

Weekly Macroeconomic Review

January 12, 2010

	Expectations derived from the capital market	Our forecast
Inflation in the coming months		0.2% in December Minus 0.1% in January
Future cumulative inflation – next 12 CPIs (through November 2010 CPI)		2.4%
Inflation through July 2011 CPI (average annual rate)	2.6%	2.6%
Bank of Israel interest rate, 6 months ahead	1.75% (up 0.50)	2.00%
Fed interest rate, 6 months ahead	0.35% (up 0.10)	0.35%
Yield on Israeli Government 10-Year bond, 6 months ahead	5.41% (up 0.26)	5.25%
Yield on US Treasury 10-Year bond, 6 months ahead	4.05% (up 0.26)	4.25%
Dollar exchange rate, 6 months ahead	NIS 3.69 (unchanged)	NIS 3.69 (unchanged)

Israel

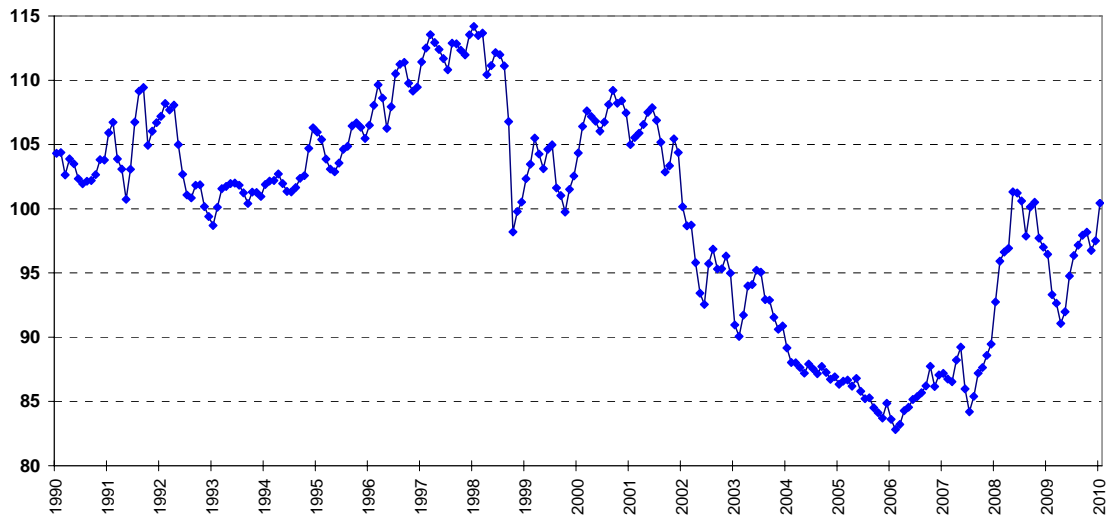
The shekel appreciated by approximately 2 percent against the dollar and the currency basket this week, and gained about 3 percent over the last two weeks, since the Bank of Israel's last interest-rate decision. The **effective exchange rate** of the shekel has strengthened significantly in January, and is now nearing the high levels of mid-2008. In contrast to the last year, this rate is now quite close to the average level of the last twenty years.

Due to this appreciation of the shekel, we are changing our **exchange-rate forecast**. We now estimate that the probabilities of appreciation and depreciation of the shekel in the coming months are equal, in contrast to our earlier estimates, which tended towards appreciation of the shekel.



Real Effective Exchange Rate

(index, average 1990-2007=100)
Basket: US 50%, Euro 25%, UK 5%, Japan 5%, Others 15%
increase means real appreciation, decrease means real depreciation



The Bank of Israel has revised its growth forecast for 2010 to 3.5 percent, from 2.5 percent previously. The BOI estimates unemployment in 2010 at 7.1 percent, down from the previous estimate of 8.3 percent. Our forecast is less optimistic; we expect average growth in 2010 to reach 2.8 percent.

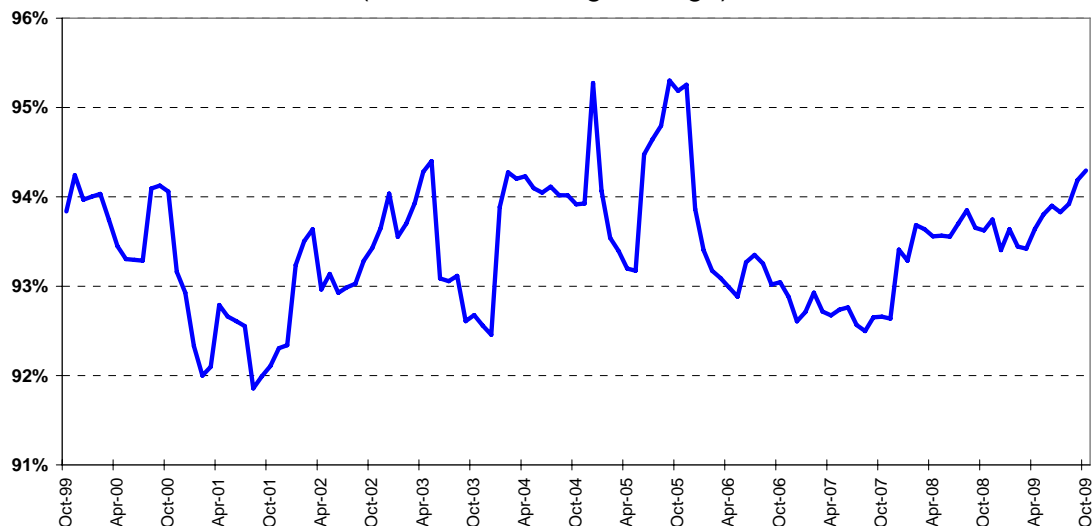
The minutes of the BOI's last interest-rate decision meeting indicate that one of the four board members recommended not raising the interest rate. According to one of the BOI's econometric models (DSGE), inflation in the last quarter of 2010 will reach 1.2 percent, and the BOI interest rate will stand at 2.3 percent. According to the other model (EC), inflation will reach 2.4 percent in the last quarter of 2010, while the BOI interest rate will be 2.9 percent. Our estimates are similar to the results of the second model.

The number of employee positions of Israeli workers remained almost unchanged in October, and decreased by 0.8 percent in the twelve months ended in October. Average nominal wages for an employee position of Israelis rose by 0.8 percent in October and by 2 percent in the twelve months ended in October (a real decrease of 0.8 percent).



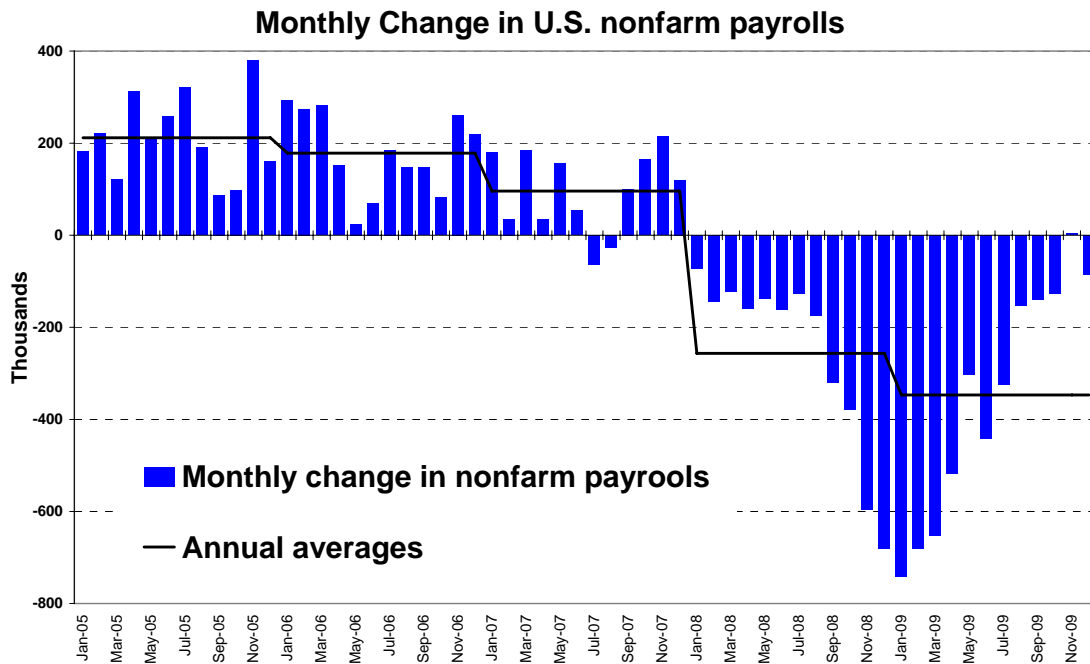
Wages in the public-service sector increased over the last year at a greater rate than in the business sector, in which the impact of the global economic crisis and the increase in the unemployment rate in Israel were strongly felt.

Wages in the public sector
as percent of wages in the business sector
(12-month moving average)



United States

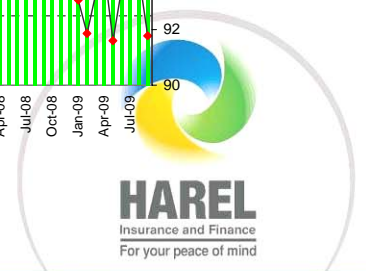
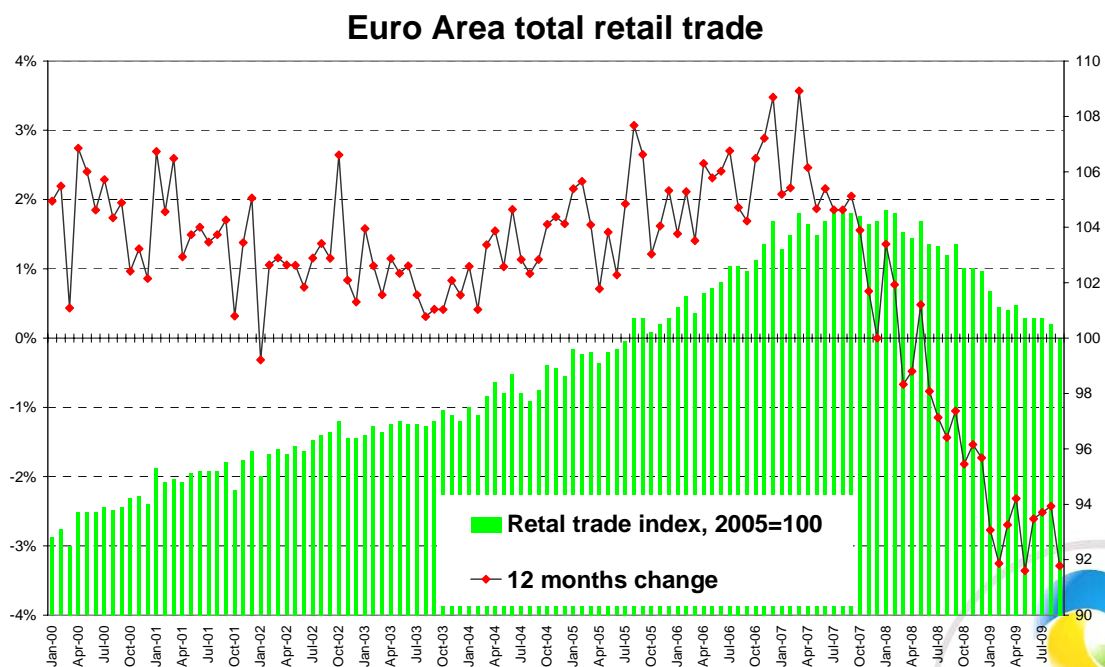
The employment report for December was weak relative to advance estimates. The **number of employed persons** decreased by 85,000, versus expectations of stability. The previous month's data were adjusted upward slightly. The **unemployment rate** remained at 10.0 percent. During 2009, the number of employed persons in the United States decreased by an average of 347,000 each month, further to an average monthly decrease of 257,000 during 2008. In order to maintain a stable unemployment rate over time, the American economy needs a monthly increase of about 100,000 employed persons, assuming a constant participation rate. The weak employment figures led to a slight reduction in **expectations of an increase in the Fed interest rate**.



The ISM services sector index stood at 50.1 points in December, in line with expectations.

Euro zone

Retail sales decreased by a sharper-than-expected 1.2 percent in November.



The unemployment rate in the euro zone rose to 10.0 percent in November, above expectations, versus 8.0 percent in November 2008.

According to initial estimates, inflation in the twelve months through December stood at 0.9 percent, in line with expectations.

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

Forecast change, November 2009 to February 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)
0.0%	-0.1%	-0.1%	-0.6%	-0.2%

Important Announcements in the Coming Week

- The Central Bureau of Statistics will publish data on Israel's foreign trade on Tuesday, January 12.
- The interest-rate decision in the euro zone will be announced on Thursday, January 14.
- Israel's CBS will publish the price indices for December, and the consumer price index will be published in the US and the euro zone, on Friday, January 15.
- The CBS will publish an update of national accounting data for the third quarter of 2009 on Sunday, January 17.



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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