



Financial
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Market Insights

October 2018



- Ten years after the collapse of Lehman Brothers and the major financial crisis, the US stock markets continue to break records. A combination of strong growth and accommodative monetary and fiscal conditions support the US stock markets to reach record highs while the rest of the world remains behind and has to face rising dollar interest rates and the strengthening of the dollar
- The era of cheap money and high liquidity is coming to an end, as more and more central banks, led by the US Fed and the ECB in Europe, are returning to normal policy
- The trade war continues to challenge the resilience of the global economy. Trump's administration has imposed a new round of tariffs on Chinese goods. Further actions are expected as the real intentions of the war between the superpowers is much more than a trade war, it is a war on hegemony of the 21st century
- Although a lull in the emerging markets has occurred lately, the increase in the dollar interest rate alongside the continued contraction of the Fed's balance sheet are expected to keep pressuring the emerging markets
- The price of Brent Crude Oil jumped last month to more than \$80 a barrel, a four-year level high due to the collapse of Venezuela and the sanctions on Iran. Trump's demand to lower prices has for the time being received only a indifferent response from OPEC



- The US economy continues to grow strongly due to accommodative economic policy. In Q2, the economy grew at an annual rate of 4.2% led by private consumption, which rose by 3.8%
- Consumer confidence reached a 14-year high, while the small business confidence has climbed to a 45-year high. According to corporate surveys, both manufacturing and services sectors continue to expand rapidly
- Hourly wages rose by 2.9% YOY, further evidence of the labor market strength. The unemployment rate remained stable at 3.9% and the economy generated 201K new jobs
- Inflation rose to 2.7% in the past year, a decrease of 0.2% from the previous month. However, the Core PCE Deflator remained stable at a level of 2%, meeting the Fed's inflation target
- The yield spread between 2 and 10 year bonds rose to 0.3%, reflecting the investors' understanding that the economy remains strong, and the interest rate is expected to keep rising into 2019
- The Fed raised the interest rate by 0.25% (to 2%-2.25%). For the first time, the base rate rose above the inflation target, and is expected to increase again by the end of 2018 and at least three additional times in the upcoming year



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Core Economic Indicator

USA

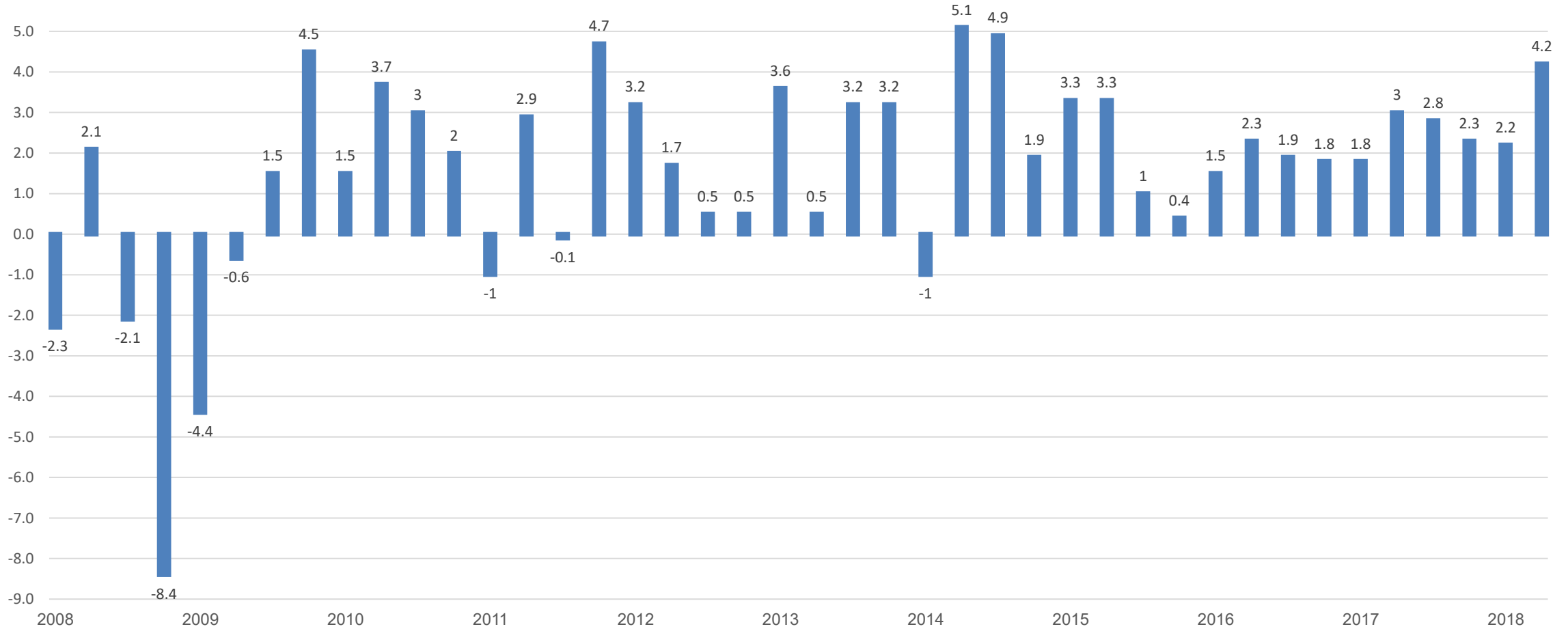
| Economic Indicator | Latest Figure | Reference Period |
|--|---------------|------------------|
| Growth Rate (YoY) | 4.2% | Q2-2018 |
| Unemployment Rate | 3.9% | Aug-2018 |
| Inflation Rate (Core, YoY) | 2.0% | Aug-2018 |
| Fed Funds Target Range | 2%-2.25% | Oct-2018 |
| 10 Year Treasury | 3.04% | Oct-2018 |
| Ratio of Surplus in Current Account to GDP | -2.17% | Q2-2018 |
| Ratio of Public Debt to GDP | 105.68% | Q1-2018 |



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Economic Growth

GDP (Annualized)

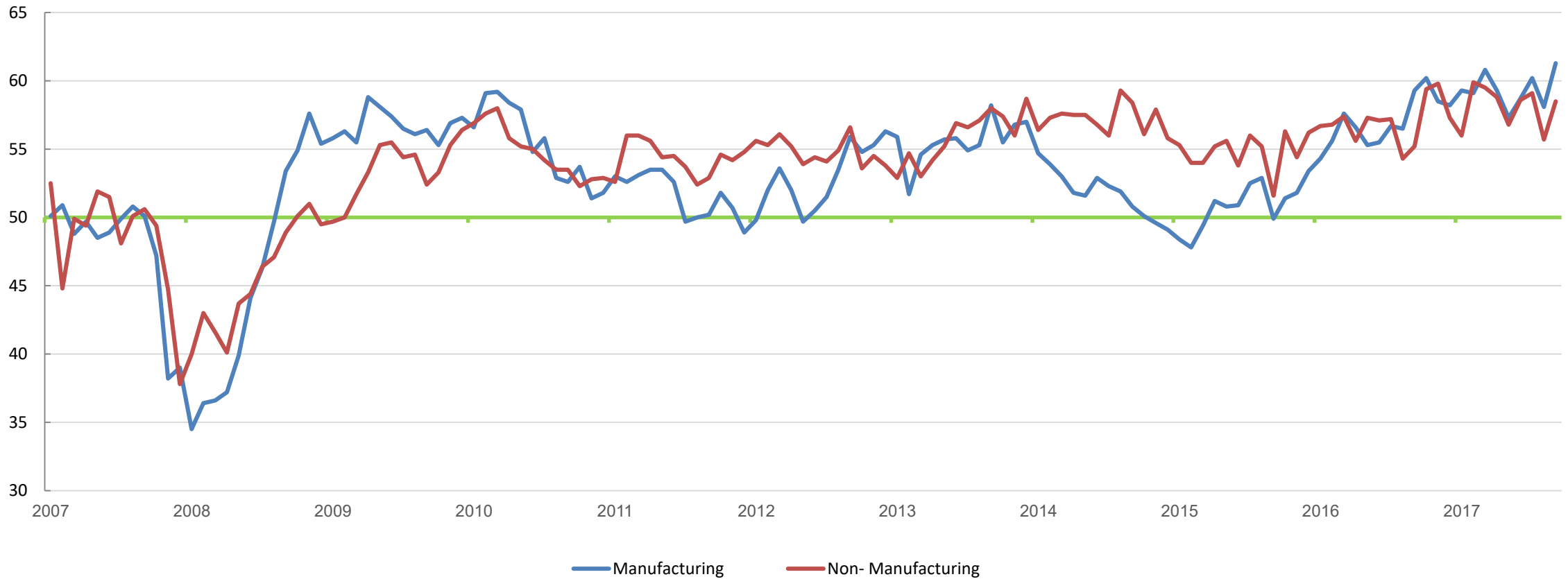




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Economic Sentiment

Manufacturing and Non-Manufacturing PMI

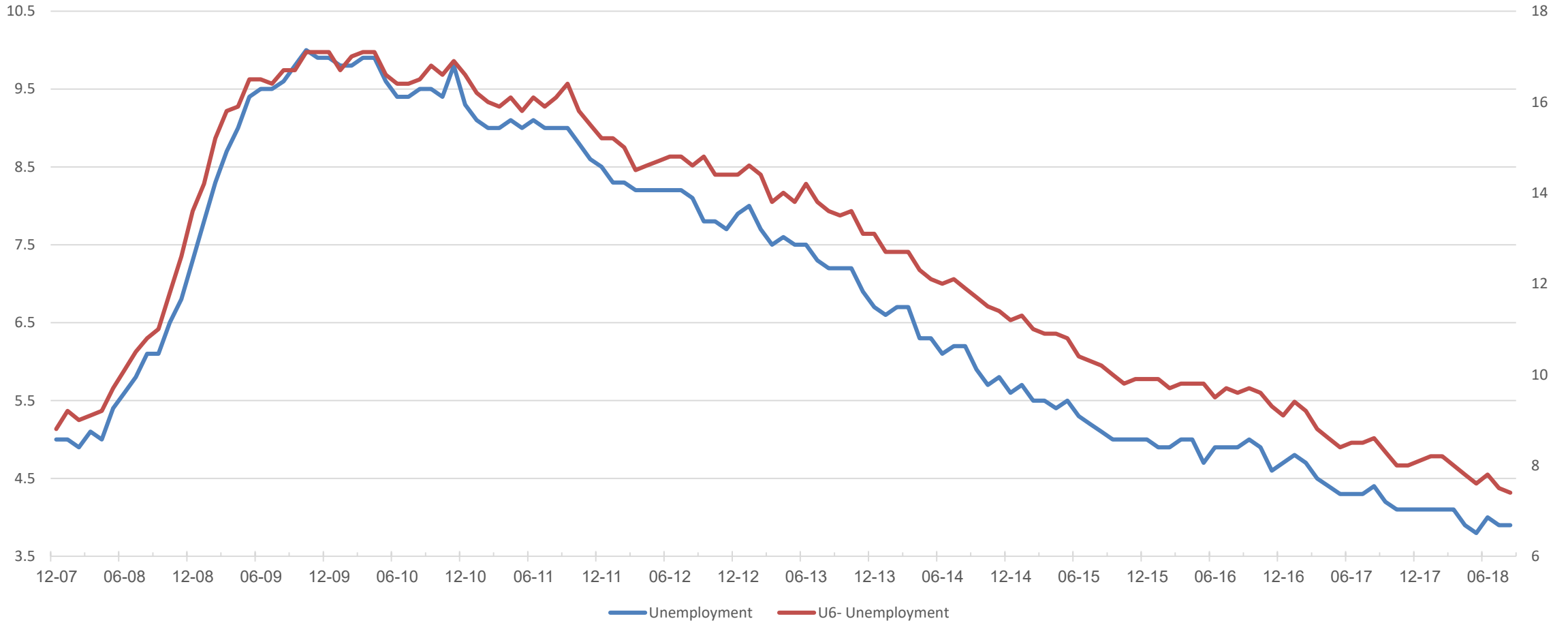




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Labor Market

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

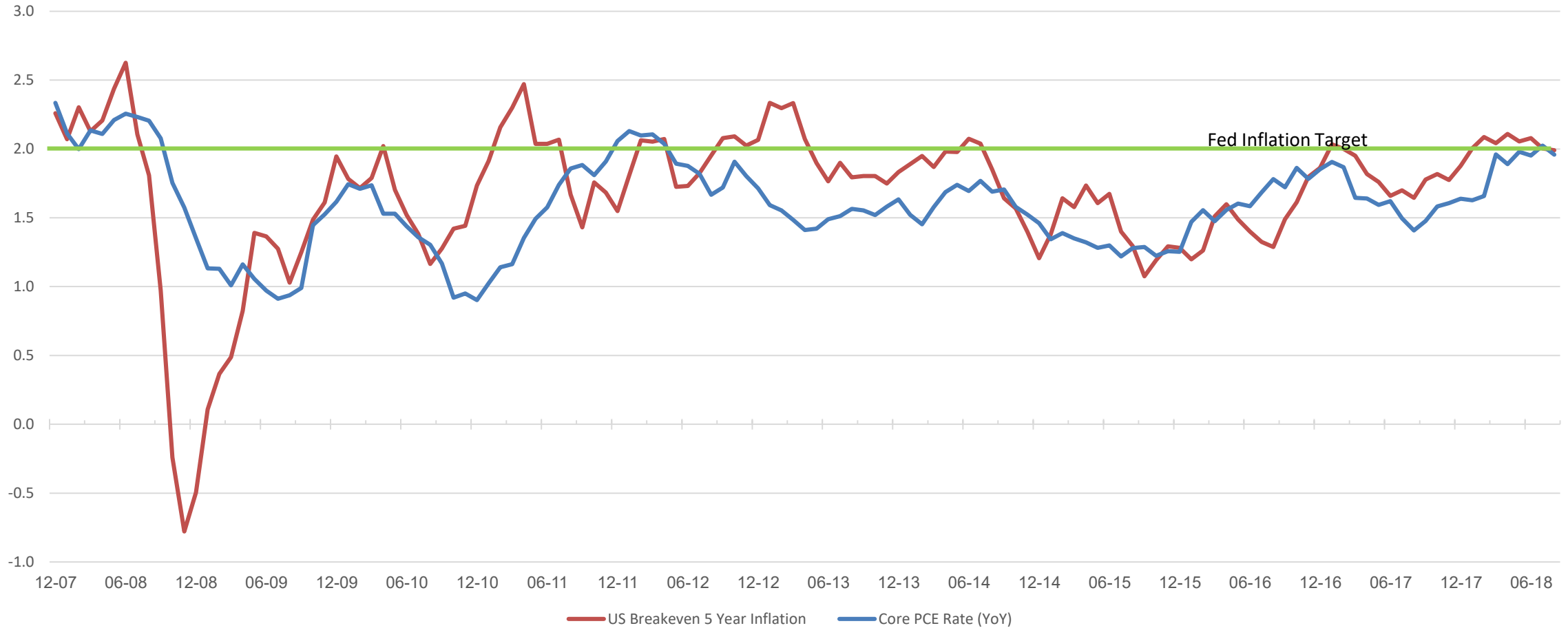




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Inflation

Core PCE (YoY) and 5Y Inflation Forecast





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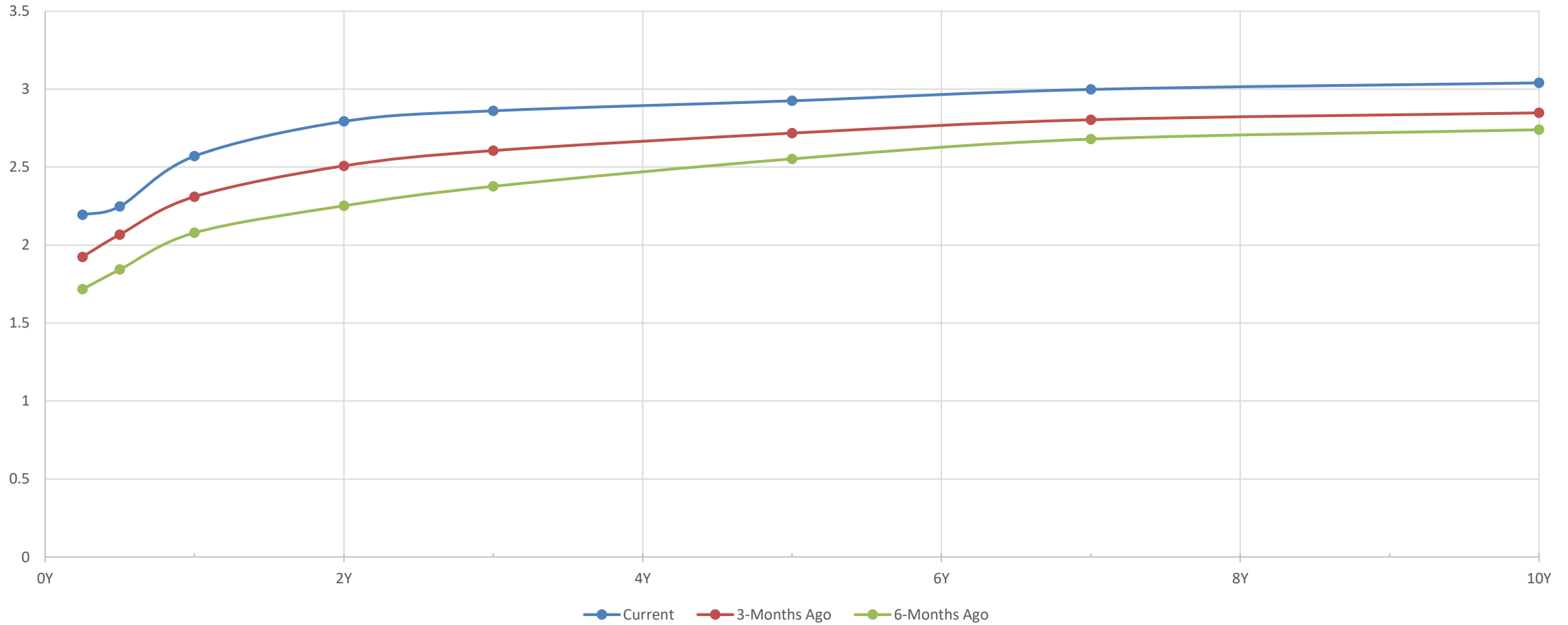
10YR Treasury Yield to Maturity





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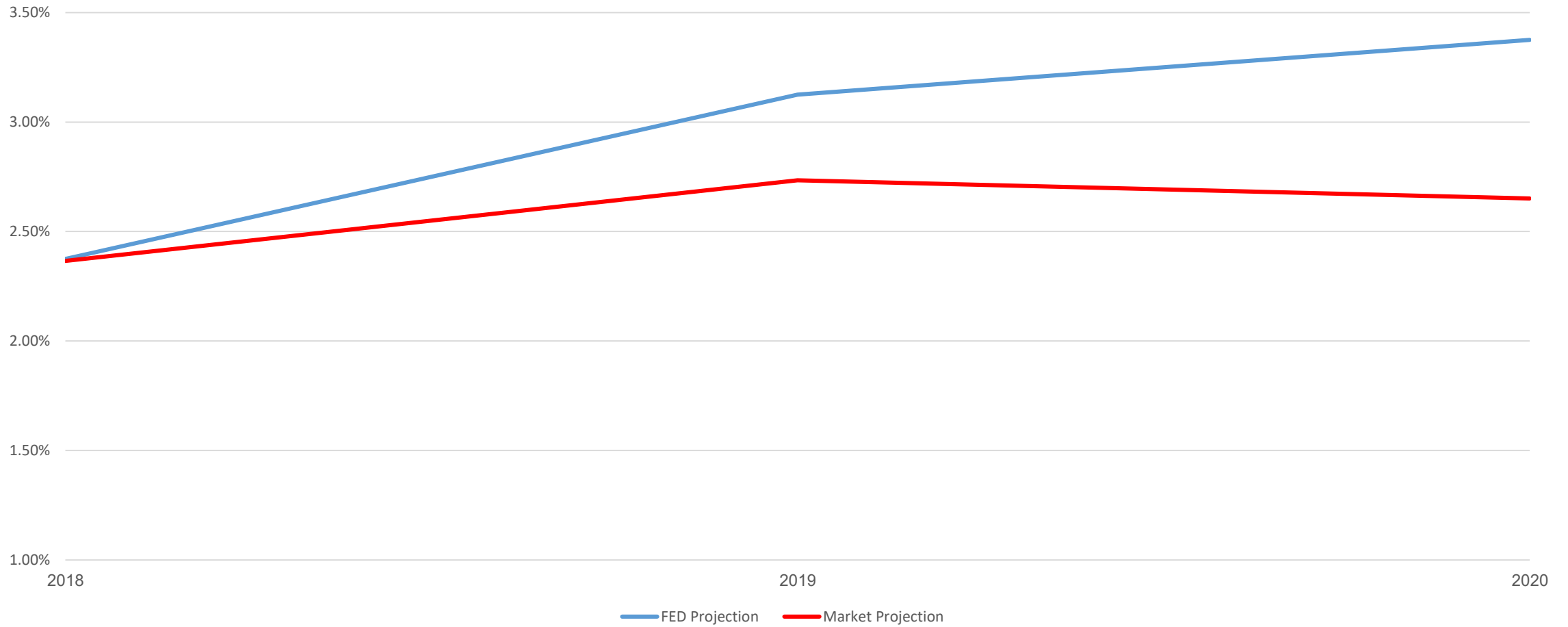
US Treasury Yield Curve





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Fed Funds Projection





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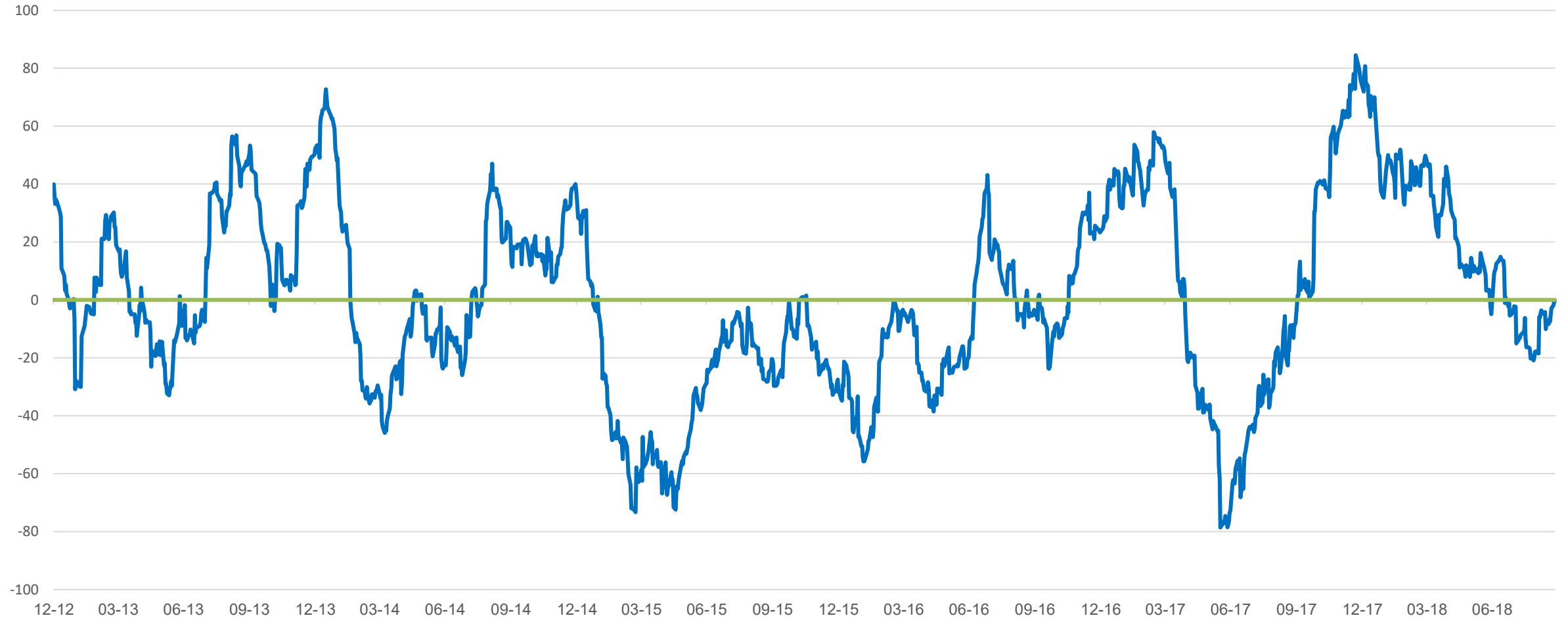
US Dollar Index (DXY)





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Citi Economic Surprise





- Q2 GDP grew by 1.5% in annual terms. The data indicates a decline in consumption, while on the other hand, an increase in public expenditure and capital investments
- Net foreign trade subtracted 0.2% in both Q1 and Q2 growth, in evidence of the crisis in emerging markets and the slowdown of international trade. Industrial production continues to decrease, when in fact, in six of the last eight months it fell and does not appear to be a positive contribution to Q3 growth
- Despite the slowdown in growth, the labor market continues to recover. The unemployment rate fell to 8.1% in August, a record-low rate since November 2008. The continuing decline in unemployment led to 2.3% increase in wages
- Forward-looking indices, including the Purchasing Managers' Index, indicate continued expansion, albeit at a slow pace
- Although headline inflation edged up from 0.1% to 2.1% in September, the core inflation decreased slightly to 0.9%, remaining far below the inflation target of 2%
- The ECB is expected to end its bond purchases at the end of the year and raise interest rates in the fall of 2019
- The chances of an orderly exit agreement between Britain and the EU diminished. The position of the British Prime Minister has been eroded and the chances that it will be overturned or that elections will be held are increasing



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Core Economic Indicator

Eurozone

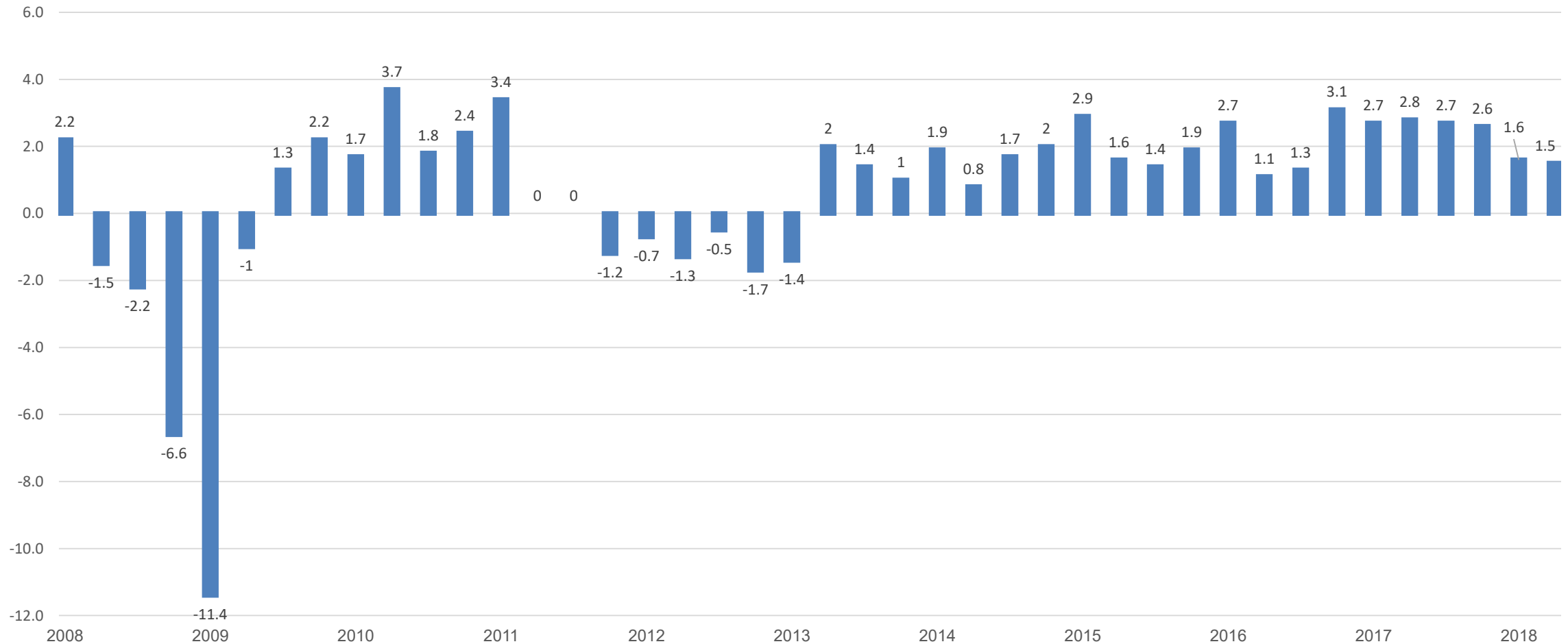
| Economic Indicator | Latest Figure | Reference Period |
|--|---------------|------------------|
| Growth Rate (YoY) | 1.5% | Q2-2018 |
| Unemployment Rate | 8.1% | May-2018 |
| Inflation Rate (Core, YoY) | 0.9% | May-2018 |
| Central Bank deposit rate | 0.00% | June-2018 |
| 10 Year Government Bond Yield (Germany) | 0.45% | June-2018 |
| Ratio of Surplus in Current Account to GDP | 3.57% | Q1-2018 |
| Ratio of Public Debt to GDP | 86.7% | Q4-2017 |



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Economic Growth

GDP (Annualized)

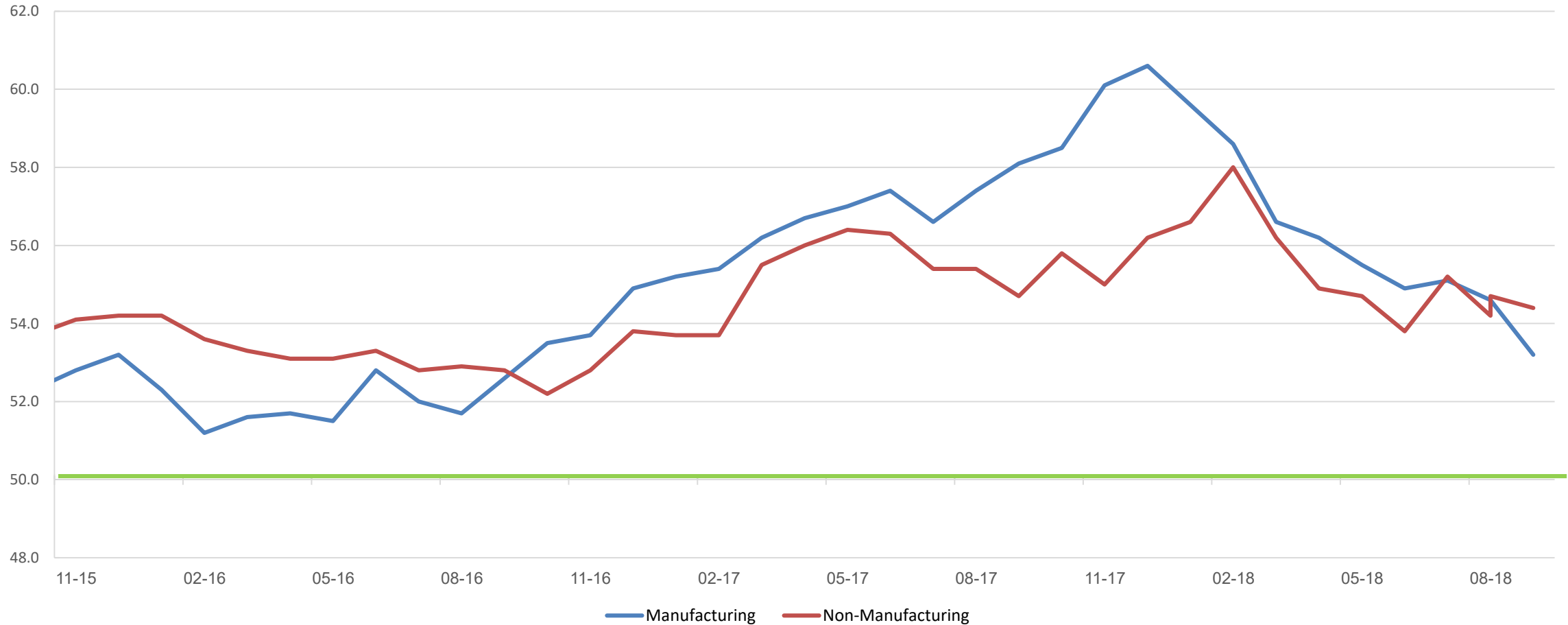




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Economic Sentiment

Manufacturing and Non-Manufacturing PMI

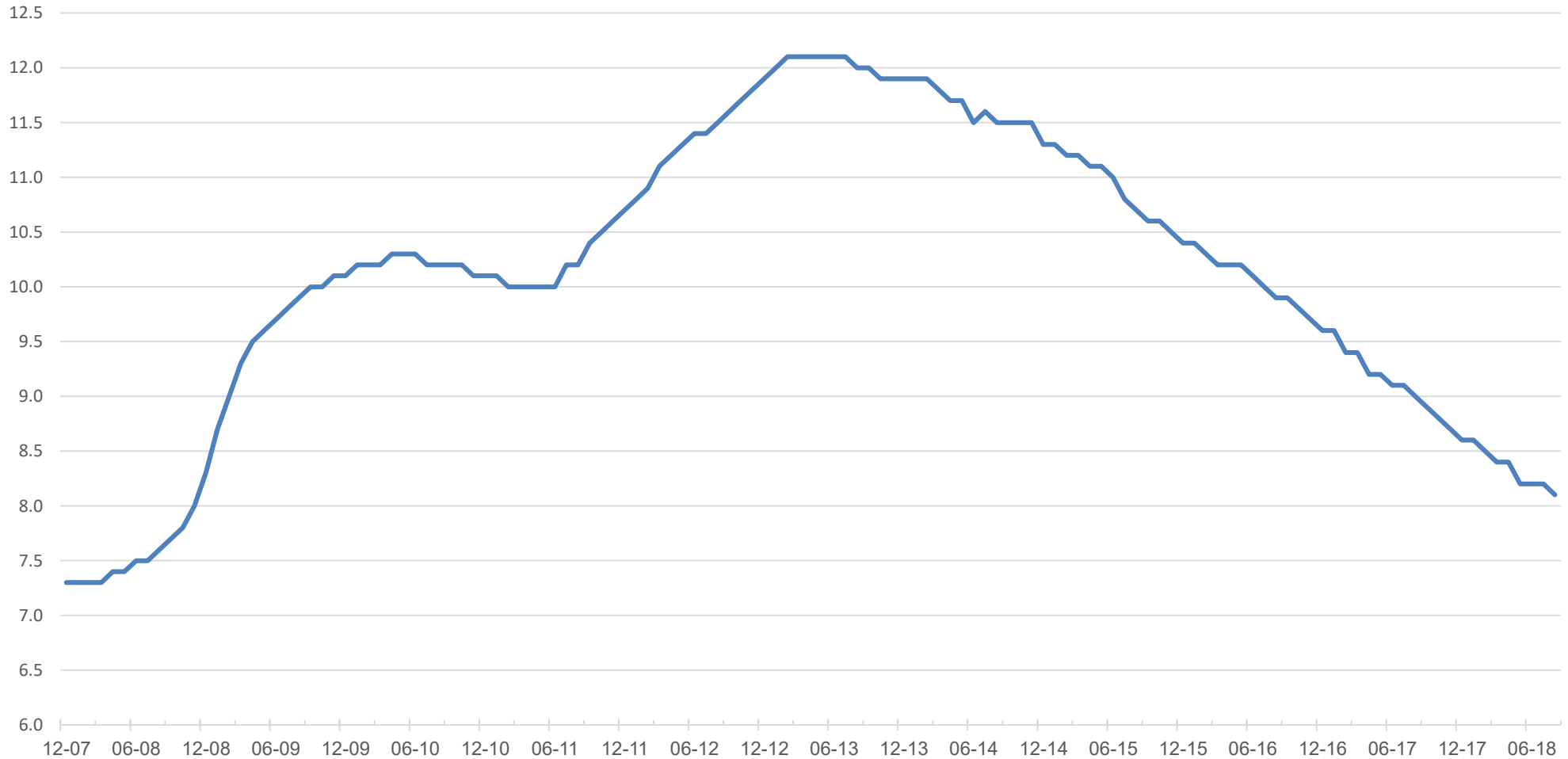




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Labor Market

Unemployment Rate

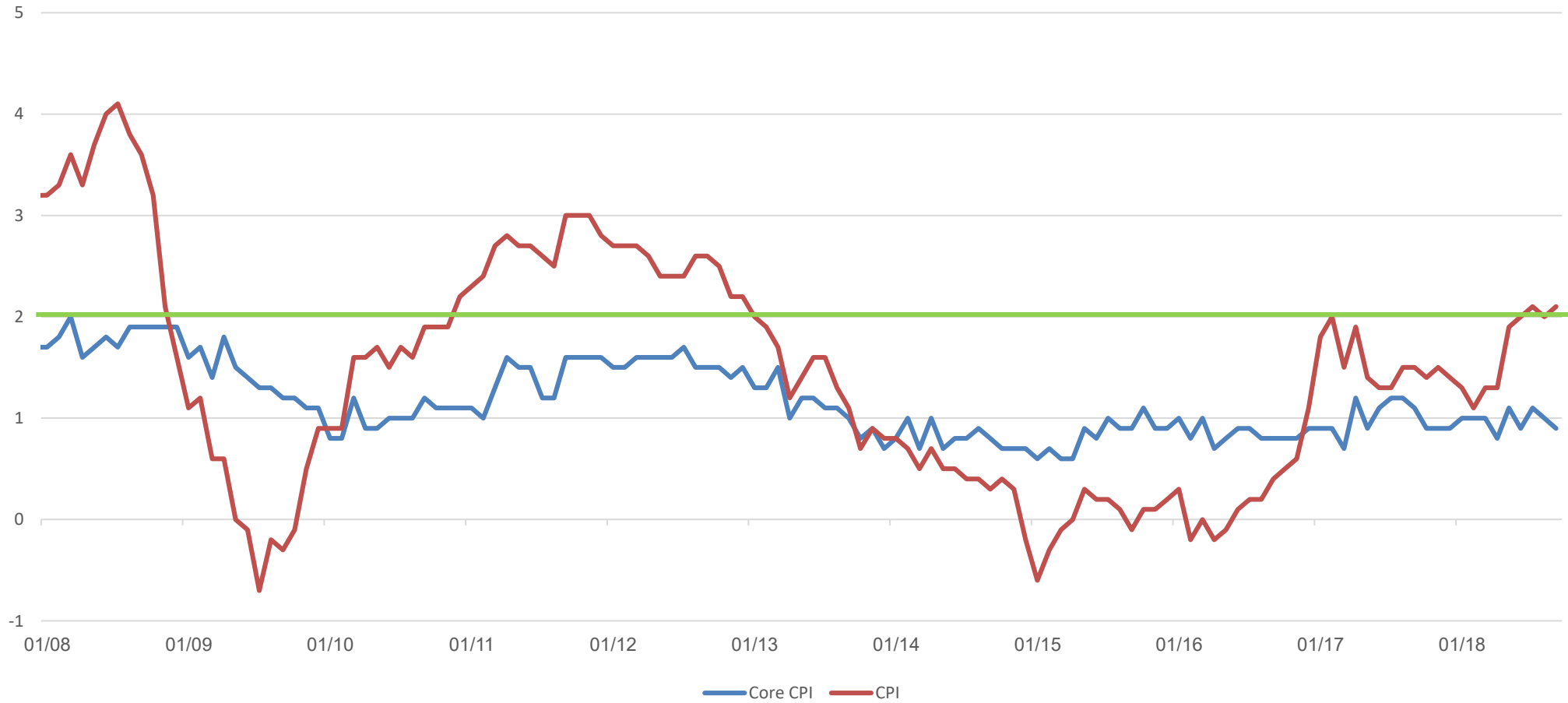




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Inflation

CPI and Core CPI (YoY)

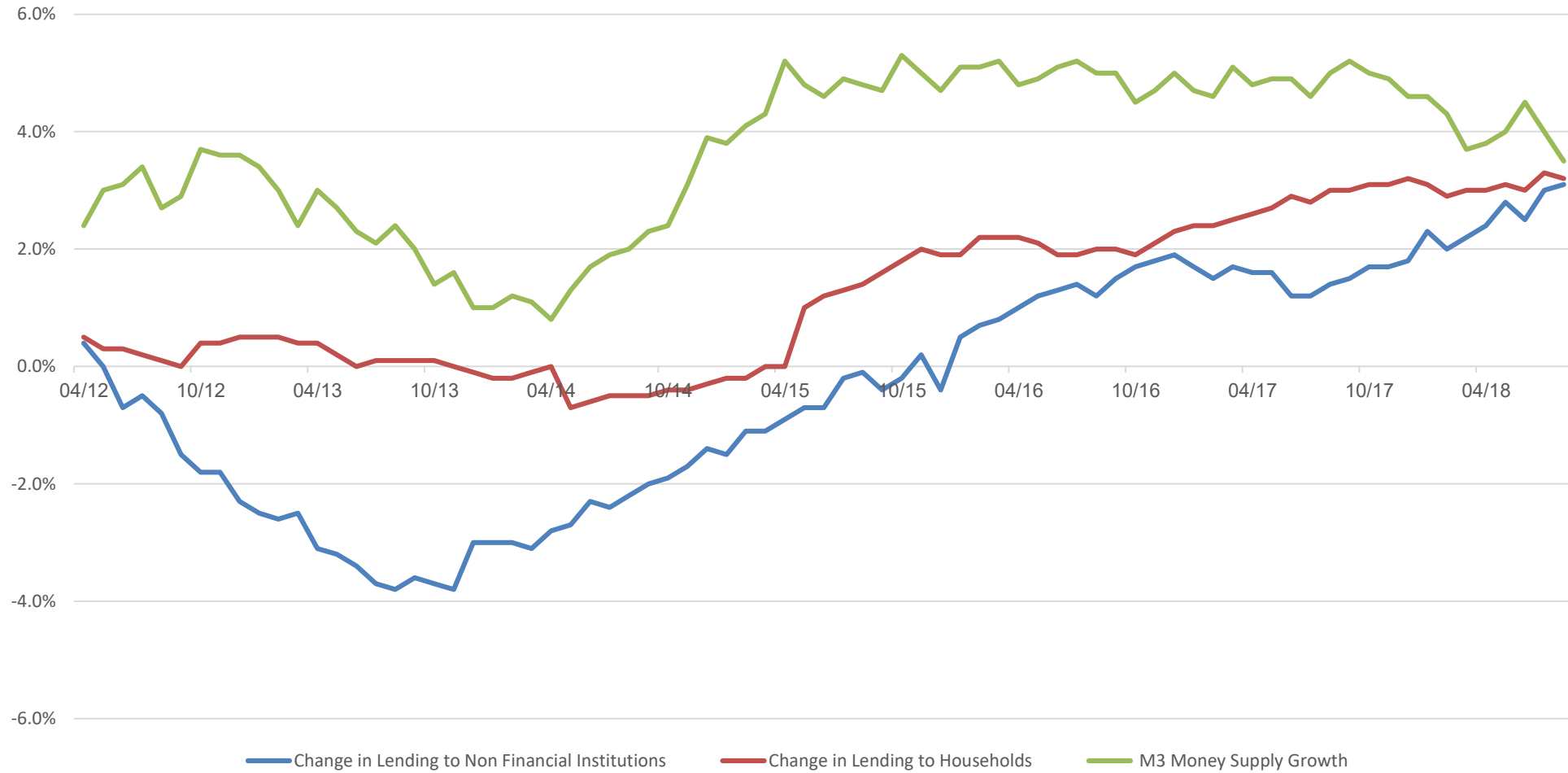




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Money Supply and Credit

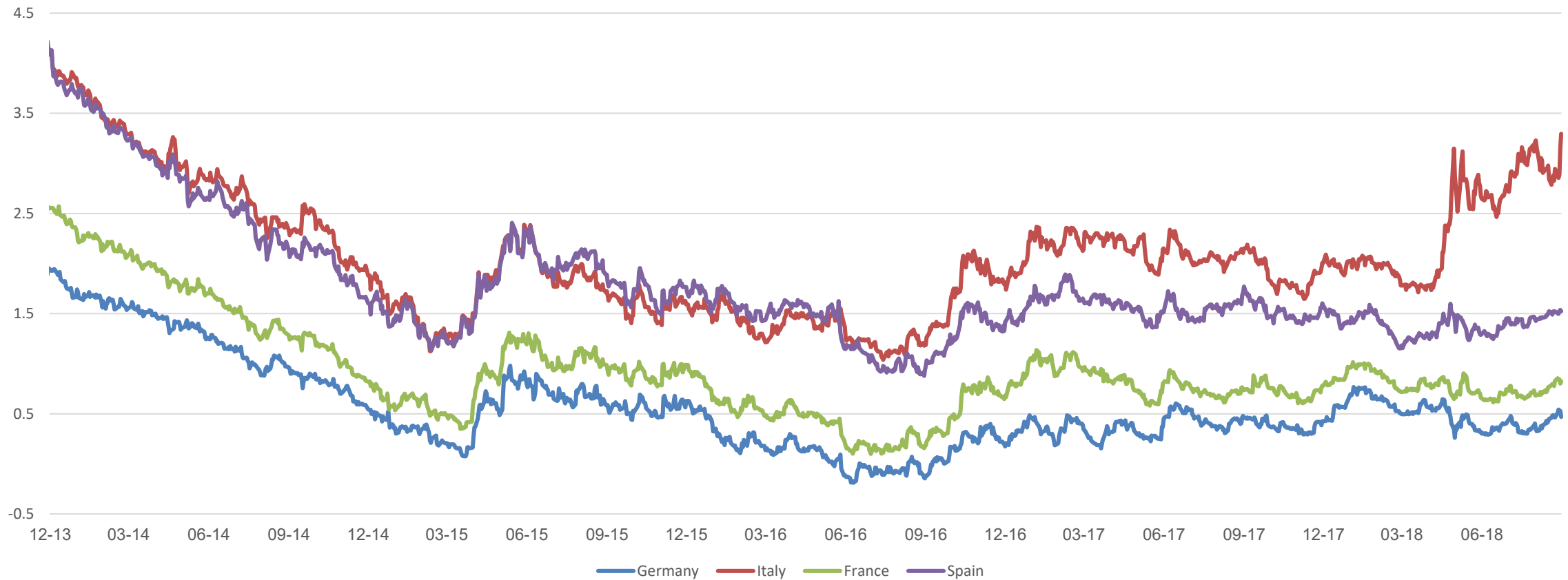
Growth in Money Supply, Loans to Real Sector





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10YR Government Bond Yield

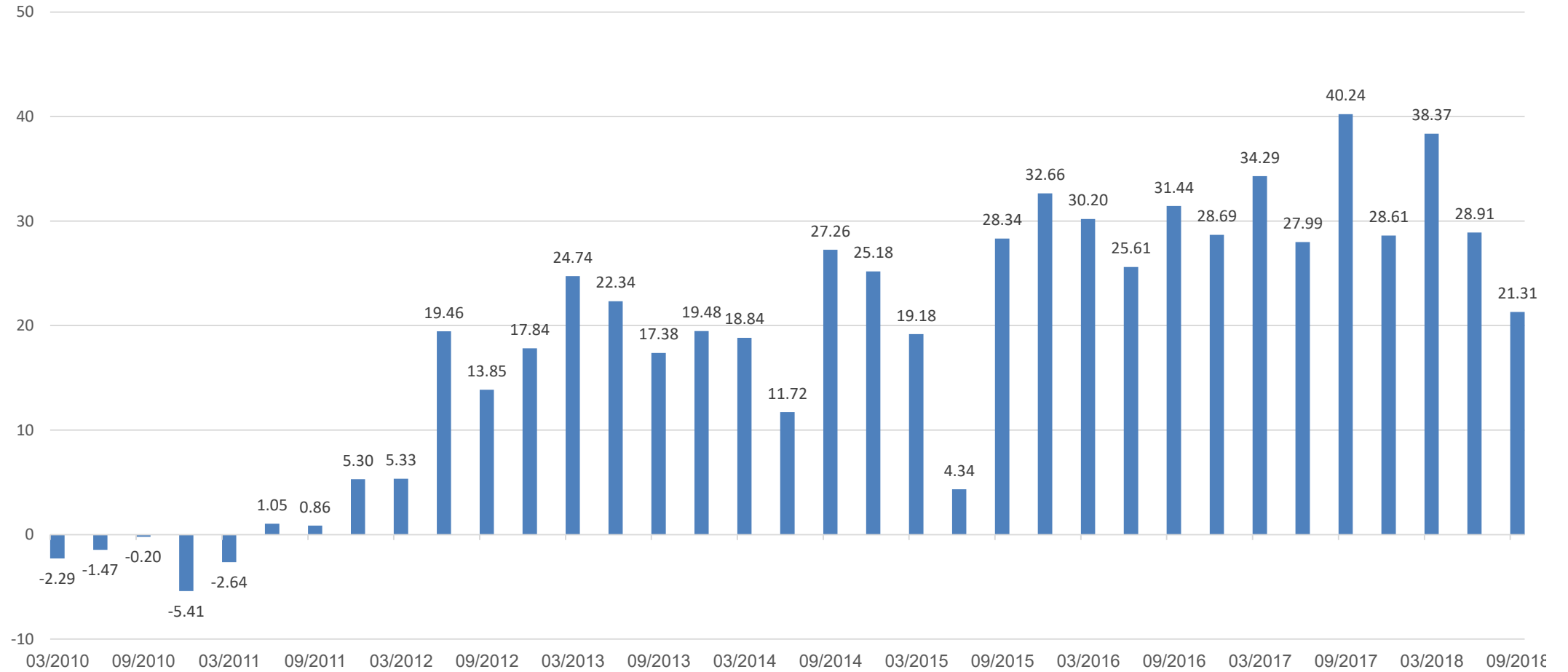




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Current Account Balance

EUR Billion

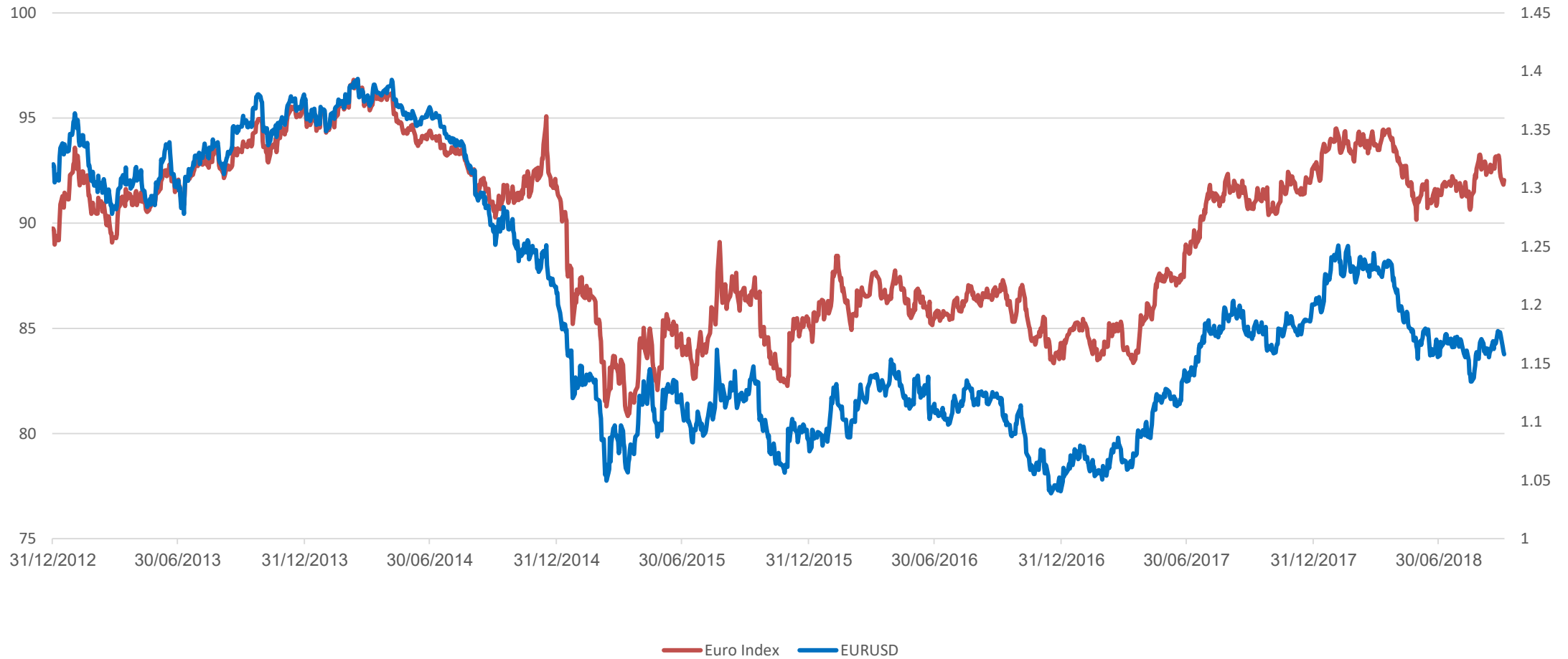




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Exchange Rate

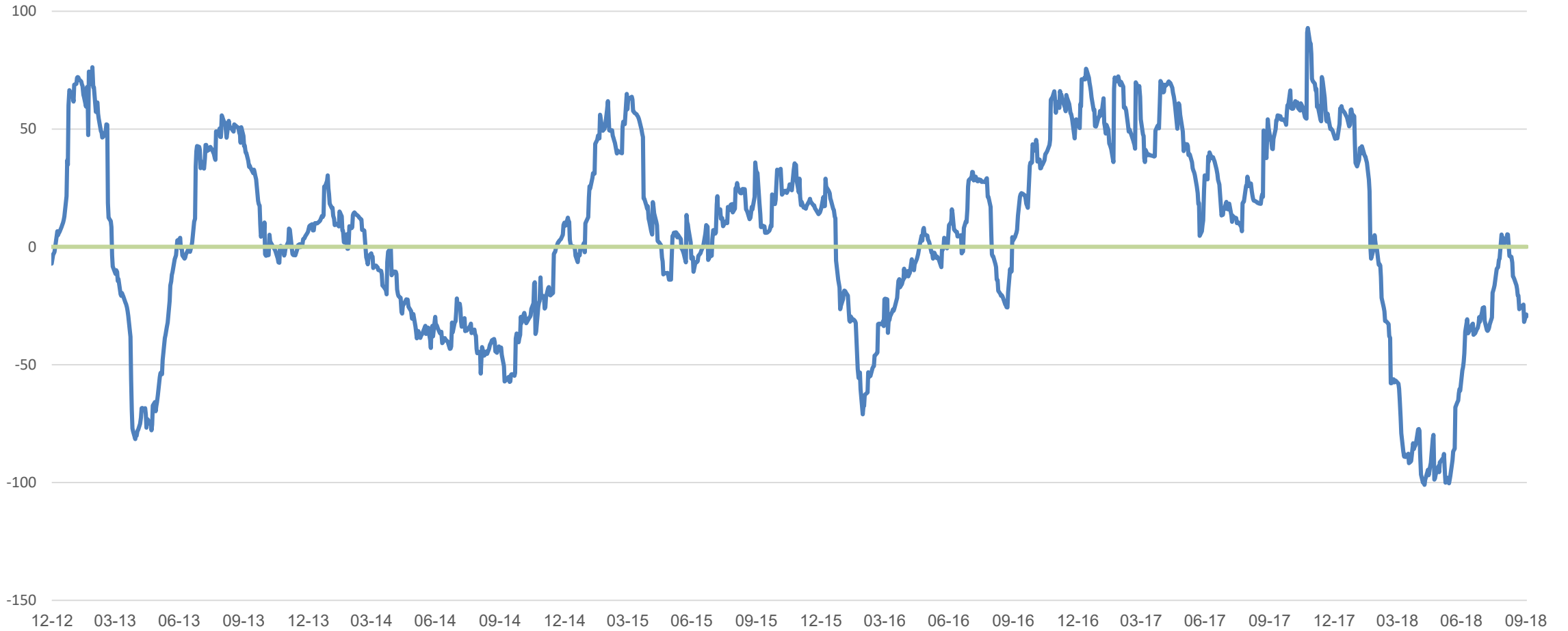
Euro Index (Left) EURUSD (Right)





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Citi Economic Surprise





- Q2 GDP grew only by 1.8% in annual terms, after increasing by 5.1% in Q1
- The headline inflation rose only by 1.2% YOY, close to the lower end of the inflation target (1%-3%). The inflation expectation for the upcoming year decreased recently to 1.3%. However, it is too early to declare that the inflation is established within the target range
- Despite the last increase in the unemployment rate, the labor market conditions are still tight
- The deterioration in the balance of payments continues: the current account surplus of H1 2018 was only \$2.27 billion, compared to a surplus of \$4.76 billion in H1 2017. The decrease is derived from a deterioration in the trade account, the continuous strengthening of the shekel and the slowdown in international trade
- The probability of an interest rate increase in 2018 reduced lately, due to moderate inflation and shekel appreciation
- On the back of the interest rate differential between Israel and the US (2.8% per year), institutional and retail investors continue to increase their exposure to US assets



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Core Economic Indicator

Israel

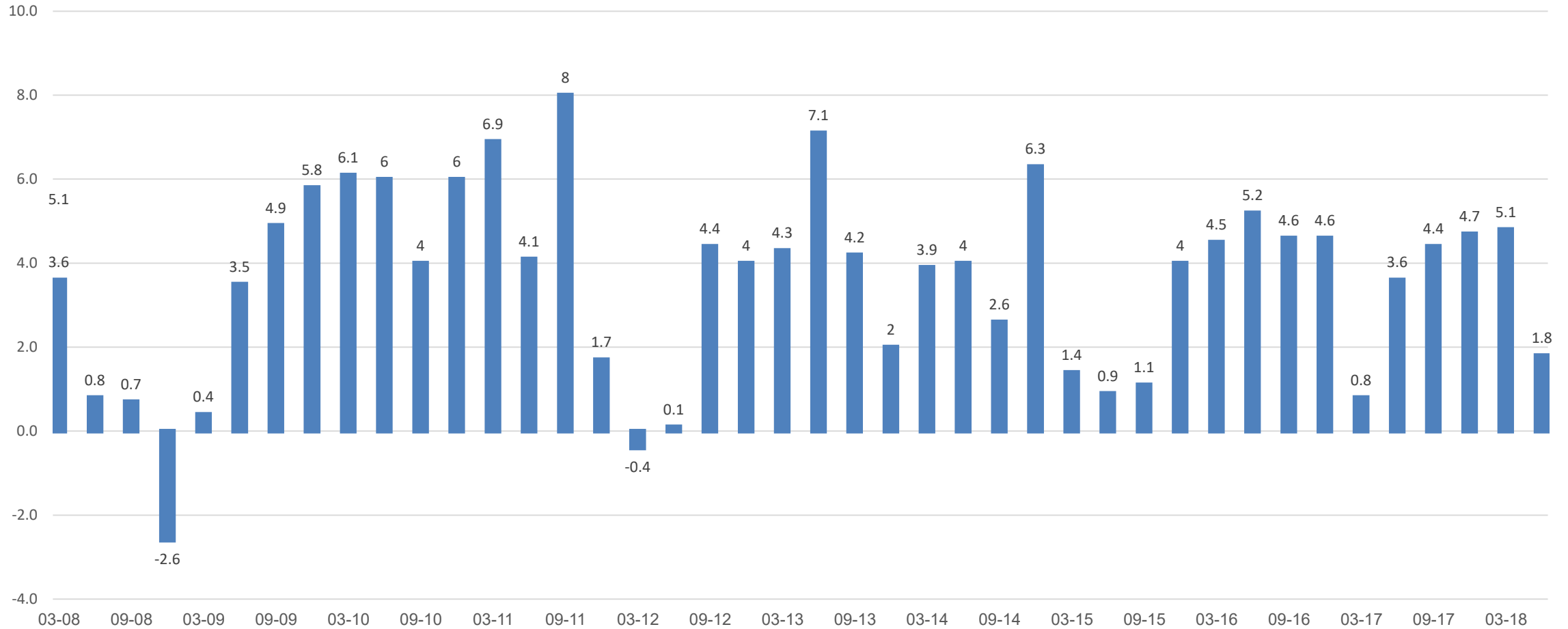
| Economic Indicator | Latest Figure | Reference Period |
|--|---------------|------------------|
| Growth Rate | 1.8% | Q2-2018 |
| Unemployment Rate | 4.2% | July-2018 |
| Inflation Rate (YoY) | 1.2% | Aug-2018 |
| Central Bank Interest Rate | 0.1% | Sep-2018 |
| 10 Year Government Bond Yield | 2.01% | Sep-2018 |
| Ratio of Surplus in Current Account to GDP | 2.06% | Q2-2018 |
| Ratio of Public Debt to GDP | 61% | Q4-2017 |



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Economic Growth

GDP (Annualized)





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Labor Market

Unemployment Rate





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Inflation

CPI (YoY)





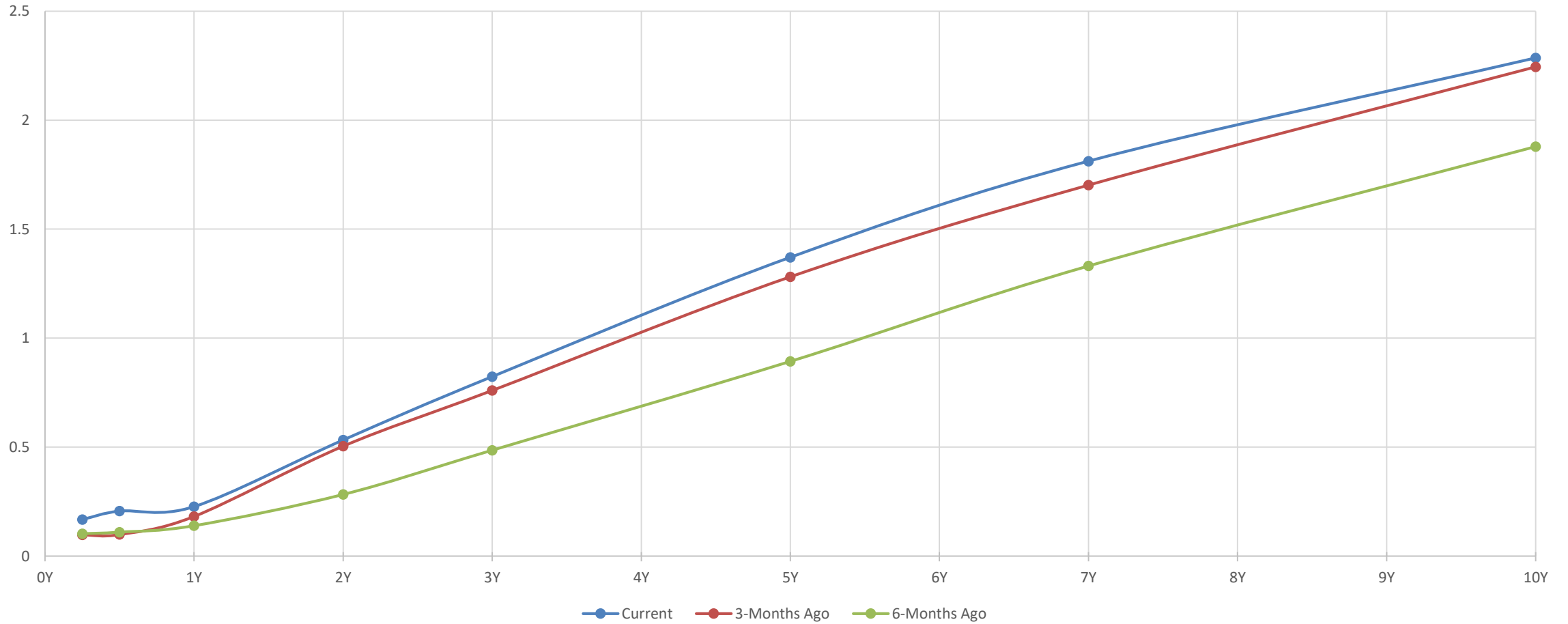
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10YR Government Bond Yield





Government Bond Yield Curve





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Hedging Costs

USDILS 1YR Forward Premium

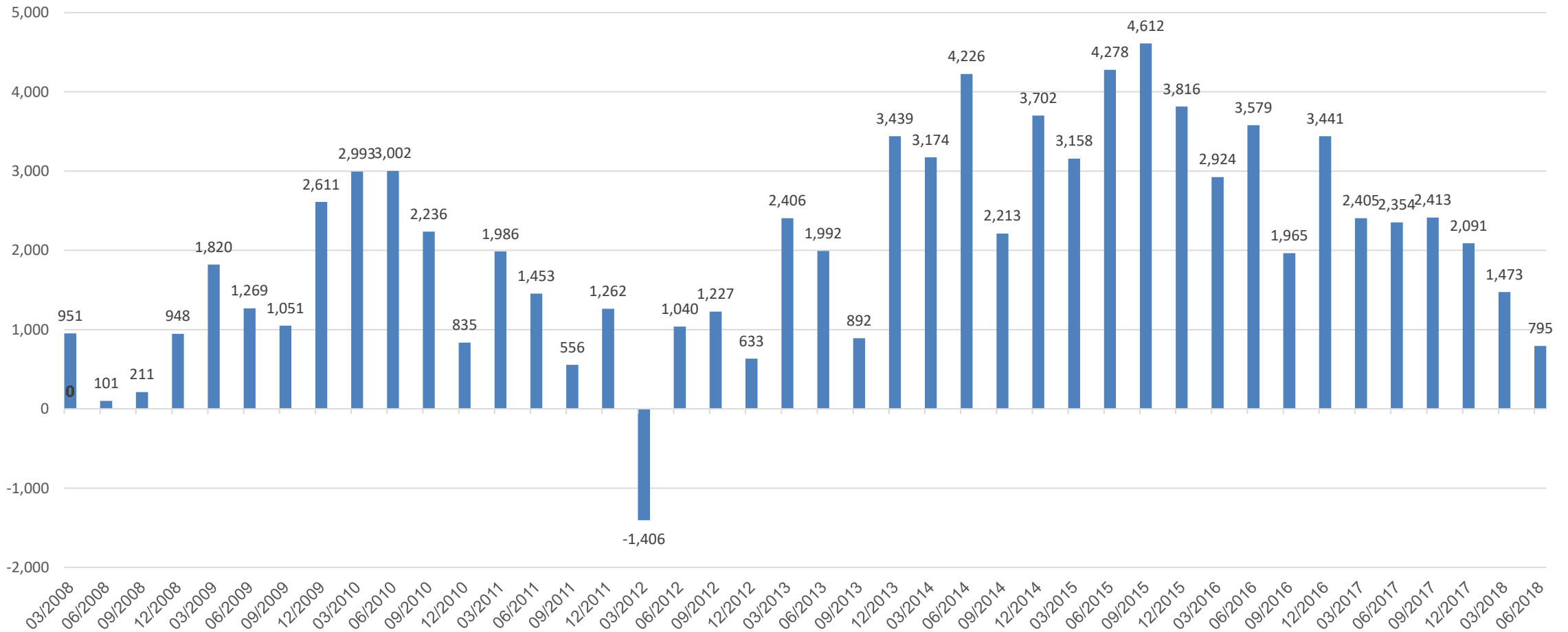




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Current Account Balance

USD Million

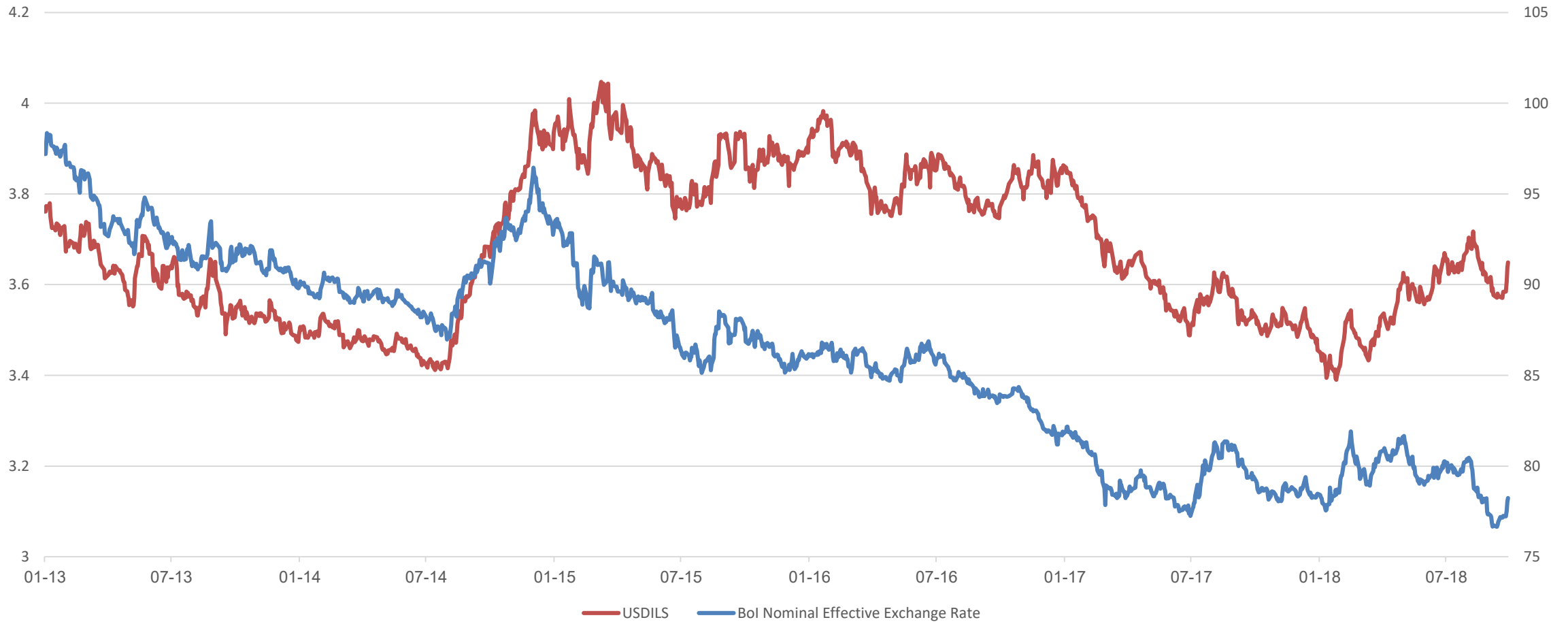




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Exchange Rate

USDILS (Left) BoI Nominal Effective Rate (Right)





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CONNECTING THE RIGHT DOTS

CREATING THE RIGHT PICTURE