Global Macroeconomic Monthly Review

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Key Issues and Table of Contents

- *Global economic activity increased in the second quarter of 2023, despite weakness in industrial sectors.*
- *The GDP of the euro bloc increased in the second quarter of 2023, undeterred by the contraction in the GDP of Italy, and a lack of growth in activity in the German economy.*
- *The GDP of China increased in the second quarter by a lower-than-expected rate, and the authorities there are expected to increase support for economic activity by focusing on raising employment and real government investment.*
- *In its July interest rate decision, the ECB hiked the central bank rate 25bps to 4.25%.*
- *The annual inflation rate in the euro bloc fell in July, yet core inflation remained unchanged at an elevated level.*
- *The central bank of Japan broadened its fluctuation band around 10-year government bond yields to 1.0% from its 0% target level, effectively expanding its tolerance by a further 50bps.*
- *The long yields of the larger euro bloc economies increased slightly in July.*

- *Economic activity increased in the second quarter of 2023, in contrast to less positive preliminary expectations in the market, and moderate growth is expected to continue in the second half of 2023.*
- *With that said, the pace of private consumption growth is expected to slow markedly.*
- *The gradual loosening in the labor market is expected to continue in the second half of 2023.*
- *The downward trend in housing prices halted in the first half of 2023. The Fitch credit rating agency lowered its rating on the US to 'AA+'.*
- *In its July interest rate decision, the Fed hiked the federal funds rate to a range of 5.25-5.50%.*
- *In our view, the macro-economic data may support an additional rate hike.*
- *Credit conditions in the economy remain tight and indicate the concerns of US banks regarding a substantial slowdown in the economy.*
- *The inflation rate continued to decline in June. Yields on long-term government bonds rose in July.*

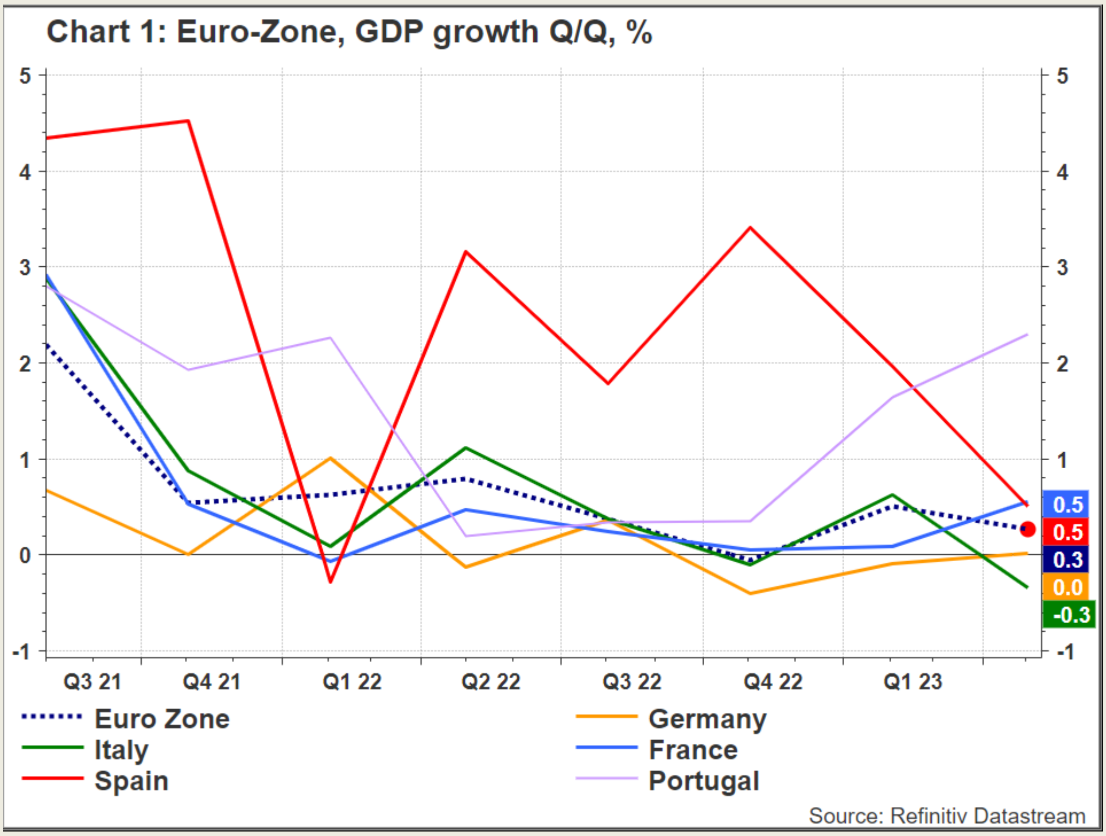
Leumi Global Economic Forecast, As of August 2023

	2020	2021	2022	2023E	2024F
GDP – Real Growth Rate					
World	*-2.8%*	*6.3%*	*3.4%*	*2.8%*	*3.0%*
USA	*-2.8 %*	*5.9%*	*2.1%*	*1.6%*	*0.6%*
UK	*-11.0%*	*7.6%*	*4.0%*	*0.2%*	*0.6%*
Japan	*-4.3%*	*2.1%*	*1.1%*	*1.3%*	*1.0%*
Eurozone	*-6.4%*	*5.4%*	*3.5%*	*0.5%*	*1.2%*
South East Asia (ex. Japan)	*-3.4%*	*3.8%*	*5.2%*	*4.3%*	*4.7%*
China	*2.2%*	*8.5%*	*3.0%*	*5.2%*	*4.7%*
India	*-5.8%*	*9.1%*	*6.8%*	*7.0%*	*6.1%*
Latin America	*-6.8%*	*7.0%*	*4.0%*	*1.4%*	*1.6%*
Israel	*-1.9%*	*8.6%*	*6.5%*	*2.6%*	*3.3%*
Trade Volume, Growth (%)					
Global	*-7.8%*	*10.6%*	*5.1%*	*2.4%*	*3.5%*
Interest rates, Year End					
US Fed	*0.00-0.25%*	*0.00-0.25%*	*4.50%*	*5.25-5.75%*	*3.75-4.25%*
Bank of England	*0.1%*	*0.1%*	*3.50%*	*5.00-5.50%*	*3.75-4.25%*
Bank of Japan-Policy Rate	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
ECB-Main Refi	*0.00%*	*0.00%*	*2.50%*	*4.25-4.75%*	*3.50-4.00%*
Israel	*0.1%*	*0.1%*	*3.25%*	*4.75%-5.25%*	*3.50-4.00%*

The Global Economy -- Overview

Economic activity: global economic activity increased in the second quarter of 2023, despite weakness in industrial sectors. The GDP of the euro bloc increased in the second quarter of 2023, undeterred by the contraction in the GDP of Italy, and a lack of growth in activity in the German economy. The GDP of China increased in the second quarter by a lower-than-expected rate, and the authorities there are expected to increase support for economic activity by focusing on raising employment and real government investment.

- Global economic activity continued to grow in the second quarter of 2023, mainly supported by services sector activity, while manufacturing activity remained weak. Growth in economic activity occurred in the developed and developing countries, while growth in the US was above the preliminary market expectations and greater than the GDP growth rate of the euro bloc.
- Euro bloc GDP grew 0.3% in the second quarter of 2023 (q/q), following weak activity in the first quarter of the year, and even contraction in the final quarter of 2022. The latest growth was supported by a moderation in inflationary pressures, which led to an increase in demand. However, continued interest rate hikes and an on-going decline in business confidence are likely to continue to weigh on economic activity growth in the second half of 2023.
- In a breakdown by country, it appears that economic activity in France and Spain is consistently growing. In Germany, activity was at a standstill in the second quarter, this following a contraction in activity in the final quarter of 2022 and the first quarter of 2023. We note that preliminary indicators are showing an additional deterioration in economic activity in the manufacturing sectors, coupled with weakness in activity in the services sector.



The GDP of Italy contracted in the second quarter of 2023, due to weakness in manufacturing. Italy's July PMI indicates continued weakness in manufacturing activity, alongside moderation in the growth rate of economic activity in the services sector, thus indicating that Italian economic activity overall will remain weak. We note that Italy is more sensitive than the other large economies of the euro bloc to the tightening monetary policy of the ECB.

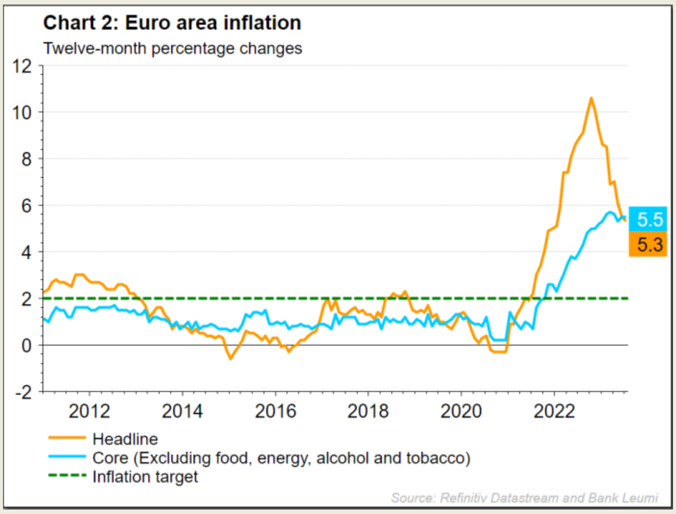
- The labor market of the euro bloc remained tight in June while the unemployment rate remained stable throughout April-May 2023 at 6.4%, the lowest level since the establishment of the euro bloc. In our view, monetary policy tightening is expected to lead to a slight uptick in the unemployment rate later in 2023, and the preliminary indicators even show weakness in employers' intention to recruit workers. However, any rise in the unemployment rate is not expected to be substantial, due to the tight labor market in the euro bloc and the very shallow recession across Europe, such that unemployment is expected to remain near its historic low and to support a rise in wages later on.
- Chinese GDP increased 0.8% in the second quarter of 2023 (q/q), below expectations, after having grown 2.2% in the first quarter of 2023 (q/q). Over the last four quarters ending in the second quarter of 2023, China's GDP increased by a rate of 6.3%, due to the impact of a base effect, which stemmed from the fact that the GDP in the second quarter of 2022 was low as a result of the policy of implementing regional shutdowns in the larger cities of China. The macro-economic data indicate that the recovery in economic activity that was supported by the renewed opening of the economy, following the shutdowns that were implemented against the backdrop of the spread of the coronavirus in China, has slowed recently. This slowdown, and the risks against sustained growth, are worrying the authorities in China. Thus, the government is expected to increase its support in the market in the coming months, in order to return the economy to a more rapid path of recovery.
- Until now, the policy makers in China helped the market mainly by means of lowering interest rates, although it appears now this is not sufficient to accelerate economic growth. This comes in light of the weakness in the external environment, coupled with financial difficulties in certain areas and insufficient demand. It appears the decision makers prefer to invest in incentives to expand local demand. This is accomplished through indirect support for household income mainly by encouraging employment, which will support an increase in private consumption later on. This support is expected to remain focused on providing assistance to companies in order to increase employment, and in real investments by the government. One area of special importance is the realm of real estate, and it is expected the government will transition to an even more supportive policy stance on this matter, which is likely to include solutions for a positive response to the housing needs of residents, with a substantial increase in the construction of public housing.
- Looking ahead, euro bloc economic activity is expected to remain weak throughout the remainder of 2023. Global GDP is expected to increase in 2023 by a rate of 2.8%, while in 2024 growth is expected to be slightly higher at a rate of 3.0%. The GDP growth forecast of the euro bloc has moderated, and we currently estimate GDP to grow in 2023 by a rate of 0.5%, while in 2024 it is expected to grow by a rate of 1.0%.

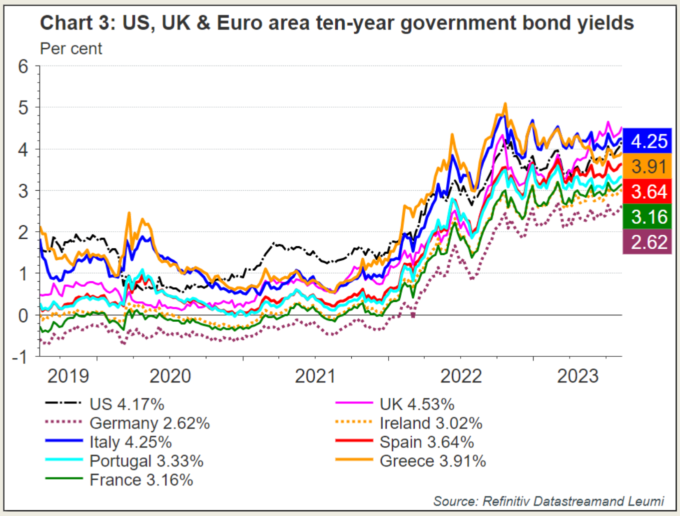
Inflation and monetary policy: in its July interest rate decision, the ECB hiked the central bank rate 25bps to 4.25%. The annual inflation rate in the euro bloc fell in July, yet core inflation remained unchanged at an elevated level. The central bank of Japan broadened its fluctuation band around 10-year government bond yields to 1.0% from its 0% target level, effectively expanding its tolerance by a further 50bps. The long yields of the larger euro bloc economies increased slightly in July.

- In its July interest rate decision, the ECB hiked the central bank rate 25bps to 4.25%, and the interest rate on deposits increased to 3.75%. This rate hike was in-line with market expectations, and we estimate there will be at least one additional rate hike of 25bps. The interest rate statement was refined compared to the statement in the previous interest rate decision. The President of the ECB changed the wording and instead of saying that in the upcoming meetings the interest rates will be raised to sufficiently restrictive levels, the current statement says future decisions "will ensure that the key ECB interest rates will be set at sufficiently restrictive levels for as long as necessary". This change in the wording suggests that the current cycle of interest rate hikes is close to its conclusion, although the interest rate is expected to remain at a relatively high level for a sustained period.
- Whereas the Fed and the ECB continued to raise interest rates in their latest policy decisions, central banks in some of the emerging markets are expected to expand the process of interest rate cuts in the coming months. This does not include all the emerging markets, for example Russia and Turkey recently raised interest rates. Instead, rate cuts are likely to occur in countries that are able to ease the current tight monetary policy in light of clear signs of a drop in the inflation rate. Thus, the central bank of Hungary is expected to continue a process of lowering interest rates, and the central bank of Chile is expected to cut rates soon, as is the central bank of Brazil.
- In Britain, the central bank hiked its interest rate in the beginning of August by 25bps to 5.25%. This occurred despite a downtrend in the inflation rate, which declined in June from 8.7% to 7.9%. This inflation rate is substantially above the target and thus supports continued monetary policy tightening. This is particularly in light of the very moderate decline in core inflation, which fell in June to 6.9% after it had climbed in April-May to a peak level of 7.1%.
- In a surprise move, the central bank of Japan announced an easing to its fluctuation band around 10-year government bond yields within its yield curve control program (YCC), to 1.0% above and below 0%, instead of the previous 0.5% limitation in either direction. Thus, the central bank will permit an increase in yields to 1%, against the backdrop of the rise in government bond yields of developed economies around the world. The expansion of the fluctuation band on Japanese 10-year government bond yields represents a tool of the central bank to battle against pricing pressures in the economy, and we estimate the slowdown in the inflation rate will lead the central bank of Japan to maintain the current short-term interest rate, at a level of minus 0.1%, and the central bank will not raise the interest rate in the coming months.
- The rise in global commodities prices stems from, among other things, the rise in oil prices, due to the tightening in supply in the markets resulting from, among other reasons, the reduction in Russian oil exports and a drop in Saudi Arabian oil production. In addition, the

price of rice increased due to a drop in exports from India, which is the largest rice exporter in the world and responsible for 40% of rice exports. Sugar prices increased as well, resulting from restrictions on the export of sugar from India, which is the second largest producer of sugar in the world, due to a drop in output that was caused by, among other reasons, poor weather conditions. These factors are likely to weigh on the slowdown in the inflation rate in developed as well as in developing countries, and to lead to inflation remaining, within a large number of countries, at above target levels for a more sustained period than previously expected until now.

- The consumer price index of the euro bloc, the Harmonized Index of Consumer Prices (HICP), fell 0.1% in July (m/m), and the annual inflation rate fell to 5.3% (see Chart 2). This comes against the backdrop of a slowdown in food inflation and a decline in the energy components resulting from base effects of the high energy prices that prevailed across Europe in the parallel period last year against the backdrop of the shortage in natural gas in the European market. However, the annual rate of core inflation, which is more important for the ECB in its decision making regarding monetary policy, remained unchanged in July at a rate of 5.5%, after it had climbed in June from 5.3% to 5.5%. The lack of change in core inflation underscores the persistent inflationary pressures in the core components of the consumer price index and thus supports restrictive monetary policy. In our view, the inflation of the energy components is expected to continue to decline in the coming months, as the energy prices in Europe from last year gradually exit the 12-month moving window of calculation; and the slowdown in the rate of increase in food prices is expected to continue. These developments will help to further decrease the inflation rate in the euro bloc. However, inflation in the core components is expected to decline by a more moderate rate.
- Yields on the long-term government bonds of the larger economies of the euro bloc increased slightly in July; however, analysis over the longer-term shows that since the beginning of 2023 long-term yields of the largest euro bloc economies have not changed substantially, after they had increased starting from the second half of 2021. In contrast, the rise in yields in Britain has continued also during 2023 (see Chart 3).

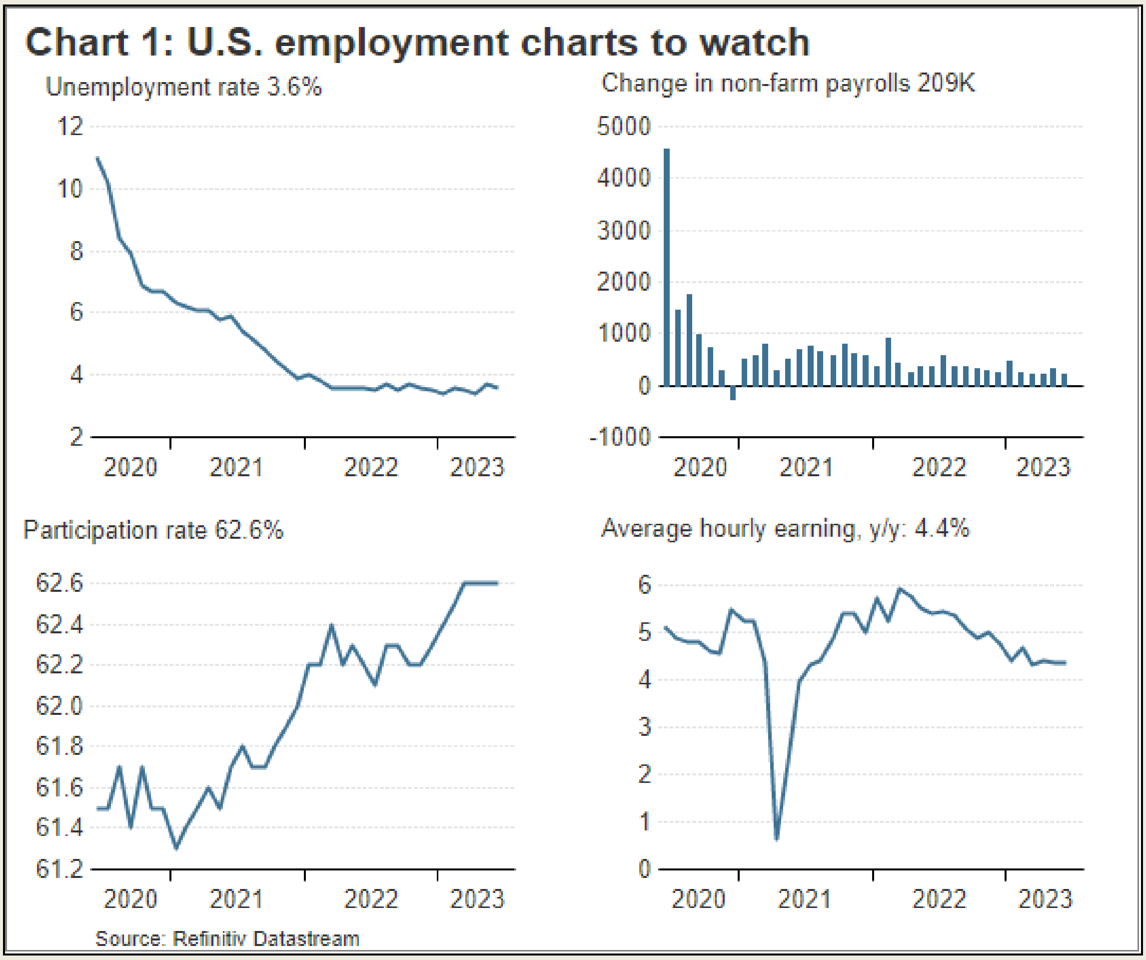




United States

Economic activity: economic activity increased in the second quarter of 2023, in contrast to less positive preliminary expectations in the market, and moderate growth is expected to continue in the second half of 2023. With that said, the pace of private consumption growth is expected to slow markedly. The gradual loosening in the labor market is expected to continue in the second half of 2023. The downward trend in housing prices halted in the first half of 2023. The Fitch credit rating agency lowered its rating on the US to 'AA+'.

- Relatively strong growth in US GDP in the second quarter of 2023 substantially lessens the concerns about a recession in the US economy for this year, thereby suggesting the US will experience a "soft landing", against the backdrop of monetary policy tightening. This growth supports an additional tightening in monetary policy, yet the decision will be dependent as well on the inflation and employment data to be published up until the upcoming interest rate decision at the end of September.
- US GDP grew in the second quarter of 2023 by a real rate of 2.4% (q/q), above market expectations, which caused GDP to grow in the first half of 2023 by the potential rate of the economy. Private consumption growth slowed in the second quarter to a rate of 1.6% (q/q), and residential investments contracted 4.2% (q/q), indicating the restraining influence of monetary policy tightening. With that said, growth in business sector investments accelerated from 0.6% to 7.7% (q/q). Investment in non-residential construction increased 9.7% (q/q), against the backdrop of accelerated construction in high-tech factories, and the easing in supply chains supported strong growth in investment in business equipment.
- The labor market continued to weaken in the second quarter of 2023, despite a drop in the unemployment rate in June from 3.7% to 3.6% (see Chart 1). The number of new jobs fell in June to 209,000, coming in below market expectations, with this number now being the lowest since the beginning of 2021. A slowdown in wage growth is expected to continue in the coming months, and this development, together with the weakness in the labor market, is expected to lead the weekly number of hours worked to drop in the future. Consequently, a slowdown is expected in the real rise in household income. These factors, together with the tightening in credit terms and the cancellation of President Biden's plan to forgive student debt, which is expected to lead to the renewal of loan payments, are expected to weigh on private consumption growth in the second half of 2023.



- Industrial production contracted in June, for the first time since March 2021, after this had increased by a low rate in May. Preliminary indicators are showing weakness in the US manufacturing sector. The Institute for Supply Management (ISM) index is indicating a decline in worker demand, against the backdrop of expectations for a drop in new orders, while the PMI indicates weakness in manufacturing as well, alongside a slowdown in the services sector. This slowdown in US manufacturing, coupled with the economic recession in Europe, is expected to lower domestic demand for commodities in the US. The developments in the American economy are expected to continue to weigh on the ability of the US business sector to raise aggregate profitability, and the increase in profits is expected to contract moderately, yet consistently.
- The downtrend in housing prices has halted since February, as housing prices increased in February-May 2023. This is despite the rise in 30-year mortgage interest rates, which have stabilized recently around 6.8%, and even slightly above this. The rise in prices is occurring in parallel to opposing trends in the new and used housing markets. The number of new homes sold increased in April-May, and despite a slight dip in June, the number of new homes sold remains high. In contrast, the number of existing homes sold in March-June was in a downward trend, after these increased sharply and in an extraordinary manner in February. These trends likely suggest that it is possible contractors are offering various incentives for purchasing homes, which are not reflected in the price.

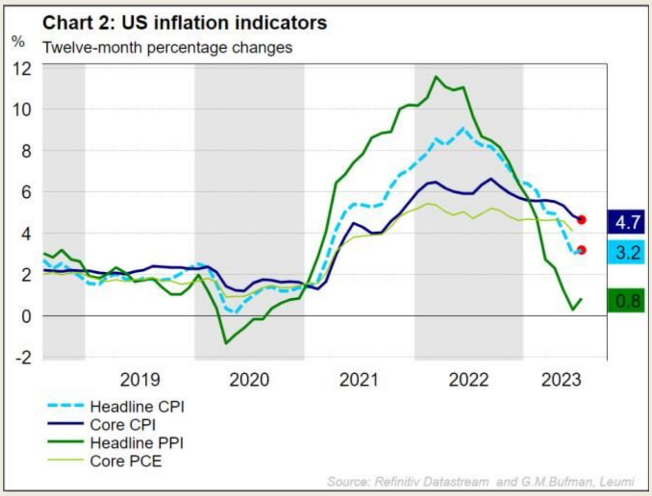
- The Fitch credit rating agency lowered its credit rating on the US in the beginning of August 2023 from ‘AAA’ down to ‘AA+’. This is due to expectations for continued deterioration in the fiscal position of the US in the coming years, which is likely to increase the government debt burden. This comes alongside an erosion in the relations between the government factions, which is being expressed in an inability to reach agreements on a solution to the problem of the US government debt ceiling despite the last-minute agreement reached on this matter that pushed the problem to the beginning of 2025. In our view, the cut in the US credit rating is likely to lead to an additional slight uptick in US long-term government bond yields, this in continuation of the rise that has occurred since May 2023. It appears that 10-year bond yields in the US will hover around 4.0% - 4.2% for the foreseeable future.
- Looking ahead, the data are indicating that the US economy is succeeding to achieve a “soft landing”, while the economy is expected to continue grow in the second half of 2023. However, the growth rate of private consumption is expected to slow substantially. In our view, US GDP will increase 1.6% in 2023, while in 2024 a lower growth rate of 0.6% is expected.

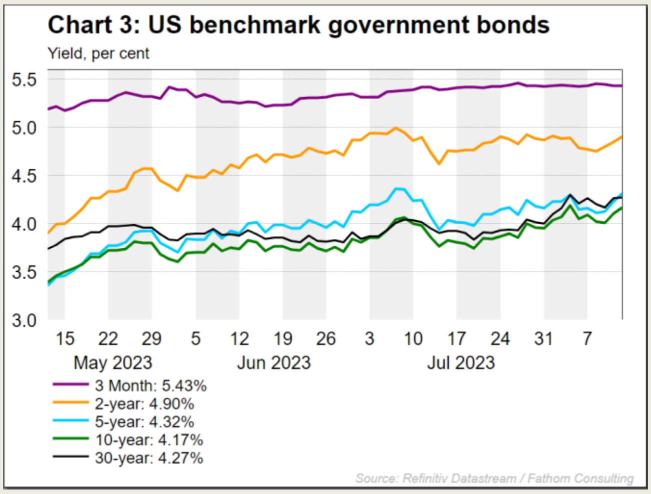
Inflation and monetary policy: in its July interest rate decision, the Fed hiked the federal funds rate to a range of 5.25-5.50%. In our view, the macro-economic data may support an additional rate hike. Credit conditions in the economy remain tight and indicate the concerns of US banks regarding a substantial slowdown in the economy. The inflation rate continued to decline in June. Yields on long-term government bonds rose in July.

- In its July interest rate decision, the Fed continued to tighten monetary policy as it hiked the federal funds rate 25bps to a range of 5.25-5.50%, in-line with market expectations. This comes after the Fed paused its series of rate hikes in the previous interest rate decision from June. The recent data, with an emphasis on the relatively high GDP growth rate in the second quarter of 2023, and also the drop in June’s unemployment rate, support additional monetary tightening. In our view, in the upcoming interest rate decision that will take place in September, the Fed is may hike the federal funds rate by an additional 25bps, although any such rate hike will be dependent on the inflation and employment data to be published during August and in the first half of September.
- Looking ahead, the rise of oil prices and the prices of agricultural may support an acceleration of inflation in the August-September CPI figures and lay the foundation for an additional rate hike. The inflation of the housing component within the CPI, which is primarily rent based, has eased only slightly and is supportive of a further rate hike. Last but not least, inflation of the "super-core" element of CPI – core services prices excluding housing, is still relatively high and has increased recently and this may also support one additional rate hike.
- The survey of credit officers by the Fed indicates that credit conditions in the economy remain very tight, despite diminishing concerns over the development of a crisis in the banking sector. The percentage of banks that are making requirements stricter for the granting of credit to the trade and manufacturing sectors reached a new peak; however, on the other hand,

there has been a slight easing in the requirements for the granting of credit in the commercial real estate sector. The tight credit conditions currently seen in the economy occurred in the past only during periods of recession or just before periods of recession. This situation hints at the fears in the US banking sector that the growth registered in the second quarter stemmed from temporary factors and that American banks are preparing for a period of substantial slowdown in the economy. In addition, the banks are being much more cautious when granting credit to households, as the worsening in credit conditions through credit cards is very high, currently at a level that was previously seen only during periods before a recession.

- The US consumer price index (CPI) increased 0.2% in July (m/m), while the annual inflation rate rose to 3.2% after falling in June from 4.1% to 3.0% (see Chart 2). The housing (shelter) component was the largest contributor to the increase in July's CPI. Core inflation fell moderately in July to an annual rate of 4.7%, which is still far from the 2% target. The producer price index (PPI) in the US increased 0.1% in June (m/m), following a 0.4% decline (m/m) in May, due to an increase in the services components. Following a notable decline in inflation last year, it appears the downward movement will moderate.
- As noted earlier, there are risks of a renewed rise in inflation, mainly from the realm of agricultural commodities prices and oil prices, and in the event the decline in inflation will indeed halt and a renewed rise in inflation will start, then this is likely to support an additional interest rate hike later on. It appears the Fed will focus on core inflation, which is at a level of 4-5% (depending on the specific index), in which the decline, has been slow and there is a large gap compared to the 2% target.
- The yields on US long-term government bonds continued to climb in June, despite a temporary decline that occurred in the second week of the month (see Chart 3). The rise in yields occurred across the entire curve, except at the very short end of 3-month durations, which are affected mainly by the interest rate decisions of the Fed. The curve remains inverted across all durations, which indicates the concerns of investors and the uncertainty prevailing in the market. CPI-linked yields (TIPS) fell in the first half of July, but returned to an upward trend in the second half of the month, such that overall, the short-term CPI-linked yields did not substantially change in July, whereas the long-term CPI-linked yields rose. In our view, US long-term bond yields are expected to continue to climb, due to the lowering in the US credit rating, such that further to the above, the yields on 10-year





government bonds will remain in the 4.0-4.2% range and 5-year to maturity yields are expected to be within the 4.3-4.5% range. Short- and medium-term CPI-linked yields (5-10 years) are expected to decline slightly in the coming months of 2023 to 1.5%.

Disclaimer

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