



Private Banking
Issue No. 77
June 2009



"Leumi - The Best Private Banking in Israel"

(Euromoney Survey, February 2009)

What's in "Investor's Review"

- Macro Economic Review
- World Macro Review
- Mexico – An Economic Review

Select Indices

	Rate	Return in % May	Return in % 2009
TA 100	808	8.42	43.24
TA 25	882	8.55	34.65
DOW JONES	8,500	4.07	-3.15
NASDAQ	1,774	3.32	12.51
NIKKEI 225	9,523	7.87	-7.49

Correct to 31.05.2009

Editing: Smadar Ilan, Head of Products Marketing Department
Leumi Int'l and Private Banking Division
Tel: 972-3-5149989
fax: 972-3-5149602
Email: smadari@bll.co.il

INVESTOR'S REVIEW

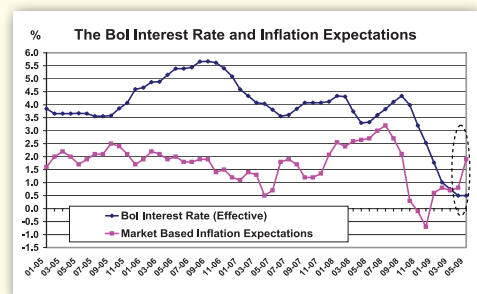
ESPECIALLY FOR LEUMI UK PRIVATE BANKING CLIENTS

Macro Economic

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

The Bank of Israel's interest rate remains unchanged

On May 26, the Bank of Israel (BoI) announced its interest rate for June will remain unchanged at 0.5%. In its interest rate announcement, the central bank noted its forecast for a 1.5% decline in Israel's 2009 GDP, based on the estimate that the return to growth will occur only at the end of the year. Also regarding the labor market it noted that some indicators show a moderation in the severity of the current economic situation.



Regarding the global economy, the bank noted, "Much of the recently published economic data is not as bad as expected, and some data are in fact positive." Thus, even though the BoI estimates that a return to growth is expected only at the end of the year – in its interest rate decision, consideration was given to a possible moderation in the negative trend in economic activity. Another factor mentioned in the BoI decision was inflation expectations are currently around the middle of the price stability target range of 1-3%.

Looking forward, it appears that until there are additional signs of a recovery in economic activity in Israel, the BoI will continue its policy of monetary expansion and will maintain a low nominal interest rate. Regarding this issue, the real expected interest rate (which is the nominal interest rate minus expected inflation, see graph) is today at a negative rate of 1.5%. This has resulted primarily due to the recent rise in inflation expectations to nearly 2%. This is an additional way to view the reduction in the price of money for the purpose of encouraging economic activity.

GDP growth in the first quarter of 2009: -3.6% in annualized terms

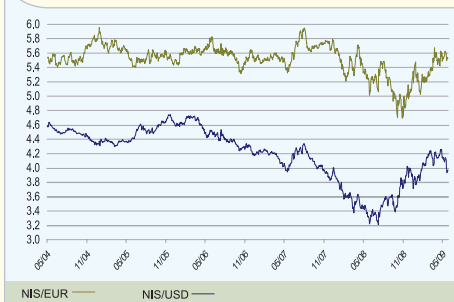
In the first quarter of the year Israel's annualized GDP declined 3.6% compared to the first quarter of 2008, following negative GDP growth of 0.5% in the fourth quarter of 2008. Since signs of a recession became noticeable in the last quarter of 2008, the average level of the GDP fell 0.9% in annualized terms, compared to the average from the second and third quarters of 2008.

All components of GDP, except for investment in residential construction, registered a downturn in the past quarter, with notable annualized declines of 46.3% and 62.7% registered in exports and imports respectively. (Looking at these figures in "annualized terms" must be viewed with caution since it implies an assumption that the sharp declines registered in the first quarter will continue a full four quarters.)

An analysis of quarterly GDP growth rates since 1995 shows that during this period negative GDP growth figures over two or more consecutive quarters was seen only at one other time – in 2001 (if we were to look at GDP per capita, then 2002 would also be included). Bank Leumi currently forecasts that Israel's GDP will show negative GDP growth of 0.9% for all of 2009. This estimate is consistent with a decline in GDP throughout the first half of 2009, and the beginning of a moderate recovery during the second half of the year.

World Macro

Euro and USD vs. NIS



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

Macroeconomic indicators published during May strengthened investors' belief that the economic slowdown is coming to a halt. Undoubtedly, the situation is still severe, but signs of stabilization are mounting. A significant event this month was the publishing of the banks' stress tests' results. The results were received positively by the public, thus fulfilling their purpose of bringing stability to the financial sector and clarity as to the banks' capital positions. As of today, it appears as if most of the panic has been washed out of the system and investors' focus has turned from the potential damage done to the global economy to signs of improvement.

TA25



Although data coming from the US housing sector this month were mixed, investors tended to ignore the bad news, making the sector a source of investor optimism. The rate of housing starts and building permits continued to slow during April, while new and existing home sales rates showed stability. The number of pending home sales grew sharply, indicating an expected growth in sales. Not enough attention was given, however, to the fact that the decline in prices continued and mortgage delinquencies as a percentage of total loans soared during Q1. Thus, it seems as if the expected rise in home sales is mainly a result of negative factors (i.e., low prices, rising foreclosures and tax breaks for first-time buyers) rather than as a result of an improvement in potential buyers' finances. Looking forward, the housing market will have to cope with the implications of a sharp rise in long-term mortgage rates. It is also important to remember that as long as there is no significant improvement in employment, there is small chance for a significant improvement in the housing sector.

Oil Prices per Barrel (USD)



Consumer sentiment and confidence measures published during the month indicate considerable improvement in sentiment. This is likely the result of relief over the positive stress tests' results in the financial sector and in light of stock market performance (which has contributed to consumers' wealth). Indicators also showed a slowing decline in the manufacturing sector. Another positive surprise came from April's jobs report, which showed a loss of only 540,000 jobs after four straight months with an average monthly loss of 700,000 jobs.

As stock markets continued their upward trend, which started in mid-March, bond prices declined. As yield curves rose, the rises were more pronounced in longer term bonds, causing a steepening of the curves. This resulted for multiple reasons, among them a decline in anxiety levels, which resulted in money flowing to riskier assets (stocks, corporate bonds, etc.) and an abundance of government issuances, brought by the need to finance various rescue plans. Another major reason was the fear that the immense amount of money injected into the markets would result in future inflationary pressures and consequently a rise in interest rates. Thus in bond trading, as in equity trading, the focus changed from fear of the current situation to fear of the effects of current steps being taken to deal with the crisis on future economic conditions.

Gold Prices (USD)



More evidence of the dropping anxiety levels could be found in anemic market reactions to major events such as GM's and Chrysler's bankruptcies and the success of banks' equity offerings, as a result of the stress tests or in order to repay loans taken from the government.

Naturally, the improving sentiment in the US affected trading globally. In light of the upward move markets have already made, we believe the risk for a correction in the short term is high, and might be triggered by macro data, which are far from being ideal.

Mexico – An Economic Review

By: **Itamar Dar**, Capital Market Research Department, Investment Counseling Division

The Mexican economy is the fourth largest in America with an annual GDP of \$1.02 trillion. In 1Q09, the economy registered negative growth in GDP for the third consecutive quarter.

The Mexican economy is not immune to the global economic crisis and, in comparison to other developing countries, is highly dependent on its northern neighbor, the US. Their geographic proximity and the 1994 free trade agreement (which enables tax-free transfer of goods between the two countries) allow companies to manufacture products in Mexico at reduced costs and then export finished goods to the US for sale. Mexico's dependence on the US is so extensive that 80% of the country's exports are designated for the US market.

In addition to the damage caused by the global economic crisis, an epidemic of swine flu broke out in Mexico in April that is expected to shave approx. 0.3%-0.5% off GDP for the current year. The Mexican government has updated its growth forecast for 2009 from -4.1% to -5.5% and it now expects the Mexican economy to begin a recovery only at the beginning of 2010. The IMF forecasts growth of -3.7% during 2009 and positive growth of 1% in 2010.

Inflation

In April, the Mexican Consumer Price Index (CPI) rose by 0.35%. The annual inflation rate rose from 6.03% in March to 6.17% in April. The April CPI was higher than earlier expectations, with the prices of vegetables, fruit and beer pushing the index upwards. The Bank of Mexico expects inflation to decrease to 4.5% by the end of 2009, while an average of economists' forecasts indicates a decrease to 4.0%.

Monetary Policy and the Domestic Currency

Similarly to most central banks in developing countries, the Bank of Mexico responded to the financial crisis by cutting its main interest rate. The interest rate in Mexico, which was 8.25% in November 2008, has since been cut by an accumulated 3% including the recent cut of 0.75% in mid-May, and now stands at only 5.25%. According to expectations, the interest rate will be cut again at the central bank's next meeting in June and, by the end of the year, the bank's rate will be lowered to 4.5%.

The domestic currency, the Mexican peso, has declined against the American dollar and the euro by approx. 4% since the beginning of 2009. It is worth noting that the weakening trend of the peso, since the beginning of the year, is contrary to the general trend over recent years,

during which the developing countries' currencies, including that of Mexico, strengthened against the currencies of developed countries.

The Country's Credit Rating

The most recent reference to Mexico's credit ranking was published by the S&P ranking agency on May 11, 2009. S&P decided to reduce Mexico's economic outlook from stable to negative while leaving the country's credit ranking unchanged at BBB+. S&P noted unfavorably the country's heavy dependence on crude oil and its low rate of tax collection, which contributes only 21% to the government budget, the lowest level amongst the OECD nations.

Bonds

Mexican two- and ten-year government bonds, quoted in pesos, are currently being traded with yields to redemption of 5.2% and 7.8% respectively. The global economic slowdown and the Bank of Mexico's interest rate cuts have resulted in yield declines of 400 basis points along the length of the curve since the end of 2008. An investment in these bonds also exposes the investor to fluctuations in the value of the peso.

We believe that the deterioration in the macroeconomic conditions in Mexico have made an investment in Mexican government bonds less attractive, especially considering the low yield level relative to the risk.

The Stock Market

The main stock index in Mexico is the Mexican Bolsa Index (MEXBOL), which includes the stocks of 35 companies. The index's market value is approx. \$184 billion.

Over the past five years, the index has increased in value by 20%. Over the past year it declined by 22%. The index's earnings multiplier was 15.7 and the future earnings multiplier 14.0. The average of the future earnings multiplier in the Mexican index since the beginning of 2006 is 12.1, 14% lower than the current future earnings multiplier. After the sharp price declines of the past year, we would expect the current future earnings multiplier to be lower and, the fact that this is not so, reduces the attractiveness of investing in the index.

We believe the Mexican stock index is not expected to outperform the stock indices of other major developing markets. Compared to companies in other developing markets, Mexican companies are largely dependent on the recovery of private consumption in the US, a large stumbling block for potential investors.

Going Further – Bank Leumi (UK) plc*

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We offer a full range of banking services in all major currencies, accept deposits for sums of £50,000 and above (or equivalent in other currencies), and provide payment services, cheque books and charge cards.

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Leumi Private Banking

Bank Leumi (UK) plc
020 7907 8008
PrivateBanking@bankleumi.co.uk www.bankleumi.co.uk

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info@leumijersey.com

www.leumijersey.com

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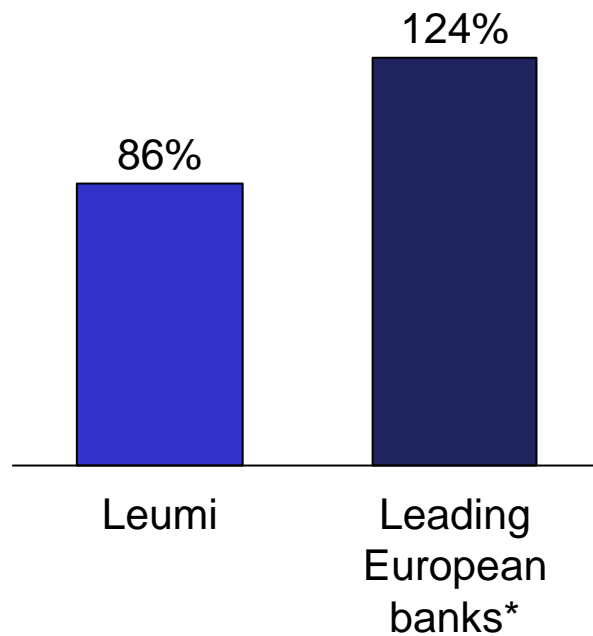
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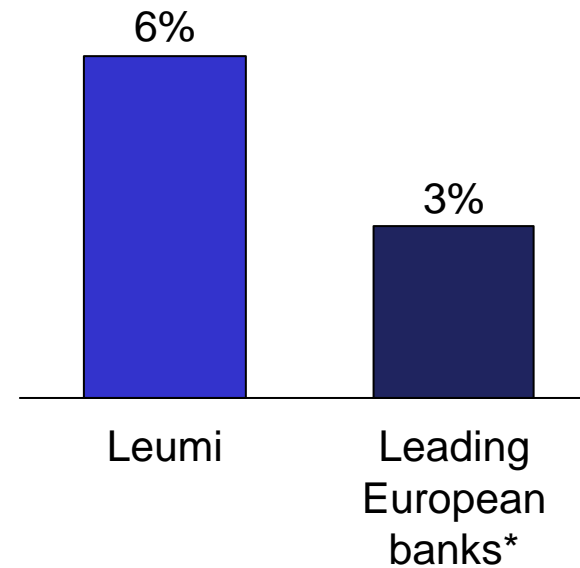
Leumi enjoys high liquidity and a low leverage ratio...

YE 2008

Loan/Deposit ratio



Tangible Equity/Tangible assets



Source: Goldman Sachs, Leumi analysis

* Simple average for HSBC, Lloyds, Santander, UniCredit, BBVA, BNPP, Barclays, DB, CASA

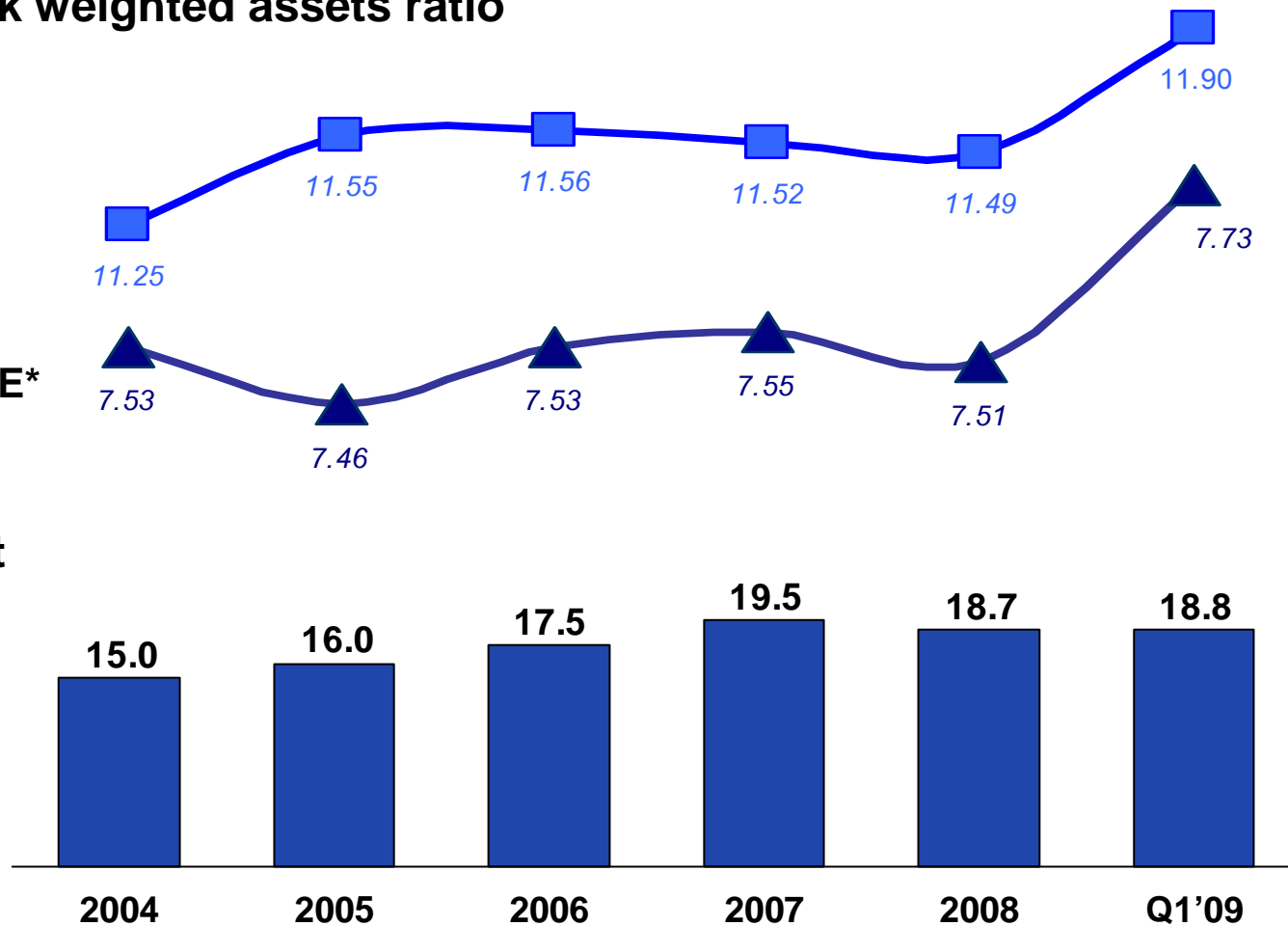
...And has maintained a strong capital position across the years

Capital to risk weighted assets ratio

%

Total

Core Tier I / TCE*

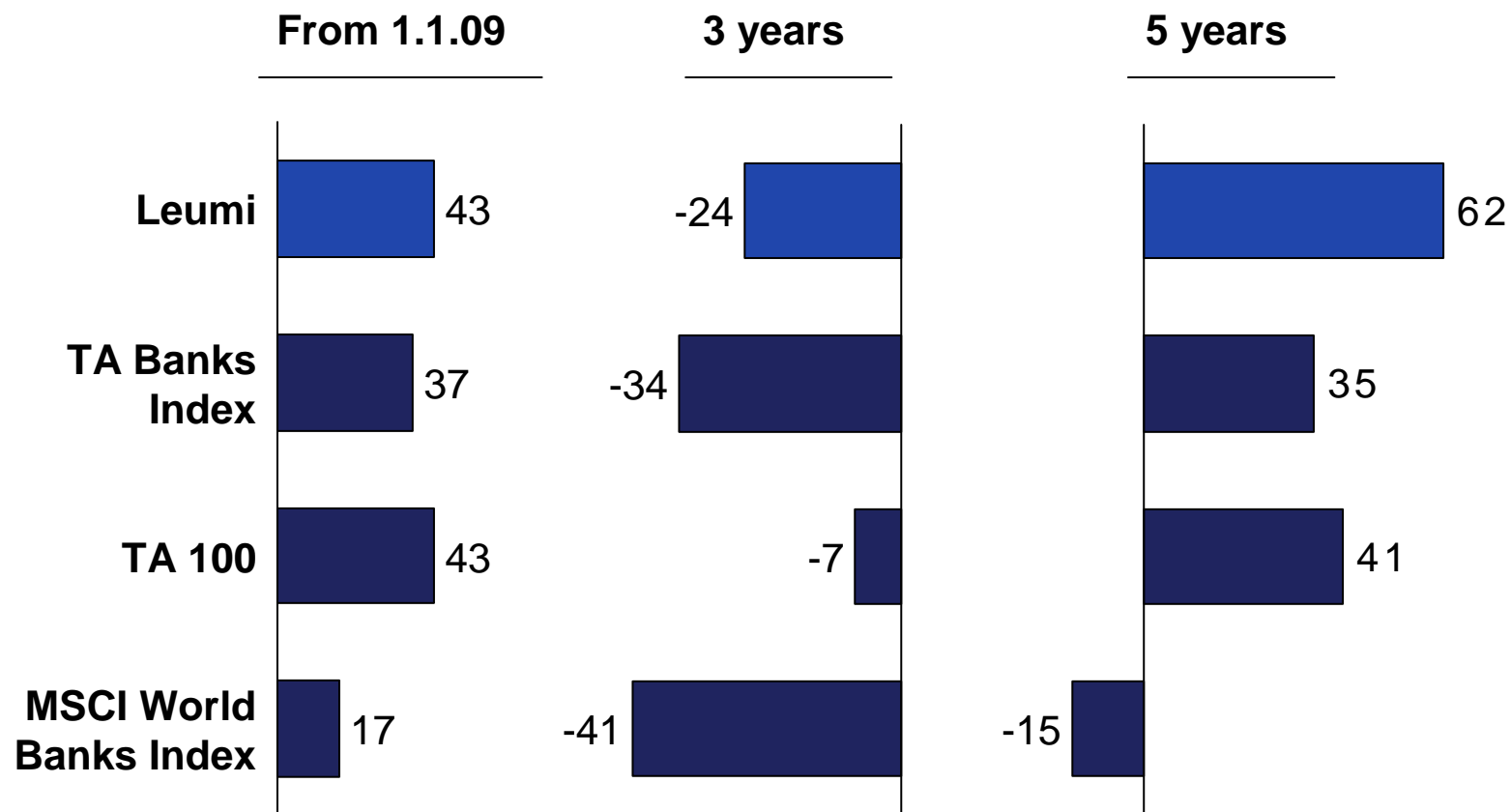


* Of that: goodwill amounts to some ILS 247 million

Over the long run, Leumi delivered its shareholders superior returns

as of 08/06/09 ,%

Shareholders' Returns*



* Stock appreciation & dividends