



Private Banking  
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"Leumi - The Best Private Banking in Israel"

(Euromoney Survey, February 2009)

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

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### Select Indices

	Rate	Return in % July	Return in % 2009
TA 100	896	11.78	58.77
TA 25	959	11.22	46.48
DOW JONES	9,172	8.58	4.50
NASDAQ	1,988	8.31	26.03
NIKKEI 225	10,357	4.01	16.90

Representative Rates July 31, 2009

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# INVESTOR'S REVIEW

ESPECIALLY FOR LEUMI UK PRIVATE BANKING CLIENTS

## Macro Economic

By: **Eyal Raz**, Head of Economics Department, Finance and Economics Division

*The interest rate of the Bank of Israel (BoI) – no change; central bank intervention in the local bond market will cease, but will continue in the foreign exchange market*

On July 28 the BoI announced its interest rate for August will remain unchanged at 0.5%. In explaining the background conditions that led to its decision, the BoI noted several points. First, the central bank highlighted its estimate that the CPI figures for the next two months will be high due to the expected increase in prices caused by tax changes and a rise in prices of certain government controlled prices (for example, water). Therefore, inflation on a trailing 12-month basis is expected to remain along the upper border of the price stability target range (1-3%) in the near term.

In addition, the central bank noted that indicators on real activity show a slowdown in the decline in activity, and perhaps even an end to the economic slowdown in the second quarter of the year. These positive indicators, alongside the weakening of the dollar around the world, supported, in the opinion of the BoI, the strengthening of the shekel.

*The significance of the actions taken by the BoI: the beginning of the "exit strategy" from the non-conventional policy steps implemented during the crisis*  
In addition to the publication of its interest rate decision, the central bank also announced it would cease purchasing government bonds in the secondary market on August 5, and that it has no intention of selling the securities already purchased by the bank. Also, the central bank announced it will continue to purchase foreign currency in the foreign exchange market.

These three decisions indicate in our opinion the beginning of the implementation of an "exit strategy" from the complete range of non-traditional monetary instruments implemented by the BoI as the Israeli economy faced the global crisis and the country entered into recession. This is a reflection of the assessment that even if the economy still has not yet exited from the recession, it is at least on the way out; while as far as the BoI is concerned, inflation does not reflect a risk at this stage. This change in policy, which precedes similar moves by other countries around the world, stems from, among other things, the unique condition of Israel and the relative weakness of the crisis felt in Israel relative to what occurred in other Western countries. Consequently, if there will be additional signs of recovery in the state of the local economy – it will likely initiate an even earlier start of a process of interest rate hikes.

*The companies survey of the Bank of Israel shows an improvement relative to previous quarters*

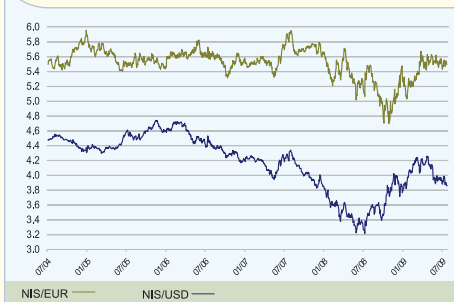
Companies' responses to the second quarter survey of companies of the BoI indicate the rate of decline in business activity is moderating compared to the two preceding quarters. All sectors still show a decline in activity. However, this decline is relatively moderate compared to the first quarter of the year, except for the construction sector, which was stable, and the communication sector, which showed an increase in activity. In most sectors there began an easing of demand side constraints (restricting an increase in activity). The data from the BoI's survey of companies, even though they are qualitative in nature and not quantitative, reflect a trend of improvement in the conAhe survey, the economy is recovering more rapidly compared to the last recession at the beginning of the decade.

This micro-economic picture, if it will continue as well in the coming quarter, will likely reflect a recovery in the business sector that shows up as a "V" shaped curve rather than a "U" shaped curve (a long period of a trough in activity as was the case in the crisis in the years 2001-2003). Initial support for such a development can be seen by looking at companies' outlooks for the third quarter. According to the views, there are specific sectors that foresee an increase in activity.

# World Macro

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

**EUR and USD vs. NIS**



Data published during July indicated further economic improvement in the US as well as Europe. As in the past few months, no signs of a breakthrough were apparent, rather evidence of a slow and gradual recovery.

Second quarter US GDP figures were among the most important indicators published. While expectations were for a 1.5% contraction in GDP (annualized), the figure was not as bad as expected, at -1%. The trade deficit and government spending were key positive contributors. Nevertheless, these two were not enough to counter the decline in investments and inventories. It is important to note that although GDP turned out to be better than expectations, private consumption did not, and Q1 growth in private consumption was revised down. We believe that the shrinking trade deficit and government stimulus will continue to support growth and at the same time expect some improvement in the other GDP components. On the other hand, growing unemployment will make quick economic recovery hard to achieve. A positive surprise might come from inventories. After a long period of contraction, a change in trend might have a considerable effect on GDP.

Housing sector indicators were mostly positive and helped lift investor sentiment. Production indicators were mixed, and consumer sentiment and confidence indices declined.

**TA25**



On July 21<sup>st</sup> Federal Reserve chairman, Bernanke, gave his semi-annual testimony on the state of the economy and monetary policy to Congress. In an unprecedented move, the chairman published an opinion piece in the Wall Street Journal on the day before. In both instances, the chairman elaborated on how the Fed will be able to prevent the record reserves that banks have accumulated from causing money supply and inflation to surge. Considering that the central bank prefers not to raise interest rates in order not to hurt that fragile economic recovery, it is understandable that inflation expectations need to be reigned in, by reassuring investors that the Fed will contain consumer prices when the economy recovers.

**Oil prices per barrel (USD)**



Second quarter financial reports were center-stage this month. Most companies have already published and while, as expected, most registered a decline in profit, the reports generally conveyed positive surprises. Thus, in most cases the decline in profit was not as bad as analysts predicted although, improved company efficiency was the main driver of better results rather than growth in demand for their products. This indicates the difficulty companies are going to have in showing further improvement in their results in the absence of a notable improvement in the real economy. Still, the results were enough to refuel investor optimism and stock markets soared. The MSCI world and emerging markets indices added 8.7% and 10.9% respectively.

**Gold prices (USD)**



In light of market gains in the past few months and considering that we are not expecting any especially good news in the near future (the reporting season is nearing its end and no dramatic changes are expected in the economic background), the trading trend in the near future might change and we might witness a correction.

# The Water Crisis

By: **Natan Bridner**, Special Credit Department

Water shortage is one of the challenges that the State of Israel is facing. Compared to the previous decade, general water consumption in Israel has increased by 23%. The most substantial increase was in domestic consumption which increased by 95%. Industrial consumption increased by four percent, while agricultural consumption decreased by nine percent as a result of agricultural water quota reductions.

Israel's annual water consumption is 1,355 million cu. meters while the total supply is only 845 million cu. meters. (i.e., there is a shortage of 510 million cu. meters.) According to forecasts, the annual demand for water in 2013 will increase to 1,845 million cu. meters, while the total supply will increase to 1,780 million cu. meters. Resulting in a 65 million cu. meters shortage.

One of the solutions for increasing the water supply is desalinating seawater. This process involves reducing the salt content in the water, improving its quality and making it suitable for drinking.

The two desalination installations currently operating in Israel at Ashkelon and Palmahim supply 138 cu. meters per annum and operate using the reverse osmosis method. Using this method, saline water is compressed through membranes, which only allow water to pass through and prevent the passage of salts.

The desalination plant at Palmahim was constructed as a B.O.O. (Build Own Operate) venture - a contractual engagement between the government of Israel and entrepreneurs who construct and operate the plant and sell its product or services to the government at a predetermined price during the contract period. Upon the termination of the contract period, the plant remains under the proprietorship of the entrepreneurs.

The plant at Ashkelon was established in pursuance of a B.O.T. (Build Operate Transfer) agreement - a contractual engagement between the government of Israel and entrepreneurs, who construct and operate the plant and sell its products and services to the government at a predetermined price for the duration of the contract. Upon the termination of the contract, the plant remains under the government's proprietorship.

As a part of additional ventures, the State of Israel is planning to construct three additional plants, which would increase the water production by 377 million cu. meters.

The Hadera plant was established as a B.O.T. venture for a period of 25 years. This plant is expected to supply 127 million cu. meters by the year 2010.

The Ashdod desalination plant is in the tender stages and should provide 100 million cu. meters by 2013. This plant will operate using the reverse osmosis method.

The third plant at Soreq is nearing the tender presentation

stage and should provide 150 million cu. meters by 2012. In 2007, Mekorot opened a central filtration plant in the Eshkol District. This plant is the only one of its kind in Israel and the fourth largest in the world. The plant filters more than 500 million cu. meters and has placed Israel in the forefront of Western countries in the quality treatment of the drinking water supplied to inhabitants.

A project that is still in the planning stage and that is expected to be completed within eight years, is increasing the water supply to Jerusalem and its surroundings. The system to be erected will exploit the desalinated water produced in both the existing and planned coastal plants. It will include 22 Km's of water piping and a 14-km long subterranean tunnel that will pass under the Judean Hills. This system will be able to supply 150 million cu. meters.

According to the water authorities, approx. 80 million cu. meters of water go down the drain annually because of the pollution of underground water and shutting down wells. Mekorot is currently working on a three-year plan aimed at upgrading 50 wells.

The situation facing the country obligates increased water saving efficiency in all sectors. Water savers save up to 15% of water consumption. Installing these savers in public buildings and raising public awareness to installing them in private housing would increase water savings substantially.

Raising the price of water for private consumption as of the 15th of July, 2009, should further reduce water wastage.

Grey water (from showers, basins and sinks and washing machines) accounts for approx. 60% of domestic water consumption. Recycling this water would save 50 million cu. meters per annum.

A study conducted by the Technion has determined that rainwater can be run off to open ground. This would result in the rainwater seeping into the underground water supply. Flood waters would not flow into the sea and savings of 100 cu. meters of water could be generated.

Sewage water treatment in purification plants would also provide a solution to the water shortage.

The water emergency in Israel can be alleviated using two methods: increasing the water supply and reducing consumption. Desalination plants are currently established through tenders. This method extends the time required for constructing the plants. The State should most probably change from tenders to licenses. The quantity of water required must be determined, minimum license conditions required and who must comply with them must be detailed in order to obtain a license and supply water. Installing water savers, water price hikes, running rainwater back into the ground and recycling grey water would decrease water consumption substantially.

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

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