

Weekly Macroeconomic Review

August 4, 2009

	Expectations derived from the capital market	Our forecast
Inflation in the coming months		1.0% in July 0.6% in August
Future cumulative inflation – next 12 CPIs (through June 2010 CPI)		3.7%
Inflation through July 2011 CPI (average annual rate)	3.5%	3.1%
Bank of Israel interest rate, 6 months ahead	1.50% (up 1.00)	1.00%
Fed interest rate, 6 months ahead	0.40% (up 0.15)	0.25%
Yield on Israeli Government 10-Year bond, 6 months ahead	5.75% (up 0.32)	5.75%
Yield on US Treasury 10-Year bond, 6 months ahead	3.86% (up 0.24)	4.00%
Dollar exchange rate, 6 months ahead	NIS 3.84 (unchanged)	NIS 3.84 (unchanged)

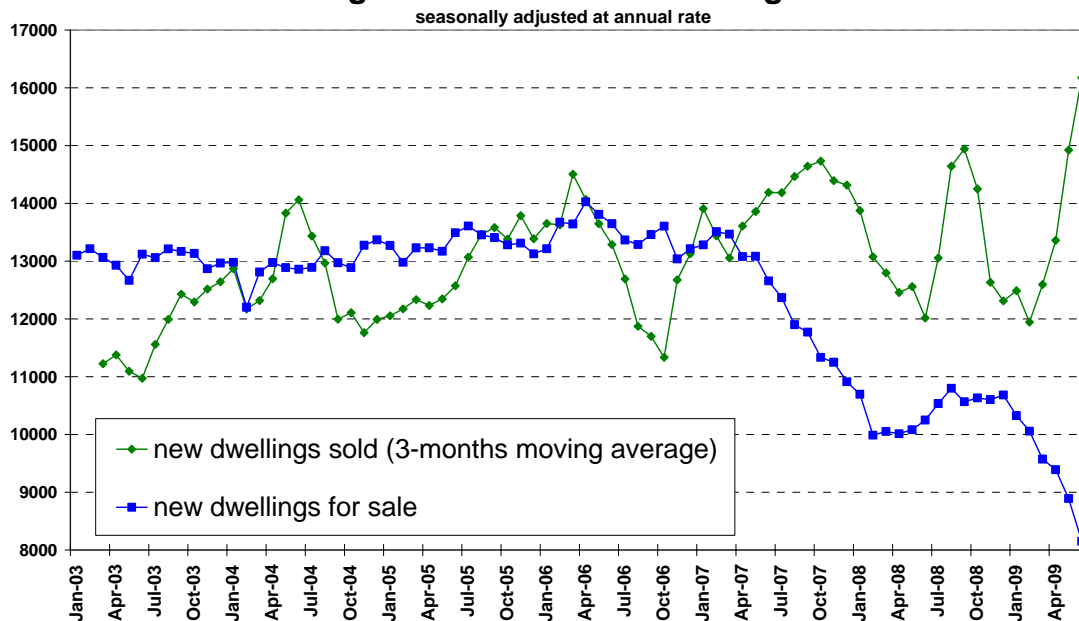
Israel

On Monday evening, the **Bank of Israel** repeated the previous week's announcement that it would **continue regular purchases of foreign currency** at a volume of USD 100 million daily. The BOI also said it would "take action in the foreign-currency market in the event of exceptional fluctuations in exchange rates incongruent with basic economic conditions, or when the foreign-currency market is not operating properly," a statement similar to the proposed terms of the new Bank of Israel Law and comments made by the BOI in the past. This announcement, though it may not contain new information, appears to be designed to refute estimates that the BOI intends to stop foreign-currency purchases shortly and support depreciation of the shekel. In fact, the shekel weakened by about 3 percent against the major currencies following the announcement, after gaining approximately 2 percent in the previous week.



The number of new homes sold grew by 16 percent in June and by 47 percent in the twelve months ended in June, with most of the increase occurring in the last three months. However, the number of homes for sale decreased by 8 percent in May and by 20 percent in the twelve months ended in May. This figure may indicate continued upward pressure on housing prices.

New Dwellings Sold and for Sale During The Period



The BOI's Inflation Report states, "*Inflation expectations for the coming year rose during the second quarter... It is likely that the increase in indirect taxes and water prices, which is expected to affect prices in the third quarter, and the increase in prices of commodities and oil during the second quarter contributed to this development. A relatively large increase in prices is therefore possible in the coming few months, to be reflected in an increase in the annual rate of inflation (in a measurement over the preceding twelve months). Later this year inflation is expected to moderate, due to the ongoing recession in domestic and global demand and the weakness in the labor market, which is expected to persist at least for some time to come.*" **We agree** with these assessments in principle, **but in our opinion** the forecast of the central model used by the BOI, in which inflation will reach 1.6 percent over the next twelve months, is too low.

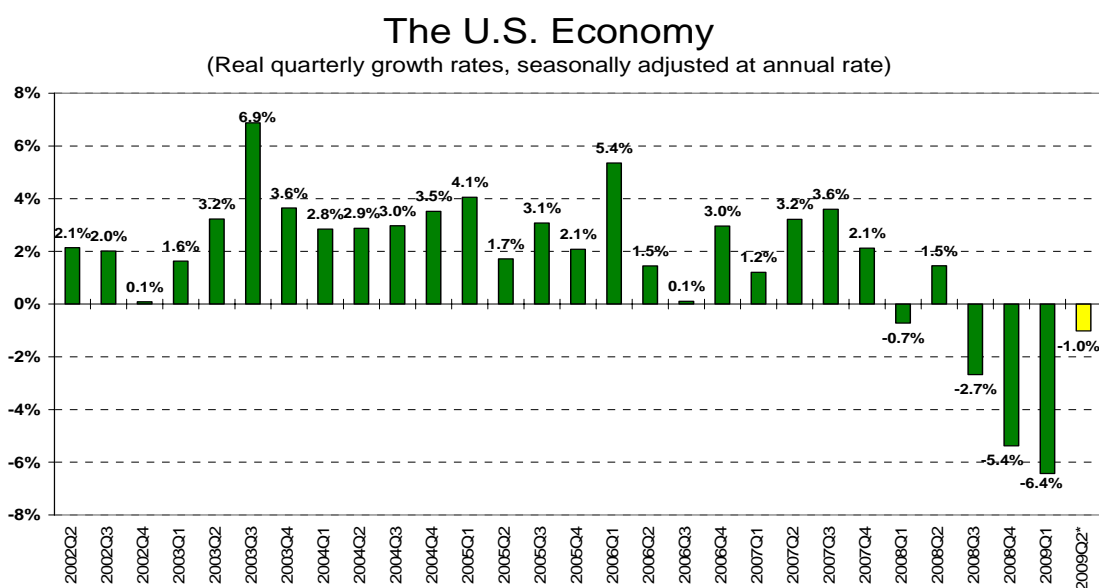
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The ISM manufacturing sector index reached 49 points in July, higher than expected.

According to an advance estimate, GDP contracted at an annualized rate of only 1.0 percent in the second quarter of 2009, a milder decline than expected. However, the composition of growth was not favorable: private consumption decreased by 1.2 percent, private investments in fixed assets decreased by 13.5 percent, and exports fell by 7.0 percent. Furthermore, extensive revisions of the GDP in the United States point to an even more severe downturn over the last year.



The S&P Case-Shiller index of housing prices in twenty major US cities rose by 0.5 percent in May, for the first time since July 2006.

The International Monetary Fund has published its annual summary on the US economy. Growth forecasts for 2008 and 2009 remain unchanged at a negative 2.6 percent and 0.8 percent, respectively. The IMF praised policy-makers' extensive coordinated efforts to address the crisis in the financial sector, increase domestic demand, and cope with the international implications of the crisis. As a result of these actions, an end to the downturn is in sight, along with a return of confidence in the financial system. However, financial pressures remain high, and economic recovery is expected to be gradual, with a risk of crises; the administration must be prepared to provide additional fiscal and monetary incentive packages if necessary.



Euro area

According to the initial estimate, **inflation** stood at a negative 0.6 percent in July, lower than expected.

Unemployment in the euro zone reached 9.4 percent, lower than expected, in June, compared to 7.5 percent in June 2008.

Important Announcements in the Coming Week

- Data on private income and consumption will be published in the US on Tuesday, August 4.
- Data on retail sales and the purchasing managers' index will be published in the euro zone, and the ISM service sector index will be published in the US, on Wednesday, August 5.
- The Central Bureau of Statistics will publish the average wages in the Israeli economy, and interest-rate decisions will be announced in the UK and the euro zone, on Thursday, August 6.
- The Employment Report will be published in the US on Friday, August 7.

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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