

Weekly Macroeconomic Review

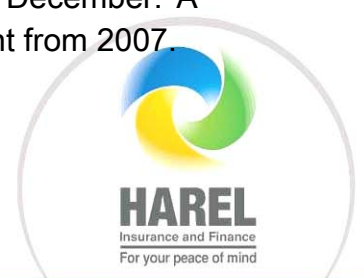
February 3, 2009

	Expectations derived from the capital market	Our forecast
Inflation in the coming months		Minus 0.4% in January 0.2% in February
Future cumulative inflation – next 12 CPIs (through December 2009)		1.8%
Inflation through May 2010 CPI (average annual rate)	0.1%	2.0%
Bank of Israel interest rate, 6 months ahead	1.35% (up 0.35)	0.75%
Fed interest rate, 6 months ahead	0.35% (up 0.10)	0.25%
Dollar exchange rate, 6 months ahead	NIS 4.07 (up 0.4%)	NIS 4.17 (up 2.6%)

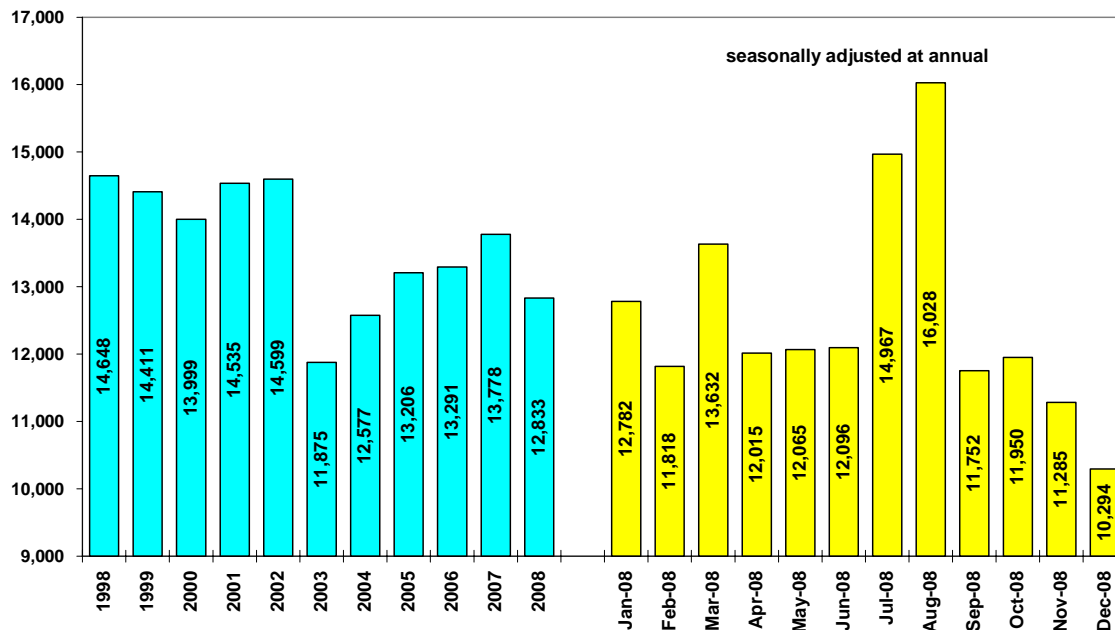
Israel

Recent media reports estimated that the **Bank of Israel would purchase Israeli government bonds**, in order to reduce the long-term interest rate, among other considerations. In our opinion, the probability that this will occur is low at this point. First, it is important to remember that the short-term interest rate in Israel is still above zero, and monetary expansion can still be performed by lowering the BOI interest rate. Second, even if the interest rate falls near zero, the amount of money can still be increased through purchases of foreign currency, also supporting exports, which have been severely damaged by the slowdown in global demand. Third, once the gates are opened and the government is allowed to borrow money from the BOI – essentially to print money – it will be very difficult to hold back the flood. If the government discovers a large, generous buyer for its bonds in the market, it may be tempted to enlarge the deficit significantly and apply pressure on the BOI to finance this deficit in the future as well.

The number of new homes sold decreased by 8.8 percent in December. A total of 12,800 homes were sold in Israel in 2008, down 7 percent from 2007.



New Dwellings Sold During The Period



The supply of homes for sale decreased again, to a record 10.7 months of sales. The decrease in the supply of homes creates upward pressure on prices, which may balance the downward pressures arising from the economic slowdown and the decline in demand for housing.

Global Economy

The IMF expects negative 1.6 percent growth in the United States in 2009, negative 2.0 percent in the euro zone, negative 2.6 percent in Japan, and negative 2.8 percent in the UK.

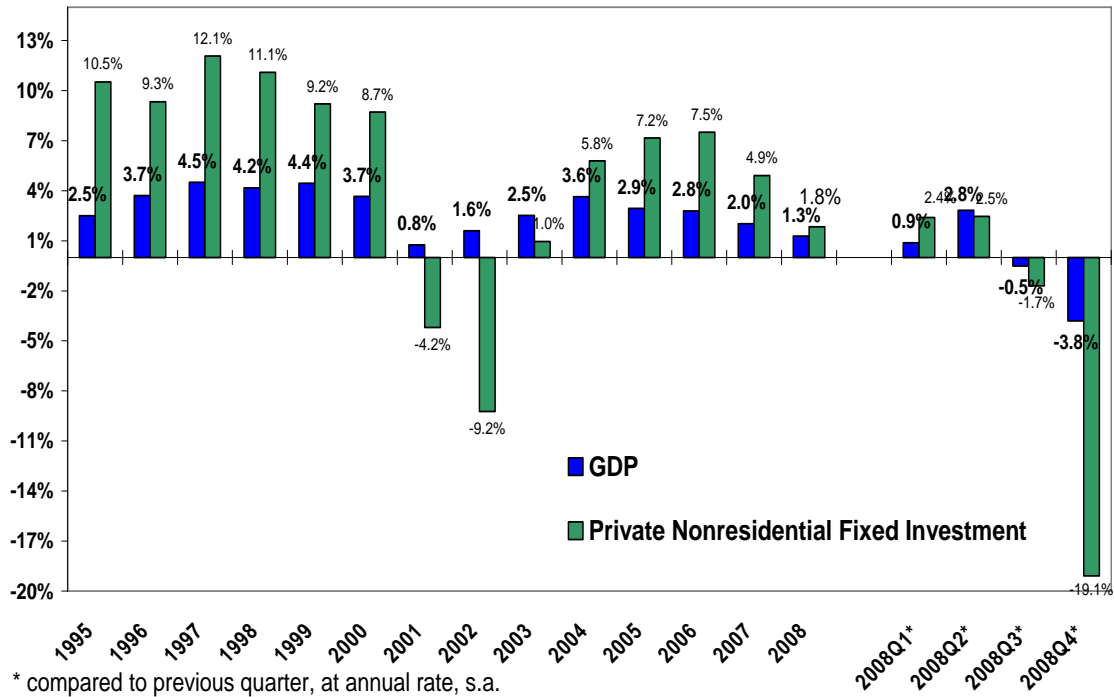
The Economist's **monthly Consensus Forecasts** point to growth rates of negative 1 percent to negative 2 percent in most of the advanced countries.

United States

According to the initial growth estimate, **GDP** decreased by an annualized 3.8 percent in the fourth quarter of 2008, following a 0.5 percent decrease in the third quarter. This was the sharpest decline in GDP in the US since the early 1980s, though still more moderate than expected. The factor mitigating the decrease in GDP in the fourth quarter was a substantial, unexpected increase in inventories, which does not bode well for growth in early 2009. In addition, notable in fourth-quarter data was a sharp decline in **investments by firms**, at an annualized rate of 19.1 percent.

The U.S. Economy, 1995-2008

Real growth rates of GDP and business investment



While the **Fed's interest-rate decision** came as no surprise, there were several interesting aspects to its announcement:

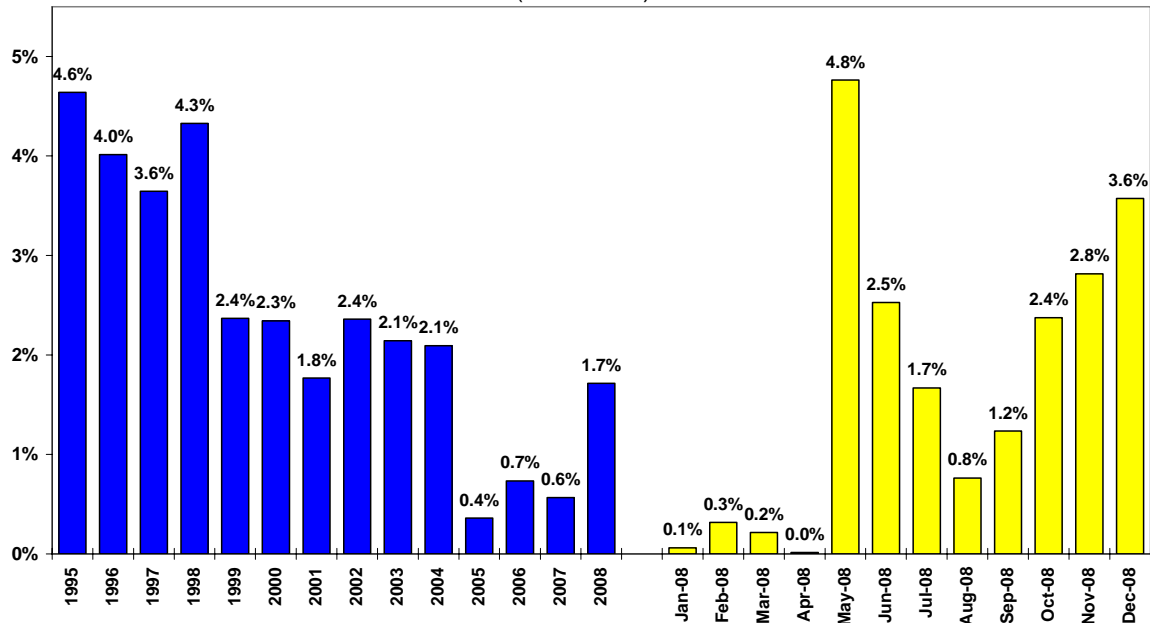
- The Fed declared an uncompromising war on deflation.
- The Fed announced that it would increase its involvement in the credit markets.
- The Fed stated that it would be willing in principle to buy government bonds, but would only do so under very special circumstances.

Yields of US government ten-year bonds rose to 2.85 percent by end-January, following the December low, in line with our advance estimates.

As expected, private-consumption figures for December were weak. **Real private consumption** decreased sharply by 0.5 percent, indicating deepening of the recession. The **rate of households' savings** out of disposable income rose further, to 3.6 percent in December, versus an average rate of just 0.5 percent in 2005-2007.



US - Personal saving as a percentage of disposable personal income
(1995-2008)



Core prices of private consumption (the core PCE deflator) remained unchanged in December for the third consecutive month. Core prices rose by 1.7 percent in the last twelve months.

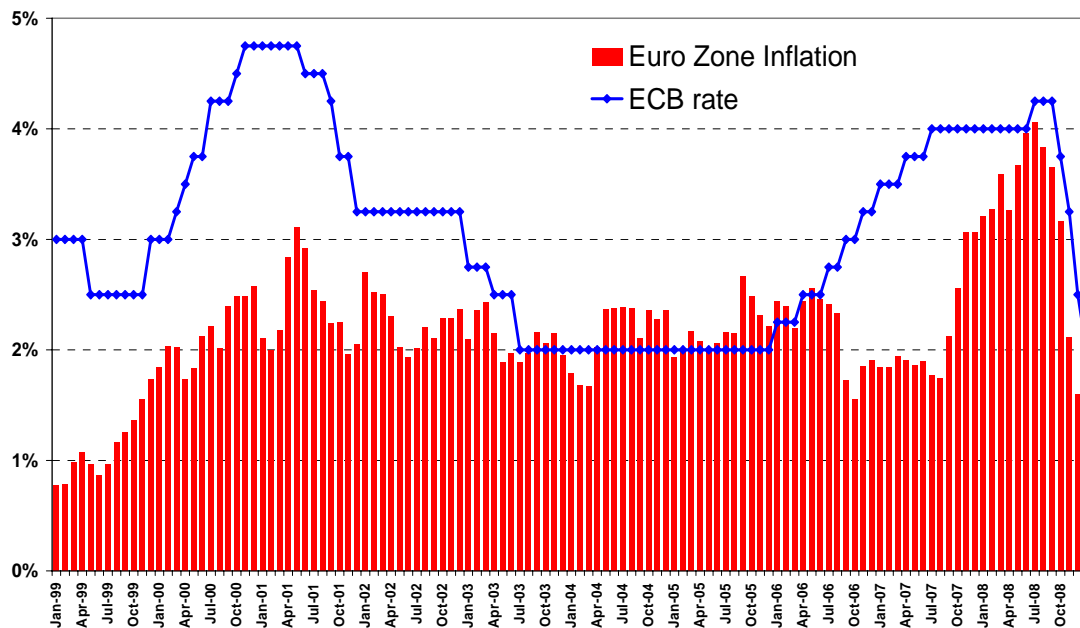
The ISM manufacturing sector index in the United States rose to 35.6 points in January, from 32.9 points in December, above expectations but still below 50 points, indicating contraction.

Europe

Inflation in the euro zone was 1.1 percent in December according to an initial estimate, lower than the expected 1.4 percent. Unemployment in the euro zone was 8.0 percent in December, higher than forecast. These figures support continued interest-rate cuts by the ECB.



Euro Zone Inflation and ECB Interest Rate



Important Announcements in the Coming Week

- The ISM service sector index will be published in the United States on Wednesday, February 4th.
- Interest-rate decisions will be announced in the UK and the euro zone on Thursday, February 5th.
- The Central Bureau of Statistics will publish data on average wages on Thursday, February 5th.
- The Employment Report will be published in the United States on Friday, February 6th.

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.

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