Financial Immunities

Market Insights

September 2019

Global Economy

- Escalating trade tensions and high uncertainty regarding the Brexit are taking a toll on the global economy
- Threats of mutual tariffs and the devaluation of the Yuan in response have been a part of the global economy in this past month. Talks between the parties are expected to continue in September, although a tangible impact on the economy and the markets will occur only in a case of achieving a trade agreement
- More and more central banks are moving towards easing monetary policy as part of a preventive proactive approach
- However, since monetary policy was expansionary in the first place, this transition towards an even more expansionary policy is not in favor of the global economy, as it leads to a currency war which is essentially a zero-sum game
- A combination of accommodative monetary policy alongside concerns over the impact of the trade war on the global economy has led investors to safe haven assets. Treasuries, German bonds, USD, and Yen all gained and the pile of negative-yielding debt has surged to roughly $17 trillion
- The gap between two-year rates and yields on 10-year Treasury notes, which is closely watched as a gauge of an impending recession, fell to a negative territory, further increasing the level of tension in the financial markets
- The global economy is already experiencing a manufacturing recession and more and more signs indicate that recession is coming. However, as consumers all over continue to consume at a healthy pace, supported by labor markets, the question is what their status will be in the next few months and whether they can operate in isolation of other parts of the economy

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United States

- Q2 growth slowed to 2% annually, inline with market expectations, as consumer spending, which accounts for 70% of the GDP, rose at a robust pace of 4.7% annually, and government spending rose 4.5%

- However, leading indicators are showing signs of exhaustion as most regional and national surveys dropped. The manufacturing sector was especially weak, as the majority of the respondents in the surveys expect the most recent round of announcements of tariffs to negatively impact their business. On the other hand, the service sector continues to grow, albeit at a slower pace

- The labor market, the main source of power for the American consumer, is still tight and the recent data remain favorable. Jobless claims (215K) and unemployment (3.7%) are close to record lows. Wages increase at a rapid pace (3.2% YOY), the level of job openings remain elevated and the number of jobs that the economy creates has recently declined slightly but remains high

- After recovering last month prices failed to increase further and inflation remained flat. Core PCE price index, the most important gauge for monetary policy remained unchanged at 1.6% and failed to advance towards the Fed's 2% inflation target. As a result, the probability of another rate cut at the next Fed meeting scheduled on the 18th increased

- U.S Government bond market has gone wild last month, as trade war and Brexit fears alongside cross-border flows sent the 10-year yields further down to 1.5%, causing the yield curve to invert, in a situation reminiscent of the one that prevailed in December 2008

- In a speech in Jackson Hole, the Fed chair, Jerome Powell, said the U.S. economy is in a favorable place but faces "significant risks", signaling that another rate cut is arriving on September 18th

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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%-2.25%	August-2019
10 Years Yield	1.5%	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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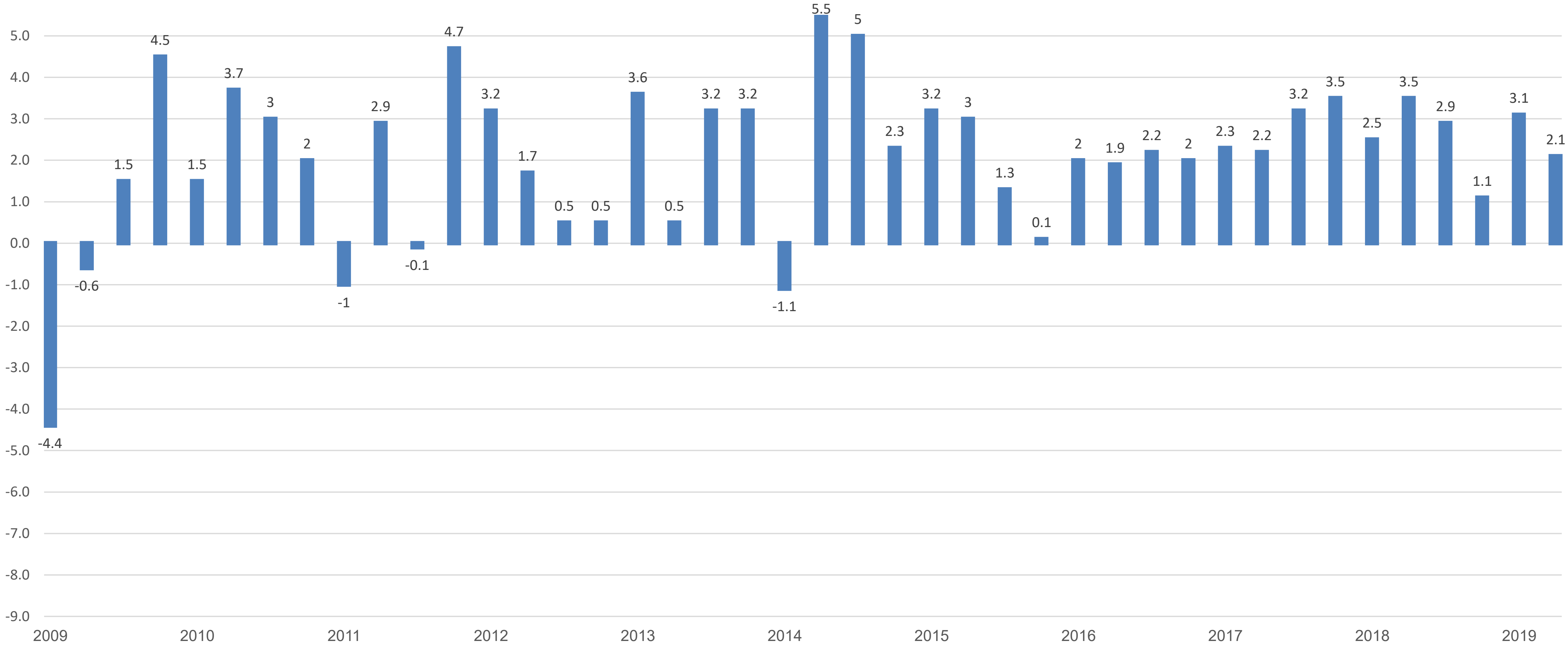
Economic Growth

GDP (Annualized)



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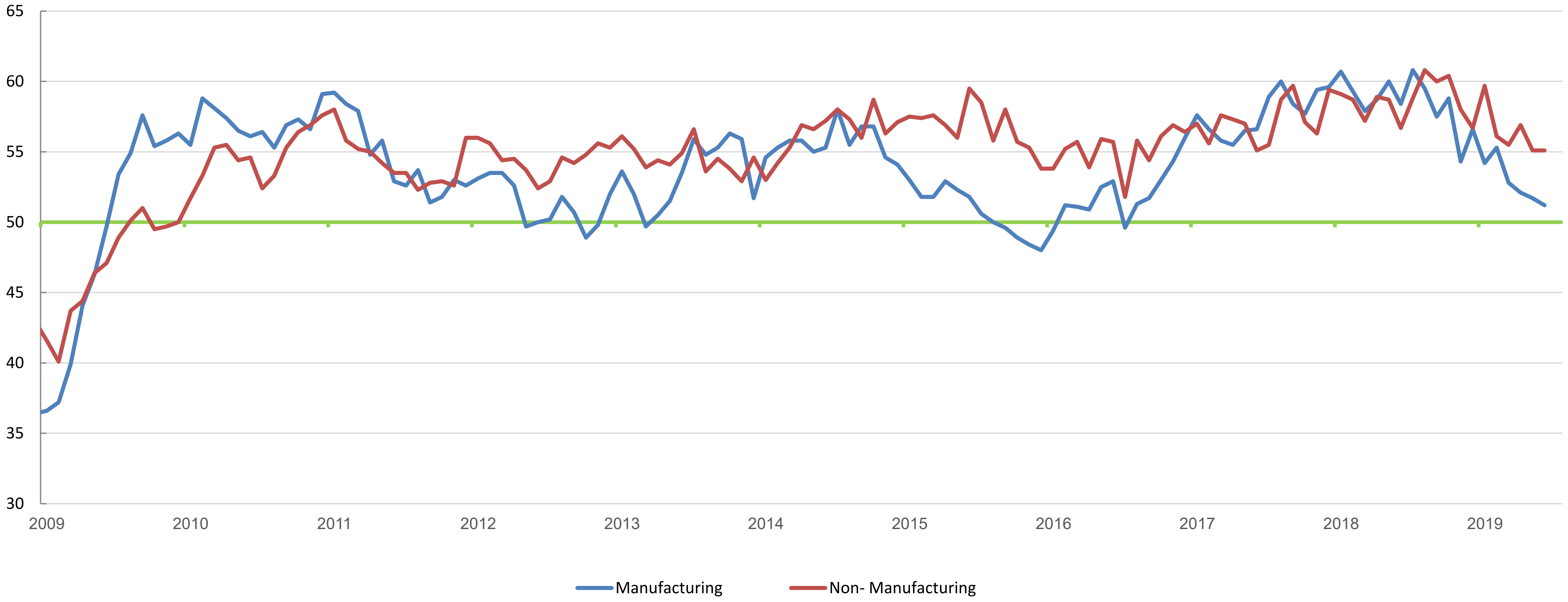
Economic Sentiment

Manufacturing and Non-Manufacturing ISM



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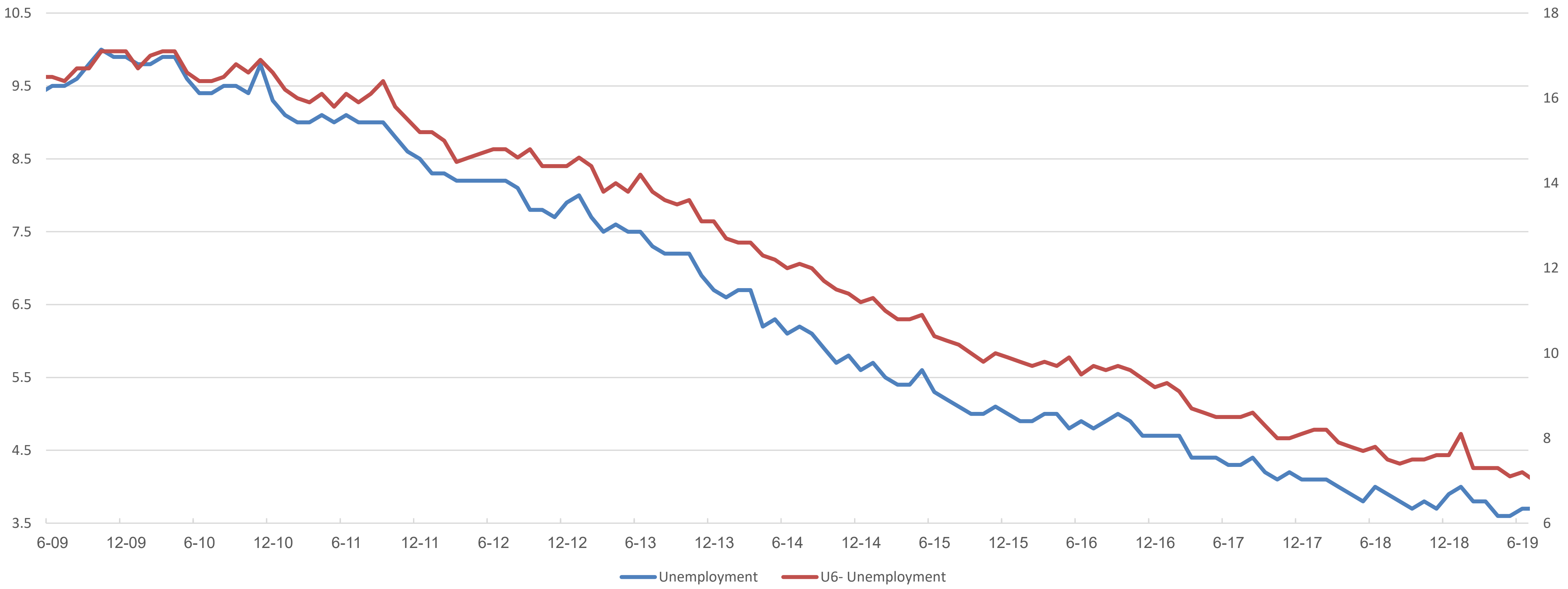
Labor Market

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



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Labor Market

Job Openings

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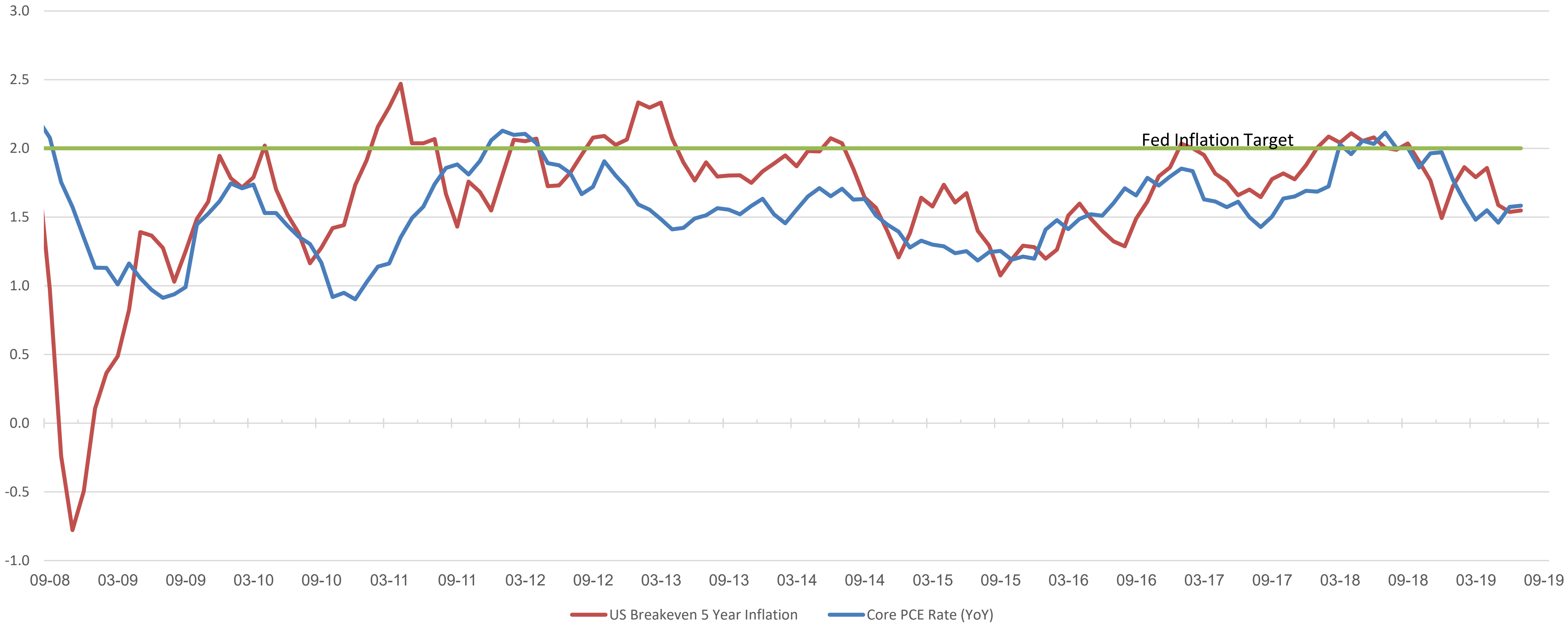
Inflation

Core PCE (YoY) and 5Y Inflation Forecast



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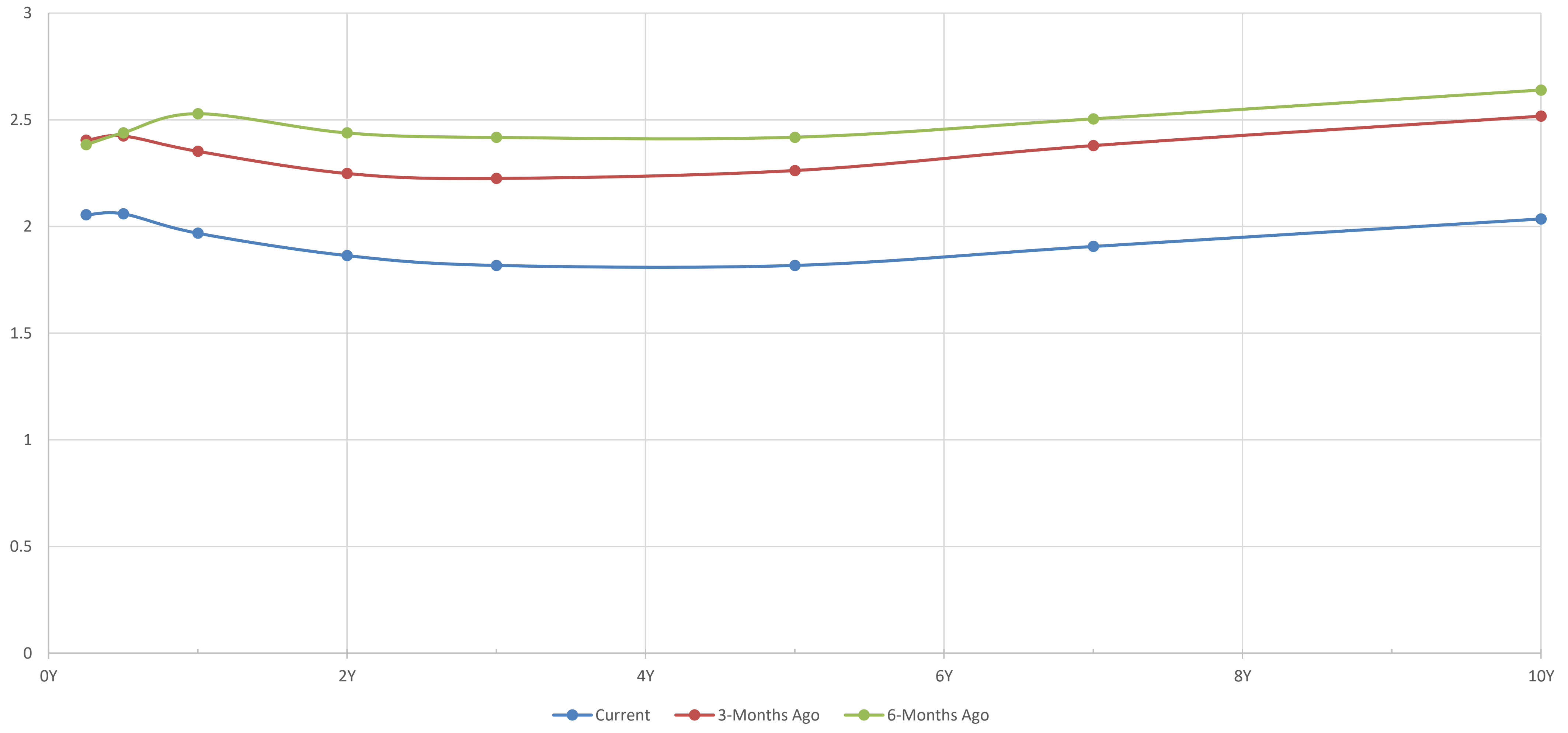
10YR Treasury Yield to Maturity

US Treasury Yield Curve



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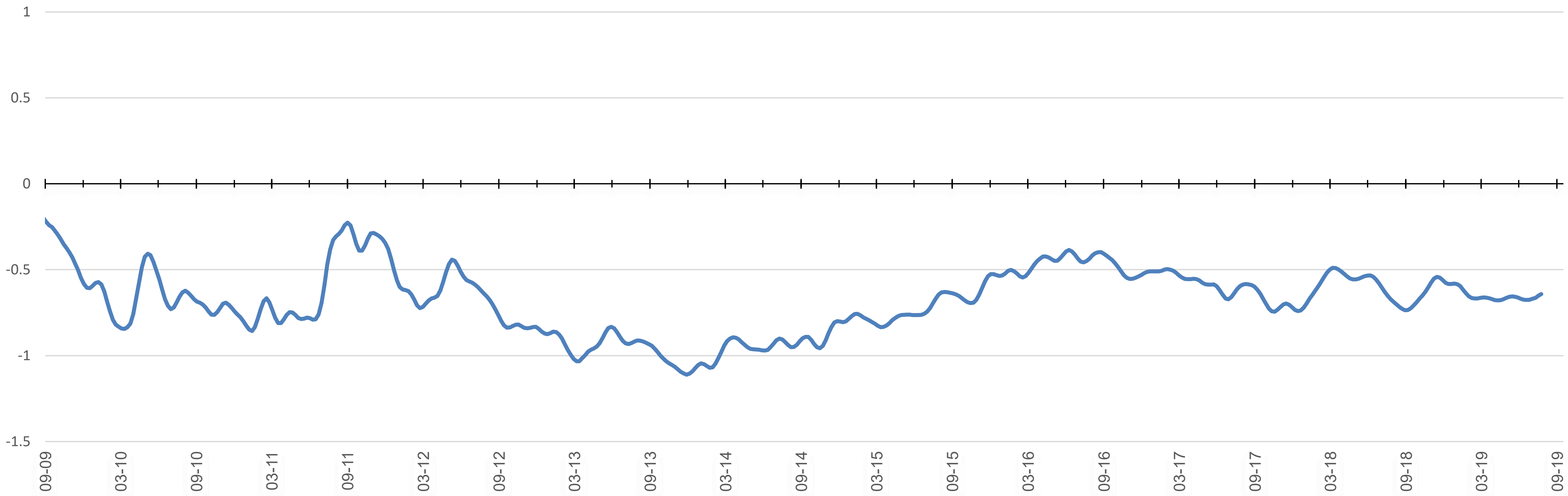
Chicago Feds National Financial Condition Index (NFCI)



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

Eurozone

- Ongoing sluggishness of business activity and contracting industrial production are the key features of the European economy. Escalating trade war, stagnation in world trade and uncertainty about the Brexit create a challenging environment that makes it difficult for the European economy to realize its potential

- After a short recovery, industrial production, which is a key factor in the European economy, is once again in decline. The slump was broad based but particularly prominent in France (-2.3%) and Germany (-1.8%). YOY industrial production fell by 2.6%

- Net export will not make a positive contribution to the GDP anytime soon as the latest data shows export is decelerating impacted by the trade war while import still rise as it go in line with the local demand, supported by the strong labor market

- Eurozone job market is still holding on as unemployment remained stable at 7.5%, the lowest level since mid 2008. However, warning signs are mounting as the fall in the number of people out of work was the smallest in the current expansion cycle

- Leading indicators like the economic sentiment and the PMI edged up a little bit, reflecting a slight improvement in the industrial sector. The PMI was better than expected as manufacturing improved to 47, which represents a slightly slower contraction and the services continue to expand at a moderate pace. All and all the numbers indicate a soft growth

- Households continue to be the bright spot of the European economy. A strong labor market and accommodative financial conditions create a healthy local demand offsetting part of the adverse external effects

- With a weak economic growth and core inflation at 0.9%, far below the ECB target of just below 2%, the door is open for the ECB officials to launch a new round of incentives on September 12th to further support the economy

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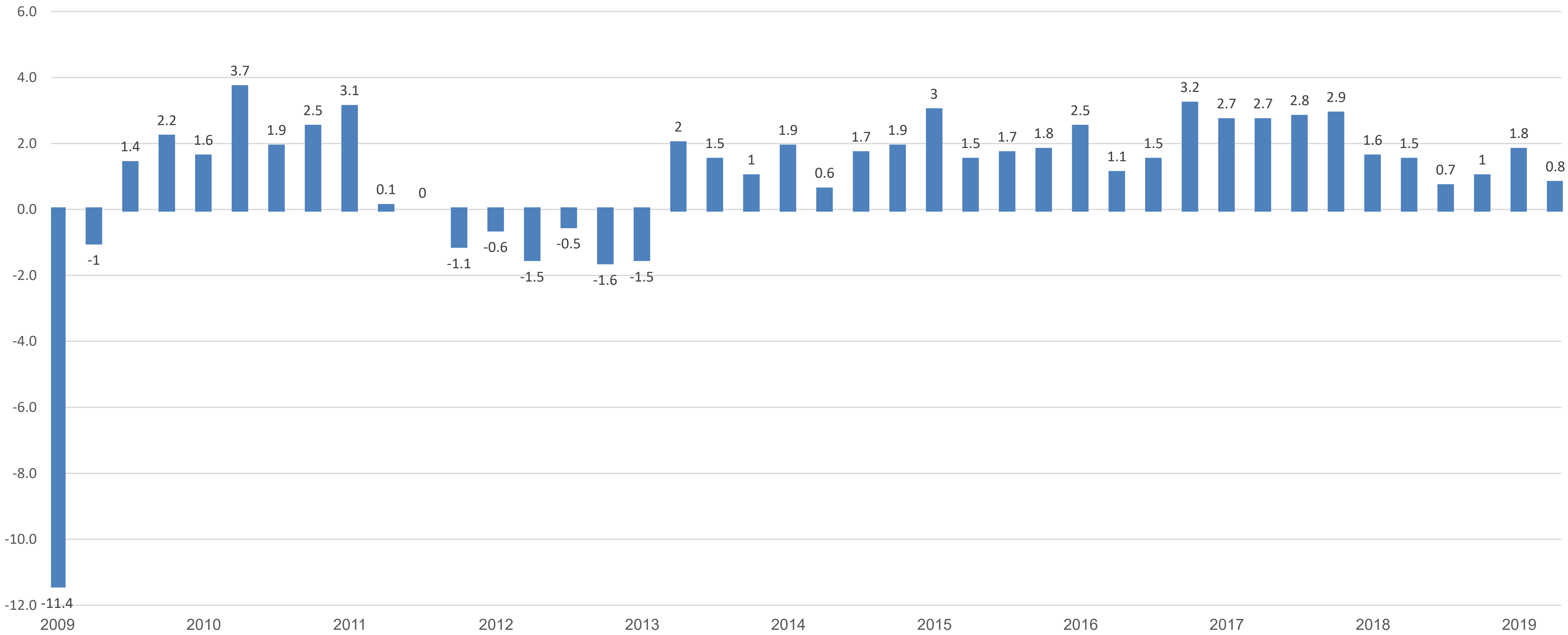
Core Economic Indicator

Eurozone

Economic Indicator	Latest Figure	Reference Period
Growth Rate	0.80%	Q2-2019
Unemployment Rate	7.5%	July-2019
Inflation Rate (Core, YoY)	0.9%	August-2019
Central Bank Interest Rate	0.00%	July-2019
10 Years Yield (Germany)	(0.70%)	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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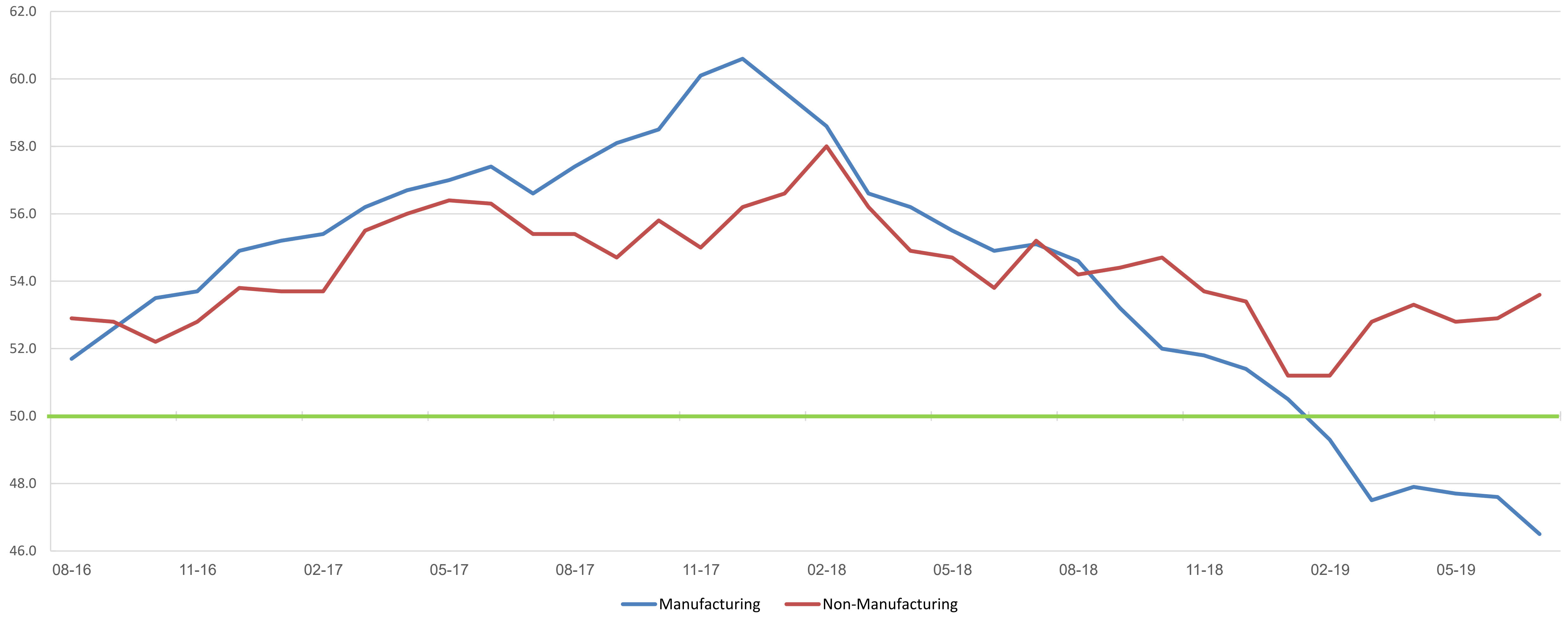
Economic Sentiment

Manufacturing and Non-Manufacturing PMI



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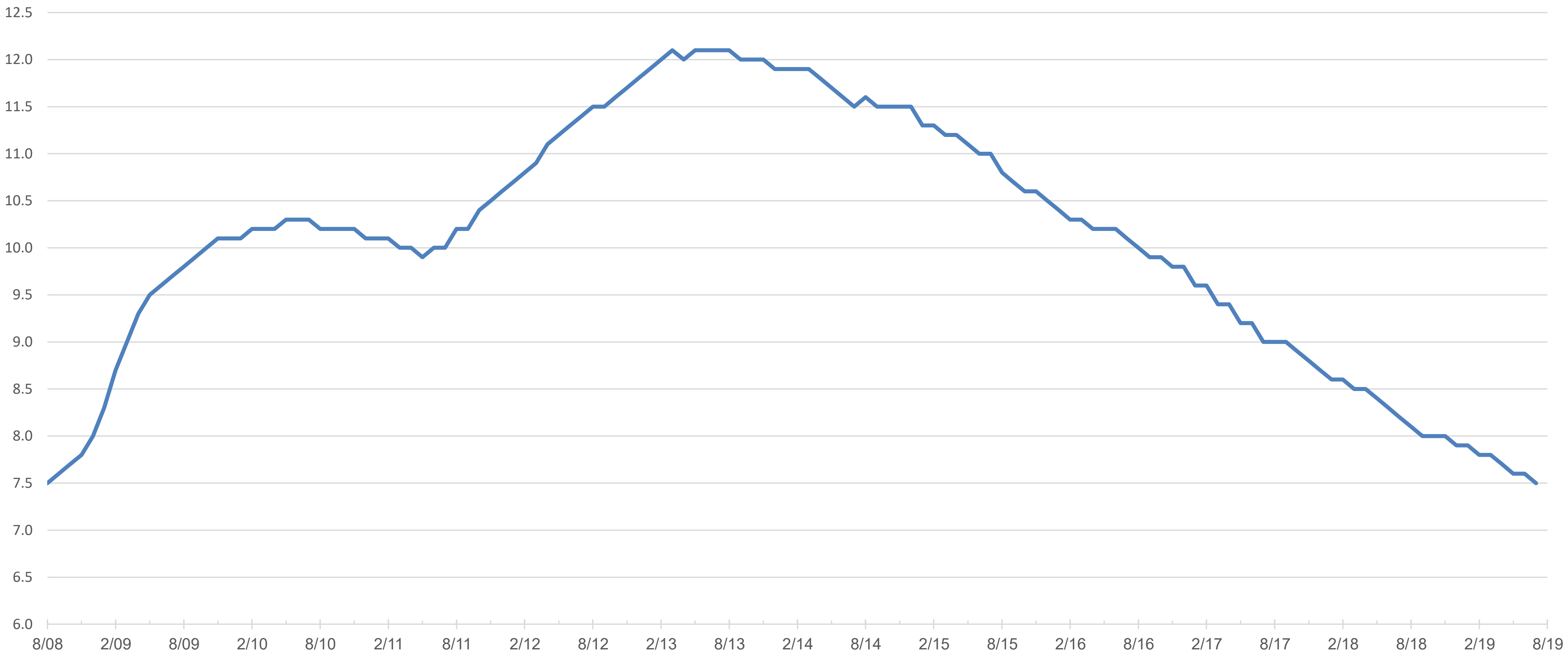
Labor Market

Unemployment Rate



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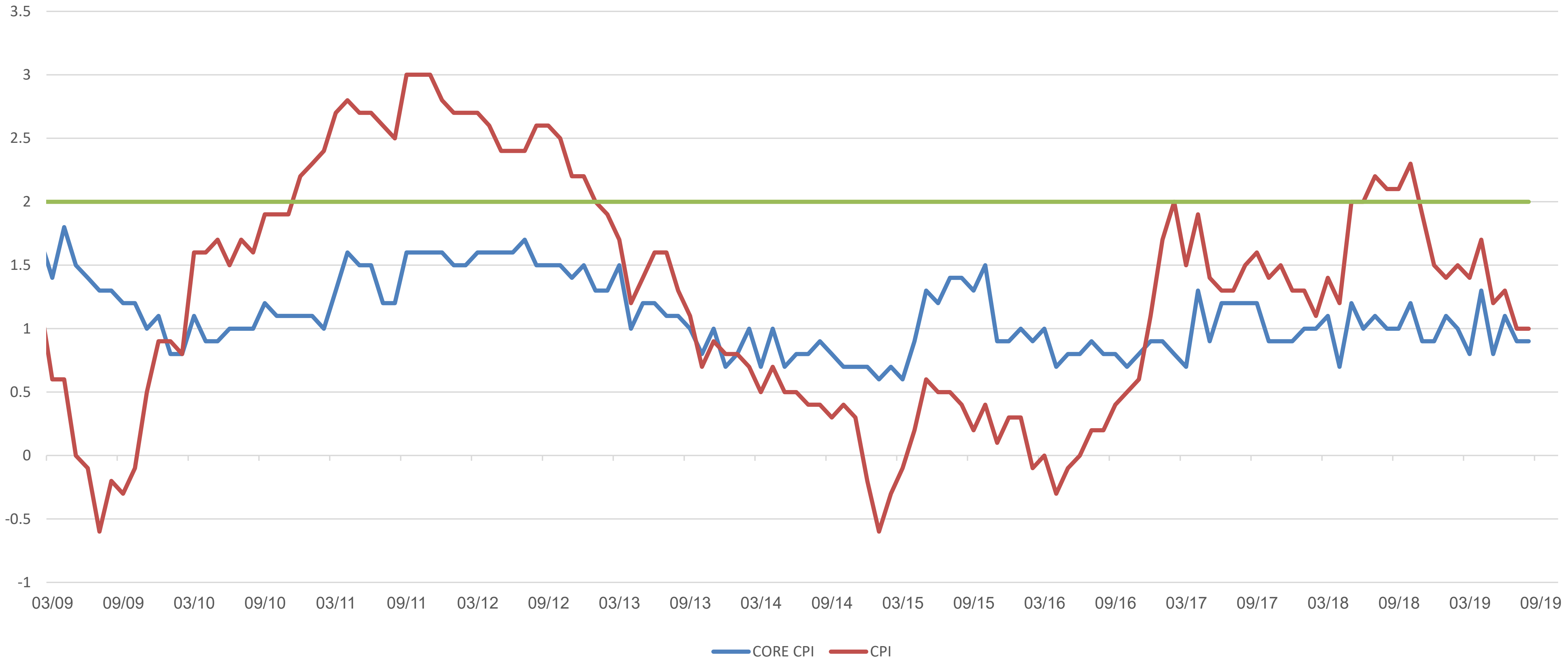
Inflation

CPI and Core CPI (YoY)



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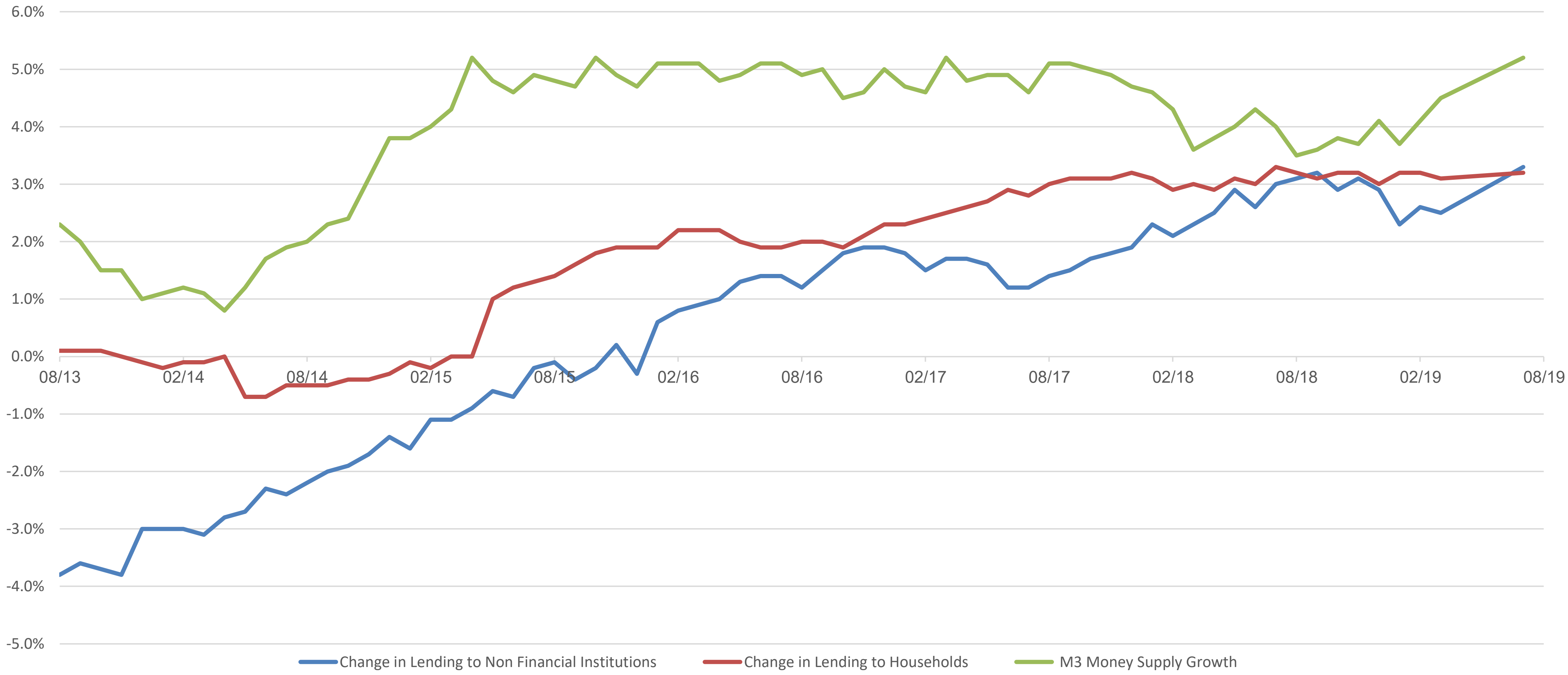
Money Supply and Credit

Growth in Money Supply, Loans to Real Sector



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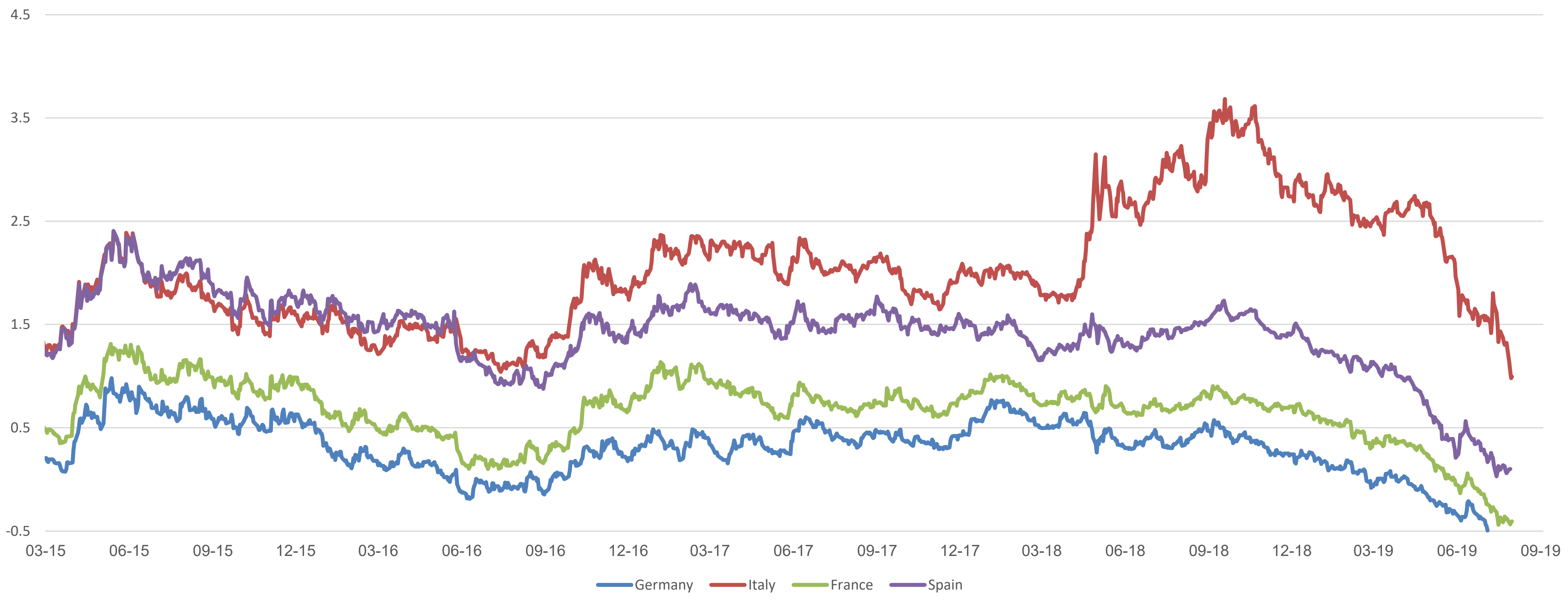
10YR Government Bond Yield



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Exchange Rate

EUR Index (Left) EURUSD (Right)

Citi Economic Surprise

Israel

- Q2 GDP slowed dramatically to 1% (annually), below market expectations, after a downwardly revised 4.7% growth in the first quarter. Without the one-off spike in car import and with weaker investments and consumption alongside a drop in export, the local economy barely held its head above water

- The local economy is small and open as foreign trade is responsible for about a third of economic activity. For now, the impact of trade war is still limited but the Israeli economy is unlikely to be isolated down the road

- After a sharp rise in June, the unemployment rate decreased once more in July to 3.7%, amid a plunge in the participation rate to 63.1%, the lowest level since 2017. Increasing signs of weakness in the labor market as the number of jobs the economy produces continue to decelerate. Jobless claims are on the rise and the rate of open jobs decreases

- After a sustained rise in prices towards the midrange of the inflation target of 1%-3%, the inflation environment has changed dramatically over the past two months. Two negative CPI readings, 0.6% in June and 0.3% in July, led to a sharp fall in inflation to just 0.5% YOY, well below the lower band of the inflation target. Inflation expectations are close to 1% as the market expects the subdued inflation to continue

- The Bank of Israel has stated that in light of the change in the inflation environment, monetary policy of the major central banks, the moderation in the global economy and the appreciation of the Shekel, it does not intend to raise interest rates for a long time. Furthermore, if necessary, the Commission will take further steps

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Core Economic Indicator

Israel

Economic Indicator	Latest Figure	Reference Period
Growth Rate	1.00%	Q2-2019
Unemployment Rate	3.7%	July-2019
Inflation Rate (YoY)	0.5%	July-2019
Central Bank Interest Rate	0.25%	August-2019
10 Years Yield	0.94%	August-2019
Ratio of Surplus in Current Account to GDP	3.05%	Q1-2019
Ratio of Public Debt to GDP	61.00%	Q4-2017

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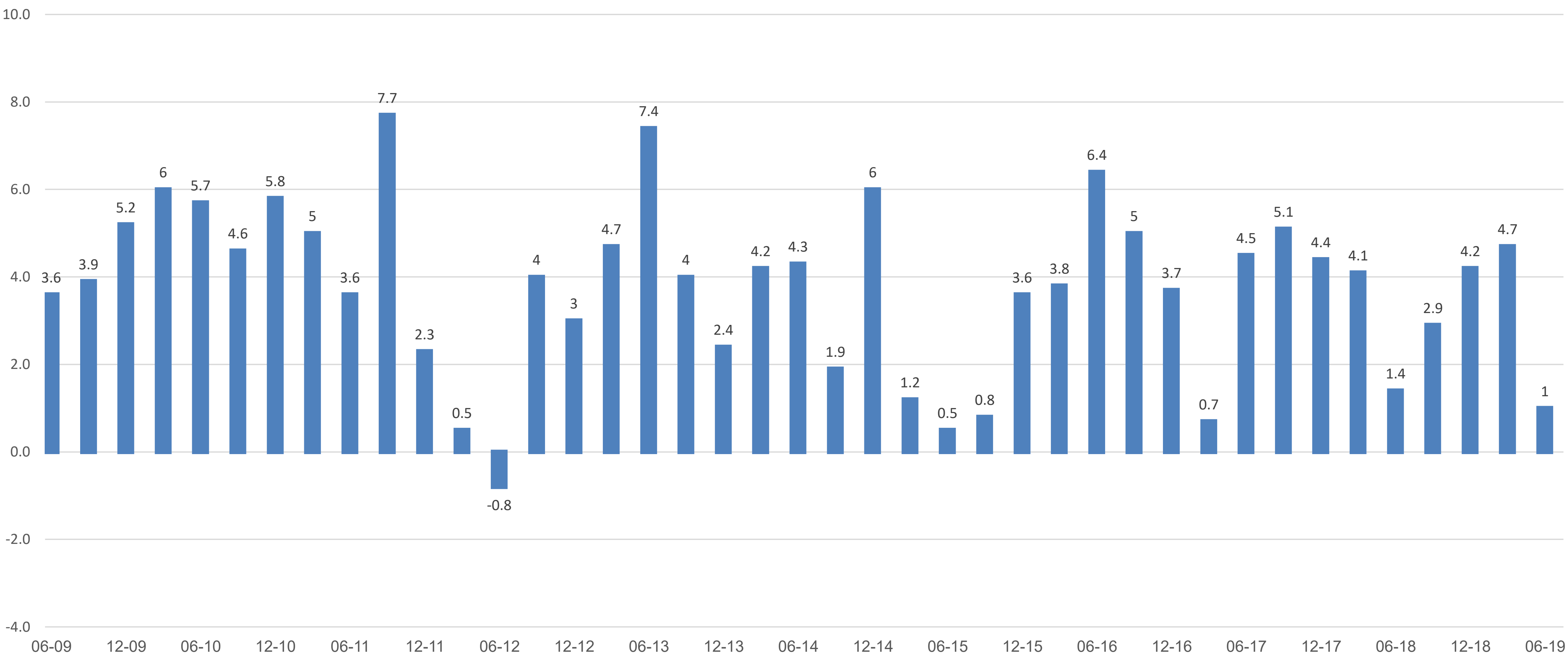
Economic Growth

GDP (Annualized)



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Labor Market

Unemployment Rate

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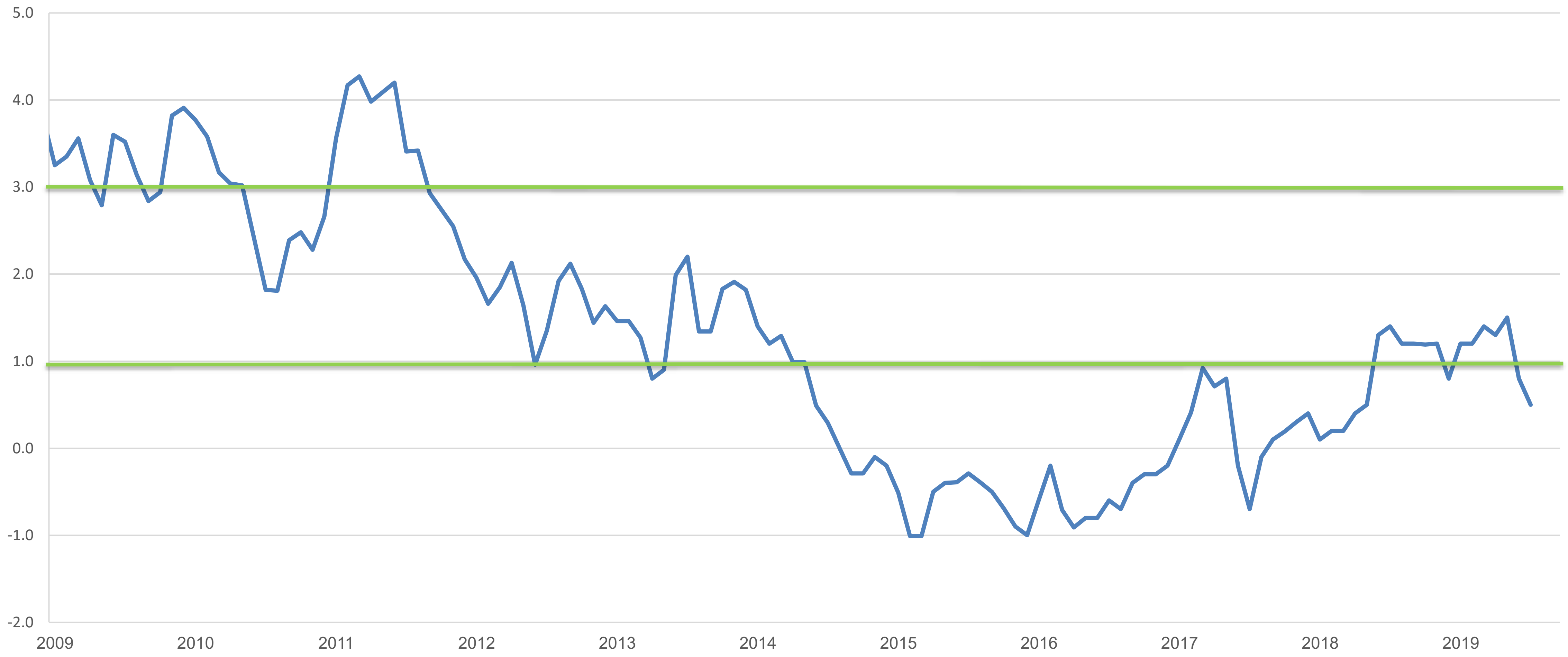
Inflation

CPI (YoY)



10YR Government Bond Yield

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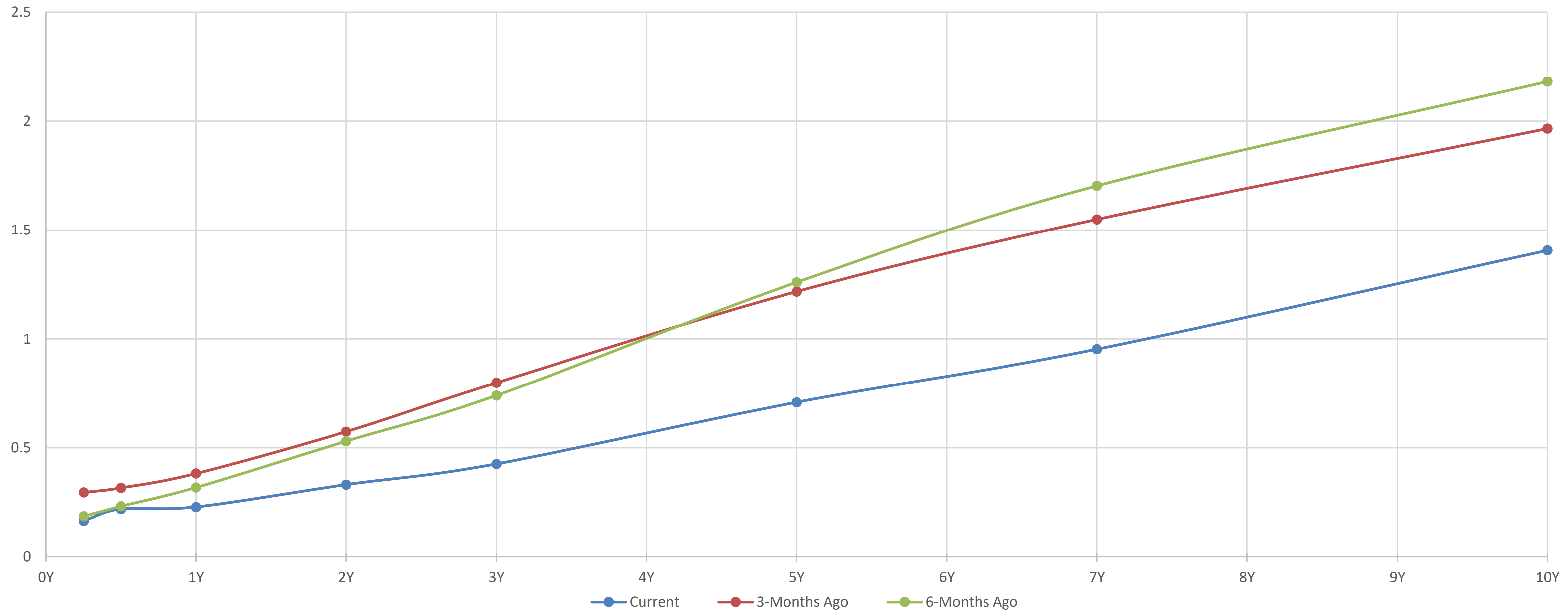
Government Bond Yield Curve



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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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