

Weekly Macroeconomic Review

November 24, 2009

	Expectations derived from the capital market	Our forecast
Inflation in the coming months		0.3% in November 0.3% in December
Future cumulative inflation – next 12 CPIs (through October 2010 CPI)		2.8%
Inflation through July 2011 CPI (average annual rate)	2.8%	2.6%
Bank of Israel interest rate, 6 months ahead	1.40% (up 0.40)	1.75%
Fed interest rate, 6 months ahead	0.25% (unchanged)	0.35%
Yield on Israeli Government 10-Year bond, 6 months ahead	5.10% (up 0.26)	5.25%
Yield on US Treasury 10-Year bond, 6 months ahead	3.56% (up 0.23)	4.00%
Dollar exchange rate, 6 months ahead	NIS 3.78 (unchanged)	NIS 3.75 (down 1.0%)

Israel

The Bank of Israel's interest rate was raised by 0.25 percentage points to 1.00 percent, in line with our forecast. Most economists estimated that the rate will remain unchanged. Our estimate is for a continued gradual trend of increasing interest rates.

In its interest rate announcement the BOI included no hints regarding future changes in the rate, but it does refer to the main factors which led to the decision to raise the interest this month:

- A mild increase in inflation expectations for the next twelve months was noted last month, bringing them to the upper part of the inflation target range, while reflecting expectations for an interest rate increase over the coming year.

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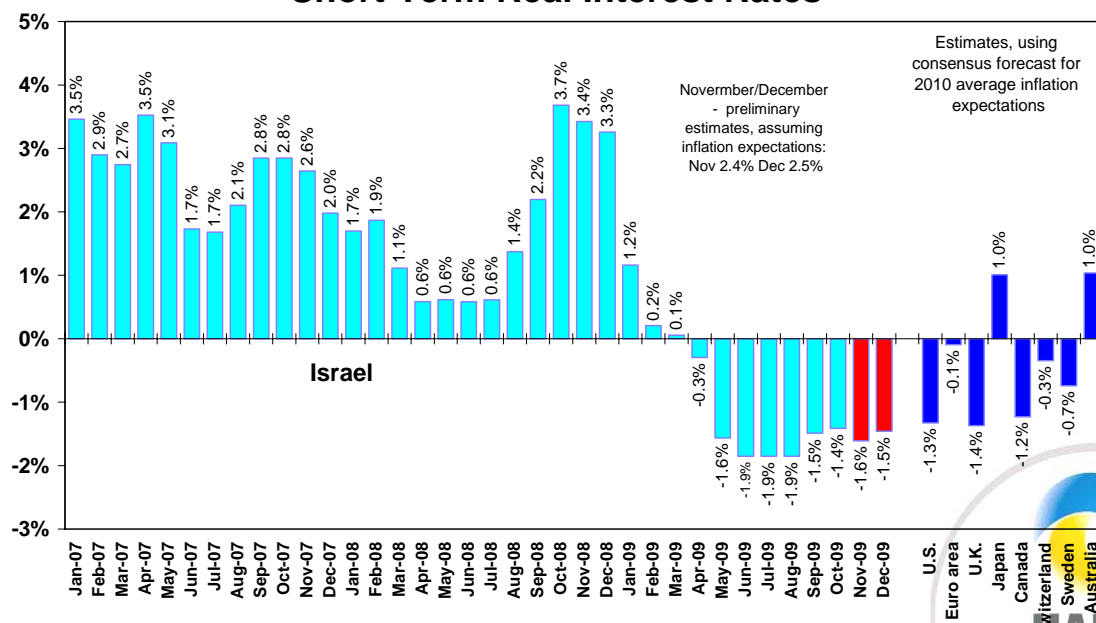


- The recent increase in Israeli exports.
- Interest rates of central banks in the leading economies are at low levels and expected to remain so over the coming months. However, the central banks in the US and Europe have started taking steps indicating gradual emergence from the unusual aspects of the expansive monetary policy. Additionally, some countries where recovery had started to solidify raised their interest rates.

We believe that the critical item that caused the BOI to raise interest rates this month, and which was the reason for our forecast of an increase, is the substantial increase in exports. As exports increase, the BOI's concern of a possible strengthening of the shekel decreases, thus the bank can afford to raise interest rates earlier than in the US and Europe.

The level of short term real interest rate is still very low even after this increase. The real interest rate in Israel is similar to the real rate in countries such as the US, the UK and Canada, where the recession was much deeper and inflation pressures are more moderate. If interest rate in Israel remains so low for a long time, it could lead to the creation of significant inflationary pressures within a year or two.

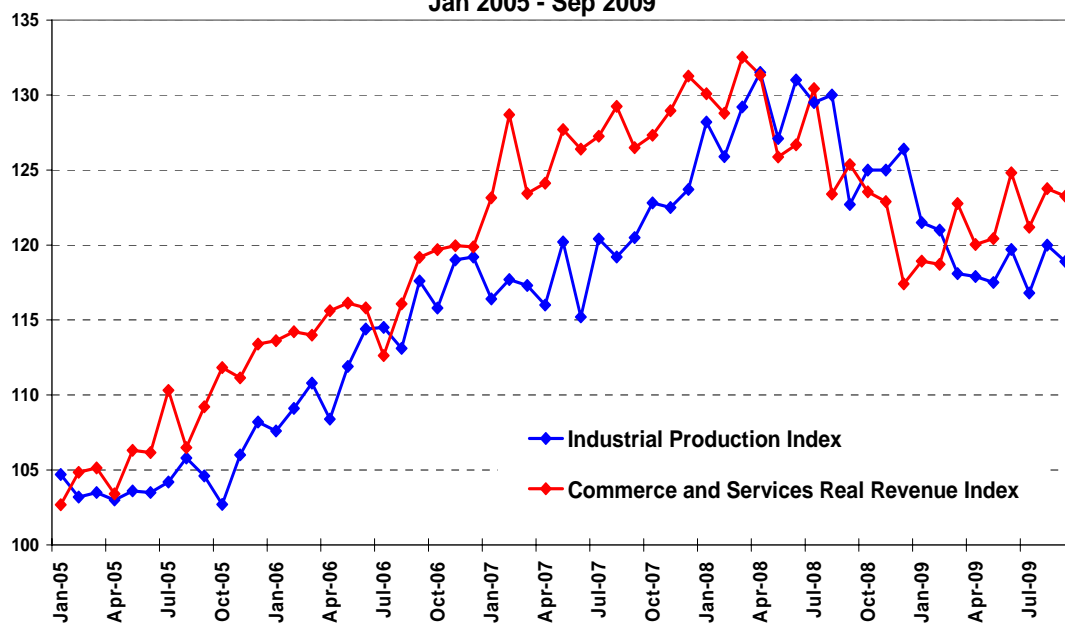
Short-Term Real Interest Rates



Our estimate therefore is that the BOI will continue to gradually increase interest rates, at an average pace of once every two months, by 0.25 percentage points each time, unless there are significant changes in the exchange rate or in other macro-economic variables.

The trade and service sectors revenue index declined by 0.4 percent in September and by 2 percent over the twelve months ended in September. The industrial production index fell by 0.9 percent in September and by 3 percent in the twelve months ended in September.

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



According to the Bank of Israel's calculations, **inflation expectations** rose slightly and totaled on averaged between mid October and mid November 2.3 percent for the first year, 3.0 percent for the second year and 2.7 percent for the third year and forward. **The amount of means of payment (M1)** declined in October by 0.7 percent, the second consecutive decline, and the annual increase moderated to 55 percent, compared to 61 percent a month ago and 65 percent at the peak of two months ago.

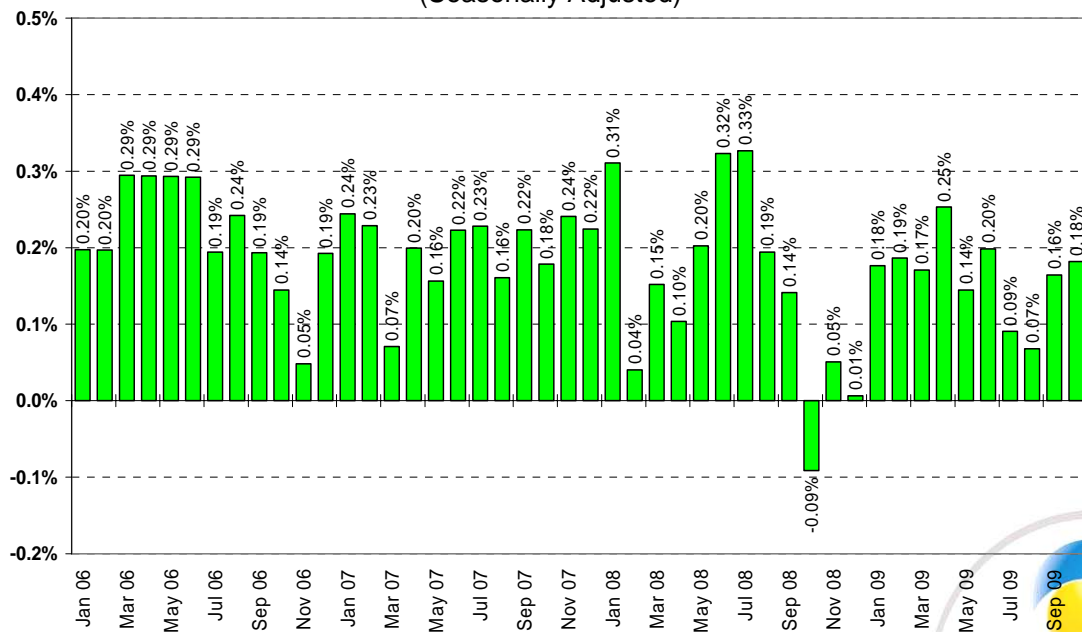
United States

The Fed interest rate is at a level of 0 - 0.25 percent since December of last year, and expectations were for the rate to start climbing toward mid-2010. Last week, following the speech by the Fed chairman Ben Bernanke to the American congress, the expectation for a future change in the Fed interest rate has decreased.

Housing starts fell in October by 11 percent and housing permits declined by 4 percent, sharper declines than anticipated. Sales of existing homes recorded a very surprising 10 percent increase in October, though their prices continue to fall.

Inflation in October stood at a negative 0.2 percent, in line with expectations. Core inflation stood at 1.7 percent, slightly above expectations. Core prices in the consumer price index have continued to go up at a positive-but-moderate rate for a long period, and at this point there are no indications of either high inflation or deflationary pressures.

USA: monthly change in Core CPI
(Seasonally Adjusted)



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

Forecast change, October 2009 to January 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%	-1.1%	-0.5%	-0.2%	-1.7%

Important Announcements in the Coming Week

- An update of the growth rate in the third quarter of 2009 and the Case-Shiller housing price index will be published in the US on Tuesday, November 24.
- The growth rate for the third quarter of 2009 will be published in the UK; in Israel the manpower survey, including the unemployment rate, will be published; and in the US data on income and private consumption, sales of new homes and the University of Michigan consumer confidence index will be published on Wednesday, November 25.
- Israel's Central Bureau of Statistics will publish data on the sale of new homes on Thursday, November 26.
- Israel's Central Bureau of Statistics will publish data on housing starts for the third quarter of 2009, and in the Euro zone an initial estimate of inflation will be published on Monday, November 30.

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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