



Financial
Immunities

Market Insights

August 2018



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Global Economy

- The robust economy and strong financial markets in the US as opposed to China's rocking markets and economy enables the trump administration to escalate trade war in order to force China to negotiate and abandoned its unfair trading practices
- Liquidity continues to be drained from the global financial system on the back of the Fed's quantitative tightening, ECB bonds tapering and the interest rate hikes
- Dollar's strength, combined with higher interest rates, continue to weigh on emerging markets
- Political instability and rise to power of populist leaders poses a risk to the global order
- It is likely that the recent driver behind the drop in oil prices from a four-year high to 69\$ per barrel, is the concerns from slowdown in the global growth



United States

- The economy exhibited considerably stronger growth in the second quarter. GDP rose by 4.1% annually in Q2, while at the same time Q1 was updated by 0.2% to 2.2%. The main contributors to growth were 4% increase in private consumption and one-time factors arising from assessments by companies for the imposition of tariffs as a result of the trade war
- Overall jobs picture continued to look solid as nonfarm payrolls increased by 157K for the month, below expectation, but previous two months' jobs numbers were revised 59K higher. Average gains for the three-month period were a strong 224K. The unemployment rate fell to 3.9% around its lowest level in nearly 50 years as average hourly earnings increased by 2.7% (YoY)
- The strong labor market, rising commodity prices and the imposition of tariffs continue to fuel inflation. Headline inflation for July was 2.9% while Core PCE Deflator was 1.9%
- Forward-looking data indicate that the economy is expected to continue growing in a fast pace
- The Fed is expected to continue its monetary tightening, with at least three interest rate hikes in the coming year alongside the balance sheet unwinding. However, the financial conditions are still accommodative



Economic Indicators

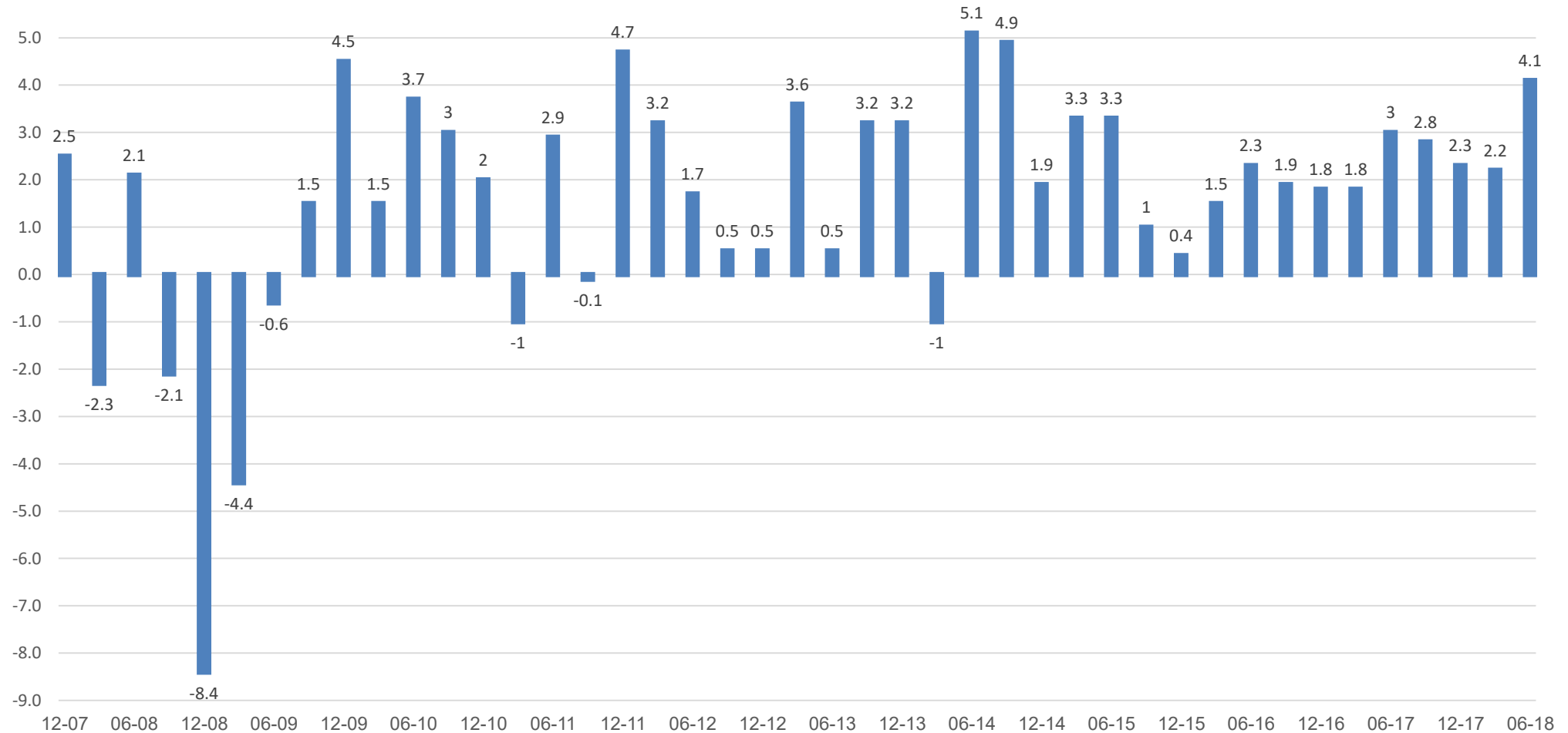
USA

Economic Indicator	Latest Figure	Reference Period
Growth Rate	4.1%	Q2-2018
Unemployment Rate	3.9%	June-2018
Inflation Rate (Core PCE, YoY)	1.9%	July-2018
FED Funds Target Range	1.75%-2%	July-2018
10 Year Treasury Yield to Maturity	2.95%	July-2018
Ratio of Current Account Balance to GDP	-2.33%	Q1-2018
Ratio of Public Debt to GDP	105.676%	Jan-2018



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Economic Growth

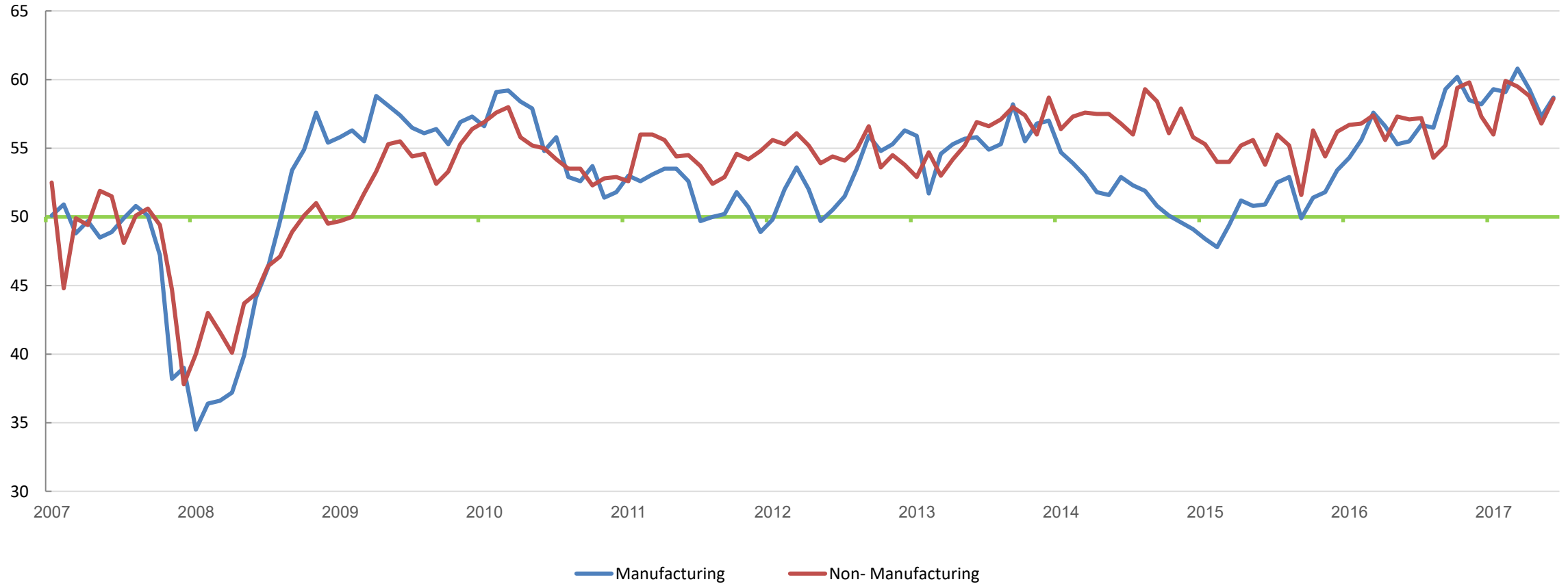




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Economic Sentiment

Manufacturing and Non-Manufacturing PMI

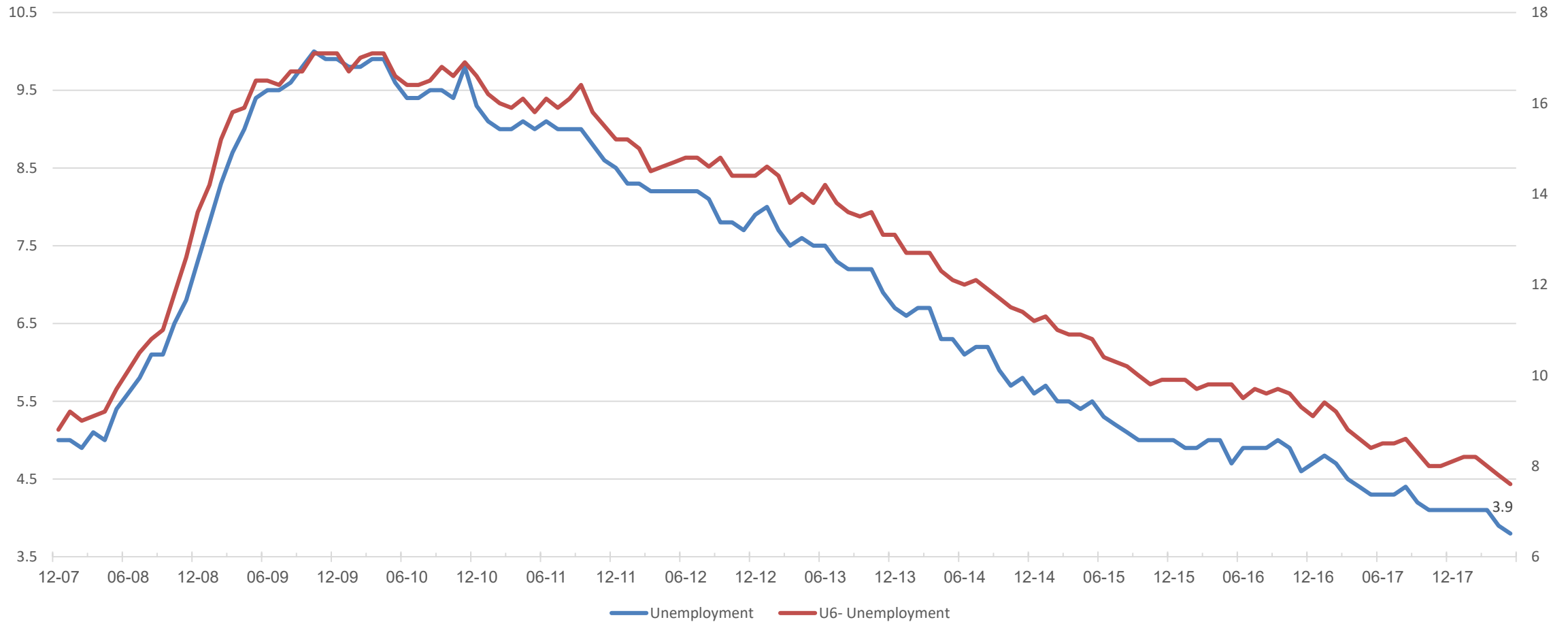




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Labor Market

Unemployment Rate (Left) and Under Unemployment Rate (Right)

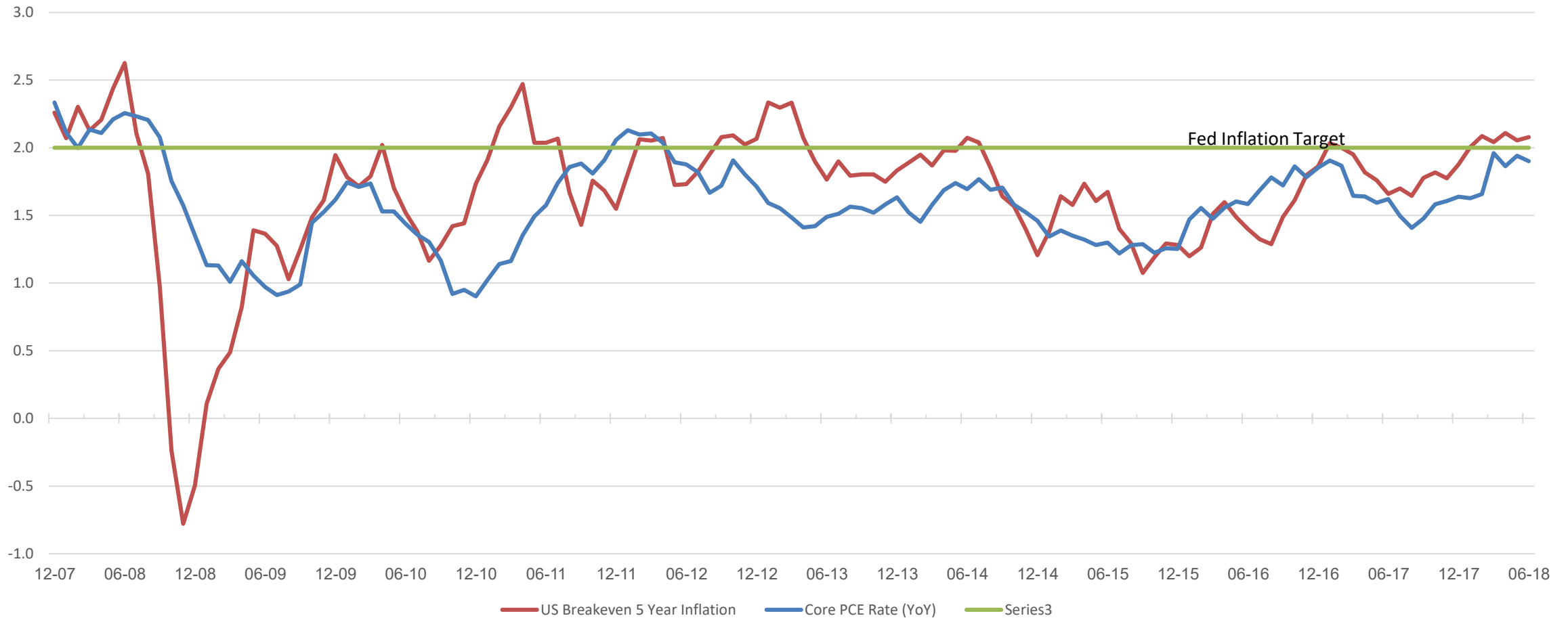




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Inflation

Core PCE (YoY) and 5Y Inflation Forecast





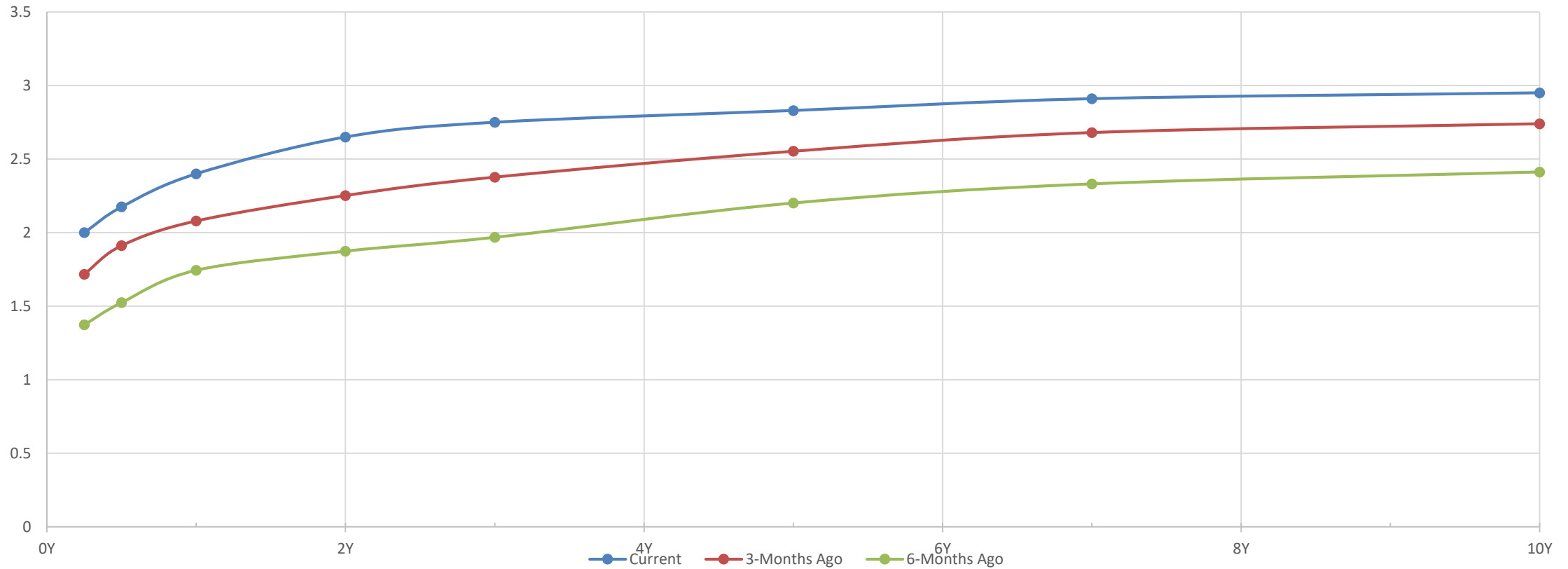
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10YR Treasury Yield





US Treasury Yield Curve





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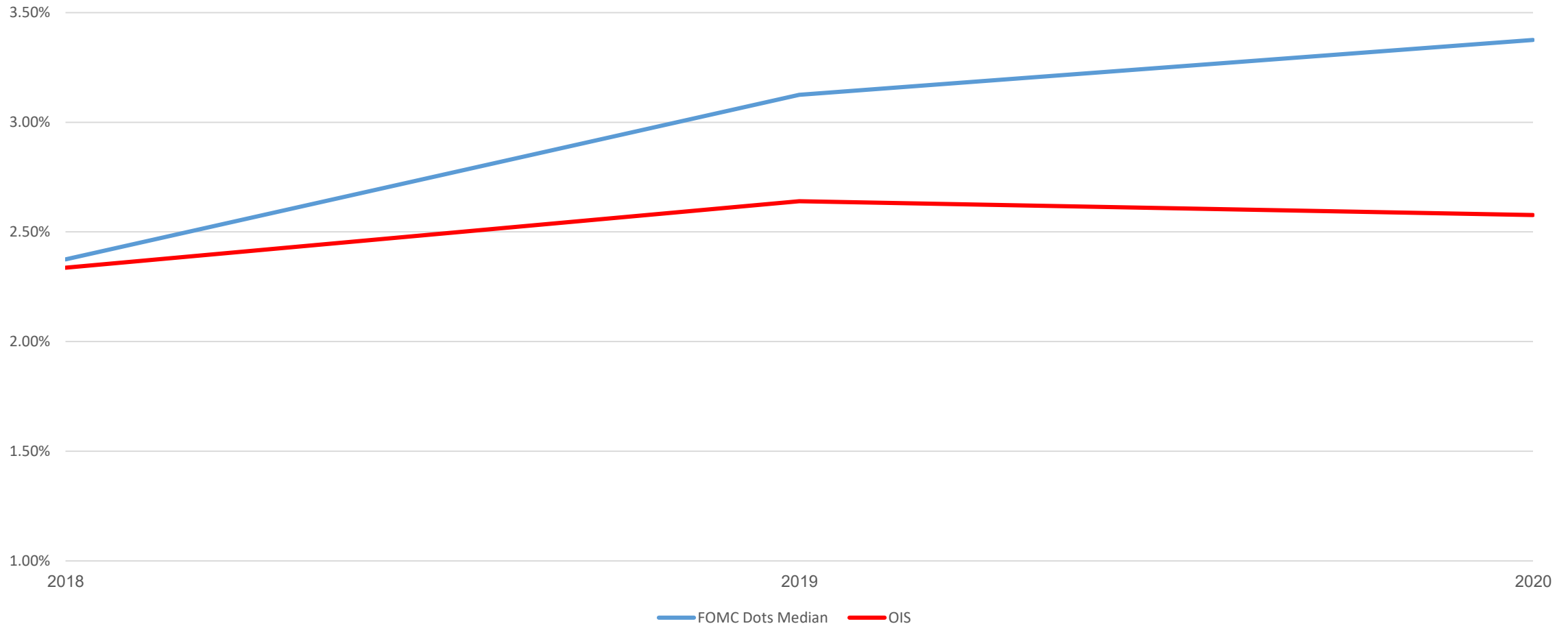
2yr-10yr Treasury Spread (bps)





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Fed Funds Projection





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Probability of a 4th Fed Hike in 2018





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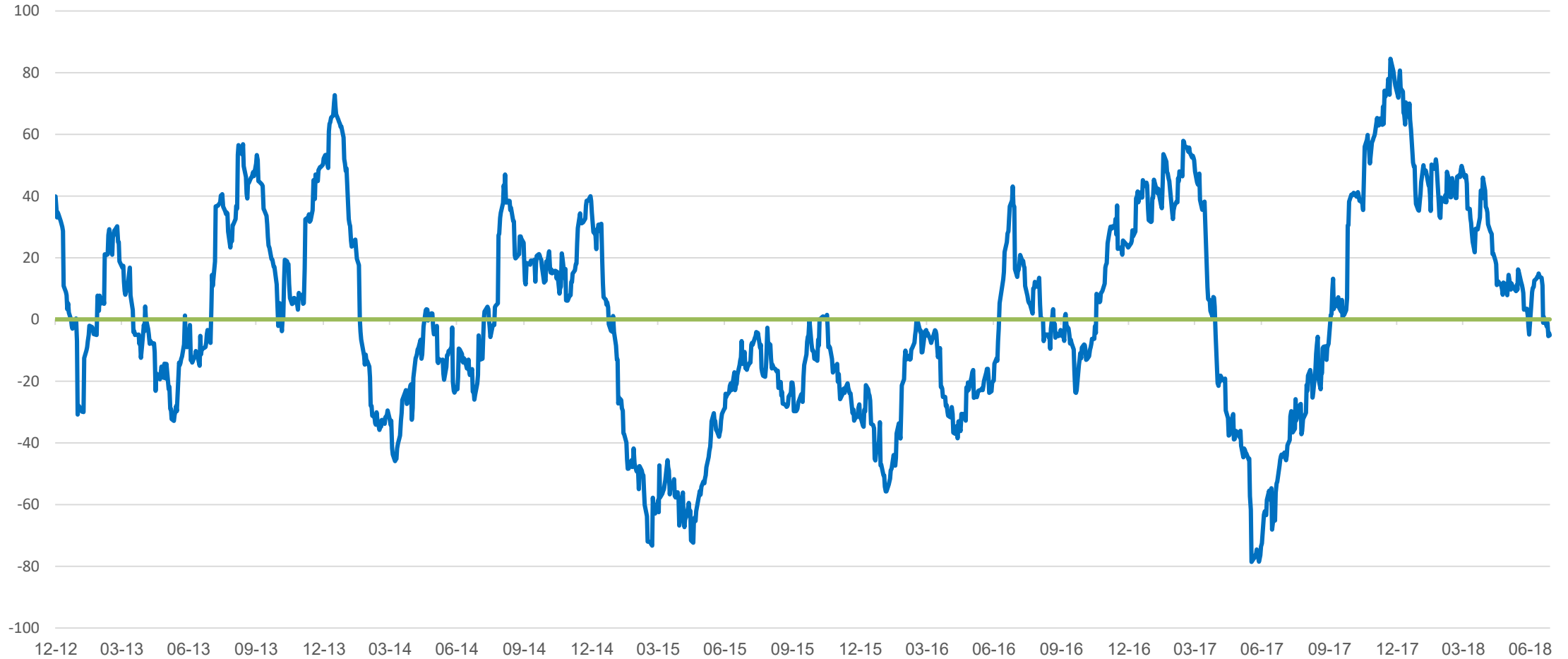
US Dollar Index (DXY)





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Citi Economic Surprise





- The economy continues to grow, albeit at a moderate pace. Q2 GDP rose by 1.4% (annually), below expectation and slower than Q1 (1.5%). Sentiment indices point to expansion, but some weakness is felt
- Inflation is stable. The core index rose only by 1.1% in the past year, higher than the previous month but far from the inflation target of 2%
- The unemployment rate continues to decrease to 8.3% in July, concurrently with the rise in wages, albeit at a moderate rate for the time being
- The central bank left its monetary policy unchanged while emphasizing the need to continue its support to the economy. Interest rate is expected to rise only in the second half of 2019, while the ECB bond buying program is expected to be completed by early 2019
- The concerns from the Brexit overshadowed the surprising central bank decision to raise interest rate to 0.75%
- Political instability continues in light of the rise in power of the populist parties, the separatist trend and xenophobia



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Economic Indicators

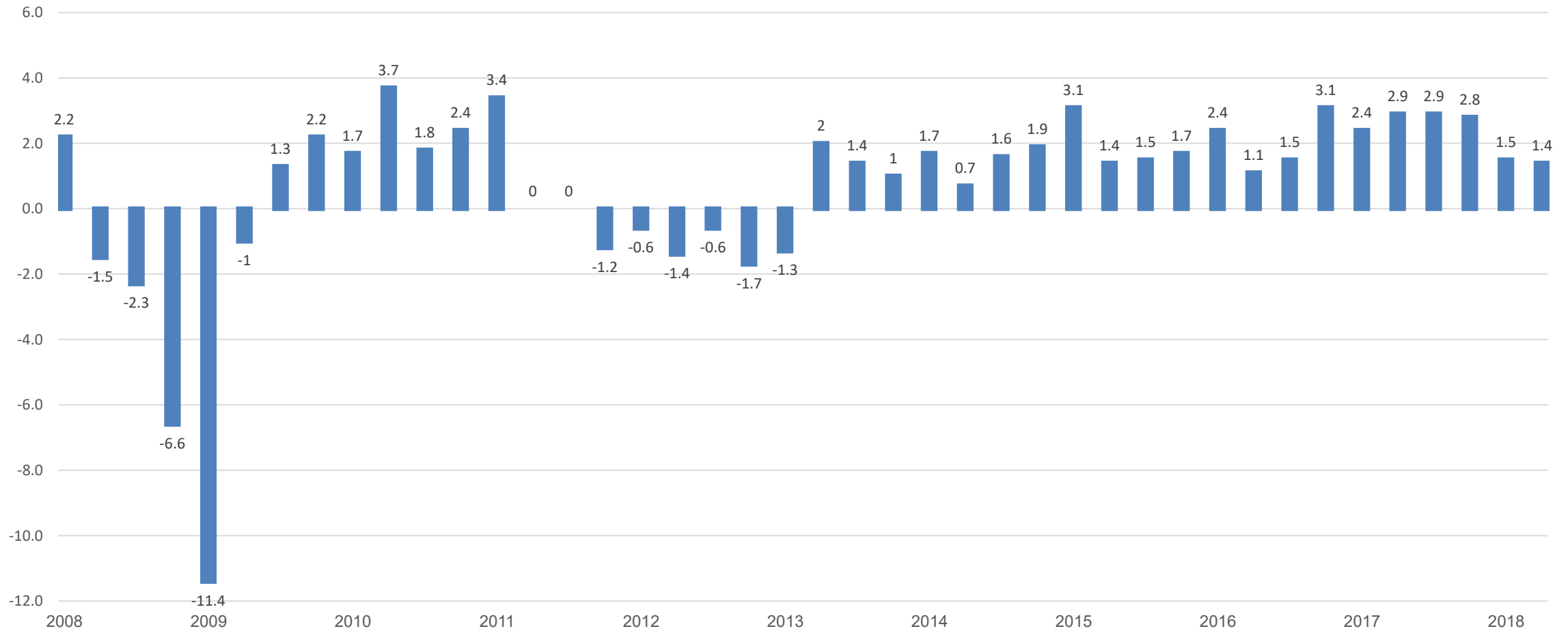
Eurozone

Economic Indicator	Latest Figure	Reference Period
Growth Rate	1.4%	Q2-2018
Unemployment Rate	8.3%	June-2018
Inflation Rate (Core, YoY)	1.1%	July-2018
Central Bank deposit rate	0.00%	July-2018
10 Year Government Bond Yield (Germany)	0.4%	July-2018
Ratio of Surplus in Current Account to GDP	3.57%	Q1-2018
Ratio of Public Debt to GDP	86.7%	Q4-2017



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Economic Growth (QoQ)

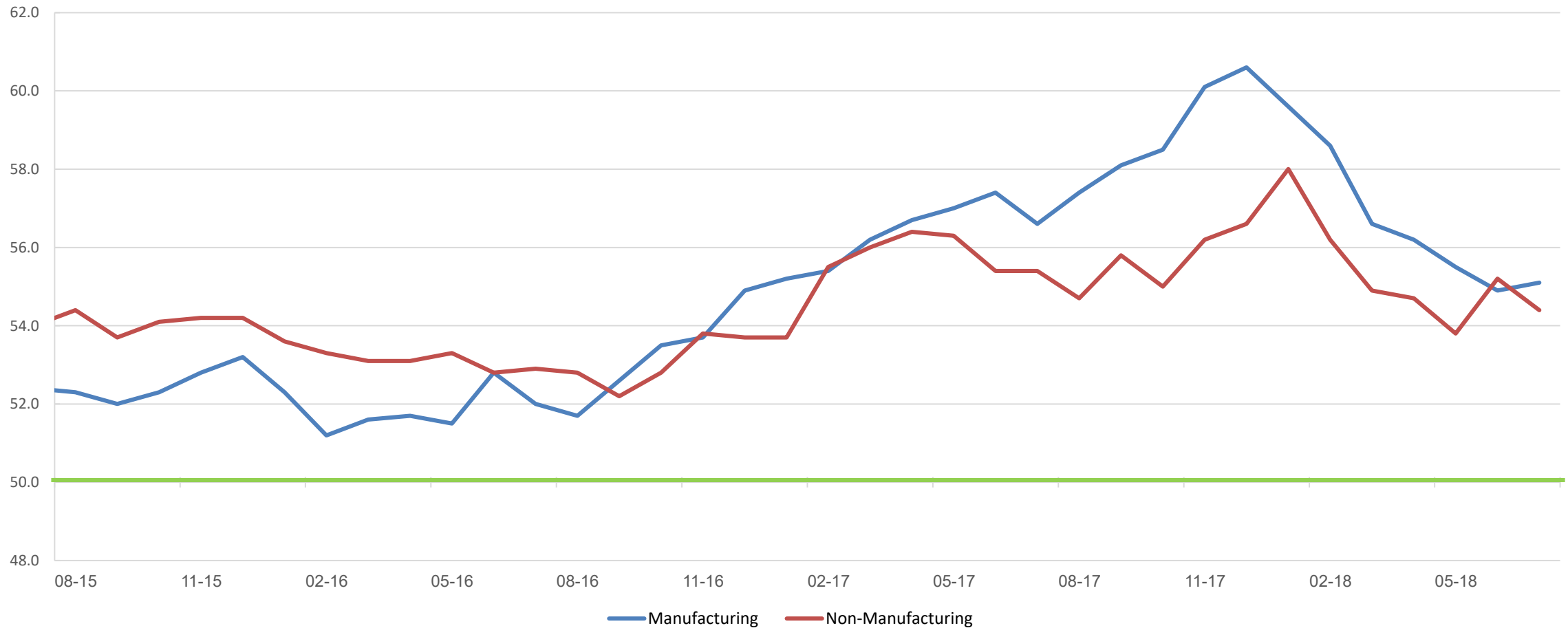




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Economic Sentiment

Manufacturing and Non-Manufacturing PMI

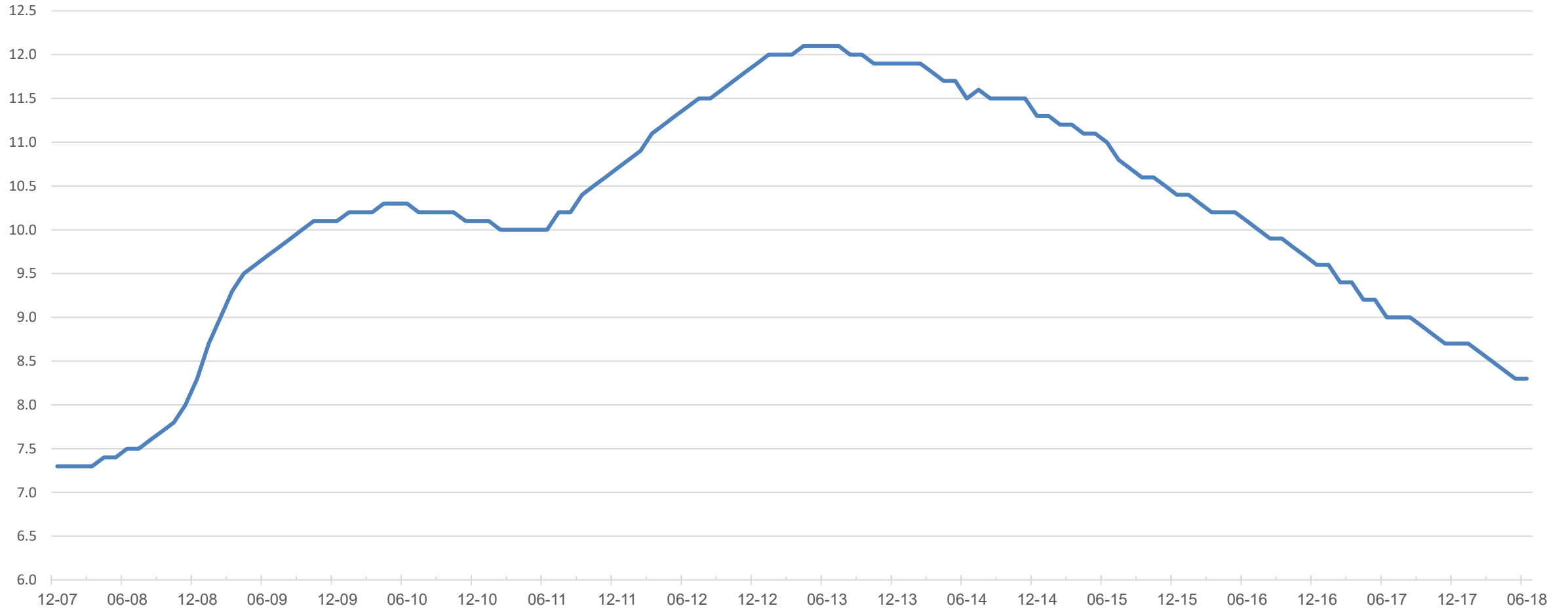




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Labor Market

Unemployment Rate

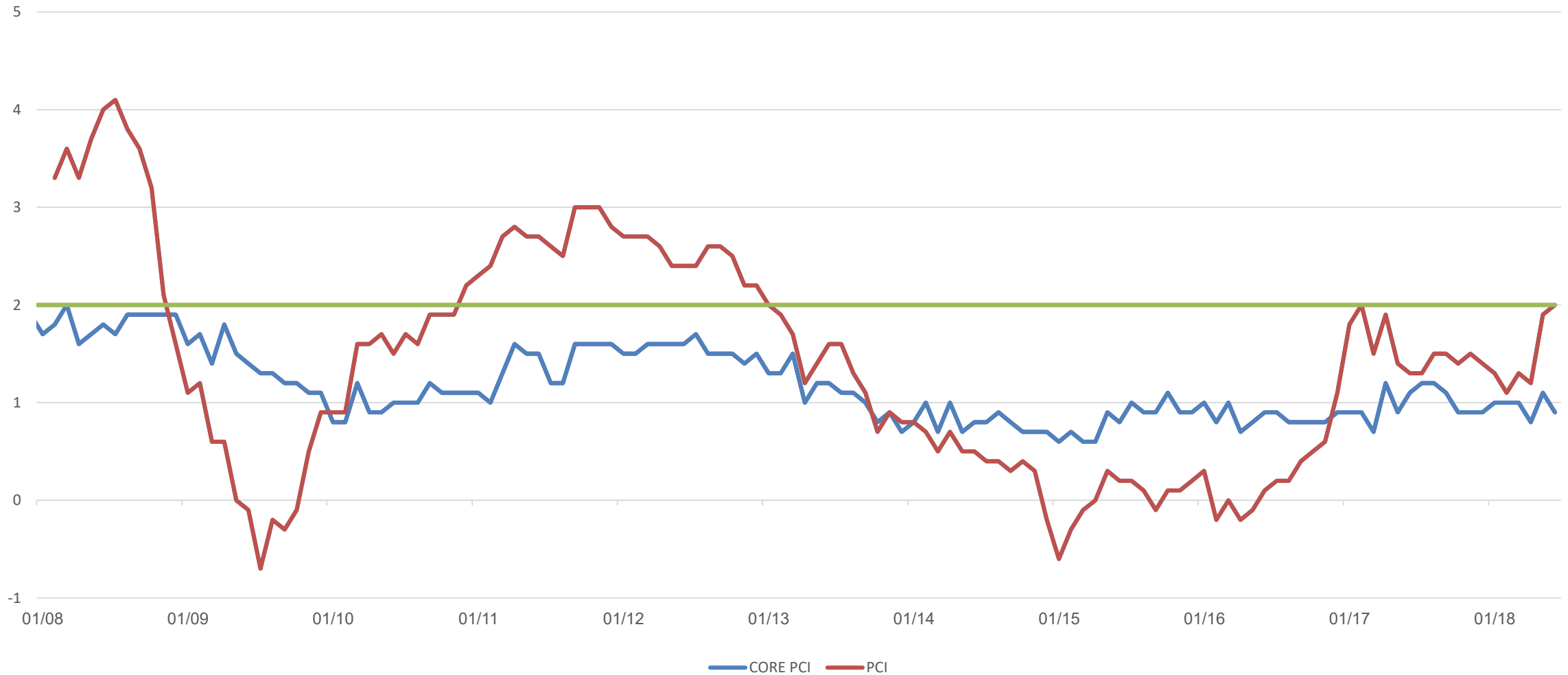




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Inflation

CPI and Core CPI (YoY)

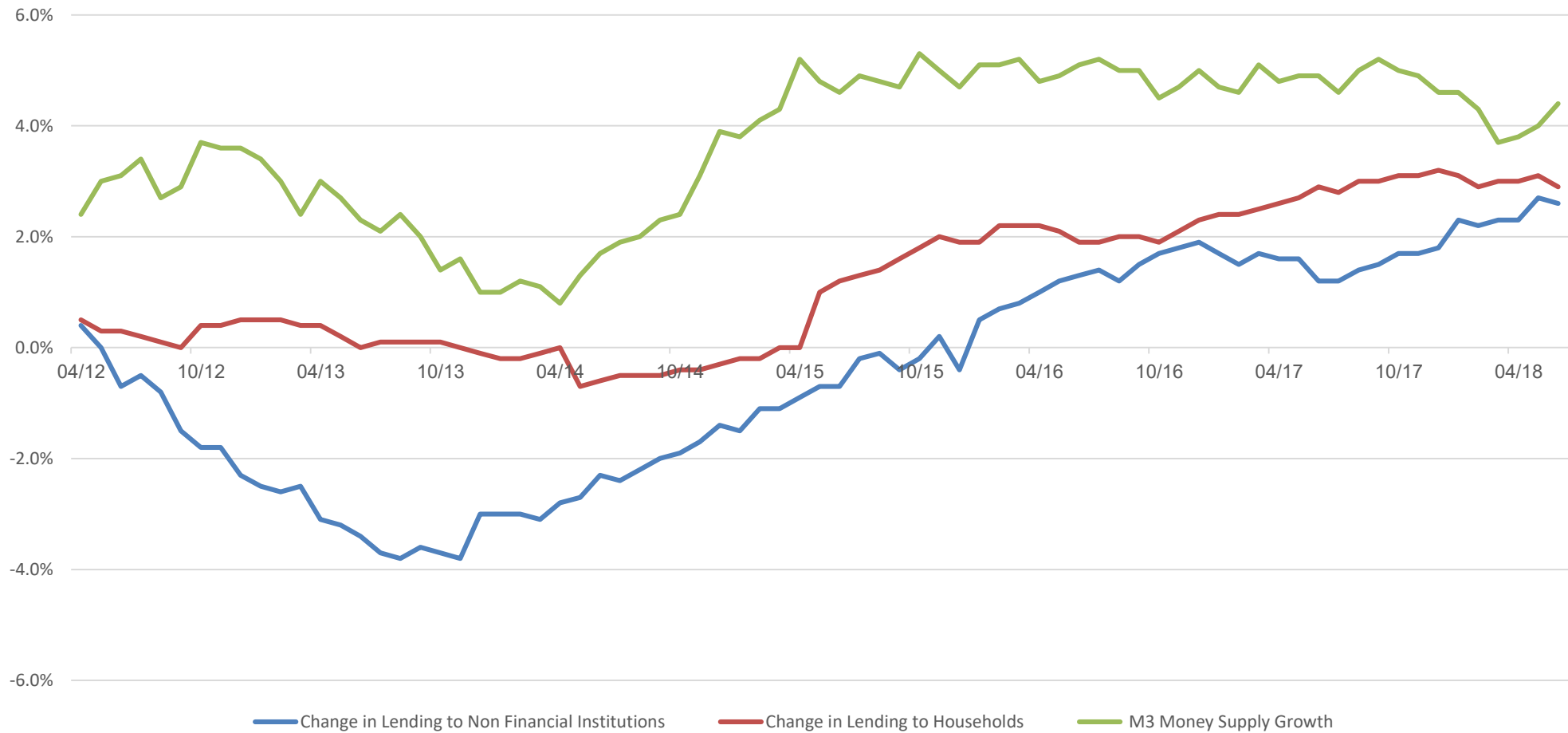




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Money Supply and Credit

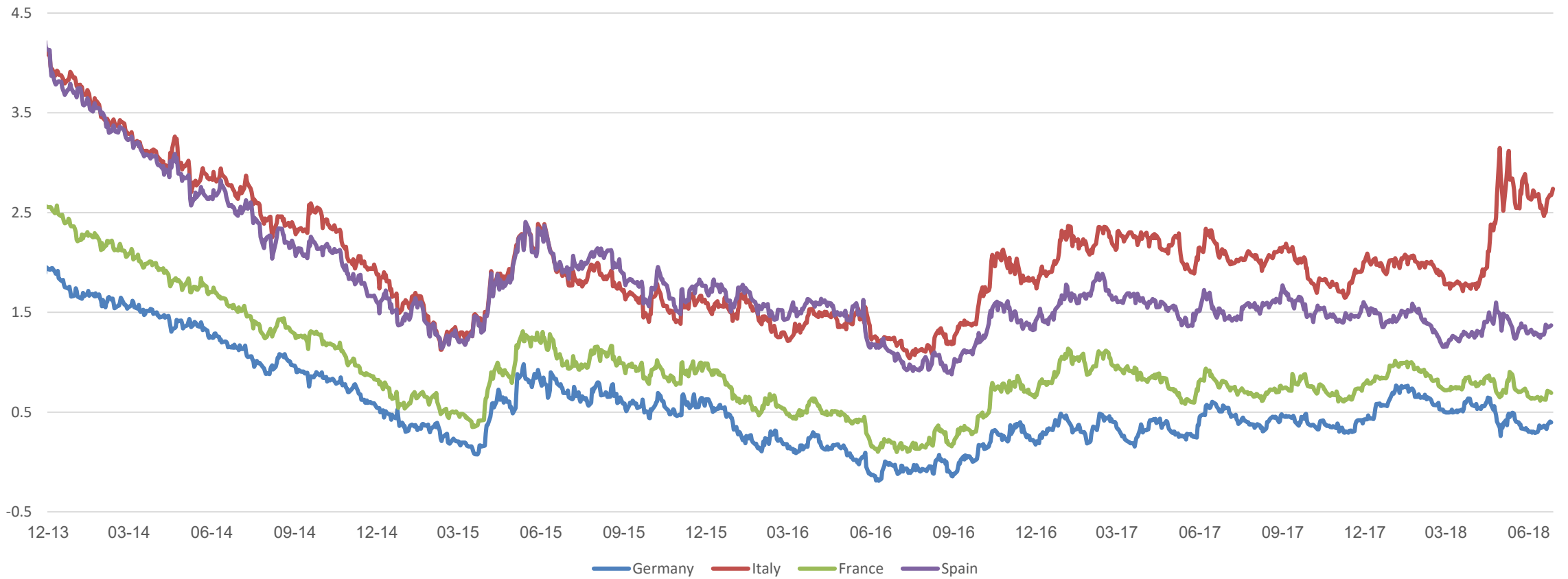
Growth in Money Supply, Loans to Real Sector





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10YR Government Bond Yield

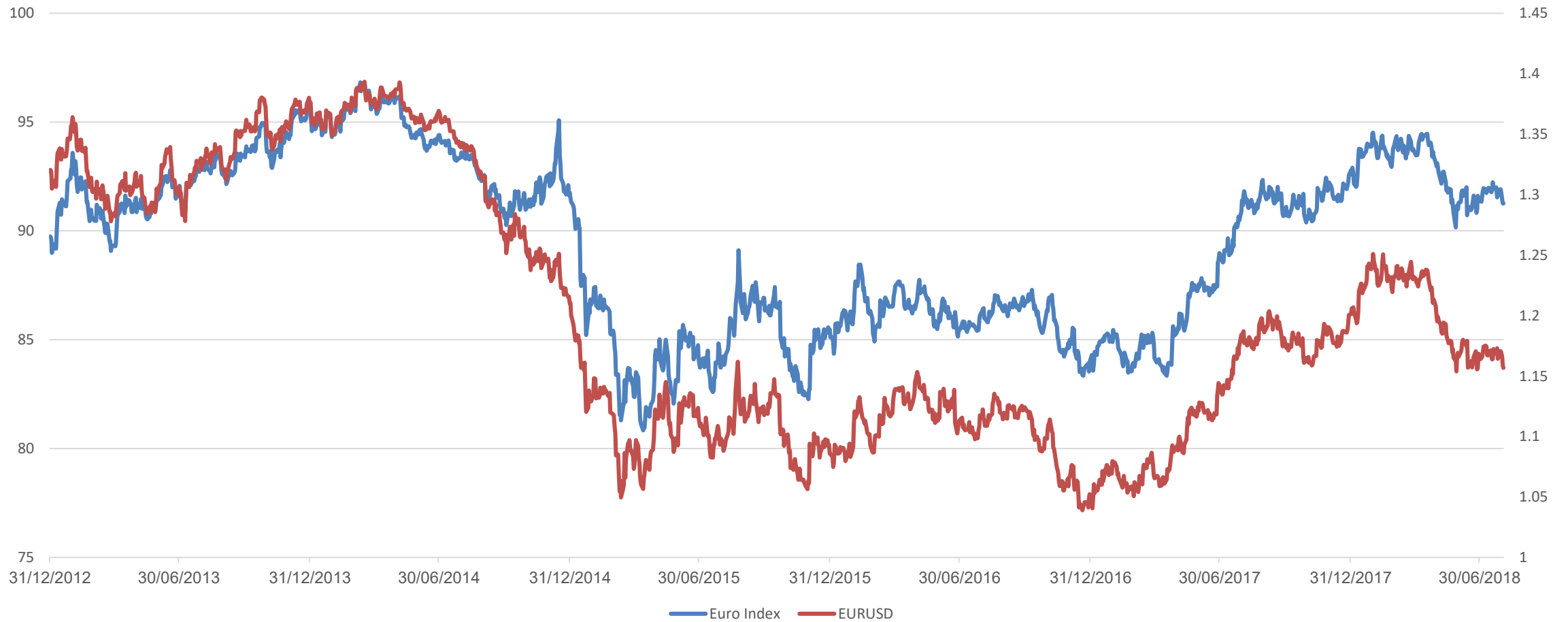




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Exchange Rate

Euro Index (Left) EURUSD (Right)





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Citi Economic Surprise





- The economy continues to grow in a strong pace. Q1 GDP rose by 4.7% (annually). However, the private consumption and export were influenced by one-time factors and the growth rate for Q2 is expected to be much lower
- The unemployment rate rose slightly to 3.9%, but is still at a very low level in historical terms
- After a long period of zero and even negative inflation, the CPI reached inflation target, while a major increase in inflation expectations has occurred. YoY inflation rose by 1.3% and by 0.9% in H1 2018
- The Bank of Israel left the interest rate unchanged and noted that the interest rate is expected to rise in Q4 2018 and then again in Q3 2019, given inflation stabilizing within the target range of 1% -3%
- The stagnation in real estate market continues, while below the surface, sentiment surveys indicate a tendency of decreasing prices
- S&P increased Israel's credit rating to AA- due to the continuous decrease in debt to GDP ratio
- In light of the continued widening of the interest rate differential, the transition from Shekel to Dollar investment channels continues among households and institutional investors



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Economic Indicators

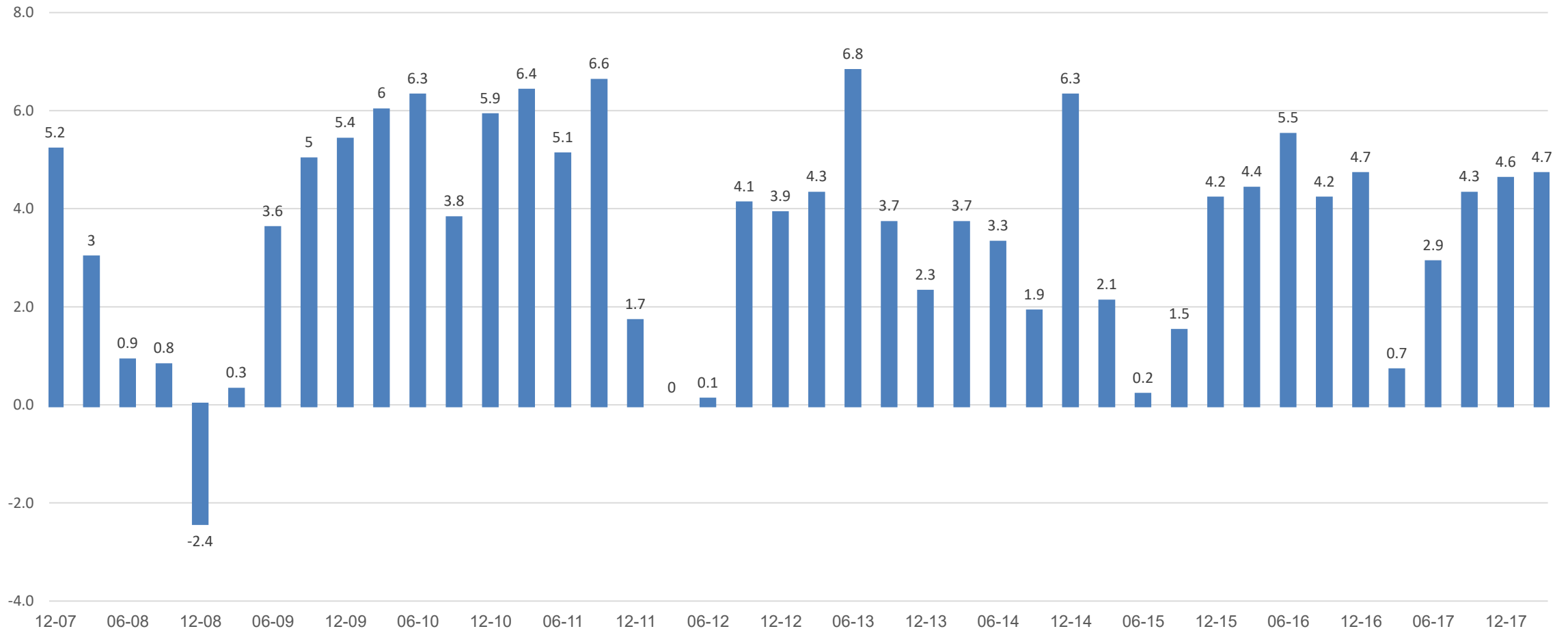
Israel

Economic Indicator	Latest Figure	Reference Period
Growth Rate	4.7%	Q1-2018
Unemployment Rate	3.9%	May-2018
Inflation Rate (YoY)	1.3%	June-2018
Central Bank Interest Rate	0.1%	July-2018
10 Year Government Bond Yield	1.98%	July-2018
Ratio of Surplus in Current Account to GDP	2.66%	Q1-2018
Ratio of Public Debt to GDP	59.5%	Q4-2017



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Economic Growth (Annualized)





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Labor Market

Unemployment Rate





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Inflation

CPI (YoY)





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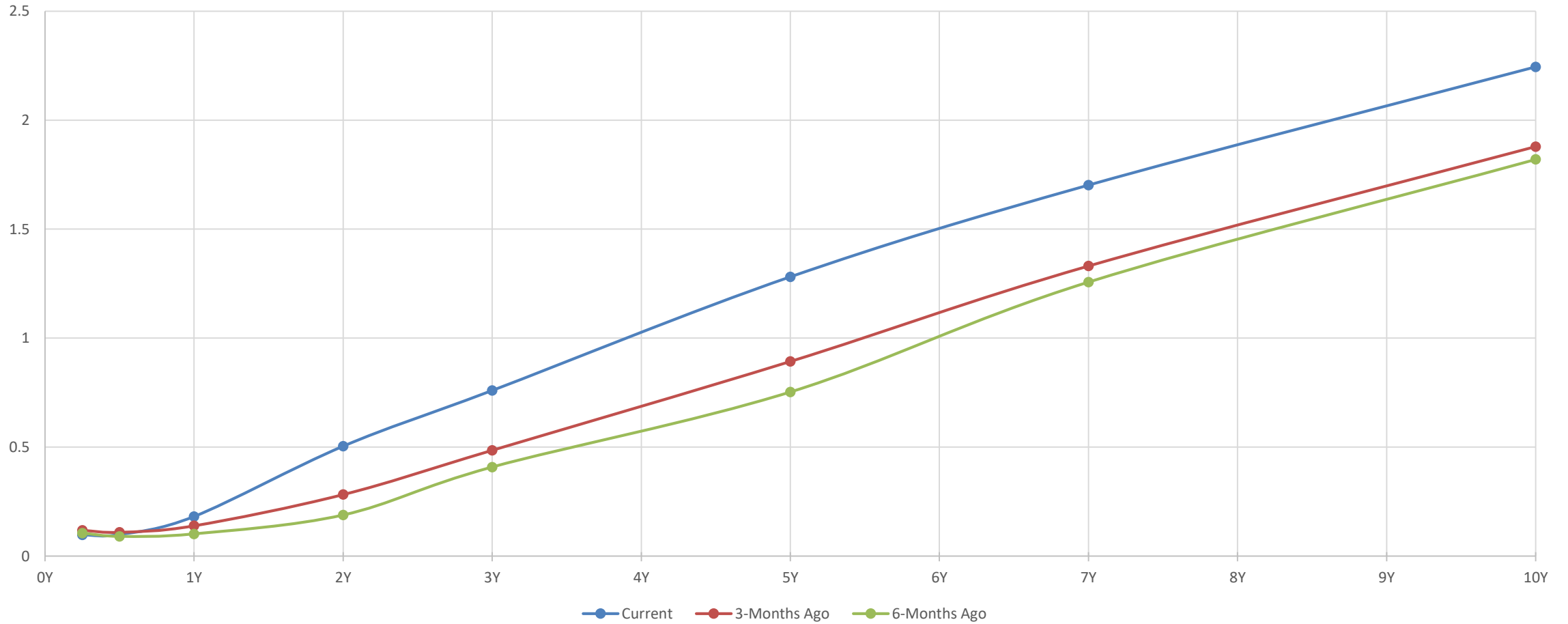
10YR Government Bond Yield





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Government Bond Yield Curve





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Hedging Costs

USDILS 1YR Forward Premium

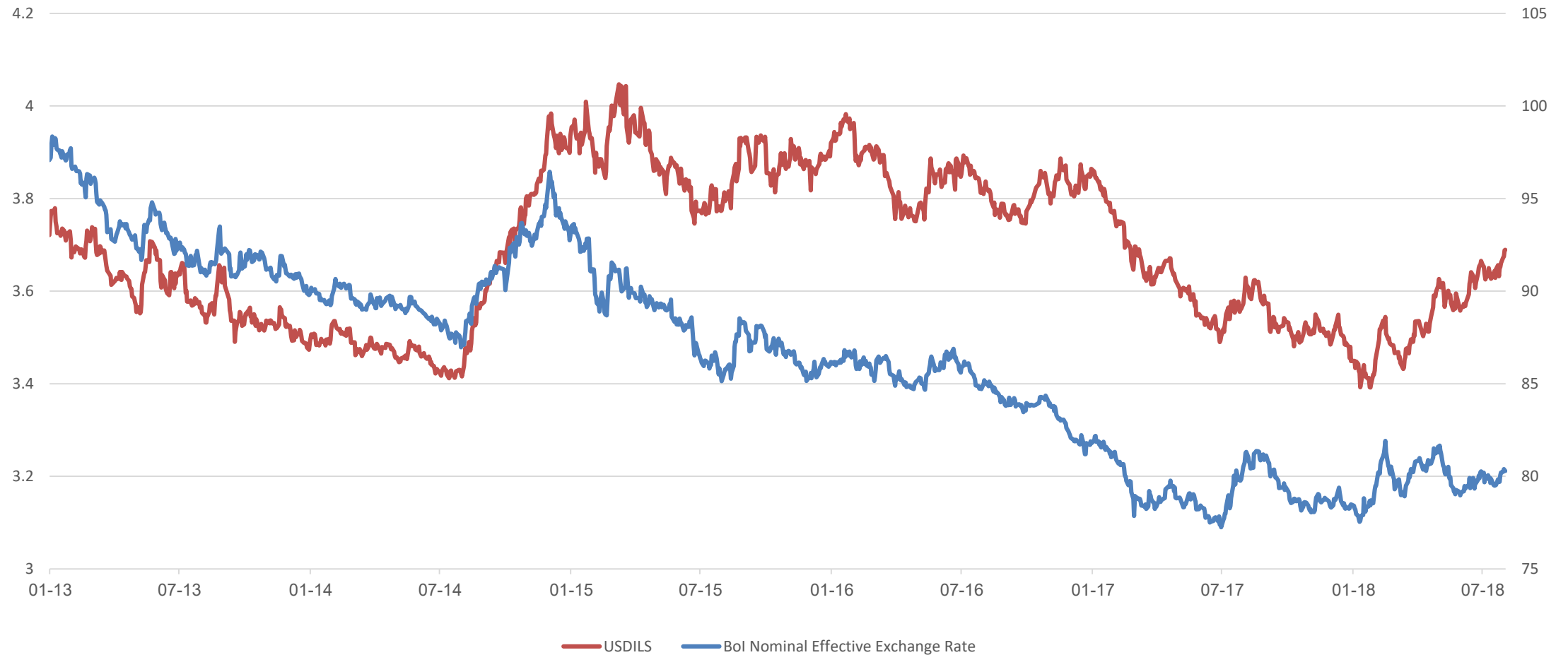




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Exchange Rate

USDILS (Left) BOI Nominal Effective Rate (Right)





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CONNECTING THE RIGHT DOTS

CREATING THE RIGHT PICTURE