Financial Immunities

Market Insights

December 2019

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Global Economy

- More than a decade since the Great Financial Crisis, despite unprecedented central bank policies, inflation and growth remained persistently low, but debt levels and asset prices peaked, as excess liquidity appears to be going into financial assets and not the real economy. Now that central banks are left with no real tools, the only option to bail out the global economy from a standstill is to adopt an expansionary fiscal policy, but increasing the possibility of another debt crisis
- Despite being at the end of a business cycle, asset prices are reach as investors price in a recovery of the global economy, continued support from central banks, increase in corporate profits and resolution of trade disputes. Certainly, this situation reflects investor complacency
- The phenomenon of negative yielding debt continues, courtesy of the central banks' ultra-accommodative policy. With 17 trillion $ of debt "under water" and failures in the money markets (repo market), the global financial system is far more vulnerable than it seems
- Moderation is the name of the game in the Chinese economy as investment, industrial production and retail sales have slowed and it seems the economy has not met the bottom yet as further weakness lurks ahead. Moreover, the fact that much of the weakness is attributed to local factors implies that even a trade agreement will not change the picture from the ground up
- As trade talks continue, the details of the potential agreement (phase one) is not clear, but it appears to include bilateral purchases commitments. These managed trade agreements are expected to have a major impact on other countries and economic regions such as the European Union and South East Asia. Scenario in which the U.S. and China will not consider the agreement implications on third parties may have adverse consequences for the global economy as a whole and for some

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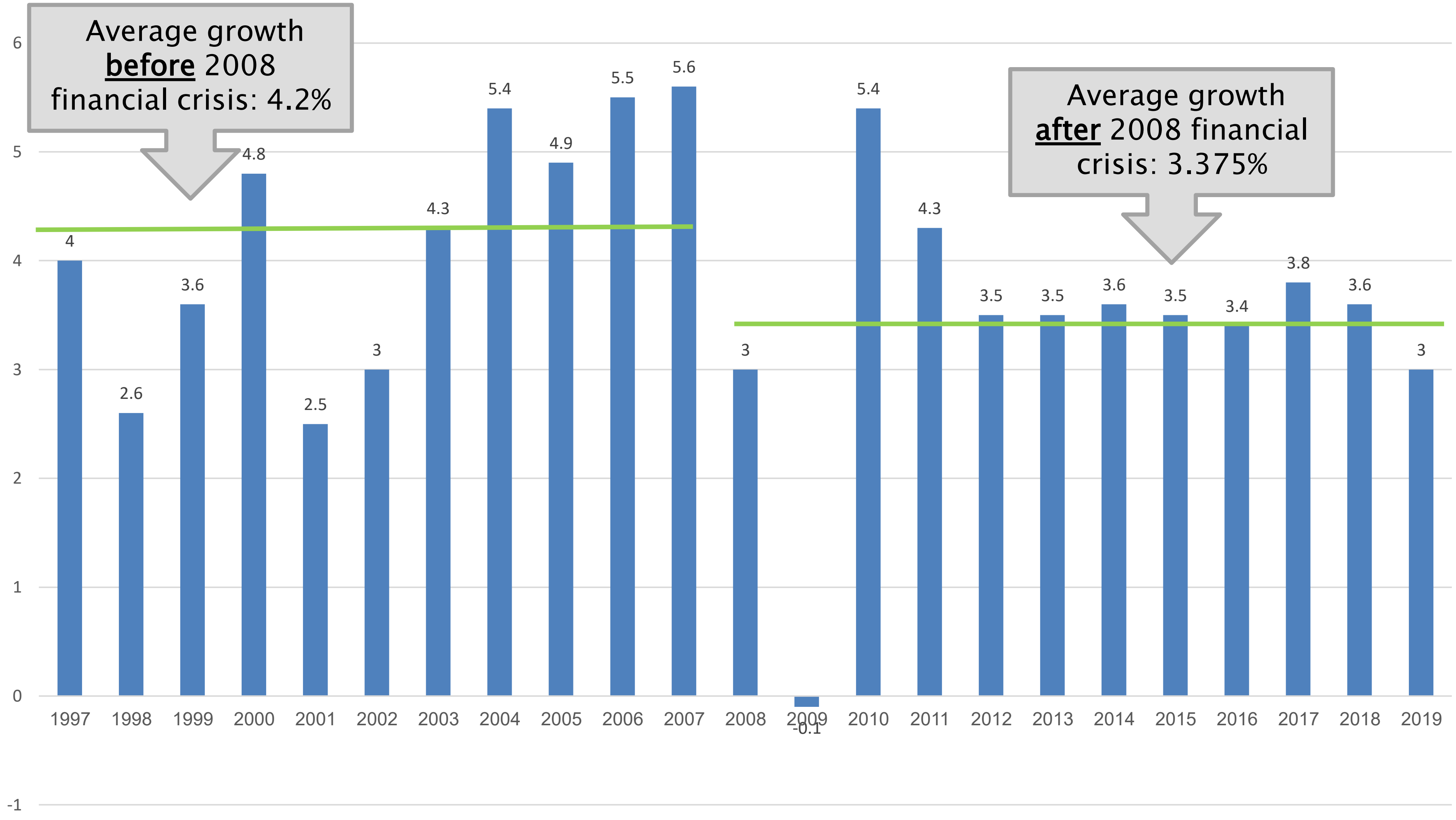
Global GDP



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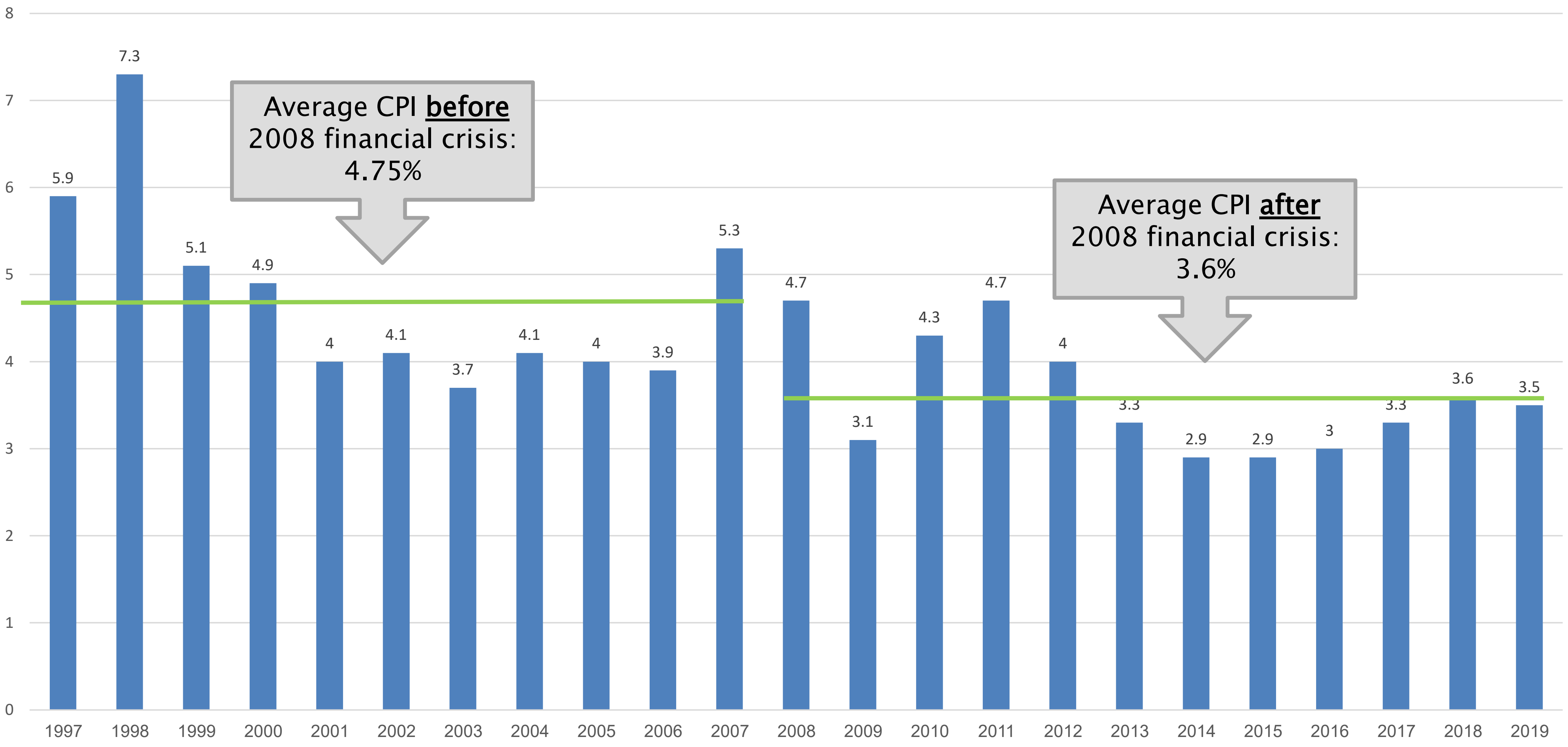
Global CPI



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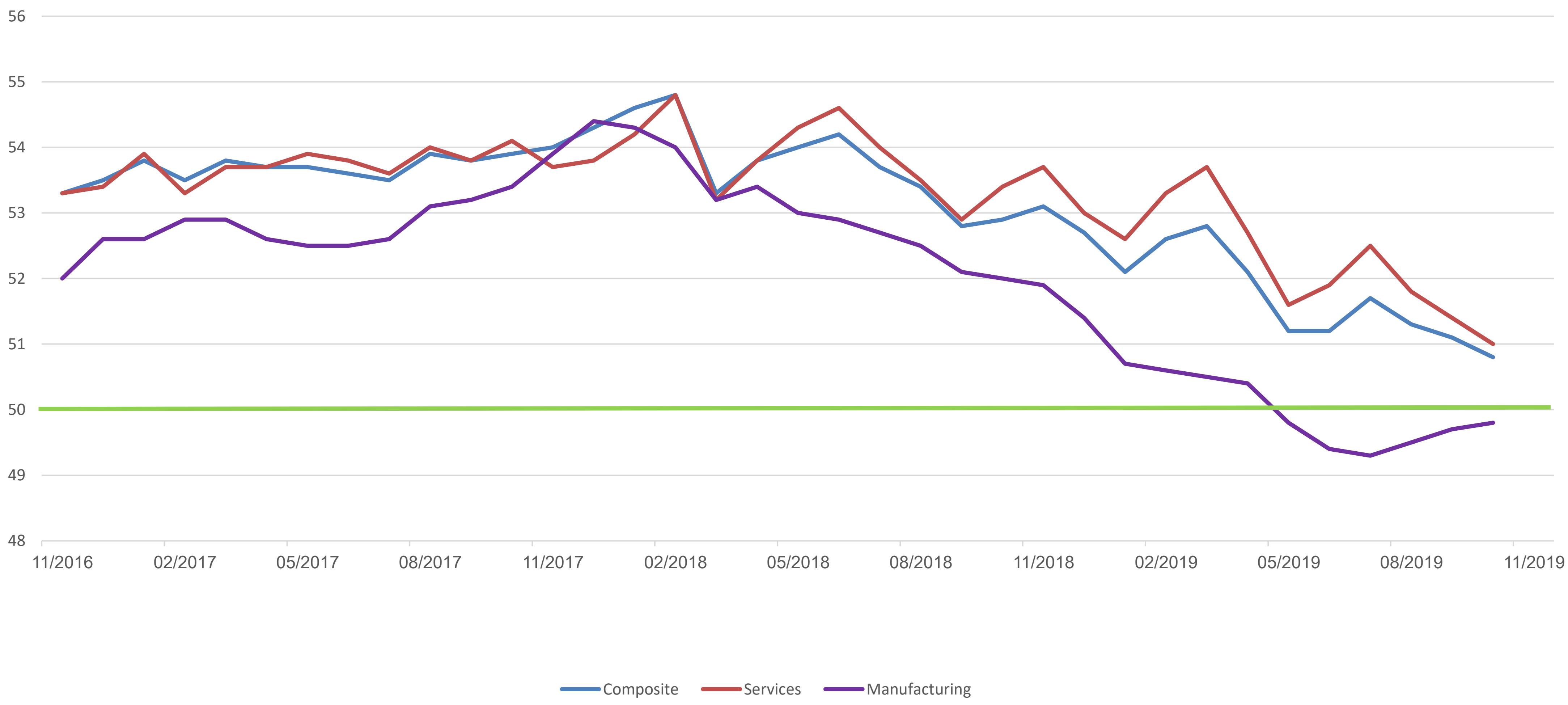
Global PMI



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United States

- Q3 economic growth revised up to 2.1%, as the record-breaking expansion in the U.S. economy continues (11 yr.). The consumer continues to show strength, being supported by the strong labor market and the easing monetary conditions, while the manufacturing sector and business investment continues to lag behind, affected by the trade war and the slowdown in the global economy

- Inflation environment has not changed recently as Inflation pressures remain stubbornly muted. The increase in wages and the rise in tariffs on Chinese goods as part of the trade war are not yet reflected in inflation, which rose by 1.8% in the past year. Excluding food and energy, the core index rose by 2.3%, below expectations. The core PCE index, which is the preferred gouge of the Fed, gained 1.6% YOY, still below the 2% inflation target

- Despite the uncertainty associated with trade wars, the GM strike which shed 41,600 payrolls, the weakness in the manufacturing sector and in investments, labor market data indicate resilience . October payrolls increased 128K, above market expectation. Unemployment edged up 0.1% to 3.6%, still near historic lows and average hourly earnings climbed at a respectable 3% pace

- U.S. President Donald Trump has continued to undermine the central bank's credibility by accusing him of the economic slowdown. He said the U.S. interest rate should have been much lower, with the Fed's unwillingness to align with the world's low interest rates, leaving the U.S. at a competitive disadvantage

- In a speech before congress, Fed Chair Powell said that politics played no role whatsoever in the Fed’s policy decisions and that based on the available data, assuming that growth outlook will not weaken, interest rates are likely to remain in place

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Core Economic Indicator

USA

Economic Indicator	Latest Figure	Reference Period
Growth Rate (Annualized)	2.1%	Q3-2019
Unemployment Rate	3.6%	October-2019
Inflation Rate (Core PCE, YoY)	1.6%	September-2019
Central Bank Interest Rate	1.5%-1.75%	November-2019
10 Years Yield	1.78%	November-2019
Ratio of Surplus in Current Account to GDP	(2.50%)	Q2-2019
Ratio of Public Debt to GDP	103.20%	April-2019

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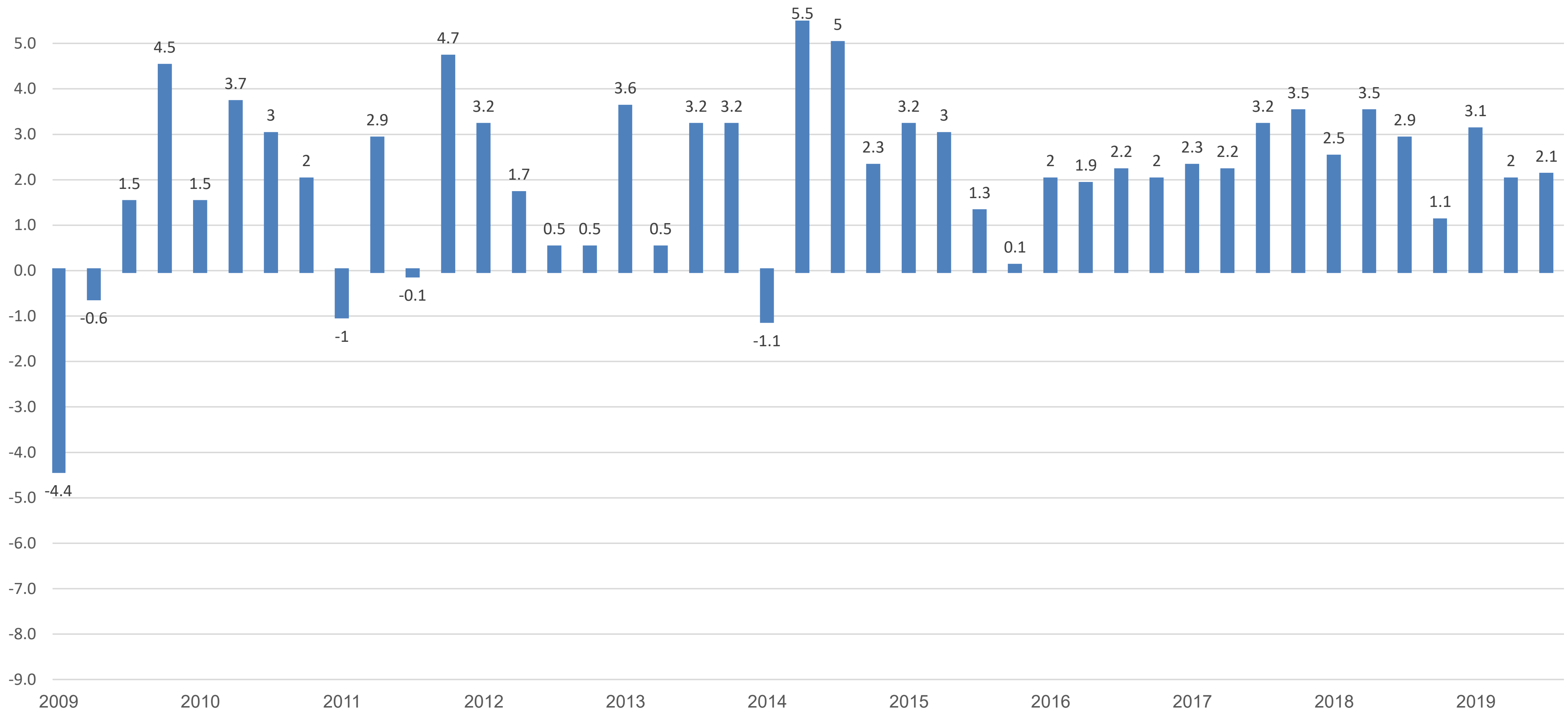
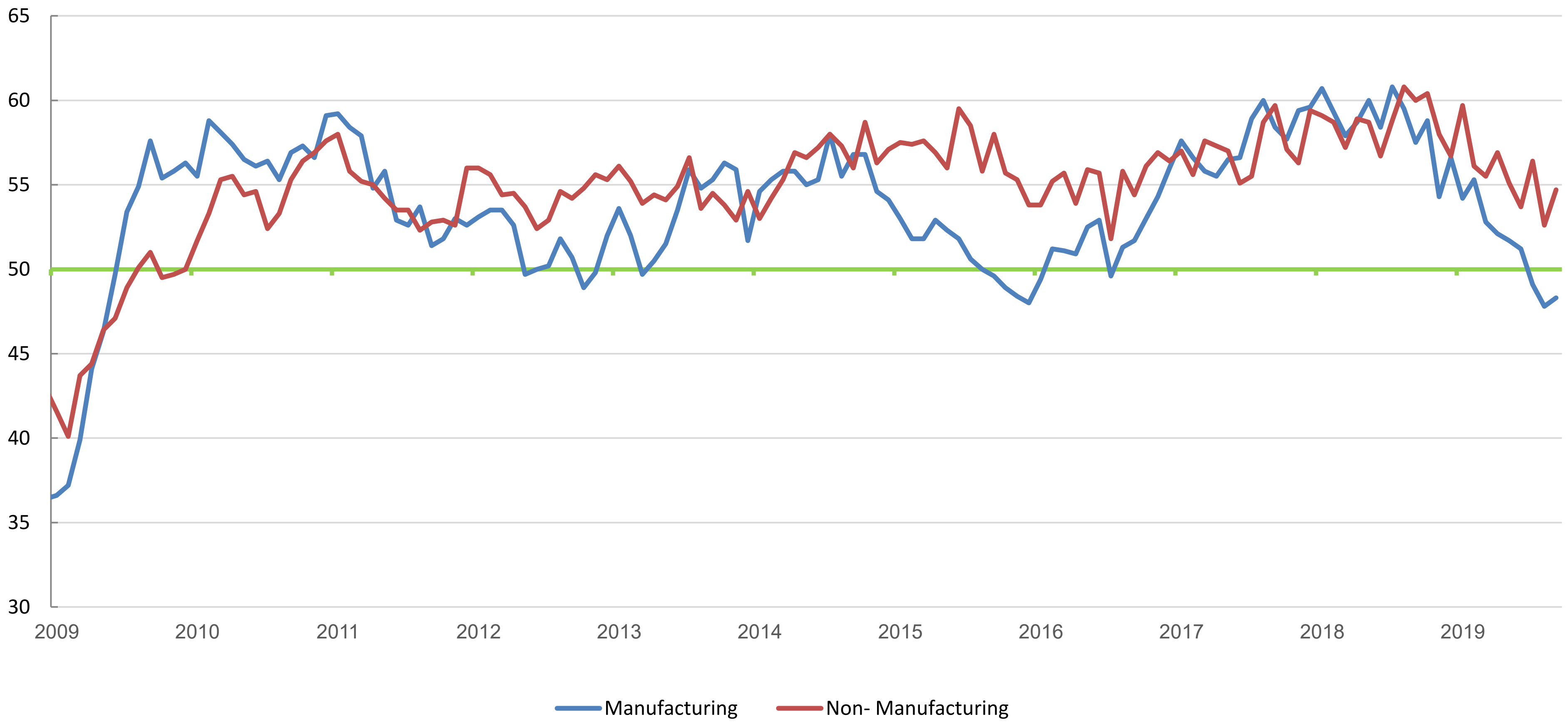
Economic Growth

GDP (Annualized)



Economic Sentiment

Manufacturing and Non-Manufacturing ISM



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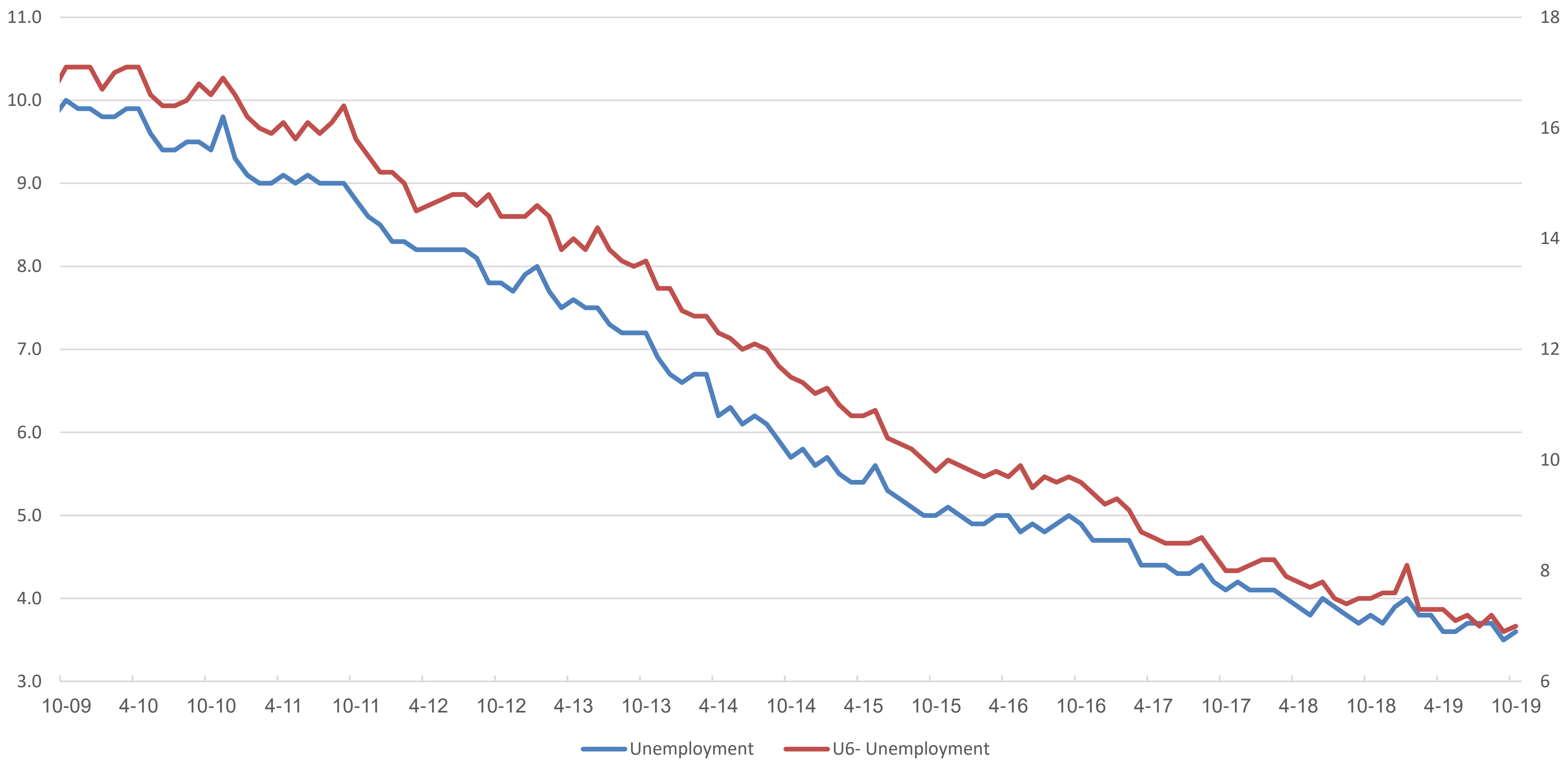
Labor Market

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



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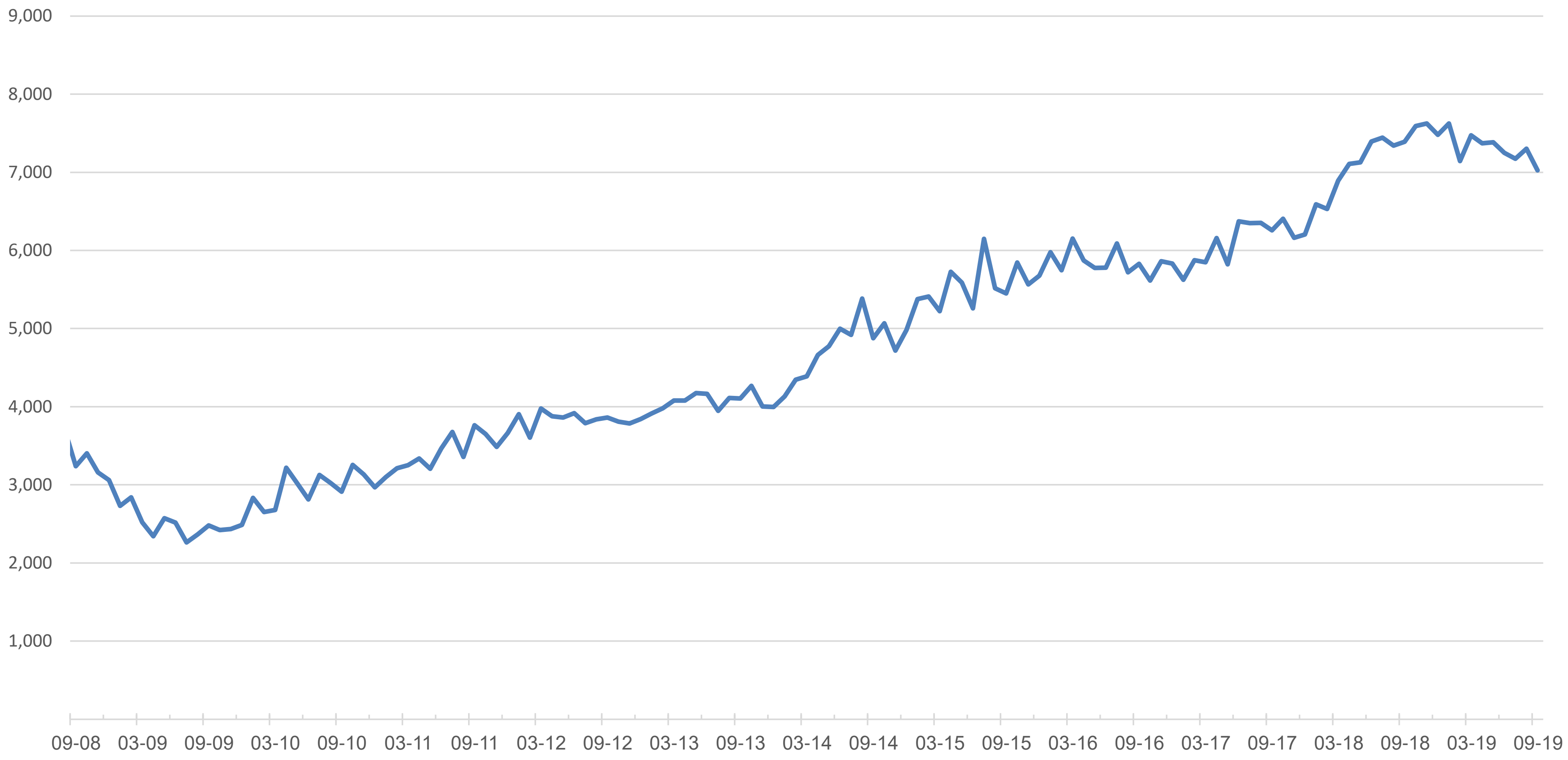
Labor Market

Job Openings



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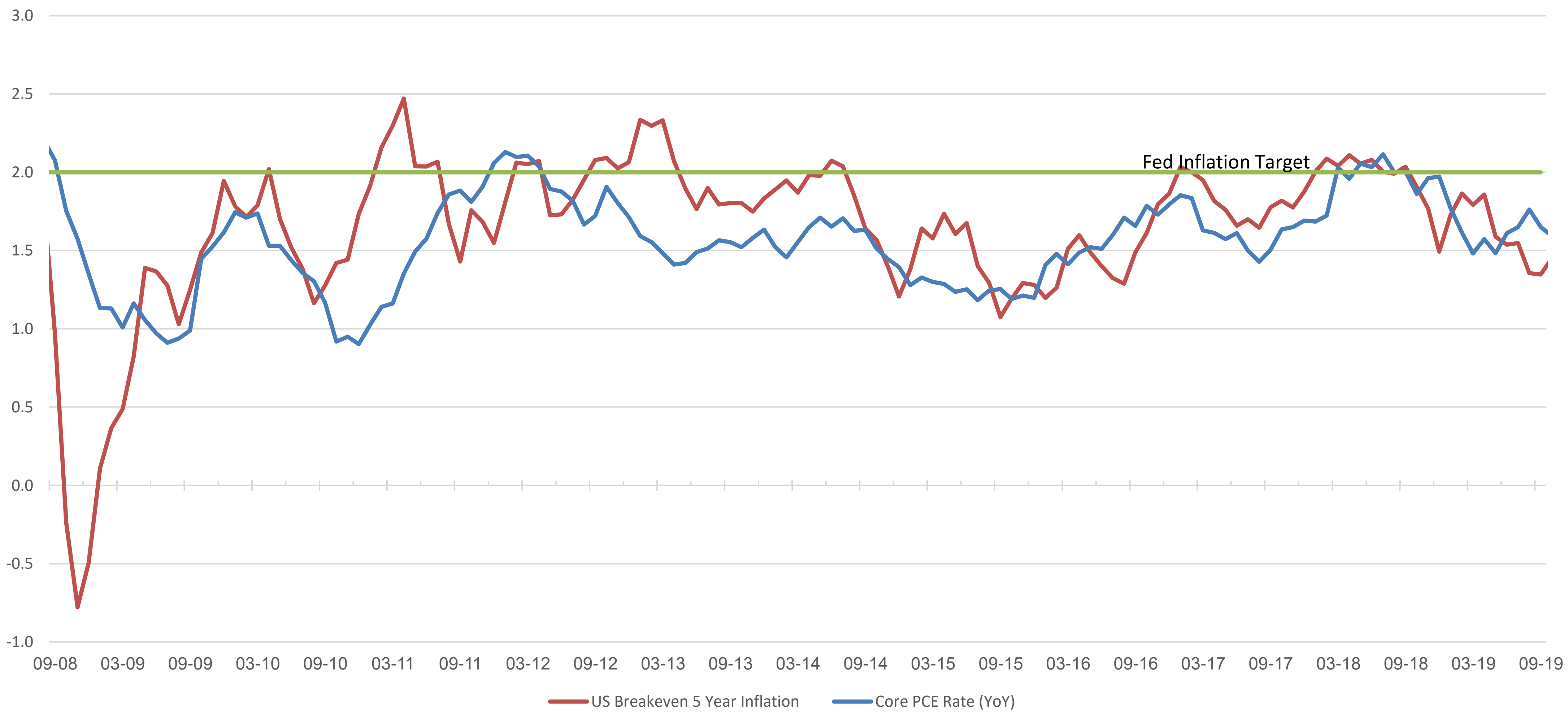
Inflation

Core PCE (YoY) and 5Y Inflation Forecast



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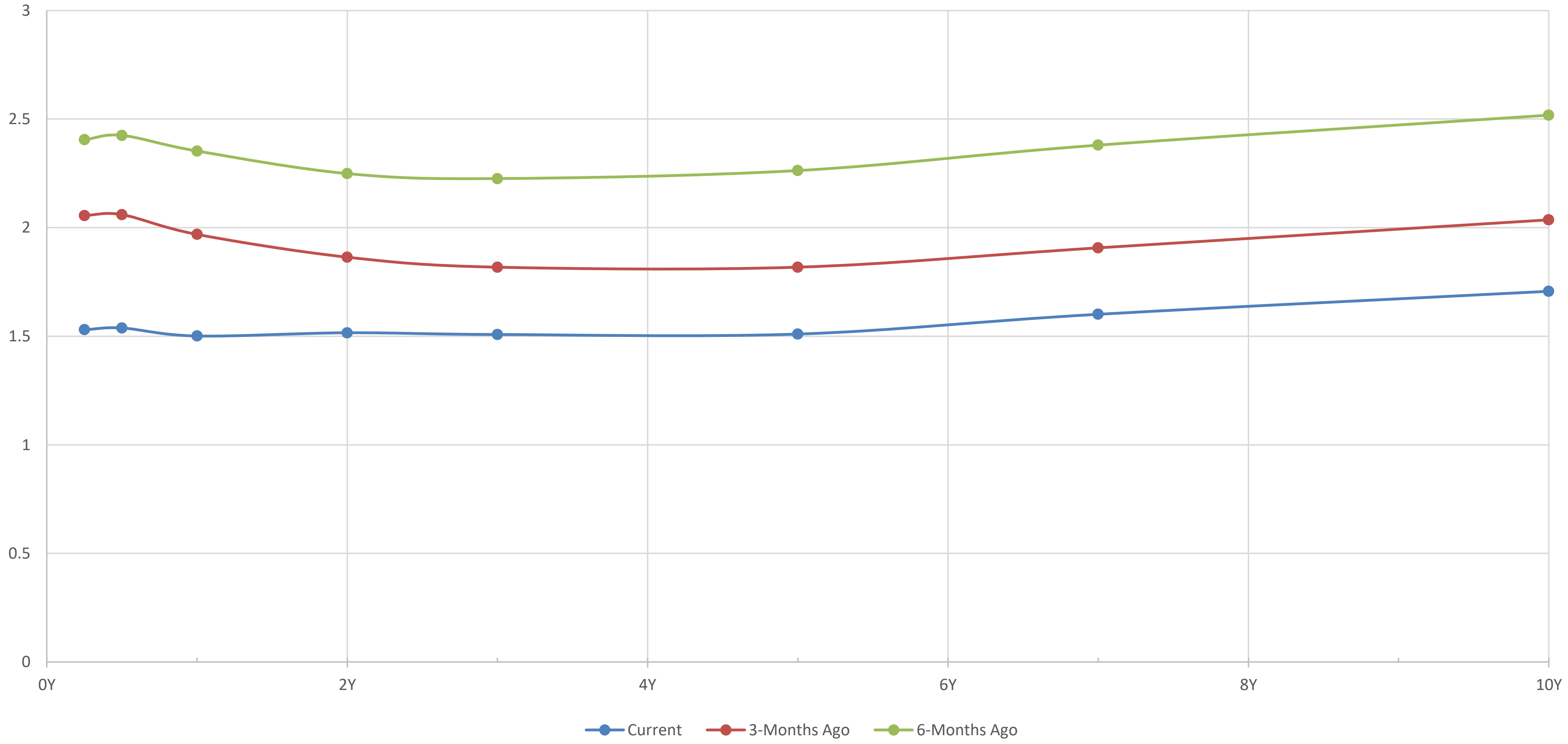
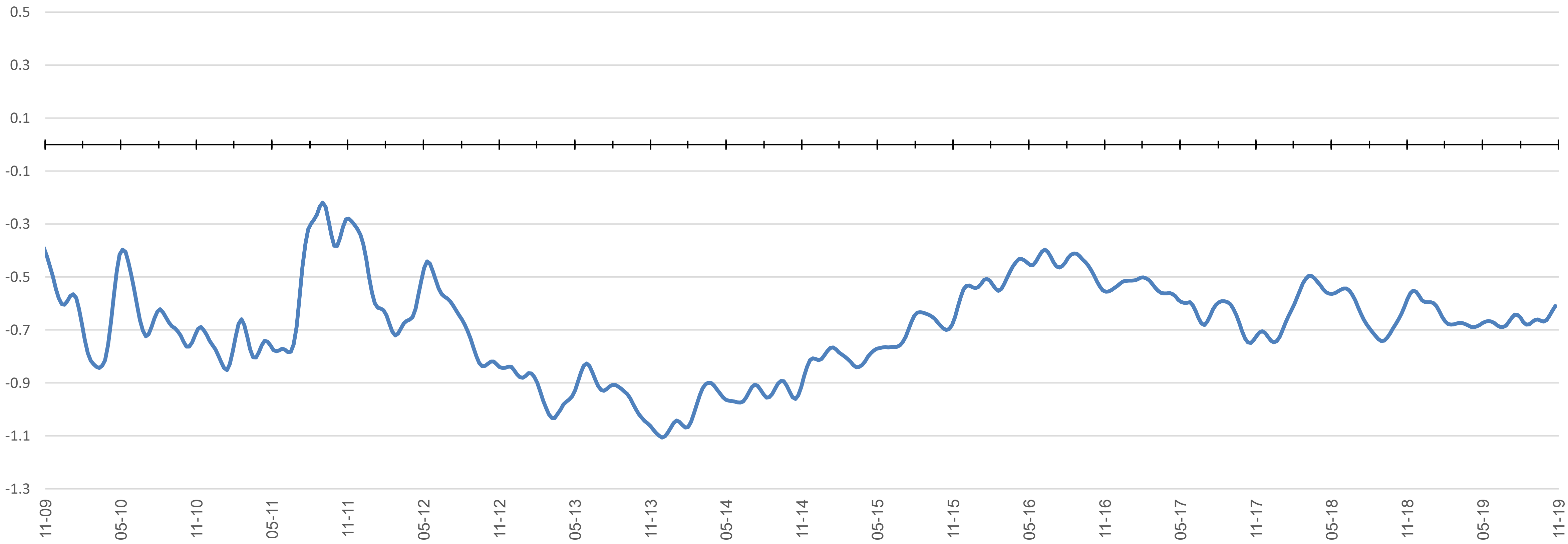
10YR Treasury Yield to Maturity

US Treasury Yield Curve



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)

Citi Economic Surprise

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Eurozone

- Economic activity in the Euro area is stabilizing at a low level. The manufacturing sector shows signs of life that are reflected in the manufacturing PMI's indices, which are still at a level lower than 50, indicating a contraction, but slower. In contrast, the services sector has weakened slightly but is still expanding, so the situation is not clear

- Regionally, the picture is uneven, with Germany and Italy demonstrating relative weakness, while France and Spain are performing better. France stands out favorably as reflected in the consumer confidence index which has risen to its highest level since 2007. In Italy, however, the situation continues to be dismal, as consumer confidence plummets to a two-year low. Germany has been able to provide slightly better data recently, but is still flirting with a recession

- Minutes from the last ECB meeting show that the council members are aware of their limited ability to support the economy through monetary means, as they call on other policy makers, especially governments with fiscal space, to contribute more decisively to supporting the Euro area economy. However, due to their concern about the region lackluster economy, they pledge to continue the unconventional policy until inflation converges back to its target level just below 2%

- The ECB warns that its unprecedented ultra accommodative monetary policy supports the economy, but at the same time increases the vulnerability to financial systems as a result of erosion of banks profits, assets mispricing, increase in debt burden and increased risk taking in non-bank financial sector. The ECB also signaled that asset mispricing increase the possibility of future correction, or in other wards crashes in the bonds and equity markets

- The December 12 election in the UK that was supposed to resolve the Brexit disputes becomes crucial on two other issues, the independence of Scotland and Northern Ireland, resulting in an unclear picture of Britain's future image. Meanwhile, hard to predict voting patterns, make it harder for the candidates to get overall majority and control of Parliament

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Core Economic Indicator

Eurozone

Economic Indicator	Latest Figure	Reference Period
Growth Rate	0.90%	Q3-2019
Unemployment Rate	7.5%	September-2019
Inflation Rate (Core, YoY)	1.1%	October-2019
Central Bank Interest Rate	0.00%	October-2019
10 Years Yield (Germany)	(0.38%)	November-2019
Ratio of Surplus in Current Account to GDP	2.68%	Q2-2019
Ratio of Public Debt to GDP	86.40%	Q2-2019

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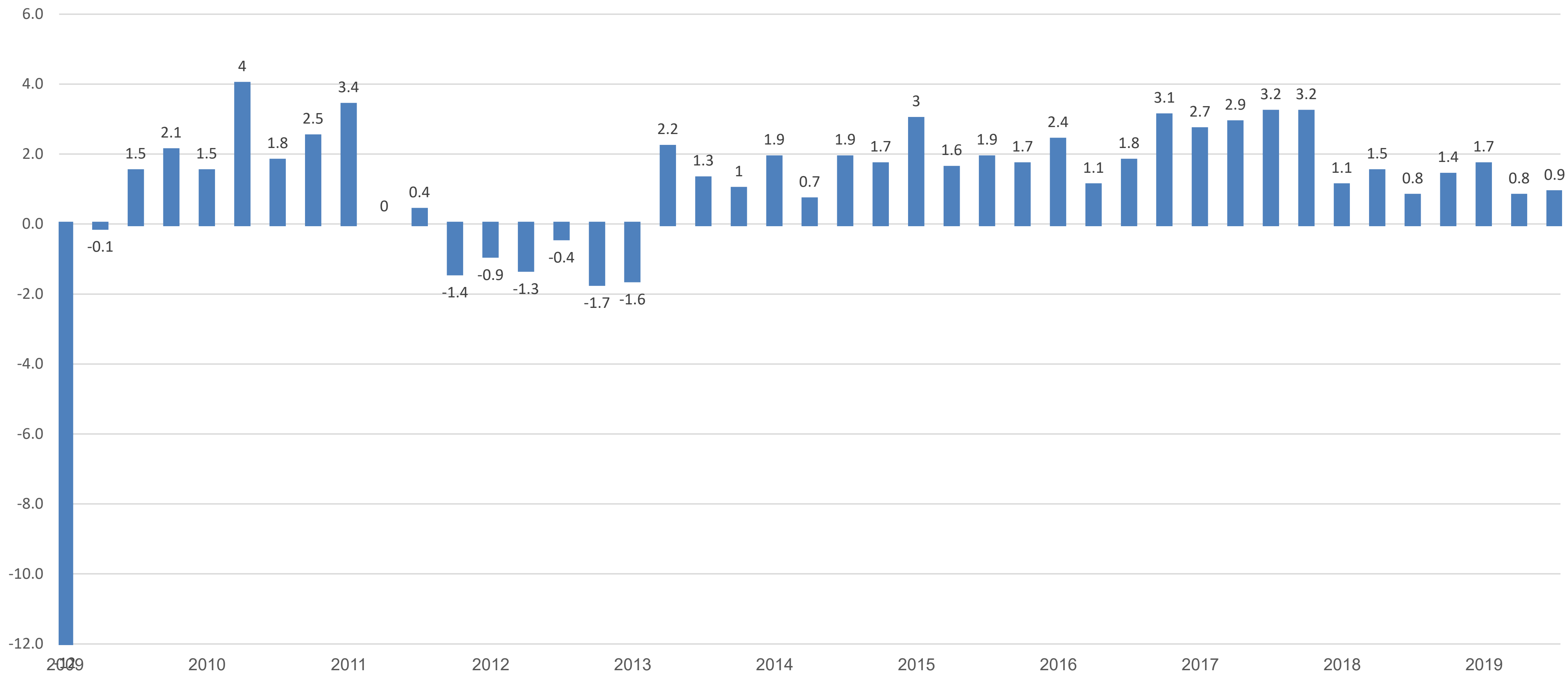
Economic Growth

GDP (Annualized)



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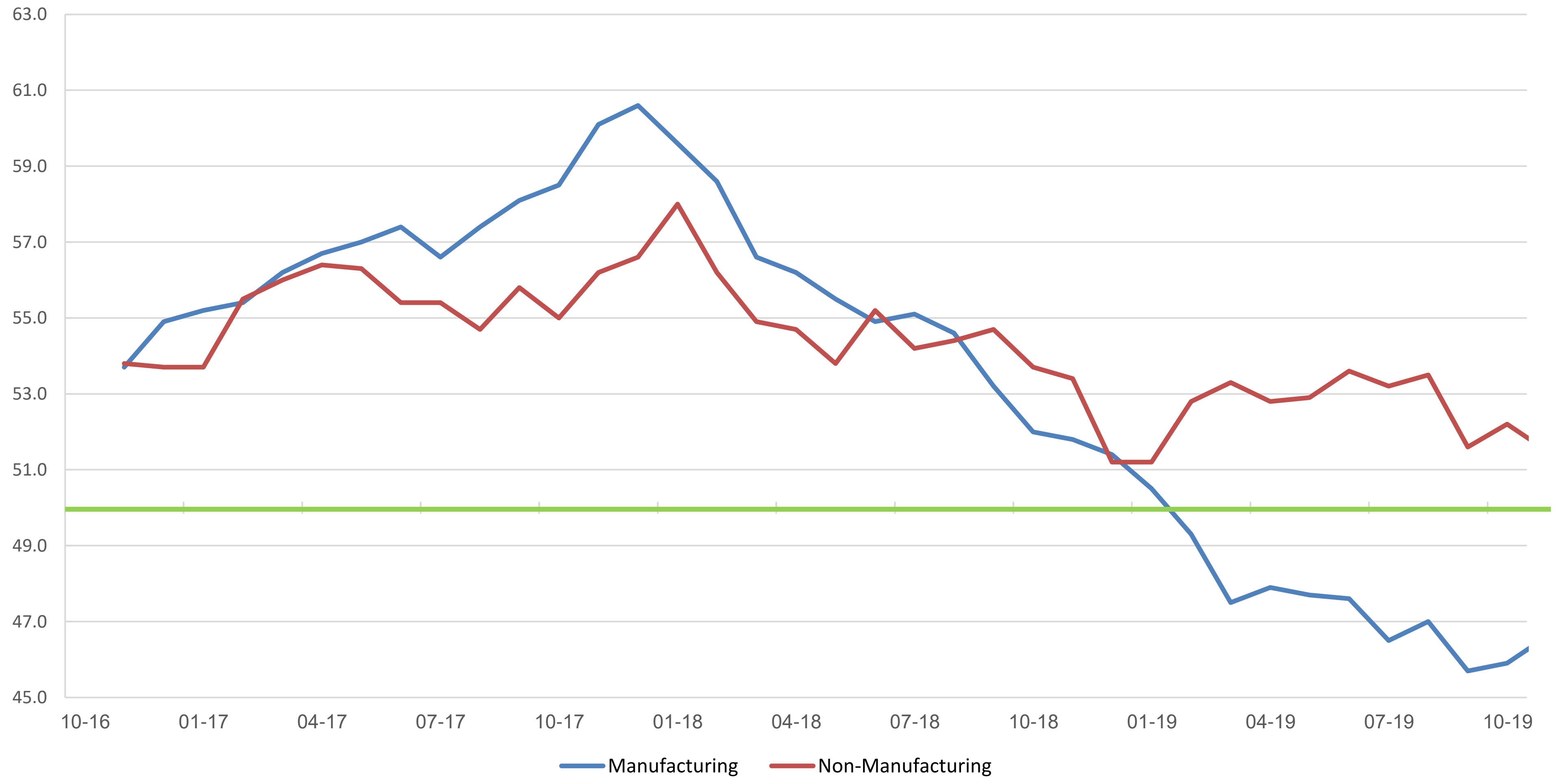
Economic Sentiment

Manufacturing and Non-Manufacturing PMI



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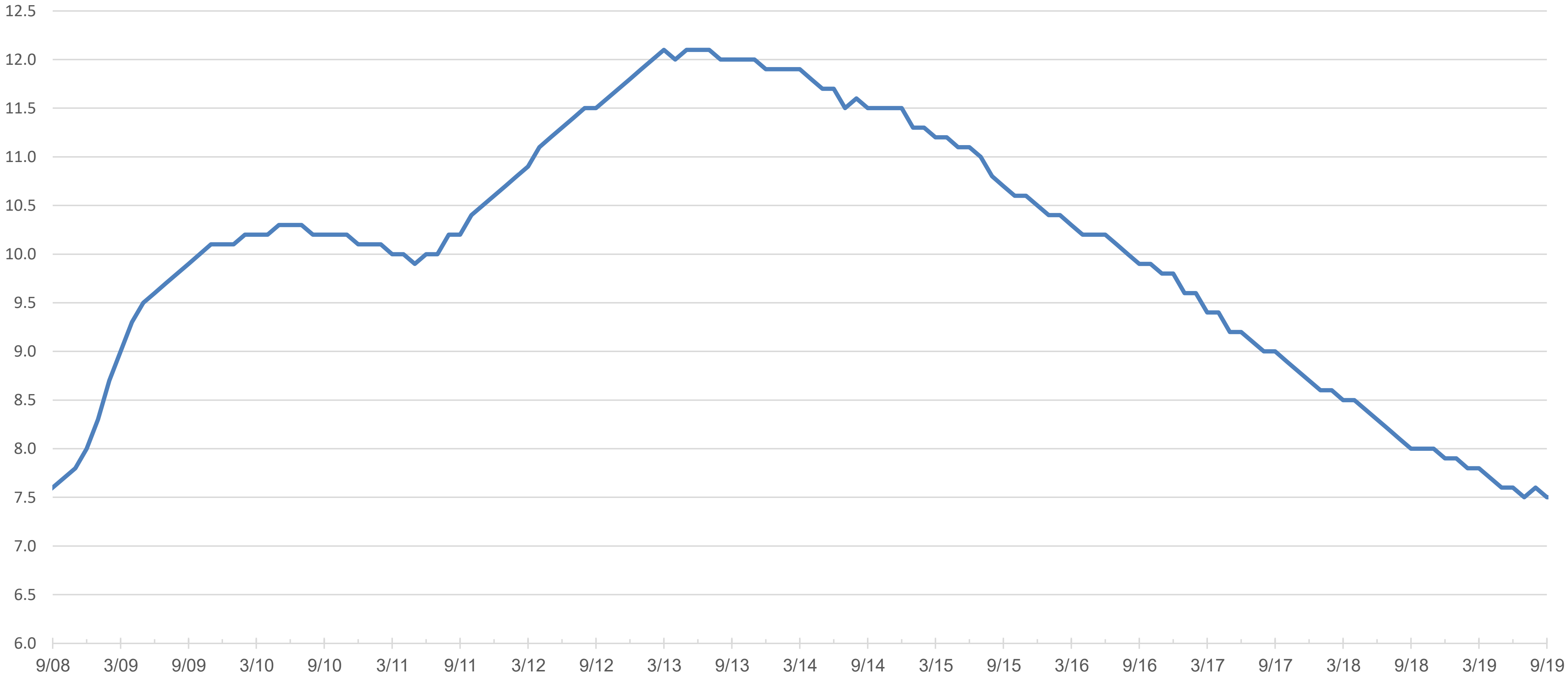
Labor Market

Unemployment Rate



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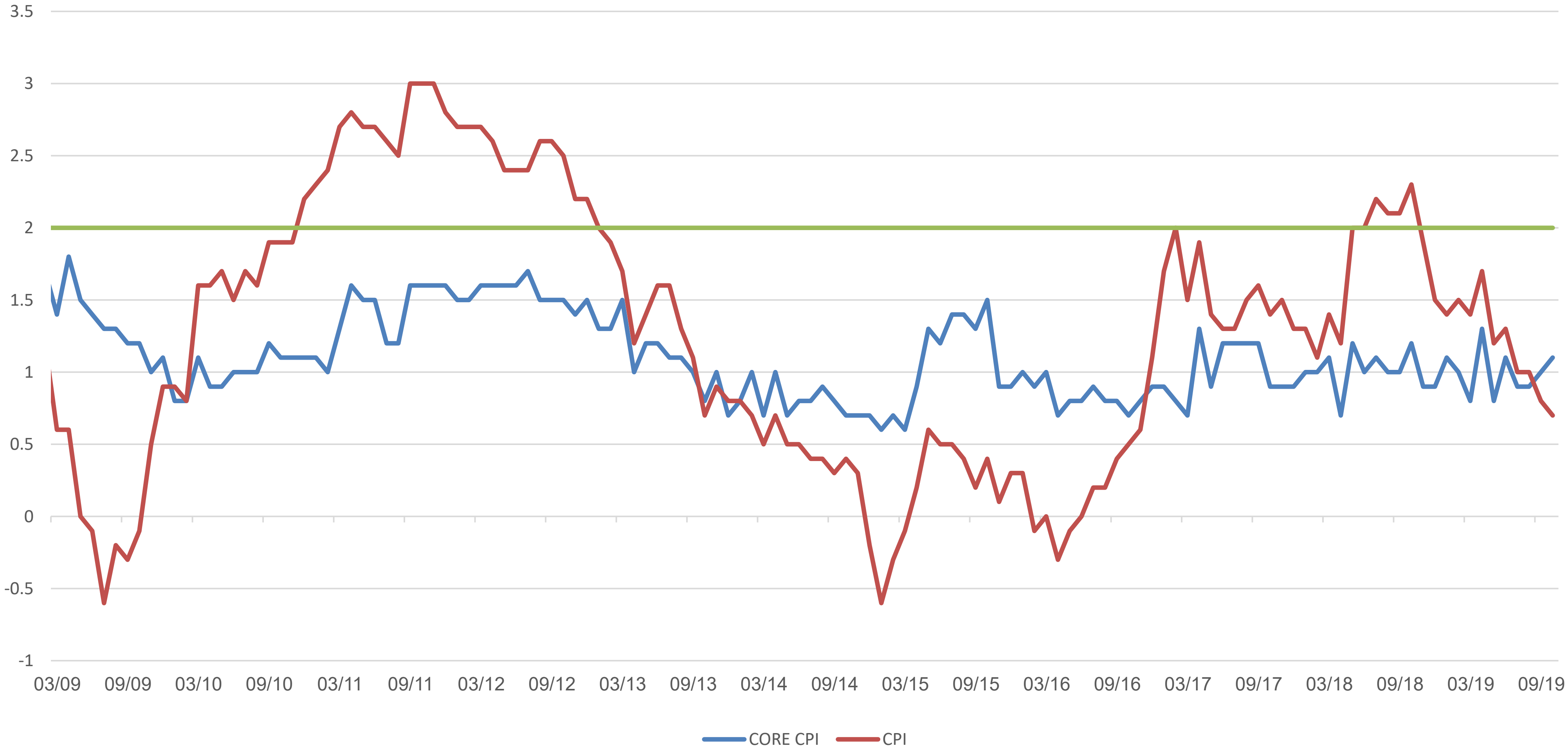
Inflation

CPI and Core CPI (YoY)



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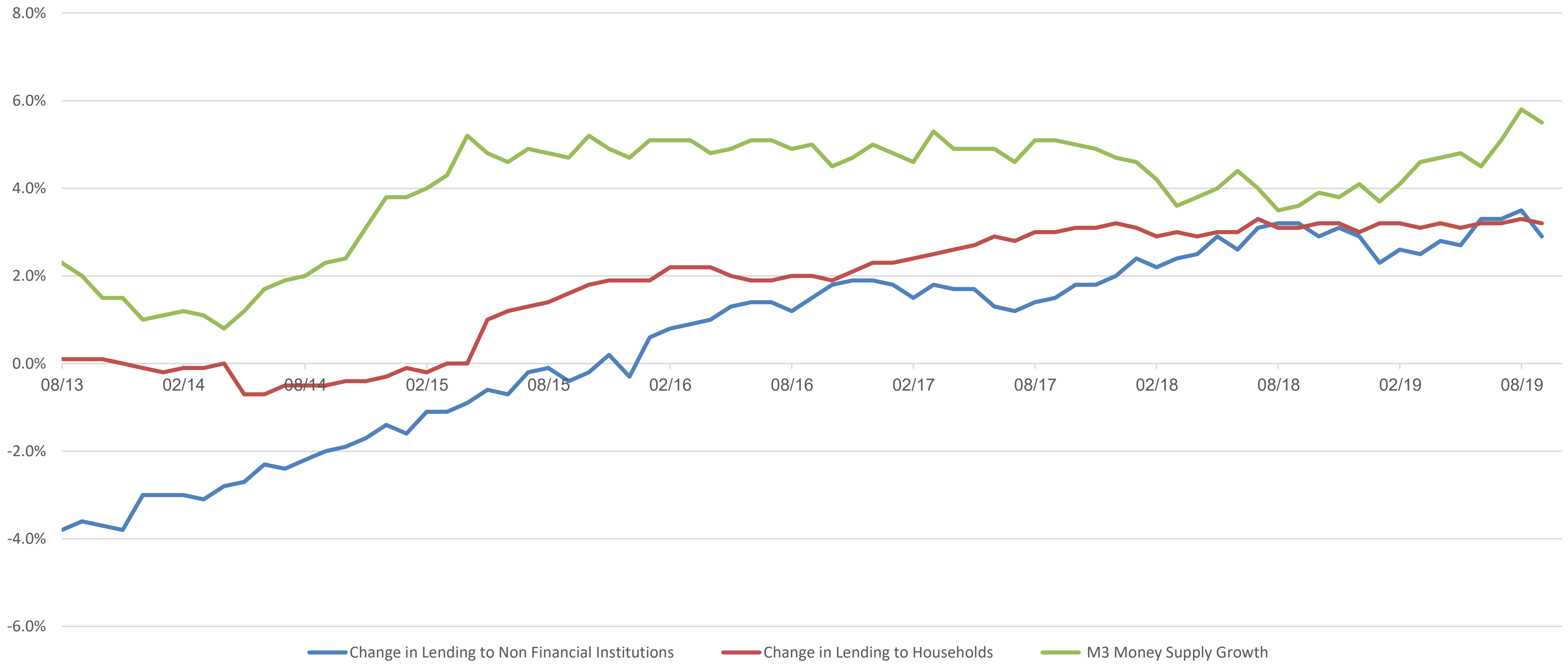
Money Supply and Credit

Growth in Money Supply, Loans to Real Sector



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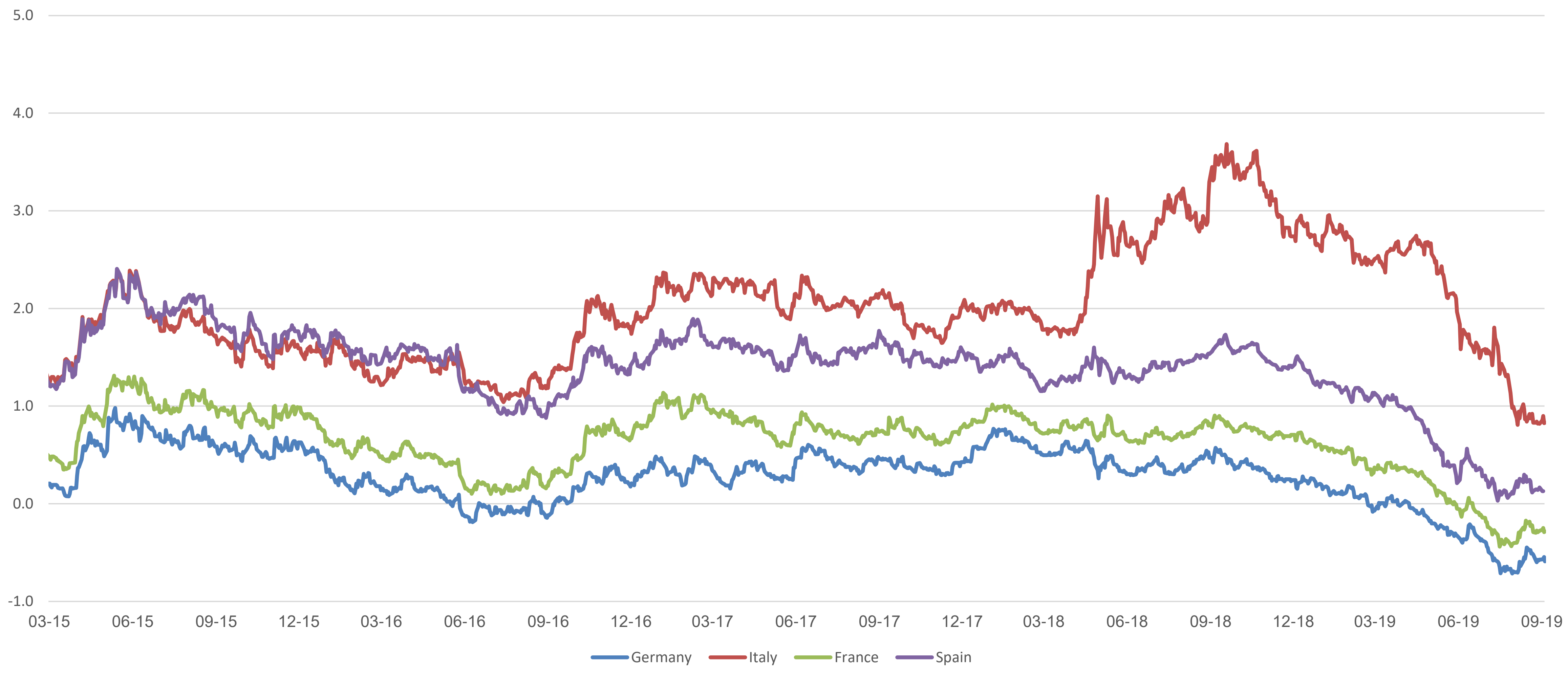
10YR Government Bond Yield



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Exchange Rate

EUR Index (Left) EURUSD (Right)

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Citi Economic Surprise

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Israel

- The deadlock in the political system continues and the possibility of a third elections become imminent. Now that both parties failed to reach an agreement and an indictment was filed against the prime minister, the political paralysis is expected to continue. Meanwhile, investors stay calm, assuming that the economy is strong enough to absorb uncertainty, and that the next government will stick to the principle of budgetary discipline

- The economy grew by 4.1% in Q3 (annually). The numbers seem to indicate robust growth but much of it is the result of inventory growth, vehicle purchases and public consumption. Weakness in the main growth engines of the economy, privet consumption and export, is evident

- The OECD downwards Israel economy's growth projections to 2.9% in 2020-2021. The slowdown in the global economy is expected to weaken exports, and the cooling of the labor market will reduce private consumption

- The Shekel continued to appreciate in the past month as it is one of the best performing currencies against the Dollar since the beginning of the year. In response, the Bank of Israel ("BOI") had to buy $ 314 million during October, the first real intervention since early 2018 and a signal for additional foreign exchange purchases he plans to make

- Despite the fall in the inflation rate to 0.4%, lower than the bottom of the inflation target range (1% -3%), the BOI decided not to reduce interest rate. However, the appreciation of the shekel, and the possibility of a further decline in inflation, led the BOI to back the interest rate decision with massive USD purchases, while leaving the door open for interest reduction later

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Core Economic Indicator

Israel

Economic Indicator	Latest Figure	Reference Period
Growth Rate	4.1%	Q3-2019
Unemployment Rate	3.4%	October-2019
Inflation Rate (YoY)	0.4%	October-2019
Central Bank Interest Rate	0.25%	November-2019
10 Years Yield	0.82%	November-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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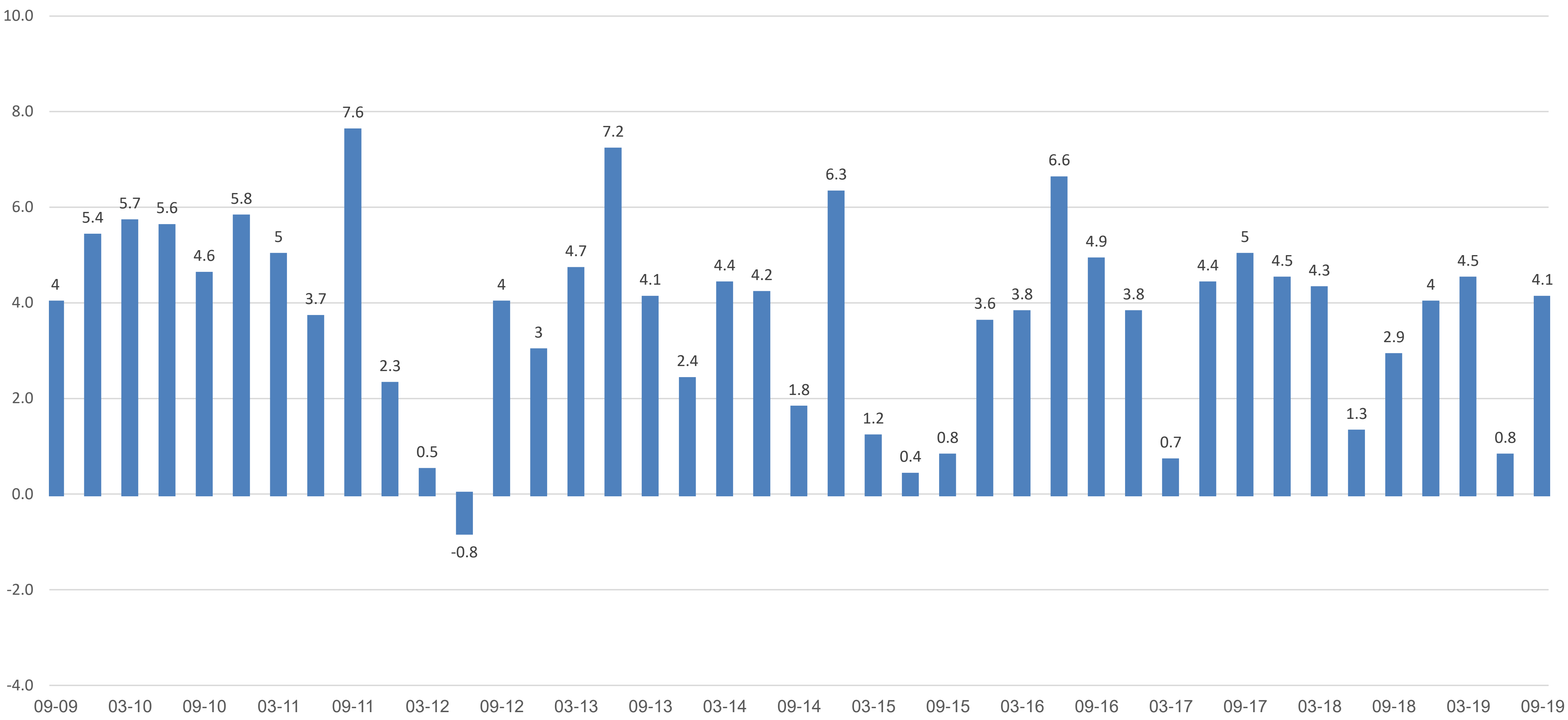
Economic Growth

GDP (Annualized)



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Labor Market

Unemployment Rate

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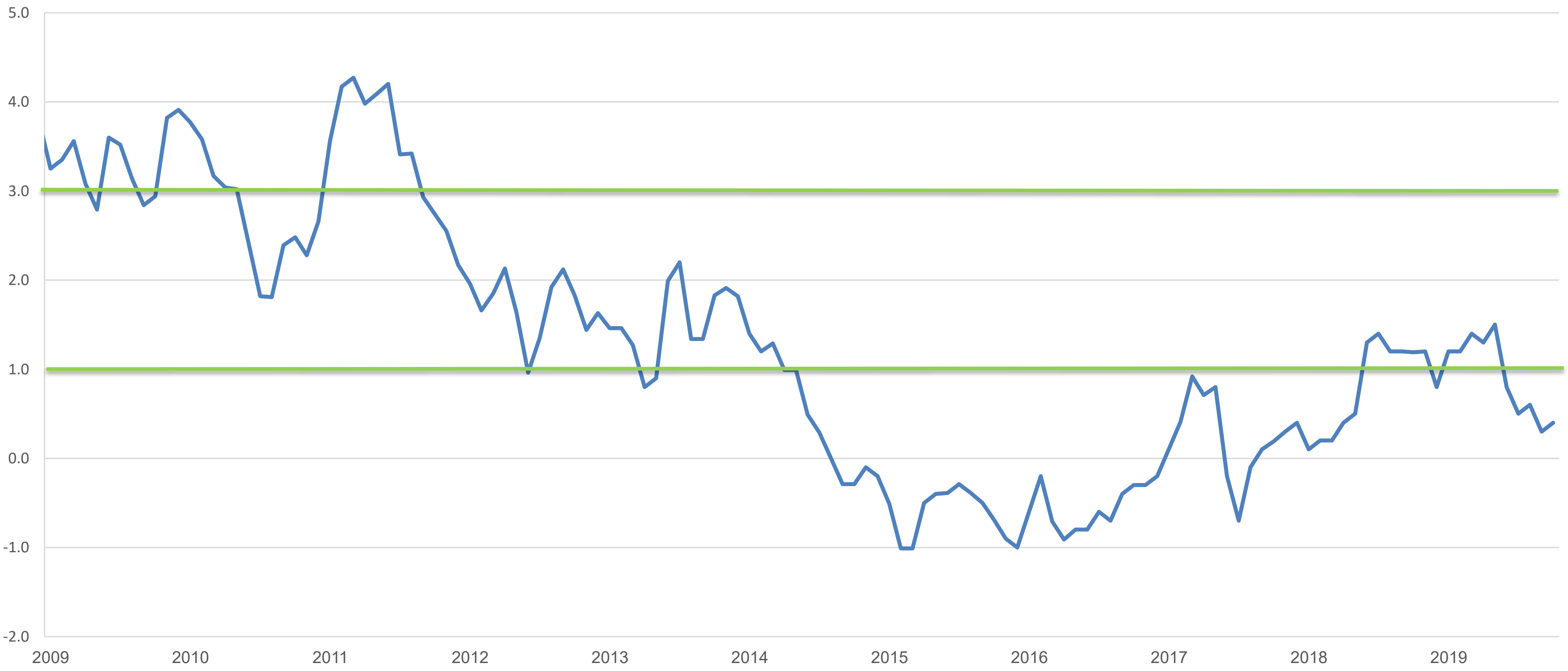
Inflation

CPI (YoY)



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10YR Government Bond Yield

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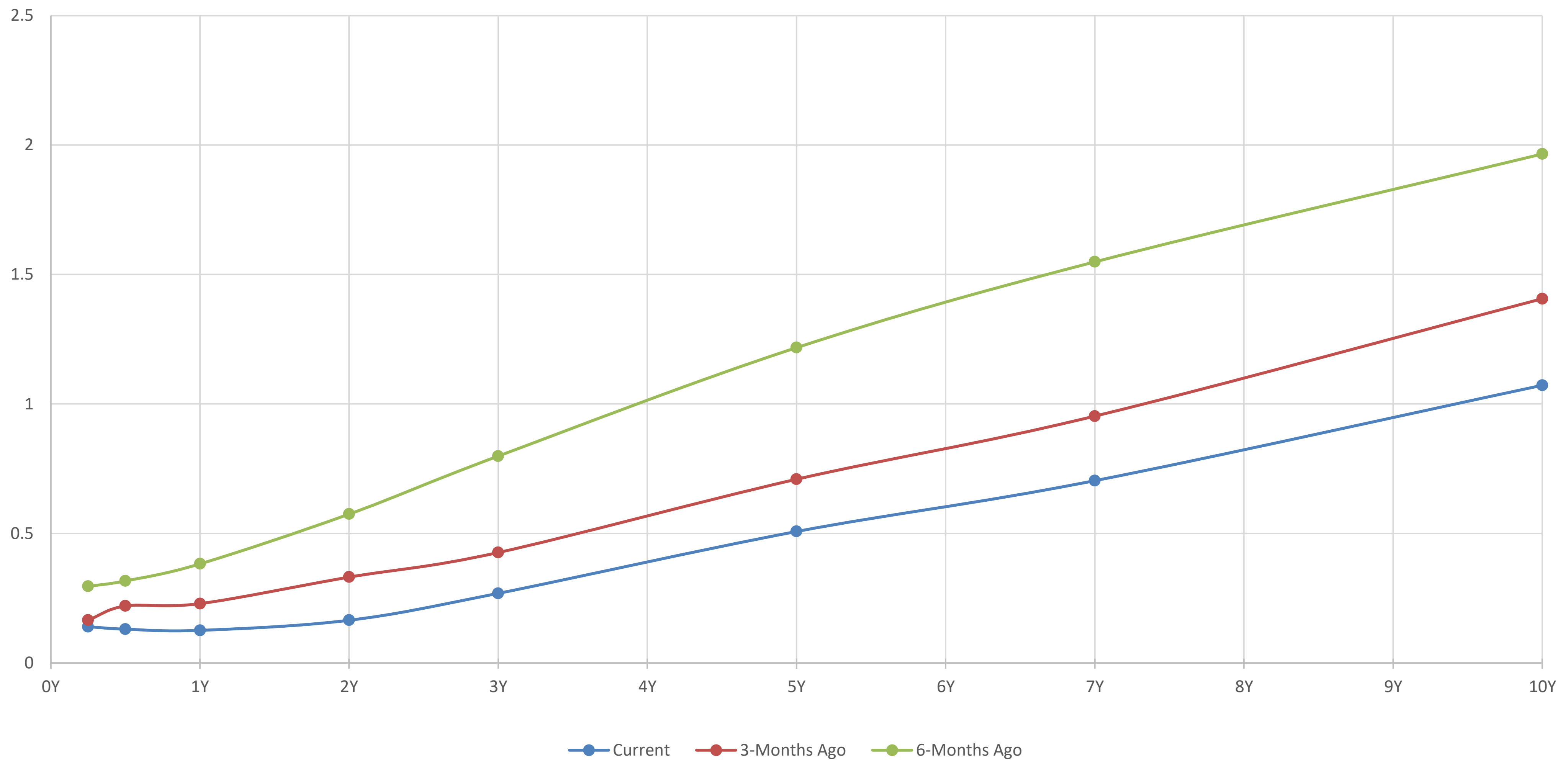
Government Bond Yield Curve



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Hedging Costs

USDILS 1YR Forward Premium

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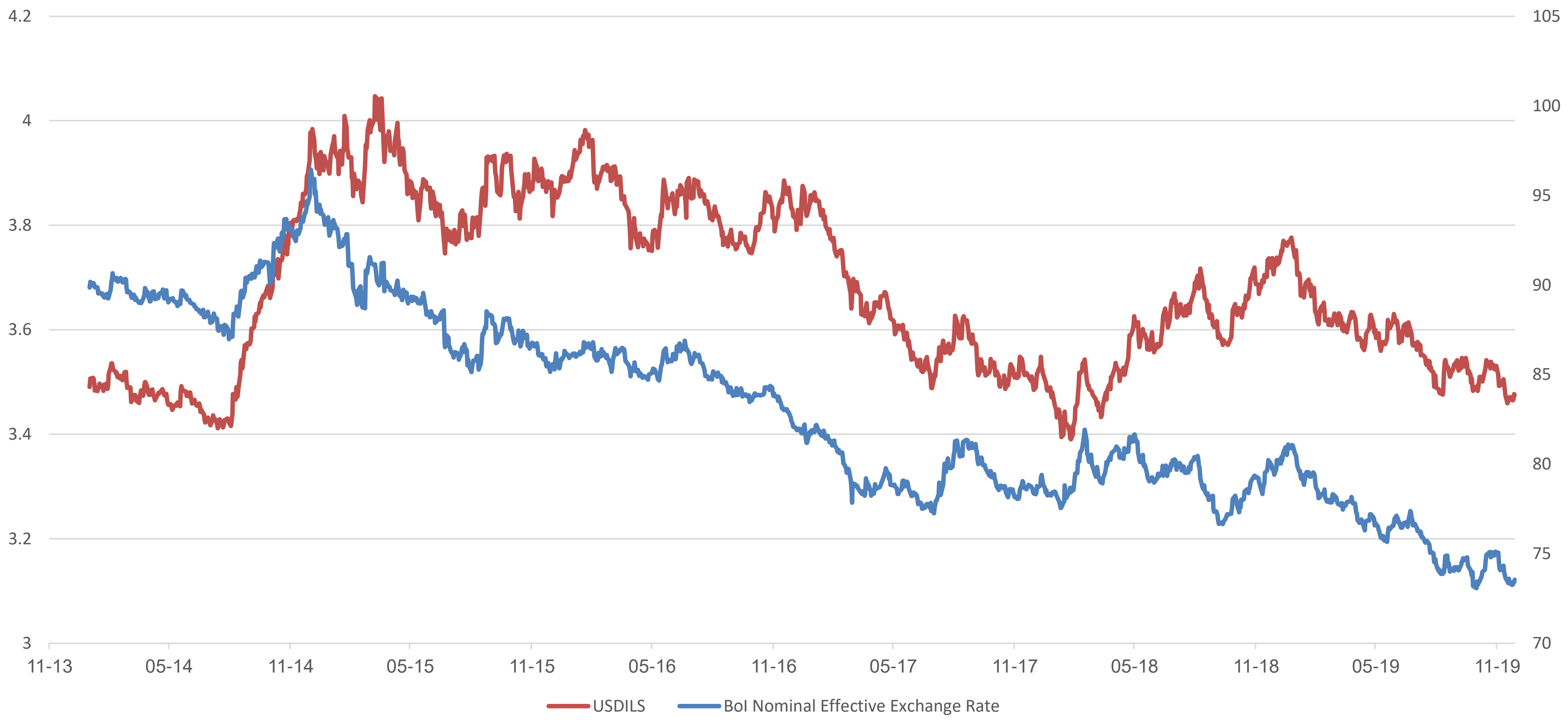
Exchange Rate

USDILS (Left) BOI Nominal Effective Rate (Right)



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CREATING THE RIGHT PICTURE

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