

Weekly Macroeconomic Review

January 27, 2009

	Expectations derived from the capital market	Our forecast
Inflation in the coming months		Minus 0.3% in January 0.4% in February
Future cumulative inflation – next 12 CPIs (through December 2009)		2.0%
Inflation through May 2010 CPI (average annual rate)	Minus 0.2%	2.2%
Bank of Israel interest rate, 6 months ahead	1.20% (up 0.20)	0.50%
Fed interest rate, 6 months ahead	0.30% (up 0.05)	0.25%
Dollar exchange rate, 6 months ahead	NIS 3.97 (up 0.4%)	NIS 4.07 (up 3.1%)

Israel

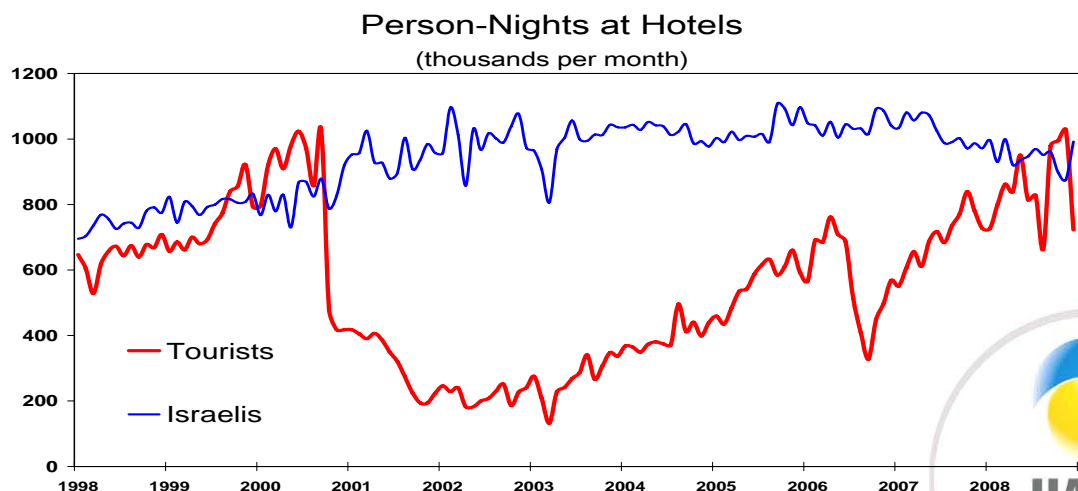
The Bank of Israel lowered the interest rate by 0.75 percentage point on Monday, to just 1 percent. After the BOI cut its growth forecast on Sunday, it was clear that the rate reduction would be larger than the previously expected 0.5 percentage point, so that the decision was not surprising. The interest-rate announcement provided no hints of further rate cuts, but the last paragraph of the announcement contains an interesting new element: it says that the BOI will continue to closely monitor developments in the Israeli and global economy, and if necessary it will use other tools at its disposal to achieve its goals, thereby supporting the stability of the financial system and encouraging employment and growth. The main new component here is the words "other tools," which seem to indicate that the BOI intends to use means other than interest-rate reductions. Such tools may include additional foreign-currency purchases and/or other means of increasing liquidity and credit in the economy. **In our opinion**, if there is no substantial depreciation of the shekel in the next month, there is a strong probability of an additional interest-rate cut by the BOI next month.

The BOI has sharply reduced its **growth forecast** for 2009, from 1.5 percent to a negative 0.2 percent, with steep drops in business GDP, exports, imports, and investments; only a moderate increase in private consumption, with a decrease in per-capita private consumption; and a sharp increase in unemployment, to an annual average of 7.6 percent. According to the BOI's forecasts, growth in 2010 is expected to reach 2 to 2.7 percent.

We believe this forecast is pessimistic, but given the macro-economic uncertainty globally and in Israel, it is certainly possible. For this forecast to materialize, growth in the US and in the other advanced countries in 2009 would have to be far worse than today's prevalent estimates, which predict a decline of 1 to 2 percent in GDP in these countries.

Though it may be too soon to determine whether the BOI's pessimistic forecast will turn out to be correct, it is clear that this forecast will have an extensive impact on the BOI's policies in the near future. The BOI is likely to continue to apply a policy of low interest rates and support for continued depreciation of the shekel, both indirectly, through interest-rate cuts, and also directly if the need arises, through continued foreign-currency purchases. The shekel may weaken as a consequence. The shekel weakened by 3 percent over the last week; we estimate that the probability of continued depreciation remains greater than the probability of appreciation of the shekel.

Tourists' hotel stays dropped sharply by 30 percent in December, based on data net of seasonal effects, and remained almost unchanged in the last twelve months. Nonetheless, 2008 was a very good year for Israeli hotels, as the number of hotel stays grew by 5.4 percent, including a 21 percent increase in tourist stays, breaking the record set in 2000. 2009 is opening on a less positive note due to the military action in Gaza and the global slowdown in tourism caused by the worsening global recession.

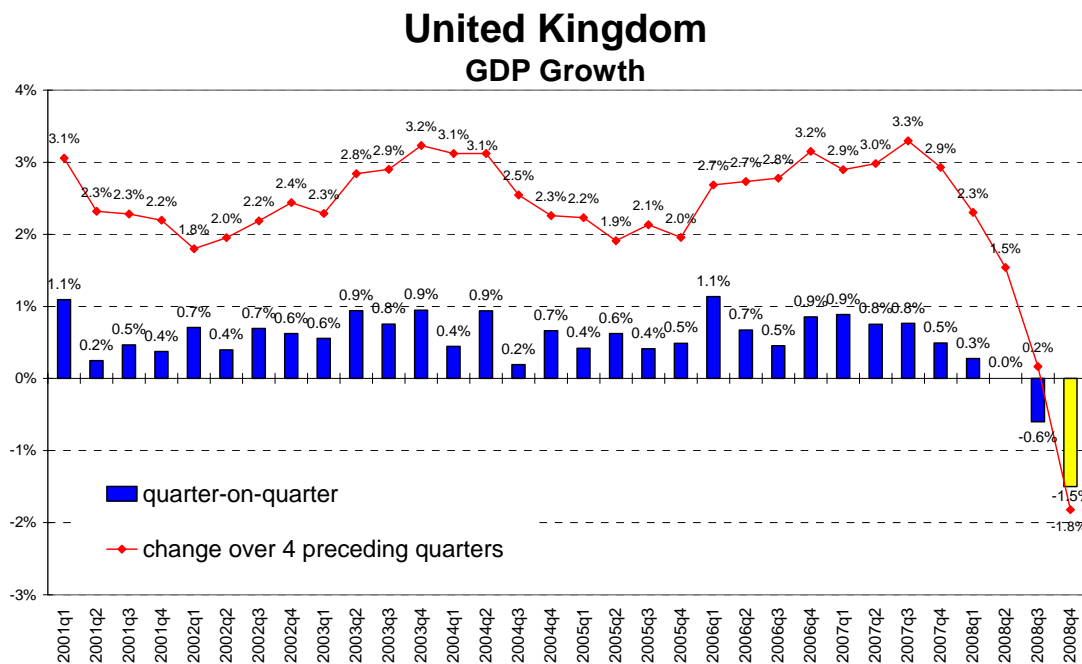


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United Kingdom

According to an initial estimate, GDP in the UK contracted by 1.5 percent, or 6 percent in annualized terms, in the last quarter of 2008, following a decrease of 0.6 percent in the third quarter. A more moderate decrease of 1.2 percent was expected. The main contributing factor to the decrease was a 4.6 percent decline in industrial production.



As we have noted before, the effect of the global financial crisis is especially pronounced in the UK due to the bubble formed in real-estate prices there, the large debts of households, and the large weight of the banking and financial sector in the economy.

United States

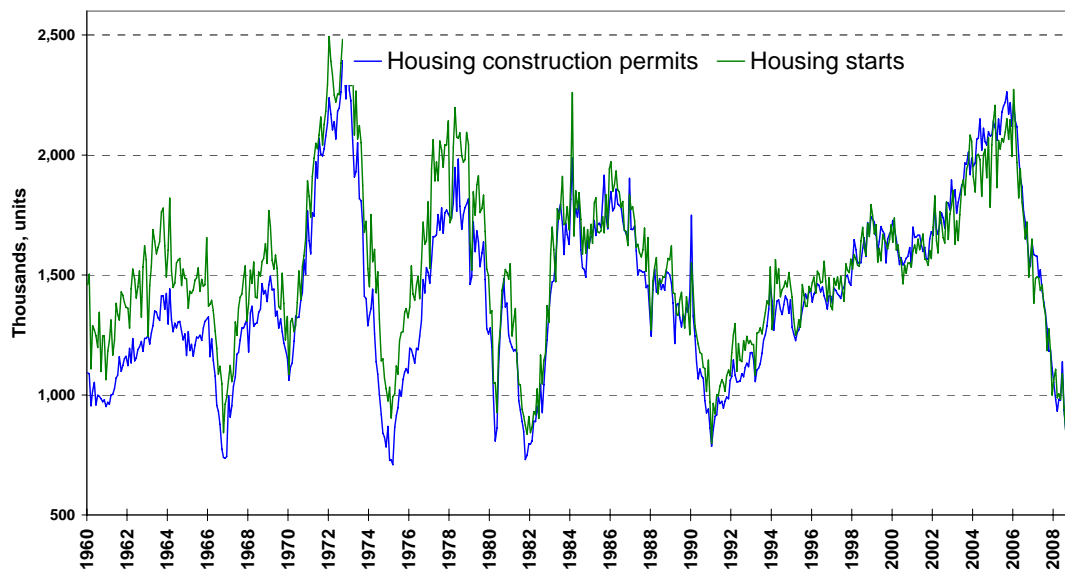
The Obama administration has presented its **plan to cope with the economic crisis**, at a total cost of USD 825 billion over the next two years. The plan includes tax cuts, increased investments in national road infrastructures, renovation and modernization of government buildings, increased investments in alternative energy aimed at doubling output, health-care reform, and education reform with improvements to the learning environment. The plan is likely to undergo changes before being approved by Congress.



Construction starts and permits decreased by 16 percent and 11 percent, respectively, in December, in a sharper-than-expected decline, reaching a historic low.

US housing permits and housing starts

(Seasonally adjusted at annual rate)



Recommended Activity in the Capital Market

- Medium-term government bonds, maturing in 2011-2015, are attractive in our opinion – especially in the CPI-linked segment, but also in the unlinked segment.

Important Announcements in the Coming Week

- The Central Bureau of Statistics will publish data on sales of new homes on Thursday, January 29th.
- An initial estimate of growth in the fourth quarter in the United States will be published on Friday, January 30th.
- Data on private consumption in the United States will be published on Monday, February 2nd.

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