Financial Immunities

Market Insights

October 2019

972-8-9369800 www.immunities.co.il info@immunities.co.il

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Global Economy

- World economy outlook continues to darken as the trade conflicts and the Brexit saga heighten uncertainty
- The OECD projects that the global economy will grow by 2.9% in 2019, the weakest annual growth rates since the financial crisis, with downside risks continuing to mount. The Outlook includes downward revisions for almost all countries. According to the OECD the trade conflicts are the principal factor undermining confidence, growth and job creation. Persistent weakness in manufacturing sectors and continuing trade tensions could weaken employment growth, household income and spending
- The world trade organization cut its forecast for trade growth to 1.2% in 2019, the lowest in a decade, after a 3% increase in 2018
- Big turmoil in financial markets due to liquidity shortage in the dollar funding markets led to a jump in the repo rate and in Federal Reserve's target interest rate and forced the Fed to intervene. For now, there is no sign of spillover overseas
- At a time when more and more central banks are moving towards easing monetary policy, the ability to deal with the economic slowdown by monetary means is limited. The cheap money loses its influence, it does not motivate the business sector to increase its investments, erodes the banks' profits and creates distortions in the capital, currency and money markets
- An attack on oil facilities in Saudi Arabia has hit 5% of global oil output, causing a sharp rise in oil prices in the days following the attack. However, prices dropped back after restoration efforts succeeded in regaining production capacity earlier than expected. The ability of the global energy market to contain the dramatic event is evidence of a shift in the balance of power: the diminishing dependence on OPEC and the rise of US power as the world's largest producer

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United States

- The US economy continues to deliver relatively good data, led by the US consumer, which is supported by the strong labor market and accommodative financial conditions. The housing sector is becoming a positive to the economy for the first time since 2017 thanks to mortgage rates as home sales, housing starts and prices were boosted

- However, the great concern is that slowing global growth will hurt business investment, damage US manufacturing and permeate to the entire economy. Leading indicators such as PMI, ISM and consumer sentiment signal that such a process does occur

- The labor market is the major source of power for the American consumer which account for about 70% of GDP. In addition, according to the rule of thumb, two-thirds of inflation is explained by the labor market. Therefore, its condition is expected to have a decisive impact on monetary policy design in the near future

- The unemployment rate fell in September to 3.5%, the lowest level in 50 years. Market added 136K jobs during September, below market expectation of 145K, but July and August reading was upwardly revised at 45K. Average hourly earnings increased by 2.9% in the past year, the lowest in a year and versus expectation of 3.2%. In addition, the labor force participation rate remained stable at 63.2%, the highest level since 2013, which indicates the return of workers to the labor force. Since labor market is still tight, it is reasonable to assume that the Fed will monitor developments in the coming months before deciding to further reduce interest rates

- There are still no signs that rising wages in labor market are driving inflation. The latest data is inconclusive: the core index rose to 2.4% but the core PCE deflator, the Fed's preferred inflation index, rose only by 1.8%, below the inflation target of 2%

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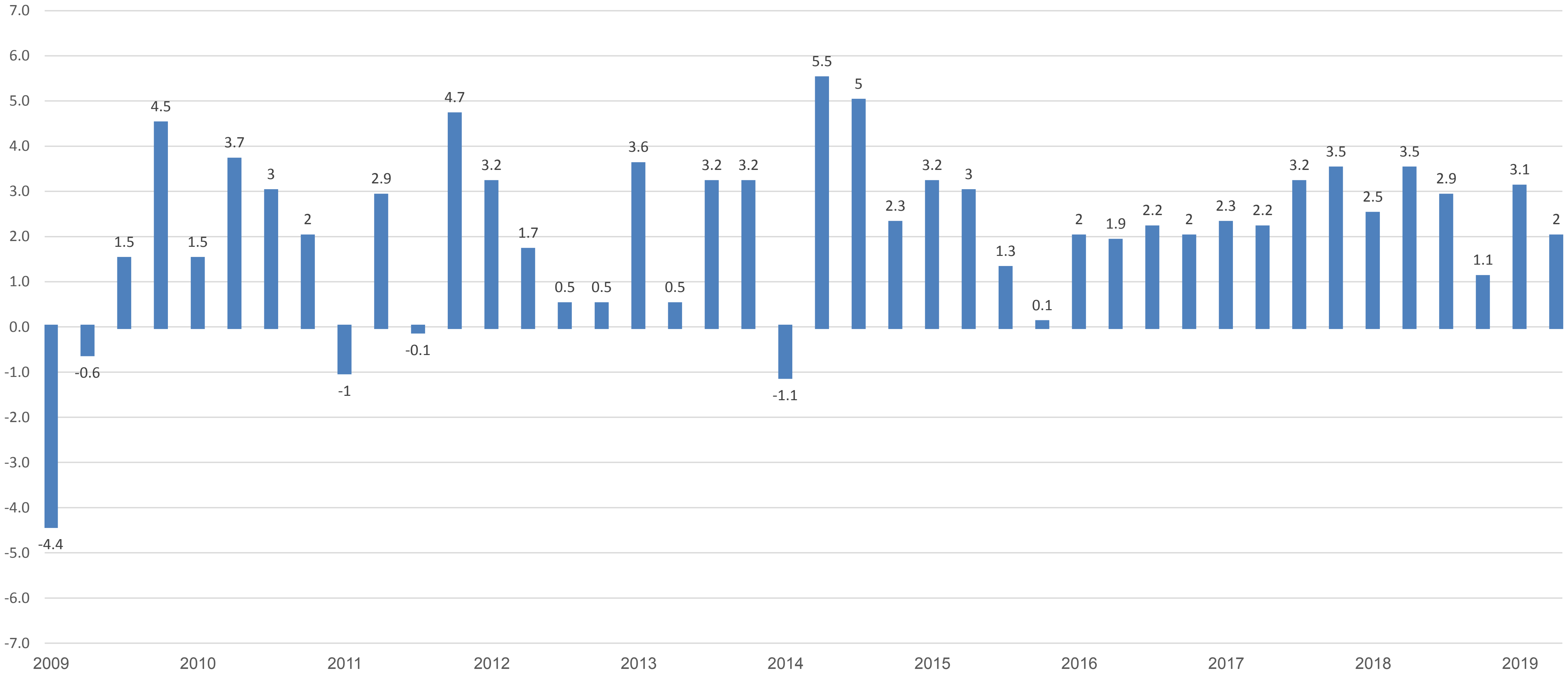
Core Economic Indicator

USA

Economic Indicator	Latest Figure	Reference Period
Growth Rate (Annualized)	2.0%	Q2-2019
Unemployment Rate	3.5%	September-2019
Inflation Rate (Core PCE, YoY)	1.8%	August-2019
Central Bank Interest Rate	1.75%-2%	October-2019
10 Years Yield	1.63%	October-2019
Ratio of Surplus in Current Account to GDP	(2.50%)	Q2-2019
Ratio of Public Debt to GDP	103.20%	April-2019

Economic Growth

GDP (Annualized)



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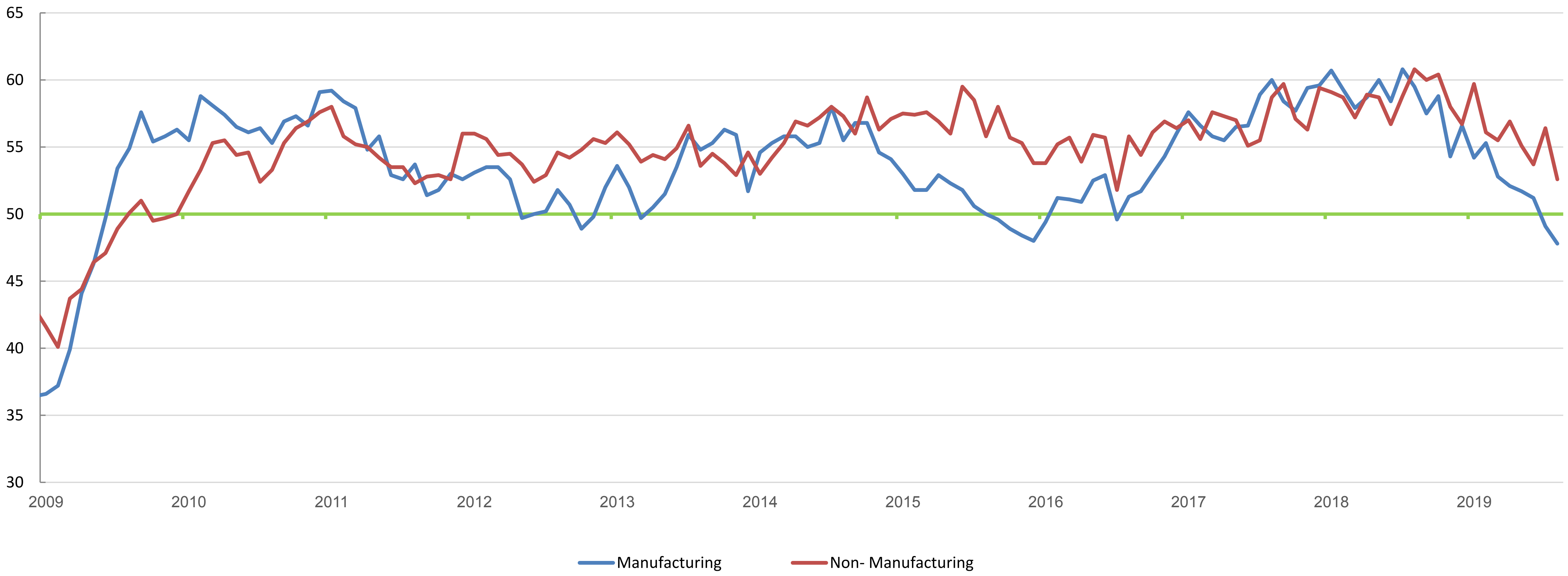
Economic Sentiment

Manufacturing and Non-Manufacturing ISM



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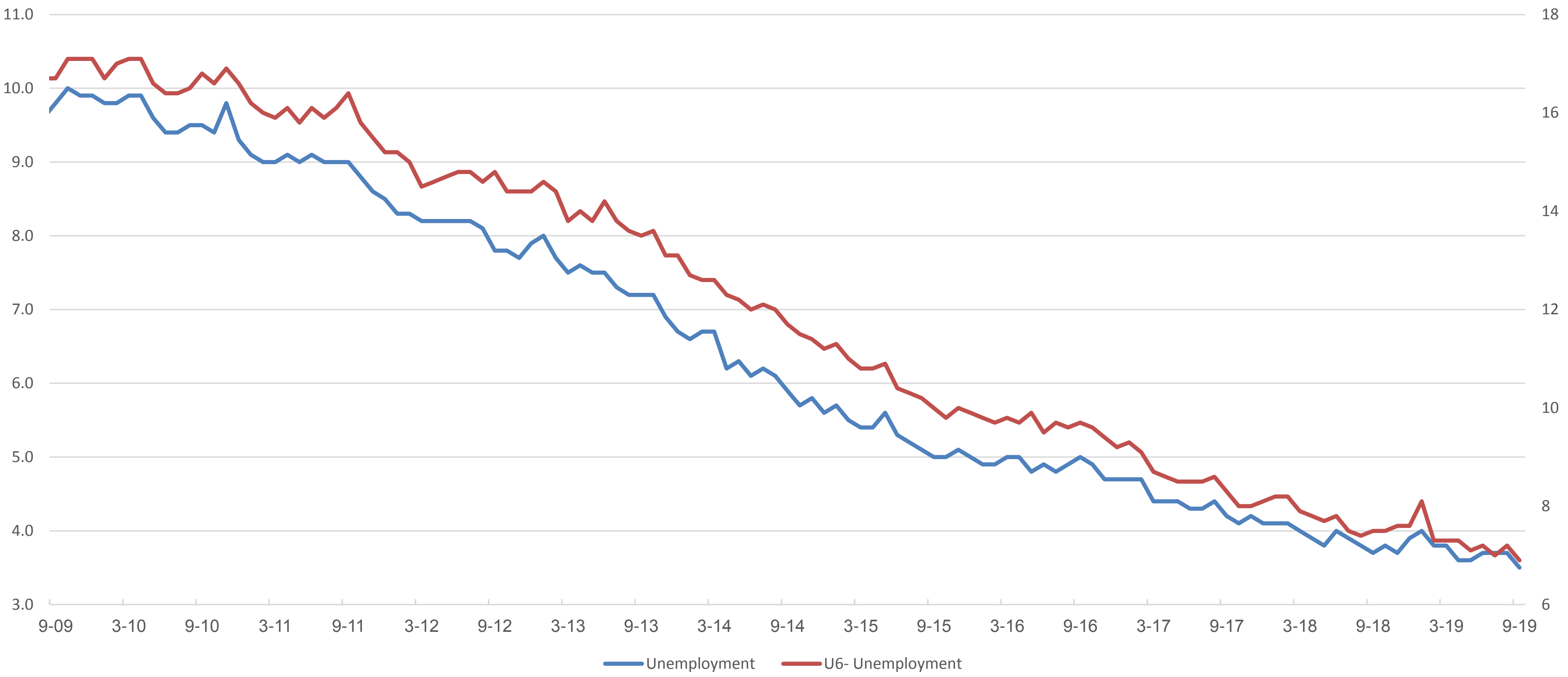
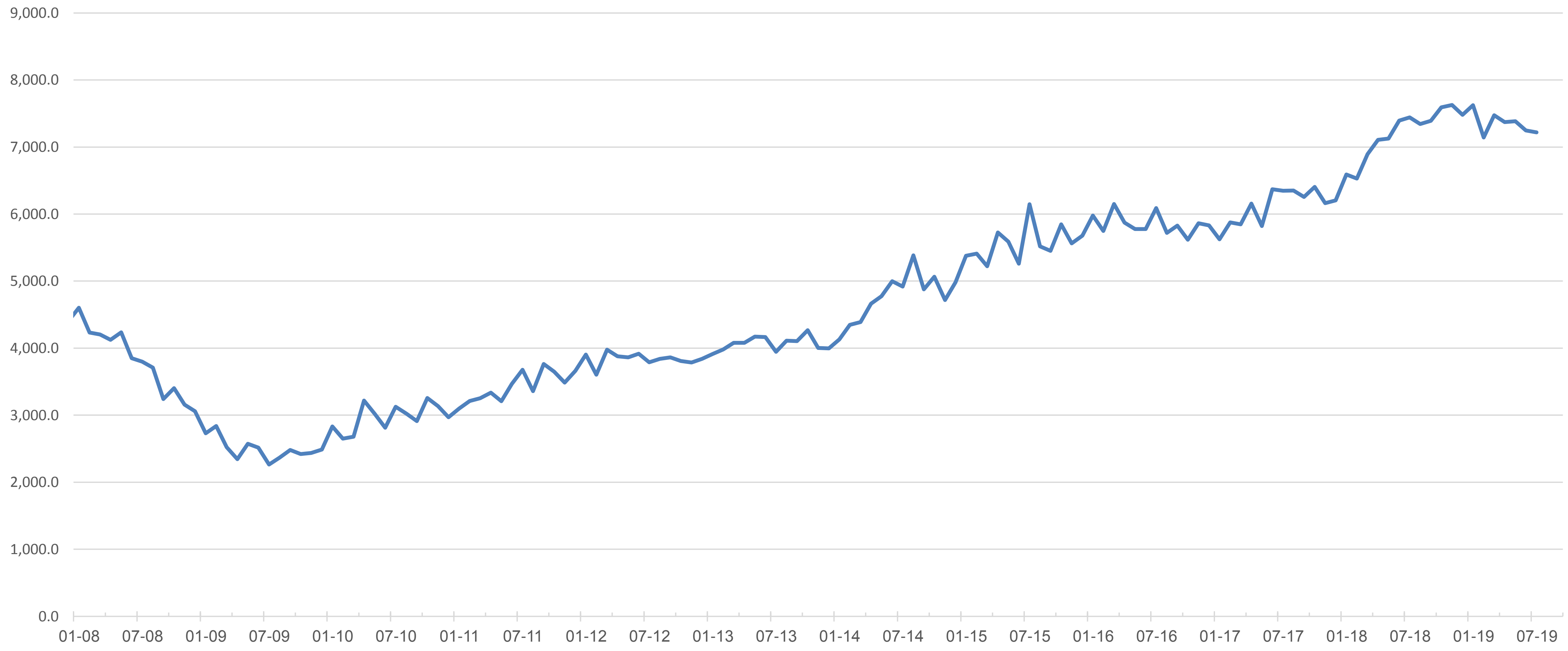
Labor Market

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



Labor Market

Job Openings



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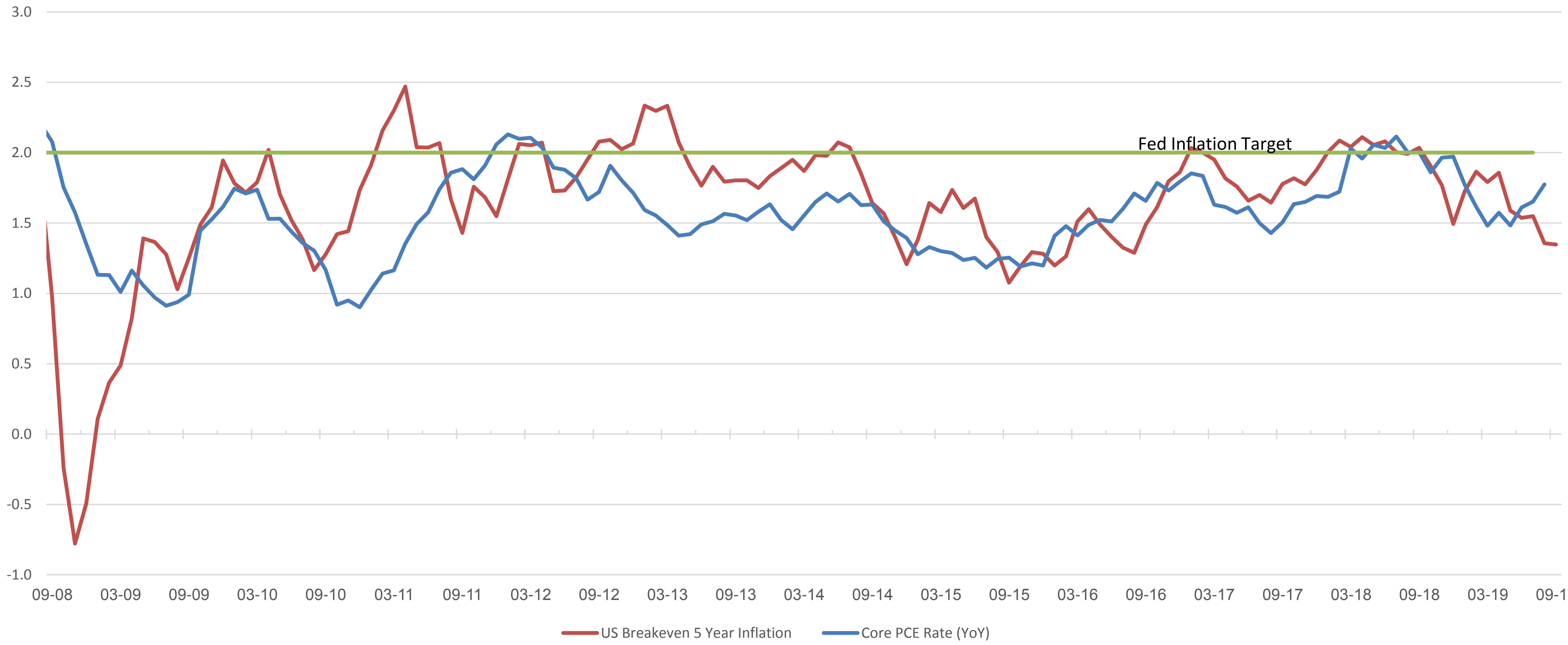
Inflation

Core PCE (YoY) and 5Y Inflation Forecast



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10YR Treasury Yield to Maturity

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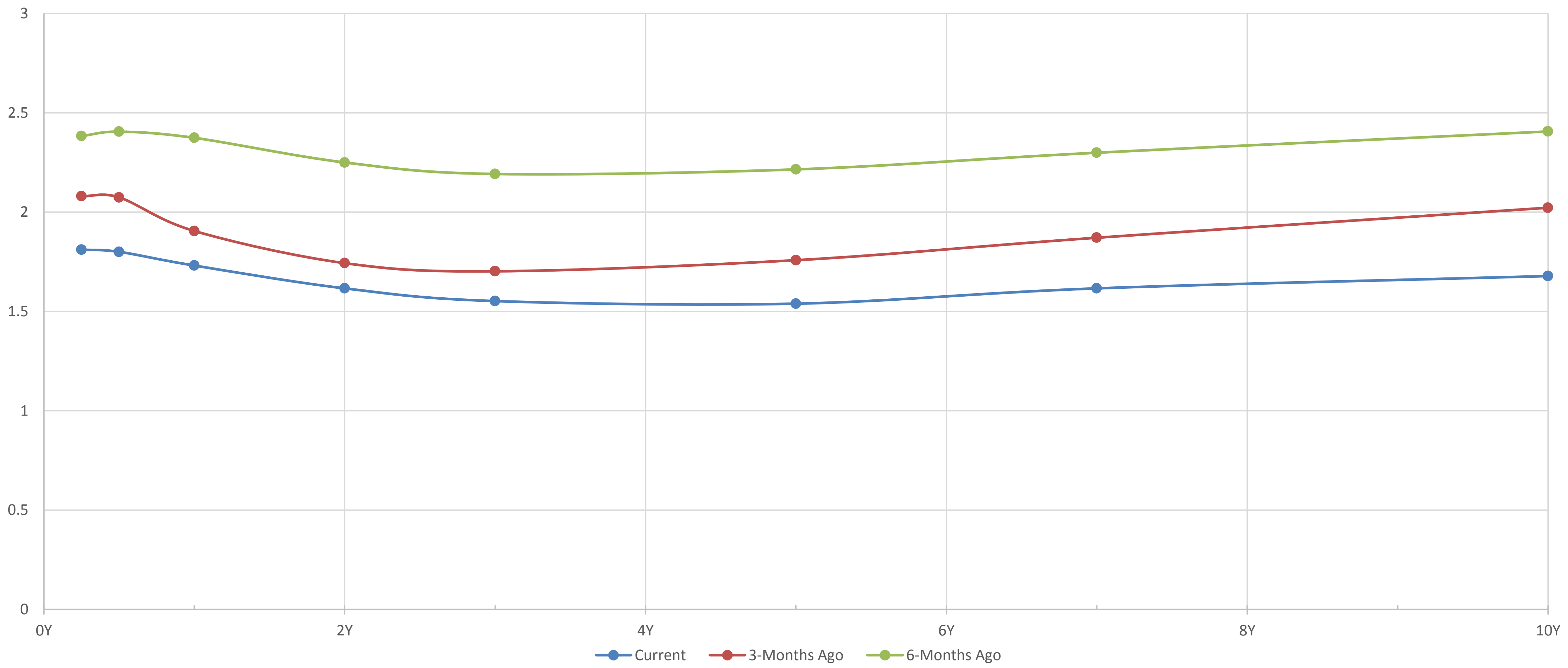
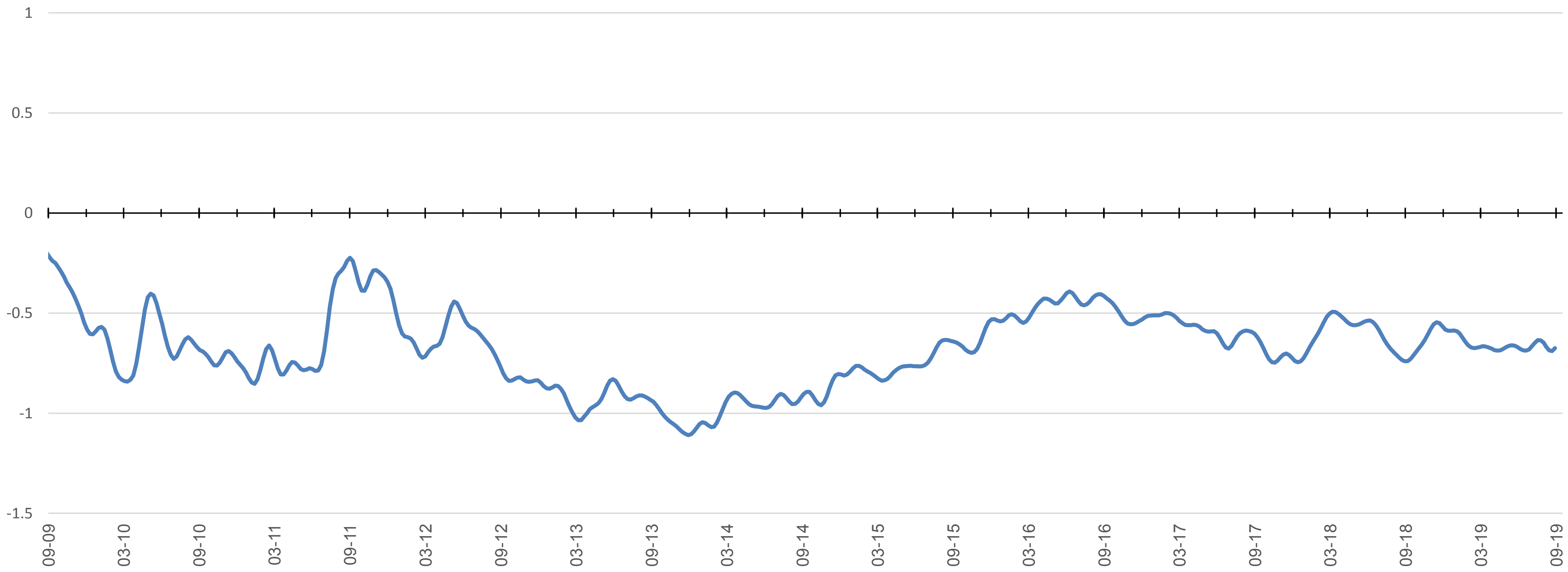
US Treasury Yield Curve



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

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US Dollar Index (DXY)

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Citi Economic Surprise

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Eurozone

- Dark clouds are gathering over the region as the Brexit saga, global trade uncertainty and the moderation of world trade take a heavy toll on the European economy and pessimism over future growth increase to levels not seen since the European debt crisis
- After it seemed that the situation in the European manufacturing sector could not be worse, September data were published, indicating continued contraction to levels seen recently in 2012. PMI for manufacturing in the Eurozone came in at 45.7 led by Germany, the Euro area's largest economy, which saw its factory gauge drop to 41.7 (the lowest since 2009) far below the 50 level which separates expansion from contraction
- Services sector, which was the bright spot of the European economy, is losing momentum in what appears to be a precursor to a possible recession after three quarters of low but stable growth
- Economic sentiment dropped below market expectation reflecting weakness in industry, trade and construction. the consumer confidence index, on the other hand, has improved slightly as it goes in line with the strong labor market and accommodative financial conditions , which constitute a convenient platform for the creation of healthy local demand
- Indeed, labor market data were surprisingly good during August when the unemployment rate dropped to 7.4%, the lowest since 2008. Spain and especially Italy contributed to the surprising decline while France and Germany remained stable. The question is whether the labor market will continue to improve as the difficulties in the manufacturing sector pile up
- The ECB joined last month to the global wave of monetary easing in respond to the economic slowdown and mute inflation. It cut interest rates and announced a new round of asset purchases in what appears to be a desperate move whose impact on the economy is questionable and its damage will probably turn out in the future

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Core Economic Indicator

Eurozone

Economic Indicator	Latest Figure	Reference Period
Growth Rate	0.80%	Q2-2019
Unemployment Rate	7.4%	August-2019
Inflation Rate (Core, YoY)	1.0%	September-2019
Central Bank Interest Rate	0.00%	September-2019
10 Years Yield (Germany)	(0.54%)	October-2019
Ratio of Surplus in Current Account to GDP	2.68%	Q2-2019
Ratio of Public Debt to GDP	85.90%	Q1-2019

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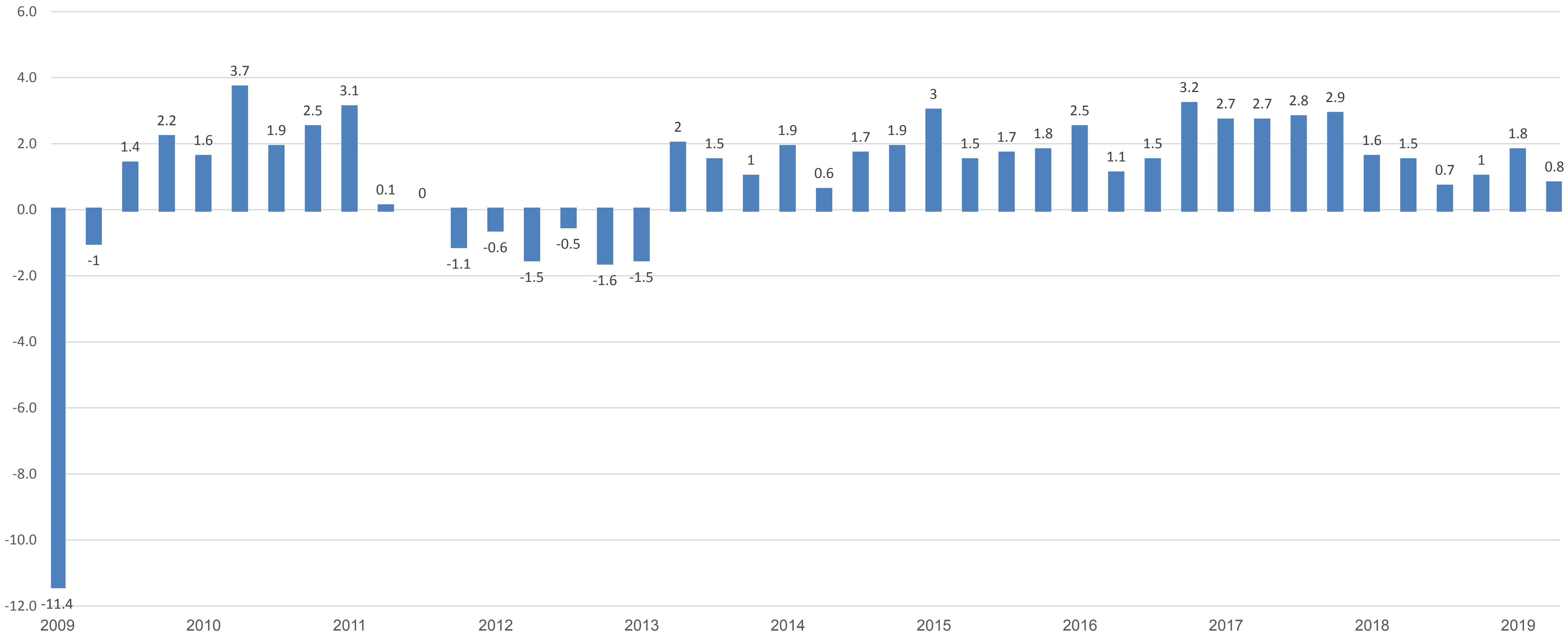
Economic Growth

GDP (Annualized)



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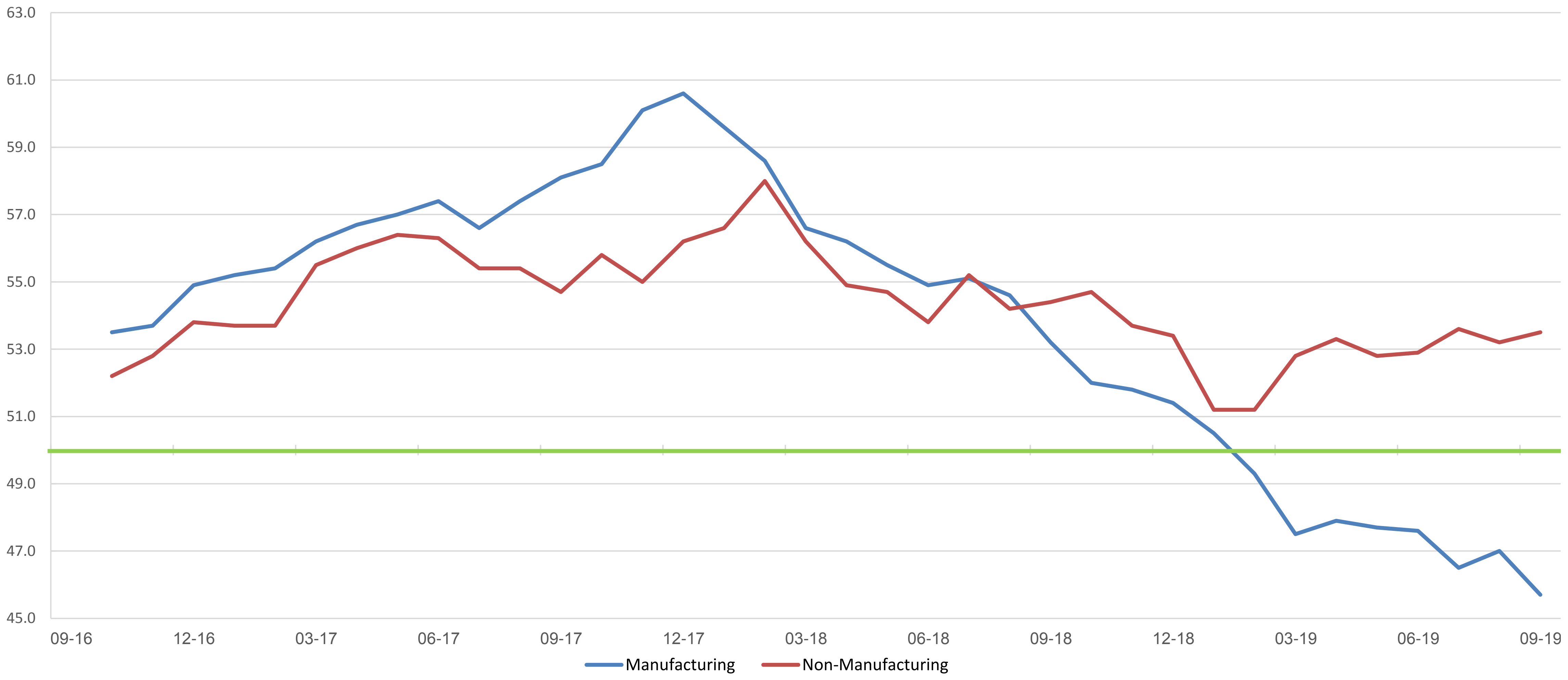
Economic Sentiment

Manufacturing and Non-Manufacturing PMI



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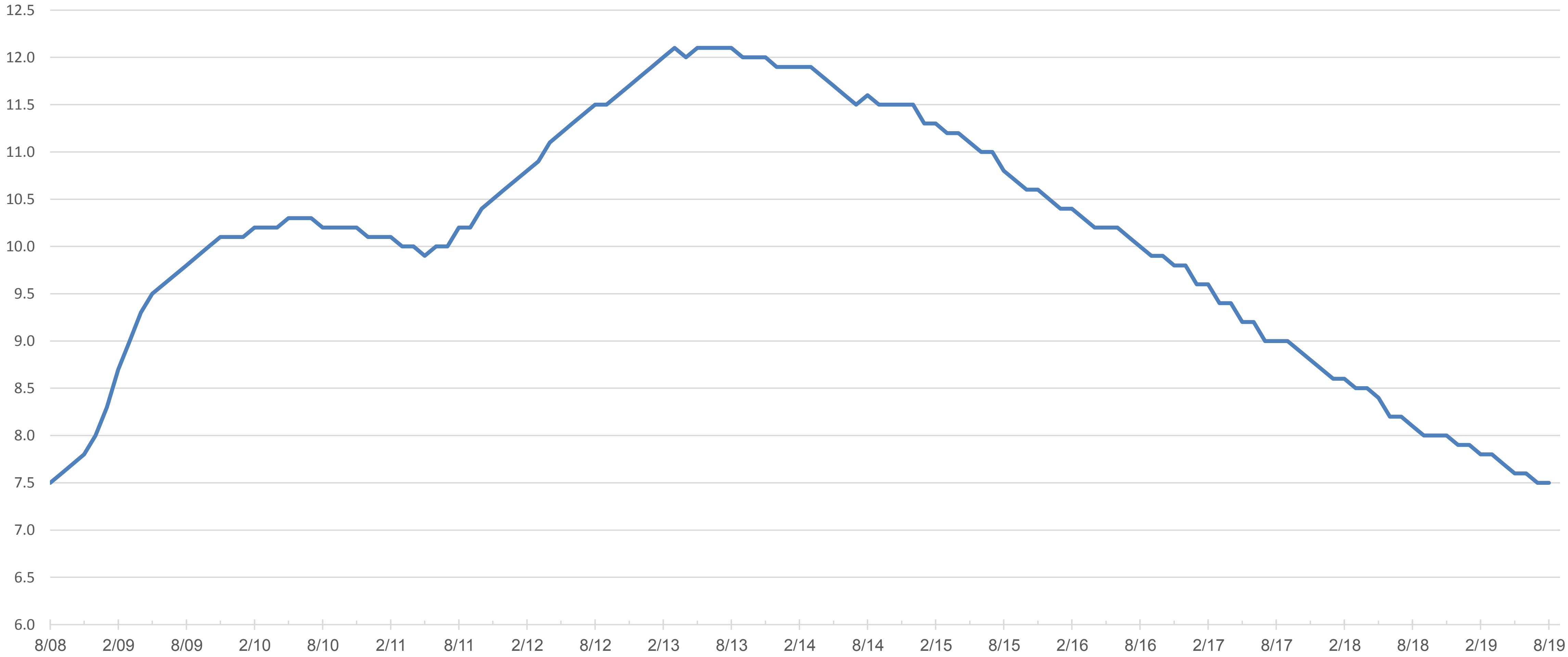
Labor Market

Unemployment Rate



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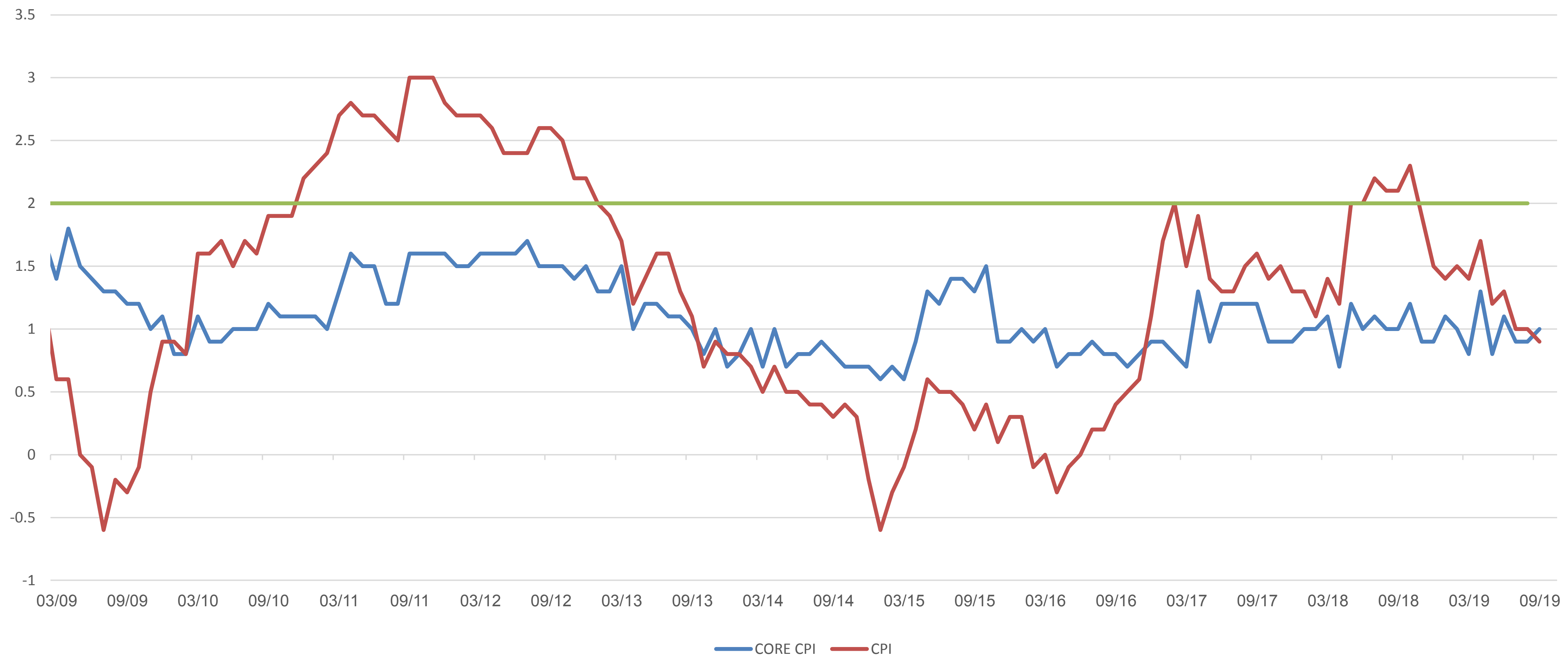
Inflation

CPI and Core CPI (YoY)



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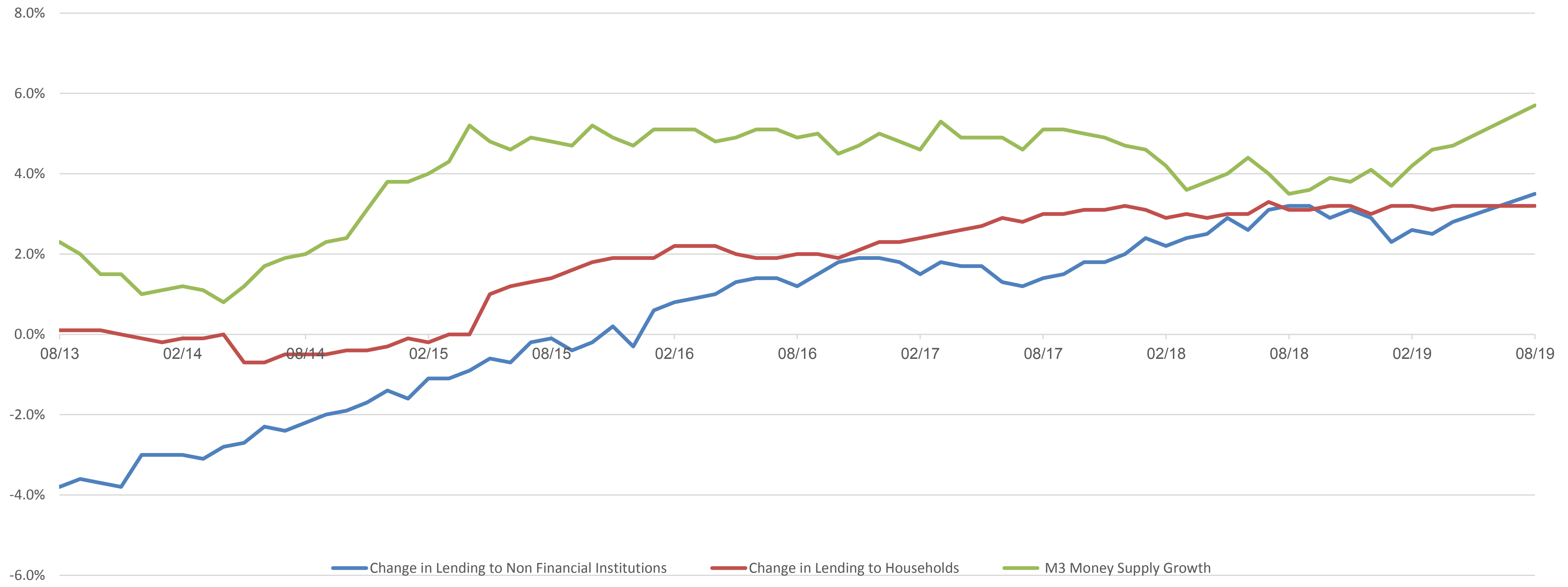
Money Supply and Credit

Growth in Money Supply, Loans to Real Sector



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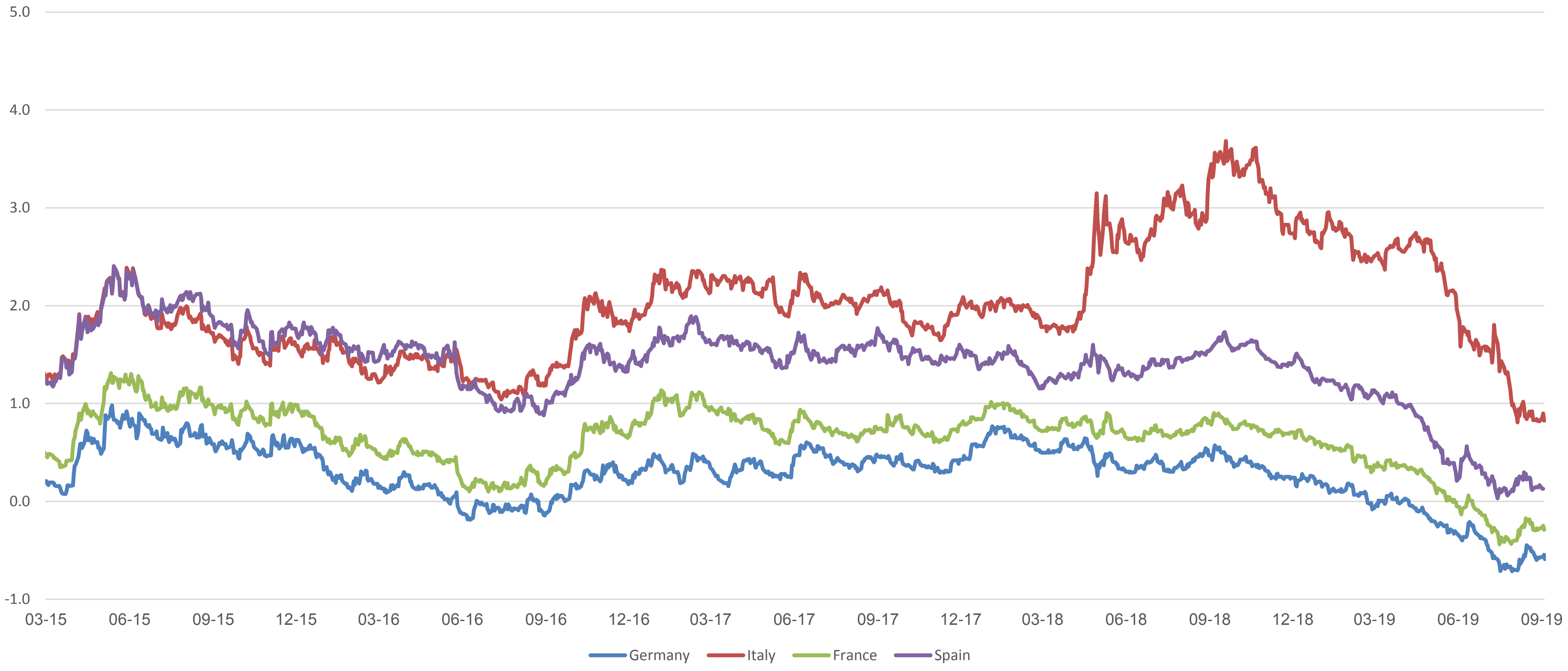
10YR Government Bond Yield



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Exchange Rate

EUR Index (Left) EURUSD (Right)

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Citi Economic Surprise

Israel

- The second round of election ended in a deadlock with neither side have enough support to assemble a coalition. The possibility of a third election round is gaining momentum and that means the country is expected to be in a state of paralysis for over a year precisely at a time when policy adjustments are needed most

- A year after joining to S&P in raising its rating outlook for Israel from 'stable' to 'positive‘, Moody's raises doubts about Israel's ability to handle the budget deficit (currently 3.8%) in light of the election results

- For now, financial markets are ignoring the political and economic issues as they assume that the new government will be committed to budget consolidation. Another reason is Israel's anticipated entry into FTSE World Government Bond Index, which generates high demand for domestic financial assets, most notably the bonds, thereby mitigating the risks

- After weak growth in the second quarter and in light of political uncertainty, the question is whether the local economy, being small but open, will be able to break away from the gravity of the slowing global economy. Recent indicators, including credit card purchases, export of services, the number and percentage of open jobs indicate potential economic weakness

- In face of global monetary easing, low inflation (0.6% YOY) and the ongoing appreciation of the Shekel, Bank of Israel faces a difficult dilemma. The choice is between reducing interest rates to a negative level, which at the moment seems too far-reaching for the Bank of Israel or, what seems more likely, to reduce interest rates by 0.25% to 0% and revert to the foreign exchange purchases policy, but in large sums and without sterilizing the purchases

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Core Economic Indicator

Israel

Economic Indicator	Latest Figure	Reference Period
Growth Rate	1.00%	Q2-2019
Unemployment Rate	3.8%	August-2019
Inflation Rate (YoY)	0.6%	August-2019
Central Bank Interest Rate	0.25%	October-2019
10 Years Yield	0.83%	October-2019
Ratio of Surplus in Current Account to GDP	3.38%	Q2-2019
Ratio of Public Debt to GDP	61.00%	Q4-2017

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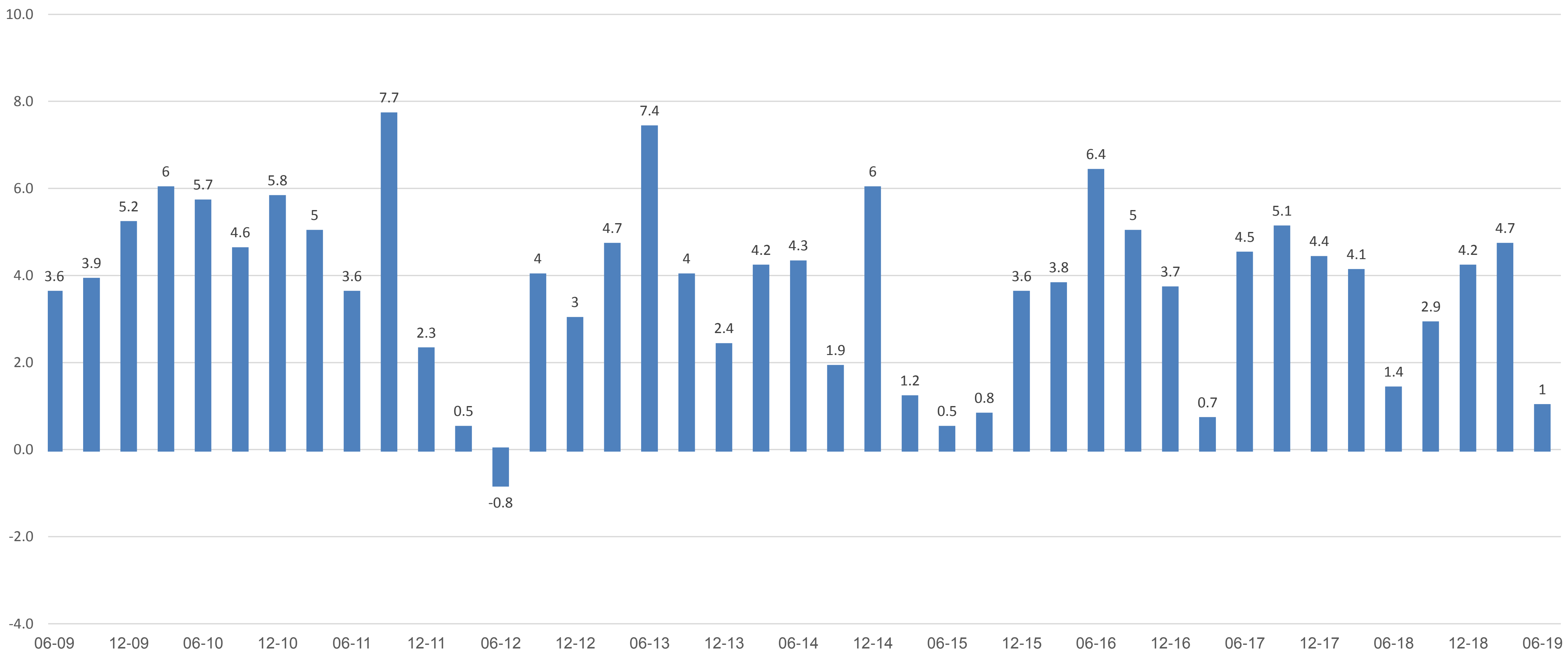
Economic Growth

GDP (Annualized)



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Labor Market

Unemployment Rate

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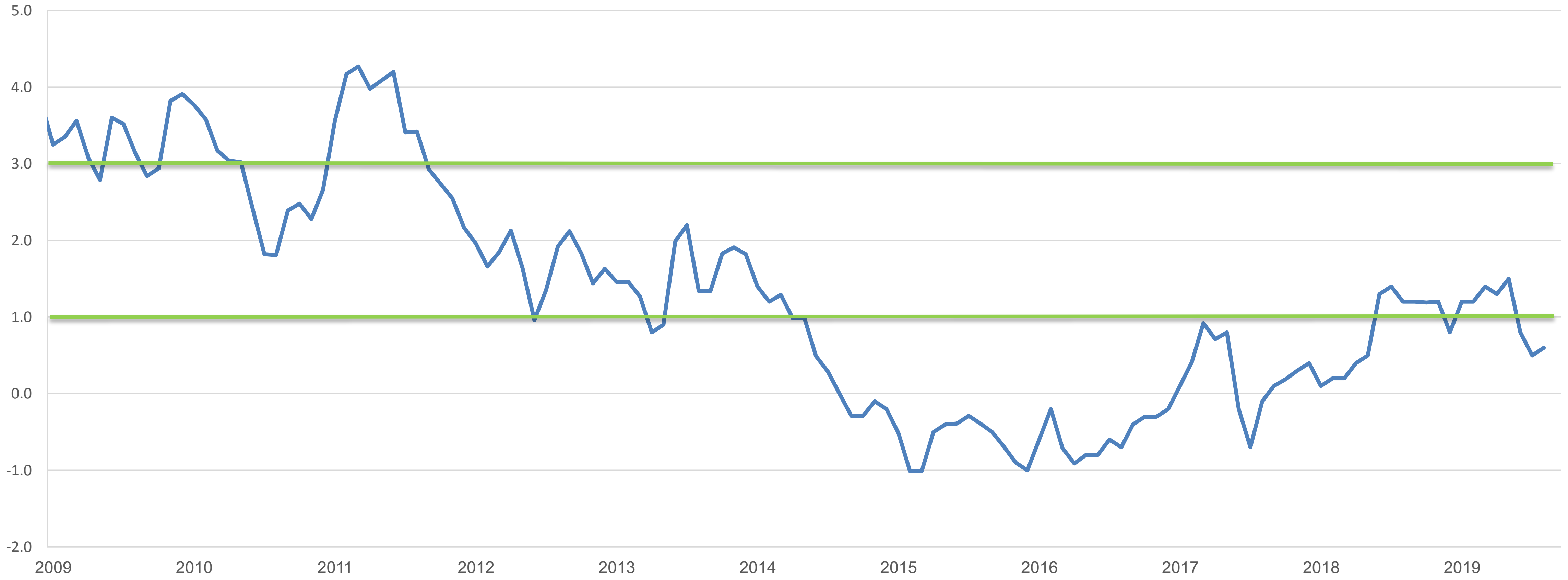
Inflation

CPI (YoY)



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10YR Government Bond Yield

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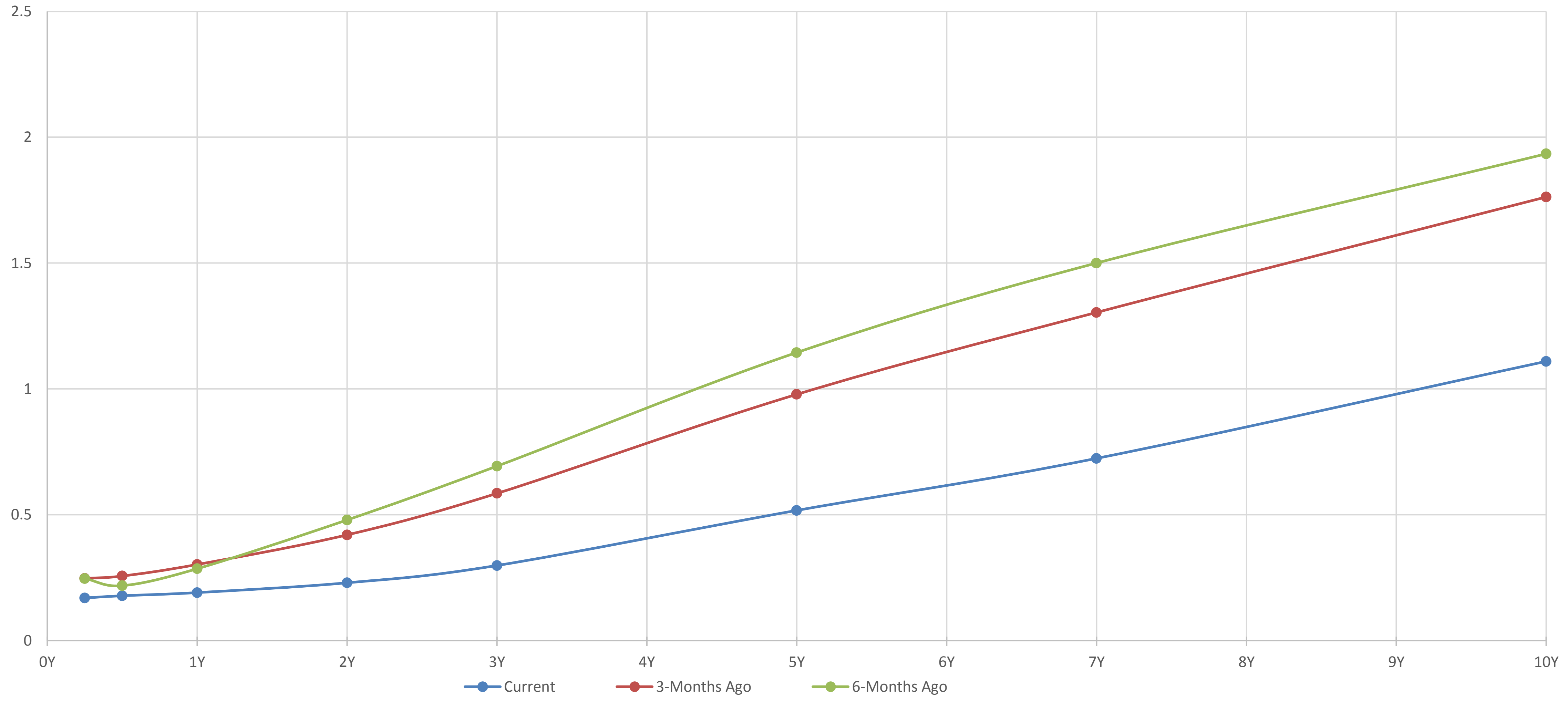
Government Bond Yield Curve



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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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