

Weekly Macroeconomic Review

April 27, 2009

	Expectations derived from the capital market	Our forecast
Inflation in the coming months		1.1% in April 0.4% in May
Future cumulative inflation – next 12 CPIs (through March 2010)		1.9%
Inflation through May 2010 CPI (average annual rate)	2.0%	2.8%
Bank of Israel interest rate, 6 months ahead	0.85% (up 0.35)	0.75%
Fed interest rate, 6 months ahead	0.40% (up 0.15)	0.25%
Yield on Israeli Government 10-Year bond, 6 months ahead	5.20% (up 0.30)	5.35%
Yield on US Treasury 10-Year bond, 6 months ahead	3.10% (up 0.20)	3.25%
Dollar exchange rate, 6 months ahead	NIS 4.26 (unchanged)	NIS 4.30 (up 1.1%)

Development in the global economy

The International Monetary Fund updated its World Economic Outlook at its semiannual meeting in Washington. The IMF estimates that despite the recent monetary and fiscal actions taken by governments and central banks worldwide, global growth is expected to drop in 2009 at the steepest rate since World War II, with the recession to encompass most countries. The **forecast for global growth in 2009** was lowered sharply to a negative 1.3 percent, 1.8 percentage points below the previous forecast from January. Recovery is expected to be slow; the **forecast for 2010** was reduced by 1.1 percentage points to 1.9 percent.



These forecasts are based on the premise that the stabilization of the financial markets will take longer than previously estimated, despite the massive efforts put forth by policy makers globally. The report estimates that total write-offs and declines in value of all assets, from the beginning of the crisis, are expected to reach USD 4.1 trillion in the next two years, with about two-thirds of the write-offs performed by banks.

According to the IMF's estimates, the Israeli economy is expected to contract by 1.7 percent in 2009 and grow by only 0.3 percent in 2010; inflation will reach annual averages of 1.4 percent in 2009 and 0.8 percent in 2010; while unemployment reaches 7.5 percent in 2009 and 7.7 percent in 2010. The IMF's estimates for growth in Israel are more pessimistic than our forecasts and those of the Bank of Israel, though its estimates concerning unemployment are relatively optimistic.

World Economic Outlook Update Projections (annual percent change)
(In brackets: the previous January estimates)

	2007	2008	2009		2010	
World growth	5.3	3.2	-1.3	(0.5)	1.9	(3.0)
Advanced economies	2.7	0.9	-3.8	(-2.0)	0.0	(1.1)
United states	2.0	1.1	-2.8	(-1.6)	0.0	(1.6)
Euro zone	2.7	0.9	-4.2	(-2.0)	-0.4	(0.2)
Japan	2.4	-0.6	-6.2	(-2.6)	0.5	(0.6)
United kingdom	3.0	0.7	-4.1	(-2.8)	-0.4	(0.2)
Canada	2.7	0.5	-2.5	(-1.2)	1.2	(1.6)
Developing economies and emerging markets	8.3	6.1	1.6	(3.3)	4.0	(5.0)
Africa	6.2	5.2	2.0	(3.4)	3.9	(4.9)
central and eastern Europe	5.4	2.9	-3.7	(-0.4)	0.8	(2.5)
Russia	8.1	5.6	-6.0	(-0.7)	0.5	(1.3)
Developing Asia economies	10.6	7.7	4.8	(5.5)	6.1	(6.9)
China	13.0	9.0	6.5	(6.7)	7.5	(8.0)
India	9.3	7.3	4.5	(5.1)	5.6	(6.5)
Middle east	6.3	5.9	2.5	(3.9)	3.5	(4.7)
South and central America	5.7	4.2	-1.5	(1.1)	1.6	(3.0)
Brazil	5.7	5.1	-1.3	(1.8)	2.2	(3.5)
Mexico	3.3	1.3	-3.7	(-0.3)	2.1	(4.5)

Israel

The Ministry of Finance has presented a package of economic measures to cope with the slowdown, but at this stage it has refrained from posting clear fiscal targets for the coming years, such as deficit targets. In our opinion, the plan as presented is missing several key elements at this point, without which it is difficult to address the plan and its chances of success. For example, no deficit targets were defined for 2009, 2010, or the medium term. In addition, no macro-economic assumptions were specified. It is not clear what the government intends to do about the future increase in its expenses; according to the current rule, these expenses are expected to grow by 1.7 percent each year. In the absence of explicit decisions on these matters, it is unclear, for example, how the government plans to finance the tax cuts included in its plan. These elements are likely to be filled in over the coming weeks, as the budget proposals for 2009 and 2010 are presented. At that time, we will be able to seriously examine the plan and its prospects for success.

Key points of the economic plan presented by the Prime Minister and the Minister of Finance:

- **Expanding credit and encouraging exports.** The state plans to provide guarantees for insurance against risks arising from the crisis. Planned measures include: doubling guarantees for capital raising to the banking system, from ILS 6 billion to ILS 12 billion; establishing funds for new non-bank credit at a volume of ILS 2 billion, mainly for high-tech industries; state-guaranteed aid packages for exports worth ILS 6 billion; and doubling of the fund for mid-sized businesses, to ILS 2.6 billion.
- **Structural reforms.** These measures focus on land, ports, and electricity, and on strengthening urban security.
- **Curbing unemployment and promoting employment.** The government plans to reduce the number of foreign workers, in order to free jobs for Israelis. Another measure is the expansion of the 'Orot Lataasuka'

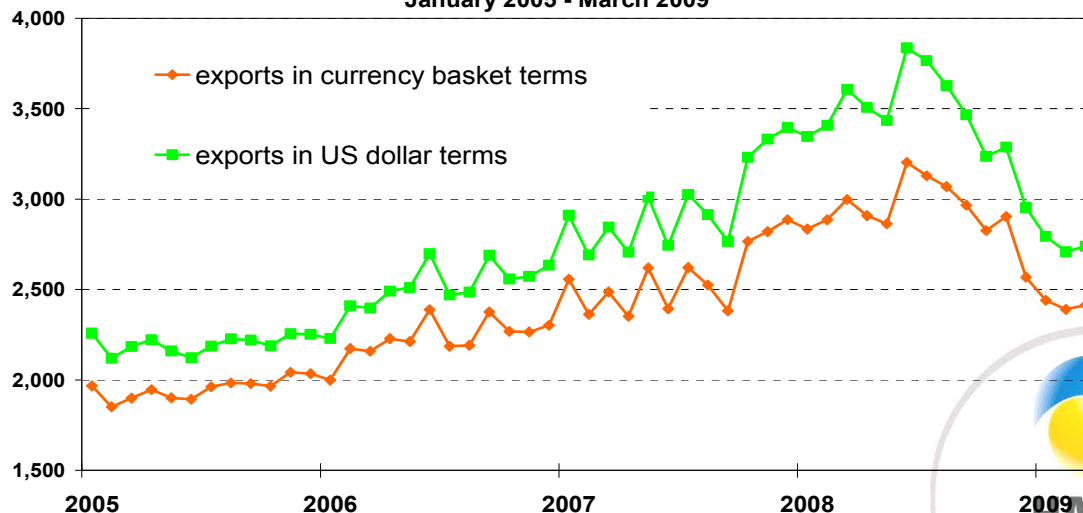
(Employment Lights) program and the negative income tax program to the entire country. In addition, a fund will be established in collaboration with the 'Histadrut' and with employers to support factories in peripheral regions, and professional training programs will be promoted.

- **Tax policy.** The plan includes a gradual reduction of tax rates from 2009 to 2016, the elimination of tax distortions, and improvement of the collection system. The maximum marginal tax rate now stands at 46 percent; this rate is planned to fall gradually to just 39 percent in early 2016. Corporation tax will decrease to 18 percent, from 26 percent today.
- **Physical infrastructures and human capital.** These measures mainly concern transportation, in order to support the connection of peripheral regions – the Negev and Galilee – to central Israel. Additional elements are investments in tourism and in making Israel more attractive for tourism.

Exports of goods (excluding ships, aircraft, and diamonds; in dollar terms) increased by 1 percent in March, but decreased by 24 percent in the twelve months ended in March. Exports of goods decreased by 13 percent in the first quarter of 2009 as compared to the preceding quarter.

Exports of Goods

(millions per month, excl. diamonds, ships & airplanes)
January 2005 - March 2009



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Imports of goods decreased by 1 percent in March and by 35 percent in the twelve months ended in March. In the first quarter of 2009, imports of goods decreased by 19 percent compared to the preceding quarter. The sharp decline in imports led to a decrease in the trade deficit in March, to just USD 0.5 billion.

Indicators of economic activity in February showed relative stability. The **industrial production index** remained unchanged in February and decreased by 2 percent in the twelve months ended in February. The **index of trade and service sector revenues** decreased by 0.5 percent in February and by 10 percent in the twelve months ended in February.

Incoming tourism increased by a slight 0.6 percent in March, based on data net of seasonal effects, and decreased by 19 percent in the twelve months ended in March. The Pope's planned visit should support tourism in the next few months.

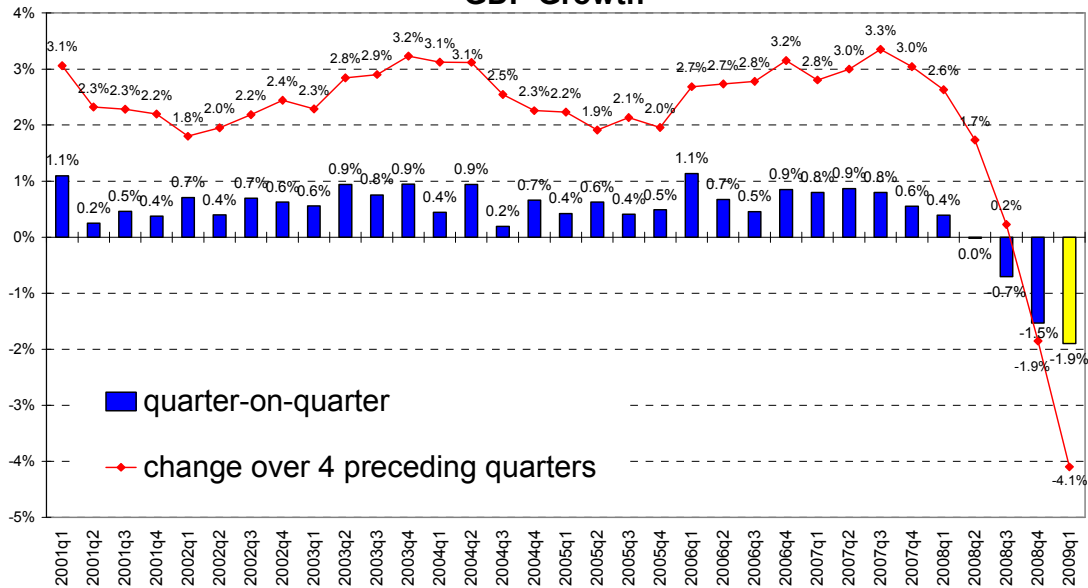
United States

Sales of existing homes decreased in March, following an increase in February. However, the median price of homes sold increased for the second consecutive month. These data, from the Realtors' Association, are quite volatile, but may indicate a significant development of stabilization and possibly an increase in housing prices. In addition, **sales of new homes** totaled 356,000 homes in March, in annualized terms, higher than expected, while figures for the last two months were adjusted upward.

Europe

GDP in the UK contracted by 1.9 percent in the first quarter of 2009, or a negative 7.4 percent in annualized terms, according to an initial estimate, in a greater-than-expected decrease. This was the sharpest drop in GDP in the last thirty years, with 6.2 percent contraction (23 percent annualized) in the industrial sector.

United Kingdom GDP Growth

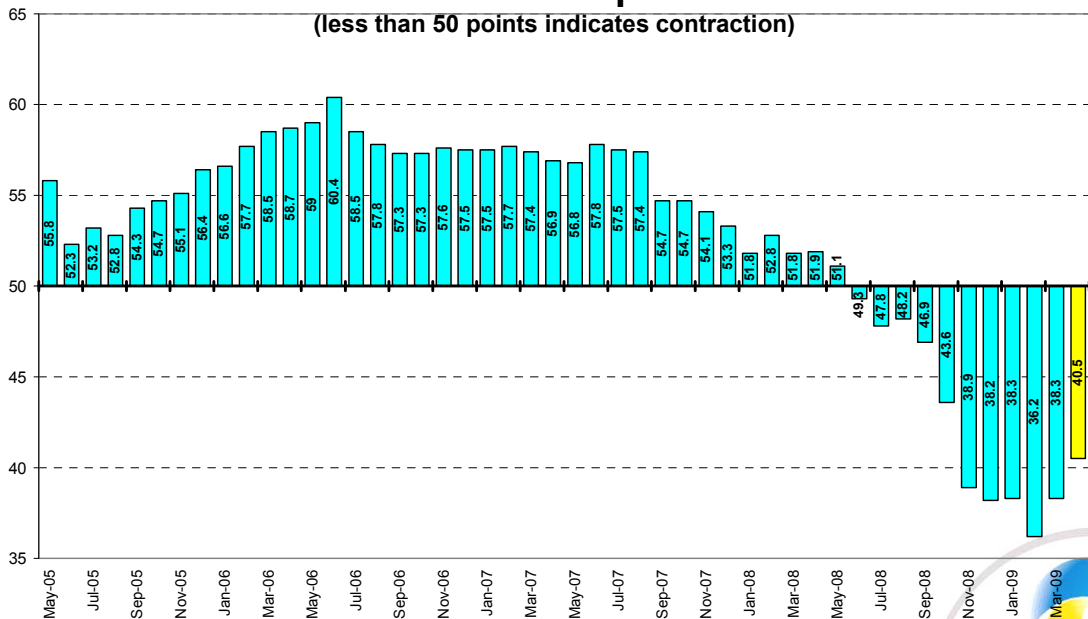


Despite the growth data, **retail sales** in the UK posted a surprising 0.3 percent increase in March, versus expectations of a decrease at a similar rate.

The euro zone **purchasing managers' index** reached 40.5 points in April, according to an initial estimate, higher than expected. This figure indicates continuation of the recession, but at lesser strength.

Euro zone PMI composite Index

(less than 50 points indicates contraction)



Important Announcements in the Coming Week

- The Bank of Israel will announce its interest-rate decision on Monday, April 27th.
- The initial growth estimate for the first quarter of 2009 and the Fed's interest-rate decision will be published in the US on Wednesday, April 29th.
- The estimated consumer price index will be published in the euro zone, data on private income and consumption will be published in the US, and data on sales of new homes will be published in Israel on Thursday, April 30th.

This review is posted online at www.harel-finance.co.il/macro in Hebrew

and at www.harel-finance.co.il/macro/ENG in English.

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