

Weekly Macroeconomic Review

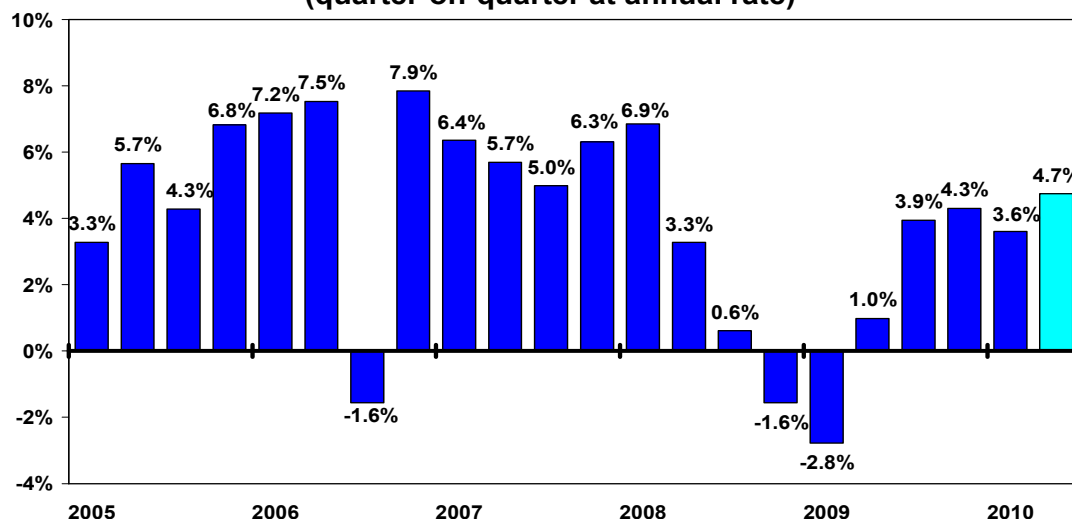
August 17, 2010

	Expectations derived from the capital market	Our forecast
Inflation in the coming months		0.3% in August Minus 0.2% in September
Future cumulative inflation – next 12 CPIs (through July 2011 CPI)	3.1%	3.7%
Bank of Israel interest rate, 6 months ahead	2.15% (up 0.40)	2.50%
Fed interest rate, 6 months ahead	0.25% (unchanged)	0.25%
Yield on Israeli Government 10-Year bond, 6 months ahead	4.47% (up 0.16)	4.90%
Yield on US Treasury 10-Year bond, 6 months ahead	2.79% (up 0.17)	3.60%
Dollar exchange rate, 6 months ahead	NIS 3.81 (up 0.3%)	NIS 3.77 (down 0.4%)

Israel

Growth in the second quarter of 2010 was surprisingly positive, at an annualized rate of 4.7 percent in the initial estimate, following 3.6 percent growth in the first quarter.

GDP Growth
(quarter-on-quarter at annual rate)

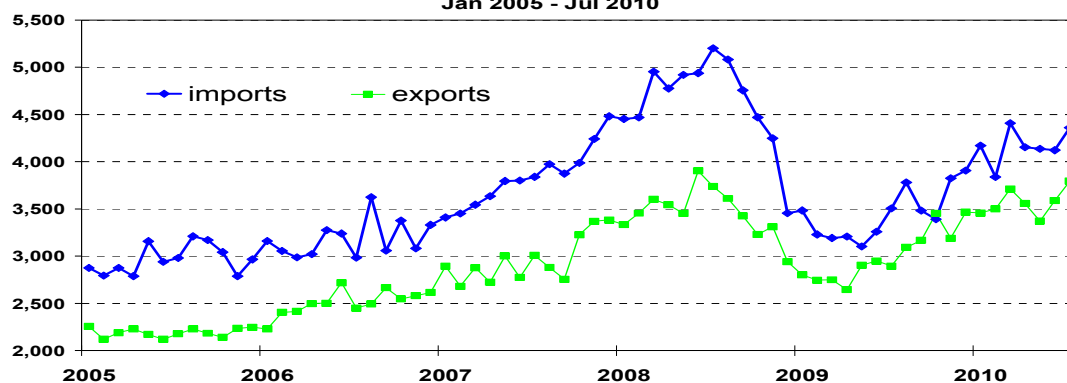


The composition of growth in the second quarter was also impressive: the **business product** grew by 6.0 percent, **private consumption** increased by 8.7 percent, **fixed-asset investments** grew by 10.9 percent, and **exports** (excluding diamonds and start-up companies) increased by 18.3 percent.

The **consumer price index** rose by 0.5 percent in July, less than expected, but prices of homes continued to rise sharply. **Twelve-month inflation** reached 1.8 percent. The surprise in the index components, relative to our estimates, mainly concerned the **clothing and footwear** item, which fell by 9.0 percent, versus expectations of a more moderate decline; and the 1.0 percent increase in the **housing** item (which mainly reflects rent prices), lower than expected. Prices of **tenant-owned homes** rose sharply, according to the latest survey, by 2.2 percent, and increased by 21 percent in the last twelve months.

Foreign-trade figures for July were encouraging. **Exports of goods** (excluding diamonds, ships, and aircraft; in dollar terms) increased by 6 percent in July, and the increase in June was revised to 6 percent as well, from the previous estimate of 1 percent. Exports expanded by 31 percent in the last twelve months. **Imports of goods** (excluding diamonds, ships, and aircraft; in dollar terms) grew by 6 percent in July, and by 24 percent in the last twelve months. The **trade deficit** (excluding diamonds, ships, and aircraft; in dollar terms) totaled approximately USD 0.6 billion, similar to the preceding months.

Exports and Imports of Goods
(US\$ millions per month, excl. diamonds, ships & airplanes)
Jan 2005 - Jul 2010



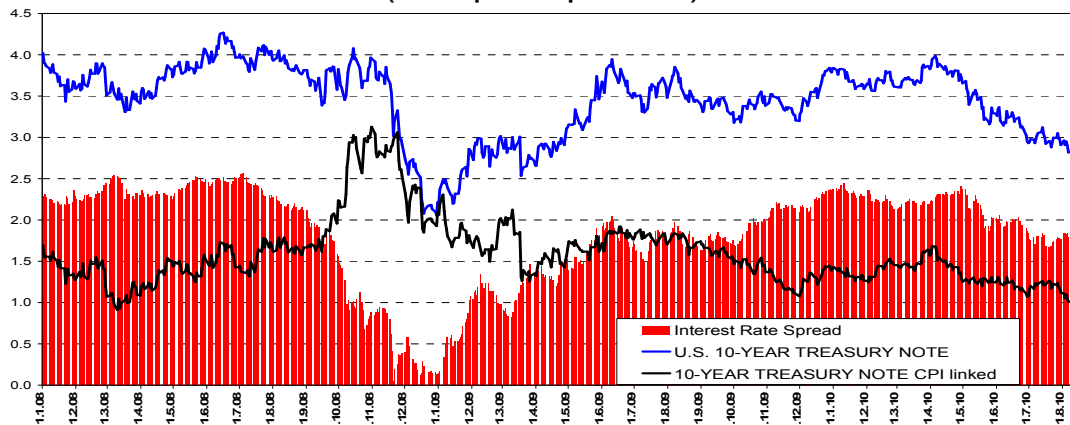
Inflation expectations according to calculations by the Bank of Israel, on average between mid-July and mid-August, reached 2.8 percent for the first year, 2.8 percent for the second year, and 2.6 percent from the third year forward. The **amount of means of payment** grew by 3.5 percent in July, the highest growth rate in many months. In the last twelve months, means of payment increased by 9.9 percent.

In our opinion, the **Bank of Israel** will not raise the interest rate on August 23. Reasons include the CPI data, last month's rate hike, and the signs of a slowdown in growth in the United States. However, the rapid growth in the second quarter, the improvement in export data, and the sharp rise in prices of homes increase the probability of continued interest-rate increases in the coming months.

United States

The Fed's statements regarding the condition of the US economy have taken on a more pessimistic tone. The Fed also announced that purchases of government bonds would resume. The amounts purchased will be relatively small, without increasing the Fed's balance sheet, through refinancing of maturing government bond series and mortgage bonds under its ownership. According to estimates, the volume involved is approximately USD 10 billion per month, on average. The **government bond market** reacted strongly, and ten-year yields fell to 2.59 percent, further to the declines of the last few weeks.

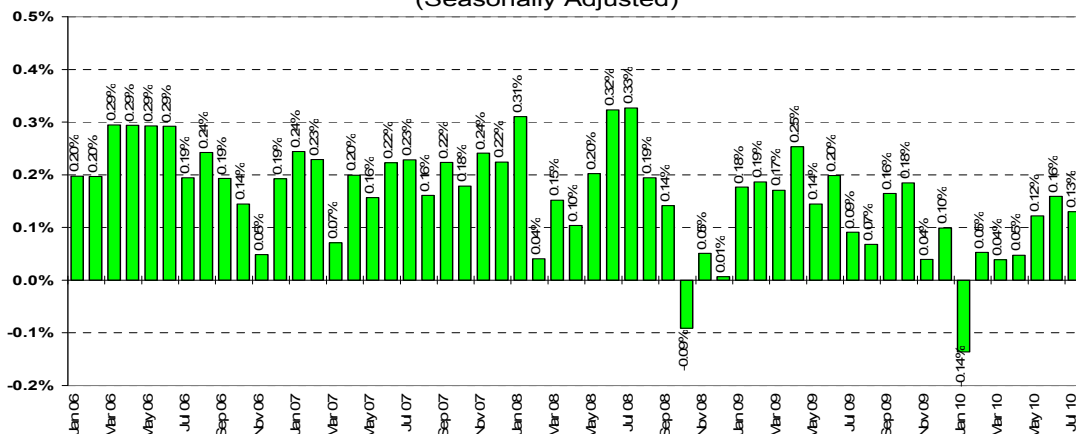
10-YEAR US BONDS
(Yield - percent per annum)



In our opinion, long-term yields in the US (real and nominal) – and consequently, long-term bond yields in Israel as well – reflect a highly pessimistic scenario of a significant slowdown or even renewed recession in the American economy. This projection appears to be far more ominous than scenarios derived from share and commodity prices. We see a renewed recession as a possible but relatively low-probability development. Thus, the probability of an increase in yields of long-term bonds both in the US and in Israel is high.

The consumer price index rose by 0.1 percent, and twelve-month inflation reached 1.2 percent. The core index rose by 0.13 percent; core inflation in the last twelve months was 0.9 percent, in line with expectations.

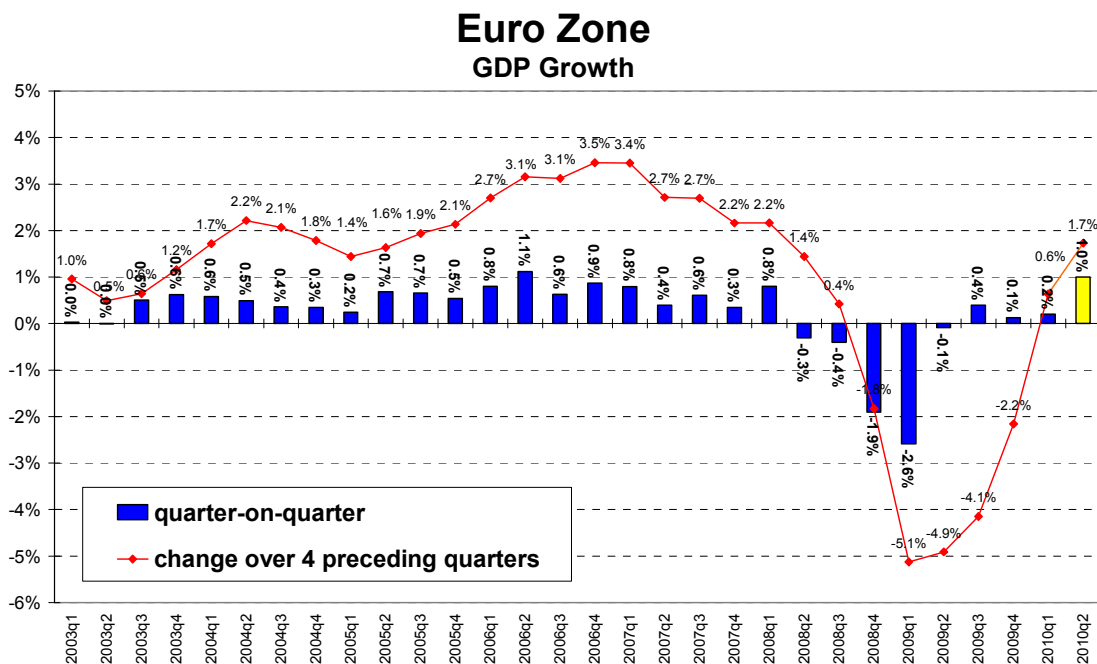
USA: monthly change in Core CPI
(Seasonally Adjusted)



Retail sales grew by 0.4 percent in July and by 5.5 percent in the last twelve months, as expected.

Euro zone

GDP grew by 1.0 percent in the second quarter of 2010, according to an initial estimate, or about 4 percent in annualized terms – far above expectations.



A significant part of the growth stemmed from the 2.2 leap in GDP (approximately 9 percent annualized) in Germany, the largest eurozone economy. The Greek economy contracted by 1.5 percent, while Spain and Portugal posted 0.2 percent growth.

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

Forecast change, July 2010 index to October 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)
0.3%	1.6%	1.0%	-0.2%	0.5%

Important Announcements in the Coming Week

- Data on construction starts and permits will be published in the US on Tuesday, August 17.
- Israel's Central Bureau of Statistics will publish the industrial production index and the trade and service sectors revenue index on Wednesday, August 18.
- The Bank of Israel will announce its interest-rate decision on Monday, August 23.

This review is posted online at www.harel-finance.co.il/macro in Hebrew
and at www.harel-group.com/finance.html in English.

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