

Weekly Macroeconomic Review

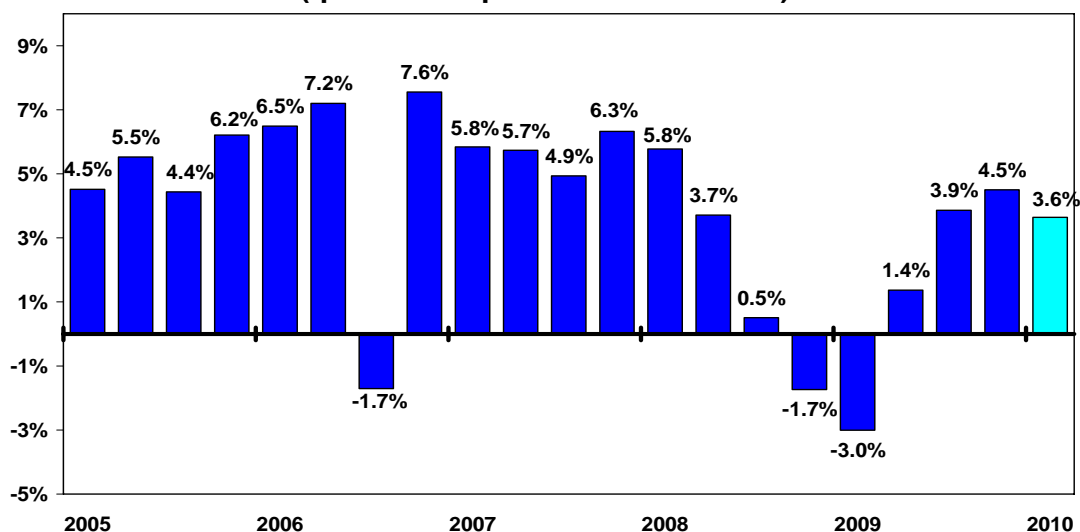
June 22, 2010

	Expectations derived from the capital market	Our forecast
Inflation in the coming months		0.2% in June 0.5% in July
Future cumulative inflation – next 12 CPIs (through May 2011 CPI)		2.6%
Inflation through July 2011 CPI (average annual rate)	3.1%	3.4%
Bank of Israel interest rate, 6 months ahead	2.00% (up 0.50)	2.25%
Fed interest rate, 6 months ahead	0.30% (up 0.05)	0.30%
Yield on Israeli Government 10-Year bond, 6 months ahead	4.93% (up 0.20)	5.10%
Yield on US Treasury 10-Year bond, 6 months ahead	3.46% (up 0.22)	4.00%
Dollar exchange rate, 6 months ahead	NIS 3.83 (unchanged)	NIS 3.83

Israel

Israel's Central Bureau of Statistics has updated the **growth rate for the first quarter of 2010** to 3.6 percent, annualized, from its earlier estimate of 3.3 percent a month ago. Real GDP grew by 1.5 percent over the last four quarters (up from 1.1 percent in the previous estimate), and GDP prices rose by 1.5 percent (versus 0.9 percent in the previous estimate). As a result, the nominal GDP for the first quarter was adjusted upward by nearly 1 percent, a very substantial revision. Major changes were also made to the estimates of GDP components; in particular, data on exports of goods were revised upward.

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

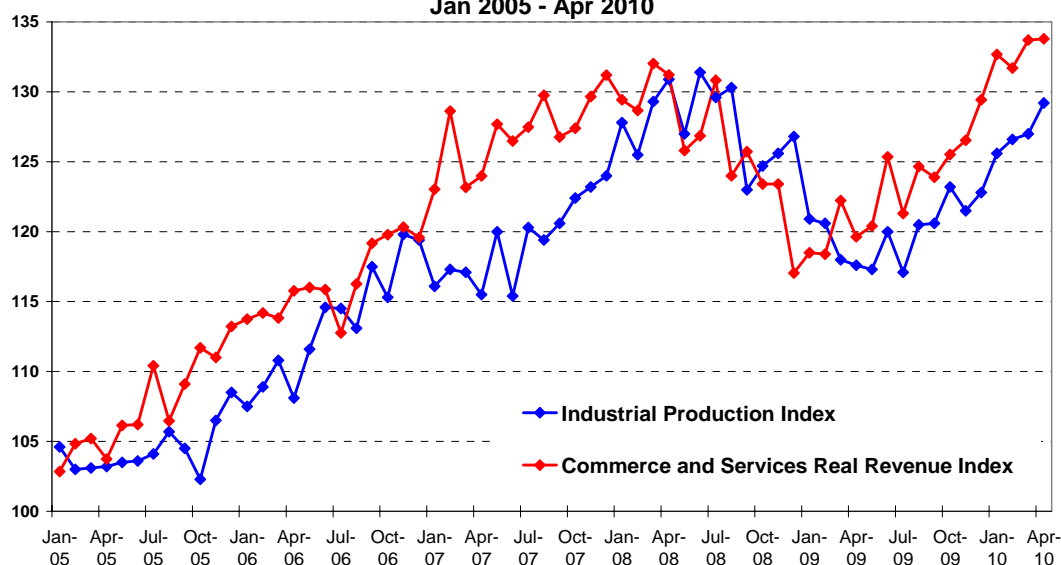


The consumer price index rose by 0.4 percent in April, in line with our forecast. Other forecasts had a similar average as well. **Twelve-month inflation** reached 3.0 percent. There were almost no surprises in the CPI components relative to our estimates. The **housing item**, which mainly reflects rent prices, rose by 0.7 percent. Prices of tenant-owned homes continued to rise in the latest survey, gaining 0.6 percent, slightly less than in the preceding months. **Prices of homes** rose by 21 percent in the twelve months ended in April.

Inflation expectations between mid-May and mid-June, according to calculations by the Bank of Israel, were at an average of 2.8 percent for the first year, 2.6 percent for the second year, and 2.8 percent from the third year forward, similar to the preceding months. However, inflation expectations appear to have increased considerably after mid-June, especially in the medium term.

The **trade and service sectors revenue index** remained almost unchanged in April, and gained 12 percent in the twelve months ended in April. The **industrial production index** rose by 2 percent for the month and by 10 percent in the twelve months ended in April.

**Industrial Production Index
& Commerce and Services Sectors Revenue Index**
Jan 2005 - Apr 2010



The interest-rate decision: As in the preceding months, our recommendation regarding the interest rate differs from our forecast: We believe that the current situation demands an increase of the interest rate, but we estimate that there is a significant probability that the Bank of Israel will maintain its policy of substantial monetary expansion and will avoid raising the interest rate at the necessary speed.

Based on the signs of a slowdown in growth, the uncertainty concerning growth in Europe, and especially the sharp decline in exports of goods in the last two months, the Bank of Israel would prefer not to raise the interest rate this month. However, the increase in inflation expectations over the last week, the upward revision of the growth and export data for the first quarter, and the continued increase in prices of homes support an increase in the interest rate. We therefore estimate a probability of slightly more than 50 percent of an increase of the BOI interest rate on June 28.

China

The central bank of China has declared that it **will allow greater flexibility in the exchange rate of the yuan**. This likely does not yet refer to a significant, immediate appreciation of the Chinese currency, instead indicating slow, crawling appreciation. Nonetheless, this is good news for the global economy, particularly the United States and Western Europe.

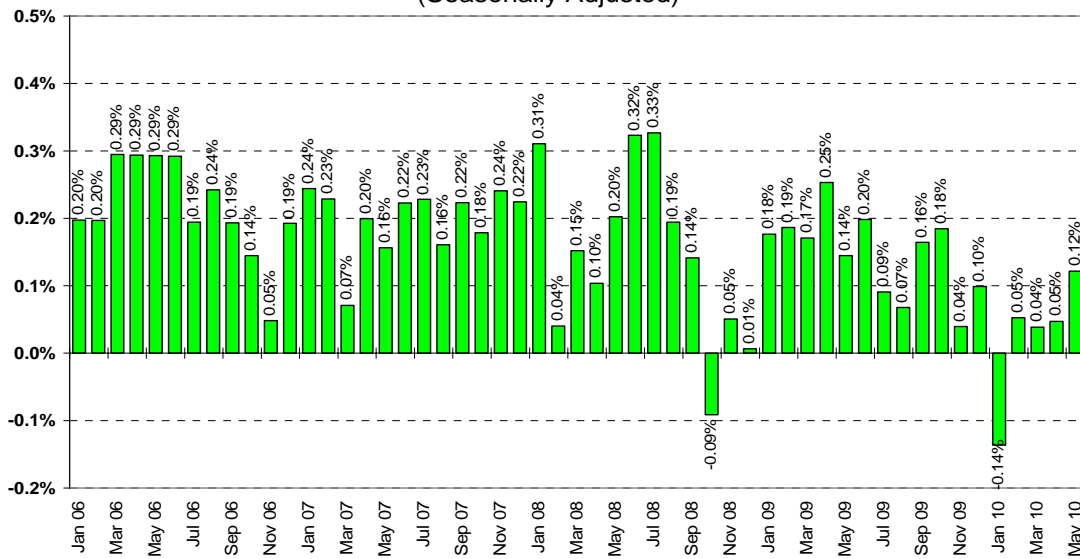
In the event of significant appreciation of the Chinese currency over the coming years, Western countries will see stronger exports and weaker imports, and the US and Europe will be able to reduce their budget deficits with more moderate damage to growth. In terms of the stock markets, the appreciation of the yuan (if it is in fact significant) will help the shares of exporting companies in the US and Europe, but not those of companies manufacturing for local consumption.

In addition, appreciation of the yuan will damage prices of US government bonds, as the Chinese will need to buy less foreign-currency reserves.

United States

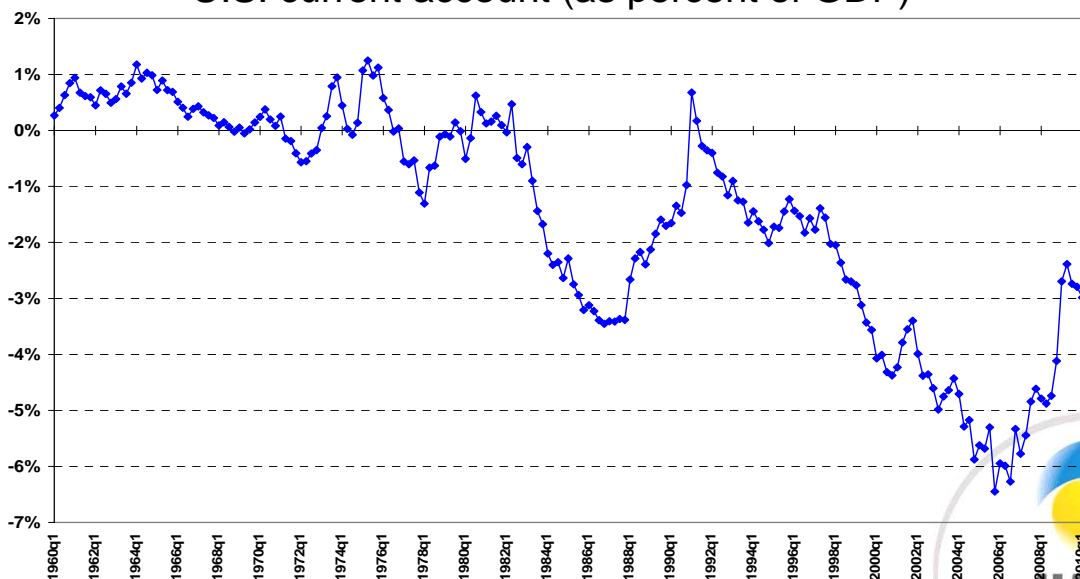
Inflation data were close to expectations. The **consumer price index** fell by 0.2 percent, and twelve-month inflation reached 2.2 percent. The **core index** rose by 0.12 percent, and twelve-month core inflation was 0.9 percent. The increase in the core index was the largest in seven months, but still small in historical terms.

USA: monthly change in Core CPI (Seasonally Adjusted)



The deficit in the current account of the balance of payments expanded to 3.0 percent of GDP in the first quarter of 2010, versus 2.8 percent of GDP in the fourth quarter of 2009, and a low of 2.4 percent of GDP in the second quarter of 2009. In our opinion, this is an anticipated process of expansion of the deficit in the current account due to the resurgence of growth and investments in the American economy. The deficit is expected to continue to expand in the coming years, barring significant depreciation of the dollar.

U.S. current account (as percent of GDP)



Data on construction starts and permits were disappointing, with a 10 percent and 6 percent decline, respectively, below expectations.

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

Forecast change, May 2010 to August 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)
1.1%	3.2%	5.6%	1.2%	1.3%

Important Announcements in the Coming Week

- Data on sales of existing homes will be published in the US on Tuesday, June 22.
- Data on sales of new homes and the Fed's interest-rate decision will be published in the US on Wednesday, June 23.
- An update of the growth rate for the first quarter of 2010 and the University of Michigan's consumer confidence index will be published in the US on Friday, June 25.
- The Bank of Israel will announce its interest-rate decision on Monday, June 28, and data on private income and consumption will be published in the US.

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

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

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