

Weekly Macroeconomic Review

April 27, 2010

| | Expectations derived from the capital market | Our forecast |
|---|--|------------------------------|
| Inflation in the coming months | | 0.9% in April 0.4% in May |
| Future cumulative inflation – next 12 CPIs (through March 2011 CPI) | | 2.9% |
| Inflation through July 2011 CPI (average annual rate) | 3.2% | 3.3% |
| Bank of Israel interest rate, 6 months ahead | 2.00% (up 0.50) | 2.25% |
| Fed interest rate, 6 months ahead | 0.40% (up 0.15) | 0.40% |
| Yield on Israeli Government 10-Year bond, 6 months ahead | 5.21% (up 0.23) | 5.25% |
| Yield on US Treasury 10-Year bond, 6 months ahead | 4.04% (up 0.25) | 4.35% |
| Dollar exchange rate, 6 months ahead | NIS 3.73 (up 0.2%) | NIS 3.72 (unchanged) |

Israel

The Bank of Israel has maintained the interest rate at 1.50 percent, though most economists placed the probability of a rate hike at more than 50 percent. The interest-rate announcement contains almost no new data or statements; it primarily describes considerations that actually support an increase in the interest rate (the increased growth forecasts globally and in Israel; the 0.6 percent inflation in the first three months of the year, excluding seasonal effects and indirect taxes; etc.). Yet a surprise is in store towards the end of the announcement: *“... These factors support a gradual increase in the interest rate. Therefore, after the increase last month, the decision was made to leave the rate unchanged in May.”* In other words, the BOI is saying (for the first time, to the best of our recollection) that all of the factors contributing to last month’s interest-rate hike are still in place and have not changed significantly, but a pace of one increase every two months is sufficient, in the BOI’s view, and as the rate was raised last month there is no need to raise it again this month.

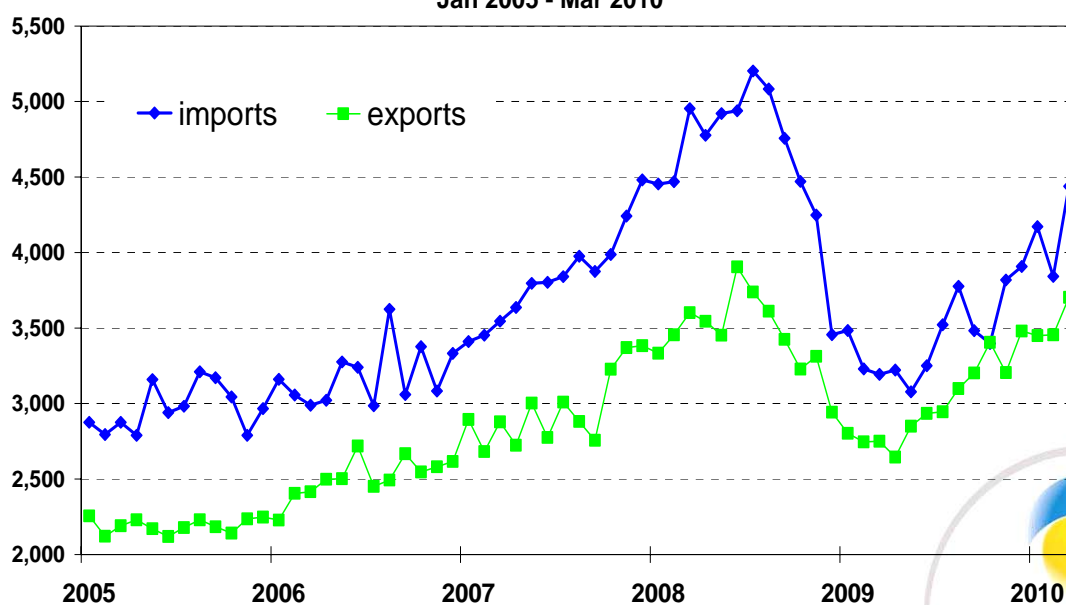
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This analysis strengthens our estimate, which we have reiterated for many months, that barring unexpected developments the BOI is likely to raise the interest rate at an average pace of one increase every two months, meaning an interest rate of about 3 percent one year from now. This pace of increases is slightly slower, in our opinion, than necessary in order to aim for the midpoint of the inflation target range, as it also reflects the BOI's wish to prevent significant pressures towards appreciation of the shekel, rather than just its commitment to compliance with the inflation target.

Of course, given this statement in the interest-rate announcement, provided that there are no unexpected developments in the coming month, we can expect an increase in the interest rate at the end of May.

Foreign-trade data for March were highly positive. **Exports of goods** (excluding diamonds, ships, and aircraft; in dollar terms) increased by 7 percent in March, and by 35 percent in the twelve months ended in March, while data for the preceding month were adjusted upward. **Imports of goods** increased by 16 percent in March, and by 39 percent in the twelve months ended in March.

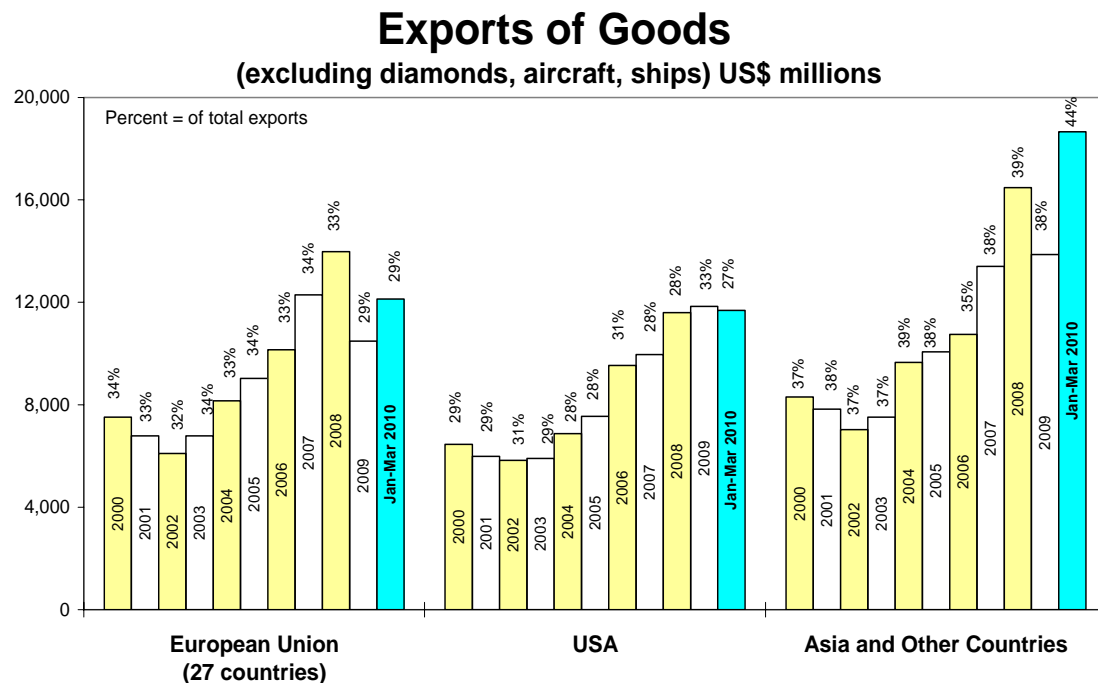
Exports and Imports of Goods
(US\$ millions per month, excl. diamonds, ships & airplanes)
Jan 2005 - Mar 2010



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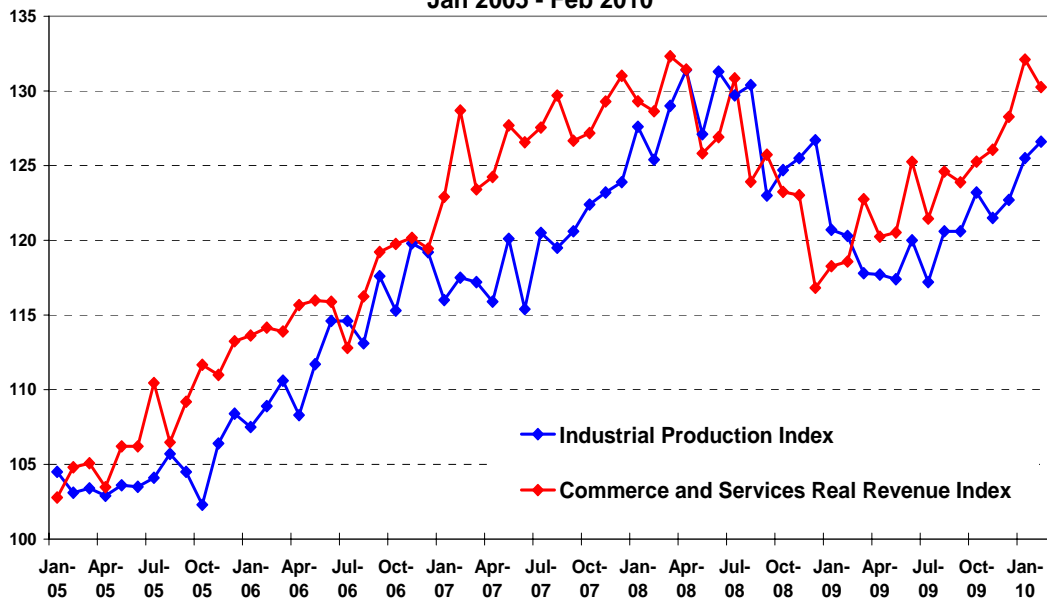


Exports of goods to Asia and other countries (other than the European Union and the United States) grew to 44 percent of total exports in the first quarter of 2010, after many years in which this rate remained stable at less than 40 percent. If this is in fact a real, permanent change – i.e. if the goods really are designated for Asia, not exported to Asia en route to the US or Europe – it will allow more rapid expansion of exports in the coming years, when growth in the US and EU is expected to be relatively low. The increase in the percentage of goods exported to Asia and other countries reflects a sharp increase in exports to those countries, a decrease in exports to the US, and moderate growth in exports to Europe.



The **industrial production index** rose by 1 percent in February and by 5 percent in the twelve months ended in February. The **index of trade and service sector revenues** fell by 1 percent in February and rose by 10 percent in the twelve months ended in February.

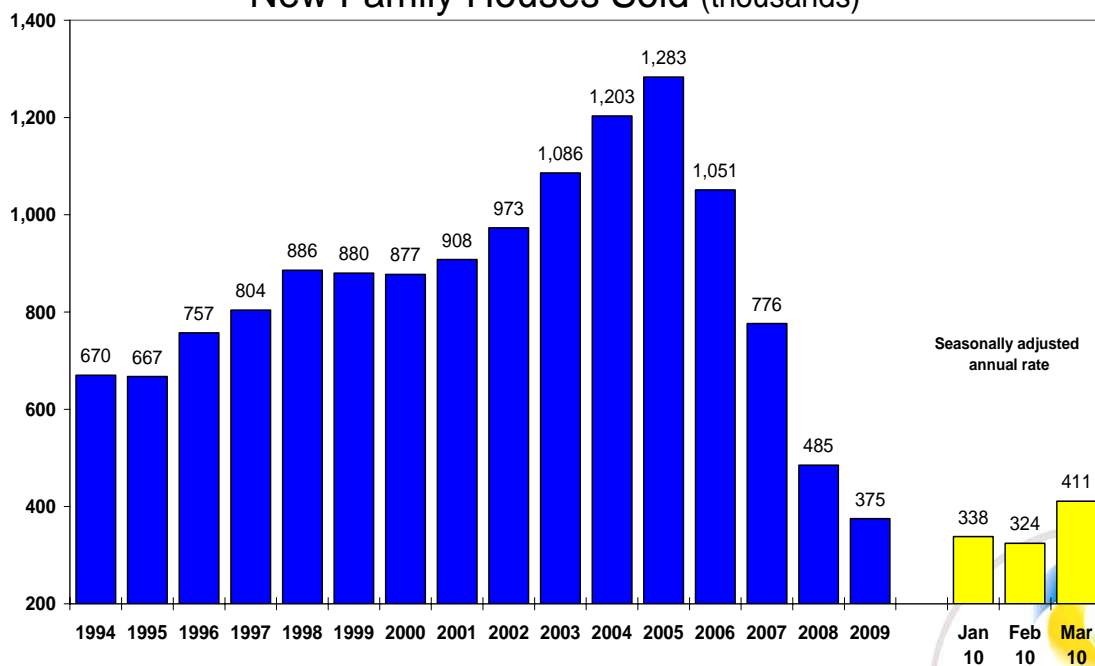
Industrial Production Index & Commerce and Services Sectors Revenue Index Jan 2005 - Feb 2010



United States

Housing market figures were better than expected. Sales of existing homes increased by 7 percent in March. Sales of new homes grew by 27 percent in March, while data for the preceding months were adjusted upward. However, the current rate of sales is still quite low compared to past years.

New Family Houses Sold (thousands)



IMF forecasts

The International Monetary Fund (IMF) has adjusted its global growth forecast upward. The current forecast calls for **global growth** of 4.2 percent in 2010 (up from 3.9 percent in the last estimate published in January), with 2.3 percent growth in the advanced countries, including 3.1 percent growth in the **US** and just 1.0 percent growth in the **euro zone**. The forecast growth rate in the developing economies and emerging markets is a strong 6.3 percent in 2010, with 10 percent growth in China and 8.8 percent growth in India.

In addition, the IMF predicts that global growth in 2011 will reach 4.3 percent, with growth rates of 2.4 percent in the US and 1.5 percent in the euro zone.

The **inflation forecast** for the advanced countries is an annual average of 1.5 percent in 2010 and 1.4 percent in 2011. The inflation forecast for the developing economies and emerging markets is higher, at an annual average of 6.2 percent in 2010 and 4.7 percent in 2011.

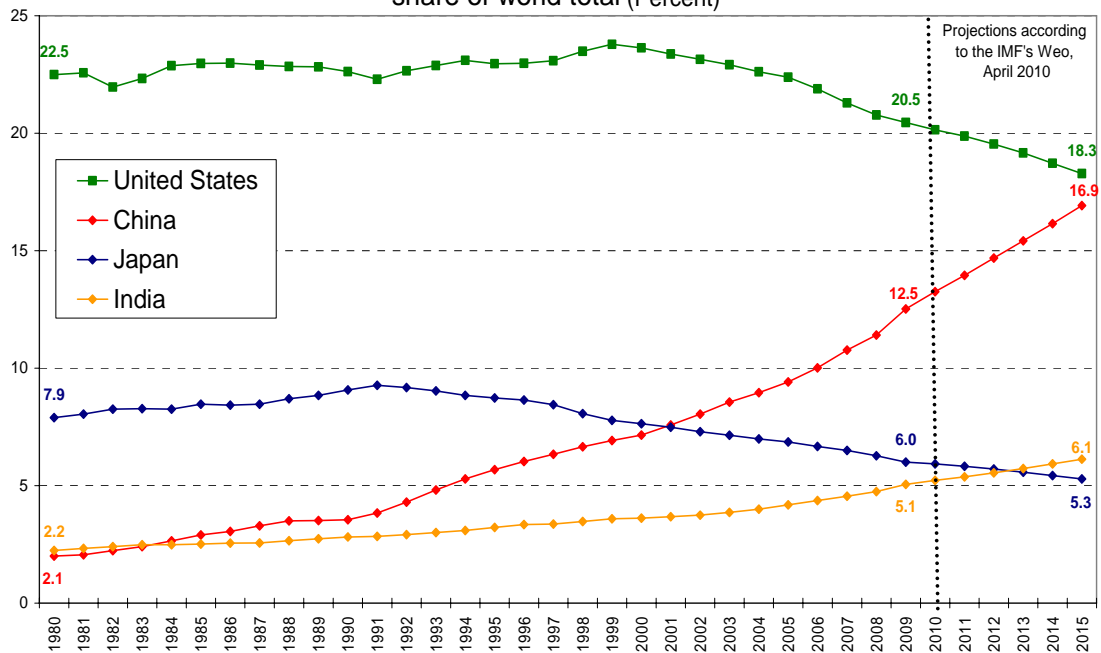
Growth in Israel, according to the IMF forecast, is estimated at 3.2 percent in 2010 and 3.5 percent in 2011. This is similar to the growth forecast we published about a month ago (3.1 percent in 2010 and 3.4 percent in 2011), but lower than the estimates released by the BOI last week (3.7 percent in 2010 and 4.0 percent in 2011).

World Economic Outlook Projections (annual percentage change)

| | 2008 | 2009 | 2010 | 2011 |
|--|------------|-------------|------------|------------|
| World growth | 3.0 | -0.6 | 4.2 | 4.3 |
| Advanced economies | 0.5 | -3.2 | 2.3 | 2.4 |
| United states | 0.4 | -2.4 | 3.1 | 2.6 |
| Euro zone | 0.6 | -4.1 | 1.0 | 1.5 |
| Germany | 1.2 | -5.0 | 1.2 | 1.7 |
| France | 0.3 | -2.2 | 1.5 | 1.8 |
| Japan | -1.2 | -5.2 | 1.9 | 2.0 |
| United kingdom | 0.5 | -4.9 | 1.3 | 2.5 |
| Canada | 0.4 | -2.6 | 3.1 | 3.2 |
| Israel | 4.0 | 0.7 | 3.2 | 3.5 |
| Developing economies and emerging markets | 6.1 | 2.4 | 6.3 | 6.5 |
| Africa | 5.5 | 2.1 | 4.7 | 5.9 |
| central and eastern Europe | 3.0 | -3.7 | 2.8 | 3.4 |
| Russia | 5.6 | -7.9 | 4.0 | 3.3 |
| Developing Asia economies | 7.9 | 6.6 | 8.7 | 8.7 |
| China | 9.6 | 8.7 | 10.0 | 9.9 |
| India | 7.3 | 5.7 | 8.8 | 8.4 |
| Middle east | 5.1 | 2.4 | 4.5 | 4.8 |
| South and central America | 4.3 | -1.8 | 4.0 | 4.0 |
| Brazil | 5.1 | -0.2 | 5.5 | 4.1 |
| Mexico | 1.5 | -6.5 | 4.2 | 4.5 |

The gap in GDP between the United States and China will shrink rapidly in the coming years, according to the IMF's growth estimates. It appears that China will become the world's largest economy (in terms of real GDP adjusted to purchasing power) by the second half of this decade.

Gross domestic product based on purchasing-power-parity (PPP) share of world total (Percent)



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

Forecast change, March 2010 to June 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) |
|-----------------------------|---|------------------------------------|---|---|
| 1.6% | 2.3% | 5.2% | 1.3% | 1.0% |



Important Announcements in the Coming Week

- The Case-Shiller house price index will be published in the United States on Tuesday, April 27.
- The Fed's interest-rate decision will be announced on Wednesday, April 28.
- Israel's Central Bureau of Statistics will publish data on sales of new homes on Thursday, April 29.
- Unemployment figures and the CPI estimate will be published in the euro zone on Friday, April 30. The initial estimate of growth in the first quarter of 2010 and the University of Michigan's consumer confidence index will be published in the US.
- Data on private income and consumption and the ISM manufacturing sector index will be published in the US on Monday, May 2.

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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