

## Weekly Macroeconomic Review

May 12, 2009

	Expectations derived from the capital market	Our forecast
Inflation in the coming months		1.2% in April 0.2% in May
Future cumulative inflation – next 12 CPIs (through March 2010)		2.1%
Inflation through May 2010 CPI (average annual rate)	2.7%	3.0%
Bank of Israel interest rate, 6 months ahead	0.80% (up 0.30)	0.75%
Fed interest rate, 6 months ahead	0.35% (up 0.10)	0.25%
Yield on Israeli Government 10-Year bond, 6 months ahead	5.55% (up 0.29)	5.60%
Yield on US Treasury 10-Year bond, 6 months ahead	3.42% (up 0.19)	3.50%
Dollar exchange rate, 6 months ahead	NIS 4.11 (unchanged)	NIS 4.20 (up 2.0%)

## Israel

The government's discussions of the state budget are still in full swing; it seems that it will be very difficult for the government to maintain budgetary discipline. A substantial increase in the budget deficit and/or a considerable increase in taxes can be expected.

Less than two weeks ago, on May 3, the government approved the Ministry of Finance's proposal for additions to the budget for 2009 and 2010. A moderate increase of 1.7 percent annually in real government expenditures was decided upon, with an immense budget deficit of 6.0 percent of GDP in 2009 and 5.5 percent of GDP in 2010. The Finance Ministry claimed that a cutback of ILS 14 billion in government spending was required in order to comply with the deficit ceiling of 5.5 percent of GDP in 2010.

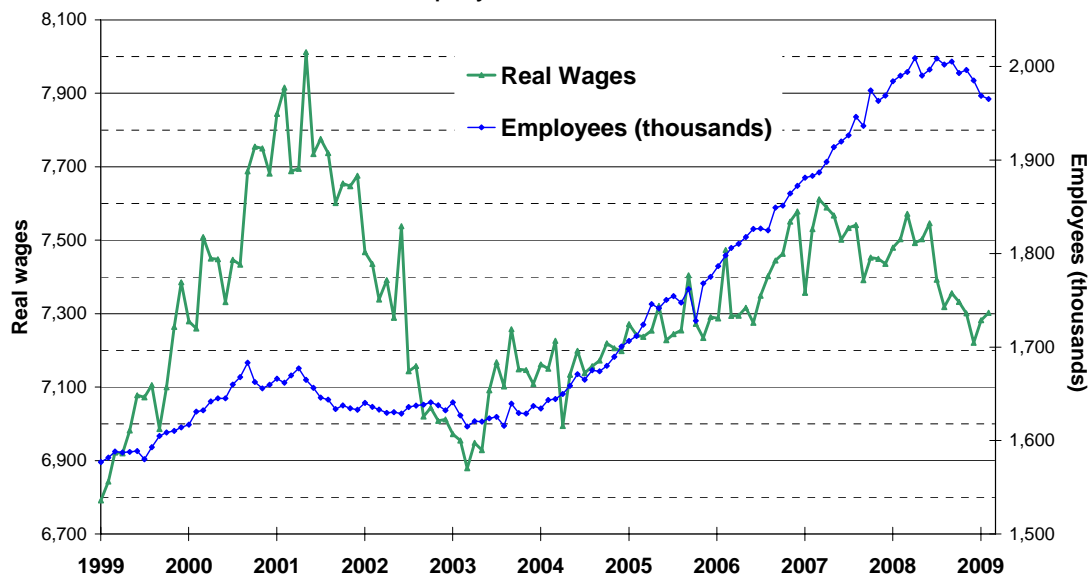


It now appears that the government's May 3 resolution will be changed, with the permitted increase in real expenditures to be expanded from 1.7 percent to 3.2 percent in each of 2009 and 2010; in other words, total expenses will grow by 1.5 percent in 2009 (approximately ILS 4 billion) and 3 percent in 2010 (approximately ILS 8 billion). Thus, the necessary cutback in 2010 has been reduced from ILS 14 billion to just ILS 6 billion, a far simpler task. However, the ILS 8 billion increase in expenditures in 2010 creates a problem in terms of the deficit, which may rise from 5.5 percent to about 6.5 percent of GDP, unless taxes are raised significantly in 2010. For example, an increase of 1 percentage point in VAT could increase tax revenues by only about ILS 3 billion, still far from the necessary ILS 8 billion.

**State tax revenues** totaled ILS 14.1 billion in April. This figure was slightly higher than our estimate, but the difference mainly stems from one-time income from the HP deal, so that there is no substantial change in the annual forecasts.

The number of employee positions and average nominal wages remained stable in February. The **number of positions of Israeli employees** remained unchanged in February, and decreased by 0.3 percent in the twelve months ended in February. Average nominal wages for employee positions of Israelis decreased by 0.1 percent in February, and increased by 0.1 percent in the twelve months ended in February, alongside a decrease in real wages (net of the consumer price index). In the **business sector**, the number of employee positions decreased by 0.2 percent, including non-Israelis, while real wages increased by 0.3 percent.

Business Sector's Real Wages  
and number of Employee Posts, Jan 1999 - Feb 2009



The Bank of Israel has published its inflation report for the first quarter of 2009. According to the BOI, "Inflation ranging from 0.8 percent to 1.1 percent in 2009 is derived from the models." The BOI repeated its recent growth forecast of negative 1.5 percent in 2009 and 1.0 percent in 2010. Also interesting is the BOI's reference to the exchange rate: "The surplus in the current account and pressures weakening the dollar globally are expected to strengthen the shekel, but the continued foreign-currency purchases by the BOI will work towards depreciation. In 2009, a surplus of USD 3.2 billion is expected in the current account [...] The surplus in the current account is expected to generate pressure towards appreciation of the effective exchange rate of the shekel. The exceptional monetary expansion in the United States is likely to weaken the dollar globally, thereby contributing to the strengthening of the shekel against the dollar. By contrast, the continued purchases of foreign currency by the BOI will contribute to offsetting the appreciation pressures."

In our opinion, the report indicates that:

1. The BOI believes that the dollar will weaken against other major currencies.
2. The BOI believes that the surplus in the current account will grow; one of the main reasons for the BOI's foreign-currency buying is the wish to prevent strengthening of the shekel.
3. The BOI will not rush to raise the interest rate, unless inflation expectations rise sharply.
4. The BOI will not stop purchasing foreign currency in the near future – again, unless inflation expectations rise sharply.

### Growth forecasts for advanced economies

The *Economist* has published its **monthly Consensus Forecast** of growth rates in the advanced countries. **For the first time in a long period, there was no significant decrease in the growth forecasts.** Estimates for 2009 fell slightly further, and now stand at a negative 2.9 percent in the US and negative 3.7 percent in the euro zone, but 2010 forecasts rose slightly.

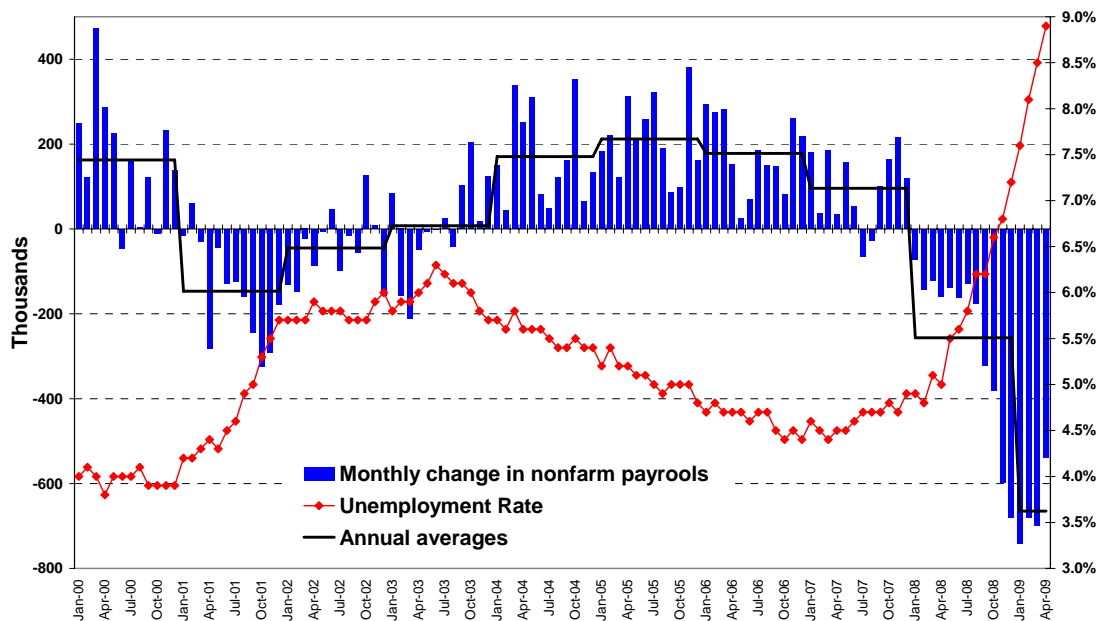
### United States

Results of the "**stress tests**" performed by the US government at nineteen major banks have been released. Ten of the nineteen banks were found to need to raise additional capital in order to withstand the pessimistic scenarios of the tests, though at relatively moderate volumes. However, the obvious question is whether the stress tests were good enough. There have been criticisms referring to the fact that the most pessimistic growth and loss scenario postulated by the government in the tests was insufficiently negative, and too close to the current central scenario of private-sector economists.



The **employment report** for April was quite negative, though less so than expected. The economy lost about 540,000 jobs in April, as the unemployment rate continued to break records, rising to 8.9 percent.

**Change in U.S. nonfarm payrolls and Unemployment rate**



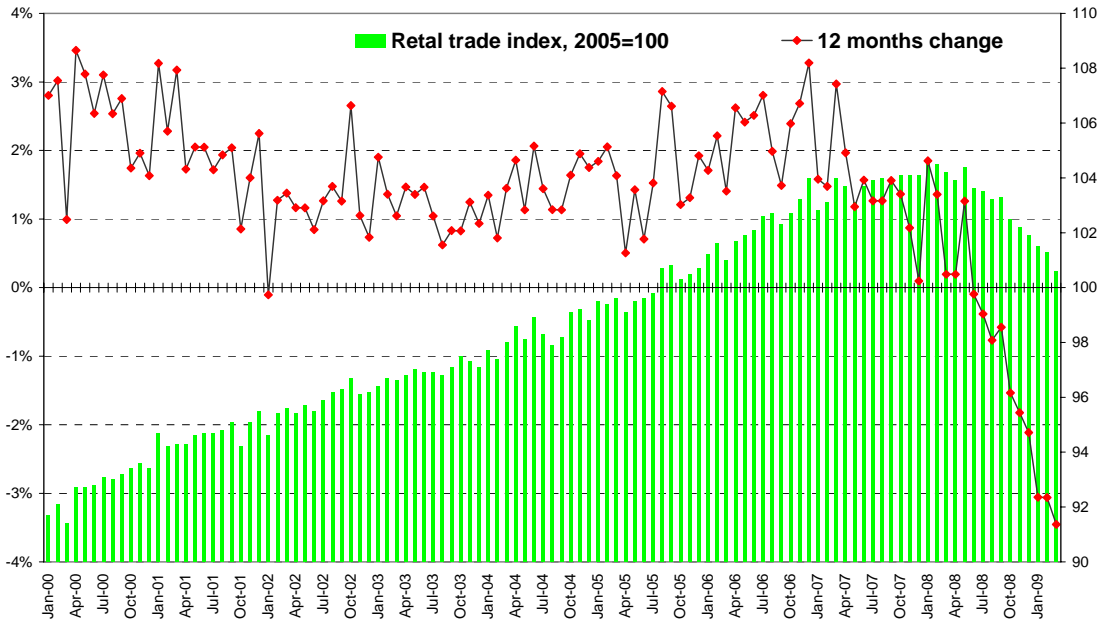
The **ISM services sector index** stood at 43.7 points in April, higher than expected.

## Europe

The **European Central Bank** lowered the interest rate by 0.25 percentage points to a historic low of 1.0 percent, as expected. The **UK's central bank** left the interest rate at 0.5 percent, in line with estimates.

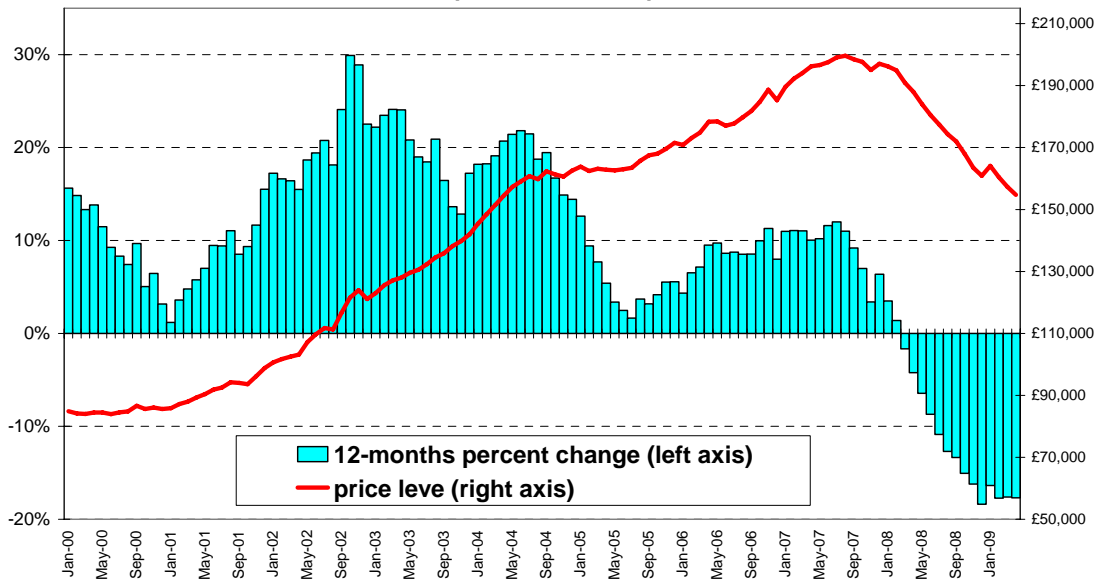
The index of **retail sales** in the euro zone decreased by 0.6 percent, a sharper-than-expected decline.

### Euro Area total retail trade



The UK's Halifax house price index fell by 1.7 percent in April, down 22 percent from the peak in August 2007.

### UK house prices (Halifax index)



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## Important Announcements in the Coming Week

- Israel's foreign-trade data and data on retail sales in the US will be published on Wednesday, May 13.
- Consumer price indices will be published in Israel, the US, and the euro zone on Friday, May 15. An initial estimate of growth in the first quarter of 2009 will also be published in the euro zone.
- The Central Bureau of Statistics will publish national accounting data for the first quarter of 2009, including the growth rate, on Sunday, May 17.

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-finance.co.il/macro/ENG](http://www.harel-finance.co.il/macro/ENG) in English.

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