MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

JANUARY 11, 2024

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A Touch on the Strong Side

U.S. CPI inflation rose 0.3% in the final month of 2023. This aligns with Moody's Analytics forecast but comes in a touch stronger than consensus expectations. Excluding food and energy, the CPI rose 0.3% in December, which was higher than our and consensus calls for a 0.2% gain. Relative to a year-ago, core CPI was up 3.9%, down slightly from November's 4% annual rate.

The Federal Open Market Committee would have certainly preferred a softer report, but December's modest acceleration will not knock the interest-rate-setting committee off course. When the FOMC meets at the end of January, fed funds pricing data place a 97% probability that committee will keep the main policy rate unchanged. With further interest rate hikes unlikely, incoming inflation and labor market data will determine when the first cut occurs. Our latest baseline forecast expects that to happen in May, while investors anticipate a March cut. Before that March FOMC meeting, there will be two more CPI reports and the important employment cost index for the fourth quarter.

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The details

After falling more than 2% in recent months, energy prices rose 0.4% in December. Gasoline prices moved sideways after falling 6% in November, but this was offset by an increase in electricity costs. Throughout 2023, food prices grew at a low and stable rate. Relative to a year prior, the CPI for food was up 2.7% in December. Relief has come from the grocery store. Food at home prices ticked up 0.1% in December and were just 1.3% higher relative to a year prior. Prices for food away from home have risen meaningfully faster. The 0.3% gain in December leaves prices 5.2% higher relative to a year earlier.

New-vehicle prices rose 0.3% in December after ticking down 0.1% in November. After a surprising 1.6% jump in November, used-vehicle prices rose 0.5% in December. The automotive industry, with its uniquely globalized supplier network, was the poster child for pandemic-induced supply-chain issues. Our near- and intermediate-term forecast calls for price moderation as inventories continue to grow.

The rapid price increases of vehicles continue to drive up insurance costs. The CPI for motor vehicle insurance rose 1.5% in December, bringing insurance prices 20.3% higher than a year ago. Maintenance and repair prices dipped 0.3% in December but were still 7.1% higher than a year ago.

Shelter prices continue to moderate. On a year-ago basis, the CPI for shelter was up 6.2% in December, down from its peak of 8.2% in March 2023. By year-end 2024, we expect shelter CPI growth to be 4.1%, nearly 2.5 percentage points below its current rate. The weight given shelter in CPI calculations means this deceleration is the primary driver behind our baseline forecast of 2.6% headline and 2.9% core CPI by the fourth quarter of 2024.

Our January baseline pulled forward the timing of the first rate cut from June to May. That decision was made in response to consistent moderation on the inflation front, and the Fed's acknowledgment of it. December's report falls on the stronger side of expectations but does not represent a material deviation.

What's behind small businesses' pessimism?

U.S.-based small businesses continue to fret amid struggles with high costs and labor constraints. The NFIB Small Business Optimism Index increased in December, rising from 90.6 to 91.9, in line with our forecast. Despite the improvement, sentiment on Main Street is not much better than its April trough below 90. It is being weighed down primarily by expectations of near-term economic weakness.

The vast majority of small firms expect the economy to deteriorate through the new year. The three-month moving average of the net percentage of firms anticipating economic improvement over the next six months is firmly negative at -40%. This is just a touch higher than July 2022's low of -55%. Firms were never this pessimistic about the future of the economy prior to the pandemic.

The feeling of insecurity about the future is linked primarily to the recent spate of inflation and labor market tightness. Prior to the pandemic, Main Street's economic outlook was hardly impacted by either issue. Years of low inflation and a well-supplied labor market kept cost pressures and labor constraints relatively low on the totem pole of small-business worries. However, since the pandemic, the two issues have become the primary drivers of weak expectations.

Year-over-year growth in the consumer price index peaked in June 2022 at 9%, a 40-year high, causing the net percentage of small firms reporting inflation as their chief problem to soar to a record 37% at its July 2022 peak. It has since backtracked to 23%. Despite significant moderation since then, inflation remains above target, and consumers and businesses appear to be sticker shocked by prices nearly 20% higher than before the pandemic began. That is, there seem to be lasting residual effects of high inflation, and Main Street is finding it difficult to move past them.

Another consequence of the pandemic was an unprecedentedly tight labor market. Labor shortages have increased stress for Main Street. In December, 89% of the small businesses that reported they were either hiring or trying to hire had few or no qualified applicants for open positions. And a net 20% of small firms reported labor quality as their primary business concern in December. That was roughly double the average leading up to the pandemic.

Until inflation is back in the bottle with little risk of it reaccelerating, and the labor market rebalances, small firms will continue to have a doom-and-gloom outlook. The good news is that, at 3.1%, inflation is closing in on the Federal Reserve's 2% target and the labor force has added more than 11 million workers since bottoming out in April 2020.

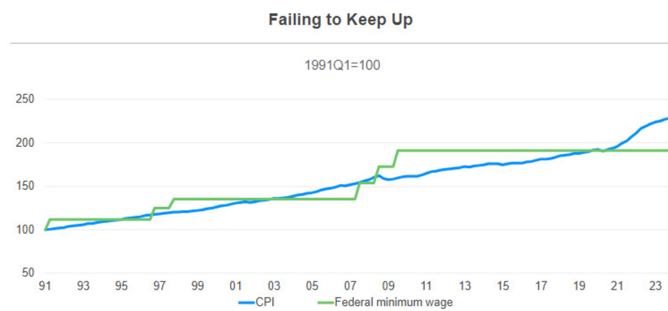
Our current baseline has inflation decelerating further to 2.5% by the end of 2024, and while labor supply growth will slow because of demographic constraints, there will be a net gain of nearly 800,000 workers throughout the year. Still, it may take more time for Main Street to adjust to the post-pandemic economic environment, as the feeling of sticker-price shock and struggles to attract qualified labor may last longer than expected.

TOP OF MIND

Higher Minimum Wages and Inflation Risk

By JUSTIN BEGLEY

On the first day of 2024, workers earning the minimum pay rate got a raise in 22 U.S. states. Minimum wage hikes are common each year, as they are typically implemented to adjust for cost of living increases or to meet certain provisions in existing legislation. Nonetheless, nearly 10 million workers will be affected by the pay hike, according to the Economic Policy Institute.

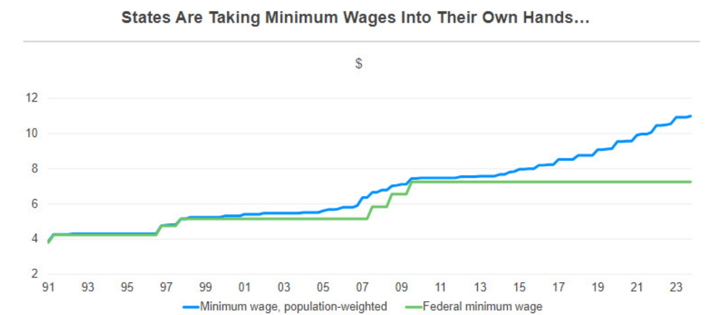


Sources: Dept. of Labor, Moody's Analytics

Increases in the federal minimum wage have been few and far between over the last 30 years; it has stood at $7.25 per hour since 2009. As a result, growth in the wage floor has failed to keep pace with inflation, particularly given the recent spate of rapid price growth, which saw annual growth in the consumer price index top 9% at its peak. Therefore, minimum-wage workers have seen real wages decline since 1991, following the passage of amendments to the Fair Labor Standards Act of 1938 in 1989, which raised the wage floor from $3.35 per hour in 1989 to $4.55 per hour by 1992 and eliminated the minimum wage and overtime pay exemption for small retail businesses.

Minimum wages at the state level

Given the different cost, structural and political dynamics across states, many state and local governments have taken up the mantle of passing their own minimum wage laws. Currently, 30 states and the District of Columbia have minimum wages above $7.25 per hour; the highest can be found in the state of Washington, which boasts a minimum wage of $16.28 per hour as of January 1. Labor markets in the other 20 states are operating at the federal minimum. Efforts at the state level to raise the minimum wage have boosted hourly earnings for many. The effective minimum wage in the U.S.—calculated on a state population-adjusted basis—tracked the federal minimum closely through 2011, but the gap quickly widened, as states took matters into their own hands. Today, the population-weighted minimum wage is nearly $11 per hour, around $3.75 higher than the federal minimum.



Sources: Dept. of Labor, Moody's Analytics

Nearly all the states that have increased their minimum wage in recent years continue to do so, using an incremental methodology. Some states have elected to increase the wage floor by a fixed dollar amount each year while others peg the hikes to some cost-of-living index, typically the CPI. Some states use a combination of both—fixed increases to a specified level, followed by additional hikes that track growth in the CPI. Connecticut, for example, scheduled $1 annual increases through 2023 when the minimum wage reached $15 per hour. In subsequent years, the wage floor will rise with the rate of inflation.

The largest increase to kick off the new year was in Hawaii, which raised its minimum wage by $2 per hour to $14. Six other states—Maryland, Delaware, Nebraska, Illinois, New Jersey and Rhode Island—increased their minimum wage by $1 per hour or more. As a result, seven states and the District of Columbia now have a minimum wage of at least $15 per hour, while several other states such as Florida, Delaware, Illinois, Maryland, Nebraska, New Jersey, Rhode Island and Virginia will join the club in the next few years.

...And These Ten States Raised the Minimum Wage Most in 2024

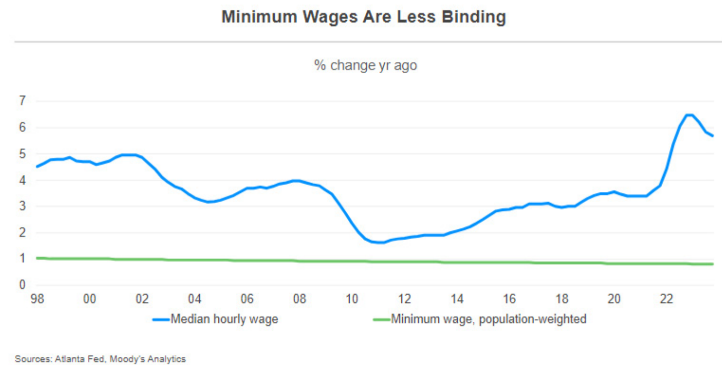
Sources: CNN, Moody's Analytics

Impact on wage growth and inflation

Economic theory typically asserts a price pass-through effect as a consequence of minimum wage increases, where the burden of higher labor costs is either borne by the consumer via higher prices or the worker via reduced hours, cut jobs, or a reduction in nonwage benefits, as firms adjust to steady their costs. However, the impact depends on the structure of each affected industry. The impact of minimum wage increases also depends on how binding they are. In other words, raising the wage floor has a meaningful economic impact only if a sufficient number of workers are being paid at or below the minimum hourly rate.

This number can be difficult to parse out, as the pool of workers earning the minimum wage in any given state is constantly in flux. Complicating the matter further is that workers do not typically earn the set minimum for long, as many firms implement regular pay increases and workers can often switch jobs to capture higher wages, if possible. As a result, the annual pace of growth in the median wage for hourly workers has averaged 3.4% since the turn of the century, which is far higher than the 0.9% average yearly growth rate in the population-weighted minimum wage over the same period. This, in turn, limits the pool of workers for which the minimum wage in a given state binds. Using the above-cited estimate from the Economic Policy Institute, the minimum wage binds only for about one out of every 20 nonfarm workers.

The literature on the impact of minimum wage increases on wage growth and inflation is somewhat limited and mixed. More popular has been the impact of minimum wage hikes on employment—and while there is a lack of consensus, a majority of recent studies have found negative low-wage employment effects. As for wages and prices, one survey of the literature suggests that the empirical evidence points to a positive wage effect for low-income earners and a small but positive price effect from raising the minimum wage. Indeed, most studies found that a 10% increase in the U.S. minimum wage raises the price level by no more than 0.4%.



This is consistent with our previous research. On both a national and regional level, we find evidence of a positive relationship between minimum wage hikes and overall wage growth, which is closely associated with inflation. However, the magnitude of the effect is small. This is because changes in the minimum wage are caused by public policy decisions, which can be abrupt, even if planned. Therefore, minimum wages will affect wage growth only following momentary jumps. When the labor market absorbs the policy shock, wage growth returns to a steadier path. Hence, over the long run, the impact of increasing the minimum wage has a rather muted effect on aggregate wage growth.

Our research is informative to the potential effect of this year's spate of minimum wage hikes on inflation given the outsize impact that wage growth has on prices. Since minimum wage increases do not seem to move the needle much when it comes to aggregate wage growth and the pass-through effect to prices found in the literature is relatively muted, we should not expect them to have a substantial effect on inflation. This is good news in a time when inflation is winding down and any evidence of reacceleration would cause the Federal Reserve to tighten monetary policy further, raising the risk of recession.

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The Week Ahead in the Global Economy

U.S.

Next week, we check the pulse of the U.S. consumer. On Wednesday, December's retail sales are expected to show 0.5% growth from the month before. This would represent a solid acceleration from November's 0.3% growth. Excluding autos, retail sales—which are not controlled for price changes—likely grew 0.6% in December.

The University of Michigan will release its preliminary estimate of consumer sentiment. The mood in the U.S. has improved in recent weeks, mostly a function of decelerating inflation. Next week's reading is expected to show a modest improvement, to 72.5, from December's final reading of 69.7.

Europe

Euro zone industrial production likely ticked down 0.3% month on month in November, deepening a 0.7% fall in October. Across countries, we have already seen mostly bad news. Germany, Italy, the Netherlands and Belgium each published dismal prints. Things were better in Spain and France, where production rebounded from prior declines. Overall, the euro zone manufacturing sector is in a difficult spot as high borrowing costs, prices and uncertainty weigh on demand for goods.

The external trade balance for the single-currency area likely improved with the not seasonally adjusted surplus rising to €14 billion in November from €11.1 billion in October (and from a deficit of €13.7 billion in November 2022). We already saw tangible increases in the nominal value of net exports from Germany and France in November, leading us to believe the euro zone aggregate will rise as well.

The euro zone HICP inflation rate will likely be confirmed at 2.9% year over year for December, up from 2.4%. Preliminary data already reported by Eurostat showed that base effects in the energy segment were responsible for the reacceleration in the headline rate. Core and food inflation decelerated, though the pace of decline for core inflation had eased from previous months, a reminder that it will not be a straightforward path back to the 2% inflation target.

In the U.K., inflation will likewise prove sticky with the rate expected to have softened just 0.2 percentage point to 3.7% year over year in December. Given the country's price cap on electricity and gas there will not be a base effect like there is in the euro zone. Core inflation will likely decline, but only slightly given sticky prices in the services sector.

U.K. retail sales likely grew in December, up 0.5% monthly. Stable unemployment—we estimate that the unemployment rate was steady at 4.2% in the November stanza—along with improved consumer confidence likely meant households were willing to continue hitting shops and markets. Black Friday sales may have proven especially tempting this year in light of inflation dragging prices higher. However, retail may subsequently recoil with the start of 2024. Given still-high prices and borrowing costs, households are not on firm footing.

Asia-Pacific

China's economy likely jumped 5% year over year in the final quarter of 2023. GDP growth was partly flattered by comparison to the lockdown-ravaged quarter a year earlier. It's still early in China's recovery, but momentum is beginning to build. An uptick in consumer confidence through the final months of 2023 pushed up retail sales and pulled down household saving rates. Better still, the extra spending has given firms the nudge needed to gradually increase production.

But the property market's troubles are ongoing, and there are no signs that the sector's multiyear correction is close to finding a floor. That's holding back investment and giving many good reason to keep spending tight. It is increasingly likely that more government support will be rolled out. Buoyed by that spending and a lift in global demand through the second half of the year, we expect China's economy to expand 5% across 2024.

Latin America

Uruguay's industrial sector likely saw year-on-year growth of 5.2% in November, with paper fabrication leading the way, although the vehicle industry struggled. We expect the economy to rebound in 2024 after stagnating in 2023 due to a severe drought.

Argentina's economy likely contracted 2.6% year-on-year in November, after 0.6% growth in the previous month, due to soaring inflation and persistent currency instability weighing on private consumption, the economy's main driver. Government spending and temporary tax breaks provided some support.

Mexico's retail consumption had a positive annual advance in November, but sales are moderating due to maximum restrictions in monetary conditions. Thus, we expect retail sales to have reported a yearly increase of 3% in November, down from 3.4% in the previous month and 6% a year before.

Geopolitical Calendar

Date	Country	Event	Economic Importance	Financial Market Risk	Risk Assessment
13-Jan	Taiwan	Presidential election	Medium	Medium	The election will have deep ramifications on the trajectory of U.S.-China relations.
15-19 Jan	WEF	World Economic Forum's annual meeting	Low	Low	The theme of the 2024 annual meeting being held in Davos, Switzerland, is "Rebuilding Trust."
19-Jan	U.S.	Federal government shutdown deadline, part 1	Low	Low	Temporary funding for DoT, HUD, Energy, the VA and Agriculture is set to expire January 19. House Republicans seek to pass individual appropriations bills to avoid a high-cost omnibus. A shutdown of a limited number of departments could occur, but the economic impact will be minimal.
2-Feb	U.S.	Federal government shutdown deadline, part 2	Low	Low	Temporary funding for Commerce/Justice/Science, Defense, Financial Services/General Government, Homeland Security, Interior/Environment, Labor/HHS/Education, Legislative Branch, and State/Foreign Operations is set to expire two weeks after the first tranche runs out.
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.
30-Apr	U.S.	Deadline to pass 12 appropriations bills before 1% spending cuts become permanent	Medium	Low	The Fiscal Responsibility Act (2023) disincentivizes the use of continuing resolutions to fund the government by enforcing a 1% automatic cut to all discretionary spending if a CR is in place on April 30, 2024. Such a cut to spending would drag GDP growth, bringing additional urgency to Congress to pass a full year budget.
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	As elections commence in Mexico, the risk of social and political unrest will rise due to concerns over election subversion and fraud. Financial markets would be shaken while consumption and investment decisions tank, raising the risk 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.

Federal Reserve's Timeline for Rate Cuts Moved Forward

By OLGA BYCHKOVA

CREDIT SPREADS

Corporate credit spreads have exhibited significant volatility since the start of the year, though narrowing close to the end-December values over the past week. 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 and persistent strength in consumer spending.

The Moody's Investors Service long-term average corporate bond spread to the 10-year U.S. Treasury has decreased less than a half basis point to 124 bps, remaining above its 12-month low of 120 bps. Similarly, Moody's long-term average industrial bond spread declined a bit more than 2 bps to 104 bps over the past week. That is still above its one-year low of 100 bps.

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 during the last weekly period. 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 contracted to 334 bps from 351 bps the previous week, while the ICE BofA U.S. high-yield option-adjusted bond spread closed Wednesday at 350 bps, down a whopping 21 bps from its prior-week value. 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—a real-time indicator of the implied volatility of S&P 500 stocks that measures the market's sentiment about future asset price variance—dropped 1.3 points over the week to 12.7, significantly below its long-term average of about 20 and median of 18, meaning investors can buy relatively cheap insurance and position in potentially profitable trades. In the middle of December, the VIX hit its lowest level since January 2020 of slightly below 12.1 as expectations that the Federal Reserve is done hiking interest rates fueled a rebound in the S&P 500, which added 24% in 2023. Since the VIX tends to move inversely to stocks, market participants watch it closely as an indicator of investor sentiment and positioning. 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 last year by 42.5% to the average of 17 has brought it back generally in line with high-yield spreads.

GLOBAL DEFAULTS

Moody's Investors Service reported that only four corporate debt issuers defaulted in November, down from 11 in October, the fewest in the past two years. However, defaults are estimated to have picked up in December because a number of issuers either missed debt payments or indicated their intention to complete a debt restructuring that is likely to have been classified as a distressed exchange.

The four defaulters in November were API Holdings III Corp., Equinox Holdings Inc., Ligado Networks LLC, and Praesidiad Group Limited. All were from the U.S. except for Praesidiad, which is based in the U.K. Distressed exchange remained the most common choice for distressed debt restructuring and accounted for three of November's four defaults. The only non-distressed-exchange default was by Ligado, a satellite company that obtained a forbearance from the requisite holders of its $4.2 billion first-lien notes that matured on 1 November for a payment extension, which Moody's Investors Service views as a missed payment under its default definition.

In 2023, the default tally reached 138 through November, slightly below 147 in the comparable 2022 period. However, if we exclude Russian defaults, the January-to-November default count would have been well above the full-year 2022 tally of 92. Of the 138 defaults, 95 were from North America (93 in the U.S. and two in Canada). The rest were from Europe (23), Asia-Pacific (11) and Latin America (9). Across sectors, business services and healthcare & pharmaceuticals each had 12 defaults, making them the

largest contributors. Construction & building and telecommunications followed with 11 each.

November's default decline drove down the global speculative-grade default rate to 4.5% for the trailing 12-month period, the lowest level since August, compared with October's upwardly revised rate of 4.6%. Moody's Investors Service estimates the rate to have ended the year at 4.6%. In 2024, the credit agency expects the default rate to stabilize in the range from 4.4% to 4.6% in the first four months before gradually easing to 3.8% by the end of November. The forecast is underpinned by limited near-term maturities and the anticipation of lower interest rates in the second half of 2024. While the current tight financing conditions will make it hard for companies at the lower end of the speculative-grade rating scale to refinance their debt in the syndicated loan market, some may be able to refinance with private funds.

Moody's Investors Service's latest default rate outlook is also driven by the tightening of high-yield spreads in November and the corresponding revision in the high-yield-spreads forecast. MIS now assumes that the U.S. high-yield spread will widen to 496 basis points over the next four quarters from about 370 bps at the end of November 2023, whereas a month ago the agency had anticipated it to widen to 504 bps from the October reading of 437 bps. The default rate forecast also incorporates the assumption that the U.S. unemployment rate will rise to 4.5% from 3.7% in the coming 12 months.

CORPORATE BOND ISSUANCE

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 accounted for more than half of activity globally, decreased 15% on an annual basis. U.S. high-yield issuance also experienced a sluggish start at just $52 billion, marking its slowest kickoff to the year since 2009, and posting an 18.4% decline compared to the first quarter of 2022.

In the second quarter of 2023 issuance strengthen as worldwide offerings of corporate bonds revealed a year-over-year increase of 20.7% 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 picked up further, with worldwide offerings of investment-grade corporate bonds rising 7.5% year over year. U.S. dollar-denominated investment-grade corporate bonds totaled $315.6 billion, up 3.5% on a year-ago basis but down 8% from the prior quarter. U.S. dollar-denominated high-yield corporate bond issuance was $54 billion in the third quarter, down from $65.8 billion in the second. However, high-yield issuance was up a whopping 70% on a year-ago basis.

Fourth-quarter 2023 corporate debt issuance came in suppressed. Worldwide offerings of investment-grade corporate bonds totaled $240.5 billion, down 35% year over year, while high-yield corporate bond issuance clocked in at $38.1 billion, increasing 15% on a year-ago basis. U.S. dollar-denominated high-yield issuance ended the year at $207.3 billion, reflecting a colossal 45.5% revival from 2022. Meanwhile, U.S. dollar-denominated investment-grade bond issuance totaled $1.26 trillion in 2023, corresponding to a 3.1% decline from 2022. Over the past 12 months, total U.S. dollar-denominated issuance has tracked at a near-decade low, surpassing only 2022 value by a marginal 2.6%.

For the most recent week, U.S. dollar-denominated investment-grade debt issuance totaled $54.3 billion, raising the headline figure to $54.5 billion since the start of the year. This reflects an 11.3% decline compared with the same period in 2023. There was $3.25 billion in high-yield debt issued in the same period, increasing 18.2% relative to last year's pace. Total U.S. dollar-denominated corporate debt issuance so far tracks 7.1% below where it stood in 2023 and is 21.4% lower compared with 2022.

U.S. ECONOMIC OUTLOOK

The U.S. economy is performing well, with above-trend growth in real GDP in the third quarter. Consequently, we made only modest adjustments to the U.S. baseline forecast, including real GDP slightly stronger in the near term, consistent with the recent declines in long-term interest rates and oil prices. Nonetheless, the pattern of slowing growth in response to fiscal tightening next year, followed by a gradual return to trend growth by 2026, remains intact. The unemployment rate will gradually rise to about 4.1%, unchanged from last month's forecast.

In sum, key assumptions changed little in January. In terms of monetary policy, rate cuts in 2024 begin in May, a month sooner than in our previous forecast, in response to the Federal Reserve's dovish shift. However, long-term rates were revised only slightly lower and the impact on expected growth was small. A slowdown in growth remains the expectation for next year. We assume passage of a federal budget and no federal government shutdown. Our oil price outlook is little changed, although we did reduce the near-term forecast for natural gas as supply remains elevated and exports are growing slower than expected. The outlook for house prices improved this month given recent price trends. The projection for commercial real estate is also modestly improved due to relative strength in the third quarter.

Recent data slightly strengthened the outlook for business investment.

Monetary policy

We have moved forward our assumptions about the Federal Reserve's timeline for rate cuts compared to our last outlook. The Federal Open Market Committee pivoted dovish in December, strongly suggesting that the fed funds rate has reached its terminal range of 5.25%-5.5%. At the same time, the committee's updated projections suggest several rate cuts in 2024. Our January baseline now has 25-basis point rate cuts in May, June, July and December, compared with only two in the previous baseline. The Fed will subsequently relax monetary policy slowly, cutting rates by 25 basis points per quarter until reaching 3% by the second half of 2026 and 2.5% by 2030.

Policymakers have seen progress in their battle against inflation in recent months. Labor markets have also been cooling, calming concerns about wage pressures. While inflation remains above target, and the FOMC has signaled readiness to tighten should incoming data suggest a resurgence of inflation, policymakers are now wary not to overtighten. The data support this view: Average monthly consumer price inflation in the first half of 2023 was 3.3% annualized, down from 6.5% in 2022. From July to November last year, the figure was stable despite a temporary surge in energy prices. More importantly, average monthly core inflation fell from 4.3% annualized in the first half of 2023 to 3.1% from July through November, as service inflation slowed. Further, while the U.S. added an average 250,000 jobs each month in the first half of 2023, the figure for the second half was only a little more than 190,000. Further, job openings are approaching pre-pandemic levels, and the quits rate, an important driver of wage inflation, is already there. The jobless rate ticked up from 3.4% to 3.7% in 2023.

Financial markets entered the new year on a bullish streak, despite Fed officials' caution against premature exuberance. The 10-year Treasury yield, which had touched on 5% in mid-October, fell from 4.2% in early December to 3.8% by the end of the month. However, after stronger-than-expected December payroll hiring suggested that the coast may not be clear yet, the yield settled around 4% in January.

Consumer price inflation is projected to be 2.9% year over year in the first quarter of 2024, 10 basis points below the previous outlook. We anticipate that inflation will return to the Fed's 2% target by the fourth quarter of 2024. In a similar vein, we anticipate that the Treasury 10-year yield will average 4.2% in the first quarter of 2024 amid ongoing volatility. This is 10 basis points below the previous outlook. For 2024 as a whole, the yield will approach its equilibrium level of 4% and remain near this level until the end of the decade.

The recent easing in Treasury yields is mirrored in foreign exchange markets, where the dollar lost some of its recent momentum. On a real broad trade-weighted basis, the currency lost 2.9% from October through December. However, reflecting high U.S. interest rates, it is still 5.5% above pre-pandemic levels.

Changes to GDP

Despite a small downward revision in the Bureau of Economic Analysis' third estimate, U.S. real GDP rose 4.9% in the third quarter, the fastest pace in nearly two years. This was the fifth consecutive quarter of growth near or above the economy's potential. Inventories and consumer spending contributed the bulk of the gain. Trade was a neutral and fixed investment grew only modestly, but those were the only weak spots outside of nearly flat real disposable income.

Consumer spending remained an important source of growth in the third quarter, adding 2.1 percentage points. Inventories added 1.3 percentage points after being neutral for growth in the prior quarter. Nonresidential fixed investment made its smallest contribution in two years, but residential investment rose for the first time since the start of 2021. Government added 1 percentage point, about evenly split between federal and state and local spending. Trade was essentially neutral, with growth in exports nearly offset by the drag from imports.

Inventory accumulation will slow over the next two quarters, as will many other components of GDP. However, the near-term outlook is a bit more optimistic than last month's. Real GDP in 2024 will be slightly higher than previously forecast, but the persistence of high interest rates ensures slower growth than in 2023. Real GDP is projected to rise 1.9% in 2024 on an annual average basis, an upward revision of 0.2 percentage point. Subsequently, growth in the following two years will be 1.6% in 2025 and 2.1% in 2026, approximately the long-term near trend.

Labor market

The labor market remained resilient in December as employment came in stronger than expected. Payroll employment rose by 216,000, with healthcare and the public sector leading the way. Private employment rose by 164,000, though it is averaging just 115,000 over the last three months. However, downside revisions to prior months were significant, reducing the gains in October and November by a total of 71,000.

On balance, stronger than expected job growth in the fourth quarter and historically low layoffs have caused us to upgrade our forecast for 2024. Job gains are now expected to total nearly 100,000 through the first half of the year compared with about 70,000 in the December forecast. Employment growth will still slow about 50,000 by the beginning of 2025. The unemployment rate forecast was little changed. December's reading came in at 3.7%, matching the fourth-quarter average. The unemployment rate is still expected to rise to 4% by the end of 2024 before peaking just above 4% in mid-2025.

Business investment and housing

BEA marginally raised its estimate of third-quarter growth in real business investment to 1.5% annualized in the December GDP release, compared with 1.3% in November data. However, performance varied substantially by category, and structures were the only segment that gained. The estimate for structures growth jumped to more than 11% annualized compared with November's 7%.

Readings for all four major categories improved but two stood out, manufacturing and commercial. The former rose by nearly 30% annualized compared with 20% in the November estimate. Construction of new facilities to make semiconductors is well underway. As a result, the manufacturing segment is up by nearly 70% year over year, lifted by incentives in the CHIPS Act. Commercial was raised significantly too. However, although the beleaguered office segment has finally begun to rise in recent quarters, it is still nearly 30% below its pre-pandemic peak.

In contrast, equipment remained the main source of weakness and was revised down slightly to a bit more than -4% annualized. On a year-over-year basis, the decline was down 1.6%, the first year-over-year drop since the end of 2020.

Monthly data do not suggest that a turnaround in equipment investment has occurred yet. New orders for nondefense, nonaircraft capital goods adjusted for inflation fell again in October, the most recent reporting month. They have declined steadily since the beginning of 2022 and are now down 7% cumulatively. Inflation-adjusted shipments have also declined during that time, down more than 2% cumulatively. However, on the positive side, unfilled inflation-adjusted nondefense manufacturing orders have risen steadily, by 4% over the course of 2023. The fulfillment of past orders helps to explain why shipments have fallen less than new orders and could portend a near-term rebound.

On balance, total real business investment will rise 2.2% in 2024 in the December forecast compared with 2% in November based on the strength in structures spending.

The outlook for house prices was revised upward in January to reflect recent price trends and the low level of homes available for sale. While affordability remains a challenge for many potential homebuyers, the lack of supply continues to support prices. Demand is being sustained by buyers who can pay cash or who can still afford a mortgage given their incomes and by existing homeowners who are moving from higher- to lower-cost areas, including many retirees.

The inventory of homes for sale has improved modestly in recent months but remains low by historical standards with just 3.5 months of supply at the current rate of sales. Listings will increase over the course of the next few years as life events and lower mortgage rates prompt more owners to sell, but this process will take time given the size of the mortgage lock-in effect. As a result, Moody's Analytics has reduced its expectation of peak-to-trough house price declines. While real price declines are still expected given the imbalance between median house prices and median incomes, this adjustment process will occur over an extended time, barring a recession.

Moody's Analytics downgraded its outlook for multifamily permits and starts due to the near-record number of properties currently under construction and the deceleration of rent growth in markets across the country. Tight underwriting standards and high interest rates will further constrain the ability of multifamily property developers to obtain credit.

The outlook for CRE prices experienced a modest improvement this month due to the relative strength of prices in the third quarter. While fundamentals remain weak for offices and apartment buildings, interest rate declines and the emergence of potential investors appear to be cushioning sharp price declines. Some caution is needed in interpreting the data given low transaction volumes and compositional effects, which may skew transactions toward more desirable properties in the short term.

Fiscal policy

Throughout 2023, the cumulative federal budget shortfall in fiscal year 2024 has been deeper than expected, driven by rapidly rising interest outlays. In December Moody's Analytics implemented a high frequency line-up that includes the monthly budget deficit and public debt outstanding and incorporated these in its forecast. As a result, the forecast for the budget deficit was widened in the fourth quarter of 2023. However, there was no meaningful impact to GDP.

Otherwise, we maintain our assumption that the federal government avoids a shutdown in the first quarter of 2024 and remains in continuous operation through the rest of the year.

There were few changes to the forecast for expenditures. Budget negotiations were paused through much of December, as Congress went on holiday recess, but in early January, negotiators agreed to top-line spending of $1.59 trillion. This will include additional supplemental spending to cover international aid, immigration, natural disasters, and other urgent matters, pushing discretionary outlays to the statutory maximum of $1.59 trillion set by the Fiscal Responsibility Act in 2023. In total, discretionary spending for fiscal year 2024 marks a 1% cut from 2023, which decomposes into a roughly 3% increase in defense and a 5% cut in nondefense. For fiscal year 2025, we assume that Congress continues to abide by the FRA's spending restrictions. Defense spending rises 1% in fiscal 2025, while nondefense remains flat.

The final months of 2024 will entail significant political volatility. Federal elections are set to take place in early November. Subsequently, the lame-duck Congress will need to grapple with the expiration of the debt-ceiling suspension, which is set to take place on January 1, 2025. We assume that the U.S. does not default on its debt and the limit is likely suspended again. The new Congress will then embark on a major debate over the extension of the many major tax provisions rewritten under the 2017 Tax Cut and Jobs Act. We assume that the tax rates revert slightly higher due to budget pressures, but most of the tax code is maintained.

Energy

Moody's Analytics has revised its natural gas price forecast lower over the past month. We still maintain our forecast narrative, which emphasizes that stronger exports and weaker production should lead to higher gas prices over the course of the year. But the slowdown in gas production is taking longer to materialize. Strong natural gas production has been supported by robust US shale oil drilling. Natural gas is a production output of the shale drilling process.

Second, the arbitrage trade to Europe has taken longer to boost prices. New LNG export terminals will increasingly come online throughout 2024, but the effects will take a while to materialize. Lastly, the weather has been unseasonably warm. This reduces natural gas consumption in the winter months, since less fuel is needed to space heat.

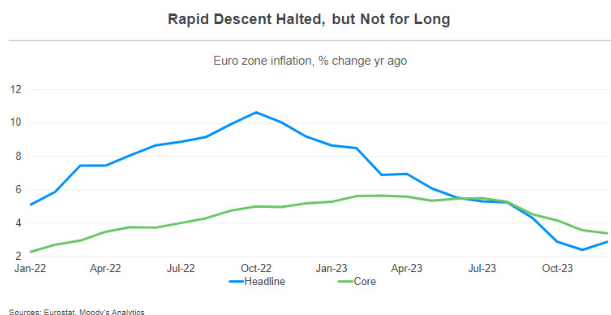
Moody's Analytics has not made any notable changes to its oil price outlook. We still expect a modest rise in oil prices as supply growth slows down.

Euro Zone Inflation a Mixed Bag

By KAMIL KOVAR

The preliminary December report for euro zone inflation helped neither the monetary policy doves nor the hawks. Headline inflation jumped, as was widely expected given the large base effect resulting from German intervention in energy prices in December 2022. While the increase was somewhat higher than we expected, it does not change the overall disinflationary narrative.

This is underlined by the fact the core inflation has again decelerated and has reached its lowest value since April 2022. While January might bring another increase in inflation due to the end of several government interventions and possible January repricing, from February onwards we will be back to declining inflation. In other words, what we are seeing is a hiatus in disinflation, not a change in the trend.



In terms of the more informative monthly changes, the story was of upside surprises in all components but food, with energy coming in significantly higher than we expected. Before Friday, we expected energy prices to decline significantly from November, driven by lower fuel prices but also aided by electricity and gas prices. We do not have details to dissect where things played out differently, but it is likely that part of the story is due to seasonal adjustment: the unadjusted data did decline and came in only somewhat higher than we expected. In any case, an upside surprise in energy is far from a worrying signal.

In contrast, the food segment brought good news. Mainly, the growth of processed food prices took another step down, to just above the 0% mark in monthly terms. This continues the long disinflationary process that began at the start of 2023 and is likely to continue this year—after a January bump. This is driven by the continued fall in wholesale food prices, which by some measures are back to normal levels. In December, the processed food prices were also joined by unprocessed food prices, which gave up some of their November bump. This left overall food prices virtually unchanged from the previous month, the lowest reading since April. We still believe that sometime this year food prices will flatten out for a prolonged period.

While the volatile energy and food segments provided mixed news, the core segments proved a bit disappointing on a monthly basis, especially in light of recent performance. Core inflation had its hottest month since August, driven both by goods and service prices. Some of this is likely a reversal of the larger-than-expected drop in November, when core prices declined on the month. Among goods, it is likely that clothing prices added to volatility, with stronger-than-usual Black Friday discounts affecting November negatively and December positively. In services, airline ticket prices likely reversed their large drop from November. We had known that November was too good to be true, so stronger price growth in December is not a surprise. That said, core prices increased a touch faster than we thought they would.

Both hawks and doves at the European Central Bank will find support in this report. Hawks will point out that the softness in core inflation in previous months was temporary. Doves will highlight that, even in December, the monthly inflation rate was consistent with the bank's inflation target. We therefore do not expect a meaningful shift in the balance within the central bank's Governing Council based on this datapoint. It did shift our subjective odds of timing for a first interest rate cut. We had expected that a cut in March would require soft reports between now and then. With December breaking the streak of outright soft reports, the bar for a March cut has increased, and we now put a 1-in-10 chance of it happening.

While an April rate cut is a much closer call, we still believe that June is most likely. In other words, we will not be changing our baseline forecast this month. Whether April or June will bring the first interest rate cut will likely depend on the January numbers; these are highly uncertain and will be influenced by multiple factors with unknown effects and even directions. Until then, we must wait and see.

The Stakes in Taiwan Elections

By HERON LIM

The Saturday election in Taiwan is of outsize significance on the global stage and could alter the trajectory of U.S.-China ties, Asia-Pacific security, and economic outlooks. The importance of the election for the self-ruled island—regarded as a breakaway province by the People's Republic of China— is not lost on the three presidential candidates. In addition to the presidency, control over Taiwan's legislature, the unicameral Legislative Yuan, is also up for grabs. Having held the presidency and controlled the legislature since 2016, a partial change looks imminent. We expect the DPP to retain the presidency for the next four years but lose control of the legislature. For the economy, that would bring no immediate impact.

Vice President Lai Ching-te leads the DPP ticket for the top job. He hopes to take over from Tsai Ing-wen, who had no choice but to stand down because of a two-term presidential limit in Taiwan. Lai's running mate is the former envoy to the U.S., Hsiao Bi-khim. Their opposition was split in two after a fleeting attempt at a unity ticket dramatically failed in November. Lai's strongest rival is the mayor of New Taipei City, Hou Yu-ih. Hou, who represents the Kuomintang and has a local television personality and talk show host, Jaw Shaw-kong, as his VP pick.

The upstart Taiwan People's Party has its chairman and former mayor of Taipei City, Ko Wen-je, leading its ticket. Cynthia Wu, a member of Taiwan's legislature, is his VP pick. Polling data published before a blackout on surveys took effect on 3 January put Lai at the head of the race. According to a Taiwan News poll of polls, Lai, at 35.3% support last week, held a 6.6-percentage point lead over Hou, while Ko, once in second position, came in third with 24% support.

Cross-strait ties top of mind

Much attention has centred on the presidential race and its implications for ties across the Taiwan Strait with Mainland China. Relations between Beijing and Taipei have been strained under Tsai's administration. Beijing cut official contact in 2016 over her refusal to affirm the 1992 Consensus—a political understanding between the two sides that states that despite differing interpretations, there is 'one China'. Beijing has set the acceptance of the 1992 Consensus as a precondition under which any high-level talks can resume.

The DPP considers Taiwan to be independent as the Republic of China and seeks no change to the status quo. But under Tsai's New Southbound Policy, Taiwan has sought to diversify its economy away from China. Results have been mixed. China and Hong Kong combined were the top export market for Taiwan in 2022, but the share of exports at 38.8% was down from around 42% in the prior two years. Meanwhile, Taiwanese exports to North America grew to more than 16% from around 15%. The pursuit for economic diversification and global recognition has drawn the ire of Beijing, which considers the DPP as a separatist organisation that advocates for formal independence of the island and rejects the 'One China' policy.

Lai has long been regarded as an outspoken advocate for Taiwan independence. He once described himself as a "political worker for Taiwanese independence". Such comments have riled Beijing, which views him as a prime separatist. Although Lai has since stated that Taiwan is already a de facto sovereign nation and does not need to declare independence, there are fears that if he wins, cross-strait ties could descend into a military conflict. China has described the Taiwan issue as the top sticking point for U.S.-China relations, which are currently at a détente. But even in the event of a Lai victory, as long as there are no attempts to break away from China and change the status quo, we see relations remaining at the level of elevated sabre-rattling rather than escalating to one of immediate threat.

Lai's opponents differ from the DPP on the cross-strait issue. The KMT accepts the 1992 Consensus and favours a resumption of trade and investment talks with Beijing. The TPP has been more ambiguous on the 1992 Consensus, with Ko remarking in a September 2023 Bloomberg interview that the consensus had been "stigmatised" in Taiwan and that he would deal with the issue "pragmatically" and not get stuck in disputes over terminology. In the same interview, Ko said that maintaining the cross-strait status quo was the only choice and that he would seek to restart talks with China. Therefore, a victory for either Hou or Ko could ease tensions on the surface and lay the foundations for better cross-strait ties.

But even in the event of a Hou or Ko victory, we expect progress on the economic front to be elusive. Previous attempts to normalise bilateral trade and investment between China and Taiwan under the presidency of KMT's Ma Ying-jeou from 2008 and 2016 netted only the Economic Cooperation Framework Agreement in 2010. That pact reduced tariffs and commercial barriers until escalating student protests from Taiwan's Sunflower Movement brought a derailment to normalisation efforts.

Also, U.S.-China geopolitical rivalry has gone beyond the Taiwan issue. Regardless of who wins the presidency, we expect broader geopolitical and economic competition between the U.S. and China to continue.

It's the economy, too

Although cross-strait ties have dominated international headlines, the economy has made its way to the top of the domestic debate. Hou and Ko have charged the DPP with mismanaging the economy—an accusation that taps into voter frustrations, particularly among the youth.

Taiwan outperformed its Asian peers and other economies in the early stages of the pandemic, helped by voracious demand for semiconductors as the shift to working from home required technology upgrades.

However, semiconductor demand has since fallen, sending Taiwan's economy back to earth. We estimate Taiwan's GDP grew just 1.2% in 2023, compared with 2.6% in 2022, 6.6% in 2021, and 3.4% in 2020.

Unusually high inflation is another headache and is being felt more keenly at the household level. After being mild for most of the Tsai era, inflation in the import-reliant island has been rising since April 2021. And for a large part of 2023, nominal wage growth has trailed inflation—something for which the DPP has shouldered the blame.

High property prices are another concern. The real estate market spiked as the onset of the pandemic led to strong semiconductor earnings and low interest rates that stoked demand—in 2022, property prices surged 12.9%. The property price boom led the government to roll out cooling measures, including a ban from January 2023 on the reselling of newly built or pre-sale homes and a 33% tax from July 2023 on unoccupied property. These slowed property price growth in 2023, but lagging nominal wage growth still made property ownership feel out of reach, particularly for those just starting out in the workforce.

Despite the mixed report on the economy and incumbency fatigue, around 12% of likely voters were undecided at the start of January. As no single candidate is polling above 50%, it will be a nervy finish for presidential candidates come polling day.

Taiwanese politics will preserve the status quo

While the presidential race has received most of the attention, the outcome of the legislature races will determine whether the next president can enact his agenda. Members are elected by a mixed electoral system, with 73 seats in a first-past-the-post constituency vote, six seats reserved for Indigenous candidates by single nontransferable vote, and the remaining 34 seats through a party-list proportional representation system. Polls suggest that a hung parliament— where the KMT has most but not a majority of seats—will be the likely outcome. If that happens, the TPP as kingmaker would likely back the legislative agenda of the KMT.

But whatever the final political configuration, it is unlikely to move the needle much for Taiwan's economy in the near term. The three presidential candidates have similar policy platforms for the domestic economy, and despite the rhetoric, Taiwan's trade with China is likely to remain intact for the immediate future. For 2024, we expect Taiwan's recovering semiconductor industry to spearhead growth after a dismal 2023, leading to a 3.2% jump in GDP.

Even the medium term may not bring major change because of factionalism. Our baseline assumption of the DPP keeping the presidency for a third consecutive term paired with a hung parliament would see Lai unable to push through major changes without getting at least the TPP on board. And if the DPP beats the odds and retains control of the Legislative Yuan, Taiwan will likely just continue on its current path of economic diversification away from China. Faced with a hung parliament, Hou as president would be in a similar position as Lai, with the TPP vote critical. Even if Hou were to win and be lucky enough to have a friendly legislature with an outright KMT majority, he would have to contend with political unrest that has previously brought closer ties with China unstuck. And as most plausible scenarios end up with the cross-strait status quo remaining intact, there could be little change to geopolitics and economics in the Asia-Pacific region.

Eyes on China

The wildcard in this is China. Chinese President Xi Jinping reiterated his claim that Taiwan would "surely be reunified" with China in his recent New Year address. Although China has not publicly backed any presidential candidate, senior Chinese officials in charge of Taiwan affairs have framed the election as a choice between war and peace while promoting the idea of reunification. Post-election, whether the status quo stays looks increasingly to be up to the Chinese political leadership.

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Argentina's Milei gamble

By JUAN PABLO FUENTES

Argentina's new president, Javier Milei, took a political gamble by issuing a historic emergency decree in his first days in office, and sending congress a sweeping bill to aggressively deregulate the economy. The president called for extraordinary congressional sessions to debate the so-called omnibus law—congress was in recess for the summer holiday in Argentina.

These legislative actions follow the implementation of drastic economic measures, including a large devaluation of the peso and the resetting of monetary and fiscal policies. As expected, Milei's early actions have brought up strong opposition from the left-leaning Peronist coalition and labor unions. The country's trade union federation has called for a national strike on January 24. Yet, early indications suggest that Milei's actions enjoy wide support. He ran on the promise of radical changes and his initial actions have delivered in that regard.

The Milei administration has wasted no time pushing forward its ambitious agenda. Sensing ample political and popular support now, Milei knows that the window to enact meaningful reforms will be small. The economy is poised to deteriorate sharply in the near term with inflation likely topping the 300% mark before midyear. The economy will contract measurably in the first half of 2024 before starting a gradual recovery. Milei's approval rating will likely drop quickly as a result.

The decree of necessity and urgency (known by its Spanish acronym as DNU) was an issue in early December and takes effect this week. The decree, which introduces wide-scale deregulation, must go through congress before becoming law; it needs only a simple majority to pass. However, the provisions in the decree will be enforced until congress votes on it (not before March 1). Before that happens, congress will likely vote on the sweeping omnibus bill, which proposes additional state reforms and further economic deregulation. If approved, the bill would give Milei special powers to legislate on certain matters for at least two years. It would also allow the new government to embark on an aggressive privatization wave. We see congress narrowly passing the bill, as well as approving the DNU, perhaps with some modifications. Still, the powerful Peronist opposition could garner enough votes to block the reforms. Also, the judicial branch could step in and deem some of the rules unconstitutional. The DNU and the omnibus law seem to infringe on congress' functions by allowing the president to legislate on key matters. The Milei administration has argued that this is needed because of the current emergency. In any case, the outcome could define the rest of Milei's tenure, with significant implications for the economic outlook.

The Milei administration will be tested in upcoming months as economic conditions deteriorate. The government hopes that the economy turns the corner by midyear and experiences a robust recovery thereafter supported by solid private investment growth. The government might enjoy some tailwinds in upcoming months. The agriculture sector is poised for a solid recovery after last year's historic drought. Development of the Vaca Muerta shale oil play will continue to support investment.

The government is also expected to successfully renegotiate the ongoing credit agreement with the International Monetary Fund before midyear, which could open the door for fresh capital and boost business confidence. Nevertheless, downside risks remain sizeable. Social and political tensions could boil over as economic conditions deteriorate in the near term, halting Milei's reform agenda and pushing the economy deeper into recession.

A Bright Start to the Year in U.S.

By OLGA BYCHKOVA

U.S.

U.S. corporate credit rating activity was light in the latest weekly period with upgrades outnumbering downgrades. Upgrades comprised four of the five rating changes and 100% of affected debt. The changes issued by Moody's Investors Service spanned a diverse set of investment- and speculative-grade bonds and industrial and financial firms.

The largest upgrade, accounting for 53% of debt affected in the period, was issued to exploration and production company Vital Energy Inc. with its corporate family and probability of default ratings raised to B1 from B2 and B1-PD from B2-PD, respectively, its senior unsecured notes rating lifted to B2 from B3, and its speculative-grade liquidity affirmed at SGL-2. The outlook remains stable. According to Moody's Investors Service Vice President and Senior Credit Officer Amol Joshi, "Vital Energy's upgrade and stable outlook reflect its leverage metrics likely remaining solid as the company's near-term free cash flow is used to pay down more debt or acquire additional assets and enhance cash flow."

The upgrade of the corporate family rating follows Vital Energy's increased scale and diversification after closing several Permian Basin acquisitions in the fourth quarter of 2023 and building up its Delaware Basin position, the rating agency said. It added that the corporate family rating benefits from the company's production and reserve base in the Permian Basin, high degree of operational control, retained gathering assets within its legacy production corridors, and management's track record of mitigating cash flow volatility by hedging a significant proportion of its oil and gas production.

The unsecured notes are rated one notch below Vital Energy's corporate family rating, reflecting the priority claim of the senior secured credit facility that has a first lien on most of the company's assets. The stable rating outlook is based on Moody's Investors Service's expectation that Vital Energy should maintain solid leverage metrics while managing its capital program and liquidity prudently.

In 2023, U.S. rating changes were predominantly negative with downgrades exceeding upgrades by 524 to 310 but impacting only 36% of the total affected debt. Similarly, in December, 71% of rating actions made by MIS were downgrades, which accounted for 81% of the affected debt.

Europe

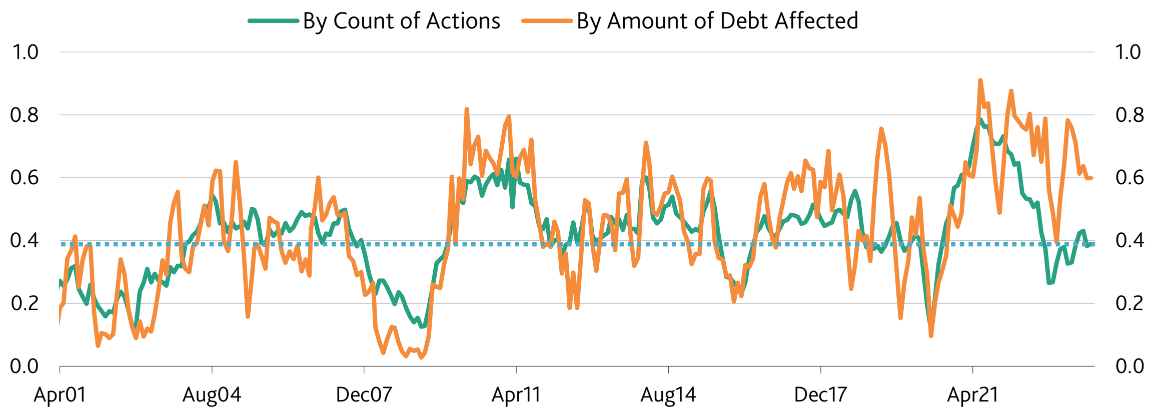
Corporate credit rating change activity was a bit lighter though much weaker across Western Europe, with three changes issued to the diverse set of speculative-grade industrial firms. Last week, downgrades outstripped upgrades, 2-to-1, and comprised 100% of affected debt.

Downgrades were headlined by a diversified resources company Vedanta Resources Limited, which through its various operating subsidiaries produces oil, gas, zinc, lead, silver, aluminum, iron ore, steel and power. Moody's Investors Service cut to Caa3 from Caa2 the company's corporate family rating and to Ca from Caa3 its rating on the senior unsecured bonds issued by VRL and those issued by VRL's wholly owned subsidiary, Vedanta Resources Finance II Plc, and guaranteed by VRL. The change impacted 100% of debt affected in the period.

At the beginning of January, VRL announced that holders of its U.S. dollar bonds provided consent to the restructuring of its debt comprising a partial upfront payment of its bond maturities in 2024 and 2025 and the extension of the balance to 2027 and 2028. Bondholders also provided their consent to amend certain financial covenants towards leverage and debt cap limits, also considering the proposed demerger of VRL's operations into six separate listed companies. The debt restructuring transaction is expected to close in January. "We view the debt restructuring as default avoidance and assess that the creditors have incurred an economic loss with respect to the original promise. We consider the transaction to be a distressed exchange under our criteria, which underpins our downgrade of VRL's ratings," Moody's Investors Service Senior Vice President Kaustubh Chaubal said.

The negative outlook reflects the rating agency's concerns over the company's ability to address its imminent cash needs, especially at the holding company. In addition, the negative outlook reflects the agency's view that the recovery prospects for VRL's debt instruments could decrease further given the holding company's high debt levels, weak liquidity and potential contagion risk impairing its operating subsidiaries' ability to raise funds to distribute dividends. Like the U.S., in December, almost 63% of rating actions issued by MIS in Western Europe were credit downgrades, which comprised 88.5% of total affected debt. In 2023, Western Europe rating changes largely broke even with downgrades slightly exceeding upgrades by 193 to 192 but impacting only 20% of affected debt.

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
1/3/2024	RESOLUTE INVESTMENT MANAGERS, INC.	Financial	SrSec/BCF/LTCFR/PDR		U	Caa2	B2	SG
1/4/2024	ZELIS HOLDINGS, L.P.-ZELIS PAYMENTS BUYER, INC.	Industrial	SrSec/BCF/LTCFR/PDR		U	B2	B1	SG
1/5/2024	REGENERON PHARMACEUTICALS, INC.	Industrial	SrUnsec/LTIR	2000	U	Baa2	Baa1	IG
1/8/2024	WAND NEWCO 3, INC.	Industrial	SrSec/BCF/LTCFR/PDR		D	B2	B3	SG
1/9/2024	VITAL ENERGY, INC.	Industrial	SrUnsec/LTCFR/PDR	2300	U	B3	B2	SG

Source: Moody's

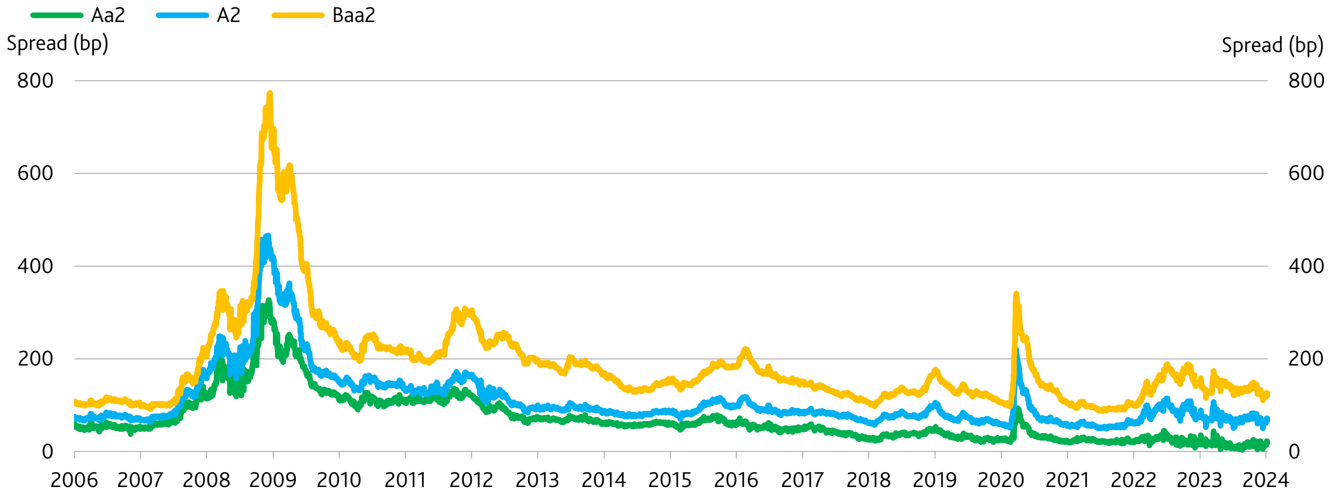
FIGURE 4

Rating Changes: Corporate & Financial Institutions - Europe

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG	Country
1/9/2024	VEDANTA RESOURCES LIMITED	Industrial	SrUnsec/LTCFR	1600	D	Caa3	Ca	SG	UNITED KINGDOM
1/9/2024	TRAVELPORT HOLDINGS LIMITED-TORO PRIVATE HOLDINGS II, LIMITED	Industrial	LTCFR/PDR		U	C	Caa1	SG	UNITED KINGDOM
1/9/2024	IGNITION TOPCO BV-IGNITION MIDCO BV	Industrial	SrSec/BCF/LTCFR/PDR		D	Caa2	Ca	SG	NETHERLANDS

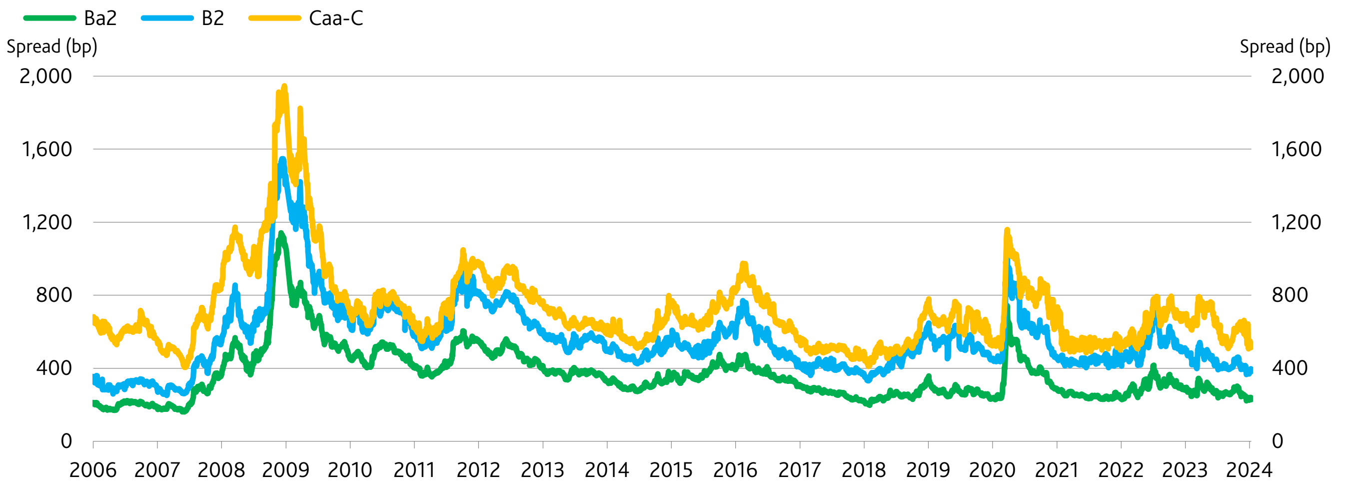
Source: Moody's

Figure 1: 5-Year Median Spreads-Global Data (High Grade)



Source: Moody's

Figure 2: 5-Year Median Spreads-Global Data (High Yield)



Source: Moody's

CDS Movers

Figure 3. CDS Movers - US (January 3, 2024 – January 10, 2024)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jan. 10	Jan. 3	Senior Ratings
Weyerhaeuser Company	Aa2	A1	Baa2
Cummins, Inc.	Aa3	A2	A2
CVS Health Corporation	A2	A3	Baa2
Amgen Inc.	A1	A2	Baa1
International Business Machines Corporation	A1	A2	A3
PepsiCo, Inc.	Aa2	Aa3	A1
Walmart Inc.	Aa1	Aa2	Aa2
Johnson & Johnson	Aaa	Aa1	Aaa
Bristol-Myers Squibb Company	Aa2	Aa3	A2
Philip Morris International Inc.	Baa1	Baa2	A2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jan. 10	Jan. 3	Senior Ratings
Citigroup Inc.	Baa2	Baa1	A3
Morgan Stanley	Baa2	Baa1	A1
Toyota Motor Credit Corporation	Aa2	Aa1	A1
American Honda Finance Corporation	Baa1	A3	A3
Boeing Company (The)	Baa2	Baa1	Baa2
Intel Corporation	Baa2	Baa1	A2
U.S. Bancorp	Baa2	Baa1	A3
Caterpillar Financial Services Corporation	A3	A2	A2
Exxon Mobil Corporation	Aa2	Aa1	Aa2
United Airlines, Inc.	Caa1	B3	Ba3

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jan. 10	Jan. 3	Spread Diff
Dish DBS Corporation	Caa2	2,799	2,235	564
Dish Network Corporation	Caa2	2,276	1,818	458
Lumen Technologies, Inc.	Caa3	3,122	2,920	203
Embarq Corporation	Caa3	2,187	2,044	143
Qwest Corporation	B3	1,374	1,284	90
iHeartCommunications, Inc.	Caa3	2,074	2,034	40
Pitney Bowes Inc.	B3	842	805	37
Scripps (E.W.) Company (The)	B3	523	502	21
Nabors Industries, Inc.	B3	694	679	15
Avis Budget Car Rental, LLC	B1	364	350	14

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jan. 10	Jan. 3	Spread Diff
Liberty Interactive LLC	Caa2	1,948	2,418	-470
Staples, Inc.	Caa2	1,572	1,727	-155
CSC Holdings, LLC	B2	1,616	1,701	-85
K. Hovnanian Enterprises, Inc.	Caa2	450	526	-76
Domtar Corporation	B2	631	683	-52
American Airlines Group Inc.	B3	643	694	-51
Nordstrom, Inc.	Ba1	429	470	-41
Macy's, Inc.	Ba2	359	400	-41
Carnival Corporation	B3	374	410	-37
Caesars Entertainment, Inc.	B3	217	254	-37

Source: Moody's, CMA

CDS Movers

Figure 4. CDS Movers - Europe (January 3, 2024 – January 10, 2024)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jan. 10	Jan. 3	Senior Ratings
Bayerische Motoren Werke Aktiengesellschaft	A2	A3	A2
ENGIE SA	Aa2	Aa3	Baa1
BASF (SE)	A2	A3	A3
Orange	Aa1	Aa2	Baa1
Veolia Environnement S.A.	Aa2	Aa3	Baa1
Airbus SE	A2	A3	A2
EnBW Energie Baden-Wuerttemberg AG	Aa1	Aa2	Baa1
Bouygues S.A.	Aa1	Aa2	A3
Bellis Acquisition Company PLC	Caa1	Caa2	Caa2
Telenor ASA	Aaa	Aa1	Baa1

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jan. 10	Jan. 3	Senior Ratings
JAB Holdings B.V.	A3	A1	Baa1
RWE AG	A2	Aa3	Baa2
Grifols S.A.	B3	B1	Caa1
France, Government of	Aa1	Aaa	Aa2
HSBC Holdings plc	Baa1	A3	A3
Ireland, Government of	Aa1	Aaa	Aa3
Banque Federative du Credit Mutuel	Baa3	Baa2	Aa3
ABN AMRO Bank N.V.	A3	A2	Aa3
Banco Bilbao Vizcaya Argentaria, S.A.	A3	A2	A3
DZ BANK AG	A3	A2	Aa2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jan. 10	Jan. 3	Spread Diff
Grifols S.A.	Caa1	447	317	130
Trinseo Materials Operating S.C.A.	B3	1,885	1,856	29
OI European Group B.V.	Ba3	220	210	11
Credit Mutuel Arkea	Aa3	96	86	10
Nexi S.p.A.	Ba1	198	189	9
Nationwide Building Society	A1	74	66	8
Hamburg Commercial Bank AG	A3	154	146	8
United Group B.V.	Caa1	470	462	8
DZ BANK AG	Aa2	57	50	6
JAB Holdings B.V.	Baa1	50	44	6

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jan. 10	Jan. 3	Spread Diff
Vedanta Resources Limited	Ca	2,975	3,276	-301
Garfunkelux Holdco 3 S.A.	Caa2	1,396	1,515	-119
CPI Property Group	Baa3	688	784	-96
Bellis Acquisition Company PLC	Caa2	481	563	-82
Stonegate Pub Company Financing 2019 plc	Caa2	527	604	-77
Boparan Finance plc	Caa3	793	844	-51
Carnival plc	B3	354	389	-35
Jaguar Land Rover Automotive Plc	Ba3	300	334	-34
Piraeus Financial Holdings S.A.	Ba3	217	250	-33
Ardagh Packaging Finance plc	Caa1	1,017	1,049	-33

Source: Moody's, CMA

CDS Movers

Figure 5. CDS Movers - APAC (January 3, 2024 – January 10, 2024)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jan. 10	Jan. 3	Senior Ratings
Australia, Government of	Aaa	Aaa	Aaa
Korea, Government of	Aa1	Aa1	Aa2
Commonwealth Bank of Australia	Aa2	Aa2	Aa3
Westpac Banking Corporation	Aa2	Aa2	Aa3
Indonesia, Government of	Baa2	Baa2	Baa2
National Australia Bank Limited	Aa2	Aa2	Aa3
Sumitomo Mitsui Banking Corporation	Aa3	Aa3	A1
Philippines, Government of	Baa1	Baa1	Baa2
Korea Development Bank	Aa2	Aa2	Aa2
Mitsubishi UFJ Financial Group, Inc.	Aa3	Aa3	A1

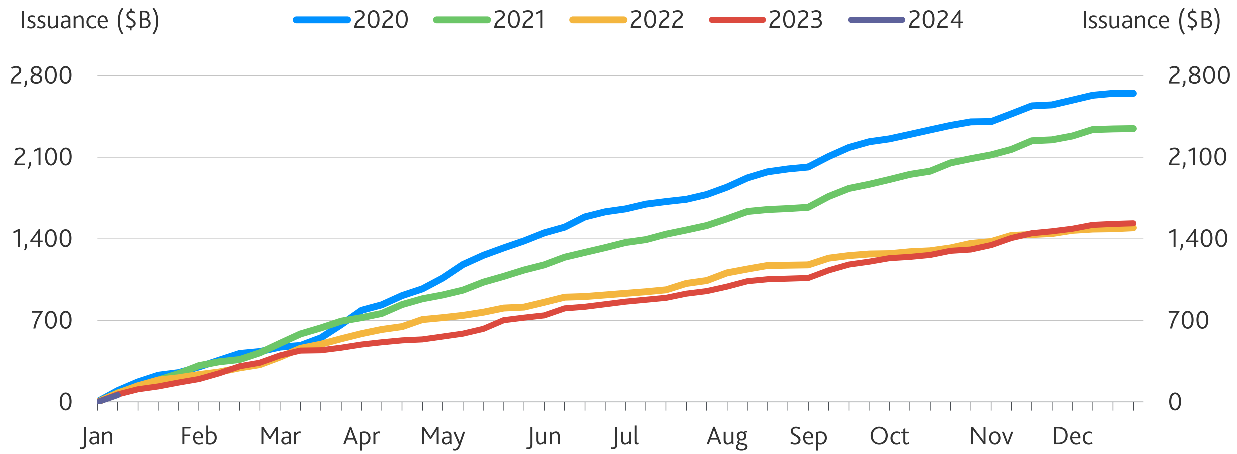
CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jan. 10	Jan. 3	Senior Ratings
Export-Import Bank of India	A1	Aa2	Baa3
Korea Railroad Corporation	A1	Aa2	Aa3
Japan, Government of	Aa1	Aaa	A1
China, Government of	Baa1	A3	A1
India, Government of	A2	A1	Baa3
Export-Import Bank of Korea (The)	Aa2	Aa1	Aa2
NBN Co Limited	Baa2	Baa1	Aa3
Mizuho Financial Group, Inc.	A3	A2	A1
Macquarie Group Limited	Baa2	Baa1	A2
Suncorp-Metway Limited	Baa2	Baa1	A1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jan. 10	Jan. 3	Spread Diff
Adani Green Energy Limited	B2	443	420	23
Halyk Bank of Kazakhstan JSC	Ba2	362	349	13
Tata Motors Limited	Ba3	149	143	7
Bank of East Asia, Limited	A3	92	87	6
Industrial & Commercial Bank of China Ltd	A1	73	67	6
Aurizon Network Pty Ltd	Baa1	60	54	6
Kia Corporation	Baa1	97	92	5
SoftBank Group Corp.	Ba3	194	190	4
Indian Railway Finance Corporation Limited	Baa3	61	57	4
SK Hynix Inc.	Baa2	109	105	4

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jan. 10	Jan. 3	Spread Diff
Vanke Real Estate (Hong Kong) Company Limited	Ba1	1,199	1,368	-169
RHB Bank Berhad	A3	87	102	-15
GMR Hyderabad International Airport Limited	Ba3	215	230	-15
Development Bank of Kazakhstan	Baa2	166	180	-14
CITIC Group Corporation	A3	76	89	-12
Flex Ltd.	Baa3	87	94	-8
Transurban Finance Company Pty Ltd	Baa2	90	96	-6
NIPPON STEEL CORPORATION	Baa2	50	55	-5
Boral Limited	Baa2	100	104	-4
National Australia Bank Limited	Aa3	33	36	-3

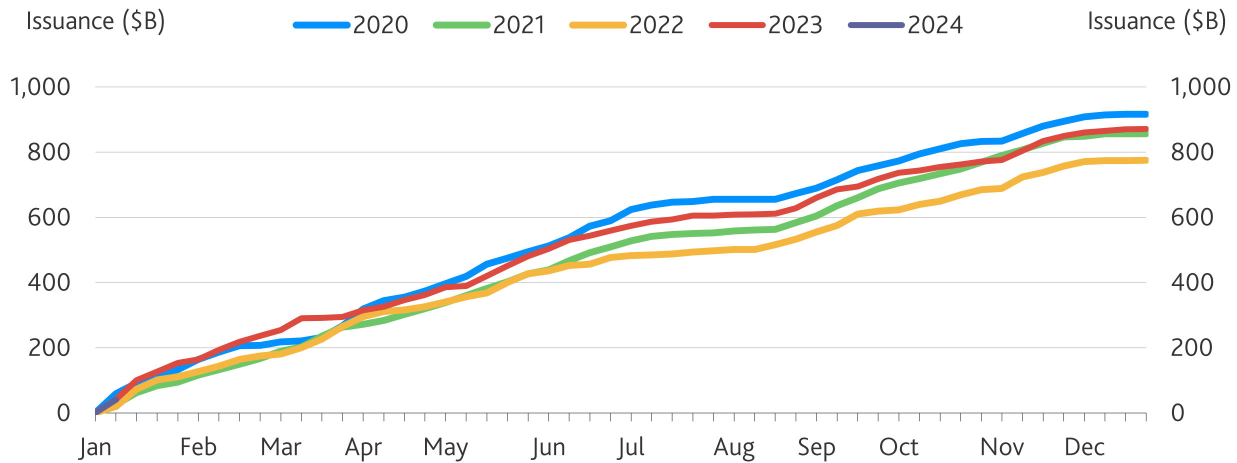
Source: Moody's, CMA

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	54.343	3.250	58.946
Year-to-Date	54.501	3.250	59.661

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	35.704	0.000	40.698
Year-to-Date	35.735	0.000	40.748

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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