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CAPITAL MARKETS RESEARCH

MOODY'S
ANALYTICS

WEEKLY MARKET OUTLOOK

Profits Give Direction to Downgrades and Defaults

Moody's Analytics Research

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Credit Markets Review and Outlook *by John Lonski*

Profits Give Direction to Downgrades and Defaults

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The Week Ahead

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

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The Long View

Full updated stories and key credit market metrics: September's newly rated loans from high-yield issuers rose yearly for a second straight month.

Credit Spreads	Investment Grade: Year-end 2020's average investment grade bond spread may slightly exceed its recent 131 basis points. High Yield: The high-yield spread may be wider than its recent 504 bp by year-end 2020.
Defaults	US HY default rate: According to Moody's Investors Service, the U.S.' trailing 12-month high-yield default rate jumped from September 2019's 3.4% to September 2020's 8.5% and may average 9.8% during 2020's final quarter.
Issuance	For 2019's offerings of US$-denominated corporate bonds, IG bond issuance rose by 2.6% to $1.309 trillion, while high-yield bond issuance surged by 55.8% to $432 billion. In 2020, US$-denominated corporate bond issuance is expected to soar higher by 52.1 for IG to a record 1.992 trillion, while high-yield supply may rise 23.4% to a record high $534 billion.

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U.S. and Europe Changes Mixed for the Latest Period

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Credit spreads, CDS movers, issuance.

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Moody's Capital Markets Research *recent publications*

Links to commentaries on: Issuance boom, default rate, volatility, credit quality, unprecedented stimulus, bond yields, record savings rates, demographic change, high tech, complacency, Fed intervention, speculation, risk, credit stress, rate cuts, optimism, coronavirus, corporate credit, spreads, leverage, VIX.

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Credit Markets Review and Outlook

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

Profits Give Direction to Downgrades and Defaults

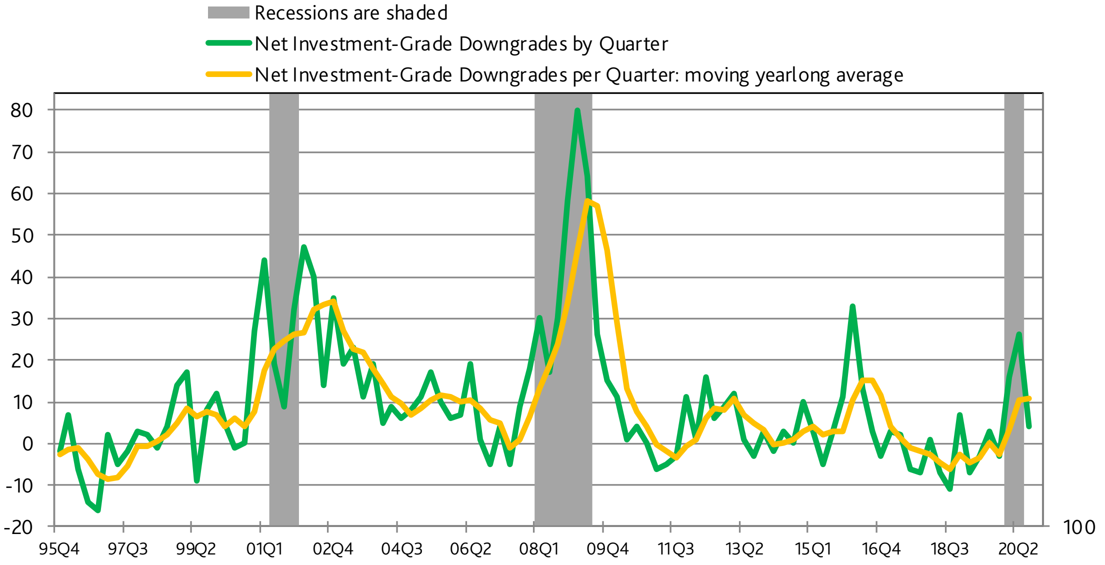
Though unresolved issues stemming from COVID-19 warn of substantial tail risk, investors have become more tolerant of above-average risk according to the recent narrowing of corporate bond yield spreads. The moving five-day averages of investment- and speculative-grade corporate bond yield spreads recently fell to their narrowest bands since March 2020.

Despite elevated equity market volatility, the Bloomberg/Barclays 467 basis point average high-yield bond spread of the five-days-ended October 14 was well under its 1,039 bp cycle peak of the five-days-ended March 25 but was wider than its 369 bp average of 2016-2019.

Compared to its 399 bp cycle peak of the five-days-ended March 25, 2020, Moody's Analytics' long-term Baa industrial company bond yield spread averaged 204 bp during the five-days-ended October 14. Nevertheless, the latest five-day average compares unfavorably to the spread's 180 bp average of 2017-2019.

A drop in net credit rating downgrades reflects a stabilization of the credit standing of U.S. investment-grade corporations. Notwithstanding how the Baa rating category comprised a much greater share of the U.S. investment-grade bond market compared to previous recessions, the COVID-19 downturn has not been especially harsh to the credit rating revisions of U.S. investment-grade corporations.

Figure 1: COVID-19's Upturn by Net Investment-Grade Downgrades Has Been Tame Compared to Previous Recessions
U.S. issuers
sources: Moody's Investors Service, Moody's Analytics



After rising from fourth-quarter 2019's 3 to the 21 of 2020's first quarter and the 26 of the second quarter, the net downgrades of U.S. IG corporate issuers sank to 7 in the third quarter. (Because of the distortions emanating from a couple of quarters where special events swelled the number of public utility rating changes, the mentioned IG rating revisions exclude those of electric and gas utilities.)

Net IG downgrades averaged 15 per quarter during 2020's first nine months. In stark contrast, net IG downgrades averaged 67 per quarter during the nine-months-ended June 2009, wherein the metric peaked at the 80 of 2009's first quarter.

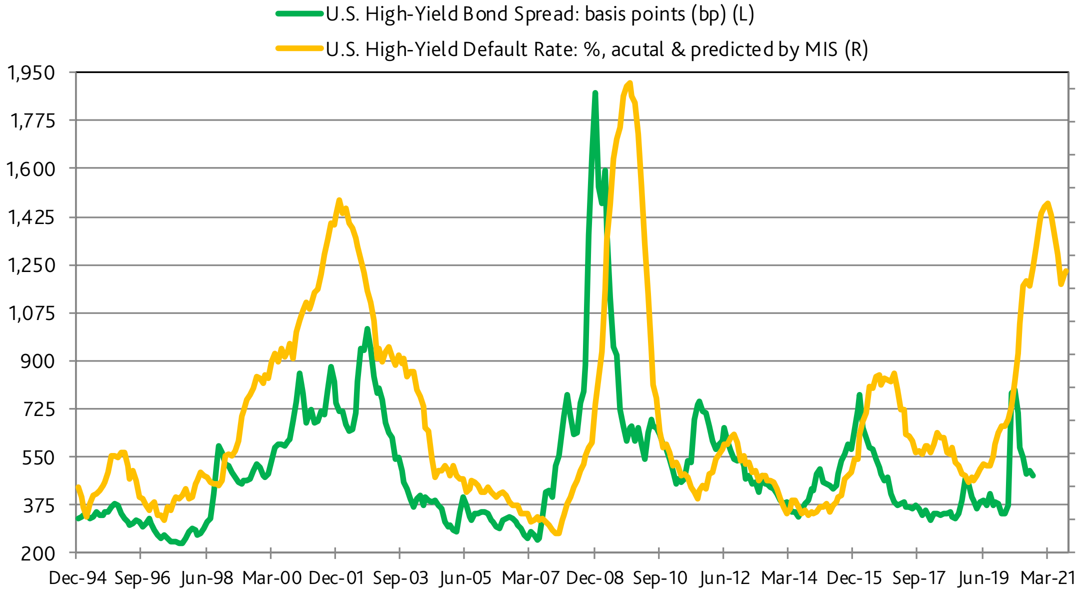
For 2009's first quarter, there were 59 net downgrades of U.S. IG financial companies and 21 net downgrades of U.S. IG industrial companies. Credit losses from exposure to home mortgages explain why IG financial institutions fared so poorly during 2008-2009's credit crunch and financial crisis.

Default Outlook Mimics 2001-2002's Climb

The U.S. high-yield default rate dipped from August 2020's 8.7% to September's 8.5%. Nevertheless, the baseline outlook of default researchers at Moody's Investors Service has the default rate resuming its ascent in September and eventually peaking at the 11.1% of March 2021. As of early October, the default rate's prospective peak is well under the Great Recession's 14.7% top of November 2009 and, instead, matches January 2002's 11.1% peak following 2001's recession.

As inferred from the default outlook, as well as medium- and speculative-grade bond yield spreads, corporate credit will fare better during the COVID-19 recession compared with the Great Recession. What is especially striking is how the course taken by the high-yield bond spread for 2020-to-date bears a closer resemblance to its temporary widenings of 2011 and 2015-2016, as opposed to the paths taken during the recessions of 2008-2009 and 2001.

Figure 2: High-Yield Default Rate Projections More Closely Resemble 2001 Recession than Great Recession...
High-Yield Bond Spread's Path Resembles 2011 and 2015-2016 More So Than Prior Recessions
sources: Bloomberg/Barclays, Moody's Investors Service

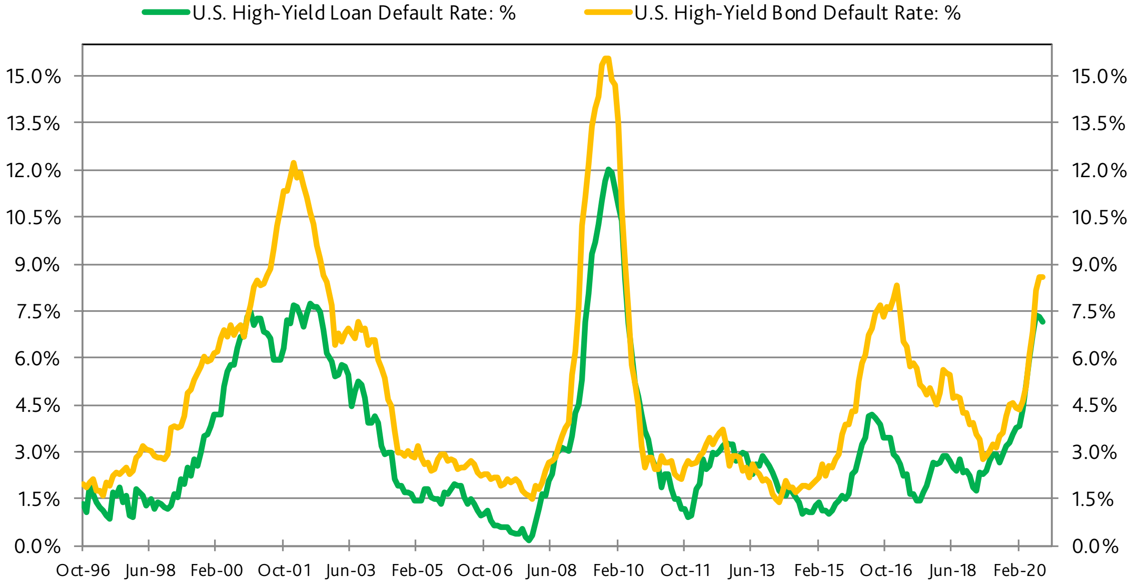


High-Yield Bond and Loan Spreads Show Muted Response to COVID-19 Recession

Markets have been less pessimistic than credit analysts regarding the default rate's forthcoming trend. As inferred from the drop by the high-yield bond spread from April 2020's peak month-long average of 796 bp to the 483 bp average of October-to-date, the relative frequency of U.S. high-yield defaults may crest at a rate no greater than 8.5% during early 2021, while easing to a rate no greater than 7% by July 2021.

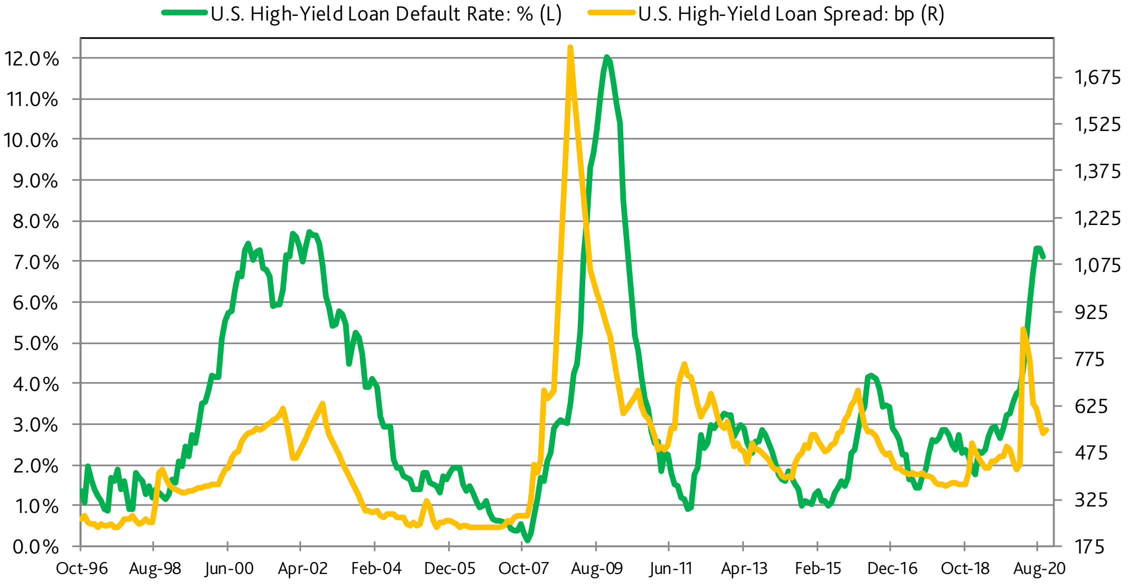
However, the muted response by the high-yield bond spread to the latest recession may cause some to expect loan debt, and not bond debt, to suffer the brunt of forthcoming defaults. Nevertheless, September's U.S. high-yield bond default rate of 8.6% was above the accompanying loan default rate of 7.1%. In fact, the high-yield default rate topped the bond default rate only once since 2014—that was in April 2020, when a marginally higher loan default rate of 5.15% compared with a bond default rate of 5.10%.

Figure 3: For September 2020, U.S. High-Yield Bond Default Rate of 8.6% Exceeded the U.S. High-Yield Loan Default Rate of 7.1%
sources: Moody's Monthly Default Report, Moody's Capital Markets



Furthermore, the recent trend by a proxy for the high-yield loan spread does not support a greater than 7% high-yield loan default rate by mid-2021. The month-long average for the high-yield loan spread proxy peaked in March 2020 at 870 bp and has since eased to an October-to-date average of 546 bp. The latter implicitly forecasts a July 2021 loan default rate that will be significantly less than September 2020's 7.1%.

Figure 4: High-Yield Loan Spread's Declining Trend Favors a Loan Default Rate That Will Be Less Than September 2020's 7.1% by Summer of 2021
sources: Moody's Monthly Default Report, Credit Suisse, Moody's Capital Markets



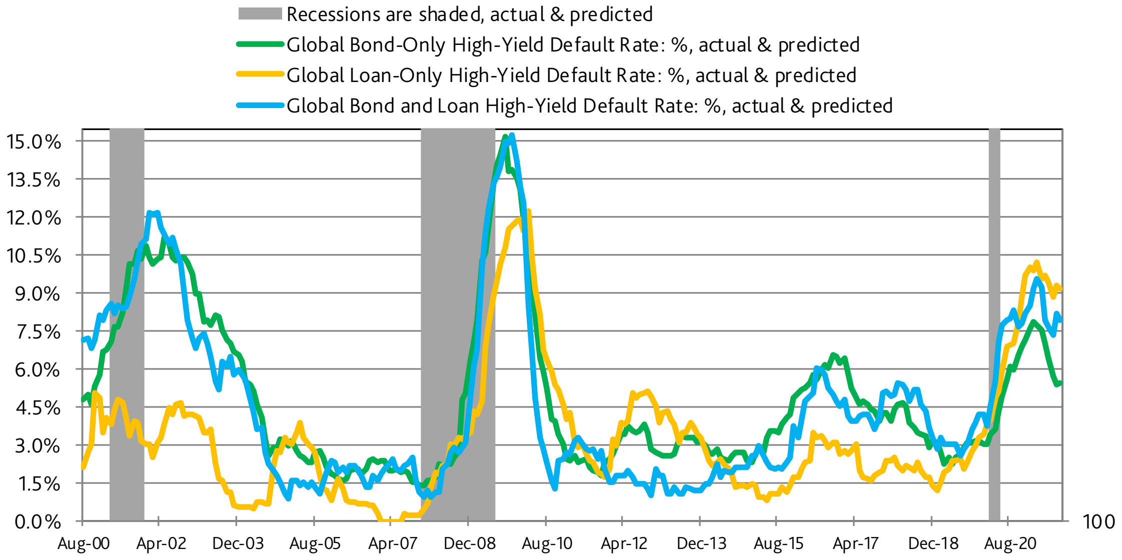
Global Outlook Has Loan Default Rate Exceeding Bond Default Rate

Moody's Investors Service does supply baseline estimates for future high-yield bond and loan default rates. However, these estimates are global in scope and, thus, do not specify projections for U.S. issuers.

MIS' baseline estimates have the global high-yield default rate for issuers having both bond and loan obligations rising from September 2020's 8.4% to a March 2021 peak of 9.6% and then easing to 7.9% by

September 2021. For high-yield issuers owing only bond debt, the global default rate climbs up from September 2020's 6.0% to February 2021's projected peak midpoint of 7.9% followed by a projected 5.4% midpoint for September 2021. For high-yield issuers having only loan debt outstanding, September's actual default rate of 7.0% is followed by baseline estimates showing a March 2021 peak of 10.2% and elevated 9.2% for September 2021.

Figure 5: In a Sharp Break from the Past, the Loan-Only High-Yield Default Rate Is Expected to Peak Well Above the Bond-Only Default Rate
One-year global default rates
sources: Moody's Investors Service, Moody's Analytics



During the global financial crisis of 2008-2009, the peak global high-yield default rates occurred in November 2009 at 15.2% for issuers with bond and loan debt outstanding, in September 2009 at 15.2% for issuers having only bond debt, and in January 2010 at 11.9% for loan-only borrowers. Thus, the forthcoming peaks for global high-yield default rates are expected to remain significantly under their highs of the Great Recession.

Operating Leverage May Take Hold in 2021

Unrivaled support from the Federal Reserve and fiscal stimulus have benefited corporate credit quality. Of related special importance has been the drop by the U.S. unemployment rate from April 2020's 80-year high of 14.7% to September's 7.9% and the climb by the percent of manufacturing capacity in use from April 2020's record low 59.9% to September's 70.2%.

Operating profits benefit considerably when rates of resource utilization rise from today's atypically low levels. This phenomenon is referred to as "operating leverage," or a situation where the percent increase by corporate earnings is a multiple of the accompanying percent increase by business sales. Operating leverage also implies a widening of profit margins, where the latter ordinarily enhances a company's financial flexibility.

Operating leverage is implicit to 2021's outlook for S&P 500 corporate earnings that has earnings per share expanding at least three-times as fast as revenues. According to October 9's FactSet consensus, a recovery by the revenues of S&P 500's member companies from 2020's prospective 2.6% drop to 2021's 8.0% advance is expected to prompt a dramatic change in direction for earnings per share from 2020's expected 17.7% contraction to a projected 25.5% surge for 2021.

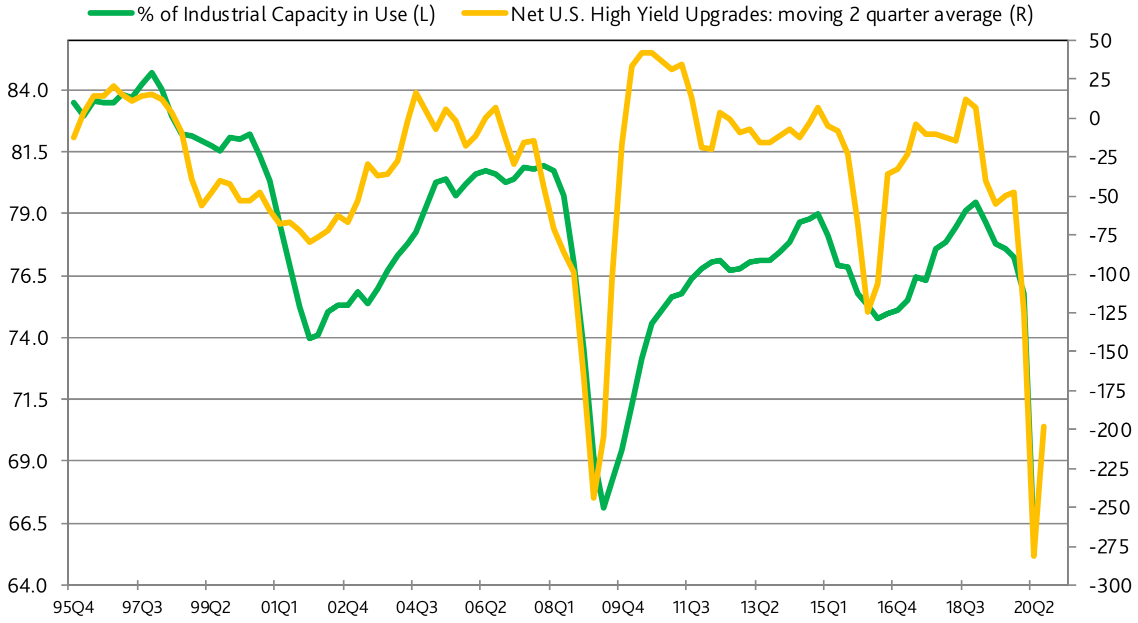
By contrast, the Blue-Chip consensus forecast of early October 2020 projected only a partial rebound by pretax profits from current production, or core profits, from 2020's anticipated 11.4% contraction to a 5.6% increase for 2021. However, the latter may be too small if the Blue-Chip consensus projections for industrial production prove correct. Early October's consensus expects the annual percent change for U.S. industrial production to recover from 2020's 7.5% contraction—the deepest since 2009's 11.5% plunge—to a 4.0% increase for 2021.

Of all readily available macro indicators, none explains annual percent changes by core profits better than the annual percentage point changes of the manufacturing and industrial rates of capacity utilization. Here, faster growth rates for manufacturing and industrial output imply bigger percentage point increases for the rates of capacity utilization.

The year-over-year percent change of core pretax profits' moving yearlong average shows its strongest correlation of 0.70 with the manufacturing capacity utilization rate's yearly percentage point change followed by its 0.69 correlation with the yearly percentage point change for the industrial capacity utilization rate. Further behind are core pretax profits' correlations of 0.45 with nominal GDP's yearly percent change, 0.44 with real GDP's yearly percent change, and -0.34 with the unemployment rate's yearly percentage-point change.

As inferred from the historical record, the latest Blue-Chip consensus projection of a 4.0% annual increase by 2021's industrial production portends an increase by the rate of industrial capacity utilization that favors a 15% midpoint for 2021's increase by core profits, wherein core nonfinancial-corporate profits advance by a livelier 18%. So big of an increase by profitability can only improve corporate credit quality.

Figure 6: Rising Rate of Industrial Capacity Utilization Would Lift Net High-Yield Upgrades
sources: Federal Reserve, Moody's Analytics



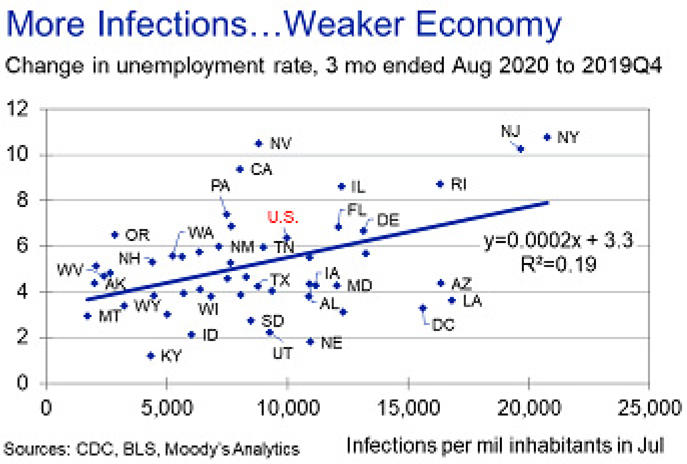
The Week Ahead – U.S., Europe, Asia-Pacific

THE U.S.
By Mark Zandi of Moody's Analytics

The Rotten Year

Twenty-twenty has been a rotten year, and any chance of it ending on a high note has faded. The COVID-19 pandemic continues to rage. Another wave of infections is a serious threat as the weather turns colder and social distancing and mask wearing are at best uneven across the country. Rancor over the presidential election is mounting, and it is disconcerting that there is even a question that there will be a graceful transition of power if President Trump loses the election. Adding to the tumult, lawmakers appear unlikely to come to terms soon on another fiscal rescue package to shore up the fragile economy, even though the president and House Democrats both have endorsed trillion-dollar plans. It is tough to see how the economy can gain any traction until next year when, we hope, the pandemic and election are in the history books.

On the pandemic, there is a clear relationship between the healthcare crisis it has created and the economic crisis. More infections results in a weaker economy. With the pandemic entering its eighth month, there is now enough data to show this econometrically using a panel regression relating confirmed infections per capita to the unemployment rate across states, Puerto Rico, and the District of Columbia since the pandemic hit in March. The best fitting regression lags infections per capita by one month, so that for example an increase in infections in August results in an increase in unemployment in September. A panel regression simply captures this relationship across states and over time, increasing the number of datapoints (260) available for the regression. The regression results are definitive (and available upon request), with confirmed infections explaining 85% of the variation in unemployment rates across states since March.



More Infections…Weaker Economy

Change in unemployment rate, 3 mo ended Aug 2020 to 2019Q4

Sources: CDC, BLS, Moody's Analytics

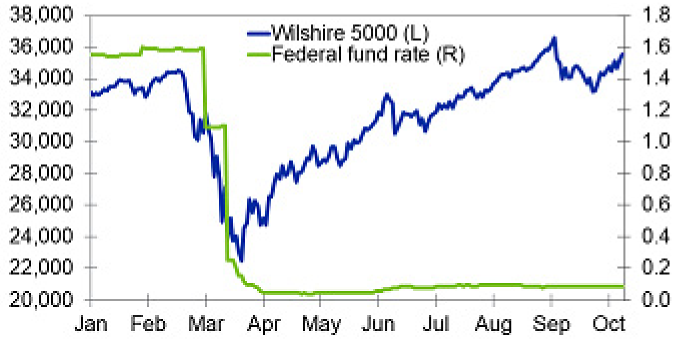
Based on this regression and other cross-country analysis, we estimate that a sustained 10,000 increase in daily confirmed infections results in an approximately 0.5-percentage point increase in the unemployment rate, all else being equal. For example, if daily infections double from 40,000, the average over the past couple of months, to say 80,000, about where infections peaked in the summer, then the unemployment rate would ultimately increase by 2 percentage points—putting it back near double digits.

It is thus not surprising that as infections have significantly intensified across Europe over the past several weeks, the European economy is faltering again. Europe had meaningfully brought down infections with its stringent lockdowns early on in the pandemic, and its economy had begun a strong comeback in the summer, but that recovery looks to be flagging again with the reintensifying pandemic. The same negative dynamic also appears to have begun in the United States. As people start to move indoors with the colder weather, infections in recent weeks are up in much of the northern part of the country, including in the Northeast, which like Europe had gotten its infections down with stringent lockdowns. College reopenings haven't helped; many college towns have quickly become hot spots. Our baseline economic outlook assumes that the worst of the pandemic is behind us, but this is clearly a tenuous assumption.

The process of electing a president has historically been neither here nor there when it comes to the economy. Even the highly contentious Bush versus Gore election in 2000 had no meaningful impact, save perhaps for a few bad days in the stock market, which was already struggling with the dot-com stock bust. This time may be different. The nation feels like it could boil over if Trump versus Biden is a close election and one side or the other believes that the election is being stolen. Fueling this political heat are the nation's extraordinarily polarized electorate as well as Trump's active effort to undermine confidence in the election and his strong suggestion that he would not leave office if he thinks he was cheated. The arrest of more than a dozen men plotting to kidnap the Democratic governor of Michigan ostensibly for the way she has handled the state's pandemic, which is very different from the president's, crystallizes the concern that the election could ignite violence.

This would be much less of a concern if the winner wins handily, making it indefensible to question the outcome. Current polling suggests this may happen. Vice President Biden is up by as much as 10 percentage points nationwide and 5 to 7 points in key swing states. However, our election model suggests the results will be much closer. Assuming that turnout by Republicans and Democrats isn't lopsided to one party or the other, which seems likely, then our modeling shows Biden winning the electoral college with 279 votes. Of course, 270 votes are needed to win. As an aside, our modeling identifies Pennsylvania as the most critical swing state, and turnout in the Philadelphia area as especially critical to who will win the state. This would seem to give Biden a further edge, since he lives just a few miles south of downtown Philly. Nonetheless, if the election outcome is as close as our modeling suggests, the election seems certain to be contested by Trump. That would make the next couple of months stomach churning while the mess gets straightened out. There is nothing but downside to the economy in such a disquieting scenario.

Federal Reserve Buoys Stock Market



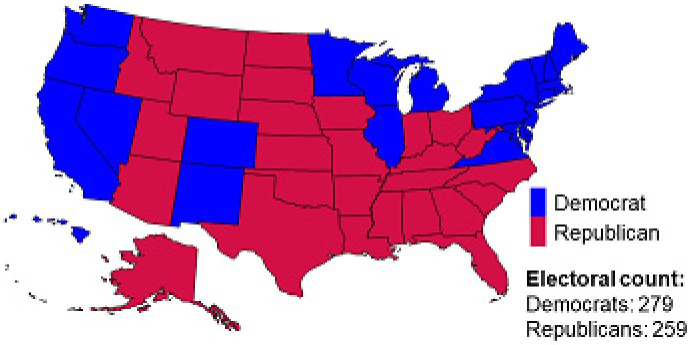
Sources: Federal Reserve, SIX Financial, Moody's Analytics

Given how hard the pandemic has been on the economy, it may be hard to fathom how our models, which include a range of both political and economic variables, show such a close race. Key is the stability of Trump's approval rating. According to the Gallup poll, which we use in our modeling given its long history, the president's popularity has been consistently the lowest among modern-day presidents, but it has also been astonishingly stable—regardless of what Trump says or does his base of supporters remains loyal. It is the change in the president's approval rating leading up the election, and not the level of that rating, that matters in our modeling of voter behavior.

The narrow election results are also due to the stock market's recovery. How stock prices fare is increasingly important to driving voting decisions, since the large baby boom generation is focused on its retirement and stock portfolios, and perhaps because Trump has used the market as a barometer of how the economy and he are performing. Stocks have recovered from their slide when the pandemic hit, and while this is because of a range of factors, not least of which is the Federal Reserve's aggressive action, Trump benefits. There is thus considerable irony in the stock market's recent strength as investors have begun to discount the prospects for a Biden victory and even a Democratic sweep. Investors appear cheered by Biden's focus on providing massive fiscal support to the economy and the implications for stronger corporate earnings. This, despite their discomfort with Biden's proposal to scale back Trump's tax cuts for corporations and well-to-do households.

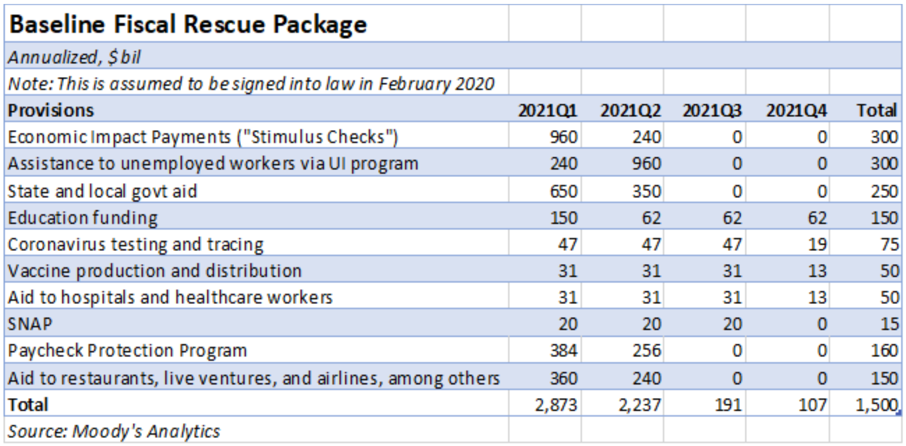
VP Biden Wins a Nail-Biter

How states will vote if nonincumbent turnout is typical



Source: Moody's Analytics

The most serious blow to the economy as the year ends will be the failure of Trump and Congress to come to terms on more help to those hit hardest by the pandemic. We have long assumed that lawmakers would agree on legislation providing $1.5 trillion in additional fiscal support. This makes economic sense. Without such support the already-fragile recovery threatens to come undone. It also makes political sense given the approaching election and the need for lawmakers to demonstrate that they have voters' backs. Yet a deal has not come to fruition, and we are now assuming in our baseline outlook (35% probability) that the $1.5 trillion package won't become law until February, after the next president is inaugurated. Our baseline also assumes that Biden will become president, and the House remains Democratic and the Senate Republican. Real GDP and job growth come almost to a standstill in the fourth quarter in the baseline, but the economy avoids a double-dip recession as the fiscal support provided early next year revives it.



Baseline Fiscal Rescue Package

Annualized, $bil

Note: This is assumed to be signed into law in February 2020

Provisions	2021Q1	2021Q2	2021Q3	2021Q4	Total
Economic Impact Payments ("Stimulus Checks")	960	240	0	0	300
Assistance to unemployed workers via UI program	240	960	0	0	300
State and local govt aid	650	350	0	0	250
Education funding	150	62	62	62	150
Coronavirus testing and tracing	47	47	47	19	75
Vaccine production and distribution	31	31	31	13	50
Aid to hospitals and healthcare workers	31	31	31	13	50
SNAP	20	20	20	0	15
Paycheck Protection Program	384	256	0	0	160
Aid to restaurants, live ventures, and airlines, among others	360	240	0	0	150
Total	2,873	2,237	191	107	1,500

Source: Moody's Analytics

Of course, there are a number of alternative scenarios for how the election will play out and what this means for the fiscal package we expect early next year. The next most likely scenario is a Democratic sweep (30% probability), which would give President Biden the political window to go big, something closer to a $3 trillion fiscal package. This would be consistent with the fiscal policy proposals he has put forward during the campaign, and the HEROES Act legislation passed by the Democratic House several months ago. This would include funds to bridge the economy to the other side of the pandemic, but also money to ramp up government investments in infrastructure, education, healthcare, housing, and other social policies to help the economy return more quickly to full employment. There are two other election outcome scenarios, including the status quo of a Trump victory with a split Congress (25% probability) and a Republican sweep (10%). These scenarios wouldn't preclude another fiscal rescue package, but it would likely be much smaller, something similar to the less than $1 trillion package Senate Republicans have been holding out for in the recent negotiations.

Unfortunately, there is a lot of difficult script to be written between now and when the next president and Congress sign another fiscal package into law. It would be prudent to buckle in.

Next Week

We will be watching our weekly Moody's Analytics & CNN Business Back-to-Normal Index, which had been holding firm with the U.S. economy operating at 19% below its pre-COVID-19 crisis level in the latest period. Updates on the very active U.S. housing market will include figures on new residential construction, existing-home sales, and the NAHB housing market index. A surprising jump this week in the Philadelphia Fed's manufacturing index increases interest in the bank's nonmanufacturing survey due Tuesday. The Fed's latest Beige Book will add color to the economic picture in all 12 of its districts.

EUROPE

By Ross Cioffi of Moody's Analytics

Russian and U.K. Retail in Likely Decline

Next week will feature Russian and British releases. We expect retail sales in Russia to be down 2.2% y/y for September, improving slightly on the 2.7% decline in August. Sales still haven't returned to year-ago levels as they have elsewhere in the world. The Russian economy is hindered by persistently low oil prices, which will also have damaging effects on the labor market. We think the unemployment rate, will be unchanged in September at 6.4%; the highest it's been since 2011. One of the most important factors for the labor market is that COVID-19 is still spreading in Russia and in its most important export market, the European Union. We expect the Central Bank of Russia to continue supporting domestic demand by keeping its key one-week repo rate steady at a historically low 4.25%. But the effects will be limited by low wage growth and dismal sentiment among consumers and businesses.

The U.K. will also publish retail sales data for September. Unfortunately, we expect retail sales fell 1% m/m in September, after having increased by 0.8% in August. This would mean that sales likely already peaked this year, as we don't expect domestic demand to improve considerably from now until next year. New social-distancing restrictions imposed between September and October will affect services much more than goods—and we may even see a bump to retail sales of food as households shift spending into supermarkets from closed restaurants and pubs. But overall, demand will fall along with darkening sentiment, since unemployment is set to continue rising, particularly as the country's current wage subsidy scheme gets replaced by a less generous one this month.

We expect that consumer price inflation in the U.K. held steady at 0.2% y/y in September. Inflation will lag for the same reason it is lagging elsewhere: domestic demand has taken a hit in the wake of the COVID-19 pandemic as firms and households hold onto their wallets more tightly. Pockets of channeled demand, such as toward food, internet services or video games, will be outweighed by new declines in oil prices and low demand in the rest of the core basket of goods and services.

	Key indicators	Units	Moody's Analytics	Last
Tues @ 2:00 p.m.	Russia: Retail Sales for September	% change yr ago	-2.2	-2.7
Tues @ 2:00 p.m.	Russia: Unemployment for September	%	6.4	6.4
Wed @ 9:30 a.m.	U.K.: Consumer Price Index for September	% change yr ago	0.2	0.2
Fri @ 9:30 a.m.	U.K.: Retail Sales for September	% change yr ago	-1.0	0.8
Fri @ 11:30 a.m.	Russia: Monetary Policy for October	%	4.25	4.25

Asia-Pacific

By Xiao Chun Xu of Moody's Analytics

Japan's Exports Can't Overcome Weak Global Demand

Japan's exports are expected to have disappointed again in September, underscoring the persistent weakness in global demand for an economy with little counter-cyclical buffer in its export basket. A volatile global COVID-19 infections curve will dampen the chances of a trade-led revival beyond the September quarter. Imports will be weaker than exports due to suppressed consumer sentiment, leading to a trade surplus for the second consecutive month.

China's economy is expected to have rebounded by 6.6% y/y in the third quarter, led by the supply side and external demand for high-tech goods and medical equipment, and fostered by high credit growth, fiscal stimulus in investment spending, and supportive policies for vulnerable sectors. China's labour market has stabilised, and the domestic tourism industry has reported a healthy rebound, although travel remains below normal.

The recovery of China's industrial production and fixed asset investment sped up in August, and we expect the trend to have continued in September ahead of the Golden Week holidays in early October. Credit growth remained high for several months, and exports have been healthy for certain segments. Furthermore, a significant portion of China's fiscal stimulus was in infrastructure investment, which should drive China's recovery for the second half of the year, along with external demand.

China's retail sales likely gradually improved again in September. Through much of the pandemic, the key growth was in online marketplaces, while the road to recovery remains fragile for in store shops because of the lingering effects of the pandemic and heightened external uncertainty. Sectors such as hotels and restaurants were the worst hit and are particularly vulnerable. We should see further gradual improvement in these sectors in September, prior to a boost from the Golden Week in October.

Depressed domestic demand, elevated saving rates and lower oil prices will continue to dampen CPI inflation in New Zealand and Japan. New Zealand's inflation decline in the second quarter was mainly driven by falling prices of transport and accommodation services, the worst hit by lockdown and travel restrictions, and we expect the trend to continue since the country's borders remained closed.

Japan's domestic travel subsidy since late July to encourage domestic tourism in the wake of widespread travel restrictions dragged down the overall price index, along with lower oil prices. Consumer prices will likely remain in deflationary territory in the coming months, as the country battles the spread of COVID-19.

	Key indicators	Units	Moody's Analytics	Confidence	Risk	Last
Mon @ 10:50 a.m.	Japan Foreign Trade for September	¥ bil	200	2	↑	350.56
Mon @ 1:00 p.m.	China GDP for Q3	% change yr ago	6.6	2	↓	3.2
Mon @ 1:00 p.m.	China Retail Sales for September	% change yr ago	2.0	3	↓	0.5
Mon @ 1:00 p.m.	China Fixed Asset Investment for September YTD	% change yr ago	2.1	3	↑	-0.3
Fri @ 8:45 a.m.	New Zealand CPI for Q3	% change yr ago	-1.0	2	↓	-0.5
Fri @ 10:30 a.m.	Japan CPI for September	% change yr ago	-0.6	2	←	-0.4

The Long View

September's newly rated loans from high-yield issuers rose yearly for a second straight month.

By John Lonski, Chief Economist, Moody's Capital Markets Research Group
October 15, 2020

CREDIT SPREADS

As measured by Moody's long-term average corporate bond yield, the recent investment grade corporate bond yield spread of 131 basis points exceeded its 116 basis-point median of the 30 years ended 2019. This spread may be no wider than 135 bp by year-end 2020.

The recent high-yield bond spread of 504 bp is thinner than what is suggested by the accompanying long-term Baa industrial company bond yield spread of 202 bp and the recent VIX of 27 points. The latter has been historically associated with a 730-bp midpoint for the high-yield bond spread.

DEFAULTS

September 2020's U.S. high-yield default rate of 8.5% was up from September 2019's 3.4% and may approximate 10.9% on average by 2021's first quarter.

US CORPORATE BOND ISSUANCE

Third-quarter 2019's worldwide offerings of corporate bonds revealed annual advances of 15.2% for IG and 56.8% for high-yield, wherein US$-denominated offerings soared higher by 36.8% for IG and 81.3% for high yield.

Fourth-quarter 2019's worldwide offerings of corporate bonds revealed annual advances of 15.3% for IG and 329% for high-yield, wherein US$-denominated offerings dipped by 0.8% for IG and surged higher by 330% for high yield.

First-quarter 2020's worldwide offerings of corporate bonds revealed annual advances of 17.7% for IG and 26.5% for high-yield, wherein US$-denominated offerings increased 43.7% for IG and grew 21.4% for high yield.

Second-quarter 2020's worldwide offerings of corporate bonds revealed annual surges of 69% for IG and 31% 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.

For 2019, worldwide corporate bond offerings grew by 5.4% annually (to $2.447 trillion) for IG and advanced by 49.2% for high yield (to $561 billion). The projected annual percent increases for 2020's worldwide corporate bond offerings are a 16.2% advance for IG and 17.0% for high yield.

US ECONOMIC OUTLOOK

Unacceptably high unemployment and other low rates of resource utilization will rein in Treasury bond yields. As long as the global economy operates below trend, 1.00% will serve as the upper bound for the 10-year Treasury yield. Until COVID-19 risks fade substantially and election year risks recede, wider credit spreads are possible.

Europe

By Ross Cioffi and Barbara Teixeira Araujo of Moody's Analytics
October 15, 2020

FRANCE

Consumer price inflation in France slowed to a standstill in September, from 0.2% y/y previously. The headline was dragged down by steeper deflation in energy prices after a minor improvement in August. Inflation in the core basket picked up by 0.5% y/y, the same as in the previous month. Manufactured goods prices fell by the same amount as in August, while service price growth eased again. The recovery in supply has been faster than that in demand as people lose their jobs, companies refrain from investing, and firms and households keep precautionary savings high. We therefore expect French consumer prices to drift into deflationary territory in the final months of the year.

Some good news came from September's figures on business creation in France. According to INSEE, there were 83,825 new business startups in September; seasonally and working-day adjusted, this was 2.3% higher than the number of new startups in August and 20.4% higher than they were in September of last year. This is a historically high number, and to a certain extent it reflects the historically high degree of job destruction and the rapid change in needs and demand that came about under the pandemic. There was a similar jump during the previous crisis.

The biggest increases were in the real estate, transport and storage, and trade sectors. Given the supply disruptions last spring, and those which are set to continue this winter, it is no surprise that entrepreneurs would see an opportunity in transport and storage services. Housing markets across advanced economies have also been running hot as individuals take advantage of ultra-low interest rates and act on a desire to move into less dense housing.

The problem is that there's no guarantee these new businesses will survive, especially if the demand behind them is linked to temporary disruptions from the COVID-19 pandemic. And it's important to remember that unemployment, which doesn't count the millions of workers on the state-sponsored wage subsidy scheme, is still well above year-ago levels. Although the startup numbers are a reminder that the entrepreneurial spirit thrives even during crisis, they aren't enough to change our outlook on the French economy—activity will slow in the months ahead with the return of COVID-19.

EURO ZONE

The big highlight Wednesday out of Europe was the euro zone's industrial production for August. The release showed that factory output recovered further during the month, in line with expectations. Unfortunately, there wasn't enough momentum to push output above its pre-pandemic level. Factory output in the currency area still read 5.7% below where it was back in February, as the European economies haven't managed to fully rebound from the COVID-led slumps in March and April.

Prospects for the euro zone's industries remain subdued, with the outlook having worsened over the past couple of weeks due to the resurgence of cases across the European economies. This second wave is prompting renewed restrictions from the euro zone governments, which should hurt both supply and demand during the fourth quarter. Granted, the restrictions shouldn't be as draconian as those enacted in the spring, but they will still cause trouble. Intra-euro zone trade will suffer, with those countries that rely heavily on goods exports expected to be hit the hardest. On the upside, external demand from Asia should remain relatively steady, as the pandemic situation there isn't as bad.

Among the euro zone's major countries, Germany is the one most exposed to foreign trade. We thus weren't surprised that factory output there was 11.6% below its February level in August (compared with an average of 5.7% for the euro zone), and unfortunately things won't get much better in coming months given the expected slowdown in the recovery. France and Spain will also take center stage. Although their economies depend more on domestic demand, the resurgence in COVID cases in both countries has been extreme, putting increased pressure on the outlook. It is worth noting that France has an outsize aerospace industry that has been bludgeoned by the lower demand for international travel. On the upside, Italy was the only major country where factory output rose above pre-pandemic levels in August, though we forecast some mean reversion in September.

Asia Pacific

By Xiao Chun Xu of Moody's Analytics
October 15, 2020

CHINA

China is continuing to lead the global recovery. China's export growth expanded to US$239.8 billion in September from US$235.2 billion in August. Exports of high-tech and medical equipment continued to drive the acceleration. Offsetting these gains were declines in commodities such as rare earths, aluminum products, steel and petroleum, and auto parts, which reflect persistent weaknesses in Asia's supply chain, especially in the auto industry. On the other hand, despite a mild catch-up in consumer demand, China's CPI and PPI were low due to moderating food prices, lower commodity and oil prices, and relatively weak consumer sentiment.

MALAYSIA

Malaysia's industrial production rallied further in yearly terms in August, adding 0.3%, led by a recovery in manufacturing and boosted by the favourable spillovers from China's recovery. However, a second wave of COVID-19 infections in Malaysia dampens the outlook. The recovery of Malaysia's industrial production is likely to be uneven in the coming quarter. Although the Chinese economy has rebounded strongly since the June quarter, the rest of the world still struggles to contain the spread of the virus.

INDIA

India's industrial production made modest progress in August, down 8% y/y. This was an improvement on the 10.8% slump in July, but the reading was still worse than expectations for a 6% yearly decline. On the upside, the daily COVID-19 case count is declining in India, and the government is pushing forward with economic reopening plans ahead of the festival season, which is usually a high-spending period. The monsoon season is predicted to be favourable and should relieve some food price pressure, increasing purchasing power for India's consumer base. The federal government also recently announced an additional $10 billion economic stimulus package aimed at reviving domestic demand.

SINGAPORE

Singapore's GDP contracted by 7% y/y in the third quarter, easing from the second quarter's 13.2% y/y plunge. The economy gradually reopened after strict social distancing measures were lifted in June, although the recovery has been uneven. Manufacturing led the recovery with a 2% y/y expansion, reversing the previous quarter's 0.8% decline. The sector was driven by a pickup in global demand for semiconductors, which in turn supported the output of electronics and precision engineering. On the other hand, the construction and services sectors have yet to recover from the impact of COVID-19 regulations. The standstill of international travel also weighed on the services sector, although the implementation of "green lanes" for business travel might offer some relief to the industry in coming quarters.

SOUTH KOREA

The Bank of Korea kept its seven-day repurchase rate unchanged at 0.5% at its October meeting. Despite signs of improvement in the economy, the BoK is cautious not to raise rates in view of the growing uncertainty over the pandemic. Moreover, increasing household debts and rising property prices place the economy at a higher risk of financial instability, leaving little room for further rate cuts.

AUSTRALIA

Australia's labour market weakened slightly in September, with the unemployment rate ticking up to 6.9% seasonally adjusted, from 6.8% in August. Around 30,000 jobs were lost during the month, while the number of unemployed rose by more than 10,000 to be 32% higher from the previous year. Conditions continue to be uneven across the states, with Victoria deteriorating during the month as it battles to contain COVID-19 infections, while New South Wales and Queensland showed slight improvements. Even though the unemployment rate has roughly stabilised, underemployment remains a substantial problem, particularly for Victoria at 14.9% of the labour force. Additional waves of infections remain a key downside risk to delay the rebound.

Ratings Round-Up

U.S. and Europe Changes Mixed for the Latest Period

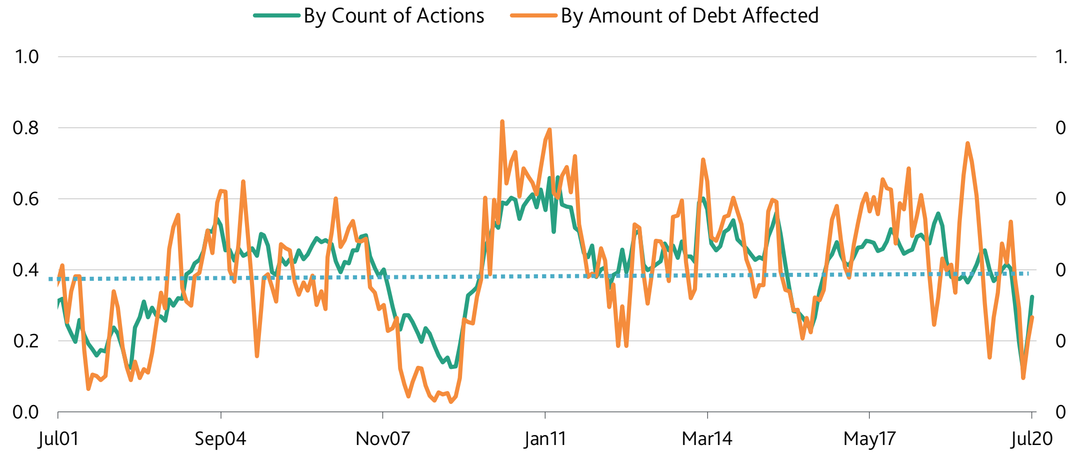
By Michael Ferlez

U.S. corporate credit performance was mixed for the period ended October 13, with upgrades accounting for 45% of total rating changes, but all the reported affected debt. The period's rating changes largely affected speculative-grade companies and were diffuse across a wide range of industries. The most notable change was made to Ascent Resources Utica Holdings LLC, which saw its corporate family rating and its senior unsecured credit rating upgraded to B2 and Caa1, respectively. The Moody's Investors Service upgrade of the Ascent's CFR rating reflects the firm's mitigation of refinancing risk and near-term maturity pressure. The rating action impacted $600 million in corporate debt.

European rating change volume remained limited and were largely credit negative. Downgrades outnumbered upgrades two to one and accounted for all the affected debt for the period. Geographically, both downgrades were to Luxembourg-based firms, while the lone upgrade was in the Netherlands. The most notable change was to Mallinckrodt International Finance SA, which saw its probability of default rating cut to D-PD from Caa1-PD and its senior secured revolver and term loans cut to Caa2 from Caa1. The Moody's Investors Service downgrade of Mallinckrodt's probability of default follows the firm's recent filing for Chapter 11 bankruptcy protection in the U.S.

FIGURE 1

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



* Trailing 3-month average

Source: Moody's

Ratings Round-Up

FIGURE 2

Rating Key

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

FIGURE 3

Rating Changes: Corporate & Financial Institutions – US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/SG
10/7/20	PROASSURANCE CORPORATION	Financial	SrUnsec/IFSR		D	Baa2	Baa3	SG
10/7/20	JILL HOLDINGS LLC -JILL ACQUISITION LLC	Industrial	LTCFR/PDR		U	Caa3	Caa2	SG
10/8/20	PSS INDUSTRIAL GROUP CORP.	Industrial	SrSec/BCF/LTCFR/PDR		D	B3	Caa2	SG
10/8/20	ASCENT RESOURCES, LLC -ASCENT RESOURCES UTICA HOLDINGS, LLC	Industrial	SrUnsec/LTCFR/PDR	600	U	Caa2	Caa1	SG
10/8/20	NEP GROUP, INC-NEP/NCP HOLDCO, INC	Industrial	SrSec/BCF/LTCFR/PDR		U	Caa2	Caa1	SG
10/12/20	GENERAC HOLDINGS INC. -GENERAC POWER SYSTEMS, INC.	Industrial	SrSec/BCF/LTCFR/PDR		U	Ba2	Ba1	SG
10/12/20	CORELLE BRANDS HOLDINGS INC.	Industrial	SrSec/BCF		D	Ba2	Ba3	SG
10/12/20	PREMIER BRANDS GROUP HOLDINGS LLC	Industrial	SrSec/BCF/LTCFR/PDR		D	Caa1	Caa2	SG
10/13/20	FILTRATION GROUP CORPORATION	Industrial	SrSec/BCF/LTCFR/PDR		D	B2	B3	SG
10/13/20	SHIFT4 PAYMENTS, LLC	Industrial	SrSec/BCF		U	B2	Ba2	SG
10/13/20	ASCEND LEARNING, LLC	Industrial	SrSec/BCF		D	Ba3	B1	SG

Source: Moody's

Ratings Round-Up

FIGURE 4
Rating Changes: Corporate & Financial Institutions – Europe

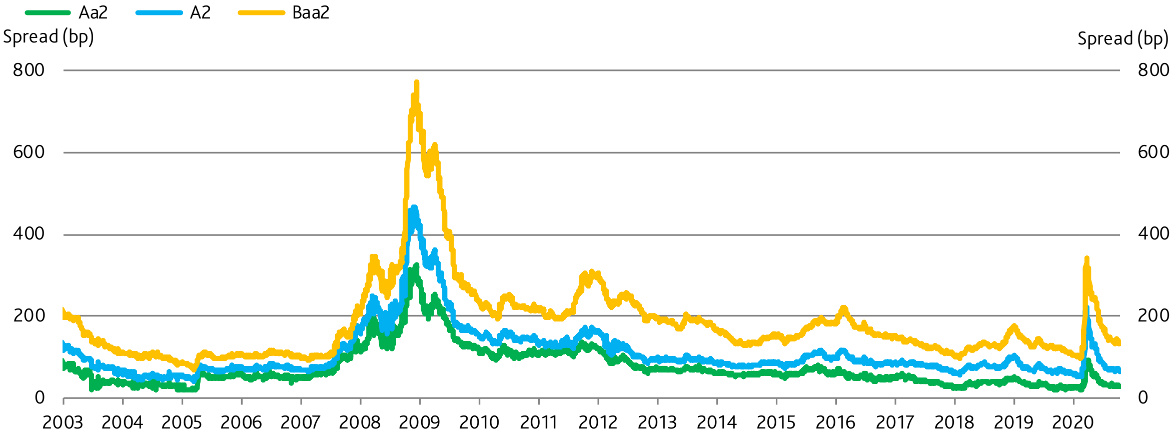
Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/SG	Country
10/12/20	CMA CGM S.A.-CEVA LOGISTICS FINANCE B.V.	Industrial	SrSec/BCF/LTCFR/PDR		U	Caa1	B3	SG	NETHERLANDS
10/12/20	MALLINCKRODT PLC-MALLINCKRODT INTERNATIONAL FINANCE SA	Industrial	SrSec/SrUnSec/BCF/LTCFR/PDR	542	D	Caa1	Caa2	SG	LUXEMBOURG
10/13/20	GLO HOLDCO S.C.A.-CURIUM BIDCO S.A.R.L	Industrial	LTCFR/PDR		D	B2	B3	SG	LUXEMBOURG

Source: Moody's

Market Data

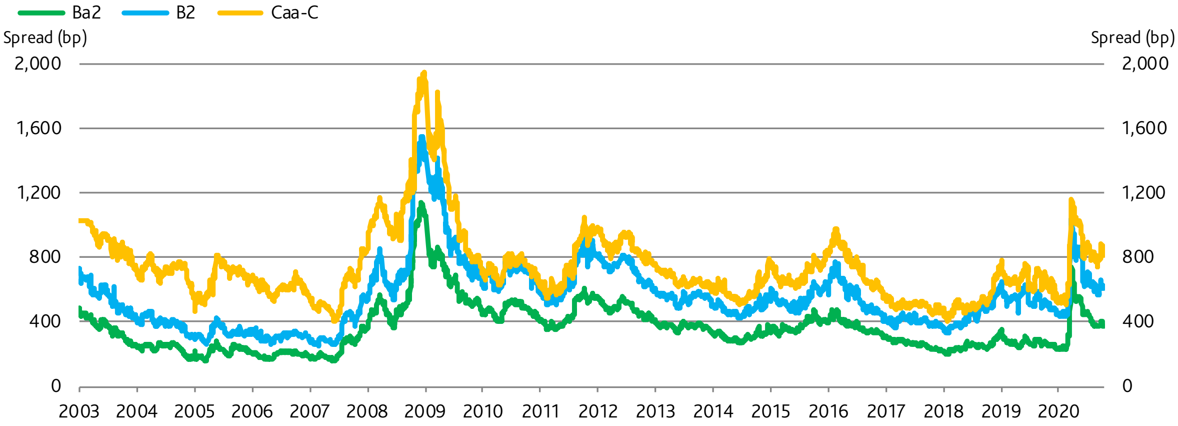
Spreads

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



Source: Moody's

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



Source: Moody's

Market Data

CDS Movers

Figure 3. CDS Movers - US (October 7, 2020 – October 14, 2020)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Oct. 14	Oct. 7	Senior Ratings
Citigroup Inc.	Baa1	Baa2	A3
Bank of America Corporation	A2	A3	A2
JPMorgan Chase Bank, N.A.	Aa3	A1	Aa2
Apple Inc.	Aa1	Aa2	Aa1
Citibank, N.A.	Baa2	Baa3	Aa3
International Business Machines Corporation	Aa2	Aa3	A2
Amazon.com, Inc.	Aa1	Aa2	A2
Philip Morris International Inc.	Baa1	Baa2	A2
Bank of New York Mellon Corporation (The)	Aa2	Aa3	A1
American Express Company	Aa1	Aa2	A3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Oct. 14	Oct. 7	Senior Ratings
Consolidated Edison Company of New York, Inc.	Baa2	A3	Baa1
CenterPoint Energy, Inc.	Baa1	A2	Baa2
Danaher Corporation	A1	Aa2	Baa1
CenterPoint Energy Resources Corp.	Baa2	A3	A3
Eaton Corporation	Baa1	A2	Baa1
Alliant Energy Corporation	A3	A1	Baa2
TECO Energy, Inc.	A3	A1	Baa2
Advanced Micro Devices, Inc.	Baa2	A3	Baa3
John Deere Capital Corporation	A1	Aa3	A2
Intel Corporation	Baa2	Baa1	A1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Oct. 14	Oct. 7	Spread Diff
UDR, Inc.	Baa1	856	806	50
JetBlue Airways Corp.	Ba3	713	689	24
Commercial Metals Company	Ba2	292	270	22
United Airlines Holdings, Inc.	Ba3	930	913	17
First Industrial, L.P.	Baa2	240	225	16
United Airlines, Inc.	Ba3	793	779	14
Service Corporation International	Ba3	165	153	12
United States Cellular Corporation	Ba1	160	149	11
Boeing Company (The)	Baa2	278	268	10
Exelon Generation Company, LLC	Baa2	100	89	10

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Oct. 14	Oct. 7	Spread Diff
Nabors Industries, Inc.	Caa1	2,564	3,278	-715
Macy's Retail Holdings, Inc.	B1	998	1,127	-129
Rite Aid Corporation	Caa3	794	862	-68
Pitney Bowes Inc.	B1	425	478	-52
Royal Caribbean Cruises Ltd.	B2	1,078	1,127	-49
Avis Budget Car Rental, LLC	B3	541	590	-49
Olin Corporation	Ba3	267	313	-46
United States Steel Corporation	Caa2	1,111	1,156	-46
American Airlines Group Inc.	Caa1	2,515	2,555	-41
Dillard's, Inc.	Baa3	354	395	-41

Source: Moody's, CMA

Market Data

Figure 4. CDS Movers - Europe (October 7, 2020 – October 14, 2020)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Oct. 14	Oct. 7	Senior Ratings
Societe Generale	Aa2	Aa3	A1
BNP Paribas	Aa2	Aa3	Aa3
Credit Agricole S.A.	Aa1	Aa2	Aa3
Electricite de France	A1	A2	A3
Orange	Aa2	Aa3	Baa1
Equinor ASA	Aa1	Aa2	Aa2
DNB Bank ASA	Aa1	Aa2	Aa2
Unione di Banche Italiane S.p.A.	Baa2	Baa3	Baa1
BASF (SE)	Aa1	Aa2	A3
UBS AG	Aa1	Aa2	Aa3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Oct. 14	Oct. 7	Senior Ratings
Lloyds Bank plc	A3	Aa3	Aa3
Alliander N.V.	A3	A1	Aa2
Atlas Copco AB	Baa2	A3	A2
Barclays PLC	Baa3	Baa2	Baa2
Portugal, Government of	A2	A1	Baa3
HSBC Holdings plc	Baa2	Baa1	A2
NatWest Markets Plc	Baa3	Baa2	Baa2
Bankia, S.A.	Baa3	Baa2	Baa3
NatWest Group plc	Baa3	Baa2	Baa2
DZ BANK AG	Baa2	Baa1	Aa1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Oct. 14	Oct. 7	Spread Diff
Vedanta Resources Limited	B3	2,010	1,274	736
Vue International Bidco plc	Caa2	1,523	1,413	110
Boparan Finance plc	Caa1	552	493	59
TUI AG	Caa1	1,162	1,132	30
Koninklijke KPN N.V.	Baa3	87	58	28
CMA CGM S.A.	Caa1	630	614	16
Schaeffler Finance B.V.	Ba2	85	70	15
Permanent tsb p.l.c.	Baa2	219	204	15
thyssenkrupp AG	B1	398	389	9
Barclays PLC	Baa2	78	70	8

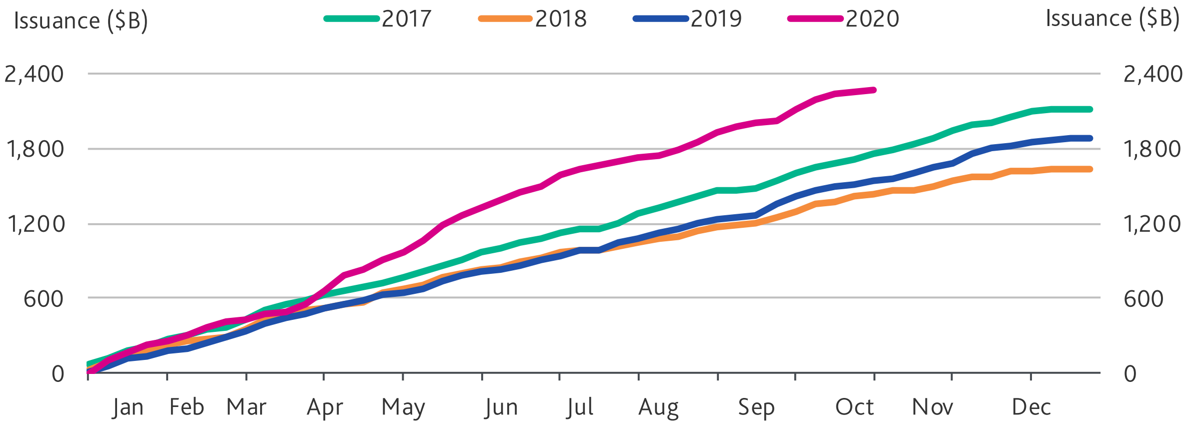
CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Oct. 14	Oct. 7	Spread Diff
Novafives S.A.S.	Caa2	1,064	1,173	-109
Jaguar Land Rover Automotive Plc	B1	730	798	-68
Atlantia S.p.A.	Ba3	215	257	-42
Rolls-Royce plc	Ba3	414	449	-35
Casino Guichard-Perrachon SA	Caa1	1,013	1,038	-25
Iceland Bondco plc	Caa2	554	571	-17
Deutsche Lufthansa Aktiengesellschaft	Ba2	355	370	-16
ITV plc	Baa3	154	166	-12
Novo Banco, S.A.	Caa2	371	380	-10
ISS Global A/S	Baa2	79	88	-9

Source: Moody's, CMA

Market Data

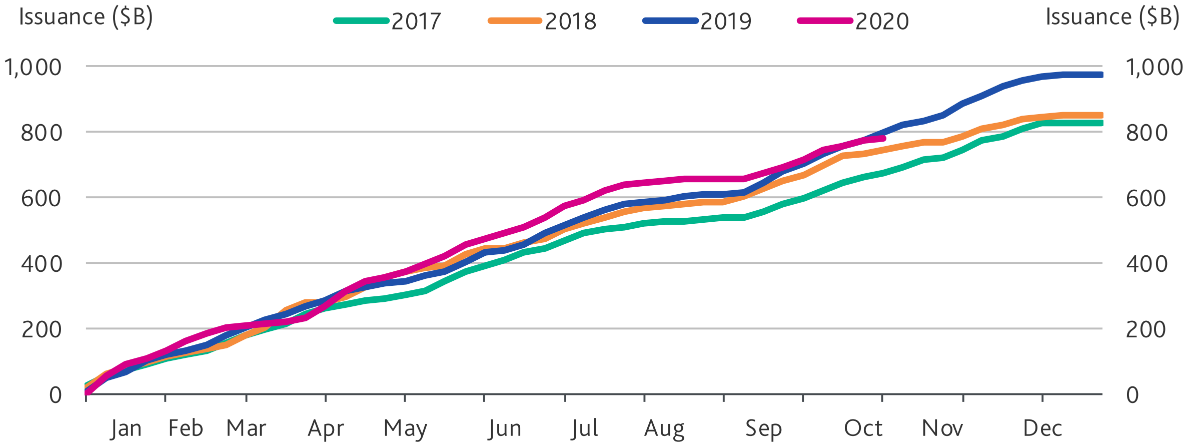
Issuance

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



Source: Moody's / Dealogic

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



Source: Moody's / Dealogic

Market Data

Figure 7. Issuance: Corporate & Financial Institutions

	USD Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	13.300	1.150	14.450
Year-to-Date	1,761.487	438.219	2,272.033

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	6.737	2.343	9.080
Year-to-Date	656.718	94.899	782.279

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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Record-High Bond Issuance Aids Nascent Upturn (Capital Market Research)

Corporate Bond Issuance Boom May Steady Credit Quality, On Balance (Capital Market Research)

Markets, Bankers and Analysts Differ on 2021's Default Rate (Capital Market Research)

Corporate Credit Mostly Unfazed by Equity Volatility (Capital Market Research)

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Fed Policy Shift Bodes Well for Corporate Credit (Capital Markets Research)

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