

## Weekly Macroeconomic Review

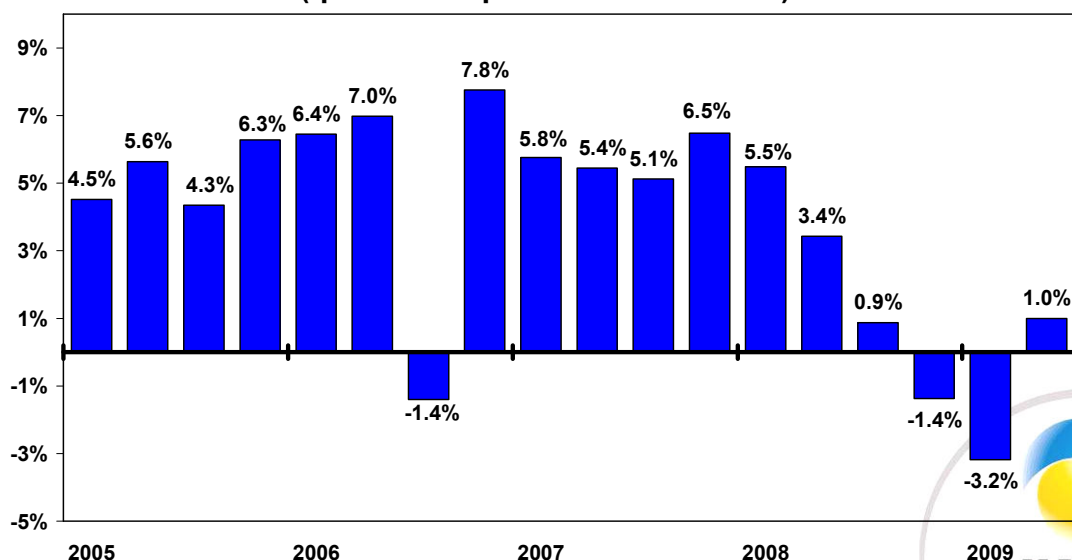
August 18, 2009

	Expectations derived from the capital market	Our forecast
Inflation in the coming months		0.7% in August Minus 0.1% in September
Future cumulative inflation – next 12 CPIs (through July 2010 CPI)		2.6%
Inflation through July 2011 CPI (average annual rate)	2.5%	2.4%
Bank of Israel interest rate, 6 months ahead	1.00% (up 0.50)	1.00%
Fed interest rate, 6 months ahead	0.40% (up 0.15)	0.40%
Yield on Israeli Government 10-Year bond, 6 months ahead	5.63% (up 0.31)	5.63%
Yield on US Treasury 10-Year bond, 6 months ahead	3.74% (up 0.23)	4.00%
Dollar exchange rate, 6 months ahead	NIS 3.82 (down 0.1%)	NIS 3.83 (unchanged)

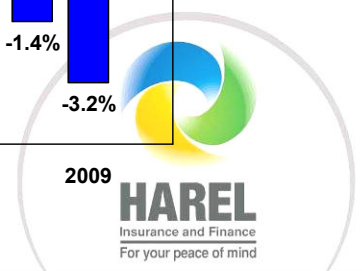
## Israel

Gross domestic product grew in the second quarter of 2009 at a surprising annualized rate of 1.0 percent, with a 0.7 percent rise in **business product**.

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



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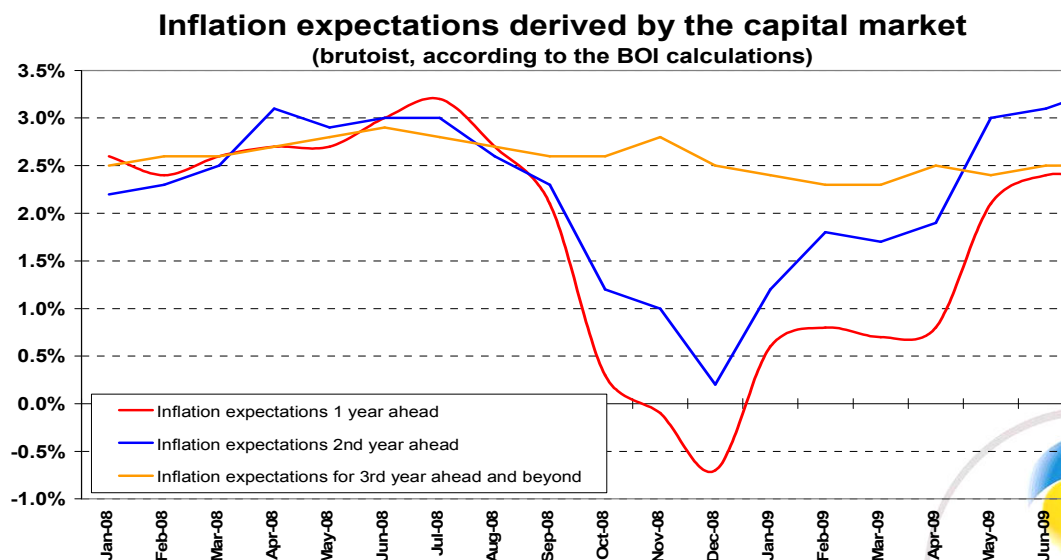


The first-quarter growth rate was also adjusted upward to negative 3.2 percent, from negative 3.7 percent. Growth in 2008 remained at 4.0 percent. Real export data for previous quarters were revised upward to a significant degree, whereas GDP prices were adjusted downward.

The growth rate in the second quarter was better in Israel than in the United States and in the euro zone (negative 1 percent and negative 0.4 percent, respectively); the composition of growth was also quite positive. **Exports of goods and services** increased at an annualized rate of 5.8 percent, while exports excluding start-up companies and diamonds expanded by 7.1 percent. **Private consumption** increased by 4.4 percent, and **public consumption** grew by 20.2 percent. However, **imports** of goods and services decreased by 6.3 percent, and **fixed-asset investments** fell at an annualized rate of 10.3 percent.

Due to the surprising rise in GDP and the high July CPI, the probability of an increase in the Bank of Israel interest rate next week has increased, although the decision also depends on additional factors, including developments in the exchange rate and inflation expectations.

According to calculations by the BOI, **inflation expectations** between mid-July and mid-August stood at an average of 2.7 percent for the first year and 3.6 percent for the second year, higher than in the preceding months.

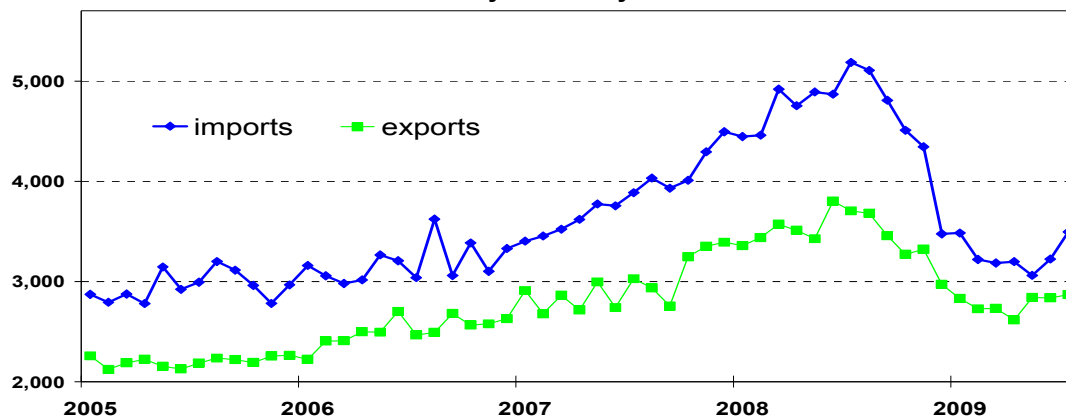


The consumer price index rose by 1.1 percent in July, slightly higher than our estimate of 1.0 percent and the average forecast of 0.9 percent. The unexpectedly high figure mainly resulted from the effect of the "drought levy," which according to calculations by the Central Bureau of Statistics contributed 0.28 percentage points to the general CPI in July, more than had been calculated by economists.

**Inflation** in the last twelve months totaled 3.5 percent, including the 1.1 percent contribution, according to our estimate, of the increase in indirect taxes (water, gasoline, cigarettes, and VAT).

**Exports of goods** (excluding diamonds, ships, and aircraft; in dollar terms) increased by 1 percent in July. However, in the twelve months ended in July exports of goods fell by 23 percent. **Imports of goods** increased by 8 percent in July, supported by a steep 71 percent increase in imports of vehicles, but dropped by 33 percent in the twelve months ended in July.

**Exports and Imports of Goods**  
(US\$ millions per month, excl. diamonds, ships & airplanes)  
January 2005 - July 2009



As a result, the **trade deficit** expanded to USD 630 million in July, from USD 390 million in June.

## United States

The Fed left the interest rate unchanged at 0-0.25 percent, as expected. Its press release stated that the economy is showing signs of a rebound, but the interest rate is likely to remain low for some time. The Fed also announced that it would slow the pace of its government-bond purchases.

The CPI remained unchanged in July, while the core index rose by 0.1 percent, both as expected. Inflation in the twelve months ended in July reached a negative 2.1 percent, with core inflation at 1.5 percent.

Retail sales decreased by 0.1 percent in July, in contrast to estimates of an increase, and by 8 percent in the last twelve months.

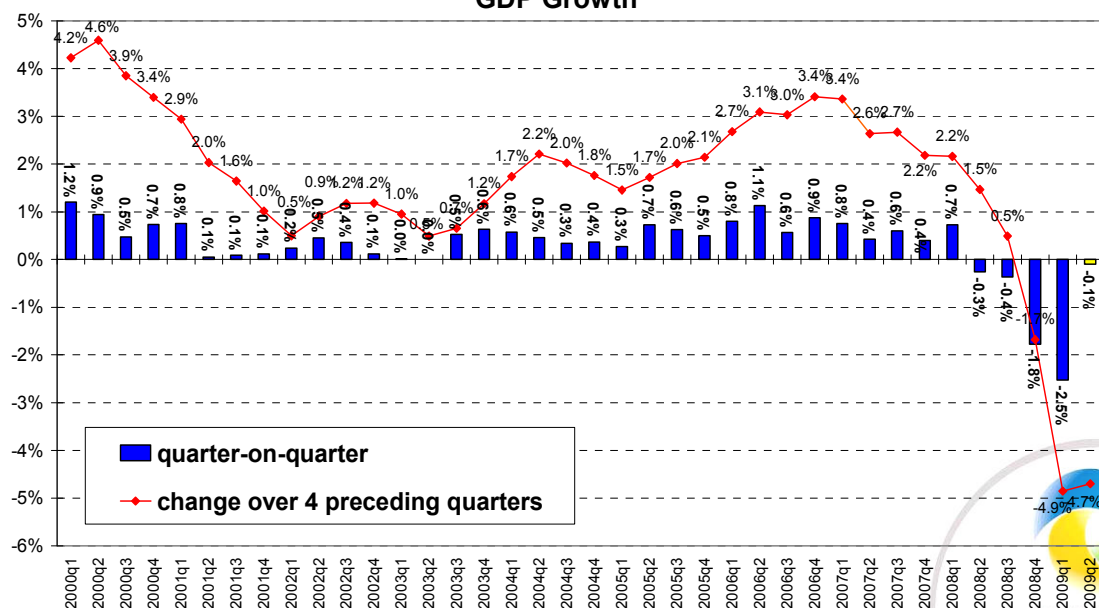
The University of Michigan's consumer confidence index stood at 63.2 points in July, according to an initial estimate, down from 66 points in June, versus expectations of an improvement. This figure contributed to declines in the equity markets.

## Euro zone

Inflation reached a negative 0.7 percent in June, lower than expected.

Based on an initial estimate, GDP contracted by 0.1 percent in the second quarter of 2009, or 0.4 percent annualized. A 0.3 percent increase in GDP in France and Germany contributed to the milder-than-expected decline. Nonetheless, overall in the first half of 2009 the slowdown in the euro zone was more severe than in the US.

### Euro Zone GDP Growth



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## Important Announcements in the Coming Week

- Israel's Central Bureau of Statistics will publish the industrial production index and the trade and service sectors revenues index, and data on construction starts and permits will be published in the US, on Tuesday, August 18.
- Data on sales of existing homes will be published in the US on Friday, August 21.
- The Bank of Israel will announce its interest-rate decision on Monday, August 24.

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

Please address comments or questions to Mr. Ofer Klein at  
[oferk@harel-finance.co.il](mailto:oferk@harel-finance.co.il)

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