

Weekly Macroeconomic Review

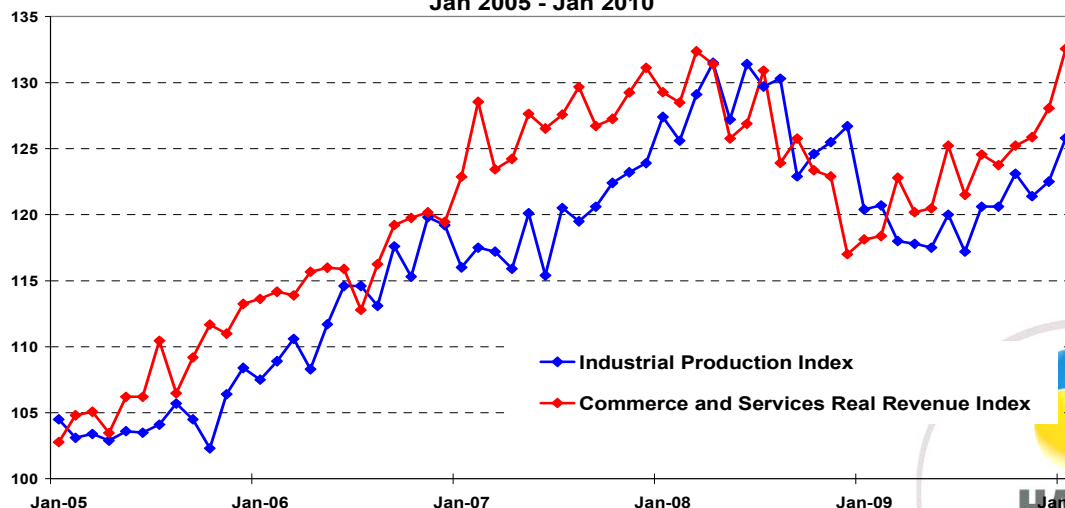
March 23, 2010

	Expectations derived from the capital market	Our forecast
Inflation in the coming months		0.1% in March 0.9% in April
Future cumulative inflation – next 12 CPIs (through February 2011 CPI)		2.5%
Inflation through July 2011 CPI (average annual rate)	3.0%	3.0%
Bank of Israel interest rate, 6 months ahead	2.10% (up 0.85)	2.00%
Fed interest rate, 6 months ahead	0.40% (up 0.15)	0.40%
Yield on Israeli Government 10-Year bond, 6 months ahead	5.16% (up 0.23)	5.15%
Yield on US Treasury 10-Year bond, 6 months ahead	3.89% (up 0.25)	4.25%
Dollar exchange rate, 6 months ahead	NIS 3.74 (unchanged)	NIS 3.72 (down 0.5%)

Israel

The industrial production index rose by 3 percent in January and by 4 percent in the twelve months ended in January. The trade and service sectors revenue index rose by 4 percent in January and by 12 percent in the twelve months ended in January.

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



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The data indicate **continued rapid growth** of economic activity in January, following strong growth during the second half of 2009.

The next interest-rate decision, on March 28, will be a difficult one, with a 50 percent probability of a 0.25-point rate hike. Several factors supporting an increase in the interest rate were added over the last week: the upward revision of growth data for the second half of 2009, the rapid increase in industrial production and in trade and service revenues in January, and the slight increase in inflation expectations (both of forecasters and of the bond market).

The only significant obstacle preventing the BOI from raising the interest rate is the pressure towards appreciation of the shekel and the BOI's wish to prevent it. If we were to make a policy recommendation to the Governor of the BOI, we would suggest, first of all, ceasing the intervention in the foreign-currency market, which was justified in the past but is not desirable in the current condition of the economy and of the foreign-currency reserves. Later, if the shekel does in fact appreciate due to the cessation of intervention, it would reduce the need for rapid interest-rate hikes in any case (appreciation reduces actual inflation as well as future inflationary pressures). The current policy of striving for an inflation target on one hand while maintaining a stable currency exchange rate on the other hand cannot be sustained over the long term, given basic pressures from the balance of payments towards appreciation of the shekel, unless it comes at a heavy price of a continual increase in the level of reserves and/or administrative restrictions of capital movements.

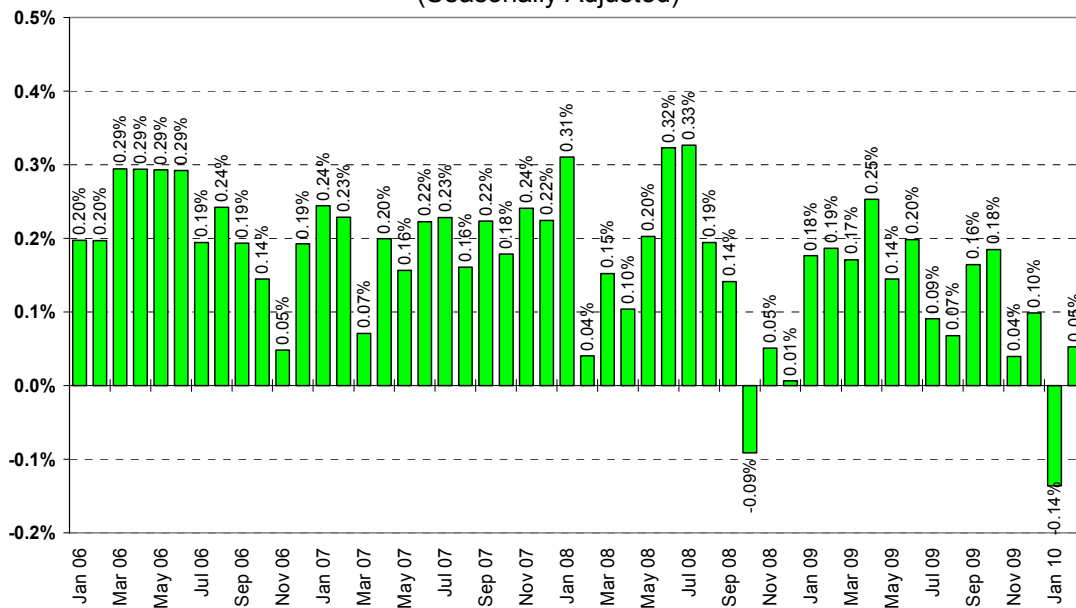
United States

The Fed left the interest rate unchanged at 0-0.25 percent, as expected. The press release again refers to “exceptionally low levels of the federal funds rate for an extended period.” Following this announcement, the expectation for an increase in the interest rate has been pushed back to the end of 2010.



Inflation remained moderate in February. The core index of the CPI rose by only 0.05 percent, while the average for the last four months is close to zero (just 0.01 percent). This contrasts with the preceding ten months (January to October 2009), when core inflation reached a monthly average of 0.16 percent (almost 2 percent annualized).

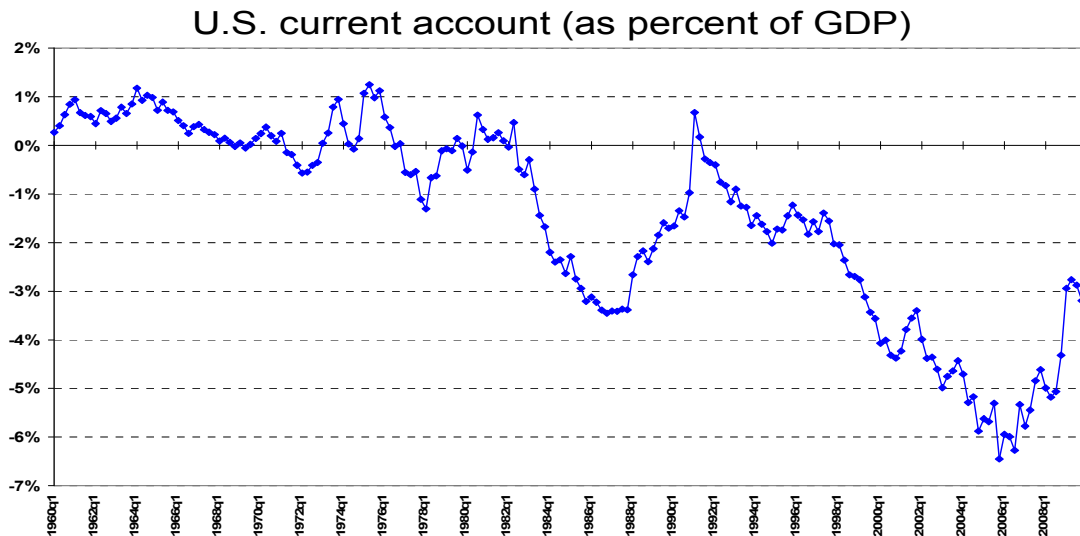
USA: monthly change in Core CPI
(Seasonally Adjusted)



This may represent a step down in core inflation, which if it continues will enable the Fed to postpone the beginning of increases in the interest rate.

The deficit in the current account of the balance of payments expanded slightly in the fourth quarter of 2009 (3.2 percent of GDP, versus 2.9 percent of GDP in the third quarter, and a low of 2.8 percent of GDP in the second quarter). In our opinion, this reflects the anticipated process of expansion of the deficit in the current account, due to the recovery in growth and investments in the American economy. The deficit is expected to expand further in the coming years, unless significant depreciation of the dollar occurs.





The health-care reform in the US has been approved in a vote by Congress. The key element of the reform is the expansion of insurance coverage to most American citizens who had not been covered until now. The estimated cost of the program is USD 1 trillion over the next ten years. The US health-care system suffers from several maladies and distorted incentives, including the exemption from tax on health-care payments of employers, which conceals the true costs of health-care services from employees and contributes to overconsumption of health-care services by employed persons; low competition among hospitals, allowing higher cost collection; and concerns over medical malpractice lawsuits, which cause physicians to order numerous tests for patients, some of which are unnecessary, generating substantial waste. As a result of these distortions, the US health-care system is far more expensive than the systems in other advanced countries (the cost as a percentage of GDP is almost double), while its performance is quite similar to that of the other systems.

The reform approved by Congress contains a number of moderate cost reduction measures, but will not correct most of the distortions in the system, thus squandering a historic opportunity for significant changes in the structure and financing method of the health-care system. The high cost of the program, especially during a period of low growth and high unemployment, is likely to weigh down future government deficits and support an increase in long-term yields.

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

Forecast change, February 2010 to May 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)
1.3%	1.9%	4.8%	0.8%	0.3%

Important Announcements in the Coming 2 Weeks

- Data on sales of existing homes will be published in the US on Tuesday, March 23.
- Data on sales of new homes will be published in the US on Wednesday, March 24.
- An update of the growth rate in the fourth quarter of 2009 and the University of Michigan's consumer confidence index will be published in the US on Friday, March 26.
- The Bank of Israel's interest-rate decision will be announced on Sunday, March 28. The Central Bureau of Statistics will publish data on sales of new homes.
- Data on private income and consumption will be published in the US on Monday, March 29.
- The Case-Shiller index of housing prices will be published on Tuesday, March 30.
- The estimated consumer price index and unemployment rate will be published in the euro zone on Wednesday, March 31.
- The ISM manufacturing sector index will be published in the US on Thursday, April 1.
- The employment report will be published in the US on Friday, April 2.
- The ISM services sector index will be published in the US on Monday, April 5.

Happy Passover to all of our readers! There will be no weekly review next week.



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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