

Global Macroeconomic Monthly Review

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Key Issues and Table of Contents

Bank Leumi Economic Forecasts (p. 3)

The Global Economy – Overview (p. 4)

- *Differences exist in the economic recoveries among the various countries of the world, according to the means by which each country has dealt with the rise in morbidity.*
- *Britain and the European Union (EU) have reached an agreement on Brexit, yet a number of points remain under negotiation.*
- *The annual inflation rate in developed countries remained unchanged.*
- *The Fed and the ECB are expected to continue to support the market, and the ECB expanded its emergency asset purchase program.*
- *The yields on US government bonds continued to climb, whereas in the most of the euro bloc yields continued to decline.*

United States (p. 8)

- *A number of areas of economic activity in the US continued to recover in the fourth quarter of 2020.*
- *The latest stimulus package approved by Congress is expected to lead to continuing economic recovery in 2021.*
- *According to the Fed, by the end of 2023 the unemployment rate will be below what it considers the sustainable long-run unemployment rate.*
- *From the Fed statement, it appears that asset purchases will last longer than markets previously expected, depending on developments in inflation and employment in the economy.*
- *The consumer price index rose in December due to rising energy prices.*
- *Long-term government bond yields are expected to rise.*

Euro Bloc (p. 13)

- *Euro bloc GDP is expected to contract in the final quarter of 2020 due to the tightening of restrictions on economic activity.*
- *For all of 2020, GDP is expected to decline 7.6%, and to increase 4.8% in 2021.*
- *The ECB expanded its emergency asset purchase program, and it also extended the horizon for net purchases under this plan.*
- *The consumer price index remained unchanged in November.*
- *Yields on long-term government bonds fell slightly in December, due to the expansion in support of the ECB in the market.*

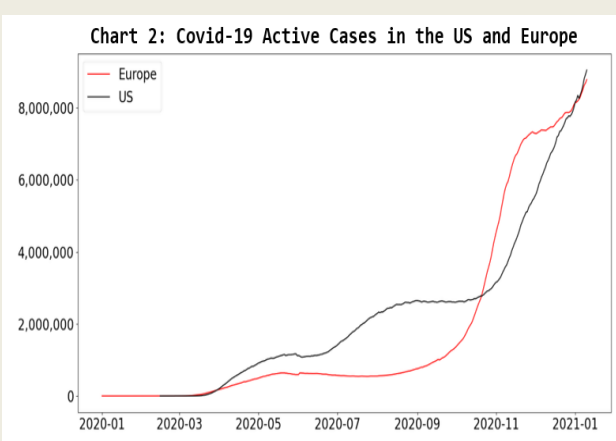
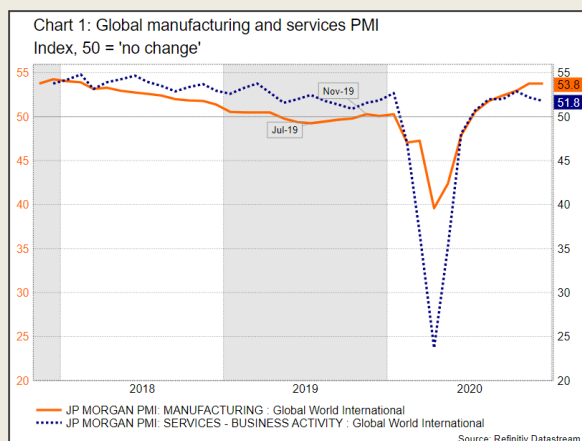
Leumi Global Economic Forecast, As of January 2021

	2017	2018	2019E	2020F	2021F
GDP – Real Growth Rate					
<i>World</i>	3.8%	3.5%	2.6%	-3.8%	4.8%
<i>USA</i>	2.3%	3.0%	2.2%	-3.7%	3.3%
<i>UK</i>	1.7%	1.3%	1.3%	-11.3%	6.6%
<i>Japan</i>	2.2%	0.3%	0.7%	-5.3%	2.6%
<i>Eurozone</i>	2.7%	1.9%	1.3%	-7.6%	4.8%
<i>South East Asia (ex. Japan)</i>	5.3%	5.1%	4.4%	-3.9%	4.2%
<i>China</i>	6.8%	6.6%	6.1%	1.9%	8.7%
<i>India</i>	7.0%	6.1%	4.2%	-7.9%	6.9%
<i>Latin America</i>	0.9%	0.7%	-0.6%	-7.8%	3.6%
<i>Israel</i>	3.6%	3.5%	3.4%	-3.9%	4.9%
Trade Volume, Growth (%)					
<i>Global</i>	5.8%	3.7%	0.9%	-10.3%	6.8%
Interest rates, Year End					
<i>US Fed</i>	1.25-1.50%	2.25-2.50%	1.50%-1.75%	0.00-0.25%	0.00-0.25%
<i>Bank of England</i>	0.50%	0.75%	0.75%	0.1%	0.1 %
<i>Bank of Japan-Policy Rate</i>	-0.04%	-0.07%	0.0%	-0.1%	-0.1%
<i>ECB-Main Refi</i>	0.00%	0.00%	0.00%	0.00%	0.00%
<i>Israel</i>	0.10%	0.25%	0.25%	0.1%	0.00-0.25%

The Global Economy – Overview

Economic activity: differences exist in the economic recoveries among the various countries of the world, according to the means by which each country has dealt with the rise in morbidity. Britain and the European Union (EU) have reached an agreement on Brexit, yet a number of points remain under negotiation.

- The recovery in economic activity continued in the final quarter of 2020, and the global industrial PMI remained at a high level throughout the entire fourth quarter (see Chart 1), this despite the continued spread of the coronavirus. However, large differences exist in the recoveries of the developed countries, due to tighter economic restrictions and the imposition of shutdowns in some countries during December. Economic indicators show GDP increased in the US during December 2020, with this growth expected to continue also during the first quarter of 2021 due to the expansion of fiscal stimulus. This comes in contrast to the expectations for contraction in GDP in the euro bloc, due to the tightening in restrictions in a number of countries, against the backdrop of an increase in the rate of spread of the coronavirus.
- This difference is more notable against the backdrop of the sharp rise in the number of active coronavirus cases in the US, which actually reached a level greater than the number of active coronavirus cases in Europe (see Chart 2) even though the European population is more than 2.2 times larger than the US population. The bulk of the damage in the countries in which the GDP declined, apparently during the final quarter of 2020, is expected to be felt primarily in the services sector. On the other hand, the damage to industry is expected to be substantially less severe. This is due to the implementation of restrictions that are more targeted on services compared to the case during the shutdown that occurred in the first quarter of 2020.
- In Britain, retail sales declined 3.8% in November 2020 (m/m) due to the tightening in restrictions. This led to most of the growth in sales over the preceding months to be erased. However, sales remained at a level approximately 2.7% higher than the pre-crisis levels. November's rate of decline is sharp compared to normal periods, yet is substantially below the sharp drop in retail sales that occurred in the first economic shutdown back in April 2020. This is because gasoline prices did not fall as sharply as they did in April last year, at which time oil prices reached a low against the backdrop of the price war that occurred between Saudi Arabia and Russia, and also the schools, factories, and construction sites have remained

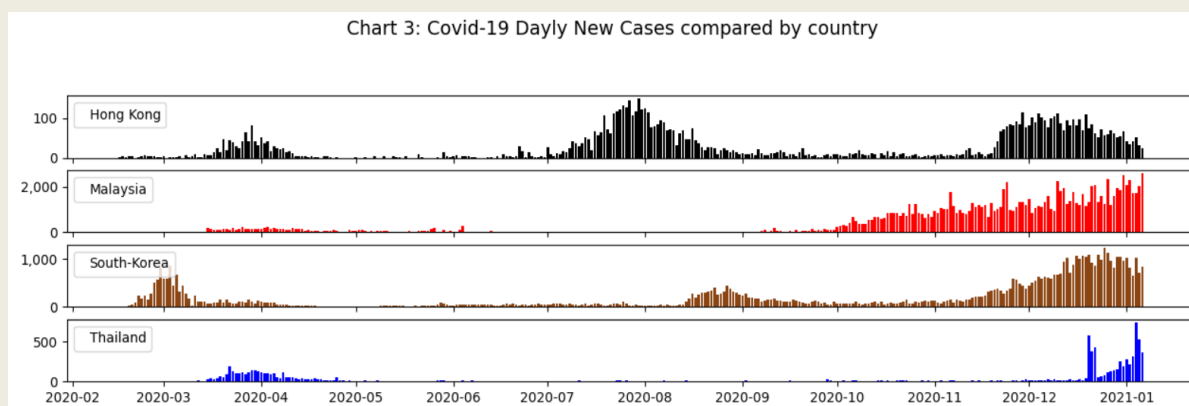


open in this latest period. The composite PMI in Britain increased in December to above 50 points, thus indicating that the recovery in economic activity is continuing. The tight shutdown announced at the beginning of January 2021, which is expected to continue at least until mid-February, is expected to bring about a decline of more than 3% (q/q) in GDP during the first quarter of 2021.

- Britain and the EU reached an agreement for implementing Brexit, which will define the relationship between the two after the departure of Britain from the EU. According to the agreement, no tariffs or quotas will be imposed on trade between the two, and the EU will be able to continue to fish in the territorial waters of Britain over the coming five years. Over this period, Britain's fishing territory will gradually increase until 2026, at which time Britain will be allowed to forbid the EU from fishing in its territory; however, in the event Britain takes such action, the EU is expected to react with tariffs on fish imports from Britain. It is expected that from 2026 the EU and Britain will hold annual talks on the matter of fishing within the jurisdiction of Britain. For now, the agreement does not cover decisions related to the financial services sector nor on the regime of information protection in the UK. Negotiations on these issues will continue.
- In the near term, substantial delays and disruptions are expected at the borders due to the obligation imposed on companies, for the first time in years, to fill out forms (laws regarding countries of origin, etc.) and documentation. Furthermore, new laws are expected regarding inspections of food, plants, and animals. All of this is likely to hurt trade between Britain and the EU, even if only temporarily. Britain has announced it will be flexible with the new laws and regulations through July 2021; however, the EU presented a stricter line when it comes to enforcement and stated that all new regulatory and legal requirements will come into force in early January 2021.
- In Japan, machine orders continued to increase in November, and during the October-November 2020 there was a 14.5% increase over the level of orders in the third quarter of 2020. In our view, the recovery in investments will characterize the entire fourth quarter of 2020, including exports of machinery and equipment. The PMI of Japan's manufacturing sector increased slightly in December, from 49.0 to 50.0 points, whereas the PMI of the services sector declined slightly from 47.8 to 47.2 points. The data indicate that the spread of the third wave of the coronavirus has indeed slowed the economic recovery, yet it did not stop it completely, and economic activity continued to recover also in the final quarter of 2020. The government of Japan passed in December 2020 an additional supplementary budget totaling 21.8tn yen, and this is expected to support the continued recovery of the economy. In contrast to the fiscal stimulus provided during the second quarter of last year, which aimed to support the labor market and prevent companies from collapsing as a result of the spread of the virus, the latest incentives focus primarily on digitization and reducing carbon emissions.
- The recovery in economic activity is evident also in the developing countries with an increase in the PMI of the manufacturing sector in December. The renewed spread of the coronavirus in South Korea, Hong Kong, Malaysia, and Thailand (see Chart 3) represents a risk to the continuing rapid economic recovery of these countries in 2021. This comes after these countries stopped the spread of the virus relatively quickly during 2020 with only minimum

damage to their economies. Their success in halting the spread of the virus during last year offers hope that they will succeed to stop also the current spread of the virus without having to impose general shutdowns in their economies. In the event they will impose a general shutdown, then the services sectors are expected to be the main victim, with an emphasis on the accommodations sector. Also, the retail sector is likely to be hurt as well, yet to a lesser degree due to the transition to online purchasing. In our opinion, even if a slight economic shutdown will be imposed, factories will still be permitted to remain open, such that the industrial sector is not expected to be materially affected by the current spread of the virus.

- Industrial manufacturing in India increased 3.6% in October (y/y) after it had risen in September for the first time since the start of the crisis in March 2020, to a positive rate of 0.5% in annualized terms (y/y). A significant portion of the increase stemmed from the manufacture of durable goods, which increased 17.6% (y/y). The PMI of India's industrial sector remained at a high level in December, thus indicating the continued growth of industry in the final quarter of 2020. This month, India is expected to start the inoculation of its population, apparently with one of the vaccines that does not require a special "cooling chain". In the event the country will indeed succeed to distribute the vaccine to a broad section of the population relatively quickly, then the positive momentum in the recovery of industry is expected to continue also throughout 2021 at a rapid pace.
- Economic growth in China continued during the final quarter of 2020. Industrial manufacturing grew 7.0% in November (y/y), after it had increased in October and September by a rate of 6.9% (y/y). A substantial portion of the growth stemmed from external demand, which led to an increase in the export of industrial goods to the highest level in two years. China's exports increased by more than 21% in November 2020 compared to the corresponding period in 2019, there has also been an increase in China's imports mainly in intermediate inputs to the electronics sector and agricultural sector such as soybeans. The December PMI indicates a continued growth in Chinese GDP at the end of the final quarter of 2020, although at a lower rate than that at the start of the quarter, while the export orders component of the index fell in December, indicating weakness in external demand.
- In South Africa, GDP increased in the third quarter of 2020 by a seasonally adjusted rate of 66.1% (q/q), after having contracted 51.7% (q/q) in the second quarter. A strong recovery was registered also in the construction, manufacturing, mining, and trade sectors, all of which were substantially hurt in the second quarter due to the severe economic restrictions imposed in the country. The business confidence index increased sharply in the final quarter of 2020,



following the historic low it had reached in the second quarter of the year, and consumer confidence increased as well and now indicates a continued recovery in economic activity. However, the data from October 2020 indicate a slowdown in industrial manufacturing and in mining. In addition, the November PMI fell sharply, from 60.9 to 52.6 points. This figure still indicates continued growth of the economy, albeit by a slower rate. In our opinion, the combination of these factors indicates the recovery in economic activity continued also in the final quarter of 2020, although at a slower rate than in the third quarter.

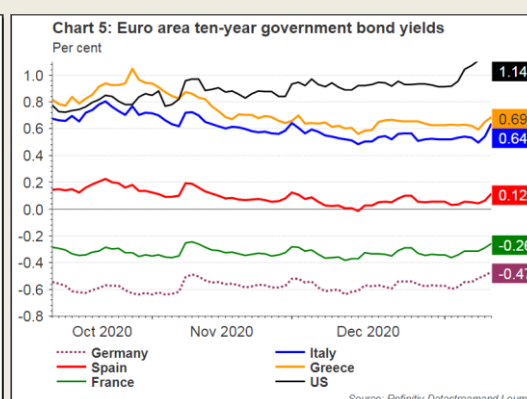
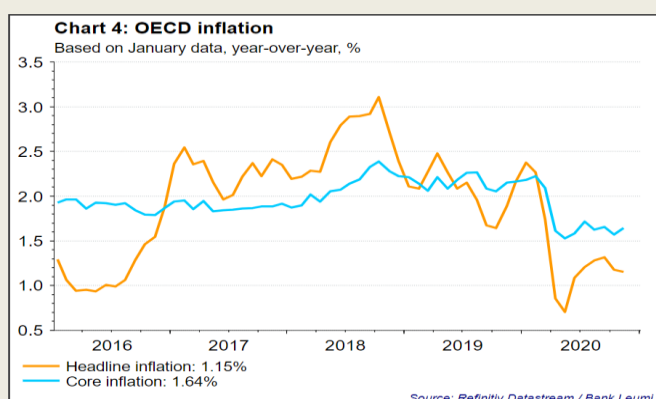
- Looking ahead, global GDP is expected to contract 3.8% in 2020, and to increase 4.8% in 2021, such that by the end of the year it is likely to return to the level of GDP registered in 2019. Non-OECD member countries are expected to increase this year by 4.5%, whereas the OECD member countries are expected to grow 3.0% in 2021. The GDP of Japan is expected to grow 2.6% in 2021, although it is not expected to return to the level registered in 2019 any time before 2024.

Inflation and monetary policy: the annual inflation rate in developed countries remained unchanged. The Fed and the ECB are expected to continue to support the market, and the ECB expanded its emergency asset purchase program. The yields on US government bonds continued to climb, whereas in the most of the euro bloc yields continued to decline.

- The annual inflation rate in the developed countries remained unchanged in November. The inflation rate is low and is at a level far from the inflation target, and in the euro bloc the inflation rate is at a negative level. The annual inflation rate in the OECD remained in November also unchanged at a rate of 1.2% (see Chart 4), despite the decline in the energy component by a higher rate than that in October. The annual rate of core inflation, excluding food and energy, in the OECD remained in November at 1.6%. In our estimation, the inflation rate in the US during 2021 (December/December) is expected to equal 2.0%, and perhaps even higher than this, representing a substantial increase over the level of 1.2% in 2020. In contrast, in the euro bloc the rate of increase in prices, although it will rise in 2021, is expected to be relatively moderate and less than 1% for the year, compared to 0.3% in 2020.
- The Fed and the ECB are expected to continue to support the market during this challenging period, using the tools they have at their disposal. The Chairman of the Fed, Jerome Powell, suggested in the December interest rate announcement that asset purchases will continue more than expected in the market and these purchases are currently dependent on economic developments that will occur, with an emphasis on price stability and employment targets, without any dependence on some sort of time framework. The ECB declared in its December interest rate announcement a €500bn increase to its Pandemic Emergency Purchase Program (PEPP), such that total purchases through this program will amount to €1,850bn. This step is expected to keep government bond yields at low levels, and it may even bring about an additional decline in the yields-to-maturity of some government bonds of euro bloc members. In addition, the ECB lengthened the time horizon of purchases through March 2022, with the redemption payments made during this period to be reinvested through December 2023. Furthermore, the ECB added three additional rounds of operations to be conducted in its Targeted Longer-Term Refinancing Operations (TLTRO) with more favorable credit

conditions than in the past, with the purpose being to incentivize the banks to reach the goal of increased credit.

- Long-term US government bond yields continued in the second half of December their upward trend from recent months, despite the Fed statement that it will support the market, this apparently due to the expectations for the expansion of fiscal support that will also lead to an increase in government bond issues. In our view, in the event the vaccines will be effective over time, also against the various mutations of the virus, and also if the population will cooperate with these efforts, then the yields-to-maturity of government bonds are expected to continue to climb. The bond yields of the major economies of the euro bloc continued to decline during December, against the backdrop of the ECB statement on its plan to continue to support the market and to expand its emergency asset purchase program (PEPP). In the beginning of January, against the backdrop of the worsening in morbidity in Germany, yields there registered a slight uptick which escalated after German chancellor warned that the lockdown may remain in place until April, while the yield differentials vis-à-vis other countries narrowed slightly.
- Concerns over the current uncertainty in the market, which may also affect the monetary policy of the ECB, together with fears of deflation in the market, against the backdrop of the annual inflation rate remaining at a negative level since August 2020, led to an inversion at the short end of the yield curves (3M-2Y) of Germany and France. The situation also led to an inversion at the short-medium portion of the yield curve (2Y-10Y) of Greece. In Latin America, the yields-to-maturity of the long-term government bonds of Brazil and Mexico fell slightly during the second half of the final quarter of 2020, against the backdrop of the recovery in economic activity, despite the continued rise in morbidity.



United States

Economic activity: a number of areas of economic activity in the US continued to recover in the fourth quarter of 2020. The latest stimulus package approved by Congress is expected to lead to continuing economic recovery in 2021. According to the Fed, by the end of 2023 the unemployment rate will be below what it considers the sustainable long-run unemployment rate.

- US economic activity continued to recover during the fourth quarter of 2020. The consumer confidence index of the University of Michigan increased in December from 76.9 to 80.7

points after much of the uncertainty that characterized November passed with the apparent stabilization following the release of the US presidential election results and against the backdrop of positive reports regarding the Covid-19 vaccine. However, confidence levels remain substantially below those registered during the period that preceded the pandemic outbreak. Industrial manufacturing, which started to recover late relative to the recovery in retail sales, continued to increase and consequently grew 0.4% in November (m/m). The positive trend indicates that industry continues to grow despite the increased severity in the spread of the virus, which is at the height of a third wave. The increase in production stems in part from the fact that companies have once again started to stockpile inventories, which is expected to support the continued growth of industrial manufacturing also in the coming year.

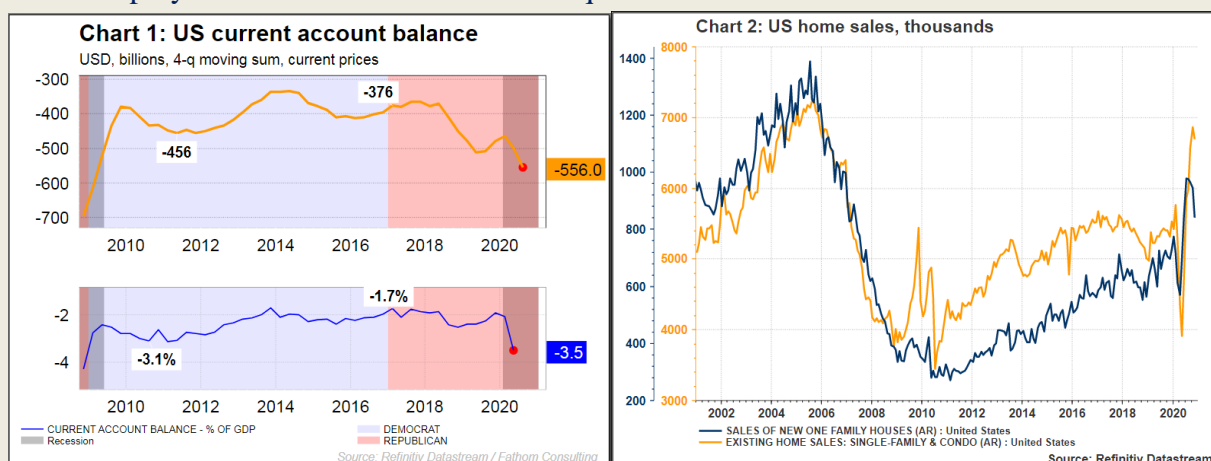
- The 140,000 drop in non-farm payrolls was due to the imposition of restrictions that led to decline in employment in the leisure and hospitality sector. However, employment in other sectors of the economy remained strong which implies that the economic recovery will continue in 2021 with the lifting of the restrictions. Overall, during Mr. Trump's term, including the Covid-19 period, employment in the US dropped by about 3 million.
- Durable goods orders increased 0.9% in November (m/m), due to, among other things, an increase in defense aircraft orders. Core orders of durable goods increased as well in November, albeit by a more moderate rate of 0.4% (m/m). This increase indicates that expansionary monetary policy is continuing to support the recovery in investments in the business sector. The number of new jobseekers declined slightly in the first week of January 2021, and was even lower than expected. However, this figure comes following a deterioration in the condition of the US labor market in December, as expressed in the average number of initial unemployment claims that was higher than that in November. This indicates that the spread of the Covid-19 in the US, together with tighter restrictions on economic activity in some regions of the country, slightly weakened the labor market.
- On the face of it, Mr. Trump's period in office is considered to have been favorable for the US economy due to the increase in household income and rise of the stock market, but when dive into the macroeconomic data a more complex picture emerges. From the beginning of Mr. Trump's term to the peak of growth in 2019, GDP increased by a cumulative rate of 9.3%. but GDP decline in the first half of 2020 due to the spread of the Covid-19 indicates that growth during Mr. Trump's presidency (2017-2020) will total about 5%, just about 1.2% a year on average. For the sake of compression, during Mr. Obama's presidency, GDP increased at an average annual rate of 1.9%.
- Mr. Trump administration's tax reductions were focused on the business sector and contributed to an increase in the fiscal deficit well before the outbreak of Covid-19. The rise of the deficit was a result of a decline of the federal government's revenue along with an increase in spending, which included rising defense spending that reached a peak level even though the US was not in active warfare during this period. The deficit has increased further with the sharp increase in public expenditure in 2020 due to the spread of the Covid-19.
- The increase in fixed assets investments during Mr. Trump's presidency was influenced by his compassion for the energy sector and the rise in energy prices which has led to large and highly leveraged investments in the energy sector. Investments in technology have increased

during Mr. Trump's presidency and have accelerated in the past year. However, investments in residential construction were low, and along with the increase in the rate of ownership of housing they resulted in an increase in the house prices. Mr. Trump's trade war with China receded somewhat after the signing of "Phase One" trade agreement without the US succeeding in achieving the structural reforms it demanded from China. This is while China is only partially fulfilling its obligations under the agreement. In addition, Trump's muted trade war against Europe also failed to achieve positive results for the United State. The overall result from the trade wars has been an increase in the current account deficit of the US balance of payments from about 1.7% of GDP at the start of Mr. Trump's term to 3.5% (see Chart 1), thus doubling the size of the current account deficit in GDP percentage terms and generating forces for US dollar depreciation.

- Congress confirmed an additional stimulus package, totaling US\$900bn, which is equivalent to slightly more than 4% of GDP. Of this sum, US\$325bn will be allocated to small business loans in order to support salary payments. In addition, the package includes an additional US\$300 to weekly unemployment benefits through mid-March and provides a one-time US\$600 per person payment directly to most households. Furthermore, some of these funds will be allocated toward the vaccine rollout to US residents. Apparently, a portion of this latest stimulus package is a renewal of payments that were allocated in the previous incentive package, yet were not taken advantage of, this together with a renewal of previous outlays that were fully paid out. This stimulus package is expected to assist in continuing the recovery in US economic activity, particularly in light of the initial rollout of the vaccine, which is expected to enable an additional expansion in economic activity, a development that slightly raises US growth expectations for 2021.
- The Democrats slim control of the US Senate along with their marginal control the US House of Representatives is expected to help them advance party policies, such as expanding fiscal support. However, that does not mean they will have complete freedom in advance the health and environmental program, since Republicans still have a filibuster tool since Democrats do not have the required two-third majority in the Senate to block the use of that tool. In addition, the environmental plan is expected to face opposition from home as two Democratic senators have previously opposed this plan. If the Democrats formulate a plan acceptable by all party delegates, then they will be able to circumvent the filibuster barrier by Budget Coordination which needs only a simple majority, with the caveat that this tool can be used once a year.
- Preliminary indicators show continued growth in the economy; however, it is likely the growth rate at the end of the final quarter of 2020 will register a slight slowdown. The composite PMI for December 2020 fell slightly from 58.6 to 55.7 points, yet it still indicates growth of the industrial sector and in services. The bulk of the decline stems from the impact of the services sector PMI, which declined from 58.4 to 55.3 points, compared to the industrial sector that registered only a minor decline in December, from 56.7 to 56.5 points.
- The existing home sales declined in November 2020 for the first time since June this year (see Chart 2), as the number of new homes that were sold fell in November by a sharp rate of 11% (m/m). This decline occurred against the backdrop of a decline in the low housing stock and following the exhaustion of the pent up demand created in the first wave of the virus

outbreak in March-May 2020. At the same time, housing prices continued to climb, supporting the assessment that demand is expected to decline slightly during 2021.

- Looking ahead, we estimate US GDP will contract 3.7% in 2020, representing a moderate decline compared to most of the major Western countries, and in 2021 US GDP is expected to grow 3.3%. According to the Fed, the unemployment rate is falling by a relatively rapid rate, due to the decline in unemployment over recent months, and by year-end 2023 the unemployment rate is expected to equal 3.7%, which is slightly below the sustainable longer-run unemployment rate that is estimated to equal 4.1%.

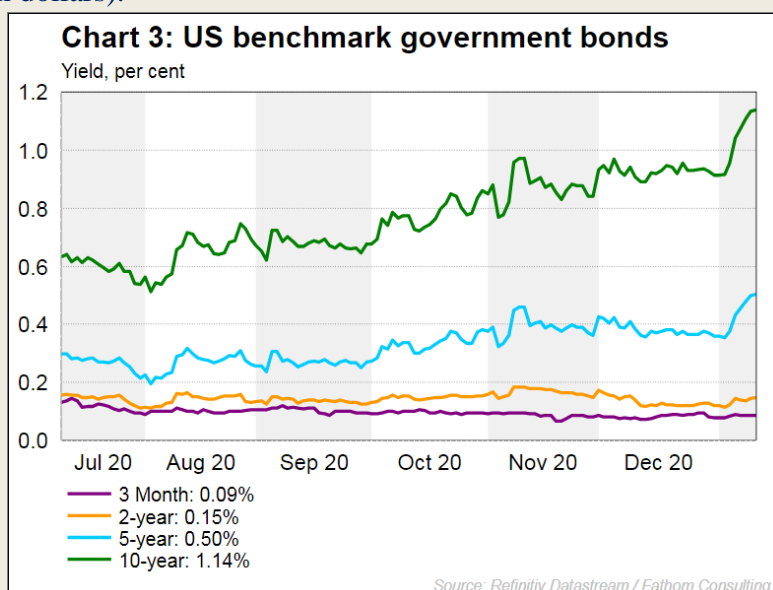


Inflation and monetary policy: from the Fed statement, it appears that asset purchases will last longer than markets previously expected, depending on developments in inflation and employment in the economy. The consumer price index rose in December due to rising energy prices. Long-term government bond yields are expected to rise.

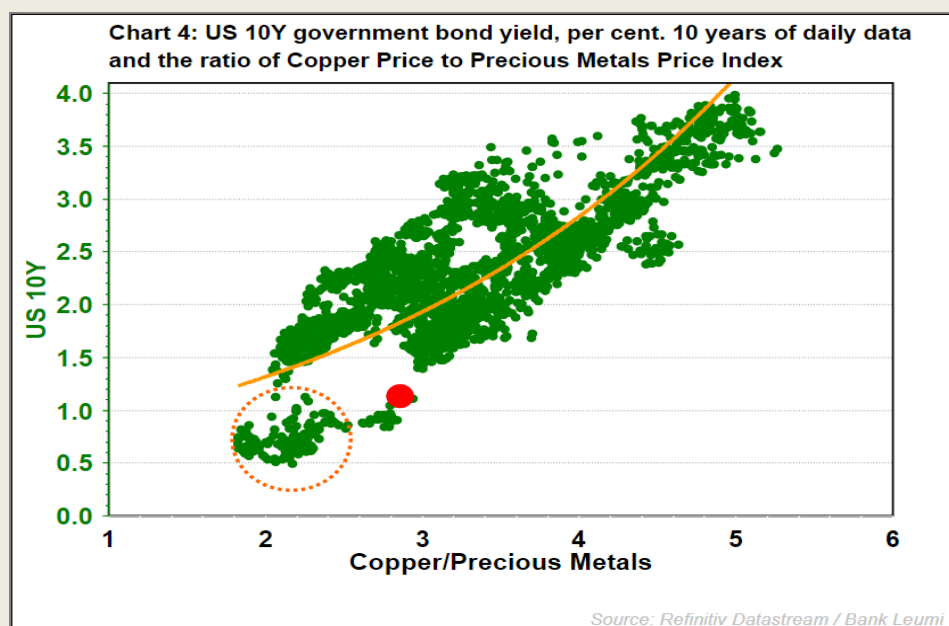
- The Fed's interest rate statement in December implies that asset purchases will last longer than markets previously expected. In its previous statement, the Fed announced that asset purchases would "continue in the coming months". However, now the Fed has changed the wording of the statement and asset purchases, amounting to US\$120bn a month or more, are not dependent on a time framework but instead on developments in the economy, with an emphasis on price stability and employment targets. The Chairman of the Fed, Jerome Powell, emphasized that the central bank will use all the tools at its disposal in order to support US economic activity during this challenging period. Surprisingly, the statement did not include reference to the third wave of the spread of the Covid-19, which is leading to tighter restrictions in some regions of the country and hampering short-term economic activity. Similarly, there was also no reference to the rollout of the Covid-19 vaccines, which could enable the return of regular economic activity.
- The consumer price index (CPI) increased by 0.4% in December (m/m) after a 0.2% increase in November (m/m). The increase in the index was primarily due to a 8.4% increase in the energy component (gasoline). In annual terms, the CPI increased at a rate of 1.4% (y/y) after remaining at 1.2% in November (y/y) and the core index continued to increase by a rate of 1.6% (y/y). According to estimates of the Fed from December 2020, the annual inflation rate will return to 2.0% only in 2023; however, in our opinion, in a scenario involving an

accelerated vaccination process for the population, inflation is expected to increase to 2.0% or higher already during 2021.

- The main drivers of an increase in inflation in 2021 include various supply side price increases that have already been taking place. There is a large amount of "pent up demand" among US households, and as restrictions on consumers are loosened, excess demand is likely to lead to a shortfall of supply in some service sector areas (leisure, hotels etc.) and to lead to an increase in prices, at least temporarily. The expansion of broad money aggregates in the US is also expected to contribute to an increase in inflation. Last but not least, a rise in inflation would coincide with policy maker's wishes and targets.
- Yields on medium- and long-term government bonds (5 and 10 years) increased in the second half of December, continuing the upward trend of recent months. Yields on short-term government bonds increased as well, although more moderately (see Chart 3). The increase in recent months in the slope of the yield curve occurred at the same time as a rise in the US stock market. We estimate that in the event the market continues to rise in the US (risk on), this may support a continued rise in the slope of the yield curve. Furthermore, there is a distinct, positive historic correlation over time between the yield-to-maturity of US government bonds (10 years to maturity) and the ratio between the price of copper and the precious metals price index (see Chart 4). This relationship stems from the fact that copper is a metal used widely in manufacturing and thus when global industry grows, the demand for copper increases, which raises the price on copper. In contrast, precious metals prices fall when the global economic situation improves, since concerns regarding the realization of risks decreases, while they rise when the state of the economy worsens, since precious metals represent a kind of "safe haven" when the state of the economy worsens, especially in times of crisis. Therefore, when the state of the economy improves, then the ratio between the price of copper and the price index of precious metals increases, yet when the state of the economy worsens, the ratio between them decreases. We note that the weakening of the US dollar also lends to a rise in commodities prices because these are denominated in dollars, but this change is neutralized in the ratio between the price of copper and precious metals (both of which are denominated in dollars).



- This index currently indicates that the yield-to-maturity of long-term government bonds (10 years) is likely to increase from its current level. Regarding the scale of the increase, it is important to take into consideration the characteristics of the Fed's activity in the government bond market, which has so far prevented any substantial rise in yields. If it were not for this intervention, and in view of the fundamental factors involving the large fiscal deficit in the US and against it an economy that continues to expand investment in capital goods, the yield levels would be higher than they are today. In our opinion, if the vaccines turn out to indeed be effective and safe over time, also against the mutations in the Covid-19, and if the general population cooperates fully in these efforts, then long-term US bond yields will increase from their current level of 1.14% to more than 1.3%. This will represent a relatively partial increase to the full potential of the rise in yields. In addition, the democrats control of the US Senate also supports the rising of yields to maturity as it will allow Mr. Biden's administration to further expand fiscal support, which will increase government bond raising. The potential for additional yield increase is there and its realizations seems to be constrained by the market's perception of the Fed's vast ability to intervene in the markets in order to limit yield increases. With is credible market influence taken into account, the yield to maturity of the US 10Y bonds is still expected to rise moderately throughout 2021 from the current level.



The Euro Bloc

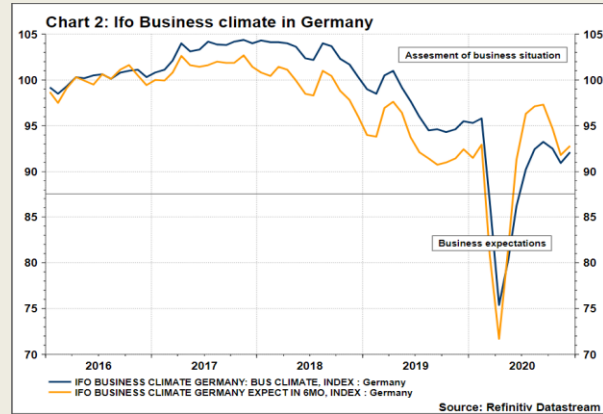
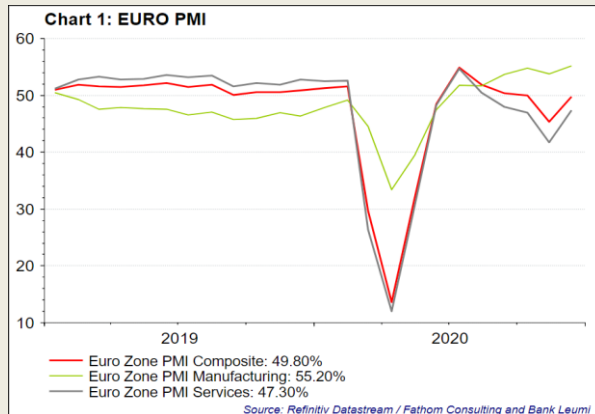
Economic activity: euro bloc GDP is expected to contract in the final quarter of 2020 due to the tightening of restrictions on economic activity. For all of 2020, GDP is expected to decline 7.6%, and to increase 4.8% in 2021.

- Economic activity in the euro bloc continued to recover in the beginning of the final quarter of 2020. Industrial manufacturing increased 2.1% in October (m/m), indicating a continued recovery in GDP in the beginning of the fourth quarter of 2020 and we believe the GDP continued to increase in all of the final quarter of 2020 despite tighter economic restrictions in a number of regions. This is because the current restrictions concentrate on the services

sectors, in contrast to the restrictions imposed at the start of the crisis that were much broader and negatively affected the industrial sector as well. Consumer confidence increased in December, despite tighter restrictions imposed in a number of euro bloc member countries, such as Italy, Germany, and Netherlands. Nonetheless, consumer confidence remains at a low level, and we believe the continued rapid spread of the coronavirus, coupled with concerns regarding mutations of the virus discovered in Britain, are expected to keep consumer confidence at a low level also throughout the first quarter of 2021. However, the vaccination of a substantial portion of the population, together with an expected easing in the restrictions in the event it will become clear the vaccination is effective also against the recently discovered mutation of the coronavirus, is expected to lead to a notable increase in consumer confidence during the second quarter of 2021.

- The composite PMI of the euro bloc increased in December (see Chart 1), indicating recovery in economic activity within the industrial and services sectors, following an easing in the restrictions that were imposed in France. Analysis according to sectors shows the index of the services sectors increased in December after it had fallen continuously since August 2020, thus indicating the services sector has started to recover slightly. This increase in the indices represents an initial indicator suggesting it is likely the GDP of the euro bloc will contract in the final quarter of 2020 by a lower rate than the expected rate of 3%. However, differences are apparent in the developments within different countries. For example, the composite PMI of France increased in December mainly due to an increase in the services sector, thereby indicating a recovery in economic activity with the easing in restrictions. In contrast, in Italy the composite PMI declined in December to the lowest level since June 2020, due to the fall in the index of the services sector that stemmed from the economic shutdown imposed within the country in the second half of the month. This shutdown had the goal of preventing the spread of the coronavirus during the celebrations that characterize that time of year. These developments point to contraction in the Italian services sector.
- A tightening of restrictions in Germany, coupled with the spread of the coronavirus in additional regions, is expected to keep the services sector, which accounts for more than 60% of GDP, weak in the near term, and this situation is likely to hamper any economic recovery. However, despite the tightening of the shutdown, the composite PMI in Germany increased in December and reflects continuing strong growth of industry together with a slight recovery in services, yet economic activity in the services sector remains weak. The IFO business climate index on the business environment in Germany increased in December (see Chart 2) and this also supports the assessment that German GDP will suffer less than the other major economies of the euro bloc and may not even contract in the final quarter of 2020. However, the tightening of restrictions in the country is expected to weigh on the economic recovery in the beginning of 2021. We note that most of the responses to the IFO survey were received before the decision was made to tighten restrictions, which are expected to continue at least until January 10, such that the index in January is likely to decline slightly and to reflect the damage of the partial shutdown on the business environment.

- Looking ahead, we estimate the euro bloc GDP will contract in the final quarter of the year, while in all of 2020 the GDP is expected to contract 7.6%, returning to growth in 2021 with an expected increase of 4.8%. The GDP of France is expected to contract 9.2% in all of 2020 and to grow 5.9% in 2021, while German GDP is expected to contract 5.4% in 2020 and to increase 4.6% in 2021.

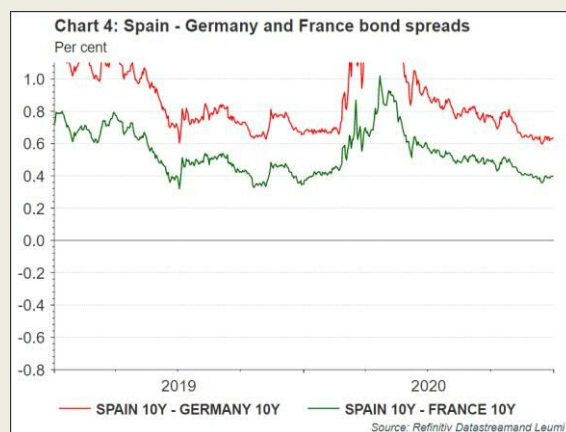
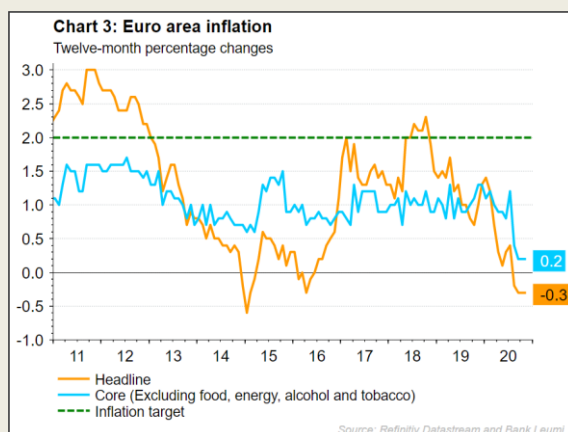


Inflation and monetary policy: the ECB expanded its emergency asset purchase program, and it also extended the horizon for net purchases under this plan. The consumer price index remained unchanged in November. Yields on long-term government bonds fell slightly in December, due to the expansion in support of the ECB in the market.

- In the December 2020 interest rate decision, the ECB announced a €500bn increase to the Pandemic Emergency Purchase Program (PEPP), such that the total sum of the emergency purchase program increased from €1,350bn to €1,850bn. In addition, the ECB extended the horizon for net purchases under the PEPP to at least the end of March 2022, while the reinvestment of principal payments from maturing securities under the PEPP will be extended until at least the end of 2023. Furthermore, the ECB decided to further recalibrate the third series of its Targeted Longer-Term Refinancing Operations (TLTRO III). Specifically, it decided to extend the period over which considerably more favorable terms will apply by 12 months, to June 2022. Three additional rounds of operations will also be conducted between June and December 2021. Moreover, it was decided to raise the total amount that counterparties will be entitled to borrow in TLTRO III operations. This will be the case as long as the banks achieve a new lending performance target. These actions strengthen the messaging that the ECB relayed in its previous decisions, specifically that the bank will support the market as needed. This means the bank believes the weakness in economic activity will continue for an extended period. These measures of the ECB are consistent with the policy of "yield curve control" even though there has been no official announcement of such, or on yield targets, and the measures are expected to keep government bond yields at low levels and to even contribute to an additional decline in the yield-to-maturity of some bonds of euro bloc countries.
- Inflation in the euro bloc, as measured by the Harmonized Index of Consumer Prices (HICP), remained unchanged in December at a negative annual rate of -0.3%, and the core inflation rate also remained unchanged at an annual rate of 0.2% (see Chart 3). This is the fourth

consecutive month in which the annual inflation rate and core inflation remained unchanged and the fifth month in which the annual inflation rate has been negative, with the tourism component in the index representing the most substantial factor behind the low inflation rate. In our opinion, only in the second quarter of 2021 is the annual inflation rate expected to rise, although it will remain below the inflation rate that was prevalent before the outbreak of the coronavirus.

- Yields on long-term government bonds of the main economies in the euro bloc continued to decline during December, following the ECB statement on its continued support for the economy and the increase in the Pandemic Emergency Purchase Program (PEPP), as well as the extension in the time horizon of this emergency purchase program. However, the yields on long-term German bonds rose, after German chancellor warned that the lockdown may remain in place until April. This raised the degree of uncertainty in the market and the expectation for larger German government bond raising. From April 2020 through mid-December, there was an inversion in the shorter portion of the yield curve of Germany (2Y-3M) and from June 2020 there was a similar inversion also in the yield curve of France. This inversion indicates the uncertainty existing in the market that is likely to influence monetary policy, as well as concerns over a lack of an increase in the inflation rate in the coming months. In Greece, an inversion occurred in the yield curve, although in the short and medium portions (10Y-2Y) since June 2020, which intensified during the second half of the year, and this indicated a larger sense of uncertainty. In Spain, the yield differential of its long-term government bonds vis-à-vis Germany and France fell in the second half of 2020, thus indicating an improvement in Spain's condition compared to the other main economies of the euro bloc. This was due to, among other things, the support of the ECB in the government bond market of the euro bloc members (see Chart 4).



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