Global Macroeconomic Monthly Review

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Key Issues and Table of Contents

- *The IMF further lowered its growth forecasts and currently estimates global growth is expected to contract 4.9% this year.*
- *Economic activity in the developed countries, and in many of the developing countries, has started to recover.*
- *Since the beginning of the year, the damage to the developed economies in Europe has been more severe than the damage to the developed economies in Asia.*
- *The inflation rate in the developed countries is expected to increase, against the backdrop of the rise in energy prices.*
- *The core inflation rate in the developed countries continued to fall and is not expected to increase in the near term due to low local demand and high unemployment rates.*
- *The central bank of Japan increased loans to the market, and total support of the bank accounts for 19% of the debt of non-financial companies.*

- *The US economic crisis is still underway, but initial signs of a recovery are beginning to emerge as private consumption increases and as the number of new unemployment claims moderates.*
- *The IMF further lowered its 2020 and 2021 growth forecasts for the US economy and raised the expectation for the budget deficit and the public debt/GDP rate, which is expected to reach above 140% this year.*
- *Purchases of government bonds by the Fed are expected to continue in the coming months, at least at the current pace.*
- *According to the Fed chairman, the economy is not expected to fully recover before the public will be certain that the spread of the coronavirus has been brought fully under control.*
- *The consumer price index (CPI) declined slightly in May, following the largest drop in the last nine years in April.*

- *The IMF forecasts euro bloc GDP will contract 10.2% in 2020, while in the second quarter GDP is expected to decline by a double-digit rate, in quarterly terms, but the third quarter will see a recovery of GDP growth.*
- *Economic activity continues to recover, with a rapid recovery expected in France, and it is possible French GDP in June will actually increase in monthly terms*
- *The ECB presented evidence of the necessity of the emergency purchase plan after the German Supreme Court demanded it.*

- *Banking loans rose sharply, marking the success of the ECB's TLTRO lending program. The inflation rate rose faster than expected in June, but core inflation fell.*

Leumi Global Economic Forecast, As of July 2020

	2017	2018	2019E	2020F	2021F
GDP – Real Growth Rate					
World	*3.8%*	*3.5%*	*2.6%*	*-3.9%*	*4.8%*
USA	*2.4%*	*2.9%*	*2.3%*	*-4.8%*	*2.4%*
UK	*1.9%*	*1.3%*	*1.4%*	*-8.7%*	*6.7%*
Japan	*2.2%*	*0.3%*	*0.7%*	*-5.2%*	*1.4%*
Eurozone	*2.7%*	*1.9%*	*1.2%*	*-8.3%*	*5.6%*
South East Asia (ex. Japan)	*5.3%*	*5.1%*	*4.4%*	*-1.6%*	*4.4%*
China	*6.8%*	*6.6%*	*6.1%*	*1.4%*	*8.0%*
India	*7.0%*	*6.1%*	*4.3%*	*-5.8%*	*9.4%*
Latin America	*0.9%*	*0.7%*	*-0.6%*	*-8.1%*	*4.1%*
Israel	*3.6%*	*3.4%*	*3.5%*	*-4.6%*	*5.3%*
Trade Volume, Growth (%)					
Global	*5.8%*	*3.7%*	*0.9%*	*-22.6%*	*11.9%*
Interest rates, Year End					
US Fed	*1.25-1.50%*	*2.25-2.50%*	*1.50%-1.75%*	*0.00-0.25%*	*0.00-0.25%*
Bank of England	*0.50%*	*0.75%*	*0.75%*	*0.1%*	*0.1 %*
Bank of Japan-Policy Rate	*-0.04%*	*-0.07%*	*0.0%*	*-0.1%*	*0.0%*
ECB-Main Refi	*0.00%*	*0.00%*	*0.00%*	*0.00%*	*0.00%*
Israel	*0.10%*	*0.25%*	*0.25%*	*0.00-0.25%*	*0.00-0.25%*

The Global Economy – Overview

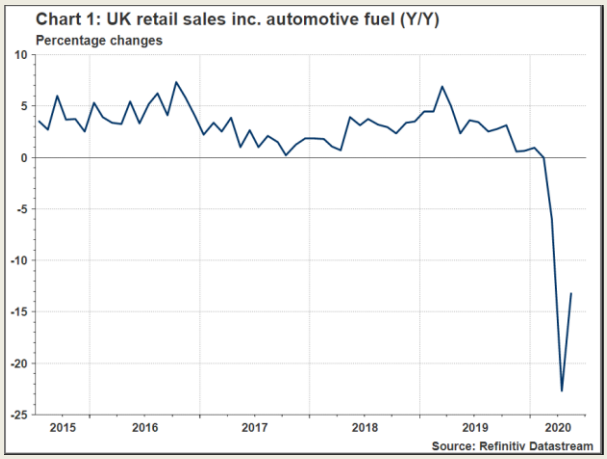
Economic activity: the IMF further lowered its growth forecasts and currently estimates global growth is expected to contract 4.9% this year. Economic activity in the developed countries, and in many of the developing countries, has started to recover. Since the beginning of the year, the damage to the developed economies in Europe has been more severe than the damage to the developed economies in Asia.

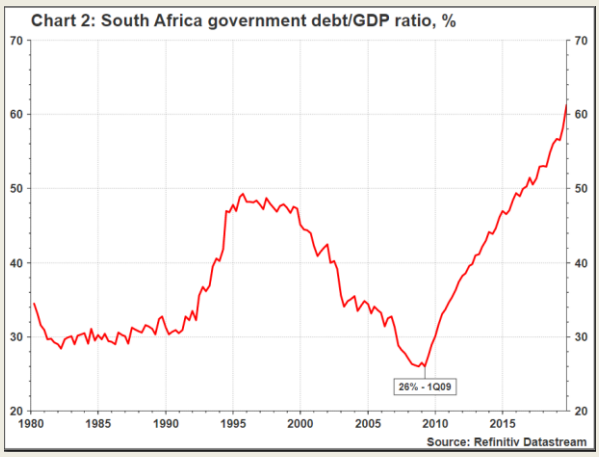
- The cessation in economic activity in the first half of the second quarter due to the spread of the coronavirus is expected to cause global GDP to contract in the second quarter. However, the effects of the coronavirus spread are expected to be different for each country. For example, in China and Taiwan, GDP is expected to grow in the second quarter, with China likely to grow by double-digit rates in quarterly terms. In South Korea, GDP is expected to decline slightly in the second quarter. In Turkey, Britain, and New Zealand, GDP is expected to contract 15% (q/q) in the second quarter; and in Italy and South Africa, GDP is expected to contract at least 20% in the second quarter (q/q). As part of the effects of the crisis, we expect to see tax hikes in the medium-long term in a large number of countries, especially on strong populations, in order to finance high health care spending and to support disadvantaged populations.
- The IMF continued to cut its 2020 growth forecasts for all major economies, both developing and developed. Furthermore, the IMF also raised its forecast for the debt/GDP ratios for all countries, except Australia, which was able to curb the spread of the first wave of the coronavirus, and Saudi Arabia, which is expected to benefit from rising oil prices. The following chapters will discuss in detail the economic developments in the US and in the euro bloc, while in this chapter we will focus on developing countries and the other developed countries.
- Developing countries suffered a severe blow with the cessation in economic activity; however, their starting point in this crisis was significantly better than in other crises. This situation permitted governments to provide fiscal incentives to ease economic activity back to pre-crisis levels as quickly as possible. In Britain, a combination of the decline in economic activity coupled with the rise in government spending to deal with the economic crisis and high healthcare spending, is expected to raise the country's debt/GDP ratio, for the first time in 50 years, to more than 100%. Retail sales in the Britain rose by a sharper rate than expected in May, with the main increase stemming from sales of non-food items (see Chart 1). However, online sales recovery was sharper than sales at physical store sales.
- The UK announced an increase of fiscal incentives of £30bn, equal to 1.4% of GDP, in order to accelerate the economic recovery. With this, the total fiscal incentives have reached up to £166bn, or 7.4% of GDP. The UK moved from the first stage of its economic plan in which it allocated about £133bn in order to limit unemployment hardships and bankruptcies, to the second stage in which it aims to boost jobs and spending. A sum of £9.4bn has been allocated for "Job Retention Bonus" of £1,000 per employee for employers bringing back furloughed workers. A sum of £4.1bn is intended for a 6 month cut in the VAT rate for the hospitality and tourism sector. In addition, the sum of £3.8bn has been allocated for a 6 month reduction in stamp duty, paid when purchasing residential real estate assets, by raising the threshold

before any duty is paid from £125,000 to £500,000. The sum of £2.1bn has been allocated for generating jobs for 16-24 years old people. A sum of £0.5bn has been allocated for encourage buying food in restaurants by a discount scheme on meals purchased at restaurants Monday to Wednesday. In addition, the government plans to invest £3.1bn for promoting energy efficiency and also £5.6bn in infrastructure spending brought forward from future years.

- In Japan, the PMI of the manufacturing sector rose slightly in June, while the PMI of the services sector rose sharply in the same month, reflecting the recovery of the services sector with the lifting of the closure and easing of government imposed restrictions. Japan's industrial manufacturing fell 8.4% (m/m) in May, but with domestic and external demand recovering, industrial manufacturing is expected to recover. In addition, foreign investment in Japan is expected to contract in the second quarter, and the low business sentiment indicates that it will take time for foreign investment to recover. The Japanese government supports companies broadly, and the number of companies receiving assistance is three times greater than the number of companies that received assistance back in the 2009 financial crisis. This broad support is likely to boost economic activity and raise household income. At the same time, the number of bankrupt companies reached a 54-year low in May. However, part of the decline stems from a decline in court activity and a postponement of non-urgent bankruptcy proceedings, which could lead to an increase in the number of bankruptcies in the third quarter, with the return to regular court activity.
- In Australia, the PMI of the manufacturing sector increased in June, suggesting growth in the manufacturing sector. In addition, the business and consumer confidence indices rose in June, supporting the return of economic activity. Retail sales in Australia increased in May as economic activity returned after an extended economic shutdown, reaching 3.9% higher than the level recorded in February, prior to the coronavirus outbreak. This is mainly due to food sales, which were 14% higher in May compared to February.
- In Canada, the rise in the PMI of the manufacturing sector in May, coupled with the increase in the business and consumer confidence indices, indicates the beginning of a recovery of the economy and the return of economic activity. Housing rents in Canada are declining due to an increase in unemployment, particularly among the lower socio-economic segments of the population who are mostly renters; the drop in immigration; and the halt in tourism, which has reduced the demand for short-term rentals (Airbnb). This situation represents a major risk for housing prices, as these may also fall as a result of the decline in rental prices.
- The economic crisis has also hit the developing countries hard, with an emphasis on the emerging economies in Europe. However, for now these countries appear to have passed through the worst. Governments have eased the closures with the flattening of the coronavirus infection curve, and in some of the countries, economic activity has started to recover quickly. India, Pakistan, and Bangladesh have eased restrictions and closures even though the spread of the coronavirus has not slowed, since continuing their closures will cause unprecedented damage to the local economy. However, the early lifting of the closure accelerated the spread of the coronavirus in these countries, causing an unprecedented increase in the number of new daily infections, the number of active patients, and even the number of people who have died of the virus.

- The PMI of the manufacturing sector in European emerging economies rose in June, with the largest increases occurring in Russia and Turkey. The increase in the index stemmed mainly from the increase in output and new orders, with the lifting of closures. In addition, the supply chain disruptions have begun to open up, and the supply of goods is expected to return to normal operational capacity. In India, the PMI indices of both the manufacturing and services sectors have increased, marking the recovery of economic activity in India after the country's prolonged closure; but the recovery may be slow due to a halt in sustained economic activity.
- The damage to the South African economy is expected to be the most severe among the developing countries, excluding Latin America, due to the country's aggressive closure. With the lifting of the closure and easing in restrictions, the economy is expected to return to activity; however, the recovery is expected to be slow, as some of the factories have not returned to full operational activity due to some restrictions that still exist. South Africa's emergency plan significantly raised the country's debt burden. The IMF estimates that South Africa's government deficit is expected to increase to 14.8% of GDP in 2020, compared with a deficit of 6.3% of GDP at the end of 2019, and the debt/GDP ratio is expected to climb from 62.2% at the end of 2019 to 79.9% by the end of this year (see Chart 2). This is with much of the debt originating from domestic sources, thus carrying a high interest rate. An increase in the debt burden will make it increasingly difficult for the government to provide fiscal incentives and could significantly slow the recovery of the economy and heighten financial stability risks.





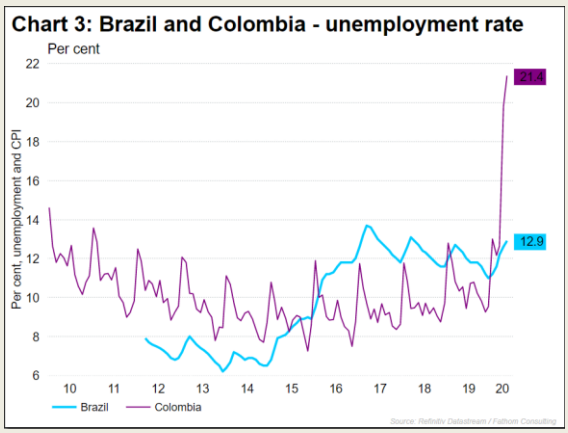
- The spread of the coronavirus in South America continues, and the IMF has further reduced its growth forecast for the Latin American economy for this year and 2021. According to the IMF estimate from June 2020, Latin American GDP will contract 9.4% this year, while in 2021 GDP is expected to grow 3.7%. Mexico is expected to absorb the largest hit to GDP this year among non - euro bloc countries, with an expected drop of 10.5%. Brazil's GDP is also expected to contract sharply this year, by 9.1%. This comes against the backdrop of a continued rise in the unemployment rate in May in most South American countries, while in Columbia the unemployment rate reached over 21% in May against the backdrop of an increase in the workforce participation rate, and in Brazil the unemployment rate equaled 12.9% (see Chart 3). However, at the same time, the workforce participation rate in Brazil declined as well, which "technically" reduces the official unemployment rate. The initial indicators for June show continued GDP contraction in Brazil and Mexico. However, in

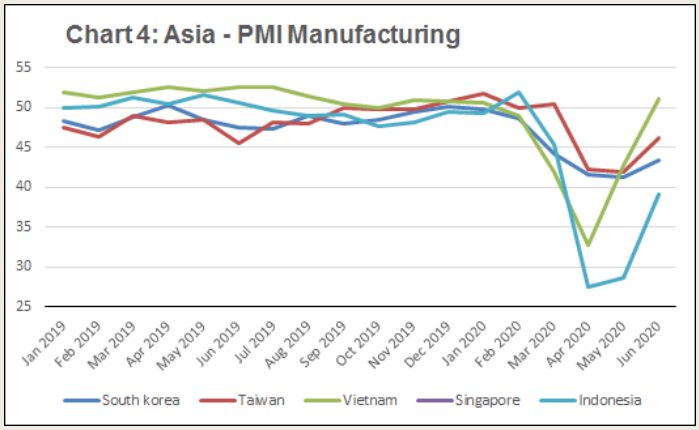
Brazil, the contraction is expected to be of a lesser degree than the contraction that occurred in April-May, and it is even possible the manufacturing sector may grow slightly.

- In contrast, Mexico's manufacturing sector is expected to contract this month by a similar rate to that in May. In addition, the IMF estimates that Latin America's deficit will reach 10.3% of GDP this year, and the debt/GDP ratio will climb to 81.5%; however, next year the deficit is expected to fall substantially, down to 4.8% of GDP, and debt/GDP is expected to decrease slightly to 79.7%. The most substantial deficit this year is expected to occur in Brazil, likely to reach 16.0% of GDP, the highest rate among developing countries, and at the same time Brazil's debt/GDP ratio is expected to increase to 102.3%. In Mexico, the deficit is expected to reach 6.0% of GDP this year, and the debt/GDP ratio is expected to reach 65.9%. These rates are very high and have not been seen in the last 20 years.
- The recovery in China's economy is mainly due to the recovery in domestic demand, while external demand remains low, even though it has started to recover. The PMI of the manufacturing sector increased in June, reaching its highest level since the beginning of the year, and indicates the growth of the manufacturing sector also in annual terms (y/y). Infrastructure construction by the state rose sharply in May, from 4.6% (y/y) to 11.6% (y/y) and increased industrial production from 3.9% (y/y) to 4.4% (y/y). Services sector growth became positive as well, suggesting that economic activity in May returned to a higher level than at year-end 2019, for the first time since the coronavirus outbreak. However, economic activity remained low compared to the same period last year (y/y). In addition, the application of China's "national security laws" in Hong Kong could result in sanctions on China and may later sever relations between some countries and China, which could make economic recovery more difficult. In our estimation, if the new virus outbreak in Beijing soon ceases and there will be no second wave of the spread of the coronavirus, and if sanctions are not imposed on China for the application of Hong Kong's national security laws, then economic activity by the end of the year is expected to be higher in annual terms (y/y).
- There is a very notable difference in the recoveries of emerging economies in Asia. Economic activity in Taiwan and Vietnam is back to normal, in South Korea and Singapore economic activity is still in the midst of recovery, and in the Philippines economic activity is at the beginning of recovery. However, in Bangladesh and Indonesia, the crisis is still underway. The PMI of the manufacturing sector indicates a continuing substantial contraction in Indonesia's manufacturing sector. However, in contrast, Vietnam's manufacturing sector is expected to increase in June (see Chart 4). This difference is mainly due to the different ways governments have dealt with the coronavirus outbreak, but also stems from the characteristics of the different economies. For example, in Taiwan, no full closure was ever imposed at any stage, so that economic activity continued relatively continuously. In addition, the strong electronics industry in Taiwan has also helped in the recovery of economic activity. Vietnam responded quickly to the spread of the virus and was able to curb the spread of the virus in the country, which helped it restore economic activity at an early stage. In South Korea as well, there was no total closure; however, the country was hit by a decline in external demand that severely damaged the automotive industry, which accounts for about 10% of its GDP. In Indonesia, the spread of the coronavirus is still continuing, making it more difficult to remove

restrictions and restore economic activity. Indonesia is apparently the country that has left the closure in place for the longest period.

- Looking ahead, according to the IMF estimates from June 2020, global GDP is expected to contract 4.9% in 2020, while in 2021 GDP is expected to increase 5.4%. The GDP of the advanced economics is expected to contract this year by 8.0%, but to rebound in 2021 with 4.8% growth, whereas the GDP of the developing countries is expected to contract 3.0% this year, with 5.9% growth expected in 2021. China is expected to be the sole country with positive GDP growth this year, and is expected to have the highest GDP growth in 2021. In addition, whereas the GDP in the developing countries of Asia is expected to contract 0.8% this year, and to grow 7.4% in 2021, the GDP in the developing countries of Europe is expected to contract 5.8% this year and to grow by 4.3% in 2021. In South Africa, GDP is expected to contract 8.0% this year, and to increase next year by only 3.5%.



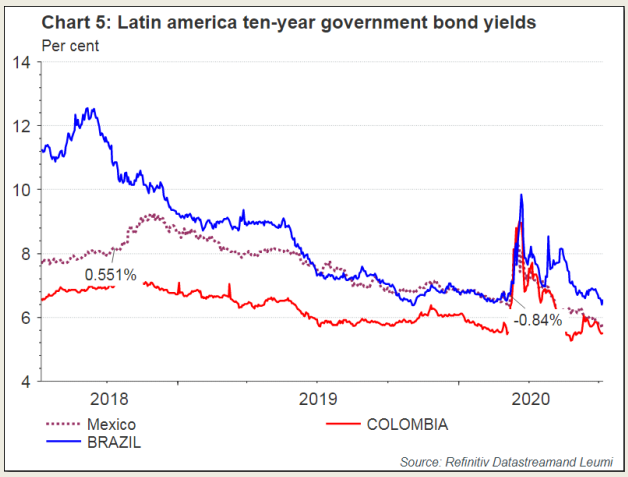


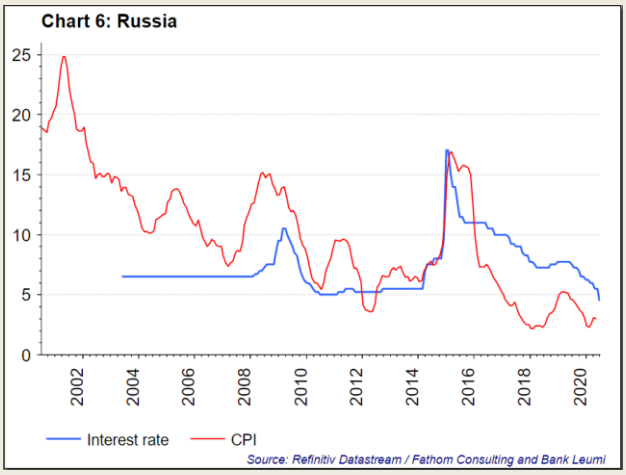
Inflation and monetary policy: the inflation rate in the developed countries is expected to increase, against the backdrop of the rise in energy prices; however, the core inflation rate in the developed countries continued to fall and is not expected to increase in the near term due to low local demand and high unemployment rates. The central bank of Japan increased loans to the market, and total support of the bank accounts for 19% of the debt of non-financial companies.

- The inflation rate in developed countries continued to decline in May, due to the fall in domestic demand stemming from social constraints as well as high unemployment rates. The inflation rate in the OECD fell in May from 0.9% to 0.7% (y/y) after the OECD inflation rate equaled 1.7% in March. The decline in the inflation rate was due to a decline in the energy component, which offset the rise in food prices, which was the highest since the end of 2011. The core inflation rate (excluding food and energy) in the OECD remained unchanged at 1.6% in May. In the euro bloc, the inflation rate rose slightly in June, but the core inflation rate continued to fall. In Canada, the inflation rate, which dropped to a negative level in April for the first time since the 2009 financial crisis, continued to fall in May, reaching -0.4%, despite rising energy prices. Housing rental inflation declined, due to low immigration and high unemployment rates, reducing domestic demand.
- Rising oil prices are expected to increase the rate of inflation in most developing countries in the coming month, even as prices of food and components of core inflation fall. As a result

of the expectations for a rise in inflation, along with the return of economic activity, the developing countries that have adopted expansionary monetary policies are not expected to continue monetary expansion in the coming month. Core inflation rates are expected to remain low in the near future, due to low demand and high unemployment rates in many countries.

- The spread of the coronavirus in Latin America has sharply raised yields of long-term government bonds in the large economies of South America. However, with the expansion of monetary policy and the large interest rate cuts, the yields of long-term government bonds fell to even below their pre-crisis levels (see chart 5). In Japan, the central bank expanded loans to support Japanese companies, and raised the maximum ceiling for purchasing corporate bonds, from ¥55tn to ¥90tn, so that the total market support of the central bank increased from ¥75tn to ¥110tn, accounting for approximately 19% of the debt of non-financial corporations. In our estimation, the central bank of Japan is not expected to cut its interest rate, which has equaled -0.1% since 2016, fearing the stability of the banking sector. Russia cut its interest rate 100bps to 4.50%, the lowest level since the breakup of the Soviet Union, in response to stronger than expected disinflationary pressures, and to stabilize the financial market (see Chart 6).
- US government bond purchases by the US Fed across the entire yield curve, coupled with market expectations that the Fed interest rate will remain at a near-zero level over time, stabilized the shorter end of the yield curve (2Y-3M), after it had flattened during April-May. The slope at the medium and long portions of the US yield curve (10Y-3M, 10Y-2Y) declined in June following the increase that occurred in April-May, reflecting the pessimism of the market in light of the continuing spread of the coronavirus in the US. In the euro bloc, the government bond yields of Italy and Greece continued to decline in May, after fears lessened over a default on the debt of these countries. French bond yields reached their lowest levels since mid-March, and remained at a negative level for most of the month.





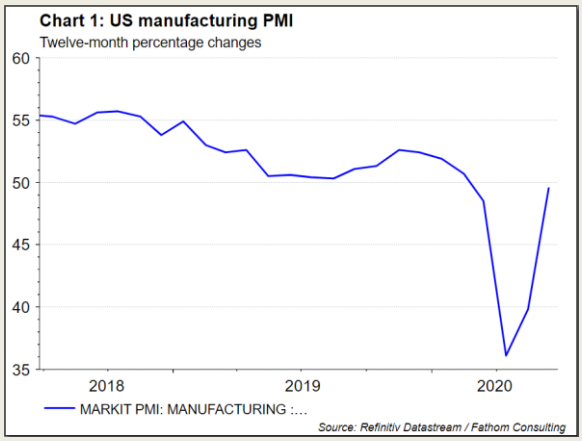
United States

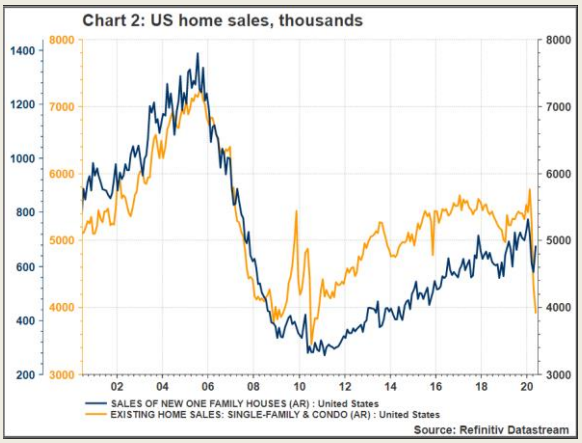
Economic activity: the US economic crisis is still underway, but initial signs of a recovery are beginning to emerge as private consumption increases and as the number of new unemployment claims moderates. The IMF lowered its 2020 and 2021 growth forecasts for the US economy and raised the expectation for the budget deficit and the public debt/GDP rate, which is expected to reach above 140% this year.

- June's data indicate a continuing moderation in the US economic crisis. The consumer confidence index continued to increase also in June, reaching 78.9 points after April's 71.8 points, an eight-year low, indicating a relative improvement in the condition of households. Furthermore, retail sales rose 17.7% (m/m) in May, the highest rate in the last 20 years, and were even higher than expected, after falling more than 14% in April. However, retail sales remain 8% below February levels. In addition, sales of durable goods increased 15.8% in May, against the backdrop of the return of aircraft production and an increase in vehicle orders. These data suggest the economy may gradually recover as the spread of the coronavirus slows in the US. In addition, the number of new unemployment claimants continues to decline, but is still very high, and we estimate the unemployment rate will remain in double-digits in the coming weeks.
- The coronavirus continues to spread throughout the US, and most of the infected persons remain active cases. From mid-June, the number of daily infections has been rising, and in seven states, in which more than half of the patients reside, the number of infections has crossed the 100,000 person threshold. With the expansion of large demonstrations in the US, there has been a fear of mass contagion among protesters who do not maintain social distancing.
- Against the backdrop of concerns over increased rates of infection that could cause an additional slowdown in the recovery of the economy, as well as against the backdrop of protests affecting the recovery of the economy, the IMF lowered its growth forecast for the US economy, for both this year and next. The IMF currently estimates the US economy is likely to contract 8.0% in 2020, while in 2021 the economy is expected to grow 4.5%, which is a lower forecast than that of April-2020.
- This forecast is similar to the OECD forecast, which expects that if a second wave of the coronavirus breaks out in the US, then the US economy is expected to contract 8.5% this year. In addition, the IMF estimates the government budget deficit will climb above 20% of GDP in 2020, and the public debt/GDP ratio is expected to rise from about 109% to over 140% in 2020.
- Early indicators for June show continued economic contraction, but by a more moderate pace that may mark the beginning of a recovery in economic activity. The composite PMI rose sharply in June from 37.0 to 46.8 (see Chart 1). The recovery occurred in both the manufacturing and service sectors, but in the manufacturing sector it was more substantial. The manufacturing survey of the Federal Reserve Bank of Philadelphia increased in June and is consistent with the recovery in economic activity in Philadelphia. Furthermore, the Empire

State Manufacturing Index (New York industry) survey also increased in June, after reaching an historic low in April.

- Residential construction starts increased 4.3% in May, after declining by double-digit rates in March and April. With the return of economic activity, new home sales rose 16% (m/m, see Chart 2) from the low reached in April; however, existing home sales fell 9.7% (m/m) in May. In our estimation, with the recovery of the economic situation and against the backdrop of low mortgage interest rates, sales of previously owned homes are expected to rise. However, the large stock of existing housing, coupled with the tightening of mortgage conditions and the high unemployment rate, may make a recovery in home sales difficult.
- Looking ahead, as noted earlier, the IMF estimate, updated in June 2020, calls for an 8% contraction in GDP growth in 2020, while in 2021 the US economy is expected to grow 4.5%. This means the GDP's return to its pre-coronavirus crisis level will not occur before 2022. Regarding the short-term, in our opinion, GDP is expected to contract 30% (q/q) in the second quarter, against the backdrop of a decline of more than 20% in private consumption, and the unemployment rate is expected to remain above 10%.

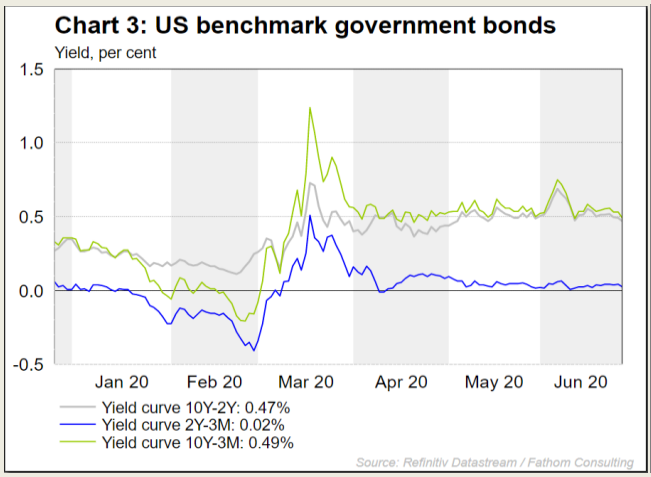


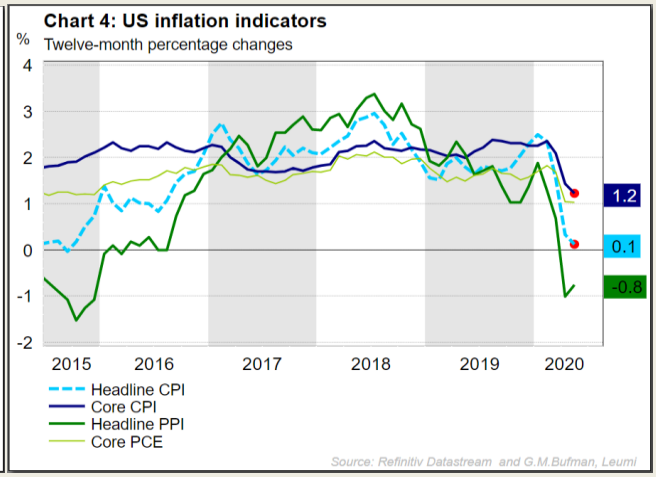


Inflation and monetary policy: purchases of government bonds by the Fed are expected to continue in the coming months, at least at the current pace. According to the Fed chairman, the economy is not expected to fully recover before the public will be certain that the spread of the coronavirus has been brought fully under control. The consumer price index (CPI) declined slightly in May, following the largest drop in the last nine years in April.

- In his half-yearly speech to Congress, the Fed chairman, Jerome Powell, emphasized the Fed's commitment to supporting the economy through the instruments at the Fed's disposal, including a new loans program. In addition, Powell said the Fed purchases will continue in order to also support the US labor market, and not only in order to maintain liquidity in the financial market. However, he noted his support for direct fiscal support from lawmakers, which could lead to an expansion in fiscal support. In addition, the Fed chairman said a full recovery of the economy is not expected until the public is confident that the spread of the coronavirus has been brought under control, and he is concerned about the long-term impact of the loss of human capital and the closure of businesses on the US economy.

- Chairman Powell said bond and MBS purchases will continue in the coming months at least at the current pace, but he did not mention other tools the Fed is considering using, such as fixing government bond yields (YCC or YCT). In our view, even if the Fed does not explicitly set targets for government bond yields, it is unlikely to allow them to move substantially away from current levels, while maintaining low and medium-term yield levels, which is a clear message to the market. The FED began in the middle of June the purchases of the concern bond as part of its SMCCF program. In addition, the FED increased the rate on its open market operations (OMO) in the primary and secondary market, and the rate on overnight operation is IOER+5bp, while the rate on the 1M operations are IOER+10bp.
- The slope at the shorter end of the yield curve (3M-2Y) remains stable after flattening completely during April-May due to government bond purchases by the Fed across the entire yield curve (see Chart 3), and in view of market expectations that the Fed's interest rate will remain at near-zero levels over time. However, the slope of the medium- and long-term portions of the yield curve (3M-10Y, 2Y-10Y), which rose in April and May, declined somewhat during June. This situation appears to reflect an increase in pessimism regarding the state of the US economy during June in light of the resurgence in virus infections.
- The consumer price index (CPI) for May declined 0.2 percentage points, down to 0.1% (y/y, see Chart 4). This follows the sharp decline of 1.2% in the inflation rate (y/y) in April, the largest decline in the CPI in the last nine years. The bulk of the decline in May's inflation rate stems from the continuing decline in prices in the tourism and travel sectors, and particularly in the airline sector and in automobile insurance.
- The core CPI declined as well by 0.2 percentage points, as the core inflation rate reached 1.2%. The core index of the PCE declined in May very slightly, from 1.04% to 1.02%, since this index is less affected by the fall in prices in sectors in which consumption fell, such as the tourism sector, because the index takes into account the frequent changes in consumption. This is in contrast to the CPI, in which the weightings in the index are adjusted only once a year. Looking ahead, with the return of economic activity and demand, inflation is not expected to continue to fall by a sharp rate as it fell in April. Against the backdrop of the expectations that the inflation rate will remain deeply below the Fed's inflation target rate, Fed policy is expected to remain accommodative, a situation that is expected to prevent additional sharp drops in the inflation rate.





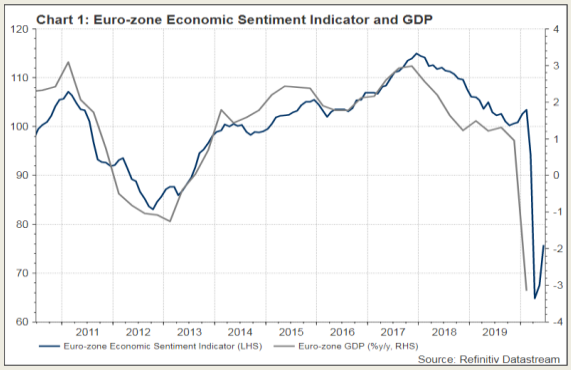
The Euro Bloc

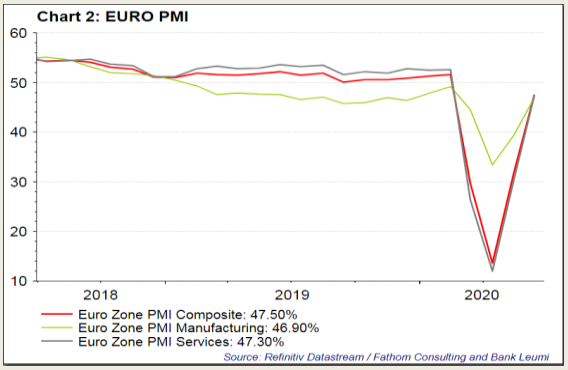
Economic activity: the IMF forecasts euro bloc GDP will contract 10.2% in 2020, while in the second quarter GDP is expected to decline by a double-digit rate, in quarterly terms. Economic activity continues to recover, with a very rapid recovery expected in France, and it is possible French GDP in June will actually increase in monthly terms.

- June data indicate a recovery in economic activity in the euro bloc. The Economic Sentiment Indicator (ESI) of the euro bloc increased in June from 67.5 to 75.7 (see Chart 1), the largest monthly increase, while the services sector index within the survey improved only slightly, as most accommodation services remained closed. The consumer confidence index rose in June from -18.8 to -14.4. The rise in the index reflects the improvement in the economic condition of households following the easing of closures that had been in place in many euro bloc countries. The initial indicators show that the euro bloc economy continued to recover in June. The composite PMI of the euro bloc rose during the month from 31.9 to 47.5 (see Chart 2) and indicates a small contraction in economic activity. The PMI of both the manufacturing and services sectors increased in June.
- Europe's economic activity is recovering faster than expected, but there are still vast differences between the countries. Consumers rushed back to spend, and in May the level of retail sales in Germany was above the level before the coronavirus outbreak.it appears that in the second quarter of 2020, Euro block GDP will decrease by 12.5% (Q/Q). even if the activity will stay at the current level, there will be a significant increase in GDP in the third quarter.
- Consumers may continue to compensate for lost shopping time and further reduce the savings by purchasing expensive durable good including cars. However, the consumption is not expected to continue to rise at such a fast rate over time. Household are going to be in the future with a lack of occupational security because short-term work plans are coming to end. Other demand components, including investment and net export, will be weaker than private consumption. Many companies will not perform large capital investment, because of the high uncertainty levels, and no matter how much support comes from economic policymakers. It is reasonable that tourism, which is very important for southern European countries, will not recover anytime soon. We mention that these forecasts assume that future outbreak of coronavirus will be localized and/or small enough not to significant damage recovery.
- The IMF further reduced its outlook for the euro bloc economy this year and currently expects GDP to contract 10.2%, but by 2021, euro bloc GDP is expected to increase 6.0%. According to the IMF, the deficit in the euro bloc is expected to reach 11.7% of GDP this year, and the public debt/GDP ratio is expected to reach 105.1%. This comes against the backdrop of the severe damage caused by the coronavirus in Italy and Spain, which have succeeded to significantly reduce the number of new infections, and also against the backdrop of the continued spread of the coronavirus in other countries within the euro bloc, and concerns regarding a second wave.
- In Germany, the number of new patients increased from mid-June, relative to the number of daily new patients from the last week of May to mid-June. In France, the number of active cases has been on the rise since the end of May, after it had been in a downward trend since

mid-April. In Greece, the number of virus infections has been on a linear upward trend since mid-April, yet the total number of cases is still relatively low, and the number of active cases has been in an upward trend since early May, after the numbers had declined in late April.

- As per a country breakdown, the IMF expects the deficit to be deeper than expected at the beginning of the quarter. In Spain, the deficit in terms of GDP is expected to reach 13.9%, in France to 13.6%, in Italy to 12.7%, and in Germany to 10.7%. These high deficit rates have not been seen in the last 25 years. The initial indicators show that Germany and France continue to recover following the government imposed closure and the halt in economic activity. The recovery of the French economy is substantially stronger and the initial indicators show that French GDP is expected to grow in June in both the manufacturing and service sectors, in contrast to Germany's GDP, which is expected to contract slightly in June. The rapid growth in France's GDP stems from the fact that France lifted its closure relatively quickly, thus enabling the return of economic activity. The composite PMI of France increased from 32.1 to 51.3 in June, and Germany's composite PMI rose from 32.3 to 45.8 in June. In addition, the IFO index of business sentiment in Germany increased in June from 79.7 to 86.2, and reflects a continuing recovery in the German economy.
- Italy, which was severely affected by the spread of the coronavirus, began to ease restrictions and restore economic activity. The halt in economic activity led to a fall in the workforce participation rate in March-April, which caused a technical decline in the unemployment rate from 9.1% in February to 6.3% in April. With economic activity restored, people are expected to return to the workforce, which may paradoxically raise the official unemployment rate due to the recovery of the economy. In Sweden, unemployment is currently at the peak of the global crisis, reaching 9%, despite a 1% drop in the workforce participation rate between February and April, and business sector sales have not shown any signs of recovery in May.
- Looking ahead, according to IMF estimates updated in June 2020, the euro bloc's GDP is projected to contract 10.2% this year, followed by 6.0% growth in 2021. When considering a series of scenarios presented by the ECB, it turns out that in each scenario GDP is expected to grow in the second half of the year, and GDP is also expected to increase in 2021-2022, although by a more moderate rate. However, according to the June forecast, only in the most optimistic scenario will GDP reach by year-end 2022 the same level the GDP was at in 2019, while according to the other scenarios (which are more pessimistic), GDP at the end of 2022 will still be below the level in 2019. In our estimation, euro bloc GDP is expected to contract by more than 10% (q/q) in the second quarter, and recovery of private consumption in the euro bloc is expected to continue, if no second wave of the coronavirus breaks out.

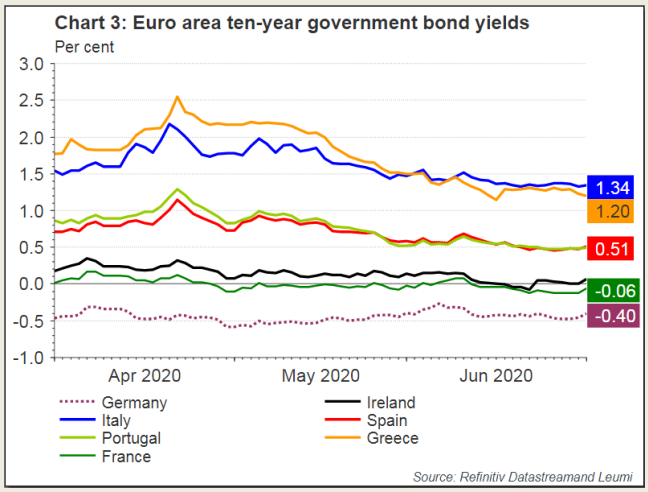


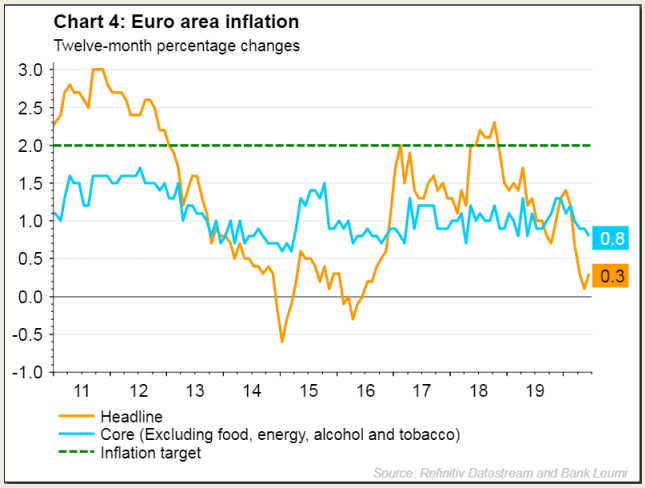


Inflation and monetary policy: the ECB presented evidence of the necessity of the emergency purchase plan after the German Supreme Court demanded it. Banking loans rose sharply, marking the success of the ECB's TLTRO lending program. The inflation rate rose faster than expected in June, but core inflation fell.

- A review of ECB protocols indicates the central bank tried to solve the dispute with Germany regarding the legality of the emergency procurement plan, PEPP. This is after the ECB increased the emergency purchase plan at the beginning of June by €600bn, such that total ECB purchases through this plan will amount to €1.35tn. The ECB also extended the duration in which it may purchase bonds to the end of June 2021, with additional bond purchases permitted through the profits received from the purchase program's plans until at least the end of 2022.
- The ECB meeting had broad consensus that all action that is required should be taken in order to maintain government bond yield spreads around their current level. There was also broad consensus that monetary policy easing was needed, but at the meeting, several views were expressed regarding the quantity and timing of bond purchases through the emergency purchase plan. In addition, the ECB used the protocols to provide evidence of the necessity of the emergency purchase plan, and it presented arguments for and against the emergency purchase plan. This, after the German Supreme Court (GCC) demanded that the ECB provide evidence that monetary policy is proportional to its response to the program's economic and fiscal policy effects.
- With the outbreak of the economic crisis resulting from the spread of the coronavirus in February across the euro bloc, bank lending rose sharply through the support of the ECB's TLTRO loan program, as well as through the support of government loan guarantees. The increase in bank loans implies that the government guarantees and the TLTRO program have achieved the desired effect. In our estimation, as economic activity returns, corporate revenues are likely to recover and cause companies to rely less on loans, which is expected to slow lending growth.
- The yield on long-term government bonds of the large euro bloc economies declined during June (see Chart 3). The largest declines were registered in the government bond yields of Italy and Greece, which have continued a downward trend since mid-March, after yields spiked at the beginning of the crisis due to concerns over the debt repayment of these countries, and these yields are approaching their pre-coronavirus levels. The long-term government bond yields of Ireland and Portugal also continued to decline during June, but these are further away from their pre-crisis yield levels. The yields on French government bonds reached their lowest levels since mid-March and remained in negative territory for most of the month.
- The inflation rate in the euro bloc (HICP) increased in June from 0.1% to 0.3% (y/y, see Chart 4). The rise in the inflation rate was faster than expected and was due to an increase in the energy component of the index. The impact of the closure across the euro bloc on food prices continues to moderate. This, after the closure caused supply chain problems and reduced food supply, together with an increase in demand, which caused food prices to rise.

- Core inflation (excluding energy, food, alcohol, and tobacco) fell in June from 0.9% to 0.8%, annualized, the lowest level in the past year. According to all ECB scenarios, inflation is expected to rise in 2021-2022, but is expected to remain below the inflation target at least until mid-2022. In our opinion, the inflation rate is expected to continue to decline due to the decline in local demand stemming from the rise in the unemployment rate and the damage to household income. Average core inflation in 2020 is expected to equal 0.5%.





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