



Financial
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Market Insights

Macroeconomic Review

January 2018



2018 – The End of Cheap Money

- The impressive economic growth that characterized 2017 is expected to continue
- The main focus economic policy management shifts from monetary to fiscal. More and more central banks are expected to tighten monetary policy, while governments increase public spending
- The increase in demand and the improvement in the labor markets, together with the stabilization, even the rise, in commodity prices are expected to lead to a rise in inflation
- The volatility in financial markets may increase as a result of reduced liquidity and bond / stock markets risks of underpricing

USA

- The economic upturn should be reinforced in the context of the tax reform. The indices forecast reflect a growth level higher than expected
- The labor market reflects full employment. The growing difficulty in recruiting skilled workers is expected to lead to pressure on wages, that in turn, will drive the prices up
- The interest rate is expected to rise three times in 2018, along with a gradual reduction in the Fed's balance sheet



2018 – The End of Cheap Money

Europe

- Unlike in previous years, the economic recovery includes all the Eurozone countries and is mainly based on domestic demand
- Sentiment indices are reaching their highest levels of the last decade which reflect high consumers businesses and investors' optimism, and consequently support the expectations of a continued growth in 2018
- The European Central Bank (ECB) is expected to end the bond purchasing program in September, however the interest rate is expected to rise only in 2019 while the accommodative monetary policy is expected to continue

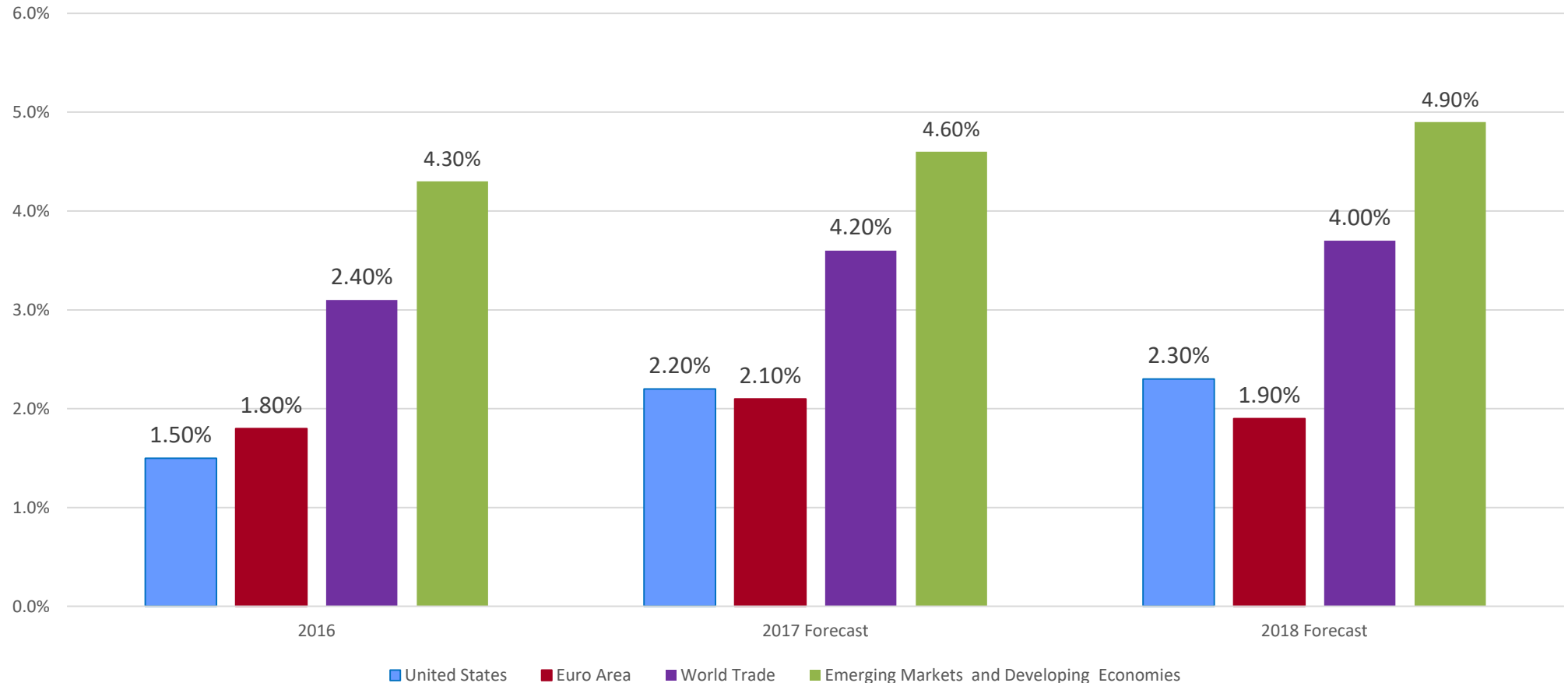
Israel

- The macroeconomic situation remains positive, in a context of full employment, decline in the ratio of debt-to-GDP, and a record level of foreign currency reserves and high-tech sector recruitment
- The main growth driver remains private consumption, which benefits from a “backwind” resulting of the low interest rate and the rise in real wage
- The Bank of Israel is expected to maintain the interest rate unchanged for a long period of time against the backdrop of zero inflation and strong Shekel. The low interest rate leads to a risk-free pricing, mainly on the bond and real estate markets



The Economy Changes Gear

Actual growth for 2016 and IMF's growth forecast for 2017 and 2018



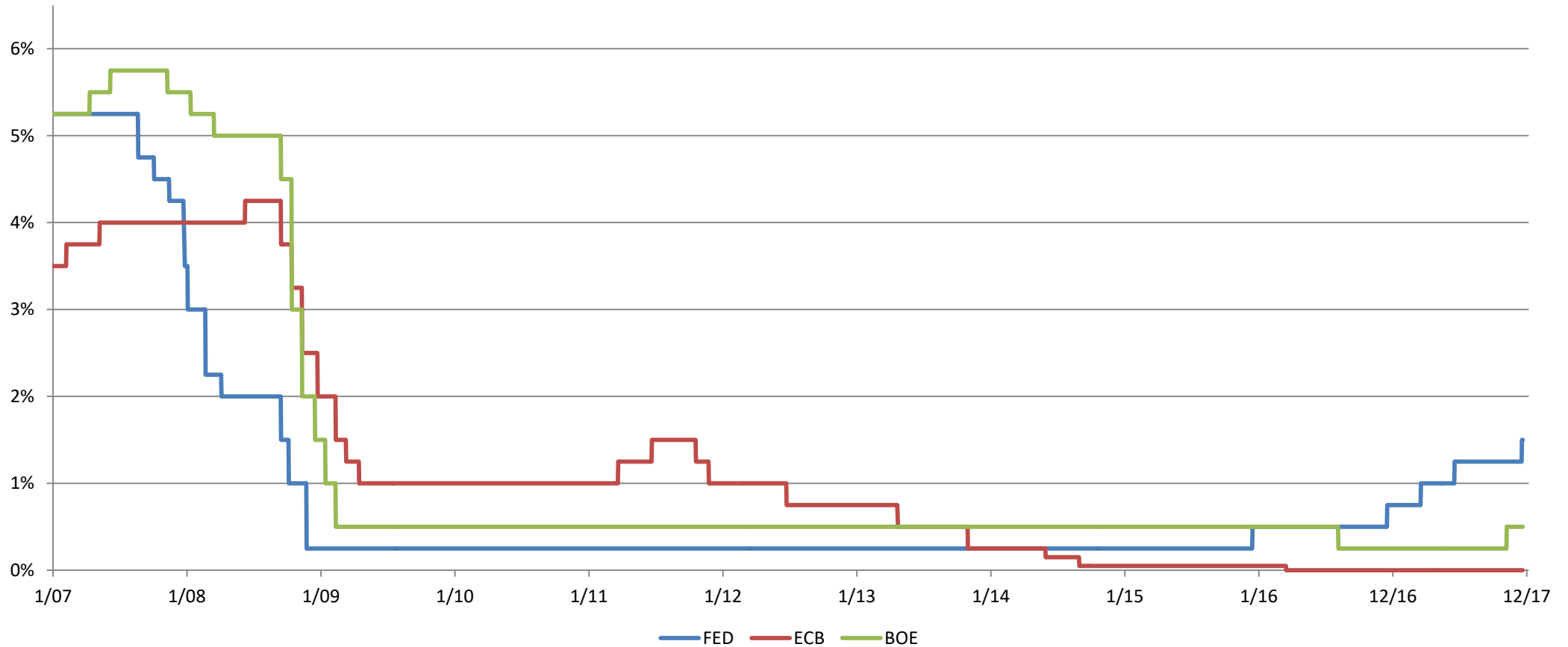
The IMF forecast was issued prior to the approval of the US tax reform, which is expected to accelerate growth in 2018 to 2.5%, based on the Fed forecast



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Monetary Policy Remains Expansionary

Interest rates of central banks in the US, Eurozone and UK

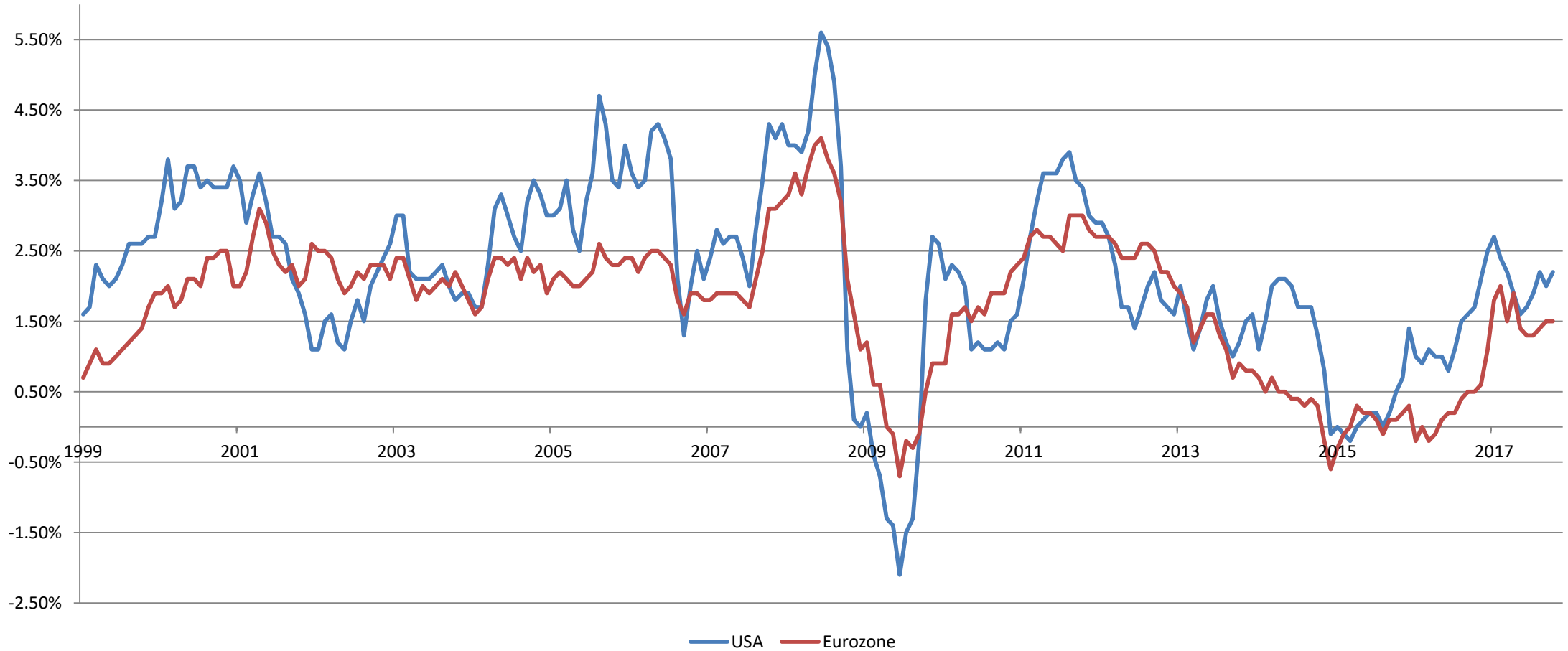




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Despite Strong Growth and High Liquidity, Inflation is Moderate

Inflation rate in the US and Eurozone (YoY)

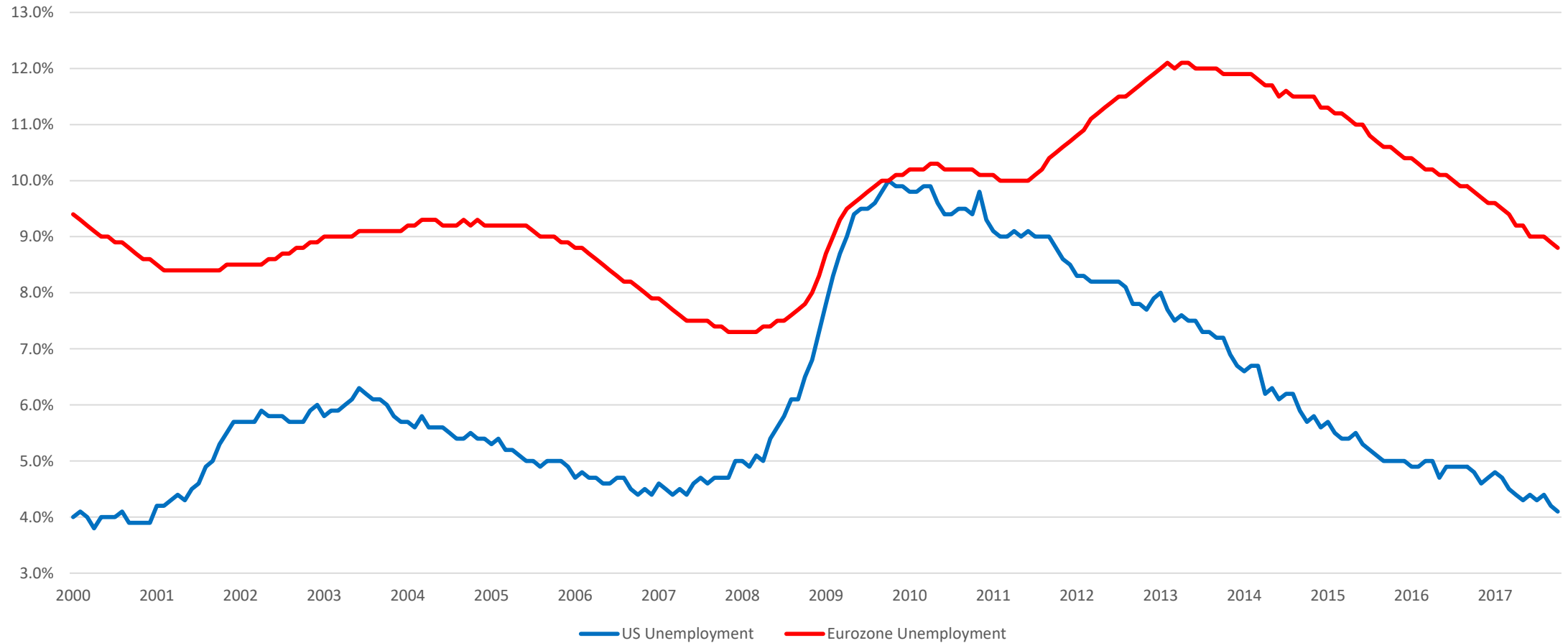




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Labor Markets are Showing Strength

Unemployment rate in the US and Eurozone

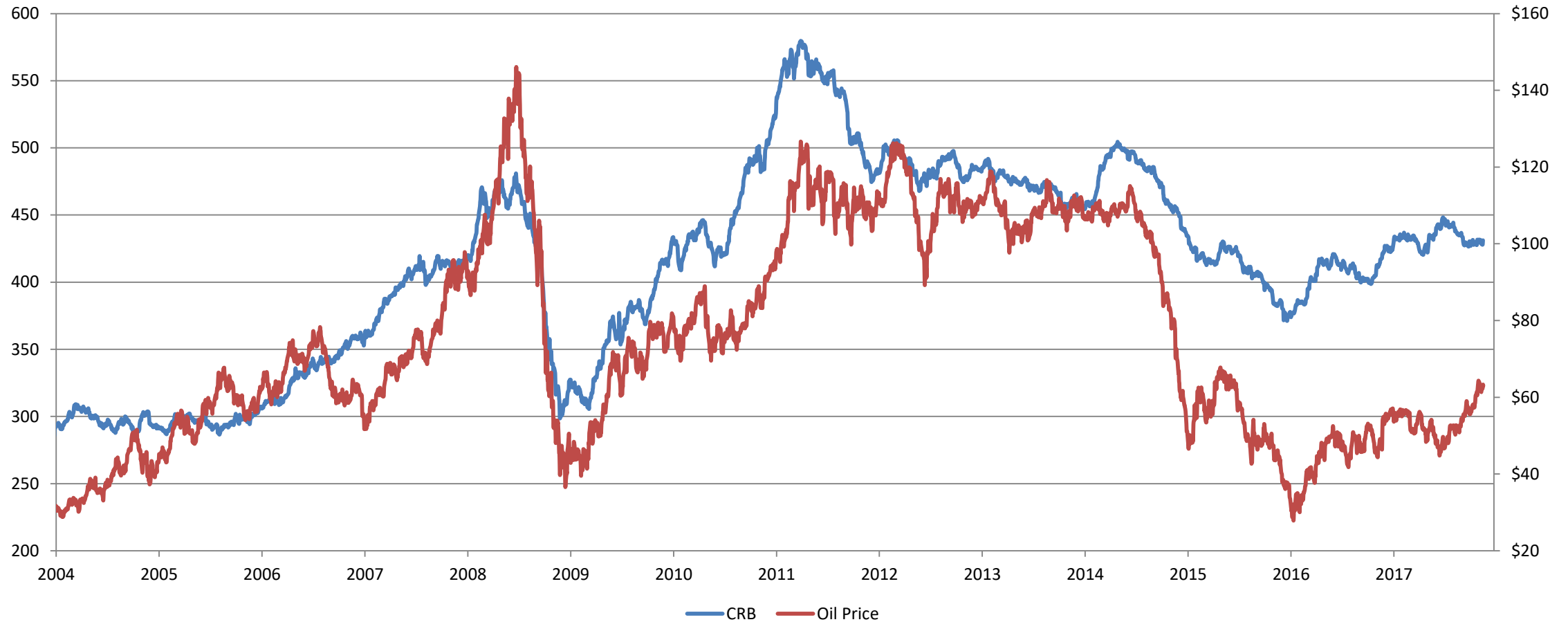




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The Decline in Commodity Prices was Halted

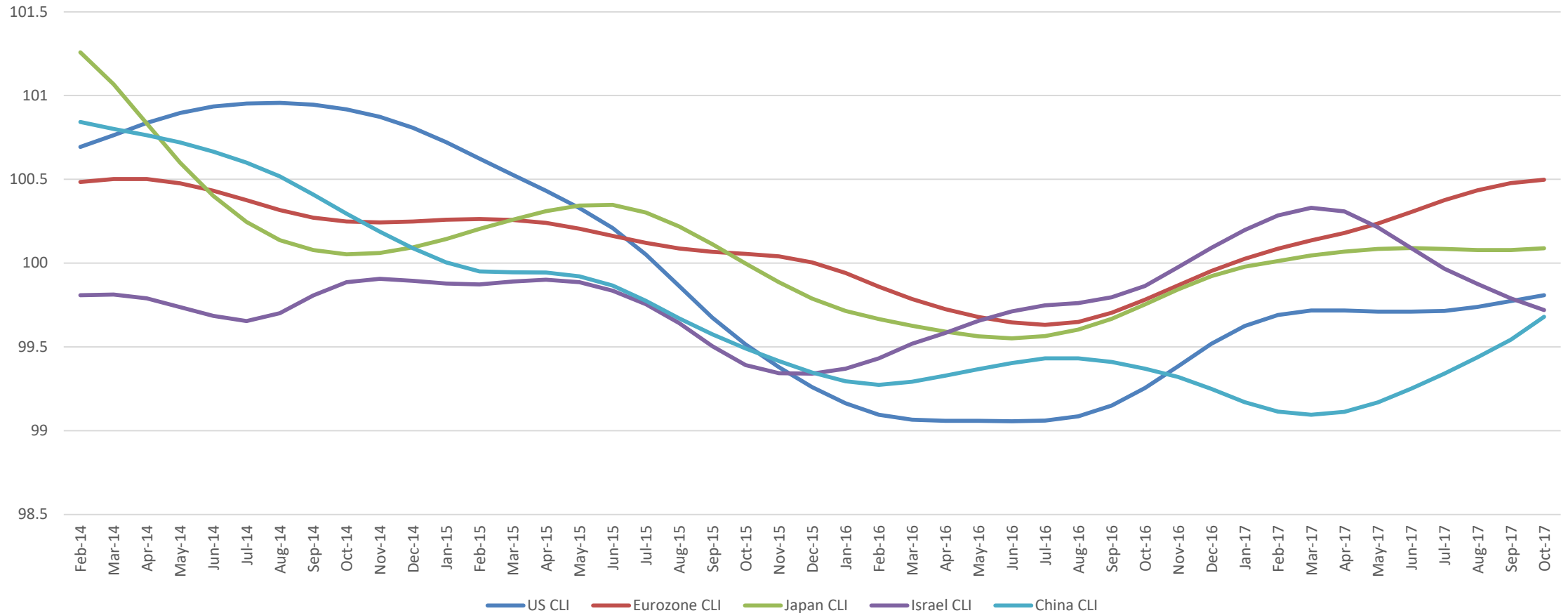
Price of a barrel of oil (right) and CRB commodity price index (left)





China and Europe May Surprise for the Best

Composite Leading Indicators (CLI) index

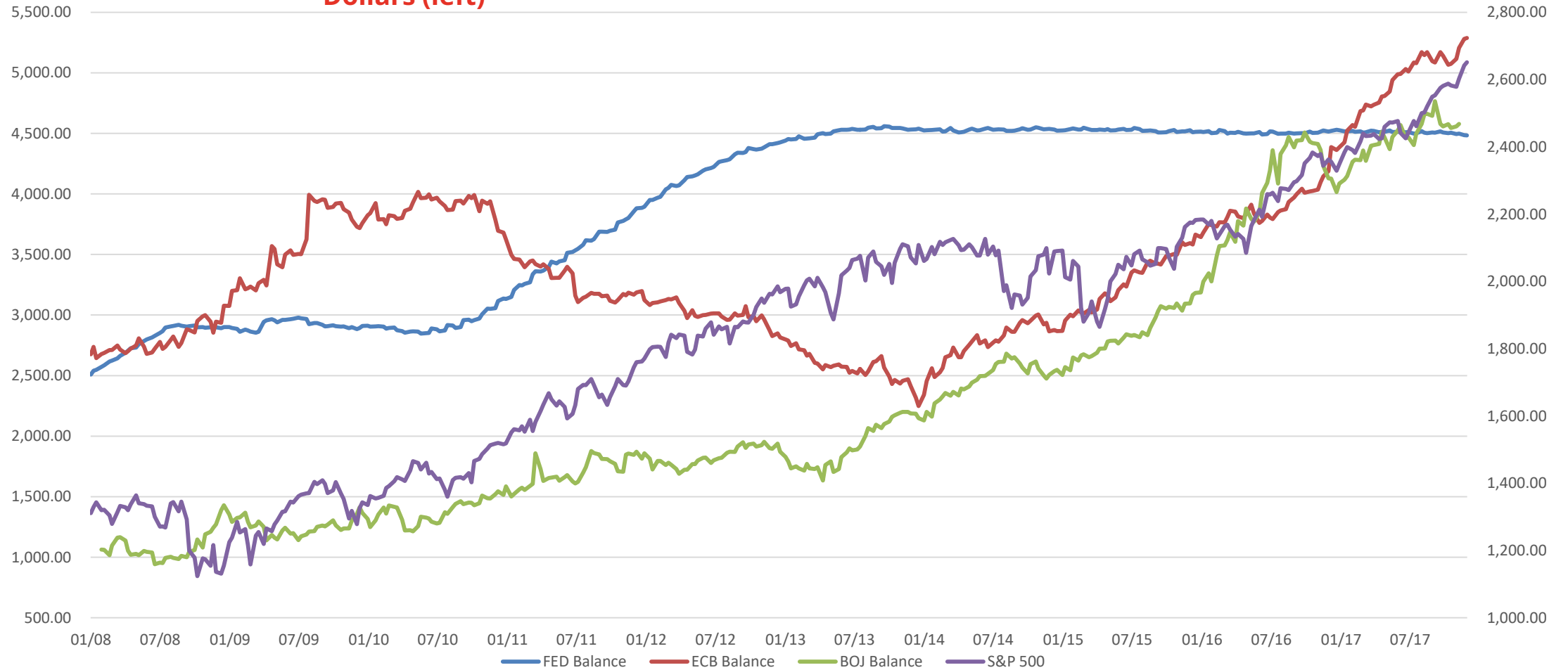


The CLI index gives an early indication of the "turning points" in the business cycle. Historically, the index was highly correlated with business cycles and actually preceded them by six to nine months



The Expected Decline in Liquidity is a Major Risk Factor

S&P 500 Index (right) and the volume of assets in the balance sheets of the central banks in billion Dollars (left)





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United States



Key Indicators

Data for 2017-2018 are based on the median of Bloomberg forecasts

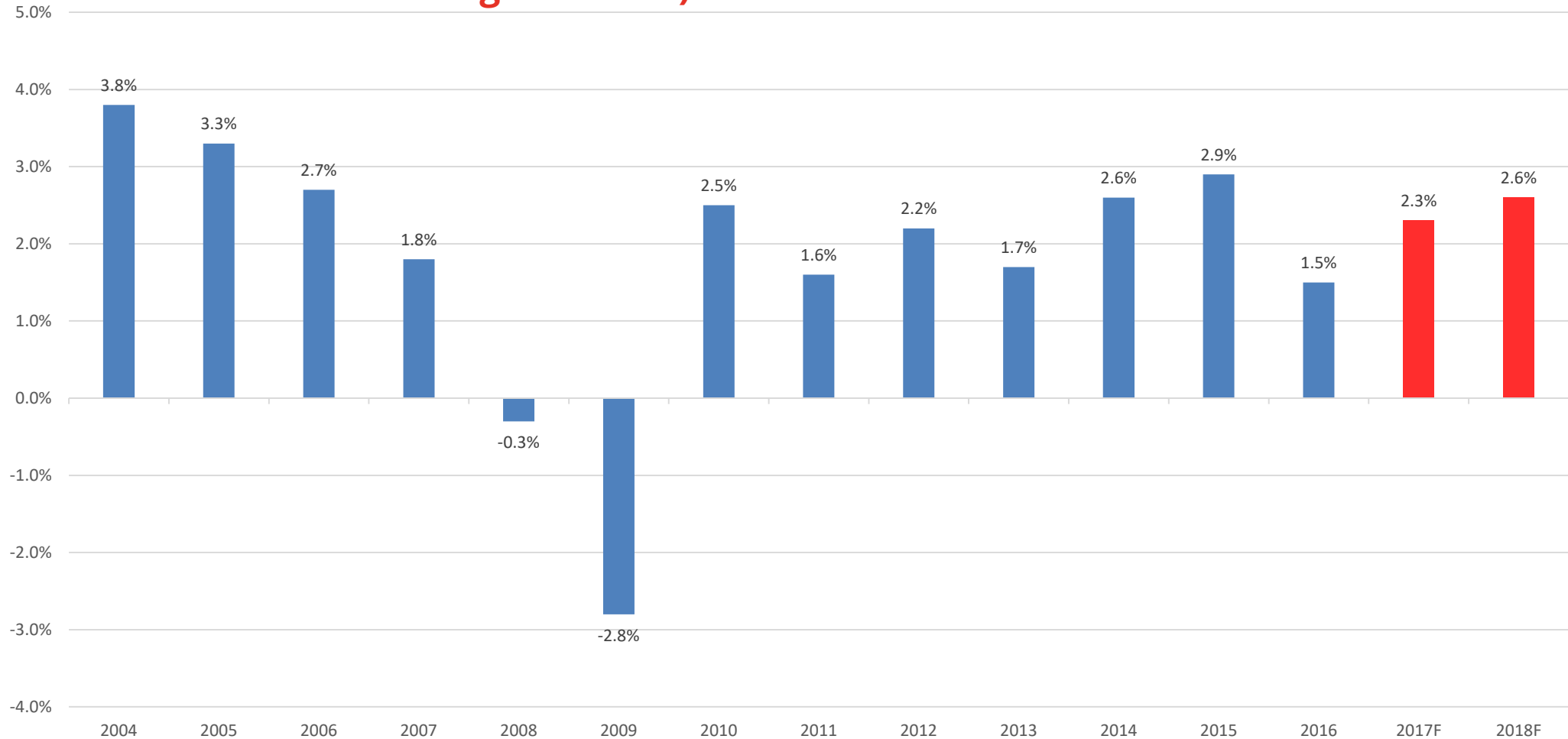
	2018	2017	2016	2015	2014
Growth Rate	2.6%	2.3%	1.5%	2.9%	2.6%
Unemployment Rate	4.0%	4.4%	4.9%	5.3%	6.2%
Inflation Rate (Core PCE, YoY)	2.1%	2.1%	1.3%	0.1%	1.6%
Central Bank Interest Rate (End of Year)	2.25%	1.5%	0.75%	0.5%	0.25%
Ratio of Surplus in Current Account to GDP	(2.5%)	(2.5%)	(2.4%)	(2.4%)	(2.1%)
Ratio of Public Debt to GDP	107.5%	107.1%	106.1%	101.2%	103.3%



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Towards a Decade of Continuous Growth

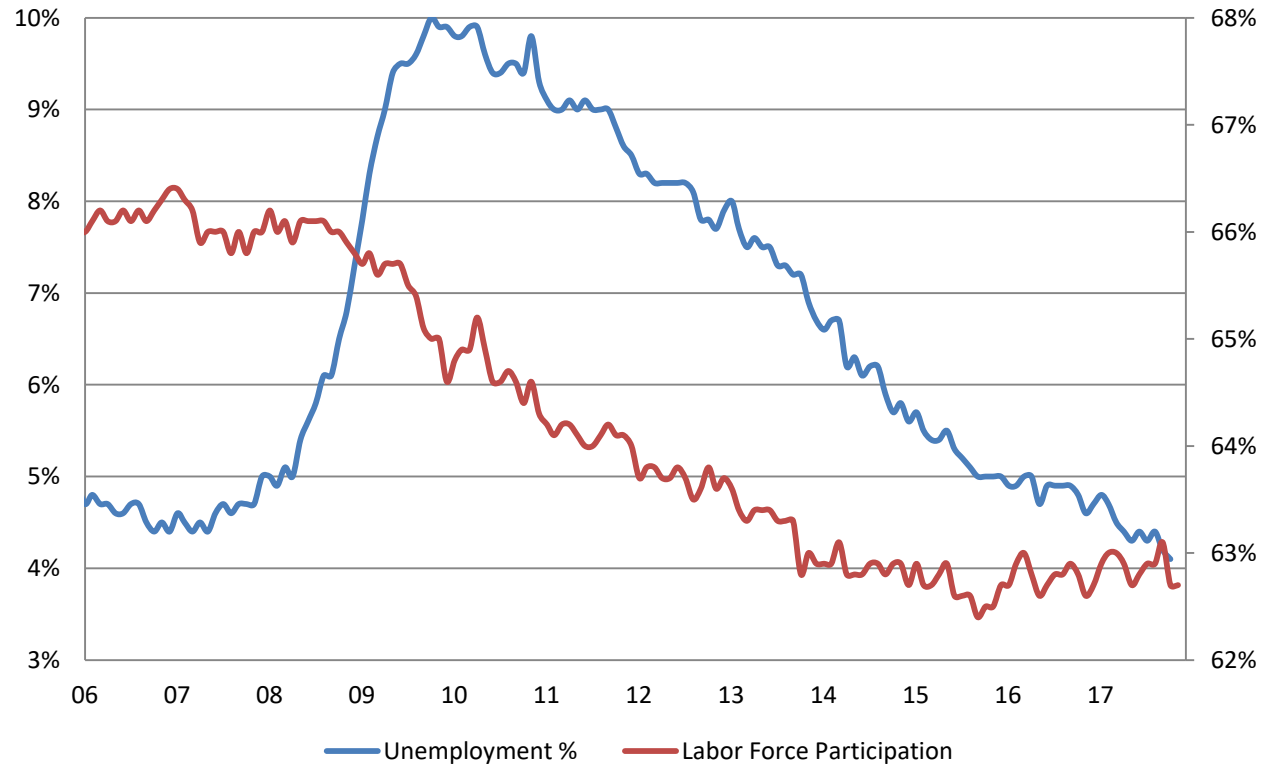
Annual Growth Rate (data for 2017-2018 are based on the median of Bloomberg forecasts)



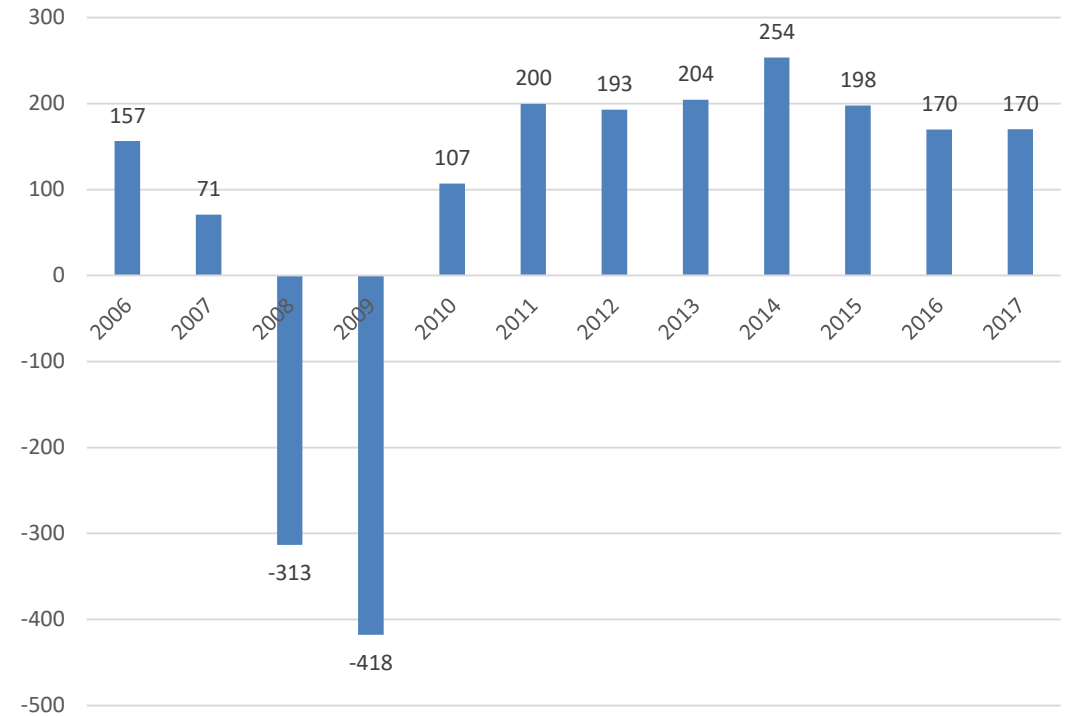


Full Employment on the Labor Market

Unemployment Rate (left) and Labor Force Participation Rate (right)



Average Monthly Employment Growth (in thousands)

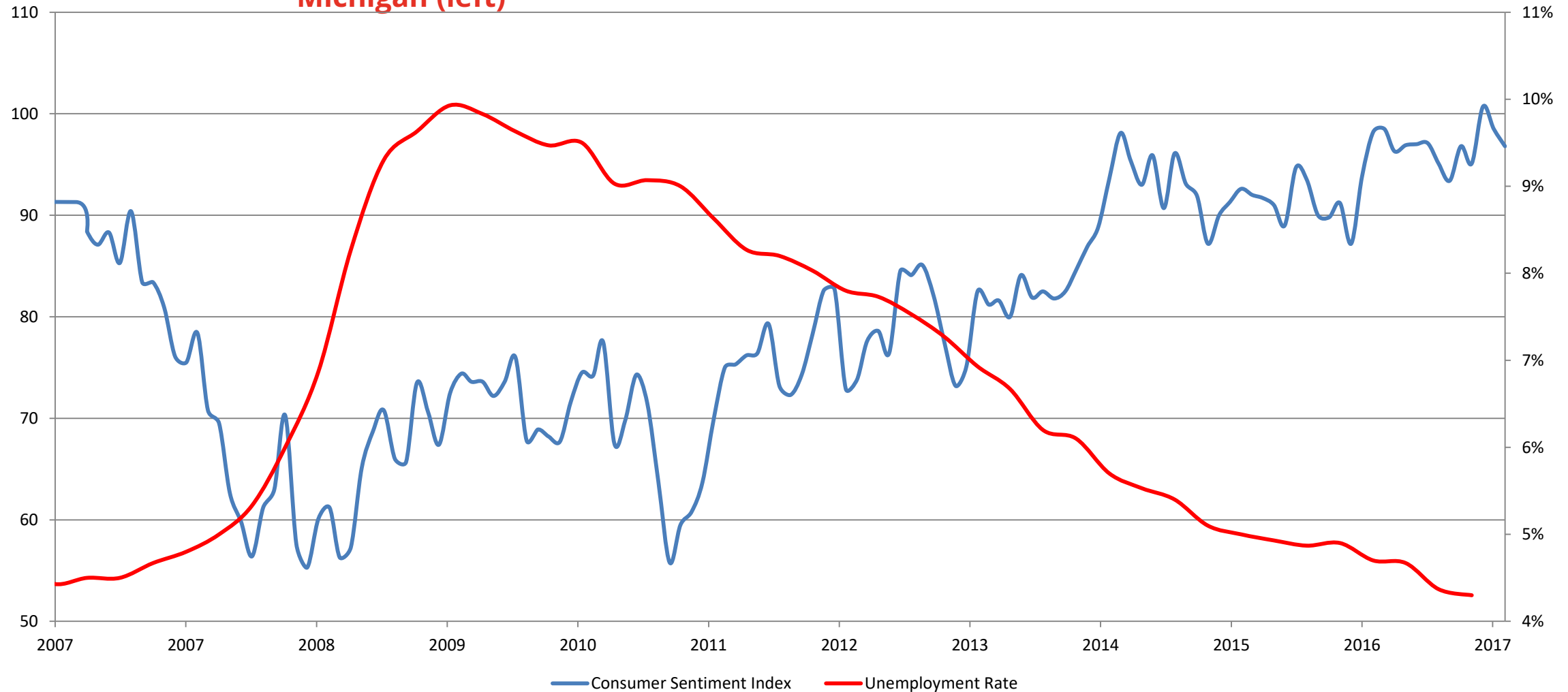




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Consumer Optimism is Supported by the Labor Market

Unemployment Rate (right) and Consumer Confidence Index of the University of Michigan (left)

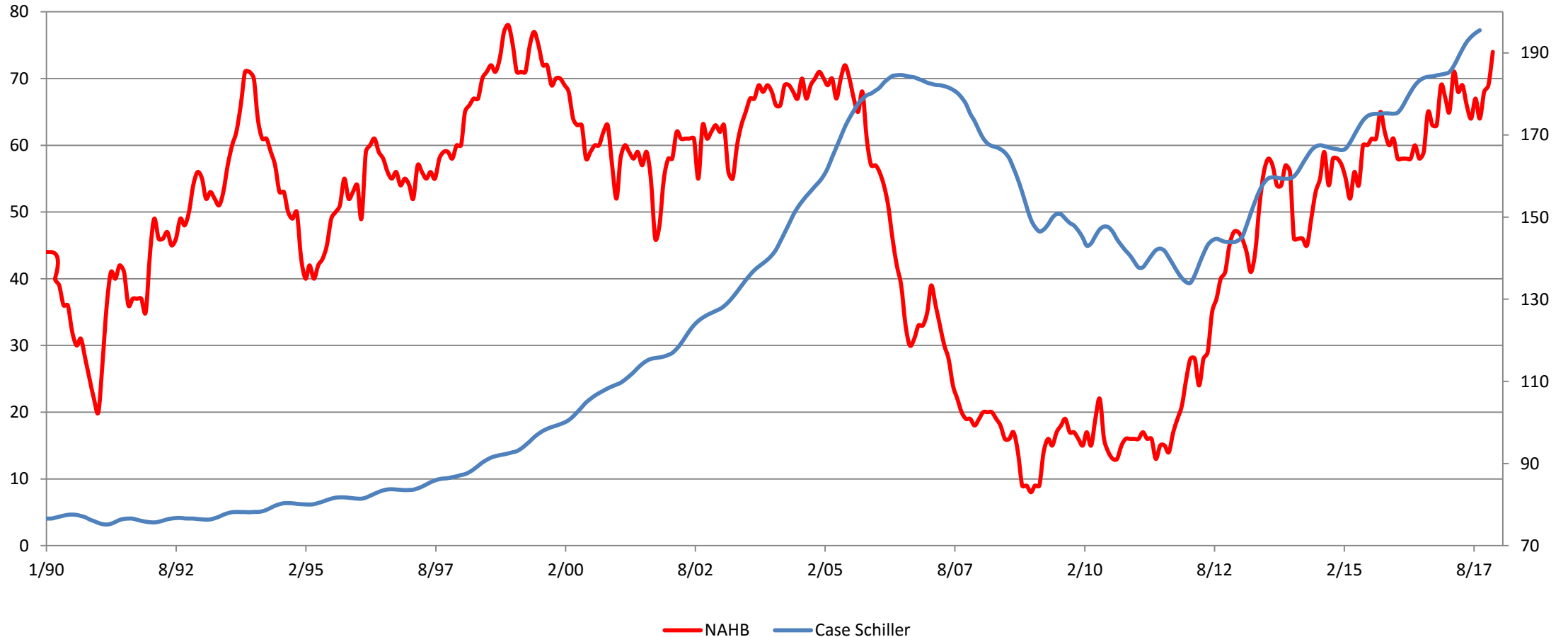




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Real Estate will Remain a Powerful Engine for Economic Growth

National Association of Home Builders Index (left) and Case-Schiller 20 Index (right)



The National Association of Home Builders index is based on a monthly survey that is designed to measure sentiment for the U.S. single-family housing market. The Case-Schiller 20 index is a composite index of the home price index for 20 major cities in the US, (the index is normalized to have a value of 100 in January 2000)



Back to Pre-Crisis Levels

Data used by the Fed in assessing the condition of the labor market

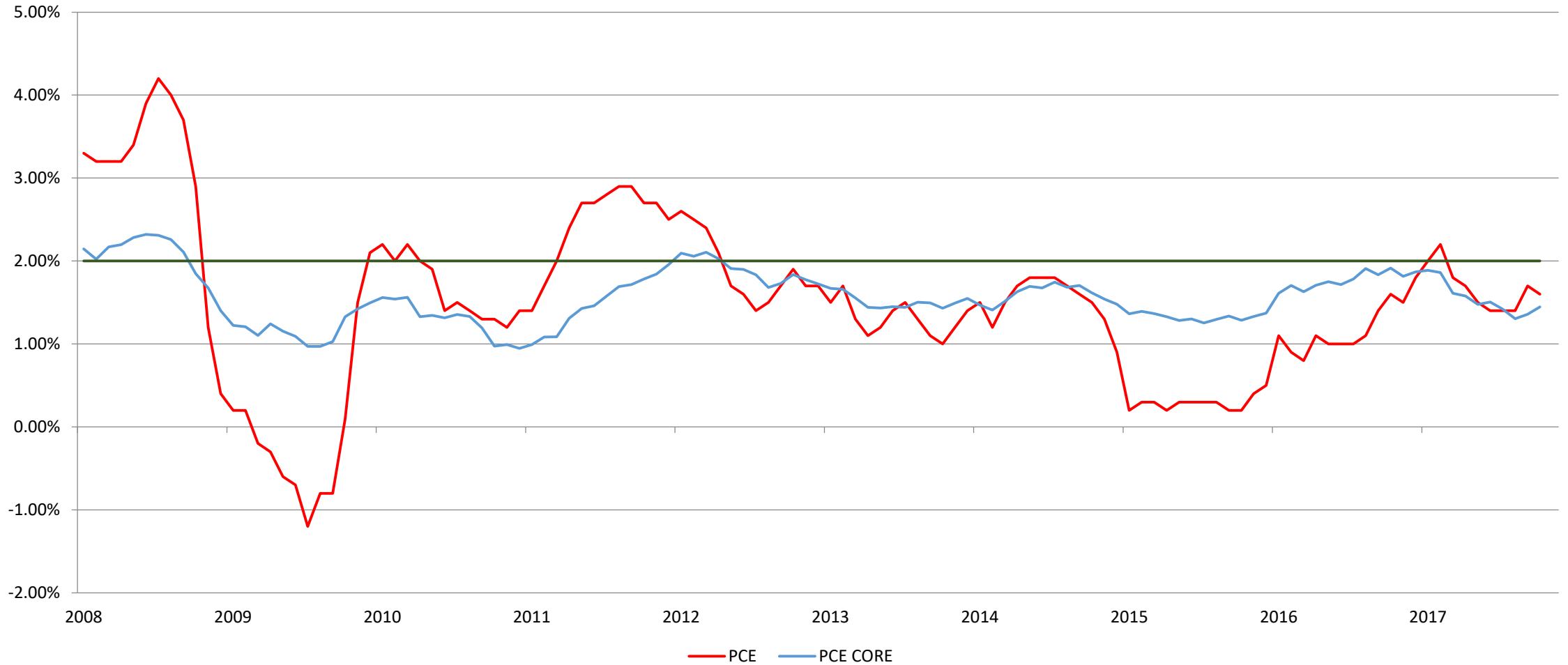
Indicator	Pre-crisis (Average 2004-2007)	Worst figure from 2008	Current figure
Layoff rate	1.4%	2.0% (April 2009)	1.2%
New employment amongst the employments	3.0%	1.6% (July 2009)	4.0%
Unemployment rate	5.0%	10.0% (October 2009)	4.1%
Percentage of employees who resigned amongst all salaried employees	2.1%	1.3% (February 2010)	2.2%
Under employment rate (U6)	8.8%	17.1% (April 2010)	8.6%
Moving average of the addition of employments in three months (thousands)	161	(826) (March 2009)	156
Percentage of employees recruited from all salaried employees	3.8%	2.8% (June 2009)	3.6%
"Chronic" unemployed among the total unemployed (over 27 weeks)	19.1%	45.3% (April 2010)	21.5%
Participation rate in the labor force	66.1%	62.4% (September 2015)	62.7%
Average hourly wage increase, YoY	3.4%	1.5% (October 2012)	2.4%



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Inflation is Reluctant to Meet Target

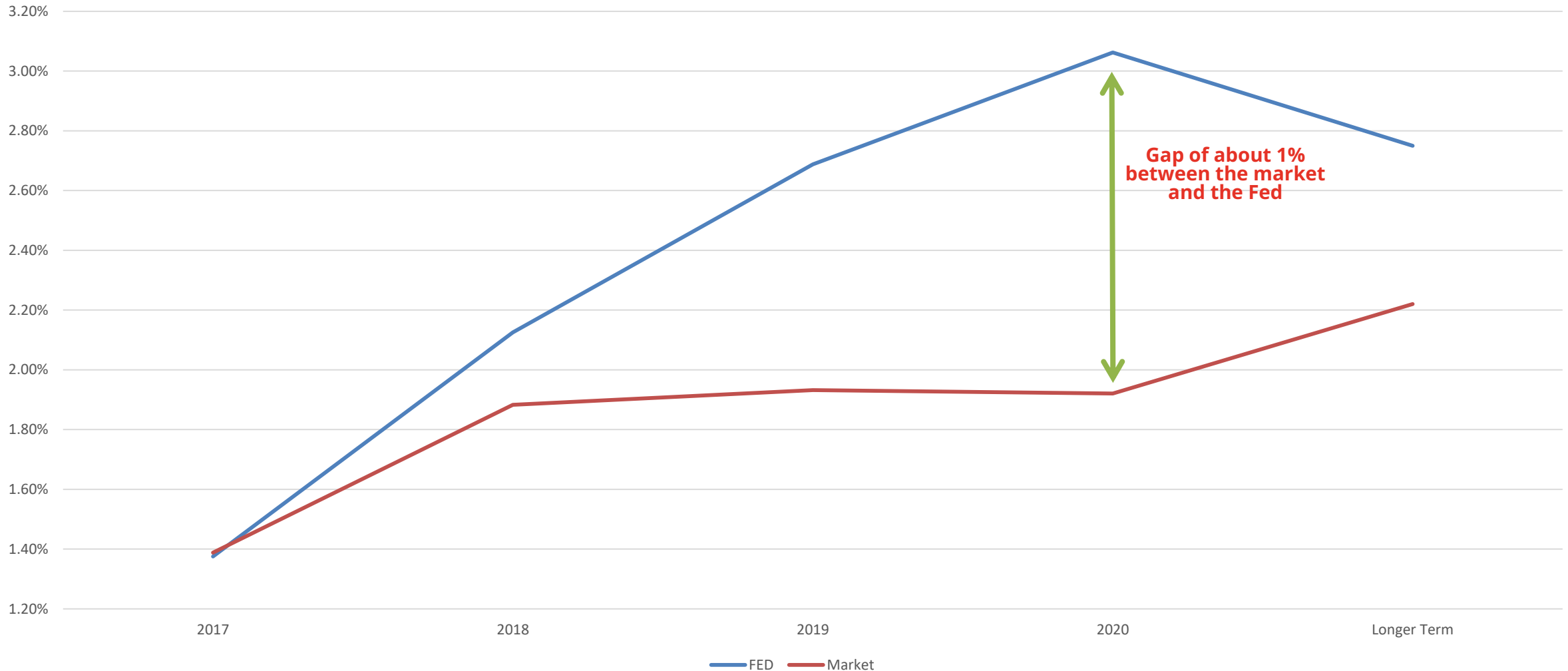
Consumer Price Index and Core PCE





The Rising Path of Interest Rate is Expected to be Slow

Fed's interest rate derived from Fed's forecasts vs. market views

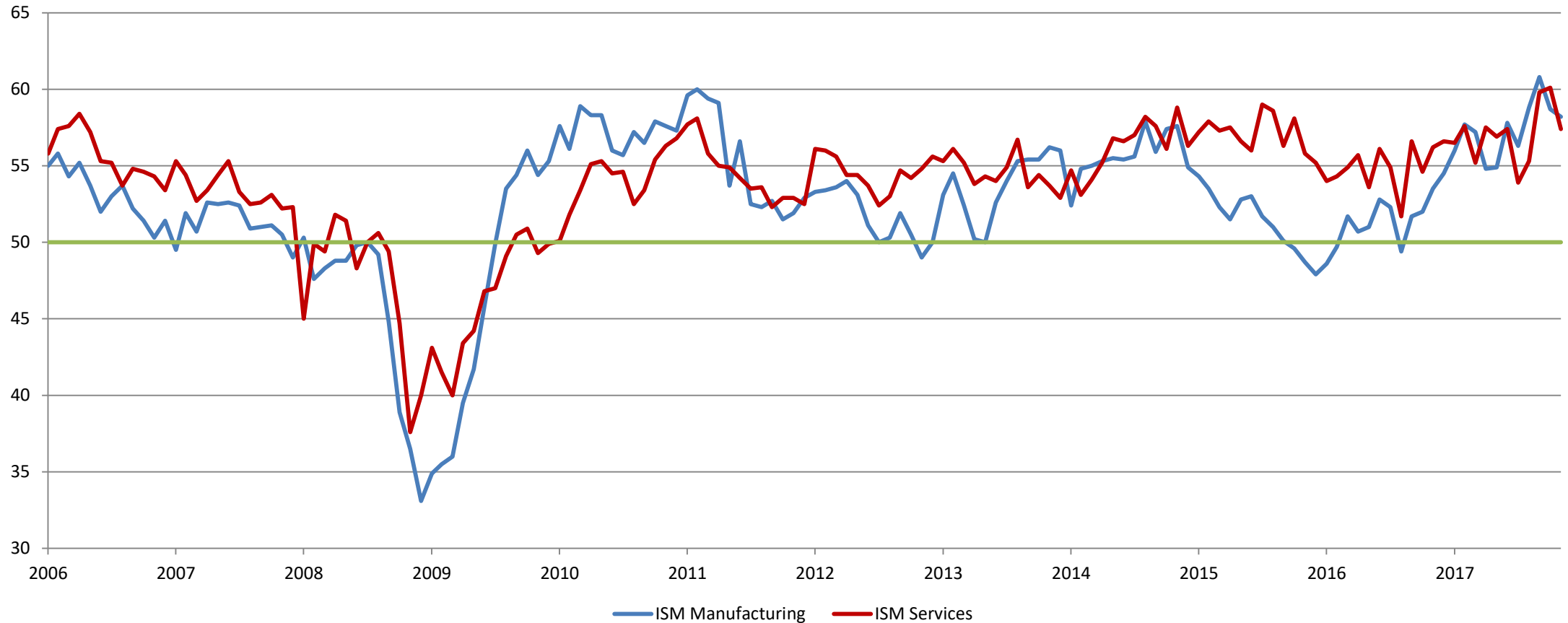




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The Economy is Expected to Expand

ISM Manufacturing and ISM Services



Reading that greater than 50 signals increased economic activity, less than 50 indicates a contraction and 50 corresponds to no change.



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Europe



Key Indicators

Data for 2017-2018 are based on the median of Bloomberg forecasts

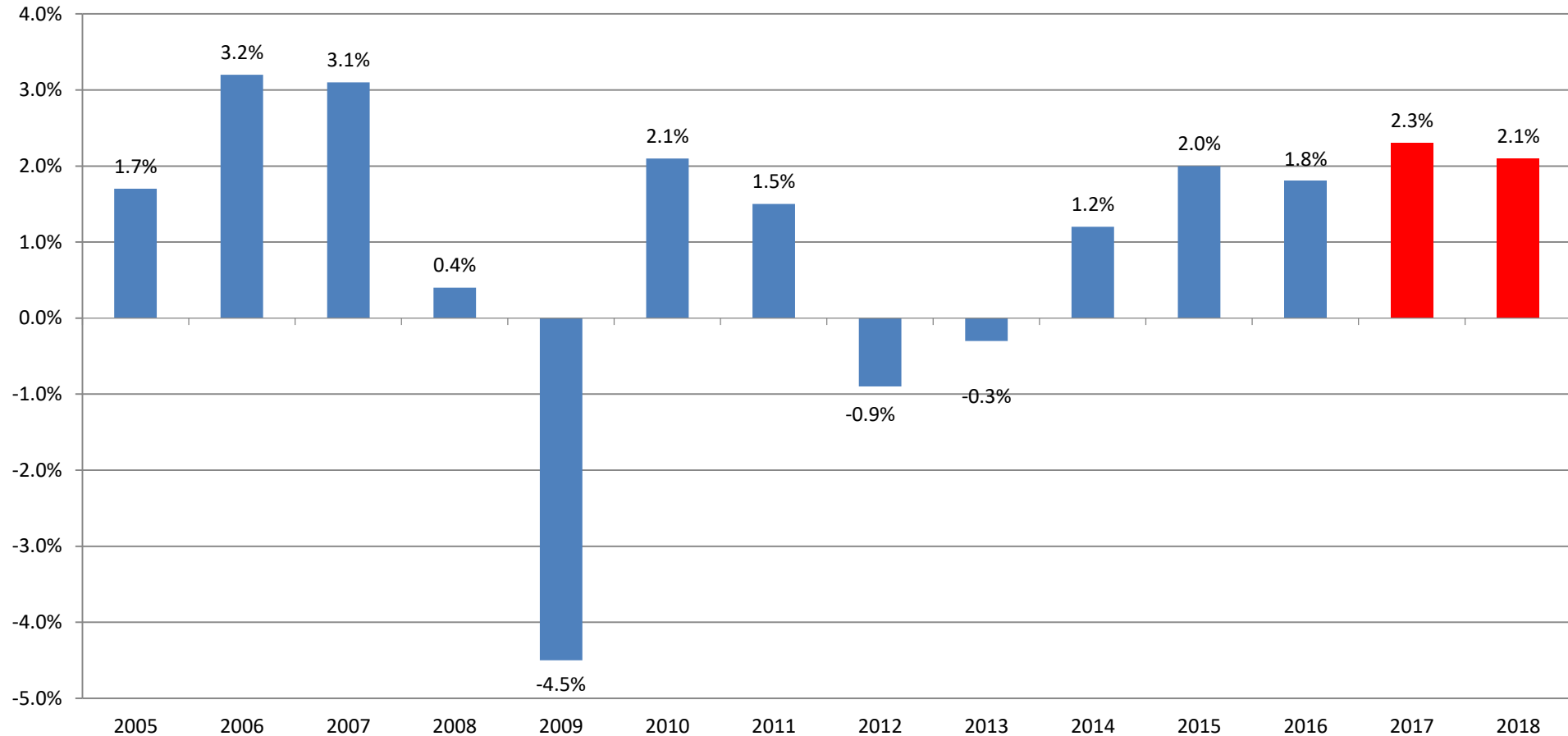
	2017	2016	2015	2014
Growth Rate	2.3%	1.8%	2.1%	1.3%
Unemployment Rate (Annual average)	9.1%	10.0%	10.9%	11.6%
Inflation Rate (YoY)	1.5%	0.2%	0.0%	0.4%
Interest Rate (End of Year)	0.0%	0.0%	0.05%	0.05%
Ratio of Surplus in Current Account to GDP	3.1%	3.3%	3.2%	2.4%
Ratio of Public Debt to GDP	89.3%	89.2%	90.4%	92.0%



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Stable and Uniform Growth within the Eurozone

The annual growth rate in the Eurozone (data for 2017-2018 are based on the European Commission forecast)

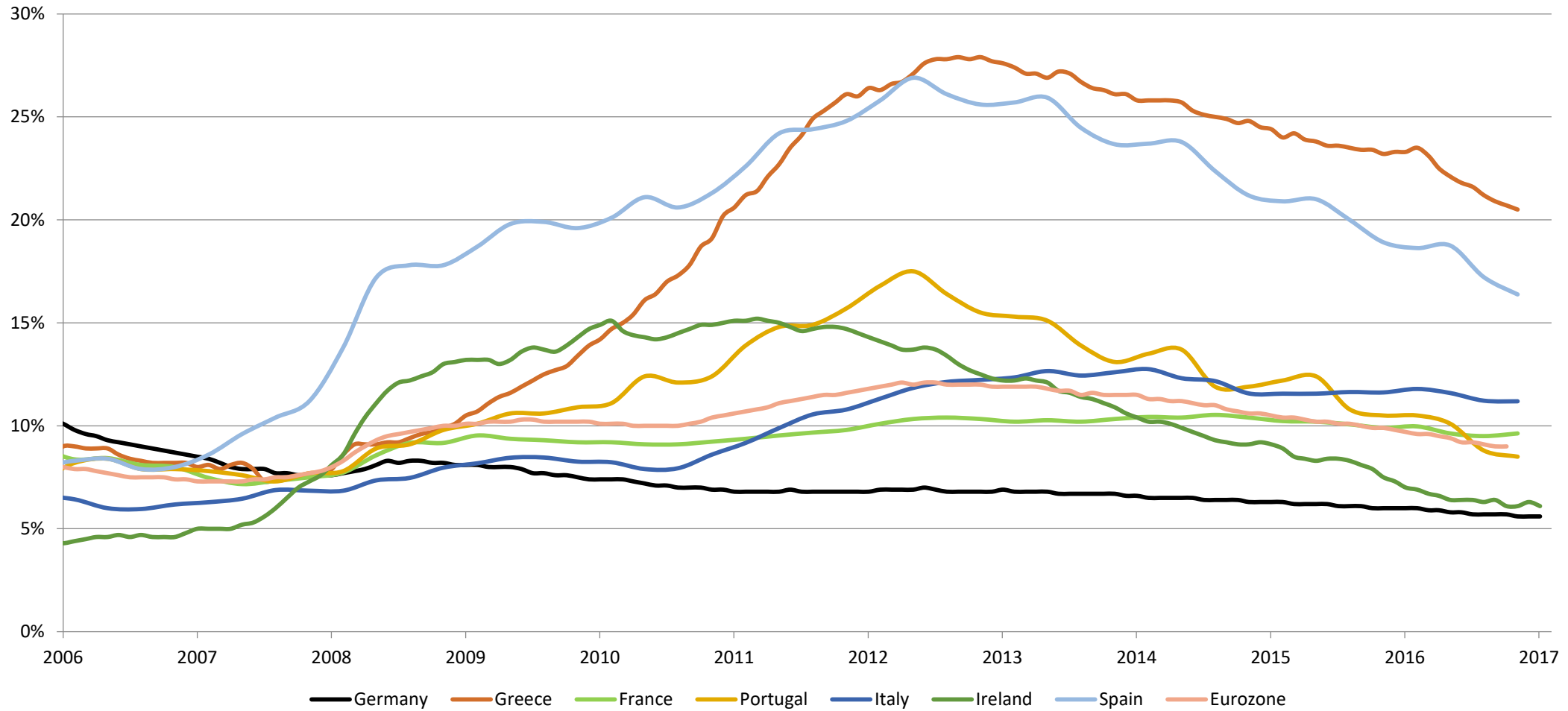




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A Significant Decline in Unemployment Rates

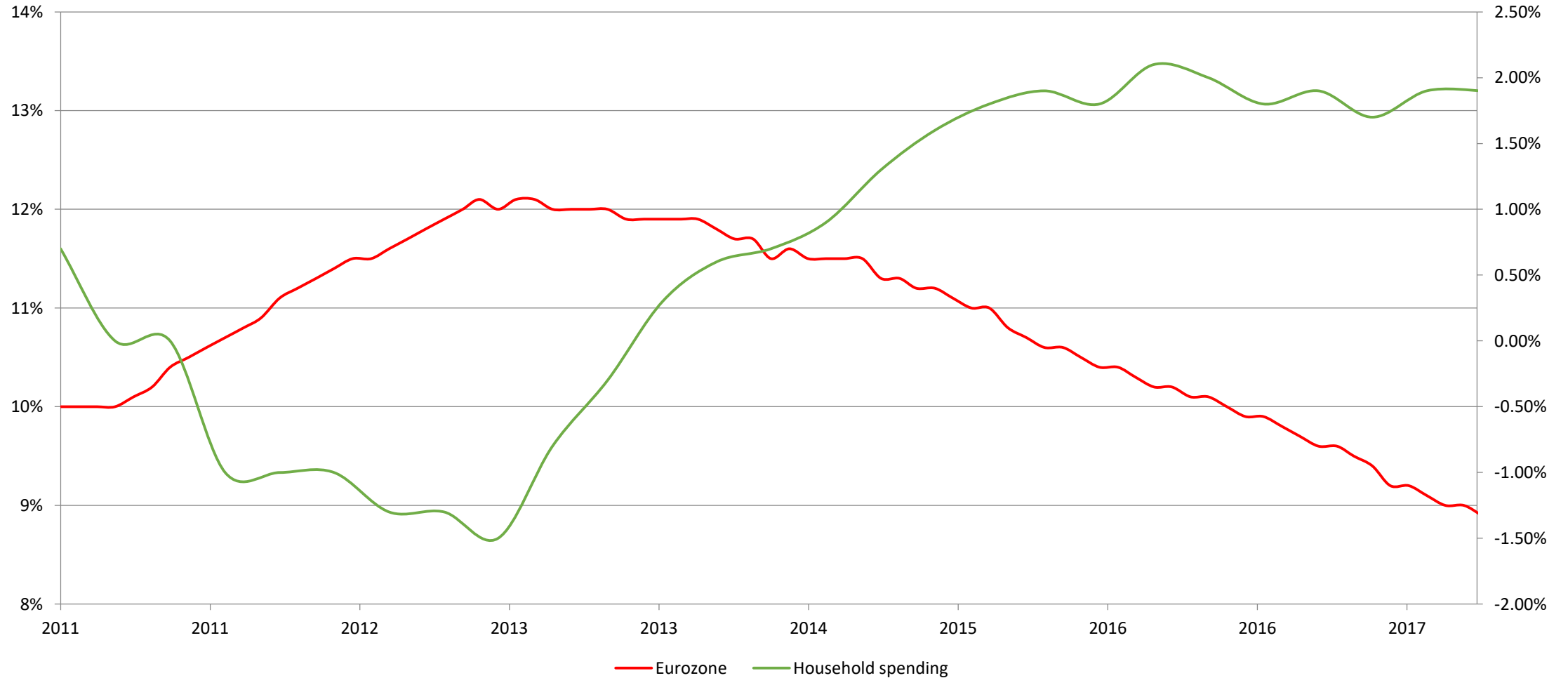
Unemployment rate in Germany, France, the PIIGS countries, and the Eurozone





The Improvement in the Labor Market Supports Consumers

◦ Changes in households' spending in the Eurozone (right) and the unemployment rate ◦ (left)





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Record of Optimism in the Business Sector

Business Climate Index of the European Commission

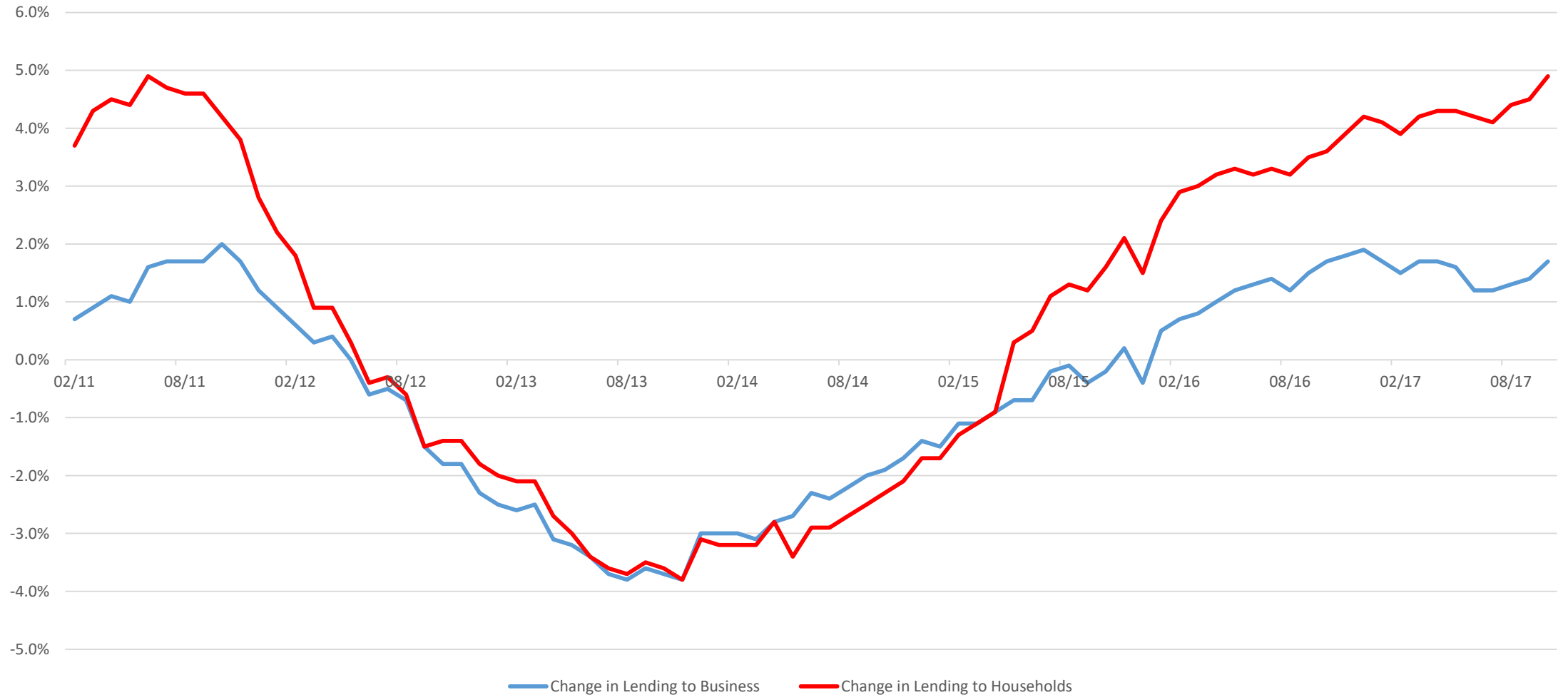




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Credit Availability has Increased

Changes in the volume of loans to households and businesses





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Israel



Key Indicators

Data for 2017-2018 are based on the research department of Bol

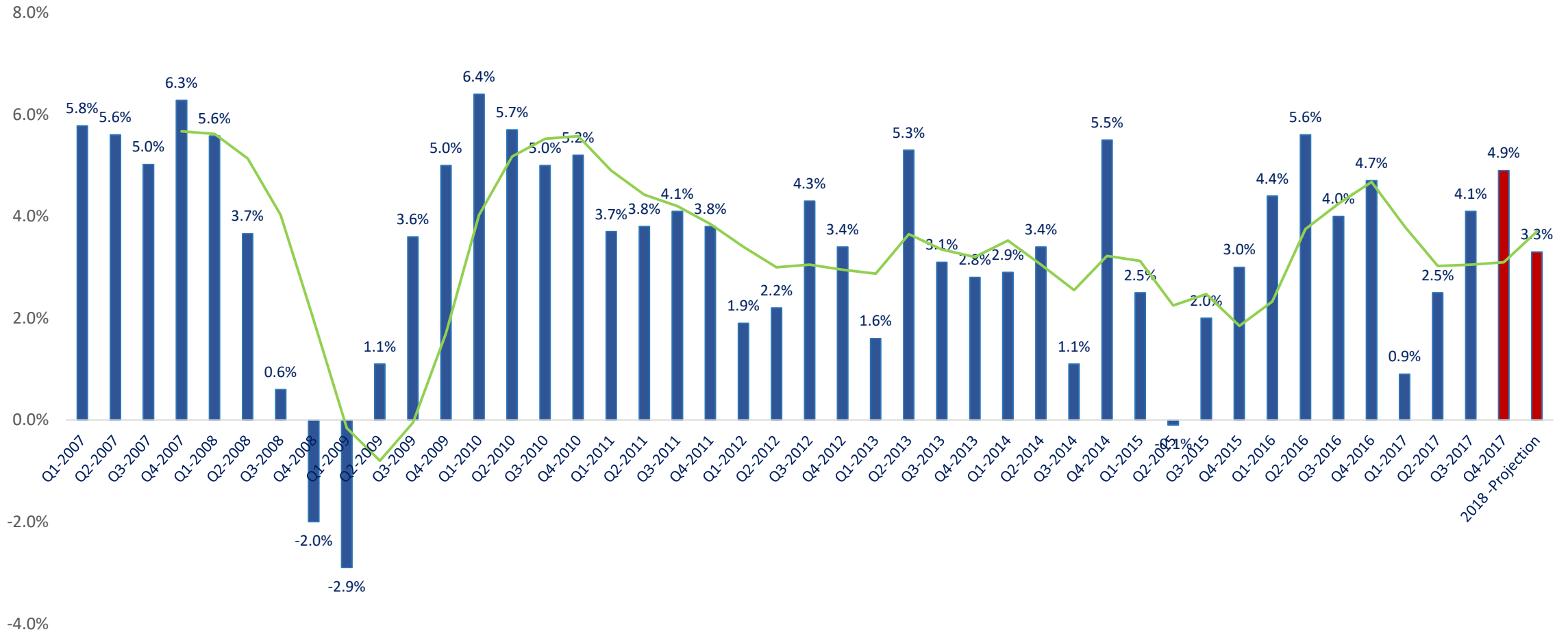
	2017	2016	2015
Growth Rate	3.1%	3.9%	2.6%
Unemployment Rate*	3.5%	4.1%	5.2%
Inflation Rate (YoY)	0%	-0.3%	-1.0%
Interest Rate (End of Year)	0.1%	0.1%	0.1%
Ratio of Surplus in Current Account to GDP	3.15%	4.2%	4.6%
Ratio of Public Debt to GDP	---	60.7%	63.3%

The unemployment rate is an annual average of unemployment at the main working ages, 25-64 *



Economic Growth

Quarterly growth in annualized terms (2017-2018 data are based on the forecast of Bank of Israel)

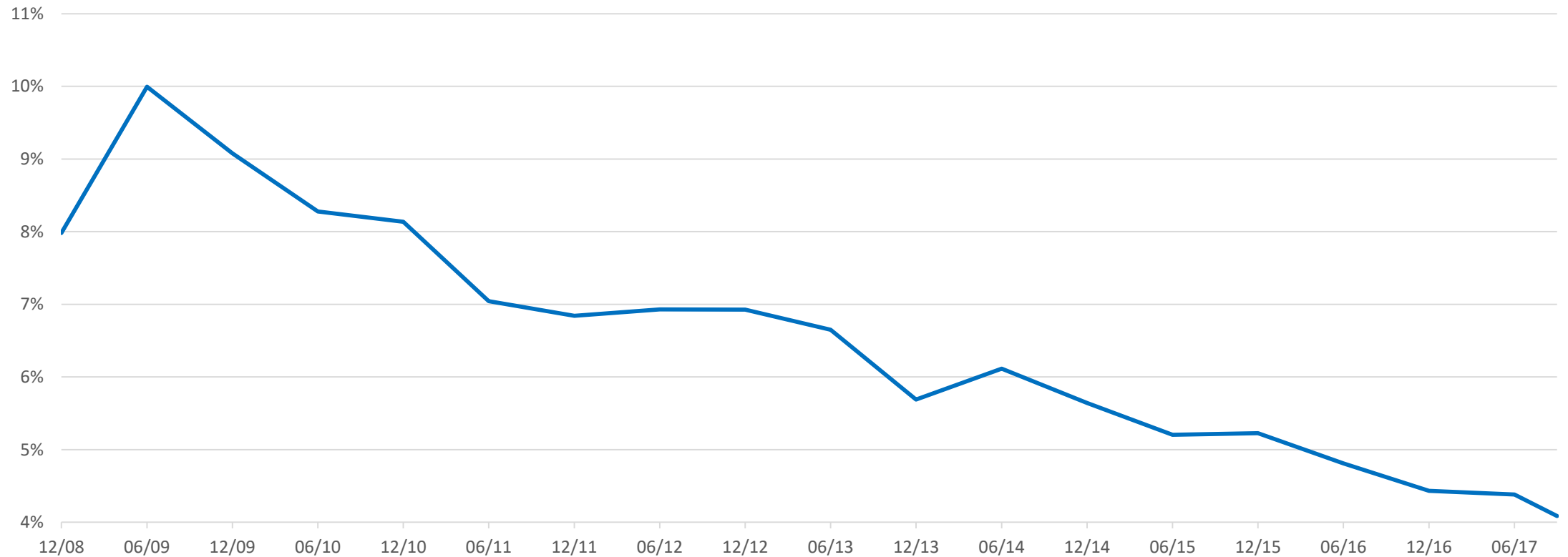




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Labor Market

Unemployment rate is at a historic low level





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A Continuous Deflationary Process

Annual inflation (YoY)

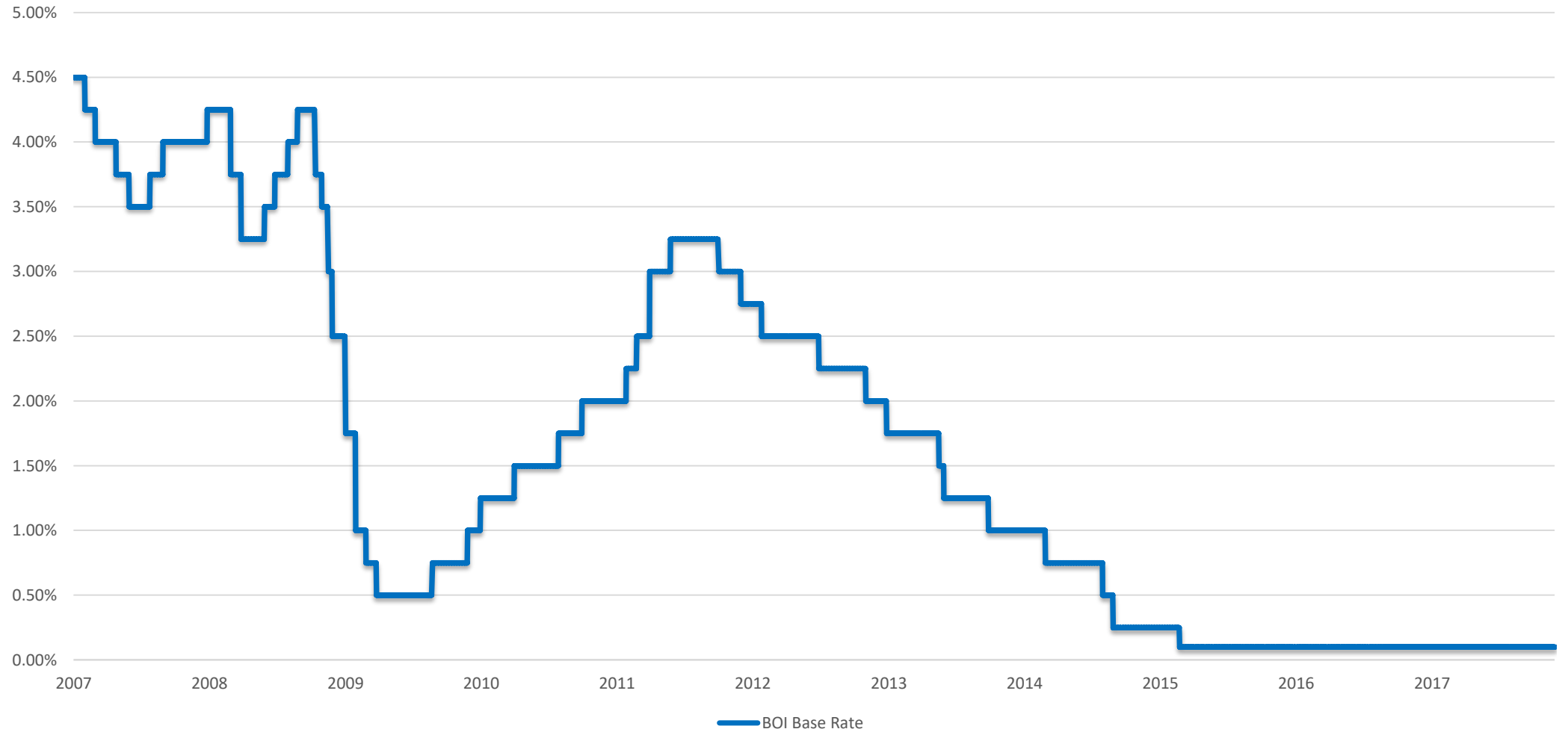




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Bank of Israel Interest Rate

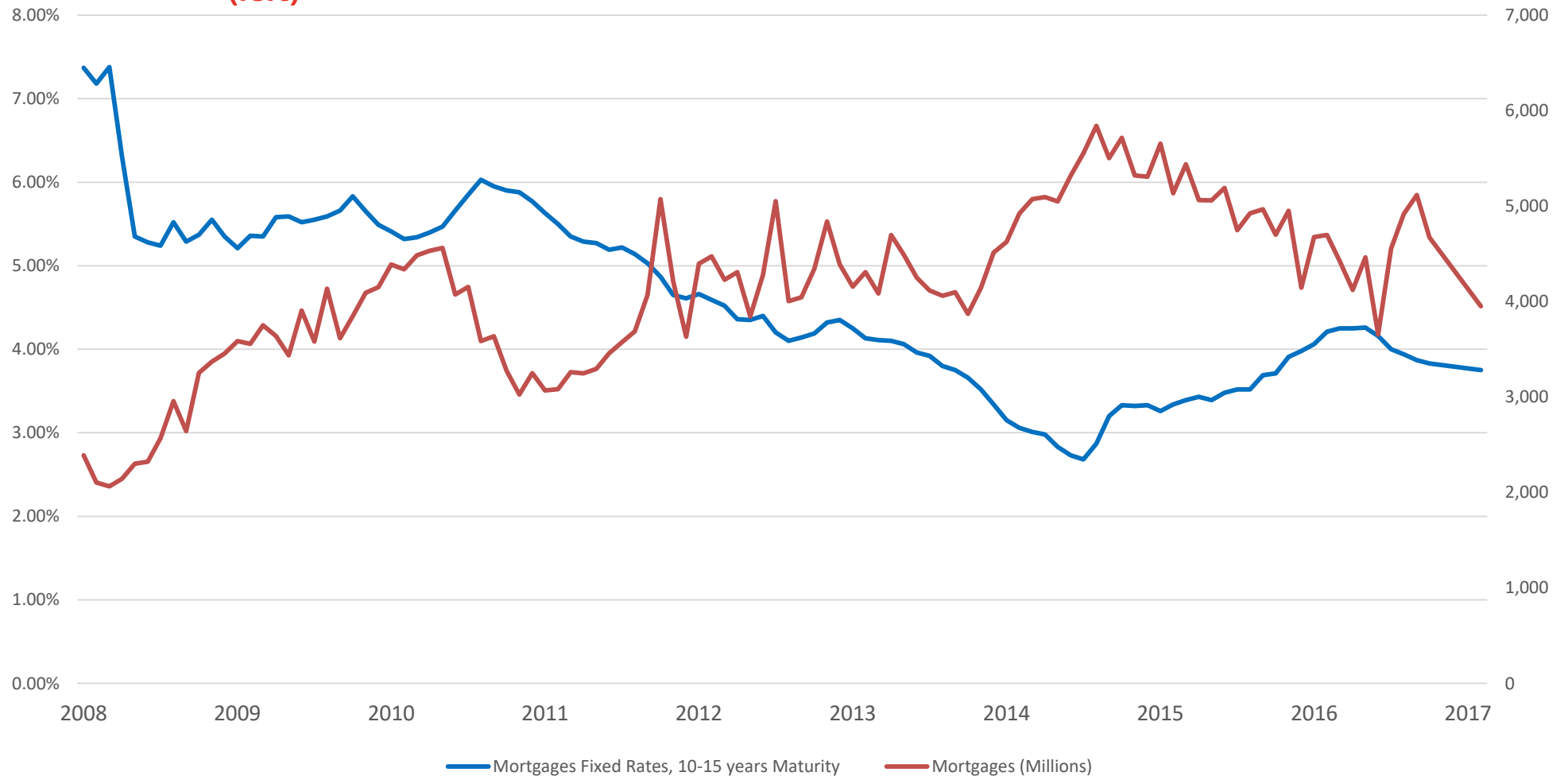
(0.1% for the last three years)





The Housing Market May be a Factor of Instability

The rate of mortgages, in millions ILS (right) and the nominal mortgage interest rate for 10-15 years (left)

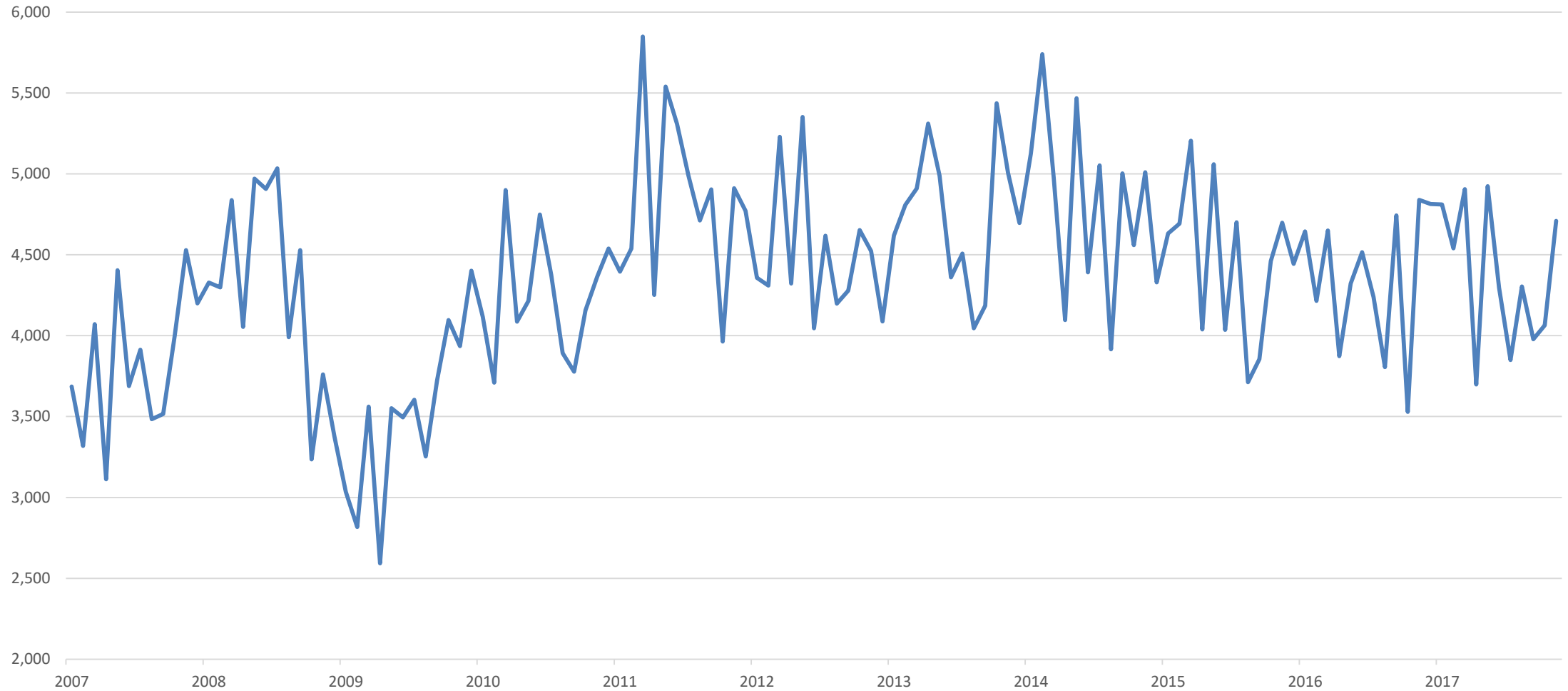




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Stagnation in Export

Export of goods in millions of Dollars

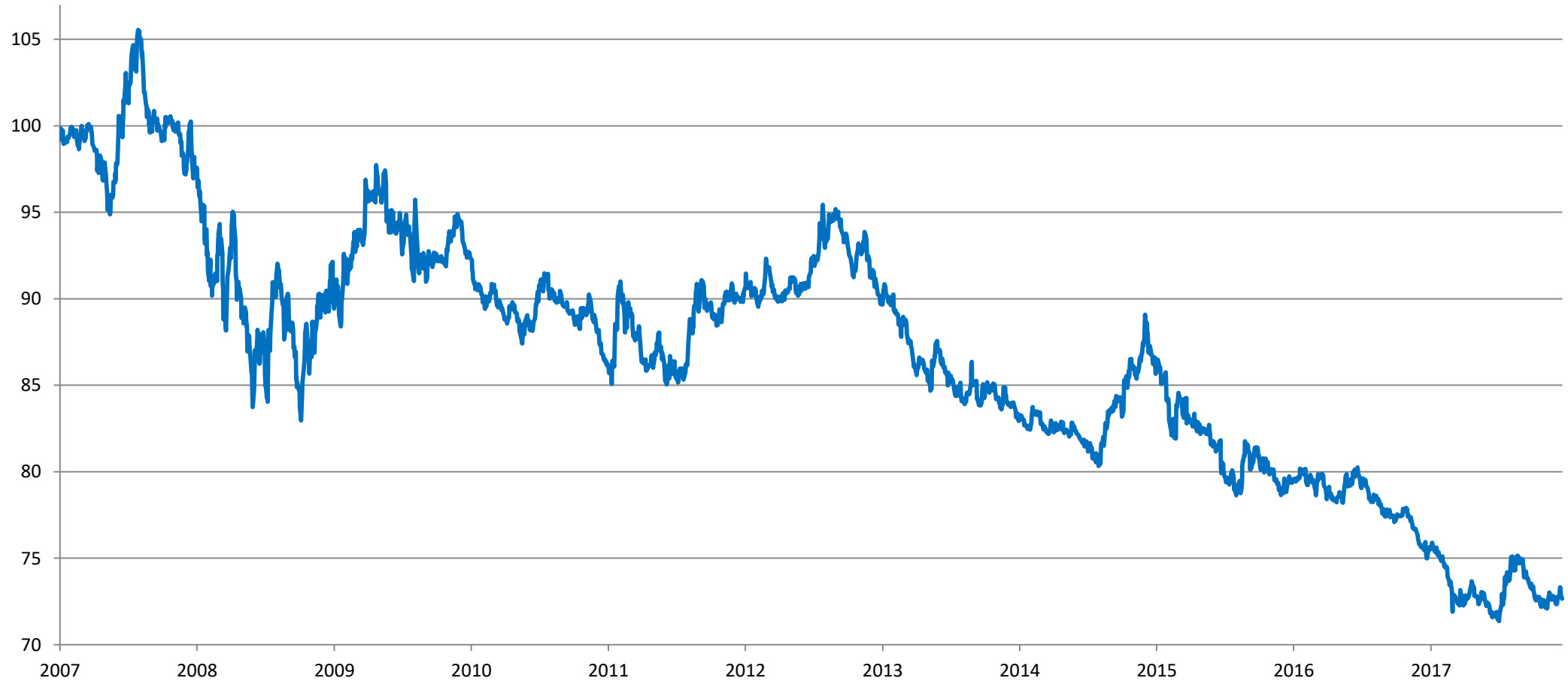




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Erosion in the Competitiveness of Israeli Export

Nominal Effective exchange rate, 01/2007=100

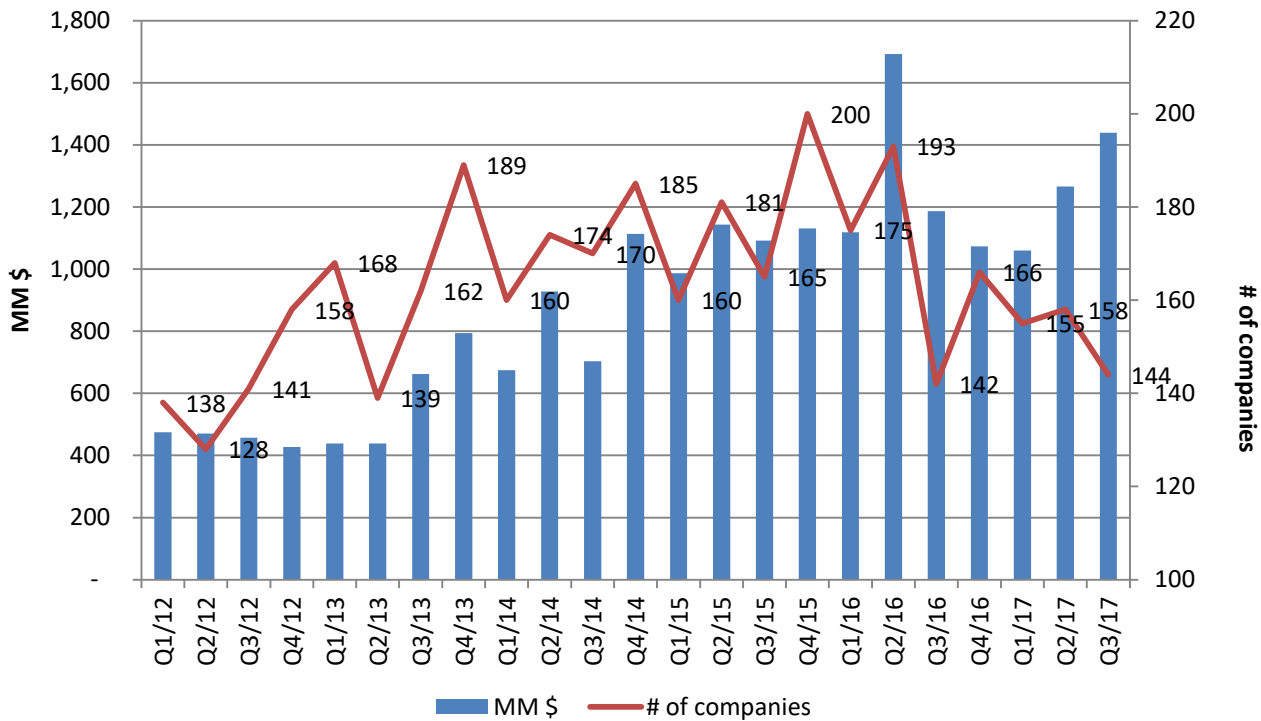


The BOI Nominal Effective Rate is the geometric average of the shekel exchange rate vis-à-vis 26 currencies representing 33 countries—Israel's major trading partners by proportion of trade

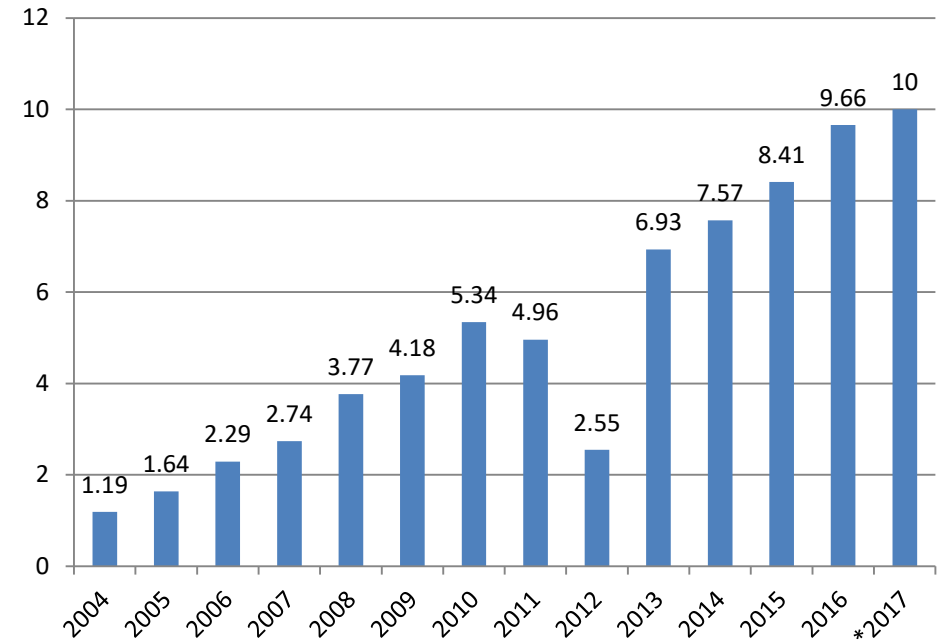


The "Dutch Disease" and the "Israeli Disease" Strengthen Appreciation Pressures

Amount Raised by High-Tech Companies in Millions of Dollars (left) and the Number of Companies that Raised Funds (right)



Supply of Natural Gas in Israel (BCM)



* According to the forecasts of the Ministry of Energy



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The Interest-Rate Differential Continues to Widen

Ratio between the exchange rate and the future rate in USDILS transactions for one year over time





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CONNECTING THE RIGHT DOTS

CREATING THE RIGHT PICTURE