Global Macroeconomic Monthly Review

September 2019

Dr. Gil Michael Bufman, Chief Economist

Yaniv Bar, Economist

Gili Ben-Avraham, Economist

Alon Kreis, Economist

Economics Department, Capital Markets Division

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Key Issues and Table of Contents

- *The indicators on activity in the third quarter of the year until now (July-August) show weak activity, with an emphasis on the industrial sectors and international trade.*
- *Risks to the growth forecasts remain high. Realization of one or more of the risks may lead to an increase in volatility in the financial markets.*
- *Inflation increased slightly in July, yet is likely to slightly moderate later.*
- *The trend of interest rate cuts by the main central banks around the world is continuing; however, it is doubtful if these measures will help, since currently active fiscal intervention is required on the part of governments around the world, a step that has not yet been taken.*
- *Expectations for a continued expansion in monetary policy, alongside moderation in growth and inflation rates, represent factors supporting a continuation in the moderate yield environment in the coming months.*

- *The apparent economic growth in the third quarter is relatively similar in its level and composition to that in the second quarter.*
- *In the coming quarters, growth is expected slow, given growing weakness in the manufacturing sector. However, the economy is not expected to slide into recession due to the continuing positive performance of the services sector.*
- *The Fed lowered the interest rate by 25bp, as expected, but it appears that the "door" has been left open for no more than one additional rate cut.*
- *The recent acceleration in core inflation, against the backdrop of strengthening wage pressures in the American economy, may restrain the pace of interest rate cuts by the Fed over the coming year.*
- *Bond yields increased over recent week and are expected to continue to climb if the Fed will indeed lower the interest rate by a more measured pace than that projected by the markets.*

- *Private consumption was weak and net exports had a negative contribution to growth in the second quarter.*
- *The data on activity and business surveys indicate a moderate growth rate also in the third quarter. The weakness in Germany is continuing.*
- *Inflation remained unchanged in August.*
- *The ECB presented a package of expansionary measures, including an interest rate cut and the renewal of quantitative expansion. The growth and inflation forecasts were revised downward.*
- *The establishment of a new government coalition in Italy contributed to a sharp decline in bond yields and in the spread vis-à-vis Germany.*

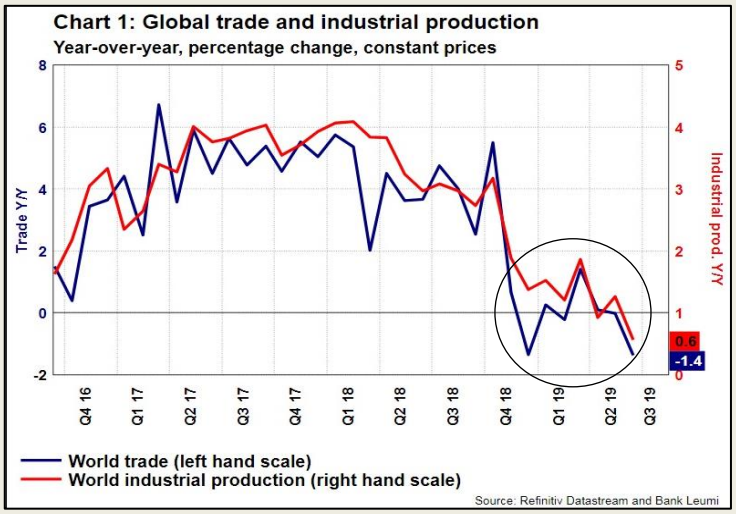
Leumi Global Economic Forecast, As of September 2019

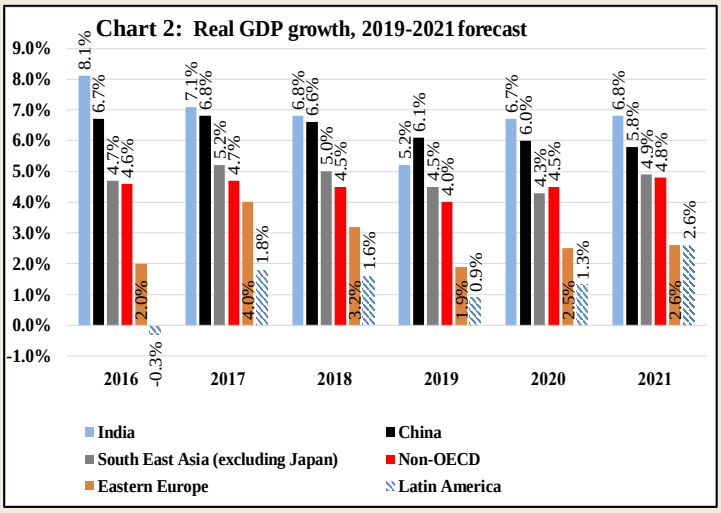
	2016	2017	2018	2019E	2020F
GDP – Real Growth Rate					
World	*3.3%*	*3.7%*	*3.5%*	*2.9%*	*3.2%*
USA	*1.6%*	*2.4%*	*2.9%*	*2.2%*	*1.6%*
UK	*1.8%*	*1.6%*	*1.3%*	*1.3%*	*1.3%*
Japan	*0.6%*	*1.9%*	*0.8%*	*1.0%*	*0.4%*
Eurozone	*1.9%*	*2.6%*	*1.9%*	*1.2%*	*1.3%*
South East Asia (ex. Japan)	*4.7%*	*5.2%*	*5.0%*	*4.5%*	*4.3%*
China	*6.7%*	*6.8%*	*6.6%*	*6.1%*	*6.0%*
India	*8.1%*	*7.1%*	*6.8%*	*5.2%*	*6.7%*
Latin America	*-0.3%*	*1.8%*	*1.6%*	*0.9%*	*1.3%*
Israel	*4.0%*	*3.6%*	*3.4%*	*3.0%*	*3.3%*
Trade Volume, Growth (%)					
Global	*2.1%*	*5.6%*	*3.9%*	*2.2%*	*2.8%*
CPI, Annual Average (%)					
USA	*1.3%*	*2.1%*	*2.4%*	*2.0%*	*1.6%*
UK	*0.7%*	*2.7%*	*2.5%*	*2.0%*	*2.1%*
Japan	*-0.1%*	*0.5%*	*1.0%*	*1.0%*	*1.3%*
Eurozone	*0.2%*	*1.5%*	*1.7%*	*1.3%*	*1.4%*
Israel	*-0.5%*	*0.2%*	*0.8%*	*0.8%*	*0.8%*
Interest rates, Year End					
US Fed	*0.50-0.75%*	*1.25-1.50%*	*2.25-2.50%*	*1.50-2.00%*	*1.50-2.25%*
Bank of England	*0.25%*	*0.50%*	*0.75%*	*0.50-1.25%*	*0.50-1.50%*
Bank of Japan-Policy Rate	*-0.10%*	*-0.10%*	*-0.10%*	*-0.10%*	*0.00%*
ECB-Main Refi	*0.00%*	*0.00%*	*0.00%*	*0.00%*	*0.00%*
Israel	*0.10%*	*0.10%*	*0.25%*	*0.25-0.50%*	*0.25-0.50%*

The Global Economy – The Big Picture

Economic activity and global forecasts (1): the indicators on activity in the third quarter of the year until now (July-August) show weakness in activity, with an emphasis on the industrial sectors and international trade. The risks to the growth forecasts remain high.

- The economic indicators point to a continuation in the weakening of global economic activity also during the third quarter of 2019, which is notable mainly in goods exports and industrial production. On this regard, we note that in June this year global industrial production and world trade volume declined (Figure 1). On the other hand, household demand remained strong, given the resilience of labor markets around the world, rising wages, and low interest rates.
- **Developed economies -** US and euro bloc economic developments are presented in detail in the following sections. As for Britain, the high degree of uncertainty surrounding Brexit continues to negatively affect economic activity in the UK, with industrial and construction activity declining and, at the same time, the rate of expansion in activity in the services sectors has lessened. Activity is expected to remain moderate until the fog dissipates with respect to Britain's exit from the EU. In Japan, growth figures for the second quarter of the year were revised downward from 1.8% (quarterly annualized change) to 1.3%, reflecting a more substantial moderation in the growth rate compared to the first quarter (2.2%). Domestic demand continues to be the main growth engine of the economy, while exports continue to demonstrate weakness, against the backdrop of trade wars around the world (mainly US-China, and the crisis with South Korea). Looking ahead, we forecast a moderation in the growth of developed countries during 2019 and a slow recovery in 2020-2021.
- **Emerging markets -** China's growth rate is expected to continue to moderate in the remainder of the year (details under next headline), a development that is expected to weigh on global economic activity, with an emphasis on EM countries. In addition, this is a substantial slowing factor, which may act to reduce global demand for commodities, including oil, and consequently this may moderate price rises. In India, After the RBI reduced the interest rate by 35bps to 5.40%, we expect two additional rate cuts to 4.90%. This is with the goal of encouraging economic activity and achieving the country's 4% inflation target. At the same time, economic data in most Asian countries continue to support the expansion of monetary policy in the near term. In Latin America, political risks across the continent remain high. Furthermore, most governments in the region have published their budget proposals for 2020, and from these proposals it can be seen that there are not enough resources to support economic activity. Looking forward, the growth rate is expected to be slightly higher in 2019-2022 than in recent years. This is due to, among other things, shifting Chinese demand in some of the trade categories – mainly agriculture – from the US to Latin American countries, such as Brazil and Argentina. Looking ahead, growth in EM countries is expected to slow slightly this year, with some variation between the various regions (Figure 2).



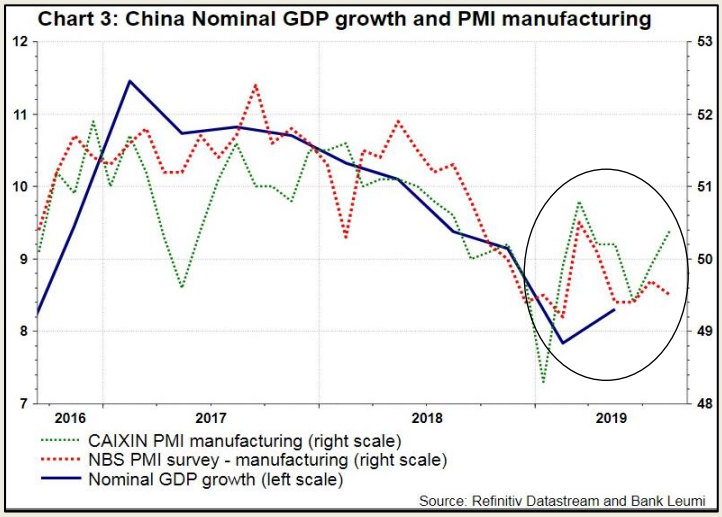


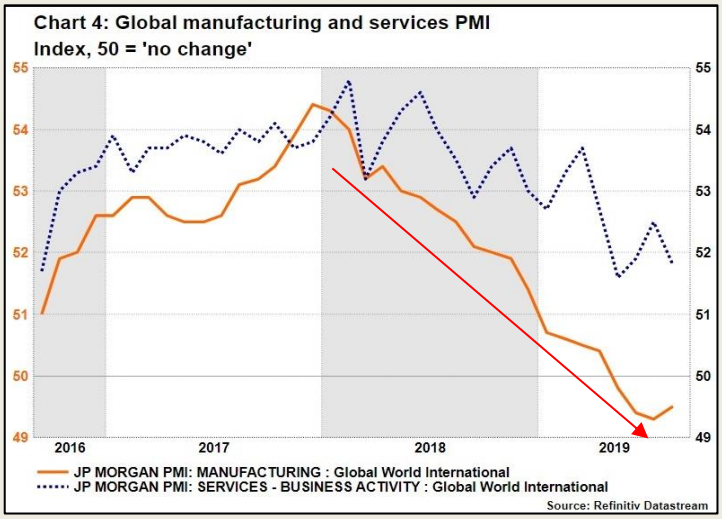
Economic activity and global forecasts (2): the indicators on activity in the third quarter of the year until now (July-August) show weakness in activity, with an emphasis on the industrial sectors and international trade. The risks to the growth forecasts remain high.

- According to most indicators, China's economic activity continued to weaken also in August. The annual growth rate of industrial manufacturing fell to a 17-year low (4.4%), monthly exports decreased alongside a decline in the annual growth rate (in dollar terms) into negative territory (minus 1% versus 3.3% in July), the producer price index fell into negative territory, and investments in fixed assets increased by a more moderate than expected rate (5.5%) and lower than in July. Furthermore, investments in the industrial sectors declined, and retail sales growth slowed compared to July. At the same time, the PMI of China's industrial sectors continues to show moderate activity, despite the increase in August (Figure 3). Looking ahead, China's economic activity appears to be slowing, with an emphasis on non-infrastructure construction sectors, which is expected to continue in the remainder of the year. This is despite the many steps being taken to expand fiscal and monetary policy and the depreciation in the currency, as a combination of factors involving a slowdown in growth, as well as an unresolved trade war, and a reduction in global demand, is expected to weigh on activity.
- The downward trend in the global purchasing managers index (PMI) of the industrial sectors somewhat halted in August. However, the index has remained below 50 points for four consecutive months (Figure 4), thus continuing to indicate a contraction in global industrial production. This development, which is a negative indicator of industrial activity in the third quarter of the year, characterizes more than half of the economies that compose the index. Countries that stand out negatively in the index include Germany, the Czech Republic, the euro bloc, and Japan. In parallel, in August the global PMI for the services sectors fell to 51.8 points, which indeed indicates an expansion in activity, but at a more moderate pace compared to previous months. This comes against the backdrop of, among other things, a decline in business confidence worldwide. The economies that stood out negatively on this front include Australia, the US, Brazil, and India; while the euro bloc, China, and Japan stood out

positively. In our estimation, the global growth rate is expected to moderate to 3.2% (average) in 2019-2020 compared to 3.5% in 2018.

- Risks to global economic activity remain high, and this appears to be the main factor affecting financial markets today. The trade war between the US and China continues to pose a major risk to global growth forecasts, despite some calm in recent days, with the president of the US, Donald Trump, announcing that the new tariffs on US$250bn worth of Chinese goods will be postponed by two weeks. At the same time, an additional round of talks is scheduled for the representatives of the two countries in the coming weeks, at which time attempts will be made to formulate an agreement. We estimate that the high tensions between the US and China are expected to continue in the coming months, and therefore the level of volatility in the financial markets is expected to remain high. In addition, the uncertainty surrounding Brexit remains intact, with a high probability for exit without an agreement (the scenario that has the most negative effects on the economy). At the same time, the UK prime minister, Boris Johnson, continues to declare he is pursuing an orderly exit on October 31 as scheduled. There are other political and geo-political risks, most notably: the acute political crisis in Hong Kong that has already begun to take a toll on the local economy, tensions in Japan-South Korea relations, tensions in India-Pakistan relations, tensions between the US and Iran, political risks in Latin America, tensions on the Korean Peninsula, tensions in the Middle East, and more.

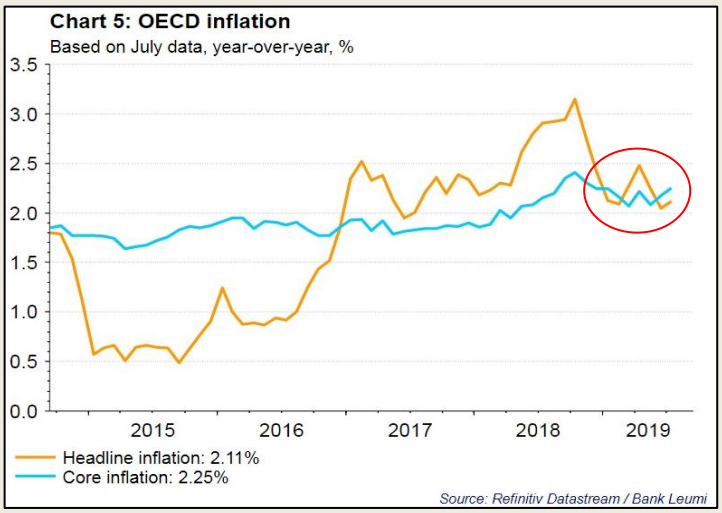


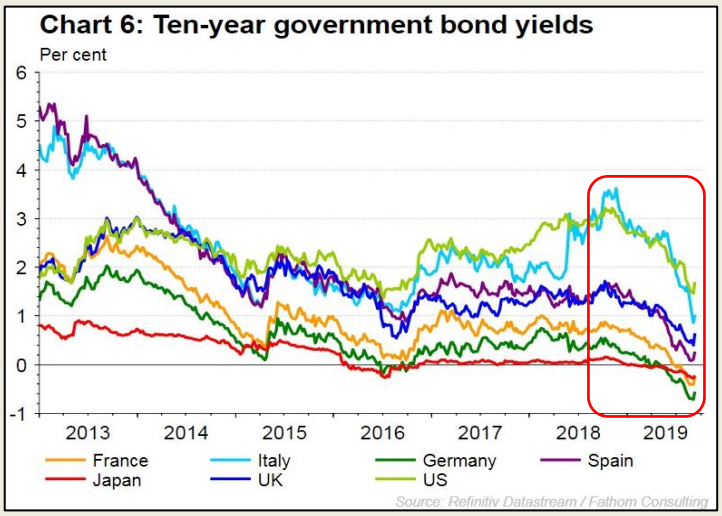


Inflation and monetary policy: inflation increased slightly in July, yet is likely to slightly moderate later. Expectations for a continued expansion in monetary policy, alongside moderation in growth and inflation rates, represent factors that support a continuation in the moderate yield environment in the coming months.

- In July, average inflation in OECD countries rose slightly to 2.1% from 2.0% in June (Figure 5). Among the large economies of the world, inflation increased in the US, Germany, and Britain. Meanwhile, inflation remained stable in Canada, and fell slightly in Italy, Japan, and France. The increase in inflation occurred despite a standstill in energy prices and a slowdown in the rate of increase in food prices. On this regard, we emphasize that oil prices have risen in recent days following the attack by armed unmanned aerial vehicles on Aramco's most important oil production facility in Saudi Arabia. This was the second attack within a number of months, highlighting the vulnerability of Saudi Arabia's oil infrastructure, and it lead to a reaction from financial markets. Looking ahead, we estimate oil prices are not expected to continue to climb in the short to immediate term, on the assumption that security incidents such as this will not change. Afterwards, in our estimation, a moderate and gradual decline in oil prices is expected due to relatively weak global demand, given the slowdown in global economic growth, also against the backdrop of a broad global supply of oil. Core inflation, which is inflation excluding food and energy prices, rose slightly to 2.3% in July, after it had stood at 2.2% in June. Looking ahead, weakening in the global growth environment, along with the decline in business sentiment, may have an impact involving moderation in core inflation. On the other hand, rising tariffs on global trade activity, alongside a tight labor market in most developed countries, are expected to limit the potential for moderation.
- Over the past month, further steps have been taken to expand monetary policy around the world, including an another interest rate cut by the FED and interest rate cut to a negative level by the ECB alongside a quantitative expansion program (see details in the euro bloc chapter), this in continuation of the trend that has occurred over recent years. This trend occurred against the backdrop of the difficulty in achieving price stability goals alongside weakness in real economic activity. However, it is doubtful whether these moves will help, as what is needed now is active budgetary intervention by governments around the world, and this is not yet being seen. Recently, the central bank of Indonesia reduced its interest rate 25bps, in line with expectations. A further 25bps reduction is expected in the fourth quarter of 2019 and during 2020, in order to bring the interest rate to 5.00%. Thailand's central bank lowered its interest rate by 25bps to 1.50% at its last meeting, sooner than expected. Trade wars and the global slowdown, along with the strength of the THB, are expected to bring another 25bps rate cut in the fourth quarter of 2019. In addition, following the recent interest rate cuts, further interest rate reductions are expected in Australia and New Zealand in the coming months, against the backdrop of slow growth due to trade wars and a downward revision in growth and inflation forecasts, as well as in Mexico. Furthermore, additional interest rate cuts were recorded in Chile (50bps to 2.00%), Iceland (25bps to 3.50%), Russia (25bps to 7.00%), and Turkey (325bps to a level of 16.50%). Monetary policy is expected to continue to be expansionary in Britain (0.75%), Japan (minus 0.10%), and China (4.35%), but no interest rate changes are expected in the near future.

- Government bond yields in most of the large developed economies have risen slightly recently, presumably due to expectations for a more expansionary move by the ECB, and thus there was a slight "correction" to the sharp decline from August. Yet, yields remain in a slump (Figure 6). Looking ahead, we estimate that the global macro environment continues to support low yields also in the coming months. This is mainly due to the slowdown in the global economy, with an emphasis on industrial activity; the trade war between the US and China, which is hurting economic sentiment; and in light of the expected continuation in the expansion in monetary policy.



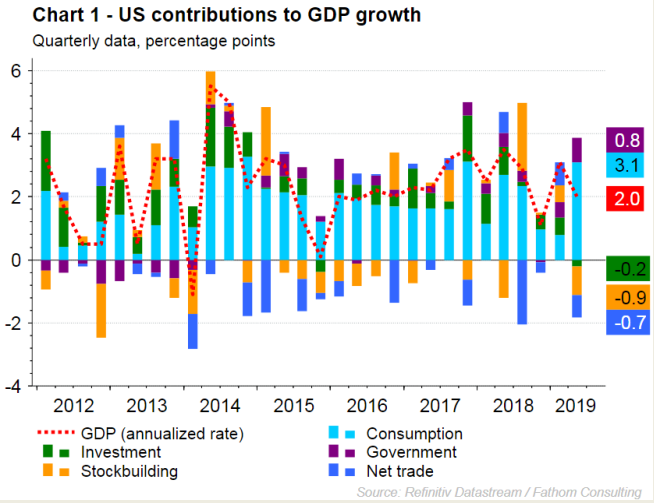


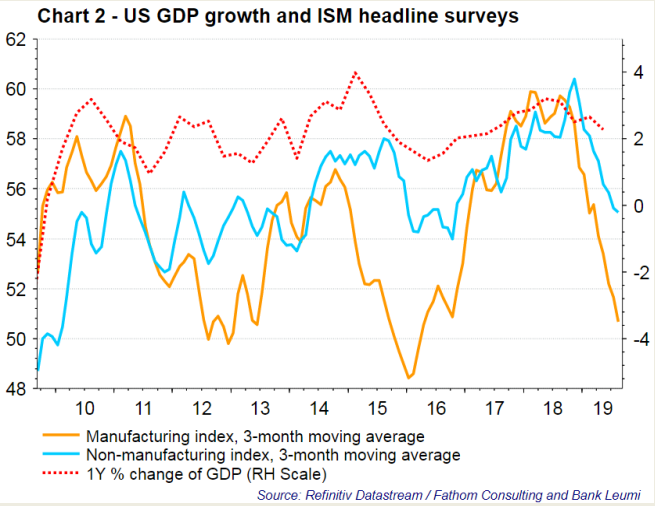
United States

Economic activity: the apparent economic growth in the third quarter is relatively similar in its level and composition to that in the second quarter. In the coming quarters, growth is expected to slow, given growing weakness in the manufacturing sector. However, the economy is not expected to slide into recession due to the better performance of the services sector.

- Current indicators of US economic activity in the third quarter show growth at a rate similar to that recorded in the second quarter (approximately 2% annualized) and with a similar composition of activity. Private consumption continues to expand at a healthy pace (over 3% on an annualized basis) and remains the main contributor to growth, as reflected in private spending and retail sales data. This development gives an indication of the strength of households and reflects the positive impact the low unemployment rate (3.7%) in the economy, as well as of the continued rise in the US stock market, have on household spending. Foreign trade, on the other hand, continues to weigh on growth, in light of a continuing substantial deficit in the trade balance (despite a slight improvement, apparently temporary, in July) and a reduction in the surplus in America's services balance.
- Third quarter investment data present a mixed picture so far. On one hand, investments in machinery and equipment continue to weaken (especially when neutralizing the recovery that occurred with orders from *Boeing*). This is in light of companies' concerns, particularly in the manufacturing sector, over whether or not to expand current activity, given the weakness in external demand and growing uncertainty resulting from the escalation in the trade war. On the other hand, in the residential construction sector, the latest data (investments, construction starts) indicate stabilization and possibly even a budding recovery. This may also be due to the recent decline in the US interest rate environment.
- Looking to the remainder of 2019 and into 2020, US economic activity is expected to continue to slow. This comes against the backdrop of, among other things, further moderation in external demand, as well as in light of the growing negative impact of the escalation in the trade war with China on the economy (particularly after the new wave of tariffs come into effect in September and December). However, at this time our expectation is for a slowdown and not a recession. Indeed, according to industry surveys, manufacturing sector activity may stop expanding in the next few quarters, and may even contract. However, the services sector, which is much larger in scope, appears to be in much better shape and is expected to continue to grow, albeit at a slower pace than in recent years (see Chart 2).
- A more substantial slowdown in the overall growth rate, to the point of recession, may occur if the weakness in the manufacturing sector begins to penetrate more significantly into the services sector, and to households as well. At the moment, there are only partial signs of this. For example, there has recently been some decline in the consumer sentiment indices (especially with regard to forward expectations), although these are still high. In addition, there has been a slowdown in job growth, including in the services sector, although the rate

remains reasonable (an average monthly increase of close to 150,000 jobs in the economy over the past six months).



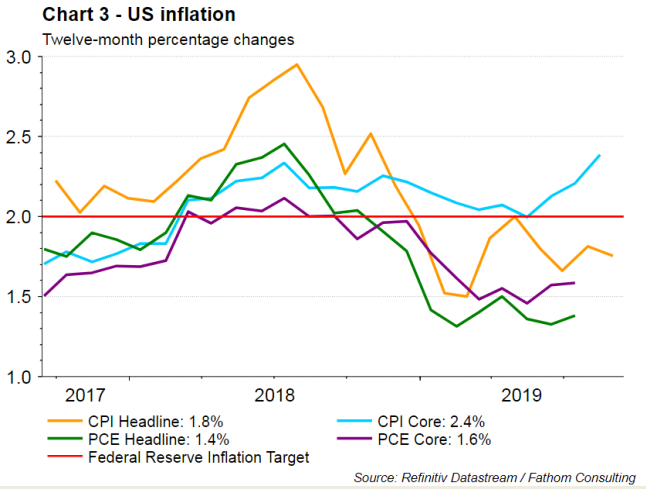


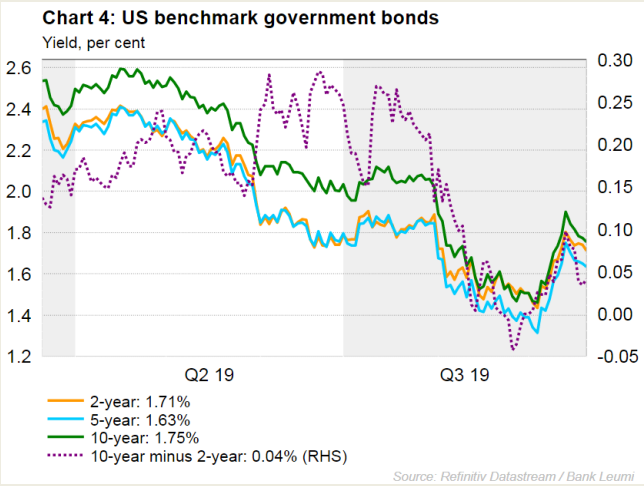
Inflation and monetary policy: the recent acceleration in core inflation, against the backdrop of strengthening wage pressures in the American economy, may restrain the pace of interest rate cuts by the Fed over the coming year. US treasury yields increased over recent weeks and are expected to continue to climb if the Fed indeed lowers the interest rate by a more measured pace than that projected by the markets.

- The acceleration in core inflation in the US continues, following the trend in recent months (see Chart 3). Core prices according to the Consumer Price Index (Core CPI) increased in August for the third consecutive month by a monthly rate of 0.3%. As a result, 3-month core inflation rose by 3.4% in annualized terms, the highest rate in 13 years, and during last 12 months, core inflation increased by 2.4%, an 11-year high. Core inflation according to private consumption prices (core PCE) remains relatively stable, but is expected to increase soon, mainly against the backdrop of increases in the services components within the index, as a result of rising wage costs in the US.
- Continuing from the above, analysis of the factors behind core inflation show that the main cause of the recent acceleration in prices is an increase in labor costs in the economy. This comes against the backdrop of the US labor market being at full employment. In contrast, the rise in tariffs on imports from China is currently having little effect on inflation. In the coming months core inflation may continue to increase, as the next round of tariffs on imports from China (implemented partly in September and partly in December) involves a much greater potential to impact inflation than the tariff hikes that have been implemented until now. In any case, the acceleration in core inflation could curb the pace of the Fed's interest rate cuts in the coming year, to a slower, more measured pace than market forecasts.
- At its meeting on September 17-18, the Fed, as expected, lowered the interest rate by 25bp to 1.75%-2.00%, in order to provide the economy with a "safety net", against the growing risks

to the economic outlook; and based on the Fed analysis, according to which the current inflation environment is still slightly lower than the price stability target (2.0%). Nevertheless, the decision wasn't unanimous, as two FOMC members voted for no rate change and one FOMC member voted for a 50bp cut. The FOMC members project stable economic growth in 2019-2021, at a pace of around 2% annually, and their median GDP growth projection for 2019 and 2021 is now even slightly higher than the June projection. The current FOMC interest rate projections cover a wide range, as seven FOMC members expect another 25bp cut by the end of 2019, with no additional cuts in 2020-2022, while five FOMC members expect one rate hike until year-end 2019. In our view, the "door" has been left open to just one additional rate cut, depending on the incoming data.

- US treasury yields have fallen sharply in recent months ("overreaction"), but since the publication of our last survey, yields have started to climb again (see Chart 4) and the yield differential between 10-year to maturity treasury and 2-year to maturity treasury has returned to being positive, after inverting slightly and temporarily during August. It appears the market has partially retreated from its "overreaction", in light of the fact that the macro data do not signal a recession soon in the American economy, but rather an expected slowdown in growth. In light of our expectation that the Fed will not lower interest rates at the pace projected currently by the markets (expectations for two and half rate cuts until the end of 2020), it appears an additional increase is expected in long-term yields in the coming months, to 2% on 10-year to maturity treasury.





The Euro zone

Economic activity and forecasts: private consumption was weak and net exports had a negative contribution to growth in the second quarter. The data on activity and business surveys indicate a moderate growth rate also in the third quarter. The weakness in Germany is continuing.

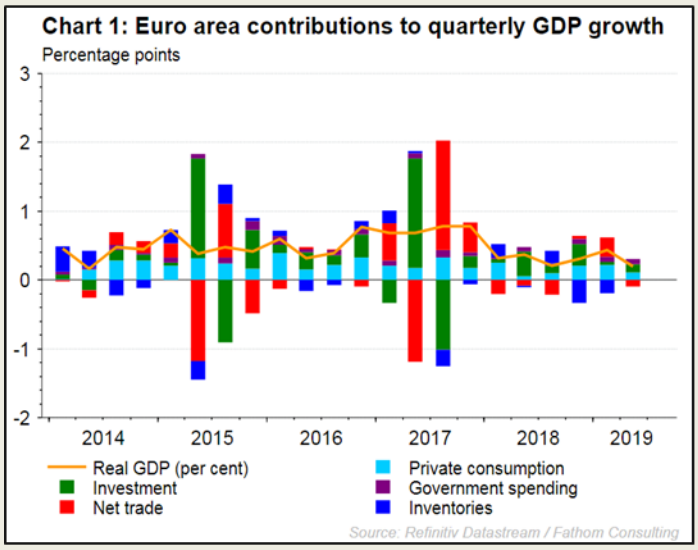
- The third and final estimate for the euro bloc GDP growth rate in the second quarter of 2019 remained at 0.2% (q/q), compared to 0.4% in the first quarter. The breakdown of contributions to growth by expenditure shows that unlike in the two preceding quarters, net exports contributed negatively to growth, and the growth rate of private consumption weakened (Figure 1). It is likely the weakening in private consumption stems from the slowdown in the rate of wage increases that have occurred in some of the major economies in the bloc, such as Italy and Germany. On the other hand, the contribution of investments to economic growth increased relative to the preceding quarter.
- The accumulation of data collected so far in the third quarter of 2019 indicates a moderate growth rate, similar to the preceding quarter. The data on July activity were weak, and various business surveys indicate continued weakness also in August:
  - Retail sales (accounting for approximately half of private consumption) in the euro bloc weakened in July, with an emphasis on Germany. This suggests a weak opening to private consumption in the third quarter. Also industrial production weakened in July compared to the previous month, highlighting the plight of industry in light of global weakness in the industrial sector, slowdowns in major economies, and growing uncertainty over global trade.
  - The European Council's ESI business survey for August rose moderately compared to July, but reflects only moderate growth, similar to the growth rate recorded in the second quarter of this year.

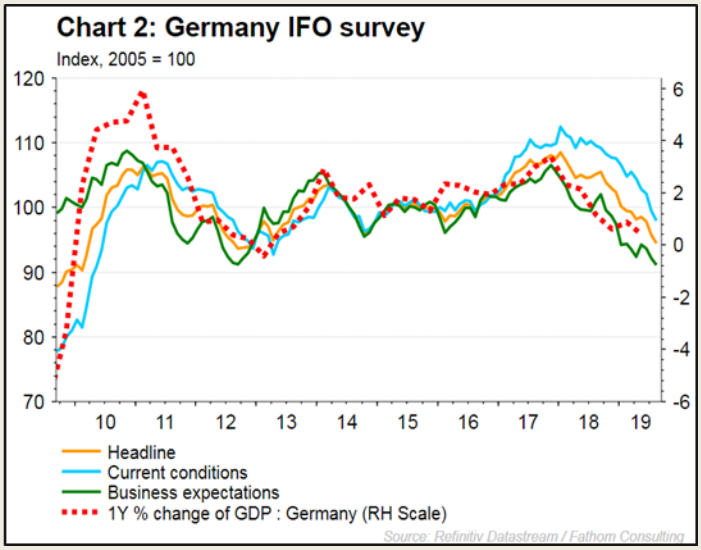
    Also the August PMI survey of the euro bloc increased compared to July, but so far, like the ESI survey, the average level of this survey in the third quarter correlates to a growth rate of 0.2% (q/q). At the national level, the PMI survey signals, at this stage, that growth in Italy and Germany will be the same as the preceding quarter, implying stagnation in Italy, and Germany's slide into recession with negative growth also in the third quarter of 2019.

    The two surveys mentioned above indicate expansion of activity in the services sectors, which compensates for the weakness in the industrial sectors and holds growth in the euro bloc in positive territory, thanks to the fact that these sectors are generally based on local demand. <u>However, looking ahead, the signs of a change in the trend in the labor market of major euro bloc economies, as reflected in the decline in firms hiring intentions, and a reduction in the impact of the shortage of workers on the activity of companies, suggest that employment growth will slow later this year. This development may also affect the services sectors.</u>

- In Germany, signs of another weak quarter are growing. Industrial production fell in July, mainly due to a decline in vehicle production, a sector of significant weight in German industry. Moreover, industrial orders fell in July to the lowest level since September 2016, due to a sharp decline in export orders, and reflect a sharp decline compared to the second quarter average of this year. In the same manner, the IFO survey declined also in August, following the sharp fall in July (Figure 2). In addition to industry's signs of weakness, which are not new, German retail sales dropped sharply in July. Recall that growth in private consumption in Germany in the second quarter was very low (0.1% q/q), which casts doubt on the ability of domestic demand to compensate for the weakness in industry and in export orders. However, it should be noted that ahead of the new date of Brexit (October 19), exports to Britain will rise as a one-off as British companies accumulate inventories, as occurred in the first quarter of the year, and will support exports to some extent. However, even if such an increase occurs, it is reasonable to assume it will be offset almost completely in the fourth quarter of the year with a sharp decline in exports to Britain.

  It is important to mention that the German economy is the most exposed in the euro zone to the realization of the main risks facing euro bloc activity, such as Brexit without a deal and the imposition of US tariffs on European vehicle imports. This is due to the portion of German exports to Britain (2.5% of GDP in 2018) and the portion of car exports to the US out of Germany's total car exports, which is the highest compared to all the other economies in Europe.

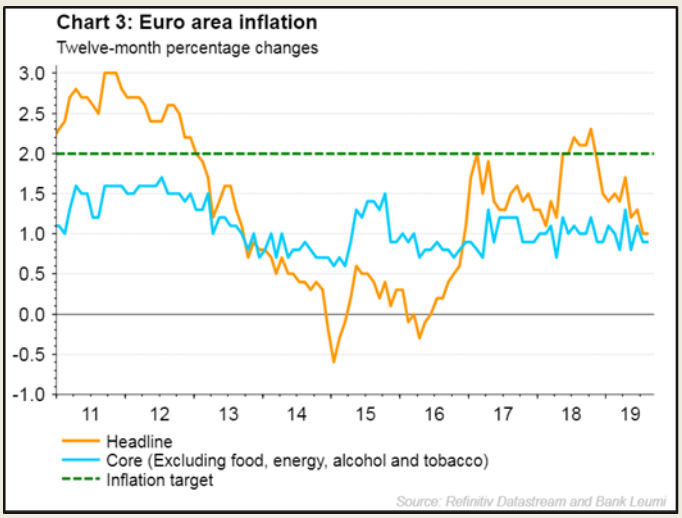


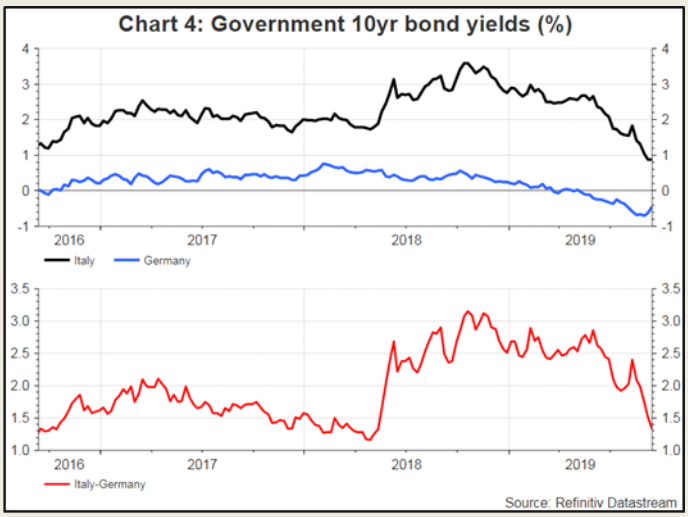


Inflation and monetary policy: inflation remained unchanged in August. The ECB presented a package of expansionary measures, including an interest rate cut and the renewal of quantitative easing. The growth and inflation forecasts were revised downward. The establishment of a new government coalition in Italy contributed to a sharp decline in bond yields and in the spread vis-à-vis Germany.

- The annual rates of inflation and core inflation remained unchanged in August, at 1.0% and 0.9% (Figure 3), respectively, according to the flash estimate. The rate of increase in energy prices has fallen sharply recently, but rising food prices have offset this, thus leaving inflation in place. Looking ahead, except for a temporary increase in inflation at the end of the year, based on a base effect in energy prices, inflation is expected to remain at around 1% over the next year.
- Given the marked disparity in inflation from the target and, thanks to weak data on euro bloc activity, as expected, the September interest rate decision presented a comprehensive package of expansionary measures. This package included, among other things, a 0.1 percentage point cut in the interest rate on the deposit facility to -0.5% and renewal of the quantitative easing (QE) program starting from November, when the monthly asset acquisition rate will equal 20bn euro. It should be noted that the rate of interest reduction and the value of asset purchases were somewhat below expectations. In addition, surprisingly, the ECB did not restrict asset purchases to a defined period, stating these would continue as long as needed, and would cease only near the same time as an interest rate hike by the bank. The wording of the forward guidance within the decision was changed and is not currently defined by time - *"The key ECB interest rates will remain at their present or lower levels until it has seen the inflation outlook robustly converge to a level sufficiently close to but below 2%"* (the phrase "at least through the first half of 2020" in the previous interest rate decision was exchanged). Furthermore, lenient measures have been issued to the banks that have somewhat reduced the costs arising from the negative interest rate on deposits, and the TLTRO terms have been eased while extending the program period.
- In the economic forecasts published jointly with the interest rate decision, both the growth forecast for 2019-2020 and the inflation forecast (against the backdrop of the downward revision in the growth forecast and also in energy prices) for the entire forecast period were lowered, with the forecast inflation rate, which reaches a maximum by 2021 (1.5%), still below the target. As part of the 2019 forecast update, the forecast for the second half of the year was revised downward (an average of 0.15%, instead of 0.35%), in line with the picture arising from business surveys and data on activity in the economy, and also against the backdrop of a substantial downward revision in the forecast on external demand. Looking ahead, in light of the structural issues weighing on growth in the euro bloc (the euro bloc's exposure to weakness in the global industrial sector, particularly German industry's exposure to external demand; the political situation and the rigid labor market in Italy; and more), it is doubtful whether the package described above will be sufficient to support the return of inflation to the target level.

- The establishment of the new government coalition in Italy, which includes the former coalition partner Five Star Movement (M5S) and until recently an opposition member the center-left Democratic Party (PD), has prevented early elections, at least for now. This move has been favorably received in the markets. The yield on Italian bonds has fallen to a multi-year low and the yield differential vis-à-vis Germany has fallen by almost 1% since the peak in early August (Figure 4). This apparently comes against the backdrop of the assumption that the new coalition will be able to pass the 2020 budget without any conflicts with the European Commission, and perhaps also in light of market assessments that the ECB will cut interest rates in September. This assumption seems highly likely, because the euro skeptic League party is currently not a coalition member, and because the European Commission also seems to have an incentive to facilitate the new coalition (sending a message that cooperation with the Commission is paying off; avoiding early elections does not benefit the League party, which is hostile to the Commission). It is important to emphasize, the two new coalition parties are actually historical political rivals, which may raise difficulties in their efforts toward cooperation over the long-term and also with respect to agreement on the government's political agenda, while it is also the case that Italian governments have a history of not reaching their full duration. In the meantime, the new coalition released a document of its intentions with dozens of points, among them the cancellation of the VAT rate hike that was planned for January 2020 and a tax cut for employers. The document does not address important structural reforms that would support the Italian economy. Thus, the bottom line is that the risk of confrontation with the European Commission has diminished, and especially in October, when the 2020 budget is transferred to the European Commission. However, a change in the country's weak economic activity is not expected.





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