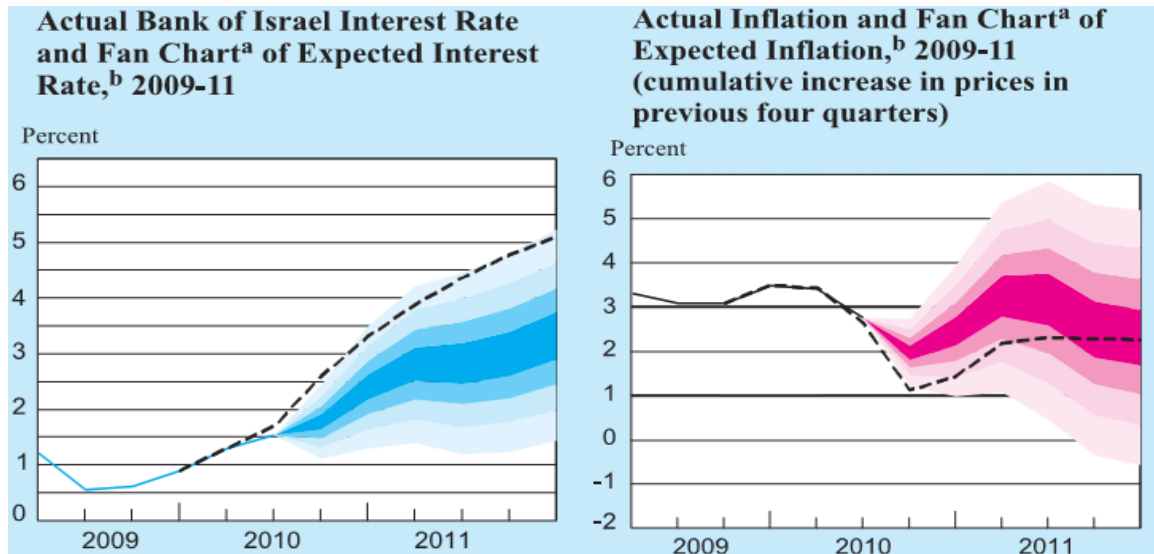


	Expectations derived from the capital market	Our forecast
Inflation in the coming months		0.8% in July 0.3% in August
Future cumulative inflation – next 12 CPIs (through May 2011 CPI)		3.8%
Inflation through July 2011 CPI (average annual rate)	3.4%	4.0%
Bank of Israel interest rate, 6 months ahead	2.20% (up 0.45)	2.50%
Fed interest rate, 6 months ahead	0.25% (unchanged)	0.25%
Yield on Israeli Government 10-Year bond, 6 months ahead	4.57% (up 0.17)	5.00%
Yield on US Treasury 10-Year bond, 6 months ahead	3.01% (up 0.19)	3.75%
Dollar exchange rate, 6 months ahead	NIS 3.78 (up 0.3%)	NIS 3.77 (unchanged)

## Israel

The **Bank of Israel** has issued updated forecasts in its inflation report. The BOI raised its inflation forecast, lowered its interest-rate forecasts, and maintained its growth forecasts unchanged. The BOI now expects **inflation** in the next twelve months to total 2.6 percent (versus expectations of 3.0 percent in the capital markets and 3.2 percent among forecasters, according to the BOI's report), reaching 2.3 percent in the last quarter of 2011, in the central scenario. According to the BOI's central scenario, the **BOI interest** rate will rise gradually, to 3.25 percent by the last quarter of 2011.



In our opinion, **growth in 2011** will be slightly lower than the BOI estimates; inflation will stand at 3.8 percent in twelve months and at about 3 percent in the last quarter of 2011; and the BOI interest rate in the last quarter of 2011 will be approximately 3.5 percent. According to our calculations, the capital market (the unlinked curve in the bond market) predicts a **BOI interest rate** of about 2.75 percent in the last quarter of 2011; in other words, both our forecast (3.5 percent) and the BOI's forecast (3.25 percent) are higher than the interest rate derived from the unlinked curve.

Regarding **prices of homes**, the BOI claims that actual prices in the past were below the equilibrium level, based on its models, but that following the sharp rise in prices over the last two years prices are now near equilibrium. **We agree** with this assessment.

The minutes of the **BOI's last interest-rate decision meeting** indicate that the recommendation of all four members of the board to the BOI Governor was to raise the interest rate.

**State tax revenues** totaled ILS 19 billion in July, far higher than expected, following revenues much lower than expected in June. These data greatly reduce the risk that the deficit in 2011 and 2012 will deviate significantly from the planned level in the state budget (3 percent of GDP in 2011 and 2 percent of GDP in 2012), assuming that the Knesset does in fact pass the budget approved by the government with no substantial changes.

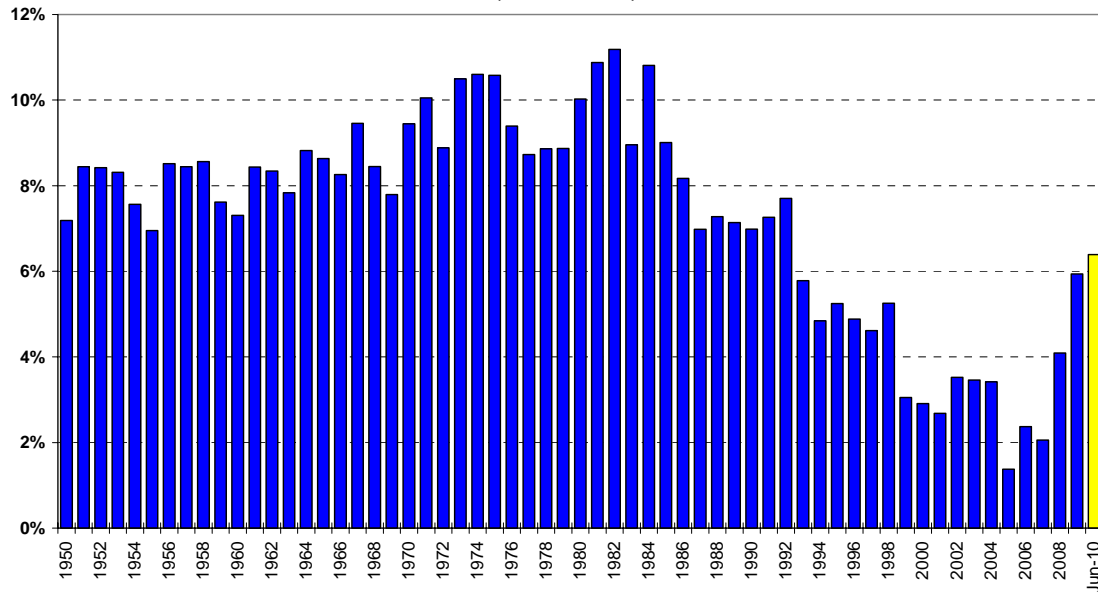
**Labor-market data** for April showed continued stability in the number of jobs and in average wages. The number of employee positions of Israeli workers increased by a minimal 0.1 percent in May, and by 3.3 percent in the twelve months ended in May. Average wages for employee positions of Israelis remained unchanged in May, and increased by 4.3 percent in the twelve-month period (a 1.1 percent increase in real terms).

**The number of incoming tourists** by air decreased by 2.5 percent in July, and increased by 12.5 percent in the last twelve months.

## United States

Data published on income, private consumption, and savings of households include significant updates regarding the last three years. The **rate of savings** was revised sharply upward, to 2.1 percent in 2007, from 1.7 percent in the previous estimate; 4.1 in 2008, up from the previous estimate of 2.7 percent; and 5.9 percent in 2009, versus the previous estimate of 4.2 percent. In May 2010, the rate of savings was 6.3 percent, versus 4.0 percent in the previous estimate. The rate of savings rose further in June 2010, to 6.4 percent.

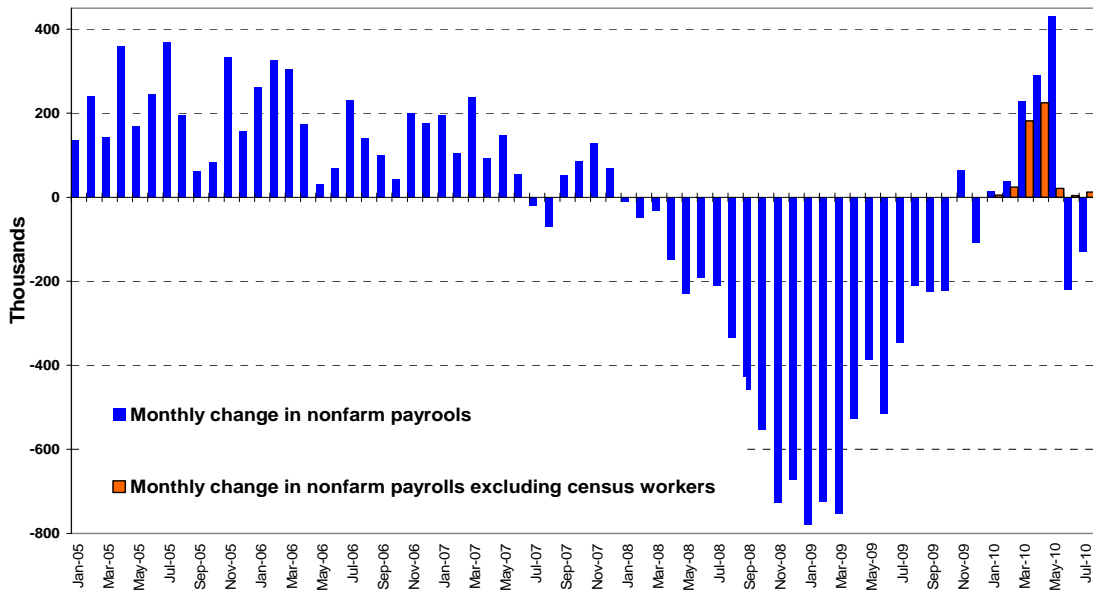
US - Personal saving as a percentage of disposable personal income  
(1929-2010)



These data mean that households' rate of savings has greatly increased in the last few years, and the additional adjustment needed in the future is far smaller than was previously believed. Consequently, the risk of a significant slowdown in growth, or even recession, in the next few years – which was thought to be high due to households' need to increase their rate of savings – now appears less threatening. However, the other factor that may impede growth in the next few years, the immense government deficits, remains in place.

**Employment data** continued to disappoint. The **number of employed persons** in the non-agricultural sector decreased by 131,000 in July, and data for the preceding month were revised downward. Excluding the effect of the temporary employees hired for the national census, the number of employed persons grew by 12,000 in July. This continues the trend of very slight increases in the number of employees, which are not fast enough to reduce unemployment rates over the long term. The **unemployment rate** was 9.5 percent in July, similar to the preceding month.

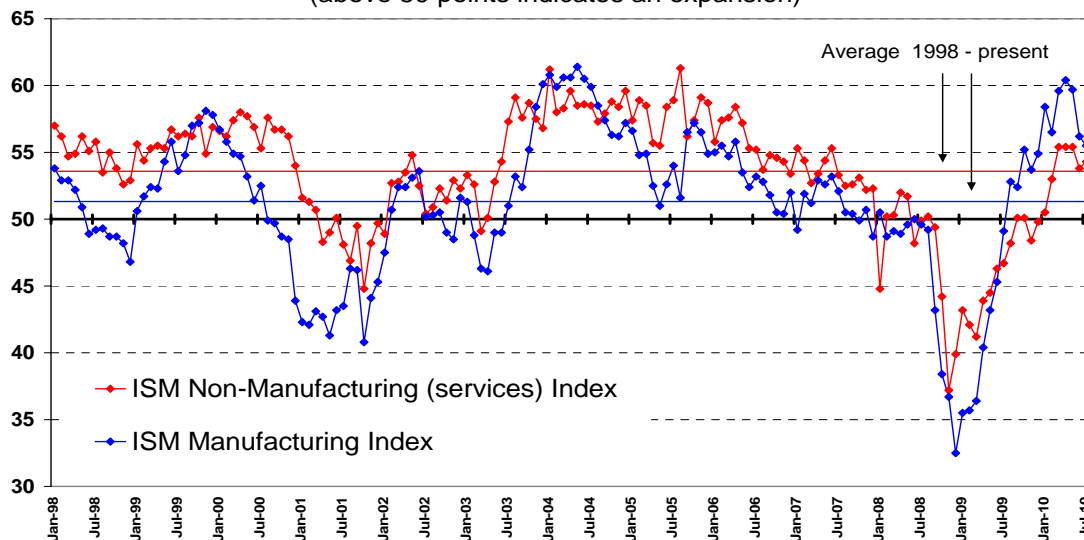
Monthly Change in U.S. nonfarm payrolls



Following these data, yields of government bonds fell further, and the expected timing of the beginning of interest-rate increases by the Fed was pushed back.

The ISM service sector purchasing managers' index rose to 54.3 points in July, versus expectations of a decrease in this index.

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



## Euro zone

The purchasing managers' index in the eurozone stood at 56.7 points in July, in line with expectations. Figures varied among eurozone member countries, with a large increase in Germany and Italy compared to the other countries.

Retail sales were stable in July, above expectations; data for the preceding month were adjusted upward. In the last twelve months, retail sales increased by a slight 0.4 percent.

## Our forecast of cumulative changes in price indices during the coming three months

Forecast change, June 2010 index to September 2010 index

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)
0.9%	3.2%	1.6%	1.2%	0.5%

## Important Announcements in the Coming Week

- The Fed's interest-rate decision will be announced in the United States on Tuesday, August 10.
- The Central Bureau of Statistics (CBS) will publish data on Israel's foreign trade on Thursday, August 12.
- The initial estimate of growth in the second quarter of 2010 will be published in the eurozone on Friday, August 13; the consumer price index and data on retail sales will be published in the US.
- The CBS will publish the price indices for July on Sunday, August 15.
- The CBS will publish the initial estimate of growth in the second quarter of 2010 on Monday, August 16.

This review is posted online at [www.harel-finance.co.il/macro](http://www.harel-finance.co.il/macro) in Hebrew  
and at [www.harel-group.com/finance.html](http://www.harel-group.com/finance.html) in English.

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