



INVESTOR'S REVIEW

Issue No. 86
May 2010

ESPECIALLY FOR LEUMI UK PRIVATE BANKING CLIENTS

Israeli Macro Economic Review

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

What's in "Investor's Review"

- Israeli Macro Economic Review
- World Macro Economic Review
- What are the Risks Involved in Investing in Structured Bonds?

Economic activity in Israel is expanding at a rapid pace

The composite state-of-the-economy index, published monthly by the Bank of Israel (BoI), increased 0.6% m/m in March, while for all of the first quarter it increased 1.3% (an annualized rate of more than 5%). Looking at the annualized rate of increase, we see that this index is today in an upward trend as it returns to its pre-crisis rapid rates of growth. This recovery in economic activity is reflected in a list of economic data published recently, with all data items showing a rapid growth trend also in the first quarter of the year, after a growth rate of 4.8% (in annualized terms) recorded in the fourth quarter of 2009. It appears this growth is being accompanied by a continued decline in the unemployment rate that, according to trend data published by the Central Bureau of Statistics (CBS), reached 7.3% in February 2010.

The interest rate of the BoI remains at 1.5%

On April 26 the BoI announced that its interest rate for May will remain unchanged at 1.5%. Within the framework of the background conditions noted by the central bank, the BoI's assessment that real activity in the economy continues to expand was mentioned, even though there is data that indicates a moderation in the rate of expansion.

Within the discussion of the main factors behind the interest rate decision, the BoI noted three items that support a gradual hike in the interest rate: (1) There is a downward trend in inflation, which is expected to enter the 1-3% target range, and even during the continuation of the year, inflation is expected to fall below the middle of the range. Inflation expectations, both those derived from the capital market and also those of private forecasters, remained close to the upper border of the target range. (2) The growth process in the economy has stabilized, even though according to the estimates of the BoI the closing of the output gap and reaching potential full growth are expected to be gradual. And finally, (3) it is estimated that central bank interest rates are expected to stay at their current levels also in the coming months.

The message that arises from the current BoI's announcement touches on the gradualness required, in the bank's opinion, in the process of hiking the interest rate in the economy. In addition, it is important to pay attention to the fact that in contrast to the previous interest rate announcement that gave consideration to the increase in asset prices, the current announcement does not mention this important issue at all.

Against this backdrop, we estimate that throughout the remainder of the year relatively expansionary monetary policy will be maintained and the expected hike in interest rates in the coming months will bring the expected real interest rate (the BoI interest rate minus expected inflation for the coming 12-month period) to 0% towards the end of the year. Such a rate is still significantly below what is considered a "neutral" real interest rate (2-3%) that is acceptable under the conditions of a normal economy.

Select Indices

	Rate	Return in % April	Return in % 2010
TA 100	1,088	-5.45	3.07
TA 25	1,157	-5.55	1.67
DOW JONES	11,009	1.03	5.57
NASDAQ	2,461	2.36	8.46
NIKKEI 225	11,057	0.65	4.85

May 2, 2010

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

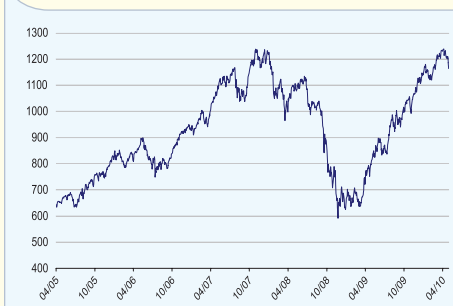
World Macro Economic Review

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

EUR and USD vs. NIS



TA25



Oil prices per barrel (USD)



Gold prices (USD)



During the past month, two central issues have been on the agenda. Firstly, the issue that continues to send shockwaves through the markets, the Greek credit squeeze. The second, which has also aroused a number of repercussions, was the fraud action filed against Goldman Sachs and one of its senior executives. It should be noted that the phenomenon in which capital markets' behavior is significantly affected by external factors, rather than company specific news or developments in the economic environment, has been an outstanding feature of the markets since the beginning of the credit crisis.

The capital markets in the Euro Zone have been fluctuating pursuant to developments relating to the Greek aid package. During the month, an aid package financed jointly by the Euro Zone countries and the IMF was consolidated. This package included extending a 45 billion € loan to Greece at a substantially lower cost than the cost at which Greece could raise debt on the free market. On its publication, this package received mixed responses. Greek citizens were angry about the harsh conditions demanded for the aid. Citizens of other Euro Zone countries, especially Germany, were angry by the demand to finance Greece's financial negligence, while investors were doubtful as to the ability to realize the program on time, in view of the fact that each individual Union country has to give its approval prior to transferring the money. Investor doubtfulness was expressed in the capital markets. The yields on Greek government bonds and the cost of insuring Greek government's debt rose, as expressed in the country's CDS margin. These trends intensified after Standard and Poor's announced it is cutting the Greek, Portuguese and Spanish governments' debt rating and as anxiety grew regarding to the financial stability of these countries. Greece has rapidly found itself in a situation in which it cannot meet the cost of debt raising in the free market and has requested to realize the rescue package. By the end of the month, the rapid deterioration resulted in a need for an alternative and more comprehensive rescue package. The target was to avoid an immediate Greek credit default, to provide the country with a longer time frame (four years) to organize its debt issue and placate investor apprehension of the possibility of a similar fate for other countries in the Zone.

Simultaneously, the Goldman Sachs saga continued to star in the news. During the last week of the month, a Senate Committee commenced investigating the bank. Naturally, GS executives categorically denied any illegal activity. Investors' fears relating to the financial sector are not limited to the possible outcome for Goldman Sachs, but to both the possibility of additional similar actions being filed against other companies and to future regulatory limitations that are likely to be imposed on all US banks.

In contrast to this negative news, US macro data published during the month was generally positive. March Job's Report indicated the creation of 160 thousand new jobs and data from the real estate sector, such as new and secondhand home sales, recorded higher increases than expected. The initial estimate for Q1 2010 GDP growth rate was of 3.2% (annually), benefiting from an impressive 3.6% growth (in annual terms) in private consumption which contributed 2.6% out of the total rise in GDP. It is interesting to note that Private Investments also had a major contribution to growth during the quarter, as well as Business Inventories increase in inventories. In contrast to regular times and, in view of the storm raging in Europe, the US Fed's stand still interest rate decision this month became an almost secondary event. However, the consistent improvement in the US economy over recent months brought us to expect the Fed to start signaling that the zero-rate environment might not be kept for so long.

As we have stated in the past, there are various risks facing the stability of the global economy and the threat derived from them is not trivial. Over the short term, questions relating to the Euro Zone countries' financial stability and regulatory risks are expected to have a negative effect on the global economy and, most certainly, on trading trends. Over the longer term, we expect the slow and gradual improvement process in both the US economy and the rest of the world to ensue.

Is Portugal Next in Line after Greece?

By: **Itamar Dar**, the Capital Market Research Department, the Investment Advice Section

The Portuguese are very proud of the discoverers of new countries who had origins in Portugal, and the affinity between Portugal and the New World countries existing up to the present day. How ironic, therefore, that the current Portuguese government's main goal is to conceal the economic affinity between Portugal and Greece as much as possible. Portugal's repudiation of Greece is not surprising in view of the determination made by a number of world-renowned economists that Portugal is the next country in line within the Euro Zone that could face difficulties in redeeming its debts.

Portugal has the smallest economy amongst the 4 PIGS countries. Its 2008 GDP was \$243 billion, compared with \$282 billion in Ireland, \$357 billion in Greece and \$1,604 billion in Spain. The following table details a number of macroeconomic data from the 4 PIGS countries. The following parameters have a critical effect on gauging the financial solidity of a country and its ability to settle its debts. (Some of the 2009 data and data from 2010-2011 are forecasts made by the European Union).

		Annual Avg. 1992-05	2009	2010	2011
GDP changes (%)	Ireland	6.9	7.5-	1.4-	2.6
	Greece	2.9	1.1-	0.3-	0.7
	Spain	3.0	3.7-	0.8-	1.0
	Portugal	2.2	2.9-	0.3	1.0
	The Euro Zone	-	4.0-	0.7	1.5
Budgetary Deficit (% of GDP)	Ireland	0.5	14.3-	14.7-	14.7-
	Greece	6.6-	13.6-	12.2-	12.8-
	Spain	2.7-	11.2-	10.1-	9.3-
	Portugal	4.0-	9.4-	8.0-	8.7-
	The Euro Zone	-	6.3-	6.9-	6.5-
Public Debt (% of GDP)	Ireland	56	64	83	96
	Greece	98	115	125	135
	Spain	56	53	66	74
	Portugal	56	77	85	91
	The Euro Zone	-	79	84	88

The table indicates that Portugal's 2009 budgetary deficit, as a proportion of the GDP, was 9.4% (the fourth largest deficit in the Euro Zone). The country's public debt reached 77% of the GDP in 2009 (the fifth largest debt in the Euro Zone). In the 2 aforementioned parameters Portugal's position is better than that of Greece. This is also true regarding the 2010-2011 forecasts. Another important point is the reliability of the data provided by the Portuguese government, in contrast to the Greek government. Another advantage that Portugal has over Greece derives from the local government's readiness to adopt substantial measures to reduce the deficit and the public's willingness to accept these measures. This is in contrast to the public upheaval spreading throughout Greece.

The Portuguese government has already decided on a program for reducing the budgetary deficit to 8.3% of the GDP in 2010 and 2.8% of the GDP in 2011. This program includes limiting salary increments in the public sector and canceling various tax exemptions. In contrast, however, the program also cancels growth encouraging projects such as developing the country's railway system, to the disappointment of investors.

The table also portrays that the average Portuguese annual growth rate during the period 1992-2005 was relatively low at 2.2% in comparison with 2.9%, 3.0% and 6.9% in Greece, Spain and Ireland respectively. Furthermore, Portugal's growth rate since the establishment of the Euro Zone in 1999 is 1.2%, lower than the average of 1.5% for all the Euro Zone countries. The Banco de Portugal has adjusted its previous growth forecast, from 0.7% to 0.4% in 2010 and from 1.4% to 0.8% in 2011. The central bank expects investment cuts of 6.3%.

The weekly magazine, Economist, maintains that the major problem facing the Portuguese economy is that of productivity. Salaries have been increasing permanently and systematically over recent years, while worker productivity has not risen and the labor market is considered one of the least flexible in Europe. Portuguese exporters are gradually losing target markets in Eastern Europe, where production costs are cheaper.

In contrast to all the aforementioned weak points, the Portuguese government is taking measures to elucidate the complimentary measures in the economy and has emphasized a number of positive elements such as a developed alternative energy sector, reducing the number of jobs in public service and investing 1.5% of the GDP in R&D. Nevertheless, the rating companies Fitch and S&P are not quick to be convinced as to the solidity of the Portuguese economy, hence lowering and from A+ to A-. While investors are also convinced that Portugal is not Greece, the economy's internal problems such as slow growth, a low competitive level and high deficits has made an investment in Portuguese government bonds relatively risky.

2-year Portuguese government bonds are currently being traded at 5.5%, compared with 0.6% in similar German government bonds. 10-year bonds issued by Portugal are being traded at 5.8%, compared with 2.8% in similar German bonds. The current risk premium is 490 and 300 basis points for 2 and 10 years respectively. On making a historical comparison this is a high premium. The question is whether the current premium reflects the risk level of investing in Portuguese government bonds properly. We believe that, despite the widening of the premium over the past months, there are still a number of risk factors that could over cloud the future of the Portuguese economy. These include the low growth rate, the failure in the attempt to reduce the deficit and, above all else, the possible bankruptcy of the Greek government, which despite the Portuguese government's "isolation" attempts, is likely to result in a snowball effect, which would damage the other PIGS countries. Under this state of affairs, given the material risk factors that could result in an additional yields hike and to transferring investor capital losses, the yields levels of 3.6% over the short term and 5.2% over the long terms are not sufficiently attractive.

Going Further – Bank Leumi (UK) plc*

Leumi Private Banking

Leumi Private Banking is proud to protect and enhance the wealth of its international clients and their families through a comprehensive range of private banking, investment and trust services.

We welcome new clients.

Banking Services

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.

Investment services

For sums of £250,000 and above (or equivalent in other currencies) we offer both Advisory and Execution Only Services. We can offer investment advice on fund choice and also asset allocation and portfolio valuations in all the major currencies. Invested cash can be held in the currency of your choice.

Wealth Planning Solutions and Fiduciary Services

We structure, establish and administer trusts, private investment companies registered in various locations, and foundations, through our subsidiary in Jersey.

Treasury and Dealing Services

Our Private Banking Relationship Managers, in conjunction with our Dealing Room, are able to offer a full dealing service and provide you with the latest market information. In addition they can offer a range of options, future and derivative strategies for sophisticated investors.

Foreign Exchange Services

We offer immediate competitive pricing in all major currencies, covering spot and forward periods and swaps trades. We offer access to a range of derivative instruments as investments, or for protection against interest, exchange, and equity risk. Our treasury team is positioned to facilitate timely execution.

Lending

We provide lending facilities against portfolios of securities, bank guarantees, UK properties, cash deposit, and on a back-to-back basis (a loan backed by a deposit held in the same or different jurisdiction).

Executive Mortgages

We offer a flexible five-year, interest only mortgage with a multi-currency option intended for UK and expatriate high net worth individuals for the purchase of their residential property in the UK.

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

Leumi Private Banking

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

Leumi Jersey

Bank Leumi (Jersey) Limited** provides a full range of private banking services for clients who are looking for an offshore location with security, confidentiality and in a stable, reputable environment. We have an experienced team who are able to provide a flexible and focused approach to meeting individual clients needs.

Additional services available from our offices in Jersey:

From Bank Leumi (Jersey) Limited Banking for Non-Domiciliaries

We routinely provide accounts where capital and income are segregated. This, combined with our attractive interest rate, should prove to be particularly beneficial to clients who are not UK domiciled but resident there. It may also be attractive in other circumstances.

Offshore Custody

We are able to provide offshore global custody arrangements for trusts, companies and individuals, whose planning include such requirements.

Offshore Executive Mortgages

This product is most applicable for UK residents who are not domiciled for tax purposes in the UK and who have foreign earnings. These clients may purchase residential or investment property in the UK using a Bank Leumi (Jersey) Limited flexible five year, interest only mortgage with a multi-currency option.

From Leumi Overseas Trust Corporation Limited***

Fiduciary Services

The formation and administration of Trusts, Foundations and Companies is at the core of our service. Whether the goal is to provide an orderly transfer of assets to future generations, to maximise returns by investing within a tax-efficient structure, or any other aspect of international planning, we can assist in the establishing and managing the most appropriate holding vehicle.

Family Office Services

The idea of having one overall focal point for many areas of planning and investment is appealing to many clients and we are able to provide this service from one office. As an enhancement, we are able to provide Private Trust Company services, where family members may be closely involved in the trustee decision making – giving an element of control if required.

Wealth Planning Solutions

Working in conjunction with tax advisors, we can provide a wide range of solutions for families or companies looking to efficiently manage and protect assets whilst planning for the future. Wherever there is a requirement for fiduciary services from an experienced team, in a reputable and stable jurisdiction, we will be able to assist.

**Bank Leumi (Jersey) Limited is regulated by the Jersey Financial Services Commission.

For more information phone: 01534 702 525

***Leumi Overseas Trust Corporation Limited is regulated by the Jersey Financial Services Commission.

For more information phone: 01534 702 500

info@leumijersey.com

www.bankleumi.co.uk

The data contained in and attached to this message has been prepared given the research, knowledge and investment views of Bank Leumi le-Israel BM or on advice from the research facilities and data sources of third parties. It is intended solely for information purposes and not as an invitation to participate in any particular trading strategy. It should not be used as the primary basis for trading decisions. No representation or warranty can be given with respect to the accuracy or completeness of the information herein.

This documentation does not constitute a recommendation or invitation to buy, or the solicitation of an offer to sell any product, security, note or instrument. There may be significant risks associated with any product, security, note or instrument described herein including, but not limited to interest rate risk, price risk, liquidity risk and credit risk. The value of investments can fall as well as rise and an investor may not get back the original amount invested. Any exposure to foreign currencies may also cause the value of an investment to fluctuate. Past performance is not necessarily indicative of future results.

We are not acting as your financial adviser or in a fiduciary capacity in respect of any transaction with you unless otherwise expressly agreed by us in writing. Before entering into any transaction you should take steps to ensure that you understand the transaction and have made an independent assessment of the appropriateness of the transaction in the light of your own objectives and circumstances, including the possible risks and benefits of entering into such transaction. You should also seek advice from your own advisers in making this assessment.

The information contained in or attached to this message is privileged and confidential. The information is intended only for the use of the individual or entity named above. If the reader of this message is not the intended recipient, you are hereby notified that any dissemination, distribution or copying of this communication is strictly prohibited. If you have received this communication in error, please notify us immediately by telephone or e-mail and delete this message.