

## Weekly Macroeconomic Review

February 23, 2010

	Expectations derived from the capital market	Our forecast
Inflation in the coming months		Minus 0.4% in February 0.0% in March
Future cumulative inflation – next 12 CPIs (through January 2011 CPI)		2.1%
Inflation through July 2011 CPI (average annual rate)	2.2%	2.6%
Bank of Israel interest rate, 6 months ahead	1.80% (up 0.55)	2.00%
Fed interest rate, 6 months ahead	0.30% (up 0.05)	0.30%
Yield on Israeli Government 10-Year bond, 6 months ahead	5.25% (up 0.25)	5.15%
Yield on US Treasury 10-Year bond, 6 months ahead	4.05% (up 0.26)	4.25%
Dollar exchange rate, 6 months ahead	NIS 3.76 (unchanged)	NIS 3.76 (unchanged)

## Israel

The Bank of Israel interest rate remained unchanged at 1.25 percent, in line with our expectations and those of most economists. Given the lower-than-expected CPI last month, the decrease in means of payment, the decrease in inflation expectations as measured in the capital market, and the more moderate expectations of interest-rate hikes in the US and the euro zone, it was fairly obvious that the BOI would decide to leave the interest rate unchanged for the second consecutive month.

The interest-rate announcement stated that the decision to maintain the February rate unchanged is part of a gradual process of returning the interest rate to a "normal" level. The announcement further said: "The International Monetary Fund has revised its global economic growth forecast upward; however, due to the weak employment figures in the G3 economies, estimates are that the risk of an additional recession is still present, and may have grown."

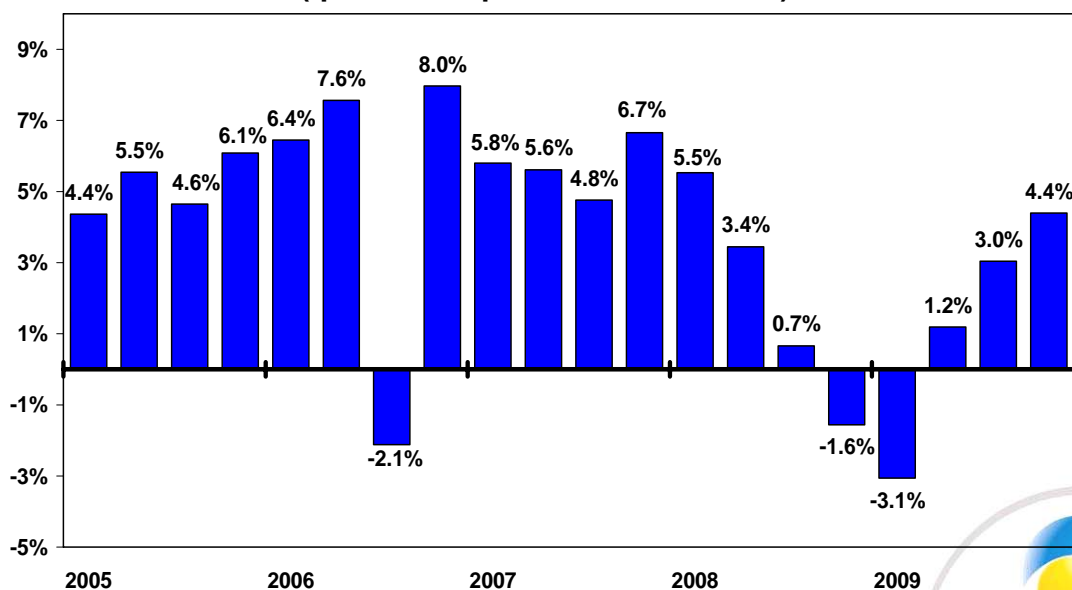
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Nonetheless, most of the parameters reviewed in the BOI's announcement support further increases in the interest rate. Thus, in our opinion the upward trend of the interest rate has only halted temporarily, and will soon resume. The probability of an interest-rate hike at the end of March is currently slightly less than 50 percent, but if the interest rate does not rise at that time, it is likely to do so at the end of April. Of course, this probability could change over the coming weeks, according to economic data published and developments in the capital markets, especially in the foreign-currency market (in our opinion, appreciation of the shekel serves as a substitute for increases in the interest rate).

**Growth in the fourth quarter of 2009**, according to the initial estimate, was 4.4 percent in annualized terms, similar to early estimates by the Central Bureau of Statistics and the BOI. The **business product** expanded by 4.2 percent. **Private consumption** grew at an annualized rate of 4 percent. **Exports** (excluding diamonds and start-up companies) grew by 16 percent. However, **investments** in fixed assets decreased, at an annualized rate of 9 percent. **Data for previous quarters** were not significantly updated. **Annual growth** in 2009 totaled 0.5 percent.

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

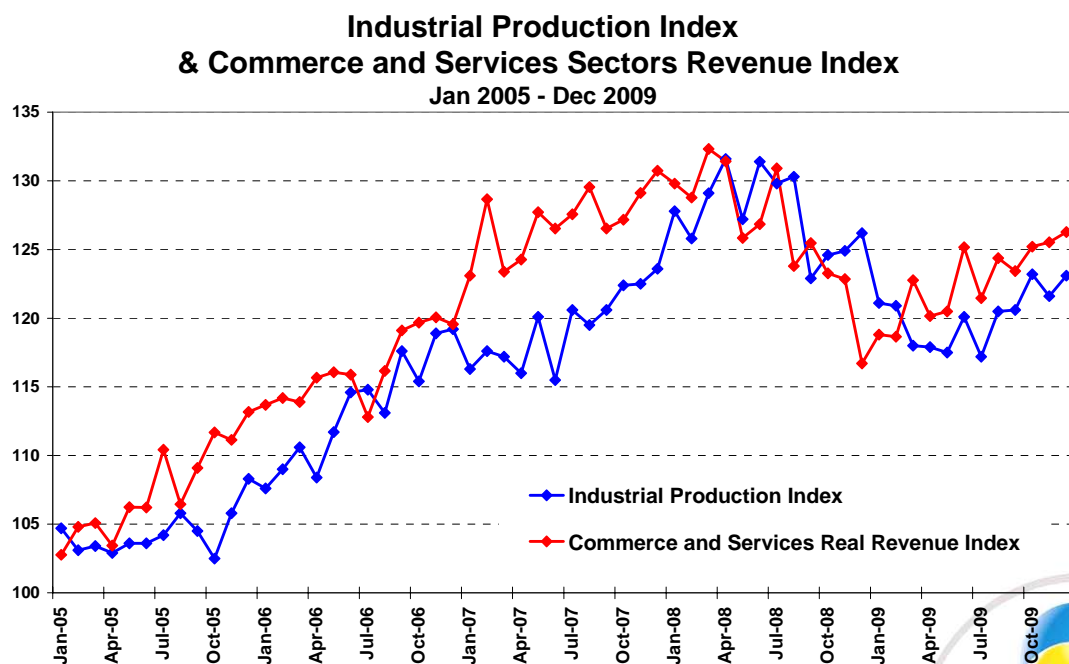


The BOI's forecast of 3.5 percent growth in 2010 still seems overly optimistic to us, in that for this forecast to materialize the necessary growth rate in each quarter of 2010 would be approximately 4 percent. This is a plausible scenario, but our central scenario is less optimistic.

According to the BOI, **inflation expectations** between mid-January and mid-February were at an average of 2.8 percent for the first year, 2.8 percent for the second year, and 2.5 percent from the third year forward. The data reflect an increase in expectations in the first year, but a decrease in expectations for the longer term. However, inflation expectations appear to have decreased since mid-February.

The amount of means of payment decreased by 2 percent in January, and the twelve-month increase fell to 44 percent (from a peak of 65 percent in August 2009).

The industrial production index rose by 1.2 percent in December and fell by 2.5 percent in the twelve months ended in December. The trade and service sectors revenue index rose by 0.6 percent in December and by 8.2 percent in the twelve months ended in December.

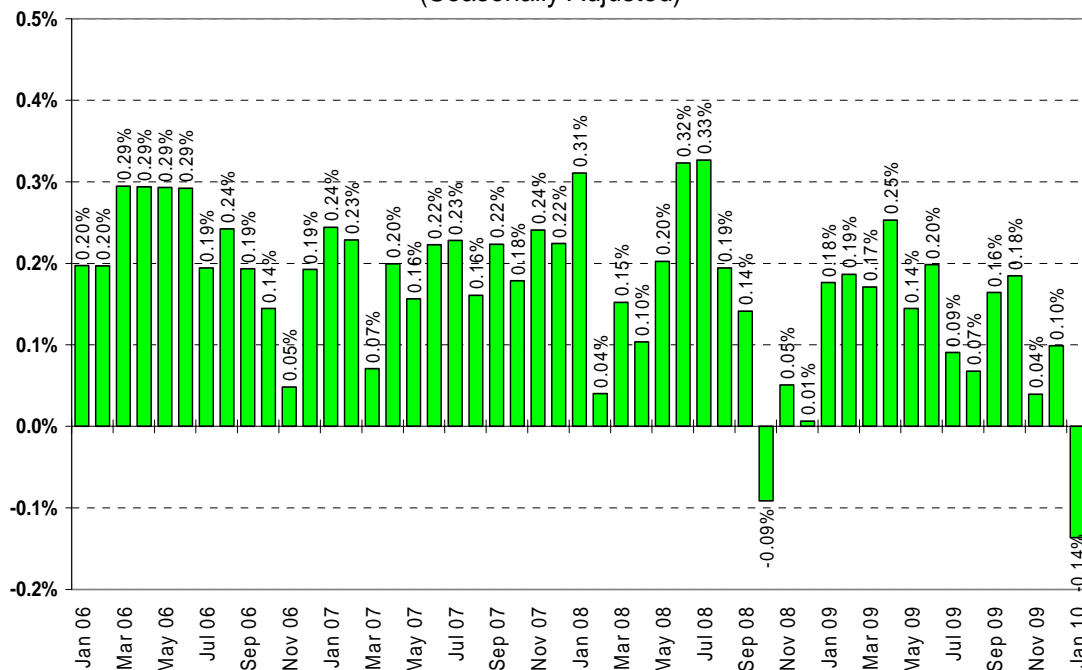


## United States

The Fed announced an increase of the discount interest rate collected by the central bank from banks, to 0.75 percent; the spread between the discount rate and the Fed rate grew to 0.5 percentage points, similar to the spread prior to the escalation of the economic crisis in 2008.

The consumer price index rose by 0.2 percent in January, and inflation stood at 2.6 percent. The core index surprisingly fell by 0.14 percent, the steepest drop in many years. In our opinion, any further declines in the core index in the coming months will delay the start of interest-rate hikes by the Fed.

USA: monthly change in Core CPI  
(Seasonally Adjusted)



Construction starts increased by 3 percent, and construction permits decreased by 5 percent, in line with estimates.

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

Forecast change, January 2010 to April 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)
0.4%	1.7%	5.4%	0.5%	0.0%

## Important Announcements in the Coming Week

- Israel's Central Bureau of Statistics will publish data on sales of new homes on Tuesday, February 23.
- Data on sales of new homes will be published in the US on Wednesday, February 24.
- Updates of the growth rate for the fourth quarter of 2009 will be published in the UK and the US on Thursday, February 26. Data on sales of existing homes and the University of Michigan's consumer confidence index will be published in the US.
- On Sunday, February 28, the CBS will publish data on construction starts and completions for the fourth quarter of 2009, and data on the employment survey for the fourth quarter of 2009, including the unemployment rate.
- Data on private income and consumption will be published in the US on Monday, March 1.



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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