# Global Macroeconomic Monthly Review

**Arie Tal, Research Economist**

***Capital Markets Division, Economics Department***

*Please see disclaimer on the last page of this report*

# Key Issues

## Global Economic Forecast Table (p. 3)

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

- *Based on January-February data, it seems global economic activity started the year on a soft note, mainly due to moderation in the industrial sector.*
- *Leading indicators suggest soft growth in the coming months.*
- *Economic growth is expected to moderate gradually further in 2019.*
- *The positive progress in US-China trade talks (according to the media), in tandem with the renewal of the dovish stance among central banks, eased financial stress.*
- *Still, risks to our 2019 growth outlook are tilted to the downside.*
- *Inflation has moderated recently. The recent recovery in oil prices, which are still lower than their levels of mid-2018, may limit the potential for a significant decrease in headline inflation. Core inflation remains resilient.*
- *Major central banks are following the Fed's dovish stance, as the global risk environment remains heightened.*
- *The recent changes in the stance of many central banks may limit the potential for a rebound in government bond yields, at least in the short-run.*

## United States (p. 7)

- *It appears first quarter activity has moderated further downward.*
- *Leading indicators point to a slower growth environment in the short-run.*
- *Risks to our growth estimate are tilted to the downside.*
- *Headline inflation may fall slightly further in the short-run before recovering in the second half of the year toward 2%.*
- *The Fed changed its policy stance to neutral. We expect a single rate hike in 2019 if financial conditions will ease further and economic conditions will not surprise to the downside.*

## Euro Area (p. 9)

- *Economic activity is not expected to rebound significantly in the short-run, instead remaining soft.*
- *We revised our 2019 growth estimates further downward.*
- *Headline inflation is expected to moderate in the coming months.*
- *The ECB announced a new TLTRO program, revised downward substantially its 2019 growth and inflation outlooks, and provided a dovish forward guidance.*
- *Euro area safe haven government bond yields are expected to remain low, at least in the short-run.*

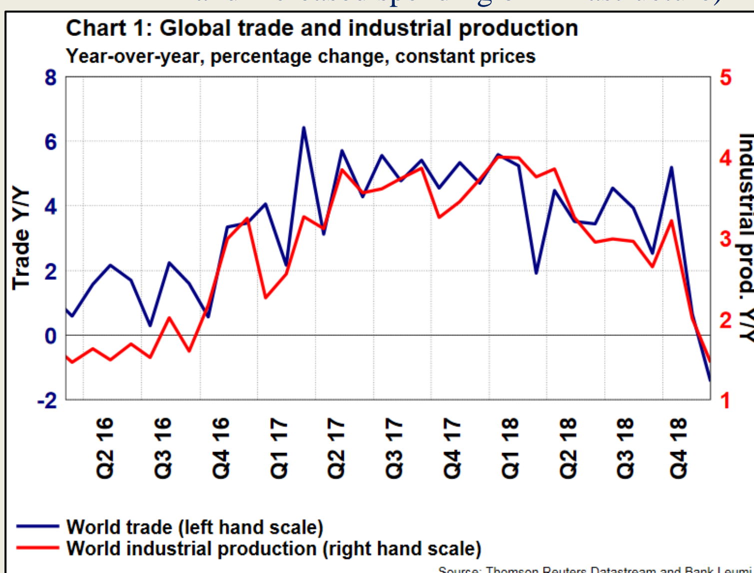
***Leumi Global Economic Forecast, As of March 2019***

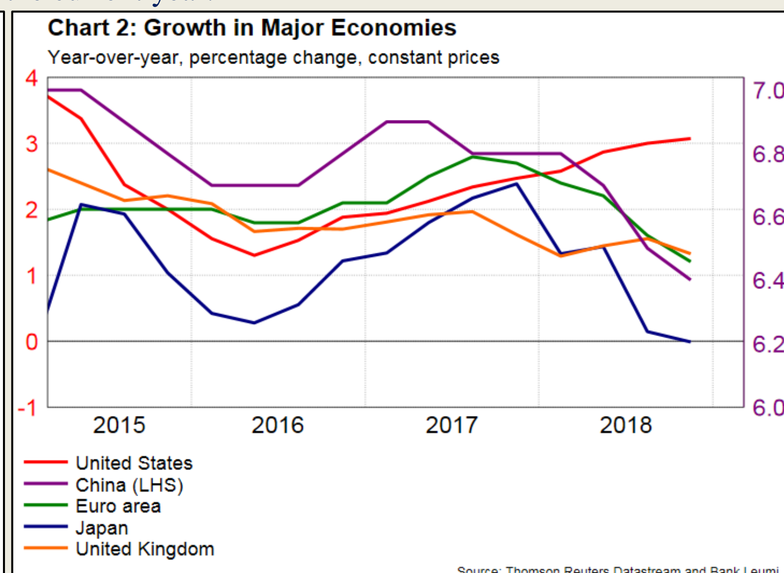
| | **2016** | **2017** | **2018E** | **2019F** | **2020F** |
|---|---|---|---|---|---|
| **GDP – Real Growth Rate** | | | | | |
| *World* | *3.2%* | *3.7%* | *3.6%* | *3.4%* | *3.4%* |
| *USA* | *1.6%* | *2.3%* | *2.9%* | *2.3%* | *1.5%* |
| *UK* | *1.8%* | *1.6%* | *1.3%* | *1.4%* | *1.5%* |
| *Japan* | *0.9%* | *1.7%* | *1.0%* | *1.2%* | *0.4%* |
| *Eurozone* | *1.7%* | *2.5%* | *1.8%* | *1.4%* | *1.5%* |
| *South East Asia (ex. Japan)* | *4.5%* | *5.2%* | *5.0%* | *4.8%* | *4.5%* |
| *China* | *6.7%* | *6.9%* | *6.6%* | *6.3%* | *6.1%* |
| *India* | *7.1%* | *6.7%* | *7.3%* | *7.4%* | *7.2%* |
| *Latin America* | *-0.7%* | *1.2%* | *1.1%* | *2.0%* | *2.2%* |
| *Israel* | *4.0%* | *3.5%* | *3.3%* | *3.0%* | *3.5%* |
| **Trade Volume, Growth (%)** | | | | | |
| *Global* | *2.3%* | *5.3%* | *4.4%* | *3.3%* | *2.9%* |
| **CPI, Annual Average (%)** | | | | | |
| *USA* | *1.3%* | *2.1%* | *2.4%* | *2.2%* | *1.4%* |
| *UK* | *0.7%* | *2.7%* | *2.5%* | *2.0%* | *2.1%* |
| *Japan* | *1.0%* | *0.5%* | *1.0%* | *1.5%* | *1.7%* |
| *Eurozone* | *-0.1%* | *1.5%* | *1.7%* | *1.5%* | *1.5%* |
| *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%* | *2.25-2.75%* | *2.00-2.50%* |
| *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%* | *-0.10%* | *-0.10%* | *0.00%* |
| *ECB-Main Refi* | *0.00%* | *0.00%* | *0.00%* | *0.00%* | *0.00-0.20%* |
| *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): the slowdown in industrial sector activity continues to weigh on global growth. Risks to our outlook remain tilted to the downside.**

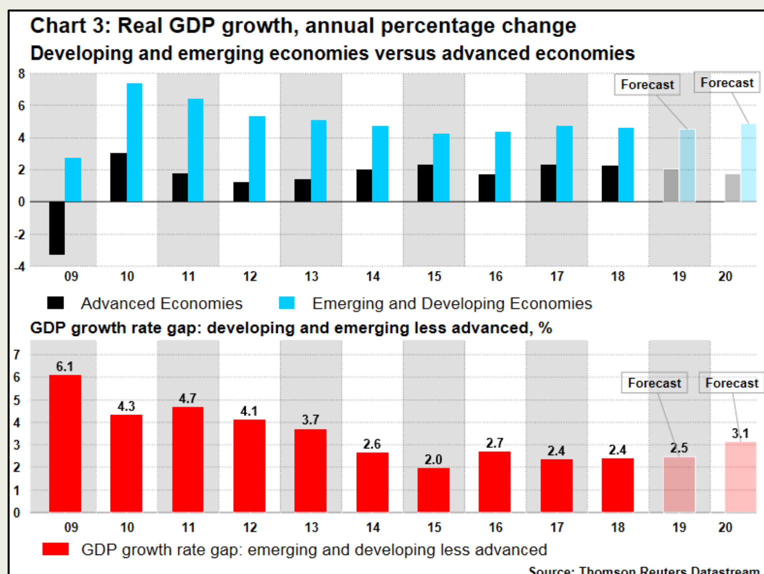
- Based on January-February data it seems global economic activity started the year on a soft note, mainly due to moderation in the industrial sector, in continuation of the trend since the beginning of 2018 (chart 1). According to the latest Markit PMI survey, the industrial sentiment index fell slightly in February to its lowest level since June 2016, suggesting that growth of global manufacturing production eased recently. This occurred mainly as new export business contracted for the sixth consecutive month on the back of the slowdown in international trade. On the other hand, the services sectors continue to show greater resilience than the manufacturing sectors, echoing, to some extent, solid household demand.
- Recently released figures continue to point to noticeable divergences in national data (chart 2). Despite the quarterly growth slowdown, the US continues to grow solidly, but with some signs of moderation expected down the road. In contrast, euro area economic growth has been moderating for five consecutive quarters, and in the fourth quarter expanded by an annual rate of just 1.2% as both domestic and external demand weighed on activity. Japan's annual growth deteriorated to a level of zero percent growth in the fourth quarter, as the recovery from the contraction in the third quarter (mainly due to natural disasters) was relatively soft. UK GDP growth also moderated in the fourth quarter to 1.3% y/y, which is close to its lowest level since the second quarter of 2012, mainly due to weakness in investments, which is expected to continue at least in the short-run due to the heightened uncertainty regarding Brexit.
- Among the emerging and developing economies, we estimate further moderation in China's economic growth in the beginning of the year, as the manufacturing PMI indices remain at contractionary levels, and below (based on the average for January-February) the average level in the fourth quarter. Overall, we expect economic activity in China to moderate this year compared to 2018, albeit just slightly. At its annual National People's Congress that was held last week, the government set a GDP growth target of 6.0%-6.5%, compared to 6.6% in 2018. The government is expected to further expand both monetary and fiscal policy (tax cuts and increased spending on infrastructure) in the current year.

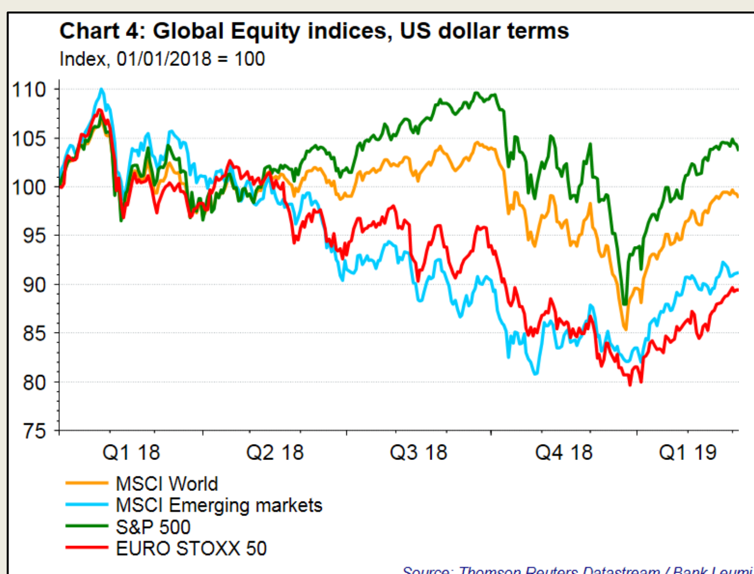


**Global outlook – economic activity (2/2): the slowdown in industrial sector and trade activity continues to weigh on global growth. Risks to our outlook remain tilted to the downside.**

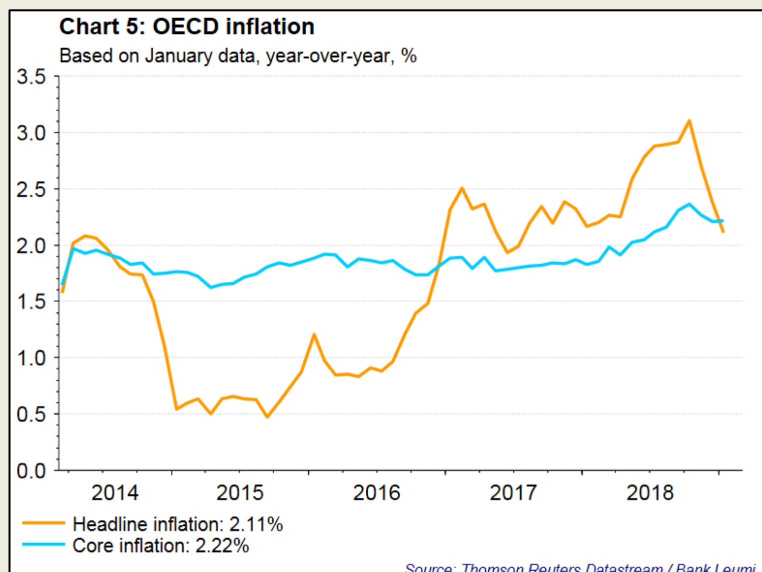
- In India, Q4-2018 GDP growth surprised on the downside (moderated to 6.6%, the lowest in six quarters and down from 7.0% in Q3), as private consumption growth slowed slightly due to tight monetary conditions, while government spending also softened. The rising tensions between India and Pakistan and the uncertainty surrounding the elections may weigh on business confidence at least in the short-run. In Brazil, growth also moderated in the fourth quarter, and the current pace suggests that Brazilian economic growth is relatively weak. We do not expect any significant acceleration in the quarters ahead.
- We expect the global economy to slow gradually and moderately in the medium-term, mainly due to an expected slowdown in the developed economies, while growth in EM economies is expected to remain more or less unchanged (chart 3). Overall, we expect global growth to ease slightly, from 3.6% in 2018 to 3.4% in 2019.
- Overall, risks to global growth are tilted to the downside, mainly due to the heightened uncertainty regarding US trade policy. It should be noted that according to media reports, China and the US are getting closer to reaching a trade deal, and both countries are expected to remove a significant portion of the tariffs levied on each other. In our opinion, if the US and China will reach a trade agreement in the short-run, in tandem with the recent dovish messages issued by central bankers, and the recent easing in financial conditions with the decline in volatility in financial markets as global equity markets recovered (chart 4) and corporate spreads narrowed, then the level of uncertainty may recede. This situation would support economic activity at least in the short-run. On the other hand, we cannot ignore the potential for negative shocks against economic and market sentiment from a future trade war between the US and the EU, and other political and geopolitical risks.

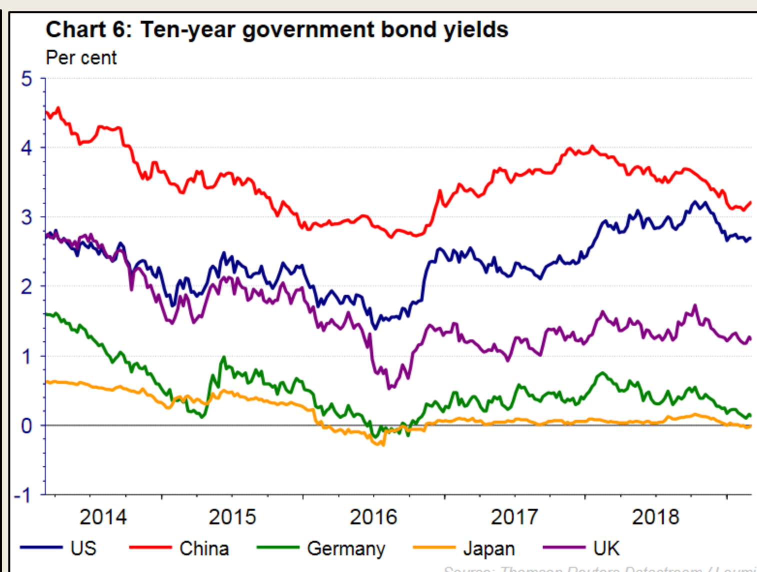


**Global inflation and monetary policy outlook: major central banks are following the Fed's dovish stance, as the global risk environment has heightened.**

- The average annual headline inflation rate in OECD economies moderated further in January to 2.1% y/y from 2.4% in December (chart 5). The moderation was mainly due to the decline in energy prices in the fourth quarter. The potential for a further downward trend is limited as oil prices have recovered since the beginning of the year. The average core inflation rate in the OECD remained stable at 2.2% in January. We estimate that the continuing rise in wages, the decline in unemployment rates, and the relatively solid growth in the services sectors will continue to support the core measure.
- Due to the slowdown in the manufacturing sector and the recent decrease in inflation, which may continue in the coming months, the communications coming from the central bankers of advanced economies have shifted away from advocating a normalization path towards stressing the risks. Under the current conditions, the bankers are closely monitoring incoming data to determine whether additional policy stimulus might be needed in the future.
- The chairman of the Fed, Jerome Powell, testified in front of the US Congress recently, delivering the existing message of "patience". He also repeated the need for further adjustment in the policy rate, while market participants expect the interest rate to remain unchanged this year, and to start to go down in 2020. The improvement in financial conditions, if it continues, may leave a chance for a single rate hike this year. The Fed's balance sheet normalization process may also come to a halt in the short-run. The ECB, in its latest meeting, introduced a new TLTRO, earlier than expected, and revised downward its growth and inflation outlooks, while also providing a dovish statement. The governor of the BoJ, Haruhiko Kuroda, stated in a newspaper interview that if the bank will fail to reach its inflation objectives then it will consider additional easing. The BoE provided a surprisingly dovish statement by acknowledging that in the case of a no-deal Brexit, rates were more likely to be cut than hiked, this compared to previous messages that rates were as likely to increase or decrease. The recent changes in the stance of central banks around the world may limit the potential for a significant rise in government bond yields at least in the short-run (chart 6).

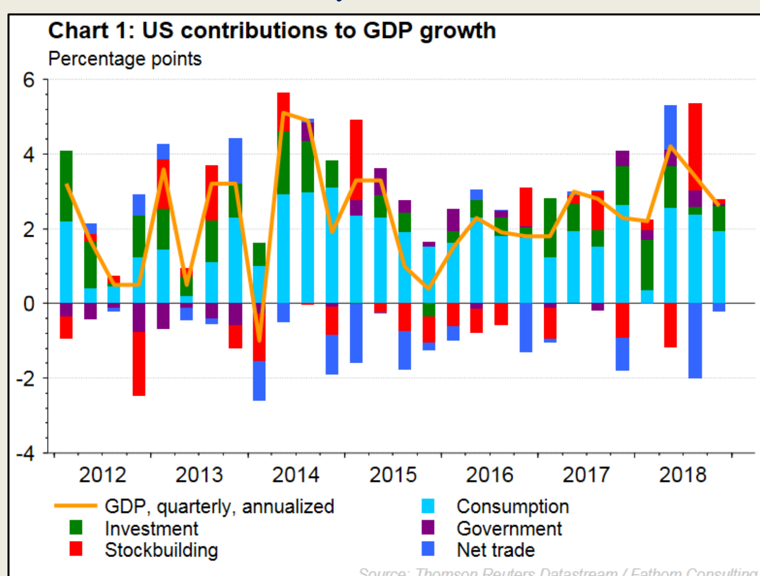


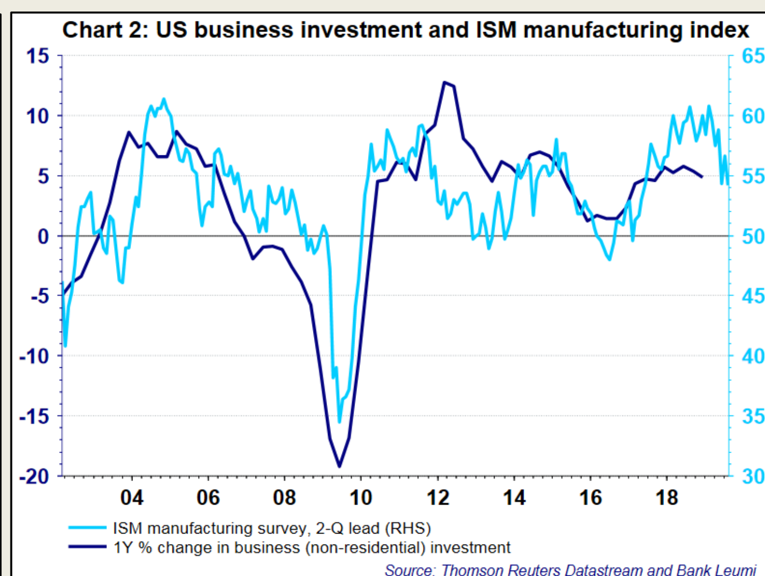



## United States

**US growth outlook: it appears first quarter activity has moderated further downward.**

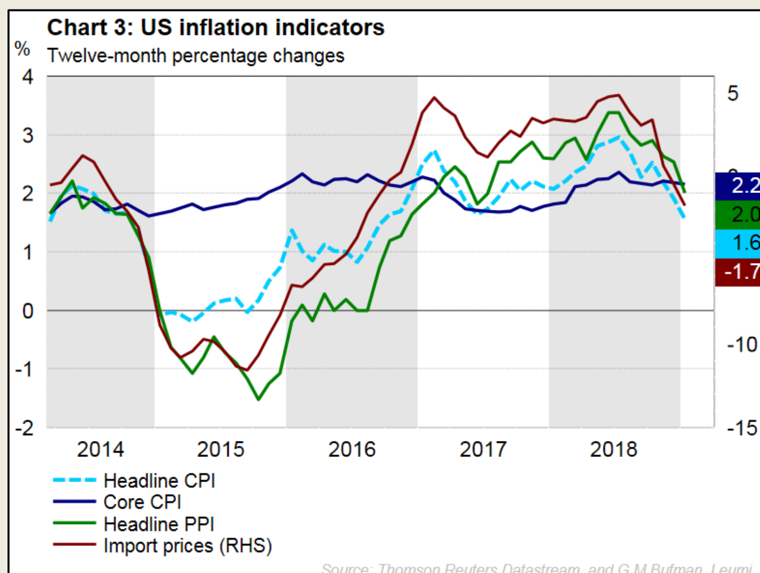
- Based on the BEA's initial estimate, the US GDP accelerated 2.6% (quarter-over-quarter, annualized) in the fourth quarter of last year (chart 1). Despite the upside surprise (estimates were below 2.5%), the US economy moderated for a second quarter in a row. Still, on a year-over-year basis, the US economy expanded solidly by 3.1%.
- To some extent, the quarterly slowdown was due to the partial government shutdown in December and a broad based slowdown in private consumption. Based on recent data on personal spending, retail sales, and car sales, we do not rule out a further moderation in private consumption in the first quarter of the year. In addition, residential investment has declined for four consecutive quarters. However, we estimate this downward trend will bottom out in the short-run, as interest rates have decreased recently, coupled with a significant fall in lumber prices since June last year, which may provide some support for home construction this year.
- In contrast, business investment has accelerated solidly, driven by investment in equipment and intellectual property. Based on leading indicators, such as new orders and business surveys (chart 2), and the effect of the fall in oil prices in the fourth quarter on mining investment, in tandem with the increase in global risks, we do not expect further strong growth in business investment in the short-run.
- Overall, we expect first quarter GDP growth to moderate compared to Q4-2018, due to, among other things, some softness in domestic demand; the partial government shutdown, which concluded at the end of January; and "residual seasonality" reasons (difficulties in measuring seasonality in the first quarter). For 2019 as a whole, we expect growth to moderate compared to 2018, which was supported by fiscal stimulus. 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%.

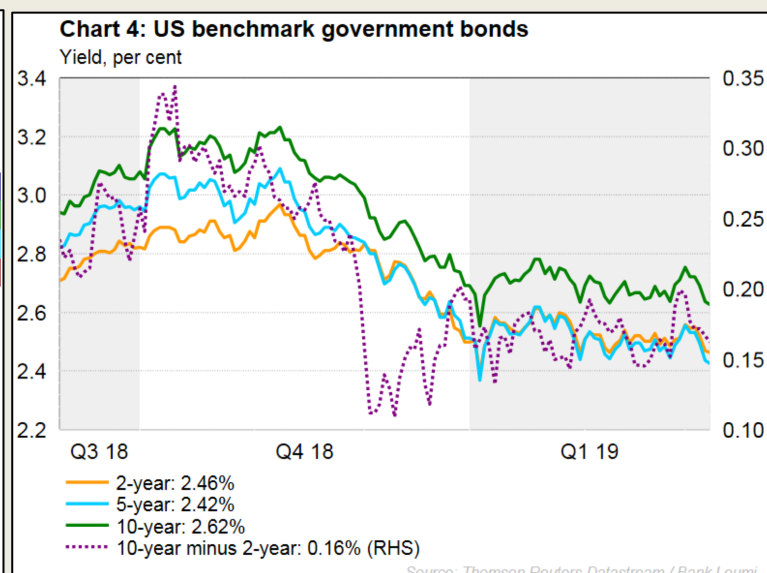


**US inflation and monetary policy outlook: the change in the Fed's stance means that the potential for a significant increase in Treasury yields is limited.**

- The CPI headline inflation rate moderated in January for a third month in a row, decreasing to 1.6% from 1.9% in the previous month (chart 3), mainly due to base effects and the lagging impact of the decrease in oil prices in Q4-2018, together with the appreciation of the US dollar. Base effects and a strong dollar are expected to keep the headline CPI rate below the Fed's target until the third quarter, before it starts to recover toward 2% by the end of the year. The core CPI inflation figure remained firmer at 2.2%, and is expected to remain close to the Fed's target, supported by solid wage growth and service inflation.
- Based on the latest testimony in front of the US Congress by the chairman of the Fed, Jerome Powell, and recent media communication made by FOMC officials, it seems the Fed is maintaining its existing message of "patience" with regard to the future direction of monetary policy. This is due to the recent "conflicting signals" (as noted by Mr. Powell) received as household demand data and global growth data have disappointed recently, while labor market data and core inflation remained solid.
- Additionally, the Fed repeated the message that it is evaluating the appropriate timing for the end of balance sheet runoff. We expect the balance sheet adjustment plan to conclude by the end of 2019. In the upcoming monetary meeting next week, the Fed may reduce its projected median federal funds rates for 2019-2021. Currently, market based interest rate expectations are not pricing in any rate hikes in 2019, and there is some probability for a rate cut in the beginning of next year. We expect a single rate hike this year, dependent on further easing in financial conditions and a gradual moderation in GDP growth.
- Based on the current developments in the economy and our forecasts, the potential for a significant rise in government bond yields is limited (chart 4). Our 2019 yield curve forecast (annual averages) was revised downward at both ends of the curve last month. Based on our models, we expect the yield-to-maturity on 10-year bonds to average 2.7% in 2019, compared to 2.8% in 2018. We expect the yield-to-maturity on 2-year Treasuries to climb to an average of 2.8% in 2019, from an average of 2.5% last year.

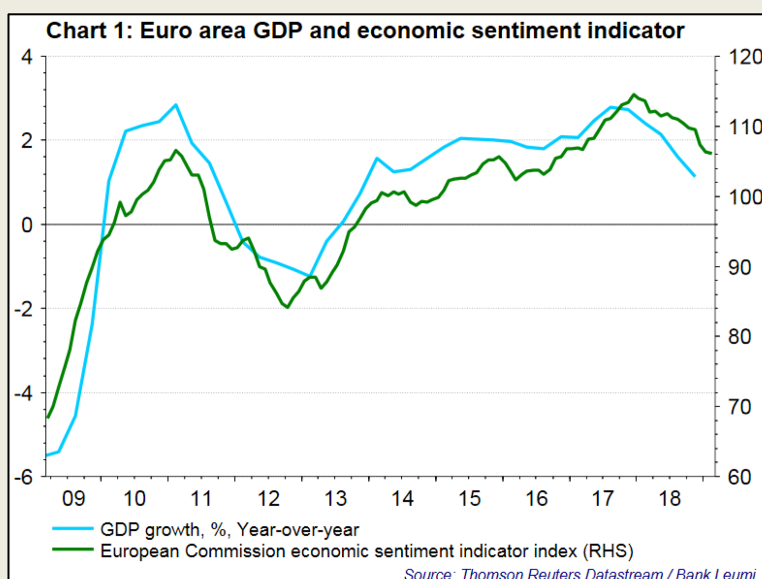


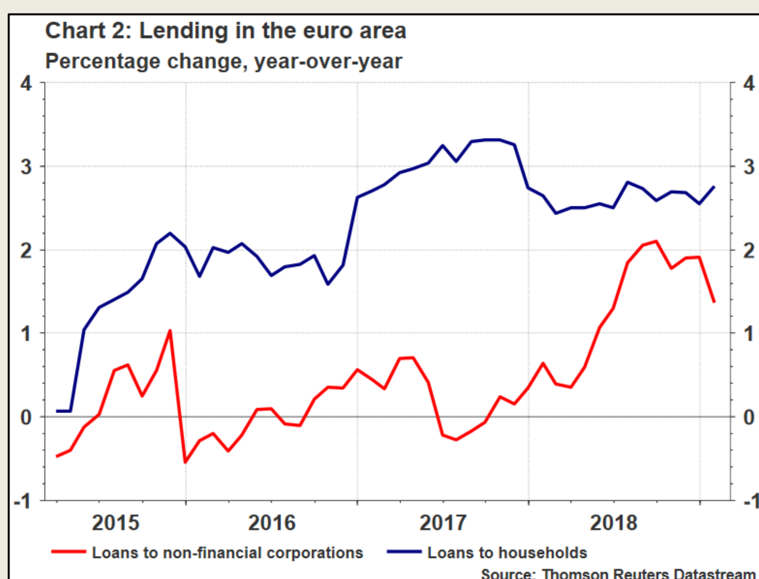



<u>**Euro Area**</u>

**EA growth outlook (1/2): no significant rebound in activity in the short-run. We revised downward our 2019 outlook growth.**

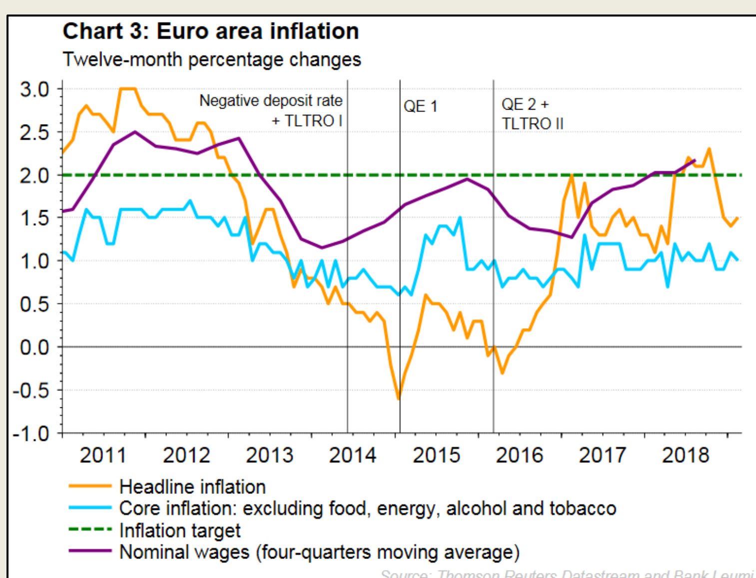
- Based on recent data, it appears activity has not rebounded so far this year. Actually, the data attest to some further softening in growth in the short-run. This comes after two consecutive quarters of weak growth in the second half of 2018. The European Commission economic sentiment index fell in February to its lowest level since November 2016 (chart 1), and the PMI surveys show a similar picture as momentum in the manufacturing sector has continued to decline, after dipping in February below the level of 50, pointing to the steepest contraction in the manufacturing sector since June 2013. On the positive side, the services sector has been showing relatively greater resilience; but data on such items as the inflow of new business remained weak, providing little hope for a meaningful improvement in the short-run. Another sign of the softness in the business sector is the recent moderation in corporate loan growth (chart 2).
- The softening in euro area growth stemmed from, among other things: the moderation in external demand due to slowdowns within some of the major trading partners, including China and Japan; moderation in domestic demand in Italy (political uncertainty) and France (Yellow Vests protests); and the deterioration in business confidence due to heightened risks, which weigh on investment and production.
- It seems the euro area economy will struggle to accelerate in the first quarter from the growth rate registered in in the second half of last year. On the back of the recent activity data, we revised further downward our 2019 outlook estimate to 1.4%, from 1.5% in the previous month. In its latest released projections, the ECB revised its growth outlook for 2019 substantially downwardly to 1.1% from 1.7% in the previous report. In our opinion, risks to our growth outlook 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.

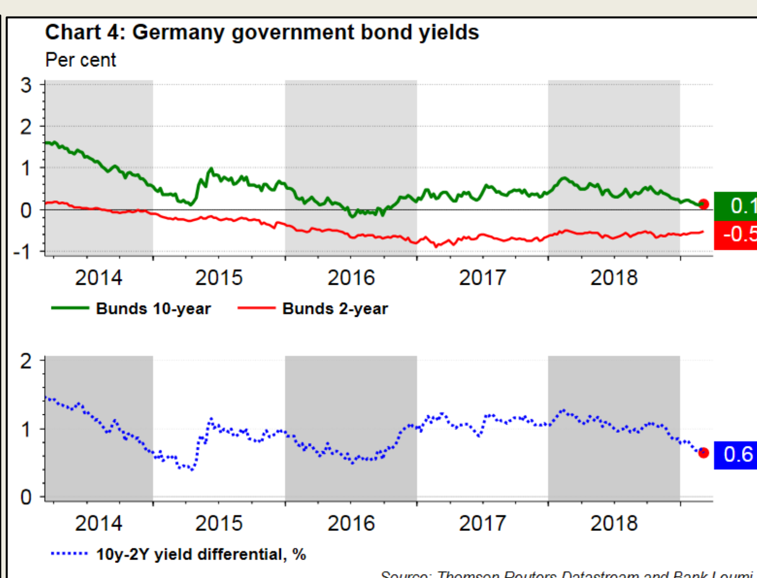


**EA inflation and monetary outlook: monetary policy more dovish than expected.**

- Preliminary inflation data for February point to an ongoing softness in the euro area, as core inflation is having difficulty trending upwards above its 5-year average of around 1% (chart 3). In February, the core measure decreased to 1.0% from 1.1%. We expect wage growth and services inflation to support the core measure, but the upward potential is expected to remain limited, due to, among other things, the expected moderation in domestic demand in 2019. Headline inflation increased slightly in February to 1.5% from 1.4%. We estimate inflation will average 1.5% in the current year, slightly below the 1.7% average in 2018.
- At its latest meeting on March 7th, the ECB surprised financial institutions and market participants after it announced a new series of quarterly targeted longer-term refinancing operations (TLTRO-III), earlier than expected. The ECB announced the program will be launched starting in September 2019 and ending in March 2021, each with a maturity of two years, meaning it will end in March 2023. According to the statement, under TLTRO-III, financial institutions will be entitled to borrow up to 30% of the stock of eligible loans at a rate indexed to the interest rate on the main refinancing operations over the life of each operation. Moreover, the ECB revised substantially downward its growth outlook for 2019 (1.1%), and slightly downward its growth outlook for 2020 (1.6%). The ECB also revised downward its inflation outlook across the projection horizon. At the same time, the ECB provided a more dovish forward guidance regarding the policy rate by saying it expects to leave interest rates at their present levels "at least through the end of 2019", rather than "at least through the summer". The launch of the new TLTRO may support heightened lending activity to some extent.
- The current developments in the economy, in tandem with the ECB's new policy stance and actions, may limit the potential for a significant rise in government bond yields in the euro area in the short-run, mainly in the safe-haven European bonds such as the German bunds (chart 4).



## Disclaimer Notice

- The Global Macroeconomic Monthly Review has been produced by Bank Leumi le-Israel.
- Any statements, data, and information in the Economic Outlook which appears to be factual in nature are based on sources, including published sources, which Bank Leumi UK believes to be reliable but has not independently verified. Bank Leumi (UK) plc does not make any guarantee, representation, or warranty as to the accuracy or completeness of such statements. This material is based on public information as of the specified date, and may be stale thereafter. We have no obligation to tell you when information herein may change. Consequently, Bank Leumi (UK) plc is not responsible for its contents nor any losses, expenditure or damages which may be incurred as a result of relying on such contents. We reiterate that no representation, warranty or undertaking, express or implied is given to the accuracy or completeness of the information contained in this presentation, and Bank Leumi (UK) plc does not accept any liability for losses which might arise from an attendee making use of the information.
- **Bank Leumi (UK) plc is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.**

**BANK LEUMI LE-ISRAEL, THE CAPITAL MARKETS DIVISION**
**The Economics Sector, P.O. Box 2, Tel Aviv 61000**
**Ph: 972-76-885-8737, Fax: 972-77-895-8737, e-mail: Gilbu@bll.co.il**
**http://english.leumi.co.il/Home/**