Moody's Analytics

WEEKLY MARKET OUTLOOK

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Clear Signs of Slowing

The Moody's Analytics high-frequency GDP estimate for the U.S. fourth quarter slid after a pair of disappointing datapoints on industrial production and retail sales were released. The latest estimate of 3.6% annualized growth in the final quarter of 2022 is down from 4.3%. The Bureau of Economic Analysis will release its preliminary GDP estimate for the fourth quarter next week.

There was nothing to like about December's industrial production report. Industrial production declined 0.7% from November to December, a much more severe contraction than the 0.1% decline Moody's Analytics and consensus expected. Further, November's figure was revised from -0.2% to -0.6%.

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The Federal Reserve is getting what it wants with industrial production falling sharply to close 2022. The pullback in production is owed to softening demand for goods. This dynamic has allowed upward price pressures to come down demonstrably. The risk, of course, is that the Fed gets too much of what it wants.

Fed Chair Jerome Powell has decomposed core inflation into three categories: core goods, shelter, and core services excluding shelter. Since delineating prices this way, core goods inflation has fallen steadily. Shifting consumer spending away from goods toward services and improvement in the functioning of supply chains have allowed prices to come in. Core goods prices fell 0.3% from November to December, pulling the year-ago rate down from 3.7% to a more comfortable 2.1%.

Retail sales also tumbled in December. Total sales fell 1.1% after dropping 1% in November and rising 1.1% in October. Three factors were at play: gasoline prices fell sharply, new-vehicle sales fell sharply, and holiday sales appear to have been modest at best.

The weakness in holiday sales had several drivers, including timing, as more sales appear to have occurred in October, the blow to budgets from sky-high inflation this year, and the shift in spending back toward services, which was encouraged by faster inflation in good prices until recently. The recent moderation in goods prices did weaken sales growth, however, and likely beyond just at gasoline stations.

Slowing and eventually pausing rate hikes is necessary for Fed officials to take stock of how previous tightening is affecting the economy. December's weaker-than-expected industrial production data, paired with a similarly downbeat retail sales report for the month, are the type of signals monetary policymakers are watching keenly. Last week's encouraging consumer price index data increased the likelihood that the Federal Open Market Committee's next meeting culminates in a reduction from December's half-point rate hike to 25 basis points. The latest data further solidifies that expectation. Futures markets place the probability that a quarter-point hike is announced in early February at more than 90%.

U.S. consumers turn a corner?

Consumer sentiment rose more than expected in January, according to the University of Michigan, maintaining the modest upward trend since it hit its record low in June. According to preliminary data, the index rose from 59.7 in December to 64.6 in January. Gasoline prices are about where they were a year ago but are moving higher, while equity prices are trending about flat and job gains remain healthy. The change from December was led by current conditions, which rose 9.2 points. The expectations component rose 2.1 points.

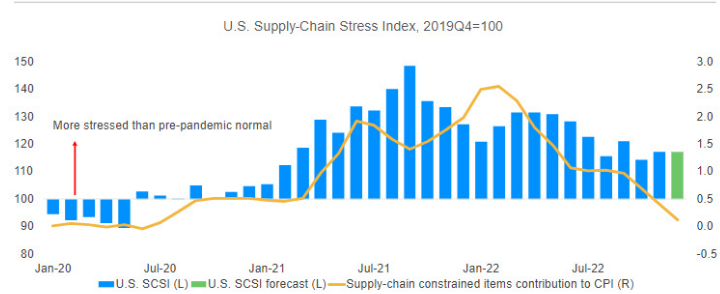
The University of Michigan consumer sentiment survey remains deep in recessionary territory despite confirming its upward trend in early January. It is at risk of dipping further as recent movements are mixed at best. Gasoline prices inched higher at the start of the year before turning recently. Equity prices are going nowhere. The labor market is strong but cooling modestly. Political dysfunction in Washington is a risk, as is the constant drumbeat of recession talk. Overall, the index remains close to its record low. It remains below where it started in 2022, below its trough in 2020 when the COVID-19 pandemic was at its worst, and consistent with levels seen in severe recessions historically. This seems inconsistent with abundant jobs and low unemployment. Adding to the weights, the Fed is still raising the fed funds rate, and all rates are much higher than a year earlier, increasing household borrowing costs and contributing to the decline in house prices in many parts of the country. Real incomes are inching higher but are still below stimulus-inflated levels in 2020 and 2021.

The low level of this index contrasts with most other measures of confidence, most notably the Conference Board. That measure remains above early-pandemic lows and is neither at a recessionary level nor near a record low. The Conference Board index tends to be more sensitive to conditions in the labor market, explaining its relative strength and suggesting something between the two may be more informative than either one individually.

Supply-chain stress eased through 2022

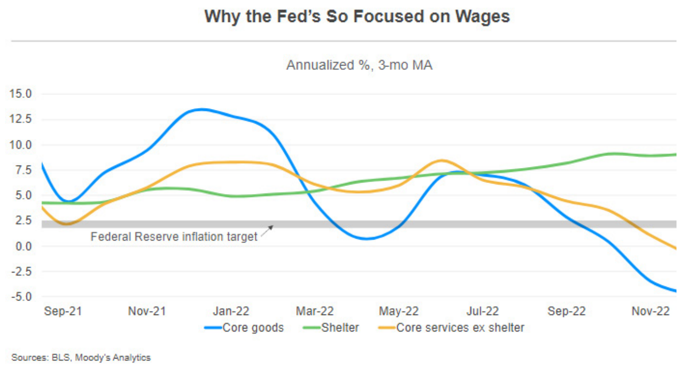
The constraints that plagued the early recovery from the COVID-19 pandemic have diminished significantly. The Moody's Analytics U.S. Supply-Chain Stress Index receded from the peak-stress levels of the latter half of 2021 to levels approaching pre-pandemic "normal" by the end of 2022. November's reading of 117.3 is a few points above October's 114.3 value but well below the 133.4 value observed a year prior. The improvement throughout 2022 is unlikely to reverse in 2023. Instead, weakening demand for goods will continue to allow inventories to be restocked and, in turn, prices to come down. Our aggregation of goods most affected by the pandemic supply crunch has seen a steady easing of price increases. By December, our supply-chain constrained CPI was contributing only minimally to inflation.

Supply-Chain Stress Reduction



Sources: Multiple sources, BLS, Moody's Analytics

Federal Reserve officials have bucketed price growth into three groups. The first is core goods. This measure excludes food and energy and captures many of the notable products that saw rapid price increases amid shortages, delays and other supply issues in 2021 and 2022. After peaking at 12.4% in February 2022, year-ago price growth for core goods has slowed demonstrably, landing at 2.1% by December. The second group is shelter prices. While this was a substantial source of inflation in December, the near-term outlook is less concerning. Private sector data on rent asking prices, which had been increasing rapidly, showed a fairly dramatic halt in late 2022. This slowdown in price increases will show up in inflationary data later this year. The final group is core services excluding shelter. This is an attempt to look at inflation within labor-intensive service industries. Elevated inflation here is likely to be driven by heady wage growth.



At the start of 2022, factors such as backlogged ports, truck-driver shortages, and intermittent disruption at Chinese factories caused by the government's zero-COVID policy were the primary drivers of inflation. The dynamics shifted meaningfully by early 2023. Wage data, like the employment cost index scheduled for release later this month, will offer the clearest signal about where inflation is headed and what the Fed will need to do to bring it under control.

TOP OF MIND

Return of the U.S. Debt Limit

BY BERNARD YAROS

The U.S. government hit its statutory borrowing limit on Thursday, setting the stage for a monthslong political fight in Washington DC with high economic stakes. The debt limit is the maximum amount of debt that the Treasury can issue to the public or to other federal agencies. In December 2021, lawmakers raised the debt limit by $2.5 trillion to $31.4 trillion.

Thursday is not a hard deadline for lawmakers to address the debt limit. The Treasury will be able to continue paying its bills by employing extraordinary measures and drawing down its cash on hand. Extraordinary measures are accounting sleights-of-hand, which reduce the level of intragovernmental debt (Treasury securities held in government accounts) that would otherwise count against the statutory limit. On Thursday, the Treasury began targeting intragovernmental debt held by the Civil Service Retirement and Disability Fund and the Postal Service Retiree Health Benefits Fund. In January, the Treasury is also expected to start suspending the daily reinvestment of Treasury securities held by the Thrift Savings Plan's G Fund, which contains contributions made by federal employees to their retirement. By itself, the G Fund will provide the Treasury nearly $300 billion in headroom under the debt limit.

Thursday is still a milestone, as the countdown clock for lawmakers to cobble together an agreement to raise or suspend the debt limit will start ticking. The Treasury cannot stay under the statutory limit indefinitely. If Congress fails to address the debt limit, the Treasury will eventually use up the extraordinary measures at its disposal and run out of cash. At that point, it will be unable to meet its financial obligations in full or on time, and an unprecedented default by the federal government will ensue.

Forecasting the length of time the Treasury can forestall a default by tapping into extraordinary measures and its cash on hand is always an intrepid affair. It requires making assumptions about federal payments and receipts months in advance. Uncertainty around the upcoming tax filing season, student loan policy and the effects of recent fiscal legislation, and the state of the economy make such forecasting even more challenging this year. According to Treasury Secretary Janet Yellen, the Treasury is unlikely to exhaust the cash and extraordinary measures at its disposal before early June. Our preliminary outlook is that the Treasury could run out of cash and default as early as August. However, if the Treasury makes it to September, a mid-month windfall of corporate tax revenue will likely push back the drop-dead date for lawmakers to avert a default to early October.

Political brinkmanship over the debt limit is a dangerous game to play. A default would be a body blow to the economy. Financial markets would be roiled, and proposed workarounds to the debt limit such as prioritizing Treasury payments to bond holders, minting a trillion-dollar platinum coin, or invoking the 14th Amendment would do little to subdue the ensuing chaos.

Starting next month, Moody's Analytics will revive its U.S. debt-ceiling tracker to provide a regular update of the estimate of the drop-dead date for lawmakers to address the debt limit or else risk a federal government default. The tracker will also monitor negotiations between House Republicans and the White House, which will ramp up as we head into the summer.

The Week Ahead in the Global Economy

U.S.

The U.S. economic calendar is packed in the back half of next week. On Thursday, the Bureau of Economic Analysis will release the first estimate of fourth-quarter GDP. We expect that growth will have remained strong and north of 3% on an annualized basis as a favorable trade balance continues to provide a tailwind to growth.

Data on new-home sales and pending home sales will reflect a housing market that is being crushed by a lack of affordability and still-rising interest rates.

We will also continue to pay close attention to initial jobless claims as the timeliest indicator of changes in the labor market. Claims fell sharply in the most recent data and remain well below our estimate of the break-even level, or that consistent with no monthly job growth. While weaker hiring will certainly play a role in the future path of the labor market, it is hard to imagine a significant deterioration occurring without a meaningful uptick in layoffs and unemployment insurance claims.

Other key data will include the Conference Board leading economic indicators index, advanced durable goods, advanced international trade, personal income, and personal spending.

Europe

We'll be covering few releases next week and will keep an eye on the jobs figures for France and Spain. In France, we expect the number of job seekers in December was nearly unchanged from November at 2.8 million. Job demand likely held up amid the lead up to the holiday season, the first month without social distancing or lockdown measures since before the pandemic. However, we do expect the labour market to begin showing some strain in the new year with slight increases in unemployment in the first quarter of 2023. High inflation and slumping demand will lead to layoffs.

Spain's unemployment rate likely inched lower during the fourth quarter, to 12.5% from the previous 12.7%. The same dynamic explained for France is supporting Spain's labour market, and the slowdown in demand will dull progress in the new year

Asia Pacific

Australia's headline CPI growth likely peaked in the December quarter with a 7.8% quarter-on-quarter rise, following 7.3% in the third stanza. We expect inflation to gradually trend lower over 2023, not returning to the Reserve Bank of Australia's 2% to 3% target range until early 2024. Upward contributions will come from energy costs, while lower new-dwelling prices will only be a partial offset. Underlying inflation is also elevated but will also trend lower over the year as tighter monetary settings filter through, capping exuberance in household consumption.

We expect the RBA will forge ahead with a further 25-basis point hike in February, that would bring the cash rate to 3.35% and total cumulative tightening since May 2022 to 325 basis points.

The Bank of Thailand will continue with its gradual monetary policy tightening. We look for the policy rate to increase by 25-basis points to 1.5%. Headline inflation looks to have passed its mid-2022 peak, while core inflation is gradually gathering pace. Domestic demand has received a lift from international borders reopening but foreign arrivals remain well short of pre-pandemic levels.

Geopolitical Calendar

Date	Country	Event	Economic Importance	Financial Market Risk
18-Jan	Japan	Bank of Japan monetary policy announcement	Medium	Low
7-Feb	Australia	Reserve Bank of Australia monetary policy announcement	Medium	Low
8-Feb	India	Reserve Bank of India monetary policy announcement	Medium	Low
March	Beijing	National People's Congress	High	Medium
7-Mar	Australia	Reserve Bank of Australia monetary policy announcement	Medium	Low
23-24-Mar	European Union	European Council summit	Low	Low
10-Mar	Japan	Bank of Japan monetary policy announcement	Medium	Low
2-Apr	Finland	General election	Medium	Low
4-Apr	Australia	Reserve Bank of Australia monetary policy announcement	Medium	Low
28-Apr	Japan	Bank of Japan monetary policy announcement	Medium	Low
April	Solomon Islands	General election	Low	Low
May	Thailand	General election	Low	Low
29-30-Jun	European Union	European Council summit	Low	Low

THE LONG VIEW: U.S.

Credit Spreads Stabilize

BY STEVEN SHIELDS

CREDIT SPREADS

Corporate credit spreads have stabilized after narrowing considerably last month. Moody's long-term average corporate bond spread averaged 149 basis points this past week, largely unchanged from December's average of 148bps. The long-term industrial corporate bond spread widened 1 bp to 127 bps. This compares with the 144 bps and 126 bps in November and December, respectively.

The ICE BofA U.S. high-yield option adjusted bond spread of 425 basis points is firmly below its twelve-month high of 599 bps recorded in July. The high-yield option adjusted bond spread mirrors what is suggested by the accompanying long-term Baa industrial company bond yield spread.

DEFAULTS

Eight Moody's-rated corporate debt issuers defaulted in December, up from five in November, closing out a challenging year for fixed-income markets as the macroeconomic environment worsened and financing conditions tightened. The global speculative-grade default rate edged up to 2.8% for the trailing 12 months ended in December from 2.6% in November.

The December defaulters included two more China property companies, pointing to the continuing credit risk in this sector resulting from the real estate downturn in China. The two defaulters were Times China Holdings Limited and Dexin China Holdings Company Limited. We expect recent policy support from Chinese authorities to boost funding conditions for financially strong developers but not financially weak ones as creditors and investors remain selective.

U.S. defaults picked up in December, with five defaults of rated issuers, up from three in November and two in October. The defaulting companies were Diebold Nixdorf Inc (technology), BW NHHC Holdco Inc (healthcare), Rite Aid Corporation (retail), Moran Foods LLC (wholesale) and Screenvision LLC (media). Distressed exchanges will likely continue to be prevalent among U.S. defaulters, particularly for low-rated firms owned by private equity, for whom this default type is more common.

The default tally in 2022 was 90, up from 55 a year earlier. The construction & building sector had the most defaults, with 23, all from China. Banking followed with 10 (eight from Ukraine, one from Poland and one from Angola). By region, North America had 38 defaults (35 in the US and three in Canada). The rest were from Europe (24), Asia-Pacific (23), Latin America (four) and Africa (one).

Corporate defaults will rise in 2023 as macroeconomic growth slows and financing conditions weaken, which will erode corporate earnings and cash flow. U.S. inflation, as measured by the year-over-year change in the consumer price index, has eased from its recent peak of 9.1% but remained high at 6.5% in December. As a result, we expect the fed funds rate to increase further this year. Under our baseline scenario, Moody's Credit Transition Model predicts that the global speculative-grade default rate will climb to 5.1% in 2023. At this level, the default rate would surpass the historical average of 4.1%. The 2023 default rate forecast considers the ramp-up of rating downgrades in the fourth quarter of 2022. Europe.

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.

Third-quarter issuance declined further as higher interest rates weighed on lending activity. Worldwide offerings of investment grade corporate bonds totaled $505 billion, down 30% year over year. US$ denominated high-yield corporate bond issuance clocked in at $21 billion in the third quarter. High-yield issuance declined approximately 84% on a year-ago basis

Fourth-quarter corporate debt issuance remained suppressed. US$-denominated high-yield issuance ended the year at $2.47 billion, reflecting a drastic 77% decline from 2021. Meanwhile investment-grade bond issuance totaled $1.29 trillion in 2022, a 20.8% decline from 2021. Over the past 12 months total US$-denominated issuance has tracked at a near-decade low.

There was $3.05 billion in high-yield debt issuance this past week. This brings the year-to-date total to $5.8 billion. US$-denominated investment-grade issuance, meanwhile, totaled $40.9 billion in the week. Cumulative issuance in the first two weeks of the year was roughly $30 billion less than the total achieved over the same period last year. Moody's Investors Service expects issuance volumes will be driven by some return to refinancing activity in 2023, but this will be limited, especially in the first half of the year because of relatively low levels of maturing debt. However, the maturity wall is higher for 2024 and Moody's expects most companies to address these maturities a year in advance.

U.S. ECONOMIC OUTLOOK

We made minor adjustments to the U.S. baseline forecast in January as new data and tweaks to our monetary policy adjustments altered the outlook slightly. Fundamentally, the outlook remains the same. Given the Federal Reserve's rhetoric, we pushed the first cut in the federal funds rate back one meeting into 2024. Its aggressive increases are taking a toll on housing markets though perhaps less than desired on labor markets. The economy remains vulnerable to falling into recession this year, an increasingly widespread expectation judging by various surveys of economic forecasters and other commentators. Views on the timing and severity of a possible downturn vary considerably, although in general the consensus holds that if it were to happen, it would be mild.

Fiscal assumptions

Federal government spending added 0.2 percentage point to annualized real GDP growth in the third quarter. This was the first positive contribution from federal spending last year after subtracting 0.4 and 0.2 percentage point from growth in the first and second quarters, respectively. An alleviation in cost pressures for the Pentagon and a rebound in nominal nondefense expenditures supported real federal spending in the third quarter.

The U.S. Treasury budget deficit will shrink from 5.5% of GDP in fiscal 2022 to 4.2% in fiscal 2023 and 2024. However, federal fiscal conditions will deteriorate over the next decade. An aging population will apply upward pressure on entitlement spending, while higher interest rates and a larger debt load will boost net outlays for interest. The Congressional Budget Office estimates that net interest payments will exceed defense spending in fiscal 2029. Consequently, the Treasury budget shortfall will increase to 5.7% of GDP by fiscal 2032. Meanwhile, the debt-to-GDP ratio will rise from 97% in fiscal 2022 to 112% in fiscal 2032. Longer term, lawmakers will pass a medley of entitlement, tax and immigration reform to put the federal budget on a sustainable trajectory.

Despite the significant buildup of federal debt during the pandemic, lawmakers will not pass budget cuts as they did after the Great Recession. While fiscal austerity may not be as much of a risk, a divided Congress will not enact any economic support if the economy falls into a recession in 2023.

Energy price forecast and assumptions

Moody's Analytics has revised its oil and gas price forecasts through 2024. The most significant changes to the oil price forecast occur in the first half of 2023. Preparation for the European Union sanctions that took effect in December has mitigated the fallout on oil prices and created relief selling. This is because many major oil importers secured their oil supplies ahead of time to ensure the implementation of sanctions did not disrupt their economies.

In the past month, weak demand has also led to substantial oil price erosion. U.S. oil demand is 7% lower than it was a year earlier. This is demand destruction resulting from the cumulative effect of high oil prices. Warm weather is another reason for weak demand; Northern Hemisphere heating degrees through this point in the winter are among the lowest of the past 20 seasons.

Our natural gas price forecast has been reduced from $7 per million BTUs to $6.25 in the first half of 2023. We view the recent collapse as weather-driven and temporary. Liquefied natural gas contract prices are still much higher than current Henry Hub prices. However, arbitrage opportunities are unavailable because the Freeport LNG hub is still offline, German gas inventory is essentially maxed, and there is a lack of infrastructure to receive more U.S. cargo. Germany recently did welcome the first LNG carrier at its new Wilhelmshaven terminal, which portends the capability of the EU to quickly replace Russian trade with greater trans-Atlantic ties.

Minor changes to GDP growth

U.S. GDP rose 3.2% in the third quarter, according to the Bureau of Economic Analysis' third estimate, more than reversing the declines over the prior two quarters. Trade was a major, if temporary, support to growth, with consumer spending, business investment and government spending also contributing. Inventories and housing investment were major drags on growth.

Revisions to the baseline forecast for real GDP growth are modest. The forecast for real GDP now shows nearly steady growth in the final quarter of 2022 but much less growth in the first quarter of 2023. Annual growth in 2022 and 2023 is 2.1% and 1.3%, respectively, modestly higher than last month, mostly because of the stronger fourth quarter of last year. Growth in 2024 was revised up slightly to 2.1%, and growth in 2025 was unchanged at 2.7%. Both figures still suggest an economy returning to near-potential growth.

Business investment and housing

Business investment decelerated substantially in the first half of 2022 amid the tightening by the Fed and the uncertainties caused by the Russian invasion of Ukraine. However, since then, the pace has been more buoyant than expected. Revised BEA data show that total real capital spending in the third quarter rose 6.2% annualized, compared with the initial published figures of 3.7% in the advance estimate and 5.1% in the second release. Further, after jumping in August, nondefense capital goods shipments adjusted for inflation continued to rise through November and are now back to their highest point since May 2019.

On balance, the outlook for total real business investment is little changed from the December forecast. Real investment will rise by 5.2% on an annual average basis in 2023, with equipment spending rising by 4.7%. Structures will finally begin to rebound, but spending will remain well below what it was back in 2019 for a long time.

House prices are expected to continue their recent decline, falling 10% from peak to trough nationally and as much as 20% in some markets. While applications for construction permits and housing starts will remain depressed, building activity will continue throughout the year, given the large number of housing units that remain under construction because of supply-chain bottlenecks. The delivery of additional multifamily properties will place downward pressure on rents and help address the nation's housing deficit.

Labor market

The labor market remains resilient but is slowly moderating. Payroll employment was in line with our expectations in December, rising by 223,000, while the October and November figures were revised modestly lower. The average gain for the past three months of 247,000 shows a downward trend. The average for the prior three months was 366,000.

Our forecast is for the unemployment rate to rise steadily this year after averaging 3.6% in the fourth quarter. The unemployment rate will average 4.1% in the final three months of 2023, slightly lower than the 4.2% in the December forecast and just below the 50-basis point increase that has coincided with every recession. The unemployment rate will fall slightly in 2024, averaging 3.9% in the fourth quarter, identical to that in the December baseline.

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%. Demographic headwinds have kept the overall participation rate below that threshold. However, with the other two conditions met and nominal wage growth still running near 5%, it is safe to say the economy is at full employment.

Monetary policy

Interest rates will continue to rise in early 2023 as the Federal Reserve remains committed to its fight against inflation. However, policymakers slowed the pace of hiking to 50 basis points at the Federal Open Market Committee's December meeting, raising the target range for the federal funds rate to 425-450 basis points. The slowdown follows signals that inflation is moderating, most notably evidenced by two consecutive better-than-expected CPI reports in November and December.

Our assumptions for the policy rate in the January outlook are similar to the previous baseline. Like in December, we expect 25-basis point increases to the feds fund rate at the January and March FOMC meetings. Therefore, our terminal fed funds rate projection in 2023 still falls just shy of 5%. We expect the Fed to keep rates at this level before cutting them at the first FOMC meeting in 2024. This is a slightly more contractionary outlook than in the previous baseline, which had the first cut at the December meeting this year. Monetary policy will remain restrictive through the end of 2025, when the fed funds rate returns to its neutral rate.

The baseline outlook reflects our expectation that inflationary pressures from supply-side frictions, energy markets, shelter, and U.S. labor market conditions will continue to soften throughout the year. The path for the Fed remains narrow: Policymakers cannot ease up too early and have repeatedly pointed to tight financial market conditions as the central monetary policy mechanism to dampen demand. Hawkish rhetoric at the December meeting reflected this concern; however, as U.S. demand is showing signs of sustained cooling, keeping interest rates too high for too long risks choking off the expansion and pushing up unemployment.

Inflation, thus, remains the key to the baseline outlook. The January vintage has the CPI rising 8% in 2022, 4% in 2023, and 2.4% in 2024, a rounding difference down from the prior baseline. The assumptions around moderating inflation have not changed and include a reduction in U.S. supply-chain stress, below-potential GDP growth, declines in global energy prices, and moderating nominal wage growth.

THE LONG VIEW: EUROPE

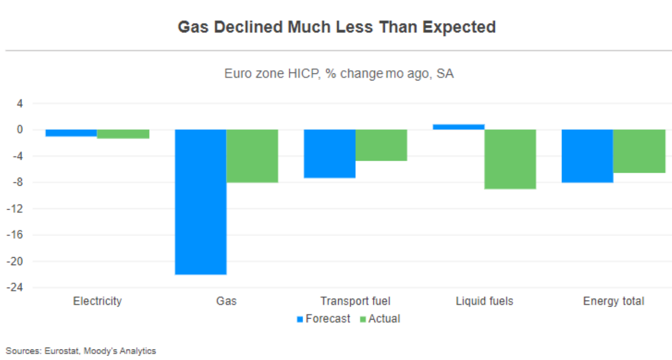
Good News on Euro Zone Inflation

BY KAMIL KOVAR

The final release on December inflation in the euro zone confirmed the preliminary estimate of a 9.2% year-over-year rate for the month, down from 10.1% in November. But attention to the release has focused on the details rather than the lower topline figure. Beyond slowing topline inflation, those details are a cause for added optimism about euro zone inflation in coming months.

Not so much about natural gas

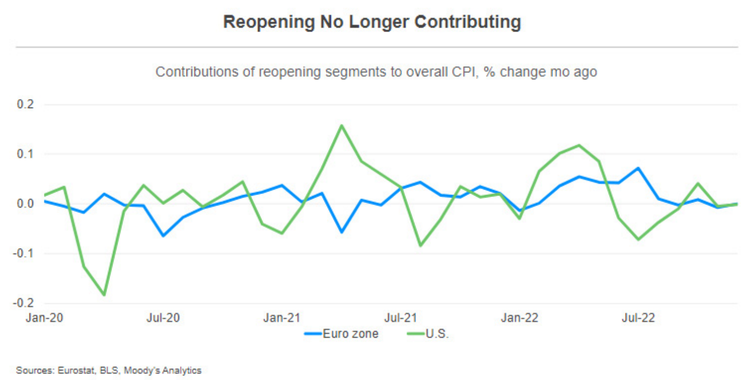
The preliminary release earlier this month made it clear that the energy component was the main driver of the decline in inflation, but only in the final release did we receive very positive details behind the decline in energy prices. While originally we thought that the German government intervention in gas markets played major role, it turns out that role was much less significant. German gas prices recorded by Destatis declined just 22% despite the government paying all consumer bills. Meanwhile, other countries' gas prices recorded declines only in low single digits; together, this translated into an 8% decline, compared with our expectation of a more-than-20% decline.



The reason this is good news is that gas prices will not be a major force pushing up inflation in coming months. True, measured German gas prices will increase in January, but likely not as much as feared, especially given that part of the intervention effect may be reflected in January. Moreover, since gas prices in other countries did not decrease by much in December despite a huge drop in wholesale prices over the course of the autumn, there will be further good news in the retail gas subcomponent of CPI in coming months.

Reopening effects wane

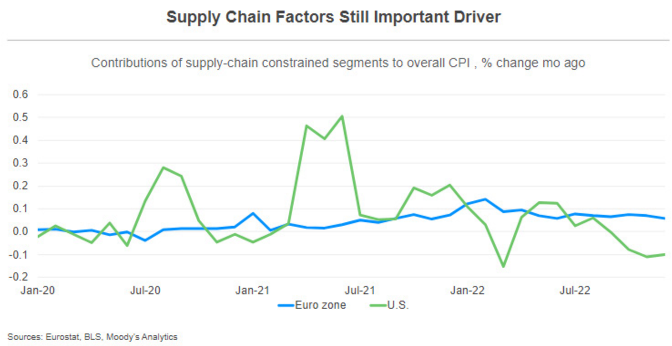
By far the best news in the December preliminary report came from service prices, which recorded their third-smallest monthly increase of last year. Where was this moderation coming from? One part of the story is the fading effect of the post-pandemic reopening. Throughout the spring, prices of travel-related services pushed higher as pandemic restrictions abated, which led to a surge in demand with a spike in energy prices contributing. Flight ticket prices were the poster child for this; they rose to levels far above previous historical highs.



December confirmed that this effect is now clearly in the past; it was the third month in a row in which reopening had virtually zero impact on the overall monthly inflation rate. The bigger question is whether the reopening effect will shift into reverse soon, as it did in the U.S. last summer. On this, there were potential good signs with international flight tickets recording their first meaningful decline since the depth of the Omicron variant of COVID-19 wave. Combined with lower fuel prices, this trend could accelerate in coming months, when demand for flights is weaker. Given that international flight ticket prices are 30% above their pre-pandemic level, this could become a major drag on service inflation. More broadly, the overall transport category, not just airline tickets, was the main driver of lower service inflation, and there are good reasons to expect this to continue. On the other hand, December benefited from several one-off declines which will not be repeated in coming months.

Supply-chain factors still strong

In contrast to services, core goods prices continued their recent increases because of the usual culprits. Unlike the U.S., nothing much has changed in the euro zone core goods prices category over the past half year. For the most part, the contribution of supply-chain constrained components such as car prices and furniture to the overall inflation rate has barely decreased since spring.



But even these developments can be interpreted in a positive light. While euro zone used-car and furniture prices are showing dynamics that are very different from the U.S., there are reasons to believe that eventually they will catch up. Indeed, there are indications elsewhere that prices for these goods may have started declining already. So the question is when rather than if used-car and furniture prices will return some of the double-digit gains they made over 2021 and 2022. The same dynamics we are now observing in the U.S., where declining used-car prices are an important driver behind lower inflation readings, might eventually come to the euro zone, though with significantly less strength.

Less broad

These improvements can also be seen in the breadth of inflation, abstracting from the volatility in individual components. Both the median and trimmed-mean monthly inflation rates were the second-lowest this year, after November. Similarly, the combined weight of categories with extremely high monthly inflation rates is now much lower than during the summer months.

These trends will almost surely be interrupted in January, when firms update their price lists for the coming year, but February should show a return to slowing inflation. Moreover, with February and March both featuring large base effects from last year, the headline inflation rate is sure to drop. The question is whether this will be enough to persuade the European Central Bank to end its tightening campaign, and here the good news ends. The focus of the ECB will now shift to the core inflation rate, which is not expected to decline measurably before spring. Therefore, more interest rate hikes are almost sure to come.

Bank of Japan Plays It Cool

BY STEFAN ANGRICK

The Bank of Japan's decision to hold monetary settings steady at Wednesday's policy meeting matched our expectations. The surprise tweak to its yield-curve control corridor in December had generated speculation about further adjustments. The BoJ's quarterly Outlook Report, released alongside the policy statement, showed that board members raised their forecast for consumer price inflation in fiscal 2022 (ending 31 March 2023). Tokyo CPI data for December 2022 showed inflation at 4% that month, driven predominantly by higher prices for imported food and energy. The board's inflation forecast for fiscal 2023 was unchanged, reflecting government measures to reduce prices. The forecast for fiscal 2024 was raised, as the expiry of those measures will see base effects lift inflation.

The BoJ board lowered its forecasts for real GDP growth across fiscal 2022, 2023 and 2024. The Outlook Report points to the slowdown abroad as a key factor behind the weaker forecast, but it notes government policy will provide some level of support. The fading of that support is cited as a reason for a weaker growth print in 2024. The significant downward revision in GDP growth rates relative to the BoJ's October Outlook Report raises some questions around the durability of inflationary momentum; it's stronger domestic demand and growth that's supposed to bring about more sustainable demand-driven inflation over the medium term.

With the end of Governor Kuroda's term approaching, our baseline case is for the BoJ to keep policy on hold. But after the turbulent weeks since the policy tweak in December, there's a high chance of surprises this year. The December decision to widen the corridor around the 0% long-term bond yield target to ±50 basis points from ±25 bps was followed by a lot of head-scratching. As Kuroda insisted, the rationale was to improve bond market functioning, not tighten policy. But yields subsequently surged, forcing the BoJ to buy increasingly large quantities of bonds in defence of its 10-year target. Whether there is a difference between unintentional tightening and intentional tightening is a question for the philosophers. What we do know is speculation about further policy changes abounds. Illustrating this, government bond yields briefly overshot the upper limit of the new YCC corridor in recent days. The yen dropped noticeably to ¥131 to the dollar after the policy statement from ¥128.5 beforehand.

The recent run of data hardly screams for tightening. Demand-driven price pressure remains preciously scarce. Inflation is largely imported and set to come down once the terms of trade stabilise and policy measures reducing prices kick in. The yen is well past the nadir of ¥150 to the dollar recorded in October. Global inflation has peaked, and central banks abroad are slowing rate hikes as growth decelerates. Also, Japan's economy remains notably smaller than before the pandemic. Although the course of policy beyond the end of Governor Kuroda's term in April will depend on personnel decisions, it's hard to see what could justify a broader move away from low interest rates generally. The factors that have kept Japanese policy rates close to 0%—especially the lack of robust wage growth—are unlikely to change soon. A strong result for the shunto spring wage negotiations this year would be a welcome development, but sustained demand pressure requires more than a single year of robust wage gains.

RATINGS ROUNDUP

Continued Deterioration

BY STEVEN SHIELDS

U.S.

U.S. corporate credit quality continues to deteriorate with downgrades accounting for the bulk of rating changes in the latest period. For the week ended January 18, credit downgrades accounted for nine of the 11 rating changes issued by Moody's Investors Service.

The most notable downgrade was issued to PM General Purchaser LLC. Its corporate family rating fell to Caa1 from B3, while its senior secured rating dropped to Caa1 from B3. The lower ratings reflect the continued deterioration in the company's operating performance and weak liquidity, Moody's said. The downgrade also incorporates the rating agency's concern over AM General's ability to restore vehicle sales amid ongoing supply chain challenges that diminish the prospect of rapid improvement in earnings. The high risk of default is supported by Moody's expectation of break-even free cash flow at best through at least 2023 while having limited access to the revolver. This is because the company's springing covenant would be breached if triggered.

Meanwhile, Moody's Investors Service upgraded Zekelman Industries, Inc.'s CFR to Ba2 from Ba3 and its probability of default rating to Ba2-PD from Ba3-PD. The rating on the company's senior secured term loan rating was affirmed at Ba3. Governance considerations were key drivers of this rating action. Moody's changed the company's governance issuer profile score to G-3 from G-4 to indicate moderate governance risks and the governance subcategories of financial strategy and risk management and management credibility and track record were also changed to moderate risk from high risk to reflect the company's stronger credit profile and reduced governance risks.

EUROPE

Rating activity was light across Western Europe with only two ratings changes issued in the period. The lone downgrade was made to Ideal Standard International S.A, which saw its CFR lowered to Caa2 from Caa1 and the instrument rating of the €325 million guaranteed senior secured notes due in 2026 lowered to Caa3 from Caa1. In a corresponding move, Moody's Investors Service downgraded the company's outlook from stable to negative. The rating action reflects Ideal Standard's strained liquidity following the high cash burn in 2022 and weak credit metrics pointing to a potential unsustainable capital structure. The rating action also reflects the risk that the slowdown in global economic growth, lower consumer sentiment and persistently high inflation could result in a liquidity shortfall and an increased probability of default.

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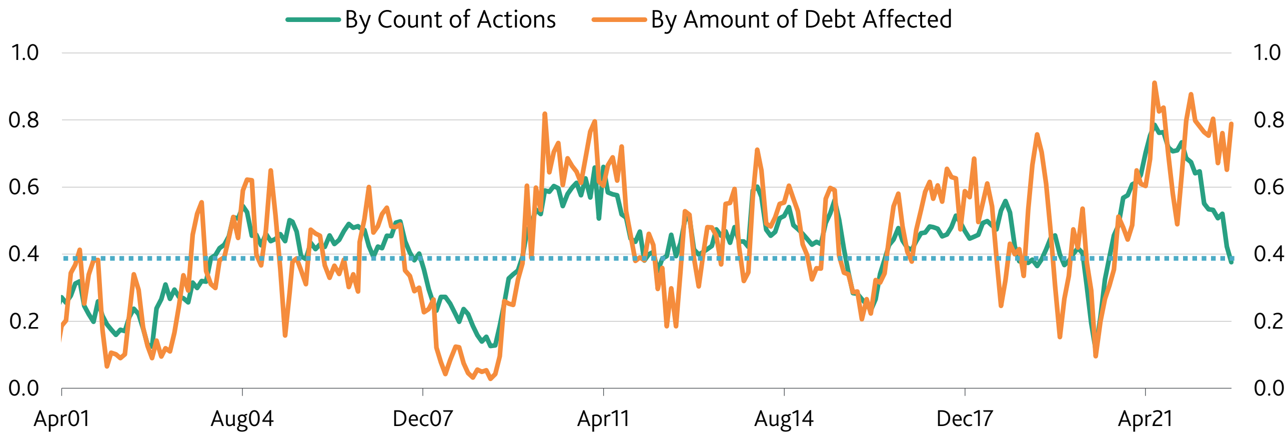
FIGURE 1
Rating Changes - US Corporate & Financial Institutions: Favorable as a % of Total Actions



* 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
1/11/2023	ARTIVION, INC.	Industrial	SrSec/BCF/LTCFR/PDR		D	B1	B2	SG
1/11/2023	LIGHTNING ACQUISITION, LLC-GREENWAY HEALTH, LLC	Industrial	SrSec/BCF/LTCFR/PDR		D	B3	Caa1	SG
1/11/2023	SVP-SINGER HOLDINGS INC	Industrial	SrSec/BCF/LTCFR/PDR		D	B3	Caa2	SG
1/12/2023	JOANN, INC.-JO-ANN STORES LLC.	Industrial	SrSec/BCF/LTCFR/PDR		D	B3	Caa2	SG
1/12/2023	PM GENERAL PURCHASER LLC	Industrial	SrSec/LTCFR/PDR	600	D	B3	Caa1	SG
1/12/2023	VALCOUR PACKAGING LLC	Industrial	SrSec/BCF/LTCFR/PDR		D	B2	B3	SG
1/13/2023	ZEKELMAN INDUSTRIES, INC.	Industrial	LTCFR/PDR		U	Ba3	Ba2	SG
1/13/2023	WEST DEPTFORD ENERGY HOLDINGS, LLC	Industrial	SrSec/BCF		D	B2	B3	SG
1/13/2023	NEW CONSTELLIS BORROWER LLC	Industrial	SrSec/BCF/LTCFR/PDR		D	Caa1	Caa2	SG
1/17/2023	RAYONIER ADVANCED MATERIALS INC.	Industrial	SrSec	500	D	B1	B3	SG
1/17/2023	BW NHHC HOLDCO, INC.	Industrial	PDR		U	D	Caa3	SG

Source: Moody's

FIGURE 4

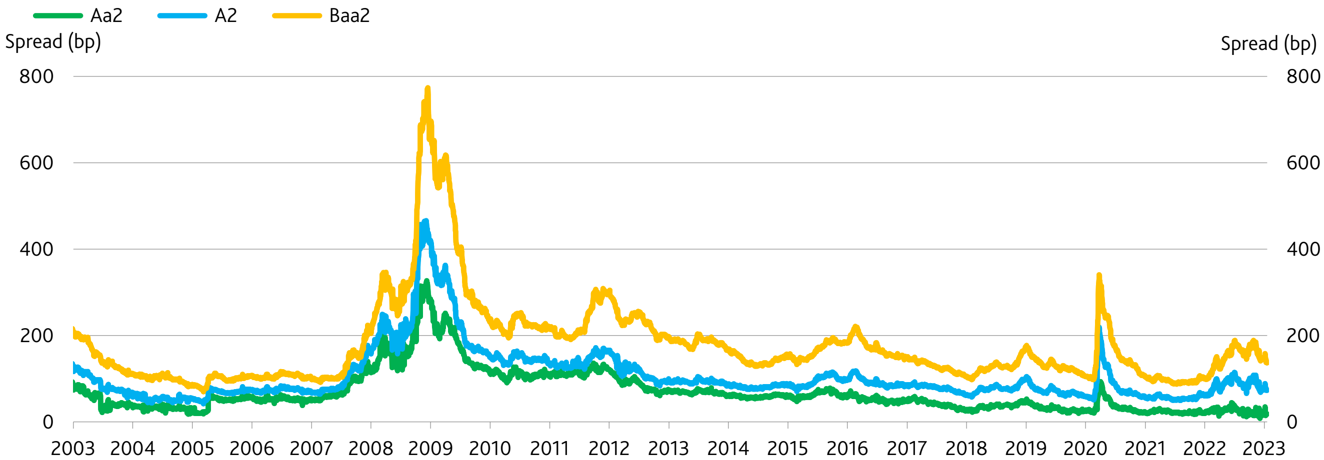
Rating Changes: Corporate & Financial Institutions - Europe

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG	Country
1/12/2023	IDEAL STANDARD INTERNATIONAL S.A.	Industrial	SrSec/LTCFR/PDR	351.9601	D	Caa1	Caa3	SG	LUXEMBOURG
1/17/2023	SPAR NORD BANK A/S	Financial	MTN		U	Baa2	Baa1	IG	DENMARK

Source: Moody's

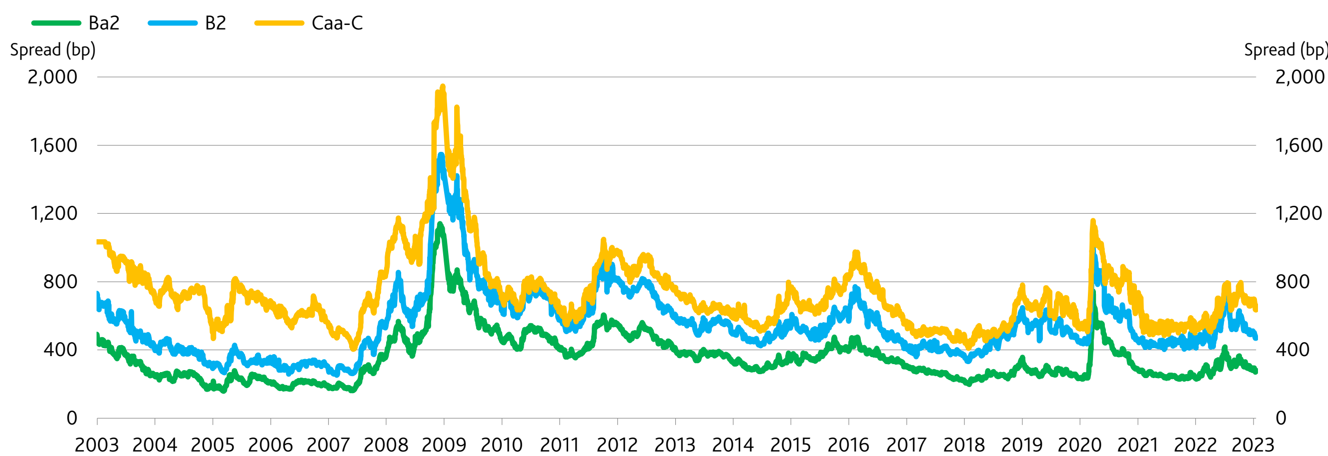
MARKET DATA

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 (January 11, 2023 – January 18, 2023)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jan. 18	Jan. 11	Senior Ratings
Gilead Sciences, Inc.	Aa3	A3	A3
Ford Motor Credit Company LLC	Ba2	Ba3	Ba2
Boeing Company (The)	Baa2	Baa3	Baa2
Southern California Edison Company	Baa2	Baa3	Baa2
United Airlines, Inc.	B3	Caa1	Ba3
Netflix, Inc.	Baa2	Baa3	Ba1
Valero Energy Corporation	Baa1	Baa2	Baa2
Fifth Third Bancorp	Baa2	Baa3	Baa1
Stryker Corporation	A3	Baa1	Baa1
United Rentals (North America), Inc.	Baa3	Ba1	Ba2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jan. 18	Jan. 11	Senior Ratings
JPMorgan Chase & Co.	Baa1	A3	A1
Citigroup Inc.	Baa2	Baa1	A3
Wells Fargo & Company	Baa1	A3	A1
Caterpillar Financial Services Corporation	A1	Aa3	A2
Intel Corporation	A3	A2	A1
HCA Inc.	Baa3	Baa2	Baa3
NextEra Energy Capital Holdings, Inc.	Baa1	A3	Baa1
State Street Corporation	A2	A1	A1
Visa Inc.	A3	A2	Aa3
Southern Company (The)	A3	A2	Baa2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jan. 18	Jan. 11	Spread Diff
Liberty Interactive LLC	B3	2,510	2,425	85
American Greetings Corporation	Caa1	669	629	40
Frontier Communications Holdings, LLC	Caa2	415	389	27
Pitney Bowes Inc.	B3	815	789	27
Caesars Entertainment, Inc.	Caa1	349	325	23
Embarq Corporation	Caa2	1,000	977	23
Lumen Technologies, Inc.	B2	804	786	18
Nissan Motor Acceptance Company LLC	Baa3	258	245	13
Vistra Operations Company LLC	Ba2	362	350	12
Cargill, Incorporated	A2	77	66	11

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jan. 18	Jan. 11	Spread Diff
Rite Aid Corporation	Caa2	4,720	4,953	-233
American Airlines Group Inc.	Caa1	854	1,009	-155
Carnival Corporation	B3	1,045	1,160	-115
Glatfelter Corporation	Caa2	814	920	-106
United Airlines Holdings, Inc.	Ba3	510	599	-89
TEGNA Inc.	Ba3	520	606	-86
United Airlines, Inc.	Ba3	566	639	-73
Staples, Inc.	Caa2	1,511	1,584	-73
Gap, Inc. (The)	Ba3	505	567	-62
Credit Suisse (USA), Inc.	A3	332	390	-57

Source: Moody's, CMA

CDS Movers

Figure 4. CDS Movers - Europe (January 11, 2023 – January 18, 2023)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jan. 18	Jan. 11	Senior Ratings
Italy, Government of	Baa2	Baa3	Baa3
Spain, Government of	Aa3	A1	Baa1
Deutsche Bank AG	Baa2	Baa3	A1
Credit Suisse Group AG	Ba3	B1	Baa2
Standard Chartered Bank	Aa3	A1	A1
Stellantis N.V.	Baa3	Ba1	Baa2
Mercedes-Benz Group AG	A3	Baa1	A3
ENEL S.p.A.	Baa2	Baa3	Baa1
Tesco Plc	Baa2	Baa3	Baa3
Anglo American plc	Baa3	Ba1	Baa2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jan. 18	Jan. 11	Senior Ratings
Dexia Credit Local	A3	Aa2	Baa3
ASML Holding N.V.	A2	Aa2	A2
Iceland, Government of	Baa1	A2	A2
BPCE	A3	A2	A1
Banco Santander S.A. (Spain)	A3	A2	A2
Banque Federative du Credit Mutuel	A3	A2	Aa3
Svenska Handelsbanken AB	A3	A2	Aa2
DNB Bank ASA	A3	A2	Aa2
Santander UK plc	A2	A1	A1
NatWest Group plc	Baa2	Baa1	A3

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jan. 18	Jan. 11	Spread Diff
INEOS Quattro Finance 2 Plc	B2	584	524	59
Garfunkelux Holdco 3 S.A.	Caa2	1,131	1,090	41
Vue International Bidco plc	C	633	594	39
Dexia Credit Local	Baa3	59	42	17
Iceland, Government of	A2	75	59	16
ASML Holding N.V.	A2	51	37	14
Sappi Papier Holding GmbH	Ba2	351	338	13
Schneider Electric SE	A3	44	37	7
Premier Foods Finance plc	B2	246	240	5
Orsted A/S	Baa1	60	56	4

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jan. 18	Jan. 11	Spread Diff
Casino Guichard-Perrachon SA	Caa1	2,332	2,527	-195
Vedanta Resources Limited	Caa1	1,981	2,175	-195
Boparan Finance plc	Caa3	1,491	1,663	-172
Carnival plc	B3	991	1,100	-109
Ardagh Packaging Finance plc	Caa1	702	761	-60
United Group B.V.	Caa1	944	1,003	-59
Credit Suisse Group AG	Baa2	288	338	-50
Stena AB	B1	489	537	-48
Iceland Bondco plc	Caa2	1,000	1,042	-42
Novafives S.A.S.	Caa2	879	919	-40

Source: Moody's, CMA

CDS Movers

Figure 5. CDS Movers - APAC (January 11, 2023 – January 18, 2023)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jan. 18	Jan. 11	Senior Ratings
China, Government of	A1	A2	A1
Australia, Government of	Aaa	Aa1	Aaa
Korea, Government of	Aa2	Aa3	Aa2
Export-Import Bank of Korea (The)	Aa3	A1	Aa2
Korea Development Bank	Aa3	A1	Aa2
Export-Import Bank of China (The)	A1	A2	A1
Oversea-Chinese Banking Corp Ltd	Aa1	Aa2	Aa1
Macquarie Bank Limited	A3	Baa1	A2
Shinhan Bank	Aa3	A1	Aa3
Kookmin Bank	Aa2	Aa3	Aa3

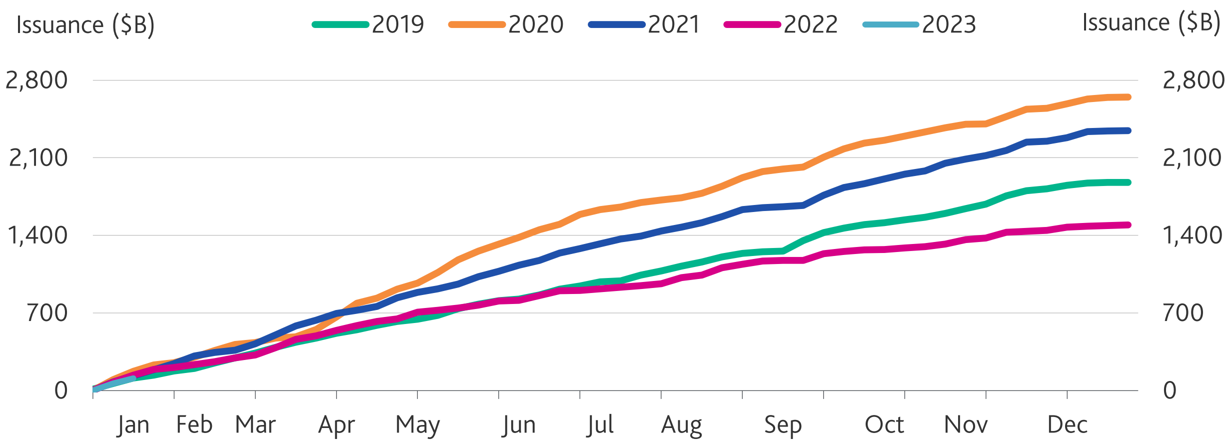
CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jan. 18	Jan. 11	Senior Ratings
Japan, Government of	Aa1	Aaa	A1
Mitsubishi UFJ Financial Group, Inc.	A2	A1	A1
Sumitomo Mitsui Banking Corporation	A2	A1	A1
Sumitomo Mitsui Trust Bank, Limited	A3	A2	A1
Mizuho Financial Group, Inc.	Baa1	A3	A1
MUFG Bank, Ltd.	A2	A1	A1
Nissan Motor Co., Ltd.	Ba1	Baa3	Baa3
JFE Holdings, Inc.	A3	A2	Baa3
Norinchukin Bank (The)	A2	A1	A1
Japan Finance Corporation	A2	A1	A1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jan. 18	Jan. 11	Spread Diff
Development Bank of Kazakhstan	Baa2	232	212	19
Nissan Motor Co., Ltd.	Baa3	154	146	8
Nippon Telegraph and Telephone Corporation	A1	33	25	8
Toyota Industries Corporation	A2	102	95	7
Halyk Savings Bank of Kazakhstan	Ba2	455	450	5
Sumitomo Mitsui Trust Bank, Limited	A1	64	59	4
JFE Holdings, Inc.	Baa3	63	59	4
NIPPON STEEL CORPORATION	Baa2	56	53	4
Mitsubishi UFJ Financial Group, Inc.	A1	53	52	2
National Australia Bank Limited	Aa3	66	65	2

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jan. 18	Jan. 11	Spread Diff
Pakistan, Government of	Caa1	3,220	4,705	-1,485
Adani Green Energy Limited	B2	479	548	-69
SK Innovation Co. Ltd.	Baa3	302	330	-28
Rizal Commercial Banking Corporation	Baa3	138	163	-25
SK Hynix Inc.	Baa2	190	211	-21
SoftBank Group Corp.	Ba3	380	398	-17
Flex Ltd.	Baa3	116	130	-14
APA Infrastructure Limited	Baa2	85	98	-12
Lenovo Group Limited	Baa2	257	268	-11
Bank of China (Hong Kong) Limited	Aa3	75	84	-9

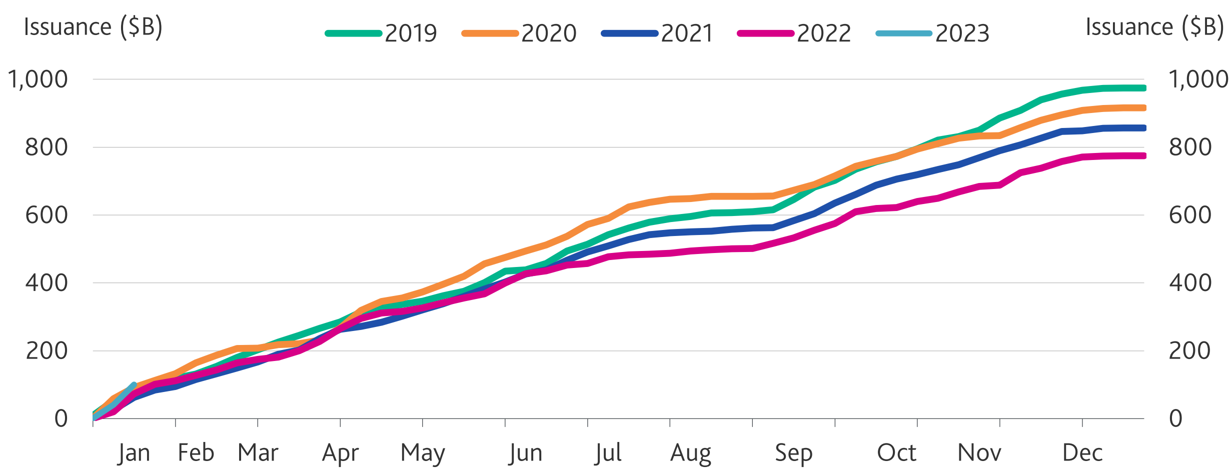
Source: Moody's, CMA

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



Source: Moody's / Dealogic

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



Source: Moody's / Dealogic

ISSUANCE

Figure 8. Issuance: Corporate & Financial Institutions

	USD Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	40.891	3.050	44.947
Year-to-Date	102.331	5.800	109.195

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	52.647	2.416	59.071
Year-to-Date	90.034	4.269	100.164

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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