar production is highly volatile, and in years when the monsoon season is bad its exports can be insignificant. In 2020, India was the region's largest net exporter of sugar by value, followed by Thailand, Myanmar, Laos, Australia and Cambodia. The new sugar trade controls could raise sugar prices, allowing these net exporters to reap the rewards, especially if they can increase supply. By contrast, buyers will be left with the bitter taste of imported inflation.

In 2020, Sri Lanka imported 84% of its sugar from India. Malaysia, Singapore and Indonesia also had large appetites

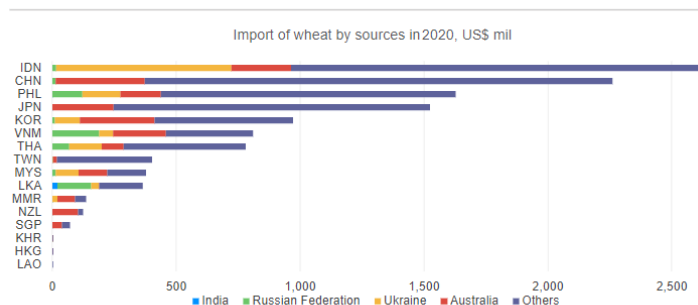
for Indian sugar, sourcing 18%, 14% and 12% of total sugar imports from that market, respectively. However, due to the unreliable nature of India's sugar harvest, these countries and other importers can typically find substitutes with relative ease.

This year, Russia's invasion of Ukraine is a complicating factor for sugar markets. The invasion has sent energy prices soaring, making it more lucrative to divert sugarcane to ethanol production. This has been evident in [Brazil](#), which has seen sugar mills cancel export contracts in order to produce ethanol. Although India's sugar export restriction is a pre-emptive policy to prevent shortages down the road, it highlights a worrying trend of governments interventions distorting markets and the flow of food staples to countries that need to import. India's sugar export restriction will have a smaller impact than its decision to ban wheat exports.

Deep into the wheats

India's ban on wheat exports is only a few weeks old. Russia's invasion of Ukraine has left global wheat supplies in a shambles; on 2020 figures, the pair accounted for almost a quarter of global wheat exports. Countries that would normally rely on wheat from Russia or Ukraine, particularly those in the Middle East and North Africa, are turning to other producers such as India. Based on UN Comtrade data, Australia and India are the only net exporters of wheat in the Asia-Pacific region. They account for 5.5% and 0.1% of global exports, respectively. Although India is amongst the largest wheat producers in the world, most of its harvest is consumed domestically.

Limited APAC Wheat Exposure



Sources: UN Comtrade, Moody's Analytics

Indonesia and China are the biggest importers of wheat in the Asia-Pacific region, and Australia, the U.S. and Canada are the key suppliers into that part of the world. We expect

India's wheat export ban to have little direct impact on food prices in a neighbourhood where rice is a more important staple than bread. But indirectly, it will add to the cost of meat, wheat being the second most popular grain after maize in pig and poultry feed.

Higher feed prices, disease and extremely hot weather have taken a toll on chicken supplies in Malaysia, leading that country to impose an export ban in recent weeks. Singapore is highly exposed to the chicken ban. According to the Singapore Food Agency, the country last year sourced 34% of its chicken imports (live, chilled and frozen) from Malaysia; Brazil was a bigger supplier, accounting for 49%, and the U.S. ranked third at 12%.

Out of the frying pan and into the fire

In the short term, protectionist trade policies are likely to result in price increases across a broad array of food products; export restrictions raise the cost not just of the specified product but also its substitutes. For instance, when Indonesia announced an export ban on palm oil in late April, the price of soybean oil futures jumped 8.1% on the announcement. Thankfully, [the ban](#) lasted for less than a month before being replaced by a so-called domestic market obligation. Higher food prices weigh disproportionately more on lower-income households and lesser developed economies, which spend a larger proportion of their income on food. Compounding the financial strain, many households across the region are grappling with rising borrowing costs as central banks normalise policy settings.

Protectionist policies tend to be short-lived and isolated. But in 2022, we are seeing an unusual convergence of protectionist policies on multiple food staples. This comes against the backdrop of disrupted supply chains and geopolitical uncertainties related to Russia's invasion of Ukraine, which pose a longer-term threat to global food security. Over the next two to three years, the food crisis precipitated by the invasion of Ukraine is the largest concern if substitutes cannot be found quickly. This can be tricky. For example, the variants of wheat grown in Ukraine are winter wheats, which are harvested in late June to July. Today, much of the country is in turmoil, there is limited capacity to move what little harvestable crops are left, and many silos to store the harvest have been destroyed. A significant food shortage is likely in 2023, with underdeveloped economies most exposed. And if the invasion drags on till September or November, there will not be enough time for planting wheat in Ukraine for the following year. Making matters worse, Russia is the largest exporter of fertilizers, which are necessary for reliable harvests.

Over the long term, climate change is the key risk for global food security because more extreme weather will weigh on fresh produce supplies. Primary producers, particularly in lower-income economies where irrigation is less advanced, are highly reliant upon favourable weather to reap a good harvest. India's wheat export ban and Indonesia's palm oil export ban followed extreme weather events that dramatically reduced harvests.

The Week Ahead in the Global Economy

U.S.

Most of the focus in a busy week ahead will be on the Federal Open Market Committee. We expect the FOMC to increase the target range for the fed funds rate by 50 basis points. We don't anticipate a larger increase, even if the May CPI, released tomorrow, comes in hotter than expected. There will likely be some changes to the post-meeting statement, and the committee will release a new Summary of Economic Projections including the so-called dot-plot. The Fed recently cut its estimate of the neutral fed funds rate from 2.5% to 2.4%, and another reduction could occur at this meeting with the addition of new projections. Based on individual projections of the estimate of the neutral rate, it appears that the bulk of the Fed governors are at 2.25% while most regional fed governors are generally higher. If the two new Fed governors join their colleagues in their estimate of the neutral rate, the central tendency estimate will decline again in June. At 2.25%, the Fed's estimate would still be higher than the most commonly referenced model for estimating neutral fed funds, the Laubach-Williams model, which puts it closer to 2%.

Europe

The U.K.'s GDP likely recovered 0.2% m/m in April after pulling back 0.1% in March. Strong PMI data, particularly for the service sectors point to momentum holding up in the economy as businesses gear up for the summer. Retail sales likely grew 0.2% m/m in May. We expect there was a boost to shopping at the tail end of the month in light of preparations for the Jubilee. Supporting consumers, the labour market likely remained tight in the three months to May with the unemployment rate falling to 3.6% from 3.9% in the January stanza. We expect hiring picked up among accommodation and other consumer-facing services. Finally, the Bank of England will likely hike its Bank Rate 25 basis points to 1.25% at its meeting next week. The BoE is looking to get inflation and expectations under control as price-growth continues accelerating from one month to the next.

In the euro zone we expect no surprises in national CPI inflation measures for May. These will match preliminary estimates, with the rate rising to 7.9% y/y in Germany, 5.2% in France, and 6.9% in Italy. The HICP at the euro zone level will speed up to 8.1% y/y in May from 7.4% in the previous month. Oil and electricity prices will be important contributors to the acceleration, but food and core inflation will also accelerate due to supply issues and resilient demand as the pandemic abates. Separately, Industrial production likely saw a partial rebound in April, by 0.8%

m/m after a 1.8% drop in March. Output snapped back as supply normalized after a difficult March. Unfortunately, PMI readings and sector confidence continues to decline, which reflects growing weakness in the sector not just with regard to supply but also to demand. The euro zone's external trade deficit likely improved to €14.8 billion in April from €16.4 billion in March. We expect imports weakened thanks to lower energy demand due to the changing of the season.

Finally, Russia's GDP likely rose 3.5% y/y in the first quarter, following a 5% growth rate in the fourth quarter of 2021. The economy benefitted from Europe's desperation to keep energy supplies from running out.

Asia-Pacific

The Bank of Japan's monetary policy decision will be the highlight on the economic calendar. We expect no change in interest rate settings. The short-term interest rate is likely to stay at -0.1% and the 10-year bond yield target at "around 0%". Inflation in several Asian economies has accelerated in recent months, and the Japanese economy is also experiencing the effects of supply-side imported inflation. Although settings will remain steady, it will be important to see how the central bank adjusts its communication in response to that elevated supply-side inflation.

Consumer price inflation has increased on the back of higher prices for imported energy and food, which are beyond the BoJ's reach. With the economy still weak and little evidence of notable demand-driven price increases, the case for interest rate hikes is weak, which is why we expect the central bank to only tweak its forward guidance and fine-tune technical aspects of its operations. Even after Governor Haruhiko Kuroda's term ends in April 2023, the fundamental factors that have kept the BoJ at close to zero are unlikely to change materially.

New Zealand's first-quarter GDP growth is likely to have eased to 0.6% y/y from 3.1% in the prior quarter. The moderation in growth will likely reflect softer domestic spending following the Omicron-led resurgence in COVID-19 cases and the restrictions to curb the spread; higher borrowing costs will likely be a contributing factor through the rest of this year. Australia's unemployment rate is likely to settle at 3.8%, reflecting continued tightness in the labour market. China's factory and retail sales activity in May are likely to have recorded another month of declines in year-on-year terms, reflecting the hit to manufacturing and demand from extended COVID-19 restrictions imposed in key cities.

Geopolitical Calendar

Date	Country	Event	Economic Importance	Financial Market Risk
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
2-Oct	Brazil	Presidential and congressional elections	High	Medium
Oct	Indonesia	G20	Medium	Low
Oct/Nov	China	National Party Congress	High	Medium
7-Nov	U.N.	U.N. Climate Change Conference 2022 (COP 27)	Medium	Low

Fed Balance Sheet to Decline by About 520 Billion This Year

BY RYAN SWEET

CREDIT SPREADS

Moody's long-term average corporate bond spread is 146 basis points, 2 bps tighter than at this time last week. It is still narrower than the 159 bps average in May. The long-term average industrial corporate bond spread narrowed by 1 bp to 132. It averaged 144 bps in May.

The recent ICE BofA U.S. high-yield option adjusted bond spread widened from 413 to 434 basis points. It is still among the widest since late 2020 but off its recent peak of 482 bps. The Bloomberg Barclays high-yield option adjusted spread widened in the last week from 401 to 420 basis points. The high-yield option adjusted bond spreads approximate what is suggested by the accompanying long-term Baa industrial company bond yield spread and that implied by a VIX of 24.7. The VIX fell over the course of the past week.

DEFAULTS

The global speculative-grade default rate for the trailing 12 months declined to 1.9% at the end of April from 2.1% a month earlier. We expect the default rate to climb steadily over the next 12 months under our baseline forecast. However, the projected increase will be modest, and the default rate will remain below the long-term average.

Year to date, the global corporate default count remains higher than last year's (29 vs. 23). The banking sector accounts for the most defaults so far this year as a result of eight Ukrainian bank defaults in February, following Russia's invasion of Ukraine (Caa2 review for downgrade). Construction and building followed with seven defaults. Across regions, North America had 12 defaults (11 in the US and one in Canada). The rest were from Europe (nine), Asia Pacific (seven) and Latin America (one).

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 fared 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 fared 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 3, US\$-denominated high-yield issuance totaled \$8.9 billion. This brings the year-to-date total to \$90.4 billion. Investment-grade bond issuance rose \$33 billion in the week, bringing its year-to-date total to \$742.5 billion. Issuance is 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.

Euro Zone Inflation Almost at Target...Really

BY KAMIL KOVAR and ROSS CIOFFI

[Euro zone](#) inflation analysis stresses the record-breaking headline inflation rate, which is currently four times the inflation target. Adding that core inflation—which doesn't include volatile energy and food components—is also high, suggesting that inflation is rampant. However, if one takes a perspective that is more focused on the medium-term evolution of less sensitive components, then the euro zone inflation rate has only now returned to target after being below target for a long time.

To see this, start with the headline figure of 8.1%. This number mostly reflects the extreme runup in energy prices over the course of the last 12 months and especially their distinct jump following the Russian invasion of Ukraine. Moreover, in the last couple of months, energy prices have been seconded by the increase in food prices. Together, these categories account for 5.9 percentage points out of the 8.1% inflation rate. But even for the remaining two categories, nonenergy goods and services, the picture seems to be worrying: the year-ago inflation rate for these categories stands at 4.2% and 3.5%, respectively, resulting in a core inflation rate of 3.8%.

However, to a significant degree this reflects the normalisation of prices of goods and services after being depressed during the pandemic. Looking at a longer horizon than just one year reveals a picture that looks very different. Since the beginning of 2020, goods prices have increased by 4.8% and service prices by 4.7%. What increase would be consistent with the 2% inflation target over this period? 4.9%. So, over the period of the last two and a half years, goods and services prices have not increased excessively; they have increased exactly at a rate consistent with the inflation target.

This is one reason why we believe the European Central Bank is possibly overreacting to the recent inflation numbers. While it is true that the recent inflation dynamics are potentially worrying—the pace of price increases has accelerated over last several months, and a period of systematically low inflation is unlikely to return—the situation is much less worrying than it seems. Moreover, from the monetary policy perspective, a spell of high inflation is only a problem if it leads to inflation deanchoring through its effect on consumers' and firms' expectations and wage bargaining. Earlier in the year, the ECB was pointing to the absence of such developments in its argument for why tightening was not called for yet. Since then, not much has

changed in terms of expectations and wages. And yet, the stance of the ECB has shifted to rapid tightening. Only time will tell if this was a prudent shift.

ECB holds back on rates for now

The [European Central Bank](#) did not hike its policy interest rates at its meeting on Thursday. The main refinancing rate remains at 0%, its marginal lending rate at 0.25%, and its deposit rate at -0.5%. However, the Governing Council did make some clarifications about July.

As ECB President Christine Lagarde announced Thursday, net purchases under the bank's Asset Purchase Programme will end on 1 July. Maturing principal will be reinvested "for an extended period of time past the date when [the Governing Council] starts raising the key ECB interest rates". Later, Lagarde stated that the council is planning on hiking policy rates by 25 basis points at the 21 July meeting.

The ECB did not lay out an exact hike for the September meeting. That said, it left the door open to a larger rate hike. If the medium-term inflation outlook does not improve, a 50-basis point rate hike would be possible, instead of the previously expected 25-basis point hike. And, given that we think the ECB is still underestimating inflation this year, we believe it is more likely that the bank will be pushed into a 50-basis point hike at the September meeting.

The ECB's June forecasts expect inflation to rise to 6.8% in 2022 and decline to 3.5% in 2023, and then 2.1% in 2024. The ECB forecasts GDP growth to be 2.8% in 2022, 2.1% in 2023, and 2.1% in 2024. As of our June baseline, we forecast inflation to be higher in 2022 (at 7.3%) and GDP growth to be slightly lower (at 2.7%).

Q1 euro zone GDP revised upward

Final estimates revised the [euro zone's](#) GDP growth rate in the first stanza of the year up to 0.6% quarter over quarter from the originally estimated 0.3%. This comes on top of a 0.3% rise in the fourth quarter of 2021. The upward revision is nice to see, but we caution against an overly optimistic reading. Most of the growth was due to the jump in inventory investments, which were a result of supply issues and lockdowns. Net trade was the other significant contributor to the growth rate as imports fell back. Omicron weighed heavily on the winter economy, but we expect consumer spending to rebound for the spring and summer, providing a base for continued growth.

Australia's Central Bank in Catch-up Mode

BY KATRINA ELL and SHAHANA MUKHERJEE

The Reserve Bank of Australia is in catch-up mode after inflation surprised on the upside, and the central bank is moving more aggressively to normalise the cash rate. The bank surprised markets by hiking the cash rate by 50 basis points to 0.85% on Tuesday. The rate on exchange settlement balances was also lifted by 50 basis points to 0.75%.

Its view of what is driving stronger price pressures has evolved substantially in recent months. The central bank now acknowledges that it is not just about imported supply-side factors such as higher energy prices. Domestic factors are increasingly at play. In particular, the labour market is tight; the unemployment rate is sitting at its lowest level in almost 50 years. This is putting upward pressure on wage growth, particularly in the private sector where firms are needing to pay more to attract and retain talent. The change in tune is important. Previously, the RBA assumed that supply-side challenges abroad would be a temporary phenomenon; that is no longer the case.

Need to anchor expectations

Short-term inflation expectations for up to one year have been trending higher since September, so the RBA needs to act to anchor those expectations. Encouragingly, long-term inflation expectations remain within the 2% to 3% target range, confirming that it is feasible for the RBA to tame today's currently elevated inflation.

There is hysteria around higher borrowing costs in Australia. This is driven by Australian households being highly leveraged, as well as the fact that borrowing costs have been low for years; the last cash rate hike was in 2010. But hysteria isn't warranted. In its June statement, the RBA was at pains to confirm that the Australian economy is resilient and that the near-term outlook is upbeat even though downside risks remain. Now is the appropriate time to be withdrawing the extraordinary monetary stimulus that was introduced at the height of the pandemic. The economy has moved out of the depths of the pandemic, emergency fiscal stimulus has already been withdrawn, and it is necessary to remove that emergency monetary support.

The near-term monetary policy outlook is highly uncertain. The pace of rate hikes will be driven by how well households take the rate hikes in their stride; consumer sentiment is already weak, so it may not take much for households to meaningfully retreat.

The other uncertainty relates to Russia's invasion of Ukraine; if energy supplies are further constrained, the RBA and other central banks will need to move more aggressively to tame inflation depending on the length of the shock. Our June baseline assumes that the RBA will progressively hike the cash rate into 2023. The cash rate is assumed to be 1.75% in the December quarter.

India also raises rates

Toeing a similar line, the Reserve Bank of India raised the benchmark repo rate by 50 basis points in its June meeting. This was marginally above our expectations for a 40-basis point rate hike. It also follows a surprise off-cycle rate hike of 40 basis points to 4.4% in May that broke a pandemic-driven pause on interest rates and marked the first hike since August 2018. The reverse repo rate was left unchanged, but associated rates such as the standing deposit facility rate and the marginal standing facility rate were raised by 50 basis points to 4.65% and 5.15%, respectively.

Indeed, the central bank's sharp pivot towards interest rate normalisation comes as inflation concerns have intensified against the backdrop of fast-evolving geopolitical factors. High costs from elevated and volatile global oil prices, higher input costs owing to industry-specific shortages, trade restrictions as a consequence of Russia's invasion of Ukraine, and a domestic heat wave have driven up consumer prices. For Indian households, prices rose nearly 6% y/y—the RBI's upper tolerance limit—through the first quarter. Supply-side factors aggravated the price rise and saw wholesale prices soar 15% y/y in April and consumer inflation hit 7.8%; the May print is set to reflect continued strain.

Supply and other uncertainties

The June statement noted the uncertainty around supply conditions and global factors behind volatility in commodity and financial markets. The central bank also noted that although domestic demand had gained some traction and the economy remained resilient in the face of these headwinds, inflation pressures have become more broad-based and that upside risks to inflation have "materialised earlier than anticipated". The central bank retained its growth forecast at 7.2% for the fiscal year to March 2023 but increased its inflation forecast to 6.7% from 5.7% in the May announcement. Inflation is forecast to peak at 7.5% this quarter before gradually easing. However, it is forecast to remain above 6% through the rest of the calendar year.

The RBI is cautious in its monetary policy management

given the uneven economic recovery. Fiscal measures announced in May, including excise duty cuts, increased subsidies on certain imported raw materials and cooking gas, and export restrictions on sugar and wheat are intended to aid this process. However, it's unlikely that these measures can do much to moderate inflation. And given that select food, grain and vegetable supplies could see continued volatility before stabilising, a substantial cooling is not expected. Further, the impending pickup in goods and services spending will add to demand-driven pressures and aggravate price increases in coming months. Given the above, the central bank is right to take a conservative view

on near-term inflation.

The months ahead will likely see more fiscal and monetary policy coordination to mitigate the overall inflation hit to growth. Interest rate hikes will likely be paired with other steps to reduce liquidity in the system. How aggressively the RBI proceeds with rate hikes will depend on cost pressures. The RBI could hike the repo rate by another 60 to 80 basis points through the rest of the year. But these rate increases will need to be carefully calibrated to meet the central bank's increasingly difficult objectives of supporting growth and taming inflation.

Latest Changes Balance Upgrades, Downgrades

BY STEVEN SHIELDS

U.S.

U.S. credit rating changes in the latest period were distributed evenly between upgrades and downgrades. However, upgrades still comprised 82% of the total affected debt. Comstock, Resources Inc was the only speculative-grade company to receive an upgrade in the period with Moody's Investors Service raising its senior unsecured rating to B2 from B3.

The largest upgrade in terms of affected debt was issued to Dell International L.L.C. The technology company's senior unsecured rating was raised to Ba2 from Baa3, reflecting Dell's strong operating performance and governance considerations, including Moody's expectation that the company will maintain a strong financial profile supported by healthy earnings and a balanced financial policy over the next 12 to 18 months. The upgrade affected more than \$17.3 billion in outstanding debt.

Moody's Investors Service raised Hess Corp.'s senior unsecured ratings to Baa3 from Ba1. According to Moody's Senior Vice President Pete Speed, "The upgrade to Baa3 reflects Hess' visible growth in asset value, production and cash flow from its Guyana development that combined with its flexible Bakken operations position the company to weather future commodity price volatility with a cost competitive and durable asset portfolio."

PPL Corp., a utility company based in Allentown PA, rounded out this week's upgrades with its senior unsecured bond ratings raised one notch to A3.

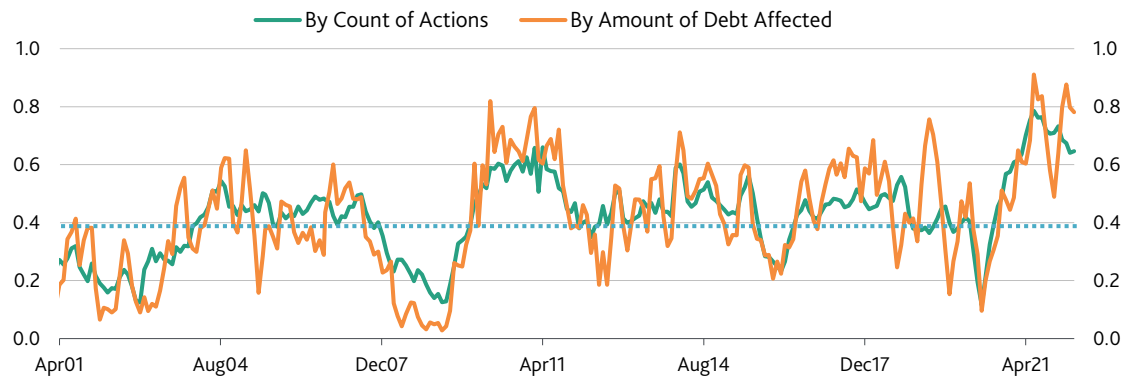
Europe

A similar trend occurred across Western Europe with four rating changes split between upgrades and downgrades. Moody's Investors Service upgraded the long-term issuer rating of Holcim Ltd. from Baa2 to Baa1 and revised the company's outlook from positive to stable. The upgrade is supported by firm construction activity across the globe brought on by the post-COVID-19 revival and state-funded stimulus programs. Moreover, the company has been successful so far in passing on cost inflation to its customers, pursuing active price increases across regions.

The largest downgrade in Europe was issued to Sigma Holdco BV. The Dutch company's B3 corporate family rating reflects the company's high financial leverage and Moody's Investors Service expectation that any reduction in leverage will be challenged by the currently high commodity prices. The company has been passing higher prices to customers since early 2021, which is resulting in volume contraction. Despite the uncertain economic landscape, Sigma's stable rating factors in its strong business profile, adequate liquidity, and the expectation that cash generation will improve in 2023, leading to a gradual reduction in leverage, according to Moody's.

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/S G
6/1/2022	ZOTEC PARTNERS, LLC	Industrial	SrSec/BCF/LTCFR/PDR		D	B2	B3	SG
6/2/2022	COMSTOCK RESOURCES, INC.	Industrial	SrUnsec/LTCFR/PDR	2215.00	U	B3	B2	SG
6/2/2022	CDK GLOBAL, INC. (NEW)	Industrial	SrUnsec	3200.00	D	Ba1	Caa1	SG
6/3/2022	ASSURANT, INC.	Financial	SrUnsec/LTIR/Sub/IFSR/CP		U	Baa3	Baa2	IG
6/3/2022	OREGON TOOL HOLDINGS, INC.	Industrial	SrUnsec/SrSec/BCF/LTCFR/PDR	300.00	D	Caa1	Caa2	SG
6/6/2022	PPL CORPORATION	Utility	SrUnsec/LTIR/JrSub/PS	3548.35	U	Baa1	A3	IG
6/6/2022	TPC GROUP INC.	Industrial	SrSec/LTCFR/PDR	1860.00	D	Caa3	C	SG
6/6/2022	DELL TECHNOLOGIES, INC.-DELL INTERNATIONAL L.L.C	Industrial	SrUnsec	17320.16	U	Baa3	Baa2	IG
6/7/2022	HESS CORPORATION	Industrial	SrUnsec	5586.29	U	Ba1	Baa3	SG
6/7/2022	GLATFELTER CORPORATION	Industrial	SrUnsec/LTCFR/PDR	1000.00	D	Ba2	B2	SG

Source: Moody's

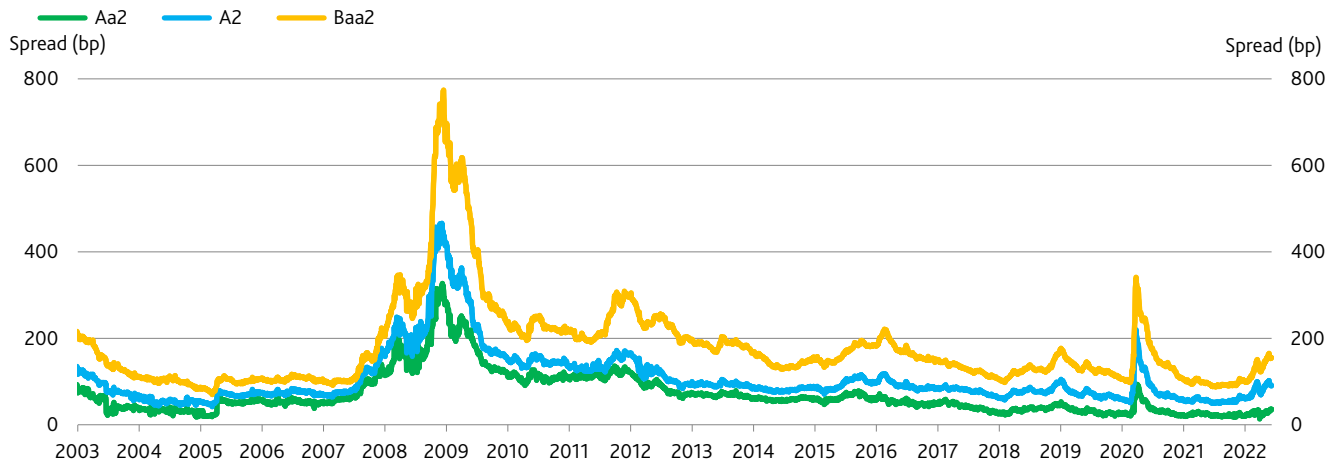
FIGURE 4
Rating Changes: Corporate & Financial Institutions - Europe

Date	Company	Sector	Rating	Amount (\$ Million)	Up/Down	Old LTD Rating	New LTD Rating	IG/SG	Country
6/1/2022	HOLCIM LTD.	Industrial	SrUnsec/LTIR/Sub/MTN	15909.47	U	Baa2	Baa1	IG	SWITZERLAND
6/1/2022	SIGMA HOLDCO BV	Industrial	SrUnsec/LTCFR/PDR	1259.46	D	Caa1	Caa2	SG	NETHERLANDS
6/3/2022	IDEAL STANDARD INTERNATIONAL S.A.	Industrial	SrSec/LTCFR/PDR	348.47	D	B3	Caa1	SG	LUXEMBOURG
6/7/2022	PREMIER FOODS PLC	Industrial	SrSec/LTCFR/PDR	413.23	U	B1	Ba3	SG	UNITED KINGDOM

Source: Moody's

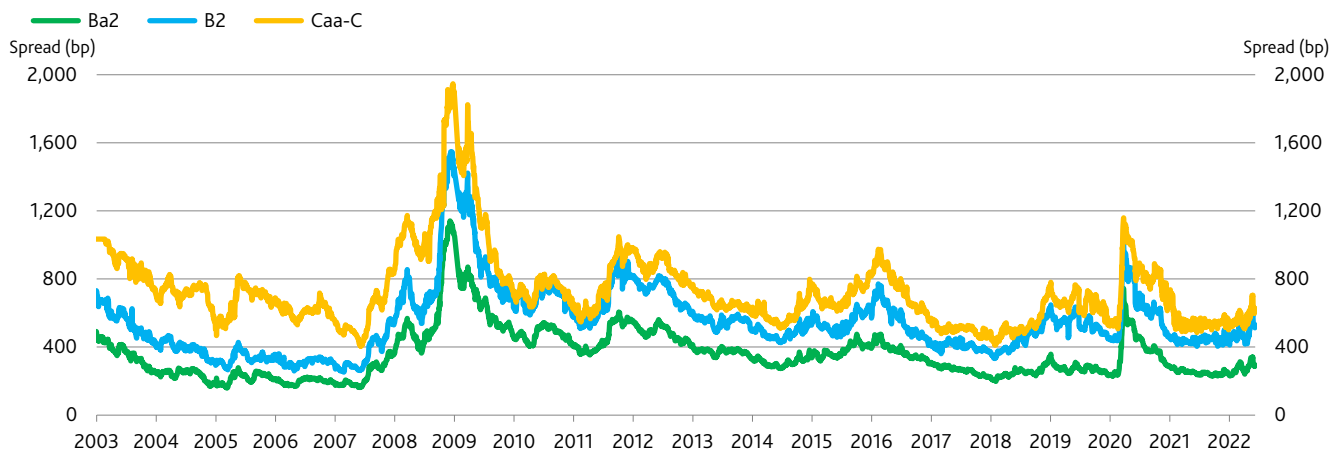
MARKET DATA

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 (June 1, 2022 – June 8, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
	Jun. 8	Jun. 1	Senior Ratings
Issuer			
Applied Materials Inc.	Aa3	A2	A2
JPMorgan Chase & Co.	Baa1	Baa2	A2
Toyota Motor Credit Corporation	Aa2	Aa3	A1
Apple Inc.	Aaa	Aa1	Aaa
John Deere Capital Corporation	A1	A2	A2
Microsoft Corporation	Aa1	Aa2	Aaa
Bristol-Myers Squibb Company	Aa1	Aa2	A2
Coca-Cola Company (The)	Aa1	Aa2	A1
PepsiCo, Inc.	Aa1	Aa2	A1
Union Pacific Corporation	Aa1	Aa2	Baa1

CDS Implied Rating Declines	CDS Implied Ratings		
	Jun. 8	Jun. 1	Senior Ratings
Issuer			
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			
	Senior Ratings	Jun. 8	Jun. 1	Spread Diff
Issuer				
American Airlines Group Inc.	Caa1	1,322	1,136	186
Staples, Inc.	Caa2	1,591	1,492	98
Royal Caribbean Cruises Ltd.	B2	763	674	90
Carnival Corporation	B2	794	721	72
Realogy Group LLC	B2	722	658	63
United Airlines Holdings, Inc.	Ba3	717	660	57
Kohl's Corporation	Baa2	458	407	51
Macy's Retail Holdings, LLC	Ba2	470	425	46
Delta Air Lines, Inc.	Baa3	412	371	41
United Airlines, Inc.	Ba3	678	639	39

CDS Spread Decreases	CDS Spreads			
	Senior Ratings	Jun. 8	Jun. 1	Spread Diff
Issuer				
K. Hovnanian Enterprises, Inc.	Caa3	1,010	1,089	-78
Gap, Inc. (The)	Ba3	578	602	-24
iHeartCommunications, Inc.	Caa1	436	457	-21
Nabors Industries, Inc.	Caa2	531	550	-20
United States Cellular Corporation	Ba2	205	225	-20
Rite Aid Corporation	Caa2	2,749	2,768	-19
Wendy's International, LLC	Caa2	225	244	-19
Dover Corporation	Baa1	100	118	-18
Univision Communications Inc.	Caa1	516	533	-17
American Axle & Manufacturing, Inc.	B2	568	585	-17

Source: Moody's, CMA

CDS Movers

Figure 4. CDS Movers - Europe (June 1, 2022 – June 8, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
	Jun. 8	Jun. 1	Senior Ratings
Issuer			
Alliander N.V.	Aa2	A1	Aa3
Rabobank	Aa1	Aa2	Aa2
Nordea Bank Abp	Aa2	Aa3	Aa3
Landesbank Baden-Wuerttemberg	Aa2	Aa3	Aa3
DZ BANK AG	Aa3	A1	Aa2
Svenska Handelsbanken AB	Aa3	A1	Aa2
Dexia Credit Local	Aa2	Aa3	Baa3
Swedbank AB	A1	A2	Aa3
DNB Bank ASA	Aa3	A1	Aa2
TotalEnergies SE	Aa2	Aa3	A1

CDS Implied Rating Declines	CDS Implied Ratings		
	Jun. 8	Jun. 1	Senior Ratings
Issuer			
Banco Bilbao Vizcaya Argentaria, S.A.	Baa1	A3	A3
NatWest Markets Plc	Baa2	Baa1	A2
Casino Guichard-Perrachon SA	Ca	Caa3	Caa1
FCE Bank plc	Ba2	Ba1	Baa3
Iceland, Government of	A2	A1	A2
Avon Products, Inc.	B1	Ba3	Ba3
United Kingdom, Government of	Aaa	Aaa	Aa3
Italy, Government of	Baa3	Baa3	Baa3
France, Government of	Aaa	Aaa	Aa2
Germany, Government of	Aaa	Aaa	Aaa

CDS Spread Increases	CDS Spreads			
	Senior Ratings	Jun. 8	Jun. 1	Spread Diff
Issuer				
Casino Guichard-Perrachon SA	Caa1	1,219	1,195	24
FCE Bank plc	Baa3	251	228	23
Boparan Finance plc	Caa3	1,938	1,915	23
Novafives S.A.S.	Caa2	1,153	1,130	23
Iceland Bondco plc	Caa2	943	924	19
CMA CGM S.A.	Ba3	416	401	15
CECONOMY AG	Ba1	455	441	14
Banco Bilbao Vizcaya Argentaria, S.A.	A3	76	64	11
Stena AB	B2	481	469	11
Jaguar Land Rover Automotive Plc	B1	689	680	9

CDS Spread Decreases	CDS Spreads			
	Senior Ratings	Jun. 8	Jun. 1	Spread Diff
Issuer				
Vedanta Resources Limited	B3	1,025	1,094	-69
SKF AB	Baa1	60	70	-10
Premier Foods Finance plc	B2	326	336	-10
Landesbank Hessen-Thuringen GZ	Aa3	64	73	-8
Bankinter, S.A.	Baa1	80	88	-8
Banca Monte dei Paschi di Siena S.p.A.	Caa1	418	424	-6
Renault S.A.	Ba2	353	358	-5
KBC Group N.V.	Baa1	99	103	-4
Banco Comercial Portugues, S.A.	Ba1	249	253	-4
BAWAG P.S.K. AG	A2	78	82	-4

Source: Moody's, CMA

CDS Movers

Figure 5. CDS Movers - APAC (June 1, 2022 – June 8, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
	Jun. 8	Jun. 1	Senior Ratings
Issuer			
Wesfarmers Limited	Aa2	A1	A3
Australia, Government of	Aaa	Aa1	Aaa
Korea, Government of	Aa2	Aa3	Aa2
Sumitomo Mitsui Banking Corporation	Aa3	A1	A1
Export-Import Bank of Korea (The)	Aa2	Aa3	Aa2
Westpac Banking Corporation	A1	A2	Aa3
National Australia Bank Limited	Aa3	A1	Aa3
Commonwealth Bank of Australia	Aa3	A1	Aa3
Korea Development Bank	Aa2	Aa3	Aa2
Thailand, Government of	Aa2	Aa3	Baa1

CDS Implied Rating Declines	CDS Implied Ratings		
	Jun. 8	Jun. 1	Senior Ratings
Issuer			
Pakistan, Government of	Ca	Caa3	B3
Tenaga Nasional Berhad	Baa1	A3	A3
Japan, Government of	Aaa	Aaa	A1
China, Government of	A3	A3	A1
China Development Bank	Baa1	Baa1	A1
India, Government of	Baa2	Baa2	Baa3
Indonesia, Government of	Baa2	Baa2	Baa2
Philippines, Government of	Baa2	Baa2	Baa2
Macquarie Bank Limited	A2	A2	A2
Macquarie Group Limited	Baa2	Baa2	A3

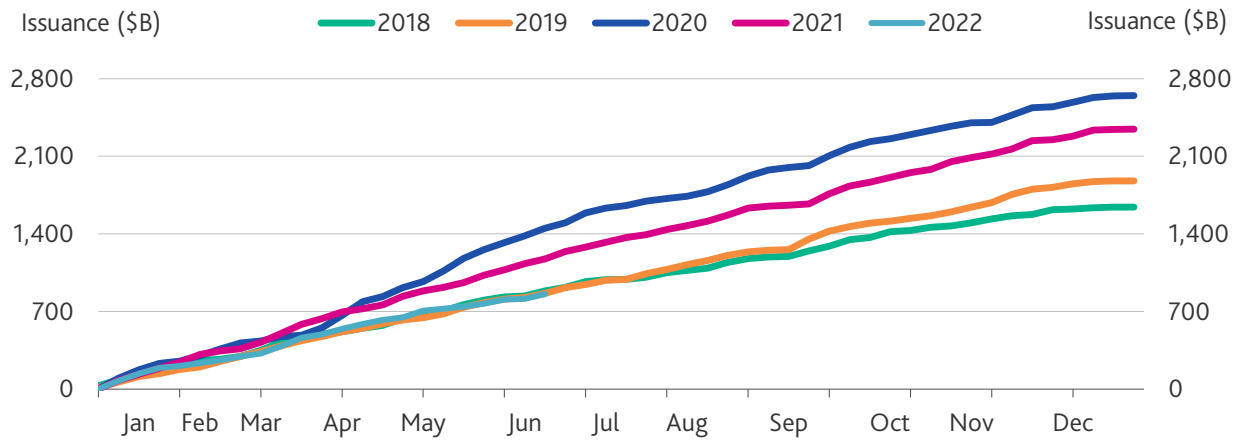
CDS Spread Increases	CDS Spreads			
	Senior Ratings	Jun. 8	Jun. 1	Spread Diff
Issuer				
SK Innovation Co. Ltd.	Baa3	131	126	5
India, Government of	Baa3	106	102	4
Export-Import Bank of India	Baa3	93	89	4
ICICI Bank Limited	Baa3	104	100	4
State Bank of India	Baa3	106	102	4
IDBI Bank Ltd	Ba2	100	96	4
Kazakhstan, Government of	Baa2	205	202	3
Woolworths Group Limited	Baa2	67	65	2
Malaysia, Government of	A3	75	75	1
Mitsubishi Corporation	A2	25	25	1

CDS Spread Decreases	CDS Spreads			
	Senior Ratings	Jun. 8	Jun. 1	Spread Diff
Issuer				
Halyk Savings Bank of Kazakhstan	Ba2	423	440	-18
Pakistan, Government of	B3	1,225	1,239	-14
Development Bank of Kazakhstan	Baa2	264	277	-13
Wesfarmers Limited	A3	45	52	-7
Suncorp-Metway Limited	A1	70	75	-6
SP PowerAssets Limited	Aa1	34	40	-6
Macquarie Bank Limited	A2	55	61	-5
Telstra Corporation Limited	A2	46	51	-5
Nissan Motor Co., Ltd.	Baa3	152	157	-5
Kansai Electric Power Company, Incorporated	A3	34	37	-4

Source: Moody's, CMA

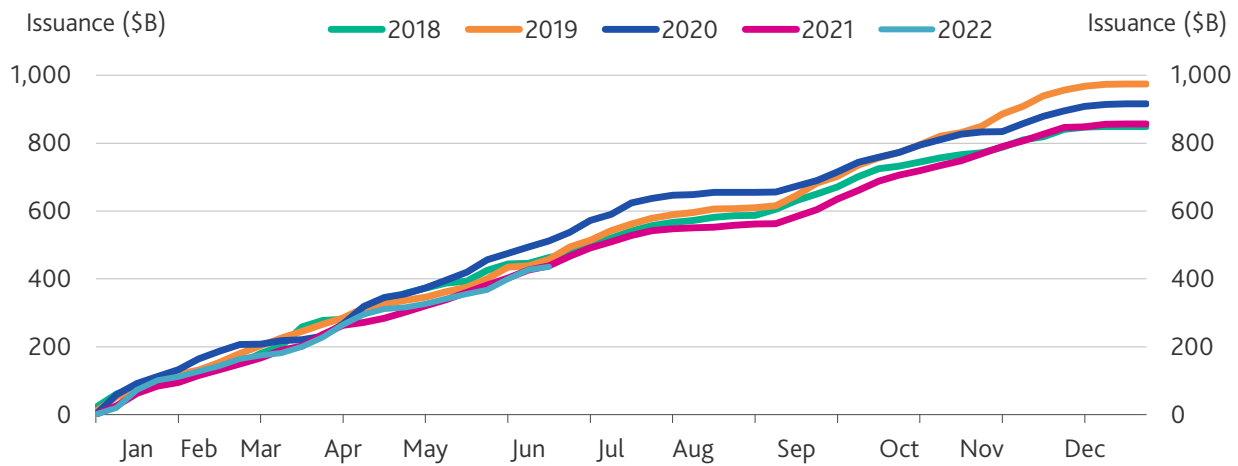
ISSUANCE

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	33.040	8.900	43.217
Year-to-Date	742.457	90.391	856.225

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount \$B	Amount \$B	Amount \$B
Weekly	6.903	1.075	8.348
Year-to-Date	403.804	24.399	435.627

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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