

## Weekly Macroeconomic Review

May 25, 2010

	Expectations derived from the capital market	Our forecast
Inflation in the coming months		0.4% in May 0.2% in June
Future cumulative inflation – next 12 CPIs (through March 2011 CPI)		2.6%
Inflation through July 2011 CPI (average annual rate)	3.0%	3.3%
Bank of Israel interest rate, 6 months ahead	2.10% (up 0.60)	2.10%
Fed interest rate, 6 months ahead	0.35% (up 0.10)	0.35%
Yield on Israeli Government 10-Year bond, 6 months ahead	5.01% (up 0.20)	5.10%
Yield on US Treasury 10-Year bond, 6 months ahead	3.33% (up 0.21)	4.00%
Dollar exchange rate, 6 months ahead	NIS 3.85 (up 0.3%)	NIS 3.84 (unchanged)

## Israel

The Bank of Israel has maintained the **interest rate** at 1.50 percent, in line with our estimates and those of most economists. The interest-rate announcement highlights several factors in the decision not to raise the rate, including the following:

- The interest rates of the central banks in the leading developed economies are very low, and given recent developments are expected to remain low for longer than earlier forecasts anticipated. In addition, due to the recent developments, some of the unconventional means of monetary easing have been reinstated.

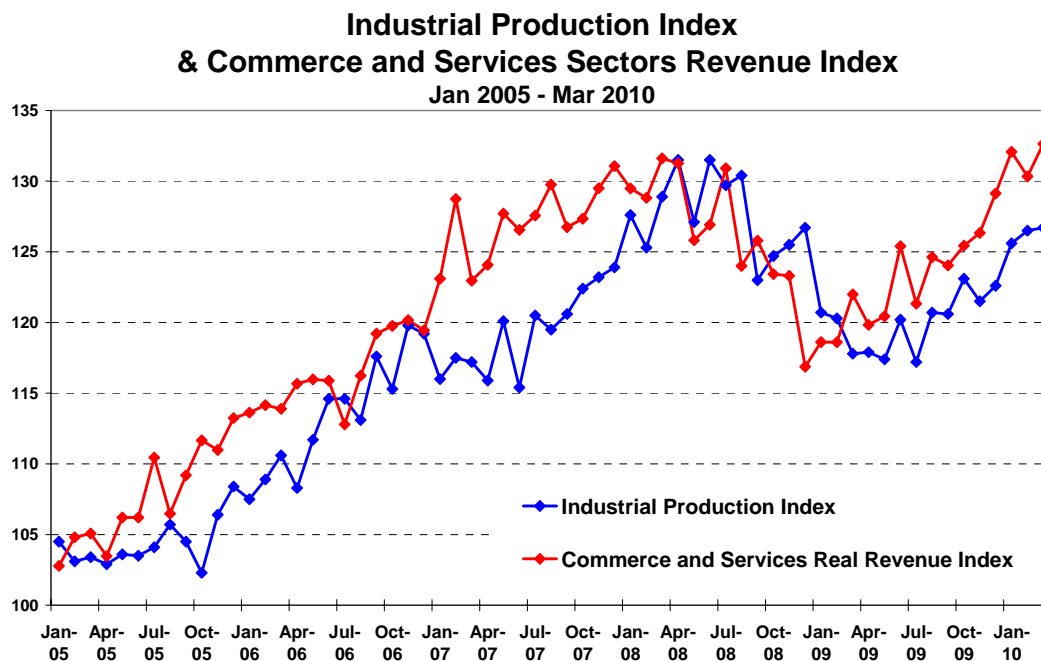
- In view of the continued rapid rise of housing prices and the rapid expansion of housing credit, due to factors including the low interest rate, in order to temper these trends and support financial stability, the Supervisor of Banks at the Bank of Israel has issued a draft directive to banks instructing them to strictly examine the area of housing credit, with a requirement for additional provisions for housing loans granted at high financing ratios.

Commentary on these two points:

- The US and Europe will not raise interest rates in the near future; thus any interest-rate hike by the Bank of Israel will necessarily expand the interest-rate spread and increase pressure towards appreciation of the shekel. The shekel has already gained strength against the currency basket in the last month, and the Bank of Israel does not wish to further damage the competitive standing of Israeli exports, especially in view of the very weak export figures published in recent weeks.
- The Bank of Israel is worried about the possibility of a bubble forming in the real-estate market, but believes there are other means of coping with this problem beyond the interest rate alone. In this regard, the instructions given to the banks and the requirement for additional provisions in respect of housing loans, as published today, serve as a substitute for an increase in the interest rate.

**In our opinion**, the instruction given to the banks and the requirement for additional provisions in respect of housing loans may affect prices of homes, but not necessarily rent prices, which are the prices included in the housing item of the consumer price index. Housing replacement also has an impact, and more people may choose to rent rather than buy homes. Thus, the Bank of Israel would be wrong to rely on regulatory measures as a monetary tool in order to meet the inflation target. Such measures should be applied only for the purpose of maintaining financial stability.

The indicators of the condition of the economy published this week were positive. **The trade and service sectors revenues index** rose by 2 percent in March and by 9 percent in the twelve months ended in March. **The industrial production index** was flat in March and rose by 8 percent in the twelve months ended in March.

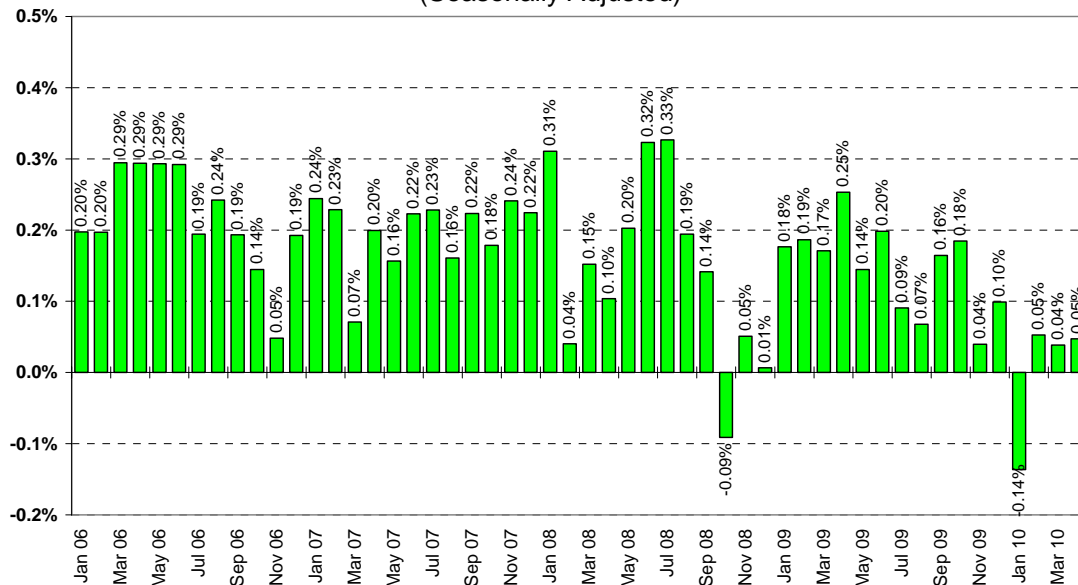


The data point to **rapid growth** of economic activity in the first quarter, as also reflected in the business product in national accounting data.

## United States

Inflation remained very low in April. **The consumer price index** decreased by 0.1 percent in April, and twelve-month inflation reached 2.2 percent. **The core index** rose by only 0.05 percent, and core twelve-month inflation was 0.9 percent, the lowest rate in the last 49 years. These figures have pushed the next interest-rate hike further away.

## USA: monthly change in Core CPI (Seasonally Adjusted)



In the real-estate market, data on **construction starts** in April were surprisingly positive, with a 7 percent increase, but **construction permits** were disappointing with an unexpected 11 percent drop. **Sales of existing homes** rose by 8 percent, more than expected.

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

Forecast change, April 2010 to July 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%	4.9%	1.5%	0.7%

## Important Announcements in the Coming Week

- The Case Shiller house price index will be published in the United States on Tuesday, May 25.
- Data on sales of new homes will be published in the US on Wednesday, May 26.
- Israel's Central Bureau of Statistics (CBS) will publish its employment report for the first quarter of 2010 on Thursday, May 27, including the unemployment rate.
- Data on private income and consumption and the University of Michigan's consumer confidence index will be published in the US on Friday, May 28.
- The CBS will publish data on construction starts and completions for the first quarter of 2010 on Monday, May 31.

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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