MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

Moody's Analytics Research

Weekly Market Outlook Contributors:

Moody's Analytics/New York:

John Lonski
Chief Economist
1.212.553.7144
john.lonski@moodys.com

Yukyung Choi
Quantitative Research

Moody's Analytics/Asia-Pacific:

Katrina Ell
Economist

Moody's Analytics/Europe:

Barbara Teixeira Araujo
Economist

Moody's Analytics/U.S.:

Ryan Sweet
Economist

Steven Shields
Economist

Editor
Reid Kanaley

Contact: help@economy.com

Bond Implied Ratings Hint of More Fallen-Angel Downgrades

Credit Markets Review and Outlook *by John Lonski*

Bond Implied Ratings Hint of More Fallen-Angel Downgrades

» FULL STORY PAGE 2

The Week Ahead

We preview economic reports and forecasts from the US, UK/Europe, and Asia/Pacific regions.

» FULL STORY PAGE 5

The Long View

Full updated stories and key credit market metrics: September's upswing by leveraged loan borrowing suggests a faster growth rate for nonfinancial-corporate debt.

Credit Spreads	Investment Grade: We see year-end 2019's average investment grade bond spread marginally above its recent 125 basis points. High Yield: Compared with a recent 426 bp, the high-yield spread may approximate 470 bp by year-end 2019.
Defaults	US HY default rate: Moody's Investors Service's Default Report has the U.S.' trailing 12-month high-yield default rate rising from July 2019's actual 3.0% to a baseline estimate of 3.2% for July 2020.
Issuance	For 2018's US$-denominated corporate bonds, IG bond issuance sank by 15.4% to $1.276 trillion, while high-yield bond issuance plummeted by 38.8% to $277 billion for high-yield bond issuance's worst calendar year since 2011's $274 billion. In 2019, US$-denominated corporate bond issuance is expected to rise by 5.4% for IG to $1.345 trillion, while high-yield supply grows by 29.4% to $359 billion. The very low base of 2018 now lends an upward bias to the yearly increases of 2019's high-yield bond offerings.

» FULL STORY PAGE 10

Ratings Round-Up

Ford Motor Co. Headlines U.S. Downgrades

» FULL STORY PAGE 14

Market Data

Credit spreads, CDS movers, issuance.

» FULL STORY PAGE 18

Moody's Capital Markets Research *recent publications*

Links to commentaries on: Corporate credit, Fed moves, spreads, yield collapse, inversions, unmasking danger, divining markets, upside risks, rating changes, high leverage, revenues and profits, riskier outlook, high-yield, defaults, confidence vs. skepticism, stabilization, volatility.

» FULL STORY PAGE 23

Click here for *Moody's Credit Outlook*, our sister publication containing Moody's rating agency analysis of recent news events, summaries of recent rating changes, and summaries of recent research.

Credit Markets Review and Outlook

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

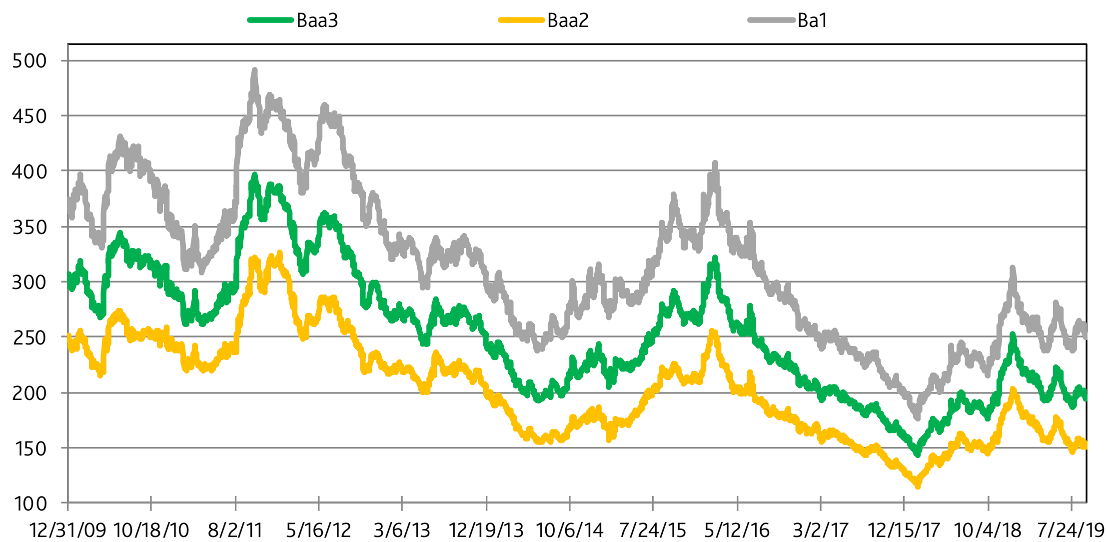
Bond Implied Ratings Hint of More Fallen-Angel Downgrades

On September 9, the senior unsecured bond rating of Ford Motor was lowered from Baa3 to Ba1, where the downgrade constituted a ratings reduction from investment- to speculative-grade (or high-yield). Because investor mandates often prohibit the inclusion of high-yield bonds in investment-grade portfolios, such a downgrade can quickly lower the prices of adversely affected bonds.

Thus, September 11's estimated median yield spreads over Treasuries at the seven-year maturity for industrial company bonds widened from 153 basis points at the Baa2 rating to 196 bp at the Baa3 rating, where the latter is the lowest rung of the investment-grade ratings ladder. The now 43 bp gap between the seven-year Baa3 and Baa2 industrial-company bond yields is somewhat wider than the gap's calendar-year averages of 36 bp for 2017 and 34 bp for 2018, while nearly matching its 41 bp average of 2019-to-date.

When the average annual number of investment- to speculative grade downgrades of U.S. domiciled companies jumped up from the 11 of 2010-2014 to the 26 of 2015-2016, the average gap between the Baa3 and Baa2 yields widened from yearlong 2014's 43 bp (matching that of September 11, 2019) to the 59 bp of the year-ended June 2016.

Figure 1: Median Seven-Year Industrial Company Bond Yield Spreads: Recent Baa3 Spread over U.S. Treasuries Has Yet to Signal Worry over an Impending Jump in Fallen Angel Downgrades
in basis points
source: Moody's Analytics



Including Ford and excluding the fallen-angel downgrades linked to the California wildfires, there have been only five downgrades of U.S. companies from investment- to speculative-grade thus far in 2019. Since the end of 2016, U.S. fallen-angel downgrades have proceeded at an average pace of roughly eight per annum.

Given how the dollar amount outstanding of Baa3-rated U.S. corporate bonds has increased at an average annualized rate of 8.6% from the $294 billion of year-end 2007 to a recent estimate of a record-high $775 billion, investors worry that the next wave of fallen-angel downgrades might disrupt both business activity and financial markets. Nevertheless, since the end of 2016, the 43 rising-star upgrades of U.S. companies (from speculative- to investment-grade) have exceeded the 27 fallen-angel downgrades.

Distribution of Bond Implied Ratings for Baa3-Rated Issuers Worsens

As of September 11, 123 North American industrial company issuers had a senior unsecured rating of Baa3, or the ratings notch just above high-yield. Moody's Analytics was able to calculate bond-implied ratings for 109 of the 123 issuers graded Baa3. Bond implied ratings frequently differ from actual ratings owing to market sentiment or demand/supply conditions. As derived from September 11's pricing of corporate bonds, the market viewed 47 of the 109 eligible Baa3-grade issuers as having an implied rating of less than Baa3, 42 as having a rating equal to Baa3, and 20 as having a rating above Baa3.

Thus, a considerable 43.1% of 109 North American Baa3-rated issuers have a bond-implied-rating of less than Baa3. Ratings less than Baa3 equate to speculative-grade or high-yield ratings.

Of the 47 Baa3-rated issuers having a speculative-grade bond-implied-rating, 29 had a bond-implied-rating of Ba1, which is the highest rung of the speculative-grade ratings ladder. Eleven had a bond-implied-rating of Ba2 (which was Ford Motor's bond-implied rating on September 5, 2019), four had a bond-implied-rating of Ba3, and three had a bond-implied-rating of B1.

For September 11's sample of 109 Baa3-rated issuers, the average bond-implied-rating was nearly midway between Baa3 and Ba1, while the group's median bond-implied-rating matched the actual Baa3.

Only 18.3% of September 11's 109 bond implied ratings for Baa3-grade industrials generated a rating above Baa3. Within this group, 15 had an implied rating of Baa2 and five had an implied rating of Baa1.

September 11's distribution of bond-implied ratings for Baa3 industrial-company issuers compared unfavorably with that of year-end 2018. As of the end of 2018, bond-implied ratings were calculated for 113 of the then 121 Baa3-rated industrial company issuers. A smaller 33, or 29.2%, of the issuers generated a bond-implied rating of less than Baa3. Moreover, 39, or 34.5%, of the bond-implied ratings matched the actual Baa3, while 41, or 36.3%, had a bond-implied rating above Baa3. Thus, from year-end 2018 to September 11, the percent of Baa3-rated issuers having an implied high-yield bond rating soared higher from 29.2% to 43.1%, while the percent having an implied rating above Baa3 plunged from 36.3% to 18.3%.

Of year-end 2018's 33 Baa3-rated issuers having a high-yield implied rating, 19 had an implied rating of Ba1, eight were equivalent to Ba2, five were priced at Ba3, and one was judged to be B1. At the other extreme, the implied ratings of year-end 2018's 41 Baa3-rated issuers have a bond-implied rating greater than Baa3 were distributed as follows: 30 were Baa2, eight were Baa1, two were A3, and one was A2.

Both the average and median bond-implied-ratings for issuers graded Baa3 by Moody's Investors Service as of year-end 2018 approximated Baa3.

In contrast to the jump in the relative incidence of implied speculative-grade ratings for Baa3-rated issuers from year-end 2018's 29.2% to September 11's 43.1%, the median bond yield spread over Treasuries for Baa3-rated bonds having a seven-year maturity narrowed from the 246 bp of year-end 2018 to the 196 bp of September 11.

Baa2 and Baa1 Categories Show Greater Incidence of Implied High Yield Ratings

As of September 11, bond implied ratings were available for 159 of the 170 North American issuers graded Baa2. Of the 159 Baa2 implied ratings, 29, or 18.2%, were speculative grade. At the same time, bond-implied ratings were calculated for 102 of the 103 Baa1-grade issuers, wherein 11, or 10.8%, of the bond implied ratings conformed to a high-yield designation. Finally, September 11 showed that of the 143 bond-implied ratings supplied by the 149 issuers rated above Baa1, only two were speculative-grade.

Year-end 2018's tally showed a much lower incidence of implied speculative grade ratings. Of the 138 Baa2-grade issuers generating a bond-implied rating, only six, or 4.3%, were speculative-grade. Two, or 2.2%, of the 92 Baa1 issuers having a bond implied rating were speculative-grade, while just one high-yield rating was found among the 134 issuers rated above Baa1 who received bond implied ratings.

According to the bond-implied ratings approach, potential rising-star upgrades are very few compared to possible fallen-angel downgrades. For companies having speculative-grade ratings, only 13 of the bond-implied ratings were investment-grade as of both year-end 2018 and September 11, 2019.

Credit Markets Review and Outlook

Figure 2: Incidence of High-Yield Ratings among Bond Implied Ratings of North American Investment-Grade Issuers
source: Moody's Analytics

Actual Rating	Number of Issuers 9/11/19	Number of Issuers with Bond Implied Ratings 9/11/19	Number of Issuers with High-Yield Implied Ratings 9/11/19	% of Implied Ratings Graded High-Yield 9/11/19	Number of Issuers end of 2018	Number of Issuers with Bond Implied Ratings end of 2018	Number of Issuers with High-Yield Implied Ratings end of 2018	% of Implied Ratings Graded High-Yield end of 2018
	1	*2*	*3*	*4 = 3 % of 2*	*5*	*6*	*7*	*8 = 6 % of 7*
Greater than Baa1	**149**	**143**	**2**	**1.4%**	**137**	**134**	**1**	**0.7%**
Baa1	**103**	**102**	**11**	**10.8%**	**94**	**92**	**2**	**2.2%**
Baa2	**170**	**159**	**29**	**18.2%**	**146**	**138**	**6**	**4.3%**
Baa3	**123**	**109**	**47**	**43.1%**	**121**	**113**	**33**	**29.2%**
Investment-Grade	***545***	***513***	***89***	***17.3%***	***498***	***477***	***42***	***8.8%***

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

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

Some Regional Economies Look Tired

Over the weekend, the Trump administration imposed a 15% tariff on about $111 billion worth of Chinese goods imports. This is the first of two fresh tariff waves in the U.S.-China trade war. The second wave is scheduled for December 15 on the remaining $156 billion worth of Chinese goods imports. China is retaliating with tariffs on a total of $75 billion worth of U.S. goods imports, also on September 1 and December 15.

The U.S. economy has slowed, but not much of the economic data we closely track for recession warnings are flashing red, unlike the message from the bond market. However, since national statistics can mask some trouble spots, we turned to metropolitan statistical areas to determine whether there are any issues.

To determine where metro areas are in the business cycle, we used K-means clustering. The idea behind K-means clustering is to identify the minimum distance to a cluster center. One key difference between regional K-means clustering and its national counterpart is that benchmarks are still based on the broader U.S. economy. In other words, when calculating distance to the cluster center, that center is based on the national economy, not a specific metro area economy.

This is primarily because of the subjective and painstaking effort associated with identifying when different phases of the business cycle occurred during prior cycles for small geographies. While the national judgments can be made with help from National Bureau of Economic Research data and a host of other metrics as guideposts, this is not the case for all but the largest states and metro areas. This approach works because each K-mean automatically adjusts for an economy's size by focusing on movement in standard deviations and means.

Four key indicators were used as the basis for the overall regional calculation. The number of indicators examined is limited because certain U.S. metrics (such as corporate profits) are not readily available subnationally, while others contain too much noise for smaller geographies. In the end, the four indicators selected were:

» Job growth: three-month moving average, year-over-year percentage change;

» Unemployment rate: three-month moving average, difference versus three months ago;

» Labor force participation rate: 12-month difference; and

» Housing starts: 12-month moving average, year-over-year percentage change.

Moving averages were used to strip out existing volatility, which is especially noticeable in the housing starts data. To determine the status of each metro area, a combined K-means clustering score was calculated, using the sum of each of the four individual components.

Based on the smallest gap between each metro area's score and the corresponding figure for each of the four categories—recession, early cycle, midcycle, and late cycle—a status was assigned to that metro area. Such an approach provides a more holistic view of what is taking place in a metro area across multiple dimensions of its economy.

There are limitations to this method. As with the U.S., it does not reveal much about where each metro area stands within a certain status, with the primary goal instead to capture recent swings in order to understand momentum. Therefore, this metric is best used in combination with a measure like the Moody's Analytics Business Cycle Index, which is designed to take a longer view of a metro area's performance over the course of the business cycle. That caveat aside, this approach yields intuitive results for the majority of metro areas while stripping out much of the noise associated with individual metrics.

For now, we are focused on those in a late-stage expansion, as there is not a significant number of large metro areas at risk of a recession. The share of metro area GDP in a late-cycle expansion is just north of 70%, higher than the peak during the last cycle.

Large economies are deeper into their cycle, but the key recession warning is when this share begins to steadily decline, signaling more economies are transitioning from late cycle to at risk or in recession. There are a number of metro areas that are at risk of being left further behind if a recession occurs soon.

Another telling sign is the share of metro areas with year-over-year job growth, which was 13% in July, compared with 15% in July 2018 and well below the 87% in July 2017. Some of this is attributed to weaker hiring, but there are signs that layoffs are increasing, albeit from low levels. The number of states with year-over-year increases in initial claims for unemployment insurance benefits is rising but still not near that seen prior to past recessions.

View the entire version of our Road to Recession.

Looking ahead

The economic calendar is lighter next week. The key data include a pair of regional manufacturing surveys, industrial production, jobless claims and existing-home sales. The main event will be the Federal Open Market Committee meeting, where we expect a 25 basis point cut.

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

EUROPE

By Barbara Teixeira Araujo of Moody's Analytics

The BoE Won't Do as the ECB Does

In the spotlight in the coming week will be the Bank of England's September monetary policy meeting. Unlike what happened in the European Central Bank this week—President Mario Draghi went all out and announced a massive stimulus package for the currency area—we expect the BoE's meeting to be a snoozer. This will be true especially because the meeting won't be followed by a press conference from BoE Governor Mark Carney, and because no updated economic forecasts will be released. In any case, the hands of the central bank remain tied because of Brexit. A solution to the Brexit problem remains as far away as ever, and it looks like the exit deadline could be extended yet again.

We maintain the view that the central bank would cut rates were a no-deal Brexit to take place—even if Carney insists that the response to a no-deal is not automatic—since such a supply shock would send inflation soaring. By contrast, given that our updated baseline assumes repeated delays of the Brexit deadline, we think that the BoE will avoid following the ECB and the Fed's footsteps and will keep rates unchanged throughout the rest of this year and the whole of 2020. This is true especially because the bank's current forecasts do not consider the fiscal boost that has been promised by the new chancellor for next year. They current government might not survive for long, but we are expecting a giveaway budget in the autumn, and the BoE would have to respond accordingly to the further stimulus.

The minutes of the meeting should again focus on the prolonged and elevated Brexit risks, which make any BoE action unthinkable right now. For us, the main story is that the U.K.'s situation is not comparable to that of the euro zone or the U.S. There is a lot of pent-up demand in the country following two years of an uncertainty-driven loss of momentum, and this pent-up demand could be unleashed as soon as there is some partial solution to the Brexit crisis. Therefore, markets shouldn't see a rate cut as a given. This is true especially because growth is expected to rebound in the third quarter, and because inflation pressures remain at target.

Accordingly, we expect inflation figures next week to show that the August CPI in the U.K. remained steady at the BoE's 2% target. A further decline in motor fuels inflation—due to base effects in oil prices—is expected to have acted as a huge drag on the headline, while electricity inflation should have fallen as well on the anniversary of the 2018 price hikes by electric companies.

By contrast, we expect that U.K. food inflation picked up due to a rise in unprocessed food prices—as the above-average temperatures and the dry weather hurt crop yields—while services inflation likely rebounded as well. Services inflation was depressed in July due to a one-off plunge in the transport services sector—where developments depend on the timing of holidays and on motor fuel prices and are therefore volatile—which warrants a mean-reversion in August. Elsewhere in the services sector, our view is that inflation pressures will have remained to the upside, supported by the recent pickup in wages. As for nonenergy goods inflation, the developments in the sector are expected to have been mixed. While the unsustainable jump in computer games inflation (which depends on bestseller charts) in July was likely corrected in August, price pressures across all other core goods subsectors should have increased somewhat. That's because the pound's recent depreciation is raising prices of imported manufactured products, especially in the food and clothing sector.

For the rest of 2019, we expect that further declines in motor fuels and electricity inflation in the U.K. will be offset by an additional increase in the core rate, which will allow the headline CPI rate to remain stuck around the BoE's 2% target. The drag from motor fuels inflation will nonetheless begin a reversal from the start of next year, raising the chances of an overshoot.

Across the Channel, final euro zone CPI numbers for August should confirm that inflation held steady at 1% y/y over the month, in line with the first estimate. The details will likely show that energy inflation plunged on base effects in oil prices—energy prices are now falling on a yearly basis—but that this drag was offset by a strong pickup in unprocessed food inflation due to weather developments and by a small rebound in services inflation to 1.3% from 1.2%.

	Key indicators	Units	Moody's Analytics	Last
Mon @ 10:00 a.m.	Italy: Consumer Price Index for August	% change yr ago	0.5	0.3
Mon @ 2:00 p.m.	Russia: Industrial Production for August	% change yr ago	2.5	2.8
Wed @ 9:30 a.m.	U.K.: Consumer Price Index for August	% change yr ago	2.0	2.1
Wed @ 10:00 a.m.	Euro Zone: Consumer Price Index for August	% change yr ago	1.0	1.0
Wed @ 2:00 p.m.	Russia: Unemployment for August	%	4.4	4.5
Wed @ 2:00 p.m.	Russia: Retail Sales for August	% change yr ago	1.2	1.0
Thur @ 9:30 a.m.	U.K.: Retail Sales for August	% change yr ago	2.4	3.3
Thur @ 12:00 p.m.	U.K.: Monetary Policy and Minutes for September	%	0.75	0.75

ASIA-PACIFIC

By Katrina Ell of Moody's Analytics

Pressure Has Increased on Bank of Japan to Act

The Bank of Japan's September monetary policy meeting will be the highlight. Pressure has increased on the BoJ to act. August exports are forecast to contract for a ninth straight month, business investment has been trending lower since late 2017, and a consumption tax hike is coming on 1 October. Prior sales tax hikes have pushed Japan's economy into technical recessions. Added strain is coming from the haven yen, which has been hovering around a seven-month high. The yen has appreciated 2% year to date. A stronger yen has far-reaching consequences. Beyond hurting exports, the appreciation is denting company profits, equity prices, income growth and inflation. Japan's core CPI is forecast to hold at 0.6% y/y in August, a two-year low. With global jitters rising alongside U.S.-China trade frictions, the yen's appreciation could continue.

In recent months Governor Haruhiko Kuroda has signaled that the BoJ will act if it sees more signs of slowing momentum, and this is exactly what's occurring. Odds that the bank will announce some form of stimulus in September are high. At the very least, it could tweak its forward guidance. This may include pushing out expectations that rates will remain low through spring 2020. Other options include further reducing negative interest rates or increasing bond purchases. If the central bank allows bond yields to stay negative, that will further burden the financial system; but if the BoJ pushes up against the slide, that could add upward pressure on the yen as Japanese Government Bonds become more attractive. With this, one option could be to widen the trading band, so it is able to operate more flexibly.

Elsewhere, China's activity data dump for August is expected to show improvement, after the disappointing July from fixed asset investment, industrial production and retail trade. Industrial production grew at its slowest rate in more than 17 years in July at 4.8% y/y and is expected to rise to 5.5% in August. Forward indicators show China's manufacturing sector is struggling with the trade war, which is creating mass uncertainty and depressing demand. The export-facing sectors are expected to remain under pressure with global demand cooling and with no end to the trade war in sight, supporting expectations of further stimulus being released heading into 2020.

The Week Ahead

	Key indicators	Units	Confidence	Risk	Moody's Analytics	Last
Mon @ 12:00 p.m.	China Fixed asset investment for August	% change yr ago YTD	3	←	5.9	5.7
Mon @ 12:00 p.m.	China Industrial production for August	% change yr ago	2	↓	5.5	4.8
Mon @ 12:00 p.m.	China Retail sales for August	% change yr ago	3	←	8.0	7.6
Mon @ 2:00 p.m.	Indonesia Foreign trade for August	US$ bil	3	↓	-0.9	-0.6
Tues @ Unknown	Singapore Nonoil domestic exports for August	% change yr ago	2	←	-9.6	-11.2
Wed @ 9:50 a.m.	Japan Foreign trade balance for August	¥ bil	3	←	-282	-127
Thurs @ 8:45 a.m.	New Zealand GDP for Q2	% change	3	↓	0.4	0.6
Thurs @ 11:30 a.m.	Australia Unemployment rate for August	%	3	↑	5.3	5.2
Thurs @ Unknown	Japan Monetary policy for September	¥ tril	3	←	80	80
Fri @ 9:30 a.m.	Japan Consumer price index for August	% change yr ago	3	←	0.6	0.6

The Long View

September's upswing by leveraged loan borrowing suggests a faster growth rate for nonfinancial-corporate debt.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group
September 12, 2019

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 125 basis points is slightly wider than its 122-point mean of the two previous economic recoveries. This spread may be no wider than 130 bp by year-end 2019.

The recent high-yield bond spread of 426 bp is thinner than what is suggested by both the accompanying long-term Baa industrial company bond yield spread of 195 bp but is wider than what typically accompanies the recent VIX of 14.1 points.

DEFAULTS

August 2019's U.S. high-yield default rate was 2.9%. The high-yield default rate may average 3.4% during 2020's first quarter, according to Moody's Investors Service.

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.

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 3.0% for IG and grew by 7.1% for high yield.

Second-quarter 2019's worldwide offerings of corporate bonds revealed an annual setback of 2.5% for IG and an annual advance of 17.6% for high-yield, wherein US$-denominated offerings sank by 12.4% for IG and surged by 30.3% 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 3.3% for IG and 20.7% for high yield. When stated in U.S. dollars, issuers based outside the U.S. supplied 60% of the investment-grade and 57% of the high-yield bond offerings of 2019's first half.

US ECONOMIC OUTLOOK

As inferred from the CME Group's Fed Watch Tool, the futures market recently assigned an implied probability of 89% to a cutting of the federal funds rate at the September 18, 2019 meeting of the Federal Open Market Committee. 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 2.00% 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 Barbara Teixeira Araujo of Moody's Analytics
September 12, 2019

EUROPEAN CENTRAL BANK

All eyes were on the European Central Bank on Thursday as the bank's Governing Council met to decide on monetary policy. While markets were expecting the ECB to act in September, the announced stimulus package was more than anyone had hoped for. The bank showed it is serious about its mandate of maintaining price stability amid faltering growth prospects. The deposit rate was lowered, a new round of QE was announced, TLTRO conditions were eased, the forward guidance was changed, and a two-tier system for reserve remuneration was introduced.

In our view, the most dovish among all those measures was that the central bank linked its forward guidance on rates to underlying inflation pressures, meaning that it is not calendar-dependent anymore. The bank now sees interest rates staying at their present, or lower, settings for as long as underlying inflation doesn't converge and stabilize around the bank's target of close to, but below, 2%. But given that the last time core inflation reached 1.8% was at the end of 2008, and that it has averaged only 1% over the past three years, this looks like wishful thinking. Or perhaps it was another way of the ECB saying we probably won't see higher interest rates in our lifetime. This change in forward guidance looks even bolder when we consider that the central bank revised its headline inflation forecasts sharply lower over the forecast period; CPI inflation is now expected to average just 1% in 2021.

Another dovish move is that the central bank left its quantitative easing programme open-ended. Purchases under the APP programme will now run for as long as necessary to return inflation back to target and will end only shortly before the ECB starts raising interest rates. Granted, at €20 billion per month the pace of purchases was below market expectations of €50 billion. But we caution that the open-ended, state-contingency guidance is what matters here, as it is far more effective than the amount of the monthly pace of purchases.

It remains to be seen how the ECB will be able to continue buying public sector bonds under its current self-imposed 33% issuer limit. As things stand, we estimate that the bank could continue buying German bonds for only nine to 12 months before it hits a brick wall. We and markets had expected ECB President Mario Draghi to announce some tweak to the current QE rules during his press conference, but he didn't. In other words, he left his successor, Christine Lagarde, the task of reforming the current APP framework.

As of now, unless the economic situation deteriorates sharply, we don't expect a further rate cut this year. Tweaks to the two-tier system multiplier, to APP rules or to TLTRO conditions, are nonetheless a possibility.

ASIA PACIFIC

By Katrina Ell of Moody's Analytics
September 12, 2019

AUSTRALIA

Australia's economy is in a slow lane. GDP growth hit a decade low in the June quarter, with a 1.4% y/y expansion. Exports were an important strength. Buoyant demand and high prices for hard commodities, including iron ore, helped pick up the slack for the rural sector, which has been plagued by poor growing conditions. The weak Australian dollar is also an important driver. It has fallen almost 6% in the past year and 3.5% YTD to US$0.681. Because of these factors, Australia recorded a current account surplus of A$5.9 billion in the June quarter, the first surplus since mid-1975.

Slower conditions are not expected to deteriorate so much that Australia's strong growth track record is threatened. Australia has entered its 29th year of uninterrupted growth. On an annual basis, GDP growth is likely to improve from the September quarter.

Low base effects, rather than the guarantee of improved economic conditions, will be the fundamental driver. Full-year GDP growth should improve to 2% in 2019, still the weakest pace in a decade and following the 2.8% expansion in 2018.

Households in a funk

Household consumption was unsurprisingly subdued over the June quarter, with a mediocre 0.2-percentage point contribution to GDP growth. Household consumption likely will enjoy a boost in the September quarter, a consequence of the government's income tax cuts taking effect broadly from early July. But given consumers' underlying caution, a decent chunk is expected to have been saved, dampening the broader economic lift. With this, we expect the household saving ratio to rise in the September quarter after dipping in the June quarter to 2.3% from 3% in March.

A strong rebound in household consumption will remain elusive given the outlook is for income growth to remain subdued in coming quarters. The close causal relationship between wage growth and consumption cannot be ignored. Consumers' somber mood was demonstrated with new-car sales down by 10.1% y/y in August, according to the Federal Chamber of Automotive Industries. New-car sales tend to be a decent barometer of discretionary consumer demand. However, the expected gradual improvement in the Sydney and Melbourne housing markets will be an ongoing support as the negative wealth effects fade.

Since household final consumption accounts for around 55% of GDP, the extent to which the household sector improves will guide how the broader economy performs and how aggressive the Reserve Bank of Australia needs to be with lowering the cash rate. The government has made it clear that materially more expansionary fiscal policy is off the cards given the preoccupation with the budget surplus.

Reinflating the housing market

We forecast the next 25-basis point reduction to occur in October. Another 50 basis points of rate cuts, as markets suggest, could trigger a pickup in the Sydney and Melbourne housing markets that is more aggressive than is comfortable for policymakers. That's because such a pickup would likely lead to further household leveraging—a problem given that households haven't deleveraged at an aggregate level. The underlying problem is that monetary policy is a blunt instrument. Broad economic activity is soft, GDP growth is below potential, inflation is below target, and the unemployment rate has trended higher to almost 1 percentage point above the natural rate, estimated to be around 4.5%.

Our long-held baseline forecast—that the trough in the national housing market has occurred—is evident in improving activity in the Sydney and Melbourne markets, where 60% of activity takes place. Improved auction clearance rates in these cities, alongside the return of monthly dwelling-value growth, according to CoreLogic data, support the outlook for ongoing improvement.

The housing market has been particularly responsive to the RBA shifting to an easing bias, which is expected given the close causal relationship to lending rates. The RBA found that much of the strength in house prices and construction during the recent boom was due to the decline in interest rates. The RBA's own modelling shows that a 1-percentage point reduction in real variable interest rates that is expected to last for three years means that real house prices increase 15% by the seventh quarter after the reduction occurs.

The Long View

As a result, we would expect that if this situation happens, the recently eased macroprudential policies regarding lending standards would be reintroduced in some form to curtail activity. The Australian Prudential Regulation Authority has unwound some limits on investor lending and interest-only loans, which contributed to the housing correction, and credit supply is still limited compared with 2015-2016.

Uncharted territory

Odds that the RBA will move into unconventional monetary policy stimulus have increased. RBA Governor Philip Lowe said in early August that "if all central banks go to zero, then we'd have to consider that as well," referencing how Australia doesn't set the tone for global monetary policymaking, but rather follows the state of play.

The consensus has emerged that unconventional methods would be deployed when the cash rate reaches 0.5%. Measures likely would be aimed at lowering the Australian dollar. This could involve buying government bonds to lower long-term yields.

The Australian dollar has been a good shock absorber. The aussie has fallen by almost 6% against the U.S. dollar in the past year, coinciding with rising concerns about cooling global growth and the escalating U.S.-China trade war. The weaker aussie has supported exporters, and the large trade surplus contributed to the current account surplus.

Ratings Round-Up

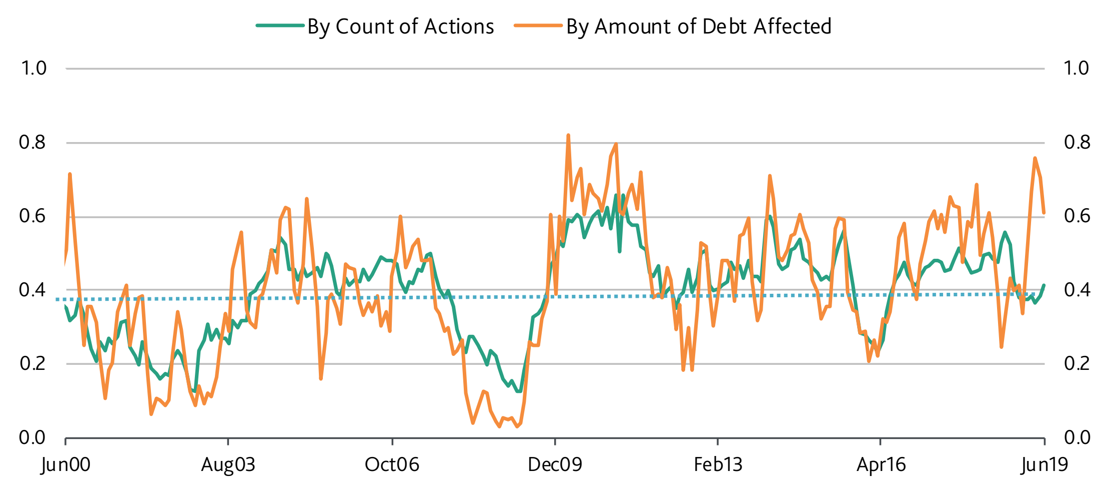
Ford Motor Co. Headlines U.S. Downgrades

By Steve Shields

Eighteen U.S. corporations received rating changes for the period ending September 10. Upgrades comprised 28% of total rating activity and only 4% of total affected debt. The most notable change during the period was Ford Motor Company. Moody's Investors Service downgraded Ford's credit rating from Baa3 to Ba1. The downgrade to speculative-grade territory is supported by Ford's weak earnings and cash generation along with ongoing risks tied to the firm's restructuring plan. The downgrade impacts $83.5 billion which accounted for more than two-thirds of all affected debt in the period. CommScope Holding Company's Corporate Family Rating was downgraded to B1 from Ba3, reflecting weaker-than-anticipated earnings and high financial leverage. The firm's outlook remains stable. Yum! Brands Inc. received the most significant upgrade in terms of total debt affected, with its CFR lifted to Ba2 from Ba3 and senior unsecured notes lifted to B1. The trend in U.S. rating activity is symptomatic of the decelerating national expansion, but weekly rating changes can largely be chalked up to idiosyncratic factors as opposed to a systemic economic weakness. Cumulative bond issuance for U.S. corporate and financial institutions has increased 8% year over year as corporations take advantage of historically low interest rates.

Rating changes were limited to only four across Europe. The most significant negative rating change, in terms of impacted debt, was to Mallinckrodt International Finance SA. The company's large downgrade to Caa2 from Baa2 mirrors its weak liquidity and rising risk of default with upcoming debt maturity. In total, $3.5 billion in issuance was impacted by the downgrade. Meanwhile, the single European upgrade in the period was assigned to utility DTEK Energy B.V.

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



* Trailing 3-month average
Source: Moody's

Ratings Round-Up

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
9/4/19	YUM! BRANDS INC.	Industrial	SrUnsec/LTCFR /PDR/LGD	4,725	U	B2	B1	SG
9/4/19	PRIORITY HOLDINGS LLC-PRIORITY PAYMENT SYSTEMS HOLDINGS, LLC	Industrial	SrSec/BCF /LTCFR/PDR		D	B1	B2	SG
9/5/19	HARLEY-DAVIDSON, INC.	Industrial	SrUnsec/MTN	5,600	D	A3	Baa1	IG
9/5/19	SPECTRUM HOLDINGS III CORP.	Industrial	SrSec/BCF /LTCFR/PDR		D	B2	B3	SG
9/6/19	HOSPITALITY PROPERTIES TRUST	Industrial	SrUnsec/Sub /JrSub/PS	3,650	D	Baa2	Baa3	IG
9/6/19	BRIGGS & STRATTON CORPORATION	Industrial	SrUnsec /LTCFR/PDR	223	D	Ba3	B2	SG
9/6/19	ALORICA INC.	Industrial	SrSec/BCF /LTCFR/PDR		D	B3	Caa1	SG
9/6/19	TRANSPLACE HOLDINGS, INC.	Industrial	SrSec/BCF /LTCFR/PDR		U	B2	B1	SG
9/9/19	FORD MOTOR COMPANY	Industrial	SrUnsec/BCF /STD/MTN/CP	83,493	D	Baa3	Ba1	IG
9/9/19	EDGEWELL PERSONAL CARE CO.	Industrial	SrUnsec /LTCFR/PDR	2,200	D	Ba3	B3	SG
9/9/19	CALCEUS ACQUISITION, INC.	Industrial	SrSec/BCF /LTCFR/PDR		U	B2	B1	SG
9/9/19	COMMSCOPE HOLDING COMPANY, INC.	Industrial	SrSec/SrUnsec /BCF/LTCFR/PDR	10,050	D	Ba1	Ba3	SG
9/9/19	CONCENTRA INC.	Industrial	LTCFR/PDR		U	B2	B1	SG
9/9/19	TRIBE BUYER LLC	Industrial	SrSec/BCF /LTCFR/PDR		D	B2	B3	SG
9/9/19	CPI INTERMEDIATE HOLDINGS, INC. -CPI INTERNATIONAL, INC.	Industrial	SrSec/BCF		D	B2	B3	SG
9/10/19	TEGNA INC.	Industrial	SrUnsec/BCF /LTCFR/PDR	2,685	D	Ba2	Ba3	SG
9/10/19	B&G FOODS, INC.	Industrial	SrSec/BCF	1,600	D	Ba1	Ba2	SG
9/10/19	DONNELLEY FINANCIAL SOLUTIONS, INC.	Industrial	SrUnsec/SGL	300	U	B3	B2	SG

Source: Moody's

Ratings Round-Up

FIGURE 4

Rating Changes: Corporate & Financial Institutions – Europe

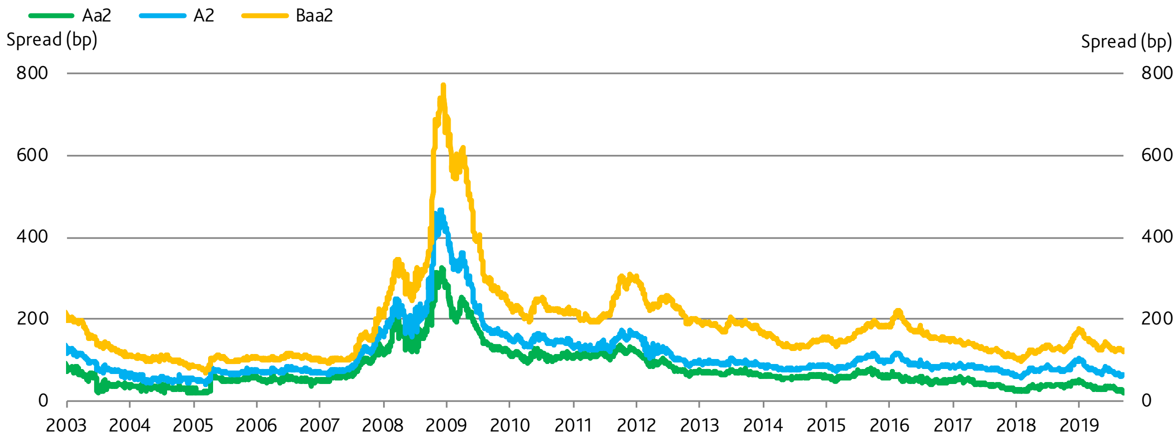
Date	Company	Sector	Rating	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG	Country
9/4/19	LECTA S.A.	Industrial	SrSec /LTCFR/PDR	D	B3	Caa1	SG	LUXEMBOURG
9/5/19	DTEK ENERGY B.V.	Utility	LTCFR/PDR	U	Ca	Caa2	SG	NETHERLANDS
9/6/19	MALLINCKRODT PLC-MALLINCKRODT INTERNATIONAL FINANCE SA	Industrial	SrUnsec/SrSec /BCF/LTCFR/PDR	D	B3	Caa2	SG	LUXEMBOURG
9/10/19	PINEWOOD GROUP LIMITED	Industrial	LTCFR	D	Ba2	Ba3	SG	NITED KINGDOI

Source: Moody's

Market Data

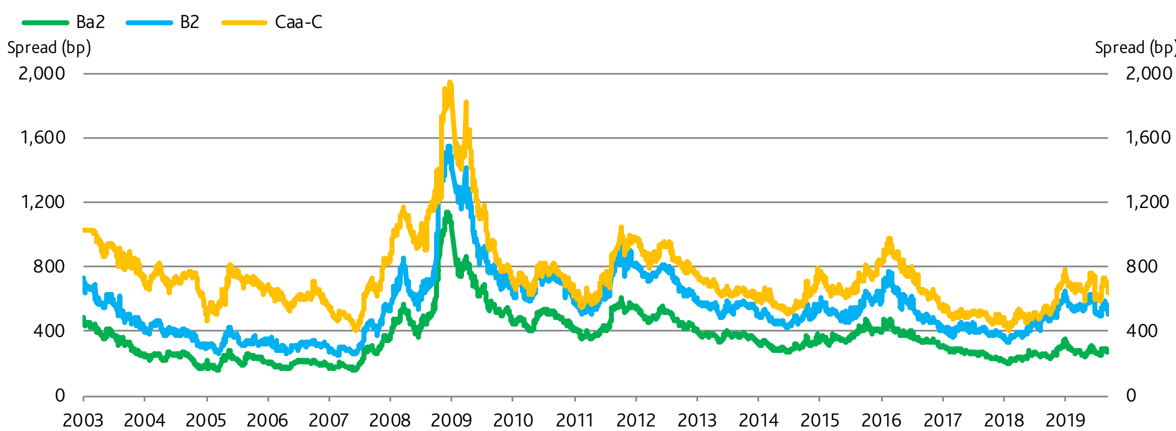
Spreads

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 (September 4, 2019 – September 11, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Sep. 11	Sep. 4	Senior Ratings
Ball Corporation	A2	Baa1	Ba1
Ashland LLC	A1	A3	Ba3
Citigroup Inc.	A3	Baa1	A3
Bank of America Corporation	A1	A2	A2
JPMorgan Chase Bank, N.A.	Aa2	Aa3	Aa2
Wells Fargo & Company	A1	A2	A2
Verizon Communications Inc.	A3	Baa1	Baa1
Amgen Inc.	A1	A2	Baa1
U.S. Bancorp	Aa2	Aa3	A1
Bank of America, N.A.	Aa3	A1	Aa2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Sep. 11	Sep. 4	Senior Ratings
Ally Financial Inc.	Ba1	Baa3	Ba2
Walt Disney Company (The) (Old)	Aa1	Aaa	A2
Intel Corporation	A3	A2	A1
General Motors Company	Ba2	Ba1	Baa3
Becton, Dickinson and Company	Ba1	Baa3	Ba1
Burlington Northern Santa Fe, LLC	Aa2	Aa1	A3
NextEra Energy Capital Holdings, Inc.	Baa3	Baa2	Baa1
FedEx Corporation	Baa3	Baa2	Baa2
Southern California Edison Company	Baa2	Baa1	Baa2
Eli Lilly and Company	Aa3	Aa2	A2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Sep. 11	Sep. 4	Spread Diff
Rite Aid Corporation	Caa2	2,073	1,955	119
iStar Inc.	Ba3	186	152	34
SLM Corporation	Ba2	237	223	14
Ford Motor Credit Company LLC	Ba1	188	179	8
Ford Motor Company	Ba1	190	181	8
Huntsman International LLC	Baa3	55	50	5
FedEx Corporation	Baa2	72	69	4
Texas Instruments, Incorporated	A1	92	88	4
Advanced Micro Devices, Inc.	B1	60	57	4
Alberto-Culver Company	Baa2	19	15	4

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Sep. 11	Sep. 4	Spread Diff
Frontier Communications Corporation	Caa3	4,618	5,314	-696
Dean Foods Company	Caa3	3,145	3,819	-674
Penney (J.C.) Corporation, Inc.	Caa3	3,361	3,744	-382
Chesapeake Energy Corporation	B2	1,032	1,253	-220
Neiman Marcus Group LTD LLC	Ca	5,190	5,383	-193
Realogy Group LLC	B3	867	1,004	-137
Diamond Offshore Drilling, Inc.	B3	499	580	-81
Staples, Inc.	B3	446	508	-61
R.R. Donnelley & Sons Company	B3	564	620	-56
Pitney Bowes Inc.	Ba2	493	547	-54

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (September 4, 2019 – September 11, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Sep. 11	Sep. 4	Senior Ratings
Casino Guichard-Perrachon SA	Caa2	Ca	B1
United Kingdom, Government of	Aa2	Aa3	Aa2
Lloyds Bank plc	A2	A3	Aa3
Barclays PLC	Baa3	Ba1	Baa3
The Royal Bank of Scotland Group plc	Baa3	Ba1	Baa2
NatWest Markets N.V.	Aa3	A1	Baa2
Credit Suisse AG	A2	A3	A1
HSBC Bank plc	Aa3	A1	Aa3
Bank of Scotland plc	A2	A3	Aa3
Atlantia S.p.A.	Ba1	Ba2	Baa3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Sep. 11	Sep. 4	Senior Ratings
Intesa Sanpaolo S.p.A.	Ba1	Baa3	Baa1
Santander UK plc	Baa3	Baa2	Aa3
Electricite de France	A2	A1	A3
Bayerische Landesbank	A2	A1	Aa3
Vodafone Group Plc	Baa2	Baa1	Baa2
Sanofi	Aa1	Aaa	A1
Allied Irish Banks, p.l.c.	Baa3	Baa2	A3
Fiat Chrysler Automobiles N.V.	Ba2	Ba1	Ba2
GlaxoSmithKline plc	Aa1	Aaa	A2
Merck KGaA	Aa1	Aaa	Baa1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Sep. 11	Sep. 4	Spread Diff
CMA CGM S.A.	B3	1,328	1,298	30
Vue International Bidco plc	Caa2	228	218	10
Altice Finco S.A.	Caa1	283	276	7
Iceland, Government of	A3	76	69	6
Wm Morrison Supermarkets plc	Baa2	76	69	6
Electricite de France	A3	42	37	5
EDP - Energias de Portugal, S.A.	Baa3	56	50	5
UPC Holding B.V.	B2	63	59	4
Novafives S.A.S.	Caa1	511	507	4
Unilever N.V.	A1	15	12	3

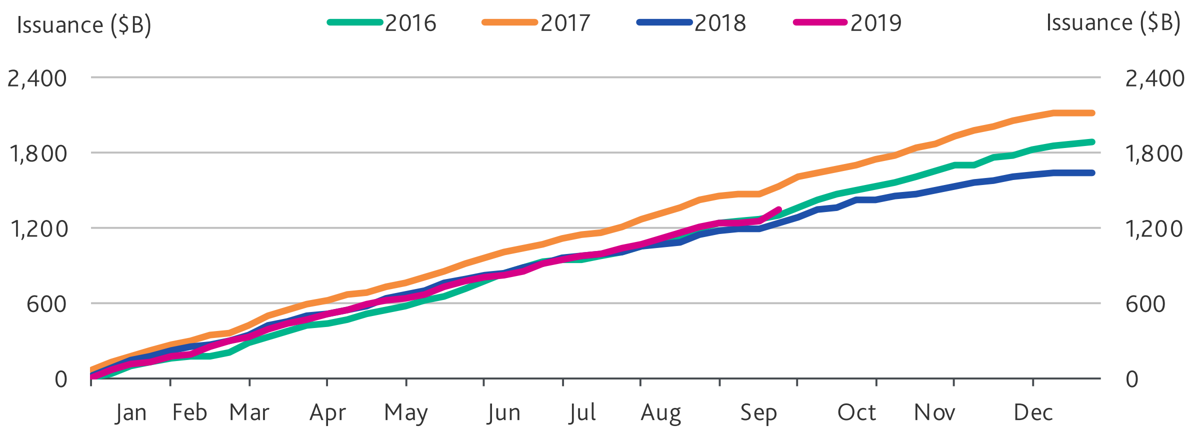
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Sep. 11	Sep. 4	Spread Diff
Boparan Finance plc	Caa1	2,387	2,855	-468
PizzaExpress Financing 1 plc	Caa2	6,699	7,035	-336
Casino Guichard-Perrachon SA	B1	633	801	-169
Matalan Finance plc	Caa1	829	881	-52
Jaguar Land Rover Automotive Plc	B1	703	753	-50
thyssenkrupp AG	Ba3	216	242	-26
Atlantia S.p.A.	Baa3	104	124	-21
Ineos Group Holdings S.A.	B1	163	182	-19
Unione di Banche Italiane S.p.A.	Baa3	120	138	-17
TUI AG	Ba2	294	311	-17

Source: Moody's, CMA

Market Data

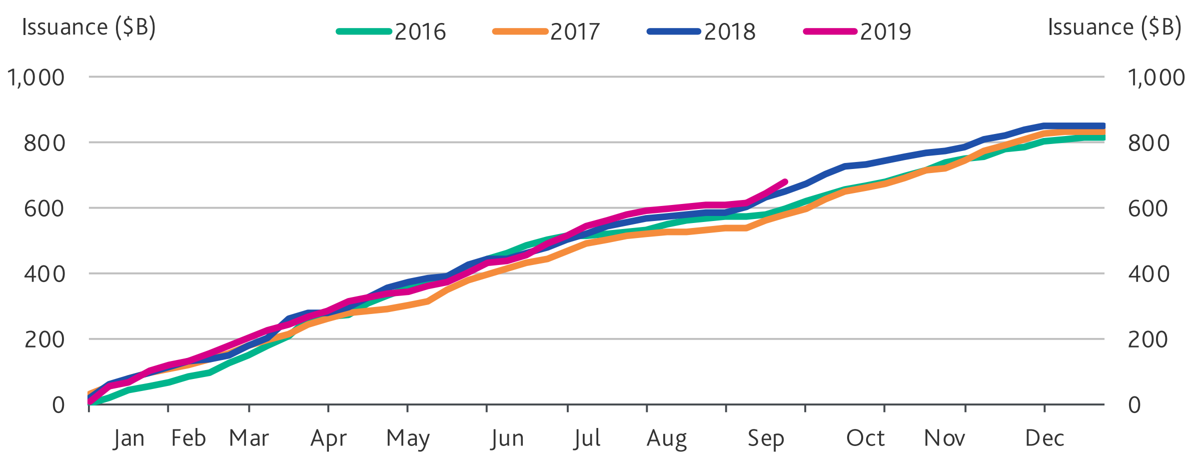
Issuance

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	80.821	8.410	92.151
Year-to-Date	988.720	286.885	1,345.434

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	32.103	2.034	35.580
Year-to-Date	598.316	61.239	679.930

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

Moody's Capital Markets Research recent publications

Leading Credit-Risk Indicator Signals A Rising Default Rate (Capital Markets Research)

Upon Further review, Aggregate Financial Metrics Worsen (Capital Markets Research)

Faster Loan Growth Would Bode Poorly for Corporate Credit Quality (Capital Markets Research)

Likelihood of a 1.88% Fed Funds Rate by End of July Soars (Capital Markets Research)

Market Implied Ratings Differ on the Likely Direction of Baa3 Ratings (Capital Markets Research)

Below-Trend Spreads Bank on Profits Growth, Lower Rates and Healthy Equities (Capital Markets Research)

Global Collapse by Bond Yields Stems from Worldwide Slowdown (Capital Markets Research)

Borrowing Restraint Likely Despite Lower Interest Rates (Capital Markets Research)

The Fed Cured 1998's Yield Curve Inversion (Capital Markets Research)

Extended Yield Curve Inversion Would Presage Wide Spreads and Many Defaults (Capital Markets Research)

Business Debt's Mild Rise Differs Drastically from 2002-2007's Mortgage Surge (Capital Markets Research)

Earnings Slump Would Unmask Dangers of High Leverage (Capital Markets Research)

Credit May Again Outshine Equities at Divining Markets' Near-Term Path (Capital Markets Research)

Not Even the Great Depression Could Push the Baa Default Rate Above 2% (Capital Markets Research)

Benign Default Outlook Implies Profits Will Outrun Corporate Debt (Capital Markets Research)

Upside Risks to the U.S. Economy (Capital Markets Research)

Outstandings and Rating Changes Supply Radically Different Default Outlooks (Capital Markets Research)

High Leverage Offset by Ample Coverage of Net Interest Expense (Capital Markets Research)

Subdued Outlook for Revenues and Profits Portend Lower Interest Rates (Capital Markets Research)

Fed Will Cut Rates If 10-Year Yield Breaks Under 2.4% (Capital Markets Research)

Riskier Outlook May Slow Corporate Debt Growth in 2019 (Capital Markets Research)

Replay of Late 1998's Drop by Interest Rates May Materialize (Capital Markets Research)

High-Yield Might Yet Be Challenged by a Worsened Business Outlook (Capital Markets Research)

Default Outlook Again Defies Unmatched Ratio of Corporate Debt to GDP (Capital Markets Research)

Equity Analysts' Confidence Contrasts with Economists' Skepticism

Fed's Pause May Refresh a Tiring Economic Recovery (Capital Markets Research)

Rising Default Rate May be Difficult to Cap (Capital Markets Research)

Baa-Grade Credits Dominate U.S. Investment-Grade Rating Revisions (Capital Markets Research)

Upper-Tier Ba Rating Comprises Nearly Half of Outstanding High-Yield Bonds (Capital Markets Research)

Stabilization of Equities and Corporates Requires Treasury Bond Rally (Capital Markets Research)

High Leverage Will Help Set Benchmark Interest Rates (Capital Markets Research)

Medium-Grade's Worry Differs from High-Yield's Complacency (Capital Markets Research)

Slower Growth amid High Leverage Lessens Upside for Interest Rates (Capital Markets Research)

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

Report Number: 1194625

Editor
Reid Kanaley
help@economy.com

Contact Us

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