WEEKLY MARKET OUTLOOK

JUNE 16, 2022

Lead Author

Ryan Sweet
Senior Director

Asia-Pacific

Shahana Mukherjee
Economist

Europe

Ross Cioffi
Economist

Kamil Kovar
Economist

U.S.

Bernard Yaros
Economist

Matt Colyar
Economist

Michael Ferlez
Economist

Matt Orefice
Data Specialist

Inside Economics Podcast:

Join the Conversation

Apple Podcasts

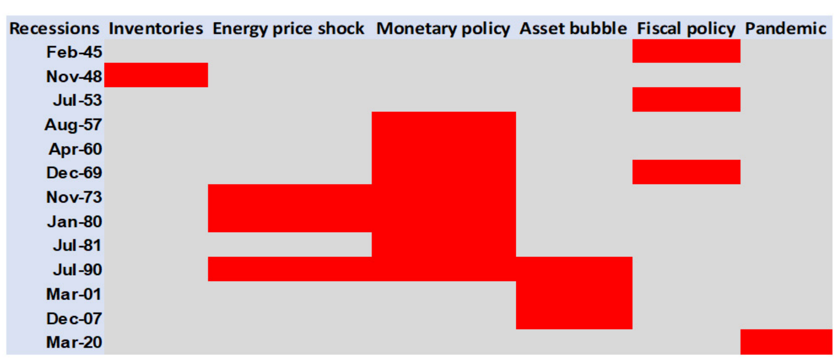
I'm From the Fed and I'm Here to Help

There is a lot to unpack from the June meeting of the Federal Open Market Committee, including the largest rate hike since 1994, a significant shift in the so-called dot plot, changes to the post-meeting statement, and new economic projections. On net, the takeaway is that the Fed is going to keep hiking rates, well past the neutral rate, in an effort to return inflation to its 2% objective. The issue is that the Fed's statement and new economic projections imply that its confidence in engineering a soft landing has declined. It won't say this publicly, but front-loading rate hikes makes it difficult to calibrate monetary policy in the future, and the central bank won't know that it was too aggressive until it is too late. The Fed has killed expansions before.

Table of Contents

Fed Has Killed Expansions Before

Major catalyst for U.S. recession



Sources: NBER, Moody's Analytics

Just getting started

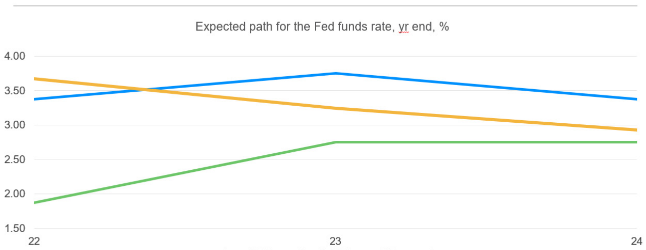
The decision to hike by 75 basis points rather than 50 basis points was clearly in response to the stronger-than-expected increase in the consumer price index in May and the rise in the University of Michigan's measure of inflation expectations. The Fed has zero tolerance for upside surprises in inflation or increases in inflation expectations. However, survey-based measures of inflation expectations are sensitive to food and energy prices. Market-based measures of inflation expectations, including five-year, five-year forward break-even rates, are in line with the Fed's inflation objective.

Some changes to the statement stood out. Removed from the June statement was mention that "with appropriate firming in the stance of monetary policy, the Committee expects inflation to return to its 2% objective and the labor market to remain strong." Rather, the new statement noted that "the Committee is strongly committed to returning inflation to its 2% objective."

The new dot plot better aligned the Fed's expectations with financial markets. The median projection among Fed officials is that the fed funds rate ends this year at 3.375% and next year at 3.75%. The Fed anticipates cutting interest rates in 2024, with the fed funds rate at 3.375%. Monetary policy is restrictive, with an actual fed funds rate above the neutral rate, for the next few years. The Fed raised its estimate of the neutral rate from 2.4% to 2.5%. With the Fed's expectation for inflation to moderate along with inflation expectations, the real fed funds rate will likely turn positive next year.

The Fed's expected terminal rate this cycle is 3.8%, above its estimate of the neutral fed funds rate of 2.5% (higher than the 2.4% in the March Summary of Economic Projections). The Fed didn't make any changes to its plans to reduce the size of its balance sheet. Quantitative tightening officially started on Wednesday.

Fed Changes Course



Sources: FOMC, Moody's Analytics

Risks are weighted that inflation remains higher than the Fed anticipates. Many Fed participants view the risk to the inflation forecast as weighted to the upside while also believing the unemployment rate could be higher than in the baseline. This sounds like a potential stagflation scenario.

Weaker growth, higher unemployment, lower inflation

The Fed released its updated Summary of Economic Projections. There was a noticeable downward revision to GDP growth (Q4/Q4) for this year and next. The median estimate is for GDP to rise 1.7% this year and next Q4/Q4, down from March, when GDP was expected to rise 2.8% and 2.2%, respectively. The Fed didn't alter its estimate of long-run GDP growth, keeping it at 1.8%.

Weaker growth implies a higher unemployment rate. The Fed expects the unemployment rate to average 3.7% in the fourth quarter of this year (previously 3.5%) and 3.9% in 2023 (previously 3.5%). The Fed expects the unemployment rate to be 4.1% in 2024, close to its estimate of 4% for the nonaccelerating inflation rate of unemployment. There has never been an increase in the jobless rate of more than 30 basis points, on a three-month moving average basis, that wasn't associated with a recession. Therefore, once the labor market overshoots full employment, it is extremely difficult for the Fed to pull off a soft landing. The Fed's forecast likely includes a very gradual rise in unemployment.

The Fed revised its forecast for growth higher in the headline and core PCE deflators. This isn't surprising, as the inflation data have been coming in hotter since the March SEP. The new inflation projections don't have inflation getting close to the Fed's 2% objective until 2024.

We modeled that (sort of)

The fed funds rate ends next year at 3.8%, which is close to the 4% we estimated in the alternative scenario we constructed in April, where the Fed returns inflation to target by the end of next year, a little sooner than the Fed itself anticipates. But a 4% terminal rate pushes the economy into a mild recession.

The Fed could be faced with a Hobson's choice: Push the economy into a mild recession, similar to our scenario, to tame inflation, or wait and cause a more significant recession, since a stagflation scenario is possible next year if the Fed isn't aggressive enough.

Following the June FOMC meeting, we're making material changes to our Fed call. The changes will be included when we update the baseline forecast for July. Odds are that 75-basis point rate hikes are not the new norm, unless inflation fails to moderate or inflation expectations keep rising. Odds are that the Fed will hike by 50 basis points at each of the next several meetings. The Fed is clearly planning on hiking rates more aggressively this year than we assumed in the June baseline, so changes are necessary.

The new forecast will be for a 50-basis point rate hike at the July and September meetings. This will be followed by a 25-basis point rate hike at the November and December meetings. This is a cumulative 150 basis points in rate hikes by the end of the year. The Fed will then raise rates by 25 basis points at each of the first two meetings in 2023, putting the terminal fed funds rate at 3.5%, less than the median projection from the latest Summary of Economic Projections.

The assumption is that the Fed will keep the fed funds rate at 3.5% for a year before gradually cutting by 100 basis points over the course of 2024 and early 2025, returning it to its neutral rate of 2.5%.

The new assumptions about the path of the fed funds rate will likely cut into GDP growth over the next couple of years and nudge the unemployment rate higher. The outlook for the rest of this year and next is turning less rosy, since the tightening in financial market conditions will have economic costs.

Could GDP decline again?

Our tracking estimate of second-quarter U.S. GDP growth continues to decline and is less than 1%, which suggests that the odds of another decline in GDP is possible. Our high-frequency GDP model now has second-quarter GDP growth on track to rise 0.8% at an annualized rate, compared with 1.7% prior to Wednesday's data on retail sales and business inventories.

Retail sales fell 0.3% in May, the first decline since December. Sales of the important control group—the total excluding autos, gasoline, building materials and food services—were unchanged in May. That's not encouraging, as it implies a decline when adjusting for inflation. This lowers our high-frequency GDP model's estimate of second-quarter real consumer spending to 2.8% at an annualized rate.

Retail sales at building material stores rose 0.2% in May, just enough to offset the decline in April. Building material store sales feed into GDP through residential home improvement. The new data lowered our estimate of real residential investment this quarter, which is on track for a sizable decline.

Business inventories increased 1.2% in April after rising 2.4% in March. This didn't noticeably alter our high-frequency GDP model's estimate that inventories will subtract 1.5 percentage points from second-quarter GDP growth.

There is plenty of missing source data for second-quarter GDP, but it is eerily similar to what happened in the first quarter when GDP unexpectedly declined. This raises the question of whether the economy is actually in a recession. The answer is no. While economic textbooks and the media often define recession as two consecutive quarters of negative GDP growth, this is not quite accurate, at least in the U.S. The National Bureau of Economic Research's business cycle dating committee—which has become the de facto arbiter of recessions in the U.S.—uses a more complex formula.

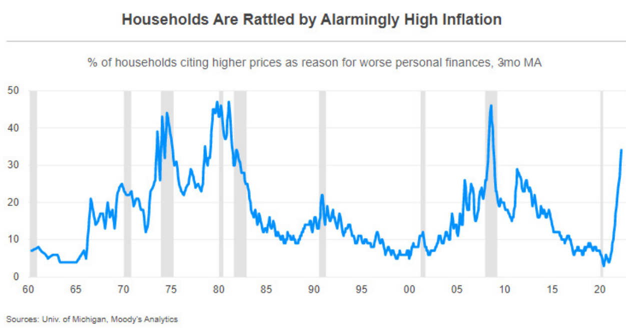
The committee defines a recession as a "significant decline in economic activity spread across the economy, lasting more than a few months." The panel examines a number of indicators, including real gross domestic product and gross domestic income, payroll employment, and industrial production. Weakness is isolated to GDP and it is difficult to declare that the economy is in a recession when the unemployment rate is around 3.5% and trend job growth is strong.

TOP OF MIND

U.S. CPI by Demographics

BY BERNARD YAROS AND MATT COLYAR

U.S. inflation is running at a 40-year high, which has unnerved consumers, and rightly so. Having inflation at 8.6% on a year-ago basis compared with the 2.1% average growth in 2018 and 2019 is costing the average household an extra $460 per month to purchase the same basket of goods and services as they did last year. Consequently, the share of households blaming higher prices for worse personal finances has surged since early 2021, and this malaise is unlikely to abate as long as the price of necessities—namely, food and energy—remains elevated.



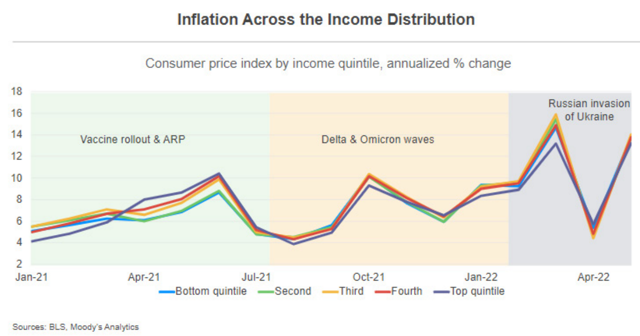
Because of high inflation, the V-shape recovery in jobs and output from the harrowing pandemic recession has been unloved by consumers. At first glance, this is perplexing. In March 2020, the economy was staring into the abyss. Why then has consumer sentiment fallen below its pandemic trough to its lowest level in over 10 years? At the worst of the pandemic recession, only 25 million Americans became unemployed or dropped out of the labor force altogether. However, currently high inflation is affecting every single one of the nearly 130 million households in the U.S. Though the unemployment rate has fallen dramatically after surging in April 2020, the sharp acceleration in inflation has coincided with the steady decline in sentiment since early 2021.

Inflation is elevated and has broadened out across consumer goods and services, but it is hitting some demographics harder than others. To underscore the differential impacts from high inflation, we lean on the Consumer Expenditure Survey, the only federal household survey to provide detailed information on consumers' expenditures, income and demographic characteristics. Most crucially, the CE Surveys reveal the share of average annual expenditures that consumers of various demographic characteristics dedicate to 20 different broad categories of goods and services.

Using these spending shares as weights, we construct estimates of the change in the consumer price index for demographic breakdowns by income, race, age, education, and region of residence and can observe which groups hurt the most under unexpectedly higher inflation in May.

Income

May's CPI data show that increases in prices hit households across the income spectrum because of the climbing costs of energy and a wide array of goods. However, the top income quintile experienced a relatively modest increase last month.



Not only has the top quintile experienced the least inflation amid recently higher energy prices, but it also boasts the largest cash buffer against inflation. Households are sitting on more than $2.5 trillion of excess savings that were accumulated during the pandemic thanks to generous federal transfer payments and an inability to spend on in-person services. While this is a prodigious amount, it is unevenly distributed across the income spectrum. The top quintile holds nearly 70% of total excess savings in the U.S. Further, the average household in the highest 20% of the distribution has $75,000 in excess savings. Therefore, currently high inflation will not make a major dent in their financial cushion.

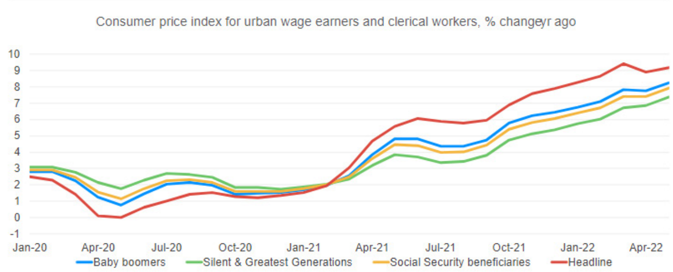
For the remaining quintiles, having inflation persistently at no less than 8% would wipe out between a third and almost one-half of the excess savings belonging to the average household in the bottom 60% of the income spectrum in a year's time. For the fourth quintile, it would snuff out three-quarters of this cash buffer for the average household within 12 months. This analysis focuses on the average household in a given quintile of income. However, there are many households that fall below these averages and hence may have already depleted or are close to exhausting their excess savings.

Age

Though retirement-age Americans are facing comparatively less inflation, rising prices are a dangerous corrosive on their fixed incomes. For example, more than 65 million Americans receive Social Security benefits and are witnessing high inflation erode these crucial federal transfer payments. For 2022, the Social Security cost-of-living adjustment was 5.9%, leading to a $154 increase in average monthly benefits for aged couples both receiving benefits. While this was the highest COLA since 1982, it still falls well short of inflation.

The CPI tracks the spending habits of two population groups: all urban consumers, and urban wage earners and clerical workers. The former is known as the CPI-U, while the latter is referred to as the CPI-W. Though the CPI-U is the most commonly cited measure of inflation, as it covers about 87% of the population, the annual Social Security COLA is tied to the CPI-W. Therefore, this specific analysis is based on the CPI-W, which was up 9.2% in May from a year earlier. CPI-W inflation was only 8.3% for baby boomers and 7.4% for members of the Silent and Greatest Generations. Using these generational measures of inflation, we constructed a CPI-W that is specific to retired workers and aged spouses receiving Social Security benefits. Of these beneficiaries, 64% are baby boomers, with the remainder belonging to the two oldest living generations. Based on these shares, we estimate that CPI-W inflation was 7.9% for Social Security beneficiaries in May.

Retiree-Specific Inflation Is Lower Than Average but Still Painfully High



Sources: BLS, Moody's Analytics

Having inflation at 7.9% is costing the average household of Social Security beneficiaries an extra $349 per month to purchase the same basket of goods and services as it did in 2020. This exceeds the average COLA bump for aged couples both receiving benefits in 2022 by $195.

Social Security enrollees could experience some meaningful relief from inflation next year. The Congressional Budget Office projects that the 2023 COLA will be 6%. Meanwhile, the Moody's Analytics baseline forecast calls for CPI-W inflation to average 3% next year. If we and the CBO are correct, then the purchasing power of retirees will improve in 2023.

Therefore, retirees' income flows have failed to keep pace with protracted and elevated inflation. Meanwhile, for younger Americans, differences in spending behavior render their budgets acutely vulnerable to the sharp rises in vehicle, rental and energy prices.

Spending on used vehicles constitutes 7.3% of Generation Z's and millennials' annual spending. For Gen X, the share is 5.4% and for baby boomers, lower still at 3.4%. The 1.8% increase from April to May in used-vehicle prices, after falling in each of the previous three months, stung younger Americans. Price pressures can turn a potential buyer of a new car to a used car. For those starting out in the used-car market, however, quickly rising prices leave little room for maneuver. Rising borrowing costs make the monthly payment even less affordable.

Geography

A similar differential exists between rural and urban households. For the former, new and used cars and trucks represent 11% of total spending, and 9.2% for the latter. All told, changes in the costs of new and used vehicles have led to some of the most pronounced differences in inflation over the past year among our varying demographic groups.

For the foreseeable future, energy prices will be paramount. Last week, Secretary of the Treasury Janet Yellen indicated gas prices are not set to come down anytime soon. Wholesale gasoline prices, which lead retail prices at the pump by two weeks, indicate prices in the U.S. are set to rise from $5 to $5.50. Lower- and middle-income households spend a larger share of their incomes on gasoline than higher-earning households. The same is true for rural and younger Americans, relative to their urban-dwelling and older counterparts.

Gas prices represent approximately 3% to 5% of total spending across our different groups, though they play an outsize role in the mind of the U.S. consumer when it comes to inflation and their feelings about the state of the economy. As a result, some demographic groups will be watching more nervously than others as the fallout from Russia's invasion of Ukraine continues to unfold.

The Week Ahead in the Global Economy

U.S.

The U.S. economic calendar is pretty light in the upcoming holiday shortened week. New housing data will likely show the market continues to cool. Existing-home sales likely fell again in May. We also get new-home sales for May. Other key data include the University of Michigan consumer confidence survey. This measure, which is sensitive to fluctuations in household finances, has been implying that consumers are down in the dumps. Retail gasoline prices have jumped and have many perceiving that their financial situations have deteriorated. The six-month rolling correlation between changes in the Michigan measure of consumer sentiment and changes in retail gasoline prices is -0.6. Therefore, we should see a noticeable bounce back after it hit a record low recently. Watch inflation expectations. The Fed is concerned that consumers' long-run inflation expectations are becoming dislodged.

Europe

Next week will be mostly calm in terms of economic releases in Europe. But we'll be watchful with regard to the U.K.'s May CPI release. We expect the inflation rate accelerated to 9.2% y/y from 9% in April. There was likely some relief from fuel prices, but core and food inflation will have continued to heat up.

Inflation will weigh on retail sales, but we are forecasting some upwind factors in May. Households likely spent in preparation for the Jubilee festivities. But retail sales will likely fall back in the coming months as households switch expenditures to services and their disposable incomes are tightened by inflation and rate hikes.

Spain's final estimate of first-quarter GDP growth likely came in at 0.3% q/q. This is a considerable slowdown from the 2.2% increase marked in the fourth quarter of 2021. The outbreak of the Omicron variant likely caused household consumption to drop. Fortunately, fixed investments and inventory investments were strong during the quarter, according to the preliminary estimate.

Asia-Pacific

This will be a quieter week in the Asia-Pacific region. Monetary policy decisions by central banks in Indonesia and the Philippines will be the highlight on the economic calendar. We expect Bank Indonesia to lift the benchmark policy rate by 25 basis points to 3.75% at its June meeting. Much like the situation in the rest of Asia, expectations around future inflation will be key in shaping this month's decision.

Although consumer inflation has trended north of 2% since the start of this year and core price pressures have gained some pace, at 3.6%, headline inflation remained below Bank Indonesia's target ceiling of 4% in May. There is some room to extend the current policy rate of 3.5% for a month or two. But it is increasingly likely that BI will take a stronger view on the expected inflation trajectory following the Federal Reserve's decision to increase interest rates more aggressively in June. This will likely budge BI from its pandemic-induced low interest rate regime and see it adopt earlier-than-planned rate normalisation.

Along similar lines, we expect the Philippine central bank to lift its policy rate by 25 basis points to 2.5% in June in response to the pickup in imported inflation. Singapore's inflation is likely to have held up at 5.6% y/y in May, reflecting broad-based pressures from higher food and services costs.

Geopolitical Calendar

Date	Country	Event	Economic Importance	Financial Market Risk
29-30-Jun	NATO	NATO Summit, hosted by Madrid	Medium	Medium
Jun/Jul	Papua New Guinea	National general election	Low	Low
Jul	Japan	House of Councillors election	Medium	Low
2-Oct	Brazil	Presidential and congressional elections	High	Medium
Oct	Indonesia	G20	Medium	Low
Oct/Nov	China	National Party Congress	High	Medium
7-Nov	U.N.	U.N. Climate Change Conference 2022 (COP 27)	Medium	Low

THE LONG VIEW: U.S.

GDP Declines in Economic Expansions Have Happened Before

BY RYAN SWEET

CREDIT SPREADS

Moody's long-term average corporate bond spread is 161 basis points, 15 bps wider than at this time last week. It is slightly wider than the 159 bps average in May. The long-term average industrial corporate bond spread widened by 16 bp to 148. It averaged 144 bps in May.

The recent ICE BofA U.S. high-yield option adjusted bond spread widened from 434 to 482 basis points. It is still among the widest since late 2020. The Bloomberg Barclays high-yield option adjusted spread widened in the last week from 420 to 477 basis points. The high-yield option adjusted bond spreads approximate what is suggested by the accompanying long-term Baa industrial company bond yield spread and that implied by a VIX of 32.6. The VIX jumped over the course of the past week.

DEFAULTS

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

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

U.S. CORPORATE BOND ISSUANCE

First-quarter 2020's worldwide offerings of corporate bonds revealed annual advances of 14% for IG and 19% for high-yield, wherein US$-denominated offerings increased 45% for IG and grew 12% for high yield.

Second-quarter 2020's worldwide offerings of corporate bonds revealed annual surges of 69% for IG and 32% for high-yield, wherein US$-denominated offerings increased 142% for IG and grew 45% for high yield.

Third-quarter 2020's worldwide offerings of corporate bonds revealed an annual decline of 6% for IG and an annual advance of 44% for high-yield, wherein US$-denominated offerings increased 12% for IG and soared upward 56% for high yield.

Fourth-quarter 2020's worldwide offerings of corporate bonds revealed an annual decline of 3% for IG and an annual advance of 8% for high-yield, wherein US$-denominated offerings increased 16% for IG and 11% for high yield.

First-quarter 2021's worldwide offerings of corporate bonds revealed an annual decline of 4% for IG and an annual advance of 57% for high-yield, wherein US$-denominated offerings sank 9% for IG and advanced 64% for high yield.

Issuance weakened in the second quarter of 2021 as worldwide offerings of corporate bonds revealed a year-over-year decline of 35% for investment grade. High-yield issuance faired noticeably better in the second quarter.

Issuance softened in the third quarter of 2021 as worldwide offerings of corporate bonds revealed a year-over-year decline of 5% for investment grade. U.S. denominated corporate bond issuance also fell, dropping 16% on a year-ago basis. High-yield issuance faired noticeably better in the third quarter.

Fourth-quarter 2021's worldwide offerings of corporate bonds fell 9.4% for investment grade. High-yield US$ denominated high-yield corporate bond issuance fell from $133 billion in the third quarter to $92 billion in the final three months of 2021. December was a disappointment for high-yield corporate bond issuance, since it was 33% below its prior five-year average for the month.

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

In the week ended June 10, US$-denominated high-yield issuance totaled $3.15 billion. This brings the year-to-date total to $93.5 billion. Investment-grade bond issuance rose $38.34 billion in the week, bringing its year-to-date total to $780.8 billion. Issuance is tracking that seen in 2018 and 2019.

U.S. ECONOMIC OUTLOOK

There were some tweaks to the U.S. baseline forecast in June, but the changes were smaller than in prior months. The new baseline forecast factors in the recent tightening in financial market conditions, increases in energy prices, and new data on first-quarter GDP.

Fiscal assumptions

The federal budget deficit will fall from 12.4% of GDP in fiscal 2021 to 4.4% this year and 3.8% the next year. This improvement largely reflects the end of federal pandemic relief and a stronger economy. In the June baseline, the effective personal tax rate was adjusted higher in the near to medium term. The U.S. Treasury Department enjoyed a better-than-expected windfall of individual income taxes in April thanks to soaring asset prices and widening participation in equity markets in 2021. Nevertheless, this is coming at the expense of personal savings. A higher tax bill has led to a faster decumulation of excess personal savings than previously thought.

In its second estimate of first-quarter GDP, the Bureau of Economic Analysis revised personal current taxes to reflect the stronger-than-anticipated filing season and lower refunds, which shaved a full percentage point off the savings rate in the first three months of the year. As a result, excess savings are decumulating at an accelerating rate, though they remain prodigiously above $2.5 trillion. Because of incoming data and fiscal changes to the forecast, the savings rate will average 1.1 and 0.7 percentage point lower in 2022 and 2023 compared with the May baseline.

COVID-19 assumptions

Changes to our epidemiological assumptions were noticeable, but the economic implications are modest as each wave of COVID-19 has a diminishing effect on the economy. Total confirmed COVID-19 cases in the U.S. will be 97.07 million, compared with 88.5 million. The seven-day moving average of daily confirmed cases has been steadily rising since the May baseline and is now 122,000, more than double that seen when we updated the May baseline forecast.

We're sticking with the concept of "effective immunity," which is a rolling number of infections plus vaccinations to account for the fact that immunity is not permanent. The forecast still assumes that COVID-19 will be endemic and seasonal.

Energy price assumptions

The European Union's sixth set of economic sanctions against Russia will create the biggest disruption to the global oil market since the Yom Kippur War. Though a strong vote of confidence in Ukraine, the move will stoke inflation, raise consumer energy bills, and complicate global central banks' task of raising interest rates without tipping their respective economies into recession.

The baseline forecast now has West Texas Intermediate crude oil prices peaking higher than in the prior baseline forecast. However, the timing hasn't changed, and the forecast assumes oil prices peak this quarter, averaging $107 per barrel. The contours of the forecast haven't changed, and the June baseline still has oil prices steadily declining in the second half of this year and throughout next year, approaching $60 per barrel in late 2024.

Nudging GDP lower

Real GDP is expected to increase 2.7% this year, compared with 2.8% in the prior baseline. We have cut our forecast for U.S. GDP growth this year by a total of 80 basis points over the past few months. We nudged the forecast for GDP growth in 2023 down from 2.7% to 2.6%. The economy is still expected to grow above its potential, which is likely between 2% and 2.5%.

Revisions to first-quarter GDP, which is now shown to have declined 1.5% at an annualized rate (previously -1.4%), were a small factor in the revision to GDP growth this year. The weakness in the first quarter was concentrated in net exports and inventories.

Net exports were an enormous weight on first-quarter GDP. Trade has been a consistent weight on GDP growth as demand for consumer goods has been robust. The U.S. consumer is buying a ton of goods and the majority of these are imported. Neither inventories nor trade tell us where the economy is headed.

Declines in GDP during economic expansions have happened before. The three contractions in GDP occurring between the global financial crisis and the COVID-19 pandemic occurred because of some combination of a widened trade deficit and the quarterly oscillations of the inventory build. Consumption, the largest component of GDP, did not contract in those instances, nor did it in the first quarter of 2022. Consumption, particularly on services, accelerated in the quarter.

Our baseline forecast for real GDP growth this year is close to the Bloomberg consensus of 2.6%. The forecast for next year is 0.6 percentage point stronger than the Bloomberg consensus of 2%.

Business investment and housing

Incoming data over the past few weeks point toward weaker U.S. real business investment in the second quarter. Still, growth will be solid and fundamentals, including supportive financial market conditions and better after-tax corporate profits as a share of nominal GDP, should continue to support investment through the rest of this year and into next. Another favorable development for business investment is that the rate of new-business formations has risen recently, tempering concerns that the pandemic could have scarring impacts on entrepreneurship.

We have real business equipment spending rising 6.5% this year, compared with 7% in the May baseline. The forecast is for real business equipment spending to increase 5.2% in 2023, compared with 3.9% next year.

There was a downward revision to housing starts as supply constraints and higher mortgage rates have started to bite into the housing market. Housing starts are expected to be 1.77 million compared with 1.83 million in the prior baseline. Housing starts are expected to total 1.86 million next year, down from 1.89 in the prior baseline.

There are likely only so many homes that can be built each year because of labor-supply constraints and a lack of buildable lots. Some of the labor-supply issues will ease as the pandemic winds down, but the reduction in immigration is particularly problematic for homebuilders' ability to find workers. We cut the forecasts for new- and existing-home sales this year. They are expected to total 6.59 million, lighter than the 6.86 million in the prior forecast. We also cut the forecast for total home sales next year. New-home sales account for about 10% of total home sales.

There were minor tweaks to the forecast for the FHFA All-Transactions House Price Index this year and next. The June baseline has it rising 11.3% this year, compared with 12.2% in the prior baseline. The forecast for 2023 and 2024 continues to expect little house price appreciation.

Labor market

The U.S. labor market remains strong even as job growth is moderating. Trend job growth is between 400,000 and 450,000 per month, but this isn't sustainable and needs to fall to around 150,000 per month later this year or the Federal Reserve's attempt to engineer a soft landing will become increasingly difficult.

Nonfarm employment rose by 390,000, on net, in May, better than either we or the consensus anticipated. The gain leaves nonfarm employment 822,000 below its pre-pandemic peak. This should be recouped over the next few months. However, excluding leisure and hospitality, employment is already above its pre-pandemic peak. Of course, this doesn't account for the jobs that would have been created if the pandemic didn't occur, which is around 5 million.

We have job growth averaging 373,000 per month this year, nearly identical to the gain in the May baseline forecast. Job growth is expected to moderate next year and in 2024. The unemployment rate is expected to average around 3.3% in the fourth quarter of this year before gradually rising over the next couple of years as the effect of tighter monetary policy starts to be felt.

We assume a full-employment economy is one with a 3.5% unemployment rate, around a 62.5% labor force participation rate, and a prime-age employment-to-population ratio a little north of 80%. All of these conditions will be met this summer.

Monetary policy

The minutes from the May meeting of the Federal Open Market Committee signal that the central bank wants to aggressively hike rates at the next couple of meetings to allow officials the potential to pause and assess the effects of policy firming on the economy, inflation and financial markets. This would improve the odds that the Fed engineers a soft landing. Previously, it appeared the Fed was going to hike until something broke, either inflation or the economy. The minutes were lighter on the inflation discussion than in March. On the balance sheet, a number of officials supported eventually selling mortgage-backed securities. The immediate market reaction to the minutes was fairly tame, potentially because there were no big surprises, and we didn't make any changes to our near-term forecast for the fed funds rate.

The Fed has begun its quantitative tightening campaign. If the Fed sticks with its current plan, its balance sheet will decline by about $520 billion this year. This may sound like a lot, but the balance sheet will still be massive, around 37% of nominal GDP. It was less than 20% of nominal GDP before the pandemic. Also, there wasn't a mention of MBS sales in the FOMC's May minutes.

The 10-year Treasury yield has bounced around recently but we didn't make any changes to the baseline forecast. The 10-year Treasury yield will average 3.14% in the final three months. We still have the 10-year Treasury yield averaging 3.25% in the fourth quarter of next year, identical to the May baseline. The June baseline forecast incorporates the recent swing in equity prices, which is the reason for the revision to the forecast. Equity prices are expected to bottom in the first quarter of next year and will resume rising in the second quarter.

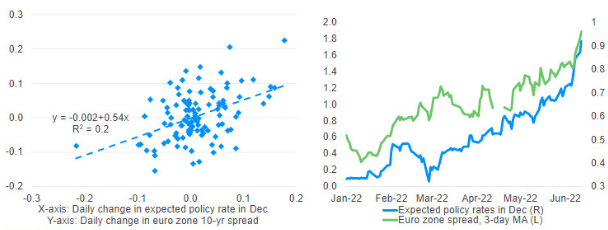
THE LONG VIEW: EUROPE

ECB’s Unscheduled Meeting Helps, a Bit

BY KAMIL KOVAR

Following the rout in the bond markets since last week’s European Central Bank meeting, the central bank was forced to call an ad-hoc meeting for Wednesday. This meeting resulted in a communique that included two pieces of information: The ECB will start to use flexibility when reinvesting its portfolio of bonds bought during the pandemic, and it will “accelerate the completion of the design of a new anti-fragmentation instrument”. Bond markets have reacted positively to the news about the unscheduled meeting, with spreads between the Italian bond yields and risk-free German bond yields dropping by more than 0.2%. However, this still leaves them higher than before last week’s ECB meeting. Is this the end or just the beginning of more serious troubles in the sovereign debt markets?

Expectations of Tightening Are Driving Spreads



Sources: ECB, Bundesbank, Bloomberg

While predicting future movements in spreads is a futile exercise, we believe the story is far from over. This belief rests on two arguments. First, we need to start with what is driving the spreads higher this year. While some argue it’s the end of the bond purchases, we believe the source is more prosaic and consequential: the expectation of faster tightening by the ECB. If this is the case, then the recent action by the ECB will be of little help, given that the central bank will not abandon its pivot towards rapid tightening—higher interest rates will continue to put pressure on governments with high debt loads in the coming months and quarters.

Second, the ECB communique brought little actual news. Flexible reinvestments were already mentioned late last year, so were expected sooner or later, and the suggestion of a new anti-fragmentation tool surfaced a couple of weeks ago. Therefore, the meeting was mostly a signal from the ECB that it is serious about addressing the situation. This move was reminiscent of Mario Draghi’s statement of “whatever it takes”, which almost single-handedly ended the debt crisis in 2012. Back then, the risk premiums were extremely elevated, while this time, the increase in spreads mostly reflects worsening fiscal fundamentals because of higher interest rates.

One can also see Wednesday’s meeting from a negative perspective. Since the ECB did not announce any new measure, it likely reflects the struggle inside the governing council to use a tool that finds consensus. It’s clear that the ECB will not restart systematic large-scale purchases, as that would go against its goal of tightening monetary policy. Rather, it will aim to keep spreads in check with more targeted intervention—like the Securities Market Programme of 2010-2012, where the ECB intervened in an ad hoc fashion and bought an unspecified number of bonds—rather than quantitative easing, where bonds purchased are untargeted, systematic and pre-announced. The hawkish members of the governing council will not want it to look as though the ECB is “keeping spreads closed” and preventing markets from properly pricing risk. Therefore, the danger is that anything that finds consensus with the ECB will fall short, and stress in the bond markets will continue to escalate. While this is not the most likely outcome, it is a clear risk.

.

New Zealand Sees GDP Decline

BY SHAHANA MUKHERJEE

New Zealand's economy contracted in the March quarter as GDP fell 0.2% q/q following a 3% expansion in the prior quarter. This translated into year-on-year growth of 1.6% after a 3.1% rise previously. The March quarter performance came in above our expectations. But a look at the finer details reveals weakness in key industries.

On the production front, weakness in primary industries extended through the quarter, resulting in consecutive quarters of contraction. Mining was the largest contributor to this decline. It fell 8.9% q/q because of lower metal ore and nonmetallic mining and more than reversed mining growth in the prior quarter. Manufacturing fell 1.4% q/q, led by transport equipment, machinery and equipment production. This compounded the overall decline. Meanwhile, services industries were unevenly impacted by renewed COVID-19 restrictions. Contact-sensitive industries such as retail trade, accommodation and restaurants declined over the quarter as expected; but the weakness was partially offset by a rise in wholesale trade and education and training.

Spending up

The highlight of the March quarter performance was that household spending held up surprisingly well. It rose 4.6% q/q, driven by a pickup in services and durables spending even though the spread of the Omicron variant saw restrictions reintroduced. Household spending was supported by an increase in fixed-asset investment. But growth was hit by considerably weaker exports of goods and services, which fell 14.3% q/q.

Mixed outlook

The outlook for New Zealand is mixed. The worst of the hit from COVID-19 restrictions is over. With movement restrictions lifted, the economy has returned to expansion this quarter. Continued tightness in the labour market and strong spending appetite will aid growth. But high and volatile energy prices are driving inflation to unsustainable levels; domestic capacity constraints being felt across industries and the labour market will aggravate this strain. The Reserve Bank of New Zealand's aggressive interest rate tightening is necessary but unlikely to fully tame exogenously driven supply-side pressures. A combination of high inflation and higher borrowing rates remain the key downside risks to growth.

Coming months will see household spending appetites, investment decisions, and exports feel the pressure from elevated uncertainty on the price front. The good news is that New Zealand has enjoyed a solid catch-up in private consumption from the COVID-19 hit; household spending sits a good 9% above pre-pandemic levels. But momentum will weaken through this quarter and next, until inflation expectations are reined in.

RATINGS ROUNDUP

Upgrades for Eight of 13 U.S. Changes

BY MICHAEL FERLEZ

U.S.

U.S. rating change activity was credit positive for the week ended June 14. Upgrades accounted for eight of the 13 rating changes and just over two-thirds of the reported affected debt. The week's activity saw rating actions across a diverse set of industries. The majority of rating change activity was again concentrated among speculative-grade companies, though three investment-grade companies received upgrades.

The most notable change in terms of affected debt was made to Becton, Dickinson and Company, which along with its wholly owned and guaranteed subsidiary, Becton Dickinson Euro Finance S.a.r.l, saw their senior unsecured rating upgraded to Baa2 from Baa3. In its rating action, Moody's Investors services cited its expectation that BD would continue operating with moderate leverage and would remain acquisitive. In total, the upgraded impacted $17 billion in outstanding senior unsecured debt. Also included in the rating action was Moody's Investors Service decision to upgrade BD's commercial paper rating to P-2.

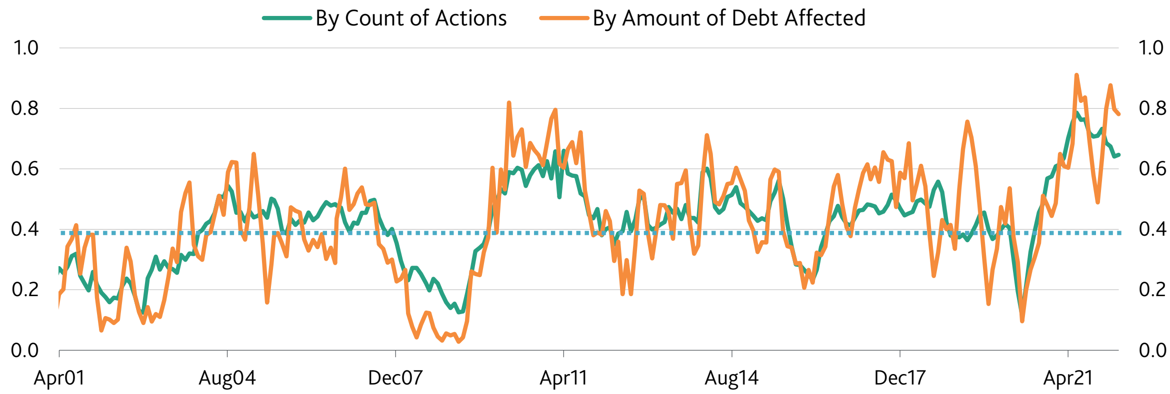
Europe

Western European rating change activity was sparse last week, registering only two rating actions—both upgrades.

The larger of the two changes in terms of affected debt was made to Dell Bank International d.a.c., which saw its senior unsecured debt and long-term issuer rating upgraded to Baa2. Concurrent with the change, Moody's Investors Services also changed DBI's outlook from stable to positive. In the rating action, Moody's Investors Service noted the upgrade reflected the recent upgrade of Dell International L.L.C.'s senior unsecured debt rating and outlook.

RATINGS ROUND-UP

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



* Trailing 3-month average

Source: Moody's

FIGURE 2
Rating Key

BCF	Bank Credit Facility Rating	MM	Money-Market
CFR	Corporate Family Rating	MTN	MTN Program Rating
CP	Commercial Paper Rating	Notes	Notes
FSR	Bank Financial Strength Rating	PDR	Probability of Default Rating
IFS	Insurance Financial Strength Rating	PS	Preferred Stock Rating
IR	Issuer Rating	SGLR	Speculative-Grade Liquidity Rating
JrSub	Junior Subordinated Rating	SLTD	Short- and Long-Term Deposit Rating
LGD	Loss Given Default Rating	SrSec	Senior Secured Rating
LTCF	Long-Term Corporate Family Rating	SrUnsec	Senior Unsecured Rating
LTD	Long-Term Deposit Rating	SrSub	Senior Subordinated
LTIR	Long-Term Issuer Rating	STD	Short-Term Deposit Rating

FIGURE 3

Rating Changes: Corporate & Financial Institutions - US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/SG
6/8/2022	UNIVISION HOLDINGS, INC.-UNIVISION COMMUNICATIONS INC.	Industrial	PDR		D	B1	B2	SG
6/8/2022	B&G FOODS, INC.	Industrial	SrUnsec/LTCFR/PDR	1450.00	D	B2	B3	SG
6/8/2022	PROSPERITY BANCSHARES, INC.-PROSPERITY BANK	Financial	LTIR		U	Baa1	A3	IG
6/8/2022	TOLL ROAD INVESTORS PARTNERSHIP II, L.P.	Industrial	SrUnsec	31.60	U	Baa2	A1	IG
6/8/2022	DAVE & BUSTER'S, INC.	Industrial	LTCFR/PDR		U	B2	B1	SG
6/8/2022	VERTEX AEROSPACE SERVICES HOLDING CORP.-VERTEX AEROSPACE SERVICES CORP.	Industrial	LTCFR/PDR		U	B2	B1	SG
6/9/2022	CALLON PETROLEUM COMPANY	Industrial	SrUnsec	1900.00	U	Caa1	B3	SG
6/9/2022	COMMSCOPE HOLDING COMPANY, INC.	Industrial	SrSec/SrUnsec/BCF/ LTCFR/PDR	6700.00	D	Ba3	B1	SG
6/10/2022	OLIN CORPORATION	Industrial	SrUnsec/LTCFR/PDR	2108.63	U	Ba2	Ba1	SG
6/10/2022	AVAYA HOLDINGS CORP-AVAYA INC.	Industrial	SrSec/BCF	1000.00	D	B2	B3	SG
6/10/2022	SPECIALTY BUILDING PRODUCTS HOLDINGS, LLC	Industrial	SrSec/BCF	725.00	D	B2	B3	SG
6/13/2022	BECTON, DICKINSON AND COMPANY	Industrial	SrUnsec/CP	16947.93	U	Baa3	Baa2	IG
6/13/2022	TITAN INTERNATIONAL, INC.	Industrial	SrSec/LTCFR/PDR	400.00	U	B3	B2	SG

Source: Moody's

FIGURE 4

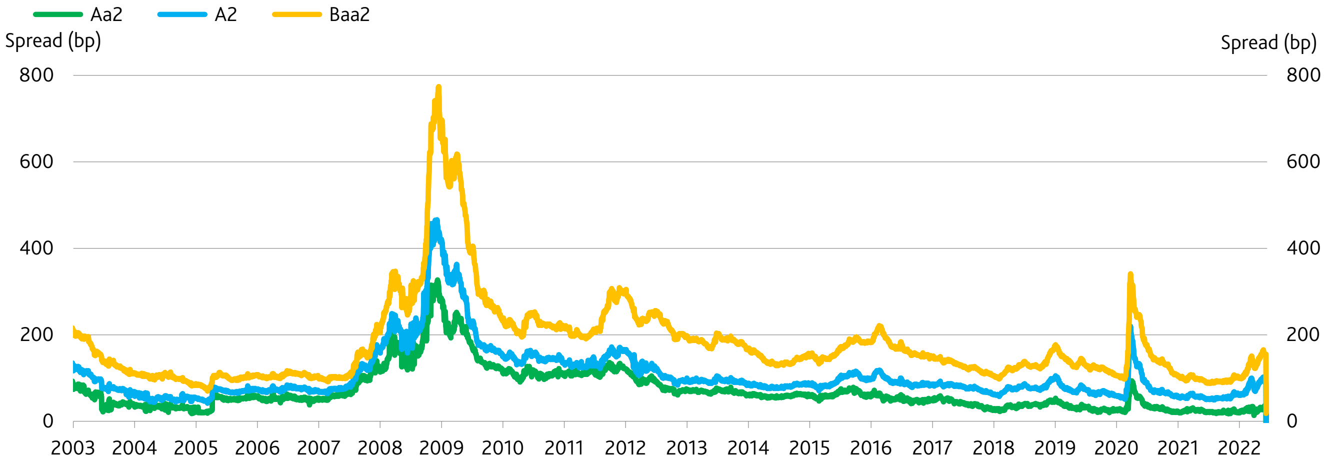
Rating Changes: Corporate & Financial Institutions - Europe

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG	Country
6/8/2022	DELL TECHNOLOGIES, INC.-DELL BANK INTERNATIONAL D.A.C.	Financial	SrUnsec/LTIR/MTN	1579.58	U	Baa3	Baa2	IG	IRELAND
6/14/2022	BANCO COMERCIAL PORTUGUES, S.A.	Financial	SrUnsec/MTN	1063.58	U	Ba1	Baa3	SG	PORTUGAL

Source: Moody's

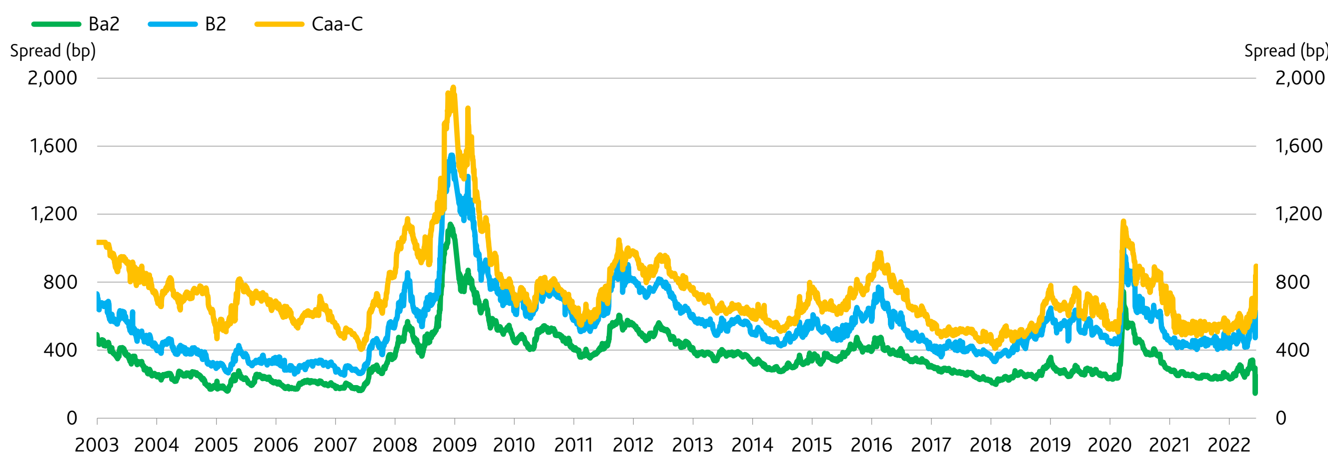
MARKET DATA

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



Source: Moody's

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



Source: Moody's

CDS MOVERS

Figure 3. CDS Movers - US (June 8, 2022 – June 15, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jun. 15	Jun. 8	Senior Ratings
ERAC USA Finance LLC	A3	Baa2	Baa1
Charles Schwab Corporation (The)	A3	Baa1	A2
General Motors Company	Ba1	Ba2	Baa3
Bank of New York Mellon Corporation (The)	A1	A2	A1
Consolidated Edison Company of New York, Inc.	A3	Baa1	Baa1
Waste Management, Inc.	Aa3	A1	Baa1
Welltower OP LLC	Baa1	Baa2	Baa1
Conagra Brands, Inc.	Baa2	Baa3	Baa3
Archer-Daniels-Midland Company	A2	A3	A2
Sysco Corporation	Baa2	Baa3	Baa1

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jun. 15	Jun. 8	Senior Ratings
CenterPoint Energy, Inc.	Baa2	A3	Baa2
PepsiCo, Inc.	A2	A1	A1
Philip Morris International Inc.	A2	A1	A2
General Electric Company	Baa3	Baa2	Baa1
Eli Lilly and Company	Aa2	Aa1	A2
FirstEnergy Corp.	Baa3	Baa2	Ba1
Emerson Electric Company	Baa1	A3	A2
Danaher Corporation	A3	A2	Baa1
Archer-Daniels-Midland Company	A2	A1	A2
United Rentals (North America), Inc.	Ba2	Ba1	Ba2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jun. 15	Jun. 8	Spread Diff
Staples, Inc.	Caa2	1,858	1,591	267
American Airlines Group Inc.	Caa1	1,582	1,322	260
United Airlines, Inc.	Ba3	920	678	242
Pitney Bowes Inc.	B3	986	805	182
United Airlines Holdings, Inc.	Ba3	866	717	149
Liberty Interactive LLC	B2	1,546	1,401	145
Pactiv LLC	Caa1	872	738	134
Dish DBS Corporation	B3	1,145	1,020	124
United States Steel Corporation	B1	618	498	120
Beazer Homes USA, Inc.	B3	707	589	118

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jun. 15	Jun. 8	Spread Diff
Scripps (E.W.) Company (The)	B3	199	237	-38
Rite Aid Corporation	Caa2	2,725	2,749	-24
ONEOK, Inc.	Baa3	87	105	-18
ERAC USA Finance LLC	Baa1	72	90	-18
ONEOK Partners, L.P.	Baa3	86	104	-18
The Terminix Company, LLC	B1	104	113	-9
Ventas Realty, Limited Partnership	Baa1	121	128	-7
Federal Realty OP LP	Baa1	93	98	-5
Charles Schwab Corporation (The)	A2	72	75	-4
Southern California Edison Company	Baa2	127	131	-4

Source: Moody's, CMA

CDS Movers

Figure 4. CDS Movers - Europe (June 8, 2022 – June 15, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jun. 15	Jun. 8	Senior Ratings
Erste Group Bank AG	A2	A3	A2
Landesbank Hessen-Thueringen GZ	A2	A3	Aa3
Nationwide Building Society	A2	A3	A1
Bayerische Landesbank	A2	A3	Aa3
Norddeutsche Landesbank GZ	A3	Baa1	A3
Banco Comercial Portugues, S.A.	Ba1	Ba2	Baa3
Casino Guichard-Perrachon SA	Caa3	Ca	Caa1
Hamburg Commercial Bank AG	Baa1	Baa2	Baa1
Novo Banco, S.A.	Baa3	Ba1	Caa2
Electrabel SA	A3	Baa1	Baa1

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jun. 15	Jun. 8	Senior Ratings
TotalEnergies SE	A1	Aa2	A1
Air Liquide S.A.	Aa3	Aa1	A3
United Utilities PLC	Aa3	Aa1	Baa1
Koninklijke Ahold Delhaize N.V.	A2	Aa3	Baa1
Spain, Government of	A2	A1	Baa1
Rabobank	Aa2	Aa1	Aa2
HSBC Holdings plc	Baa2	Baa1	A3
Standard Chartered PLC	Baa2	Baa1	A3
Lloyds Bank plc	A2	A1	A1
Portugal, Government of	A2	A1	Baa2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jun. 15	Jun. 8	Spread Diff
Boparan Finance plc	Caa3	2,358	1,938	420
Novafives S.A.S.	Caa2	1,386	1,153	232
Vue International Bidco plc	Ca	1,324	1,164	160
Jaguar Land Rover Automotive Plc	B1	819	689	130
Iceland Bondco plc	Caa2	1,066	943	123
Casino Guichard-Perrachon SA	Caa1	1,339	1,219	120
Stena AB	B2	588	481	108
Telecom Italia S.p.A.	Ba3	406	300	105
CECONOMY AG	Ba1	549	455	93
CMA CGM S.A.	Ba3	503	416	87

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jun. 15	Jun. 8	Spread Diff
Wienerberger AG	Ba1	122	157	-34
Hamburg Commercial Bank AG	Baa1	88	94	-6
ISS Global A/S	Baa3	77	79	-2
Nordea Bank Abp	Aa3	44	45	-1
DNB Bank ASA	Aa2	47	49	-1
Deutsche Bahn AG	Aa1	17	18	-1
Raiffeisen Bank International AG	A2	145	146	-1
NXP B.V.	Baa3	48	50	-1
Iceland, Government of	A2	54	55	-1
Swedish Match AB	Baa2	83	84	-1

Source: Moody's, CMA

CDS Movers

Figure 5. CDS Movers - APAC (June 8, 2022 – June 15, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jun. 15	Jun. 8	Senior Ratings
Pakistan, Government of	Caa3	Ca	B3
Development Bank of Kazakhstan	Ba1	Ba2	Baa2
Nomura Securities Co., Ltd.	A3	Baa1	A3
Japan, Government of	Aaa	Aaa	A1
China, Government of	A3	A3	A1
Australia, Government of	Aaa	Aaa	Aaa
China Development Bank	Baa1	Baa1	A1
Sumitomo Mitsui Banking Corporation	Aa3	Aa3	A1
Westpac Banking Corporation	A1	A1	Aa3
Philippines, Government of	Baa2	Baa2	Baa2

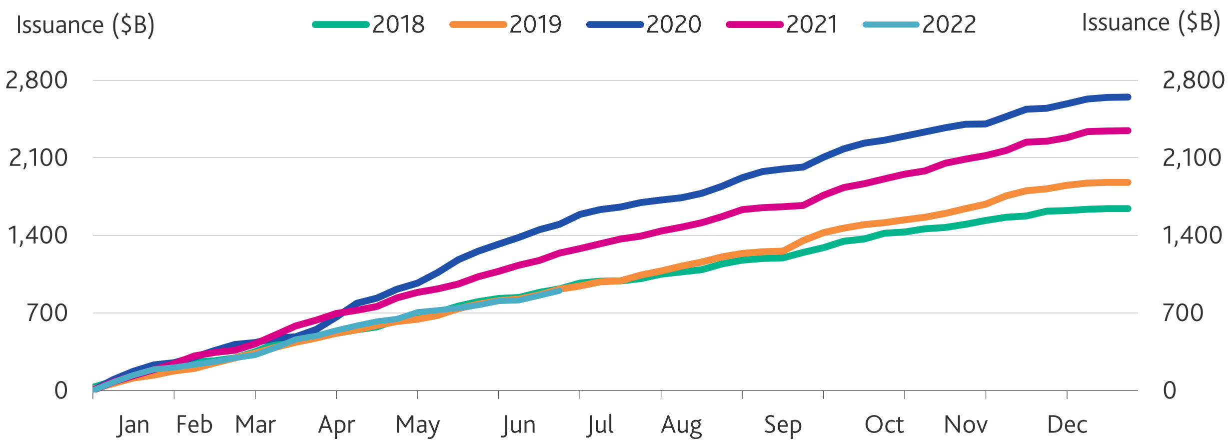
CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jun. 15	Jun. 8	Senior Ratings
National Australia Bank Limited	A2	Aa3	Aa3
Thailand, Government of	A1	Aa2	Baa1
Australia and New Zealand Banking Grp. Ltd.	A1	Aa2	Aa3
Tokyo Electric Power Company Holdings, Inc.	Baa2	A3	Ba1
Wesfarmers Limited	A1	Aa2	A3
Honda Motor Co., Ltd.	Aa3	Aa1	A3
Marubeni Corporation	Aa3	Aa1	Baa2
ORIX Corporation	A1	Aa2	A3
Korea, Government of	Aa3	Aa2	Aa2
India, Government of	Baa3	Baa2	Baa3

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jun. 15	Jun. 8	Spread Diff
SoftBank Group Corp.	Ba3	442	387	55
SK Hynix Inc.	Baa2	144	90	54
Tokyo Electric Power Company Holdings, Inc.	Ba1	110	63	46
Nissan Motor Co., Ltd.	Baa3	187	152	35
India, Government of	Baa3	130	106	25
ICICI Bank Limited	Baa3	129	104	25
IDBI Bank Ltd	Ba2	124	100	25
State Bank of India	Baa3	130	106	24
Export-Import Bank of India	Baa3	116	93	23
SK Innovation Co. Ltd.	Baa3	155	131	23

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jun. 15	Jun. 8	Spread Diff
Tata Motors Limited	B1	275	292	-17
Development Bank of Kazakhstan	Baa2	251	264	-12
Pakistan, Government of	B3	1,217	1,225	-8
New Zealand, Government of	Aaa	21	25	-4
Flex Ltd.	Baa3	107	109	-2
Australia, Government of	Aaa	21	22	-1
Sumitomo Mitsui Banking Corporation	A1	46	47	-1
DBS Bank Ltd.	Aa1	43	44	-1
Mitsubishi Electric Corporation	A2	32	33	-1
Singapore, Government of	Aaa	23	23	0

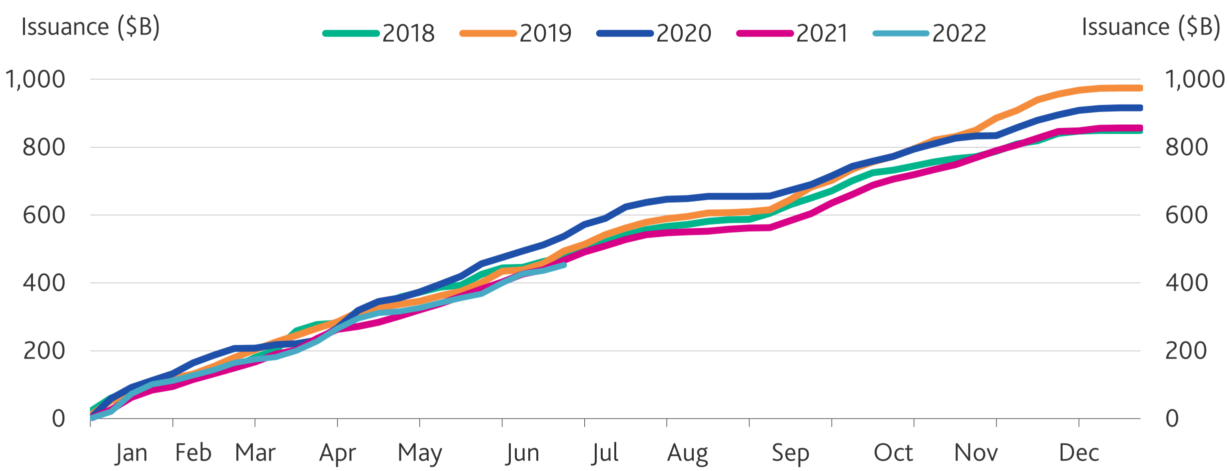
Source: Moody's, CMA

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



Source: Moody's / Dealogic

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



Source: Moody's / Dealogic

Figure 8. Issuance: Corporate & Financial Institutions

	USD Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	38.340	3.150	43.191
Year-to-Date	780.797	93.541	899.416

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	16.054	0.855	16.909
Year-to-Date	419.858	25.254	452.536

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

To order reprints of this report (100 copies minimum), please call 212.553.1658.

Report Number: 1332395

Editor
Reid Kanaley
help@economy.com

Contact Us
Americas
+1.212.553.1658
clientservices@moodys.com

Europe
+44.20.7772.5454
clientservices.emea@moodys.com

Asia (Excluding Japan)
+85 2 2916 1121
clientservices.asia@moodys.com

Japan
+81 3 5408 4100
clientservices.japan@moodys.com