

## Weekly Macroeconomic Review

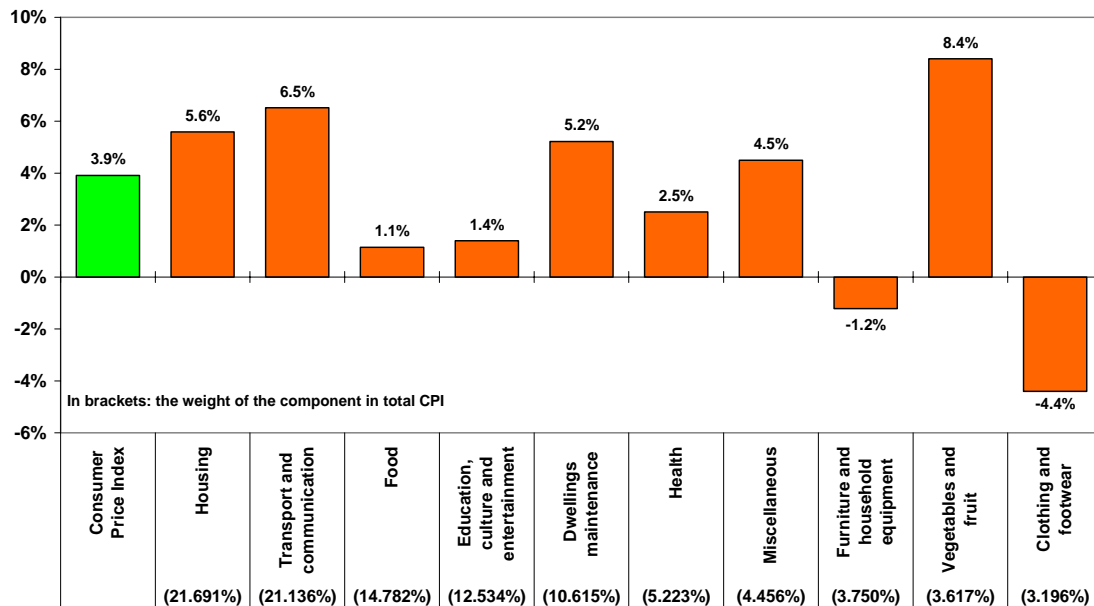
January 19, 2010

	Expectations derived from the capital market	Our forecast
Inflation in the coming months		Minus 0.2% in January Minus 0.1% in February
Future cumulative inflation – next 12 CPIs (through November 2010 CPI)		2.0%
Inflation through July 2011 CPI (average annual rate)	2.6%	2.5%
Bank of Israel interest rate, 6 months ahead	1.85% (up 0.60)	1.85%
Fed interest rate, 6 months ahead	0.35% (up 0.10)	0.35%
Yield on Israeli Government 10-Year bond, 6 months ahead	5.28% (up 0.25)	5.25%
Yield on US Treasury 10-Year bond, 6 months ahead	3.92% (up 0.25)	4.25%
Dollar exchange rate, 6 months ahead	NIS 3.68 (unchanged)	NIS 3.68 (unchanged)

## Israel

The consumer price index remained unchanged in December. We expected a 0.2 percent increase, and most economists predicted a 0.3 percent rise. The surprisingly low figure mainly stemmed from **the housing item**, which decreased by 0.6 percent. However, according to the latest survey by the Central Bureau of Statistics, **prices of homes under ownership** continued to rise. Prices of homes are not included in the consumer price index; this data is published with a one-month delay after the housing item, which mainly reflects rent prices.

Changes in the CPI and its components during the last 12-months  
(until Dec 2009)



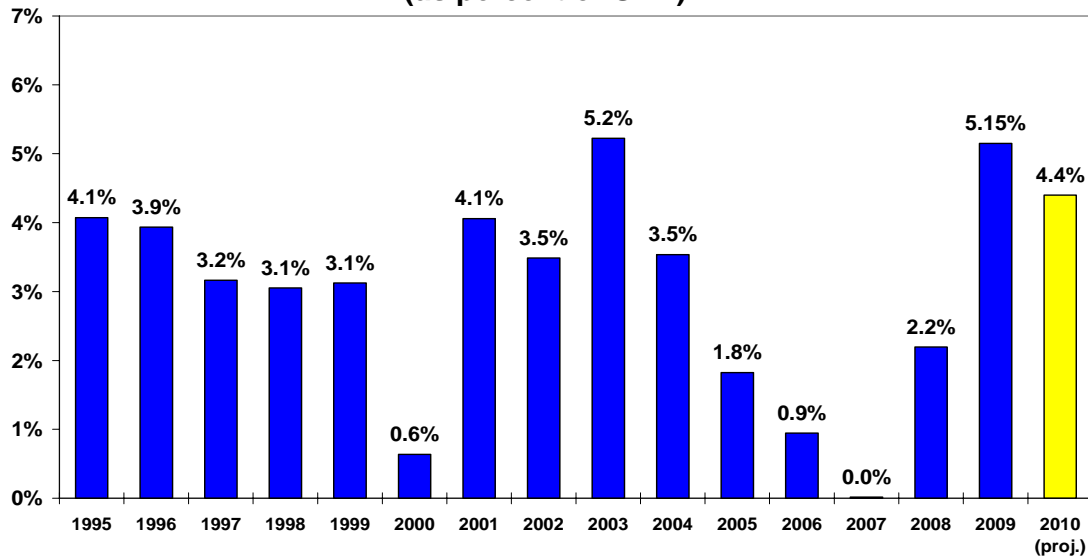
The lower-than-expected CPI, the appreciation of the shekel in the last two months, the decrease in the amount of means of payment, and the poor employment data in the US (which are expected to delay the increase in the interest rate there) form a series of developments which is likely to cause the Bank of Israel to **pause the increases in the interest rate**. The BOI will probably wait at least another month, or possibly more, before continuing the interest-rate increase process.

**State tax revenues** totaled ILS 14.8 billion in December and ILS 177.7 billion in the full year of 2009, 0.6 percent of GDP above the planned budget. Our estimate in recent months was a surplus of about 0.5 percent of GDP.

**The budget deficit** totaled 5.15 percent of GDP, versus the budget plan of 6.0 percent of GDP, due to higher tax revenues than in the original planned budget. Government expenditures appear to have been significantly increased in December, with expenses moved from 2011 to 2010.



## The Central Government Budget Deficit (as percent of GDP)

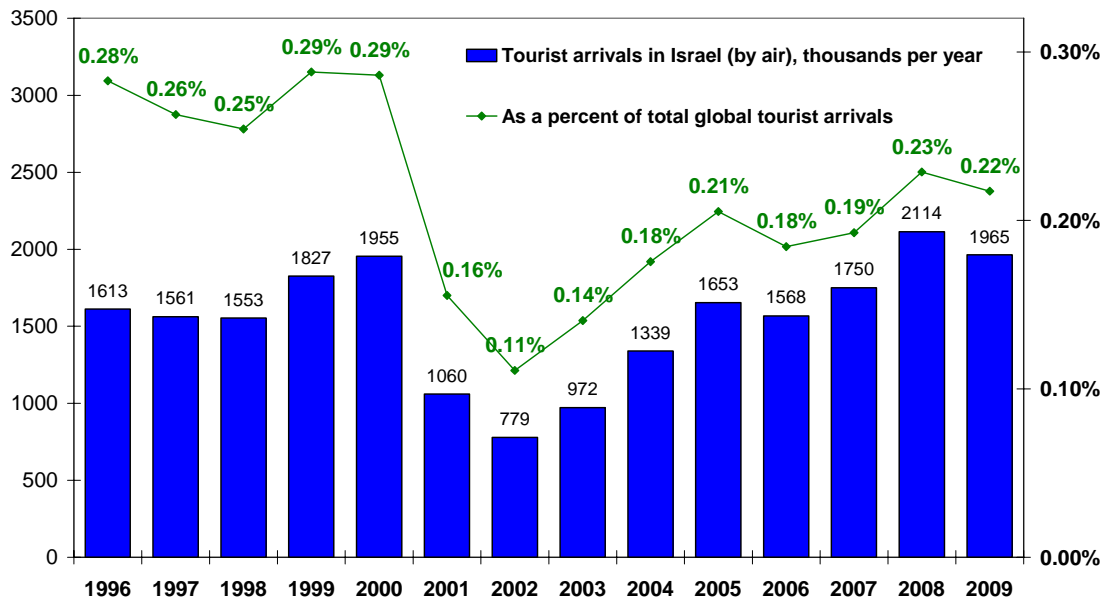


According to our estimates, the deficit in 2010 will reach 4.5 percent, about 1 percent of GDP less than the objective in the state budget. The government has declared a budget deficit target of 3.0 percent in 2011; based on the current trajectory of government expenditures (a real increase of 1.7 percent) and expected revenues (including the future tax cut), the deficit will be higher, at around 4.5 percent. **Budget talks** will begin soon; in order to comply with the deficit target, the government will need to cut back the state budget for 2011 (less than 1.7 percent growth in expenditures) and/or postpone the planned tax reductions. A third option is to raise the deficit target, though this makes no economic sense, in our view. A fourth possibility, the worst option in terms of desirable policy, is to present an unrealistic revenue forecast, so that the forecast deficit meets the target and no policy steps are necessary.

**The number of incoming tourists** by air decreased by 12 percent in December. This figure declined by 7 percent in 2009. The global recession and the military campaign in Gaza in late 2008 contributed to the decrease in incoming tourism. In an international comparison, Israel maintained approximately the same share of total global tourism.



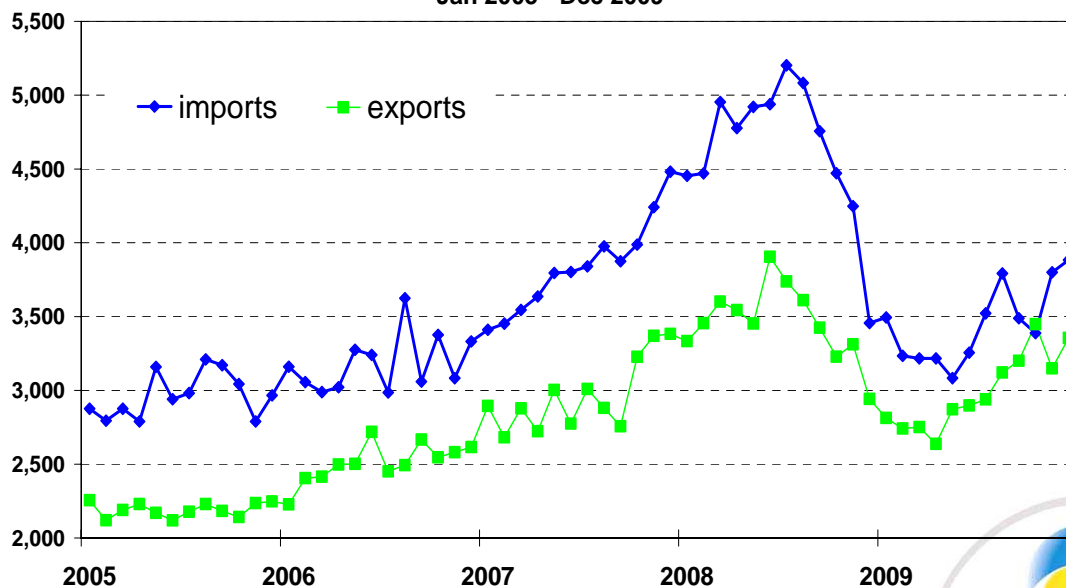
## Tourist arrivals in Israel



**Exports of goods** (excluding diamonds, ships, and aircraft, in dollar terms) grew by 7 percent in December and by 14 percent in the last twelve months. **Imports of goods** grew by 2 percent in December and by 12 percent in the last twelve months.

### Exports and Imports of Goods

(US\$ millions per month, excl. diamonds, ships & airplanes)  
Jan 2005 - Dec 2009



According to the latest update by the CBS, **growth in the third quarter** stood at an annualized rate of 3.0 percent, similar to the previous estimate.

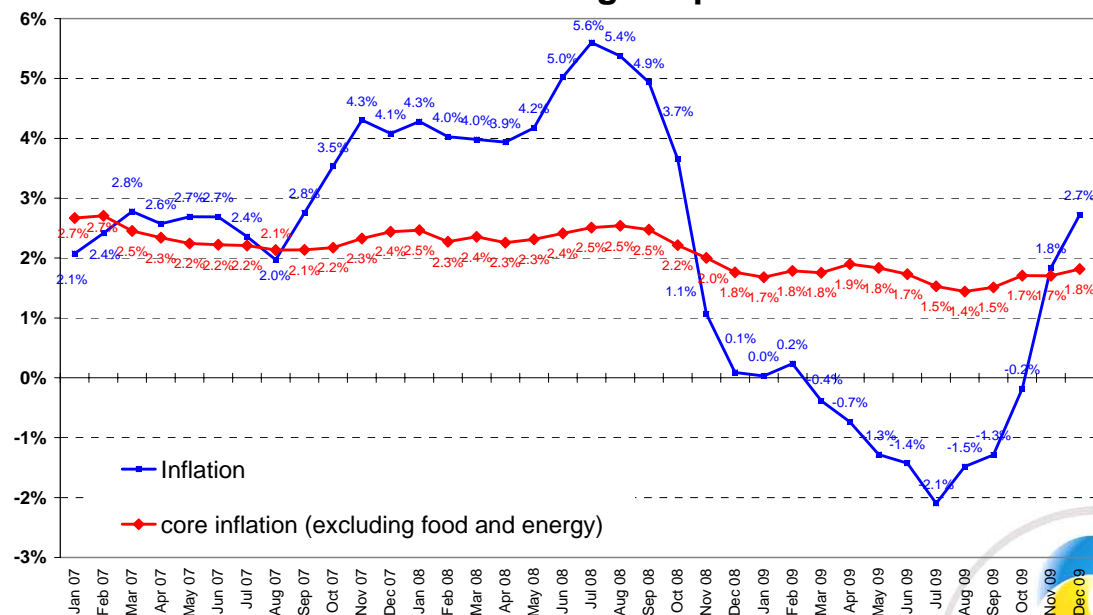
**Inflation expectations**, according to calculations by the BOI, between mid-December and mid-January stood at an average level of 2.5 percent for the first year, 3.1 percent for the second year, and 2.5 percent for the third year forward, similar to the preceding month. **The amount of means of payment** decreased by 1.2 percent in December, and the annual growth rate decreased to 51 percent. This rate is high compared to previous years, but significantly lower than the peak rate of 65 percent seen in August 2009.

## United States

**Retail sales** declined by a surprising 0.3 percent in December, and increased by 5.4 percent in the last twelve months.

**Inflation** reached 2.7 percent in December, while **core inflation** was 1.8 percent, with an increase of 0.1 percent in the core index, in line with expectations.

**USA: Inflation rate during the past 12 month**



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

Forecast change, December 2009 to March 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)
-0.2%	0.0%	1.1%	0.0%	0.4%

### Important Announcements in the Coming Week

- The CBS will publish the industrial production index and the trade and service sectors revenue index on Tuesday, January 19.
- Data on construction starts and permits will be published in the US on Wednesday, January 20.
- The BOI's interest-rate decision will be announced, and data on sales of existing homes will be published in the US, on Monday, January 25.

This review is posted online at [www.harel-finance.co.il/macro](http://www.harel-finance.co.il/macro) in Hebrew

and at <http://www.harel-group.com/finance.html> in English.

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