Financial Immunities

Market Insights

August 2019

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Global Economy

- IMF revised downward its projection for world economic growth to 3.2% in 2019 and 3.5% in 2020. The revision comes on top of previous significant revisions made recently and is typical for a late economic business cycle
- The ongoing trade and technology tensions heavily disrupt the global supply chains and together with the ongoing Brexit saga weigh down on the global economy
- The weakest link in the global economy is the manufacturing sector which suffers from the weakness in global trade. The services sector is still expanding as it goes in line with the strong labor markets and accommodative financial conditions
- High level of uncertainty damages business sentiment, causing more businesses to hold off on investing
- High level of debt (global debt is just shy of an all time high at over $246 trillion) makes it impossible for central banks to return to normal monetary policy as financial markets demand ongoing supply of liquidity
- In response, central banks all over the world adopted recently a proactive and preemptive dovish approach in order to extend the current business cycle. However, the ammunition left in their tool box is limited
- The ultra accommodative financial conditions continue to fuel the rally in risk assets at a time when corporate profits decline, stretching valuations to the extreme and breaking loose from economic gravity

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United States

- The current U.S. expansion is the longest on record. Q2 growth slowed to 2.1% annually, above market expectation, as households continued to spend at a healthy pace of 4.3% thanks to a robust job market and elevated consumer confidence

- IMF revised upward its projection for the U.S. economy to 2.6% in 2019 due to stronger than expected growth in Q1

- Trade war weighs on U.S. businesses as it curbs their appetite for investments. In the meantime, the impact is concentrated in the manufacturing sector that shows signs of deceleration, but the question whether it will spill over to the service sector, that constitutes the majority of the economy and the labor market, remains open

- The labor market continues to show signs of strength. Jobless claims and unemployment are close to record lows. Wages increase at a rapid pace of 3.2% and the level of job openings remains elevated

- After a few months of soft data, prices are recovering. Core PCE price index gathered momentum as it climbed 1.6% YOY and 2.5% annualized over the past three months, a sign that inflation is trending back up

- The Fed cut interest rates by 0.25%, the first reduction since 2018, and ended QT 2 months ahead of schedule. Although the Fed emphasized that it is worried about a possible slowdown, it also said the job market is solid and the consumer remains a bright spot. At the news conference after the decision the Fed chair, Jerome Powell, poured a bucket of cold water on markets' expectations saying that the rate cut is a mid-cycle adjustment and isn't necessarily a start of an easing cycle

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Core Economic Indicator

USA

Economic Indicator	Latest Figure	Reference Period
Growth Rate (Annualized)	2.1%	Q2-2019
Unemployment Rate	3.7%	July-2019
Inflation Rate (Core PCE, YoY)	1.6%	June-2019
Central Bank Interest Rate	2.25%-2%	August-2019
10 Years Yield	1.85%	August-2019
Ratio of Surplus in Current Account to GDP	-2.41	Q1-2019
Ratio of Public Debt to GDP	104.60%	January-2019

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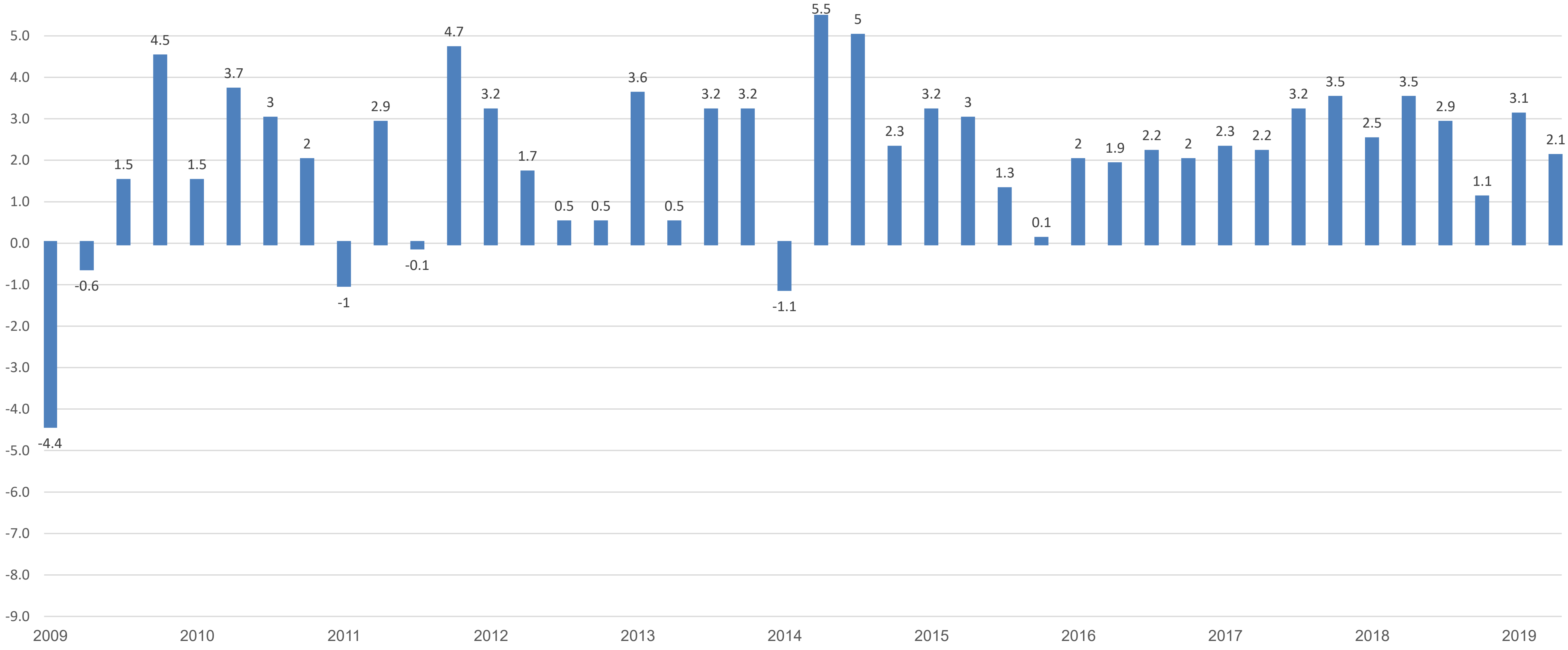
Economic Growth

GDP (Annualized)



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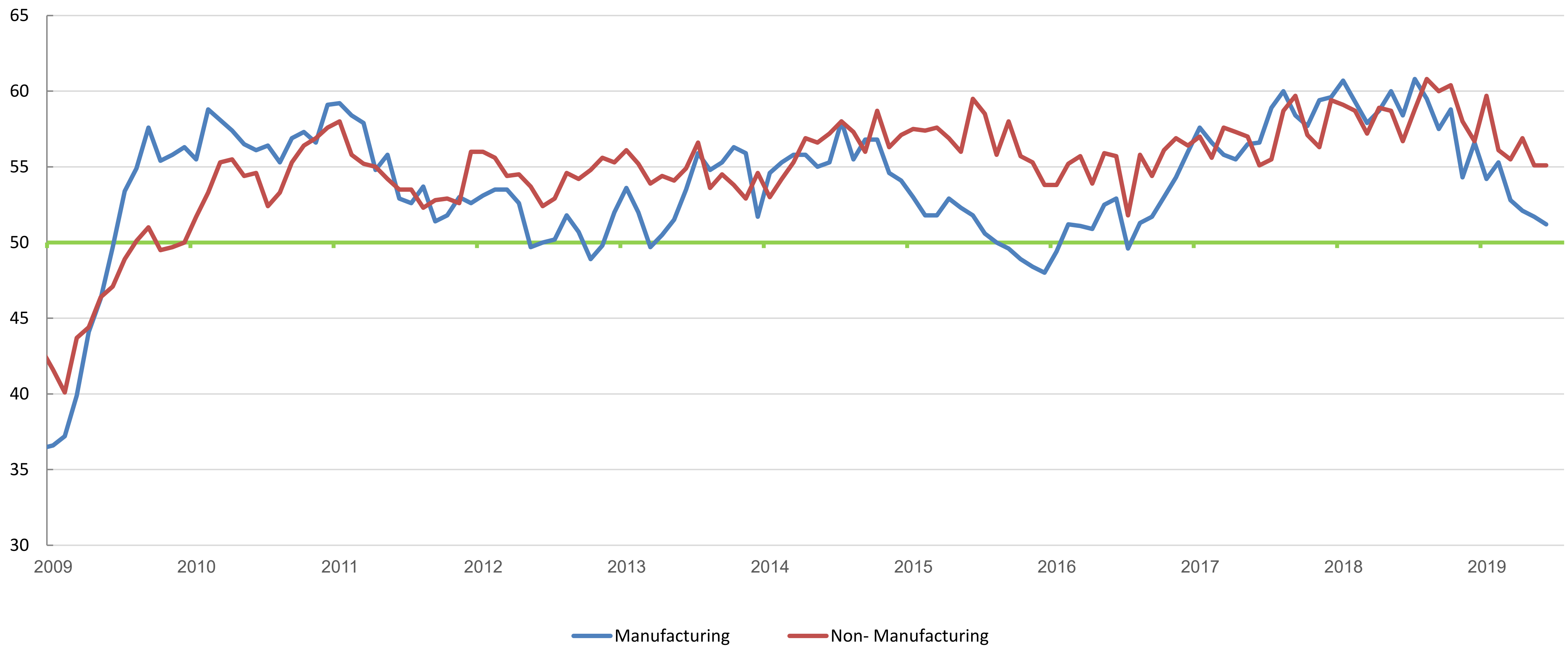
Economic Sentiment

Manufacturing and Non-Manufacturing ISM



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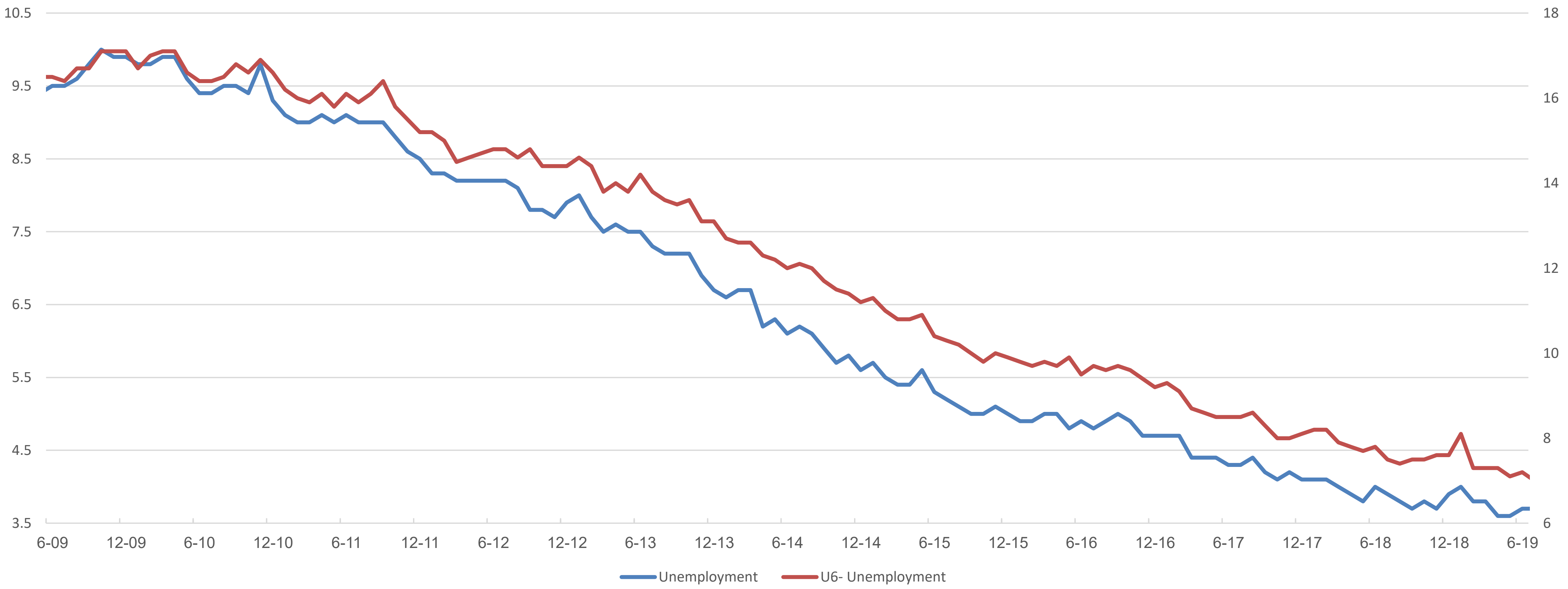
Labor Market

Unemployment Rate (Left) and Under Unemployment Rate, U6 (Right)



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Labor Market

Jolts: Job Openings

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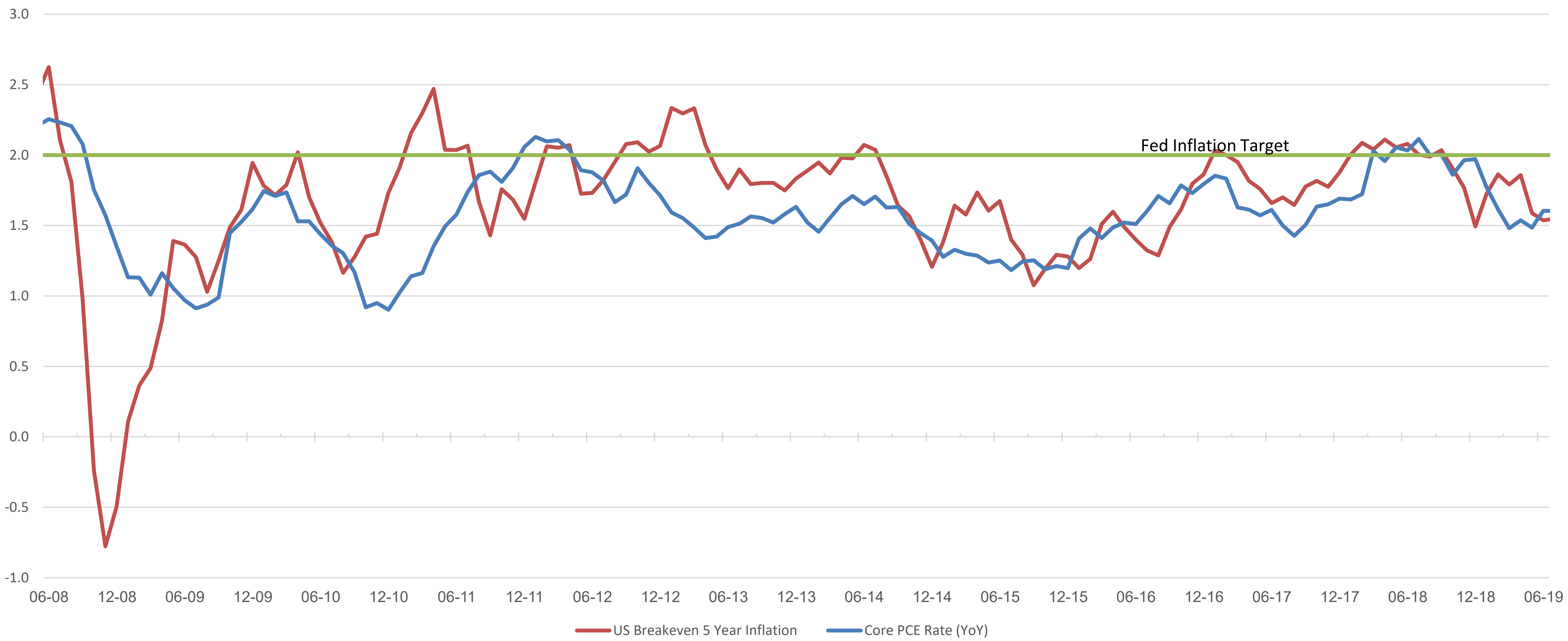
Inflation

Core PCE (YoY) and 5Y Inflation Forecast



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10YR Treasury Yield to Maturity

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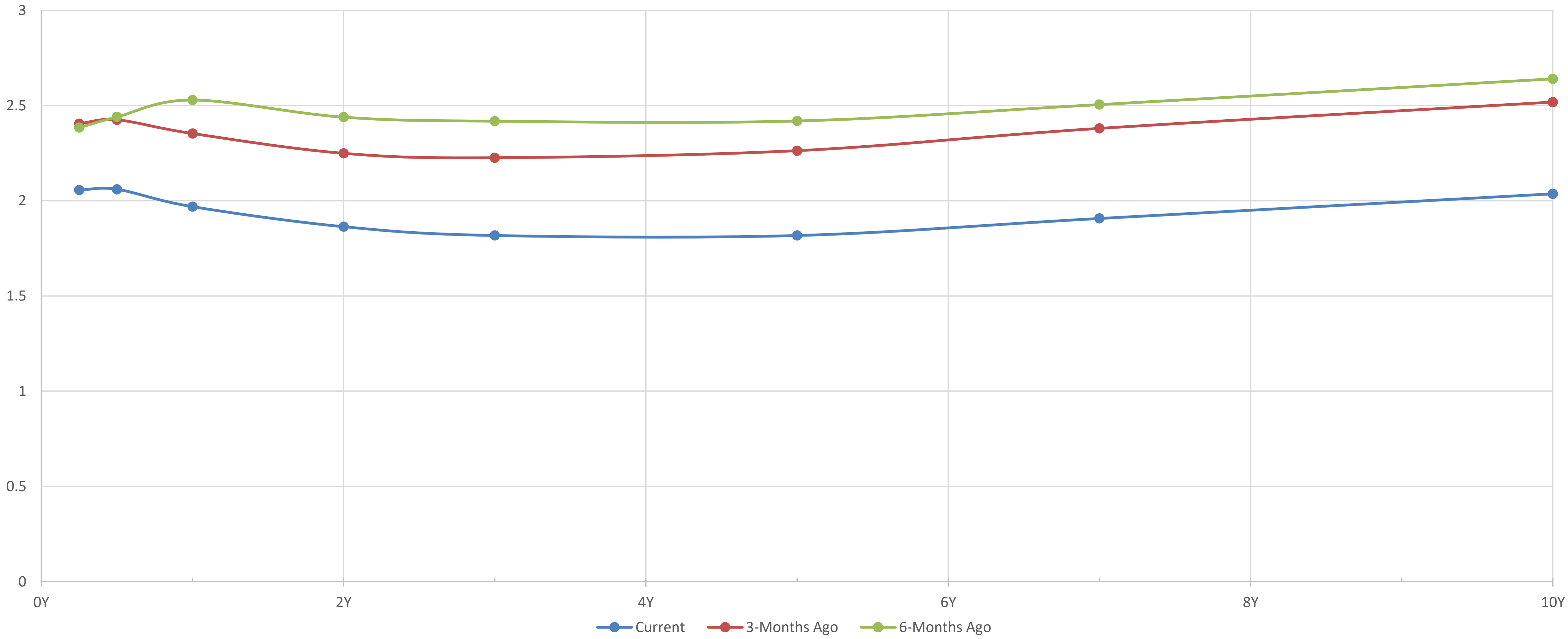
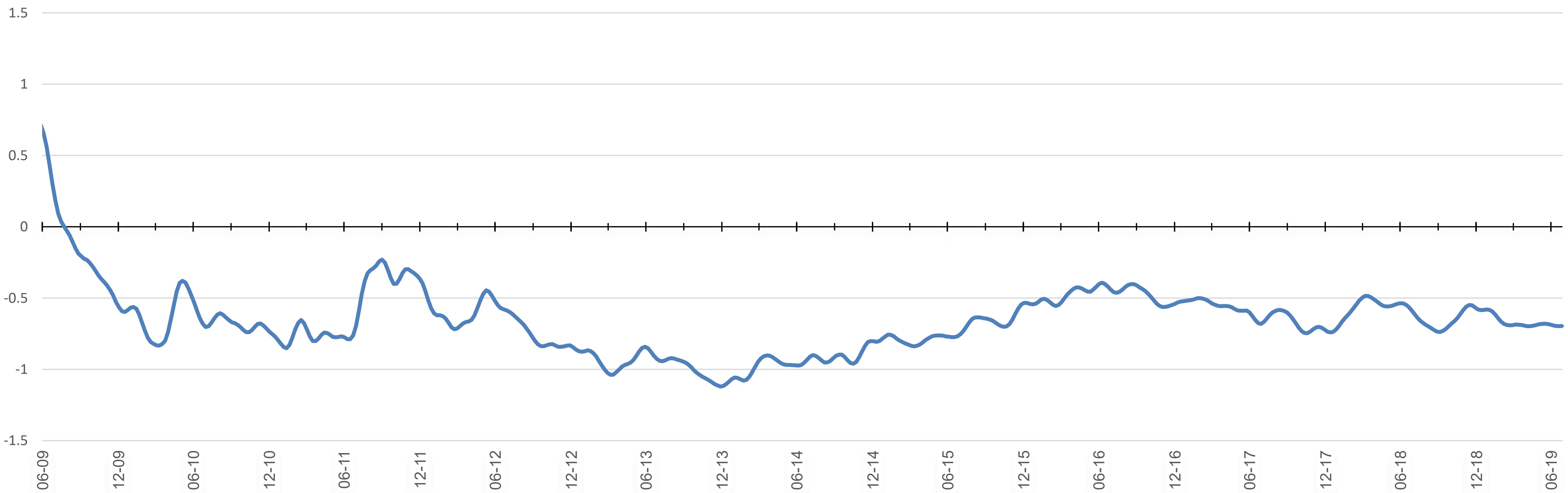
US Treasury Yield Curve



Chicago Feds National Financial (NFCI) Condition Index



The NFCI provides a comprehensive weekly update on U.S. financial conditions in money markets, debt and equity markets and the traditional and “shadow” banking systems. Negative values have been historically associated with looser-than-average financial conditions

US Dollar Index (DXY)

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Citi Economic Surprise

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Eurozone

- Euro-Area economy is in pain as Q2 GDP slowed dramatically to 0.8% from 1.8% in Q1, below the trend pace. YOY growth was 1.1% the weakest in 5 years. The slowdown was evident all over the region and especially in Italy and Germany that were hurt by trade tensions and the slump in manufacturing

- Businesses, especially in the manufacturing sector, find it more and more difficult to cope with the trade tensions and the fading external demand. The service sector is still growing as it goes in line with the local demand but due to its relative low significance it will only help to counter some of the bad effects

- Eurozone job market is still holding on as unemployment decreased slightly to 7.5%. However, warning signs are mounting as the fall in the number of people out of work is decelerating

- Economic sentiment continued to fall as part of a long-term trend with all sectors falling except households, which is the only bright spot. Leading indicators signal a sharp contraction in business activity as the manufacturing sector doesn't show any sign of recovery and services continue to exhibit only moderate momentum

- Adverse development on the inflation front as inflation expectations are falling, signaling that convergence of the core inflation to the ECB target at below but close to 2% is not realistic at current monetary policy. Actual inflation slowed to 1.1%, the slowest since early 2018, and core inflation dropped sharply to 0.9%

- As expected, the ECB decided to keep interest rates unchanged. However, the bank changed its guidance and opened the door for more policy easing. In the news conference after the statement Mario Draghi, the ECB president, said that he doesn't like what he sees in the inflation front and talked about the weaker outlook – "worse and worse", implying that a rate cut and a new round of bond purchases is expected as soon as September

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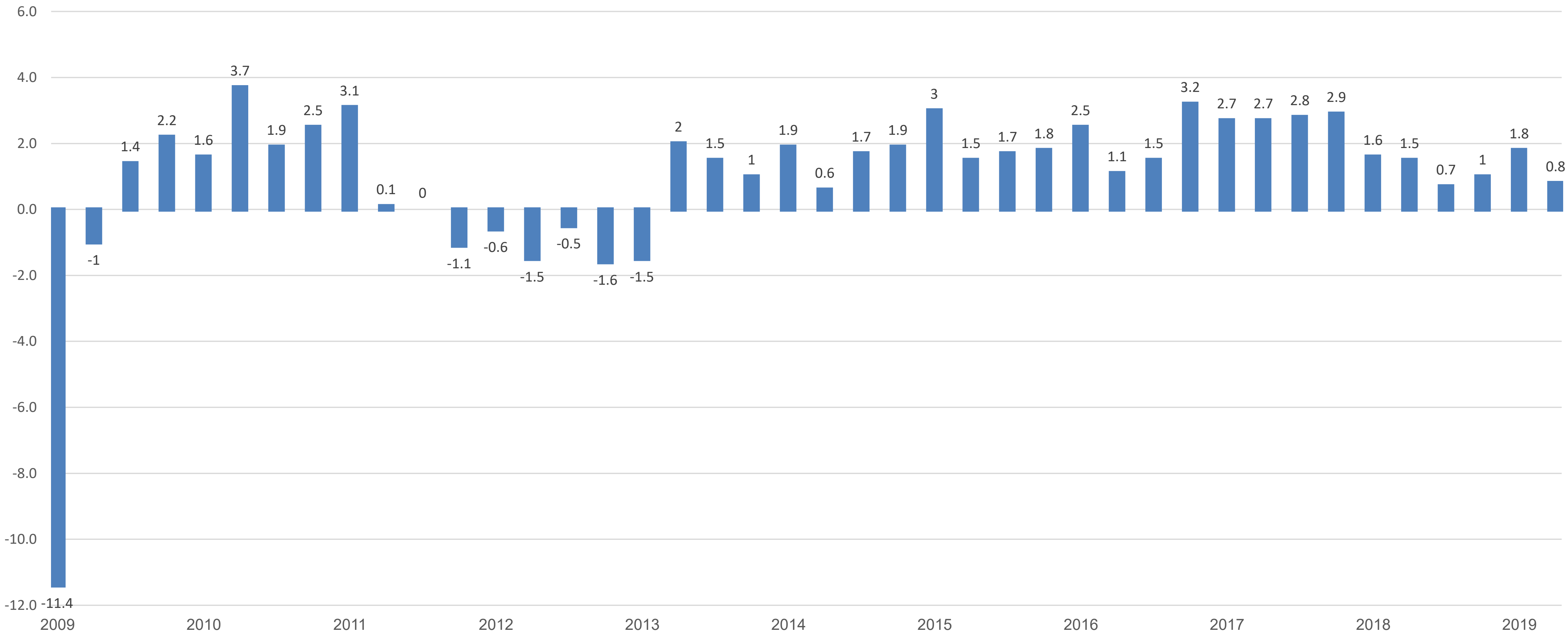
Core Economic Indicator

Eurozone

Economic Indicator	Latest Figure	Reference Period
Growth Rate	0.80%	Q2-2019
Unemployment Rate	7.5%	June-2019
Inflation Rate (Core, YoY)	0.9%	July-2019
Central Bank Interest Rate	0.00%	July-2019
10 Years Yield (Germany)	-0.50%	August-2019
Ratio of Surplus in Current Account to GDP	2.77%	Q1-2019
Ratio of Public Debt to GDP	85.90%	Q1-2019

Economic Growth

GDP (Annualized)



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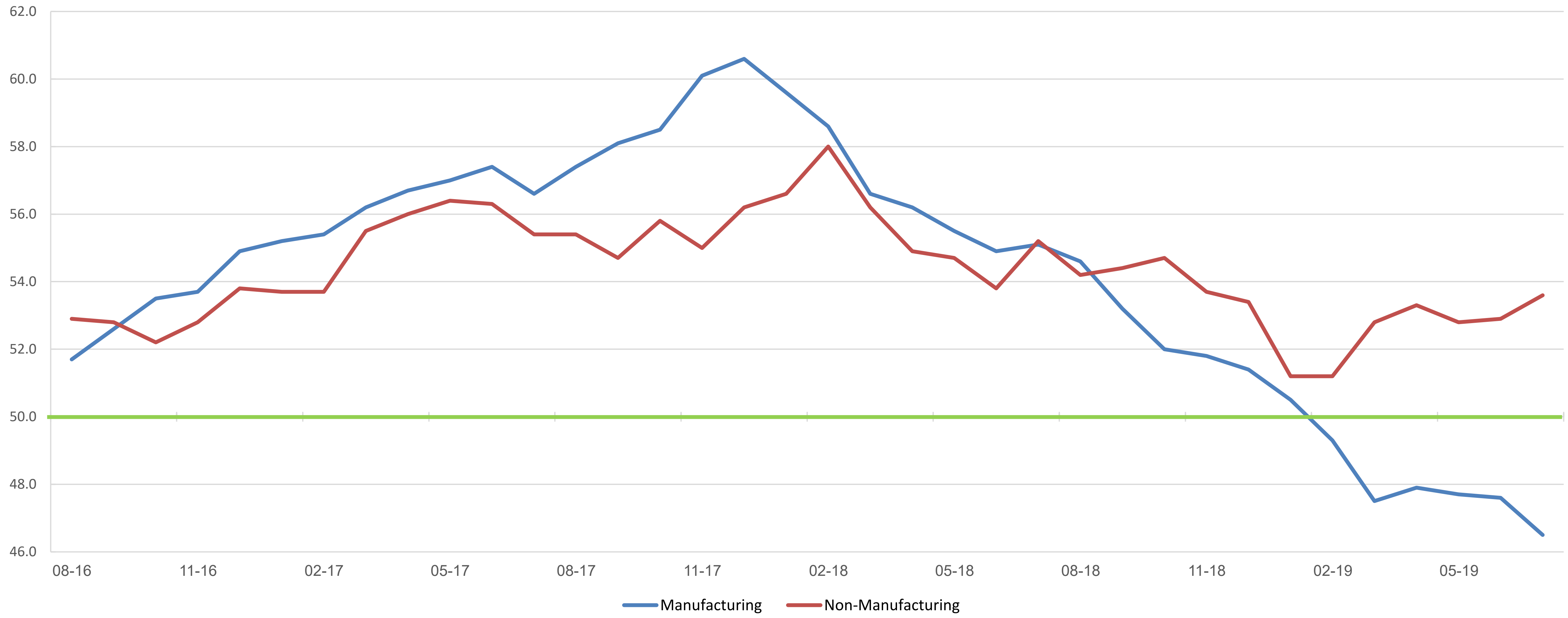
Economic Sentiment

Manufacturing and Non-Manufacturing PMI



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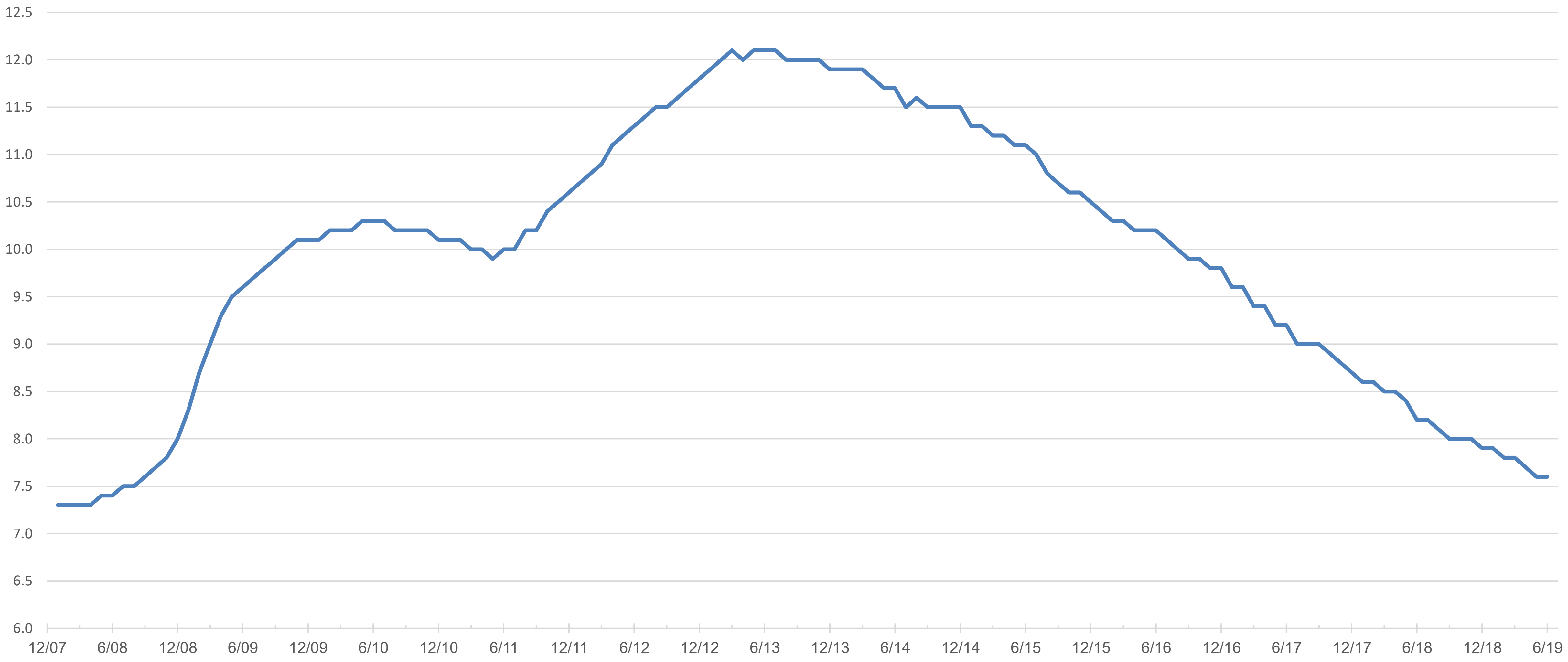
Labor Market

Unemployment Rate



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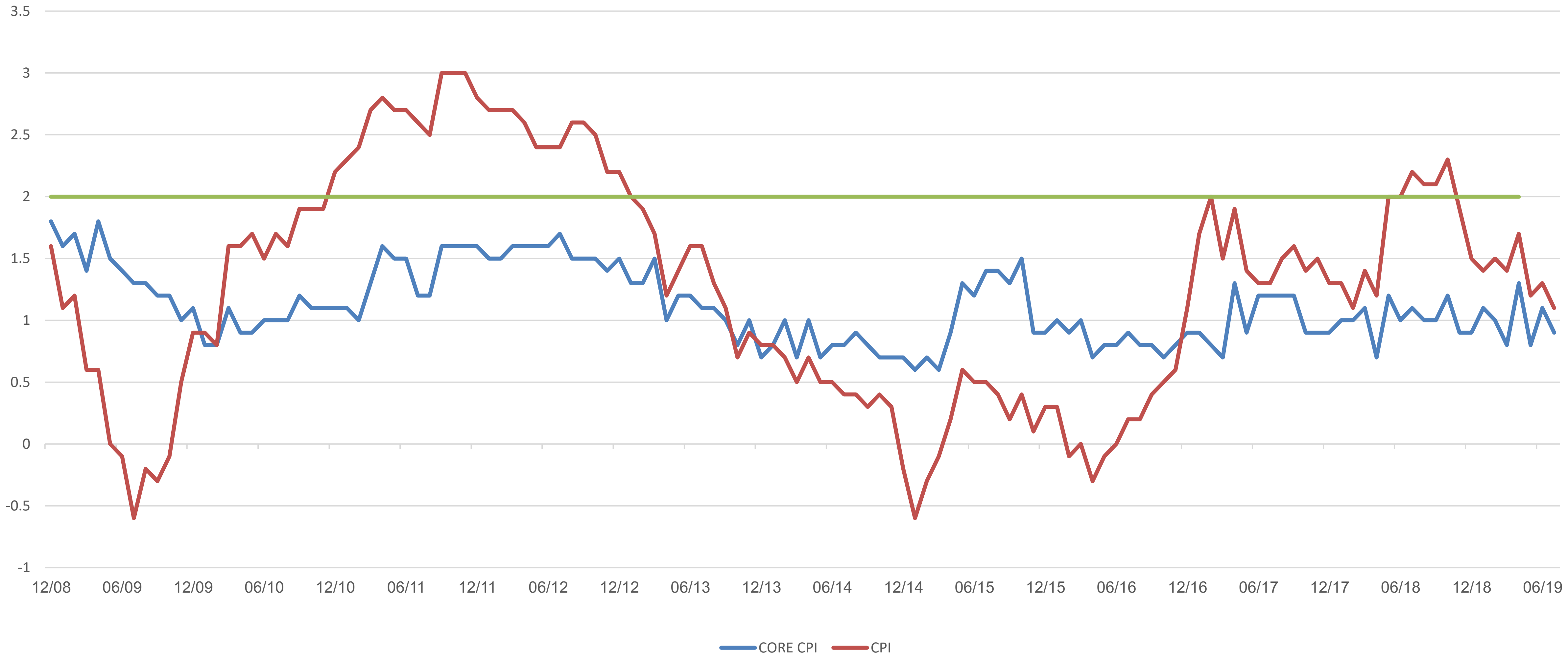
Inflation

CPI and Core CPI (YoY)



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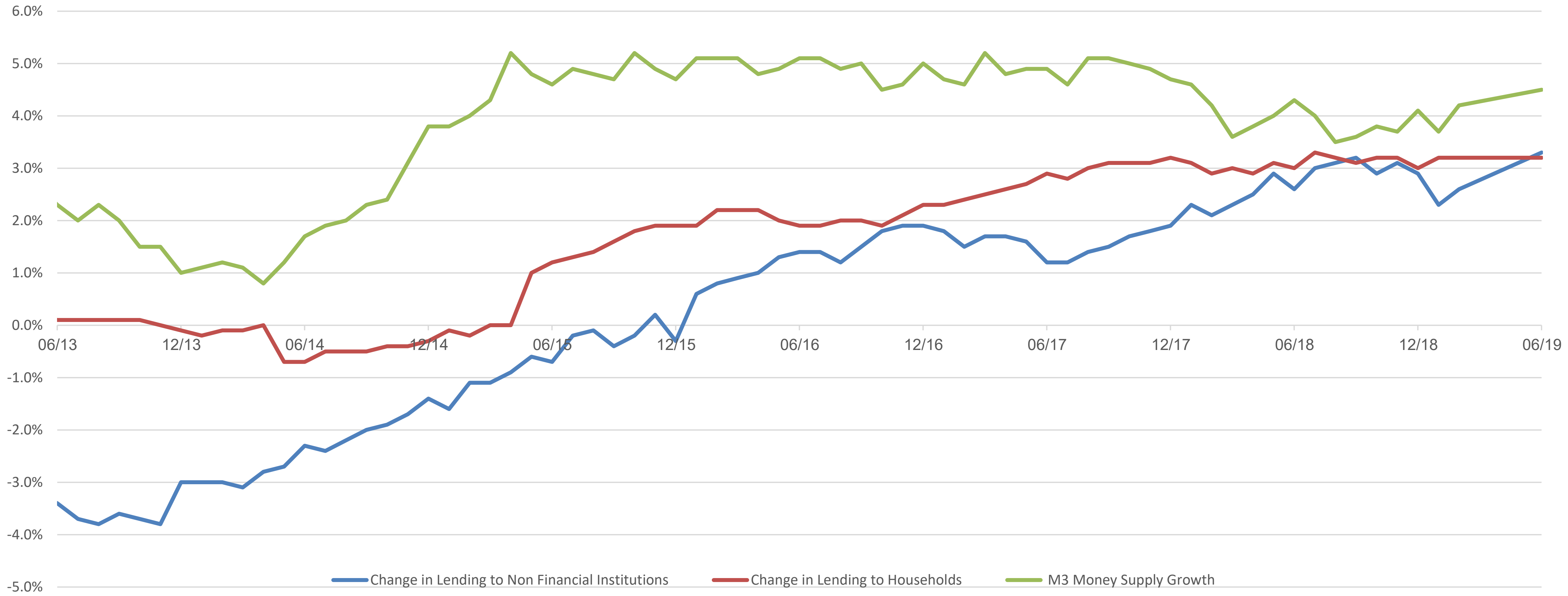
Money Supply and Credit

Growth in Money Supply, Loans to Real Sector



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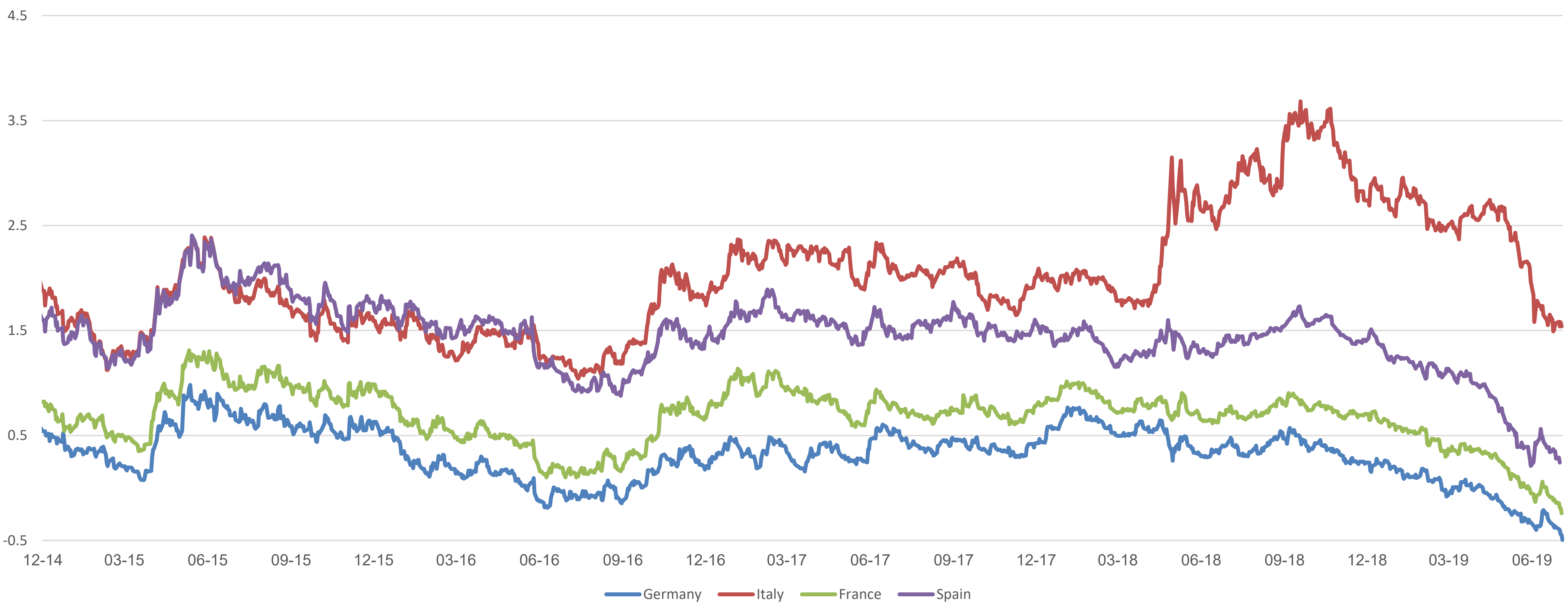
10YR Government Bond Yield



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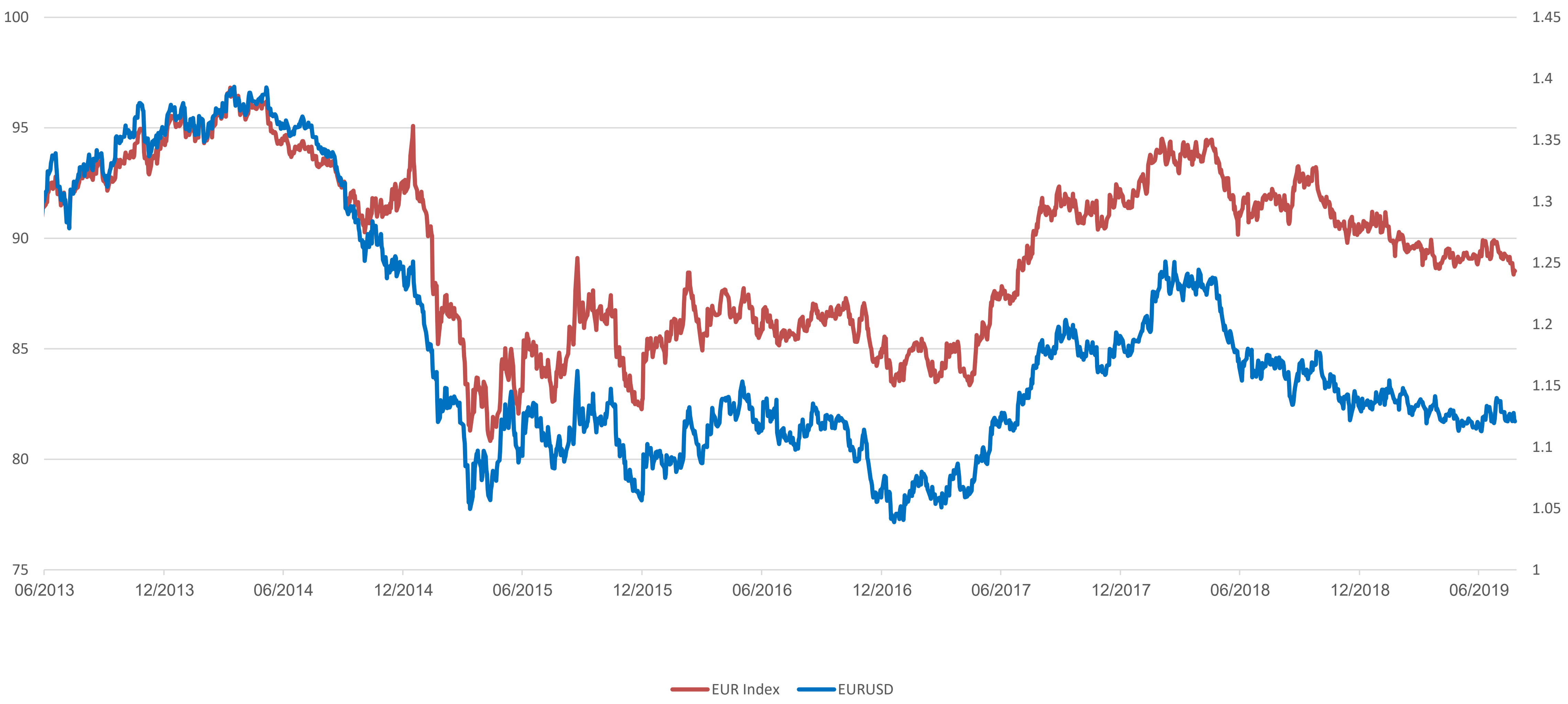
Exchange Rate

EUR Index (Left) EURUSD (Right)



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Citi Economic Surprise

Israel

- Economic growth is about to slow dramatically in Q2 as the impact of the elevated car sales in Q1 dissipated. BOI revised downward its projection for 2019 to 3.1%, after growing 3.4% in 2018
- The unemployment rate increased to 4.1%. Increasing signs of weakness in the labor market as the number of jobs the economy produces continues to decelerate and jobless claims are on the rise
- After shifting to the upside since the beginning of 2019, the inflation plummeted below the lower band of the inflation target of 1%-3%. The headline CPI dropped in June by 0.6% and YOY inflation rose just 0.8%, 0.4% below market expectations. Inflation expectations are above but close to 1% as the market expects inflation to remain subdued
- Budget deficit increased to 3.9% of GDP and is expected to rise to 4.5%, the highest in 10 years. Debt to GDP ratio will increase in 2019 for the second year. Investors assume that the next government will act and even succeed in addressing the budget deficit issue. As a result, for now, the bond and foreign exchange markets are not affected by the deficit growth
- The Shekel rallied after the BOI estimated that 3 interest rate increases will be required by the end of 2020. It made the BOI the only one in the world intending to raise interest rates and was in fact a naïve invitation to purchase the Shekel
- The sharp and uncontrolled appreciation of the Shekel alongside the fall in inflation, led the BOI to announce that it is not expected to raise interest rates for a long time. Past experience teaches us that the statement will not be enough to stop the appreciation and further steps will be required (foreign exchange buying, interest rate cuts, taxation of speculators and so forth)

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Core Economic Indicator

Israel

Economic Indicator	Latest Figure	Reference Period
Growth Rate	5.00%	Q1-2019
Unemployment Rate	4.1%	June-2019
Inflation Rate (YoY)	0.8%	June-2019
Central Bank Interest Rate	0.25%	August-2019
10 Years Yield	1.04%	August-2019
Ratio of Surplus in Current Account to GDP	3.07%	Q1-2019
Ratio of Public Debt to GDP	61.00%	Q4-2017

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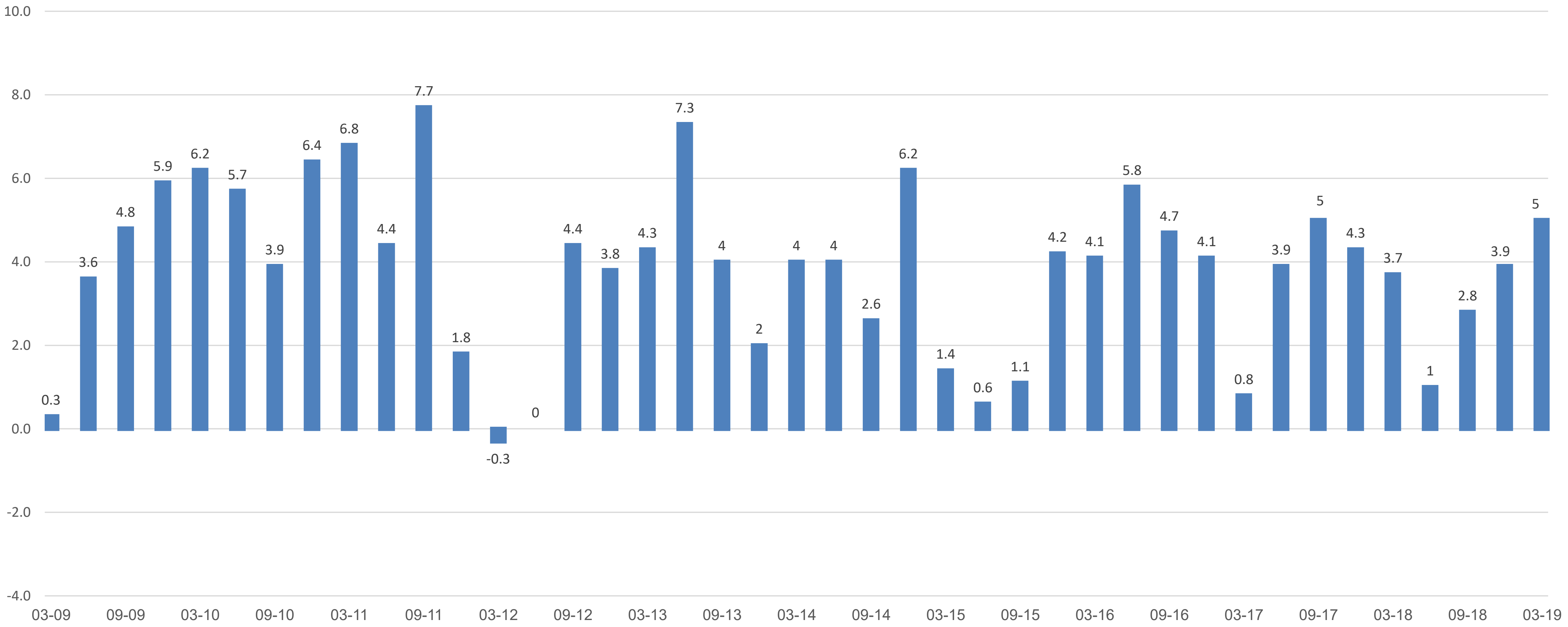
Economic Growth

GDP (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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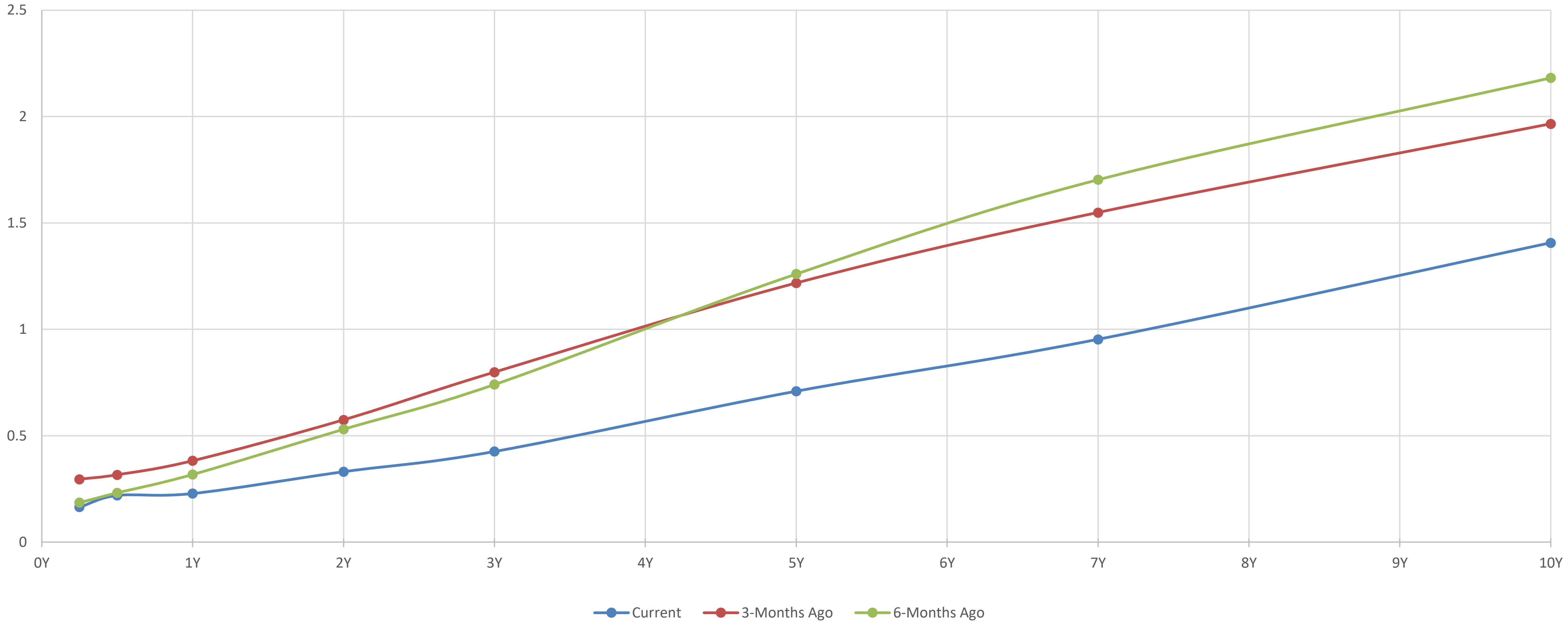
Government Bond Yield Curve



Hedging Costs

USDILS 1YR Forward Premium

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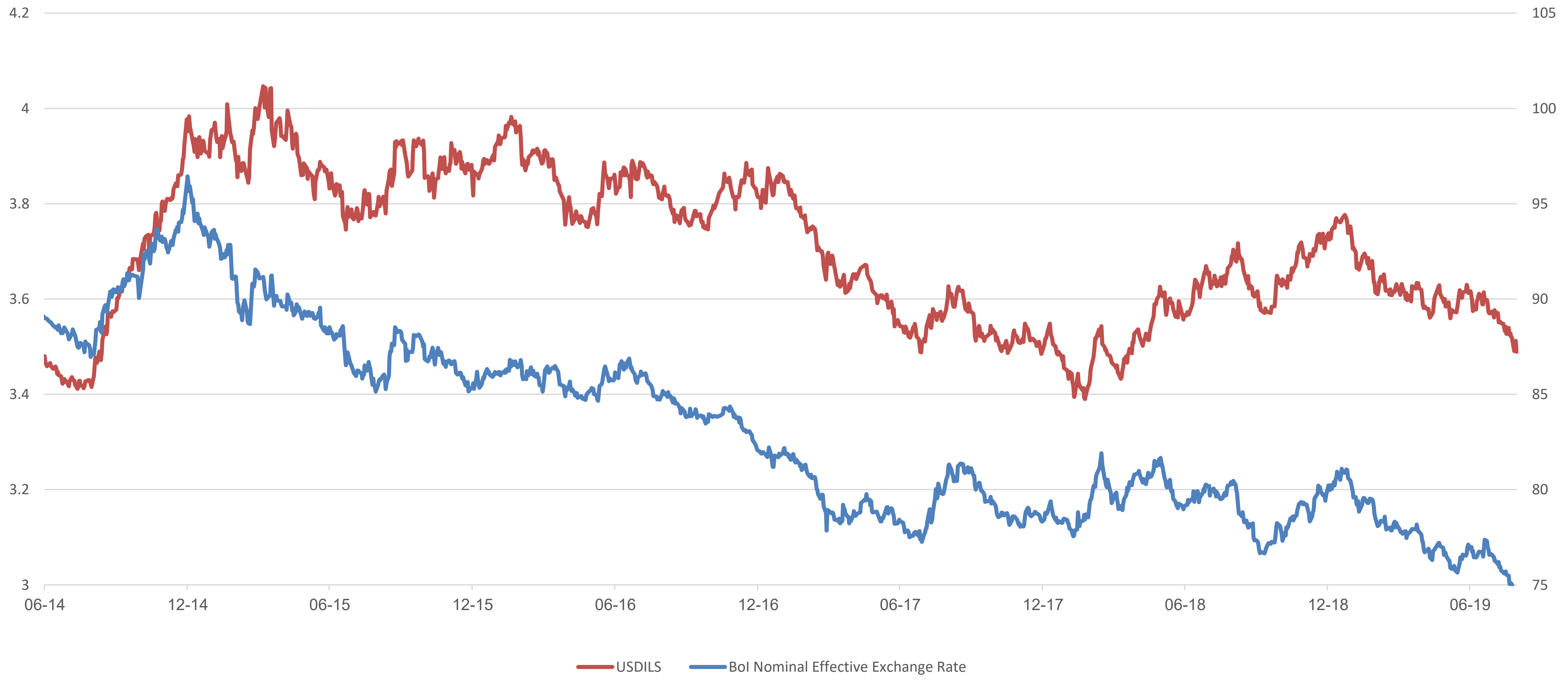
Exchange Rate

USDILS (Left) BoI Nominal Effective Rate (Right)



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CREATING THE RIGHT PICTURE

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