MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK
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Lead Authors

Ryan Sweet
Senior Director-Economic Research

Scott Hoyt
Senior Director

Asia-Pacific

Katrina Ell
Senior Economist

Stefan Angrick
Senior Economist

Xiao Chun Xu
Economist

Jeff Yu
Economist

Europe

Ross Cioffi
Economist

U.S.

Steven Shields
Economist

Matt Orefice
Data Specialist

Podcast

Maybe U.S. Consumers Won't Turn Fuelish

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There is no doubt that the Federal Reserve will increase the target range for the fed funds rate later this month as higher energy prices are making the central bank's problems even worse. The February consumer price index was up 0.8%, in line with our forecast and an acceleration from the 0.6% gain in each of the prior two months. Food prices were up 1%, while energy jumped 3.5% in February. Excluding food and energy, the CPI increased 0.5% after rising 0.6% in January.

There are some initial signs that growth in prices for supply-chain constrained components in February moderated, as used-car prices edged lower. On a year-ago basis, the CPI was up 7.9% in February.

Having inflation at 7.9% on a year-ago basis, compared with the 2.1% average growth in 2018 and 2019, is costing the average household $296.45 per month, up from $276 in January. It is easy to see why inflation is politically and publicly unpopular. The Fed is feeling the heat, and some of the Fed officials are responding.

It is going to get worse before it gets better. U.S. gasoline prices are set to rise further because of past gains in global oil prices. Our rule of thumb is that every $10 per barrel increase in the West Texas Intermediate crude oil price will lift U.S. retail gasoline prices by 30 cents per gallon. Therefore, the Russia military conflict with the Ukraine has boosted retail gasoline prices by $1 per gallon.

Wholesale gasoline prices suggest that average U.S. gasoline prices are going to eclipsed $4.50 per gallon soon. The U.S. average gasoline price is currently $4.25 per gallon, compared with $3.50 per gallon this time last month and $2.80 per gallon this time last year.

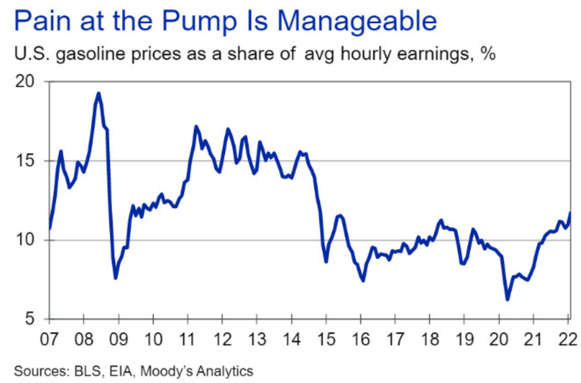
The cost to consumers is high. Every 10-cent increase in the price of gasoline costs consumers a combined $11 billion or more over the course of a year. Also, higher gasoline prices will weigh on consumer sentiment and will boost inflation expectations.

There are plenty of reasons to be concerned that the increase in gasoline prices could noticeably weigh on real consumer spending. However, there are also reasons to be optimistic that consumers can weather a temporary spike in gasoline prices as household balance sheets in aggregate are in great shape. Also, consumers are sitting on $2.6 trillion in excess savings.

Another reason for optimism is that gasoline spending as a share of total nominal consumption is low. Also, growth in average hourly earnings, though not our preferred measure of wages, has been strong. In fact, retail gasoline prices as a share of average hourly earnings for private workers is 11.7%. Between 2011 and 2014, retail gasoline prices accounted for 15% of average hourly earnings.

Higher gasoline prices are a risk to our forecast for real consumer spending over the next few months, but there are reasons to be both optimistic and pessimistic.

The Fed will respond. Federal Reserve Chair Jerome Powell was explicit during his semiannual testimony to the House Committee on Financial Services. He took away all uncertainty about the outcome of March's Federal Open Market Committee meeting by throwing his support behind a 25-basis point rate hike and saying that plans to reduce the size of the balance sheet will not be finalized.



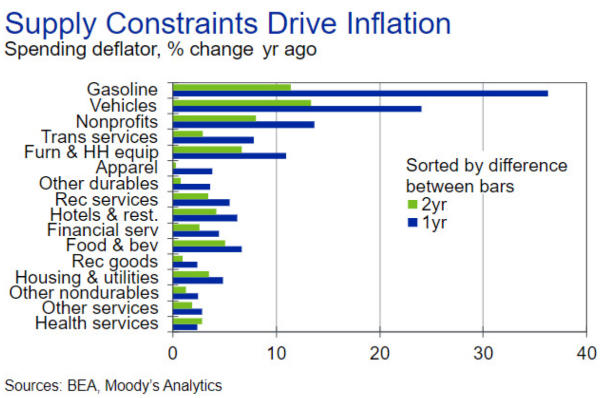
Normally, Fed chairs avoid tipping their hands, as doing so could be seen as front-running the FOMC. However, Russia's invasion of Ukraine has caused a lot of volatility in financial markets and created new uncertainty. Therefore, Powell likely wanted to reduce any uncertainty about the Fed's intention at its upcoming meeting. Powell did leave the door open for larger rate hikes at future meetings.

We maintained our assumption that the Fed raises the target range for the fed funds rate four times this year, 25 basis points each time. Markets are pricing in more hikes, just south of seven hikes over the next 12 months. The tightening in financial market conditions did some of the Fed's work for it. The primary channel through which monetary policy impacts the economy is financial markets. With financial market conditions tightening, the Fed doesn't need to do as much this year.

Inflation Hits U.S. Consumer Spending

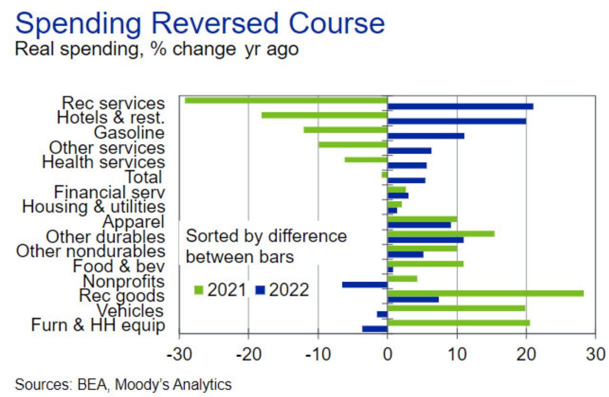
BY SCOTT HOYT

U.S. inflation is at its highest level in about four decades. Much of the inflation has been caused by pandemic-generated supply constraints, although Russia's invasion of Ukraine is creating additional constraints that will push inflation higher and for longer than thought before the assault began. Inflation varies widely across different spending categories, and the adverse impact of supply constraints, especially over the past year, is evident in the pattern.



Through January, before the invasion of Ukraine had a direct impact on prices, inflation was fastest for gasoline and vehicles. Clearly demand had risen faster than supply for both goods. The reopening economy occurred faster than oil producers expected, and demand outpaced supply. Pandemic-related supply constraints on vehicle parts, computer chips in particular, put a severe limit on auto production as demand accelerated rapidly. Fears of an invasion had begun to boost oil prices. For both gasoline and vehicles, prices soared. Price increases were less evident for health and other services, and other nondurable goods, including medical goods, where supply constraints were not binding. Inflation for other goods and services fell between these extremes.

There are many drivers of spending at present which theoretically could mask the impact of differential inflation rates on spending. Perhaps the largest is simply the magnitude of the decline in spending in 2020 as the COVID-19 pandemic initially decimated the economy. The sharper the decline in spending, the more need for a rebound and, because of base effects, the easier it was to post strong growth in the subsequent rebound. This is evident in the spending data, where the segments that posted the largest declines in real spending in the year ending January 2021 posted the largest gains in the following year.

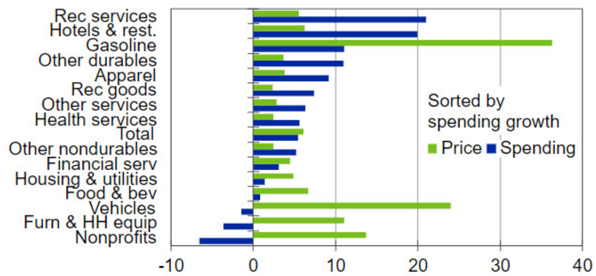


Spending on recreational services and hotels and restaurants was particularly hard hit at the onset of the pandemic but rebounded in outsize fashion last year. By contrast, home furnishings and equipment, vehicles and recreational goods like toys, games and hobby supplies were in relatively high demand as the pandemic kept people at home and away from mass transit and other gatherings. But those same goods generated little, if any, sales growth last year.

There were many other important drivers of spending over the past year. Household financial conditions are a major one. Wealth is high despite the stock market losses early this year. Income is healthy and growing strongly when the impact of fading government stimulus is discounted. Job growth is rapid and should continue given abundant job openings. The return to work for many folks may have altered the composition of spending for these households in addition to any impact it had on the amount spent.

Even through all of this, however, the impact of inflation broadly, and relative price changes in particular, on spending is clear. Outside of gasoline where expanding economic activity is boosting demand despite rising prices, real spending growth correlates well with inflation. The segments with the fastest inflation are generally seeing falling spending after adjusting for inflation, while real spending is generally growing rapidly for goods and services with lower inflation. Rapidly rising vehicle, food, and furniture and household equipment prices are limiting demand. Other factors may be playing a role as well, including supply constraints, but the relationship is clear. Spending growth is rapid for apparel, recreational goods, and other spending categories with the lowest inflation.

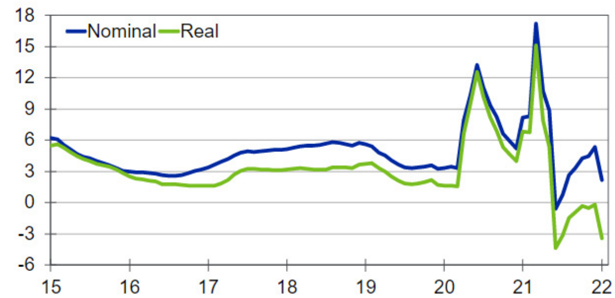
Inflation Undermines Spending
Real spending & spending deflator, % change yr ago



Sources: BEA, Moody's Analytics

Inflation will also impact the overall magnitude of consumer spending. While income growth is strong, over the past year it has not kept pace with inflation and prospects are poor for the next several months. Income growth, measured on a year-ago basis, has been weak since the middle of last year when initial waves of government stimulus began to be anniversaried, making comparisons difficult. This will drive comparisons down even further beginning with March, when the comparisons come against the last and largest set of stimulus payments. However, while income has continued to grow nearly every month, after adjustment for inflation, real income has been falling since the middle of last year and the drop has intensified in recent months as inflation has increased. Current trends suggest the gap between real and nominal income growth will widen further for at least another few months, and potentially longer.

Inflation Eliminates Real Income Growth
Disposable income, 3-mo MA, % change yr ago



Sources: BEA, Moody's Analytics

Risks to the outlook at this time skew toward higher inflation and a corresponding larger-than-expected adverse impact on consumer spending. Many scenarios that include longer or more intense conflicts in Ukraine would push prices higher for longer, especially for energy, food and other goods that use inputs sourced from that area. Increased inflation expectations could also push up wage demands and create more of a wage-price spiral than currently anticipated.

The Week Ahead in the Global Economy

U.S.

It will be a busy week on the U.S. economic data front. The focus will be on the Federal Open Market Committee. Federal Reserve Chair Jerome Powell was explicit during his semiannual testimony to the House Committee on Financial Services. He took away all uncertainty about the outcome of March's FOMC meeting by throwing his support behind a 25-basis point rate hike and saying that plans to reduce the size of the balance sheet will not be finalized.

Elsewhere, we will get new data on producer and import prices. Also, February retails sales will give us a look at consumer spending midway through the first quarter. We also get housing starts and industrial production.

Europe

The Bank of England's monetary policy meeting is set for next Thursday, and we expect a 25 bps hike in the policy rate to 0.75%. Inflation in the U.K. has been speeding up over the past year with little relief. Indeed, the CPI is set to balloon even further in April, when the country's electricity and gas price cap is recalculated. The BoE is likely focusing hard on keeping inflation expectations in check amid these inflationary pressures and the tight labor market. Indeed, we expect the U.K.'s unemployment rate was stable at 4.1% in the three months to January from the preceding quarter. Social distancing measures were only lifted at the end of the month, so we do not expect many gains in employment.

Final estimates in the euro zone, meanwhile, will report an inflation rate of 5.8% y/y in February, up from 5.1% in January. Energy prices were the primary driver of inflation, though inflation is above-target for each of the major segments of the basket. Final estimates for Italy and France's national estimates of CPI are also due next week, and we do not expect deviations from the preliminary estimates.

The euro zone's external trade balance likely fell to a deficit of €6.4 billion in January from a surplus of €10.6 billion a year earlier. Although exports are up considerably from a year earlier, imports recovered even more so, and in January there was a wave of LNG imports from the U.S. which likely boosted imports for the month even further. That said, social distancing and lockdown measures may have limited imports of consumer goods, but we don't expect this to have had a particularly strong effect.

Industrial production in the euro zone likely rose 0.4% m/m in January after December's 1.2% gain. The French and German readings were promising, though the transport equipment struggled during the month as inventories and rising production costs remained an issue. Italy and Spain's releases were considerably weaker, partly due to the hit in consumer goods production provoked by European lockdown measures during the month.

Finally, the Central Bank of Russia will likely hike its policy rate 500 basis points to 25%. In the wake of the country's invasion into Ukraine, the CBR hiked rates massively to 20%. This was to help stem the outflow of rubles from the country. With the sanctions piled onto the country, the ruble has collapsed, but the CBR will still need to push rates higher to incentivize against bank runs, and in light of the inflationary pressures building.

Asia-Pacific

China will release a suit of activity data for January-February to smooth the Lunar New Year distortion. We look for industrial production to slow to 4% y/y in January-February from December's 4.3%. Pandemic-related disruptions, partly owing to China's zero-COVID policy, remain a blight on manufacturing. Fixed-asset investment likely gathered pace in the opening months of 2022; we look for 5.3% y/y growth, compared with 4.9% for all of 2021. Targeted fiscal and monetary stimulus are helping to bolster the subdued demand environment that emerged from the second half of 2021.

China has set its growth target for 2022 at 5.5% and confirmed that accommodative monetary policy should play a role in propping up growth. Subdued inflation, a sizeable China-U.S. 10-year government bond yield differential, and a high trade surplus and foreign exchange reserve give the People's Bank of China capacity when it comes to further easing of monetary policy. The reserve requirement ratio, seven-day reverse repo rate, one-year medium-lending facility rate, and loan prime rates are likely to be reduced in 2022.

Australia's unemployment rate likely dipped to 4.1% in February from January's 4.2%. The labour market continues to tighten alongside strengthening domestic demand. Household consumption has gathered pace and investment intentions are improving. We expect the labour market will continue to strengthen through the first half of 2022, putting increasing pressure on wage growth.

Geopolitical Calendar

Date	Country	Event	Economic Importance	Financial Market Risk
9-Mar	South Korea	Presidential election	Medium	Medium
28-29-Mar	ASEAN	U.S.-ASEAN summit	Low	Low
10-Apr	France	General elections	Medium	Medium
8-May	Hong Kong	Chief executive election	Low	Low
9-May	Philippines	Presidential election	Low	Low
29-May	Colombia	Presidential election	Medium	Low
Jun	Switzerland	World Economic Forum annual meeting	Medium	Low
29-30-Jun	NATO	NATO Summit, hosted by Madrid	Medium	Medium
Jun/Jul	PNG	National general election	Low	Low
2-Oct	Brazil	Presidential and congressional elections	High	Medium
Oct/Nov	China	National Party Congress	High	Medium
7-Nov	U.N.	U.N. Climate Change Conference 2022 (COP 27)	Medium	Low

Forecast Updates: Oil Bites Into GDP

BY RYAN SWEET

CREDIT SPREADS

Moody's long-term average corporate bond spread is 152 basis points, 5 bps wider than the 147 bps at this time last week and wider than the 136 bps average in February. The long-term average industrial corporate bond spread widened 5 bps to 137. It averaged 154 bps in February.

The recent ICE BofA U.S. high-yield option-adjusted bond spread widened from 371 to 394 bps. The Bloomberg Barclays high-yield option-adjusted spread has bounced around recently and is currently 384 bps compared with 355 at this time last week. The high-yield option adjusted bond spreads approximate what is suggested by the accompanying long-term Baa industrial company bond yield spread and that implied by a VIX of 32.7.

Defaults

Defaults remain very low. In the latest Moody's monthly default report, the global speculative-grade default rate rose from 1.7% to 1.8% for the trailing 12 months ended in January. This is well below its cyclical peak of 6.9% at the end of 2020 and remains below the pre-pandemic level of 3.3%. Under our baseline scenario, Moody's Credit Transition Model predicts that the global speculative-grade default rate will resume declining over the next several months but then increase in the second half of the year, ending 2022 at 2.5%.

We also expect default risk to remain low for speculative-grade companies as a whole because many have refinanced their debt in the last two years at very low interest rates, therefore mitigating their near-term default risk. However, some low-rated companies that are under liquidity or solvency stress could be vulnerable to default in the event of tighter liquidity, higher borrowing costs and profit erosion.

U.S. Corporate Bond Issuance

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

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

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

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

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

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

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

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

In the week ended March 4, US$-denominated high-yield issuance totaled $2.5 billion, bringing the year-to-date total to $47.5 billion. Investment-grade bond issuance rose $62.7 billion in the current week, bringing its year-to-date total to $327 billion. Total US$-denominated issuance is currently between that seen in 2018 and 2019.

U.S. ECONOMIC OUTLOOK

There were some adjustments to our forecast between the February and March baselines, as the latest incorporates new assumptions around the effect of the military conflict between Russia and Ukraine. There are many scenarios on how the Russian invasion of Ukraine will unfold, each darker than the next, but the most likely scenario is that Russian troops will go no farther than Ukraine and any disruptions to oil, natural gas and other commodity markets will be limited and temporary. If so, the impact of the Russian invasion on the U.S. economy will be on the margins.

The U.S. banking and trade exposure to either Russia or Ukraine is very small. The primary channels through which the military conflict will adversely impact the U.S. economy is oil prices and financial market conditions. Europe's economy will be hit harder, but its economic recovery will continue. Russia, however, will suffer a debilitating recession, and for Ukraine's economy this is a catastrophe.

Smaller fiscal package

President Biden renamed his economic agenda from "Build Back Better" to "Building a Better America." Prior to Biden's first State of the Union, we revised our BBA assumptions in the March forecast. We no longer assume Democrats pass a $1.2 trillion package of social safety net and climate policies through budget reconciliation, but rather a $600 billion legislation. We jettisoned the following two provisions that had been included in the February forecast: $400 billion in Affordable Care Act premium credits and $200 billion in universal preschool investments.

The BBA package would pass by the end of the third quarter, with implementation starting in the fourth quarter. It would center around $330 billion in clean energy tax credits and $230 billion in direct federal spending to address climate change. The reconciliation bill would also modestly expand the Child Tax Credit by $40 billion by making it fully refundable on a permanent basis. The BBA would be a virtual nonevent for the economy in 2022, but its gross fiscal support would amount to 0.1% of GDP in 2023, peak at 0.25% in 2026, and settle at less than 0.2% by the end of a 10-year budget horizon.

Because we have rolled back the number of BBA investments, the March forecast also assumes a smaller number of pay-fors. We removed the following offsets that were previously part of the February forecast: a new excise tax applying to stock buybacks, higher taxes on global intangible low-taxed income for U.S. multinationals, and other international tax changes.

The March forecast still includes the following changes to the personal tax code: ensuring high-income business owners pay either the 3.8% Medicare tax or the 3.8% net investment income tax and limiting business loss deductions for noncorporate taxpayers. In addition, IRS funding would increase to improve tax compliance. Finally, prescription drug savings would solely come from repealing a Trump-era rule eliminating safe harbor from a federal anti-kickback law for rebates paid by pharmaceutical manufacturers to health plans and pharmacy benefit managers in Medicare Part D. We do not assume Democrats implement other prescription drug reforms such as allowing the federal government to negotiate drug prices in Medicare or requiring drug companies to pay rebates when annual increases in drug prices for Medicare and private insurance exceed the rate of inflation.

In sum, the BBA would include $700 billion in tax increases on well-to-do households, as well as prescription drug savings. As a result, it would lead to a net deficit reduction of $100 billion over the next 10 years. Our BBA assumption in the March forecast is broadly in line with recent comments by Senator Joe Manchin.

COVID-19 assumptions

We adjusted our epidemiological assumptions to anticipate that total confirmed COVID-19 cases in the U.S. will be 81 million, less than the 82.9 million in the February baseline. However, the number of assumed cases is still well above that assumed before the Omicron variant. The seven-day moving average of daily confirmed cases dropped sharply recently and was around 39,000, below its recent peak of 807,000 and among the lowest since July. The date for abatement of the pandemic, where total case growth is less than 0.05% per day, changed slightly, as it has already occurred. We had expected it to abate on April 4.

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

Oil bites into GDP

The March baseline factors in the recent jump in energy prices, and that led us to revise our forecast lower for U.S. GDP growth by 0.2 of a percentage point to 3.5% this year. We nudged up the forecast for GDP growth in 2023 from 3% to 3.1%.

The bulk of the downward revision was in the second quarter, when real GDP is expected to rise 4.8% at an annualized rate, compared with the 6.1% in the February baseline forecast. We now expect oil prices to peak in the second quarter, with West Texas Intermediate crude oil prices averaging $100 per barrel. Our rule of thumb is that every $10 increase in the per barrel price of oil increases U.S. retail gasoline prices by 30 cents a gallon. Every penny increase in retail gasoline prices reduces consumer spending by about $1.5 billion over the course of a year.

GDP growth in the second half of this year will average 2.7% at an annualized rate. The Bloomberg consensus is for real GDP to increase 3.6% this year and 2.4% in 2023.

Oil prices, financial market conditions, inventories, and global supply-chain issues remain downside risks to the near-term forecast. While inventories played an enormous role in the gain in fourth-quarter GDP, they are on track, along with net exports, to be a significant drag on growth early this year. Our high-frequency GDP model's tracking estimate of first-quarter GDP growth keeps heading south, but it has nothing to do with recent geopolitical events. Currently, first-quarter GDP is on track to rise 0.5% at an annualized rate.

Business investment and housing

Fundamentals have turned less supportive for business investment as corporate credit spreads continue to widen. However, corporate profit margins are fairly wide, and banks are easing lending standards.

We have real business equipment spending rising 7.3% this year, compared with 8.2% in the February baseline. The forecast is for real business equipment spending to increase 5.6% in 2023, a touch stronger than the 5.4% gain in the February baseline forecast.

Risks are weighted to the downside for nonenergy business investment, as financial markets could tighten more than we anticipate and corporate credit spreads widen further. The correlation coefficient between monthly changes in the high-yield corporate bond spread and changes in the S&P 500 is -0.71 since 2000. The relationship is still strong if we look at it on a weekly basis. Using no and various lags, the Granger causality tests showed changes in the S&P 500 caused changes in the high-yield corporate bond spread. The causal relationship runs in one direction.

The real nonresidential structures investment is now expected to increase 14.4% this year, compared with the 11% gain in the February forecast. Some of the upward revision is the boost to business investment from higher energy prices, primarily in mining exploration, shafts and wells. The Bureau of Economic Analysis uses the American Petroleum Institute's weighted average of footage drilled along with rotary rig counts from Baker Hughes in its current-quarter estimate of private fixed investment in mining exploration, shafts and wells. This segment now accounts for more than 10% of nominal private fixed investment in nonresidential structures. Therefore, a rise in energy prices would lead to an increase in the number of active rotary rigs.

Separately, growth in the Commercial Property Price Index was revised higher; it is now expected to increase 8.6% this year, compared with 5.2% in the February baseline. We raised the forecast next year from 2% to 7.7%.

Revisions to housing starts were small. Housing starts are expected to be 1.81 million, compared with 1.84 million in the February baseline. Revisions to housing starts next year were also modest. Risks are heavily weighted to the downside. There are likely only so many homes that can be built each year because of labor-supply constraints and lack of buildable lots. Some of the labor-supply issues will ease as the pandemic winds down, but the reduction in immigration is particularly problematic for homebuilders' ability to find workers. Revisions to the forecast for new- and existing-home sales this year were minor, as mortgage rates haven't risen either fast or high enough to cut noticeably into sales.

We nudged up the forecast for the FHFA All-Transactions House Price Index this year, with it rising 11.5%, compared with 9.8% in the February baseline. House price growth moderates noticeably in 2023, as prices are forecast to rise 2.3%, a touch weaker than the 2.4% in the February baseline. This is attributable to rebalancing of supply and demand.

Labor market

The February employment data are incorporated into the March baseline forecast. They led to minor tweaks to the forecast. We have job growth averaging 367,000 per month this year, compared with the February baseline forecast of 384,000. There weren't material changes to the forecast for the unemployment rate this year, as it is still expected to average 3.4% in the final three months of this year and 3.4% in the fourth quarter of next year.

We assume a full-employment economy is one with a 3.5% unemployment rate, around a 62.5% labor force participation rate, and an 80% prime-age employment-to-population ratio. All of these conditions will be met by late this year or early next.

Fed sticks to its plan

Federal Reserve Chair Jerome Powell was explicit during his semiannual testimony to the House Committee on Financial Services. He took away all uncertainty about the outcome of March's Federal Open Market Committee meeting by throwing his support behind a 25-basis point rate hike and saying that plans to reduce the size of the balance sheet will not be finalized.

Normally, Fed chairs avoid tipping their hands, as it could be seen as front-running the FOMC. However, Russia's invasion of Ukraine has caused a lot of volatility in financial markets and created new uncertainty. Therefore, Powell likely wanted to reduce any uncertainty about the Fed's intention at its upcoming meeting. Powell did leave the door open for larger rate hikes at future meetings.

He sounded optimistic that the Fed can engineer a soft landing, where it raises interest rates enough to curb inflation but not enough to tip the economy into recession. Powell floated the idea that this tightening cycle will end above his estimate of the neutral fed funds rate of 2% to 2.5%.

We maintained our assumption that the Fed raises the target range for the fed funds rate four times this year, 25 basis points each time. Markets are pricing in more hikes, just south of seven hikes over the next 12 months. The tightening in financial market conditions did some of the Fed's work for it. The primary channel through which monetary policy impacts the economy is financial markets. With financial market conditions tightening, the Fed doesn't need to do as much this year.

The Fed is also expected to begin quantitative tightening this summer. That is, the central bank will not replace the Treasury and mortgage securities it owns as they mature or prepay, allowing its balance sheet to slowly shrink, and putting upward pressure on longer-term rates.

Risks are weighted toward more rate hikes this year. Higher energy prices are going to cause inflation to peak higher than we had previously expected. We look for year-over-year growth in the consumer price index to be 7.4% in the first quarter, compared with 7% in the February baseline. The inflation forecast follows a similar trajectory as past baseline forecasts, just higher. Inflation moderates through the remainder of the year, returning to the Fed's target in the first half of next year. Key to this forecast is that oil prices average $100 per barrel in the second quarter, with that being the peak. Also, supply-chain issues are expected to ease, leading to significant disinflation in goods prices.

We didn't make significant changes to the forecast for the 10-year Treasury yield. The forecast is that the Dow Jones Industrial Average incorporates the recent developments. The new baseline will have the Dow Jones Industrial Average lower than its February baseline. The recent decline accounted for the bulk of the decline we expected to occur throughout the year. Therefore, the March baseline has another leg lower in equity prices, which we expect will remain within a tight range through the end of next year.

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ECB Set to Tighten Sooner

BY ROSS CIOFFI

The European Central Bank left its interest rate policy unchanged at its March meeting, but it tightened its Asset Purchase Program. The APP will still be expanded to €40 billion in April, as previously announced, but it will be reduced to €30 billion in May and to €20 billion in June. The ECB added that net purchases under the APP could end in the third quarter if the data support the view that medium-term inflation will remain above target. Although the bank's statement also implied that net asset purchases could be increased if needed, the fact that the ECB singles out the third quarter and only hints at this possibility of expansion are slightly more hawkish details.

That said, there was no major change to the guidance on interest rates, and the ECB stated that it would hike rates only "some time after the end of the Governing Council's net purchases under the APP and [it] will be gradual." This is the ECB saying that it does not plan a rate hike in the third quarter, contrary to what many market participants have been betting. This does not rule out an earlier rate hike though, and indeed, following the ECB's initial press release, September Euribor futures reflect that markets are still betting on a September rate hike.

During the press conference, the ECB spoke about how the Russia-Ukraine conflict will affect the economy. The conflict will disrupt trade lines, hit sentiment, and add to already-strong inflation pressures. The ECB raised its inflation forecast to 5.1% for 2022, up from its previous forecast of 3.2%. This comes in under our revised March baseline forecast of a 5.9% inflation rate for 2022. Meanwhile, the ECB's new forecast for GDP came in at 3.7% for 2022, down from 4.2%. The ECB's forecast is slightly above our March baseline forecast of a 3.6% increase.

EC proposes break from Russian gas

The European Commission announced its RePowerEU plan on March 8, which includes the goal to end Europe's reliance on Russian natural gas before 2030. The Commission cannot unilaterally impose action here, but instead it offers proposals for member states to take or for the European Parliament and Council to vote on. If member states enacted its proposals now, the EC estimates that gas imports from Russia could be reduced by two-thirds by the end of this year.

According to the plan, the main ways to do this would be to reduce consumption of gas—which will happen this year already given the price shock—to increase renewable energy production, and to substitute Russian natural gas with non-Russian imports and liquefied natural gas imports. LNG capacity is high in Europe, but not in every country, so investments would be needed to expand the intake and transfer network. Germany, for example, has no LNG import terminal, and although it recently started construction on a new terminal, following earlier statements by the energy minister for the Lower Saxony region, Olaf Lies, it will not be operational until 2024.

Even before the invasion in Ukraine, there was uncertainty about Europe's ability to replenish its gas reserves before next winter. We expect member states will take actions to lower their energy dependence on Russia even without the Commission's proposal. But either way, it is difficult to imagine how Europe arrives at next October with reserves 90% full, also one of the proposals made by the European Commission. Decoupling from Russian gas will require investment, which should offer some support to investment demand and government spending in the euro zone. That said, households will be faced with rising energy costs for the time being, so much so that we are expecting consumption to tangibly slow this year.

The costs of cutting gas imports from Russia will be high. Although the Commission's official announcement only alludes to these, it does mention that the Commission will extend the temporary "Energy Prices Toolbox" it announced last October; that is, the measures that member states can take to protect households. For example, member states will be able to regulate prices directly or grant direct support to firms, but again this is all in the context of a temporary crisis framework.

Japan's Recovery Lacks Oomph

BY KATRINA ELL, STEFAN ANGRICK, XIAO CHUN XU and JEFF YU

Japan's GDP grew 1.1% q/q in the fourth quarter of 2021, a more modest improvement than the 1.3% growth initially estimated and a disappointing result considering expectations for a modest upward revision. The downward revision is primarily the result of slower private consumption growth and larger drops in government consumption and investment. A more modest quarter-on-quarter increase in consumption aligns better with monthly metrics of household spending, but the remaining revisions will probably leave analysts scratching their heads.

Most notably, business investment was downgraded another 0.1 percentage point from an already-weak initial estimate of 0.4% q/q. This was a surprise, as the latest corporate financial statement survey showed that businesses increased capex spending (excluding software) by a seasonally adjusted 2.7% q/q in the final quarter of 2021. The rise was led by a 3.8% increase by manufacturers and a more modest 2.2% increase by non-manufacturers. Recent core private machinery orders have also been quite robust, even accounting for their large monthly volatility. Although business capex data in national accounts does not overlap perfectly with either indicator, the fairly large discrepancy is striking. Meanwhile, the downward revision to an already weak initial reading for government investment sits uncomfortably with the various investment projects announced under past fiscal packages.

Overall, the revised fourth-quarter reading illustrates that Japan's recovery continues to lack pace. With Omicron weighing down domestic demand in the first quarter of 2022, the likelihood of a renewed decline in GDP is high. And although the fading impact of 2021's supply disruptions will help exports and production in the first quarter, this is of little comfort; the Russia-Ukraine military conflict means renewed disruptions are on the horizon. Risks are firmly skewed to the downside.

China's simmering producer price pressures

Producer prices in China rose 8.8% y/y in February, easing from 9.1% y/y in the previous month. However, over the month, producer prices rose 0.5% m/m as a result of higher oil prices. The military conflict in Ukraine will further lift PPI inflation; skyrocketing world oil prices will filter through to factory gate prices in coming months. Aside from crude oil, there will also be significant disruptions to agricultural and mineral supply, which will lift prices and cause bottlenecks in supply chains.

Disruptions to the world oil supply caused by Russia will significantly impact China. Risk premium hikes caused the world oil price to soar. China is somewhat insulated by its large domestic energy sources and close ties with Russia, but uncertainty over energy security poses a significant downside risk. The government can order state-owned oil refineries to cut margins, thereby reducing fuel prices, and can offer subsidies to factories to ease the burden on SMEs. Nevertheless, this will likely force the government to delay or reduce plans for infrastructure building that was meant to make up for a lack of investment in property development.

Rising producer price inflation poses a challenge for the People's Bank of China. It is caught in two minds. China is suffering from demand drags, from the ongoing COVID-19 pandemic, and a slowing property sector in 2022. At the same time, surges in oil prices and disruptions to other agricultural and mineral supplies will raise producer price and consumer price inflation. If the war in Ukraine drags on, the PBoC may need to abandon its easing bias, and local governments may need to halt their infrastructure projects so that prices do not get out of control. This presents a major downside risk to growth for 2022. Even though we still think China can meet the 5.5% growth target for the year, it may require more stimulus in order to achieve it.

China's consumer prices remain subdued

China's consumer price inflation stayed subdued in February as year-over-year price increases remained unchanged at 0.9% in comparison with January. Food prices fell 3.9% y/y and nonfood prices rose 2.1% y/y. Food prices were dragged lower by pork, which was down by 42.5% y/y after a 41.6% y/y drop in January. Core inflation, which excludes food and energy, increased 1.1% y/y, a symptom of China's still subdued demand environment. In month-on-month terms, consumer prices increased 0.6%, a step up from 0.4% in January.

Although headline inflation pressures will likely gather steam in coming months from high commodity prices, including for energy, this is unlikely to deter the central bank from further easing. There is plenty of breathing space when it comes to inflation because the government's target for 2022 was maintained at 3%.

Western Europe Changes Are Broadly Negative

BY STEVEN SHIELDS

U.S.

Ratings activity continues to reflect improved corporate credit quality within the United States. For the period ended March 7, credit upgrades accounted for two-thirds of changes issued by Moody's Investors Service and more than 80% of the affected debt. Rating change activity spanned a diverse set of industrial groups, but two of the largest changes were made to energy firms.

Occidental Petroleum Corporation was the most notable change across the U.S. with its senior unsecured debt raised to Ba1 from Ba2 as its positive outlook was maintained. The stronger credit rating reflects stronger earning in 2021 as oil and gas prices increased combined with significant debt reduction funded by free cash flow and asset sales.

In a related move, Western Midstream Operating, LP's senior unsecured notes rating were also lifted to Ba1 from Ba2. According to Moody's Vice President James Wilkins, "The upgrade for WES Operating reflects a similar change to the Corporate Family Rating for Occidental Petroleum, WES Operating's primary customer and owner of Western Midstream Holdings LLC, which owns the general partner interest in WES Operating's parent company." After Moody's issued widespread downgrades to the oil and gas firms at the onset of the COVID-19 pandemic, industry upgrades outnumbered downgrades 2:1 in 2021.

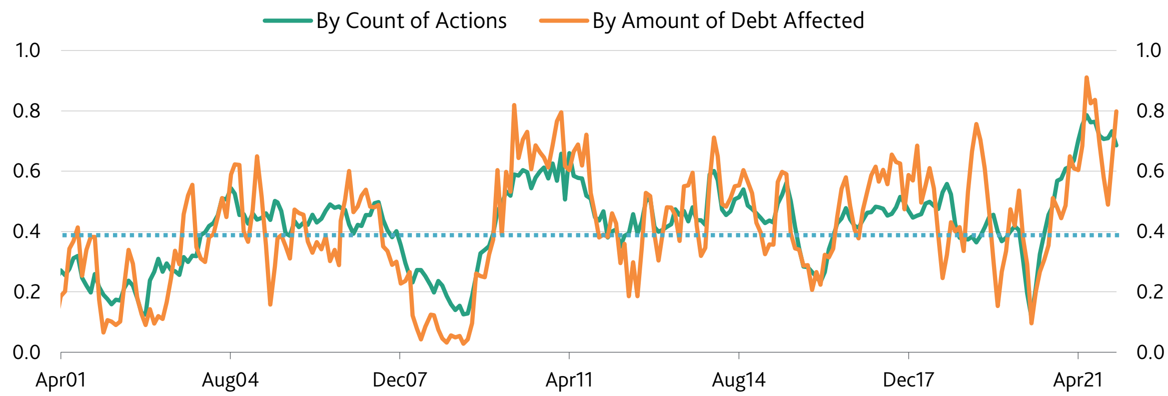
Europe

Across Western Europe, ratings activity was broadly negative with downgrades accounting for five of seven changes and most of the debt affected in period. Telcom Italia S.p.A. was by far the largest change in the region with the downgrade affecting approximately $22.2 billion in debt. Moody's Investors Service lowered the senior unsecured debt instruments for Telecom Italia and its subsidiaries to Ba3 from Ba2. This rating action follows the firm's release of 2021 results, which showed weaker than expected credit metrics due to the exposure of highly competitive market conditions in the Italian market and negative impact from Telcom Italia's content strategy.

In positive news, Obrascon Huarte Lain S.A.'s senior secured notes were raised to B3 from Caa2. The two-notch upgrade incorporates the repayment of the Spanish-government guaranteed loan, which ranked ahead of the bondholders in Moody's priority of claim analysis. Following this repayment in early 2022, the group's capital structure consists primarily of a single class of debt, and the instrument rating and corporate family rating are therefore aligned.

RATINGS ROUND-UP

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



* Trailing 3-month average

Source: Moody's

FIGURE 2
Rating Key

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

FIGURE 3

Rating Changes: Corporate & Financial Institutions - US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/SG
3/3/2022	LSB INDUSTRIES, INC.	Industrial	SrSec/LTCFR/PDR	700.00	U	B3	B2	SG
3/3/2022	D.R. HORTON, INC.	Industrial	SrUnsec	3150.00	U	Baa2	Baa1	IG
3/3/2022	GEO GROUP, INC.	Industrial	SrUnsec/SrSec/BCF/ LTCFR	900.00	D	B2	Caa1	SG
3/4/2022	R.R. DONNELLEY & SONS COMPANY	Industrial	SrUnsec/LTCFR/PDR	1137.05	D	B3	Caa1	SG
3/4/2022	OCCIDENTAL PETROLEUM CORPORATION	Industrial	SrUnsec/LTCFR/PDR/ MTN	28118.85	U	Ba2	Ba1	SG
3/4/2022	SINCLAIR BROADCAST GROUP, INC.-DIAMOND SPORTS GROUP, LLC	Industrial	SrSec/BCF	6100.00	D	Caa1	Caa3	SG
3/4/2022	WESTERN MIDSTREAM OPERATING, LP	Industrial	SrUnsec/LTCFR/PDR	6855.30	U	Ba2	Ba1	SG
3/7/2022	ZIONS BANCORPORATION	Financial	LTIR/LTD	240.00	U	Baa2	Baa1	IG
3/8/2022	PENNYMAC FINANCIAL SERVICES INC.	Financial	SrUnsec/LTIR/LTCFR	1800.00	U	B1	Ba3	SG

Source: Moody's

FIGURE 4

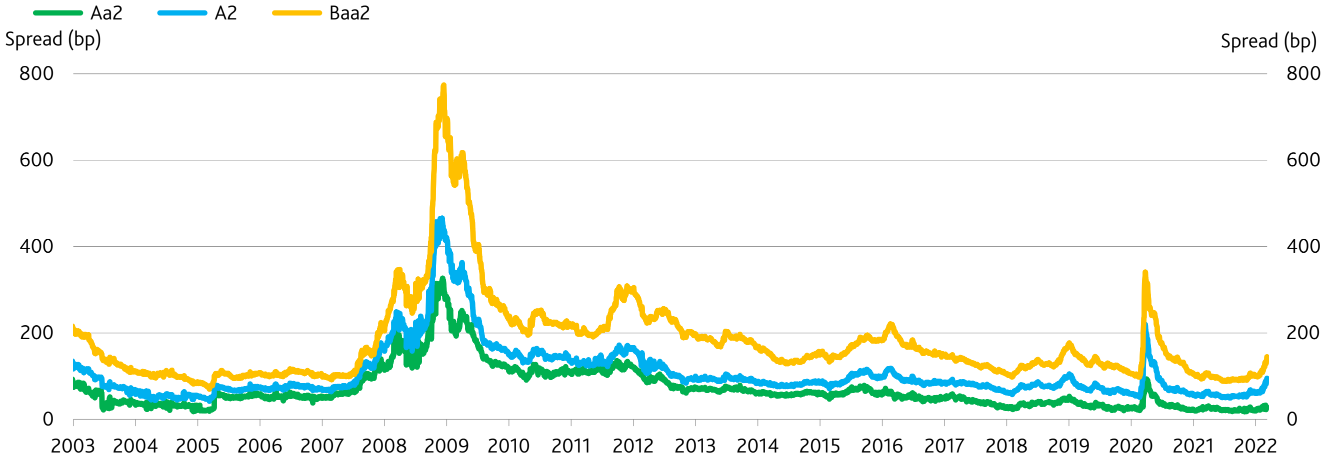
Rating Changes: Corporate & Financial Institutions - Europe

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG	Country
3/2/2022	ONTEX GROUP NV	Industrial	SrUnsec/LTCFR/PDR	675.49	D	B1	B2	SG	BELGIUM
3/3/2022	HOSPITAL COMPANY (DARTFORD) ISSUER PLC (THE)	Industrial	SrSec	210.07	D	A2	A3	IG	UNITED KINGDOM
3/3/2022	DIOCLE S.P.A.	Industrial	SrSec/LTCFR/PDR	362.79	U	B2	B1	SG	ITALY
3/4/2022	CONSORT HEALTHCARE (TAMESIDE) PLC	Industrial	SrSec	257.00	D	Ba2	B3	SG	UNITED KINGDOM
3/7/2022	SCHUR FLEXIBLES GMBH	Industrial	SrSec/BCF/LTCFR/PDR		D	B2	Caa3	SG	GERMANY
3/8/2022	OLIVETTI S.P.A. [OLD]-TELECOM ITALIA S.P.A.	Industrial	SrUnsec/LTCFR/PDR/ MTN	22239.48	D	Ba2	Ba3	SG	ITALY
3/8/2022	OBRASCON HUARTE LAIN S.A.	Industrial	SrSec/LTCFR/PDR	1134.37	U	Caa2	B3	SG	SPAIN

Source: Moody's

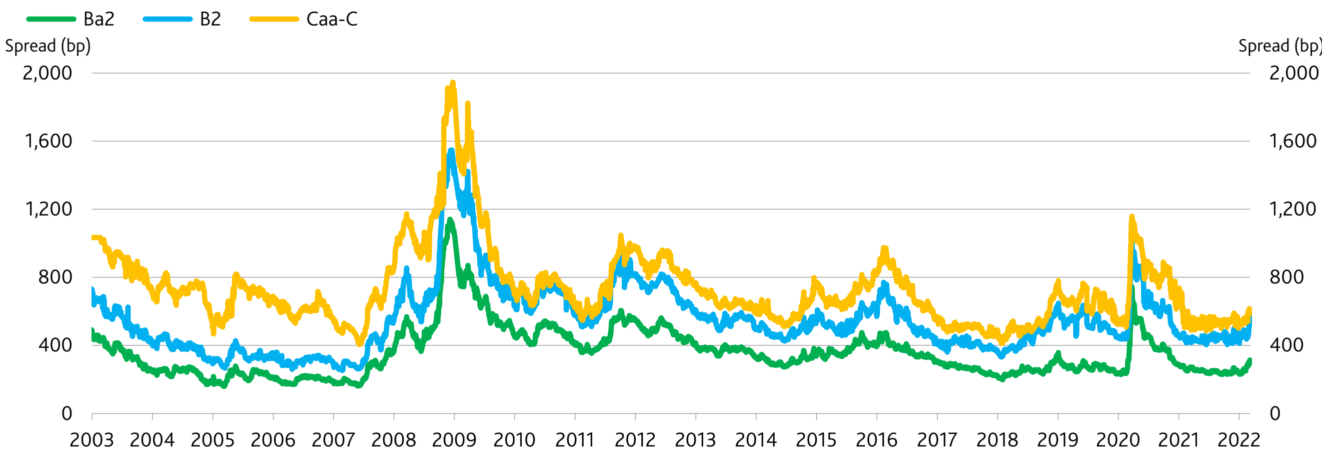
MARKET DATA

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



Source: Moody's

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



Source: Moody's

CDS MOVERS

Figure 3. CDS Movers - US (March 2, 2022 – March 9, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Mar. 9	Mar. 2	Senior Ratings
Comcast Corporation	A3	Baa1	A3
PepsiCo, Inc.	Aa1	Aa2	A1
Enterprise Products Operating, LLC	A3	Baa1	Baa1
American Tower Corporation	Baa3	Ba1	Baa3
Southern California Edison Company	Baa3	Ba1	Baa2
CCO Holdings, LLC	Ba1	Ba2	B1
Cox Communications, Inc.	A3	Baa1	Baa2
Eli Lilly and Company	Aa1	Aa2	A2
Williams Companies, Inc. (The)	Baa2	Baa3	Baa2
Becton, Dickinson and Company	A3	Baa1	Baa3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Mar. 9	Mar. 2	Senior Ratings
CenterPoint Energy, Inc.	Baa2	A3	Baa2
PepsiCo, Inc.	A2	A1	A1
Philip Morris International Inc.	A2	A1	A2
General Electric Company	Baa3	Baa2	Baa1
Eli Lilly and Company	Aa2	Aa1	A2
FirstEnergy Corp.	Baa3	Baa2	Ba1
Emerson Electric Company	Baa1	A3	A2
Danaher Corporation	A3	A2	Baa1
Archer-Daniels-Midland Company	A2	A1	A2
United Rentals (North America), Inc.	Ba2	Ba1	Ba2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Mar. 9	Mar. 2	Spread Diff
Talen Energy Supply, LLC	Caa2	5,201	4,721	480
American Airlines Group Inc.	Caa1	1,168	881	287
United Airlines, Inc.	Ba3	733	509	224
Staples, Inc.	Caa2	1,228	1,036	192
United Airlines Holdings, Inc.	Ba3	654	519	135
Rite Aid Corporation	Caa2	1,366	1,233	133
Carnival Corporation	B2	587	472	115
Delta Air Lines, Inc.	Baa3	405	311	94
Goodyear Tire & Rubber Company (The)	B2	395	311	85
Nissan Motor Acceptance Company LLC	Baa3	240	159	81

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Mar. 9	Mar. 2	Spread Diff
Nabors Industries, Inc.	Caa2	523	571	-48
Lumen Technologies, Inc.	B2	474	488	-13
Domtar Corporation	Ba3	393	405	-12
Progress Energy, Inc.	Baa1	10	20	-10
Universal Health Services, Inc.	Ba2	136	143	-7
Qwest Corporation	Ba2	257	264	-7
Occidental Petroleum Corporation	Ba1	145	150	-6
Embarq Corporation	Ba2	278	284	-5
Plains All American Pipeline L.P.	Baa3	185	189	-4
Apache Corporation	Ba1	152	157	-4

Source: Moody's, CMA

CDS Movers

Figure 4. CDS Movers - Europe (March 2, 2022 – March 9, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Mar. 9	Mar. 2	Senior Ratings
Italy, Government of	Baa2	Baa3	Baa3
Spain, Government of	Aa2	Aa3	Baa1
Societe Generale	A2	A3	A1
Portugal, Government of	Aa2	Aa3	Baa2
UniCredit S.p.A.	Baa2	Baa3	Baa1
Greece, Government of	Baa3	Ba1	Ba3
Nordea Bank Abp	Aa1	Aa2	Aa3
Norddeutsche Landesbank GZ	Baa1	Baa2	A3
KBC Group N.V.	Baa1	Baa2	Baa1
KBC Bank N.V.	Aa3	A1	A1

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Mar. 9	Mar. 2	Senior Ratings
EnBW Energie Baden-Wuerttemberg AG	A3	Aa2	Baa1
ENGIE SA	Baa2	A2	Baa1
Telecom Italia S.p.A.	B2	Ba3	Ba3
BASF (SE)	A3	A1	A3
RWE AG	Baa2	A3	Baa2
National Grid plc	A3	A1	Baa2
Scottish Power UK plc	A1	Aa2	Baa1
ENGIE Alliance	Baa2	A3	Baa1
Credit Agricole S.A.	A1	Aa3	Aa3
Erste Group Bank AG	Baa1	A3	A2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Mar. 9	Mar. 2	Spread Diff
Boparan Finance plc	Caa1	2,131	1,841	290
Vue International Bidco plc	Ca	790	648	142
Jaguar Land Rover Automotive Plc	B1	550	442	108
Telecom Italia S.p.A.	Ba3	376	281	96
Piraeus Financial Holdings S.A.	Caa2	686	609	78
Deutsche Lufthansa Aktiengesellschaft	Ba2	344	273	71
Telefonaktiebolaget LM Ericsson	Ba1	212	149	63
Renault S.A.	Ba2	323	280	43
Fortum Oyj	Baa2	159	116	42
Premier Foods Finance plc	B3	333	296	37

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Mar. 9	Mar. 2	Spread Diff
CMA CGM S.A.	B2	403	441	-39
Casino Guichard-Perrachon SA	Caa1	990	1,012	-22
Leonardo S.p.A.	Ba1	172	185	-13
BAWAG P.S.K. AG	A2	72	82	-9
Hammerson Plc	Baa3	235	242	-7
Greece, Government of	Ba3	126	132	-5
Sappi Papier Holding GmbH	Ba2	332	337	-5
Thales	A2	48	52	-4
Portugal, Government of	Baa2	38	42	-3
Novo Banco, S.A.	Caa2	166	169	-3

Source: Moody's, CMA

CDS Movers

Figure 5. CDS Movers - APAC (March 2, 2022 – March 9, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Mar. 9	Mar. 2	Senior Ratings
China, Government of	A2	A3	A1
Sumitomo Mitsui Banking Corporation	Aa1	Aa2	A1
Philippines, Government of	Baa2	Baa3	Baa2
Malaysia, Government of	Baa1	Baa2	A3
China Development Bank	Baa1	Baa2	A1
Telstra Corporation Limited	A1	A2	A2
Industrial & Commercial Bank of China Ltd	Baa1	Baa2	A1
Bank of China Limited	Baa1	Baa2	A1
Woolworths Group Limited	A3	Baa1	Baa2
SK Hynix Inc.	Baa2	Baa3	Baa2

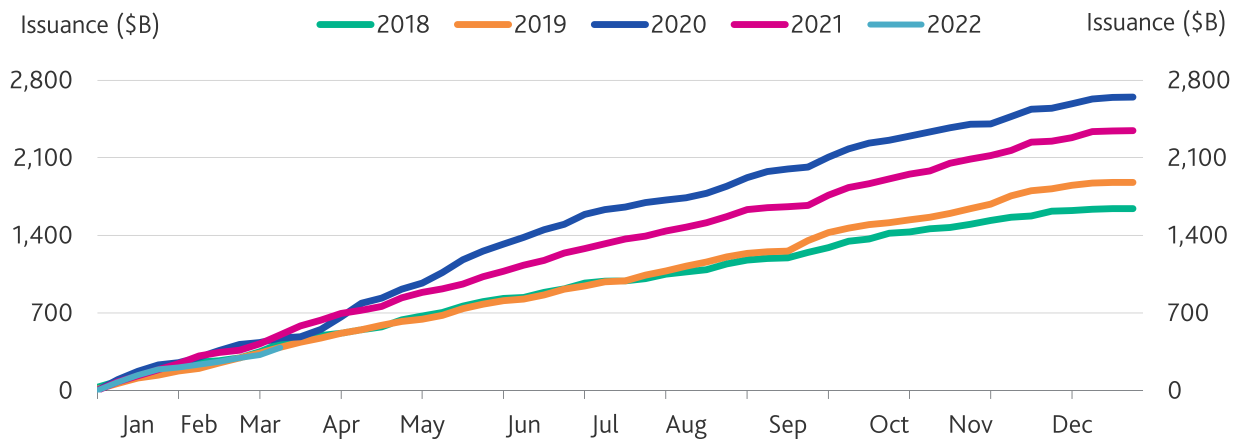
CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Mar. 9	Mar. 2	Senior Ratings
Pakistan, Government of	Caa3	B3	B3
Development Bank of Kazakhstan	B3	Ba3	Baa2
Honda Motor Co., Ltd.	A3	Aa3	A3
JFE Holdings, Inc.	Baa1	A2	Baa3
Kazakhstan, Government of	Ba3	Ba1	Baa2
NIPPON STEEL CORPORATION	A2	Aa3	Baa2
Tokyo Electric Power Company Holdings, Inc.	Baa1	A2	Ba1
Mitsui & Co., Ltd.	A1	Aa2	A3
Panasonic Corporation	A1	Aa2	Baa1
PTT Global Chemical Public Company Limited	A2	Aa3	Baa2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Mar. 9	Mar. 2	Spread Diff
Pakistan, Government of	B3	856	495	361
Development Bank of Kazakhstan	Baa2	492	246	246
Kazakhstan, Government of	Baa2	274	137	137
Nissan Motor Co., Ltd.	Baa3	171	101	70
Nippon Yusen Kabushiki Kaisha	Ba3	83	54	30
SoftBank Group Corp.	Ba3	387	359	28
Mitsui O.S.K. Lines, Ltd.	B1	97	76	22
Honda Motor Co., Ltd.	A3	57	39	18
Tokyo Electric Power Company Holdings, Inc.	Ba1	66	49	17
Halyk Savings Bank of Kazakhstan	Ba2	385	367	17

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Mar. 9	Mar. 2	Spread Diff
SK Innovation Co. Ltd.	Baa3	98	102	-4
China, Government of	A1	55	57	-2
Indonesia, Government of	Baa2	105	107	-1
New Zealand, Government of	Aaa	17	18	-1
GPT RE Limited	A2	56	57	-1
MTR Corporation Limited	Aa3	34	34	0
Asahi Group Holdings, Ltd.	Baa1	27	27	0
Australia, Government of	Aaa	16	15	0
Sumitomo Mitsui Banking Corporation	A1	31	31	0
Industrial & Commercial Bank of China Ltd	A1	73	73	0

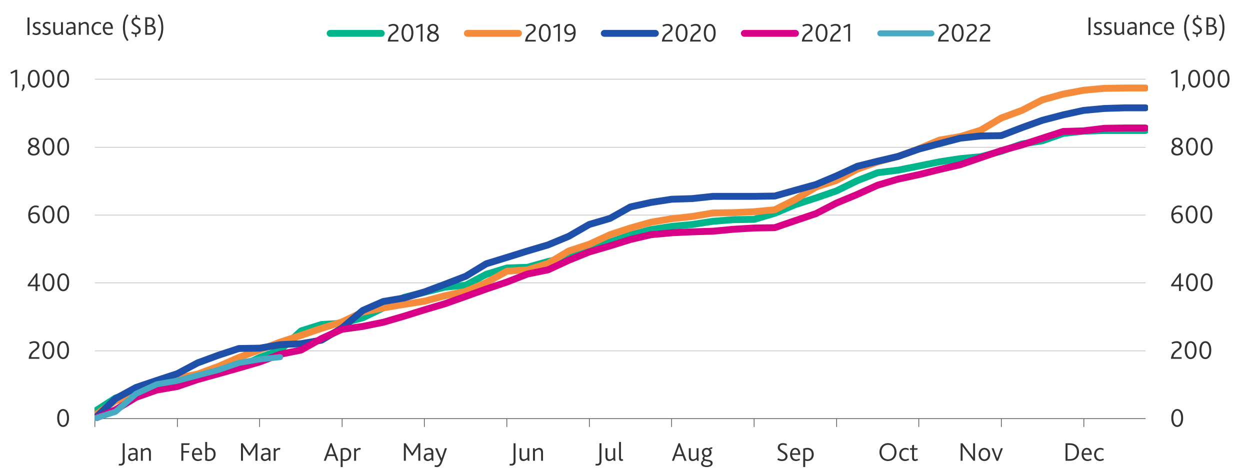
Source: Moody's, CMA

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



Source: Moody's / Dealogic

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



Source: Moody's / Dealogic

ISSUANCE

Figure 8. Issuance: Corporate & Financial Institutions

	USD Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	62.650	2.455	65.627
Year-to-Date	327.040	47.496	386.995

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	6.109	0.000	6.109
Year-to-Date	166.879	12.951	180.856

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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Editor
Reid Kanaley
help@economy.com

Contact Us
Americas
+1.212.553.1658
clientservices@moodys.com

Europe
+44.20.7772.5454
clientservices.emea@moodys.com

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

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