

Global Macroeconomic Monthly Review

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March 2021

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Key Issues and Table of Contents

Bank Leumi Economic Forecasts (p. 3)

The Global Economy – Overview (p. 4)

- *Global economic activity of the manufacturing sector continues to recover.*
- *There are dissimilarities in the growth rates of the developing countries within Europe due to differences in the policies each country has adopted to deal with the coronavirus.*
- *Brazil suffered less activity loss in 2020 than other countries in Latin America, but there are signs of a slowdown in strong growth.*
- *Inflation in the developed countries increased in the beginning of the year, while in the US and the euro bloc inflation remained in February was higher than during the past year.*
- *The central bank of Australia expanded its asset purchase program, and the central bank of Mexico lowered its interest rate by 0.25 percentage points.*

United States (p. 9)

- *It appears that US GDP has continued to increase in early 2021, supported by fiscal stimulus.*
- *Industrial manufacturing continued to grow consistently; however, mining output in February was temporarily hampered due to the extreme cold wave that hit the Gulf of Mexico.*
- *Construction starts declined in January; however, the numbers are expected to climb again later in the year.*
- *The Fed is focusing on achieving the employment target, even at the cost of a temporary rise in the inflation rate.*
- *Inflation is expected to increase in the near-term, with an emphasis on the gasoline component.*
- *The Fed Chairman's semi-annual testimony to Congress was dovish, and led to a temporary drop in the yields-to-maturity of government bonds and to a narrowing in yield spreads. Yields have risen in early March following ambiguity as to the Fed's view on the inflation outlook. The Fed may need to revise its QE targets, in terms of composition and/or size.*

Euro Bloc (p. 12)

- *GDP of Germany and Spain increased in the final quarter of 2020, but the GDP of other euro bloc countries contracted, while that of Austria contracted the most sharply.*
- *The labor market of the euro bloc remains strong due to the massive government support it receives, but the unemployment rate will likely increase later in the year as people return to the workforce.*
- *Looking ahead, the purchasing managers' indices for Europe indicate a path of improvement in industry.*

- *The ECB is expected to continue its current expansionary monetary policy, and to even keep up the purchase of assets at the current pace. These moves are expected to moderate the continued rise in government bond yields.*
- *The February inflation rate remained unchanged despite a rise in energy prices, as the increase was offset by a decline in core components.*

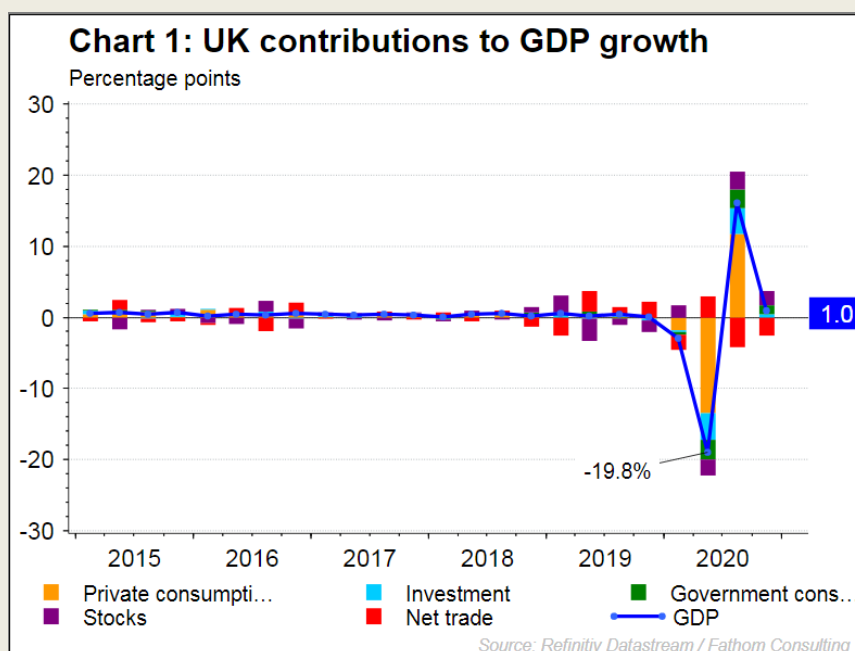
Leumi Global Economic Forecast, As of March 2021

	2018	2019	2020E	2021F	2022F
GDP – Real Growth Rate					
<i>World</i>	3.5%	2.6%	-3.3%	4.9%	4.0%
<i>USA</i>	3.0%	2.2%	-3.5%	4.3%	3.0%
<i>UK</i>	1.3%	1.4%	-9.9%	4.4%	7.4%
<i>Japan</i>	0.6%	0.3%	-4.8%	1.7%	2.7%
<i>Eurozone</i>	1.9%	1.3%	-7.1%	4.3%	4.0%
<i>South East Asia (ex. Japan)</i>	5.1%	4.3%	-3.9%	4.4%	5.0%
<i>China</i>	6.6%	6.1%	2.3%	8.5%	5.0%
<i>India</i>	6.1%	4.2%	-7.9%	6.9%	5.1%
<i>Latin America</i>	0.8%	-0.5%	-7.3%	3.9%	2.8%
<i>Israel</i>	3.5%	3.4%	-2.5%	4.9%	4.1%
Trade Volume, Growth (%)					
<i>Global</i>	3.7%	0.9%	-9.6%	6.7%	6.5%
Interest rates, Year End					
<i>US Fed</i>	2.25-2.50%	1.50%-1.75%	0.00-0.25%	0.00-0.25%	0.00-0.25%
<i>Bank of England</i>	0.75%	0.75%	0.1%	0.1%	0.1 %
<i>Bank of Japan-Policy Rate</i>	-0.07%	0.0%	0.0%	0.0%	0.0%
<i>ECB-Main Refi</i>	0.00%	0.00%	0.00%	0.00%	0.50%
<i>Israel</i>	0.25%	0.25%	0.1%	0.00-0.25%	0.00-0.25%

The Global Economy – Overview

Economic activity: Global economic activity of the manufacturing sector continues to recover. There are dissimilarities in the growth rates of the developing countries within Europe due to the differences in the policies each country has adopted to deal with the coronavirus. Brazil suffered less activity loss in 2020 than other countries in Latin America, but there are signs of a slowdown in strong growth.

- Economic activity in the manufacturing sector continues to recover also in the countries that tightened restrictions in an effort to halt the rise in morbidity. The tightening of restrictions in some countries, particularly in the euro bloc, hurt primarily the services sector; however, the damage is expected to be substantially below that experienced during the previous economic shutdowns, apparently because business owners learned to adapt to the new reality. The composite PMI increased in February in the developed countries. The index of the US showed no substantial change, staying near a high level, thus indicating continued recovery of the economy. However, the index of the euro bloc remained below 50 points, thus indicating a slight contraction in economic activity despite a continuing recovery in manufacturing. The index also indicates supply chain problems, which are likely to lead to an increase in manufacturer prices.
- The GDP of Britain increased in the final quarter of 2020 by 1.0% (q/q) due to an increase in inventories, investments, and government consumption, and thus Britain was prevented from entering into recession despite a contraction in private consumption (see Chart 1). Retail sales declined 8.2% in January (m/m), due to the shutdown that was imposed in response to the spread of morbidity. The data indicate that the current shutdown in Britain has been more difficult for retailers than the shutdown imposed back in November, despite the government support for the economy; yet, the damage experienced by retailers has been less than that at the time of the first shutdown at the beginning of the crisis. The decline kept retail sales 6% below the pre-crisis levels. In our view, the spread of the third wave of the coronavirus is

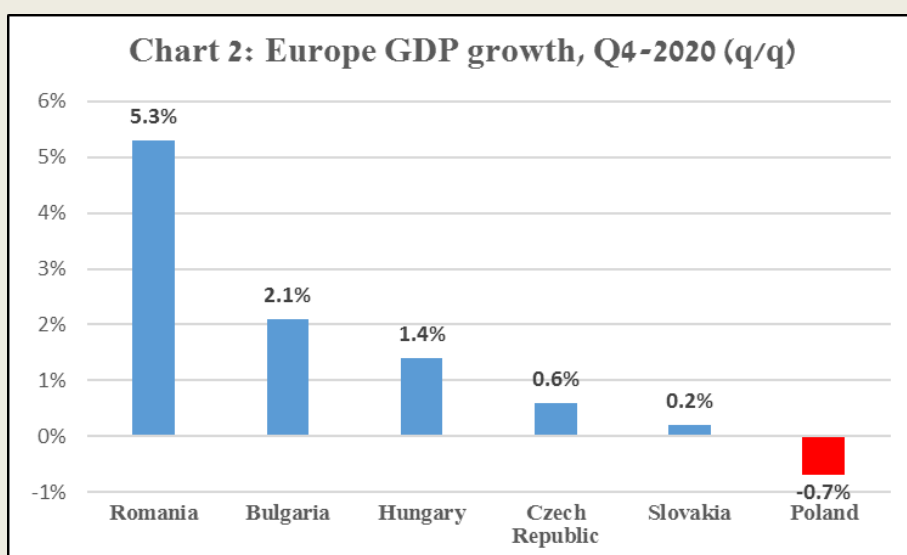


expected to cause a contraction in GDP in January, but in the second half of 2021 the GDP of Britain is expected to recover at a rapid pace.

- The substantial rise in the composite PMI of Britain indicates that the GDP is not expected to contract in February and that with the lifting of the restrictions that were imposed in the country, the GDP is expected to return to growth at a rapid pace. The bulk of the increase in the composite index stemmed from an increase in the PMI of the services sector, which increased from the eight-month low it was at, yet it still does not signal growth of the services sector, thus indicating weakness in the activity of this sector. The index of the manufacturing sector increased slightly, since the restrictions that were imposed had almost no impact on manufacturing, and it indicates a continued growth in activity. v
- In Japan, machinery orders increased in December 2020, representing the third consecutive month of gains, and remained at the highest level since November 2019. This increase indicates that the recovery in investments in the business sector is expected to continue throughout the first quarter. Retail sales fell 0.5% in January (m/m) due to the existing shutdown in the country. This decline is below the forecasts, and in particular, it is substantially below the contraction in sales that occurred during the time of the first shutdown in the country back in April 2020. Industrial manufacturing increased 4.2% in January (m/m), and is currently only 1.8% below its pre-crisis level. The minor decline in retail sales, coupled with the strong increase in industrial manufacturing, indicates the Japanese economy is succeeding to deal reasonably well with the current restrictions imposed in the country, and it is likely the GDP will not contract during the first quarter of 2021, despite the shutdown. In addition, the minor increase in the February composite PMI of Japan indicates the country is dealing with the current shutdown better than the case during the first shutdown. The rise in the composite index stems mainly from an increase in the manufacturing sector index, from 49.8 to 51.4 points, the highest level in the last two years, thus attesting to the strength of the manufacturing sector. This increase in the index stems from, among other things, a strengthening in the new export orders component, which increased to a three-year peak and indicates continued growth in exports of the manufacturing sector. The index of the services sector also increased slightly, following two months of declines, thus supporting the assessment that Japan is dealing better with this current shutdown.
- GDP in the developing countries continued to recover during the first quarter of 2021. The PMI of China declined slightly in February, yet it still indicates the manufacturing sector was not hurt by the restrictions imposed to prevent the spread of the coronavirus, against the backdrop of the Chinese New Year holiday, and in our view industrial manufacturing is expected to continue to recover in the coming months. In India, industrial manufacturing increased 1.0% in December 2020 (y/y) and the February PMI indicates continued growth in manufacturing and services. In our view, the government fiscal support is expected to encourage a continued recovery in the economic activity of the manufacturing sector throughout the coming year.
- India's imports, which declined slightly in January-February after a sharp increase at the end of 2020, are expected to return to their upward trend in the remainder of this year, due to a recovery in local demand coupled with the rise in oil prices. India's exports are expected to expand in the remainder of the year with the vaccination of a substantial portion of the

population in the developed countries, which is likely to raise external demand. However, in our view exports will not increase by an extraordinary rate since they are already at a level very close to that from before the crisis. In addition, with the increase in exports, imports are expected to expand as well and contribute to an increase of the current account deficit of the balance of payments. We forecast that in the remainder of the year the GDP of China will increase 8.5% after it increased in 2020 by a rate of 2.5%, and the GDP of India will grow this year by 6.9%, after its 7.9% contraction in 2020.

- The GDP data from the end of 2020 indicate differences in the growth rates among the various countries, in accordance with the manner in which each country managed the rise in morbidity during the final quarter of 2020. These differences are pronounced especially between the countries in Eastern and Central Europe, which share geographical proximity (see Chart 2). The GDP of Romania and Hungary, both of which implemented relatively light restrictions, increased in the final quarter of 2020 by 5.3% (q/q) and 1.4% (q/q), respectively. In contrast, in the Czech Republic and Slovakia, both of which implemented more severe restrictions, the GDP grew in the final quarter of 2020 by 0.6% (q/q) and 0.2% (q/q) respectively. In our view, the recovery of activity in these countries is expected to continue also throughout the first quarter of 2021. However, the slow rollout of the vaccination of the population in the Eastern and Central European countries is expected to hamper the recovery in activity, which poses a risk to GDP growth in these countries in the first half of 2021.
- Norway's GDP growth in the final quarter of 2020, by 0.6% (q/q), following 4.5% growth (q/q) in the third quarter of 2020, indicates the country is recovering more quickly from the crisis than other countries in Eastern and Central Europe. Currently, Norway's GDP is only 1.1% below its pre-crisis level. The contraction in Norway's GDP in 2020 was the country's steepest contraction since 1970; however, it is relatively low compared to the GDP contraction that has occurred in other European countries. In our view, the economic activity of Norway is expected to remain vulnerable; however, rising oil prices are expected to support continued economic recovery.
- In Poland, the GDP contracted 0.7% in the final quarter of 2020 (q/q), due to the restrictions implemented in the country. The primary weakness occurred in Poland's retail sector and services, which apparently were hurt more than in other countries in Eastern and Central



Europe; however, the manufacturing sector continued to grow. In our view, the removal of the restrictions in the coming weeks, together with the strong industrial activity, is expected to return the GDP to a path of growth in the first quarter of 2021. However, the slow inoculation of the population indicates that an additional risk exists to GDP growth in the second quarter of the year.

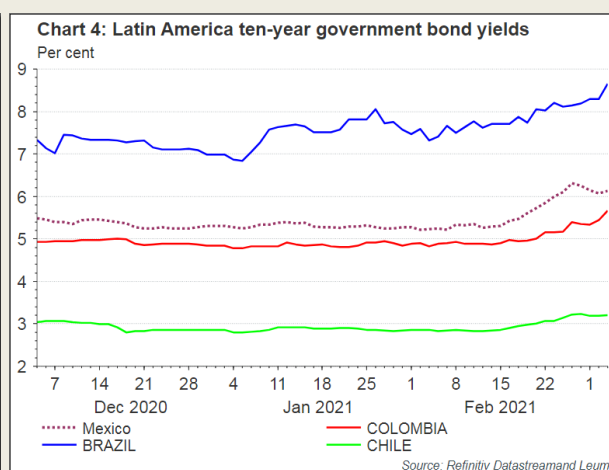
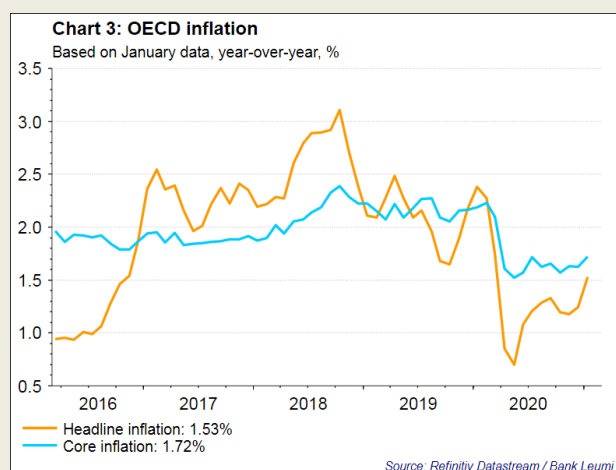
- In Latin America, the GDP of Brazil increased 3.2% in the final quarter of 2020 (q/q), and thus the GDP of the country is currently only 1% below the level from the end of 2019. This development indicates that the GDP of Brazil suffered over the course of the past year less than other Latin American countries. However, there are signs of slight weakness to this strong growth, particularly against the backdrop of the rise in morbidity in the country, which raises the risk of a tightening in restrictions. GDP growth stemmed from the rise in consumption and investments, yet some of the growth in investments stemmed from temporary factors included increasing investments in oil rigs and infrastructure.
- We note that the growth in investments led to a rise also in imports, which has a negative impact on the calculation of GDP. Columbia's GDP increased 6.0% in the final quarter of 2020 (q/q), indicating strong growth in activity in the second half of 2020; however, the GDP remains 3.6% below its level at the end of 2019. In our view, the recovery is expected to weaken in the first quarter of 2021 due to tightening restrictions in the country against the backdrop of the high morbidity in early January. However, as morbidity declines, economic activity is expected to recover once again and we estimate the GDP of Columbia will return to its pre-crisis level in 2022.
- Looking ahead, we expect global GDP to recover during the year and will increase 4.9%, with the recovery in the non-OECD member countries expected to be stronger. China and India are expected to enjoy the highest rates of economic growth this year, at 8.5% and 6.9%, respectively. The GDPs of the US and the euro bloc are expected to increase this year by a rate of 4.3%, whereas in Southeast Asia and in Latin America the GDP is expected to increase this year by 4.4% and 3.9%, respectively.

Inflation and monetary policy: Inflation in the developed countries increased in the beginning of the year, while in the US and the euro bloc inflation remained in February was higher than during the past year. The central bank of Australia expanded its asset purchase program, and the central bank of Mexico lowered its interest rate by 0.25 percentage points.

- Inflation in the developed countries increased in early 2021 and remained at a relatively high level also in February. The annual inflation rate in the OECD increased in January from 1.2% to 1.5% (see Chart 3), due to the rise in energy prices, coupled with the increase in food prices that slowed in the beginning of the year. Despite the rise in energy prices, their contribution to the CPI remained negative because the index analyzes the annual rate of change. The core inflation rate (excluding food and energy) increased as well in January, albeit by a more moderate rate, while annual core inflation increased from 1.6% to 1.7%.
- From the minutes of the last meeting of the US Fed's Federal Open Market Committee (FOMC), as well as from the semi-annual testimony of the Fed Chairman before Congress, it

can be determined that the Fed is primarily focused on achieving its employment target and lowering the unemployment rate to 4%. These goals are being pursued even at the cost of a temporary rise in the inflation rate.

- It appears that also the members of the ECB monetary committee are not worried about concerns over an increase in the inflation rate, despite the uncertainty relating to the inflation forecasts because of the change in the weighting of the CPI components during the period of the current health crisis. In our view, the Fed and the ECB are expected to continue their accommodative monetary policies in order to continue to support the recovery of the market and the lowering of the unemployment rate. At the same time, the ECB is expected to continue its current pace of emergency asset purchases in order to prevent an increase in the yields-to-maturity of the long-term government bonds of the euro bloc member countries.
- In Australia, the central bank expanded its asset purchase plan by an additional AUD100bn in its interest rate decision from the beginning of February. This comes as the existing budget for the purchase of assets totaling AUD100bn that the central bank allocated in November 2020 for the purchase of Australian bonds with durations of five and ten years at a pace of AUD5bn per week is expected to conclude in mid-2021. The expansion of the purchase plan stems from the expectations for a negative impact from the closure of the country's borders on economic activity, and the assessment of the central bank that the borders are expected to remain closed at least through the end of the year.
- The central bank of Mexico decided unanimously in February on an interest rate cut of 0.25 percentage points to 4.00%, due to the renewed spread of the coronavirus and despite the rise in the inflation rate in January. The decision indicates that the policy makers were more dovish than expected, and this raises the chances for an additional rate cut in the coming months. In our view, the window of opportunity for an additional rate cut is in the first half of 2021; however, the chances for an additional cut remain low due to the inflation rate (3.5%), which is close to the upper border of the inflation target (2%-4%). Furthermore, in the second half of the year no interest rate cut is expected, due to the expectation for an increase in the inflation rate, coupled with a recovery in economic activity.
- The increase in long-term US bond yields moderated only temporarily following the semi-annual testimony of the Fed Chairman before Congress. The moderation in the rise in yields-to-maturity of long-term bonds of the large economies of the euro bloc was temporary as well. The rise in Latin American yields was affected mainly by a substantial rise in inflation



expectations in these countries. In Brazil, the yield curve is very steep at its front end and this increased further in February due to the steep rise the yields of medium-term bonds (5 years).

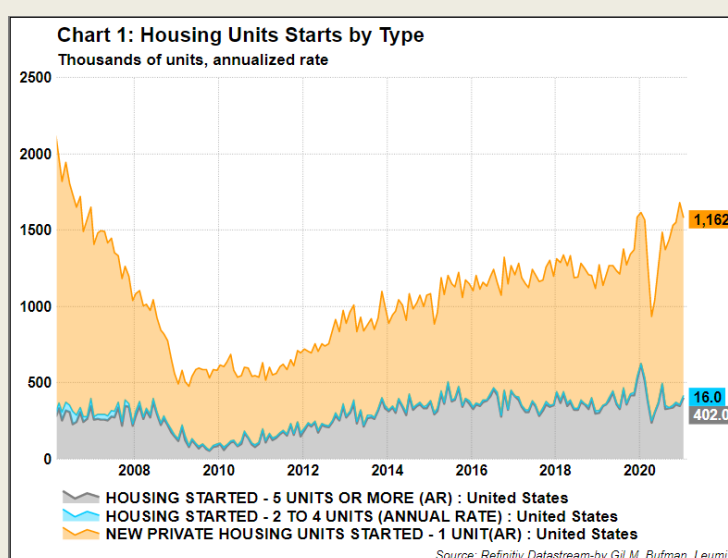
United States

Economic activity: It appears that US GDP has continued to increase in early 2021, supported by fiscal stimulus. Industrial manufacturing continued to grow consistently; however, mining output in February was temporarily hampered due to the extreme cold wave that hit the Gulf of Mexico. Construction starts declined in January; however, the numbers are expected to climb again later in the year.

- Economic activity in the US continued to recover in the beginning of the year, supported by more than US\$900bn in fiscal stimulus, with this sum likely to increase further later in the year in accordance with President Biden's expansion of fiscal support by US\$1.9tn. As part of the fiscal stimulus package approved back at the end of 2020, when Donald Trump was still acting president, households received a grant consisting of a check amounting to US\$600 per person. This led to an increase in retail sales, which increased 5.3% in January (m/m), suggesting that GDP growth in the first quarter of this year is expected to be relatively robust. It is likely that during April 2021 the next wave of grants will be transferred with the delivery of checks to most households, amounting to an additional US\$1,400 per person (subject to an income ceiling).
- US industrial manufacturing increased 0.9% in January 2021 (m/m), but remained below the level from the parallel period of last year, while the annual rate declined by a lesser degree, from -3.2% (y/y) to -1.8% (y/y). Industrial output increased broadly, as the growth of output of the metals, electronic equipment, and the aeronautics equipment sectors strengthened. Mining output increased as well in the early part of the year due to the growth in oil production, but a wave of extreme cold weather in mid-February led to a substantial slowdown in oil production in the Gulf of Mexico, especially in Texas. Consequently, we estimate mining output will show a contraction in February. However, output is expected to recover throughout the coming months and to return to the path of growth that has characterized this activity in the beginning of the year. The composite PMI of the US remained in February near its highest level in recent years, indicating continued growth of economic activity in industry and in services.
- Durable goods orders increased 3.4% in January (m/m), primarily due to a sharp rise in commercial aircraft orders, reflecting minimal cancellation rates in orders from Boeing Corporation. This increase has brought durable goods orders to a level 4.7% greater than the level from before the spread of the coronavirus, even though aircraft orders have not increased substantially compared to the pre-crisis period. In our assessment, this increase in goods orders indicates that business equipment investment will increase in the first quarter by a substantial rate.
- The number of construction starts declined 6.0% in January (m/m), stemming mostly from a drop in construction starts of single family homes in the US, which declined 12.2% in January

(m/m; see Chart 1). Despite this decline, the NHAB index measuring builder confidence remained high due to the low housing inventory level, which supports an increase in the number of construction starts later in the year, particularly in light of the upward trend in construction approvals, which increased substantially in recent months. Existing home sales increased slightly in early 2021 despite the decline in inventory, which is expected to lead to a decline in sales later in the year. In our view, the expected rise in mortgage interest rates, which fell recently to their lowest levels of the last three months, is expected as well to support a decline in sales later in the year.

- Looking ahead, the growth in economic activity in the US is expected to continue further in the coming months. This is the case especially in light of the decline in recent weeks in morbidity across the US, as expressed in the number of new daily patients, as well as in the number of active patients, which for the first time since the spread of the pandemic has been in a downtrend for a complete month. In summary for the year, we estimate US GDP will grow 4.3% in 2021, such that it is expected to return to its 2019 level during the year.



Inflation and monetary policy: The Fed is focusing on achieving the employment target, even at the cost of a temporary rise in the inflation rate. Inflation is expected to increase in the near-term, with an emphasis on the gasoline component. The Fed Chairman's semi-annual testimony to Congress was dovish, and led to a temporary drop in the yields-to-maturity of government bonds and to a narrowing in yield spreads.

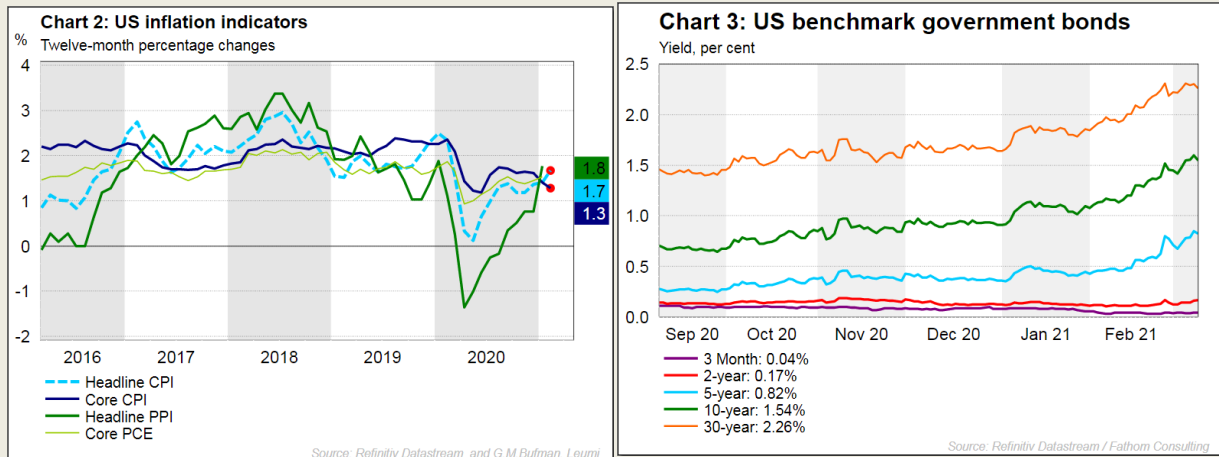
- The Federal Open Market Committee (FOMC) meeting notes from the end of January show that the discussions focused on achieving the Fed's employment target, and committee members noted that "The risks to the inflation forecast are more balanced today than what they were throughout most of 2020." Most of the committee members are still more concerned about the risk of a decline in inflation. However, a small portion of the committee members expressed concerns regarding the risks of a rise in the inflation rate due to the impact of the restrictions on supply chains, with an emphasis on producer prices, which were more exposed to the effects of the spread of the virus. Part of the FOMC meeting was dedicated also to changes in the degree of financial stability. The members of the committee noted the

decline in corporate bond spreads and in the capital market risk premium, which reached pre-crisis levels. In addition, some of the committee members noted that the market value of stocks has continued to climb, and that IPO activity has increased as well. These developments indicate concerns regarding asset price inflation, yet the Fed prefers to deal with these matters using regulatory measures and not through monetary policy.

- The semi-annual testimony to Congress of the Chairman of the Fed, Jerome Powell, was dovish. His conclusion was that "The economy is far from the employment and inflation targets of the Fed, and it is reasonable to assume that it will take time until substantial progress is achieved." This statement indicates that the Fed will not slow the pace of asset purchases, even if the US government will pass an additional substantial stimulus package. Powell emphasized his desire to achieve a "broad and inclusive" recovery in the labor market, and he noted that the high level of non-employment was especially difficult for lower salaried workers, as well as for African-American, Hispanic, and other minority workers. From his statements, it appears the Fed will not carry out any process of narrowing the current monetary policy as long as the unemployment rate does not return to 4% or lower, which is the current estimate of the long-term unemployment rate. Meanwhile, the Fed is expected to emphasize lowering the unemployment rates among minority groups and low-salaried workers. In our view, the Fed will give substantial weighting to the impact of temporary factors with respect to their effects on inflation, such that at present it will avoid tightening monetary policy in response to the expected rise in the inflation rate.
- The February consumer price index (CPI) increased by an annualized rate of 1.7%, mainly due to rising energy prices, while the annual core inflation rate fell in February from 1.4% to 1.3% (see Chart 2). In our view, the on-going rise in oil prices, coupled with the rise in gasoline prices in the states that were hurt by the severe cold wave and in the states that rely on the oil refineries located in these states, is expected to lead to a rise in the gasoline component in the CPI in the near-term. The year on year rate of increase of the CPI and core CPI are expected to rise substantially in coming months due to base effects and supply side pressures.
- Over the longer-term, the rise in the minimum wage over the next few years planned by the US administration is expected to support inflation. It is also likely that governmental fiscal expansion will have inflationary aspects to it, although this matter is currently embroiled in controversy between the proponents of expansion as the president plans, and the proponents of a smaller fiscal expansion. The producer price index increased by an annual rate of 1.8% in January as a result of the strengthening of local demand, alongside the strengthening of exports, which led to a larger increase in the components of goods and services intended for export.
- The dovish statement of the Fed Chairman only temporarily moderated the rise in US government bond yields (see Chart 3). The rise in yield-to-maturity rates occurred as a result of the expected rise in breakeven inflation inherent in bond prices, and recently there also occurred a rise in real bond yields, which reflects the expected effects of real factors, such as the government deficit, on the bond market. Absent the Fed's substantial market intervention,

US bond yields would have been much higher than the current level of about 1.5% in 10 years to maturity bonds, possibly by 100bps or more than the current yield levels.

- Yields have risen in early March following ambiguity as to the Fed's view on the inflation outlook. The Fed may need to revise its QE targets, in terms of composition and/or size. Another possible change in the QE characteristics may be through extending the average duration of the bonds purchased.



The Euro Bloc

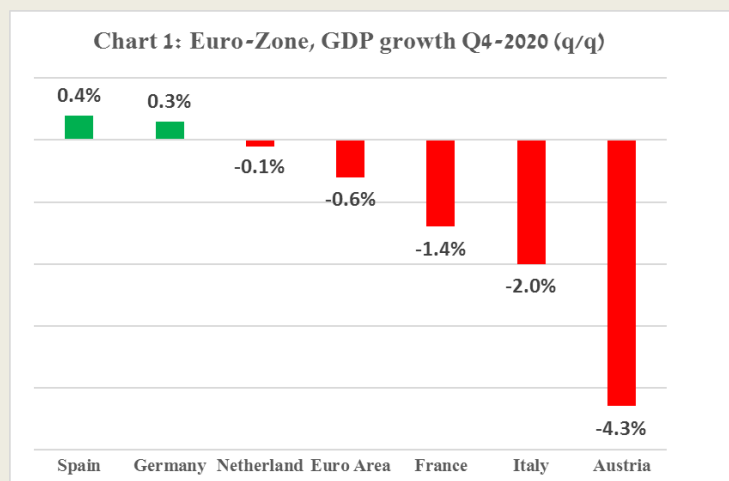
Economic activity: GDP of Germany and Spain increased in the final quarter of 2020, but the GDP of other euro bloc countries contracted, while that of Austria contracted the most sharply. The labor market of the euro bloc remains strong due to the massive government support it receives, but the unemployment rate will likely increase later in the year as people return to the workforce. Looking ahead, the purchasing managers' indices for Europe indicate a path of improvement in industry.

- The third estimate of the euro bloc GDP in the final quarter of 2020 indicating a 0.7% contraction (q/q), such that the GDP is currently 5.0% below its level from the end of 2019. However, the number of employed persons increased in the last quarter, for the first time since the outbreak of the crisis, by 0.3% (q/q). This came despite the tightening in restrictions and the shutdowns imposed in some regions, as more than half a million new jobs were created.
- Nonetheless, the number of jobs is still more than three million below the number from the end of 2019. The strengthening of the labor market stems from government programs to save places of employment in the euro bloc. These government programs have provided support throughout the crisis. In our view, the unemployment rate is expected to increase slightly later in the year due to the impact of the crisis at some companies, to the point at which they cease their operations, together with the return to the labor market of individuals who worked prior to the crisis and exited from the workforce. However, the uptick in the unemployment rate is not expected to be substantial.

- The EC index on consumer confidence in the euro bloc rose slightly in February, yet it remains at a low level, thus indicating private consumption is expected to remain low in the first quarter of 2021, and may even decline slightly. This comes particularly in light of the continuing shutdown in Germany and the existing restrictions in other euro bloc countries. In our view, as long as the inoculation of the population does not gain momentum, which would permit the lifting of the existing restrictions, consumer confidence is expected to remain at a low level.
- Industrial manufacturing in the euro bloc continued to increase in the final quarter of 2020, although it contracted 1.6% in December 2020 (m/m) due to a decline in the manufacture of capital goods and non-durable consumption goods. In particular, in France and Italy industrial manufacturing contracted in December 2020 by 0.8% and 0.2% (m/m), respectively. The composite PMI of the euro bloc increased slightly in February from 47.8 to 48.8 points, yet it remains at a level that indicates a contraction in the GDP in the first quarter of the year, mainly due to weakness in the services sector. The slight increase stems from the improvement in the manufacturing sector index, which reached 57.9 points, representing a three-year peak, and indicates a partial recovery in industry. However, some of this increase originates also from global supply chain blockages that stem from freight problems that are expected to be short-term.
- Growth at the end of 2020 varied among the member countries of the euro bloc (see Chart 1). Whereas the GDP of Germany and Spain increased in the final quarter of 2020, the GDP of other euro bloc member countries contracted in this period. The contraction in the GDP of Austria was the deepest in the euro bloc at 4.3% (q/q), while the GDP of France and Italy contracted as well, although by a lower rate. The GDP of Netherlands contracted slightly during the final quarter of 2020, by 0.1% (q/q), due to a decline in private consumption that was almost completely offset by an increase in investments. Netherlands's GDP is currently only 3.0% below its level at the end of 2019.
- The IFO business climate index in Germany increased in February and indicates that German economic activity experienced less damage than expected from the shutdown. In particular, the IFO index indicates positive expectations for a rapid recovery of activity with the removal of restrictions. The composite PMI of Germany increased slightly as well in February, indicating a continued recovery in industrial economic activity, alongside a slight decline in the activity of the services sector.
- The February purchasing managers' indices in Europe indicate a recovery of industry in the larger economies of the euro bloc. In France, the manufacturing PMI registered a substantial increase from 51.6 in January to 56.1 points in February. In Germany, the manufacturing index increased to over 60 points. In Italy, the manufacturing index increased as well, despite high morbidity in the country, and in Spain the index increased from 49.3 points to 52.9 points, thus currently indicating a recovery in industrial manufacturing. Alongside this, the economic activity of the services sector remained relatively weak in February, and the index of the services sector of the larger economies of the euro bloc remains below 50 points, thus signaling a decline in the economic activity of services. In France, the services index also fell for a second consecutive month, thus indicating weakness in the French services sector.

In contrast, in Italy the index registered increases over the last two months, indicating that even though the economic activity of the services sector remains weak, it is likely to strengthen during the coming period.

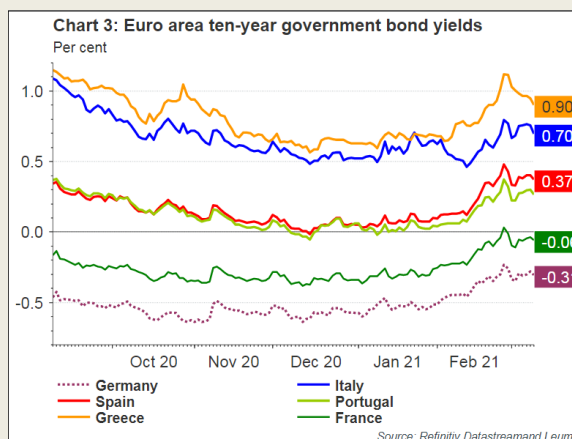
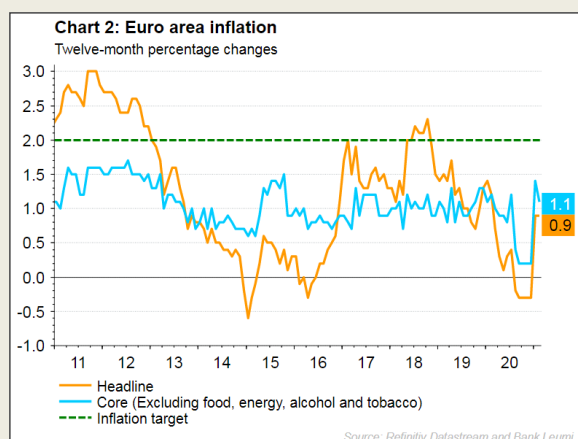
- Looking ahead, we expect GDP of the euro bloc to continue to recover in the remainder of the year, while the recovery is expected to be more pronounced once a substantial portion of the population will be inoculated. Such a development will permit an additional easing of the restrictions. The GDP of the euro bloc is expected to increase this year by 4.3%, but only in 2022 will the GDP return to the level it was at back in 2019.



Inflation and monetary policy: The ECB is expected to continue its current expansionary monetary policy, and to even keep up the purchase of assets at the current pace. These moves are expected to moderate the continued rise in government bond yields. The February inflation rate remained unchanged despite a rise in energy prices, as the increase was offset by a decline in core components.

- The minutes of the Monetary Committee of the ECB confirm that the decision reached in December 2020 to expand the Pandemic Emergency Purchase Program (PEPP) to €1.85tn, and also to increase the Targeted Longer-Term Refinancing Operations (TLTRO) plan, passed unanimously, and we forecast the ECB will continue this accommodative policy in the medium-term. The committee members emphasized the uncertainty regarding the inflation forecast resulting from acute measurement problems related to, among other things, the weights of the components in the consumer price index (CPI) during this period of the pandemic. In their view, the rise in the inflation rate is temporary and is not expected to continue over time.
- Most of the members of the monetary committee were not concerned about rising yields-to-maturity of government bonds, since credit spreads remain low, as reflected in the favorable bond market conditions and the very low lending rate of banks. The ECB interest rate also remains low. In our view, despite the additional increase in government bond yields, as well as the rise in the inflation rate in the beginning of the year, the ECB is expected to continue its current policy of asset purchases. This move will prevent substantial increases in government bond yields, and may even lead to a decline in yields, along with no change in the interest rate.

- The ECB's policy statement is more dovish than anticipated and it explicitly states that the ECB expects purchases under PEPP over the next quarter to be conducted at a significantly higher pace than during the first months of this year. The purchase will be managed flexibly according to the market conditions and with a view to preventing a tightening of financing conditions.
- The consumer price index used in the euro bloc, the harmonized indices of consumer prices (HICP), increased in February by an annual rate similar to that of January, and annual inflation remained at a rate of 0.9% (see Chart 2). Approximately 0.1 percentage point from the sharp rise in January stems from changes in the weightings in the index. These changes reflect the significant changes in consumption patterns over the past year resulting from the restrictions imposed in a large number of euro bloc countries; yet, even without the changes in the weightings, the index would have gone up sharply as well. The energy components in the February index increased due to the rise in oil prices, yet this increase was fully offset by the decline in inflation of the core components of the index. The core inflation rate fell to 1.1% in February (y/y) after it had jumped sharply in January to 1.4% in annualized terms. Part of this decline was expected due to the cancellation of some of the end-of-season sales of winter clothing, but surprisingly also the services components in the index fell.
- In our view, the inflation in transportation prices is expected to rise in the near-term, since it is positively correlated to the price of oil, which rose recently. In addition, the inflation rate is expected to continue to climb throughout the year, particularly in light of the high energy prices, together with the imposition of the tax on carbon dioxide emissions in Germany, which is expected to raise even further the price of energy in Germany and in additional euro bloc member countries. The expected rise in the inflation rate may bring it temporarily closer to the ECB's inflation target, which is slightly below 2%, yet it appears that in the medium-term the inflation rate is expected to remain below this target.
- The yields-to-maturity of the government bonds of the large euro bloc economies continued to rise in February (see Chart 3), after the inflation rate increased sharply in January, and also against the backdrop of the expectations for an additional increase in the inflation rate in the near-term. Government bond yields in Italy fell in the first week of February after Mario Draghi, the former President of the ECB, who earned a high degree of confidence from investors, accepted the invitation of the Italian president to establish a government following the fall of the previous government. With the support of centrist parties in the country, Mr.



Draghi was able to establish a government. The ongoing rise in the US yield to maturity seems to be generating pressures for an increase in European yields. In addition, there has been an increase in the yield gap of south European countries compared to Germany. The macroeconomic characteristics of Portugal, Spain, Italy, and to a lesser extent Greece, seem relatively weak and this may be reflected in the yield gap between them and Germany.

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