Global Macroeconomic Monthly Review

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Key Issues

Global Economic Forecast Table (p. 3)

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

- *GDP growth slowed in the third quarter. Heightened economic uncertainty and volatility in the financial markets may weigh on growth in the short-run. We expect further moderation in economic growth rates over the short-medium term.*
- *Base effects and the recent decline in oil prices may weigh, at least temporarily, on headline and break-even inflation in the short-run. Further tightening in the global labor market may eventually put upward pressure on core inflation.*
- *Monetary policy normalization is expected to continue, both in major advanced economies, as well as in emerging economies. In China we expect further easing.*
- *Short-term rate differentials between the US and other advanced economies may widen further in the short-run before they start narrowing sometime in 2019-2020.*

United States (p. 6)

- *The degree of political uncertainty somewhat receded after the outcome of the midterm elections. A split Congress will make legislation more complicated.*
- *GDP growth moderated in Q3 after a strong performance in the previous quarter. Overall, US economic activity continues to grow strongly, supported by fiscal stimulus. Economic growth is expected to moderate in 2019-2020 due to an eventual waning of fiscal stimulus over time, along with tighter financial conditions and USD appreciation.*
- *Inflation is expected to remain above the Fed's target in the short-run.*
- *The Fed is expected to hike the interest rate in December 2018. The tightening cycle is expected to continue in 2019, but we do not rule out the possibility that the Fed will temporarily pause the rate hike cycle in 2019, and may cut rates gradually later on in 2020.*
- *US Treasury yields have increased over the last few weeks and the yield curve has returned to its flattening mode after a short pause. Looking forward, rates at the short-end of the yield curve are expected to increase further in 2019, while the potential for a significant increase in longer-end yields is relatively limited. The slope is expected to somewhat flatten in the short-medium term.*

Euro Area (p. 12)

- *A low growth environment may persist at least in the short-run, as political uncertainty is expected to weigh on domestic demand.*
- *Core inflation may rise moderately in 2019 supported by the decline in the unemployment rate and some modest acceleration in wage growth.*
- *The ECB may change its policy rate forward guidance if the growth environment will remain low and risks persist.*
- *Long-term government bond yields are expected to rise gradually in the short-run in tandem with the ECB's tapering actions and along with a narrowing of current account surpluses, supporting some steepening in the EA yield curve.*

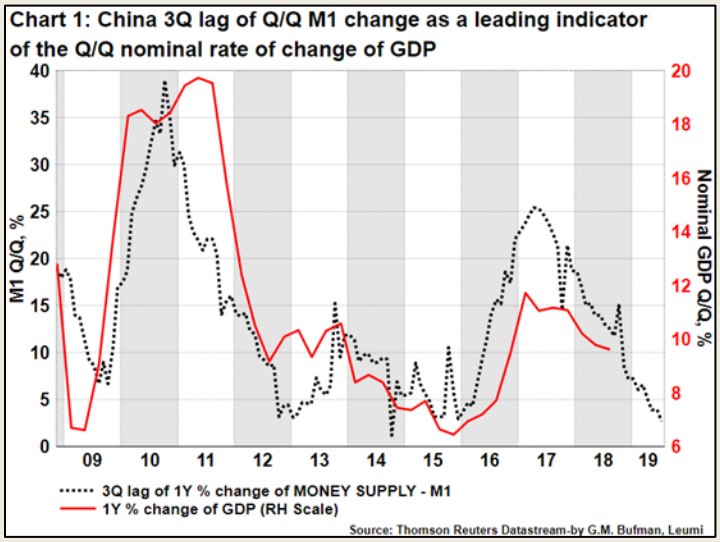
Leumi Global Economic Forecast, As of November 2018

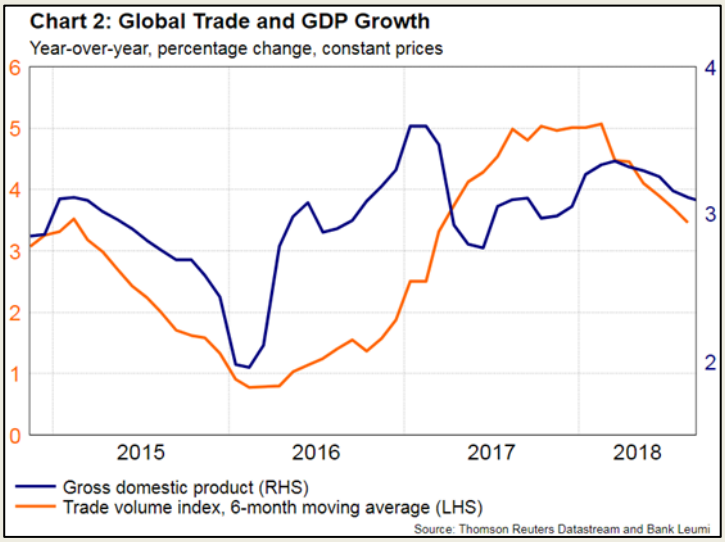
	2015	2016	2017	2018F	2019F
GDP – Real Growth Rate					
World	*3.3%*	*3.2%*	*3.7%*	*3.6%*	*3.5%*
USA	*2.9%*	*1.6%*	*2.3%*	*2.9%*	*2.2%*
UK	*2.2%*	*1.8%*	*1.6%*	*1.3%*	*1.5%*
Japan	*1.4%*	*0.9%*	*1.7%*	*1.2%*	*1.4%*
Eurozone	*2.0%*	*1.7%*	*2.6%*	*2.1%*	*1.8%*
South East Asia (ex. Japan)	*4.5%*	*4.5%*	*5.2%*	*5.0%*	*4.7%*
China	*6.9%*	*6.7%*	*6.9%*	*6.6%*	*6.2%*
India	*7.9%*	*7.1%*	*6.7%*	*7.6%*	*7.7%*
Latin America	*0.1%*	*-0.7%*	*1.2%*	*1.1%*	*2.0%*
Israel	*2.5%*	*4.0%*	*3.5%*	*3.2%*	*3.3%*
Trade Volume, Growth (%)					
Global	*2.5%*	*2.3%*	*5.3%*	*4.0%*	*3.7%*
CPI, Annual Average (%)					
USA	*0.1%*	*1.3%*	*2.1%*	*2.6%*	*2.4%*
UK	*0.1%*	*0.7%*	*2.7%*	*2.5%*	*2.2%*
Japan	*0.5%*	*1.0%*	*0.5%*	*1.0%*	*1.8%*
Eurozone	*0.8%*	*-0.1%*	*1.5%*	*1.6%*	*1.8%*
Israel	*-0.6%*	*-0.5%*	*0.2%*	*1.1%*	*0.5%*
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*	*0.50-0.75%*

The Big Picture – The Global Economy

Global outlook – economic activity (1/2): GDP growth slowed in the third quarter. Increasing economic uncertainty and volatility in the financial markets may weigh on growth in the short-run. We expect further moderation in economic growth over the short-medium term.

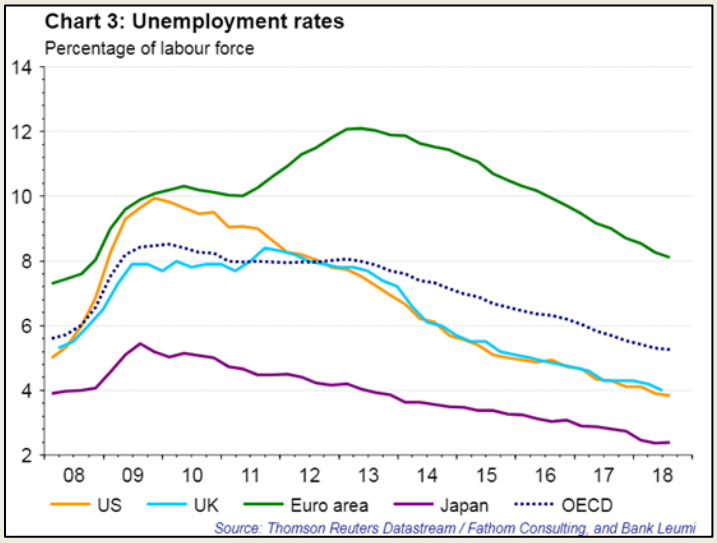
- Based on the national accounts data, world GDP growth slowed in Q3 compared to the previous quarter, as slowdowns (on a quarter-over-quarter basis) were registered in the US, the euro area (EA), Japan, and China. On a year-over-year basis, growth differentials between the US and the EA widened further in the third quarter, as the US grew 3.0% y/y and EA economic growth moderated to 1.7% from 2.2% in the previous quarter. We expect the gaps to narrow in the medium-term after the impact of US expansionary fiscal policy will wane and as tightening monetary conditions will start to weigh on domestic demand.
- In China, Q3 GDP growth moderated, mainly reflecting slowing infrastructure investment and softer IP growth. Growth is expected to moderate further due to the ongoing trade conflict with the US, some slowdown in growth among China's trading partners, and continuing moderation in money supply (chart 1). The chart shows the long-run positive correlation between China's GDP growth and M1 money supply. The high debt level is expected to remain a substantial economic risk for China.
- Recently released business surveys and economic leading indicators paint a mixed picture regarding the performance of the global economy. Markit's global composite PMI rose slightly in October from a two-year low, as a stronger performing services sector offset the ongoing slowdown at manufacturers. The new export orders component of the global manufacturing PMI continued to fall in October, but at a slowing rate. The current trend is consistent with the slowdown in global trade activity (chart 2), this partly due to a slowdown in some major economies and uncertainty regarding US trade policy, mainly vis-à-vis China, and the European Union to some extent. The recent trade agreements between the US and some of its trade partners, including Canada, Mexico, and South Korea, may suggest the Trump administration is willing to compromise.

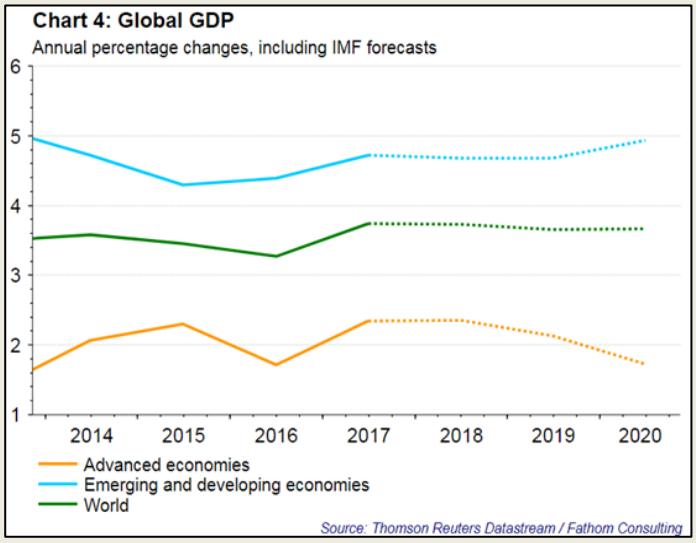




Global outlook – economic activity (2/2): GDP growth slowed in the third quarter. Increasing economic uncertainty and volatility in the financial markets may weigh on growth in the short-run. We expect further moderation in economic growth over the short-medium term.

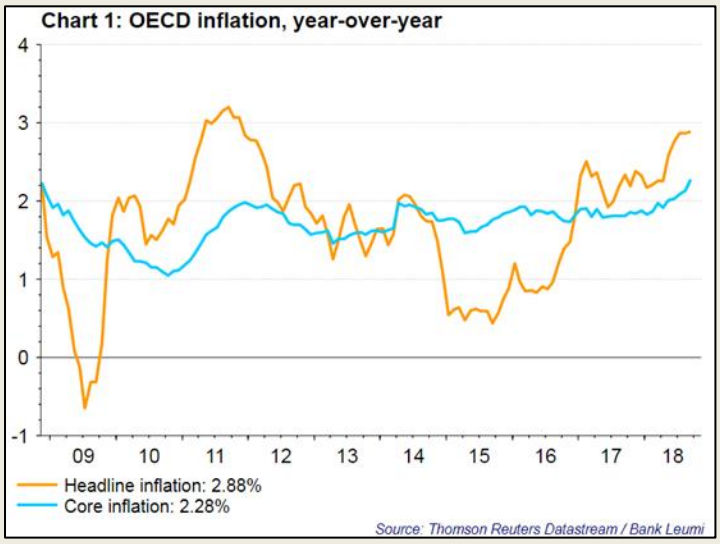
- Household demand indicators remained positive in some major economies, supported by the improvement in the labor markets. Unemployment rates have been declining recently in the major advanced economies (chart 3), and remained relatively strong in the emerging economies as well. In addition, pay growth has accelerated further in recent months. We expect the continuing improvement in the world labor market, particularly in the advanced economies, to support private spending at least in the short-run. However, private spending should start moderating sometime in 2019-2020 as employment growth is expected to slow and higher interest rates are expected to weigh on demand.
- The world economy has lost some momentum in recent months and is likely 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 EA. Growth in the emerging economies is expected to remain stable, but desynchronized. While growth in China is expected to moderate, activity should remain strong in India, and pick up slightly in Brazil, Mexico, and Russia. In addition, Turkey and Argentina are both experiencing significant economic weakness and financial instability, and these economies are expected to remain highly vulnerable in the short-run. Overall, we expect global growth to ease slightly, from 3.6% this year to 3.5% in 2019 and 3.4% in 2020, with some increasing divergence in the medium-term, between the advanced economies and emerging economies, as growth in the advanced economies is expected to moderate while growth in EM economies is expected to remain constant or even somewhat accelerate. Our estimates are slightly lower relative to IMF's latest estimates (chart 4).
- Risks to our 2019-2020 global growth outlook stem from various factors, including: growth moderation among some of the major economies including the US, the EU, and China; rising uncertainty due to protectionism; monetary and financial tightening conditions; and political and geo-political risks. In our opinion, due to the heightened risks environment, we do not rule out downward revisions to our growth outlook.

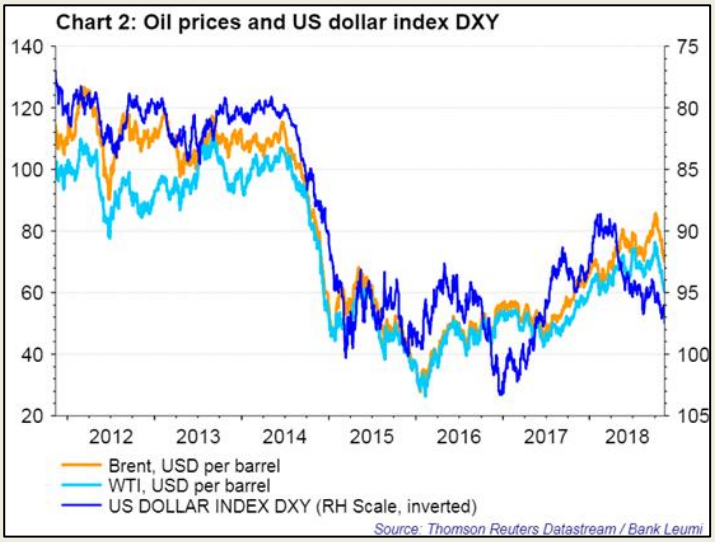




Global inflation outlook: Base effects and the decline in oil prices may weigh on headline inflation. Further tightening in the global labor market may put upward pressure on underlying inflation.

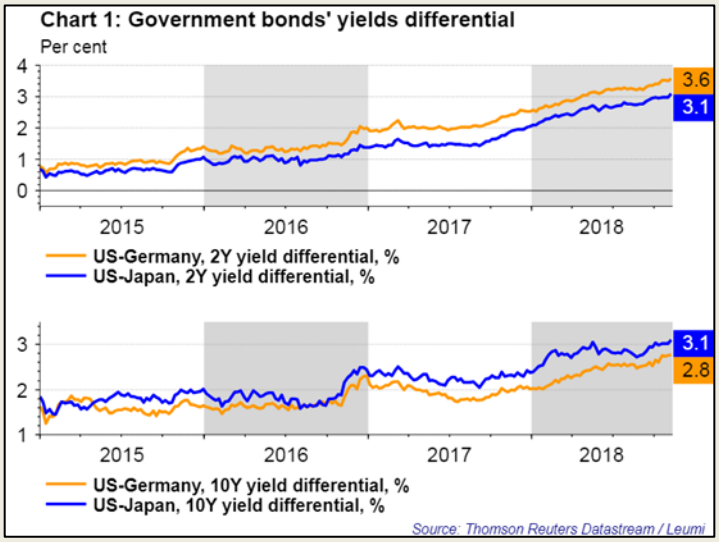
- The average headline inflation rate in OECD economies was unchanged at 2.9% y/y in September, compared to an average of 2.4% in the first half of the year (chart 1). Also, some of the major emerging economies experienced a rise in inflation due to increases in import prices as a result of depreciations in their exchange rates. Headline inflation in the advanced economies is expected to somewhat moderate in the short-run due to, among other things, base effects.
- The recent fall in oil prices may also contribute to some extent to a decrease in consumer prices. The recent fall in oil prices, which also caused a decrease in break-even inflation expectations, is a result of a few factors including an increase in US oil production, downward revision to oil demand growth, and USD appreciation (chart 2).
- The OECD average core inflation rate rose to a 10-year high (2.3% y/y) in September, but most of the contribution in recent months came from Turkey's high figures. Overall, core inflation remained relatively low, mainly in the advanced economies, and most prominently in the EA and Japan. However, further falls in unemployment and rising labor costs may support wage growth and core inflation in the short-medium term.

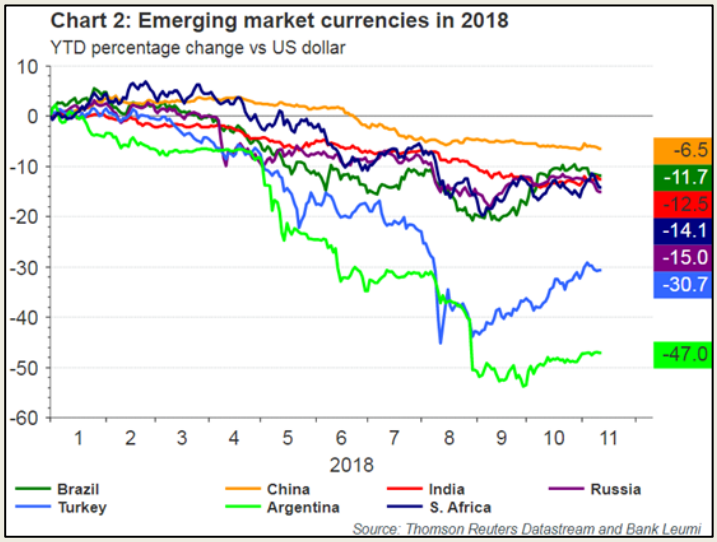




Global monetary policy outlook: Monetary policy normalization is expected to continue, both in major advanced economies, as well as in emerging economies. In China we expect further easing.

- Central banks in the major advanced economies are likely to "look through" headline inflation data, if it will moderate in the short-run, and continue to normalize policy to contain core inflation. Despite the heightened volatility in the financial markets, the Fed is expected to raise interest rates again in December, and then continue raising between two to three additional times in 2019. The ECB is expected to end its net asset purchases in December, and to wait at least until the summer of 2019 before slowly and gradually raising interest rates. In the UK, we foresee between one and two rate hikes in 2019. We may change our estimation based on the political developments surrounding the Brexit negotiations. In Japan, we expect minor changes in monetary policy, while the interest rate is expected to remain unchanged in 2019 at least.
- Due to the expected rise in policy rate differentials between the US and most other advanced economies, we expect government bond yield differentials to rise, mainly at the short-end of the yield curves (chart 1). The longer-end of the curves may "normalize" slowly upwards in the short-medium term, as a result of the normalization processes among the major advanced economies' central banks.
- After several rate hikes in the emerging markets over recent months, some major EM central banks, including those in Turkey, Russia, and India, kept their monetary policies unchanged in the past month. This comes against the backdrop of a recent decrease in CDS spreads and "corrections" in EM currencies (appreciations) in the past two months (chart 2), which may point to some improvement in investors' assessments regarding the risks environment.
- In China, we expect further expansionary monetary policy steps in the short-run, either through continued cuts in the reserve ratio rate or the main policy rate, this in order to support economic growth. In India, we do not rule out a rate hike in the short-run if inflationary pressures will emerge. Heightened volatility in the financial market, in tandem with currency depreciations, may continue to have an effect on monetary policy decisions in EM economies, toward the hawkish side, at least in the short-run.

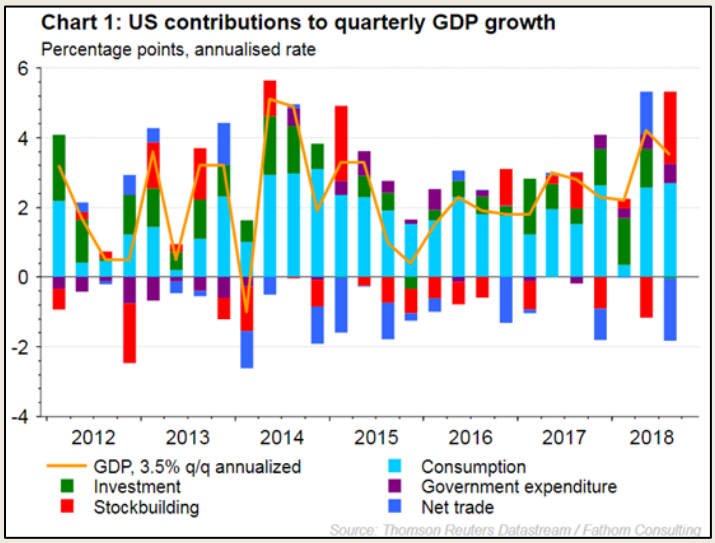


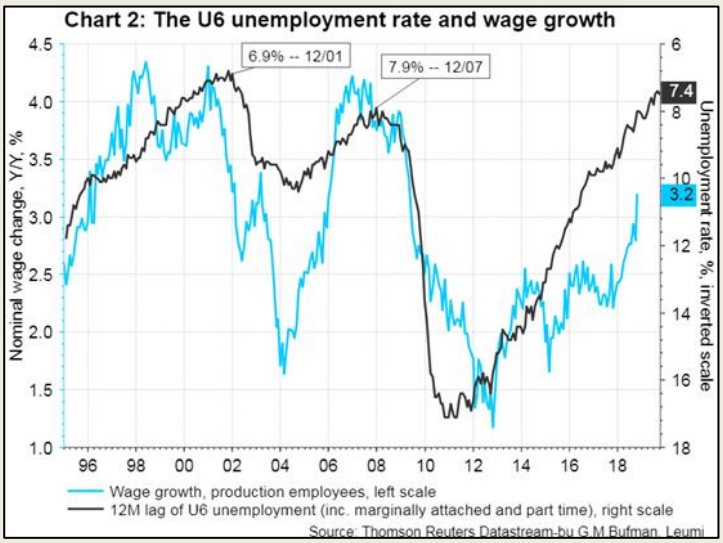


United States

US growth outlook (1/2): US economic activity continues to grow strongly, supported by fiscal stimulus. Political uncertainty somewhat receded after the result of the midterm elections. Growth is expected to moderate in 2019-2020.

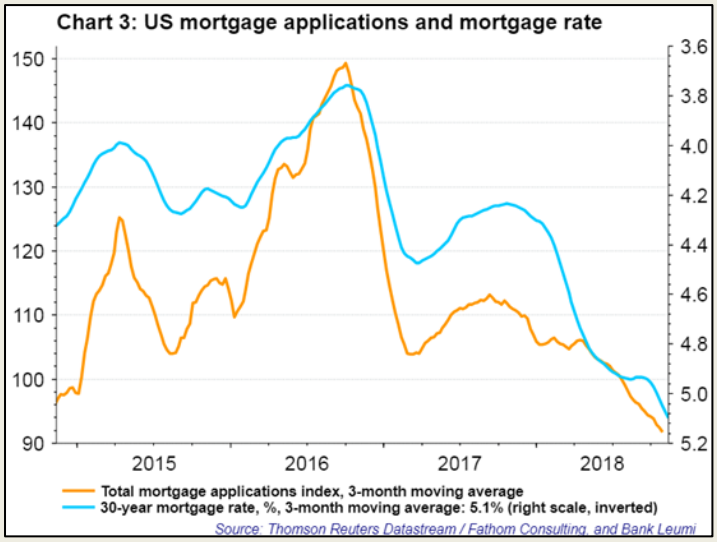
- Based on preliminary national accounts data, Q3 real GDP increased 3.5% q/q annualized, attesting to another robust increase after the 4.2% rise in the preceding quarter (chart 1). Q3 growth was supported by domestic demand, mainly private consumption and government spending. Business investment somewhat disappointed, mainly due to moderation in equipment and structures investment, and continuing weakness in residential investment. Net trade subtracted from GDP growth due to base effects.
- Meanwhile, political uncertainty has decreased, to some extent, following the November 6 midterm elections. The split Congress may reduce the probability of further significant fiscal stimulus. However, we do not expect a change in US trade policy, which is to a large extent under the president's authority.
- Recently released employment data attest to further strength in the labor market. Non-farm payrolls increased strongly in October following the modest gain in September, confirming the natural disaster effects depressed employment growth in September. The private sector drove employment growth. The unemployment rate remained at 3.7% (the lowest since 1969) despite an increase in the participation rate. The broad U-6 unemployment rate decreased slightly back to 7.4% (the lowest since 2002). Based on a long-run correlation, the decrease in U-6 unemployment is expected to support further acceleration in wage growth (chart 2). Average weekly earnings growth accelerated to 3.2% (the highest since May 2009), driven by the services sector. The strength in the labor market, in tandem with the acceleration in wage growth and a positive wealth effect, are expected to support household demand in the short-run.

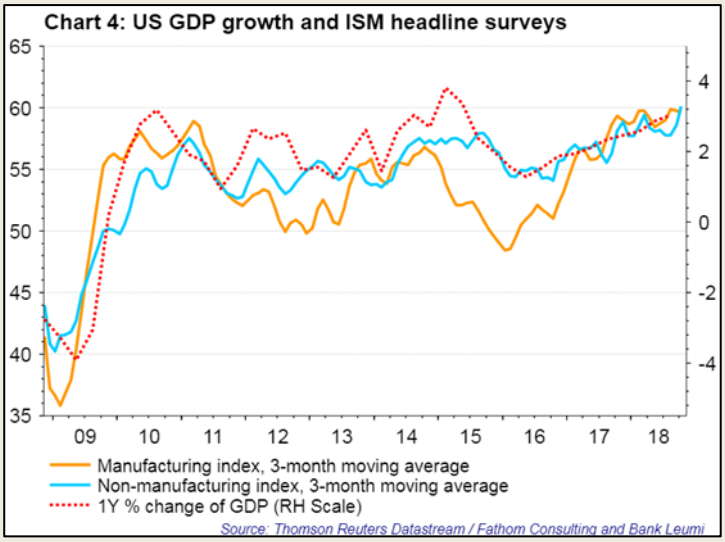




US growth outlook (2/2): US economic activity continues to grow strongly, supported by fiscal stimulus. Political uncertainty somewhat receded after the result of the midterm elections. Growth is expected to moderate in 2019-2020.

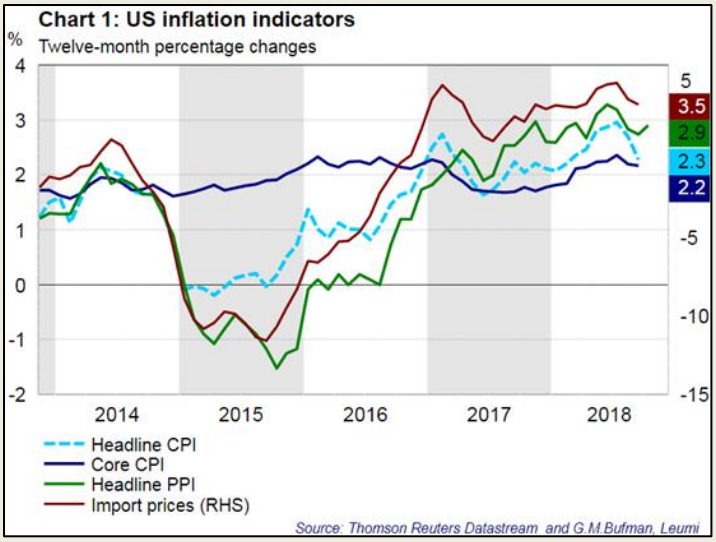
- Despite the above, rising consumer prices and interest rates may erode household purchasing power and somewhat weigh on spending growth in the short-medium term. Sectors that are sensitive to interest rates, such as housing, have been characterized recently by a slowdown in demand, as mortgage interest rates rose substantially in the past year (chart 3). This, in tandem with a decrease in housing affordability, caused a fall in demand for mortgages and homes in the past year. The recent fall in demand led to an increase in the months of housing supply. If this will continue, we would expect housing price inflation to somewhat moderate. It should be noted that the construction sector has been affected negatively by an increase in input prices and wages, squeezing profit margins. Softening demand, in tandem with labor shortages in the housing sector, is expected to continue to weigh on housing starts and residential investment in the short-medium term.
- October business surveys may attest to some moderation in the beginning of the fourth quarter. The ISM manufacturing index and the non-manufacturing index fell somewhat in October, but remained at levels that point to a solid growth environment (chart 4). Also, other survey measures, like the Markit PMI and some regional Fed surveys, point to some moderation in economic activity.
- Looking forward, we expect US growth to remain solid, with the economy growing above its potential growth level. We expect 2018 GDP growth to accelerate to 2.9% from 2.3% in 2017, moderating to 2.2% in 2019. The moderation next year is expected to be driven by several factors, including: the fading effects of the current expansionary fiscal policy; higher interest rates; USD appreciation; rising uncertainty regarding US trade and foreign policy; and some political risks that may stem from policy uncertainty after the midterm elections and ongoing investigations of the president. We expect further moderation in 2020, as growth may dip below 2%.

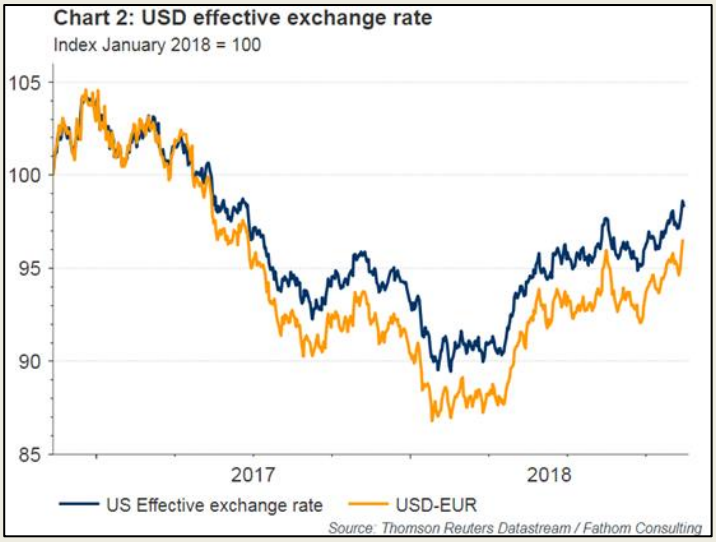




US inflation and monetary policy outlook (1/2): Inflation is expected to remain above the Fed's target in the short-run. The Fed is expected to hike the interest rate in December. The tightening cycle is expected to continue in 2019, but may pause in the second half of the year.

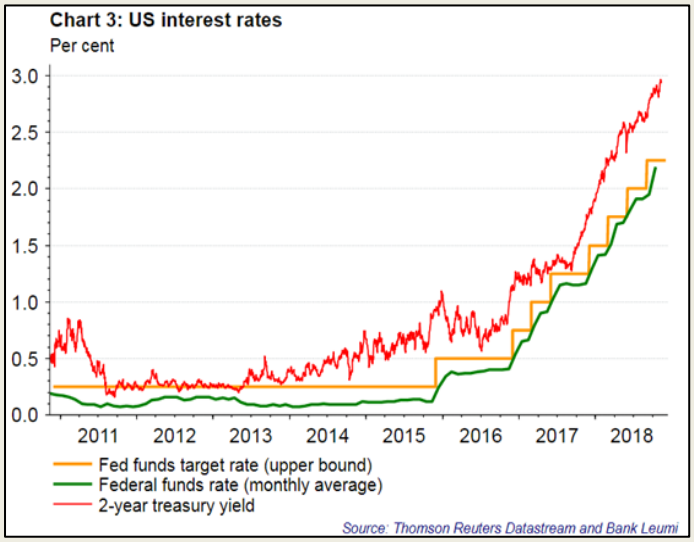
- Headline CPI inflation moderated in September, for the second month in a row, as expected, due to base effects, but remained above the FOMC inflation target (chart 1). The recent fall in oil prices may temporarily offset to some extent the rise in consumer prices. Additional downside risks to the short-term inflation outlook may stem from the continuing appreciation in the USD (chart 2). New tariffs imposed by the US on Chinese imported goods so far have not significantly affected consumer prices. However, we do not rule out inflationary effects if the US will impose additional, significant tariffs in the future, as was threatened by the president.
- Both headline and core producer prices rose strongly in October, led by services, trade, transportation, and warehousing prices, reflecting some inflationary pressures. We expect some of the rise in producer prices to be rolled over to consumer prices.
- Both core and headline inflation are expected to remain above the FOMC target in the short-run at least, supported by a further tightening labor market, which may support wage growth. On average, we expect CPI inflation to be around 2.5% in the current year, compared to 2.1% in 2017, and to remain above the Fed's target in 2019.
- At its last monetary meeting on November 7-8th, the FOMC kept the federal funds rate unchanged at 2.00-2.25%, in line with expectations. The committee's statement was almost unchanged compared to the one published in September, and was generally positive on the growth outlook, noting, "economic activity has been rising at a strong rate". The FOMC slightly downgraded its language on investment, noting that "business fixed investment has moderated from its rapid pace earlier this year", as was prominent also in Q3 GDP data. The language on inflation and interest rates remained unchanged. Based on its projections, the Fed expects the interest rate to rise to 2.4% in 2018, 3.1% in 2019, and 3.4% in 2020.

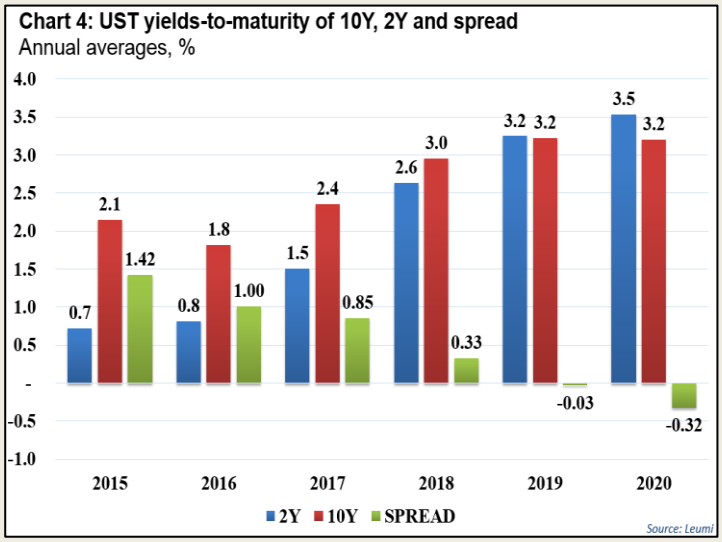




US inflation and monetary policy outlook (2/2): Inflation is expected to remain above the Fed's target in the short-run. The Fed is expected to hike the interest rate in December. The tightening cycle is expected to continue in 2019, but may pause in the second half of the year.

- Based on the Fed' recent communication, and in accordance with recently released data, the Fed is expected to raise the interest rate in the December meeting, as reflected in market-derived interest rate expectations. Looking ahead, we expect the Fed to continue hiking the interest rate in 2019, providing upward pressure to short-term yields (chart 3). However, due to the increase in risks, the level of uncertainty regarding the number of hikes next year is relatively high. We expect two (similar to market-implied interest rate expectations) to three additional rate hikes in 2019. If the growth environment will start to clearly moderate during 2019, then we do not rule out the possibility that the Fed will pause the tightening process already in the second half of 2019, and start cutting rates gradually in 2020, in contrast to the FOMC projections that point to an additional one or two hikes in 2020.
- The yield curve has returned to its flattening mode in the past month after it had steepened between mid-September to the beginning of October. Labor market and inflation data supported a rise in the yield curve in the past month, as the yield-to-maturity of the 2-year Treasury bond reached a new high of more than a decade (2.98%), and the yield-to-maturity of the 10-year bond reached a 7.5-year high (3.23%).
- Based on our models, we expect the yield-to-maturity on 10-year bonds to rise throughout 2019 towards 3.5% with an average of 3.2% in for the year compared to an average of 3.0% in 2018. We expect the yield-to-maturity on 2-year bonds to rise to an average of 3.3% in 2019, from 2.6% this year, reflecting some flattening of the yield curve in 2019 on an average basis compared to 2018. A modest and transitory 10-2 year curve inversion is expected in 2020 (chart 4).

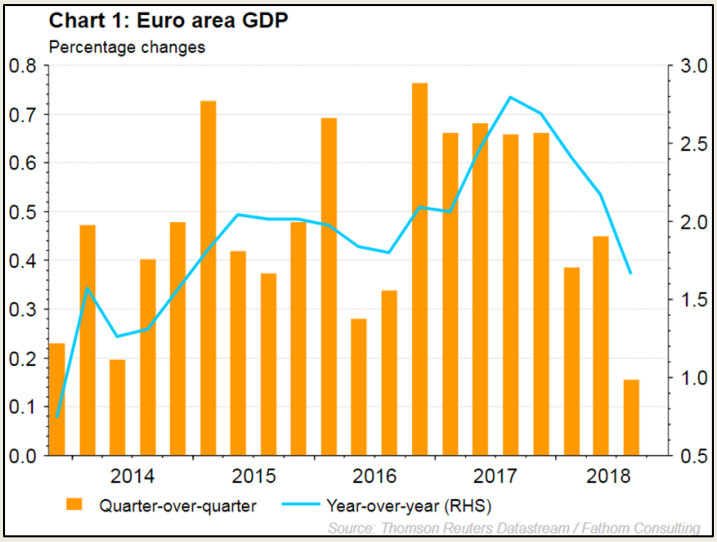


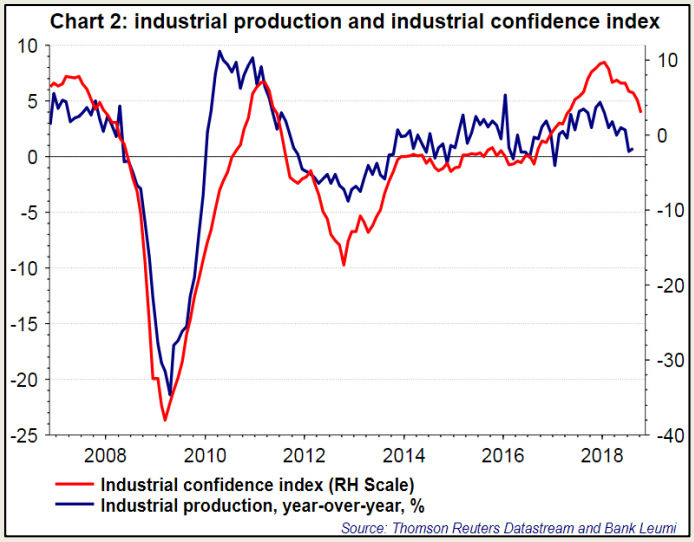


Euro Area

EA growth outlook (1/2): A low growth environment may persist at least in the short-run, as political uncertainty is expected to weigh on domestic demand.

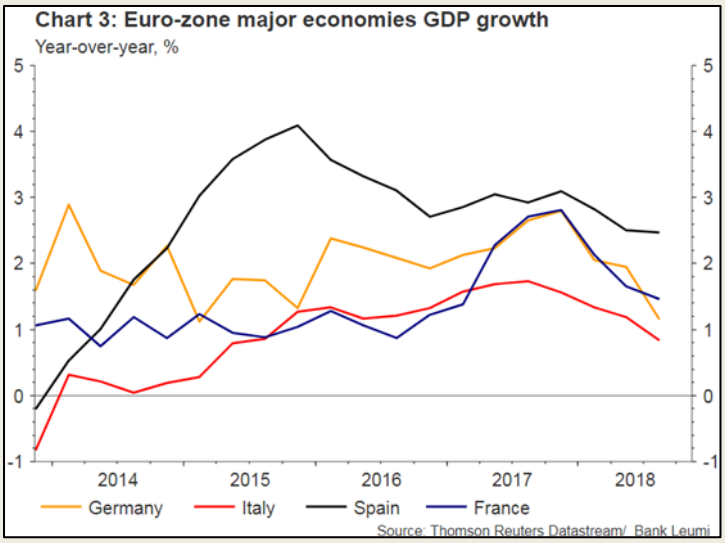
- Q3 GDP growth moderated to a very low rate of 0.2% q/q, this compared to quarterly growth of 0.4% in the previous two quarters. On a year-on-year basis, growth slowed, for the fourth consecutive quarter, to 1.7% from 2.2% in the previous quarter (chart 1). The growth components' breakdown is not available yet, but based on the available GDP national data and monthly data, growth was restrained by net trade and moderation in Italy's domestic demand growth against the backdrop of political uncertainty. Also, temporary factors appear to have affected growth, to some extent, mainly involving disruptions in European automobile production, mainly in Germany (where GDP growth contracted more than expected), due to regulatory changes in the industry.
- Both hard and soft data reflect the moderation in the growth environment in the EA. Growth in industrial production (chart 2) and retail sales have continued to moderate recently in the past few months. We expect industrial production growth to remain low, hindered mainly by political uncertainty regarding Italy and EU-UK economic relations against the backdrop of the Brexit process. Export orders were significantly weak recently and hence we expect a low contribution, if any, from net trade to growth in the short-run. In contrast, we expect a positive contribution from household demand in the short-run, supported by a further decline in unemployment and a moderate improvement in wage growth, which is on an upward trajectory.
- Based on recent business surveys, which have a long-run positive correlation with GDP growth, EA economic activity started the fourth quarter on a soft note, as the PMI composite and the EC Economic Sentiment Indicator both fell in October. Based on leading indicators, we do not rule out an additional low quarterly growth rate in the fourth quarter and further moderation in growth (on a y/y basis) in the short-run at least, vis-à-vis the potential growth level.

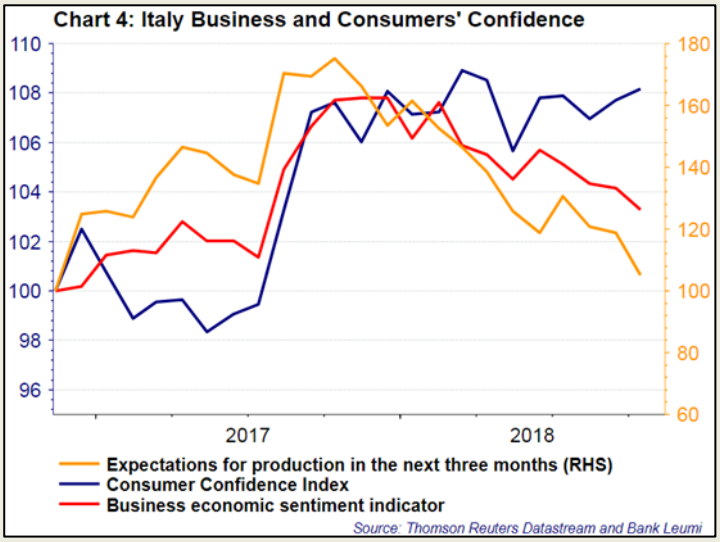




EA growth outlook (2/2): A low growth environment may persist at least in the short-run, as political uncertainty is expected to weigh on domestic demand.

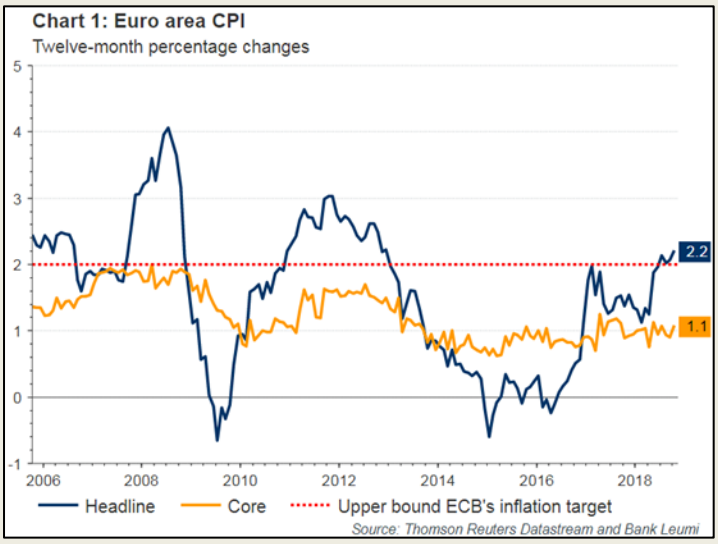
- Overall, economic growth in the EA moderated since the beginning of the year, as expected, compared to the significantly above-potential growth in 2017. The moderation in growth was affected mainly by base effects and some softening in external demand. Still, economic activity continues to grow at a reasonably healthy pace, despite the moderation in economic activity since the beginning of the year. GDP growth is expected to moderate to 2.1% this year from 2.6% in 2017, and moderate further in 2019 to around 1.8%.
- We also expect a continuous divergence in the growth environment on the national level among euro area major economies (chart 3), as Italy's growth is expected to moderate more substantially this year and probably also in 2019 compared to Germany and France. The loose expansionary fiscal policy in Italy may be offset by higher borrowing costs and low confidence in the business sector. Based on Italy's business sector sentiment and expectations surveys, we estimate further weakness in economic activity in the short-run at least (chart 4).
- The main risks to the short-medium term growth outlook are concerns regarding changes in US-EU trade policy, uncertainty regarding Brexit, and other political risks in Europe, including Italy's political and fiscal risks.

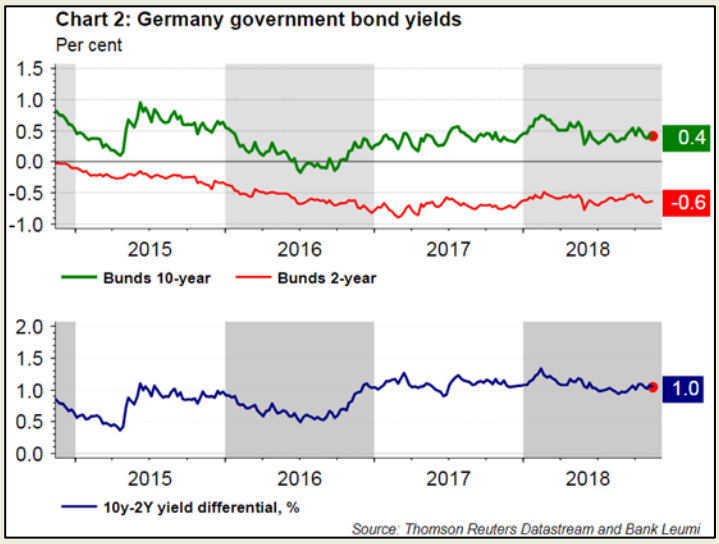




EA inflation and monetary outlook: The ECB may change its policy rate forward guidance if the growth environment will remain low and risks persist.

- Headline inflation rose slightly by 0.1pp to 2.2% in October led by energy prices, while core inflation rose 0.2pp to 1.1% (chart 1), which is close to its average over the past five years. Headline inflation is expected to remain around 2% in the upcoming months and moderate in 2019 due to base effects (trends in commodity prices pose a risk to these estimates). Core inflation is expected to rise modestly in 2019 as the unemployment rate continues to fall and wage growth moderately accelerates.
- Despite the moderation in economic activity, we expect the ECB to stick to its plans to end asset purchases this year. However, we do not rule out a change to the ECB's policy rate forward guidance, sometime in the near future. Nor do we rule out a possible delay in an initial rate hike if the weakness in economic activity will persist. This situation may support a further increase in government bond yield differentials between the US and EA benchmark bonds, at the short-end of the curve in the upcoming months.
- However, we expect some modest recovery in longer-term government bond yields, albeit with some heightened volatility down the road due to the existing risks, including trade protectionism, further possible downward changes to the EA growth outlook, and substantial political risks in the bloc. Based on the current macro environment, we do not rule out some steepening of the EA yield curve in short-medium term (chart 2).





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