MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

Moody's Analytics Research

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Market Implied Ratings Differ on the Likely Direction of Baa3 Ratings

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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.

Market Implied Ratings Differ on the Likely Direction of Baa3 Ratings

Baa3-grade issuers constitute the bottom rung of the investment-grade ratings ladder. Once a Baa3 rating is subject to a "fallen angel" downgrade to speculative-grade, investors who are mandated to hold only investment-grade obligations must sell the now high-yield debt.

Because Baa3 ratings border high-yield space, it is conceivable that buyers of Baa3 obligations might demand additional yield as compensation for the above-average risk of a fallen-angel downgrade. According to Moody's Analytics' 1991 through 2018 history of 336 estimated month-end yields and spreads at the seven-year maturity, the median spread over Treasuries jumps up from the 160 basis points of Baa2 to the 203 bp of Baa3. The next lowest rating's notch of Ba1, or the top rung of the high-yield rating's ladder, shows a long-term median spread of 271 bp.

Figure 1: Estimated Yield Spreads at the Seven-Year Maturity
month-end medians by rating category in basis points; source: Moody's Analytics

	----------INVESTMENT-GRADE----------										----------HIGH-YIELD----------						
	Aaa	Aa1	Aa2	Aa3	A1	A2	A3	Baa1	Baa2	Baa3	Ba1	Ba2	Ba3	B1	B2	B3	Caa
	1	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*11*	*12*	*13*	*14*	*15*	*16*	*17*
1991-2018 Averages	76	95	119	130	135	138	148	158	185	**218**	304	348	383	430	493	594	908
1991-2018 Medians	**65**	**77**	**94**	**102**	**113**	**119**	**127**	**141**	**160**	**203**	**271**	**309**	**354**	**410**	**458**	**545**	**732**
Dec-18	78	93	115	117	132	151	156	192	194	**250**	312	356	401	498	526	554	731
Jan-19	71	65	109	116	120	149	151	168	179	**232**	256	286	323	457	436	485	652
Feb-19	61	62	98	101	106	138	145	159	168	**210**	250	258	287	400	385	459	604
Mar-19	61	64	94	99	103	132	147	159	169	**219**	260	272	296	440	406	479	625
Apr-19	62	62	92	93	100	126	139	150	157	**210**	236	264	281	355	352	447	577
May-19	69	85	94	94	106	123	133	154	171	**232**	274	316	359	399	438	532	666
Jun-19	**58**	**72**	**87**	**86**	**93**	**116**	**122**	**138**	**154**	**211**	**257**	**285**	**335**	**368**	**430**	**486**	**655**

When moving down the investment-grade ratings ladder notch-by-notch, the biggest jump in the median spread is the 43 bp from Baa2 to Baa3. The next largest is the 19 bp from the 141 bp of Baa1 to the 160 bp of Baa2. For the seven gaps between notches above Baa2, the average difference between the median spreads is 11 bp for the period of 1991 through 2018.

When moving down the high-yield rating's ladder, the most pronounced increases in spreads occurred at the lowest speculative-grade ratings. The 1991-2018 sample of median high-yield spreads shows a relatively wide gap of 68 bp between Baa3 and Ba1. Thereafter the spread widened by 38 bp to the 309 bp of Ba2 and, then, by 46 bp to the 354 bp of Ba3. The next big jump by the median spread was the 87 bp from the 458 bp of B2 to the 545 of B3. The most jarring widening of all was the 186 bp increase from B3 to the 732 bp of Caa. The latter category includes bonds very close to, if not already in, default.

Only the Baa3 Spread Was Wider than Its Long-Term Median as of the End of June

The latest available estimate of median spreads applies to the end of June 2019. June 2019's Baa3 spread of 211 bp exceeds its 1991-2018 median by 8 bp. By contrast, each of the other rating categories shows a spread that is thinner than their respective 1991-2018 median.

More specifically, June 2019's spreads for investment-grade ratings above Baa3 were eight basis points less, on average, compared to their medians of 1991-2018. In addition, June 2019's spreads for high-yield rating categories trailed their 1991-2018 medians by 38 bp, on average. High-yield's deepest shortfalls relative to the long-term medians applied to the two lowest rating categories. June 2019's median yield spread of 486 bp for B3 was 60 bp under its 1991-2018 median, while June 2019's 655 bp spread for Caa was 77 bp under its long-term median.

Corporate Bond Yields and EDFs Provide the Basis for Market Implied Ratings

Bond implied ratings provide an estimate of the corporate bond market's view of where a senior unsecured bond credit rating should reside. By contrast, the expected default frequency metric can estimate an issuer's implied bond rating by way of an issuer's vulnerability to default.

Though a bond implied rating is entirely market driven, an EDF-implied rating is only partly market driven. An issuer's EDF, or probability of default, will be greater (i) the lower is an issuer's market value of net worth and (ii) the more volatile is the market value of an issuer's business assets. The market value of net worth equals the market value of an issuer's business assets less the issuer's outstanding debt. Unlike the EDF-implied rating, the bond implied rating does not directly consider the issuer's indebtedness.

Bond Implied Ratings Offer a Somewhat Negative View of Baa3 Credits

Friday, July 5 will be the date of reference for the following discussion concerning the difference between the market implied and actual ratings of US/Canadian issuers whose senior unsecured bond rating is Baa3, or the bottom rung of the investment-grade ratings ladder. All ratings below Baa3 are labeled speculative-grade or high-yield.

July 5's available corporate bond prices included 105 nonfinancial-company issuers having a senior, unsecured rating of Baa3. Among July 5's batch of Baa3-rated issuers, 24, or 23%, had a bond implied rating above Baa3. For these 24 "under-rated" issuers, the derived average and median premia above Baa3 were 1.25 and 1.00 notches, respectively. (One notch above Baa3 equals Baa2, while two notches above Baa3 corresponds to Baa1.)

The bond implied ratings of 39, or 37%, of July 5's Baa3 sample equaled Baa3. The remaining 42, or 40%, of July 5's sample of actual Baa3 rated issuers produced a bond implied rating that was less than Baa3.

A rating of less-than-Baa3 is necessarily equivalent to a high-yield, or speculative-grade, bond rating. For the 42 prospective "high-yield" issuers, the average discount to the Baa3 rating was 1.55 notches and the median discount was 1.00 notches. (Relative to a Baa3 rating, a one-notch discount equals Ba1, a two-notch discount equals Ba2.)

For July 5's entire 105 company sample of Baa3-rated issuers, the average bond implied rating was 0.33 notches under Baa3. However, the sample's median bond implied rating equaled Baa3.

Figure 2: Bond Implied Rating versus Baa3 Senior Unsecured Rating: July 5, 2019
U.S. nonfinancial companies, source: Moody's Analytics

Baa3	Number of Issuers	% of number of Baa3 Issuers	Average number of notches from Baa3	Median number of notches from Baa3
Entire Baa3 Sample: U.S.	105	100%	-0.33	0.0
Bond Implied Rating Greater than Baa3	24	23%	1.25	1.0
Bond Implied Rating Equal to Baa3	39	37%	0.00	0.0
Bond Implied Rating Less than Baa3	42	40%	-1.55	-1.0

EDF-Derived Market Implied Ratings Offered a More Positive View of Baa3 Credits

In stark contrast, July 5's EDF-derived senior-unsecured ratings exceeded the accompanying Baa3-grade rating by 1.30 notches, on average, while showing a medium premium of one notch.

Of July 5's 83 EDF-implied ratings for nonfinancial-company Baa3-grade issuers, 44, or 53%, produced an implied rating that exceeded Baa3 by 4.91 notches, on average. (A1 and A2 correspond to five and four notches above Baa3, respectively.)

Only six, or 7%, of the EDF-implied ratings were equal to Baa3. The remaining 33, or 40%, of July 5's EDF-implied ratings were less than Baa3, where each of the 33 implied a high-yield rating. For the 33 issuers, whose Baa3 rating was deemed too high by the EDF methodology, the average discount to Baa3 was 3.27 notches and the median discount was 3.00 notches. Discounts of 3 and 4 notches to Baa3 are equivalent to high-yield ratings of Ba3 and B1.

July 5's entire 83-issuer sample of EDF implied ratings for Baa3-grade issuers supplied an average premium of 1.30 notches above Baa3, where the median premium equaled one notch.

Figure 3: EDF Implied Rating versus Baa3 Senior Unsecured Rating: July 5, 2019
U.S. nonfinancial companies, source: Moody's Analytics

Baa3	Number of Issuers	% of number of Baa3 Issuers	Average number of notches from Baa3	Median number of notches from Baa3
Entire Baa3 Sample: U.S.	83	100%	1.30	1.0
EDF Implied Rating Greater than Baa3	44	53%	4.91	5.0
EDF Implied Rating Equal to Baa3	6	7%	0.00	0.0
EDF Implied Rating Less than Baa3	33	40%	-3.27	-3.0

For the Baa3 ratings category, market implied ratings can supply a vastly different assessment regarding where a corporate credit rating might be headed depending on whether a bond- or EDF-implied model is used. However, because an EDF implied rating partly depends on the issuer's outstanding amount of debt, the EDF implied rating may be less susceptible to swings in market sentiment relative to the bond implied rating.

Despite Thinner Spread since End of 2018, Bond Implied Ratings of Baa3 Group Softens

The estimated median Baa3 yield spread at the seven-year maturity narrowed from year-end 2018's 250 bp to June 2019's 211 bp. However, despite the spread narrowing, the bond implied ratings of Baa3-grade issuers worsened from the end of 2018 to July 5.

Year-end 2018 supplied bond implied ratings for 113 Baa3-rated issuers. The bond implied rating averaged an imperceptible 0.02 notches above Baa3, where the median bond implied rating equaled Baa3. As of year-end 2018, 41, or 36%, of the sample's bond implied ratings exceeded Baa3 by 1.37 notches, on average. The "under-rated" group also showed a median premium of one notch above Baa3. The 33, or 29%, of the sample that produced a speculative-grade bond-implied-rating of less than Baa3 supplied an average discount of 1.64 notches under Baa3 and a median discount of one notch.

Figure 4: Bond Implied Rating versus Baa3 Senior Unsecured Rating: year-end 2018
U.S. nonfinancial companies, source: Moody's Analytics

Baa3	Number of Issuers	% of number of Baa3 Issuers	Average number of notches from Baa3	Median number of notches from Baa3
Entire Baa3 Sample: U.S.	113	100%	0.02	0.0
Bond Implied Rating Greater than Baa3	41	36%	1.37	1.0
Bond Implied Rating Equal to Baa3	39	35%	0.00	0.0
Bond Implied Rating Less than Baa3	33	29%	-1.64	-1.0

Also, as of year-end 2018, the EDF implied ratings of 78 Baa3-grade issuers supplied an average premium over Baa3 of 0.68 notches, where the median EDF implied rating equaled Baa3. For 31, or 40%, of the 78-issuer sample, the EDF implied rating topped Baa3. This group showed strikingly high average and median premia of 5.19 and 5.00 notches, respectively. At the other extreme, 35, or 45%, of the sample yielded an EDF implied rating that was less than Baa3. This group's average discount of 3.09 notches was joined by a median discount of 3.00 notches.

Figure 5: EDF Implied Rating versus Baa3 Senior Unsecured Rating: year-end 2018
U.S. nonfinancial companies, source: Moody's Analytics

Baa3	Number of Issuers	% of number of Baa3 Issuers	Average number of notches from Baa3	Median number of notches from Baa3
Entire Baa3 Sample: U.S.	78	100%	0.68	0.0
EDF Implied Rating Greater than Baa3	31	40%	5.19	5.0
EDF Implied Rating Equal to Baa3	12	15%	0.00	0.0
EDF Implied Rating Less than Baa3	35	45%	-3.09	-3.0

Thus, from year-end 2018 to July 5, 2019, the bond-implied ratings of nonfinancial-company Baa3 issuers improved, on balance, while the group's EDF-implied ratings improved. Perhaps the corporate bond market senses a worsening of credit fundamentals that the Baa3-grade EDFs have yet to detect.

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

THE U.S.

By Ryan Sweet, Moody's Analytics

Powell Speaks and Removes All Doubt

Federal Reserve Chairman Jerome Powell's prepared remarks to the U.S. House Committee on Financial Services implied a July rate cut is almost a slam dunk. He went to great lengths to provide a laundry list of reasons to justify the recalibration of monetary policy in July, likely in an effort to address any speculation that the central bank is bending under political pressure from the Trump administration.

It's not the recent economic data on GDP or employment that trouble Powell and the Fed. Rather, it's the heightened uncertainties and the developing downside risks from trade tensions, plus concerns about the global economy. Powell noted these are weighing on the U.S. economic outlook.

Powell also noted a number of government policy issues beyond trade that haven't been resolved, including the federal debt ceiling and Brexit. What's worrying Powell is inflation, which he said remains muted. Powell's prepared remarks contained no references to transitory factors depressing inflation—a change from his past communication.

From our perspective, the key takeaway is that Powell tied the potential rate cut mostly to risks to the outlook, implying July's move should be interpreted as an insurance cut rather than the beginning of an easing cycle. This is where the Fed and markets differ. Based on forward rates, markets anticipate a cumulative 82-basis point easing between now and July 2020. This seems aggressive, and it will be a challenge for the Fed to manage expectations without causing another taper tantrum.

During his Q&A, Powell dodged questions about whether a 25- or 50-basis point cut in July was needed. The insurance cuts in 1995 and 1998 were done in 25-basis point increments as the Fed saved larger moves for financial crises or periods when the outlook was deteriorating faster than expected. Neither apply today. The one argument for a 50-basis point cut is research suggesting that when it is close to the zero lower bound, it's better to be aggressive in easing. Given the economic data, a 50-basis point cut is extremely unlikely.

We are raising our subjective odds of a 25-basis point rate cut in July from 75% to 90%. Beyond July, we expect an extended pause by the Fed.

The minutes from the June meeting of the Federal Open Market Committee were also released. They generally mirrored what was in Powell's testimony but they showed the Fed was close to pulling the trigger on a cut in June. The minutes contained a discussion of a potential standing repo facility, which would lend cash at a fixed rate against high-quality collateral. There are two potential policy goals: to prevent overnight rates from spiking too high on certain days, and to incentivize banks to hold less of their high-quality liquid assets in the form of reserves, thereby allowing the Fed to have a smaller balance sheet. There were some concerns among Fed officials and they seem lukewarm on the idea.

Perception versus reality

The June U.S. employment report likely tempered, but did not eliminate, concerns about the strength of the job market. Trend job growth has slowed this year, but it's easy to misread that and make a mountain out of a molehill. In the first six months of this year, employment has risen by an average of 172,000, compared with the 235,000 in the comparable period in 2018. This is a significant deceleration but not an apples-to-apples comparison. The economy last year was juiced by the fiscal stimulus, whose effect has faded this year. For perspective, job growth in the first six months of 2017 averaged 182,000, not significantly stronger than the pace this year.

Perception can differ from reality. In fact, trend growth of 172,000 per month is still strong. It is more than enough to keep the unemployment rate stable. This is key because a rising unemployment rate,

even from low levels, can have a psychological impact and cause consumers to pack it in. In fact, if the unemployment rate increases by more than 25 basis points in a three-month period, a recession normally follows. Each of the 10 recessions since World War II began in tandem with such an increase in unemployment.

To assess the risks of further increases in the unemployment rate, we turn to our flow-consistent unemployment rate model, which uses labor force flows in a given month to predict future unemployment rates. The model anticipates that unemployment will hit 3.9% by the end of the third quarter, compared with the current 3.7%. A key weakness in the model is its inability to distinguish between workers finding employment and those leaving the labor force.

Therefore, we updated our estimate of the number of new jobs needed to keep the unemployment rate stable, and it remains near 100,000 per month. This estimate is the function of the size of the civilian population, the labor force participation rate, the employment-to-labor force ratio, and the ratio of payroll-to-household employment.

The break-even rate of job growth isn't constant, and the key determinant will be the labor force participation rate. Plugging our forecasts in, the break-even rate of job growth will begin to decline in the second half and into 2020. Therefore, while trend job growth will moderate further, there isn't a lot of cause for concern as long as it remains above the break-even level. The problem is that job growth may not settle down in an orderly manner. Therefore, there is the possibility that it will fall temporarily below its break-even level, pushing the unemployment rate higher and raising the risk of a recession.

Looking ahead

The key data next week include June retail sales, industrial production, business inventories, consumer confidence and jobless claims.

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

EUROPE

By Barbara Teixeira Araujo of Moody's Analytics

Inflation Pressures Likely Steady in the U.K. and Euro Zone

June CPI figures for the U.K. and the euro zone are next week's main releases. We expect both to show that inflation pressures remained steady in June, at 2% y/y in the U.K. and at a much lower 1.2% in the currency area. The main story from the two reports will be that energy inflation pressures fell further at the end of the quarter, in line with base effects in oil prices. And this trend isn't expected to go away any time soon. Provided that the price of a Brent barrel remains steady at its current value of around $67, energy prices should continue on a downward path until October, alleviating the pressure on household purchasing power.

In the euro zone, we expect an increase in core inflation to 1.1% y/y, from 0.9% in May to offset this decline in energy inflation. But we caution against reading too much into the core increase. It would be mainly due to base effects in transport, accommodation and package holiday inflation, if individual country figures are anything to go by. Developments in the travel-related CPI subsectors are notoriously volatile, because they depend on the timing of holidays (which often vary from year to year). June had one more holiday this year than in 2018—in Germany and France, though not for all euro zone countries—which boosted accommodation inflation and airfares substantially over the month. This warrants some correction in July. Developments in the rest of the services sectors are expected to have been unimpressive, though we caution that there is scope for rent services inflation to have risen somewhat given that inflation in the sector rose sharply in France as base effects from last year's reduction in French social housing costs were eliminated.

In addition, we expect core goods inflation to have dropped yet again mainly due to gathering momentum in deflation in the clothing sector. By contrast, we expect that food inflation picked up somewhat, since a heatwave across Western Europe should have dealt a heavy blow to crop yields during the end of June and beginning of July, putting further upward pressure on unprocessed food inflation.

In the U.K., we expect that travel-services inflation will have rebounded somewhat following a drop in May, itself due to base effects related to the late timing of the Easter holidays compared with 2018. By contrast, we expect that developments in most other services sectors held relatively steady in June, following already strong results for May.

Contrary to the developments observed in the euro zone, we expect that the main upside surprise from the U.K. figures will have come from core inflation. Notably, the recent depreciation of the exchange rate and the subsequent rise in import prices means that further increases in imported goods prices are warranted in June and during the second half of this year. This will also raise food prices, as a huge proportion of food products sold in the U.K. are currently imported from the EU. For June, we expect that food inflation rose to 1.2% y/y, from 1%, not only because of higher import prices, but also because the heatwave that hit Europe in June hurt crop yields and raised fresh produce prices.

Next week will also bring the U.K.'s unemployment figures for May. We expect them to show that joblessness held steady at 3.8% during the May quarter, its lowest in 44 years. Employment gains are nonetheless expected to have slowed somewhat from the previous quarter, even if unemployment should have fallen further. Regarding wage growth, we expect it remained relatively steady at 3.1% y/y in the May quarter (including bonuses). Looking further ahead, we expect that the still-tight labour market will ensure that wages continue to grow at a rate above 3% y/y in 2019, up from an average of 2.9% in 2018.

	Key indicators	Units	Moody's Analytics	Last
Mon @ 2:00 p.m.	Russia: Industrial Production for June	% change yr ago	2.0	0.9
Tues @ 9:30 a.m.	U.K.: Unemployment for May	%	3.8	3.8
Tues @ 10:00 a.m.	Italy: Consumer Price Index for June	% change yr ago	0.8	0.9
Tues @ 10:00 a.m.	Euro Zone: External Trade for May	bil euro	14.0	15.7
Wed @ 9:30 a.m.	U.K.: Consumer Price Index for June	% change yr ago	2.0	2.0
Wed @ 10:00 a.m.	Euro Zone: Consumer Price Index for June	% change yr ago	1.2	1.2
Wed @ 2:00 p.m.	Russia: Unemployment for June	%	4.5	4.5
Wed @ 2:00 p.m.	Russia: Retail Sales for June	% change yr ago	1.2	1.4
Thur @ 9:30 a.m.	U.K.: Retail Sales for June	% change yr ago	2.7	2.3

ASIA-PACIFIC

By Katrina Ell of Moody's Analytics

China's GDP Likely at 6.3% as Easing Measures Help Stabilize Growth

China's GDP growth likely slowed to 6.3% y/y in the June quarter, from 6.4% in the March quarter. Beijing's measured and targeted easing to stabilize economic growth is having some impact. Stimulus methods have included reserve requirement ratio cuts, higher tax reimbursement rates for exporters dealing with U.S. tariffs, tax cuts, and a push to increase bank lending and public works. The trade war with the U.S. has hurt the manufacturing and export engines. The contribution from net exports to GDP growth is being lifted by the slump in imports. Imports from the U.S. have collapsed since the trade war escalated and this is impacting the headline given shipments from the U.S. into China account for almost 10% of total imports.

June's activity data are expected to show some improvement after the generally disappointing months of April and May. Fixed asset investment likely picked up to 5.8% y/y YTD in June, from the 5.6% gain

in May. Manufacturing has been a particular weak spot of late as firms grapple with the soft near-term outlook, especially for the export-oriented sectors. Some relief is coming from the government's increased infrastructure push, ongoing since mid-2018. China's industrial production data have been particularly volatile this year. Production is forecast to pick up to 5.7% y/y in June, after slowing to 5% in May, the weakest reading since 2002. The underlying trend and outlook are for ongoing softness.

Central banks in South Korea and Indonesia will likely keep their monetary policy rates on hold in July, but the likelihood that both will ease is elevated, particularly in Indonesia. Bank Indonesia has flagged a strong desire to loosen policy settings after the aggressive hikes that were employed in 2018 to try to stem capital outflows as emerging markets fell out of favour. Now that Indonesia's rupiah has stabilized, BI does not need to keep the monetary policy settings in place. There's a high likelihood of easing in the third quarter, and the easing cycle will be gradual and measured.

In South Korea there are strong arguments for the central bank to ease policy. These include inflation slowing to below 1%, a sustained weakness in exports leading to a moderation in output, and still plenty of downside risks domestically and abroad, specifically in regard to the U.S.-China trade war. But high household debt is one factor keeping the Bank of Korea on the sidelines amid concern that debt could climb further.

	Key indicators	Units	Confidence	Risk	Moody's Analytics	Last
Mon @ 12:00 p.m.	China GDP for Q2	% change yr ago	4	←	6.3	6.4
Mon @ 12:00 p.m.	China Fixed asset investment for June	% change yr ago YTD	3	←	5.8	5.6
Mon @ 12:00 p.m.	China Industrial production for June	% change yr ago	3	↓	5.7	5.0
Mon @ 12:00 p.m.	China Retail sales for June	% change yr ago	3	↑	8.2	8.6
Mon @ Unknown	Indonesia Foreign trade for June	US$ bil	2	←	-1.4	0.2
Mon @ Unknown	India Foreign trade for June	US$ bil	3	↓	-15.1	-15.4
Tues @ 8:45 a.m.	New Zealand CPI for Q2	% change	3	←	0.3	0.1
Wed @ Unknown	Singapore Nonoil domestic exports for June	% change yr ago	3	←	-14.4	-15.9
Thurs @ 9:50 a.m.	Japan Foreign trade for June	bil	2	↓	-345	-609
Thurs @ 11:00 a.m.	South Korea Monetary policy for July	%	3	←	1.75	1.75
Thurs @ 11:30 a.m.	Australia Unemployment rate for June		3	←	5.3	5.2
Thurs @ Unknown	Indonesia Monetary policy for July	%	3	↓	6.0	6.0
Fri @ 9:30 a.m.	Japan Consumer price index for June	% change yr ago	3	←	0.9	0.8

The Long View

Oil & gas figured in 19% and retailing entered into 12% of the high-yield downgrades of the second-quarter-to-date.

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

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 119 basis points is just under its 122-point mean of the two previous economic recoveries. This spread may be no wider than 135 bp by year-end 2019.

The recent high-yield bond spread of 421 bp is thinner than what is suggested by both the accompanying long-term Baa industrial company bond yield spread of 186 bp but is wider than what ordinarily accompanies the recent VIX of 12.9 points.

DEFAULTS

June 2019's U.S. high-yield default rate was 3.0%. The high-yield default rate may average 3.2% during 2019's final 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.

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 4.6% for IG and 18.0% for high yield. When stated in U.S. dollars, issuers based outside the U.S. supplied 60% of the investment-grade and 61% of the high-yield bond offerings of 2019's first quarter.

US ECONOMIC OUTLOOK

As inferred from the CME Group's FedWatch Tool, the futures market recently assigned an implied probability of 100% to a cutting of the federal funds rate at the July 31, 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 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 Barbara Teixeira Araujo of Moody's Analytics
July 11, 2019

UNITED KINGDOM

Thursday saw the release of the Bank of England's twice-yearly Financial Stability Report. As expected, the focus was on what a no-deal Brexit would do to financial markets, and the bank concluded nothing new. The BoE again assured that city banks are well-prepared to withstand any shock related to the U.K. crashing out of the EU with no deal on October 31, and that all of the U.K.'s biggest banks would manage to continue trading without risk of collapse. Adding to the good news was the BoE's claim that those banks could withstand a no-deal Brexit even if it were compounded by an international trade war, given the heightened trade tensions between the U.S. and China.

The central bank warned that a major threat remains, though, as European companies are at significant risk of losing access to their lenders overnight if the U.K. leaves with no deal on Halloween. The BoE stated that half of those EU companies using banks registered in Britain would be cut off from their bank services. That's because, while the U.K. has passed legislation that would allow British firms banking with EU banks located in the country to keep on trading in the same way, the EU has not taken similar steps yet.

This would only add to the huge numbers of disruptions caused by a hasty exit. Although this is not our base case scenario—we expect that the U.K. will eventually leave with a deal, even if it does so under a Labour government—the chances of a no-deal exit have soared lately, as Boris Johnson remains the favourite candidate to replace Theresa May as prime minister. Johnson's tough Brexit stance—he has repeatedly said that Brexit will happen on October 31, come what may—suggests that he would have no problem with a no-deal Brexit. And while we think that Parliament would try to stop him if push came to shove, the main risk here is that he decides to shut down Parliament, making it impossible for lawmakers to stop him. It's worrying that in a televised debate this week, Johnson refused to rule out suspending Parliament. By contrast, his opponent Jeremy Hunt said he would not shut it down.

Although the rebound in the U.K.'s GDP in May was welcome following the dismal figures for April, looking past the volatility the main story from the release was that the underlying momentum in the economy remained weak in the middle of the second quarter. This is true mainly because growth in services output disappointed again; it held only steady over the month and failed to recover from the sorely unimpressive results for March and April. Services output accounts for around 80% of all that is produced in the U.K. economy and is a far better indicator of the economy's direction, since it is less volatile and was less affected by the stockpiling before the March Brexit deadline.

A key downside detail was that growth in financial services output fell for the 15th consecutive month in May, as companies continued to relocate part of their operations to continental Europe, fearing what will happen to their 'passporting rights' when the U.K. finally leaves the EU. But output in most other service subsectors also disappointed, highlighting just how little momentum is in the U.K. economy right now, and that's despite strongly rising wages and a still-solid labour market.

Worth noting is that significant upward revisions to March's figures suggest that the numbers for the second quarter will be a better than previously expected. We now forecast that overall GDP held steady over the quarter—

we had previously expected a fall—following a 0.5% q/q gain in the first stanza of the year. We project growth will remain subdued during the second half of 2019 as well, at an average of around 0.2% q/q.

ASIA PACIFIC

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

CHINA

China has had a tough year. The enduring trade war with the U.S. has hurt manufacturing and exports and steepened the entrenched structural decline in broad economic conditions. Evidence is rising of the disruption to manufacturing production lines from the trade dispute, and forward indicators including new export orders suggest weakness through the second half of 2019. Inflation in China has been a background issue this past year. But the outbreak of African swine flu has made inflation a bigger concern in recent months, a situation that is unlikely to be resolved quickly.

Beijing's quest to stabilize domestic demand has proven difficult. China's May activity data mostly surprised on the downside, against market consensus for an improvement from April's already disappointing print. In particular, fixed asset investment cooled in May for a second straight month, to 5.6% y/y year to date, its weakest reading since September, following the 6.1% gain in April. Industrial production also slowed, against expectations for it to at least hold steady; it came in at 5% y/y in May, the softest reading since 2002, after April's 5.4%. Some improvement is expected in the June numbers.

Stimulus this cycle has been measured and piecemeal, with the longer-term goal of achieving higher-quality growth. The government has avoided the large-scale stimulus of prior downturns, and this has resulted in a gradual improvement of some conditions, namely via infrastructure spending, tax cuts, and easing credit conditions in some sectors. Further stimulus is expected into 2020, not least because the unresolved trade war between the U.S. and China continues to hurt the manufacturing and export sectors. The monetary stimulus will continue focusing on smaller, private firms.

JAPAN

The Bank of Japan signaled in June that it is ready and willing to up the stimulus, if necessary. Governor Haruhiko Kuroda said that the bank could combine bigger asset purchases with interest rate cuts, if the downside risks to global growth materialized and further hurt Japan's already weakened economy. Whispers that the BoJ will need to up the ante have been growing for some time, given that the 2% inflation target is unlikely to be hit in the foreseeable future. But this is not a straightforward, win-win endeavour. Negative rates are distorting financial markets and profitability of financial institutions, particularly regional banks, which are already struggling with the side effects of an aging population.

Japan's important export sector is struggling. Exports fell for a sixth straight month in May, with particular weakness in semiconductors and auto parts bound for China. Headline exports fell by 7.8% y/y in May, from April's 2.4% decline. The slowdown in exports was likely exacerbated by the 10-day holiday in Japan for the enthronement of the new emperor. The Tankan survey shows that business conditions hit a three-year low in the June quarter. Business sentiment has been deteriorating since late 2017, coinciding with the trade war escalation. This is denting capital investment plans and hiring intentions.

The bright spot in Japan's economy is the labour market. The job-to-applicant ratio was 1.63 in May, near its highest on record. There is a reasonable correlation between Japan's vacancy rate and wages. As the vacancy rate rises, employers are forced to offer higher wages to secure the right candidate. The extent of tightening in Japan's labour market is even more impressive when put in context of other developed markets. Less remarkable is the weak pass-through to higher wage growth.

Prime Minister Shinzo Abe recently confirmed that the October sales tax hike from 8% to 10% will go ahead as planned, despite growing speculation it would be delayed given the weakness at home and abroad. With this, we expect a temporary rise in spending in the third quarter, which will then collapse through the fourth quarter after the tax implementation, a situation that has occurred with Japan's other tax hikes.

Ratings Round-Up

U.S. and European Rating Activity Mixed

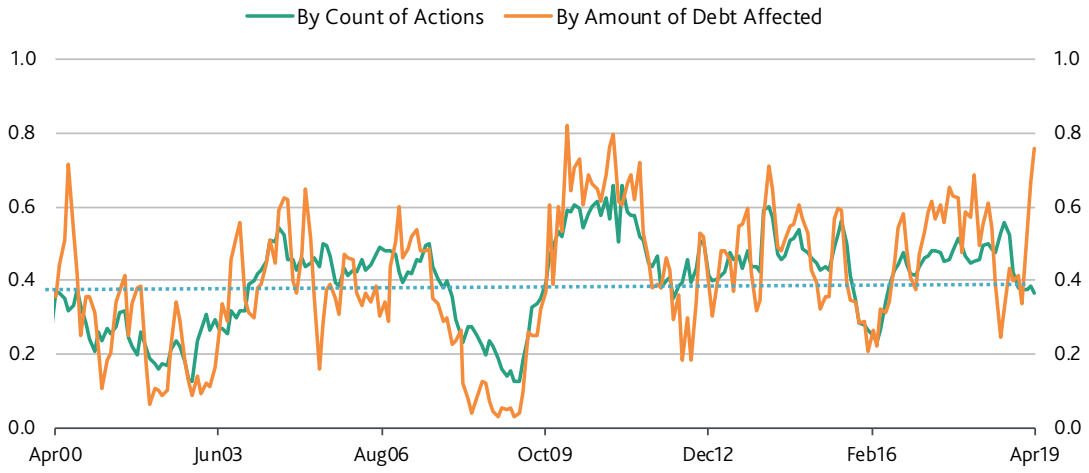
By Steven Shields

U.S. credit rating changes were predominantly positive in the latest week, but a single downgrade drove negative rating changes to account for 94% of the affected U.S. debt. Technology firm International Business Machines Corp. received a downgrade to its long-term issuer rating from A1 to A2. The change affected approximately $58 billion total debt. The change comes on the heels of IBM closing its $34 billion acquisition of Red Hat Inc. According to Moody's Investors Service, its credit rating reflects the company's strong business model, large scale, strong free cash flow generation, and liquidity. The purchase of Red Hat is considered beneficial for IBM's long-term cloud computing strategy, but poses integration risk due to the size and scale of the acquisition. Moody's Investors Service upgraded Hughes Satellite Systems Corp.'s senior unsecured notes to Ba1 from Ba2. The firm's LTCF also received an upgrade to Ba3 from B1. The U.S. economy remains in good standing overall with none of the sources of past recessions—overheating risk, financial and inventory imbalances, shocks to the economy's balance sheet—looking worrisome. The Fed's dovish pivot reduces the risk that financial market conditions will tighten in the near term. Markets are currently expecting a 25 basis point rate cut this month.

European rating activity was relatively quiet with just two rating changes occurring. The single European upgrade was to Bank Saint-Petersburg PJSC. The firm's long-term foreign currency deposit rating was upgraded to Ba3 from B1, and the outlook was revised to stable from positive. Ferroglobe PLC received the lone European downgrade with its senior unsecured notes lowered to Caa1 from B3. Ferroglobe's LTCF is under review for downgrade following weak operating performance in the first quarter of 2019.

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

FIGURE 3

Rating Changes: Corporate & Financial Institutions – US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG
7/8/19	SCRIPPS (E.W.) CO. (OLD)-SCRIPPS (E.W.) COMPANY (THE)	Industrial	SrSec/BCF		U	Ba3	Ba2	SG
7/8/19	TRIUMPH GROUP, INC.	Industrial	SrUnsec /LTCFR/PDR	1,175	D	Caa1	Caa2	SG
7/8/19	MTS SYSTEMS CORPORATION	Industrial	SrSec/BCF		U	B1	Ba2	SG
7/9/19	INTERNATIONAL BUSINESS MACHINES CORPORATION	Industrial	SrUnsec/LTIR	58,388	D	A1	A2	IG
7/9/19	BROOKS AUTOMATION, INC.	Industrial	SrSec/BCF /LTCFR/PDR		U	B1	Ba3	SG
7/9/19	HUGHES SATELLITE SYSTEMS CORPORATION	Industrial	SrSec/SrUnsec /LTCFR/PDR	4,050	U	Ba2	Ba1	SG
7/9/19	GOBP HOLDINGS, INC.	Industrial	LTCFR/PDR		U	B3	B2	SG

Source: Moody's

FIGURE 4

Rating Changes: Corporate & Financial Institutions – Europe

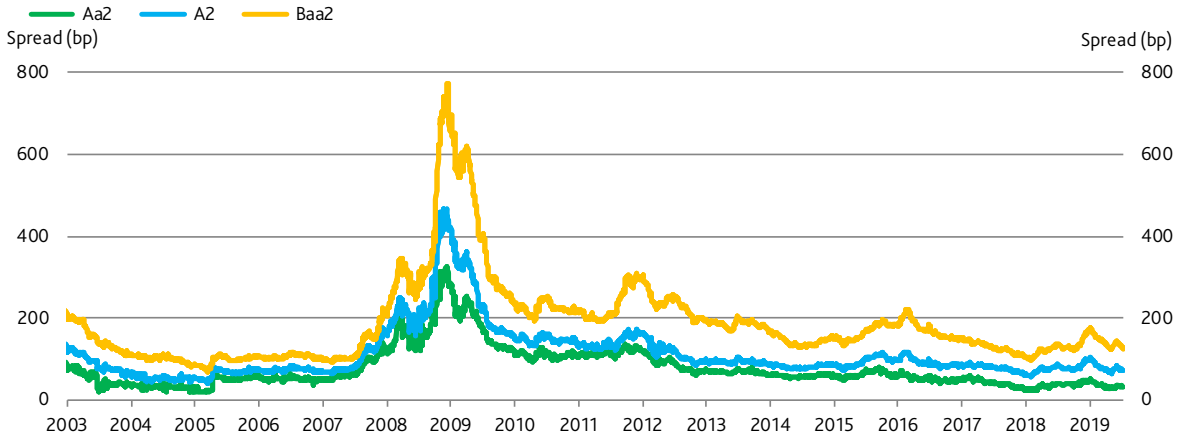
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG	Country
7/4/19	BANK SAINT -PETERSBURG PJSC	Financial	LTD		U	B1	Ba3	SG	RUSSIA
7/4/19	FERROGLOBE PLC	Industrial	SrUnsec /LTCFR/PDR	350	D	B3	Caa1	SG	UNITED KINGDOM

Source: Moody's

Market Data

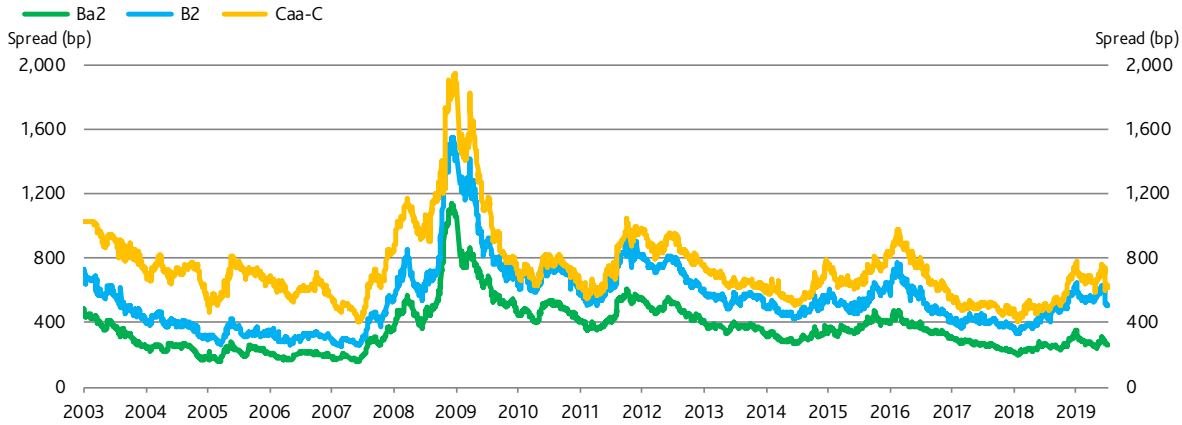
Spreads

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 (July 3, 2019 – July 10, 2019)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jul. 10	Jul. 3	Senior Ratings
PepsiCo, Inc.	A1	A2	A1
Amgen Inc.	A1	A2	Baa1
Union Pacific Corporation	Aa1	Aa2	Baa1
Amazon.com, Inc.	Aa3	A1	A3
Burlington Northern Santa Fe, LLC	Aa1	Aa2	A3
CenturyLink, Inc.	B2	B3	B2
Lowe's Companies, Inc.	A1	A2	Baa1
Eli Lilly and Company	Aa2	Aa3	A2
General Mills, Inc.	A3	Baa1	Baa2
Target Corporation	Aa2	Aa3	A2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jul. 10	Jul. 3	Senior Ratings
CSC Holdings, LLC	Ba3	Ba2	B3
CCO Holdings, LLC	Ba2	Ba1	B1
PNC Financial Services Group, Inc.	Baa2	Baa1	A3
Texas Instruments, Incorporated	Ba1	Baa3	A1
PPG Industries, Inc.	Ba1	Baa3	A3
Realogy Group LLC	Caa2	Caa1	B2
Universal Health Services, Inc.	Baa2	Baa1	Ba1
Iron Mountain Incorporated	A1	Aa3	Ba3
International Lease Finance Corporation	Baa3	Baa2	Baa3
Royal Caribbean Cruises Ltd.	Ba1	Baa3	Baa2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jul. 10	Jul. 3	Spread Diff
Neiman Marcus Group LTD LLC	Ca	3,508	3,286	222
Frontier Communications Corporation	Caa2	3,063	2,928	135
Penney (J.C.) Corporation, Inc.	Caa3	4,662	4,610	52
Nabors Industries Inc.	B1	566	526	40
Dean Foods Company	Caa2	2,539	2,501	38
AK Steel Corporation	B3	897	861	36
Talen Energy Supply, LLC	B3	662	628	34
Realogy Group LLC	B2	804	772	32
United States Steel Corporation	B2	565	533	31
American Axle & Manufacturing, Inc.	B2	347	323	24

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jul. 10	Jul. 3	Spread Diff
Diamond Offshore Drilling, Inc.	B3	398	444	-46
Cablevision Systems Corporation	B3	388	424	-36
R.R. Donnelley & Sons Company	B3	789	822	-33
Beazer Homes USA, Inc.	B3	413	441	-28
K. Hovnanian Enterprises, Inc.	Caa3	1,892	1,914	-22
Office Depot, Inc.	B3	483	505	-22
Dish DBS Corporation	B1	436	457	-20
Mattel, Inc.	B3	313	332	-18
JetBlue Airways Corp.	Ba1	88	105	-17
Univision Communications Inc.	Caa2	293	304	-11

Source: Moody's, CMA

Market Data

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

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jul. 10	Jul. 3	Senior Ratings
Safeway Limited	Aa1	A1	Baa2
Wm Morrison Supermarkets plc	Baa2	Ba1	Baa2
Banque Federative du Credit Mutuel	Aa2	Aa3	Aa3
Nordea Bank Abp	Aa1	Aa2	Aa3
Bayerische Landesbank	A1	A2	Aa3
SEB AB	Aa1	Aa2	Aa2
DNB Bank ASA	Aa1	Aa2	Aa2
Siemens Aktiengesellschaft	Aaa	Aa1	A1
Bank of Scotland plc	A3	Baa1	Aa3
National Grid Plc	A2	A3	Baa1

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jul. 10	Jul. 3	Senior Ratings
Spain, Government of	A1	Aa3	Baa1
Banco Bilbao Vizcaya Argentaria, S.A.	A3	A2	A3
HSBC Holdings plc	A3	A2	A2
Credit Agricole S.A.	Aa2	Aa1	A1
Banco Santander S.A. (Spain)	Aa3	Aa2	A2
Vodafone Group Plc	Baa2	Baa1	Baa2
Swedbank AB	Aa3	Aa2	Aa2
RCI Banque	Ba1	Baa3	Baa1
Credit Suisse AG	A3	A2	A1
BASF (SE)	Aa2	Aa1	A1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jul. 10	Jul. 3	Spread Diff
Galapagos Holding S.A.	C	24,036	19,775	4,261
PizzaExpress Financing 1 plc	Caa2	4,667	3,710	957
Boparan Finance plc	Caa1	3,551	3,275	276
CMA CGM S.A.	B3	1,196	1,065	131
Casino Guichard-Perrachon SA	B1	949	823	127
Novafives S.A.S.	Caa1	460	414	47
Matalan Finance plc	Caa1	712	675	37
Jaguar Land Rover Automotive Plc	B1	605	569	36
Ineos Group Holdings S.A.	B1	210	183	27
Altice Finco S.A.	Caa1	362	339	23

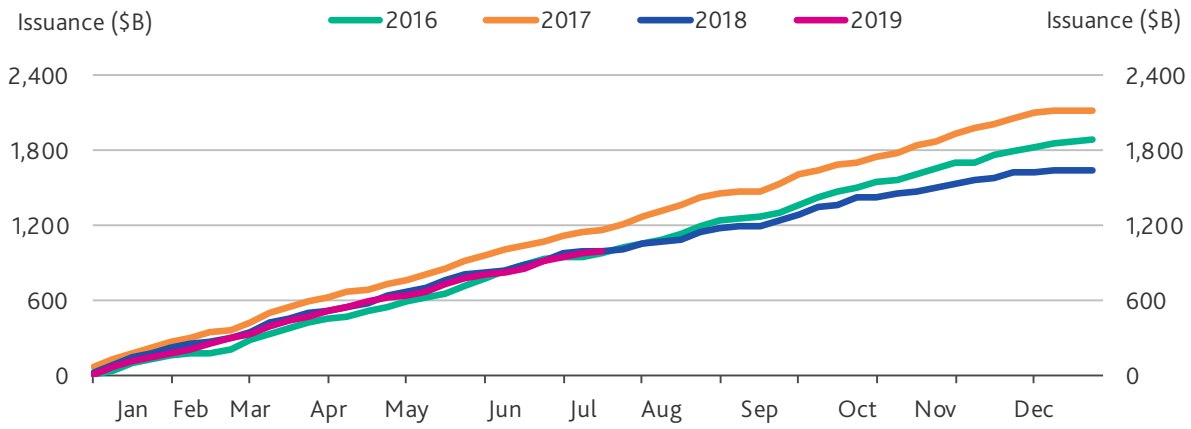
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jul. 10	Jul. 3	Spread Diff
Wm Morrison Supermarkets plc	Baa2	66	99	-33
METRO Finance B.V.	Ba1	125	139	-14
Safeway Limited	Baa2	24	35	-12
CaixaBank, S.A.	Baa1	72	79	-7
Bankinter, S.A.	Baa2	61	68	-7
Vedanta Resources Limited	B2	457	464	-7
Bankia, S.A.	Baa3	77	83	-6
Banco Sabadell, S.A.	Baa3	99	104	-5
Banco Comercial Portugues, S.A.	Ba2	152	156	-4
Unione di Banche Italiane S.p.A.	Baa3	157	161	-4

Source: Moody's, CMA

Market Data

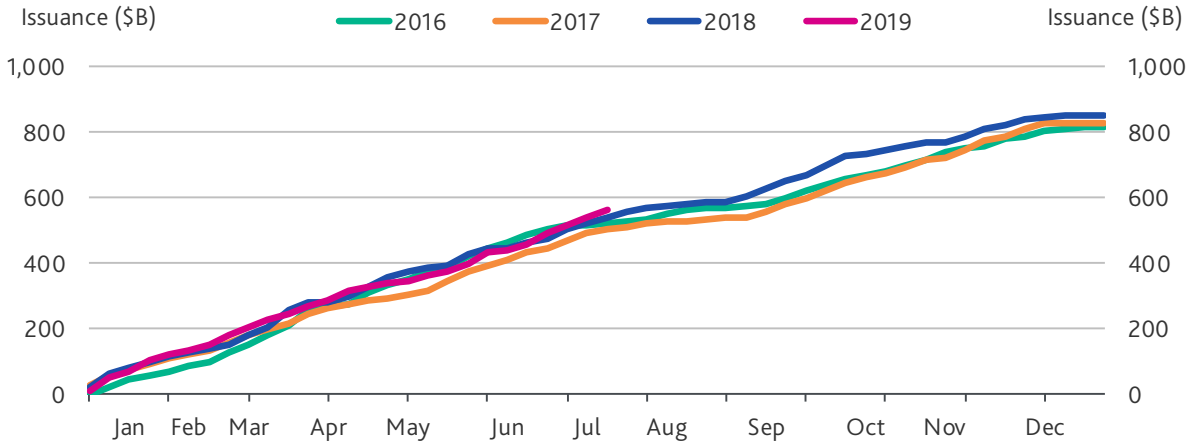
Issuance

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	1.624	5.584	9.054
Year-to-Date	706.191	224.730	986.517

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	17.344	0.903	18.839
Year-to-Date	496.443	47.359	560.323

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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