MOODY'S ANALYTICS

WEEKLY MARKET OUTLOOK

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Venturing Down the Ratings Ladder

It is increasingly difficult to find a decent yield on U.S. corporate debt. To get a 5% yield return, you must go really far down the high-yield credit ratings ladder. Returns have also been decent in the high-yield bond market, with it up around 1% in June and having not fallen since September. Within the high-yield bond market, returns for the Ba and Caa segments of the markets have been outperforming others. Expectations for solid returns through the remainder of this year suggest that risk appetites won't change appreciably.

This isn't a problem now. Default risk should remain low over the next couple of years because of strong corporate profit growth, a booming U.S. economy, and accommodative monetary policy. However, down the road any hiccups in the corporate bond market could be amplified by the recent increase of risk tolerance in search of higher yields. The Barclays Capital U.S. high yield to worst for single-B recently was 4.07%, a record low. Meanwhile, yields on Caa yield to worst, which is the riskiest of the junk bond market, recently fell 6 basis points to 5.76%.

Though assuming so much risk is fraught with long-term dangers, the Bloomberg consensus is for U.S. GDP to rise 6.6% this year and 4.1% next. Growth is forecast to return closer to the economy's potential in 2023, with GDP rising 2.3%. This rosy outlook appears to have significantly lowered the weight assigned to the long-term dangers of the riskiest part of the high-yield corporate bond market.

This isn't the first time that investors have ventured into the lower end of the investment-grade ratings. Before the pandemic, there were plenty of concerns that the increase in corporate debt, particularly among highly leveraged firms, could be a catalyst for a recession. Our work then showed that increased corporate debt does not necessarily need to be the cause of recession to pose a risk to the economy.

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The increased indebtedness of the nonfinancial sector would likely drag on the economy in a downturn that leads to the widening of corporate bond spreads. In other words, a more indebted corporate sector will, on average, carry lower-rated debt more susceptible to larger rate spikes in response to economic shocks, increasing strain on corporate coffers.

Tapering may focus initially on MBS

Federal Reserve Governor Christopher Waller believes the Fed should begin tapering monthly asset purchases this year, a little sooner than in our baseline. The most interesting part of his comments was that the Fed could focus initially on its $40 billion in mortgage-backed security purchases. Our assumption was that the Fed would treat its MBS and Treasury purchases equally, but this may not be the case.

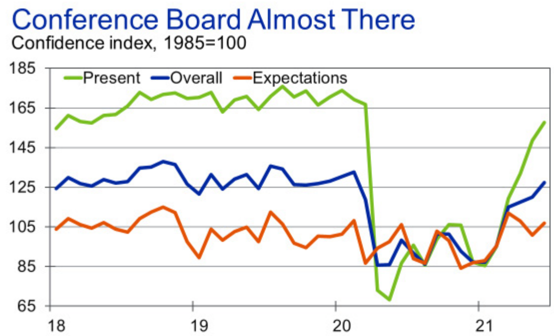
Tapering of the Fed's MBS purchases seems to be coming, but the timing remains unclear. If policymakers focus on MBS first, which isn't our baseline, it would affect mortgage-backed security spreads. The Fed's monthly MBS purchases were the primary reason mortgage spreads tightened and some of that tightening would unwind later this year if the initial tapering focuses on MBS.

Sticking with housing, Ginnie Mae unveiled 40-year mortgage terms for issues. Forty-year mortgages emerge from the shadows when prices rise and affordability becomes an issue. Originations rose during the housing boom alongside interest only and low doc mortgages. Creative financing doesn't address the underlying supply-demand issues. As a point solution for borrowers who are already at risk of foreclosure, modifying into a 40-year mortgage might be a stop-gap measure. If the alternative is default, the downside risk of extending the term is low. While it might be helpful in these specific cases, a 40-year mortgage is not a solution for broader affordability issues.

U.S. economic roundup

U.S. economic growth this cycle may have peaked, but that doesn't mean the economy won't do very well through next year. The ISM manufacturing index fell from 61.2 in May to 60.6 in June. Odds are it will drop further over the next few months, since the index doesn't normally spend too much time north of 60. The details softened as new orders dropped and the employment index fell below its neutral threshold of 50. The prices paid index continued to climb, but a number of commodity prices have fallen recently, and that could help take the edge off prices paid.

Consumer confidence improved more than expected in June as consumers turned more upbeat on the labor market and income prospects. The Conference Board's consumer confidence index increased from a revised 120 (previously 117.2) in May to 127.3 in June. The Conference Board altered its methodology. The survey is now conducted online, includes a larger sample, and the reference period has shifted a little. Turning to the details, consumers' assessment of present conditions was up from 148.7 to 157.7. Expectations also improved in June, rising from 100.9 to 107. This gain reverses most of the decline in May.



Confidence doesn't normally have an enormous impact on consumer spending. To highlight this, we created a fairly simple model of real consumer spending growth. In the model, consumer spending growth (real personal expenditures) is a function of growth in real disposable income, household net worth, a lag of leverage (defined as household debt as a share of disposable income), and a lag of consumer confidence. We used both the Conference Board consumer confidence and University of Michigan surveys as measures of sentiment. Though both were statistically significant and had the correct sign, neither showed an enormous impact on near-term spending. We have lofty expectations for real consumer spending this year and next, but this is more a function of a strengthening labor market, income growth, a safety net of excess savings, and the wealth effect, rather than a rise in sentiment.

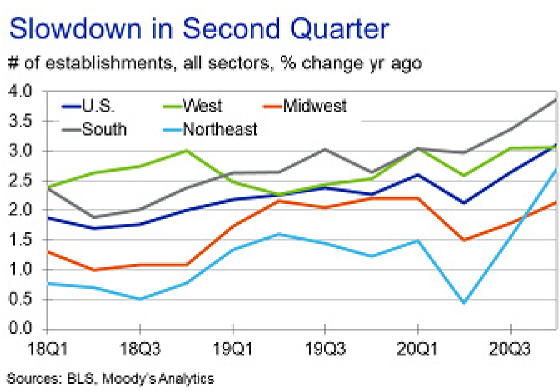
The labor market details improved. In June, 54.4% of respondents said jobs were plentiful compared with 48.5% in May. Also, 10.9% said jobs were hard to get. The labor market differential, or the difference between those saying jobs are plentiful and hard to get, increased from 36.9 in May to 43.5 in June, the highest since 2000, around the last time a consensus among economists was that the economy was at full employment. The labor market differential doesn't suggest we're currently at full employment but doesn't point to a drop in the unemployment rate in June. We're not at full employment now, but this is encouraging.

Meanwhile, our estimate of U.S. real monthly GDP slipped 0.1% in May. But this isn't concerning. Monthly GDP has fallen in consecutive months; April's result was revised higher from -0.3% previously. Despite the decline over the past couple of months, the level of real monthly GDP is still 1.2% (not annualized) above its first-quarter average.

Business Closures May Slow Consumer Jobs Recovery

BY LAURA RATZ

The U.S. employment recovery is underway, yet some businesses will never reopen. In the second quarter of 2020, there was a clear slowdown in establishment growth, according to the Quarterly Census of Employment and Wages. (Establishments are single units of employment at a specific location, and each establishment of a multi-establishment firm is counted separately.)



The second-quarter slowdown was most pronounced in the Northeast, which is consistent with earlier and more severe outbreaks of the virus and mandated business closures. Some states saw outright year-over-year declines in the number of establishments, including Massachusetts, Maryland and Nebraska.

Among the 100 largest metro areas, 14 experienced year-over-year losses, including Chicago and Baltimore. Most of these metro areas had instituted strict stay-at-home orders, but they were also generally slower-growing economies even before the pandemic and concentrated within the Northeast, which is a perennial laggard.

The sharper declines in establishments underscore how the pandemic was particularly painful for already middling and struggling economies. By the end of the year, many economies were finding their footing while others such as San Francisco were feeling the effects of prolonged closures, and the number of establishments dipped below year-ago levels.

Short-term, but not long-term, effects

A hit to the number of establishments is unlikely to have a lasting effect on employment because the establishments that closed were likely the smallest and most vulnerable, but it may slow the near-term recovery, particularly in regions where stay-at-home orders and business restrictions were longest. However, even at the height of the pandemic, establishments opened or reopened even in the hardest-hit parts of the country.

Not all industries declined or even slowed. Office-using industries in particular saw little change, consistent with how the pandemic wreaked more havoc in some parts of the economy than others. Nonetheless, a closer look at the establishments by sector and regions offers clues to how the recovery will progress.

Private services bore the brunt

The hardest-hit sector in terms of establishment counts was a catchall segment of private services—sometimes referred to as personal services but officially named "other services." This includes salons, auto repair, household workers and social organizations. As of April 2020, industry employment was second only to leisure/hospitality in the share of jobs lost. While most sectors did not decline or slow until the second quarter of 2020, other services were most vulnerable to a suddenly wary public.

The establishment count was down by a whopping 4% year over year in the first quarter, and as of the latest datapoint from the fourth quarter, the recovery had yet to begin. Private households led the decline, which is consistent with the lockdown and a reluctance to have nonfamily members in the home. Given that lockdowns did not begin until March, the massive drop for the entire first quarter indicates how massive the abrupt exodus of household workers from their employment was.

Leisure/hospitality held up better than expected in the nationwide count, but this seeming resilience was concentrated in the South, where COVID-19 mitigation measures were not as widespread or strict compared with the rest of the country. In the second quarter of 2020, the Northeast and the Midwest saw clear year-over-year declines in restaurants while the West merely held steady. Restaurants in the Northeast and Midwest continued to close for the remainder of the year, and as the pandemic wore on, even the West saw year-over-year declines by the fourth quarter.

Employment implications

Whether the establishment counts were down, as in the case of personal services nationwide and leisure/hospitality in many regions, or just flat, any weakness bodes ill for employment. So far, the U.S. economy has recouped about two-thirds of jobs lost in the spring of 2020. Personal services and leisure/hospitality are actually outperforming total employment, having recovered 75% and 70%, respectively.

However, that is based on the monthly survey, and the potential sources of error in the payroll survey include accounting for recently created or closed establishments, which must be estimated. This could lead to overestimating employment when the number of establishments is falling. The QCEW data are more lagged, albeit more accurate because they are based on a near complete census of all workplaces, as opposed to a sample.

By the end of 2020, currently the last datapoints from the QCEW, the payroll survey already indicated that the personal services jobs recovery was ahead of total employment and leisure/hospitality was slightly behind total employment. However, according to the more accurate employment count in the QCEW, both industries were actually lagging the broader recovery. This, paired with ongoing declines in the number of establishments that would presumably contribute to the employment recovery, suggests that employment gains in these industries might be overstated. It remains to be seen whether or not the consumer industry has indeed caught up.

Data for the first quarter of 2021 should be available later this summer, but even then we will likely not have a clear view of business recoveries given that the pandemic was still raging at the start of the year and many regional economies were not yet fully reopened in the first quarter. Indeed, it may not be until the next round of benchmark employment revisions next March that we have an accurate view of the consumer services employment recovery so far.

The Week Ahead in the Global Economy

U.S.

The U.S. economic calendar is very light next week. The key data include the ISM nonmanufacturing survey for June and Job Opening and Labor Turnover Survey for May. For the latter, we will be watching the number of job openings and quits. The number of people quitting their jobs has surged since the beginning of the year. Indeed, the number of quits, according to the Job Openings and Labor Turnover Survey, has risen 16% over that time period. Quits are up 87.6% on a year-ago basis and are the highest since the inception of the data in the early 2000s. By industry, quits have risen significantly in both manufacturing and retail trade. Elsewhere, the minutes from the June meeting of the Federal Open Market Committee will be released. Based on recent Fed comments, there was likely some lively discussion about tapering the central bank's $120 billion in monthly asset purchases.

Europe

The euro zone retail sales and the major economies' industrial production releases will be the focus next week. We expect positive results on both fronts. Retail sales will have begun to rebound from their slump in April that was caused by the extension of lockdowns throughout the bloc. After falling 3.1% m/m in April, retail sales likely bounced back by 2.8% in May. Gains should be seen across goods types but be strongest in segments like clothing and footwear that have been most hit by lockdowns.

Likewise, we expect industrial production ramped up in France and Germany. Industrial production stumbled in April because of the COVID-19 outbreak and due to supply chain effects from global bottlenecks of inputs. With the improvements made on the epidemiological front in May, we expect demand picked up and some improvement on the deliveries front after hold ups in April due to the Suez Canal blockage.

Finally, the U.K.'s monthly estimate of GDP for May will be released and will likely show a 3.4% m/m uptick in the economy. The British economy loosened social distancing measures significantly during the month and we expect a large increase in the consumption of services to drive growth. Meanwhile, the PMIs from the manufacturing, services, and construction sectors were each favorable for the month.

Asia-Pacific

The Reserve Bank of Australia's monetary policy decision will be the highlight on the economic calendar. We expect the central bank to keep its interest rate settings steady in July, with the cash rate likely to be maintained at its record-low 0.1%. Although domestic demand has rebounded strongly and the pace of the labour market revival has exceeded expectations in recent months, wage growth and inflation have remained relatively subdued over this period, necessitating an extended phase of conducive policy settings. Moreover, the recent disruptions caused by localized outbreaks, although likely to be temporary, will increase the odds of the central bank expanding its current quantitative easing program by undertaking a third round of bond purchases in the coming months. Similarly, Bank Negara Malaysia is also likely to have kept its benchmark policy rate unchanged at 1.75% in its July announcement.

China's producer and consumer prices are likely to have ticked up in June. We expect producer prices to have increased by 9.4% in yearly terms in June, following a 9% increase in May, largely driven by rising raw materials and commodity prices. In comparison, annual inflation is likely to have settled at 1.5% in June, inching up from 1.3% in May, with softness in rent, services and pork prices likely to have dampened the net increase.

Geopolitical Calendar

Date	Country	Event	Economic Importance	Financial Market Risk
16-Jul	Japan	BOJ Monetary Policy meeting	Medium	Medium
23-Jul to 8-Aug	Japan	Summer Olympics, Tokyo	Medium	Low
5-Sep	Hong Kong	Legislative Council elections	Low	Medium
22-Oct	Japan	General elections	Medium	Medium
Oct/Nov	ASEAN	ASEAN summit	Low	Low
Nov	Asia-Pacific	Asia-Pacific Economic Cooperation forum	Medium	Low
Nov	G-20	G-20 Summit	Medium	Low
7-Nov	Nicaragua	Presidential, congressional elections	Low	Low
14-Nov	Argentina	Legislative elections	Medium	Low
21-Nov	Chile	Presidential elections	Low	Low
28-Nov	Honduras	Presidential, congressional and municipal elections	Low	Low

Default risk should remain low over the next couple of years.

BY RYAN SWEET

CREDIT SPREADS

Moody's long-term average corporate bond spread is 90 basis points, down 4 bp from this time last week. This is below its high over the past 12 months of 139 bp among the lowest over the past year. This spread may be no wider than 110 bp by year-end 2021.

The long-term investment grade corporate bond spread was 123 bp, 7 bp tighter than that seen last week. It remains well below its recent high of 222 bp.

The recent ICE BofA U.S. high-yield option adjusted bond spread of 304 bp approximates what is suggested by the accompanying long-term Baa industrial company bond yield spread and is a little narrower than the recent VIX of 15.6. The VIX didn't budged much over the past week and remains below its historical average of 19.

DEFAULTS

The global speculative-grade corporate default rate fell to 4.9% for the trailing 12 months ended in May, returning to where it stood a year earlier and down from 5.6% at the end of April. Among high-yield bond issuers, the U.S. default rate was 2.8% at the end of May when measured on a dollar-volume basis, down from 4.5% at the end of April. The decline reflects the exit of a few large defaults in 2020 from the trailing 12-month window.

According to the Moody's Credit Transition Model, the trailing 12-month global speculative-grade default rate will fall to 1.8% by the end of the year under the MIS baseline scenario and remain little change through May 2022. To derive default-rate forecasts, Moody's CTM uses inputs, including ratings and rating transitions, as well as assumed future paths of high-yield bond spreads and changes in unemployment rates.

In the Moody's Investors Service baseline scenario, the speculative-grade default rate will drop to 1.7% at the end of this year before creeping higher in April and May of next year, touching 1.9%. For Europe, the speculative-grade default rate will steadily decline over the next several months and end 2021 at 1.9%.

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.

April and May corporate bond issuance came in a little lighter than expected. U.S. dollar-denominated corporate bond issuance has moderated, not surprising as issuance typically is slow this time of year.

U.S. investment-grade and high-yield corporate bond issuance has moderated, and this condition will linger into early July, which is normal. Investment-grade issuance rose $26.1 billion in the week ended June 30, bringing year-to-date issuance to $901.7 billion. High-yield corporate bond issuance was up $12.9 billion, putting year-to-date issuance at $380.9 billion.

U.S. ECONOMIC OUTLOOK

The Moody's Analytics June baseline now looks for real GDP to rise 6.9% this year, compared with the 6.8% in our May baseline. We have been consistently revising our forecast higher for GDP this year because of changes to our fiscal policy assumptions, but the adjustment in June is modest compared with prior forecast revisions. The June baseline incorporates the government's second estimate of first-quarter GDP, but the top-line number was unrevised, still rising 6.4% at an annualized rate.

We raised our forecast for GDP growth in 2022 from 4.8% to 5%. Risks to the forecast are weighted to the upside because of the lack of inventory build this year. The global semiconductor shortage bit into inventories during the first quarter and will likely continue to do so through the remainder of this year. Inventories lend a downside risk to our forecast for GDP this year but are an upside for 2022 and 2023.

There is the potential that supply issues become a big problem, particularly for autos. Auto industrial production is trailing sales. Therefore, inventories could continue to decline. We didn't alter our forecast for the change in private inventories over the next few years, but this may need to be revisited, since lean inventories need to be replenished, and that could add more to GDP growth next year than we expect.

The June baseline forecast has average monthly job growth this year of 510,000, in line with the May baseline. Similarly, there were no significant revisions to average monthly job growth next year, which will be 327,000.

The unemployment rate is expected to average 4.5% in the fourth quarter of this year, the same as in the May baseline. A 3.5% unemployment rate and an 80% prime-age employment-to-population ratio are consistent with an economy at full employment. We don't have the prime-age employment-to-population ratio in our model but we do a back-of-the-envelope estimate based on the other labor market variables we forecast.

There weren't any changes to our assumptions about monetary policy. We still expect the Fed to announce its tapering plans in September and a $15 billion reduction to occur at each Federal Open Market Committee meeting in 2022. The Fed has signaled that it wants tapering to be on autopilot. Once its monthly asset purchases have been reduced from $120 billion to zero, the Fed will reinvest proceeds from maturing assets to ensure its balance sheet doesn't contract, which would be contractionary monetary policy.

The Fed will aim for inflation to exceed its 2% objective. How large of an overshoot is allowed before a rate liftoff will also be important in gauging the pace of tightening. If the Fed allows a larger overshoot, then the pace of tightening will likely be similar to a traditional tightening cycle, 25 basis points per quarter, because inflation should continue to accelerate even after the first rate hike. If the Fed doesn't allow too much of an overshoot, then the tightening cycle will be less aggressive. The first hike for the target range for the fed funds rate occurs in early 2023 and the pace of tightening is expected to be similar to historical norms.

There were no significant changes to the forecast for the 10-year U.S. Treasury yield. The forecast is for the 10-year Treasury yield to end this year just north of 2% and near 2.4% next year.

A Glimpse at Germany's Economic Future

BY KATRINA PIRNER

Germany's Christian Democratic Union and its Bavarian sister party, the Christian Social Union, released their election platform ahead of the September 26 vote. The manifesto, entitled "The Program for Stability and Renewal—Together for a Modern Germany," sticks to the parties' conservative roots, though squaring lower taxes with the parties' commitment to balanced budgets could prove difficult.

The CDU/CSU have held the chancellorship for the majority of the postwar period and are leading in the polls. For this reason, their election platform offers reliable insight into the economic future of a post-Merkel Germany. However, Germany's parliamentary system means a coalition government will be the most likely outcome, requiring the CDU/CSU to compromise on some parts of their election manifesto.

Increasing Germany's housing stock won't be easy

Germany, like many other developed countries, saw housing costs rise throughout the pandemic. The CDU/CSU have committed to supporting the construction of 1.5 million new apartments by 2025. Part of the plan to achieve this goal is to cut the superfluous red tape associated with construction projects. This is desperately needed. The World Bank ranks Germany 30th in the world for dealing with construction permits. The parties would also extend the 5% tax rebate on the acquisition and building costs of new rental accommodation beyond its original 2021 expiration date.

The CDU/CSU could face considerable hurdles in meeting this target. Specifically, it would require building 375,000 new units each year from 2022 to 2025, which exceeds the 293,000 residential units built in 2019. It's also more than the 323,900 units built on average each year from 1990 to 2019. Furthermore, cities such as Berlin have a history of scuppering large property development plans, such as those that were slated for the former Tempelhof Airport in 2016. Last, if building costs remain elevated, property developers may postpone new projects.

The CDU/CSU's potential coalition partners could also undermine this goal. The Social Democratic Party's manifesto includes the introduction of a national rent cap, which would likely deter investment even if new builds are excluded from the cap. Similarly, the Green Party has committed to tightening restrictions on rent increases. That said, we suspect the Greens would prioritise their environmental policies while the SPD could trade a rent cap for an increase in the minimum wage.

A digital transformation will progress at a measured pace

The CDU/CSU have not struck an especially ambitious tone when it comes to digitalization. Although the parties will move to digitalize the professional qualification and certification process as well as health records, we view these as basic initiatives. The establishment of a Federal Ministry for Digital Innovations and Transformation to oversee new digitalization projects such as an electronic identity card could be useful if it doesn't act as another layer of bureaucracy.

Potential coalition partners could push the CDU/CSU to go further. For example, the SPD and the Greens want to invest in digital devices for schools and offer subsidies to cover internet bills for low-income households. The business-friendly Free Democratic Party would broaden the school curriculum to include digital and entrepreneurial skills and streamline online tax returns.

We believe the benefits of accelerating Germany's digital transition would outweigh the costs. Digitalizing government services should reduce business expenses and could encourage more entrepreneurship. By investing in the next generation's digital skills, Germany will have a better chance at maintaining its competitiveness. The country has historically been a manufacturing superpower, but with software increasingly embedded in everyday goods and commerce moving online, curriculum staples such as reading, writing and arithmetic aren't enough to ensure Germany's future workforce can support its Mittelstand firms.

The manifesto strikes a compromise on pension policy. The CSU's call for an increase in the maternal pension for mothers with children born before 1992 is not included, thereby avoiding additional strain on the pension pot. However, the CDU/CSU won't go further than the already planned increase in the retirement age to 67 by 2029.

Interestingly, the CDU/CSU have committed to exploring a "generation fund" that would put aside €100 every month for every child until the age of 18. The fund would act as a building block for pensions later in life and be protected from state access. Although the initiative would ensure pensions for the next generation, it wouldn't help fund current pension obligations. This would likely require some combination of increasing the retirement age or boosting contributions given that pension cuts are prohibited by law.

Other political parties have taken similar stances. The Green Party and the SPD reject increasing the retirement age. Conversely, the FDP encourages postponing retirement by offering higher pension benefits to those who retire later while younger retirees would receive a lower pension. The FDP has also put generational fairness at the heart of its pension policy and therefore may be inclined to support a generation fund.

Climate policy

The CDU/CSU's climate change policy relies heavily on emissions trading systems. It proposes extending the European ETS to heating, transport and shipping while also strengthening its coverage of the aviation industry. Although the parties support higher carbon rises, they would reduce electricity costs by eliminating the renewable energy tax, a policy also included in the SPD's manifesto. This wouldn't entirely negate the inflationary impact of higher upfront energy prices, but it would help offset any fall in consumption as a result of rising electricity prices.

Also notable is the CDU/CSU's stance on diesel engines. The German auto manufacturing industry has been relatively slow to transition to electric cars, but the Greens have proposed banning the registration of diesel engines by 2030. The CDU/CSU have rejected this stance, which should provide a buffer to the German automotive industry as it ramps up production of electric vehicles.

A bet on strong growth to finance spending plans

The CDU/CSU will not finance their spending package through higher taxes. In fact, they have proposed lowering some levies. For instance, the maximum corporate tax rate would fall from around 30% to 25%. In addition, the maximum monthly income that counts as an income tax-free "mini job" will be increased from €450 to €550. Notably, those with mini jobs, the majority of whom are women, were excluded from Germany's furlough scheme, so this could help them rebuild some of their lost income.

At the same time, the CDU/CSU reiterated their commitment to reinstating Germany's debt break and swiftly returning government debt to below 60%. The parties argue that a sharp economic rebound will boost government revenue and reduce the need for new borrowing. However, we believe this is an overly optimistic assumption. Our current baseline forecast shows Germany's debt-to-GDP ratio rising to 71% in 2023 before it slowly trends downwards. Given the CDU/CSU's allegiance to balanced budgets, we expect they would more easily stomach a cut in government spending than a rise in government debt, which could constrain Germany's economic recovery.

The CDU/CSU's potential coalition partners differ significantly on fiscal policy. The SPD and the Greens have included a wealth tax in their platforms and propose raising income tax on higher earners. The SPD would also introduce a financial transaction tax. Meanwhile, the FDP supports reducing the corporate tax rate to 25% and would lift the threshold for Germany's top income tax bracket to €90,000.

Germany's main parties are split over the debt break. The Greens and the SPD favor a more flexible approach to financing their investment plans. However, the FDP stands with the CDU/CSU on the quick reduction in German debt levels and the reinstatement of balanced budgets.

A black-green coalition is in the cards

The CDU/CSU view the center-right FDP as their preferred coalition partner. Unfortunately, polling suggests this won't be possible without the support of other parties. As of June 27, the FDP would garner around 12% of the vote, placing it fourth, behind the SPD in third place and the Greens, who are about eight points behind the CDU/CSU. These numbers make a coalition between the CDU/CSU and Greens, a first in German federal politics, the most likely election outcome.

Such a coalition has precedent inside Germany and across the border. The Greens have entered coalitions with the CDU in German state governments and are also the junior partner in a coalition with the conservative party in Austria's federal government. Still, fundamental disagreements over spending and taxation would require some uncomfortable concessions by both parties. If the Greens successfully pushed for more investment, this could boost our forecasts for the German economy even if it meant a slower reduction in Germany's debt-to-GDP ratio.

Eye on Interest Rates in Australia

BY KATRINA ELL

As economic recoveries proceed at different speeds and stages around the globe, there is rising interest about when normalisation of monetary policy will begin. Many central banks have had interest rates sitting at the lower bound since providing unprecedented monetary support at the height of the global pandemic. Normalisation of the U.S. federal funds rate could begin in early 2023, while tapering of the Federal Reserve's quantitative easing could begin in January. This will likely prompt some emerging markets, including those in Asia, to follow suit. Interest rate hikes in 2022 are looking more probable for some developed Asia-Pacific economies, provided economic recoveries remain on track.

Central banks in South Korea and New Zealand have been the first in the region to openly float the idea of interest rate increases. The Reserve Bank of New Zealand has predicted that its official cash rate will begin increasing in the second half of 2022. The Bank of Korea has begun talking about an "orderly exit" from record-low rates sometime in the future, with the second half of 2022 the likely start date.

The Reserve Bank of Australia has indicated that it will not increase rates until the economy is at full employment and inflation sustainably returns to the 2% to 3% target, a situation unlikely to occur until the second half of 2023. But rate increases could come earlier. Strong labour market figures for May, where the unemployment rate dropped to 5.1% from 5.5% in April, suggest that the likelihood of this rate profile being brought forward has increased. The sustained low interest rate environment is leading to pockets of rising concern in Australia, with household credit sustainability a particular pressure point.

Macroprudential tools are particularly useful with sustained low interest rates, because they can target pockets of concern. The Australian Prudential Regulation Authority is on the verge of intervening in the housing market to cool the spectacular momentum experienced across capital cities; similar intervention has previously occurred.

National dwelling values have increased 9.1% in yearly terms in May, according to CoreLogic data. Sydney dwellings have increased 11.2%, Brisbane was up 12.1%, and Melbourne has gained 5%. The strong runup in home values has been spurred by sustained low interest rates and unprecedented fiscal support against the backdrop of an economy that is healing from the worst of COVID-19.

An environment where credit growth far outpaces income growth is unsustainable. Household debt is already elevated, sitting at 180.4% of disposable income in the December quarter and there's growing concern that when interest rates eventually rise, highly leveraged households could find it challenging to service their loans. From a broader perspective, household consumption typically accounts for around 55% of GDP. If households are put under stress from rising lending rates, there will be wider implications as they curtail spending in other areas. Further, most home mortgages in Australia are floating, making households vulnerable to interest rate shocks.

The underlying concern prompting likely regulator intervention is that lending standards may weaken. In mid-June, the Council of Financial Regulators acknowledged that there had been some deterioration, a first since late 2018, when the CFR began issuing quarterly statements of concern around the housing market.

Macroprudential tools are particularly useful in the sustained low interest rate environment. Rate increases are not expected in Australia for at least another year. It is likely they will be increasingly used throughout Asia-Pacific as low interest rates and burgeoning economic recoveries lead to pockets of concern. Household credit sustainability will be a pressure point.

RATINGS ROUND-UP

Broad Positive Trend Continues

BY MICHAEL FERLEZ

U.S. rating change activity remained overwhelmingly positive in the latest period. For the week ended June 29, upgrades accounted for 85% of the total changes and all the reported debt. This continues the broader positive trend in credit markets with upgrades continuing to outpace downgrades. The most notable change last week was made to HCA Healthcare Inc. and HCA Inc., referred to collectively as HCA. Moody's Investors Service upgraded numerous ratings for both entities, including upgrading their senior unsecured ratings to Baa3. In the rating action, Moody's Investors Service noted HCA's financial resiliency and growing evidence of the firm's ability to operate with moderate financial leverage as factors for the upgrade of its senior unsecured ratings. In total the upgrade impacted $13 billion in outstanding debt. Concurrent with the upgrade Moody's Investors Service withdrew all ratings on HCA Healthcare Inc.

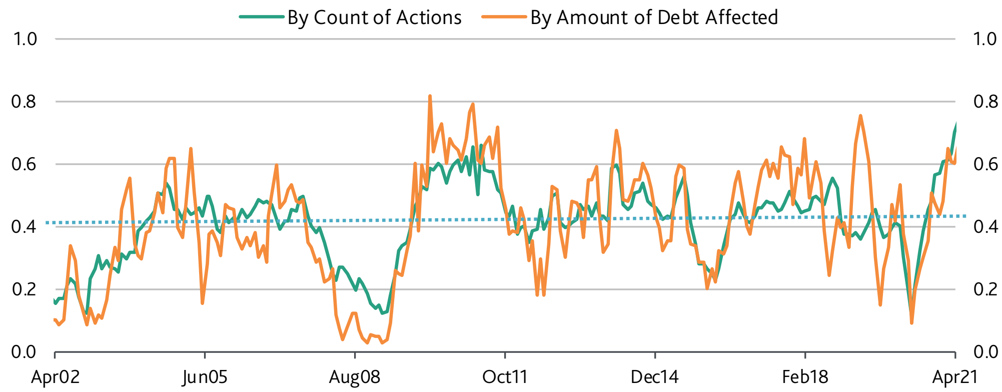
The other notable upgrade was made to Albertsons Companies Inc.'s. As part of the rating action, Moody's Investors Service upgraded Albertsons' existing senior unsecured notes to Ba3. In its rating action, Moody's Vice President Mickey Chadha was cited as saying, "Albertsons has benefited from the increased demand for food at home during the pandemic with record sales and EBITDA in fiscal 2020." Chadha was cited as further saying, "The company has also reduced its debt burden and we expect metrics to remain strong even after buying patterns normalize."

Western European rating change activity was credit positive last week. All three of the rating changes were upgrades. Geographically, Luxembourg-based firms received two rating changes, while Germany received one.

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
6/23/21	CLEVELAND-CLIFFS INC.	Industrial	SrSec/SrUnsec/LTCFR/ PDR	3,529	U	B1	Ba2	SG
6/23/21	AMERICAN FINANCIAL GROUP, INC.-REPUBLIC INDEMNITY COMPANY OF AMERICA	Financial	IFSR		U	A3	A1	IG
6/23/21	WEST DEPTFORD ENERGY HOLDINGS, LLC	Industrial	SrSec/BCF		D	B1	B2	SG
6/23/21	NANNA MIDCO II AS-NAVICO INC.	Industrial	SrSec/BCF/LTCFR/PDR		U	Caa1	B3	SG
6/23/21	JANE STREET GROUP, LLC	Financial	SrSec/BCF/LTCFR		U	Ba3	Ba2	SG
6/23/21	PAPAY HOLDCO, LLC.-CVENT, INC.	Industrial	SrSec/BCF/LTCFR/PDR		U	Caa1	B3	SG
6/23/21	CARROLS RESTAURANT GROUP, INC.	Industrial	SrSec/BCF		U	B3	Ba3	SG
6/24/21	HCA HEALTHCARE, INC.-HCA INC.	Industrial	SrUnsec/SrSec/BCF	12,952	U	Ba2	Baa3	SG
6/24/21	ALBERTSONS COMPANIES, INC.	Industrial	SrUnsec/LTCFR/PDR	9,562	U	B1	Ba3	SG
6/24/21	APCO HOLDINGS, LLC	Financial	SrSec/BCF/LTCFR/PDR		U	Caa1	B3	SG
6/24/21	MAIN EVENT ENTERTAINMENT INC.	Industrial	SrSec/BCF/LTCFR/PDR		U	Caa2	Caa1	SG
6/25/21	LIMETREE BAY TERMINALS, LLC	Industrial	SrSec/BCF		D	B2	Caa1	SG
6/25/21	VIVINT SMART HOME, INC.-APX GROUP, INC.	Industrial	SrSec	600	U	B2	B1	SG

Source: Moody's

FIGURE 4

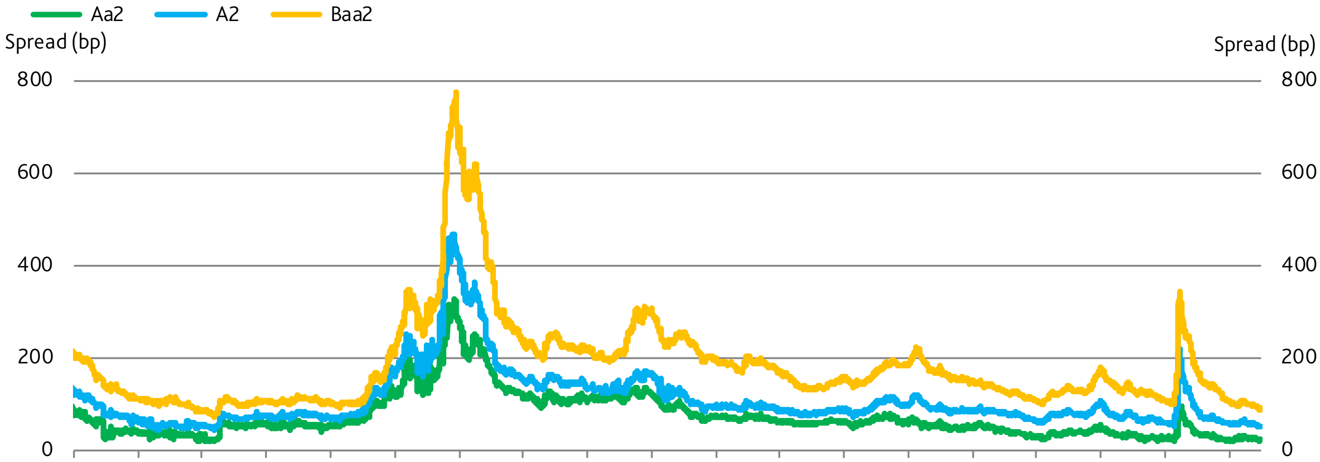
Rating Changes: Corporate & Financial Institutions - Europe

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/SG	Country
6/23/2021	EURASIAN RESOURCES GROUP S.A R.L.	Industrial	LTCFR/PDR		U	B2	B1	SG	LUXEMBOURG
6/24/2021	SUSE S.A.-MARCEL LUX DEBTCO SARL	Industrial	SrSec/BCF/LTCFR		U	B2	B1	SG	LUXEMBOURG
6/28/2021	SPRINGER NATURE AG & CO. KGAA-SPRINGER NATURE DEUTSCHLAND GMBH	Industrial	SrSec/BCF/LTCFR/PDR		U	B2	B1	SG	GERMANY

Source: Moody's

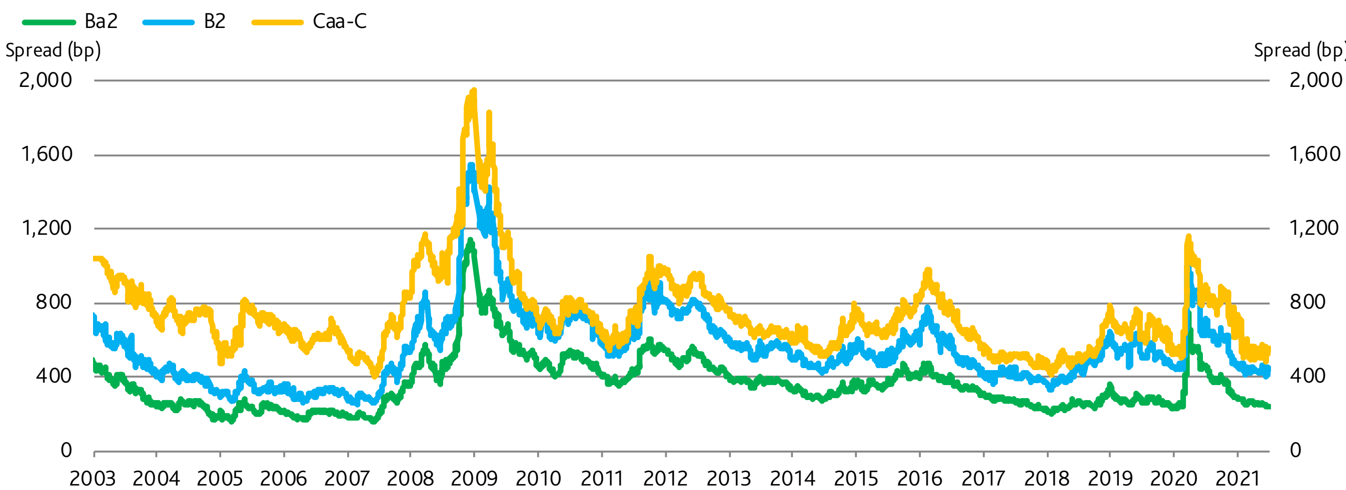
MARKET DATA

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 23, 2021 – June 30, 2021)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jun. 30	Jun. 23	Senior Ratings
Eversource Energy	A2	Baa1	Baa1
Citigroup Inc.	Baa1	Baa2	A3
Bank of America Corporation	A3	Baa1	A2
AT&T Inc.	Baa2	Baa3	Baa2
Verizon Communications Inc.	Baa1	Baa2	Baa1
Citibank, N.A.	Baa2	Baa3	Aa3
Procter & Gamble Company (The)	Aa3	A1	Aa3
HCA Inc.	Baa3	Ba1	Baa3
Consolidated Edison Company of New York, Inc.	A3	Baa1	Baa1
Bank of America, N.A.	A3	Baa1	Aa2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jun. 30	Jun. 23	Senior Ratings
Apple Inc.	A1	Aa3	Aa1
Amazon.com, Inc.	A2	A1	A1
PepsiCo, Inc.	A3	A2	A1
Raytheon Technologies Corporation	A3	A2	Baa1
U.S. Bancorp	A2	A1	A1
Abbott Laboratories	Baa1	A3	A2
Royal Caribbean Cruises Ltd.	B3	B2	B2
Costco Wholesale Corporation	A2	A1	Aa3
Iron Mountain Incorporated	Ba2	Ba1	Ba3
Textron Inc.	Ba3	Ba2	Baa2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jun. 30	Jun. 23	Spread Diff
Talen Energy Supply, LLC	B3	1,900	1,447	452
Rite Aid Corporation	Caa3	834	683	151
American Airlines Group Inc.	Caa1	617	590	27
Laboratory Corporation of America Holdings	Baa2	71	54	17
Meritage Homes Corporation	Ba1	145	129	17
Avis Budget Car Rental, LLC	B3	280	263	16
R.R. Donnelley & Sons Company	B3	491	477	13
BorgWarner Inc.	Baa1	68	56	12
The Terminix Company, LLC	B1	220	208	12
Carnival Corporation	B2	341	332	9

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jun. 30	Jun. 23	Spread Diff
Hilton Worldwide Finance, LLC	Ba2	150	206	-56
Hasbro, Inc.	Baa3	73	106	-33
Occidental Petroleum Corporation	Ba2	192	222	-30
Calpine Corporation	B2	310	340	-30
Macy's Retail Holdings, LLC	B1	289	315	-26
HCA Inc.	Baa3	85	108	-23
Service Corporation International	Ba3	145	168	-23
AutoNation, Inc.	Baa3	68	91	-23
Service Properties Trust	Ba2	193	213	-20
Pitney Bowes Inc.	B1	397	415	-18

Source: Moody's, CMA

CDS Movers

Figure 4. CDS Movers - Europe (June 23, 2021 – June 30, 2021)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Jun. 30	Jun. 23	Senior Ratings
Casino Guichard-Perrachon SA	Caa2	Caa3	Caa1
de Volksbank N.V.	A2	A3	A2
Santander Financial Services plc	Baa1	Baa2	A1
Orsted A/S	A1	A2	Baa1
Severn Trent Plc	Baa1	Baa2	Baa2
ASML Holding N.V.	Baa1	Baa2	A3
Alpha Services and Holdings S.A.	B3	Caa1	Caa2
Italy, Government of	Baa3	Baa3	Baa3
France, Government of	Aa2	Aa2	Aa2
United Kingdom, Government of	Aaa	Aaa	Aa3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Jun. 30	Jun. 23	Senior Ratings
Heathrow Finance plc	Ba2	Baa2	Ba2
Societe Generale	A2	A1	A1
CaixaBank, S.A.	Baa1	A3	Baa1
ABN AMRO Bank N.V.	Aa3	Aa2	A1
Natixis	A2	A1	A1
Commerzbank AG	A3	A2	A1
Danske Bank A/S	A2	A1	A3
RCI Banque	Ba3	Ba2	Baa2
Banco Comercial Portugues, S.A.	Ba3	Ba2	Ba1
GlaxoSmithKline plc	A1	Aa3	A2

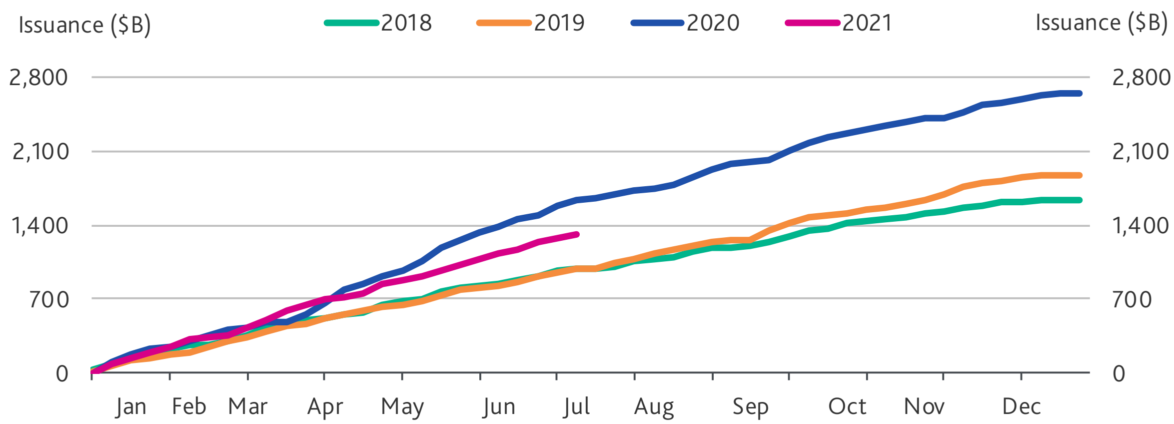
CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Jun. 30	Jun. 23	Spread Diff
TUI AG	Caa1	697	600	97
Heathrow Finance plc	Ba2	146	60	86
Boparan Finance plc	Caa1	857	786	71
Piraeus Financial Holdings S.A.	Caa3	515	499	16
Deutsche Lufthansa Aktiengesellschaft	Ba2	240	226	15
Permanent tsb p.l.c.	Baa2	220	214	6
Marks & Spencer p.l.c.	Ba1	175	170	5
Sappi Papier Holding GmbH	Ba2	354	349	5
Elisa Corporation	Baa2	41	37	4
CECONOMY AG	Ba1	155	151	4

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Jun. 30	Jun. 23	Spread Diff
Alpha Services and Holdings S.A.	Caa2	346	380	-34
Banca Monte dei Paschi di Siena S.p.A.	Caa1	198	229	-31
Casino Guichard-Perrachon SA	Caa1	471	490	-19
Stena AB	Caa1	491	505	-14
thyssenkrupp AG	B1	280	290	-10
National Bank of Greece S.A.	Caa1	184	191	-7
Vedanta Resources Limited	Caa1	846	853	-7
Greece, Government of	Ba3	66	73	-6
de Volksbank N.V.	A2	37	43	-6
Severn Trent Plc	Baa2	46	52	-6

Source: Moody's, CMA

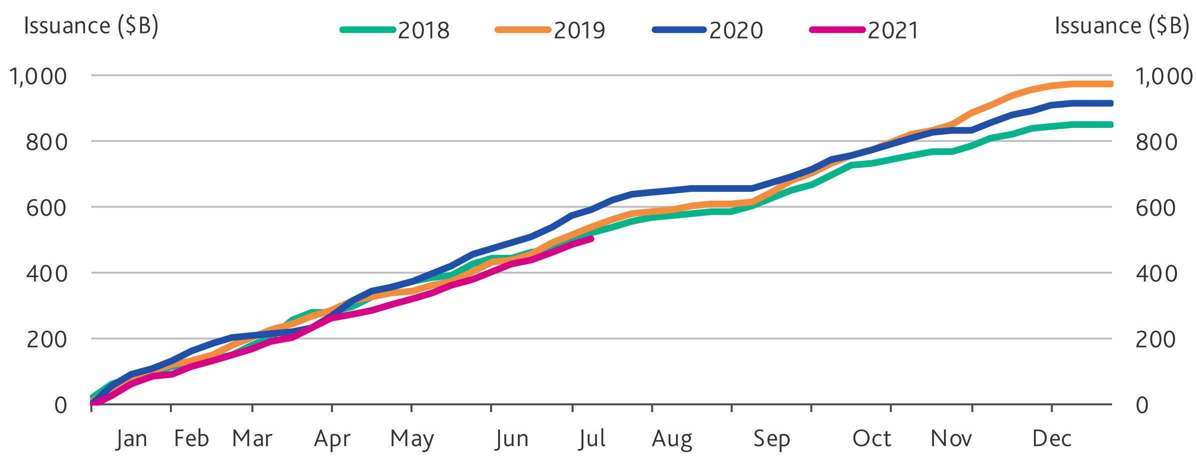
ISSUANCE

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



Source: Moody's / Dealogic

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



Source: Moody's / Dealogic

ISSUANCE

Figure 7. Issuance: Corporate & Financial Institutions

	USD Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	26.068	12.920	41.635
Year-to-Date	901.681	380.863	1,315.902

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	11.673	4.124	17.370
Year-to-Date	401.190	89.519	504.884

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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