

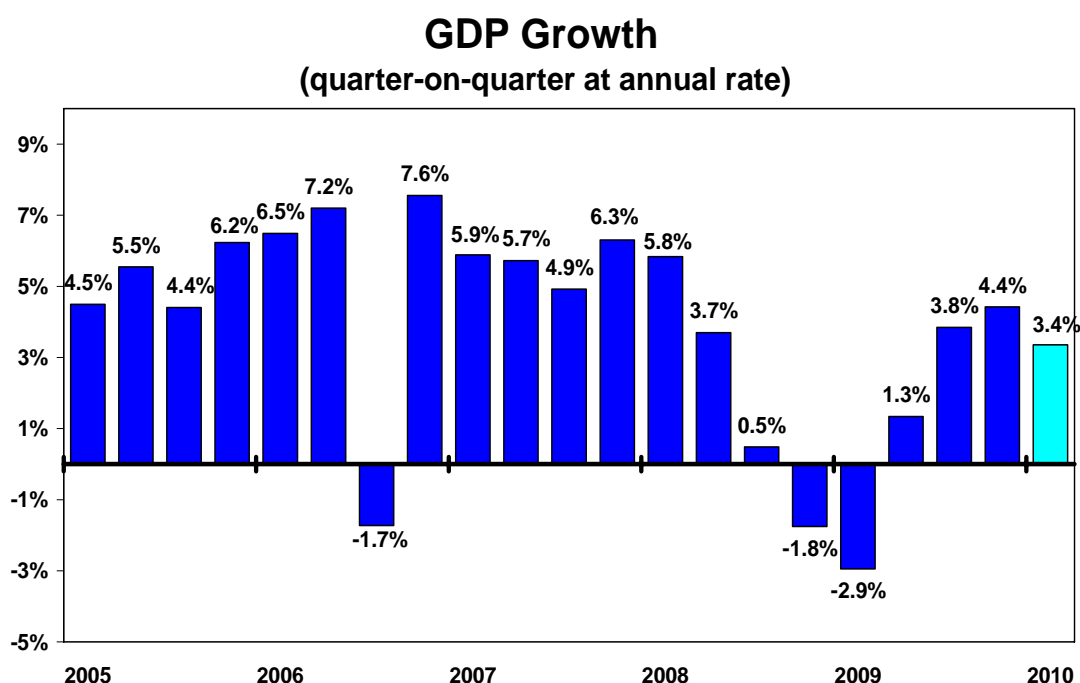
- Israel's Central Bureau of Statistics (CBS) has revised the **growth rate for the first quarter of 2010** to an annualized 3.4 percent (from 3.6 percent in the previous estimate last month). Business product growth was adjusted more sharply, to 4.4 percent from the previous estimate of 4.8 percent.
- **Most current indicators** of economic activity in Israel point to moderation of the growth rate in the second quarter of 2010. **Foreign-trade data** stabilized in June, following the weakness of the preceding months. **State tax revenues** in June were lower than expected. **The trade and service sectors revenue index** fell by 1 percent in May, while the **industrial production index** rose by 1 percent. According to monthly trend data, the **unemployment rate** dropped sharply in recent months, to 6.5 percent in May.
- **The consumer price index** rose by 0.3 percent in June, in line with expectations. The **Bank of Israel** raised the interest rate by 0.25 percentage points, to 1.75 percent, and updated its inflation forecast for the next twelve months with an upward shift towards 3 percent.
- **The government bond yield curve** remained almost unchanged in July, other than a slight increase in the short-term range following the increase in the BOI interest rate. The **US government bond yield curve** also showed no significant change.
- According to the initial estimate, the **US economy grew** at an annualized rate of 2.4 percent in the second quarter of 2010, slightly below advance estimates.
- **Global equity markets** were strongly positive during July. The MSCI World index gained 8 percent, the S&P 500 index rose by 7 percent, the NASDAQ index rose by 7 percent, and the MSCI Emerging Markets index rose by 8 percent. The **TA-100 index** rose by 4 percent, or 7 percent in dollar terms.

This review contains four chapters:

- A. Developments in the Israeli Economy.
- B. Developments in the Capital Market.
- C. Developments in Inflation and Monetary Policy.
- D. Developments in the Global Economy.

A. Developments in the Israeli Economy

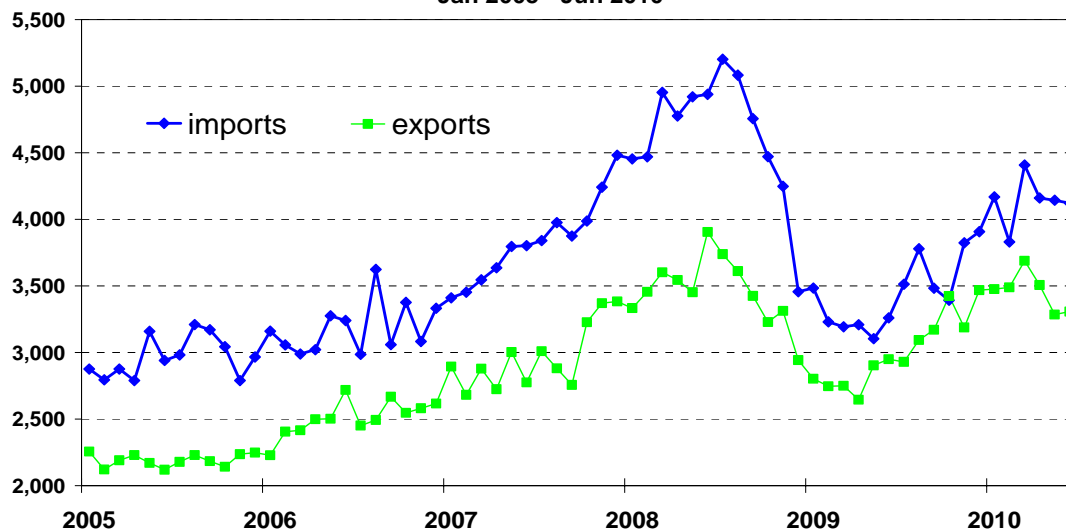
Israel's Central Bureau of Statistics has updated the **growth rate for the first quarter of 2010**, revising its figure downward to an annualized 3.4 percent, from 3.6 percent in last month's estimate. The growth of the business product was revised more sharply, to 4.4 percent, from the previous estimate of 4.8 percent.



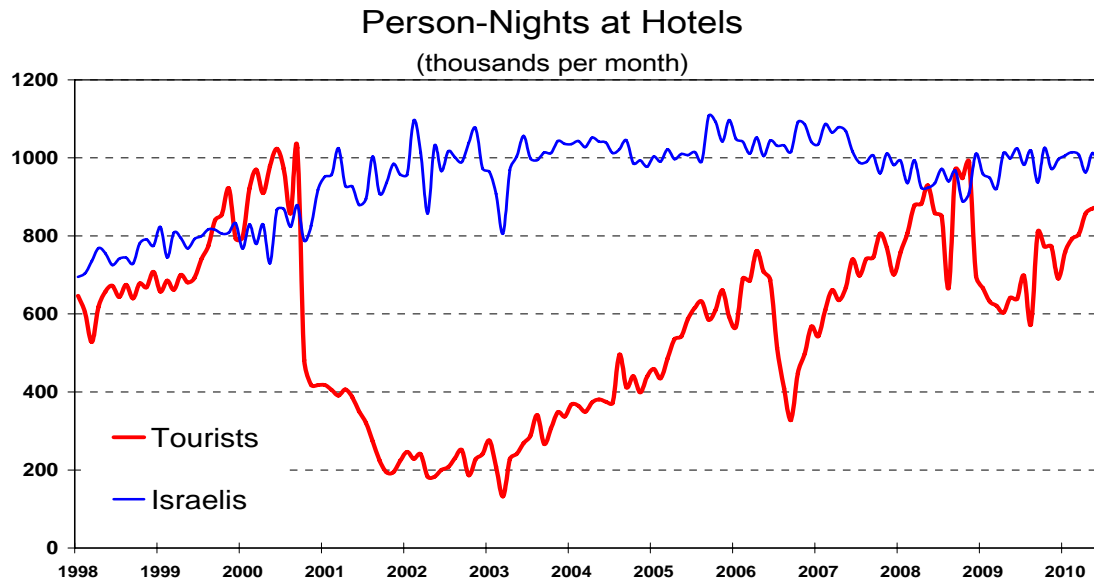
Most of the data published over the last month point to moderation of the growth rate in the second quarter of 2010.

Foreign-trade data stabilized in June, following weakness in the preceding months. **Exports of goods** (excluding diamonds, ships, and aircraft; in dollar terms) grew by 1 percent in June, following a decrease of 6 percent in May and 5 percent in April. Exports increased by 12 percent in the twelve months ended in June. **Imports of goods** decreased by 1 percent in June and increased by 26 percent in the twelve months ended in June.

Exports and Imports of Goods
(US\$ millions per month, excl. diamonds, ships & airplanes)
Jan 2005 - Jun 2010



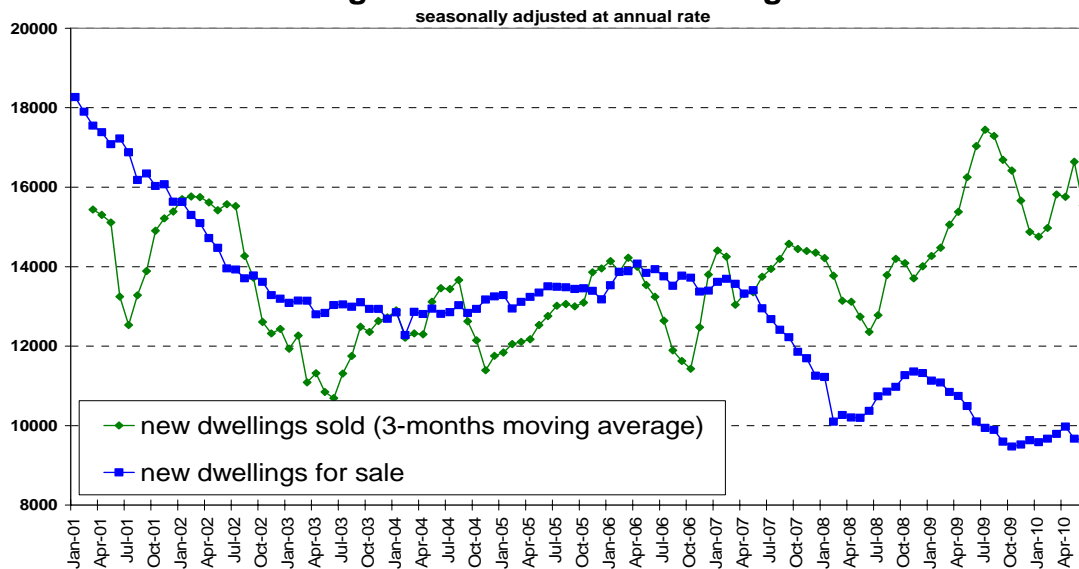
The number of **incoming tourists** to Israel by air increased by 1 percent in June and by 23 percent in the twelve months ended in June. **Tourists' hotel stays** increased by 1 percent in June, and by 37 percent in the twelve months ended in June. **Israelis' hotel stays** decreased by 3 percent in June and by 5 percent in the twelve-month period.



State tax revenues totaled ILS 14.0 billion in June, less than expected, reinforcing estimates that growth has cooled considerably in recent months. In **our updated forecast**, state revenues in 2010 will still be higher than planned in the budget, but the surplus will be relatively low, likely around 1 percent of GDP (ILS 8 billion) or even less. The tax revenue forecast in the Ministry of Finance's **budget proposal** for 2011 and 2012 may well prove to be overly optimistic, leading to a higher-than-planned budget deficit (3 percent of GDP in 2011 and 2 percent of GDP in 2012).

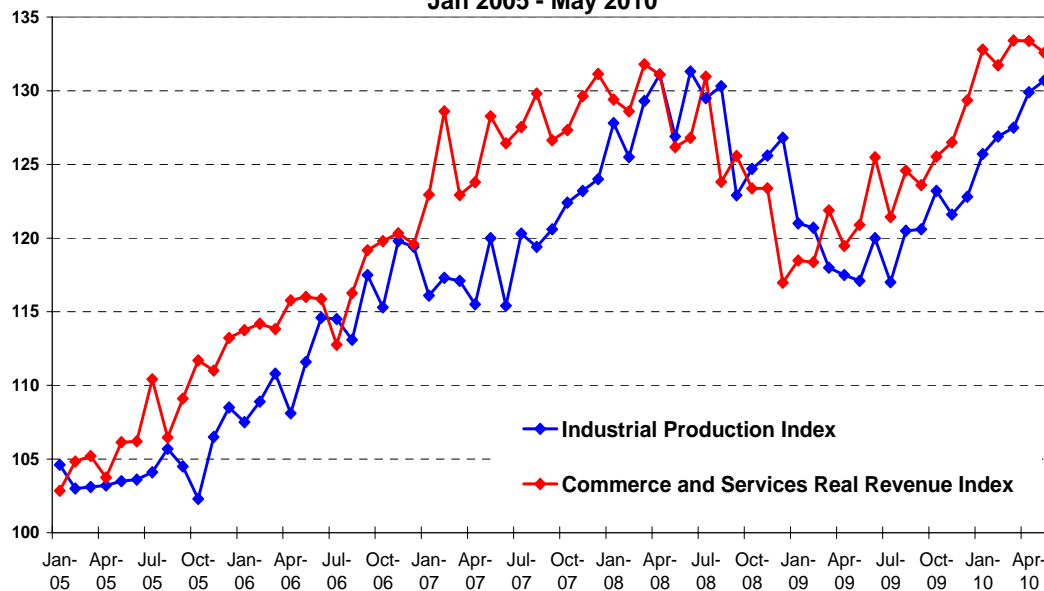
The number of new homes sold dropped sharply, by 25 percent in June and 27 percent in the twelve months ended in June. The **supply of new homes for sale** remained almost unchanged in June, and was 5 percent lower year-on-year.

New Dwellings Sold and for Sale During The Period

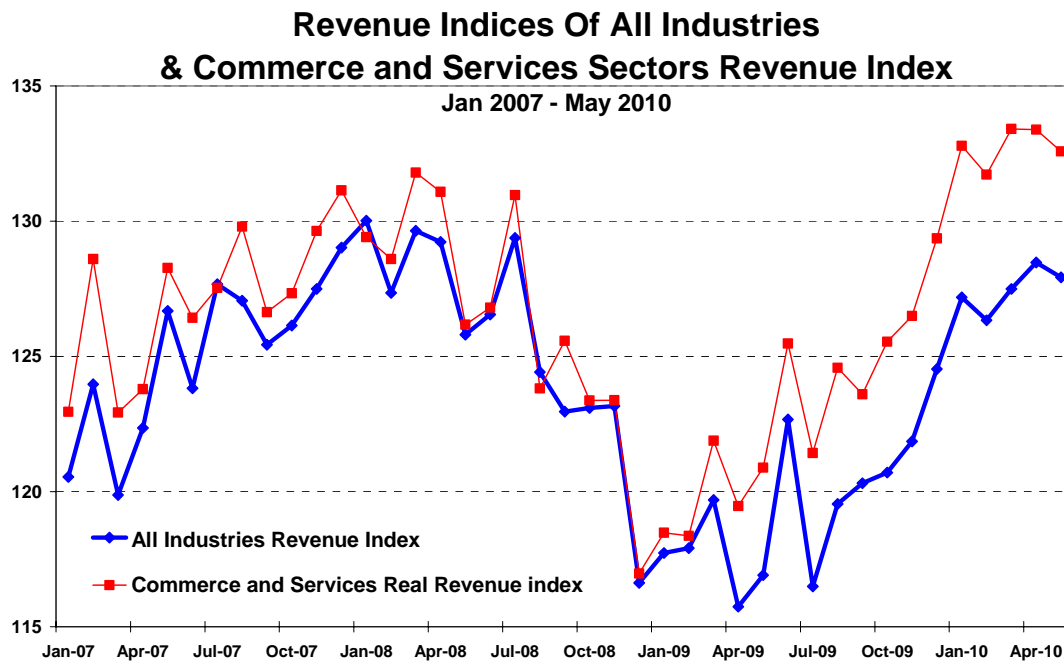


The industrial production index rose by 1 percent in May, and by 12 percent in the twelve months ended in May. The index of trade and service sector revenues fell by 1 percent in May, and rose by 10 percent in the twelve months ended in May.

Industrial Production Index & Commerce and Services Sectors Revenue Index Jan 2005 - May 2010



For the first time, the CBS published a series of **revenue indices for all sectors of the economy**. The trade and service sectors revenue index published in the past constitutes 53 percent of the new index. The trend of both indices was similar in recent months, but over the last two years the trade and service sectors revenue index has risen, while the revenue index for all sectors of the economy has fallen slightly.

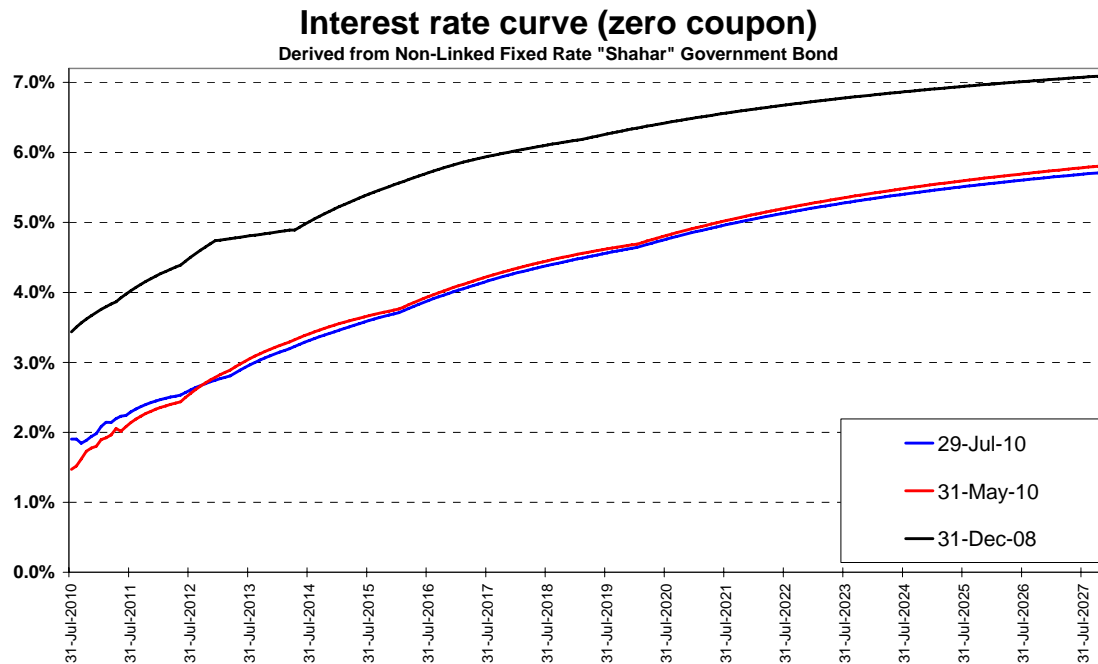


Labor-market data in April indicated a moderate increase in the number of employed persons and a decrease in wages. The number of employee positions of Israeli workers rose by 0.6 percent in April and by 3 percent in the twelve months ended in April. Average wages of Israeli employees declined by 1.1 percent in April and increased by 3 percent in the twelve months ended in April (no change in real terms). **In the business sector**, the number of employee positions rose by 2 percent over the twelve-month period and average real wages per employee position decreased by 0.3 percent.

B. Developments in the Capital Market

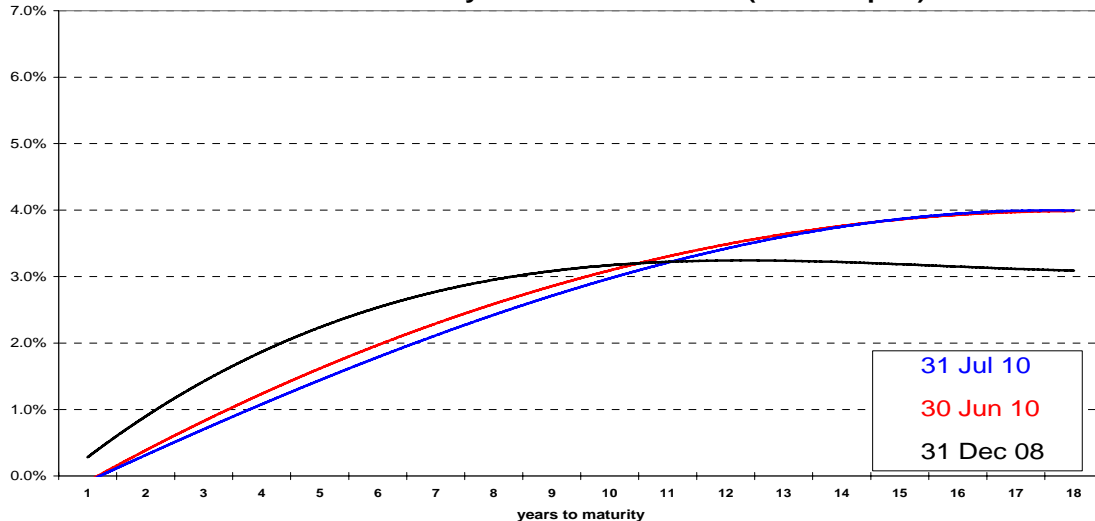
Bond Market

The government bond yield curve remained almost unchanged in July, other than a slight increase in the short-term range following the increase in the BOI interest rate.



The US government bond yield curve also showed no significant change.

United States Treasury - Interest rate curve (zero coupon)

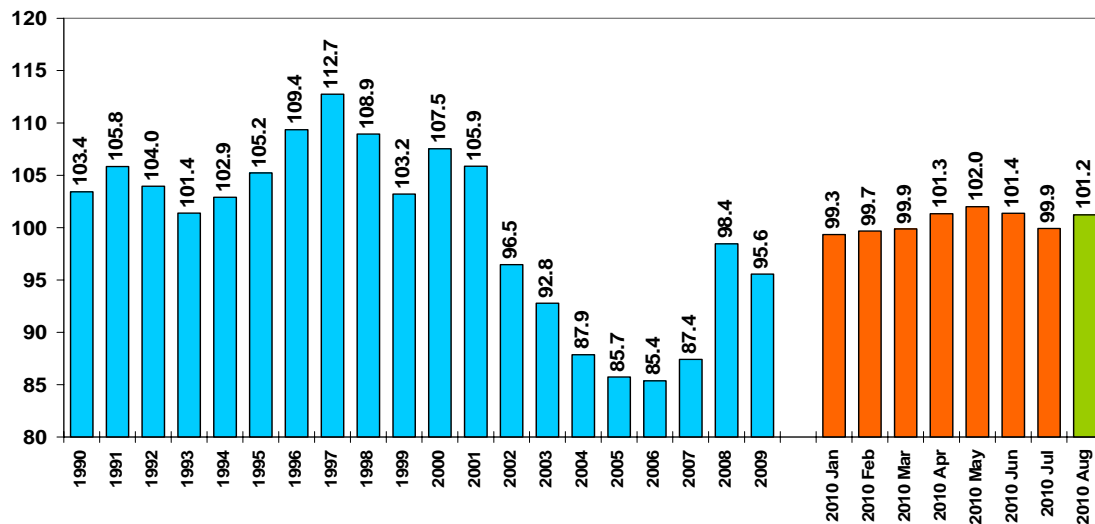


Exchange Rates

The shekel appreciated by 2 percent against the dollar and depreciated by 3 percent against the euro in July; it gained 1 percent against the currency basket. The effective real exchange rate of the shekel strengthened over the last month and is now about 6 percent higher than the average level in 2009.

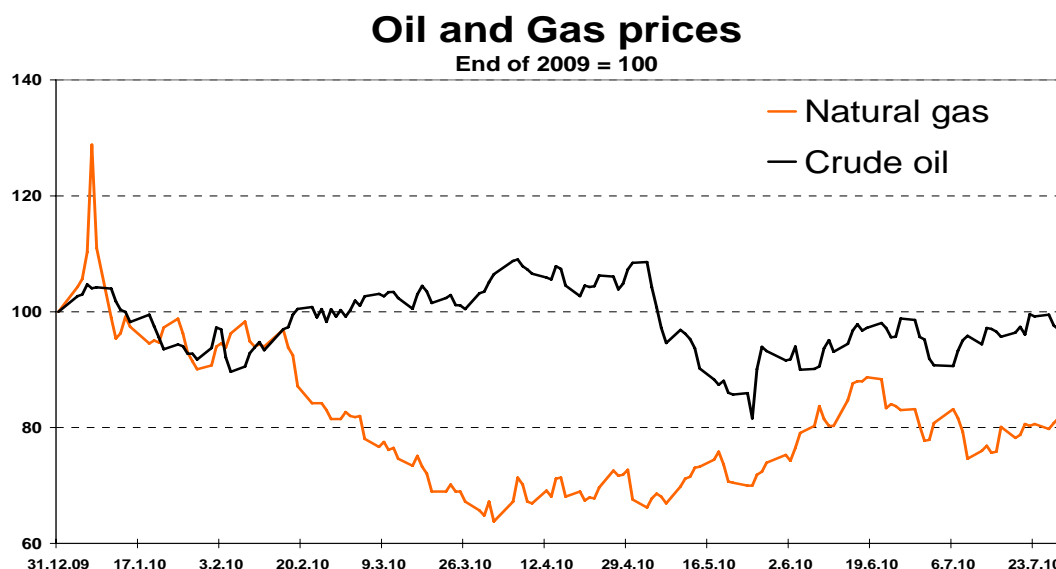
Real Effective Exchange Rate

Basket: US 50%, Euro 25%, UK 5%, Japan 5%, Others 15%
(index, average 1990-2009=100; increase means real appreciation, decrease means real depreciation)



Energy prices

The price of a WTI oil barrel rose by 4 percent in dollar terms in July, and fell by 2 percent in euro terms. The price of natural gas rose by 6 percent in dollar terms in July.



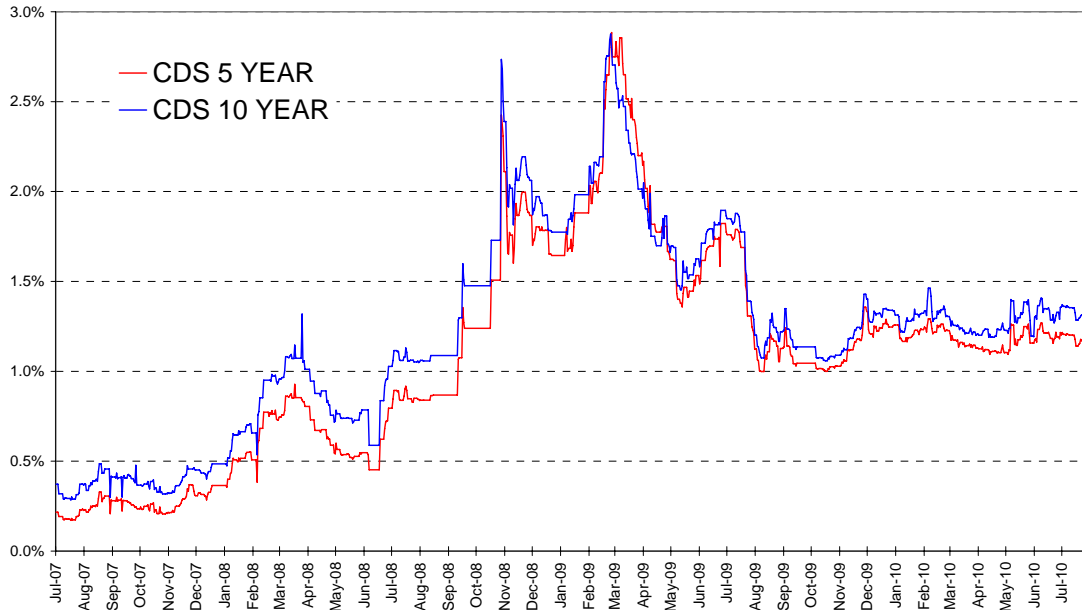
Stock Markets

Global equity markets were strongly positive during July. The MSCI World index gained 8 percent, the S&P 500 index rose by 7 percent, the NASDAQ index rose by 7 percent, and the MSCI Emerging Markets index rose by 8 percent. The TA-100 index rose by 4 percent, or 7 percent in dollar terms.

	MSCI World (gross)	MSCI EM (gross)	Tel-Aviv 100 (in shekel terms)	Tel-Aviv 100 (in dollar terms)
2005	10%	35%	29%	21%
2006	21%	33%	12%	22%
2007	10%	40%	25%	37%
2008	-40%	-53%	-51%	-50%
2009	28%	70%	78%	78%
2010 (Jan-Jul)	-2%	2%	-3%	-3%
July 2010	8%	8%	4%	7%

Israel's risk premium, based on its five-year CDS spread, stood at 1.1 percent at the end of July, slightly lower than in the preceding months.

Israel's risk premium according to the CDS spread

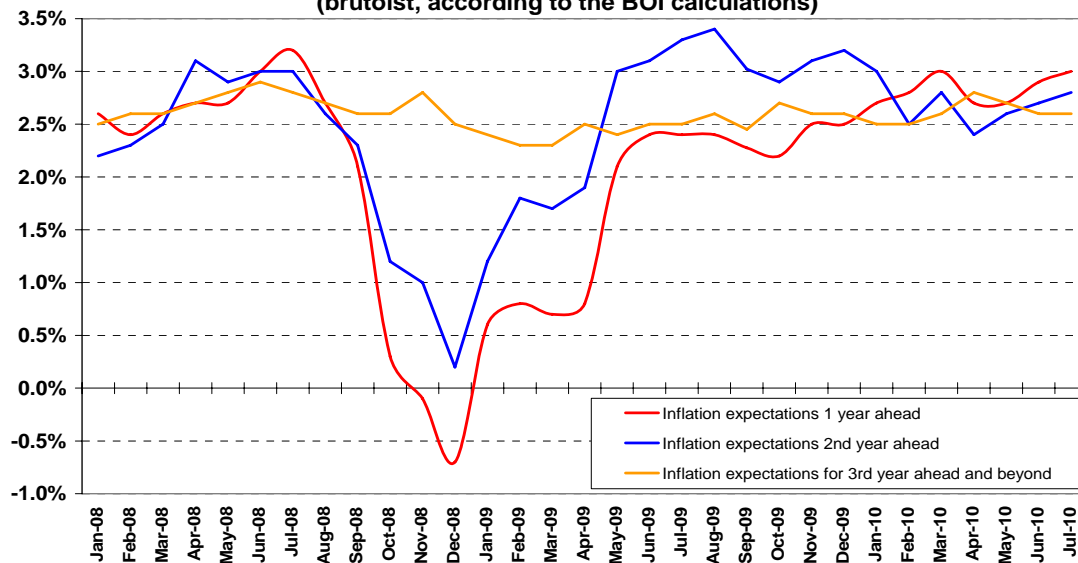


C. Developments in Inflation and Monetary Policy

The consumer price index rose by 0.3 percent in June, in line with the average forecast. Inflation in the twelve months ended in June totals 2.4 percent. The housing item (which mainly reflects rent prices) rose by 0.6 percent. Prices of tenant-owned homes rose sharply, by 1.2 percent, according to the last survey, versus an increase of 0.6 percent in the preceding month. Prices of homes increased by 21 percent in the last twelve months.

Inflation expectations between mid-June and mid-July, according to calculations by the Bank of Israel, were at an average of 3.0 percent for the first year, 2.8 percent for the second year, and 2.6 percent from the third year forward -- a slight increase compared to the preceding months.

**Inflation expectations derived by the capital market
(brutoist, according to the BOI calculations)**



According to monthly trend data, **unemployment** fell sharply over recent months, reaching just 6.5 percent in May, a decrease of almost 1 percentage point within six months. The monthly survey is not always reliable and the data may be revised in the future; however, if this unemployment rate turns out to be accurate, it may lead to a significant increase in wage and inflation pressures, and a more rapid rise of the interest rate.

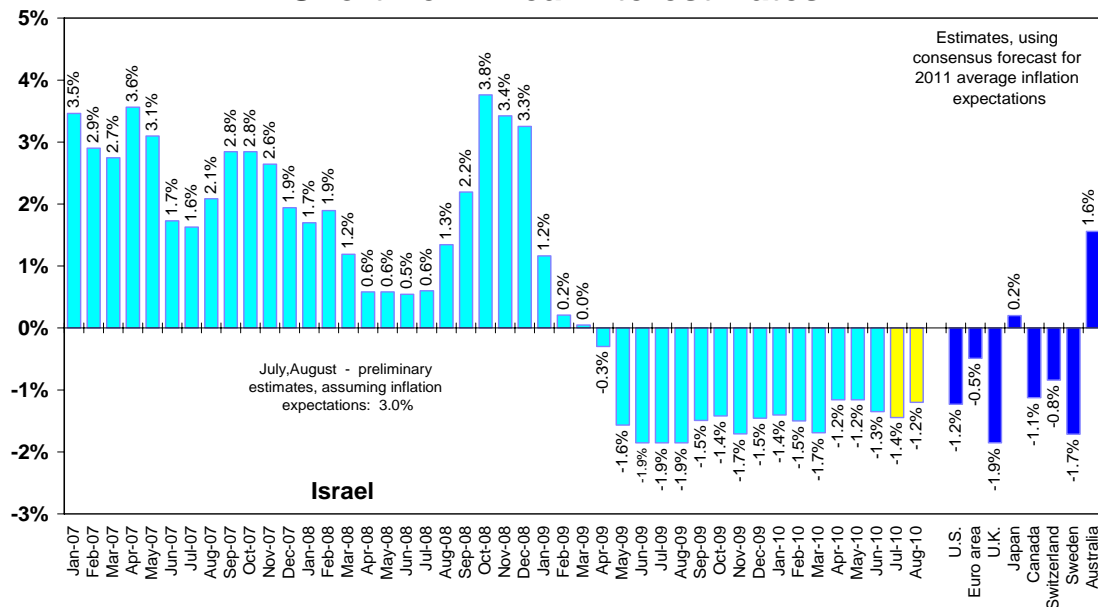
The **Bank of Israel interest rate** rose by 0.25 percentage points, to 1.75 percent. The increase in the interest rate was in line with our forecast, but not with those of most economists. There were no surprises in the interest-rate announcement. Three factors were emphasized, which likely contributed to the decision to raise the rate:

- An increase in inflation expectations for the coming year, both of forecasters and of the BOI itself, approaching the upper limit of the inflation target range.
- Several highly positive indicators in the labor market.

- The continued rapid increase in prices of homes and in credit for the housing market.

In our opinion, the interest rate is currently too low, even after the latest increase. The real interest rate is strongly negative (approximately negative 1.2 percent), similar to the United States and Europe, whereas economic conditions in Israel are very different: faster economic growth, a lower GDP gap, steeply rising home prices, no high unemployment rate, upward pressures on wages, stronger actual inflation, and higher inflation expectations.

Short-Term Real Interest Rates



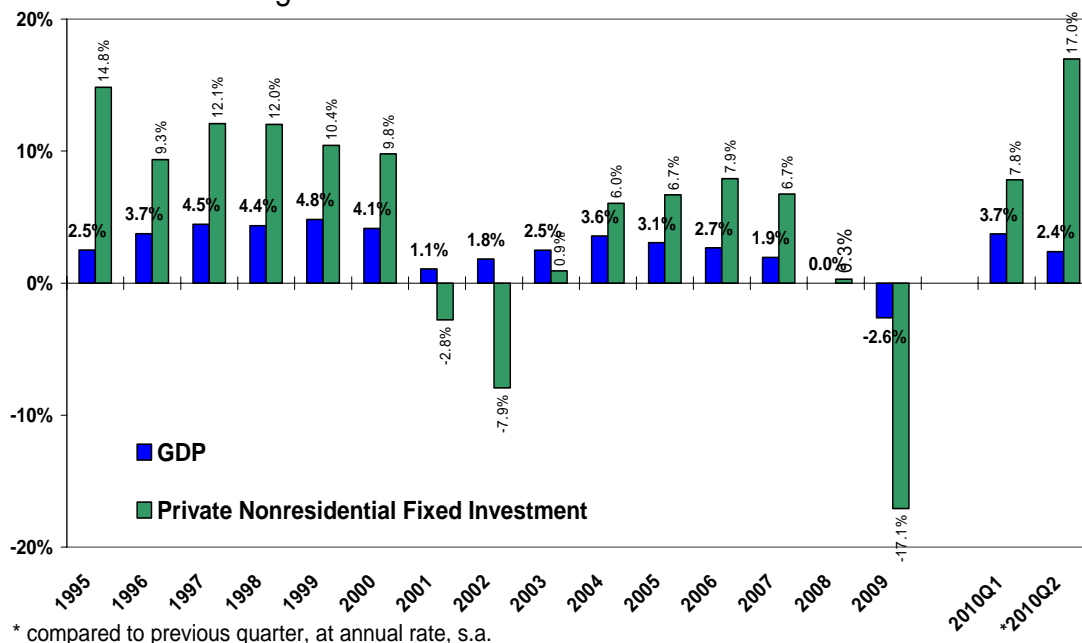
We therefore believe that the BOI will need to continue to raise the interest rate over the coming year, at a more rapid rate than estimated by most forecasters and by the capital market (which expects a 0.25-point rate hike every 3-4 months).

D. Developments in the Global Economy

United States

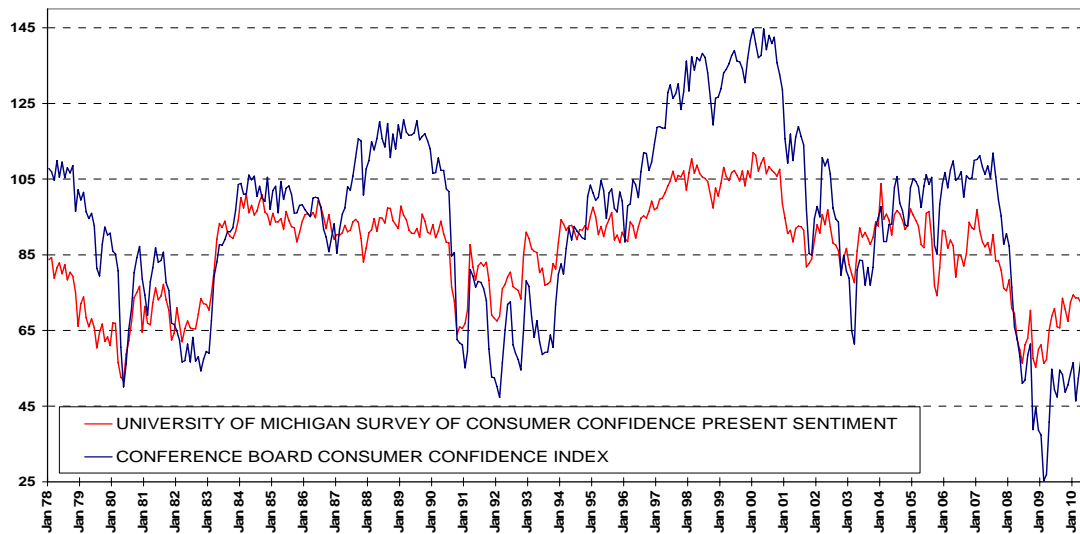
According to an initial estimate, the **US economy grew** at an annualized rate of 2.4 percent in the second quarter of 2010, slightly below advance estimates. Private consumption grew by 1.6 percent, and investments by firms increased by an impressive 17 percent. In addition, past data were amended: growth for the first quarter of 2010 was adjusted upward to an annualized rate of 3.7 percent, but growth rates for 2007, 2008, and 2009 were revised downward, by about 0.3 percentage points for each year.

The U.S. Economy, 1995-2010
Real growth rates of GDP and business investment



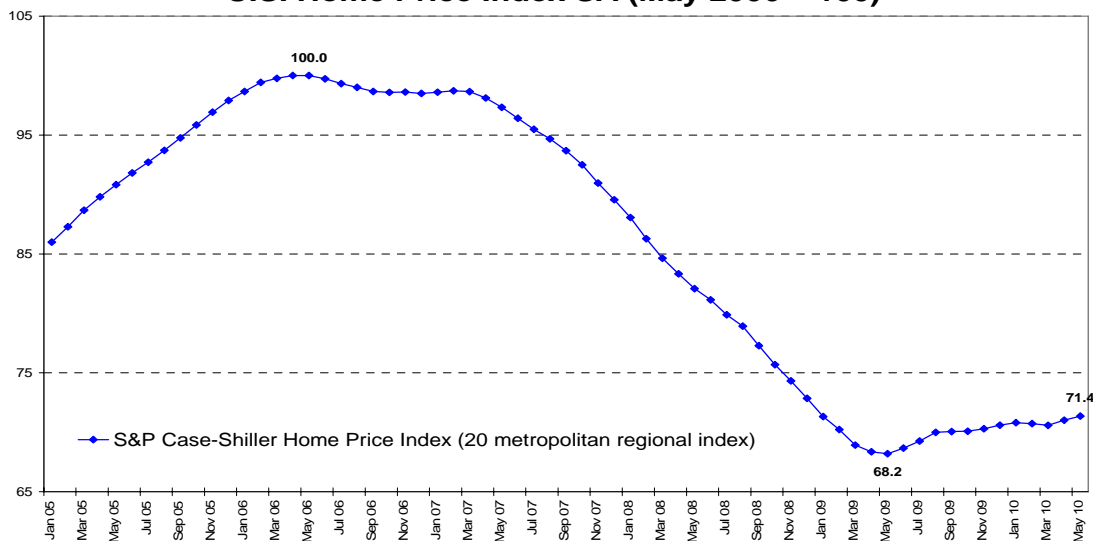
The University of Michigan's **consumer confidence index** was a negative surprise, at 67.8 points in July, according to the initial estimate. **The consumer confidence index** also fell sharply, to 50.4 points in July, below expectations.

Consumer confidence indices



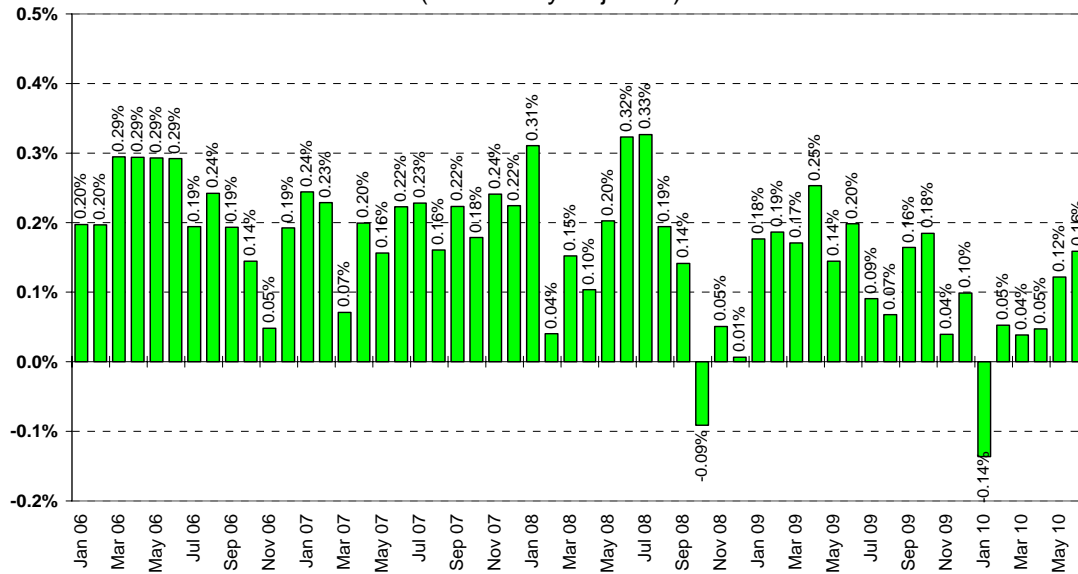
Data published regarding the construction sector were mixed, but mostly disappointing. **Construction starts** decreased by 5 percent, and **construction permits** increased by 2 percent in June, below expectations. **Sales of existing homes** fell by 5.1 percent in June, a smaller-than-expected decline; the median price rose by 5 percent in June, and by 1 percent in the last twelve months. **Sales of new homes** increased sharply by 24 percent in June, but remain very low in historical terms; sales for May were revised sharply downward. **The Case-Shiller twenty city house price index** rose by 0.5 percent in May and by 4.6 percent in the last twelve months, more than expected.

U.S. Home Price Index SA (May 2006 = 100)

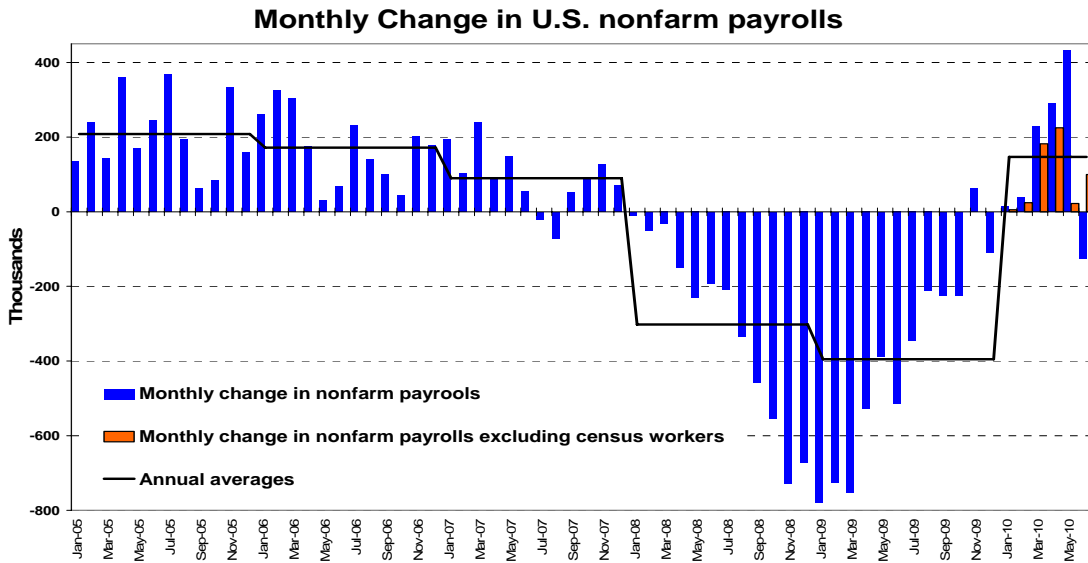


The consumer price index fell by 0.1 percent, and twelve-month inflation reached 1.1 percent. The core index rose by 0.16 percent, and core inflation for the last twelve months stood at 0.9 percent. Both indices were expected to remain stable. The developments in the core index over the last two months point to a significant decrease in the threat of deflation.

USA: monthly change in Core CPI
(Seasonally Adjusted)

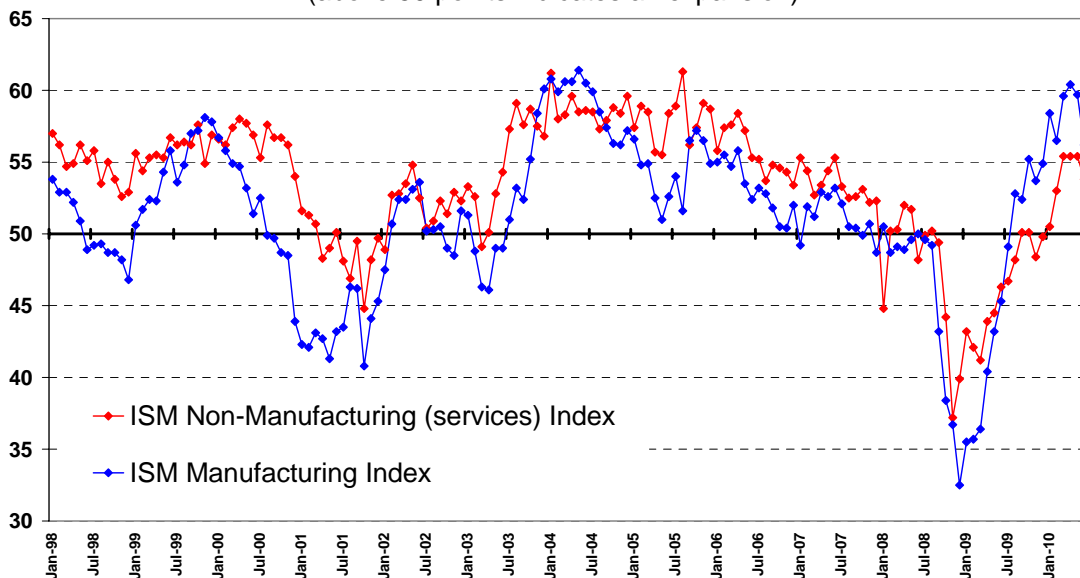


Employment data continue to disappoint. The number of employed persons in the non-agricultural sector decreased by 125,000, due to the end of the employment period of temporary personnel taken on by the government for the national census. Excluding the effect of the census, the number of employed persons grew by 100,000 in June and by a monthly average of 93,000 year to date – an insufficiently rapid increase to reduce the unemployment rate over time. The **unemployment rate** decreased to 9.5 percent in June, from 9.7 percent in the preceding month, due to a further decline in the participation rate.



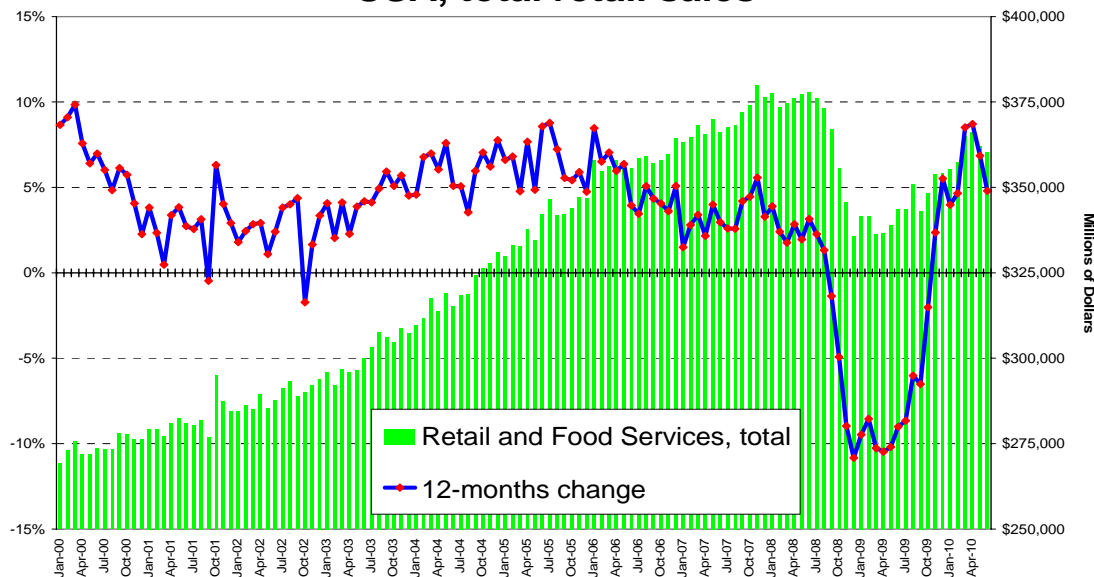
The ISM service sector purchasing managers' index fell to 53.8 points in June, lower than expected. Indices in recent months point to a slowdown in growth in the United States during these months, although the growth rate is still positive (values higher than 50 indicate expansion).

The Institute for Supply Management Index (above 50 points indicates an expansion)



Retail sales fell by 0.5 percent in June, a greater-than-expected decrease. Retail sales increased by 6 percent in the twelve months ended in June.

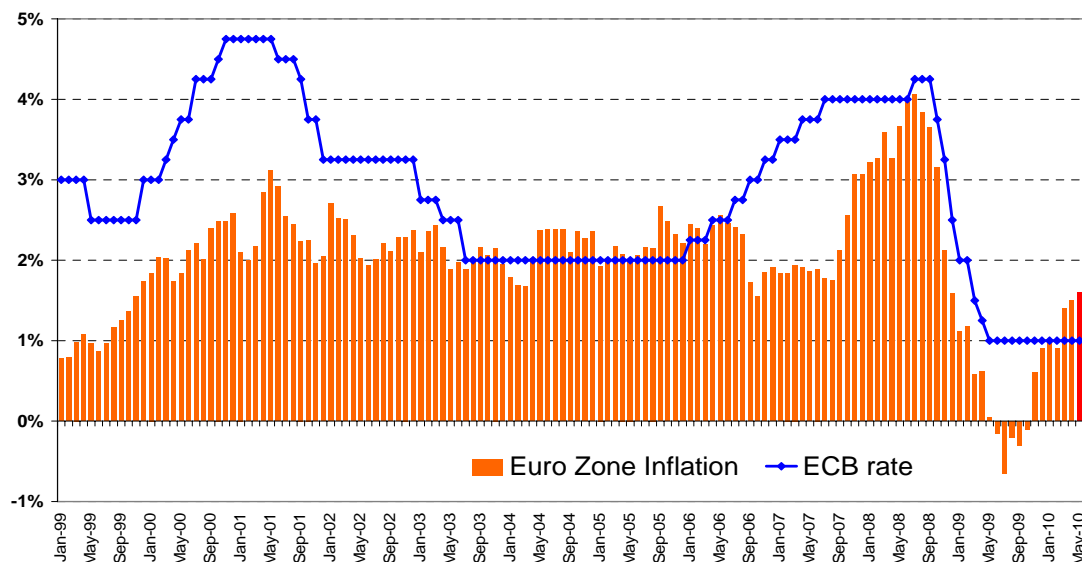
USA, total retail sales



Europe

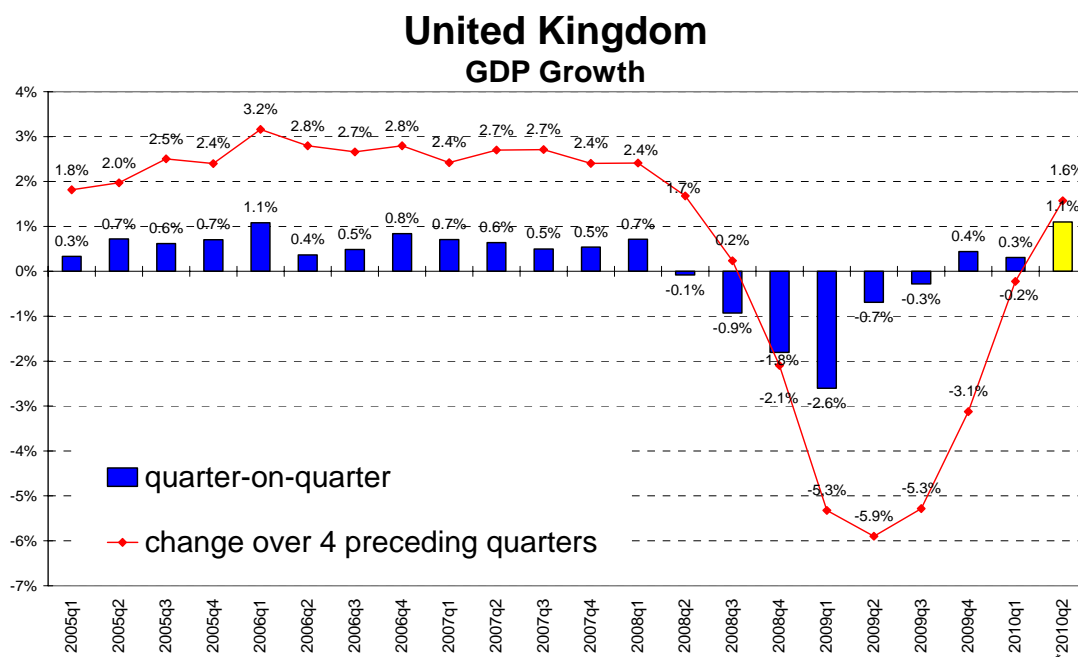
Twelve-month inflation reached 1.7 percent in July, according to an initial estimate, in line with expectations.

Euro Zone Inflation and ECB Interest Rate



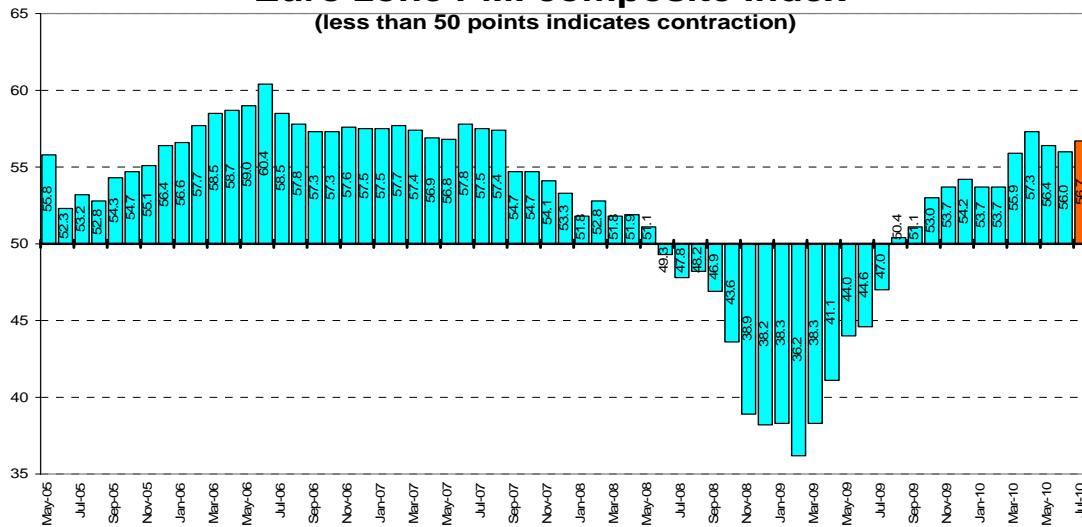
Results of **stress tests** conducted by European banks indicate that only 7 of 91 banks failed the tests; they will be required to raise only EUR 3.5 billion, a very low figure relative to advance estimates. This would appear to be a highly favorable outcome, but it is not surprising given the fact that the scenarios tested were not very severe. For example, scenarios of insolvency of countries were not tested.

The **British GDP** grew by 1.1 percent in the second quarter of 2010, according to an initial estimate (4.4 percent annualized), far above expectations. A surprising recovery in the housing market and in the services sector contributed to the high growth rate.



The **euro zone purchasing managers' index** stood at 56.7 points in July, according to an initial estimate, above expectations. At this stage, the effects of the fiscal crisis in the southern European countries do not seem to be causing a significant slowdown in the eurozone growth rate.

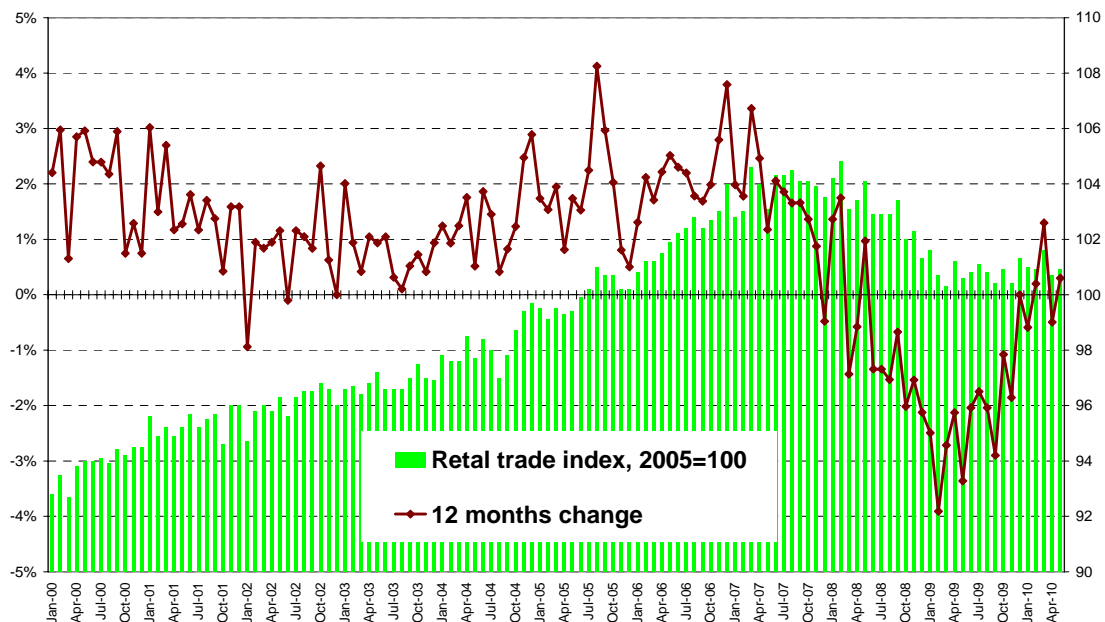
Euro zone PMI composite Index (less than 50 points indicates contraction)



The unemployment rate in the eurozone stabilized in the four months through June, when it stood at 10.0 percent. However, rates still range widely within the eurozone; the unemployment rate is 20 percent in Spain, but 7 percent in Germany.

Retail sales in the eurozone increased by 0.2 percent in May, as expected.

Euro Area total retail trade



Important Announcements in the Coming Month

Title	date	Day	Time	Link
ISM manufacturing sector index, US	Aug 2	Mon	17:00	www.ism.ws
US, Private income and consumption	Aug 3	Tue	15:30	www.bea.gov
Retail sales, euro zone	Aug 4	Wed	15:30	www.ec.europa.eu/eurostat
Interest-rate decision, Euro zone	Aug 5	Thu	14:45	www.ecb.int
Employment report, US	Aug 6	Fri	15:30	www.bls.gov
ISM service sector index, US	Aug 6	Fri	17:00	www.ism.ws
Israel, average wages	Aug 8	Sun	13:00	www1.cbs.gov.il/reader
Incoming tourists, Israel	Aug 9	Mon	13:00	www1.cbs.gov.il/reader
Foreign trade, Israel	Aug 12	Thu	13:00	www1.cbs.gov.il/reader
2Q growth rate estimates, euro zone	Aug 13	Fri	12:00	www.ec.europa.eu/eurostat
CPI, US	Aug 13	Fri	15:30	www.bls.gov
Retail sales, US	Aug 13	Fri	15:30	www.census.gov/svsd/www/adseries.html
CPI, Israel	Aug 15	Sun	18:30	www1.cbs.gov.il/reader
CPI, euro zone	Aug 16	Mon	12:00	www.ec.europa.eu/eurostat
National accounting data estimates, 2Q 2010	Aug 16	Mon	13:00	www1.cbs.gov.il/reader
Construction starts and permits, US	Aug 17	Tue	15:30	www.census.gov/pub/const
Industrial production index and trade and service sectors revenue index	Aug 18	Wed	13:00	www1.cbs.gov.il/reader
Interest-rate decision, BOI	Aug 23	Mon	17:30	www.bankisrael.gov.il
Sales of existing homes, US	Aug 24	Tue	17:00	www.realtor.org/Research.nsf/Pages/EHSdata
Sales of new homes, US	Aug 25	Wed	17:00	www.census.gov/const/www/newressalesindex.html
Israel, New dwelling sold in private sector	Aug 25	Wed	13:00	www1.cbs.gov.il/reader
2Q growth rate, US	Aug 27	Fri	15:30	www.bea.gov
Michigan University consumer confidence index	Aug 27	Fri	17:00	www.sca.isr.umich.edu
US, Private income and consumption	Aug 30	Mon	15:30	www.bea.gov
Euro Zone, CPI estimate	Aug 31	Tue	12:00	www.ec.europa.eu/eurostat
Israel, 2010 Q2 house starts and completions	Aug 31	Tue	13:00	www1.cbs.gov.il/reader
Israel, 2010 Q2 labor force survey	Aug 31	Tue	13:00	www1.cbs.gov.il/reader
US, Case-Shiller index	Aug 31	Tue	16:00	http://www2.standardandpoors.com
Unemployment situation, euro zone	Aug 31	Tue	12:00	www.ec.europa.eu/eurostat
2Q growth rate, euro zone	Sep 2	Thu	12:00	www.ec.europa.eu/eurostat
Retail sales, euro zone	Sep 3	Fri	12:00	www.ec.europa.eu/eurostat
Employment report, US	Sep 3	Fri	15:30	www.bls.gov
ISM manufacturing sector index, US	Sep 3	Fri	17:00	www.ism.ws
Israel, average wages	Sep 7	Tue	13:00	www1.cbs.gov.il/reader

This review is posted online at www.harel-finance.co.il/macro in Hebrew

and at <http://www.harel-group.com/finance.html> in English.

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