



Private Banking  
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# INVESTOR'S REVIEW

ESPECIALLY FOR LEUMI PRIVATE BANKING CLIENTS

## Macro Economic

By: **Eyal Raz**, Finance & Economics Division, Leumi

### What's in "Investor's Review"

- Macro Economic Review
- World Macro Review
- General Electric Bonds: An Opportunity for Investment?

### **The Bank of Israel cuts interest rate by 25bps, to 3.5%**

The Bank of Israel (BoI) announced on October 27 that it is cutting interest rates in November by 25bps, bringing the rate to 3.5%. The main conditions noted by the central bank in its announcement included the continuation of the downward trend in inflation expectations and forecasts; the slowdown in the rate of economic activity – both according to the composite state-of-the-economy index (see next paragraph), and also according to initial data from the companies survey; and the negative effects of the previous points on tax collections. In addition, the continued deterioration in global markets was mentioned in the announcement, and the expectation that central banks around the world will continue to cut interest rates, maintaining them at low levels.

Against this backdrop, the main factor behind the BoI's interest rate decision was the belief that inflation is expected to drop to within the 1-3% target range towards the middle of 2009. Therefore, it seems that the matter of inflation has become less of a consideration in interest rate decisions; while the rise of uncertainty in the financial markets has become a major factor. Thus, the BoI claims, *"the current cut in the interest rate is intended to reduce the cost of credit and to help the economy deal with the possible implications of the global financial crisis."* In addition, the interest rate cut is intended to support economic activity in the local economy against the backdrop of a slowdown in the rate of economic growth (according to the BoI, the economy is expected to grow 2.7% in 2009; while Bank Leumi forecasts a lower growth rate of 2.2% for next year.)

The recent depreciation of the shekel vis-à-vis the US dollar had only a slight influence on the interest rate decision of the BoI. This is due to the fact that this weakness was derived more so from the behavior of the dollar in world markets and less so from a weakness in the shekel, and according to the BOI, *"has at this stage had only a minimal effect on inflation in Israel"*. In the coming months we expect the BoI to continue to cut its interest rate.

The real interest rate in the economy (the interest rate of the BoI minus expected inflation) is expected to rise above 2% in November, which is a relatively high real rate for an economy in a severe slowdown. Thus, it appears the process of cutting interest rates is still not at an end, **with the severity of the crisis and its implications on Israel consequently dictating the degree and the speed at which local interest rates are cut.**

### Index

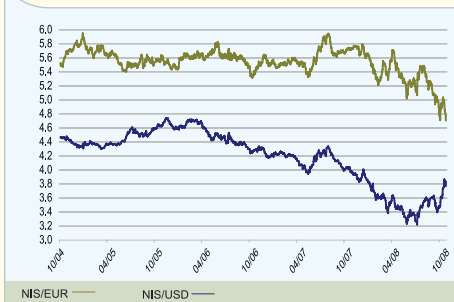
	Rate	Return in % October	Return in % in 2008
TA 100	682	-19.67	-44.08
TA 25	733	-18.20	-40.39
DOW JONES	9,325	-10.04	-29.70
NASDAQ	1,721	-13.25	-35.11
NIKKEI 225	8,577	-26.96	-43.97

Correct to 02.11.2008

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# World Macro

### Euro and USD vs. NIS



By: **Liora Caplan**, The Capital Market Research Department, The Investment Counseling Division, Leumi

How do you even begin to sum up October's events? No doubt, things looked rough to begin with, but as the month progressed, an "end of the world" gloom seemed to take hold. As the global credit freeze reached yet another pinnacle, investors realized that many financial companies around the world will not be able to survive without government help, even though some hardly had any exposure to the US subprime market. Thus, stock markets continued collapsing, some at unprecedented rates.

Under Bernanke's leadership, central banks tried to address the situation by conducting a historical coordinated rate cut of 0.5%. This was accompanied by an injection of almost unrestricted short term liquidity to the markets. When it became clear that these steps did nothing to ease the credit crunch, or save those who need saving, governments stepped in with a series of dramatic measures. European leaders finally agreed that coordinated action was needed and the UK took the lead as the first to announce a rescue package. This package included direct capital injections to local banks via preferred shares and government backing for short term debt issuance. The US followed step as Treasury Secretary Paulson announced that \$250 billion out of the TARP money will be used for direct investment in local banks in order to strengthen capital ratios and stimulate lending.

In spite of all these efforts, the global financial system seemed extremely slow to respond and there was no evidence of a substantial ease in the credit freeze. In addition, economic data from all over the world intensified the anxiety and realization that what started as a local real estate problem in the US might have transformed into a global recession, one which is threatening to drag down not only companies, but countries as well. Thus, Argentina nationalized local pension funds, due to its own liquidity problems; the financial sector in Iceland went bust, dragging the currency to a total collapse (the USD gained around 90% vs. the krona since the beginning of the year); a number of countries turned to the IMF for help, including Iceland, Hungary, Belarus and the Ukraine. All these events contributed to the panic which prompted liquidation of carry trades and an extraction of money from emerging markets.

Some may say that the steep decline in commodity prices, especially oil, was one of the few bright spots in the past weeks, as it brought a promise of relief for consumers and enabled central banks to loosen their monetary stance. Nevertheless, these declines hurt companies and countries whose earnings are commodity related; stark examples are Russia and Brazil.

This article is being written prior to the end of the month and following a very green day. Does this mean that things are going to change? Truth be told, when the VIX index (measuring S&P500 volatility) fluctuates between 40 and 90, extremes which have never been witnessed before, it is extremely hard to find rationality in the markets, and certainly not a clear answer.

Lower VIX levels will indicate lower panic levels. A lower Ted Spread (the difference between the 3 month libor rate minus the T-Bill yield) will indicate a growing willingness of banks to lend to each other. These two elements must exist in order for markets to return to normalcy. However, these elements are far from being enough. In the short term, the global financial system has to return to its traditional role of lending money to businesses; otherwise the real global economy will continue to suffer. In the longer term, the financial system needs new reliable tools to properly evaluate true asset value and risk; nowadays it is clear that credit ratings have completely lost their credibility. There is no doubt that the remainder of 2008 and 2009 are going to be difficult for the global economy. Nevertheless, it is worth remembering that markets usually move ahead of the real economy and currently they are already pricing a significant blow to future companies' earnings.

### TA25



### Oil Prices per Barrel (USD)



### Gold Prices (USD)



# Going Further – Bank Leumi (UK) plc\*

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\*Bank Leumi (UK) plc is authorised and regulated by the Financial Services Authority

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