WEEKLY MARKET OUTLOOK
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Inside Economics Podcast:

How Inverted Could the U.S. Yield Curve Get?

The U.S. yield curve has been inverted for four weeks and is among the most inverted in decades. This is sending an ominous sign about recession risks, but how much more inverted could the yield curve become? Historically, the largest inversion between the 10- and two-year Treasury yields occurred during the recessions in the early 1980s, as then Federal Reserve Chairman Paul Volcker was aggressively raising interest rates to tame inflation. The yield curve was systematically inverted by around 50 basis points and at one point by more than 200 basis points, which makes Wednesday's inversion of 37 basis points seem somewhat benign. However, since then, inversions rarely have exceeded 20 basis points and reached a maximum below 50 basis points in 1989 and 2000. Could the current inversion exceed these values?

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Largest Inversion Since 2000

Sources: FRB, Moody's Analytics

Contrast the traditional view of inversions and their role in signaling recession with what is happening during this tightening cycle. The traditional view holds that yield-curve inversions happen when the Fed either tightens too far by mistake, or when it fails to react to a weakening economy in time. In either case, financial markets foresee the need for lower rates in the future, causing an inversion between the short-term and the long-term yields, since the short-term yields reflect the currently high policy rates. In such a situation, the inversion is an accident caused by too tight of a policy stance, not part of a plan.

This cycle is following a different script. According to the Fed's dot plot, the Fed plans to take the federal funds rate temporarily above neutral; the dot plot has the federal funds rate significantly higher at the end of 2022 and 2023 than the long run rate of 2.5%, making the dot plot itself inverted. If that script is followed, then the inversion will not be accidental but rather intentional. And intentional inversions are very different from inadvertent ones.

Currently, the best example of this mechanism is on display in the Czech Republic and Poland. Both central banks intentionally took policy rates way above neutral levels in order to prevent inflation expectations from de-anchoring. Since both are communicating that they expect to take policy rates lower in due course, this caused abnormally large inversions of close to 200 basis points.

The main takeaway is that the U.S. yield-curve inversion in this cycle could get much larger than in previous cycles during the last three decades. It could end up resembling the inversion seen in the early 1980s, since now as then the Fed's plans call for an intentional inversion. The other takeaway is that this time around inversion might not be as precise a signal as usual about an upcoming recession. Part of the forecasting power of inverted yield curves comes from bond prices signaling that the economy is weakening and will need lower interest rates in the near future. However, this time around, the inversion will be more about the Fed's intentions than about market expectations of recession, which might mean that yield-curve watchers will overstate recession risks.

Of course, this rests on the assumption that the Fed's dot plot should be believed, and that the Fed will be able to follow the charted course. Both assumptions might not be true. The Fed might say it plans to hike more than it actually does in order to send a more powerful signal to markets. This might cool inflation without the need to implement as many hikes. Or alternatively, the Fed might be planning to take rates above neutral, but the economy will break before the Fed gets that chance. In this, the Fed's situation is very different from the Czech or Polish central banks, since their tightening has a much smaller effect on their respective economies, so they can tighten more than the Fed can without breaking the economy. Therefore, it is unlikely that inversion would get as large as in those countries. So, while recent inversions are likely to get topped, the Volcker-era records for inversion are likely safe.

A summer of spurts

Summer is normally a quiet time for U.S. corporate bond issuance, but this year, issuance is occurring in spurts. Companies are taking advantage of the recent slide in interest rates and attempting to get ahead of the Federal Reserve, which has clearly signaled that it will continue to front-load rate hikes. A 50-basis point hike in September is likely, but there is the risk of a 75-basis point hike if the inflation data continue to come in hotter than expected. Companies are trying to tap the investment or high-yield corporate bond markets before rates rise.

While more deals are occurring in both the investment-grade and high-yield corporate bond markets, companies are still paying larger concessions. Investors have been dipping their toes into the high-yield corporate bond market, which had been ice cold this year. However, investors are demanding some additional concessions. There was little issuance immediately after last week's meeting of the Federal Open Market Committee, but the high-yield corporate bond market has come to life recently.

Investors are still cautious, prioritizing quality as the economy has clearly slowed. The weakening in the U.S. economy has fanned concerns about an increase in credit risk, since corporate earnings are not immune to a deterioration in the U.S. economy, particularly if a recession takes hold. Corporate debt has surged recently, which is another concern, particularly as higher interest rates are going to add billions to corporate interest expenses.

U.S. Corporations Are Flush with Cash

Sources: BEA, Federal Reserve, Moody's Analytics

Despite the drop in the default count from last month, the trailing 12-month global speculative-grade default rate held steady at 2.1% at the end of June, the same reading from the end of May. Corporate default rates in the U.S. remain low, at 0.8% in June. Looking up and down the credit ladder, defaults are highest among those companies rated Caa_C. The investment grade default rate was 0% in June while it was 1.4% for speculative grade. Default rates will likely rise further but remain fairly low.

One reason that defaults are unlikely to spike is that U.S. companies are flush with cash. Cash as a share of corporate GDP is more than 50%, which is noticeably higher than prior to the pandemic and among the largest since the 1970s. Having U.S. corporations flush with cash should limit the rise in corporate defaults, barring any enormous economic disruption.

TOP OF MIND

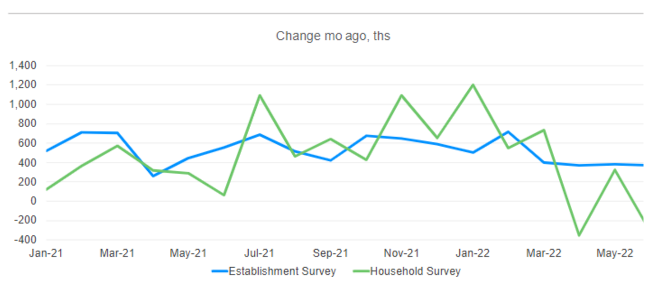
Job Survey Divergence Not Troubling, Yet

BY JUSTIN BEGLEY and MATT COLYAR

U.S. GDP declined for a second consecutive quarter, fueling the debate of whether the economy is in recession. While a two-quarter decline meets the definition of recession for some, other economic data suggest we're not there yet. Weakness in GDP this year has been attributed to net trade and inventories, which are volatile and often mean-reverting components. Domestic final sales, gross domestic income, and the labor market, on the other hand, remain healthy. It is also important to note that GDP is just one of many variables used in the broader definition of recession used by the National Bureau of Economic Research, the de facto arbiter of U.S. recessions. The research body defines recession as a "significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in production, employment, real income and other indicators."

Though GDP has slipped, unemployment in the U.S. remains low at 3.6%. June's figure was just 0.1 percentage point higher than the pre-pandemic rate, which was the lowest in 50 years. But the two most cited employment surveys, from the Bureau of Labor Statistics, are sending conflicting signals as to whether job growth is continuing its rally or coming to a screeching halt. In June, the BLS's establishment survey reported a gain of 372,000 jobs, while its household survey showed a loss of 315,000 jobs.

Employment Surveys Heading in Different Directions...



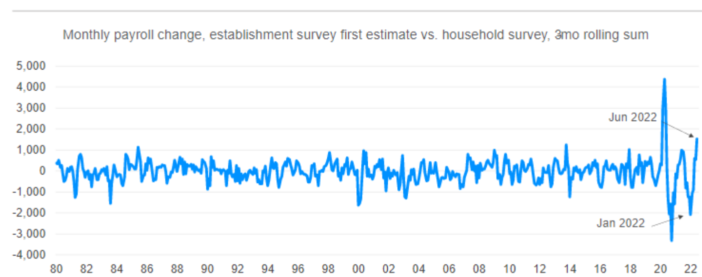
Sources: BLS, Moody's Analytics

The establishment survey is considered a better measure of employment, since it contains a larger sample and counts the number jobs rather than individuals with jobs, as the household survey does. The establishment survey is also subject to historical revisions, whereas the household survey's estimates are not.

Divergence of the two surveys in opposite directions is not uncommon; this occurs about a quarter of the time. However, since the pandemic the magnitude of the difference in job gains (or losses) reported by the establishment and household surveys has been significantly higher than the historical norm. The differences between the two surveys, excluding the most pandemic-disrupted months of 2020, have never been larger.

The preliminary estimates from the establishment survey, which garner the most media and financial market attention, show 1.5 million more jobs added in the second quarter than the three monthly household surveys estimate. Earlier in 2022, the opposite was true. Then, initial estimates from the establishment survey showed 2 million fewer jobs added than the household surveys reported.

...And the Magnitude Is Getting Larger



Sources: BLS, Moody's Analytics

July's jobs data are set to be released by the BLS on Friday. We expect a noticeable cooldown from June's robust pace and will be keeping keen watch on any ongoing differences between the two surveys.

For now, the more reliable of the two surveys is the one sending positive signals. While the chorus of economists, investors and pundits declaring a recession in the first half of 2022 in the U.S. grows by the day, the strength of the labor market remains the primary bulwark for optimists. Given today's precarious economy, there is an immense emphasis on the establishment survey as a major economic datapoint each month and the unusually large gap between the two surveys calls for acute circumspection.

The Week Ahead in the Global Economy

U.S.

The U.S. focus will be on the consumer price index for July, since it will influence what the Federal Reserve does. The decline in retail gasoline prices will be disinflationary for the CPI. Changes in retail gasoline prices closely track changes in the CPI for gasoline. Retail gasoline prices point toward a 10.8% decline in the CPI for gasoline, which would reduce growth in the headline CPI by 0.5 percentage point in July. Even with the decline, the CPI for gasoline is going to add a lot to year-over-year growth in the headline result. Also, while the headline CPI will post a small monthly gain in July, the core CPI, which excludes food and energy, will remain hot.

We'll also get new data on producer and import prices. The data on initial claims for unemployment insurance benefits will be important, but their recent rise is potentially misleading. Unadjusted for seasonal fluctuations, initial claims are not alarming. In fact, they are running around that seen over the past several months. Nonseasonally adjusted new filings have fallen in each of the past two weeks and are around 200,000. Historically, nonseasonally adjusted claims are north of 300,000 when the economy is headed into a recession.

Europe

The U.K.'s economy likely contracted in June by 1% month over month, resulting in a 0.1% quarter-over-quarter decline for the second quarter. We expect health services to weigh on overall output, as general practitioner appointments and the Test and Trace programme recoil from their pop in May.

Euro zone industrial production will likely contract 0.8% month over month in June after a 0.8% rise in May. Worsening PMI scores and contractions in factory orders for major economies leading up to the month will shine a downbeat light. New car registrations continued to slump considerably in year-ago terms during the month, which also caused concern that output in the car sector did not pick up much.

We do not expect surprises in the final estimates of CPIs in Germany, France, Spain and Italy. In Germany, inflation likely eased to 7.5% on a year-ago basis, because of a further decline in oil and fuel prices. In Italy, the inflation rate likely slowed to 7.9% from 8%. In Spain, inflation jumped to 10.8%, likely because of higher electricity prices, and in France, inflation will be up 6.1%. Russia will also print an estimate of inflation in July. We expect inflation slowed to 15.1% from 15.9% previously. Greater stability and a stronger ruble are helping to tame inflation, which shot up in the wake of Russia's invasion in late February.

Asia-Pacific

All eyes will be on China's consumer and producer price data for July. We look for producer price growth to notch 5.8% y/y, continuing the deceleration trend. Consumer prices are forecast to rise 2.9% y/y in July, up from 2.5% in June. Pork will be an important upward contributor on account of prices jumping again in July despite government intervention to tame gains.

The Bank of Thailand is expected to raise its benchmark interest rate by 25 basis points to 0.75% as it tackles increasing inflation. The last meeting saw a narrow call to keep rates steady to "ensure that the recovery will continue to gain traction as anticipated". Fast-growing tourist arrival figures will support domestic demand, pointing to a robust GDP print ahead. Given the recent inflation print of 7.7% y/y in June and inaction by the BoT at the last meeting, medium-term inflation expectations are at risk of becoming unanchored. It will be vital for the central bank to move now to prevent cost-push factors from accelerating inflation.

Philippine GDP growth will likely hit 8.8% y/y in the June quarter. This follows four quarters of spectacular growth that have put the country on track to comfortably meet its GDP growth target of 7% to 9% in 2022. Private consumption and investment will buoy second-quarter growth, but higher inflation, rising interest rates, and fiscal consolidation will see the economic expansion slow in the second half of the year.

Geopolitical Calendar

Date	Country	Event	Economic Importance	Financial Market Risk
Aug	Papua New Guinea	Declaration of general election result	Low	Low
4-Sep	Chile	Referendum on New Constitution	Medium	Low
6-Sep	Australia	Reserve Bank of Australia monetary policy announcement	Medium	Low
11-Sep	Sweden	Swedish election	Low	Low
20-21-Sep	U.S.	Federal Open Market Committee meeting	High	High
22-Sep	Japan	Bank of Japan monetary policy announcement	Medium	Low
25-Sep	Italy	General Election	Low	Low
30-Sep	India	Reserve Bank of India monetary policy announcement	Medium	Low
2-Oct	Brazil	Presidential and congressional elections	High	Medium
4-Oct	Australia	Reserve Bank of Australia monetary policy announcement	Medium	Low
28-Oct	Japan	Bank of Japan monetary policy announcement	Medium	Low
Oct/Nov	China	National Party Congress	High	Medium
1-Nov	Australia	Reserve Bank of Australia monetary policy announcement	Medium	Low
1-2-Nov	U.S.	Federal Open Market Committee meeting	High	High
7-18-Nov	U.N.	U.N. Climate Change Conference 2022 (COP 27)	Medium	Low
8-Nov	U.S.	Midterm elections	High	Medium
15-16-Nov	G-20	G-20 Heads of State and Government Summit, hosted by Indonesia	Medium	Low
18-19-Nov	APEC	Economic Leaders' Meeting, hosted by Thailand	Low	Low
7-Dec	Australia	Reserve Bank of Australia monetary policy announcement	Medium	Low
7-Dec	India	Reserve Bank of India monetary policy announcement	Medium	Low
13-14-Dec	U.S.	Federal Open Market Committee meeting	High	High
20-Dec	Japan	Bank of Japan monetary policy announcement	Medium	Low
18-Jan	Japan	Bank of Japan monetary policy announcement	Medium	Low
7-Feb	Australia	Reserve Bank of Australia monetary policy announcement	Medium	Low
8-Feb	India	Reserve Bank of India monetary policy announcement	Medium	Low
7-Mar	Australia	Reserve Bank of Australia monetary policy announcement	Medium	Low
10-Mar	Japan	Bank of Japan monetary policy announcement	Medium	Low
2-Apr	Finland	General election	Medium	Low
4-Apr	Australia	Reserve Bank of Australia monetary policy announcement	Medium	Low
28-Apr	Japan	Bank of Japan monetary policy announcement	Medium	Low
April	Solomon Islands	General election	Low	Low

Long-Term Corporate Spreads Widen

BY RYAN SWEET

CREDIT SPREADS

Moody's long-term average corporate bond spread widened from 147 to 156 basis points over the past week in line with the 156 basis point average in July. The long-term average industrial corporate bond spread widened by 9 basis points to 140. It averaged 141 in July.

The ICE BofA U.S. high-yield option adjusted bond spread narrowed from 507 to 454 basis points. The Bloomberg Barclays high-yield option adjusted spread narrowed this past week from 491 to 444 basis points. This compares with a high-yield spread that averaged 1,000 basis points during recent recessions and an average of 350 outside of recessions. Spreads might not widen significantly from here. The most recent Fed minutes noted that policymakers believe financial market conditions are roughly where they would want them to be.

The high-yield option adjusted bond spreads approximate what is suggested by the accompanying long-term Baa industrial company bond yield spread but are wider than implied by a VIX of 22. The VIX slipped over the course of the past week.

DEFAULTS

Despite the drop in the default count from last month, the trailing 12-month global speculative-grade default rate held steady at 2.1% at the end of June, the same reading as at the end of May.

The default tally reached 43 in the first half of the year, up from 29 in the same period last year. Across sectors, Construction & Building remains the largest contributor to defaults with 11. The banking sector followed with eight. By region, North America had 18 defaults (17 in the U.S. and one in Canada). The rest were from Europe (12), Asia-Pacific (11), and Latin America (two).

In accordance with our credit conditions outlook, we lifted our one-year baseline global speculative-grade default rate forecast to 3.7% from last month's 3.3%. If realized, the new forecast will inch closer to the historical average of 4.1%.

U.S. CORPORATE BOND ISSUANCE

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

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

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

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

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

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

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

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

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

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

In the week ended July 29, US$-denominated high-yield issuance totaled $725 million. This puts the year-to-date total at $100 billion. Investment-grade bond issuance totaled $22.3 billion in the same week. This brings its year-to-date total to $906 billion. Issuance is still tracking that seen in 2018 and 2019.

U.S. ECONOMIC OUTLOOK

There were some material changes to the Moody's Analytics U.S. baseline forecast in July. These changes were larger than in June as we have altered our expectations for the path of the fed funds rate and have incorporated a larger drag from the tightening in financial market conditions into the baseline. GDP growth for 2022 and 2023 was revised lower, with it now rising just south of 2%.

Fiscal assumptions

The July baseline forecast expects the federal deficit to fall from 12.4% in fiscal 2021 to less than 4% in the current fiscal year, as federal pandemic aid has all but dried up. This will be the largest fiscal drag since the demobilization of U.S. armed forces after World War II. By our estimate, it will reduce real GDP growth in 2022 by 4.2 percentage points compared with what would have been the case if the federal pandemic aid offered the same amount of support as it did in 2021. In turn, this fiscal drag will cut headline inflation for 2022 by at least a full percentage point.

Just months after we removed our assumption that congressional Democrats would enact a slimmed-down version of President Biden's Build Back Better agenda, Senate Democrats are showing signs of momentum in cobbling together many prior BBB policies into a potential reconciliation package. The details of the legislation are not final, but it would likely raise $1 trillion in prescription drug savings and tax revenue. Of this amount, half would finance new spending, while the remainder would go toward deficit reduction.

Our forecasting philosophy is that there needs to be a two-thirds probability that a piece of fiscal legislation will get passed for Moody's Analytics to adopt it in the baseline. Though the likelihood of Democratic success in resurrecting a stalled BBB agenda has risen over the past few months, it still isn't high enough that we would reincorporate some version of the BBB agenda in the baseline. At the time of the July forecast's publication, political betting markets were ascribing only an approximately 40% probability that a reconciliation bill would pass the Senate by early September. Nevertheless, if Democrats do prevail, then future vintages will have to revise down our current forecast for federal budget deficits in the next decades.

COVID-19 assumptions

Changes to our epidemiological assumptions were small and the economic implications are modest as each wave of COVID-19 has a diminishing effect on the economy. Total confirmed COVID-19 cases in the U.S. will be 96.6 million, compared with 97.07 million in the July baseline. The seven-day moving average of daily confirmed cases has edged lower recently.

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

Energy price forecast and assumptions

The baseline forecast now has West Texas Intermediate crude oil prices peaking higher than in the prior baseline forecast. However, the timing hasn't changed, and the forecast assumes oil prices peak in the second quarter, at $108.50 per barrel. The contours of the forecast haven't changed, and the July baseline still has oil prices steadily declining in the second half of this year and throughout next year. However, the decline is more gradual than in the prior baseline with West Texas Intermediate crude oil prices averaging $98.70 per barrel in the fourth quarter of this year, compared with $92.20 in the June baseline. Oil prices don't drop below $70 per barrel until 2024.

A key assumption is that even with the European ban, the global oil market will be roughly balanced by the end of 2022. Risks are that are it takes longer than expected. The EU ban will reduce Russian oil shipments to global markets by an additional 1 million bpd. The official bans cover about 4% of total global supply.

Cutting GDP forecast

Real GDP is expected to increase 1.9% this year, compared with 2.7% in the prior baseline. We have cut our forecast for U.S. GDP growth this year by a total of 160 basis points over the past few months. We nudged the forecast for GDP growth in 2023 down from 2.6% to 1.9%. The economy is now expected to be near its potential, which is likely around 2%.

There were revisions to first-quarter GDP, which declined 1.6% at an annualized rate (previously -1.5%). However, this masks significant revisions among the components, some more puzzling than others.

Real consumer spending is now shown to have added 1.2 percentage points to first-quarter GDP, compared with the 2.1-percentage point contribution in the government's second estimate. The big downward revision was concentrated to real consumer spending on services, which now added 1.3 percentage points to GDP growth, compared with the 2.1-percentage point contribution in the second estimate of first-quarter GDP.

Inventories rose $188.5 billion at an annualized rate in the first quarter, more than the $149.6 billion increase in the second estimate. This bodes ill for second-quarter GDP. For GDP, it's the change in the change in inventories that matters. Therefore, a smaller inventory increase relative to the first quarter could mean inventories are a bigger weight on growth in the second quarter.

The forecast has real GDP declining 0.5% at an annualized rate in the second quarter, consistent with our high-frequency GDP model's tracking estimate. This would be the second consecutive decline in GDP, but if the inventories are the main reason GDP declined in the second quarter, we wouldn't view this as a recession because it wouldn't be broad-based. Economic textbooks and the media often define a recession as two consecutive quarters of contracting GDP. But this is not quite accurate. In the U.S., GDP could decline in a quarter when the economy may not be in recession. The National Bureau of Economic Research's business cycle dating committee—which has become the de facto arbiter of recession in the U.S.—uses a more complex formula.

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

Our baseline forecast for real GDP growth this year is below the Bloomberg consensus of 2.4%. The forecast for next year is 0.1 percentage point stronger than the Bloomberg consensus of 1.8%.

Business investment and housing

There wasn't a material revision to the forecast for growth in real business investment this year. However, fundamentals have turned less favorable for the outlook as financial market conditions have tightened, including a noticeable widening in investment and high-yield corporate bond spreads. Therefore, we cut the forecast for growth in real business equipment spending next year, with it rising 4.1%, compared with 5.2% in the prior baseline.

There was a slight downward revision to housing starts as supply constraints and higher mortgage rates have started to bite into the housing market. Housing starts are expected to be 1.75 million, compared with 1.77 million in the prior baseline. Housing starts are expected to total 1.81 million next year, down from 1.86 in the prior baseline.

There are likely only so many homes that can be built each year because of labor-supply constraints and a lack of buildable lots. Some of the labor-supply issues will ease as the pandemic winds down, but the reduction in immigration is particularly problematic for homebuilders' ability to find workers. There were no material changes to the forecast for new- and existing-home sales this year. They are expected to total 6.59 million. We also cut the forecast for total home sales next year to 6.51 million, compared with 6.54 million in the June baseline. New-home sales account for about 10% of total new-home sales.

There were minor revisions to the forecast for the FHFA All-Transactions House Price Index this year and next. The June baseline has it rising 12.7% this year, compared with 11.3% in the prior baseline. The forecasts for 2023 and 2024 continue to expect little house price appreciation.

Labor market

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

Nonfarm employment increased by a net 372,000 in June, close to the gain in May and better than either we or the consensus anticipated. Trend job growth is likely running between 400,000 to 450,000. In the aftermath of the pandemic, revisions to monthly employment data remain larger than normal, but the direction of the adjustments has flipped. The back half of 2021 saw monthly job gains consistently revised upward with each subsequent estimate. Relative to their preliminary estimates, March, April and May now show 100,000 fewer jobs added to payrolls.

We have job growth averaging 359,000 per month this year before dropping to 133,000 in 2023. The unemployment rate is now expected to average around 3.5% in the fourth quarter of this year, 0.2 percentage point higher than in the June baseline. The unemployment rate is expected to continue increasing in the first half of next year until it hits 3.7% and then is little changed through the remainder of the year.

We assume a full-employment economy is one with approximately a 3.5% unemployment rate, around a 62.5%

labor force participation rate, and a prime-age employment-to-population ratio a little north of 80%. The labor force participation rate is close, but not at this threshold.

On the surface, there appears to be a disconnect between actual employment and GDP. Also, the forecast revision to GDP is larger than the one to the labor market. Beyond data issues, there are real differences in how output and the labor market respond during the business cycle. For example, firms normally adjust workers' hours before adding or subtracting staff, which can cause output to rise or fall before employment does. Also, if we factor in productivity growth, employment and GDP are telling different stories.

Monetary policy

The Federal Open Market Committee's June meeting, where the central bank jacked up interest rates by the most since 1994, showed a significant shift in the so-called dot plot and it tweaked the post-meeting statement strengthening its prioritization of taming inflation over nurturing the labor market. Following that, we're making material changes to the forecast.

The new forecast is for a 50-basis point rate hike at the July and September meetings. This will be followed by a 25-basis point rate hike at the November and December meetings. This is a cumulative 150 basis points in rate hikes by the end of the year. The Fed will then raise rates by 25 basis points at each of the first two meetings in 2023, putting the terminal fed funds rate at 3.5%, less than the median projection from the latest Summary of Economic Projections. The assumption is that the Fed will keep the fed funds rate at 3.5% for less than a year before gradually cutting by 100 basis points over the course of 2024, returning it to its neutral rate of 2.5%.

The 10-year Treasury yield has bounced around recently, but will average 3.33% in the final three months, compared with 3.14% in the prior baseline. We still have the 10-year Treasury yield averaging 3.5% in the fourth quarter of next year, compared with 3.25% in the June baseline. The forecast has the yield curve, or the difference between the 10- and two-year Treasury yields, remaining positive over the next few years.

Bank of England Hikes Rates

BY ROSS CIOFFI

The Bank of England stepped up its pace of monetary tightening at the August meeting. The Monetary Policy Committee voted 8-1 to raise interest rates by 50 basis points to 1.75%, marking the largest increase in more than a quarter of a century. The BoE also worked to bolster its credibility, speaking clearly about its pessimistic view of the economy. It now forecasts the U.K. economy to be in recession through 2023. But with inflation risks taking priority, the MPC is likely to tighten policy further. Tighter policy will cool off demand, pushing it further in line with severely limited supply. Prices will cool as a result, but as the BoE also noted, inflation has not peaked. The BoE sees inflation coming in at 13.3% y/y in October and remaining above target throughout 2023. The problem now is that energy prices will be pushed higher in October when the national electricity and gas price caps are updated to reflect significantly higher wholesale and producer costs.

Euro zone retail sales drop

Retail sales in the euro zone tumbled by 1.2% this June, reversing May's 0.4% growth. Sales of both food and nonfood items fell, as inflation heated up and consumer confidence soured. Households are shifting their expenditures from goods into services and normalising their spending habits in the absence of social-distancing measures. That said, we would expect retail sales to hold up better if there weren't the added problems of inflation and low morale.

The euro zone's year-on-year inflation rate rose to 8.6% in June, a record that was only beaten in July when it sped up to 8.9%. It's not just essentials like food and energy that have seen rapid price growth. July's core inflation also ran hot on a yearly basis—at 3.7%. Higher prices are forcing households to choose between purchases. Rather than buying a trip abroad and new outfits to wear while travelling, consumers will pick just the trip.

Dismal confidence is also sapping energy from consumers. Survey data show that consumer expectations have steadily worsened over the last five months and households are as negative now about their future financial prospects as they were at the start of the pandemic. Households are pessimistic about price trends and increasingly unlikely to undertake major purchases over the next 12 months. The only bright spot is the job market, which will put a floor beneath spending. But with disposable incomes likely falling in real terms, households will have to cut back—even if they feel secure in their jobs.

German factory orders still falling

Germany's factory orders fell by 0.4% month over month in June, deepening a five-month streak of declines. May's figures were revised downward, so that rather than a 0.1% increase, orders fell by 0.2%. The release speaks to the problems facing Germany's, and Europe's, industrial sector. Demand for manufactured goods was riding high last year, but as inflation continued to mount and supply issues persist, demand for goods has begun to falter. In June, a 1.8% drop in orders for capital goods outweighed similar increases in consumer and intermediate goods. The release is also in line with the spate of worsening manufacturing PMI surveys. Germany's latest score fell to 49.3 in July from 52 in June. Surveyed firms reported falling production and orders. Here too, the message is that Germany's industrial sector is slowing down further, supporting our view that the German economy will stagnate in the third quarter and contract in the fourth.

Dutch inflation shoots up

The Netherlands' inflation rate jumped to 10.3% on a year-ago basis in July from 8.6% in June. The reading comes as a surprise, as we expected the introduction of a 12-percentage point VAT cut to energy prices to lower energy and headline inflation rates. Despite the policy move, however, energy prices rose at an even quicker pace than before. This came as natural gas prices shot up during the month; the pass-through to electricity prices was quick.

Dutch consumers will be dismayed as well. Higher prices will weigh further on disposable incomes. Consumer confidence is also slumping. The indicator fell to a record low of -51 in July. We expect consumers to pull back on spending more so this fall, after the post-pandemic demand this summer becomes largely satisfied.

RBA Lifts Cash Rate Yet Again

BY HARRY MURPHY CRUISE

The Reserve Bank of Australia is pushing hard to combat buoyant price rises. At its August meeting, the RBA board lifted the cash rate by 50 basis points to 1.85%. This is the board's fourth hike in as many months and its third consecutive 50-basis point rise. Price growth came in at an uneasy 6.1% in the June quarter, mostly driven by factors outside Australia's borders; inflation for goods and services exposed to international forces rose 8% y/y. But domestic factors are also playing a part. The board noted June's exceptionally low unemployment rate of 3.5%—a five-decade low—as a key driver of domestic demand.

Other forces are also at play. Payments of up to $1500 through the low- and middle-income tax offset have started to hit the bank accounts of more than 10 million Aussies. Further, floods through New South Wales state are adding to domestic supply-chain issues. Last, the reversal of the fuel excise cut at the end of September will lift the cost of fuel at the pump. All this will see inflation peak later this year.

The central bank is faced with a balancing act. Although unemployment is falling spectacularly quickly, measures of consumer confidence are dropping just as fast in the face of global uncertainty and rising prices. The fear is that the loss of confidence could send households to the hills, denting spending and weakening domestic demand. Yes, the RBA is hiking rates to achieve just that. But the lag between hikes and changes in household behaviour makes it difficult for the RBA to evaluate the impact of its work. With monetary policy the bluntest of tools, caution is required. As the board noted, "the path to achieve this balance is a narrow one and clouded in uncertainty, not least because of global developments."

To that end, the pace of future rate hikes will be driven by how well households respond to rising borrowing costs. The board is closely monitoring real-time spending indicators, looking for any sign that household budgets are faltering. Jobs remain the biggest support for families and will drive a recovery in confidence soon. As the RBA walks this tightrope, we expect 50-basis point hikes to return to the board's back pocket, with 25-basis point hikes returning as the central bank's favoured rate-hike increment. We expect the cash rate to reach 2.6% by December.

RATINGS ROUNDUP

U.S. Corporate Credit Quality Improves

BY STEVEN SHIELDS

U.S.

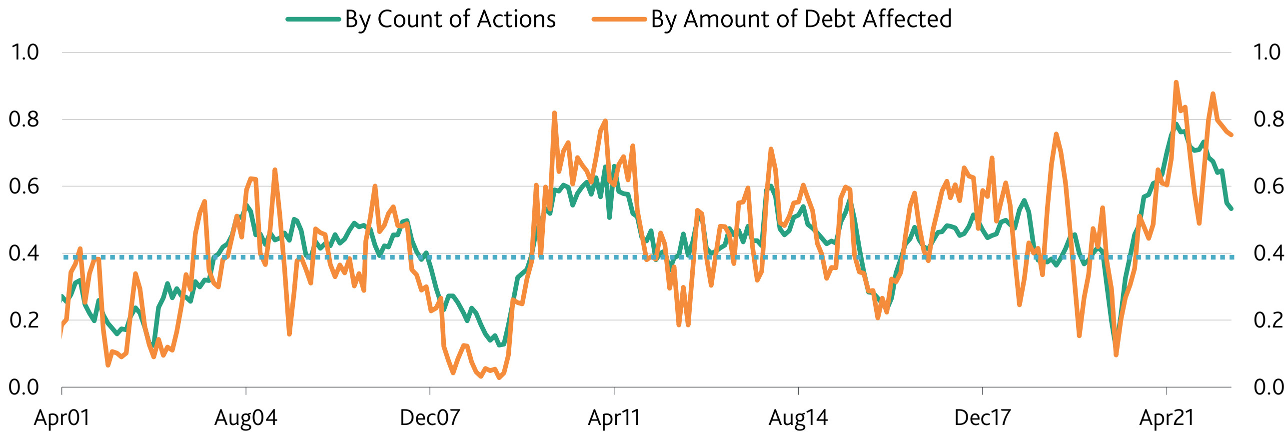
U.S. corporate credit quality improved this week. Upgrades outnumbered downgrades 7-to-1 with positives changes accounting for virtually all the affected debt. Of the upgrades, Union Pacific Railroad, a wholly owned subsidiary of Union Pacific Corp., saw its senior secured rating raised to Aa2 from Aa3, impacting approximately $39.6 billion in debt. According to the ratings action, the upgrades reflect Moody's Investors Service's expectation that Union Pacific will continue to operate with excellent scale and a diversified customer base. Further, the rating agency said, the company will have opportunities to improve its operating margin as network fluidity and service levels rebound, enabling it to transport more volume across its network over the next 12-18 months. The lone U.S. downgrade in the period was issued to Carrols Restaurant Group Inc. The downgrade from Caa1 to Caa2 reflects Carrols weakened operating performance and very high financial leverage driven by macroeconomic pressures including wage and commodity inflation which, along with industry wide staffing shortages, have resulted in reduced store hours and negative customer traffic.

Europe

Corporate credit quality was far weaker across Western Europe with downgrades accounting for five of the seven changes. Of the changes, Credit Suisse Group AG's senior unsecured debt rating was lowered one-notch to Baa2. The outlook remains negative, reflecting the challenges the group is facing in successfully executing on its repositioning of its investment bank in the more difficult macroeconomic and market environment as well as uncertainty as to the business and financial implications of the group's plans to take further steps to achieve a more stable investment banking business. The largest upgrade in terms of affected debt was issued to Redes Energeticas Nacionais, SGPS S.A. Its long-term issuer rating and senior unsecured debt ratings were raised to Baa2 from Baa3, reflecting Moody's Investors Service's expectation that REN is likely to maintain key credit metrics in line with the guidance for the Baa2 rating over the next three years, following the start of a new four-year regulatory period for electricity transmission in Portugal.

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

Rating Changes: Corporate & Financial Institutions - US

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG
7/27/2022	CARROLS RESTAURANT GROUP, INC.	Industrial	SrUnsec/SrSec/BCF/LTCFR /PDR	600.0	D	Caa1	Caa2	SG
7/28/2022	KOCH INDUSTRIES, INC.-MOLEX ELECTRONIC TECHNOLOGIES, LLC	Industrial	SrUnsec/LTIR	500.0	U	Baa2	Baa1	IG
7/28/2022	GRIFFEY HOLDINGS, INC.	Industrial	SrUnsec/SrSec/BCF/LTCFR /PDR	300.0	U	Caa2	Caa1	SG
7/29/2022	UNION PACIFIC CORPORATION	Industrial	SrSec/SrUnsec/LTIR/Sub/ MTN/PS	39640.554	U	Aa3	Aa2	IG
7/29/2022	ARROW BIDCO LLC	Industrial	SrSec	337.0	U	Caa1	B2	SG
7/29/2022	NASCAR HOLDINGS, LLC	Industrial	SrSec/BCF/LTCFR/PDR		U	Ba3	Ba2	SG
8/1/2022	LENNAR CORPORATION	Industrial	SrUnsec	4189.321	U	Baa3	Baa2	IG
8/2/2022	FORTRESS TRANSPORTATION AND INFRASTRUCTURE INVESTO	Financial	SrUnsec/LTCFR	2250.0	U	Ba3	Ba2	SG

Source: Moody's

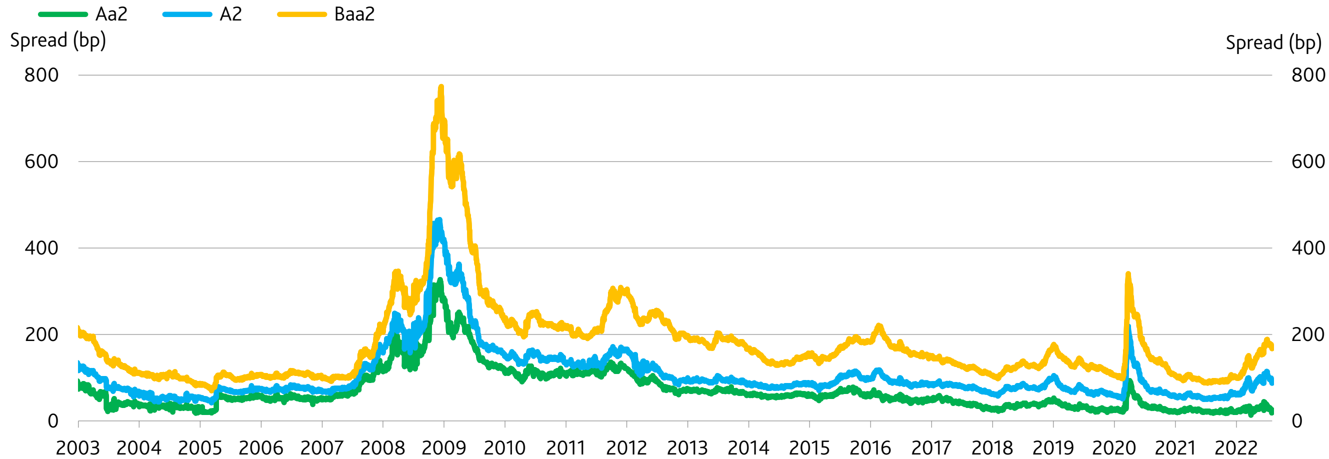
FIGURE 4
Rating Changes: Corporate & Financial Institutions - Europe

Date	Company	Sector	Rating	Amount ($ Million)	Up/ Down	Old LTD Rating	New LTD Rating	IG/ SG	Country
7/27/2022	REN - REDES ENERGETICAS NACIONAIS, SGPS, S.A.	Utility	SrUnsec/LTIR/MTN	1757.243	U	Baa3	Baa2	IG	PORTUGAL
7/27/2022	DEMIRE DEUTSCHE MITTELSTAND REAL ESTATE AG	Industrial	SrUnsec/LTCFR	611.789	D	Ba3	B1	SG	GERMANY
7/27/2022	F-BRASILE S.P.A.	Industrial	SrSec/BCF/LTCFR/PDR	505.0	D	B3	Caa2	SG	ITALY
7/28/2022	ZUERCHER KANTONALBANK	Financial		1118.228	U	Baa1	A1	IG	SWITZERLAND
7/28/2022	FLEET MIDCO I LIMITED	Industrial	SrSec/BCF/LTCFR/PDR		U	B2	B1	SG	UNITED KINGDOM
7/29/2022	ST. GALLER KANTONALBANK AG	Financial			D	Aa1	Aa2	IG	SWITZERLAND
8/1/2022	CREDIT SUISSE GROUP AG	Financial	SrUnsec/LTIR/LTD/Sub/ MTN	91822.262	D	Baa1	Baa2	IG	SWITZERLAND
8/2/2022	CONSORT HEALTHCARE (TAMESIDE) PLC	Industrial	SrSec	227.074	D	B3	Caa1	SG	UNITED KINGDOM

Source: Moody's

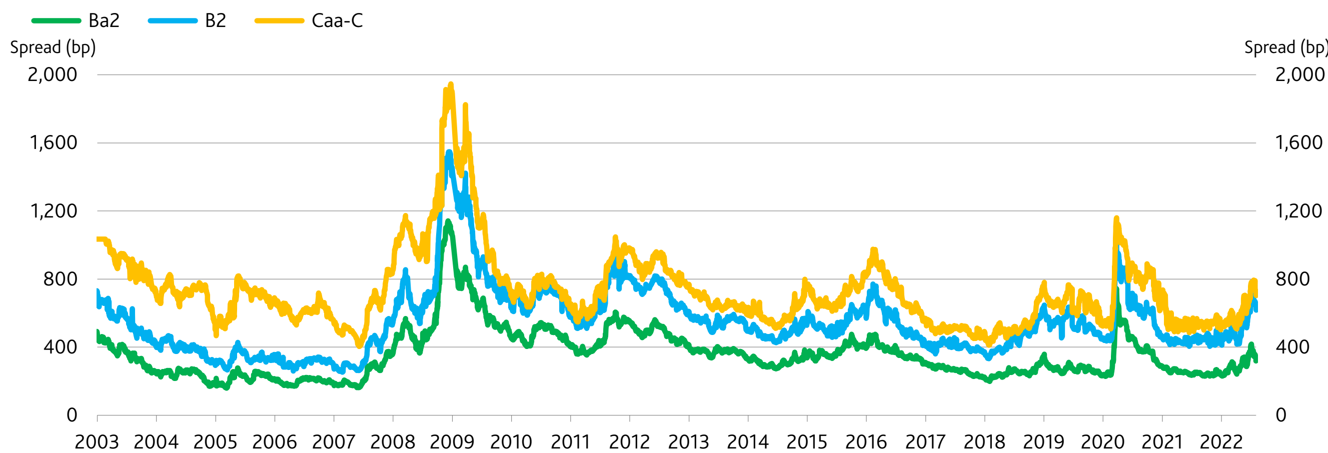
MARKET DATA

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



Source: Moody's

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



Source: Moody's

CDS MOVERS

Figure 3. CDS Movers - US (July 27, 2022 – August 3, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Aug. 3	Jul. 27	Senior Ratings
Merck & Co., Inc.	Aa3	A2	A1
Delhaize America, LLC	A1	A3	Baa1
CVS Health Corporation	A1	A2	Baa2
Ford Motor Company	Ba2	Ba3	Ba2
American Express Company	A1	A2	A2
Raytheon Technologies Corporation	Aa2	Aa3	Baa1
Enterprise Products Operating, LLC	A1	A2	Baa1
Carnival Corporation	Caa1	Caa2	B2
Consolidated Edison Company of New York, Inc.	A3	Baa1	Baa1
Cargill, Incorporated	A1	A2	A2

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Aug. 3	Jul. 27	Senior Ratings
Ally Financial Inc.	Ba2	Ba1	Baa3
Comcast Corporation	A3	A2	A3
Amazon.com, Inc.	Aa2	Aa1	A1
Walt Disney Company (The) (Old)	Aa1	Aaa	A2
CSC Holdings, LLC	B3	B2	B3
CCO Holdings, LLC	Ba2	Ba1	B1
Kraft Heinz Foods Company	Baa1	A3	Baa3
Crown Castle Inc.	Baa3	Baa2	Baa3
Tenet Healthcare Corporation	B1	Ba3	B3
Target Corporation	A1	Aa3	A2

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Aug. 3	Jul. 27	Spread Diff
Pitney Bowes Inc.	B3	1,136	931	205
CSC Holdings, LLC	B3	585	543	42
Anywhere Real Estate Group LLC	B2	730	701	29
Mattel, Inc.	Ba2	325	300	24
AutoNation, Inc.	Baa3	188	166	22
CCO Holdings, LLC	B1	283	264	19
SITE Centers Corp.	Baa3	192	176	16
DTE Energy Company	Baa2	113	99	14
Wendy's International, LLC	Caa2	318	305	13
OneMain Finance Corporation	Ba2	535	524	12

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Aug. 3	Jul. 27	Spread Diff
Rite Aid Corporation	Caa2	1,702	1,953	-251
Royal Caribbean Cruises Ltd.	B2	1,032	1,259	-227
Carnival Corporation	B2	1,014	1,190	-176
Nabors Industries, Inc.	Caa2	593	736	-144
K. Hovnanian Enterprises, Inc.	Caa3	1,127	1,271	-143
Pactiv LLC	Caa1	813	943	-130
Staples, Inc.	Caa2	1,759	1,855	-95
American Airlines Group Inc.	Caa1	1,431	1,523	-91
United Airlines Holdings, Inc.	Ba3	834	910	-76
United States Steel Corporation	B1	548	622	-74

Source: Moody's, CMA

CDS Movers

Figure 4. CDS Movers - Europe (July 27, 2022 – August 3, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Aug. 3	Jul. 27	Senior Ratings
Spain, Government of	Aa3	A2	Baa1
Portugal, Government of	Aa3	A2	Baa2
Landesbank Hessen-Thueringen GZ	A2	Baa1	Aa3
France, Government of	Aaa	Aa1	Aa2
BNP Paribas	A2	A3	Aa3
Deutsche Bank AG	Baa2	Baa3	A2
Intesa Sanpaolo S.p.A.	Baa2	Baa3	Baa1
ABN AMRO Bank N.V.	A2	A3	A1
Credit Agricole S.A.	A1	A2	Aa3
Banque Federative du Credit Mutuel	A2	A3	Aa3

CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Aug. 3	Jul. 27	Senior Ratings
Dexia Credit Local	Aa2	Aa1	Baa3
Unibail-Rodamco-Westfield SE	Ba2	Ba1	Baa2
Fresenius SE & Co. KGaA	Baa3	Baa2	Baa3
Alpha Services and Holdings S.A.	B1	Ba3	B3
Casino Guichard-Perrachon SA	C	Ca	Caa1
Lanxess AG	Ba2	Ba1	Baa2
Rolls-Royce plc	B1	Ba3	Ba3
Alstom	Ba1	Baa3	Baa2
Hammerson Plc	B1	Ba3	Baa3
Vedanta Resources Limited	C	Ca	B3

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Aug. 3	Jul. 27	Spread Diff
Casino Guichard-Perrachon SA	Caa1	2,261	1,837	424
Iceland, Government of	A2	68	57	11
BASF (SE)	A3	139	129	9
Lanxess AG	Baa2	247	238	9
Swedish Match AB	Baa2	93	84	9
Wienerberger AG	Ba1	320	312	8
Coca-Cola HBC Finance B.V.	Baa1	104	99	6
Stagecoach Group Plc	Baa3	219	213	6
HSBC Holdings plc	A3	86	81	5
Norddeutsche Landesbank GZ	A3	74	69	5

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Aug. 3	Jul. 27	Spread Diff
Piraeus Financial Holdings S.A.	Caa1	932	1,029	-97
Vue International Bidco plc	C	968	1,061	-93
Boparan Finance plc	Caa3	1,817	1,901	-85
Novafives S.A.S.	Caa2	1,329	1,410	-81
Jaguar Land Rover Automotive Plc	B1	896	971	-74
Iceland Bondco plc	Caa2	1,029	1,086	-57
CMA CGM S.A.	Ba3	484	541	-57
FCE Bank plc	Baa3	192	239	-47
Renault S.A.	Ba2	346	391	-45
UPC Holding B.V.	B3	372	416	-43

Source: Moody's, CMA

CDS Movers

Figure 5. CDS Movers - APAC (July 27, 2022 – August 3, 2022)

CDS Implied Rating Rises	CDS Implied Ratings		
Issuer	Aug. 3	Jul. 27	Senior Ratings
Telstra Corporation Limited	Aa3	A2	A2
Sumitomo Mitsui Banking Corporation	Aa3	A1	A1
National Australia Bank Limited	A2	A3	Aa3
Commonwealth Bank of Australia	A2	A3	Aa3
Export-Import Bank of Korea (The)	Aa2	Aa3	Aa2
MUFG Bank, Ltd.	Aa3	A1	A1
Thailand, Government of	A2	A3	Baa1
Malaysia, Government of	A3	Baa1	A3
Malayan Banking Berhad	Baa1	Baa2	A3
Sumitomo Corporation	Aa3	A1	Baa1

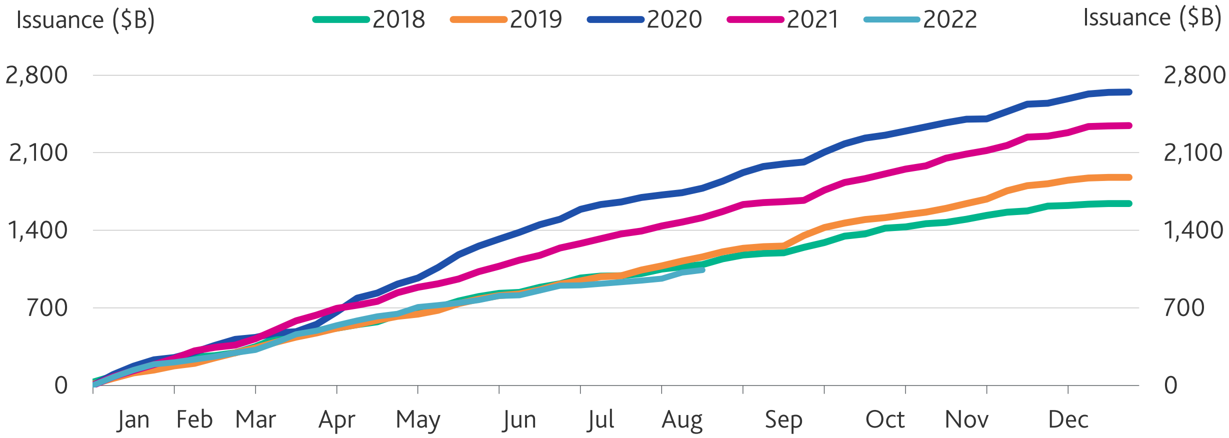
CDS Implied Rating Declines	CDS Implied Ratings		
Issuer	Aug. 3	Jul. 27	Senior Ratings
Export-Import Bank of China (The)	Baa1	A3	A1
Hong Kong SAR, China, Government of	Aa1	Aaa	Aa3
Nomura Holdings, Inc.	Baa2	Baa1	Baa1
Nissan Motor Co., Ltd.	Ba1	Baa3	Baa3
East Japan Railway Company	Aa2	Aa1	A1
Asahi Group Holdings, Ltd.	Aa1	Aaa	Baa1
Tata Motors Limited	Ba3	Ba2	B1
PTT Global Chemical Public Company Limited	Baa1	A3	Baa2
PTT Public Company Limited	Baa1	A3	Baa1
Japan, Government of	Aaa	Aaa	A1

CDS Spread Increases		CDS Spreads		
Issuer	Senior Ratings	Aug. 3	Jul. 27	Spread Diff
Pakistan, Government of	B3	3,544	3,262	282
PTT Global Chemical Public Company Limited	Baa2	87	79	8
PTT Public Company Limited	Baa1	82	75	7
SoftBank Group Corp.	Ba3	449	444	5
Industrial & Commercial Bank of China Ltd	A1	102	99	4
Bank of China Limited	A1	101	97	4
SK Innovation Co. Ltd.	Baa3	171	167	4
Export-Import Bank of China (The)	A1	82	79	3
Nomura Holdings, Inc.	Baa1	97	94	3
Bank of East Asia, Limited	A3	102	99	3

CDS Spread Decreases		CDS Spreads		
Issuer	Senior Ratings	Aug. 3	Jul. 27	Spread Diff
Development Bank of Kazakhstan	Baa2	338	363	-25
Indonesia, Government of	Baa2	115	128	-13
Export-Import Bank of India	Baa3	112	125	-13
Kazakhstan, Government of	Baa2	284	297	-13
Tokyo Electric Power Company Holdings, Inc.	Ba1	76	89	-13
Philippines, Government of	Baa2	104	116	-12
IDBI Bank Ltd	Ba2	125	137	-12
India, Government of	Baa3	135	147	-11
Vietnam, Government of	Ba3	139	150	-11
ICICI Bank Limited	Baa3	124	135	-11

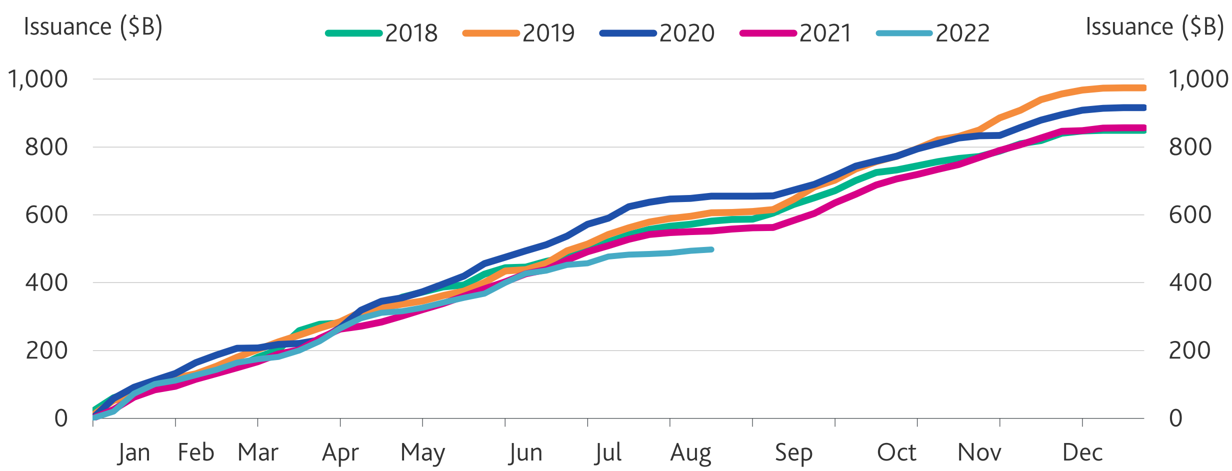
Source: Moody's, CMA

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



Source: Moody's / Dealogic

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



Source: Moody's / Dealogic

Figure 8. Issuance: Corporate & Financial Institutions

	USD Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	22.294	0.725	23.151
Year-to-Date	905.989	100.009	1,040.402

	Euro Denominated		
	Investment-Grade	High-Yield	Total*
	Amount $B	Amount $B	Amount $B
Weekly	3.657	0.000	3.845
Year-to-Date	461.674	28.087	497.744

* Difference represents issuance with pending ratings.

Source: Moody's/ Dealogic

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