

## Weekly Macroeconomic Review

February 17, 2009

	Expectations derived from the capital market	Our forecast
Inflation in the coming months		0.2% in February 0.5% in March
Future cumulative inflation – next 12 CPIs (through January 2010)		2.2%
Inflation through May 2010 CPI (average annual rate)	0.2%	2.6%
Bank of Israel interest rate, 6 months ahead	1.00% (unchanged)	0.50%
Fed interest rate, 6 months ahead	0.35% (up 0.10)	0.25%
Dollar exchange rate, 6 months ahead	NIS 4.16 (up 0.1%)	NIS 4.25 (up 2.3%)

## Israel

The Bank of Israel announced that it would begin to purchase and perform transactions in **government bonds** of various types, for various terms, in the secondary market. This move has a dual aim: to reduce interest rates all across the curve (not just in the short-term range affected by the BOI interest rate); and to continue to increase the amount of money, even with the BOI interest rate near zero. The BOI will thereby try to boost economic growth (weaken and shorten the recession) and generate positive inflation (avert the risk of deflation).

Following the BOI's announcement, **yields of government bonds** fell, as prices rose by 2 to 3 percent in both the linked and unlinked segments, while the **shekel weakened** by approximately 1.5 percent.

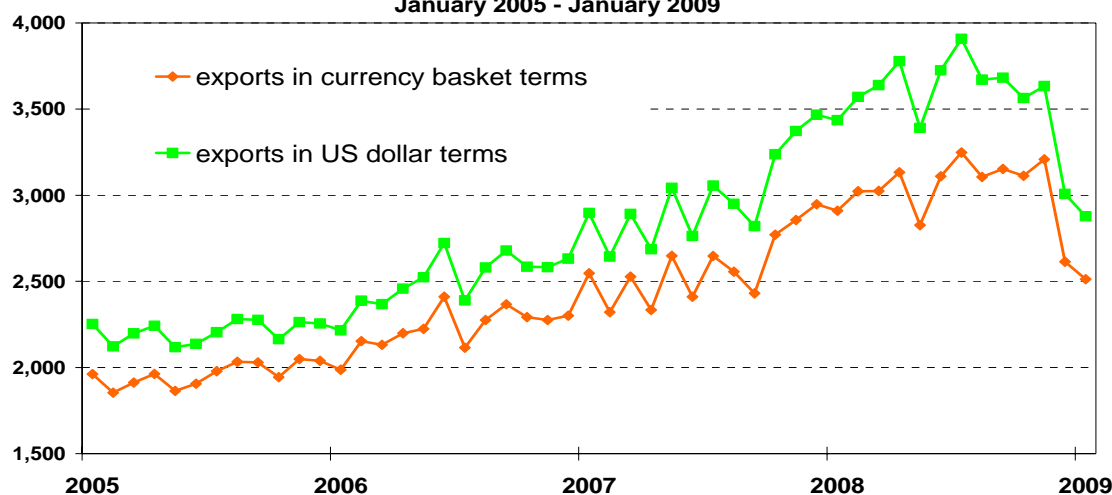
The gain in CPI-linked government bonds is certainly justified **in our opinion**, but the effect on unlinked government bonds appears somewhat exaggerated, as the BOI's move may increase demand for bonds but is also likely to increase expected inflation.

This step by the BOI entails **significant risks**, especially during the current period of ambiguity regarding the composition and the economic policies of the new government. We worry that if the government discovers a large, generous buyer for its bonds in the market, it may be tempted to substantially enlarge the deficit and pressure the BOI to finance this deficit again in the future.

Foreign-trade figures for January were weak. **Exports of goods** (excluding aircraft, ships, and diamonds; in dollar terms) decreased by 4 percent, and by 16 percent in the last twelve months. The sharp decline in exports in December and January heralds a **substantial contraction in GDP** in the first quarter of 2009, in our opinion.

### Exports of Goods

(millions per month, excl. diamonds, ships & airplanes)  
January 2005 - January 2009



**Imports of goods** remained almost unchanged in January, following a very large decrease in the preceding month. Imports fell by 21 percent in the last twelve months. Israel's **trade deficit**, which greatly contracted last month, grew by 12 percent again in January.

The **consumer price index** decreased by 0.5 percent in January, versus our forecast of a 0.4 percent decrease, and the Bloomberg survey's forecast range of a decrease of 0.4 to 0.8 percent. As in the preceding months, the main surprise was in the housing item, but this time the figure was surprisingly low, with a 0.7 percent decline. **Inflation** in the last twelve months is at 3.3 percent, significantly more moderate than in the previous months but still above target.

The number of **incoming tourists** by air increased by 3 percent in January, following a sharp decrease in December. Tourist entries decreased by 7 percent in the last twelve months.

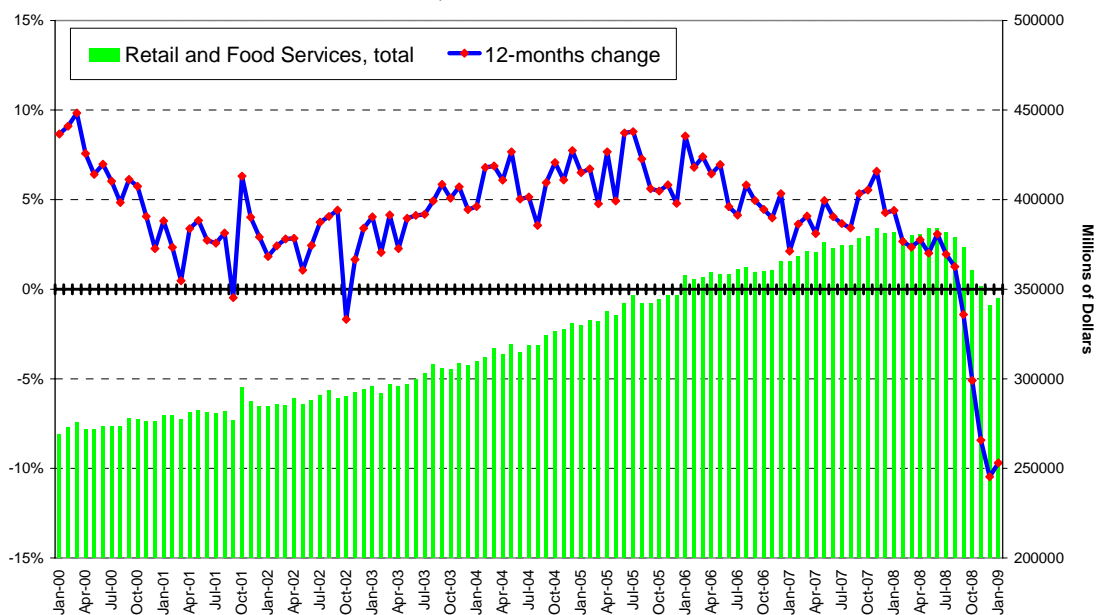
## Euro zone

The contraction of the euro-zone economy continued for the third consecutive quarter. **GDP** decreased by 1.5 percent in the last quarter of 2008, or 6 percent in annualized terms, following a decrease of 0.2 percent (0.8 percent annualized) in each of the preceding two quarters. Particularly poor figures were noted in Germany, the EU's largest economy, with negative 2.1 percent growth. These data support continued interest-rate cuts by the ECB.

## United States

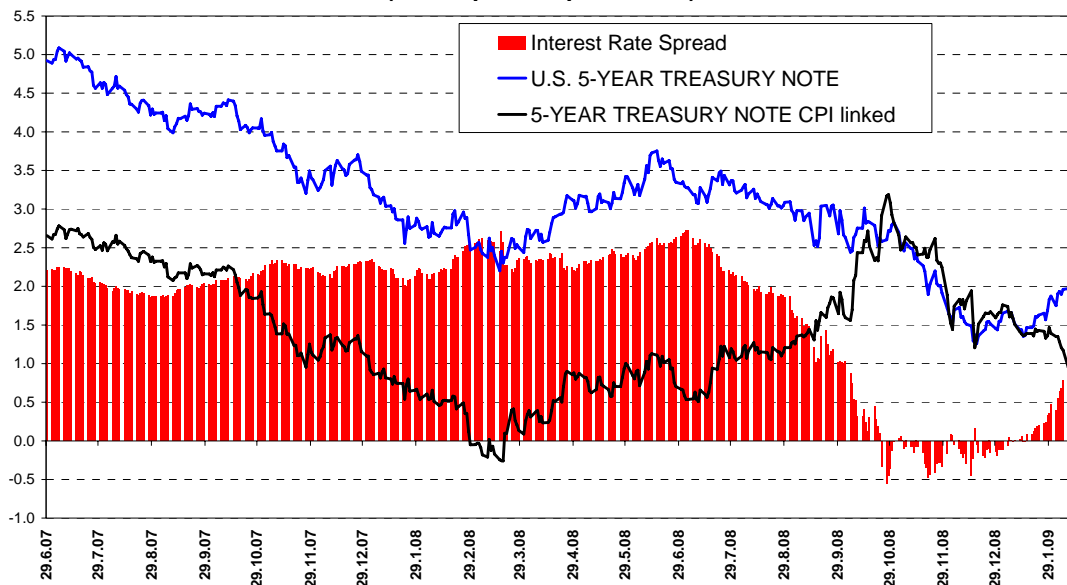
Following six consecutive months of declines in **retail sales**, a surprising 1.0 percent increase occurred in January, in contrast to expectations of further decline. However, in the last twelve months retail sales decreased by 9.7 percent.

### USA, total retail sales



In line with our estimates, **inflation expectations** derived from the difference between linked and nominal government bonds increased in recent weeks.

## 5-YEAR US BONDS (Yield - percent per annum)



## Japan

GDP contraction in the fourth quarter of 2008 was far more severe in Japan than in the other advanced countries, at an annualized rate of negative 12.7 percent, with declines in exports, investments, and private consumption.

## Important Announcements in the Coming Week

- Data on construction starts and permits will be published in the United States on Wednesday, January 18<sup>th</sup>.
- The Central Bureau of Statistics (CBS) will publish the industrial production index and the trade and service sectors revenue index on Thursday, February 19<sup>th</sup>.
- The consumer price index will be published in the United States on Friday, February 20<sup>th</sup>.
- The CBS will publish national accounting data for the fourth quarter of 2008 on Monday, February 23<sup>rd</sup>.
- The BOI will announce its interest-rate decision on Monday, February 23<sup>rd</sup>.



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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