

Global Macroeconomic Monthly Review

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September 2020

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- *US economic activity continues to recover in the third quarter, despite the continued spread of the coronavirus.*
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- *The rate of spread of the coronavirus across the US remains relatively high, but the pace has slowed and the number of daily new patients is in a downward trend.*
- *The chairman of the Fed announced the adoption of a flexible, multi-year average inflation target (average inflation target – AIT), instead of a specific inflation target that has been the custom until now.*
- *This announcement led to an additional increase in long-term inflation expectations and in the yields of long-term government bonds, as well as an increase in the slope at the longer and medium portions of the yield curve. However, this decision did not affect the shorter section of the yield curve.*

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- *Economic activity within the euro bloc has continued to recover in the third quarter, although by a slower pace due to the spread of the coronavirus.*
- *The spread of the coronavirus has accelerated recently in the larger economies of the euro bloc and the daily number of new infections is in an upward trend.*
- *In our opinion, the GDP is not expected to return to its level from 2019 before 2022.*
- *At the last meeting of the ECB, there was broad agreement among the committee members to maintain the current monetary policy.*
- *The spread between the yields of Italian and Spanish long-term government bonds and those of Germany and France narrowed.*
- *The consumer confidence index declined sharply to a negative rate of change, and core inflation registered a historic low.*

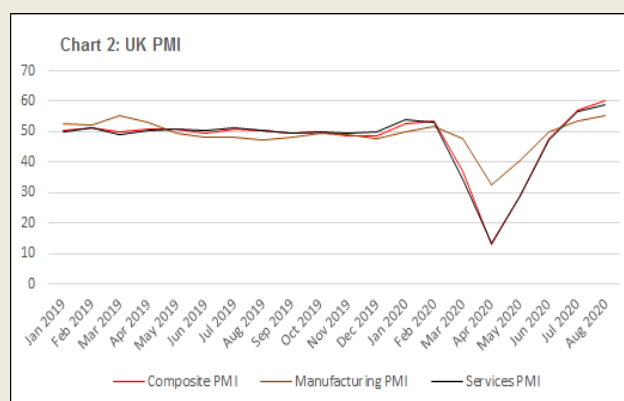
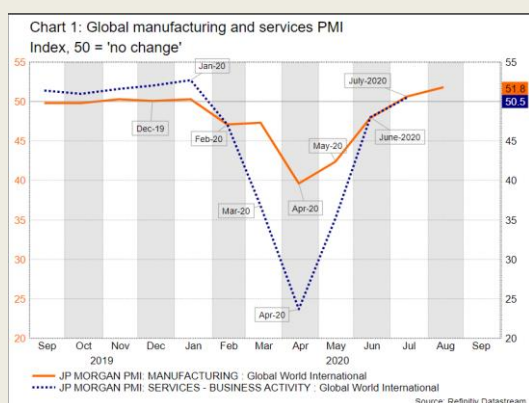
Leumi Global Economic Forecast, As of September 2020

	2017	2018	2019E	2020F	2021F
GDP – Real Growth Rate					
<i>World</i>	3.8%	3.4%	2.6%	-4.3%	4.9%
<i>USA</i>	2.4%	2.9%	2.3%	-5.3%	3.7%
<i>UK</i>	1.9%	1.3%	1.5%	-9.4%	6.9%
<i>Japan</i>	2.2%	0.3%	0.7%	-5.2%	1.7%
<i>Eurozone</i>	2.7%	1.8%	1.3%	-8.7%	5.5%
<i>South East Asia (ex. Japan)</i>	5.3%	5.1%	4.4%	-2.1%	4.5%
<i>China</i>	6.8%	6.6%	6.1%	1.7%	8.0%
<i>India</i>	7.0%	6.1%	4.2%	-8.5%	9.1%
<i>Latin America</i>	0.9%	0.7%	-0.6%	-8.2%	3.3%
<i>Israel</i>	3.6%	3.4%	3.5%	-5.5%	5.8%
Trade Volume, Growth (%)					
<i>Global</i>	5.8%	3.7%	0.9%	-18.3%	9.5%
Interest rates, Year End					
<i>US Fed</i>	1.25-1.50%	2.25-2.50%	1.50%-1.75%	0.00-0.25%	0.00-0.25%
<i>Bank of England</i>	0.50%	0.75%	0.75%	0.1%	0.1 %
<i>Bank of Japan-Policy Rate</i>	-0.04%	-0.07%	0.0%	-0.1%	0.0%
<i>ECB-Main Refi</i>	0.00%	0.00%	0.00%	0.00%	0.5%
<i>Israel</i>	0.10%	0.25%	0.25%	0.00-0.25%	0.00-0.25%

The Global Economy – Overview

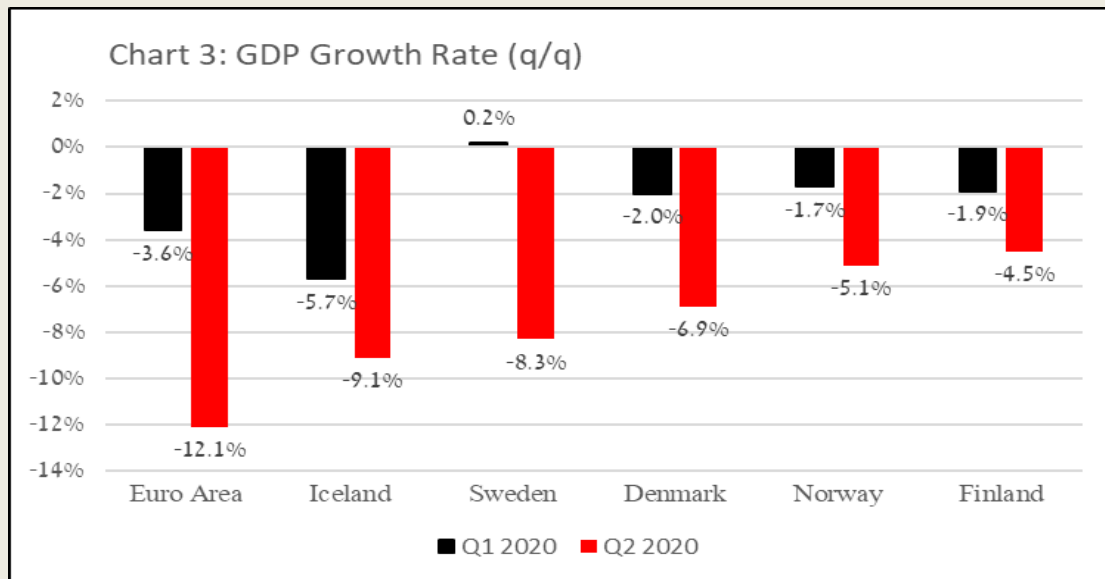
Economic activity: global economic activity continues to recover and global trade increased in June. The preliminary indicators show a continuing recovery in the developed economies and in some of the developing economies, while the growth in China has slowed.

- Global economic activity continues to recover despite a continued increase in morbidity resulting from coronavirus infections. The recovery in global economic activity has prompted a recovery in world trade, which increased 7.6% in June (m/m), the highest monthly increase. The recovery in the exports of South America was the most significant. Exports from the US and the euro bloc recovered as well and increased in June by 9.4% and 18.8% (m/m), respectively; however, exports remain below their pre-coronavirus levels.
- We expect exports to continue to recover as long as there will be no lockdowns or new restrictions. The challenge of halting the spread of the coronavirus is expected to intensify, against the backdrop of the return of students to schools in a large number of countries. This situation demands tighter supervision over the spread of the virus, and local restrictions may even be implemented in areas in which there are substantial infection rates. However, a consensus exists regarding the weighty economic price of a general lockdown, and thus there is great importance in avoiding such a measure.
- The preliminary indicators for the third quarter show a continuing recovery in global economic activity. The PMI of the global industrial manufacturing sector increased in August from 50.6 to 51.8 points, showing continuing industrial growth (see Chart 1). The growth in economic activity is continuing in the large economies; however, in some of these countries the growth rate is moderating, primarily in the services sectors, due to the renewed rise in the rate of spread of the coronavirus. Retail sales increased in June in most of the large economies, with the exception of Germany, despite the substantial rise in sales registered in May following the April low that stemmed from the cessation in economic activity, which indicates the continued return of economic activity.
- In the US and Britain, retail sales increased also in July, albeit by much lower rates than the increase registered in the two preceding months. In contrast, in Holland and Germany retail sales declined in July, while in Germany this was the second consecutive month of decline in retail sales.
- In Britain, the PMI increased in August from 57.0 to 60.3 points (see Chart 2), indicating strong growth, both in the industrial and in the services sectors. Meanwhile, the growth of



the services sector, which has suffered the most damage during the current crisis, is expected to be stronger. The strong growth of the services sector is supported by the government assistance to restaurants through the "Eat Out to Help Out" plan that encourages people to eat at restaurants, and also through the lowering of the VAT rate on hospitality and tourism services. The employment component in the index indicates the labor market remains weak and that it is expected to continue to contract. This development signals that the growth in economic activity has not yet trickled down to the labor market, and this growth is not preventing employers from continuing to dismiss employees.

- In Australia, the PMI of industrial manufacturing declined in August to below 50 points, thus indicating contraction in the sector, against the backdrop of the closure imposed on Victoria, Australia's second-most populated state, where 23% of the country's residents reside. In addition, the consumer confidence index fell sharply in July-August, indicating the concern of households with respect to the spread of the second wave of the coronavirus, which has actually reached a higher peak during the third quarter than that registered in the first wave.
- The Canadian government announced an extension to its Canada Emergency Response Benefit (CERB) plan, which supports residents who have been economically hurt as a result of the coronavirus, by four additional weeks, through the end of September. Following this, the government will launch a new plan covering employment insurance for the unemployed. There are a number of differences between the employment insurance and the CERB plans, with the main difference involving a reduction in the weekly benefit from CA\$500 to CA\$400; furthermore, unemployed persons will be required to prove they are seeking employment in order to be eligible to receive payments. The government expects this plan to bring the total direct expenditures declared for dealing with the current crisis to a sum equal to 11.5% of GDP.
- The Scandinavian countries suffered substantially less from the current crisis than the other member countries of the euro bloc. This is due to their moderate response to the spread of the virus, the structure of the economies of these countries, the small weighting of the sectors that were hurt in the crisis in relation to their overall economies, and the government support for economic activity. Whereas the GDP of the euro bloc contracted in the first quarter of the year by 3.6% (q/q) and in the second quarter by 12.1% (q/q), the GDP of Denmark, Norway, Finland, and Sweden contracted by relatively low rates (see Chart 3). The ETI index for the analysis of economic trends in Sweden increased in August and now indicates that the recovery in economic activity is expected to continue in the third quarter.
- The GDP of Japan declined 7.8% in the second quarter (q/q). This is the third consecutive quarterly decline, and output has dropped by a cumulative 10.0% since the peak prior to the hike in the purchase tax back in October. In an analysis of the first half of 2020, it appears Japan suffered from the crisis by a lesser degree compared to other large economies. The GDP of Japan declined like in Sweden in the last quarter. This occurred as both Sweden and Japan implemented relatively few restrictions on economic activity at the peak of the pandemic.



- Japan's foreign trade continued to climb in July and it contributed to the recovery in economic activity. The composite PMI of August remained unchanged at a level of 44.9 points, indicating that the spread of the second wave of the coronavirus, which is more severe than the first wave, is weighing on the economy's recovery. The PMI of the industrial manufacturing sector increased slightly, but still indicates a contraction in economic activity in the industrial sectors. The minimal decline in the PMI of the services sectors indicates a continued contraction of the sectors, reflecting the new restrictions imposed on dining activities and transportation.
- The prime minister of Japan, Shinzo Abe, announced his intention to resign from his position in the near term due to medical reasons. In our opinion, the new government is not expected to bring about substantial changes in the current fiscal policy framework. This is because his potential successor supports continued fiscal expansion in order to support acceleration of the low demand in the economy. We forecast the Japanese economy will recover at a much faster pace than other advanced economies. This situation reflects the strength of the balance sheets of Japanese corporations, the extensive government guarantees for credit, and the country's low reliance on tourism.
- Economic recovery is continuing also in the developing countries. The PMI of the developing countries increased in August to the highest level in the last nine years, indicating a continuing acceleration in economic activity. However, differences exist in the recoveries among the various developing countries. The PMI of the industrial sectors in the Philippines, Vietnam, and Columbia declined in July – August, indicating a slowdown in the recovery of industrial manufacturing in Columbia and a continuing contraction in the industrial sectors of the Philippines and Vietnam.
- In China, the July data indicate that the recovery in economic activity continued in the beginning of the third quarter, albeit by a slower rate. The growth rate of industrial manufacturing remained unchanged in July at a rate of 4.8% (y/y). The growth rate of retail sales became slightly less negative in July, improving from -1.8% (y/y) to -1.1% (y/y), but the growth rate was below the forecasts that called for this figure to be higher than the level from the parallel period of last year. This is apparently due to the labor market, which is still

weak with an unemployment rate that remains unchanged at a level of 5.7%. The PMI for August indicates continuing growth in the industrial sector, at a slightly higher rate. In our opinion, until the end of the year China's GDP will reach a higher level than that registered in 2019.

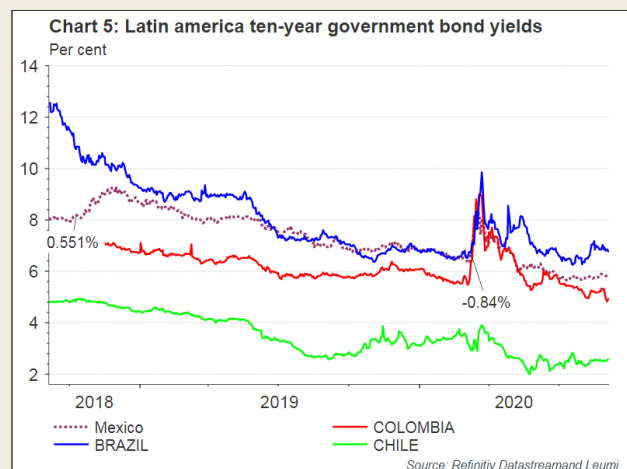
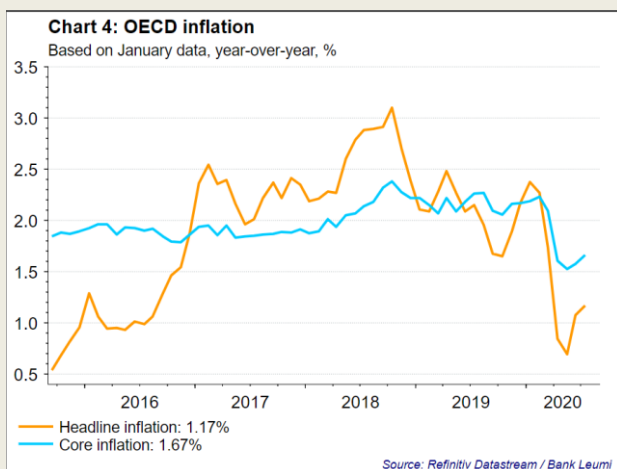
- India's trade balance returned to a deficit in July, after it had been in surplus in June for the first time in 20 years, and it had even reached an historic peak. However, its low level hints that external demand remains weak. Goods exports in July declined 10% (y/y), in contrast to other countries in Asia such as China and Pakistan, the exports of which increased in annualized terms. Domestic demand remained weak as well and imports, excluding oil and gold, were lower in July by 30% (y/y), after in June imports were 40% lower (y/y).
- Looking ahead, economic growth is expected to continue despite the spread of the coronavirus, which weighs on activity in the economy, and against the backdrop of the return of students to schools that is likely to accelerate its spread. In our opinion, global GDP is expected to contract 4.3% in 2020, and in 2021 it is expected to grow 4.9%. The GDP of OECD member countries is expected to contract 6.2% this year and to increase 4.0% in 2021. The GDP of Latin America is expected to contract 8.2% in 2020 and to increase 3.3% in 2021. China is expected to be the sole country to conclude 2020 with a positive growth rate, and in our opinion the country's GDP is expected to increase 1.7% for the year.

Inflation and monetary policy: inflation in the developed countries increased in July, but in August the inflation rate in the euro bloc fell to a negative level. The central bank of Australia is concerned about dis-inflationary pressures after the inflation rate fell in the second quarter into negative territory. In Mexico, the central bank cut the interest rate in August, and additional monetary easing is likely, albeit at a slower pace.

- Inflation in the developed countries increased in July. The inflation rate in the OECD increased in July from 1.1% to 1.2% in annualized terms, while core inflation in the OECD, excluding food and energy, increased from 1.6% to 1.7% (see Chart 4). Inflation in the euro bloc (HICP) declined in August, reaching a negative rate of -0.2% in annualized terms, due to a fall in clothing prices and a cut in the VAT rate in Germany in July. Core inflation fell in August from 1.2% to 0.4%, after in July it had increased by a sharp rate of 0.4%. The level indicates low local demand.
- The US Fed decided to adopt policy of a flexible inflation target, calculated as a multi-year average, thus allowing the inflation rate to climb in the future slightly above 2% for some period without the Fed taking steps to rein in inflation. This will apply if the rise in the inflation rate will occur following a period of low interest rates as has been the case in recent years in which most of the time the US inflation rate was below the 2% target. The ECB did not signal a similar intention to change its policy (although it is in a process of analyzing such a move) and for the moment, it is leaving the euro bloc inflation target at a low level "slightly below 2%." This inflexible target is expected to prevent the inflation rate of the euro bloc from climbing in the future to a rate higher than 2%.
- In Australia, the August protocols indicate the central bank is concerned about the impact of the high unemployment rate in the economy and it is tending to continue to ease monetary

policy against the backdrop of its assessment that the unemployment rate will remain high in the near term and will create dis-inflationary pressures. This follows the second quarter during which time the annual inflation rate fell sharply to a negative level of -0.3%, after the first quarter annual inflation rate had equaled 2.2%.

- In Mexico, the central bank cut its interest rate 50bps in August to 4.50%. The interest rate decision was accompanied by a moderate statement hinting that additional monetary easing is likely, albeit at a slower pace. The rate cut occurred despite the increase in the inflation rate, which reached in July an annual rate of 3.6%, while core inflation also increased in July, to 3.9% (y/y). The central bank believes inflation is expected to remain during the next 12-24 months close to 3% in annualized terms, which happens to be the inflation target for the medium-term. The interest rate cut came after the GDP of Mexico contracted in the second quarter by a sharp rate of 17.1% (q/q); however, since then economic activity has started to recover.
- US long-term government bond yields increased, following the Fed chairman's statement on a policy change that could lead to an increase in the inflation rate above 2% in the future. This increase also led to a rise in the medium and long portions of the yield curve in the US (3M-10Y, 2Y-10Y, 5Y-10Y). The rise in the slope of the US yield curve is consistent with the fall in aggregate savings there, due to the large fiscal deficit, this at a time in which real investment declines were moderate. In the euro bloc, 10-year government bond yields in the large economies fell following the meeting of ECB members in mid-July, yet in the last week of August yields climbed once again. In Brazil, long-term bond yields increased in the first half of August, after having been in a downward trend since mid-May; however, in the second half of August the increase halted and yields even fell slightly (see Chart 5). This comes against the backdrop of the expectation for strong growth of Brazilian industry and a slowdown in the spread of the coronavirus.



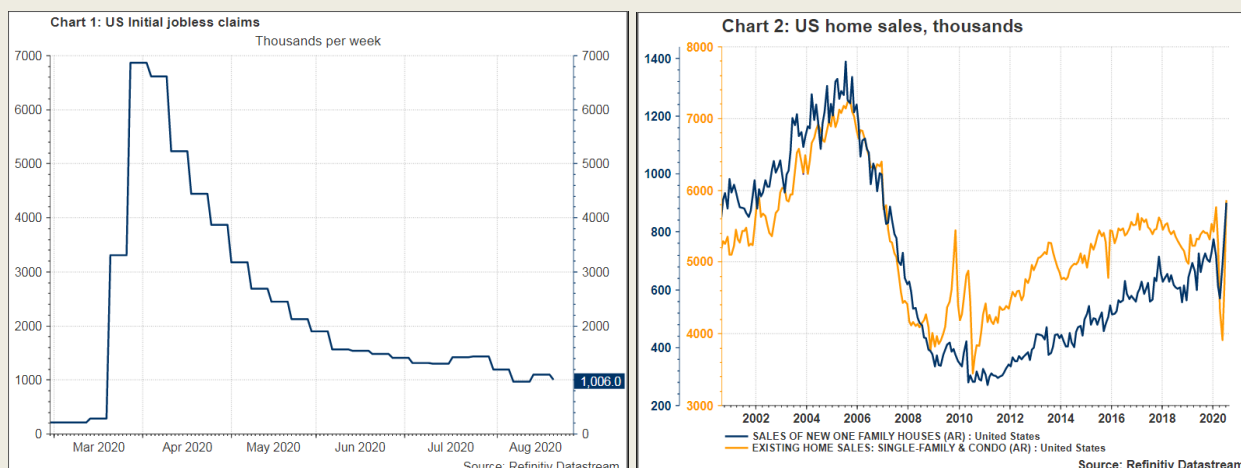
United States

Economic activity: US economic activity continues to recover in the third quarter, despite the continued spread of the coronavirus. The recovery is evident in the retail and manufacturing sectors, in durable goods orders, as well as in the housing market. The rate of spread of the coronavirus across the US remains relatively high, but the pace has slowed and the number of daily new patients is in a downward trend.

- US economic activity is continuing to recover during the third quarter, following the sharp decline in GDP in the second quarter resulting from the government-imposed shutdown. Retail sales increased 1.2% in July (m/m). This growth rate is substantially more modest than the retail sales growth in May-June, which increased 18.3% and 8.4%, respectively. However, retail sales have reached pre-coronavirus levels, indicating that sales have returned, albeit temporarily, to a growth trajectory similar to that prior to the outbreak of the virus.
- Industrial manufacturing increased 3.0% in July. However, despite the continuing recovery, it remains 8.4% below the level from before the spread of the coronavirus in the US, indicating that the recovery of the manufacturing sector is slower than the recovery in retail sales. The slow recovery in the industrial sectors stems primarily from the difficulties in the recovery of activity in the mining sector and the slowdown in the energy sector, with an emphasis on oil produced from oil shales, due to the low oil prices that harm the economic viability of its extraction.
- The number of new unemployment claims has fallen in recent months and in the last week of August, there were 1.006m new unemployment claims. This is after the number of new unemployment claims fell temporarily during August, for the first time since the outbreak of the coronavirus spread, to below one million new claims per week (see Chart 1). At the end of August, there were 14.54m ongoing claims for unemployment benefits, and according to the employment report, the unemployment rates based on the narrow and broad definitions were 8.4% and 14.2% in August.
- Preliminary indicators point to a continued recovery in economic activity in August as well. The composite PMI index increased from 50.3 to 54.7 during the month, indicating that economic activity is continuing to recover and that growth is expected in both the manufacturing and the services sectors. This is despite the continued spread of the coronavirus across the US and despite the halt in the US\$600 per week unemployment benefit supplement provided by the US government to the unemployed since the beginning of the crisis. The consumer confidence index increased slightly in August, indicating that the negative effect of the expiration of the US\$600 unemployment benefit supplement, which was discontinued at the end of July, on consumer confidence has been offset by the declining trend in the spread of coronavirus in the US.
- Durable goods orders continue to recover, with an 11.2% increase in July (m/m), amid a higher-than-expected increase in vehicles orders that reached a higher level than that before the outbreak of the coronavirus. Orders remain 5% below levels from last year, mainly due to the decline in aircraft orders against the backdrop of the cancellation of orders for Boeing's 737 MAX aircraft after two fatal accidents involving this model. Core orders, excluding

transportation, increased in July by only 2.4% (m/m), reaching a level just short of pre-coronavirus levels.

- New home sales increased in July by 13.9% (m/m, see Chart 2), reaching their highest level in the last 13 years. This is the third consecutive month in which sales have risen by double-digit rates, following the April slump created as a result of the lockdown and halt in economic activity. However, the rate of increase moderated in each of these three months. The Existing home sales increased 24.7% in July (m/m), after also rising by more than 20% in monthly terms in June. The increase in sales occurred in all areas of the US, reflecting a substantial boost in demand for housing ever since the closures were lifted and economic activity returned. US construction starts rose 22.6% in July (m/m), representing the third consecutive month with double-digit growth rates. The number of issued building permits continued to recover as well, increasing by 17.8% in July (m/m), indicating continued future recovery in construction starts in the short- and medium-term.
- The coronavirus continues to spread across the US, albeit at a more moderate pace. The daily number of new infections has been in a downward trend since the last week of July after reaching a peak of over 78,000 infections per day. During the second half of August, almost every single day, with the exception of just one day, the daily number of new infections was even below 50,000. California, Texas, Florida, and New York are the states with the highest number of infections. In California, the number of new daily patients has been declining since mid-August, but the number of active patients remains very high. In Texas, the daily number of patients has been declining since the beginning of August and the number of active patients has dropped from a peak of over 173,000 and is now approaching 100,000 active patients. In Florida, the daily number of new infections has been declining since the last week of July, but the number of active patients is at its highest level, and during August there was a sharp increase in the number of daily deaths from the virus. New York has succeeded to curb the outbreak of the second wave of the virus, and the state is managing to keep a relatively moderate and steady number of new patients after this number dropped from the April peak. Furthermore, the number of active patients in New York has been in a downward trend since the beginning of July, while in August the decline moderated and the daily number of deaths from the virus in July-August was very low.
- Looking ahead, GDP is expected to increase 20%-30% in the third quarter in annualized terms, this against the backdrop of the recovery reflected in the preliminary indicators and from the July data, despite the continuing spread of the coronavirus across the US, which is likely to weigh on economic activity. In our opinion, US GDP is expected to contract 5.3% in all of 2020, while in 2021 it is expected to increase 3.7%, yet it will remain below the 2019 level in 2021.

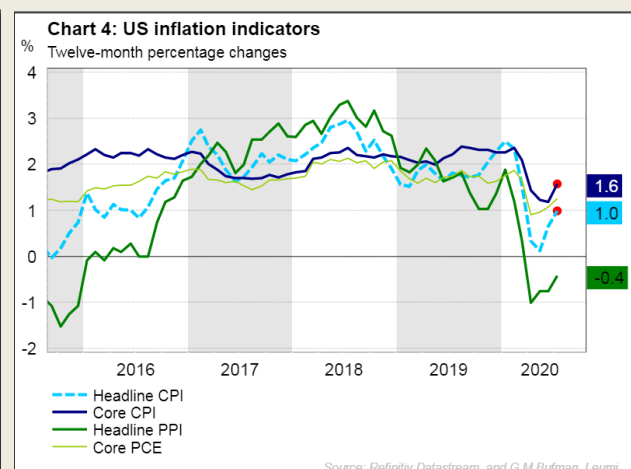
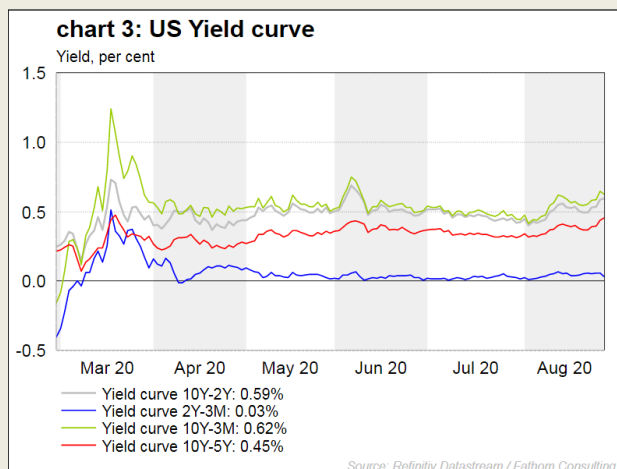


Inflation and monetary policy: the chairman of the Fed announced the adoption of a flexible, multi-year average inflation target (average inflation target – AIT), instead of a specific inflation target that has been the custom until now. This announcement led to an additional increase in long-term inflation expectations and in the yields of long-term government bonds, as well as an increase in the slope at the longer and medium portions of the yield curve. However, this decision did not affect the shorter section of the yield curve.

- The chairman of the Fed, Jerome Powell, announced the adoption of a flexible, multi-year average inflation target – AIT, to replace the specific inflation target that has been the custom until now. Thus, following a period in which inflation has been below 2%, a monetary policy will be followed that will bring the inflation rate to a level that is above 2% for a specified period. Since over the past decade the inflation rate has been below the target, the Fed is expected to attempt to bring the inflation rate to a level slightly above the 2% target.
- However, the Fed chair did not detail to what degree the inflation rate is likely to rise above the target, and he kept the policy vague. This decision has almost no significant real meaning in the short-term because inflation is substantially below the Fed's current target. However, over the medium- and long-terms the significance of this decision is that in the distant future the inflation rate is likely rise above the 2% inflation target, which will bring about a situation in which the real interest rate will be lower and may even become more negative. This comes during a time when the Fed continues to oppose a negative nominal interest rate. It is expected that the federal bank will focus on the development of long-term inflation expectations, such that because of the change in policy, these inflation expectations will become firmly anchored at a level slightly above 2%. Because of this, there will be an impact on the inflation component inherent in the yield curve, with an additional steepening of the curve.
- An additional change implemented by the Fed is in setting a broad-based employment target. That is to say, instead of considering only the aggregate labor market, the Fed will give an emphasis to the participation rate in the labor market among low-wage earners and among the middle-classes. In addition, in the last announcement of the Fed it was stated that the policy decision will be based on the estimates of a decline in employment from the maximum level and not based on the deviations of employment from the maximum level, as the Fed

declared in its previous announcement. This change in the statement reflects the Fed's assessment that it is possible to support labor market resilience without causing a breakout in inflation.

- The message emerging from the speech of the Fed chair, according to which the long-term inflation rate may rise above 2%, led to an increase in long-term government bond yields. This increase resulted in an increase in the slope at the medium and longer portions of the yield curve (3M-10Y, 2Y-10Y, 5Y-10Y; see Chart 3). The statement of the Fed chair did not affect the shorter portion of the yield curve (3M-2Y), which remained stable after flattening in recent months, against the backdrop of Fed purchases of government bonds and given market expectations that Fed interest rates will remain unchanged in the near future.
- The consumer price index (CPI) increased 0.6% in July (m/m) and the inflation rate rose from 0.6% to 1.0% in annual terms (see Chart 4). This was mainly due to an increase in the core components, against the backdrop of the recovery in economic activity, which led to an increase in the core CPI in July from 1.2% to 1.6% in annualized terms. The core PCE price index also increased in July, from 1.1% to 1.3%. We note that the decline in the core PCE price index in April was relatively low as the index is less affected by falling prices in industries in which consumption declined, such as tourism and aviation. The producer price index (PPI) also increased during the month, but decreased 0.4% for the 12 months ended in July. In our estimation, despite the rise in core inflation and the core PCE price index, it will take a long time for the Fed to start raising the interest rate.



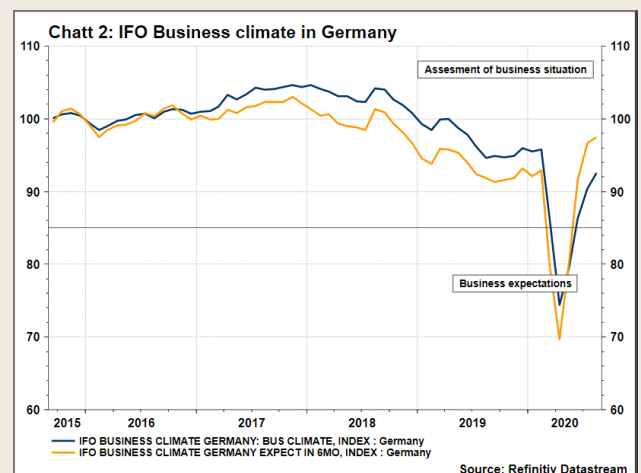
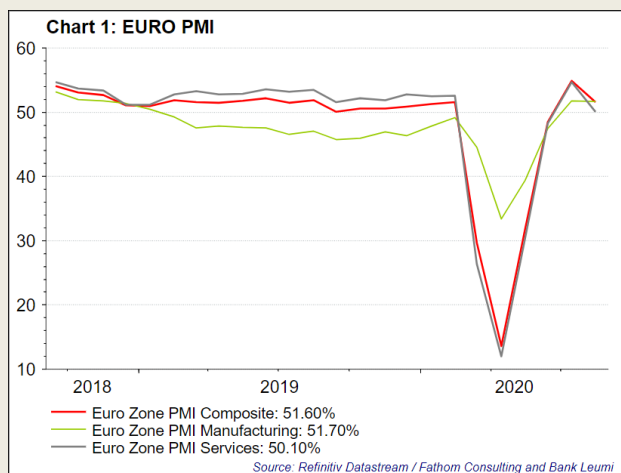
The Euro Bloc

Economic activity: economic activity within the euro bloc has continued to recover in the third quarter, although by a slower pace due to the spread of the coronavirus. The spread of the coronavirus has accelerated recently in the larger economies of the euro bloc and the daily number of new infections is in an upward trend. In our opinion, the GDP is not expected to return to its level from 2019 before 2022.

- Economic activity in the euro bloc has continued to recover during the third quarter, following the historic contraction in the GDP in the second quarter. The increase in industrial manufacturing and in consumer confidence in the second half of the second quarter attests to a recovery that started already during the second quarter, and signals that the sharp drop in GDP stemmed from the halt in economic activity in April. The rise in the euro bloc August consumer confidence index, which increased for the third consecutive month, together with the rise in business confidence levels in the larger economies of the euro bloc, indicates that their economies are continuing to recover in the third quarter.
- Preliminary indicators also show a continuing recovery in economic activity in the third quarter. The composite PMI of the euro bloc declined in August after it had increased sharply in the three preceding months (see Chart 1) and it indicates a slowdown in the rate of economic recovery, but the economy is still expected to continue to grow, albeit by a slower rate. The decline in the composite index stems from a decline in the PMI of the services sectors, which fell in August from 54.7 to 50.1 points, compared to the PMI of the manufacturing sector, which increased slightly in August. The economic sentiment indicator (ESI) for the euro bloc increased in August from 82.4 to 87.7 points. This indicator increased for the fourth consecutive month, following the low it had reached in April; however, the rate of increase over the last three months has been declining. It appears the economic recovery is continuing at a slower pace due to the rise in the morbidity from the coronavirus.
- As per a country breakdown, the second estimate on Germany's second quarter GDP was revised slightly from -10.1% (q/q) to -9.7% (q/q). The German second quarter GDP figure shows that all the components of local demand, except for government expenditures, fell sharply. An increase in the third quarter is already evident in a variety of indices; however, according to the IFO business climate index, it appears the strength of the recovery has slowed due to the renewed rise in morbidity (see Chart 2). The German composite PMI index for August also shows moderation in the economic recovery, stemming from a slowdown in the pace of recovery of the services sectors compared to the industrial sector, in which economic activity is actually expected to strengthen. Against the backdrop of the slowdown in the economic recovery, together with the rise in morbidity, Germany announced an extension to its shortened week plan (Kurzarbeit), which supports the labor market, from 12 months to 24 months.
- In France, the composite PMI also shows moderation in the economic recovery, with the moderation stemming from the services sectors, as well as the industrial sector, which is likely as well to contract slightly. The economic sentiment indicator (ESI) increased in August in

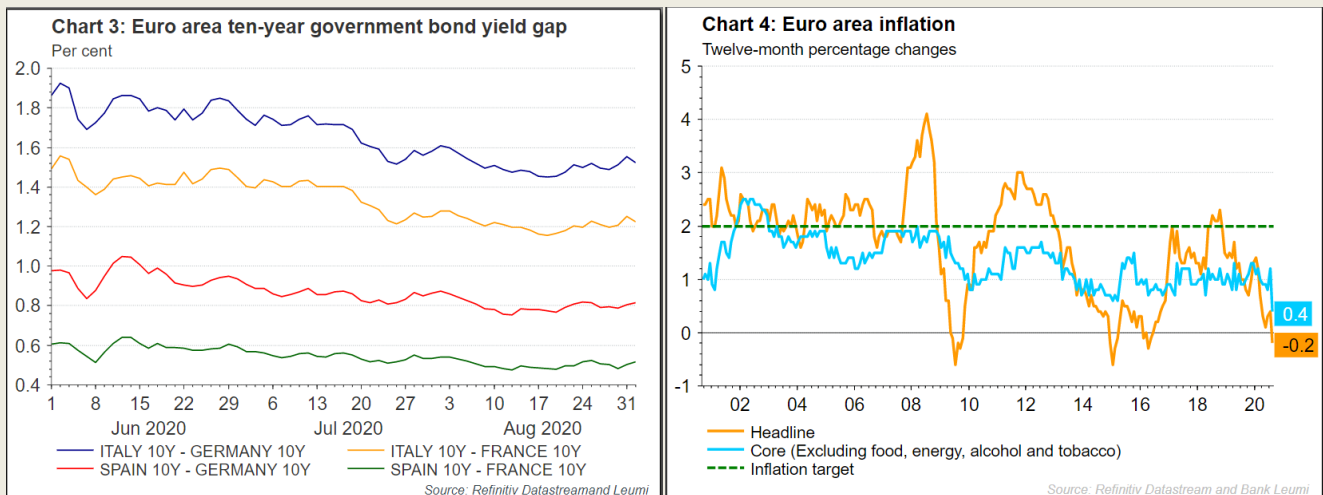
Italy, Germany, and France, despite the continuing spread of the coronavirus; however, Spain's ESI declined in August after it had increased over recent months from its April low.

- The coronavirus continues to spread across Europe, and the second wave of morbidity has started to intensify, particularly in the larger economies of the euro bloc. In Italy, the number of active cases started to climb in mid-August against the backdrop of an increase in the daily number of new patients. This comes after Italy had succeeded to contain the morbidity in June-July. In Germany, the number of active cases has been in an upward trend since the end of July and has tripled from the low level recorded in mid-July, and the number of daily new infections in July-August was in an upward trend.
- In Spain, the daily number of new infections has also increased sharply since the beginning of July. Indeed, in the second half of August there was a slight decline; however, the daily number of infections remains high. In France, the daily number of virus infections increased in August and reached a new peak in the beginning of September. Furthermore, the number of active cases increased and reached a peak level of more than 216,000. However, in France the situation does not reflect a second wave, but instead a continuation of the first wave, since the number of active cases never substantially declined at any stage since the breakout of the virus at the end of February. The number of deaths from the virus in the large economies of the euro bloc has not increased over the last two months, and in our opinion, this number is expected to climb during the coming weeks due to the rise in morbidity.
- Looking ahead, the economic recovery in the euro bloc is expected to continue at a slower pace, against the backdrop of the continuing spread of the virus. In our opinion, the GDP of the euro bloc is expected to contract 8.7% in 2020, and to increase 5.5% in 2021, and it is expected to remain below its level from 2019 until 2022.



Inflation and monetary policy: at the last meeting of the ECB, there was broad agreement among the committee members to maintain the current monetary policy. The spread between the yields of Italian and Spanish long-term government bonds and those of Germany and France narrowed. The consumer confidence index declined sharply to a negative rate of change, and core inflation registered a historic low.

- The protocols from the July 16 meeting of the ECB indicate there was broad agreement among the monetary committee members to maintain the current policy, and if there will not be any substantial developments in the economic data or in the financial markets, then the ECB is expected to maintain the current policy until the end of the year. In the July 16 meeting, no substantial decisions were made. The last time the ECB made a substantial decision was back in the beginning of June, when the central bank increased the Pandemic Emergency Purchase Program (PEPP) from €750bn to €1,350bn.
- The protocols show that the committee members in July were less pessimistic regarding the economic forecasts for the remainder of the year, due to the positive economic data that indicate a stronger than expected economic improvement, and they are more confident in their baseline scenario, which expects the GDP of the euro bloc to contract 8.7% this year. In their opinion, the pessimistic scenario, in which the GDP of the euro bloc will contract 12.6% this year, is less likely. The emergency purchases of the ECB, through the PEPP, slowed from average weekly purchases of €25bn in the first four months since the plan was launched, to €17bn in the weeks that passed since the July monetary committee meeting. In our opinion, in the event there will be no deterioration in the financial data, then the ECB is not expected to increase the pace of its emergency purchases.
- The financial conditions of the large economies of the euro bloc continued to improve following the July ECB meeting, and 10-year government bond yields declined. However, in the last week of August, long-term government bond yields increased again and approached the levels they were at back in mid-July. In addition, the spread between the yields of Italian government long-term bonds and the long-term bonds of the German government narrowed. Also, the spread between the yields of Italian government bonds and those of France narrowed since July (see Chart 3), thus signaling the improvement in the financial conditions also of Italy, which was one of the most heavily hurt countries in the current crisis among the euro bloc members. We note that the dollar financing conditions of the euro bloc also improved because of the rise in the euro exchange rate vis-à-vis the dollar since June.
- The consumer price index of the euro bloc (HICP) declined sharply in August, from 0.4% to -0.2% in annualized terms (see Chart 4). The last time the euro bloc inflation rate was negative was back in May 2016. The decline in the index stems primarily from the decline in clothing prices, after these had increased in July, and also from the cut in the German VAT rate in July, although its impact on inflation in the euro bloc was offset temporarily due to the rise in clothing prices in the same month. The core inflation rate (excluding energy, food, alcohol, and tobacco) of the euro bloc declined in August as well, by a sharp rate, from 1.2% to the historic low of 0.4% in annualized terms. The sharp drop in core inflation indicates the low demand attributed to social distancing.



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