Global Macroeconomic Monthly Review

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Key Issues and Table of Contents

- *There is a slight slowdown in global economic growth in the second quarter of 2019, mainly against the backdrop of weakness in industrial activity and international trade.*
- *The risks to the growth forecast have increased recently. The realization of one or more of the risks may lead to the return of high volatility in the financial markets.*
- *Even though it continued to rise also in April, the inflation environment remains relatively moderate, but is not expected to moderate significantly in the future.*
- *The leading central banks are expected to continue to maintain a cautious, patient approach also in the coming months, and there may also be expansionary policy measures in the future.*
- *The current macro-economic environment supports a relatively low yield environment in the bond market at least in the short-term.*

- *A slowdown in growth is evident in the second quarter, which is likely to worsen in the remainder of the year as the escalation in the trade war intensifies.*
- *The growth environment is expected to moderate in 2019-2020. We emphasize that the expectation for the coming one-two years is for a slowdown in growth, and not a recession.*
- *Inflation continues to be moderate, but may rise slightly as a result of a further escalation in the US-China trade war. The Fed currently projects an interest rate cut, possibly still through 2019, in our view probably in the 3rd quarter of the year, but at a slower pace than the market expectations.*
- *Treasury yields may rise later in the year, if the process of the rate cuts turns out to be slower than the current market expectations.*

- *The relatively strong growth in the first quarter was based on a positive trend in local demand.*
- *However, a variety of indicators indicates moderation in the second quarter growth rate.*
- *Inflation dropped sharply in May, due to, among other things, an "end effect" in energy prices.*
- *The ECB introduced a number of monetary policy changes and revised its growth and inflation forecasts.*
- *The yield differential between Greece and Italy is narrowing, this against the backdrop of an increase in the relative risks of Italy, which may fall into a "debt trap" that it will not be able to extricate itself from without debt restructuring.*

Leumi Global Economic Forecast, As of June 2019

	2016	2017	2018	2019F	2020F
GDP – Real Growth Rate					
World	*3.2%*	*3.7%*	*3.5%*	*3.1%*	*3.4%*
USA	*1.6%*	*2.3%*	*2.9%*	*2.2%*	*1.7%*
UK	*1.8%*	*1.6%*	*1.3%*	*1.3%*	*1.5%*
Japan	*0.9%*	*1.7%*	*0.8%*	*1.0%*	*0.4%*
Eurozone	*1.7%*	*2.5%*	*1.8%*	*1.2%*	*1.4%*
South East Asia (ex. Japan)	*4.5%*	*5.2%*	*5.0%*	*4.7%*	*4.3%*
China	*6.7%*	*6.9%*	*6.6%*	*6.3%*	*6.1%*
India	*7.1%*	*6.7%*	*6.9%*	*6.9%*	*7.1%*
Latin America	*-0.7%*	*1.2%*	*1.1%*	*2.0%*	*2.2%*
Israel	*4.0%*	*3.5%*	*3.3%*	*2.9%*	*3.6%*
Trade Volume, Growth (%)					
Global	*2.3%*	*5.3%*	*4.4%*	*3.1%*	*2.9%*
CPI, Annual Average (%)					
USA	*1.3%*	*2.1%*	*2.4%*	*2.2%*	*1.4%*
UK	*0.7%*	*2.7%*	*2.5%*	*2.0%*	*2.1%*
Japan	*1.0%*	*0.5%*	*1.0%*	*1.1%*	*1.5%*
Eurozone	*-0.1%*	*1.5%*	*1.7%*	*1.4%*	*1.5%*
Israel	*-0.5%*	*0.4%*	*0.8%*	*1.5%*	*0.7%*
Interest rates, Year End					
US Fed	*0.50-0.75%*	*1.25-1.50%*	*2.25-2.50%*	*2.00-2.50%*	*1.75-2.25%*
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%*	*0.00-0.20%*
Israel	*0.10%*	*0.10%*	*0.25%*	*0.25-0.75%*	*0.50-1.25%*

The Global Economy – The Big Picture

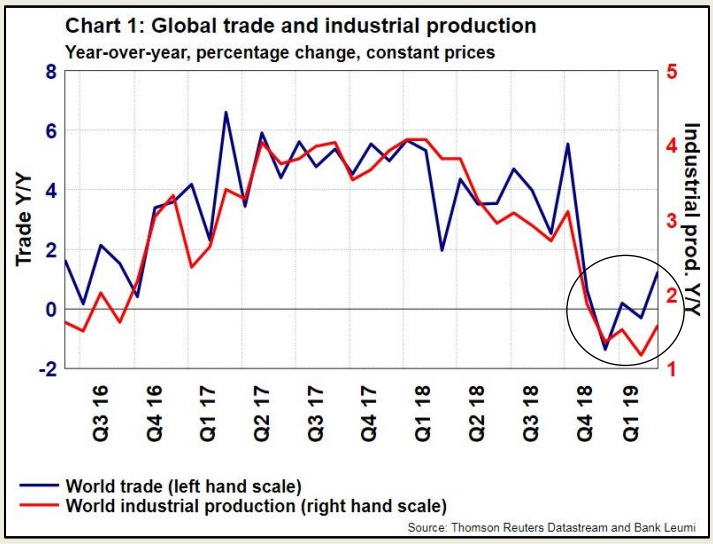
Economic activity and global forecasts (1): there is a slight slowdown in global economic growth in the second quarter of 2019, mainly against the backdrop of weakness in industrial activity and international trade. The risks to the growth forecast have increased.

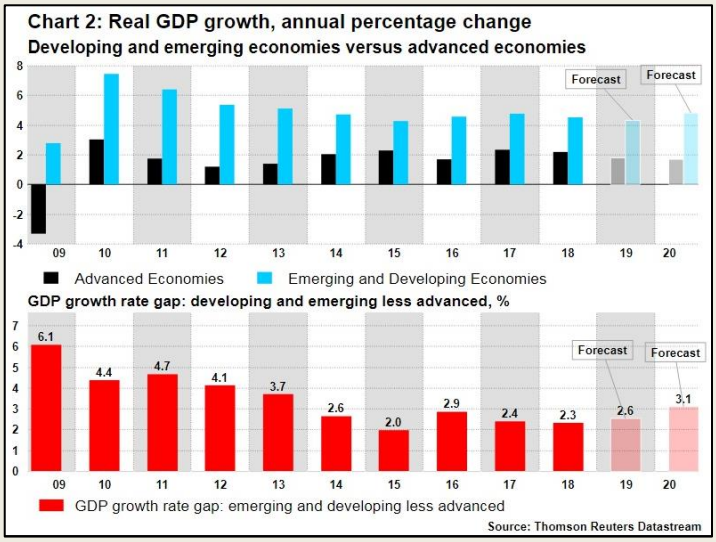
- In most of the world's economies, especially the developed countries, the data on activity published so far indicate moderation in the growth rate in the second quarter of the year compared to the first quarter, which was partially affected by one-time factors. The relative slowdown in economic activity is evident in industrial activity, business sector investment, retail sales, and international trade. The latter is affected by, among other things, a worsening of the US-China trade war. On this regard, we note that in the first quarter of 2019 international trade volume and global industrial production remained low compared to previous quarters (Chart 1). Exports of the emerging markets were notable for their weakness, as were the exports of the electronics industries.

- In the US, indicators of trade activity and business sector investments point to a weakening in activity in the second quarter of the year, which we expect to be reflected in a moderation in the growth rate in this quarter. On the other hand, private consumption is expected to recover and to support growth. Looking forward, a gradual slowdown is expected in the growth of the American economy in 2019-2020. In the euro bloc, following relatively rapid growth in the first quarter of the year, several indicators (industrial production, retail sales, and business surveys) indicate weakness in activity in the second quarter of the year. In light of this, we believe that the growth rate in the second quarter will be lower than that in the first quarter, equaling 0.2% (q/q). This compares to 0.3% average quarterly growth in 2018. After an increase in inventories and imports positively affected the data on activity in the first quarter of the year, the data on activity for the second quarter of the year indicate a weakening of activity in Britain, with an emphasis on the industrial sectors. The high degree of uncertainty surrounding Brexit, which increased recently, is expected to continue to weigh on activity also in the coming months. The relatively rapid growth in Japan in the first quarter of 2019 was mainly due to a relatively sharp decline in imports, while domestic demand and exports weakened. The data on activity for the second quarter indicate a weakening of industrial activity as well as private consumption. In our assessment, growth in the developed countries is expected to moderate in 2019 compared to 2018, mainly due to expectations for a slowdown in activity in Europe, combined with the fact the US economy is beyond the peak of its current growth cycle.

- Regarding the emerging markets, the data on China point to a weakening in activity in the second quarter of the year, following the acceleration experienced in March (details below). In India, the central bank (RBI) lowered the interest rate (as expected) at the beginning of June (to 5.75%) for the third time this year, against the backdrop of moderation in activity, with an emphasis on a decline in investments and slow growth in private consumption. The RBI slightly lowered its growth forecasts for 2019-2020 and is expected to continue its expansionary monetary policy in the coming months as well. In general, the other emerging economies in Asia published relatively weak data. In South America, concerns among most

of the economies of the region have increased regarding the negative effects of the worsening trade war between the US and China (and between the US and other countries, such as Mexico) on economic activity. Looking ahead, growth in the emerging markets is expected to remain stable in 2019 compared to 2018 (Chart 2), with some variation amongst the different regions. In Asian economies, the growth rate is expected to moderate due to the economic developments in China. In South American countries, the slow and gradual process of recovery is expected to continue during the year, with the exception of the crisis countries - Argentina and Venezuela. On the other hand, the expected slowdown in economic growth in the euro bloc is likely to weigh on the economic activity of the central-eastern European countries.

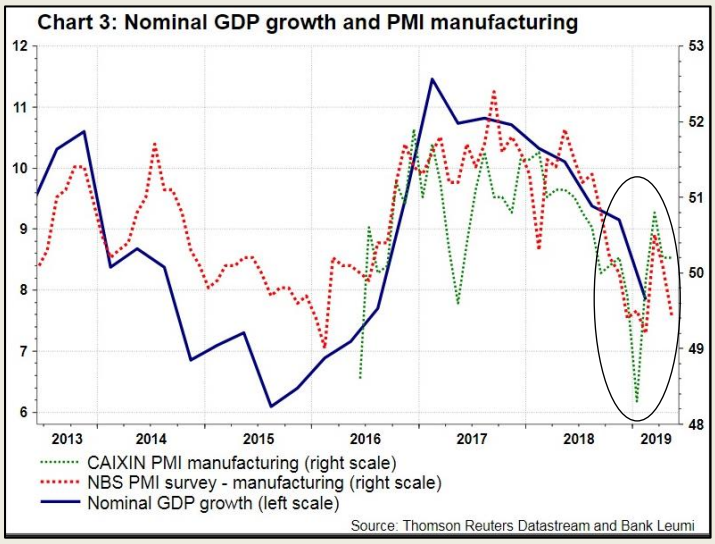


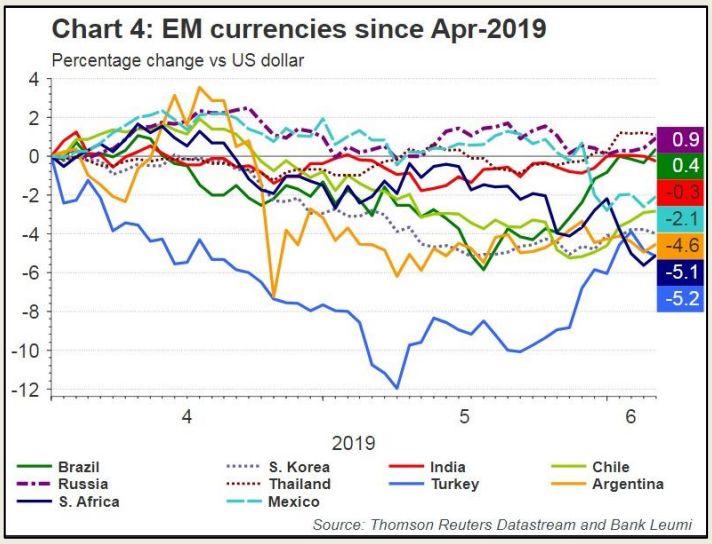


Economic activity and global forecasts (2): there is a slight slowdown in global economic growth in the second quarter of 2019, mainly against the backdrop of weakness in industrial activity and international trade. The risks to the growth forecast have increased.

- The indicators published regarding economic activity in China in the second quarter of the year show a weakening in the rate of expansion of activity compared to March figures. On this regard, we note the March data were relatively strong, due to, among other things, the positive effects of the government's expansionary economic policy (fiscal and monetary), together with positive seasonal effects. The April-May data show relative weakness in the export and manufacturing sectors in China, this against the backdrop of, among other things, the worsening in the trade war with the US, which has started to be reflected in the data. The PMI indices (Chart 3) and the export data indicate stagnation / decline in May activity. It is the same situation as well for the PMI of the services sectors. Looking forward, the risks have increased for a downward revision in the growth forecasts, mainly due to the faultiness in the forecasts regarding the formulation of a new trade agreement between the US and China in the near future, and a substantial increase in uncertainty in this area (see below).
- The global purchasing managers' indices of the industrial and services sectors declined in May and continued to indicate weakness in global economic sentiment, in continuation of the longstanding trend from the beginning of 2018. The PMI index of the industrial sectors dropped to its lowest level since October 2012 (49.8), and it currently indicates a contraction in industrial activity. In parallel, the PMI of the services sectors and the Composite Index, an index that includes the services and industrial sectors together, dropped as well to their lowest levels in almost three years, although they continue to indicate a moderate expansion in activity. These data indicate expectations for weakening economic activity in the coming months, and for relatively weak growth data for the second quarter of the year, mainly among the developed countries. Looking forward, we believe more moderate growth of 3.2% (on average) is expected in 2019-2020, compared to 3.5% growth in 2018.
- The main threats to growth remain high, headed by the US-China trade war. Recently, services exports entered the trade war, as China launched a counter-attack with various restrictions on imports of services from the US, including administrative restrictions on types of imports of services from the US and the inclusion of substantial American countries on a black list. Furthermore, the Chinese government issued warnings against the travel of its citizens to the US for study and tourism. We estimate that at least some of the indirect effects of these steps have already been felt, and in our assessment, the indirect effects of the trade war on trade are greater than the direct effects. Overall, the direct and indirect effects are expected to offset around 0.5% of world GDP through the end of 2020. This is a one-time hit, but it remains unclear whether the trade war is a sign of permanent damage to globalization down the road.
- Among the other major risks, we note the uncertainty surrounding Brexit, especially the increase in the probability of Britain leaving the EU without an agreement (the scenario with the most negative effects on the economy) after the resignation of the prime minister, Theresa May, which took effect on June 7th. In addition, there are other political risks in Europe in view of the strengthening of right-wing parties, mostly Euro-skeptic parties, in the European

Parliament, and elections in some of the continent's countries. The currencies of the EM economies reacted differently to the recent intensification of the trade war, with Russia, Thailand, and India reacting with moderate increases, while Mexico, South Korea, and Chile responded with relatively steep declines. The Argentine Peso and the Turkish Lira continue to weaken due to the economic crisis that these countries find themselves in (Chart 4).

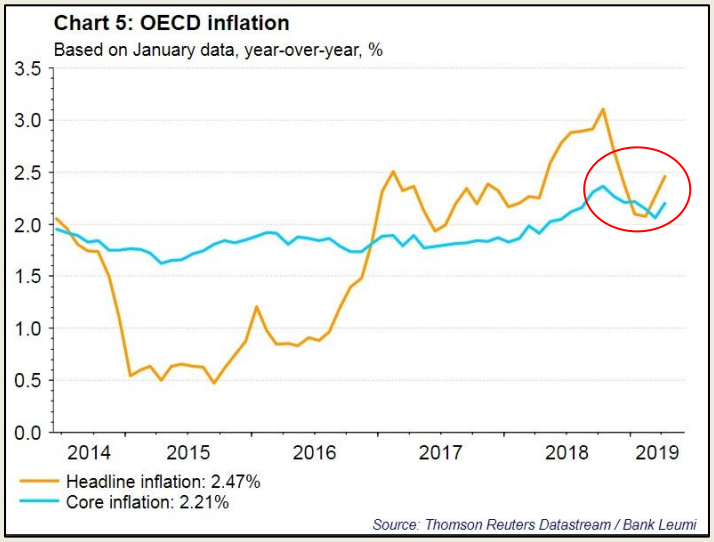


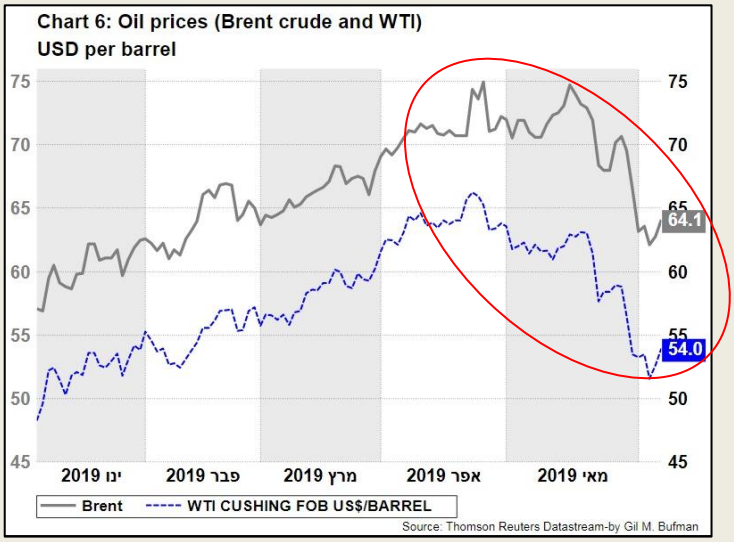


Inflation and monetary policy: even though it continued to climb also in April, the inflation environment remains relatively moderate, but is not expected to moderate substantially down the road. The change in the tone of the leading central banks to a more patient and cautious stance supports a relatively low yield environment in the short-term.

- Inflation in the OECD countries rose to 2.5% in April, after equaling 2.3% in March and 2.1% in February (Chart 5). Thus, inflation rose to its highest level since November 2018. The increase in inflation was broad in all the large economies of the world, led by Germany and Japan, and was supported mainly by acceleration in the rate of increase in energy prices. This was due to the rise in oil prices and other industrial commodities from the beginning of 2019 until recently (Chart 6). Looking ahead, rising expectations for weaker demand for oil against the backdrop of expectations for weakness in world trade due to the worsening trade conflict between the US and China could lead to a more significant weakening of prices later in the year, a development that may limit the potential for rising inflation. At the same time, core inflation increased 0.1% in April to 2.2%, this after it had been in a moderating trend in most of the recent months. Looking ahead, there are a number of factors that are expected to support core inflation in the short-term. These factors are headed by unemployment rates that are in a downward trend, wage increases in most large economies, and a continued relatively rapid expansion in the services industries. Overall, no substantial inflationary pressures are expected during the year.
- At its meeting on June 18-19, the Fed maintained the interest rate between 2.25%-2.50%, as expected, but in light of the moderation in economic expansion and of the increasing uncertainties in the economy, revised down its interest rate projections. The median FOMC projection point currently to stability in the interest rate level during 2019 and one rate cut during 2020, while some of the FOMC members project one or two rate cuts still through 2019. This is the first time since the projections began in 2012 that the median interest rate forecast shows a decline in interest rate. The majority of FOMC members project a rate cut only in 2020. Not one of the 17 FOMC members expects more than 50bp of rate cuts. We project one rate cut (0.25%) in September 2019 and another rate cut (0.25%) in March 2020.
- At the same time, against the backdrop of forecasts of a slowdown in the euro bloc growth rate, the continuation of a moderate inflation environment, alongside the increase in global risks (the "trade war", Brexit, and emerging markets), the ECB announced at its last meeting the interest rate will remain unchanged at least until the first half of 2020. This differs from the preceding stance, declared at previous meetings, that the rate would remain unchanged only until the end of 2019. In addition, the ECB announced that the conditions for TLTRO-III will be slightly less generous than in the past, because back then they were a "safety net" for the banking system. Furthermore, it was emphasized that if "negative situations" materialize, it will not be possible to rule out the use of policy tools, such as a further reduction in the deposit interest rate and/or a re-launching of the QE mechanism. Among the developing countries, we expect a continuation of monetary expansion in China, at least through the remainder of the year, against the backdrop of the worsening of the trade war with the US.

- The expectations for moderation in the growth and inflation rates later in the year, alongside a change in the tone of the leading central banks towards a more patient and cautious approach, support a relatively low yields environment in the short-term. In addition, the longer sections of the yield curves were affected by the changes in expectations of future interest rate paths. In the US, yields on government bonds fell in the past month, against the backdrop of the escalating trade war. The 10-year bond is still trading at a yield similar to that of 3-month bonds, yet at a higher level than the yield on two-year bonds. Thus, market yields still reflect expectations for a slowdown, but not for recession. Overall, the current macro-economic picture continues to support low yields in the short-term. However, it is not possible to rule out the possibility that this trend is also affected by the fact that investors' assessments of the future course of activity are overly pessimistic, alongside excessive expectations for the inflation outlook to remain very low over time.



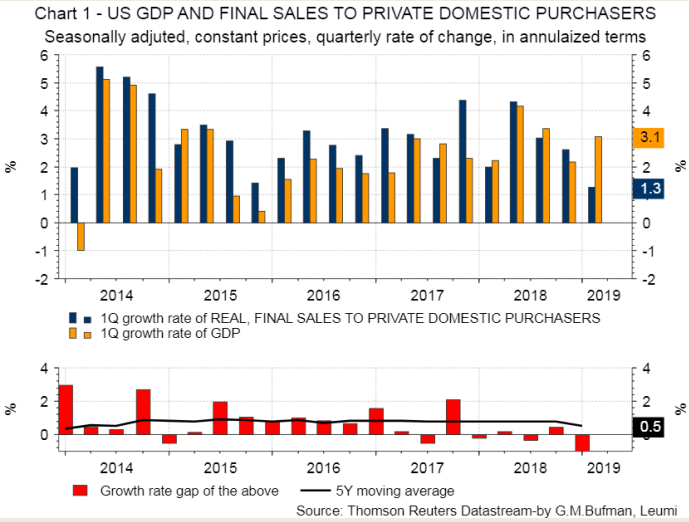


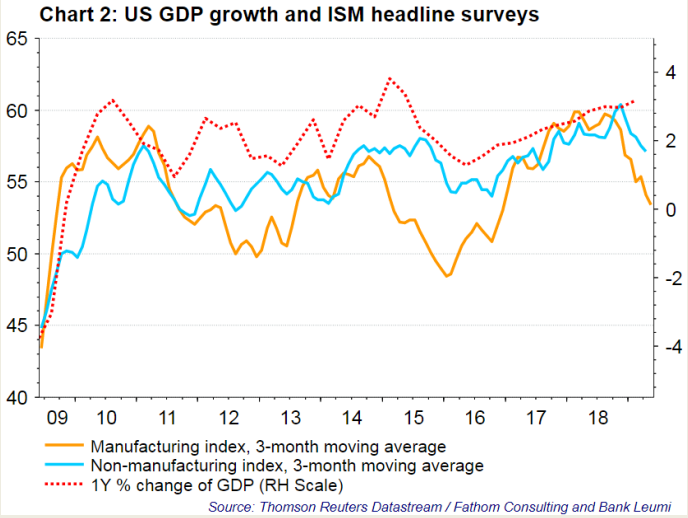
United States

Economic activity: a slowdown in growth is evident in the second quarter, and may worsen later in the year, as the impact of the escalation in the trade war intensifies; the forecast for the next 1-2 years is for a slowdown in growth, but not for a recession.

- The growth rate of the US economy apparently moderated in the second quarter of 2019. The substantial gap that opened in the first quarter of the year between overall economic growth and growth in final sales to private domestic purchasers (a measure of the core economic growth, see Diagram 1) is a leading indicator of this. The data that have been released until now regarding the second quarter indicate there is a negligible contribution to the growth of net trade activity (following a substantial positive contribution in the first quarter), as a result of both a drop in exports and imports. In addition, business investment evidently slowed in the second quarter, resulting from a variety of negative background factors. These include the exhaustion of a substantial portion of the fiscal expansion, the high interest rate environment relative to the past, and increased uncertainty in the economy in view of the escalation of the trade war with China in recent weeks. Inventories are also expected to contribute relatively modestly to growth after a jump in the first quarter of the year. On the more positive side, retail sales have been strong and indicate the 2Q19 private consumption may grow by as much as 4% in real annualized terms.
- Overall growth in the second quarter is still expected to be decent, at around 2.0% -2.5% (in annual terms, still higher than the growth potential of the US economy). This is mainly thanks to private consumption, which is expected to recover and become the largest contributor to growth, after being adversely affected in the first quarter by temporary factors (the partial government shutdown, severe weather). The US labor market remains solid (despite a moderation in recent months, especially in May, in employment growth rate), and consumer confidence continues to be high, supporting the continued high demand of households, at least in the short-term. Together with private consumption, government investments in roads, which contributed significantly to growth in the first quarter, continue to expand and are therefore expected to continue supporting growth in the second quarter as well.
- From an annual perspective, signs of a slowdown in economic activity are increasing in 2019 compared to previous years. Among other things, there is a tangible moderation in the activity of the manufacturing sectors and, to a lesser extent, in the services industries (see Diagram 2). There is a slowdown in new purchase orders and a decline in imports of capital goods. Other factors include a decline in investment in construction in the private sector (possibly also due to the slowdown in the US housing market) and a slowdown in the employment growth rate. The decline in the growth rate is likely to deepen later this year, after the escalation in the US trade war with China over the last few weeks will be reflected more broadly in the activity data. There is also the possibility for further escalation in the trade war in the remainder of the year (such as the implementation of tariffs by the Trump administration on all Chinese imports).

- Looking ahead, a gradual slowdown is expected in the growth of the US economy in the years ahead (annual growth forecasts remain unchanged from the previous monthly review), with a temporary decline below the potential in 2020. One of the best indicators for assessing the state of the US economy is the LEI (Leading Economic Index), an index based on ten economic indicators, which according to past experience has a very good ability to predict the entry into recession six months before the realization of this event. To date, the change in the index indicates the expectation for a slowdown in growth to a rate more moderate than that from a year or two ago, but no recession is expected.





Inflation and monetary policy: inflation continues to be moderate, but may rise slightly as a result of the escalation in the US-China trade war; treasury yields have decreased substantially during the last couple weeks, but may rise somewhat later in the year, if the process of Fed Funds Rate cuts turns out to be slower than the current market expectations.

- Inflation (CPI) moderated in May to an annualized rate of 1.8% (compared to 2.0% in April), particularly as a result of the decline in fuel prices. Together with this, there was a renewed moderation in core inflation (core CPI) in May to an annual rate of 2.0% (compared with 2.1% in April), mainly due to a decline in the prices of automobiles and medical services. The moderation in core inflation in recent months is even more pronounced in the PCE core index, which reached an annual rate of 1.6% in April, significantly below the Fed's price stability target (2.0%). However, the Fed has been emphasizing the use if "trimmed mean" price indexes, that strip out volatile items, and these index are consistent with the 2% target.
- Looking ahead, the escalation in the US-China trade war in recent weeks could lead to a slight uptick in inflation in the coming months (mainly in general inflation). This is based on the assumption that the diversion of US imports from China to other destinations (such as Vietnam, Taiwan, and Thailand) will lead to an increase in import prices that will, at least partially, be rolled over to consumer prices. We believe the weakening of domestic demand in the US economy, against the backdrop of the expected slowdown, will only partially offset the rise in inflation deriving from import prices.
- At its meeting on June 18-19, the Fed maintained the interest rate between 2.25%-2.50%, as expected, but the tone of the monetary statement and the press conference that followed the FOMC meeting was more dovish than previously expected. The statement described current expansion of economic activity as "moderate" (rather than the previous "solid") and admitted that "uncertainties" to the economic outlook "have increased".
- The FOMC median projections left growth outlook almost unchanged, while inflation outlook (core PCE) for 2019-2020 was revised slightly down. In tandem, median interest rate projection for 2019 was kept unchanged on 2.4%, while projections for 2020-2021 were revised down (from 2.6% to 2,1% and from 2,6% to 2.4%, respectively). Fed's estimate of long-term interest rate was revised down as well, from 2.8% to 2.5%. It should be noted that around these medians there is a wide range of projections; according to the central tendency, a path of up to two rate cuts until the end of 2019 cannot be ruled out. In view of the last monetary meeting, we have updated the first interest cut timing to take place in September 2019 and we project another cut in March 2020.
- Treasury yields have declined since the publication of our previous survey (see Figure 4), against the backdrop of the escalation in the trade war and the intensification of expectations in the market for rate cuts in the US (current expectations are for three rate cuts until the end of 2019, with more cuts expected for 2020). The 10-year to maturity treasuries are currently traded at the lowest yield since November 2016, but at a higher level than the yield on two-year to maturity treasury, such that market yields still reflect expectations of an economic slowdown, rather than a recession. In our opinion, in the event the Fed Funds Rate path develops in line with our forecast, the yields environment of 10-year to maturity treasuries will rise slightly from the current level in the period remaining until the end of the year.

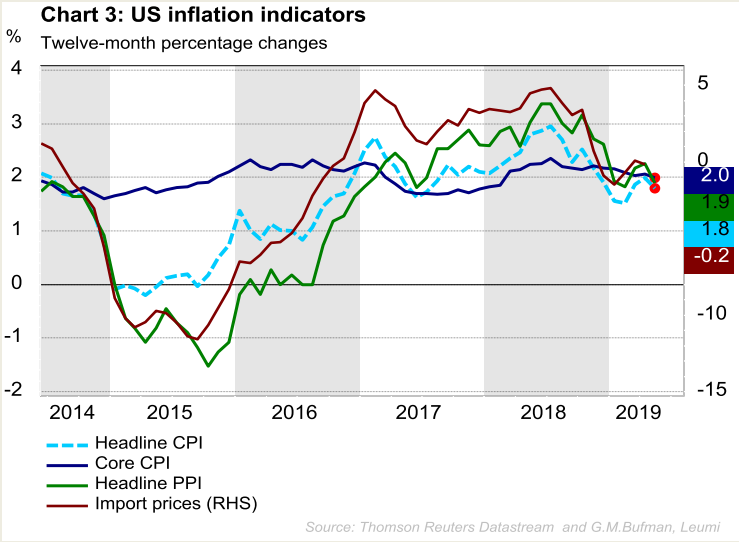


Chart 3: US inflation indicators
Twelve-month percentage changes
%
4
3
2
1
0
-1
-2
5
0
-10
-15
2.0
1.9
1.8
-0.2
2014
2015
2016
2017
2018
2019
Headline CPI
Core CPI
Headline PPI
Import prices (RHS)
Source: Thomson Reuters Datastream and G.M.Bufman, Leumi

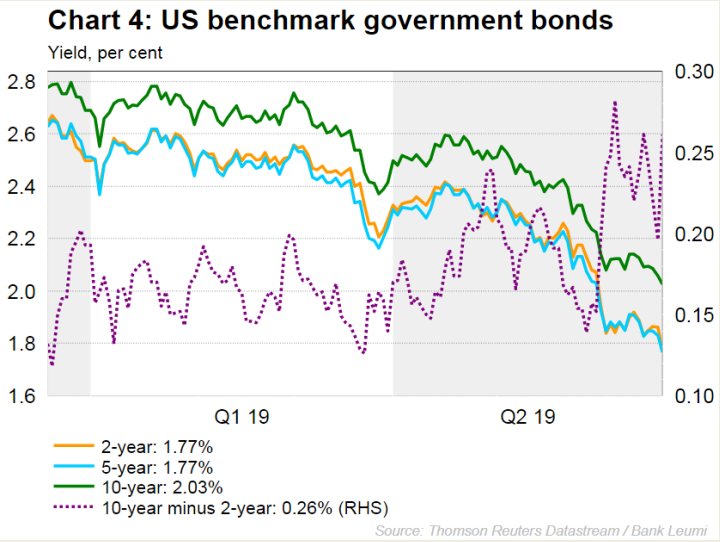


Chart 4: US benchmark government bonds
Yield, per cent
2.8
2.6
2.4
2.2
2.0
1.8
1.6
0.30
0.25
0.20
0.15
0.10
Q1 19
Q2 19
2-year: 1.77%
5-year: 1.77%
10-year: 2.03%
10-year minus 2-year: 0.26% (RHS)
Source: Thomson Reuters Datastream / Bank Leumi

The Euro Zone

Economic activity and forecasts: the relatively strong economic growth in the first quarter in the Euro Zone was based on a positive trend in local demand. A variety of indicators shows moderation in the quarterly growth rate in the second quarter.

- The update to the growth data for the first quarter of 2019 confirms that the rate of growth in the quarter equaled 0.4% (q/q). The quarterly growth rate was surprisingly good and was higher than in the second half of 2018, despite a slight downward revision to Italy's growth rate (0.1% q/q, instead of 0.2%). A breakdown of the composition of growth shows that, as expected, most of the support for growth came from domestic demand. Private consumption and investment grew robustly and net exports rose slightly, while government consumption slowed significantly.

- A variety of indicators are signaling weakness evident in the opening of the second quarter of the year:

  - April's industrial production in Germany fell sharply compared to March. It should be mentioned that a decline in external demand, changes in regulation in the automotive sector, and the slowdown in private consumption growth are all weighing on manufacturing activity in Germany. Moreover, industrial orders fell in April at the highest annual rate in years (see Diagram 1), suggesting a continuation in the weakness in German industry in May-June. This decline stems from a weakness in both domestic as well as overseas orders, with the weakness in external demand being more severe. Industrial production in Italy also showed a similar theme and weakened in April. In contrast, industrial production in Spain and France actually increased. Taking all this into consideration, the aggregate industrial production in the euro bloc in April declined 0.5% compared to March.

  - Retail sales in the euro zone fell in April compared to March, broadly across almost all categories, which may indicate weakness in private consumption at the beginning of the second quarter. As mentioned above, private consumption was an important component of growth in the first quarter.

  - The various business surveys for May signaled an increase relative to April, but the levels in these two months point to a decline in the growth rate relative to the first quarter. Thus, as noted, the euro bloc's ESI index rose in comparison to April (see Figure 2), after falling every month since June 2018. The increase magnitude was surprisingly positive, as the rise in industrial confidence levels contributed the largest portion of the increase in the index. The components involving services and consumers also improved relative to April. In addition, in a similar manner, the May PMI rose slightly relative to April, but still signals moderation in growth relative to the first quarter. On the positive side, the index points to a slight recovery in manufacturing, yet points to a contraction in manufacturing activity for the fourth straight month, although at a more moderate level.

- Looking ahead, in light of the cumulative signs of a slight slowdown in economic activity on the part of industry and private consumption, we believe the second quarter growth rate will be lower than that of the first quarter, equaling approximately 0.2% (q/q). This compares to a quarterly average of 0.3% in 2018.


Chart 1: German Industrial Orders & Industrial Production
3 Month moving average, Y/Y %
10
8
6
4
2
0
-2
-4
-6
-8
6
4
2
0
-2
-4
2014
2015
2016
2017
2018
2019
Industrial Orders, advanced 2M
Industrial Production: (RH Scale)
Source: Thomson Reuters Datastream

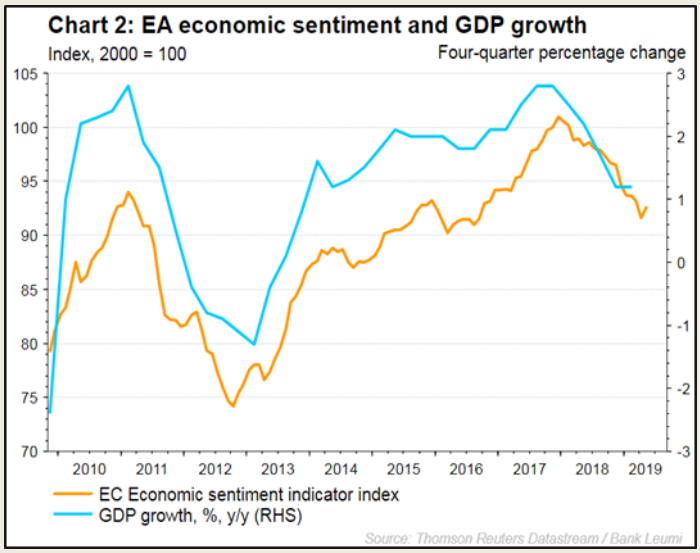


Chart 2: EA economic sentiment and GDP growth
Index, 2000 = 100
Four-quarter percentage change
105
100
95
90
85
80
75
70
3
2
1
0
-1
-2
-3
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
EC Economic sentiment indicator index
GDP growth, %, y/y (RHS)
Source: Thomson Reuters Datastream / Bank Leumi

Inflation and monetary policy: inflation dropped sharply in May. The ECB presented a number of changes to its monetary policy and revised its growth and inflation forecasts. The spread between Greece and Italy is decreasing.

- As expected, the rise in the annual inflation rate that occurred April was temporary. Inflation fell 0.5 percentage points in May to 1.2% (see Figure 3), and core inflation fell by the same magnitude to 0.8%. The sharp decline in the rate of inflation stemmed from, among other things, the base effect of energy prices, which in May last year rose sharply. The sharp decline in core inflation, which neutralizes energy, food, alcohol, and tobacco prices, was due to a sharp drop in services prices, apparently against the backdrop of the easing of the inflationary effects of the Easter holiday on hotel accommodation, and airline prices.
- At the last meeting of the ECB (held on June 6, 2019), two noteworthy decisions were made. First, the bank changed its forward guidance by declaring the interest rate will remain unchanged at least until the first half of 2020, instead of until the end of 2019, as announced at the previous meeting. This is due to increased uncertainty in geo-political issues and around trade conflicts. Second, the ECB published the final details of the third TLTRO program, and it turned out to be somewhat less generous than the previous program.

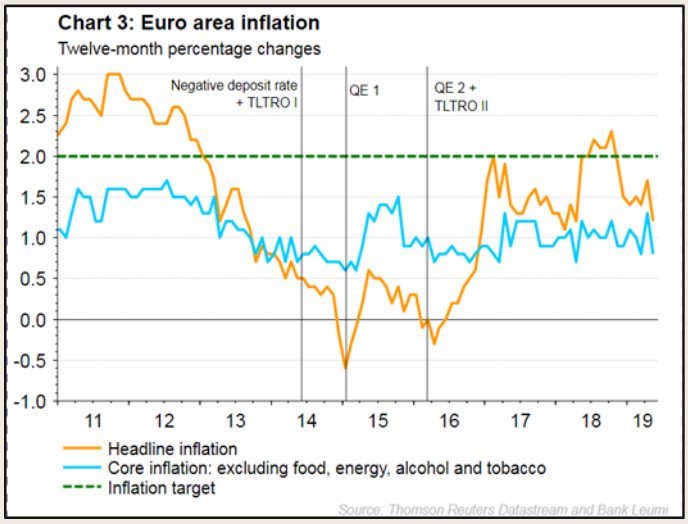
  In addition, the ECB updated its forecasts regarding economic activity and inflation. The 2019 growth forecast for the euro zone was raised 0.1 percentage point to 1.2%, against the background of the surprising growth rate in the first quarter. However, according to the ECB's forecast, growth in the coming quarters will weaken as the temporary factors supporting growth in the first quarter will dissipate, and against the backdrop of a downward revision in the forecast on external demand growth due to increased uncertainty (Brexit, trade wars, etc.). Concerns regarding fiscal policy in Italy also contribute to uncertainty. The ECB reduced its growth forecast for the years 2020-2021 by 0.2 and 0.1 percentage points, respectively. Various revisions were also made to the forecast on Harmonised Indices of Consumer Prices (HICP), but this measure still indicates growth rates that are below the target for each of the forecast years.

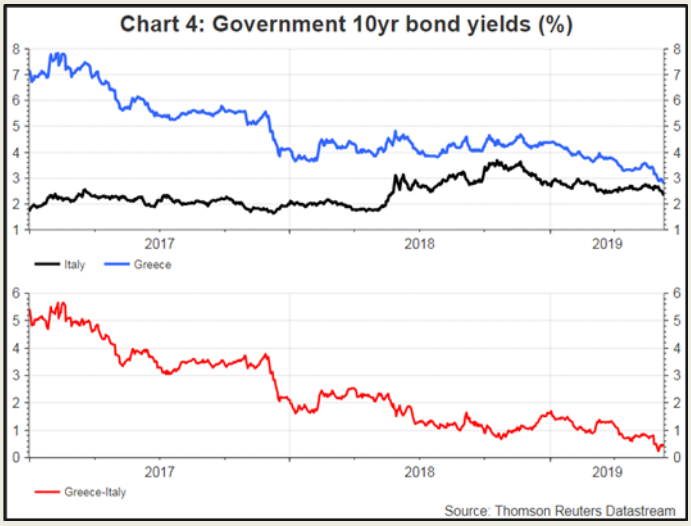
  Overall, from the central bank meeting it can be seen that the ECB's monetary policy tends to be dovish, especially in view of the admission of the ECB president, Mario Draghi, that the possibility of using additional tools (QE, further expansion of the forward guidance, etc.) was mentioned at the meeting and may well be realized.
- As expected, in the European Parliament elections there was no surprise at the level of the European Union, such that the pro-European parties won most of the seats. However, the election results from Italy and Greece indicate there has been a change in public opinion in these countries. In Italy, the strengthening of the League party likely points to a continuation in the conflict that country is having with the EU. This is because the leader of the party, the deputy prime minister of Italy, only recently expressed that he does not have a problem breaching the EU budget constraint and increasing government debt, and he even aspires to cut taxes. All this while the relationship between the two is so strained by the country's failure to achieve the fiscal targets of the Commission. Moreover, according to the updated European Commission forecast, Italy is expected to exceed the deficit limit in 2020 and fail to meet the

reduction target of the structural deficit, against the backdrop of, among other things, the expected cancellation of the VAT increase planned for January of that year.

On the other hand, the results of the elections in Greece indicate that the SYRIZA party, which happens to be the party of that country's prime minister, Alexis Tsipras, was only second to the New Democracy party. The New Democracy party is considered friendlier to business and the European Union than SYRIZA, yet in the national parliament SYRIZA holds double the number of seats.

The developments described above contributed to a further decline in the yield spread between Greece and Italy (see Diagram 4), as part of a long-term trend, and is currently at a multi-year low. According to the credit rating agencies, at least four "notches" separate the two economies; and while Greece does not have an investment rating, Italy still does. Looking ahead, it appears this trend is likely to continue, because as far as Greece is concerned, its growth forecast, political risk (especially the relationship with the EU), and short-term government debt service (thanks to the debt restructuring) are currently all better compared to the situation regarding Italy.





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