MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

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The minutes from the June meeting of the Federal Open Market Committee didn't contain a ton of surprises. The central bank is worried that if it doesn't aggressively remove monetary policy accommodation, inflation could become entrenched. Participants judged a 50- or 75-basis point rate hike at the July meeting would be appropriate. The minutes are dated, and inflation expectations have dropped recently along with commodity prices. Still, the incoming data on consumer prices could determine if it is a 50- or 75-basis point rate hike. The minutes noted that policy would need to be even more restrictive.

Since the minutes, market-based measures of inflation expectations have dropped and are consistent with where the Fed would want them. Also, the jump in the University of Michigan's measure of inflation expectations, which spooked the Fed, has been revised away. The June CPI will likely determine how aggressive the Fed is this month. Our preliminary forecast is for the CPI to have risen 1.1% between May and June. This would be the second consecutive monthly gain of at least 1%.

There were a few references to tighter financial market conditions, which are doing some of the work for the Fed. Monetary policy primarily affects the economy via financial market conditions. Therefore, the Fed is getting exactly what it wants: lower stock prices, higher Treasury yields, and wider corporate bond spreads

Pause is possible

The front-loading of rate hikes gives the Fed the flexibility to pause, which the minutes alluded to. Once the target range for the fed funds rate is at its neutral rate of 2.5%, the Fed may pause to assess how the removal of monetary policy is affecting the economy, inflation and the outlook.

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Fed officials don't seem concerned about a recession. There was no reference to recession in the minutes. Also, the Fed described the labor market as very tight. The minutes did highlight some downside risks to the outlook, including further tightening in financial market conditions that would be a larger drag on the economy. This is a subtle sign that the Fed has financial market conditions roughly where it would like them and further tightening could concern the central bank.

Fed gives shout out to GDI

The Fed didn't avoid discussing the drop in first-quarter GDP and the prospect that it didn't do well in the second quarter. However, the minutes referenced gross domestic income, which has held up better than GDP.

GDP May Ultimately Be Revised Up

Sources: BEA, Moody's Analytics

The difference between real GDP and real GDI, also known as the statistical discrepancy, has never been so large. The Bureau of Economic Analysis, the government agency that constructs these estimates, may be having an especially difficult time accurately measuring real GDP in the pandemic given the resulting big swings in global trade and inventories. If so, the BEA could ultimately revise GDP up to be more consistent with real GDI. It is also possible that the BEA is overstating corporate profits. The strength of GDI is likely one reason the Fed doesn't seem concerned about a recession.

High-yield spreads will widen further

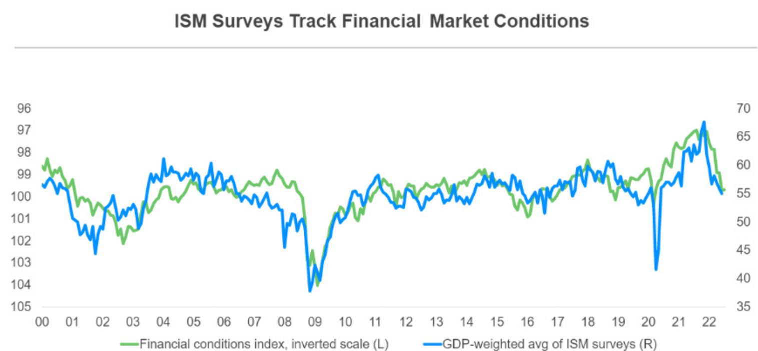
U.S. high-yield corporate bond spreads have widened noticeably this year and likely have not peaked as the economy continues to cool and volatility in equity markets remains above historical averages. The current high-yield corporate bond spread would put the odds of a recession at 33%. This would potentially be a reason for optimism, since the credit cycle normally leads the economic cycle. However, the investment-grade corporate bond spreads put the recession odds at 52%.

For now, volatility isn't out of line with economic fundamentals. To estimate the level of the VIX consistent with fundamentals, we model the monthly average of the VIX using an ordinary least squares regression. Independent variables include the GDP-weighted average of the ISM surveys, financial market stress, a dummy variable for recessions, and U.S. economic policy uncertainty.

The results were in line with our a priori, as all coefficients had the expected sign. All were statistically significant and had an adjusted r-squared of 0.62. The regression was re-estimated, but we replaced U.S. economic policy uncertainty with global policy uncertainty. The assumption is that uncertainty abroad would affect volatility in U.S. equity markets. However, the results showed this explained less of the variation in the VIX than U.S. policy uncertainty.

Overall, the VIX isn't out of line with fundamentals, so the widening in spreads for high-yield corporate bonds shouldn't be surprising. A model we built to forecast high-yield corporate bond spreads uses the ISM surveys, and odds are that they will decline further, implying further widening in the spreads. The high-yield corporate bond spread is currently 583 basis points, more than an average spread of 350 basis points outside of a recession.

ISM Surveys Track Financial Market Conditions



Sources: ISM, Moody's Analytics

Spreads are still noticeably tighter than the 1,000-point average spread during the past three recessions. The baseline forecast doesn't assume a recession, therefore spreads shouldn't come anywhere close to the average seen over the past three recessions. Though U.S. GDP could decline in the first half of this year, other data don't signal a recession, including the ISM manufacturing and nonmanufacturing surveys.

Both of the ISM surveys declined in June, but neither are near levels that have historically signaled a recession. The GDP-weighted average of the ISM surveys tracks financial market conditions. Financial market stress so far in July points to further ISM survey declines, though they would not be as significant as in prior months. There is still some cushion as the GDP-weighted average of the ISM surveys remains above its neutral threshold of 50.

TOP OF MIND

Is Emerging Market Inflation Peaking?

BY JESSE ROGERS

Large trade and current account surpluses have been a bubble wrap-like barrier for emerging economies, but fresh routs in emerging market currency, bond and equity markets are tearing at the padding. With fast-rising interest rates in both advanced and emerging economies stacking the deck against the emerging world, our call for most emerging economies to grow this year may seem foolhardy. But we stand with our cards firmly on the table. This is because inflation in most emerging economies has already peaked or will do so by summer's end, with falling food and energy prices pulling inflation lower.

This does not mean that price pressures will fully recede. While falling global food and energy prices will allow emerging market central banks to ease off the pedal, the cost of food staples, gasoline, and consumer-related services will remain elevated. This means that while most emerging economies will avoid recession, it certainly won't feel like it with elevated unemployment and still-large holes in incomes.

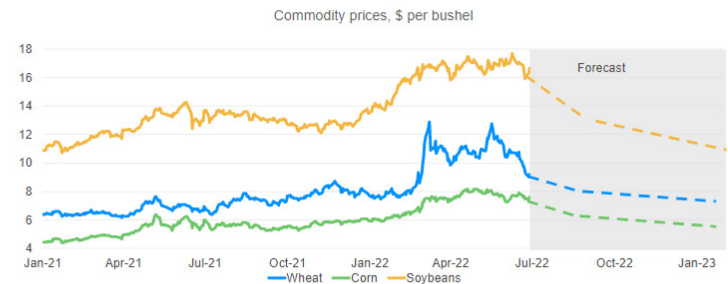
Calling inflation's peak

The next few inflation prints will mark the peak for inflation in the emerging world; by late summer year-on-year price gains will begin to ease. Most large economies in Latin America saw inflation budge a little in May—in Brazil and Colombia the pace of inflation actually decreased. We expect this pattern to play out in emerging Asia, Africa, and the Middle East, where inflation has been later to rise due to a combination of fuel subsidies and a period of falling food prices in Asia following Chinese farmers' near-three-year battle with swine flu. Things could take longer in emerging Europe, where labor markets are tighter and expectations of higher prices are more entrenched.

Two forces will work in conjunction to reduce price pressures. The first is the broader decline in commodity prices. This owes partly to the anticipation of a better wheat harvest in Australia, a bumper corn crop in Argentina and Brazil, and of another large soybean harvest in the U.S., and partly to commitments by global energy producers to raise crude oil production.

Also helping things is that by now, emerging economies highly dependent on food and energy imports from Ukraine and Russia have secured new supplies or found their way to discounts.

Food Prices Headed Lower



Sources: CME, Moody's Analytics

The second force is a more aggressive Federal Reserve, which has pushed up the dollar and reduced growth expectations. That in turn has pushed down inflation expectations and commodity prices. Because most commodities are priced in dollars, a stronger dollar tends to put downward pressure on prices.

There is little disagreement that commodity prices are now past their peak, and that action by the Fed and other major central banks will work to push them even lower. But there is less of a consensus that inflation in emerging markets will fall in kind. This is because of fears that inflation expectations have become perniciously ingrained in Latin America, Africa, and parts of emerging Europe and the Middle East. However, these concerns are based largely on the past experience of high and hyperinflation in these regions and ignores the fact that price pressures are not finding their way into wages.

What's needed to send inflation back up is a feedback loop between higher prices and demands for higher wages, known as a wage-price spiral. But growth in nominal wages in most emerging economies has so far been outpaced by inflation. This is the case in Latin America, where average real monthly pay is some 15% below the pre-pandemic peak, and in emerging Europe. The little wage data there is in Southeast Asia, Africa, and the Middle East points to this also being the case. The reason is that labor markets have yet to fully heal from the pandemic's blunt-force blow, robbing workers of the bargaining power they would need to push wages higher.

What about core?

Analysts are right to note that higher food and energy prices have spilled into the cost of other goods, pushing measures of core inflation—that is, inflation excluding food and energy—above central bank targets. But this is because food

and energy commodities are also key inputs into the broader basket of consumer goods and services. As these commodity prices fall, overall inflation will ease, putting less pressure on emerging market central banks to step on the gas and paving the way for growth to continue.

The price of unrest

That commodity prices will continue to move lower does not make up for the fact that today and tomorrow, they remain uncomfortably high. Take wheat, the commodity most shaken by Russia's invasion of Ukraine after oil—and one that is also critically important to the global economy. Amid anticipation of better harvests in Australia and faster tightening by the Fed, prices have fallen by almost half from all-time highs set earlier this year. But at $9 per bushel, wheat prices are still well above the average recorded during the 2004-2014 commodities boom.

Food insecurity has stoked resentment in wheat-hungry Egypt, Turkey and South Africa, and will be a thorn in the side of the frail recovery in other emerging economies. Frustration with rising living costs has propelled populist leaders to victory in recent presidential elections in Chile, Colombia, Peru and the Philippines and has shaken up the political landscape in Turkey. While there is little chance that new leaders will fundamentally alter the economic landscape in the near term, they will face pressure to counter higher living costs with budget-busting subsidies.

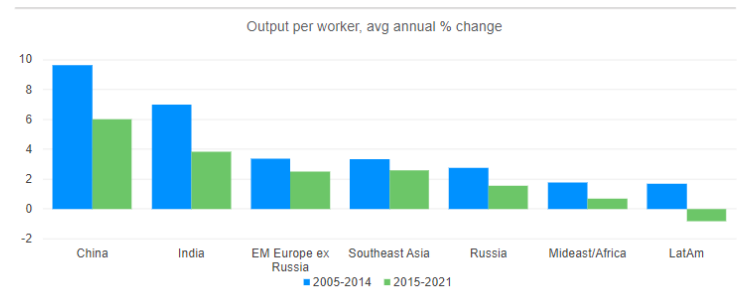
And things could get worse. The last time food prices were this high, social protests erupted across the emerging world, culminating in the Arab Spring and in protest movements in China and Iran. Today's political climate is even more volatile, the product of a decade of stagnation in most emerging economies and the prolonged blow from the COVID-19 pandemic. There is little patience for the kinds of changes that would get emerging economies moving again, mostly because they are less visible to ordinary voters and the payoff is down the road.

A harder landing to stick

We are confident that our call for emerging markets to grow this year is the right one, while remaining well aware that what's in store can hardly be called good growth, at least not of the kind needed to boost jobs and bolster incomes. We also caution that higher growth rates—especially in emerging Asia and the Middle East—are largely an illusion. Higher growth figures in India and Southeast Asia are largely a consequence of their bouts with the Delta and Omicron waves of the COVID-19 pandemic and the delayed recovery relative to the rest of the emerging world.

The Middle East is the sole emerging region where higher commodity prices will do more good than harm. But higher growth rates are largely a function of a faster-growing population rather than a rise in living standards. Like the rest of the emerging world, productivity has barely risen in the last decade, something that is dead evident in Latin America and most other emerging regions.

EM Productivity Falters



Sources: National statistics bureaus, central banks, Moody's Analytics

Things should not be this way. Textbook economics teaches that in a globalized economy, firms will exploit differences in wages and production costs to pad profits, driving faster economic growth along the way. This is the story of 21st-century China, but the rest of the emerging world has been less able to latch on. Despite calls to re-shore supply chains, China's dominance of global manufacturing will budge little—firms and workers in China are just too good at what they do. To grow and prosper, emerging economies will instead need to raise educational attainment, integrate the informal economy, and cultivate high-value-added services. This is a much harder landing to stick.

The Week Ahead in the Global Economy

U.S.

The U.S. economic calendar is busy next week and could determine whether the Federal Reserve raises the fed funds rate by 50 or 75 basis points at its meeting this month. The key will be the June consumer price index, which likely will rise by more than 1% for June because of a jump in retail gasoline prices. Excluding food and energy, the early consensus is for the CPI to have risen 0.6%, matching the increase in May. On a year-ago basis, the CPI will be up around 8.9% in June compared with 8.6% in May. We also get the University of Michigan consumer sentiment survey, and the Fed is very sensitive to inflation expectations.

Also, we'll get new data on producer and import prices. Once the CPI and PPI are released, we will have a good idea what the PCE deflator did in June. Other key data include retail sales, industrial production, the NFIB small business optimism index, and business inventories.

Europe

The U.K.'s GDP likely inched lower by 0.1% m/m in May, deepening the 0.3% decline in April. Surging inflation likely weighed on appetite to spend, while supply shortages likely continued to thwart output. Indeed, the country's PMI reading nosedived to 53.1 in May from 58.2 in the previous month.

Meanwhile, we expect that the euro zone's industrial output picked up by 0.4% m/m this May, the same as in April. Germany and Ireland's manufacturing sectors likely propped up the aggregate as those out of France and Spain were lackluster. Supply conditions evidently eased enough to allow output in the transport equipment sectors to recover during the month. Unfortunately, future conditions are not yet secured.

We do not expect any surprises from the final readings of next week's CPI releases. In Germany, we expect the inflation rate to have slowed to 7.6% y/y in June from 7.9% in May; in Spain we expect the rate jumped to 10.2% from 8.7%; in France it was likely up at 5.8% from 5.2%; and in Italy, inflation likely rose to 8% from 6.8%. We suspect a significant decrease in transport service prices in Germany, thanks to policies introduced to ease the cost of living, was one of the main reasons Germany's inflation rate decreased.

Finally, the euro zone's external trade balance likely reported another significant deficit in May. We anticipate a deficit of €33.3 billion for May, slightly worse than the prior month's €32.4 billion deficit. Imports likely continued to grow at a much quicker pace than exports. Oil and gas will continue to supercharge imports while exports are being weighed down by tight supply and weaker demand from abroad, namely China amidst that country's COVID-19 lockdowns.

Asia-Pacific

China's economic data barrage will be a highlight on the economic calendar. We expect the annual decline in retail trade to have moderated in June as aggressive movement controls that were a notable dampener on April data eased. Industrial production likely picked up modestly in the same month. Mining, manufacturing and utilities all improved in May, led by energy-related industries; this should repeat in June. Manufacturing and nonmanufacturing PMI data support our view that goods and services industries continued mending last month.

China's GDP growth likely moderated to 3.8% y/y in the second quarter from 4.8% in the March quarter, reflecting lockdowns and other pandemic-related controls in several large cities early in the period.

Central banks in New Zealand and South Korea are likely to lift benchmark rates by 50 basis points at their July policy meetings. The Reserve Bank of New Zealand is trying to anchor long-term inflation expectations. Demand-pull pressures are running beyond comfort levels and have pushed wage growth to a multiyear high. A 50-basis point increase would lift the official cash rate to 2.5% and take cumulative hiking this tightening cycle to 225 basis points. The Bank of Korea is contending with inflation that soared well beyond comfort levels in June to 6% y/y, its highest in almost 24 years. A 50-basis point hike would take BoK's policy rate to 2.25%.

Households in New Zealand and South Korea are relatively highly leveraged, making them sensitive to aggressive rises in borrowing costs. Higher lending rates as well as elevated prices for nondiscretionary items such as food will put more pressure on consumption in those markets.

Geopolitical Calendar

Date	Country	Event	Economic Importance	Financial Market Risk
Jun/Jul	Papua New Guinea	National general election	Low	Low
Jul	Japan	House of Councillors election	Medium	Low
12-14-Jul	Pacific Islands Forum	Pacific Islands Forum leaders' meeting	Low	Low
21-Jul	Mercosur	Mercosur 2022 Summit	Low	Low
4-Sep	Chile	Referendum on New Constitution	Medium	Low
2-Oct	Brazil	Presidential and congressional elections	High	Medium
Oct/Nov	China	National Party Congress	High	Medium
7-18-Nov	U.N.	U.N. Climate Change Conference 2022 (COP 27)	Medium	Low
15-16-Nov	G-20	G-20 Heads of State and Government Summit, hosted by Indonesia	Medium	Low
18-19 Nov	APEC	Economic Leaders' Meeting, hosted by Thailand	Low	Low

Corporate Bond Issuance Weakens for Q2

BY RYAN SWEET

CREDIT SPREADS

Moody's long-term average corporate bond spread is 166 basis points, compared with the 160 bps this time last week. The spread is slightly wider than the 155 bps average in June. The long-term average industrial corporate bond spread narrowed by 5 bps to 150. It averaged 141 bps in June.

The ICE BofA U.S. high-yield option adjusted bond spread widened from 562 basis points to 580 bps, the widest since mid-2020. The Bloomberg Barclays high-yield option adjusted spread widened this past week from 549 to 566 bps. The high-yield option adjusted bond spreads approximate what is suggested by the accompanying long-term Baa industrial company bond yield spread but are wider than implied by a VIX of 25.9. The VIX fell over the course of the past week.

DEFAULTS

Defaults rose in May as nine Moody's-rated corporate debt issuers defaulted, up from April's revised count of five. The May defaults lifted the global speculative-grade default rate to 2.1% for the trailing 12 months ended in May from 1.9% a month earlier. Six of the month's defaults came from advanced markets and three were from emerging markets.

The year to date global corporate default tally was 39 through May, up from 26 in the same period last year. Across sectors, Construction & Building, with nine defaults, is the largest contributor to defaults so far this year. The banking sector followed with eight. By region, North America had 17 defaults (16 in the U.S. and one in Canada). The rest were from Europe (11), Asia-Pacific (nine) and Latin America (two).

Moody's Credit Transition Model predicts that the trailing 12-month global speculative-grade corporate default rate will rise to 2.8% by the end of 2022 and then climb to 3.3% by May 2023. If realized, these forecast rates would remain below the long-term average of 4.1%.

U.S. CORPORATE BOND ISSUANCE

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

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

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

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

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

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

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

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

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

In the second quarter, corporate bond issuance weakened. Worldwide offerings of investment grade corporate bonds totaled $548 billion, down 21% on a year-ago basis. US$ denominated high-yield corporate bond issuance was $38 billion in the second quarter, down from $63 billion in the first three months of the year. High-yield issuance is down 79% on a year-ago basis.

In the week ended July 1, US$-denominated high-yield issuance totaled $0.788 billion. This brings the year-to-date total to $98.2 billion. Investment-grade bond issuance totaled $11.5 billion in the same week. This brings its year-to-date total to $805.8 billion. Issuance is still tracking that seen in 2018 and 2019.

U.S. ECONOMIC OUTLOOK

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

Fiscal assumptions

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

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

COVID-19 assumptions

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

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

Energy price assumptions

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

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

Nudging GDP lower

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

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

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

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

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

Business investment and housing

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

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

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

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

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

Labor market

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

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

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

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

Monetary policy

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

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

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

Boris Johnson as Caretaker PM

BY ROSS CIOFFI

U.K. Prime Minister Boris Johnson resigned on Thursday but vowed to stay on as a caretaker until a new leader is selected. There will be more details about the timetable for finding a new prime minister next week. Although Johnson's resignation creates a period of additional uncertainty for the U.K., we are not making changes to our forecast in response to Thursday's news. Whoever takes over will need to refocus policy on addressing the key risks to the economy, such as the cost-of-living squeeze, and the country's longer-term challenges.

German industry grows

German industrial production expanded 0.2% month on month in May, following April's 1.3% growth—an upward revision from the initial estimate of 0.7%. However, output remains 2.7% below February's level. Excluding energy production, manufacturing would have expanded by 0.6%. This was supported by a rebound in transport equipment production, up 5.5%. Shortages of intermediate products, cost pressures, slowing global demand and heightened uncertainty weigh on prospects for the manufacturing sector in the second half of the year. In June, the manufacturing PMI reading dropped by 2.8 points to 52 as output and new orders contracted.

Ireland's industrial production rebounded strongly in May, increasing by 13.9% month over month, after a 9.6% slump in April. Modern industries drove the rebound, surging by 32.6% and reversing the large 20.4% decline in April. Traditional industries boasted a 6.1% increase following two months of decline. The same supply and inflation issues are creating considerable risks for Irish manufacturing. Indeed, this June, the manufacturing PMI dropped to by 3.3 points to 53.1, its lowest reading in 16 months.

The May releases for Ireland and Germany were each upbeat, despite the overall uncertainty growing in the economy. They will also be the reason industrial output likely grew this May at the aggregate level of the euro zone. In next week's release, we predict a 0.4% month-on-month increase in euro zone industrial production in May.

Dutch inflation softens in June

Year-on-year inflation in the Netherlands decelerated to 8.6% in June. After peaking at 9.7% in March, a moderation in energy's contribution has pushed down the headline rate. Inflation pressures will ease in the coming months as base effects revert and start pushing down the year-ago comparison. Moreover, next month, a 12-point VAT cut on energy will drive the headline rate even lower. However, natural gas prices have been soaring recently and if they stay up, we will see the effect on Dutch inflation figures. Even in the case that inflation decelerates, we would still expect second-round effects to keep the consumer price index growing at a rate that is above target. We expect these higher prices to weigh on consumer spending, with prices increasing with greater intensity later this year.

Swiss labour market still going strong

The situation in Switzerland's labour market was stable. June's unemployment rate remained where it has been since February at 2.2%. Construction, retail, and food and accommodation services sectors saw significant declines in unemployment. Post-lockdown spending this summer is supporting economic activity and demand for employment. As there are headwinds in the global economy that will soften growth later this year, we expect that the unemployment rate has likely bottomed out.

THE LONG VIEW: ASIA-PACIFIC

Election Test for Japan's Kishida

BY STEFAN ANGRICK

With the campaign for Japan's House of Councillors election approaching the finish line, Prime Minister Fumio Kishida is facing his first real electoral test nine months into his administration. Although we expect little in the way of surprises from the 10 July poll, which sees half of the upper house seats up for grabs, the election outcome will be an important signal of economic and foreign policy over the next two years. Polls for Kishida have largely been positive but dipped in recent weeks amidst public dissatisfaction with rising prices. Inflation has been a headache for the prime minister, whose "new capitalism" program has been positioned as a way of addressing income inequalities and raising household incomes.

Still, it seems unlikely that public frustration with inflation will hurt Kishida's chances. An improving COVID-19 situation and Kishida's opposition to Russia's invasion of Ukraine have boosted the prime minister's popularity, and victory for the ruling Liberal Democratic Party-Komeito coalition appears all but guaranteed.

Splintered opposition

The coalition is helped by the fact that its opposition is splintered and lacks a common agenda. One of the two major opposition parties, the centre-left Constitutional Democratic Party, has struggled to define its position after a setback in the 2021 general election. The CDP has attacked Kishida for rising inflation and yen weakness but has offered few tangible policy alternatives. The second major opposition party, the right-populist Japan Innovation Party, saw a surge in popularity in 2021 but remains focussed geographically on Osaka and the surrounding Kansai region. One of the more interesting aspects of the election relates to potential constitutional change. Under Japan's system of government, many decisions of the upper house can be overturned by the lower house, but not when it comes to the constitution. The Innovation Party, the smaller centre-right Democratic Party for the People, and the ruling LDP-Komeito coalition favour a revision of Article 9 of Japan's constitution—the "peace clause"—which limits the country's ability to engage in military action. A two-thirds majority for this group would in theory enable constitutional change, but while polls suggest this is achievable, experience has shown the path towards that goal would be difficult.

Strong results would strengthen Kishida

A stronger-than-expected showing for the LDP may not change the outcome of the election, but it would give Kishida greater autonomy vis-à-vis his own party. The past nine months have been marked by friction between his dovish faction and the hawkish faction of former Prime Minister Shinzo Abe over foreign and fiscal policy. Members of Abe's faction—the largest within the LDP—favour raising Japan's defence spending to 2% of GDP, much to the chagrin of the LDP's more dovish members and the party's junior coalition partner, Komeito. The LDP's conservative wing is also more comfortable with fiscal deficits, reflected in a recent loosening of the wording on the government's balanced budget commitment. A robust election result for the ruling coalition would provide Kishida with greater authority to put his stamp on policy and party.

But don't expect a major break with past policy

That said, barring a surprise election outcome, we don't expect a major policy shift. The biggest implication of a strong election result for the prime minister would likely be greater efforts to patch Japan's strained relationship with neighbouring South Korea. As for economic policy, we don't see a major departure from the course laid out by Kishida's immediate predecessor, Yoshihide Suga, or Abe. Although Kishida's "new capitalism" is not expected to be fleshed until after the election, commentary has portrayed the program either as a sharp break with Abenomics or an outright turn towards socialism. Neither view is plausible. Kishida's main strength is the stability he projects. That may not be to everyone's liking, but it's hard not to see the appeal for a country scarred by a public health crisis, economic hardship, and geopolitical upheaval.

The course also seems to be more or less set on key questions of economic and defence policy. With Japan's recovery still trailing peers, fiscal and monetary support remains warranted. Criticism of monetary policy and yen weakness may satisfy political calculus but overlooks that these are not the main drivers of current inflation.

Kishida may have been a foreign policy dove traditionally, but polls show the public has warmed considerably to the idea of higher defence spending following Russia's invasion of Ukraine. And for all the attention the government's loosened balanced budget commitment has received, a dispassionate view of the matter needs to recognise that the prior target always seemed like a long shot. Myopic pursuit of that goal has all too often led to policy mistakes that derailed the economy and ultimately did little for the deficit. The trick will be, of course, to avoid making new ones.

Downgrades Dominate in U.S. and Europe

BY STEVEN SHIELDS

U.S.

U.S. credit downgrades outnumbered upgrades in the latest weekly period. The changes issued by Moody's Investors Service spanned a diverse set of industrial groups with speculative-grade firms accounting for four of the five changes.

The largest downgrade, accounting for nearly all the debt affected in the period, was issued to FLNG Liquefaction 3 with its senior secured rating lowered to Baa2 from Baa3. Moody's Investors Service also placed the senior secured ratings on review for further downgrade. The rating action was issued after the news of a fire and explosion at the liquefied natural gas export facility on June 8 that resulted in the complete closure of operations for all three of Freeport LNG's liquefaction trains for at least 90 days. A further downgrade of FLIQ3 could occur if liquidity weakens greater than forecasted if business interruption insurance proceeds are not realized as expected if the broader Freeport LNG family experiences severe financial stress such as a debt default or if the project's return to operations is estimated to take longer than currently anticipated.

Meanwhile Fitness International, LLC's senior secured notes were upgraded to B3 from B2 on June 29, reflecting Moody's Investors Service's expectation that operating performance including membership trends will continue to recover in 2022 and 2023 as the threat of the coronavirus pandemic subsides.

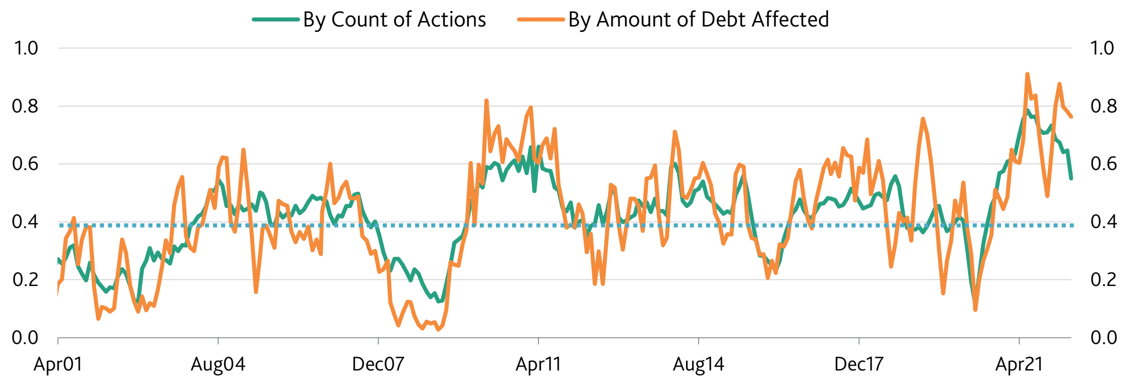
Despite upgrades being outnumbered in the latest period, through the first half of this year U.S. rating changes were favorable with upgrades exceeding downgrades 169:112.

Europe

Ratings activity was weak in Western Europe as well with downgrades outstripping upgrades 2:1. The majority of ratings changes were issued to investment-grade financial firms. On June 30, Moody's Investors Service lowered Commerzbank AG's long-term senior unsecured debt ratings one notch to A2 from A1. The ratings change was prompted by the expected reduction in the volume of this loss-absorbing debt class relative to the size of the bank's balance sheet. This development results in a higher loss severity for senior unsecured debt under Moody's Advanced Loss Given Failure analysis. The change impacted approximately $8.4B in outstanding debt.

RATINGS ROUND-UP

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



* Trailing 3-month average

Source: Moody's

FIGURE 2
Rating Key

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

FIGURE 3

Rating Changes: Corporate & Financial Institutions - US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/SG
6/29/2022	FITNESS INTERNATIONAL, LLC	Industrial	SrSec/BCF/LTCFR/PDR		U	B3	B2	SG
6/29/2022	FREEPORT LNG INVESTMENTS, LLLP	Industrial	SrSec/BCF/LTCFR/PDR		D	B1	B3	SG
6/29/2022	FLNG LIQUEFACTION 3, LLC	Industrial	SrSec/BCF	3075.2	D	Baa2	Baa3	IG
6/30/2022	VANTAGE SPECIALTY CHEMICALS, INC.	Industrial	SrSec/BCF/LTCFR/PDR		U	Caa3	Caa2	SG
6/30/2022	CORSAIR GROUP (CAYMAN) LP-CORSAIR GAMING, INC.	Industrial	SrSec/BCF/LTCFR/PDR		D	Ba3	B1	SG

Source: Moody's

FIGURE 4

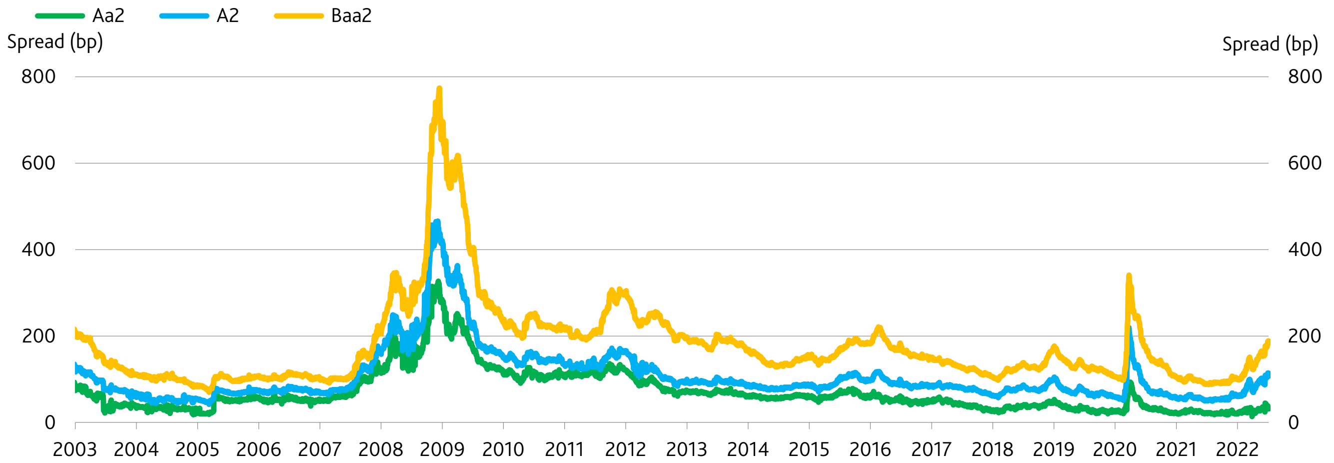
Rating Changes: Corporate & Financial Institutions - Europe

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG	Country
6/29/2022	DEUTSCHE APOTHEKER- UND AERZTEBANK EG	Financial	LTD		D	Aa1	Aa2	IG	GERMANY
6/29/2022	KVIKA BANKI HF.	Financial	LTD		U	Baa2	Baa1	IG	ICELAND
6/30/2022	COMMERZBANK AG	Financial	SrUnsec/LTIR/MTN	8338.021	D	A1	A2	IG	GERMANY
6/30/2022	CATALYST HEALTHCARE (ROMFORD) FINANCING PLC	Industrial	SrSec	154.1509	D	A2	A3	IG	UNITED KINGDOM
6/30/2022	BOELS TOPHOLDING B.V.	Industrial	SrSec/BCF/LTCFR/PDR		U	B1	Ba3	SG	NETHERLANDS
7/1/2022	AXA	Financial	SrUnsec/Sub/JrSub/MTN		U	A2	A1	IG	FRANCE
7/1/2022	ZEPHYR GERMAN TOPCO GMBH-FLENDER INTERNATIONAL GMBH	Industrial	SrSec/BCF/LTCFR/PDR		D	B1	B2	SG	GERMANY
7/4/2022	DEUTSCHE BAHN AG-DEUTSCHE BAHN FINANCE GMBH	Industrial	Sub	2078.311	D	A3	Baa1	IG	GERMANY
7/5/2022	OCTAGON HEALTHCARE FUNDING PLC	Industrial	SrSec	367.7628	D	A2	A3	IG	UNITED KINGDOM

Source: Moody's

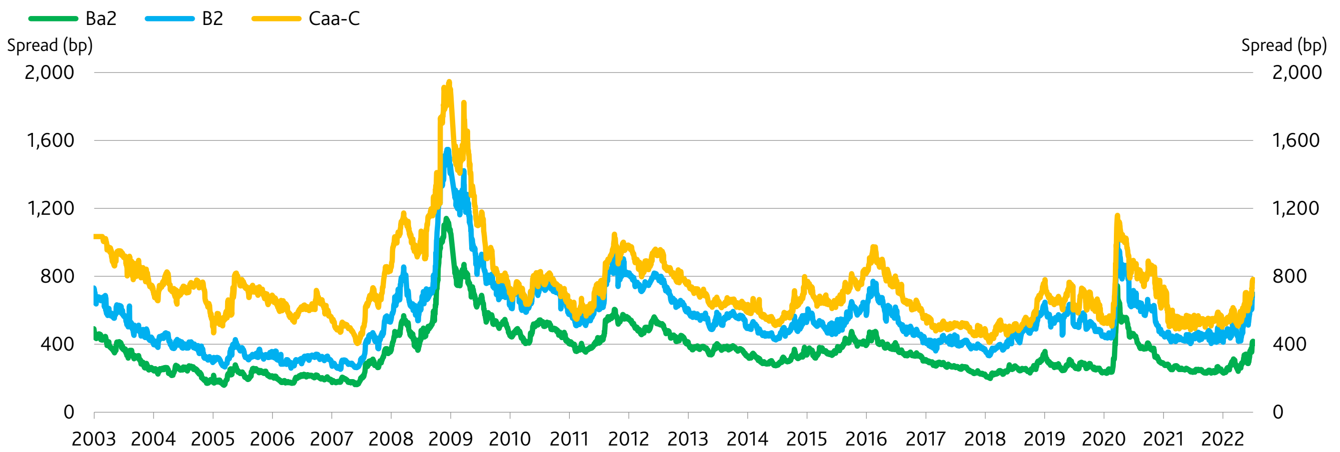
MARKET DATA

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



Source: Moody's

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



Source: Moody's

CDS MOVERS

Figure 3. CDS Movers - US (June 29, 2022 – July 6, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jul. 6	Jun. 29	Senior Ratings
American Airlines Group Inc.	Caa2	Ca	Caa1
JPMorgan Chase & Co.	Baa1	Baa2	A2
Motorola Solutions, Inc.	Baa1	Baa2	Baa3
Goldman Sachs Group, Inc. (The)	Baa2	Baa3	A2
Comcast Corporation	A3	Baa1	A3
Union Pacific Corporation	Aa1	Aa2	Baa1
Home Depot, Inc. (The)	Aa2	Aa3	A2
Intel Corporation	Aa2	Aa3	A1
Walt Disney Company (The) (Old)	Aaa	Aa1	A2
Raytheon Technologies Corporation	Aa3	A1	Baa1

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jul. 6	Jun. 29	Senior Ratings
TRW Automotive Inc.	B1	Baa2	Ba1
Merck & Co., Inc.	A3	Aa3	A1
Colgate-Palmolive Company	Baa2	A2	Aa3
Philip Morris International Inc.	Baa3	Baa1	A2
Illinois Tool Works Inc.	Aa3	Aa1	A2
Applied Materials Inc.	A2	Aa3	A2
Hershey Company (The)	A1	Aa2	A1
Federal Realty OP LP	Baa3	Baa1	Baa1
Toyota Motor Credit Corporation	Aa3	Aa2	A1
Coca-Cola Company (The)	Aa3	Aa2	A1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jul. 6	Jun. 29	Spread Diff
TRW Automotive Inc.	Ba1	508	100	408
Deluxe Corporation	B3	788	588	200
Carnival Corporation	B2	1,545	1,388	157
Nabors Industries, Inc.	Caa2	816	676	139
Embarq Corporation	Ba2	710	579	130
Domtar Corporation	Ba3	661	548	112
Royal Caribbean Cruises Ltd.	B2	1,228	1,128	100
Commercial Metals Company	Ba2	331	248	83
Meritage Homes Corporation	Ba1	363	279	83
Liberty Interactive LLC	B2	1,711	1,643	69

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jul. 6	Jun. 29	Spread Diff
American Airlines Group Inc.	Caa1	1,457	1,678	-221
United Airlines Holdings, Inc.	Ba3	919	988	-69
Enbridge Energy Limited Partnership	Baa1	119	159	-40
Calpine Corporation	B2	558	595	-37
KB Home	Ba2	430	461	-31
Unisys Corporation	B3	533	564	-31
Anywhere Real Estate Group LLC	B2	822	848	-25
Dillard's, Inc.	Baa3	131	155	-24
AutoNation, Inc.	Baa3	153	171	-18
Delta Air Lines, Inc.	Baa3	543	560	-17

Source: Moody's, CMA

CDS Movers

Figure 4. CDS Movers - Europe (June 29, 2022 – July 6, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jul. 6	Jun. 29	Senior Ratings
BNP Paribas	A2	A3	Aa3
Barclays PLC	Baa2	Baa3	Baa2
CaixaBank, S.A.	A2	A3	Baa1
Lloyds Bank plc	A2	A3	A1
DZ BANK AG	Aa2	Aa3	Aa2
Bayerische Landesbank	A1	A2	Aa3
UniCredit Bank Austria AG	A3	Baa1	Baa1
ENEL S.p.A.	Baa2	Baa3	Baa1
Anheuser-Busch InBev SA/NV	Baa1	Baa2	Baa1
KBC Group N.V.	Baa1	Baa2	Baa1

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jul. 6	Jun. 29	Senior Ratings
Hamburg Commercial Bank AG	Baa3	Baa1	Baa1
Banca Monte dei Paschi di Siena S.p.A.	B3	B1	Caa1
Scottish Power UK plc	A2	Aa3	Baa1
Vedanta Resources Limited	Ca	Caa2	B3
Spain, Government of	A1	Aa3	Baa1
Banco Santander S.A. (Spain)	A3	A2	A2
Deutsche Bank AG	Baa3	Baa2	A2
Nordea Bank Abp	A1	Aa3	Aa3
Commerzbank AG	Baa2	Baa1	A2
Bayerische Motoren Werke Aktiengesellschaft	Baa2	Baa1	A2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jul. 6	Jun. 29	Spread Diff
Vedanta Resources Limited	B3	2,000	1,157	844
Boparan Finance plc	Caa3	2,412	2,100	312
Novafives S.A.S.	Caa2	1,817	1,552	265
Casino Guichard-Perrachon SA	Caa1	1,870	1,611	259
Banca Monte dei Paschi di Siena S.p.A.	Caa1	741	515	225
Jaguar Land Rover Automotive Plc	B1	1,111	921	190
Wienerberger AG	Ba1	276	131	145
Ardagh Packaging Finance plc	Caa1	972	829	142
Iceland Bondco plc	Caa2	1,287	1,161	127
Stena AB	B2	815	689	125

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jul. 6	Jun. 29	Spread Diff
Smiths Group plc	Baa2	84	96	-12
ITV plc	Baa3	264	271	-7
ASML Holding N.V.	A2	33	39	-6
Atlas Copco AB	A2	41	47	-6
CaixaBank, S.A.	Baa1	74	78	-5
Dexia Credit Local	Baa3	40	44	-4
adidas AG	A2	57	61	-4
Nestle S.A.	Aa3	39	42	-4
Anheuser-Busch InBev SA/NV	Baa1	97	100	-3
Heineken N.V.	Baa1	48	51	-3

Source: Moody's, CMA

CDS Movers

Figure 5. CDS Movers - APAC (June 29, 2022 – July 6, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jul. 6	Jun. 29	Senior Ratings
China Development Bank	A3	Baa1	A1
Macquarie Bank Limited	A2	A3	A2
Hong Kong SAR, China, Government of	Aaa	Aa1	Aa3
Wesfarmers Limited	A1	A2	A3
Chorus Limited	A3	Baa1	Baa2
SK Hynix Inc.	Baa2	Baa3	Baa2
China, Government of	A3	A3	A1
Korea, Government of	Aa3	Aa3	Aa2
Commonwealth Bank of Australia	A2	A2	Aa3
Indonesia, Government of	Baa3	Baa3	Baa2

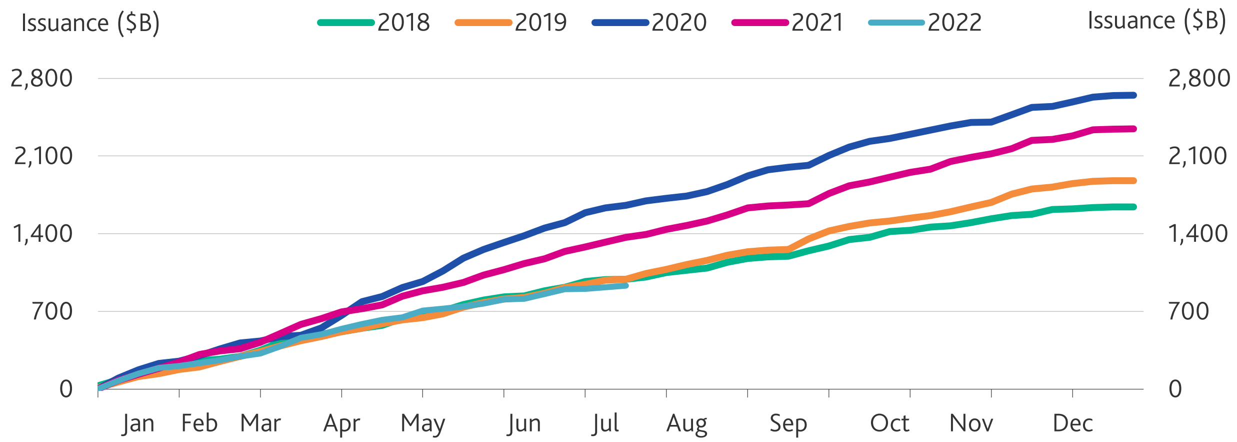
CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jul. 6	Jun. 29	Senior Ratings
Suncorp-Metway Limited	Baa1	A2	A1
Mitsubishi Corporation	A1	Aa2	A2
Sumitomo Corporation	A2	Aa3	Baa1
Nippon Yusen Kabushiki Kaisha	A2	Aa3	Ba2
Japan, Government of	Aa1	Aaa	A1
Australia, Government of	Aa1	Aaa	Aaa
India, Government of	Baa3	Baa2	Baa3
Westpac Banking Corporation	A3	A2	Aa3
New Zealand, Government of	Aa1	Aaa	Aaa
SoftBank Group Corp.	B2	B1	Ba3

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jul. 6	Jun. 29	Spread Diff
Pakistan, Government of	B3	1,483	1,314	169
SoftBank Group Corp.	Ba3	548	482	66
Development Bank of Kazakhstan	Baa2	338	273	65
Kazakhstan, Government of	Baa2	261	211	50
Halyk Savings Bank of Kazakhstan	Ba2	518	490	28
Suncorp-Metway Limited	A1	93	67	26
India, Government of	Baa3	147	124	23
Nomura Holdings, Inc.	Baa1	117	94	23
Nomura Securities Co., Ltd.	A3	109	89	20
Mitsubishi Corporation	A2	60	42	19

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jul. 6	Jun. 29	Spread Diff
SK Hynix Inc.	Baa2	123	147	-23
Hong Kong SAR, China, Government of	Aa3	25	29	-4
SK Innovation Co. Ltd.	Baa3	162	165	-3
East Japan Railway Company	A1	34	35	-1
Asahi Group Holdings, Ltd.	Baa1	26	26	-1
Coca-Cola Amatil Limited	Baa1	34	35	-1
DBS Bank Ltd.	Aa1	38	38	0
Chorus Limited	Baa2	89	89	0
Amcor Pty Ltd	Baa2	118	118	0
MTR Corporation Limited	Aa3	39	39	0

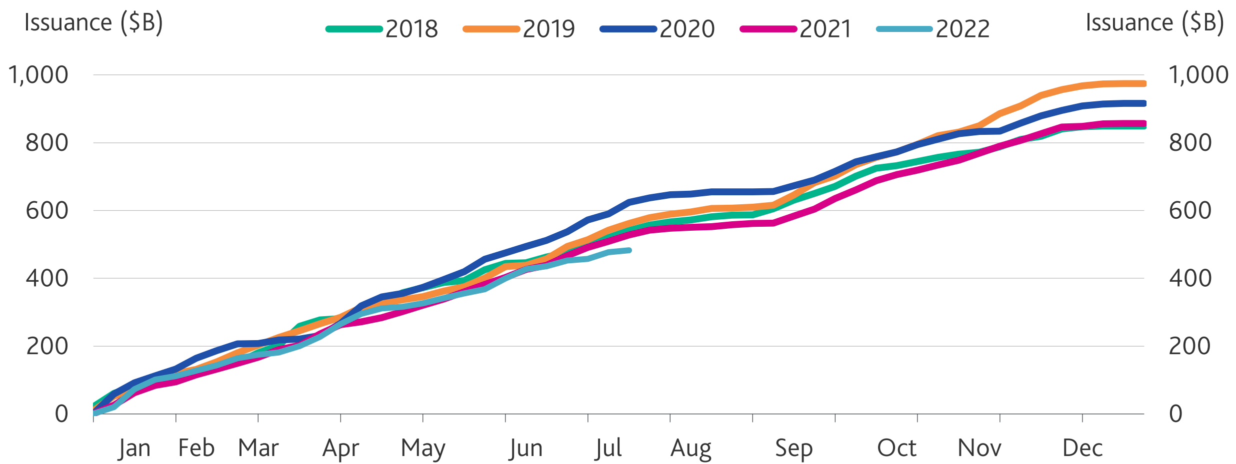
Source: Moody's, CMA

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



Source: Moody's / Dealogic

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



Source: Moody's / Dealogic

Figure 8. Issuance: Corporate & Financial Institutions

	USD Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	11.499	0.788	13.075
Year-to-Date	805.305	98.174	930.820

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	5.597	0.462	6.081
Year-to-Date	448.066	27.072	482.798

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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