WEEKLY MARKET OUTLOOK

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No Surprise in September CPI

September's consumer price index, as Moody's Analytics expected, showed a 0.4% monthly increase that held the annual inflation rate at 3.7%. Behind the monthly increase was a milder, but still positive, contribution from energy prices. The CPI for shelter's slow deceleration is ongoing, but shelter costs remain a material upward pressure on inflation. After peaking at an all-time high of 8.2% in March, the CPI for rent of shelter clocked in at 7.3% in August and 7.2% in September.

Core CPI, which excludes food and energy prices, also came in as we anticipated with a continuation of the steady disinflation that began in late 2022. Relative to a year earlier, core CPI was up 4.1% in September, a healthy deceleration from August's 4.3% pace. Using an annualized three-month moving average, core CPI was expanding at a 3.1% pace in September. While much improved, this is still above the Federal Reserve's target of 2% to 2.5%.

Financial conditions have tightened, and wage growth has encouragingly softened. This gives decision-makers at the central bank a degree of confidence that their policy tightening is working. However, minutes from the Federal Open Market Committee's September meeting released this week show committee members' surprise at how resilient business and consumer spending has been in the face of restrictive policy.

There are hawks within the FOMC who believe this is evidence that policy is not sufficiently restrictive to get inflation back to target. In fact, a majority of members believed in September that one more increase in the fed funds rate would likely be appropriate.

The other camp, which we ascribe to, believes the Fed's current policy stance is sufficiently restrictive and the disinflation of the past year is sticky. Shelter prices will reliably moderate and deliver less to inflation. Wage growth has softened, despite any rise in joblessness.

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Headwinds seem to be multiplying of late: war in the Middle East, striking autoworkers, the end of the student loan moratorium, and sharply rising bond yields. It is easy to imagine the U.S. expansion getting knocked off course—and zealously tightening monetary policy would be an avoidable mistake. Better to step back and observe the U.S. economy's reaction to previous rate hikes and the emerging headwinds.

The FOMC meets in a few weeks, before any inflation data from October are available. Because of the recent runup in long-term interest rates, September's report would have needed to deliver a worrying upside surprise for the rate-setting committee to change course. Since it did not, we are highly confident in our forecast of a pause at November's meeting.

Its dreary on Main Street

The NFIB Small Business Optimism Index took another step back in September, falling 0.5 point to 90.8, which is lower than our forecast of 91.2. Small businesses are especially pessimistic about the economy, particularly with regard to future business conditions. As a result, the expectations component of the headline index is in the gutter, weighed down by concerns over still-high inflation, elevated interest rates, tightened access to credit, and a dearth of qualified workers.

To be sure, inflation is cooling, and the supply of labor is improving. Year-ago growth in the consumer price index has declined from June 2022's 9.1% peak to 3.7%, and nearly 3 million additional workers have entered the labor force this year—prime-age (25-54) male labor force participation is at an approximately 13-year high while prime-age female labor force participation is hovering near an all-time high. Even so, not enough of the pressures facing small businesses have been alleviated. Unlike larger firms that are better able to absorb higher costs because of their larger scale and that have access to more financing options, small businesses face more consequential pressures when access to credit diminishes and costs rise.

At the same time, the net percent of small firms reporting higher sales volumes over the past three months is firmly negative and at a level consistent with previous recessions. Higher costs and lower sales have pinched profit margins, adding to the pain on Main Street and darkening its perspective regarding where the economy is heading. Interestingly, small business and consumer expectations of future economic conditions track each other closely. Therefore, weak sentiment from consumers is likely spilling over into the small business arena one way or another—perhaps even through a pullback in spending at smaller establishments.

Another major concern on Main Street is the state of credit markets. In September, a net 8% of small businesses reported that their last loan was harder to get than in previous attempts, which is the highest since March when the economy was contending with a banking crisis. Moreover, the average rate paid on short maturity business loans was up 80 basis points from August to 9.8%, which is significantly higher than the average rate of 6.2% recorded in 2019. Rising interest rates and shakiness in the banking system have led to a tightening of credit standards, deterring businesses from accessing credit. As a result, the net percent of small firms expecting credit conditions to improve in the next six months is the lowest since the aftermath of the Great Recession.

This is consequential for the economy more broadly. Lower profit margins and reduced access to credit result in less inventory and capital investment. Indeed, according to the NFIB, small businesses are investing in their firms at historically low rates; the net percent of firms that believe now is a good time to expand is only slightly above the all-time low reached in March. This warrants attention because firms with 50 employees or less, which account for nearly all the NFIB's national membership, make up roughly 45% of private nonfarm payrolls.

TOP OF MIND

Toting Up the Headwinds

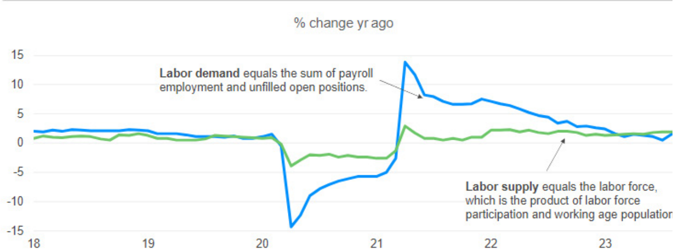
By MARK ZANDI

The U.S. economy is hanging tough. Growth in the just-ended third quarter was solid, bordering on robust. Annualized real GDP growth appears set to come in at more than 3% and could be closer to 4%. Average monthly job growth in the quarter was well over 250,000, and the job gains remain broad-based across most industries.

Despite the heady growth, wage and price pressures continue to abate. Annualized average hourly earnings growth over the past three months was 3.4%, and inflation as measured by the core consumer expenditure deflator was 2.2%. Both are in line with the Federal Reserve's inflation target. While it is much too early to think inflation is sustainably back to the Fed's target, it is nonetheless impressive.

Enabling the strong growth with moderating inflation is the steadily improving supply side of the economy.

Labor Supply Catches Labor Demand



Sources: Bureau of Labor Statistics, Moody's Analytics

The economic fallout from the massive supply shocks caused by the pandemic and Russian war have largely faded, and the labor force and labor productivity growth have some pep. Testimony to this is the rock-solid sub-4% unemployment rate: this despite the strong job gains. Moreover, concern that low unemployment means the economy is operating beyond full employment is hard to square with the strong labor force growth and moderating inflation.

Q4 headwinds

While the economy is performing well, it faces some intensifying headwinds as the year comes to an end. While none by itself could push the economy over, together under certain scenarios they threaten to.

The end of the moratorium on student loan payments is having the most immediate impact. An estimated 24 million borrowers with an average monthly payment of $300 are required to resume paying on their loans this month. This amounts to an increase of over $85 billion in annual payments. However, not all borrowers will resume payments, in part because President Biden through executive order has told student loan servicers not to report delinquent borrowers to the credit bureaus. Borrowers will thus prioritize their other obligations before paying on their student loans. Still other borrowers will move into income-driven repayment plans, reducing their monthly payment. And many borrowers have other financial resources and will thus not cut back their spending dollar-for-dollar to cover student loan payments. All this will reduce annualized real GDP in the fourth quarter by an estimated 0.3 percentage point.

Then there is the United Auto Workers strike, which to date has impacted few of the Big 3 automakers' factories but is expected to steadily widen. If the strike lasts through mid-November as Moody's Analytics anticipates, it will further reduce annualized real GDP in the fourth quarter by an estimated 0.3 percentage point. This includes the direct impact of lost auto and parts production as well as the multiplier impacts on suppliers and auto dealers and the hit to spending due to income lost by workers impacted by the strike.

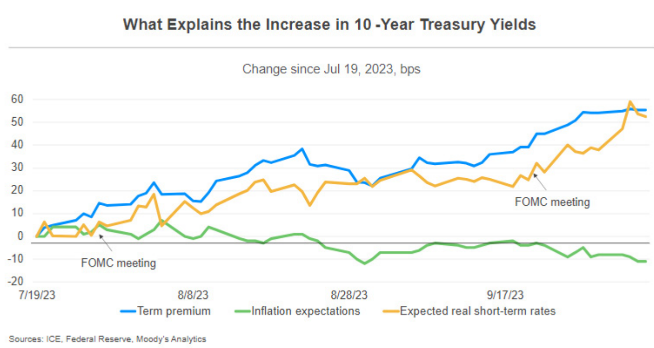
Mid-November is also when a federal government shutdown appears more likely than not. Lawmakers skirted a shutdown as the new fiscal year began on October 1 by passing a continuing resolution to fund the government for six weeks. While the unprecedented dysfunction in the House makes it difficult to game how things will play out, it is difficult to see a resolution to the budget standoff without at least a brief shutdown. We assume a three-week shutdown on either side of Thanksgiving. If this is the extent of it, the shutdown will reduce annualized real GDP growth in the fourth quarter by 0.25 percentage point, largely due to the reduction in the hours worked by furloughed government employees. Those hours cannot be made up. Consumer spending will soften initially as government and contract workers turn more cautious, fearful their incomes will be disrupted, but spending should quickly bounce back once the government reopens, and there will be no discernible impact on spending in the quarter.

The possibility of much higher oil prices is also worrisome. The price of a barrel of West Texas Intermediate crude is in the mid-$80s, but given the uncertainty around demand and supply in the global oil markets—Israel's declaration of war against Hamas being the latest—it would not be too surprising if they jumped to more than $90 or even $100 per barrel. Because the U.S. produces about as much oil as it consumes, the ultimate impact of higher prices will be largely a wash, but the early impact is decidedly negative since after-inflation household incomes suffer and inflation expectations rise, potentially pushing up wage growth and pressuring the Federal Reserve to further tighten monetary policy. We are assuming oil will average just over $90 per barrel this quarter, up about $20 per barrel since its recent summer low, shaving another 0.25 percentage point from annualized fourth-quarter real GDP.

Interest rates surge

Suddenly, however, surging long-term interest rates pose another potential threat to the economy. The 10-year Treasury yield has surged to over 4.75%, up about a percentage point since the summer. Fixed mortgage rates are closing in on 8%. Ten-year yields are their highest since before the global financial crisis, and mortgage rates have not been this high since Y2K.

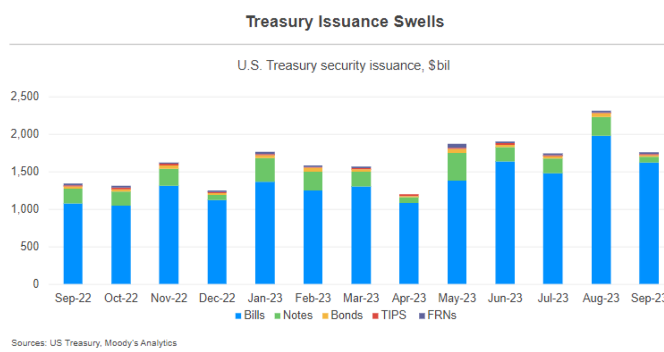
To understand what is propelling rates higher, it is useful to decompose the 10-year into the sum of inflation expectations, expected real short-term interest rates, and the term premium—the yield compensation required by bond investors to buy a long-term versus short-term bond given the uncertainties involved in longer-term investing. Of the approximately 100-basis point increase in the 10-year since mid-July, about half is due to higher expected real short-term rates and the other half to an increase in the term premium.



The higher expected real short-term rates reflect investor expectations of the conduct of future monetary policy, which has shifted significantly in the wake of the FOMC meetings in July and September. Prior to these meetings, investors had expected the Fed to begin lowering short-term rates soon in response to a weakening even recessionary economy, and then cutting them quickly. But given the economy's resilience and the Fed's strong and consistent messaging that it will not cut rates anytime soon, and when it does cut, it likely will do so slowly, investor expectations have shifted. They have bought into the Fed's so-called higher-for-longer strategy for short-term rates.

The bigger term premium is due to a mélange of factors. Especially prominent is the surge in Treasury debt issuance after the drama this summer over raising the Treasury debt ceiling.

This supply of new issuance combined with less demand from the Federal Reserve as it allows its Treasury and mortgage security holdings to mature without replacing them (under its quantitative tightening policy) is a lot for other bond investors to digest: particularly when liquidity in the Treasury market is questionable given limitations on the size of the balance sheets of the dealers charged with ensuring the market is well-functioning. Furthermore, the tsunami of issuance may also be focusing more attention on the nation's long-term fiscal challenges, which are daunting even separate from the political dysfunction in Washington DC.



Also potentially adding to the term premium is market sentiment. The bond market, like other financial markets, historically has been swung around by speculators, momentum players and short-sellers. This may be one of those times when social media posts and pronouncements by several prominent investors are fanning pessimism in the market. While economic fundamentals ultimately determine bond yields, investor sentiment can drive the term premium and yields higher for some time.

It is encouraging that inflation expectations have remained anchored and have not contributed to the higher yields. As measured by 1-year, 5-year forwards—the inflation investors expect beginning one year from now and over the subsequent five years—investors anticipate inflation will remain steadfastly consistent with the Fed's inflation target. Other measures of investors' inflation expectations are similarly low and stable. A critical priority for the Fed is to keep inflation expectations tethered since this is necessary to rein in actual inflation, and the central bank is succeeding.

Near a peak

While forecasting near-term movements in long-term interest rates is highly problematic, as the bond market is driven by investor sentiment, technical factors and multiple cross-currents, the most likely outlook is that rates are near a peak. A 10-year Treasury yield of 5%-plus is certainly possible given the volatility in rates, but not for long. A yield closer to 4% is more likely by year's end.

The rationale for this outlook can be seen using the same decomposition of the 10-year yield. We expect inflation expectations remain anchored. If the recently strong economy and increase in oil prices—a common source of higher inflation expectations in the bond market—have not been enough to dislodge expectations, we can be reasonably confident they will remain tethered as the economy slows and oil prices stabilize in the weeks ahead.

Moreover, investors' expectations regarding the conduct of monetary policy finally appear largely to line up with the Fed's own expectations. Expected real short-term rates need not rise further. Indeed, they should recede a bit as the softening economy and tighter financial conditions resulting from the higher yields convince the Fed that it need not tighten policy again, though most policymakers at the September FOMC meeting anticipated they would need to. The current federal funds rate of just under 5.5% will be the terminal rate—the highest the rate will go in this cycle.

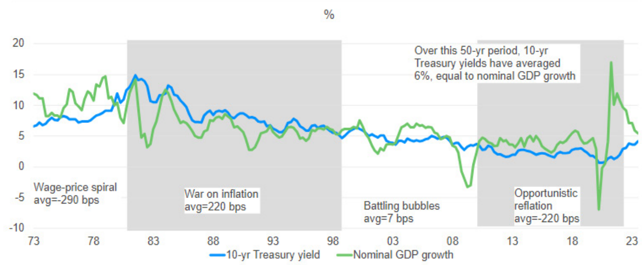
The term premium should also narrow somewhat as the softish economy and less aggressive Fed provide some cheer for pessimistic bond investors. The post-debt limit flood of Treasury bond issuance will also abate, and despite reasonable concerns over the nation's long-term fiscal situation, Treasury bonds remain the safest asset on the planet. Given the seemingly never-ending geopolitical turmoil, with the conflict between Israel and Hamas the most recent example, Treasury bonds will continue to get a strong bid from global investors looking for a safe haven.

Long rates in the long run

Moreover, in the long run—abstracting from the ups-and-downs of the business cycle—the 10-year Treasury yield should be equal to nominal potential GDP, which is the growth consistent with stable unemployment. The reasoning here is that the Treasury yield is the economy-wide cost of capital, and nominal GDP is the return on that capital. In the long run, these should more-or-less equal each other. Nominal potential growth is estimated currently at 4%, which is equal to the sum of the Fed's 2% inflation target and 2% real potential GDP. The 2% real potential growth is in turn the sum of 0.5% labor force growth and 1.5% labor productivity growth.

Indeed, over the past 50 years, the 10-year Treasury yield and annualized nominal GDP have both equaled 6%.

R vs. G (in Different Monetary Regimes)



Sources: Federal Reserve Board, Moody's Analytics

Over this half century, inflation and real GDP were both close to 3%. There can be long stretches when the 10-year Treasury yield and nominal potential GDP vary, largely depending on the conduct of monetary policy. In the 1970s, the Fed accommodated the oil price shocks of the period, working to offset the hit to growth from the higher oil prices, and rates lagged GDP growth. Of course, this turned out to be a mistake as a wage-price spiral and stagflation took hold. The Fed followed a highly restrictive monetary policy in the 1980s and 1990s to root out the stubborn inflation, and rates were consistently greater than GDP growth.

The 2000s were a period in which monetary policy swung wildly, and so did long-term rates and nominal GDP as the Fed battled the formation and subsequent bursting of asset bubbles. They included the Y2K stock market bubble and then the housing bubble at the center of the global financial crisis. Between that crisis and the pandemic, disinflation and below-target inflation were the problems, and the Fed pursued a generally easy monetary policy. Long-term rates were consistently lower than nominal GDP.

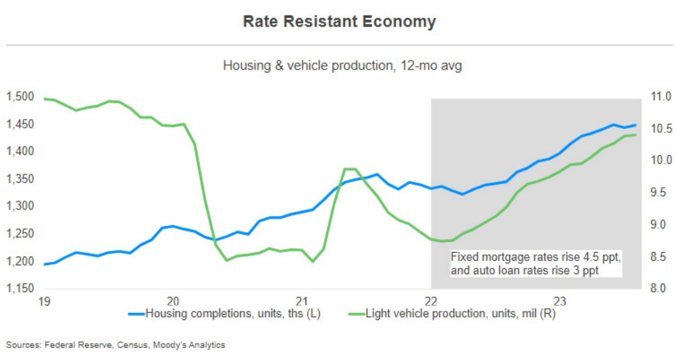
Neither restrictive nor expansionary monetary policy will be necessary over the next year or so with inflation expected to settle into the Fed's target. The 10-year Treasury yield should equal nominal potential GDP, or about 4%. There are reasonable arguments that inflation may remain stubbornly on the high side of the Fed's 2% target and thus require somewhat higher rates. Reasons for this include the inflationary impact of de-globalization, the costs of transition to a greener economy, and the aging of the global workforce and resulting tighter labor markets and higher labor costs. Perhaps. But at this point it is appropriate to consider these as risks to the 4% rate outlook.

How big a hit?

Even though long-term rates are expected to ultimately find their way closer to 4% by the end of the year, the higher rates will be another meaningful headwind to the economy, knocking off another 0.25 percentage point from annualized fourth-quarter real GDP.

Single-family housing, the most rate-sensitive sector of the economy, will be the most significant casualty. Home sales are already in a deep freeze with existing homeowners effectively locked into their homes and mortgages. With fixed mortgage rates approaching 8% and the average coupon on existing mortgages near 3.5%, it makes no economic sense to move. The only moves happening are those that absolutely need to happen due to life events such as death, divorce, children and job changes. House prices, which have generally gone sideways since peaking in summer 2022, now appear set to decline in earnest. Households cannot put off moving forever, and to do so they will have no choice but to cut prices on their homes to make them reasonably affordable to would-be buyers.

The higher rates will also be somewhat painful for other rate-sensitive parts of the economy. Stocks prices are already off, business investment will be dinged, and commercial real estate development will suffer. Most difficult to gauge is the impact on the fragile banking system and the availability and cost of credit.



Having said this, the economy appears meaningfully less rate-sensitive than in times past, which should limit the economic damage from higher rates. To see this, consider the housing market again. Housing completions, including both single- and multifamily homes continue to increase, and with close to 1 million multifamily units in the pipeline to completion, this is likely to continue.

The pandemic is behind this. Construction was impaired due to disrupted supply chains and labor markets. With the pandemic and the disruptions fading, construction is ramping up. The same sort of dynamic is also evident in the vehicle industry, another typically rate-sensitive sector. Instead of vehicle sales and production falling as rates rise, they have continued to push higher as they recover from the pandemic-era disruptions.

Conclusions

Toting up the real GDP hit from the headwinds buffeting the economy, it amounts to an estimated 1.35 percentage points annualized in the fourth quarter. To summarize, this includes 0.3 percentage point for the end of the student loan payment moratorium, 0.3 percentage point for the UAW strike, and 0.25 percentage point each for a government shutdown, higher oil prices, and the recent surge in long-term rates. This is strong enough of a collective headwind to ensure a soft economy at year's end and early next, but not enough to push the resilient economy into recession. Real GDP in the quarter is expected to come in just barely positive and be near 1% in the first quarter of 2024. The most likely scenario thus remains that the economy will avoid a downturn. But it is tough to gauge how hard each of these headwinds will ultimately blow and whether others will kick up. As such, it would be Pollyannish not to consider the darker scenarios.

The Week Ahead in the Global Economy

U.S.

The economic calendar gets busier next week with a wide range of data on consumers, manufacturing, and the housing market. We expect housing market data to remain subdued—from builder sentiment to new residential construction and existing home sales. The recent uptick in mortgage rates will provide an additional headwind to any housing market rebound.

We will get a first look at manufacturing activity in October with the release of both the NY Empire State and Philadelphia Fed manufacturing surveys. There is little hope for a meaningful turnaround in manufacturing activity through year end, and the ongoing UAW strike is likely to weigh on sentiment.

Other key data to be released include retail sales, industrial production, business inventories and jobless claims.

Asia-Pacific

Supported by a flurry of stimulus measures, China's economy is ever-so-slowly starting to turn. Industrial production likely jumped 4.9% year on year through September, with an earlier drawdown of inventories prompting a lift in output. With households out and about, we expect retail sales to climb 4.5% from September 2022. That will be roughly in line with August's jump. Meanwhile, the property market's capitulation likely held back investment in September—an all too familiar story. All up, China's economy in the September quarter likely grew 0.8% from the June quarter and 4.4% from the third quarter of 2022.

Europe

U.K. unemployment was likely stable at 4.3% for the three months through August, compared with the July stanza. While the economy remained sluggish, there were indicators that the labour market had held its own. For one, the August PMI showed a net increase in employment. But considering the underwhelming economic activity, we expect the labour market to weaken in coming months, accompanied by a gradual increase in the unemployment rate.

U.K. retail sales likely ticked 0.3% higher monthly in September, adding to a 0.4% rise in August. What growth there was will not cancel out the 1.1% drop in sales back in July. For the third quarter, retail sales will have contracted. Supported by the results of monthly GDP releases from July and August, we are forecasting that private consumption will have declined over the third quarter.

High inflation remains one of the factors behind faltering consumer demand in the U.K. We are expecting a minor decrease in the headline inflation rate to 6.5% year over year in September from 6.7% in August. While there should be another considerable slowdown in food inflation, it will likely be mitigated by sticky core inflation and the rise in oil and gasoline prices. We do not expect the Bank of England to change the course it set for itself at its September meeting and will hike again at its November meeting.

The euro zone's September HICP inflation rate will be finalised next week. We do not expect any revisions, which would mean that inflation comes in at 4.3% year on year in September, down from 5.3% in October. Base effects in the services and energy segments will be the main forces behind the deceleration. That said, there will also be more tangible improvements in food and core goods inflation as well. Weaker consumer demand is helping to lower inflationary dynamics, but when it comes to the supply side of the equation, high costs are still pushing businesses to hike prices or are preventing them from lowering them.

Finally, we expect the euro zone's external trade balance in goods to come in at a surplus of €6.9 billion for August, up from a deficit of €54.3 billion in August 2022. The euro zone terms of trade improved significantly since this time last year as the price of natural gas has declined immensely. But natural gas prices are still higher than pre-pandemic norms, and Brent crude prices were also on the rise during August, likely weighing on the surplus.

Latin America

The jobless rate for metropolitan Lima, Peru—a barometer of job market conditions at the national level—likely ticked up again in the September rolling quarter as a stalling economy and subdued confidence weighed on hiring. While the decline in inflation in the past six months has kicked off a recovery in real incomes, it is still in the early innings, and both hiring and spending will remain in a holding pattern until more meaningful declines in inflation are charted in mid-2024.

Brazil's retail sales likely grew 3% in August from a year prior, benefiting from hiring gains in the public and private sectors. July growth was 2.4%, and growth a year prior was 1.6%.

Mexico's retail sales volume also likely grew 4.5% in August from a year earlier, down from 5.1% in July and 8.3% a year prior.

Geopolitical Calendar

Date	Country	Event	Economic Importance	Financial Market Risk	Risk Assessment
15-Oct	Ecuador	Second-round presidential election	Low	Low	Against a backdrop of rising drug-related violence and concerns over corruption, Ecuadorians will head to the polls to elect a successor to President Guillermo Lasso.
22-Oct	Switzerland	Federal elections	Low	Low	
22-Oct	Argentina	General election	Medium	Medium	The highly contested election might yield a drastic shift in economic policy and the country's political orientation. The ruling leftist coalition faces an uphill battle with two opposition candidates having strong showings in recent polls.
26-27 Oct	EU	European Council summit	Low	Low	
Oct/Nov	Poland	Parliamentary elections	Low	Low	
12-18 Nov	APEC	Leaders' meeting, to be held in San Francisco, U.S.	Low	Low	The APEC summit will be watched for the latest cooperation agenda between members on goods, services, investment and people.
17-Nov	U.S.	Potential government shutdown	Low	Low	Congress has passed a continuing resolution that will fund the government at current spending levels through November 17. If lawmakers cannot come to an agreement on the FY 2024 budget bills, the government will again face the possibility of a shutdown.
22-Nov	Netherlands	General election	Medium	Low	After a volatile first half of 2023 for Dutch politics, this snap election will determine whether the growing populist, right-wing presence will cement itself in the nation's politics.
26-Nov	OPEC+	OPEC and non-OPEC Ministerial Meeting and Joint Ministerial Monitoring Committee Meeting	High	High	The OPEC+ meetings will be closely watched on changes to oil production output and quotas as crude oil benchmarks have been getting closer to $100 due to cuts from Saudi Arabia and Russia.
30-Nov-12-Dec	U.N.	COP 28, to be held in Dubai, UAE	Low	Low	
14-15 Dec	EU	European Council summit	Low	Low	
31-Dec	U.S.	Deadline for enactment of FY24 National Defense Authorization Act	Medium	Low	As the U.S. faces a growing set of national security challenges from competitors like China and military aggressors such as Russia, Iran and North Korea, appropriate funding has become increasingly necessary to combat external risks.
13-Jan	Taiwan	Presidential election	Medium	Medium	The election will have deep ramifications on the trajectory of U.S.-China relations.
14-Feb	Indonesia	General election (including presidential election)	Low	Low	Term-limited president Joko Widodo has put Indonesia's economic development agenda on a steady course, and his successor will be expected to follow through.
March	Russia	Presidential election	High	Medium	As the first presidential election in Russia since the war in Ukraine began and constitutional amendments were made in 2020, the election will be closely watched for internal instability and potential disruption, even as Vladimir Putin is highly likely to win re-election.
March	China	Two Sessions (Meetings of China's top legislative body and political advisory body)	High	Medium	The annual Two Sessions meeting sets the wider policy agenda along with economic and social goals for the world's second-largest economy.
10-Apr	South Korea	General election	Low	Low	The election will determine whether President Yoon's policy agenda will continue to face opposition in the National Assembly.
May	India	Election (Lok Sabha, lower house)	Medium	Low	Prime Minister Narendra Modi is vying for a third term building India as an economic engine of the world, but the domestic focus is now towards inflation and economic inequality.
1-Jun	Mexico	General election	High	High	Mexico will hold presidential and congressional elections as well as some state and local elections. Financial markets will be concerned that election results will be rejected due to fraud accusations, resulting in social and political unrest. This will affect consumption and investment decisions and put the economy on the brink of recession.
6-9 June	EU	Parliamentary elections	Medium	Low	The European Parliament has increased in importance since the founding of the EU. The parliament has the power to amend or adopt legislation proposed by the European Commission.

Credit Spreads Are Barely Changed

By OLGA BYCHKOVA

CREDIT SPREADS

Since the start of October, corporate credit spreads have barely changed, coming in Wednesday at the levels recorded on the last day of September. Tight credit spreads show market participants remain confident in the creditworthiness of borrowers and see the overall economy as favorable. As a result, despite monetary policy tightening worldwide, market participants see a high likelihood for a "soft landing." This has been underpinned by healthy corporate balance sheets, persistent strength in consumer spending, and a relatively low level of corporate defaults this year. The Moody's Investors Service long-term average corporate bond spread to the 10-year U.S. Treasury has increased marginally by 1 basis point to 133 bps, its 12-month low. In contrast, Moody's long-term average industrial bond spread stalled at its one-year low of 114 bps, the same as the previous two weeks.

Low-grade credit spreads—the difference between the yield on high-yield or below-investment-grade corporate bonds and the risk-free 10-year Treasury yield—have also trended lower since spiking to over 500 basis points in the wake of the banking crisis in March. This yield spread represents the compensation investors demand for the risk that businesses they invest in could run into financial trouble and miss making timely principal and interest payments. The U.S. Bloomberg/Barclays high-yield option-adjusted spread declined to 405 basis points from 427 bps the previous week, while the ICE BofA U.S. high-yield option-adjusted bond spread closed Wednesday at 425 bps, down 12 bps from its value last week. This compares with an average high-yield spread of 1,000 bps during recent recessions and an average 350 bps outside of recessions. The average spread since the high-yield market was established in the 1990s is about 500 bps.

The VIX index also decreased dramatically over the week, falling 2.5 points to 16.1 Wednesday, well below its long-term average near 20. The stock market is currently recalibrating itself to accommodate a prolonged era of heightened interest rates and sustained inflation, which, in turn, is propelling volatility. In the past, there has been a significant correlation between credit spreads and equity market volatility, as measured by the VIX. This relationship was disrupted in recent years, but the decline in the VIX this year has brought it back in line with high-yield spreads.

GLOBAL DEFAULTS

Moody's Investors Service reported 12 corporate debt issuers defaulted in August, the same as the previous month's upwardly revised count. In August, eight of the defaults were from the U.S., including Carvana Co., the month's largest defaulter. The Arizona-based used-vehicles online retailer completed a debt restructuring in which about $5.5 billion in unsecured bonds were exchanged for roughly $4.2 billion of senior secured notes with extended maturities. This restructuring constituted a distressed exchange.

Of the eight U.S. defaults last month, five were in the form of distressed exchanges, the most common default type in recent years, particularly for companies owned by private equity firms. Besides Carvana, the other four U.S. companies that completed distressed exchanges in August were CNG Holdings Inc, CSTN Merger Sub Inc, Digital Media Solutions LLC, and U.S. Renal Care Inc. Outside the U.S., Moody's Investors Service recorded two defaults in Europe and two in the Asia-Pacific region. The two European defaulters were Casino Guichard-Perrachon SA, a French retailer, and Keter Group BV, a Netherlands-based manufacturer and distributor of a variety of resin-based consumer goods. The two APAC defaulters, both property developers, were China-based Sino-Ocean Group Holding Limited and Vietnam-based BIM Land Joint Stock Company.

August's defaulters increased the year-to-date tally to 109. Across sectors, business services and telecommunications are the largest contributors to year-to-date defaults, with 10 each. Healthcare and pharmaceuticals followed with nine. By region, North America had 77 defaults (75 in the U.S. and two in Canada). The rest were from Europe (18), Latin America (8) and Asia-Pacific (6).

Despite the recent slowdown in monthly defaults, the trailing 12-month global speculative-grade default rate rose to 4.3% at the end of August from 4.2% a month earlier, both surpassing the long-term average of 4.1%. Moody's Investors Service forecast the rate to trend higher over the remainder of 2023, reaching 4.6% in December. In 2024, the credit agency expects the default rate to peak at 4.7% in the first quarter before easing to 4.2% in August. Moody's Investors Service's latest baseline default rate forecasts incorporate the assumptions that the U.S. high-yield spread will widen to 522 bps over the next four quarters from about

372 bps at the end of August and that the U.S. unemployment rate will rise to 4.3% from 3.8% in the comparable period.

The above default rate forecasts are based on the assumption that economic activity will continue to slow this year and into 2024 in most countries, including the U.S., as the full effects of tight monetary policy on aggregate demand are realized. In addition, major central banks are expected to maintain a restrictive policy stance through 2024 as core inflation, although declining, remains above target levels. The combination of higher rates and lower growth will dent corporate earnings and cash flows, particularly for financially weaker companies. This underpins Moody's Investors Service's prediction that the global default rate will likely remain above the historical average in the coming 12 months.

CORPORATE BOND ISSUANCE

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

Corporate bond issuance proceeded to weaken in the second quarter of 2022. Worldwide offerings of investment-grade corporate bonds totaled $548 billion, down 21% on a year-ago basis. U.S. dollar-denominated high-yield corporate bond issuance was $38 billion in the second quarter, down from $63 billion in the first three months of the year. High-yield issuance was down 79% on a year-ago basis.

Issuance declined further in 2022's third quarter as higher interest rates weighed on lending activity. Worldwide offerings of investment-grade corporate bonds totaled $505 billion, down 30% year over year. U.S. dollar-denominated high-yield corporate bond issuance clocked in at $21 billion in the third quarter. High-yield issuance has declined approximately 84% on a year-ago basis.

Corporate debt issuance remained suppressed in the fourth quarter of 2022. U.S. dollar-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, corresponding to a 20.8% decline from 2021. Over the past 12 months, total U.S. dollar-denominated issuance has tracked at a near-decade low.

The first quarter of 2023 saw a decline in global offerings of corporate bonds, with investment-grade offerings falling 7.9% and high-yield offerings dropping 10.1% year over year. U.S. dollar-denominated investment-grade issuance, which accounts for half of activity globally, decreased 15% on an annual basis. U.S. high-yield issuance also experienced a slow start at just $31.5 billion, marking its slowest start to the year since 2008, and posting a 15% decline compared to the first quarter of 2022.

Issuance strengthened in the second quarter of 2023 as worldwide offerings of corporate bonds revealed a year-over-year increase of 26.8% for investment grade. High-yield issuance in the period nearly doubled the amount recorded in 2022. Approximately 60% of U.S. dollar-denominated high-yield proceeds in the period were allocated to debt refinancing.

Third-quarter 2023 corporate bond issuance weakened, with worldwide offerings of investment-grade corporate bonds falling 5.6% year over year. U.S. dollar-denominated investment-grade corporate bonds totaled $290.4 billion, down 4.7% on a year-ago basis and 15.4% from the prior quarter. U.S. dollar-denominated high-yield corporate bond issuance was $41.7 billion in the third quarter, down from $65.8 billion in second. However, high-yield issuance was up 42.6% on a year-ago basis.

U.S. dollar-denominated investment-grade debt issuance totaled $9.65 billion in the most recent week, bringing the year-to-date figure to $1,055.1 billion. This reflects a 5.9% decline compared with the same period in 2022.

Meanwhile, there was no high-yield debt issued in the same period, keeping the total at $158 billion this year. High-yield issuance has outstripped early-year expectations, increasing 26.1% relative to last year's pace. Total U.S. dollar-denominated corporate debt issuance now tracks 3.4% below where it stood in 2022 and is 36.3% lower compared with 2021.

U.S. ECONOMIC OUTLOOK

The U.S. economy continues to show significant resilience, consistent with or slightly exceeding our expectations. Consequently, we made only modest adjustments to the U.S. baseline forecast largely in response to revised second-quarter and earlier data and high-frequency data showing a strong start to the third quarter.

Key assumptions changed little in October. Monetary policy assumptions were not changed at all. We did alter the timing of the two-week federal government shutdown into November, but the impact on the broader economy is minimal. We raised out oil price outlook slightly as we expect tougher sanctions on Iran as a result of the war in the Middle East. Recent data and revisions modestly strengthened the outlook for business investment. The outlook for the 10-year Treasury is slightly changed, reflecting the recent increase in the rate. The short-term trajectory for new home sales was adjusted downward modestly this month to account for recent sales trends and rising mortgage rates. The labor market forecast changed little but acknowledged recent strength in job gains.

Fiscal policy

As of October, the baseline forecast maintains the assumption of a two-week government shutdown. Previously it was assumed that the shutdown would commence on October 1. However, with the passage of the last-minute, 45-day continuing resolution, the timing of the shutdown has been shifted to start when the resolution expires on November 17th. The rationale is that the new election for Speaker of the House wastes scarce time that is needed for negotiations. Come mid-November, we do not anticipate that the House of Representatives will be able to build consensus around a budget that suits the Senate and White House, and a shutdown ensues.

In the October baseline forecast, Moody's Analytics has calibrated the shutdown shock according to the observed severities from previous shutdowns, adjusted for the assumed 2-week duration. The result is a 0.26-percentage point hit to annualized real GDP growth in the fourth quarter of 2023, much of which is due to productivity losses by furloughed federal workers. However, these losses will be made up in the first quarter of 2024 as work schedules bounce back to normality, causing GDP growth to rebound. Therefore, we boosted our estimate of annualized real GDP growth in the first quarter of 2024 by a similar margin.

In June, President Biden signed into law the Fiscal Responsibility Act, which resolved the debt-limit crisis and established limits on federal discretionary spending for the next two years. Originally, it was assumed that these spending limits would have reduced, if not eliminated, the potential for brinkmanship around the federal budget for the coming fiscal year. We maintain the assumption that that Congress will pass the 12 annual spending bills, which fund all federal government activities and that these 12 annual spending bills would sum up to the limits established by the FRA. Failing to pass the 12 bills would result in an across-broad 1% cut to federal discretionary spending.

The Senate passed all 12 annual spending bills and heeded the letter of the law as written in the FRA. However, the same cannot be said of the House of Representatives. Many House Republicans are dissatisfied with the FRA, and they want to cut federal spending even more than agreed-upon limits in the FRA. Unlike the Senate, the House has only passed 1 of the 12 annual spending bills.

A technical note on NIPA accounting and shutdowns: In the national product accounts, compensation of federal workers is counted as output by the federal government. However, there is an important difference in the way the Bureau of Economic Analysis treats real versus nominal compensation. Nominal compensation is the actual pay federal workers receive. Therefore, the back pay they traditionally get erases the shutdown's direct impact on nominal GDP. On the other hand, real compensation is calculated from hours worked. Since furloughed federal workers do not work overtime after a shutdown, hours that are not worked are permanently lost, raising the implicit cost of public services. Implied prices paid for federal government compensation is the ratio between nominal and real compensation. During past shutdowns, because there was a decrease in real compensation due to fewer hours worked without a corresponding decrease in nominal compensation, which was restored by retroactive back pay, implied prices for federal compensation shot up. In other words, the furlough's effect on the BEA's estimates was to lower the level of government services provided while maintaining the same cost of those services.

Changes to GDP growth

U.S. GDP rose a healthy 2.1% in the second quarter, according to the Bureau of Economic Analysis' third estimate, the fourth consecutive quarter of growth near or above the economy's potential. Inventories switched from a major drag to neutral as many components, including consumer spending, imports, government spending, and nonresidential business investment, contributed to growth with none dominating. Exports and residential investment weighed on growth.

Revisions to second-quarter GDP were neutral on net. Downward revisions to consumer spending primarily on utilities, transportation services, furniture and apparel were offset by upward revisions led by structures investments, exports of services, and a downward revision to imports of business services. Beyond that, revisions were large as comprehensive revisions done once every five years were released. The base year for real measures was advanced from 2012 to 2017 impacting the level of all deflators and real measures. Average annual growth over the 2017-2022 and 2009-2019 periods were each revised up by 0.1 percentage point. The impact of the comprehensive revisions on the GDP outlook was minimal, however.

Consumer spending remained a source of growth in the second quarter, but its contribution shrank dramatically after cost-of-living adjustments boosted after-tax income in the first quarter. It added 0.55 percentage point to growth. Nonresidential fixed investment improved, adding 1 percentage point to growth, its largest contribution since the first quarter of last year. Government contributed 0.6 percentage point with state and local spending leading the gain. Residential investment continued to slide, pulling growth down by 0.1 percentage point. Trade was nearly neutral for growth with a 1.1-percentage point drag from exports slightly more than fully offset by falling imports. Inventories were neutral for growth.

High-frequency data suggest the economy had more momentum at the start of the third quarter than previously thought. Hence, growth is expected to accelerate briefly before slowing in the fourth quarter. We now expect that third-quarter real GDP growth will be higher than previously forecast, with upward revisions to consumer spending growth, federal government spending and international trade outweighing downward revisions to the contribution from inventory investment. Subsequently, growth was revised down marginally as higher long-term interest rates take their toll. The net effect is little change in projected real GDP projected for this year, followed by modestly weaker growth the next few years. On an annual average basis, growth is projected to be 2.1% in 2023 and 1.3% in 2024, compared with projections of 2.1% and 1.4%, respectively, in the September outlook. Growth returns to trend in 2026.

Monetary policy

Monetary policy assumptions are unchanged from the last update. We expect that Fed's July 25 basis points rate hike was the last of the current tightening cycle and that the policy rate has reached its terminal range of 5.25%-5.5%. We anticipate that the Federal Open Market Committee will start lowering rates by June of next year. We expect that the Fed will relax monetary policy slowly, cutting rates by 25 basis points per quarter until reaching 2.75% by the fourth quarter of 2026, and 2.5% in 2027.

The Fed continues to balance inflation and labor market tightness against financial conditions. A summer rally in global oil prices had a modest impact on August year-ago headline inflation, which rose from 3.4% to 3.5%. But year-ago core inflation came in lower than expected, falling from 4.3% to 3.9%. In a similar vein, headline year-ago September consumer price inflation held steady at 3.7% from August, while core inflation fell from 4.4% to 4.1%.

Meanwhile, U.S. Treasuries witnessed a sharp September sell-off, which caused the cost of credit to rise broadly. The 10-year Treasury yield, which had been on the incline since May, briefly breached 4.8% in early October, a 60 basis point increase from early September, before settling near 4.6% as oil prices receded, and Hamas attacks in Israel caused flight to safety into Treasuries.

Markets have come to terms with Fed announcements that interest rates will remain high for longer given the U.S. economy's underlying strength. A much stronger than expected September jobs report, which had the U.S. add 336,000 jobs from August, contributed to this perception. In our estimation these tighter financial conditions will exert sufficient downward pressures on demand and prices. Our baseline assumes that banks will continue to throttle credit growth, but that the financial system overall remains stable.

Inflation remains the key to our outlook. The October vintage has year-ago consumer price inflation at 3% by the end of 2023, as in the previous outlook. We now anticipate inflation to approach the Fed's target range around the fourth quarter of next year. Remaining inflationary pressures from shelter and other U.S. service industries will soften. We also believe a soft landing to be the most likely outcome for the U.S. economy, thanks to resilience of consumers and labor markets.

Financial conditions, meanwhile, have tightened. The Treasury 10-year yield averaged 4.2% in the third quarter, and we expected it to average 4.3% in the fourth, up by 20 basis points from the September baseline. We still expect the rate to fall and approach its equilibrium level of 4%, although more slowly, by the second quarter of next year.

Foreign exchange markets are more relaxed than they were at their peak last October, as the Fed has approached the end of the current hiking cycle. However, rising U.S. interest rates have recently strengthened the Dollar. On a real broad trade-weighted basis, the U.S. dollar is still up more than 7% from its pre-pandemic level and has appreciated by 3% from July through September.

Energy

Moody's Analytics has kept its energy price forecasts little changed in the month of October. Oil prices finally lost steam as we had been expecting them to, but then war broke out between Israel and Hamas. This has caused us to believe that the U.S. will tighten screws on Iranian oil exports by more strictly enforcing oil sanctions. As a result, we have raised our price forecast for Brent and WTI by $1 per barrel in the near term.

Our forecast for U.S. natural gas prices has been trimmed by 20-40 cents over the next 2-3 years. Natural gas prices have finally shown signs of life, buoyed by expected cooler temperatures in the U.S. over the next few weeks. Gas prices still have further to go, however. Henry Hub futures have risen to $3.37, but we expect them to average $3.74 in the fourth quarter of 2024. Prices will rise further in 2024 as more LNG export capacity comes online that will help send gas from the U.S. to Europe.

Labor market

The September employment report was an upside surprise but is bad news for the Federal Reserve in its fight to cool the economy. Payroll employment rose by 336,000, far stronger than both our forecast and consensus expectations. In addition, the impact of revisions to prior months was significantly positive with the July and August figures revised higher by a combined 119,000. Job growth has now averaged 266,000 over the last three months, compared with a pre-revision average of just 150,000 in August.

Monthly job gains in the third quarter were in line with the second quarter, but a sharp slowdown is still expected into year end. Job growth will average about 75,000 in the fourth quarter before dropping below 50,000 per month in the first half of 2024. The unemployment rate forecast was little changed given that it held steady at 3.8% to close the third quarter. The unemployment rate is still expected to close the year at 3.9% before rising further next year to reach a peak at 4.2%, unchanged from the prior forecast. Over the next year, the change in the unemployment rate will be right on the border of the 50-basis point increase—within a 12-month period—that historically has been a reliable indicator that the economy is in a recession.

Business investment and housing

In its benchmark revisions of the GDP data, BEA moderately raised its estimate of second-quarter growth in real business investment compared to its previous report. The new figure was 7.5% annualized compared to earlier 6.1%. Equally important, the revised figures show that growth in real investment back in 2022 and the first quarter of 2023 was substantially higher than in the pre-benchmark data.

Structures and intellectual property accounted for the increases, whereas the overall growth in total equipment spending was essentially unchanged. Within structures, the second quarter decline in mining structures was less than previously reported and spending was up nearly 9% year over year. Although there was a small downward revision in second quarter spending on new manufacturing plants, the segment is booming, up more than 60% year over year. The struggling commercial segment, which includes office, rose somewhat more than in the earlier report, but that was because a previously reported jump in the fourth quarter of 2022 was erased in the new data.

Even though the growth in total equipment was fundamentally unchanged overall, there were shifts in the detail. Real transportation equipment spending is still leading the way, up more than 20% year over year. Aircraft spending was the biggest source, up nearly 50% year over year as airlines work to meet post-pandemic demand for air travel and replace older planes with more fuel-efficient models. Light trucks were up more than 25% year over year as supply chain shortages ease and auto rental companies add to their fleets, consistent with the surge in vacation travel. By contrast, IT equipment spending was revised downward for the second time, consistent with the fact that outlays by companies to support remote working has fallen sharply following the end of the pandemic.

But high frequency data remain unimpressive. Although shipments of nondefense, nonaircraft capital goods adjusted for inflation rose modestly in August, they have trended down since early 2022 are 1% below a year ago. Inflation adjusted new orders are down 3% over that time.

The benchmark revisions to business investment in 2022 and the first half of 2023 contributes to a higher outlook. Real fixed business investment will grow 4.0% at an annual rate in 2023 compared to 2.7% in the September forecast.

The short-term trajectory for new home sales was adjusted downward modestly this month to account for recent sales trends and rising mortgage rates. Existing home sales activity was already projected to be low with the marginal impact of higher interest rates on additional home listings expected to be limited.

New single-family home construction activity is expected to remain muted but will trend higher in the long run given favorable demographics and a housing deficit of over 1.5 million units based on recent vacancy rates. Multifamily permits and starts are expected to remain depressed given tighter lending standards for CRE construction loans, higher cost of capital, and the record number of projects currently under construction.

House prices are forecasted to report near term strength as homebuyers who locked in their interest rates previously complete their transactions. Over a longer time horizon, prices are expected to trend down slightly through late 2025. Limited inventory will support prices in the near term, but lack of mortgage payment affordability will lead to price discounts given expectations for interest rates to remain high.

The outlook for CRE prices remains pessimistic but is largely unchanged from last month with office and apartment buildings expected to register the largest price declines.

THE LONG VIEW: EUROPE

U.K. Stages a Shallow Comeback

By OLIA KURANOVA

The U.K.'s real GDP expanded 0.2% month over month in August, following a decline of 0.6% in July—a downward revision from the initial estimate of a 0.5% fall. Activity inched up after July's contraction, but August's rebound still failed to reverse all the previous month's losses. Service output rose 0.4% and was the only contributor to growth from the three main sectors. Business-related activity and education and healthcare made positive contributions to growth.

Even within services, the news was not all rosy. Weakness was evident within consumer-facing services, with activity declining for a second consecutive month. This suggests there was negative impact on willingness to spend, after it became apparent in the summer that interest rates would peak at a higher level than previously expected.

In August, after a series of on-and-off hikes, the Bank of England implemented its latest 25-basis point increase to the policy rate, leaving it at 5.25%. Indeed, in August, one of the largest contractions in services was in the arts, entertainment and recreation sector, which shrank 7.4% month over month. This signals that as fears over rising interest rates permeated the economy, consumers cut back on discretionary spending.

In September, the bank kept its policy rate unchanged. Consumer confidence recovered handily, even though it remained firmly in negative territory.

Other headwinds to growth are building. Over the next 18 months, around 2 million fixed-rate mortgages will expire, and those homeowners are likely to be adjusting their spending and savings habits in advance. Meanwhile, rents are rising more rapidly than incomes.

We believe that discretionary consumer spending will remain under pressure, since the underlying pace of economic growth remains muted. And absent a notable acceleration in September, third-quarter GDP growth is likely to fall a little short of the baseline assumption.

Germany Cheers for Base Effects

In September, German inflation declined significantly to 4.5% year over year from 6.1% previously. But since the deceleration largely stemmed from base effects within energy and service inflation, the drop in the headline did not come as a big surprise. We expect inflation to moderate further in the months ahead, averaging 4% in the fourth quarter.

From June to August, base effects related to last year's reduction in public transport prices exerted upward pressure on the inflation rate. In September, when they ceased to have an influence, service inflation eased markedly with the rate falling to a nine-month low.

Although we expect price pressures within services to moderate in upcoming months, service inflation will remain too high for comfort through next year. Meanwhile, although the inflation rate for nonenergy goods came down in September, production costs are high and continue to feed into consumer prices.

Indeed, core inflation will become the main driver of price dynamics. At 4.6% year over year, the core rate was higher than the headline during September, and we expect this gap to widen. Stickier core inflation will be the case in much of the euro zone, so a restrictive monetary policy stance will remain necessary to bring inflation back to target on a sustainable basis.

Regarding the headline components, the annual inflation rate within energy slowed considerably, helped along by base effects. From August to September, prices changed little, but at the same time last year prices rose around 8% as wholesale natural gas prices spiked. Therefore, year-over-year progress in commodity markets has allowed consumer utility bills to ease to just 1% above where they were a year earlier.

On a final note, food inflation also sharply declined, by 1.5 percentage points. But at 7.5% year over year, the food inflation rate remains considerably above historic standards.

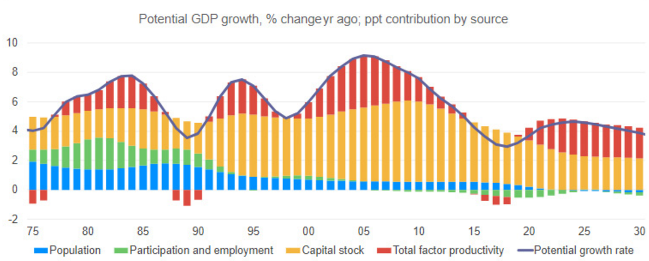
We expect that over the coming year, headline inflation will be close to the 2% target, but the core rate will be closer to 3%. Upside risks to the inflation outlook could materialise if oil prices settle at a rate higher than the baseline expectation. As of the September baseline, we expect Brent crude to begin the first quarter of 2024 at around $90 and then ease to $79 per barrel by the first quarter of 2025.

Demographics—the Least of China's Problems

By STEFAN ANGRICK

Demographics are important, but they're not destiny. Nowhere is this more evident than in Northeast Asia. Although most of the world saw rapid population growth in the second half of the 20th century, few countries grew their economies as fast as China, South Korea, Taiwan, and Japan.

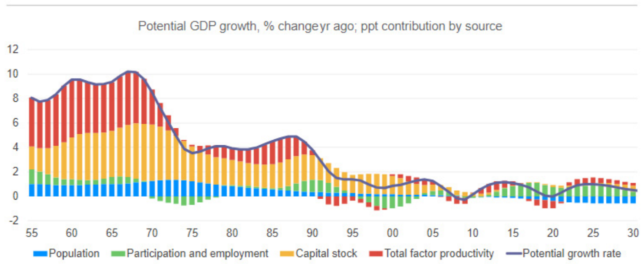
Population Growth Explains Only a Fraction of Chinese Output Growth



Sources: National Bureau of Statistics, Penn World Tables, Moody's Analytics

Population growth has played a relatively limited role at driving economic gains, based on our analysis examining output growth in these four Northeast Asian economies. Using a method called "growth accounting", we have broken down potential output growth into contributions from changes in population, labour participation and employment, capital, and total factor productivity (which captures gains not attributable to other factors). Our findings indicate that population growth accounts for only a fraction—roughly between a tenth to a fifth—of historical GDP growth. Capital accumulation and total factor productivity were more influential drivers of economic progress in all four economies. In essence, what matters most for developmental gains is not the size of a population, but how it is put to work.

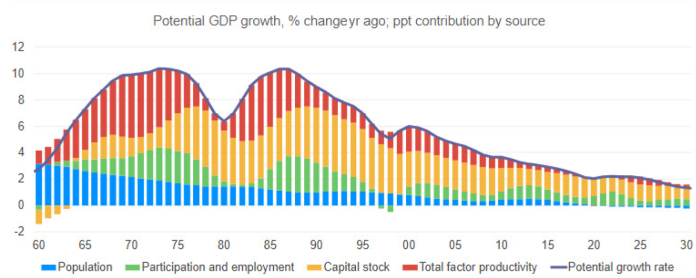
Demographics Don't Explain Japan's Sharp Slowdown in the 1990s



Sources: Cabinet Office Japan, Penn World Tables, Moody's Analytics

Our results also show that large shifts in output growth—slowdowns or accelerations—are largely unrelated to demographic factors. For example, Japan's slowdown in the 1990s was not due to a sudden population decline, but rather an abrupt slump in demand that increased unemployment and zapped capital spending. This aspect is often overlooked in comparisons between China and Japan that focus only on demographics. Similarly, South Korean economic growth accelerated in the 1960s while population growth slowed.

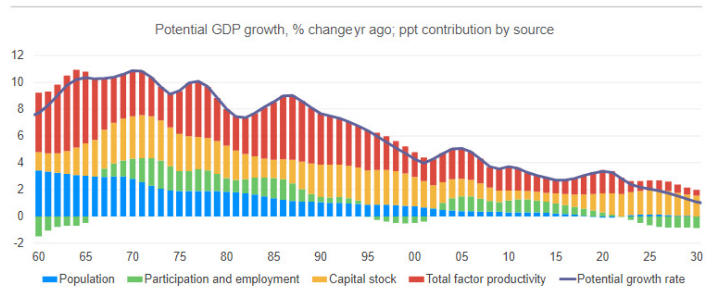
South Korean Output Growth Picked Up as Population Growth Slowed



Sources: Bank of Korea, Penn World Tables, Moody's Analytics

Although population growth does influence our outlook for China, South Korea, Taiwan, and Japan, it is only one piece of the puzzle. We look for GDP to keep growing in all four economies despite demographic challenges. Chinese per capita output still trails neighbouring economies, leaving room for catch-up growth through increased capital accumulation and productivity gains. These same factors will also be pivotal in driving growth in South Korea, Taiwan, and Japan. However, as they have already reaped many of the benefits of better technology and productivity, innovation will offer smaller gains from here for this trio. Efforts to lift the number of women and foreign workers in the labour force can also help offset demographic drag, particularly in rapidly ageing economies like Japan and South Korea.

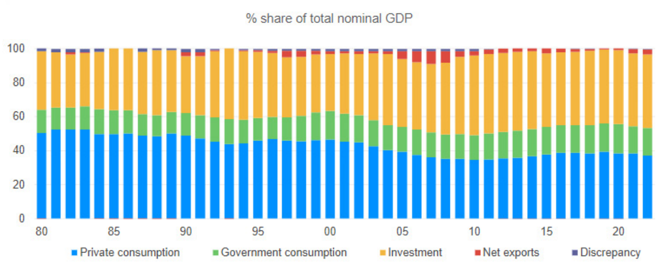
Taiwan's Economy Will Grow Despite a Greater Demographic Drag



Sources: Central Bank of Taiwan, Penn World Tables, Moody's Analytics

Demographics are therefore an important but often overstated part of China's economic challenges. The biggest problem facing China's economy today is not its ageing population but rather weak domestic demand. In other words, China doesn't lack people to produce output; it lacks consumers who can purchase what is made. This has contributed to an [unbalanced growth model] that is overly reliant on trade surpluses and investment for growth.

China's Consumption Share of GDP Is Low



Sources: National Bureau of Statistics, Moody's Analytics

None of this is to say demographics aren't important: far from it. Demographic change can influence labour participation and the pace of capital spending, although both effects can be hard to pin down in practice. But overemphasis of demographics and other supply-side factors risks [skewing policy] away from effective demand management. When Japan's asset price bubble burst in the 1990s, policymakers and economists largely attributed the subsequent slowdown to [supply-side] factors, delaying necessary monetary and fiscal policy action. Much like a mechanic who insists on a complete engine overhaul to fix a flat tyre, focus was directed away from remedies to the problem at hand. This deepened the economy's demand shortfall. Investment spending evaporated and capital accumulation stalled. In a cruel irony, this had a more detrimental impact than demographic drag on Japan's potential growth rate. China would do well to avoid a repeat of that experience.

IMF Forecast Revision Shows a Better Outlook

By GUSTAVO ROJAS-MATUTE

The International Monetary Fund published its update of the World Economic Outlook, pointing out a more optimistic picture than other regions. In Latin America and the Caribbean, things are looking better. Although the region will grow less than in 2022, the IMF raised its expectations by a small amount: 0.4 percentage point in 2023 and 0.1 in 2024. This means the region might be on a path to improved economic conditions.

The revision is less optimistic when we look at the category of countries called Emerging Markets and Developing Economies; there's a slight drop in their expected growth by 0.1 percentage point. China, a significant player in the world economy, is set to grow lower than previously forecast. The IMF predicts China will grow at 5% and 4.2% in 2023 and 2024, respectively. These numbers are less than forecasters previously thought, indicating that there are challenges ahead.

Looking at the whole world, the IMF tells us that the global economy is staying the same. Things are stable but not getting much better. Most advanced economies are going to grow more slowly. They went from growing 2.6% in 2022 to just 1.5% in 2023 and 1.4% in 2024.

The divergences among economies are noticeable. While the U.S. is doing better than expected, with a growth rate of 2.1% in 2023, Europe is expected to grow by just 0.7% in 2023.

Regarding inflation, the IMF also says that it is going down. Nevertheless, it will still be higher than what countries would like in 2023 and 2024. In most advanced economies, the inflation rate will hit the central bank targets by 2025.

In the background, some risks could make the economy more uncertain. One of these is the prices of commodities such as oil and gas, which can change due to geopolitical conflicts such as the one between Russia and Ukraine. There are also concerns about China's economy slowing down even more.

In summary, the world's economic situation is mixed, but the region's outlook is more optimistic. The divergence is present in the global economy. Different areas have different stories.

Central banks of major economies and their monetary policy will continue to play a significant role during the rest of this year and the next. Although inflation is expected to ease over time, the cost of disinflation could cause a severe downturn.

Downgrades Dominate in U.S., Europe Breaks Even

By OLGA BYCHKOVA

U.S.

U.S. credit downgrades outnumbered upgrades in the latest weekly period. The changes issued by Moody's Investors Service spanned a diverse set of speculative- and investment-grade bonds and industrial and financial companies. Downgrades comprised two of the four rating changes and 100% of affected debt.

Downgrades were headlined by a technology-focused mortgage company, LD Holdings Group LLC, with its corporate family rating lowered to Caa1 from B3 and its backed senior unsecured debt rating cut to Caa2 from Caa1, impacting 100% of debt affected in the period. The outlook was changed to negative from stable. According to Moody's Investors Service, the downgrade the corporate family rating reflects the company's modest capitalization and weak profitability. While its first unsecured debt maturity is not until November 2025, the company faces rising refinancing risk given its weak profitability and modest capitalization along with a continued expected challenging operating environment. The rating agency expects the company's profitability to remain constrained over the next 12 to 18 months as industry origination volumes will continue to be depressed given current high interest rates, and residential mortgage originators will continue to face excess capacity headwinds pressuring gain-on-sale margins and, in turn, return on assets.

LD Holdings' Caa2 long-term senior unsecured debt rating is one notch below its Caa1 corporate family rating and is reflective of its subordinate ranking to mortgage servicing rights secured debt facilities in the company's capital structure. The lower unsecured debt rating reflects the company's current ratio of mortgage servicing rights secured corporate debt to total corporate debt of around 50%. The unsecured debt rating could be downgraded further if the ratio of secured debt to total corporate debt increases and is expected to remain meaningfully above 50%. The change in outlook to negative is driven by the credit agency's expectation that it could be very challenging for the company to achieve profitability in the current market.

In September, almost 60% of ratings actions issued by Moody's Investors Service were credit downgrades. Similarly, through the first nine months of the year U.S. rating changes were predominantly negative with downgrades exceeding upgrades 392:238.

Europe

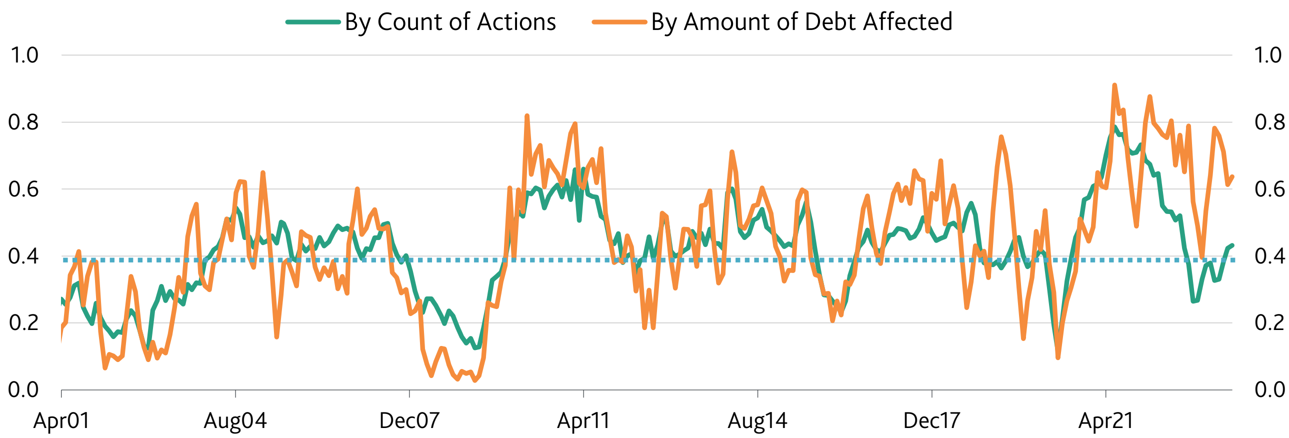
Corporate credit rating change activity was a bit stronger across Western Europe with as many upgrades as downgrades. Upgrades comprised two of the four rating changes and 70% of debt affected in the period. The changes issued by Moody's Investors Service spanned a diverse set of speculative- and investment-grade firms.

The largest upgrade was to contract food service company Compass Group PLC, which saw its long-term senior unsecured debt ratings raised to A2 from A3. Moody's Investors Service also upgraded the backed long-term senior unsecured debt ratings of Compass Group Finance Netherlands B.V. (Compass Finco), an indirect subsidiary of Compass Group PLC, to A2 from A3; the provisional unbacked and backed ratings on the £6 billion senior unsecured Euro Medium Term Note program issued by Compass and Compass Finco, respectively, to (P)A2 from (P)A3; and the short-term issuer ratings of Compass and Compass Finco and the short-term unbacked and backed ratings of the $4 billion commercial paper program issued by Compass and Compass Finco, respectively, to Prime-1 from Prime-2. The outlook on all ratings changed to stable from positive.

According to Moody's Investors Service, the ratings upgrades reflect the company's leading market positions, with sustainable competitive advantages, particularly in North America; diversified industry mix and track record of stable performance through the cycle; high levels of sustained organic revenue growth before the pandemic; strong recovery in trading performance in fiscal 2022 and year-to-date 2023 with prospects for continued growth on a sustained basis; conservative financial policies including a disciplined approach to acquisitions; and excellent liquidity profile. The rating action also reflects the company's continued strong trading in the context of ongoing inflationary and economic pressures and expectations that Compass will continue to grow organic revenues and margins and gain market share.

Contrastingly to the U.S., in September, 69% of ratings actions issued by Moody's Investors Service in Western Europe were credit upgrades. Nevertheless, from January to September this year Western Europe rating changes were mostly negative with downgrades slightly exceeding upgrades 140:138.

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
10/5/2023	QLIK TECHNOLOGIES, INC.-PROJECT ALPHA INTERMEDIATE HOLDING, INC.	Industrial	LTCFR/PDR		U	B3	B2	SG
10/5/2023	LD HOLDINGS GROUP, LLC	Financial	SrUnsec/LTCFR	1100	D	Caa1	Caa2	SG
10/9/2023	LINCOLN NATIONAL CORPORATION	Financial	SrUnsec/Sub/JrSub/IFSR		D	Baa1	Baa2	IG
10/10/2023	CPV SHORE HOLDINGS, LLC	Industrial	SrSec/BCF		D	Ba3	B1	SG

Source: Moody's

FIGURE 4

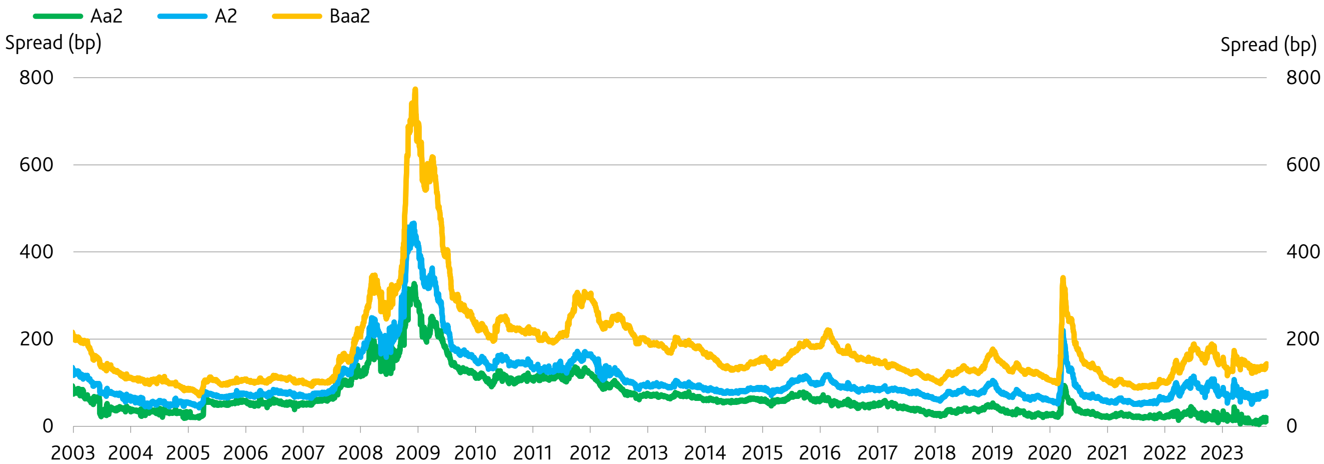
Rating Changes: Corporate & Financial Institutions - Europe

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG	Country
10/4/2023	COMPASS GROUP PLC-COMPASS GROUP FINANCE NETHERLANDS B.V.	Industrial	SrUnsec/MTN/CP	3124.089	U	A3	A2	IG	NETHERLANDS
10/5/2023	ZEPHYR MIDCO 2 LIMITED	Industrial	LTCFR/PDR		U	B3	B2	SG	UNITED KINGDOM
10/9/2023	CHROME HOLDCO-CHROME BIDCO	Industrial	SrSec/SrUnsec/SrSec/BCF/LTCFR/PDR	1312.046	D	B1	B2	SG	FRANCE
10/10/2023	S4 CAPITAL PLC-S4 CAPITAL LUX FINANCE S.A R.L.	Industrial	SrSec/BCF/LTCFR/PDR		D	Ba3	B1	SG	LUXEMBOURG

Source: Moody's

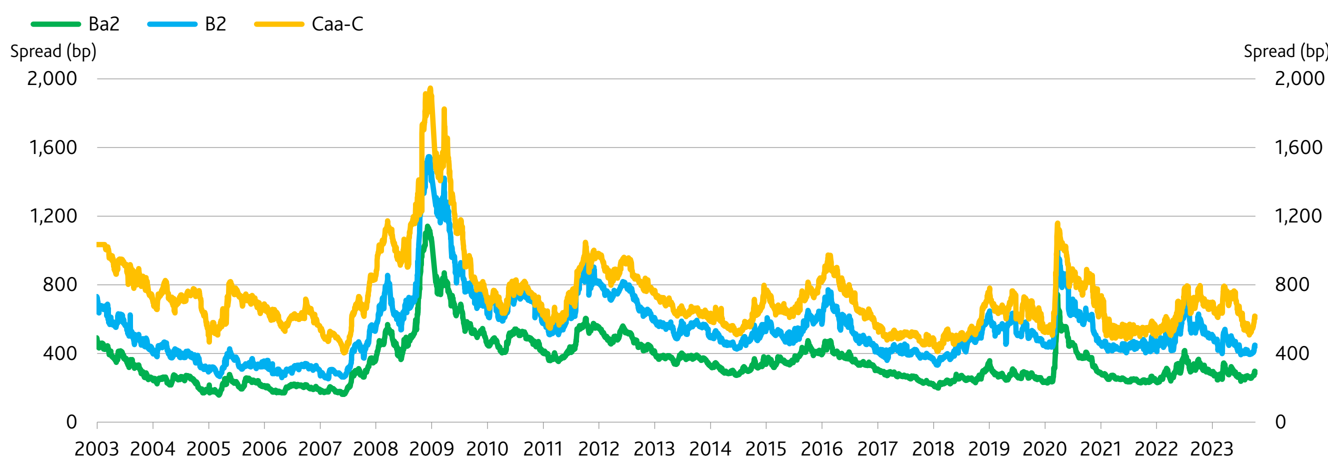
MARKET DATA

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 (October 4, 2023 – October 11, 2023)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Oct. 11	Oct. 4	Senior Ratings
Pioneer Natural Resources Company	Aa2	A3	Baa1
Bank of America Corporation	Baa2	Baa3	A1
JPMorgan Chase Bank, N.A.	A2	A3	Aa2
John Deere Capital Corporation	Aa3	A1	A2
Ford Motor Credit Company LLC	Ba2	Ba3	Ba1
International Business Machines Corporation	A1	A2	A3
McDonald's Corporation	Aa1	Aa2	Baa1
Walmart Inc.	Aa1	Aa2	Aa2
Bristol-Myers Squibb Company	Aa1	Aa2	A2
U.S. Bancorp	Baa2	Baa3	A3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Oct. 11	Oct. 4	Senior Ratings
Alabama Power Company	Baa2	A3	A1
DaVita Inc.	B1	Ba2	B1
American Honda Finance Corporation	A3	A2	A3
Southern Company (The)	A3	A2	Baa2
State Street Corporation	A3	A2	A1
Bank of America, N.A.	Baa3	Baa2	Aa1
Becton, Dickinson and Company	Baa2	Baa1	Baa2
Fifth Third Bancorp	Ba1	Baa3	Baa1
Texas Instruments, Incorporated	A2	A1	Aa3
Emerson Electric Company	A2	A1	A2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Oct. 11	Oct. 4	Spread Diff
Rite Aid Corporation	Ca	59,384	46,896	12,488
DaVita Inc.	B1	366	239	127
Liberty Interactive LLC	Caa2	3,208	3,115	93
Deluxe Corporation	B3	788	741	47
Hertz Corporation (The)	Caa1	460	423	37
KeyCorp	Baa1	242	207	35
Lumen Technologies, Inc.	Caa3	3,499	3,470	29
Tenet Healthcare Corporation	B3	372	345	27
Brandywine Operating Partnership, L.P.	Ba1	436	409	27
Fifth Third Bancorp	Baa1	161	137	24

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Oct. 11	Oct. 4	Spread Diff
CSC Holdings, LLC	B2	1,624	1,858	-234
Dish DBS Corporation	Caa2	1,815	1,933	-118
Dish Network Corporation	Caa2	1,524	1,623	-99
Embarq Corporation	Caa2	2,469	2,554	-85
Staples, Inc.	Caa2	2,814	2,899	-84
Pitney Bowes Inc.	B3	1,139	1,189	-50
Service Properties Trust	B2	505	552	-47
Frontier Communications Holdings, LLC	Caa2	686	727	-41
Nabors Industries, Inc.	Caa1	530	564	-34
Gap, Inc. (The)	B1	466	500	-34

Source: Moody's, CMA

CDS Movers

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

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Oct. 11	Oct. 4	Senior Ratings
France, Government of	Aaa	Aa1	Aa2
Commerzbank AG	Baa1	Baa2	A2
Orange	Aa2	Aa3	Baa1
Equinor ASA	Aa1	Aa2	Aa2
British Telecommunications Plc	Baa2	Baa3	Baa2
Bank of Ireland	Baa3	Ba1	A1
ZF Europe Finance B.V.	B1	B2	Ba1
Pernod Ricard S.A.	Aa1	Aa2	Baa1
Experian Finance plc	Aa1	Aa2	Baa1
Jaguar Land Rover Automotive Plc	B3	Caa1	B1

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Oct. 11	Oct. 4	Senior Ratings
Landesbank Hessen-Thueringen Girozentrale	Baa1	A2	Aa3
Royal Philips N.V.	Baa1	A2	Baa1
Italy, Government of	Baa3	Baa2	Baa3
Spain, Government of	A2	A1	Baa1
NATIXIS S.A.	A3	A2	A1
BPCE	A3	A2	A1
HSBC Holdings plc	Baa2	Baa1	A3
Credit Agricole S.A.	A2	A1	Aa3
UniCredit S.p.A.	Baa3	Baa2	Baa1
Svenska Handelsbanken AB	A3	A2	Aa2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Oct. 11	Oct. 4	Spread Diff
Vedanta Resources Limited	Caa3	3,026	2,681	345
Stonegate Pub Company Financing 2019 plc	Caa2	618	541	77
Alstom	Baa3	220	150	70
Garfunkelux Holdco 3 S.A.	Caa2	1,576	1,538	38
Piraeus Financial Holdings S.A.	Ba3	295	268	26
Schaeffler AG	Baa3	285	264	21
Fresenius SE & Co. KGaA	Baa3	154	135	19
CPI Property Group	Baa3	629	610	19
Virgin Money UK PLC	Baa1	202	184	18
TK Elevator Holdco GmbH	Caa1	604	587	17

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Oct. 11	Oct. 4	Spread Diff
Jaguar Land Rover Automotive Plc	B1	539	605	-67
Boparan Finance plc	Caa3	1,884	1,949	-65
Carnival plc	B3	585	613	-28
OI European Group B.V.	Ba3	248	264	-16
Hapag-Lloyd AG	Ba3	252	266	-14
Verisure Midholding AB	B3	468	481	-13
Bank of Ireland	A1	130	142	-12
Ziggo Bond Company B.V.	B3	472	483	-11
ZF Europe Finance B.V.	Ba1	384	394	-10
Volvo Car AB	Ba1	250	260	-10

Source: Moody's, CMA

CDS Movers

Figure 5. CDS Movers - APAC (October 4, 2023 – October 11, 2023)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Oct. 11	Oct. 4	Senior Ratings
Korea Gas Corporation	Aa3	A2	Aa2
LG Chem, Ltd.	A3	Baa2	A3
China, Government of	Baa1	Baa2	A1
Philippines, Government of	Baa1	Baa2	Baa2
Bank of China (Hong Kong) Limited	Baa2	Baa3	Aa3
Vanke Real Estate (Hong Kong) Company Limited	Caa3	Ca	Baa2
LG Electronics Inc.	Baa1	Baa2	Baa2
Japan Tobacco Inc.	Aaa	Aa1	A2
Japan, Government of	Aa1	Aa1	A1
Australia, Government of	Aaa	Aaa	Aaa

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Oct. 11	Oct. 4	Senior Ratings
Mizuho Financial Group, Inc.	A2	Aa3	A1
Mizuho Bank, Ltd.	A1	Aa2	A1
Tenaga Nasional Berhad	A2	Aa3	A3
Telekom Malaysia Berhad	A2	Aa3	A3
India, Government of	Baa1	A3	Baa3
Westpac Banking Corporation	A2	A1	Aa3
Mitsubishi UFJ Financial Group, Inc.	Aa3	Aa2	A1
Sumitomo Mitsui Trust Bank, Limited	A2	A1	A1
Korea Development Bank	Aa3	Aa2	Aa2
Development Bank of Japan Inc.	A3	A2	A1

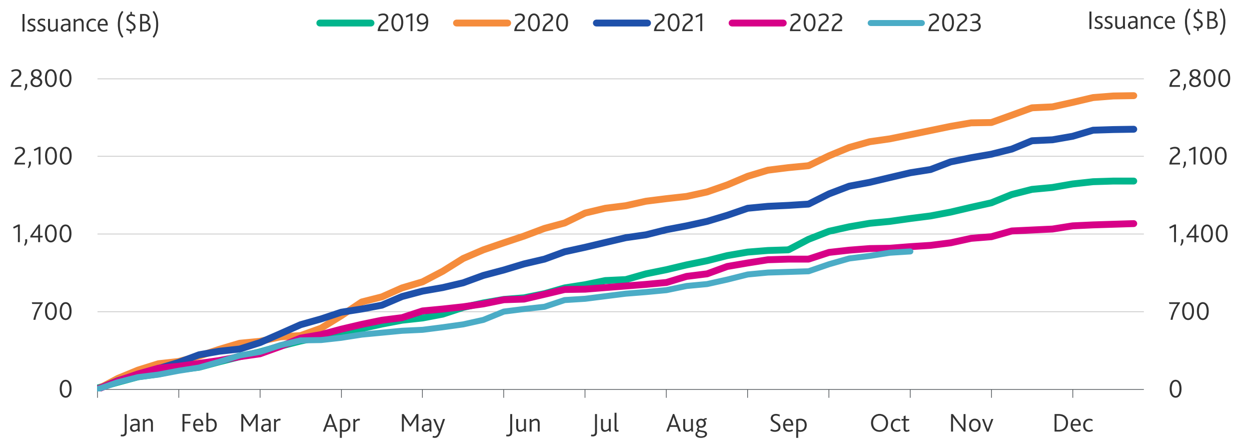
CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Oct. 11	Oct. 4	Spread Diff
Pakistan, Government of	Caa3	3,603	3,262	341
Adani Green Energy Limited	B2	796	773	23
Mizuho Financial Group, Inc.	A1	56	45	11
GMR Hyderabad International Airport Limited	Ba3	247	236	11
JSC Halyk Savings Bank of Kazakhstan	Ba2	379	367	11
Mizuho Bank, Ltd.	A1	50	40	10
CNAC (HK) Finbridge Company Limited	Baa2	204	196	9
Development Bank of Kazakhstan	Baa2	172	162	9
Toyota Industries Corporation	A2	104	95	9
Amcor Pty Ltd	Baa2	120	113	7

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Oct. 11	Oct. 4	Spread Diff
Vanke Real Estate (Hong Kong) Company Limited	Baa2	865	1,098	-233
LG Chem, Ltd.	A3	69	86	-17
Boral Limited	Baa2	110	128	-17
Bank of China (Hong Kong) Limited	Aa3	102	112	-9
RHB Bank Berhad	A3	94	103	-9
Bank of China Limited	A1	91	100	-8
Korea Gas Corporation	Aa2	47	55	-8
LG Electronics Inc.	Baa2	80	88	-8
Agricultural Bank of China Limited	A1	93	101	-8
CITIC Group Corporation	A3	116	123	-8

Source: Moody's, CMA

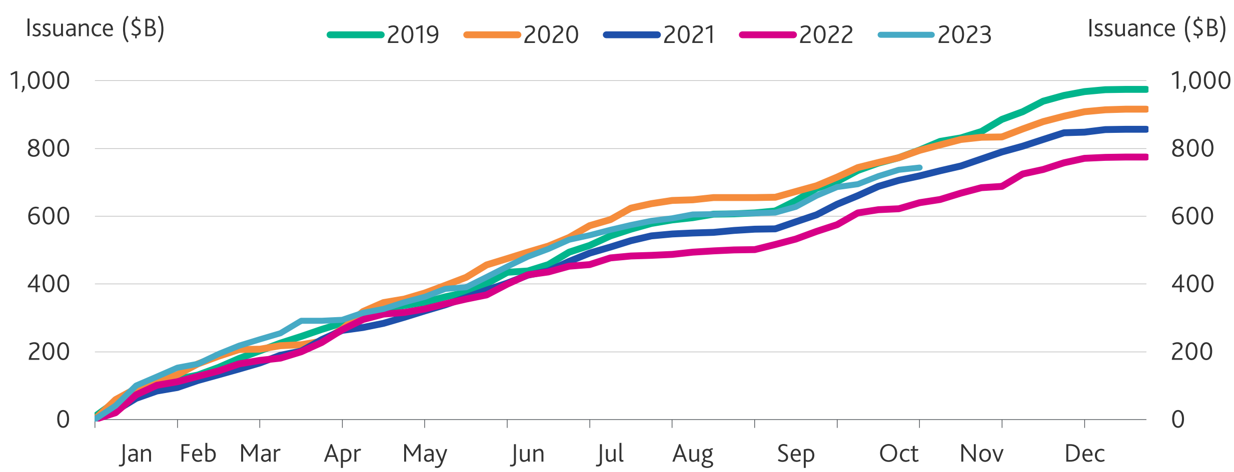
ISSUANCE

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	9.650	0.000	10.550
Year-to-Date	1,055.142	157.991	1,243.541

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	4.837	0.370	6.860
Year-to-Date	658.657	57.942	743.522

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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