

Weekly Macroeconomic Review

January 20, 2009

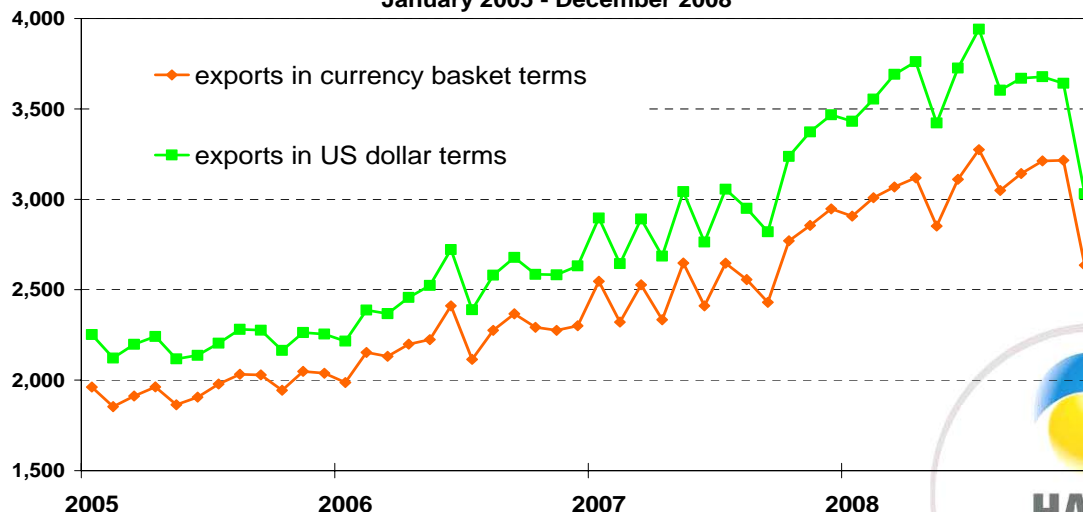
	Expectations derived from the capital market	Our forecast
Inflation in the coming months		Minus 0.3% in January 0.3% in February
Future cumulative inflation – next 12 CPIs (through December 2009)		1.9%
Inflation through May 2010 CPI (average annual rate)	Minus 0.3%	2.1%
Bank of Israel interest rate, 6 months ahead	1.40% (down 0.35)	1.25%
Fed interest rate, 6 months ahead	0.30% (up 0.05)	0.25%
Dollar exchange rate, 6 months ahead	NIS 3.90 (up 0.5%)	NIS 4.01 (up 3.3%)

Israel

Exports and imports of goods dropped sharply in December. **Exports of goods** (excluding ships, aircraft, and diamonds; in dollar terms) declined by 5 percent in December and by 10 percent in the last twelve months, falling by 11 percent in the fourth quarter of 2008 as compared to the preceding quarter. **Imports of goods** fell by 19 percent in December and by 22 percent in the last twelve months; imports of goods, excluding energy materials, decreased by 17 percent in December and by 13 percent in the last twelve months. These data indicate escalation of the downturn in economic activity.

Exports of Goods

(millions per month, excl. diamonds, ships & airplanes)
January 2005 - December 2008

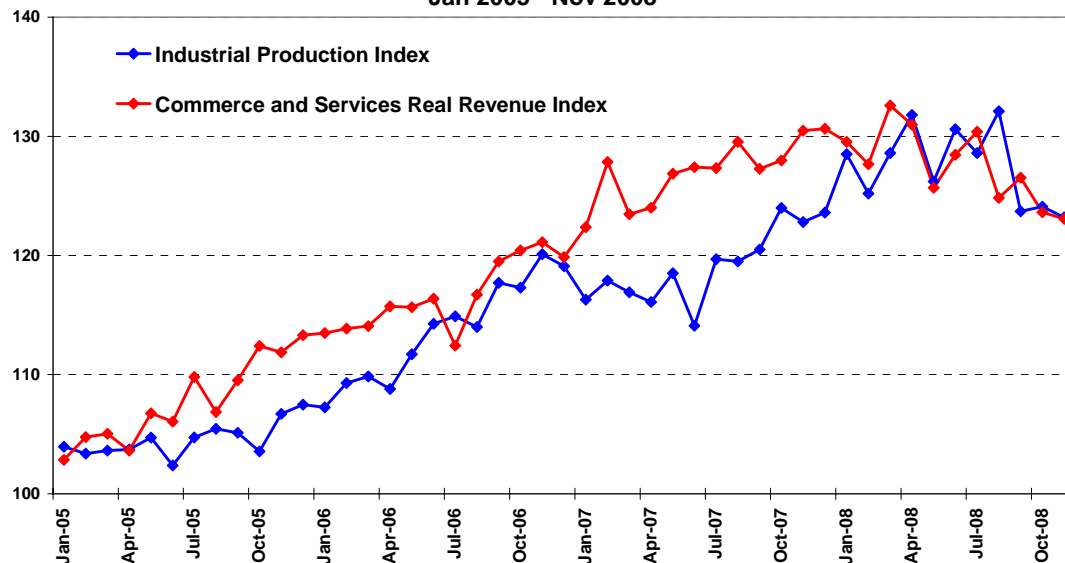


Tel: 1-800-310-330 | www.harel-finance.co.il



Indicators of economic activity in November were negative. The **industrial production index** fell by 0.7 percent in November, and remained unchanged in the last twelve months. The **trade and service sectors revenue index** lost 0.4 percent in November and 6 percent in the last twelve months.

**Industrial Production Index
& Commerce and Services Sectors Revenue Index**
Jan 2005 - Nov 2008

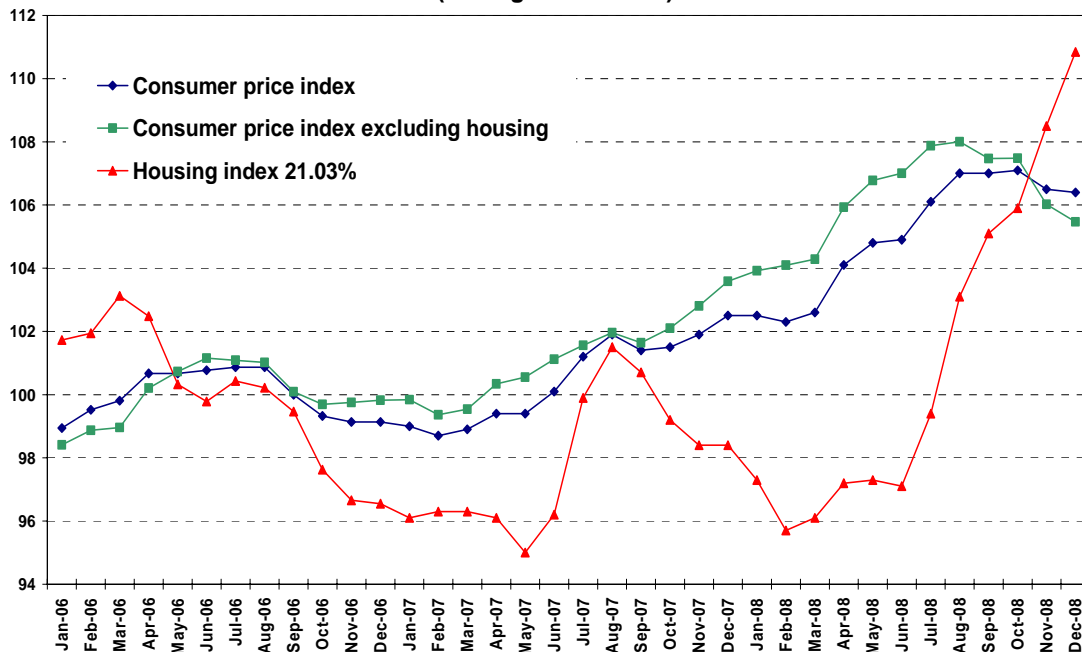


Our **current growth estimate** is near zero in the last quarter of 2008 and negative in the first quarter of 2009.

Inflation expectations calculated by the Bank of Israel were at negative 0.1 percent for the first year and positive 0.7 percent for the second year, on average between mid-December and mid-January – still low, but up significantly from the average in December. Expectations from the third year forward remained at 2.5 percent. Concurrently, the **amount of means of payment** rose sharply, by 4.0 percent in December and 17.5 percent in the last twelve months.

The **consumer price index** decreased by only 0.1 percent in December. Our estimate was 0.2 percent, while most other forecasts called for a far sharper decrease. Inflation in 2008 totaled 3.8 percent, above target. As in the previous months, housing prices rose sharply in December, by 2.2 percent; the total increase in housing prices over the last six months is 13.4 percent.

Consumer price index and the Housing price index (Average 2006 = 100)



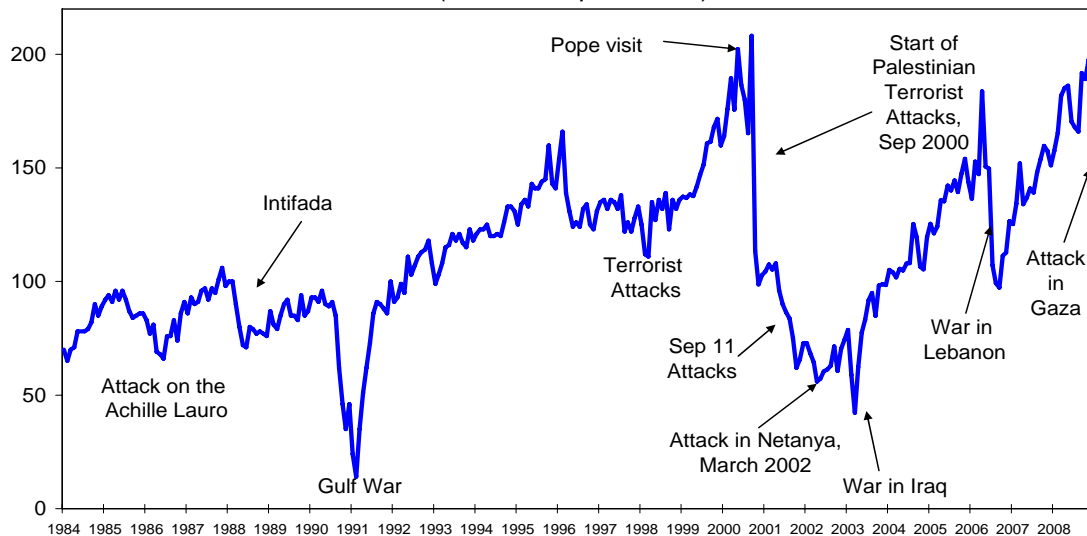
As we predicted in the middle of last year, housing prices have now corrected for the large erosion of the housing item in the preceding period, which resulted from the linkage of rent prices to the dollar and the decline of the dollar exchange rate. We believe that this correction has nearly run its course, and housing prices will rise much more moderately in the coming months.

We expect **another interest-rate reduction** by the BOI on January 26th, likely by 0.5 percentage points. If there is no significant depreciation of the shekel, an additional rate cut is expected in late February.

State tax revenues were exceptionally low in December, at ILS 12.7 billion. The **budget deficit** for 2008 totaled 2.1 percent of GDP, versus the planned 1.6 percent. These figures reinforce our estimate that **a severe budgetary problem will arise in 2009**, and possibly in the subsequent years as well. Our updated forecast, following the data for December, indicates a tax revenue shortfall of ILS 35 billion, or 4.5 percent of GDP, in 2009.

Incoming tourism by air decreased by a steep 23 percent in December, based on data net of seasonal effects, and increased by 1 percent in the last twelve months. The decline in incoming tourism in December was affected by the fighting in Gaza in the final third of the month, but probably also reflected a downturn in global tourism as a result of the worsening recession in the advanced countries.

Tourist Arrivals (thousands per month)

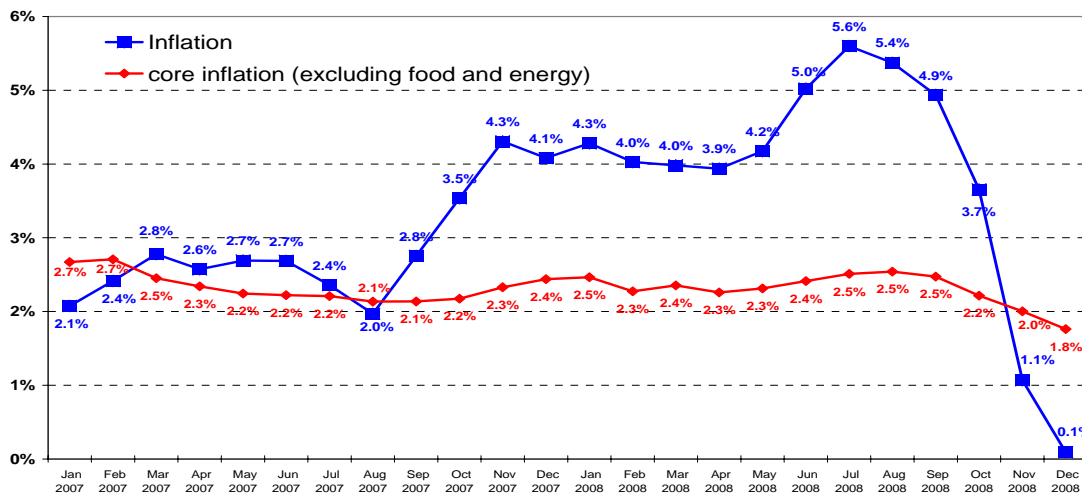


The discovery of commercial quantities of natural gas at the Tamar 1 drilling site was announced this week. If it does become apparent that immense quantities are involved, the main macro-economic effect to be expected is strengthening of the **shekel** against other currencies. However, at this stage our estimate remains that the **probability of depreciation** of the shekel later this year is greater than the probability of appreciation, based on our estimates regarding BOI monetary policy.

United States

The consumer price index decreased by 0.7 percent, versus an expected 0.9 percent decrease. The core index remained unchanged, versus estimates of a 0.1 percent increase. **Inflation** in the last twelve months dropped sharply to just 0.1 percent in December, from 4.9 percent in September.

USA: Inflation rate during the past 12 month



Barack Obama takes office as **President of the United States** today. The elected President has announced that he will put through a stimulus plan on an immense scale in an attempt to support the American economy, in addition to the USD 350 billion of the TARP. The final scope of the plan, the speed of its approval, and the manner of its implementation will provide a better understanding of its effectiveness and impact on the global economy.

Important Announcements in the Coming Week

- Data on construction starts and permits will be published in the United States on Thursday, January 22nd.
- The BOI will announce its interest-rate decision on Monday, January 26th.

This review is posted online at www.harel-finance.co.il/macro in Hebrew

and at www.harel-finance.co.il/macro/ENG in English.

Please address comments or questions to Mr. Ofer Klein at

oferk@harel-finance.co.il

If you would like to be removed from the Harel Group mailing list, please let us know in a reply to this e-mail.