

Global Macroeconomic Monthly Review

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May 2020

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Key Issues and Table of Contents

Bank Leumi Economic Forecasts (p. 3)

The Global Economy – Overview (p. 4)

- *The imposition of closures in many areas of the world has halted economic activity.*
- *In the second quarter of this year, economic activity in the developed countries will contract further.*
- *China has apparently passed the hardest stage in the current wave, and its economy is expected to recover gradually during the coming quarter.*
- *Inflation in the developed countries is expected to continue to decline during the second quarter due to the drop in domestic demand and the fall in oil prices.*
- *Central banks are adjusting accommodative monetary policies in accordance with the needs of their domestic financial markets.*
- *The yield curves of Germany and France inverted at the shorter durations (up to three years to maturity).*

United States (p. 8)

- *The US economy is entering into recession, with GDP expected to contract in 2020.*
- *In the second quarter of 2020 the services sector is expected to suffer to a greater degree than the manufacturing sector.*
- *Home sales are expected to decline in the second quarter of 2020 by tens of percentage points.*
- *The Fed kept the interest rate at a range of 0.00%-0.25%, and it expects this interest rate target range will be maintained in the near-term.*
- *The Fed emphasized it will continue to purchase government bonds and mortgage backed securities (MBS) in order to maintain the proper functioning of the markets.*
- *As a result of the purchases by the Fed, government bond yields remained very low and the Fed balance sheet expanded.*

Euro Bloc (p. 11)

- *Due to the economic shutdowns imposed in March in many countries within the euro bloc, the GDP of the euro bloc fell 3.3% (q/q) in the first quarter, and in the second quarter the GDP is expected to decline 20% (q/q).*
- *The bulk of the damage is expected to occur in the services sector; however, the manufacturing sector is also expected to contract.*
- *The finance ministers of the euro bloc agreed on a fiscal response totaling €540bn.*

- The ECB kept the interest rate unchanged and did not change the amount of its Pandemic Emergency Purchase Program (PEPP); however, it did lower the interest rate on TLTRO III activity and launched a new series of PELTROs.
- Inflation in the euro bloc fell from 0.7% to 0.4%. The yield curves of Germany and France inverted at the shorter durations.

Leumi Global Economic Forecast, As of April 2020

	2017	2018	2019E	2020F	2021F
GDP – Real Growth Rate¹					
<i>World</i>	3.9%	3.6%	2.9%	-3.0%	5.8%
<i>USA</i>	2.4%	2.9%	2.3%	-5.9%	4.7%
<i>UK</i>	1.9%	1.3%	1.4%	-6.5%	4.0%
<i>Japan</i>	2.1%	0.3%	0.7%	-5.2%	3.0%
<i>Eurozone</i>	2.5%	1.9%	1.2%	-7.5%	4.7%
<i>South East Asia (ex. Japan)</i>	6.7%	6.3%	5.5%	1.0%	8.5%
<i>China</i>	6.9%	6.8%	6.1%	1.2%	9.2%
<i>India</i>	7.0%	6.1%	4.2%	1.9%	7.4%
<i>Latin America</i>	1.3%	1.1%	0.1%	-5.2%	3.4%
<i>Israel</i>	3.6%	3.4%	3.5%	-6.3%	5.0%
Trade Volume, Growth (%)					
<i>Global</i>	5.8%	3.7%	0.9%	-15.3%	22.8%
Interest rates, Year End					
<i>US Fed</i>	1.25-1.50%	2.25-2.50%	1.50%-1.75%	0.00-0.25%	0.50-1.00%
<i>Bank of England</i>	0.50%	0.75%	0.75%	0.1%	0.1 %
<i>Bank of Japan-Policy Rate</i>	-0.10%	-0.10%	-0.10%	-0.20%	-0.20%
<i>ECB-Main Refi</i>	0.00%	0.00%	0.00%	0.00%	0.00%
<i>Israel</i>	0.10%	0.25%	0.25%	0.0-0.1%	0.00-0.50%

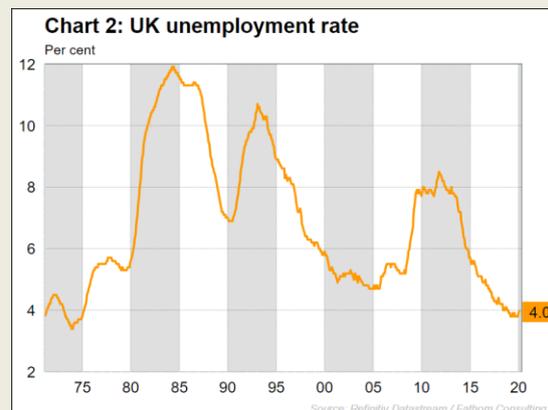
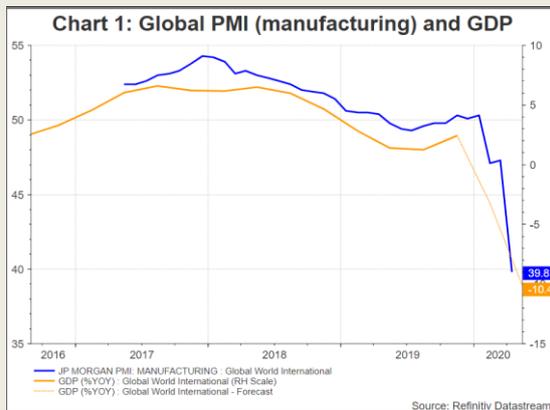
¹ IMF forecasts.

The Global Economy – Overview

Economic activity: the imposition of closures in many areas of the world has halted economic activity. In the second quarter of this year, there was another contraction in the economic activity in the developed countries. China has apparently passed the hardest stage in the current wave, and its economy is expected to recover gradually during the coming quarter.

- The imposition of closures in many areas of the world, in an attempt to halt the spread of the coronavirus, caused a halt in economic activity. Many governments are supporting their economies through fiscal expansion, which is expected to cause a substantial rise in their deficits and in the debt/GDP ratios of most countries. According to the IMF, published during April, global GDP is expected to contract 3.0% in 2020, this compared to contraction of 0.5% at the time of the 2009 financial crisis. In the optimistic scenario, of the IMF, in which the spread of the coronavirus will halt in the second half of 2020, global GDP is expected to increase 5.8% in 2021.
- The economic damage is expected to vary among the different countries, such that the countries with weak health systems will be more substantially hurt. Furthermore, poorer countries are expected to experience greater damage, due to the difficulty of quarantining the sick in light of the crowded conditions in which households live. In addition, the absence of good Internet infrastructure that enables individuals to work from home in poorer countries, and also the low earnings of households and their dearth of savings, all these weigh on the countries' abilities to halt economic activity and to impose an effective closure in order to stop the spread of the virus.
- The substantial declines in PMI data, which are part of a set of preliminary indicators on GDP growth, reflect the contraction in GDP in leading economies caused by the cessation in economic activity. Economic activity in Europe is expected to contract 20% in the second quarter, the largest contraction in economic activity since the Second World War.
- According to the IMF, the GDP of the European Union (EU) is expected to contract to a greater degree than in other countries around the world, by 7.5% in 2020, with 4.7% growth expected in 2021, similar to the average of developed countries. All this is under the assumption the spread of the coronavirus will be halted during the second half of 2020. The later sections of this survey discuss in more detail the economic developments in the US and the euro bloc, while in this section we focus on the other developed countries and on developing countries.
- The PMI of the global manufacturing sector declined in April from 47.3 to 39.8, reaching the lowest level since March 2009 (see Chart 1). The PMI of the manufacturing sector in Britain fell in April from 47.8 to 32.9, the lowest level in the last 28 years. However, the most substantial decline occurred in the PMI of the services sector, which dropped from 34.5 to 12.3. In addition, retail sales in Britain declined in March by a sharp rate of 5.1% (m/m), thereby signaling that retail sales declined in the first quarter of the year. In our opinion, in April an additional substantial decline is expected in retail sales, due to the on-going closure in Britain. Furthermore, the unemployment rate in Britain is expected to climb from 4% to

9% (see Chart 2). This high unemployment rate is likely to make an economic recovery more difficult after the coronavirus ceases to spread.



- In Japan, the PMI of the manufacturing sector fell in April from 44.8 to 43.7, the lowest level since the 2009 financial crisis. The PMI of the services sector declined in April from 33.8 to 22.8, thus underscoring the damage to the services sector. In addition, retail sales fell in March by 4.5% (m/m), while Japanese exports declined 11.7% in March (y/y). However, imports fell only 5.0% (y/y) in March, after plummeting 13.9% (y/y) in February. Despite the recovery of the Chinese economy, exports from Japan to China fell 8.7% in March (y/y) after in February exports to China declined only 0.4% (y/y). Japan's exports to China are likely to increase towards the end of the second quarter, in the event the closure in Japan will end, apparently at the end of May, and this will help Japan to deal with the decline in foreign trade.
- The GDP of the Chinese economy declined 6.8% in the first quarter of 2020 compared to the first quarter of 2019. This is the first quarter in which China's GDP contracted since the country started to publish quarterly data in 1992. The bulk of the decline occurred in industry and construction, as the output of both of these activities contracted sharply. The services sector contracted 5.8% (y/y) in the first quarter. In March, the declines in retail trade moderated from minus 20.5% (y/y) in January and February to 15.8% (y/y), and investment in capital goods declined 16.1% (y/y) in the first three months of the year. It appears that due to the increase in infrastructure expenditures, supported by fiscal expansion, the decline in investments in capital goods moderated in March. Industrial manufacturing declined in March by only 1.1%, this compared to a decline of 13.5% in January and February.
- China's PMI data indicate the beginning of a recovery in the services sector. The PMI of the services sector increased in April from its low level of 26.5 to 43.0. The PMI of the manufacturing sector declined slightly in April, from 50.1 to 49.4 (see Chart 3), yet remains substantially higher than the index from February, which was at an historic low. It appears the Chinese economy has passed the most difficult stage of all in the current wave, and the economic recovery is expected to continue. The return of economic activity has returned both the private and public sectors back to a path of growth, yet economic activity remains considerably low due to the decline in domestic demand stemming from the high unemployment rate, and also due to the decline in external demand stemming from the global economic crisis.

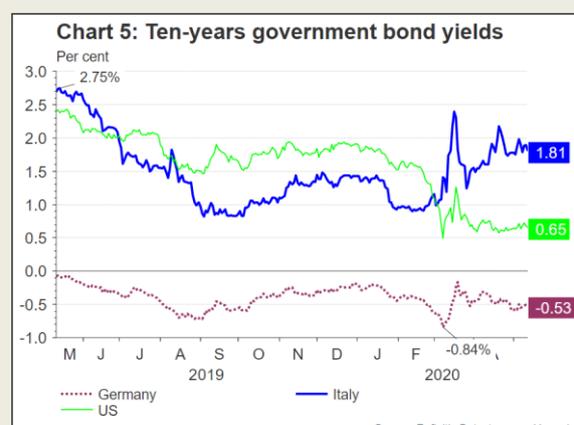
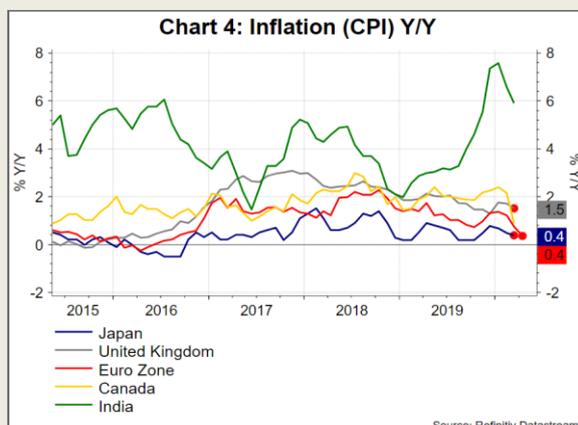
- Looking ahead, according to the IMF's forecast, global GDP is expected to contract 3% in 2020 and global trade is expected to shrink 15%. Meanwhile, Britain's GDP is expected to contract 6.5% in 2020. In light of the estimated £100bn in fiscal measures of the British government, the deficit of Britain is expected to increase from 2.1% to 15% of GDP, and the public debt/GDP ratio is expected to increase from 80% to 105%. In Japan, GDP is expected to contract 12% (q/q) in the second quarter, with a 5.2% contraction in GDP expected for all of 2020. In Australia, second quarter GDP is expected as well to contract by a double-digit rate, while unemployment is expected to increase to a rate of 12%, due to the on-going shutdown in that country.
- The economy of the emerging markets is expected to contract 4% in 2020. Most of the governments in the developing countries are expected to increase fiscal support for their economies by raising public debt, and the deficits in most of the developing countries are expected to expand to 5%-15% of GDP.



Inflation and monetary policy: inflation in the developed countries is expected to continue to decline during the second quarter due to the drop in domestic demand. Central banks are adjusting accommodative monetary policies in accordance with the needs of their domestic financial markets. The yield curves of Germany and France inverted at the shorter durations.

- Inflation in the developed countries declined significantly in March-April and is expected to continue to decline in the second quarter. This is due to the decline in domestic demand stemming from the imposition of closures in some of the countries in order to halt the spread of the coronavirus, and also due to the fall in energy prices. Inflation in the OECD declined in March from 2.3% to 1.7%, because of the drop in energy prices that offset the rise in food prices. This is the largest drop in inflation in the OECD since the financial crisis and this decline was especially felt among the major OECD countries. Core inflation in the OECD, excluding food and energy, edged downward in March from 2.2% to 2.1%.
- In the euro bloc, inflation declined in March from 0.7% to 0.4%, with declines also registered in inflation in most countries in March (see Chart 4). The fall in inflation is likely to make economic recovery from the current crisis more difficult. In the event the drop in inflation will continue, then central banks are expected to continue expansionary monetary policy in order to assist their economies to deal with the economic crisis and to return to growth, with additional interest rate cuts also possible.

- In Japan, the central bank (BOJ) kept its interest rate unchanged at its current level of -0.1%, but aggressive measures were announced to ease pressures in the financial market. The central bank increased the maximum amount of commercial paper (CP) it will purchase to ¥7.5tn, and the same with respect to corporate bonds. In this manner, the upper limit of the amount outstanding of these assets will increase from ¥5tn to ¥20tn in total. In addition, the BOJ decided by unanimous vote to expand the range of eligible collateral to private debt in general, including household debt, in order to receive the emergency loans that were declared last month. Furthermore, the central bank is changing its annual government bond purchasing target, which had equaled ¥80tn, and now it will purchase bonds in accordance with developments in the market, such that the government bond yields of Japan will remain around 0%.
- In Australia, the central bank (RBA) kept its interest rate unchanged, and the target government bond yield remained unchanged at 0.25%. The central bank lowered government bond purchases from \$6.0bn per day to \$0.5bn per day, because of the liquidity in the government bond market, but it noted that it will increase bond purchases if needed. Since mid-March, the central bank has purchased \$40bn of government bonds, which accounts for 7% of issued government debt. In China, the large banks are passing the rate cuts of the central bank of China (PBOC) through to the market, and thus have lowered the prime rate on one-year loans (LPR) by 20bps (from 4.05% to 3.85%), while the prime rate on loans for five years declined by 10bps to 4.65%.
- US government bond yields continued to decline in April despite the rise in stock prices, due to the Fed's purchasing program. However, this has reversed somewhat in May. In the euro bloc, the government bond yields of Italy increased, while at the same time the government bond yields of Germany declined, following the April 9 declaration of the finance ministers of the euro bloc countries announcing a €540bn fiscal assistance program (see Chart 5). In Germany, the yield curve inverted at the shorter durations (3M- 2Y and 3M-2Y) at the end of April. Also in France the yield curve inverted at the shorter durations (2M-2Y). These developments lower the worthwhileness for the banks to loan money to the market, and likely give a hint of the difficulties faced by these economies in their efforts to exit from the crisis.

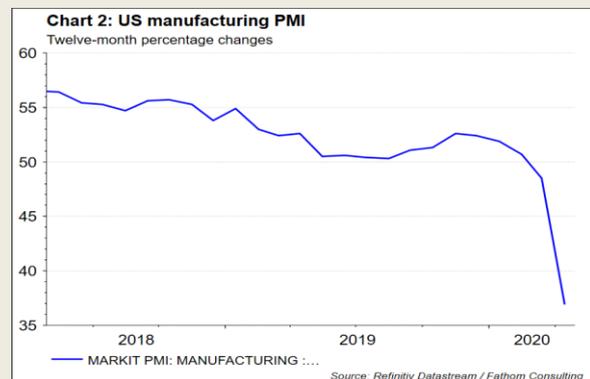
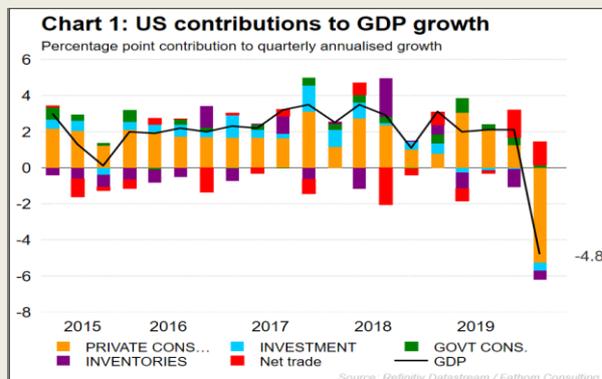


United States

Economic activity: the US economy is entering into recession, with GDP expected to contract in 2020. Unemployment has increased to double-digit rates. In the second quarter of 2020 the services sector is expected to suffer to a greater degree than the manufacturing sector. In addition, home sales are expected to decline in the second quarter of 2020 by tens of percentage points.

- The coronavirus outbreak in the US began to affect the economy negatively during the first quarter of 2020 and the economic data are starting to support the estimate that the economy is sliding into a deep recession. First quarter GDP declined 4.8% in annualized terms (see Chart 1). Real private consumption fell 7.6%, while the consumption of services dropped by a sharp rate of 10.2%, with this component representing the most substantial factor behind the contraction in first quarter GDP. Industrial manufacturing fell 5.4% in March (m/m), the sharpest decline since World War II. Retail trade declined 8.4% in March, and an additional decline in retail trade is expected in April due to continuing closures in many parts of the US. Consumption of clothing goods declined 50%; however, food and beverage consumption increased 26%. Durable goods orders declined 14% in March (m/m), with the bulk of the decline stemming from a sharp drop in orders for commercial aircraft; however, the core index of durable goods orders fell in March only 0.2% (m/m). The number of unemployment claims increased in the last week of April by 3.8m, as 30m persons applied for unemployment benefits over the last six weeks, reflecting a 17% unemployment rate.
- Initial indicators are showing a continued economic contraction in April. The Purchasing Managers Index (PMI) indicates a continued contraction in the US economy in both the manufacturing and services sectors; however, the services sector is expected to be more substantially hurt. The composite PMI declined in April from 40.9 to 27.4. Meanwhile, the PMI of the manufacturing sector declined in April from 48.5 to 36.9 (see Chart 2) and the PMI of the services sector fell from 39.8 to 27.0. The Empire State Manufacturing Survey, the monthly survey of manufacturers in New York State conducted by the Federal Reserve Bank of New York, plummeted 56.7 points in April to -78.2, its lowest level in the history of the survey. Similarly, one of the main indices within the Manufacturing Business Outlook Survey of the Federal Reserve Bank of Philadelphia declined in April from -12.7 to -56.6.
- In April, a loss of 20.5 million jobs was recorded, as was expected based on the "tidal wave" of unemployment claims over the past six weeks. The unemployment rate has risen "only" to 14.7% (from 10.3%), slightly below expectations, and this is mainly because the BLS encountered problems of classifying workers who are temporarily absent from the workplace and therefore they are not considered unemployed. Without this distortion, the unemployment rate would have approached 20%. The number of unemployment increased from 15.9 million in March to 23.1 million in April. The decline in employment was concentrated in the leisure and hospitality industry, which lost 7,653,000 jobs. This means that employment in this industry has plummeted in 45% since February. Almost all sectors of the economy were hit hard, including education and health, which lost 2.5 million jobs and retail that has lost 2.1 million. Even government employment fell by 980,000 due to school closures.

- The US Small Business Administration (SBA) launched the US\$660bn Paycheck Protection Program (PPP), which is intended to provide incentives to small businesses to keep workers on the payroll. Thus, in the event a business will keep its employees on the payroll during a period of eight weeks, the loan funds provided to small businesses by the SBA that will be used to pay wages, rent, mortgage interest or expenditures on services, will be converted into a grant. In our opinion, the plan has come too late and will not prevent the first wave of firings; however, it will help companies that are less directly affected by the restrictions implemented to survive the crisis during the coming weeks and will slow the rise in the unemployment rate. Expanding this program will raise the chances for a rapid economic recovery after the coronavirus is brought under control and ceases to spread; however, the cost for this will involve an additional increase in the federal budget deficit.
- Construction starts in the first quarter declined 2.1% (q/q), with March's figure falling 22.3% (m/m). The number of new homes sold declined 15.4% in March (m/m); however, the bulk of the declines occurred in the northeast and in the west of the US. The uneven breakdown in home sales between the different regions of the country indicates the declines in home sales stem from the spread of the coronavirus.
- Looking ahead, the International Monetary Fund (IMF) expects US GDP to contract 5.9% in 2020. In our opinion, GDP is expected to decline 40% (y/y) in the second quarter, and the unemployment rate is expected to spike to 15%-20%. However, with the return of economic activity, the unemployment rate is expected to drop back down to a single-digit figure. The IMF expects the unemployment rate will decline to slightly below 10% in 2021.

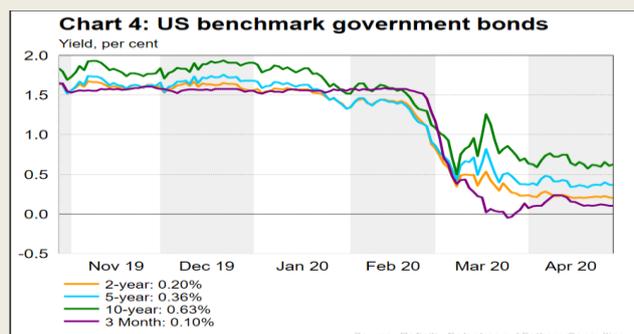
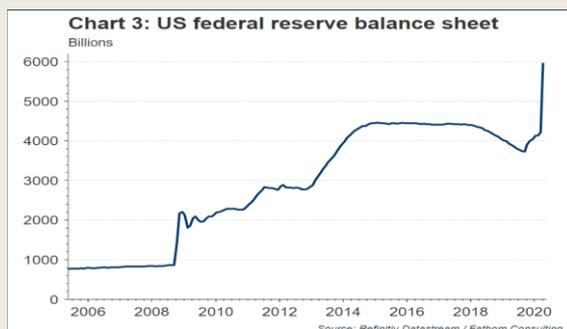


Inflation and monetary policy: the Fed kept the interest rate at a range of 0.00%-0.25%, and it expects this interest rate target range will be maintained in the near-term. The Fed emphasized it will continue to purchase government bonds and mortgage backed securities (MBS) in order to maintain the proper functioning of the markets. As a result of the purchases by the Fed, government bond yields continued to decline and the Fed balance sheet expanded, with this expected to grow to US\$6.5tn.

- In its interest rate announcement at the end of April, the Fed declared it was keeping its target interest rate range at 0.00% - 0.25%. Furthermore, the central bank expects the current target interest rate range to stay at this level until the US economy will recover, with a return to normal activity and advancement made on the way to achieving employment and stability

targets. The Fed committed "to use the variety of instruments within its authority" in order to support the US economy during this period in which the breakout of the virus is causing economic difficulties and job losses in the US and around the world. In addition, the virus is causing a decline in oil prices and a drop in private consumption, which are lowering the inflation rate. The Fed emphasized it will continue to purchase government bonds and mortgage backed securities (MBS) at whatever sums are required in order to support the proper functioning of the markets, and will in this manner encourage the passage of monetary policy toward broader financial conditions. Furthermore, Fed activity in the repo market will continue and the Fed will continue to follow developments in the market and to adjust its plans accordingly.

- The Fed is about to begin the second phase of addressing the economic crisis, and to purchase US\$2.3bn in non-financial private sector bonds. This step will support non-financial businesses, households, states, and local municipalities. The Fed launched a number of assistance programs, including US\$600bn in "Main Street" loans in order to assist businesses that employ up to 10,000 employees. These loans will be channeled through commercial banks. There is also a plan to purchase US\$850bn in corporate bonds, including recently issued debt and "high yield" debt. Furthermore, the Fed plans to provide up to US\$500bn in liquidity to local authorities, cities, and states.
- The Fed balance sheet expanded over the last month from less than US\$4tn to more than US\$6tn, as the holdings of the Fed in US government bonds increased by more than US\$1tn (see Chart 3). The Fed reduced its purchases of financial assets from the peak of US\$75bn per day to US\$10bn per day, due to a reduction in liquidity shortages in the government bond market. Despite the reduction in financial asset purchases, the Fed balance sheet is expected to reach US\$6.5tn.
- In The US, the April CPI declined by 0.8%, which reflecting a sharp drop in energy prices along with unprecedented 0.4% drop in core CPI. The decline in the core component resulted from a large decline in the components related to travel and tourism, such as hotel room rates, flight prices and car rental prices. Against the decline in fuel, travel and leisure prices, food prices rose by 1.5% due to home food prices increased by 2.6%, the largest monthly increase in 45 years. This reflects the large increase in demand for food products, as well as disruptions in the supply chain associated with the coronavirus, especially in meat processing factories.
- US government bond yields continued to decline in April despite the rise in the equity markets, with the support of the purchase programs of the Fed (see Chart 4). In our opinion, bond yields are not likely to increase to a level that corresponds with the fundamentals that



are expected for the future. Rates have drawn down by market expectation for the Fed to maintain the interest rate at current low levels. Since in times of crisis investors seek investments in relatively secure assets, high demand for US government bonds is likely to be maintained in the near future.

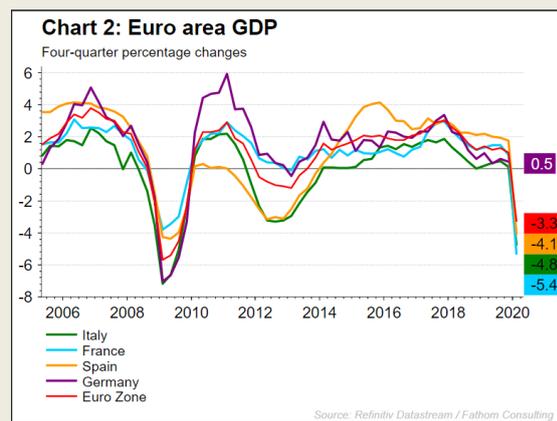
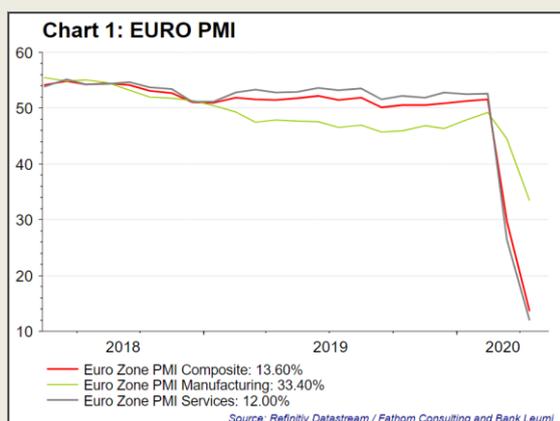
The Euro Bloc

Economic activity: due to the economic shutdowns imposed in March in many countries within the euro bloc, the GDP of the euro bloc fell 3.3% (q/q) in the first quarter, and in the second quarter the GDP is expected to decline 20% (q/q). The bulk of the damage is expected to occur in the services sector; however, the manufacturing sector is also expected to contract. The finance ministers of the euro bloc agreed on a fiscal response totaling €540bn.

- The GDP of the euro bloc declined 3.3% (q/q) in the first quarter. This was due to a sharp decline in the GDP in the second half of March that stemmed from the shutdowns imposed in euro bloc countries during March 10-22. In our opinion, the shutdowns imposed are expected to remain in place at least until mid-May and are expected to cause a sharp contraction in second quarter GDP. Even if the economy will begin to return to regular activity during the second half of the quarter, some restrictions imposed are expected to remain in place (a new "corona routine") and to hinder economic growth. The initial indicators show a substantial contraction in GDP. The composite PMI of the euro bloc declined 16.2 points in April, reaching an historic low of 13.5. The majority of the decline is expected to be in the services sector, as signaled by the sharp drop in the services sector PMI, which fell in April from 26.4 to 11.7. The manufacturing sector is also expected to contract substantially, as the PMI of the manufacturing sector fell in April from 44.5 to 33.4 (see Chart 1). In addition, the consumer confidence index of the euro bloc declined in April from -11.6 to -22.7, reflecting the sharp drop in consumer expenditures. In our opinion, consumer expenditures are expected to decline by a double-digit rate, with the most substantial decline expected to be in expenditures on entertainment, recreation, and travel. The ZEW index of the euro bloc and Germany increased in April, reflecting the estimates of investors for the beginning of an economic recovery in the coming weeks; however, in our opinion, investors are overly optimistic with respect to the degree of improvement, and the economic recovery will be slow. In order to deal with the economic crisis, the finance ministers of the euro bloc reached a compromise on a €540bn fiscal response (4.5% of euro bloc GDP). The expenditures include: €200bn to the European Investment Bank (EIB), €100bn to the European Commission (EC), and €240bn to the establishment of a temporary "recovery fund" within the European Stability Mechanism (ESM).
- In a country breakdown, in France the GDP fell 5.4% (q/q) in the first quarter. This is the country's largest contraction in GDP since 1949. In Spain, the GDP fell 4.1% (q/q) in the first quarter, and in Italy the GDP fell 4.8% (q/q) in the first quarter (see Chart 2). The PMI of the large euro bloc economies indicates the economy will continue to contract in the coming month, with the main damage to be felt in the services sector. The IFO business

confidence index in Germany fell 11.6 points in April, reaching an historic low of 74.3. For the sake of comparison, in the financial crisis in 2009 the IFO index fell to 80. The Italian economy is expected to contract more substantially than other countries in the euro bloc, and it is also expected that following the economic recovery, the Italian economy will remain weak for a very long period, which will hinder the country's ability to repay its public debt. Only 56% of employees work in sectors that have not yet shutdown and 60% of industrial companies have closed, due to the shutdown imposed in Italy. Meanwhile, the activity of the public and food sectors was not substantially hurt. The unemployment rate in Italy is expected to remain very high, at a double-digit rate, at least until the end of the year. In Spain, the unemployment rate is expected to climb to 25%, because of the high rate of temporary workers. In Holland, the impact of the shutdown is not evident in the initial indicators for March, which hints it is possible the Dutch economy succeeded to prevent contraction in the first quarter of the year. In our opinion, in the second quarter of the year we expect to see the effects of the closure on the economic activity of Holland. As an early sign of the expected contraction in the Dutch economy during the second quarter, the number of unemployment claims spiked 42% during March; also, the number of bankruptcies increased.

- Looking ahead, the GDP of the euro bloc is expected to contract 20% (q/q) in the second quarter, against the backdrop of the decline in consumer expenditures, which are expected to contract in 2020 by 12%, compared to a 1% decline in consumer expenditures at the time of the financial crisis in 2009. In Germany, the GDP is expected to contract 12% (q/q) in the second quarter and in all of 2020 the German GDP is expected to contract 8%, while the deficit of the German government is expected to increase to 8% and the public debt/GDP ratio is expected to climb to 80%. In France, the GDP is expected to decline in the second quarter by at least 12%. What this all means is that, as shown in Chart 2, compared to the 2008 financial crisis, the coronavirus crisis is expected to be much more severe with respect to its impact on economic activity.

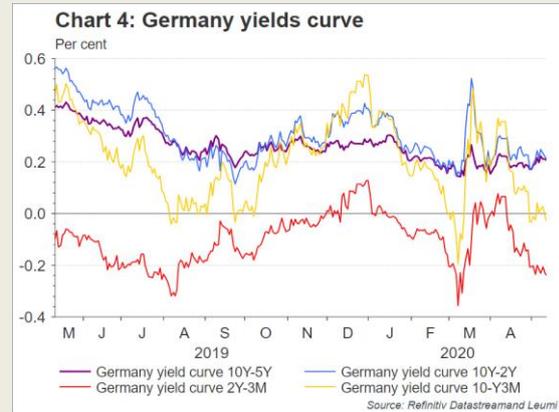
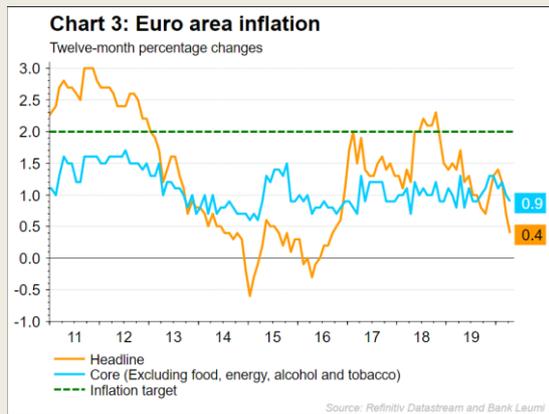


Inflation and monetary policy: the ECB kept the interest rate unchanged and did not change the amount of its Pandemic Emergency Purchase Program (PEPP); however, it did lower the interest rate on TLTRO III activity and launched a new series of PELTROs. Inflation in the euro bloc fell from 0.7% to 0.4%. The yield curves of Germany and France inverted at the shorter durations.

- The ECB, in the interest rate announcement at the end of April, kept the interest rate unchanged at 0.00%; it also kept the amount of its Pandemic Emergency Purchase Program (PEPP) unchanged. However, the central bank noted it is prepared to increase the scope of the purchase program and to adjust its composition, as will be needed, and for whatever time period will be necessary. Some of the government bond investors who expected an increase in the emergency purchases of the ECB within the PEPP framework are likely to be disappointed from the fact that the sum of purchases was not raised, because at the current pace of purchasing, the program is expected to end by October this year. We note that the PEPP program of the ECB totals €750bn, and it raises the ECB's balance sheet to more than €5tn, compared to less than €3t in 2011.
- The ECB reduced by 25bps the interest rate for targeted long-term refinancing operations (TLTRO III), effective from June 2020 to June 2021, to 50bps below the average deposit facility rate, which equals 0.00%. This program is intended to incentivize the banks to provide loans to the private and business sectors, including those hurt by the spread of the coronavirus. Banks that meet their targets for granting credit will receive loans at an interest rate of -1%. In addition, the ECB launched a new series of longer-term refinancing operations (PELTROs), in order to ensure sufficient liquidity in the euro bloc financial markets. The new series will include seven rounds of PELTRO tenders, starting from this month and lasting through September, at an interest rate equal to 25bps below the average rate applied in the Eurosystem's main refinancing operations (currently 0%) over the life of the respective PELTRO.
- The German Constitutional Court (GCC) recently ruled on a controversial matter that dates back to 2015, related to the legality of the ECB's bond buying program. This ruling, which contradicts an earlier ruling by the European Court of Justice (ECJ), is likely to prevent the German Central Bank (Bundesbank) from participating in the bond purchasing program of the ECB, and this raises to some degree the risk of Germany exiting from the euro bloc. This ruling does not specifically refer to the Pandemic Emergency Purchase Program (PEPP) of the ECB and it is not expected to lead to a sudden halt to the ECB's asset purchase program. However, the PEPP does not meet the criteria of the GCC to permit the continuation of purchases. Therefore, in the event the court ruling will stand, in another three months the Bundesbank will cease participating in the purchases of the ECB, unless the ECB will succeed to convince the GCC of the necessity of this program.
- Inflation in the euro bloc fell in April from 0.7% to 0.4%, due to the sharp drop in energy prices that offset the rise in food prices (see Chart 3). In our opinion, inflation is expected to continue to decline and may even turn negative, due to the sharp drop in domestic demand stemming from the implementation of shutdowns in certain euro bloc countries. Thus,

inflation is expected to decline in the second quarter to an annual rate of -1%, and average core inflation in 2020 is expected to equal 0.5%.

- Italian government bond yields increased since the April 9 announcement on the fiscal assistance plan by the euro bloc ministers of finance. At the same time, French and German government bond yields fell. These developments likely indicate that investors are not confident regarding the stability of Italy's debt dynamics and the government's ability to repay its debt. In Germany, the yield curve at the shorter portion of the curve (3M – 2Y and 3M - 10Y) inverted at the end of April (see Chart 4). In France the yield curve also inverted at the shorter end of the curve (3M – 2Y) in the final week of April, which reflects the financial crisis occurring in the stronger economies of the euro bloc and raises the likelihood for the continuation of expansionary monetary policy.



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