

Weekly Macroeconomic Review

March 24, 2009

	Expectations derived from the capital market	Our forecast
Inflation in the coming months		0.2% in March 1.0% in April
Future cumulative inflation – next 12 CPIs (through February 2010)		1.9%
Inflation through May 2010 CPI (average annual rate)	0.9%	2.7%
Bank of Israel interest rate, 6 months ahead	0.90% (up 0.40)	0.75%
Fed interest rate, 6 months ahead	0.40% (up 0.15)	0.25%
Dollar exchange rate, 6 months ahead	NIS 4.04 (unchanged)	NIS 4.13 (up 2.2%)

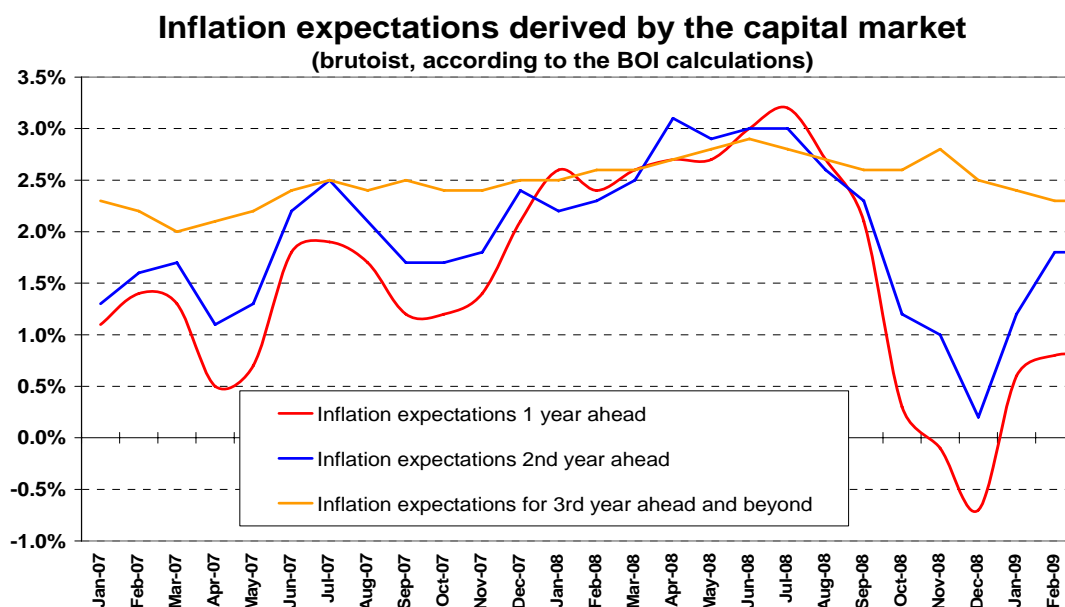
Israel

The Bank of Israel has lowered the interest rate by 0.25 percentage point to just 0.5 percent, in line with our expectations. The BOI's announcement contained no hints of its forthcoming steps, but based on its past statements we may deduce that the **current interest rate is likely to be the bottom limit**. From now on, the BOI can be expected to apply monetary expansion (increasing the amount of money in the economy) using other means, such as purchasing assets while "printing" money. The BOI deliberately left its intentions vague in the interest-rate announcement in order to grant itself as much flexibility as possible in the future. In our opinion, if the BOI believes that the most severe crisis lies in exports, it will decide to continue to buy foreign currency, as aside from increasing the amount of money such purchases also cause currency depreciation, which supports exports. On the other hand, if it believes that the most critical problem is in the area of credit spreads for companies, it may decide to buy corporate bonds.



The BOI has changed its estimates regarding the **budget deficit** and now expects a deficit of 5.2 percent of GDP, up from 4.1 percent previously. We see this forecast as still too optimistic and estimate that the deficit will be much higher, at 6 percent of GDP or more. The BOI also confirmed the reduction of its 2009 **growth estimate** to a negative 1.5 percent, but did not provide a detailed forecast. We find this estimate slightly pessimistic; if it materializes, the deficit will be even larger.

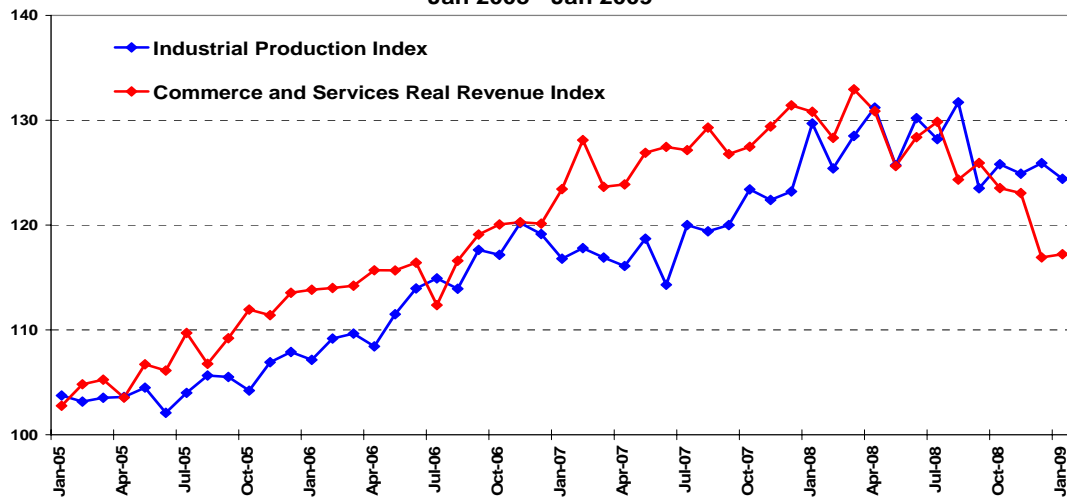
Inflation expectations for the coming year remained stable, at 0.7 percent on average between mid-February and mid-March, similar to the previous month but far higher than the negative inflation expectations in November-December.



The amount of means of payment continued to grow rapidly, rising by 7.5 percent in February, following increases of 3.6 percent in January and 3.9 percent in December. This figure rose by 32 percent in the twelve months ended in February.

Indicators of economic activity in January were weak. The industrial production index fell by 1 percent in January and by 4 percent in the twelve months ended in January. The trade and service sectors revenue index remained almost unchanged in January, and fell by 10 percent in the twelve months ended in January.

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



United States

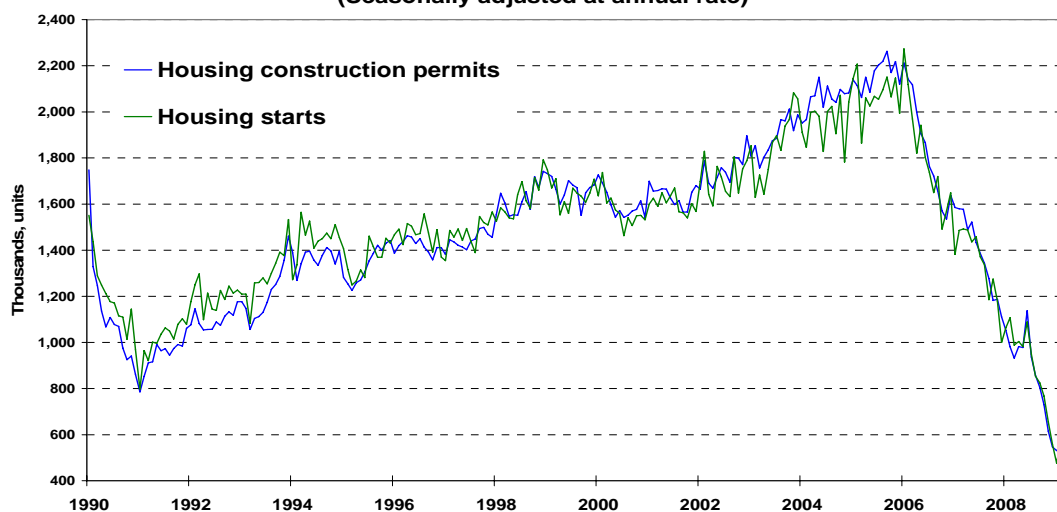
The Fed has announced that it will purchase long-term US government bonds for USD 300 billion over the next six months. In line with estimates, the Fed left the interest rate unchanged. The announcement was not much of a surprise, as the Fed had recently hinted at this move; however, government-bond yields dropped sharply after the publication, possibly due to investors' assessment of the amount as significant.

The government has presented a plan for dealing with the "toxic" assets held by the financial system. According to the plan, the government will invest USD 75-100 billion and grant additional subsidies in the form of low-interest loans to investment funds willing to buy the "toxic" assets held by the financial system. The government will encourage pension funds and insurance companies to join this process; it hopes for a total of USD 500 billion in toxic assets to be purchased. The administration has also mentioned the possibility of expanding this plan in the future, to total purchases of USD 1 trillion. The plan is similar in structure to the leverage funds being established by the Finance Ministry in Israel, although, of course, the types of assets to be purchased are different: In Israel, the assets in question are corporate bonds, while in the US they are problematic assets held by banks and other financial institutions, mainly related to the mortgage market.

A plan of this kind requires capabilities of good planning and meticulous management by the government of the process of establishing the investment funds, and correct pricing of the government aid granted to the funds. If the administration carries it out properly, we believe there is a real chance that the plan will significantly reduce uncertainty in the financial system, renew the flow of credit to firms and households, and shorten the recession in economic activity. Yet given the considerable technical difficulties facing both the planning and execution of the plan, its success is not certain at this point.

In contrast to expectations, **construction starts** increased by 22 percent in February, the first gain in ten months, while the **number of construction permits** grew by 3 percent. However, these figures decreased by 48 percent and 44 percent, respectively, in the twelve months ended in February.

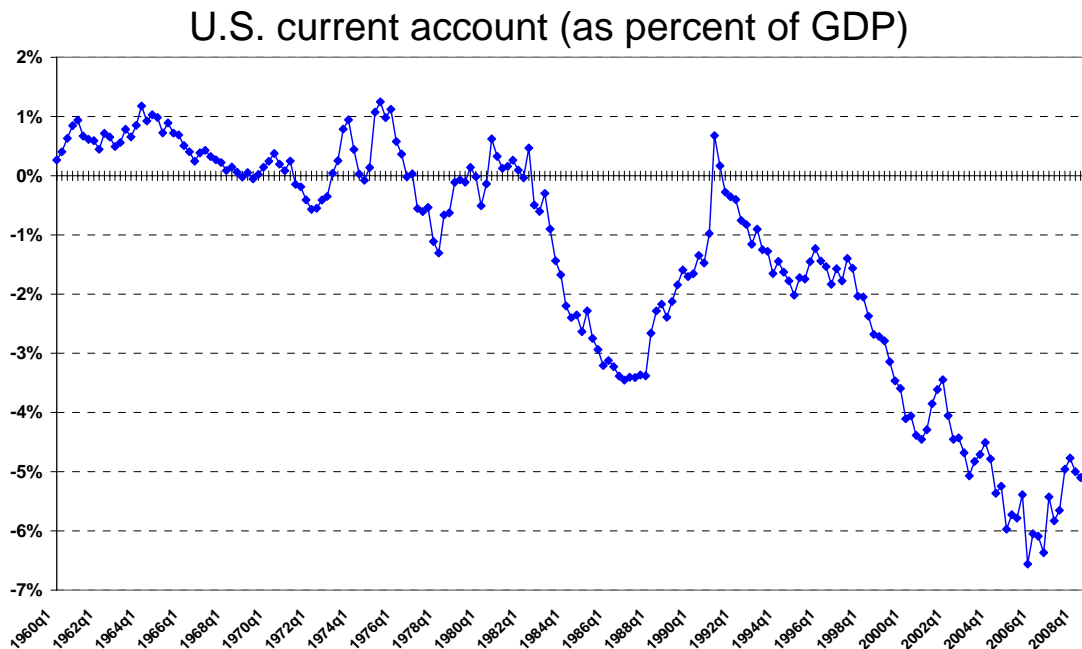
US housing permits and housing starts (Seasonally adjusted at annual rate)



Sales of existing homes rose by 5 percent in February, versus expectations of a slight decline. **Housing prices** remained almost unchanged, in contrast to the continuous decrease in prices since June 2008.

The consumer price index rose by 0.4 percent in February, versus estimates of a 0.3 percent increase. Inflation in the twelve months ended in February totaled 0.2 percent. **The core index**, excluding food and energy products, rose by 0.2 percent, versus an expected increase of 0.1 percent; core inflation totaled 1.8 percent.

The deficit in the current account of the balance of payments narrowed sharply in the fourth quarter of 2008, to 3.7 percent of GDP, from 5.0 percent in the third quarter and 5.1 percent in the second quarter. This was the lowest rate of the deficit as a percentage of GDP since the fourth quarter of 2001.



The decrease in the trade deficit in the fourth quarter, as imports of goods dropped more sharply than exports of goods due to factors including the decline in oil prices, contributed greatly to the improvement in the balance.

Important Announcements in the Coming Week

- Data on sales of new homes will be published in the US on Wednesday, March 25th.
- An update of the fourth-quarter growth rate in the US will be published on Thursday, March 26th.
- The University of Michigan's consumer confidence index and private consumption data will be published in the US on Friday, March 27th.

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