Monthly Macroeconomic Review May 3, 2010

- **The International Monetary Fund** (IMF) has adjusted its global growth forecast upward. The updated forecast calls for **global growth** of 4.2 percent in 2010 (up from 3.9 percent in the previous statement published in January), with 2.3 percent growth in the advanced countries and a strong 6.3 percent in the developing economies and emerging markets.

- Following the deterioration of **the fiscal crisis in Greece**, the euro zone countries and the IMF have agreed on a financial bailout, in which the country will be loaned EUR 110 billion over the next three years, in return for which Greece is obligated to deep deficit cuts. The financial markets are still unconvinced that the plan will be implemented successfully.

- **Current indicators** of economic activity in Israel signal continuing recovery in the first quarter of 2010. March saw a sharp increase in the import and export of goods, a growth in the number of incoming tourists, and an increase in the Bank of Israel's composite index.

- **The consumer price index** went up 0.1 percent in March, as expected. **Inflation** over the last twelve months amounted to 3.2 percent, versus 3.6 percent in the preceding month.

- **The Bank of Israel** has maintained the interest rate at 1.50 percent.

- **The government bond yield curve** is almost unchanged, whereas the **US government bond yield curve** sloped downward in April.

- **World equity markets** posted almost no changes for April. The MSCI World index remained unchanged, the S&P index went up 1 percent, NASDAQ rose by 3 percent, and the MSCI Emerging Markets index gained 1 percent. The **TA-100 index** went down 5 percent (down 5 percent in dollar terms as well).

This review contains four chapters:

A. Developments in the Israeli Economy.

B. Developments in the Capital Market.

C. Developments in Inflation and Monetary Policy.

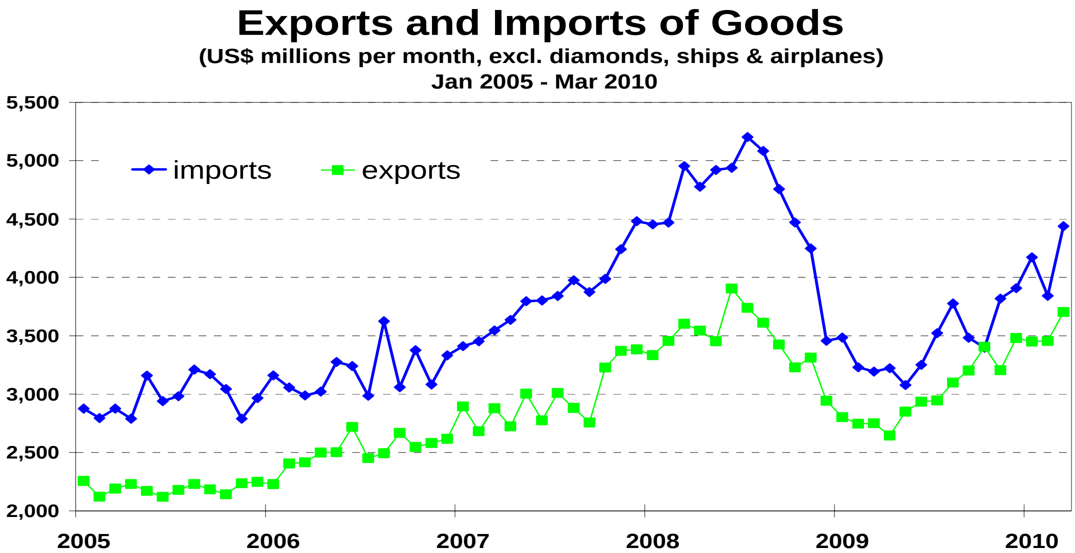
D. Developments in the Global Economy.

A. Developments in the Israeli Economy

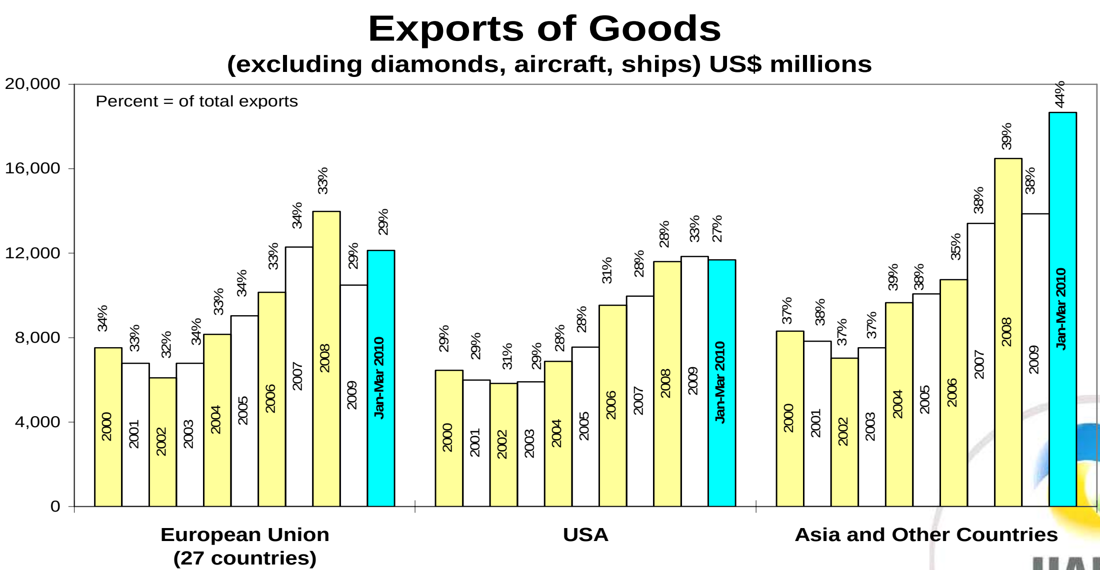
Current indicators of economic activity signal continuing recovery of the economy in the first quarter of 2010. March saw a sharp increase in the import and export of goods, a growth in the number of incoming tourists, and an increase in the Bank of Israel's composite index.

Growth in the last quarter of 2009 was updated by the Central Bureau of Statistics to an annual rate of 4.8 percent, from 4.9 percent in the previous estimate last month.

Foreign-trade data for March were highly positive. **Exports of goods** (excluding diamonds, ships, and aircraft; in dollar terms) increased by 7 percent in March, and by 35 percent in the twelve months ended in March, while data for the preceding month were adjusted upward. **Imports of goods** increased by 16 percent in March, and by 39 percent in the twelve months ended in March.

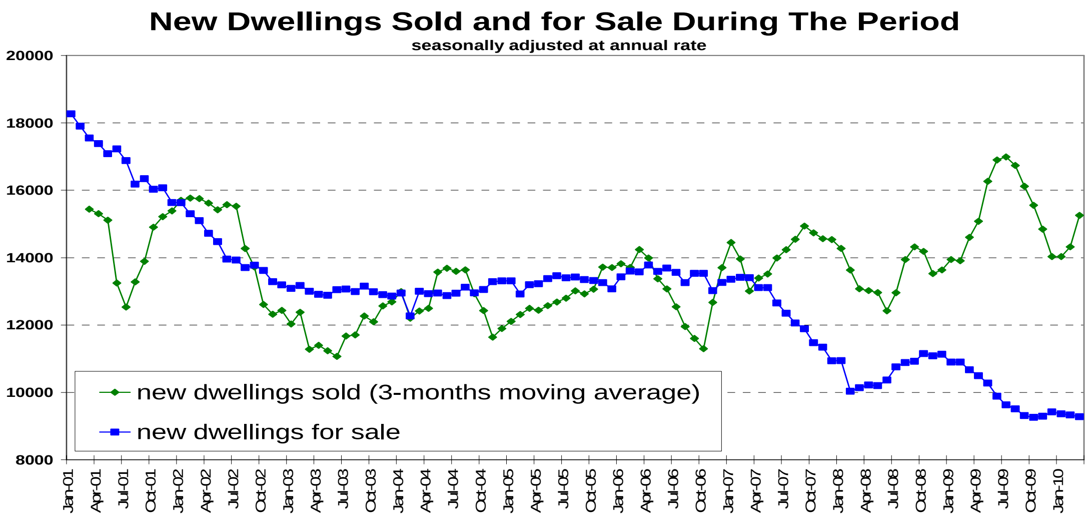


Exports of goods to Asia and other countries (other than the European Union and the United States) grew to 44 percent of total exports in the first quarter of 2010, after many years in which this rate remained stable at less than 40 percent. If this is in fact a real, permanent change – i.e. if the goods really are designated for Asia, not exported to Asia en route to the US or Europe – it will allow more rapid expansion of exports in the coming years, when growth in the US and EU is expected to be relatively low. The increase in the percentage of goods exported to Asia and other countries reflects a sharp increase in exports to those countries, a decrease in exports to the US, and moderate growth in exports to Europe.

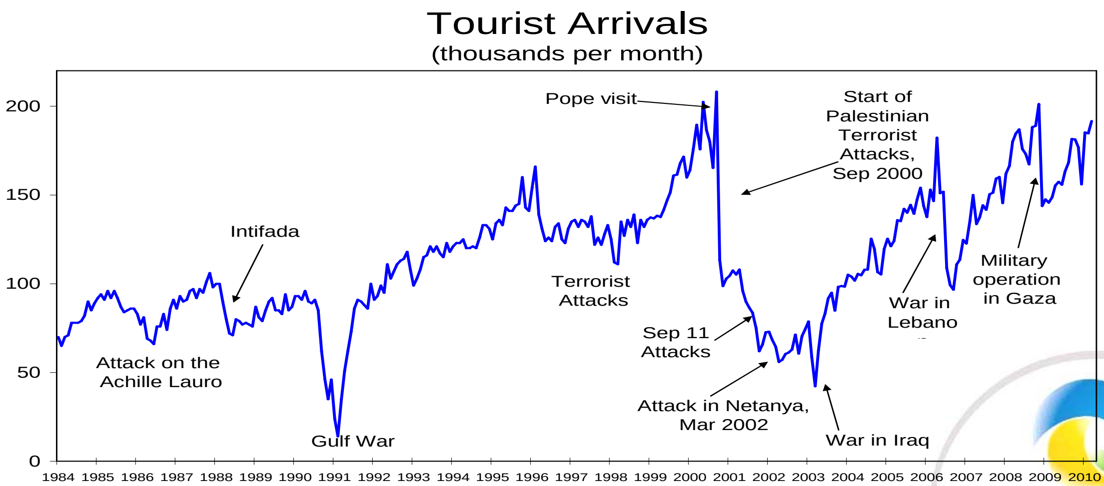


State tax revenues totaled ILS 16.3 billion in March. This figure conforms with our expectations and strengthens our estimate that tax revenues in 2010 will be significantly higher (by 1-2 percent of GDP) than the forecast in the state budget.

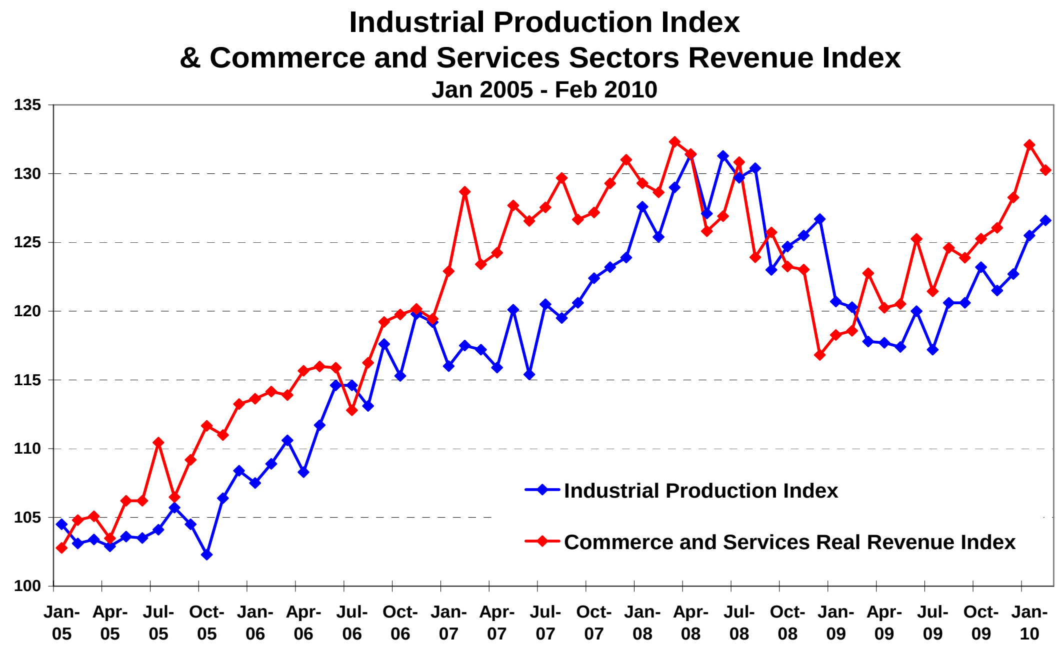
The number of new homes sold grew by 6 percent in March and by 3 percent in the twelve months ended in March, while previous months' data have been adjusted upward. The supply of new homes for sale decreased by 1 percent and is 13 percent lower than in March of last year; here too, previous months' data were revised upward.



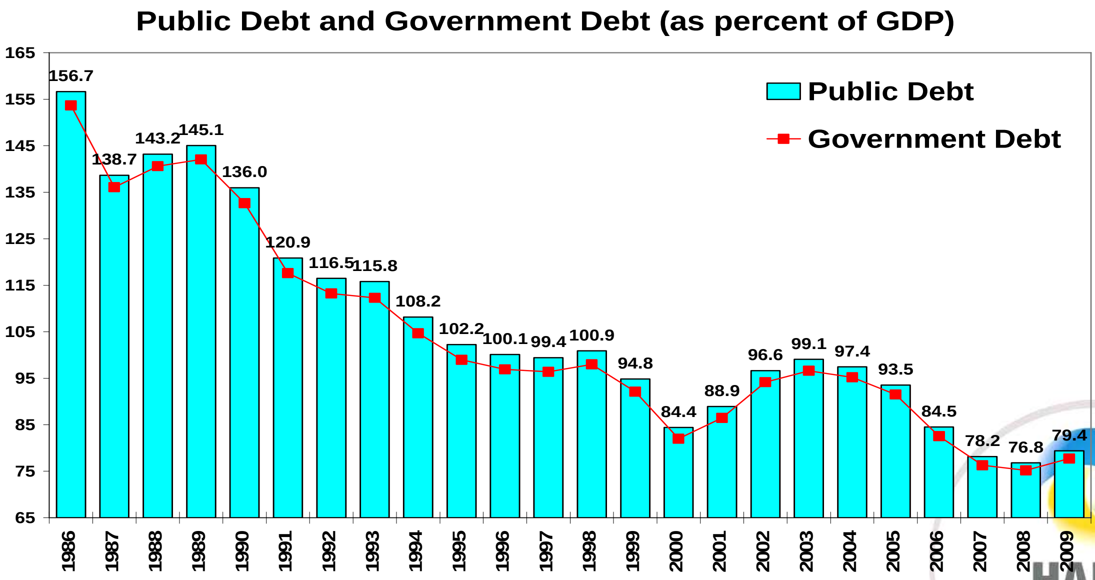
The number of **incoming tourists** by air, according to data net of seasonal effects, increased by 4 percent in March.



The industrial production index rose by 1 percent in February and by 5 percent in the twelve months ended in February. The **index of trade and service sector revenues** fell by 1 percent in February and rose by 10 percent in the twelve months ended in February.

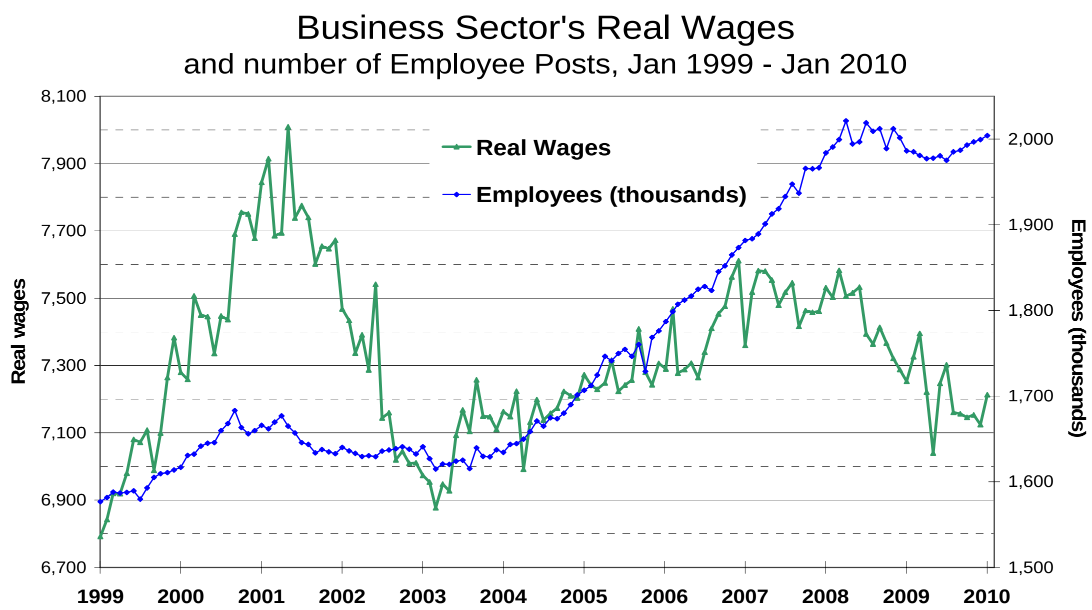


Israel's national debt was 79.4 percent of the GDP in 2009, and has risen by 2.6 percentage points. This growth is, however, quite moderate relative to other advanced economies.



The number of employee positions of Israeli workers rose by 0.5 percent in January, the fastest growth in a long time, and by 1.9 percent in the twelve months ended in January. **Average nominal wages** per employee position of Israeli workers increased by 1.8 percent in January – also the most rapid growth in a long time – and by 2.6 percent in the twelve months ended in January, which still reflects a 2.0 percent decline in real wages.

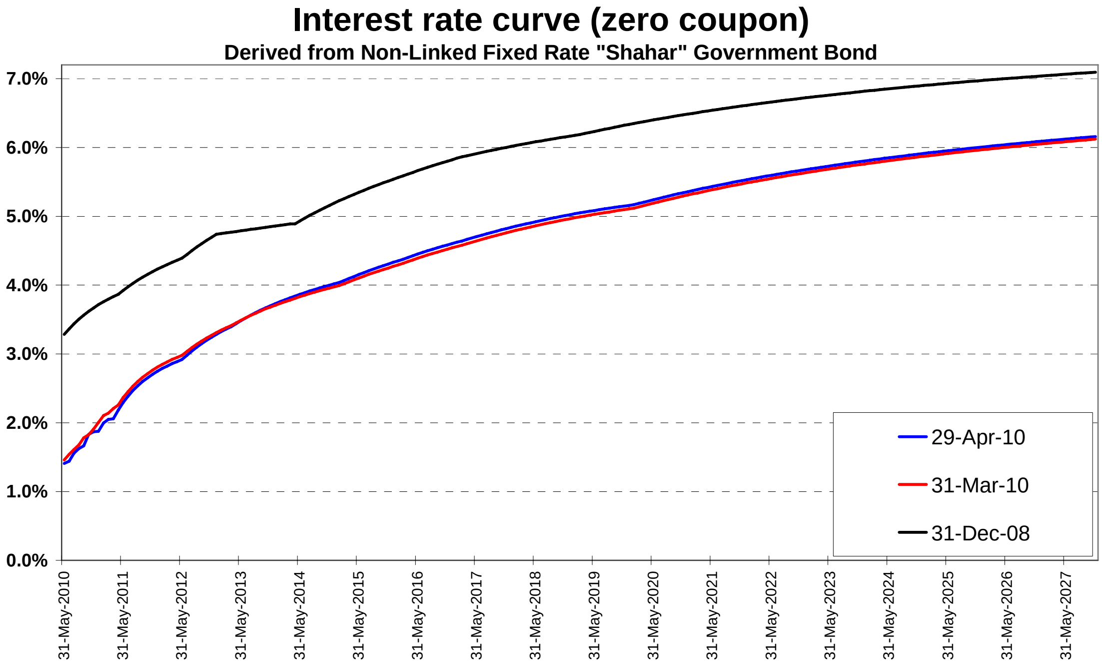
In the business sector, the number of employee positions grew by 0.2 percent in January and by 0.9 percent in the twelve months ended in January. **Real wages** rose by 1.2 percent in January and decreased by 0.5 percent in the twelve-month period.



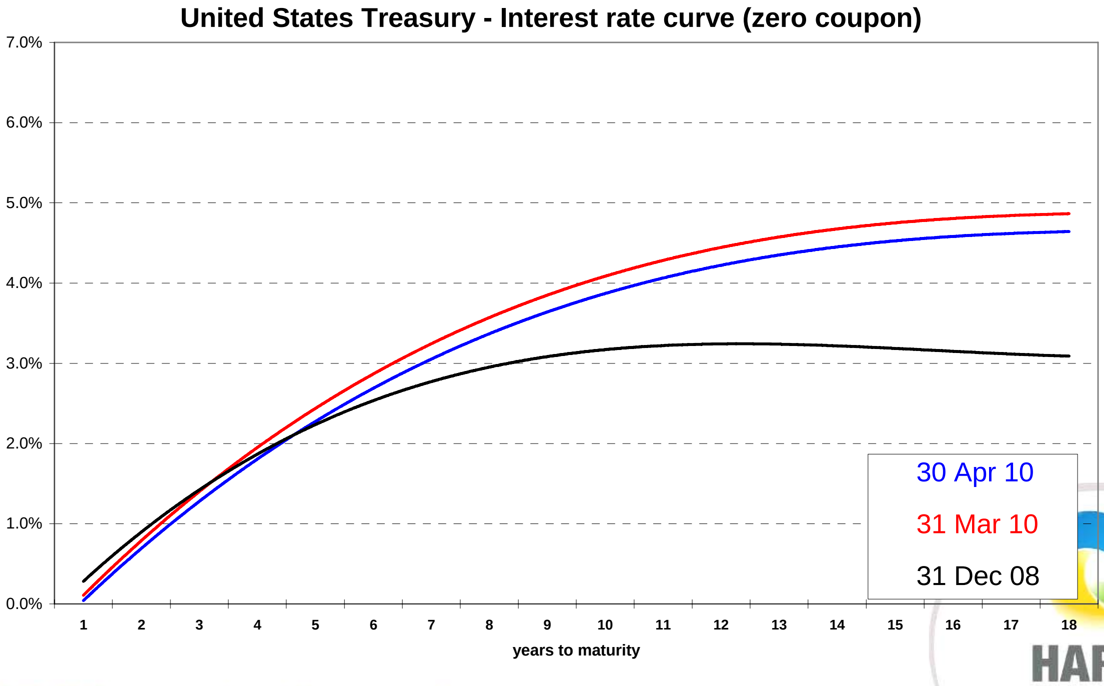
B. Developments in the Capital Market

Bond Market

The government bond yield curve is almost unchanged in April.



US government bond yield curve sloped downward in April.



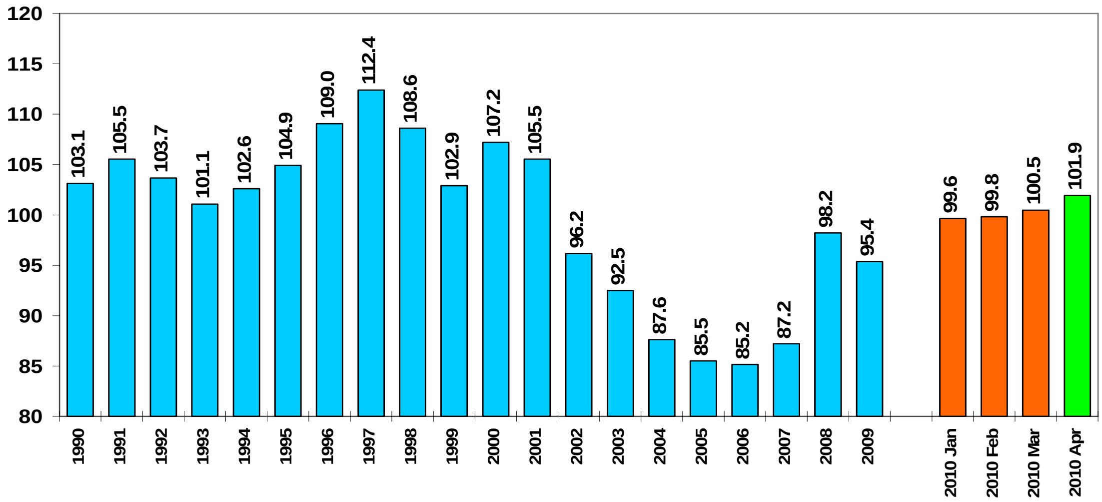
Exchange Rates

The shekel did not significantly change its value against the dollar or the currency basket in April, but appreciated by 1 percent against the euro. **The real exchange rate of the shekel** increased by another 1 percent in April and is 7 percent higher than its 2009 average.

Real Effective Exchange Rate

Basket: US 50%, Euro 25%, UK 5%, Japan 5%, Others 15%

(index, average 1990-2007=100; increase means real appreciation, decrease means real depreciation)

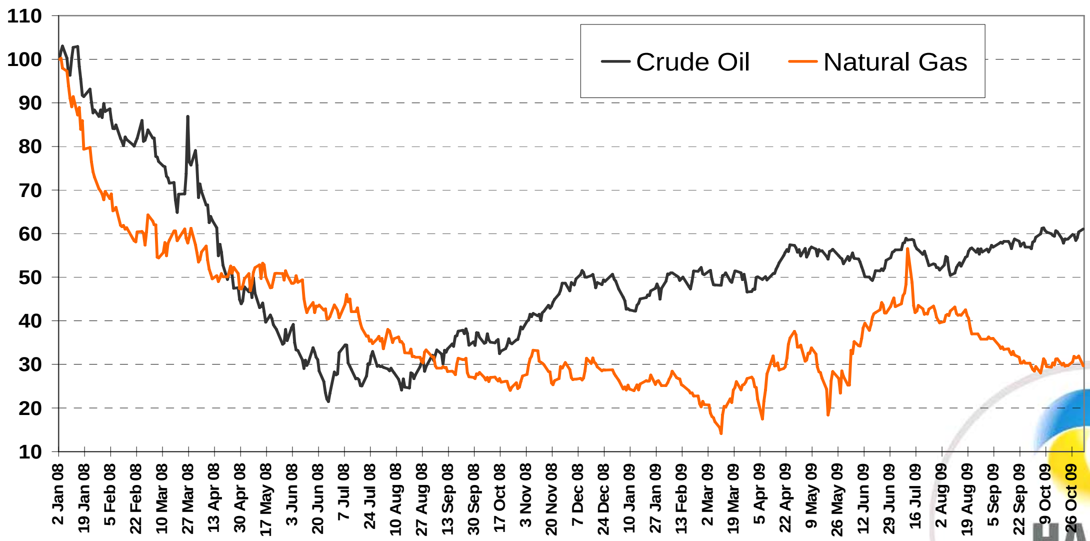


Energy prices

The price of a WTI oil barrel increased by 3 percent in dollar terms and by 2 percent in euro terms during April. **The price of natural gas** rose by 1 percent in dollar terms over the month of April.

Oil and Gas prices

Jul 2008 = 100



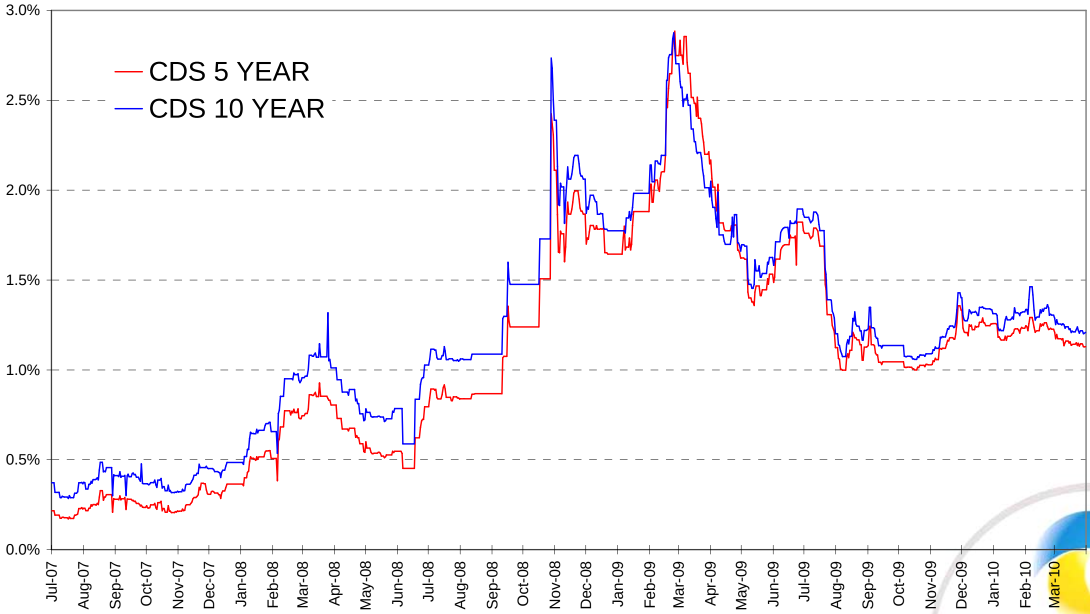
Stock Markets

World equity markets posted almost no changes for April. The MSCI World index remains unchanged, the S&P index went up 1 percent, NASDAQ rose by 3 percent, and the MSCI Emerging Markets index gained 1 percent. The **TA-100 index** went down 5 percent (5 percent in dollar terms as well).

	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-Apr)	3%	4%	3%	4%
Apr 2010	0%	1%	-5%	-5%

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

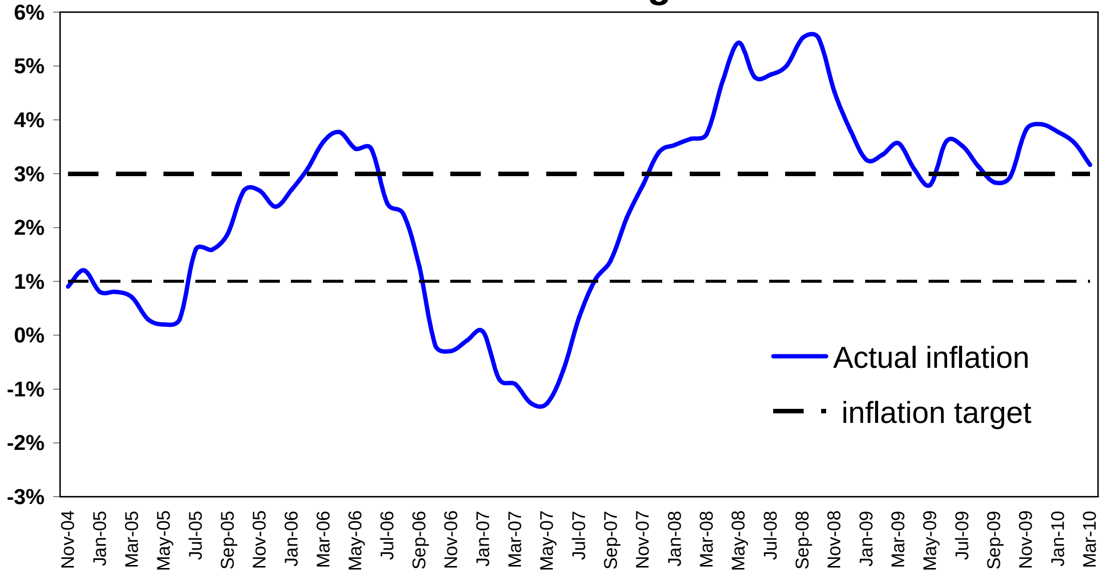
Israel's risk premium according to the CDS spread



C. Developments in Inflation and Monetary Policy

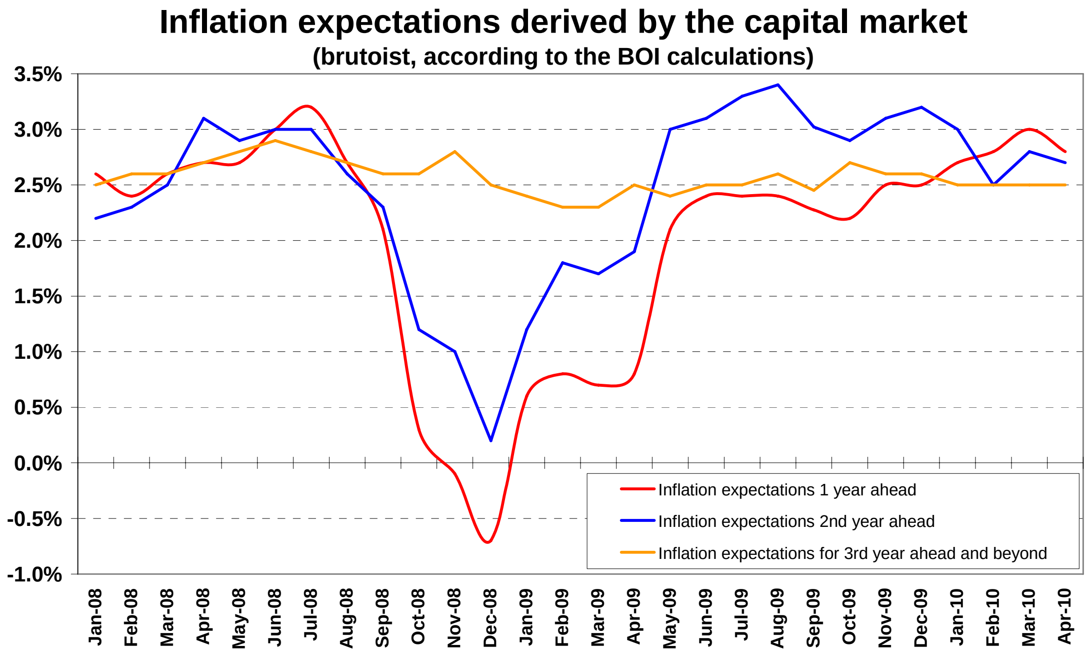
The consumer price index rose by 0.1 percent in March, in line with expectations. Twelve-month inflation reached 3.2 percent, down from 3.6 percent in the preceding month. Surprises (relative to our estimates) were mainly in the education item (which rose, versus our forecast of no change), and in the housing item (a sharp 0.7 percent increase, versus our forecast of a more moderate gain).

The Inflation Target and the 12-month Rate of Change in the CPI

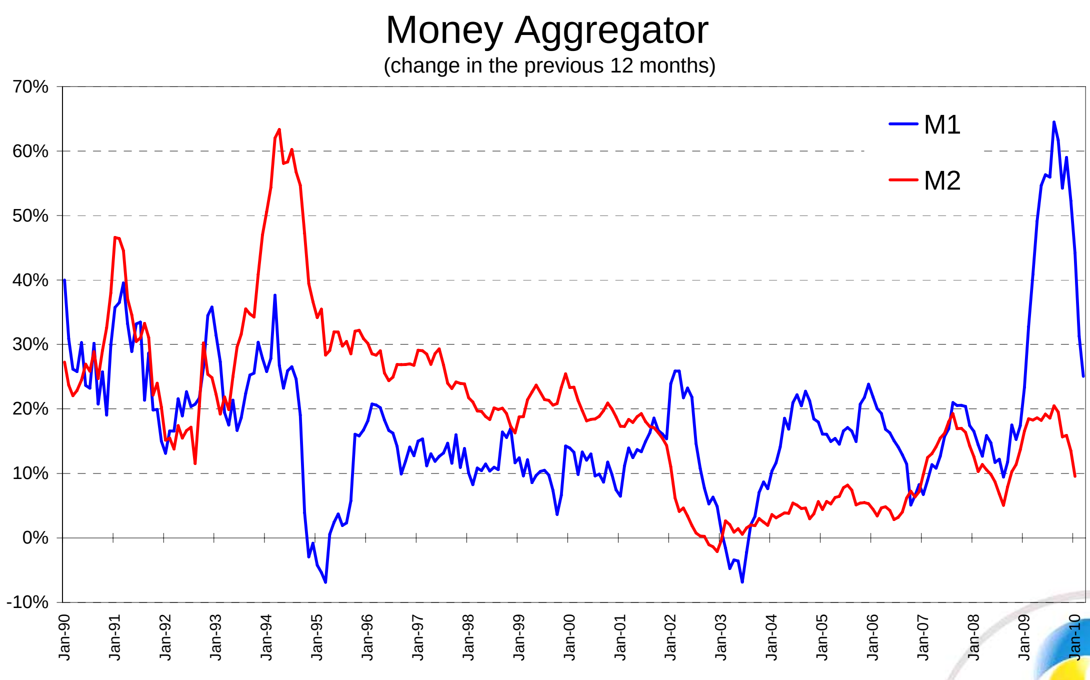


The wholesale price index rose sharply by 1.2 percent, while **prices of tenant-owned homes** rose by 1.3 percent in the last monthly survey and by 22 percent in the last twelve months.

The Bank of Israel has announced a slight decrease in **inflation expectations**, which stood at an average between mid-March and mid-April of 2.8 percent for the first year, 2.7 percent for the second year, and 2.5 percent from the third year forward.



The quantity of means of payment grew by 2 percent in March, but the rate of growth in the twelve months ended in March fell to 25 percent, from the peak of 65 percent last August.



The Bank of Israel has maintained the interest rate at 1.50 percent, though most economists placed the probability of a rate hike at more than 50 percent.

The interest-rate announcement contains almost no new data or statements; it primarily describes considerations that actually support an increase in the interest rate (the increased growth forecasts globally and in Israel; the 0.6 percent inflation in the first three months of the year, excluding seasonal effects and indirect taxes; etc.). Yet a surprise is in store towards the end of the announcement: *"…These factors support a gradual increase in the interest rate. Therefore, after the increase last month, the decision was made to leave the rate unchanged in May."* In other words, the BOI is saying (for the first time, to the best of our recollection) that all of the factors contributing to last month's interest-rate hike are still in place and have not changed significantly, but a pace of one increase every two months is sufficient, in the BOI's view, and as the rate was raised last month there is no need to raise it again this month.

This analysis strengthens our estimate, which we have reiterated for many months, that barring unexpected developments the BOI is likely to raise the interest rate at an average pace of one increase every two months, meaning an interest rate of about 3 percent one year from now. This pace of increases is slightly slower, in our opinion, than necessary in order to aim for the midpoint of the inflation target range, as it also reflects the BOI's wish to prevent significant pressures towards appreciation of the shekel, rather than just its commitment to compliance with the inflation target.

Of course, given this statement in the interest-rate announcement, provided that there are no unexpected developments in the coming month, we can expect an increase in the interest rate at the end of May.

D. Developments in the Global Economy

IMF forecasts

The International Monetary Fund (IMF) has adjusted its global growth forecast upward. The current forecast calls for **global growth** of 4.2 percent in 2010 (up from 3.9 percent in the last estimate published in January), with 2.3 percent growth in the advanced countries, including 3.1 percent growth in the **US** and just 1.0 percent growth in the **euro zone**. The forecast growth rate in the developing economies and emerging markets is a strong 6.3 percent in 2010, with 10 percent growth in China and 8.8 percent growth in India.

In addition, the IMF predicts that global growth in 2011 will reach 4.3 percent, with growth rates of 2.4 percent in the US and 1.5 percent in the euro zone.

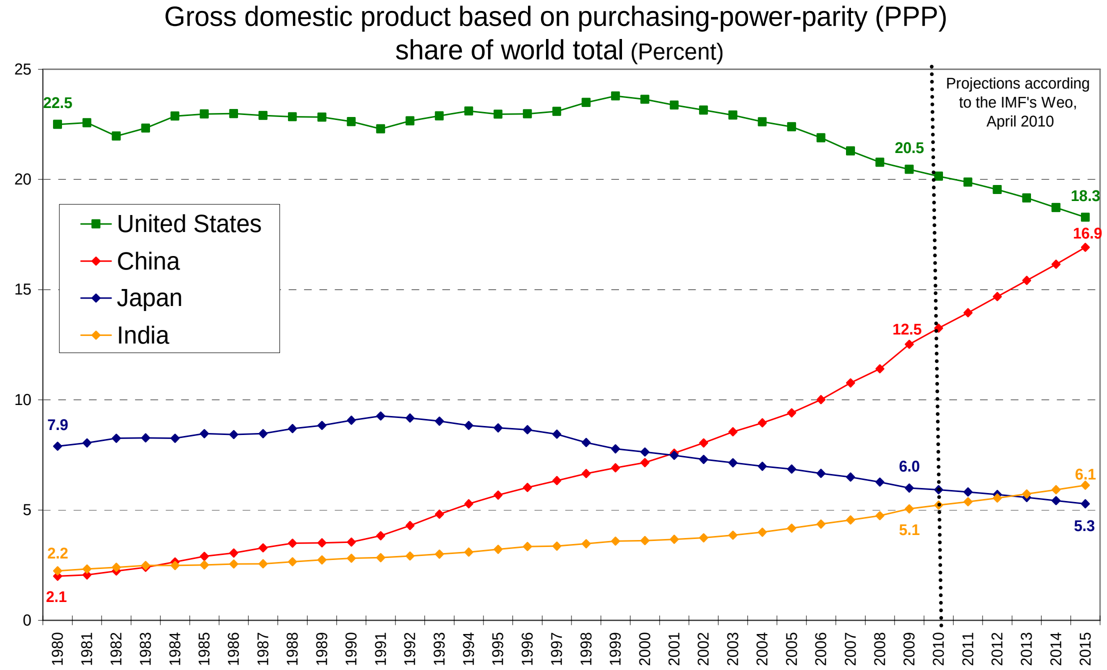
The inflation forecast for the advanced countries is an annual average of 1.5 percent in 2010 and 1.4 percent in 2011. The inflation forecast for the developing economies and emerging markets is higher, at an annual average of 6.2 percent in 2010 and 4.7 percent in 2011.

Growth in Israel, according to the IMF forecast, is estimated at 3.2 percent in 2010 and 3.5 percent in 2011. This is similar to the growth forecast we published about a month ago (3.1 percent in 2010 and 3.4 percent in 2011), but lower than the estimates released by the BOI last week (3.7 percent in 2010 and 4.0 percent in 2011).

World Economic Outlook Projections (annual percentage change)

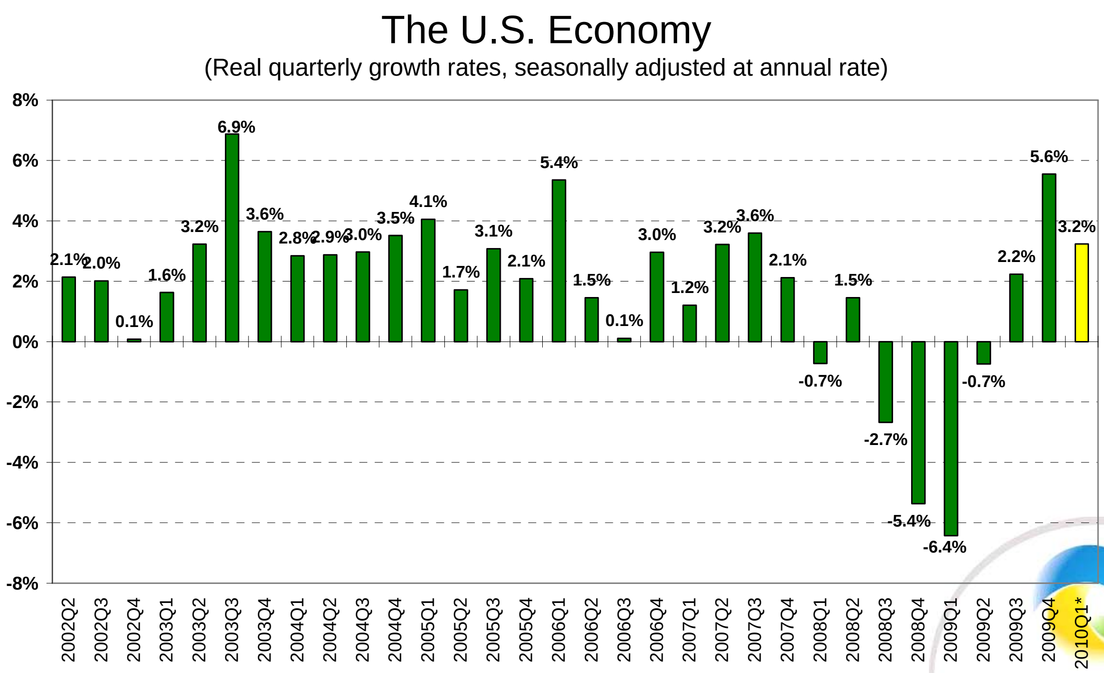
	2008	2009	2010	2011
World growth	3.0	-0.6	4.2	4.3
Advanced economies	0.5	-3.2	2.3	2.4
United states	0.4	-2.4	3.1	2.6
Euro zone	0.6	-4.1	1.0	1.5
Germany	1.2	-5.0	1.2	1.7
France	0.3	-2.2	1.5	1.8
Japan	-1.2	-5.2	1.9	2.0
United kingdom	0.5	-4.9	1.3	2.5
Canada	0.4	-2.6	3.1	3.2
Israel	4.0	0.7	3.2	3.5
Developing economies and emerging markets	6.1	2.4	6.3	6.5
Africa	5.5	2.1	4.7	5.9
central and eastern Europe	3.0	-3.7	2.8	3.4
Russia	5.6	-7.9	4.0	3.3
Developing Asia economies	7.9	6.6	8.7	8.7
China	9.6	8.7	10.0	9.9
India	7.3	5.7	8.8	8.4
Middle east	5.1	2.4	4.5	4.8
South and central America	4.3	-1.8	4.0	4.0
Brazil	5.1	-0.2	5.5	4.1
Mexico	1.5	-6.5	4.2	4.5

The gap in GDP between the United States and China will shrink rapidly in the coming years, according to the IMF's growth estimates. It appears that China will become the world's largest economy (in terms of real GDP adjusted to purchasing power) by the second half of this decade.



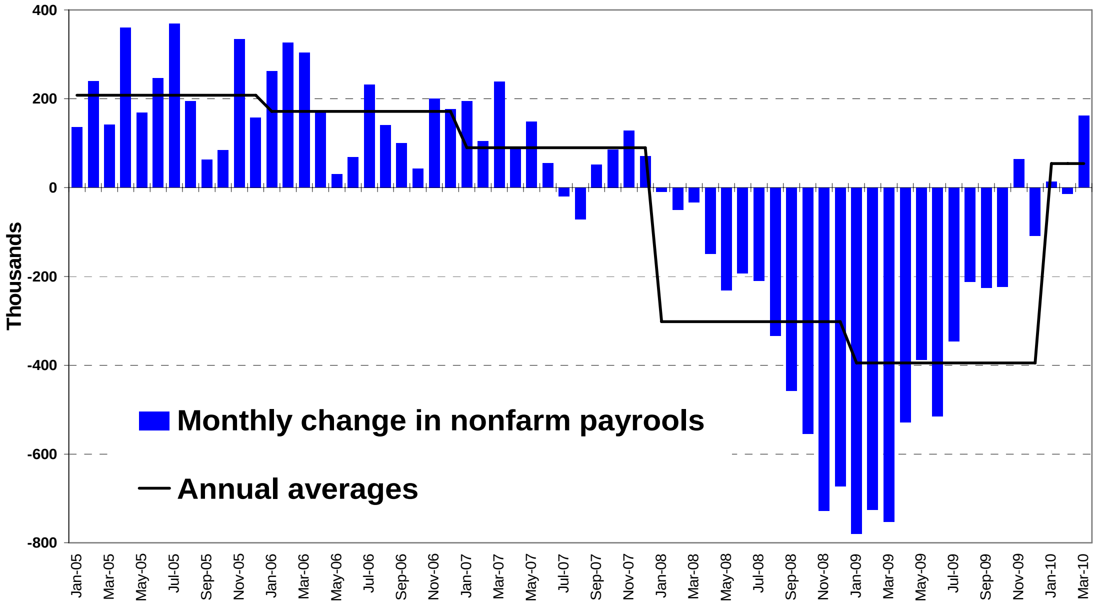
United States

The initial estimate shows **US economy growth** at an annual rate of 3.2 percent during the first quarter of 2010, close to earlier estimations. Private consumption grew at a rate of 3.6 percent, and firms' investments in fixed assets increased at a rate of 4.0 percent.



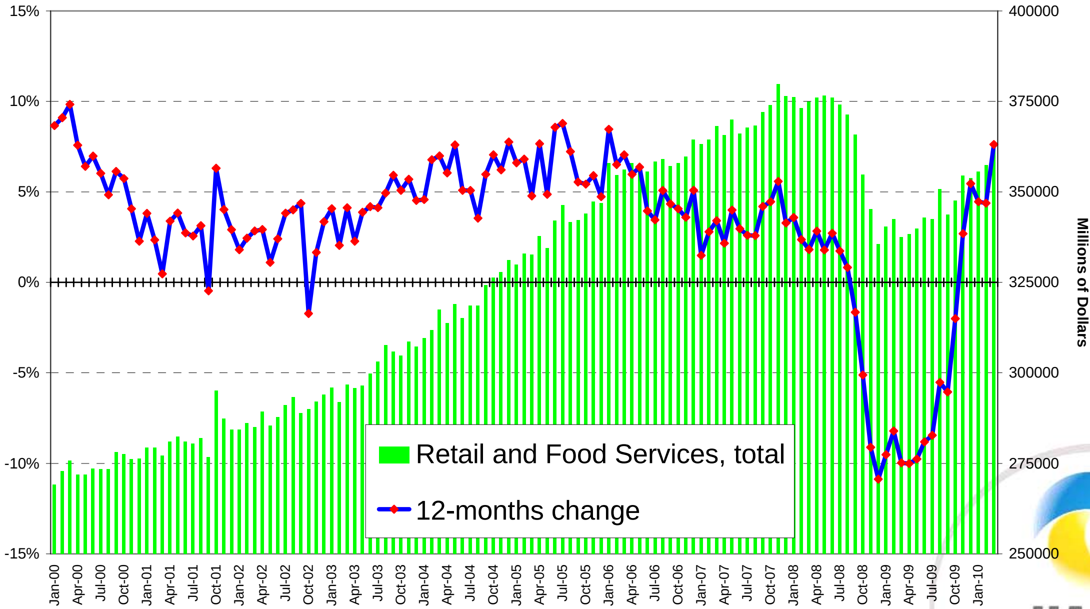
The Employment Report for March was favorable, with an increase of about 160,000 jobs (more than expected), as the unemployment rate remained at 9.7 percent, in line with expectations.

Monthly Change in U.S. nonfarm payrolls



Retail sales grew by 1.5 percent in March and by 7.6 percent in the twelve months ended in March, above expectations.

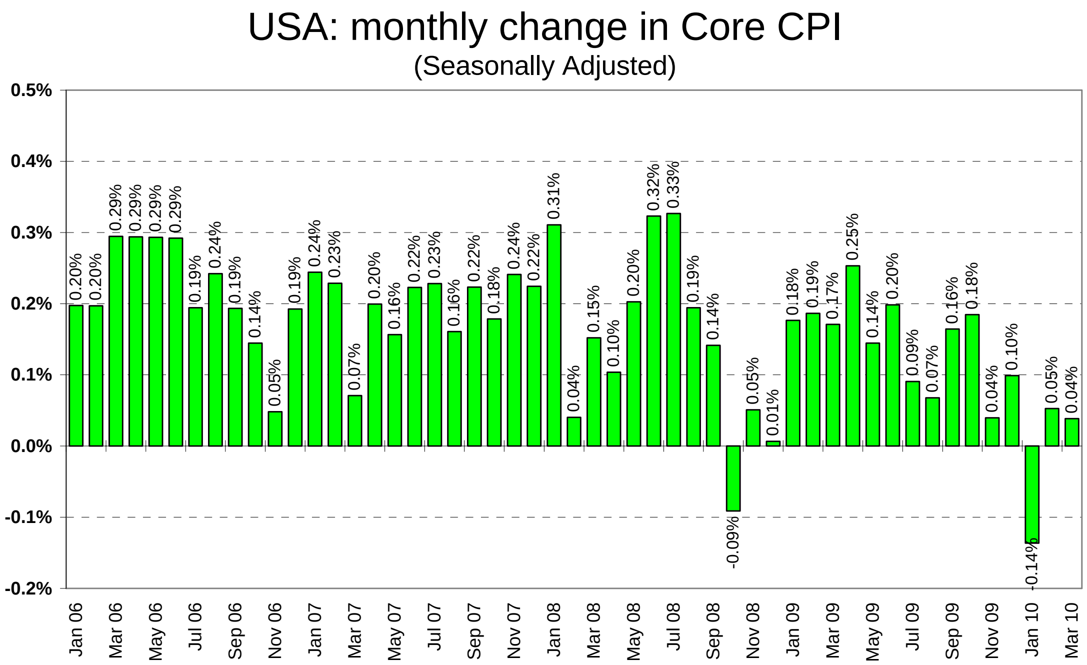
USA, total retail sales



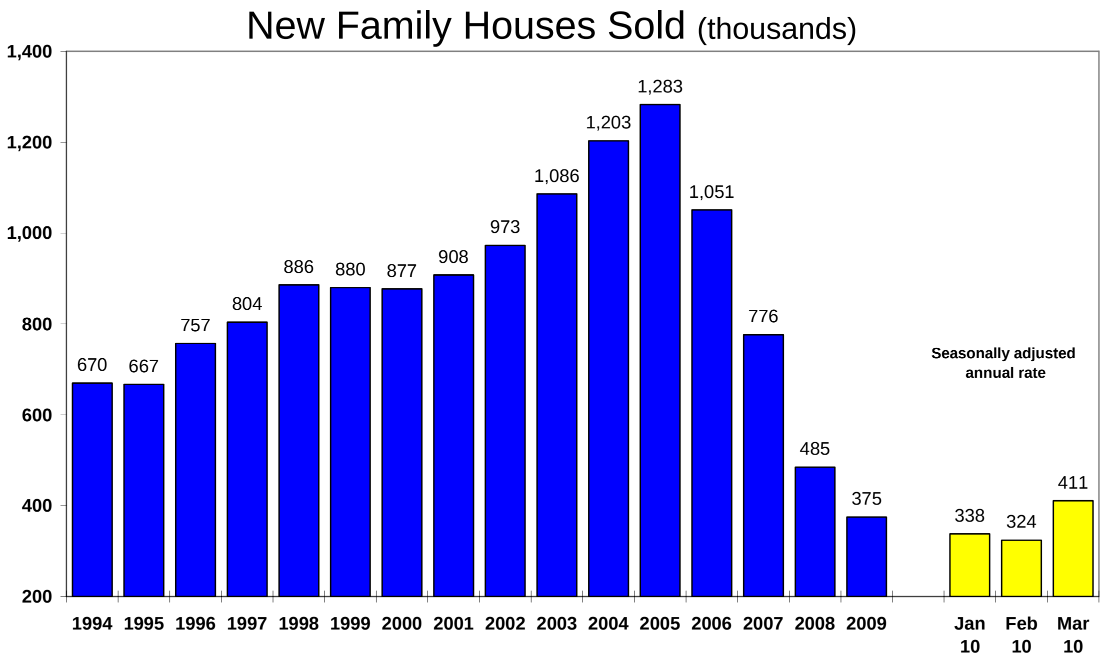
The University of Michigan's consumer confidence index stood at 72.2 points in April, down since March.

The Fed kept interest rates unchanged. The main concern before the announcement was whether the Fed would keep the phrase "interest rates are likely to remain exceptionally low for an extended period" in its policy statement. The phrase remained and consequently interest rates are not expected to rise before late 2010.

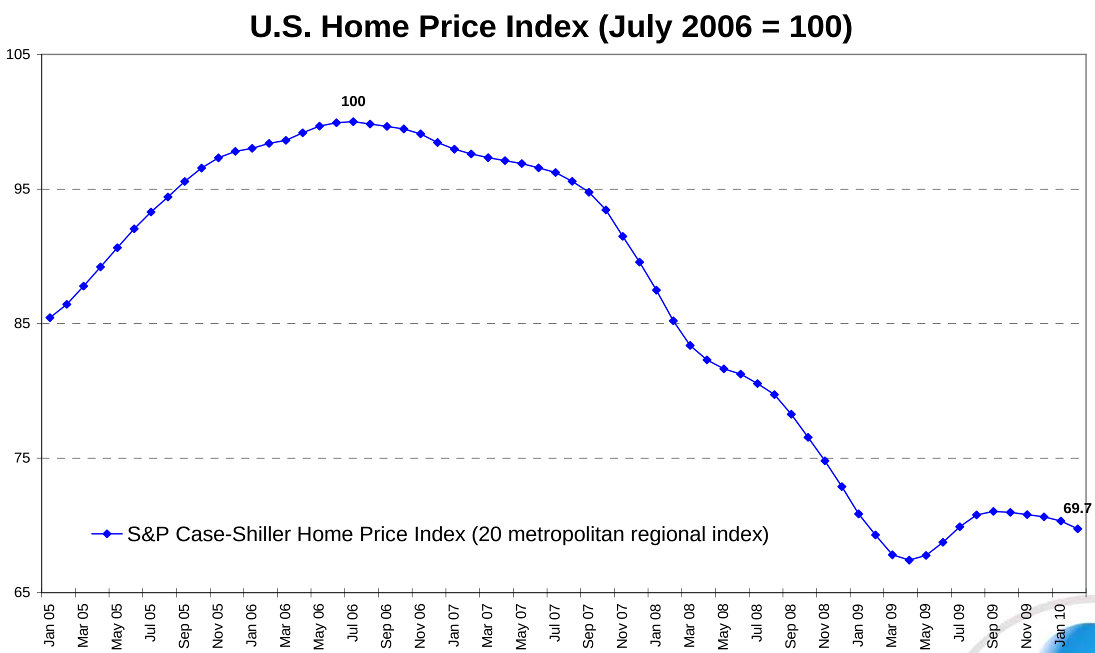
The trend of very low inflation, near zero, continued in March. The **consumer price index** rose by 0.1 percent in March, and twelve-month inflation reached 2.3 percent. The **core index** rose by 0.04 percent, and twelve-month core inflation stood at 1.1 percent.



Data on **construction starts and permits** for March were surprisingly positive, increasing by 2 percent and 8 percent respectively, while data for the preceding month were adjusted upward. **Sales of existing homes** increased by 7 percent in March. **Sales of new homes** grew by 27 percent in March, while data for the preceding months were adjusted upward. However, the current rate of sales is still quite low compared to past years.

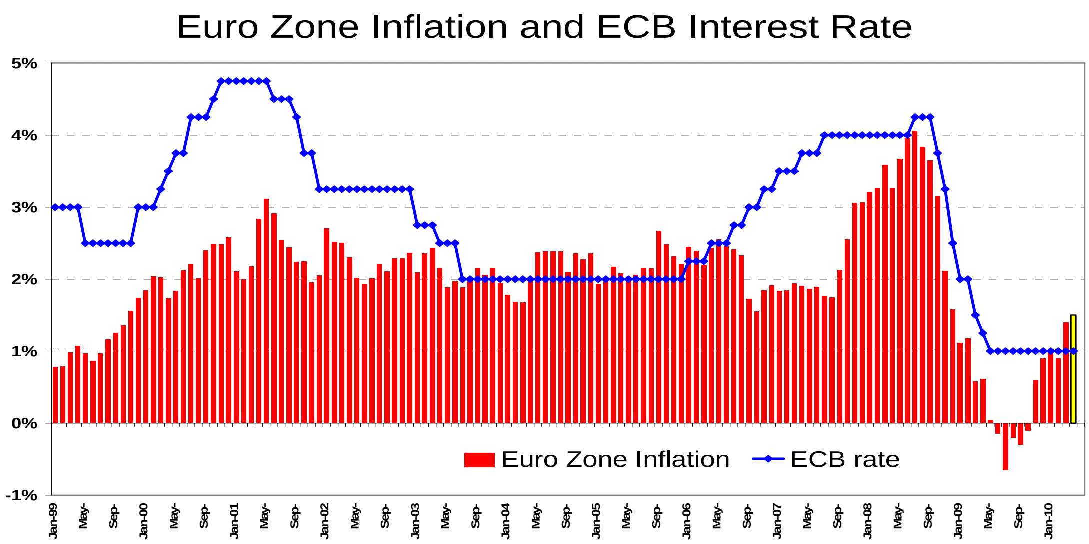


The Case-Shiller home price composite 20-city index went down 1 percent in February, below expectations, with home prices 30 percent lower than the peak of 2006.



Euro zone

Inflation in the twelve months through April was 1.5 percent, according to an initial estimate, in line with expectations. **The European Central Bank** left the interest rate unchanged, as expected, at 1.0 percent for the eleventh consecutive month. The ECB President reiterated that the data indicate that the economic recovery is proceeding in line with expectations, but with variation among the countries in the EU.



Retail sales fell by 0.6 percent in February and by 0.9 percent in the twelve months ended in February, below expectations.

Unemployment rates in the euro zone stood at 10.0 percent in March, as in April and as expected. There are large differences in unemployment rates between the countries. Holland and Austria recorded low unemployment rates of 1.4 and 4.9 percent respectively, as opposed to 19.1 percent in Spain.

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

and at www.harel-finance.co.il/macro/ENG in English.

Please address comments or questions to Mr. Ofer Klein at

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Important Announcements in the Coming Month

Title	date	Day	Time	Link
US, Private income and consumption	May 3	Mon	15:30	www.bea.gov
US, ISM manufacturing index	May 3	Mon	17:00	www.ism.ws
US, ISM Services index	May 5	Wed	17:00	www.ism.ws
Euro Zone, Retail sales	May 5	Wed	12:00	www.ec.europa.eu/eurostat
Israel, average wages	May 6	Thu	13:00	www1.cbs.gov.il/reader
Euro zone, interest rate decision	May 6	Thu	14:45	www.ecb.int
US, employment report	May 7	Fri	15:30	www.bls.gov
UK, interest rate decision	May 10	Mon	14:00	www.bankofengland.co.uk
Israel, incoming tourists	May 10	Mon	13:00	www1.cbs.gov.il/reader
Israel, foreign trade	May 11	Tue	13:00	www1.cbs.gov.il/reader
Euro zone, Q1 GDP estimate	May 12	Tue	12:00	www.ec.europa.eu/eurostat
US, retail sales	May 14	Fri	15:30	www.census.gov/svsd/www/adseries.html
Israel, CPI	May 14	Fri	14:00	www1.cbs.gov.il/reader
ISRAEL, Q1 GDP estimate	May 16	Sun	13:00	www1.cbs.gov.il/reader
Euro zone, CPI	May 18	Tue	12:00	www.ec.europa.eu/eurostat
US, housing stars and permits	May 18	Tue	15:30	www.census.gov/pub/const
US, CPI	May 19	Wed	15:30	www.bls.gov
Israel, Industrial production index and trade and service sectors revenue index	May 20	Thu	13:00	www1.cbs.gov.il/reader
US, Sales of existing homes	May 24	Mon	17:00	www.realtor.org/Research.nsf/Pages/EHSdata
UK, Q1 GDP	May 25	Tue	11:30	www.statistics.gov.uk
US, Case-Shiller index	May 25	Tue	16:00	http://www2.standardandpoors.com
Israel, New dwelling sold in private sector	May 26	Wed	13:00	www1.cbs.gov.il/reader
US, new home sales	May 26	Wed	17:00	www.census.gov/const/www/newressalesindex.html
Israel, 2010 Q1 labor force survey	May 27	Thu	13:00	www1.cbs.gov.il/reader
US, Q1 GDP	May 27	Thu	15:30	www.bea.gov
Israel, BOI interest rate decision	May 27	Thu	17:30	www.bankisrael.gov.il
US, Private income and consumption	May 28	Fri	15:30	www.bea.gov
US, Michigan University consumer confidence index	May 28	Fri	17:00	www.sca.isr.umich.edu
Euro Zone, CPI estimate	May 31	Mon	12:00	www.ec.europa.eu/eurostat
Israel, 2010 Q1 house starts and completions	May 31	Mon	13:00	www1.cbs.gov.il/reader
Euro zone, employment	Jun 1	Tue	12:00	www.ec.europa.eu/eurostat
Euro Zone, Retail sales	Jun 3	Thu	15:30	www.ec.europa.eu/eurostat
Euro zone, Q1 GDP	Jun 4	Fri	12:00	www.ec.europa.eu/eurostat
US, employment report	Jun 4	Fri	15:30	www.bls.gov