Global Macroeconomic Monthly Review

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Key Issues

Global Economic Forecast Table (p. 3)

The Big Picture – The Global Economy (p. 4)

- *Global economic activity started 2019 on a soft note. Leading indicators suggest slow growth in the upcoming months.*
- *GDP growth apparently moderated in the fourth quarter last year, after slowing in the preceding quarter.*
- *Economic growth is expected to moderate gradually further in 2019.*
- *Risks to our 2019 growth outlook are tilted to the downside.*
- *Concerns for no-deal between US and China until March 1st, and potential for escalating tensions between the US and the EU over trade policy.*
- *Financial conditions have improved recently after a tightening trend in the fourth quarter.*
- *Base effects and the recent decline in oil and other commodity prices may weigh further on headline inflation in the short-run..*
- *Due to an increase in the risk environment and economic uncertainty, the extent of monetary policy normalization may be more limited.*
- *The Fed's neutrality call affected other central banks statements.*
- *The recent decrease in US interest rate expectations may limit the widening trend in yield differentials between the US and other advanced economies in the short-run, before they start narrowing probably sometime in 2019-2020.*

United States (p. 7)

- *Growth continues, but various headwinds are expected to begin taking a toll in the short-run.*
- *Risks to our growth estimate are tilted to the downside.*
- *Headline inflation is expected to fall further in the short-run.*
- *The Fed changed its policy stance to neutral. The Fed's stance will be affected by both economic and financial conditions.*

Euro Area (p. 11)

- *Economic activity remains soft, and leading indicators point to further moderation in annual growth.*
- *We revised downward our 2019 growth estimates.*
- *Headline inflation is expected to moderate in the coming months.*
- *The ECB revised its assessment on risks to the downside. It may soon announce an additional TLTRO program.*

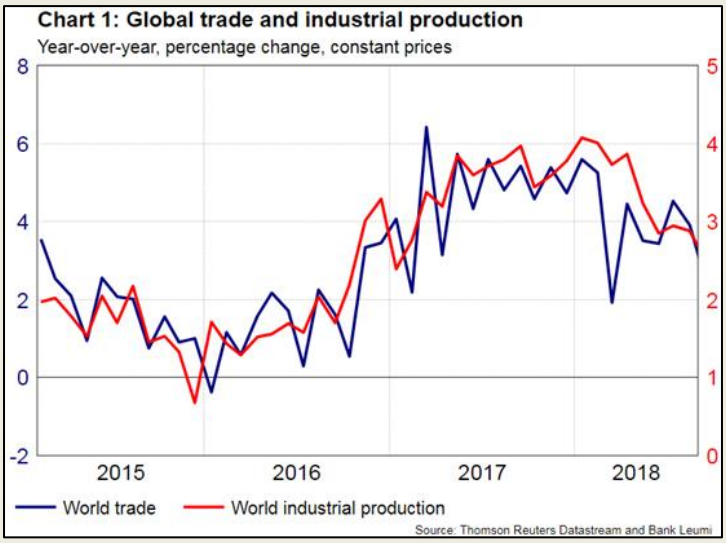
Leumi Global Economic Forecast, As of February 2019

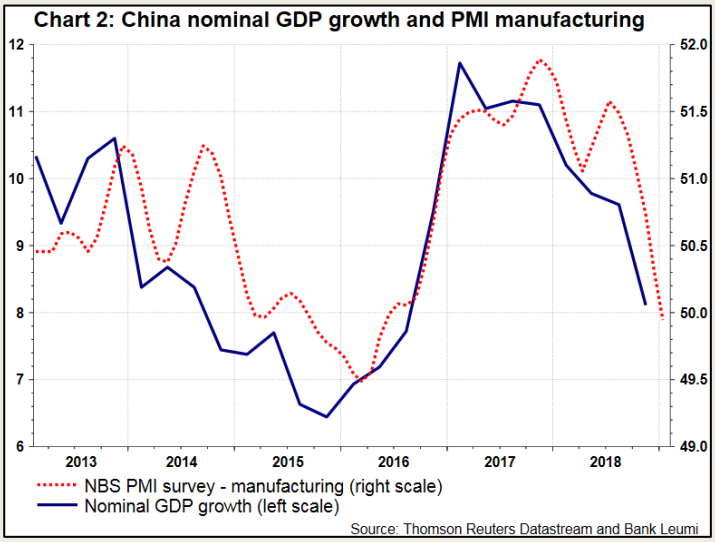
	2016	2017	2018F	2019F	2020F
GDP – Real Growth Rate					
World	*3.2%*	*3.7%*	*3.6%*	*3.5%*	*3.4%*
USA	*1.6%*	*2.3%*	*2.9%*	*2.3%*	*1.3%*
UK	*1.8%*	*1.6%*	*1.3%*	*1.5%*	*1.6%*
Japan	*0.9%*	*1.7%*	*1.0%*	*1.3%*	*0.5%*
Eurozone	*1.7%*	*2.5%*	*1.8%*	*1.5%*	*1.5%*
South East Asia (ex. Japan)	*4.5%*	*5.2%*	*5.0%*	*4.7%*	*4.4%*
China	*6.7%*	*6.9%*	*6.6%*	*6.3%*	*6.1%*
India	*7.1%*	*6.7%*	*7.6%*	*7.7%*	*7.5%*
Latin America	*-0.7%*	*1.2%*	*1.1%*	*2.0%*	*2.2%*
Israel	*4.0%*	*3.5%*	*3.2%*	*3.1%*	*3.5%*
Trade Volume, Growth (%)					
Global	*2.3%*	*5.3%*	*4.3%*	*3.4%*	*2.8%*
CPI, Annual Average (%)					
USA	*1.3%*	*2.1%*	*2.6%*	*2.4%*	*1.6%*
UK	*0.7%*	*2.7%*	*2.5%*	*2.0%*	*2.1%*
Japan	*1.0%*	*0.5%*	*1.0%*	*1.7%*	*2.0%*
Eurozone	*-0.1%*	*1.5%*	*1.8%*	*1.8%*	*1.7%*
Israel	*-0.5%*	*0.4%*	*0.8%*	*1.1%*	*0.6%*
Interest rates, Year End					
US Fed	*0.50-0.75%*	*1.25-1.50%*	*2.25-2.50%*	*2.50-3.00%*	*2.00-2.75%*
Bank of England	*0.25%*	*0.50%*	*0.75%*	*0.50-1.25%*	*0.50-1.50%*
Bank of Japan-Policy Rate	*-0.10%*	*-0.10%*	*0.00%*	*-0.10%*	*0.00%*
ECB-Main Refi	*0.00%*	*0.00%*	*0.00%*	*0.10-0.30%*	*0.20-0.50%*
Israel	*0.10%*	*0.10%*	*0.25%*	*0.25-0.75%*	*0.50-1.50%*

The Big Picture – The Global Economy

Global outlook – economic activity (1/2): Global economic activity started 2019 on a positive soft. Leading indicators suggest soft growth in the upcoming months.

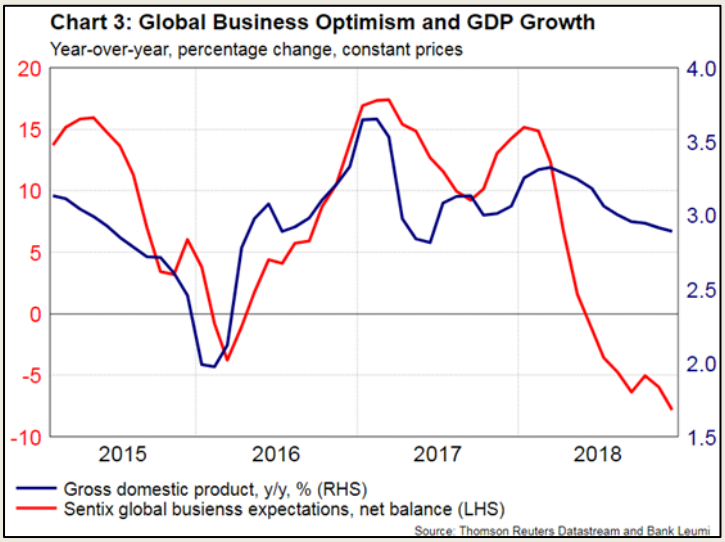
- Based on the latest economic data, global growth slowed in the fourth quarter, albeit just marginally, in tandem to the moderation in global trade and industrial production (chart 1). Among the developed economies, the euro area growth rate was unchanged in the fourth quarter compared to Q3, with Italy being the main drag on activity, while Spain and France somewhat surprised to the upside. The US economy apparently somewhat moderated in the fourth quarter (read more in the US chapter), while Japan's GDP growth most likely accelerated in the fourth quarter following weak numbers in the third quarter.
- Among the EM economies, we have recently seen mixed growth trends in the major regions during the fourth quarter. Overall, it seems that EM economic growth has started to lose some steam and is expected to somewhat moderate in the coming quarters, with some variation in trends between the regions. Overall, we expect growth in emerging Asia to remain stable or to slightly slow, as India drives activity up, while China moderates, in tandem with the moderation in credit growth. Business surveys, which are good leading indicators for future output, suggest that China's economic activity may moderate further downward in the short-run at least (chart 2), which may weigh on its main trading partners in the region.
- Latin America's growth is expected to pick up following the recovery in Brazil, where business confidence has increased recently. However, expectations for tighter fiscal policy and political risks threaten the outlook. In Mexico, we expect steady growth and do not rule out policy support in the short-medium term. Elections add to the risky environment in Argentina. Chile and Peru will be affected by global trends in metals.
- Growth in emerging European economies is expected to be weaker in the region due to the expected slowdown among the major EA economies. The recovery in Russia is expected to continue, albeit slowly. Increased inflation may support a rate hike in the short-run. Slovakia, Poland, and Romania are expected to be the best performers in the area in terms of growth. Turkey is expected to be the weakest performer in 2019, which may force the government and the central bank to provide fiscal, banking, and monetary support in the short-run.

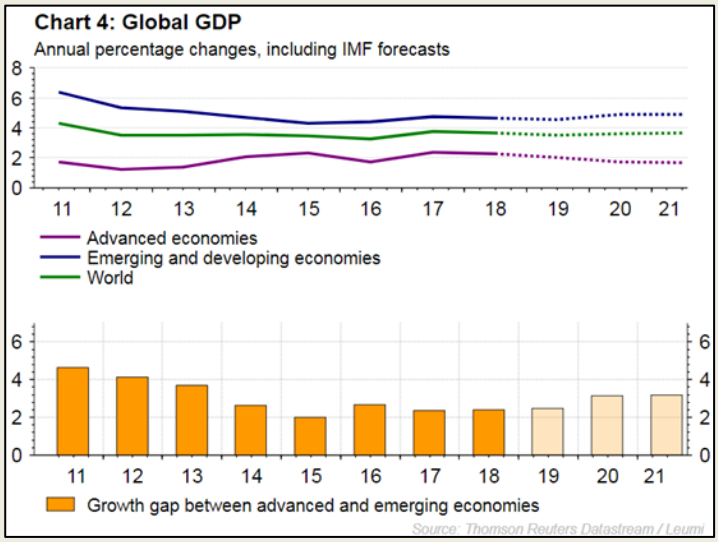




Global outlook – economic activity (2/2): Global economic activity started 2019 on a positive soft. Leading indicators suggest soft growth in the upcoming months.

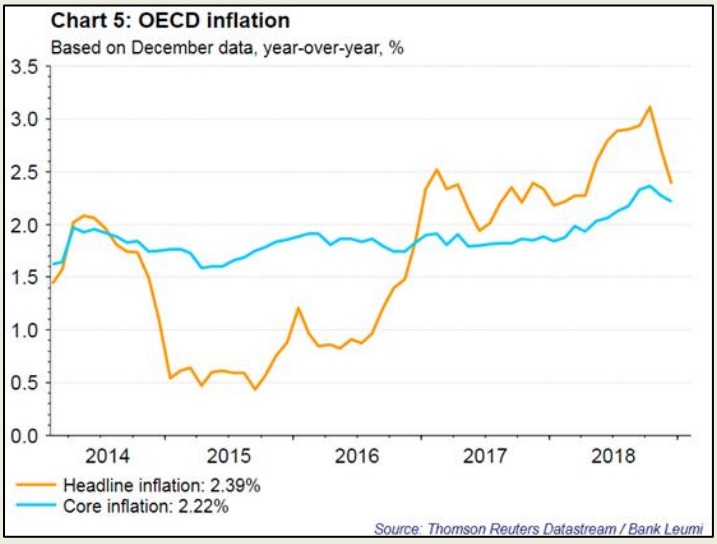
- Based on the global PMI survey, global economic activity started 2019 on a soft note. The composite January PMIs showed that global economic growth slowed to a 28-month low, driven by both the manufacturing and services sectors, as inflows of new businesses rose at a weaker pace and international trade in goods and services fell for the second month in a row.
- The US economy was the strongest performer among the major economies, while the slowdown in China manufacturing was the main drag. The euro area and Japan PMIs fell to 50- and 29-month lows respectively. EM PMI data also weighed on growth. The Sentix global business expectations index dropped further downward (chart 3). The weakness in the leading indicators may point to a further slowdown in global economic activity in the short-run.
- We expect the global economy to slow gradually and moderately in the medium-term, mainly due to an expected slowdown in the US in 2019-2020, and also due to a continuing slowdown in the EU economy and in China. Overall, we expect global growth to ease slightly, from 3.6% in 2018 to 3.5% in 2019 and 3.4% in 2020, with some increasing divergence in the medium-term between the advanced and emerging economies, as growth in the advanced economies is expected to moderate while growth in EM economies is expected to remain more or less unchanged (chart 4).
- Overall, risks to global growth are tilted to the downside. One of the major risks to our global growth outlook remains the uncertainty regarding changes in US trade policies with its trading partners, and mainly the prospects of the trade war with China. The uncertainty may continue to weigh on market and business sentiment in the short-run at least. Another potential negative shock for economic and market sentiment in the short-run may occur on the back of the US Commerce Department's investigation into national security threats surrounding auto imports from the EU, which is expected to be concluded by February 17th. Imposing tariffs on EU cars may hurt the European auto industry and pose a downside risk to the overall growth outlook. In addition, it may cause counter actions by the European countries, leading to an increase in economic uncertainty and heightened volatility in the financial markets. Uncertainty regarding Brexit is also expected to affect economic and financial sentiment to some extent in the short-run.





Global inflation and monetary policy outlook: The Fed's neutrality call affected other central banks statements which became more dovish. Financial conditions have improved recently after a tightening trend in the fourth quarter.

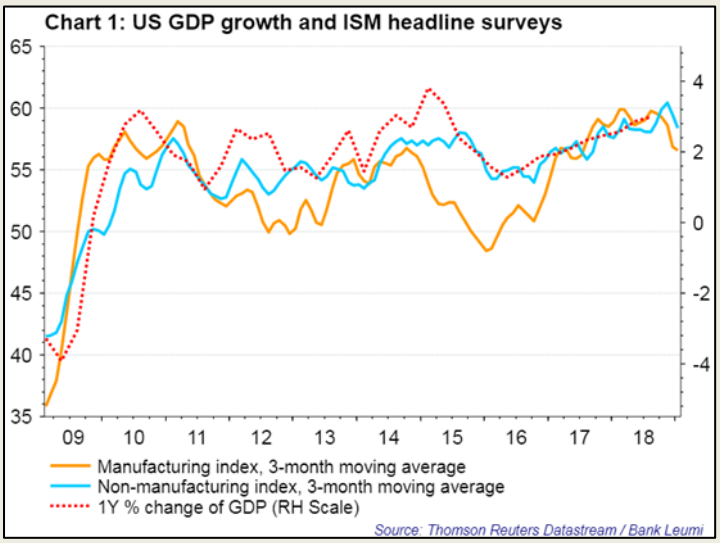
- The average annual headline inflation rate in OECD economies moderated further in December to 2.4% after it reached more than a seven-year high in October at 3.1% (chart 5). The decrease in December inflation was mainly due to the decline in energy prices in the past few months. In fact, it should be noted that oil prices recovered since the beginning of the year, and if this trend continues then it will ease the recent dis-inflationary effects. Looking forward, we expect headline inflation to moderate somewhat further in the short-run in some OECD economies, mainly due to base effects and the lagging effect of the fall in commodity prices in the previous quarter.
- The OECD average core inflation rate also moderated, albeit slightly, by 0.1 percentage points to 2.2% in December compared to 2.3% in the previous month. Looking forward, core inflation may also moderate, but to a lesser extent, compared to the headline measure, as wage growth has been accelerating in some of the major economies.
- In our opinion, the continuing slowdown in economic activity, the expected drop in inflation in the coming months, and the heightened risk environment, will continue to support a more dovish stance among the major central banks. Moreover, trends in financial conditions will also have a significant impact on the policies of central banks.
- Financial conditions have continued to improve recently after the capital markets experienced substantial volatility in the fourth quarter (chart 6). The St. Louis Fed Financial Stress Index (FSI) has eased recently after reaching a 34-month high at the end of December. The improvement in the FSI was supported by, among other things, the recovery in the equity markets, in tandem with a fall in the volatility indices and a decline in credit spreads. Due to the heightened risks environment, we do not rule out additional periods during 2019 of tightening in financial conditions. Higher stress levels may weigh on economic sentiment, and as a result, hinder domestic demand and support a more dovish stance among central banks, thus delaying normalization processes.

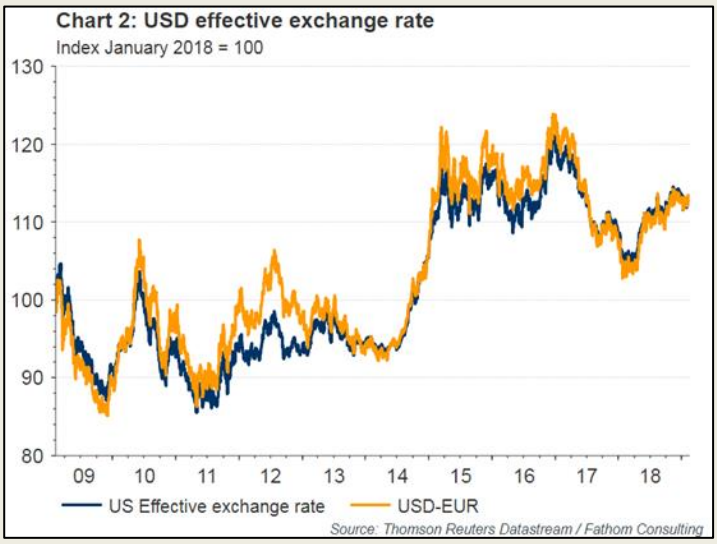


United States

US growth outlook (1/2): Growth continues, but various headwinds are expected to begin taking a toll in the short-run. Risks to our growth estimate are tilted to the downside.

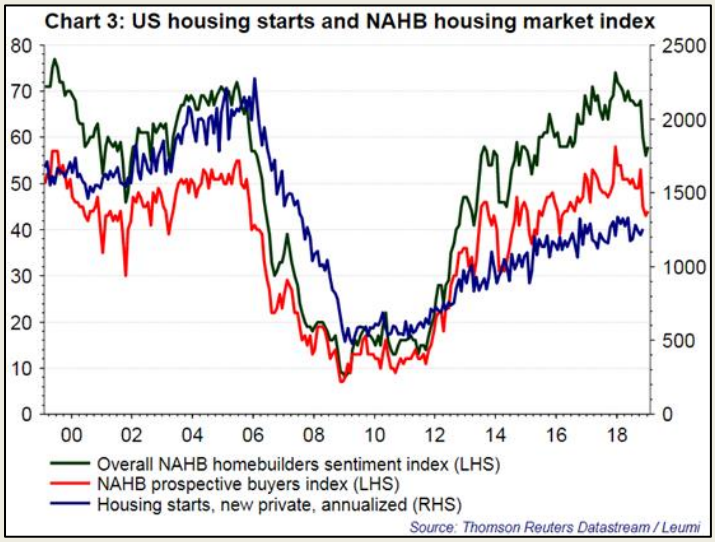
- Based on the latest data, economic activity continues to grow solidly, but growth moderated to some extent in the fourth quarter of 2018. Due to the partial government shutdown, which ended in the end of January, the releases of economic reports have been delayed. The initial GDP report for the fourth quarter will be published only on February 28, in tandem with the 2018 annual national accounts report. Based on Reuters' median consensus estimates and Fed's estimates, Q4 GDP growth is expected to be around 2.6% quarter-on-quarter annualized, compared to 3.4% in the previous quarter. The government shutdown appears to have had an insignificant effect on Q4 GDP growth as it started at the end of the last quarter. The effect on the first quarter GDP growth was apparently also limited, but if the shutdown is renewed, the damage to the economy could start to accumulate.
- However, there are some headwinds down the road that are already having some partial effect on activity. Industrial production rose just moderately in December. On a year-over-year basis, industrial production growth somewhat slowed recently due to base effects, a strong dollar, weakening business expectations, weaker external demand, and more.
- The manufacturing PMI and the ISM manufacturing index ticked up in January, but both surveys remain quite some way below their peaks from last year, and the three-month moving average data are still trending downwardly (chart 1). This suggests that while activity has probably stayed strong at the beginning of 2019, past policy tightening, weaker global demand, and last year's appreciation of the dollar are slowly starting to take their toll on the economy (chart 2).
- In addition, the ISM non-manufacturing index fell slightly in January but remained at relatively high levels, and the weighted average of both manufacturing and non-manufacturing is consistent on past form with GDP growth of around 3% annualized. Other survey indicators, including the regional Fed surveys, are signaling weaker growth than the ISM indices.

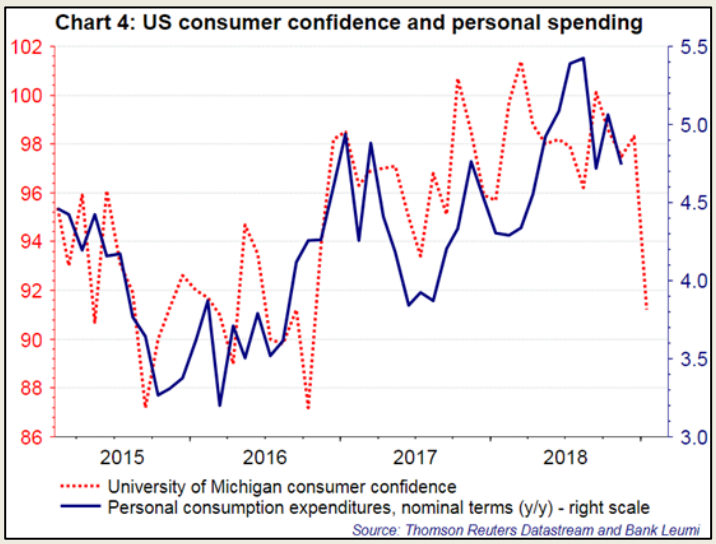




US growth outlook (2/2): Growth continues, but various headwinds are expected to begin taking a toll in the short-run. Risks to our growth estimate are tilted to the downside.

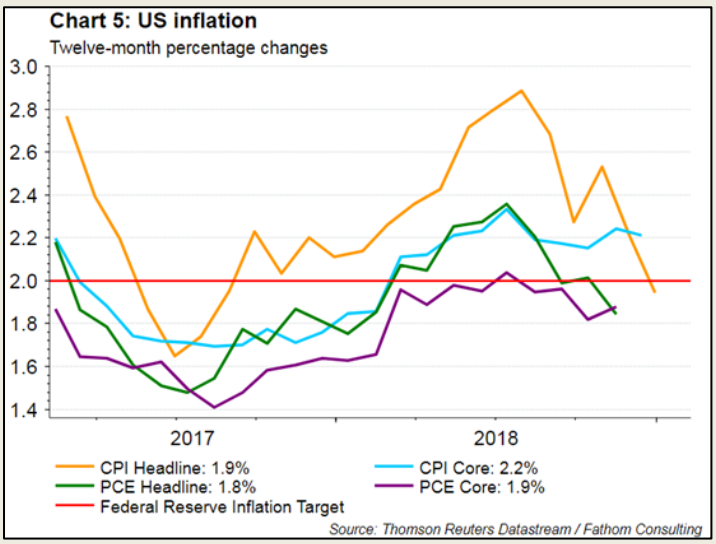
- In the housing sector, the data are mixed as existing home sales dropped to a three-year low, but new home sales rebounded in tandem with an increase in mortgage applications, as mortgage interest rates recently decreased. The market is now faced with some cross currents. On the weak side we see: the recent slowdown in housing prices and easing price expectations, a continued lack of inventory, and a looming economic slowdown. Given these factors, we do not expect a significant upward turnaround in housing demand; however, the potential for a further decrease in demand is limited. The softness in demand led to a drop in the homebuilder confidence index. Further softness may weigh on residential investment and housing starts (chart 3), and will keep the market rather tight. Supporting the housing market, we see: positive labor market conditions, wage growth, and the approach to the end of the tightening monetary cycle, which will limit a significant rise in mortgage interest rates.
- The latest available data for consumer spending suggest that private consumption growth continues to be robust, albeit the recent moderation in demand (chart 4). Looking forward, we expect household demand growth to somewhat slow this year as the positive impact of tax cuts fades, and as signs of an economic slowdown may somewhat weigh on consumer confidence. Also, a return to heightened volatility in the financial markets may also hurt consumer confidence, and thus private spending as well.
- Economic data continue to attest to further solid growth at the current time. However, there are some leading indicators that point to a possible moderation in economic growth in the short-run, in line with our estimations. Our GDP forecasts have not changed significantly since our January report. Economic activity is expected to grow 2.3% this year compared to 2.9% last year. Risks to our 2019 growth outlook are clearly tilted to the downside. We expect further moderation in 2020, as growth is expected to dip substantially below 2%.

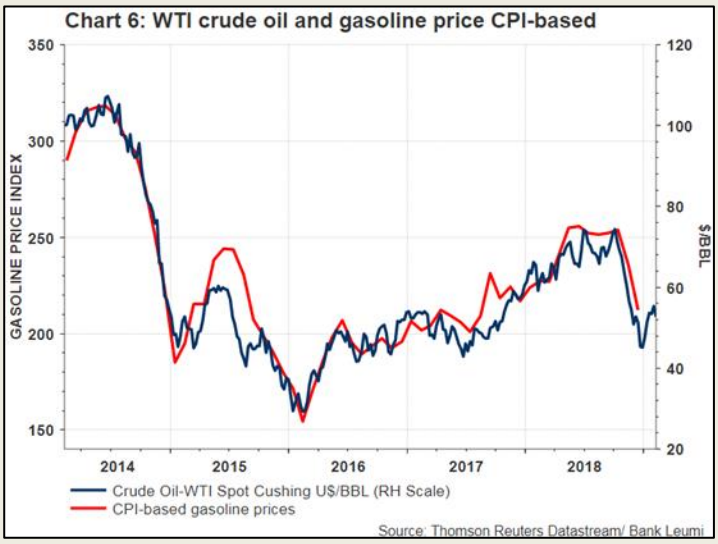




US inflation and monetary policy outlook (1/2): Headline inflation is expected to fall further in the short-run. The Fed changed its policy stance to neutral. The Fed's stance will be affected by both economic and financial conditions.

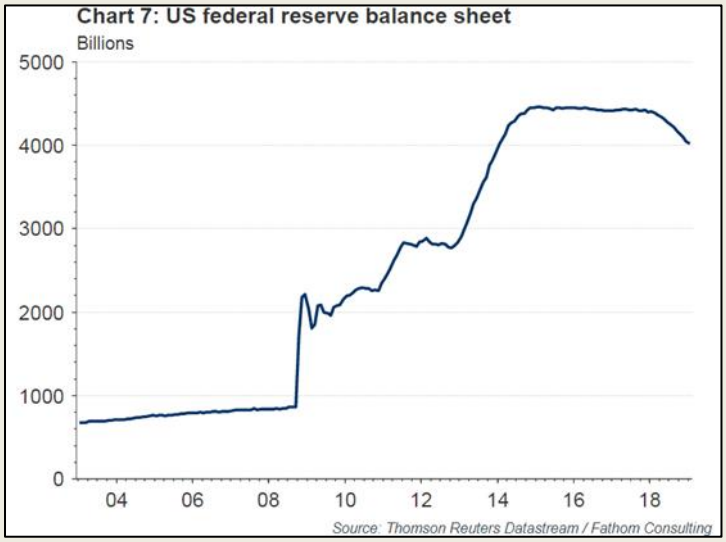
- The CPI headline inflation rate moderated recently and fell below the Fed's target (chart 5), mainly due to base effects and the lagging effect of the decrease in the energy component. The core CPI inflation figure remained firmer, around the Fed's target. The lagging effect of the fall in oil prices in the fourth quarter (chart 6), the lagging effect of the US dollar appreciation in 2018, and base effects are expected to push inflation downward in the short-run. Inflation is expected to fall to around 1.5%, and perhaps even lower, in the first half of 2019 and remain low for most of the year, before recovering in the fourth quarter of the year.
- Core inflation is expected to moderate as well in the coming months, but to a lesser extent compared to the headline measure, as underlying fundamentals (labor market, wage growth, and domestic demand) are expected to remain solid, keeping the core rate close to the Fed's projected target.
- The recent moderation in the inflation environment, in tandem with estimations for a slowdown in economic activity and the relatively heightened risk environment, caused the Fed to change its policy stance from hawkish to neutral. At its meeting on January 29-30, the Fed maintained the interest rate between 2.25%-2.50%, as expected, but the tone of the monetary statement and the press conference that followed the FOMC meeting was more dovish than previously expected.
- Within its monetary statement, the Fed dropped the line stating "further gradual increases" in the fed funds rate. Instead, the Fed stated "the Committee will be patient as it determines what future adjustments to the target range for the federal funds rate may be appropriate to support these outcomes". The statement stressed that the assessment of the economy will take into account "a wide range of information, including measures of labor market conditions, indicators of inflation pressures and inflation expectations, and readings on financial and international developments."

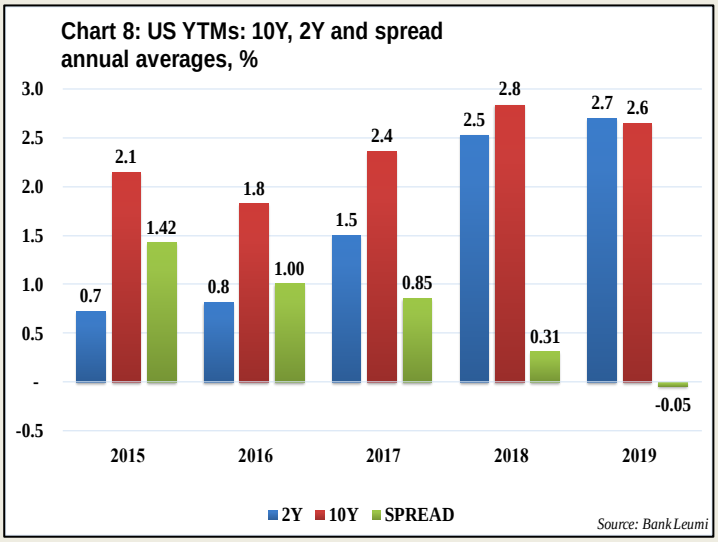




US inflation and monetary policy outlook (2/2): Headline inflation is expected to fall further in the short-run. The Fed changed its policy stance to neutral. The Fed's stance will be affected by both economic and financial conditions.

- Additionally, the FOMC also revised its guidance on its balance sheet (chart 7) normalization program, saying that it intends to continue its post-crisis policy regime in which there are an "ample supply of reserves", but it is prepared to adjust any of the details for completing balance sheet normalization in light of economic and financial developments. The Fed also noted the normalization of the size of the portfolio will be completed sooner, and with a larger balance sheet, than in previous estimates. In addition, the Fed noted that it is now evaluating the appropriate timing for the end of balance sheet runoff, and they will be finalizing these plans at coming meetings.
- In its next monetary meeting on March 20th, dependent on the economic and financial conditions at that time, we do not rule out the possibility that the Fed will reduce its projected median federal funds rates for 2019-2021, which are currently at 2.9%, 3.1%, and 3.1% respectively. Currently, market based interest rate expectations are not pricing in any rate hikes in 2019, and there is an increasing probability for a rate cut by the end of the year or the beginning of next year.
- The current developments in the economy, together with the changing monetary policy stance and forward guidance, limit a potential rise in government bond yields. Our 2019 yield curve forecast (annual averages) was revised further downward at both ends of the curve. Based on our models (chart 8), we expect the yield-to-maturity on 10-year bonds to average 2.6% in 2019, which is around the current rate. We expect the yield-to-maturity on 2-year Treasuries to rise to an average of 2.7% in 2019, slightly more than the current rate (2.52%).

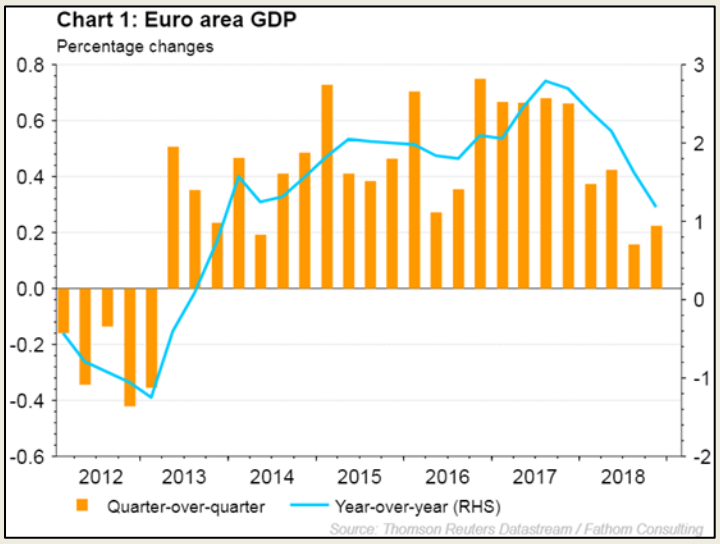




Euro Area

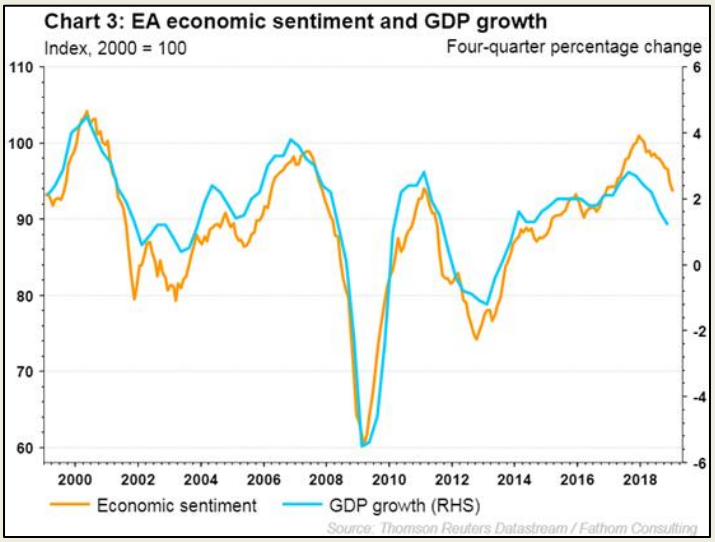
EA growth outlook (1/2): Economic activity remains soft, and leading indicators point to further moderation in annual growth. We revised downward our 2019 growth estimates.

- The latest released data suggest that economic activity in the euro area (EA) continued to grow softly in the fourth quarter last year, following the slowdown in the third quarter. Q4 GDP increased 0.2% quarter-on-quarter (chart 1), similar to the growth rate registered in the previous quarter. On a year-on-year basis, growth in the EA moderated further, to 1.2% in Q4 (the lowest since Q4-2013) compared to 1.6% in the previous quarter. Growth in all of 2018 was 1.9%, versus 2.4% in 2017.
- On the national level, growth in Spain surprised to the upside, while Italy entered a technical recession (two or more consecutive quarters of a decline in GDP). We expect growth in Italy to remain weak on the back of heightened political risks and poor sentiment. Growth in France also surprised to the upside, but this was driven mainly by net exports. Looking forward, we expect soft growth in France, mainly due to the continuing protests, which weigh on domestic demand.
- Germany's first estimate of Q4 GDP has not been published yet, but based on the preliminary estimate of 2018 GDP released last month by the Federal Statistics Office, the German economy rose very modestly after contracting in the third quarter of last year. It should be noted that German industry has been hit by a fall in exports and a slowdown in domestic demand (chart 2) as economic sentiment shifted downward in 2018 due to rising political risks in the EA and concerns regarding trade tensions. Some sector-specific problems, mainly in the auto industry, weighed substantially on activity in the second half of the year. If the issues in the auto industry will be resolved soon, then industrial production growth should pick up, but a sharp rebound is unlikely.



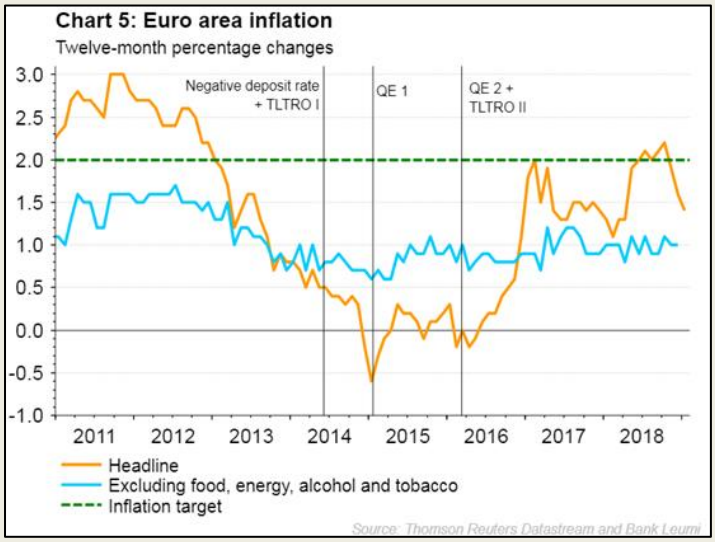
EA growth outlook (2/2): Economic activity remains soft, and leading indicators point to further moderation in annual growth. We revised downward our 2019 growth estimates.

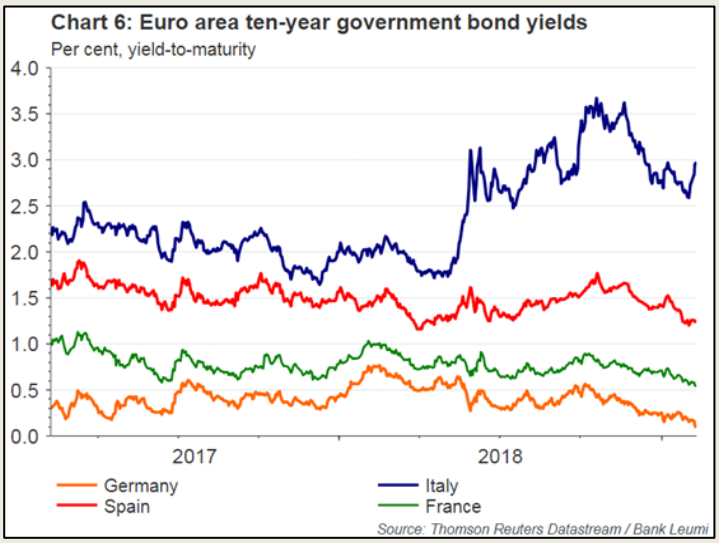
- Business surveys, such as the Markit PMI and European Commission's ESI, attest to further weakness in the beginning of 2019. The composite PMI fell in January to its lowest level since July 2013, this due to a slowdown in both the manufacturing and the services sectors. The ESI results also added to the evidence that the EA economy is slowing, as it continued to decrease for the 13th consecutive month. Leading indicators components, such as new orders and expectations relating to future output, continue to suggest that companies are not anticipating a revival in demand in the short-run. The softening in business sentiment may weigh on GDP growth, which continues to trend downward (chart 3).
- Based on leading indicators, we do not rule out another low quarterly growth rate figure in the first quarter of the year, with further moderation in growth (on a year-on-year basis) in the short-run, slowing toward the potential growth rate. On the back of the recent activity data and leading indicators, mainly consumer demand (chart 4) and industrial production data, we revised further downwards our 2019 outlook estimate to 1.5% from 1.7%. In our opinion, risks are currently tilted to the downside. The main risks to the short-medium term growth outlook include concerns regarding changes in US-EU trade policy, uncertainty regarding Brexit, the continuing slowdown in China, and other political and fiscal risks within Europe.



EA inflation and monetary outlook: Headline inflation is expected to moderate in the coming months. The ECB revised its assessment on risks to the downside. It may announce soon an additional TLTRO program.

- Headline inflation fell further in January to 1.4% from 1.6% in December (chart 5), driven by a significant drop in energy inflation. The headline measure is expected to moderate further during 2019, reaching a trough in the second or third quarter. On the other hand, core inflation edged up to 1.1% from 1.0% in December, supported by services inflation. The core measure is expected to show more durability to the easing in oil and other input prices, and be supported by services inflation during 2019.
- Based on the moderation in economic activity and heightened risk environment, the ECB changed its assessment on the risks to its growth outlook at its latest meeting on January 24th. As expected, policy remained unchanged. The president of the ECB, Mario Draghi, mentioned that incoming economic data since the December meeting have been weaker and that risks have moved to the downside. Mr. Draghi clarified that the change in the assessment was unanimous. We expect the ECB will revise downward its growth and inflation outlooks for 2019 in its March meeting, and we do not rule out a change in its forward guidance regarding its interest rate policy, after interest rate expectations decreased further downward recently.
- In addition, it should be noted that Mr. Draghi admitted that some of the ECB's governing council members discussed at the January meeting the need for another TLTRO program. As we discussed in the past, we do not rule out the possibility that the ECB will announce another TLTRO program in the next coming months. The current developments in the economy, in tandem with the ECB's policy stance, may keep government bond yields relatively low, mainly in the safe-haven European bonds such as the German bunds (chart 6).





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