

## Weekly Macroeconomic Review

July 21, 2009

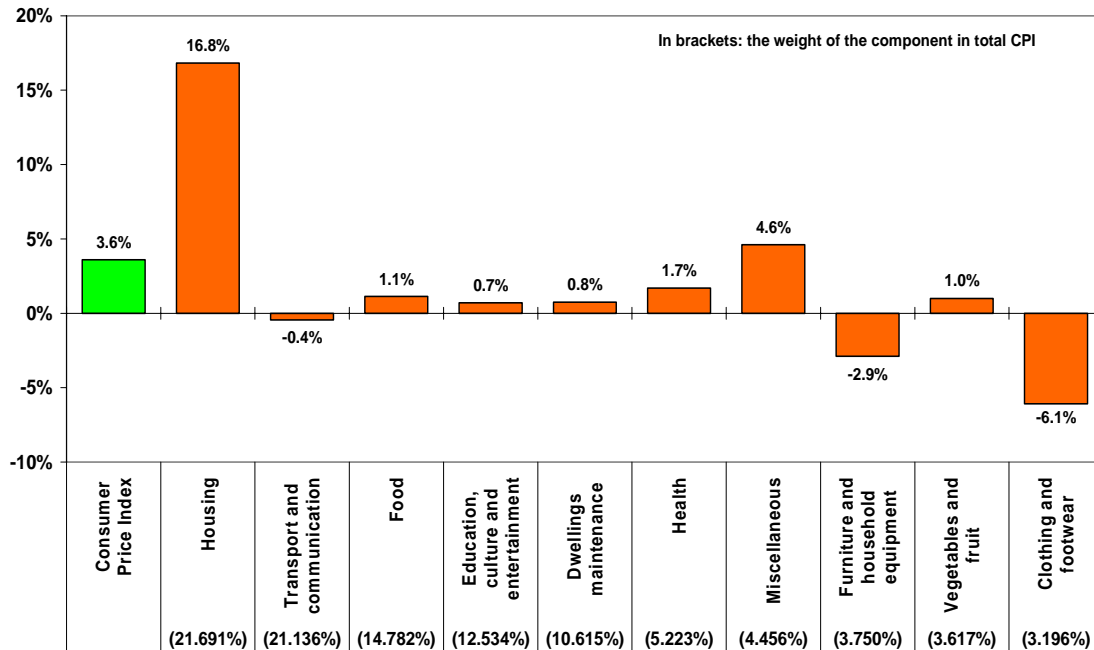
	Expectations derived from the capital market	Our forecast
Inflation in the coming months		1.0% in July 0.5% in August
Future cumulative inflation – next 12 CPIs (through June 2010 CPI)		3.1%
Inflation through July 2011 CPI (average annual rate)	3.1%	2.7%
Bank of Israel interest rate, 6 months ahead	1.40% (up 0.90)	1.00%
Fed interest rate, 6 months ahead	0.40% (up 0.15)	0.25%
Yield on Israeli Government 10-Year bond, 6 months ahead	5.73% (up 0.32)	5.73%
Yield on US Treasury 10-Year bond, 6 months ahead	3.84% (up 0.24)	4.00%
Dollar exchange rate, 6 months ahead	NIS 3.89 (unchanged)	NIS 3.89 (unchanged)

## Israel

The consumer price index rose by 0.9 percent in June, far above our estimate and those of other forecasters. The housing item showed a surprising 0.5 percent increase, despite the appreciation of the shekel during the relevant period. The transportation and communications item also rose far more than expected, by 2.6 percent. Inflation in the twelve months through June reached 3.6 percent, above the upper limit of the target range; the housing item, which has gained about 17 percent in the last twelve months, is the main culprit. The next item is the "miscellaneous" item, which rose by 4.6 percent, but about half of this increase resulted from the increased taxes on cigarettes.



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



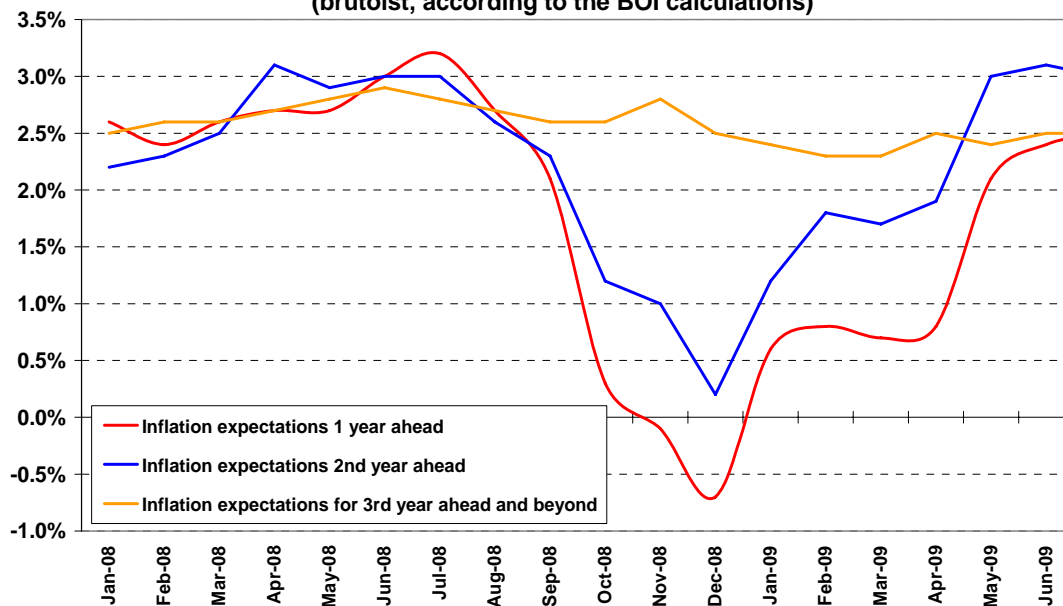
In our opinion, the pace of the increase in the housing item will weaken considerably in the coming months. However, both inflation and inflation expectations are much higher in Israel than in other countries, and the recession is weaker in Israel than elsewhere; thus, the probability of an interest-rate hike by the Bank of Israel within the coming few months, before other central banks raise rates globally, has grown. We also believe that the intervention in the foreign-currency market will be phased out over the next few months.

Due to the high CPI and the expectation of an earlier start to the increase in the BOI interest rate, yields of **unlinked government bonds** increased all across the curve. However, the **shekel** did not gain strength against the major currencies. We have slightly changed our forecast regarding the exchange rate, from moderate depreciation of the shekel to stability. According to calculations by the BOI, **inflation expectations** between mid-June and mid-July were at 2.4 percent on average for the first year, 3.0 percent for the second year, and 2.5 percent for the third year and beyond, similar to the preceding month, but much higher (for the first and second years) than in the previous months.

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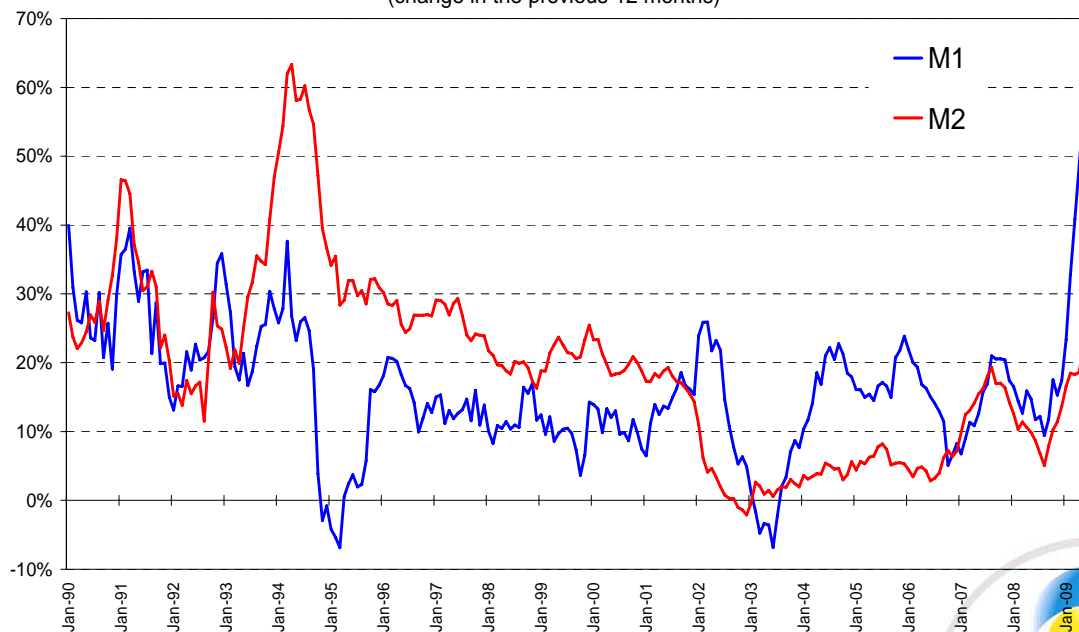
**Inflation expectations derived by the capital market  
(brutoist, according to the BOI calculations)**



The quantity of means of payment has continued to expand, though at a slower pace compared to previous months. Means of payment grew by 56.5 percent in the last twelve months, a record of many years.

**Money Aggregator**

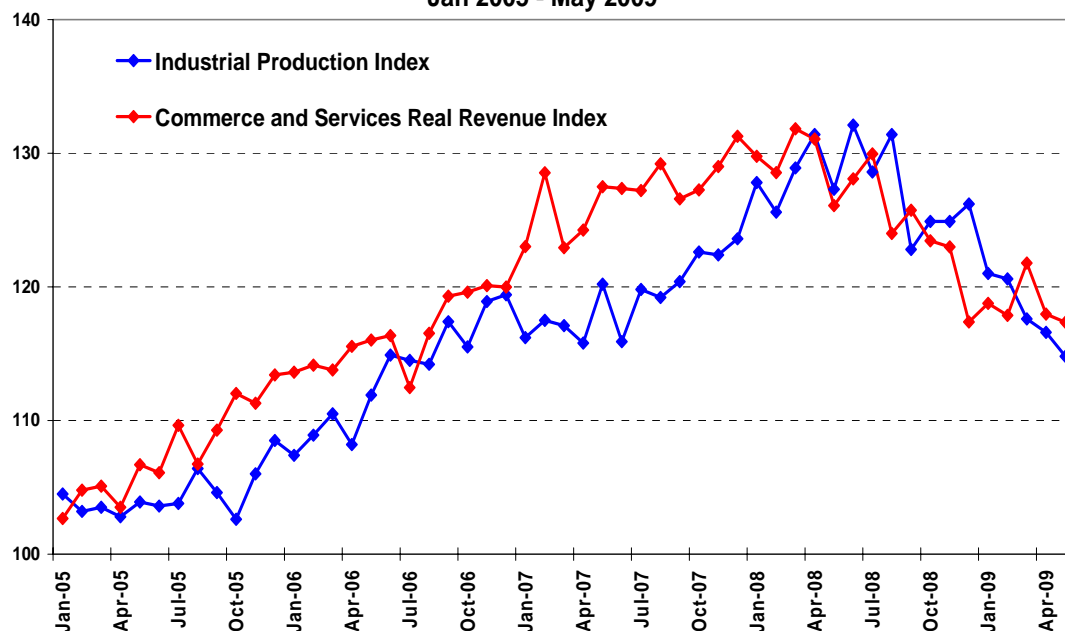
(change in the previous 12 months)



The Central Bureau of Statistics has adjusted first-quarter GDP data slightly upward. The **growth rate** was revised to a negative 3.7 percent, from a negative 3.9 percent in the previous estimate, with a more moderate decline in exports.

Industrial production and trade and service revenues declined again in May. The **industrial production index** fell by 1.5 percent in May and 10 percent in the twelve months ended in May, while the **trade and service sectors revenue index** decreased by 0.5 percent in April and 7 percent in the twelve months ended in April.

**Industrial Production Index  
& Commerce and Services Sectors Revenue Index**  
Jan 2005 - May 2009



The Bank of Israel's **composite index** rose by 0.2 percent in June. This index decreased by 2.4 percent on average in the second quarter of 2009, following a 4.3 percent decrease in the first quarter.

According to indicators published to date, it appears that GDP decreased further in the second quarter, though apparently more moderately than in the first quarter, mainly thanks to a relative improvement in exports.

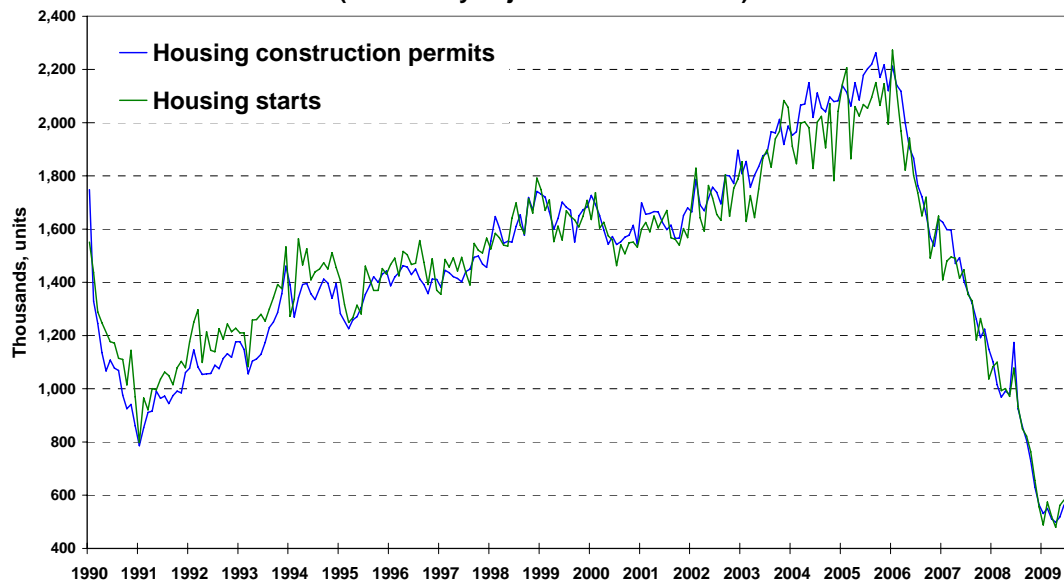
## United States

The consumer price index rose by 0.7 percent in June, in line with expectations, and inflation in the twelve months ended in June reached a negative 1.4 percent. The core index, excluding food products and energy, rose by 0.2 percent, as expected, while core inflation totaled 1.7 percent.

Construction starts and permits surprisingly increased by 4 and 9 percent respectively, but remained about 50 percent lower than a year ago.

### US housing permits and housing starts

(Seasonally adjusted at annual rate)



## Euro zone

In line with the initial estimate, inflation in June stood at a negative 0.1 percent.

## Recommended activity in the capital market

- In our opinion, unlinked government bonds are currently preferable to CPI-linked bonds for short and medium durations (maturity up to 2015). The gap between unlinked yields and CPI-linked yields increased following publication of the CPI, and now stands at approximately 3 percent in the short and medium terms. In our opinion, the surprisingly high June CPI is largely accounted for by the housing item, which should not greatly affect inflation expectations for the coming months, and certainly not for the longer term.

## Important Announcements in the Coming Week

- Data on sales of existing homes will be published in the United States on Thursday, July 23.
- The initial estimate of growth in the second quarter will be published in the UK, and the University of Michigan's consumer confidence index will be published in the US, on Friday, July 24.
- The Bank of Israel's interest-rate decision will be announced, and data on sales of new homes will be published in the US, on Monday, July 27.

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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