Global Macroeconomic Monthly Review

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- *A slowdown in global economic growth occurred in the first quarter of the year against the backdrop of weakness in the industrial sectors.*
- *Activity is expected to slightly accelerate in the second quarter.*
- *The risks to the growth estimates remain relatively high. The realization of one of the risks will likely cause a return to high volatility in the financial markets.*
- *The inflation environment moderated recently; however, the potential for a continued substantial moderation is limited.*
- *Central banks are expected to continue to be characterized by a dovish stance. We do not rule out further expansionary measures by some of the central banks in the world's major economies.*
- *The current macro environment supports a relatively low yield environment in the bond market, at least in the short-term.*
- *We do not rule out that current yields reflect a very high degree of pessimism regarding the real economy in the US. The situation likely indicates the expectation for the very low inflation environment to be maintained over time.*

United States (p. 8)

- *Growth is expected to accelerate in the second quarter of the year, following a slowdown in the preceding quarter; however, any acceleration is expected to be limited in strength.*
- *The growth environment is expected to moderate in 2019, yet it appears the degree of pessimism expressed in the bond market is overblown.*
- *Inflation is continuing to moderate, but the trend is expected to cease.*
- *Market expectations regarding the dovish stance of the Fed limit the potential for a substantial increase in yields.*

Euro Area (p. 10)

- *The growth environment is continuing to be slow. The growth rate is likely to increase slightly in the second half of the year.*
- *The industrial economies are more vulnerable than economies that rely more on the services industries.*
- *We have revised our 2019 growth forecast downwards.*
- *We do not expect an increase in inflationary pressures during the year.*
- *The monetary policy of the ECB is expected to support the availability of credit and low interest rates across the yield curve.*

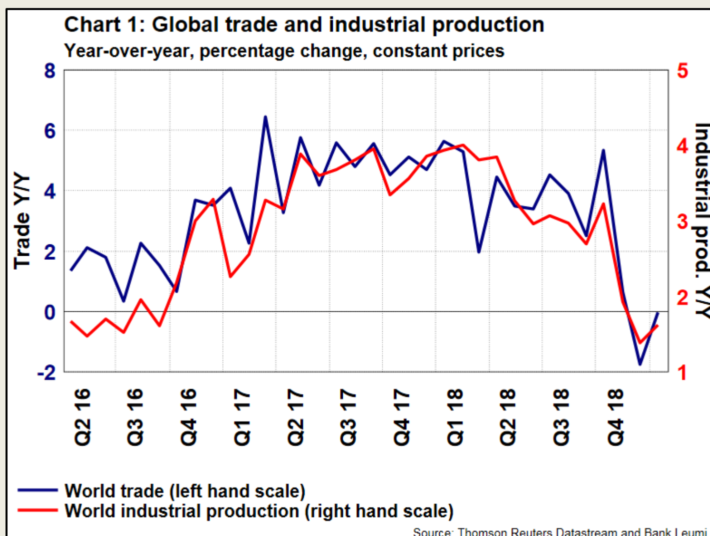
Leumi Global Economic Forecast, As of April 2019

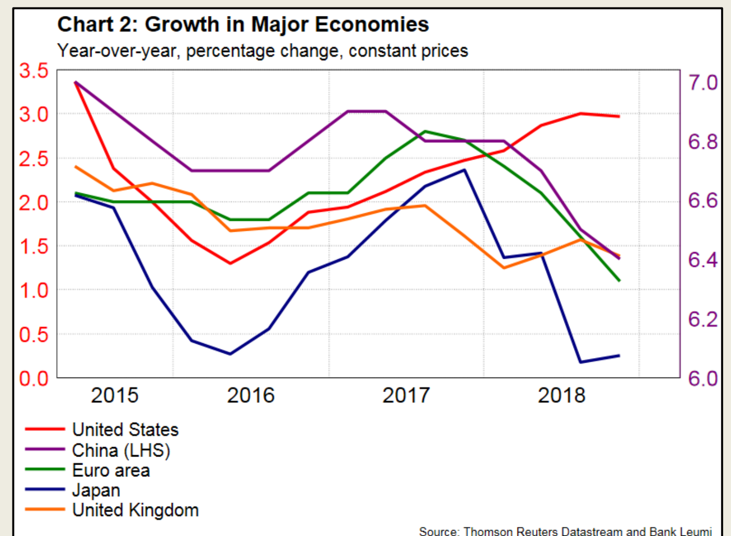
	2016	2017	2018E	2019F	2020F
GDP – Economic Growth, Rate of Change					
World	*3.2%*	*3.7%*	*3.6%*	*3.4%*	*3.4%*
USA	*1.6%*	*2.3%*	*2.9%*	*2.3%*	*1.5%*
UK	*1.8%*	*1.6%*	*1.3%*	*1.3%*	*1.5%*
Japan	*0.9%*	*1.7%*	*0.7%*	*1.0%*	*0.4%*
Eurozone	*1.7%*	*2.5%*	*1.8%*	*1.2%*	*1.4%*
South East Asia (ex. Japan)	*4.5%*	*5.2%*	*5.0%*	*4.7%*	*4.4%*
China	*6.7%*	*6.9%*	*6.6%*	*6.3%*	*6.1%*
India	*7.1%*	*6.7%*	*7.3%*	*7.4%*	*7.2%*
Latin America	*-0.7%*	*1.2%*	*1.1%*	*2.0%*	*2.2%*
Israel	*4.0%*	*3.5%*	*3.3%*	*3.1%*	*3.6%*
Trade Volume – Quantitative Terms, Rate of Change					
Global	*2.3%*	*5.3%*	*4.4%*	*3.3%*	*2.8%*
CPI, Rate of Change, 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%*	*1.5%*	*1.7%*
Eurozone	*-0.1%*	*1.5%*	*1.7%*	*1.4%*	*1.5%*
Israel	*-0.5%*	*0.4%*	*0.8%*	*1.3%*	*0.6%*
Central Bank Interest Rates, Year End					
US Fed	*0.50-0.75%*	*1.25-1.50%*	*2.25-2.50%*	*2.25-2.75%*	*2.00-2.50%*
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): a slowdown in global economic growth occurred in the first quarter of the year against the backdrop of weakness in the industrial sectors. Activity is expected to slightly accelerate in the second quarter.

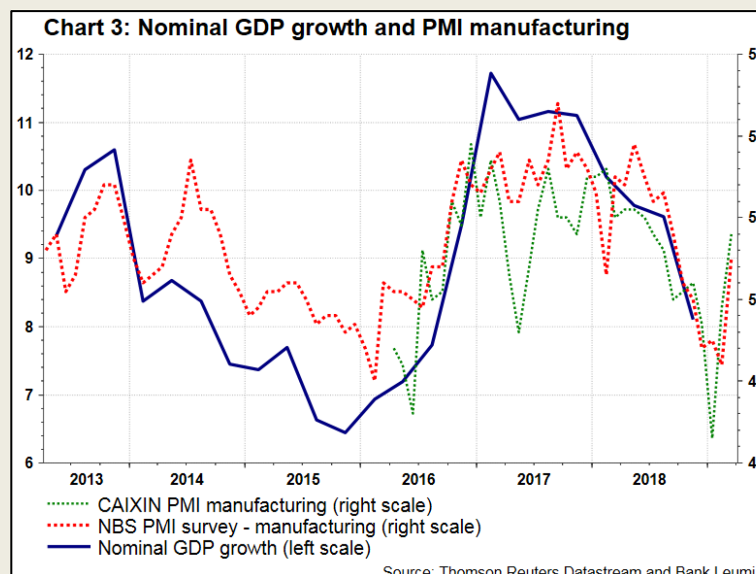
- According to recently published economic data, it appears a slowdown in economic activity occurred among some of the major economies of the world in the first quarter of the year, particularly within developed countries. The slowdown is evident primarily in the industrial manufacturing data and in international trade, whereas growth in the services sectors continues to be strong (chart 1).
- Among the major economies (chart 2), it appears a slowdown occurred in the US in the first quarter, due to, among other things, a slowdown in domestic demand and in private consumption in particular. This comes against the backdrop of severe weather conditions, the partial government shutdown in the beginning of the year, the fading positive effects of the expansionary fiscal policy, and the effects of the interest rate hike in recent years that affected the sectors that are interest rate sensitive, such as real estate. On this regard, there was a decrease in housing demand, and consequently a slowdown occurred in the demand for durable goods. Furthermore, the slowdown in exports and in the industrial sectors continues to weigh on the euro bloc, particularly the countries open to trade, among them Germany, which has recently been characterized by moderate growth. Also, the political risks in the region are having a strong influence over the growth environment in Europe, a development that can be seen in a number of large European economies, including Italy and France.
- The uncertainty surrounding Brexit continues to take a high toll on the British economy, which is being expressed primarily in a weakness in investments. On Thursday (11.04.2019), the EU officials granted the UK a second delay to Brexit until October 31st 2019, meaning further uncertainty which will continue to weigh on GDP growth in the short-run. In addition, growth in Japan apparently slowed in the first quarter from both base effects and due to a substantial slowdown in exports and in industrial manufacturing. In our opinion, growth in the developed countries will moderate this year compared to last year, led by the US, which apparently reached a peak rate in the current growth cycle, and due to the slowdown in some of the European countries. It is important to note that financial institutions these days are continuing to revise their 2019 growth forecasts downwards.





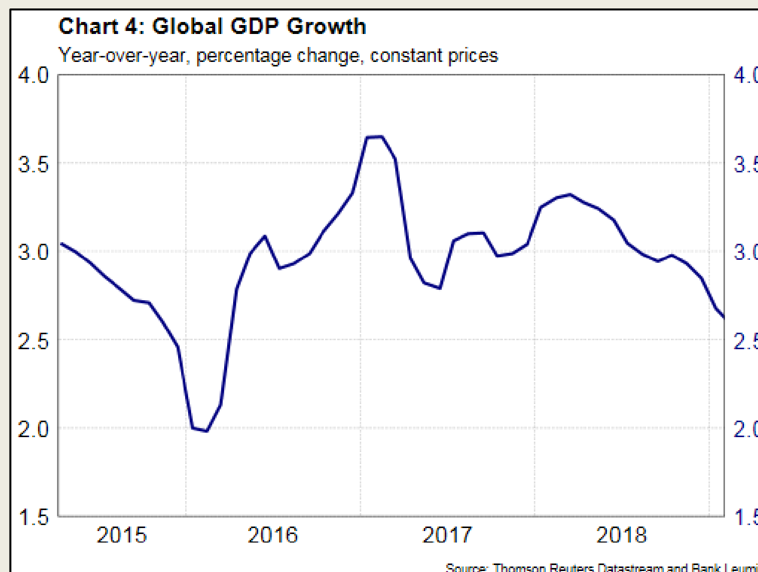
Economic activity and global forecasts (2): a slowdown in global economic growth occurred in the first quarter of the year against the backdrop of weakness in the industrial sectors. Activity is expected to slightly accelerate in the second quarter.

- Among the developing countries and emerging markets the growth picture was slightly more mixed. Whereas in China the data attest to a slight slowdown in growth, in India the growth rate is expected to increase in the first quarter following a slowdown in the preceding quarter. In South America economic activity is expected to continue to grow gradually against the backdrop of, among other things, expectations for an economic recovery in Brazil and in Mexico, whereas the weakness in economic activity in Argentina has continued against the backdrop of the high risk environment. The growth rate in the developing countries is expected to remain stable in 2019 compared to last year with variances among the different regions. The slowdown in growth in the large economies of Europe will weigh on the growth in the economies of eastern and central Europe. On the other hand, the economic recovery in South American countries is expected to continue this year at a moderate and gradual pace. In Asia, the growth rate is expected to moderate slightly against the backdrop of forecasts for a slowdown in China, even though the slowdown is not expected to be substantial. In addition, we do not rule out an upward surprise in China's growth data in the event the government's economic plans will succeed there.
- Despite the slowdown in China, recently we have witnessed a number of positive economic figures in the economy. Data on retail sales growth attest to a cessation in the downward trend, at least temporarily, in recent months; the growth in fixed capital investments increased somewhat recently after a long-term downward trend, and the slowdown in M1 money supply growth (a variable used as a leading indicator of growth in China) ceased recently. In addition, the PMI data in February and March showed an improvement in economic sentiment (chart 3), and the stock market indices reflect optimism recently. However, in our opinion it is still too early to reach a conclusion that the slowdown in the Chinese economy has ended and that we are at the beginning of a stage of accelerated economic activity. It appears that relative weakness still exists in the export and industrial sectors, and the recent improvement is the result of expansionary economic policy of the government on both the monetary and the fiscal sides. The success of economic policy, together with reaching a trade agreement between the US and China (the forecasts for the timing of a signing of an agreement of principles ranges between April and June of this year), will likely provide a tailwind to the economy and the financial markets, at least in the short-term.



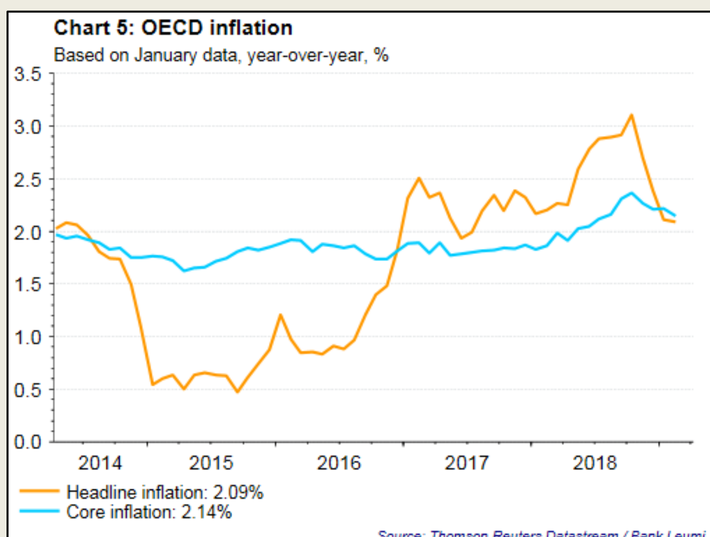
Economic activity and global forecasts (3): a slowdown in global economic growth occurred in the first quarter of the year against the backdrop of weakness in the industrial sectors. Activity is expected to slightly accelerate in the second quarter.

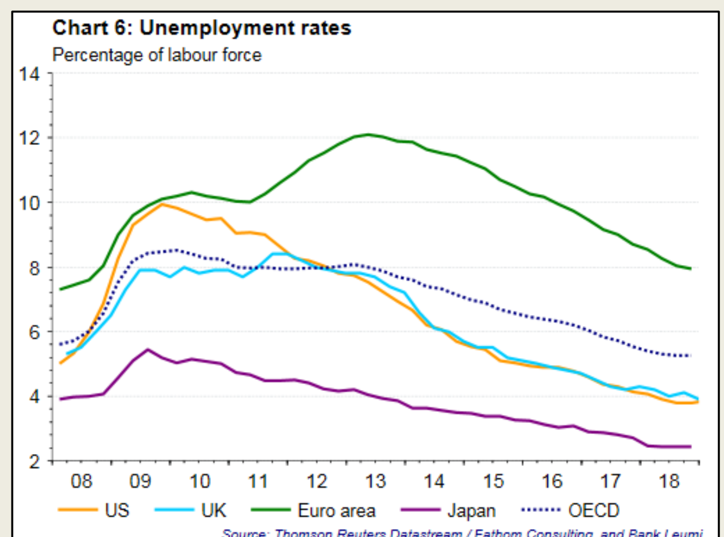
- According to data from the March PMI, it is likely that a change occurred in the economic sentiment at the global level. The Composite Index, which includes the industrial and services sectors, increased to a four month high. This was primarily led by the services sectors, whereas the weakness in the industrial sectors is continuing. However, it is important to note that recently an improvement occurred in the expectations among businesses in the industrial sectors, a development that if it will continue, may be reflected in an increase in activity in the sector at least in the short-term.
- We assume that in the second quarter of the year there will be an increase in economic activity after the recent slowdown (chart 4). This assumption is supported by leading indicators and by data from different business surveys, and is based also on the assumption that the slowdown in the first quarter was affected by, among other things, temporary and transient factors, primarily in the US and in China, which are not expected to have an impact in the current quarter. Looking at the whole year, we forecast the economic growth rate will moderate slightly to a rate of 3.4% this year compared to 3.6% in 2018. Next year the growth rate is expected to remain stable.
- The main risks to growth are related to the degree of uncertainty surrounding the trade policy of the US, even though recently the media has published that the sides are close to an agreement that may be signed in the coming months. However, it is possible that the next goal in US trade policy will be extracting a better trade deal from the EU. Other main risks include the uncertainty surrounding Brexit, and political risks in Europe against the backdrop of the elections to parliament and elections in some of the economies on the continent, and financial risks in some of the large developing countries that are characterized by weak fundamentals. Recently we have been witness to a substantial weakness in the currencies of emerging markets, and particularly Turkey and Argentina, which are characterized by high political risks, weakness in economic activity, and a lack of confidence among investors. The realization of just one of the primary risks will likely cause a substantial rise in volatility in the financial markets during the year.



Inflation and monetary policy: Central banks are expected to continue to be characterized by a dovish stance and to support a low yield environment in the bond market.

- Inflation in the OECD countries remains stable at around 2.1% - the lowest level since August 2017 (chart 5). The recent decline in inflation stems primarily from a lagging effect of the drop in oil prices in the last quarter of 2018. The recovery in oil and other industrial commodities prices since the beginning of the year, against the backdrop of, among other things, expectations for the signing of a trade agreement between the US and China soon, will likely limit the downward trend in inflation and even support its stabilization at least in the short-term. Core inflation also moderated recently, albeit by a relatively small degree. We assume that the downward trends in the unemployment rate (chart 6), the increase in wages in the main economies of the world, and the strength of the services sectors, will limit the continuation of the moderating trend in core inflation in the short-term. Overall, we do not anticipate substantial inflationary pressures in 2019.
- Due to the slowdown in activity in the industrial sectors, the rise in the risks to growth, and the moderation in the inflation environment, central banks switched from a hawkish stance on monetary policy to a neutral stance or dovish recently. The US Fed announced at its March monetary meeting that it will conclude its balance sheet reductions in September this year and revised downward its interest rate forecast substantially. The ECB announced a new, third TLTRO plan and changed its intention regarding an initial interest rate hike to the end of the year. In the event the weakness in Europe will continue, then we do not rule out that the ECB will carry out additional expansionary monetary measures. In the emerging markets, the central bank of India lowered its interest rate in its last meeting and in China we assume a continuation of monetary expansion in 2019 at least.
- Due to the changes in the stances and in the policies of the leading central banks and against the backdrop of a change in the growth and inflation forecasts of leading financial institutions, recently we have witnessed a decline in short-term interest rate expectations in the US and in Europe. The changes in expectations and in the future interest rate paths were reflected also in the longer ends of the yield curves. In the US the yield differential between 3-month and 10-year government bonds declined to a negative level temporarily during the preceding month, this for the first time since 2007, and the curve of 2-year / 10-year bonds is still relatively flat. Also in Europe, the flattening trend in the curve is continuing due to the decline in the yields of 10-year bonds. Due to the recent macro environment we assume a low yield environment in the short-term, although we do not rule out that investors are pricing in a very pessimistic scenario for the real economy, this together with expectations for a very low inflation environment over time.

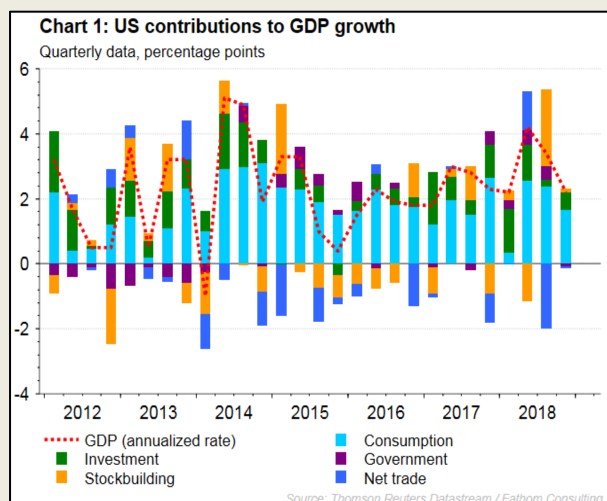


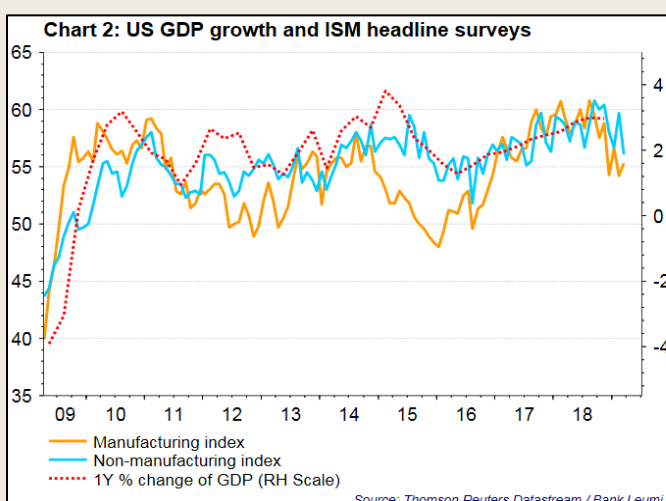


United States

Economic activity and forecasts (1): Growth is expected to accelerate in the second quarter of the year. It appears the degree of pessimism expressed in the bond market is overblown.

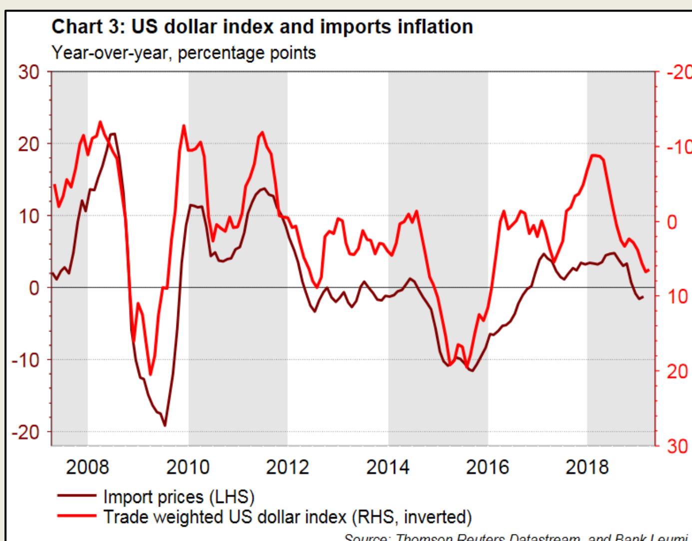
- The growth rate of the US economy apparently moderated in the first quarter of the year, for the third quarter in a row (chart 1), primarily impacted by private consumption data. This is due to, among other things, transient effects such as the partial government shutdown that continued also in January of this year, and the effects from the severe weather and residual seasonality in the first quarter of the year. In addition, it appears that domestic demand is in a slowdown against the backdrop of the fact that a substantial portion of the fiscal expansion implemented last year has already been fully realized. Furthermore, short-term interest rates are higher than what they were in the past. It is important to note that we do not forecast a substantial deterioration in private consumption. Households are expected to remain the main contributors to growth in the short-term at least, against the backdrop of positive labor market data, high consumer confidence levels, and the wealth effect.
- Despite the expected slowdown in private consumption in the first quarter, the overall growth of GDP is still expected to be reasonable, at a rate close to the first quarter average growth rate over recent years. This is due to the inherent positive contribution in the net trade of the US. The GDP growth in the first quarter in the US is expected to be around 1.5 – 2.0% in annualized terms, a level that is slightly weaker than the revised figure of 2.2% in the preceding quarter. Apparently, the growth rate in the second quarter will be greater than that in the first, after the preceding quarter was affected by temporary and transient factors. However, there are increasing signs that the growth of the US economy will slow this year. Our assumptions are reflected in a variety of indicators related to household demand, weakness in new orders in the industrial sectors, and a slight slowdown in activity in the industrial and services sectors (chart 2).
- We assume the growth in the US economy will slow during 2019-2020, perhaps even below the economy's potential growth rate, but currently we do not expect the economy to enter into recession in the short-term. This is a clear message against opinions trying to draw "exaggerated" conclusions from the changes in the yield curve. One of the best indicators for assessing the state of the US economy is the LEI index (Leading Economic Index), which is a leading indicators index that is based on ten economic indicators. Past experience shows that this index has a strong ability to predict the economy's entry into recession six months before it actually happens. To date, the change in the index is evidence of a slowdown in growth, to a moderate rate relative to that registered one – two years ago, and no expectation for a recession.

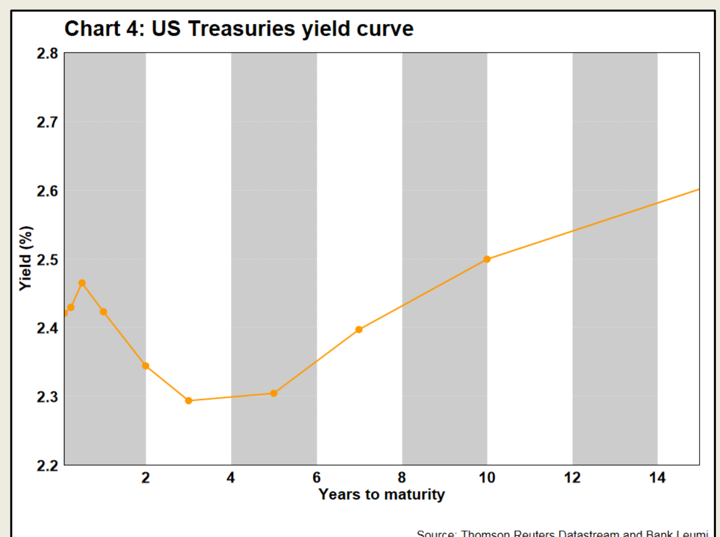




Inflation and monetary policy: The FOMC dovish stance limits a substantial increase in yields.

- Annual inflation (CPI) rose to 1.9% in March from 1.5% in the previous month, driven by a recent rebound in gasoline prices. In contrast, core inflation fell for the second month in a row, to 2% from 2.1% in February. Also the preferred inflation indices of the US Fed, and based on personal consumption expenditure prices (PCE), showed similar data. We do not forecast a continued substantial downward trend in inflation in the short-term, yet the delayed effects of the appreciation that occurred in the US dollar last year is likely to weigh on import prices and to "roll over" into the consumer price indices (chart 3). On the other hand, the recovery in commodities prices is likely to offset these effects to some degree.
- In its last monetary meeting the Fed kept the interest rate unchanged at 2.25% - 2.50%, as expected, but the overall meeting content was more dovish than expected. The interest rate path to the end of 2019, in the median of the forecast of the Federal Open Market Committee (FOMC) members, was lowered to 2.4% at year-end 2019, from 2.9% three months ago, a development that attests to a drop in the chances for a rate hike this year. The median forecasts for 2020-2021 were reduced as well, by 50 basis points, to 2.6% from 3.1% prior to that. It is important to emphasize this is the median of the range of forecasts, and there is a spread of opinions surrounding the median. Thus, according to the central tendency, the possibility for an additional rate hike in the short-medium term cannot be ruled out. In addition, the Fed announced it will conclude its balance sheet reduction plan in September this year. The balance sheet has already been reduced from US$4.3 trillion to US$3.8 trillion, and is expected to equal close to US$3.5 trillion in September under the revised plan. Starting from September, the Fed will reduce its MBS holdings by US$20bn per month. What this means is the Fed will be a net purchaser of government bonds in another six months.
- The current economic environment, together with the FOMC dovish stance, support a relatively low yield environment at least in the short-term. We have recently revised the yield forecast at the long end of the yield curve downwards (a 10-year bond forecast for 2019, on average, was reduced to 2.3% compared to 2.7% in the previous forecast). It is important to note that currently, the yield curve is U shaped and not completely inverted from beginning to end (chart 4). The markets expect the Fed rate to fall during the coming two years, but in less than five years from now interest rates are expected to rise again. Accordingly, although the 10-year yield is similar to that of the three months to maturity, the 10-year yield remains higher than that of the yield on 2-year bonds, and this is still not a clear indication for "recession". Nonetheless, there is also a clear message of the expected slowdown and adjustment of monetary policy of this in the short-medium term.

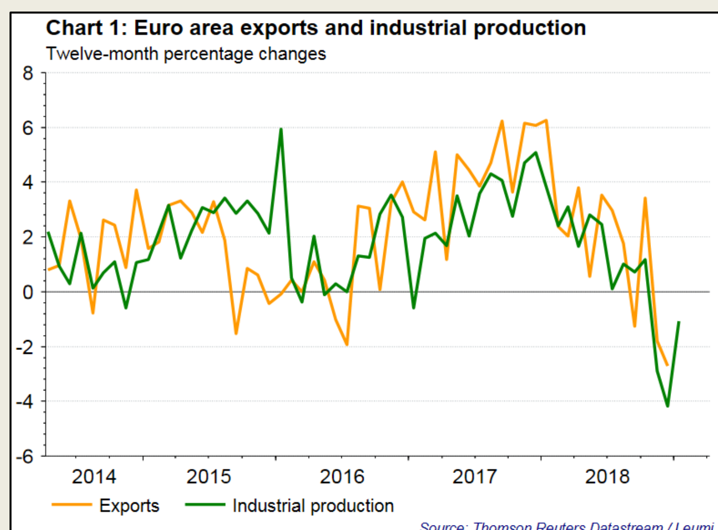


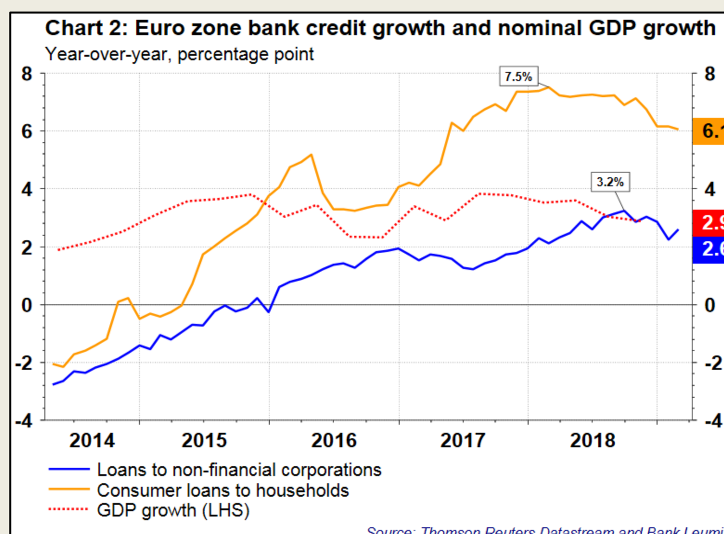


Euro Area

Economic activity and forecasts: The industrial economies are more vulnerable than economies that rely more on the services industries. We have revised our 2019 growth forecast downwards.

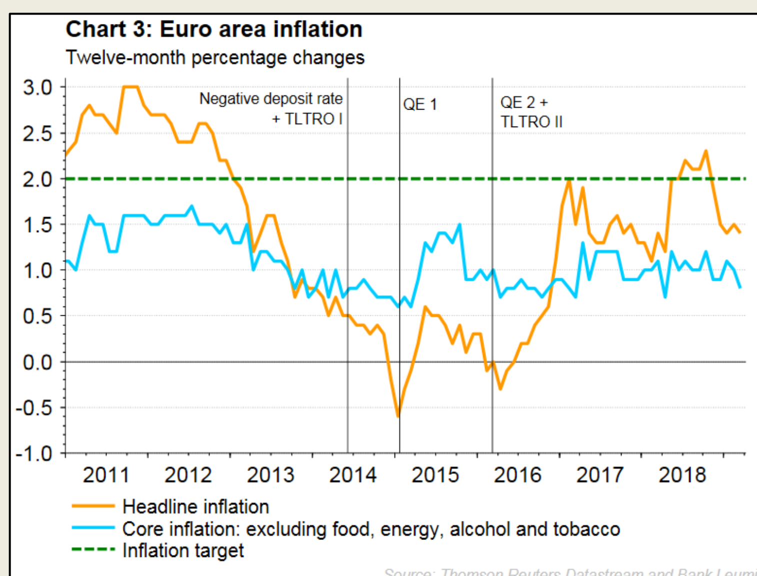
- Recently released data attest to a continuing moderate growth environment, similar to the growth rate in the two preceding quarters. However, it appears this is nothing more than a process involving a "normal" cyclical slowdown and not a downturn to recession. Consequently, the economic activity indices indicate a slow growth in the first quarter of the year, and it is expected GDP growth will be close to zero at only 0.2% (in quarterly terms), this for the third consecutive quarter. This is primarily due to weakness in the industrial sector, which is being restrained by weakness in exports (chart 1). On the other hand, the retail sales data for February and the indices on sentiment in the services sectors were relatively strong and are expected to support the economy at this time.
- In a geographical breakdown, there are variances in the performance of the four largest economies in Europe. In Italy activity shrunk in the fourth quarter of last year, although by "only" 0.1%. Different surveys show the recession in Italy continued in the first quarter of this year as well. Meanwhile, Germany barely avoided entering into a "technical recession" (a decline in GDP in two or more consecutive quarters) last year, and is expected to register low GDP growth in the first quarter of 2019. In contrast, GDP continued to expand in France and especially in Spain last year. In light of the differences in the business surveys between the industrial and the services sectors, it is reasonable to assume that the economies with the larger industrial sectors will be more strongly affected by the current slowdown. Among the four large economies, it appears Germany was the most affected, and apparently will be more affected also down the road, while France is likely to be less damaged.
- Parallel to the slowdown in economic activity, the most recent data indicate a slowdown in credit growth (chart 2), and this stands as the backdrop to the extension of the TLTROs of the European Central Bank (ECB). The growth in loans to the non-financial business sector declined from 3.2% during 2018 to only 2.6% recently. Also credit to households, excluding housing, registered a slowdown in growth. The past record indicates a high correlation between credit expansion in the Eurozone and GDP growth, and the credit factor now points to GDP growth at a rate of 1% in real, annualized terms at best. Among the core countries, the growth in loans to businesses fell sharply in Italy and Spain. Previously, the banks in Italy and Spain "leaned" heavily on the TLTRO loans of the ECB. The TLTRO loan mechanism should help to maintain credit availability and low interest rates. Against the backdrop of the latest data, we revised our 2019 growth forecast to 1.2% compared to 1.4% in the previous forecast, and this compared to 1.8% growth last year and 2.5% growth in 2017.





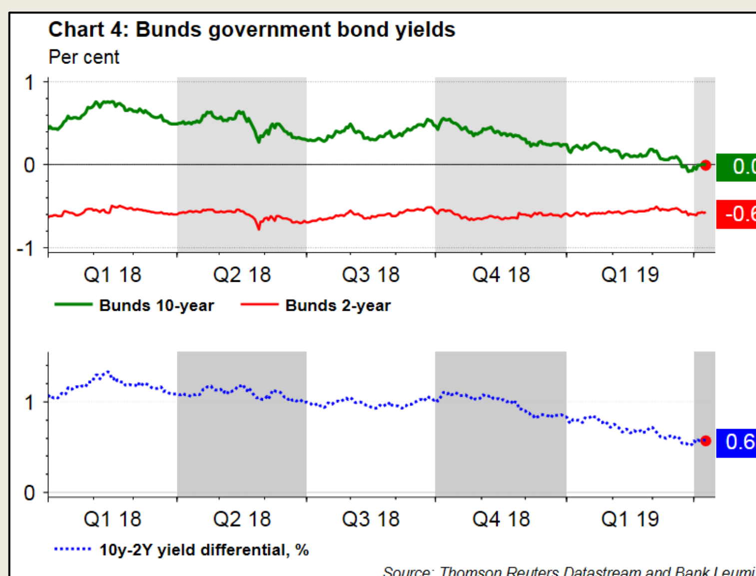
Inflation and monetary policy (1): The monetary policy of the ECB is expected to support the availability of credit and low interest rates across the yield curve.

- Inflation in the euro bloc declined in March to an annual rate of 1.4%, compared to 1.5% in the preceding month (chart 3). At the same time, core inflation declined to 0.8% compared to 1.0% in February. The decline in inflation stems from, among other things, the late timing of the Easter holiday this year (weighed on flight prices and vacation costs), the slowdown in wages in the fourth quarter, and the slowdown in services inflation recently. Looking forward, we do not expect substantial inflationary pressures in the short-term during the year, and core inflation is expected to remain moderate, likely at a rate of slightly more than 1% in the short-term.
- At the conclusion of its latest meeting on April 10, the ECB did not make any substantial changes in its announcements compared to the March meeting. As a reminder, in the previous meeting the central bank announced an additional round of TLTRO and changed its expectation regarding interest rates, while extending the expected timing for the initiation of a hike – to the end of the year.
- According to the speech of the ECB president, Mario Draghi, from the end of March, the ECB is likely to provide further support to the economy throughout the year. The ECB president emphasized that despite the fact that the central bank lowered its GDP growth forecasts, the risks are biased downwards toward an additional weakening in the economy. In particular, he noted that external demand was weak and able to damage the local economy.
- According to the economic developments, it cannot be ruled out that the ECB may further lower the macro-economic forecasts in the coming months. At the same time, the ECB is likely to provide more dovish forward guidance that will include a delay in the expected timing for an interest rate hike to late 2020, and it is possible that the ECB will suggest an improvement in the conditions for long-term loans within the framework of TLTRO - III.



Inflation and monetary policy (2): The monetary policy of the ECB is expected to support the availability of credit and low interest rates across the yield curve.

- Since the monetary meeting in March, government bond yields fell broadly in the euro bloc countries, primarily at the longer end of the yield curve. Furthermore, it is quite possible that the yields fell also against the backdrop of expectations that the ECB will once again implement QE actions, including purchasing government bonds and other financial assets, in 2020.
- History has shown that the ECB will apparently use some of the other tools it has at its disposal before it will turn to QE. These include an additional expansion of TLTROs and perhaps also a type of "operation twist" that the US Fed implemented in the past, in a European form, through which the ECB will purchase long-term bonds and will sell short-term bonds it has in its possession. In the absence of a sufficiently large inventory of government bonds for purchase in the market, the ECB is likely to buy additional assets, as was done in the past, and particularly corporate bonds.
- The hawkish faction within the ECB is likely to claim that the price of QE is too high in order to bring inflation to its target. If the next head of the ECB after Mario Draghi, who is supposed to be replaced at the end of October, will be Mr. Jens Weidmann from the German Bundesbank, then it will make the decision to implement QE that much more difficult. However, the fact that the ECB already carried out broad QE activity in the past is likely to make its implementation in the future easier. The content of the monetary meeting in March and the decline in interest rates also weakened the euro vis-à-vis the US dollar.
- Looking ahead, we are of the opinion that the yields-to-maturity of the German Bund will continue to be very low, since the expectations for a change in the interest rate remained very low and also since it is a type of "safe asset" (chart 4).



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