

Weekly Macroeconomic Review

March 9, 2010

	Expectations derived from the capital market	Our forecast
Inflation in the coming months		Minus 0.4% in February 0.1% in March
Future cumulative inflation – next 12 CPIs (through January 2011 CPI)		2.1%
Inflation through July 2011 CPI (average annual rate)	2.4%	2.6%
Bank of Israel interest rate, 6 months ahead	2.00% (up 0.75)	2.00%
Fed interest rate, 6 months ahead	0.30% (up 0.05)	0.30%
Yield on Israeli Government 10-Year bond, 6 months ahead	5.13% (up 0.24)	5.15%
Yield on US Treasury 10-Year bond, 6 months ahead	.394% (up 0.25)	4.25%
Dollar exchange rate, 6 months ahead	NIS 3.77 (unchanged)	NIS 3.77 (unchanged)

Israel

State tax revenues totaled ILS 14.6 billion in February, slightly below our estimate, following a large surplus in January. Revenues during 2010 are still expected to be significantly higher than the forecast in the state budget.

The **government** approved a **new fiscal rule** for its expenditures this week. According to the new rule, the increase in real expenses in the state budget from year to year will be calculated by dividing the Maastricht Treaty debt-to-GDP ratio of 60 percent by the current debt-to-GDP ratio in Israel (about 80 percent), and multiplying the result by the average growth rate of the Israeli economy in the last ten years (3.5 percent). The outcome is real expense growth of 2.6 percent each year in 2011-2012. Assuming that the ratio of debt to GDP falls gradually in the coming years and that future growth remains at about 3.5 percent, the increase in real expenses will gradually grow in the coming years, up to 3.5 percent.

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In our opinion, in quantitative terms, the expected increase in real government expenses in the coming years as a result of the new fiscal rule is appropriate and reasonable, and properly balances the need to lower the ratio of debt to GDP with the desire to continue cutting back direct taxes (income tax and corporation tax) in the coming years.

However, the new rule is not entirely free of problems. For example, it does not address the expenditures of the broad government, which are more important on the macro-economic level than the expenses of the central government; it does not address debt generated by local authorities; and it does not address tax benefits, which are a type of expense, but are recorded on the income side in accounting. Thus, the new rule may lead to accounting tricks, overuse of less effective and more distorting policy tools such as tax benefits, and a lack of fiscal transparency.

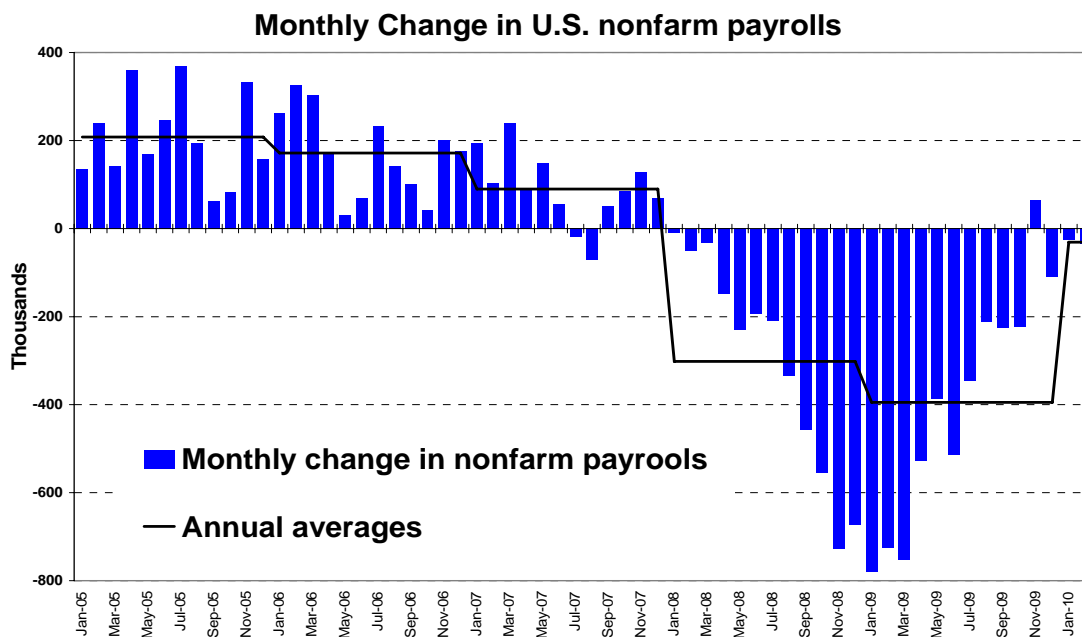
The Bank of Israel bought USD 0.2 billion in February, a significantly lower amount than in the preceding months. The minutes of the monetary meetings regarding the decision on the interest rate for March 2010 indicate that all four members of the governing board recommended leaving the interest rate unchanged. The minutes also note that both of the BOI's econometric models predict an interest rate of 2.4 percent in the last quarter of 2010.

The balance of payments in 2009: The surplus in the current account totals USD 7.2 billion, or 3.7 percent of GDP. The goods and services account has moved to a surplus of USD 4.5 billion, from a deficit of USD 3.1 billion in the previous year, due to sharp declines in imports. Israeli residents' investments in tradable securities abroad increased substantially, to USD 7.6 billion. The rate of foreign direct investments in Israel and of investments by Israelis abroad slowed. **In the last quarter of 2009**, the current account grew compared to the preceding quarter; investments by Israeli residents abroad grew by USD 4.5 billion, versus a decrease in the previous quarters of the year.

The number of employee positions of Israeli workers remained unchanged in December, and grew by 0.6 percent in the twelve months ended in December. Average wages for employee positions of Israelis decreased by 0.7 percent in December and increased by 0.6 percent in the twelve months ended in December, a real decrease of 3.4 percent. The sharp drop in real wages over the last year contrasts with the stability (or even slight increase) in real GDP per capita and per employed person during the same period.

United States

Employment report data for February were stable. The unemployment rate remained at 9.7 percent. The number of employed persons decreased by 40,000, versus expectations of a sharper decline of 70,000 jobs. Data for the preceding month were revised upward, for more moderate declines.



Euro zone

The ECB left the interest rate unchanged at 1.0 percent, in line with expectations. Twelve-month inflation reached 0.9 percent in February, as expected.

Our forecast of cumulative changes in price indices due to be publish during the coming three months

Forecast change, January 2010 to April 2010

Consumer Prices Index (CPI)	Housing component in the CPI (mainly rent prices)	Prices of Owner-Occupied Dwellings	Price Index of Inputs in Residential Building	Wholesale Price Index of Manufacturing (excl. Fuel)
0.4%	1.7%	5.1%	0.6%	-0.3%

Important Announcements in the Coming Week

- The Central Bureau of Statistics will publish data on Israel's foreign trade on Thursday, March 11.
- Data on retail sales will be published in the United States on Friday, March 12.
- The CBS will publish the consumer price index for February on Monday, March 15.

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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