Financial Immunities

Market Insights

September 2018

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Global Economy

- Investors remain wary that escalating tariffs imposed by the US and China could imperil global economic growth
- However, US stocks are at all-time highs in what seems to be the longest bull market ever. The robust US financial markets and strong economic indicators as opposed to the turmoil elsewhere enables the trump administration to keep pushing its trade agenda
- Volatility in global financial markets continue to increase as liquidity is drying up enhanced by the Fed and ECB normalization in monetary policy
- After sinking in mid-August to the lowest in almost two months against the background of trade war and emerging markets turmoil, oil prices have stabilized and advanced amid US crude stockpiles drop and signs of tighter supply

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United States

- The US economy continues to produce above trend figures, with Q2 GDP growth at 4.2%, while unemployment rate is at 3.9%, an 18 year low. The economy continues to add an average of 200K jobs per month. Hence, the interest rate trajectory is unlikely to change, according to Fed chair Powell
- Although headline inflation figures came in at 2.9%, Core PCE deflator has increased only by 2% in July. Based on the Fed estimations, the probability for inflation overshooting is relatively low. Therefore, rate hikes are expected to be gradual
- Trump's USD discount – Trump's verbal assaults on the US trading partners (regarding competitive devaluation) and the continuous criticism on the Fed's chair Powell regarding his gradual rate hike approach, begins to create a headwind to the USD, as evidenced by the Dollar index inching lower during August
- The flattening of the US yield curve, 0.19% spread between 2 and 10 year treasury (lowest level since 2008), which was in the past a precursor to previous downturns, is still not considered to be a major concern among policy makers, although the issue is beginning to gain traction among Fed officials and market analysts
- Forward looking data estimates for Q3 GDP stands at 4.6% according to the Atlanta Fed and 2.00% according to NY Fed, which indicates contradicting opinion regarding the longer term impact of the fiscal stimulus

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Economic Indicators

USA

Economic Indicator	Latest Figure	Reference Period
Growth Rate	4.2%	Q2-2018
Unemployment Rate	3.9%	July-2018
Inflation Rate (Core PCE, YoY)	2.0%	July-2018
FED Funds Target Range	1.75%-2%	September-2018
10 Year Treasury Yield to Maturity	2.86%	August-2018
Ratio of Current Account Balance to GDP	-2.33%	Q1-2018
Ratio of Public Debt to GDP	105.68%	Jan-2018

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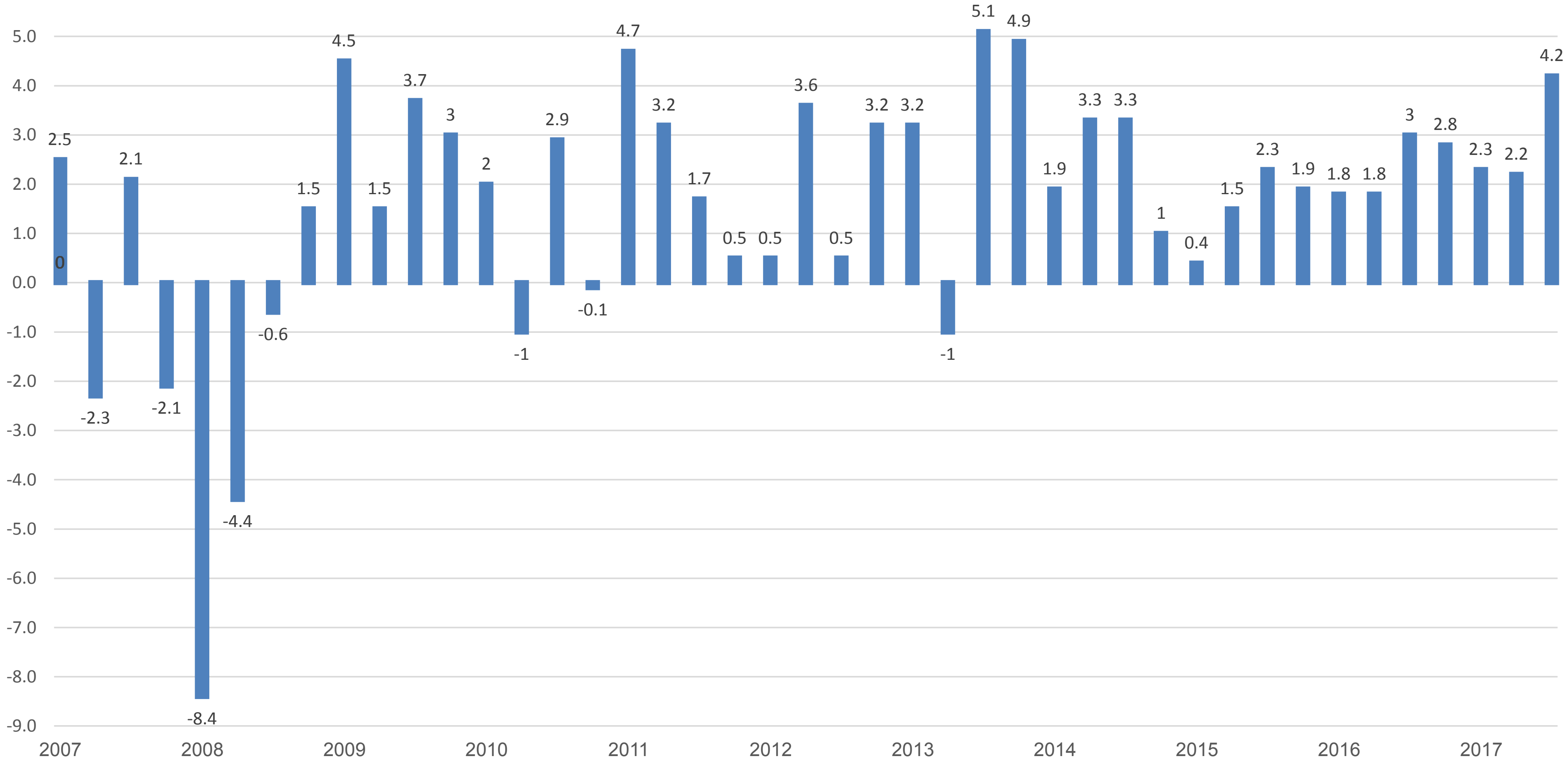
Economic Growth



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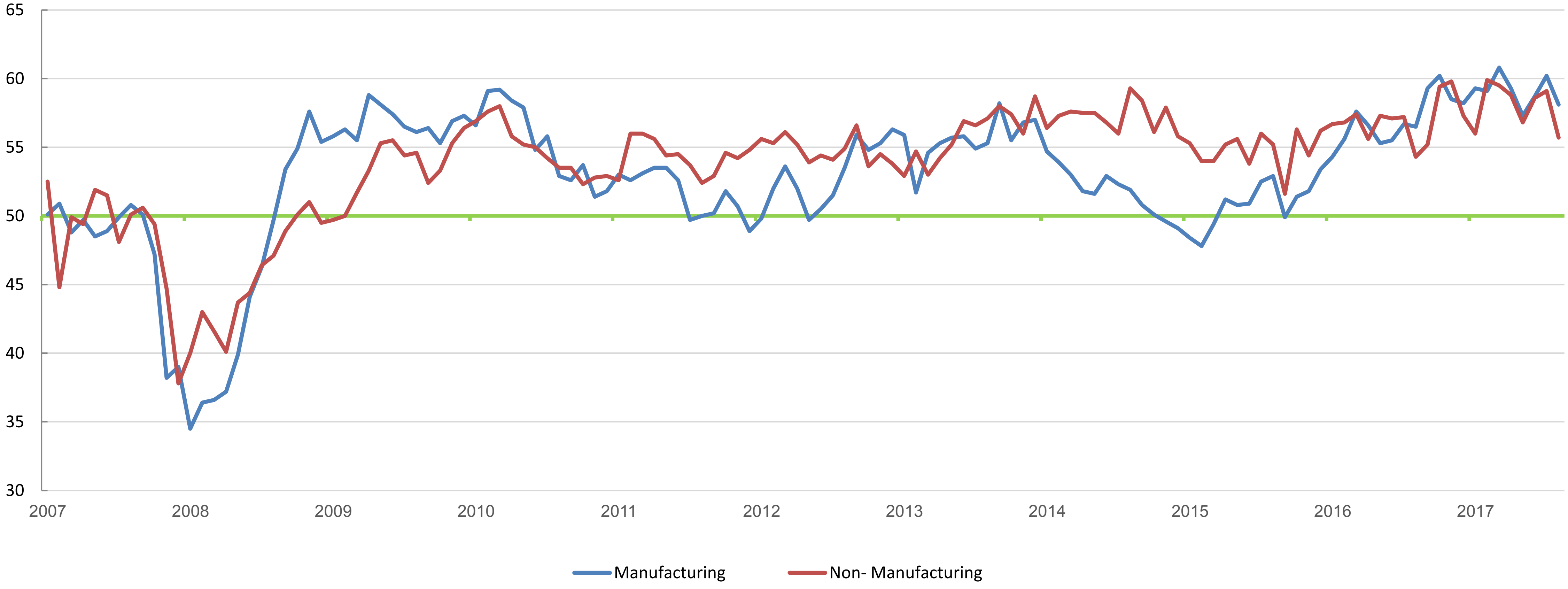
Economic Sentiment

Manufacturing and Non-Manufacturing PMI



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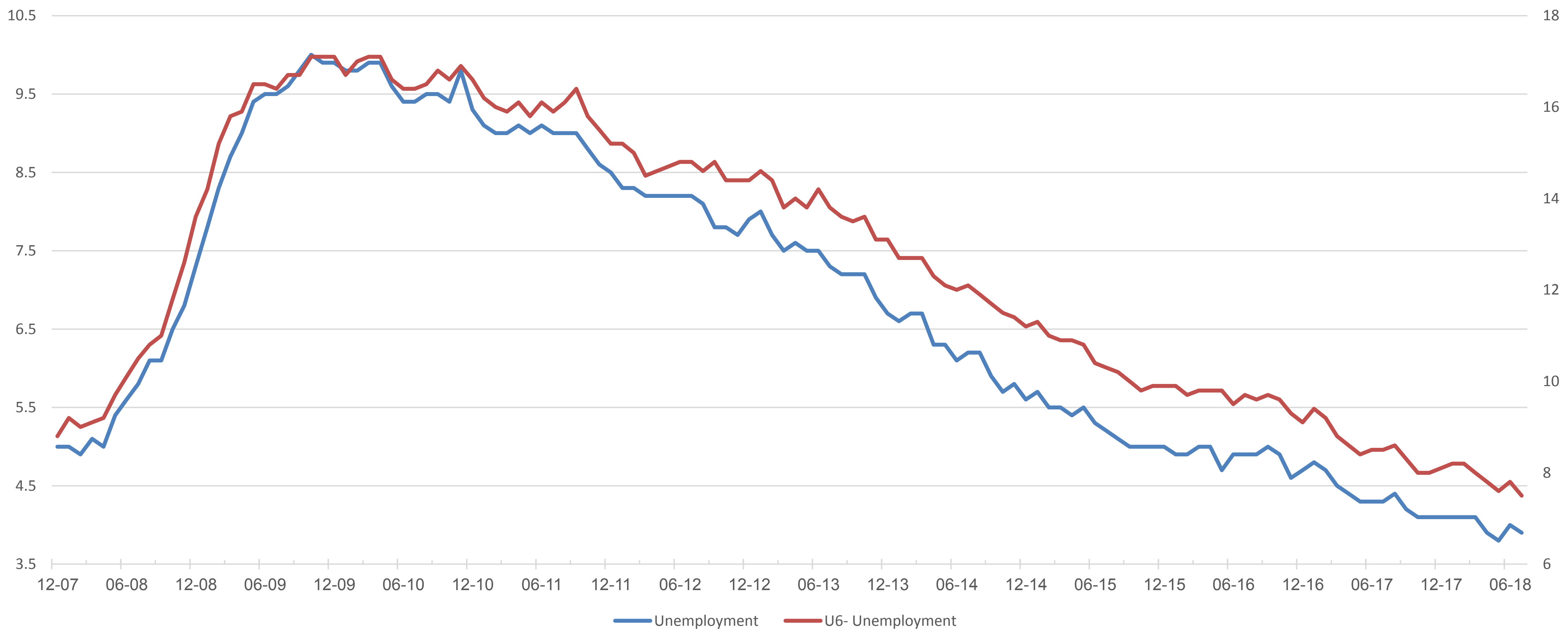
Labor Market

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



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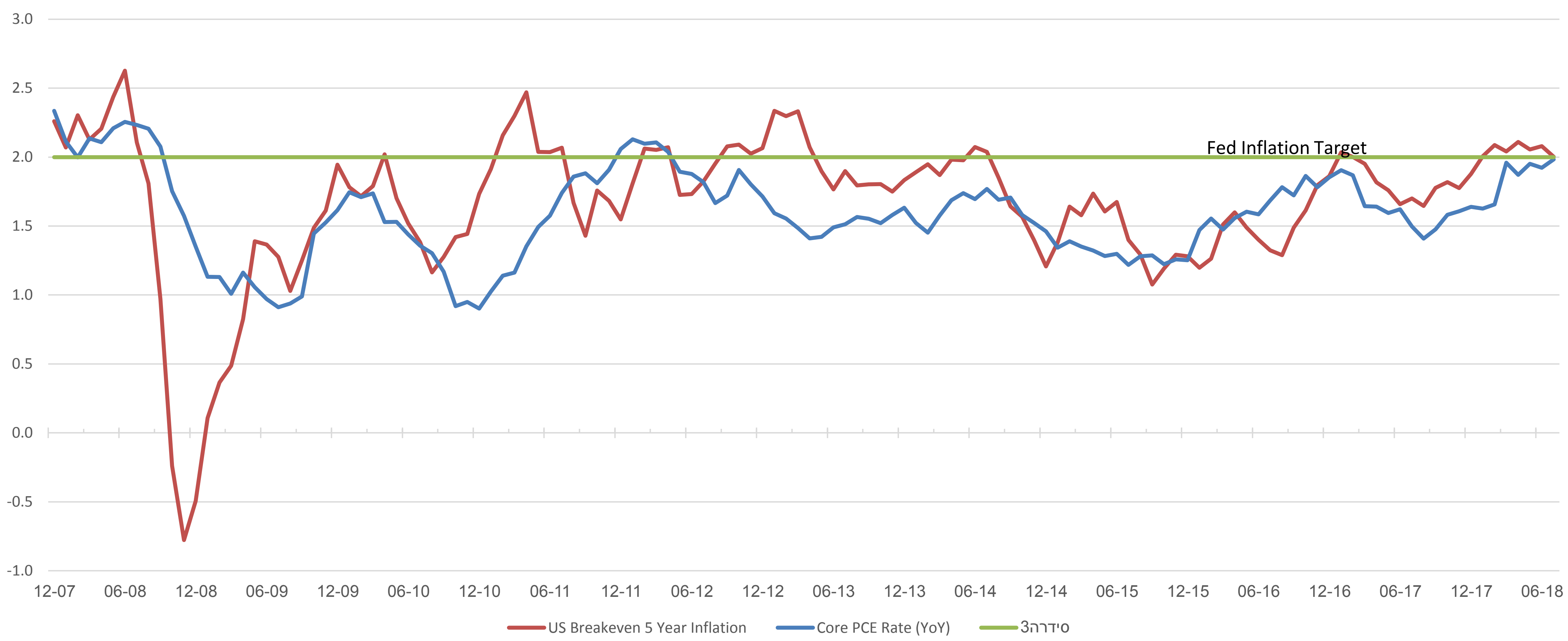
Inflation

Core PCE (YoY) and 5Y Inflation Forecast



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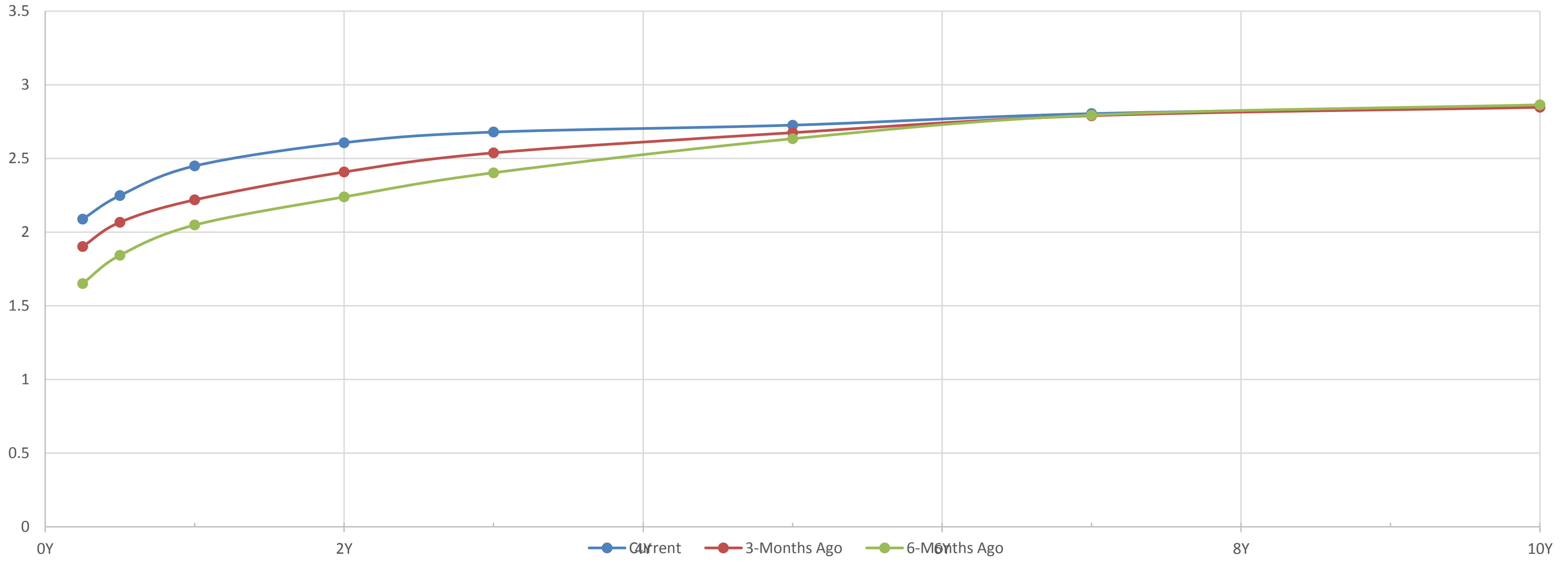
10YR Treasury Yield

US Treasury Yield Curve



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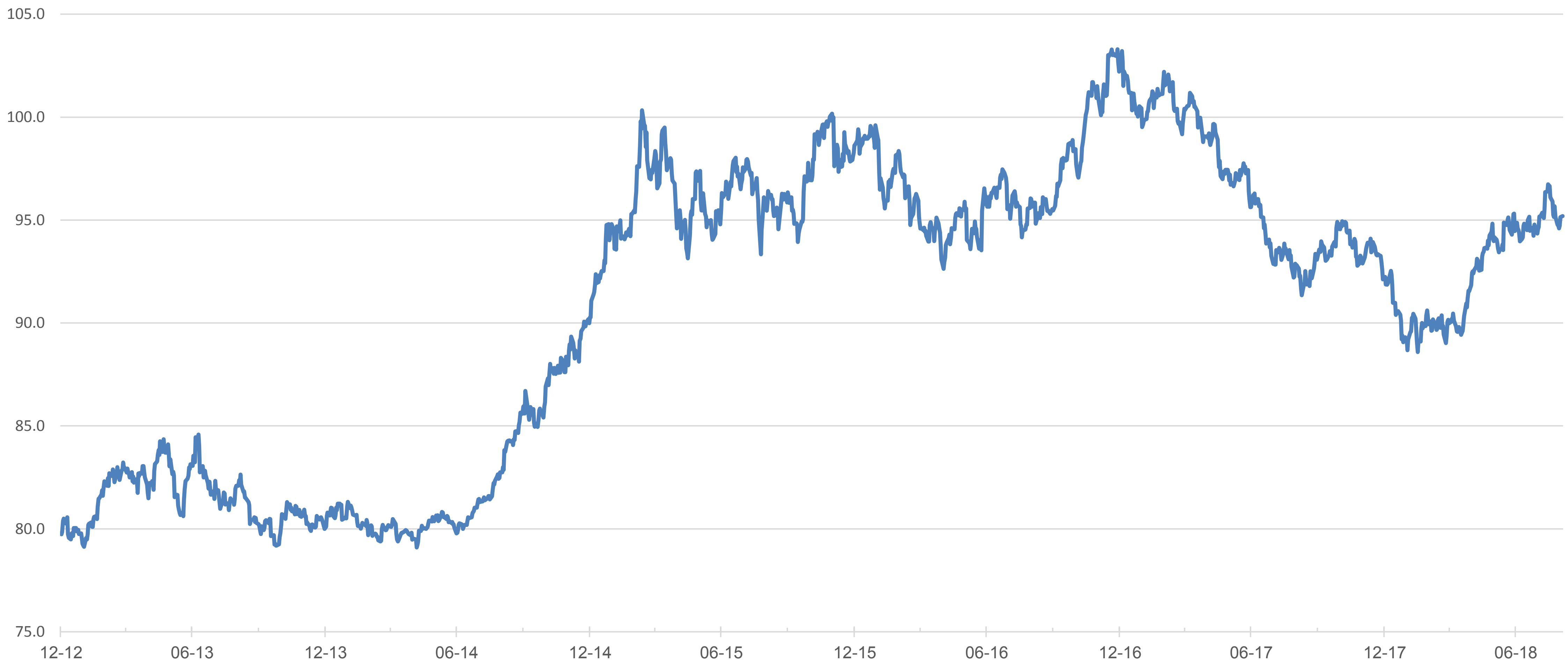
US Dollar Index (DXY)



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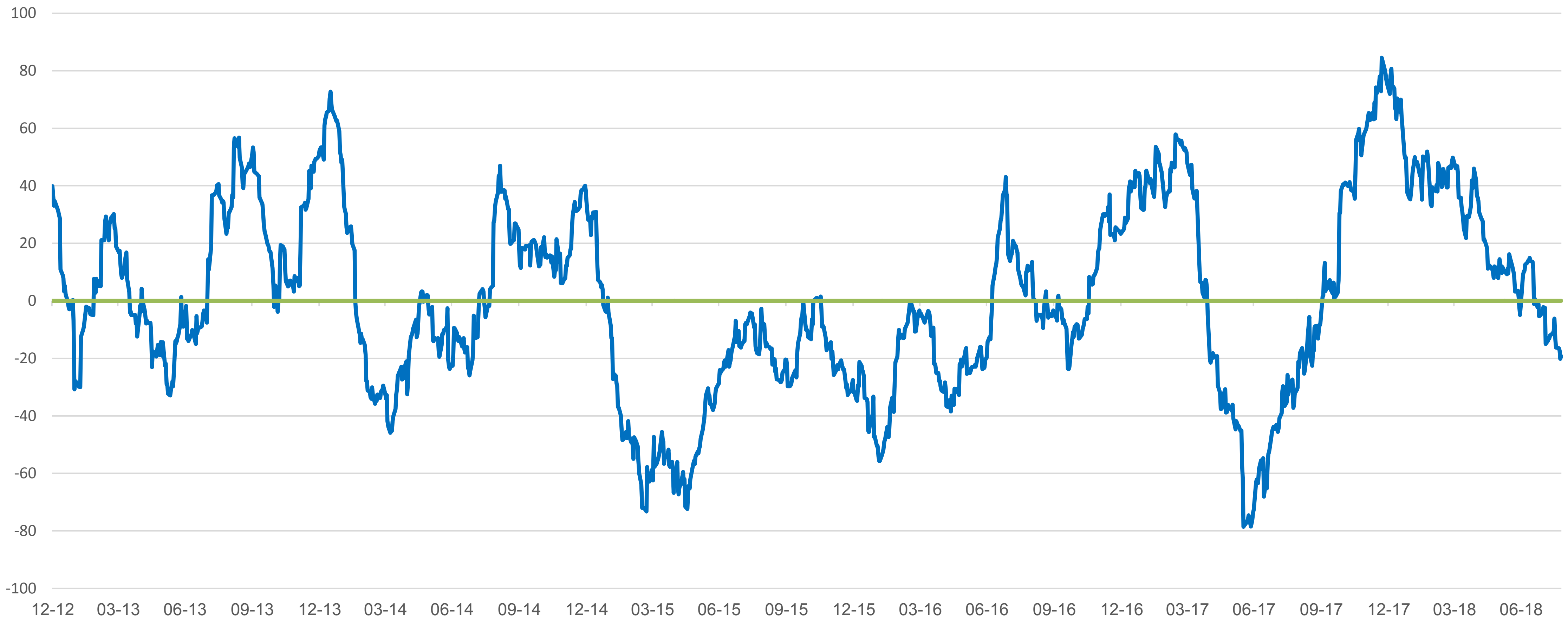
Citi Economic Surprise



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Eurozone

- Data in the second quarter has stabilized converging to long term trend of around 2% GDP growth rate
- CPI growth came in at 2%, below the 2.1% reading in July that economists expected to see repeated. The core measure, which excludes energy and food, fell to 1%, also below expectation
- The unemployment rate continues to decrease to 8.2% in August, concurrently with the rise in wages, albeit at a moderate rate for the time being
- Economic confidence slipped to the weakest in a year as businesses and consumers remain concerned over international trade tensions and political instability in Italy. Italy's government bond yields are steadily on the rise, reflecting high credit risk and expectation of the ECB reduction of bond purchases in September
- The financial turmoil in Turkey could pose a risk to the financial stability of some European banks, although markets are seem to be less concerned with such prospect
- The ECB continues to maintain its "Forward Guidance" schema, with interest rate expected to remain at a level of 0% until the autumn of 2019, solidifying the interest rate differential between the EU and the US

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Economic Indicators

Eurozone

Economic Indicator	Latest Figure	Reference Period
Growth Rate	1.5%	Q2-2018
Unemployment Rate	8.2%	July-2018
Inflation Rate (Core, YoY)	1.0%	August-2018
Central Bank deposit rate	0.00%	September-2018
10 Year Government Bond Yield (Germany)	0.34%	August-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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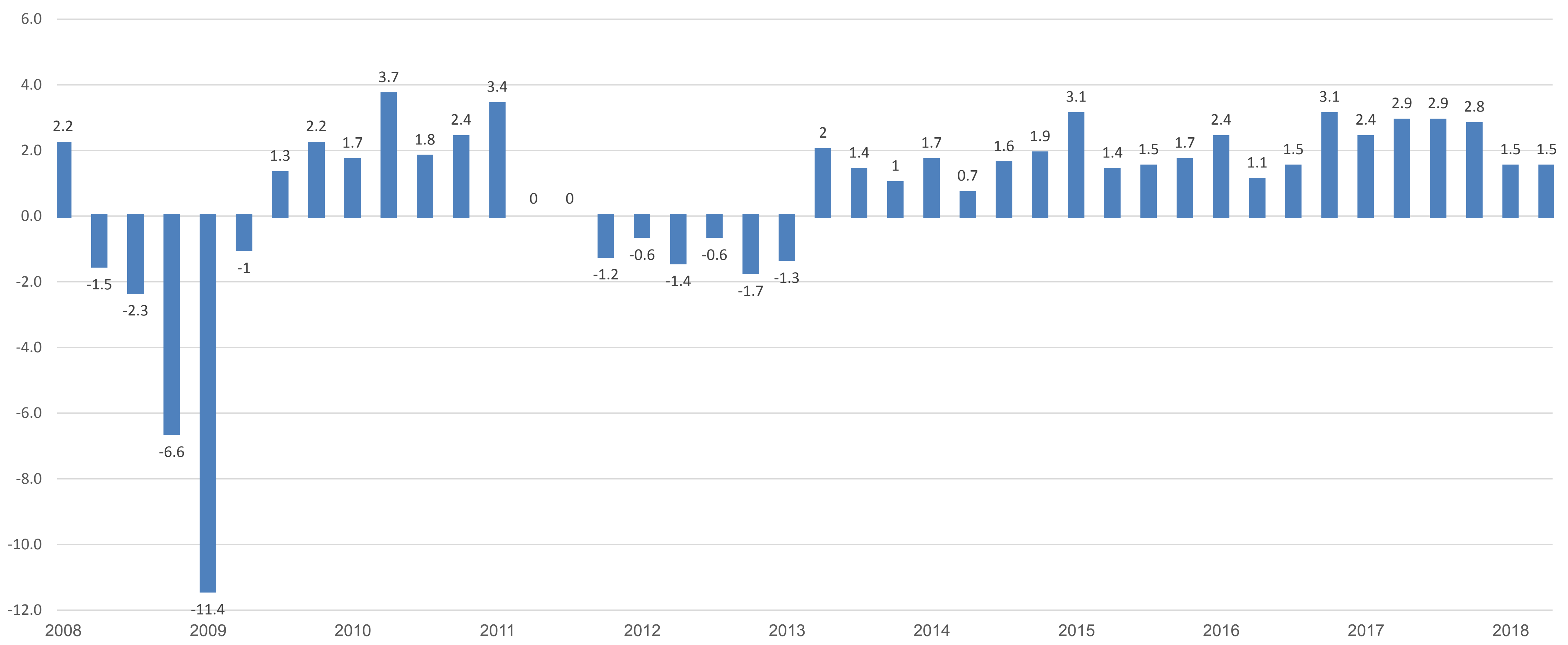
Economic Growth (QoQ)



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Economic Sentiment

Manufacturing and Non-Manufacturing PMI

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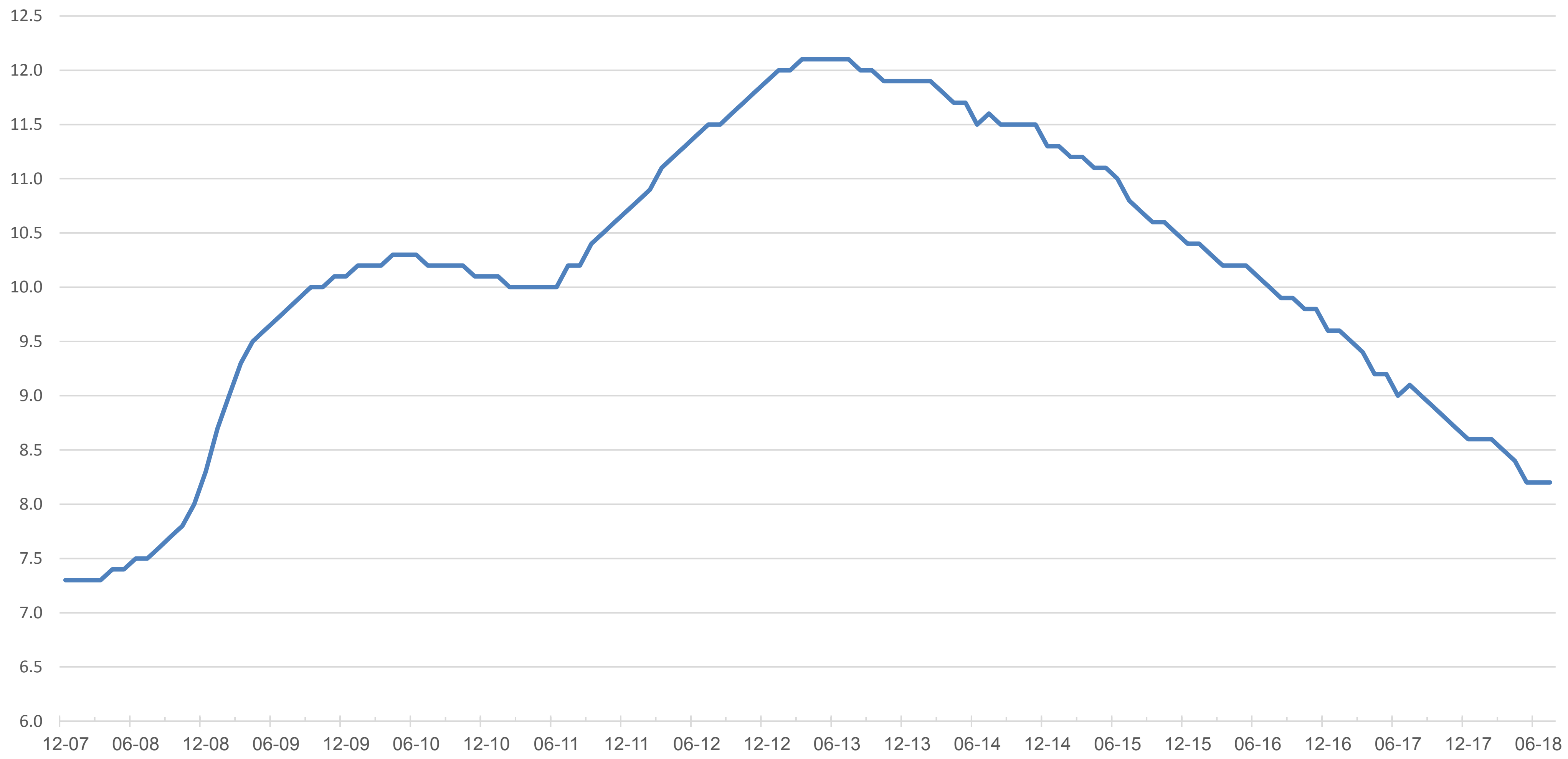
Unemployment Rate



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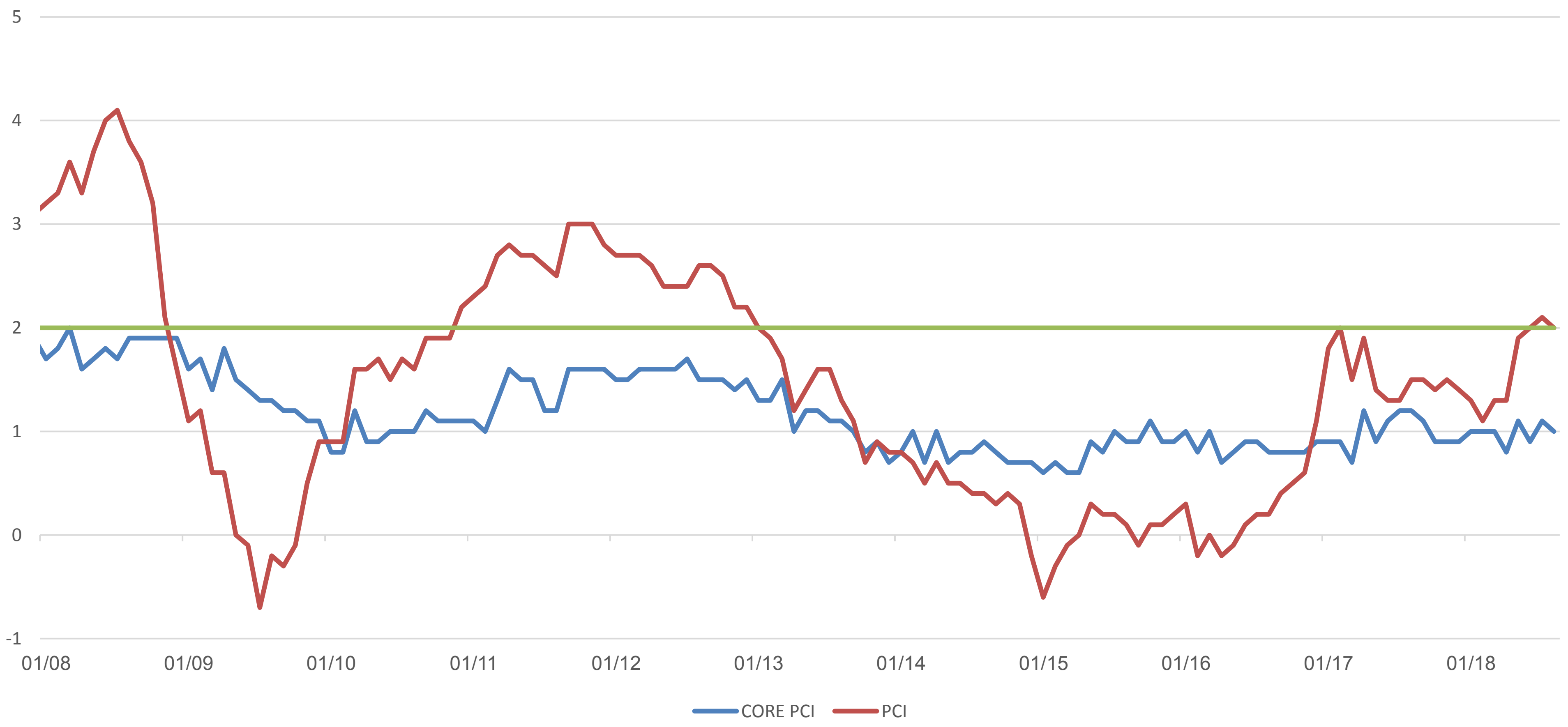
Inflation

CPI and Core CPI (YoY)



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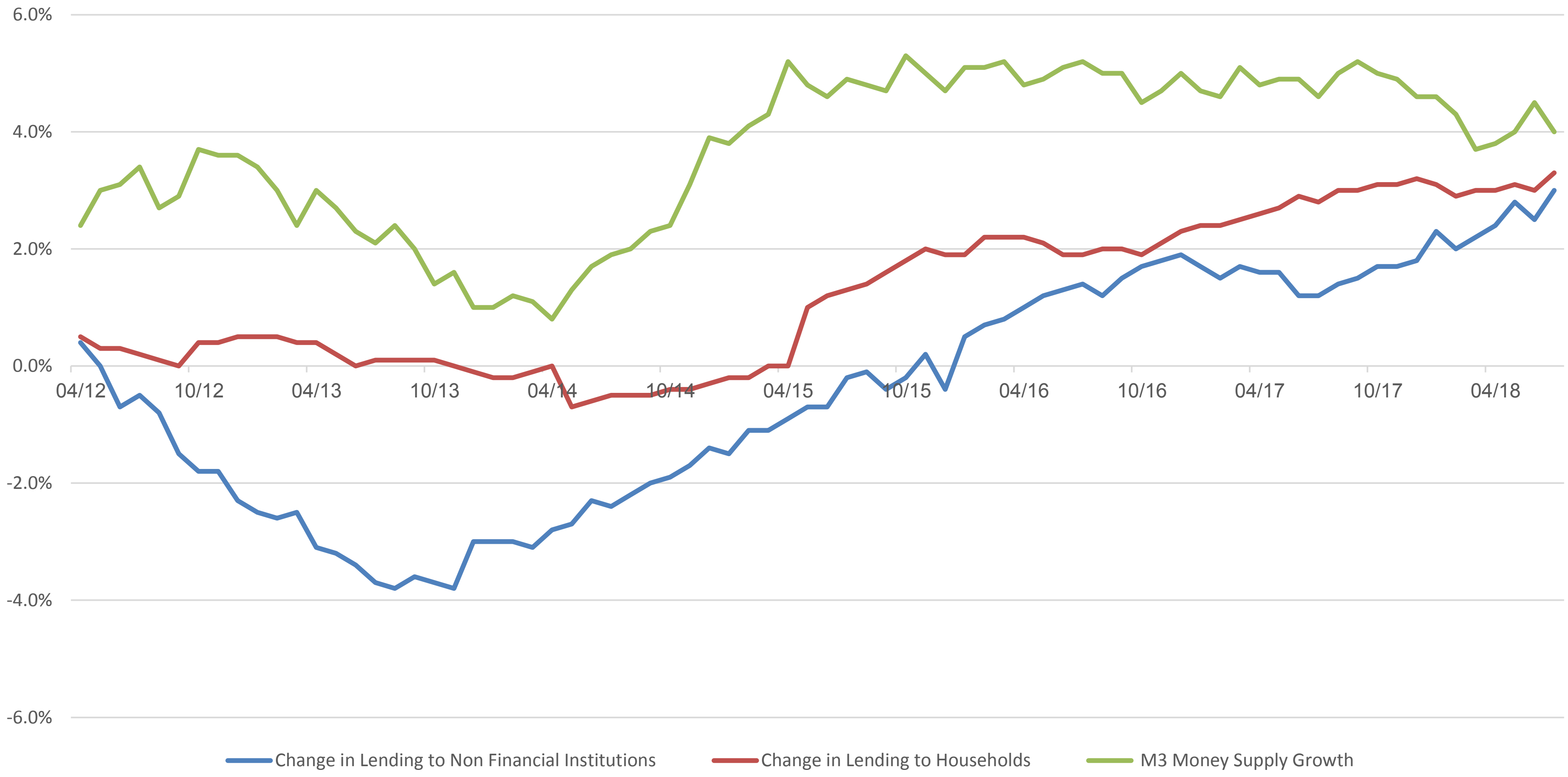
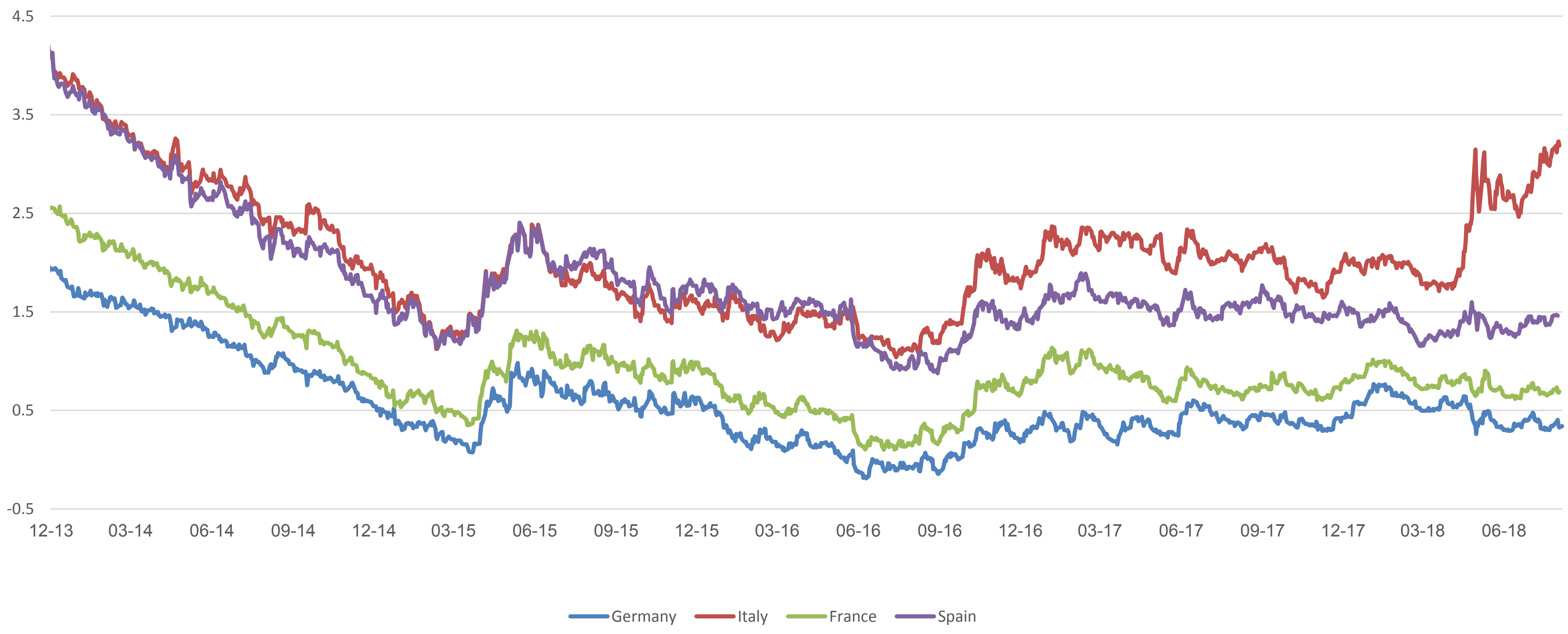
Money Supply and Credit

Growth in Money Supply, Loans to Real Sector



10YR Government Bond Yield



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Exchange Rate

Euro Index (Left) EURUSD (Right)

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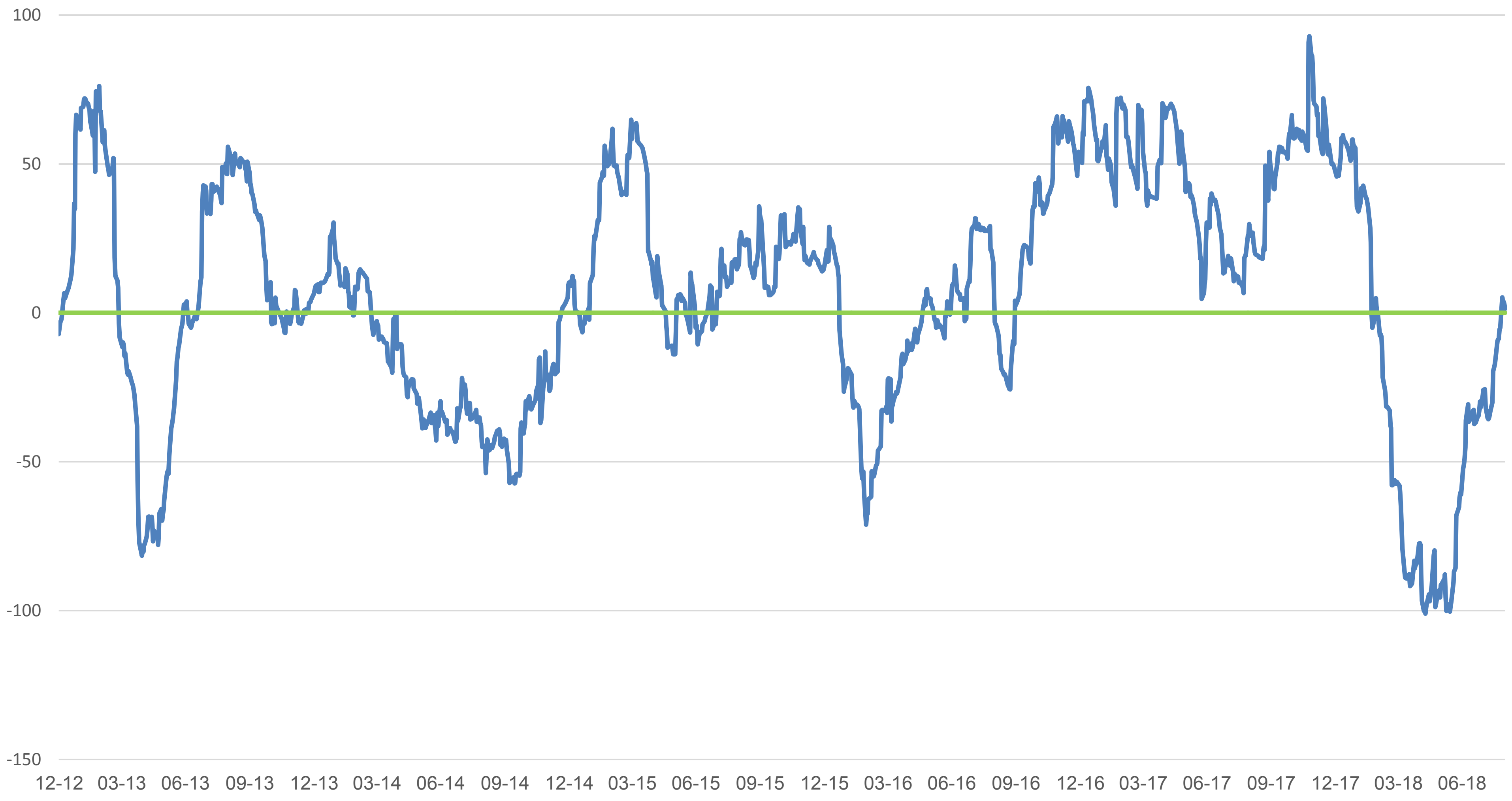
Citi Economic Surprise



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Israel

- After three strong quarters, GDP growth in Q2 has moderated to 2% due to stagnation in consumer spending and exports, while a contraction was observed in public expenditure and investments
- Unemployment rate increased from 4% to 4.2%, the highest level since November 2017
- Despite the decrease in debt to GDP ratio to 59.2% and the recent S&P credit upgrade to AA-, the budget outlook is expected to deteriorate in the upcoming months due to base effect and increase in government expenses. Hence, after a few years of stabilized deficit around 2%, it is expected to reach 3% and above
- Inflation expectations and actual inflation continued to rise and reached the inflation target of 1%-3%. However, it is expected to stabilize and even decrease in the upcoming months. During the last interest rate decision announcement, the BOI established a link between future rate hikes and ILS appreciation risk due to its effect on inflation
- The BOI Governor, Karnit Flug, is expected to end her five-year term in November. The uncertainty regarding the next governor might increase fluctuations in local financial markets
- On the back of the interest rate differential between Israel and the US (2.8% per year), institutional and retail investors continue to increase their exposure to US assets

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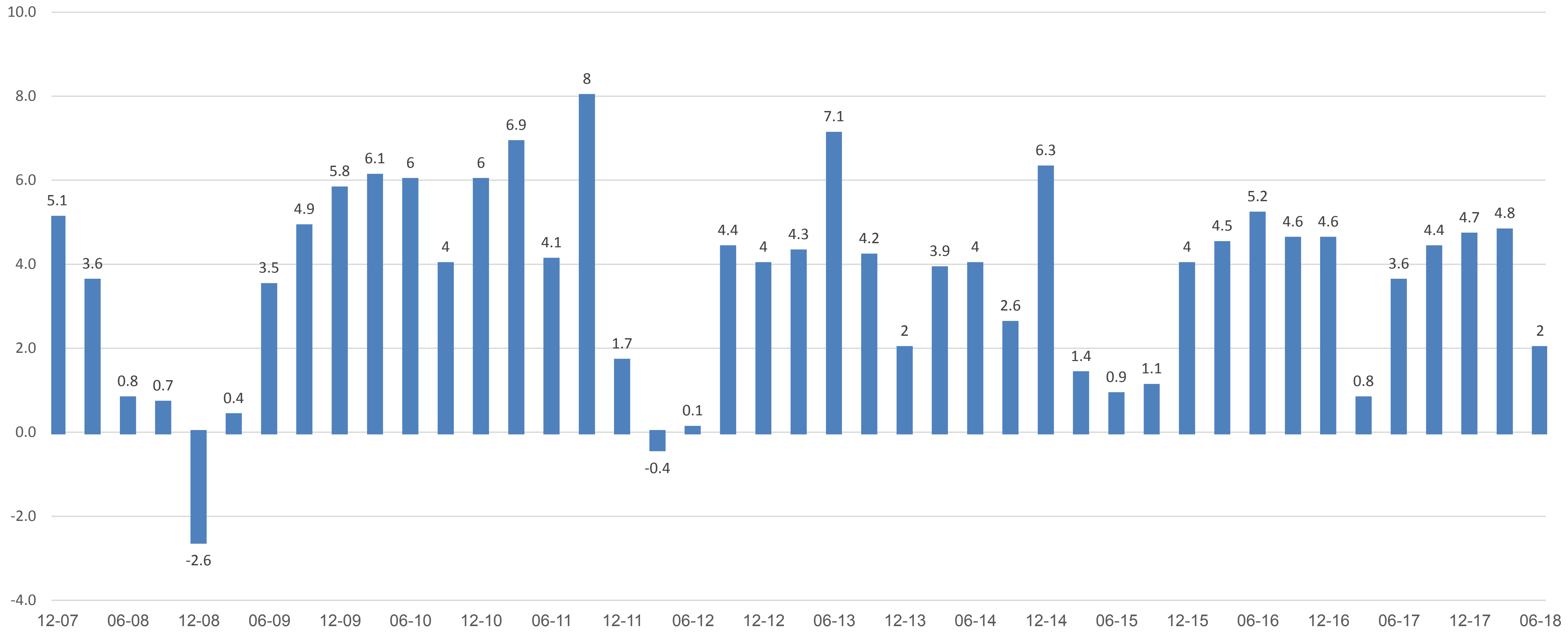
Economic Indicators

Israel

Economic Indicator	Latest Figure	Reference Period
Growth Rate	2.0%	Q2-2018
Unemployment Rate	4.2%	July-2018
Inflation Rate (YoY)	1.4%	July-2018
Central Bank Interest Rate	0.1%	September-2018
10 Year Government Bond Yield	1.94%	July-2018
Ratio of Surplus in Current Account to GDP	2.66%	Q1-2018
Ratio of Public Debt to GDP	61%	December-2017

Economic Growth
(Annualized)



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Labor Market

Unemployment Rate

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Inflation

CPI (YoY)

10YR Government Bond Yield

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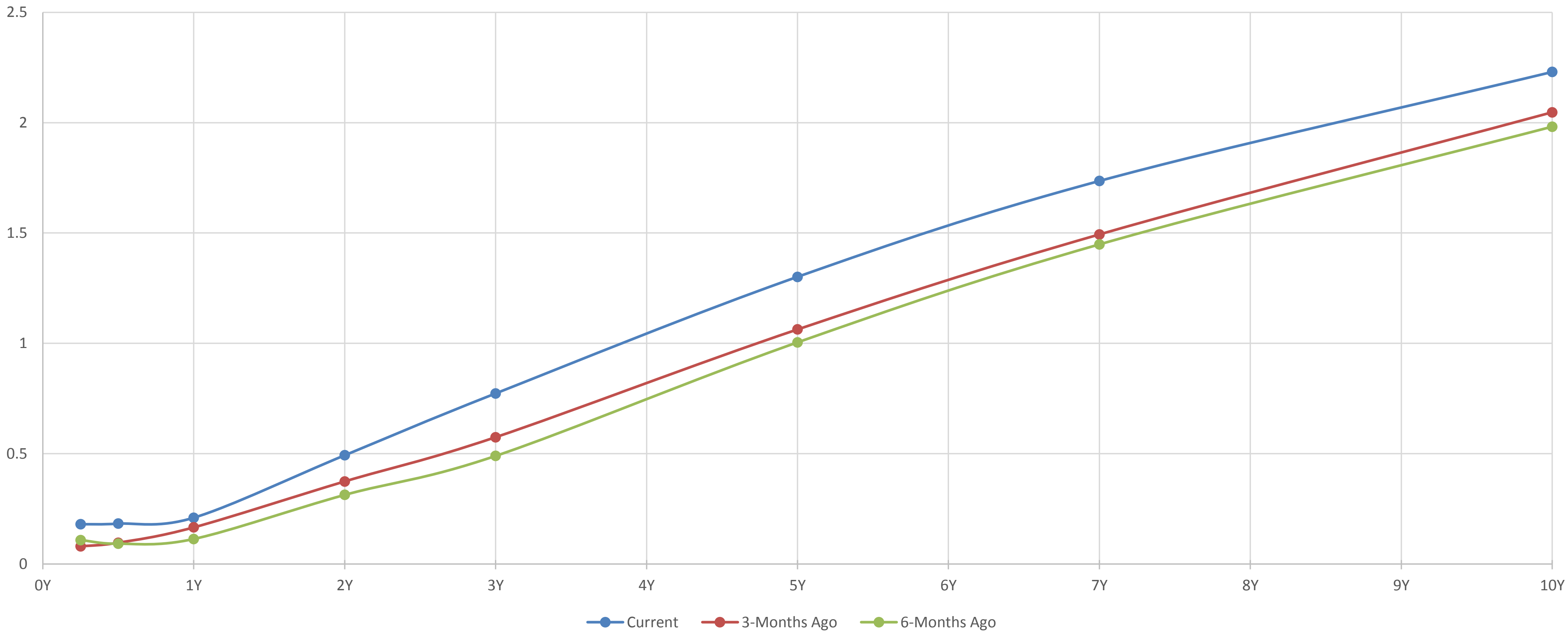
Government Bond Yield Curve



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Hedging Costs

USDILS 1YR Forward Premium

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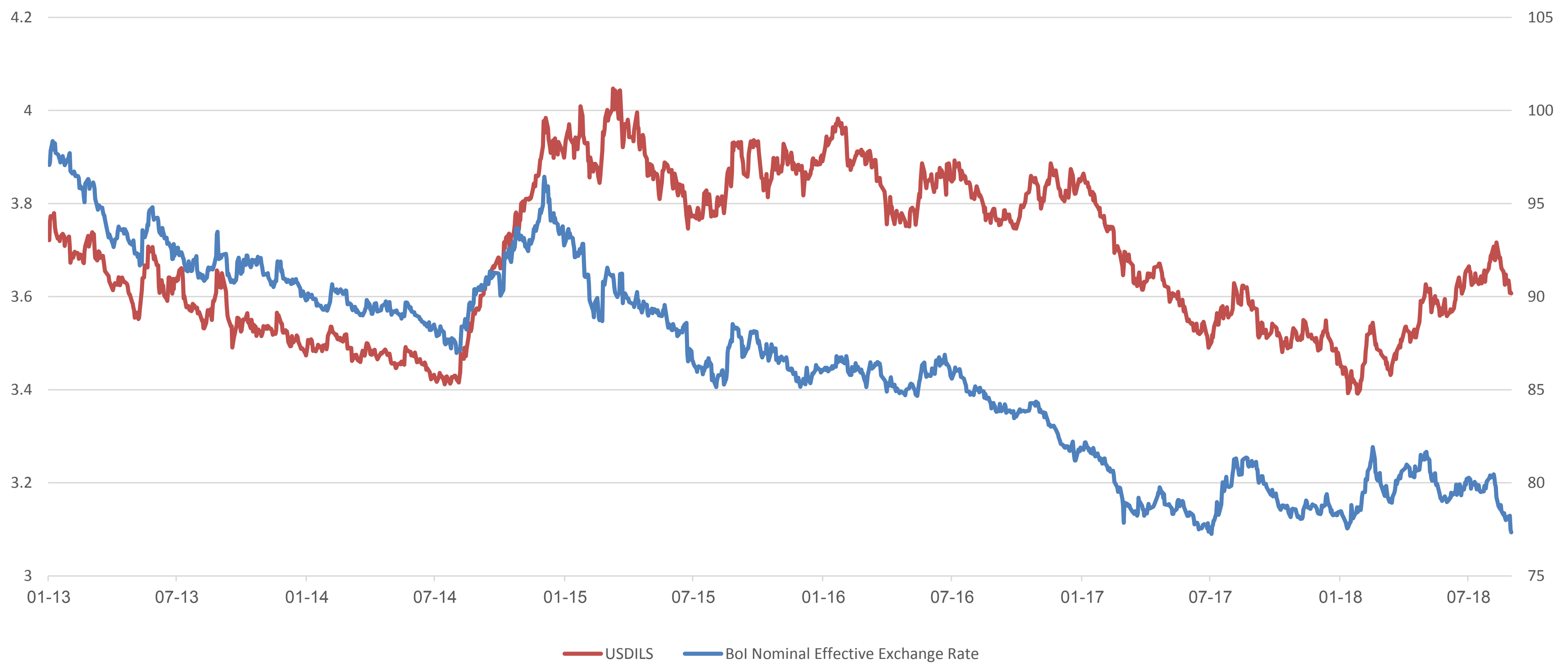
Exchange Rate

USDILS (Left) BOI Nominal Effective Rate (Right)



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CONNECTING THE RIGHT DOTS

CREATING THE RIGHT PICTURE

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