Global Macroeconomic Monthly Review

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Dr. Gil Michael Bufman, Chief Economist

Bnayahu Bolotin, Economist

Economics Department, Capital Markets Division

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Key Issues and Table of Contents

- *Global economic activity grew in the beginning of the second quarter of 2023, due to growth in the developing economies.*
- *The German economy slid into a technical recession, after the country's GDP contracted in the final quarter of 2022 and in the first quarter of 2023.*
- *The GDP of the euro bloc is expected to remain mostly unchanged in the second quarter of 2023, after having contracted in the first quarter, although the labor market is expected to remain tight.*
- *Economic activity in China and India continued to grow, yet a slowdown is likely against the backdrop of weakening demand.*
- *Headline inflation declined in the euro bloc in May, and core inflation moderated as well.*
- *Inflationary pressures from wages are continuing and the ECB raised the interest rate in the June by 25bps and it is expected to maintain high interest rates until 2024.*
- *Long yields of the larger euro bloc economies, as well as in Britain, continued to rise in May and in the first half of June, while the rise in yields in the euro bloc was moderate*

- *Growth in economic activity slowed, and GDP is expected to increase by slightly more than 0% in the second quarter of 2023, with the bulk of growth stemming from the services sector.*
- *A gradual loosening in the labor market is continuing, this despite an increase in the number of jobs, and the unemployment rate increased in May to 3.7%.*
- *The downtrend in housing prices halted in February-March 2023*
- *In its June interest rate decision, the Fed left the interest rate unchanged and indicated the possibility of raising the interest rate in the upcoming interest rate decisions.*
- *The annual inflation rate fell in May, yet core inflation declined modestly.*
- *Yields on CPI-linked and non-linked government bonds rose in May.*

Leumi Global Economic Forecast, As of June 2023

	2020	2021E	2022F	2023F	2024F
GDP – Real Growth Rate					
World	*-2.8%*	*6.3%*	*3.4%*	*2.8%*	*3.0%*
USA	*-2.8 %*	*5.9%*	*2.1%*	*1.1%*	*0.7%*
UK	*-11.0%*	*7.6%*	*4.0%*	*0.2%*	*0.9%*
Japan	*-4.3%*	*2.1%*	*1.1%*	*1.3%*	*1.0%*
Eurozone	*-6.4%*	*5.4%*	*3.5%*	*0.6%*	*1.0%*
South East Asia (ex. Japan)	*-3.4%*	*3.8%*	*5.2%*	*4.3%*	*4.7%*
China	*2.2%*	*8.5%*	*3.0%*	*5.5%*	*4.9%*
India	*-5.8%*	*9.1%*	*6.8%*	*7.0%*	*6.0%*
Latin America	*-6.8%*	*7.0%*	*4.0%*	*0.8%*	*1.7%*
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%*	*5.00-5.50%*	*3.50%-4.00%*
Bank of England	*0.1%*	*0.1%*	*3.50%*	*5.00-5.50%*	*3.50-4.00%*
Bank of Japan-Policy Rate	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
ECB-Main Refi	*0.00%*	*0.00%*	*2.50%*	*3.50-4.00%*	*3.25-3.75%*
Israel	*0.1%*	*0.1%*	*3.25%*	*4.50-5.00%*	*3.75-4.25%*

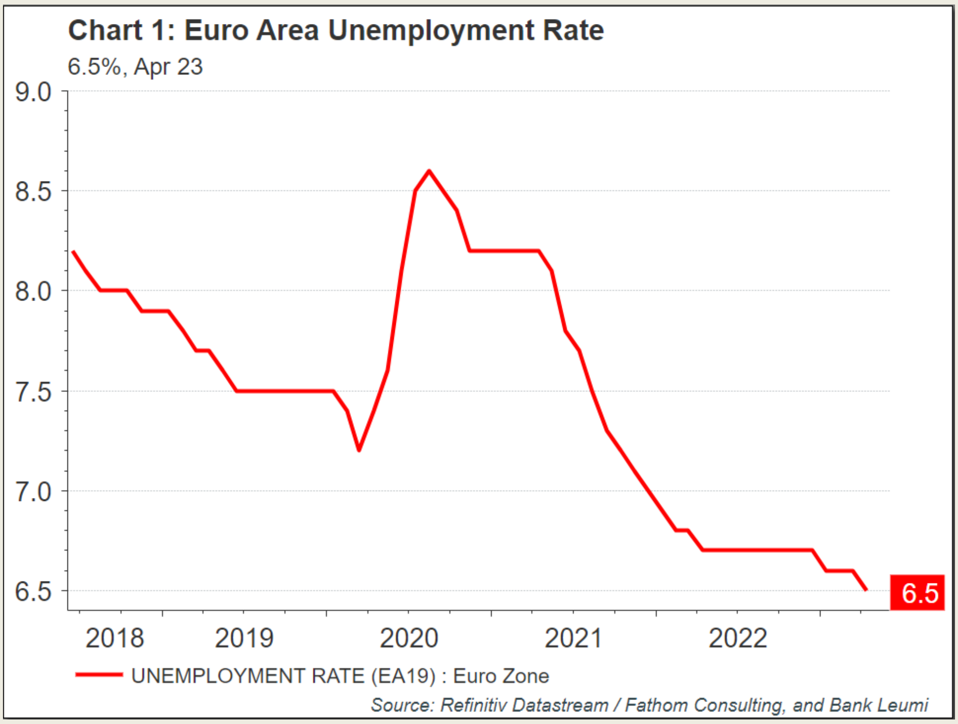
The Global Economy -- Overview

Economic activity: Global economic activity grew in the beginning of the second quarter of 2023, due to growth in the developing economies. The German economy slid into a technical recession, after the country's GDP contracted in the final quarter of 2022 and in the first quarter of 2023. The GDP of the euro bloc is expected to remain mostly unchanged in the second quarter of 2023, after having contracted in the first quarter, although the labor market is expected to remain tight. Economic activity in China and India continued to grow, yet a slowdown is likely against the backdrop of weakening demand.

- Global economic activity grew in the beginning of the second quarter of 2023. Preliminary indicators are showing a recovery in manufacturing activity, mainly due to growth in industrial activity within the developing economies, yet it appears this growth is temporary and is not expected to continue into the second half of 2023 at the current rate, in light of a drop in orders. In the developed economies, indicators are showing a slowdown in manufacturing activity, while in the European Union and Britain activity is actually likely to contract. In contrast, indicators are showing continued growth in activity in the services sector in the beginning of the second quarter, in light of a slowdown in inflationary pressures, and despite the monetary tightening that is leading to stricter credit terms. In our view, global economic activity will remain weak in the second half of 2023, mainly in light of weakening activity in the developed economies, which will offset growth in the developing economies, especially in China and India.
- Euro bloc GDP contracted 0.1% in the first quarter of 2023 (q/q), after having contracted by a similar rate also in the final quarter of 2022, and thus the euro bloc economy slid into a mild technical recession. The contraction in GDP stemmed from a drop in private consumption, against the backdrop of inflationary pressures and high interest rates, which are weighing on households. A decline in government consumption contributed as well to the slight contraction in GDP. In our view, there are risks for an additional contraction in GDP, but not to a large degree.
- The GDP figure for Germany for the first quarter of 2023 was revised downward, showing that German GDP contracted in the first quarter of 2023, after having contracted as well in the final quarter of 2022. Thus, the German economy slid into a technical recession. The European Commission's economic sentiment indicator – an aggregate measure of business and consumer confidence – fell in May more than expected, and it is indicating a continuing standstill in euro bloc GDP in the second quarter of 2023. The drop in this index was broad and suggests weakness in manufacturing, services, and in retail trade, despite an increase in consumer confidence. However, the index indicates additional weakness in pricing pressures, particularly sales prices of manufactured goods, which returned to regular levels.
- Despite the weakness in manufacturing in the euro bloc, where industrial production contracted 4.1% in March (m/m), the labor market in the euro bloc was not adversely affected. Employment increased more than expected, by a rate of 0.6% in the first quarter (q/q), following 0.3% expansion (q/q) in the fourth quarter of 2022; and the downtrend in the unemployment rate continued as well in the beginning of the second quarter of 2023 as the

unemployment rate declined to 6.5% in April (see Chart 1). Taking into consideration the continuing strength of the employment surveys and the high proportion of companies that are still reporting on worker shortages, a substantial drop in employment is not expected.

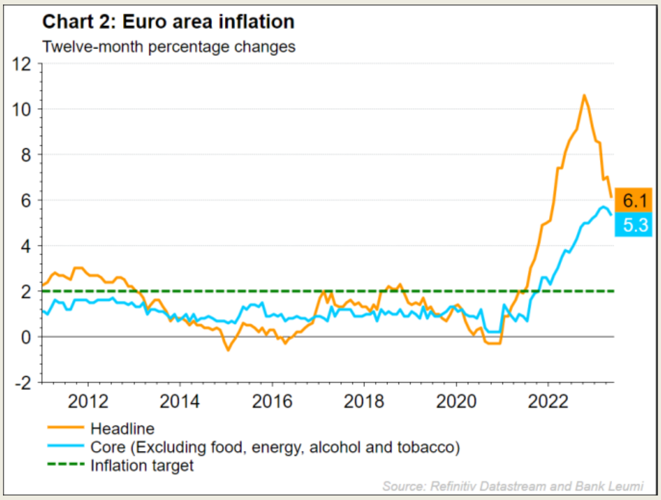
- In China, economic activity continued to recover in May. This is attributed to an increase in industrial output, together with growth in services and despite the burden felt by the construction sector due to declining fiscal support. The PMI indices are showing weakness in demand in the component involving new orders, which includes new export orders. However, this weak demand has led to an additional easing in supply chains, including reductions in supply times. In our view, Chinese economic activity is expected to continue to grow in the coming months in light of expectations for an increase in private consumption, this is against the backdrop of a tightening in the labor market and rising wages.
- In India, the rate of GDP growth accelerated in the first quarter of 2023 as GDP grew by an annual rate of 6.1%, a rate that reflects 1.7% growth (q/q). The PMI indicates continued growth in GDP and services in April-May; however, business confidence declined in the first two quarters of 2023, reflecting the concerns of businesses regarding global developments. In our view, growth of economic activity in India will continue, albeit at a lower rate, in light of the high interest rates in the economy and lowered fiscal support.
- Looking ahead, economic activity in the euro bloc is expected to remain weak in the coming months, yet employment in the euro bloc is expected to remain strong. Global GDP is expected to grow in 2023 by a rate of 2.8%, with growth in 2024 expected to be slightly higher at 3.0%. In the euro bloc, GDP is expected to grow 0.6% in 2023, while in 2024 GDP is expected to grow by a rate of 1.0%.

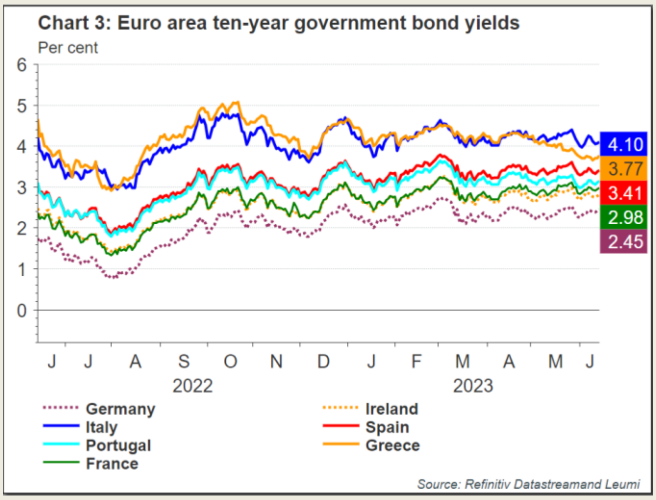


Inflation and monetary policy: Headline inflation declined in the euro bloc in May, and core inflation moderated as well. Inflationary pressures from wages are continuing and the ECB raised the interest rate in the June by 25bps and it is expected to maintain high interest rates until 2024. Long yields of the larger euro bloc economies, as well as in Britain, continued to rise in May and in the first half of June, while the rise in yields in the euro bloc was moderate.

- In its June interest rate decision, the ECB raised the interest rate by 25bps to 4.00% and the deposit facility rate to 3.50%. This, is due to the expectation that inflation will remain higher than the ECB inflation target (2%) for "too long", and even though it has started to decrease. According to the ECB, the downward trend will continue and the average inflation rate in 2023 will be 5.4% and in 2024-2025 it will decline to 3.0% and 2.2%, respectively.
- The consumer price index used in the euro bloc, the harmonized indices of consumer prices (HICP), remained unchanged in May, in contrast to the expectations in the market that were forecasting a moderate rise in the index, while the annual inflation rate fell to 6.1% (see Chart 2). This comes in continuation of the downward trend that started in November last year, which halted temporarily in April. The fall in inflation stemmed partially from a moderation in services inflation, coupled with declines in the food and energy components. Core inflation, which is more important for the ECB in its monetary policy decision-making process, fell as well, reaching 5.3%. Meanwhile, improvements in global supply conditions led to a decline in the goods components of the core index. In our view, the inflation rate is expected to continue to decline in the coming months and core inflation is expected to moderate as well, albeit by a more moderate rate. However, the labor market remains tight and the unemployment rate declining, thus raising the inflationary pressures from salaries, which supports a continuation in the rate hikes by the ECB.
- From the ECI survey, an index that analyzes economic sentiment in the euro bloc, it can be seen that pricing pressures continued to weaken, and the expectations on sales prices returned to regular levels in manufacturing, yet remained very high in retail trade and services. Together with a recovery in inventory levels, the decline in expectations on goods prices in manufacturing indicates that inflation on core goods will continue to decline in the coming months. In contrast, services inflation is expected to be stickier, this because many companies are still expecting prices to rise and employment expectations are still very high. In total, the euro bloc economy continues to operate under conditions similar to stagflation. In light of expectations for core inflation to fall slowly, the ECB is likely to hike further the interest rate in the second half of 2023 and to maintain a high interest rate until 2024.
- In Britain, the April price index surprised on the upside with an upward movement of 1.2% (m/m). The increase also stemmed from, among other things, increases in the core components, which led to a 1.3% rise in the core index (m/m). Despite this increase, the annual inflation rate fell from 10.1% down to 8.7%, due to the high index readings back during the parallel period in 2022. Core inflation increased to 6.8%, thus supporting interest rate hikes by the Bank of England in the upcoming June interest rate decision to 4.75%, and also in the August interest rate decision.

- The yields on long-term government bonds in the euro bloc and in Britain increased in May and in the first half of June, while the rise in euro bloc yields was relatively mild (see Chart 3). In contrast, Greek yields fell in May, which led to a reduction in the yield differentials between Greece, and the yields in Germany and France, which are considered strong and stable economies. In Latin America, the downtrend in the long-term bonds of Brazil and Columbia continued in May, after they had increased slightly for a short period at the end of April.





United States

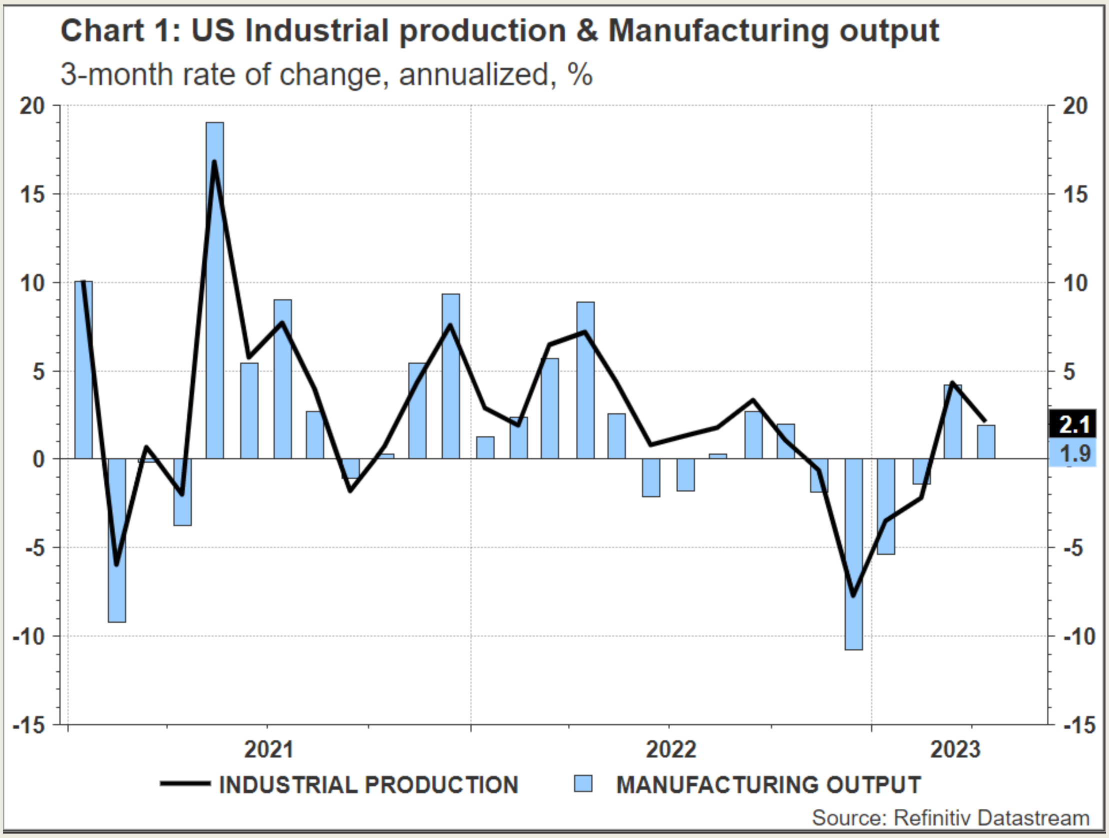
Economic activity: Growth in economic activity slowed, and GDP is expected to increase by slightly more than 0% in the second quarter of 2023, with the bulk of growth stemming from the services sector. A gradual loosening in the labor market is continuing, this despite an increase in the number of jobs, and the unemployment rate increased in May to 3.7%. The downtrend in housing prices halted in February-March 2023.

- Preliminary indicators show US economic activity continued to grow in April-May this year, albeit by a relatively slow rate, in continuation of the slowdown that started in the first quarter of 2023. Growth in the services sector is stronger than that in manufacturing, despite a drop in consumer confidence and rising unemployment. However, there are still concerns regarding sustained growth in economic activity, mainly in light of weakness in new orders, which suggests weakness in demand within the US economy. This risk is also likely to intensify in the event the labor market will continue to loosen, in light of the tight monetary policy, which is likely to lower private consumption.

- In our view, real private consumption is expected to grow in the second quarter of 2023 by an annual rate of 1.8%, after having increased by an annual rate of 3.7% in the first quarter of the year, while GDP growth in the second quarter will be slightly greater than zero. In addition to expectations for very moderate growth in 2023, the 2024 economic growth rate was lowered as well over recent months.

- The May jobs report, which relies on employees' payslips, indicates a greater-than-expected rise in the number of jobs. May's figure is the largest in the last four months, and widespread across all the sectors of the economy, with the exception of manufacturing in which a small decline was registered in the number of jobs. In addition, the employment data from the preceding months were even revised upward. However, the household survey, which is more comprehensive with better coverage of the labor market and includes freelancers as well, indicates a drop in employment. This development, together with the rise in the workforce due to the addition of new workers into the market, led to an increase in the unemployment rate in May from 3.4% to 3.7%.

- We note that a rise of 50bps in the unemployment rate over the course of 12 months signals a substantial slowdown in economic growth later on, such that a continued rise in the unemployment rate will raise the risks for a slowdown in the economic growth rate, with the possibility for a mild recession in the US economy. Average weekly work hours fell in May from 34.4 to 34.3, the lowest level since the April 2020 low. It appears that labor market conditions are reaching equilibrium, and as a result, the upward pressures on wages are dissipating. Despite a 0.3% increase in wages in May, the annual rate of increase in hourly wages fell slightly from 4.4% to 4.3%.
- Industrial production increased 0.5% in April (m/m), following two months of no change (see Chart 1). Meanwhile, industrial output increased 1.0% in April (m/m); however, we estimate the strong growth will not continue in the coming months. Durable goods orders increased 1.1% in April (m/m), with the bulk of the growth stemming from an increase in military aircraft orders. In contrast, automobile orders declined, indicating that the unexpected increase in car manufacturing was likely a seasonal distortion. Core orders excluding transportation contracted 0.2% in April, yet non-defense capital goods orders, which are a good indicator of investment in business equipment, increased 1.4%.



- A downward trend in housing prices halted in February-March, after these had dropped since July 2022. This comes despite an increase in mortgage interest rates that occurred in March. In our view, a decline in mortgage interest rates in April, and the lack of any meaningful change in May, apparently continued to halt the downward trend in housing prices. However, a renewed rise in mortgage interest rates in the beginning of June, coupled with the loosening in the labor market, are likely to renew the downward trend in housing prices later on. Home sales fell in April, with the drop stemming mainly from a decline in existing home sales, which more than offset an increase in sales of new homes. In our view, the loosening in the labor market, coupled with the interest rate hikes and tightening in monetary policy that lowers the ability of households to purchase homes, is likely to support later on a drop in the number of home sales.
- Looking ahead, the data indicate a slowdown in US economic activity, and there is even the possibility for the American economy to slide into a mild recession in the second half of 2023. In our view, US GDP will grow 1.0% in 2023, with a similar growth rate expected in 2024 as well.

Inflation and monetary policy: In its June interest rate decision, the Fed left the interest rate unchanged and indicated the possibility of raising the interest rate in the upcoming interest rate decisions. The annual inflation rate fell in May, yet core inflation declined modestly. Yields on CPI-linked and non-linked government bonds rose in May.

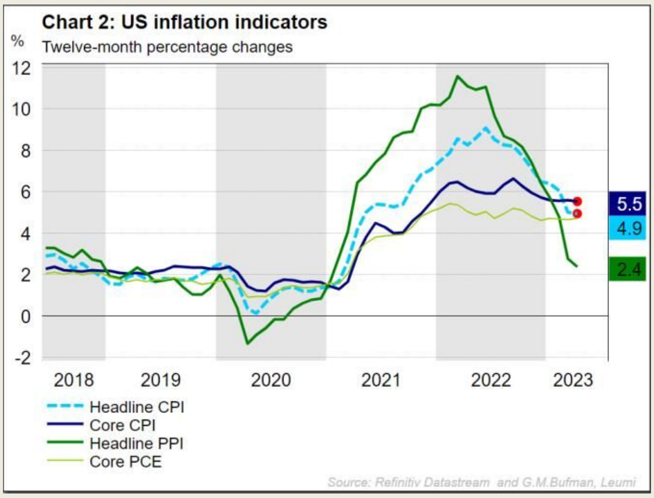
- In its June interest rate decision, the Fed left the interest rate unchanged in the range of 5.00-5.25%. The Chairman of the Fed hinted at the possibility of raising the interest rate during the second half of 2023, possibly as soon as the end of July. The FOMC member's forecast indicates an increase in the interest rate by 50bps during the second half of 2023 and a moderate lowering of the interest rate in 2024. He noted that recent indicators suggest that the economic activity has continued to expand at a modest pace, job gains have been robust in recent months, the unemployment rate has remained low and inflation remain elevated.
- Despite recent events in the banking sector, the Chairman of the Fed noted that "the US banking system is sound and resilient". Also, he noted the difficulty of assessing future economic developments and the effects of the interest rate hike and credit conditions that have tightened. A further increase of the interest rate may take place if economic activity remains robust during the third quarter of 2023 along with a low unemployment rate which will lead to continued inflationary pressures. The Fed is expected to starting cutting the interest rate in early 2024 is the Fed towards the long-term interest rate target (2.5%). The interest rate reductions are expected to continue in 2025 as well, but will remain above the long-term target.
- The Fed's projections call for a gradual drop in inflation toward the target rate and also a continued loosening in the labor market, with an increase in the unemployment rate together with a drop in the rate of increase in wages, which are expected to reduce inflationary pressures. Furthermore, the tightening in credit conditions in the economy, mainly in regards

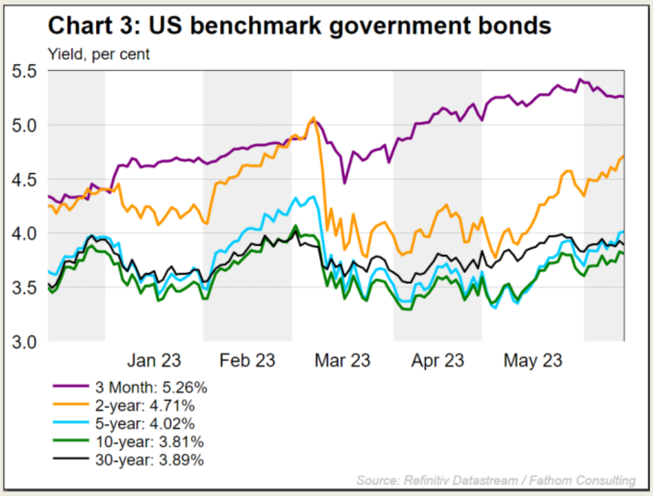
to the real estate sector, against the backdrop of the erosion in the value of collateral assets and rising financing costs, is acting as well to cool economic activity.

- The US CPI increased 0.1% in May, after it increased 0.4% in April. The annual inflation rate in the US fell in May to 4.0%, while core CPI dropped to an annual rate of 5.3% (see Chart 2). The housing component was a largest contributor to the increase in the CPI, with the food components also rising after being unchanged in the previous two months. Energy components declined and were the major factor in the decline in annual inflation rate. Core prices, as measured in the PCE index, increased 0.4% in April, slightly above expectations, such that the core PCE index increased back up to 4.7%. In our view, headline inflation and core inflation rate are expected to continue to decline, which may support a halt of interest rate hikes in the upcoming Fed's interest rate decisions.

- An agreement was reached to suspend the US debt ceiling until 2025. This interim agreement points to the large gaps between the Democrats and the Republicans and the inability to reach an agreement that would anchor the debt path over the longer-term. The central element of the “deal” involves a freeze in federal discretionary spending (excluding defense) in the next fiscal year, after which only a 1% increase in spending will be allowed in fiscal year 2025 (the fiscal year begins in October). This expenditure includes main components such as health, transportation, education, government housing construction, social work, government investment in science, environment expenditures, and more. Discretionary spending excluding defense was supposed to increase by about US$80bn in fiscal year 2024 – from a level of approximately US$1.7tn in 2022 including defense spending (approximately 6.6% of GDP) and approximately US$0.9tn excluding defense spending. The deal will also cut US$10bn from expanded funding for the IRS – a previously approved addition. These measures represent another series of budget cuts, so the net impact on growth in 2024 is expected to be negative, but not by a large margin.

- Yields on long-term US government bonds climbed once again in May, after an uptrend was halted in March-April this year (see Chart 3). This comes against the backdrop of investors’ concerns about a moderation in economic activity in the US, coupled with the concerns that the government would find it difficult to reach an agreement on the debt ceiling. The yields on CPI-linked bonds (TIPS) increased as well, as the yield on 5-year CPI-linked bonds reached a level higher than the CPI-linked yields of longer durations (10Y, 20Y, 30Y),





indicating the concerns of investors with respect to the American economy and developments in the path of inflation. In our view, the yields on 10-year Treasuries are not expected to change substantially during the second half of 2023. The 10-year CPI-linked yields are expected to decline slightly in the second half of 2023 to approximately 1.5%.

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BANK LEUMI LE-ISRAEL, THE CAPITAL MARKETS DIVISION
The Economics Sector, P.O. Box 2, Tel Aviv 61000
Ph: 972-76-885-8737, Fax: 972-77-895-8737, e-mail: Gilbu@bll.co.il
http://english.leumi.co.il/Home/