

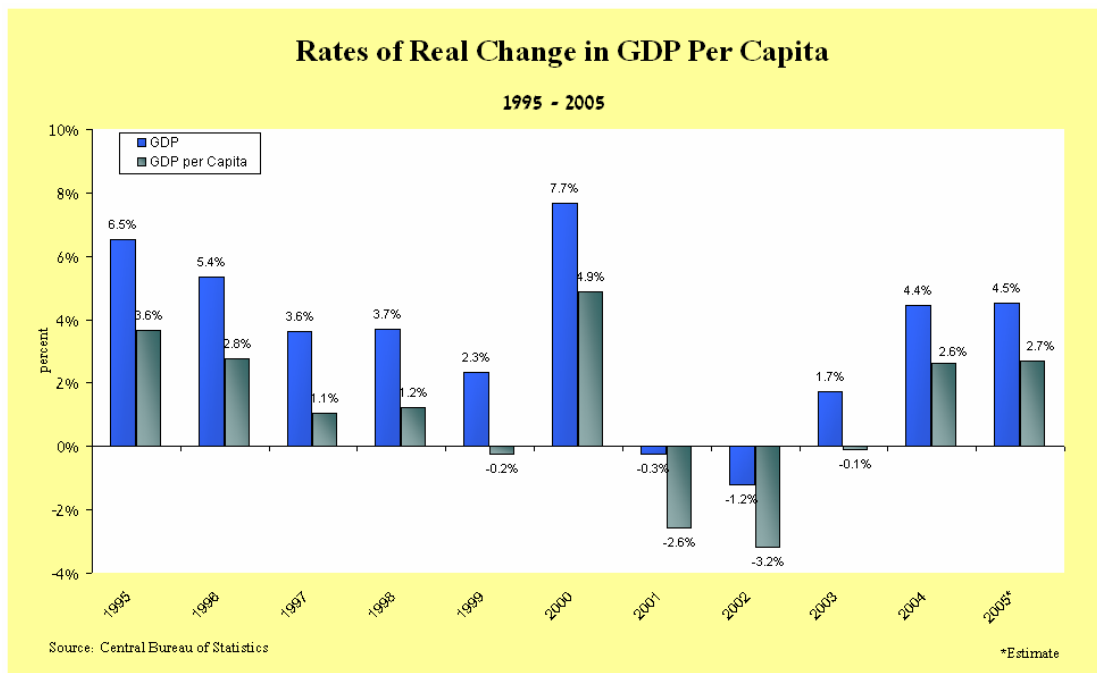
Main Economic Developments

Growth

The GDP grew by 4.9% in the first half of 2005, in annual terms, while the per-capita GDP rose by 3.1%. The rapid growth in the first half of 2005 is a continuation of the high growth rate of 5.4% in the previous half and 4.7% in the first half of 2004.

An examination of the economic developments in each quarter shows that the GDP increased by 5.6% in the second quarter of 2005, further to a 3.9% increase in the first quarter and a 6.4% increase in the last quarter of 2004. The composition of the increase in GDP in the second quarter of 2005 reflects an increase in all usages of resources – exports of commodities and services (13.2%), investments in fixed assets (7.8%), spending on private consumption (5.3%), and spending on public consumption, excluding defense imports (5%, after three consecutive quarters of declines).

The consistent budgetary policy applied over the last three years helped halt the recession and led to high growth rates in 2004 and in the first half of 2005, stabilizing economic activity and renewing the flow of capital into Israel. The tight fiscal policy increased the government's credibility; together with the continuation of granting the loan guarantees by the United States, led to a decrease in Israel's risk premium on the financial markets. Along with the government's responsible fiscal policy, the acceleration in global economic activity allowed per-capita growth to resume a positive trajectory for the second consecutive year, following three years of negative per-capita growth.

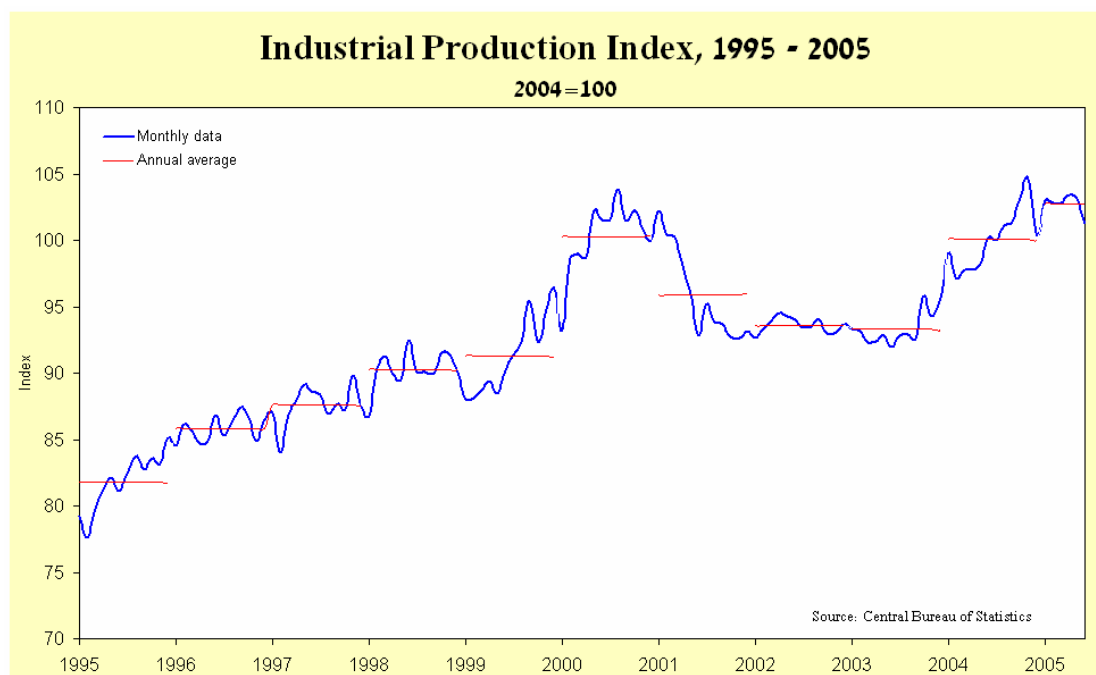


The gross domestic product of the business sector rose by 6.1% in the first half of 2005, in annual terms, further to a 7.6% increase in the previous half and a 6.6% increase in the first half of 2004. The development of the business product in the first half of 2005 reflects growth in the industrial sector and in most business services sectors.

Private consumption increased at an annualized rate of 4.1% in the first half of 2005, following a 4.2% increase in the previous half and a 3.7% increase in the first half of 2004. This increase was influenced by the considerable growth in the number of employed Israelis. Public consumption (excluding defense imports) decreased by 3.3%, in annual terms, in the first half of 2005, further to a 4.5% decrease in the previous half. Investments in fixed assets increased by 0.4% in the first half of 2005, further to an 0.9% increase in the previous half and a 2.7% increase in the corresponding half of 2004.

Industry

The industrial production index (excluding diamonds) rose at an annualized rate of 4.6% in the first half of 2005, and 8.4% in the second half of 2004.



Exports increased at an annualized rate of 8.6% in the first half of 2005, further to increases of 13.3% and 22.6% in the two preceding halves. The increase in exports in the first half of 2005 mainly reflects an increase in industrial exports, excluding diamonds – 10.2%, in agricultural exports – 27.2%, and in tourism exports – 21.8%, in annual terms.

Residential Construction

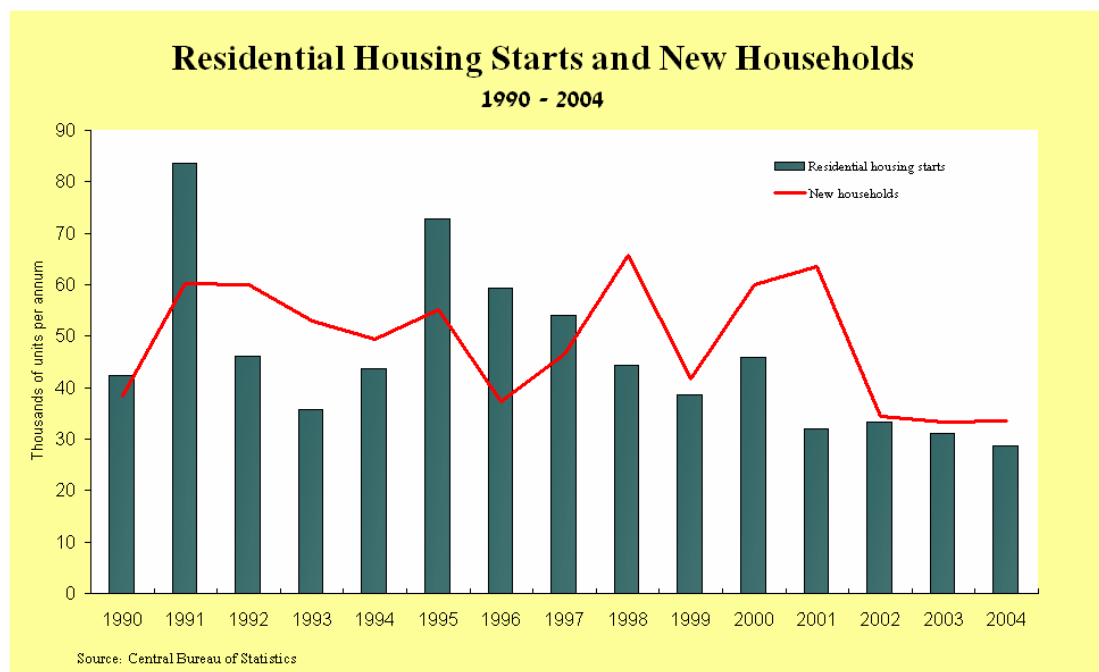
Since 1996, the construction industry in Israel has been adjusting its level of activity to the level of demand. This process began with the decline in the number of immigrants arriving in Israel, following the immigration wave of the early 1990s. Activity in the industry expanded in 1999-2000, but the security events of September 2000 caused a contraction that persisted continuously until the first half of 2005.

Despite improvements in 2004 and in the first half of 2005 in factors that affect demand for housing, such as the increase in average wages, the decrease in interest rates on mortgages, and stability in housing prices, demand for housing remained low. The growth process is expected to trickle down to wider population segments, leading to increased demand for housing, in the second half of 2005.

Housing Supply

Marketing of land – in the first seven months of 2005, the Israel Lands Administration and the Ministry of Construction and Housing marketed land for 7,656 residential units. This figure is approximately 30% lower than the volume in the same period last year.

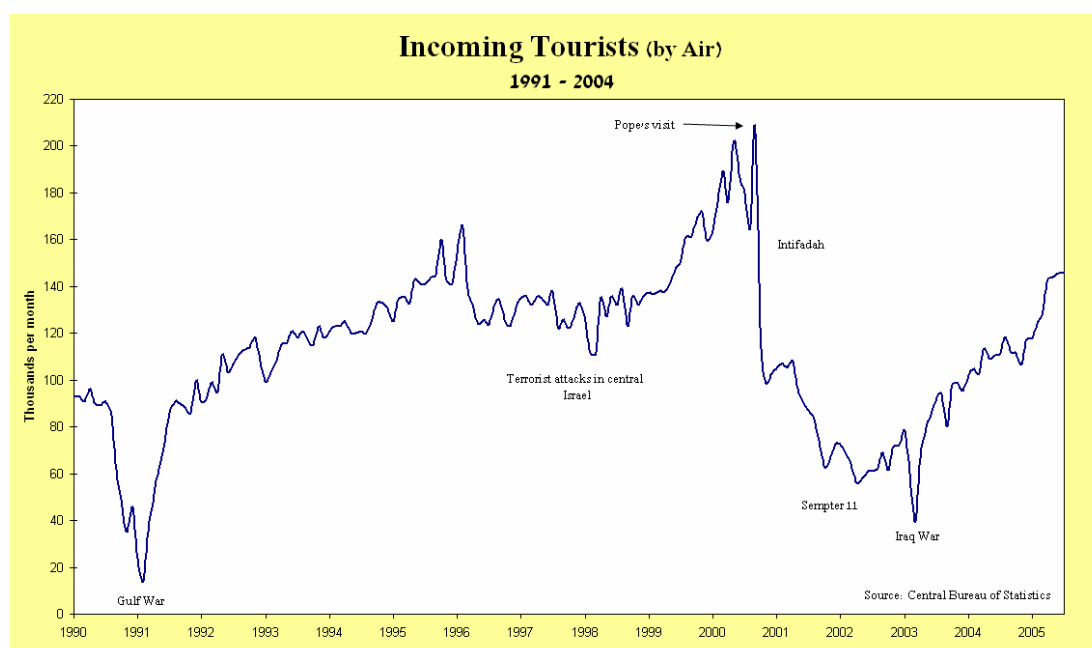
Housing starts – the number of housing starts totaled 28,747 residential units in 2004, an 8% decline as compared to 2003. Housing starts in 2005 are estimated at 27,000 residential units, a 6% decrease as compared to 2004.



Tourism

After three years of declines in the number of tourists entering Israel, with a low point of 860,000 arrivals in 2002, incoming tourism began recovering somewhat in 2003. The trend reversal continued in 2004, in which 1.4 million tourists entered Israel. The same trend continued in the first half of 2005 as well, with a 27% increase in tourist arrivals as compared to the corresponding period in 2004.

However, in domestic tourism, the peak level of 12 million overnight stays by Israelis attained in 2002 was maintained during 2003-2004. The same stability continued in the first half of 2005, with no apparent tendency towards change.



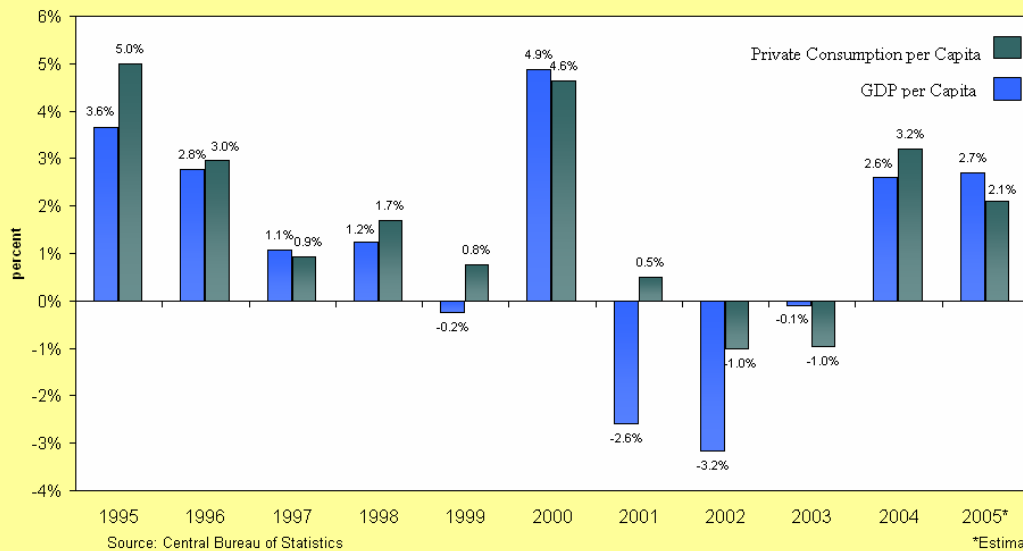
Private Consumption

Per-capita spending on private consumption rose by 2.3% in the first half of 2005, further to increases of 2.0% and 2.2% in the first and second halves of 2004, respectively.

The increase in per-capita consumption in the first half of 2005 reflects a 2.8% increase in per-capita spending by households on durable goods, along with a 2.3% increase in per-capita current consumption spending.

The increase in private consumption spending reflects the effect of the increase in individuals' disposable income as a result of tax reductions, the increase in real wages in the business sector, and a sizable increase of 90,000 in the number of employed Israelis.

Real Change in GDP per Capita and Private Consumption Per Capita 1995 - 2005



Investments

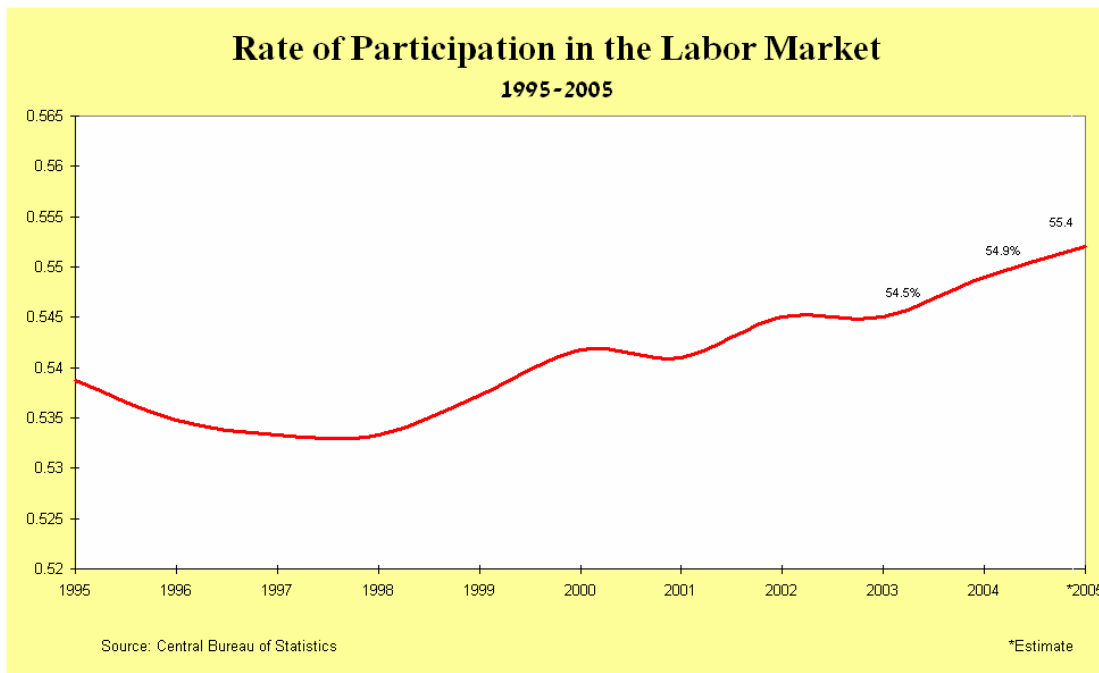
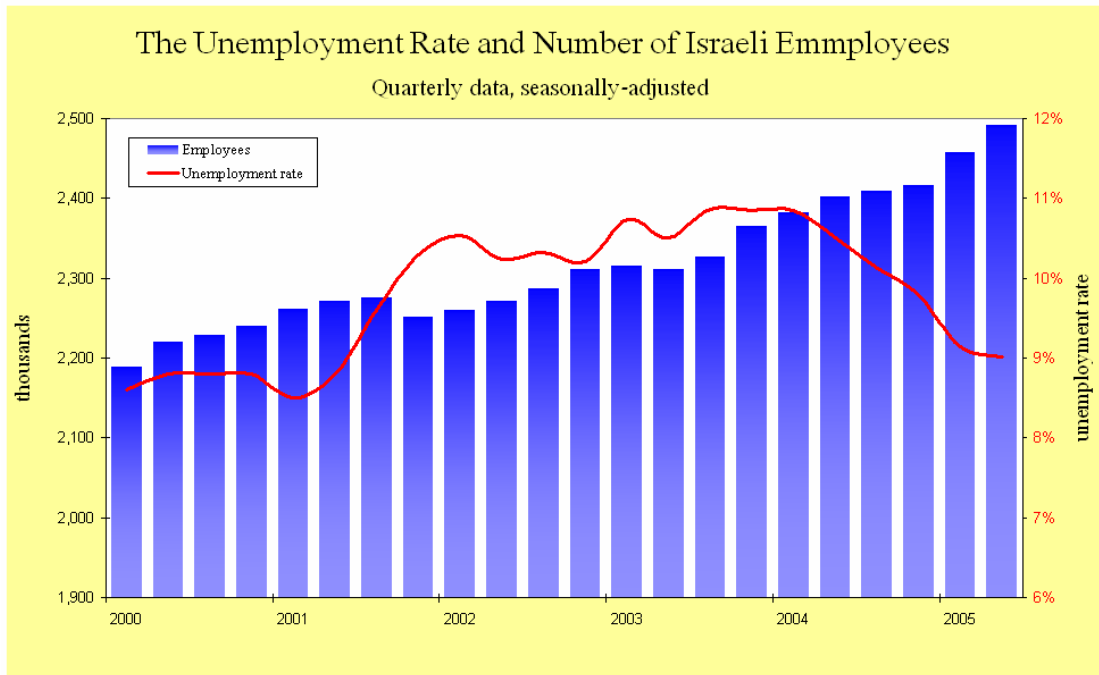
Investments in fixed assets increased by 0.4% in the first half of 2005, further to increases of 0.9% in the previous half and 2.7% in the first half of 2004. Investments in sectors of the economy increased by 1.9% in the first half of 2005, following a 4.2% increase in the previous half. Investments in residences decreased by 1.6% in the first half of the year, further to declines of 10.0% in the previous half and 4.3% in the corresponding period last year.

Employment

Employment figures for 2004 and 2005 indicate a continuation of the positive trend in the labor market, with Israelis returning to the workforce and the creation of new jobs. The number of employed Israelis rose by 3.7% in the second quarter of 2005 as compared to the corresponding quarter last year. Concurrently, the number of full-time employees increased while the number of part-time employees decreased.

The unemployment rate fell from 10.9% in the first quarter of 2004 to 9.1% in the second quarter of 2005, reflecting a decrease of 43,000 in the number of unemployed persons, despite the considerable increase in the workforce participation rate during the period.

The workforce participation rate increased to 55.3% during the first half of 2005, versus 54.1% in 2002.



Despite the increase in the workforce participation rate, it should be emphasized that the participation rate in Israel remains significantly low in comparison to rates in Western Europe and the United States, particularly among men. The low participation rate reflects low workforce participation in the Ultra-Orthodox population and in minority sectors, among other factors.

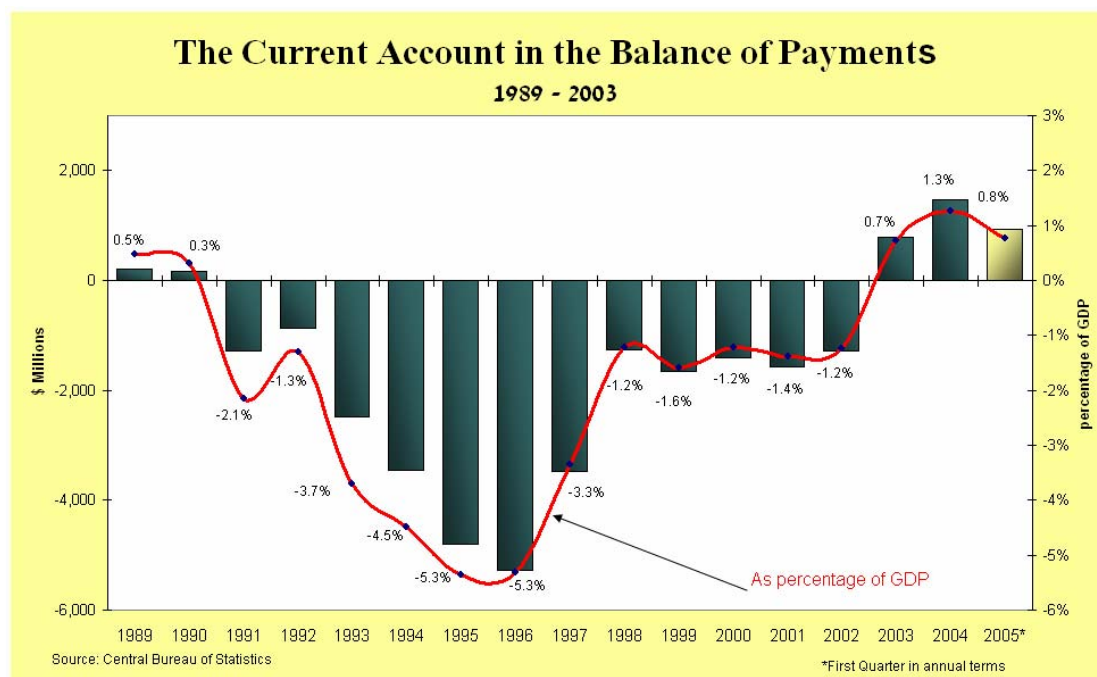
Wages

Following declines in the preceding two years, subsequent to the trend reversal in 2004, average wages for salaried employees continued to rise in the first half of 2005. The average wage for a salaried employee was 1.4% higher in the first half of 2005 as compared to the second half of 2004, with an annualized growth rate of 4.8% in current prices.

The increase in wages stemmed from several sectors, including the following: business services – 4.5%; industry, trade, hospitality, and food – 2.0%; banking, insurance, and finances – 1%; agriculture – 0.5%; construction – 2%, following a 1% decline in the second half of 2004.

Balance of Payments and Foreign Trade

The surplus in the balance of payments current account stood at approximately \$0.5 billion in the first half of 2005, following a surplus of \$1 billion in the previous half, and surpluses in each of the four quarters in 2004. The surplus indicates high external stability, both by international comparison and relative to the rate of the deficit in the mid-1990s, which reached 6% of the GDP.

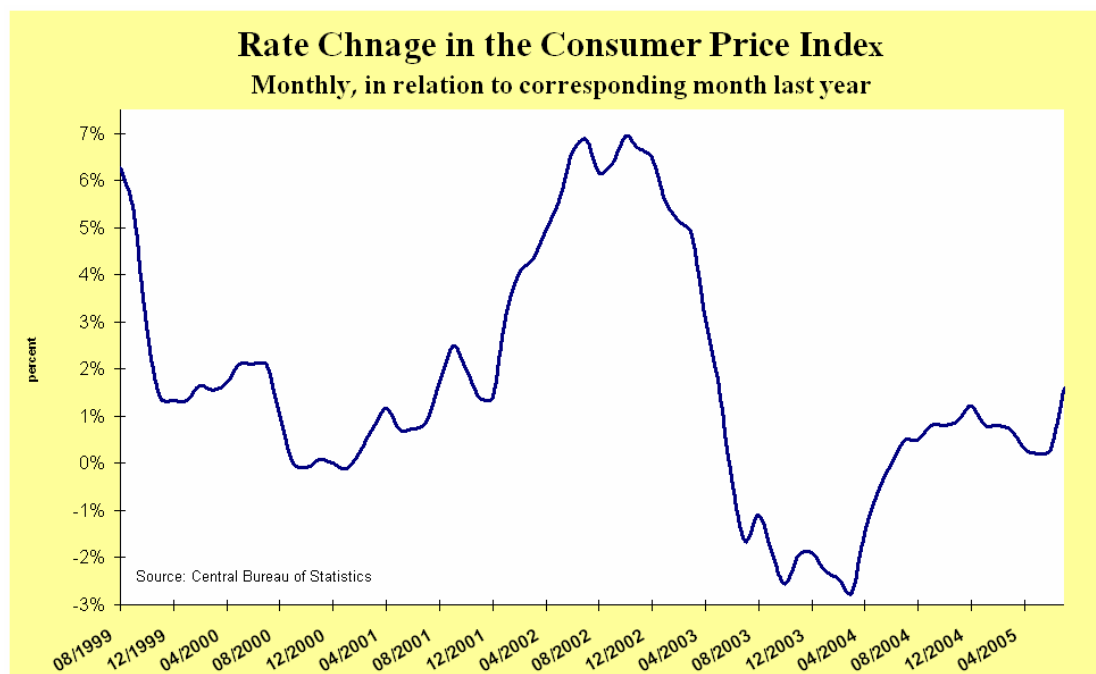


Inflation and Monetary Policy

Inflation was quite moderate in the first half of 2005. The Consumer Price Index rose at an annualized rate of just 0.8%, net of seasonal effects. The low inflation rate in the first half of 2005 resulted from the moderating effect of housing prices, as well as the depreciation of the shekel against the dollar, which began in June but was checked during July.

The appreciation of the dollar against the shekel starting in July, the continued increase in oil prices, and the economic growth led to a sharp 1.1% increase in the Consumer Price Index in July.

The CPI gained 1.6% during the first seven months of 2005. Excluding fruits and vegetables, the CPI increased by 2.3%; excluding housing, the CPI increased by 1.0%.



Exchange Rate

The shekel exchange rate against the dollar remained nearly flat during the first five months of 2005. Depreciation occurred in June, but was checked in July; subsequently, during July and August, the dollar appreciated sharply against the shekel. From the end of December 2003 to mid-September 2004, the dollar exchange rate rose by 4.7%, the currency basket rate rose by 1.3%, and the Euro exchange rate fell by 5.5%.

Budget Deficit

The government's overall deficit (excluding credit) totaled 5.6% in 2003, versus a target of 3.0%. In order to attain the deficit target in 2004, the government implemented a responsible fiscal policy, as expressed in the continued execution of the long-term plan, starting with the approval of the plan for recovery of the Israeli economy. Under the plan, the government decided on a series of measures aimed at reducing the State budget by a total of NIS 9 billion. During 2004, internal changes were made to the State budget in the amount of NIS 4.5 billion, primarily the transfer of NIS 1.6 billion to the defense budget and NIS 1.2 billion to local authorities.

In 2004, the government's overall deficit (excluding credit) totaled 3.9% of the GDP, while the deficit target was 4.0% of the GDP. In 2005, the overall deficit (excluding credit) is expected to reach up to 3.0% of the GDP, while the deficit target is 3.4% of the GDP. In 2006, the overall deficit target (excluding credit) is 3% of the GDP.