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 growth accelerated in the second quarter of the year, albeit unevenly, driven by the US economy, as the EA economy moderated.*
- *Initial data on activity in July attest to some moderation in global growth in the beginning of the third quarter.*
- *Growth in advanced economies is expected to moderate in 2019-2020.*
- *Global inflation is expected to increase slightly in the coming months, due to, among other things, temporary factors.*
- *Monetary policy normalization is expected to continue, both in major advanced economies, as well as in emerging economies.*
- *Due to the current macroeconomic and policy developments, government bond yield curves have steepened temporarily in the second half of July, supported by rising longer-term yields.*

United States (p. 6)

- *The US economy grew strongly in Q2.*
- *Growth is expected to somewhat moderate in the second half of the year.*
- *We expect further moderation in 2019, and to a greater extent in 2020 after the effects of US fiscal policy will fade, and due to the constraints of full employment and tighter monetary conditions.*
- *Inflation rose further in June, but may moderate by the end of the year. Still, inflation is expected to remain above the Fed's target in the short-run.*
- *The probability for two additional hikes this year has increased. We expect the Fed to pause the rate hike cycle in 2019, and start cutting rates gradually in 2020.*
- *The yield curve has steepened temporarily in July after reaching a multi-year low. A modest 10-2 inversion is expected in 2020.*

Euro Area (p. 9)

- *EA economic growth moderated in the second quarter of the year. Business surveys attest to low growth in the beginning of the third quarter.*
- *Inflation rose in July and is expected to remain close to the ECB's inflation target in the short-run, before moderating toward the end of the year. Core inflation is set to rise modestly.*
- *No change in ECB's tone despite the moderation in economic growth.*
- *Long-term government bond yields are expected to rise gradually in the short-run.*
- *Concerns over Italy's fiscal profile supported a significant rise in risk premiums.*

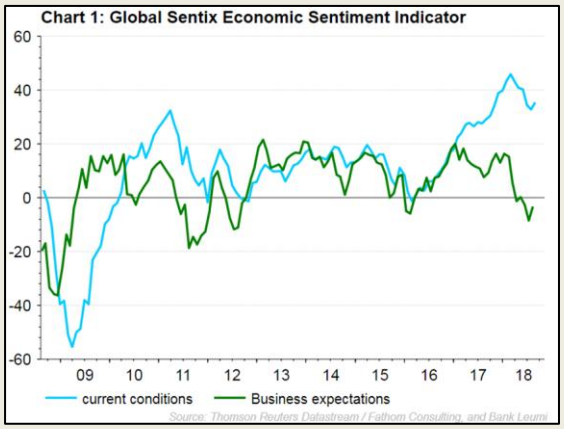
Leumi Global Economic Forecast, As of August 2018

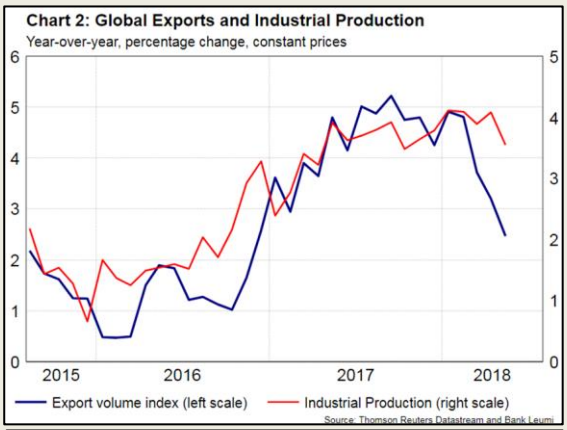
	2015	2016	2017E	2018F	2019F
GDP – Real Growth Rate					
World	*3.3%*	*3.2%*	*3.7%*	*3.8%*	*3.8%*
USA	*2.9%*	*1.6%*	*2.3%*	*2.7%*	*2.5%*
UK	*2.2%*	*1.8%*	*1.6%*	*1.3%*	*1.5%*
Japan	*1.4%*	*0.9%*	*1.7%*	*1.6%*	*1.7%*
Eurozone	*2.0%*	*1.7%*	*2.5%*	*2.2%*	*1.9%*
South East Asia (ex. Japan)	*4.5%*	*4.5%*	*5.2%*	*5.1%*	*4.9%*
China	*6.9%*	*6.7%*	*6.9%*	*6.7%*	*6.4%*
India	*7.9%*	*7.1%*	*6.7%*	*7.3%*	*7.7%*
Latin America	*0.1%*	*-0.7%*	*1.2%*	*1.5%*	*2.3%*
Israel	*2.5%*	*4.0%*	*3.3%*	*3.7%*	*3.4%*
Trade Volume, Growth (%)					
Global	*2.5%*	*2.3%*	*4.6%*	*4.0%*	*3.8%*
CPI, Annual Average (%)					
USA	*0.1%*	*1.3%*	*2.1%*	*2.4%*	*2.4%*
UK	*0.1%*	*0.7%*	*2.7%*	*2.5%*	*2.1%*
Japan	*0.5%*	*1.0%*	*0.5%*	*1.3%*	*1.6%*
Eurozone	*0.8%*	*-0.1%*	*1.5%*	*1.4%*	*1.5%*
Israel	*-0.6%*	*-0.5%*	*0.2%*	*0.9%*	*0.8%*
Interest rates, Year End					
US Fed	*0.25-0.50%*	*0.50-0.75%*	*1.25-1.50%*	*2.00-2.50%*	*2.75-3.25%*
Bank of England	*0.50%*	*0.25%*	*0.50%*	*0.75%*	*1.00-1.25%*
Bank of Japan-Policy Rate	*0.00%*	*-0.10%*	*-0.10%*	*0.00%*	*0.00%*
ECB-Main Refi	*0.05%*	*0.00%*	*0.00%*	*0.00%*	*0.10-0.30%*
Israel	*0.10%*	*0.10%*	*0.10%*	*0.10-0.25%*	*0.50-1.00%*

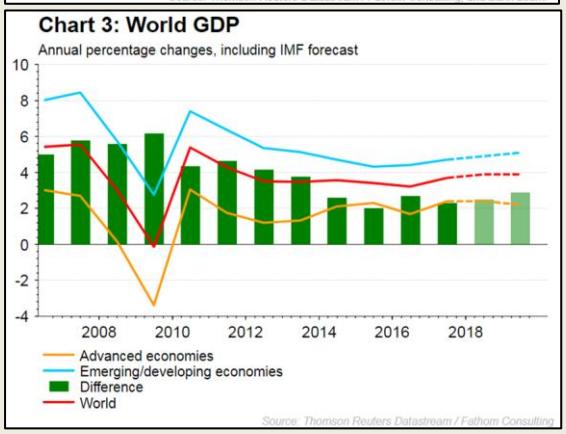
The Big Picture – The Global Economy

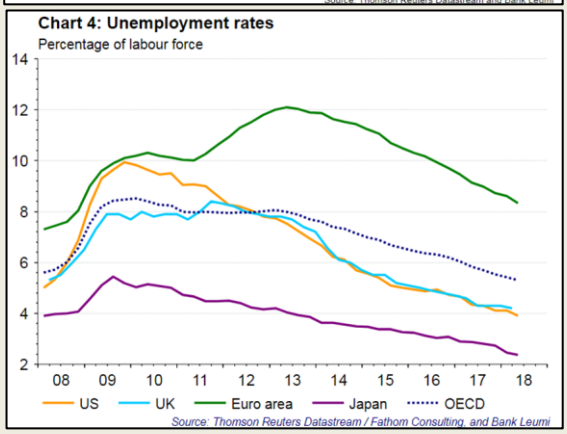
Global outlook: the growth environment in advanced economies is expected to moderate in 2019-2020. Monetary policy normalization is expected to continue.

- Based on recently released economic data, global economic growth likely accelerated in the second quarter of the year, albeit unevenly. The US economy grew strongly during the quarter, supported by fiscal stimulus; however, GDP growth may moderate in Q3, mainly due to base effects and the appreciation in the exchange rate of the US dollar since the beginning of the year. Eurozone economic activity slightly moderated, for the second quarter in a row. Based on monthly data, economic growth in the UK and Japan also likely accelerated somewhat. On a quarterly basis, China's economic growth also accelerated in the second quarter of the year.
- Initial data on activity in July, based mainly on business surveys, attest to some moderation in global growth in the beginning of the third quarter. Business expectations (chart 1) and other forward-looking indicators, such as export orders, have weakened since the start of 2018, and weighed on production (chart 2). This has been due to the increase in uncertainty, mainly related to the rise in risks of trade protectionism, and the rise in risks in some emerging markets, particularly in the fundamentally weak economies that have suffered from major imbalances and depreciation in their currencies recently, such as Turkey which faces significant risks.
- Despite the expected moderation in Q3, global growth is expected to slightly accelerate this year, and remain stable in 2019, supported by easing or expansionary fiscal policies in advanced economies, easing lending standards by the financial system, and improving labor markets. The IMF's newly released global growth estimates (July, WEO) have remained unchanged (chart 3). The aggregate unemployment rate in the OECD fell to its lowest level in several decades, and is expected to fall further in the short-run (chart 4).



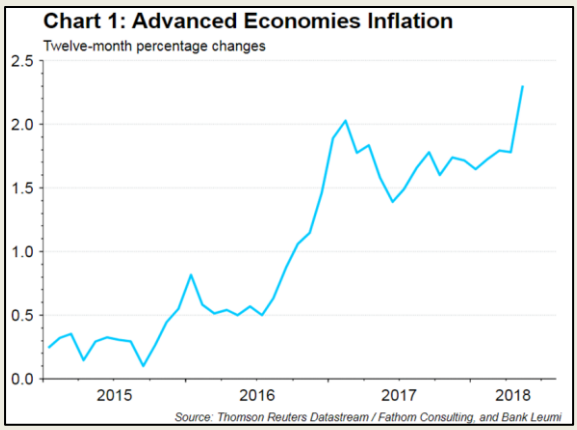


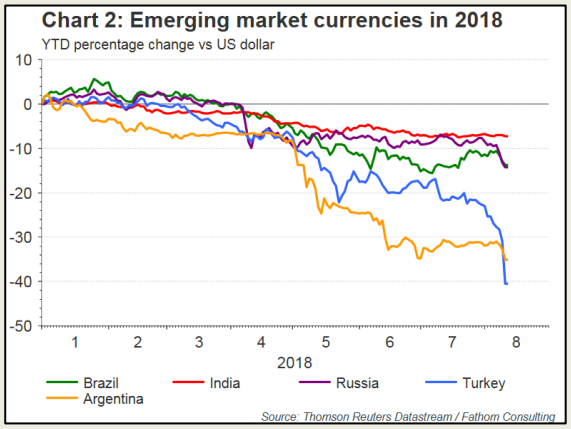


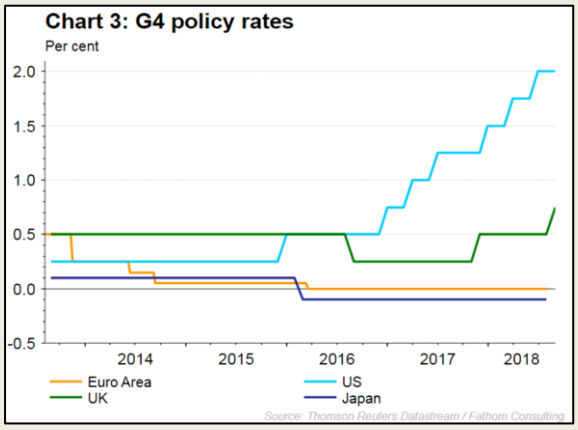


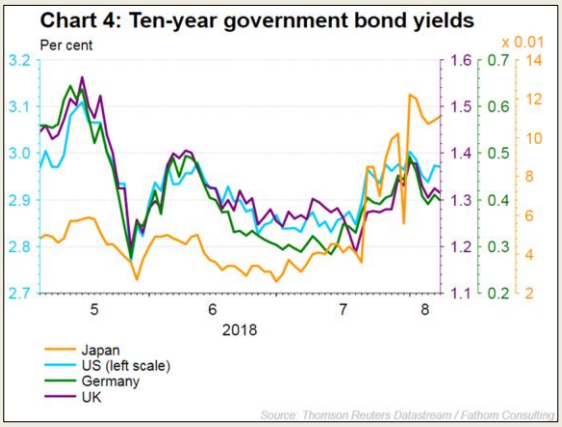
Global outlook (cont.): the growth environment in advanced economies is expected to moderate in 2019-2020. Monetary policy normalization is expected to continue.

- Growth of both advanced economies and emerging markets is expected to be uneven. We expect growth in some of the major advanced economies to moderate in 2019, and more significantly in 2020 after the effects of US fiscal policy will fade and tighter monetary conditions will begin to weigh, to some extent, on demand. In addition, it should be noted that there are downside risks to our growth outlook, particularly due to the possibility of escalating and sustained protectionism measures, and tighter financial conditions in emerging markets (further discussion on risks in our previous monthly report). Hence, we do not rule out downward revisions to our 2018-2019 global growth outlook if risks continue to rise.
- Inflation in advanced economies has increased recently (chart 1), particularly in the US and in the EA economies, but core inflation in most advanced economies has remained low. Also, some of the major emerging economies experienced a rise in inflation due to increases in import prices as a result of depreciations in their exchange rates (chart 2).
- Due to the recent macroeconomic developments, more and more central banks in both advanced and emerging economies sound more hawkish and are expected to tighten or normalize policy further in the short-run (chart 3). In the past month, the Bank of Japan adjusted its monetary policy stance by providing a greater flexibility on its yield curve control policy (supported some yield curve steepening), the Bank of England increased its interest rate 25bp to 0.75%, and some EM central banks, including India, raised their policy rates as well. Due to the current macroeconomic and policy developments, government bond yield curves have steepened since the second half of July, after falling in the previous two months, supported by rising longer-term yields (chart 4).





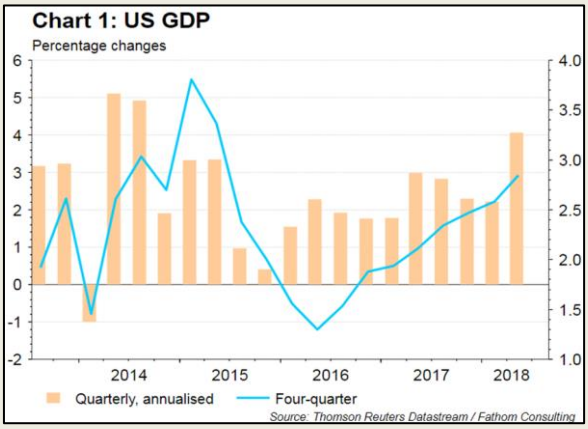


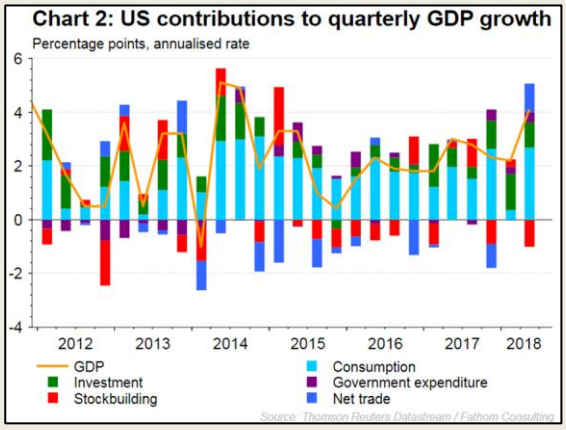


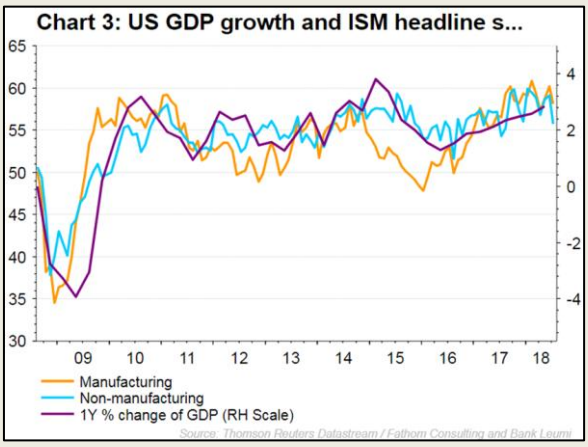
United States

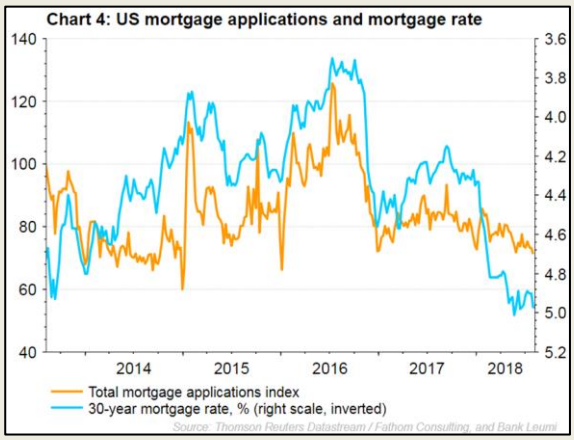
US growth outlook: A trend of gradual growth moderation is expected in 2019-2020.

- US GDP increased in Q2 by 4.1% quarter-on-quarter annualized. On a year-on-year basis, growth accelerated to 2.8% from 2.6% (chart 1). The expenditure breakdown reveals (chart 2) that growth was driven by strong consumer spending and a large contribution from net trade. We expect a reversal in exports growth in the current quarter, dragging on net trade and overall GDP growth. Inventories surprised to the downside, dragging growth down significantly.
- July business surveys (chart 3), both in the manufacturing and services sectors, pointed to some moderation in economic activity last month. Moreover, it should be noted that recent housing data, including home sales and mortgage applications, were weak, and this weakness may continue in the short-run as home buyer sentiment (based on the Fannie Mae Home Purchase Sentiment Index) has drifted downwards recently, due to, among other things, the rise in mortgage rates (chart 4). The growth environment is expected to remain healthy in the second half of the year, but may moderate compared to the growth rate registered in Q2.
- We expect 2018 GDP growth to accelerate to 2.7% from 2.3% in 2017.Downside risks to our growth estimates have increased recently, mainly due to the heightened concerns from a trade war. Due to the rising risks, we do not rule out subtle downward revisions to our 2019 growth outlook for the US. Additionally, we expect further moderation in 2020, which might be significant, after the effects of US fiscal policy will fade and tighter monetary conditions will weigh, to some extent, on domestic demand. The constraints of full employment are likely to become evident in the weak growth rate expected for 2020.



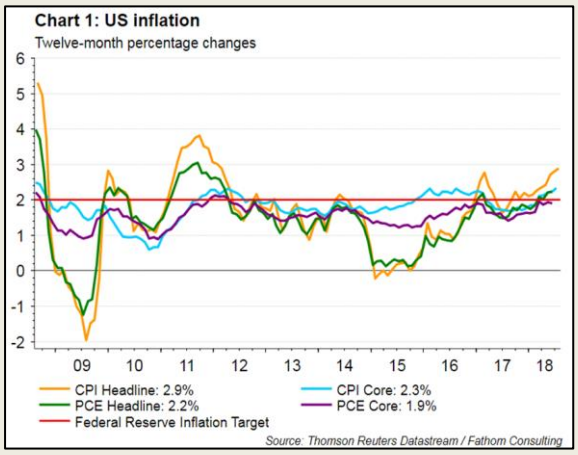


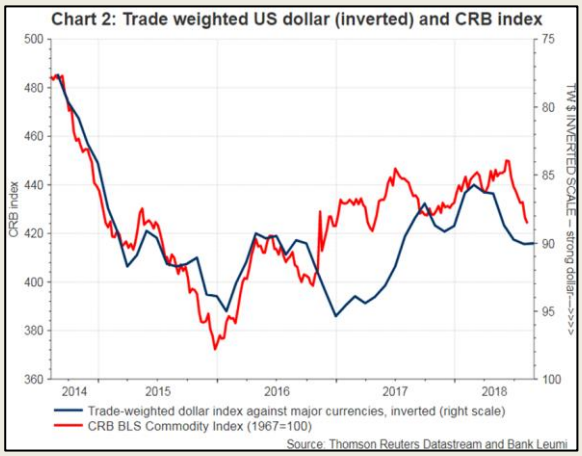


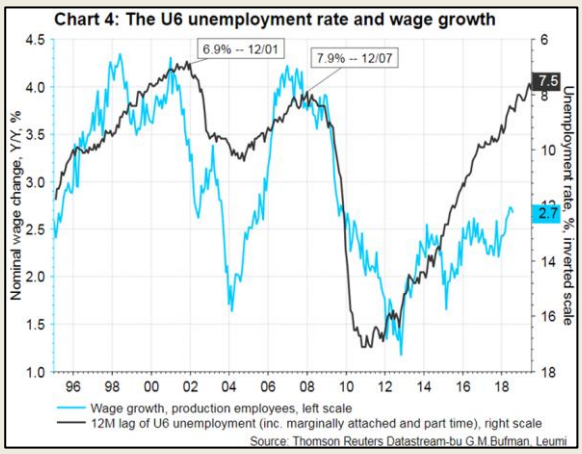


US inflation outlook: inflation rose further in June, but may moderate by the end of the year. Still, inflation is expected to remain above the Fed's target in the short-run.

- Most inflation measures rose or remained unchanged in June, reaching close to or above the Fed's inflation target, with headline CPI reaching 2.9% - more than a six-year high, and the core CPI reached its highest level since October 2008 (chart 1).
- Inflation is currently close to its cyclical peak, and may even moderate toward the end of the year, against the backdrop of the appreciation of the US dollar (chart 2), and under the condition that commodity prices, and mainly oil prices, will not increase significantly in the short-run. The latest drop in commodity prices weighed mainly on the short-medium term inflation expectations (chart 3). The longer-term expectations remained anchored.
- Having said that, inflation is expected to remain above the Fed's inflation target in the short-medium term, supported by a further tightening labor market which may support wage growth (chart 4), in tandem to solid domestic demand, which is expected to be driven partly by fiscal policy expansion.
- All other things being equal, the tariffs imposed by the US government may also support inflation, to some extent, in the short-run. On average, we expect CPI inflation to be around 2.4% in the current year, compared to 2.1% in 2017.

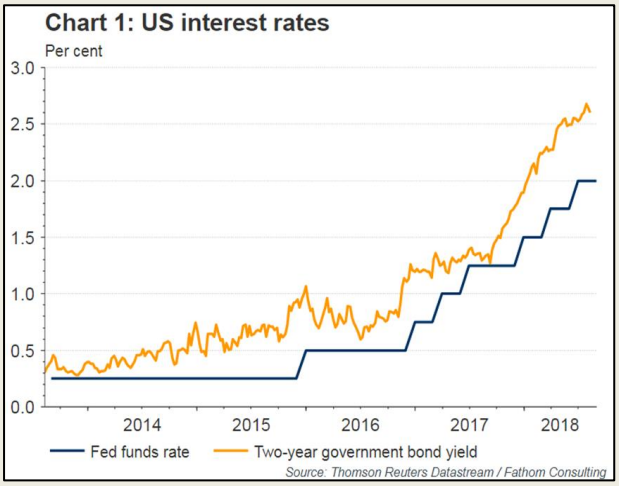


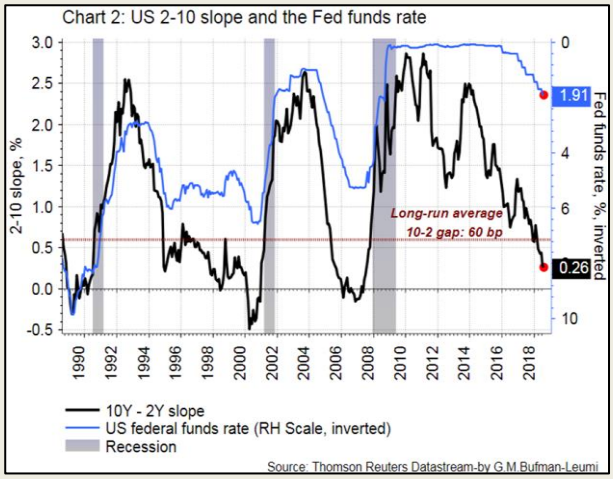




US monetary policy outlook: We expect the Fed to pause rate hikes in the second half of 2019, and start cutting rates gradually in 2020.

- On August 1st, the FOMC left monetary policy unchanged (chart 1), but the statement's content was more optimistic compared to June's meeting statement, as the Fed upgraded its assessment of economic growth, describing it as "strong" versus "solid" previously, and noted that "risks to the economic outlook appear roughly balanced".
- The Fed is expected to raise the interest rate in September, and the likelihood for an additional hike this year has increased. As a result of our forecast for a notable slowdown in 2020 (growth of around or below 1.5%), we expect the Fed to pause the tightening policy already in the second half of 2019, in contrast to the FOMC projections that point to an additional one or two hikes in 2020. We estimate the Fed will start cutting rates gradually in 2020. It should be noted that the tendency for the Fed to overshoot during a rate increase cycle has been observed frequently in the past (chart 2).
- Due to the Fed's hawkish communication, the 10-year Treasury yield increased temporarily more than the shorter-term Treasuries, causing some transitory re-steepening of the yield.
- Based on our models, we expect the yield-to-maturity on 10-year bonds to rise toward an average of 3.2% in 2019 compared to an average of 2.8% in the current year. We expect the yield-to-maturity on 2-year bonds to rise to an average of 3.0% in 2019, from 2.5% this year, reflecting some additional flattening of the yield curve in 2019 on an average basis compared to 2018. A modest 10-2 curve inversion is expected in 2020.

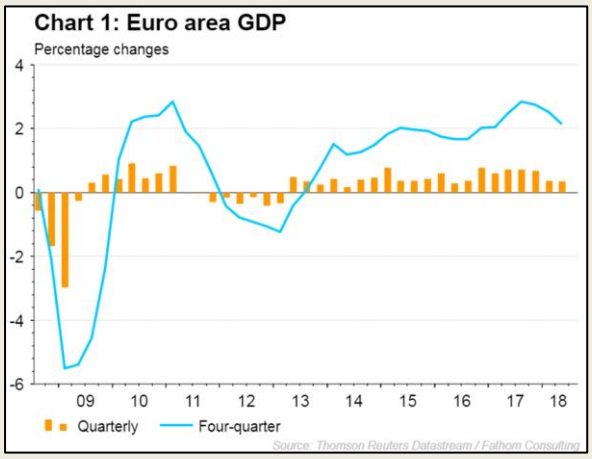


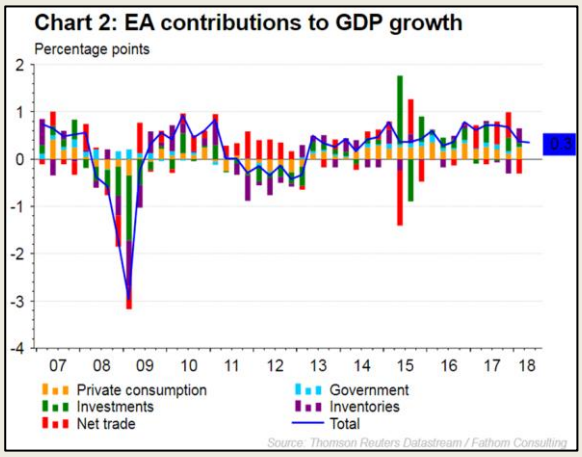


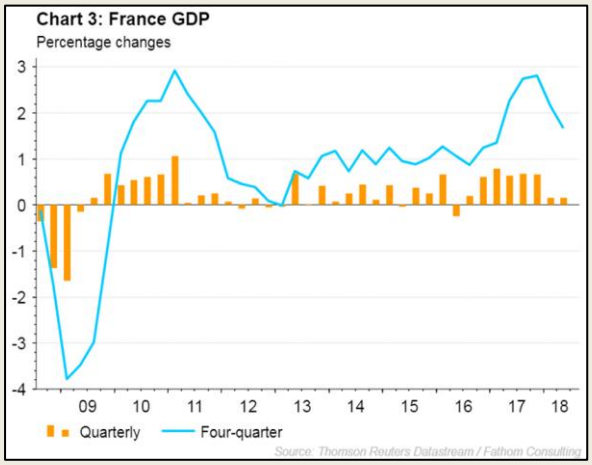
Euro Area

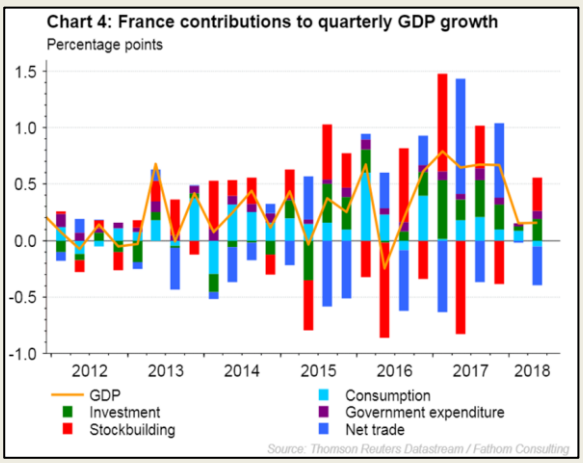
EA growth outlook: economic growth moderated in the second quarter of the year. Business surveys attest to low growth in the beginning of the third quarter.

- The euro area grew 0.4% quarter-on-quarter in the second quarter of the year, alike the growth rate in the first quarter (chart 1), but lower than the average growth rate in the last two quarters of 2017 (0.7% quarter-on-quarter). On a year-on-year basis, growth moderated for the second quarter in a row to 2.2% from 2.5% in Q1, and 2.8% on average in the second half of 2017.
- The recent relatively slow growth is a result of several factors, including base effects (slowdown after strong growth in the second half of 2017), and political uncertainty (concerns over Italy's fiscal profile, the German government coalition, and Brexit). Eurostat has not yet published the GDP expenditure breakdown, but we assume domestic demand was the main contributor to second quarter growth in similar to the previous quarters (chart 2).
- On the national level, economic growth in France was weak at 0.2% quarter-on-quarter (chart 3), for the second quarter in a row, compared to an average quarterly growth of 0.7% in 2017. On y/y basis, France GDP growth moderated to 1.7% compared to 2.2% in Q1 (chart 3). The weakness is attributed, to some extent, to temporary factors such as worker strikes in the railway sector, timing of public holidays, unseasonably warm weather, and some drag from net trade (chart 4). France's economic growth is expected to somewhat accelerate in the second half of the year.



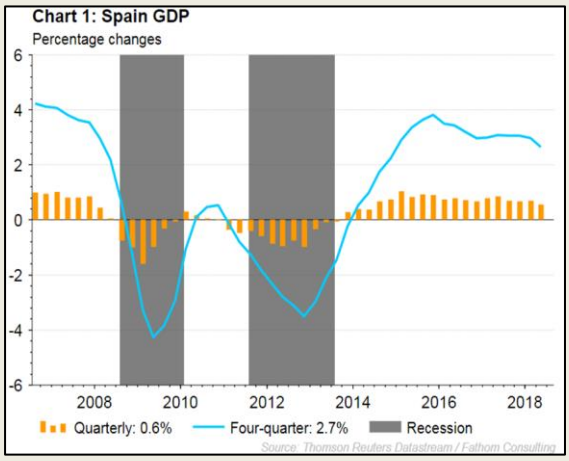


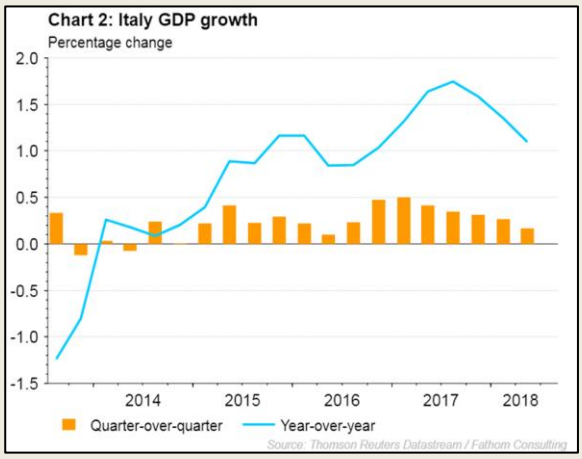


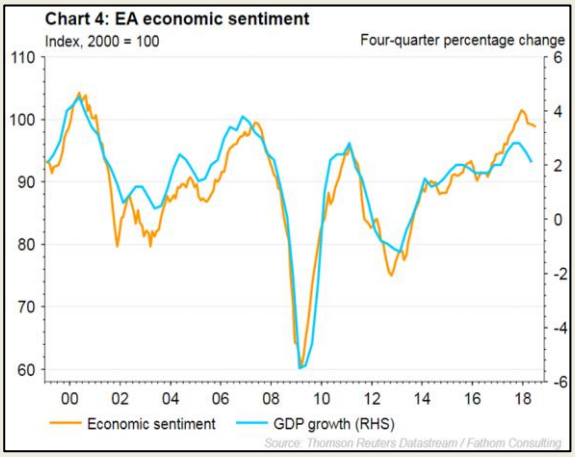


EA growth outlook (continued): economic growth moderated in the second quarter of the year. Business surveys attest to low growth in the beginning of the third quarter.

- Spain's GDP data also surprised to the downside, due to contraction in exports and some easing in private consumption growth (chart 1). Exports also dragged on Italy's growth, causing it to moderate to 0.2% quarter-on-quarter from 0.3% in the previous quarter (chart 2). Political uncertainty in Italy will continue to weigh on investment to some extent. Germany will publish its GDP data on August 14th. Based on the monthly data, Germany's economy likely grew slowly in the second quarter, nearly the same pace registered in the first quarter (chart 3).
- Based on July business surveys (EC, PMI), economic activity was apparently soft in the beginning of the third quarter (chart 4). In addition, based on the PMI survey, companies showed concerns regarding trade wars, EM vulnerability, and political risks, and their potential spillover into the broader economy, and manufacturing in particular.
- We currently expect some moderation in 2018 growth, to 2.2% from 2.5% in 2017. However, due to the downside surprises in GDP data and the slow growth in the first half of the year, and if economic activity will not rebound in the third quarter, we may revise our 2018 growth outlook downward. At its July World Economic Outlook, the IMF revised its EA 2018 and 2019 growth outlook downward, by 0.2 and 0.1 percentage points, respectively, to 2.2% and 1.9%. Also, based on the latest Consensus Economics survey, financial institutions revised downward their EA 2018 growth outlook in the past few months.

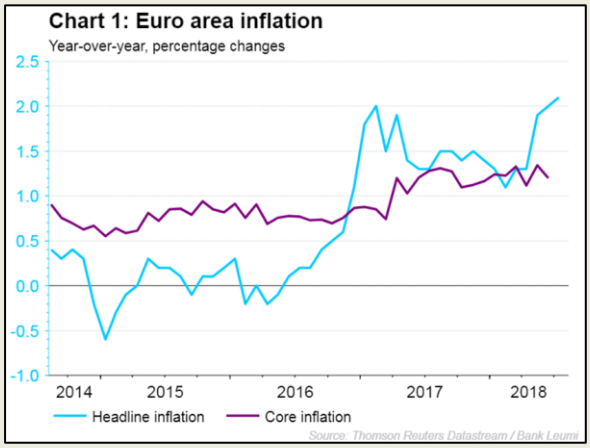


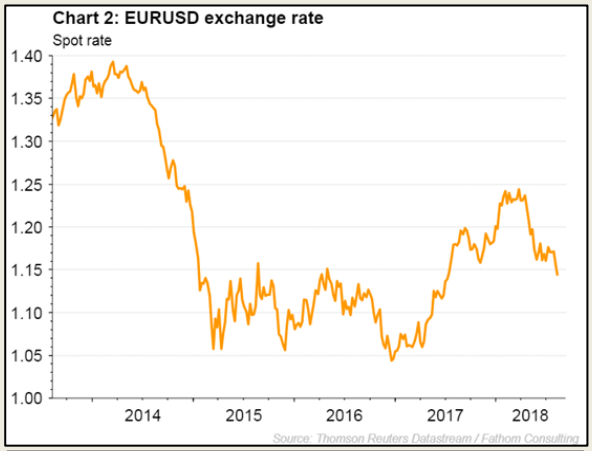


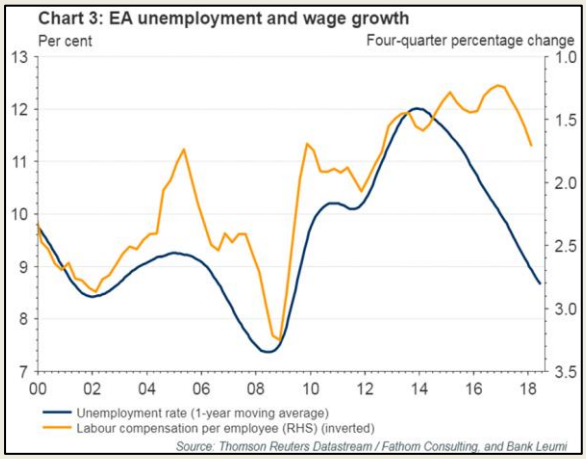


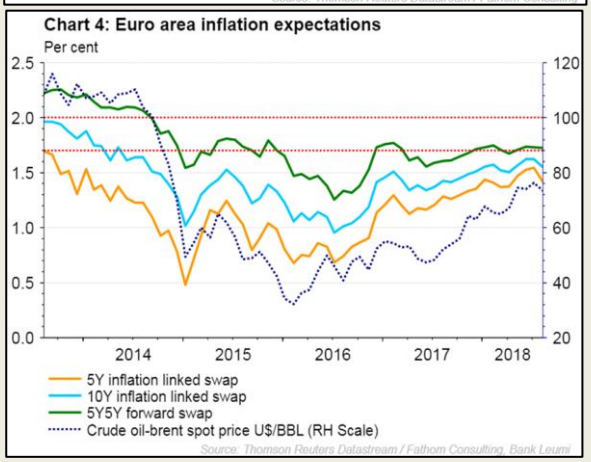
EA inflation outlook: inflation rose in July and is expected to remain close to the ECB's target in the short-run, before moderating toward the end of the year. Core inflation is set to rise modestly.

- The preliminary headline index of EA consumer prices rose to 2.1% year-on-year in July, from 2.0% in June (chart 1). The current level of inflation is relatively high, after averaging around 1.3% in the first four months of the year. Headline inflation has likely reached its cyclical peak, supported by base effects, energy prices, and food prices.
- Headline inflation may start to moderate toward the end of the year after the positive contribution of the temporary factors and base effects will start to fade. In contrast, the depreciation in the exchange rate of the euro in the past few months may support, to some extent, inflation in the short-run (chart 2).
- Core inflation, which excludes the volatile energy and food price components, rose to 1.1% from 0.9%, close to its average over the past few years. Further improvement in the labor market may support wage growth, and as a result provide some support to core inflation (chart 3).
- Market-derived inflation expectations decreased in the past month due to the drop in oil prices, this after a positive trend in expectations in the past two years (chart 4). As a result of the recent drop, the medium- to longer-duration expectations have somewhat moved away from the ECB's inflation target, which is "below, but close to 2% over the medium-term".



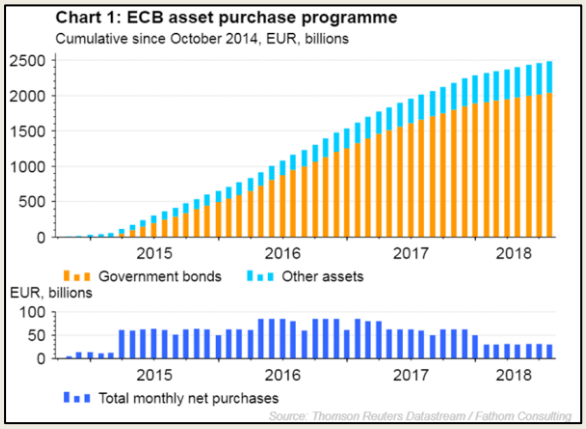


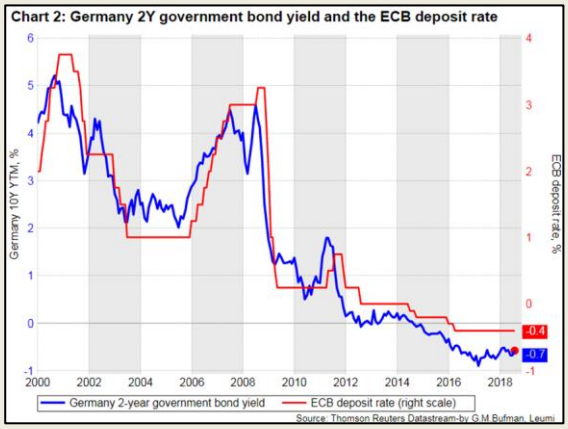


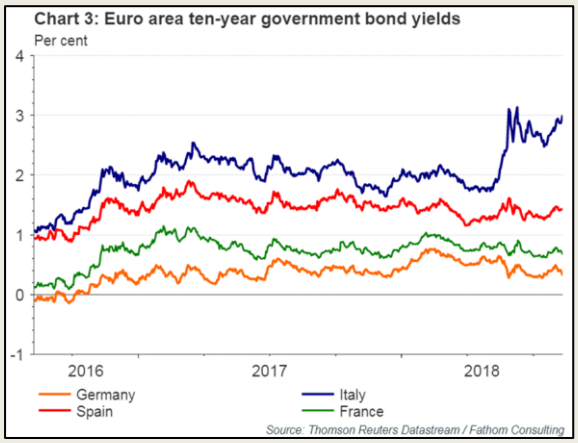


Monetary policy outlook and financial indicators: Long-term government bond yield are expected to rise gradually in the short-run.

- At its latest monetary meeting on July 26th, the ECB left its monetary policy unchanged, as expected. Also, based on the press conference that followed the monetary statement, the ECB's tone and risk assessment toward the euro area economy was not changed. The president of the ECB, Mario Draghi, signaled that the Governing Council remains concerned about the threat of protectionism, yet the ECB is also encouraged by the recent negotiations between the EU and the US.
- Looking forward, we expect a complete discontinuation of QE purchases by the end of the year (chart 1), and the interest rate may start rising "through the summer" in 2019 in accordance with the ECB's forward guidance and markets expectations. The expected gradual and moderate hike limits the potential for a significant increase in the short-term government bond yield (chart 2). The ECB's continuous reduction in the level of accommodation may support a recovery in government bond yields over the short-medium term. However, we expect the recovery in yields to be moderate and volatile (chart 3), due to the existing risks, including trade protectionism, further possible downward changes to the EA growth outlook, and the existing political risks in the bloc, mainly in Italy.
- The yield spread between 10-year Italian and German bonds widened in the past few weeks (chart 4) due to mounting concerns over Italy's budget plans. Implementation of the coalition's top economic policies in 2019 budget is expected to cause a rise in Italy's budget deficit, at least temporarily, thus worsening Italy's weak fiscal profile further. We estimate the Italian government will implement a lighter version of their populist fiscal plans, but this will still increase the budget deficit and public debt.







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