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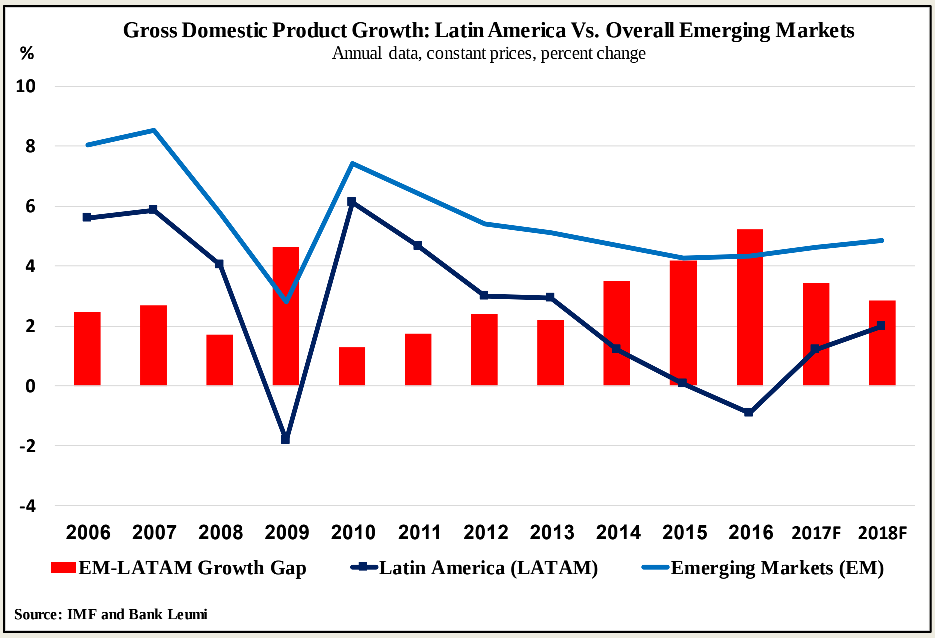
Leumi Global Economic Forecast, As of January 2018

	2015	2016	2017F	2018F
GDP – Real Growth Rate				
World	*3.3%*	*3.2%*	*3.7%*	*3.6%*
USA	*2.9%*	*1.6%*	*2.2%*	*2.5%*
UK	*2.2%*	*1.8%*	*1.6%*	*1.5%*
Japan	*1.3%*	*1.0%*	*1.6%*	*1.3%*
Eurozone	*2.0%*	*1.7%*	*2.4%*	*2.1%*
South East Asia (ex. Japan)	*4.5%*	*4.5%*	*4.9%*	*4.6%*
China	*6.9%*	*6.7%*	*6.8%*	*5.8%*
India	*7.9%*	*7.1%*	*6.7%*	*7.7%*
Latin America	*0.1%*	*-0.7%*	*1.2%*	*2.0%*
Israel	*2.5%*	*4.0%*	*2.9%*	*4.0%*
Trade Volume, Growth (%)				
Global	*2.5%*	*2.3%*	*4.6%*	*3.5%*
CPI, Annual Average (%)				
USA	*0.1%*	*1.3%*	*2.1%*	*2.2%*
UK	*0.1%*	*0.7%*	*2.7%*	*2.6%*
Japan	*0.5%*	*1.0%*	*0.5%*	*0.6%*
Eurozone	*0.8%*	*-0.1%*	*1.4%*	*1.5%*
Israel	*-0.6%*	*-0.5%*	*0.3%*	*0.6%*
Interest rates, Year End				
US Fed	*0.25-0.50%*	*0.50-0.75%*	*1.25-1.50%*	*1.75-2.00%*
Bank of England	*0.50%*	*0.25%*	*0.50%*	*0.50-0.75%*
Bank of Japan-Policy Rate	*0.00%*	*-0.10%*	*-0.10%*	*-0.10%*
ECB-Main Refi	*0.05%*	*0.00%*	*0.00%*	*0.00%*
Israel	*0.10%*	*0.10%*	*0.10%*	*0.25%*

Latin America

Latin American economies are expected to recover further in 2018 led by external demand: The Latin American economy registered a modest recovery in 2017, after the region experienced a recession in 2016. In fact, the region has faced major challenges over the past few years, reflected in a moderation in economic activity from 2011 until 2016, while other emerging and developing economies moderated to a lesser extent (see chart). This occurred as a result of: moderation in external demand from China and other trading partners; the global drop in commodity prices; capital outflows; and high levels of uncertainty among businesses and households, caused by, among other things, heightened political risks in several major countries that had negative effects on domestic demand as well.

Based on national accounts data from the first three quarters of 2017 and monthly indicators from the fourth quarter of 2017, we estimate that Latin American economies grew on average slightly more than one percent in 2017 (in line with IMF forecasts) following a contraction of 0.7% in 2016. Growth in the region is expected to accelerate in 2018 to 2%, led by Brazil and other commodity-exporting countries.



Changes in US trade policy may weigh on economic growth: The region is most likely to benefit from a possible acceleration in global trade, an increase in commodity prices, accommodative economic policies, and base effects. However, the recovery in the region is expected to be accompanied by risks for some of the economies. This is mainly due to the increase in uncertainty surrounding US trade policy, which is weighing on sentiment towards several countries in the region, and domestic political risks. Latin American economies are exposed unequally to possible changes in US monetary, fiscal and trade policies. With almost 80% of total exports destined for the US, Mexico is the most exposed, followed by Colombia. Trade links are lower for Brazil and Argentina and are composed of items that are less likely to draw US policy attention.

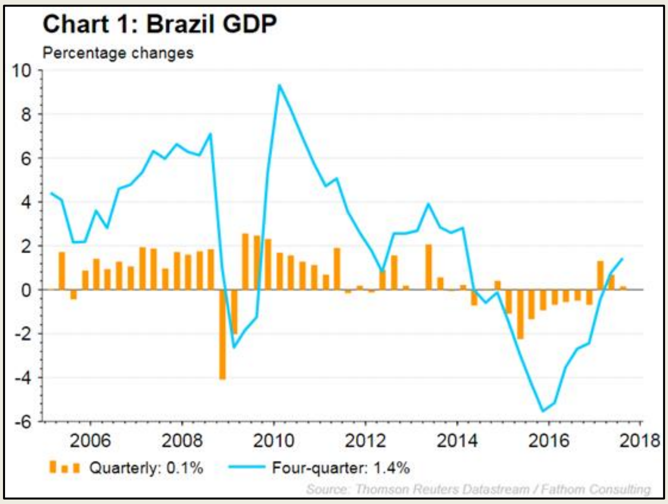
It should be noted that expansionary fiscal policy in the US, which will most likely encourage investment and consumption, should support an increase in demand for commodities and support an increase in commodity prices as well. Hence, some of the commodity-exporting countries, such as Brazil, Chile and Peru, which export capital goods and raw materials to the US, and are less likely to by targeted by US trade policy changes, are expected to benefit in net terms.

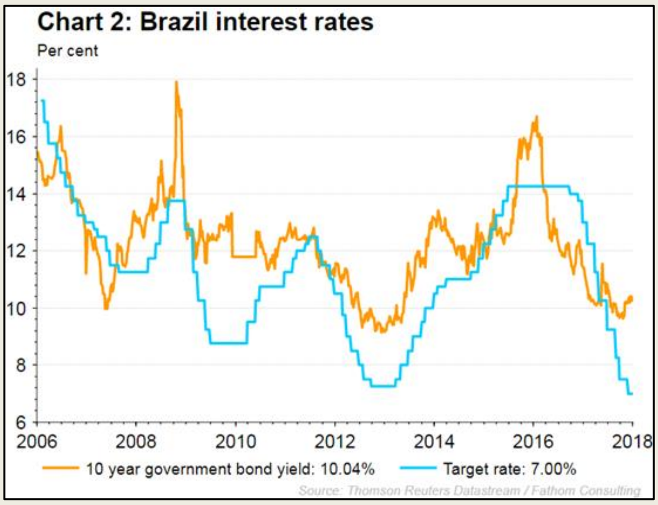
External accounts may benefit from the improvement in global trade: The improvement in external demand is expected to have a positive effect on the external accounts of some of the commodity-exporting economies. The current account deficit in Colombia is expected to decrease slightly, while the current account deficits in most of the major economies, including Brazil and Mexico, are expected to remain at relatively normal levels.

The fiscal profiles vary substantially by country: On the fiscal front, there are substantial variations among the region's economies. Brazil's fiscal profile is characterized by large budget deficits and high government debt, while Argentina also has both high budget deficits and government debt, but the fiscal parameters have improved recently and are expected to improve further in the short-medium term. On the other hand, Chile and Peru are characterized by much smaller budget deficits and relatively low debt.

Brazil - economic recovery in 2018. The easing cycle is nearing its end.

- The latest data on activity in Brazil suggest the economy recovered in 2017 from the recession it experienced in 2015-2016 (chart 1). The improvement in activity was led by private consumption, in tandem with the improvement in the labor market; and exports against the backdrop of the improvement in global trade. The improvement in Brazil's external demand has led to an improvement in its external accounts, reflected mainly in a decrease in the current account deficit.
- Brazil's economy is expected to grow 0.8% in 2017 after contracting 3.5% in 2016. Economic growth is expected to accelerate by a further 2.5% in 2018, led by domestic demand supported by a further improvement in the labor market, as well as expansionary monetary policy. The political uncertainty that has negatively affected the economy already for a considerable period remains a significant risk to our estimates. This political uncertainty may continue to weigh on business and investor sentiment at least until the October 2018 general elections.
- The decrease in inflation during 2016-2017 and the weakness in the economic growth situation allowed the central bank to cut its interest rate from 14.25% in September 2016 to a record low of 7.00% in November 2017 (chart 2). Inflation is expected to recover in 2018 but to remain below the central bank's inflation target for most of the year. Due to the low inflation and growth environment, we do not rule out another cut in the short-run, probably in the February meeting. That said, it seems that the potential for additional rate cuts throughout the remainder of the year is limited, as is the potential for a significant decrease in government bond yields.





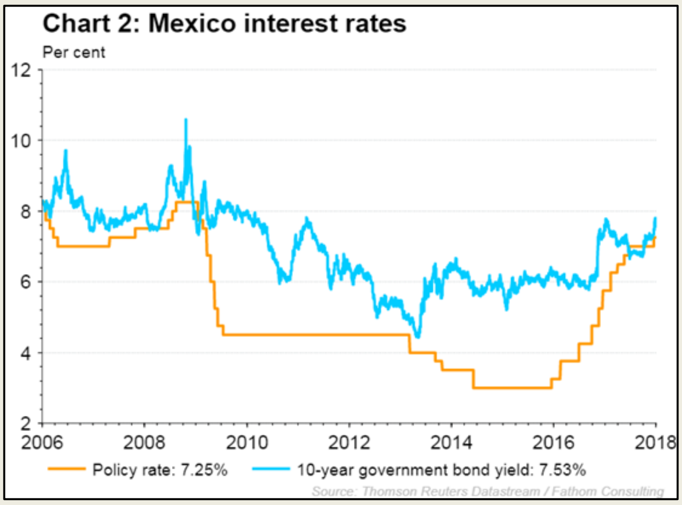
Mexico – heightened political risk will continue to weigh on domestic demand in 2018

- The Mexican economy contracted slightly in the third quarter of last year, after economic growth moderated for several quarters. The contraction in Q3 was probably temporary, driven mainly by a temporary decline in oil production as a result of hurricane season. The Mexican economy is estimated to grow by 2.1% in 2017, reflecting a moderation in the growth environment for the second year in a row. The moderation this year was partly a result of the weakness in business investment, mainly due to the increase in political risk stemming from both the uncertainty regarding NAFTA's negotiations, and the uncertainty surrounding the upcoming presidential elections, which will be held on July 1st, 2018.

  Another factor that weighed on domestic demand is the significant increase in the central bank's interest rate due to the high inflation environment.

- At this stage, it is hard to predict how the political risks will evolve. The NAFTA talks are expected to continue for many more months as there are several controversies regarding the US demands. Regarding the upcoming presidential elections, the race is tight, but it seems that Andres Manuel Lopez Obrador, of the left wing Morena party, is still the frontrunner for the presidency. Uncertainty regarding the existing political risks will continue to weigh on business confidence, sustain currency risks, and keep economic growth sluggish. We estimate Mexico's GDP growth will moderate slightly further in 2018 as the political risk is expected to weigh on domestic demand.

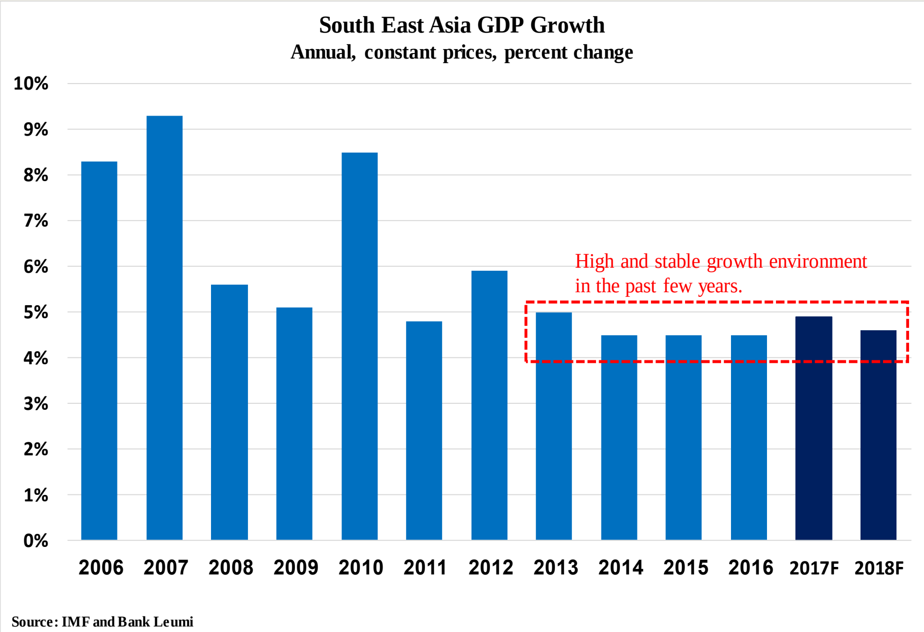
- Mexico's monetary policy will be largely dependent on how the NAFTA and electoral risks evolve, due to the effects of political risk on the country’s currency, and consequently on inflation. The central bank's policy may also be contingent on the US Federal Reserve actions, but due to the weakness in economic activity and expectations that inflation will moderate during 2018, we do not rule out a reverse in Mexico's interest rate cycle already in 2018.



Asia

The emerging Asian economy is expected to grow solidly also in 2018: Economic growth among the emerging Asian economies remained high in 2017 (see chart). This growth was driven by various factors including: the stabilization in China's growth environment last year; solid external demand from some of the major developed economies; strong government spending in some of the economies, including India and China; accommodative monetary policy in some of the countries in the region; and recovery in commodity prices.

Based on national accounts data from the first three quarters of 2017 and monthly indicators from the fourth quarter of 2017, we estimate that the South Asian region (excluding Japan) grew on average 4.9% in 2017 compared to 4.5% in the previous year. Growth in the region is expected to slightly moderate in 2018 to 4.6%, mainly due to the government managed slowdown in China (see the chapter on China). In contrast, economic growth is expected to accelerate in some of the emerging economies in the region this year, including India, Indonesia, and the Philippines.



The region's growth in 2018 will be supported by the following: improvement in domestic demand, driven mainly by economies that are expected to implement pro-growth fiscal policies; and solid external demand from the major developed economies. The economies that will most likely benefit from external demand are those that have a significantly high share of exports of goods and services going to the US and the euro area. The economies that may benefit from these themes include India, Indonesia, Malaysia, and Thailand.

Interest rates may rise in some countries, albeit modestly and gradually: The positive growth environment, in tandem with an expected recovery in headline inflation in the region, may force some central banks to hike rates in 2018, mainly in the economies that have negative or historically low real interest rates, such as South Korea and Malaysia. Recently, South Korea raised its interest rate, for the first time since the country started an easing cycle in 2012. We do not rule further hikes in 2018-2019, conditional on further improvement in economic activity.

The region is characterized by healthy external accounts: Most of the major economies in the region are characterized by surpluses in their current accounts or low deficits. As we wrote in the Latin America chapter, further improvement in global trade is expected to have a positive effect on external accounts, mainly for the commodity-exporting economies, including Thailand, Malaysia, and Vietnam.

The main risks for the region include: geopolitical risks, including the tensions between North Korea and the US; heightened domestic political risks in some countries; changes in US trade policy toward protectionism; significant worsening in China's debt situation and growth outlook and; substantially higher than expected interest rates hikes in the US, which may cause capital outflows and damage to investor and business confidence.

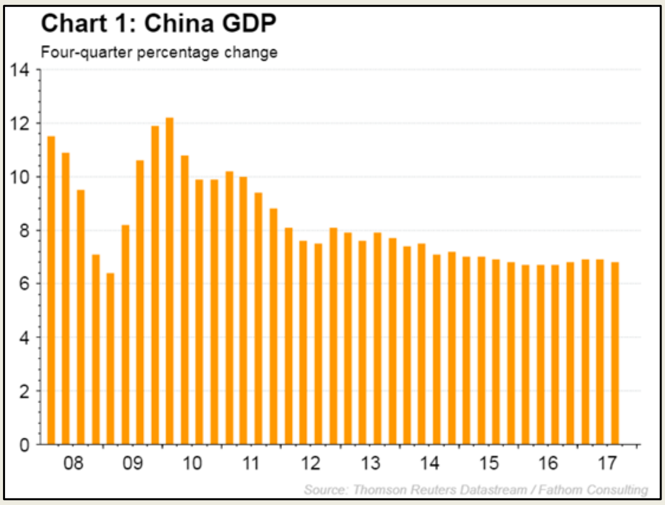
China - a managed slowdown led by the government in order to reduce economic risks.

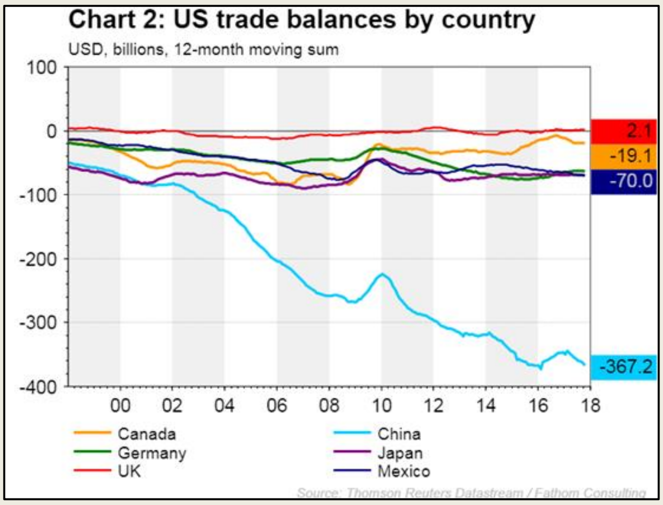
- China's growth environment has stabilized over recent quarters, and 2017 is likely to show a slightly greater growth rate than that in 2016, following several years of a slowing trend (chart 1). The stabilization was supported by private consumption, government spending, and an improvement in exports. However, a continuing trend of heightened regulation due to the risks in the financial and business sectors is expected to weigh on economic growth in the coming years.

- Business sector debt continues to rise and is currently at an historical peak level, and is very high in an international comparison. According to the Chinese government, this is the central risk in the economy, and the authorities are expected to continue to heighten supervision over the financial sector and to tighten the conditions for credit in order to lessen the risks in the economy.

- An additional risk that is likely to affect the Chinese economy involves protective trade policies imposed by the US administration against Chinese exporters as a result of the high trade deficit in US-China trade relations (chart 2). If this risk indeed materializes, it may cause financial capital outflows, resulting in a depreciation in the effective exchange rate and negative sentiment in the financial markets. The government’s economic policies are likely to lessen the risks. One of the central questions is if the government will succeed to lower the risks in the financial sector, and at the same time maintain a relatively high growth environment that will be sustainable.

- Based on the CDS spreads over the past year, it appears the concerns of investors in the financial markets have declined recently. However, from a macro- outlook, we estimate the risk environment in China is not as low as is reflected in the CDS spreads, but as we remarked prior, the risk environment will be strongly dependent on the success of the government reforms.



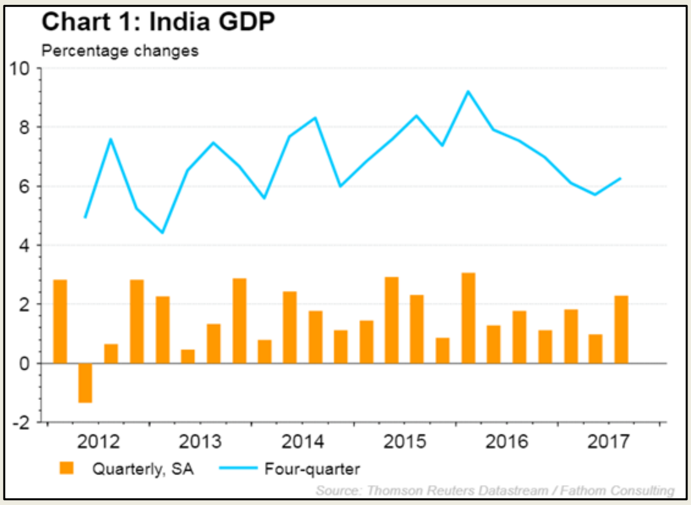


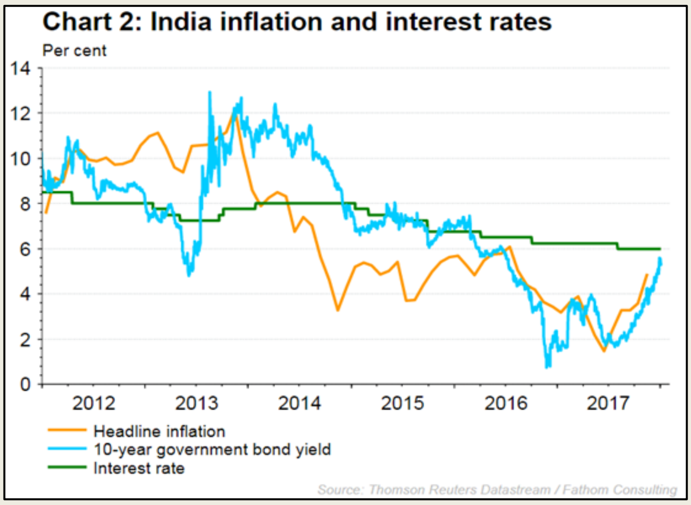
India – pro-growth economic reforms support a rise in India's potential growth.

- India's economy has been among the world's fastest growing economies over recent years. In 2014-2016, the economy grew at an average rate of 7.5% (8th in the world), compared to growth of 6.0% in the preceding three years. The main growth engine of the economy in recent years was domestic demand, which was supported by: an improvement in the labor market; improvement in business sentiment stemming from pro-growth government reforms; expansionary monetary policy in recent years; and relatively low oil prices.

- In the last few quarters, the Indian growth environment moderated (chart 1), partly due to an overcapacity in certain low-tech industries, a slowdown in credit growth due to weakness in the banks' balance sheets, and some government actions, including the removal of the largest banknotes from circulation and a large tax reform. The recent slowdown is most likely temporary, and GDP growth is expected to accelerate in 2018, led by domestic demand and government reforms (labor market, FDI, privatization, CAPEX, taxes, and more). According to the IMF, the implementation of the reforms is proceeding at a relatively rapid pace and expected to support a rise in India's potential growth rate to around 8% in the medium–term.

- Monetary policy in recent years has been characterized by a slow and gradual reduction in interest rates (chart 2). The recent rise in inflation and expectations for acceleration in GDP growth limit further cuts. Expectations regarding the interest rate direction are reflected in government bond yields, which have been upward trending in recent months. The rise in yields, which has intensified in recent months, has been accompanied by a steepening of the yield curve to a multi-year high, which may also indicate the direction and path of interest rates in the short- to medium-term.





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