Weekly Macroeconomic Review January 26, 2010

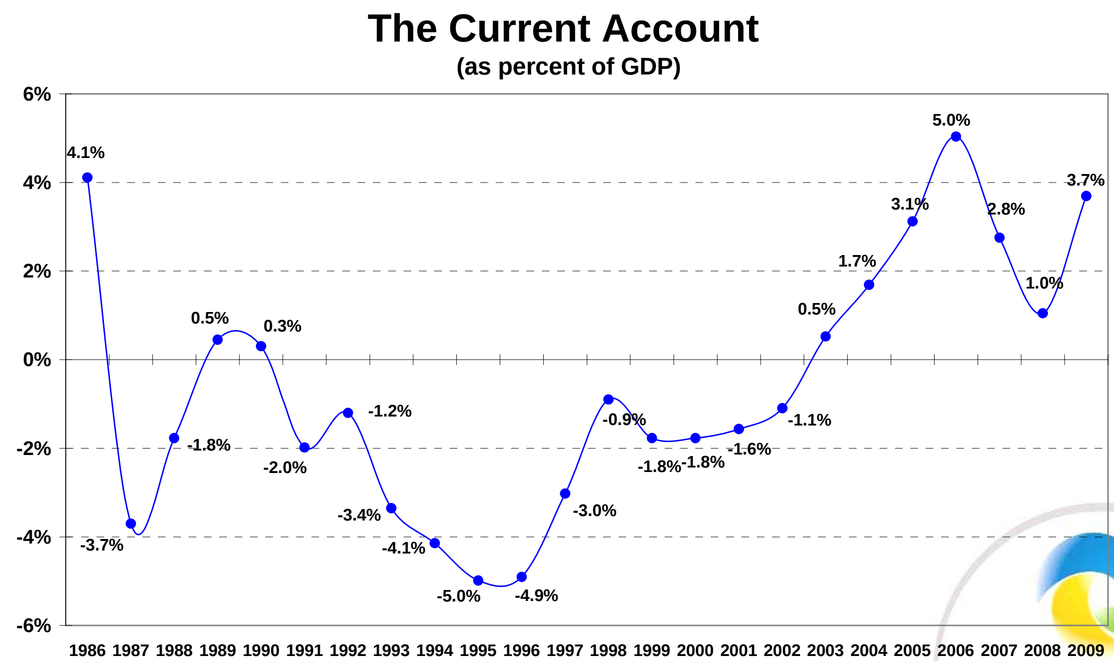
	Expectations derived from the capital market	Our forecast
Inflation in the coming months		Minus 0.2% in January Minus 0.1% in February
Future cumulative inflation – next 12 CPIs (through November 2010 CPI)		2.0%
Inflation through July 2011 CPI (average annual rate)	2.4%	2.5%
Bank of Israel interest rate, 6 months ahead	1.95% (up 0.70)	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	5.26% (up 0.24)	5.25%
Yield on US Treasury 10-Year bond, 6 months ahead	3.83% (up 0.25)	4.25%
Dollar exchange rate, 6 months ahead	NIS 3.73 (unchanged)	NIS 3.73 (unchanged)

Israel

The Bank of Israel interest rate remained unchanged at 1.25 percent, in line with our expectations and those of most economists. It is quite clear that after a month in which the shekel appreciated (despite significant intervention by the BOI), stock indices fell, expectations for the US interest rate moderated, the amount of means of payment decreased, and the CPI was 0.3 percentage points lower than expected, the BOI was obliged to pause the increases in the interest rate. **The interest-rate** announcement reviews many figures but contains no clear hints for the trajectory of the interest rate in the coming months. One key piece of data due to be published in the coming month, on February 16, is the **growth rate for the fourth quarter of 2009. In our opinion,** this rate will be lower than the estimates by the CBS and the BOI (4.0-4.5 percent), and the BOI may subsequently need to lower its growth forecast for 2010, now at 3.5 percent. In that case, of course, the probability of an interest-rate increase next month will decrease.

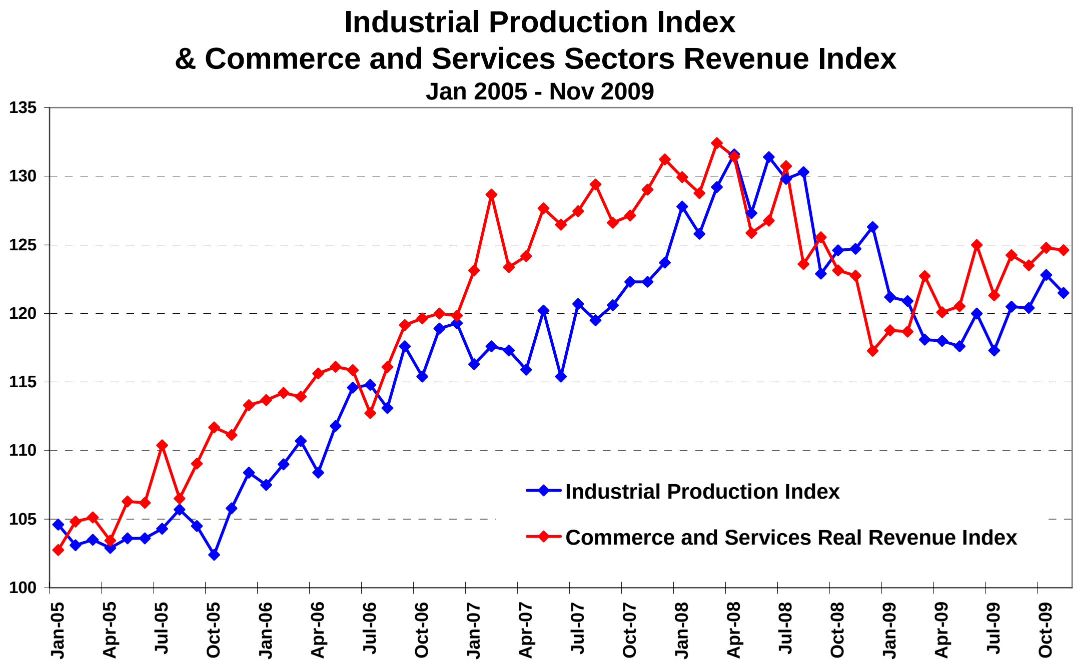
The surplus in the current account of the balance of payments expanded to USD 7.2 billion (3.7 percent of GDP) in 2009, following a surplus of USD 2.1 billion (1.0 percent of GDP) in 2008, according to an initial estimate by Israel's Central Bureau of Statistics (CBS).

- The increase in the surplus in the current account in 2009 as compared to the preceding year mainly reflects a decrease in the deficit in the goods account, along with a slight increase in the surplus in the services account, partially offset by an increase in the deficit in the income account and a decrease in net current transfers from overseas.
- The sharp decline in the value of fuel imports, as a result of the significant decrease in average fuel prices in 2009 compared to 2008, had a considerable contribution to the reduction of the deficit in the goods account.
- Another reason for the improvement in the goods balance was the substantial decreases in imports and exports of other goods, due to the economic crisis and the decline in global trade volumes, as imports decreased more than exports.



We estimate that the surplus in the current account will contract considerably in 2010.

The industrial production index decreased by 1.1 percent in November and by 2.6 percent in the twelve months ended in November. **The trade and service sectors revenue index** fell by 0.1 percent in November and rose by 1.5 percent in the twelve months ended in November.



Tourists' hotel stays decreased by 16 percent in December and by 2 percent in the last twelve months. **Israelis' hotel stays** increased by 2 percent in December and decreased by 2 percent in the last twelve months.

United States

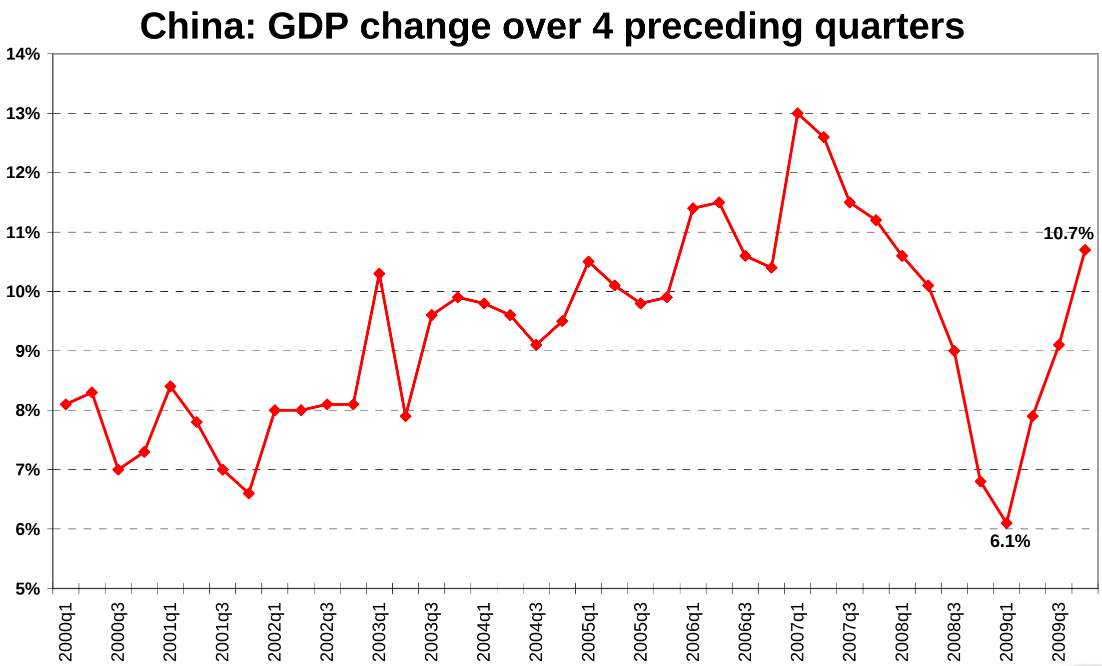
The US government has published a plan to reduce risks in the financial system, the key element of which is a limit on banks' ability to invest their own funds in high-risk instruments. Following publication of the plan, stock markets worldwide recorded sharp declines.

In our opinion, increased regulation of financial institutions, including limits on risk-taking and a requirement to increase capital, is a natural outcome of the conclusions drawn from the financial crisis. Regulation is likely to increase in the coming years, as economic conditions improve and financial institutions' profits grow.

Construction permits increased by a surprising 11 percent in December, but **construction starts** were disappointing, with a 4 percent decrease, and **sales of new homes** declined sharply by 16.7 percent.

China

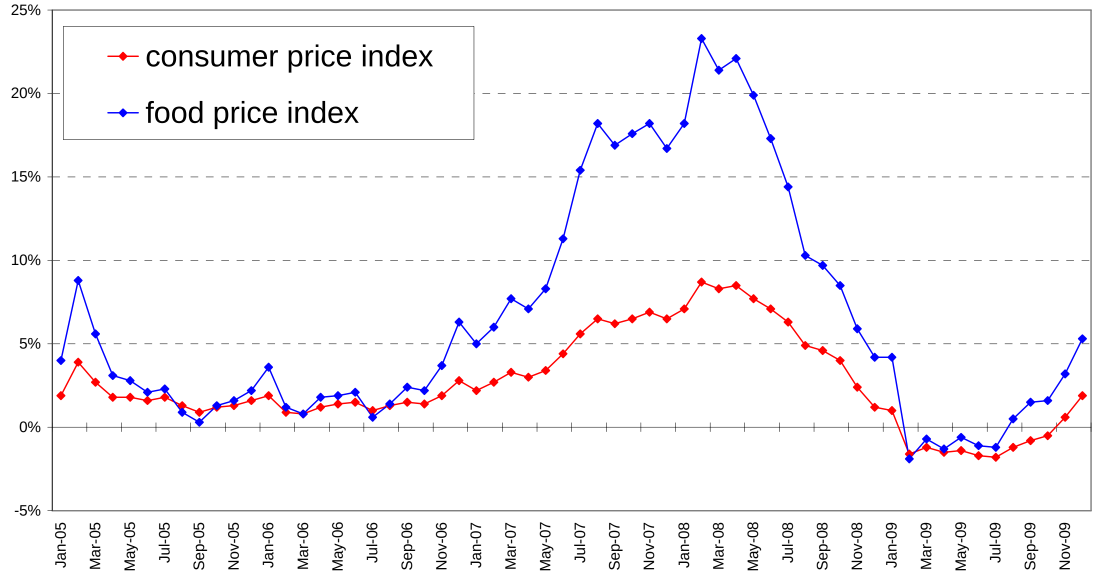
The Chinese economy grew at a steep rate of 10.7 percent in the four quarters up to the last quarter of 2009. Industrial production grew by 18.5 percent, while retail sales increased by 17.5 percent, supported by the government's incentive program and tax cuts.



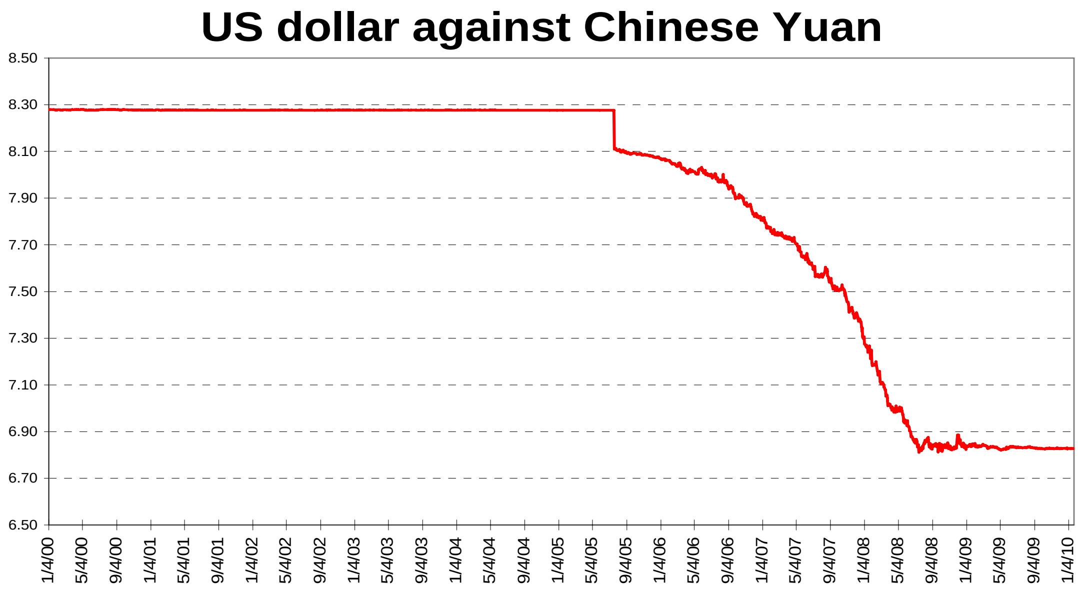
The consumer price index rose by 1.9 percent in the twelve months ended in December, mainly due to an increase in food prices; food prices comprise about one-third of the CPI in China, more than in the advanced countries. Excluding food prices, inflation stood at 0.2 percent.

China: consumer price index and foox index

(change during the last 12-months)



A year ago, there were concerns in China over a sharp increase in unemployment and deflation, as inflation reached a negative 1.8 percent in July 2008. Today, inflation is rising and very rapid GDP growth has resumed. An increase in growth and inflation will cause the central bank to begin raising the interest rate during 2010, and create pressure on the government to allow the local currency (the yuan) to strengthen, in order to rein in inflation. Last year, the authorities explained the need for a stable and relatively weak yuan due to the decrease in exports, the slowdown in growth, and negative inflation. These arguments now sound weak, and support **future appreciation** of the yuan.



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

Forecast change, December 2009 to March 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)
-0.2%	-0.3%	1.2%	0.1%	0.2%

Important Announcements in the Coming Week

- The initial estimate of growth in the fourth quarter will be published in the UK, and the Case-Shiller house price index will be published in the US, on Tuesday, January 26.
- Data on sales of new homes and the Fed's interest-rate decision will be published in the US on Wednesday, January 27.
- Israel's CBS will publish data on sales of new homes on Thursday, January 28.
- The unemployment rate and the estimated consumer price index will be published in the euro zone, and the initial fourth-quarter growth estimate and the University of Michigan's consumer confidence index will be published in the US, on Friday, January 29.

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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