

## Weekly Macroeconomic Review

June 29, 2010

	Expectations derived from the capital market	Our forecast
Inflation in the coming months		0.2% in June 0.5% in July
Future cumulative inflation – next 12 CPIs (through May 2011 CPI)		2.6%
Inflation through July 2011 CPI (average annual rate)	3.1%	3.1%
Bank of Israel interest rate, 6 months ahead	2.10% (up 0.60)	2.25%
Fed interest rate, 6 months ahead	0.25% (unchanged)	0.25%
Yield on Israeli Government 10-Year bond, 6 months ahead	4.79% (up 0.19)	5.10%
Yield on US Treasury 10-Year bond, 6 months ahead	3.18% (up 0.20)	4.00%
Dollar exchange rate, 6 months ahead	NIS 3.89 (up 0.1%)	NIS 3.88

## Israel

The Bank of Israel interest rate remains unchanged at 1.50 percent. The BOI's announcement stressed that the decision was made due to the increase in uncertainty in the global economy, particularly in Europe, and its effects on the Israeli economy.

We thought that the considerable increase in medium- to long-term inflation expectations over the last two weeks (an inflation rate of more than 3 percent for ranges of up to 8 years) would cause the BOI to raise the interest rate this month, despite the questions surrounding the continued economic recovery globally and in Israel, as medium- to long-term inflation expectations serve as the anchor for the inflation target regime and monetary policy.

However, surprisingly and somewhat puzzlingly, the announcement does not mention the increase in medium- to long-term expectations. While according to the interest-rate announcement, the capital market estimates the rate of inflation for the next twelve months at approximately 3 percent, the BOI is more optimistic: “Looking twelve months back, inflation is trending down; it is expected to approach the lower limit of the price target range at the end of this year, and to be around the midpoint of the target range in twelve months. Concurrently, according to the model, the BOI interest rate is expected to rise to an average level of 2.1% in the last quarter of the year and 2.5% in one year’s time.”

In other words, the BOI estimates that inflationary pressures are quite moderate, and that it will need to raise the interest rate only four times during the coming twelve months.

## United States

**Financial sector regulation reform:** The US House of Representatives and Senate have reached an agreement regarding the language of the reform, and final approval of the law is expected within about a week. The reform, led by the Obama administration following the global financial crisis, is aimed at tightening supervision of risk levels in the banking sector in order to avoid additional bailouts of financial institutions, enable government agencies to cope better with threats to the stability of the financial system as a whole, and strengthen mechanisms for the protection of financial consumers.

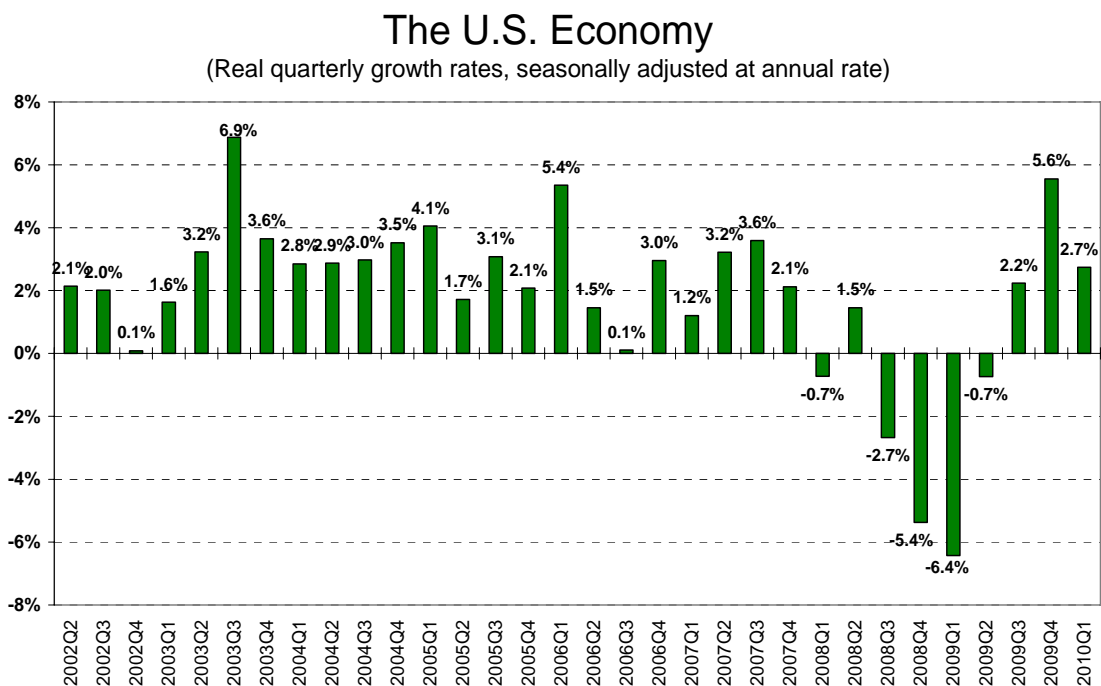
The reform includes:

- Regulatory supervision imposed on the derivatives market (a watered-down version of the original proposal).
- Limits on banks’ trading in their own (“nostro”) funds (also a watered-down version of the original proposal).

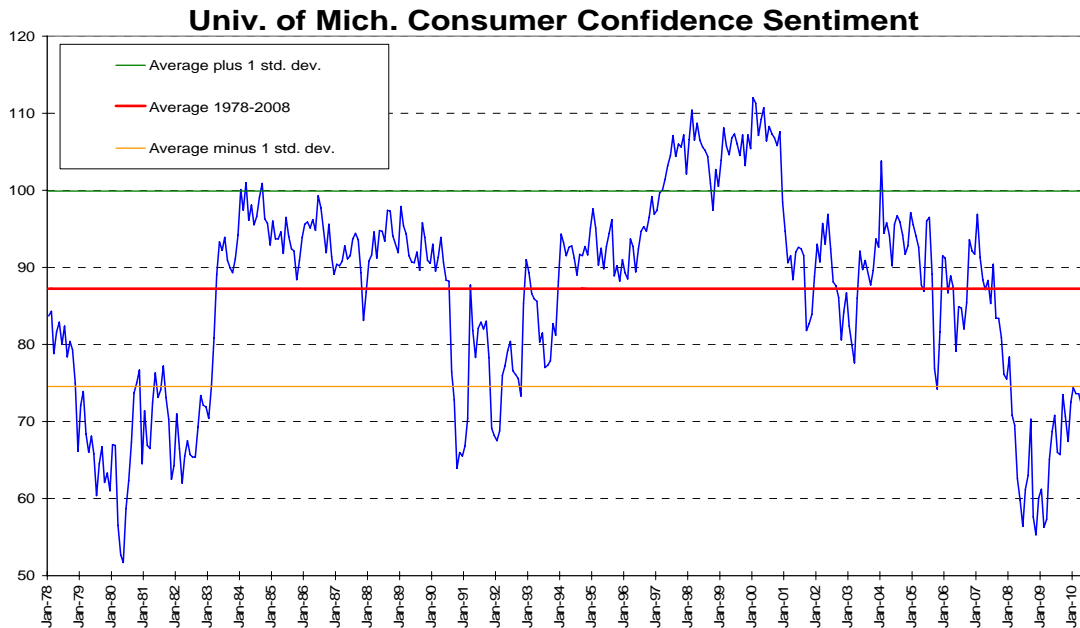
- Mechanisms and authorizations for the liquidation of large companies whose collapse could undermine the stability of the financial system.
- Tighter supervision of the hedge-fund sector.
- Additional measures to protect consumers.

The reform does not apply a special tax to the financial sector (as proposed by the International Monetary Fund), but this subject will be discussed separately at this week's G20 meeting.

**Growth data** for the first quarter of 2010 were revised downward. According to the most recent estimate, GDP grew at an annualized rate of only 2.7 percent.



The University of Michigan's **consumer confidence index** reached 76 points in June, above expectations. This is the highest readout for this index since November 2007, but still lower than the multi-year average.



Housing market figures released over the last week were not favorable. **Sales of new homes** dropped 30 percent, below expectations. The level recorded in April is the lowest since the documentation of sales began in the 1960s. **Sales of existing homes** fell by 2.2 percent in March, also below expectations. The US government incentive programs designed to support the housing market have recently been drawing to an end. This has reawakened concerns over a renewed decline in prices of homes.

**The Fed** left the interest rate unchanged, as expected. The interest-rate announcement emphasized the weakness of the economy, and led to a further postponement of the expected increase in the Fed interest rate, to around mid-2011.

**Real consumption** increased by 0.3 percent in May, a relatively strong gain following a flat rate in the preceding month. The **rate of savings** increased to 4.0 percent, from 3.8 percent in the preceding month. **Core prices of private consumption** (the core PCE deflator) rose by 0.2 percent in April, following an increase of 0.1 percent in the preceding month.

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

Forecast change, May 2010 to August 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%	3.3%	5.8%	1.2%	1.3%

## Important Announcements in the Coming Week

- The Case-Shiller home price indices will be published in the United States on Tuesday, June 29.
- Israel's Central Bureau of Statistics will publish data on sales of new homes on Wednesday, June 30. The estimated consumer price index will be published in the eurozone.
- The ISM manufacturing sector index will be published in the US on Thursday, July 1.
- The Employment Report will be published in the US on Friday, July 2.

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.

Please address comments or questions to Mr. Ofer Klein at

[oferk@harel-finance.co.il](mailto:oferk@harel-finance.co.il)

*If you would like to be removed from the Harel Group mailing list, please let us know in a reply to this e-mail.*