

Weekly Macroeconomic Review

January 6, 2009

	Expectations derived from the capital market	Our forecast
Inflation in the coming months		Minus 0.1% in December Minus 0.3% in January
Future cumulative inflation – next 12 CPIs (through november 2009)		1.6%
Inflation through May 2010 CPI (average annual rate)	Minus 0.2%	2.0%
Bank of Israel interest rate, 6 months ahead	1.55% (down 0.20)	1.50%
Fed interest rate, 6 months ahead	0.40% (up 0.15)	0.25%
Dollar exchange rate, 6 months ahead	NIS 3.89 (up 0.4%)	NIS 4.03 (up 4.0%)

Israel

The military campaign in Gaza, and in particular its expansion into a massive land-based action and the recruitment of tens of thousands of reserve troops, pose significant budgetary challenges; moreover, the condition of the 2009 state budget looked poor even before the campaign began.

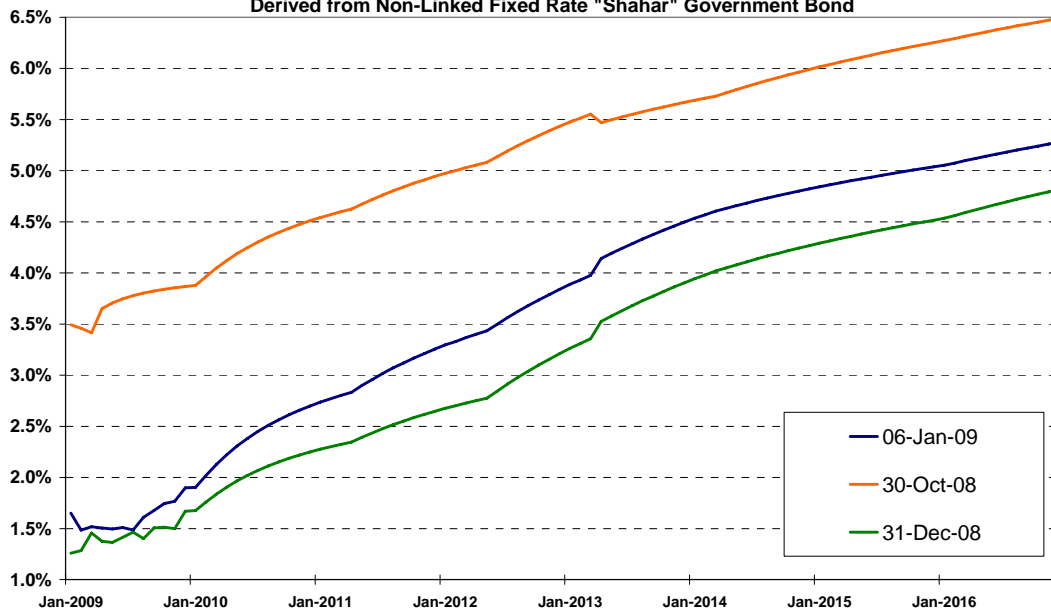
The budget deficit in 2009 may eventually far exceed the 2003 high of 5.3 percent of GDP, reaching levels not seen since the mid-1980s, before the stabilization plan. Such a deficit could cause the fiscal risk premium to grow and yields of long-term bonds to rise. At the very least, in order to finance the substantial deficit, the government will have to increase funding through bonds far beyond the original planning, thereby contributing to a surplus supply of bonds, a decrease in prices, and an increase in yields.

Prices of long-term government bonds have in fact fallen by about 3 percent in the last few days, and the yields of these bonds have increased considerably. In our opinion, this increase is justified and is likely to continue in the near term, especially if the military campaign is extended and expanded.



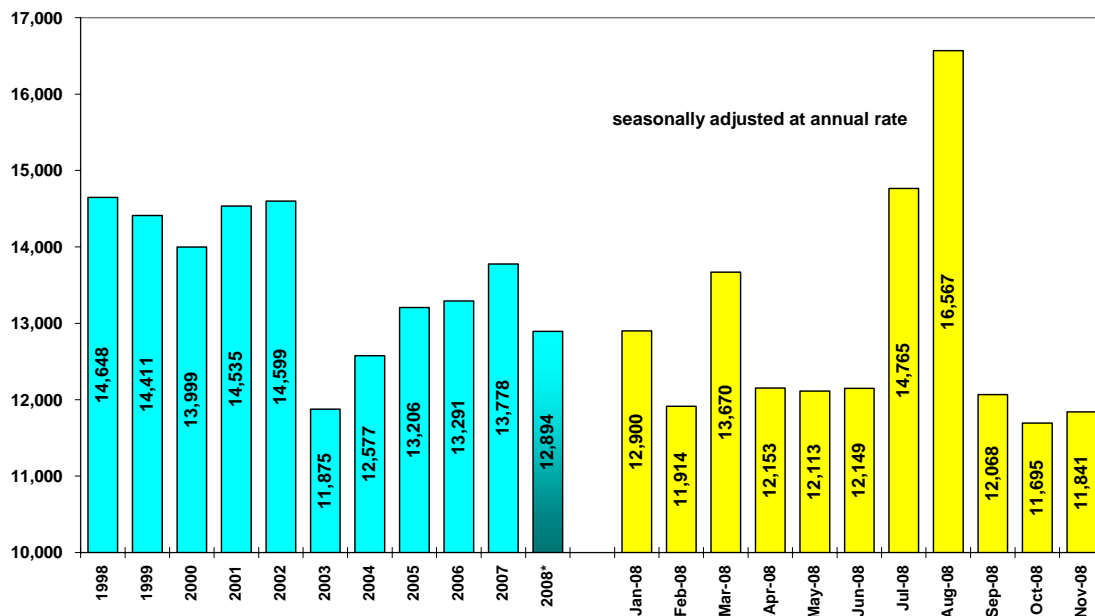
Interest rate curve (zero coupon)

Derived from Non-Linked Fixed Rate "Shahar" Government Bond



The number of new homes sold grew by 1 percent in November, while figures for October were adjusted upward.

New Dwellings Sold During The Period



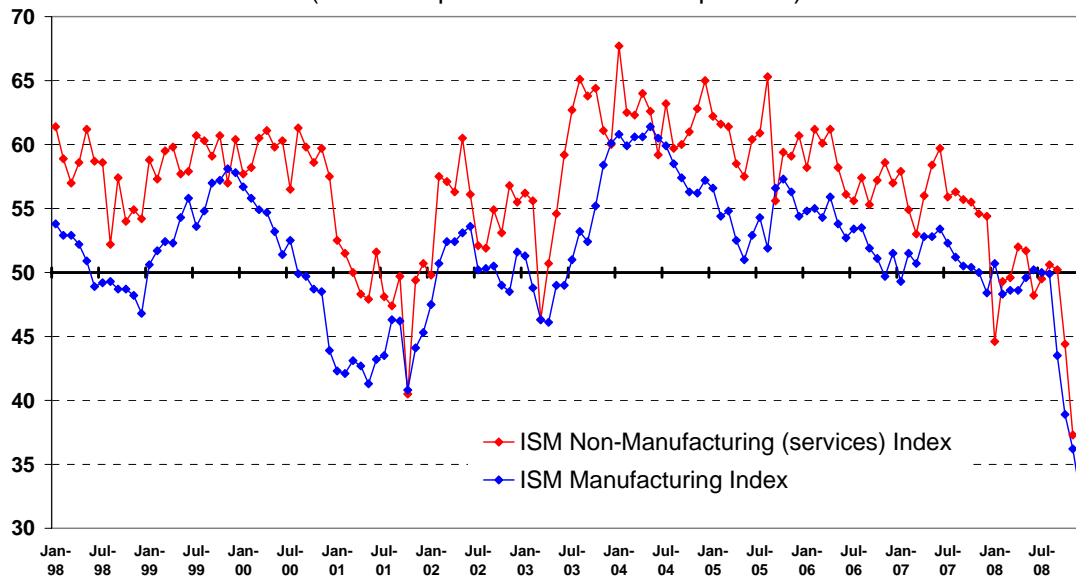
The supply of homes for sale continued to decrease, reaching a low of 7.7 months of sales. The decreasing supply of homes exerts upward pressure on prices, which may balance the downward pressures caused by the economic slowdown and the decline in demand for homes.



United States

The ISM manufacturing sector purchasing managers' index dropped sharply, to 32.4 points (less than 50 points indicates contraction of activity), from 36.2 points in November. The steep declines in ISM indices since September reflect the escalation of the slowdown in real activity in the United States.

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



Important Announcements in the Coming Week

- The PMI index and the inflation estimate will be published in the euro zone on Tuesday, January 6th.
- The ISM index for the non-manufacturing sector will be published in the United States on Tuesday, January 6th.
- The Central Bureau of Statistics will publish data on jobs and average wages on Wednesday, January 7th.
- The interest-rate decision in the UK will be announced on Thursday, January 8th.

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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