MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

Outstandings and Rating Changes Supply Radically Different Default Outlooks

Moody's Analytics Research

Weekly Market Outlook Contributors:

John Lonski
1.212.553.7144
john.lonski@moodys.com

Yukyung Choi
1.212.553.0906
yukyung.choi@moodys.com

Moody's Analytics/Asia-Pacific:

Katrina Ell
+61.2.9270.8144
katrina.ell@moodys.com

Moody's Analytics/Europe:

Barbara Teixeira Araujo
+420.224.106.438
barbara.teixeiraaraujo@moodys.com

Brendan Meighan
1.610.235.5282
brendan.meighan@moodys.com

Moody's Analytics/U.S.:

Ryan Sweet
1.610.235.5000
ryan.sweet@moodys.com

Greg Cagle
1.610.235.5211
greg.cagle@moodys.com

Steven Shields
1.610.235.5142
steven.shields@moodys.com

Editor
Reid Kanaley
1.610.235.5273
reid.kanaley@moodys.com

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Credit Markets Review and Outlook

By John Lonski, Chief Economist, Moody's Capital Markets Research, Inc.

Outstandings and Rating Changes Supply Radically Different Default Outlooks

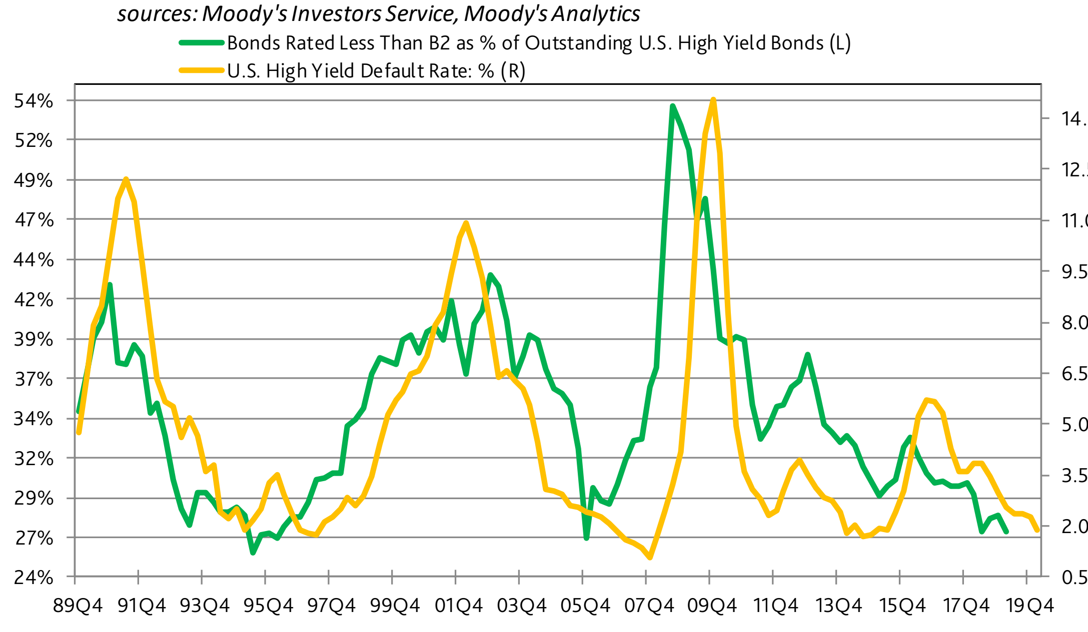
The credit ratings distribution of outstanding U.S. high-yield corporate bond debt and the distribution of high-yield credit rating revisions now deliver conflicting messages regarding the high-yield default rate's likely direction.

High-yield issuers having a corporate family rating less than B2 show an above-average propensity to default. For all high-yield corporate issuers across all countries, the average annual incidence of default equals 4.1% for a sample that starts in 1983. At the lower rungs of the high-yield credit ratings ladder, the average annual default rates are 4.9% for B3-grade issuers, 7.9% for Caa-rated issuers, and 30.7% for issuers rated less than Caa.

In terms of first-quarter 2019's amounts outstanding of U.S. corporate bonds, the B3 category equaled $145 billion (which was under its $165 billion average of 2014-2018), the Caa group equaled $155 billion (which was considerably less than 2014-2018's $204 billion average) and the less-than-Caa bottom approximated $24 billion (which eclipsed its $18 billion average of the previous five years). Thus, first-quarter 2019's $325 billion of bonds rated less than B2 was 16.3% under its $388 billion average of 2014-2018. In turn, the share of outstanding U.S. high-yield corporate bonds rated less than B2 fell from 2014-2018's 30.2% average to the 26.8% of 2019's first quarter.

The historical record shows that the 26.8% ratio of very low-rated bonds to outstanding high-yield corporate bonds is in the bottom decile of a sample of quarterly observations beginning with 1989's final quarter. Moreover, first-quarter 2019's ratio of very low rated bonds to high-yield bonds outstanding now favors a high-yield default rate of 1.7% to 2.5% for 2019's final quarter and 2020's first quarter. By comparison, the latest baseline estimates supplied by the Default Research Group of Moody's Investor Service puts the U.S. high-yield default rate at 2.3% for 2019's final quarter and 1.9% for 2020's first quarter.

Figure 1: Relatively Low Ratio of Riskier Bonds to U.S. High-Yield Corporate Bonds Outstanding Complements Benign Outlook for High-Yield Defaults
sources: Moody's Investors Service, Moody's Analytics



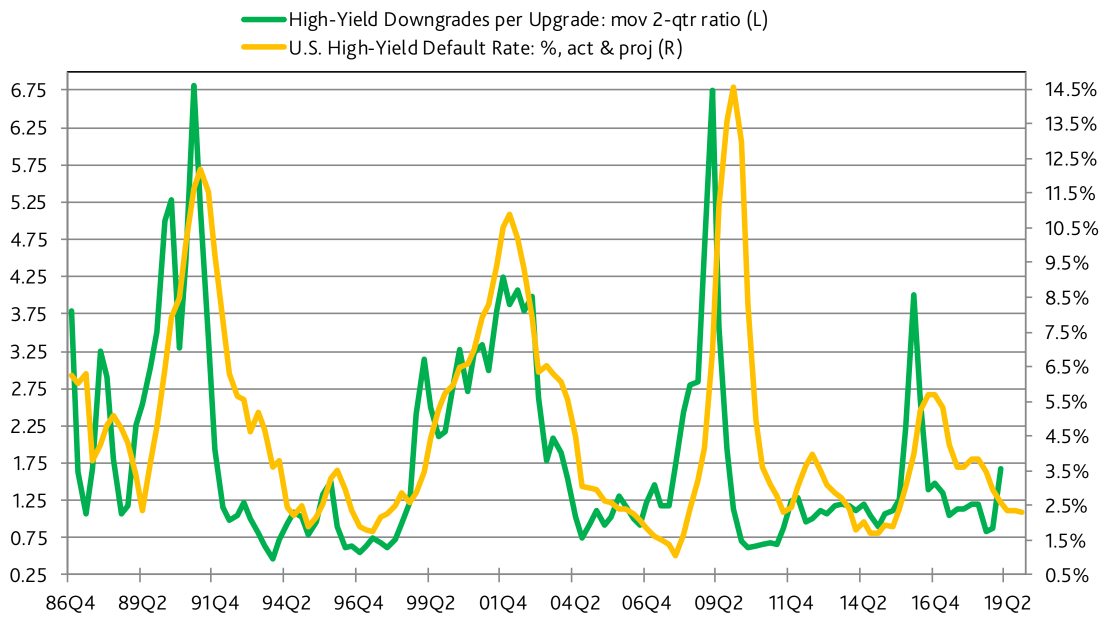
Credit Markets Review and Outlook

Far More Downgrades than Upgrades Should Temper High-Yield's Optimists

However, the latest excess of downgrades over upgrades for U.S. high-yield credit rating revisions provides a much different assessment for the default rate's direction over the next 12 months. First-quarter 2019's credit rating revisions of U.S. high-yield companies showed downgrades outnumbering upgrades by a 2.27:1 margin. The latter was the highest such ratio since the 4.50:1 of 2016's first quarter. Shortly thereafter, the default rate climbed from the 4.0% of 2016's first quarter to 5.7%, on average, during 2016's second half.

In terms of quarterly observations starting with 1986's final quarter, the high-yield default rate generates significant correlations with the lagged moving six-month ratios of high-yield downgrades per upgrade of 0.72 with the ratio of one quarter earlier, 0.82 with the ratio of two quarters earlier, 0.83 with the ratio of three quarters earlier and 0.79 with the ratio of one year back. Via statistical inference, the 1.67:1 high-yield downgrade per upgrade ratio of the six-months-ended March 2019 favors a range of 3.7% to 4.3% for the high-yield default rate of 2019's final quarter. Worse yet, if the moving six-month ratio of high yield downgrades per upgrade were to equal the 2.27:1 of 2019's first quarter by June 2019, the statistical record warns of a 5.5% default rate for 2020's first quarter.

Figure 2: Recent Upswing by High-Yield Downgrades per Upgrade Questions Benign Default Outlook
sources: Moody's Investors Service, Moody's Analytics

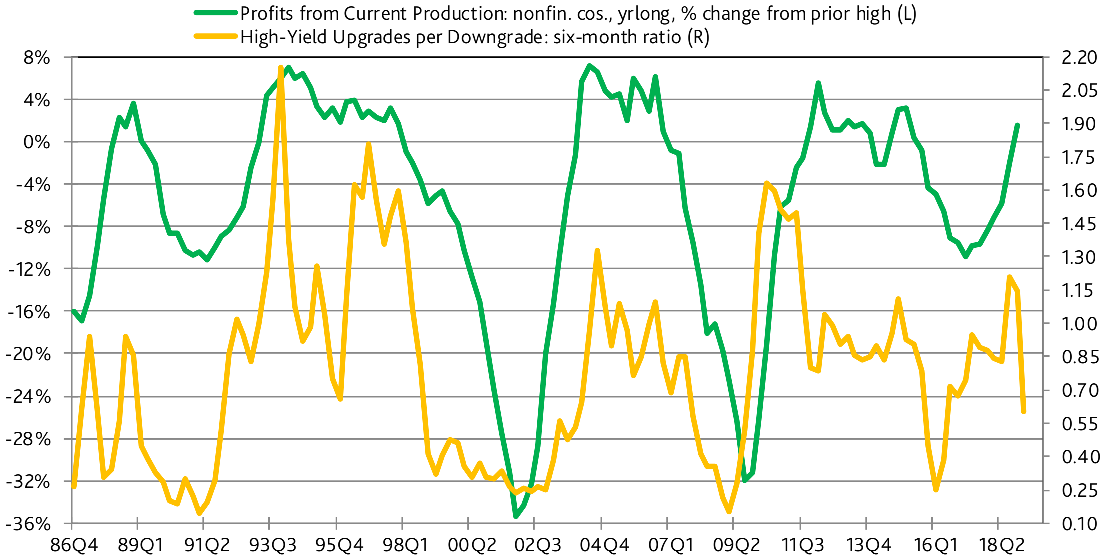


Profitability Will Ultimately Decide Who Has the Better Default Outlook

In order for the default rate to fall from the 2.6% of 2019's first quarter to the 1.9% baseline estimate for 2020's first quarter, core pretax profits must continue to grow. If the high-yield downgrade per upgrade ratio does not fall under the 2.27:1 of 2019's first-quarter, a profits recession is likely.

Since 1987, core pretax profits' moving yearlong average fell well under its previous record high for each of the four times the moving yearlong ratio of high-yield downgrades per upgrade worsened to the 2.27:1 quarterly ratio of January-March 2019. Moreover, the high-yield default rate would eventually peak at something significantly above 5% in conjunction with these atypically high downgrade per upgrade ratios.

Figure 3: A Continuation of Q1-2019's 0.44:1 High-Yield Upgrade per Downgrade Ratio Implies a Likely Slide by Core Pretax Profits by Late 2019
sources: BEA, Moody's Analytics



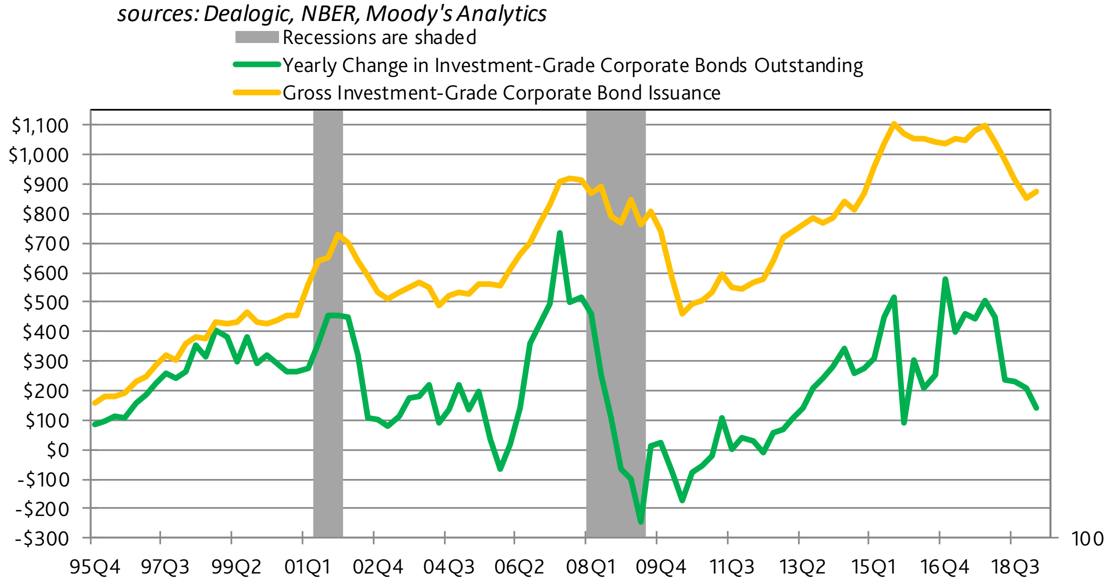
Outstandings of Investment-Grade Corporate Bonds Barely Grow

As of 2019's first quarter, the outstandings of investment-grade corporate bonds owed by U.S.-based companies rose by 2.4% year-to-year to a new zenith of $6.134 trillion. About 33% of that amount was from financial companies, 57% was from industrial companies and 10% was from public utilities. First-quarter 2019's annual increase by the outstandings of U.S. investment-grade corporate bonds was the smallest since the 1.7% yearly rise of 2012's final quarter.

During the soon to be record long U.S. economic recovery, the outstandings of U.S. investment-grade corporate bonds have grown at an average annualized rate of 4.0%, which is much slower than their 6.9% average annual increase of 2002-2007's business cycle upturn.

Refinancings explain why the $7.992 trillion of gross investment-grade bond issuance by U.S. corporations for the current recovery to date was so much greater than the accompanying $1.938 trillion increase for the outstandings of investment-grade bonds. The ongoing recovery's 24% ratio of investment-grade issuance to the increase in outstandings is significantly less than the 36% ratio of 2002-2007's business cycle upturn. The lower ratio of the current recovery hints of a greater role for refinancings as a driver of investment-grade bond issuance. And it is through the refinancing of maturing and outstanding debt that companies are able to enhance credit quality by reducing interest expenses and/or lengthening the term to maturity of debt.

Figure 4: For U.S. Investment-Grade Corporate Bonds, Refi's Now Rule as the Change in Outstandings as Percent of Issuance Drops from the 36% of 2002-2007's Recovery to the Ongoing Upturn's 24%
$ billions
sources: Dealogic, NBER, Moody's Analytics



The Baa-rated category has received a great deal of attention if only because in terms of moving yearlong averages, Baa-rated bonds have soared from 2007's 23% to the latest 47% of outstanding investment-grade bonds from U.S. corporations. Nevertheless, the outstandings of Baa-grade U.S. corporate bonds dipped from fourth-quarter 2018's record high $2.958 trillion to the $2.835 trillion of 2019's first quarter.

As of 2019's first quarter, industrial companies supplied $1.968 trillion of Baa-grade corporate bonds, financial companies had issued $565 billion, and the utilities owed $302 billion.

Despite late 2018's record amount of outstanding Baa-rated U.S. corporate bonds, the credit ratings of the Baa category held up fairly well during the first three months of 2019 following a relatively stable 2018. Regarding the latter, Baa ratings were involved in 20 downgrades and 22 upgrades across the entirety of 2018. The first-quarter of 2019 included the upgrade of a major U.S. money center bank from Baa1 to A3 that affected $185 billion of outstanding bonds. The first quarter also saw the upgrade of seven Baa-rated industrial companies. Within the latter group were four upgrades of Baa3 ratings that affected $26 billion of bonds.

Not only were first-quarter 2019's six investment-grade industrial company downgrades few in number, but four were prompted by California's disastrous wild fires. The two investment-grade industrial company downgrades that were not wild-fire-related affected less than $5 billion of Baa-grade bonds.

High-Yield Bonds Outstanding Shrink Yearly for Ninth Straight Quarter

The first quarter of 2019 showed a 4.5% yearly drop by the outstandings of high-yield bonds from U.S. companies to $1.210 trillion. U.S. high-yield bonds outstanding set their record-high at the $1.344 trillion of 2016's final quarter and are now down by 10% from that zenith.

The outstandings of U.S. high-yield corporate bonds have now declined from their year earlier mark for nine consecutive quarters. To a considerable degree, an increased reliance on leveraged loan debt explains the slide by high-yield bond debt.

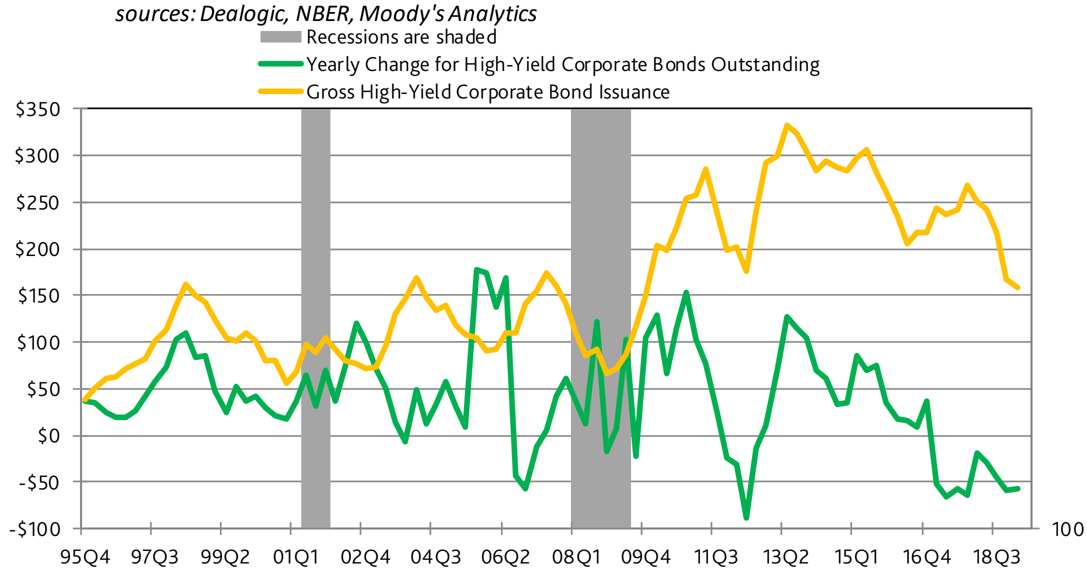
Despite a relatively small $213 billion increase by the outstandings of high-yield bonds since June 2009's end to the Great Recession, the gross issuance of high-yield bonds by U.S. based companies has totaled a much greater $2.385 trillion for the ongoing economic recovery. Regarding U.S. high-yield companies, the current recovery's 9% ratio of the increase in outstandings to gross bond issuance is far under the

45% ratio of 2002-2007's business cycle upturn. The now unmatched role played by refinancings among the drivers of high-yield bond offerings helps explain why high-yield bond spreads are still relatively thin notwithstanding the first quarter's considerable excess of high-yield credit rating downgrades over upgrades and the risks surrounding a continued expansion of core profits.

Figure 5: For U.S. High-Yield Corporate Bonds, Refi's Dominate as the Change in Outstandings as Percent of Issuance Plunges from the 45% of 2002-2007's Recovery to the Ongoing Upturn's 9%

$ billions

sources: Dealogic, NBER, Moody's Analytics

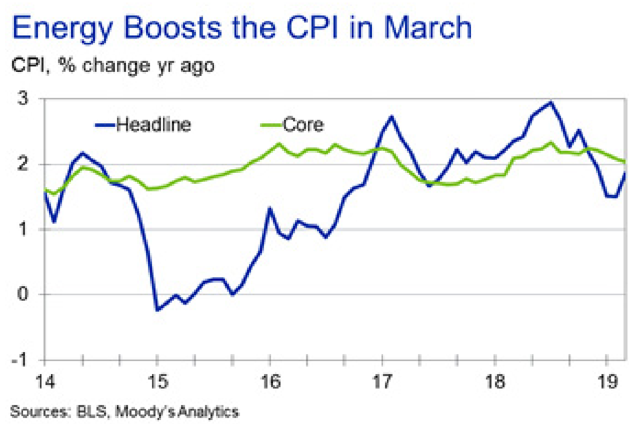


The Week Ahead – U.S., Europe, Asia-Pacific

THE U.S.
By Ryan Sweet, Moody's Analytics

The Case for Core Inflation to Move Toward 2% This Year

The March consumer price index won't cause the Federal Reserve to be less dovish, but it does suggest that the bond market's increased bets on a rate cut late this year or early next are premature and overdone. The CPI increased 0.4% in March, compared with 0.2% in February. The increase was in line with our forecast and driven by higher energy prices. The CPI for energy was up 3.5% following a 0.4% gain in February. Food prices were up 0.3%, in line with the average increase over the prior three months.



The core CPI came in light, rising 0.1%. There was a sizable drop in apparel prices, as the Bureau of Labor Statistics incorporated new source data. In fact, the 1.9% decline in apparel prices was the largest on record. The methodology change affected about 5% of apparel prices; therefore, not all of the drop is likely attributed to this. Growth in apparel prices had been strong recently, therefore some payback was inevitable.

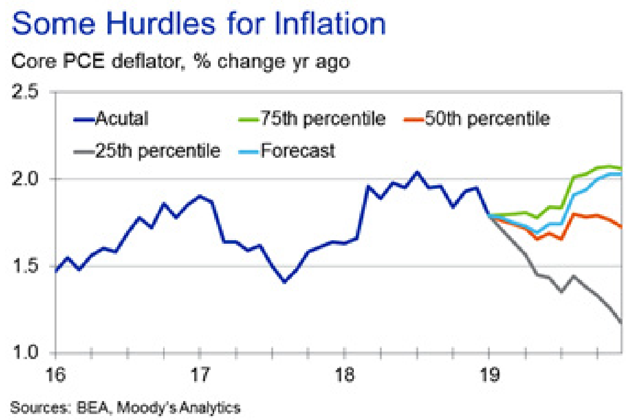
Elsewhere, new-vehicle prices rose 0.4%. Used-car prices fell 0.4%, their second consecutive monthly decline. Medical care commodity prices rose 0.4%, reversing some of the sharp 1% drop in February. The CPI for rent rose 0.4%, while the index for owners' equivalent rent increased 0.3%. Rents are typically sticky.

Based on the details of the CPI, we look for the core PCE deflator, the Fed's preferred measure of inflation, to have risen 0.1% in March, leaving it up 1.6% on a year-ago basis. This is still a modest inflation undershoot and not sufficient for the Fed to seriously consider cutting rates soon.

Because inflation will be steering monetary policy, it's important to assess where consumer prices are headed. Our baseline forecast is for the core PCE deflator to be up 2.03% on a year-ago basis at the end of this year, but risks are still weighted to the downside. To achieve that forecast, some of the drags on inflation will need to lift quickly.

To put our forecast into perspective, we looked at the distribution of monthly changes in the core PCE deflator over the past three years and applied assumed paths based on constant monthly changes. The forecast assumes that the core PCE deflator rises by an average of 0.18% per month from February to December. This would put growth in the monthly core PCE deflator in the 75th percentile since 2015.

This means that inflation would have to be better than 75% of all monthly changes in the core PCE deflator since 2015.



Although this may appear unlikely, we identify three reasons that core inflation should accelerate through the remainder of this year and into next. Some of the weakness in core inflation is attributed to financial services, shelter and healthcare, with the latter being the most significant for the core PCE deflator. These shortfalls are not attributed to the business cycle.

For example, a good chunk of the weakness in healthcare prices is attributed to the direct and indirect effects of the Affordable Care Act. The drag on consumer prices from public-payer healthcare costs is fading and should soon be behind us. Also, the tight labor market and gradual acceleration in wage growth should boost prices for healthcare and should add 0.1 to 0.2 percentage point to year-over-year growth to core inflation late this year or early next.

Some of the weakness in the core PCE deflator in January was attributed to a drop in financial services prices, which are closely tied to changes in the S&P 500. With the stock market recovering, this weight should lift fairly soon. Growth in the PCE deflator for housing should also accelerate this year as the drop in mortgage rates boosts housing demand. Also, rising construction costs will bleed into consumer prices.

All told, inflation will gradually move toward 2% this year but that doesn't justify the Fed abandoning its plan to pause interest rates. However, our forecast is for inflation to run enough above 2% next year that it would allow the Fed to raise rates once.

Looking ahead

The economic calendar is packed. The key data include retail sales, industrial production, the trade deficit and business inventories. All will have potential implications for our tracking estimate of first quarter GDP growth, which is currently 2% at an annualized rate.

We will publish our forecasts for next week's data on Monday on Economy.com.

EUROPE

By Brendan Meighan of Moody's Analytics

Euro Zone CPI and Foreign Trade Data Will Be the Highlight

While this past week has been dominated by Brexit news, the coming week may offer something of a reprieve, with relatively little data set to debut outside of a Wednesday dump by the euro zone, U.K., Italy, and Russia. The euro zone numbers will be the highlight of the week, with highly anticipated data releases for its consumer price index and foreign trade. Euro zone inflation numbers are likely to play out in much the same way as it has over the last few months, with headline inflation seeing a slight decline to 1.4% y/y. Energy prices will push headline inflation up somewhat, but that will be counteracted by sluggish price growth elsewhere both due to slower trending global growth and EU economic weakness. Adding to our expectations of stability in prices is the European Central Bank's decision to not rock the boat, keeping interest rates where they have been, as was widely expected.

Unlike inflation, the outlook for foreign trade is much less clear. We expect the trade surplus to bounce back to €12.6 billion after a narrowing in January, as the short term prospects have not changed much for the euro zone. However, the outlook over the rest of 2019 and into 2020 remains less clear for three reasons. First, while we still expect the U.K. to exit the EU at some point, its trade relationship with Europe thereafter remains a question. A no-deal Brexit could result in a dramatic negative trade shock to both the U.K. and Europe, while a smoother Brexit, where the U.K. opts to keep its trade relationships with the EU intact, could see almost no disruption whatsoever.

Second, China's downward trend has some uncertainty surrounding it, most of which is related to U.S. trade policy. It is becoming increasingly likely that some kind of resolution will be reached in the coming months between Beijing and Washington, but the Trump administration is becoming increasingly mercurial in its disposition towards a number of different policies. China is an important destination for expensive capital goods, especially from Germany. A boost from a positive trade war resolution with the U.S. could be a boon for EU exports. If the trade dispute drags on, the EU exporters will suffer.

Third, as if the trade war with China was not enough, the U.S. is also making tariff threats about EU subsidies for Airbus. An aerospace trade war between the U.S. and EU would hammer the economies of the Euro zone. Airbus, like Boeing in the U.S., relies on an enormous, and highly diverse array of subcontractors making specialized parts for aircraft. Even minor disruptions to trade or a decline in aircraft orders could ripple through the EU.

The U.K. will also be posting some topline macro-indicators in the coming week. Unemployment, inflation, and retail sales are all set to come out by the end of Thursday. While the U.K. numbers will offer some insight into the continued effects of the ongoing Brexit saga, they will not reflect the economic effects of the most recent developments in the story. We expect U.K. unemployment to remain at 3.9% in February, as the manufacturing decline during the latter half of 2018 seemed to do little to hamper employment growth. However, consumer price growth, which has been trending down for some time now, is expected to slow to 1.7% y/y after a slight uptick in February. Retail sales are expected to see strong growth in March, as poor weather earlier in the year may have kept consumers demand pent up, while rising fuel prices combined with the after effects of a February spike in food inflation will boost retail sales.

As for Brexit, the new October 31 deadline for leaving the EU puts the U.K. in a bind. First, Theresa May has lost a considerable amount of legitimacy and authority, despite remaining Prime Minister. She had previously insisted that she would not accept a delay of Article 50 that extended beyond June 30. There is a good chance that elections will be called and May could lose her position. Compounding this, the lack of legitimacy and authority held by May means that the Labour party will be reluctant to deal with the Tories. The prospect of a Brexit deal passing with Tory support alone is extremely unlikely and whatever does pass will need the support of at least some Labour MPs. The Labour party has expressed interest in the prospect of maintaining some of the relationships the U.K. currently has with the EU, but a deal with May would be for nothing if she is unable to bring along Tories to provide cover for the Labour MPs who ultimately vote for the deal. Finally, with each passing day, businesses in the U.K. and EU begin hedging their risks and limiting their exposure to a possible rupture in the trade and economic relationships between the two entities. With the most recent extension, the uncertainty that had been creeping into the U.K. economy over the last two and a half years will metastasize.

	Key indicators	Units	Moody's Analytics	Last
Mon @ 2:00 p.m.	Russia: Industrial Production for March	% change yr ago	2.1	4.1
Tues @ 9:30 a.m.	U.K.: Unemployment for February	%	3.9	3.9
Wed @ 9:30 a.m.	U.K.: Consumer Price Index for March	% change yr ago	1.7	1.9
Wed @ 10:00 a.m.	Italy: Consumer Price Index for March	% change yr ago	1.0	1.1
Wed @ 10:00 a.m.	Euro Zone: External Trade for February	bil euro	12.6	1.5
Wed @ 10:00 a.m.	Euro Zone: Consumer Price Index for March	% change yr ago	1.4	1.5
Wed @ 2:00 p.m.	Russia: Unemployment for March	%	5.0	4.9
Wed @ 2:00 p.m.	Russia: Retail Sales for March	% change yr ago	2.3	2.0
Thur @ 9:30 a.m.	U.K.: Retail Sales for February	% change yr ago	4.5	4.0

ASIA-PACIFIC

By Katrina Ell and the Asia-Pacific staff of Moody's Analytics in Sydney

China Won't Give Much of a Lift to Slowing Global Growth

China's first quarter national accounts will be the highlight. We expect GDP growth slowed to 6.1% y/y, following the fourth quarter's 6.4%. We expect the government's shift to focus on greater stimulus has provided only measured benefit to the economy in the March quarter. A broader stabilization of activity is unlikely to take place until around the middle of 2019. Improvement in fixed asset investment and more recently credit growth and the manufacturing PMI have shown the benefits of improved demand, but weakness in still pronounced in other areas including industrial production. Fixed asset investment has been on an improving trend since mid-2018, while industrial production has been on a bumpy downtrend since early 2018. The monthly March data are expected to show further modest improvement in fixed asset investment, while industrial production growth has likely found a floor.

The stimulus this cycle is about stabilizing growth, rather than reinvigorating the economy. China is a critical stimulant of global growth so its measured approach to stimulus means that China won't give much of a lift to already slowing global growth. There's no avoiding that global demand is over the peak.

The government's quest to create more sustainable growth by reducing financial risks has not been abandoned, but the journey will be slow. It will also be slower than expected at the beginning of last year, as the priority to stabilize growth has increased. It remains to be seen whether confidence will remain in Beijing's ability to deleverage given its less aggressive deleveraging path and saddling local governments with more debt.

Japan's core CPI inflation decelerated in February, a sign that soft growth from late 2018 is setting in. The core-CPI inflation measure, which is the Bank of Japan's inflation target, was 0.7% y/y in February, and we expect it held there in March. Energy costs remain the primary driver of inflation, but the fall in oil prices towards the end of 2018 has led to energy costs adding less to overall inflation. Core-core inflation, which excludes food and energy prices, is even lower at 0.1% y/y. The Bank of Japan is unlikely to reach its 2% inflation target in the foreseeable future, while further easing measures are unlikely from the BoJ this year.

The Week Ahead

The Bank of Korea is resisting the dovish tilt of some major central banks. The BoK is expected to keep policy settings steady at 1.75% in April. The baseline is that policy settings will remain on hold through most of 2019. Low inflation alongside unrelenting concerns about domestic demand and the health of the global economy means that the central bank is unlikely to normalize policy settings any time soon.

	Key indicators	Units	Confidence	Risk	Moody's Analytics	Last
Mon @ Unknown	Indonesia Foreign trade for March	US$ bil	2	↑	-0.23	0.33
Mon @ Unknown	India Foreign trade for March	US$ bil	2	↓	-6.3	-9.6
Wed @ 8:45 a.m.	New Zealand Consumer price index for Q1	% change	3	←	0.4	0.1
Wed @ Unknown	Singapore Nonoil domestic exports for March	% change yr ago	3	←	2.0	4.9
Wed @ 9:50 a.m.	Japan Foreign trade for March	¥ bil	3	←	-170	116
Wed @ 12:00 p.m.	China Fixed asset investment for March	% change yr ago YTD	3	←	6.3	6.1
Wed @ 12:00 p.m.	China GDP for Q1	% change yr ago	3	←	6.1	6.4
Wed @ 12:00 p.m.	China Industrial production for March	% change yr ago	3	←	5.5	5.3
Wed @ 12:00 p.m.	China Retail sales for March	% change yr ago	3	↓	8.4	8.2
Thurs @ 11:30 a.m.	Australia Unemployment rate for March	%	4	←	5.0	4.9
Thurs @ Unknown	South Korea Monetary policy for April	%	5	←	1.75	1.75
Fri @ 9:30 a.m.	Japan Consumer price index for March	% change	3	↓	0.7	0.7

The Long View

April-to-date's $17.6 billion of worldwide high-yield bond issuance consisted of $6.6 billion from U.S. companies and $11.0 billion from issuers based outside the U.S.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group
April 11, 2019

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 123 basis points resembles its 122-point mean of the two previous economic recoveries. This spread may be no wider than 140 bp by year-end 2019.

The recent high-yield bond spread of 406 bp is thinner that what is suggested by the accompanying long-term Baa industrial company bond yield spread of 195 bp but is wider than what is suggested by the recent VIX of 13.3 points.

DEFAULTS

March 2019's U.S. high-yield default rate of 2.4% was less than the 4.2% of March 2018. Moody's Investors Service now expects the default rate will average 1.9% during 2020's first quarter.

US CORPORATE BOND ISSUANCE

Yearlong 2017's US$-denominated bond issuance rose by 6.8% annually for IG, to $1.508 trillion and soared by 33.0% to $453 billion for high yield. Across broad rating categories, 2017's newly rated bank loan programs from high-yield issuers sank by 26.2% to $72 billion for Baa, advanced by 50.6% to $319 billion for Ba, soared by 56.0% to $293 billion for programs graded single B, and increased by 28.1% to $25.5 billion for new loans rated Caa.

First-quarter 2018's worldwide offerings of corporate bonds incurred year-over-year setbacks of 6.3% for IG and 18.6% for high-yield, wherein US$-denominated offerings posted sank by 14.4% for IG and 20.8% for high yield.

Second-quarter 2018's worldwide offerings of corporate bonds eked out an annual increase of 2.8% for IG, but incurred an annual plunge of 20.4% for high-yield, wherein US$-denominated offerings rose by 1.6% for IG and plummeted by 28.1% for high yield.

Third-quarter 2018's worldwide offerings of corporate bonds showed year-over-year setbacks of 6.0% for IG and 38.7 % for high-yield, wherein US$-denominated offerings plunged by 24.4% for IG and by 37.5% for high yield.

Fourth-quarter 2018's worldwide offerings of corporate bonds incurred annual setbacks of 23.4% for IG and 75.5% for high-yield, wherein US$-denominated offerings plunged by 26.1% for IG and by 74.1% for high yield.

First-quarter 2019's worldwide offerings of corporate bonds revealed annual setbacks of 0.5% for IG and 3.6% for high-yield, wherein US$-denominated offerings fell by 2.3% for IG and grew by 7.1% for high yield.

During yearlong 2017, worldwide corporate bond offerings increased by 4.1% annually (to $2.501 trillion) for IG and advanced by 41.5% for high yield (to $603 billion).

For 2018, worldwide corporate bond offerings sank by 7.2% annually (to $2.322 trillion) for IG and plummeted by 37.6% for high yield (to $376 billion). The projected annual percent increases for 2019's worldwide corporate bond offerings are 1.3% for IG and 8.4% for high yield.

US ECONOMIC OUTLOOK
As inferred from the CME Group's FedWatch Tool, the futures market recently assigned an implied probability of 0.0% to at least one Fed rate hike in 2019. In view of the underutilization of the world's productive resources, low inflation should help to rein in Treasury bond yields. As long as the global economy operates below trend, the 10-year Treasury yield may not remain above 3% for long. A fundamentally excessive climb by Treasury bond yields and a pronounced slowing by expenditures in dynamic emerging market countries are among the biggest threats to the adequacy of economic growth and credit spreads.

EUROPE

By Brendan Meighan and Barbara Teixeira Araujo of Moody's Analytics
April 11, 2019

EUROPEAN UNION
EU leaders and British Prime Minister Theresa May have agreed to a new date for the U.K. to leave the EU. The U.K. now has until October 31 to finally pull the trigger and leave. The agreement came after a marathon negotiation session between May and her EU counterparts. It is unclear right now what May's strategy will be or whether she will even be prime minister by the time October 31 rolls around. What is clear is that the new date, shorter than the nine-month extension EU President Donald Tusk had proposed, puts the U.K. under an immense amount of pressure.

To count this as a win for the U.K., however, would be a serious mistake. It is an admission of political failure to seek the extension in the first place. Right now there is no indication of what changes to the current Brexit deal would be acceptable to both the EU and the U.K., or even if any potential Brexit deal would be palatable to a majority in Parliament. Despite this, the six-month extension leaves almost no time for the U.K. to organize and hold a second referendum, either. Elections could change the political calculus, but the additional half year of uncertainty will weigh heavily on economic sentiment.

Putting the Brexit melodrama to the side for a moment, two of the EU's largest countries released new inflation data. Germany's national measure of inflation accelerated further in March to 1.6% y/y, seasonally adjusted, after ticking up to 1.5% in February. The increase was mainly because of stronger gains in energy prices, which have been driven by a recovery in oil prices from the start of this year. Excluding energy prices, inflation ticked down to 1.3% y/y from 1.4% in February. Although this is the ninth consecutive year of economic growth, the rate was the slowest in five years and the outlook for this year is also muted.

France's headline CPI slowed again, coming in at just 1.1% y/y after February saw the first uptick since last June. The 'yellow vests' protests over higher taxes and services cuts have taken their toll on French economic demand, as consumers have stayed home. Only higher energy prices kept inflation above 1%, with core inflation coming in at 0.5%, the lowest reading in more than a year.

EURO ZONE
The European Central Bank left policy rates unchanged at its April meeting, which was widely expected. The central bank reiterated that it doesn't have plans to increase rates this year. The ECB isn't alone as the odds of tighter monetary policy in other major developed economies have faded since the beginning of the year. The main refinancing operations and the interest rates on the marginal lending facility and the deposit facility remain unchanged at 0%, 0.25% and -0.4%. During his post-meeting presser, ECB President Mario Draghi hinted that the effects of negative interest rates (which means banks have to pay to deposit money with the ECB) may be alleviated. This will likely be done via tiered rates, but that's not ready to roll out.

In the euro zone, barely a quarter ago markets were expecting a deposit rate hike as soon this spring. Now, markets have started pricing in a slight chance of a rate cut by the end of this year. This is not our base case scenario, but if the growth figures continue to disappoint, the bank's next move on rates is likely to be down rather than up.

That's because the economic data for the currency area have been horrific; there is no way to sugarcoat it. Growth came in at 0.8% annualized in the fourth quarter of 2018, while the current survey and high-frequency figures for the three months to March suggest that the economy could have all but stalled in the first stanza this year. Manufacturing output has fallen off a cliff over the past few months on the sharp easing in foreign demand from China and the U.S.

The currency area's manufacturing PMI has been in contraction territory for two consecutive months, with manufacturing operating conditions deteriorating to the greatest degree in nearly six years in March. Germany has been dealt the largest blow—its manufacturers are extremely export-dependent—with both total new orders and export sales in the industry falling at rates not seen since the global financial crisis.

True, the services sector is still humming along—supported by healthy consumers, who are seeing their real pay growth rise—but risks of spillovers to the rest of the economy are huge, especially given how the heightened geopolitical risks are keeping a lid on sentiment across the board. The ECB has turned more dovish recently, signaling rates are not expected to increase this year.

Our forecast is that the rates will increase in the summer of 2020, but if growth figures don't pick up soon, and if underlying inflation doesn't leave the doldrums, markets will likely begin to wonder if the bank's quantitative easing program will be relaunched—or indeed if rates will ever rise. There are downside risks to the euro zone economy this year, including Brexit and, more recently, the U.S. considering imposing tariffs.

ASIA PACIFIC

By Katrina Ell of Moody's Analytics
April 11, 2019

JAPAN

Japan's Tankan survey for the March quarter was woeful. The headline large manufacturers index dropped by 7 points to 12, its lowest level since the first quarter of 2017. This was the sharpest drop in more than six years. The Tankan survey has been heading south since the fourth quarter of 2017, when it peaked at 25. The resoundingly weak reading and moderating trend are important because the Tankan survey is a good, timely barometer of Japan's economic health.

Unfortunate timing

It's an important input to monetary policymaking, sometimes foreshadowing movements in monetary policy. But this time around we are not expecting the Tankan's weakness to prompt action from the Bank of Japan. The BoJ lacks firepower to cushion a renewed downturn. This is concerning, as the weaker outlook has particularly unfortunate timing with the consumption tax hike from 8% to 10% scheduled for October.

The Tankan survey follows peaks and troughs in Japan's GDP growth, with both reporting that the most recent upturn began in early 2016 and the peak occurred in late 2017. The Tankan points to a weaker March quarter GDP print, while our high-frequency GDP tracker suggests 0.8% y/y with most of the February data in the bag, following the 0.83% pace of 2018.

The tight correlation between the Tankan and corporate earnings is significant. The correlation coefficient from the March quarter of 1991 to the December quarter of 2018 was 0.8. As corporate earnings data are not yet available for the March quarter, the lofty drop in the Tankan survey suggests a pullback in corporate earnings.

This has implications for retained earnings and eventually wage growth, the latter of which has been on an uptrend for the past three years. Wages are an important ingredient to delivering stronger consumption in Japan. Corporates were already more reluctant this year, compared with 2018, to meaningfully lift wages at the shunto, or spring wage negotiations, in April.

Improved wage growth of the past three years has coincided with the Tankan survey reporting continued tightening of the labour market. This situation is reflected in the official monthly employment data, which has the job-to-applicant ratio sitting at 1.63 in February, near its highest on record.

Manufacturing weakening

In the past five years the nonmanufacturing segment of the economy has been relatively stable compared with manufacturing. In the March quarter, the index of large manufacturers was 9 points lower than the equivalent nonmanufacturing index, the largest difference since mid-2016.

The weaker performance of manufacturing is likely related to the softness emerging in global demand. For instance, there were hefty falls over the quarter in the important tech and auto industries, which have a heavy export focus. Medium- and smaller-size manufacturing firms also reported a deterioration in conditions. Sales and profit forecasts were revised down sharply, confirming that the export slump has weighed on businesses' bottom lines.

Evidence that the deterioration is unlikely to be short-lived came from capital investment plans. Large companies had been looking to increase their capital investment by 14.3% over the fiscal year that ended on 31 March, according to the fourth quarter Tankan. In the current fiscal year that began on 1 April, capital investment was forecast to rise by just 1.2%.

Nonmanufacturing tends to have a greater focus on domestic demand, and it held up relatively well in the March quarter. In addition, the important construction and real estate subcategories improved slightly over the period. Since early 2016, nonmanufacturers have reported, on average, better conditions than manufacturers, according to the Tankan.

Easy credit still there

One constant is that the lending attitudes of financial institutions have held at reasonably high levels for the past five years, a function of easy credit availability, helped by the Bank of Japan's accommodative stance.

Clearly, the problem of cooling demand in Japan isn't the result of a lack of trying by the central bank. Indeed, the accommodative stance resulting in negative interest rates has hurt lenders' profitability and contributed to local firms looking abroad for expansion and maintaining operating viability.

Ratings Round-Up

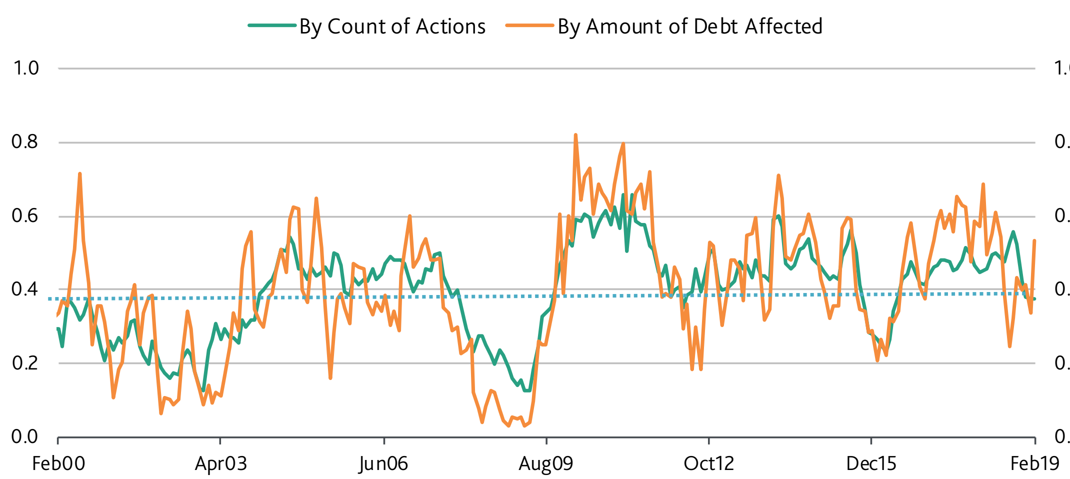
Industrials Dominate U.S. Credit Activity

By Steven Shields

The industrial sector accounted for all nineteen U.S. credit ratings changes this week. Activity was overwhelmingly negative with downgrades accounting for 14 of the 19 changes. Similar to last week, downgrades comprised the majority of affected debt at 88% of total debt. The most notable downgrade was to EP Energy LLC's senior secured and unsecured debt received a downgrade from Caa2 to CA. The change affected $5.9 billion in debt. In addition, the issuer outlook was lowered from stable to negative due to increased liquidity and high-leverage concerns. Stagnant production volumes put EP Energy LLC at risk of generating negative free cash flow in 2019. Specialty chemical manufacturer, Hexion Inc. also received a downgrade from Caa2 to Ca before having its rating withdrawn on April 4. PQ Corporation was one of the few upgrades this week, with their rating raised to B1 from B2 on April 8. The improved rating was supported by reduced leverage, lower debt service costs, and the company's strong commitment to debt reduction. The recent shift in downgrades controlling credit rating activity is expected with upside potential for rating activity limited this far into the business cycle.

European credit rating activity slowed to a crawl this week. Two of the four rating changes were upgrades, with those upgrades accounting for 55% of the affected debt. Russian bank Promsvyazbank received an upgrade from B2 to Ba3 with $327 million in debt impacted by the change. The credit opinion noted an improved capital buffer and strong likelihood of government has reduced insolvency concerns. Elsewhere, Debenhams PLC was downgraded to Ca from Caa1. The UK retailer entered administration on April 9 with control of the company placed into the hands of creditors. The company's outlook remained negative.

FIGURE 1
Rating Changes - US Corporate & Financial Institutions: Favorable as % 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

Ratings Round-Up

FIGURE 3

Rating Changes: Corporate & Financial Institutions – US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG
4/3/19	MOMENTIVE PERFORMANCE MATERIALS HOLDINGS LLC -HEXION INC.	Industrial	SrSec/LTCFR/PDR	3,224	D	Caa1	Ca	SG
4/3/19	EPE HOLDINGS LLC -EP ENERGY LLC	Industrial	SrSec/SrUnsec /BCF/LTCFR/PDR	5,923	D	Caa2	Ca	SG
4/3/19	SOUTHCROSS HOLDINGS LP-SOUTHCROSS ENERGY PARTNERS, L.P.	Industrial	PDR		D	Ca	D	SG
4/3/19	AIR METHODS CORPORATION	Industrial	SrUnsec/SrSec /BCF/LTCFR/PDR	500	D	Caa2	Caa3	SG
4/4/19	ACI WORLDWIDE, INC.	Industrial	SrUnsec	400	D	B1	B2	SG
4/4/19	FUSION CONNECT, INC.	Industrial	SrSec/BCF /LTCFR/PDR		D	Caa2	Ca	SG
4/4/19	BARRACUDA NETWORKS, INC.	Industrial	LTFR/PDR		U	B3	B2	SG
4/4/19	RODAN & FIELDS, LLC	Industrial	SrSec/BCF /LTCFR/PDR		D	B1	B2	SG
4/5/19	TERRA MILLENNIUM CORPORATION	Industrial	SrSec/BCF /LTCFR/PDR		D	Caa1	Caa2	SG
4/8/19	PQ CORPORATION	Industrial	SrSec/SrUnsec /BCF/LTCFR/PDR	925	U	B2	B1	SG
4/8/19	NPC INTERNATIONAL, INC.	Industrial	SrSec/BCF /LTCFR/PDR		D	B1	B2	SG
4/8/19	ASCENT CAPITAL GROUP, INC. -MONITRONICS INTERNATIONAL, INC.	Industrial	SrUnsec/SrSec /BCF/LTCFR/PDR	585	D	Caa3	C	SG
4/8/19	VERTIV INTERMEDIATE HOLDING CORPORATION -VERTIV GROUP CORPORATION	Industrial	SrUnsec/SrSec /BCF/LTCFR/PDR	1,250	D	Caa1	Caa2	SG
4/8/19	CORELLE BRANDS HOLDINGS INC.	Industrial	SrSec/BCF /LTCFR/PDR		U	B1	Ba2	SG
4/8/19	IGLOO INTERMEDIATE HOLDINGS, INC. -IG INVESTMENTS HOLDINGS, LLC	Industrial	LTCFR/PDR		D	B2	B3	SG
4/9/19	PERFORMANCE FOOD GROUP COMPANY-PERFORMANCE FOOD GROUP, INC.	Industrial	SrUnsec /LTCFR/PDR	350	U	B2	B1	SG
4/9/19	CROSSMARK HOLDINGS, INC.	Industrial	SrSec/BCF /LTCFR/PDR		D	Ca	C	SG
4/9/19	BMC STOCK HOLDINGS, INC.	Industrial	SrSec /LTCFR/PDR	350	U	B2	B1	SG
4/9/19	ASP MCS ACQUISITION CORP.	Industrial	SrSec/BCF /LTCFR/PDR		D	Caa1	Ca	SG

Source: Moody's

FIGURE 4

Rating Changes: Corporate & Financial Institutions – Europe

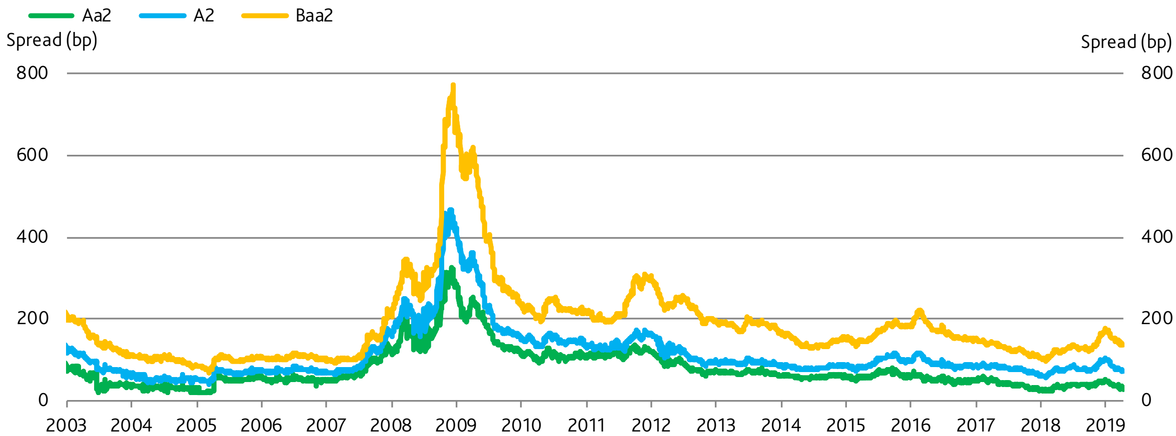
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/SG	Country
4/3/19	X5 RETAIL GROUP N.V.	Industrial	LTCFR/PDR		U	Ba2	Ba1	SG	NETHERLANDS
4/4/19	DEBENHAMS PLC	Industrial	SrUnsec /LTCFR/PDR	260	D	Caa1	Ca	SG	UNITED KINGDOM
4/8/19	AXILONE SA-CCP LUX HOLDING S.A.R.L.	Industrial	SrSec/BCF		D	B2	B3	SG	LUXEMBOURG
4/9/19	PROMSVYAZBANK	Financial	SrUnsec /LTD/MTN	327	U	B2	Ba3	SG	RUSSIA

Source: Moody's

Market Data

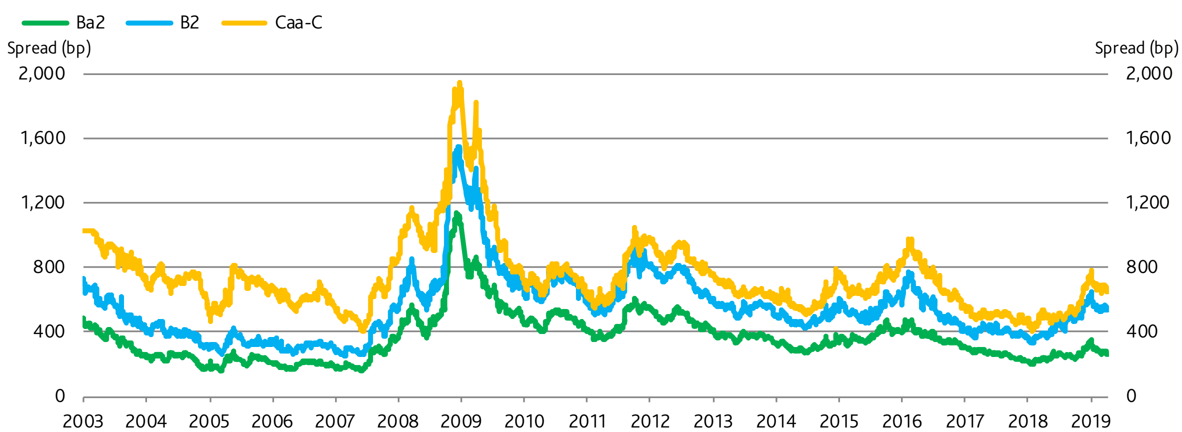
Spreads

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

Market Data

CDS Movers

Figure 3. CDS Movers - US (April 3, 2019 – April 10, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Apr. 10	Apr. 3	Senior Ratings
Dish DBS Corporation	Caa1	Caa3	B1
Hertz Corporation (The)	Caa2	Ca	B3
R.R. Donnelley & Sons Company	Caa2	Ca	B3
Pride International, Inc.	Caa1	Caa3	B3
McClatchy Company (The)	Caa2	Ca	Caa2
JPMorgan Chase & Co.	A2	A3	A2
Bank of America Corporation	A2	A3	A3
Ally Financial Inc.	Ba1	Ba2	Ba3
Verizon Communications Inc.	A3	Baa1	Baa1
Caterpillar Financial Services Corporation	A2	A3	A3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Apr. 10	Apr. 3	Senior Ratings
United Airlines, Inc.	B2	Ba3	Ba3
Qwest Corporation	B2	Ba3	Ba2
Owens Corning	B2	Ba3	Ba1
ServiceMaster Company, LLC (The)	B2	Ba3	B2
Unisys Corporation	B3	B1	B2
Apple Inc.	Aa1	Aaa	Aa1
Ford Motor Credit Company LLC	B2	B1	Baa3
Microsoft Corporation	Aa2	Aa1	Aaa
Chevron Corporation	Aa2	Aa1	Aa2
Ford Motor Company	B2	B1	Baa3

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Apr. 10	Apr. 3	Spread Diff
Frontier Communications Corporation	Caa1	2,559	2,281	279
Weatherford International, LLC (Delaware)	Caa3	1,896	1,662	234
Dean Foods Company	B3	2,400	2,191	210
Rite Aid Corporation	Caa2	1,657	1,529	128
Staples, Inc.	B3	572	513	60
Office Depot, Inc.	B3	509	454	54
United States Steel Corporation	B2	372	334	38
ServiceMaster Company, LLC (The)	B2	221	193	27
Unisys Corporation	B2	272	250	22
AK Steel Corporation	B3	758	739	19

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Apr. 10	Apr. 3	Spread Diff
Neiman Marcus Group LTD LLC	Ca	2,590	3,134	-544
Penney (J.C.) Corporation, Inc.	Caa2	3,213	3,446	-233
K. Hovnanian Enterprises, Inc.	Caa3	2,350	2,453	-103
Dish DBS Corporation	B1	558	605	-47
Univision Communications Inc.	Caa2	477	508	-31
American Axle & Manufacturing, Inc.	B2	282	310	-29
Sprint Communications, Inc.	B3	339	367	-28
Beazer Homes USA, Inc.	B3	414	440	-26
Springleaf Finance Corporation	B1	242	257	-15
Corning Incorporated	Baa1	65	80	-15

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (April 3, 2019 – April 10, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Apr. 10	Apr. 3	Senior Ratings
Unione di Banche Italiane S.p.A.	Ba2	B1	Baa3
Ukraine, Government of	Caa1	Caa3	Caa1
National Bank of Greece S.A.	Caa2	Ca	Caa2
Jaguar Land Rover Automotive Plc	Caa1	Caa3	Ba3
Lloyds Bank plc	A2	A3	Aa3
HSBC Holdings plc	A3	Baa1	A2
Banco Santander S.A. (Spain)	A2	A3	A2
Nordea Bank AB	Aa2	Aa3	Aa3
Alpha Bank AE	Caa2	Caa3	Caa2
Erste Group Bank AG	A2	A3	A2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Apr. 10	Apr. 3	Senior Ratings
Ardagh Packaging Finance plc	B2	Ba3	B3
Italy, Government of	B1	Ba3	Baa3
France, Government of	Aa2	Aa1	Aa2
ING Bank N.V.	Aa2	Aa1	Aa3
Bayerische Landesbank	A1	Aa3	Aa3
Turkey, Government of	Caa1	B3	Ba3
Bank VTB, PJSC	B1	Ba3	Ba1
Allied Irish Banks, p.l.c.	Baa2	Baa1	A3
Telecom Italia S.p.A.	B2	B1	Ba1
Czech Republic, Government of	A2	A1	A1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Apr. 10	Apr. 3	Spread Diff
Weatherford International Ltd. (Bermuda)	Caa3	2,126	1,863	263
Galapagos Holding S.A.	Caa3	6,298	6,083	216
Boparan Finance plc	Caa1	1,643	1,489	154
PizzaExpress Financing 1 plc	Caa2	2,685	2,556	129
CMA CGM S.A.	B3	793	699	94
Yapi ve Kredi Bankasi A.S.	B1	464	443	21
Turkey, Government of	Ba3	392	374	18
Casino Guichard-Perrachon SA	Ba1	481	465	16
Stena AB	B3	549	537	12
TDC A/S	Ba3	146	138	8

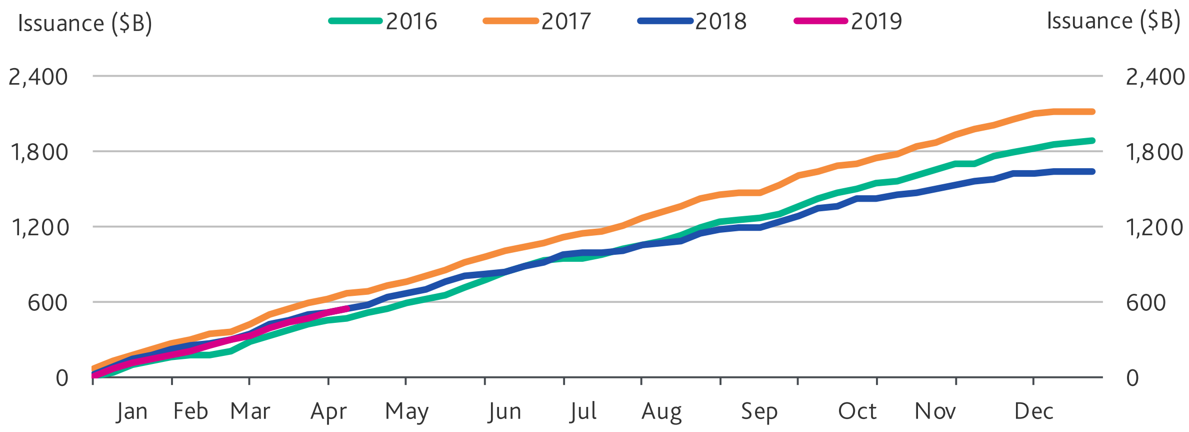
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Apr. 10	Apr. 3	Spread Diff
Unione di Banche Italiane S.p.A.	Baa3	152	217	-65
Ukraine, Government of	Caa1	561	610	-48
Stonegate Pub Company Financing plc	Caa1	202	239	-37
Jaguar Land Rover Automotive Plc	Ba3	554	575	-21
Novafives S.A.S.	Caa1	514	532	-17
Greece, Government of	B3	325	340	-15
UniCredit S.p.A.	Baa1	118	129	-11
thyssenkrupp AG	Ba2	211	221	-11
Ineos Group Holdings S.A.	B1	265	277	-11
Erste Group Bank AG	A2	46	54	-8

Source: Moody's, CMA

Market Data

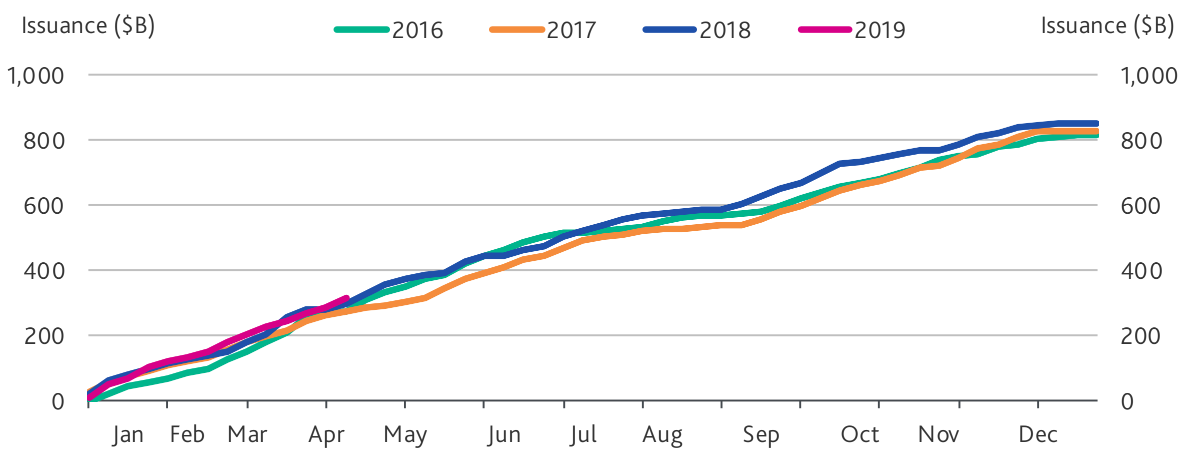
Issuance

Figure 5. Market Cumulative Issuance - Corporate & Financial Institutions: USD Denominated



Source: Moody's / Dealogic

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



Source: Moody's / Dealogic

Market Data

Figure 7. Issuance: Corporate & Financial Institutions

	USD Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	23.506	7.140	31.766
Year-to-Date	403.369	117.279	547.476

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	24.226	2.659	28.878
Year-to-Date	280.887	25.526	313.178

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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Editor
Reid Kanaley
reid.kanaley@moodys.com

Contact Us

Americas:	1.212.553.4399
Europe:	+44 (0) 20.7772.5588
Asia:	813.5408.4131