Global Macroeconomic Monthly Review

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- *Growth in the developing countries is expected to slow against the backdrop of an increase in morbidity in India and Brazil, and against the backdrop of an expected slowdown in the continuation of high growth rates in China and a gradual convergence toward "normal" growth rates.*
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- *The labor market continues to recover.*
- *Industrial manufacturing suffered only temporarily in the middle of the first quarter of the year due to extreme weather conditions in February.*
- *The Fed left monetary policy unchanged with an eye toward achieving the employment target, and does not anticipate a significant increase in the inflation rate. This situation supports maintaining the current policy.*
- *US bond yields rose along the entire yield curve, but the long term yield-to-maturity fell slightly in the first half of April, following explanations by the Fed's Chairman as to longer term policy steps.*

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- *It appears the GDP of the euro bloc declined in the first quarter of 2021, while in the second quarter, GDP is expected to rise moderately.*
- *For the full year, the lion's share of annual growth is expected to occur in the second half.*
- *Italy and France entered again into lockdown, and Germany as well tightened its pandemic related restrictions due to a rise in morbidity. These developments are likely to hamper any recovery.*
- *Members of the ECB Monetary Committee expect the rate of asset purchases made by the central bank will increase in the coming months, and this is expected to support the low yields on government bonds.*
- *The consumer price index increased in March due to the rise in energy prices, yet core inflation dipped.*

Leumi Global Economic Forecast, As of April 2021

	2018	2019	2020E	2021F	2022F
GDP – Real Growth Rate					
World	*3.5%*	*2.6%*	*-3.2%*	*5.6%*	*3.9%*
USA	*3.0%*	*2.2%*	*-3.5%*	*5.5%*	*3.1%*
UK	*1.3%*	*1.4%*	*-9.9%*	*4.4%*	*4.9%*
Japan	*0.6%*	*0.3%*	*-4.8%*	*2.7%*	*2.6%*
Eurozone	*1.9%*	*1.3%*	*-6.9%*	*4.2%*	*4.0%*
South East Asia (ex. Japan)	*5.1%*	*4.3%*	*-3.9%*	*4.3%*	*4.9%*
China	*6.6%*	*6.1%*	*2.3%*	*8.5%*	*5.0%*
India	*6.1%*	*4.2%*	*-7.0%*	*13.0%*	*4.5%*
Latin America	*0.8%*	*-0.5%*	*-7.1%*	*4.1%*	*3.0%*
Israel	*3.5%*	*3.4%*	*-2.5%*	*4.9%*	*3.9%*
Trade Volume, Growth (%)					
Global	*3.8%*	*0.2%*	*-8.1%*	*7.0%*	*5.7%*
Interest rates, Year End					
US Fed	*2.25-2.50%*	*1.50%-1.75%*	*0.00-0.25%*	*0.00-0.25%*	*0.00-0.25%*
Bank of England	*0.75%*	*0.75%*	*0.1%*	*0.1%*	*0.1 %*
Bank of Japan-Policy Rate	*-0.07%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
ECB-Main Refi	*0.00%*	*0.00%*	*0.00%*	*0.00%*	*0.00%*
Israel	*0.25%*	*0.25%*	*0.1%*	*0.00-0.25%*	*0.00-0.25%*

The Global Economy – Overview

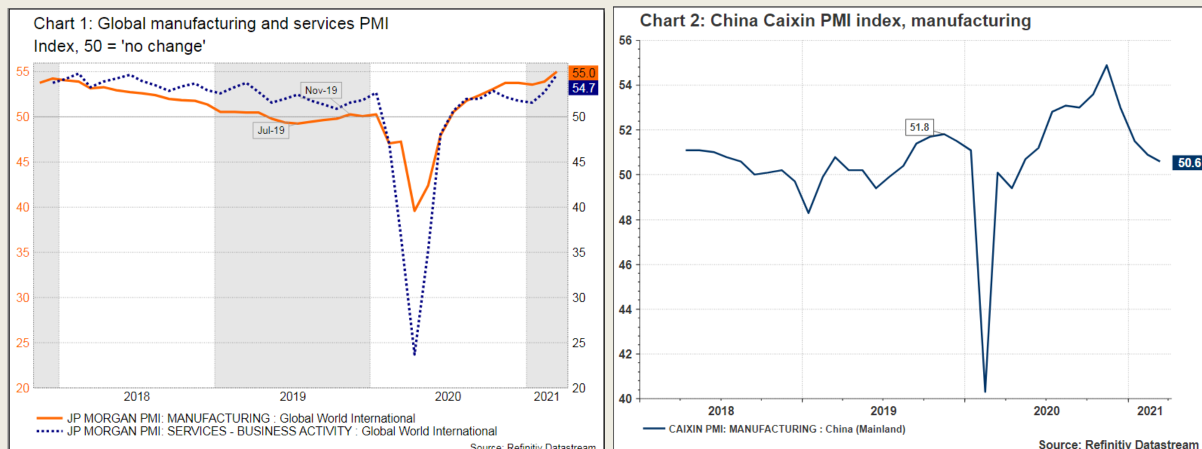
Economic activity: global economic activity continues to recover, but not consistently across all regions. There is economic expansion in the US and the developed countries of Southeast Asia, while in contrast, GDP is expected to contract in the euro bloc, resulting from a tightening in pandemic-related restrictions in some countries. Growth in the developing countries is expected to slow against the backdrop of an increase in morbidity in India and Brazil, and against the backdrop of an expected slowdown in the continuation of high growth rates in China and a gradual convergence toward "normal" growth rates.

- Aggregate global economic activity is continuing despite a rise in morbidity in India, Brazil, and some of the euro bloc countries. The global PMI for March indicates growth in economic activity in industry and services (see Chart 1). The economic recovery in the US is trickling into the labor market, which strengthened broadly, with an emphasis on the sectors that have been severely hurt in the current crisis and that have suffered from the tightening in pandemic-related restrictions. In our view, the direct support of the Biden administration will boost economic activity in the short term, including retail sales. In the medium-term, the infrastructure and green energy investment plan of the Biden administration is expected to continue the strengthening trend of the labor market and to accelerate economic growth, while at the same time increasing public debt in the coming years. Activity in the euro bloc is expected to grow in the coming months by only a moderate rate against the backdrop of weak domestic demand; however, we expect that in the second half of the year the recovery will occur at a faster pace.
- The GDP of Britain declined 2.9% in January (m/m) due to the government-imposed lockdown; however, the renewed opening of the economy, in parallel to the continuing inoculation of the population, is expected to support economic growth in the coming months. The bulk of the decline in GDP occurred in the services sector, with an emphasis on education, due to the closure of schools, and also on accommodation and food venues. Britain's exports and imports contracted sharply in January, due to the Brexit agreement that came into effect in the beginning of the year and led to disruptions in foreign trade due to new regulatory requirements. This situation led to a temporary 41.7% drop (m/m) in goods exports to the European Union, compared to a decline of only 1.6% (m/m) in goods exports to non-European Union member countries. A tightening in pandemic-related restrictions also weighed on foreign trade. In addition, part of the decline derives from a change in the registration of trade that stems from Brexit, which led to a delay in the registration of some of the transactions that prior to Brexit were registered in January and now they are registered in February. This is due to components in the agreement between the parties that require the registration of any transaction only five days after the conclusion of such transaction, such that the transactions carried out in the last five days of January will be registered only in February.
- The composite PMI of Britain continued to climb in March, reaching its highest level in the last six months. The increase stems from a rise in the manufacturing sector PMI, which is at a high level, and also due to an increase in the index of the services sector, which rose in March from 49.5 to 56.3 points. For the first time since November 2020, the services sector PMI is at a level above 50 points, which indicates growth in economic activity in this sector.

In our view, the government-imposed restrictions are expected to weigh on the economic recovery in the immediate term; however, with the lifting of restrictions and the return of economic activity, a more rapid recovery is expected.

- Retail sales in Japan increased in February, reaching their highest level since September 2019, and additional data suggest that economic activity did not contract in the first quarter of the year. Industrial manufacturing declined 2.1% in February (m/m); however, this decline comes following 4.3% growth (m/m) in industrial manufacturing in January. These developments indicate that despite the decline in February's industrial manufacturing, a contraction is not expected for all of the first quarter of the year. March's PMI increased very slightly, indicating activity is expected to recover slightly during the month, and the economy will enter the second quarter with weak momentum. The increase in the index stems from, among other things, an increase in the new export orders component, which increased to a 3 1/2 year peak, indicating that external demand is strengthening.
- Growth in the developing countries continued also in the first quarter of the year; however, in our view, the growth in the coming months will be more moderate. The PMI of India declined slightly in March, but still indicates continued growth in economic activity. In our view, the rise in morbidity in India is likely to lead to a tightening in restrictions and calls for people to maintain voluntary social distancing. These steps are expected to weigh on economic growth in the near-term, with an emphasis on the services sector.
- Economic activity in China increased in January and February, as the pandemic-related restrictions in the country weighed on retail sales, but the industrial sector continued to grow. Industrial manufacturing increased during this period by an annual rate of 39.5% (y/y); however, we recall that the bulk of the crisis in China occurred during the parallel period in 2020. The manufacturing PMI of China declined in March, reaching its lowest level in the last 11 months (see Chart 2), indicating a low rate of GDP growth. In our view, growth in activity will continue also in the second quarter of the year, but is likely to weaken during the second half of the year.
- In Latin America, Mexican industrial manufacturing increased 0.4% in February (m/m), despite disruptions that occurred in the north of the country due to extreme weather conditions in Texas that led to disruptions in the supply of natural gas used to operate power plants, which caused electricity outages and hurt production. A substantial portion of this growth stemmed from an expansion in the output of the mining and construction sectors, which more than offset the decline in production resulting from the power outages. In our view, growth of the manufacturing sector is expected to have continued also in March and we expect that Mexico's GDP grew in the first quarter of the year by at least 0.5% (q/q). In Brazil, industrial manufacturing contracted 0.7% in February (m/m), for the first time since April 2020, against the backdrop of the decline in economic activity in the automobile sector that stemmed from a global shortage of manufacturing components, and from a drop in local demand against the backdrop of the rise in morbidity. The manufacturing PMI declined in March, yet remains at a level above 50 points and indicates growth in activity, yet we expect that the activity of the automobile sector will remain low.
- Looking ahead, in the estimation of the International Monetary Fund (IMF) from April, global GDP is expected to increase 6.0% this year, with growth in the developed countries expected

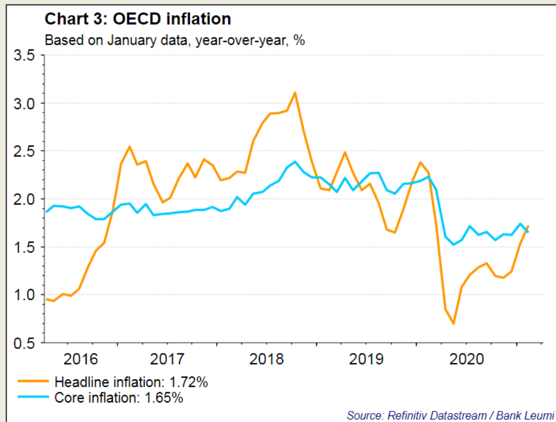
to reach 5.1% and the growth of the developing countries expected to reach 6.7%. The growth of GDP this year in the US and Spain is expected to be the highest among the developed countries, and in the opinion of the IMF, they will grow this year by 6.4%. However, in our view, the GDP of the US will grow this year by a more moderate rate of 5.5%.

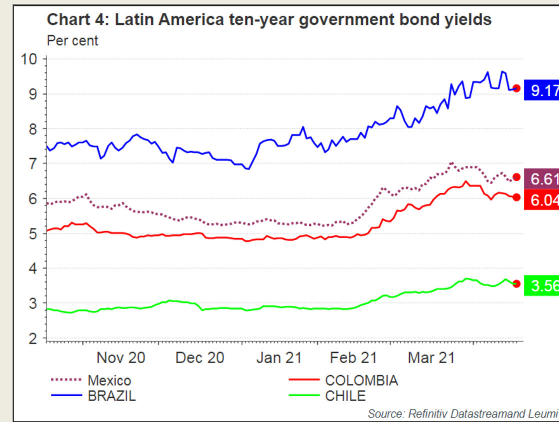


Inflation and monetary policy: inflation in the developed countries increased in the first quarter of the year. March was characterized by a number of significant developments in the monetary policies of Britain, Turkey, India, and Brazil. India launched a defined asset purchase program that is expected to prevent a substantial increase in government bond yields.

- Inflation in the developed countries increased in the first quarter of the year. The annual inflation rate in the OECD countries increased in February from 1.5% to 1.7% (see Chart 3) against the backdrop of a moderation in the decline in annualized terms in the energy component, and a continued rise in food prices. However, core inflation in the OECD declined in February from 1.7% to 1.6%.
- In its March interest rate decision, the central bank of England did not follow the path of the ECB, which announced an increase in the pace of asset purchases, and just like the Fed in the US, it emphasized that no interest rate hike is expected anytime soon. In our view, the interest rate is not expected to rise during the coming year. The Monetary Committee announced it will use all the additional sum of £150bn that was approved in November, such that the total sum of assets that will be purchased by the bank will equal £895bn. The bank will use this added sum by the end of 2021. This means there will be a slight slowdown in the pace of purchases from the current level of £4.4bn per week, and this indicates that the central bank is not worried about a rise in the yields of the long-term government bonds of Britain.
- The central bank of Turkey raised its interest rate sharply, from 17.0% to 19.0%, after it had raised the interest rate sharply also during the last quarter of 2020. This move is intended to maintain the tight monetary conditions in the country in order to halt the rise in the inflation rate that occurred over recent months, which brought the annual inflation rate in February to 15.6% and in March to 16.0%. The interest rate hike is greater than the forecasts of the investors that expected an increase of only one percentage point, and is intended to strengthen investor confidence in the central bank.

- This hike in the interest rate has led to the president of Turkey, Recep Tayyip Erdogan, who is interested in low interest rates, to fire the governor of the central bank of Turkey and to appoint another candidate who has called in the past for lowering the interest rate. This step likely indicates a halt to the central bank's struggle against the rising inflation rate, and it severely damages the integrity of the central bank while deteriorating the economic condition of Turkey and its banking system. These developments will also deter foreign investors, and consequently the Turkish lira will probably weaken further.
- Turkey is in near a crisis point regarding its external liabilities. This comes against the backdrop of the expansion in the deficit of the current account of Turkey's balance of payments over the last year, coupled with external debt totaling US$190bn (26.7% of GDP). Furthermore, Turkey's foreign currency reserves have declined, reaching a low net level of only US$11bn (1.5% of GDP), which is below the reserves it held prior to the crisis the country experienced back in 2018.
- The central bank of Brazil hiked its interest rate, for the first time since 2016, by 0.75 percentage points to 2.75%. This move was in response to the rise in the inflation rate, to beyond the upper border of the inflation target of 4.0%, with a band of 1.5% in either direction. The rise in inflation stemmed from an increase in food and energy prices, coupled with the weakness in the local currency. The interest rate hike comes against the backdrop of estimates of the bank that the economic recovery will continue. However, the central bank noted that the indicators upon which it relies do not take into consideration the recent rise in morbidity in the country, and this raises the risk to growth in the first half of the year.
- In India, the central bank decided in March to keep its interest rate unchanged at 4%. This rate has remained unchanged since mid-May 2020, after it was cut in early 2020, and we expect that no rate hike is expected during the coming months. The central bank announced an asset purchase program (G-SAP) in which the bank will purchase government bonds totaling US$14bn, with the goal of maintaining favorable financing conditions in the country. These purchases are not foreign to the central bank, as during the last decade the bank held 10-18% of the government's bonds, acquired through open market operations (OMO).
- These purchases were carried out occasionally in order to prevent a sharp rise in government bond yields. However, the uniqueness in the bank's announcement is that in this case, for the first time, the purchases are being carried out through an organized program in which there is a defined target for purchases. Furthermore, the central bank suggests that it is expected to oversee government bond yields and to restrict the upper limit on yields. In our view, this tool will not be used as a substitute to the use of traditional monetary tools in order to achieve the central bank's targets (such as the inflation target), but instead to prevent increases in the yields-to-maturity of government bonds and to maintain favorable financing conditions in the country.
- Latin American bond yields increased in March (see Chart 4) against the backdrop of the rise in morbidity in a large number of countries in the region. The yields-to-maturity of Brazilian 10-year government bonds increased to their highest rate since April 2020. In Mexico, bond yields increased as well during March, against the backdrop of the morbidity that remained high despite a decline experienced over recent weeks. However, in early April a slight decline occurred in Mexican bond yields.

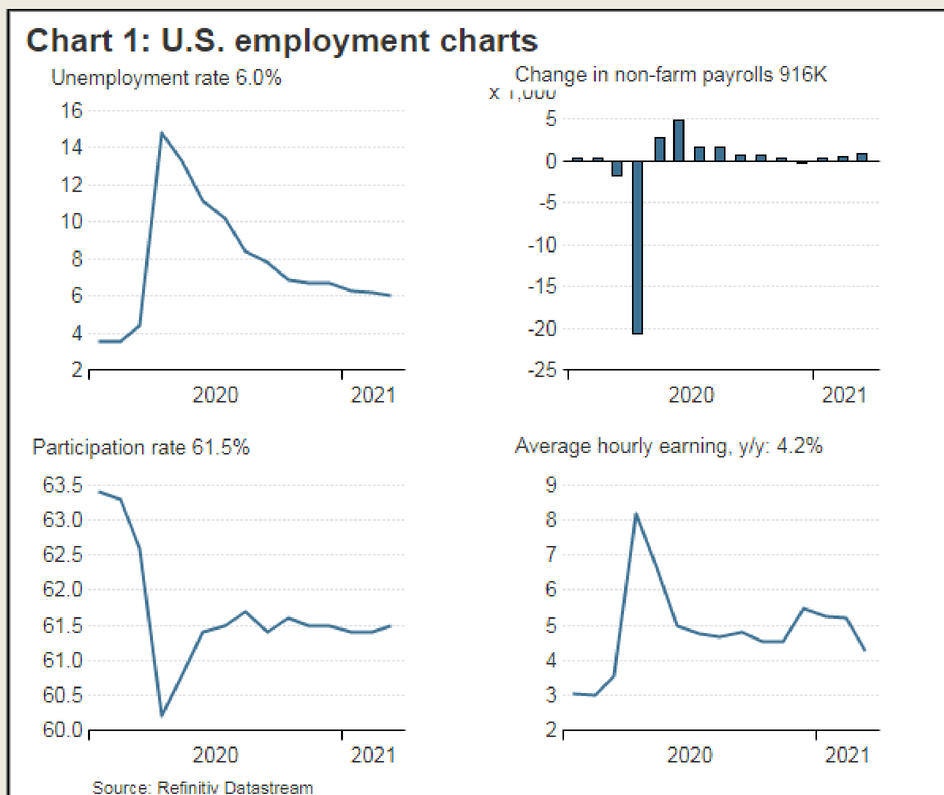




United States

Economic activity: The labor market continues to recover. Industrial manufacturing suffered only temporarily in the middle of the first quarter of the year due to extreme weather conditions in February.

- The economic recovery in the US, supported by fiscal stimulus, started to trickle down to the labor market, as the economy added 916,000 jobs in March (see Chart 1). This represents a large increase in employment, being even greater than the average market forecast. The unemployment rate continued to decline in March, reaching 6.0%; however, this figure remains 2.5 percentage points greater than its pre-crisis level.
- The improvement in the labor market reflects the continuing recovery in economic activity, which stood out positively in the leisure and accommodation, education, and construction sectors, all of which were very negatively affected by the pandemic. The bulk of the decline in unemployment occurred among the "temporarily unemployed" (furloughed workers). Looking ahead, progress in the inoculation of the population and the impact of this process on the decline in morbidity are likely to lead to a continued removal of restrictions and to a decline in the unemployment rate, which according to the consensus forecast will fall to 5.7% in the coming year.
- US retail sales fell temporarily in February by 3.0% (m/m), following the sharp increase in sales at the start of the year that resulted from the direct government support granted to households in December 2020. February's retail sales also reflect the difficult winter, which kept people in their homes and contributed to the decline in sales. However, sales increased in March by 9.8% (m/m) which is a rise of 27.7% compare to the same period last year, due to direct government support of the Biden administration, which is greater than support provided at the end of 2020. In addition, there was some easing of restrictions which led to an increase in spending on bars and restaurants by double digit rates as well as a significant increase in vehicle sales, electronics store sales and furniture and clothing sales. The consumer confidence index of the University of Michigan increased in March, reaching its highest level of the last year. This underscores the positive impact of the decline in morbidity,



alongside the acceleration in the vaccination of the population and the provision of fiscal stimulus, on the improvement in the situation of consumers. Consumption will grow further this year with the vaccination of a significant portion of the population, which will allow the opening of activities that are under restriction, with an emphasize on the services sector.

- US industrial manufacturing dipped in February due to severe weather conditions that occurred in the second half of the month. However, it increased in March which has not yet offset the decline of February. The preliminary indicators (PMI, ISM) are at very high levels, indicating continued growth in manufacturing economic activity. However, the global shortage in semiconductors, which have an essential role in the industrial manufacturing process, and in particular in the vehicle manufacturing process, is likely to hamper the recovery in manufacturing and may even postpone it till later on this year. The disruptions in manufacturing caused as a result of the harsh weather conditions led to a drop in orders of durable goods, which fell 1.1% in February (m/m) due to, among other things, an 8.7% decline (m/m) in automobile orders as a result of the global shortage in semiconductors. In our view, the shortage in semiconductors is expected to remain an issue in the near-term; however, the growth in investment in business equipment is expected to remain robust.
- The number of construction starts in the US declined 12.7% in February (m/m), due to the extreme cold that affected activity, coupled with an increase in lumber prices, which disrupted the construction process. However, starts increased in March by 19% (m/m) to the highest level in last decade. In our view, construction starts in the coming months are expected to continue to increase with the return of weather conditions that will enable consistent construction, particularly against the backdrop of the low housing supply that supports the confidence level of contractors in the market. In addition, the number of construction approvals declined, for the first time since October 2020, by 8.8% (m/m). However, the

number remains high and it increased in March by 2.7% (m/m), which will enable the continuation of the recovery in the construction sector.

- The difficult weather conditions, coupled with the low housing supply, led to a 6.6% decline in the number of completed units sold in February (m/m), the sharpest monthly drop since May 2020. Also, the number of new units sold declined in February, by 18.2% (m/m), reaching the lowest level since May 2020. Mortgage interest rates increased recently, according to estimates to 4% for a 30-year mortgage, and this is weighing as well on home sales; however, we estimate that with the continued return of economic activity, coupled with the rise in household savings, home sales are expected to recover by a moderate rate during the coming year.
- The new economic plan of US President Biden includes investments totaling US$2.25tn in infrastructure, with some of these investments earmarked for green investments that the president wants to advance with the goal of protecting the environment. The plan includes US$621bn for investment in fixing and upgrading transportation infrastructure, including the encouragement of the transition to electric vehicles, grants for investments in charging stations for electric vehicles, and transitioning the federal fleet of cars to electric vehicles. Also included is the upgrade of roads and bridges, with an emphasis on public transportation and the improvement of airports and seaports. The sum of US$590bn will be allocated to investment in manufacturing, R&D, and worker training programs. The plan allocates US$400bn in tax incentives to encourage green energy, such that the overall fiscal cost reaches US$2.65tn.
- A sum of US$328bn will be allocated to investments in housing and building infrastructure, and another US$311bn will be allocated to investments in broadband Internet communication, electrical grid, and water infrastructure. The investments are scheduled to be spread out over the course of the next eight years, and the plan is expected to add millions of new jobs to the American economy and to accelerate economic growth in the US. We note that the plan has not yet received the approval of Congress, and the Republicans are expected to object due to the tax hikes included in the plan. Thus, all the representatives of the Democrat party must approve in order for them to succeed to use the slim majority they hold in Congress. Under these circumstances, it is expected that confirmation of the plan will be postponed to 2022 under the framework of reconciliation.
- The large infrastructure plan is expected to be financed by taxes over the course of the next 15 years, which will lower the deficit in the long-term. The Biden administration intends to raise the corporate tax rate from 21% to 28%, after President Trump had lowered this tax rate in 2018 from 35%, which was the corporate tax rate in the US since the mid-1990s, to 21%. In addition, sweeping reforms are expected to reduce US corporations' access to foreign tax havens. These steps will address the practice of establishing multi-national corporations and then registering them in countries with low tax rates. Accordingly, the plan includes an increase the global minimum tax (GILTI) for U.S. multinational corporations from 10.5% to 21.0%, the cancellation of tax deductions for Foreign Derived Intangible Income (FDII), the implementation of a minimum 15% tax on companies with book income of at least US$100m, and more. In addition, the US administration plans to heighten corporate tax enforcement,

and will seek global cooperation in an effort to raise the minimum corporate tax rate on international companies. This tax policy is expected to raise the tax burden on American corporations, and will increase the competitive strengths of countries with significantly lower corporate tax rates. Furthermore, the tax benefits granted to gas and oil companies are expected to be cancelled.

- Looking ahead, growth in US economic activity is expected to continue also in the second quarter of the year, against the backdrop of the moderation in the number of new daily coronavirus patients throughout the month of March. The recovery is expected to encompass all of industry and services as well, with an increase in retail sales also expected due to the large direct support of the Biden administration. The US GDP growth forecast for 2021 increased 1.2 percentage points compared to the forecast from the previous month, as we currently estimate the GDP will grow 5.5% this year, and will increase 3.1% in 2022. The range of forecasts within the consensus falls between 3.4% - 7.5%, which gives an indication of the optimism among the various forecasting bodies. Thus, it appears the GDP this year will most likely reach its 2019 level, prior to the pandemic outbreak.

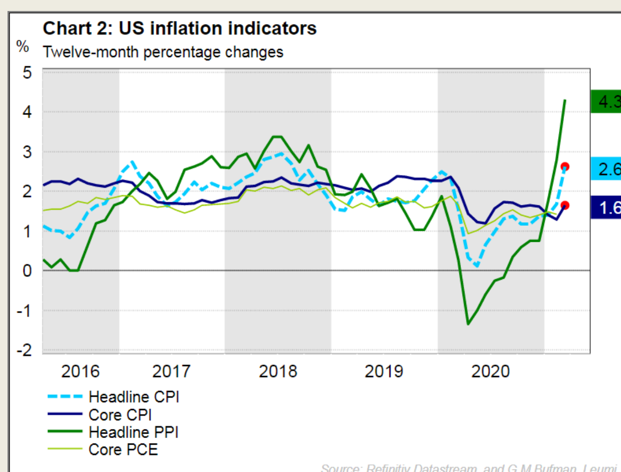
Inflation and monetary policy: The Fed left monetary policy unchanged with an eye toward achieving the employment target, and does not anticipate a significant increase in the inflation rate. This situation supports maintaining the current policy. US bond yields rose along the entire yield curve, but the long term yield-to-maturity fell slightly in the first half of April following Mr. Powell's views on longer term policy.

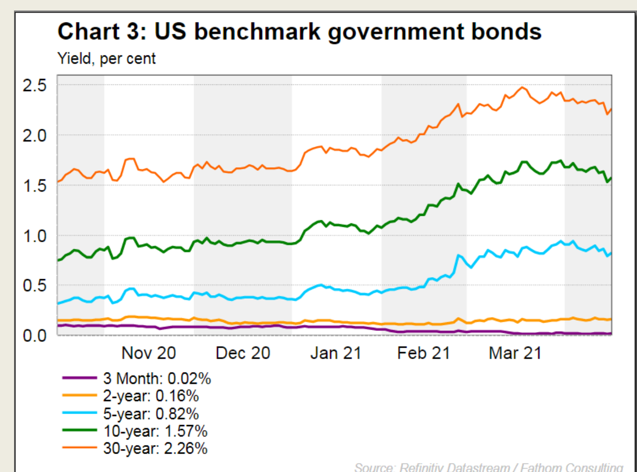
- In its mid-March interest rate decision, the Fed kept rates unchanged within a range of 0.00 – 0.25%. The Fed expects the interest rate will remain within this range until the goal of full employment will be achieved, which we estimate to be an unemployment rate of 4%, and also until the achievement of the 2% inflation target in annualized terms, and even a moderate increase above this level for a certain period. The economic forecasts of the Federal Open Market Committee (FOMC) members indicate they expect robust economic growth this year and only a temporary increase in inflation, which explains their stance to not hike the interest rate in the foreseeable future. In our view, the Fed is interested in permitting inflation to climb slightly above the 2% target rate, and it is possible the Fed will even permit inflation to remain at a level slightly above 2% for a sustained period. This is part of the transition in the direction of a long-term average inflation target. The expectations of the FOMC members for robust growth brings with it as well the expectation for a lower unemployment rate, and in their opinion, unemployment will reach 3.9% and 3.5% by year-end 2022 and year-end 2023, respectively. That is to say, they expect a return to full employment.
- The committee members do not anticipate the return to full employment, coupled with robust growth, will lead to a substantial increase in the inflation rate. In their opinion, the inflation rate in PCE terms will equal 2.4% by year-end 2021, compared to the forecast in December 2020 that the inflation rate in 2021 will be 1.8%, but in 2022 it is expected to fall back down to 2.0% and to climb only slightly in 2023 to 2.1%. These forecasts led to the expectations of most of the Fed members that the interest rate path will remain unchanged through the end of 2023, yet a minority of the members (four FOMC members) forecast an interest rate hike

in 2022, and seven committee members forecast an interest rate hike in 2023. In our view, the main risk is that the inflation rate will rise above the expectations of the Fed, which will demand the implementation of restraining measures.

- The minutes from the latest FOMC meeting state that the committee members are not worried about an increase in inflation. Most of the committee members noted that the risks to inflation are balanced and inflation is expected to climb this year due to temporary factors such as a shortage in raw materials, intermediate inputs, and labor; and also bottlenecks in shipping. However, any uptick in inflation is expected to be temporary and it is expected to decline in 2022. The committee members do not expect any reduction in the current pace of asset purchases, equaling US$120bn per month, anytime soon and in any event, a change in the pace of purchases in the future is expected to precede any process of an interest rate hike.
- In the opinion of the committee members, the rise in the yields-to-maturity of long-term government bonds reflects their economic forecast for robust growth this year, the rise in inflation expectations, and the expectations for an increase in US Treasury debt issues in order to finance the growing deficit. The FOMC members are tracking the impact of the rise in long-term yields and they noted that a sustained rise in yields is likely to endanger the progress made toward the full employment and the 2% average inflation targets. In addition, the committee members are worried about the effects of the expansionary financial conditions on heightened risk taking and on financial stability. In our view, the FOMC is not expected to transition suddenly to contractionary monetary policy with the goal of preventing the creation of asset price bubbles and/or other risks to financial stability. Instead, the Fed is expected to deal with these risks by means of regulatory measures and not monetary policy tools.
- The inflation forecasts for the coming year made by forecasters are similar to those of the Fed, while the average inflation rate forecast equals 2.3% and the median being the same as the Fed's forecast. However, the consensus forecasts for the 2022 inflation rate are above the Fed's forecast, with the average forecast equaling 2.1% while the forecast of forecasters floats within a broad range of 1.5% - 2.9%. In addition, the inflation forecasts based on indicators of market interest rates as well as consumer and business confidence surveys indicate that the inflation rate in 2022 will be greater than the Fed's forecast, which supports our assessment that the inflation rate will rise at a rate faster than that expected by the Fed.
- The consumer confidence index (CPI) increased in March 2021 by an annual rate of 2.6%, the highest rate since August 2018, primarily due to an increase in energy prices which has been affected by disruptions on the supply side and global transport, but also due to the increase in services prices which led to an increase in the annual core inflation rate in March from 1.3% to 1.6% (see Chart 2). In our view, the inflation rate will continue to increase in the short term due to the collapse in prices during the same period last year. The manufacturer price index increased in March by an annual rate of 4.3%, the highest rate since September 2011, due to the increase in prices in the export components and the increase in the government procurement. This increase occurred after sharp increases recorded in January and February, against the background of increased demand and supply chain disruptions which have heightened the risk of economic bottlenecks.

- The yield-to-maturity of US government bonds increased during March (see Chart 3) as a result of a rise in the inflation expectations of the Fed and of market forecasters, coupled with an increase in real long-term interest rates, but the long term yield-to-maturity fell slightly in the first half of April. The rise in yields has occurred despite the on-going massive intervention of the Fed in the markets. The Fed is expected to continue to purchase assets at the current pace, and without this intervention, the rise in the long-term bond yields would probably have been greater.
- The macro-economic growth is reflected in the financial markets, which are at peak levels, as well as in many of the commodities prices, which are affected by the rising demand for industrial materials. Copper prices increased with the recovery in economic activity, after they had fallen in April 2020 to a low of recent years, and reached their highest level since August 2011. In parallel, prices of precious metals, which are perceived as a secure investment at times of crisis, dropped their peaks in August 2020, against the backdrop of the economic recovery. The relative change in copper prices vis-à-vis precious metals prices is consistent with the process of rising yields in the US.
- The underlying economic conditions of the US support the rise in yields, including: the large and persistent budget deficit of the US government, the expectation for a decline in the household saving rate with the return of normal consumer patterns, and a continuing boom in real investment in a variety of areas throughout the US. This gap between aggregate savings and real investment is expected to broaden further and be reflected in an increase in the deficit of the current account of the US balance of payments and further upward pressure on yields.
- It appears the intervention of the Fed is maintaining a lower level of yields than that consistent with the macro-economic conditions, by approximately 100bps. Eventually, as the US economy returns to full activity, the unemployment rate falls to the desirable level, and as inflation remains near or above the target, the Fed will gradually remove its support. At such time, a further step of rising yields will probably take hold, whether only on the basis of expectations for a future change in Fed policy, or at a later date with the announcement of the actual implementation of such a change.

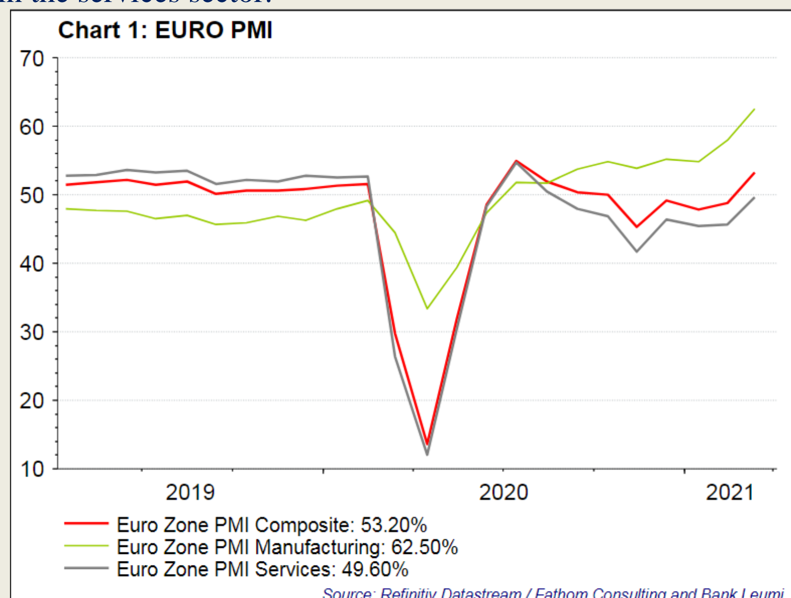




The Euro Bloc

Economic activity: it appears the GDP of the euro bloc declined in the first quarter of 2021, while in the second quarter, GDP is expected to rise moderately. For the full year, the lion's share of annual growth is expected to occur in the second half. Italy and France entered again into lockdown, and Germany as well tightened its pandemic related restrictions due to a rise in morbidity. These developments are likely to hamper any recovery.

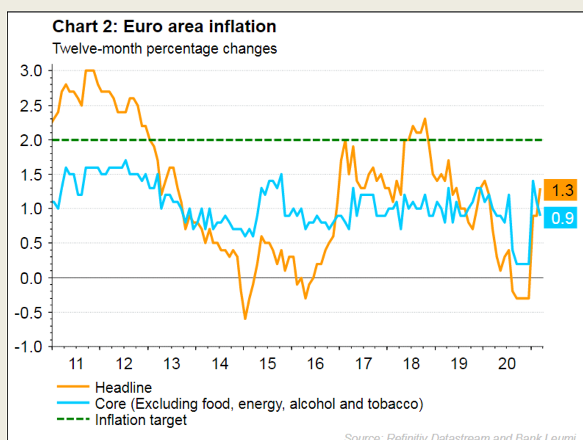
- Overall economic activity in the euro bloc has not yet returned to growth in the beginning of the year. Industrial activity growth, which has recently characterized most of the countries of the world, was evident in the euro bloc in January despite the supply chain disruptions that have led to a drop in the manufacture of automobiles. However, these disruptions together with the tightening of restrictions led to a decrease in industrial production in February by 1.0% (m/m).
- A sharp decline was recorded in France's industrial production and Germany's industrial production also contracted while in Italy it grew at a moderate rate. Manufacturing growth is expected to continue during the coming months, particularly after supply chain disruptions start to ease, but the recovery of the automobile industry is expected to be at a later stage.
- We expect local demand to increase in the coming monthly only moderately, due to the rise in morbidity and the tightening of pandemic-related restrictions in a number of euro bloc member countries. These developments have impacted the services sectors and to a lesser extent the manufacturing sector. The rise in external demand is expected to support industrial growth later on. Accordingly, preliminary indicators show a continuing recovery in the industrial sector. The PMI of the euro bloc increased to a level above 50 points in March (see Chart 1), for the first time in the last six months, and indicates economic growth at the end of the first quarter of the year. The bulk of the increase stems from a rise in the index of the manufacturing sector, which increased sharply from 57.9 to a peak level of 62.5 points. However, the tightening of restrictions in a number of euro bloc member countries is expected to hamper the continuation of growth in the near-term, with the damage expected to be concentrated in the services sector.

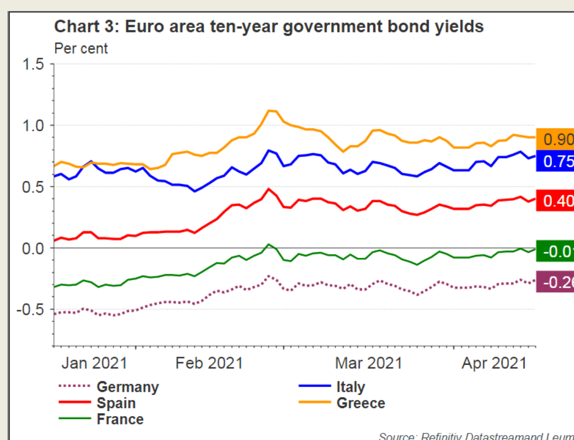


- The EC index on consumer confidence in the euro bloc improved in March from -14.8 to -10.8 points. The latest figure is the highest level since the beginning of the crisis, yet it remains below the level registered in February 2020, prior to the crisis. In our view, consumption in the first quarter of the year is expected to be low despite the rise in consumer confidence, due to the tightening in pandemic related restrictions and against the backdrop of the decline registered in retail sales in the beginning of the quarter.
- German industrial production declined 1.6% (m/m) in February after it contracted by 2.5% in January (m/m) due to a decline in the construction sector, and also due to temporary supply chain problems. These developments indicate it is likely the GDP of Germany will contract during the first quarter of 2021. However, the IFO business climate index in Germany, which increased in the last two months, indicates that German industrial manufacturing, with the exception of automobile production, returned to growth in the second half of the first quarter of the year. The composite PMI of Germany increased in March to 56.8 points, the highest level in the last three years, and this gives an indication as well of the growth in industrial activity. In our view, growth in services remains weak, and together with the rise in morbidity, which is expected to weigh on the recovery in the near term due to a tightening in restrictions, we forecast growth will be low in the second quarter of 2021. Any strong recovery will be postponed to the second half of the year.
- The rise in morbidity in Italy led to the imposition of another lockdown in the country, and this is expected to weigh on any recovery in economic activity, with an emphasis on retail and accommodation activity, which are expected to suffer more than the economic activity in other sectors. However, the impact of the contraction in these sectors on GDP is expected to be partially offset by continued growth in other sectors of the economy, with an emphasis on industrial activity, which will be hurt less by the tightening in restrictions. Retail sales in Italy fell 3.3% in January (m/m), but sales are expected to climb in February, following the easing in restrictions, yet we expect that in March-April retail sales will contract once again due to the imposed shutdown.
- France as well imposed a shutdown, due to a rise in morbidity, which led to a contraction in industrial production by 4.7% (m/m) in February after it grew by 3.2% (m/m) in January and this is expected to lead to a slight decline in GDP. In our view, the GDP contraction will be smaller than that of previous shutdowns since some businesses have adjusted their activities and are expected to deal relatively well with the restrictions. In addition, schools in France are remaining open, which will make it possible to lessen the disruptions to local economic activity, with an emphasis on industrial activity, which was hurt less also in previous shutdowns. In our view, the imposition of a shutdown, together with the slow pace of inoculation of the population, are expected to lead to very weak growth in the second quarter of the year.
- Looking ahead, we expect that euro bloc GDP will recover only later in the year, while in the shorter-term, against the backdrop of heightened morbidity, the GDP contracted in the first quarter of the year and is expected to grow by only a moderate rate in the second quarter. In total for the year, the GDP of the euro bloc is expected to increase 4.2% this year, and in 2022 it is expected to increase 4.0%.

Inflation and monetary policy: members of the ECB Monetary Committee expect the rate of asset purchases made by the central bank will increase in the coming months, and this is expected to support the low yields on government bonds. The consumer price index increased in March due to the rise in energy prices, yet core inflation dipped.

- The president of the European Central Bank (ECB) emphasized in the March interest rate announcement the uncertainty that will remain in the market in the near-term, which has been affected by the rise in morbidity, as well as the inoculation of the population. She noted that growing global demand, together with fiscal support, bolsters global as well as euro bloc economic activity; however, in the short-term, the impact of these factors is lower than the impact of the rise in morbidity that is weighing on euro bloc economic activity. Therefore, members of the Monetary Committee of the ECB forecast an increase in the rate of asset purchases, within the framework of the Pandemic Emergency Purchase Program (PEPP), during the coming months, while the purchases will be adjusted in accordance with market developments.
- This will occur with the goal of preventing a tightening in financial conditions. As expected, the ECB decided to keep its interest rate unchanged at 0.00%, and the central bank estimates the interest rate will remain at its current level, or lower, until inflation will reach the target, slightly below 2%. The ECB raised its inflation forecast for this year from 1.0% to 1.5% due to the impact of temporary factors and high energy prices; however, the ECB kept its 2023 inflation forecast unchanged at 1.4%. The president of the ECB estimates the rise in the inflation rate is temporary and is not expected to remain over time, which means the interest rate is not expected to rise before 2024.
- The consumer price index used in the euro bloc, the harmonized indices of consumer prices (HICP), increased in March from 0.9% to 1.3% (y/y, see Chart 2), continuing the sharp rise registered in the beginning of the year. The increase stems primarily from the rise in energy prices, different inputs, and freight prices. The annual core inflation rate declined in March from 1.1% to 0.9%, as services prices increased by 0.1 percentage point and goods prices increased as well, albeit by a lower rate than the increase registered in February. In our view, the inflation rate is expected to continue to climb in the coming months, while it is possible for it to increase in the second half of the year temporarily above 2%. The rise in inflation is expected to be supported by high energy prices and also by pricing pressures in the manufacturing sector, and the shortage in inventories, which is expected to raise prices of goods and automobiles. In summary for the year, the inflation rate this year is expected to equal 1.2% and the inflation rate in 2022 is expected to equal 1.4%.
- The yields-to-maturity of euro bloc government bonds declined moderately during March (see Chart 3), following February's rise, and rose at a moderate rate in the first half of April despite the increase in the inflation rate. These developments indicate a slight decline in the long-term real interest rate. The low yield levels are supported by the ECB's on-going asset purchases. Furthermore, the central bank's statement that it will continue to purchase assets, coupled with the expectations of the Monetary Committee members for an increase in the rate of purchases, is expected to halt any substantial rise in yields-to-maturity.





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